



# **FORM 10-Q**

**Duke Energy Ohio, Inc. - N/A**

**Filed: November 13, 2008 (period: September 30, 2008)**

Quarterly report which provides a continuing view of a company's financial position

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended September 30, 2008 Or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-1232

**DUKE ENERGY OHIO, INC.**  
(Exact Name of Registrant as Specified in its Charter)

Ohio  
(State or Other Jurisdiction of Incorporation)

31-0240030  
(IRS Employer Identification No.)

139 East Fourth Street  
Cincinnati, OH  
(Address of Principal Executive Offices)

45202  
(Zip code)

704-594-6200  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer   
Non-accelerated filer   
(Do not check if a smaller reporting company)

Accelerated filer   
Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).  
Yes  No

All of the registrant's common stock is indirectly owned by Duke Energy Corporation (File No. 1-32853) which is a reporting company under the Securities Exchange Act of 1934, as amended.

The registrant meets the conditions set forth in General Instructions H(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format specified in General Instructions H(2) of Form 10-Q.

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SEPTEMBER 30, 2008

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## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management's beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "plan," "project," "predict," "will," "potential," "forecast," "target," and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- State and federal legislative and regulatory initiatives, including costs of compliance with existing and future environmental requirements;
- State and federal legislative and regulatory initiatives and rulings that affect cost and investment recovery or have an impact on rate structures;
- Costs and effects of legal and administrative proceedings, settlements, investigations and claims;
- Industrial, commercial and residential growth in Duke Energy Ohio, Inc.'s (Duke Energy Ohio) service territories;
- Additional competition in electric markets and continued industry consolidation;
- The influence of weather and other natural phenomena on Duke Energy Ohio's operations, including the economic, operational and other effects of storms, hurricanes, tornados, droughts and other natural phenomena;
- The timing and extent of changes in commodity prices and interest rates;
- Unscheduled generation outages, unusual maintenance or repairs and electric transmission system constraints;
- The performance of electric generation facilities;
- The results of financing efforts, including Duke Energy Ohio's ability to obtain financing on favorable terms, which can be affected by various factors, including Duke Energy Ohio's credit ratings and general economic conditions;
- Declines in the market prices of equity securities and resultant cash funding requirements of Duke Energy Ohio for Cinergy Corp.'s defined benefit pension plans;
- The level of creditworthiness of counterparties to Duke Energy Ohio's transactions;
- Employee workforce factors, including the potential inability to attract and retain key personnel;
- Growth in opportunities for Duke Energy Ohio's business units, including the timing and success of efforts to develop power and other projects; and
- The effect of accounting pronouncements issued periodically by accounting standard-setting bodies.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Duke Energy Ohio has described. Duke Energy Ohio undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I. FINANCIAL INFORMATION

DUKE ENERGY OHIO, INC  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)  
(In millions)

**Item 1. Financial Statements.**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
<b>Operating Revenues</b>				
Non-regulated electric and other	\$ 446	\$ 613	\$ 1,292	\$ 1,381
Regulated electric	286	278	756	742
Regulated natural gas	86	64	556	511
<b>Total operating revenue</b>	<b>818</b>	<b>955</b>	<b>2,604</b>	<b>2,634</b>
<b>Operating Expenses</b>				
Fuel used in electric generation and purchased power—non-regulated	332	310	612	728
Fuel used in electric generation and purchased power—regulated	49	49	116	116
Cost of natural gas and coal sold	42	32	341	356
Operation, maintenance and other	205	186	571	553
Depreciation and amortization	106	107	305	295
Property and other taxes	62	60	197	195
Impairments and other charges	82	—	82	—
<b>Total operating expenses</b>	<b>878</b>	<b>744</b>	<b>2,224</b>	<b>2,243</b>
<b>(Losses) Gains on Sales of Other Assets and Other, net</b>	<b>—</b>	<b>(1)</b>	<b>46</b>	<b>(12)</b>
<b>Operating (Loss) Income</b>	<b>(60)</b>	<b>210</b>	<b>426</b>	<b>379</b>
<b>Other Income and Expenses, net</b>	<b>8</b>	<b>5</b>	<b>23</b>	<b>22</b>
<b>Interest Expense</b>	<b>23</b>	<b>28</b>	<b>72</b>	<b>73</b>
<b>(Loss) Income Before Income Taxes</b>	<b>(75)</b>	<b>187</b>	<b>377</b>	<b>328</b>
<b>Income Tax (Benefit) Expense</b>	<b>(21)</b>	<b>69</b>	<b>141</b>	<b>124</b>
<b>Net (Loss) Income</b>	<b>\$ (54)</b>	<b>\$ 118</b>	<b>\$ 236</b>	<b>\$ 204</b>

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED BALANCE SHEETS**  
(Unaudited)  
(In millions)

	September 30, 2008	December 31, 2007
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 341	\$ 33
Receivables (net of allowance for doubtful accounts of \$18 at September 30, 2008 and \$3 at December 31, 2007)	186	334
Inventory	270	212
Unrealized gains on mark-to-market and hedging transactions	104	22
Other	172	94
Total current assets	1,073	695
<b>Investments and Other Assets</b>		
Restricted funds held in trust	60	62
Goodwill	2,324	2,325
Intangibles, net	416	551
Unrealized gains on mark-to-market and hedging transactions	30	17
Other	33	33
Total investments and other assets	2,863	2,988
<b>Property, Plant and Equipment</b>		
Cost	9,954	9,577
Less accumulated depreciation and amortization	2,277	2,097
Net property, plant and equipment	7,677	7,480
<b>Regulatory Assets and Deferred Debits</b>		
Deferred debt expense	23	23
Regulatory assets related to income taxes	100	90
Other	318	401
Total regulatory assets and deferred debits	441	514
<b>Total Assets</b>	<b>\$ 12,054</b>	<b>\$ 11,677</b>

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED BALANCE SHEETS—(Continued)**  
(Unaudited)  
(In millions, except share and per-share amounts)

	September 30, 2008	December 31, 2007
<b>LIABILITIES AND COMMON STOCKHOLDER'S EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 400	\$ 602
Notes payable and commercial paper	492	189
Taxes accrued	231	172
Interest accrued	23	24
Current maturities of long-term debt	27	126
Unrealized losses on mark-to-market and hedging transactions	76	24
Other	70	86
Total current liabilities	1,319	1,223
<b>Long-term Debt</b>		
	1,856	1,810
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes	1,482	1,436
Investment tax credit	14	16
Accrued pension and other post-retirement benefit costs	242	259
Unrealized losses on mark-to-market and hedging transactions	28	25
Asset retirement obligations	33	31
Other	296	343
Total deferred credits and other liabilities	2,095	2,110
<b>Commitments and Contingencies</b>		
<b>Common Stockholder's Equity</b>		
Common Stock, \$8.50 par value, 120,000,000 shares authorized; 89,663,086 shares outstanding at September 30, 2008 and December 31, 2007	762	762
Additional paid-in capital	5,570	5,570
Retained earnings	463	227
Accumulated other comprehensive loss	(11)	(25)
Total common stockholder's equity	6,784	6,534
<b>Total Liabilities and Common Stockholder's Equity</b>	<b>\$ 12,054</b>	<b>\$ 11,677</b>

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
**(In millions)**

Nine Months Ended  
September 30,

	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 236	\$ 204
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	308	295
(Gains) losses on sales of other assets and other, net	(46)	12
Impairment charges	82	—
Deferred income taxes	(37)	45
Accrued pension and other post-retirement benefit costs	16	28
Contribution to company-sponsored pension and other post-retirement benefit plans	—	(92)
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	(19)	31
Receivables	168	71
Inventory	(58)	(14)
Other current assets	(36)	(1)
Increase (decrease) in:		
Accounts payable	(209)	(56)
Taxes accrued	70	(153)
Other current liabilities	(10)	(6)
Regulatory asset/liability deferrals	(24)	(20)
Other assets	21	141
Other liabilities	(73)	(46)
Net cash provided by operating activities	389	439
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Capital expenditures	(381)	(461)
Purchases of emission allowances	(15)	(14)
Sales of emission allowances	60	25
Change in restricted funds held in trust	2	21
Other	3	(1)
Net cash used in investing activities	(331)	(430)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Issuance of long-term debt	73	6
Redemption of long-term debt	(139)	(5)
Notes payable and commercial paper	276	—
Notes payable to affiliate, net	40	74
Dividends to parent	—	(135)
Capital contribution from parent	—	29
Net cash provided by (used in) financing activities	250	(31)
Net increase (decrease) in cash and cash equivalents	308	(22)
<b>Cash and cash equivalents at beginning of period</b>	<b>33</b>	<b>45</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 341</b>	<b>\$ 23</b>
<b>Supplemental Disclosures</b>		
<b>Significant non-cash transactions:</b>		
Purchase accounting adjustments	\$ —	\$ (8)
Accrued capital expenditures	\$ 60	\$ 13

See Notes to Unaudited Consolidated Financial Statements



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DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME**  
(Unaudited)  
(In millions)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)		Total
				Net Gains (Losses) on Cash Flow Hedges	Pension and OPEB Related Adjustments to AOCI	
<b>Balance at December 31, 2006</b>	\$ 762	\$ 5,601	\$ 55	\$ (36)	\$ (2)	\$ 6,380
Net income	—	—	204	—	—	204
Other comprehensive income						
Cash flow hedges <sup>(a)</sup>	—	—	—	1	—	1
Pension and OPEB-related Adjustments to AOCI	—	—	—	—	1	1
<b>Total comprehensive income</b>						206
Capital contribution from parent	—	29	—	—	—	29
Push-down accounting adjustments	—	(8)	—	—	—	(8)
Adoption of SFAS No. 158—measurement <sup>(b)</sup> date provision	—	—	(3)	—	(2)	(5)
Dividend to parent	—	(46)	(89)	—	—	(135)
<b>Balance at September 30, 2007</b>	\$ 762	\$ 5,576	\$ 167	\$ (35)	\$ (3)	\$ 6,467
<b>Balance at December 31, 2007</b>	\$ 762	\$ 5,570	\$ 227	\$ (32)	\$ 7	\$ 6,534
Net income	—	—	236	—	—	236
Other comprehensive income						
Cash flow hedges <sup>(c)</sup>	—	—	—	12	—	12
Pension and OPEB-related Adjustments to AOCI <sup>(d)</sup>	—	—	—	—	2	2
<b>Total comprehensive income</b>						250
<b>Balance at September 30, 2008</b>	\$ 762	\$ 5,570	\$ 463	\$ (20)	\$ 9	\$ 6,784

(a) Net of \$1 tax expense in 2007

(b) Net of \$2 tax benefit in 2007.

(c) Net of \$7 tax expense in 2008.

(d) Net of insignificant tax expense in 2008.

See Notes to Unaudited Consolidated Financial Statements

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### PART I

## DUKE ENERGY OHIO, INC. Notes To Unaudited Consolidated Financial Statements

### 1. Basis of Presentation

**Nature of Operations and Basis of Consolidation.** Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through its wholly-owned subsidiary, Duke Energy Kentucky, Inc. (Duke Energy Kentucky), in nearby areas of Kentucky, as well as unregulated electric generation in parts of Ohio, Illinois, Indiana and Pennsylvania. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Except where separately noted, references to Duke Energy Ohio herein relate to the consolidated operations of Duke Energy Ohio, including Duke Energy Kentucky. These Unaudited Consolidated Financial Statements include, after eliminating intercompany transactions and balances, the accounts of Duke Energy Ohio and all majority-owned subsidiaries where Duke Energy Ohio has control, as well as Duke Energy Ohio's proportionate share of certain generation and transmission facilities in Ohio, Kentucky and Indiana.

These Unaudited Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles (GAAP) in the United States of America (U.S.) for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, these Unaudited Consolidated Financial Statements do not include all of the information and notes required by GAAP in the U.S. for annual financial statements. Because the interim Unaudited Consolidated Financial Statements and Notes do not include all of the information and notes required by GAAP in the U.S. for annual financial statements, the Unaudited Consolidated Financial Statements and other information included in this quarterly report should be read in conjunction with the Unaudited Consolidated Financial Statements and Notes in Duke Energy Ohio's Form 10-K for the year ended December 31, 2007.

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

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

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

**Netting of Cash Collateral and Derivative Assets and Liabilities Under Master Netting Arrangements.** On January 1, 2008, Duke Energy Ohio adopted FSP No. FIN 39-1. In accordance with FSP No. FIN 39-1, Duke Energy Ohio offsets fair value amounts (or amounts that approximate fair value) recognized on its Consolidated Balance Sheets related to cash collateral amounts receivable or payable against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting agreement. Prior to the adoption of FSP No. FIN 39-1, Duke Energy Ohio offset the fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting agreement in accordance with FIN 39, "Offsetting of Amounts Related to Certain Contracts," but presented cash collateral on a gross basis within the Consolidated Balance Sheets. At September 30, 2008 and December 31, 2007, Duke Energy Ohio had receivables related to the right to reclaim cash collateral of approximately \$9 million and \$5 million, respectively, and had payables related to obligations to return cash collateral of an insignificant amount at each balance sheet date that have been offset against net derivative positions in the Consolidated Balance Sheets. Duke Energy Ohio had cash collateral receivables of approximately \$64 million and \$15 million under master netting arrangements that have not been offset against net derivative positions at September 30, 2008 and December 31, 2007 respectively, as these amounts primarily represent initial margin deposits related to NYMEX futures contracts. Duke Energy Ohio had insignificant cash collateral payables under master netting arrangements that have not been offset against net derivative positions at September 30, 2008 and December 31, 2007.

**Unbilled Revenue.** Revenues on sales of electricity and gas are recognized when either the service is provided or the product is delivered. Unbilled revenues are estimated by applying an average revenue per kilowatt-hour or per thousand cubic feet (Mcf) for all customer classes to the number of estimated kilowatt-hours or Mcf's delivered but not billed. The amount of unbilled revenues can vary sig-

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PART I

DUKE ENERGY OHIO, INC

### Notes To Unaudited Consolidated Financial Statements—(Continued)

nificantly period to period as a result of factors including seasonality, weather, customer usage patterns and customer mix. Unbilled revenues, which are included in Receivables on the Consolidated Balance Sheets, primarily relate to wholesale sales at Commercial Power and were approximately \$36 million and \$38 million at September 30, 2008 and December 31, 2007, respectively. Additionally, receivables for unbilled revenues of approximately \$105 million and \$145 million at September 30, 2008 and December 31, 2007, respectively, related to retail accounts receivable at Duke Energy Ohio and Duke Energy Kentucky are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables). Duke Energy Ohio and Duke Energy Kentucky sell, on a revolving basis, nearly all of their retail accounts receivable and related collections to Cinergy Receivables, a bankruptcy remote, special purpose entity that is a wholly-owned limited liability company of Cinergy. The securitization transaction was structured to meet the criteria for sale treatment under Statement of Financial Accounting Standards (SFAS) No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125," and, accordingly, Cinergy does not consolidate Cinergy Receivables and the transfers of receivables are accounted for as sales.

**Other Regulatory Assets and Deferred Debits.** The state of Ohio passed comprehensive electric deregulation legislation in 1999, and in 2000, the Public Utilities Commission of Ohio (PUCO) approved a stipulation agreement relating to Duke Energy Ohio's transition plan creating a Regulatory Transition Charge (RTC) designed to recover Duke Energy Ohio's generation-related regulatory assets and transition costs over a ten-year period beginning January 1, 2001 and ending December 2010. Accordingly, application of SFAS No. 71, "Accounting for Certain Types of Regulation" (SFAS No. 71), was discontinued for the generation portion of Duke Energy Ohio's business. Duke Energy Ohio has a RTC related regulatory asset balance of approximately \$162 million and \$239 million as of September 30, 2008 and December 31, 2007, respectively, which is classified in Other within Regulatory Assets and Deferred Debits on the Consolidated Balance Sheets.

## 2. Business Segments

Duke Energy Ohio operates the following business segments, which are considered reportable business segments under SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information": Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these business segments in deciding how to allocate resources and evaluate performance. There is no aggregation within Duke Energy Ohio's reportable business segments.

Franchised Electric and Gas, which conducts operations primarily through Duke Energy Ohio and its wholly-owned subsidiary Duke Energy Kentucky, generates, transmits, distributes and sells electricity in southwestern Ohio and northern Kentucky, as well as transports and sells natural gas in southwestern Ohio and northern Kentucky.

Commercial Power owns, operates and manages non-regulated power plants and engages in the wholesale marketing and procurement of electric power, fuel and emission allowances related to these plants as well as other contractual positions. Commercial Power's generation asset fleet consists of Duke Energy Ohio's non-regulated generation in Ohio and five Midwestern gas-fired non-regulated generation assets that were transferred from Duke Energy in connection with Duke Energy's merger with Cinergy in April 2006. Commercial Power's assets comprise approximately 7,600 megawatts of power generation primarily located in the Midwestern U.S. The asset portfolio has a diversified fuel mix with baseload and mid-merit coal-fired units as well as combined cycle and peaking natural gas-fired units. Most of the generation asset output in Ohio has been contracted through the rate stabilization plan (RSP) (see Note 11).

The remainder of Duke Energy Ohio's operations is presented as Other. While it is not considered a business segment, Other primarily includes certain allocated governance costs (see Note 9).

Duke Energy Ohio's reportable segments offer different products and services and are managed separately as business units. Accounting policies for Duke Energy Ohio's segments are the same as those described in the Notes to the Consolidated Financial Statements in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2007. Management evaluates segment performance based on earnings before interest and taxes from continuing operations (EBIT). On a segment basis, EBIT excludes discontinued operations and represents all profits from continuing operations (both operating and non-operating and excluding corporate governance costs) before deducting interest and taxes.

Cash, cash equivalents, and short-term investments, if any, are managed centrally by Duke Energy, so the interest and dividend income on those balances are excluded from segment EBIT. Transactions between reportable segments, if any, are included in segment EBIT.

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PART I

DUKE ENERGY OHIO, INC.  
Notes To Unaudited Consolidated Financial Statements—(Continued)

**Business Segment Data**

	Unaffiliated Revenues <sup>(a)</sup>	Segment EBIT/ Consolidated (Loss) Income Before Taxes	Depreciation and Amortization
(in millions)			
<b>Three Months Ended September 30, 2008</b>			
Franchised Electric and Gas	\$ 372	\$ 59	\$ 65
Commercial Power	446	(105)	41
Total reportable segments	818	(46)	106
Other	—	(11)	—
Interest expense	—	(23)	—
Interest income and other	—	5	—
Total consolidated	\$ 818	\$ (75)	\$ 106
<b>Three Months Ended September 30, 2007</b>			
Franchised Electric and Gas	\$ 344	\$ 54	\$ 65
Commercial Power	611	175	42
Total reportable segment	955	229	107
Other	—	(19)	—
Interest expense	—	(28)	—
Interest income and other	—	5	—
Total consolidated	\$ 955	\$ 187	\$ 107
<b>Nine Months Ended September 30, 2008</b>			
Franchised Electric and Gas	\$ 1,312	\$ 197	\$ 181
Commercial Power	1,292	282	124
Total reportable segment	2,604	479	305
Other	—	(48)	—
Interest expense	—	(72)	—
Interest income and other	—	18	—
Total consolidated	\$ 2,604	\$ 377	\$ 305
<b>Nine Months Ended September 30, 2007</b>			
Franchised Electric and Gas	\$ 1,255	\$ 183	\$ 172
Commercial Power	1,379	255	123
Total reportable segment	2,634	438	295
Other	—	(58)	—
Interest expense	—	(73)	—
Interest income and other	—	21	—
Total consolidated	\$ 2,634	\$ 328	\$ 295

(a) There were no intersegment revenues for the three and nine months ended September 30, 2008 and 2007

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PART I

DUKE ENERGY OHIO, INC.  
**Notes To Unaudited Consolidated Financial Statements—(Continued)**

**Segment Assets**

	September 30, 2008	December 31, 2007
(in millions)		
Franchised Electric and Gas	\$ 5,689	\$ 5,530
Commercial Power	6,352	6,147
<b>Total reportable segments</b>	<b>12,041</b>	<b>11,677</b>
Other	13	—
<b>Total consolidated assets</b>	<b>\$ 12,054</b>	<b>\$ 11,677</b>

**3. Sales of Other Assets**

For the three months ended September 30, 2008, the sale of other assets resulted in approximately \$4 million in proceeds and net pre-tax gains of an insignificant amount. For the nine months ended September 30, 2008, the sale of other assets resulted in approximately \$64 million in proceeds and net pre-tax gains of approximately \$46 million recorded in (Losses) Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These gains primarily relate to Commercial Power's sales of zero cost basis emission allowances.

For the three months ended September 30, 2007, the sale of other assets resulted in approximately \$1 million in proceeds and net pre-tax losses of approximately \$1 million recorded in (Losses) Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. For the nine months ended September 30, 2007, the sale of other assets resulted in approximately \$25 million in proceeds and net pre-tax losses of approximately \$12 million recorded in (Losses) Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These amounts primarily relate to Commercial Power's sales of emission allowances acquired in connection with Duke Energy's merger with Cinergy in April 2006, which were written up to fair value as part of purchase accounting.

**4. Inventory**

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

	September 30, 2008	December 31, 2007
(in millions)		
Coal held for electric generation	\$ 85	\$ 77
Materials and supplies	84	66
Natural gas	101	69
<b>Total inventory</b>	<b>\$ 270</b>	<b>\$ 212</b>

**5. Debt and Credit Facilities**

**Available Credit Facilities and Capacity Utilized Under Available Credit Facilities.** In March 2008, Duke Energy entered into an amendment to its \$2.65 billion master credit facility whereby the borrowing capacity was increased by \$550 million to \$3.2 billion. Duke Energy has the unilateral ability under the master credit facility to increase or decrease the borrowing sub limits of each borrower, subject to maximum cap limitation, at any time. At September 30, 2008, Duke Energy Ohio and Duke Energy Kentucky had borrowing sub limits under Duke Energy's master credit facility of \$700 million and \$100 million, respectively. In October 2008, Duke Energy reallocated the borrowing sub limits under the master credit facility, which resulted in the reduction of Duke Energy Ohio's borrowing sub limit by \$50 million to \$650 million. Additionally, in October 2008, Duke Energy terminated the participation of one of the financial institutions supplying approximately \$63 million of credit commitment under its master credit facility, which reduced the total credit facility capacity under Duke Energy's master credit facility to approximately \$3.14 billion. This termination reduced Duke Energy Ohio's and Duke Energy Kentucky's borrowing sub limits by approximately \$13 million and \$2 million, respectively. The amount available to Duke Energy Ohio and Duke Energy Kentucky under their sub limits to Duke Energy's master credit facility has been reduced by drawdowns of cash, borrowings through the money pool arrangement, and the use of the master credit facility to backstop issuances of letters of credit and pollution control bonds, as discussed below.

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PART I

DUKE ENERGY OHIO, INC.

### Notes To Unaudited Consolidated Financial Statements—(Continued)

In September 2008, Duke Energy and its wholly-owned subsidiaries, including Duke Energy Ohio and Duke Energy Kentucky, borrowed a total of approximately \$1 billion under Duke Energy's master credit facility. Of the approximate \$1 billion, Duke Energy Ohio's and Duke Energy Kentucky's portions are approximately \$276 million and \$73 million, respectively. The loan, which is a revolving credit loan, bears interest at the bank prime rate and is due in September 2009; however, Duke Energy Ohio and Duke Energy Kentucky have the ability under the master credit facility to renew the loan up through the date the master credit facility matures, which is in June 2012. As Duke Energy Kentucky has the intent and ability to refinance this obligation on a long-term basis, either through renewal of the terms of the loan through the master credit facility, which has non-cancelable terms in excess of one-year, or through issuance of long-term debt to replace the amounts drawn under the master credit facility, Duke Energy Kentucky's borrowing is reflected as Long-Term Debt on the Consolidated Balance Sheets at September 30, 2008. Since Duke Energy Ohio does not have the intent to refinance these obligations on a long-term basis, Duke Energy Ohio's borrowing is reflected in Current Liabilities within Notes Payable and Commercial Paper on the Consolidated Balance Sheets at September 30, 2008. These borrowings reduce Duke Energy Ohio's and Duke Energy Kentucky's available credit capacity under Duke Energy's Master Credit Facility, as discussed above.

Duke Energy Ohio and its wholly-owned subsidiary, Duke Energy Kentucky, receive support for their short-term borrowing needs through their participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. The money pool is structured such that Duke Energy Ohio and Duke Energy Kentucky separately manage their cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables of Duke Energy Ohio and Duke Energy Kentucky, as each of these entities independently participate in the money pool. As of September 30, 2008, Duke Energy Kentucky had net receivables of approximately \$1 million, which are classified within Receivables in the accompanying Consolidated Balance Sheets, and Duke Energy Ohio had net borrowings of approximately \$229 million, of which approximately \$216 million is classified within Notes Payable and Commercial Paper, and approximately \$13 million is classified as Long-Term Debt in the accompanying Consolidated Balance Sheets, as discussed below. As of December 31, 2007, Duke Energy Ohio and Duke Energy Kentucky had combined net borrowings of approximately \$189 million, which are classified within Notes Payable and Commercial Paper in the accompanying Consolidated Balance Sheets. The \$40 million and \$74 million increases in the money pool borrowings during the nine months ended September 30, 2008 and 2007, respectively, are reflected in Notes Payable to Affiliate, net within Net cash provided by (used in) financing activities on the Consolidated Statements of Cash Flows. The \$1 million increase in the money pool receivables during the nine months ended September 30, 2008 is reflected in Other within Net cash used in investing activities on the Consolidated Statements of Cash Flows.

At September 30, 2008 and December 31, 2007, approximately \$84 million and \$96 million, respectively, of certain pollution control bonds, which are short-term obligations by nature, are classified as Long-Term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio's intent and ability to utilize such borrowings as long-term financing. Duke Energy's credit facilities with non-cancelable terms in excess of one year as of the balance sheet date give Duke Energy Ohio the ability to refinance these short-term obligations on a long-term basis. Additionally, at September 30, 2008, approximately \$13 million of borrowings via the money pool are classified as Long-Term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio's intent and ability to utilize such borrowings as long-term financing. Of the \$84 million of pollution control bonds outstanding at September 30, 2008, approximately \$72 million were backstopped by Duke Energy's master credit facility, with the remaining balance backstopped by other specific credit facilities separate from the master credit facility.

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

**Restrictive Debt Covenants.** Duke Energy's credit agreement contains various financial and other covenants, including, but not limited to, a covenant regarding the debt-to-total capitalization ratio at Duke Energy, Duke Energy Ohio and Duke Energy Kentucky to not exceed 65%. Duke Energy Ohio's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of September 30, 2008, Duke Energy, Duke Energy Ohio and Duke Energy Kentucky were in compliance with all covenants that would impact Duke Energy Ohio's or Duke Energy Kentucky's ability to borrow funds under the debt and credit facilities. In addition, some credit agreements may allow for

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DUKE ENERGY OHIO, INC.  
**Notes To Unaudited Consolidated Financial Statements—(Continued)**

acceleration of payments or termination of the agreements due to nonpayment, or the acceleration of other significant indebtedness of the borrower or some of its subsidiaries. None of the debt or credit agreements contain material adverse change clauses.

**6. Employee Benefit Obligations**

Duke Energy Ohio participates in pension and other post-retirement benefit plans sponsored by Cinergy. Duke Energy Ohio's net periodic benefit costs, as allocated by Cinergy, were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Qualified Pension Benefits <sup>(a)</sup>	\$ 3	\$ 5	\$ 9	\$ 12
Other Post-retirement Benefits <sup>(b)</sup>	\$ (2)	\$ 4	\$ 3	\$ 9

(a) These amounts exclude approximately \$1 million and \$(2) million for the three months ended September 30, 2008 and 2007, respectively, and approximately \$3 million and \$5 million for the nine months ended September 30, 2008 and 2007, respectively, of regulatory asset amortization resulting from purchase accounting.

(b) These amounts exclude insignificant amounts for the three months ended September 30, 2008 and 2007, respectively, and approximately \$1 million and \$2 million for the nine months ended September 30, 2008 and 2007, respectively, of regulatory asset amortization resulting from purchase accounting.

During the third quarter of 2008, Duke Energy Ohio recorded pre-tax income of approximately \$23 million related to the correction of errors related to the accounting for Duke Energy Ohio's other post-retirement benefit plans. Of this amount, approximately \$20 million relates to errors in actuarial valuations prior to 2008 that would have reduced amounts recorded as other post-retirement benefit expense recorded during those historical periods and approximately \$3 million relates to an error reflected in other post-retirement benefit expense for the first six months of 2008.

Duke Energy's policy is to fund amounts for its U.S. qualified pension plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. Duke Energy did not require Duke Energy Ohio to make contributions to the legacy Cinergy qualified or non-qualified pension plans during the three and nine months ended September 30, 2008 and Duke Energy does not anticipate requiring Duke Energy Ohio to make contributions to the legacy Cinergy qualified or non-qualified pension plans during the remainder of 2008. During the nine months ended September 30, 2007, approximately \$350 million of qualified pension plan contributions were made to the legacy Cinergy qualified pension plans, of which approximately \$83 million represents contributions made by Duke Energy Ohio. During the three and nine months ended September 30, 2007, approximately \$32 million of other post-retirement plan contributions were made to the legacy Cinergy other post-retirement plans, of which approximately \$9 million represents contributions made by Duke Energy Ohio. Additionally, Duke Energy Ohio participates in Cinergy sponsored employee savings plans that cover substantially all Duke Energy Ohio employees. Duke Energy Ohio made its proportionate share of pre-tax employer matching contributions of approximately \$2 million and \$5 million during the three and nine months ended September 30, 2008, respectively. Duke Energy Ohio made its proportionate share of pre-tax employer matching contributions of approximately \$1 million and \$3 million during the three and nine months ended September 30, 2007, respectively.

**7. Goodwill and Intangibles****Carrying Amount of Goodwill**

Duke Energy Ohio evaluates the carrying amount of its recorded goodwill for impairment under the guidance of SFAS No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). At a minimum, SFAS No. 142 requires a goodwill impairment test to be performed annually as of the same date each year. Duke Energy Ohio performs its annual impairment testing of goodwill as of August 31 of each year, or more frequently if events or circumstances occur that would indicate the probability of impairment. As the fair value of each of Duke Energy Ohio's reporting units exceeded their respective carrying values at August 31, 2008, Duke Energy Ohio did not record any impairment charges in the third quarter of 2008 as a result of its annual impairment test. However, in light of recent market and economic events, management is reassessing the potential for any impairments to recorded goodwill balances. These assessments are in their early stages and management cannot yet predict the outcome, but it is possible that the current assessments could result in goodwill impairments being recorded at one or more reporting units.

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DUKE ENERGY OHIO, INC.  
**Notes To Unaudited Consolidated Financial Statements—(Continued)**

The following table shows the components of goodwill by reportable business segment at September 30, 2008 and December 31, 2007:

	Balance December 31, 2007	Changes	Balance September 30, 2008
	(in millions)		
Commercial Power	\$ 1,188	\$ (1)	\$ 1,187
Franchised Electric and Gas	1,137	—	1,137
<b>Total Goodwill</b>	<b>\$ 2,325</b>	<b>\$ (1)</b>	<b>\$ 2,324</b>

**Intangible Assets**

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

	September 30, 2008	December 31, 2007
	(in millions)	
Emission allowances	\$ 246	\$ 365
Gas, coal, and power contracts	271	271
Other	9	9
<b>Total gross carrying amount</b>	<b>526</b>	<b>645</b>
Accumulated amortization—gas, coal, and power contracts	(105)	(89)
Accumulated amortization—other	(5)	(5)
<b>Total accumulated amortization</b>	<b>(110)</b>	<b>(94)</b>
<b>Total intangible assets, net</b>	<b>\$ 416</b>	<b>\$ 551</b>

Emission allowances in the table above include emission allowances which were recorded at fair value on the date of Duke Energy's merger with Cinergy and emission allowances purchased by Duke Energy Ohio. Additionally, Duke Energy Ohio is allocated certain zero cost emission allowances on an annual basis. The change in the gross carrying value of emission allowances during the nine months ended September 30, 2008 is as follows:

	(in millions)
Gross carrying value at January 1, 2008	\$ 365
Purchases of emission allowances	15
Sales and consumption of emission allowances <sup>(a)(b)</sup>	(59)
Impairment of emission allowances <sup>(c)</sup>	(82)
Other changes	7
<b>Gross carrying value at September 30, 2008</b>	<b>\$ 246</b>

- (a) Carrying value of emission allowances are recognized via a charge to expense when consumed. Carrying value of emission allowances sold or consumed during the three months ended September 30, 2008 and 2007 were \$17 million and \$34 million, respectively. Carrying value of emission allowances sold or consumed during the nine months ended September 30, 2008 and 2007 were \$59 million and \$134 million, respectively.
- (b) See Note 3 for a discussion of gains and losses on sales of emission allowances by Commercial Power during the three and nine months ended September 30, 2008 and 2007.
- (c) See Note 8 for discussion of impairments of the carrying value of emission allowances of approximately \$82 million during the three months ended September 30, 2008. Amortization expense for gas, coal and power contracts and other intangible assets for the three months ended September 30, 2008 and 2007 was approximately \$6 million and \$13 million, respectively. Amortization expense for gas, coal and power contracts and other intangible assets for the nine months ended September 30, 2008 and 2007 was approximately \$16 million and \$38 million, respectively.



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PART I

DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)****Intangible Liabilities**

In connection with the Duke Energy and Cinergy merger in April 2006, Duke Energy Ohio recorded an intangible liability of approximately \$113 million associated with the market based standard service offer (MBSSO) in Ohio, which is being recognized in earnings over the remaining regulatory period that ends on December 31, 2008. The carrying amount of this intangible liability was approximately \$17 million and \$67 million at September 30, 2008 and December 31, 2007, respectively. Duke Energy Ohio also recorded approximately \$56 million of intangible liabilities associated with other power sale contracts in connection with the Duke Energy and Cinergy merger. The carrying amount of this intangible liability was approximately \$18 million and \$22 million at September 30, 2008 and December 31, 2007, respectively. During the three and nine months ended September 30, 2008, Duke Energy Ohio amortized approximately \$18 million and \$54 million, respectively, to income related to these intangible liabilities. During the three and nine months ended September 30, 2007, Duke Energy Ohio amortized approximately \$15 million and \$29 million, respectively, to income related to these intangible liabilities. Intangible liabilities are classified as Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

**8. Impairment Charges**

**Emission Allowances.** On July 11, 2008, the U.S. Court of Appeals for the District of Columbia issued a decision vacating the Clean Air Interstate Rule (CAIR). See Note 12 for further discussion of the decision, which resulted in sharp declines in market prices of sulfur dioxide (SO<sub>2</sub>) and nitrogen oxide (NO<sub>x</sub>) allowances in the third quarter of 2008 due to uncertainty associated with future federal requirements to reduce emissions. Accordingly, pursuant to SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," Duke Energy Ohio evaluated the carrying value of emission allowances held by its non-regulated businesses for impairment at September 30, 2008.

Prior to its repeal, the CAIR required 50% reductions in SO<sub>2</sub> emissions beginning in 2010 and further 30% reductions in SO<sub>2</sub> emissions in 2015 beyond specified requirements. These reductions were to be achieved by requiring the surrender of SO<sub>2</sub> allowances in a ratio of two allowances per ton of SO<sub>2</sub> emitted beginning in 2010, up from a current one-to-one ratio, escalating to 2.86 allowances per ton of SO<sub>2</sub> emitted beginning in 2015. Taking into account these increases in emission allowance requirements under CAIR, Commercial Power's forecasted SO<sub>2</sub> emissions needed through 2037 exceeded the number of emission allowances held prior to the vacating of the CAIR. Subsequent to the decision to vacate CAIR, Commercial Power determined that it had SO<sub>2</sub> allowances in excess of forecasted emissions and those allowances held in excess of forecasted emissions from future generation required an impairment evaluation. In performing the impairment evaluation for SO<sub>2</sub> allowances at September 30, 2008, management compared quoted market prices for each vintage year allowance to the carrying value of the related allowances in excess of forecasted emissions through 2038. Due to the sharp decline in market prices of SO<sub>2</sub> allowances, as discussed above, Commercial Power recorded pre-tax impairment charges of approximately \$77 million related to forecasted excess SO<sub>2</sub> allowances held at September 30, 2008. Additionally, Commercial Power recorded pre-tax impairment charges of approximately \$5 million related to annual NO<sub>x</sub> allowances during the three months ended September 30, 2008 as these were also affected by the decision to vacate the CAIR. These impairment charges are recorded in Impairments and Other Charges within Operating Expenses on the Consolidated Statements of Operations.

Management will continue to assess the forecasted usage and carrying value of emission allowances going forward to determine if further impairment write-downs are necessary. See Note 7 for further information regarding the carrying value of emission allowances.

**9. Related Party Transactions**

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

	September 30, 2008	December 31, 2007
	(in millions)	
Current assets due from affiliated companies <sup>(a)(b)</sup>	\$ 30	\$ 58
Current liabilities due to affiliated companies <sup>(a)(c)</sup>	\$ (197)	\$ (266)
Non-current liabilities due to affiliated companies <sup>(a)(d)</sup>	\$ (5)	\$ —
Net deferred tax liabilities to Duke Energy <sup>(a)(e)</sup>	\$ (1,399)	\$ (1,401)

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DUKE ENERGY OHIO, INC.  
**Notes To Unaudited Consolidated Financial Statements—(Continued)**

- (a) Balances exclude assets or liabilities associated with accrued pension and other post-retirement benefits, Cinergy Receivables and money pool arrangements, all of which are discussed below.
- (b) Of the balance at September 30, 2008, approximately \$26 million is classified as Receivables, and approximately \$4 million is classified as Other within Current Assets on the Consolidated Balance Sheets. The balance at December 31, 2007 is classified as Receivables on the Consolidated Balance Sheets.
- (c) Of the balance at September 30, 2008, approximately \$(125) million is classified as Accounts Payable, approximately \$(70) million is classified as Taxes Accrued, and approximately \$(2) million is classified as Unrealized Losses on Mark-to-Market and Hedging Transactions on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately \$(256) million is classified as Accounts Payable and approximately \$(10) million is classified as Taxes Accrued on the Consolidated Balance Sheets.
- (d) The balance at September 30, 2008 is classified as Unrealized Losses on Mark-to-Market and Hedging Transactions on the Consolidated Balance Sheets.

- (e) Of the balance at September 30, 2008, approximately \$(1,458) million is classified as Deferred Income Taxes, approximately \$(14) million is classified as Investment Tax credit, and approximately \$73 million is classified as Other within Current Assets on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately \$(1,409) million is classified as Deferred Income Taxes, approximately \$(16) million is classified as Investment Tax Credit, and approximately \$24 million is classified as Other within Current Assets on the Consolidated Balance Sheets.

Duke Energy Ohio is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy and a consolidated affiliate of Cinergy. Corporate governance and other shared services costs are primarily allocations of corporate costs, such as human resources, legal and accounting fees, as well as other third party costs. The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Ohio, which are recorded in Operation, maintenance and other within Operating Expenses on the Consolidated Statements of Operations were approximately \$83 million and \$67 million for the three months ended September 30, 2008 and 2007, respectively, and approximately \$203 million and \$183 million for the nine months ended September 30, 2008 and 2007, respectively.

Duke Energy Ohio incurs expenses related to its property insurance coverage through Bison Insurance Company Limited, Duke Energy's wholly-owned captive insurance subsidiary. These expenses, which are recorded in Operation, maintenance and other within Operating Expenses on the Consolidated Statements of Operations, were approximately \$4 million and \$3 million for the three months ended September 30, 2008 and 2007, respectively, and approximately \$11 million and \$17 million for the nine months ended September 30, 2008 and 2007, respectively. Additionally, Duke Energy Ohio records income associated with the rental of office space to a consolidated affiliate of Duke Energy. Rental income was approximately \$2 million for each of the three months ended September 30, 2008 and 2007, respectively, and approximately \$7 million for each of the nine months ended September 30, 2008 and 2007, respectively.

Duke Energy Ohio participates in Cinergy's qualified pension plan, non-qualified pension plan and other post-retirement benefit plans and is allocated its proportionate share of expenses associated with these plans (see Note 6). Additionally, Duke Energy Ohio has been allocated accrued pension and other post-retirement benefit obligations from Cinergy of approximately \$252 million at September 30, 2008 and approximately \$266 million at December 31, 2007. These amounts have been classified in the Consolidated Balance Sheets as follows:

	September 30, 2008	December 31, 2007
(in millions)		
Other current liabilities	\$ 5	\$ 5
Accrued pension and other post-retirement benefit costs	\$ 242	\$ 259
Other deferred credits and other liabilities	\$ 5	\$ 2

As discussed in Note 1, certain trade receivables have been sold by Duke Energy Ohio to Cinergy Receivables. The proceeds obtained from the sales of receivables are largely cash, but do include a subordinated note from Cinergy Receivables for a portion of the purchase price. This subordinated note is classified as Receivables in the Consolidated Balance Sheets and was approximately \$118 million and \$189 million, as of September 30, 2008 and December 31, 2007, respectively. The interest income associated with the subordinated note, which is recorded in Other Income and Expenses, net on the Consolidated Statements of Operations, was approximately \$5 million and \$6 million for three months ended September 30, 2008 and 2007, respectively, and approximately \$17 million and \$19 million for the nine months ended September 30, 2008 and 2007, respectively.

During the nine months ended September 30, 2007, Duke Energy Ohio received a \$29 million capital contribution from its parent, Cinergy. Additionally, during the nine months ended September 30, 2007, Duke Energy Ohio paid dividends to its parent, Cinergy, of \$135 million.

As discussed further in Note 5, Duke Energy Ohio participates in a money pool arrangement with Duke Energy and other Duke Energy subsidiaries. The expenses associated with money pool activity, which are recorded in Interest Expense on the Consolidated Statements of Operations, were approximately \$2 million and \$4 million for the three months ended September 30, 2008 and 2007, respectively, and approximately \$3 million and \$7 million for the nine months ended September 30, 2008 and 2007, respectively.

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DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)****10. Risk Management Instruments**

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

The following table shows the carrying value of Duke Energy Ohio's derivative portfolio as of September 30, 2008, and December 31, 2007

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

	September 30, 2008	December 31, 2007
	(in millions)	
Hedging	\$ (14)	\$ (23)
Undesignated	35	7
<b>Total</b>	<b>\$ 21</b>	<b>\$ (16)</b>

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

The \$9 million change in the fair value of the hedging portfolio is due primarily to a gain on cash flow hedges at Commercial Power.

The \$28 million increase in the undesignated derivative portfolio fair value is due primarily to unrealized mark-to-market gains within Commercial Power, which primarily consists of in-the-money contracts to purchase coal as a result of higher coal prices at September 30, 2008 as compared to December 31, 2007.

During the three and nine months ended September 30, 2008, Duke Energy Ohio included in earnings approximately \$128 million of pre-tax losses and approximately \$28 million of pre-tax gains, respectively, related to mark-to-market adjustments on derivative contracts that do not qualify for hedge accounting. Duke Energy Ohio included in earnings approximately \$4 million of pre-tax gains and an insignificant amount during the three and nine months ended September 30, 2007, respectively, related to mark-to-market adjustments on derivative contracts that do not qualify for hedge accounting. These amounts, which relate to the balances included within undesignated in the above table, primarily represent the mark-to-market impacts of derivative contracts used in Duke Energy Ohio's hedging of a portion of the economic value of its generation assets in Commercial Power.

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

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

See Note 13 for additional information related to the fair value of Duke Energy Ohio's derivative instruments.

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DUKE ENERGY OHIO, INC.

### Notes To Unaudited Consolidated Financial Statements—(Continued)

#### 11. Regulatory Matters

##### Regulatory Merger Approvals

On April 3, 2006, the merger between Duke Energy and Cinergy was consummated to create a newly formed company, Duke Energy Holding Corp. (subsequently renamed Duke Energy Corporation). As a condition to the merger approval, the PUCO and the Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Ohio and Kentucky, respectively. The commissions also required Duke Energy Ohio and Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- The PUCO required that Duke Energy Ohio provide (i) a rate reduction of approximately \$15 million for one year to facilitate economic development in a time of increasing rates and market prices and (ii) a reduction of approximately \$21 million to its gas and electric consumers in Ohio for one year, with both credits beginning January 1, 2006. During the first quarter of 2007, Duke Energy Ohio completed its merger related rate reductions and filed a report with the PUCO to terminate the merger credit riders. Approximately \$2 million of the rate reductions was passed through to customers during the nine months ended September 30, 2007.
- The KPSC required that Duke Energy Kentucky provide \$8 million in rate reductions to its customers over five years, ending when new rates are established in the next rate case after January 1, 2008. Less than \$1 million and approximately \$2 million of the rate reduction was passed through to customers during the three and nine months ended both September 30, 2008 and 2007, respectively.
- The FERC approved the merger without conditions.

**Restrictions on the Ability of Duke Energy Ohio to Make Dividends, Advances and Loans to Duke Energy Corporation.** As a condition of approving the merger of Duke Energy and Cinergy, the state utility commissions imposed conditions (the Merger Conditions) on the ability of Duke Energy Ohio and Duke Energy Kentucky to transfer funds to Duke Energy through loans or advances, as well as restricted amounts available to pay dividends to Duke Energy. Duke Energy Ohio will not declare and pay dividends out of capital or unearned surplus without the prior authorization of the PUCO. Duke Energy Kentucky is required to pay dividends solely out of retained earnings and to maintain a minimum of 35% equity in its capital structure. At September 30, 2008, Duke Energy Ohio had restricted net assets of approximately \$6.3 billion that may not be transferred to Duke Energy without appropriate approval based on the aforementioned Merger Conditions.

##### Franchised Electric and Gas

**Rate Related Information.** The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. The PUCO approves rates and market prices for retail gas and electric service within the state of Ohio, except that non-regulated sellers of gas and electric generation also are allowed to operate in Ohio (see "Commercial Power" below). The FERC approves rates for electric sales to wholesale customers served under cost-based rates.

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

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

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DUKE ENERGY OHIO, INC.  
**Notes To Unaudited Consolidated Financial Statements—(Continued)**

denying in part Duke Energy Ohio's Application for Rehearing. Among other things, the PUCO modified and clarified the applicability of various rate riders during customer shopping situations. It also clarified that the residential RTC terminates at the end of 2008 and that the nonresidential RTC terminates at the end of 2010 and agreed to give further consideration to whether Duke Energy Ohio may transfer its generating assets to an EWG.

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

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

On July 31, 2008, Duke Energy Ohio filed a new generation pricing formula to be effective January 1, 2009, when the current RSP is scheduled to expire. Among other things, the plan provides pricing mechanisms for compensation related to the advanced energy, renewables and energy efficiency portfolio standards established by SB 221.

On October 27, 2008, Duke Energy Ohio filed a Stipulation and Recommendation (Stipulation) for consideration by the PUCO regarding Duke Energy Ohio's July 31, 2008 ESP filing. The Stipulation reflects agreement on all but two issues in this proceeding and is filed with the support of most of the parties to this proceeding. In addition to the Stipulation, the ability for residential governmental aggregation customers to avoid certain charges and to receive a shopping credit will be presented to the PUCO for a ruling. Parties to this proceeding who do not support the Stipulation may litigate any, or all, issues.

The Stipulation agrees to a net increase in base generation revenues of approximately \$36 million, \$74 million and \$98 million in 2009, 2010 and 2011, respectively, including termination of the residential and non-residential RTC. Such amounts result in a residential net rate increase of 2% in 2009 and in 2010, and a non-residential net rate increase of 2% in 2009, 2010 and 2011. The Stipulation also allows the recovery of expenditures incurred to deploy SmartGrid infrastructure modernization technology on the distribution system. The recovery of such expenditures, net of savings, is subject to an annual residential revenue cap. Further, the Stipulation allows for the implementation of a new energy efficiency compensation model, referred to as Save-A-Watt, to achieve the energy efficiency mandate.

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pursuant to the recent electric energy legislation. The criteria customers must meet to be exempt from Duke Energy Ohio's program will also be presented to the PUCO for a ruling in this case. Also, under the Stipulation, Duke Energy Ohio may defer up to \$50 million of certain operation and maintenance costs incurred at the W.C. Beckjord generating station and amortize such costs over a three-year period.

The PUCO will consider the Stipulation and hear evidence beginning on November 10, 2008.

**Duke Energy Ohio Gas Rate Case.** In July 2007, Duke Energy Ohio filed an application with the PUCO for an increase in its base rates for gas service. Duke Energy Ohio sought an increase of approximately \$34 million in revenue, or approximately 5.7%, to be effective in the spring of 2008. The application also requested approval to continue tracker recovery of costs associated with the accelerated gas main replacement program. The staff of the PUCO issued a Staff Report in December 2007 recommending an increase of approximately \$14 million to \$20 million in revenue. The Staff Report also recommended approval for Duke Energy Ohio to continue tracker recovery of costs associated with the accelerated gas main replacement program. On February 28, 2008, Duke Energy Ohio reached a settlement agreement with the PUCO Staff and all of the intervening parties on its request for an increase in natural gas base rates. The settlement called for an annual revenue increase of approximately \$18 million in base revenue, or 3% over current revenue, permitted continued recovery of costs through 2018 for Duke Energy Ohio's accelerated gas main replacement program and permitted recovery of carrying costs on gas stored underground via its monthly gas cost adjustment filing. The settlement did not resolve a proposed rate design for residential customers, which involved moving more of the fixed charges of providing gas service, such as capital investment in pipes and regulating equipment, billing and meter reading, from the per unit charges to the monthly charge. On May 28, 2008, the PUCO approved the settlement in its entirety and the proposed rate design. On June 28, 2008, the OCC and OPAE filed Applications for Rehearing opposing the rate design. On July 23, 2008, the Ohio Commission issued an Entry denying the rehearing requests of OCC and OPAE. On September 16 and 19, 2008 respectively, OCC and OPAE filed their notices of appeal to the Ohio Supreme Court opposing the residential rate design issue.

**Duke Energy Ohio Electric Distribution Rate Case.** On June 25, 2008, Duke Energy Ohio filed notice with the PUCO that it will seek a rate increase for electric delivery service of approximately \$86 million, or 4.8% on total electric revenues, to be effective in the second quarter of 2009. Among other things, the rate request includes a proposal to increase the monthly residential customer charge from \$4.50 to \$10, with an offsetting reduction in the usage-based charge. This change in rate design will make customer bills more even throughout the year. Duke Energy Ohio also proposes a distribution modernization tracker that would allow smaller annual increases to reflect increased investment in the delivery system. The rate case test period may be updated to reflect certain expenses, such as costs related to storm damage.

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

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

In August 2007, the Franklin Circuit Court consolidated all the pending appeals and ruled that the KPSC lacks legal authority to approve the gas main replacement tracking mechanism, and any other annual rate adjustments under the tracking mechanism. To date, Duke Energy Kentucky has collected approximately \$9 million in annual rate adjustments under the tracking mechanism and continues to utilize tracking mechanisms in its billed rates to customers. Duke Energy Kentucky and the KPSC appealed these cases to the Kentucky Court of Appeals. In November 2008, the Kentucky Court of Appeals ruled that the KPSC had no legal authority to approve tracker recovery of gas main replacement costs prior to 2005. Duke Energy Kentucky is evaluating this ruling and cannot predict the outcome of these proceedings.

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**Energy Efficiency.** On July 11, 2007, the PUCO approved Duke Energy Ohio's Demand Side Management/Energy Efficiency Program (DSM Program). A series of DSM Programs were first proposed in 2006 and were endorsed by the Duke Energy Community Partnership, which is a collaborative group made up of representatives of organizations interested in energy conservation, efficiency and assistance to low-income customers. The program costs are recouped through a cost recovery mechanism that will be adjusted annually to reflect the previous year's activity. Duke Energy Ohio is permitted to recover lost revenues, program costs and shared savings (once the programs reach 65% of the targeted savings level) through the cost recovery mechanism based upon impact studies to be provided to the Staff of the PUCO. Duke Energy Ohio filed the Save-A-Watt Energy Efficiency Plan as part of its ESP filed with the PUCO on July 31, 2008 (discussed above). A Stipulation and Recommendation for consideration by the PUCO regarding Duke Energy Ohio's ESP filing, including implementation of Save-A-Watt, was filed on October 27, 2008. The ESP hearing occurred on November 10, 2008. A decision on the stipulation is expected by the end of the year.

On November 15, 2007, Duke Energy Kentucky filed its annual application to continue existing energy efficiency programs, consisting of nine residential and two commercial and industrial programs, and to true-up its gas and electric tracking mechanism for recovery of lost revenues, program costs and shared savings. On February 11, 2008, Duke Energy Kentucky filed a motion to amend its energy efficiency programs and applied to reinstitute a low income Home Energy Assistance Program. The KPSC bifurcated the proposed Home Energy Assistance Program from the other energy efficiency programs. On May 14, 2008, the KPSC approved the energy efficiency programs. On September 25, 2008, the KPSC approved Duke Energy Kentucky's Home Energy Assistance program, making it available for customers at or below 150% of the federal poverty level.

#### Other Matters

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

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

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

**Midwest ISO's Establishment of an Ancillary Services Market.** On February 25, 2008, the FERC conditionally accepted the Midwest ISO proposal to implement a day-ahead and real-time ancillary services market (ASM), including a scarcity pricing proposal. By approving the ASM proposal, the FERC essentially approved the transfer and consolidation of Balancing Authority for the entire Midwest.

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ISO area. This will allow the Midwest ISO to determine operating reserve requirements and procure operating reserves from all qualified resources from an organized market, in place of the current system of local management and procurement of reserves by the 24 Balancing Authorities. The Midwest ISO delayed the ASM launch date, previously scheduled for September 9, 2008 to January 6, 2009. At this time, Duke Energy Ohio does not believe the establishment of the Midwest ASM will have a material impact on its consolidated results of operations, cash flows or financial position.

### **Commercial Power**

Reported results for Commercial Power are subject to volatility due to the over- or under-collection of certain costs, including fuel and purchased power, since Commercial Power is not subject to regulatory accounting pursuant to SFAS No. 71. In addition, Commercial Power could be impacted by certain of the regulatory matters discussed above, including the Duke Energy Ohio electric rate filings.

**FERC 203 Application.** On April 23, 2008 (supplemented on May 6, 2008), Duke Energy Ohio and certain affiliates filed an application with the FERC requesting approval to transfer Duke Energy Ohio's electric generating facilities, some of which are designated to serve Ohio customers, to affiliate companies. The FERC filing, if approved, does not obligate Duke Energy to make the transfer of the electric generating facilities, and does not impact Duke Energy Ohio's current rates. On October 10, 2008, Duke Energy Ohio and affiliates filed a notice with the FERC reporting that Duke Energy Ohio is in settlement discussions with all parties in the Ohio proceeding regarding Duke Energy Ohio's application to establish an ESP, as discussed above. Duke Energy Ohio advised the FERC that it believes that in light of those discussions good cause exists for the FERC to extend the time to consider Duke Energy Ohio's Section 203 application. On October 17, 2008, the FERC issued an order extending the time for the FERC to act on the application by 180 additional days, and ordered Duke Energy Ohio to inform the FERC of the status of settlement discussions by November 16, 2008. The settlement in Ohio has been agreed to by most parties and was filed with the PUCO on October 27, 2008. Pursuant to the settlement, if approved by the PUCO, Duke Energy Ohio agrees to withdraw that portion of its application for approval related to the transfer of its generating facilities designated to serve Ohio customers. Acceptance of the settlement by the PUCO would constitute its approval of the transfer for the remaining generating facilities.

**PJM Interconnection Reliability Pricing Model (RPM) Buyers' Complaint.** On May 30, 2008, a group of public utility commissions, state consumer counsels, industrial power customers and load serving entities, known collectively as the RPM Buyers, filed a complaint at FERC. The complaint asks FERC to find that the results of the three transitional base residual auctions conducted by PJM to procure capacity for its RPM capacity market during the years 2008-2011 are unjust and unreasonable because, allegedly, they have produced excessive capacity prices, have failed to prevent suppliers from exercising market power, and have not produced benefits commensurate with costs. In their complaint, the RPM Buyers propose revised, administratively determined auction clearing prices. Certain Duke Energy Ohio revenues during the years 2008-2011 are at risk, as Duke Energy Ohio planned to supply capacity to this market. On July 11, 2008, Duke Energy Ohio filed a response to the complaint with the FERC. On September 19, 2008, the FERC issued an Order denying the Buyer's complaint. The FERC dismissed the RPM Buyers' complaint, finding that, for the transition auctions, no party violated PJM's tariff and the prices determined during the auctions were in accordance with the tariff provisions governing the auctions. On October 20, 2008, the RPM buyers filed a Request for Rehearing with the FERC that raised the same issues as in the initial complaint that was denied by the FERC.

## **12. Commitments and Contingencies**

### **Environmental**

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

**Remediation Activities.** Duke Energy Ohio and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Ohio operations, sites formerly owned or used by Duke Energy Ohio entities, and sites owned by third parties. Remediation typically involves management of contaminated soils and may involve groundwater remediation. Managed in conjunction with relevant federal, state and local agencies, activities vary with site conditions and locations, remedial requirements, complexity and sharing of responsibility. If remediation activities involve statutory joint and several liability provisions, strict liability, or cost recovery or contribution actions, Duke Energy Ohio or its affiliates could potentially be held



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responsible for contamination caused by other parties. In some instances, Duke Energy Ohio may share liability associated with contamination with other potentially responsible parties, and may also benefit from insurance policies or contractual indemnities that cover some or all cleanup costs. All of these sites generally are managed in the normal course of business or affiliate operations. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

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

**Clean Air Interstate Rule (CAIR).** The EPA finalized its CAIR in May 2005. The CAIR was to have limited total annual and summertime NO<sub>x</sub> emissions and annual SO<sub>2</sub> emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 was to begin in 2009 for NO<sub>x</sub> and in 2010 for SO<sub>2</sub>. Phase 2 was to begin in 2015 for both NO<sub>x</sub> and SO<sub>2</sub>. On March 25, 2008, the U.S. Court of Appeals for the District of Columbia (D.C. Circuit) heard oral argument in a case involving multiple challenges to the CAIR. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA filed a petition for rehearing on September 24, 2008 with the D.C. Circuit asking the court to reconsider various parts of its ruling vacating CAIR. A decision is pending on that petition. Subsequent to the filing of the rehearing petitions, the D.C. Circuit ordered all Petitioners (including Duke Energy) to file briefs on the petition for rehearing. The D.C. Circuit directed the parties to address whether any party is seeking vacatur of CAIR, and whether the Court should stay its mandate until the EPA promulgates a revised rule. Duke Energy has responded to the request accordingly. The D.C. Circuit's decision creates uncertainty regarding future NO<sub>x</sub> and SO<sub>2</sub> emission reductions requirements and their timing. Although as a result of the decision there may be a delay in the timing of federal requirements to reduce emissions, it is expected that electric sector emission reductions at least as stringent as those imposed by CAIR will be required in the near future, through new federal rules and/or individual state requirements. CAIR remains in effect until the Court issues its mandate, which will not be before it decides whether to grant rehearing. Duke Energy Ohio's plan had been to spend approximately \$150 million between 2008 and 2012 to comply with Phase 1 of CAIR. It has not been determined how the court's decision will affect these planned expenditures but each of the states in which Duke Energy Ohio operates is considering adopting state regulations to address the court's decision. Duke Energy Ohio did not expect to incur any significant costs for complying with Phase 2 of CAIR. Duke Energy Ohio receives partial recovery of depreciation and financing costs related to environmental compliance projects for 2005-2008 through its RSP (see Note 11).

Duke Energy Ohio is unable to estimate the costs to comply with any new rule the EPA or states may issue as a result of this decision. See Note 8 for a discussion of the impacts of the D.C. Circuit Court's decision to vacate CAIR on the carrying value of emission allowances.

**Clean Air Mercury Rule (CAMR).** The EPA finalized its CAMR in May 2005. The CAMR was to have limited total annual mercury emissions from coal-fired power plants across the U.S. through a two-phased cap-and-trade program beginning in 2010. On February 8, 2008, the D.C. Circuit issued its opinion in *New Jersey v. EPA*, No. 05-1097 vacating the CAMR. Requests for rehearing were denied. The U.S. EPA and the Utility Air Regulatory Group have requested that the U.S. Supreme Court review the D.C. Circuit's decision. The D.C. Circuit's decision creates uncertainty regarding future mercury emission reduction requirements and their timing, but makes it fairly certain that there will be a delay in the implementation of federal mercury requirements for existing coal-fired power plants. At this point, Duke Energy Ohio is unable to estimate the costs to comply with any future mercury regulations that might result from the D.C. Circuit's decision.

**Coal Combustion Product (CCP) Management.** Duke Energy Ohio currently estimates that it will spend approximately \$50 million over the period 2008-2012 to install synthetic caps and liners at existing and new CCP landfills and to convert CCP handling systems from wet to dry systems.

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

**Extended Environmental Activities and Accruals.** Included in Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets were total accruals related to extended environmental-related activities of approximately \$8 million as of both September 30, 2008 and December 31, 2007. These accruals represent Duke Energy Ohio's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

#### Litigation

**New Source Review (NSR).** In 1999-2000, the U.S. Department of Justice (DOJ), acting on behalf of the EPA and joined by various citizen groups and states, filed a number of complaints and notices of violation against multiple utilities across the country for alleged violations of the NSR provisions of the Clean Air Act (CAA). Generally, the government alleges that projects performed at various coal-fired units were major modifications, as defined in the CAA, and that the utilities violated the CAA when they undertook those projects without obtaining permits and installing the best available emission controls for SO<sub>2</sub>, NO<sub>x</sub> and particulate matter. The complaints seek injunctive relief to require installation of pollution control technology on various generating units that allegedly violated the CAA, and unspecified civil penalties in amounts of up to \$32,500 per day for each violation. Two of Duke Energy Ohio's plants have been subject to these allegations. Duke Energy Ohio asserts that there were no CAA violations because the applicable regulations do not require permitting in cases where the projects undertaken are "routine" or otherwise do not result in a net increase in emissions.

In November 1999, the U.S. brought a lawsuit in the U.S. Federal District Court for the Southern District of Indiana against Duke Energy Ohio alleging various violations of the CAA at Duke Energy Ohio's W.C. Beckjord and Miami Fort Stations. Three northeast states and two environmental groups have intervened in the case. A jury trial commenced on May 5, 2008 and jury verdict was returned on May 22, 2008. The jury found in favor of Cinergy, Duke Energy Ohio and Duke Energy Indiana, Inc. on all but three units at Wabash River. Additionally, the plaintiffs had claimed that Duke Energy Ohio violated an Administrative Consent Order entered into in 1998 between the EPA and Cinergy relating to alleged violations of Ohio's State Implementation Plan (SIP) provisions governing particulate matter at Duke Energy Ohio's W.C. Beckjord Station. The judge previously granted summary judgment against Duke Energy Ohio with respect to this allegation and it will be considered during the February 2009 remedy phase as well.

Duke Energy Ohio has been informed by Dayton Power and Light (DP&L) that in June 2000, the EPA issued a Notice of Violation (NOV) to DP&L for alleged violations of CAA requirements at a station operated by DP&L and jointly-owned by DP&L, Columbus Southern Power Company (CSP), and Duke Energy Ohio. The NOV indicated the EPA may issue an order requiring compliance with the requirements of the Ohio SIP, or bring a civil action seeking injunctive relief and civil penalties of up to \$27,500 per day for each violation. In September 2004, Marilyn Wall and the Sierra Club brought a lawsuit against Duke Energy Ohio, DP&L and CSP for alleged violations of the CAA at this same generating station. The parties reached an agreement to settle this matter in the form of a consent decree which was submitted for comment to the EPA and ultimately approved and entered by the court on October 23, 2008. The consent decree will not have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

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

**Carbon Dioxide (CO<sub>2</sub>) Litigation.** In July 2004, the states of Connecticut, New York, California, Iowa, New Jersey, Rhode Island, Vermont, Wisconsin and the City of New York brought a lawsuit in the U.S. District Court for the Southern District of New York

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against Cinergy, American Electric Power Company, Inc., American Electric Power Service Corporation, The Southern Company, Tennessee Valley Authority, and Xcel Energy Inc. A similar lawsuit was filed in the U.S. District Court for the Southern District of New York against the same companies by Open Space Institute, Inc., Open Space Conservancy, Inc., and The Audubon Society of New Hampshire. These lawsuits allege that the defendants' emissions of CO<sub>2</sub> from the combustion of fossil fuels at electric generating facilities contribute to global warming and amount to a public nuisance. The complaints also allege that the defendants could generate the same amount of electricity while emitting significantly less CO<sub>2</sub>. The plaintiffs are seeking an injunction requiring each defendant to cap its CO<sub>2</sub> emissions and then reduce them by a specified percentage each year for at least a decade. In September 2005, the District Court granted the defendants' motion to dismiss the lawsuit. The plaintiffs have appealed this ruling to the Second Circuit Court of Appeals. Oral arguments were held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

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

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

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

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

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

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PART I

DUKE ENERGY OHIO, INC.

### Notes To Unaudited Consolidated Financial Statements—(Continued)

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

#### Other Commitments and Contingencies

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

#### 13. Fair Value of Financial Assets and Liabilities

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

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

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

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

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

**Level 3 inputs**—unobservable inputs for the asset or liability.

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

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PART I

DUKE ENERGY OHIO, INC.  
**Notes To Unaudited Consolidated Financial Statements—(Continued)**

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

Description	Total Fair Value Amounts at			
	September 30, 2008	Level 1	Level 2	Level 3
	(in millions)			
Derivative assets	\$ 133	\$ 10	\$ —	\$ 123
Derivative liabilities	\$ (112)	\$ (25)	\$ (2)	\$ (85)

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

**Rollforward of Level 3 Measurements**

	Derivatives (net)	
	(in millions)	
<b>Three Months Ended September 30, 2008</b>		
Balance at July 1, 2008	\$	29
Total pre-tax realized or unrealized gains included in earnings:		
Revenue, non-regulated electric and other		10
Fuel used in electric generation and purchased power—non-regulated		4
Total pre-tax gains included in other comprehensive income		9
Net purchases, sales, issuances and settlements		(14)
Balance at September 30, 2008	\$	38
<b>Nine Months Ended September 30, 2008</b>		
Balance at January 1, 2008	\$	(22)
Total pre-tax realized or unrealized gains (losses) included in earnings:		
Revenue, non-regulated electric and other		(14)
Fuel used in electric generation and purchased power—non-regulated		105
Net purchases, sales, issuances and settlements		(31)
Balance at September 30, 2008	\$	38
Pre-tax amounts included in the Consolidated Statements of Operations related to Level 3 measurements outstanding at September 30, 2008:		
Revenue, non-regulated electric and other	\$	(4)
Fuel used in electric generation and purchased power—non-regulated		62
Total	\$	58

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

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

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PART I

DUKE ENERGY OHIO, INC.  
Notes To Unaudited Consolidated Financial Statements—(Continued)

### 14. New Accounting Standards

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

*SFAS No. 157.* Refer to Note 13 for a discussion of Duke Energy Ohio's adoption of SFAS No. 157.

*SFAS No. 159.* Refer to Note 13 for a discussion of Duke Energy Ohio's adoption of SFAS No. 159.

*FSP No. FIN 39-1.* Refer to Notes 1 and 10 for a discussion of Duke Energy Ohio's adoption of FSP No. FIN 39-1.

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

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

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

### 15. Income Taxes and Other Taxes

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

At September 30, 2008, Duke Energy Ohio has approximately \$46 million recorded for unrecognized tax benefits and no portion of the total unrecognized tax benefits, if recognized, would affect the effective tax rate. Additionally, at September 30, 2008, Duke Energy Ohio has approximately \$7 million of unrecognized tax benefits related to pre-merger tax positions that, if recognized prior to the adoption of SFAS No. 141R, would affect goodwill. It is reasonably possible that Duke Energy Ohio will reflect an approximate \$35 million reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

Duke Energy Ohio has the following tax years open:

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

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PART I

DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

The effective tax rate for the three months ended September 30, 2008 was approximately 28% as compared to the effective tax rate of approximately 37% for the same period in 2007. The decrease in the effective tax rate for the three months ended September 30, 2008 is due primarily to adjustments related to prior year tax returns. The effective tax rate for the nine months ended September 30, 2008 was approximately 37% as compared to the effective tax rate of approximately 38% for the same period in 2007.

As of September 30, 2008 and December 31, 2007, approximately \$80 million and \$27 million, respectively, of deferred income taxes were included in Other within Current Assets in the Consolidated Balance Sheets. At September 30, 2008, this balance exceeded 5% of total current assets.

**Excise Taxes.** Certain excise taxes levied by state or local governments are collected by Duke Energy Ohio from its customers. These taxes, which are required to be paid regardless of Duke Energy Ohio's ability to collect from the customer, are accounted for on a gross basis. When Duke Energy Ohio acts as an agent, and the tax is not required to be remitted if it is not collected from the customer, the taxes are accounted for on a net basis. Duke Energy Ohio's excise taxes accounted for on a gross basis and recorded as Operating Revenues in the accompanying Consolidated Statements of Operations were approximately \$27 million for both the three months ended September 30, 2008 and 2007, respectively, and approximately \$95 million and \$93 million for the nine months ended September 30, 2008 and 2007, respectively.

**16. Comprehensive Income and Total Comprehensive Income**

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

**Total Comprehensive (Loss) Income**

	Three Months Ended September 30,	
	2008	2007
	(in millions)	
<b>Net (Loss) Income</b>	\$ (54)	\$ 118
Other comprehensive income (loss)		
Cash flow hedges <sup>(a)</sup>	11	(7)
Pension and OPEB-related Adjustments to AOCI <sup>(b)</sup>	2	1
Other comprehensive income (loss), net of tax	13	(6)
<b>Total Comprehensive (Loss) Income</b>	\$ (41)	\$ 112

(a) Cash flow hedges, net of \$6 million tax expense and \$4 million tax benefit for the three months ended September 30, 2008 and 2007, respectively

(b) Pension and OPEB-related Adjustments to AOCI, net of an insignificant tax expense for each of the three months ended September 30, 2008 and 2007.

**17. Subsequent Events**

For information on subsequent events related to debt and credit facilities, regulatory matters and commitments and contingencies, see Notes 5, 11 and 12, respectively.

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### PART I

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### INTRODUCTION

Management's Discussion and Analysis should be read in conjunction with the Unaudited Consolidated Financial Statements.

Duke Energy Ohio, Inc. (Duke Energy Ohio) is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing.

### BASIS OF PRESENTATION

The results of operations and variance discussion for Duke Energy Ohio is presented in a reduced disclosure format in accordance with General Instructions H(2) of Form 10-Q.

### DUKE ENERGY OHIO

	Nine Months Ended September 30,		
	2008	2007	Increase (Decrease)
	(in millions)		
Operating revenues	\$ 2,604	\$ 2,634	\$ (30)
Operating expenses	2,224	2,243	(19)
Gains (losses) on sales of other assets and other, net	46	(12)	58
Operating income	426	379	47
Other income and expenses, net	23	22	1
Interest expense	72	73	(1)
Income before income taxes	377	328	49
Income tax expense	141	124	17
Net income	\$ 236	\$ 204	\$ 32

The \$32 million increase in Duke Energy Ohio's Net Income was primarily due to the following factors:

*Operating Revenues* The decrease was primarily due to

- A \$36 million decrease in volumes of coal sales due to expiration of contracts,
- A \$22 million decrease in retail electric revenues primarily due to lower retail pricing principally related to timing of collections on the Fuel and Purchased Power rider of the Rate Stabilization Plan (RSP), net of increased amortization of purchase accounting valuation liability of the RSP,
- A \$21 million decrease due to milder weather in 2008 compared to 2007, and
- A \$19 million decrease in wholesale electric revenues due to lower generation volumes primarily resulting from higher plant outages and lower hedge realization in 2008 compared to 2007.

Partially offsetting these decreases were:

- A \$23 million increase in regulated fuel revenues driven mainly by higher natural gas costs,
- A \$13 million increase due to implementation of new gas rates in Ohio,
- A \$9 million increase related to the Demand Side Management (DSM) rider implemented in the third quarter of 2007, and
- An \$8 million increase in Ohio electric base transmission due to a change in the Transmission Cost Recovery rider.

*Operating Expenses* The decrease was primarily due to

- A \$52 million decrease due primarily to lower sulfur dioxide emission allowance expenses due to installation of flue gas desulphurization equipment and lower generation volumes resulting from increased plant outages in 2008 as compared to 2007,
- A \$36 million decrease in expenses associated with coal sales due to expiration of contracts,



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### PART I

- A \$27 million decrease in fuel expense due to mark-to-market gains on non-qualifying fuel hedge contracts of \$73 million in 2008 compared to gains of \$46 million in 2007.
- A \$20 million decrease in other post-employment benefits due to an adjustment to the liability recorded for these benefits.
- A \$13 million decrease in corporate governance and administrative costs, partially offset by higher plant maintenance expenses resulting from increased plant outages in 2008 as compared to 2007.
- A \$13 million decrease in short-term incentive costs, and
- A \$7 million decrease in retail fuel and purchased power expenses due to realized gains from the settlement of certain fuel contracts, partially offset by higher purchased power as a result of increased plant outages.

Partially offsetting these decreases were:

- An \$82 million impairment of emission allowances due to the invalidation of the Clean Air Interstate Rule in July 2008.
- A \$34 million increase due to storm restoration work for damage caused by Hurricane Ike.
- A \$23 million increase in regulated fuel expense primarily due to higher natural gas costs, and
- A \$12 million increase in regulatory amortization of the Ohio DSM costs and regulatory transition charge.

*Gains (Losses) on Sales of Other Assets and Other, net* The increase is attributable to gains on sales of emission allowances in 2008 compared to losses on sales of emission allowances in 2007. Gains in 2008 were primarily a result of sales of zero cost basis emission allowances. Losses in 2007 were a result of sales of emission allowances acquired in connection with Duke Energy's merger with Cinergy in April 2006 which were written up to fair value as part of purchase accounting.

*Income Tax Expense* Income Tax Expense increased primarily as a result of higher pre-tax income.

#### **MATTERS IMPACTING FUTURE RESULTS AND OTHER MATTERS**

Duke Energy Ohio has approximately \$440 million of auction rate pollution control bonds outstanding. The maximum auction rate for these pollution control bonds outstanding is 2.0 times one-month London Interbank Offered Rate (LIBOR). While Duke Energy Ohio intends to refund and refinance these tax exempt auction rate bonds, the timing of such refinancing transactions is uncertain and subject to market conditions.

Duke Energy Ohio evaluates the carrying amount of its recorded goodwill for impairment under the guidance of SFAS No. 142, "Goodwill and Other Intangible Assets". As the fair value of each of Duke Energy Ohio's reporting units exceeded their respective carrying values at August 31, 2008, Duke Energy Ohio did not record any impairment charges in the third quarter of 2008 as a result of its annual impairment test. However, in light of recent market and economic events, management is reassessing the potential for any impairments to recorded goodwill balances. These assessments are in their early stages and management cannot yet predict the outcome, but it is possible that the current assessments could result in goodwill impairments being recorded at one or more reporting units.

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### **PART I**

#### **Item 4. Controls and Procedures.**

##### **Disclosure Controls and Procedures**

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized, and reported, within the time periods specified by the Securities and Exchange Commission's (SEC) rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2008, and, based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

##### **Changes in Internal Control over Financial Reporting**

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended September 30, 2008 and other than the third quarter financial system changes described below, have concluded that no change has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

During the third quarter of 2008, Duke Energy Ohio converted the general ledger and consolidation systems to those currently used by other Duke Energy operations. Additionally, Duke Energy Ohio implemented a new income tax system and upgraded the asset accounting system. These system changes are a result of an evaluation of previous systems and related processes to support evolving operational needs, and are not the result of any identified deficiencies in the previous systems. Duke Energy Ohio reviewed the implementation effort as well as the impact on Duke Energy Ohio's internal control over financial reporting and where appropriate, made changes to internal controls over financial reporting to address these system changes.

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**Table of Contents****PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

For information regarding legal proceedings that became reportable events or in which there were material developments in the third quarter of 2008, see Note 11 to the Consolidated Financial Statements, "Regulatory Matters" and Note 12 to the Consolidated Financial Statements, "Commitments and Contingencies."

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, careful consideration should be given to the factors discussed in Part I, "Item 1A. Risk Factors" in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect Duke Energy Ohio's financial condition or future results. In addition to the risk factors included in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2007, Duke Energy Ohio has identified the following risk factor as of September 30, 2008:

**Current Levels of Market Volatility are Unprecedented**

The capital and credit markets have been experiencing extreme volatility and disruption. In recent months, the volatility and disruption have reached unprecedented levels. In some cases, the markets have exerted downward pressure on stock prices and credit capacity for certain issuers. If current levels of market disruption and volatility continue or worsen, Duke Energy Ohio may be forced to meet its other liquidity needs by further drawing upon contractually committed lending agreements primarily provided by global banks, although there is no assurance that the commitments made by lenders under Duke Energy's master credit facility will be available if needed due to the recent turmoil throughout the financial services industry. This could require Duke Energy Ohio to seek other funding sources. However, under such extreme market conditions, there can be no assurance other funding sources would be available or sufficient.

Additional risks and uncertainties not currently known to Duke Energy Ohio or that Duke Energy Ohio currently deems to be immaterial also may adversely affect Duke Energy Ohio's financial condition and/or results of operations.

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PART II

**Item 6. Exhibits****(a) Exhibits**

Exhibits filed or furnished herewith are designated by an asterisk (\*).

**Exhibit  
Number**

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*31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The total amount of securities of the registrant or its subsidiaries authorized under any instrument with respect to long-term debt not filed as an exhibit does not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. The registrant agrees, upon request of the Securities and Exchange Commission, to furnish copies of any or all of such instruments to it.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DUKE ENERGY OHIO, INC.

Date: November 13, 2008

/s/ DAVID L. HAUSER

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David L. Hauser  
Group Executive and  
Chief Financial Officer

Date: November 13, 2008

/s/ STEVEN K. YOUNG

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Steven K. Young  
Senior Vice President and  
Controller

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James E. Rogers, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting

Date: November 13, 2008

/s/ JAMES E. ROGERS

James E. Rogers  
Chief Executive Officer

**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, David L. Hauser, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2008

/s/ DAVID L. HAUSER  
\_\_\_\_\_  
David L. Hauser  
Group Executive and  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending September 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Rogers, Chief Executive Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

*/s/* JAMES E. ROGERS

---

James E. Rogers  
Chief Executive Officer  
November 13, 2008



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending September 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David L. Hauser, Group Executive and Chief Financial Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

          /s/ DAVID L. HAUSER          

David L. Hauser  
Group Executive and Chief Financial Officer  
November 13, 2008

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## FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended June 30, 2008 Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-1232

### DUKE ENERGY OHIO, INC.

(Exact Name of Registrant as Specified in its Charter)

Ohio  
(State or Other Jurisdiction of Incorporation)

31-0240030  
(IRS Employer Identification No.)

139 East Fourth Street  
Cincinnati, OH  
(Address of Principal Executive Offices)

45202  
(Zip code)

704-594-6200  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer   
Non-accelerated filer   
(Do not check if a smaller reporting company)

Accelerated filer   
Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).  
Yes  No

All of the registrant's common stock is indirectly owned by Duke Energy Corporation (File No. 1-32853) which is a reporting company under the Securities Exchange Act of 1934, as amended.

The registrant meets the conditions set forth in General Instructions H(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format specified in General Instructions H(2) of Form 10-Q.

DUKE ENERGY OHIO, INC.

**FORM 10-Q FOR THE QUARTER ENDED  
JUNE 30, 2008**

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This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management's beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "plan," "project," "predict," "will," "potential," "forecast," "target," and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- State and federal legislative and regulatory initiatives, including costs of compliance with existing and future environmental requirements;
- State and federal legislative and regulatory initiatives and rulings that affect cost and investment recovery or have an impact on rate structures;
- Costs and effects of legal and administrative proceedings, settlements, investigations and claims;
- Industrial, commercial and residential growth in Duke Energy Ohio, Inc.'s (Duke Energy Ohio) service territories;
- Additional competition in electric markets and continued industry consolidation;
- The influence of weather and other natural phenomena on Duke Energy Ohio's operations, including the economic, operational and other effects of tornados, droughts and other natural phenomena;
- The timing and extent of changes in commodity prices and interest rates;
- Unscheduled generation outages, unusual maintenance or repairs and electric transmission system constraints;
- The performance of electric generation facilities;
- The results of financing efforts, including Duke Energy Ohio's ability to obtain financing on favorable terms, which can be affected by various factors, including Duke Energy Ohio's credit ratings and general economic conditions;
- Declines in the market prices of equity securities and resultant cash funding requirements of Duke Energy Ohio for Cinergy Corp.'s defined benefit pension plans;
- The level of credit worthiness of counterparties to Duke Energy Ohio's transactions;
- Employee workforce factors, including the potential inability to attract and retain key personnel;
- Growth in opportunities for Duke Energy Ohio's business units, including the timing and success of efforts to develop domestic power and other projects; and
- The effect of accounting pronouncements issued periodically by accounting standard-setting bodies.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Duke Energy Ohio has described. Duke Energy Ohio undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**  
**(In millions)**

**Item 1. Financial Statements.**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
<b>Operating Revenues</b>				
Non-regulated electric and other	\$454	\$422	\$ 846	\$ 768
Regulated electric	228	233	470	464
Regulated natural gas	113	108	470	447
Total operating revenues	795	763	1,786	1,679
<b>Operating Expenses</b>				
Fuel used in electric generation and purchased power	170	260	347	485
Cost of natural gas and coal sold	49	69	299	324
Operation, maintenance and other	184	182	366	367
Depreciation and amortization	100	95	199	188
Property and other taxes	62	62	135	135
Total operating expenses	565	668	1,346	1,499
<b>Gains (Losses) on Sales of Other Assets and Other, net</b>	33	—	46	(11)
<b>Operating Income</b>	263	95	486	169
<b>Other Income and Expenses, net</b>	6	8	15	17
<b>Interest Expense</b>	23	22	49	45
<b>Income Before Income Taxes</b>	246	81	452	141
<b>Income Tax Expense</b>	89	32	162	55
<b>Net Income</b>	\$157	\$ 49	\$ 290	\$ 86

See Notes to Unaudited Consolidated Financial Statements

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**  
**(In millions)**

	June 30, 2008	December 31, 2007
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 32	\$ 33
Receivables (net of allowance for doubtful accounts of \$4 at June 30, 2008 and \$3 at December 31, 2007)	263	334
Inventory	228	212
Unrealized gains on mark-to-market and hedging transactions	152	22
Other	56	94
<b>Total current assets</b>	<b>731</b>	<b>695</b>
<b>Investments and Other Assets</b>		
Restricted funds held in trust	60	62
Goodwill	2,325	2,325
Intangibles, net	514	551
Unrealized gains on mark-to-market and hedging transactions	95	17
Other	29	33
<b>Total investments and other assets</b>	<b>3,023</b>	<b>2,988</b>
<b>Property, Plant and Equipment</b>		
Cost	9,812	9,577
Less accumulated depreciation and amortization	2,213	2,097
<b>Net property, plant and equipment</b>	<b>7,599</b>	<b>7,480</b>
<b>Regulatory Assets and Deferred Debits</b>		
Deferred debt expense	23	23
Regulatory assets related to income taxes	97	90
Other	351	401
<b>Total regulatory assets and deferred debits</b>	<b>471</b>	<b>514</b>
<b>Total Assets</b>	<b>\$11,824</b>	<b>\$11,677</b>

See Notes to Unaudited Consolidated Financial Statements

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED BALANCE SHEETS—(Continued)**  
**(Unaudited)**  
(In millions, except share and per-share amounts)

	June 30, 2008	December 31, 2007
<b>LIABILITIES AND COMMON STOCKHOLDER'S EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 617	\$ 602
Notes payable	8	189
Taxes accrued	156	172
Interest accrued	23	24
Current maturities of long-term debt	6	126
Unrealized losses on mark-to-market and hedging transactions	109	24
Other	94	86
Total current liabilities	1,013	1,223
<b>Long-term Debt</b>	<b>1,807</b>	<b>1,810</b>
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes	1,492	1,436
Investment tax credits	15	16
Accrued pension and other post-retirement benefit costs	291	259
Unrealized losses on mark-to-market and hedging transactions	66	25
Asset retirement obligations	33	31
Other	282	343
Total deferred credits and other liabilities	2,179	2,110
<b>Commitments and Contingencies</b>		
<b>Common Stockholder's Equity</b>		
Common stock, \$8.50 par value; 120,000,000 shares authorized and 89,663,086 shares outstanding at June 30, 2008 and December 31, 2007	762	762
Additional paid-in capital	5,570	5,570
Retained earnings	517	227
Accumulated other comprehensive loss	(24)	(25)
Total common stockholder's equity	6,825	6,534
<b>Total Liabilities and Common Stockholder's Equity</b>	<b>\$11,824</b>	<b>\$11,677</b>

See Notes to Unaudited Consolidated Financial Statements

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
**(In millions)**

	Six Months Ended June 30,	
	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 290	\$ 86
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	201	188
(Gains) losses on sales of other assets and other, net	(46)	11
Deferred income taxes	47	(18)
Regulatory asset/liability amortization	11	13
Accrued pension and other postretirement benefit costs	14	21
Contribution to company-sponsored pension and other postretirement benefit plans	—	(83)
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	(153)	9
Receivables	94	92
Inventory	(4)	12
Other current assets	88	2
Increase (decrease) in:		
Accounts payable	37	51
Taxes accrued	(23)	(120)
Other current liabilities	7	(13)
Regulatory asset/liability deferrals	(14)	(23)
Other assets	34	84
Other liabilities	(44)	(4)
Net cash provided by operating activities	539	308
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Capital expenditures	(285)	(302)
Purchases of emission allowances	(8)	(14)
Sales of emission allowances	56	24
Change in restricted funds held in trust	3	15
Other	(1)	—
Net cash used in investing activities	(235)	(277)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Redemption of long-term debt	(124)	(3)
Notes payable to affiliate, net	(181)	53
Dividends to parent	—	(135)
Capital contribution from parent	—	29
Net cash used in financing activities	(305)	(56)
Net decrease in cash and cash equivalents	(1)	(25)
<b>Cash and cash equivalents at beginning of period</b>	<b>33</b>	<b>45</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 32</b>	<b>\$ 20</b>
<b>Supplemental Disclosures</b>		
<b>Significant non-cash transactions:</b>		
Purchase accounting adjustments	\$ —	\$ (8)
Accrued capital expenditures	\$ 31	\$ 26

See Notes to Unaudited Consolidated Financial Statements



DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME**  
**(Unaudited)**  
**(In millions)**

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)		Total
				Net Gains (Losses) on Cash Flow Hedges	SFAS No. 158 Adjustment	
<b>Balance at December 31, 2006</b>	<b>\$762</b>	<b>\$5,601</b>	<b>\$ 55</b>	<b>\$(36)</b>	<b>\$(2)</b>	<b>\$6,380</b>
Net income	—	—	86	—	—	86
Other comprehensive income						
Cash flow hedges <sup>(a)</sup>	—	—	—	8	—	8
Total comprehensive income						94
Capital contribution from parent	—	29	—	—	—	29
Push-down accounting adjustments	—	(8)	—	—	—	(8)
Adoption of SFAS No. 158—measurement date provision	—	—	(3)	—	(2)	(5)
Dividend to parent	—	(46)	(89)	—	—	(135)
<b>Balance at June 30, 2007</b>	<b>\$762</b>	<b>\$5,576</b>	<b>\$ 49</b>	<b>\$(28)</b>	<b>\$(4)</b>	<b>\$6,355</b>
<b>Balance at December 31, 2007</b>	<b>\$762</b>	<b>\$5,570</b>	<b>\$227</b>	<b>\$(32)</b>	<b>\$ 7</b>	<b>\$6,534</b>
Net income	—	—	290	—	—	290
Other comprehensive income						
Cash flow hedges <sup>(b)</sup>	—	—	—	1	—	1
Total comprehensive income						291
<b>Balance at June 30, 2008</b>	<b>\$762</b>	<b>\$5,570</b>	<b>\$517</b>	<b>\$(31)</b>	<b>\$ 7</b>	<b>\$6,825</b>

(a) Net of \$4 tax expense in 2007.

(b) Net of \$1 tax expense in 2008.

See Notes to Unaudited Consolidated Financial Statements

DUKE ENERGY OHIO, INC.  
**Notes To Unaudited Consolidated Financial Statements**

**1. Basis of Presentation**

**Nature of Operations and Basis of Consolidation.** Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through its wholly-owned subsidiary, Duke Energy Kentucky, Inc. (Duke Energy Kentucky), in nearby areas of Kentucky, as well as unregulated electric generation in parts of Ohio, Illinois, Indiana and Pennsylvania. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Except where separately noted, references to Duke Energy Ohio herein relate to the consolidated operations of Duke Energy Ohio, including its wholly-owned subsidiary Duke Energy Kentucky. These Unaudited Consolidated Financial Statements include, after eliminating intercompany transactions and balances, the accounts of Duke Energy Ohio and all majority-owned subsidiaries where Duke Energy Ohio has control, as well as Duke Energy Ohio's proportionate share of certain generation and transmission facilities in Ohio, Kentucky and Indiana.

These Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles (GAAP) in the United States of America (U.S.) for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, these Consolidated Financial Statements do not include all of the information and footnotes required by GAAP for annual financial statements. Because the interim Consolidated Financial Statements and Notes do not include all of the information and footnotes required by GAAP for annual financial statements, the Consolidated Financial Statements and other information included in this quarterly report should be read in conjunction with the Consolidated Financial Statements and Notes in Duke Energy Ohio's Form 10-K for the year ended December 31, 2007.

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

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

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

**Netting of Cash Collateral and Derivative Assets and Liabilities Under Master Netting Arrangements.** On January 1, 2008, Duke Energy Ohio adopted FSP No. FIN 39-1. In accordance with FSP No. FIN 39-1, Duke Energy Ohio offsets fair value amounts (or amounts that approximate fair value) recognized on its Consolidated Balance Sheets related to cash collateral amounts receivable or payable against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting agreement. Prior to the adoption of FSP No. FIN 39-1, Duke Energy Ohio offset the fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting agreement in accordance with FIN 39, "Offsetting of Amounts Related to Certain Contracts," but presented cash collateral on a gross basis within the Consolidated Balance Sheets. At June 30, 2008 and December 31, 2007, Duke Energy Ohio had receivables related to the right to reclaim cash collateral of approximately \$16 million and \$5 million, respectively, and had payables related to obligations to return cash collateral of approximately \$82 million and an insignificant amount, respectively, that have been offset against net derivative positions in the Consolidated Balance Sheets. Duke Energy Ohio had insignificant cash collateral receivables and payables under master netting arrangements that have not been offset against net derivative positions at June 30, 2008 or December 31, 2007.

**Unbilled Revenue.** Revenues on sales of electricity and gas are recognized when either the service is provided or the product is delivered. Unbilled revenues are estimated by applying an average revenue per kilowatt hour or per thousand cubic feet (Mcf) for all customer classes to the number of estimated kilowatt hours or Mcf's delivered but not billed. The amount of unbilled revenues can vary sig-

## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

nificantly period to period as a result of factors including seasonality, weather, customer usage patterns and customer mix. Unbilled revenues, which are included in Receivables on the Consolidated Balance Sheets, primarily relate to wholesale sales at Commercial Power and were approximately \$57 million and \$38 million at June 30, 2008 and December 31, 2007, respectively. Additionally, receivables for unbilled revenues of approximately \$104 million and \$145 million at June 30, 2008 and December 31, 2007, respectively, related to retail accounts receivable at Duke Energy Ohio and Duke Energy Kentucky are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables). Duke Energy Ohio and Duke Energy Kentucky sell, on a revolving basis, nearly all of their retail accounts receivable and related collections to Cinergy Receivables, a bankruptcy remote, special purpose entity that is a wholly-owned limited liability company of Cinergy. The securitization transaction was structured to meet the criteria for sale treatment under Statement of Financial Accounting Standards (SFAS) No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125," and, accordingly, Cinergy does not consolidate Cinergy Receivables and the transfers of receivables are accounted for as sales.

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

**2. Business Segments**

Duke Energy Ohio operates the following business segments, which are considered reportable business segments under SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information": Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these business segments in deciding how to allocate resources and evaluate performance. There is no aggregation within Duke Energy Ohio's reportable business segments.

Franchised Electric and Gas, which conducts operations primarily through Duke Energy Ohio and its wholly-owned subsidiary Duke Energy Kentucky, generates, transmits, distributes and sells electricity in southwestern Ohio and northern Kentucky, as well as transports and sells natural gas in southwestern Ohio and northern Kentucky.

Commercial Power owns, operates and manages non-regulated power plants and engages in the wholesale marketing and procurement of electric power, fuel and emission allowances related to these plants as well as other contractual positions. Commercial Power's generation asset fleet consists of Duke Energy Ohio's non-regulated generation in Ohio and five Midwestern gas-fired non-regulated generation assets that were transferred from Duke Energy in connection with Duke Energy's merger with Cinergy in April 2006. Commercial Power's assets comprise approximately 7,600 megawatts of power generation primarily located in the Midwestern U.S. The asset portfolio has a diversified fuel mix with baseload and mid-merit coal-fired units as well as combined cycle and peaking natural gas-fired units. Most of the generation asset output in Ohio has been contracted through the rate stabilization plan (RSP) (see Note 10).

The remainder of Duke Energy Ohio's operations is presented as Other. While it is not considered a business segment, Other primarily includes certain allocated governance costs (see Note 8).

Duke Energy Ohio's reportable segments offer different products and services and are managed separately as business units. Accounting policies for Duke Energy Ohio's segments are the same as those described in the Notes to the Consolidated Financial Statements in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2007. Management evaluates segment performance based on earnings before interest and taxes from continuing operations (EBIT). On a segment basis, EBIT excludes discontinued operations and represents all profits from continuing operations (both operating and non-operating and excluding corporate governance costs) before deducting interest and taxes.

Cash, cash equivalents, and short-term investments, if any, are managed centrally by Duke Energy, so the interest and dividend income on those balances are excluded from segment EBIT. Transactions between reportable segments, if any, are included in segment EBIT.

DUKE ENERGY OHIO, INC.  
**Notes To Unaudited Consolidated Financial Statements—(Continued)**

**Business Segment Data**

	Unaffiliated Revenues <sup>(a)</sup>	Segment EBIT/ Consolidated Income Before Income Taxes  (in millions)	Depreciation and Amortization
<b>Three Months Ended June 30, 2008</b>			
Franchised Electric and Gas	\$ 341	\$ 41	\$ 58
Commercial Power	454	242	42
Total reportable segments	795	283	100
Other	—	(19)	—
Interest expense	—	(23)	—
Interest income and other	—	5	—
Total consolidated	\$ 795	\$246	\$100
<b>Three Months Ended June 30, 2007</b>			
Franchised Electric and Gas	\$ 341	\$ 50	\$ 54
Commercial Power	422	67	41
Total reportable segment	763	117	95
Other	—	(21)	—
Interest expense	—	(22)	—
Interest income and other	—	7	—
Total consolidated	\$ 763	\$ 81	\$ 95
<b>Six Months Ended June 30, 2008</b>			
Franchised Electric and Gas	\$ 940	\$138	\$116
Commercial Power	846	387	83
Total reportable segment	1,786	525	199
Other	—	(37)	—
Interest expense	—	(49)	—
Interest income and other	—	13	—
Total consolidated	\$1,786	\$452	\$199
<b>Six Months Ended June 30, 2007</b>			
Franchised Electric and Gas	\$ 911	\$129	\$107
Commercial Power	768	80	81
Total reportable segment	1,679	209	188
Other	—	(39)	—
Interest expense	—	(45)	—
Interest income and other	—	16	—
Total consolidated	\$1,679	\$141	\$188

(a) There were no intersegment revenues for the three and six months ended June 30, 2008 and 2007.

Duke Energy Ohio's chief operating decision maker does not regularly review any asset information at a business segment level in deciding how to allocate resources.

DUKE ENERGY OHIO, INC.  
**Notes To Unaudited Consolidated Financial Statements—(Continued)**

**Segment Assets**

	June 30, 2008	December 31, 2007
	(in millions)	
Franchised Electric and Gas	\$ 5,463	\$ 5,530
Commercial Power	6,361	6,147
Total reportable segments/consolidated assets	<u>\$11,824</u>	<u>\$11,677</u>

**3. Sales of Other Assets**

For the three months ended June 30, 2008, the sale of other assets resulted in approximately \$44 million in proceeds and net pre-tax gains of approximately \$33 million recorded in Gains (Losses) on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. For the six months ended June 30, 2008, the sale of other assets resulted in approximately \$60 million in proceeds and net pre-tax gains of approximately \$46 million recorded in Gains (Losses) on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These amounts primarily relate to Commercial Power's sales of zero cost basis emission allowances.

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

**4. Inventory**

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

	June 30, 2008	December 31, 2007
	(in millions)	
Coal held for electric generation	\$ 97	\$ 77
Materials and supplies	69	66
Natural gas	62	69
Total inventory	<u>\$228</u>	<u>\$212</u>

**5. Debt and Credit Facilities**

**Money Pool Arrangement.** Duke Energy Ohio and its wholly-owned subsidiary, Duke Energy Kentucky, receive support for their short-term borrowing needs through their participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. The money pool is structured such that Duke Energy Ohio and Duke Energy Kentucky separately manage their cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables of Duke Energy Ohio and Duke Energy Kentucky, as each of these entities independently participate in the money pool. As of June 30, 2008, Duke Energy Ohio had net receivables of approximately \$6 million, which are classified within Receivables in the accompanying Consolidated Balance Sheets, and Duke Energy Kentucky had net borrowings of approximately \$8 million, which are classified within Notes payable in the accompanying Consolidated Balance Sheets. As of December 31, 2007, Duke Energy Ohio and Duke Energy Kentucky had combined net borrowings of approximately \$189 million, which are classified within Notes payable in the accompanying Consolidated Balance Sheets. During the six months ended June 30, 2008 and 2007, the \$181 million decrease and \$53 million increase in the money pool borrowings, respectively, are reflected in Notes payable to affiliate, net within Net cash used in financing activities on the Consolidated Statements of Cash Flows. During the six months ended June 30, 2008, the \$6 million increase in the money pool receivables is reflected in Other within Net cash used in investing activities on the Consolidated Statements of Cash Flows.

## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

At June 30, 2008 and December 31, 2007, approximately \$96 million of certain pollution control bonds, which are short-term obligations by nature, are classified as Long-term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio's intent and ability to utilize such borrowings as long-term financing. Duke Energy's credit facilities with non-cancelable terms in excess of one year as of the balance sheet date give Duke Energy Ohio the ability to refinance these short-term obligations on a long-term basis.

**Available Credit Facilities and Restrictive Debt Covenants.** In March 2008, Duke Energy entered into an amendment to its \$2.65 billion master credit facility whereby the borrowing capacity was increased by \$550 million to \$3.2 billion. Pursuant to the amendment, the additional credit capacity of \$550 million specifically increased the borrowing sub limit for Duke Energy Ohio (excluding Duke Energy Kentucky) by \$250 million to \$750 million. In May 2008, Duke Energy reallocated the borrowing sub limits under the master credit facility and reduced Duke Energy Ohio's borrowing sub limit by \$50 million to \$700 million. The borrowing sub limit of Duke Energy Kentucky did not change.

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

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

**6. Employee Benefit Obligations**

Duke Energy Ohio participates in pension and other post-retirement benefit plans sponsored by Cinergy. Duke Energy Ohio's net periodic benefit costs as allocated by Cinergy were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(in millions)			
Qualified Pension Benefits <sup>(a)</sup>	\$4	\$3	\$6	\$7
Other Post-retirement Benefits <sup>(b)</sup>	\$2	\$3	\$5	\$5

(a) These amounts exclude approximately \$1 million and \$4 million for the three months ended June 30, 2008 and 2007, respectively, and approximately \$2 million and \$7 million for the six months ended June 30, 2008 and 2007, respectively, of regulatory asset amortization resulting from purchase accounting.

(b) These amounts exclude approximately \$1 million for each of the three months ended June 30, 2008 and 2007, respectively, and approximately \$1 million and \$2 million for the six months ended June 30, 2008 and 2007, respectively, of regulatory asset amortization resulting from purchase accounting.

Duke Energy's policy is to fund amounts for its U.S. qualified pension plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. Duke Energy did not require Duke Energy Ohio to make contributions to the legacy Cinergy qualified or non-qualified pension plans during the three and six months ended June 30, 2008 and Duke Energy does not anticipate requiring Duke Energy Ohio to make contributions to the legacy Cinergy qualified or non-qualified pension plans during the remainder of 2008. During the six months ended June 30, 2007, approximately \$350 million of qualified pension plan contributions were made to the legacy Cinergy qualified pension plans, of which approximately \$83 million represents contributions made by Duke Energy Ohio. Additionally, Duke Energy Ohio participates in Cinergy sponsored employee savings plans that cover substantially all Duke Energy Ohio employees. Duke Energy Ohio made its proportionate share of pre-tax employer matching contributions of approximately \$2 million and \$3 million during the three and six months ended June 30, 2008, respectively. Duke Energy Ohio made its proportionate share of pre-tax employer matching contributions of approximately \$1 million and \$2 million during the three and six months ended June 30, 2007, respectively.

## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)****7. Goodwill and Intangibles****Carrying Amount of Goodwill**

The carrying amount of goodwill as of both June 30, 2008 and December 31, 2007 was \$2,325 million, of which \$1,188 million was reflected in the Commercial Power segment and \$1,137 million was reflected in the Franchised Electric and Gas segment.

**Intangible Assets**

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

	June 30, 2008	December 31, 2007
	(in millions)	
Emission allowances	\$ 338	\$365
Gas, coal, and power contracts	271	271
Other	9	9
Total gross carrying amount	<u>618</u>	<u>645</u>
Accumulated amortization—gas, coal, and power contracts	(99)	(89)
Accumulated amortization—other	(5)	(5)
Total accumulated amortization	<u>(104)</u>	<u>(94)</u>
Total intangible assets, net	<u>\$ 514</u>	<u>\$551</u>

Emission allowances in the table above include emission allowances which were recorded at fair value on the date of Duke Energy's merger with Cinergy and emission allowances purchased by Duke Energy Ohio. Additionally, Duke Energy Ohio is allocated certain zero cost emission allowances on an annual basis. The carrying value of emission allowances sold or consumed during the three months ended June 30, 2008 and 2007 were \$26 million and \$33 million, respectively. The carrying value of emission allowances sold or consumed during the six months ended June 30, 2008 and 2007 were \$42 million and \$100 million, respectively. See Note 3 for discussion of gains and losses on sales of emission allowances at Commercial Power during the three and six months ended June 30, 2008 and 2007.

Amortization expense for gas, coal and power contracts and other intangible assets for the three months ended June 30, 2008 and 2007 was approximately \$4 million and \$13 million, respectively. Amortization expense for gas, coal and power contracts and other intangible assets for the six months ended June 30, 2008 and 2007 was approximately \$10 million and \$25 million, respectively.

On July 11, 2008, the U.S. Court of Appeals for the District of Columbia issued a decision vacating the Clean Air Interstate Rule (CAIR). See Note 11 for a discussion of the decision. Duke Energy Ohio is currently evaluating the effect of the decision on the carrying value of emission allowances held by its non-regulated businesses. Based on current market prices for sulfur dioxide (SO<sub>2</sub>) allowances, and the uncertainty associated with future federal requirements to reduce emissions, management believes that it is possible that Duke Energy Ohio may incur an impairment of the carrying value of emission allowances held by Commercial Power of up to \$100 million in the third quarter of 2008. This current estimate is based on total allowances held by Commercial Power as of June 30, 2008 compared to amounts projected to be utilized in operations through 2037.

**Intangible Liabilities**

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

## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

and \$14 million, respectively, to income related to these intangible liabilities. Intangible liabilities are classified as Other Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

**8. Related Party Transactions**

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

	June 30, 2008	December 31, 2007
	(in millions)	
Current assets due from affiliated companies <sup>(a)(b)</sup>	\$ 44	\$ 58
Non-current assets due from affiliated companies <sup>(c)</sup>	\$ 1	\$ —
Current liabilities due to affiliated companies <sup>(a)(d)</sup>	\$ (308)	\$ (266)
Net deferred tax liabilities to Duke Energy <sup>(a)(e)</sup>	\$(1,457)	\$(1,401)

- (a) Balances exclude assets or liabilities associated with accrued pension and other post-retirement benefits, Cinergy Receivables and money pool arrangements, all of which are discussed below.
- (b) Of the balance at June 30, 2008, approximately \$36 million is classified as Receivables, approximately \$7 million is classified as Other within Current Assets, and approximately \$1 million is classified as Unrealized gains on mark-to-market and hedging transactions within Current Assets on the Consolidated Balance Sheets. The balance at December 31, 2007 is classified as Receivables on the Consolidated Balance Sheets.
- (c) The balance at June 30, 2008 is classified as Unrealized gains on mark-to-market and hedging transactions within Investments and Other Assets on the Consolidated Balance Sheets.
- (d) Of the balance at June 30, 2008, approximately \$(297) million is classified as Accounts payable and approximately \$(11) million is classified as Taxes accrued on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately \$(256) million is classified as Accounts payable and approximately \$(10) million is classified as Taxes accrued on the Consolidated Balance Sheets.
- (e) Of the balance at June 30, 2008, approximately \$(1,465) million is classified as Deferred income taxes, approximately \$(15) million is classified as Investment tax credits, and approximately \$23 million is classified as Other within Current Assets on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately \$(1,409) million is classified as Deferred income taxes, approximately \$(16) million is classified as Investment tax credits, and approximately \$24 million is classified as Other within Current Assets on the Consolidated Balance Sheets.

Duke Energy Ohio is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy and a consolidated affiliate of Cinergy. Corporate governance and other shared services costs are primarily allocations of corporate costs, such as human resources, legal and accounting fees, as well as other third party costs. The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Ohio, which are recorded in Operation, maintenance and other within Operating Expenses on the Consolidated Statements of Operations were approximately \$59 million and \$60 million for the three months ended June 30, 2008 and 2007, respectively, and approximately \$120 million and \$116 million for the six months ended June 30, 2008 and 2007, respectively.

Duke Energy Ohio incurs expenses related to its property insurance coverage through Bison Insurance Company Limited, Duke Energy's wholly-owned captive insurance subsidiary. These expenses, which are recorded in Operation, maintenance and other within Operating Expenses on the Consolidated Statements of Operations, were approximately \$3 million and \$10 million for the three months ended June 30, 2008 and 2007, respectively, and approximately \$7 million and \$14 million for the six months ended June 30, 2008 and 2007, respectively. Additionally, Duke Energy Ohio records income associated with the rental of office space to a consolidated affiliate of Duke Energy. Rental income was approximately \$3 million for each of the three months ended June 30, 2008 and 2007, respectively, and approximately \$5 million for each of the six months ended June 30, 2008 and 2007, respectively.

Duke Energy Ohio participates in Cinergy's qualified pension plan, non-qualified pension plan and other post-retirement benefit plans and is allocated its proportionate share of expenses associated with these plans (see Note 6). Additionally, Duke Energy Ohio has been allocated accrued pension and other post-retirement benefit obligations from Cinergy of approximately \$300 million at June 30, 2008 and approximately \$266 million at December 31, 2007. These amounts have been classified in the Consolidated Balance Sheets as follows:

	June 30, 2008	December 31, 2007
	(in millions)	
Other current liabilities	\$ 5	\$ 5
Accrued pension and other post-retirement benefit costs	\$291	\$259
Other deferred credits and other liabilities	\$ 4	\$ 2



## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

As discussed in Note 1, certain trade receivables have been sold by Duke Energy Ohio to Cinergy Receivables. The proceeds obtained from the sales of receivables are largely cash, but do include a subordinated note from Cinergy Receivables for a portion of the purchase price. This subordinated note is classified as Receivables in the Consolidated Balance Sheets and was approximately \$107 million and \$189 million, as of June 30, 2008 and December 31, 2007, respectively. The interest income associated with the subordinated note, which is recorded in Other Income and Expenses, net on the Consolidated Statements of Operations, was approximately \$4 million and \$5 million for three months ended June 30, 2008 and 2007, respectively, and approximately \$12 million and \$13 million for the six months ended June 30, 2008 and 2007, respectively.

During the second quarter of 2007, Duke Energy Ohio received a \$29 million capital contribution from its parent, Cinergy. Additionally, during the second quarter of 2007, Duke Energy Ohio paid dividends to its parent, Cinergy, of \$135 million.

As discussed further in Note 5, Duke Energy Ohio participates in a money pool arrangement with Duke Energy and other Duke Energy subsidiaries. The expenses associated with money pool activity, which are recorded in Interest Expense on the Consolidated Statements of Operations, were an insignificant amount and approximately \$1 million for the three months ended June 30, 2008 and 2007, respectively, and approximately \$1 million and \$3 million for the six months ended June 30, 2008 and 2007, respectively.

**9. Risk Management Instruments**

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

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

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

	June 30, 2008	December 31, 2007
	(in millions)	
Hedging	\$ (28)	\$(23)
Undesignated	<u>166</u>	<u>7</u>
Total	<u>\$138</u>	<u>\$(16)</u>

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

The \$159 million increase in the undesignated derivative portfolio fair value is due primarily to unrealized mark-to-market gains within Commercial Power, primarily as a result of higher coal prices.

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

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

See Note 12 for additional information related to the fair value of Duke Energy Ohio's derivative instruments.

DUKE ENERGY OHIO, INC.  
**Notes To Unaudited Consolidated Financial Statements—(Continued)**

## 10. Regulatory Matters

### Regulatory Merger Approvals

On April 3, 2006, the merger between Duke Energy and Cinergy was consummated to create a newly formed company, Duke Energy Holding Corp. (subsequently renamed Duke Energy Corporation). As a condition to the merger approval, the PUCO, and the Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Ohio and Kentucky, respectively. The commissions also required Duke Energy Ohio and Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- The PUCO required that Duke Energy Ohio provide (i) a rate reduction of approximately \$15 million for one year to facilitate economic development in a time of increasing rates and market prices and (ii) a reduction of approximately \$21 million to its gas and electric consumers in Ohio for one year, with both credits beginning January 1, 2006. During the first quarter of 2007, Duke Energy Ohio completed its merger related rate reductions and filed a report with the PUCO to terminate the merger credit riders. Approximately \$2 million of the rate reductions was passed through to customers during the six months ended June 30, 2007.
- The KPSC required that Duke Energy Kentucky provide \$8 million in rate reductions to its customers over five years, ending when new rates are established in the next rate case after January 1, 2008. Approximately \$1 million of the rate reduction was passed through to customers during the three and six months ended June 30, 2008, respectively. Approximately less than \$1 million and \$1 million of the rate reduction was passed through to customers during the three and six months ended June 30, 2007, respectively.
- The FERC approved the merger without conditions.

### Franchised Electric and Gas

**Rate Related Information.** The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. The PUCO approves rates and market prices for retail gas and electric service within the state of Ohio, except that non-regulated sellers of gas and electric generation also are allowed to operate in Ohio (see "Commercial Power" below). The FERC approves rates for electric sales to wholesale customers served under cost-based rates.

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

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

On February 15, 2008, Duke Energy Ohio filed a notice of appeal with the Ohio Supreme Court challenging a portion of the PUCO's decision on remand regarding Duke Energy Ohio's RSP. The October 2007 order permits non-residential customers to avoid certain charges associated with the costs of Duke Energy Ohio standing ready to serve such customers if they return after being served by another supplier. Duke Energy Ohio believes the PUCO exceeded its authority in modifying the charges that may be avoided, resulting in

## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

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

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

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

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

## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

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

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

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

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

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

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

**Other Matters**

**Ohio Riser Leak Investigation.** In April 2005, the PUCO issued an order opening a statewide investigation into riser leaks in gas pipeline systems throughout Ohio. The investigation followed four explosions since 2000 caused by gas riser leaks, including an April 2000 explosion in Duke Energy Ohio's service area. In November 2006, the PUCO Staff released the expert report, which concluded that certain types of risers are prone to leaks under various conditions, including over-tightening during initial installation. The PUCO Staff

## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

recommended that natural gas companies continue to monitor the situation and study the cause of any further riser leaks to determine whether further remedial action is warranted. Duke Energy Ohio has approximately 87,000 of these risers on its distribution system. If the PUCO orders natural gas companies to replace all of these risers, Duke Energy Ohio estimates a replacement cost of approximately \$40 million. As part of the rate case filed in July 2007 (see "Duke Energy Ohio Gas Rate Case" above), Duke Energy Ohio requested approval from the PUCO to accelerate its riser replacement program. The riser replacement program is contained in the settlement reached with all interveners and will be completed at the end of 2012.

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

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

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

**Midwest ISO's Establishment of an Ancillary Services Market.** On February 25, 2008, the FERC conditionally accepted the Midwest ISO proposal to implement a day-ahead and real-time ancillary services market (ASM), including a scarcity pricing proposal. By approving the ASM proposal, the FERC essentially approved the transfer and consolidation of Balancing Authority for the entire Midwest ISO area. This will allow the Midwest ISO to determine operating reserve requirements and procure operating reserves from all qualified resources from an organized market, in place of the current system of local management and procurement of reserves by the 24 Balancing Authorities. The Midwest ISO has delayed the ASM launch date until September 9, 2008. At this time, Duke Energy Ohio does not believe the establishment of the Midwest Ancillary Services Market will have a material impact on its consolidated results of operations, cash flows or financial position.

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

## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)****Commercial Power**

Reported results for Commercial Power are subject to volatility due to the over- or under-collection of certain costs, including fuel and purchased power, since Commercial Power is not subject to regulatory accounting pursuant to SFAS No. 71. In addition, Commercial Power could be impacted by certain of the regulatory matters discussed above, including the Duke Energy Ohio electric rate filings.

**11. Commitments and Contingencies****Environmental**

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

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

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

**Clean Air Interstate Rule (CAIR).** The EPA finalized its CAIR in May 2005. The CAIR was to have limited total annual and summer-time nitrogen oxides (NO<sub>x</sub>) emissions and annual SO<sub>2</sub> emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 was to begin in 2009 for NO<sub>x</sub> and in 2010 for SO<sub>2</sub>. Phase 2 was to begin in 2015 for both NO<sub>x</sub> and SO<sub>2</sub>. On March 25, 2008, the U.S. Court of Appeals for the District of Columbia (D.C. Circuit) heard oral argument in a case involving multiple challenges to the CAIR. Nearly all aspects of the rule were challenged, but Duke Energy challenged only the portions pertaining to SO<sub>2</sub> allowance allocations. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA has until August 25, 2008 to appeal the decision. The D.C. Circuit's decision creates uncertainty regarding future NO<sub>x</sub> and SO<sub>2</sub> emission reductions requirements and their timing. Although as a result of the decision there may be a delay in the timing of federal requirements to reduce emissions, it is expected that electric sector emission reductions at least as stringent as those imposed by CAIR will be required in the near future, through new federal rules and/or individual state requirements. CAIR remains in effect until the Court issues its mandate, which will not be before the period for petitions for rehearing runs. Duke Energy Ohio's plan had been to spend approximately \$150 million between 2008 and 2012 to comply with Phase 1 of CAIR at plants that Duke Energy Ohio owns or partially owns but does not operate. It has not been determined how the court's decision will affect these planned expenditures. Duke Energy Ohio did not expect to incur any significant costs for complying with Phase 2 of CAIR. Duke Energy Ohio receives partial recovery of depreciation and financing costs related to environmental compliance projects for 2005-2008 through its RSP (see Note 10).

## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

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

**Clean Air Mercury Rule (CAMR).** The EPA finalized its CAMR in May 2005. The CAMR was to have limited total annual mercury emissions from coal-fired power plants across the U.S. through a two-phased cap-and-trade program beginning in 2010. On February 8, 2008, the D.C. Circuit issued its opinion in *New Jersey v. EPA*, No. 05-1097 vacating the CAMR. Requests for rehearing were denied. Parties have until August 18, 2008 to request U.S. Supreme Court review of the D.C. Circuit's decision. The D.C. Circuit's decision creates uncertainty regarding future mercury emission reduction requirements and their timing, but makes it fairly certain that there will be a delay in the implementation of federal mercury requirements for existing coal-fired power plants. At this point, Duke Energy Ohio is unable to estimate the costs to comply with any future mercury regulations that might result from the D.C. Circuit's decision.

**Coal Combustion Product (CCP) Management.** Duke Energy Ohio currently estimates that it will spend approximately \$95 million over the period 2008-2012 to install synthetic caps and liners at existing and new CCP landfills and to convert CCP handling systems from wet to dry systems.

**Zimmer Generating Station Clean Air Act Notice of Violation/Finding of Violation.** On March 10, 2008, the EPA issued a Clean Air Act Notice of Violation/Finding of Violation (NOV/FOV) asserting noncompliance with SO<sub>2</sub> emission limits, opacity standards, and permitting requirements at Duke Energy Ohio's Zimmer Generating Station. The NOV/FOV also asserts that a Prevention of Significant Deterioration (PSD) permit should have been obtained for the installation in 2004 of a pollution control project in order to comply with the EPA's regional cap-and-trade program for NO<sub>x</sub> emissions. Duke Energy Ohio disputes the legal and factual basis for the NOV/FOV. Duke Energy Ohio is unable to predict at this time what, if any, remedies or potential penalties may result from the NOV/FOV.

**Extended Environmental Activities and Accruals.** Included in Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets were total accruals related to extended environmental-related activities of approximately \$8 million as of both June 30, 2008 and December 31, 2007, respectively. These accruals represent Duke Energy Ohio's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Duke Energy Ohio believes that completion or resolution of these matters will have no material impact on its consolidated results of operations, cash flows or financial position.

**Litigation**

**New Source Review (NSR).** In 1999-2000, the U.S. Department of Justice, acting on behalf of the EPA and joined by various citizen groups and states, filed a number of complaints and notices of violation against multiple utilities across the country for alleged violations of the NSR provisions of the Clean Air Act (CAA). Generally, the government alleges that projects performed at various coal-fired units were major modifications, as defined in the CAA, and that the utilities violated the CAA when they undertook those projects without obtaining permits and installing the best available emission controls for SO<sub>2</sub>, NO<sub>x</sub> and particulate matter. The complaints seek injunctive relief to require installation of pollution control technology on various allegedly violating generating units, and unspecified civil penalties in amounts of up to \$32,500 per day for each violation. Two of Duke Energy Ohio's plants have been subject to these allegations. Duke Energy Ohio asserts that there were no CAA violations because the applicable regulations do not require permitting in cases where the projects undertaken are "routine" or otherwise do not result in a net increase in emissions.

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

Duke Energy Ohio has been informed by Dayton Power and Light (DP&L) that in June 2000, the EPA issued a NOV to DP&L for alleged violations of CAA requirements at a station operated by DP&L and jointly-owned by DP&L, Columbus Southern Power Company

## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

(CSP), and Duke Energy Ohio. The NOV indicated the EPA may issue an order requiring compliance with the requirements of the Ohio SIP, or bring a civil action seeking injunctive relief and civil penalties of up to \$27,500 per day for each violation. In September 2004, Marilyn Wall and the Sierra Club brought a lawsuit against Duke Energy Ohio, DP&L and CSP for alleged violations of the CAA at this same generating station. Trial of this case was originally scheduled to commence in August 2008, however, the parties have reached an agreement in principle to settle this matter, subject to the execution of a definitive agreement, which is currently being negotiated, and court approval. The proposed settlement will not have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

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

**Carbon Dioxide (CO<sub>2</sub>) Litigation.** In July 2004, the states of Connecticut, New York, California, Iowa, New Jersey, Rhode Island, Vermont, Wisconsin and the City of New York brought a lawsuit in the U.S. District Court for the Southern District of New York against Cinergy, American Electric Power Company, Inc., American Electric Power Service Corporation, The Southern Company, Tennessee Valley Authority, and Xcel Energy Inc. A similar lawsuit was filed in the U.S. District Court for the Southern District of New York against the same companies by Open Space Institute, Inc., Open Space Conservancy, Inc., and The Audubon Society of New Hampshire. These lawsuits allege that the defendants' emissions of CO<sub>2</sub> from the combustion of fossil fuels at electric generating facilities contribute to global warming and amount to a public nuisance. The complaints also allege that the defendants could generate the same amount of electricity while emitting significantly less CO<sub>2</sub>. The plaintiffs are seeking an injunction requiring each defendant to cap its CO<sub>2</sub> emissions and then reduce them by a specified percentage each year for at least a decade. In September 2005, the District Court granted the defendants' motion to dismiss the lawsuit. The plaintiffs have appealed this ruling to the Second Circuit Court of Appeals. Oral arguments were held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

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

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

**Ohio Antitrust Lawsuit.** In January 2008, four plaintiffs, including individual, industrial and non-profit customers, filed a lawsuit against Duke Energy Ohio in federal court in the Southern District of Ohio. Plaintiffs allege that Duke Energy Ohio (then The Cincinnati Gas & Electric Company (CG&E)), conspired to provide inequitable and unfair price advantages for certain large business consumers by entering into non-public option agreements with such consumers in exchange for their withdrawal of challenges to Duke Energy Ohio's (then CG&E's) pending RSP, which was implemented in early 2005. Duke Energy Ohio denies the allegations made in the lawsuit. Following Duke Energy Ohio's filing of a motion to dismiss plaintiffs' claims, plaintiffs amended their complaint on May 30, 2008. Plaintiffs now contend that the contracts at issue were an illegal rebate which violate antitrust and RICO statutes. Defendants have again moved to



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**Notes To Unaudited Consolidated Financial Statements—(Continued)**

dismiss the claims. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

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

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

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

**Other Commitments and Contingencies**

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

**12. Fair Value of Financial Assets and Liabilities**

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

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

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

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

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

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

## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

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

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

Description	Total Fair Value Amounts at June 30, 2008			
	Level 1	Level 2	Level 3	
	(in millions)			
Derivative assets	\$329	\$111	\$—	\$218
Derivative liabilities	\$191	\$ —	\$ 2	\$189

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

**Rollforward of Level 3 Measurements**

	Derivatives (net) (in millions)
<b>Three Months Ended June 30, 2008</b>	
Balance at April 1, 2008	\$(25)
Total pre-tax realized or unrealized gains included in earnings:	
Revenue, non-regulated	68
Total pre-tax losses included in other comprehensive income	(6)
Net purchases, sales, issuances and settlements	(9)
Total gains included on balance sheet as regulatory asset or liability or as non-current liability	<u>1</u>
Balance at June 30, 2008	<u>\$ 29</u>
<b>Six Months Ended June 30, 2008</b>	
Balance at January 1, 2008	\$(22)
Total pre-tax realized or unrealized gains included in earnings:	
Revenue, non-regulated	77
Total pre-tax losses included in other comprehensive income	(9)
Net purchases, sales, issuances and settlements	<u>(17)</u>
Balance at June 30, 2008	<u>\$ 29</u>
Pre-tax amounts included in the Consolidated Statements of Operations related to Level 3 measurements outstanding at June 30, 2008:	
Revenue, non-regulated	<u>63</u>
Total	<u>\$ 63</u>

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

• **Commodity derivatives:** The pricing for commodity derivatives is primarily a calculated value which incorporates the forward price and is adjusted for liquidity (bid-ask spread), credit or non-performance risk (after reflecting credit enhancements such as collateral) and

## DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

discounted to present value. The primary difference between a Level 2 and a Level 3 measurement has to do with the level of activity in forward markets for the commodity. If the market is relatively inactive, the measurement is deemed to be a Level 3 measurement. Some commodity derivatives are NYMEX contracts, which Duke Energy Ohio classifies as Level 1 measurements.

**13. New Accounting Standards**

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

SFAS No. 157. Refer to Note 12 for a discussion of Duke Energy Ohio's adoption of SFAS No. 157.

SFAS No. 159. Refer to Note 12 for a discussion of Duke Energy Ohio's adoption of SFAS No. 159.

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

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

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

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

**14. Income Taxes and Other Taxes**

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

At June 30, 2008, Duke Energy Ohio has approximately \$46 million recorded for unrecognized tax benefits and no portion of the total unrecognized tax benefits, if recognized, would affect the effective tax rate. Additionally, at June 30, 2008, Duke Energy Ohio has approximately \$7 million of unrecognized tax benefits related to pre-merger tax positions that, if recognized prior to the adoption of SFAS No. 141R, would affect goodwill. It is reasonably possible that Duke Energy Ohio will reflect an approximate \$35 million reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

During the three and six months ended June 30, 2008, Duke Energy Ohio recognized net interest expense of approximately \$1 million and \$2 million, respectively, in the Consolidated Statements of Operations related to income taxes. At June 30, 2008, Duke Energy

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Ohio had approximately \$8 million of interest payable, which reflects all interest related to income taxes, and no amount has been accrued for the payment of penalties in the Consolidated Balance Sheets.

Duke Energy Ohio has the following tax years open:

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

The effective tax rate for the three months ended June 30, 2008 was approximately 35.9% as compared to the effective tax rate of 39.8% for the same period in 2007. The effective tax rate for the six months ended June 30, 2008 was approximately 35.8% as compared to the effective tax rate of 39.0% for the same period in 2007. The decrease in the effective tax rate for both the three and six months ended June 30, 2008 is due primarily to less of an effect to the effective tax rate calculation from permanent items in 2008 as compared to 2007 as a result of significantly higher pre-tax income in 2008.

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

	<u>Three Months Ended June 30, 2008</u>	<u>Three Months Ended June 30, 2007</u>	<u>Six Months Ended June 30, 2008</u>	<u>Six Months Ended June 30, 2007</u>
	(in millions)			
Excise Taxes	<u>\$29</u>	<u>\$27</u>	<u>\$68</u>	<u>\$66</u>

**15. Comprehensive Income and Total Comprehensive Income**

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

**Total Comprehensive Income (Loss)**

	<u>Three Months Ended June 30,</u>	
	<u>2008</u>	<u>2007</u>
	(in millions)	
<b>Net Income</b>	<u>\$157</u>	<u>\$49</u>
Other comprehensive (loss) income		
Cash flow hedges <sup>(a)</sup>	(1)	4
Other comprehensive (loss) income, net of tax	(1)	4
<b>Total Comprehensive Income</b>	<u>\$156</u>	<u>\$53</u>

(a) Cash flow hedges, net of an insignificant tax benefit and \$2 million tax expense for the three months ended June 30, 2008 and 2007, respectively.

**16. Subsequent Events**

For information on subsequent events related to goodwill and intangibles, regulatory matters and commitments and contingencies, see Notes 7, 10 and 11, respectively.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.****INTRODUCTION**

Management's Discussion and Analysis should be read in conjunction with the Consolidated Financial Statements.

Duke Energy Ohio, Inc. (Duke Energy Ohio) is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing.

**BASIS OF PRESENTATION**

The results of operations and variance discussion for Duke Energy Ohio is presented in a reduced disclosure format in accordance with General Instructions H(2) of Form 10-Q.

**DUKE ENERGY OHIO**

	Six Months Ended June 30,		
	2008	2007	Increase (Decrease)
	(in millions)		
Operating revenues	\$1,786	\$1,679	\$ 107
Operating expenses	1,346	1,499	(153)
Gains (losses) on sales of other assets and other, net	46	(11)	57
Operating income	486	169	317
Other income and expenses, net	15	17	(2)
Interest expense	49	45	4
Income before income taxes	452	141	311
Income tax expense	162	55	107
Net income	<u>\$ 290</u>	<u>\$ 86</u>	<u>\$ 204</u>

The \$204 million increase in Duke Energy Ohio's Net Income was primarily due to the following factors:

*Operating Revenues. The increase was primarily due to:*

- A \$60 million increase in net mark-to-market revenues on non-qualifying power and capacity hedge contracts, consisting of mark-to-market gains of \$11 million in 2008 compared to losses of \$49 million in 2007,
- A \$30 million increase in retail electric revenues primarily due to increased amortization of purchase accounting valuation liability of the rate stabilization plan,
- A \$16 million increase in regulated fuel revenues driven mainly by higher natural gas costs,
- An \$8 million increase due to higher PJM capacity revenues in 2008 compared to 2007, partially offset by lower generation volumes from the Midwest gas-fired generation assets,
- An \$8 million increase related to the Demand Side Management rider implemented in the third quarter of 2007,
- A \$5 million increase in wholesale revenues due to higher generation volumes in 2008 compared to 2007, and
- A \$4 million increase due to implementation of new gas rates in Ohio.

Partially offsetting these increases were:

- A \$27 million decrease in volumes of coal sales due to expiration of contracts, and
- A \$4 million decrease due to milder weather in 2008 compared to 2007.

*Operating Expenses. The decrease was primarily due to:*

- A \$100 million decrease in fuel expense due to mark-to-market gains on non-qualifying fuel hedge contracts of \$145 million in 2008 compared to gains of \$45 million in 2007,

## PART I

- A \$32 million decrease due primarily to lower sulfur dioxide emission allowance expenses due to installation of flue gas desulfurization equipment,
- A \$26 million decrease in expenses associated with coal sales due to expiration of contracts,
- A \$13 million decrease in retail fuel and purchased power expenses due to realized gains from the settlement of certain fuel contracts, and
- A \$7 million decrease in fuel and operating expenses for the Midwest gas-fired generation assets primarily due to lower generation volumes in 2008 compared to 2007.

Partially offsetting these decreases were:

- An \$18 million increase in regulated fuel expense primarily due to higher natural gas costs, and
- A \$5 million increase in amortization of the Ohio Demand Side Management costs.

*Gains (Losses) on Sales of Other Assets and Other, net.* Increase in 2008 compared to 2007 is attributable to gains on sales of emission allowances in 2008 compared to losses on sales of emission allowances in 2007. Gains in 2008 were a result of sales of zero cost basis emission allowances. Losses in 2007 were a result of sales of emission allowances acquired in connection with Duke Energy's merger with Cinergy in April 2006 which were written up to fair value as part of purchase accounting.

*Income Tax Expense.* Income Tax Expense increased for the six months ended June 30, 2008 as compared to the same period in the prior year. The increase is primarily the result of higher pre-tax income, partially offset by a lower effective tax rate for the six months ended June 30, 2008 (36%) compared to the same period in 2007 (39%). The decrease in the effective tax rate is due primarily to less of an effect to the effective tax rate calculation from permanent items in 2008 as compared to 2007 as a result of significantly higher pre-tax income in 2008.

### **MATTERS IMPACTING FUTURE RESULTS**

On July 11, 2008, the U.S. Court of Appeals for the District of Columbia issued a decision vacating the Clean Air Interstate Rule. See Note 11, "Commitments and Contingencies," to the Consolidated Financial Statements for a discussion of the decision. Duke Energy Ohio is currently evaluating the effect of the decision on the carrying value of emission allowances held by its non-regulated businesses. Based on current market prices for sulfur dioxide allowances, and the uncertainty associated with future federal requirements to reduce emissions, management believes that it is possible that Duke Energy Ohio may incur an impairment of the carrying value of emission allowances held by Commercial Power of up to \$100 million in the third quarter of 2008. This current estimate is based on total allowances held by Commercial Power as of June 30, 2008 compared to amounts projected to be utilized in operations through 2037.

### **OTHER MATTERS**

At June 30, 2008, Duke Energy Ohio had approximately \$440 million of auction rate pollution control bonds outstanding. The maximum auction rate for approximately \$270 million of this debt is 1.75 times one-month London Interbank Offered Rate (LIBOR) and the maximum auction rate for the remaining balance of approximately \$170 million is 2.0 times one-month LIBOR. While Duke Energy Ohio intends to refund and refinance these tax exempt auction rate bonds, the timing of such refinancing transactions is uncertain and subject to market conditions.

**Item 4. Controls and Procedures.**

**Disclosure Controls and Procedures**

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized, and reported, within the time periods specified by the Securities and Exchange Commission's (SEC) rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2008, and, based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

**Changes in Internal Control over Financial Reporting**

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended June 30, 2008 and have concluded that no change has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

## PART II. OTHER INFORMATION

### **Item 1. Legal Proceedings**

For information regarding legal proceedings that became reportable events or in which there were material developments in the second quarter of 2008, see Note 10 to the Consolidated Financial Statements, "Regulatory Matters" and Note 11 to the Consolidated Financial Statements, "Commitments and Contingencies."

### **Item 1A. Risk Factors**

In addition to the other information set forth in this report, careful consideration should be given to the factors discussed in Part I, "Item 1A. Risk Factors" in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect Duke Energy Ohio's financial condition or future results. Additional risks and uncertainties not currently known to Duke Energy Ohio or that Duke Energy Ohio currently deems to be immaterial also may adversely affect Duke Energy Ohio's financial condition and/or results of operations.



**Item 6. Exhibits**

**(a) Exhibits**

Exhibits filed or furnished herewith are designated by an asterisk (\*).

<b>Exhibit Number</b>	
* 31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
* 31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
* 32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
* 32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The total amount of securities of the registrant or its subsidiaries authorized under any instrument with respect to long-term debt not filed as an exhibit does not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. The registrant agrees, upon request of the Securities and Exchange Commission, to furnish copies of any or all of such instruments to it.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DUKE ENERGY OHIO, INC.

Date: August 14, 2008

\_\_\_\_\_  
/s/ DAVID L. HAUSER

David L. Hauser  
Group Executive and  
Chief Financial Officer

Date: August 14, 2008

\_\_\_\_\_  
/s/ STEVEN K. YOUNG

Steven K. Young  
Senior Vice President and  
Controller

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James E. Rogers, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2008

/s/ JAMES E. ROGERS

\_\_\_\_\_  
James E. Rogers  
Chief Executive Officer

**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, David L. Hauser, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2008

/s/ DAVID L. HAUSER

\_\_\_\_\_  
David L. Hauser  
Group Executive and  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending June 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Rogers, Chief Executive Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

/s/ JAMES E. ROGERS

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James E. Rogers  
Chief Executive Officer  
August 14, 2008

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending June 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David L. Hauser, Group Executive and Chief Financial Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

/s/ DAVID L. HAUSER

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David L. Hauser  
Group Executive and Chief Financial Officer  
August 14, 2008





# **FORM 10-Q**

**Duke Energy Ohio, Inc. - N/A**

**Filed: May 15, 2008 (period: March 31, 2008)**

Quarterly report which provides a continuing view of a company's financial position



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10-Q - FORM 10-Q

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Item 1.      Financial Statements.

## PART I

## PART I

Item 2.      Management s Discussion and Analysis of Financial Condition and Results of Operations.

Item 4.      Controls and Procedures.

## PART II.

Item 1.      Legal Proceedings

Item 1A.     Risk Factors

Item 6.      Exhibits

SIGNATURES

EX-31.1 (CEO CERTIFICATION)

EX-31.2 (CFO CERTIFICATION)

EX-32.1 (CEO CERTIFICATION SEC 906)

EX-32.2 (CFO CERTIFICATION SEC 906)

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 2008 Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-1232

**DUKE ENERGY OHIO, INC.**

(Exact Name of Registrant as Specified in its Charter)

Ohio  
(State or Other Jurisdiction of Incorporation)

31-0240030  
(IRS Employer Identification No.)

139 East Fourth Street  
Cincinnati, OH  
(Address of Principal Executive Offices)

45202  
(Zip code)

704-594-6200  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer   
Non-accelerated filer   
(Do not check if a smaller reporting company)

Accelerated filer   
Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).  
Yes  No

All of the registrant's common stock is indirectly owned by Duke Energy Corporation (File No. 1-32853) which is a reporting company under the Securities Exchange Act of 1934, as amended.

The registrant meets the conditions set forth in General Instructions H(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format specified in General Instructions H(2) of Form 10-Q.

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DUKE ENERGY OHIO, INC.  
**FORM 10-Q FOR THE QUARTER ENDED  
MARCH 31, 2008**

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**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION**

This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management's beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "plan," "project," "predict," "will," "potential," "forecast," "target," and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- State and federal legislative and regulatory initiatives, including costs of compliance with existing and future environmental requirements;
- State and federal legislative and regulatory initiatives and rulings that affect cost and investment recovery or have an impact on rate structures;
- Costs and effects of legal and administrative proceedings, settlements, investigations and claims;
- Industrial, commercial and residential growth in Duke Energy Ohio, Inc.'s (Duke Energy Ohio) service territories;
- Additional competition in electric markets and continued industry consolidation;
- The influence of weather and other natural phenomena on Duke Energy Ohio operations, including the economic, operational and other effects of tornados, droughts and other natural phenomena;
- The timing and extent of changes in commodity prices and interest rates;
- Unscheduled generation outages, unusual maintenance or repairs and electric transmission system constraints;
- The performance of electric generation facilities;
- The results of financing efforts, including Duke Energy Ohio's ability to obtain financing on favorable terms, which can be affected by various factors, including Duke Energy Ohio's credit ratings and general economic conditions;
- Declines in the market prices of equity securities and resultant cash funding requirements of Duke Energy Ohio for Cinergy's defined benefit pension plans;
- The level of credit worthiness of counterparties to Duke Energy Ohio's transactions;
- Employee workforce factors, including the potential inability to attract and retain key personnel;
- Growth in opportunities for Duke Energy Ohio's business units, including the timing and success of efforts to develop domestic power and other projects; and
- The effect of accounting pronouncements issued periodically by accounting standard-setting bodies.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Duke Energy Ohio has described. Duke Energy Ohio undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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## PART I. FINANCIAL INFORMATION

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)  
(In millions)

**Item 1. Financial Statements.**

	Three Months Ended March 31,	
	2008	2007
<b>Operating Revenues</b>		
Non-regulated electric and other	\$ 392	\$ 346
Regulated electric	242	231
Regulated natural gas	357	339
<b>Total operating revenues</b>	<b>991</b>	<b>916</b>
<b>Operating Expenses</b>		
Fuel used in electric generation and purchased power	177	225
Operation, maintenance and other	182	185
Cost of natural gas	250	255
Depreciation and amortization	99	93
Property and other taxes	73	73
<b>Total operating expenses</b>	<b>781</b>	<b>831</b>
<b>Gains (Losses) on Sales of Other Assets and Other, net</b>	<b>13</b>	<b>(11)</b>
<b>Operating Income</b>	<b>223</b>	<b>74</b>
<b>Other Income and Expenses, net</b>	<b>9</b>	<b>9</b>
<b>Interest Expense</b>	<b>26</b>	<b>23</b>
<b>Income Before Income Taxes</b>	<b>206</b>	<b>60</b>
<b>Income Tax Expense</b>	<b>73</b>	<b>23</b>
<b>Net Income</b>	<b>\$ 133</b>	<b>\$ 37</b>

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED BALANCE SHEETS**  
(Unaudited)  
(In millions)

	March 31, 2008	December 31, 2007
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 38	\$ 33
Receivables (net of allowance for doubtful accounts of \$3 at March 31, 2008 and at December 31, 2007)	281	334
Inventory	168	212
Unrealized gains on mark-to-market and hedging transactions	52	22
Other	67	94
<b>Total current assets</b>	<b>606</b>	<b>695</b>
<b>Investments and Other Assets</b>		
Restricted funds held in trust	63	62
Goodwill	2,325	2,325
Intangibles, net	529	551
Unrealized gains on mark-to-market and hedging transactions	40	17
Other	36	33
<b>Total investments and other assets</b>	<b>2,993</b>	<b>2,988</b>
<b>Property, Plant and Equipment</b>		
Cost	9,671	9,577
Less accumulated depreciation and amortization	2,151	2,097
<b>Net property, plant and equipment</b>	<b>7,520</b>	<b>7,480</b>
<b>Regulatory Assets and Deferred Debits</b>		
Deferred debt expense	23	23
Regulatory assets related to income taxes	93	90
Other	375	401
<b>Total regulatory assets and deferred debits</b>	<b>491</b>	<b>514</b>
<b>Total Assets</b>	<b>\$ 11,610</b>	<b>\$ 11,677</b>

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED BALANCE SHEETS—(Continued)**  
**(Unaudited)**  
(In millions, except share and per-share amounts)

	March 31, 2008	December 31, 2007
<b>LIABILITIES AND COMMON STOCKHOLDER'S EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 458	\$ 602
Notes payable	47	189
Taxes accrued	228	172
Interest accrued	28	24
Current maturities of long-term debt	126	126
Unrealized losses on mark-to-market and hedging transactions	56	24
Other	86	86
Total current liabilities	1,029	1,223
<b>Long-term Debt</b>		
	1,808	1,810
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes	1,450	1,436
Investment tax credits	16	16
Accrued pension and other post-retirement benefit costs	285	259
Unrealized losses on mark-to-market and hedging transactions	31	25
Asset retirement obligations	32	31
Other	290	343
Total deferred credits and other liabilities	2,104	2,110
<b>Commitments and Contingencies</b>		
<b>Common Stockholder's Equity</b>		
Common stock, \$8.50 par value; 120,000,000 shares authorized and 89,663,086 shares outstanding at March 31, 2008 and December 31, 2007	762	762
Additional paid-in capital	5,570	5,570
Retained earnings	360	227
Accumulated other comprehensive loss	(23)	(25)
Total common stockholder's equity	6,669	6,534
Total Liabilities and Common Stockholder's Equity	\$ 11,610	\$ 11,677

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)  
(In millions)

	Three Months Ended March 31,	
	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 133	\$ 37
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	100	93
(Gains) losses on sales of other assets and other, net	(13)	11
Deferred income taxes	8	(20)
Regulatory asset/liability amortization	7	8
Accrued pension and other post-retirement benefit costs	6	15
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	(38)	25
Receivables	52	67
Inventory	59	64
Other current assets	32	(14)
Increase (decrease) in:		
Accounts payable	(132)	149
Taxes accrued	49	(124)
Other current liabilities	3	(11)
Regulatory asset/liability deferrals	7	(4)
Other assets	17	40
Other liabilities	(24)	(3)
Net cash provided by operating activities	266	333
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Capital expenditures	(133)	(147)
Purchases of emission allowances	—	(14)
Sales of emission allowances	12	22
Net proceeds from the sales of other assets	4	—
Change in restricted funds held in trust	—	11
Net cash used in investing activities	(117)	(128)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Redemption of long-term debt	(2)	(2)
Notes payable to affiliate, net	(142)	(227)
Net cash used in financing activities	(144)	(229)
Net increase (decrease) in cash and cash equivalents	5	(24)
Cash and cash equivalents at beginning of period	33	45
Cash and cash equivalents at end of period	\$ 38	\$ 21
<b>Supplemental Disclosures</b>		
<b>Significant non-cash transactions:</b>		
Purchase accounting adjustments	\$ —	\$ 4
Accrued capital expenditures	\$ 39	\$ 22

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME**  
(Unaudited)  
(In millions)

	Accumulated Other Comprehensive Income (Loss)					Total
	Common Stock	Additional Paid-in Capital	Retained Earnings	Net Gains (Losses) on Cash Flow Hedges	SFAS No. 158 Adjustment	
<b>Balance at December 31, 2006</b>	\$ 762	\$ 5,601	\$ 55	\$ (36)	\$ (2)	\$ 6,380
Net income	—	—	37	—	—	37
Other comprehensive income, net of tax effect of (\$2)	—	—	—	—	—	—
Cash flow hedges	—	—	—	4	—	4
<b>Total comprehensive income</b>	—	—	—	—	—	41
Push-down accounting adjustments	—	4	—	—	—	4
Adoption of SFAS No. 158—measurement date provision	—	—	(4)	—	—	(4)
<b>Balance at March 31, 2007</b>	\$ 762	\$ 5,605	\$ 88	\$ (32)	\$ (2)	\$ 6,421
<b>Balance at December 31, 2007</b>	\$ 762	\$ 5,570	\$ 227	\$ (32)	\$ 7	\$ 6,534
Net income	—	—	133	—	—	133
Other comprehensive income, net of tax effect of (\$1)	—	—	—	—	—	—
Cash flow hedges	—	—	—	2	—	2
<b>Total comprehensive income</b>	—	—	—	—	—	135
<b>Balance at March 31, 2008</b>	\$ 762	\$ 5,570	\$ 360	\$ (30)	\$ 7	\$ 6,669

See Notes to Unaudited Consolidated Financial Statements



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PART I

DUKE ENERGY OHIO, INC.  
**Notes To Unaudited Consolidated Financial Statements**

### 1. Basis of Presentation

**Nature of Operations and Basis of Consolidation.** Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through Duke Energy Kentucky, Inc. (Duke Energy Kentucky) in nearby areas of Kentucky. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing. Duke Energy Ohio's principal subsidiary is Duke Energy Kentucky, a Kentucky corporation organized in 1901. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. References herein to Duke Energy Ohio includes Duke Energy Ohio and its subsidiaries.

These Consolidated Financial Statements include, after eliminating intercompany transactions and balances, the accounts of Duke Energy Ohio and all majority-owned subsidiaries where Duke Energy Ohio has control. These Consolidated Financial Statements also reflect Duke Energy Ohio's proportionate share of certain generation and transmission facilities in Ohio and Kentucky.

These Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles (GAAP) in the United States of America (U.S.) for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, these Consolidated Financial Statements do not include all of the information and footnotes required by GAAP for annual financial statements. Because the interim Consolidated Financial Statements and Notes do not include all of the information and footnotes required by GAAP for annual financial statements, the Consolidated Financial Statements and other information included in this quarterly report should be read in conjunction with the Consolidated Financial Statements and Notes in Duke Energy Ohio's Form 10-K for the year ended December 31, 2007.

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

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

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

**Netting of cash collateral and derivative assets and liabilities under master netting arrangements.** On January 1, 2008, Duke Energy Ohio adopted FSP No. FIN 39-1. In accordance with FSP No. FIN 39-1, Duke Energy Ohio offsets fair value amounts (or amounts that approximate fair value) recognized on its Consolidated Balance Sheets related to cash collateral amounts receivable or payable against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting agreement. Prior to the adoption of FSP No. FIN 39-1, Duke Energy Ohio offset the fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting agreement in accordance with FIN 39, "Offsetting of Amounts Related to Certain Contracts," but presented cash collateral on a gross basis within the Consolidated Balance Sheets. At March 31, 2008 and December 31, 2007, Duke Energy Ohio had receivables related to the right to reclaim cash collateral of approximately \$16 million and \$5 million, respectively, and had payables related to obligations to return cash collateral of approximately \$34 million and an immaterial amount, respectively, that have been offset against net derivative positions in the Consolidated Balance Sheets. Duke Energy Ohio had immaterial cash collateral receivables under master netting arrangements that have not been offset against net derivative positions at March 31, 2008 and December 31, 2007, respectively. Duke Energy Ohio had an immaterial amount of cash collateral payables under master netting arrangements that have not been offset against net derivative positions at March 31, 2008 and December 31, 2007.

**Unbilled Revenue.** Revenues on sales of electricity and gas are recognized when either the service is provided or the product is delivered. Unbilled revenues are estimated by applying an average revenue per kilowatt hour or per thousand cubic feet (Mcf) for all cus-

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PART I

DUKE ENERGY OHIO, INC.

### Notes To Unaudited Consolidated Financial Statements—(Continued)

tomers classes to the number of estimated kilowatt hours or Mcf delivered but not billed. The amount of unbilled revenues can vary significantly period to period as a result of factors including seasonality, weather, customer usage patterns and customer mix. Receivables for unbilled revenues of \$121 million and \$145 million at March 31, 2008 and December 31, 2007, respectively are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables), an unconsolidated entity formed by Cinergy.

**Other Regulatory Assets and Deferred Debts.** The state of Ohio passed comprehensive electric deregulation legislation in 1999, and in 2000, the Public Utilities Commission of Ohio (PUCO) approved a stipulation agreement relating to Duke Energy Ohio's transition plan creating a Regulatory Transition Charge (RTC) designed to recover Duke Energy Ohio's generation-related regulatory assets and transition costs over a ten-year period beginning January 1, 2001 and ending December 2010. Accordingly, application of Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for Certain Types of Regulation," (SFAS No. 71) was discontinued for the generation portion of Duke Energy Ohio's business. Duke Energy Ohio has a RTC related regulatory asset balance of approximately \$215 million and \$239 million as of March 31, 2008 and December 31, 2007, respectively, which is classified in Other Regulatory Assets and Deferred Debts on the Consolidated Balance Sheets.

## 2. Business Segments

Duke Energy Ohio operates the following business units: Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these business units in deciding how to allocate resources and evaluate performance. Both of the business units are considered reportable segments under SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." There is no aggregation within Duke Energy Ohio's defined business segments.

Franchised Electric and Gas generates, transmits, distributes and sells electricity in southwestern Ohio and northern Kentucky. Franchised Electric and Gas also transports and sells natural gas in southwestern Ohio and northern Kentucky. It conducts operations primarily through Duke Energy Ohio and Duke Energy Kentucky.

Commercial Power owns, operates and manages non-regulated power plants and engages in the wholesale marketing and procurement of electric power, fuel and emission allowances related to these plants as well as other contractual positions. Commercial Power's generation asset fleet consists of Duke Energy Ohio's non-regulated generation in Ohio and the five Midwestern gas-fired non-regulated generation assets. Commercial Power's assets comprise approximately 7,600 megawatts of power generation primarily located in the Midwestern U.S. The asset portfolio has a diversified fuel mix with baseload and mid-merit coal-fired units as well as combined cycle and peaking natural gas-fired units. Most of the generation asset output in Ohio has been contracted through the rate stabilization plan (RSP).

The remainder of Duke Energy Ohio's operations are presented as Other. While it is not considered a business segment, Other primarily includes certain allocated governance costs (see Note 8).

Duke Energy Ohio's reportable segments offer different products and services and are managed separately as business units. Accounting policies for Duke Energy Ohio's segments are the same as those described in the Notes to the Consolidated Financial Statements in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2007. Management evaluates segment performance based on earnings before interest and taxes from continuing operations (EBIT).

On a segment basis, EBIT excludes discontinued operations and represents all profits from continuing operations (both operating and non-operating and excluding corporate governance costs) before deducting interest and taxes. Cash, cash equivalents, and investments in marketable securities, if any, are managed centrally by Duke Energy, so the interest and dividend income on those balances are excluded from the segments' EBIT.

Transactions between reportable segments are accounted for on the same basis as unaffiliated revenues and expenses in the accompanying Consolidated Financial Statements.

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PART I

DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

**Business Segment Data**

	Unaffiliated Revenues <sup>(a)</sup>	Segment EBIT/ Consolidated Income from Continuing Operations Before Income Taxes	Depreciation and Amortization
(In millions)			
<b>Three Months Ended March 31, 2008</b>			
Franchised Electric and Gas	\$ 599	\$ 97	\$ 58
Commercial Power	392	145	41
Total reportable segments	991	242	99
Other	—	(18)	—
Interest expense	—	(26)	—
Interest income and other	—	8	—
Total consolidated	\$ 991	\$ 206	\$ 99
<b>Three months Ended March 31, 2007</b>			
Franchised Electric and Gas	\$ 570	\$ 79	\$ 53
Commercial Power	346	13	40
Total reportable segments	916	92	93
Other	—	(18)	—
Interest expense	—	(23)	—
Interest income and other	—	9	—
Total consolidated	\$ 916	\$ 60	\$ 93

(a) There were no intersegment revenues for the three months ended March 31, 2008 and 2007.

**Segment Assets**

	March 31, 2008	December 31, 2007
(In millions)		
Franchised Electric and Gas	\$ 5,469	\$ 5,530
Commercial Power	6,141	6,147
Total reportable segments/consolidated assets	\$ 11,610	\$ 11,677

**3. Dispositions**

For the three months ended March 31, 2008 and 2007, the sale of emission allowances resulted in approximately \$12 million and \$22 million, respectively, in proceeds and net pre-tax gains (losses) of \$12 million and \$(11) million, respectively, recorded in Gains (losses) on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These amounts primarily relate to Commercial Power's sales of emission allowances.

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PART I

DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)****4. Inventory**

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

	March 31, 2008	December 31, 2007
	(In millions)	
Gas held in storage	\$ 22	\$ 69
Fuel for use in electric generation	77	77
Materials and supplies	69	66
<b>Total Inventory</b>	<b>\$ 168</b>	<b>\$ 212</b>

**5. Debt and Credit Facilities**

Duke Energy Ohio receives support for its short-term borrowing needs through its participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement, which allows Duke Energy Ohio to better manage its cash and working capital requirements. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. As of March 31, 2008 and December 31, 2007, Duke Energy Ohio was in a payable position of \$47 million and \$189 million, respectively, classified within Notes payable in the accompanying Consolidated Balance Sheets. During the three months ended March 31, 2008 and 2007, the \$142 million and \$227 million change in the money pool, respectively, is reflected as a cash outflow in Notes payable to affiliate, net within Net cash used in financing activities on the Consolidated Statements of Cash Flows.

*Available Credit Facilities and Restrictive Debt Covenants.* In March 2008, Duke Energy entered into an amendment to its \$2.65 billion master credit facility whereby the borrowing capacity was increased by \$550 million to \$3.2 billion. Pursuant to the amendment, the additional credit capacity of \$550 million specifically increased the borrowing sub limit for Duke Energy Ohio (excluding Duke Energy Kentucky) by \$250 million to \$750 million. The borrowing sub limit of Duke Energy Kentucky did not change. In May 2008, Duke Energy reallocated the borrowing sub limits under the master credit facility and reduced Duke Energy Ohio's borrowing sub limit by \$50 million to \$700 million.

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

Duke Energy's credit agreement contains various financial and other covenants, including, but not limited to, a covenant regarding the debt-to-total capitalization ratio at Duke Energy, Duke Energy Ohio and Duke Energy Kentucky to not exceed 65%. Duke Energy Ohio's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of March 31, 2008, Duke Energy and Duke Energy Ohio were in compliance with those covenants. In addition, some credit agreements may allow for acceleration of payments or termination of the agreements due to nonpayment, or the acceleration of other significant indebtedness of the borrower or some of its subsidiaries. None of the debt or credit agreements contain material adverse change clauses.

As of March 31, 2008 and December 31, 2007, approximately \$96 million of certain pollution control bonds, which are short-term obligations by nature, are classified as Long-term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio's intent and ability to utilize such borrowings as long-term financing. Duke Energy's credit facilities with non-cancelable terms in excess of one year as of the balance sheet date give Duke Energy Ohio the ability to refinance these short-term obligations on a long-term basis.

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PART I

DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

**6. Employee Benefit Obligations**

Duke Energy Ohio participates in pension and other post-retirement benefit plans sponsored by Cinergy. Duke Energy Ohio's net periodic benefit costs as allocated by Cinergy were as follows:

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
(in millions)		
Qualified Pension Benefits <sup>(a)</sup>	\$ 2	\$ 8
Other Post-retirement Benefits <sup>(b)</sup>	\$ 3	\$ 3

(a) These amounts exclude approximately \$1 million and \$3 million for the three months ended March 31, 2008 and 2007, respectively, of regulatory asset amortization resulting from purchase accounting.

(b) The three months ended March 31, 2007 excludes approximately \$1 million of regulatory asset amortization resulting from purchase accounting. Duke Energy's policy is to fund amounts for its U.S. qualified pension plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. Duke Energy did not make contributions to the legacy Cinergy qualified or non-qualified pension plans during the three months ended March 31, 2008 or 2007. Duke Energy does not anticipate making contributions to the legacy Cinergy qualified or non-qualified pension plans during 2008. Duke Energy also sponsors employee savings plans that cover substantially all U.S. employees. Duke Energy Ohio expensed pre-tax employer matching contributions of approximately \$1 million for each of the three months ended March 31, 2008 and 2007.

**7. Goodwill and Intangibles**

The following table shows goodwill by business segment at March 31, 2008 and December 31, 2007:

**Carrying Amount of Goodwill**

Business Segment:	Balance at December 31, 2007	Changes	Balance at March 31, 2008
	(in millions)		
Commercial Power	\$ 1,188	\$ —	\$ 1,188
Franchised Electric and Gas	1,137	—	1,137
<b>Total Goodwill</b>	<b>\$ 2,325</b>	<b>\$ —</b>	<b>\$ 2,325</b>

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

	March 31, 2008	December 31, 2007
(in millions)		
Emission allowances	\$ 349	\$ 365
Gas, coal, and power contracts	271	271
Other	9	9
<b>Total gross carrying amount</b>	<b>629</b>	<b>645</b>
Accumulated amortization—gas, coal, and power contracts	(95)	(89)
Accumulated amortization—other	(5)	(5)
<b>Total accumulated amortization</b>	<b>(100)</b>	<b>(94)</b>
<b>Total intangible assets, net</b>	<b>\$ 529</b>	<b>\$ 551</b>

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PART I

DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

Emission allowances in the table above include emission allowances, which as part of the Duke Energy and Cinergy merger, were recorded at fair value on the date of the merger and emission allowances purchased by Duke Energy Ohio. Additionally, Duke Energy Ohio is allocated certain zero cost emission allowances on an annual basis. Carrying value of emission allowances sold or consumed during the three months ended March 31, 2008 and 2007 were \$16 million and \$67 million, respectively. See Note 3 for discussion of gains and losses on sales of emission allowances at Commercial Power during the three months ended March 31, 2008 and 2007.

Amortization expense for gas, coal and power contracts and other intangible assets for the three months ended March 31, 2008 and 2007 was approximately \$6 million and \$12 million, respectively.

In connection with the Duke Energy and Cinergy merger, Duke Energy Ohio recorded an intangible liability of approximately \$113 million associated with the market based standard service offer (MBSSO) in Ohio, which is being recognized in earnings over the remaining regulatory period that ends on December 31, 2008. During the three months ended March 31, 2008 and 2007, Duke Energy Ohio amortized approximately \$17 million and less than \$1 million, respectively, to income related to this intangible liability. The carrying amount of this intangible liability was approximately \$50 million and \$67 million at March 31, 2008 and December 31, 2007, respectively. Duke Energy Ohio also recorded approximately \$56 million of intangible liabilities associated with other power sale contracts in connection with the merger. The carrying amount of this intangible liability was approximately \$21 million and \$22 million at March 31, 2008 and December 31, 2007, respectively. During the three months ended March 31, 2008 and 2007, Duke Energy Ohio amortized approximately \$1 million and \$4 million, respectively, to income related to these power sale contracts.

**8. Related Party Transactions**

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

	March 31, 2008	December 31, 2007
	(in millions)	
Current assets due from affiliated companies <sup>(a)(b)</sup>	\$ 49	\$ 58
Current liabilities due to affiliated companies <sup>(a)(c)</sup>	\$ (221)	\$ (266)
Non-current liabilities due to affiliated companies <sup>(d)</sup>	\$ (4)	—
Net deferred tax liabilities to Duke Energy <sup>(a)(e)</sup>	\$ (1,416)	\$ (1,401)

- (a) Balances exclude assets or liabilities associated with accrued pension and other post-retirement benefits, Cinergy Receivables and money pool arrangements as discussed below.
- (b) Of the balance at March 31, 2008, approximately (\$38) million is classified as Receivables and (\$11) million is classified as Other Current Assets. The balance at December 31, 2007 is classified as Receivables on the Consolidated Balance Sheets.
- (c) Of the balance at March 31, 2008, approximately (\$159) million is classified as Accounts payable and (\$62) million is classified as Taxes accrued on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately (\$256) million is classified as Accounts payable and (\$10) million is classified as Taxes accrued on the Consolidated Balance Sheets.
- (d) The balance at March 31, 2008 is classified as Unrealized losses on mark-to-market and hedging transactions within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.
- (e) Of the balance at March 31, 2008, approximately (\$1,423) million is classified as Deferred income taxes, (\$16) million is classified as Investment tax credits and \$23 million is classified as Other within Current Assets on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately (\$1,409) million is classified as Deferred income taxes, (\$16) million is classified as Investment tax credits and \$24 million is classified as Other within Current Assets on the Consolidated Balance Sheets.

Duke Energy Ohio is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy and a consolidated affiliate of Cinergy. Corporate governance and other shared services costs are primarily allocations of corporate costs, such as human resources, legal and accounting fees, as well as other third party costs. The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Ohio, which are recorded in Operation, maintenance and other within Operating Expenses on the Consolidated Statements of Operations were \$61 million and \$56 million for the three months ended March 31, 2008 and 2007, respectively.

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PART I

DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

See Note 6 for detail on expense amounts allocated from Cinergy to Duke Energy Ohio related to Duke Energy Ohio's participation in Cinergy's qualified and non-qualified defined benefit pension plans and post-retirement health care and insurance benefits. Additionally, Duke Energy Ohio has been allocated accrued pension and other post-retirement benefit obligations from Cinergy of approximately \$293 million at March 31, 2008 and approximately \$266 million at December 31, 2007. These amounts have been classified in the Consolidated Balance Sheets as follows:

	March 31, 2008	December 31, 2007
(In millions)		
Other current liabilities	\$ 5	\$ 5
Accrued pension and other post-retirement benefit costs	\$ 285	\$ 259
Other deferred credits and other liabilities	\$ 3	\$ 2

Additionally, certain trade receivables have been sold by Duke Energy Ohio to Cinergy Receivables, an unconsolidated entity formed by Cinergy. The proceeds obtained from the sales of receivables are largely cash but do include a subordinated note from Cinergy Receivables for a portion of the purchase price. This subordinated note is classified by Duke Energy Ohio as Receivables in the Consolidated Balance Sheets and was approximately \$175 million and \$189 million as of March 31, 2008 and December 31, 2007, respectively. The interest income associated with Cinergy Receivables for Duke Energy Ohio, which is recorded in Other Income and Expenses, net on the Consolidated Statements of Operations, was approximately \$8 million for the three months ended March 31, 2008 and 2007.

Duke Energy Ohio participates in a money pool with Duke Energy and other Duke Energy subsidiaries. As of March 31, 2008 and December 31, 2007, Duke Energy Ohio was in a payable position of \$47 million and \$189 million, respectively, classified within Notes payable in the accompanying Consolidated Balance Sheets. The expenses associated with money pool activity for Duke Energy Ohio, which are recorded in Interest Expense on the Consolidated Statements of Operations for the three months ended March 31, 2008 and 2007 were \$1 million and \$2 million, respectively. See Note 5 for further discussion of the money pool arrangement.

**9. Risk Management Instruments**

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

The following table shows the carrying value of Duke Energy Ohio's derivative portfolio as of March 31, 2008, and December 31, 2007.

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

	March 31, 2008	December 31, 2007
Hedging	\$ (23)	\$ (23)
Undesignated	46	7
<b>Total</b>	<b>\$ 23</b>	<b>\$ (16)</b>

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

The \$39 million increase in the undesignated derivative portfolio fair value is due primarily to unrealized mark-to-market gains within Commercial Power, primarily as a result of increasing coal prices.

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PART I

DUKE ENERGY OHIO, INC.

### Notes To Unaudited Consolidated Financial Statements—(Continued)

**Commodity Cash Flow Hedges.** As of March 31, 2008, approximately \$38 million of the pre-tax unrealized net losses on derivative instruments related to commodity cash flow hedges included on the Consolidated Balance Sheet in Accumulated Other Comprehensive Loss (AOCL) are expected to be recognized in earnings during the next 12 months as the hedged transactions occur. However, due to the volatility of the commodities markets, the corresponding values in AOCL will likely change prior to its reclassification into earnings.

No gains or losses due to hedge ineffectiveness were recorded during the three months ended March 31, 2008 or 2007. The amount recognized for transactions that no longer qualified as cash flow hedges was not material for either the three months ended March 31, 2008 or March 31, 2007.

See Note 12 for additional information related to the fair value of Duke Energy Ohio's derivative instruments.

#### 10. Regulatory Matters

**Regulatory Merger Approvals** On April 3, 2006, the merger between Duke Energy and Cinergy was consummated to create a newly formed company, Duke Energy Holding Corp. (subsequently renamed Duke Energy Corporation). As a condition to the merger approval, the PUCO, and the Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Ohio and Kentucky, respectively. The commissions also required Duke Energy Ohio and Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- The PUCO required that Duke Energy Ohio provide (i) a rate reduction of approximately \$15 million for one year to facilitate economic development in a time of increasing rates and market prices and (ii) a reduction of approximately \$21 million to its gas and electric consumers in Ohio for one year, with both credits beginning January 1, 2006. During the first quarter of 2007, Duke Energy Ohio completed its merger related rate reductions and filed a report with the PUCO to terminate the merger credit riders. Approximately \$2 million of the rate reductions was passed through to customers during the three months ended March 31, 2007.
- The KPSC required that Duke Energy Kentucky provide \$8 million in rate reductions to its customers over five years, ending when new rates are established in the next rate case after January 1, 2008. Approximately \$1 million of the rate reduction was passed through to customers during each of the three months ended March 31, 2008 and 2007.
- The FERC approved the merger without conditions.

**Franchised Electric and Gas. Rate Related Information.** The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. The PUCO approves rates and market prices for retail gas and electric service within the state of Ohio, except that non-regulated sellers of gas and electric generation also are allowed to operate in Ohio (see "Commercial Power" below). The FERC approves rates for electric sales to wholesale customers served under cost-based rates.

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

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



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**Notes To Unaudited Consolidated Financial Statements—(Continued)**

the nonresidential RTC terminates at the end of 2010 and agreed to give further consideration to whether Duke Energy Ohio may transfer its generating assets to an EWG.

On February 15, 2008, Duke Energy Ohio filed a notice of appeal with the Ohio Supreme Court challenging a portion of the PUCO's decision on remand regarding Duke Energy Ohio's RSP. The October 2007 order permits non-residential customers to avoid certain charges associated with the costs of Duke Energy Ohio standing ready to serve such customers if they return after being served by another supplier. Duke Energy Ohio believes the PUCO exceeded its authority in modifying the charges that may be avoided, resulting in Duke Energy Ohio having to subsidize Ohio's competitive electric market. Duke Energy Ohio has asked the Supreme Court to reverse the PUCO ruling and require that non-residential customers pay the charges associated with Duke Energy Ohio standing ready to serve them should they return from a competitive supplier. On March 28, 2008, Duke Energy Ohio voluntarily withdrew its appeal. The OCC filed a notice of appeal challenging the PUCO's October 2007 decision as unlawful and unreasonable. The OCC and Ohio Partners for Affordable Energy (OPAE) also filed appeals from the PUCO's November 20, 2007 order approving Duke Energy Ohio's MBSSO riders. Duke Energy Ohio has intervened in each appeal. Pending the Ohio Supreme Court's consideration of its initial appeal, the OCC has requested that the PUCO stay implementation of the Infrastructure Maintenance Fund charge to be collected from customers approved in the October 2007 order. On April 14, 2008, Duke Energy Ohio filed a motion to intervene in OCC's appeal and on April 30, 2008, the Ohio Supreme Court granted such motion to intervene. At this time, Duke Energy Ohio cannot predict whether the Ohio Supreme Court will reverse the PUCO's decision or whether the PUCO will grant the OCC's request for a stay. Additionally, Duke Energy Ohio cannot predict the outcome of the MBSSO rider appeal; however, Duke Energy Ohio does not anticipate the resolution of this matter will have a material impact on its results of operations, cash flows or financial position.

In August 2006, Duke Energy Ohio filed an application with the PUCO to amend its MBSSO through 2010. The proposal provides for continued electric system reliability, a simplified market price structure and clear price signals for customers, while helping to maintain a stable revenue stream for Duke Energy Ohio. On November 30, 2007, due to new legislation pending in the Ohio General Assembly regarding the pricing of competitive retail generation services, Duke Energy Ohio requested PUCO approval, which the PUCO granted, to withdraw the Duke Energy Ohio application to amend its MBSSO. New legislation (SB 221) was passed on April 23, 2008 and signed by the Governor of Ohio on May 1, 2008. The new law codifies the PUCO's authority to approve an electric utility's standard service offer through an electric security plan (ESP), which would allow for pricing structures similar to the current MBSSO. Electric utilities are required to file an ESP and may also file an application for a market rate option at the same time. The market rate option is a price determined through a competitive bidding process. If a market rate option price is approved, the utility would blend in the MBSSO or ESP price with the market rate option price over a two- to ten-year period, subject to the PUCO's discretion. SB 221 provides for the PUCO to approve non-by-passable charges for new generation, including construction work-in-process (CWIP) from the outset of construction, as part of an ESP. The new law grants the PUCO discretion to approve single issue rate adjustments to distribution and transmission rates and establishes new alternative energy resources portfolio standards, such that the utility's portfolio must consist of at least 25% of these resources by 2025. SB 221 also provides a separate requirement for energy efficiency, which must reduce 22% of the utility's load by 2025. The utility's earnings under the ESP are subject to an annual earnings test and the PUCO must order a refund if it finds that the utility's earnings significantly exceed the earnings of benchmark companies with similar business and financial risks. The earnings test acts as a cap to the ESP price. SB 221 also limits the ability of a utility to transfer its dedicated generating assets to an EWG absent PUCO approval. Duke Energy Ohio plans to file a new generation pricing formula before the MBSSO expires.

Duke Energy Ohio is currently preparing an ESP filing under SB 221. This filing will address pricing for generation service beginning January 1, 2009, when the current RSP is scheduled to expire. The plan will also provide for pricing for the advanced energy, renewables and energy efficiency portfolio standards that Duke Energy Ohio is required to meet under SB 221. Duke Energy Ohio expects to make the filing on or shortly after the effective date of the new legislation. At this time, Duke Energy Ohio cannot predict the outcome of this proceeding.

*Duke Energy Ohio Gas Rate Case.* In July 2007, Duke Energy Ohio filed an application with the PUCO for an increase in its base rates for gas service. Duke Energy Ohio sought an increase of approximately \$34 million in revenue, or approximately 5.7%, to be effective in the spring of 2008. The application also requests approval to continue tracker recovery of costs associated with an accelerated gas main replacement program. The PUCO accepted the application for filing in September 2007. The staff of the PUCO issued a Staff Report in December 2007 recommending an increase of approximately \$14 million to \$20 million in revenue. The Staff Report also recommended approval for Duke Energy Ohio to continue tracker recovery of costs associated with an accelerated gas main replacement program. On February 28, 2008, Duke Energy Ohio reached a settlement agreement with the PUCO Staff and all of the intervening parties on its

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request for an increase in natural gas base rates. The settlement calls for an annual revenue increase of approximately \$18 million in base revenue, or 3 percent over current revenue, and permits continued recovery of costs through 2018 for Duke Energy Ohio's accelerated gas main replacement program and permits recovery of carrying costs on gas stored underground via its monthly gas cost adjustment filing. The settlement is subject to the review and approval of the PUCO. An order is expected in the second quarter of 2008.

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

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

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

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

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

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

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

*FERC 203 Application.* On April 23, 2008, Duke Energy Ohio and certain affiliates filed an application with the FERC requesting approval to transfer Duke Energy Ohio's electric generating facilities, some of which are designated to serve Ohio customers, to affiliate companies. The transaction may also entail the transfer of certain liabilities and debt. The affiliate companies would be consolidated by Duke Energy, but may not be consolidated by Duke Energy Ohio. The FERC filing does not obligate Duke Energy to make the transfer of the electric generating facilities, and management is in the process of evaluating the potential transfer. Management believes the proposed asset transfer could provide greater financial flexibility for the assets. The asset transfer complies with Duke Energy Ohio's Corporate Separation Plan that was amended by the PUCO in 2007. The PUCO has requested that FERC not rule on the matter until after January 1, 2009. As previously discussed, SB 221 limits the ability of a utility to transfer its designated generating assets to an EWG absent PUCO approval. The filing does not impact Duke Energy Ohio's current rates.

*Midwest Independent Transmission System Operator, Inc. (Midwest ISO) Resource Adequacy Filing.* On December 28, 2007, the Midwest ISO filed its "Electric Tariff Filing Regarding Resource Adequacy" in compliance with the FERC's request that Midwest ISO file Phase II of its long-term Resource Adequacy plan by December 2007. The proposal establishes a resource adequacy requirement in the form of planning reserve margin. On March 26, 2008, the FERC ruled on the Midwest ISO's Resource Adequacy filing and ordered that the new tariff be effective March 27, 2008. This action established a Midwest ISO-wide resource adequacy requirement for the first Planning Year. In the Order, the FERC clarified that States have the authority to set their own planning reserve margins, as long as they are consistent with any FERC-approved reliability standard. The FERC also rejected the use of power purchase agreements or seller's choice contracts as capacity resources if the contracts do not specify resources. Duke Energy Ohio does not believe the Midwest ISO resource adequacy requirement will have a material impact on its consolidated results of operations, cash flows, or financial position.

*Midwest ISO's Establishment of an Ancillary Services Market.* On February 25, 2008, the FERC conditionally accepted the Midwest ISO proposal to implement a day-ahead and real-time ancillary services market (ASM), including a scarcity pricing proposal. The FERC's conditional approval is based upon "cost benefits" verification. By approving the ASM proposal, the FERC essentially approved the transfer to, and consolidation of, balancing authority responsibility in the Midwest ISO so that it will become the North American Electric Reliability Council-certified Balancing Authority for the entire Midwest ISO area. This transfer will allow the Midwest ISO to determine operating reserve requirements and procure operating reserves from all qualified resources from an organized market, in place of the current system of local management and procurement of reserves by the 24 balancing authorities. On March 21, 2008, Midwest ISO informed the FERC that it was delaying the ASM launch date until September 9, 2008. At this time, Duke Energy Ohio does not believe the establishment of the Midwest Ancillary Services Market will have a material impact on its consolidated results of operations, cash flows, or financial position.

**Commercial Power.** Reported results for Commercial Power are subject to volatility due to the over- or under-collection of certain costs, including fuel and purchased power, since Commercial Power is not subject to regulatory accounting pursuant to SFAS No. 71. In addition, Commercial Power could be impacted by certain of the regulatory matters discussed above, including the Duke Energy Ohio electric rate filings.

## 11. Commitments and Contingencies

### Environmental

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

*Remediation activities.* Duke Energy Ohio and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Ohio operations, sites formerly owned or used by Duke

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### Notes To Unaudited Consolidated Financial Statements—(Continued)

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

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

**Clean Air Interstate Rule (CAIR).** The EPA finalized its CAIR in May 2005. The CAIR limits total annual and summertime nitrogen oxides (NO<sub>x</sub>) emissions and annual sulfur dioxide (SO<sub>2</sub>) emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO<sub>x</sub> and in 2010 for SO<sub>2</sub>. Phase 2 begins in 2015 for both NO<sub>x</sub> and SO<sub>2</sub>. Duke Energy Ohio currently estimates that it will spend approximately \$150 million between 2008 and 2012 to comply with Phase 1 of CAIR at plants that Duke Energy Ohio owns or partially owns but does not operate. Duke Energy Ohio currently estimates that it will not incur any significant costs for complying with Phase 2 of CAIR. Duke Energy Ohio receives partial recovery of depreciation and financing costs related to environmental compliance projects for 2005-2008 through its RSP (see Note 10).

On March 25, 2008, the U.S. Court of Appeals for the District of Columbia heard oral arguments in a case involving multiple challenges to the CAIR. Nearly all aspects of the rule were challenged, but Duke Energy challenged only the portions pertaining to SO<sub>2</sub> allowance allocations. A decision is expected in the summer of 2008. The outcome and any resulting consequences cannot be estimated at this time.

**Clean Air Mercury Rule (CAMR).** The EPA finalized its CAMR in May 2005. The CAMR was to have limited total annual mercury emissions from coal-fired power plants across the U.S. through a two-phased cap-and-trade program beginning in 2010. On February 8, 2008 the U.S. Court of Appeals for the District of Columbia issued its opinion in *New Jersey v. EPA*, No. 05-1097, vacating the CAMR. The decision creates uncertainty regarding future mercury emission reduction requirements and their timing. The EPA and utilities have requested rehearing of the D.C. Circuit Court decision by the entire D.C. Circuit panel (en banc review). The court has ordered briefing on whether it should accept the case for en banc review. Thus, the matter remains unsettled until the court decides whether to rehear the case. Barring reversal of the decision if reheard, there will be a delay in the implementation of federal mercury requirements for existing coal-fired power plants while the EPA conducts a new rulemaking. Duke Energy Ohio is unable to estimate the costs to comply with a new EPA rule, although it is expected that costs will increase as a result of the court's decision.

**Coal Combustion Product (CCP) Management.** Duke Energy Ohio currently estimates that it will spend approximately \$95 million over the period 2008-2012 to install synthetic caps and liners at existing and new CCP landfills and to convert CCP handling systems from wet to dry systems.

**Extended Environmental Activities and Accruals.** Included in Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets were total accruals related to extended environmental-related activities of approximately \$8 million as of March 31, 2008 and December 31, 2007, respectively. These accruals represent Duke Energy Ohio's provisions for costs associated with remediation.

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activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Duke Energy Ohio believes that completion or resolution of these matters will have no material impact on its consolidated results of operations, cash flows or financial position.

#### Litigation

*New Source Review (NSR).* In 1999-2000, the U.S. Department of Justice acting on behalf of the EPA, filed a number of complaints and notices of violation against multiple utilities across the country for alleged violations of the NSR provisions of the Clean Air Act (CAA). Generally, the government alleges that projects performed at various coal-fired units were major modifications, as defined in the CAA, and that the utilities violated the CAA when they undertook those projects without obtaining permits and installing the best available emission controls for SO<sub>2</sub>, NO<sub>x</sub> and particulate matter. The complaints seek injunctive relief to require installation of pollution control technology on various allegedly violating generating units, and unspecified civil penalties in amounts of up to \$27,500 per day for each violation. Two of Duke Energy Ohio's plants have been subject to these allegations. Duke Energy Ohio asserts that there were no CAA violations because the applicable regulations do not require permitting in cases where the projects undertaken are "routine" or otherwise do not result in a net increase in emissions.

In November 1999, the U.S. brought a lawsuit in the U.S. Federal District Court for the Southern District of Indiana against Duke Energy Ohio alleging various violations of the CAA at Duke Energy Ohio's Beckjord and Miami Fort Stations. The lawsuit alleges that Duke Energy Ohio violated the CAA by not obtaining Prevention of Significant Deterioration, Non-Attainment New Source Review and Ohio's State Implementation Plan (SIP) permits. Additionally, the suit claims that Duke Energy Ohio violated an Administrative Consent Order entered into in 1998 between the EPA and Cinergy relating to alleged violations of Ohio's SIP provisions governing particulate matter at Duke Energy Ohio's Beckjord Station. Three northeast states and two environmental groups have intervened in the case. In June 2007, the trial court ruled, as a matter of law, that certain of the projects do not qualify for the "routine" exception in the regulations. The court ruled further that the defendants had "fair notice" of the EPA's interpretation of the applicable regulations. Duke Energy Ohio is arguing at trial that all of the projects were not reasonably expected to cause an increase in annual emissions and that certain of the projects are also exempt from the statute because they were "routine." A jury trial commenced on May 5, 2008.

Duke Energy Ohio has been informed by Dayton Power and Light (DP&L) that in June 2000, the EPA issued a Notice of Violation (NOV) to DP&L for alleged violations of CAA requirements at a station operated by DP&L and jointly-owned by DP&L, Columbus Southern Power Company (CSP), and Duke Energy Ohio. The NOV indicated the EPA may issue an order requiring compliance with the requirements of the Ohio SIP, or bring a civil action seeking injunctive relief and civil penalties of up to \$27,500 per day for each violation. In September 2004, Marilyn Wall and the Sierra Club brought a lawsuit against Duke Energy Ohio, DP&L and CSP for alleged violations of the CAA at this same generating station. On December 14, 2007, the Court ordered a stay of the litigation pending settlement negotiations among the parties. That stay is set to expire on May 15, 2008. Trial is currently scheduled to commence in August 2008.

It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with these matters. Ultimate resolution of these matters, even in settlement, could have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position. However, Duke Energy Ohio will pursue appropriate regulatory treatment for any costs incurred in connection with such resolution.

*Section 126 Petitions.* In March 2004, the state of North Carolina filed a petition under Section 126 of the CAA in which it alleges that sources in 13 upwind states, including Ohio, significantly contribute to North Carolina's non-attainment with certain ambient air quality standards. In August 2005, the EPA issued a proposed response to the petition. The EPA proposed to deny the ozone portion of the petition based upon a lack of contribution to air quality by the named states. The EPA also proposed to deny the particulate matter portion of the petition based upon the CAIR Federal Implementation Plan (FIP), that would address the air quality concerns from neighboring states. On April 28, 2006, the EPA denied North Carolina's petition based upon the final CAIR FIP described above. North Carolina has filed a legal challenge to the EPA's denial.

*Carbon Dioxide (CO<sub>2</sub>) Litigation.* In July 2004, the states of Connecticut, New York, California, Iowa, New Jersey, Rhode Island, Vermont, Wisconsin and the City of New York brought a lawsuit in the U.S. District Court for the Southern District of New York against Cinergy, American Electric Power Company, Inc., American Electric Power Service Corporation, The Southern Company, Tennessee Valley Authority, and Xcel Energy Inc. A similar lawsuit was filed in the U.S. District Court for the Southern District of New York against the same companies by Open Space Institute, Inc., Open Space Conservancy, Inc., and The Audubon Society of New Hampshire. These

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lawsuits allege that the defendants' emissions of CO<sub>2</sub> from the combustion of fossil fuels at electric generating facilities contribute to global warming and amount to a public nuisance. The complaints also allege that the defendants could generate the same amount of electricity while emitting significantly less CO<sub>2</sub>. The plaintiffs are seeking an injunction requiring each defendant to cap its CO<sub>2</sub> emissions and then reduce them by a specified percentage each year for at least a decade. In September 2005, the District Court granted the defendants' motion to dismiss the lawsuit. The plaintiffs have appealed this ruling to the Second Circuit Court of Appeals. Oral arguments were held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

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

*Hurricane Katrina Lawsuit.* In April 2006, Cinergy was named in the third amended complaint of a purported class action lawsuit filed in the U.S. District Court for the Southern District of Mississippi. Plaintiffs claim that Cinergy, along with numerous other utilities, oil companies, coal companies and chemical companies, are liable for damages relating to losses suffered by victims of Hurricane Katrina. Plaintiffs claim that defendants' greenhouse gas emissions contributed to the frequency and intensity of storms such as Hurricane Katrina. In October 2006, Cinergy was served with this lawsuit. On August 30, 2007, the court dismissed the case. The plaintiffs have filed their appeal to the Fifth Circuit Court of Appeals. Briefing is ongoing in the Fifth Circuit. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

*Ohio Antitrust Lawsuit.* In January 2008, four plaintiffs, including individual, industrial and non-profit customers, filed a lawsuit against Duke Energy Ohio in federal court in the Southern District of Ohio. Plaintiffs allege that Duke Energy Ohio (then The Cincinnati Gas & Electric Company (CG&E)), conspired to provide inequitable and unfair price advantages for certain large business consumers by entering into non-public option agreements with such consumers in exchange for their withdrawal of challenges to Duke Energy Ohio's (then CG&E's) pending RSP, which was implemented in early 2005. Duke Energy Ohio strongly denies the allegations made in the lawsuit and on March 21, 2008, Duke Energy Ohio filed a motion to dismiss plaintiffs' claims. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

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

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

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

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### Other Commitments and Contingencies

On March 10, 2008, the EPA issued a Clean Air Act Notice of Violation/Finding of Violation (NOV/FOV) asserting noncompliance with SO<sub>2</sub> emission limits, opacity standards, and permitting requirements at Duke Energy Ohio's Zimmer Generating Station. The NOV/FOV also asserts that a PSD permit should have been obtained for the installation in 2004 of a pollution control project in order to comply with the EPA's regional cap-and-trade program for NO<sub>x</sub> emissions. Duke Energy Ohio disputes the legal and factual basis for the NOV/NOV. Duke Energy Ohio is unable to predict at this time what, if any, remedies or potential penalties may result from the NOV/NOV.

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

### 12. Fair Value of Financial Assets and Liabilities

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

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

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

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

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

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

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

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PART I

DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

The following table provides the fair value measurement amounts for assets and liabilities recorded on Duke Energy Ohio's Consolidated Balance Sheets at fair value at March 31, 2008:

Description	Total Fair Value			
	Amounts at March 31, 2008	Level 1	Level 2	Level 3
	(In millions)			
Derivative assets	\$ 126	\$ 51	\$ —	\$ 75
Derivative liabilities	\$ 103	\$ —	\$ 3	\$ 100

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

**Rollforward of Level 3 Measurements**

	Derivatives (net)	
	(In millions)	
Balance at January 1, 2008	\$	(22)
Total pre-tax realized or unrealized gains included in earnings:		
Revenue, non-regulated		8
Total pre-tax losses included in other comprehensive income		(3)
Net purchases, sales, issuances and settlements		(8)
Balance at March 31, 2008	\$	(25)
Pre-tax amounts included in the Consolidated Statements of Operations related to Level 3 measurements outstanding at March 31, 2008:		
Revenue, non-regulated		1
Total	\$	1

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

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

**13. New Accounting Standards**

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

*SFAS No. 157.* Refer to Note 12 for a discussion of Duke Energy Ohio's adoption of SFAS No. 157.

*SFAS No. 159.* Refer to Note 12 for a discussion of Duke Energy Ohio's adoption of SFAS No. 159.

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

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

*SFAS No. 141 (revised 2007), "Business Combinations" (SFAS No. 141R).* In December 2007, the FASB issued SFAS No. 141R, which replaces SFAS No. 141, "Business Combinations." SFAS No. 141R retains the fundamental requirements in SFAS No. 141 that the acquisition method of accounting be used for all business combinations and that an acquirer be identified for each business combination. This statement also establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling (minority) interests in an acquiree, and any goodwill acquired in a business combination or gain recognized from a bargain purchase. For Duke Energy Ohio, SFAS No. 141R must be applied prospectively



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PART I

DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

to business combinations for which the acquisition date occurs on or after January 1, 2009. The impact to Duke Energy Ohio of applying SFAS No. 141R for periods subsequent to implementation will be dependent upon the nature of any transactions within the scope of SFAS No. 141R.

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

**14. Income Taxes and Other Taxes**

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

At March 31, 2008, Duke Energy Ohio has approximately \$46 million recorded for unrecognized tax benefits and no portion of the total unrecognized tax benefits that, if recognized, would affect the effective tax rate. Additionally, at March 31, 2008, Duke Energy Ohio has approximately \$7 million of unrecognized tax benefits related to pre-merger tax positions that, if recognized, would affect goodwill. It is reasonably possible that Duke Energy Ohio will reflect an approximate \$35 million reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

During the three months ended March 31, 2008, Duke Energy Ohio recognized net interest expense of approximately \$1 million in the Consolidated Statements of Operations related to income taxes. At March 31, 2008, Duke Energy Ohio had approximately \$7 million of interest payable, which reflects all interest related to income taxes, and no amount has been accrued for the payment of penalties in the Consolidated Balance Sheets.

Duke Energy Ohio has the following tax years open:

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

**Excise Taxes.** Certain excise taxes levied by state or local governments are collected by Duke Energy Ohio from its customers. These taxes, which are required to be paid regardless of Duke Energy Ohio's ability to collect from the customer, are accounted for on a gross basis. When Duke Energy Ohio acts as an agent, and the tax is not required to be remitted if it is not collected from the customer, the taxes are accounted for on a net basis. Duke Energy Ohio's excise taxes accounted for on a gross basis and recorded as Operating Revenues in the accompanying Consolidated Statements of Operations for the three months ended March 31, 2008 and 2007 were as follows:

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
	(in millions)	
Excise Taxes	\$ 39	\$ 39

**15. Subsequent Events**

For information on subsequent events related to debt and credit facilities, regulatory matters and commitments and contingencies, see Notes 5, 10 and 11, respectively.

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PART I

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

#### INTRODUCTION

#### EXECUTIVE OVERVIEW

Management's Discussion and Analysis should be read in conjunction with the Consolidated Financial Statements.

Duke Energy Ohio, Inc. (Duke Energy Ohio), is a wholly-owned subsidiary of Duke Energy Corp. (Duke Energy). Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing.

#### BASIS OF PRESENTATION

The results of operations and variance discussion for Duke Energy Ohio is presented in a reduced disclosure format in accordance with General Instructions H(2) of Form 10-Q.

#### RESULTS OF OPERATIONS

##### Results of Operations and Variances

##### Summary of Results (In millions)

	Three Months Ended March 31,		
	2008	2007	Increase (Decrease)
Operating revenues	\$ 991	\$ 916	\$ 75
Operating expenses	781	831	(50)
Gains (losses) on sales of other assets and other, net	13	(11)	24
Operating income	223	74	149
Other income and expenses, net	9	9	—
Interest expense	26	23	3
Income tax expense	73	23	50
Net income	\$ 133	\$ 37	\$ 96

The \$96 million increase in Duke Energy Ohio's Net Income was primarily due to the following factors:

#### Operating Revenues

The \$75 million increase in operating revenues was driven primarily by:

- A \$30 million increase in net mark-to-market revenues on non-qualifying power and capacity hedge contracts, consisting of mark-to-market losses of \$14 million in 2008 compared to losses of \$44 million in 2007,
- An \$18 million increase in retail demand resulting from favorable weather in 2008 compared to 2007,
- A \$17 million increase in revenues from the Midwest gas-fired generation assets due primarily to higher generation due to favorable weather in 2008 compared to 2007 and higher PJM capacity revenues,
- A \$15 million increase in regulated fuel revenues driven mainly by higher natural gas costs, and
- An \$11 million increase in retail electric revenues primarily due to increased amortization of purchase accounting valuation liability of rate stabilization plan.

Partially offsetting these increases was:

- A \$16 million decrease in volumes of coal sales due to expiration of contracts.

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### **PART I**

#### *Operating Expenses*

The \$50 million decrease in operating expenses was driven primarily by:

- A \$40 million decrease in fuel expense due to mark-to-market gains on non-qualifying fuel hedge contracts of \$58 million in 2008 compared to gains of \$18 million in 2007,
- An \$18 million decrease due primarily to lower sulfur dioxide emission allowance expenses due to installation of flue gas desulphurization equipment, and
- A \$17 million decrease in expenses associated with coal sales due to expiration of contracts.

Partially offsetting these decreases were:

- A \$16 million increase in regulated fuel expense primarily due to higher natural gas costs, and
- A \$7 million increase in fuel and operating expenses for the Midwest gas-fired generation assets primarily due to increased generation volumes in 2008 compared to 2007.

#### *Gains (Losses) on Sales of Other Assets and Other, net.*

The \$24 million increase in gains (losses) on sales of other assets and other, net is attributable to gains on sales of emission allowances in 2008 compared to losses on sales of emission allowances in 2007.

#### *Income Tax Expense.*

The \$50 million increase in Income Tax Expense was primarily due to an increase in pre-tax income.

### **OTHER MATTERS**

At March 31, 2008, Duke Energy Ohio had approximately \$440 million of auction rate pollution control bonds outstanding. The maximum auction rate for the majority of this auction rate debt is 1.75 times one-month LIBOR. While Duke Energy Ohio has plans to refund and refinance these tax exempt auction rate bonds, the timing of such refinancing transactions is uncertain and subject to market conditions.

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### **PART I**

#### **Item 4. Controls and Procedures.**

##### **Disclosure Controls and Procedures**

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized, and reported, within the time periods specified by the Securities and Exchange Commission's (SEC) rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2008, and, based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

##### **Changes in Internal Control over Financial Reporting**

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended March 31, 2008 and, other than the third party sourcing arrangement discussed below, found no change that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

During the first quarter of 2008, Duke Energy Ohio transferred payroll processing to the same third party provider currently used by other Duke Energy subsidiaries. Duke Energy Ohio reviewed the impact of this change on Duke Energy Ohio's internal control over financial reporting and made changes to internal control over financial reporting related to the data transmission to, and receipt from, the third party provider.

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## PART II. OTHER INFORMATION

**Item 1. Legal Proceedings**

For information regarding legal proceedings that became reportable events or in which there were material developments in the first quarter of 2008, see Note 10 to the Consolidated Financial Statements, "Regulatory Matters" and Note 11 to the Consolidated Financial Statements, "Commitments and Contingencies."

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, careful consideration should be given to the factors discussed in Part I, "Item 1A. Risk Factors" in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect Duke Energy Ohio's financial condition or future results. Additional risks and uncertainties not currently known to Duke Energy Ohio or that Duke Energy Ohio currently deems to be immaterial also may adversely affect Duke Energy Ohio's financial condition and/or results of operations.

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PART II

**Item 6. Exhibits****(a) Exhibits**

Exhibits filed or furnished herewith are designated by an asterisk (\*).

**Exhibit  
Number**

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10.1	Amendment No. 1 to the Amended and Restated Credit Agreement (filed on Form 8-K of Duke Energy Ohio, Inc., March 12, 2008, File No. 1-1232, as Exhibit 10.1).
*31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The total amount of securities of the registrant or its subsidiaries authorized under any instrument with respect to long-term debt not filed as an exhibit does not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. The registrant agrees, upon request of the Securities and Exchange Commission, to furnish copies of any or all of such instruments to it.

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PART II

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DUKE ENERGY OHIO, INC.

Date: May 15, 2008

/s/ DAVID L. HAUSER

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David L. Hauser  
Group Executive and  
Chief Financial Officer

Date: May 15, 2008

/s/ STEVEN K. YOUNG

---

Steven K. Young  
Senior Vice President and  
Controller

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James E. Rogers, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 15, 2008

\_\_\_\_\_  
/s/ JAMES E. ROGERS  
James E. Rogers  
Chief Executive Officer



**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, David L. Hauser, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 15, 2008

\_\_\_\_\_  
/s/ DAVID L. HAUSER  
David L. Hauser  
Group Executive and  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending March 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Rogers, Chief Executive Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

/s/ JAMES E. ROGERS

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James E. Rogers  
Chief Executive Officer  
May 15, 2008

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending March 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David L. Hauser, Group Executive and Chief Financial Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

/s/ DAVID L. HAUSER

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David L. Hauser  
Group Executive and Chief Financial Officer  
May 15, 2008

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# **FORM 10-Q**

**Duke Energy Ohio, Inc. - N/A**

**Filed: November 14, 2007 (period: September 30, 2007)**

Quarterly report which provides a continuing view of a company's financial position

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10-Q - FORM 10-Q

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- Item 2.      Management's Discussion and Analysis of Financial Condition and Results of Operations.
- Item 4.      Controls and Procedures.

## PART II.

- Item 1.      Legal Proceedings
- Item 1A.     Risk Factors
- Item 6.      Exhibits

### SIGNATURES

EX-31.1 (CERTIFICATION OF CEO PURSUANT TO SEC. 302 OF SARBANES OXLEY)

EX-31.2 (CERTIFICATION OF CFO PURSUANT TO SEC. 302 OF SARBANES OXLEY)

EX-32.1 (CERTIFICATION OF CEO PURSUANT TO SEC. 906 OF SARBANES OXLEY)

EX-32.2 (CERTIFICATION OF CFO PURSUANT TO SEC. 906 OF SARBANES OXLEY)

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended September 30, 2007 Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-1232

**DUKE ENERGY OHIO, INC.**

(Exact Name of Registrant as Specified in its Charter)

Ohio  
(State or Other Jurisdiction of Incorporation)

31-0240030  
(IRS Employer Identification No.)

139 East Fourth Street  
Cincinnati, OH  
(Address of Principal Executive Offices)

45202  
(Zip code)

704-594-6200  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).  
Yes  No

All of the registrant's common stock is indirectly owned by Duke Energy Corporation (File No. 1-32853) which is a reporting company under the Securities Exchange Act of 1934, as amended.

The registrant meets the conditions set forth in General Instructions H(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format specified in General Instructions H(2) of Form 10-Q.

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DUKE ENERGY OHIO, INC.  
FORM 10-Q FOR THE QUARTER ENDED  
SEPTEMBER 30, 2007

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#### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management's beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "plan," "project," "predict," "will," "potential," "forecast," and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- State and federal legislative and regulatory initiatives, including costs of compliance with existing and future environmental requirements;
- State and federal legislative and regulatory initiatives and rulings that affect cost and investment recovery or have an impact on rate structures;
- Costs and effects of legal and administrative proceedings, settlements, investigations and claims;
- Industrial, commercial and residential growth in Duke Energy Ohio, Inc.'s (Duke Energy Ohio) service territories;
- Additional competition in electric markets and continued industry consolidation;
- The influence of weather and other natural phenomena on Duke Energy Ohio operations, including the economic, operational and other effects of tornados, droughts and other natural phenomena;
- The timing and extent of changes in commodity prices and interest rates;
- Unscheduled generation outages, unusual maintenance or repairs and electric transmission system constraints;
- The performance of electric generation facilities;
- The results of financing efforts, including Duke Energy Ohio's ability to obtain financing on favorable terms, which can be affected by various factors, including Duke Energy Ohio's credit ratings and general economic conditions;
- Declines in the market prices of equity securities and resultant cash funding requirements of Duke Energy Ohio for Cinergy's defined benefit pension plans;
- The level of credit worthiness of counterparties to Duke Energy Ohio's transactions;
- Employee workforce factors, including the potential inability to attract and retain key personnel;
- Growth in opportunities for Duke Energy Ohio's business units, including the timing and success of efforts to develop domestic power and other projects; and
- The effect of accounting pronouncements issued periodically by accounting standard-setting bodies.



In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Duke Energy Ohio has described. Duke Energy Ohio undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I. FINANCIAL INFORMATION

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)  
(In millions)

**Item 1. Financial Statements.**

	Successor				Predecessor
	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007	Three Months Ended September 30, 2006	Six Months Ended September 30, 2006	Three Months Ended March 31, 2006
<b>Operating Revenues</b>					
Non-regulated electric and other	\$ 613	\$ 1,381	\$ 470	\$ 869	\$ 421
Regulated electric	278	742	235	439	220
Regulated natural gas	64	511	71	164	322
<b>Total operating revenues</b>	<b>955</b>	<b>2,634</b>	<b>776</b>	<b>1,472</b>	<b>963</b>
<b>Operating Expenses</b>					
Fuel used in electric generation and purchased power	359	844	299	548	196
Operation, maintenance and other	186	553	168	341	173
Natural gas purchased	25	317	31	82	232
Costs of fuel resold	7	39	29	58	44
Depreciation and amortization	107	295	94	187	68
Property and other taxes	60	195	56	111	68
<b>Total operating expenses</b>	<b>744</b>	<b>2,243</b>	<b>677</b>	<b>1,327</b>	<b>781</b>
(Losses) Gains on Sales of Other Assets and Other, net	(1)	(12)	(9)	(14)	26
<b>Operating Income</b>	<b>210</b>	<b>379</b>	<b>90</b>	<b>131</b>	<b>208</b>
<b>Other Income and Expenses, net</b>	<b>5</b>	<b>22</b>	<b>6</b>	<b>13</b>	<b>8</b>
<b>Interest Expense</b>	<b>28</b>	<b>73</b>	<b>26</b>	<b>54</b>	<b>30</b>
<b>Income from Continuing Operations Before Income Taxes</b>	<b>187</b>	<b>328</b>	<b>70</b>	<b>90</b>	<b>186</b>
<b>Income Tax Expense from Continuing Operations</b>	<b>69</b>	<b>124</b>	<b>29</b>	<b>36</b>	<b>68</b>
<b>Income from Continuing Operations</b>	<b>118</b>	<b>204</b>	<b>41</b>	<b>54</b>	<b>118</b>
<b>Income (Loss) from Discontinued Operations, net of tax</b>	<b>—</b>	<b>—</b>	<b>19</b>	<b>(1)</b>	<b>(2)</b>
<b>Net Income</b>	<b>\$ 118</b>	<b>\$ 204</b>	<b>\$ 60</b>	<b>\$ 53</b>	<b>\$ 116</b>

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED BALANCE SHEETS**  
(Unaudited)  
(In millions)

Successor

	September 30, 2007	December 31, 2006
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 23	\$ 45
Receivables (net of allowance for doubtful accounts of \$3 at September 30, 2007 and \$5 at December 31, 2006)	241	308
Inventory	232	217
Assets held for sale	5	25
Unrealized gains on mark-to-market and hedging transactions	18	54
Other	120	117
<b>Total current assets</b>	<b>639</b>	<b>766</b>
<b>Investments and Other Assets</b>		
Restricted funds held in trust	10	30
Goodwill	2,337	2,348
Intangible assets	576	732
Unrealized gains on mark-to-market and hedging transactions	17	27
Assets held for sale	—	18
Other	26	21
<b>Total Investments and other assets</b>	<b>2,966</b>	<b>3,176</b>
<b>Property, Plant and Equipment</b>		
Cost	9,459	9,049
Less accumulated depreciation and amortization	2,092	1,914
<b>Net property, plant and equipment</b>	<b>7,367</b>	<b>7,135</b>
<b>Regulatory Assets and Deferred Debits</b>		
Deferred debt expense	22	24
Regulatory assets related to income taxes	93	96
Other	451	533
<b>Total regulatory assets and deferred debits</b>	<b>566</b>	<b>653</b>
<b>Total Assets</b>	<b>\$ 11,538</b>	<b>\$ 11,730</b>

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED BALANCE SHEETS—(Continued)**  
(Unaudited)  
(In millions, except share and per-share amounts)

	Successor	
	September 30, 2007	December 31, 2006
<b>LIABILITIES AND COMMON STOCKHOLDER'S EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 327	\$ 408
Notes payable and commercial paper	348	274
Taxes accrued	152	301
Interest accrued	29	27
Liabilities associated with assets held for sale	5	25
Current maturities of long-term debt	227	105
Unrealized losses on mark-to-market and hedging transactions	33	46
Other	78	99
<b>Total current liabilities</b>	<b>1,199</b>	<b>1,285</b>
<b>Long-term Debt</b>		
	1,658	1,776
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes	1,494	1,475
Investment tax credit	17	19
Accrued pension and other postretirement benefit costs	315	381
Regulatory liabilities	174	167
Unrealized losses on mark-to-market and hedging transactions	27	29
Liabilities associated with assets held for sale	—	18
Asset retirement obligations	43	41
Other	144	159
<b>Total deferred credits and other liabilities</b>	<b>2,214</b>	<b>2,289</b>
<b>Commitments and Contingencies</b>		
<b>Common Stockholder's Equity</b>		
Common stock, \$8.50 par value; 120,000,000 shares authorized and 89,663,086 shares outstanding at September 30, 2007 and December 31, 2006	762	762
Additional paid-in capital	5,576	5,601
Retained earnings	167	55
Accumulated other comprehensive loss	(38)	(38)
<b>Total common stockholder's equity</b>	<b>6,467</b>	<b>6,380</b>
<b>Total Liabilities and Common Stockholder's Equity</b>	<b>\$ 11,538</b>	<b>\$ 11,730</b>

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)  
(In millions)

	Successor		Predecessor	
	Nine Months Ended September 30, 2007	Six Months Ended September 30, 2006	Three Months Ended March 31, 2006	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>				
Net income	\$ 204	\$ 53	\$ 116	
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	295	187	68	
Losses (gains) on sales of equity investments and other assets	12	14	(26)	
Deferred income taxes	45	(95)	7	
Regulatory asset/liability amortization	15	6	7	
Accrued pension and other postretirement benefit costs	28	21	9	
Contribution to company-sponsored pension and other postretirement benefit plans	(92)	(22)	—	
(Increase) decrease in:				
Net realized and unrealized mark-to-market and hedging transactions	31	(18)	(30)	
Receivables	71	202	10	
Inventory	(14)	(2)	56	
Other current assets	(1)	45	68	
Increase (decrease) in:				
Accounts payable	(56)	(159)	(157)	
Taxes accrued	(153)	108	50	
Other current liabilities	(6)	(52)	(78)	
Regulatory asset/liability deferrals	(20)	(9)	(1)	
Other assets	126	112	17	
Other liabilities	(46)	(28)	—	
Net cash provided by operating activities	439	363	116	
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Capital expenditures	(461)	(244)	(135)	
Investment expenditures	(1)	—	—	
Purchases of emission allowances	(14)	(133)	(162)	
Sales of emission allowances	25	105	105	
Withdrawal of restricted funds held in trust	21	—	8	
Net cash used in investing activities	(430)	(272)	(184)	
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>				
Issuance of long-term debt	6	77	141	
Redemption of long-term debt	(5)	(78)	(1)	
Redemption of preferred stock of subsidiaries	—	—	(21)	
Notes payable and commercial paper	74	(56)	50	
Dividends paid	(135)	—	(102)	
Capital contribution from parent	29	—	—	
Other	—	(2)	(1)	
Net cash (used in) provided by financing activities	(31)	(59)	66	
Net (decrease) increase in cash and cash equivalents	(22)	32	(2)	
Cash and cash equivalents at beginning of period	45	8	10	
Cash and cash equivalents at end of period	\$ 23	\$ 40	\$ 8	
<b>Supplemental Disclosures</b>				
Significant non-cash transactions:				
Purchase accounting adjustments	\$ (8)	\$ 2,894	\$ —	
Allowance for funds used during construction (AFUDC) – equity component	\$ 3	\$ 2	\$ 1	
Accrued capital expenditures	\$ 13	\$ 22	\$ —	
Transfer of generating assets from Duke Energy	\$ —	\$ 1,452	\$ —	

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME**  
(Unaudited)  
(In millions)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Net Gains (Losses) on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss) Minimum Pension Liability Adjustment	SFAS No. 158 Adjustment	Total Common Stockholder's Equity
<b>Successor</b>							
<b>Nine Months Ended September 30, 2007</b>							
Balance at December 31, 2006	\$ 762	\$ 5,601	\$ 55	\$ (36)	\$ —	\$ (2)	\$ 6,380
Net income	—	—	204	—	—	—	204
Other comprehensive income	—	—	—	—	—	—	—
Cash flow hedges	—	—	—	1	—	—	1
Other	—	—	—	—	—	1	1
Total comprehensive income	—	—	—	—	—	—	206
Capital contribution from parent	—	29	—	—	—	—	29
Push-down accounting adjustments	—	(8)	—	—	—	—	(8)
Adoption of SFAS No. 158 – measurement date provision <sup>(c)</sup>	—	—	(3)	—	—	(2)	(5)
Common stock dividends	—	(46)	(89)	—	—	—	(135)
Balance at September 30, 2007	\$ 762	\$ 5,576	\$ 167	\$ (35)	\$ —	\$ (3)	\$ 6,467
<b>Six Months Ended September 30, 2006</b>							
Balance at April 1, 2006	\$ 762	\$ 4,123	\$ —	\$ —	\$ —	\$ —	\$ 4,885 <sup>(b)</sup>
Net income and total comprehensive income	—	—	53	—	—	—	53
Transfer of generating assets from Duke Energy <sup>(a)</sup>	—	1,452	—	(39)	—	—	1,413
Balance at September 30, 2006	\$ 762	\$ 5,575	\$ 53	\$ (39)	\$ —	\$ —	\$ 6,351
<b>Predecessor</b>							
<b>Three Months Ended March 31, 2006</b>							
Balance at December 31, 2005	\$ 762	\$ 603	\$ 657	\$ (14)	\$ (33)	\$ —	\$ 1,975
Net income	—	—	116	—	—	—	116
Other comprehensive income	—	—	—	—	—	—	—
Minimum pension liability adjustment	—	—	—	—	1	—	1
Cash flow hedges	—	—	—	1	—	—	1
Total comprehensive income	—	—	—	—	—	—	118
Common stock dividends	—	—	(102)	—	—	—	(102)
Balance at March 31, 2006	\$ 762	\$ 603	\$ 671	\$ (13)	\$ (32)	\$ —	\$ 1,991 <sup>(b)</sup>

(a) Includes \$39 (net of tax benefit of \$24) related to deferred losses on terminated cash flow hedges included in Accumulated Other Comprehensive Income (Loss).

(b) Difference in equity balances at March 31, 2006 and April 1, 2006 is due to the application of push-down accounting reflecting Duke Energy's merger with Cinergy (see Notes 1 and 2 to the Consolidated Financial Statements).

(c) Net of \$2 tax benefit in 2007.

See Notes to Unaudited Consolidated Financial Statements

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### PART I

## DUKE ENERGY OHIO, INC. Notes To Consolidated Financial Statements (Unaudited)

### 1. Basis of Presentation

**Nature of Operations and Basis of Consolidation.** Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through Duke Energy Kentucky, Inc. (Duke Energy Kentucky) in nearby areas of Kentucky. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing. Duke Energy Ohio's principal subsidiary is Duke Energy Kentucky, a Kentucky corporation organized in 1901. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. References herein to Duke Energy Ohio includes Duke Energy Ohio and its subsidiaries. In October 2006, Cinergy and Duke Energy Ohio completed the sale of Duke Energy Ohio's trading contracts to Fortis Bank S.A./N.V. (Fortis), a Benelux-based financial services group. See Note 9 for additional information.

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

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

These Consolidated Financial Statements include, after eliminating intercompany transactions and balances, the accounts of Duke Energy Ohio and all majority-owned subsidiaries where Duke Energy Ohio has control. These Consolidated Financial Statements also reflect Duke Energy Ohio's proportionate share of certain generation and transmission facilities.

**Predecessor and Successor Reporting.** In connection with the Duke Energy merger, Duke Energy acquired all of the outstanding common stock of Cinergy. The merger has been accounted for under the purchase method of accounting with Duke Energy treated as the acquirer for accounting purposes. As a result, the assets and liabilities of Cinergy were recorded at their respective fair values as of the merger consummation date. Purchase accounting impacts, including goodwill recognition, have been "pushed down" to Duke Energy Ohio, resulting in the assets and liabilities of Duke Energy Ohio being recorded at their respective fair values as of April 3, 2006 (see Note 2). Except for an adjustment related to pension and other postretirement benefit obligations, as mandated by Statement of Financial Accounting Standards (SFAS) No. 87, "Employers' Accounting for Pensions," and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," the accompanying consolidated financial statements do not reflect any adjustments related to Duke Energy Ohio's regulated operations that are accounted for pursuant to SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71), which are comprised of Duke Energy Ohio's regulated transmission and distribution operations and Duke Energy Kentucky. Under the rate setting and recovery provisions currently in place for these regulated operations which provide revenues derived from cost, the fair values of the individual tangible and intangible assets and liabilities are considered to approximate their carrying values.

Duke Energy Ohio's Consolidated Statements of Operations subsequent to the merger include amortization expense relating to purchase accounting adjustments and depreciation of fixed assets based upon their fair values as of the merger date. Therefore, the Duke Energy Ohio financial data prior to the merger will not generally be comparable to its financial data subsequent to the merger. See Note 2 for additional information.

Due to the impact of push-down accounting, the financial statements and certain note presentations separate Duke Energy Ohio's presentations into two distinct periods, the period before the consummation of the merger (labeled "Predecessor") and the period after that date (labeled "Successor"), to indicate the application of different basis of accounting between the periods presented.

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PART I

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**  
**(Unaudited)**

These Consolidated Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present Duke Energy Ohio's financial position and results of operations. Amounts reported in the interim Consolidated Statements of Operations are not necessarily indicative of amounts expected for the respective annual periods due to the effects of seasonal temperature variations on energy consumption, regulatory rulings, the timing of maintenance on electric generating units, changes in mark-to-market valuations, changing commodity prices, and other factors. These Consolidated Financial Statements and other information included in this quarterly report should be read in conjunction with the Consolidated Financial Statements and Notes in Duke Energy Ohio's Form 10-K for the year ended December 31, 2006.

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

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

**Unbilled Revenue.** Revenues on sales of electricity and gas are recognized when the service is provided. Unbilled revenues are estimated by applying an average revenue per kilowatt hour or per Mcf for all customer classes to the number of estimated kilowatt hours or Mcf's delivered but not billed. The amount of unbilled revenues can vary significantly period to period as a result of factors including seasonality, weather, customer usage pattern and customer mix. Unbilled revenues, which are recorded as Receivables in Duke Energy Ohio's Consolidated Balance Sheets at September 30, 2007 and December 31, 2006 were approximately \$105 million and \$130 million, respectively.

**Other Regulatory Assets and Deferred Debits.** The state of Ohio passed comprehensive electric deregulation legislation in 1999, and in 2000, the Public Utilities Commission of Ohio (PUCO) approved a stipulation agreement relating to Duke Energy Ohio's transition plan creating a Regulatory Transition Charge (RTC) designed to recover Duke Energy Ohio's generation-related regulatory assets and transition costs over a ten-year period beginning January 1, 2001 and ending December 2010. Accordingly, application of SFAS No. 71 was discontinued for the generation portion of Duke Energy Ohio's business. Duke Energy Ohio has a RTC related regulatory asset balance of approximately \$260 million and \$331 million as of September 30, 2007 and December 31, 2006, respectively, which is classified in Other Regulatory Assets and Deferred Debits on the Consolidated Balance Sheets.

**2. Duke Energy/Cinergy Merger**

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

As discussed in Note 1 above, purchase accounting impacts, including goodwill recognition, have been "pushed down" to Duke Energy Ohio, resulting in the assets and liabilities of Duke Energy Ohio being recorded at their respective fair values as of April 3, 2006. The following unaudited consolidated pro forma financial results for Duke Energy Ohio are presented as if the merger with Duke Energy had occurred at the beginning of the period presented:

**Unaudited Consolidated Pro Forma Results (Predecessor)**

	<b>Three Months Ended March 31, 2006</b>
	<b>(in millions)</b>
Operating revenues	\$ 966
Income from continuing operations	\$ 88
Net income	\$ 86



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PART I

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**  
**(Unaudited)**

These pro forma results do not include any significant transactions completed by Duke Energy Ohio other than the impact of Cinergy's merger with Duke Energy. Prior to consummation of the merger, certain regulatory approvals were received from the state utility commissions and the Federal Energy Regulatory Commission (FERC). See Note 12 for a discussion of the regulatory impacts of the merger.

**3. Transfer of Generating Assets and Dispositions**

**Transfer of Certain Duke Energy Generating Assets to Duke Energy Ohio.** In April 2006, Duke Energy contributed to Duke Energy Ohio its ownership interest in five plants, representing a mix of combined cycle and peaking plants, with a combined capacity of 3,600 megawatts (MW). The transaction was effective in April 2006 and was accounted for at Duke Energy's net book value for these assets. The entities holding these generating plants, which were indirect subsidiaries of Duke Energy, were first distributed to Duke Energy, which then contributed them to Cinergy which, in turn, contributed them to Duke Energy Ohio. In the final step, the entities were then merged into Duke Energy Ohio.

The following unaudited consolidated pro forma financial results for Duke Energy Ohio are presented as if the contribution of the Duke Energy generating assets to Duke Energy Ohio had occurred at the beginning of the period presented:

**Unaudited Consolidated Pro Forma Results (Predecessor)**

	<b>Three Months Ended March 31, 2006</b>
	<b>(in millions)</b>
Operating revenues	\$ 971
Income from continuing operations	\$ 106
Net income	\$ 104

These pro forma results do not include any significant transactions completed by Duke Energy Ohio other than the impact of the transfer of the ownership interest in the five plants as discussed above. As part of this transaction, Duke Energy agreed to reimburse Duke Energy Ohio, on a quarterly basis, through April 2016 in the event of certain cash shortfalls related to the performance of the five plants. Based on the assessment of the performance of the five plants during the first, second and third quarters of 2007, Duke Energy Ohio did not incur any qualifying shortfalls related to the performance of the five plants and thus no cash reimbursement was required from Duke Energy. During the third quarter of 2006, Duke Energy reimbursed Duke Energy Ohio \$1.9 million for certain cash shortfalls that occurred during the second quarter of 2006. However, as a result of the calculation pertaining to the third quarter 2006 performance of the five plants, the \$1.9 million received by Duke Energy Ohio from Duke Energy was returned to Duke Energy during the fourth quarter of 2006. Duke Energy Ohio accounts for any payments from or return of payments to Duke Energy in Common Stockholder's Equity as an adjustment to Additional paid-in capital.

**Dispositions.** For the three and nine months ended September 30, 2007 the sale of emission allowances resulted in approximately \$1 million and \$25 million, respectively, in proceeds and net pre-tax gains (losses) of less than \$1 million and \$(11) million, respectively, recorded in (Losses) Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. For the three and six months ended September 30, 2006, the sale of emission allowances resulted in approximately \$42 million and \$105 million, respectively, in proceeds and net pre-tax losses of \$9 million and \$14 million, respectively, recorded in (Losses) Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. For the three months ended March 31, 2006, the sale of emission allowances resulted in approximately \$105 million in proceeds and net pre-tax gains of \$26 million recorded in (Losses) Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These amounts primarily relate to Commercial Power's sales of emission allowances. See Note 9 for dispositions related to discontinued operations.

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PART I

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**  
**(Unaudited)**

**4. Common and Preferred Stock**

**Common Stock.** Cinergy owns all of the common stock of Duke Energy Ohio. In April 2006, Duke Energy acquired 100 percent of Cinergy's outstanding stock for 1.56 shares of Duke Energy common stock per outstanding share of Cinergy common stock. This conversion resulted in the issuance of approximately 313 million shares of Duke Energy common stock. See Note 1 for additional information.

In April 2006, Duke Energy Ohio filed a petition with the FERC for a declaratory ruling that its payment of dividends out of its paid-in capital account, using the balance transferred from the retained earnings account, resulting from purchase accounting arising from the Duke Energy/Cinergy merger, would not violate section 305(a) of the Federal Power Act, which generally precludes the payment of dividends out of paid-in capital. Such a ruling was necessary because purchase/push-down accounting reset retained earnings to zero as of April 3, 2006, thus potentially precluding Duke Energy Ohio from using pre-merger retained earnings to pay dividends. Without this approval, Duke Energy Ohio's ability to pay dividends would have been constrained to earnings since April 3, 2006. In May 2006, the FERC issued an order approving Duke Energy Ohio's petition.

During the nine months ended September 30, 2007 and the three months ended March 31, 2006, Duke Energy Ohio paid dividends to its parent, Cinergy, of \$135 million and \$102 million, respectively.

**Preferred Stock.** In March 2006, Duke Energy Ohio redeemed all outstanding shares of its \$16.98 million notional amount 4% Cumulative Preferred Stock and its \$3.5 million notional amount 4.75% Cumulative Preferred Stock at a price of \$108 per share and \$101 per share, respectively, plus accrued and unpaid dividends.

**5. Inventory**

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

	Successor <sup>(a)</sup>	
	September 30, 2007	December 31, 2006
	(in millions)	
Gas held in storage	\$ 87	\$ 82
Fuel for use in electric generation	78	74
Materials and supplies	67	67
<b>Total Inventory</b>	<b>\$ 232</b>	<b>\$ 217</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

**6. Debt and Credit Facilities**

Duke Energy Ohio receives support for its short-term borrowing needs through its participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement, which allows Duke Energy Ohio to better manage its cash and working capital requirements. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. Prior to the merger, Duke Energy Ohio participated in a similar money pool arrangement with Cinergy and other Cinergy subsidiaries. As of September 30, 2007 and December 31, 2006, Duke Energy Ohio was in a payable position of \$348 million and \$274 million, respectively, classified within Notes payable and commercial paper in the accompanying Consolidated Balance Sheets. During the nine months ended September 30, 2007, the \$74 million change in the money pool is reflected as a cash inflow in Notes payable and commercial paper within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the six months ended September 30, 2006, the \$40 million change in the money pool is reflected as a cash outflow in Notes payable and commercial paper within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the three months ended March 31, 2006, the \$108 million change in the money pool is reflected as a cash inflow in Notes payable and commercial paper within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows.

In October 2007, Duke Energy Ohio had approximately \$100 million of debt which matured and was repaid, principally from short-term borrowings and cash from operations.

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PART I

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**  
**(Unaudited)**

In October 2007, Duke Energy and certain of its subsidiaries filed a registration statement (Form S-3) with the Securities and Exchange Commission (SEC). Under this Form S-3, which is uncapped, Duke Energy and certain of its subsidiaries, including Duke Energy Ohio, may issue debt and other securities in the future at amounts, prices and with terms to be determined at the time of future offerings.

*Available Credit Facilities and Restrictive Debt Covenants.* In June 2007, Duke Energy closed on the syndication of an amended and restated credit facility, replacing the existing credit facilities totaling \$2.65 billion with a 5-year, \$2.65 billion master credit facility. Duke Energy Ohio (excluding Duke Energy Kentucky) has a borrowing sub limit of \$500 million and Duke Energy Kentucky has a borrowing sub limit of \$100 million under the master credit facility. Concurrent with the syndication of the master credit facility, Duke Energy established a new \$1.5 billion commercial paper program at Duke Energy and terminated Cinergy's previously existing commercial paper program.

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

Duke Energy's credit agreement contains various financial and other covenants, including, but not limited to, a covenant regarding the debt-to-total capitalization ratio at Duke Energy, Duke Energy Ohio and Duke Energy Kentucky to not exceed 65%. Duke Energy Ohio's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of September 30, 2007, Duke Energy and Duke Energy Ohio were in compliance with these covenants. In addition, some credit agreements may allow for acceleration of payments or termination of the agreements due to nonpayment, or the acceleration of other significant indebtedness of the borrower or some of its subsidiaries. None of the debt or credit agreements contain material adverse change clauses.

As of September 30, 2007 and December 31, 2006, approximately \$96 million of certain pollution control bonds, which are short-term obligations by nature, are classified as Long-term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio's intent and ability to utilize such borrowings as long-term financing. Duke Energy's credit facilities with non-cancelable terms in excess of one year as of the balance sheet date give Duke Energy Ohio the ability to refinance these short-term obligations on a long-term basis.

### 7. Employee Benefit Obligations

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

Duke Energy's policy is to fund amounts for its U.S. retirement plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. During the nine months ended September 30, 2007, Duke Energy made qualified pension benefit contributions of approximately \$350 million to the legacy Cinergy qualified pension benefit plans, of which approximately \$83 million represents contributions made by Duke Energy Ohio. During the nine months ended September 30, 2006, Duke Energy made qualified pension benefit contributions of approximately \$124 million to the legacy Cinergy qualified pension benefit plans, of which approximately \$22 million represents contributions made by Duke Energy Ohio. During the three and nine months ended September 30, 2007, Duke Energy contributed approximately \$32 million to the legacy Cinergy other post-retirement plans, of which approximately \$9 million represents contributions made by Duke Energy Ohio. Duke Energy does not anticipate making any additional contributions to its legacy Cinergy retirement plans during the remainder of 2007.

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

	Successor <sup>(a)</sup>				Predecessor <sup>(a)</sup>
	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007	Three Months Ended September 30, 2006	Six Months Ended September 30, 2006	Three Months Ended March 31, 2006
	(In millions)				
Qualified Pension Benefits <sup>(b)</sup>	\$ 5	\$ 12	\$ 5	\$ 10	\$ 6
Other Postretirement <sup>(c)</sup>	\$ 4	\$ 9	\$ 2	\$ 5	\$ 3

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) These amounts exclude approximately \$(2) million and \$5 million for the three and nine months ended September 30, 2007, respectively, and approximately \$3 million and \$5 million for the three months and six months ended September 30, 2006, respectively, of regulatory asset amortization resulting from purchase accounting.

(c) These amounts exclude approximately zero and \$2 million for the three and nine months ended September 30, 2007, respectively, and approximately zero and \$1 million for the three months and six months ended September 30, 2006, respectively, of regulatory asset amortization resulting from purchase accounting.

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

See Note 15 for a discussion of the effect of adoption of SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of Financial Accounting Standards Board (FASB) Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158). Also, refer to Note 14 for a discussion of the amounts in the Consolidated Balance Sheets related to allocated accrued pension and other postretirement benefit obligations from Cinergy.

**8. Goodwill and Intangibles**

As discussed in Note 2, in April 2006, Duke Energy and Cinergy consummated the merger, which resulted in Duke Energy Ohio recording goodwill of approximately \$2.3 billion. The following table shows the components of goodwill at September 30, 2007 and December 31, 2006:

**Carrying Amount of Goodwill**

	Successor <sup>(a)</sup>		
	Balance at December 31, 2006	Changes	Balance at September 30, 2007
	(in millions)		
<b>Business Segment:</b>			
Commercial Power	\$ 1,200	\$ (5)	\$ 1,195
Franchised Electric and Gas	1,148	(6)	1,142
<b>Total Goodwill</b>	<b>\$ 2,348</b>	<b>\$ (11)</b>	<b>\$ 2,337</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

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The carrying amount and accumulated amortization of intangible assets as of September 30, 2007 and December 31, 2006 are as follows:

	Successor <sup>(a)</sup>	
	September 30, 2007	December 31, 2006
	(in millions)	
Emission allowances	\$ 377	\$ 495
Gas, coal, and power contracts	271	271
Other	9	9
<b>Total gross carrying amount</b>	<b>657</b>	<b>775</b>
Accumulated amortization—gas, coal, and power contracts	(77)	(40)
Accumulated amortization—other	(4)	(3)
<b>Total accumulated amortization</b>	<b>(81)</b>	<b>(43)</b>
<b>Total intangible assets, net</b>	<b>\$ 576</b>	<b>\$ 732</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

The carrying value of emission allowances sold or consumed for Duke Energy Ohio were as follows:

	Successor <sup>(a)</sup>				Predecessor <sup>(a)</sup>
	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007	Three Months Ended September 30, 2006	Six Months Ended September 30, 2006	Three Months Ended March 31, 2006
	(in millions)				
	\$ 34	\$ 134	\$ 100	\$ 188	\$ 36

(a) See Note 1 for additional information on Predecessor and Successor reporting.

Amortization expense recorded for Duke Energy Ohio was as follows:

	Successor <sup>(a)</sup>				Predecessor <sup>(a)</sup>
	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007	Three Months Ended September 30, 2006	Six Months Ended September 30, 2006	Three Months Ended March 31, 2006
	(in millions)				
	\$ 13	\$ 38	\$ 14	\$ 28	\$ 1

(a) See Note 1 for additional information on Predecessor and Successor reporting.

As of April 3, 2006, Duke Energy Ohio recorded an intangible liability in connection with the merger with Duke Energy amounting to approximately \$113 million associated with the Market Based Standard Service Offer (MBSSO) in Ohio that will be recognized in earnings over the remaining regulatory period, which ends on December 31, 2008. Duke Energy Ohio also recorded approximately \$56 million of intangible liabilities associated with other power sale contracts in connection with the merger with Duke Energy. The carrying amount of these liabilities as of September 30, 2007 and December 31, 2006 is as follows:

	Successor <sup>(a)</sup>	
	September 30, 2007	December 31, 2006
	(in millions)	
MBSSO	\$ 78	\$ 95
Other power sale contracts	27	39
<b>Total intangible liabilities</b>	<b>\$ 105</b>	<b>\$ 134</b>

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(a) See Note 1 for additional information on Predecessor and Successor reporting.

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During the three and nine months ended September 30, 2007, Duke Energy Ohio amortized approximately \$15 million and \$29 million to income, respectively, related to these intangible liabilities. During the three months and six months ended September 30, 2006, Duke Energy Ohio amortized approximately \$31 million and \$35 million, respectively, to income, related to these intangible liabilities. Intangible liabilities are classified as Other Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

**9. Discontinued Operations and Assets Held for Sale**

In June 2006, Cinergy agreed to sell its commercial marketing and trading businesses, including certain of Duke Energy Ohio's trading contracts, to Fortis, a Benelux-based financial services group. In October 2006, the sale was completed. Results of operations for these trading contracts have been reflected in Income (Loss) from Discontinued Operations, net of tax in the accompanying Consolidated Statements of Operations. In October 2006, in connection with this transaction, Duke Energy Ohio entered into a series of Total Return Swaps (TRS) with Fortis, which are accounted for as mark to market derivatives. The TRS offsets the net fair value of the contracts being sold to Fortis. The TRS will be cancelled for each underlying contract as each is transferred to Fortis. All economic and credit risk associated with the contracts has been transferred to Fortis as of the date of the sale through the TRS. As of September 30, 2007, substantially all of the contracts have been novated by Fortis. At September 30, 2007, contracts with a net fair value of approximately \$5 million remain in Assets held for sale and represent contracts that have yet to be novated by Fortis.

The following table summarizes the results classified as Income (Loss) from Discontinued Operations, net of tax, in the accompanying Consolidated Statements of Operations.

Successor <sup>(a)</sup>				
Operating Income				
Operating Revenues	Pre-tax Income	Income Tax Expense	Income (Loss) From Discontinued Operations, Net of Tax	
(in millions)				
Three Months Ended September 30, 2006	\$ 35	\$ 30	\$ 11	\$ 19
Commercial Power				
Six Months Ended September 30, 2006	\$ 6	\$ (1)	\$ —	\$ (1)
Commercial Power				
Predecessor <sup>(a)</sup>				
Operating (Loss) Income				
Operating Revenues	Pre-tax Loss	Income Tax Benefit	Income (Loss) From Discontinued Operations, Net of Tax	
(in millions)				
Three Months Ended March 31, 2006	\$ 9	\$ (3)	\$ (1)	\$ (2)
Commercial Power				

(a) See Note 1 for additional information on Predecessor and Successor reporting.

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The following table presents the carrying values of the major classes of assets and associated liabilities held for sale in the Consolidated Balance Sheets as of September 30, 2007 and December 31, 2006.

	Successor <sup>(a)</sup>	
	September 30, 2007	December 31, 2006
	(in millions)	
Current assets	\$5	\$ 25
Investments and other assets	—	18
<b>Total assets held for sale</b>	<b>\$5</b>	<b>\$ 43</b>
Current liabilities	\$5	\$ 25
Deferred credits and other liabilities	—	18
<b>Total liabilities associated with assets held for sale</b>	<b>\$5</b>	<b>\$ 43</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

**10. Business Segments**

Duke Energy Ohio operates the following business units: Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these business units in deciding how to allocate resources and evaluate performance. Both of the business units are considered reportable segments under SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." There is no aggregation within Duke Energy Ohio's defined business segments.

The remainder of Duke Energy Ohio's operations are presented as "Other." While it is not considered a business segment, Other primarily includes certain allocated governance costs (see Note 14).

Accounting policies for Duke Energy Ohio's segments are the same as those described in the Notes to the Consolidated Financial Statements in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2006. Management evaluates segment performance based on earnings before interest and taxes from continuing operations (EBIT).

On a segment basis, EBIT excludes discontinued operations and represents all profits from continuing operations (both operating and non-operating and excluding corporate governance costs) before deducting interest and taxes. Cash, cash equivalents, and short-term investments are managed centrally by Cinergy and Duke Energy, so the interest and dividend income on those balances are excluded from the segments' EBIT.

Transactions between reportable segments are accounted for on the same basis as unaffiliated revenues and expenses in the accompanying Consolidated Financial Statements.



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**Business Segment Data<sup>(a)</sup>**

	Unaffiliated Revenues	Intersegment Revenues	Total Revenues	Segment EBIT/ Consolidated Income from Continuing Operations Before Income Taxes	Depreciation and Amortization
(In millions)					
<b>Successor<sup>(b)</sup></b>					
<b>Three Months Ended September 30, 2007</b>					
Franchised Electric and Gas	\$ 344	\$ —	\$ 344	\$ 54	\$ 65
Commercial Power	611	—	611	175	42
Total reportable segments	955	—	955	229	107
Other	—	—	—	(19)	—
Interest expense	—	—	—	(28)	—
Interest income and other	—	—	—	5	—
Total consolidated	\$ 955	\$ —	\$ 955	\$ 187	\$ 107
<b>Nine Months Ended September 30, 2007</b>					
Franchised Electric and Gas	\$ 1,255	\$ —	\$ 1,255	\$ 183	\$ 172
Commercial Power	1,379	—	1,379	255	123
Total reportable segments	2,634	—	2,634	438	295
Other	—	—	—	(58)	—
Interest expense	—	—	—	(73)	—
Interest income and other	—	—	—	21	—
Total consolidated	\$ 2,634	\$ —	\$ 2,634	\$ 328	\$ 295
<b>Three Months Ended September 30, 2006</b>					
Franchised Electric and Gas	\$ 308	\$ —	\$ 308	\$ 47	\$ 58
Commercial Power	468	—	468	67	36
Total reportable segments	776	—	776	114	94
Other	—	—	—	(23)	—
Interest expense	—	—	—	(26)	—
Interest income and other	—	—	—	5	—
Total consolidated	\$ 776	\$ —	\$ 776	\$ 70	\$ 94
<b>Six Months Ended September 30, 2006</b>					
Franchised Electric and Gas	\$ 605	\$ —	\$ 605	\$ 67	\$ 109
Commercial Power	867	1	868	103	78
Total reportable segments	1,472	1	1,473	170	187
Other	—	—	—	(36)	—
Eliminations	—	(1)	(1)	—	—
Interest expense	—	—	—	(54)	—
Interest income and other	—	—	—	10	—
Total consolidated	\$ 1,472	\$ —	\$ 1,472	\$ 90	\$ 187
<b>Predecessor<sup>(b)</sup></b>					
<b>Three Months Ended March 31, 2006</b>					
Franchised Electric and Gas	\$ 542	\$ —	\$ 542	\$ 80	\$ 50
Commercial Power	421	1	422	166	18
Total reportable segments	963	1	964	246	68
Other	—	—	—	(39)	—
Eliminations	—	(1)	(1)	—	—
Interest expense	—	—	—	(30)	—
Interest income and other	—	—	—	9	—
Total consolidated	\$ 963	\$ —	\$ 963	\$ 186	\$ 68

(a) Segment results exclude results of discontinued operations.

(b) See Note 1 for additional information on Predecessor and Successor reporting.

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Segment assets in the following table exclude all intercompany assets.

**Segment Assets**

	Successor <sup>(a)</sup>	
	September 30, 2007	December 31, 2006
	(in millions)	
Franchised Electric and Gas	\$ 5,444	\$ 5,381
Commercial Power	6,094	6,349
<b>Total reportable segments/consolidated assets</b>	<b>\$ 11,538</b>	<b>\$ 11,730</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

**11. Risk Management Instruments**

The following table shows the carrying value of Duke Energy Ohio's derivative portfolio as of September 30, 2007, and December 31, 2006.

**Derivative Portfolio Carrying Value**

	Successor <sup>(a)</sup>	
	September 30, 2007	December 31, 2006
	(in millions)	
Hedging	\$ (20)	\$ (2)
Undesignated	(5)	8
<b>Total</b>	<b>\$ (25)</b>	<b>\$ 6</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

The amounts in the table above represent the combination of assets and (liabilities) for unrealized gains and losses on mark-to-market and hedging transactions on Duke Energy Ohio's Consolidated Balance Sheets, excluding approximately \$5 million of derivative assets and \$5 million of derivative liabilities which were transferred to assets and liabilities held for sale. See Note 9 for additional information.

The \$18 million decrease in the hedging portfolio fair value is due primarily to declines in the fair value of certain commodity cash flow hedges within Commercial Power.

The \$13 million decrease in the undesignated derivative portfolio fair value is due primarily to unrealized mark-to-market losses within Commercial Power, primarily as a result of higher power prices. This was partially offset by unrealized mark-to-market gains on coal derivatives within Commercial Power.

**12. Regulatory Matters**

**Regulatory Merger Approvals.** As discussed in Note 1 and Note 2, on April 3, 2006, the merger between Duke Energy and Cinergy was consummated to create a newly formed company, Duke Energy Holding Corp. (subsequently renamed Duke Energy Corporation). As a condition to the merger approval, the PUCO, and the Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Ohio and Kentucky, respectively. The commissions also required Duke Energy Ohio and Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- The PUCO required that Duke Energy Ohio provide (i) a rate reduction of approximately \$15 million for one year to facilitate economic development in a time of increasing rates and market prices and (ii) a reduction of approximately \$21 million to its gas and electric consumers in Ohio for one year, with both credits beginning January 1, 2006. As of March 31, 2007, Duke Energy Ohio

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had completed its merger related rate reductions and filed a report with the PUCO to terminate the merger credit riders. Approximately \$2 million of these rate reduction were passed through to customers during 2007. Approximately \$10 million and \$26 million of these rate reduction were passed through to customers during three and six months ended September 30, 2006, respectively.

- The KPSC required that Duke Energy Kentucky provide \$8 million in rate reductions to its customers over five years, ending when new rates are established in the next rate case after January 1, 2008. Approximately \$1 million and \$2 million of the rate reduction was passed through to customers during the three and nine months ended September 30, 2007, respectively. Approximately \$1 million was passed through to customers during the three and six months ended September 30, 2006, respectively.
- The FERC approved the merger without conditions.

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

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

In October 2007, the PUCO issued its ruling affirming the MBSSO, with certain modifications, and maintained the current price. The ruling provides for continuation of the existing rate components, including the recovery of costs related to new pollution control equipment and capacity costs associated with power purchase contracts to meet customer demand, but provided customers an enhanced opportunity to avoid certain pricing components if they are served by a competitive supplier. The ruling also rescinds the requirement that Duke Energy Ohio transfer its generating assets to an exempt wholesale generator (EWG) and required Duke Energy Ohio to retain ownership for the remainder of the RSP period. Duke Energy Ohio has not decided whether to seek a rehearing of the PUCO's ruling. The Order also discusses the termination of the RTC at the end of 2008. Duke Energy Ohio will seek further confirmation from the PUCO that the RTC termination in 2008 pertains only to residential customers pursuant to a 2004 order of the PUCO.

In August 2006, Duke Energy Ohio filed an application with the PUCO to amend its MBSSO through 2010. The proposal provides for continued electric system reliability, a simplified market price structure and clear price signals for customers, while helping to maintain a stable revenue stream for Duke Energy Ohio. The application is pending and Duke Energy Ohio cannot predict the outcome of this proceeding.

Duke Energy Ohio's MBSSO includes a fuel clause, reserve capacity (System Reliability Tracker or SRT) and an Annually Adjusted Component (AAC) to recover changes in environmental, tax and homeland security costs which are audited annually by the PUCO. In April 2007 Duke Energy Ohio entered into a settlement resolving all open issues identified in the 2006 audits and application to amend the 2007 AAC market price with some, but not all, of the parties. The PUCO held a hearing regarding the settlement. A PUCO decision is expected before the end of 2007. Duke Energy Ohio cannot predict an outcome of these proceedings; however, Duke Energy Ohio does not expect the settlement agreement to have a material impact on its consolidated results of operations, cash flows or financial position.

*Duke Energy Ohio Gas Rate Case.* In July 2007, Duke Energy Ohio filed an application with the PUCO for an increase in its base rates for gas service. Duke Energy Ohio seeks an increase of approximately \$34 million in revenue, or approximately 5.7%, to be effective in the spring of 2008. The application also requests approval to continue tracker recovery costs associated with an accelerated gas main replacement program. The PUCO accepted the application for filing in September 2007.

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

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

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

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

**New Legislation.** On September 25, 2007, at the request of the Governor of Ohio, the Ohio Senate introduce a bill ("SB 221") that proposes a comprehensive change to Ohio's 1999 electric energy industry restructuring legislation. If enacted, SB 221 would expand the PUCO's authority over generation to: implement the state's revised energy policy; regulate electric distribution utility prices for standard service; and permit the PUCO to implement rules for advanced energy portfolio and energy efficiency standards, greenhouse gas emission reporting requirements, and pilot project carbon sequestration activities in conjunction with other state agencies. Under SB 221, electric distribution utilities have the ability to apply for PUCO approval of one of two generation pricing alternatives – a market option, or an Electric Security Plan (ESP) option. The market option is based upon a competitive bidding process. The ESP option will allow for the recovery of specified costs. The PUCO, however, would have authority to disallow the market option and compel the ESP option. SB 221, if enacted, would limit the ability of a utility to transfer its dedicated generating assets to an EWG absent PUCO approval. SB 221 passed the Ohio Senate on October 31, 2007, and is currently pending before the Ohio House.

**Other.** In April 2005, the PUCO issued an order opening a statewide investigation into riser leaks in gas pipeline systems throughout Ohio. The investigation followed four explosions since 2000 caused by gas riser leaks, including an April 2000 explosion in Duke Energy Ohio's service area. In November 2006, the PUCO Staff released an expert report, which concluded that certain types of risers are prone to leaks under various conditions, including over-tightening during initial installation. The PUCO Staff recommended that natural gas companies continue to monitor the situation and study the cause of any further riser leaks to determine whether further remedial action is warranted. Duke Energy Ohio has approximately 87,000 of these risers on its distribution system. If the PUCO orders natural gas companies to replace all of these risers, Duke Energy Ohio estimates a replacement cost of approximately \$40 million. As part of the rate case filed in July 2007 (see "Duke Energy Ohio Gas Rate Case" above), Duke Energy Ohio requested approval from the PUCO to accelerate its riser replacement program; however, at this time, Duke Energy Ohio cannot predict the outcome or the impact of the statewide Ohio investigation.

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

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

### 13. Commitments and Contingencies

#### Environmental

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

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

*Clean Water Act 316(b)* The U.S. Environmental Protection Agency (EPA) finalized its cooling water intake structures rule in July 2004. The rule established aquatic protection requirements for existing facilities that withdraw 50 million gallons or more of water per day from rivers, streams, lakes, reservoirs, estuaries, oceans, or other U.S. waters for cooling purposes. Three of six coal-fired generating facilities in which Duke Energy Ohio is either a whole or partial owner are affected sources under that rule. On January 25, 2007, the U.S. Court of Appeals for the Second Circuit issued its opinion in *Riverkeeper, Inc. v. EPA*, Nos. 04-6692-ag(L) et. al. (2d Cir. 2007) remanding most aspects of EPA's rule back to the agency. The court effectively disallowed those portions of the rule most favorable to industry, and the decision creates a great deal of uncertainty regarding future requirements and their timing. Duke Energy Ohio is still unable to estimate costs to comply with the EPA's rule, although it is expected that costs will increase as a result of the court's decision. The magnitude of any such increase cannot be estimated at this time.

*Clean Air Mercury Rule (CAMR) and Clean Air Interstate Rule (CAIR).* The EPA finalized its CAMR and CAIR in May 2005. The CAMR limits total annual mercury emissions from coal-fired power plants across the United States through a two-phased cap-and-trade program. Phase 1 begins in 2010 and Phase 2 begins in 2018. The CAIR limits total annual and summertime nitrogen oxides (NO<sub>x</sub>) emissions and annual sulfur dioxide (SO<sub>2</sub>) emissions from electric generating facilities across the Eastern United States through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO<sub>x</sub> and in 2010 for SO<sub>2</sub>. Phase 2 begins in 2015 for both NO<sub>x</sub> and SO<sub>2</sub>.

Duke Energy Ohio currently estimates that it will spend approximately \$325 million between 2007 and 2011 to comply with Phase 1 of CAMR and CAIR at plants that Duke Energy Ohio owns or partially owns but does not operate. Duke Energy Ohio currently estimates that it will not incur any significant costs for complying with Phase 2 of CAIR and is currently unable to estimate the cost of complying with Phase 2 of CAMR. Duke Energy Ohio receives partial recovery of depreciation and financing costs related to environmental compliance projects for 2005-2008 through its RSP (see Note 12).

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

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*Coal Combustion Product (CCP) Management.* Duke Energy Ohio currently estimates that it will spend approximately \$25 million over the period 2007-2012 to install synthetic caps and liners at existing and new CCP landfills and to convert CCP handling systems from wet to dry systems.

*Extended Environmental Activities and Accruals* Included in Other Deferred Credits and Other Liabilities on the Consolidated Balance Sheets were total accruals related to extended environmental-related activities of approximately \$8 million as of September 30, 2007 and December 31, 2006, respectively. These accruals represent Duke Energy Ohio's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Duke Energy Ohio believes that completion or resolution of these matters will have no material impact on its consolidated results of operations, cash flows or financial position.

### Litigation

*New Source Review (NSR).* In 1999-2000, the U.S. Justice Department, acting on behalf of the EPA, filed a number of complaints and notices of violation against multiple utilities across the country for alleged violations of the NSR provisions of the Clean Air Act (CAA). Generally, the government alleges that projects performed at various coal-fired units were major modifications, as defined in the CAA, and that the utilities violated the CAA when they undertook those projects without obtaining permits and installing the best available emission controls for SO<sub>2</sub>, NO<sub>x</sub> and particulate matter. The complaints seek injunctive relief to require installation of pollution control technology on various allegedly violating generating units and, unspecified civil penalties in amounts of up to \$27,500 per day for each violation. Two of Duke Energy Ohio's plants have been subject to these allegations. Duke Energy Ohio asserts that there were no CAA violations because the applicable regulations do not require permitting in cases where the projects undertaken are "routine" or otherwise do not result in a net increase in emissions.

In November 1999, the United States brought a lawsuit in the United States Federal District Court for the Southern District of Indiana against Duke Energy Ohio alleging various violations of the CAA at Duke Energy Ohio's W.C. Beckjord and Miami Fort Stations. The lawsuit alleges that Duke Energy Ohio violated the CAA by not obtaining Prevention of Significant Deterioration, Non-Attainment NSR and Ohio's State Implementation Plan (SIP) permits for 8 projects undertaken at those plants. Additionally, the suit claims that Duke Energy Ohio violated an Administrative Consent Order entered into in 1998 between the EPA and Cinergy relating to alleged violations of Ohio's SIP provisions governing particulate matter at Unit 1 at Duke Energy Ohio's W.C. Beckjord Station. Three northeast states and two environmental groups have intervened in the case. In June 2007, the trial court ruled, as a matter of law that 6 of the 8 projects undertaken at the Duke Energy Ohio plants do not qualify for the "routine" exception in the regulations. The court ruled further that the defendants had "fair notice" of EPA's interpretation of the applicable regulations. The defendants have filed motions for reconsideration of the trial court's rulings. A jury trial has been set to commence on May 5, 2008.

In March 2000, the United States also filed suit in the United States District Court for the Southern District of Ohio an amended complaint in a separate lawsuit alleging violations of the CAA regarding various generating stations, including a generating station operated by Columbus Southern Power Company (CSP) and jointly-owned by CSP, The Dayton Power and Light Company (DP&L), and Duke Energy Ohio. This suit is being defended by CSP (the CSP case). A trial on liability issues was conducted in July 2005. On October 9, 2007, CSP announced a settlement of its case. The settlement includes commitments by CSP to construct environmental equipment or otherwise to reduce emissions at certain plants and the payment of penalties and money to various environmental projects. Duke Energy Ohio does not expect the settlement to have a material impact on its consolidated results of operations, cash flows, or financial position.

In addition, Duke Energy Ohio has been informed by DP&L that in June 2000, the EPA issued a Notice of Violation (NOV) to DP&L for alleged violations of CAA requirements at a station operated by DP&L and jointly-owned by DP&L, CSP, and Duke Energy Ohio. The NOV indicated the EPA may issue an order requiring compliance with the requirements of the Ohio SIP, or bring a civil action seeking injunctive relief and civil penalties of up to \$27,500 per day for each violation. In September 2004, Marilyn Wall and the Sierra Club brought a lawsuit against Duke Energy Ohio, DP&L and CSP for alleged violations of the CAA at this same generating station. This case is currently in discovery in front of the same judge who has the CSP case.

Other than the CSP case, it is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with these matters.

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*Section 126 Petitions* In March 2004, the state of North Carolina filed a petition under Section 126 of the CAA in which it alleges that sources in 13 upwind states, including Ohio, significantly contribute to North Carolina's non-attainment with certain ambient air quality standards. In August 2005, the EPA issued a proposed response to the petition. The EPA proposed to deny the ozone portion of the petition based upon a lack of contribution to air quality by the named states. The EPA also proposed to deny the particulate matter portion of the petition based upon the CAIR Federal Implementation Plan (FIP), that would address the air quality concerns from neighboring states. On April 28, 2006, the EPA denied North Carolina's petition based upon the final CAIR FIP described above. North Carolina has filed a legal challenge to the EPA's denial.

*Carbon Dioxide (CO<sub>2</sub>) Litigation* In July 2004, the states of Connecticut, New York, California, Iowa, New Jersey, Rhode Island, Vermont, Wisconsin, and the City of New York brought a lawsuit in the United States District Court for the Southern District of New York against Cinergy, American Electric Power Company, Inc., American Electric Power Service Corporation, The Southern Company, Tennessee Valley Authority, and Xcel Energy Inc. A similar lawsuit was filed in the United States District Court for the Southern District of New York against the same companies by Open Space Institute, Inc., Open Space Conservancy, Inc., and The Audubon Society of New Hampshire. These lawsuits allege that the defendants' emissions of CO<sub>2</sub> from the combustion of fossil fuels at electric generating facilities contribute to global warming and amount to a public nuisance. The complaints also allege that the defendants could generate the same amount of electricity while emitting significantly less CO<sub>2</sub>. The plaintiffs are seeking an injunction requiring each defendant to cap its CO<sub>2</sub> emissions and then reduce them by a specified percentage each year for at least a decade. In September 2005, the District Court granted the defendants' motion to dismiss the lawsuit. The plaintiffs have appealed this ruling to the Second Circuit Court of Appeals. Oral argument was held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

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

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

*Hurricane Katrina Lawsuit* In April 2006, Cinergy was named in the third amended complaint of a purported class action lawsuit filed in the United States District Court for the Southern District of Mississippi. Plaintiffs claim that Cinergy, along with numerous other utilities, oil companies, coal companies and chemical companies, are liable for damages relating to losses suffered by victims of Hurricane Katrina. Plaintiffs claim that defendants' greenhouse gas emissions contributed to the frequency and intensity of storms such as Hurricane Katrina. In October 2006, Cinergy was served with this lawsuit. On August 30, 2007, the court dismissed the case. The plaintiffs have filed their notice of appeal to the Fifth Circuit Court of Appeals. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

*Asbestos-related Injuries and Damages Claims* Duke Energy Ohio has also been named as a defendant or co-defendant in lawsuits related to asbestos at its electric generating stations. The impact on Duke Energy Ohio's results of operations, cash flows, or financial position of these cases to date has not been material. Based on estimates under varying assumptions, concerning uncertainties, such as, among others: (i) the number of contractors potentially exposed to asbestos during construction or maintenance of Duke Energy Ohio's generating plants; (ii) the possible incidence of various illnesses among exposed workers, and (iii) the potential settlement costs without

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federal or other legislation that addresses asbestos tort actions, Duke Energy Ohio estimates that the range of reasonably possible exposure in existing and future suits over the foreseeable future is not material. This estimated range of exposure may change as additional settlements occur and claims are made and more case law is established.

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

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

**Other Commitments and Contingencies**

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

**14. Related Party Transactions**

*Duke Energy Ohio engages in related party transactions.* These transactions are generally performed at cost and in accordance with the applicable state and federal commission regulations. Balances due to or due from related parties included in the Consolidated Balance Sheets as of September 30, 2007 and December 31, 2006 are as follows:

	Successor <sup>(a)(b)</sup>	
	September 30, 2007	December 31, 2006
	(in millions)	
Current assets <sup>(c)</sup>	\$ 34	\$ 51
Non-current assets <sup>(d)</sup>	\$ —	\$ 1
Current liabilities <sup>(e)</sup>	\$ (98)	\$ (196)
Net deferred tax liabilities <sup>(f)</sup>	\$ (1,442)	\$ (1,417)

(a) See Note 1 for additional information on Predecessor and Successor reporting.

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

(c) Of the balance at September 30, 2007, approximately \$35 million is classified as Receivables and \$(1) million is classified as Other current assets on the Consolidated Balance Sheets. The balance at December 31, 2006 is classified as Receivables on the Consolidated Balance Sheets.

(d) The balance at December 31, 2006 is classified as Other non-current assets on the Consolidated Balance Sheets.

(e) The balance at September 30, 2007 is classified as Accounts payable on the Consolidated Balance Sheets. Of the balance at December 31, 2006, approximately (\$95) million is classified as Accounts payable and (\$101) million is classified as Taxes accrued on the Consolidated Balance Sheets.

(f) Of the balance at September 30, 2007, approximately (\$1,455) million is classified as Deferred income taxes, (\$17) million is classified as Investment tax credit and \$30 million is classified as Other current assets on the Consolidated Balance Sheets. Of the balance at December 31, 2006, approximately (\$1,417) million is classified as Deferred income taxes, (\$19) million is classified as Investment tax credit and \$19 million is classified as Other current assets on the Consolidated Balance Sheets.



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Duke Energy Ohio is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy. Duke Energy Ohio is also allocated its proportionate share of other corporate governance costs from a consolidated affiliate of Cinergy. Corporate governance and other shared services costs are primarily allocations of corporate costs, such as human resources, legal and accounting fees, as well as other third party costs.

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

	Successor <sup>(a)</sup>				Predecessor <sup>(a)</sup>
	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007	Three Months Ended September 30, 2006	Six Months Ended September 30, 2006	Three Months Ended March 31, 2006
	(In millions)				
Corporate governance and shared services expenses	\$ 67	\$ 183	\$ 77	\$ 175	\$ 112

(a) See Note 1 for additional information on Predecessor and Successor reporting.

See Note 7 for detail on expense amounts allocated from Cinergy to Duke Energy Ohio related to Duke Energy Ohio's participation in Cinergy's qualified and non-qualified defined benefit pension plans and postretirement health care and insurance benefits. Additionally, Duke Energy Ohio has been allocated accrued pension and other postretirement benefit obligations from Cinergy of approximately \$327 million at September 30, 2007 and approximately \$393 million at December 31, 2006. These amounts have been classified on the Consolidated Balance Sheets as follows:

	Successor <sup>(a)</sup>	
	September 30, 2007	December 31, 2006
	(in millions)	
Other current liabilities	\$ 9	\$ 9
Accrued pension and other postretirement benefit costs	\$ 315	\$ 381
Other deferred credits and other liabilities	\$ 3	\$ 3

(a) See Note 1 for additional information on Predecessor and Successor reporting.

Additionally, certain trade receivables have been sold by Duke Energy Ohio to Cinergy Receivables, an unconsolidated entity formed by Cinergy. The proceeds obtained from the sales of receivables are largely cash but do include a subordinated note from Cinergy Receivables for a portion of the purchase price. This subordinated note is classified by Duke Energy Ohio as Receivables in the Consolidated Balance Sheets and was approximately \$118 million and \$133 million as of September 30, 2007 and December 31, 2006, respectively.

During the second quarter of 2007 Duke Energy Ohio received a \$29 million capital contribution from its parent, Cinergy.

See Note 3 for a discussion of amounts paid to Duke Energy Ohio as a result of the agreement between Duke Energy and Duke Energy Ohio related to Duke Energy's contribution of its ownership interests in five plants to Duke Energy Ohio. See Note 4 for a discussion of dividends Duke Energy Ohio paid to its parent, Cinergy.

Duke Energy Ohio participates in a money pool with Duke Energy and other Duke Energy subsidiaries. As of September 30, 2007 and December 31, 2006, Duke Energy Ohio was in a payable position of \$348 million and \$274 million, respectively, classified within Notes payable and commercial paper in the accompanying Consolidated Balance Sheets. The expenses associated with money pool activity for Duke Energy Ohio, which are recorded in Interest Expense on the Consolidated Statements of Operations for the three and nine months ended September 30, 2007, were \$4 million and \$7 million, respectively. For the three and six months ended September 30, 2006 and three months ended March 31, 2006, money pool activity recorded in Interest Expense on the Consolidated Statements of Operations was \$2 million, \$4 million, and \$2 million, respectively. See Note 6 for further discussion of the money pool arrangement.

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**(Unaudited)****15. New Accounting Standards**

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

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

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

*SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158)* In October 2006, the FASB issued SFAS No. 158, which changes the recognition and disclosure provisions and measurement date requirements for an employer's accounting for defined benefit pension and other postretirement plans. The recognition and disclosure provisions require an employer to (1) recognize the funded status of a benefit plan—measured as the difference between plan assets at fair value and the benefit obligation—in its statement of financial position, (2) recognize as a component of other comprehensive loss, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost, and (3) disclose in the notes to financial statements certain additional information. SFAS No. 158 does not change the amounts recognized in the income statement as net periodic benefit cost. Duke Energy Ohio recognized the funded status of its defined benefit pension and other postretirement plans and provided the required additional disclosures as of December 31, 2006. The adoption of SFAS No. 158 recognition and disclosure provisions resulted in an increase in total assets of approximately \$33 million (consisting of an increase in regulatory assets of \$31 million and an increase in deferred tax assets of \$2 million), an increase in total liabilities of approximately \$35 million and a decrease in accumulated other comprehensive income (loss) (AOCI), net of tax, of approximately \$2 million as of December 31, 2006.

Under the measurement date requirements of SFAS No. 158, an employer is required to measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions). Historically, Duke Energy Ohio has measured its plan assets and obligations up to three months prior to the fiscal year-end, as allowed under the authoritative accounting literature. Duke Energy Ohio adopted the change in measurement date effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date, pursuant to the transition requirements of SFAS No. 158. Net periodic benefit cost of approximately \$3 million for the three-month period between September 30, 2006 and December 31, 2006 was recognized, net of tax, as a separate adjustment of retained earnings as of January 1, 2007. Additionally, in the first quarter of 2007, the changes in plan assets and plan obligations between the September 30, 2006 and December 31, 2006 measurement dates not related to net periodic benefit cost was required to be recognized, net of tax, as a separate adjustment of the opening balance of AOCI and regulatory assets. This adjustment was not material. During the second quarter of 2007, Duke Energy Ohio completed these calculations. The finalization of these actuarial calculations resulted in a \$2 million adjustment to AOCI and an immaterial adjustment to regulatory assets.

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

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

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

*FASB Interpretation (FIN) 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" (FIN 48).* In July 2006, the FASB issued FIN 48, which provides guidance on accounting for income tax positions about which Duke Energy Ohio has concluded there is a level of uncertainty with respect to the recognition of a tax benefit in Duke Energy Ohio's financial statements. FIN 48 prescribes the minimum recognition threshold a tax position is required to meet. Tax positions are defined very broadly and include not only tax deductions and credits but also decisions not to file in a particular jurisdiction, as well as the taxability of transactions. Duke Energy Ohio adopted FIN 48 effective January 1, 2007. See Note 16 for additional information.

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

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

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

*EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4" (EITF No. 06-5).* In June 2006, the EITF reached a consensus on the accounting for corporate-owned and bank-owned life insurance policies. EITF No. 06-5 requires that a policyholder consider the cash surrender value and any additional amounts to be

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received under the contractual terms of the policy in determining the amount that could be realized under the insurance contract. Amounts that are recoverable by the policyholder at the discretion of the insurance company must be excluded from the amount that could be realized. Fixed amounts that are recoverable by the policyholder in future periods in excess of one year from the surrender of the policy must be recognized at their present value. EITF No. 06-5 was effective for Duke Energy Ohio as of January 1, 2007 and must be applied as a change in accounting principle through a cumulative-effect adjustment to retained earnings or other components of equity as of January 1, 2007. The adoption of EITF No. 06-5 did not have a material impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

The following new accounting standards have been issued, but have not yet been adopted by Duke Energy Ohio as of September 30, 2007:

*SFAS No. 157, "Fair Value Measurements" (SFAS No. 157).* In September 2006, the FASB issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, in some cases, the application of SFAS No. 157 may change Duke Energy Ohio's current practice for measuring and disclosing fair values under other accounting pronouncements that require or permit fair value measurements. For Duke Energy Ohio, SFAS No. 157 is effective as of January 1, 2008 and must be applied prospectively except in certain cases. Duke Energy Ohio is currently evaluating the impact of adopting SFAS No. 157, and cannot currently estimate the impact of SFAS No. 157 on its consolidated results of operations, cash flows or financial position.

*SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159).* In February 2007, the FASB issued SFAS No. 159, which permits entities to choose to measure many financial instruments and certain other items at fair value. For Duke Energy Ohio, SFAS No. 159 is effective as of January 1, 2008 and will have no impact on amounts presented for periods prior to the effective date. Duke Energy Ohio cannot currently estimate the impact of SFAS No. 159 on its consolidated results of operations, cash flows or financial position and has not yet determined whether or not it will choose to measure items subject to SFAS No. 159 at fair value.

**16. Income Taxes and Other Taxes**

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

On January 1, 2007, Duke Energy Ohio adopted FIN 48. The following table shows the impacts of adoption of FIN 48 on Duke Energy Ohio's Consolidated Balance Sheets.

	Increase/ (Decrease)
	(in millions)
<b>Assets</b>	
Goodwill	\$ 4
<b>Liabilities</b>	
Other Liabilities (non-current) <sup>(a)</sup>	\$ 51
Interest Accrued (current)	(11)
Deferred Income Taxes	(36)
<b>Total</b>	<b>\$ 4</b>
<b>Common Stockholder's Equity</b>	
Retained Earnings – Cumulative Effect of Accounting Change	\$ —

(a) Includes liability for unrecognized tax benefits and accrued interest and penalties, net of gain contingencies that were not recorded prior to the adoption of FIN 48.

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PART I

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**  
**(Unaudited)**

The following table shows the accounting for the adoption of FIN 48 on January 1, 2007 and the increase/(decrease) in Duke Energy Ohio's unrecognized tax benefits from January 1, 2007 to September 30, 2007.

	January 1, 2007	Changes In Balances	September 30, 2007
	(in millions)		
Unrecognized Tax Benefits <sup>(a)</sup>	\$ 63	\$ (16)	\$ 47
Unrecognized Tax Benefits that, if recognized, would affect the effective tax rate	\$ —	\$ —	\$ —
Interest Payable/(Receivable) <sup>(b)</sup>	\$ 6	\$ (3)	\$ 3
Penalties Payable	\$ —	\$ —	\$ —

(a) Decrease in the liability of \$16 million is primarily related to an \$18 million settlement offer and a \$6 million settlement, partially offset by an \$8 million increase primarily related to the timing of certain deductions taken on tax returns in prior years.

(b) Reflects all interest related to income taxes. The decrease in the liability was recorded primarily as a reduction to goodwill.

It is reasonably possible that Duke Energy Ohio will reflect an approximate \$25 million reduction in unrecognized tax benefits in the next twelve months due to expected settlements.

Duke Energy Ohio has the following tax years open.

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

Effective with the adoption of FIN 48, Duke Energy Ohio records, as it relates to taxes, interest expense as Interest Expense and interest income and penalties in Other Income and Expenses, net in the Consolidated Statements of Operations.

The \$40 million increase in income tax expense from continuing operations for the comparative three-month periods ended September 30, 2007 and 2006 is primarily due to the \$117 million increase in income from continuing operations before income taxes.

As of September 30, 2007 and December 31, 2006, approximately \$33 million and \$0 million, respectively, of deferred income taxes were included in Other within Current Assets in the Consolidated Balance Sheets. At September 30, 2007, this balance exceeded 5% of total current assets.

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

	Successor <sup>(a)</sup>				Predecessor <sup>(a)</sup>
	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007	Three Months Ended September 30, 2006	Six Months Ended September 30, 2006	Three Months Ended March 31, 2006
	(in millions)				
Excise Taxes	\$ 27	\$ 93	\$ 28	\$ 55	\$ 38

(a) See Note 1 for additional information on Predecessor and Successor reporting.

**17. Subsequent Events**

For information on subsequent events related to debt and credit facilities, regulatory matters and commitments and contingencies, see Notes 6, 12 and 13, respectively.

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PART I

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

#### INTRODUCTION

#### EXECUTIVE OVERVIEW

Management's Discussion and Analysis should be read in conjunction with the Consolidated Financial Statements.

On April 3, 2006, Duke Energy Corporation (Old Duke Energy) and Cinergy Corp. (Cinergy) merged into wholly-owned subsidiaries of Duke Energy Holding Corp. (Duke Energy HC), resulting in Duke Energy HC becoming the parent entity. In connection with the closing of the merger transactions, Duke Energy HC changed its name to Duke Energy Corporation (Duke Energy).

Due to the impact of push-down accounting, the financial statements and certain note presentations separate Duke Energy Ohio, Inc.'s (Duke Energy Ohio) presentations into two distinct periods, the period before the consummation of the merger (labeled "Predecessor") and the period after that date (labeled "Successor"), to indicate the application of different bases of accounting between the periods presented.

#### BASIS OF PRESENTATION

The results of operations and variance discussion for Duke Energy Ohio is presented in a reduced disclosure format in accordance with General Instructions (H)(2) of Form 10-Q.

#### RESULTS OF OPERATIONS

##### Results of Operations and Variances

##### Summary of Results (in millions)

	Successor <sup>(a)</sup>		
	Six Months Ended September 30, 2007	Six Months Ended September 30, 2006	Increase (Decrease)
Operating revenues	\$ 1,718	\$ 1,472	\$ 246
Operating expenses	1,412	1,327	85
(Losses) gains on sales of other assets and other, net	(1)	(14)	13
Operating income	305	131	174
Other income and expenses, net	13	13	—
Interest expense	50	54	(4)
Income tax expense from continuing operations	101	36	65
Income (Loss) from discontinued operations, net of tax	—	(1)	1
Net income	\$ 167	\$ 53	\$ 114

(a) See Note 1 to the Consolidated Financial Statements, "Basis of Presentation" for additional information on Predecessor and Successor reporting.

#### Net Income

The \$114 million increase in Duke Energy Ohio's Net income for the six months ended September 30, 2007 compared to the same period in 2006 was primarily due to the following factors:

##### Operating Revenues

The \$246 million increase in Operating revenues was driven primarily by:

- \$118 million increase as a result of higher retail generation revenue principally related to the timing of collections on Commercial Power's fuel and purchased power rider compared to the same period of 2006,
- \$86 million increase in wholesale revenues from the Midwest gas-fired generation assets due primarily to higher generation volumes as a result of favorable weather and higher tolling and capacity revenues in 2007 compared to 2006,

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### **PART I**

- \$41 million increase in retail demand resulting from favorable weather in 2007 compared to 2006,
- \$37 million increase in regulated fuel revenue due to increased volume and implementation of new fuel clause rates in Kentucky,
- \$17 million increase resulting from temporary rate reductions in 2006 associated with the regulatory approval of the Cinergy merger with Duke Energy, and
- \$13 million increase due to new electric base rates implemented in the first quarter of 2007 for Duke Energy Kentucky, Inc.

Partially offset by:

- \$40 million decrease in revenues from sales of fuel, and
- \$39 million decrease in net mark-to-market revenues on non-qualifying power and capacity hedge contracts, consisting of \$1 million of net mark-to-market gains in 2007 compared to net mark-to-market gains of \$40 million in 2006.

#### *Operating Expenses*

The \$85 million increase in Operating expenses was driven primarily by:

- \$82 million increase in fuel and operating expenses for the Midwest gas-fired generation assets primarily due to increased generation volumes in 2007 as compared to 2006,
- \$38 million increase in retail generation fuel and purchased power expense resulting primarily from the increase in sales volumes compared to the same period of 2006,
- \$15 million increase in maintenance expenses due to more generation plant outages in 2007 versus 2006,
- \$10 million increase in property and other taxes mainly driven by increased property taxes due to capital additions and increased revenue taxes due to increased revenues,
- \$10 million increase in regulatory amortization, and
- \$5 million increase in depreciation primarily due to new assets placed in service.

Partially offset by:

- \$48 million decrease in net mark-to-market expenses on non-qualifying fuel hedge contracts as a result of \$25 million of net mark-to-market gains in 2007 as compared to net mark-to-market losses of \$23 million in 2006, and
- \$39 million decrease in expenses from sales of fuel.

#### *(Losses) Gains on Sales of Other Assets and Other, net*

The improvement in (Losses) gains on sales of other assets and other, net is primarily attributable to losses in 2006 of approximately \$14 million related to sales of emission allowances as compared to negligible sales in the comparable period of 2007.

#### *Operating Income*

The increase in Operating income resulted primarily from favorable weather conditions, timing of collection of non-regulated riders, elimination of merger rate credits, new electric rates for Duke Energy Kentucky and improved results from the Midwest gas-fired generation assets. These increases were partially offset by increased operating expenses.

#### *Income Tax Expense from Continuing Operations*

The \$65 million increase in Income tax expense from continuing operations was due primarily to an increase in pre-tax income.

#### *Income (Loss) From Discontinued Operations, Net of Tax*

The Income (Loss) from discontinued operations, net of tax for 2006 is primarily related to the marketing and trading operations, which were classified as discontinued operations in connection with the June 2006 announcement to sell certain of Duke Energy Ohio's contracts to Fortis Bank S.A./N.V., a Benelux-based financial services group.

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PART I

**RESULTS OF OPERATIONS****Results of Operations and Variances****Summary of Results (in millions)**

	<u>Successor<sup>(a)</sup></u>	<u>Predecessor<sup>(a)</sup></u>	<u>Increase</u>
	<u>Three Months</u>	<u>Three Months</u>	<u>(Decrease)</u>
	<u>Ended</u>	<u>Ended</u>	
	<u>March 31,</u>	<u>March 31,</u>	
	<u>2007</u>	<u>2006</u>	
Operating revenues	\$ 916	\$ 963	\$ (47)
Operating expenses	831	781	50
(Losses) gains on sales of other assets and other, net	(11)	26	(37)
Operating income	74	208	(134)
Other income and expenses, net	9	8	1
Interest expense	23	30	(7)
Income tax expense from continuing operations	23	68	(45)
Income (Loss) from discontinued operations, net of tax	—	(2)	2
Net income	\$ 37	\$ 116	\$ (79)

(a) See Note 1 to the Consolidated Financial Statements, "Basis of Presentation" for additional information on Predecessor and Successor reporting.

**Net Income**

The 68 percent decrease in Duke Energy Ohio's Net income for the three months ended March 31, 2007 compared to the same period in 2006 was primarily due to the following factors:

**Operating Revenues**

The \$47 million decrease in Operating revenues was driven primarily by:

- \$88 million as a result of mark-to-market losses on non-qualifying power hedge contracts in 2007 of \$45 million versus gains of \$43 million in 2006, and
- \$28 million as a result of decreased volumes of physical coal sales due to expiration of contracts and the increased use of financial products to manage fuel costs which are reported net in operating expenses.

Partially offset by:

- Approximately \$40 million increase in generation revenues due to Duke Energy's contribution of its five Midwest generating plants in the second quarter of 2006,
- \$24 million increase resulting from favorable weather in 2007 compared to 2006,
- \$7 million increase due to new electric base rates implemented in the first quarter of 2007 for Duke Energy Kentucky, and
- \$4 million resulting from temporary rate reductions in 2006 associated with the regulatory approval of the Cinergy merger with Duke Energy.

**Operating Expenses**

The \$50 million increase in Operating expenses was driven primarily by:

- \$55 million increase in operating expenses due to Duke Energy's contribution of its five Midwest generating plants in the second quarter of 2006,
- \$30 million higher fuel and emission allowance consumption expense due to recognizing coal and emission allowances at fair value as of April 1, 2006 in conjunction with the Cinergy merger with Duke Energy,
- \$7 million increase in line maintenance expense as a result of ice storms in February 2007, and
- \$7 million of incremental amortization expense resulting from recognizing the unregulated generation facilities at fair value as of April 1, 2006 in conjunction with the Cinergy merger with Duke Energy.



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### **PART I**

Partially offset by:

- \$35 million related to \$19 million of mark-to-market gains on non-qualifying fuel hedge contracts in 2007 versus losses of \$16 million in 2006, and
- \$12 million related to 2006 costs for incentive and retention payments incurred as a result of the Duke Energy merger.

#### *(Losses) Gains on Sales of Other Assets and Other, net*

The decrease in (Losses) gains on sales of other assets and other, net is due to losses on emission allowance sales in 2007 of \$11 million versus gains of \$26 million in 2006. The losses in 2007 were a result of recording emission allowances at fair value as of April 1, 2006 as part of purchase accounting for the Cinergy merger with Duke Energy and decreases in market prices at the time of sale.

#### *Income Tax Expense from Continuing Operations*

The \$45 million decrease in Income tax expense from continuing operations was due primarily to a \$126 million decrease in pre-tax income.

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PART I

### **Item 4. *Controls and Procedures.***

#### **Disclosure Controls and Procedures**

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized, and reported, within the time periods specified by the Securities and Exchange Commission's (SEC) rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2007, and, based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

#### **Changes in Internal Control over Financial Reporting**

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended September 30, 2007 and found no change that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

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## PART II. OTHER INFORMATION

**Item 1. Legal Proceedings**

For information regarding legal proceedings that became reportable events or in which there were material developments in the third quarter of 2007, see Note 12 to the Consolidated Financial Statements, "Regulatory Matters" and Note 13 to the Consolidated Financial Statements, "Commitments and Contingencies".

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, careful consideration should be given to the factors discussed in Part I, "Item 1A. Risk Factors" in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2006, which could materially affect Duke Energy Ohio's financial condition or future results. Additional risks and uncertainties not currently known to Duke Energy Ohio or that Duke Energy Ohio currently deems to be immaterial also may adversely affect Duke Energy Ohio's financial condition and/or results of operations.

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PART II

**Item 6. Exhibits****(a) Exhibits**

Exhibits filed or furnished herewith are designated by an asterisk (\*).

**Exhibit  
Number**

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*31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The total amount of securities of the registrant or its subsidiaries authorized under any instrument with respect to long-term debt not filed as an exhibit does not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. The registrant agrees, upon request of the Securities and Exchange Commission, to furnish copies of any or all of such instruments to it.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DUKE ENERGY OHIO, INC.

Date: November 14, 2007

/s/ DAVID L. HAUSER

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David L. Hauser  
Group Executive and  
Chief Financial Officer

Date: November 14, 2007

/s/ STEVEN K. YOUNG

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Steven K. Young  
Senior Vice President and  
Controller

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James E. Rogers, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2007

\_\_\_\_\_  
/s/ JAMES E. ROGERS  
James E. Rogers  
Chief Executive Officer

**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, David L. Hauser, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2007

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/s/ DAVID L. HAUSER  
David L. Hauser  
Group Executive and  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending September 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Rogers, Chief Executive Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

/s/ JAMES E. ROGERS

James E. Rogers  
Chief Executive Officer  
November 14, 2007



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending September 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David L. Hauser, Group Executive and Chief Financial Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

/s/ DAVID L. HAUSER

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David L. Hauser  
Group Executive and Chief Financial Officer  
November 14, 2007

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# **FORM 10-Q**

**Duke Energy Ohio, Inc. - N/A**

**Filed: August 14, 2007 (period: June 30, 2007)**

Quarterly report which provides a continuing view of a company's financial position

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10-Q - FORM 10-Q DUKE ENERGY OHIO, INC.

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## PART II.

- Item 1.            Legal Proceedings
- Item 1A.          Risk Factors
- Item 4.            Submission of Matters to a Vote of Security Holders
- Item 6.            Exhibits

### SIGNATURES

EX-31.1 (CERT OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO SEC. 302 OF THE SOA 2002)

EX-31.2 (CERT OF THE CHIEF FINANCIAL OFFICER PURSUANT TO SEC. 302 OF THE SOA 2002)

EX-32.1 (CERT OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO SEC. 906 OF THE SOA 2002)

EX-32.2 (CERT OF THE CHIEF FINANCIAL OFFICER PURSUANT TO SEC. 906 OF THE SOA 2002)

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended June 30, 2007 or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-1232

**DUKE ENERGY OHIO, INC.**  
(Exact Name of Registrant as Specified in its Charter)

Ohio  
(State or Other Jurisdiction of Incorporation)

31-0240030  
(IRS Employer Identification No.)

139 East Fourth Street  
Cincinnati, OH  
(Address of Principal Executive Offices)

45202  
(Zip code)

704-594-6200  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).  
Yes  No

All of the registrant's common stock is indirectly owned by Duke Energy Corporation (File No. 1-32853) which is a reporting company under the Securities Exchange Act of 1934, as amended.

The registrant meets the conditions set forth in General Instructions H(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format specified in General Instructions H(2) of Form 10-Q.

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DUKE ENERGY OHIO, INC.  
**FORM 10-Q FOR THE QUARTER ENDED  
JUNE 30, 2007**

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**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION**

This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management's beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "plan," "project," "predict," "will," "potential," "forecast," and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- State and federal legislative and regulatory initiatives, including costs of compliance with existing and future environmental requirements;
- State and federal legislative and regulatory initiatives that affect cost and investment recovery, have an impact on rate structures, and affect the speed at and degree to which competition enters the electric and natural gas industries;
- Costs and effects of legal and administrative proceedings, settlements, investigations and claims;
- Industrial, commercial and residential growth in Duke Energy Ohio, Inc.'s (Duke Energy Ohio) service territories;
- Additional competition in electric markets and continued industry consolidation;
- The influence of weather and other natural phenomena on Duke Energy Ohio operations, including the economic, operational and other effects of tornados and other natural phenomena;
- The timing and extent of changes in commodity prices and interest rates;
- Unscheduled generation outages, unusual maintenance or repairs and electric transmission system constraints;
- The performance of electric generation facilities;
- The results of financing efforts, including Duke Energy Ohio's ability to obtain financing on favorable terms, which can be affected by various factors, including Duke Energy Ohio's credit ratings and general economic conditions;
- Declines in the market prices of equity securities and resultant cash funding requirements of Duke Energy Ohio for Cinergy's defined benefit pension plans;
- The level of credit worthiness of counterparties to Duke Energy Ohio's transactions;
- Employee workforce factors, including the potential inability to attract and retain key personnel;
- Growth in opportunities for Duke Energy Ohio's business units, including the timing and success of efforts to develop domestic power and other projects;

- The extent of success in connecting and expanding electric markets; and

- The effect of accounting pronouncements issued periodically by accounting standard-setting bodies.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Duke Energy Ohio has described. Duke Energy Ohio undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I. FINANCIAL INFORMATION

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)  
(In millions)

**Item 1. Financial Statements.**

	Successor			Predecessor
	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007	Three Months Ended June 30, 2006	Three Months Ended March 31, 2006
<b>Operating Revenues</b>				
Non-regulated electric and other	\$ 422	\$ 768	\$ 399	\$ 421
Regulated electric	233	464	204	220
Regulated natural gas	108	447	93	322
<b>Total operating revenues</b>	<b>763</b>	<b>1,679</b>	<b>696</b>	<b>963</b>
<b>Operating Expenses</b>				
Fuel used in electric generation and purchased power	260	485	249	196
Operation, maintenance and other	182	367	173	173
Natural gas purchased	57	292	51	232
Costs of fuel resold	12	32	29	44
Depreciation and amortization	95	188	93	68
Property and other taxes	62	135	55	68
<b>Total operating expenses</b>	<b>668</b>	<b>1,499</b>	<b>650</b>	<b>781</b>
(Losses) Gains on Sales of Other Assets and Other, net	—	(11)	(5)	26
<b>Operating Income</b>	<b>95</b>	<b>169</b>	<b>41</b>	<b>208</b>
<b>Other Income and Expenses, net</b>	<b>8</b>	<b>17</b>	<b>7</b>	<b>8</b>
<b>Interest Expense</b>	<b>22</b>	<b>45</b>	<b>28</b>	<b>30</b>
<b>Income from Continuing Operations Before Income Taxes</b>	<b>81</b>	<b>141</b>	<b>20</b>	<b>186</b>
<b>Income Tax Expense from Continuing Operations</b>	<b>32</b>	<b>55</b>	<b>7</b>	<b>68</b>
<b>Income from Continuing Operations</b>	<b>49</b>	<b>86</b>	<b>13</b>	<b>118</b>
<b>Loss from Discontinued Operations, net of tax</b>	<b>—</b>	<b>—</b>	<b>(20)</b>	<b>(2)</b>
<b>Net Income (Loss)</b>	<b>\$ 49</b>	<b>\$ 86</b>	<b>\$ (7)</b>	<b>\$ 116</b>

See Notes to Unaudited Consolidated Financial Statements



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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED BALANCE SHEETS**  
(Unaudited)  
(In millions)

Successor

June 30,  
2007

December 31,  
2006

ASSETS	June 30, 2007	December 31, 2006
<b>Current Assets</b>		
Cash and cash equivalents	\$ 20	\$ 45
Receivables (net of allowance for doubtful accounts of \$4 at June 30, 2007 and \$5 at December 31, 2006)	226	308
Inventory	206	217
Assets held for sale	12	25
Unrealized gains on mark-to-market and hedging transactions	27	54
Other	115	117
<b>Total current assets</b>	<b>606</b>	<b>766</b>
<b>Investments and Other Assets</b>		
Restricted funds held in trust	16	30
Goodwill	2,335	2,348
Intangible assets	623	732
Unrealized gains on mark-to-market and hedging transactions	19	27
Assets held for sale	—	18
Other	21	21
<b>Total investments and other assets</b>	<b>3,014</b>	<b>3,176</b>
<b>Property, Plant and Equipment</b>		
Cost	9,320	9,049
Less accumulated depreciation and amortization	2,032	1,914
<b>Net property, plant and equipment</b>	<b>7,288</b>	<b>7,135</b>
<b>Regulatory Assets and Deferred Debits</b>		
Deferred debt expense	23	24
Regulatory assets related to income taxes	96	96
Other	484	533
<b>Total regulatory assets and deferred debits</b>	<b>603</b>	<b>653</b>
<b>Total Assets</b>	<b>\$ 11,511</b>	<b>\$ 11,730</b>

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED BALANCE SHEETS—(Continued)**  
**(Unaudited)**  
(In millions, except share and per-share amounts)

	Successor	
	June 30, 2007	December 31, 2006
<b>LIABILITIES AND COMMON STOCKHOLDER'S EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 449	\$ 408
Notes payable and commercial paper	327	274
Taxes accrued	175	301
Interest accrued	15	27
Liabilities associated with assets held for sale	12	25
Current maturities of long-term debt	226	105
Unrealized losses on mark-to-market and hedging transactions	28	46
Other	81	99
<b>Total current liabilities</b>	<b>1,313</b>	<b>1,285</b>
<b>Long-term Debt</b>	<b>1,653</b>	<b>1,776</b>
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes	1,445	1,475
Investment tax credit	18	19
Accrued pension and other postretirement benefit costs	320	381
Regulatory liabilities	169	167
Unrealized losses on mark-to-market and hedging transactions	20	29
Liabilities associated with assets held for sale	—	18
Asset retirement obligations	42	41
Other	176	159
<b>Total deferred credits and other liabilities</b>	<b>2,190</b>	<b>2,289</b>
<b>Commitments and Contingencies</b>		
<b>Common Stockholder's Equity</b>		
Common stock, \$8.50 par value; 120,000,000 shares authorized and 89,663,086 shares outstanding at June 30, 2007 and December 31, 2006	762	762
Additional paid-in capital	5,576	5,601
Retained earnings	49	55
Accumulated other comprehensive loss	(32)	(38)
<b>Total common stockholder's equity</b>	<b>6,355</b>	<b>6,380</b>
<b>Total Liabilities and Common Stockholder's Equity</b>	<b>\$ 11,511</b>	<b>\$ 11,730</b>

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)  
(In millions)

	Successor		Predecessor
	Six Months Ended June 30, 2007	Three Months Ended June 30, 2006	Three Months Ended March 31, 2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income (loss)	\$ 86	\$ (7)	\$ 116
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	188	93	68
Losses (gains) on sales of equity investments and other assets	11	5	(26)
Deferred income taxes	(18)	8	7
Regulatory asset/liability amortization	13	3	7
Accrued pension and postretirement benefit costs	21	12	9
Contribution to company-sponsored pension plans	(83)	—	—
(Increase) decrease in:			
Net realized and unrealized mark-to-market and hedging transactions	9	28	(30)
Receivables	92	66	10
Inventory	12	(15)	56
Other current assets	2	22	68
Increase (decrease) in:			
Accounts payable	51	19	(157)
Taxes accrued	(120)	(22)	50
Other current liabilities	(13)	(35)	(78)
Regulatory asset/liability deferrals	(23)	(7)	(1)
Other assets	84	57	17
Other liabilities	(4)	(17)	—
Net cash provided by operating activities	308	210	116
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Capital expenditures	(302)	(136)	(135)
Purchases of emission allowances	(14)	(83)	(162)
Sales of emission allowances	24	63	105
Withdrawal of restricted funds held in trust	15	—	8
Net cash used in investing activities	(277)	(156)	(184)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Issuance of long-term debt	—	—	141
Redemption of long-term debt	(3)	(17)	(1)
Redemption of preferred stock of subsidiaries	—	1	(21)
Notes payable and commercial paper	53	(24)	50
Dividend paid	(135)	—	(102)
Capital contribution from parent	29	—	—
Other	—	(1)	(1)
Net cash (used in) provided by financing activities	(56)	(41)	66
Net (decrease) increase in cash and cash equivalents	(25)	13	(2)
Cash and cash equivalents at beginning of period	45	8	10
Cash and cash equivalents at end of period	\$ 20	\$ 21	\$ 8
<b>Supplemental Disclosures</b>			
Significant non-cash transactions:			
Purchase accounting adjustments	\$ (8)	\$ 2,894	\$ —
Allowance for funds used during construction (AFUDC) – equity component	\$ 2	\$ 1	\$ 1
Transfer of generating assets from Duke Energy	\$ —	\$ 1,452	\$ —

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)**  
(Unaudited)  
(In millions)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Net Gains (Losses) on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss) Minimum Pension Liability Adjustment	SFAS No. 158 Adjustment	Total Common Stockholder's Equity
<b>Successor</b>							
<b>Six Months Ended June 30, 2007</b>							
Balance at December 31, 2006	\$ 762	\$ 5,601	\$ 55	\$ (36)	—	\$ (2)	\$ 6,380
Net income	—	—	86	—	—	—	86
Cash flow hedges, net of tax effect of (\$4)	—	—	—	8	—	—	8
Total comprehensive income	—	—	—	—	—	—	94
Capital contribution from parent	—	29	—	—	—	—	29
Push-down accounting adjustments	—	(8)	—	—	—	—	(8)
Adoption of SFAS No. 158 – measurement date provision	—	—	(3)	—	—	(2)	(5)
Common stock dividends	—	(46)	(89)	—	—	—	(135)
Balance at June 30, 2007	\$ 762	\$ 5,576	\$ 49	\$ (28)	\$ —	\$ (4)	\$ 6,355
<b>Three Months Ended June 30, 2006</b>							
Balance at April 1, 2006	\$ 762	\$ 4,123	—	—	—	—	\$ 4,885(b)
Net loss and total comprehensive loss	—	—	(7)	—	—	—	(7)
Transfer of generating assets from Duke Energy <sup>(a)</sup>	—	1,452	—	(39)	—	—	1,413
Other	—	1	—	—	—	—	1
Balance at June 30, 2006	\$ 762	\$ 5,576	\$ (7)	\$ (39)	—	—	\$ 6,292
<b>Predecessor</b>							
<b>Three Months Ended March 31, 2006</b>							
Balance at December 31, 2005	\$ 762	\$ 603	\$ 657	\$ (14)	\$ (33)	—	\$ 1,975
Net income	—	—	116	—	—	—	116
Other comprehensive income	—	—	—	—	—	—	—
Minimum pension liability adjustment	—	—	—	—	1	—	1
Cash flow hedges	—	—	—	1	—	—	1
Total comprehensive income	—	—	—	—	—	—	118
Common stock dividends	—	—	(102)	—	—	—	(102)
Balance at March 31, 2006	\$ 762	\$ 603	\$ 671	\$ (13)	\$ (32)	—	\$ 1,991(b)

(a) Includes \$39 (net of tax benefit of \$24) related to deferred losses on terminated cash flow hedges included in Accumulated Other Comprehensive Loss.

(b) Difference in equity balances at March 31, 2006 and April 1, 2006 is due to the application of push-down accounting reflecting Duke Energy's merger with Cinergy (see Notes 1 and 2 to the Consolidated Financial Statements).

See Notes to Unaudited Consolidated Financial Statements

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### PART I

## DUKE ENERGY OHIO, INC. Notes To Consolidated Financial Statements (Unaudited)

### 1. Basis of Presentation

**Nature of Operations and Basis of Consolidation.** Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through Duke Energy Kentucky, Inc. (Duke Energy Kentucky) in nearby areas of Kentucky. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing. Duke Energy Ohio's principal subsidiary is Duke Energy Kentucky, a Kentucky corporation organized in 1901. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. References herein to Duke Energy Ohio includes Duke Energy Ohio and its subsidiaries. In October 2006, Cinergy and Duke Energy Ohio completed the sale of Duke Energy Ohio's trading contracts to Fortis Bank S.A./N.V. (Fortis), a Benelux-based financial services group. See Note 9 for additional information.

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

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

These Consolidated Financial Statements include, after eliminating intercompany transactions and balances, the accounts of Duke Energy Ohio and all majority-owned subsidiaries where Duke Energy Ohio has control.

**Predecessor and Successor Reporting.** In connection with the Duke Energy merger, Duke Energy acquired all of the outstanding common stock of Cinergy. The merger has been accounted for under the purchase method of accounting with Duke Energy treated as the acquirer for accounting purposes. As a result, the assets and liabilities of Cinergy were recorded at their respective fair values as of the merger consummation date. Purchase accounting impacts, including goodwill recognition, have been "pushed down" to Duke Energy Ohio, resulting in the assets and liabilities of Duke Energy Ohio being recorded at their respective fair values as of April 3, 2006 (see Note 2). Except for an adjustment related to pension and other postretirement benefit obligations, as mandated by Statement of Financial Accounting Standards (SFAS) No. 87, "Employers' Accounting for Pensions," and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," the accompanying consolidated financial statements do not reflect any adjustments related to Duke Energy Ohio's regulated operations that are accounted for pursuant to SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71), which are comprised of Duke Energy Ohio's regulated transmission and distribution and Duke Energy Kentucky. Under the rate setting and recovery provisions currently in place for these regulated operations which provide revenues derived from cost, the fair values of the individual tangible and intangible assets and liabilities are considered to approximate their carrying values.

Duke Energy Ohio's Consolidated Statements of Operations subsequent to the merger include amortization expense relating to purchase accounting adjustments and depreciation of fixed assets based upon their fair values. Therefore, the Duke Energy Ohio financial data prior to the merger will not generally be comparable to its financial data subsequent to the merger. See Note 2 for additional information.

Due to the impact of push-down accounting, the financial statements and certain note presentations separate Duke Energy Ohio's presentations into two distinct periods, the period before the consummation of the merger (labeled "Predecessor") and the period after that date (labeled "Successor"), to indicate the application of different basis of accounting between the periods presented.

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

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PART I

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**  
**(Unaudited)**

of Operations are not necessarily indicative of amounts expected for the respective annual periods due to the effects of seasonal temperature variations on energy consumption, the timing of maintenance on electric generating units, changes in mark-to-market (MTM) valuations, changing commodity prices, and other factors. These Consolidated Financial Statements and other information included in this quarterly report should be read in conjunction with the Consolidated Financial Statements and Notes in Duke Energy Ohio's Form 10-K for the year ended December 31, 2006.

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

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

**Other Regulatory Assets and Deferred Debits.** The state of Ohio passed comprehensive electric deregulation legislation in 1999, and in 2000, the Public Utilities Commission of Ohio (PUCO) approved a stipulation agreement relating to Duke Energy Ohio's transition plan creating a Regulatory Transition Charge (RTC) designed to recover Duke Energy Ohio's generation-related regulatory assets and transition costs over a ten-year period beginning January 1, 2001 and ending December 2010. Accordingly, application of SFAS No. 71 was discontinued for the generation portion of Duke Energy Ohio's business. Duke Energy Ohio has a RTC related regulatory asset balance of approximately \$288 million and \$331 million as of June 30, 2007 and December 31, 2006, respectively, which is classified in Other Regulatory Assets and Deferred Debits on the Consolidated Balance Sheets.

**2. Duke Energy/Cinergy Merger**

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

As discussed in Note 1 above, purchase accounting impacts, including goodwill recognition, have been "pushed down" to Duke Energy Ohio, resulting in the assets and liabilities of Duke Energy Ohio being recorded at their respective fair values as of April 3, 2006. The following unaudited consolidated pro forma financial results for Duke Energy Ohio are presented as if the merger with Duke Energy had occurred at the beginning of the period presented:

**Unaudited Consolidated Pro Forma Results (Predecessor)**

	<b>Three Months Ended March 31, 2006</b>
	<i>(in millions)</i>
Operating revenues	\$ 966
Income from continuing operations	\$ 88
Net income	\$ 86

These pro forma results do not include any significant transactions completed by Duke Energy Ohio other than the impact of Cinergy's merger with Duke Energy. Prior to consummation of the merger, certain regulatory approvals were received from the state utility commissions and the Federal Energy Regulatory Commission (FERC). See Note 12 for a discussion of the regulatory impacts of the merger.

**3. Transfer of Generating Assets and Dispositions**

**Transfer of Certain Duke Energy Generating Assets to Duke Energy Ohio.** In April 2006, Duke Energy contributed to Duke Energy Ohio its ownership interest in five plants, representing a mix of combined cycle and peaking plants, with a combined capacity of 3,600 megawatts (MW). The transaction was effective in April 2006 and was accounted for at Duke Energy's net book value for these

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PART I

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**  
**(Unaudited)**

assets. The entities holding these generating plants, which were indirect subsidiaries of Duke Energy, were first distributed to Duke Energy, which then contributed them to Cinergy which, in turn, contributed them to Duke Energy Ohio. In the final step, the entities were then merged into Duke Energy Ohio.

The following unaudited consolidated pro forma financial results for Duke Energy Ohio are presented as if the contribution of the Duke Energy generating assets to Duke Energy Ohio had occurred at the beginning of the period presented:

**Unaudited Consolidated Pro Forma Results (Predecessor)**

	<b>Three Months Ended March 31, 2006</b>
	<b>(in millions)</b>
Operating revenues	\$ 971
Income from continuing operations	\$ 106
Net income	\$ 104

These pro forma results do not include any significant transactions completed by Duke Energy Ohio other than the impact of the transfer of the ownership interest in the five plants as discussed above. As part of this transaction, Duke Energy agreed to reimburse Duke Energy Ohio, on a quarterly basis, through April 2016 in the event of certain cash shortfalls related to the performance of the five plants. Based on the assessment of the performance of the five plants during the first and second quarters of 2007, Duke Energy Ohio did not incur any qualifying shortfalls related to the performance of the five plants and thus no cash reimbursement was required from Duke Energy. During the second quarter of 2006, Duke Energy Ohio did incur qualifying shortfalls, which resulted in Duke Energy Ohio being reimbursed \$1.9 million during the third quarter of 2006. Duke Energy Ohio accounts for any payments from or return of payments to Duke Energy in Common Stockholder's Equity as an adjustment to Additional paid-in capital.

**Dispositions.** For the three months ended June 30, 2007, June 30, 2006 and March 31, 2006 the sale of emission allowances resulted in approximately \$2 million, \$63 million and \$105 million, respectively, in proceeds and net pre-tax gains (losses) of an immaterial amount, (\$5) million and \$26 million, respectively, recorded in (Losses) Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. For the six months ended June 30, 2007, the sale of emission allowances resulted in approximately \$24 million in proceeds and net pre-tax losses of \$11 million recorded in (Losses) Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These amounts primarily relate to Commercial Power's sales of emission allowances. See Note 9 for dispositions related to discontinued operations.

**4. Common and Preferred Stock**

**Common Stock.** Cinergy owns all of the common stock of Duke Energy Ohio. In April 2006, Duke Energy acquired 100 percent of Cinergy's outstanding stock for 1.56 shares of Duke Energy common stock per outstanding share of Cinergy common stock. This conversion resulted in the issuance of approximately 313 million shares of Duke Energy common stock. See Note 1 for additional information.

In April 2006, Duke Energy Ohio filed a petition with the FERC for a declaratory ruling that its payment of dividends out of its paid-in capital account, using the balance transferred from the retained earnings account, resulting from purchase accounting arising from the Duke Energy/Cinergy merger, would not violate section 305(a) of the Federal Power Act, which generally precludes the payment of dividends out of paid-in capital. Such a ruling was necessary because purchase/push-down accounting reset retained earnings to zero as of April 3, 2006, thus potentially precluding Duke Energy Ohio from using pre-merger retained earnings to pay dividends. Without this approval, Duke Energy Ohio's ability to pay dividends would have been constrained to earnings since April 3, 2006. In May 2006, the FERC issued an order approving Duke Energy Ohio's petition.

During the three months ended June 30, 2007 and March 31, 2006, Duke Energy Ohio paid dividends to its parent, Cinergy, of \$135 million and \$102 million, respectively.

**Preferred Stock.** In March 2006, Duke Energy Ohio redeemed all outstanding shares of its \$16.98 million notional amount 4% Cumulative Preferred Stock and its \$3.5 million notional amount 4.75% Cumulative Preferred Stock at a price of \$108 per share and \$101 per share, respectively, plus accrued and unpaid dividends.

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PART I

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**  
**(Unaudited)**

**5. Inventory**

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

	Successor <sup>(a)</sup>	
	June 30, 2007	December 31, 2006
	(in millions)	
Gas held in storage	\$ 60	\$ 82
Fuel for use in electric generation	78	74
Materials and supplies	68	61
<b>Total Inventory</b>	<b>\$ 206</b>	<b>\$ 217</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

**6. Debt and Credit Facilities**

Duke Energy Ohio receives support for its short-term borrowing needs through its participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement, which allows Duke Energy Ohio to better manage its cash and working capital requirements. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. Prior to the merger, Duke Energy Ohio participated in a similar money pool arrangement with Cinergy and other Cinergy subsidiaries. As of June 30, 2007 and December 31, 2006, Duke Energy Ohio was in a payable position of \$327 million and \$274 million, respectively, classified within Notes payable and commercial paper in the accompanying Consolidated Balance Sheets. During the six months ended June 30, 2007, the \$53 million change in the money pool is reflected as a cash inflow in Notes payable and commercial paper within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the three months ended June 30, 2006, the \$24 million change in the money pool is reflected as a cash outflow in Notes payable and commercial paper within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the three months ended March 31, 2006, the \$50 million change in the money pool is reflected as a cash inflow in Notes payable and commercial paper within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows.

In June 2007, Duke Energy closed on the syndication of an amended and restated credit facility, replacing the existing credit facilities totaling \$2.65 billion with a 5-year, \$2.65 billion master credit facility. Duke Energy Ohio (excluding Duke Energy Kentucky) has a borrowing sub limit of \$500 million and Duke Energy Kentucky has a borrowing sub limit of \$100 million under the master credit facility. Concurrent with the syndication of the master credit facility, Duke Energy established a new \$1.5 billion commercial paper program at Duke Energy and terminated Cinergy's previously existing commercial paper program.

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

Duke Energy's credit agreement contains various financial and other covenants, including, but not limited to, a covenant regarding the debt-to-total capitalization ratio at Duke Energy, Duke Energy Ohio and Duke Energy Kentucky to not exceed 65%. Duke Energy Ohio's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of June 30, 2007, Duke Energy and Duke Energy Ohio were in compliance with these covenants. In addition, some credit agreements may allow for acceleration of payments or termination of the agreements due to nonpayment, or the acceleration of other significant indebtedness of the borrower or some of its subsidiaries. None of the debt or credit agreements contain material adverse change clauses.

As of June 30, 2007 and December 31, 2006, approximately \$96 million of certain pollution control bonds, which are short-term obligations by nature, are classified as Long-term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio's intent and ability to utilize such borrowings as long-term financing. Duke Energy's credit facilities with non-cancelable terms in excess of one year as of the balance sheet date give Duke Energy Ohio the ability to refinance these short-term obligations on a long-term basis.

**7. Employee Benefit Obligations**

Duke Energy Ohio participates in pension and other postretirement benefit plans sponsored by Cinergy. Cinergy's qualified defined benefit pension plans cover substantially all United States employees meeting certain minimum age and service requirements. Funding for



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

During the six months ended June 30, 2007, Duke Energy made qualified pension benefit contributions of \$350 million to the legacy Cinergy qualified pension benefit plans, of which, approximately \$83 million represents contributions made by Duke Energy Ohio. There were no qualified pension benefit contributions for the three months ended June 30, 2006 or March 31, 2006. Duke Energy does not anticipate making any additional contributions to its legacy Cinergy qualified pension benefit plans during the remainder of 2007.

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

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup>
	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007	Three Months Ended June 30, 2006	Three Months Ended March 31, 2006
	(In millions)			
Qualified Pension Benefits <sup>(b)</sup>	\$ 3	\$ 7	\$ 5	\$ 6
Other Postretirement <sup>(c)</sup>	\$ 3	\$ 5	\$ 3	\$ 3

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) These amounts exclude approximately \$3 million and \$7 million for the three and six months ended June 30, 2007, respectively, and approximately \$2 million for the three months ended June 30, 2006, of regulatory asset amortization resulting from purchase accounting.

(c) These amounts exclude approximately \$1 million and \$2 million for the three and six months ended June 30, 2007, respectively, and approximately \$2 million for the three months ended June 30, 2006, of regulatory asset amortization resulting from purchase accounting.

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

See Note 15 for a discussion of the effect of adoption of SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of Financial Accounting Standards Board (FASB) Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158). Also, refer to Note 14 for a discussion of the amounts in the Consolidated Balance Sheets related to allocated accrued pension and other postretirement benefit obligations from Cinergy.

**8. Goodwill and Intangibles**

As discussed in Note 2, in April 2006, Duke Energy and Cinergy consummated the merger, which resulted in Duke Energy Ohio recording goodwill of approximately \$2.3 billion. The following table shows the components of goodwill at June 30, 2007 and December 31, 2006:

**Carrying Amount of Goodwill**

	Successor <sup>(a)</sup>		
	Balance at December 31, 2006	Changes	Balance at June 30, 2007
	(in millions)		
<b>Business Segment:</b>			
Commercial Power	\$ 1,200	\$ (6)	\$ 1,194
Franchised Electric and Gas	1,148	(7)	1,141
<b>Total Goodwill</b>	<b>\$ 2,348</b>	<b>\$ (13)</b>	<b>\$ 2,335</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

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The carrying amount and accumulated amortization of intangible assets as of June 30, 2007 and December 31, 2006 are as follows:

	Successor <sup>(a)</sup>	
	June 30, 2007	December 31, 2006
	(in millions)	
Emission allowances	\$ 411	\$ 495
Gas, coal, and power contracts	271	271
Other	9	9
<b>Total gross carrying amount</b>	<b>691</b>	<b>775</b>
Accumulated amortization—gas, coal, and power contracts	(64)	(40)
Accumulated amortization—other	(4)	(3)
<b>Total accumulated amortization</b>	<b>(68)</b>	<b>(43)</b>
<b>Total intangible assets, net</b>	<b>\$ 623</b>	<b>\$ 732</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

The carrying value of emission allowances sold or consumed for Duke Energy Ohio were as follows:

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup>
	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007	Three Months Ended June 30, 2006	Three Months Ended March 31, 2006
	(in millions)			
	\$33	\$ 100	\$ 88	\$ 36

(a) See Note 1 for additional information on Predecessor and Successor reporting.

Amortization expense recorded for the three months ended June 30, 2006 and 2007, three months ended March 31, 2006 and the six months ended June 30, 2007 was as follows:

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup>
	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007	Three Months Ended June 30, 2006	Three Months Ended March 31, 2006
	(in millions)			
	\$13	\$ 25	\$ 15	\$ 1

(a) See Note 1 for additional information on Predecessor and Successor reporting.

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As of April 3, 2006, Duke Energy Ohio recorded an intangible liability in connection with the merger with Duke Energy amounting to approximately \$113 million associated with the Market Based Standard Service Offer (MBSSO) in Ohio that will be recognized in earnings over the remaining regulatory period, which ends on December 31, 2008. Duke Energy Ohio also recorded approximately \$56 million of intangible liabilities associated with other power sale contracts in connection with the merger with Duke Energy. The carrying amount of these liabilities as of June 30, 2007 and December 31, 2006 is as follows:

	Successor <sup>(a)</sup>	
	June 30, 2007	December 31, 2006
	(in millions)	
MBSSO	\$ 89	\$ 95
Other power sale contracts	31	39
<b>Total intangible liabilities</b>	<b>\$ 120</b>	<b>\$ 134</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

During the three and six months ended June 30, 2007, Duke Energy Ohio amortized approximately \$10 million and \$14 million to income, respectively, related to these intangible liabilities. During the three months ended June 30, 2006, Duke Energy Ohio amortized approximately \$4 million to income, related to these intangible liabilities. Intangible liabilities are classified as Other Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

**9. Discontinued Operations and Assets Held for Sale**

In June 2006, Cinergy agreed to sell its commercial marketing and trading businesses, including certain of Duke Energy Ohio's trading contracts, to Fortis, a Benelux-based financial services group. In October 2006, the sale was completed. Results of operations for these trading contracts have been reflected in Loss from Discontinued Operations, net of tax in the accompanying Consolidated Statements of Operations. In October 2006, in connection with this transaction, Duke Energy Ohio entered into a series of Total Return Swaps (TRS) with Fortis, which are accounted for as mark to market derivatives. The TRS offsets the net fair value of the contracts being sold to Fortis. The TRS will be cancelled for each underlying contract as each is transferred to Fortis. All economic and credit risk associated with the contracts has been transferred to Fortis as of the date of the sale through the TRS. As of June 30, 2007, approximately 98% of the contracts have been novated by Fortis. At June 30, 2007, contracts with a net fair value of approximately \$12 million remain in Assets held for sale and represent contracts that have yet to be novated by Fortis.

The following table summarizes the results classified as Loss from Discontinued Operations, net of tax, in the accompanying Consolidated Statements of Operations.

	Successor <sup>(a)</sup>			
	Operating (Loss) Income			
	Operating Revenues	Pre-tax Loss	Income Tax Benefit	Loss From Discontinued Operations, Net of Tax
	(in millions)			
Three Months Ended June 30, 2006				
Commercial Power	\$ (29)	\$ (31)	\$ (11)	\$ (20)
	Predecessor <sup>(a)</sup>			
	Operating (Loss) Income			
	Operating Revenues	Pre-tax Loss	Income Tax Benefit	Loss From Discontinued Operations, Net of Tax
	(in millions)			
Three Months Ended March 31, 2006				
Commercial Power	\$ 9	\$ (3)	\$ (1)	\$ (2)

(a) See Note 1 for additional information on Predecessor and Successor reporting.

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The following table presents the carrying values of the major classes of assets and associated liabilities held for sale in the Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006.

	Successor <sup>(a)</sup>	
	June 30, 2007	December 31, 2006
	(in millions)	
Current assets	\$ 12	\$ 25
Investments and other assets	—	18
<b>Total assets held for sale</b>	<b>\$ 12</b>	<b>\$ 43</b>
Current liabilities	\$ 12	\$ 25
Deferred credits and other liabilities	—	18
<b>Total liabilities associated with assets held for sale</b>	<b>\$ 12</b>	<b>\$ 43</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

**10. Business Segments**

Duke Energy Ohio operates the following business units: Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these business units in deciding how to allocate resources and evaluate performance. Both of the business units are considered reportable segments under SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." There is no aggregation within Duke Energy Ohio's defined business segments.

The remainder of Duke Energy Ohio's operations are presented as "Other." While it is not considered a business segment, Other primarily includes certain allocated governance costs (see Note 14).

Accounting policies for Duke Energy Ohio's segments are the same as those described in the Notes to the Consolidated Financial Statements in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2006. Management evaluates segment performance based on earnings before interest and taxes from continuing operations (EBIT).

On a segment basis, EBIT excludes discontinued operations and represents all profits from continuing operations (both operating and non-operating and excluding corporate governance costs) before deducting interest and taxes. Cash, cash equivalents, and short-term investments are managed centrally by Cinergy and Duke Energy, so the interest and dividend income on those balances are excluded from the segments' EBIT.

Transactions between reportable segments are accounted for on the same basis as unaffiliated revenues and expenses in the accompanying Consolidated Financial Statements.

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**Business Segment Data<sup>(a)</sup>**

	Unaffiliated Revenues	Intersegment Revenues	Total Revenues	Segment EBIT/ Consolidated Income from Continuing Operations Before Income Taxes	Depreciation and Amortization
(In millions)					
<b>Successor<sup>(b)</sup></b>					
<b>Three Months Ended June 30, 2007</b>					
Franchised Electric and Gas	\$ 341	\$ —	\$ 341	\$ 50	\$ 54
Commercial Power	422	—	422	67	41
Total reportable segments	763	—	763	117	95
Other	—	—	—	(21)	—
Interest expense	—	—	—	(22)	—
Interest income and other	—	—	—	7	—
Total consolidated	\$ 763	\$ —	\$ 763	\$ 81	\$ 95
<b>Six Months Ended June 30, 2007</b>					
Franchised Electric and Gas	\$ 911	\$ —	\$ 911	\$ 129	\$ 107
Commercial Power	768	—	768	80	81
Total reportable segments	1,679	—	1,679	209	188
Other	—	—	—	(39)	—
Interest expense	—	—	—	(45)	—
Interest income and other	—	—	—	16	—
Total consolidated	\$ 1,679	\$ —	\$ 1,679	\$ 141	\$ 188
<b>Three Months Ended June 30, 2006</b>					
Franchised Electric and Gas	\$ 297	\$ —	\$ 297	\$ 20	\$ 51
Commercial Power	399	1	400	36	42
Total reportable segments	696	1	697	56	93
Other	—	—	—	(13)	—
Eliminations	—	(1)	(1)	—	—
Interest expense	—	—	—	(28)	—
Interest income and other	—	—	—	5	—
Total consolidated	\$ 696	\$ —	\$ 696	\$ 20	\$ 93
<b>Predecessor<sup>(b)</sup></b>					
<b>Three Months Ended March 31, 2006</b>					
Franchised Electric and Gas	\$ 542	\$ —	\$ 542	\$ 80	\$ 50
Commercial Power	421	1	422	166	18
Total reportable segments	963	1	964	246	68
Other	—	—	—	(39)	—
Eliminations	—	(1)	(1)	—	—
Interest expense	—	—	—	(30)	—
Interest income and other	—	—	—	9	—
Total consolidated	\$ 963	\$ —	\$ 963	\$ 186	\$ 68

(a) Segment results exclude results of discontinued operations.

(b) See Note 1 for additional information on Predecessor and Successor reporting.

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Segment assets in the following table exclude all intercompany assets.

**Segment Assets**

	Successor <sup>(a)</sup>	
	June 30, 2007	December 31, 2006
	(in millions)	
Franchised Electric and Gas	\$ 5,447	\$ 5,381
Commercial Power	6,064	6,349
<b>Total reportable segments/consolidated assets</b>	<b>\$ 11,511</b>	<b>\$ 11,730</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

**11. Risk Management Instruments**

The following table shows the carrying value of Duke Energy Ohio's derivative portfolio as of June 30, 2007, and December 31, 2006.

**Derivative Portfolio Carrying Value**

	Successor <sup>(a)</sup>	
	June 30, 2007	December 31, 2006
	(in millions)	
Hedging	\$ (2)	\$ (2)
Undesignated	—	8
<b>Total</b>	<b>\$ (2)</b>	<b>\$ 6</b>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

The amounts in the table above represent the combination of assets and (liabilities) for unrealized gains and losses on mark-to-market and hedging transactions on Duke Energy Ohio's Consolidated Balance Sheets, excluding approximately \$12 million of derivative assets and \$12 million of derivative liabilities which were transferred to assets and liabilities held for sale. See Note 9 for additional information.

The \$8 million decrease in the undesignated derivative portfolio fair value is due primarily to unrealized mark-to-market losses within Commercial Power, primarily as a result of higher power prices. This was partially offset by unrealized mark-to-market gains on coal derivatives within Commercial Power.

**Credit Risk.** Included in Other Current Assets in the Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006 are collateral assets of approximately \$32 million and \$58 million, respectively, which represent cash collateral posted by Duke Energy Ohio with third parties. Included in Other Current Liabilities in the Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006 are collateral liabilities of approximately \$4 million and \$27 million, respectively, which represent cash collateral, posted by third parties to Duke Energy Ohio. This decrease in cash collateral posted by third parties to Duke Energy Ohio is primarily due the sale of the commercial marketing and trading business to Fortis in 2006.

**12. Regulatory Matters**

**Regulatory Merger Approvals.** As discussed in Note 1 and Note 2, on April 3, 2006, the merger between Duke Energy and Cinergy was consummated to create a newly formed company, Duke Energy Holding Corp. (subsequently renamed Duke Energy Corporation). As a condition to the merger approval, the PUCO, and the Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Ohio and Kentucky, respectively. The commissions also required Duke Energy Ohio and Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- The PUCO required that Duke Energy Ohio provide (i) a rate reduction of approximately \$15 million for one year to facilitate economic development in a time of increasing rates and market prices (ii) a reduction of approximately \$21 million to its gas and

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electric consumers in Ohio for one year, with both credits beginning January 1, 2006. As of March 31, 2007, Duke Energy Ohio had completed its merger related rate reductions and filed a report with the PUCO to terminate the merger credit riders. Approximately \$2 million and \$16 million of the rate reduction was passed through to customers during the six months ended June 30, 2007 and the three months ended June 30, 2006, respectively.

- The KPSC required that Duke Energy Kentucky provide \$8 million in rate reductions to its customers over five years, ending when new rates are established in the next rate case after January 1, 2008. Approximately less than \$1 million and \$1 million of the rate reduction was passed through to customers during the three and six months ended June 30, 2007, respectively. During the three months ended June 30, 2006, \$1 million was returned to customers on this rate credit.
- The FERC approved the merger without conditions.

*Rate Related Information.* The KPSC approves rates for retail electric and gas sales within the state of Kentucky. The PUCO approves rates and market prices for retail electric and gas sales within Ohio. The FERC approves rates for electric sales to wholesale customers served under cost-based rates.

*Duke Energy Ohio Electric Rate Filings.* Duke Energy Ohio operates under a Rate Stabilization Plan (RSP), a MBSSO approved by the PUCO in November 2004. In March 2005, the Office of the Ohio Consumers' Counsel (OCC) appealed the PUCO's approval of the MBSSO to the Supreme Court of Ohio and the Court issued its decision in November 2006. It upheld the MBSSO in virtually every respect but remanded to the PUCO on two issues. The Court ordered the PUCO to support a certain portion of its order with reasoning and record evidence and to require Duke Energy Ohio to disclose certain confidential commercial agreements with other parties previously requested by the OCC. Duke Energy Ohio has complied with the disclosure order. Such confidential commercial agreements are relatively common in the jurisdiction and the PUCO has not allowed production of such agreements in past cases in which the PUCO was presented with a settlement agreement on the basis that they are irrelevant. A hearing on remand has concluded and Duke Energy Ohio expects a Commission Order before the end of the year.

On August 2, 2006, Duke Energy Ohio filed an application with the PUCO to amend its MBSSO through 2010. The proposal provides for continued electric system reliability, a simplified market price structure and clear price signals for customers, while helping to maintain a stable revenue stream for Duke Energy Ohio. The application is pending and Duke Energy Ohio cannot predict the outcome of this proceeding.

Duke Energy Ohio's MBSSO includes a fuel clause reserve capacity (System Reliability Tracker or SRT) and an Annually Adjusted Component (AAC) to recover changes in environmental, tax and homeland security costs which are audited annually by the PUCO. In April 2007 Duke Energy Ohio entered a settlement resolving all open issues identified in the 2006 audits and application to amend the 2007 AAC market price with some, but not all, of the parties. The PUCO held a hearing regarding the settlement. A PUCO decision is expected before the end of the year. Duke Energy Ohio cannot predict an outcome of these cases; however, Duke Energy Ohio does not expect the agreement to have a material impact on its consolidated results of operations, cash flows or financial position.

In July 2007, the PUCO approved Duke Energy Ohio's application to establish energy efficiency programs. The programs consist of gas and electric programs for residential and commercial customers. Duke Energy Ohio will recover its investments in the energy efficiency programs, including shared savings and lost revenues, through a Demand Side Management Rider. With PUCO approval, Duke Energy Ohio may implement additional programs. Large non-residential customers may opt out of the program. Duke Energy Ohio's energy efficiency programs are expected to decrease the need for fuel while providing savings for both customers and the Company.

*Duke Energy Ohio Gas Rate Case.* In July 2007, Duke Energy Ohio filed an application with the PUCO for an increase in its base rates for gas service. Duke Energy Ohio seeks an increase of approximately \$34 million in revenue, or approximately 5.7%, to be effective in the spring of 2008. The application also requests approval to continue tracker recovery costs associated with an accelerated gas main replacement program.

*Duke Energy Kentucky Electric Rate Case.* In May 2006, Duke Energy Kentucky filed an application for an increase in its base electric rates of approximately \$67 million in revenue, or approximately 28 percent, to be effective in January 2007 pursuant to the KPSC's 2003 Order approving the transfer of 1,100 MW of generating assets from Duke Energy Ohio to Duke Energy Kentucky. In the fourth quarter of 2006, the KPSC approved the settlement agreement resolving all the issues raised in the proceeding. Among other things, the settlement agreement provided for a \$49 million increase in Duke Energy Kentucky's base electric rates and reinstatement of the fuel cost recovery mechanism, which had been frozen since 2001. The settlement agreement also provided for Duke Energy Kentucky to obtain KPSC approval for a back-up power supply plan. In January 2007, Duke Energy Kentucky filed a back-up power supply plan with the KPSC.

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The plan provided for Duke Energy Kentucky to purchase back-up power through bilateral contracts for scheduled outages. Duke Energy Kentucky will recover these costs through base rates. The plan provided for Duke Energy Kentucky to purchase back-up power through the Midwest Independent System Operator, Inc. energy markets for unscheduled outages. Duke Energy Kentucky will recover these costs through its fuel adjustment clause. The KPSC issued an order in March 2007 approving Duke Energy Kentucky's back-up power supply plan.

*Duke Energy Kentucky Gas Rate Cases.* In 2002, the KPSC approved Duke Energy Kentucky's gas base rate case which included, among other things, recovery of costs associated with an accelerated gas main replacement program. The approval authorized a tracking mechanism to recover certain costs including depreciation and a rate of return on the program's capital expenditures. The Kentucky Attorney General appealed to the Franklin Circuit Court the KPSC's approval of the tracking mechanism as well as the KPSC's subsequent approval of annual rate adjustments under this tracking mechanism. In 2005, both Duke Energy Kentucky and the KPSC requested that the court dismiss these cases. At the present time, Duke Energy Kentucky cannot predict the timing or outcome of this litigation.

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

In August 2007 the Franklin Circuit Court consolidated all the pending appeals and ruled that the KPSC lacks legal authority to approve the gas main replacement tracking mechanism, and the annual rate adjustments under the tracking mechanism. To date, Duke Energy Kentucky has collected approximately \$9 million in annual rate adjustments under the tracking mechanism. Duke Energy Kentucky intends to appeal these cases to the Kentucky Court of Appeals. At this time, Duke Energy Kentucky cannot predict the outcome of this litigation.

*Other.* In April 2005, the PUCO issued an order opening a statewide investigation into riser leaks in gas pipeline systems throughout Ohio. The investigation followed four explosions since 2000 caused by gas riser leaks, including an April 2000 explosion in Duke Energy Ohio's service area. In November 2006, the PUCO Staff released an expert report, which concluded that certain types of risers are prone to leaks under various conditions, including over-tightening during initial installation. The PUCO Staff recommended that natural gas companies continue to monitor the situation and study the cause of any further riser leaks to determine whether further remedial action is warranted. Duke Energy Ohio has approximately 87,000 of these risers on its distribution system. If the PUCO orders natural gas companies to replace all of these risers, Duke Energy Ohio estimates a replacement cost of \$35 million. As part of the rate case filed in July 2007, Duke Energy Ohio requested approval from the PUCO to accelerate its riser replacement program; however, at this time, Duke Energy Ohio cannot predict the outcome or the impact of the statewide Ohio investigation.

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

### 13. Commitments and Contingencies

#### Environmental

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



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### DUKE ENERGY OHIO, INC. Notes To Consolidated Financial Statements—(Continued) (Unaudited)

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

**Clean Water Act.** The U.S. Environmental Protection Agency's (EPA's) final Clean Water Act Section 316(b) rule became effective July 9, 2004. The rule established aquatic protection requirements for existing facilities that withdraw 50 million gallons or more of water per day from rivers, streams, lakes, reservoirs, estuaries, oceans, or other U.S. waters for cooling purposes. Three of six coal-fired generating facilities in which Duke Energy Ohio is either a whole or partial owner are affected sources under that rule. On January 25, 2007, the U.S. Court of Appeals for the Second Circuit issued its opinion in *Riverkeeper, Inc. v. EPA*, Nos. 04-6692-ag(L) et. al. (2d Cir. 2007) remanding most aspects of EPA's rule back to the agency. The court effectively disallowed those portions of the rule most favorable to industry, and the decision creates a great deal of uncertainty regarding future requirements and their timing. Duke Energy Ohio is still unable to estimate costs to comply with the EPA's rule, although it is expected that costs will increase as a result of the court's decision. The magnitude of any such increase cannot be estimated at this time.

**Clean Air Mercury Rule (CAMR) and Clean Air Interstate Rule (CAIR).** The EPA finalized its CAMR and CAIR in May 2005. The CAMR limits total annual mercury emissions from coal-fired power plants across the United States through a two-phased cap-and-trade program. Phase 1 begins in 2010 and Phase 2 begins in 2018. The CAIR limits total annual and summertime nitrogen oxides (NO<sub>x</sub>) emissions and annual sulfur dioxide (SO<sub>2</sub>) emissions from electric generating facilities across the Eastern United States through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO<sub>x</sub> and in 2010 for SO<sub>2</sub>. Phase 2 begins in 2015 for both NO<sub>x</sub> and SO<sub>2</sub>.

Duke Energy Ohio currently estimates that it will spend approximately \$325 million between 2007 and 2011 to comply with Phase 1 of CAMR and CAIR at plants that Duke Energy Ohio owns or partially owns but does not operate. Duke Energy Ohio currently estimates that it will not incur any significant costs for complying with Phase 2 of CAIR and is currently unable to estimate the cost of complying with Phase 2 of CAMR. Duke Energy Ohio receives partial recovery of depreciation and financing costs related to environmental compliance projects for 2005-2008 through its rate stabilization plan (see Note 12).

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

**Extended Environmental Activities and Accruals** Included in Other Deferred Credits and Other Liabilities on the Consolidated Balance Sheets were total accruals related to extended environmental-related activities of approximately \$8 million as of June 30, 2007 and December 31, 2006, respectively. These accruals represent Duke Energy Ohio's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Management believes that completion or resolution of these matters will have no material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

#### Litigation

**New Source Review (NSR).** In 1999-2000, the U.S. Justice Department, acting on behalf of the EPA, filed a number of complaints and notices of violation against multiple utilities across the country for alleged violations of the NSR provisions of the Clean Air Act (CAA). Generally, the government alleges that projects performed at various coal-fired units were major modifications, as defined in the CAA, and that the utilities violated the CAA when they undertook those projects without obtaining permits and installing the best available emission controls for SO<sub>2</sub>, NO<sub>x</sub> and particulate matter. The complaints seek (1) injunctive relief to require installation of pollution control technology on various allegedly violating generating units and, (2) unspecified civil penalties in amounts of up to \$27,500 per day for each violation.

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DUKE ENERGY OHIO, INC.

### Notes To Consolidated Financial Statements—(Continued) (Unaudited)

Two of Duke Energy Ohio's plants have been subject to these allegations. Duke Energy Ohio asserts that there were no CAA violations because the applicable regulations do not require permitting in cases where the projects undertaken are "routine" or otherwise do not result in a net increase in emissions.

In November 1999, the United States brought a lawsuit in the United States Federal District Court for the Southern District of Indiana against Duke Energy Ohio alleging various violations of the CAA at Duke Energy Ohio's W.C. Beckjord and Miami Fort Stations. The lawsuit alleges that Duke Energy Ohio violated the CAA by not obtaining Prevention of Significant Deterioration, Non-Attainment NSR and Ohio's State Implementation Plan (SIP) permits for 8 projects undertaken at those plants. Additionally, the suit claims that Duke Energy Ohio violated an Administrative Consent Order entered into in 1998 between the EPA and Cinergy relating to alleged violations of Ohio's SIP provisions governing particulate matter at Unit 1 at Duke Energy Ohio's W.C. Beckjord Station. Three northeast states and two environmental groups have intervened in the case. In June 2007, the trial court ruled, as a matter of law that 6 of the 8 projects undertaken at the Duke Energy Ohio plants do not qualify for the "routine" exception in the regulations. The court ruled further that the defendants had "fair notice" of EPA's interpretation of the applicable regulations. The defendants have filed motions for reconsideration of the trial court's rulings. A jury trial has been set to commence on May 5, 2008.

In March 2000, the United States also filed suit in the United States District Court for the Southern District of Ohio an amended complaint in a separate lawsuit alleging violations of the CAA regarding various generating stations, including a generating station operated by Columbus Southern Power Company (CSP) and jointly-owned by CSP, The Dayton Power and Light Company (DP&L), and Duke Energy Ohio. This suit is being defended by CSP (the CSP case). A trial on liability issues was conducted in July 2005. No decision on liability has been rendered; however, the Court has scheduled a trial on remedy issues to commence on October 9, 2007. Prior to the trial on liability, the court ruled that the plaintiffs cannot seek monetary damages for alleged violations that occurred prior to November 3, 1994; however, they are entitled to seek injunctive relief for such alleged violations.

In addition, Duke Energy Ohio has been informed by DP&L that in June 2000, the EPA issued a Notice of Violation (NOV) to DP&L for alleged violations of CAA requirements at a station operated by DP&L and jointly-owned by DP&L, CSP, and Duke Energy Ohio. The NOV indicated the EPA may (1) issue an order requiring compliance with the requirements of the Ohio SIP, or (2) bring a civil action seeking injunctive relief and civil penalties of up to \$27,500 per day for each violation. In September 2004, Marilyn Wall and the Sierra Club brought a lawsuit against Duke Energy Ohio, DP&L and CSP for alleged violations of the CAA at this same generating station. This case is currently in discovery in front of the same judge who has the CSP case.

It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with these matters.

**Section 126 Petitions.** In March 2004, the state of North Carolina filed a petition under Section 126 of the CAA in which it alleges that sources in 13 upwind states, including Ohio, significantly contribute to North Carolina's non-attainment with certain ambient air quality standards. In August 2005, the EPA issued a proposed response to the petition. The EPA proposed to deny the ozone portion of the petition based upon a lack of contribution to air quality by the named states. The EPA also proposed to deny the particulate matter portion of the petition based upon the CAIR Federal Implementation Plan (FIP), that would address the air quality concerns from neighboring states. On April 28, 2006, the EPA denied North Carolina's petition based upon the final CAIR FIP described above. North Carolina has filed a legal challenge to the EPA's denial.

**Carbon Dioxide Litigation.** In July 2004, the states of Connecticut, New York, California, Iowa, New Jersey, Rhode Island, Vermont, Wisconsin, and the City of New York brought a lawsuit in the United States District Court for the Southern District of New York against Cinergy, American Electric Power Company, Inc., American Electric Power Service Corporation, The Southern Company, Tennessee Valley Authority, and Xcel Energy Inc. A similar lawsuit was filed in the United States District Court for the Southern District of New York against the same companies by Open Space Institute, Inc., Open Space Conservancy, Inc., and The Audubon Society of New Hampshire. These lawsuits allege that the defendants' emissions of carbon dioxide (CO<sub>2</sub>) from the combustion of fossil fuels at electric generating facilities contribute to global warming and amount to a public nuisance. The complaints also allege that the defendants could generate the same amount of electricity while emitting significantly less CO<sub>2</sub>. The plaintiffs are seeking an injunction requiring each defendant to cap its CO<sub>2</sub> emissions and then reduce them by a specified percentage each year for at least a decade. In September 2005, the District Court granted the defendants' motion to dismiss the lawsuit. The plaintiffs have appealed this ruling to the Second Circuit Court of Appeals. Oral argument was held before the Second Circuit Court of Appeals on June 7, 2006.

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It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

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

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

*Hurricane Katrina Lawsuit.* In April 2006, Cinergy was named in the third amended complaint of a purported class action lawsuit filed in the United States District Court for the Southern District of Mississippi. Plaintiffs claim that Cinergy, along with numerous other utilities, oil companies, coal companies and chemical companies, are liable for damages relating to losses suffered by victims of Hurricane Katrina. Plaintiffs claim that defendants' greenhouse gas emissions contributed to the frequency and intensity of storms such as Hurricane Katrina. In October 2006, Cinergy was served with this lawsuit and subsequently filed a motion to dismiss. Prior to a ruling on that motion, in December 2006 plaintiffs filed a motion for leave to file a fourth amended complaint to set forth additional claims, add additional parties and to substitute proper parties for improperly named defendants. Specifically, plaintiffs seek to replace holding companies, such as Cinergy, with their operating company subsidiaries, such as Duke Energy Ohio. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

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

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

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

**Other Commitments and Contingencies**

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

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**14. Related Party Transactions**

Duke Energy Ohio engages in related party transactions. These transactions are generally performed at cost and in accordance with the applicable state and federal commission regulations. Balances due to or due from related parties included in the Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006 are as follows:

	Successor <sup>(a)</sup>	
	June 30, 2007	December 31, 2006
	(in millions)	
Current assets <sup>(b)</sup>	\$ 43	\$ 51
Non-current assets <sup>(c)</sup>	\$ —	\$ 1
Current liabilities <sup>(d)</sup>	\$ (182)	\$ (196)
Net deferred tax liabilities <sup>(e)</sup>	\$ (1,409)	\$ (1,417)

- (a) See Note 1 for additional information on Predecessor and Successor reporting.
- (b) Of the balance at June 30, 2007, approximately \$35 million is classified as Receivables and \$8 million is classified as Other current assets on the Consolidated Balance Sheets. The balance at December 31, 2006 is classified as Receivables on the Consolidated Balance Sheets.
- (c) The balance at December 31, 2006 is classified as Other non-current assets on the Consolidated Balance Sheets.
- (d) Of the balance at June 30, 2007, approximately (\$170) million is classified as Accounts payable and (\$12) million is classified as Taxes accrued on the Consolidated Balance Sheets. Of the balance at December 31, 2006, approximately (\$95) million is classified as Accounts payable and (\$101) million is classified as Taxes accrued on the Consolidated Balance Sheets.
- (e) Of the balance at June 30, 2007, approximately (\$1,408) million is classified as Deferred income taxes, (\$18) million is classified as Investment tax credit and \$17 million is classified as Other current assets on the Consolidated Balance Sheets. Of the balance at December 31, 2006, approximately (\$1,417) million is classified as Deferred income taxes, (\$19) million is classified as Investment tax credit and \$19 million is classified as Other current assets on the Consolidated Balance Sheets.

Duke Energy Ohio is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy. Duke Energy Ohio is also allocated its proportionate share of other corporate governance costs from a consolidated affiliate of Cinergy. Corporate governance and other shared services costs are primarily allocations of corporate costs, such as human resources, legal and accounting fees, as well as other third party costs.

The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Ohio, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Consolidated Statements of Operations for the three and six months ended June 30, 2007, three months ended June 30, 2006 and three months ended March 31, 2006 were as follows:

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup>
	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007	Three Months Ended June 30, 2006	Three Months Ended March 31, 2006
	(in millions)			
Corporate governance and shared services expenses	\$ 60	\$ 116	\$ 98	\$ 112

- (a) See Note 1 for additional information on Predecessor and Successor reporting.

See Note 7 for detail on expense amounts allocated from Cinergy to Duke Energy Ohio related to Duke Energy Ohio's participation in Cinergy's qualified and non-qualified defined benefit pension plans and health care and insurance benefits. Additionally, Duke Energy Ohio has been allocated accrued pension and other postretirement benefit obligations from Cinergy of approximately \$334 million at June 30, 2007 and approximately \$393 million at December 31, 2006. The above amounts have been classified on the Consolidated Balance Sheets as follows:

	Successor <sup>(a)</sup>	
	June 30, 2007	December 31, 2006
	(in millions)	
Other current liabilities	\$ 9	\$ 9
Accrued pension and other postretirement benefit costs	\$ 320	\$ 381
Other deferred credits and other liabilities	\$ 5	\$ 3

- (a) See Note 1 for additional information on Predecessor and Successor reporting.

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Additionally, certain trade receivables have been sold by Duke Energy Ohio to Cinergy Receivables Company, LLC (Cinergy Receivables), an unconsolidated entity formed by Cinergy. The proceeds obtained from the sales of receivables are largely cash but do include a subordinated note from Cinergy Receivables for a portion of the purchase price. This subordinated note is classified by Duke Energy Ohio as Receivables in the Consolidated Balance Sheets and was approximately \$90 million and \$133 million as of June 30, 2007 and December 31, 2006, respectively.

During the second quarter of 2007 Duke Energy Ohio received a \$29 million capital contribution from its parent, Duke Energy.

See Note 3 for a discussion of amounts paid to Duke Energy Ohio as a result of the agreement between Duke Energy and Duke Energy Ohio related to Duke Energy's contribution of its ownership interests in five plants to Duke Energy Ohio. See Note 4 for a discussion of dividends Duke Energy Ohio paid to its parent, Cinergy.

Duke Energy Ohio participates in a money pool with Duke Energy and other Duke Energy subsidiaries. As of June 30, 2007 and December 31, 2006, Duke Energy Ohio was in a payable position of \$327 million and \$274 million, respectively, classified within Notes payable and commercial paper in the accompanying Consolidated Balance Sheets. See Note 6 for further discussion of the money pool arrangement.

### 15. New Accounting Standards

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

*FASB Staff Position (FSP) No. FIN 46(R)-6, "Determining the Variability to Be Considered In Applying FASB Interpretation No. 46(R) (FSP No. FIN 46(R)-6)." In April 2006, the FASB staff issued FSP No. FIN 46(R)-6 to address how to determine the variability to be considered in applying FIN 46(R), "Consolidation of Variable Interest Entities." The variability that is considered in applying FIN 46(R) affects the determination of whether the entity is a variable interest entity (VIE), which interests are variable interests in the entity, and which party, if any, is the primary beneficiary of the VIE. The variability affects the calculation of expected losses and expected residual returns. This guidance was effective for all entities with which Duke Energy Ohio first becomes involved or existing entities for which a reconsideration event occurs after July 1, 2006. The adoption of FSP No. FIN 46(R)-6 did not have a material impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.*

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

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

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SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158). In October 2006, the FASB issued SFAS No. 158, which changes the recognition and disclosure provisions and measurement date requirements for an employer's accounting for defined benefit pension and other postretirement plans. The recognition and disclosure provisions require an employer to (1) recognize the funded status of a benefit plan—measured as the difference between plan assets at fair value and the benefit obligation—in its statement of financial position, (2) recognize as a component of other comprehensive income (OCI), net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost, and (3) disclose in the notes to financial statements certain additional information. SFAS No. 158 does not change the amounts recognized in the income statement as net periodic benefit cost. Duke Energy Ohio recognized the funded status of its defined benefit pension and other postretirement plans and provided the required additional disclosures as of December 31, 2006. The adoption of SFAS No. 158 recognition and disclosure provisions resulted in an increase in total assets of approximately \$33 million (consisting of an increase in regulatory assets of \$31 million and an increase in deferred tax assets of \$2 million), an increase in total liabilities of approximately \$35 million and a decrease in accumulated other comprehensive loss, net of tax, of approximately \$2 million as of December 31, 2006.

Under the measurement date requirements of SFAS No. 158, an employer is required to measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions). Historically, Duke Energy Ohio has measured its plan assets and obligations up to three months prior to the fiscal year-end, as allowed under the authoritative accounting literature. Duke Energy Ohio adopted the change in measurement date effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date, pursuant to the transition requirements of SFAS No. 158. Net periodic benefit cost of approximately \$3 million for the three-month period between September 30, 2006 and December 31, 2006 was recognized, net of tax, as a separate adjustment of retained earnings as of January 1, 2007. Additionally, in the first quarter of 2007, the changes in plan assets and plan obligations between the September 30, 2006 and December 31, 2006 measurement dates not related to net periodic benefit cost was required to be recognized, net of tax, as a separate adjustment of the opening balance of accumulated other comprehensive income (AOCI) and regulatory assets. This adjustment was not material. During the second quarter of 2007, Duke Energy Ohio completed these calculations. The finalization of these actuarial calculations resulted in a \$2 million adjustment to AOCI and an immaterial adjustment to regulatory assets.

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

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

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

FASB Interpretation (FIN) 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" (FIN 48). In July 2006, the FASB issued FIN 48, which provides guidance on accounting for income tax positions about which Duke Energy Ohio has concluded there is a level of uncertainty with respect to the recognition of a tax benefit in Duke Energy Ohio's financial statements. FIN 48 prescribes the minimum recognition threshold a tax position is required to meet. Tax positions are defined very broadly and include not

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only tax deductions and credits but also decisions not to file in a particular jurisdiction, as well as the taxability of transactions. Duke Energy Ohio adopted FIN 48 effective January 1, 2007. See Note 16 for additional information.

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

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

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

*EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4" (EITF No. 06-5)* In June 2006, the EITF reached a consensus on the accounting for corporate-owned and bank-owned life insurance policies. EITF No. 06-5 requires that a policyholder consider the cash surrender value and any additional amounts to be received under the contractual terms of the policy in determining the amount that could be realized under the insurance contract. Amounts that are recoverable by the policyholder at the discretion of the insurance company must be excluded from the amount that could be realized. Fixed amounts that are recoverable by the policyholder in future periods in excess of one year from the surrender of the policy must be recognized at their present value. EITF No. 06-5 was effective for Duke Energy Ohio as of January 1, 2007 and must be applied as a change in accounting principle through a cumulative-effect adjustment to retained earnings or other components of equity as of January 1, 2007. The adoption of EITF No. 06-5 did not have any material impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

The following new accounting standards have been issued, but have not yet been adopted by Duke Energy Ohio as of June 30, 2007:

*SFAS No. 157, "Fair Value Measurements" (SFAS No. 157)* In September 2006, the FASB issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, in some cases, the application of SFAS No. 157 may change Duke Energy Ohio's current practice for measuring and disclosing fair values under other accounting pronouncements that require or permit fair value measurements. For Duke Energy, SFAS No. 157 is effective as of January 1, 2008 and must be applied prospectively except in certain cases. Duke Energy Ohio is currently evaluating the impact of adopting SFAS No. 157, and cannot currently estimate the impact of SFAS No. 157 on its consolidated results of operations, cash flows or financial position.

*SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159)* In February 2007, the FASB issued SFAS No. 159, which permits entities to choose to measure many financial instruments and certain other items at fair value. For Duke Energy Ohio, SFAS No. 159 is effective as of January 1, 2008 and will have no impact on amounts presented for periods prior to the effective date. Duke Energy Ohio cannot currently estimate the impact of SFAS No. 159 on its consolidated results of operations, cash flows or financial position and has not yet determined whether or not it will choose to measure items subject to SFAS No. 159 at fair value.

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**16. Income Taxes and Other Taxes**

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

On January 1, 2007, Duke Energy Ohio adopted FIN 48. The following table shows the impacts of adoption of FIN 48 on Duke Energy Ohio's Consolidated Balance Sheets.

		Increase/ (Decrease)
(in millions)		
<b>Assets</b>		
Goodwill	\$	4
<b>Liabilities</b>		
Other Liabilities (non-current) <sup>(a)</sup>	\$	51
Interest Accrued (current)		(11)
Deferred Income Taxes		(36)
<b>Total</b>	<b>\$</b>	<b>4</b>
<b>Common Stockholder's Equity</b>		
Retained Earnings—Cumulative Effect of Accounting Change	\$	—

(a) Includes liability for unrecognized tax benefits and accrued interest and penalties, net of gain contingencies that were not recorded prior to the adoption of FIN 48.

The following table shows the accounting for the adoption of FIN 48 on January 1, 2007 and the increase/(decrease) in Duke Energy Ohio's unrecognized tax benefits from January 1, 2007 to June 30, 2007.

	January 1, 2007	Changes in Balances	June 30, 2007
(in millions)			
Unrecognized Tax Benefits <sup>(a)</sup>	\$ 63	\$ (23)	\$ 40
Unrecognized Tax Benefits that, if recognized, would affect the effective tax rate	\$ —	\$ —	\$ —
Interest Payable/(Receivable) <sup>(b)</sup>	\$ 6	\$ (9)	\$ (3)
Penalties Payable	\$ —	\$ —	\$ —

(a) Decrease in the liability primarily related to a \$16 million settlement offer and a \$7 million settlement.

(b) Reflects all interest related to income taxes. The decrease in the liability was recorded primarily as a reduction to goodwill.

It is reasonably possible that Duke Energy Ohio will reflect an approximate \$28 million reduction in unrecognized tax benefits in the next twelve months due to expected settlements.

Duke Energy Ohio has the following tax years open.

Jurisdiction	Tax Years
Federal	2000 and after
State	Closed through 2001, with the exception of any adjustments related to open federal years
Effective with the adoption of FIN 48, Duke Energy Ohio records, as it relates to taxes, interest expense as Interest Expense and interest income and penalties in Other Income and Expenses, net in the Consolidated Statements of Operations.	



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PART I

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**  
**(Unaudited)**

The \$25 million increase in income tax expense for the comparative three-month periods ended June 30, 2007 and 2006 is primarily due to the \$61 million increase in consolidated income before income taxes.

**Excise Taxes.** Certain excise taxes levied by state or local governments are collected by Duke Energy Ohio from its customers. These taxes, which are required to be paid regardless of Duke Energy Ohio's ability to collect from the customer, are accounted for on a gross basis. When Duke Energy Ohio acts as an agent, and the tax is not required to be remitted if it is not collected from the customer, the taxes are accounted for on a net basis. Duke Energy Ohio's excise taxes accounted for on a gross basis and recorded as Operating Revenues in the accompanying Consolidated Statements of Operations for the three and six months ended June 30, 2007, three months ended June 30, 2006 and three months ended March 31, 2006 were as follows:

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup>
	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007	Three Months Ended June 30, 2006	Three Months Ended March 31, 2006
		(In millions)		
Excise Taxes	\$ 27	\$ 66	\$ 27	\$ 38

(a) See Note 1 for additional information on Predecessor and Successor reporting.

**17. Subsequent Events**

For information on subsequent events related to regulatory matters, see Note 12.

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PART I

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

#### INTRODUCTION

##### EXECUTIVE OVERVIEW

Management's Discussion and Analysis should be read in conjunction with the Consolidated Financial Statements.

On April 3, 2006, Duke Energy Corporation (Old Duke Energy) and Cinergy Corp. (Cinergy) merged into wholly-owned subsidiaries of Duke Energy Holding Corp. (Duke Energy HC), resulting in Duke Energy HC becoming the parent entity. In connection with the closing of the merger transactions, Duke Energy HC changed its name to Duke Energy Corporation (Duke Energy).

Due to the impact of push-down accounting, the financial statements and certain note presentations separate Duke Energy Ohio, Inc.'s (Duke Energy Ohio) presentations into two distinct periods, the period before the consummation of the merger (labeled "Predecessor") and the period after that date (labeled "Successor"), to indicate the application of different bases of accounting between the periods presented.

##### BASIS OF PRESENTATION

The results of operations and variance discussion for Duke Energy Ohio is presented in a reduced disclosure format in accordance with General Instructions (H)(2) of Form 10-Q.

##### RESULTS OF OPERATIONS

###### Results of Operations and Variances

###### Summary of Results (in millions)

	Successor <sup>(a)</sup>		
	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006	Increase (Decrease)
Operating revenues	\$ 763	\$ 696	\$ 67
Operating expenses	668	650	18
(Losses) gains on sales of other assets and other, net	—	(5)	5
Operating income	95	41	54
Other income and expenses, net	8	7	1
Interest expense	22	28	(6)
Income tax expense from continuing operations	32	7	25
Loss from discontinued operations, net of tax	—	(20)	20
Net income (loss)	\$ 49	\$ (7)	\$ 56

(a) See Note 1 to the Consolidated Financial Statements, "Basis of Presentation" for additional information on Predecessor and Successor reporting.

##### Net Income

The \$56 million increase in Duke Energy Ohio's Net income for the three months ended June 30, 2007 compared to the same period in 2006 was primarily due to the following factors:

##### Operating Revenues

The \$67 million increase in Operating revenues was driven primarily by:

- \$30 million increase as a result of higher retail generation revenue primarily due to increase in fuel and purchased power rider compared to the same quarter of 2006,
- \$27 million increase in wholesale revenues from the Midwest gas-fired generation assets due primarily to higher generation volumes as a result of favorable weather in 2007 compared to 2006,
- \$20 million increase in retail demand resulting from favorable weather in 2007 compared to 2006,

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## Table of Contents

### PART I

- \$19 million increase in regulated fuel revenue due to increased volume and implementation of new fuel clause rates in Kentucky,
- \$7 million increase due to new electric base rates implemented in the first quarter of 2007 for Duke Energy Kentucky, Inc. (Duke Energy Kentucky), and
- \$8 million resulting from temporary rate reductions in 2006 associated with the regulatory approval of the Cinergy merger with Duke Energy.

Partially offset by:

- \$29 million net mark-to-market losses on non-qualifying power hedge contracts consisting of \$5 million of net mark-to-market losses in 2007 as compared to net mark-to-market gains of \$24 million in 2006, and
- \$19 million decrease in revenues from sales of fuel.

#### *Operating Expenses*

The \$18 million increase in Operating expenses was driven primarily by:

- \$38 million increase in fuel expense for the Midwest gas-fired generation assets primarily due to increased generation volumes as a result of favorable weather in 2007 as compared to 2006,
- \$10 million increase in maintenance expenses due to more generation plant outages in 2007 versus 2006,
- \$24 million increase in fuel and purchased power expense primarily resulting from the increase in load due to warmer weather compared to the same quarter of 2006, and
- \$7 million increase in property and other taxes mainly driven by increased property taxes due to capital additions.

Partially offset by:

- \$49 million decrease in mark-to-market on non-qualifying fuel hedge contracts as a result of \$27 million of mark-to-market gains in 2007 as compared to mark-to-market losses of \$22 million in 2006, and
- \$15 million decrease in expenses from sales of fuel.

#### *(Losses) Gains on Sales of Other Assets and Other, net*

The \$5 million improvement in (Losses) gains on sales of other assets and other, net is primarily attributable to losses in the second quarter of 2006 of approximately \$5 million related to sales of emissions allowances, as compared to negligible sales in the comparable period of 2007.

#### *Operating Income*

The increase in operating income resulted primarily from favorable weather conditions, mark-to-market gains on non-qualifying fuel hedge contracts, new rates for Duke Energy Kentucky and improved results from the Midwest gas-fired generation assets. These increases were partially offset by increased operating and maintenance expenses due primarily to plant outages in 2007.

#### *Income Tax Expense from Continuing Operations*

The \$25 million increase in income tax expense from continuing operations was due primarily to an increase in pre-tax income.

#### *Loss From Discontinued Operations, Net of Tax*

The Loss from discontinued operations, net of tax for 2006 is primarily related to the marketing and trading operations, which were classified as discontinued operations in connection with the June 2006 announcement to sell certain of Duke Energy Ohio's contracts to Fortis Bank S.A./N.V., a Benelux-based financial services group.

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PART I

**RESULTS OF OPERATIONS****Results of Operations and Variances****Summary of Results (in millions)**

	Successor <sup>(a)</sup>		Predecessor <sup>(a)</sup>		
	Three Months Ended March 31, 2007		Three Months Ended March 31, 2006		Increase (Decrease)
Operating revenues	\$	916	\$	963	\$ (47)
Operating expenses		831		781	50
(Losses) gains on sales of other assets and other, net		(11)		26	(37)
Operating income		74		208	(134)
Other income and expenses, net		9		8	1
Interest expense		23		30	(7)
Income tax expense from continuing operations		23		68	(45)
Loss from discontinued operations, net of tax		—		(2)	2
Net income	\$	37	\$	116	\$ (79)

(a) See Note 1 to the Consolidated Financial Statements, "Basis of Presentation" for additional information on Predecessor and Successor reporting.

**Net Income**

The 68 percent decrease in Duke Energy Ohio's Net income for the three months ended March 31, 2007 compared to the same period in 2006 was primarily due to the following factors:

**Operating Revenues**

The \$47 million decrease in Operating revenues was driven primarily by:

- \$88 million as a result of mark-to-market losses on non-qualifying power hedge contracts in 2007 of \$45 million versus gains of \$43 million in 2006, and
- \$28 million as a result of decreased volumes of physical coal sales due to expiration of contracts and the increased use of financial products to manage fuel costs which are reported net in operating expenses.

Partially offset by:

- Approximately \$40 million increase in generation revenues due to Duke Energy's contribution of its five Midwest generating plants in the second quarter of 2006,
- \$24 million increase resulting from favorable weather in 2007 compared to 2006,
- \$7 million increase due to new electric base rates implemented in the first quarter of 2007 for Duke Energy Kentucky, and
- \$4 million resulting from temporary rate reductions in 2006 associated with the regulatory approval of the Cinergy merger with Duke Energy.

**Operating Expenses**

The \$50 million increase in Operating expenses was driven primarily by:

- \$55 million increase in operating expenses due to Duke Energy's contribution of its five Midwest generating plants in the second quarter of 2006,
- \$30 million higher fuel and emission allowance consumption expense due to recognizing coal and emission allowances at fair value as of April 1, 2006 in conjunction with the Cinergy merger with Duke Energy,
- \$7 million increase in line maintenance expense as a result of ice storms in February 2007, and
- \$7 million of incremental amortization expense resulting from recognizing the unregulated generation facilities at fair value as of April 1, 2006 in conjunction with the Cinergy merger with Duke Energy.

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## **Table of Contents**

### **PART I**

Partially offset by:

- \$35 million related to \$19 million of mark-to-market gains on non-qualifying fuel hedge contracts in 2007 versus losses of \$16 million in 2006, and
- \$12 million related to 2006 costs for incentive and retention payments incurred as a result of the Duke Energy merger.

#### *(Losses) Gains on Sales of Other Assets and Other, net*

The decrease in (Losses) gains on sales of other assets and other, net is due to losses on emission allowance sales in 2007 of \$11 million versus gains of \$26 million in 2006. The losses in 2007 were a result of recording emission allowances at fair value as of April 1, 2006 as part of purchase accounting for the Cinergy merger with Duke Energy and decreases in market prices at the time of sale.

#### *Income Tax Expense from Continuing Operations*

The \$45 million decrease in Income tax expense from continuing operations was due primarily to a \$126 million decrease in pre-tax income.

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PART I

**Item 4. Controls and Procedures.****Disclosure Controls and Procedures**

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized, and reported, within the time periods specified by the Securities and Exchange Commission's (SEC) rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2007, and, based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

**Changes in Internal Control over Financial Reporting**

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended June 30, 2007 and found no change that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

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## PART II. OTHER INFORMATION

**Item 1. Legal Proceedings**

For information regarding legal proceedings that became reportable events or in which there were material developments in the second quarter of 2007, see Note 12 to the Consolidated Financial Statements, "Regulatory Matters" and Note 13 to the Consolidated Financial Statements, "Commitments and Contingencies".

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, careful consideration should be given to the factors discussed in Part I, "Item 1A. Risk Factors" in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2006, which could materially affect Duke Energy Ohio's financial condition or future results. Additional risks and uncertainties not currently known to Duke Energy Ohio or that Duke Energy Ohio currently deems to be immaterial also may adversely affect Duke Energy Ohio's financial condition and/or results of operations.

**Item 4. Submission of Matters to a Vote of Security Holders**

In lieu of an annual meeting of shareholders of Duke Energy Ohio, a resolution was duly adopted by unanimous written consent of Cinergy Corp., Duke Energy Ohio's sole shareholder, effective March 14, 2007, electing the following members to the Board of Directors for one-year terms expiring in 2008:

- David L. Hauser
  
- James E. Rogers
  
- James L. Turner

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## **Table of Contents**

PART II

### **Item 6. Exhibits**

#### **(a) Exhibits**

Exhibits filed or furnished herewith are designated by an asterisk (\*).

#### **Exhibit Number**

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10.1	\$2,650,000,000 Amended and Restated Credit Agreement, dated as of June 28, 2007, among Duke Energy Corporation, Duke Energy Carolinas, LLC, Duke Energy Ohio, Inc., Duke Energy Indiana, Inc. and Duke Energy Kentucky, Inc., as Borrowers, the banks listed therein, Wachovia Bank, National Association, as Administrative Agent, JPMorgan Chase Bank, National Association, Barclays Bank PLC, Bank of America, N.A. and Citibank, N.A., as Co-Syndication Agents and The Bank of Tokyo-Mitsubishi, Ltd., New York Branch and Credit Suisse, as Co-Documentation Agents (filed in Form 8-K of Duke Energy Ohio, Inc., July 5, 2007, File No. 1-1232, as Exhibit 10.1).
*31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The total amount of securities of the registrant or its subsidiaries authorized under any instrument with respect to long-term debt not filed as an exhibit does not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. The registrant agrees, upon request of the Securities and Exchange Commission, to furnish copies of any or all of such instruments to it.



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DUKE ENERGY OHIO, INC.

Date: August 14, 2007

/s/ DAVID L. HAUSER

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David L. Hauser  
Group Executive and  
Chief Financial Officer

Date: August 14, 2007

/s/ STEVEN K. YOUNG

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Steven K. Young  
Senior Vice President and  
Controller

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James E. Rogers, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2007

/s/ JAMES E. ROGERS  
\_\_\_\_\_  
James E. Rogers  
Chief Executive Officer

**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, David L. Hauser, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2007

*/s/* DAVID L. HAUSER  
\_\_\_\_\_  
David L. Hauser  
Group Executive and  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending June 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Rogers, Chief Executive Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

/s/ JAMES E. ROGERS

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James E. Rogers  
Chief Executive Officer  
August 14, 2007

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending June 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David L. Hauser, Group Executive and Chief Financial Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

*/s/* DAVID L. HAUSER

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David L. Hauser  
Group Executive and Chief Financial Officer  
August 14, 2007

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# **FORM 8-K**

**Duke Energy Ohio, Inc. - N/A**

**Filed: May 15, 2009 (period: May 14, 2009)**

Report of unscheduled material events or corporate changes.

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Item 7.01.      Regulation FD Disclosure.

SIGNATURE

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**FORM 8-K**

**CURRENT REPORT**  
Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934

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**Date of Report (Date of earliest event reported): May 14, 2009**

**DUKE ENERGY CORPORATION**

(Exact Name of Registrant as Specified in its Charter)

**Delaware**  
(State or Other Jurisdiction  
of Incorporation)

**001-32853**  
(Commission  
File Number)

**20-2777218**  
(IRS Employer  
Identification No.)

**526 South Church Street, Charlotte, North Carolina 28202-1904**  
(Address of Principal Executive Offices, including Zip code)

**(704) 594-6200**  
(Registrant's telephone number, including area code)

**DUKE ENERGY OHIO, INC.**

(Exact Name of Registrant as Specified in its Charter)

**Ohio**  
(State or Other Jurisdiction  
of Incorporation)

**001-1232**  
(Commission  
File Number)

**31-0240030**  
(IRS Employer  
Identification No.)

**139 East Fourth Street, Cincinnati, Ohio 45202**  
(Address of Principal Executive Offices, including Zip code)

**(704) 594-6200**  
(Registrant's telephone number, including area code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
  - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
  - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
  - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
- 
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**Item 7.01. Regulation FD Disclosure.**

On May 14, 2009, Duke Energy Ohio, Inc. was notified that it was one of the successful bidders in the FirstEnergy Ohio Utilities Standard Service Offer auction to supply the retail generation needs of FirstEnergy Corp.'s Ohio operating companies from June 1, 2009 through May 31, 2011 at a final wholesale price of \$61.50 per megawatt hour. The auction results have been accepted by the Public Utilities Commission of Ohio.

**SIGNATURE**

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**DUKE ENERGY CORPORATION**

Date: May 15, 2009

By: /s/Marc E. Manly

Name: Marc E. Manly

Title: Group Executive, Chief Legal Officer and Corporate Secretary

**DUKE ENERGY OHIO, INC.**

Date: May 15, 2009

By: /s/Marc E. Manly

Name: Marc E. Manly

Title: Group Executive and Chief Legal Officer

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# **FORM 8-K**

**Duke Energy Ohio, Inc. - N/A**

**Filed: March 23, 2009 (period: March 23, 2009)**

Report of unscheduled material events or corporate changes.

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**Item 8.01.**     Other Events.

**Item 9.01.**     Financial Statements and Exhibits.

SIGNATURES

EXHIBIT INDEX

EX-5.1 (EX-5.1)

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 8-K**

**CURRENT REPORT  
Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934**

Date of Report (Date of earliest event reported): **March 23, 2009**

**DUKE ENERGY OHIO, INC.**  
(Exact Name of Registrant as Specified in its Charter)

**Ohio**  
(State or Other Jurisdiction  
of Incorporation)

**1-1232**  
(Commission  
File Number)

**31-0240030**  
(IRS Employer  
Identification No.)

**139 East Fourth Street, Cincinnati, Ohio 45202**  
(Address of Principal Executive Offices, including Zip code)

**(704) 594-6200**  
(Registrant's telephone number, including area code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
  - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
  - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
  - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
- 
-

**Item 8.01. Other Events.**

On March 18, 2009, Duke Energy Ohio, Inc. (the "Company") entered into an underwriting agreement, dated as of March 18, 2009, with Barclays Capital Inc., Deutsche Bank Securities Inc., SunTrust Robinson Humphrey, Inc. and UBS Securities LLC, as representatives of the several underwriters named therein (the "Underwriters"), pursuant to which the Company agreed to issue and sell to the Underwriters \$450,000,000 aggregate principal amount of the Company's First Mortgage Bonds, 5.45% Series, Due April 1, 2019 (the "Bonds"). The Bonds will be issued under the First Mortgage, dated as of August 1, 1936, as amended from time to time, including by the Fortieth Supplemental Indenture, dated as of March 23, 2009, between the Company and The Bank of New York Mellon Trust Company, N.A., as successor trustee. In connection with the issuance and sale of the Bonds, the Company is filing a legal opinion regarding the validity of the Bonds as Exhibit 5.1 to this Form 8-K for the purpose of incorporating the opinion into the Company's Registration Statement No. 333-146483-01.

**Item 9.01. Financial Statements and Exhibits.**

*(d) Exhibits*

5.1 Opinion regarding validity of the Bonds.

23.1 Consent (included as part of Exhibit 5.1).

**SIGNATURES**

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**DUKE ENERGY OHIO, INC.**

Date: March 23, 2009

By: /s/ Robert T. Lucas III, Esq.  
Name: Robert T. Lucas III, Esq.  
Title: Associate General Counsel and  
Assistant Secretary

## EXHIBIT INDEX

<u>Exhibit</u>	<u>Description</u>
5.1	Opinion regarding validity of the Bonds.
23.1	Consent (included as part of Exhibit 5.1).

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**Frost  
Brown Todd** LLC  
ATTORNEYS

OHIO · KENTUCKY · INDIANA · TENNESSEE · WEST VIRGINIA

March 23, 2009

Duke Energy Ohio, Inc.  
139 East Fourth Street  
Cincinnati, Ohio 45202

Ladies and Gentlemen:

We have acted as counsel to Duke Energy Ohio, Inc., an Ohio corporation (the “Company”), in connection with the public offering of \$450,000,000 aggregate principal amount of the Company’s First Mortgage Bonds, 5.45% Series, Due April 1, 2019 (the “Bonds”), issuable pursuant to a First Mortgage, dated August 1, 1936, between the Company and The Bank of New York Mellon, as supplemented and amended from time to time (the “Original Mortgage”), which has been amended and restated in its entirety by a Fortieth Supplemental Indenture, dated as of March 23, 2009 (the “Fortieth Supplemental Indenture”), between the Company and The Bank of New York Mellon Trust Company, N.A., as successor trustee (the “Trustee”) (the Original Mortgage, as so amended and restated, being hereinafter called the “Indenture”). On March 18, 2009, the Company entered into an Underwriting Agreement (the “Underwriting Agreement”) with Barclays Capital Inc., Deutsche Bank Securities Inc., SunTrust Robinson Humphrey, Inc. and UBS Securities LLC, as representatives of the several underwriters named therein (the “Underwriters”), relating to the sale by the Company to the Underwriters of the Bonds.

In connection with the rendering of this opinion, we have examined and relied, as to factual matters, upon originals, or copies certified or otherwise identified to our satisfaction, of such documents, corporate records, statements of public officials and Company officers and directors, and such other instruments, and have made such investigations of law, as we have deemed relevant and necessary as a basis for this opinion, including, without limitation, the following documents:

- (a) the registration statement on Form S-3 (File No. 333-146483-01) of the Company filed on October 3, 2007, with the Securities and Exchange Commission (the “Commission”) under the Securities Act of 1933, as amended (the “1933 Act”), allowing for delayed offerings pursuant to Rule 415 under the 1933 Act, the

2200 PNC Center, 201 East Fifth Street      Cincinnati, Ohio 45202-4182      (513) 651-6800 • (513) 651-6981 fax      www.frostbrowntodd.com

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information deemed to be a part of such registration statement as of the date hereof pursuant to Rule 430B of the rules and regulations under the 1933 Act (the "1933 Act Regulations") and the information incorporated or deemed to be incorporated by reference in such registration statement pursuant to Item 12 of Form S-3 under the 1933 Act (such registration statement being hereinafter referred to as the "Registration Statement");

- (b) the prospectus, dated October 3, 2007, which forms a part of and is included in the Registration Statement in the form filed with the Commission pursuant to Rule 424(b) of the 1933 Act Regulations;
- (c) the preliminary prospectus supplement, dated March 18, 2009, relating to the offering of the Bonds in the form filed with the Commission pursuant to Rule 424(b) of the 1933 Act Regulations;
- (d) the prospectus supplement, dated March 18, 2009, relating to the offering of the Bonds in the form filed with the Commission pursuant to Rule 424(b) of the 1933 Act Regulations;
- (e) the Issuer Free Writing Prospectus issued at or prior to the Applicable Time, attached as Schedule C to the Underwriting Agreement and filed with the Commission pursuant to Rule 433(d) of the 1933 Act Regulations and Section 5(e) of the Underwriting Agreement;
- (f) an executed copy of the Underwriting Agreement;
- (g) an executed copy of the Indenture;
- (h) an executed copy of the Fortieth Supplemental Indenture;
- (i) a specimen of the Bonds;
- (j) the Amended Articles of Incorporation of the Company, effective October 1, 2006;
- (k) the Regulations of the Company, as amended on July 23, 2003;
- (l) the Company's minute books, including an Action by Written Consent of the Board of Directors of the Company, effective September 26, 2007, relating to the preparation and filing with the Commission of the Registration Statement and the issuance of the Company's securities, and a Written Consent of the Assistant

Treasurer of the Company, effective March 20, 2009, establishing the terms of the Bonds pursuant to authority granted in the aforementioned Action of the Board of Directors;

- (m) the Order entered on February 11, 2009 by The Public Utilities Commission of Ohio in Case No. 09-18-GE-AIS wherein, among other things, the Company secured the necessary authorizations and approvals of said Commission in respect of the issuance of the Bonds;
- (n) a Certificate of Assistant Secretary of the Company, dated March 23, 2009, with respect to signatures and incumbency of officers of the Company, and other corporate matters; and
- (o) an Officers' Certificate of the Company, dated March 23, 2009, pursuant to Section 6(i) of the Underwriting Agreement.

We have discussed with representatives of the Company such questions of fact as we have deemed necessary or appropriate for the purpose of this opinion, and have relied upon certificates of officers of the Company with respect to the accuracy of such factual matters as well as the factual matters contained in the representations and warranties of the Company that are contained in the Underwriting Agreement.

For purposes of this opinion, we have assumed, other than as to the Company, (i) the due authorization, execution and delivery of each of the Underwriting Agreement and the Indenture and (ii) that each of the Underwriting Agreement and the Indenture constitutes the legal, valid and binding obligation of all respective parties to each of the Underwriting Agreement and the Indenture under applicable law, enforceable against all such parties in accordance with its terms. Further, we have assumed the authenticity of all documents submitted to us as originals, the legal capacity of all parties signing such documents, the genuineness of the signatures on such documents, and the conformity to original documents of all photostatic copies of such documents submitted to us.

The opinions expressed herein are limited to the laws (excluding principles of conflicts of law) of the State of Ohio and the laws of the United States of America. In rendering such opinions, we have made such examination of Ohio law and federal laws as we have deemed relevant for the purposes hereof, but we have not made an independent review of the laws of any jurisdiction other than the State of Ohio and the United States of America. Accordingly, we express no opinions as to the laws of any jurisdiction other than the State of Ohio and the laws of the United States of America.

Based upon the foregoing, and subject to the assumptions, qualifications and limitations set forth herein, we are of the opinion that the Bonds have been duly authorized, and when duly executed by the Company, authenticated by the Trustee and delivered to and paid for by the Underwriters pursuant to the Underwriting Agreement, will be valid and binding obligations of the Company enforceable in accordance with their terms.

The above opinion with regard to the enforceability of the Bonds is qualified by the effects of bankruptcy, insolvency, reorganization, moratorium or similar laws relating to or affecting creditors' rights generally and general principles of equity (regardless of whether such principles are considered in a proceeding in equity or at law).

This opinion is rendered as of the date hereof based upon the facts and law in existence on the date hereof. We assume no obligation to update or supplement this letter to reflect any circumstances which may hereafter come to our attention with respect to the opinion and statements set forth above, including any changes in applicable law which may hereafter occur.

We hereby consent to the filing of this letter as an exhibit to the Current Report on Form 8-K filed by the Company in connection with the issuance and sale of the Bonds, incorporated by reference in the Registration Statement. In giving such consent, we do not thereby concede that we are within the category of persons whose consent is required under Section 7 of the 1933 Act or the 1933 Act Regulations.

Very truly yours,

/s/ FROST BROWN TODD LLC

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# **FORM 10-Q**

**Duke Energy Ohio, Inc. - N/A**

**Filed: May 13, 2009 (period: March 31, 2009)**

Quarterly report which provides a continuing view of a company's financial position

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10-Q - FORM 10-Q

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- Item 1.      Financial Statements.
- Item 2.      Management s Discussion and Analysis of Financial Condition and Results of Operations.
- Item 4.      Controls and Procedures.

## PART II.

- Item 1.      Legal Proceedings
- Item 1A.     Risk Factors
- Item 6.      Exhibits



# **FORM 10-Q**

**Duke Energy Ohio, Inc. - N/A**

**Filed: May 13, 2009 (period: March 31, 2009)**

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10-Q - FORM 10-Q

## PART I.

- Item 1.**      Financial Statements.
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- Item 4.**      Controls and Procedures.

## PART II.

- Item 1.**      Legal Proceedings
- Item 1A.**     Risk Factors
- Item 6.**      Exhibits
- SIGNATURES
- EX-31.1 (SECTION 302 CEO CERTIFICATION)
- EX-31.2 (SECTION 302 CFO CERTIFICATION)
- EX-32.1 (SECTION 906 CEO CERTIFICATION)
- EX-32.2 (SECTION 906 CFO CERTIFICATION)

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 2009 Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-1232

**DUKE ENERGY OHIO, INC.**

(Exact Name of Registrant as Specified in its Charter)

Ohio  
(State or Other Jurisdiction of Incorporation)

31-0240030  
(IRS Employer Identification No.)

139 East Fourth Street  
Cincinnati, OH  
(Address of Principal Executive Offices)

45202  
(Zip code)

704-594-6200  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer   
Non-accelerated filer   
(Do not check if a smaller reporting company)

Accelerated filer   
Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).  
Yes  No

All of the registrant's common stock is indirectly owned by Duke Energy Corporation (File No. 1-32853) which is a reporting company under the Securities Exchange Act of 1934, as amended.

The registrant meets the conditions set forth in General Instructions H(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format specified in General Instructions H(2) of Form 10-Q.

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## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management's beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "plan," "project," "predict," "will," "potential," "forecast," "target," and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- State and federal legislative and regulatory initiatives, including costs of compliance with existing and future environmental requirements;
- State and federal legislative and regulatory initiatives and rulings that affect cost and investment recovery or have an impact on rate structures;
- Costs and effects of legal and administrative proceedings, settlements, investigations and claims;
- Industrial, commercial and residential growth or decline in Duke Energy Ohio, Inc.'s (Duke Energy Ohio) service territories, customer base or customer usage patterns;
- Additional competition in electric markets and continued industry consolidation;
- The influence of weather and other natural phenomena on Duke Energy Ohio's operations, including the economic, operational and other effects of storms, hurricanes, droughts and tornados;
- The timing and extent of changes in commodity prices and interest rates;
- Unscheduled generation outages, unusual maintenance or repairs and electric transmission system constraints;
- The performance of electric generation facilities;
- The results of financing efforts, including Duke Energy Ohio's ability to obtain financing on favorable terms, which can be affected by various factors, including Duke Energy Ohio's credit ratings and general economic conditions;
- Declines in the market prices of equity securities and resultant cash funding requirements of Duke Energy Ohio for Cinergy Corp.'s defined benefit pension plans;
- The level of credit worthiness of counterparties to Duke Energy Ohio's transactions;
- Employee workforce factors, including the potential inability to attract and retain key personnel;
- Growth in opportunities for Duke Energy Ohio's business units, including the timing and success of efforts to develop domestic power and other projects; and
- The effect of accounting pronouncements issued periodically by accounting standard-setting bodies.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Duke Energy Ohio has described. Duke Energy Ohio undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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## PART I. FINANCIAL INFORMATION

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)  
(In millions)

**Item 1. Financial Statements.**

Three Months Ended  
March 31,

	2009	2008
<b>Operating Revenues</b>		
Regulated electric	\$ 590	\$ 242
Non-regulated electric and other	116	392
Regulated natural gas	300	357
Total operating revenue	1,006	991
<b>Operating Expenses</b>		
Fuel used in electric generation and purchased power—regulated	208	33
Fuel used in electric generation and purchased power—non-regulated	59	144
Cost of natural gas and coal sold	193	250
Operation, maintenance and other	202	182
Depreciation and amortization	103	99
Property and other taxes	78	73
Total operating expenses	843	781
<i>Gains on Sales of Other Assets and Other, net</i>	4	13
<b>Operating Income</b>	167	223
<b>Other Income and Expenses, net</b>	—	9
<b>Interest Expense</b>	35	26
<b>Income Before Income Taxes</b>	132	206
<b>Income Tax Expense</b>	47	73
<b>Net Income</b>	\$ 85	\$ 133

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED BALANCE SHEETS**  
(Unaudited)  
(In millions)

	March 31, 2009	December 31, 2008
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 26	\$ 27
Receivables (net of allowance for doubtful accounts of \$17 at March 31, 2009 and \$18 at December 31, 2008)	533	303
Inventory	185	180
Unrealized gains on mark-to-market and hedging transactions	44	51
Other	299	336
<b>Total current assets</b>	<b>1,087</b>	<b>897</b>
<b>Investments and Other Assets</b>		
Restricted funds held in trust	10	10
Goodwill	2,360	2,360
Intangibles, net	386	403
Unrealized gains on mark-to-market and hedging transactions	17	17
Other	54	55
<b>Total investments and other assets</b>	<b>2,827</b>	<b>2,845</b>
<b>Property, Plant and Equipment</b>		
Cost	10,103	10,047
Less accumulated depreciation and amortization	2,341	2,277
<b>Net property, plant and equipment</b>	<b>7,762</b>	<b>7,770</b>
<b>Regulatory Assets and Deferred Debits</b>		
Deferred debt expense	24	23
Regulatory assets related to income taxes	105	103
Other	487	451
<b>Total regulatory assets and deferred debits</b>	<b>616</b>	<b>577</b>
<b>Total Assets</b>	<b>\$ 12,292</b>	<b>\$ 12,089</b>

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED BALANCE SHEETS—(Continued)**  
**(Unaudited)**  
(In millions, except share and per-share amounts)

	March 31, 2009	December 31, 2008
<b>LIABILITIES AND COMMON STOCKHOLDER'S EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 347	\$ 511
Notes payable	279	343
Taxes accrued	128	134
Interest accrued	20	24
Current maturities of long-term debt	27	27
Unrealized losses on mark-to-market and hedging transactions	36	47
Other	100	93
Total current liabilities	937	1,179
<b>Long-term Debt</b>		
	2,304	1,856
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes	1,630	1,619
Investment tax credits	13	14
Accrued pension and other post-retirement benefit costs	288	406
Unrealized losses on mark-to-market and hedging transactions	14	15
Asset retirement obligations	34	33
Other	310	297
Total deferred credits and other liabilities	2,287	2,384
<b>Commitments and Contingencies</b>		
<b>Common Stockholder's Equity</b>		
Common Stock, \$8.50 par value, 120,000,000 shares authorized; 89,663,086 shares outstanding at March 31, 2009 and December 31, 2008	762	762
Additional paid-in capital	5,570	5,570
Retained earnings	466	381
Accumulated other comprehensive loss	(34)	(43)
Total common stockholder's equity	6,764	6,670
<b>Total Liabilities and Common Stockholder's Equity</b>	<b>\$ 12,292</b>	<b>\$ 12,089</b>

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)  
(In millions)

Three Months Ended  
March 31,

	2009	2008
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 85	\$ 133
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	104	100
Gains on sales of other assets and other	(4)	(13)
Deferred income taxes	26	8
Accrued pension and other post-retirement benefit costs	3	6
Contributions to qualified pension plans	(143)	—
(Increase) decrease in		
Net realized and unrealized mark-to-market and hedging transactions	(16)	(38)
Receivables	16	52
Inventory	(5)	59
Other current assets	33	32
Increase (decrease) in		
Accounts payable	(163)	(132)
Taxes accrued	(6)	49
Other current liabilities	(19)	3
Regulatory asset/liability deferrals	7	7
Other assets	33	24
Other liabilities	1	(24)
Net cash (used in) provided by operating activities	(48)	266
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Capital expenditures	(91)	(133)
Net proceeds from the sales of other assets	—	4
Purchases of emission allowances	(7)	—
Sales of emission allowances	5	12
Notes due from affiliate, net	(243)	—
Net cash used in investing activities	(336)	(117)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Issuance of long-term debt	450	—
Redemption of long-term debt	(2)	(2)
Notes payable to affiliate, net	(63)	(142)
Other	(2)	—
Net cash provided by (used in) financing activities	383	(144)
Net (decrease) increase in cash and cash equivalents	(1)	5
Cash and cash equivalents at beginning of period	27	33
Cash and cash equivalents at end of period	\$ 26	\$ 38
<b>Supplemental Disclosures</b>		
Significant non-cash transactions:		
Accrued capital expenditures	\$ 55	\$ 39

See Notes to Unaudited Consolidated Financial Statements

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PART I

DUKE ENERGY OHIO, INC.  
**CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME**  
(Unaudited)  
(In millions)

	Accumulated Other Comprehensive Income (Loss)					Total
	Common Stock	Additional Paid-in Capital	Retained Earnings	Net Gains (Losses) on Cash Flow Hedges	Pension and OPEB Related Adjustments to AOCI	
<b>Balance at December 31, 2007</b>	\$ 762	\$ 5,570	\$ 227	\$ (32)	\$ 7	\$ 6,534
Net income	—	—	133	—	—	133
Other comprehensive income	—	—	—	—	—	—
Cash flow hedges <sup>(a)</sup>	—	—	—	2	—	2
<b>Total comprehensive income</b>						135
<b>Balance at March 31, 2008</b>	\$ 762	\$ 5,570	\$ 360	\$ (30)	\$ 7	\$ 6,669
<b>Balance at December 31, 2008</b>	\$ 762	\$ 5,570	\$ 381	\$ (15)	\$ (28)	\$ 6,670
Net income	—	—	85	—	—	85
Other comprehensive income	—	—	—	—	—	—
Cash flow hedges <sup>(a)</sup>	—	—	—	9	—	9
<b>Total comprehensive income</b>						94
<b>Balance at March 31, 2009</b>	\$ 762	\$ 5,570	\$ 466	\$ (6)	\$ (28)	\$ 6,764

(a) Net of \$4 tax expense in 2009 and \$1 tax expense in 2008.

See Notes to Unaudited Consolidated Financial Statements



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### PART I

DUKE ENERGY OHIO, INC.

## Notes To Unaudited Consolidated Financial Statements

### 1. Basis of Presentation

**Nature of Operations and Basis of Consolidation.** Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through its wholly-owned subsidiary, Duke Energy Kentucky, Inc. (Duke Energy Kentucky), in nearby areas of Kentucky, as well as unregulated electric generation in parts of Ohio, Illinois, Indiana and Pennsylvania. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Except where separately noted, references to Duke Energy Ohio herein relate to the consolidated operations of Duke Energy Ohio, including Duke Energy Kentucky. These Unaudited Consolidated Financial Statements include, after eliminating intercompany transactions and balances, the accounts of Duke Energy Ohio and all majority-owned subsidiaries where Duke Energy Ohio has control, as well as Duke Energy Ohio's proportionate share of certain generation and transmission facilities in Ohio, Kentucky and Indiana.

These Unaudited Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles (GAAP) in the United States of America (U.S.) for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, these Unaudited Consolidated Financial Statements do not include all of the information and notes required by GAAP in the U.S. for annual financial statements. Because the interim Unaudited Consolidated Financial Statements and Notes do not include all of the information and notes required by GAAP in the U.S. for annual financial statements, the Unaudited Consolidated Financial Statements and other information included in this quarterly report should be read in conjunction with the Consolidated Financial Statements and Notes in Duke Energy Ohio's Form 10-K for the year ended December 31, 2008.

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

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

**Unbilled Revenue.** Revenues on sales of electricity and gas are recognized when either the service is provided or the product is delivered. Unbilled retail revenues are estimated by applying an average revenue per kilowatt-hour or per thousand cubic feet (Mcf) for all customer classes to the number of estimated kilowatt-hours or Mcfs delivered but not billed. Unbilled wholesale energy revenues are calculated by applying the contractual rate per megawatt hour (MWh) to the number of estimated MWh delivered, but not yet billed. Unbilled wholesale demand revenues are calculated by applying the contractual rate per megawatt (MW) to the MW volume not yet billed. The amount of unbilled revenues can vary significantly from period to period as a result of factors, including seasonality, weather, customer usage patterns and customer mix. Unbilled revenues, which are primarily recorded as Receivables on the Consolidated Balance Sheets, primarily relate to wholesale sales at Commercial Power and were approximately \$45 million and \$41 million, at March 31, 2009 and December 31, 2008, respectively. Additionally, Duke Energy Ohio and Duke Energy Kentucky sell, on a revolving basis, nearly all of their retail and wholesale accounts receivable and related collections to Cinergy Receivables Company, LLC (Cinergy Receivables), a bankruptcy remote, special purpose entity that is a wholly-owned limited liability company of Cinergy. The securitization transaction was structured to meet the criteria for sale treatment under Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125" (SFAS No. 140), and, accordingly, the transfers of receivables are accounted for as sales. Receivables for unbilled revenues of approximately \$92 million and \$149 million at March 31, 2009 and December 31, 2008, respectively, related to retail and wholesale accounts receivable at Duke Energy Ohio and Duke Energy Kentucky were included in the sales of accounts receivable to Cinergy Receivables.

**Other Regulatory Assets and Deferred Debits.** The state of Ohio passed comprehensive electric deregulation legislation in 1999, and in 2000, the Public Utilities Commission of Ohio (PUCO) approved a stipulation agreement relating to Duke Energy Ohio's transition plan creating a Regulatory Transition Charge (RTC) designed to recover Duke Energy Ohio's generation-related regulatory assets and transition costs over a ten-year period beginning January 1, 2001 and ending December 2010. Accordingly, application of SFAS No. 71,

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PART I

DUKE ENERGY OHIO, INC.

### Notes To Unaudited Consolidated Financial Statements—(Continued)

"Accounting for Certain Types of Regulation" (SFAS No. 71), was discontinued for the generation portion of Duke Energy Ohio's business at that time (see below for subsequent reapplication of SFAS No. 71 to certain portions of Commercial Power's business). Duke Energy Ohio has a RTC related regulatory asset balance of approximately \$123 million and \$138 million as of March 31, 2009 and December 31, 2008, respectively, which is classified in Other within Regulatory Assets and Deferred Debits on the Consolidated Balance Sheets.

**Reapplication of SFAS No. 71 to Portions of Generation in Ohio.** Duke Energy Ohio's generation operations within its Commercial Power business segment (see Note 2) include generation assets located in Ohio that are dedicated to serve Ohio native load customers. These assets, as excess capacity allows, also generate revenues through sales outside the native load customer base, and such revenue is termed non-native.

Prior to December 17, 2008, Duke Energy Ohio's Commercial Power business segment did not apply the provisions of SFAS No. 71 due to the comprehensive electric deregulation legislation passed by the state of Ohio in 1999. As described further below, effective December 17, 2008, the PUCO approved Duke Energy Ohio's Electric Security Plan (ESP), which resulted in the reapplication of SFAS No. 71 to certain portions of Commercial Power's operations as of that date.

From January 1, 2005 through December 31, 2008, Duke Energy Ohio, including its Commercial Power business segment, had been operating under a rate stabilization plan (RSP), which was a market-based standard service offer. Although the RSP contained certain trackers that enhanced the potential for cost recovery, there was no assurance of stranded cost recovery upon the expiration of the RSP on December 31, 2008 since it was initially anticipated that, upon the expiration of the RSP, there would be a move to full competitive markets. Accordingly, Duke Energy Ohio's Commercial Power business segment did not apply the provisions of SFAS No. 71 to any of its generation operations prior to December 17, 2008. As discussed further in Note 10, in April 2008, new legislation (SB 221) was passed in Ohio and signed by the Governor of Ohio on May 1, 2008. The new law codified the PUCO's authority to approve an electric utility's standard service offer either through an ESP or a Market Rate Option (MRO). The MRO is a price determined through a competitive bidding process. On July 31, 2008, Duke Energy Ohio filed an ESP, and with certain amendments, the ESP was approved by the PUCO on December 17, 2008. The ESP became effective on January 1, 2009.

In connection with the approval of the ESP, Duke Energy Ohio reassessed the applicability of SFAS No. 71 to Commercial Power's generation operations as SB 221 substantially increased the PUCO's oversight authority over generation in the state of Ohio, including giving the PUCO complete approval of generation rates and the establishment of an earnings test to determine if a utility has earned significantly excessive earnings. Duke Energy Ohio determined that certain costs and related rates (riders) of Commercial Power's operations related to generation serving native load meet the criteria established by SFAS No. 71 for regulatory accounting treatment as SB 221 and Duke Energy Ohio's approved ESP solidified the automatic recovery of certain costs of its generation serving native load within its Commercial Power business segment and increased the likelihood that Commercial Power's operations will remain under a cost recovery model for certain costs for the foreseeable future.

Under the ESP, Duke Energy Ohio bills for its native load generation via numerous riders. SB 221 and the ESP resulted in the approval of the automatic recovery of certain of these riders, which includes, but is not limited to, a price-to-compare fuel and purchased power rider and certain portions of a price-to-compare cost of environmental compliance rider. Accordingly, Duke Energy Ohio's Commercial Power business segment began applying SFAS No. 71 to the corresponding RSP riders granting automatic recovery under the ESP on December 17, 2008. The remaining portions of Commercial Power's native load generation operations, revenues from which are reflected in rate riders for which the ESP does not specifically allow automatic cost recovery, as well as all generation operations associated with non-native customers, including Commercial Power's Midwest gas-fired generation assets, continue to not apply regulatory accounting as those operations do not meet the criteria of SFAS No. 71. Moreover, generation remains a competitive market in Ohio and native load customers continue to have the ability to switch to alternative suppliers for their electric generation service. As customers switch, there is a risk that some or all of the regulatory assets will not be recovered through the established riders. Duke Energy Ohio will continue to monitor the amount of native load customers that have switched to alternative suppliers when assessing the recoverability of its regulatory assets established for its native load generation operations within its Commercial Power business segment.

Despite certain portions of the Ohio native load operations not being subject to the accounting provisions of SFAS No. 71, all of Duke Energy Ohio's native load operations' rates are subject to approval by the PUCO, and thus these operations are referred to herein as Duke Energy Ohio's regulated operations. Accordingly, beginning January 1, 2009, these revenues and corresponding fuel and purchased power expenses are recorded in Regulated Electric within Operating Revenues and Fuel Used in Electric Generation and Purchased Power—Regulated within Operating Expenses, respectively, on the Consolidated Statements of Operations.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

**2. Business Segments**

Duke Energy Ohio operates the following business segments, which are all considered reportable business segments under SFAS No. 131, "*Disclosures about Segments of an Enterprise and Related Information*": Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's management believes these reportable business segments properly align the various operations of Duke Energy Ohio with how the chief operating decision maker views the business. Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these reportable business segments in deciding how to allocate resources and evaluate performance. There is no aggregation within Duke Energy Ohio's defined business segments.

Franchised Electric and Gas generates, transmits, distributes and sells electricity in southwestern Ohio and northern Kentucky and transports and sells natural gas in southwestern Ohio and northern Kentucky. It conducts operations primarily through Duke Energy Ohio and Duke Energy Kentucky. These electric and gas operations are subject to the rules and regulations of the Federal Energy Regulatory Commission (FERC), the PUCO and the Kentucky Public Service Commission (KPSC). Substantially all of *Franchised Electric and Gas' operations are regulated and, accordingly, these operations are accounted for under the provisions of SFAS No. 71.*

Commercial Power owns, operates and manages power plants and engages in the wholesale marketing and procurement of electric power, fuel and emission allowances related to these plants, as well as other contractual positions. Commercial Power's asset portfolio comprises approximately 7,550 net MW and its generation assets consist of a diversified fuel mix with baseload and mid-merit coal-fired units, as well as combined cycle and peaking natural gas-fired units. Commercial Power's portfolio includes the five Midwestern gas-fired generation assets that were transferred from Duke Energy in 2006. Through December 31, 2008, most of the generation asset output in Ohio was contracted through the RSP (see Note 10). Effective January 1, 2009, Commercial Power began operating under an ESP, which expires on December 31, 2011. As a result of the approval of the ESP, certain of Commercial Power's operations reapplied the provisions of SFAS No. 71 effective December 17, 2008. See Notes 1 and 10 for a discussion of the reapplication of the provisions of SFAS No. 71 to certain of Commercial Power's operations, as well as for further discussion related to the RSP and ESP.

*The remainder of Duke Energy Ohio's operations is presented as Other. While it is not considered a business segment, Other primarily includes certain allocated governance costs (see Note 8).*

Duke Energy Ohio's reportable business segments offer different products and services or operate under different competitive environments and are managed separately as business units. Accounting policies for Duke Energy Ohio's segments are the same as those described in the Notes to the Consolidated Financial Statements in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2008. Management evaluates segment performance based on earnings before interest and taxes from continuing operations (EBIT). On a segment basis, EBIT excludes discontinued operations and represents all profits from continuing operations (both operating and non-operating and excluding corporate governance costs) before deducting interest and taxes.

Cash, cash equivalents, and short-term investments, if any, are managed centrally by Cinergy and Duke Energy, so the interest and dividend income on those balances are excluded from the segments' EBIT.

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DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

**Business Segment Data**

	Unaffiliated Revenues <sup>(a)</sup>	Segment EBIT/ Consolidated Income Before Income Taxes	Depreciation and Amortization
(in millions)			
<b>Three Months Ended March 31, 2009</b>			
Franchised Electric and Gas	\$ 540	\$ 80	\$ 52
Commercial Power	466	99	51
<b>Total reportable segments</b>	<b>1,006</b>	<b>179</b>	<b>103</b>
Other	—	(15)	—
Interest expense	—	(35)	—
Interest income and other	—	3	—
<b>Total consolidated</b>	<b>\$ 1,006</b>	<b>\$ 132</b>	<b>\$ 103</b>
<b>Three Months Ended March 31, 2008</b>			
Franchised Electric and Gas	\$ 599	\$ 97	\$ 58
Commercial Power	392	145	41
<b>Total reportable segments</b>	<b>991</b>	<b>242</b>	<b>99</b>
Other	—	(18)	—
Interest expense	—	(26)	—
Interest income and other	—	8	—
<b>Total consolidated</b>	<b>\$ 991</b>	<b>\$ 206</b>	<b>\$ 99</b>

(a) There were no intersegment revenues for the three months ended March 31, 2009 and 2008.

**Segment Assets**

	March 31, 2009	December 31, 2008
(in millions)		
Franchised Electric and Gas	\$ 6,028	\$ 5,857
Commercial Power	6,459	6,249
<b>Total reportable segments</b>	<b>12,487</b>	<b>12,106</b>
Other	1	17
Eliminations and reclassifications	(196)	(34)
<b>Total consolidated assets</b>	<b>\$ 12,292</b>	<b>\$ 12,089</b>

**3. Sales of Other Assets**

For the three months ended March 31, 2009 and 2008, the sale of other assets resulted in proceeds of approximately \$5 million and \$16 million, respectively, and net pre-tax gains of approximately \$4 million and \$13 million, respectively, recorded in Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These amounts primarily relate to Commercial Power's sales of emission allowances.

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PART I

DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)****4. Inventory**

Inventory consists primarily of coal held for electric generation and materials and supplies and is recorded primarily using the average cost method. Inventory related to Duke Energy Ohio's regulated operations is valued at historical cost consistent with ratemaking treatment. Materials and supplies are recorded as inventory when purchased and subsequently charged to expense or capitalized to plant when installed. Inventory related to Duke Energy Ohio's non-regulated operations is valued at the lower of cost or market.

	March 31, 2009	December 31, 2008
	(In millions)	
Coal held for electric generation	\$ 95	\$ 89
Materials and supplies	87	88
Natural gas	3	3
<b>Total Inventory</b>	<b>\$ 185</b>	<b>\$ 180</b>

Effective November 1, 2008, Duke Energy Ohio and Duke Energy Kentucky executed agreements with a third party to transfer title of natural gas inventory purchased by Duke Energy Ohio and Duke Energy Kentucky to the third party. Under the agreements, the gas inventory will be stored and managed for Duke Energy Ohio and Duke Energy Kentucky and will be delivered on demand. The gas storage agreements will expire on October 31, 2009, unless extended by the third party for an additional 12 months. As a result of the agreements, the combined natural gas inventory of approximately \$18 million and \$81 million being held by a third party as of March 31, 2009 and December 31, 2008, respectively, has been classified as Other within Current Assets on the Consolidated Balance Sheets.

**5. Debt and Credit Facilities**

**First and Refunding Mortgage Bonds.** In March 2009, Duke Energy Ohio issued \$450 million principal amount of first mortgage bonds, which carry a fixed interest rate of 5.45% and mature April 1, 2019. Proceeds from this issuance will be used to repay short-term notes and for general corporate purposes, including funding capital expenditures.

**Money Pool.** Duke Energy Ohio and its wholly-owned subsidiary, Duke Energy Kentucky, receive support for their short-term borrowing needs through their participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. The money pool is structured such that Duke Energy Ohio and Duke Energy Kentucky separately manage their cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables of Duke Energy Ohio and Duke Energy Kentucky, as each of these entities independently participate in the money pool. As of March 31, 2009, Duke Energy Ohio and Duke Energy Kentucky had combined net receivables of approximately \$243 million, which is classified within Receivables in the accompanying Consolidated Balance Sheets. As of December 31, 2008, Duke Energy Ohio and Duke Energy Kentucky had combined net borrowings of approximately \$63 million, which is classified within Notes Payable in the accompanying Consolidated Balance Sheets. The \$243 million increase in receivables during the three months ended March 31, 2009 is reflected in Notes due from affiliate, net within Net cash used in investing activities on the Consolidated Statements of Cash Flows. In addition, the \$63 million decrease in payables during the three months ended March 31, 2009 is reflected in Notes payable to affiliate, net within Net cash provided by (used in) financing activities on the Consolidated Statements of Cash Flows.

**Available Credit Facilities and Capacity Utilized Under Available Credit Facilities.** The total credit facility capacity under Duke Energy's master credit facility is approximately \$3.14 billion. Duke Energy has the unilateral ability under the master credit facility to increase or decrease the borrowing sub limits of each borrower, subject to maximum cap limitation, at any time. At March 31, 2009, Duke Energy Ohio and Duke Energy Kentucky had borrowing sub limits under Duke Energy's master credit facility of \$650 million and \$100 million, respectively. The amount available to Duke Energy Ohio and Duke Energy Kentucky under their sub limits to Duke Energy's master credit facility has been reduced by drawdowns of cash, borrowings through the money pool arrangement, and the use of the master credit facility to backstop issuances of letters of credit and pollution control bonds, as discussed below.

At March 31, 2009, Duke Energy and its wholly-owned subsidiaries, including Duke Energy Ohio and Duke Energy Kentucky, had outstanding borrowings of approximately \$750 million under Duke Energy's master credit facility, of which Duke Energy Ohio's and Duke Energy Kentucky's portions are approximately \$279 million and \$74 million, respectively. The loans, which are revolving credit loans, bear interest at one-month London Interbank Offered Rate (LIBOR) plus an applicable spread ranging from 19 to 24 basis points and are due in

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PART I

DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

September 2009; however, Duke Energy Ohio and Duke Energy Kentucky have the ability under the master credit facility to renew the loan up through the date the master credit facility matures, which is in June 2012. As Duke Energy Kentucky has the intent and ability to refinance this obligation on a long-term basis, either through renewal of the terms of the loan through the master credit facility, which has non-cancelable terms in excess of one-year, or through issuance of long-term debt to replace the amounts drawn under the master credit facility, Duke Energy Kentucky's borrowing is reflected as Long-Term Debt on the Consolidated Balance Sheets at March 31, 2009. Since Duke Energy Ohio does not have the intent to refinance these obligations on a long-term basis, Duke Energy Ohio's borrowing is reflected in Notes Payable within Current Liabilities on the Consolidated Balance Sheets at March 31, 2009. These borrowings reduce Duke Energy Ohio's and Duke Energy Kentucky's available credit capacity under Duke Energy's Master Credit Facility, as discussed above.

At both March 31, 2009 and December 31, 2008, approximately \$146 million of certain pollution control bonds, which are short-term obligations by nature, were classified as Long-Term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio's intent and ability to utilize such borrowings as long-term financing. Duke Energy's credit facilities with non-cancelable terms in excess of one year as of the balance sheet date give Duke Energy Ohio the ability to refinance these short-term obligations on a long-term basis. Of the \$146 million of pollution control bonds outstanding at March 31, 2009, approximately \$84 million were backstopped by Duke Energy's master credit facility, with the remaining balance backstopped by other specific credit facilities separate from the master credit facility.

**Restrictive Debt Covenants.** Duke Energy's debt and credit agreement contains various financial and other covenants. Duke Energy Ohio's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of March 31, 2009, Duke Energy, Duke Energy Ohio and Duke Energy Kentucky were in compliance with all covenants that would impact Duke Energy Ohio's or Duke Energy Kentucky's ability to borrow funds under the debt and credit facilities. In addition, some credit agreements may allow for acceleration of payments or termination of the agreements due to nonpayment, or the acceleration of other significant indebtedness of the borrower or some of its subsidiaries. None of the debt or credit agreements contain material adverse change clauses.

**6. Employee Benefit Obligations**

Duke Energy Ohio participates in pension and other post-retirement benefit plans sponsored by Cinergy. Net periodic pension cost discussed below for qualified and other post-retirement benefit plans represents the allocated cost of the respective pension plan for the periods presented. However, portions of the net periodic pension cost discussed below have been capitalized as a component of property, plant and equipment. Duke Energy Ohio's net periodic benefit costs as allocated by Cinergy were as follows:

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
	(in millions)	
Qualified Pension Benefits <sup>(a)</sup>	\$ 1	\$ 2
Other Post-retirement Benefits <sup>(b)</sup>	\$ —	\$ 3

(a) These amounts exclude approximately \$1 million of regulatory asset amortization resulting from purchase accounting adjustments in connection with Duke Energy's merger with Cinergy in April 2006 for each of the three months ended March 31, 2009 and 2008.

(b) These amounts exclude approximately \$1 million and an insignificant amount of regulatory asset amortization resulting from purchase accounting adjustments in connection with Duke Energy's merger with Cinergy in April 2006 for the three months ended March 31, 2009 and 2008, respectively. Duke Energy's policy is to fund amounts for its U.S. qualified pension plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. In February 2009, Duke Energy Ohio made a cash contribution of approximately \$143 million, which represented its proportionate share of an approximate \$500 million total contribution to Cinergy's and Duke Energy's qualified pension plans. Duke Energy did not make contributions to the legacy Cinergy qualified or non-qualified pension plans during the three months ended March 31, 2008. Duke Energy does not anticipate making additional contributions to the legacy Cinergy qualified or non-qualified pension plans during the remainder of 2009. Cinergy also sponsors employee savings plans that cover substantially all employees. Duke Energy Ohio expensed pre-tax employer matching contributions of approximately \$1 million for each of the three months ended March 31, 2009 and 2008.

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DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

**7. Goodwill and Intangibles**

**Goodwill**

The carrying amount of goodwill as of both March 31, 2009 and December 31, 2008 was approximately \$2,360 million, of which approximately \$1,206 million was reflected in the Commercial Power segment and approximately \$1,154 million was reflected in the Franchised Electric and Gas segment.

**Intangible Assets**

The carrying amount and accumulated amortization of intangible assets as of March 31, 2009 and December 31, 2008 are as follows:

	March 31, 2009	December 31, 2008
(in millions)		
Emission allowances	\$ 228	\$ 239
Gas, coal and power contracts	271	271
Other	9	9
<b>Total gross carrying amount</b>	<b>508</b>	<b>519</b>
Accumulated amortization—gas, coal and power contracts	(116)	(111)
Accumulated amortization—other	(6)	(5)
<b>Total accumulated amortization</b>	<b>(122)</b>	<b>(116)</b>
<b>Total intangible assets, net</b>	<b>\$ 386</b>	<b>\$ 403</b>

Emission allowances in the table above include emission allowances which were recorded at the then fair value on the date of Duke Energy's merger with Cinergy in April 2006 and emission allowances purchased by Duke Energy Ohio. Additionally, Duke Energy Ohio is allocated certain zero cost emission allowances on an annual basis. The change in the gross carrying value of emission allowances during the three months ended March 31, 2009 is as follows:

	(in millions)
Gross carrying value at beginning of period	\$ 239
Purchases of emission allowances	7
Sales and consumption of emission allowances <sup>(a),(b)</sup>	(18)
<b>Gross carrying value at end of period</b>	<b>\$ 228</b>

(a) Carrying values of emission allowances are recognized via a charge to expense when consumed. Carrying values of emission allowances sold or consumed during the three months ended March 31, 2008 was approximately \$16 million.

(b) See Note 3 for a discussion of gains and losses on sales of emission allowances by Commercial Power during the three months ended March 31, 2009 and 2008. Amortization expense for gas, coal and power contracts and other intangible assets for both the three months ended March 31, 2009 and 2008 was approximately \$6 million.

**Intangible Liabilities**

In connection with the Duke Energy and Cinergy merger, Duke Energy Ohio recorded an intangible liability of approximately \$113 million associated with the RSP in Ohio, which was recognized in earnings over the regulatory period that ended on December 31, 2008. This liability became fully amortized in the fourth quarter of 2008. Duke Energy Ohio also recorded approximately \$56 million of intangible liabilities associated with other power sale contracts in connection with the Duke Energy and Cinergy merger. The carrying amount of these intangible liabilities associated with other power sale contracts was approximately \$15 million and \$16 million at March 31, 2009 and December 31, 2008, respectively. During the three months ended March 31, 2009 and 2008, Duke Energy Ohio amortized approximately \$1 million and \$18 million, respectively, to income related to these intangible liabilities. Intangible liabilities are classified as Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

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DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

**8. Related Party Transactions**

Duke Energy Ohio engages in related party transactions, which are generally performed at cost and in accordance with the applicable state and federal commission regulations. Balances due to or due from related parties included in the Consolidated Balance Sheets as of March 31, 2009 and December 31, 2008 are as follows:

	March 31, 2009 <sup>(a)</sup>	December 31, 2008 <sup>(a)</sup>
	(in millions)	
Current assets <sup>(b)</sup>	\$ 52	\$ 55
Non-current assets <sup>(c)</sup>	\$ 4	\$ 5
Current liabilities <sup>(d)</sup>	\$ (63)	\$ (138)
Non-current liabilities <sup>(e)</sup>	\$ (5)	\$ (4)
Net deferred tax liabilities <sup>(f)</sup>	\$ (1,546)	\$ (1,519)

- (a) Balances exclude assets or liabilities associated with accrued pension and other post-retirement benefits, Cinergy Receivables and money pool arrangements as discussed below.
- (b) Of the balance at March 31, 2009, approximately \$38 million is classified as Receivables, approximately \$2 million is classified as Unrealized gains on mark-to-market and hedging transactions within Current Assets and approximately \$12 million is classified as Other within Current Assets. Of the balance at December 31, 2008, approximately \$18 million is classified as Receivables, approximately \$2 million is classified as Unrealized gains on mark-to-market and hedging transactions within Current Assets and approximately \$35 million is classified as Other within Current Assets on the Consolidated Balance Sheets.
- (c) The balances at March 31, 2009 and December 31, 2008 are classified as Unrealized gains on mark-to-market and hedging transactions within Investments and Other Assets on the Consolidated Balance Sheets.
- (d) Of the balance at March 31, 2009, approximately \$(56) million is classified as Accounts payable, approximately \$(3) million is classified as Taxes accrued and approximately \$(4) million is classified as Unrealized losses on mark-to-market and hedging transactions within Current Liabilities on the Consolidated Balance Sheets. Of the balance at December 31, 2008, approximately \$(133) million is classified as Accounts payable, approximately \$(2) million is classified as Taxes accrued and approximately \$(3) million is classified as Unrealized losses on mark-to-market and hedging transactions within Current Liabilities on the Consolidated Balance Sheets.
- (e) The balances at March 31, 2009 and December 31, 2008 are classified as Unrealized losses on mark-to-market and hedging transactions within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.
- (f) Of the balance at March 31, 2009, approximately \$(1,595) million is classified as Deferred income taxes and approximately \$49 million is classified as Other within Current Assets on the Consolidated Balance Sheets. Of the balance at December 31, 2008, approximately \$(1,580) million is classified as Deferred income taxes and approximately \$61 million is classified as Other within Current Assets on the Consolidated Balance Sheets.
- Duke Energy Ohio is charged its proportionate share of corporate governance and other costs by an unconsolidated affiliate that is a consolidated affiliate of Duke Energy. Corporate governance and other shared services costs are primarily related to human resources, legal and accounting fees, as well as other third party costs. During the three months ended March 31, 2009 and 2008, Duke Energy Ohio recorded governance and shared services expenses of approximately \$100 million and \$61 million, respectively, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Consolidated Statements of Operations.
- Duke Energy Ohio incurs expenses related to certain insurance coverages through Bison Insurance Company Limited, Duke Energy's wholly-owned captive insurance subsidiary. These expenses, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Consolidated Statements of Operations, were approximately \$4 million for each of the three months ended March 31, 2009 and 2008. Additionally, Duke Energy Ohio records income associated with the rental of office space to a consolidated affiliate of Duke Energy, as well as income associated with certain other recoveries of cost. Rental income and other cost recoveries were approximately \$2 million for each of the three months ended March 31, 2009 and 2008.
- Duke Energy Ohio participates in Cinergy's qualified pension plan, non-qualified pension plan and other post-retirement benefit plans and is allocated its proportionate share of expenses associated with these plans (see Note 6). Additionally, Duke Energy Ohio has been allocated accrued pension and other post-retirement benefit obligations from Cinergy of approximately \$296 million at March 31, 2009 and approximately \$416 million at December 31, 2008. These amounts have been classified in the Consolidated Balance Sheets as follows:

	March 31, 2009	December 31, 2008
	(in millions)	
Other current liabilities	\$ 5	\$ 5
Accrued pension and other post-retirement benefit costs	\$ 286	\$ 406
Other deferred credits and other liabilities	\$ 5	\$ 5

As discussed in Note 1, certain trade receivables have been sold by Duke Energy Ohio to Cinergy Receivables, an unconsolidated entity formed by Cinergy. The proceeds obtained from the sales of receivables are largely cash but do include a subordinated note from Cinergy Receivables for a portion of the purchase price. This subordinated note is classified as Receivables in the Consolidated Balance



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DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

Sheets and was approximately \$154 million and \$174 million as of March 31, 2009 and December 31, 2008, respectively. The interest income associated with the subordinated note, which is recorded in Other Income and Expenses, net on the Consolidated Statements of Operations, was approximately \$5 million and \$8 million for the three months ended March 31, 2009 and 2008, respectively.

As discussed further in Note 5, Duke Energy Ohio participates in a money pool arrangement with Duke Energy and other Duke Energy subsidiaries. As of March 31, 2009, Duke Energy Ohio was in a receivable position of approximately \$243 million. As of December 31, 2008, Duke Energy Ohio was in a payable position of approximately \$63 million. The expenses associated with money pool activity, which are recorded in Interest Expense on the Consolidated Statements of Operations for the three months ended March 31, 2009 and 2008 were insignificant and approximately \$1 million, respectively.

**9. Risk Management, Derivative Instruments and Hedging Activities**

The primary risks Duke Energy Ohio manages by utilizing derivative instruments are commodity price risk and interest rate risk. Duke Energy Ohio closely monitors the risks associated with commodity price changes and changes in interest rates on its operations and, where appropriate, uses various commodity and interest rate instruments to manage these risks. Certain of these derivative instruments are designated as hedging instruments under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133), while others either do not qualify as a hedge or have not been designated as hedges by Duke Energy Ohio (hereinafter referred to as undesignated contracts). Duke Energy Ohio's primary use of energy commodity derivatives is to hedge its generation portfolio against exposure to the prices of power and fuel. Interest rate swaps are entered into to manage interest rate risk primarily associated with Duke Energy Ohio's variable-rate and fixed-rate borrowings.

SFAS No. 133 requires the recognition of all derivative instruments as either assets or liabilities at fair value in the Consolidated Balance Sheets. In accordance with SFAS No. 133, Duke Energy Ohio may elect to designate qualifying commodity and interest rate derivatives as either cash flow hedges or fair value hedges.

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss is reported as a component of Accumulated Other Comprehensive Income (AOCI) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Any gains or losses on the derivative that represent either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item are recognized in earnings, to the extent effective, in the current period. Duke Energy Ohio includes the gain or loss on the hedged items in the same line item as the offsetting loss or gain on the derivative in the Consolidated Statements of Operations. Additionally, Duke Energy Ohio enters into derivative agreements that are economic hedges that either do not qualify for hedge accounting or have not been designated as a hedge. These derivative instruments are typically reflected on the Consolidated Balance Sheets at fair value with changes in the value of the derivative instrument reflected in regulatory assets or liabilities, as discussed below, or, if appropriate, in current earnings.

As Duke Energy Ohio's regulated operations within its Franchised Electric and Gas and Commercial Power business segments apply the provisions of SFAS No. 71, certain gains and losses associated with undesignated contracts are deferred as regulatory liabilities and assets, respectively, thus there is no immediate earnings impact associated with the change in fair values associated with these derivative contracts.

**Commodity Price Risk**

Duke Energy Ohio is exposed to the impact of market changes in the future prices of electricity (energy, capacity and financial transmission rights), coal, natural gas and emission allowances (sulfur dioxide (SO<sub>2</sub>), seasonal nitrogen oxide (NO<sub>x</sub>) and annual NO<sub>x</sub>) as a result of its energy operations such as electric generation and natural gas distribution. With respect to commodity price risks associated with electric generation, Duke Energy Ohio is exposed to changes including, but not limited to, the cost of coal and natural gas used to generate electricity, the prices of electricity in wholesale markets, the cost of capacity required to purchase and sell electricity in wholesale markets and the cost of emission allowances for SO<sub>2</sub>, seasonal NO<sub>x</sub> and annual NO<sub>x</sub>, primarily at Duke Energy Ohio's coal fired power plants. Duke Energy Ohio closely monitors the risks associated with commodity price changes on its future operations and, where appropriate, uses various commodity contracts to mitigate the effect of such fluctuations on operations. Duke Energy Ohio's exposure to commodity price risk is influenced by a number of factors, including, but not limited to, the term of the contract, the liquidity of the market and delivery location.

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DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

Commodity derivatives associated with the risk management of Duke Energy Ohio's energy operations are accounted for as either cash flow hedges or fair value hedges if the derivative instrument qualifies as a hedge under SFAS No. 133, or as an undesignated contract if either the derivative instrument does not qualify as a hedge or Duke Energy Ohio has elected to not designate the contract as a hedge. Additionally, Duke Energy Ohio enters into various contracts that qualify for the normal purchase and normal sales (NPNS) exception described in paragraph 10 of SFAS No. 133, as amended. Duke Energy Ohio primarily applies the NPNS exception to contracts within the Franchised Electric and Gas and Commercial Power business segments that relate to the physical delivery of electricity over the next 5 years.

*Commodity Fair Value Hedges.* At March 31, 2009, Duke Energy Ohio did not have any open commodity derivative instruments that were designated as fair value hedges under SFAS No. 133.

*Commodity Cash Flow Hedges.* Duke Energy Ohio uses commodity instruments, such as swaps, futures, forwards and options, to protect margins for a portion of future revenues and fuel and purchased power expenses. Duke Energy Ohio generally uses commodity cash flow hedges to mitigate exposures to the price variability of the underlying commodities for a maximum period of 1 year.

*Undesignated Contracts.* Duke Energy Ohio uses derivative contracts as economic hedges to manage the market risk exposures that arise from providing electric generation and capacity to large energy customers, energy aggregators and other wholesale companies. Undesignated contracts include contracts not designated as a hedge, contracts that do not qualify for hedge accounting, derivatives that no longer qualify for the NPNS scope exception, and de-designated hedge contracts that were not re-designated as a hedge. The contracts in this category as of March 31, 2009 are primarily associated with forward power sales and coal purchases, as well as forward SO<sub>2</sub> emission allowances, for the Commercial Power and Franchised Electric and Gas business segments.

**Interest Rate Risk**

Duke Energy Ohio is exposed to risk resulting from changes in interest rates as a result of its issuance or anticipated issuance of variable and fixed-rate debt and commercial paper. Duke Energy Ohio manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. To manage risk associated with changes in interest rates, Duke Energy Ohio may enter into financial contracts, primarily interest rate swaps and U.S. Treasury lock agreements. All of Duke Energy Ohio's derivative instruments related to interest rate risk are categorized as undesignated contracts. At March 31, 2009, the total notional amount of Duke Energy Ohio's receive variable/pay-fixed interest rate swaps was approximately \$27 million.

**Volumes**

The following table shows information relating to the volume of Duke Energy Ohio's derivative activity as of March 31, 2009. Amounts disclosed represent the notional volumes of commodities and the notional dollar amounts of debt subject to derivative contracts accounted for at fair value in accordance with SFAS No. 133. For option contracts, notional amounts include only the delta-equivalent volumes which represent the notional volumes times the probability of exercising the option based on current price volatility. Volumes associated with contracts qualifying for the NPNS exception have been excluded from the table below. Amounts disclosed represent the absolute value of notional amounts. Duke Energy Ohio has netted contractual amounts where offsetting purchase and sale contracts exist with identical delivery locations and times of delivery.

**Underlying Notional Amounts for Derivative Instruments Accounted for At Fair Value**

	<u>March 31, 2009</u>
<u>Commodity contracts</u>	
Electricity-energy (Gigawatt hours)	4,370
Electricity-capacity (Gigawatt months)	2
Emission allowances: SO <sub>2</sub> (thousands of tons)	18
Emission allowances: NO <sub>x</sub> (thousands of tons)	4
Natural gas (millions of decatherms)	9
Coal (millions of tons)	3
<u>Financial contracts</u>	
Interest rates (dollars in millions)	\$ 27

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**Notes To Unaudited Consolidated Financial Statements—(Continued)**

The following table shows fair value amounts of derivative contracts as of March 31, 2009 and the line item(s) in the Consolidated Balance Sheets in which such amounts are included. The fair values of derivative contracts are presented on a gross basis, even when the derivative instruments are subject to master netting arrangements. Cash collateral payables and receivables associated with the derivative contracts have not been netted against the fair value amounts.

**Location and Fair Value Amounts of Derivatives reflected in the Consolidated Balance Sheets**

Balance Sheet Location	March 31, 2009	
	Asset Derivatives	Liability Derivatives
	(In millions)	
<b>Derivatives designated as hedging instruments under SFAS No. 133</b>		
Commodity contracts		
Investments and Other Assets: Other	\$ 1	\$ —
Current Liabilities: Other	—	4
<b>Total derivatives designated as hedging instruments under SFAS No. 133</b>	<b>\$ 1</b>	<b>\$ 4</b>
<b>Derivatives not designated as hedging instruments under SFAS No. 133</b>		
Commodity contracts		
Current Assets: Other	\$ 55	\$ 12
Investments and Other Assets: Other	23	6
Current Liabilities: Other	223	326
Deferred Credits and Other Liabilities: Other	23	121
Interest rate contracts		
Current Liabilities: Other	—	1
Deferred Credits and Other Liabilities: Other	—	6
<b>Total derivatives not designated as hedging instruments under SFAS No. 133</b>	<b>\$ 324</b>	<b>\$ 472</b>
<b>Total Derivatives</b>	<b>\$ 325</b>	<b>\$ 476</b>

The following table shows the amount of the gains and losses recognized on derivative instruments designated and qualifying as cash flow hedges by type of derivative contract during the three months ended March 31, 2009 and the financial statement line items in which such gains and losses are included.

**Cash Flow Hedges—Location and Amount of Pre-tax Losses Recognized in Comprehensive Income**

Location of Pre-tax Losses Reclassified from AOCI into Earnings <sup>(a)</sup>	Three Months Ended March 31, 2009	
	(In millions)	
Commodity contracts		
Revenue, non-regulated electric and other	\$ —	(7)
Fuel used in electric generation and purchased power-non-regulated		(6)
<b>Total Pre-tax Losses Reclassified from AOCI into Earnings</b>	<b>\$ —</b>	<b>(13)</b>

(a) Represents the gains and losses on cash flow hedges previously recorded in AOCI during the term of the hedging relationship and reclassified into earnings during the current period.

The effective portion of gains on cash flow hedges that were recognized in AOCI during the three months ended March 31, 2009 were insignificant. In addition, there was no hedge ineffectiveness during the three months ended March 31, 2009. No gains or losses have been excluded from the assessment of hedge effectiveness. As of March 31, 2009, approximately \$11 million of pre-tax deferred net losses on derivative instruments related to commodity cash flow hedges accumulated on the Consolidated Balance Sheets in AOCI are expected to be recognized in earnings during the next twelve months as the hedged transactions occur.

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DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

The following table shows the amount of the pre-tax gains and losses recognized on undesignated hedges by type of derivative instrument during the three months ended March 31, 2009 and the line item(s) in the Consolidated Statements of Operations in which such gains and losses are included or deferred on the Consolidated Balance Sheets as regulatory assets.

**Undesignated Hedges—Location and Amount of Pre-tax Gains and (Losses) Recognized in Income or as Regulatory Assets**

	Three Months Ended March 31, 2009	
	(in millions)	
<b>Location of Pre-tax Gains and (Losses) Recognized in Earnings</b>		
Commodity contracts		
Revenue, non-regulated electric and other	\$	8
Fuel used in electric generation and purchased power-non-regulated		(8)
<b>Total Pre-tax Gains and (Losses) Recognized in Earnings</b>	<b>\$</b>	<b>—</b>
<b>Location of Pre-tax Gains and (Losses) Recognized as Regulatory Assets</b>		
Commodity contracts		
Regulatory Asset	\$	(77)
Interest rate contracts		
Regulatory Asset		1
<b>Total Pre-tax Losses Recognized as Regulatory Assets</b>	<b>\$</b>	<b>(76)</b>

Certain of Duke Energy Ohio's derivative contracts contain contingent credit features, such as material adverse change clauses or payment acceleration clauses that could result in immediate payments, the posting of letters of credit or the termination of the derivative contract before maturity if specific events occur, such as a downgrade of Duke Energy Ohio's credit rating below investment grade.

The following table shows information with respect to derivative contracts that are in a net liability position and contain objective credit-risk related payment provisions. The amounts disclosed in the table below represents the aggregate fair value amounts of such derivative instruments at the end of the reporting period, the aggregate fair value of assets that are already posted as collateral under such derivative instruments at the end of the reporting period, and the aggregate fair value of additional assets that would be required to be transferred in the event that credit-risk-related contingent features were triggered at March 31, 2009.

**Information Regarding Derivative Instruments that Contain Credit-risk Related Contingent Features**

	March 31, 2009	
	(in millions)	
Aggregate Fair Value Amounts of Derivative Instruments in a Net Liability Position	\$	440
Collateral Already Posted	\$	219
Additional Cash Collateral or Letters of Credit in the Event Credit-risk-related Contingent Features were Triggered at the End of the Reporting Period	\$	26

Netting of cash collateral and derivative assets and liabilities under master netting arrangements. In accordance with FASB Staff Position (FSP) No. FIN 39-1, "Amendment of FASB Interpretation No 39, Offsetting of Amounts Related to Certain Contracts" (FSP No. FIN 39-1), Duke Energy Ohio offsets fair value amounts (or amounts that approximate fair value) recognized on its Consolidated Balance Sheets related to cash collateral amounts receivable or payable against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting agreement. At March 31, 2009 and December 31, 2008, Duke Energy Ohio had receivables related to the right to reclaim cash collateral of approximately \$162 million and \$85 million, respectively, and had payables related to obligations to return cash collateral of an insignificant amount, respectively, that have been offset against net derivative positions in the Consolidated Balance Sheets. Duke Energy Ohio had \$60 million and approximately \$57 million in cash collateral receivables under master netting arrangements that have not been offset against net derivative positions at March 31, 2009 and December 31, 2008, respectively, as these amounts primarily represent initial margin deposits related to New York Mercantile

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DUKE ENERGY OHIO, INC.

### Notes To Unaudited Consolidated Financial Statements—(Continued)

Exchange (NYMEX) futures contracts. Duke Energy Ohio had insignificant cash collateral payables under master netting arrangements that have not been offset against net derivative positions at March 31, 2009 and December 31, 2008.

See Note 12 for additional information on fair value disclosures related to derivatives required by SFAS No. 157, "Fair Value Measurements" (SFAS No. 157).

#### 10. Regulatory Matters

##### Franchised Electric and Gas.

**Rate Related Information.** The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. The PUCO approves rates and market prices for retail gas and electric service within the state of Ohio, except that non-regulated sellers of gas and electric generation also are allowed to operate in Ohio (see "Commercial Power" below). The FERC approves rates for electric sales to wholesale customers served under cost-based and market-based rates.

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

On July 31, 2008, Duke Energy Ohio filed a new generation pricing formula to be effective January 1, 2009, when the current RSP expired. Among other things, the plan provides pricing mechanisms for compensation related to the advanced energy, renewable energy supply and energy efficiency portfolio standards established by SB 221.

On October 27, 2008, Duke Energy Ohio filed a Stipulation and Recommendation (Stipulation) for consideration by the PUCO regarding Duke Energy Ohio's July 31, 2008 ESP filing. The Stipulation reflects agreement on all but two issues in this proceeding and was filed with the support of most of the parties to this proceeding. In addition to the Stipulation, the ability for residential governmental aggregation customers to avoid certain charges and to receive a shopping credit was presented to the PUCO for a ruling. Parties to this proceeding who did not support the Stipulation were free to litigate any, or all, issues.

The Stipulation agrees to a net increase in base generation revenues of approximately \$36 million, \$74 million and \$98 million in 2009, 2010 and 2011, respectively, including termination of the residential and non-residential RTC. Such amounts result in a residential net rate increase of 2% in 2009 and in 2010, and a non-residential net rate increase of 2% in 2009, 2010 and 2011. The Stipulation also allows the recovery of expenditures incurred to deploy SmartGrid infrastructure modernization technology on the distribution system. The recovery of such expenditures, net of savings, is subject to an annual residential revenue cap. Further, the Stipulation allows for the implementation of a new energy efficiency compensation model, referred to as save-a-watt, to achieve the energy efficiency mandate pursuant to the recent electric energy legislation. The criteria customers must meet to be exempt from Duke Energy Ohio's program was also presented to the PUCO for a ruling in this case. Also, under the Stipulation, Duke Energy Ohio may defer up to \$50 million of certain operation and maintenance costs incurred at the W.C. Beckjord generating station and amortize such costs over a three-year period.

The ESP hearing occurred on November 10, 2008. On December 17, 2008, the PUCO issued its finding and order resolving the two litigated issues and adopting a modified Stipulation. Specifically, the PUCO modified the Stipulation to permit certain non-residential customers to opt out of utility-sponsored energy efficiency initiatives and to allow residential governmental aggregation customers who leave Duke Energy Ohio's system to avoid some charges. Applications for rehearing of the PUCO's decision have been filed by environmental groups and a residential customer advocate group. On February 11, 2009, the PUCO issued an Entry denying the rehearing requests. On April 13, 2009, the Office of the Ohio Consumers' Counsel (OCC) filed a notice of appeal to the Ohio Supreme Court, challenging the

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DUKE ENERGY OHIO, INC.

### Notes To Unaudited Consolidated Financial Statements—(Continued)

PUCO's interpretation of the system-reliability-adjustment capacity dedication rider (SRA-CD). The OCC claims that the PUCO incorrectly determined that SRA-CD is unavoidable for residential governmental aggregation customers. Duke Energy Ohio has moved to intervene as an appellee in the proceeding.

As discussed further below within "Commercial Power" and in Note 1, as a result of the approval of the ESP, effective December 17, 2008, Commercial Power reapplied the provisions of SFAS No. 71 to certain portions of its operations.

**Duke Energy Ohio Gas Rate Case.** In July 2007, Duke Energy Ohio filed an application with the PUCO for an increase in its base rates for gas service. Duke Energy Ohio sought an increase of approximately \$34 million in revenue, or approximately 5.7%, to be effective in the spring of 2008. The application also requested approval to continue tracker recovery of costs associated with the accelerated gas main replacement program. The staff of the PUCO issued a Staff Report in December 2007 recommending an increase of approximately \$14 million to \$20 million in revenue. The Staff Report also recommended approval for Duke Energy Ohio to continue tracker recovery of costs associated with the accelerated gas main replacement program. On February 28, 2008, Duke Energy Ohio reached a settlement agreement with the PUCO Staff and all of the intervening parties on its request for an increase in natural gas base rates. The settlement called for an annual revenue increase of approximately \$18 million in base revenue, or 3% over current revenue, permitted continued recovery of costs through 2018 for Duke Energy Ohio's accelerated gas main replacement program and permitted recovery of carrying costs on gas stored underground via its monthly gas cost adjustment filing. The settlement did not resolve a proposed rate design for residential customers, which involved moving more of the fixed charges of providing gas service, such as capital investment in pipes and regulating equipment, billing and meter reading, from the per unit charges to the monthly charge. On May 28, 2008, the PUCO approved the settlement in its entirety and the proposed rate design. On June 28, 2008, the OCC and Ohio Partners for Affordable Energy (OPAE) filed Applications for Rehearing opposing the rate design. On July 23, 2008, the Ohio Commission issued an Entry denying the rehearing requests of OCC and OPAE. On September 16 and 19, 2008, respectively, the OCC and OPAE filed their notices of appeal to the Ohio Supreme Court opposing the residential rate design issue. Merit briefs were filed with the Ohio Supreme Court on February 2, 2009. On April 17, 2009, and after providing the required notice to the PUCO, the OCC filed a motion to stay implementation of Stage 3 of the rate design, which was approved to take effect on June 1, 2009. Duke Energy Ohio filed a memorandum in opposition to this request on April 27, 2009. At this time, Duke Energy Ohio cannot predict whether the Ohio Supreme Court will reverse the PUCO's decision of May 28, 2008.

**Duke Energy Ohio Electric Distribution Rate Case.** On June 25, 2008, Duke Energy Ohio filed notice with the PUCO that it will seek a rate increase for electric delivery service of approximately \$86 million, or 4.8% on total electric revenues, to be effective in the second quarter of 2009. On December 22, 2008, Duke Energy Ohio filed an application requesting deferral of approximately \$31 million related to damage to its distribution system from a September 14, 2008 windstorm. On January 14, 2009, the PUCO granted Duke Energy Ohio's deferral request. Accordingly, a regulatory asset was recorded as of December 31, 2008 for \$31 million. On March 31, 2009, Duke Energy Ohio and Parties to the case filed a Stipulation and Recommendation which settles all issues in the case. The Stipulation provides for a revenue increase of \$55.3 million or approximately a 2.9% overall increase. The Parties also agreed that Duke Energy Ohio will recover any approved costs associated with the September 14, 2008 wind storm restoration through a separate rider recovery mechanism. Duke Energy Ohio agreed to file a separate application to set the rider and the PUCO will review the request and determine the appropriate amount of storm costs that should be recovered. The Stipulation includes, among other things, a weatherization and energy efficiency program, and recovery of uncollectible expenses through a rider mechanism. The Stipulation is subject to approval by the PUCO.

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

In February 2005, Duke Energy Kentucky filed a gas base rate case with the KPSC requesting approval to continue the tracking mechanism and for a \$14 million annual increase in base rates. A portion of the increase is attributable to recovery of the current cost of the accelerated gas main replacement program in base rates. In June 2005, the Kentucky General Assembly enacted Kentucky Revised Statute 278.509 (KRS 278.509), which specifically authorizes the KPSC to approve tracker recovery for utilities' gas main replacement programs. In December 2005, the KPSC approved an annual rate increase of \$8 million and re-approved the tracking mechanism through

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### Notes To Unaudited Consolidated Financial Statements—(Continued)

2011. In February 2006, the Kentucky Attorney General appealed the KPSC's order to the Franklin Circuit Court, claiming that the order improperly allows Duke Energy Kentucky to increase its rates for gas main replacement costs in between general rate cases, and also claiming that the order improperly allows Duke Energy Kentucky to earn a return on investment for the costs recovered under the tracking mechanism which permits Duke Energy Kentucky to recover its gas main replacement costs.

In August 2007, the Franklin Circuit Court consolidated all the pending appeals and ruled that the KPSC lacks legal authority to approve the gas main replacement tracking mechanism, which were approved prior to enactment of KRS 278.509. To date, Duke Energy Kentucky has collected approximately \$9 million in annual rate adjustments under the tracking mechanism. Per the KPSC order, Duke Energy Kentucky collected these revenues subject to refund pending the final outcome of this litigation. Duke Energy Kentucky and the KPSC have requested that the Kentucky Court of Appeals grant a rehearing of its decision. On February 5, 2009, the Kentucky Court of Appeals denied the rehearing requests of both Duke Energy Kentucky and the KPSC. Duke Energy Kentucky filed a motion for discretionary review to the Kentucky Supreme Court on March 9, 2009. At this time, Duke Energy Kentucky cannot predict whether the Kentucky Supreme Court will accept the case for review.

**Energy Efficiency.** On July 11, 2007, the PUCO approved Duke Energy Ohio's Demand Side Management/Energy Efficiency Program (DSM Program). The DSM programs were first proposed in 2006 and were endorsed by the Duke Energy Community Partnership, which is a collaborative group made up of representatives of organizations interested in energy conservation, efficiency and assistance to low-income customers. The program costs are recouped through a cost recovery mechanism that will be adjusted annually to reflect the previous year's activity. Duke Energy Ohio is permitted to recover lost revenues, program costs and shared savings (once the programs reach 65% of the targeted savings level) through the cost recovery mechanism based upon impact studies to be provided to the Staff of the PUCO. Duke Energy Ohio filed the save-a-watt Energy Efficiency Plan as part of its ESP filed with the PUCO on July 31, 2008 (discussed above). A Stipulation and Recommendation for consideration by the PUCO regarding Duke Energy Ohio's ESP filing, including implementation of save-a-watt, was filed on October 27, 2008. The ESP hearing occurred on November 10, 2008. On December 17, 2008, the PUCO approved the ESP, including allowing for the implementation of a new save-a-watt energy efficiency compensation model. However, the PUCO determined that certain non-residential customers may opt out of Duke Energy Ohio's energy efficiency initiative. Applications for rehearing of this issue were denied by the PUCO and no further appeals of this issue have been taken.

On November 15, 2007, Duke Energy Kentucky filed its annual application to continue existing energy efficiency programs, consisting of nine residential and two commercial and industrial programs, and to true-up its gas and electric tracking mechanism for recovery of lost revenues, program costs and shared savings. On February 11, 2008, Duke Energy Kentucky filed a motion to amend its energy efficiency programs and applied to reinstitute a low income Home Energy Assistance Program. The KPSC bifurcated the proposed Home Energy Assistance Program from the other energy efficiency programs. On May 14, 2008, the KPSC approved the energy efficiency programs. On September 25, 2008, the KPSC approved Duke Energy Kentucky's Home Energy Assistance program, making it available for customers at or below 150% of the federal poverty level. On December 1, 2008, Duke Energy Kentucky filed an application for a save-a-watt Energy Efficiency Plan. The application seeks a new energy efficiency recovery mechanism similar to what was proposed in Ohio. Intervenor testimony is due on May 11, 2009. An evidentiary hearing with the KPSC is expected to occur in the third quarter of 2009.

**Ohio Riser Leak Investigation.** In April 2005, the PUCO issued an order opening a statewide investigation into riser leaks in gas pipeline systems throughout Ohio. The investigation followed four explosions since 2000 caused by gas riser leaks, including an April 2000 explosion in Duke Energy Ohio's service area. In November 2006, the PUCO Staff released the expert report, which concluded that certain types of risers are prone to leaks under various conditions, including over-tightening during initial installation. The PUCO Staff recommended that natural gas companies continue to monitor the situation and study the cause of any further riser leaks to determine whether further remedial action is warranted. As of January 1, 2009, Duke Energy Ohio had approximately 80,000 of these risers on its distribution system. If the PUCO orders natural gas companies to replace all of these risers, Duke Energy Ohio estimates a replacement cost of approximately \$40 million. As part of the rate case filed in July 2007 (see "Duke Energy Ohio Gas Rate Case" above), Duke Energy Ohio requested approval from the PUCO to accelerate its riser replacement program. The riser replacement program is contained in the settlement reached with all intervenors and expected to be completed at the end of 2012.

**Midwest Independent Transmission System Operator, Inc. (Midwest ISO) Resource Adequacy Filing.** On December 28, 2007, the Midwest ISO filed its Electric Tariff Filing Regarding Resource Adequacy in compliance with the FERC's request of Midwest ISO to file Phase II of its long-term Resource Adequacy plan by December 2007. The proposal includes establishment of a resource adequacy requirement in the form of planning reserve margin. On March 26, 2008, the FERC ruled on the Midwest ISO's Resource Adequacy filing.

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### Notes To Unaudited Consolidated Financial Statements—(Continued)

and ordered that the new Module E tariff be effective March 27, 2008. This action established a Midwest ISO-wide resource adequacy requirement for the first Planning Year, which begins June 2009. In the Order, the FERC, among other things, clarified that States have the authority to set their own Planning Reserve Margins, as long as they are not inconsistent with any reliability standard approved by the FERC.

**Midwest ISO's Establishment of an Ancillary Services Market (ASM).** On February 25, 2008, the FERC conditionally accepted the Midwest ISO proposal to implement a day-ahead and real-time ASM, including a scarcity pricing proposal. By approving the ASM proposal, the FERC essentially approved the transfer and consolidation of balancing authority for the entire Midwest ISO area. This will allow the Midwest ISO to determine operating reserve requirements and procure operating reserves from all qualified resources from an organized market, in place of the current system of local management and procurement of reserves by the 24 balancing authorities in the Midwest ISO area. The Midwest ISO launched the ASM on January 6, 2009.

#### Commercial Power.

As discussed in Note 1, effective December 17, 2008, Commercial Power reapplied the provisions of SFAS No. 71 to certain portions of its operations due to the passing of SB 221 and the PUCO's approval of the ESP. However, since certain portions of Commercial Power's operations are not subject to regulatory accounting pursuant to SFAS No. 71, reported results for Commercial Power are subject to volatility due to the over- or under-collection of certain costs for which recovery is not automatic under the ESP. Commercial Power may be impacted by certain of the regulatory matters discussed above, including the Duke Energy Ohio electric rate filings.

**FERC 203 Application.** On April 23, 2008 (supplemented on May 6, 2008), Duke Energy Ohio and certain affiliates filed an application with the FERC requesting approval to transfer Duke Energy Ohio's electric generating facilities, some of which are designated to serve Ohio customers, to affiliate companies. The FERC filing, if approved, does not obligate Duke Energy to make the transfer of the electric generating facilities, and does not impact Duke Energy Ohio's current rates. On October 10, 2008, Duke Energy Ohio and affiliates filed a notice with the FERC reporting that Duke Energy Ohio was in settlement discussions with all parties in the Ohio proceeding regarding Duke Energy Ohio's application to establish an ESP, as discussed above. Duke Energy Ohio advised the FERC that it believes that in light of those discussions good cause exists for the FERC to extend the time to consider Duke Energy Ohio's Section 203 application. On October 17, 2008, the FERC issued an order extending the time for the FERC to act on the application by 180 additional days, and ordered Duke Energy Ohio to inform the FERC of the status of settlement discussions by November 16, 2008. As part of the settlement that was approved by the PUCO on December 17, 2008 (see discussion above) Duke Energy Ohio agreed to withdraw that portion of its application for approval related to the transfer of its generating facilities designated to serve Ohio customers and the PUCO approved of the transfer for the remaining generating facilities. Duke Energy Ohio filed a new application requesting FERC approval to transfer to affiliate companies only the remaining generating facilities not designated to serve Ohio customers, which was conditionally approved by the FERC on February 19, 2009. As a condition of approval, the FERC requires that all acquisition premiums related to generating assets being transferred to an affiliate of Duke Energy be removed from Duke Energy Ohio's financial statements when Duke Energy Ohio submits its final accounting entries and that any debt associated with the generation assets being transferred be transferred to the generating facility before Duke Energy Ohio submits its final accounting entries. In addition, the FERC will hold Duke Energy Ohio to its commitments to not pay taxes associated with the proposed transaction, to maintain a minimum equity to total capital ratio of 30%, and to retain an amount of debt that will accommodate the preservation of Duke Energy Ohio's current credit ratings.

**PJM Interconnection Reliability Pricing Model (RPM) Buyers' Complaint.** On May 30, 2008, a group of public utility commissions, state consumer counsels, industrial power customers and load serving entities, known collectively as the RPM Buyers, filed a complaint at the FERC. The complaint asks the FERC to find that the results of the three transitional base residual auctions conducted by PJM to procure capacity for its RPM capacity market during the years 2008-2011 are unjust and unreasonable because, allegedly, they have produced excessive capacity prices, have failed to prevent suppliers from exercising market power, and have not produced benefits commensurate with costs. In their complaint, the RPM Buyers propose revised, administratively determined auction clearing prices. Certain Duke Energy Ohio revenues during the years 2008-2011 are at risk, as Duke Energy Ohio planned to supply capacity to this market. On July 11, 2008, Duke Energy Ohio filed a response to the complaint with the FERC. On September 19, 2008, the FERC issued an Order denying and dismissing the RPM Buyer's complaint, finding that, for the transition auctions, no party violated PJM's tariff and the prices determined during the auctions were in accordance with the tariff provisions governing the auctions. On October 20, 2008, the RPM Buyers filed a Request for Rehearing with the FERC that raised the same issues as in the initial complaint that was denied by the FERC.



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DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)****11. Commitments and Contingencies****Environmental**

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

**Remediation Activities.** Duke Energy Ohio and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Ohio operations, sites formerly owned or used by Duke Energy Ohio entities, and sites owned by third parties. Remediation typically involves management of contaminated soils and may involve groundwater remediation. Managed in conjunction with relevant federal, state and local agencies, activities vary with site conditions and locations, remedial requirements, complexity and sharing of responsibility. If remediation activities involve statutory joint and several liability provisions, strict liability, or cost recovery or contribution actions, Duke Energy Ohio or its affiliates could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Ohio may share liability associated with contamination with other potentially responsible parties, and may also benefit from insurance policies or contractual indemnities that cover some or all cleanup costs. All of these sites generally are managed in the normal course of business or affiliate operations. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable. During 2009, it is reasonably possible that Duke Energy Ohio will incur costs associated with remediation activities at certain of its sites.

**Clean Water Act 316(b).** The U.S. Environmental Protection Agency (EPA) finalized its cooling water intake structures rule in July 2004. The rule established aquatic protection requirements for existing facilities that withdraw 50 million gallons or more of water per day from rivers, streams, lakes, reservoirs, estuaries, oceans or other U.S. waters for cooling purposes. Three of six coal-fired generating facilities in which Duke Energy Ohio is either a whole or partial owner are affected sources under that rule. On April 1, 2009, the U.S. Supreme Court ruled in favor of the plaintiff that the EPA may consider costs when determining which technology option each site should implement. Depending on how the cost-benefit analysis is incorporated into the revised EPA rule, the analysis could narrow the range of technology options required for each of the three affected facilities. Because of the wide range of potential outcomes, Duke Energy Ohio is unable to estimate its costs to comply at this time.

**Clean Air Interstate Rule (CAIR).** The EPA finalized its CAIR in May 2005. The CAIR limits total annual and summertime NO<sub>x</sub> emissions and annual SO<sub>2</sub> emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO<sub>x</sub> and in 2010 for SO<sub>2</sub>. Phase 2 begins in 2015 for both NO<sub>x</sub> and SO<sub>2</sub>. On March 25, 2008, the U.S. Court of Appeals for the District of Columbia (D.C. Circuit) heard oral argument in a case involving multiple challenges to the CAIR. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA filed a petition for rehearing on September 24, 2008 with the D.C. Circuit asking the court to reconsider various parts of its ruling vacating the CAIR. In December 2008, the D.C. Circuit issued a decision remanding the CAIR to the EPA without vacatur. The EPA must now conduct a new rulemaking to modify the CAIR in accordance with the court's July 11, 2008 opinion. This decision means that the CAIR as initially finalized in 2005 remains in effect until the new EPA rule takes effect. The court did not impose a deadline or schedule on the EPA. It is uncertain how long the current CAIR will remain in effect or how the new rulemaking will alter the CAIR.

Duke Energy Ohio plans to spend approximately \$85 million between 2009 and 2013 to comply with Phase 1 of the CAIR. Duke Energy Ohio is currently unable to estimate the costs to comply with any new rule the EPA will issue in the future as a result of the D.C. District Court's December 2008 decision discussed above. Duke Energy Ohio received partial recovery of depreciation and financing costs related to environmental compliance projects for 2005-2008 through its RSP and continues to be able to recover a portion of these costs through the ESP.

**Coal Combustion Product (CCP) Management.** Duke Energy Ohio currently estimates that it will spend approximately \$68 million over the period 2009-2013 to install synthetic caps and liners at existing and new CCP landfills and to convert some of its CCP handling systems from wet to dry systems.

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PART I

DUKE ENERGY OHIO, INC.

### Notes To Unaudited Consolidated Financial Statements—(Continued)

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

**Extended Environmental Activities and Accruals.** Included in Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets were total accruals related to extended environmental-related activities of approximately \$11 million as of both March 31, 2009 and December 31, 2008. These accruals represent Duke Energy Ohio's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

#### Litigation

**New Source Review (NSR).** In 1999-2000, the U.S. Department of Justice, acting on behalf of the EPA and joined by various citizen groups and states, filed a number of complaints and notices of violation against multiple utilities across the country for alleged violations of the NSR provisions of the Clean Air Act (CAA). Generally, the government alleges that projects performed at various coal-fired units were major modifications, as defined in the CAA, and that the utilities violated the CAA when they undertook those projects without obtaining permits and installing the best available emission controls for SO<sub>2</sub>, NO<sub>x</sub> and particulate matter. The complaints seek injunctive relief to require installation of pollution control technology on various generating units that allegedly violated the CAA, and unspecified civil penalties in amounts of up to \$32,500 per day for each violation. Two of Duke Energy Ohio's plants have been subject to these allegations. Duke Energy Ohio asserts that there were no CAA violations because the applicable regulations do not require permitting in cases where the projects undertaken are "routine" or otherwise do not result in a net increase in emissions.

In November 1999, the U.S. brought a lawsuit in the U.S. Federal District Court for the Southern District of Indiana against Duke Energy Ohio alleging various violations of the CAA at Duke Energy Ohio's W.C. Beckjord and Miami Fort Stations. Three northeast states and two environmental groups have intervened in the case. A jury trial commenced on May 5, 2008 and jury verdict was returned on May 22, 2008. The jury found in favor of Cinergy and Duke Energy Ohio. Additionally, the plaintiffs had claimed that Duke Energy Ohio violated an Administrative Consent Order entered into in 1998 between the EPA and Cinergy relating to alleged violations of Ohio's State Implementation Plan (SIP) provisions governing particulate matter at Duke Energy Ohio's W.C. Beckjord Station.

On October 21, 2008, plaintiffs filed a motion for a new liability trial claiming that defendants misled the plaintiffs and the jury by, among other things, not disclosing a consulting agreement with a fact witness and by referring to that witness as "retired" during the liability trial when in fact he was working for Duke Energy under the referenced consulting agreement in connection with the trial. On December 18, 2008, the court granted plaintiffs' motion for a new liability trial on claims for which Duke Energy Ohio was not previously found liable. That trial began on May 11, 2009. The remedy trial for violations already established at the W.C. Beckjord Station was held during the week beginning February 2, 2009. The parties are awaiting a decision from the trial court.

It is not possible to estimate the damages, if any, that Duke Energy Ohio might incur in connection with these matters. Ultimate resolution of these matters relating to NSR, even in settlement, could have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position. However, Duke Energy Ohio will pursue appropriate regulatory treatment for any costs incurred in connection with such resolution.

**Section 126 Petitions.** In March 2004, the state of North Carolina filed a petition under Section 126 of the CAA in which it alleges that sources in 13 upwind states, including Ohio, significantly contribute to North Carolina's non-attainment with certain ambient air quality standards. In August 2005, the EPA issued a proposed response to the petition. The EPA proposed to deny the ozone portion of the petition based upon a lack of contribution to air quality by the named states. The EPA also proposed to deny the particulate matter portion of the petition based upon the CAIR Federal Implementation Plan (FIP) that would address the air quality concerns from neighboring states. On April 28, 2006, the EPA denied North Carolina's petition based upon the final CAIR FIP described above. North Carolina has filed a legal challenge to the EPA's denial. Briefing in that case is under way. On March 5, 2009 the D.C. Circuit remanded the case to the EPA for reconsideration. The EPA has conceded that the D.C. Circuit's July 18, 2008 decision in the CAIR litigation, *North Carolina v. EPA* No. 05-1244, discussed above, and a subsequent order issued by the D.C. Circuit on December 23, 2008, have eliminated the legal basis for the EPA's denial of North Carolina's Section 126 petition. At this time, Duke Energy Ohio cannot predict the outcome of this proceeding.

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PART I

DUKE ENERGY OHIO, INC.

### Notes To Unaudited Consolidated Financial Statements—(Continued)

**Carbon Dioxide (CO<sub>2</sub>) Litigation.** In July 2004, the states of Connecticut, New York, California, Iowa, New Jersey, Rhode Island, Vermont, Wisconsin and the City of New York brought a lawsuit in the U.S. District Court for the Southern District of New York against Cinergy, American Electric Power Company, Inc., American Electric Power Service Corporation, The Southern Company, Tennessee Valley Authority, and Xcel Energy Inc. A similar lawsuit was filed in the U.S. District Court for the Southern District of New York against the same companies by Open Space Institute, Inc., Open Space Conservancy, Inc., and The Audubon Society of New Hampshire. These lawsuits allege that the defendants' emissions of CO<sub>2</sub> from the combustion of fossil fuels at electric generating facilities contribute to global warming and amount to a public nuisance. The complaints also allege that the defendants could generate the same amount of electricity while emitting significantly less CO<sub>2</sub>. The plaintiffs are seeking an injunction requiring each defendant to cap its CO<sub>2</sub> emissions and then reduce them by a specified percentage each year for at least a decade. In September 2005, the District Court granted the defendants' motion to dismiss the lawsuit. The plaintiffs have appealed this ruling to the Second Circuit Court of Appeals. Oral arguments were held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

**Zimmer Generating Station (Zimmer Station) Lawsuit.** In November 2004, a citizen of the Village of Moscow, Ohio, the town adjacent to Duke Energy Ohio's Zimmer Station, brought a purported class action in the U.S. District Court for the Southern District of Ohio seeking monetary damages and injunctive relief against Duke Energy Ohio for alleged violations of the CAA, the Ohio SIP, and Ohio laws against nuisance and common law nuisance. The plaintiffs have filed a number of additional notices of intent to sue and two lawsuits raising claims similar to those in the original claim. One lawsuit was dismissed on procedural grounds, and the remaining two have been consolidated. On December 28, 2006, the District Court certified this case as a class action. In March 2009, a settlement in principle was reached with the class plaintiffs, subject to execution of a definitive settlement document and approval by the court. The settlement, as currently structured, will not have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

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

**Ohio Antitrust Lawsuit.** In January 2008, four plaintiffs, including individual, industrial and non-profit customers, filed a lawsuit against Duke Energy Ohio in federal court in the Southern District of Ohio. Plaintiffs allege that Duke Energy Ohio (then The Cincinnati Gas & Electric Company (CG&E)), conspired to provide inequitable and unfair price advantages for certain large business consumers by entering into non-public option agreements with such consumers in exchange for their withdrawal of challenges to Duke Energy Ohio's (then CG&E's) pending RSP, which was implemented in early 2005. Duke Energy Ohio denies the allegations made in the lawsuit. Following Duke Energy Ohio's filing of a motion to dismiss plaintiffs' claims, plaintiffs amended their complaint on May 30, 2008. Plaintiffs now contend that the contracts at issue were an illegal rebate which violate antitrust and Racketeer Influenced and Corrupt Organizations (RICO) statutes. Defendants have again moved to dismiss the claims. On March 31, 2009, the District Court granted Duke Energy Ohio's motion to dismiss. Plaintiffs have filed a motion to alter or set aside the judgment.

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

**Other Litigation and Legal Proceedings.** Duke Energy Ohio and its subsidiaries are involved in other legal, tax and regulatory proceedings arising in the ordinary course of business, some of which involve substantial amounts. Duke Energy Ohio believes that the

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DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

final disposition of these proceedings will not have a material adverse effect on its consolidated results of operations, cash flows or financial position.

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

**Other Commitments and Contingencies**

*General.* Duke Energy Ohio enters into various fixed-price, non-cancelable commitments to purchase or sell power (tolling arrangements or power purchase contracts) that may or may not be recognized on the Consolidated Balance Sheets. Some of these arrangements may be recognized at market value on the Consolidated Balance Sheets as undesignated hedge contracts or qualifying hedge positions.

**12. Fair Value of Financial Assets and Liabilities**

On January 1, 2008, Duke Energy Ohio adopted SFAS No. 157. Through December 31, 2008, Duke Energy Ohio's adoption of SFAS No. 157 was limited to financial instruments and to non-financial derivatives as, in February 2008, the FASB issued FSP No. FAS 157-2, "Effective Date of FASB Statement No. 157," which delayed the effective date of SFAS No. 157 until January 1, 2009 for non-financial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. There was no cumulative effect adjustment to retained earnings for Duke Energy Ohio as a result of the adoption of SFAS No. 157.

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

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

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

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

**Level 3 inputs**—unobservable inputs for the asset or liability.

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

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DUKE ENERGY OHIO, INC.  
**Notes To Unaudited Consolidated Financial Statements—(Continued)**

The following tables provide the fair value measurement amounts for assets and liabilities recorded in both current and non-current unrealized gains on mark-to-market and hedging transactions and unrealized losses on mark-to-market and hedging transactions on Duke Energy Ohio's Consolidated Balance Sheets at fair value at March 31, 2009 and December 31, 2008. Amounts presented in the tables below exclude cash collateral amounts which are disclosed separately in Note 9.

Description	Total Fair Value Amounts at			
	March 31, 2009	Level 1	Level 2	Level 3
	(In millions)			
Derivative Assets	\$ 61	\$ 9	\$ —	\$ 52
Derivative Liabilities	(212)	(162)	(7)	(43)
<b>Net (Liabilities) Assets</b>	<b>\$ (151)</b>	<b>\$ (153)</b>	<b>\$ (7)</b>	<b>\$ 9</b>

Description	Total Fair Value Amounts at			
	December 31, 2008	Level 1	Level 2	Level 3
	(In millions)			
Derivative Assets	\$ 68	\$ 9	\$ —	\$ 59
Derivative Liabilities	(147)	(88)	(8)	(51)
<b>Net (Liabilities) Assets</b>	<b>\$ (79)</b>	<b>\$ (79)</b>	<b>\$ (8)</b>	<b>\$ 8</b>

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

**Rollforward of Level 3 Measurements**

	Derivatives (net)	
	(In millions)	
Balance at January 1, 2009	\$	8
Total pre-tax realized or unrealized gains included in earnings:		
Fuel used in electric generation and purchased power-non-regulated		1
Total pre-tax gains included in other comprehensive income		1
Net purchases, sales, issuances and settlements		(5)
Total gains included on balance sheet as regulatory asset or liability or as non-current liability		4
<b>Balance at March 31, 2009</b>	<b>\$</b>	<b>9</b>
Pre-tax (losses) gains included in the Consolidated Statements of Operations related to Level 3 measurements outstanding at March 31, 2009:		
Revenue, non-regulated electric, and other	\$	(5)
Fuel used in electric generation and purchased power-non-regulated		18
<b>Total</b>	<b>\$</b>	<b>13</b>
Balance at January 1, 2008	\$	(22)
Total pre-tax realized or unrealized gains included in earnings:		
Revenue, non-regulated electric and other		8
Total pre-tax losses included in other comprehensive income		(3)
Net purchases, sales, issuances and settlements		(8)
<b>Balance at March 31, 2008</b>	<b>\$</b>	<b>(25)</b>
Pre-tax gains included in the Consolidated Statements of Operations related to Level 3 measurements outstanding at March 31, 2008:		
Revenue, non-regulated electric and other	\$	1
<b>Total</b>	<b>\$</b>	<b>1</b>

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DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

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

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

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

	As of March 31, 2009		As of December 31, 2008	
	Book Value	Approximate Fair Value	Book Value	Approximate Fair Value
	(in millions)			
Long-term debt, including current maturities	\$ 2,331	\$ 2,130	\$ 1,883	\$ 1,729

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

**13. New Accounting Standards**

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

**SFAS No. 141 (revised 2007), "Business Combinations" (SFAS No. 141R).** In December 2007, the FASB issued SFAS No. 141R, which replaces SFAS No. 141, "Business Combinations." SFAS No. 141R retains the fundamental requirements in SFAS No. 141 that the acquisition method of accounting be used for all business combinations and that an acquirer be identified for each business combination. This statement also establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling (minority) interests in an acquiree, and any goodwill acquired in a business combination or gain recognized from a bargain purchase. For Duke Energy Ohio, SFAS No. 141R must be applied prospectively to business combinations for which the acquisition date occurs on or after January 1, 2009. The impact to Duke Energy Ohio of applying SFAS No. 141R for periods subsequent to implementation will be dependent upon the nature of any transactions within the scope of SFAS No. 141R. Additionally, SFAS No. 141R changes the accounting for income taxes related to prior business combinations.

**SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment to FASB Statement No. 133" (SFAS No. 161).** In March 2008, the FASB issued SFAS No. 161, which amends and expands the disclosure requirements for derivative instruments and hedging activities prescribed by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. Duke Energy Ohio adopted SFAS No. 161 as of January 1, 2009. The adoption of SFAS No. 161 did not have any impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position. See Note 9 for the disclosures required under SFAS No. 161.

**14. Income Taxes and Other Taxes**

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

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DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)****Changes to Unrecognized Tax Benefits**

	Increase/(Decrease)	
	(in millions)	
Unrecognized Tax Benefits—January 1, 2009	\$	15
Unrecognized Tax Benefits Changes		
Gross increases—tax positions in prior periods		3
Gross decreases—tax positions in prior periods		(1)
Settlements		(5)
Total Changes		(3)
Unrecognized Tax Benefits—March 31, 2009	\$	12

At March 31, 2009, no portion of the total unrecognized tax benefits, if recognized, would affect the effective tax rate. Duke Energy Ohio does not anticipate a significant increase or decrease in unrecognized tax benefits in the next twelve months.

Duke Energy Ohio has the following tax years open:

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

The effective tax rate for the three months ended March 31, 2009 was approximately 35.4% as compared to the effective tax rate of approximately 35.7% for the same period in 2008.

As of March 31, 2009 and December 31, 2008, approximately \$63 million and \$64 million, respectively, of deferred income taxes were included in Other within Current Assets on the Consolidated Balance Sheets. At March 31, 2009 and December 31, 2008, these balances exceeded 5% of total current assets.

**Excise Taxes.** Certain excise taxes levied by state or local governments are collected by Duke Energy Ohio from its customers. These taxes, which are required to be paid regardless of Duke Energy Ohio's ability to collect from the customer, are accounted for on a gross basis. When Duke Energy Ohio acts as an agent, and the tax is not required to be remitted if it is not collected from the customer, the taxes are accounted for on a net basis. Duke Energy Ohio's excise taxes accounted for on a gross basis and recorded as revenues in the accompanying Consolidated Statements of Operations were approximately \$40 million and \$39 million for the three months ended March 31, 2009 and 2008, respectively.

**15. Sales of Accounts Receivable**

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

The proceeds obtained from the sales of receivables are largely cash but do include a subordinated note from Cinergy Receivables for a portion of the purchase price (typically approximates 25% of the total proceeds). The note, which amounts to approximately \$154 million and \$174 million at March 31, 2009 and December 31, 2008, respectively, is subordinate to senior loans that Cinergy Receivables obtains from commercial paper conduits controlled by unrelated financial institutions, which is the source of funding for the subordinated note. This subordinated note is a retained interest (right to receive a specified portion of cash flows from the sold assets) under SFAS No. 140 and is classified within Receivables in the accompanying Consolidated Balance Sheets at March 31, 2009 and December 31, 2008.

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

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DUKE ENERGY OHIO, INC.

**Notes To Unaudited Consolidated Financial Statements—(Continued)**

Duke Energy Ohio and Duke Energy Kentucky retain servicing responsibilities for their role as collection agents on the amounts due on the sold receivables. However, Cnergy Receivables assumes the risk of collection on the purchased receivables without recourse to Duke Energy Ohio and Duke Energy Kentucky in the event of a loss. While no direct recourse to Duke Energy Ohio and Duke Energy Kentucky exists, these entities risk loss in the event collections are not sufficient to allow for full recovery of their retained interests. No servicing asset or liability is recorded since the servicing fee paid to Duke Energy Ohio approximates a market rate.

The carrying value of the retained interest is determined by allocating the carrying value of the receivables between the assets sold and the interests retained based on relative fair value. The key assumptions used in estimating the fair value for 2009 were an anticipated credit loss ratio of 0.7%, a discount rate of 2.8% and a receivable turnover rate of 12.5%. Because (a) the receivables generally turnover in less than two months, (b) credit losses are reasonably predictable due to Duke Energy Ohio's broad customer base and lack of significant concentration, and (c) the purchased beneficial interest is subordinate to all retained interests and thus would absorb losses first, the allocated bases of the subordinated notes are not materially different than their face value. The hypothetical effect on the fair value of the retained interests assuming both a 10% and a 20% unfavorable variation in credit losses or discount rates is not material due to the short turnover of receivables and historically low credit loss history. Interest accrues to Duke Energy Ohio and Duke Energy Kentucky on the retained interests using the accretable yield method, which generally approximates the stated rate on the notes since the allocated basis and the face value are nearly equivalent. An impairment charge is recorded against the carrying value of both the retained interests and purchased beneficial interest whenever it is determined that an other-than-temporary impairment has occurred.

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

	Three Months Ended March 31, 2009	
	(In millions)	
Receivables sold as of March 31,	\$	441
Less: Retained interests		154
Net receivables sold as of March 31,	\$	287
<b>Sales</b>		
Receivables sold	\$	958
Loss recognized on sale		8
<b>Cash flows</b>		
Cash proceeds from receivables sold	\$	970
Collection fees received		—
Return received on retained interests		5

The loss recognized on the sale of receivables is calculated monthly by multiplying the receivables sold during the month by the required discount which is derived monthly utilizing a three year weighted average formula that considers charge-off history, late charge history, and turnover history on the sold receivables, as well as a component for the time value of money. The discount rate, or component for the time value of money, is calculated monthly by summing the prior month-end LIBOR rate plus a fixed rate of 2.39%.

**16. Subsequent Events**

For information on subsequent events related to regulatory matters and commitments and contingencies, see Notes 10 and 11, respectively.



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## PART I

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.****INTRODUCTION**

Management's Discussion and Analysis should be read in conjunction with the Unaudited Consolidated Financial Statements.

Duke Energy Ohio, Inc. (Duke Energy Ohio) is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing.

**BASIS OF PRESENTATION**

The results of operations and variance discussion for Duke Energy Ohio is presented in a reduced disclosure format in accordance with General Instructions H(2) of Form 10-Q.

**DUKE ENERGY OHIO**

	Three Months Ended March 31,		
	2009	2008	Increase (Decrease)
	(In millions)		
Operating revenues	\$ 1,006	\$ 991	\$ 15
Operating expenses	843	781	62
Gains on sales of other assets and other, net	4	13	(9)
Operating income	167	223	(56)
Other income and expenses, net		9	(9)
Interest expense	35	26	9
Income before income taxes	132	206	(74)
Income tax expense	47	73	(26)
Net income	\$ 85	\$ 133	\$ (48)

**Net Income**

The \$48 million decrease in Duke Energy Ohio's Net Income was primarily due to the following factors:  
*Operating Revenues.* The increase was primarily driven by:

- A \$52 million increase in retail electric revenues resulting from higher retail pricing principally related to the implementation of the Electric Security Plan (ESP) in 2009;
- A \$27 million increase in revenues due to higher generation volumes and PJM capacity revenues from the Midwest gas-fired assets in 2009 compared to 2008; and
- A \$23 million increase in net mark-to-market revenues on non-qualifying power and capacity hedge contracts, consisting of mark-to-market gains of \$9 million in 2009 compared to losses of \$14 million in 2008.

Partially offsetting these increases were:

- A \$47 million decrease in regulated fuel revenues driven primarily by lower natural gas costs and reduced sales;
- A \$13 million decrease in retail electric revenues resulting from lower retail volumes due to the overall declining economic conditions, which are primarily impacting the industrial sector;
- A \$12 million decrease in wholesale electric revenues due to lower generation margin and hedge realization in 2009 compared to 2008;
- A \$9 million decrease related to native load due to milder weather in 2009 compared to 2008; and
- A \$9 million decrease in retail electric revenues resulting from the expiration of the Ohio electric Regulatory Transition Charge (RTC) for residential customers.

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### **PART I**

*Operating Expenses.* The increase was primarily driven by:

- A \$66 million increase in mark-to-market fuel expense on non-qualifying fuel hedge contracts, consisting of mark-to-market losses of \$8 million in 2009 compared to gains of \$58 million in 2008;
- A \$21 million increase in fuel and operating expenses for the Midwest gas-fired assets primarily due to higher generation volumes in 2009 compared to 2008;
- A \$16 million increase in plant maintenance expenses resulting from increased plant outages and maintenance in 2009 compared to 2008; and
- A \$9 million increase in operating and maintenance expenses primarily due to higher storm costs largely driven by the impact of an ice storm in January 2009.

Partially offsetting these increases were:

- A \$52 million decrease in regulated fuel expense primarily due to lower natural gas costs and reduced purchases; and
- A \$9 million decrease in regulatory asset amortization resulting from the expiration of the Ohio electric RTC for residential customers.

*Gains on Sales of Other Assets and Other, net.* The decrease in 2009 as compared to 2008 is attributable to lower gains on sales of emission allowances in 2009 compared to 2008.

*Other Income and Expenses, net.* The decrease in 2009 as compared to 2008 is primarily attributable to reduced interest income on the subordinated note from Cinergy Receivables Company, LLC, a wholly-owned subsidiary of Cinergy, to which Duke Energy Ohio sells certain of its accounts receivable, resulting from lower interest rates and a reduction in interest income accrued for uncertain income tax positions.

*Interest Expense.* The increase was primarily due to higher debt balances in the first quarter of 2009 as compared to the same period in 2008.

*Income Tax Expense.* The decrease was primarily the result of lower pre-tax income.

### **Matters Impacting Future Results**

Duke Energy Ohio evaluates the carrying amount of its recorded goodwill for impairment under the guidance of SFAS No. 142, "Goodwill and Intangible Assets." For further information on key assumptions that impact Duke Energy Ohio's goodwill impairment assessments, see Critical Accounting Policy for Goodwill Impairment in Duke Energy Ohio's Form 10-K for the year ended December 31, 2008. As of the date of the August 2008 annual impairment test, the fair value of Duke Energy Ohio's reporting units exceeded their respective carrying values, thus no goodwill impairment charges were recorded. However, management is continuing to monitor the impact of recent market and economic events to determine if it is more likely than not that the carrying values of Duke Energy Ohio's reporting units have been impaired. Should any such triggering events or circumstances occur in 2009 prior to the annual August 2009 testing date that would more likely than not reduce the fair value of a reporting unit below its carrying value, management would perform an interim detailed impairment test of Duke Energy Ohio's goodwill and it is possible that goodwill impairment charges could be recorded as a result of these tests. At March 31, 2009, Duke Energy Ohio had goodwill of approximately \$2,360 million.

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PART I

### **Item 4. Controls and Procedures.**

#### **Disclosure Controls and Procedures**

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized, and reported, within the time periods specified by the Securities and Exchange Commission's (SEC) rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2009, and, based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

#### **Changes in Internal Control over Financial Reporting**

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended March 31, 2009 and have concluded no change has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

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## PART II. OTHER INFORMATION

**Item 1. Legal Proceedings**

For information regarding legal proceedings that became reportable events or in which there were material developments in the first quarter of 2009, see Note 10 to the Consolidated Financial Statements, "Regulatory Matters" and Note 11 to the Consolidated Financial Statements, "Commitments and Contingencies."

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, careful consideration should be given to the factors discussed in Part I, "Item 1A. Risk Factors" in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2008, which could materially affect Duke Energy Ohio's financial condition or future results. Additional risks and uncertainties not currently known to Duke Energy Ohio or that Duke Energy Ohio currently deems to be immaterial also may adversely affect Duke Energy Ohio's financial condition and/or results of operations.

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### **PART II**

#### **Item 6. Exhibits**

##### **(a) Exhibits**

Exhibits filed or furnished herewith are designated by an asterisk (\*). All exhibits not so designated are incorporated by reference to a prior filing, as indicated. Items constituting management contracts or compensatory plans or arrangements are designated by a double asterisk (\*\*).

##### **Exhibit Number**

4.1**	Fortieth Supplemental Indenture, dated as of March 23, 2009 to the First Mortgage, dated as of August 1, 1936, between Duke Energy Ohio, Inc. and The Bank of New York Mellon Trust Company, N.A., as successor trustee (filed on Form 8-K of Duke Energy Ohio, March 24, 2009, File No. 1-01232, as Exhibit 4.1).
10.1**	Underwriting Agreement, dated March 18, 2009, between Duke Energy Ohio, Inc. and Barclays Capital Inc., Deutsche Bank Securities Inc., SunTrust Robinson Humphrey, Inc. and UBS Securities LLC, as representatives of the several underwriters named therein (filed on Form 8-K of Duke Energy Ohio, March 24, 2009, File No. 1-01232, as Exhibit 4.1).
*31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The total amount of securities of the registrant or its subsidiaries authorized under any instrument with respect to long-term debt not filed as an exhibit does not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. The registrant agrees, upon request of the Securities and Exchange Commission, to furnish copies of any or all of such instruments to it.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DUKE ENERGY OHIO, INC.

Date: May 13, 2009

/s/ DAVID L. HAUSER

\_\_\_\_\_  
David L. Hauser  
Group Executive and  
Chief Financial Officer

Date: May 13, 2009

/s/ STEVEN K. YOUNG

\_\_\_\_\_  
Steven K. Young  
Senior Vice President and  
Controller

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James E. Rogers, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 13, 2009

/s/ JAMES E. ROGERS  
James E. Rogers  
Chief Executive Officer

**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, David L. Hauser, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 13, 2009

\_\_\_\_\_  
/s/ DAVID L. HAUSER  
David L. Hauser  
Group Executive and  
Chief Financial Officer



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending March 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Rogers, Chief Executive Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

---

/s/ JAMES E. ROGERS  
James E. Rogers  
Chief Executive Officer  
May 13, 2009

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending March 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David L. Hauser, Group Executive and Chief Financial Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

*/s/* DAVID L. HAUSER

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David L. Hauser  
Group Executive and Chief Financial Officer  
May 13, 2009

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# **FORM 10-K**

**Duke Energy Ohio, Inc. - N/A**

**Filed: March 13, 2009 (period: December 31, 2008)**

Annual report which provides a comprehensive overview of the company for the past year

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10-K - FORM 10-K

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-K**

FOR ANNUAL AND TRANSITION REPORTS  
PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2008 or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-1232

**DUKE ENERGY OHIO, INC.**

(Exact name of registrant as specified in its charter)

Ohio  
(State or other jurisdiction of  
incorporation or organization)

31-0240030  
(I.R.S. Employer Identification No.)

139 East Fourth Street, Cincinnati, Ohio  
(Address of principal executive offices)

45202  
(Zip Code)

704-594-6200  
(Registrant's telephone number, including area code)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer   
Non-accelerated filer   
(Do not check if a smaller reporting company)

Accelerated filer   
Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes  No

The registrant meets the conditions set forth in General Instructions (I)(1)(a) and (b) of Form 10-K and is therefore filing this Form 10-K with the reduced disclosure format. Part II Items 4 and 6 and Part III Items 10, 11, 12 and 13 have been omitted in accordance with Instruction (I)(2)(a) and (c).

All of the registrant's common stock is indirectly owned by Duke Energy Corporation (File No. 1-32853), which files reports and proxy material pursuant to the Securities Exchange Act of 1934, as amended.

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**FORM 10-K FOR THE YEAR ENDED**  
**DECEMBER 31, 2008**

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**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION**

This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management's beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "plan," "project," "predict," "will," "potential," "forecast," "target," and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- State and federal legislative and regulatory initiatives, including costs of compliance with existing and future environmental requirements;
- State and federal legislative and regulatory initiatives and rulings that affect cost and investment recovery or have an impact on rate structures;
- Costs and effects of legal and administrative proceedings, settlements, investigations and claims;
- Industrial, commercial and residential growth in Duke Energy Ohio, Inc.'s (Duke Energy Ohio) service territories;
- Additional competition in electric markets and continued industry consolidation;
- The influence of weather and other natural phenomena on Duke Energy Ohio's operations, including the economic, operational and other effects of storms, hurricanes, droughts and tornados;
- The timing and extent of changes in commodity prices and interest rates;
- Unscheduled generation outages, unusual maintenance or repairs and electric transmission system constraints;
- The performance of electric generation facilities;
- The results of financing efforts, including Duke Energy Ohio's ability to obtain financing on favorable terms, which can be affected by various factors, including Duke Energy Ohio's credit ratings and general economic conditions;
- Declines in the market prices of equity securities and resultant cash funding requirements of Duke Energy Ohio for Cinergy Corp.'s defined benefit pension plans;



- The level of credit worthiness of counterparties to Duke Energy Ohio's transactions;
- Employee workforce factors, including the potential inability to attract and retain key personnel;
- Growth in opportunities for Duke Energy Ohio's business units, including the timing and success of efforts to develop domestic power and other projects; and
- The effect of accounting pronouncements issued periodically by accounting standard-setting bodies.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Duke Energy Ohio has described. Duke Energy Ohio undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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### PART I

#### Item 1. Business.

##### GENERAL

**Overview.** Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through its wholly-owned subsidiary, Duke Energy Kentucky, Inc. (Duke Energy Kentucky), in nearby areas of Kentucky, as well as electric generation in parts of Ohio, Illinois, Indiana and Pennsylvania through Duke Energy Ohio's Commercial Power business segment operations, which are discussed further below. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity, as well as the sale of and/or transportation of natural gas in northern Kentucky. Except where separately noted, references to Duke Energy Ohio herein relate to the consolidated operations of Duke Energy Ohio, including Duke Energy Kentucky.

In the second quarter of 2006, Duke Energy and Cinergy consummated a merger which combined the Duke Energy and Cinergy regulated franchises as well as *deregulated generation in the Midwestern United States (U.S.)*

**Business Segments.** At December 31, 2008, Duke Energy Ohio operated two business segments, both of which are considered reportable segments under the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 131, "*Disclosures about Segments of an Enterprise and Related Information*": Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these business segments in deciding how to allocate resources and evaluate performance. For additional information on each of these business segments, including financial information about each reportable business segment, see Note 2 to the Consolidated Financial Statements, "Business Segments."

The following is a brief description of the nature of operations of each of Duke Energy Ohio's reportable business segments, as well as Other.

**Franchised Electric and Gas.** Franchised Electric and Gas consists of Duke Energy Ohio's regulated electric and gas transmission and distribution systems, including its regulated electric generation in Kentucky. Franchised Electric and Gas plans, constructs, operates and maintains Duke Energy Ohio's transmission and distribution systems, which generate, transmit and distribute electric energy to consumers in southwestern Ohio and northern Kentucky. Franchised Electric and Gas also transports and sells natural gas in southwestern Ohio and northern Kentucky. These electric and gas operations are subject to the rules and regulations of the Federal Energy Regulatory Commission (FERC), the Public Utilities Commission of Ohio (PUCO) and the Kentucky Public Service Commission (KPSC). Substantially all of Franchised Electric and Gas' operations are regulated and, accordingly, these operations are accounted for under the provisions of SFAS No. 71, "*Accounting for the Effects of Certain Types of Regulation*" (SFAS No. 71).

Franchised Electric and Gas' service area covers about 3,000 square miles with an estimated population of 2.1 million in southern Ohio and northern Kentucky. Franchised Electric and Gas supplies electric service to approximately 820,000 residential, commercial and industrial customers over approximately 19,500 miles of distribution lines and an approximate 2,500-mile transmission system in Ohio and Kentucky. Franchised Electric and Gas provides regulated transmission and distribution services for natural gas to approximately 500,000 customers via approximately 7,100 miles of gas mains (gas distribution lines that serve as a common source of supply for more than one service line) and service lines. See Item 2. "Properties" for further discussion of Franchised Electric and Gas' generating facilities.

**Commercial Power.** Commercial Power owns, operates and manages power plants and engages in the wholesale marketing and procurement of electric power, fuel and emission allowances related to these plants, as well as other contractual positions. Commercial Power's asset portfolio comprises approximately 7,550 net megawatts (MW) and its generation assets consist of a diversified fuel mix with baseload and mid-merit coal-fired units, as well as combined cycle (CC) and peaking natural gas-fired units. Commercial Power's portfolio includes the five Midwestern gas-fired generation assets that were transferred from Duke Energy in 2006. See Item 2. "Properties" for further discussion of Commercial Power's generating facilities. Most of the generation asset output in Ohio has been contracted through the Rate Stabilization Plan (RSP), which expired on December 31, 2008. Effective January 1, 2009, Commercial Power began operating under an Electric Security Plan (ESP), which expires on December 31, 2011. As a result of the approval of the ESP, certain of Commercial Power's operations reapplied the provisions of SFAS No. 71 effective December 17, 2008. See Notes 1 and 4, "Summary of Significant Accounting Policies," and "Regulatory Matters," to the Consolidated Financial Statements, respectively, for a discussion of the reapplication of SFAS No. 71 to certain of Commercial Power's operations, as well as for further discussion related to the RSP and ESP.

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### PART I

*Other.* The remainder of Duke Energy Ohio's operations is presented as Other. While it is not considered a business segment, Other for Duke Energy Ohio includes certain allocated governance costs.

*General.* Duke Energy Ohio is an Ohio corporation. Duke Energy Ohio's principal executive offices are located at 139 East Fourth Street, Cincinnati, Ohio 45202. The telephone number is 704-594-6200. Duke Energy Ohio electronically files reports with the Securities and Exchange Commission (SEC), including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports. The public may read and copy any materials that Duke Energy Ohio files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>. Additionally, information about Duke Energy Ohio, including its reports filed with the SEC, is available through Duke Energy's web site at <http://www.duke-energy.com>. Such reports are accessible at no charge through Duke Energy's web site and are made available as soon as reasonably practicable after such material is filed with or furnished to the SEC.

### GLOSSARY OF TERMS

The following terms or acronyms used in this Form 10-K are defined below:

<u>Term or Acronym</u>	<u>Definition</u>
AAC	Annually Adjusted Component
AFUDC	Allowance for Funds Used During Construction
APB	Accounting Principles Board
CC	Combined Cycle
Cinergy	Cinergy Corp. (collectively with its subsidiaries)
CO <sub>2</sub>	Carbon dioxide
CT	Combustion Turbine
DOE	Department of Energy
DOJ	Department of Justice
Duke Energy	Duke Energy Corporation (collectively with its subsidiaries)
Duke Energy Kentucky	Duke Energy Kentucky, Inc.
Duke Energy Ohio	Duke Energy Ohio, Inc.
EITF	Emerging Issues Task Force
EPA	Environmental Protection Agency
ESP	Electric Security Plan
EWG	Exempt Wholesale Generator
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FIN	Financial Accounting Standards Board Interpretation
FPP	Fuel and Purchased Power
FSP	Financial Accounting Standards Board Staff Position
FTC	United States Federal Trade Commission
GAAP	United States Generally Accepted Accounting Principles
KPSC	Kentucky Public Service Commission
LIBOR	London Interbank Offered Rate
Midwest ISO	Midwest Independent Transmission System Operator
MMBtu	Million British thermal units
MW	Megawatt

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<u>Term or Acronym</u>	<u>Definition</u>
NOx	Nitrogen oxide
OCC	Office of the Ohio Consumers' Counsel
PUCO	Public Utilities Commission of Ohio
RSP	Rate Stabilization Plan
RTC	Regulatory Transition Charges
SAB	Securities and Exchange Commission Staff Accounting Bulletin
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
SO <sub>2</sub>	Sulfur dioxide

#### ENVIRONMENTAL MATTERS

Duke Energy Ohio is subject to federal, state and local laws and regulations with regard to air and water quality, hazardous and solid waste disposal and other environmental matters. Environmental laws and regulations affecting Duke Energy Ohio include, but are not limited to:

- The Clean Air Act, as well as state laws and regulations impacting air emissions, including State Implementation Plans related to existing and new national ambient air quality standards for ozone and particulate matter. Owners and/or operators of air emission sources are responsible for obtaining permits and for annual compliance and reporting.
- The Clean Water Act which requires permits for facilities that discharge wastewaters into the environment.
- The Comprehensive Environmental Response, Compensation and Liability Act, which can require any individual or entity that currently owns or in the past may have owned or operated a disposal site, as well as transporters or generators of hazardous substances sent to a disposal site, to share in remediation costs.
- The Solid Waste Disposal Act, as amended by the Resource Conservation and Recovery Act, which requires certain solid wastes, including hazardous wastes, to be managed pursuant to a comprehensive regulatory regime.
- The National Environmental Policy Act, which requires federal agencies to consider potential environmental impacts in their decisions, including siting approvals.

(For more information on environmental matters involving Duke Energy Ohio, including possible liability and capital costs, see Notes 4 and 18 to the Consolidated Financial Statements, "Regulatory Matters," and "Commitments and Contingencies," respectively.)

Except to the extent discussed in Note 4 to the Consolidated Financial Statements, "Regulatory Matters," and Note 18 to the Consolidated Financial Statements, "Commitments and Contingencies," compliance with current federal, state and local provisions regulating the discharge of materials into the environment, or otherwise protecting the environment, is incorporated into the routine cost structure of our various business segments and is not expected to have a material adverse effect on the competitive position, consolidated results of operations, cash flows or financial position of Duke Energy Ohio.

#### Item 1A. Risk Factors.

The risk factors discussed herein relate specifically to risks associated with Duke Energy Ohio.

***Duke Energy Ohio's electric revenues, earnings and results are dependent on federal and state legislation and regulation that affect electric generation, transmission, distribution and related activities, which may limit Duke Energy Ohio's ability to recover costs.***

Duke Energy Ohio's franchised electric businesses are regulated on a cost-of-service/rate-of-return basis subject to the statutes and regulatory commission rules and procedures of Ohio and Kentucky. If Duke Energy Ohio's franchised electric earnings exceed the returns established by the state regulatory commissions, Duke Energy Ohio's retail electric rates may be subject to review by the commissions and possible reduction, which may decrease Duke Energy Ohio's future earnings. Additionally, if regulatory bodies do not allow recovery of costs incurred in providing service on a timely basis, Duke Energy Ohio's future earnings could be negatively impacted. Additionally, certain portions of Duke Energy Ohio's Commercial Power operations are regulated on a partial cost-of-service/rate-of-return basis under the ESP.

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#### ***Duke Energy Ohio's business is subject to extensive regulation that will affect Duke Energy Ohio's operations and costs.***

Duke Energy Ohio is subject to regulation by FERC and by federal, state and local authorities under environmental laws and by state public utility commissions under laws regulating Duke Energy Ohio's businesses. Regulation affects almost every aspect of Duke Energy Ohio's businesses, including, among other things, Duke Energy Ohio's ability to: take fundamental business management actions; determine the terms and rates of Duke Energy Ohio's transmission and distribution businesses' services as well as its regulated generation business; make acquisitions; issue debt securities; engage in transactions between Duke Energy Ohio's utilities and other subsidiaries and affiliates; and pay dividends to its ultimate parent, Duke Energy. Changes to these regulations are ongoing, and Duke Energy Ohio cannot predict the future course of changes in this regulatory environment or the ultimate effect that this changing regulatory environment will have on Duke Energy Ohio's businesses. However, changes in regulation (including re-regulating previously deregulated markets) can cause delays in or affect business planning and transactions and can substantially increase Duke Energy Ohio's costs.

#### ***New laws or regulations could have a negative impact on Duke Energy Ohio's results of operations, cash flows or financial position.***

Changes in laws and regulations affecting Duke Energy Ohio, including new accounting standards could change the way Duke Energy Ohio is required to record revenues, expenses, assets and liabilities. These types of regulations could have a negative impact on Duke Energy Ohio's results of operations, cash flows or financial position or access to capital.

#### ***Deregulation or restructuring in the electric industry may result in increased competition and unrecovered costs that could adversely affect Duke Energy Ohio's consolidated results of operations, cash flows or financial position and its utilities' businesses.***

Increased competition resulting from deregulation or restructuring efforts could have a significant adverse financial impact on Duke Energy Ohio and consequently on its consolidated results of operations, cash flows or financial position. Increased competition could also result in increased pressure to lower costs, including the cost of electricity. Duke Energy Ohio cannot predict the extent and timing of entry by additional competitors into the electric markets. Duke Energy Ohio cannot predict when it will be subject to changes in legislation or regulation, nor can it predict the impact of these changes on its consolidated results of operations, cash flows or financial position.

#### ***Duke Energy Ohio may be unable to secure long-term power sales agreements or transmission agreements, which could expose Duke Energy Ohio's sales to increased volatility.***

In the future, Duke Energy Ohio may not be able to secure long-term power sales agreements for Duke Energy Ohio's unregulated power generation facilities. If Duke Energy Ohio is unable to secure these types of agreements, Duke Energy Ohio's sales volumes would be exposed to increased volatility. Without the benefit of long-term customer power purchase agreements, Duke Energy Ohio cannot assure that it will be able to operate profitably. The inability to secure these agreements could materially adversely affect Duke Energy Ohio's results and business.

#### ***Competition in the unregulated markets in which Duke Energy Ohio operates may adversely affect the growth and profitability of Duke Energy Ohio's business.***

Duke Energy Ohio may not be able to respond in a timely or effective manner to the many changes designed to increase competition in the electricity industry. To the extent competitive pressures increase, the economics of Duke Energy Ohio's business may come under long-term pressure.

Duke Energy Ohio may also face competition from new competitors that have greater financial resources than Duke Energy Ohio does, seeking attractive opportunities to acquire or develop energy assets or energy trading operations both in the United States and abroad. These new competitors may include sophisticated financial institutions, some of which are already entering the energy trading and marketing sector, and international energy players, which may enter regulated or unregulated energy businesses. This competition in generation assets in non-regulated competitive markets may adversely affect Duke Energy Ohio's ability to make investments or acquisitions.

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***Duke Energy Ohio must meet credit quality standards and there is no assurance that Duke Energy Ohio will maintain investment grade credit ratings. If Duke Energy Ohio or its rated subsidiary is unable to maintain an investment grade credit rating, it would be required under credit agreements to provide collateral in the form of letters of credit or cash, which may materially adversely affect its liquidity.***

Both Duke Energy Ohio's and its rated subsidiary's senior unsecured long-term debt is rated investment grade by various rating agencies. Duke Energy Ohio cannot be sure that its or its rated subsidiary's senior unsecured long-term debt will continue to be rated investment grade.

If the rating agencies were to rate Duke Energy Ohio or its rated subsidiary below investment grade, Duke Energy Ohio's borrowing costs would increase, perhaps significantly. In addition, Duke Energy Ohio would likely be required to pay a higher interest rate in future financings, and its potential pool of investors and funding sources would likely decrease. Any downgrade or other event negatively affecting the credit ratings of Duke Energy Ohio or its rated subsidiary could also increase Cinergy's or Duke Energy's need to provide liquidity in the form of capital contributions or loans, thus reducing the liquidity and borrowing availability of the consolidated group.

A downgrade below investment grade could also trigger termination clauses in some interest rate and foreign exchange derivative agreements, which would require cash payments. All of these events would likely reduce Duke Energy Ohio's liquidity and profitability and could have a material adverse effect on its consolidated results of operations, cash flows or financial position.

***Duke Energy Ohio relies on access to short-term intercompany borrowings and longer-term capital markets to finance its capital requirements and support its liquidity needs, and Duke Energy Ohio's access to those markets can be adversely affected by a number of conditions, many of which are beyond its control.***

Duke Energy Ohio's business is financed to a large degree through debt and the maturity and repayment profile of debt used to finance investments often does not correlate to cash flows from its assets. Accordingly, Duke Energy Ohio relies on access to short-term borrowings via Duke Energy's money pool arrangement and financings from longer-term capital markets as a source of liquidity for capital requirements not satisfied by the cash flow from its operations and to fund investments originally financed through debt instruments with disparate maturities. If Duke Energy Ohio is not able to access capital at competitive rates or Duke Energy Ohio cannot obtain short-term borrowings via the money pool arrangement, its ability to finance its operations and implement its strategy could be adversely affected.

Market disruptions may increase Duke Energy Ohio's cost of borrowing or adversely affect its ability to access one or more financial markets. Such disruptions could include: economic downturns; the bankruptcy of an unrelated energy company; capital market conditions generally; market prices for electricity and gas; terrorist attacks or threatened attacks on Duke Energy Ohio's facilities or unrelated energy companies; or the overall health of the energy industry. Restrictions on Duke Energy Ohio's ability to access financial markets may also affect its ability to execute its business plan as scheduled. An inability to access capital may limit Duke Energy Ohio's ability to pursue improvements or acquisitions that it may otherwise rely on for future growth.

Duke Energy Ohio's ultimate parent, Duke Energy, maintains revolving credit facilities to provide back-up for commercial paper programs and/or letters of credit at various entities. These facilities typically include financial covenants which limit the amount of debt that can be outstanding as a percentage of the total capital for the specific entity. Failure to maintain these covenants at a particular entity could preclude that entity from issuing commercial paper or letters of credit or borrowing under the revolving credit facility and could require other of Duke Energy Ohio's affiliates to immediately pay down any outstanding drawn amounts under other revolving credit agreements.

***Current levels of market volatility are unprecedented.***

The capital and credit markets have been experiencing extreme volatility and disruption. In recent months, the volatility and disruption have reached unprecedented levels. In some cases, the markets have exerted downward pressure on credit capacity for certain issuers. If current levels of market disruption and volatility continue or worsen, Duke Energy Ohio may be forced to meet its other liquidity needs by further drawing upon contractually committed lending agreements primarily provided by global banks, although there is no assurance that the commitments made by lenders under Duke Energy's master credit facility will be available if needed due to the recent turmoil throughout the financial services industry. This could require Duke Energy Ohio to seek other funding sources. However, under such extreme market conditions, there can be no assurance other funding sources would be available or sufficient.

***Duke Energy Ohio is exposed to credit risk of customers and counterparties with whom it does business.***

Adverse economic conditions affecting, or financial difficulties of customers and counterparties with whom Duke Energy Ohio does business could impair the ability of these customers and counterparties to pay for Duke Energy Ohio's services or fulfill their contractual

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obligations, including loss recovery payments under insurance contracts or cause them to delay such payments or obligations. Duke Energy Ohio depends on these customers and counterparties to remit payments on a timely basis. Any delay or default in payment could adversely affect Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

***Poor investment performance of Cinergy's pension plan holdings and other factors impacting pension plan costs could unfavorably impact Duke Energy Ohio's liquidity and results of operations.***

Duke Energy Ohio participates in certain employee benefit plans sponsored by its parent, Cinergy. Duke Energy Ohio is allocated costs and obligations related to these plans. Cinergy's costs of providing non-contributory defined benefit pension plans are dependent upon a number of factors, such as the rates of return on plan assets, discount rates, the level of interest rates used to measure the required minimum funding levels of the plans, future government regulation and required or voluntary contributions made to the plans. While Cinergy has complied with the minimum funding requirements as of December 31, 2008, Cinergy's qualified pension plans had obligations which exceeded the value of plan assets by approximately \$882 million. Without sustained growth in the pension investments over time to increase the value of plan assets and depending upon the other factors impacting Cinergy's costs as listed above, Duke Energy Ohio could be required to fund its parent's plans with significant amounts of cash. Such cash funding obligations could have a material impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

***Duke Energy Ohio is subject to numerous environmental laws and regulations that require significant capital expenditures, can increase its cost of operations, and which may impact or limit its business plans, or expose it to environmental liabilities.***

Duke Energy Ohio is subject to numerous environmental laws and regulations affecting many aspects of its present and future operations, including air emissions (such as reducing nitrogen oxide, sulfur dioxide and mercury emissions or potential future control of greenhouse gas emissions), water quality, wastewater discharges, solid waste and hazardous waste. These laws and regulations can result in increased capital, operating and other costs. These laws and regulations generally require Duke Energy Ohio to obtain and comply with a wide variety of environmental licenses, permits, inspections and other approvals. Compliance with environmental laws and regulations can require significant expenditures, including expenditures for clean up costs and damages arising out of contaminated properties, and failure to comply with environmental regulations may result in the imposition of fines, penalties and injunctive measures affecting operating assets. The steps Duke Energy Ohio takes to ensure that its facilities are in compliance could be prohibitively expensive. As a result, Duke Energy Ohio may be required to shut down or alter the operation of its facilities, which may cause it to incur losses. Further, Duke Energy Ohio's regulatory rate structure and its contracts with customers may not necessarily allow it to recover capital costs Duke Energy Ohio incurs to comply with new environmental regulations. Also, Duke Energy Ohio may not be able to obtain or maintain from time to time all required environmental regulatory approvals for its operating assets or development projects. If there is a delay in obtaining any required environmental regulatory approvals, if Duke Energy Ohio fails to obtain and comply with them or if environmental laws or regulations change and become more stringent, then the operation of Duke Energy Ohio's facilities or the development of new facilities could be prevented, delayed or become subject to additional costs. Although it is not expected that the costs of complying with current environmental regulations will have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position, no assurance can be made that the costs of complying with environmental regulations in the future will not have such an effect.

There is growing consensus that some form of regulation will be forthcoming at the federal level with respect to greenhouse gas emissions, including carbon dioxide (CO<sub>2</sub>), and such regulation could result in the creation of substantial compliance costs.

In addition, Duke Energy Ohio is generally responsible for on-site liabilities, and in some cases off-site liabilities, associated with the environmental condition of Duke Energy Ohio's power generation facilities and natural gas assets which it has acquired or developed, regardless of when the liabilities arose and whether they are known or unknown. In connection with some acquisitions and sales of assets, Duke Energy Ohio may obtain, or be required to provide, indemnification against some environmental liabilities. If Duke Energy Ohio incurs a material liability, or the other party to a transaction fails to meet its indemnification obligations to Duke Energy Ohio, Duke Energy Ohio could suffer material losses.

***Duke Energy Ohio is involved in numerous legal proceedings, the outcomes of which are uncertain, and resolution adverse to Duke Energy Ohio could negatively affect its consolidated results of operations, cash flows or financial position.***

Duke Energy Ohio is subject to numerous legal proceedings. Litigation is subject to many uncertainties and Duke Energy Ohio cannot predict the outcome of individual matters with assurance. It is reasonably possible that the final resolution of some of the matters in which Duke Energy Ohio is involved could require it to make additional expenditures, in excess of established reserves, over an extended period.

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of time and in a range of amounts that could have a material effect on its consolidated results of operations and cash flows. Similarly, it is reasonably possible that the terms of resolution could require Duke Energy Ohio to change its business practices and procedures, which could also have a material effect on its consolidated results of operations, cash flows or financial position.

*Duke Energy Ohio's consolidated results of operations may be negatively affected by sustained downturns or sluggishness in the economy, including low levels in the market prices of commodities, all of which are beyond Duke Energy Ohio's control.*

Sustained downturns or sluggishness in the economy generally affect the markets in which Duke Energy Ohio operates and negatively influence its operations. Declines in demand for electricity as a result of economic downturns in Duke Energy Ohio's franchised electric service territories will reduce overall electricity sales and lessen Duke Energy Ohio's cash flows, especially as its industrial customers reduce production and, therefore, consumption of electricity and gas. Although Duke Energy Ohio's franchised electric business is subject to regulated allowable rates of return and recovery of fuel costs under a fuel adjustment clause, overall declines in electricity sold as a result of economic downturn or recession could reduce revenues and cash flows, thus diminishing results of operations. Additionally, prolonged economic downturns that negatively impact Duke Energy Ohio's result of operations and cash flows could result in future material impairment charges being recorded to write down the carrying value of certain assets, including goodwill, to their respective fair values.

Duke Energy Ohio also sells electricity into the spot market or other competitive power markets on a contractual basis. With respect to such transactions, Duke Energy Ohio is not guaranteed any rate of return on Duke Energy Ohio's capital investments through mandated rates, and Duke Energy Ohio's revenues and results of operations are likely to depend, in large part, upon prevailing market prices in Duke Energy Ohio's regional markets and other competitive markets. These market prices may fluctuate substantially over relatively short periods of time and could reduce Duke Energy Ohio's revenues and margins and thereby diminish its consolidated results of operations.

Factors that could impact sales volumes, generation of electricity and market prices at which Duke Energy Ohio is able to sell electricity are as follows:

- weather conditions, including abnormally mild winter or summer weather that cause lower energy usage for heating or cooling purposes, respectively, and periods of low rainfall that decrease Duke Energy Ohio's ability to operate its facilities in an economic manner;
- supply of and demand for energy commodities;
- illiquid markets including reductions in trading volumes which result in lower revenues and earnings;
- general economic conditions, including downturns in the U.S. or other economies which impact energy consumption particularly in which sales to industrial or large commercial customers comprise a significant portion of total sales;
- transmission or transportation constraints or inefficiencies which impact Duke Energy Ohio's non-regulated energy operations;
- availability of competitively priced alternative energy sources, which are preferred by some customers over electricity produced from coal, or gas plants, and of energy-efficient equipment which reduces energy demand;
- natural gas prices;
- ability to procure satisfactory levels of fuel supplies and inventory, such as coal and natural gas;
- electric generation capacity surpluses which cause Duke Energy Ohio's non-regulated energy plants to generate and sell less electricity at lower prices and may cause some plants to become non-economical to operate;
- capacity and transmission service into, or out of, Duke Energy Ohio's markets;
- natural disasters, acts of terrorism, wars, embargoes and other catastrophic events to the extent they affect Duke Energy Ohio's operations and markets, as well as the cost and availability of insurance covering such risks; and
- federal, and state energy and environmental regulation and legislation.

*Duke Energy Ohio's operating results may fluctuate on a seasonal and quarterly basis.*

Electric power generation is generally a seasonal business. In most parts of the United States and in markets in which Duke Energy Ohio operates, demand for electricity peaks during the warmer summer months and demand for natural gas peaks during the cold winter months, with market prices also peaking during the warmer summer months for electricity and cold winter months for natural gas. Further, extreme weather conditions such as heat waves or winter storms could cause these seasonal fluctuations to be more pronounced. As a result, in the future, the overall operating results of Duke Energy Ohio's businesses may fluctuate substantially on a seasonal and quarterly basis and thus make period comparison less relevant.



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#### ***Potential terrorist activities or military or other actions could adversely affect Duke Energy Ohio's business.***

The continued threat of terrorism and the impact of retaliatory military and other action by the United States and its allies may lead to increased political, economic and financial market instability and volatility in prices for natural gas and oil which may materially adversely affect Duke Energy Ohio in ways it cannot predict at this time. In addition, future acts of terrorism and any possible reprisals as a consequence of action by the United States and its allies could be directed against companies operating in the United States. Infrastructure and generation facilities could be potential targets of terrorist activities. The potential for terrorism has subjected Duke Energy Ohio's operations to increased risks and could have a material adverse effect on Duke Energy Ohio's business. In particular, Duke Energy Ohio may experience increased capital and operating costs to implement increased security for its plants, such as additional physical plant security, additional security personnel or additional capability following a terrorist incident.

The insurance industry has also been disrupted by these events. As a result, the availability of insurance covering risks that Duke Energy Ohio and its competitors typically insure against may decrease. In addition, the insurance Duke Energy Ohio is able to obtain may have higher deductibles, higher premiums and more restrictive policy terms.

Additional risks and uncertainties not currently known to Duke Energy Ohio or that Duke Energy Ohio currently deems to be insignificant also may adversely affect Duke Energy Ohio's consolidated results of operations, cash flows or financial condition.

#### **Item 1B. Unresolved Staff Comments.**

None.

#### **Item 2. Properties.**

##### **FRANCHISED ELECTRIC AND GAS**

As of December 31, 2008, Franchised Electric and Gas operated two coal-fired stations with a combined net capacity of 577 MW and one combustion turbine (CT) station with a net capacity of 501 MW. Franchised Electric and Gas also owns two underground caverns with a total storage capacity of approximately 16 million gallons of liquid propane. The stations and caverns are located in Ohio and Kentucky.

In addition, as of December 31, 2008, Duke Energy Ohio owned approximately 2,500 conductor miles of electric transmission lines, including 1,000 miles of 345 kilovolts, 700 miles of 100 to 161 kilovolts, and 800 miles of 13 to 69 kilovolts. Duke Energy Ohio also owned approximately 19,500 conductor miles of electric distribution lines, including 14,000 miles of overhead lines and 5,500 miles of underground lines, as of December 31, 2008 and approximately 7,100 miles of gas mains and service lines. As of December 31, 2008, the electric transmission and distribution systems had approximately 280 substations. In addition, Duke Energy Ohio has access to 5.5 million gallons of liquid propane storage and product loaned through a commercial services agreement with a third party. This liquid propane is used in the three propane/air peak shaving plants located in Ohio and Kentucky. Propane/air peak shaving plants vaporize the propane and mix with natural gas to supplement the natural gas supply during peak demand periods and emergencies.

Substantially all of Franchised Electric and Gas' electric plant in service is mortgaged under the mortgage bond indenture of Duke Energy Ohio.

##### **COMMERCIAL POWER**

As of December 31, 2008, Commercial Power jointly owns six coal-fired stations with a combined net capacity of 3,529 MW, of which Duke Energy Ohio operates three. Commercial Power also owns and operates five CT stations, one of which is jointly owned, with a combined net capacity of 1,544 MW and three CC stations with a combined net capacity of 2,480 MW. The stations are located in Ohio, Illinois, Indiana and Pennsylvania.

#### **Item 3. Legal Proceedings.**

For information regarding legal proceedings, including regulatory and environmental matters, see Note 4 to the Consolidated Financial Statements, "Regulatory Matters" and Note 18 to the Consolidated Financial Statements, "Commitments and Contingencies—Litigation" and "Commitments and Contingencies—Environmental."

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**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Cinergy owns all of the common stock of Duke Energy Ohio. Duke Energy owns all of the common stock of Cinergy. Duke Energy Ohio anticipates making periodic dividends to provide funding support for Duke Energy's dividend. During the years ended December 31, 2008, 2007 and 2006, Duke Energy Ohio paid dividends to its parent, Cinergy, of \$200 million, \$135 million and \$102 million, respectively.

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**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.****INTRODUCTION**

Management's Discussion and Analysis should be read in conjunction with the accompanying Consolidated Financial Statements and Notes for the years ended December 31, 2008, 2007 and 2006.

**BASIS OF PRESENTATION**

The results of operations and variance discussion for Duke Energy Ohio is presented in a reduced disclosure format in accordance with General Instruction (I)(2)(a) of Form 10-K.

**RESULTS OF OPERATIONS****Results of Operations and Variances****Summary of Results (in millions)**

	Years Ended December 31,		
	2008	2007	Increase (Decrease)
Operating revenues	\$ 3,424	\$ 3,455	\$ (31)
Operating expenses	2,965	2,964	1
Gains (losses) on sales of other assets and other, net	59	(8)	67
Operating income	518	483	35
Other income and expenses, net	34	32	2
Interest expense	94	100	(6)
Income before income taxes	458	415	43
Income tax expense	171	151	20
Income before extraordinary items	287	264	23
Extraordinary items, net of tax	67	—	67
Net income	\$ 354	\$ 264	\$ 90

**Net Income**

The \$90 million increase in Duke Energy Ohio's net income was primarily due to the following factors:  
*Operating Revenues.* The decrease was due primarily to:

- A \$38 million decrease from coal sales due to the expiration of contracts,
- A \$30 million decrease in retail electric revenues resulting from lower retail volumes due to the weakening economy,
- A \$21 million decrease in wholesale electric revenues due to lower hedge realization and lower generation volumes primarily resulting from increased plant outages in 2008 compared to 2007,
- A \$21 million decrease in net mark-to-market revenues on non-qualifying hedge accounting power and capacity contracts, consisting of \$74 million of net mark-to-market losses in 2008, as compared to net mark-to-market losses of \$53 million in 2007,
- A \$17 million decrease in revenues due to lower generation volumes from the Midwest gas-fired assets resulting from milder weather net of increased PJM capacity revenues in 2008 compared to 2007, and
- An \$11 million decrease related to native load due to milder weather in 2008 compared to 2007.

Partially offsetting these decreases were:

- A \$45 million increase in regulated fuel revenues driven primarily by higher natural gas costs,
- A \$21 million increase in retail electric revenues resulting from higher retail pricing primarily related to environmental and capacity riders that were approved in the fourth quarter of 2007 by the PUCO and increased amortization of purchase accounting valuation liability of the Rate Stabilization Plan (RSP) in 2008 compared to 2007,

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- A \$19 million increase due to implementation of new gas rates in Ohio,
- A \$9 million increase related to the Ohio electric Demand Side Management (DSM) rider implemented in the third quarter of 2007, and
- A \$9 million increase in Ohio electric base transmission due to a change in the Transmission Cost Recovery rider.

*Operating Expenses.* The increase was due primarily to:

- An \$82 million impairment of emission allowances due to the invalidation of the Clean Air Interstate Rule (CAIR) in July 2008,
- A \$69 million increase in fuel expense due to mark-to-market losses on non-qualifying fuel hedge contracts, consisting of mark-to-market losses of \$3 million in 2008, as compared to gains of \$66 million in 2007,
- A \$40 million increase in regulated fuel expense primarily due to higher natural gas costs, and
- A \$16 million increase in regulatory amortization of the Ohio and Kentucky DSM costs and Ohio regulatory transition charge.

Partially offsetting these increases were:

- A \$63 million decrease in emission allowance expenses due to lower cost basis emission allowances consumed and lower overall emission allowance consumption due to installation of flue gas desulfurization equipment and lower generation volumes due to increased plant outages in 2008 compared to 2007,
- A \$46 million decrease in net fuel and purchased power expense for retail load due to realized gains on fuel hedges, partially offset by higher purchased power as a result of increased plant outages in 2008 compared to 2007,
- A \$31 million decrease in expenses associated with coal sales due to the expiration of contracts,
- A \$24 million decrease in fuel and operating expenses for the Midwest gas-fired assets primarily due to lower generation volumes and lower amortization of locked-in hedge losses in 2008 compared to 2007, net of an approximate \$15 million bad debt reserve related to the Lehman Bros. bankruptcy and higher plant maintenance expenses,
- A \$21 million decrease in other post-employment benefits due to an adjustment to the liability recorded for these benefits, and
- An \$18 million decrease in short-term incentive costs.

*Gains (Losses) on Sales of Other Assets and Other, net.* The increase in 2008 as compared to 2007 was attributable to gains on sales of emission allowances in 2008 compared to losses on sales of emission allowances in 2007. Gains in 2008 were a result of sales of zero cost basis emission allowances, while losses in 2007 were as a result of sales of emission allowances acquired in connection with Duke Energy's merger with Cinergy in 2006 which were written up to fair value as part of purchase accounting.

*Income Tax Expense.* The increase was primarily the result of higher pre-tax income.

*Extraordinary Items, net of tax.* The reapplication of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71), on December 17, 2008 resulted in an approximate \$67 million after-tax (approximately \$103 million pre-tax) extraordinary gain related to total mark-to-market losses previously recorded in earnings associated with open forward native load economic hedge contracts for fuel, purchased power and emission allowances, which the Electric Security Plan (ESP) allows to be recovered through a fuel and purchased power rider. See further discussion under the "Matters Impacting Future Results" below.

#### **Matters Impacting Future Results**

Sales, especially in the industrial sector, were impacted by the economic downturn in 2008. Duke Energy Ohio expects this trend to continue for some period into 2009, and perhaps beyond, until the economy begins to recover. Duke Energy Ohio's current strategy is focused on maximizing the returns and cash flows from its current portfolio. Results for Duke Energy Ohio are sensitive to changes in power supply, power demand and weather.

On December 17, 2008, the PUCO approved Duke Energy Ohio's ESP price structure, which establishes generation rates for 2009 through 2011. The base cost for generation service will increase by approximately 2 percent annually in 2009 and 2010 for residential customers, and each year from 2009 through 2011 for non-residential customers. Additionally, the ESP provides for a new Infrastructure Modernization rider to maintain distribution system reliability and to purchase and deploy SmartGrid technology. As discussed further below, the approval of the ESP also resulted in the reapplication of SFAS No. 71 to portions of generation within Duke Energy Ohio's Commercial Power business segment. As a result of the reapplication of SFAS No. 71 to certain portions of Duke Energy Ohio's operations, Duke Energy Ohio's future results will be subject to less volatility than had been caused by the timing of under-and-over collections of certain costs, as well as the impacts of mark-to-market activity on certain coal and power derivatives.

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The outcome of the pending Duke Energy Ohio electric distribution rate case could impact future results through the increase of base rates.

Duke Energy Ohio's generation operations within its Commercial Power business segment include generation assets located in Ohio that are dedicated to serve Ohio native load customers. These assets, as excess capacity allows, also generate revenues through sales outside the native load customer base, and such revenue is termed non-native.

Prior to December 17, 2008, Duke Energy Ohio's Commercial Power business segment did not apply the provisions of SFAS No. 71 due to the comprehensive electric deregulation legislation passed by the state of Ohio in 1999. As described further below, effective December 17, 2008, the Public Utilities Commission of Ohio (PUCO) approved Duke Energy Ohio's ESP, which resulted in the reapplication of SFAS No. 71 to certain portions of Commercial Power's operations as of that date.

From January 1, 2005 through December 31, 2008, Duke Energy Ohio, including its Commercial Power business segment, had been operating under a RSP, which was a market-based standard service offer. Although the RSP contained certain trackers that enhanced the potential for cost recovery, there was no assurance of stranded cost recovery upon the expiration of the RSP on December 31, 2008 since it was initially anticipated that, upon the expiration of the RSP, there would be a move to full competitive markets. Accordingly, Duke Energy Ohio's Commercial Power business segment did not apply the provisions of SFAS No. 71 to any of its generation operations prior to December 17, 2008. As discussed further in Note 4 to the Consolidated Financial Statements, "Regulatory Matters," in April 2008, new legislation (SB 221) was passed in Ohio and signed by the Governor of Ohio on May 1, 2008. The new law codified the PUCO's authority to approve an electric utility's standard service offer either through an ESP or a Market Rate Option (MRO). The MRO is a price determined through a competitive bidding process. On July 31, 2008, Duke Energy Ohio filed an ESP, and with certain amendments, the ESP was approved by the PUCO on December 17, 2008. The ESP became effective on January 1, 2009.

In connection with the approval of the ESP, Duke Energy Ohio reassessed the applicability of SFAS No. 71 to Commercial Power's generation operations as SB 221 substantially increased the PUCO's oversight authority over generation in the state of Ohio, including giving the PUCO complete approval of generation rates and the establishment of an earnings test to determine if a utility has earned significantly excessive earnings. Duke Energy Ohio determined that certain costs and related rates (riders) of Commercial Power's operations related to generation serving native load meet the criteria established by SFAS No. 71 for regulatory accounting treatment as SB 221 and Duke Energy Ohio's approved ESP solidified the automatic recovery of certain costs of its generation serving native load within its Commercial Power business segment and increased the likelihood that Commercial Power's operations will remain under a cost recovery model for certain costs for the foreseeable future.

Under the ESP, Duke Energy Ohio will bill for its native load generation via numerous riders. SB 221 and the ESP resulted in the approval of the automatic recovery of certain of these riders, which includes, but is not limited to, a fuel and purchased power (FPP) rider and certain portions of a cost of environmental compliance (AAC) rider. Accordingly, Duke Energy Ohio's Commercial Power business segment began applying SFAS No. 71 to the corresponding RSP riders granting automatic recovery under the ESP on December 17, 2008. The remaining portions of Commercial Power's native load generation operations, revenues from which are reflected in rate riders for which the ESP does not specifically allow automatic cost recovery, as well as all generation operations associated with non-native customers, including Commercial Power's Midwest gas-fired generation assets, continue to not apply regulatory accounting as those operations do not meet the criteria of SFAS No. 71. Moreover, generation remains a competitive market in Ohio and native load customers continue to have the ability to switch to alternative suppliers for their electric generation service. As customers switch, there is a risk that some or all of the regulatory assets will not be recovered through the established riders. Duke Energy Ohio will continue to monitor the amount of native load customers that have switched to alternative suppliers when assessing the recoverability of its regulatory assets established for its native load generation operations within its Commercial Power business segment.

Duke Energy Ohio evaluates the carrying amount of its recorded goodwill for impairment under the guidance of SFAS No. 142, "Goodwill and Intangible Assets." As of the date of the 2008 annual impairment analysis, the estimated fair value of Duke Energy Ohio's reporting units exceeded their respective carrying value, thus no goodwill impairment charges were recorded. However, management is continuing to monitor the impact of recent market and economic events to determine if it is more likely than not that the carrying value of any of Duke Energy Ohio's reporting units have been impaired. Should any such triggering events or circumstances occur in 2009 that would more likely than not reduce the fair value of a reporting unit below its carrying value, management would perform an impairment assessment of Duke Energy Ohio's goodwill and it is possible that goodwill impairment charges could be recorded as a result of any such assessments. At December 31, 2008, Duke Energy Ohio had total goodwill of approximately \$2,360 million.

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### PART II

#### Other Matters

*General.* Duke Energy Ohio's fixed charges coverage ratio, as calculated using SEC guidelines, was 4.6 times for the year ended December 31, 2008, 3.8 times for the year ended December 31, 2007, 1.9 times for the nine months ended December 31, 2006 and 6.2 times for the three months ended March 31, 2006.

As of December 31, 2008, Duke Energy Ohio had approximately \$390 million of auction rate pollution control bonds outstanding. While these debt instruments are long-term in nature and cannot be put back to Duke Energy Ohio prior to maturity, the interest rates on these instruments are designed to reset periodically through an auction process. In February 2008, Duke Energy Ohio began to experience failed auctions on these debt instruments. When failed auctions occur on a series of this debt, Duke Energy Ohio is required to pay the maximum auction rate as prescribed by the bond document. The maximum auction rate for the auction rate debt is 2.0 times one-month London Interbank Offered Rate. Payment of the failed-auction interest rates will continue until Duke Energy Ohio is able to either successfully remarket these instruments through the auction process or refund and refinance the existing debt through the issuance of an equivalent amount of tax exempt bonds. While Duke Energy Ohio intends to refund and refinance these tax exempt auction rate bonds, the timing of such refinancing transactions is uncertain and subject to market conditions. However, even if Duke Energy Ohio is unable to successfully refund and refinance these debt instruments, the impact of paying higher interest rates on the outstanding auction rate debt is not expected to materially affect Duke Energy Ohio's consolidated results of operations, cash flows or financial position. The weighted-average interest rate, associated with Duke Energy Ohio's auction rate pollution control bonds, was 1.58% as of December 31, 2008 and 4.56% as of December 31, 2007.

*Global Climate Change.* A body of scientific evidence now accepted by a growing majority of the public and policymakers suggests that the Earth's climate is changing, caused in part by greenhouse gases emitted into the atmosphere from human activities. Although there is still much to learn about the causes and long-term effects of climate change, many, including Duke Energy Ohio, advocate taking steps now to begin reducing emissions with the aim of stabilizing the atmospheric concentration of greenhouse gases at a level that avoids the potentially worst-case effects of climate change.

Greenhouse gas (GHG) emissions are produced from a wide variety of human activities. The U.S. EPA publishes an inventory of these emissions annually. Carbon dioxide (CO<sub>2</sub>), an essential trace gas, is a by product of fossil fuel combustion and currently accounts for about 85% of U.S. greenhouse gas emissions. Duke Energy Ohio currently accounts for about 0.30% of total U.S. CO<sub>2</sub> emissions, and about 0.26% of total U.S. GHG emissions.

Duke Energy Ohio's long-term strategies for how best to meet its customers' growing demand for electricity are impacted by the issues surrounding global warming. These strategies include significant commitments to customer energy efficiency and renewable energy. Each of these actions will or has the potential to reduce Duke Energy Ohio's CO<sub>2</sub> emissions and therefore its exposure to the costs of future GHG regulation.

Duke Energy Ohio's cost of complying with any federal GHG emissions law that may be enacted will depend on the design details of the program. If potential future GHG legislation adopts a cap-and-trade approach, the design elements of such a program that will have the greatest influence on Duke Energy Ohio's compliance costs include (1) the required levels and timing of the cap, which will drive emission allowance prices, (2) the emission sources covered under the cap, (3) the number of allowances that Duke Energy Ohio might be allocated at no cost on a year-to-year basis, (4) the type and effectiveness of any cost control mechanisms included in the program, (5) the role of emission offsets, which will also influence allowance prices, and (6) the availability and cost of technologies that Duke Energy Ohio can deploy to lower its emissions. While Duke Energy Ohio believes it is very likely that Congress will adopt mandatory GHG emission reduction legislation at some point, the timing and design details of any such legislation are highly uncertain.

While there were many bills introduced in both houses of Congress during the 110<sup>th</sup> Congress that proposed mandatory limits on GHG emissions, S. 2191—America's Climate Security Act of 2007 (commonly referred to as the Lieberman-Warner bill after the sponsors Senators Joseph Lieberman of Connecticut and John Warner of Virginia) became the primary climate change related legislative vehicle. The bill was approved by the Senate Environment and Public Works Committee in December 2007, but failed to advance on the Senate floor in June 2008 when the bill fell considerably short of the 60 votes necessary to invoke cloture and cut off debate. No subsequent action was taken in the 110<sup>th</sup> Congress related to mandatory federal GHG legislation.

Numerous bills mandating reductions in GHG emissions are expected to be introduced in both houses of Congress in 2009. The leadership in both the House and Senate has publicly stated it is their intent to proceed with climate legislation. President Obama, in his presidential campaign and after the election, indicated passage of climate change legislation is a priority. Still, as the Senate debate in 2008 revealed, there are wide-ranging views in Congress regarding what constitutes acceptable GHG legislation. The current condition of the U.S. economy could add a degree of uncertainty, and there are indications that, in the 111<sup>th</sup> Congress multiple committees will be involved in crafting GHG legislation, which will make the process of developing GHG legislation potentially more challenging.

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Duke Energy Ohio supports the enactment of federal GHG cap-and-trade legislation. Due to Duke Energy Ohio's concern about patchwork policies focused on a single industrial sector or particular region of the country, Duke Energy Ohio believes this legislation should establish a program that applies to all parts of the economy, including power generation, industrial and commercial sources and motor vehicles. To permit the economy to adjust rationally to the policy, legislation should establish a long-term program that first slows the growth of emissions, stops them and then transitions to a gradually declining emissions cap as new lower-and non-emitting technologies are developed and become available for wide-scale deployment. Legislation should also include adequate cost-containment measures to protect the U.S. economy from grave and unintended impacts of the policy.

Duke Energy Ohio is unable to estimate the potential cost of complying with currently unspecified and unknowable future GHG legislation or any indirect costs that might result. Compliance costs are sensitive to numerous policy design details, allowance prices, and technology availability and cost. During the Senate debate on the Lieberman-Warner legislation in 2007 and 2008, Duke Energy Ohio attempted to estimate its cost of complying with that legislation over a range of potential allowance prices. Duke Energy Ohio estimated its compliance costs under the Lieberman-Warner model to be between approximately \$230 million to \$680 million in the first year of the program (2012), which represented the cost to purchase emission allowances needed for compliance over and above what might be allocated to Duke Energy Ohio at zero cost. Duke Energy Ohio would have continued to incur similar or greater annual compliance costs in subsequent years for continued allowance purchases until such time as new lower-and zero-emitting technologies could be deployed to reduce emissions. Duke Energy Ohio's compliance costs at that time would then include the cost of purchasing and deploying new generation technologies. Duke Energy Ohio would only be able to reduce its allowance purchase costs after new technologies were actually deployed.

There is no way to know how similar or different the requirements of the Lieberman-Warner legislation might be to any future GHG legislation that Congress may eventually adopt, so it is uncertain whether these costs are at all representative of compliance costs that Duke Energy Ohio might incur as a result of any potential future GHG legislation. Under any future scenario involving mandatory GHG limitations, Duke Energy Ohio would plan to seek to recover its compliance costs through appropriate regulatory mechanisms in the jurisdictions in which it operates.

At the state level, the Midwestern Governors Association has an initiative under way called the Midwestern Greenhouse Gas Reduction Accord. One of the ongoing activities of the initiative is the design of a regional GHG cap-and-trade system, with the anticipated end product to be a Model Rule for implementing a GHG cap-and-trade system. Once complete, the Model Rule would go to participating states for their consideration and possible adoption. The state of Ohio is currently only an observer to the accord process. The outcome of this initiative is highly uncertain and Duke Energy Ohio is unable to determine at this time whether there might be direct or indirect cost impacts from any new regulations that might result from the initiative.

While Duke Energy Ohio's near-term compliance strategy associated with any potential future GHG legislation that incorporates a cap-and-trade mechanism will likely be focused on allowance purchases, it is expected that at some point in the future Duke Energy Ohio would begin reducing emissions by replacing existing coal-fired generation with new lower-and zero-emitting generation technologies, and/or installing new carbon capture and sequestration technology on existing coal-fired generating plants when the technologies become available and cost-effective. It is not possible at this time, however, to predict with certainty what new technologies might be developed, when they will be ready to be deployed, or what their costs will be. There is also uncertainty as to how or when certain non-technical issues, such as legal and liability questions, that could affect the cost and availability of new technologies might be resolved by regulators. Duke Energy Ohio currently is focused on integrated gasification combined cycle generation with carbon capture and sequestration, and capture and storage retrofit technology for existing pulverized coal-fired generation as promising new technologies for generating electricity with lower or no CO<sub>2</sub> emissions.

Duke Energy Ohio has regulatory requirements in Ohio to meet increasing percentages of customer demand for electricity with renewable energy. The requirement reaches a minimum of 12.5% in 2024. Duke Energy Ohio also anticipates the Congress will consider a federal renewable portfolio standard in 2009. Previous attempts have passed in the U.S. House of Representatives but fallen short in the Senate. Duke Energy Ohio believes, however, chances of passage in the 111<sup>th</sup> Congress have increased.

In addition to relying on new technologies to reduce its CO<sub>2</sub> emissions, Duke Energy Ohio has received regulatory approval in Ohio for a first-of-its-kind innovative approach in the utility industry to help meet growing customer demand with new and creative ways to increase energy efficiency, thereby reducing demand (Save-A-Watt) instead of relying almost exclusively on new power plants to generate electricity.

Each of these activities has the potential to reduce Duke Energy Ohio's future CO<sub>2</sub> emissions which will reduce Duke Energy Ohio's exposure to future GHG regulation.

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Duke Energy Ohio recognizes the potential for more frequent and severe extreme weather events as a result of climate change and the possibility that these weather events could have a material impact on its future results of operations should these events occur. However, the uncertain nature of potential changes in extreme weather events (such as increased frequency, duration, and severity) and the long period of time over which any changes might take place make estimating any potential future financial risk to Duke Energy Ohio's operations that may be caused by the physical risks of climate change extremely challenging. Currently, Duke Energy Ohio plans and prepares for extreme weather events that it experiences from time to time, such as ice storms, tornados, severe thunderstorms, high winds and droughts. Duke Energy Ohio's past experiences preparing for and responding to the impacts of these types of weather-related events would reasonably be expected to help management plan and prepare for future climate change-related severe weather events to reduce, but not eliminate, the operational, economic and financial impacts of such events.

For additional information on other issues related to Duke Energy Ohio, see Note 4 to the Consolidated Financial Statements, "Regulatory Matters" and Note 18 to the Consolidated Financial Statements, "Commitments and Contingencies."

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

### **Risk Management Policies**

Duke Energy Ohio is exposed to market risks associated with commodity prices, credit exposure and interest rates. Management has established comprehensive risk management policies to monitor and manage these market risks. The Treasurer of Duke Energy, the ultimate parent entity of Duke Energy Ohio, is responsible for the overall governance of managing credit risk and commodity price risk, including monitoring exposure limits for Duke Energy Ohio.

### **Commodity Price Risk**

Duke Energy Ohio is exposed to the impact of market fluctuations in the prices of electricity, coal, natural gas and other energy-related products marketed and purchased within its non-regulated operations, as well as within its regulated operations, to the extent there is excess capacity from generation assets that are dedicated to serve Ohio native load customers. Price risk represents the potential risk of loss from adverse changes in the market price of electricity or other energy commodities, such as gas and coal. For Duke Energy Ohio, this price risk has been somewhat reduced by the December 17, 2008 PUCO approval of Duke Energy Ohio's ESP, which resulted in the reapplication of SFAS No. 71 to certain portions of Duke Energy Ohio's Commercial Power business segment operations as of that date. Duke Energy Ohio employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity derivatives, such as swaps, futures, forwards and options. See Note 1 to the Consolidated Financial Statements, "Summary of Significant Accounting Policies" and Note 8 to the Consolidated Financial Statements, "Risk Management and Hedging Activities and Credit Risk," for additional information.

Validation of a contract's fair value is performed by an internal group separate from Duke Energy Ohio's deal origination areas. Duke Energy Ohio's derivative contract portfolio is predominantly valued using observable market inputs with little internally developed assumptions. However, for contracts valued beyond the observable market period, Duke Energy Ohio uses common industry practices to develop its valuation techniques and changes in its pricing methodologies or the underlying assumptions could result in significantly different fair values and income recognition.

*Hedging Strategies.* Duke Energy Ohio closely monitors the risks associated with commodity price changes on its future operations and, where appropriate, uses various commodity instruments such as electricity, coal and natural gas forward contracts to mitigate the effect of such fluctuations on operations. Duke Energy Ohio's primary use of energy commodity derivatives is to hedge the generation portfolio against exposure to changes in the prices of power and fuel.

Certain derivatives used to manage Duke Energy Ohio's commodity price exposure are accounted for as either cash flow hedges or fair value hedges. To the extent that instruments accounted for as hedges are effective in offsetting the transaction being hedged, there is no impact to the Consolidated Statements of Operations until delivery or settlement occurs. Accordingly, assumptions and valuation techniques for these contracts have no impact on reported earnings prior to settlement. Several factors influence the effectiveness of a hedge contract, including the use of contracts with different commodities or unmatched terms and counterparty credit risk. Hedge effectiveness is monitored regularly and measured at least quarterly.

In addition to the hedge contracts described above and recorded on the Consolidated Balance Sheets, Duke Energy Ohio enters into other contracts that qualify for the normal purchases and sales exception described in paragraph 10 of SFAS No. 133, as amended and interpreted by Derivatives Implementation Group Issue C15, "Scope Exceptions: Normal Purchases and Normal Sales Exception for Option-Type Contracts and Forward Contracts in Electricity," and SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments"



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*and Hedging Activities*." On a limited basis, Franchised Electric and Gas and Commercial Power apply the normal purchase and normal sales exception to certain contracts. Income recognition and realization related to normal purchases and normal sales contracts generally coincide with the physical delivery of power. For contracts qualifying for the scope exception, no recognition of the contract's fair value in the Consolidated Financial Statements is required until settlement of the contract unless the contract ceases to qualify for the normal purchase and normal sale exception at some point during the contract period. Recognition of the contracts in the Consolidated Statements of Operations will be the same regardless of whether the contracts are accounted for as cash flow hedges or as normal purchases and sales assuming no hedge ineffectiveness.

Other derivatives used to manage Duke Energy Ohio's commodity price exposure are either not designated as a hedge or do not qualify for hedge accounting. Derivatives related to regulated businesses reflect changes in the fair value of the derivative instruments as a regulatory asset or liability on the Consolidated Balance Sheets. Derivatives related to unregulated businesses are marked-to-market each period, with changes in the fair value of the derivative instruments reflected in earnings.

*Generation Portfolio Risks for 2009.* Duke Energy Ohio is primarily exposed to market price fluctuations of wholesale power, coal, natural gas and emission allowance prices associated with its excess capacity from generation assets that are dedicated to serve Ohio native load customers and its non-regulated operations. Duke Energy Ohio closely monitors the risks associated with these commodity price changes on its future generation operations and, where appropriate, uses various commodity instruments such as electricity, coal and natural gas forward contracts to mitigate the effect of such fluctuations on operations, in addition to optimizing the value of its non-regulated generation portfolio. The portfolio includes generation assets (power and capacity), fuel, and emission allowances. Modeled forecasts of future generation output, fuel requirements, and emission allowance requirements are based on forward power, fuel and emission allowance markets. The component pieces of the portfolio are bought and sold based on this model in order to manage the economic value of the portfolio, where such market transparency exists. The generation portfolio not utilized to serve native load or committed load is subject to commodity price fluctuations. Based on a sensitivity analysis as of December 31, 2008 and 2007, it was estimated that a ten percent price change per megawatt hour in forward wholesale power prices would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately \$5 million in 2009 and \$13 million in 2008, respectively, excluding the impact of mark-to-market changes on non-qualifying or undesignated hedges relating to periods in excess of one year from the respective date, which are discussed further below. Based on a sensitivity analysis as of December 31, 2008 and 2007, it was estimated that a ten percent change in the forward price per ton of coal would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately \$10 million in 2009 and \$4 million in 2008, respectively, excluding the impact of mark-to-market changes on non-qualifying or undesignated hedges relating to periods in excess of one year from the respective date, which are discussed further below. Based on a sensitivity analysis as of December 31, 2008 and 2007, it was estimated that a ten percent price change per MMBtu (one million British thermal units) in natural gas prices would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately \$5 million in 2009 and \$9 million in 2008 respectively, excluding the impact of mark-to-market changes on undesignated hedges relating to periods in excess of one year from the respective date.

*Sensitivities for derivatives beyond 2009.* Derivative contracts executed to manage generation portfolio risks for delivery periods beyond 2009 are also exposed to changes in fair value due to market price fluctuations of wholesale power and coal. Based on a sensitivity analysis as of December 31, 2008 and 2007, it was estimated that a ten percent price change in the forward price per megawatt hour of wholesale power would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately \$11 million in 2009 and \$16 million in 2008, respectively, resulting from the impact of mark-to-market changes on non-qualifying and undesignated power contracts pertaining to periods in excess of one year from the respective date. Based on a sensitivity analysis as of December 31, 2008 and 2007, it was estimated that a ten percent change in the forward price per ton of coal would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately \$10 million in 2009 and \$14 million in 2008, respectively, resulting from the impact of mark-to-market changes on non-qualifying and undesignated coal contracts pertaining to periods in excess of one year from the respective date.

*Comparability of sensitivity analysis.* As Commercial Power began reapplying the provisions of SFAS No. 71 on December 17, 2008 to portions of its operations, certain derivative contracts that historically resulted in earnings volatility receive regulatory deferral of gains and losses. Accordingly, the mark-to-market associated with these contracts will not impact earnings until recovered in revenues. However, to achieve comparability of sensitivity information between periods, the portion of the derivative contracts that receive regulatory treatment has been included in the sensitivity amounts for both periods presented. Since certain derivative contracts included in the sensitivity analysis for 2009 will not result in earnings impacts, the forecasted sensitivities for 2009 are less than the pre-tax income amounts disclosed above.

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The commodity price sensitivity calculations above consider existing hedge positions and estimated production levels, but do not consider other potential effects that might result from such changes in commodity prices.

#### **Credit Risk**

Credit risk represents the loss that Duke Energy Ohio would incur if a counterparty fails to perform under its contractual obligations.

*Retail.* Credit risk associated with Duke Energy Ohio's service to residential, commercial and industrial customers is generally limited to outstanding accounts receivable. Duke Energy Ohio mitigates this credit risk by requiring customers to provide a cash deposit or letter of credit until a satisfactory payment history is established, at which time the deposit is typically refunded. Charge-offs for the retail customers have historically been insignificant to the operations of Duke Energy Ohio and are typically recovered through the retail rates. However, in light of current overall economic conditions, management continues to monitor customer charge-offs and payment patterns to ensure the adequacy of bad debt reserves. Duke Energy Ohio sells certain of their accounts receivable and related collections through Cinergy Receivables Company, LLC a bankruptcy remote, special purpose entity. While no direct recourse to Duke Energy Ohio exists, it risks loss in the event collections are not sufficient to allow for full recovery of its retained interests or in the event the level of charge-offs in future periods increases. See Note 13 to the Consolidated Financial Statements, "Sales of Accounts Receivable."

*Wholesale and Non-native Sales.* To reduce credit exposure related to non-native sales, Duke Energy Ohio seeks to enter into netting agreements with counterparties that permit it to offset receivables and payables with such counterparties. Duke Energy Ohio attempts to further reduce credit risk with certain counterparties by entering into agreements that enable it to obtain collateral or to terminate or reset the terms of transactions after specified time periods or upon the occurrence of credit-related events. Where exposed to credit risk, Duke Energy Ohio analyzes the counterparties' financial condition prior to entering into an agreement, establishes credit limits and monitors the appropriateness of those limits on an ongoing basis. Duke Energy Ohio's industry has historically operated under negotiated credit lines for physical delivery contracts. Duke Energy Ohio may use master collateral agreements to mitigate certain credit exposures. The collateral agreements provide for a counterparty to post cash or letters of credit to the exposed party for exposure in excess of an established threshold. The threshold amount represents an unsecured credit limit, determined in accordance with the corporate credit policy. Collateral agreements also provide that the inability to post collateral is sufficient cause to terminate contracts and liquidate all positions.

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

Based on Duke Energy Ohio's policies for managing credit risk, its exposures and its credit and other reserves, Duke Energy Ohio does not anticipate a materially adverse effect on its consolidated results of operations, cash flows or financial position as a result of non-performance by any counterparty.

#### **Interest Rate Risk**

Duke Energy Ohio is exposed to risk resulting from changes in interest rates as a result of its issuance of variable and fixed rate debt. Duke Energy Ohio manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Ohio also enters into financial derivative instruments, including interest rate swaps, swaptions and U.S. Treasury lock agreements to manage and mitigate interest rate risk exposure. See Notes 1, 8, and 16 to the Consolidated Financial Statements, "Summary of Significant Accounting Policies," "Risk Management and Hedging Activities and Credit Risk" and "Debt and Credit Facilities," respectively.

Based on a sensitivity analysis as of December 31, 2008, it was estimated that if market interest rates average 1% higher (lower) in 2009 than in 2008, interest expense, net of offsetting impacts in interest income, would increase (decrease) by approximately \$11 million. Comparatively, based on a sensitivity analysis as of December 31, 2007, had interest rates averaged 1% higher (lower) in 2008 than in 2007, it was estimated that interest expense, net of offsetting impacts in interest income, would have increased (decreased) by approximately \$8 million. These amounts were estimated by considering the impact of the hypothetical interest rates on variable-rate securities outstanding, including money pool balances, adjusted for interest rate hedges and cash and cash equivalents outstanding as of December 31, 2008 and 2007. If interest rates changed significantly, management would likely take actions to manage its exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, the sensitivity analysis assumes no changes in Duke Energy Ohio's financial structure.

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**Item 8. Financial Statements and Supplementary Data.**

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of Duke Energy Ohio, Inc.  
Charlotte, North Carolina

We have audited the accompanying consolidated balance sheets of Duke Energy Ohio, Inc. and subsidiaries (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of operations, common stockholder's equity and comprehensive income, and cash flows for the years ended December 31, 2008 and 2007, the nine months ended December 31, 2006 (successor period), and the three months ended March 31, 2006 (predecessor period). Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Duke Energy Ohio, Inc. and subsidiaries at December 31, 2008 and 2007, and the results of their operations their cash flows for the periods stated above, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ DELOITTE & TOUCHE LLP  
Charlotte, North Carolina  
March 13, 2009

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DUKE ENERGY OHIO, INC.  
**Consolidated Statements of Operations**  
(In millions)

	Successor			Predecessor
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
<b>Operating Revenues</b>				
Non-regulated electric and other	\$ 1,646	\$ 1,751	\$ 1,236	\$ 421
Regulated electric	988	984	638	220
Regulated natural gas	790	720	387	322
<b>Total operating revenue</b>	<b>3,424</b>	<b>3,455</b>	<b>2,261</b>	<b>963</b>
<b>Operating Expenses</b>				
Fuel used in electric generation and purchased power—non-regulated	847	916	712	172
Fuel used in electric generation and purchased power—regulated	157	154	92	24
Cost of natural gas and coal sold	486	496	313	276
Operation, maintenance and other	743	756	505	173
Depreciation and amortization	409	392	280	68
Property and other taxes	241	250	165	68
Impairment charges	82	—	—	—
<b>Total operating expenses</b>	<b>2,965</b>	<b>2,964</b>	<b>2,067</b>	<b>781</b>
<b>Gains (Losses) on Sales of Other Assets and Other, net</b>	<b>59</b>	<b>(8)</b>	<b>(28)</b>	<b>26</b>
<b>Operating Income</b>	<b>518</b>	<b>483</b>	<b>166</b>	<b>208</b>
<b>Other Income and Expenses, net</b>	<b>34</b>	<b>32</b>	<b>17</b>	<b>8</b>
<b>Interest Expense</b>	<b>94</b>	<b>100</b>	<b>81</b>	<b>30</b>
<b>Income From Continuing Operations Before Income Taxes</b>	<b>458</b>	<b>415</b>	<b>102</b>	<b>186</b>
<b>Income Tax Expense from Continuing Operations</b>	<b>171</b>	<b>151</b>	<b>41</b>	<b>68</b>
<b>Income From Continuing Operations</b>	<b>287</b>	<b>264</b>	<b>61</b>	<b>118</b>
<b>Loss From Discontinued Operations, net of tax</b>	<b>—</b>	<b>—</b>	<b>(6)</b>	<b>(2)</b>
<b>Income Before Extraordinary Items</b>	<b>287</b>	<b>264</b>	<b>55</b>	<b>116</b>
<b>Extraordinary Items, net of tax</b>	<b>67</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>Net Income</b>	<b>\$ 354</b>	<b>\$ 264</b>	<b>\$ 55</b>	<b>\$ 116</b>

See Notes to Consolidated Financial Statements

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PART II

DUKE ENERGY OHIO, INC.  
**Consolidated Balance Sheets**  
(In millions)

	December 31,	
	2008	2007
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 27	\$ 33
Receivables (net of allowance for doubtful accounts of \$18 at December 31, 2008 and \$3 at December 31, 2007)	303	334
Inventory	180	212
Unrealized gains on mark-to-market and hedging transactions	51	22
Other	336	94
<b>Total current assets</b>	<b>897</b>	<b>695</b>
<b>Investments and Other Assets</b>		
Restricted funds held in trust	10	62
Goodwill	2,360	2,325
Intangibles, net	403	551
Unrealized gains on mark-to-market and hedging transactions	17	17
Other	55	33
<b>Total investments and other assets</b>	<b>2,845</b>	<b>2,988</b>
<b>Property, Plant and Equipment</b>		
Cost	10,047	9,577
Less accumulated depreciation and amortization	2,277	2,097
<b>Net property, plant and equipment</b>	<b>7,770</b>	<b>7,480</b>
<b>Regulatory Assets and Deferred Debits</b>		
Deferred debt expense	23	23
Regulatory assets related to income taxes	103	90
Other	451	401
<b>Total regulatory assets and deferred debits</b>	<b>577</b>	<b>514</b>
<b>Total Assets</b>	<b>\$ 12,089</b>	<b>\$ 11,677</b>

See Notes to Consolidated Financial Statements

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PART II

DUKE ENERGY OHIO, INC.  
**Consolidated Balance Sheets—(Continued)**  
(In millions, except share and per-share amounts)

	December 31,	
	2008	2007
<b>LIABILITIES AND COMMON STOCKHOLDER'S EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 511	\$ 602
Notes payable	343	189
Taxes accrued	134	172
Interest accrued	24	24
Current maturities of long-term debt	27	126
Unrealized losses on mark-to-market and hedging transactions	47	24
Other	93	86
Total current liabilities	1,179	1,223
<b>Long-term Debt</b>		
	1,856	1,810
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes	1,619	1,436
Investment tax credit	14	16
Accrued pension and other post-retirement benefit costs	406	259
Unrealized losses on mark-to-market and hedging transactions	15	25
Asset retirement obligations	33	31
Other	297	343
Total deferred credits and other liabilities	2,384	2,110
<b>Commitments and Contingencies</b>		
<b>Common Stockholder's Equity</b>		
Common Stock, \$8.50 par value, 120,000,000 shares authorized; 89,663,086 shares outstanding at December 31, 2008 and December 31, 2007	762	762
Additional paid-in capital	5,570	5,570
Retained earnings	381	227
Accumulated other comprehensive loss	(43)	(25)
Total common stockholder's equity	6,670	6,534
<b>Total Liabilities and Common Stockholder's Equity</b>	<b>\$ 12,089</b>	<b>\$ 11,677</b>

See Notes to Consolidated Financial Statements

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PART II

DUKE ENERGY OHIO, INC.  
**Consolidated Statements of Cash Flows**  
(In millions)

	Successor			Predecessor
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>				
Net income	\$ 354	\$ 264	\$ 55	\$ 116
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	412	395	280	68
Extraordinary items, net of taxes	(67)	—	—	—
(Gains) losses on sales of other assets and other, net	(59)	8	31	(26)
Impairment charges	82	—	—	—
Deferred income taxes	53	18	(120)	7
Accrued pension and other post-retirement benefit costs	4	37	40	9
Contribution to company-sponsored pension and other post-retirement benefit plans	—	(92)	(22)	—
(Increase) decrease in:				
Net realized and unrealized mark-to-market and hedging transactions	10	21	(6)	(30)
Receivables	47	(25)	132	10
Inventory	(70)	5	(84)	56
Other current assets	(28)	22	25	68
Increase (decrease) in:				
Accounts payable	(130)	181	(86)	(157)
Taxes accrued	(43)	(144)	54	50
Other current liabilities	9	1	(63)	(78)
Regulatory asset/liability deferrals	(50)	(19)	(7)	(1)
Other assets	19	165	184	24
Other liabilities	4	(89)	(50)	—
Net cash provided by operating activities	547	748	363	116
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Capital expenditures	(565)	(593)	(391)	(135)
Purchases of emission allowances	(17)	(23)	(167)	(162)
Sales of emission allowances	74	29	138	105
Net proceeds from the sales of other assets	4	—	32	—
Change in restricted funds held in trust	52	(31)	22	8
Other	1	—	—	—
Net cash used in investing activities	(451)	(618)	(366)	(184)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>				
Issuance of long-term debt	136	205	88	141
Redemption of long-term debt	(191)	(153)	(80)	(1)
Redemption of preferred stock of subsidiaries	—	—	—	(21)
Notes payable and commercial paper	279	—	—	—
Notes payable to affiliate, net	(126)	(85)	36	50
Dividends to parent	(200)	(135)	—	(102)
Capital contribution from parent	—	29	—	—
Other	—	(3)	(4)	(1)
Net cash (used in) provided by financing activities	(102)	(142)	40	66
Net (decrease) increase in cash and cash equivalents	(6)	(12)	37	(2)
Cash and cash equivalents at beginning of period	33	45	8	10
Cash and cash equivalents at end of period	\$ 27	\$ 33	\$ 45	\$ 8
<b>Supplemental Disclosures:</b>				
Cash paid for interest, net of amount capitalized	\$ 91	\$ 91	\$ 103	\$ 21
Cash paid for income taxes	\$ 187	\$ 159	\$ 77	\$ —
<b>Significant non-cash transactions:</b>				
Purchase accounting adjustments	\$ —	\$ (14)	\$ 2,894	\$ —
Accrued capital expenditures	\$ 81	\$ 62	\$ 49	\$ —
Transfer of generating assets from Duke Energy	\$ —	\$ —	\$ 1,462	\$ —

See Notes to Consolidated Financial Statements

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PART II

DUKE ENERGY OHIO, INC.  
**Consolidated Statements of Common Stockholder's Equity  
and Comprehensive Income**  
(In millions)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)			Total
				Net Gains (Losses) on Cash Flow Hedges	Minimum Pension Liability Adjustment	Pension and OPEB Related Adjustments to AOCI	
<b>Successor</b>							
Nine Months Ended December 31, 2006							
<b>Balance at April 1, 2006</b>	\$ 762	\$ 4,123	\$ —	\$ —	\$ —	\$ —	\$ 4,885 <sup>(b)</sup>
Net income	—	—	55	—	—	—	55
Other comprehensive income	—	—	—	—	—	—	—
Cash flow hedges <sup>(d)</sup>	—	—	—	3	—	—	3
<b>Total comprehensive income</b>	—	—	55	3	—	—	58
Transfer of generating assets from Duke Energy <sup>(a)</sup>	—	1,462	—	(39)	—	—	1,423
Contribution from parent company for reallocation of taxes	—	16	—	—	—	—	16
SFAS No. 158 funded status provision	—	—	—	—	—	(2)	(2)
<b>Balance at December 31, 2006</b>	\$ 762	\$ 5,601	\$ 55	\$ (36)	\$ —	\$ (2)	\$ 6,380
Year Ended December 31, 2007							
<b>Balance at December 31, 2006</b>	\$ 762	\$ 5,601	\$ 55	\$ (36)	\$ —	\$ (2)	\$ 6,380
Net income	—	—	264	—	—	—	264
Other comprehensive income	—	—	—	—	—	—	—
Cash flow hedges <sup>(d)</sup>	—	—	—	4	—	—	4
SFAS 158 net actuarial gain <sup>(c), (e)</sup>	—	—	—	—	—	11	11
<b>Total comprehensive income</b>	—	—	264	4	—	11	279
Capital contribution from parent	—	29	—	—	—	—	29
Push-down accounting adjustments	—	(14)	—	—	—	—	(14)
Adoption of SFAS No. 158 —measurement date provision	—	—	(3)	—	—	(2)	(5)
Dividends to Cinergy Corp.	—	(46)	(89)	—	—	—	(135)
<b>Balance at December 31, 2007</b>	\$ 762	\$ 5,570	\$ 227	\$ (32)	\$ —	\$ 7	\$ 6,534
Year Ended December 31, 2008							
<b>Balance at December 31, 2007</b>	\$ 762	\$ 5,570	\$ 227	\$ (32)	\$ —	\$ 7	\$ 6,534
Net income	—	—	354	—	—	—	354
Other comprehensive income	—	—	—	—	—	—	—
Cash flow hedges <sup>(d)</sup>	—	—	—	17	—	—	17
Pension and OPEB related adjustments to AOCI <sup>(f)</sup>	—	—	—	—	—	(35)	(35)
<b>Total comprehensive income</b>	—	—	354	17	—	(35)	336
Dividends to Cinergy Corp.	—	—	(200)	—	—	—	(200)
<b>Balance at December 31, 2008</b>	\$ 762	\$ 5,570	\$ 381	\$ (15)	\$ —	\$ (28)	\$ 6,670
<b>Predecessor</b>							
Three Months Ended March 31, 2006							
<b>Balance at December 31, 2005</b>	\$ 762	\$ 603	\$ 657	\$ (14)	\$ (33)	\$ —	\$ 1,975
Net income	—	—	116	—	—	—	116
Other comprehensive income	—	—	—	—	—	—	—
Minimum pension liability adjustment	—	—	—	—	1	—	1
Cash flow hedges	—	—	—	1	—	—	1
<b>Total comprehensive income</b>	—	—	116	1	—	—	117
Dividends to Cinergy Corp.	—	—	(102)	—	—	—	(102)
<b>Balance at March 31, 2006</b>	\$ 762	\$ 603	\$ 671	\$ (13)	\$ (32)	\$ —	\$ 1,991 <sup>(b)</sup>

- (a) Includes \$39 (net of tax benefit of \$24) related to deferred losses on terminated cash flow hedges included in Accumulated Other Comprehensive Income (Loss).
- (b) Difference in equity balances at March 31, 2006 and April 1, 2006 is due to the application of push-down accounting reflecting Duke Energy's merger with Cinergy (see Notes 1 and 3 to the Consolidated Financial Statements).
- (c) Excludes \$50 reflected as regulatory assets.
- (d) Net of \$10 tax expense in 2008, \$3 tax expense in 2007 and \$2 tax expense for the nine months ended December 31, 2006.
- (e) Net of \$5 tax expense in 2007.
- (f) Net of \$19 tax benefit in 2008.

See Notes to Consolidated Financial Statements



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PART II

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements**  
For the Years Ended December 31, 2008, 2007 and 2006

### 1. Summary of Significant Accounting Policies

**Nature of Operations and Basis of Consolidation.** Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through its wholly-owned subsidiary, Duke Energy Kentucky, Inc. (Duke Energy Kentucky), in nearby areas of Kentucky, as well as electric generation in parts of Ohio, Illinois, Indiana and Pennsylvania through Duke Energy Ohio's Commercial Power business segment operations, which are discussed further below. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas and energy marketing. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity, as well as the sale of and/or transportation of natural gas. Except where separately noted, references to Duke Energy Ohio herein relate to the consolidated operations of Duke Energy Ohio, including Duke Energy Kentucky.

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

These Consolidated Financial Statements include, after eliminating intercompany transactions and balances, the accounts of Duke Energy Ohio and all majority-owned subsidiaries where Duke Energy Ohio has control, as well as Duke Energy Ohio's proportionate share of certain generation and transmission facilities in Ohio, Kentucky and Indiana.

**Predecessor and Successor Reporting.** In connection with the merger between Duke Energy and Cinergy, Duke Energy acquired all of the outstanding common stock of Cinergy. The merger was accounted for under the purchase method of accounting with Duke Energy treated as the acquirer for accounting purposes. As a result, the assets and liabilities of Cinergy were recorded at their respective fair values as of the merger consummation date. Purchase accounting impacts, including goodwill recognition, have been "pushed down" to Duke Energy Ohio, resulting in the assets and liabilities of Duke Energy Ohio being recorded at their respective fair values as of April 3, 2006 (see Note 3). Except for an adjustment related to pension and other post-retirement benefit obligations, as mandated by the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 87, "Employers' Accounting for Pensions," and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," the accompanying consolidated financial statements do not reflect any adjustments related to Duke Energy Ohio's regulated operations that were accounted for pursuant to SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71) at the time of the merger, which are comprised of Duke Energy Ohio's regulated transmission and distribution operations and Duke Energy Kentucky. Under the rate setting and recovery provisions currently in place for these regulated operations which provide revenues derived from cost, the fair values of the individual tangible and intangible assets and liabilities are considered to approximate their carrying values.

Duke Energy Ohio's Consolidated Statements of Operations subsequent to the merger include amortization expense relating to purchase accounting adjustments and depreciation of fixed assets based upon their fair value as of the merger date. Therefore, the Duke Energy Ohio financial data prior to the merger will not generally be comparable to its financial data subsequent to the merger. See Note 3 for additional information.

Due to the impact of push-down accounting, the financial statements and certain note presentations separate Duke Energy Ohio's presentations into two distinct periods, the period before the consummation of the merger (labeled "Predecessor") and the period after that date (labeled "Successor"), to indicate the application of different bases of accounting between the periods presented.

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

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PART II

DUKE ENERGY OHIO, INC.

### Notes To Consolidated Financial Statements—(Continued)

**Reapplication of SFAS No. 71 to Portions of Generation in Ohio.** Duke Energy Ohio's generation operations within its Commercial Power business segment (see Note 2) include generation assets located in Ohio that are dedicated to serve Ohio native load customers. These assets, as excess capacity allows, also generate revenues through sales outside the native load customer base, and such revenue is termed non-native.

Prior to December 17, 2008, Duke Energy Ohio's Commercial Power business segment did not apply the provisions of SFAS No. 71 due to the comprehensive electric deregulation legislation passed by the state of Ohio in 1999. As described further below, effective December 17, 2008, the Public Utilities Commission of Ohio (PUCO) approved Duke Energy Ohio's Electric Security Plan (ESP), which resulted in the reapplication of SFAS No. 71 to certain portions of Commercial Power's operations as of that date.

From January 1, 2005 through December 31, 2008, Duke Energy Ohio, including its Commercial Power business segment, had been operating under a rate stabilization plan (RSP), which was a market-based standard service offer. See "Cost-Based Regulation" section below for further information on the RSP and the market-based standard service offer. Although the RSP contained certain trackers that enhanced the potential for cost recovery, there was no assurance of stranded cost recovery upon the expiration of the RSP on December 31, 2008 since it was initially anticipated that, upon the expiration of the RSP, there would be a move to full competitive markets. Accordingly, Duke Energy Ohio's Commercial Power business segment did not apply the provisions of SFAS No. 71 to any of its generation operations prior to December 17, 2008. As discussed further in Note 4, in April 2008, new legislation (SB 221) was passed in Ohio and signed by the Governor of Ohio on May 1, 2008. The new law codified the PUCO's authority to approve an electric utility's standard service offer either through an ESP or a Market Rate Option (MRO). The MRO is a price determined through a competitive bidding process. On July 31, 2008, Duke Energy Ohio filed an ESP, and with certain amendments, the ESP was approved by the PUCO on December 17, 2008. The ESP became effective on January 1, 2009.

In connection with the approval of the ESP, Duke Energy Ohio reassessed the applicability of SFAS No. 71 to Commercial Power's generation operations as SB 221 substantially increased the PUCO's oversight authority over generation in the state of Ohio, including giving the PUCO complete approval of generation rates and the establishment of an earnings test to determine if a utility has earned significantly excessive earnings. Duke Energy Ohio determined that certain costs and related rates (riders) of Commercial Power's operations related to generation serving native load meet the criteria established by SFAS No. 71 for regulatory accounting treatment as SB 221 and Duke Energy Ohio's approved ESP solidified the automatic recovery of certain costs of its generation serving native load within its Commercial Power business segment and increased the likelihood that Commercial Power's operations will remain under a cost recovery model for certain costs for the foreseeable future.

Under the ESP, Duke Energy Ohio will bill for its native load generation via numerous riders. SB 221 and the ESP resulted in the approval of the automatic recovery of certain of these riders, which includes, but is not limited to, a fuel and purchased power (FPP) rider and certain portions of a cost of environmental compliance (AAC) rider. Accordingly, Duke Energy Ohio's Commercial Power business segment began applying SFAS No. 71 to the corresponding RSP riders granting automatic recovery under the ESP on December 17, 2008. The remaining portions of Commercial Power's native load generation operations, revenues from which are reflected in rate riders for which the ESP does not specifically allow automatic cost recovery, as well as all generation operations associated with non-native customers, including Commercial Power's Midwest gas-fired generation assets, continue to not apply regulatory accounting as those operations do not meet the criteria of SFAS No. 71. Moreover, generation remains a competitive market in Ohio and native load customers continue to have the ability to switch to alternative suppliers for their electric generation service. As customers switch, there is a risk that some or all of the regulatory assets will not be recovered through the established riders. Duke Energy Ohio will continue to monitor the amount of native load customers that have switched to alternative suppliers when assessing the recoverability of its regulatory assets established for its native load generation operations within its Commercial Power business segment.

Despite certain portions of the Ohio native load operations not being subject to the accounting provisions of SFAS No. 71, all of Duke Energy Ohio's native load operations' rates are subject to approval by the PUCO, and thus these operations are referred to herein as Duke Energy Ohio's regulated operations.

**Extraordinary Item.** The reapplication of SFAS No. 71 to certain portions of generation in Ohio on December 17, 2008, as discussed above, resulted in an approximate \$67 million after-tax (approximately \$103 million pre-tax) extraordinary gain related to mark-to-market losses previously recorded in earnings associated with open forward native load economic hedge contracts for fuel, purchased power and emission allowances, which the RSP and ESP allow to be recovered through a FPP rider. There were no other immediate income statement impacts on the date of reapplication of SFAS No. 71. A corresponding regulatory asset was established for the value of these contracts.

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PART II

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

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

**Restricted Funds Held In Trust.** At December 31, 2008 and 2007, Duke Energy Ohio had approximately \$10 million and \$62 million, respectively, of restricted cash related primarily to proceeds from debt issuances that are held in trust, primarily for the purpose of funding future environmental expenditures.

**Inventory.** Inventory consists primarily of coal held for electric generation, materials and supplies and natural gas held in storage for transmission and sales commitments, and is recorded primarily using the average cost method. Inventory related to Duke Energy Ohio's regulated operations is valued at historical cost consistent with ratemaking treatment. Materials and supplies are recorded as inventory when purchased and subsequently charged to expense or capitalized to plant when installed. Inventory related to Duke Energy Ohio's non-regulated operations is valued at the lower of cost or market.

**Components of Inventory**

	December 31,	
	2008	2007
	(in millions)	
<b>Inventory</b>		
Fuel for use in electric generation	\$ 89	\$ 77
Materials and supplies	88	66
Gas held in storage	3	69
<b>Total Inventory</b>	<b>\$ 180</b>	<b>\$ 212</b>

Effective November 1, 2008, Duke Energy Ohio and Duke Energy Kentucky executed agreements with a third party to transfer title of natural gas inventory purchased by Duke Energy Ohio and Duke Energy Kentucky to the third party. Under the agreements, the gas inventory will be stored and managed for Duke Energy Ohio and Duke Energy Kentucky and will be delivered on demand. The gas storage agreements will expire on October 31, 2009, unless extended by the third party for an additional 12 months. As a result of the agreements, the combined natural gas inventory of approximately \$81 million being held by a third party as of December 31, 2008 has been classified as Other within Current Assets on the Consolidated Balance Sheets. At December 31, 2008, this balance exceeded 5% of total current assets.

**Cost-Based Regulation.** Duke Energy Ohio accounts for certain of its regulated operations under the provisions of SFAS No. 71. The economic effects of regulation can result in a regulated company recording assets for costs that have been or are expected to be approved for recovery from customers in a future period or recording liabilities for amounts that are expected to be returned to customers in the rate-setting process in a period different from the period in which the amounts would be recorded by an unregulated enterprise. Accordingly, Duke Energy Ohio records assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. Regulatory assets and liabilities are amortized consistent with the treatment of the related costs in the ratemaking process. Management continually assesses whether regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes, recent rate orders applicable to other regulated entities and the status of any pending or potential deregulation legislation. Additionally, management continually assesses whether any regulatory liabilities have been incurred. Based on this continual assessment, management believes the existing regulatory assets are probable of recovery and that no regulatory liabilities, other than those recorded, have been incurred. These regulatory assets and liabilities are primarily classified in the Consolidated Balance Sheets as Regulatory Assets and Deferred Debits, and Deferred Credits and Other Liabilities. Duke Energy Ohio periodically evaluates the applicability of SFAS No. 71, and considers factors such as regulatory changes and the impact of competition. If cost-based regulation ends or competition increases, Duke Energy Ohio may have to reduce its asset balances to reflect a market basis less than cost and write off the associated regulatory assets and liabilities. For further information see Note 4.

In order to apply the accounting provisions of SFAS No. 71 and record regulatory assets and liabilities, the scope criteria in SFAS No. 71 must be met. Management makes significant judgments in determining whether the scope criteria of SFAS No. 71 are met for its operations, including determining whether revenue rates for services provided to customers are subject to approval by an independent, third-party regulator, whether the regulated rates are designed to recover specific costs of providing the regulated service, and a determination of whether, in view of the demand for the regulated services and the level of competition, it is reasonable to assume that

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PART II

### DUKE ENERGY OHIO, INC. Notes To Consolidated Financial Statements—(Continued)

rates set at levels that will recover the operations' costs can be charged to and collected from customers. This final criterion requires consideration of anticipated changes in levels of demand or competition, direct and indirect, during the recovery period for any capitalized costs. If facts and circumstances change so that a portion of Duke Energy Ohio's regulated operations meet all of the scope criteria set forth in SFAS No. 71 when such criteria had not been previously met, SFAS No. 71 would be reapplied to all or a separable portion of the operations. Such reapplication includes adjusting the balance sheet for amounts that meet the definition of a regulatory asset or regulatory liability of SFAS No. 71. Refer to the above section titled, "Reapplication of SFAS No. 71 to Portions of Generation in Ohio."

From January 1, 2005 through December 31, 2008, Duke Energy Ohio operated under a RSP, a market-based standard service offer which was approved by the PUCO in November 2004, and which provided price certainty through December 31, 2008. See Note 4 for additional information. The RSP consisted of the following discrete charges:

- **Annually Adjusted Component**—intended to provide cost recovery primarily for environmental compliance expenditures. This component was avoidable (or by-passable) for the first 25% of residential load and 50% of non-residential load to switch to an alternative electric service provider.
- **Infrastructure Maintenance Fund Charge**—intended to compensate Duke Energy Ohio for committing its physical capacity. This charge was unavoidable (or non-by-passable).
- **System Reliability Tracker**—intended to provide actual cost recovery for capacity purchases, purchased power, reserve capacity, and related market costs for purchases to meet capacity needs. This charge was non-by-passable for residential load and by-passable for non-residential load under certain circumstances.
- **Rate Stabilization Charge**—intended to compensate Duke Energy Ohio for maintaining a fixed price through 2008. This charge was by-passable by the first 25% of residential load and 50% of non-residential load to switch.
- **Generation Prices and Fuel Recovery**—A market price has been established for generation service. A component of the market price was a fuel cost recovery mechanism that was adjusted quarterly for fuel, emission allowances, and certain purchased power costs, that exceed the amount originally included in the rates frozen in the Duke Energy Ohio transition plan. These new prices were applied to non-residential customers beginning January 1, 2005 and to residential customers beginning January 1, 2006.
- **Transmission Cost Recovery**—A transmission cost recovery mechanism was established beginning January 1, 2005 for non-residential customers and beginning January 1, 2006 for residential customers. The transmission cost recovery mechanism was designed to permit Duke Energy Ohio to recover certain Midwest Independent Transition System Operator, Inc. (Midwest ISO) charges, all Federal Energy Regulatory Commission (FERC) approved transmission costs, and all congestion costs allocable to retail ratepayers that are provided service by Duke Energy Ohio.

**Energy Purchases and Fuel Costs.** A cost tracking recovery mechanism is used to recover costs of retail fuel and emission allowances that exceed the amount originally included in the rates frozen in the Duke Energy Ohio transition plan. Also, Duke Energy Ohio began utilizing a tracking mechanism approved by the PUCO for the recovery of system reliability capacity costs related to certain specified purchases of power.

**Accounting for Risk Management and Hedging Activities and Financial Instruments.** Duke Energy Ohio may use a number of different derivative and non-derivative instruments in connection with its commodity price and interest rate risk management activities, including swaps, futures, forwards and options. All derivative instruments not designated and qualifying for the normal purchases and normal sales exception under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended (SFAS No. 133), are recorded on the Consolidated Balance Sheets at their fair value. Cash inflows and outflows related to derivative instruments, except those that contain financing elements and those related to other investing activities, are presented as a component of operating cash flows in the accompanying Consolidated Statements of Cash Flows. Cash inflows and outflows related to derivative instruments containing financing elements are presented as a component of financing cash flows in the accompanying Consolidated Statements of Cash Flows while cash inflows and outflows from derivatives related to investing activities are presented as a component of investing cash flows in the accompanying Consolidated Statements of Cash Flows.

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PART II

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

Duke Energy Ohio has designated all energy commodity derivatives as non-trading subsequent to the October 2006 sale of Cinergy Marketing and Trading, LP, and Cinergy Canada, Inc. (collectively CMT), which is discussed further in Note 14. Gains and losses for all derivative contracts that do not represent physical delivery contracts are reported on a net basis in the Consolidated Statements of Operations. For each of Duke Energy Ohio's physical delivery contracts that are derivatives, the accounting model and presentation of gains and losses, or revenue and expense in the Consolidated Statements of Operations is shown below.

Classification of Contract	Duke Energy Ohio Accounting Model	Presentation of Gains & Losses or Revenue & Expense
<i>Trading derivatives</i>	Mark-to-market <sup>(a)</sup>	Net basis in Non-regulated electric and other
<b>Non-trading derivatives:</b>		
Cash flow hedge	Accrual <sup>(b)</sup>	Gross basis in the same Statement of Operations category as the related hedged item
Fair value hedge	Accrual <sup>(b)</sup>	Gross basis in the same Statement of Operations category as the related hedged item
Normal purchase or sale	Accrual <sup>(b)</sup>	Gross basis upon settlement in the corresponding Statement of Operations category based on commodity type
Undesignated	Mark-to-market <sup>(a)</sup>	Net basis in the related Statement of Operations category for interest rate and commodity derivatives in the non-regulated business. For derivatives related to the regulated business, gains and losses are deferred as regulatory liabilities and assets, respectively.

- (a) An accounting term used by Duke Energy Ohio to refer to derivative contracts for which an asset or liability is recognized at fair value and the change in the fair value of that asset or liability is generally recognized in the Consolidated Statements of Operations for the non-regulated business and the Consolidated Balance Sheets within regulatory assets or regulatory liabilities for the regulated business. This term is applied to trading and undesignated non-trading derivative contracts. As this term is not explicitly defined within GAAP, Duke Energy Ohio's application of this term could differ from that of other companies.
- (b) An accounting term used by Duke Energy Ohio to refer to contracts for which there is generally no recognition in the Consolidated Statements of Operations for any changes in fair value until the service is provided, the associated delivery period occurs or there is hedge ineffectiveness. As discussed further below, this term is applied to derivative contracts that are accounted for as cash flow hedges, fair value hedges, and normal purchases or sales, as well as to non-derivative contracts used for commodity risk management purposes. As this term is not explicitly defined within GAAP, Duke Energy Ohio's application of this term could differ from that of other companies.

On January 1, 2008, Duke Energy Ohio adopted FASB Staff Position (FSP) No. FIN 39-1, "Amendment of FASB Interpretation No. (FIN) 39, Offsetting of Amounts Related to Certain Contracts" (FSP No. FIN 39-1). In accordance with FSP No. FIN 39-1, Duke Energy Ohio offsets fair value amounts (or amounts that approximate fair value) recognized on its Consolidated Balance Sheets related to cash collateral amounts receivable or payable against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting agreement. Prior to the adoption of FSP No. FIN 39-1, Duke Energy Ohio offset the fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting agreement in accordance with FIN 39, "Offsetting of Amounts Related to Certain Contracts," but presented cash collateral on a gross basis within the Consolidated Balance Sheets. At December 31, 2008 and 2007, Duke Energy Ohio had receivables related to the right to reclaim cash collateral of approximately \$85 million and \$5 million, respectively, and had payables related to obligations to return cash collateral of an insignificant amount at each balance sheet date that have been offset against net derivative positions in the Consolidated Balance Sheets. Additionally, Duke Energy Ohio had cash collateral receivables of approximately \$53 million and \$15 million under master netting arrangements that have not been offset against net derivative positions at December 31, 2008 and 2007, respectively, as these amounts primarily represent initial margin deposits related to New York Mercantile Exchange (NYMEX) futures contracts. Duke Energy Ohio had insignificant cash collateral payables under master netting arrangements that have not been offset against net derivative positions at December 31, 2008 and December 31, 2007.

**Cash Flow and Fair Value Hedges.** Qualifying energy commodity and other derivatives may be designated as either a hedge of a forecasted transaction or future cash flows (cash flow hedge) or a hedge of a recognized asset, liability or firm commitment (fair value hedge). For all contracts accounted for as a hedge, Duke Energy Ohio prepares formal documentation of the hedge in accordance with SFAS No. 133. In addition, at inception and at least every three months thereafter, Duke Energy Ohio formally assesses whether the hedge contract is highly effective in offsetting changes in cash flows or fair values of hedged items. Duke Energy Ohio documents hedging activity by transaction type (futures/swaps) and risk management strategy (commodity price risk/interest rate risk).

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## PART II

DUKE ENERGY OHIO, INC.

**Notes To Consolidated Financial Statements—(Continued)**

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

For derivatives designated as fair value hedges, Duke Energy Ohio recognizes the gain or loss on the derivative instrument, as well as the offsetting loss or gain on the hedged item in earnings, to the extent effective, in the current period. All derivatives designated and accounted for as hedges are classified in the same category as the item being hedged in the Consolidated Statements of Cash Flows. In addition, all components of each derivative gain or loss are included in the assessment of hedge effectiveness.

**Normal Purchases and Normal Sales (NPNS).** On a limited basis, Duke Energy Ohio applies the NPNS exception to certain contracts. If contracts cease to meet this exception, the fair value of the contracts is recognized on the Consolidated Balance Sheets and the contracts are accounted for prospectively using the MTM Model unless immediately designated as a cash flow or fair value hedge.

**Valuation.** When available, quoted market prices or prices obtained through external sources are used to measure a contract's fair value. For contracts with a delivery location or duration for which quoted market prices are not available, fair value is determined based on internally developed valuation techniques or models. For derivatives recognized under the MTM Model, valuation adjustments are also recognized in the Consolidated Statements of Operations.

**Goodwill.** Duke Energy Ohio evaluates goodwill for potential impairment under the guidance of SFAS No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). Under this provision, goodwill is subject to an annual test for impairment. Duke Energy Ohio has designated August 31 as the date it performs the annual review for goodwill impairment for its reporting units. Under the provisions of SFAS No. 142, Duke Energy Ohio performs the annual review for goodwill impairment at the reporting unit level, which Duke Energy Ohio has determined to be an operating segment.

Impairment testing of goodwill consists of a two-step process. The first step involves a comparison of the determined fair value of a reporting unit with its carrying amount. If the carrying amount of the reporting unit exceeds its fair value, the second step of the process involves a comparison of the fair value and carrying value of the goodwill of that reporting unit. If the carrying value of the goodwill of a reporting unit exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to the excess. Additional impairment tests are performed between the annual reviews if events or changes in circumstances make it more likely than not that the fair value of a reporting unit is below its carrying amount.

Duke Energy Ohio primarily uses a discounted cash flow analysis to determine fair value. Key assumptions in the determination of fair value include the use of an appropriate discount rate, estimated future cash flows and estimated run rates of operation, maintenance, and general and administrative costs. In estimating cash flows, Duke Energy Ohio incorporates expected growth rates, regulatory stability and ability to renew contracts as well as other factors into its revenue and expense forecasts. See Note 10 for further information.

**Property, Plant and Equipment.** As discussed under "Predecessor and Successor Reporting" above, recorded balances for property, plant and equipment existing as of April 3, 2006 were adjusted to reflect fair values as of that date. Due to rate-setting and recovery provisions currently in place for regulated operations, the fair values of property plant and equipment of the regulated operations were considered to approximate their carrying values as of the date of Duke Energy's merger with Cinergy. Accumulated depreciation was not reset to zero as of the merger date for the regulated property, plant and equipment due primarily to regulatory reporting implications. Unregulated property, plant and equipment were recorded at respective fair values and accumulated depreciation was reset to zero as of the merger date. Otherwise, property, plant and equipment are stated at the lower of historical cost less accumulated depreciation or fair value, if impaired. Duke Energy Ohio capitalizes all construction-related direct labor and material costs, as well as indirect construction costs. Indirect costs include general engineering, taxes and the cost of funds used during construction (see "Allowance for Funds Used During Construction (AFUDC)," discussed below). The cost of renewals and betterments that extend the useful life of property, plant and equipment are also capitalized. The cost of repairs, replacements and major maintenance projects, which do not extend the useful life or increase the expected output of the asset, is expensed as incurred. Depreciation is generally computed over the asset's estimated useful life using the composite straight-line method. The composite weighted-average depreciation rates were 2.6% for 2008, 2.6% for 2007

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DUKE ENERGY OHIO, INC.

### Notes To Consolidated Financial Statements—(Continued)

and 2.7% for 2006. Depreciation studies are conducted periodically to update the composite rates and are approved by the PUCO and the Kentucky Public Service Commission (KPSC).

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

See Note 15 for further information on the components and estimated useful lives of Duke Energy Ohio's property, plant and equipment balance.

**Asset Retirement Obligations.** Duke Energy Ohio recognizes asset retirement obligations in accordance with SFAS No. 143, "Accounting For Asset Retirement Obligations" (SFAS No. 143), for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset and FIN No. 47, "Accounting for Conditional Asset Retirement Obligations" (FIN 47), for conditional asset retirement obligations. The term conditional asset retirement obligation as used in SFAS No. 143 and FIN 47 refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Both SFAS No. 143 and FIN 47 require that the present value of the projected liability for an asset retirement obligation be recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. The present value of the liability is added to the carrying amount of the associated asset. This additional carrying amount is then depreciated over the estimated useful life of the asset. See Note 7 for further information regarding Duke Energy Ohio's asset retirement obligations.

**Long-Lived Asset Impairments, Assets Held For Sale and Discontinued Operations.** Duke Energy Ohio evaluates whether long-lived assets, excluding goodwill, have been impaired when circumstances indicate the carrying value of those assets may not be recoverable. For such long-lived assets, an impairment exists when its carrying value exceeds the sum of estimates of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. When alternative courses of action to recover the carrying amount of a long-lived asset are under consideration, a probability-weighted approach is used for developing estimates of future undiscounted cash flows. If the carrying value of the long-lived asset is not recoverable based on these estimated future undiscounted cash flows, the impairment loss is measured as the excess of the asset's carrying value over its fair value, such that the asset's carrying value is adjusted to its estimated fair value.

Management assesses the fair value of long-lived assets using commonly accepted techniques, and may use more than one source. Sources to determine fair value include, but are not limited to, recent third party comparable sales, internally developed discounted cash flow analysis and analysis from outside advisors. Significant changes in market conditions resulting from events such as changes in commodity prices or the condition of an asset, or a change in management's intent to utilize the asset may generally require management to re-assess the cash flows related to the long-lived assets.

Duke Energy Ohio uses the criteria in SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144), to determine when an asset is classified as "held for sale." Upon classification as "held for sale," the long-lived asset or asset group is measured at the lower of its carrying amount or fair value less cost to sell, depreciation is ceased and the asset or asset group is separately presented on the Consolidated Balance Sheets. When an asset or asset group meets the SFAS No. 144 criteria for classification as held for sale within the Consolidated Balance Sheets, Duke Energy Ohio does not retrospectively adjust prior period balance sheets to conform to current year presentation.

Duke Energy Ohio uses the criteria in SFAS No. 144 and Emerging Issues Task Force (EITF) Issue No. 03-13, "Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations" (EITF 03-13), to determine whether components of Duke Energy Ohio that are being disposed of, are classified as held for sale or have been wound down are required to be reported as discontinued operations in the Consolidated Statements of Operations. To qualify as a discontinued operation under SFAS No. 144, the component being disposed of must have clearly distinguishable operations and cash flows. Additionally, pursuant to EITF 03-13, Duke Energy Ohio must not have significant continuing involvement in the operations after the disposal (i.e., Duke Energy Ohio must not have the ability to influence the operating or financial policies of the disposed component) and cash flows of the operations being disposed of must have been eliminated from Duke Energy Ohio's ongoing operations (i.e., Duke Energy Ohio does not

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DUKE ENERGY OHIO, INC.

**Notes To Consolidated Financial Statements—(Continued)**

expect to generate significant direct cash flows from activities involving the disposed component after the disposal transaction is completed). Assuming both preceding conditions are met, the related results of operations for the current and prior periods, including any related impairments, are reflected within discontinued operations, net of tax, in the Consolidated Statements of Operations. If an asset held for sale does not meet the requirements for discontinued operations classification, any impairments and gains or losses on sales are recorded as a component of continuing operations in the Consolidated Statements of Operations. Impairments for all other long-lived assets are recorded in Operating Expenses in the Consolidated Statements of Operations.

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

**Loss Contingencies.** Duke Energy Ohio is involved in certain legal and environmental matters that arise in the normal course of business. Loss contingencies are accounted for under SFAS No. 5, "Accounting for Contingencies" (SFAS No. 5). Under SFAS No. 5, contingent losses are recorded when it is determined that it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. When a range of the probable loss exists and no amount within the range is a better estimate than any other amount, Duke Energy Ohio records a loss contingency at the minimum amount in the range. Unless otherwise required by GAAP, legal fees are expensed as incurred. See Note 18 for further information.

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

**Revenue Recognition and Unbilled Revenue.** Revenues on sales of electricity and gas are recognized when either the service is provided or the product is delivered. Unbilled revenues are estimated by applying an average revenue per kilowatt-hour or per thousand cubic feet (Mcf) for all customer classes to the number of estimated kilowatt-hours or Mcfs delivered but not billed. The amount of unbilled revenues can vary significantly from period to period as a result of factors, including seasonality, weather, customer usage patterns and customer mix. Unbilled revenues, which are included in Receivables on the Consolidated Balance Sheets, primarily relate to wholesale sales at Commercial Power and were approximately \$40 million and \$38 million, at December 31, 2008 and 2007, respectively. Additionally, receivables for unbilled revenues of approximately \$149 million and \$145 million at December 31, 2008 and 2007, respectively, related to retail accounts receivable at Duke Energy Ohio and Duke Energy Kentucky are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables). See Note 13 for additional information.

**Fuel Cost Deferrals.** Fuel expense includes fuel costs or other recoveries that are deferred through fuel clauses established by Duke Energy Ohio's regulators. These clauses allow Duke Energy Ohio to recover fuel costs, fuel-related costs and portions of purchased power costs through surcharges on customer rates. These deferred fuel costs are recognized in revenues and fuel expenses as they are billable to customers.

**AFUDC.** In accordance with regulatory treatment, Duke Energy Ohio records AFUDC, which represents the estimated debt and equity costs of capital funds necessary to finance the construction of new regulated facilities. Both the debt and equity components of AFUDC are non-cash amounts within the Consolidated Statements of Operations. AFUDC is capitalized as a component of the cost of Property, Plant and Equipment, with an offsetting credit to Other Income and Expenses, net on the Consolidated Statements of Operations for the equity component and as an offset to Interest Expense on the Consolidated Statements of Operations for the debt component. After construction is completed, Duke Energy Ohio is permitted to recover these costs through inclusion in the rate base and the corresponding depreciation expense. The total amount of AFUDC included in the Consolidated Statements of Operations was \$26 million in 2008, which consisted of an after-tax equity component of \$7 million and a before-tax interest expense component of \$19 million. The total amount of AFUDC included in the Consolidated Statements of Operations was \$34 million in 2007, which consisted of an after-tax equity component of \$4 million and a before-tax interest expense component of \$30 million. The total amount of AFUDC included in the Consolidated Statements of Operations for the nine months ended December 31, 2006 was \$16 million, which consisted of an after-tax



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DUKE ENERGY OHIO, INC.

### Notes To Consolidated Financial Statements—(Continued)

equity component of \$2 million and a before-tax interest expense component of \$14 million. The total amount of AFUDC included in the Consolidated Statements of Operations for the three months ended March 31, 2006 was \$4 million, which consisted of an after-tax equity component of \$1 million and a before-tax interest expense component of \$3 million.

AFUDC equity is recorded in the Consolidated Statements of Operations on an after-tax basis and is a permanent difference item for income tax purposes (i.e., a permanent difference between financial statement and income tax reporting), thus reducing Duke Energy Ohio's income tax expense and effective tax rate during the construction phase in which AFUDC equity is being recorded. The effective tax rate is subsequently increased in future periods when the completed property, plant and equipment is placed in service and depreciation of the AFUDC equity commences.

**Accounting For Purchases and Sales of Emission Allowances.** Emission allowances are issued by the Environmental Protection Agency (EPA) at zero cost and permit the holder of the allowance to emit certain gaseous by-products of fossil fuel combustion, including sulfur dioxide (SO<sub>2</sub>) and nitrogen oxide (NO<sub>x</sub>). Allowances may also be bought and sold via third party transactions or consumed as the emissions are generated. Allowances allocated to or acquired by Duke Energy Ohio are held primarily for consumption. Duke Energy Ohio records emission allowances as Intangibles, net on its Consolidated Balance Sheets and recognizes the allowances in earnings as they are consumed or sold. Gains or losses on sales of emission allowances for non-regulated businesses are presented on a net basis in Gains (Losses) on Sales of Other Assets and Other, net, in the accompanying Consolidated Statements of Operations. For regulated businesses that provide for direct recovery of emission allowances, any gain or loss on sales of recoverable emission allowances are included in the rate structure of the regulated entity and are deferred as a regulatory asset or liability. Future rates charged to retail customers are impacted by any gain or loss on sales of recoverable emission allowances and, therefore, as the recovery of the gain or loss is recognized in operating revenues, the regulatory asset or liability related to the emission allowance activity is recognized as a component of Fuel Used in Electric Generation and Purchased Power—Regulated in the Consolidated Statements of Operations. Purchases and sales of emission allowances are presented gross as investing activities on the Consolidated Statements of Cash Flows. See Note 11 for discussion regarding the impairment of the carrying value of certain emission allowances in 2008.

**Income Taxes.** As a result of Duke Energy's merger with Cinergy, Duke Energy Ohio entered into a tax sharing agreement with Duke Energy, where the separate return method is used to allocate tax expenses and benefits to the subsidiaries whose investments or results of operations provide these tax expenses or benefits. The accounting for income taxes essentially represents the income taxes that Duke Energy Ohio would incur if Duke Energy Ohio were a separate company filing its own federal tax return as a C-Corporation. The current tax sharing agreement Duke Energy Ohio has with Duke Energy is substantially the same as the tax sharing agreement between Duke Energy Ohio and Cinergy prior to the merger. Deferred income taxes have been provided for temporary differences between the GAAP and tax carrying amounts of assets and liabilities. These differences create taxable or tax-deductible amounts for future periods. Investment tax credits have been deferred and are being amortized over the estimated useful lives of the related properties in Duke Energy Ohio's regulated operations.

Management evaluates and records uncertain tax positions in accordance with FIN 48, "Accounting For Uncertainty in Income Taxes—an Interpretation of FASB Statement 109" (FIN 48), which was adopted by Duke Energy Ohio on January 1, 2007. Duke Energy Ohio records tax benefits for uncertain positions taken or expected to be taken on tax returns, including the decision to exclude certain income or transactions from a return, when a more-likely-than-not threshold is met for a tax position and management believes that the position will be sustained upon examination by the taxing authorities. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. In accordance with FIN 48, Duke Energy Ohio records the largest amount of the uncertain tax benefit that is greater than 50% likely of being realized upon settlement or effective settlement. Management considers a tax position effectively settled for the purpose of recognizing previously unrecognized tax benefits when the following conditions exist: (i) the taxing authority has completed its examination procedures, including all appeals and administrative reviews that the taxing authority is required and expected to perform for the tax positions, (ii) Duke Energy Ohio does not intend to appeal or litigate any aspect of the tax position included in the completed examination, and (iii) it is remote that the taxing authority would examine or reexamine any aspect of the tax position. See Note 6 for further information.

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

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DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

**Excise Taxes.** Certain excise taxes levied by state or local governments are collected by Duke Energy Ohio from its customers. These taxes, which are required to be paid regardless of Duke Energy Ohio's ability to collect from the customer, are accounted for on a gross basis. When Duke Energy Ohio acts as an agent, and the tax is not required to be remitted if it is not collected from the customer, the taxes are accounted for on a net basis. Duke Energy Ohio's excise taxes accounted for on a gross basis and recorded as revenues in the accompanying Consolidated Statements of Operations were as follows:

Year Ended December 31, 2008	Successor(a) Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Predecessor(a) Three Months Ended March 31, 2006
(in millions)			
\$121	\$119	\$77	\$38

(a) See "Predecessor and Successor Reporting" section above for additional information on Predecessor and Successor reporting.

**Segment Reporting.** SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" (SFAS No. 131), establishes standards for a public company to report financial and descriptive information about its reportable operating segments in annual and interim financial reports. Operating segments are components of an enterprise about which separate financial information is available and evaluated regularly by the chief operating decision maker in deciding how to allocate resources and evaluate performance. Two or more operating segments may be aggregated into a single reportable segment provided aggregation is consistent with the objective and basic principles of SFAS No. 131, if the segments have similar economic characteristics, and the segments are considered similar under criteria provided by SFAS No. 131. There is no aggregation within Duke Energy Ohio's reportable business segments. SFAS No. 131 also establishes standards and related disclosures about the way the operating segments were determined, including products and services, geographic areas and major customers, differences between the measurements used in reporting segment information and those used in the general-purpose financial statements, and changes in the measurement of segment amounts from period to period. The description of Duke Energy Ohio's reportable segments, consistent with how business results are reported internally to management and the disclosure of segment information in accordance with SFAS No. 131, are presented in Note 2.

**Statements of Consolidated Cash Flows.** Duke Energy Ohio has made certain classification elections within its Consolidated Statements of Cash Flows related to discontinued operations and debt restricted for qualified capital and maintenance expenditures. Cash flows from discontinued operations are combined with cash flows from continuing operations within operating, investing and financing cash flows within the Consolidated Statements of Cash Flows. Proceeds from debt issued with restrictions to fund future capital and maintenance expenditures are presented on a gross basis, with the debt proceeds classified as a financing cash inflow and the changes in the restricted funds held in trust presented as a component of investing activities.

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

SFAS No. 157, "Fair Value Measurements" (SFAS No. 157) Refer to Note 9 for a discussion of Duke Energy Ohio's adoption of SFAS No. 157.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities- including an amendment of FASB Statement No. 115" (SFAS No. 159) Refer to Note 9 for a discussion of Duke Energy Ohio's adoption of SFAS No. 159.

FASB Staff Position (FSP) No. FIN 39-1, "Amendment of FASB Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts" (FSP No. FIN 39-1). Refer to "Accounting for Risk Management and Hedging Activities and Financial Instruments" above for a discussion of Duke Energy Ohio's adoption of FSP No. FIN 39-1.

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

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140" (SFAS No. 155) In February 2006, the FASB issued SFAS No. 155, which amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (SFAS No. 140). SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for at fair value at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement (new basis) event, on an instrument-by-instrument basis, in cases in which a derivative would otherwise have to be bifurcated. SFAS No. 155 was effective for Duke

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## PART II

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

Energy Ohio for all financial instruments acquired, issued, or subject to remeasurement after January 1, 2007, and for certain hybrid financial instruments that had been bifurcated prior to the effective date, for which the effect is to be reported as a cumulative-effect adjustment to beginning retained earnings. The adoption of SFAS No. 155 did not have a material impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

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

**SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158)** In October 2006, the FASB issued SFAS No. 158, which changes the recognition and disclosure provisions and measurement date requirements for an employer's accounting for defined benefit pension and other post-retirement plans. The recognition and disclosure provisions require an employer to (1) recognize the funded status of a benefit plan—measured as the difference between plan assets at fair value and the benefit obligation—in its statement of financial position, (2) recognize as a component of other comprehensive loss, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost, and (3) disclose in the notes to financial statements certain additional information. SFAS No. 158 does not change the amounts recognized in the income statement as net periodic benefit cost. Duke Energy Ohio recognized the funded status of its defined benefit pension and other post-retirement plans and provided the required additional disclosures as of December 31, 2006. The adoption of SFAS No. 158 recognition and disclosure provisions resulted in an increase in total assets of approximately \$33 million (consisting of an increase in regulatory assets of \$31 million and an increase in deferred tax assets of \$2 million), an increase in total liabilities of approximately \$35 million and a decrease in AOCI, net of tax, of approximately \$2 million as of December 31, 2006. The adoption of SFAS No. 158 did not have a material impact on Duke Energy Ohio's consolidated results of operations or cash flows.

Under the measurement date requirements of SFAS No. 158, an employer is required to measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions). Historically, Duke Energy Ohio has measured its plan assets and obligations up to three months prior to the fiscal year-end, as allowed under the authoritative accounting literature. Duke Energy Ohio adopted the change in measurement date effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date, pursuant to the transition requirements of SFAS No. 158. Net periodic benefit cost of approximately \$3 million for the three-month period between September 30, 2006 and December 31, 2006 was recognized, net of tax, as a separate adjustment of retained earnings as of January 1, 2007. Additionally, in the first quarter of 2007, the changes in plan assets and plan obligations between the September 30, 2006 and December 31, 2006 measurement dates not related to net periodic benefit cost was required to be recognized, net of tax, as a separate adjustment of the opening balance of AOCI and regulatory assets. This adjustment was not material. During the second quarter of 2007, Duke Energy Ohio completed these calculations. The finalization of these actuarial calculations resulted in a \$2 million adjustment to AOCI and an insignificant adjustment to regulatory assets.

**FIN 48.** In July 2006, the FASB issued FIN 48, which provides guidance on accounting for income tax positions about which Duke Energy Ohio has concluded there is a level of uncertainty with respect to the recognition of a tax benefit in Duke Energy Ohio's financial statements. FIN 48 prescribes the minimum recognition threshold a tax position is required to meet. Tax positions are defined very broadly and include not only tax deductions and credits but also decisions not to file in a particular jurisdiction, as well as the taxability of transactions. Duke Energy Ohio adopted FIN 48 effective January 1, 2007. See Note 6 for additional information.

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

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### PART II

DUKE ENERGY OHIO, INC.

### Notes To Consolidated Financial Statements—(Continued)

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

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

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

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

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

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

## 2. Business Segments

Duke Energy Ohio operates the following business segments, which are all considered reportable business segments under SFAS No. 131: Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's management believes these reportable business segments properly align the various operations of Duke Energy Ohio with how the chief operating decision maker views the business.

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DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these reportable business segments in deciding how to allocate resources and evaluate performance. There is no aggregation within Duke Energy Ohio's defined business segments.

Franchised Electric and Gas generates, transmits, distributes and sells electricity in southwestern Ohio and northern Kentucky. Franchised Electric and Gas also transports and sells natural gas in southwestern Ohio and northern Kentucky. It conducts operations primarily through Duke Energy Ohio and Duke Energy Kentucky. These electric and gas operations are subject to the rules and regulations of the FERC, the PUCO and the KPSC. *Substantially all of Franchised Electric and Gas' operations are regulated and, accordingly, these operations are accounted for under the provisions of SFAS No. 71.*

Commercial Power owns, operates and manages power plants and engages in the wholesale marketing and procurement of electric power, fuel and emission allowances related to these plants, as well as other contractual positions. Commercial Power's asset portfolio comprises approximately 7,550 net megawatts (MW) and its generation assets consist of a diversified fuel mix with baseload and mid-merit coal-fired units, as well as combined cycle and peaking natural gas-fired units. Commercial Power's portfolio includes the five Midwestern gas-fired generation assets that were transferred from Duke Energy in 2006. Most of the generation asset output in Ohio has been contracted through the RSP, which expired on December 31, 2008 (see Note 4). Effective January 1, 2009, Commercial Power began operating under an ESP, which expires on December 31, 2011. As a result of the approval of the ESP, certain of Commercial Power's operations reapplied the provisions of SFAS No. 71 effective December 17, 2008. See Notes 1 and 4 for a discussion of the reapplication of the provisions of SFAS No. 71 to certain of Commercial Power's operations, as well as for further discussion related to the RSP and ESP.

The remainder of Duke Energy Ohio's operations is presented as Other. While it is not considered a business segment, Other primarily includes certain allocated governance costs (see Note 12).

Duke Energy Ohio's reportable business segments offer different products and services or operate under different competitive environments and are managed separately as business units. Accounting policies for Duke Energy Ohio's segments are the same as those described in Note 1. Management evaluates segment performance based on earnings before interest and taxes from continuing operations (EBIT). On a segment basis, EBIT excludes discontinued operations and represents all profits from continuing operations (both operating and non-operating and excluding corporate governance costs) before deducting interest and taxes.

Cash, cash equivalents and short-term investments, if any, are managed centrally by Cinergy and Duke Energy, so the interest and dividend income on those balances are excluded from the segments' EBIT. Transactions between reportable business segments, if any, are accounted for on the same basis as revenues and expenses in the accompanying Consolidated Financial Statements.

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**Notes To Consolidated Financial Statements—(Continued)**

**Business Segment Data<sup>(a)</sup>**

	Unaffiliated Revenues	Intersegment Revenues	Total Revenues	Segment EBIT/ Consolidated Income from Continuing Operations before Income Taxes	Depreciation and Amortization	Capital Expenditures	Segment Assets <sup>(b)(d)</sup>
(In millions)							
<b>Successor<sup>(c)</sup></b>							
<b>Year Ended December 31, 2008</b>							
Franchised Electric and Gas	\$ 1,778	\$ —	\$ 1,778	\$ 291	\$ 243	\$ 305	\$ 5,857
Commercial Power	1,646	—	1,646	301	166	260	6,249
Total reportable segments	3,424	—	3,424	592	409	565	12,106
Other	—	—	—	(67)	—	—	17
Eliminations and reclassifications	—	—	—	—	—	—	(34)
Interest expense	—	—	—	(94)	—	—	—
Interest income and other	—	—	—	27	—	—	—
Total consolidated	\$ 3,424	\$ —	\$ 3,424	\$ 458	\$ 409	\$ 565	\$ 12,089
<b>Successor<sup>(c)</sup></b>							
<b>Year Ended December 31, 2007</b>							
Franchised Electric and Gas	\$ 1,707	\$ —	\$ 1,707	\$ 257	\$ 228	\$ 275	\$ 5,530
Commercial Power	1,748	—	1,748	304	164	318	6,147
Total reportable segments	3,455	—	3,455	561	392	593	11,677
Other	—	—	—	(75)	—	—	—
Eliminations and reclassifications	—	—	—	—	—	—	—
Interest expense	—	—	—	(100)	—	—	—
Interest income and other	—	—	—	29	—	—	—
Total consolidated	\$ 3,455	\$ —	\$ 3,455	\$ 415	\$ 392	\$ 593	\$ 11,677
<b>Successor<sup>(c)</sup></b>							
<b>Nine Months Ended December 31, 2006</b>							
Franchised Electric and Gas	\$ 1,027	\$ —	\$ 1,027	\$ 130	\$ 160	\$ 198	\$ 5,381
Commercial Power	1,234	1	1,235	93	120	193	6,349
Total reportable segments	2,261	1	2,262	223	280	391	11,730
Other	—	—	—	(56)	—	—	—
Eliminations and reclassifications	—	(1)	(1)	—	—	—	—
Interest expense	—	—	—	(81)	—	—	—
Interest income and other	—	—	—	16	—	—	—
Total consolidated	\$ 2,261	\$ —	\$ 2,261	\$ 102	\$ 280	\$ 391	\$ 11,730
<b>Predecessor<sup>(c)</sup></b>							
<b>Three Months Ended March 31, 2006</b>							
Franchised Electric and Gas	\$ 543	\$ —	\$ 543	\$ 80	\$ 50	\$ 75	
Commercial Power	420	1	421	166	18	60	
Total reportable segments	963	1	964	246	68	135	
Other	—	—	—	(39)	—	—	
Eliminations and reclassifications	—	(1)	(1)	—	—	—	
Interest expense	—	—	—	(30)	—	—	
Interest income and other	—	—	—	9	—	—	
Total consolidated	\$ 963	\$ —	\$ 963	\$ 186	\$ 68	\$ 135	

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DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

- (a) Segment results exclude results of entities classified as discontinued operations.
- (b) Segment assets at December 31, 2006 include assets held for sale.
- (c) See Note 1 for additional information on Predecessor and Successor reporting.
- (d) Amounts include goodwill recorded as of December 31, 2008 and December 31, 2007 resulting from Duke Energy's merger with Cinergy in the amount of \$2,360 million and \$2,325 million, respectively. Franchised Electric and Gas' allocated amount as of December 31, 2008 and December 31, 2007 was \$1,154 million and \$1,137 million, respectively. Commercial Power's allocated amount as of December 31, 2008 and December 31, 2007 was \$1,206 million and \$1,188 million, respectively. All of Duke Energy Ohio's revenues are generated domestically and its long-lived assets are all in the U.S.

**3. Merger, Transfer of Generating Assets and Sales of Other Assets**

**Acquisitions.** Duke Energy Ohio consolidates assets and liabilities from acquisitions as of the purchase date, and includes earnings from acquisitions in consolidated earnings after the purchase date. Assets acquired and liabilities assumed are recorded at estimated fair values on the date of acquisition. The purchase price minus the estimated fair value of the acquired assets and liabilities meeting the definition of a business as defined in EITF Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business" (EITF 98-3), is recorded as goodwill. The allocation of the purchase price may be adjusted if additional, requested information is received during the allocation period, which generally does not exceed one year from the consummation date, however, it may be longer for certain income tax items. As discussed in Note 1, effective January 1, 2009, Duke Energy Ohio adopted SFAS No. 141(R) and will apply the provisions of this standard to any future acquisitions.

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

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

As discussed in Note 1, purchase accounting impacts, including goodwill recognition, have been "pushed down" to Duke Energy Ohio, resulting in the assets and liabilities of Duke Energy Ohio being recorded at their respective fair values as of April 3, 2006. The following unaudited consolidated pro forma financial results for Duke Energy Ohio are presented as if the merger with Duke Energy had occurred at the beginning of 2006:

**Unaudited Consolidated Pro Forma Results (Predecessor)**

	<b>Three Months Ended</b>	
	<b>March 31, 2006</b>	
	<b>(In millions)</b>	
Operating revenues	\$	966
Income from continuing operations		88
Net income		86
Earnings available for common stockholder		86

Pro forma results for the nine months ended December 31, 2006 are not presented since the merger occurred at the beginning of such period. Additionally, pro forma results do not include any significant transactions completed by Duke Energy Ohio other than the impact of Cinergy's merger with Duke Energy.

Prior to consummation of the merger, certain regulatory approvals were received from the state utility commissions and the FERC. See Note 4 for a discussion of the regulatory impacts of the merger.

**Transfer of Certain Duke Energy Generating Assets to Duke Energy Ohio.** In April 2006, Duke Energy contributed to Duke Energy Ohio its ownership interest in five plants, representing a mix of combined cycle and peaking plants, with a combined capacity of 3,600 MW. The transaction was effective in April 2006 and was accounted for at Duke Energy's net book value for these assets. The entities holding these generating plants, which were indirect subsidiaries of Duke Energy, were first distributed to Duke Energy, which then contributed them to Cinergy which, in turn, contributed them to Duke Energy Ohio. In the final step, the entities were then merged into Duke Energy Ohio.

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DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

The following unaudited consolidated pro forma financial results for Duke Energy Ohio are presented as if the contribution of the Duke Energy generating assets to Duke Energy Ohio had occurred at the beginning of the periods presented:

**Unaudited Consolidated Pro Forma Results (Predecessor)**

	<b>Three Months Ended March 31, 2006</b>	
	<b>(In millions)</b>	
Operating revenues	\$	971
Income from continuing operations		106
Net income		104
Earnings available for common stockholder		104

These pro forma results do not include any significant transactions completed by Duke Energy Ohio other than the impact of the transfer of the ownership interest in the five plants as discussed above. As part of this transaction, Duke Energy agreed to reimburse Duke Energy Ohio, on a quarterly basis, through April 2016 in the event of certain cash shortfalls related to the performance of the five plants. Based on the assessment of the performance of the five plants on a quarterly basis during 2008 and 2007, Duke Energy Ohio did not incur any qualifying shortfalls related to the performance of the five plants and thus no cash reimbursement was required from Duke Energy. During the third quarter of 2006, Duke Energy reimbursed Duke Energy Ohio \$1.9 million for certain cash shortfalls that occurred during the second quarter of 2006. However, as a result of the calculation pertaining to the third quarter 2006 performance of the five plants, the \$1.9 million received by Duke Energy Ohio from Duke Energy was returned to Duke Energy during the fourth quarter of 2006. Duke Energy Ohio accounts for any payments from or return of payments to Duke Energy in Common Stockholder's Equity as an adjustment to Additional paid-in capital.

**Other Asset Sales.** For the year ended December 31, 2008, the sale of other assets resulted in approximately \$77 million in proceeds and net pre-tax gains of approximately \$59 million, which is recorded in Gains (Losses) on Sales of Other Assets and Other, net in the Consolidated Statements of Operations. These gains primarily relate to Commercial Power's sales of zero cost basis emission allowances.

For the year ended December 31, 2007 and the nine months ended December 31, 2006, the sale of other assets resulted in proceeds of approximately \$29 million and \$138 million, respectively, and net pre-tax losses of approximately \$8 million and \$28 million, respectively, recorded in Gains (Losses) on Sales of Other Assets and Other, net in the Consolidated Statements of Operations. These losses primarily relate to Commercial Power's sales of emission allowances that were written up to fair value in purchase accounting in connection with Duke Energy's merger with Cinergy in April 2006.

See Note 14 for dispositions related to discontinued operations.

For the three months ended March 31, 2006, the sale of other assets resulted in approximately \$105 million in proceeds and net pre-tax gains of approximately \$26 million recorded in Gains (Losses) on Sales of Other Assets and Other, net in the Consolidated Statements of Operations. These gains primarily relate to Commercial Power's sales of emission allowances.

**4. Regulatory Matters**

**Regulatory Assets and Liabilities.** Substantially all of Franchised Electric and Gas' operations and certain portions of Commercial Power's operations apply the provisions of SFAS No. 71. Accordingly, these businesses record assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. See Note 1 for further information.



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DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

**Duke Energy Ohio's Regulatory Assets and Liabilities:**

	As of December 31,		Recovery/Refund Period Ends
	2008	2007	
	(in millions)		
<b>Regulatory Assets<sup>(a)</sup></b>			
Regulatory Transition Charges (RTC) <sup>(d)(e)</sup>	\$ 138	\$ 239	2011
Accrued pension and post-retirement <sup>(e)</sup>	191	120	(b)
Net regulatory asset related to income taxes	103	90	(i)
Capital-related distribution costs <sup>(e)</sup>	15	22	(m)
Unamortized costs of reacquiring debt <sup>(f)</sup>	10	11	2025
Vacation accrual <sup>(g)</sup>	12	10	2009
Deferred operating expense <sup>(e)(c)</sup>	8	7	2067
Hedge costs and other deferrals <sup>(h)(n)</sup>	106	5	2009
Storm cost deferrals <sup>(e)</sup>	36	—	(b)
Other <sup>(h)</sup>	15	9	(b)
<b>Total Regulatory Assets</b>	<b>\$ 634</b>	<b>\$ 513</b>	
<b>Regulatory Liabilities<sup>(a)</sup></b>			
Removal costs <sup>(c)(k)</sup>	\$ 189	\$ 181	(j)
Accrued pension and post-retirement <sup>(k)</sup>	—	27	(b)
Over-recovery of fuel costs <sup>(l)</sup>	36	1	2009
Other <sup>(l)</sup>	29	7	(b)
<b>Total Regulatory Liabilities</b>	<b>\$ 254</b>	<b>\$ 216</b>	

- (a) All regulatory assets and liabilities are excluded from rate base unless otherwise noted.
- (b) Recovery/Refund period currently unknown.
- (c) Included in rate base.
- (d) The state of Ohio passed comprehensive electric deregulation legislation in 1999, and in 2000, the PUCO approved a stipulation agreement relating to Duke Energy Ohio's transition plan creating a RTC designed to recover Duke Energy Ohio's generation-related regulatory assets and transition costs over a ten-year period beginning January 1, 2001.
- (e) Included in Other within Regulatory Assets and Deferred Debits on the Consolidated Balance Sheets.
- (f) Included in Deferred Debt Expense on the Consolidated Balance Sheets.
- (g) Included in Other within Current Assets on the Consolidated Balance Sheets.
- (h) Included in Other within Current Assets and Other within Regulatory Assets and Deferred Debits on the Consolidated Balance Sheet.
- (i) Recovery/refund is over the life of the associated asset or liability.
- (j) Liability is extinguished over the lives of the associated assets.
- (k) Included in Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.
- (l) Included in Accounts Payable or Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.
- (m) Recovered via revenue rider.
- (n) Approximately \$95 million of the balance at December 31, 2008 relates to mark-to-market deferrals associated with open hedge positions at Commercial Power as a result of the reapplication of SFAS No. 71.

**Regulatory Merger Approvals.** On April 3, 2006, the merger between Duke Energy and Cinergy was consummated to create a newly-formed company, Duke Energy Holding Corp. (subsequently renamed Duke Energy Corporation). As a condition to the merger approval, the PUCO and the Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Ohio and Kentucky, respectively. The commissions also required Duke Energy Ohio and Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- The PUCO required that Duke Energy Ohio provide (i) a rate reduction of approximately \$15 million for one year to facilitate economic development in a time of increasing rates and market prices and (ii) a reduction of approximately \$21 million to its gas and electric consumers in Ohio for one year, with both credits beginning January 1, 2006. During the first quarter of 2007, Duke Energy Ohio completed its merger related rate reductions and filed a report with the PUCO to terminate the merger credit riders. Approximately \$2 million and \$34 million of the rate reductions was passed through to customers during the year ended December 31, 2007 and 2006, respectively.

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### PART II

DUKE ENERGY OHIO, INC.

### Notes To Consolidated Financial Statements—(Continued)

- The KPSC required that Duke Energy Kentucky provide \$8 million in rate reductions to its customers over five years, ending when new rates are established in the next rate case after January 1, 2008. Approximately \$2 million of the rate reduction was passed through to customers during the years ended December 31, 2008, 2007 and 2006, respectively.
- The FERC approved the merger without conditions.

**Restrictions on the Ability of Duke Energy Ohio to Make Dividends, Advances and Loans to Duke Energy Corporation.** As discussed above, on April 3, 2006, the merger between Duke Energy and Cinergy was consummated. As a condition of the merger approval the state utility commissions imposed conditions (the Merger Conditions) on the ability of Duke Energy Ohio and Duke Energy Kentucky to transfer funds to Duke Energy through loans or advances, as well as restricted amounts available to pay dividends to Duke Energy. Pursuant to the Merger Conditions, Duke Energy Ohio will not declare and pay dividends out of capital or unearned surplus without the prior authorization of the PUCO and Duke Energy Kentucky is required to pay dividends solely out of retained earnings and to maintain a minimum of 35% equity in its capital structure. At December 31, 2008, Duke Energy Ohio had restricted net assets of approximately \$6.3 billion that may not be transferred to Duke Energy without appropriate approval based on the aforementioned Merger Conditions.

#### Franchised Electric and Gas.

**Rate Related Information.** The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. The PUCO approves rates and market prices for retail gas and electric service within the state of Ohio, except that non-regulated sellers of gas and electric generation also are allowed to operate in Ohio (see "Commercial Power" below). The FERC approves rates for electric sales to wholesale customers served under cost-based rates.

**Duke Energy Ohio Electric Rate Filings.** Duke Energy Ohio operated under a RSP, a market-based standard service approved by the PUCO in November 2004, from January 1, 2005 through December 31, 2008. In March 2005, the Office of the Ohio Consumers' Counsel (OCC) appealed the PUCO's approval of the RSP to the Supreme Court of Ohio which issued its decision in November 2006. It upheld the RSP in virtually every respect but remanded to the PUCO on two issues. The Supreme Court of Ohio ordered the PUCO to support a certain portion of its order with reasoning and record evidence and to require Duke Energy Ohio to disclose certain confidential commercial agreements with other parties previously requested by the OCC. Duke Energy Ohio has complied with the disclosure order.

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

On February 15, 2008, Duke Energy Ohio filed a notice of appeal with the Ohio Supreme Court challenging a portion of the PUCO's decision on remand regarding Duke Energy Ohio's RSP. The October 2007 order permits non-residential customers to avoid certain charges associated with the costs of Duke Energy Ohio standing ready to serve such customers if they return after being served by another supplier. Duke Energy Ohio believes the PUCO exceeded its authority in modifying the charges that may be avoided, resulting in Duke Energy Ohio having to subsidize Ohio's competitive electric market. Duke Energy Ohio asked the Ohio Supreme Court to reverse the PUCO ruling and require that non-residential customers pay the charges associated with Duke Energy Ohio standing ready to serve them should they return from a competitive supplier. On March 28, 2008, Duke Energy Ohio voluntarily withdrew its appeal. The OCC filed a notice of appeal challenging the PUCO's October 2007 decision as unlawful and unreasonable. The OCC and Ohio Partners for Affordable Energy (OPAe) also filed appeals from the PUCO's November 20, 2007 order approving Duke Energy Ohio's RSP riders. Duke Energy

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DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

Ohio intervened in each appeal. Pending the Ohio Supreme Court's consideration of its initial appeal, the OCC requested that the PUCO stay implementation of the Infrastructure Maintenance Fund charge to be collected from customers approved in the October 2007 order. The Commission denied the OCC's request and the OCC filed a similar request with the Ohio Supreme Court. On July 9, 2008, the court denied the OCC's request to stay implementation of the Infrastructure Maintenance Fund. On April 30, 2008, the Ohio Supreme Court granted Duke Energy Ohio's motion to intervene in the OCC's appeal. Oral arguments were conducted on November 18, 2008. On January 2, 2009, the PUCO filed a motion to dismiss the action as moot. The PUCO argued that the rates at issue in this matter expired on January 1, 2009, with the implementation of Duke Energy Ohio's ESP. On February 19, 2009, the Ohio Supreme Court issued its decision on OCC's appeal. The Ohio Supreme Court granted the PUCO's motion to dismiss ruling that because the challenged rate structure is no longer in effect, it can neither order lower prospective rates nor order a refund.

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

On July 31, 2008, Duke Energy Ohio filed a new generation pricing formula to be effective January 1, 2009, when the current RSP expired. Among other things, the plan provides pricing mechanisms for compensation related to the advanced energy, renewables and energy efficiency portfolio standards established by SB 221.

On October 27, 2008, Duke Energy Ohio filed a Stipulation and Recommendation (Stipulation) for consideration by the PUCO regarding Duke Energy Ohio's July 31, 2008 ESP filing. The Stipulation reflects agreement on all but two issues in this proceeding and was filed with the support of most of the parties to this proceeding. In addition to the Stipulation, the ability for residential governmental aggregation customers to avoid certain charges and to receive a shopping credit will be presented to the PUCO for a ruling. Parties to this proceeding who do not support the Stipulation were free to litigate any, or all, issues.

The Stipulation agrees to a net increase in base generation revenues of approximately \$36 million, \$74 million and \$98 million in 2009, 2010 and 2011, respectively, including termination of the residential and non-residential RTC. Such amounts result in a residential net rate increase of 2% in 2009 and in 2010, and a non-residential net rate increase of 2% in 2009, 2010 and 2011. The Stipulation also allows the recovery of expenditures incurred to deploy SmartGrid infrastructure modernization technology on the distribution system. The recovery of such expenditures, net of savings, is subject to an annual residential revenue cap. Further, the Stipulation allows for the implementation of a new energy efficiency compensation model, referred to as Save-A-Watt, to achieve the energy efficiency mandate pursuant to the recent electric energy legislation. The criteria customers must meet to be exempt from Duke Energy Ohio's program will also be presented to the PUCO for a ruling in this case. Also, under the Stipulation, Duke Energy Ohio may defer up to \$50 million of certain operation and maintenance costs incurred at the W.C. Beckjord generating station and amortize such costs over a three-year period.

The ESP hearing occurred on November 10, 2008. On December 17, 2008, the PUCO issued its finding and order resolving the two litigated issues and adopting a modified Stipulation. Specifically, the PUCO modified the Stipulation to permit certain non-residential customers to opt out of utility-sponsored energy efficiency initiatives and to allow residential governmental aggregation customers who leave Duke Energy Ohio's system to avoid some charges. Applications for rehearing of the PUCO's decision have been filed by environmental groups and a residential customer advocate group. On February 11, 2009 the PUCO issued an Entry denying the rehearing requests.

As discussed further below within "Commercial Power" and in Note 1, as a result of the approval of the ESP, effective December 17, 2008, Commercial Power reapplied the provisions of SFAS No. 71 to certain portions of its operations.

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#### DUKE ENERGY OHIO, INC. Notes To Consolidated Financial Statements—(Continued)

**Duke Energy Ohio Gas Rate Case.** In July 2007, Duke Energy Ohio filed an application with the PUCO for an increase in its base rates for gas service. Duke Energy Ohio sought an increase of approximately \$34 million in revenue, or approximately 5.7%, to be effective in the spring of 2008. The application also requested approval to continue tracker recovery of costs associated with the accelerated gas main replacement program. The staff of the PUCO issued a Staff Report in December 2007 recommending an increase of approximately \$14 million to \$20 million in revenue. The Staff Report also recommended approval for Duke Energy Ohio to continue tracker recovery of costs associated with the accelerated gas main replacement program. On February 28, 2008, Duke Energy Ohio reached a settlement agreement with the PUCO Staff and all of the intervening parties on its request for an increase in natural gas base rates. The settlement called for an annual revenue increase of approximately \$18 million in base revenue, or 3% over current revenue, permitted continued recovery of costs through 2018 for Duke Energy Ohio's accelerated gas main replacement program and permitted recovery of carrying costs on gas stored underground via its monthly gas cost adjustment filing. The settlement did not resolve a proposed rate design for residential customers, which involved moving more of the fixed charges of providing gas service, such as capital investment in pipes and regulating equipment, billing and meter reading, from the per unit charges to the monthly charge. On May 28, 2008, the PUCO approved the settlement in its entirety and the proposed rate design. On June 28, 2008, the OCC and OPAE filed Applications for Rehearing opposing the rate design. On July 23, 2008, the Ohio Commission issued an Entry denying the rehearing requests of OCC and OPAE. On September 16 and 19, 2008 respectively, OCC and OPAE filed their notices of appeal to the Ohio Supreme Court opposing the residential rate design issue. Merit briefs were filed with the Ohio Supreme Court on February 2, 2009. At this time, Duke Energy Ohio cannot predict whether the Ohio Supreme Court will reverse the PUCO's decision of May 28, 2008.

**Duke Energy Ohio Electric Distribution Rate Case.** On June 25, 2008, Duke Energy Ohio filed notice with the PUCO that it will seek a rate increase for electric delivery service of approximately \$86 million, or 4.8% on total electric revenues, to be effective in the second quarter of 2009. Among other things, the rate request includes a proposal to increase the monthly residential customer charge from \$4.50 to \$10, with an offsetting reduction in the usage-based charge. This change in rate design will make customer bills more even throughout the year. Duke Energy Ohio also proposes a distribution modernization tracker that would allow smaller annual increases to reflect increased investment in the delivery system. On December 22, 2008, Duke Energy Ohio filed an application requesting deferral of approximately \$31 million related to damage to its distribution system from a September 14, 2008 windstorm. On January 14, 2009, the PUCO granted Duke Energy Ohio's deferral request. Accordingly, a regulatory asset was recorded as of December 31, 2008 for \$31 million. The staff of the PUCO issued a Staff Report in January 2009 recommending an increase of approximately \$54 million to \$62 million associated with the Ohio distribution rate case. The staff report did not recommend approval of the distribution modernization tracker. The report also recommended approval of a rider to recover the deferred storm costs from the September 14, 2008 windstorm and recommended a future hearing be established to evaluate the windstorm related costs and implement a rider. An evidentiary hearing with the PUCO is scheduled to begin March 31, 2009.

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

In February 2005, Duke Energy Kentucky filed a gas base rate case with the KPSC requesting approval to continue the tracking mechanism and for a \$14 million annual increase in base rates. A portion of the increase is attributable to recovery of the current cost of the accelerated gas main replacement program in base rates. In June 2005, the Kentucky General Assembly enacted Kentucky Revised Statute 278.509 (KRS 278.509), which specifically authorizes the KPSC to approve tracker recovery for utilities' gas main replacement programs. In December 2005, the KPSC approved an annual rate increase of \$8 million and re-approved the tracking mechanism through 2011. In February 2006, the Kentucky Attorney General appealed the KPSC's order to the Franklin Circuit Court, claiming that the order improperly allows Duke Energy Kentucky to increase its rates for gas main replacement costs in between general rate cases, and also claiming that the order improperly allows Duke Energy Kentucky to earn a return on investment for the costs recovered under the tracking mechanism which permits Duke Energy Kentucky to recover its gas main replacement costs.

In August 2007, the Franklin Circuit Court consolidated all the pending appeals and ruled that the KPSC lacks legal authority to approve the gas main replacement tracking mechanism, which were approved prior to the enactment of KRS 278.509. To date, Duke Energy Kentucky has collected approximately \$9 million in annual rate adjustments under the tracking mechanism. Per the KPSC order,

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Duke Energy Kentucky collected these revenues subject to refund pending the final outcome of this litigation. Duke Energy Kentucky and the KPSC have requested that the Kentucky Court of Appeals grant a rehearing of its decision. On February 5, 2009, the Kentucky Court of Appeals denied the rehearing requests of both Duke Energy Kentucky and the KPSC. Duke Energy Kentucky filed a motion for discretionary review to the Kentucky Supreme Court on March 9, 2009. At this time, Duke Energy Kentucky cannot predict whether the Kentucky Supreme Court will accept the case for review.

**Energy Efficiency.** On July 11, 2007, the PUCO approved Duke Energy Ohio's Demand Side Management/Energy Efficiency Program (DSM Program). The DSM programs were first proposed in 2006 and were endorsed by the Duke Energy Community Partnership, which is a collaborative group made up of representatives of organizations interested in energy conservation, efficiency and assistance to low-income customers. The program costs are recouped through a cost recovery mechanism that will be adjusted annually to reflect the previous year's activity. Duke Energy Ohio is permitted to recover lost revenues, program costs and shared savings (once the programs reach 65% of the targeted savings level) through the cost recovery mechanism based upon impact studies to be provided to the Staff of the PUCO. Duke Energy Ohio filed the Save-A-Watt Energy Efficiency Plan as part of its ESP filed with the PUCO on July 31, 2008 (discussed above). A Stipulation and Recommendation for consideration by the PUCO regarding Duke Energy Ohio's ESP filing, including implementation of Save-A-Watt, was filed on October 27, 2008. The ESP hearing occurred on November 10, 2008. On December 17, 2008, the PUCO approved the ESP, including allowing for the implementation of a new Save-A-Watt energy efficiency compensation model. However, the PUCO determined that certain non-residential customers may opt out of Duke Energy Ohio's energy efficiency initiative. Applications for rehearing of this decision have been filed by environmental groups and a residential customer advocate group.

On November 15, 2007, Duke Energy Kentucky filed its annual application to continue existing energy efficiency programs, consisting of nine residential and two commercial and industrial programs, and to true-up its gas and electric tracking mechanism for recovery of lost revenues, program costs and shared savings. On February 11, 2008, Duke Energy Kentucky filed a motion to amend its energy efficiency programs and applied to reinstitute a low income Home Energy Assistance Program. The KPSC bifurcated the proposed Home Energy Assistance Program from the other energy efficiency programs. On May 14, 2008, the KPSC approved the energy efficiency programs. On September 25, 2008, the KPSC approved Duke Energy Kentucky's Home Energy Assistance program, making it available for customers at or below 150% of the federal poverty level. On December 1, 2008, Duke Energy Kentucky filed an application for a Save-A-Watt Energy Efficiency Plan. The application seeks a new energy efficiency recovery mechanism similar to what was proposed in Ohio. An evidentiary hearing with the KPSC is expected to occur in the third quarter of 2009.

**Other Franchised Electric and Gas Matters.**

**Ohio Riser Leak Investigation.** In April 2005, the PUCO issued an order opening a statewide investigation into riser leaks in gas pipeline systems throughout Ohio. The investigation followed four explosions since 2000 caused by gas riser leaks, including an April 2000 explosion in Duke Energy Ohio's service area. In November 2006, the PUCO Staff released the expert report, which concluded that certain types of risers are prone to leaks under various conditions, including over-tightening during initial installation. The PUCO Staff recommended that natural gas companies continue to monitor the situation and study the cause of any further riser leaks to determine whether further remedial action is warranted. As of January 1, 2008, Duke Energy Ohio had approximately 87,000 of these risers on its distribution system. If the PUCO orders natural gas companies to replace all of these risers, Duke Energy Ohio estimates a replacement cost of approximately \$40 million. As part of the rate case filed in July 2007 (see "Duke Energy Ohio Gas Rate Case" above), Duke Energy Ohio requested approval from the PUCO to accelerate its riser replacement program. The riser replacement program is contained in the settlement reached with all intervenors and expected to be completed at the end of 2012.

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

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**Midwest ISO's Establishment of an Ancillary Services Market.** On February 25, 2008, the FERC conditionally accepted the Midwest ISO proposal to implement a day-ahead and real-time ancillary services market (ASM), including a scarcity pricing proposal. By approving the ASM proposal, the FERC essentially approved the transfer and consolidation of Balancing Authority for the entire Midwest ISO area. This will allow the Midwest ISO to determine operating reserve requirements and procure operating reserves from all qualified resources from an organized market, in place of the current system of local management and procurement of reserves by the 24 Balancing Authorities. The Midwest ISO launched the ASM on January 6, 2009.

**Commercial Power.**

As discussed in Note 1, effective December 17, 2008, Commercial Power reapplied the provisions of SFAS No. 71 to certain portions of its operations due to the passing of SB 221 and the PUCO's approval of the ESP. However, since certain portions of Commercial Power's operations are not subject to regulatory accounting pursuant to SFAS No. 71, reported results for Commercial Power are subject to volatility due to the over- or under-collection of certain costs for which recovery is not automatic under the ESP. Commercial Power may be impacted by certain of the regulatory matters discussed above, including the Duke Energy Ohio electric rate filings.

**FERC 203 Application.** On April 23, 2008 (supplemented on May 6, 2008), Duke Energy Ohio and certain affiliates filed an application with the FERC requesting approval to transfer Duke Energy Ohio's electric generating facilities, some of which are designated to serve Ohio customers, to affiliate companies. The FERC filing, if approved, does not obligate Duke Energy to make the transfer of the electric generating facilities, and does not impact Duke Energy Ohio's current rates. On October 10, 2008, Duke Energy Ohio and affiliates filed a notice with the FERC reporting that Duke Energy Ohio was in settlement discussions with all parties in the Ohio proceeding regarding Duke Energy Ohio's application to establish an ESP, as discussed above. Duke Energy Ohio advised the FERC that it believes that in light of those discussions good cause exists for the FERC to extend the time to consider Duke Energy Ohio's Section 203 application. On October 17, 2008, the FERC issued an order extending the time for the FERC to act on the application by 180 additional days, and ordered Duke Energy Ohio to inform the FERC of the status of settlement discussions by November 16, 2008. As part of the settlement that was approved by the PUCO on December 17, 2008 (see discussion above) Duke Energy Ohio agreed to withdraw that portion of its application for approval related to the transfer of its generating facilities designated to serve Ohio customers and the PUCO approved of the transfer for the remaining generating facilities. Duke Energy Ohio filed a new application requesting FERC approval to transfer to affiliate companies only the remaining generating facilities not designated to serve Ohio customers, which was conditionally approved by the FERC on February 19, 2009. As a condition of approval, the FERC requires that all acquisition premiums related to generating assets being transferred to Cinergy Power be removed from Duke Energy Ohio's financial statements when Duke Energy Ohio submits its final accounting entries and that any debt associated with the generation assets being transferred be transferred to the generating facility before Duke Energy Ohio submits its final accounting entries. In addition, the FERC will hold Duke Energy Ohio to its commitments to have the affiliate company receiving assets pay taxes associated with the proposed transaction rather than Duke Energy Ohio, to maintain a minimum equity to total capital ratio of 30%, and to retain an amount of debt that will accommodate the preservation of Duke Energy Ohio's current credit ratings.

**PJM Interconnection Reliability Pricing Model (RPM) Buyers' Complaint.** On May 30, 2008, a group of public utility commissions, state consumer counsels, industrial power customers and load serving entities, known collectively as the RPM Buyers, filed a complaint at FERC. The complaint asks FERC to find that the results of the three transitional base residual auctions conducted by PJM to procure capacity for its RPM capacity market during the years 2008-2011 are unjust and unreasonable because, allegedly, they have produced excessive capacity prices, have failed to prevent suppliers from exercising market power, and have not produced benefits commensurate with costs. In their complaint, the RPM Buyers propose revised, administratively determined auction clearing prices. Certain Duke Energy Ohio revenues during the years 2008-2011 are at risk, as Duke Energy Ohio planned to supply capacity to this market. On July 11, 2008, Duke Energy Ohio filed a response to the complaint with the FERC. On September 19, 2008, the FERC issued an Order denying and dismissing the RPM Buyer's complaint, finding that, for the transition auctions, no party violated PJM's tariff and the prices determined during the auctions were in accordance with the tariff provisions governing the auctions. On October 20, 2008, the RPM Buyers filed a Request for Rehearing with the FERC that raised the same issues as in the initial complaint that was denied by the FERC.

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**Other Matters.**

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

**5. Joint Ownership of Generating and Transmission Facilities**

Duke Energy Ohio, Columbus Southern Power Company (CSP), and Dayton Power & Light (DP&L) jointly own electric generating units and related transmission facilities in Ohio. Duke Energy Kentucky and DP&L jointly own an electric generating unit. Duke Energy Ohio and Wabash Valley Power Association Inc. jointly own the Vermillion generating station in Indiana.

Duke Energy Ohio's share of jointly-owned plant or facilities included on the December 31, 2008 Consolidated Balance Sheet were as follows:

	Ownership Share	Property, Plant, and Equipment	Accumulated Depreciation	Construction Work in Progress
(in millions)				
<b>Duke Energy Ohio</b>				
Production:				
Miami Fort Station (Units 7 and 8) <sup>(b)</sup>	64.0%	\$ 591	\$ 160	\$ 4
W.C. Beckjord Station (Unit 6) <sup>(b)</sup>	37.5	55	31	1
J.M. Stuart Station <sup>(a)(b)</sup>	39.0	426	200	342
Conesville Station (Unit 4) <sup>(a)(b)</sup>	40.0	82	56	174
W.M. Zimmer Station <sup>(b)</sup>	46.5	1,321	509	10
Killen Station <sup>(a)(b)</sup>	33.0	207	128	96
Vermillion <sup>(b)</sup>	75.0	197	47	—
Transmission <sup>(c)</sup>	Various	90	51	—
<b>Duke Energy Kentucky</b>				
Production:				
East Bend Station <sup>(c)</sup>	69.0	423	219	5

(a) Station is not operated by Duke Energy Ohio.

(b) Included in Commercial Power segment.

(c) Included in Franchised Electric and Gas segment.

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

**6. Income Taxes**

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

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

**Income Tax Expense**

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup>
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
	(in millions)			
Current income taxes				
Federal	\$ 110	\$ 120	\$ 139	\$ 55
State	9	13	22	6
Total current income taxes <sup>(b)</sup>	119	133	161	61
Deferred income taxes				
Federal	52	19	(100)	11
State	2	1	(18)	(3)
Total deferred income taxes	54	20	(118)	8
Investment tax credit amortization	(2)	(2)	(2)	(1)
Total income tax expense from continuing operations	171	151	41	68
Total income tax benefit from discontinued operations	—	—	(3)	(1)
Total income tax expense from extraordinary item	37	—	—	—
Total income tax expense included in Consolidated Statements of Operations	\$ 208	\$ 151	\$ 38	\$ 67

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Included are FIN 48 benefits of approximately \$17 million in 2008 and \$13 million in 2007.

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

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup>
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
	(in millions)			
Income tax expense, computed at the statutory rate of 35%	\$ 160	\$ 145	\$ 36	\$ 65
State income tax, net of federal income tax effect	7	9	3	2
Depreciation and other PP&E related differences	7	9	6	2
ITC amortization	(2)	(2)	(2)	(1)
Manufacturing deduction	(6)	(10)	(2)	—
Other items, net	5	—	—	—
Total income tax expense from continuing operations	\$ 171	\$ 151	\$ 41	\$ 68
Effective Tax Rates	37.3%	36.4%	40.2%	36.6%

(a) See Note 1 for additional information on Predecessor and Successor reporting.



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**Notes To Consolidated Financial Statements—(Continued)**

The manufacturing deduction was created by the American Job Creation Act of 2004 (the Act). The Act provides a deduction for income from qualified domestic production activities. During the year ended December 31, 2006, the Act provided for a 3% deduction on qualified production activities. During the years ended December 31, 2008 and 2007, the deduction increased to 6% on qualified production activities.

**Net Deferred Income Tax Liability Components**

	As of December 31,	
	2008	2007
	(in millions)	
Deferred credits and other liabilities	\$ 13	\$ 100
Other	52	54
<b>Total deferred income tax assets</b>	<b>65</b>	<b>154</b>
Investments and other assets	(111)	(68)
Accelerated depreciation rates	(1,373)	(1,311)
Regulatory assets and deferred debits	(142)	(195)
<b>Total deferred income tax liabilities</b>	<b>(1,626)</b>	<b>(1,574)</b>
<b>Total net deferred income tax liabilities</b>	<b>\$ (1,561)</b>	<b>\$ (1,420)</b>

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

**Net Deferred Income Tax Liabilities**

	As of December 31,	
	2008	2007
	(in millions)	
Current deferred tax assets, included in other current assets	\$ 64	\$ 26
Current deferred tax liabilities, included in other current liabilities	(6)	(10)
Non-current deferred tax liabilities	(1,619)	(1,436)
<b>Total net deferred income tax liabilities</b>	<b>\$ (1,561)</b>	<b>\$ (1,420)</b>

**Changes to Unrecognized Tax Benefits**

	2008	2007
	Increase/ (Decrease) (in millions)	Increase/ (Decrease) (in millions)
Unrecognized Tax Benefits—January 1	\$ 47	\$ 63
<b>Unrecognized Tax Benefits Changes</b>		
Gross increases—tax positions in prior periods	—	9
Gross decreases—tax positions in prior periods	(22)	(19)
Gross increases—current period tax positions	—	—
Settlements	(10)	(6)
<b>Total Changes</b>	<b>(32)</b>	<b>(16)</b>
Unrecognized Tax Benefits—December 31	\$ 15	\$ 47

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

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**Notes To Consolidated Financial Statements—(Continued)**

It is reasonably possible that Duke Energy Ohio will reflect an approximate \$6 million reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

During the years ended December 31, 2008 and December 31, 2007, Duke Energy Ohio recognized net interest income of approximately \$7 million and a net interest expense of approximately \$2 million, respectively. At December 31, 2008 and December 31, 2007, Duke Energy Ohio had approximately \$1 million of interest receivable and \$7 million of interest payable, respectively, which reflects all interest related to income taxes. No amount has been accrued for the payment of penalties in the Consolidated Balance Sheets at either December 31, 2008 or 2007.

Duke Energy Ohio has the following tax years open:

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

As of December 31, 2008 and 2007, approximately \$64 million and \$26 million, respectively, of deferred income taxes were included in Other within Current Assets on the Consolidated Balance Sheets. At December 31, 2008 this balance exceeded 5% of total current assets.

**7. Asset Retirement Obligations**

Asset retirement obligations, which represent legal obligations associated with the retirement of certain tangible long-lived assets, are computed as the present value of the projected costs for the future retirement of specific assets and are recognized in the period in which the liability is incurred, if a reasonable estimate of fair value can be made. The present value of the liability is added to the carrying amount of the associated asset in the period the liability is incurred. This additional carrying amount is then depreciated over the life of the asset. Subsequent to the initial recognition, the liability is adjusted for any revisions to the estimated future cash flows associated with the asset retirement obligation (with corresponding adjustments to property, plant and equipment), which can occur due to a number of factors including, but not limited to, cost escalation, changes in technology applicable to the assets to be retired and changes in federal, state or local regulations, as well as for accretion of the liability due to the passage of time until the obligation is settled. Depreciation expense is adjusted prospectively for any increases or decreases to the carrying amount of the associated asset. There is no impact on the earnings of Duke Energy Ohio's regulated operations within the Franchised Electric and Gas business segment when an asset retirement obligation is recognized as the effects of the recognition and subsequent accounting are offset by the establishment of regulatory assets and liabilities to defer all income statement impacts related to SFAS No. 143.

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

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

	Years Ended December 31,	
	2008	2007
	(in millions)	
Balance as of January 1,	\$ 31	\$ 41
Accretion expense	2	2
Liabilities settled <sup>(a)</sup>	—	(12)
Balance as of December 31,	\$ 33	\$ 31

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

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**Notes To Consolidated Financial Statements—(Continued)**

Duke Energy Ohio's regulated electric and regulated natural gas operations accrue costs of removal for property that does not have an associated legal retirement obligation based on regulatory orders from the PUCO and the KPSC. These costs of removal are recorded as a regulatory liability in accordance with regulatory treatment under SFAS No. 71. Duke Energy Ohio does not accrue the estimated cost of removal when no legal obligation associated with retirement or removal exists for any non-regulated assets (including Duke Energy Ohio's generation assets). The total amount of removal costs included in Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets was \$189 million and \$181 million as of December 31, 2008 and 2007, respectively. Duke Energy Ohio's non-regulated operations expense cost of removal as incurred.

**8. Risk Management and Hedging Activities and Credit Risk**

Duke Energy Ohio is exposed to the impact of market fluctuations in the prices of electricity, coal, natural gas and other energy-related products marketed and purchased within its non-regulated operations, as well as within its regulated operations, to the extent there is excess capacity from generation assets that are dedicated to serve Ohio native load customers. Exposure to interest rate risk exists as a result of the issuance of variable and fixed rate debt. Duke Energy Ohio employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity and financial derivative instruments, including swaps, futures, forwards and options. For Duke Energy Ohio, commodity price risk has been somewhat reduced by the December 17, 2008 PUCO approval of Duke Energy Ohio's ESP, which resulted in the reapplication of SFAS No. 71 to certain portions of Duke Energy Ohio's Commercial Power business segment operations as of that date.

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

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

	Years Ended December 31,	
	2008	2007
	(in millions)	
Hedging	\$ (9)	\$ (23)
Undesignated	(70)	7
Total	\$ (79)	\$ (16)

The amounts in the table above represent the combination of amounts presented as assets and liabilities for unrealized gains and losses on mark-to-market and hedging transactions on Duke Energy Ohio's Consolidated Balance Sheets.

**Transfer of Certain Duke Energy Assets and Commodity Cash Flow Hedges.** As part of the merger with Duke Energy on April 3, 2006, Duke Energy Ohio acquired certain generation assets from Duke Energy, representing approximately 3,600 MW of power generation and those assets were added to Duke Energy Ohio's non-regulated generation portfolio. Duke Energy Ohio also assumed approximately \$63 million of pre-tax deferred losses (\$39 million, after-tax) associated with contracts formerly designated as cash flow hedges of forecasted power sales and gas purchases from Duke Energy's Midwestern generation fleet. These contracts were sold by Duke Energy in 2005 and the deferred losses remain on the Consolidated Balance Sheet in AOCI until the related hedged transactions (gas purchases and power sales) occur. See Note 1 and Note 3 for further details on the completed merger and for details on the transfer of generation assets. During 2007, Duke Energy Ohio entered into additional contracts to protect margins for a portion of future sales and generation revenues and fuel expenses for the Midwestern generation fleet. Duke Energy Ohio is hedging exposures to the price variability of these commodities for a maximum period of 2 years. All derivatives related to the Midwestern generation fleet are included in Duke Energy Ohio's Consolidated Balance Sheets at December 31, 2008 and 2007.

As of December 31, 2008, \$24 million of pre-tax deferred net losses on derivative instruments related to commodity cash flow hedges accumulated on the Consolidated Balance Sheet in AOCI are expected to be recognized in earnings during the next twelve

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months. However, due to the volatility of the commodities markets, the corresponding value in AOCI will likely change prior to its reclassification into earnings.

**Other Derivative Contracts. Trading.** Duke Energy Ohio had been exposed to the impact of market fluctuations in the prices of natural gas, electricity and other energy-related products marketed and purchased as a result of proprietary trading activities. In June 2006, Cinergy sold CMT, including certain of Duke Energy Ohio's trading contracts, to Fortis. The results of this trading activity up through the date of the sale, which was completed in October 2006, has been reflected in Loss from Discontinued Operations, net of tax, in the Consolidated Statements of Operations. In connection with the sale, Duke Energy Ohio entered into a series of Total Return Swaps (TRS) with Fortis (see Note 14). As of December 31, 2008, all of the underlying contracts that were part of the TRS had been transferred to Fortis and, as a result, Duke Energy Ohio has no future exposure associated with these TRS.

**Undesignated.** Duke Energy Ohio uses derivative contracts to manage the market risk exposures that arise from energy supply, structured origination, marketing, risk management, and commercial optimization services to large energy customers, energy aggregators and other wholesale companies, and to manage interest rate exposures. This category would include changes in fair value for derivatives that no longer qualify for the NPNS scope exception and disqualified hedge contracts, unless the derivative contract is subsequently re-designated as a hedge. The contracts in this category as of December 31, 2008 are primarily associated with forward power sales and coal purchases, as well as forward contracts to purchase SO<sub>2</sub> emission allowances and certain interest rate derivatives, for the Commercial Power and Franchised Electric and Gas operations. Duke Energy Ohio's exposure to price risk is influenced by a number of factors, including contract size, length, market liquidity, location and unique or specific contract terms.

During the years ended December 31, 2008 and 2007, Duke Energy Ohio included in earnings approximately \$75 million of pre-tax losses and approximately \$13 million of pre-tax gains, respectively, related to mark-to-market adjustments within Commercial Power, which are reported primarily in operating revenues within Non-regulated electric and other and Fuel used in electric generation and purchased power—non-regulated on the Consolidated Statements of Operations. As discussed in Note 1 and Note 4, beginning on December 17, 2008, Commercial Power reapplied the provisions of SFAS No. 71 to certain portions of its operations due to the passing of SB 221 and the approval of the ESP. The reapplication of SFAS No. 71 on December 17, 2008 resulted in an approximate \$67 million after-tax (approximately \$103 million pre-tax) extraordinary gain related to total mark-to-market losses previously recorded in earnings associated with open forward hedge contracts, which the ESP allows to be recovered through an FPP rider. Subsequent to December 17, 2008, mark-to-market gains and losses on certain open hedge positions related to native load generation will be deferred as regulatory assets or liabilities and recovered through the FPP rider.

**Interest Rate (Fair Value or Cash Flow) Hedges.** Changes in interest rates expose Duke Energy Ohio to risk as a result of its issuance of variable and fixed rate debt. Duke Energy Ohio manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Ohio also enters into financial derivative instruments, including interest rate swaps, swaptions and U.S. Treasury lock agreements to manage and mitigate interest rate risk exposure. Duke Energy Ohio's existing interest rate derivative instruments and related ineffectiveness were insignificant to its consolidated results of operations, cash flows and financial position in 2008, 2007, and 2006.

As of December 31, 2008, approximately \$2 million of pre-tax net losses on terminated interest rate hedges were accumulated on the Consolidated Balance Sheets in AOCI and are expected to be recognized in earnings during the next twelve months as the hedged transactions occur.

**Normal Purchases and Normal Sales Exception.** Duke Energy Ohio has applied the normal purchases and normal sales scope exception, as provided in SFAS No. 133 and interpreted by Derivatives Implementation Group Issue C 15, "Scope Exceptions: Normal Purchases and Normal Sales Exception for Option-Type Contracts and Forward Contracts in Electricity," and amended by SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," to certain contracts involving the purchase and sale of electricity at fixed prices in future periods. These contracts, which relate primarily to the delivery of electricity over the next 6 years, are not included in the table above.

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

Duke Energy Ohio's industry has historically operated under negotiated credit lines for physical delivery contracts. Duke Energy Ohio may use master collateral agreements to mitigate certain credit exposures. The collateral agreements provide for a counterparty to post

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DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

cash or letters of credit to the exposed party for exposure in excess of an established threshold. The threshold amount represents an unsecured credit limit, determined in accordance with the corporate credit policy. Collateral agreements also provide that the inability to post collateral is sufficient cause to terminate contracts and liquidate all positions.

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

**9. Fair Value of Financial Assets and Liabilities**

On January 1, 2008, Duke Energy Ohio adopted SFAS No. 157. Duke Energy Ohio's adoption of SFAS No. 157 is currently limited to financial instruments and to non-financial derivatives as, in February 2008, the FASB issued FSP No. 157-2, which delayed the effective date of SFAS No. 157 until January 1, 2009 for non-financial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. There was no cumulative effect adjustment to retained earnings for Duke Energy Ohio as a result of the adoption of SFAS No. 157.

SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP in the U.S. and expands disclosure requirements about fair value measurements. Under SFAS No. 157, fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition under SFAS No. 157 focuses on an exit price, which is the price that would be received by Duke Energy Ohio to sell an asset or paid to transfer a liability versus an entry price, which would be the price paid to acquire an asset or received to assume a liability. Although SFAS No. 157 does not require additional fair value measurements, it applies to other accounting pronouncements that require or permit fair value measurements. In October 2008, the FASB issued FSP No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" (FSP FAS 157-3), which illustrated key considerations in determining the fair value of a financial asset when the market for that asset is not active. The application of FSP FAS 157-3 did not change the way Duke Energy Ohio determined fair value of its financial assets and liabilities.

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

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

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

**Level 3 inputs**—unobservable inputs for the asset or liability.

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

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DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

The following table provides the fair value measurement amounts for assets and liabilities recorded in both current and non-current Unrealized gains on mark-to-market and hedging transactions and Unrealized losses on mark-to-market and hedging transactions on Duke Energy Ohio's Consolidated Balance Sheets at fair value at December 31, 2008. Amounts presented in the table below exclude cash collateral amounts which are disclosed separately in Note 1.

Description	Total Fair Value Amounts at December 31, 2008			
	Level 1 (in millions)	Level 2	Level 3	
Derivative assets	\$ 68	\$ 9	\$ —	\$ 59
Derivative liabilities	\$ (147)	\$ (88)	\$ (8)	\$ (51)

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

**Rollforward of Level 3 Measurements**

Year Ended December 31, 2008	Derivatives (net) (in millions)
Balance at January 1, 2008	\$ (22)
Total pre-tax realized or unrealized gains (losses) included in earnings:	
Revenue, non-regulated electric and other	(1)
Fuel used in electric generation and purchased power—non-regulated	96
Net purchases, sales, issuances and settlements	(63)
Total losses included on balance sheet as regulatory asset or liability or as non-current liability	(2)
Balance at December 31, 2008	\$ 8
Pre-tax gains (losses) included in the Consolidated Statements of Operations related to Level 3 measurements outstanding at December 31, 2008:	
Revenue, non-regulated electric and other	\$ 7
Fuel used in electric generation and purchased power—non-regulated	30
Total	\$ 37

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

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

**Fair Value Disclosures Required Under SFAS No. 107, "Disclosures About Fair Value of Financial Instruments."** The fair value of financial instruments, excluding financial assets and liabilities included in the scope of SFAS No. 157 disclosed in the tables above, is summarized in the following table. Judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates determined as of December 31, 2008 and 2007, are not necessarily indicative of the amounts Duke Energy Ohio could have realized in current markets.

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DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

**Financial Instruments**

	As of December 31,			
	2008		2007	
	Book Value	Approximate Fair Value	Book Value	Approximate Fair Value
Long-term debt, including current maturities	\$ 1,883	\$ 1,729	\$ 1,936	\$ 1,914

(In millions)

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

**10. Goodwill and Intangibles**

Duke Energy Ohio evaluates the impairment of goodwill under the guidance of SFAS No. 142. There were no goodwill impairment charges in 2008, 2007 or 2006 as a result of the annual impairment tests required by SFAS No. 142. As discussed further in Note 3, in April 2006, Duke Energy and Cinergy consummated their merger, which resulted in Duke Energy Ohio recording goodwill of approximately \$2.3 billion. Duke Energy Ohio had no goodwill prior to this date. The following table shows the components of goodwill at December 31, 2008 and 2007:

**Carrying Amount of Goodwill**

	Balance at December 31, 2007	Changes (in millions)	Balance at December 31, 2008
	Commercial Power		\$ 1,188
Franchised Electric and Gas	1,137	17	1,154
Total Goodwill	\$ 2,325	\$ 35	\$ 2,360

  

	Balance at December 31, 2006	Changes (in millions)	Balance at December 31, 2007
	Commercial Power		\$ 1,200
Franchised Electric and Gas	1,148	(11)	1,137
Total Goodwill	\$ 2,348	\$ (23)	\$ 2,325

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DUKE ENERGY OHIO, INC.  
Notes To Consolidated Financial Statements—(Continued)

**Intangible Assets**

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

	December 31, 2008	December 31, 2007
	(in millions)	
Emission allowances	\$ 239	\$ 365
Gas, coal, and power contracts	271	271
Other	9	9
Total gross carrying amount	519	645
Accumulated amortization—gas, coal, and power contracts	(111)	(89)
Accumulated amortization—other	(5)	(5)
Total accumulated amortization	(116)	(94)
Total intangible assets, net	\$ 403	\$ 551

Emission allowances in the table above include emission allowances which were recorded at fair value on the date of Duke Energy's merger with Cinergy and emission allowances purchased by Duke Energy Ohio. Additionally, Duke Energy Ohio is allocated certain zero cost emission allowances on an annual basis. The change in the gross carrying value of emission allowances during the years ended December 31, 2008 and 2007 is as follows:

	December 31, 2008	December 31, 2007
	(in millions)	
Gross carrying value at beginning of period	\$ 365	\$ 495
Purchases of emission allowances	17	23
Sales and consumption of emission allowances <sup>(a)(b)</sup>	(69)	(154)
Impairment of emission allowances <sup>(c)</sup>	(82)	—
Other changes	8	1
Gross carrying value at end of period	\$ 239	\$ 365

(a) Carrying values of emission allowances are recognized via a charge to expense when consumed. Carrying values of emission allowances sold or consumed during the years ended December 31, 2008 and 2007, the nine months ended December 31, 2006 and the three months ended March 31, 2006 were \$69 million, \$154 million, \$267 million and \$36 million, respectively.

(b) See Note 3 for a discussion of gains and losses on sales of emission allowances by Commercial Power during the years ended December 31, 2008, 2007 and 2006.

(c) See Note 11 for discussion of impairments of the carrying value of emission allowances during the year ended December 31, 2008.

Amortization expense for gas, coal and power contracts and other intangible assets for Duke Energy Ohio was approximately \$22 million and \$51 million for the years ended December 31, 2008 and 2007, respectively, approximately \$43 million for the nine months ended December 31, 2006 and approximately \$1 million for the three months ended March 31, 2006.

The table below shows the expected amortization expense for the next five years for intangible assets as of December 31, 2008. The expected amortization expense includes estimates of emission allowances consumption and estimates of consumption of commodities such as gas and coal under existing contracts. The amortization amounts discussed below are estimates. Actual amounts may differ from these estimates due to such factors as changes in consumption patterns, sales or impairments of emission allowances or other intangible assets, additional intangible acquisitions and other events.

	2009	2010	2011	2012	2013
	(in millions)				
Expected amortization expense	\$ 90	\$ 31	\$ 29	\$ 29	\$ 26



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PART II

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

### Intangible Liabilities

In connection with the merger with Cinergy in April 2006, Duke Energy recorded an intangible liability of approximately \$113 million associated with the market-based standard service offer in Ohio, which was recognized in earnings over the regulatory period that ended on December 31, 2008. The carrying amount of this intangible liability was zero and approximately \$67 million at December 31, 2008 and 2007, respectively. Duke Energy also recorded approximately \$56 million of intangible liabilities associated with other power sale contracts in connection with the merger with Cinergy. The carrying amount of these intangible liabilities was approximately \$16 million and \$22 million at December 31, 2008 and 2007, respectively. During the years ended December 31, 2008, 2007 and 2006, Duke Energy amortized approximately \$73 million, \$45 million and \$35 million, respectively, to income related to intangible liabilities. The remaining balance of approximately \$16 million will be amortized to income as follows: approximately \$6 million in each of the years 2009 through 2010, and approximately \$4 million in 2011. Intangible liabilities are classified as Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

### 11. Impairment Charges

**Emission Allowances.** On July 11, 2008, the U.S. Court of Appeals for the District of Columbia issued a decision vacating the Clean Air Interstate Rule (CAIR). In December 2008, a federal appeals court reinstated the CAIR while the EPA develops a new clean air program (see Note 18 for additional information). However, as a result of the July 11, 2008 decision temporarily vacating the CAIR, there were sharp declines in market prices of SO<sub>2</sub> and NO<sub>x</sub> allowances in the third quarter of 2008 due to uncertainty associated with future federal requirements to reduce emissions. Accordingly, pursuant to SFAS No. 144, Duke Energy Ohio evaluated the carrying value of emission allowances held by its regulated and non-regulated businesses for impairment during the third quarter of 2008.

At the time of its repeal, the CAIR required 50% reductions in SO<sub>2</sub> emissions beginning in 2010 and further 30% reductions in SO<sub>2</sub> emissions in 2015 beyond specified requirements. These reductions were to be achieved by requiring the surrender of SO<sub>2</sub> allowances in a ratio of two allowances per ton of SO<sub>2</sub> emitted beginning in 2010, up from a current one-to-one ratio, escalating to 2.86 allowances per ton of SO<sub>2</sub> emitted beginning in 2015. Taking into account these increases in emission allowance requirements under the CAIR, Commercial Power's forecasted SO<sub>2</sub> emissions needed through 2037 exceeded the number of emission allowances held prior to the vacating of the CAIR. Subsequent to the decision to vacate the CAIR, Commercial Power determined that it had SO<sub>2</sub> allowances in excess of forecasted emissions and those allowances held in excess of forecasted emissions from future generation required an impairment evaluation. In performing the impairment evaluation for SO<sub>2</sub> allowances in the third quarter of 2008, management compared quoted market prices for each vintage year allowance to the carrying value of the related allowances in excess of forecasted emissions through 2038. Due to the sharp decline in market prices of SO<sub>2</sub> allowances, as discussed above, during the third quarter of 2008, Commercial Power recorded pre-tax impairment charges of approximately \$77 million related to forecasted excess SO<sub>2</sub> allowances held. Additionally, Commercial Power recorded pre-tax impairment charges of approximately \$5 million in the third quarter of 2008 related to annual NO<sub>x</sub> allowances as these were also affected by the decision to vacate the CAIR. These impairment charges are recorded in Impairment Charges within Operating Expenses on the Consolidated Statements of Operations.

As a result of the reinstatement of the CAIR, as discussed above, all emission allowances and certain commitments to purchase emission allowances held by Commercial Power as of December 31, 2008 are anticipated to be utilized for future emission allowance requirements under the CAIR, unless the EPA develops a new clean air program that changes the existing requirements under the CAIR.

See Note 10 for further information regarding the carrying value of emission allowances.

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DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

**12. Related Party Transactions**

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

	December 31, 2008(a)	December 31, 2007(a)
	(In millions)	
Current assets <sup>(b)</sup>	\$ 55	\$ 58
Non-current assets <sup>(c)</sup>	\$ 5	\$ —
Current liabilities <sup>(d)</sup>	\$ (138)	\$ (266)
Non-current liabilities <sup>(e)</sup>	\$ (4)	\$ —
Net deferred tax liabilities <sup>(f)</sup>	\$ (1,519)	\$ (1,385)

- (a) Balances exclude assets or liabilities associated with accrued pension and other post-retirement benefits, Cinergy Receivables and money pool arrangements as discussed below.
- (b) Of the balance at December 31, 2008, approximately \$18 million is classified as Receivables, approximately \$2 million is classified as Unrealized gains on mark-to-market and hedging transactions and approximately \$35 million is classified as Other within Current Assets on the Consolidated Balance Sheets. The balance at December 31, 2007 is classified as Receivables on the Consolidated Balance Sheets.
- (c) The balance at December 31, 2008 is classified as Unrealized gains on mark-to-market and hedging transactions within Investments and Other Assets on the Consolidated Balance Sheets.
- (d) Of the balance at December 31, 2008, approximately (\$133) million is classified as Accounts payable, approximately (\$2) million is classified as Taxes accrued and approximately (\$3) million is classified as Unrealized losses on mark-to-market and hedging transactions within Current Liabilities on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately (\$256) million is classified as Accounts payable and approximately (\$10) million is classified as Taxes accrued on the Consolidated Balance Sheets.
- (e) The balance at December 31, 2008 is classified as Unrealized losses on mark-to-market and hedging transactions within *Deferred Credits and Other Liabilities* on the Consolidated Balance Sheets.
- (f) Of the balance at December 31, 2008, approximately (\$1,580) million is classified as Deferred income taxes and approximately \$61 million is classified as Other within Current Assets on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately (\$1,409) million is classified as Deferred income taxes and approximately \$24 million is classified as Other within Current Assets on the Consolidated Balance Sheets.

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

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup>
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
	(in millions)			
Corporate governance and shared services expenses	\$ 319	\$ 249	\$ 290	\$ 112

- (a) See Note 1 for additional information on Predecessor and Successor reporting.  
 Duke Energy Ohio incurs expenses related to certain insurance coverages through *Bison Insurance Company Limited*, Duke Energy's wholly-owned captive insurance subsidiary. These expenses, which are recorded in Operation, maintenance and other within Operating Expenses on the Consolidated Statements of Operations, were approximately \$18 million, \$24 million, and \$12 million for the years ended December 31, 2008, 2007 and 2006, respectively. Additionally, Duke Energy Ohio records income associated with the rental of office space to a consolidated affiliate of Duke Energy, as well as income associated with certain other recoveries of cost. Rental income and other cost recoveries were approximately \$13 million, \$12 million, \$9 million and \$2 million for the years ended December 31, 2008 and 2007, the nine months ended December 31, 2006 and the three months ended March 31, 2006, respectively.

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PART II

**DUKE ENERGY OHIO, INC.  
Notes To Consolidated Financial Statements—(Continued)**

Duke Energy Ohio participates in Cinergy's qualified pension plan, non-qualified pension plan and other post-retirement benefit plans and is allocated its proportionate share of expenses associated with these plans (see Note 19). Additionally, Duke Energy Ohio has been allocated accrued pension and other post-retirement and post-employment benefit obligations from Cinergy of approximately \$416 million and \$266 million at December 31, 2008 and 2007, respectively. The above amounts have been classified in the Consolidated Balance Sheets as follows:

	December 31, 2008	(in millions)	December 31, 2007
Other current liabilities	\$	5	\$ 6
Accrued pension and other post-retirement benefit costs	\$	406	\$ 259
Other deferred credits and other liabilities	\$	5	\$ 2

Additionally, certain trade receivables have been sold by Duke Energy Ohio to Cinergy Receivables, an unconsolidated entity formed by Cinergy. The proceeds obtained from the sales of receivables are largely cash but do include a subordinated note from Cinergy Receivables for a portion of the purchase price. This subordinated note is classified by Duke Energy Ohio as Receivables in the Consolidated Balance Sheets and was approximately \$174 million and \$189 million as of December 31, 2008 and December 31, 2007, respectively. The interest income associated with the subordinated note, which is recorded in Other Income and Expenses, net on the Consolidated Statements of Operations, was approximately \$21 million and \$25 million for the years ended December 31, 2008 and 2007, respectively.

See Note 17 for a discussion of dividends Duke Energy Ohio paid to its parent, Cinergy.

During the second quarter of 2007 Duke Energy Ohio received a \$29 million capital contribution from its parent, Cinergy.

See Note 3 for a discussion of amounts paid to Duke Energy Ohio as a result of the agreement between Duke Energy and Duke Energy Ohio related to Duke Energy's contribution of its ownership interests in five plants to Duke Energy Ohio.

As discussed further in Note 16, Duke Energy Ohio participates in a money pool arrangement with Duke Energy and other Duke Energy subsidiaries. As of December 31, 2008 and December 31, 2007, Duke Energy Ohio was in a payable position of \$63 million and \$189 million, respectively, classified within Notes payable in the accompanying Consolidated Balance Sheets. The expenses associated with money pool activity, which are recorded in Interest Expense on the Consolidated Statements of Operations, for the years ended December 31, 2008 and 2007, nine months ended December 31, 2006 and three months ended March 31, 2006 were approximately \$3 million, \$11 million, \$6 million and \$2 million, respectively.

**13. Sales of Accounts Receivable**

**Accounts Receivable Securitization** Duke Energy Ohio and Duke Energy Kentucky sell, on a revolving basis, nearly all of their retail accounts receivable and related collections to Cinergy Receivables, a bankruptcy remote, special purpose entity that is a wholly-owned limited liability company of Cinergy. The securitization transaction was structured to meet the criteria for sale treatment under SFAS No. 140, and, accordingly, Cinergy does not consolidate Cinergy Receivables and the transfers of receivables are accounted for as sales.

The proceeds obtained from the sales of receivables are largely cash but do include a subordinated note from Cinergy Receivables for a portion of the purchase price (typically approximates 25 percent of the total proceeds). The note, which amounts to approximately \$174 million and \$189 million at December 31, 2008 and 2007, respectively, is subordinate to senior loans that Cinergy Receivables obtain from commercial paper conduits controlled by unrelated financial institutions which is the source of funding for the subordinated note. This subordinated note is a retained interest (right to receive a specified portion of cash flows from the sold assets) under SFAS No. 140 and is classified within Receivables in the accompanying Consolidated Balance Sheets at December 31, 2008 and 2007.

The carrying values of the retained interests are determined by allocating the carrying value of the receivables between the assets sold and the interests retained based on relative fair value. The key assumptions in estimating fair value are the anticipated credit losses, the selection of discount rates, and expected receivables turnover rate. Because (a) the receivables generally turnover in less than two months, (b) credit losses are reasonably predictable due to Duke Energy Ohio's broad customer base and lack of significant concentration, and (c) the purchased beneficial interest is subordinate to all retained interests and thus would absorb losses first, the allocated bases of the subordinated notes are not materially different than their face value. Interest accrues to Duke Energy Ohio on the retained

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DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

interests using the accretable yield method, which generally approximates the stated rate on the notes since the allocated basis and the face value are nearly equivalent. An impairment charge is recorded against the carrying value of both the retained interests and purchased beneficial interest whenever it is determined that an other-than-temporary impairment has occurred (which is unlikely unless credit losses on the receivables far exceed the anticipated level).

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

	Years Ended December 31,		
	2008	2007	2006
Anticipated credit loss rate	0.7%	0.7%	0.8%
Discount rate on expected cash flows	5.3%	7.7%	7.4%
Receivables turnover rate	12.4%	12.4%	12.7%

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

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

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

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup>
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
	(in millions)			
Receivables sold as of period end	\$ 473	\$ 437	\$ 370	
Less: Retained interests	174	189	133	
Net receivables sold as of period end	\$ 299	\$ 248	\$ 237	
<b>Sales during period</b>				
Receivables sold	\$ 3,316	\$ 3,189	\$ 1,982	\$ 869
Loss recognized on sale	38	46	29	12
<b>Cash flows during period</b>				
Cash proceeds from receivables sold	\$ 3,276	\$ 3,086	\$ 1,935	\$ 919
Collection fees received	3	3	2	
Return received on retained interests	21	25	13	8

(a) See Note 1 for additional information on Predecessor and Successor reporting.

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DUKE ENERGY OHIO, INC.

**Notes To Consolidated Financial Statements—(Continued)****14. Discontinued Operations and Assets Held for Sale**

In June 2006, Cinergy agreed to sell CMT, including certain of Duke Energy Ohio's trading contracts, to Fortis, a Benelux-based financial services group. In October 2006, the sale was completed. Results of operations for these trading contracts have been reflected in Loss from Discontinued Operations, net of tax in the accompanying Consolidated Statements of Operations. In October 2006, in connection with this transaction, Duke Energy Ohio entered into a series of TRS with Fortis, which were accounted for as mark-to-market derivatives. The TRS was cancelled for each underlying contract as each was transferred to Fortis. As of December 31, 2008, all of the underlying contracts that were part of the TRS had been transferred to Fortis and, as a result, Duke Energy Ohio has no future exposure associated with these TRS.

The following table summarizes the results classified as Loss from Discontinued Operations, net of tax, in the accompanying Consolidated Statements of Operations. There was no discontinued operations activity in 2008 or 2007.

	<u>Successor<sup>(a)</sup></u> <u>Nine Months</u> <u>Ended</u> <u>December 31,</u> <u>2006</u>	(In millions)	<u>Predecessor<sup>(a)</sup></u> <u>Three Months</u> <u>Ended</u> <u>March 31,</u> <u>2006</u>
Revenues	\$ 5		\$ 9
Operating Loss			
Loss before taxes	(6)		(3)
Income tax benefit	(2)		(1)
Loss from Discontinued Operations, net of tax	\$ (4)		\$ (2)
Net Loss on Dispositions			
Pre-tax loss on dispositions	\$ (3)		\$ —
Income tax benefit	(1)		—
Loss on dispositions, net of tax	\$ (2)		\$ —
Total Loss from Discontinued Operations, net of tax	\$ (6)		\$ (2)

(a) See Note 1 for additional information on Predecessor and Successor reporting.

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DUKE ENERGY OHIO, INC.  
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**15. Property, Plant and Equipment**

	Estimated Useful Life (Years)	December 31, 2008	December 31, 2007
(in millions)			
Land	—	\$ 126	\$ 129
Plant—Regulated			
Electric generation, distribution and transmission <sup>(a)</sup>	8 – 100	3,262	3,197
Natural gas transmission and distribution <sup>(a)</sup>	12 – 60	1,566	1,436
Other buildings and improvements <sup>(a)</sup>	25 – 100	103	129
Plant—Unregulated			
Electric generation, distribution and transmission	8 – 100	3,710	3,813
Other buildings and improvements	30	190	25
Equipment	5 – 25	60	64
Construction in process	—	843	594
Other	5 – 20	187	190
Total property, plant and equipment		10,047	9,577
Total accumulated depreciation—regulated <sup>(b)</sup>		(1,646)	(1,640)
Total accumulated depreciation—unregulated		(631)	(457)
Total net property, plant and equipment		\$ 7,770	\$ 7,480

(a) Includes capitalized leases of approximately \$109 million for 2008 and \$88 million for 2007.

(b) Includes accumulated amortization of capitalized leases: \$6 million for 2008 and \$10 million for 2007. Capitalized interest, which includes the interest expense component of AFUDC, amounted to \$19 million for the year ended December 31, 2008, \$30 million for the year ended December 31, 2007, \$14 million for the nine months ended December 31, 2006 and \$3 million for the three months ended March 31, 2006.

**16. Debt and Credit Facilities**

Summary of Debt and Related Terms

	Weighted- Average Rate	Year Due	December 31, 2008	December 31, 2007
(in millions)				
Unsecured debt	5.8%	2012 – 2036	\$ 1,225	\$ 1,345
Capital leases	5.2%	2009 – 2020	51	59
Other debt <sup>(a)</sup>	2.0%	2011 – 2041	646	572
Notes payable	2.2%		280	—
Money pool	0.5%		63	189
Unamortized debt discount and premium, net			(39)	(40)
Total debt			2,226	2,125
Current maturities of long-term debt			(27)	(126)
Short-term notes payable			(343)	(189)
Total long-term debt			\$ 1,856	\$ 1,810

(a) Includes \$538 million of Duke Energy Ohio pollution control bonds as of both December 31, 2008 and 2007. As of December 31, 2008 and 2007, zero and \$84 million, respectively, was secured by first and refunding mortgage bonds and \$62 million and \$12 million, respectively, was secured by a letter of credit.

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### PART II

#### DUKE ENERGY OHIO, INC.

### Notes To Consolidated Financial Statements—(Continued)

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

In December 2007, Duke Energy Ohio issued \$140 million in tax-exempt floating-rate bonds. The bonds are structured as insured auction rate securities, subject to an auction process every 35 days and bear a final maturity of 2041. The bonds were issued through the Ohio Air Quality Development Authority to fund a portion of the environmental capital expenditures at the Conesville, Stuart and Killen Generation Stations in Ohio.

**Money Pool.** Duke Energy Ohio and its wholly-owned subsidiary, Duke Energy Kentucky, receive support for their short-term borrowing needs through their participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. The money pool is structured such that Duke Energy Ohio and Duke Energy Kentucky separately manage their cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables of Duke Energy Ohio and Duke Energy Kentucky, as each of these entities independently participate in the money pool. As of December 31, 2008 and December 31, 2007, Duke Energy Ohio and Duke Energy Kentucky had combined net borrowings of approximately \$63 million and \$189 million, respectively, classified within Notes payable in the accompanying Consolidated Balance Sheets. During the year ended December 31, 2008, the \$126 million decrease in the money pool activity is reflected as a cash outflow in Notes payable to affiliate, net within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the year ended December 31, 2007, the \$85 million decrease in the money pool activity is reflected as a cash outflow in Notes payable to affiliate, net within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the nine months ended December 31, 2006, the \$52 million increase in the money pool activity is reflected as a cash inflow in Notes payable to affiliate, net within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the three months ended March 31, 2006, the \$108 million increase in the money pool activity is reflected as a cash inflow in Notes payable to affiliate, net within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows.

**Floating Rate Debt.** Unsecured debt and other debt included approximately \$611 million and \$538 million of floating-rate debt as of December 31, 2008 and 2007, respectively. Floating-rate debt is primarily based on commercial paper rates or a spread relative to an index such as a London Interbank Offered Rate (LIBOR) for debt denominated in U.S. dollars. As of December 31, 2008 and 2007, the weighted-average interest rate associated with floating-rate debt was approximately 1.9% and 4.4%, respectively.

**Auction Rate Debt.** As of December 31, 2008, Duke Energy Ohio had approximately \$390 million of auction rate pollution control bonds outstanding. While these debt instruments are long-term in nature and cannot be put back to Duke Energy Ohio prior to maturity, the interest rates on these instruments are designed to reset periodically through an auction process. In February 2008, Duke Energy Ohio began to experience failed auctions on these debt instruments. When failed auctions occur on a series of this debt, Duke Energy Ohio is required to pay the maximum auction rate as prescribed by the bond document. The maximum auction rate for the auction rate debt is 2.0 times one-month LIBOR. Payment of the failed-auction interest rates will continue until Duke Energy Ohio is able to either successfully remarket these instruments through the auction process or refund and refinance the existing debt through the issuance of an equivalent amount of tax exempt bonds. While Duke Energy Ohio intends to refund and refinance these tax exempt auction rate bonds, the timing of such refinancing transactions is uncertain and subject to market conditions. However, even if Duke Energy Ohio is unable to successfully refund and refinance these debt instruments, the impact of paying higher interest rates on the outstanding auction rate debt is not expected to materially affect Duke Energy Ohio's consolidated results of operations, cash flows or financial position. The weighted-average interest rate associated with Duke Energy Ohio's auction rate pollution control bonds, was 1.58% as of December 31, 2008 and 4.56% as of December 31, 2007.

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DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)****Maturities, Call Options and Acceleration Clauses.****Annual Maturities as of December 31, 2008**

	(in millions)	
2009	\$	27
2010		6
2011		31
2012		579
2013		6
Thereafter		1,235
Total long-term debt including current maturities <sup>(a)</sup>	\$	1,883

(a) Excludes short-term notes payable of \$343 million.

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

**Available Credit Facilities and Capacity Utilized Under Available Credit Facilities.** In June 2007, Duke Energy closed the syndication of an amended and restated credit facility, which replaced existing credit facilities, with a 5-year, \$2.65 billion master credit facility. In March 2008, Duke Energy entered into an amendment to its \$2.65 billion master credit facility whereby the borrowing capacity was increased by \$550 million to \$3.2 billion. In October 2008, Duke Energy terminated the participation of one of the financial institutions supplying approximately \$63 million of credit commitment under its master credit facility. The total credit facility capacity under the master credit facility subsequent to this termination is approximately \$3.14 billion. Duke Energy has the unilateral ability under the master credit facility to increase or decrease the borrowing sub limits of each borrower, subject to maximum cap limitation, at any time. At December 31, 2008, Duke Energy Ohio and Duke Energy Kentucky had borrowing sub limits under Duke Energy's master credit facility of \$650 million and \$100 million, respectively. The amount available to Duke Energy Ohio and Duke Energy Kentucky under their sub limits to Duke Energy's master credit facility has been reduced by drawdowns of cash, borrowings through the money pool arrangement, and the use of the master credit facility to backstop issuances of letters of credit and pollution control bonds, as discussed below.

In September 2008, Duke Energy and its wholly-owned subsidiaries, including Duke Energy Ohio and Duke Energy Kentucky, borrowed a total of approximately \$1 billion under Duke Energy's master credit facility, of which Duke Energy Ohio's and Duke Energy Kentucky's portions are approximately \$279 million and \$74 million, respectively. Duke Energy Ohio's and Duke Energy Kentucky's amounts remained outstanding as of December 31, 2008. The loans, which are revolving credit loans, bear interest at one-month LIBOR plus an applicable spread ranging from 19 to 24 basis points and are due in September 2009; however, Duke Energy Ohio and Duke Energy Kentucky have the ability under the master credit facility to renew the loan up through the date the master credit facility matures, which is in June 2012. As Duke Energy Kentucky has the intent and ability to refinance this obligation on a long-term basis, either through renewal of the terms of the loan through the master credit facility, which has non-cancelable terms in excess of one-year, or through issuance of long-term debt to replace the amounts drawn under the master credit facility, Duke Energy Kentucky's borrowing is reflected as Long-Term Debt on the Consolidated Balance Sheets at December 31, 2008. Since Duke Energy Ohio does not have the intent to refinance these obligations on a long-term basis, Duke Energy Ohio's borrowing is reflected in Notes payable within Current Liabilities on the Consolidated Balance Sheets at December 31, 2008. These borrowings reduce Duke Energy Ohio's and Duke Energy Kentucky's available credit capacity under Duke Energy's Master Credit Facility, as discussed above.

At December 31, 2008 and December 31, 2007, approximately \$146 million and \$96 million, respectively, of certain pollution control bonds, which are short-term obligations by nature, are classified as Long-Term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio's intent and ability to utilize such borrowings as long-term financing. Duke Energy's credit facilities with non-cancelable terms in excess of one year as of the balance sheet date give Duke Energy Ohio the ability to refinance these short-term obligations on a long-term basis. Of the \$146 million of pollution control bonds outstanding at December 31, 2008, approximately \$84 million were backstopped by Duke Energy's master credit facility, with the remaining balance backstopped by other specific credit facilities separate from the master credit facility.



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PART II

DUKE ENERGY OHIO, INC.

### Notes To Consolidated Financial Statements—(Continued)

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

**Restrictive Debt Covenants.** Duke Energy's debt and credit agreement contains various financial and other covenants, including, but not limited to, a covenant regarding the debt-to-total capitalization ratio at Duke Energy, Duke Energy Ohio and Duke Energy Kentucky to not exceed 65%. Duke Energy Ohio's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of December 31, 2008, Duke Energy, Duke Energy Ohio and Duke Energy Kentucky were in compliance with all covenants that would impact Duke Energy Ohio's or Duke Energy Kentucky's ability to borrow funds under the debt and credit facilities. In addition, some credit agreements may allow for acceleration of payments or termination of the agreements due to nonpayment, or the acceleration of other significant indebtedness of the borrower or some of its subsidiaries. None of the debt or credit agreements contain material adverse change clauses.

**Other Assets Pledged as Collateral.** As of December 31, 2008, substantially all of Franchised Electric and Gas' electric plant in service is mortgaged under the mortgage bond indenture of Duke Energy Ohio.

#### 17. Common and Preferred Stock

**Common Stock.** Cinergy owns all of the common stock of Duke Energy Ohio. In April 2006, Duke Energy acquired 100 percent of Cinergy's outstanding stock. See Note 3 for additional information.

In April 2006, Duke Energy Ohio filed a petition with the FERC for a declaratory ruling that its payment of dividends out of its paid-in capital account, using the balance transferred from the retained earnings account, resulting from purchase accounting arising from the Duke Energy/Cinergy merger, would not violate section 305(a) of the Federal Power Act, which generally precludes the payment of dividends out of paid-in capital. Such a ruling was necessary because purchase/push-down accounting reset retained earnings to zero as of April 3, 2006, thus potentially precluding Duke Energy Ohio from using pre-merger retained earnings to pay dividends. Without this approval, Duke Energy Ohio's ability to pay dividends to Duke Energy or Cinergy would have been constrained to earnings since April 3, 2006. In May 2006, the FERC issued an order approving Duke Energy Ohio's petition. For further discussion of restrictions on Duke Energy Ohio's ability to pay dividends to its parent, see Note 4.

During the years ended December 31, 2008, 2007 and 2006, Duke Energy Ohio paid dividends to its parent, Cinergy, of \$200 million, \$135 million and \$102 million, respectively.

**Preferred Stock.** In March 2006, Duke Energy Ohio redeemed all outstanding shares of its \$16.98 million notional amount 4% Cumulative Preferred Stock and its \$3.5 million notional amount 4.75% Cumulative Preferred Stock at a price of \$108 per share and \$101 per share, respectively, plus accrued and unpaid dividends.

#### 18. Commitments and Contingencies

##### General Insurance

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

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### PART II

DUKE ENERGY OHIO, INC.

### Notes To Consolidated Financial Statements—(Continued)

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

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

#### Environmental

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

**Remediation Activities.** Duke Energy Ohio and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Ohio operations, sites formerly owned or used by Duke Energy Ohio entities, and sites owned by third parties. Remediation typically involves management of contaminated soils and may involve groundwater remediation. Managed in conjunction with relevant federal, state and local agencies, activities vary with site conditions and locations, remedial requirements, complexity and sharing of responsibility. If remediation activities involve statutory joint and several liability provisions, strict liability, or cost recovery or contribution actions, Duke Energy Ohio or its affiliates could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Ohio may share liability associated with contamination with other potentially responsible parties, and may also benefit from insurance policies or contractual indemnities that cover some or all cleanup costs. All of these sites generally are managed in the normal course of business or affiliate operations. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

**Clean Water Act 316(b).** The EPA finalized its cooling water intake structures rule in July 2004. The rule established aquatic protection requirements for existing facilities that withdraw 50 million gallons or more of water per day from rivers, streams, lakes, reservoirs, estuaries, oceans, or other U.S. waters for cooling purposes. Three of six coal-fired generating facilities in which Duke Energy Ohio is either a whole or partial owner are affected sources under that rule. On January 25, 2007, the U.S. Court of Appeals for the Second Circuit issued its opinion in *Riverkeeper, Inc. v. EPA*, Nos. 04-6692-ag(L) et. al. (2d Cir. 2007) remanding most aspects of the EPA's rule back to the agency. The court effectively disallowed those portions of the rule most favorable to industry, and the decision creates a great deal of uncertainty regarding future requirements and their timing. On April 14, 2008, the U.S. Supreme Court issued an order granting review of the case and briefs were filed on July 14, 2008. Oral argument occurred on December 2, 2008. A decision is expected in 2009. If the Supreme Court upholds the lower court decision, it is expected that costs will increase as a result of the court's decision, however, Duke Energy Ohio is unable to estimate at this time its costs to comply.

**Clean Air Interstate Rule (CAIR).** The EPA finalized its CAIR in May 2005. The CAIR limits total annual and summertime NO<sub>x</sub> emissions and annual SO<sub>2</sub> emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO<sub>x</sub> and in 2010 for SO<sub>2</sub>. Phase 2 begins in 2015 for both NO<sub>x</sub> and SO<sub>2</sub>. On March 25, 2008, the U.S. Court of Appeals for the District of Columbia (D.C. Circuit) heard oral argument in a case involving multiple challenges to the CAIR. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA filed a petition for rehearing on September 24, 2008 with the D.C. Circuit asking the court to reconsider various parts of its ruling vacating the CAIR. In December 2008, the D.C. Circuit issued a decision remanding the CAIR to the EPA without vacatur. The EPA must now conduct a new rulemaking to modify the CAIR in accordance with the court's July 11, 2008 opinion. This decision means that the CAIR as initially finalized in 2005 remains in effect until the new EPA rule takes effect. The court did not impose a deadline or schedule on the EPA. It is uncertain how long the current CAIR will remain in effect or how the new rulemaking will alter the CAIR.

Duke Energy Ohio plans to spend approximately \$85 million between 2009 and 2013 to comply with Phase 1 of the CAIR. Duke Energy Ohio is currently unable to estimate the costs to comply with any new rule the EPA will issue in the future as a result of the D.C. District Court's December 2008 decision discussed above. Duke Energy Ohio received partial recovery of depreciation and financing costs related to environmental compliance projects for 2005-2008 through its RSP. See Note 11 for a discussion of the impacts of the D.C. Circuit Court's July 11, 2008 decision to vacate the CAIR on the carrying value of emission allowances.

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DUKE ENERGY OHIO, INC.

### Notes To Consolidated Financial Statements—(Continued)

**Clean Air Mercury Rule (CAMR).** The EPA finalized its CAMR in May 2005. The CAMR was to have limited total annual mercury emissions from coal-fired power plants across the U.S. through a two-phased cap-and-trade program beginning in 2010. On February 8, 2008, the D.C. Circuit issued its opinion in *New Jersey v. EPA*, No. 05-1097 vacating the CAMR. Requests for rehearing were denied. The U.S. EPA and the Utility Air Regulatory Group have requested that the U.S. Supreme Court review the D.C. Circuit's decision. The D.C. Circuit's decision creates uncertainty regarding future mercury emission reduction requirements and their timing, but makes it fairly certain that there will be a delay in the implementation of federal mercury requirements for existing coal-fired power plants. On January 29, 2009, the EPA requested the U.S. Department of Justice withdraw its Petition for Writ of Certiorari filed on October 17, 2008. On February 23, 2009, the Supreme Court denied the Utility Air Regulatory Group's petition. The EPA will now develop emission standards for utility units under section 112 of the Clean Air Act, thus abiding by the D.C. Circuit's decision. At this point, Duke Energy Ohio is unable to estimate the costs to comply with any future mercury regulations that might result from the D.C. Circuit's decision.

**Coal Combustion Product (CCP) Management.** Duke Energy Ohio currently estimates that it will spend approximately \$68 million over the period 2009-2013 to install synthetic caps and liners at existing and new CCP landfills and to convert CCP handling systems from wet to dry systems.

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

**Extended Environmental Activities and Accruals.** Included in Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets were total accruals related to extended environmental-related activities of approximately \$11 million and \$8 million as of December 31, 2008 and 2007, respectively. These accruals represent Duke Energy Ohio's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

#### Litigation

**New Source Review (NSR).** In 1999-2000, the U.S. Department of Justice (DOJ), acting on behalf of the EPA and joined by various citizen groups and states, filed a number of complaints and notices of violation against multiple utilities across the country for alleged violations of the NSR provisions of the Clean Air Act (CAA). Generally, the government alleges that projects performed at various coal-fired units were major modifications, as defined in the CAA, and that the utilities violated the CAA when they undertook those projects without obtaining permits and installing the best available emission controls for SO<sub>2</sub>, NO<sub>x</sub> and particulate matter. The complaints seek injunctive relief to require installation of pollution control technology on various generating units that allegedly violated the CAA, and unspecified civil penalties in amounts of up to \$32,500 per day for each violation. Two of Duke Energy Ohio's plants have been subject to these allegations. Duke Energy Ohio asserts that there were no CAA violations because the applicable regulations do not require permitting in cases where the projects undertaken are "routine" or otherwise do not result in a net increase in emissions.

In November 1999, the U.S. brought a lawsuit in the U.S. Federal District Court for the Southern District of Indiana against Duke Energy Ohio alleging various violations of the CAA at Duke Energy Ohio's W.C. Beckjord and Miami Fort Stations. Three northeast states and two environmental groups have intervened in the case. A jury trial commenced on May 5, 2008 and jury verdict was returned on May 22, 2008. The jury found in favor of Cinergy, Duke Energy Ohio and Duke Energy Indiana, Inc. on all but three units at Wabash River. Additionally, the plaintiffs had claimed that Duke Energy Ohio violated an Administrative Consent Order entered into in 1998 between the EPA and Cinergy relating to alleged violations of Ohio's State Implementation Plan (SIP) provisions governing particulate matter at Duke Energy Ohio's W.C. Beckjord Station.

On October 21, 2008, Plaintiffs filed a motion for a new liability trial claiming that defendants misled the Plaintiffs and the jury by, among other things, not disclosing a consulting agreement with a fact witness and by referring to that witness as "retired" during the liability trial when in fact he was working for Duke Energy under the referenced consulting agreement in connection with the trial. On December 18, 2008, the court granted Plaintiffs' motion for a new liability trial on claims for which Duke Energy Ohio was not previously found liable. That trial is scheduled to begin on May 11, 2009. The remedy trial for violations already established at the Wabash River

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PART II

DUKE ENERGY OHIO, INC.

### Notes To Consolidated Financial Statements—(Continued)

Station and W.C. Beckjord Station was held during the week beginning February 2, 2009. The parties are awaiting a decision from the trial court.

Duke Energy Ohio has been informed by Dayton Power and Light (DP&L) that in June 2000, the EPA issued a Notice of Violation (NOV) to DP&L for alleged violations of CAA requirements at a station operated by DP&L and jointly-owned by DP&L, Columbus Southern Power Company (CSP), and Duke Energy Ohio. The NOV indicated the EPA may issue an order requiring compliance with the requirements of the Ohio SIP, or bring a civil action seeking injunctive relief and civil penalties of up to \$27,500 per day for each violation. In September 2004, Marilyn Wall and the Sierra Club brought a lawsuit against Duke Energy Ohio, DP&L and CSP for alleged violations of the CAA at this same generating station. The parties reached an agreement to settle this matter in the form of a consent decree which was submitted for comment to the EPA and ultimately approved and entered by the court on October 23, 2008. The consent decree did not have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

It is not possible to estimate the damages, if any, that Duke Energy Ohio might incur in connection with these matters. Ultimate resolution of these matters relating to NSR, even in settlement, could have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position. However, Duke Energy Ohio will pursue appropriate regulatory treatment for any costs incurred in connection with such resolution.

**Section 126 Petitions.** In March 2004, the state of North Carolina filed a petition under Section 126 of the CAA in which it alleges that sources in 13 upwind states, including Ohio, significantly contribute to North Carolina's non-attainment with certain ambient air quality standards. In August 2005, the EPA issued a proposed response to the petition. The EPA proposed to deny the ozone portion of the petition based upon a lack of contribution to air quality by the named states. The EPA also proposed to deny the particulate matter portion of the petition based upon the CAIR Federal Implementation Plan (FIP) that would address the air quality concerns from neighboring states. On April 28, 2006, the EPA denied North Carolina's petition based upon the final CAIR FIP described above. North Carolina has filed a legal challenge to the EPA's denial. Briefing in that case is under way. On March 5, 2009 the D.C. Circuit remanded the case to the EPA for reconsideration. The EPA has conceded that the D.C. Circuit's July 18, 2008 decision in the CAIR litigation, *North Carolina v. EPA* No. 05-1244, discussed above, and a subsequent order issued by the D.C. Circuit on December 23, 2008, have eliminated the legal basis for the EPA's denial of North Carolina's Section 126 petition. At this time, Duke Energy Ohio cannot predict the outcome of this proceeding.

**Carbon Dioxide (CO<sub>2</sub>) Litigation.** In July 2004, the states of Connecticut, New York, California, Iowa, New Jersey, Rhode Island, Vermont, Wisconsin and the City of New York brought a lawsuit in the U.S. District Court for the Southern District of New York against Cinergy, American Electric Power Company, Inc., American Electric Power Service Corporation, The Southern Company, Tennessee Valley Authority, and Xcel Energy Inc. A similar lawsuit was filed in the U.S. District Court for the Southern District of New York against the same companies by Open Space Institute, Inc., Open Space Conservancy, Inc., and The Audubon Society of New Hampshire. These lawsuits allege that the defendants' emissions of CO<sub>2</sub> from the combustion of fossil fuels at electric generating facilities contribute to global warming and amount to a public nuisance. The complaints also allege that the defendants could generate the same amount of electricity while emitting significantly less CO<sub>2</sub>. The plaintiffs are seeking an injunction requiring each defendant to cap its CO<sub>2</sub> emissions and then reduce them by a specified percentage each year for at least a decade. In September 2005, the District Court granted the defendants' motion to dismiss the lawsuit. The plaintiffs have appealed this ruling to the Second Circuit Court of Appeals. Oral arguments were held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

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

**Hurricane Katrina Lawsuit.** In April 2006, Cinergy was named in the third amended complaint of a purported class action lawsuit filed in the U.S. District Court for the Southern District of Mississippi. Plaintiffs claim that Cinergy, along with numerous other utilities, oil companies, coal companies and chemical companies, are liable for damages relating to losses suffered by victims of Hurricane Katrina.

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DUKE ENERGY OHIO, INC.

**Notes To Consolidated Financial Statements—(Continued)**

Plaintiffs claim that defendants' greenhouse gas emissions contributed to the frequency and intensity of storms such as Hurricane Katrina. On August 30, 2007, the court dismissed the case. The plaintiffs have filed their appeal to the Fifth Circuit Court of Appeals and oral argument was heard on August 6, 2008. Due to the late recusal of one of the judges on the Fifth Circuit panel, the court held a new oral argument on November 3, 2008. It is not possible to predict with certainty whether Duke Energy will incur any liability or to estimate the damages, if any, that Duke Energy might incur in connection with this matter.

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

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

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

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

**Other Commitments and Contingencies**

**General.** Duke Energy Ohio enters into various fixed-price, non-cancelable commitments to purchase or sell power (tolling arrangements or power purchase contracts) that may or may not be recognized on the Consolidated Balance Sheets. Some of these arrangements may be recognized at market value on the Consolidated Balance Sheets as undesignated hedge contracts or qualifying hedge positions.

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PART II

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)****Operating and Capital Lease Commitments**

Duke Energy Ohio leases assets in several areas of its operations. Consolidated rental expense for operating leases were approximately \$31 million for the year ended December 31, 2008, approximately \$32 million for the year ended December 31, 2007, approximately \$20 million for the nine months ended December 31, 2006 and approximately \$7 million for the three months ended March 31, 2006, which is included in Operation, Maintenance and Other on the Consolidated Statements of Operations. Capitalized lease obligations are classified as debt on the Consolidated Balance Sheets (see Note 16). Amortization of assets recorded under capital leases was included in Depreciation and Amortization on the Consolidated Statements of Operations. The following is a summary of future minimum lease payments under operating leases, which at inception had a noncancelable term of more than one year, and capital leases as of December 31, 2008:

	Operating Leases	Capital Leases (In millions)
2009	\$ 17	\$ 9
2010	15	8
2011	13	7
2012	11	7
2013	10	6
Thereafter	47	14
Total future minimum lease payments	\$ 113	\$ 51

**19. Employee Benefit Obligations**

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

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

Cinergy adopted the funded status recognition and disclosure provisions of SFAS No. 158 effective December 31, 2006. Cinergy adopted the change in measurement date transition requirements of SFAS No. 158 effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date. Previously, Cinergy used a September 30 measurement date for its defined benefit and other post-retirement plans. The adoption of SFAS No. 158 did not have a material impact on Duke Energy Ohio's consolidated results of operations or cash flows. See Note 1 for additional information related to the adoption of SFAS No. 158.

Net periodic benefit cost disclosed in the tables below for the qualified, non-qualified and other post-retirement benefit plans represent the cost of the respective plan for the periods presented. However, portions of the net periodic benefit cost disclosed in the tables have been capitalized as a component of property, plant and equipment.

**Qualified Pension Plans**

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

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PART II

DUKE ENERGY OHIO, INC.

**Notes To Consolidated Financial Statements—(Continued)**

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

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

Duke Energy Ohio's qualified pension plan pre-tax net periodic pension benefit costs as allocated by Cinergy were as follows:

	Successor(a)			Predecessor(a) Three Months Ended March 31, 2006(b)
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006(b)	
	(In millions)			
Qualified Pension Benefits(c)	\$ 12	\$ 14	\$ 20	\$ 6

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Includes insignificant amounts reflected in Loss From Discontinued Operations, net of tax, in the Consolidated Statements of Operations.

(c) Excludes approximately \$4 million, \$7 million and \$8 million, respectively, of regulatory asset amortization resulting from purchase accounting for the years ended December 31, 2008 and 2007 and the nine months ended December 31, 2006.

The fair value of Cinergy's plan assets was approximately \$1,110 million and \$1,701 million as of December 31, 2008 and 2007, respectively. The projected benefit obligation for the plans was approximately \$1,992 million and \$1,941 million as of December 31, 2008 and 2007, respectively. The accumulated benefit obligation for the plans was approximately \$1,729 million and \$1,753 million as of December 31, 2008 and 2007, respectively. The accrued qualified pension liability allocated by Cinergy to Duke Energy Ohio, which represents Duke Energy Ohio's proportionate share of the unfunded status of the Cinergy qualified pension plan, was approximately \$334 million and \$118 million as of December 31, 2008 and 2007, respectively, and is recognized in Accrued pension and other post-retirement benefit costs within the Consolidated Balance Sheets.

Duke Energy's policy is to fund amounts on an actuarial basis to provide assets sufficient to meet benefits to be paid to plan participants. Duke Energy did not make any contributions to its defined benefit retirement plans in 2008. Duke Energy made qualified pension benefit contributions of approximately \$350 million and \$124 million to the legacy Cinergy qualified pension benefit plans in 2007 and 2006, of which approximately \$83 million and \$22 million represents contributions made by Duke Energy Ohio for the year ended December 31, 2007 and nine months ended December 31, 2006, respectively. No amounts were contributed to the legacy Cinergy qualified pension plans for the three months ended March 31, 2006. In February 2009, Duke Energy Ohio made a cash contribution of approximately \$143 million, which represented its proportionate share of an approximate \$500 million total contribution to Cinergy's and Duke Energy's qualified pension plans.

Qualified Pension Plans—Amounts Recognized in Accumulated Other Comprehensive Income (Loss) and Regulatory Assets Consist of:

	As of December 31,	
	2008	2007
	(In millions)	
Regulatory Assets	\$ 104	\$ 33
Accumulated Other Comprehensive Loss (Income)		
Deferred income tax (liability) asset	\$ (21)	\$ 5
Prior service cost	3	2
Net actuarial loss (gain)	53	(14)
Net amount recognized—Accumulated other comprehensive loss (income)	\$ 35	\$ (7)

An insignificant amount in AOCI will be recognized in net periodic pension costs in 2009.

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PART II

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

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

	2008	2007 (percentages)	2006
<b>Benefit Obligations</b>			
Discount rate	6.50	6.00	5.75
Salary increase	4.50	5.00	5.00
<b>Net Periodic Benefit Cost</b>			
Discount rate <sup>(a)</sup>	6.00	5.75	5.50-6.00
Salary increase	5.00	5.00	5.00
Expected long-term rate of return on plan assets	8.50	8.50	8.50

(a) Discount rate for Successor was 6.00% for the nine months ended December 31, 2006. Discount rate for Predecessor was 5.50% for the three months ended March 31, 2006 (see Note 1 for additional information on Predecessor and Successor reporting).

**Non-Qualified Pension Plans**

Cinergy also maintains, and Duke Energy Ohio participates in, non-qualified, non-contributory defined benefit retirement plans (plans that do not meet the criteria for certain tax benefits) that cover officers, certain other key employees, and non-employee directors. Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of active employees covered by the non-qualified retirement plans is 11 years. There are no plan assets. The projected benefit obligation for the plans was approximately \$113 million and \$105 million as of December 31, 2008 and 2007, respectively. The accumulated benefit obligation for the plans was approximately \$104 million and \$102 million as of December 31, 2008 and 2007, respectively. The accrued non-qualified pension liability allocated by Cinergy to Duke Energy Ohio, which represents Duke Energy Ohio's proportionate share of the unfunded status of the Cinergy non-qualified pension plan, was approximately \$6 million and \$7 million as of December 31, 2008 and 2007, respectively, of which approximately \$4 million and \$5 million, respectively, is recognized in Accrued pension and other post-retirement benefit costs within the Consolidated Balance Sheets at December 31, 2008 and 2007, and approximately \$2 million is recognized in Other within Current Liabilities on the Consolidated Balance Sheets at December 31, 2008 and 2007.

Duke Energy Ohio's non-qualified pension plan pre-tax net periodic pension benefit costs as allocated by Cinergy were as follows:

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup> Three Months Ended March 31, 2006
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	
	(in millions)			
<b>Non-Qualified Pension<sup>(b)</sup></b>	\$ —	\$ 1	\$ 1	\$ —

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Includes insignificant amounts in 2006, which are reflected in Loss From Discontinued Operations, net of tax, in the Consolidated Statements of Operations.

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

	2008	2007 (percentages)	2006
<b>Benefit Obligations</b>			
Discount rate	6.50	6.00	5.75
Salary increase	4.50	5.00	5.00
<b>Net Periodic Benefit Cost</b>			
Discount rate <sup>(a)</sup>	6.00	5.75	5.50-6.00
Salary increase	5.00	5.00	5.00

(a) Discount rate for Successor was 6.00% for the nine months ended December 31, 2006. Discount rate for Predecessor was 5.50% for the three months ended March 31, 2006 (see Note 1 for additional information on Predecessor and Successor reporting).

**Other Post-Retirement Benefit Plans**

Duke Energy Ohio participates in other post-retirement benefit plans sponsored by Duke Energy. Prior to January 1, 2008, Cinergy was the sponsor of the other post-retirement benefit plans. Effective January 1, 2008, Duke Energy became the sponsor of these other post-retirement benefit plans. Duke Energy provides certain health care and life insurance benefits to retired employees and their



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PART II

DUKE ENERGY OHIO, INC.

**Notes To Consolidated Financial Statements—(Continued)**

eligible dependents on a contributory and non-contributory basis. These benefits are subject to minimum age and service requirements. The health care benefits include medical coverage, dental coverage, and prescription drug coverage and are subject to certain limitations, such as deductibles and co-payments. These benefit costs are accrued over an employee's active service period to the date of full benefits eligibility. The net unrecognized transition obligation is amortized over approximately 20 years. Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of the active employees covered by the plan is 12 years. During the third quarter of 2008, Duke Energy Ohio recorded pre-tax income of approximately \$20 million related to the correction of errors in actuarial valuations prior to 2008 that would have reduced amounts recorded as other post-retirement benefit expense recorded during those historical periods.

Duke Energy Ohio's other post-retirement plan pre-tax net periodic benefit costs as allocated by Duke Energy were as follows:

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup> Three Months Ended March 31, 2006 <sup>(b)</sup>
	Year Ended December 31, 2008 <sup>(d)</sup>	Year Ended December 31, 2007	Nine Months Ended December 31, 2006 <sup>(b)</sup>	
	(in millions)			
Other Post-retirement <sup>(c)</sup>	\$ (16)	\$ 11	\$ 9	\$ 3

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Includes insignificant amounts reflected in Loss From Discontinued Operations, net of tax, in the Consolidated Statements of Operations.

(c) Excludes approximately \$2 million, \$4 million and \$2 million, respectively, of regulatory asset amortization resulting from purchase accounting for the years ended December 31, 2008 and 2007 and the nine months ended December 31, 2006.

(d) Includes the recognition of the approximate \$20 million correction of errors discussed above.

The fair value of Duke Energy's other post-retirement benefit plans assets was approximately \$23 million and \$32 million as of December 31, 2008 and 2007, respectively. The accumulated other post-retirement benefit obligation for the plans was approximately \$330 million and \$464 million as of December 31, 2008 and 2007, respectively. The accrued other post-retirement liability allocated by Duke Energy to Duke Energy Ohio, which represents Duke Energy Ohio's proportionate share of the unfunded status of the Duke Energy other post-retirement benefit plans, was approximately \$70 million and \$138 million, respectively, of which approximately \$68 million and \$136 million, respectively, is recognized in Accrued pension and other post-retirement benefit costs within the Consolidated Balance Sheets at December 31, 2008 and 2007, and approximately \$2 million is recognized in Other within Current Liabilities on the Consolidated Balance Sheets at December 31, 2008 and 2007.

Duke Energy did not make any contributions to its other post-retirement plans in 2008. Duke Energy made contributions to its other post-retirement benefit plan during 2007 of approximately \$32 million to the legacy Cinergy other post-retirement plans, of which approximately \$9 million represents contributions made by Duke Energy Ohio. No amounts were contributed to the legacy Cinergy other post-retirement plans for the nine months ended December 31, 2006 or three months ended March 31, 2006.

Duke Energy Ohio recognized a reduction in regulatory assets and a pre-tax credit to AOCI related to its other post-retirement benefit plans of approximately \$32 million and \$12 million, respectively, as of December 31, 2008 and a reduction in regulatory assets and a pre-tax credit to AOCI of \$2 million and \$1 million, respectively, as of December 31, 2007 within the Consolidated Balance Sheets.

An insignificant amount in AOCI will be recognized in net periodic other post-retirement benefit costs in 2009.

**Assumptions Used in Duke Energy's Other Post-retirement Benefits Accounting**

	2008	2007	2006
	(percentages)		
Benefit Obligations			
Discount rate	6.50	6.00	5.75
<b>Net Periodic Benefit Cost</b>			
Discount rate <sup>(a)</sup>	6.00	5.75	5.50-6.00
Expected long-term rate of return on plan assets	8.50	8.50	N/A

(a) Discount rate for Successor was 6.00% for the nine months ended December 31, 2006. Discount rate for Predecessor was 5.50% for the three months ended March 31, 2006 (see Note 1 for additional information on Predecessor and Successor reporting).

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PART II

DUKE ENERGY OHIO, INC.  
**Notes To Consolidated Financial Statements—(Continued)**

**Assumed Health Care Cost Trend Rates**

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

**20. Other Income and Expenses, net**

The components of Other Income and Expenses, net on the Consolidated Statements of Operations for the years ended December 31, 2008 and 2007, the nine months ended December 31, 2006 and the three months ended March 31, 2006 are as follows:

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup> Three Months Ended March 31, 2006
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	
	(in millions)			
Income/(Expense)				
Interest income	\$ 27	\$ 29	\$ 15	\$ 8
AFUDC equity	7	4	2	1
Other	—	(1)	—	(1)
Total	\$ 34	\$ 32	\$ 17	\$ 8

(a) See Note 1 for additional information on Predecessor and Successor reporting.

**21. Subsequent Events**

For information related to subsequent events related to regulatory matters, commitments and contingencies, and employee benefit obligations, see Notes 4, 18 and 19, respectively.

**22. Quarterly Financial Data (Unaudited)**

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
	(in millions)				
<b>2008</b>					
Total operating revenues	\$ 991	\$ 795	\$ 818	\$ 820	\$ 3,424
Operating income (loss)	223	263	(60)	92	518
Income (loss) before extraordinary items	133	157	(54)	51	287
Net income (loss)	133	157	(54)	118	354
<b>2007</b>					
Total operating revenues	\$ 916	\$ 763	\$ 955	\$ 821	\$ 3,455
Operating income	74	95	210	104	483
Net income	37	49	118	60	264

There were no extraordinary, significant or unusual items during the first or second quarters of 2008.

During the third quarter of 2008, Duke Energy Ohio recorded the following extraordinary, unusual or infrequently occurring items: an approximate \$82 million pre-tax impairment charge related to emission allowances (see Note 11); and pre-tax income of approximately \$20 million related to the correction of errors in actuarial valuations related to other post-retirement benefit plans (see Note 19).

During the fourth quarter of 2008, Duke Energy Ohio recorded the following extraordinary, unusual or infrequently occurring item: an approximate \$67 million after-tax (approximately \$103 million pre-tax) extraordinary gain related to the reapplication of SFAS No. 71 to certain operations of Commercial Power (see Note 1).

During the first quarter of 2007, Duke Energy Ohio recorded the following extraordinary, unusual or infrequently occurring item: a temporary rate reduction of \$2 million due to merger approval obtained from PUCO related to the merger between Duke Energy and Cinergy.

There were no extraordinary, significant or unusual items during the second, third or fourth quarters of 2007.

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DUKE ENERGY OHIO, INC.  
**SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS AND RESERVES**

	Balance at Beginning of Period	Additions :		Deductions(b)	Balance at End of Period
		Charged to Expense	Charged to Other Accounts		
(In millions)					
<b>Successor<sup>(a)</sup></b>					
<b>Year Ended December 31, 2008:</b>					
Allowance for doubtful accounts	\$ 3	\$ 15	\$ —	\$ —	\$ 18
Environmental <sup>(c)</sup>	8	4	—	1	11
Uncertain tax provisions <sup>(d)</sup>	10	—	—	10	—
Other <sup>(e)</sup>	3	10	—	2	11
	<u>\$ 24</u>	<u>\$ 29</u>	<u>\$ —</u>	<u>\$ 13</u>	<u>\$ 40</u>
<b>Year Ended December 31, 2007:</b>					
Injuries and damages	\$ 3	\$ —	\$ —	\$ 3	\$ —
Allowance for doubtful accounts	5	1	—	3	3
Environmental <sup>(c)</sup>	8	—	—	—	8
Uncertain tax provisions <sup>(d)</sup>	26	—	—	16	10
Other <sup>(e)</sup>	11	3	—	11	3
	<u>\$ 53</u>	<u>\$ 4</u>	<u>\$ —</u>	<u>\$ 33</u>	<u>\$ 24</u>
<b>Nine Months Ended December 31, 2006:</b>					
Injuries and damages	\$ 5	\$ 1	\$ —	\$ 3	\$ 3
Allowance for doubtful accounts	4	4	—	3	5
Environmental <sup>(c)</sup>	8	—	—	—	8
Uncertain tax provisions <sup>(d)</sup>	28	3	—	5	26
Other <sup>(e)</sup>	16	6	—	13	11
	<u>\$ 63</u>	<u>\$ 14</u>	<u>\$ —</u>	<u>\$ 24</u>	<u>\$ 53</u>
<b>Predecessor<sup>(a)</sup></b>					
<b>Three Months Ended March 31, 2006:</b>					
Injuries and damages	\$ 4	\$ 1	\$ —	\$ —	\$ 5
Allowance for doubtful accounts	4	2	—	2	4
Environmental <sup>(c)</sup>	8	—	—	—	8
Uncertain tax provisions <sup>(d)</sup>	28	—	—	—	28
Other <sup>(e)</sup>	21	5	—	8	18
	<u>\$ 65</u>	<u>\$ 8</u>	<u>\$ —</u>	<u>\$ 10</u>	<u>\$ 63</u>

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Principally cash payments and reserve reversals. For 2007, this also includes the impacts from the adoption of FIN 48.

(c) Included in Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

(d) Included in Taxes accrued and Interest accrued within Current Liabilities on the Consolidated Balance Sheets. The December 31, 2007 ending balance primarily contains non-income tax reserves.

(e) Principally mark-to-market and other reserves, included in Unrealized gains on mark-to-market and hedging transactions within Current Assets and Other within Investments and Other Assets, Unrealized losses on mark-to-market and hedging transactions within Current Liabilities and Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

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PART II

### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

### **Item 9A. Controls and Procedures.**

#### **Disclosure Controls and Procedures**

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized, and reported, within the time periods specified by the Securities and Exchange Commission's (SEC) rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2008, and, based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

#### **Changes in Internal Control over Financial Reporting**

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended December 31, 2008, and other than the coal settlements and accounting system transition described below, have concluded that no change has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

During the fourth quarter 2008, Duke Energy Ohio transitioned coal settlements accounting from one system to an already existing system used for purchased power. This system change is a result of an evaluation of previous systems and related processes to support evolving operational needs, and is not the result of any identified deficiencies in the previous systems. Duke Energy Ohio reviewed the implementation effort as well as the impact on Duke Energy Ohio's internal control over financial reporting and where appropriate, made changes to internal controls over financial reporting to address the system transition.

#### **Management's Annual Report On Internal Control Over Financial Reporting**

Duke Energy Ohio's management is responsible for establishing and maintaining an adequate system of internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Duke Energy Ohio's internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes, in accordance with generally accepted accounting principles. Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies and procedures may deteriorate.

Duke Energy Ohio's management, including the Chief Executive Officer and Chief Financial Officer, has conducted an evaluation of the effectiveness of Duke Energy Ohio's internal control over financial reporting as of December 31, 2008 based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2008.

This annual report does not include an attestation report of Deloitte & Touche LLP, Duke Energy Ohio's registered independent public accounting firm, regarding internal control over financial reporting. Management's report was not subject to attestation by Deloitte & Touche LLP pursuant to temporary rules of the SEC that permit Duke Energy Ohio to provide only management's report in this annual report.

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## PART III

**Item 14. Principal Accounting Fees and Services.**

Deloitte & Touche LLP, and the member firms of Deloitte Touche Tohmatsu and their respective affiliates (collectively, "Deloitte") provided professional services to Duke Energy Corporation (Duke Energy) and its consolidated subsidiaries for 2008 and 2007. The following table presents the fees that have been allocated to Duke Energy Ohio, Inc. (Duke Energy Ohio) and its subsidiaries as part of corporate governance costs:

	FY 2008	FY 2007
	(in millions)	
Audit Fees <sup>(a)</sup>	\$ 2.3	\$ 2.6
Audit-Related Fees <sup>(b)</sup>	0.4	0.4
Tax Fees <sup>(c)</sup>	0.1	0.4
Total Fees:	\$ 2.8	\$ 3.4

- (a) Audit Fees are fees billed or expected to be billed by Deloitte for professional services for the audit of Duke Energy and are allocated by Duke Energy to Duke Energy Ohio for the audit of the Duke Energy Ohio consolidated financial statements included in Duke Energy Ohio's annual report on Form 10-K and review of financial statements included in Duke Energy Ohio's quarterly reports on Form 10-Q, services that are normally provided by Deloitte in connection with statutory, regulatory or other filings or engagements or any other service performed by Deloitte to comply with generally accepted auditing standards.
- (b) Audit-Related Fees are fees billed by Deloitte to Duke Energy and are allocated by Duke Energy to Duke Energy Ohio for assurance and related services that are reasonably related to the performance of an audit or review of Duke Energy Ohio's financial statements, including assistance with acquisitions and divestitures and internal control reviews.
- (c) Tax Fees are fees billed by Deloitte to Duke Energy and are allocated by Duke Energy to Duke Energy Ohio for tax return assistance and preparation, tax examination assistance, and professional services related to tax planning and tax strategy.

To safeguard the continued independence of the independent auditor, the Duke Energy Audit Committee adopted a policy that provides that the independent public accountants are only permitted to provide services to Duke Energy and its consolidated subsidiaries, including Duke Energy Ohio, that have been pre-approved by the Duke Energy Audit Committee. Pursuant to the policy, detailed audit services, audit-related services, tax services and certain other services have been specifically pre-approved up to certain fee limits. In the event that the cost of any of these services may exceed the pre-approved limits, the Duke Energy Audit Committee must pre-approve the service. All other services that are not prohibited pursuant to the SEC's or other applicable regulatory bodies' rules of regulations must be specifically pre-approved by the Duke Energy Audit Committee. All services performed in 2008 and 2007 by the independent public accountant were approved by the Duke Energy Audit Committee pursuant to its pre-approval policy.

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PART IV

**Item 15. Exhibits, Financial Statement Schedules.**

(a) Consolidated Financial Statements, Supplemental Financial Data and Supplemental Schedule included in Part II of this annual report are as follows:

*Consolidated Financial Statements*

Consolidated Statements of Operations for the Year Ended December 31, 2008, Year Ended December 31, 2007, Nine Months Ended December 31, 2006, and the Three Months Ended March 31, 2006

Consolidated Balance Sheets as of December 31, 2008 and 2007

Consolidated Statements of Cash Flows for the Year Ended December 31, 2008, Year Ended December 31, 2007, Nine Months Ended December 31, 2006, and the Three Months Ended March 31, 2006

Consolidated Statements of Common Stockholder's Equity and Comprehensive Income for the Year Ended December 31, 2008, Year Ended December 31, 2007, Nine Months Ended December 31, 2006, and the Three Months Ended March 31, 2006

Notes to the Consolidated Financial Statements

Quarterly Financial Data (unaudited, included in Note 22 to the Consolidated Financial Statements)

Consolidated Financial Statement Schedule II—Valuation and Qualifying Accounts and Reserves for the Year Ended December 31, 2008, Year Ended December 31, 2007, Nine Months Ended December 31, 2006, and the Three Months Ended March 31, 2006

Report of Independent Registered Public Accounting Firm

All other schedules are omitted because they are not required, or because the required information is included in the Consolidated Financial Statements or Notes.

(b) Exhibits—See Exhibit Index immediately following the signature page.

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PART IV

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 13, 2009

DUKE ENERGY OHIO, INC.  
(Registrant)

By:           /s/ JAMES E. ROGERS            
          James E. Rogers  
          Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

(i)           /s/ JAMES E. ROGERS            
          James E. Rogers  
          Chief Executive Officer (Principal Executive Officer)

(ii)           /s/ DAVID L. HAUSER            
          David L. Hauser  
          Group Executive and Chief Financial Officer  
          (Principal Financial Officer)

(iii)           /s/ STEVEN K. YOUNG            
          Steven K. Young  
          Senior Vice President and Controller (Principal  
          Accounting Officer)

(iv) Directors

          /s/ JAMES E. ROGERS            
          James E. Rogers

          /s/ DAVID L. HAUSER            
          David L. Hauser

          /s/ JAMES L. TURNER            
          James L. Turner

Date: March 13, 2009

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PART IV

**EXHIBIT INDEX**

Exhibits filed herewith are designated by an asterisk (\*). All exhibits not so designated are incorporated by reference to a prior filing, as indicated.

**Exhibit  
Number**

- 3.1 Amended Articles of Incorporation of Duke Energy Ohio, Inc. effective October 23, 1996 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 1996, File No. 1-1232).
- 3.1.1 Amended Articles of Consolidation, effective October 1, 2006 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2006, File No. 1-1232).
- 3.2 Regulations of Duke Energy Ohio, Inc., as amended on July 23, 2003 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 2003, File No. 1-1232).
- 4.1 Original Indenture (First Mortgage Bonds) between Duke Energy Ohio, Inc. and The Bank of New York (as Trustee) dated as of August 1, 1936 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-2374).
- 4.1.1 Fourteenth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of November 2, 1972 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-60961).
- 4.1.2 Thirty-third Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of September 1, 1992 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-53578).
- 4.1.3 Thirty-fourth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of October 1, 1993 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 1993, File No. 1-1232).
- 4.1.4 Thirty-fifth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of January 1, 1994 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-52335).
- 4.1.5 Thirty-sixth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of February 15, 1994 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-52335).
- 4.1.6 Thirty-seventh Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of October 14, 1996 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended December 31, 1996, File No. 1-1232).
- 4.1.7 Thirty-eighth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of February 1, 2001 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended March 31, 2001, File No. 1-1232).
- 4.1.8 Thirty-ninth Supplemental Indenture dated as of September 1, 2002, between Duke Energy Ohio, Inc. and The Bank of New York, as Trustee (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2002, File No. 1-1232).
- 4.2 Repayment Agreement between Duke Energy Ohio, Inc. and The Dayton Power and Light Company dated as of December 23, 1992 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended December 31, 1992, File No. 1-1232).



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### PART IV

#### Exhibit Number

- 4.3 Loan Agreement between Duke Energy Ohio, Inc. and the State of Ohio Air Quality Development Authority dated as of September 13, 1995 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 1995, File No. 1-1232).
- 4.4 Loan Agreement between Duke Energy Ohio, Inc. and the State of Ohio Air Quality Development Authority dated August 1, 2001 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2001, File No. 1-1232).
- 4.5 Original Indenture (Unsecured Debt Securities) between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of May 15, 1995 (filed with the registration statement on Form 8-A, filed on July 24, 1995, File No. 1-1232).
- 4.5.1 First Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of June 1, 1995 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 1995, File No. 1-1232).
- 4.5.2 Second Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of June 30, 1995 (filed with the registration statement on Form 8-A, filed on July 24, 1995, File No. 1-1232).
- 4.5.3 Third Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of October 9, 1997 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 1997, File No. 1-1232).
- 4.5.4 Fourth Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of April 1, 1998 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended March 31, 1998, File No. 1-1232).
- 4.5.5 Fifth Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of June 9, 1998 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 1998, File No. 1-1232).
- 4.5.6 Sixth Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of September 15, 2002 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2002, File No. 1-1232).
- 4.5.7 Seventh Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of June 15, 2003 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 2003, File No. 1-1232).
- 4.6 Loan Agreement between Duke Energy Ohio, Inc. and the Ohio Air Quality Development Authority dated as of September 1, 2002 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2002, File No. 1-1232).
- 4.7 Loan Agreement between Duke Energy Ohio, Inc. and the Ohio Air Quality Development Authority dated as of November 1, 2004, relating to Series A (filed with the Form 8-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company), filed on November 19, 2004, File No. 1-1232).
- 4.8 Loan Agreement between Duke Energy Ohio, Inc. and the Ohio Air Quality Development Authority dated as of November 1, 2004, relating to Series B (filed with the Form 8-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company), filed on November 19, 2004, File No. 1-1232).
- 10.1 Employment Agreement dated February 4, 2004, among Cinergy Corp., Duke Energy Ohio, Inc., and Duke Energy, Indiana, Inc., and James E. Rogers (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).

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### PART IV

#### Exhibit Number

- 10.2 Amended and Restated Employment Agreement dated October 11, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and William J. Grealis (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/02, File No. 1-1232).
- 10.2.1 Amended Employment Agreement effective December 17, 2003 to Employment Agreement dated October 11, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and William J. Grealis (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
- 10.3 Amended and Restated Employment Agreement dated October 1, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and Donald B. Ingle, Jr. (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/02, File No. 1-1232).
- 10.4 Amended and Restated Employment Agreement dated September 12, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and Michael J. Cyrus (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/02, File No. 1-1232).
- 10.4.1 Amended Employment Agreement effective December 17, 2003 to Employment Agreement dated September 12, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and Michael J. Cyrus (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
- 10.4.2 Form of amendment to employment agreement, adopted and effective December 14, 2005, between Services and each of Michael J. Cyrus and James L. Turner (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/02, File No. 1-1232).
- 10.5 Amended and Restated Employment Agreement dated September 24, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and James L. Turner (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
- 10.5.1 Amended Employment Agreement effective December 17, 2003 to Employment Agreement dated September 24, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and James L. Turner (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
- 10.6 Employment Agreement dated November 15, 2002, among Cinergy Corp., Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc. and Marc E. Manly (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
- 10.6.1 Amended Employment Agreement effective December 17, 2003 to Employment Agreement dated November 15, 2002, among Cinergy Corp., Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and Marc E. Manly (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
- 10.7 Deferred Compensation Agreement between Duke Energy Ohio, Inc. and Jackson H. Randolph dated January 1, 1992 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/92, File No. 1-1232).
- 10.8 Split Dollar Insurance Agreement, effective as of May 1, 1993, between Duke Energy Ohio, Inc. and Jackson H. Randolph (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/94, File No. 1-1232).
- 10.9 Amended and Restated Supplemental Retirement Income Agreement between Duke Energy Ohio, Inc. and Jackson H. Randolph dated January 1, 1995 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/95, File No. 1-1232).

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### PART IV

<u>Exhibit Number</u>	
10.10	Amended and Restated Supplemental Executive Retirement Income Agreement between Duke Energy Ohio, Inc. and certain executive officers (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/97, File No. 1-1232).
10.11	Asset Purchase Agreement by and among Duke Energy Indiana, Inc. and Duke Energy Ohio, Inc. and Allegheny Energy Supply Company, LLC, Allegheny Energy Supply Wheatland Generating Facility, LLC and Lake Acquisition Company, L.L.C., dated as of May 6, 2005 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 2005, File No. 1-1232).
10.12	\$2,650,000,000 Amended and Restated Credit Agreement, dated as of June 28, 2007, among Duke Energy Corporation, Duke Energy Carolinas, LLC, Duke Energy Ohio, Inc., Duke Energy Indiana, Inc. and Duke Energy Kentucky, Inc., as Borrowers, the banks listed therein, Wachovia Bank, National Association, as Administrative Agent, JPMorgan Chase Bank, National Association, Barclays Bank PLC, Bank of America, N.A. and Citibank, N.A., as Co-Syndication Agents and The Bank of Tokyo-Mitsubishi, Ltd., New York Branch and Credit Suisse, as Co-Documentation Agents (filed in Form 8-K of Duke Energy Ohio, Inc., July 5, 2007, File No. 1-1232, as Exhibit 10.1).
10.12.1	Amendment No. 1 to the Amended and Restated Credit Agreement (filed on Form 8-K of Duke Energy Ohio, Inc., March 12, 2008, File No. 1-1232, as Exhibit 10.1).
10.13	Keepwell Agreement, dated April 10, 2006, between Duke Capital LLC and Duke Energy Ohio, Inc. (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company), filed on April 14, 2006, File No. 1-1232).
*12	Computation of Ratio of Earnings to Fixed Charges.
*23.1	Consent of Independent Registered Public Accounting Firm.
*31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The total amount of securities of the registrant or its subsidiaries authorized under any instrument with respect to long-term debt not filed as an exhibit does not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. The registrant agrees, upon request of the Securities and Exchange Commission, to furnish copies of any or all of such instruments to it.

## COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

The ratio of earnings to fixed charges is calculated using the Securities and Exchange Commission guidelines.

	Successor <sup>(a)</sup>			Predecessor <sup>(a)</sup>		
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
(in millions)						
Earnings as defined for fixed charges calculation						
Add:						
Pretax income from continuing operations	\$ 458	\$ 415	\$ 102	\$ 186	\$ 412	\$ 378
Fixed charges	122	139	100	35	114	106
Deduct:						
Interest capitalized <sup>(b)</sup>	19	30	14	3	7	5
Total earnings (as defined for the Fixed Charges calculation)	\$ 561	\$ 524	\$ 188	\$ 218	\$ 519	\$ 479
Fixed charges:						
Interest on debt, including capitalized portions	\$ 113	\$ 130	\$ 95	\$ 33	\$ 105	\$ 95
Estimate of interest within rental expense	9	9	5	2	9	11
Total fixed charges	\$ 122	\$ 139	\$ 100	\$ 35	\$ 114	\$ 106
Ratio of earnings to fixed charges	4.6	3.8	1.9	6.2	4.6	4.5

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Excludes equity costs related to AFUDC that are included in Other Income and Expenses in the Consolidated Statements of Operations.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement No. 333-146483-01 on Form S-3 of our report dated March 13, 2009, relating to the financial statements and financial statement schedule of Duke Energy Ohio, Inc., appearing in this Annual Report on Form 10-K of Duke Energy Ohio, Inc. for the year ended December 31, 2008.

/S/ DELOITTE & TOUCHE LLP  
Charlotte, North Carolina  
March 13, 2009

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James E. Rogers, certify that:

- 1) I have reviewed this annual report on Form 10-K of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2009

/s/ JAMES E. ROGERS

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James E. Rogers  
Chief Executive Officer

**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, David L. Hauser, certify that:

- 1) I have reviewed this annual report on Form 10-K of Duke Energy Ohio, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2009

/s/ DAVID L. HAUSER

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David L. Hauser  
Group Executive and  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-K for the period ending December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Rogers, Chief Executive Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

Date: March 13, 2009

/s/ JAMES E. ROGERS

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James E. Rogers  
Chief Executive Officer



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-K for the period ending December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David L. Hauser, Group Executive and Chief Financial Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

Date: March 13, 2009

/s/ DAVID L. HAUSER

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David L. Hauser  
Group Executive and  
Chief Financial Officer

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# **FORM 8-K**

**Duke Energy Ohio, Inc. - N/A**

**Filed: March 24, 2009 (period: March 18, 2009)**

Report of unscheduled material events or corporate changes.

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8-K - FORM 8-K

**Item 8.01.**      Other Events.

**Item 9.01.**      Financial Statements and Exhibits.

SIGNATURES

EXHIBIT INDEX

EX-4.1 (EX-4.1)

EX-99.1 (EX-99.1)

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 8-K**

**CURRENT REPORT  
Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934**

**Date of Report (Date of earliest event reported): March 18, 2009**

**DUKE ENERGY OHIO, INC.**  
(Exact Name of Registrant as Specified in its Charter)

**Ohio**  
(State or Other Jurisdiction  
of Incorporation)

**1-1232**  
(Commission  
File Number)

**31-0240030**  
(IRS Employer  
Identification No.)

**139 East Fourth Street, Cincinnati, Ohio 45202**  
(Address of Principal Executive Offices, including Zip code)

**(704) 594-6200**  
(Registrant's telephone number, including area code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
  - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
  - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
  - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
- 
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**Item 8.01. Other Events.**

On March 18, 2009, Duke Energy Ohio, Inc. (the "Company") entered into an underwriting agreement, dated as of March 18, 2009, with Barclays Capital Inc., Deutsche Bank Securities Inc., SunTrust Robinson Humphrey, Inc. and UBS Securities LLC, as representatives of the several underwriters named therein (the "Underwriters"), pursuant to which the Company agreed to issue and sell to the Underwriters \$450,000,000 aggregate principal amount of the Company's First Mortgage Bonds, 5.45% Series, Due April 1, 2019 (the "Bonds"). The Bonds were issued under the First Mortgage, dated as of August 1, 1936, as amended from time to time, including by the Fortieth Supplemental Indenture, dated as of March 23, 2009, between the Company and The Bank of New York Mellon Trust Company, N.A., as successor trustee. In connection with the issuance and sale of the Bonds, the Company is filing the above-described supplemental indenture and underwriting agreement as Exhibits 4.1 and 99.1 to this Form 8-K, respectively.

**Item 9.01. Financial Statements and Exhibits.***(d) Exhibits*

- 4.1 Fortieth Supplemental Indenture, dated as of March 23, 2009 to the First Mortgage, dated as of August 1, 1936, between the Company and The Bank of New York Mellon Trust Company, N.A., as successor trustee
  - 99.1 Underwriting Agreement, dated March 18, 2009, between the Company and Barclays Capital Inc., Deutsche Bank Securities Inc., SunTrust Robinson Humphrey, Inc. and UBS Securities LLC, as representatives of the several underwriters named therein
-

**SIGNATURES**

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**DUKE ENERGY OHIO, INC.**

Date: March 24, 2009

By: /s/ Robert T. Lucas III, Esq.

Name: Robert T. Lucas III, Esq.

Title: Associate General Counsel and  
Assistant Secretary

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## EXHIBIT INDEX

<u>Exhibit</u>	<u>Description</u>
4.1	Fortieth Supplemental Indenture, dated as of March 23, 2009 to the First Mortgage, dated as of August 1, 1936, between the Company and The Bank of New York Mellon Trust Company, N.A., as successor trustee
99.1	Underwriting Agreement, dated March 18, 2009, between the Company and Barclays Capital Inc., Deutsche Bank Securities Inc., SunTrust Robinson Humphrey, Inc. and UBS Securities LLC, as representatives of the several underwriters named therein



*This instrument is the Fortieth Supplemental Indenture to, and an amendment and restatement in its entirety of, the First Mortgage, dated as of August 1, 1936, between The Cincinnati Gas & Electric Company (predecessor to Duke Energy Ohio, Inc.) and Irving Trust Company, as trustee (a predecessor to the trustee herein), as heretofore amended and supplemented.*

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**DUKE ENERGY OHIO, INC.**

(FORMERLY NAMED "THE CINCINNATI GAS & ELECTRIC COMPANY")

**TO**

**THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A.,  
AS TRUSTEE**

(SUCCESSOR TRUSTEE TO THE BANK OF NEW YORK MELLON  
AND TO IRVING TRUST COMPANY)

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**FIRST MORTGAGE**

**DATED AS OF AUGUST 1, 1936**

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**FORTIETH SUPPLEMENTAL INDENTURE**

**DATED AS OF MARCH 23, 2009**

**Constituting an Amendment and Restatement in its Entirety  
of the aforesaid First Mortgage, as heretofore amended**

**and**

**Creating First Mortgage Bonds, 5.45% Series, Due April 1, 2019**

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**DUKE ENERGY OHIO, INC.**  
**Reconciliation and tie between Trust Indenture Act of 1939 and Indenture, dated as of**  
**August 1, 1936, as amended and restated in its entirety on March 23, 2009**

<u>Trust Indenture Act Section</u>	<u>Indenture Section</u>
310	(a)(1) 10.09
	(a)(2) 10.09
	(a)(3) 10.14
	(a)(4) Not Applicable
	(b) 10.08, 10.10
311	(a) 10.13
	(b) 10.13
	(c) Not Applicable
312	(a) 11.01
	(b) 11.01
	(c) 11.01
313	(a) 11.02
	(b)(1) Not Applicable
	(b)(2) 11.02
	(c) 11.02
	(d) 11.02
314	(a) 11.02
	(a)(4) 7.05
	(b) Not Applicable
	(c)(1) 1.04
	(c)(2) 1.04
	(c)(3) Not Applicable
	(d) Not Applicable
	(e) 1.04
315	(a) 10.01(a)
	(b) 10.02
	(c) 10.01(b)
	(d) 10.01(c)
	(d)(1) 10.01(a)(1), 10.01(c)(1)
	(d)(2) 10.01(c)(2)
	(d)(3) 10.01(c)(3)
	(e) 9.14
316	(a) 9.12, 9.13
	(a)(1)(A) 9.02, 9.12
	(a)(1)(B) 9.13
	(a)(2) Not Applicable
	(b) 9.08
317	(a)(1) 9.03
	(a)(2) 9.04
	(b) 7.03
318	(a) 1.09

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**FORTIETH SUPPLEMENTAL INDENTURE**, dated as of March 23, 2009 (the “Execution Date”), between **DUKE ENERGY OHIO, INC.** (hereinafter sometimes referred to as the “Company”), a corporation organized and existing under the laws of the State of Ohio, formerly named The Cincinnati Gas & Electric Company, and **THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A.**, a national banking association, and the successor trustee to The Bank of New York Mellon and Irving Trust Company (hereinafter sometimes referred to as the “Trustee”), whose mailing address is 900 Ashwood Parkway, Suite 425, Atlanta, Georgia 30338, this Fortieth Supplemental Indenture being an amendment and restatement in its entirety of the Indenture, dated as of August 1, 1936 (the “Original Indenture”), between the Company and the Trustee, as heretofore from time to time amended.

#### **RECITALS OF THE COMPANY**

The Original Indenture was authorized, executed and delivered by the Company to provide for the issuance from time to time of its bonds (herein called the “Securities”), to be issued in one or more series as contemplated therein, and to provide security for the payment of the principal of and premium, if any, and interest, if any, on the Securities.

The Company has heretofore executed and delivered to the Trustee thirty-nine supplemental indentures for the purposes recited therein, including creating series of Securities and otherwise supplementing and amending the Original Indenture. There are no Securities now outstanding under the Original Indenture, as so amended and supplemented.

Effective upon the execution and delivery of this Fortieth Supplemental Indenture:

(a) The Bank of New York Mellon shall be deemed to have resigned as Trustee, Bond registrar and paying agent under the Indenture;

(b) the Company shall be deemed to have accepted such resignations and appointed The Bank of New York Mellon Trust Company, N.A. as successor Trustee, Security Registrar and Paying Agent (each as hereinafter defined) under the Indenture;

(c) The Bank of New York Mellon Trust Company, N.A. shall be deemed to have accepted such appointments and to be vested with all the estates, properties, rights, powers, trusts, duties and obligations of The Bank of New York Mellon, as Trustee, Security Registrar and Paying Agent under the Indenture;

(d) such resignations, appointments and acceptances thereof shall be deemed to be effective, notwithstanding anything to the contrary contained in Section 2 or 4 of Article Sixteen of the Original Indenture, as heretofore amended and supplemented, including any provision therein for notice of such resignations, appointments and acceptances; and

(e) the Company shall be deemed to have requested the release, and the Trustee shall be deemed to have released, from the Lien of the Original Indenture, as heretofore amended, any mortgaged property (as defined in the Original Indenture, as heretofore amended) not otherwise set forth in the granting clauses below, to the extent such mortgaged property has not been previously released, including, without limitation, the following:

---

(i)Electric Generating Plants. All electric generating plants and stations of the Company owned by it as of the Execution Date, including all buildings, structures and works, and the land on which the same are situated, and all other lands and easements, rights of way, permits, privileges, towers, poles, wires, machinery, equipment, appliances, appurtenances and supplies forming a part of such plants and stations;

(ii)Water Systems. All water systems of the Company owned by it as of the Execution Date, including pumping and purification equipment, wells, structures, rights of way, tanks, mains, fire hydrants, services and meters and all other property, real or personal, forming a part of or appertaining to, or used, occupied or enjoyed in connection with such water systems, together with permits, privileges, franchises and rights in or relating to the construction, maintenance or operation thereof, through, under or upon any private property or any public streets or highways within as well as without the corporate limits of any municipal corporation; and

(iii)Gas Transmission and Distribution Systems. All gas plants, compressor stations, gas measuring, regulating, and mixing stations, gas transmission lines and gas distribution systems, including, but not limited to, all water sets, benches and retorts, gas holders, boilers, purification apparatus, exhausters and pumps, meters and meter installations, gauges, regulators and regulator installations, governors, calorimetric devices, valves, fuel handling apparatus, safety tanks, valves, pipes and piping, couplings, gates, drips, lighting and heating apparatus, machinery, equipment, appliances, and all accessory equipment, appurtenances and supplies forming a part of such gas plants, stations, transmission lines and distribution systems.

The Company now desires to amend and restate the Indenture as now in effect (comprised of the Original Indenture as heretofore from time to time amended) and has requested the Trustee to join in the execution and delivery of this Fortieth Supplemental Indenture in order to effectuate such amendment and restatement; it being understood, acknowledged and agreed, however, that, anything herein or in the Original Indenture or any supplemental indenture to the contrary notwithstanding, (a) the execution and delivery of this Fortieth Supplemental Indenture and the amendment and restatement of the Original Indenture as heretofore amended, as aforesaid, shall not affect the Lien granted and/or created in the granting clauses of the Original Indenture with respect to the mortgaged property, and confirmed in the granting clauses of supplemental indentures heretofore executed and delivered, or the priority of such Lien and (b) such Lien shall continue in effect from the date of the original grant or creation thereof (except to the extent hereby or heretofore released).

The Company duly authorized the execution and delivery of the Original Indenture and of each supplemental indenture heretofore executed and delivered. The Company has further duly authorized the execution and delivery of this Fortieth Supplemental Indenture to amend and restate the Original Indenture as heretofore amended, as contemplated above; and all acts and things necessary to make each of this Fortieth Supplemental Indenture and the Indenture a valid agreement of the Company have been performed.

For all purposes of this Indenture, except as otherwise expressly provided or unless the context otherwise requires, capitalized terms used herein shall have the meanings assigned to them in Article One of this Indenture.

### GRANTING CLAUSES

**NOW, THEREFORE, THIS INDENTURE WITNESSETH**, that, the Company has granted, bargained, sold, conveyed, assigned, transferred, mortgaged, pledged, set over and confirmed, and in consideration of the premises and of the purchase of the Securities by the Holders thereof, and in order to secure the payment of the principal of and premium, if any, and interest, if any, on all Securities from time to time Outstanding and the performance of the covenants therein and herein contained, and to declare the terms and conditions on which such Securities are secured, the Company hereby grants, bargains, sells, conveys, assigns, transfers, mortgages, pledges, sets over and confirms to the Trustee, in trust, and grants to the Trustee a security interest in and lien on, the following (subject, however, to the terms and conditions set forth in this Indenture):

### FIRST GRANTING CLAUSE

All right, title and interest of the Company, as of the Execution Date, in and to all property, real, personal and mixed, wherever located (other than Excepted Property), in any case used or to be used in or in connection with the transmission and distribution of electric energy by the Company (whether or not such use is the sole use of such property), including without limitation, all right, title and interest of the Company in and to the following:

(a) all real property owned in fee, easements and other interests in real property which are specifically described or referred to in the Original Indenture and in supplemental indentures thereto, recording information with respect to which is set forth in Exhibit A hereto, and the real property acquired by the Company between December 1, 1985, the date of the Twenty-Fifth Supplemental Indenture, and the date of this Fortieth Supplemental Indenture, and owned by it at the latter date, which is described on Exhibit B hereto, except real property owned in fee, easements and other interests in real property which have been specifically released from such Lien from time to time (without limiting the generality of the foregoing, a listing of the Company's principal real estate holdings (by address and county) encumbered by the Original Indenture or supplements thereto, and intended to be encumbered by this Indenture is set forth on Exhibit C hereto);

(b) without limiting the generality of the foregoing, all recorded easements or rights of way on, upon, over, under and through real property located in the State of Ohio, used or useful in the Company's transmission or distribution of electric energy and acquired by the Company in the ordinary course of its business, whether acquired by deed, grant of easement, dedication by plat or otherwise, and whether acquired in the name of the Company or any of

its predecessor companies and including the Company's right to the joint use of any easement or right of way acquired by any other utility company;

(c) all facilities, machinery, equipment and fixtures for the transmission and distribution of electric energy including, but not limited to, all switchyards, towers, substations, transformers, poles, lines, cables, conduits, ducts, conductors, meters, regulators and all other property used or to be used for any or all of such purposes;

(d) all buildings, offices, warehouses, structures or improvements in addition to those referred to or otherwise included in clauses (a) and (c) above;

(e) all franchises, licenses, permits, grants, immunities, privileges and rights of the Company used or useful in the operation of its electric transmission and distribution businesses, including all franchises, licenses, permits, grants, immunities, privileges and rights of the Company granted by any municipalities or political subdivisions, and all right, title and interest therein owned by the Company on the Execution Date, and all renewals, extensions and modifications of said franchises, grants, privileges and rights, or any of them;

(f) all computers, data processing, data storage, data transmission and/or telecommunications facilities, equipment and apparatus necessary for the operation or maintenance of any facilities, machinery, equipment or fixtures described or referred to in clause (c) above; and

(g) all of the foregoing property in the process of construction;

#### **SECOND GRANTING CLAUSE**

Subject to the applicable exceptions permitted by Section 17.09(d), Section 12.03 and Section 12.05, all right, title and interest of the Company in all property, real, personal and mixed, wherever located (other than Excepted Property) which may be hereafter acquired by the Company, it being the intention of the Company that all such property acquired by the Company after the Execution Date shall be as fully embraced within and subjected to the Lien hereof as if such property were owned by the Company as of the Execution Date; and

#### **THIRD GRANTING CLAUSE**

Any Excepted Property, which may, from time to time after the Execution Date, by delivery or by an instrument supplemental hereto, be subjected to the Lien hereof by the Company, the Trustee being hereby authorized to receive the same at any time as additional security hereunder; it being understood that any such subjection to the Lien hereof of any Excepted Property as additional security may be made subject to such reservations, limitations or conditions respecting the use and disposition of such property or the proceeds thereof as shall be set forth in such instrument;

## EXCEPTED PROPERTY

Expressly excepting and excluding, however, from the Lien of this Indenture all right, title and interest of the Company in and to the following property, whether now owned or hereafter acquired (herein sometimes called "Excepted Property"):

(a) all cash on hand or in banks or other financial institutions, deposit accounts, securities accounts, shares of stock, interests in business or statutory trusts, general or limited partnerships or limited liability companies, bonds, notes, other evidences of indebtedness and other securities, security entitlements, commodities accounts and other investment property and policies of insurance on lives of officers of the Company, of whatsoever kind and nature, not hereafter paid or delivered to, deposited with or held by the Trustee hereunder or required so to be;

(b) all contracts, leases, operating agreements and other agreements of whatsoever kind and nature and rights thereunder (other than the Company's franchises, permits and licenses that are used or useful in the operation of its electric transmission and distribution businesses); all bills, notes and other instruments and chattel paper (except to the extent that any of the same constitute securities, security entitlements or investment property, in which case they are separately excepted from the Lien of this Indenture under clause (a) above); all revenues, income and earnings, all accounts, accounts receivable, rights to payment, payment intangibles and unbilled revenues, rights or property consisting of rights granted by statute or governmental action to bill and collect revenues or other amounts from customers or others, including rate stabilization charges and other special charges, and all rents, tolls, issues, product and profits, dividends, income, claims, credits, demands and judgments; all governmental and other licenses, permits and franchises (other than the Company's franchises, permits and licenses that are used or useful in the operation of its electric transmission and distribution businesses); all unrecorded easements and rights of way; all consents and allowances, including emission allowances and regulatory assets; all documents, including warehouse receipts; all cooperative interests; and all patents, patent licenses and other patent rights, patent applications, trade names, trademarks, copyrights and other intellectual property; and all claims, credits, choses in action, commercial tort claims, tax credits and other intangible property and general intangibles including, but not limited to, computer software;

(c) all automobiles, buses, trucks, truck cranes, tractors, trailers and similar vehicles and movable equipment; all rolling stock, rail cars and other railroad equipment; all vessels, boats, barges, and other marine equipment; all airplanes, helicopters, aircraft engines and other flight equipment; all parts, accessories and supplies used in connection with any of the foregoing; and all personal property of such character that the perfection of a security interest therein or other Lien thereon is not governed by the Uniform Commercial Code as in effect in the jurisdiction in which such property is located;

(d) all goods, stock in trade, wares, merchandise and inventory held for the purpose of sale or lease in the ordinary course of business; all materials, supplies, inventory and other items of personal property which are consumable (otherwise than by ordinary wear and tear) in their use in the operation of the Mortgaged Property; all fuel, whether or not any such fuel is in a form consumable in the operation of the Mortgaged Property, including separate components of any fuel in the forms in which such components exist at any time before, during or after the period of the use thereof as fuel; all hand and other portable tools and equipment; all furniture and furnishings; and computers and data processing, data storage, data transmission, telecommunications and other facilities, equipment and apparatus, which, in any case, are used primarily for administrative or clerical purposes or are otherwise not necessary for the operation or maintenance of the facilities, machinery, equipment or fixtures described or referred to in clauses (c), (d), (f) or (g) of the First Granting Clause of this Indenture;

(e) all coal, lignite, ore, gas, oil and other minerals and all timber, and all rights and interests in any of the foregoing, whether or not such minerals or timber shall have been mined or extracted or otherwise separated from the land; and all electric energy and capacity, gas (natural or artificial), steam, water and other products generated, produced, manufactured, purchased or otherwise acquired by the Company;

(f) all property which is the subject of a lease agreement designating the Company as lessee and all right, title and interest of the Company in and to such property and in, to and under such lease agreement, whether or not such lease agreement is intended as security;

(g) all property, real, personal and mixed, which has been released from the Lien of this Indenture and any improvements, extensions and additions to such properties and renewals, replacements and substitutions of or for any parts thereof;

(h) all property located outside of the State of Ohio;

(i) any and all property, stations and plants used by the Company in the generation of electricity, including all buildings, structures and works, and the land on which the same are situated, and all other lands and easements, rights of way, permits, privileges, towers, poles, wires, machinery, equipment, appliances, appurtenances and supplies forming a part of such plants and stations;

(j) any and all water systems of the Company, including pumping and purification equipment, wells, structures, rights of way, tanks, mains, fire hydrants, services and meters and all other property, real or personal, forming a part of or appertaining to, or used, occupied or enjoyed in connection with such water systems, together with permits, privileges, franchises and rights in or relating to the construction, maintenance or operation thereof, through, under or

upon any private property or any public streets, or highways within as well as without the corporate limits of any municipal corporation;

(k) any and all gas plants, compressor stations, gas measuring, regulating, and mixing stations, gas transmission lines and gas distribution systems, including, but not limited to, all water sets, benches and retorts, gas holders, boilers, purification apparatus, exhausters and pumps, meters and meter installations, gauges, regulators and regulator installations, governors, calorimetric devices, valves, fuel handling apparatus, safety tanks, valves, pipes and piping, couplings, gates, drips, lighting and heating apparatus, machinery, equipment, appliances, and all accessory equipment, appurtenances and supplies forming a part of such gas plants, stations, transmission lines and distribution systems; and

(l) all property not acquired or constructed by the Company for use in its electric transmission and distribution businesses; provided, however, that, subject to the provisions of Section 12.03, (x) if, at any time after the occurrence of an Event of Default, the Trustee, or any separate trustee or co-trustee appointed under Section 10.14 or any receiver appointed pursuant to Section 9.16 or otherwise, shall have entered into possession of all or substantially all the Mortgaged Property, to the extent permitted by law, all the Excepted Property described or referred to in the foregoing clauses (b), (c) and (d) then owned or held or thereafter acquired by the Company, to the extent that the same is used in connection with, or otherwise relates or is attributable to, the Mortgaged Property, shall immediately, and, in the case of any Excepted Property described or referred to in clause (f), to the extent that the same is used in connection with, or otherwise relates or is attributable to, the Mortgaged Property, upon demand of the Trustee or such other trustee or receiver, become subject to the Lien of this Indenture, junior and subordinate to any Liens at that time existing on such Excepted Property, and the Trustee or such other trustee or receiver may, to the extent permitted by law or by the terms of any such other Lien (and subject to the rights of the holders of all such other Liens), at the same time likewise take possession thereof, and (y) whenever all Events of Default shall have been cured and the possession of all or substantially all of the Mortgaged Property shall have been restored to the Company, such Excepted Property shall again be excepted and excluded from the Lien hereof to the extent set forth above; it being understood that the Company may, however, pursuant to the Third Granting Clause, subject any Excepted Property to the Lien of this Indenture whereupon the same shall cease to be Excepted Property;

**TO HAVE AND TO HOLD** all such property, real, personal and mixed, unto the Trustee, its successors in trust and their assigns forever;

**SUBJECT, HOWEVER,** to Permitted Liens;

**IN TRUST, NEVERTHELESS,** for the equal and ratable benefit and security of the Holders from time to time of all Outstanding Securities without any priority of any such Security over any other such Security;



**PROVIDED, HOWEVER,** that if the right, title and interest of the Trustee in and to the Mortgaged Property shall cease, terminate and become void in accordance with, and subject to the conditions set forth in, Article Eight hereof, and if the principal of and premium and interest, if any, on the Securities shall have been paid to the Holders thereof, or shall have been paid to the Company pursuant to Section 7.03 hereof or to the appropriate Governmental Authority pursuant to applicable law after the Maturity thereof, then and in that case this Indenture shall cease, terminate and become void in accordance with, and subject to the conditions set forth in, Article Eight hereof, and the Trustee shall execute and deliver to the Company such instruments as the Company shall require to evidence such termination; otherwise this Indenture, and the estate and rights hereby granted, shall be and remain in full force and effect; and

**IT IS HEREBY COVENANTED AND AGREED** by and between the Company and the Trustee that all the Securities are to be authenticated and delivered, and that the Mortgaged Property is to be held, subject to the further covenants, conditions and trusts hereinafter set forth, and the Company hereby covenants and agrees to and with the Trustee, for the equal and ratable benefit of all holders of the Securities, as follows:

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**ARTICLE ONE.**

**DEFINITIONS AND OTHER PROVISIONS OF GENERAL APPLICATION**

**SECTION 1.01. DEFINITIONS.**

For all purposes of this Indenture, except as otherwise expressly provided or unless the context otherwise requires:

(a) the terms defined in this Article have the meanings assigned to them in this Article and include the plural as well as the singular;

(b) all terms used herein without definition which are defined in the Trust Indenture Act as in effect on the Execution Date, either directly or by reference therein, have the meanings assigned to them therein;

(c) all terms used herein without definition which are defined in the Uniform Commercial Code of Ohio as in effect on the Execution Date shall have the meanings assigned to them therein;

(d) all accounting terms not otherwise defined herein have the meanings assigned to them in accordance with generally accepted accounting principles in the United States, and, except as otherwise herein expressly provided, the term "generally accepted accounting principles" with respect to any computation required or permitted hereunder shall mean such accounting principles as are generally accepted in the United States at the date of such computation or, at the election of the Company from time to time, at the Execution Date; provided, however, that in determining generally accepted accounting principles applicable to the Company, effect shall be given, to the extent required, to any order, rule or regulation of any administrative agency, regulatory authority or other governmental body having jurisdiction over the Company;

(e) any reference to an "Article" or a "Section" refers to an Article or a Section, as the case may be, of this Indenture; and

(f) the words "herein", "hereof" and "hereunder" and other words of similar import refer to this Indenture as a whole and not to any particular Article, Section or other subdivision.

**"Accountant"** means a person engaged in the accounting profession or otherwise qualified to pass on accounting matters (including, but not limited to, a Person certified or licensed as a public accountant, whether or not then engaged in the public accounting profession), which Person, unless required to be Independent, may be an employee or Affiliate of the Company.

**"Act"**, when used with respect to any Holder of a Security, has the meaning specified in Section 1.06.

**"Affiliate"** of any specified Person means any other Person directly or indirectly controlling or controlled by or under direct or indirect common control with such specified

Person. For the purposes of this definition, “**Control**” when used with respect to any specified Person means the power to direct generally the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise; and the terms “**Controlling**” and “**Controlled**” have meanings correlative to the foregoing.

“**Authenticating Agent**” means any Person or Persons (other than the Company or an Affiliate of the Company) authorized by the Trustee to act on behalf of the Trustee to authenticate the Securities of one or more series.

“**Authorized Officer**” means the Chairman of the Board, the Vice Chairman, the President, any Vice President, the Treasurer, any Assistant Treasurer, or any other officer, manager or agent of the Company duly authorized pursuant to a Board Resolution to act in respect of matters relating to this Indenture.

“**Authorized Publication**” means a newspaper or financial journal of general circulation, printed in the English language and customarily published on each Business Day, whether or not published on Saturdays, Sundays or holidays; or, in the alternative, shall mean such form of communication as may have come into general use for the dissemination of information of similar import. In the event that successive weekly publications in an Authorized Publication are required hereunder they may be made (unless otherwise expressly provided herein) on the same or different days of the week and in the same or in different Authorized Publications. In case, by reason of the suspension of publication of any Authorized Publication, or by reason of any other cause, it shall be impractical without extraordinary expense to make publication of any notice in an Authorized Publication as required by this Indenture, then such method of publication or notification as shall be made with the approval of the Trustee shall be deemed the equivalent of the required publication of such notice in an Authorized Publication.

“**Authorized Purposes**” means the authentication and delivery of Securities, the release of property and/or the withdrawal of cash under any of the provisions of this Indenture.

“**Board of Directors**” means either the board of directors, board of managers or similar governing body of the Company or any committee thereof duly authorized to act in respect of matters relating to this Indenture.

“**Board Resolution**” means a copy of a resolution certified by the Secretary, an Assistant Secretary or an Authorized Officer of the Company to have been duly adopted by the Board of Directors and to be in full force and effect on the date of such certification, and delivered to the Trustee.

“**Bonds of Series Due 2019**” has the meaning specified in Section 4.01.

“**Business Day**”, when used with respect to a Place of Payment or any other particular location specified in the Securities or this Indenture, means any day, other than a Saturday or Sunday, which is not a day on which banking institutions or trust companies in such Place of Payment or other location are generally authorized or required by law, regulation or executive order to remain closed, except as may be otherwise specified as contemplated by Section 3.01.

**“Commission”** means the Securities and Exchange Commission, as from time to time constituted, created under the Exchange Act, or, if at any time after the Execution Date such Commission is not existing and performing the duties now assigned to it under the Trust Indenture Act, then the body, if any, performing such duties at such time.

**“Company”** means the Person named as the “Company” in the first paragraph of this instrument until a successor Person shall have become such pursuant to the applicable provisions of this Indenture, and thereafter “Company” shall mean such successor Person.

**“Company Order”** or **“Company Request”** mean, respectively, a written order or request, as the case may be, signed in the name of the Company by an Authorized Officer and delivered to the Trustee.

**“Corporate Trust Office”** means the designated office of the Trustee at which at any particular time its corporate trust business shall be administered, which office at the Execution Date is located at 900 Ashwood Parkway, Suite 425, Atlanta, Georgia 30338.

**“corporation”** means a corporation, association, company, limited liability company, partnership, limited partnership, joint stock company, or business or statutory trust, and references to “corporate” and other derivations of “corporation” herein shall be deemed to include appropriate derivations of such entities.

**“Cost”**, with respect to Property Additions, has the meaning specified in Section 1.03.

**“Defaulted Interest”** has the meaning specified in Section 3.07.

**“Discount Security”** means any Security which provides for an amount less than the principal amount thereof to be due and payable upon a declaration of acceleration of the Maturity thereof pursuant to Section 9.02. **“Interest”** with respect to a Discount Security means interest, if any, borne by such Security at a Stated Interest Rate.

**“Dollar”** or **“\$”** means a dollar or other equivalent unit in such coin or currency of the United States of America as at the time shall be legal tender for the payment of public and private debts.

**“Eligible Obligations”** means:

(a) with respect to Securities denominated in Dollars, Government Obligations or, if specified pursuant to Section 3.01 with respect to any Securities, other Investment Securities; or

(b) with respect to Securities denominated in a currency other than Dollars or in a composite currency, such other obligations or instruments as shall be specified with respect to such Securities, as contemplated by Section 3.01.

**“Event of Default”** has the meaning specified in Section 9.01.

**“Excepted Property”** has the meaning specified in the granting clauses of this instrument.

**“Exchange Act”** means, as of any time, the Securities Exchange Act of 1934, as amended, as in effect at such time.

**“Execution Date”** has the meaning specified in the first paragraph of this instrument.

**“Expert”** means a Person which is an engineer, appraiser or other expert and which, with respect to any certificate to be signed by such Person and delivered to the Trustee, is qualified to pass upon the matters set forth in such certificate. For purposes of this definition, (a) “engineer” means a Person engaged in the engineering profession or otherwise qualified to pass upon engineering matters (including, but not limited to, a Person licensed as a professional engineer, whether or not then engaged in the engineering profession) and (b) “appraiser” means a Person engaged in the business of appraising property or otherwise qualified to pass upon the Fair Value or fair market value of property.

**“Expert’s Certificate”** means a certificate signed by an Authorized Officer and by an Expert (which Expert (a) shall be selected either by the Board of Directors or by an Authorized Officer, the execution of such certificate by such Authorized Officer to be conclusive evidence of such selection, and (b) except as otherwise required in Sections 12.06, 16.02 or 17.09, may be an employee or Affiliate of the Company) and delivered to the Trustee. The amount stated in any Expert’s Certificate as to the Cost, Fair Value or fair market value of property shall be conclusive and binding upon the Company, the Trustee and the Holders of the Securities.

**“Fair Value”**, with respect to property, means the fair value of such property as may be determined by reference to (a) the amount which would be likely to be obtained in an arm’s-length transaction with respect to such property between an informed and willing buyer and an informed and willing seller, under no compulsion, respectively, to buy or sell, (b) the amount of investment with respect to such property which, together with a reasonable return thereon, would be likely to be recovered through ordinary business operations or otherwise, (c) the Cost, accumulated depreciation, and replacement cost with respect to such property and/or (d) any other relevant factors; provided, however, that (x) the Fair Value of property shall be determined without deduction for any Liens on such property prior to the Lien of this Indenture (except as otherwise provided in Section 17.03) and (y) the Fair Value to the Company of Property Additions may be of less value to a Person which is not the owner or operator of the Mortgaged Property or any portion thereof than to a Person which is such owner or operator. Fair Value may be determined, without physical inspection, by the use of accounting and engineering records and other data maintained by the Company or otherwise available to the Expert certifying the same.

**“Funded Cash”** has the meaning specified in Section 1.02.

**“Funded Property”** has the meaning specified in Section 1.02.

**“Governmental Authority”** means the government of the United States or of any State or Territory thereof or of the District of Columbia or of any county, municipality or other

political subdivision of any thereof, or any department, agency, authority or other instrumentality of any of the foregoing.

**“Government Obligations”** means securities which are (a) (i) direct obligations of the United States where the payment or payments thereunder are supported by the full faith and credit of the United States or (ii) obligations of a Person controlled or supervised by and acting as an agency or instrumentality of the United States where the timely payment or payments thereunder are unconditionally guaranteed as a full faith and credit obligation by the United States or (b) depository receipts issued by a bank (as defined in Section 3(a)(2) of the Securities Act, which may include the Trustee or any Paying Agent) as custodian with respect to any such Government Obligation or a specific payment of interest on or principal of or other amount with respect to any such Government Obligation held by such custodian for the account of the holder of a depository receipt, provided that (except as required by law) such custodian is not authorized to make any deduction from the amount payable to the holder of such depository receipt from any amount received by the custodian in respect of the Government Obligation or the specific payment of interest on or principal of or other amount with respect to the Government Obligation evidenced by such depository receipt.

**“Holder”** means a Person in whose name a Security is registered in the Security Register.

**“Indenture”** means this instrument as originally executed and as it may from time to time be supplemented or amended by one or more indentures supplemental hereto entered into pursuant to the applicable provisions hereof, including, for all purposes of this instrument and any such supplemental indenture, the provisions of the Trust Indenture Act that are deemed to be a part of and govern this Indenture and any such supplemental indenture, respectively. The term “Indenture” shall also include the provisions or terms of particular series of Securities established in any Officer’s Certificate, Board Resolution or Company Order delivered pursuant to Sections 2.01, 3.01, 3.03 and 13.07.

**“Independent”**, when applied to any Accountant or Expert, means such a Person who (a) is in fact independent, (b) does not have any direct material financial interest in the Company or in any other obligor upon the Securities or in any Affiliate of the Company or of such other obligor, and (c) is not connected with the Company or such other obligor as an officer, employee, promoter, underwriter, trustee, partner, director or any person performing similar functions.

**“Independent Expert’s Certificate”** means a certificate signed by an Expert who is Independent and delivered to the Trustee.

**“interest”** with respect to a Discount Security means interest, if any, borne by such Security at a Stated Interest Rate rather than interest calculated at any imputed rate.

**“Interest Payment Date”**, when used with respect to any Security, means the Stated Maturity of an installment of interest on such Security.

**“Investment Securities”** means any of the following obligations or securities on which neither the Company, any other obligor on the Securities nor any Affiliate of either is the

obligor: (a) Government Obligations; (b) interest bearing deposit accounts (which may be represented by certificates of deposit) in any national or state bank (which may include the Trustee or any Paying Agent) or savings and loan association which has outstanding securities rated by a nationally recognized rating organization in either of the two (2) highest rating categories (without regard to modifiers) for short term securities or in any of the three (3) highest rating categories (without regard to modifiers) for long term securities; (c) bankers' acceptances drawn on and accepted by any commercial bank (which may include the Trustee or any Paying Agent) which has outstanding securities rated by a nationally recognized rating organization in either of the two (2) highest rating categories (without regard to modifiers) for short term securities or in any of the three (3) highest rating categories (without regard to modifiers) for long term securities; (d) direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by, any State or Territory of the United States or the District of Columbia, or any political subdivision of any of the foregoing, which are rated by a nationally recognized rating organization in either of the two (2) highest rating categories (without regard to modifiers) for short term securities or in any of the three (3) highest rating categories (without regard to modifiers) for long term securities; (e) bonds or other obligations of any agency or instrumentality of the United States; (f) corporate debt securities which are rated by a nationally recognized rating organization in either of the two (2) highest rating categories (without regard to modifiers) for short term securities or in any of the three (3) highest rating categories (without regard to modifiers) for long term securities; (g) repurchase agreements with respect to any of the foregoing obligations or securities with any banking or financial institution (which may include the Trustee or any Paying Agent) which has outstanding securities rated by a nationally recognized rating organization in either of the two (2) highest rating categories (without regard to modifiers) for short term securities or in any of the three (3) highest rating categories (without regard to modifiers) for long term securities; (h) securities issued by any regulated investment company (including any investment company for which the Trustee or any Paying Agent is the advisor), as defined in Section 851 of the Internal Revenue Code of 1986, as amended, or any successor section of such Code or successor federal statute, provided that the portfolio of such investment company is limited to obligations or securities of the character and investment quality contemplated in clauses (a) through (f) above and repurchase agreements which are fully collateralized by any of such obligations or securities; and (i) any other obligations or securities which may lawfully be purchased by the Trustee in its capacity as such.

**“Lien”** means any mortgage, deed of trust, pledge, security interest, encumbrance, easement, lease, reservation, restriction, servitude, charge or similar right and any other lien of any kind, including, without limitation, any conditional sale or other title retention agreement, any lease in the nature thereof, and any defect, irregularity, exception or limitation in record title.

**“Maturity”**, when used with respect to any Security, means the date on which the principal of such Security or an installment of principal becomes due and payable as provided in such Security or in this Indenture, whether at the Stated Maturity, by declaration of acceleration, upon call for redemption or otherwise.

**“Mortgaged Property”** means, as of any particular time, all property which at such time is subject to the Lien of this Indenture (which, for the avoidance of doubt, includes, without limitation, Funded Cash, Investment Securities and obligations secured by Purchase Money Liens to the extent held by the Trustee as part of the Mortgaged Property as set forth herein).

“**Notice of Default**” means a written notice of the kind specified in Section 9.01(c).

“**Officer’s Certificate**” means a certificate signed by an Authorized Officer of the Company and delivered to the Trustee.

“**Opinion of Counsel**” means a written opinion of counsel, who may be counsel for the Company, or an individual who is an employee of the Company or an Affiliate of the Company, and who shall be acceptable to the Trustee.

“**Original Indenture**” has the meaning specified in the first paragraph of this instrument.

“**Outstanding**”, when used with respect to Securities, means, as of the date of determination, all Securities theretofore authenticated and delivered under this Indenture, except:

(a) Securities theretofore canceled or delivered to the Security Registrar for cancellation;

(b) Securities deemed to have been paid for all purposes of this Indenture in accordance with Section 8.01 (whether or not the Company’s indebtedness in respect thereof shall be satisfied and discharged for any other purpose), or deemed to have been paid in accordance with the terms of the Securities; and

(c) Securities, the principal, premium, if any, and interest, if any, which have been fully paid pursuant to the third paragraph of Section 3.06 or in exchange for or in lieu of which other Securities have been authenticated and delivered pursuant to this Indenture, other than any such Securities in respect of which there shall have been presented to the Trustee proof satisfactory to it and the Company that such Securities are held by a bona fide purchaser or purchasers in whose hands such Securities are valid obligations of the Company;

provided, however, that in determining whether or not the Holders of the requisite principal amount of the Securities Outstanding under this Indenture, or the Outstanding Securities of any series or Tranche, have given any request, demand, authorization, direction, notice, consent or waiver hereunder or whether or not a quorum is present at a meeting of Holders of Securities,

(x) Securities owned by the Company or any other obligor upon the Securities or any Affiliate of the Company or of such other obligor (unless the Company, such Affiliate or such obligor owns all Securities Outstanding under this Indenture, or (except for the purposes of actions to be taken by Holders of more than one series or more than one Tranche, as the case may be, voting as a class under Section 13.02) all Outstanding Securities of each such series and each such Tranche, as the case may be, determined without regard to this clause (x)) shall be disregarded and deemed not to be Outstanding, except that, in determining whether the Trustee shall be protected in relying upon any such request, demand, authorization, direction, notice, consent or waiver or upon any such determination as to the presence of a quorum, only Securities which a Responsible Officer of the Trustee actually knows to be so owned shall be so disregarded; provided, however, that Securities so owned which have been pledged in good faith may be regarded as Outstanding if it is established to the



reasonable satisfaction of the Trustee that the pledgee, and not the Company, or any such other obligor or Affiliate of either thereof, has the right so to act with respect to such Securities and that the pledgee is not the Company or any other obligor upon the Securities or any Affiliate of the Company or of such other obligor; and provided, further, that in no event shall any Security which shall have been delivered to evidence or secure, in whole or in part, the Company's obligations in respect of other indebtedness be deemed to be owned by the Company if the principal of such Security is payable, whether at Stated Maturity or upon mandatory redemption or acceleration, at the same time as the principal of such other indebtedness is payable, whether at Stated Maturity or upon mandatory redemption or acceleration, but only to the extent of such portion of the principal amount of such Security as does not exceed the principal amount of such other indebtedness, and

(y) the principal amount of a Discount Security that shall be deemed to be Outstanding for such purposes shall be the amount of the principal thereof that would be due and payable as of the date of such determination upon a declaration of acceleration of the Maturity thereof pursuant to Section 902; and

(z) the principal amount of any Security which is denominated in a currency other than Dollars or in a composite currency that shall be deemed to be Outstanding for such purposes shall be the amount of Dollars which could have been purchased by the principal amount (or, in the case of a Discount Security, the Dollar equivalent on the date determined as set forth below of the amount determined as provided in (y) above) of such currency or composite currency evidenced by such Security, in each such case certified to the Trustee in an Officer's Certificate, based (i) on the average of the mean of the buying and selling spot rates quoted by three banks which are members of the New York Clearing House Association selected by the Company in effect at 11:00 A.M. (New York time) in The City of New York on the fifth Business Day preceding any such determination or (ii) if on such fifth Business Day it shall not be possible or practicable to obtain such quotations from such three banks, on such other quotations or alternative methods of determination which shall be as consistent as practicable with the method set forth in (i) above;

provided, further, that in the case of any Security the principal of which is payable from time to time without presentment or surrender, the principal amount of such Security that shall be deemed to be Outstanding at any time for all purposes of this Indenture shall be the original principal amount thereof less the aggregate amount of principal thereof theretofore paid.

**"Paying Agent"** means any Person, including the Company, authorized by the Company to pay the principal of, and premium, if any, or interest, if any, on any Securities on behalf of the Company; provided, however, that unless otherwise provided as contemplated by Section 3.01, the Trustee shall be the Paying Agent for all series of Securities.

**"Periodic Offering"** means an offering of Securities of a series from time to time any or all of the specific terms of which Securities, including without limitation the rate or rates of

interest, if any, thereon, the Stated Maturity or Maturities thereof and the redemption provisions, if any, with respect thereto, are to be determined by the Company or its agents from time to time subsequent to the initial request for the authentication and delivery of such Securities by the Trustee, as contemplated in Section 3.01 and clause (b) of Section 3.03.

“**Permitted Liens**” means, as of any particular time, any of the following:

(a) Liens existing at the date of execution and delivery of the Original Indenture;

(b) as to property acquired by the Company after the date of execution and delivery of the Original Indenture, Liens existing or placed thereon at the time of the acquisition thereof and any Purchase Money Liens;

(c) Liens for taxes, assessments and other governmental charges or requirements which are not delinquent or which are being contested in good faith by appropriate proceedings or of which at least ten (10) Business Days notice has not been given to the general counsel of the Company or to such other Person designated by the Company to receive such notices;

(d) Mechanics’, workmen’s, repairmen’s, materialmen’s, warehousemen’s, and carriers’ Liens, other Liens incident to construction, Liens or privileges of any employees of the Company for salary or wages earned, but not yet payable, and other Liens, including without limitation Liens for worker’s compensation awards, arising in the ordinary course of business for charges or requirements which are not delinquent or which are being contested in good faith and by appropriate proceedings or of which at least ten (10) Business Days notice has not been given to the general counsel of the Company or to such other Person designated by the Company to receive such notices;

(e) Liens in respect of attachments, judgments or awards arising out of judicial or administrative proceedings (i) in an amount not exceeding the greater of (A) Fifty Million Dollars (\$50,000,000) and (B) three percent (3%) of the principal amount of the Securities then Outstanding or (ii) with respect to which the Company shall (X) in good faith be prosecuting an appeal or other proceeding for review and with respect to which the Company shall have secured a stay of execution pending such appeal or other proceeding or (Y) have the right to prosecute an appeal or other proceeding for review or (Z) have not received at least ten (10) Business Days notice given to the general counsel of the Company or to such other Person designated by the Company to receive such notices;

(f) easements, leases, reservations or other rights of others in, on, over and/or across, and laws, regulations and restrictions affecting, and defects, irregularities, exceptions and limitations in title to, the Mortgaged Property or any part thereof; provided, however, that such easements, leases, reservations, rights, laws, regulations, restrictions, defects, irregularities, exceptions and limitations do not in the aggregate materially impair the use by the Company of the Mortgaged Property considered as a whole for the purposes for which it is held by the Company;

(g) Liens, defects, irregularities, exceptions and limitations in (i) title to real property subject to rights-of-way in favor of the Company or otherwise or used or to be used by the Company primarily for right-of-way purposes; (ii) real property held under lease, easement,

license or similar right; or (iii) the rights-of-way, leases, easements, licenses or similar rights in favor of the Company; provided, however, that (A) the Company shall have obtained from the apparent owner or owners of such real property a sufficient right, by the terms of the instrument granting such right-of-way, lease, easement, license or similar right, to the use thereof for the purposes for which the Company acquired the same; (B) the Company has power under eminent domain or similar statutes to remove or subordinate such Liens, defects, irregularities, exceptions or limitations or (C) such defects, irregularities, exceptions and limitations may be otherwise remedied without undue effort or expense; and defects, irregularities, exceptions and limitations in title to flood lands, flooding rights and/or water rights;

(h) Liens securing indebtedness or other obligations neither created, assumed nor guaranteed by the Company nor on account of which it customarily pays interest upon real property or rights in or relating to real property acquired by the Company for the purpose of the transmission or distribution of electric energy, gas or water, for the purpose of telephonic, telegraphic, radio, wireless or other electronic communication or otherwise for the purpose of obtaining rights-of-way;

(i) leases existing at the date of execution and delivery of the Original Indenture affecting properties owned by the Company at said date and renewals and extensions thereof; and leases affecting such properties entered into after such date or affecting properties acquired by the Company after such date which, in either case, (i) have respective terms of not more than ten (10) years (including extensions or renewals at the option of the tenant) or (ii) do not materially impair the use by the Company of such properties for the respective purposes for which they are held by the Company;

(j) Liens vested in lessors, licensors, franchisors or permittees for rent or other amounts to become due or for other obligations or acts to be performed, the payment of which rent or the performance of which other obligations or acts is required under leases, subleases, licenses, franchises or permits, so long as the payment of such rent or other amounts or the performance of such other obligations or acts is not delinquent or is being contested in good faith and by appropriate proceedings;

(k) controls, restrictions, obligations, duties and/or other burdens imposed by federal, state, municipal or other law, or by rules, regulations or orders of Governmental Authorities, upon the Mortgaged Property or any part thereof or the operation or use thereof or upon the Company with respect to the Mortgaged Property or any part thereof or the operation or use thereof or with respect to any franchise, grant, license, permit or public purpose requirement, or any rights reserved to or otherwise vested in Governmental Authorities to impose any such controls, restrictions, obligations, duties and/or other burdens;

(l) rights which Governmental Authorities may have by virtue of franchises, grants, licenses, permits or contracts, or by virtue of law, to purchase, recapture or designate a purchaser of or order the sale of the Mortgaged Property or any part thereof, to terminate franchises, grants, licenses, permits, contracts or other rights or to regulate the property and business of the Company; and any and all obligations of the Company correlative to any such rights;

(m) Liens required by law or governmental regulations (i) as a condition to the transaction of any business or the exercise of any privilege or license, (ii) to enable the Company to maintain self-insurance or to participate in any funds established to cover any insurance risks, (iii) in connection with workmen's compensation, unemployment insurance, social security, any pension or welfare benefit plan or (iv) to share in the privileges or benefits required for companies participating in one or more of the arrangements described in clauses (ii) and (iii) above;

(n) Liens on the Mortgaged Property or any part thereof which are granted by the Company to secure duties or public or statutory obligations or to secure, or serve in lieu of, surety, stay or appeal bonds;

(o) rights reserved to or vested in others to take or receive any part of any coal, ore, gas, oil and other minerals, any timber and/or any electric capacity or energy, gas, water, steam and any other products, developed, produced, manufactured, generated, purchased or otherwise acquired by the Company or by others on property of the Company;

(p) (i) rights and interests of Persons other than the Company arising out of contracts, agreements and other instruments to which the Company is a party and which relate to the common ownership or joint use of property; and (ii) all Liens on the interests of Persons other than the Company in property owned in common by such Persons and the Company if and to the extent that the enforcement of such Liens would not adversely affect the interests of the Company in such property in any material respect;

(q) any restrictions on assignment and/or requirements of any assignee to qualify as a permitted assignee and/or public utility or public service corporation;

(r) any Liens which have been bonded for the full amount in dispute or for the payment of which other adequate security arrangements have been made;

(s) rights and interests granted pursuant to Section 17.02(c);

(t) Prepaid Liens and Purchase Money Liens; and

(u) any Lien of the Trustee granted pursuant to Section 10.07.

**"Person"** means any individual, corporation, joint venture, trust or unincorporated organization or any Governmental Authority.

**"Place of Payment"**, when used with respect to the Securities of any series, or Tranche thereof, means the place or places, specified as contemplated by Section 3.01 or specified in Section 4.06 with respect to the Bonds of Series Due 2019, at which, subject to Section 7.02, principal of and premium, if any, and interest, if any, on the Securities of such series or Tranche are payable.

**"Predecessor Security"** of any particular Security means every previous Security evidencing all or a portion of the same debt as that evidenced by such particular Security; and, for the purposes of this definition, any Security authenticated and delivered under Section 3.06 in

exchange for or in lieu of a mutilated, destroyed, lost or stolen Security shall be deemed to evidence the same debt as the mutilated, destroyed, lost or stolen Security.

**“Prepaid Lien”** means any Lien securing indebtedness for the payment of which money in the necessary amount shall have been irrevocably deposited in trust with the trustee or other holder of such Lien; provided, however, that if such indebtedness is to be redeemed or otherwise prepaid prior to the Stated Maturity thereof, any notice requisite to such redemption or prepayment shall have been given in accordance with the mortgage or other instrument creating such Lien or irrevocable instructions to give such notice shall have been given to such trustee or other holder.

**“Property Additions”** has the meaning specified in Section 1.03.

**“Purchase Money Lien”** means, with respect to any property being acquired or disposed of by the Company or being released from the Lien of this Indenture, a Lien on such property which

(a) is taken or retained by the transferor of such property to secure all or part of the purchase price thereof;

(b) is granted to one or more Persons other than the transferor which, by making advances or incurring an obligation, give value to enable the grantor of such Lien to acquire rights in or the use of such property;

(c) is granted to any other Person in connection with the release of such property from the Lien of this Indenture on the basis of the deposit with the Trustee or the trustee or other holder of a Lien prior to the Lien of this Indenture of obligations secured by such Lien on such property (as well as any other property subject thereto);

(d) is held by a trustee or agent for the benefit of one or more Persons described in clause (a), (b) and/or (c) above, provided that such Lien may be held, in addition, for the benefit of one or more other Persons which shall have theretofore given, or may thereafter give, value to or for the benefit or account of the grantor of such Lien for one or more other purposes; or

(e) otherwise constitutes a purchase money mortgage or a purchase money security interest under applicable law;

and, without limiting the generality of the foregoing, for purposes of this Indenture, the term Purchase Money Lien shall be deemed to include any Lien described above whether or not such Lien (x) shall permit the issuance or other incurrence of additional indebtedness secured by such Lien on such property, (y) shall permit the subjection to such Lien of additional property and the issuance or other incurrence of additional indebtedness on the basis thereof and/or (z) shall have been granted prior to the acquisition, disposition or release of such property, shall attach to or otherwise cover property other than the property being acquired, disposed of or released and/or shall secure obligations issued prior and/or subsequent to the issuance of the obligations delivered in connection with such acquisition, disposition or release.

**“Redemption Date”**, when used with respect to any Security to be redeemed, means the date fixed for such redemption by or pursuant to this Indenture.

**“Redemption Price”**, when used with respect to any Security to be redeemed, means the price at which it is to be redeemed pursuant to this Indenture, exclusive of accrued and unpaid interest.

**“Regular Record Date”** for the interest payable on any Interest Payment Date on the Securities of any series means the date specified for that purpose as contemplated by Section 3.01 or specified for that purpose in Section 4.10 with respect to the Bonds of Series Due 2019.

**“Required Currency”** has the meaning specified in Section 3.11.

**“Responsible Officer”**, when used with respect to the Trustee, means any Vice President, Assistant Vice President, Trust Officer or other officer of the Trustee who, in the case of each of the foregoing, is assigned by the Trustee to its corporate trust department responsible for the administration of this Indenture that is located in the Corporate Trust Office.

**“Retired Securities”** means any Securities authenticated and delivered under this Indenture on or after the Execution Date, which (a) no longer remain Outstanding by reason of the applicability of clause (a) or (b) in the definition of “Outstanding” (other than any Predecessor Security of any Security), (b) have not been made the basis under any of the provisions of this Indenture of one or more Authorized Purposes or (c) have not been paid, redeemed, purchased or otherwise retired by the application thereto of Funded Cash.

**“Securities”** has the meaning stated in the first recital of this Indenture and more particularly means any securities authenticated and delivered under this Indenture.

**“Securities Act”** means, as of any time, the Securities Act of 1933, as amended, as in effect at such time.

**“Security Register”** and **“Security Registrar”** have the respective meanings specified in Section 3.05.

**“Special Record Date”** for the payment of any Defaulted Interest on the Securities of any series means a date fixed by the Trustee pursuant to Section 3.07.

**“Stated Interest Rate”** means a rate (whether fixed or variable) at which an obligation by its terms is stated to bear simple interest. Any calculation or other determination to be made under this Indenture by reference to the Stated Interest Rate on a Security shall be made without regard to the effective interest cost to the Company of such Security and without regard to the Stated Interest Rate on, or the effective cost to the Company of, any other indebtedness the Company’s obligations in respect of which are evidenced or secured in whole or in part by such Security.

**“Stated Maturity”**, when used with respect to any Security or any obligation or any installment of principal thereof or interest thereon, means the date on which the principal of such

obligation or such installment of principal or interest is stated to be due and payable (without regard to any provisions for redemption, prepayment, acceleration, purchase or extension).

“**Successor Company**” has the meaning set forth in Section 12.01.

“**supplemental indenture**” or “**indenture supplemental hereto**” means an instrument supplementing or amending this Indenture executed and delivered pursuant to Article Thirteen.

“**Tranche**” means a group of Securities which (a) are of the same series and (b) have identical terms except as to principal amount and/or date of issuance.

“**Trustee**” means the Person named as the “Trustee” in the first paragraph of this instrument until a successor Trustee shall have been appointed by the Company pursuant to Section 10.10 or otherwise have become such with respect to one or more series of Securities pursuant to the applicable provisions of this Indenture, and thereafter “Trustee” shall mean or include each Person who is then a Trustee hereunder, and if at any time there is more than one such Person, “Trustee” as used with respect to the Securities of any series shall mean the Trustee with respect to Securities of that series.

“**Trust Indenture Act**” means, as of any time, the Trust Indenture Act of 1939, as amended, as in effect at such time.

“**United States**” means the United States of America, its territories, its possessions and other areas subject to its jurisdiction.

## **SECTION 1.02. FUNDED PROPERTY; FUNDED CASH.**

“**Funded Property**” means:

(a) all Property Additions to the extent that the same shall have been made the basis of the authentication and delivery of Securities under this Indenture pursuant to Section 16.02;

(b) all Property Additions to the extent that the same shall have been made the basis of the release of Funded Property from the Lien of this Indenture pursuant to Section 17.03;

(c) all Property Additions to the extent that the same shall have been substituted for Funded Property retired pursuant to Section 1.03;

(d) all Property Additions to the extent that the same shall have been made the basis of the withdrawal of cash held by the Trustee pursuant to Section 16.04 or 17.06; and

(e) all Property Additions to the extent that the same shall have been used as the basis of a credit against, or otherwise in satisfaction of, the requirements of any sinking, improvement, maintenance, replacement or similar fund or analogous provision established with respect to the Securities of any series, or any Tranche thereof, as contemplated by Section 3.01; provided, however, that any such Property Additions shall cease to be Funded Property when all of the Securities of such series or Tranche shall cease to be Outstanding.

In the event that in any certificate filed with the Trustee in connection with any of the Property Additions referred to in clauses (a), (b), (d) and (e) of this Section, only a part of the Cost or Fair Value of the Property Additions described in such certificate shall be required for the purposes of such certificate, then such Property Additions shall be deemed to be Funded Property only to the extent so required for the purpose of such certificate.

All Funded Property that shall be abandoned, destroyed, released or otherwise disposed of shall for the purpose of Section 1.03 hereof be deemed Funded Property retired and for other purposes of this Indenture shall thereupon cease to be Funded Property but as in this Indenture provided may at any time thereafter again become Funded Property. Neither any reduction in the Cost or book value of property recorded in the plant account of the Company, nor the transfer of any amount appearing in such account to intangible and/or adjustment accounts, otherwise than in connection with actual retirements of physical property abandoned, destroyed, released or disposed of, and otherwise than in connection with the removal of such property in its entirety from plant account, shall be deemed to constitute a retirement of Funded Property.

The Company may make allocations, on a pro-rata or other reasonable basis (including, but not limited to, the designation of specific properties or the designation of all or a specified portion of the properties reflected in one or more generic accounts or subaccounts in the Company's books of account), for the purpose of determining the extent to which fungible properties, or other properties not otherwise identified, reflected in the same generic account or subaccount in the Company's books of account constitute Funded Property or Funded Property retired.

**"Funded Cash"** means:

(a) cash, held by the Trustee hereunder, to the extent that it represents the proceeds of insurance on Funded Property (except as otherwise provided in Section 17.13), or cash deposited in connection with the release of Funded Property pursuant to Article Seventeen, or the payment of the principal of, or the proceeds of the release of, obligations secured by Purchase Money Lien and delivered to the Trustee pursuant to Article Seventeen, all subject, however, to the provisions of Section 17.13 and Section 17.06; and

(b) any cash deposited with the Trustee under Section 16.04.

#### **SECTION 1.03. PROPERTY ADDITIONS; COST.**

(a) **"Property Additions"** means, as of any particular time, any item, unit or element of property which at such time is owned by the Company and is Mortgaged Property.

(b) When any Property Additions are certified to the Trustee as the basis of any Authorized Purpose (except as otherwise provided in Section 17.03 and Section 17.06),

(i) there shall be deducted from the Cost or Fair Value to the Company thereof, as the case may be (as of the date so certified), an amount equal to the Cost (or as to Property Additions of which the Fair Value to the Company at the time the same became Funded Property was certified to be an amount less than the Cost as determined pursuant to this Section, then such Fair Value, as so certified, in lieu of Cost) of all



Funded Property of the Company retired to the date of such certification (other than the Funded Property, if any, in connection with the application for the release of which such certificate is filed) and not theretofore deducted from the Cost or Fair Value to the Company of Property Additions theretofore certified to the Trustee, and

(ii) there may, at the option of the Company, be added to such Cost or Fair Value, as the case may be, the sum of

(1) the principal amount of any obligations secured by Purchase Money Lien, not theretofore so added and which the Company then elects so to add, which shall theretofore have been delivered to the Trustee or the trustee or other holder of a Lien prior to the Lien of this Indenture as the basis of the release of Funded Property retired from the Lien of this Indenture or such prior Lien, as the case may be;

(2) the amount of any cash, not theretofore so added and which the Company then elects so to add, which shall theretofore have been delivered to the Trustee or the trustee or other holder of a Lien prior to the Lien of this Indenture as the proceeds of insurance on Funded Property retired (to the extent of the portion thereof deemed to be Funded Cash) or as the basis of the release of Funded Property retired from the Lien of this Indenture or from such prior Lien, as the case may be;

(3) the principal amount of any Security or Securities, or portion of such principal amount, not theretofore so added and which the Company then elects so to add, (I) which shall theretofore have been delivered to the Trustee as the basis of the release of Funded Property retired or (II) the right to the authentication and delivery of which under the provisions of Section 16.03 shall at any time theretofore have been waived under Section 17.03(d)(iii) as the basis of the release of Funded Property retired;

(4) the Cost or Fair Value to the Company (whichever shall be less) of any Property Additions, not theretofore so added and which the Company then elects so to add, which shall theretofore have been made the basis of the release of Funded Property retired (such Fair Value to be the amount shown in the Expert's Certificate delivered to the Trustee in connection with such release); and

(5) the Cost to the Company of any Property Additions not theretofore so added and which the Company then elects so to add, to the extent that the same shall have been substituted for Funded Property retired;

provided, however, that the aggregate of the amounts added under clause (ii) above shall in no event exceed the amounts deducted under clause (i) above.

(c) Except as otherwise provided in Section 17.03, the term "Cost" with respect to Property Additions shall mean the sum of (i) any cash delivered in payment therefor or for the acquisition thereof, (ii) an amount equivalent to the fair market value in cash (as of the date of delivery) of any securities or other property delivered in payment therefor or for the acquisition

thereof, (iii) the principal amount of any obligations secured by prior Lien upon such Property Additions outstanding at the time of the acquisition thereof, (iv) the principal amount of any other obligations incurred or assumed in connection with the payment for such Property Additions or for the acquisition thereof and (v) any other amounts which, in accordance with generally accepted accounting principles, are properly charged or chargeable to the plant or other property accounts of the Company with respect to such Property Additions as part of the cost of construction or acquisition thereof, including, but not limited to, any allowance for funds used during construction or any similar or analogous amount; provided, however, that, notwithstanding any other provision of this Indenture,

(i) with respect to Property Additions owned by a successor corporation immediately prior to the time it shall have become such by consolidation or merger or acquired by a successor corporation in or as a result of a consolidation or merger (excluding, in any case, Property Additions owned by the Company immediately prior to such time), Cost shall mean the amount or amounts at which such Property Additions are recorded in the plant or other property accounts of such successor corporation, or the predecessor corporation from which such Property Additions are acquired, as the case may be, immediately prior to such consolidation or merger;

(ii) with respect to Property Additions which shall have been acquired (otherwise than by construction) by the Company without any consideration consisting of cash, securities or other property or the incurring or assumption of indebtedness, no determination of Cost shall be required, and, wherever in this Indenture provision is made for Cost or Fair Value, Cost with respect to such Property Additions shall mean an amount equal to the Fair Value to the Company thereof or, if greater, the aggregate amount reflected in the Company's books of account with respect thereto upon the acquisition thereof; and

(iii) in no event shall the Cost of Property Additions be required to reflect any depreciation or amortization in respect of such Property Additions, or any adjustment to the amount or amounts at which such Property Additions are recorded in plant or other property accounts due to the non-recoverability of investment or otherwise. If any Property Additions are shown by the Expert's Certificate provided for in Section 16.02(b)(ii) to include property which has been used or operated by others than the Company in a business similar to that in which it has been or is to be used or operated by the Company, the Cost thereof need not be reduced by any amount in respect of any goodwill, going concern value rights and/or intangible property simultaneously acquired for which no separate or distinct consideration shall have been paid or apportioned, and in such case the term Property Additions as defined herein may include such goodwill, going concern value rights and intangible property.

#### **SECTION 1.04. COMPLIANCE CERTIFICATES AND OPINIONS.**

Except as otherwise expressly provided in this Indenture, upon any application or request by the Company to the Trustee to take any action under any provision of this Indenture, the Company shall furnish to the Trustee an Officer's Certificate stating that in the opinion of the Authorized Officer executing such Officer's Certificate all conditions precedent, if any, provided

for in this Indenture relating to the proposed action (including any covenants compliance with which constitutes a condition precedent) have been complied with and an Opinion of Counsel stating that in the opinion of such counsel all such conditions precedent, if any, have been complied with, except that in the case of any such application or request as to which the furnishing of such documents is specifically required by any provision of this Indenture relating to such particular application or request, no additional certificate or opinion need be furnished.

Every certificate or opinion with respect to compliance with a condition or covenant provided for in this Indenture shall include:

(a) a statement that each Person signing such certificate or opinion has read such covenant or condition and the definitions herein relating thereto;

(b) a brief statement as to the nature and scope of the examination or investigation upon which the statements or opinions contained in such certificate or opinion are based;

(c) a statement that, in the opinion of each such Person, such Person has made such examination or investigation as is necessary to enable such Person to express an informed opinion as to whether or not such covenant or condition has been complied with; and

(d) a statement as to whether, in the opinion of each such Person, such condition or covenant has been complied with.

#### **SECTION 1.05. FORM OF DOCUMENTS DELIVERED TO TRUSTEE.**

(a) Any Officer's Certificate may be based (without further examination or investigation), insofar as it relates to or is dependent upon legal matters, upon an opinion of, or representations by, counsel, and, insofar as it relates to or is dependent upon matters which are subject to verification by Accountants, upon a certificate or opinion of, or representations by, an Accountant, and insofar as it relates to or is dependent upon matters which are required in this Indenture to be covered by a certificate or opinion of, or representations by, an Expert, upon the certificate or opinion of, or representations by, an Expert, unless, in any case, such officer has actual knowledge that the certificate or opinion or representations with respect to the matters upon which such Officer's Certificate may be based as aforesaid are erroneous.

Any Expert's Certificate may be based (without further examination or investigation), insofar as it relates to or is dependent upon legal matters, upon an opinion of, or representations by, counsel, and insofar as it relates to or is dependent upon factual matters, information with respect to which is in the possession of the Company and which are not subject to verification by Experts, upon a certificate or opinion of, or representations by, an officer or officers of the Company, unless such expert has actual knowledge that the certificate or opinion or representations with respect to the matters upon which his certificate or opinion may be based as aforesaid are erroneous.

Any certificate of an Accountant may be based (without further examination or investigation), insofar as it relates to or is dependent upon legal matters, upon an opinion of, or representations by, counsel, and insofar as it relates to or is dependent upon factual matters, information with respect to which is in the possession of the Company and which are not subject

to verification by Accountants, upon a certificate of, or representations by, an officer or officers of the Company, unless such Accountant has actual knowledge that the certificate or opinion or representations with respect to the matters upon which his certificate or opinion may be based as aforesaid are erroneous.

Any Opinion of Counsel may be based (without further examination or investigation), insofar as it relates to or is dependent upon factual matters, information with respect to which is in the possession of the Company, upon a certificate of, or representations by, an officer or officers of the Company, and, insofar as it relates to or is dependent upon matters which are subject to verification by Accountants upon a certificate or opinion of, or representations by, an Accountant, and, insofar as it relates to or is dependent upon matters required in this Indenture to be covered by a certificate or opinion of, or representations by, an Expert, upon the certificate or opinion of, or representations by, an Expert, unless such counsel has actual knowledge that the certificate or opinion or representations with respect to the matters upon which his opinion may be based as aforesaid are erroneous. In addition, any Opinion of Counsel may be based (without further examination or investigation), insofar as it relates to or is dependent upon matters covered in an Opinion of Counsel rendered by other counsel, upon such other Opinion of Counsel, unless such counsel has actual knowledge that the Opinion of Counsel rendered by such other counsel with respect to the matters upon which his Opinion of Counsel may be based as aforesaid are erroneous. Further, any Opinion of Counsel with respect to the status of title to or the sufficiency of descriptions of property, and/or the existence of Liens thereon, and/or the recording or filing of documents, and/or any similar matters, may be based (without further examination or investigation) upon (i) title insurance policies or commitments and reports, abstracts of title, lien search certificates and other similar documents or (ii) certificates of, or representations by, officers, employees, agents and/or other representatives of the Company or (iii) any combination of the documents referred to in (i) and (ii), unless, in any case, such counsel has actual knowledge that the document or documents with respect to the matters upon which his opinion may be based as aforesaid are erroneous. If, in order to render any Opinion of Counsel provided for herein, the signer thereof shall deem it necessary that additional facts or matters be stated in any Officer's Certificate, certificate of an Accountant or Expert's Certificate provided for herein, then such certificate may state all such additional facts or matters as the signer of such Opinion of Counsel may request.

(b) In any case where several matters are required to be certified by, or covered by an opinion of, any specified Person, it is not necessary that all such matters be certified by, or covered by the opinion of, only one such Person, or that they be so certified or covered by only one document, but one such Person may certify or give an opinion with respect to some matters and one or more other such Persons as to other matters, and any such Person may certify or give an opinion as to such matters in one or several documents. Where (i) any Person is required to make, give or execute two or more applications, requests, consents, certificates, statements, opinions or other instruments under this Indenture, or (ii) two or more Persons are each required to make, give or execute any such application, request, consent, certificate, statement, opinion or other instrument, any such applications, requests, consents, certificates, statements, opinions or other instruments may, but need not, be consolidated and form one instrument.

(c) Whenever, subsequent to the receipt by the Trustee of any Board Resolution, Officer's Certificate, Expert's Certificate, Opinion of Counsel or other document or instrument, a

clerical, typographical or other inadvertent or unintentional error or omission shall be discovered therein, a new document or instrument may be substituted therefor in corrected form with the same force and effect as if originally filed in the corrected form and, irrespective of the date or dates of the actual execution and/or delivery thereof, such substitute document or instrument shall be deemed to have been executed and/or delivered as of the date or dates required with respect to the document or instrument for which it is substituted. Anything in this Indenture to the contrary notwithstanding, if any such corrective document or instrument indicates that action has been taken by or at the request of the Company which could not have been taken had the original document or instrument not contained such error or omission, the action so taken shall not be invalidated or otherwise rendered ineffective but shall be and remain in full force and effect, except to the extent that such action was a result of willful misconduct or bad faith. Without limiting the generality of the foregoing, any Securities issued under the authority of such defective document or instrument shall nevertheless be the valid obligations of the Company entitled to the benefits of this Indenture equally and ratably with all other Outstanding Securities, except as aforesaid.

#### **SECTION 1.06. ACTS OF HOLDERS.**

(a) Any request, demand, authorization, direction, notice, consent, election, waiver or other action provided by this Indenture to be made, given or taken by Holders may be embodied in and evidenced by one or more instruments of substantially similar tenor signed by such Holders in person or by an agent duly appointed in writing or, alternatively, may be embodied in and evidenced by the record of Holders voting in favor thereof, either in person or by proxies duly appointed in writing, at any meeting of Holders duly called and held in accordance with the provisions of Article Fourteen, or a combination of such instruments and any such record. Except as herein otherwise expressly provided, such action shall become effective when such instrument or instruments or record or both are delivered to the Trustee and, where it is hereby expressly required, to the Company. Such instrument or instruments and any such record (and the action embodied therein and evidenced thereby) are herein sometimes referred to as the "Act" of the Holders signing such instrument or instruments and so voting at any such meeting. Proof of execution of any such instrument or of a writing appointing any such agent, or of the holding by any Person of a Security, shall be sufficient for any purpose of this Indenture and (subject to Section 10.01) conclusive in favor of the Trustee and the Company, if made in the manner provided in this Section. The record of any meeting of Holders shall be proved in the manner provided in Section 14.06.

(b) The fact and date of the execution by any Person of any such instrument or writing may be proved by the affidavit of a witness of such execution or by a certificate of a notary public or other officer authorized by law to take acknowledgments of deeds, certifying that the individual signing such instrument or writing acknowledged to him the execution thereof or may be proved in any other manner which the Trustee and the Company deem sufficient. Where such execution is by a signer acting in a capacity other than his individual capacity, such certificate or affidavit shall also constitute sufficient proof of his authority.

(c) The ownership, principal amount (except as otherwise contemplated in clause (y) of the first proviso to the definition of Outstanding) and serial numbers of Securities held by any Person, and the date of holding the same, shall be proved by the Security Register.

(d) Any request, demand, authorization, direction, notice, consent, election, waiver or other Act of a Holder shall bind every future Holder of the same Security and the Holder of every Security issued upon the registration of transfer thereof or in exchange therefor or in lieu thereof in respect of anything done, omitted or suffered to be done by the Trustee or the Company in reliance thereon, whether or not notation of such action is made upon such Security.

(e) Until such time as written instruments shall have been delivered to the Trustee with respect to the requisite percentage of principal amount of Securities for the action contemplated by such instruments, any such instrument executed and delivered by or on behalf of a Holder may be revoked with respect to any or all of such Securities by written notice by such Holder or any subsequent Holder, proven in the manner in which such instrument was proven.

(f) Securities of any series, or any Tranche thereof, authenticated and delivered after any Act of Holders may, and shall, if required by the Trustee, bear a notation in form approved by the Company as to any action taken by such Act of Holders. If the Company shall so determine, new Securities of any series, or any Tranche thereof, so modified as to conform, in the opinion of the Trustee and the Company, to such action may be prepared and executed by the Company and authenticated and delivered by the Trustee in exchange for Outstanding Securities of such series or Tranche.

(g) If the Company shall solicit from Holders any request, demand, authorization, direction, notice, consent, waiver or other Act, the Company may, at its option, fix in advance a record date for the determination of Holders entitled to give such request, demand, authorization, direction, notice, consent, waiver or other Act, but the Company shall have no obligation to do so. If such a record date is fixed, such request, demand, authorization, direction, notice, consent, waiver or other Act may be given before or after such record date, but only the Holders of record at the close of business on the record date shall be deemed to be Holders for the purposes of determining whether Holders of the requisite proportion of the Outstanding Securities have authorized or agreed or consented to such request, demand, authorization, direction, notice, consent, waiver or other Act, and for that purpose the Outstanding Securities shall be computed as of the record date.

#### **SECTION 1.07. NOTICES, ETC. TO TRUSTEE OR COMPANY.**

Except as otherwise provided herein, any request, demand, authorization, direction, notice, consent, election, waiver or Act of Holders or other document provided or permitted by this Indenture to be made upon, given or furnished to, or filed with, the Trustee by any Holder or by the Company, or the Company by the Trustee or by any Holder, shall be sufficient for every purpose hereunder (unless otherwise expressly provided herein) if in writing and delivered personally to an officer or other responsible employee of the addressee, or transmitted by facsimile transmission or other direct written electronic means (such means of delivery being acceptable to the Trustee) to such telephone number or other electronic communications address set forth for such party below or such other address as the parties hereto shall from time to time designate, or delivered by registered or certified mail or reputable overnight courier, charges prepaid, to the applicable address set forth for such party below or to such other address as either party hereto may from time to time designate:

If to the Trustee, to:

The Bank of New York Mellon Trust Company, N.A.  
Corporate Trust Administration  
900 Ashwood Parkway, Suite 425  
Atlanta, Georgia 30338  
Attention: Vice President  
Telecopy: (770) 698-5195

If to the Company, to:

Duke Energy Ohio, Inc.  
526 South Church Street  
Charlotte, North Carolina 28202  
Attention: Treasurer  
Telecopy: (980) 373-3699

Any communication contemplated herein shall be deemed to have been made, given, furnished and filed if personally delivered, on the date of delivery, if transmitted by facsimile transmission or other direct written electronic means, on the date of transmission, and if transmitted by registered or certified mail or reputable overnight courier, on the date of receipt.

#### **SECTION 1.08. NOTICE TO HOLDERS OF SECURITIES; WAIVER.**

Except as otherwise expressly provided herein, where this Indenture provides for notice to Holders of any event, such notice shall be sufficiently given, and shall be deemed given, to Holders if in writing and mailed, first-class postage prepaid, to each Holder affected by such event, at the address of such Holder as it appears in the Security Register, not later than the latest date, and not earlier than the earliest date, if any, prescribed for the giving of such notice.

In case by reason of the suspension of regular mail service or by reason of any other cause it shall be impracticable to give such notice to Holders by mail, then such notification as shall be made with the approval of the Trustee shall constitute a sufficient notification for every purpose hereunder. In any case where notice to Holders is given by mail, neither the failure to mail such notice, nor any defect in any notice so mailed, to any particular Holder shall affect the sufficiency of such notice with respect to other Holders.

Any notice required by this Indenture may be waived in writing by the Person entitled to receive such notice, either before or after the event otherwise to be specified therein, and such waiver shall be the equivalent of such notice. Waivers of notice by Holders shall be filed with the Trustee, but such filing shall not be a condition precedent to the validity of any action taken in reliance upon such waiver.

#### **SECTION 1.09. CONFLICT WITH TRUST INDENTURE ACT.**

If any provision of this Indenture limits, qualifies or conflicts with another provision hereof which is required or deemed to be included in this Indenture by, or is otherwise governed

by, any provision of the Trust Indenture Act, such other provision shall control; and if any provision hereof otherwise conflicts with the Trust Indenture Act, the Trust Indenture Act shall control unless otherwise provided as contemplated by Section 3.01 with respect to any series of Securities.

**SECTION 1.10. EFFECT OF HEADINGS AND TABLE OF CONTENTS.**

The Article and Section headings in this Indenture and the Table of Contents are for convenience only and shall not affect the construction hereof.

**SECTION 1.11. SUCCESSORS AND ASSIGNS.**

All covenants and agreements in this Indenture by the Company and Trustee shall bind their respective successors and assigns, whether so expressed or not.

**SECTION 1.12. SEPARABILITY CLAUSE.**

In case any provision in this Indenture or the Securities shall be held to be invalid, illegal or unenforceable, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

**SECTION 1.13. BENEFITS OF INDENTURE.**

Nothing in this Indenture or the Securities, express or implied, shall give to any Person, other than the parties hereto, their successors hereunder and the Holders of any Outstanding Securities, any benefit or any legal or equitable right, remedy or claim under this Indenture.

**SECTION 1.14. GOVERNING LAW.**

This Indenture and the Securities shall be governed by and construed in accordance with the laws of the State of Ohio, except (a) to the extent that the Trust Indenture Act shall be applicable, and (b) that the rights, duties, obligations, privileges, immunities and standard of care of the Trustee shall be governed by the laws of the State of New York.

**SECTION 1.15. LEGAL HOLIDAYS.**

In any case where any Interest Payment Date, Redemption Date or Stated Maturity of any Security shall not be a Business Day at any Place of Payment, then (notwithstanding any other provision of this Indenture or of the Securities other than a provision in Securities of any series, or any Tranche thereof, or in the indenture supplemental hereto, Board Resolution or Officer's Certificate which establishes the terms of the Securities of such series or Tranche, which specifically states that such provision shall apply in lieu of this Section) payment of interest or principal and premium, if any, need not be made at such Place of Payment on such date, but may be made on the next succeeding Business Day at such Place of Payment with the same force and effect as if made on the Interest Payment Date, Redemption Date, or Stated Maturity, and, if such payment is made or duly provided for on such Business Day, no interest shall accrue on the amount so payable for the period from and after such Interest Payment Date, Redemption Date or Stated Maturity, as the case may be, to such Business Day.



#### **SECTION 1.16. INVESTMENT OF CASH HELD BY TRUSTEE.**

Any cash held by the Trustee or any Paying Agent under any provision of this Indenture shall, except as otherwise provided in Section 17.06 or in Article Eight, at the request of the Company evidenced by Company Order, be invested or reinvested in Investment Securities designated by the Company (such Company Order to contain a representation to the effect that the securities designated therein constitute Investment Securities), and any interest on such Investment Securities shall be promptly paid over to the Company as received free and clear of any Lien. Such Investment Securities shall be held subject to the same provisions hereof as the cash used to purchase the same, but upon a like request of the Company shall be sold, in whole or in designated part, and the proceeds of such sale shall be held subject to the same provisions hereof as the cash used to purchase the Investment Securities so sold. If the cash used to purchase such Investment Securities was being held as part of the Mortgaged Property, then such Investment Securities and proceeds shall also be held as part of the Mortgaged Property. If such sale shall produce a net sum less than the cost of the Investment Securities so sold, the Company shall pay to the Trustee or any such Paying Agent, as the case may be, such amount in cash as, together with the net proceeds from such sale, shall equal the cost of the Investment Securities so sold, and if such sale shall produce a net sum greater than the cost of the Investment Securities so sold, the Trustee or any such Paying Agent, as the case may be, shall promptly pay over to the Company an amount in cash equal to such excess, free and clear of any Lien. In no event shall the Trustee be liable for any loss incurred in connection with the sale of any Investment Security pursuant to this Section.

Notwithstanding the foregoing, if an Event of Default shall have occurred and be continuing, interest on Investment Securities and any gain upon the sale thereof shall be held as part of the Mortgaged Property until such Event of Default shall have been cured or waived, whereupon such interest and gain shall be promptly paid over to the Company free and clear of any Lien.

#### **SECTION 1.17. FORCE MAJEURE.**

In no event shall the Trustee be responsible or liable for any failure or delay in the performance of its obligations hereunder arising out of or caused by, directly or indirectly, forces beyond its control, including, without limitation, strikes, work stoppages, accidents, acts of war or terrorism, civil or military disturbances, nuclear or natural catastrophes or acts of God, and interruptions, loss or malfunctions of utilities, communications or computer (software and hardware) services; it being understood that the Trustee shall use reasonable efforts which are consistent with accepted practices in the banking industry to resume performance as soon as practicable under the circumstances.

**SECTION 1.18. WAIVER OF JURY TRIAL.**

EACH OF THE COMPANY AND THE TRUSTEE HEREBY IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY AND ALL RIGHT TO TRIAL BY JURY IN ANY LEGAL PROCEEDING ARISING OUT OF OR RELATING TO THIS INDENTURE, THE SECURITIES OR THE TRANSACTIONS CONTEMPLATED HEREBY OR THEREBY.

[END OF ARTICLE ONE]

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**ARTICLE TWO.  
SECURITY FORMS**

**SECTION 2.01. FORMS GENERALLY.**

The definitive Securities of each series shall be in substantially the form or forms thereof established in the indenture supplemental hereto establishing such series or in a Board Resolution establishing such series, or in an Officer's Certificate pursuant to such a supplemental indenture or Board Resolution, or with respect to the Bonds of Series Due 2019, in substantially the form set forth in Section 4.10, in each case with such appropriate insertions, omissions, substitutions and other variations as are required or permitted by this Indenture, and may have such letters, numbers or other marks of identification and such notations, legends or endorsements placed thereon as may be required to comply with applicable law, the rules of any securities exchange or depository, including The Depository Trust Company, or other clearing corporation or securities intermediary, automated quotation system, agreements to which the Company is subject, or usage, or as may, consistently herewith, be determined by the officers executing such Securities, as evidenced by their execution thereof. If the form or forms of Securities of any series are established in a Board Resolution or in an Officer's Certificate pursuant to a supplemental indenture or a Board Resolution, such Board Resolution and Officer's Certificate, if any, shall be delivered to the Trustee at or prior to the delivery of the Company Order contemplated by Section 3.03 for the authentication and delivery of such Securities.

Unless otherwise specified as contemplated by Section 3.01, the Securities of each series shall be issuable in registered form without coupons. The definitive Securities shall be produced in such manner as shall be determined by the officers executing such Securities, as evidenced by their execution thereof.

**SECTION 2.02. FORM OF TRUSTEE'S CERTIFICATE OF AUTHENTICATION.**

The Trustee's certificate of authentication shall be in substantially the form set forth below:

This is one of the Securities of the series designated therein referred to in the within-mentioned Indenture.

THE BANK OF NEW YORK MELLON TRUST  
COMPANY, N.A., as Trustee

By: \_\_\_\_\_  
Authorized Signatory

[END OF ARTICLE TWO]

**ARTICLE THREE.  
THE SECURITIES**

**SECTION 3.01. AMOUNT UNLIMITED; ISSUABLE IN SERIES.**

The aggregate principal amount of Securities which may be authenticated and delivered under this Indenture is unlimited.

The Securities may be issued in one or more series. Subject to the second to last paragraph of this Section and except with respect to the Bonds of Series Due 2019, prior to the authentication and delivery of Securities of any series there shall be established by specification in a supplemental indenture or in a Board Resolution or in an Officer's Certificate pursuant to a supplemental indenture or a Board Resolution:

(a) the title of the Securities of such series (which shall distinguish the Securities of such series from Securities of all other series);

(b) any limit upon the aggregate principal amount of the Securities of such series which may be authenticated and delivered under this Indenture (except for Securities authenticated and delivered upon registration of transfer of, or in exchange for, or in lieu of, other Securities of such series pursuant to Section 3.04, 3.05, 3.06, 5.06 or 13.06 and except for any Securities which, pursuant to Section 3.03, are deemed never to have been authenticated and delivered hereunder);

(c) the Person or Persons (without specific identification) to whom any interest on Securities of such series, or any Tranche thereof, shall be payable, if other than the Person in whose name that Security (or one or more Predecessor Securities) is registered at the close of business on the Regular Record Date for such interest;

(d) the date or dates on which the principal of the Securities of such series or any Tranche thereof, is payable or any formulary or other method or other means by which such date or dates shall be determined, by reference to an index or other fact or event ascertainable outside of this Indenture or otherwise (without regard to any provisions for redemption, prepayment, acceleration, purchase or extension); and the right, if any, to extend the Maturity of the Securities of such series, or any Tranche thereof, and the duration of any such extension;

(e) the rate or rates at which the Securities of such series, or any Tranche thereof, shall bear interest, if any (including the rate or rates at which overdue principal shall bear interest after Maturity if different from the rate or rates at which such Securities shall bear interest prior to Maturity, and, if applicable, the rate or rates at which overdue premium or interest shall bear interest, if any), or any formulary or other method or other means by which such rate or rates shall be determined by reference to an index or other fact or event ascertainable outside of this Indenture or otherwise, the date or dates from which such interest shall accrue; the Interest Payment Dates and the Regular Record Dates, if any, for the interest payable on such Securities on any Interest Payment Date; and the basis of computation of interest, if other than as provided in Section 3.10; and the right, if any, to extend the interest payment periods and the duration of any such extension;

(f) the place or places at which and/or methods (if other than as provided elsewhere in this Indenture) by which (i) the principal of and premium, if any, and interest, if any, on Securities of such series, or any Tranche thereof, shall be payable, (ii) registration of transfer of Securities of such series, or any Tranche thereof, may be effected, (iii) exchanges of Securities of such series, or any Tranche thereof, may be effected and (iv) notices and demands to or upon the Company in respect of the Securities of such series, or any Tranche thereof, and this Indenture may be served; the Security Registrar and any Paying Agent or Agents for such series or Tranche, if other than the Trustee; and, if such is the case and if administratively acceptable to the Trustee, that the principal of such Securities shall be payable without the presentment or surrender thereof;

(g) the period or periods within which, or the date or dates on which, the price or prices at which and the terms and conditions upon which the Securities of such series, or any Tranche thereof, may be redeemed, in whole or in part, at the option of the Company and any restrictions on such redemptions; including but not limited to a restriction on a partial redemption by the Company of the Securities of any series, or any Tranche thereof, resulting in delisting of such Securities from any national exchange;

(h) the obligation or obligations, if any, of the Company to redeem or purchase or repay the Securities of such series, or any Tranche thereof, pursuant to any sinking fund or other mandatory redemption provisions or at the option of a Holder thereof and the period or periods within which or the date or dates on which, the price or prices at which and the terms and conditions upon which such Securities shall be redeemed or purchased or repaid, in whole or in part, pursuant to such obligation and applicable exceptions to the requirements of Section 5.04 in the case of mandatory redemption or redemption or repayment at the option of the Holder;

(i) the denominations in which Securities of such series, or any Tranche thereof, shall be issuable if other than denominations of One Thousand Dollars (\$1,000) and any integral multiple thereof;

(j) if the principal of or premium, if any, or interest, if any, on the Securities of such series, or any Tranche thereof, are to be payable, at the election of the Company or a Holder thereof, in a coin or currency other than that in which the Securities are stated to be payable, the period or periods within which, and the terms and conditions upon which, such election may be made and the manner in which the amount of such coin or currency payable is to be determined;

(k) the currency or currencies, including composite currencies, in which payment of the principal of and premium, if any, and interest, if any, on the Securities of such series, or any Tranche thereof, shall be payable (if other than Dollars) and the manner in which the equivalent of the principal amount thereof in Dollars is to be determined for any purpose, including for the purpose of determining the principal amount deemed to be Outstanding at any time;

(l) if the principal of or premium, if any, or interest, if any, on the Securities of such series, or any Tranche thereof, are to be payable, or are to be payable at the election of the Company or a Holder thereof, in securities or other property, the type and amount of such securities or other property, or the formulary or other method or other means by which such

amount shall be determined, and the period or periods within which, and the terms and conditions upon which, any such election may be made;

(m) if the amount payable in respect of principal or premium, if any, or interest, if any, on the Securities of such series, or any Tranche thereof, may be determined with reference to an index or other fact or event ascertainable outside this Indenture, the manner in which such amounts shall be determined to the extent not established pursuant to clause (e) of this paragraph;

(n) if other than the entire principal amount thereof, the portion of the principal amount of Securities of such series, or any Tranche thereof, which shall be payable upon declaration of acceleration of the Maturity thereof pursuant to Section 9.02;

(o) any Events of Default, in addition to those specified in Section 9.01, and any covenants of the Company for the benefit of the Holders of Securities, in addition to those set forth in Article Seven; provided, however, that such supplemental indenture, Board Resolution or Officer's Certificate may provide that such additions or exceptions shall only be effective so long as the Securities of such series, or one or more Tranches thereof, remain Outstanding;

(p) the terms, if any, pursuant to which the Securities of such series, or any Tranche thereof, may be converted into or exchanged for shares of capital stock or other securities of the Company or any other Person;

(q) the obligations or instruments, if any, which shall be considered to be Eligible Obligations in respect of the Securities of such series, or any Tranche thereof, denominated in a currency other than Dollars or in a composite currency, whether Eligible Obligations include Investment Securities with respect to Securities of such series, and any provisions for satisfaction and discharge of Securities of any series, in addition to those set forth in Article Eight, or any exceptions to those set forth in Article Eight;

(r) if the Securities of such series, or any Tranche thereof, are to be issued in global form, (i) any limitations on the rights of the Holder or Holders of such Securities to transfer or exchange the same or to obtain the registration of transfer thereof, (ii) any limitations on the rights of the Holder or Holders thereof to obtain certificates therefor in definitive form in lieu of global form and (iii) any other matters incidental to such Securities;

(s) if the Securities of such series, or any Tranche thereof, are to be issuable as bearer securities, any and all matters incidental thereto which are not specifically addressed in a supplemental indenture as contemplated by clause (g) of Section 13.01;

(t) to the extent not established pursuant to clause (r) of this paragraph, any limitations on the rights of the Holders of the Securities of such Series, or any Tranche thereof, to transfer or exchange such Securities or to obtain the registration of transfer thereof; and if a service charge will be made for the registration of transfer or exchange of Securities of such series, or any Tranche thereof, the amount or terms thereof;

(u) any exceptions to Section 1.15, or variation in the definition of Business Day, with respect to the Securities of such series, or any Tranche thereof; and

(v) any other terms of the Securities of such series, or any Tranche thereof, that the Company may elect to specify.

With respect to Securities of a series subject to a Periodic Offering, the indenture supplemental hereto or the Board Resolution which establishes such series, or the Officer's Certificate pursuant to such supplemental indenture or Board Resolution, as the case may be, may provide general terms or parameters for Securities of such series and provide either that the specific terms of Securities of such series, or any Tranche thereof, shall be specified in a Company Order or that such terms shall be determined by the Company or its agents in accordance with procedures specified in a Company Order as contemplated in clause (b) of Section 3.03.

Unless otherwise provided with respect to a series of Securities as contemplated in Section 3.01(b), without the consent of any Holder, the aggregate principal amount of a series of Securities, including the Bonds of Series Due 2019, may be increased and additional Securities of such series may be issued up to the maximum aggregate principal amount authorized with respect to such series as increased, provided that such additional Securities of such series are fungible with the previously issued Securities of such series for Federal income tax purposes.

### **SECTION 3.02. DENOMINATIONS.**

Unless otherwise provided as contemplated by Section 3.01 with respect to any series of Securities, or any Tranche thereof, the Securities of each series shall be issuable in denominations of One Thousand Dollars (\$1,000) and any integral multiple thereof.

### **SECTION 3.03. EXECUTION, AUTHENTICATION, DELIVERY AND DATING.**

Unless otherwise provided as contemplated by Section 3.01 with respect to any series of Securities or any Tranche thereof, the Securities shall be executed on behalf of the Company by an Authorized Officer, and may (but need not) have the corporate seal of the Company affixed thereto or reproduced thereon attested by any other Authorized Officer or by the Secretary or an Assistant Secretary of the Company. The signature of any or all of these officers on the Securities may be manual or facsimile.

Securities bearing the manual or facsimile signatures of individuals who were at the time of execution Authorized Officers or the Secretary or an Assistant Secretary of the Company shall bind the Company, notwithstanding that such individuals or any of them have ceased to hold such offices prior to the authentication and delivery of such Securities or did not hold such offices at the date of such Securities.

The Trustee shall authenticate and deliver Securities of a series for original issue, at one time or from time to time in accordance with the Company Order referred to below, upon receipt by the Trustee of:

(a) the instrument or instruments establishing the form or forms and terms of the Securities of such series, as provided in Sections 2.01 and 3.01;

(b) a Company Order requesting the authentication and delivery of such Securities and, to the extent that the terms of such Securities shall not have been established in an indenture supplemental hereto or in a Board Resolution, or in an Officer's Certificate pursuant to a supplemental indenture or Board Resolution, all as contemplated by Section 3.01, or pursuant to Article Four, either (i) establishing such terms or (ii) in the case of Securities of a series subject to a Periodic Offering, specifying procedures, acceptable to the Trustee, by which such terms are to be established (which procedures may provide, to the extent acceptable to the Trustee, for authentication and delivery pursuant to oral or electronic instructions from the Company or any agent or agents thereof, which oral instructions are to be promptly confirmed electronically or in writing), in either case in accordance with the instrument or instruments establishing the terms of the Securities of such series delivered pursuant to clause (a) above;

(c) any opinions, certificates, documents and instruments required by Article Sixteen;

(d) Securities of such series, each executed on behalf of the Company by an Authorized Officer of the Company;

(e) an Officer's Certificate (i) which shall comply with the requirements of Section 1.04 of this Indenture and (ii) which states that no Event of Default under this Indenture has occurred or is occurring; and

(f) an Opinion of Counsel which shall comply with the requirements of Section 1.04 of this Indenture and that states that:

(i) the form or forms of such Securities have been duly authorized by the Company and have been established in conformity with the provisions of this Indenture;

(ii) the terms of such Securities have been duly authorized by the Company and have been established in conformity with the provisions of this Indenture; and

(iii) when such Securities shall have been authenticated and delivered by the Trustee and issued and delivered by the Company in the manner and subject to any conditions specified in such Opinion of Counsel, such Securities will have been duly issued under this Indenture and will constitute valid and legally binding obligations of the Company, entitled to the benefits provided by this Indenture, and enforceable in accordance with their terms, subject, as to enforcement, to laws relating to or affecting generally the enforcement of mortgagees' and other creditors' rights, including, without limitation, bankruptcy, insolvency, reorganization, receivership, moratorium and other laws affecting the rights and remedies of creditors and mortgagees generally and general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law);

provided, however, that, with respect to Securities of a series subject to a Periodic Offering, the Trustee shall be entitled to receive such Opinion of Counsel only once at or prior to the time of the first authentication and delivery of Securities of such series and that in lieu of the opinions described in clauses (ii) and (iii) above such Opinion of Counsel may, alternatively, state, respectively,



(x) that, when the terms of such Securities shall have been established pursuant to a Company Order or Orders, or pursuant to such procedures as may be specified from time to time by a Company Order or Orders, all as contemplated by and in accordance with the instrument or instruments delivered pursuant to clause (a) above, such terms will have been duly authorized by the Company and will have been established in conformity with the provisions of this Indenture; and

(y) that, such Securities, when (1) executed by the Company, (2) authenticated and delivered by the Trustee in accordance with this Indenture, (3) issued and delivered by the Company and (4) paid for, all as contemplated by and in accordance with the aforesaid Company Order or Orders, as the case may be, will have been duly issued under this Indenture and will constitute valid and legally binding obligations of the Company, entitled to the benefits provided by the Indenture, and enforceable in accordance with their terms, subject, as to enforcement, to laws relating to or affecting generally the enforcement of mortgagees' and other creditors' rights, including, without limitation, bankruptcy, insolvency, reorganization, receivership, moratorium and other laws affecting the rights and remedies of creditors and mortgagees generally and general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

With respect to Securities of a series subject to a Periodic Offering, the Trustee may conclusively rely, as to the authorization by the Company of any of such Securities, the forms and terms thereof and the legality, validity, binding effect and enforceability thereof, and compliance of the authentication and delivery thereof with the terms and conditions of this Indenture, upon the Opinion of Counsel and other documents delivered pursuant to Sections 2.01 and 3.01 and this Section, as applicable, at or prior to the time of the first authentication of Securities of such series, unless and until such opinion or other documents have been superseded or revoked or expire by their terms. In connection with the authentication and delivery of Securities of a series, pursuant to a Periodic Offering, the Trustee shall be entitled to assume that the Company's instructions to authenticate and deliver such Securities do not violate any applicable law or any applicable rule, regulation or order of any Governmental Authority having jurisdiction over the Company.

If the forms or terms of the Securities of any series have been established by or pursuant to a Board Resolution or an Officer's Certificate as permitted by Sections 2.01 or 3.01, the Trustee shall not be required to authenticate such Securities if the issuance of such Securities pursuant to this Indenture will affect the Trustee's own rights, duties or immunities under the Securities and this Indenture or otherwise in a manner which is not reasonably acceptable to the Trustee.

Except as otherwise specified as contemplated by Section 3.01 with respect to any series of Securities, or any Tranche thereof, each Security shall be dated the date of its authentication.

Except as otherwise specified as contemplated by Section 3.01 with respect to any series of Securities, or any Tranche thereof, no Security shall be entitled to any benefit under this Indenture or be valid or obligatory for any purpose unless there appears on such Security a certificate of authentication substantially in the form provided for herein executed by the Trustee or its agent by manual signature of an authorized signatory thereof, and such certificate upon any

Security shall be conclusive evidence, and the only evidence, that such Security has been duly authenticated and delivered hereunder and is entitled to the benefits of this Indenture. Notwithstanding the foregoing, if any Security shall have been authenticated and delivered hereunder to the Company, or any Person acting on its behalf, but shall never have been issued and sold by the Company, and the Company shall deliver such Security to the Trustee for cancellation as provided in Section 3.09 together with a written statement (which need not comply with Section 1.04 and need not be accompanied by an Opinion of Counsel) stating that such Security has never been issued and sold by the Company, for all purposes of this Indenture such Security shall be deemed never to have been authenticated and delivered hereunder and shall never be entitled to the benefits hereof.

#### **SECTION 3.04. GLOBAL OR TEMPORARY SECURITIES.**

The Company may issue some or all of the Securities in temporary or permanent global form. The Company may issue a global Security only to a depository, including The Depository Trust Company, or other clearing corporation or securities intermediary, or its nominee. A depository or its nominee may transfer a Security in global form only to the depository, a nominee of a depository or to a successor depository, but upon request of such depository, the Company shall deliver non-global Securities in exchange for global Securities. A global Security shall represent the amount of Securities specified in the global Security. A global Security may have variations that the depository requires or that the Company considers appropriate for such a Security, including grids for increasing or decreasing the principal amount of such Security. Beneficial owners of part or all of a global Security are subject to the rules of the depository as in effect from time to time. The Company, the Trustee and any Registrar and any Paying Agent shall not be responsible for any acts or omissions of a depository, for any depository records of beneficial ownership interests or for any transactions between the depository and beneficial owners.

Until definitive Securities are ready for delivery, the Company may use temporary Securities. Temporary Securities shall be substantially in the form of definitive Securities but may have variations that the Company considers appropriate for temporary Securities. Without unreasonable delay, the Company shall deliver definitive Securities in exchange for temporary Securities. Until exchanged in full as hereinabove provided, temporary Securities shall in all respects be entitled to the same benefits under this Indenture as definitive Securities of the same series and Tranche and of like tenor authenticated and delivered hereunder.

#### **SECTION 3.05. REGISTRATION, REGISTRATION OF TRANSFER AND EXCHANGE.**

The Company shall cause to be kept in an office designated pursuant to Section 7.02, with respect to the Securities of each series, a register (all registers kept in accordance with this Section being collectively referred to as the "Security Register") in which, subject to such reasonable regulations as it may prescribe, the Company shall provide for the registration of Securities of such series, or any Tranche thereof, and the registration of transfer thereof. The Company shall designate one Person to maintain the Security Register for the Securities of each series, and such Person is referred to herein, with respect to such series, as the "Security Registrar." Unless otherwise provided as contemplated by Section 3.01, the Trustee shall be the

Security Registrar for all series of Securities. Anything herein to the contrary notwithstanding, the Company may designate one of its offices as an office in which the register with respect to the Securities of a series shall be maintained, and the Company may designate itself the Security Registrar with respect to one or more series of Securities. The Security Register shall be open for inspection by the Trustee and the Company at all reasonable times.

Except as otherwise specified as contemplated by Section 3.01 with respect to the Securities of any series, or any Tranche thereof, upon surrender for registration of transfer of any Security of such series or Tranche at the office or agency of the Company maintained pursuant to Section 7.02 in a Place of Payment for such series or Tranche, the Company shall execute, and the Trustee shall authenticate and deliver, in the name of the designated transferee or transferees, one or more new Securities of the same series and Tranche, of authorized denominations and of like tenor and aggregate principal amount.

Except as otherwise specified as contemplated by Section 3.01 with respect to the Securities of any series, or any Tranche thereof, any Security of such series or Tranche may be exchanged at the option of the Holder for one or more new Securities of the same series and Tranche, of authorized denominations and of like tenor and aggregate principal amount, upon surrender of the Securities to be exchanged at any such office or agency. Whenever any Securities are so surrendered for exchange, the Company shall execute, and the Trustee shall authenticate and deliver, the Securities, which the Holder making the exchange is entitled to receive.

All Securities delivered upon any registration of transfer or exchange of Securities shall be valid obligations of the Company, evidencing the same obligation, and entitled to the same benefits under this Indenture, as the Securities surrendered upon such registration of transfer or exchange.

Every Security presented or surrendered for registration of transfer or for exchange shall (if so required by the Company, the Trustee or the Security Registrar) be duly endorsed or shall be accompanied by a written instrument of transfer in form satisfactory to the Company, the Trustee or the Security Registrar, as the case may be, duly executed by the Holder thereof or his attorney duly authorized in writing.

Unless otherwise specified as contemplated by Section 3.01, with respect to Securities of any series, or any Tranche thereof, no service charge shall be made for any registration of transfer or exchange of Securities, but the Company may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in connection with any registration of transfer or exchange of Securities, other than exchanges pursuant to Sections 3.04, 5.06 or 13.06 not involving any transfer.

The Company shall not be required to execute or to provide for the registration of transfer of or the exchange of (a) Securities of any series, or any Tranche thereof, during a period of 15 days immediately preceding the date notice is to be given identifying the serial numbers of the Securities of such series or Tranche called for redemption, or (b) any Security so selected for redemption in whole or in part, except the unredeemed portion of any Security being redeemed in part.

**SECTION 3.06. MUTILATED, DESTROYED, LOST AND STOLEN SECURITIES.**

If any mutilated Security is surrendered to the Trustee, the Company shall execute and the Trustee shall authenticate and deliver in exchange therefor a new Security of the same series and Tranche, and of like tenor and principal amount, bearing a number not contemporaneously outstanding.

If there shall be delivered to the Company and the Trustee (a) evidence to their satisfaction of the ownership of and the destruction, loss or theft of any Security and (b) such security or indemnity as may be reasonably required by them to save each of them and any agent of any of them harmless, then, in the absence of notice to the Company or the Trustee that such Security has been acquired by a bona fide purchaser, the Company shall execute and the Trustee shall authenticate and deliver, in lieu of any such destroyed, lost or stolen Security, a new Security of the same series and Tranche, and of like tenor and principal amount, bearing a number not contemporaneously outstanding.

Notwithstanding the foregoing, in case any such mutilated, destroyed, lost or stolen Security has become or is about to become due and payable, the Company in its discretion may, instead of issuing a new Security, pay such Security.

Upon the issuance of any new Security under this Section, the Company may require the payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto and any other reasonable expenses (including the fees and expenses of the Trustee) in connection therewith.

Every new Security of any series issued pursuant to this Section in lieu of any destroyed, lost or stolen Security shall constitute an original additional contractual obligation of the Company, whether or not the destroyed, lost or stolen Security shall be at any time enforceable by anyone other than the Holder of such new Security, and any such new Security shall be entitled to all the benefits of this Indenture equally and proportionately with any and all other Securities of such series duly issued hereunder.

The provisions of this Section are exclusive and shall preclude (to the extent lawful) all other rights and remedies with respect to the replacement or payment of mutilated, destroyed, lost or stolen Securities.

**SECTION 3.07. PAYMENT OF INTEREST; INTEREST RIGHTS PRESERVED.**

Unless otherwise specified as contemplated by Section 3.01 with respect to the Securities of any series, or any Tranche thereof, interest on any Security which is payable, and is punctually paid or duly provided for, on any Interest Payment Date shall be paid to the Person in whose name that Security (or one or more Predecessor Securities) is registered at the close of business on the Regular Record Date for such interest.

Any interest on any Security of any series which is payable, but is not punctually paid or duly provided for, on any Interest Payment Date (herein called "Defaulted Interest") shall forthwith cease to be payable to the Holder on the related Regular Record Date by virtue of

having been such Holder, and such Defaulted Interest may be paid by the Company, at its election, as provided in clause (a) or (b) below:

(a) The Company may elect to make payment of any Defaulted Interest to the Persons in whose names the Securities of such series (or their respective Predecessor Securities) are registered at the close of business on a date (a "Special Record Date") for the payment of such Defaulted Interest, which shall be fixed in the following manner. The Company shall notify the Trustee in writing of the amount of Defaulted Interest proposed to be paid on each Security of such series and the date of the proposed payment, and at the same time the Company shall deposit with the Trustee an amount of money equal to the aggregate amount proposed to be paid in respect of such Defaulted Interest or shall make arrangements satisfactory to the Trustee for such deposit prior to the date of the proposed payment, such money when deposited to be held in trust (and at the request of the Company, invested or reinvested in Government Obligations designated by the Company and maturing on or before the Special Record Date fixed by the Trustee, any interest accruing on such Government Obligations to be promptly paid over to the Company free and clear of any Lien) for the benefit of the Persons entitled to such Defaulted Interest as in this clause provided. Thereupon the Trustee shall fix a Special Record Date for the payment of such Defaulted Interest which shall be not more than 15 days and not less than 10 days prior to the date of the proposed payment and not less than 10 days after the receipt by the Trustee of the notice of the proposed payment. The Trustee shall promptly notify the Company of such Special Record Date and, in the name and at the expense of the Company shall promptly cause notice of the proposed payment of such Defaulted Interest and the Special Record Date therefor to be mailed, first-class postage prepaid, to each Holder of Securities of such series at the address of such Holder as it appears in the Security Register, not less than 10 days prior to such Special Record Date. Notice of the proposed payment of such Defaulted Interest and the Special Record Date therefor having been so mailed, such Defaulted Interest shall be paid to the Persons in whose names the Securities of such series (or their respective Predecessor Securities) are registered at the close of business on such Special Record Date.

(b) The Company may make payment of any Defaulted Interest on the Securities of any series in any other lawful manner not inconsistent with the requirements of any securities exchange on which such Securities may be listed, and upon such notice as may be required by such exchange, if, after notice given by the Company to the Trustee of the proposed payment pursuant to this clause, such manner of payment shall be deemed practicable by the Trustee.

Subject to the foregoing provisions of this Section and Section 3.05, each Security delivered under this Indenture upon registration of transfer of or in exchange for or in lieu of any other Security shall carry the rights to interest accrued and unpaid, and to accrue, which were carried by such other Security.

#### **SECTION 3.08. PERSONS DEEMED OWNERS.**

Prior to due presentment of a Security for registration of transfer, the Company, the Trustee and any agent of the Company or the Trustee may treat the Person in whose name such Security is registered as the absolute owner of such Security for the purpose of receiving payment of principal of and premium, if any, and (subject to Sections 3.05 and 3.07) interest, if any, on such Security and for all other purposes whatsoever, whether or not such Security be

overdue, and none of the Company, the Trustee or any agent of the Company or the Trustee shall be affected by notice to the contrary.

### **SECTION 3.09. CANCELLATION.**

All Securities surrendered for payment, redemption, registration of transfer or exchange or for credit against any sinking fund payment shall, if surrendered to any Person other than the Security Registrar, be delivered to the Security Registrar and, if not theretofore canceled, shall be promptly canceled by the Security Registrar. The Company may at any time deliver to the Security Registrar for cancellation any Securities previously authenticated and delivered hereunder which the Company may have acquired in any manner whatsoever or which the Company shall not have issued and sold, and all Securities so delivered shall be promptly canceled by the Security Registrar. No Securities shall be authenticated in lieu of or in exchange for any Securities canceled as provided in this Section, except as expressly permitted by this Indenture. All canceled Securities held by the Security Registrar shall be disposed of in accordance with the customary practices of the Security Registrar at the time in effect, and the Security Registrar shall not be required to destroy any such certificates. The Security Registrar shall promptly deliver a certificate of disposition to the Trustee and the Company unless, by a Company Order, similarly delivered, the Company shall direct that canceled Securities be returned to it. The Security Registrar shall promptly deliver evidence of any cancellation of a Security in accordance with this Section 3.09 to the Trustee and the Company upon their request therefor.

### **SECTION 3.10. COMPUTATION OF INTEREST.**

Except as otherwise specified as contemplated by Section 3.01 for Securities of any series, or Tranche thereof, interest on the Securities of each series shall be computed on the basis of a three hundred sixty (360) day year consisting of twelve (12) thirty (30) day months, and with respect to any period less than a full month, on the basis of the actual number of days elapsed during such period. For example, the interest for a period running from the 15th day of one month to the 15th day of the next month would be calculated on the basis of one 30-day month.

### **SECTION 3.11. PAYMENT TO BE IN PROPER CURRENCY.**

In the case of any Security denominated in any currency other than Dollars or in a composite currency (the "Required Currency"), except as otherwise specified with respect to such Security as contemplated by Section 3.01, the obligation of the Company to make any payment of the principal thereof, or the premium or interest thereon, shall not be discharged or satisfied by any tender by the Company, or recovery by the Trustee, in any currency other than the Required Currency, except to the extent that such tender or recovery shall result in the Trustee timely holding the full amount of the Required Currency then due and payable. If any such tender or recovery is in a currency other than the Required Currency, the Trustee may take such actions as it considers appropriate to exchange such currency for the Required Currency. The costs and risks of any such exchange, including without limitation the risks of delay and exchange rate fluctuation, shall be borne by the Company, the Company shall remain fully liable for any shortfall or delinquency in the full amount of Required Currency then due and payable,

and in no circumstances shall the Trustee be liable therefor except in the case of its negligence or willful misconduct.

**SECTION 3.12. EXTENSION OF INTEREST PAYMENT.**

The Company shall have the right at any time, to extend interest payment periods on all the Securities of any series hereunder, if so specified as contemplated by Section 3.01 with respect to such Securities and upon such terms as may be specified as contemplated by Section 3.01 with respect to such Securities.

**SECTION 3.13. CUSIP AND ISIN NUMBERS.**

The Company in issuing the Securities may use CUSIP, ISIN or other similar numbers (if then generally in use), and, if so, the Company, the Trustee or the Security Registrar may use CUSIP, ISIN or such other numbers in notices of redemption as a convenience to Holders; provided that any such notice may state that no representation is made as to the correctness of such numbers either as printed on the Securities or as contained in any notice of a redemption and that reliance may be placed only on the other identification numbers printed on the Securities, in which case none of the Company or, as the case may be, the Trustee or the Security Registrar, or any agent of any of them, shall have any liability in respect of any CUSIP, ISIN or other number used on any such notice, and any such redemption shall not be affected by any defect in or omission of such numbers. The Company shall promptly notify the Trustee and Security Registrar of any change in the CUSIP, ISIN or other such number.

[END OF ARTICLE THREE]

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## ARTICLE FOUR.

### FIRST MORTGAGE BONDS, 5.45% SERIES DUE APRIL 1, 2019

#### SECTION 4.01. CREATION AND DESIGNATION OF BONDS OF SERIES DUE 2019.

There is hereby created a series of Securities to be issued under and secured by the Indenture, to be designated as "First Mortgage Bonds, 5.45% Series, Due April 1, 2019 (herein sometimes referred to as the "Bonds of Series Due 2019").

#### SECTION 4.02. AGGREGATE PRINCIPAL AMOUNT OF BONDS OF SERIES DUE 2019 ISSUABLE.

(a) The principal amount of Bonds of Series Due 2019 which may be authenticated and delivered hereunder is limited to the aggregate principal amount of Four Hundred Fifty Million Dollars (\$450,000,000) (except for Bonds of Series Due 2019 authenticated and delivered upon registration of transfer of, or in exchange for, or in lieu of, other Bonds of Series Due 2019 pursuant to Section 3.04, 3.05, 3.06, 5.06 or 13.06 and except for any Bonds of Series Due 2019 which, pursuant to Section 3.03, are deemed never to have been authenticated and delivered hereunder).

(b) The Bonds of Series Due 2019 in the aggregate principal amount of Four Hundred Fifty Million Dollars (\$450,000,000) may at any time subsequent to the execution hereof be executed by the Company and delivered to the Trustee and shall be authenticated by the Trustee and delivered (either before or after the recording hereof) upon the basis of Property Additions issued and delivered to the Trustee for such purpose, pursuant to a Company Order referred to in Section 16.02 of this Indenture and upon receipt by the Trustee of the opinions and other documents required by said Section 16.02.

#### SECTION 4.03. BOOK-ENTRY SYSTEM.

The following provisions shall apply to the Bonds of Series Due 2019.

(a) The Bonds of Series Due 2019 shall be issued in fully registered form only. However, except as provided elsewhere in this Section, the registered owner of all of the Bonds of Series Due 2019 initially shall be The Depository Trust Company ("DTC") or its nominee, and such Bonds of Series Due 2019 initially shall be registered in the name of DTC or its nominee. Payment of the principal of or interest on Bonds of Series Due 2019 registered in the name of DTC or its nominee shall be made in the manner specified in DTC's rules and by-laws. DTC (and any successor securities depository) and its (or their) participating institutions (collectively "Participants") shall maintain a book-entry registration and transfer system with respect to ownership of beneficial interests in the Bonds of Series Due 2019 (the "Book-Entry System").

(b) The Bonds of Series Due 2019 initially shall be issued in the form of one or more authenticated, fully registered bonds for such series (each a "Global Security") which (i) need not be in the form of a lithographed or engraved certificate, but may be typewritten or printed on ordinary paper or such paper as the Trustee may reasonably request, (ii) shall represent and be



denominated in an amount equal to 100% of the aggregate principal amount of the Bonds of Series Due 2019 issued under this Indenture, (iii) shall be executed by the Company and authenticated by the Trustee in accordance with the provisions of this Indenture, (iv) shall be registered in the name of DTC or its nominee, and delivered to DTC or its nominee or a custodian therefor, and (v) shall contain the following legend on the face thereof:

Unless this certificate is presented by an authorized representative of The Depository Trust Company, a New York corporation (“DTC”), to issuer or its agent for registration of transfer, exchange or payment, and any certificate issued is registered in the name of Cede & Co. or in such other name as is requested by an authorized representative of DTC (and any payment is made to Cede & Co. or to such other entity as is requested by an authorized representative of DTC), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL inasmuch as the registered holder hereof, Cede & Co., has an interest herein.

Unless and until it is exchanged in whole or in part for Bonds of Series Due 2019 in definitive certificated form, each Global Security representing the Bonds of Series Due 2019 may not be transferred except as a whole by DTC to a nominee of DTC or by a nominee of DTC to DTC or another nominee of DTC or by DTC or any such nominee to a successor securities depository or a nominee of any such successor securities depository.

(c) The Trustee and the Company may treat DTC or its nominee, or any successor securities depository or nominee thereof (collectively, the “Depository”) as the sole and exclusive owner of the Bonds of Series Due 2019, registered in its name for the purposes of payment of the principal or redemption price of or interest on the Bonds of Series Due 2019, giving any notice permitted or required to be given to Holders of the Bonds of Series Due 2019, under this Indenture, registering the transfer of the Bonds of Series Due 2019, obtaining any consent or other action to be taken by Holders of the Bonds of Series Due 2019, and for all other purposes whatsoever and neither the Trustee nor the Company shall be affected by any notice to the contrary. Neither the Company nor the Trustee nor any Security Registrar nor any Paying Agent shall have any responsibility or obligation to any Participant, any Person claiming a beneficial ownership interest in the Bonds of Series Due 2019 under or through the Depository or any Participant, or any other Person which is not shown on the Security Register as being a Holder of the Bonds of Series Due 2019 with respect to (i) the accuracy of any records maintained by the Depository or any Participant; (ii) the payment by the Depository to any Participant of any amount in respect of the principal or Redemption Price of or interest on the Bonds of Series Due 2019; (iii) the payment by any Participant to any owner of a beneficial ownership interest in the Bonds of Series Due 2019, in respect of the principal or Redemption Price of or interest on the Bonds of Series Due 2019 or (iv) any consent or other action taken by the Depository as owner of the Bonds of Series Due 2019. The Trustee shall pay all principal or Redemption Price of and interest on the Bonds of Series Due 2019 only to or upon the order of the registered Holder or Holders of the Bonds of Series Due 2019, as shown on the Security Register, and all such payments shall be valid and effective to fully satisfy and discharge the Company’s obligations with respect to the principal or Redemption Price of and interest on the Bonds of Series Due 2019, to the extent of the sum or sums so paid. Except as hereinafter

provided, no Person other than a Holder of the Bonds of Series Due 2019, as shown on the Security Register, shall receive an authenticated Bond evidencing the obligation of the Company to make payment of the principal or Redemption Price of and interest on the Bonds of Series Due 2019, pursuant to this Indenture. Upon delivery by DTC to the Trustee of written notice to the effect that DTC has determined to substitute a new nominee for Cede & Co, and subject to the provisions of this Indenture, the word "Cede & Co.", as used in this Indenture, shall refer to each new nominee of DTC.

(d) In the event that after the occurrence of an Event of Default that has not been cured or waived, holders of a majority in aggregate principal amount of the beneficial interests in the Bonds of Series Due 2019, as reflected in the books and records of the Depository, notify the Trustee, through the Depository or any Participant, that the continuation of the Book-Entry System is no longer in the best interests of such holders of beneficial interests in the Bonds of such Series, then the Trustee shall notify the Depository and the Company, and the Depository will notify the Participants of the availability through the Depository of definitive certificated Bonds of such Series. In such event, the Company shall execute, and the Trustee, upon receipt of a Company Order, for the authentication and delivery of definitive certificated Bonds of Series Due 2019, will authenticate and deliver Bonds of such Series in definitive certificated form, in any authorized denominations, all pursuant to the provisions of this Indenture, to the Person or Persons specified to the Trustee in writing by the Depository in the aggregate principal amount of the applicable Global Security or Securities and in exchange for such Global Security or Securities.

(e) If at any time the Depository notifies the Company that it is unwilling or unable to continue as Depository for the Bonds of Series Due 2019, or if at any time the Depository shall no longer be registered as a clearing agency in good standing under the Exchange Act or other applicable statute or regulation, the Company may appoint a successor Depository with respect to the Bonds of such Series. If a successor Depository for the Bonds of such Series is not appointed by the Company within 90 days after the Company receives such notice or becomes aware of such condition, the Company will execute, and the Trustee, upon receipt of a Company Order for the authentication and delivery of definitive certificated Bonds of Series Due 2019, will authenticate and deliver Bonds of such Series in definitive certificated form, in any authorized denominations, all pursuant to the provisions of this Indenture, to the Person or Persons specified to the Trustee in writing by the Depository in the aggregate principal amount of the applicable Global Security or Global Securities and in exchange for such Global Security or Global Securities.

(f) The Company may at any time and in its sole discretion and subject to the procedures of the Depository determine that the Bonds of Series Due 2019 shall no longer be represented by a Global Security or Global Securities. In such event the Company will execute, and the Trustee, upon receipt of a Company Order for the authentication and delivery of definitive certificated Bonds of Series Due 2019, will authenticate and deliver Bonds of Series Due 2019 in definitive certificated form, in any authorized denominations, all pursuant to the provisions of this Indenture, to the Person or Persons specified to the Trustee in writing by the Depository in the aggregate principal amount of the Global Security or Global Securities and in exchange for such Global Security or Global Securities.

(g) Upon the exchange of any Global Security for the Bonds of Series Due 2019 in definitive certificated form, in authorized denominations, the Global Security or Global Securities shall be cancelled by the Trustee.

(h) Whenever the Depository requests the Company and the Trustee to do so, the Trustee and the Company will cooperate with the Depository in taking appropriate action after reasonable notice to (i) make available one or more separate Global Securities evidencing the Bonds of Series Due 2019 to any Participant having such Bonds of Series Due 2019 credited to its account at the Depository, or (ii) arrange for another Depository to maintain custody of the Global Security or Securities evidencing the Bonds of Series Due 2019.

(i) In connection with any notice or other communication to be provided to Holders of the Bonds of Series Due 2019 pursuant to this Indenture by the Company or the Trustee with respect to any consent or other action to be taken by Holders of such Bonds of Series Due 2019, the Company or the Trustee, as the case may be, shall establish a record date for such consent or other action and give the Depository notice of such record date not less than 15 calendar days in advance of such record date to the extent possible. Such notice to the Depository shall be given only so long as a Depository or its nominee is the sole Holder of the Bonds of Series Due 2019.

#### **SECTION 4.04. DATE OF BONDS OF SERIES DUE 2019.**

Each Bond of Series Due 2019 issued prior to the first Interest Payment Date therefor shall be dated as of March 23, 2009, and otherwise shall be dated as provided in Section 3.03 of this Indenture.

#### **SECTION 4.05. MATURITY DATES, INTEREST RATES, INTEREST PAYMENT DATES AND REGULAR RECORD DATES FOR BONDS OF SERIES DUE 2019.**

All Bonds of Series Due 2019 shall be due and payable on April 1, 2019, and shall bear interest from the date of original issuance thereof or the last date to which interest has been paid or duly provided for at the rate of 5.45% per annum, payable semi-annually on the first day of April and October in each year, commencing October 1, 2009 (each such date being an Interest Payment Date for Bonds of Series Due 2019).

Subject to certain exceptions provided in this Indenture, the interest payable on any Interest Payment Date for Bonds of Series Due 2019 shall be paid to the Person in whose name a Bond of Series Due 2019 shall be registered at the close of business on the Regular Record Date for the Bonds of Series Due 2019 (as defined in the form of the Bonds of Series Due 2019 set forth in Section 4.10) or, in the case of any Defaulted Interest therefor, in the manner and to the Person as provided in Section 3.07 of this Indenture. If any Interest Payment Date for Bonds of Series Due 2019 should fall on a day that is not a Business Day, then the interest payment shall be made on the next succeeding Business Day and no interest shall accrue for the intervening period with respect to the payment so deferred.

**SECTION 4.06. PLACE AND MANNER OF PAYMENT OF BONDS OF SERIES DUE 2019.**

Subject to agreements with or the rules of the Depository or any successor book-entry security system or similar system with respect to Global Securities, both the principal of and the interest on the Bonds of Series Due 2019 shall be payable in any coin or currency of the United States of America which at the time of payment is legal tender for the payment of public and private debts, at the office or agency of the Company in Cincinnati, Ohio, or, at the option of the Holder thereof, at the office or agency of the Company in the Borough of Manhattan, the City of New York, State of New York, except that interest on the Bonds of Series Due 2019 may be paid, at the option of the Company, by check or draft mailed to the address of the Person entitled thereto as it appears on the Security Register.

**SECTION 4.07. DENOMINATIONS AND NUMBERING OF DEFINITIVE BONDS OF SERIES DUE 2019.**

Definitive Bonds of Series Due 2019 shall be issuable in denominations of \$2,000 and multiples of \$1,000 in excess thereof, numbered consecutively from "R-1" upward.

**SECTION 4.08. TEMPORARY BONDS OF SERIES DUE 2019 AND EXCHANGE THEREOF.**

Pursuant to the provisions of Section 3.04 of this Indenture, Bonds of Series Due 2019 may be issued in temporary form, and if temporary bonds be issued, the Company shall, with all reasonable dispatch, at its own expense and without charge to the holders of the temporary bonds, prepare and execute definitive Bonds of Series Due 2019 and exchange the temporary bonds for such definitive bonds in the manner provided for in said Section, provided, however, no presentation or surrender of temporary Bonds of Series Due 2019 shall be necessary in order for the Holders entitled to interest thereon to receive such interest.

**SECTION 4.09. REDEMPTION PROVISIONS OF THE BONDS OF SERIES DUE 2019.**

(a) The Bonds of Series Due 2019 may be redeemed at the option of the Company, as a whole or in part at any time, at a redemption price equal to the greater of (1) 100% of the principal amount of the Bonds of Series Due 2019 to be redeemed and (2) the sum of the present values of the remaining scheduled payments of principal and interest thereon (exclusive of interest accrued to the Redemption Date), discounted to the Redemption Date on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate plus 0.40% (40 basis points), plus, in each case, accrued interest to the Redemption Date. For the avoidance of doubt, interest that is due and payable on an Interest Payment Date for the Bonds of Series Due 2019 falling on or prior to a Redemption Date therefor will be payable on such Interest Payment Date in accordance with the Bonds of Series Due 2019 and this Indenture. The Company shall notify the Trustee of the Redemption Price with respect to any redemption pursuant to this paragraph promptly after the calculation thereof. The Trustee shall not be responsible for calculating said Redemption Price.

(b) For purposes of this Section, except as otherwise expressly provided or unless the context otherwise requires:

“Business Day” means any day other than a day on which banks in New York City are required or authorized to be closed.

“Comparable Treasury Issue” means the United States Treasury security or securities selected by the Quotation Agent as having an actual or interpolated maturity comparable to the remaining term of the Bonds of Series Due 2019 to be redeemed that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of a comparable maturity to the remaining term of the Bonds of Series Due 2019.

“Comparable Treasury Price” means, with respect to any Redemption Date for the Bonds of Series Due 2019, (A) the average of the Reference Treasury Dealer Quotations for such Redemption Date, after excluding the highest and lowest such Reference Treasury Dealer Quotations, or (B) if the Quotation Agent obtains fewer than four such Reference Treasury Dealer Quotations, the average of all such quotations.

“Quotation Agent” means one of the Reference Treasury Dealers appointed by the Company.

“Reference Treasury Dealer” means each of Barclays Capital Inc., Deutsche Bank Securities Inc. and UBS Securities LLC, plus two other financial institutions appointed by the Company at the time of any redemption or their affiliates which are primary U.S. Government securities dealers, and their respective successors; provided, however, that if any of the foregoing or their affiliates shall cease to be a primary U.S. Government securities dealer in the United States (a “Primary Treasury Dealer”), the Company shall substitute therefor another Primary Treasury Dealer.

“Reference Treasury Dealer Quotations” means, with respect to each Reference Treasury Dealer and any Redemption Date, the average, as determined by the Quotation Agent, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Quotation Agent by the Reference Treasury Dealers at 3:30 p.m., New York time, on the third Business Day preceding such Redemption Date.

“Treasury Rate” means, with respect to any Redemption Date, the rate per annum equal to the semiannual equivalent yield to maturity or interpolated maturity (on a day count basis) of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for such Redemption Date.

(c) Notice of any redemption by the Company will be mailed at least thirty (30) days but not more than sixty (60) days before any Redemption Date to each Holder of Bonds of Series Due 2019 to be redeemed. If less than all the Bonds of Series Due 2019 are to be redeemed at the option of the Company, the Trustee shall select, in such manner as it shall deem fair and appropriate, the Bonds of Series Due 2019 to be redeemed in whole or in part.

(d) Unless the Company defaults in payment of the Redemption Price therefor, on and after any Redemption Date therefor, interest will cease to accrue on the Bonds of Series Due 2019 or portions thereof called for redemption.

(e) The Company shall indemnify and hold harmless the Trustee from any and all losses, costs, damages, expenses, fees (including reasonable attorneys' fees), court costs, judgments, penalties, obligations, suits, disbursements and liabilities of any kind or character whatsoever which may at any time be imposed upon, incurred by or asserted against the Trustee by reason of or arising out of or caused, directly or indirectly, by any act or omission of the Trustee with respect to this Section 4.09, except for such that would arise out of the gross negligence, willful misconduct or bad faith of the Trustee and except for costs and expenses arising in the ordinary course of the Trustee's business.

**SECTION 4.10. FORM OF THE BONDS OF SERIES DUE 2019.**

The Bonds of Series Due 2019 and the Trustee's certificate to be endorsed thereon shall be substantially in the following form:

[THE REMAINDER OF THIS PAGE HAS BEEN LEFT BLANK INTENTIONALLY.]

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(FORM OF BOND OF SERIES DUE 2019)

[Unless this certificate is presented by an authorized representative of The Depository Trust Company, a New York corporation (“DTC”), to issuer or its agent for registration of transfer, exchange or payment, and any certificate issued is registered in the name of Cede & Co. or in such other name as is requested by an authorized representative of DTC (and any payment is made to Cede & Co. or to such other entity as is requested by an authorized representative of DTC), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL inasmuch as the registered holder hereof, Cede & Co., has an interest herein.]<sup>1</sup>

No. R-

CUSIP No: 26442E AA 8

ISIN: US26442EAA82

\$ \_\_\_\_\_

DUKE ENERGY OHIO, INC.  
FIRST MORTGAGE BOND, 5.45% SERIES,  
DUE APRIL 1, 2019

Duke Energy Ohio, Inc., an Ohio corporation (hereinafter called the “Company”), for value received, hereby promises to pay to \_\_\_\_\_, or registered assigns, the principal sum of \_\_\_\_\_ Dollars (\$ ) on the first day of April, 2019 and to pay interest on said sum from the date hereof or from the most recent date to which interest has been paid or duly provided for, until said principal sum is paid or made available for payment, at the rate of 5.45% per annum, payable semi-annually on the first day of April and October in each year, commencing October 1, 2009 (each such date herein called an “Interest Payment Date”). Both the principal of and the interest on this bond shall be payable in any coin or currency of the United States of America which at the time of payment is legal tender for the payment of public and private debts at the office or agency of the Company in Cincinnati, Ohio, or, at the option of the registered owner hereof, at the office or agency of the Company in the Borough of Manhattan, the City of New York, State of New York, except that interest on this bond may be paid, at the option of the Company, by check or draft mailed to the address of the Person entitled thereto as it appears on the Security Register.

This bond is one of the Securities of the Company issued and to be issued from time to time under and in accordance with and all secured by a First Mortgage Indenture, dated as of August 1, 1936, from the Company to The Bank of New York Mellon Trust Company, N.A., as successor Trustee (which indenture as amended by all supplemental indentures is hereinafter referred to as the “Indenture”). Said Trustee or its successor in trust under the Indenture is hereinafter sometimes referred to as the “Trustee.” Reference is hereby made to the Indenture for a description of the property mortgaged and pledged and the nature and extent of the security for said Securities. Capitalized terms not otherwise defined herein have the meanings specified therefor in the Indenture. By the terms of the Indenture, the Securities secured thereby are issuable in series which may vary as to date, amount, date of maturity, rate of interest and in other respects as in the Indenture provided.

<sup>1</sup> This should be included only if the Bonds of Series Due 2019 are being issued in global form.

This bond is one of a series designated as “First Mortgage Bonds, 5.45% Series, Due April 1, 2019” (hereinafter referred to as the “Bonds of Series Due 2019”) of the Company issued under and secured by the Indenture and created by a Fortieth Supplemental Indenture, dated as of March 23, 2009, which Supplemental Indenture also amends and restates in its entirety the Indenture.

Subject to certain exceptions provided in the Indenture, the interest payable on any Interest Payment Date shall be paid to the Person in whose name this bond shall be registered at the close of business on the Regular Record Date (hereinafter defined) or, in the case of Defaulted Interest therefor, in the manner and to the person as provided in the Indenture. If any Interest Payment Date should fall on a day that is not a Business Day, then the interest payment shall be made on the next succeeding Business Day and no interest shall accrue for the intervening period with respect to the payment so deferred.

The term “Regular Record Date” shall mean, with respect to any Interest Payment Date for any Bonds of Series Due 2019, the close of business on the fifteenth (15th) calendar day next preceding the respective Interest Payment Date (whether or not a Business Day); provided, however, that so long as the Bonds of Series Due 2019 are held by a Depository in the form of one or more Global Securities, the Regular Record Date with respect to each Interest Payment Date will be the close of business on the Business Day before the applicable Interest Payment Date.

The Bonds of Series Due 2019 may be redeemed at the option of the Company, as a whole or in part at any time, at a Redemption Price equal to the greater of (1) 100% of the principal amount of the Bonds of Series Due 2019 to be redeemed and (2) the sum of the present values of the remaining scheduled payments of principal and interest thereon (exclusive of interest accrued to the Redemption Date), discounted to the Redemption Date on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate plus 0.40% (40 basis points), plus, in the case of each of clause (1) and (2), accrued and unpaid interest, if any, to the Redemption Date. For the avoidance of doubt, interest that is due and payable on an Interest Payment Date falling on or prior to a Redemption Date therefor will be payable on such Interest Payment Date in accordance with the Bonds of Series Due 2019 and the Indenture.

Notice of any redemption by the Company will be mailed at least thirty (30) days but not more than sixty (60) days before any Redemption Date to each Holder of Bonds of Series Due 2019 to be redeemed. If less than all the Bonds of Series Due 2019 are to be redeemed at the option of the Company, the Trustee shall select, in such manner as it shall deem fair and appropriate, the Bonds of Series Due 2019 to be redeemed..

The Bonds of Series Due 2019 are not otherwise redeemable prior to their maturity.

Unless the Company defaults in payment of the Redemption Price, on and after any Redemption Date for the Bonds of Series Due 2019, interest will cease to accrue on the Bonds of Series Due 2019 or portions thereof called for redemption.



In the case of any of certain Events of Default specified in the Indenture, the principal of this bond may be declared or may become due and payable prior to the stated date of maturity hereof in the manner and with the effect provided in the Indenture.

No recourse shall be had for the payment of the principal of or interest on this bond, or for any claim based hereon, or otherwise in respect hereof or of the Indenture, to or against any incorporator, shareholder, officer or director, past, present or future, of the Company or of any predecessor or successor company, either directly or through the Company or such predecessor or successor company, under any constitution or statute or rule of law, or by the enforcement of any assessment or penalty, or otherwise, all such liability of incorporators, shareholders, directors and officers being waived and released by the registered owner hereof by the acceptance of this bond and being likewise waived and released by the terms of the Indenture.

The Bonds of Series Due 2019 are issuable only in registered form without coupons. This bond is transferable by the registered owner hereof, in person or by an attorney duly authorized, at the Corporate Trust Office of The Bank of New York Mellon Trust Company, N.A., the Trustee, or its successor in trust under the Indenture, or, at the option of the registered owner, at the office or agency of the Company in the Borough of Manhattan, the City of New York, State of New York, upon the surrender and cancellation of this bond, and upon any such transfer a new registered Security or Securities of the same series and maturity date and for the same aggregate principal amount will be issued to the transferee in exchange herefor.

The Bonds of Series Due 2019 are issuable in denominations of \$2,000 and multiples of \$1,000 in excess thereof. In the manner and subject to the limitations provided in the Indenture, Bonds of Series Due 2019 are exchangeable as between authorized denominations, upon presentation thereof for such purpose by the registered owner, at the Corporate Trust Office of The Bank of New York Mellon Trust Company, N.A., the Trustee, or its successor in trust under the Indenture, or, at the option of the registered owner, at the office or agency of the Company in the Borough of Manhattan, the City of New York, State of New York.

No service charge will be made for any transfer or exchange of this bond, but the Company may require a sum sufficient to cover any tax or other governmental charge payable in connection therewith.

This bond shall not be valid or become obligatory for any purpose unless and until it shall have been authenticated by the execution by the Trustee, or its successor in trust under the Indenture, of the certificate endorsed hereon.

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IN WITNESS WHEREOF, Duke Energy Ohio, Inc. has caused this bond to be executed in its name by the manual or facsimile signature of an Authorized Officer.

Dated as of:

DUKE ENERGY OHIO, INC.

By \_\_\_\_\_  
Authorized Officer

TRUSTEE'S CERTIFICATE OF AUTHENTICATION

This is one of the Securities of the series designated therein referred to in the within-mentioned Indenture.

THE BANK OF NEW YORK MELLON TRUST  
COMPANY, N.A., AS TRUSTEE

By \_\_\_\_\_  
Authorized Signatory

[END OF ARTICLE FOUR]

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**ARTICLE FIVE.**  
**REDEMPTION OF SECURITIES**

**SECTION 5.01. APPLICABILITY OF ARTICLE.**

Securities of any series, or any Tranche thereof, which are redeemable before their Stated Maturity shall be redeemable in accordance with their terms and (except as otherwise specified as contemplated by Section 3.01 for Securities of such series or Tranche) in accordance with this Article.

**SECTION 5.02. ELECTION TO REDEEM; NOTICE TO TRUSTEE.**

The election of the Company to redeem any Securities shall be evidenced by a Board Resolution or an Officer's Certificate. The Company shall, at least 40 days prior to the Redemption Date fixed by the Company (unless a shorter notice shall be satisfactory to the Trustee), notify the Trustee in writing of such Redemption Date and of the principal amount of such Securities to be redeemed. In the case of any redemption of Securities which are subject to the prior compliance with any restriction or condition on such redemption provided in the terms of such Securities or elsewhere in this Indenture, the Company shall furnish the Trustee with an Officer's Certificate evidencing compliance with such restriction or condition.

**SECTION 5.03. SELECTION OF SECURITIES TO BE REDEEMED.**

If less than all the Securities of any series, or any Tranche thereof, are to be redeemed, the particular Securities to be redeemed shall be selected by the Trustee from the Outstanding Securities of such series or Tranche not previously called for redemption, by such method as shall be provided for such particular series or Tranche, or in the absence of any such provision, by such method of random selection as the Trustee shall deem fair and appropriate and which may, in any case, provide for the selection for redemption of portions (equal to any authorized denomination for Securities of such series or Tranche) of the principal amount of Securities of such series or Tranche of a denomination larger than the minimum authorized denomination for Securities of such series or Tranche; provided, however, that if, as indicated in an Officer's Certificate, the Company shall have offered to purchase all or any principal amount of the Securities then Outstanding of any series, or any Tranche thereof, and less than all of such Securities as to which such offer was made shall have been tendered to the Company for such purchase, the Trustee, if so directed by Company Order, shall select for redemption all or any principal amount of such Securities which have not been so tendered.

The Trustee shall promptly notify the Company and the Security Registrar in writing of the Securities selected for redemption and, in the case of any Securities selected to be redeemed in part, the principal amount thereof to be redeemed.

For all purposes of this Indenture, unless the context otherwise requires, all provisions relating to the redemption of Securities shall relate, in the case of any Securities redeemed or to be redeemed only in part, to the portion of the principal amount of such Securities which has been or is to be redeemed.

#### SECTION 5.04. NOTICE OF REDEMPTION.

Except as otherwise specified as contemplated by Section 3.01 for Securities of any series, notice of redemption shall be given in the manner provided in Section 1.08 to the Holders of the Securities to be redeemed not less than 30 days prior to the Redemption Date.

Except as otherwise specified as contemplated by Section 3.01 for Securities of any series, all notices of redemption shall state:

- (a) the Redemption Date,
- (b) the Redemption Price (if known),
- (c) if less than all the Securities of any series or Tranche are to be redeemed, the identification of the particular Securities to be redeemed and the portion of the principal amount of any Security to be redeemed in part,
- (d) that on the Redemption Date the Redemption Price, together with accrued interest, if any, to the Redemption Date, will become due and payable upon each such Security to be redeemed and, if applicable, that interest thereon will cease to accrue on and after said date,
- (e) the place or places where such Securities are to be surrendered for payment of the Redemption Price and accrued interest, if any, unless it shall have been specified as contemplated by Section 3.01 with respect to such Securities that such surrender shall not be required,
- (f) that the redemption is for a sinking or other fund, if such is the case,
- (g) the CUSIP, ISIN or other similar numbers, if any, assigned to such Securities; provided, however, that such notice may state that no representation is made as to the correctness of CUSIP, ISIN or other similar numbers, in which case none of the Company, the Trustee or any agent of the Company or the Trustee shall have any liability in respect of the use of any CUSIP, ISIN or other similar number or numbers on such notices, and the redemption of such Securities shall not be affected by any defect in or omission of such numbers, and
- (h) such other matters as the Company shall deem desirable or appropriate.

Unless otherwise specified with respect to any Securities in accordance with Section 3.01, with respect to any notice of redemption of Securities at the election of the Company, unless, upon the giving of such notice, such Securities shall be deemed to have been paid in accordance with Section 8.01, such notice may state that such redemption shall be conditional upon the receipt by the Paying Agent or Agents for such Securities, on or prior to the date fixed for such redemption, of money sufficient to pay the principal of and premium, if any, and interest, if any, on such Securities and that if such money shall not have been so received such notice shall be of no force or effect and the Company shall not be required to redeem such Securities. In the event that such notice of redemption contains such a condition and such money is not so received, the redemption shall not be made and within a reasonable time thereafter notice shall be given, in the manner in which the notice of redemption was given, that such

money was not so received and such redemption was not required to be made, and the Paying Agent or Agents for the Securities otherwise to have been redeemed shall promptly return to the Holders thereof any of such Securities which had been surrendered for payment upon such redemption. Notice of redemption of Securities to be redeemed at the election of the Company, and any notice of non-satisfaction of a condition for redemption as aforesaid, shall be given by the Company or, at the Company's request, by the Security Registrar in the name and at the expense of the Company. Except as provided in Section 6.03, notice of any mandatory redemption of Securities shall be given by the Security Registrar in the name and at the expense of the Company.

**SECTION 5.05. SECURITIES PAYABLE ON REDEMPTION DATE.**

Notice of redemption having been given as aforesaid, and the conditions, if any, set forth in such notice having been satisfied, the Securities or portions thereof so to be redeemed shall, on the Redemption Date, become due and payable at the Redemption Price therein specified, and from and after such date (unless, in the case of an unconditional notice of redemption, the Company shall default in the payment of the Redemption Price and accrued interest, if any) such Securities or portions thereof, if interest-bearing, shall cease to bear interest. Upon surrender of any such Security for redemption in accordance with such notice, such Security or portion thereof shall be paid by the Company at the Redemption Price, together with accrued interest, if any, to the Redemption Date; provided, however, that no such surrender shall be a condition to such payment if so specified as contemplated by Section 3.01 with respect to such Security; and provided, further, that except as otherwise specified as contemplated by Section 3.01 with respect to such Security, any installment of interest on any Security the Stated Maturity of which installment is on or prior to the Redemption Date shall be payable to the Holder of such Security, or one or more Predecessor Securities, registered as such at the close of business on the related Regular Record Date according to the terms of such Security and subject to the provisions of Sections 3.05 and 3.07.

**SECTION 5.06. SECURITIES REDEEMED IN PART.**

Upon the surrender of any Security which is to be redeemed only in part at a Place of Payment therefor (with, if the Company or the Trustee so requires, due endorsement by, or a written instrument of transfer in form satisfactory to the Company and the Trustee duly executed by, the Holder thereof or his attorney duly authorized in writing), the Company shall execute, and the Trustee shall authenticate and deliver to the Holder of such Security, without service charge, a new Security or Securities of the same series and Tranche, of any authorized denomination requested by such Holder and of like tenor and in aggregate principal amount equal to and in exchange for the unredeemed portion of the principal of the Security so surrendered.

[END OF ARTICLE FIVE]

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**ARTICLE SIX.  
SINKING FUNDS**

**SECTION 6.01. APPLICABILITY OF ARTICLE.**

The provisions of this Article shall be applicable to any sinking fund for the retirement of the Securities of any series, or any Tranche thereof, except as otherwise specified as contemplated by Section 3.01 for Securities of such series or Tranche.

The minimum amount of any sinking fund payment provided for by the terms of Securities of any series, or any Tranche thereof, is herein referred to as a "mandatory sinking fund payment", and any payment in excess of such minimum amount provided for by the terms of Securities of any series, or any Tranche thereof, is herein referred to as an "optional sinking fund payment". If provided for by the terms of Securities of any series, or any Tranche thereof, the cash amount of any sinking fund payment may be subject to reduction as provided in Section 6.02. Each sinking fund payment shall be applied to the redemption of Securities of the series or Tranche in respect of which it was made as provided for by the terms of such Securities.

**SECTION 6.02. SATISFACTION OF SINKING FUND PAYMENTS WITH SECURITIES.**

The Company (a) may deliver to the Trustee Outstanding Securities (other than any previously called for redemption) of a series or Tranche in respect of which a mandatory sinking fund payment is to be made and (b) may apply as a credit Securities of such series or Tranche which have been redeemed either at the election of the Company pursuant to the terms of such Securities or through the application of permitted optional sinking fund payments pursuant to the terms of such Securities, in each case in satisfaction of all or any part of such mandatory sinking fund payment with respect to the Securities of such series; provided, however, that no Securities shall be applied in satisfaction of a mandatory sinking fund payment if such Securities shall have been previously so applied. Securities so applied shall be received and credited for such purpose by the Trustee at the Redemption Price specified in such Securities for redemption through operation of the sinking fund and the amount of such mandatory sinking fund payment shall be reduced accordingly.

**SECTION 6.03. REDEMPTION OF SECURITIES FOR SINKING FUND.**

Not less than 40 days prior to each sinking fund payment date for the Securities of any series, or any Tranche thereof, the Company shall deliver to the Trustee an Officer's Certificate specifying:

- (a) the amount of the next succeeding mandatory sinking fund payment for such series or Tranche;
- (b) the amount, if any, of the optional sinking fund payment to be made together with such mandatory sinking fund payment;
- (c) the aggregate sinking fund payment; and

(d) the portion, if any, of such aggregate sinking fund payment which is to be satisfied by the payment of cash;

(e) the portion, if any, of such aggregate sinking fund payment which is to be satisfied by delivering and crediting Securities of such series or Tranche pursuant to Section 6.02 and stating the basis for such credit and that such Securities have not previously been so credited, and the Company shall also deliver to the Trustee any Securities to be so delivered.

If the Company shall not deliver such Officer's Certificate and, to the extent applicable, all such Securities, the next succeeding sinking fund payment for such series or Tranche shall be made entirely in cash in the amount of the mandatory sinking fund payment. Not less than 30 days before each such sinking fund payment date the Trustee shall select the Securities to be redeemed upon such sinking fund payment date in the manner specified in Section 5.03 and cause notice of the redemption thereof to be given in the name of and at the expense of the Company in the manner provided in Section 5.04. Such notice having been duly given, the redemption of such Securities shall be made upon the terms and in the manner stated in Sections 5.05 and 5.06.

[END OF ARTICLE SIX]

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**ARTICLE SEVEN.  
REPRESENTATIONS AND COVENANTS**

**SECTION 7.01. PAYMENT OF SECURITIES; LAWFUL POSSESSION.**

(a) The Company shall pay the principal of and premium, if any, and interest, if any, on the Securities of each series in accordance with the terms of such Securities and this Indenture.

(b) At the Execution Date, the Company is lawfully possessed of the Mortgaged Property and has sufficient right and authority to mortgage and pledge the Mortgaged Property, as provided in and by this Indenture.

**SECTION 7.02. MAINTENANCE OF OFFICE OR AGENCY.**

The Company shall maintain in each Place of Payment for the Securities of each series, or any Tranche thereof, an office or agency where payment of such Securities shall be made, where the registration of transfer or exchange of such Securities may be effected and where notices and demands to or upon the Company in respect of such Securities and this Indenture may be served.

The Company shall give prompt written notice to the Trustee of the location, and any change in the location, of each such office or agency and prompt notice to the Holders of any such change in the manner specified in Section 1.08. If at any time the Company shall fail to maintain any such required office or agency or shall fail to furnish the Trustee with the address thereof, then payment of such Securities shall be made, registration of transfer or exchange thereof may be effected and notices and demands in respect of such Securities and this Indenture may be served at the Corporate Trust Office of the Trustee, and the Company hereby appoints the Trustee as its agent for all such purposes in any such event.

The Company may also from time to time designate one or more other offices or agencies with respect to the Securities of one or more series, or any Tranche thereof, for any or all of the foregoing purposes and may from time to time rescind such designations; provided, however, that, unless otherwise specified as contemplated by Section 3.01 with respect to the Securities of such series or Tranche, no such designation or rescission shall in any manner relieve the Company of its obligation to maintain an office or agency for such purposes in each Place of Payment for such Securities in accordance with the requirements set forth above. The Company shall give prompt written notice to the Trustee, and prompt notice to the Holders in the manner specified in Section 1.08, of any such designation or rescission and of any change in the location of any such other office or agency.

Anything herein to the contrary notwithstanding, any office or agency required by this Section may be maintained at an office of the Company or an Affiliate of the Company, in which event the Company or such Affiliate shall perform all functions to be performed at such office or agency.



### **SECTION 7.03. MONEY FOR SECURITIES PAYMENTS TO BE HELD IN TRUST.**

If the Company shall at any time act as its own Paying Agent with respect to the Securities of any series, or any Tranche thereof, it shall, on or before each due date of the principal of and premium, if any, and interest, if any, on any of such Securities, segregate and hold in trust for the benefit of the Persons entitled thereto a sum sufficient to pay the principal and premium or interest so becoming due until such sums shall be paid to such Persons or otherwise disposed of as herein provided. The Company shall promptly notify the Trustee of any failure by the Company (or any other obligor on such Securities) to make any payment of principal of or premium, if any, or interest, if any, on such Securities.

Whenever the Company shall have one or more Paying Agents for the Securities of any series, or any Tranche thereof, it shall, on or before each due date of the principal of and premium, if any, and interest, if any, on such Securities, deposit with such Paying Agents sums sufficient (without duplication) to pay the principal and premium or interest so becoming due, such sums to be held in trust for the benefit of the Persons entitled to such principal, premium or interest, and (unless such Paying Agent is the Trustee) the Company shall promptly notify the Trustee of any failure by it so to act.

The Company shall cause each Paying Agent for the Securities of any series, or any Tranche thereof, other than the Company or the Trustee, to execute and deliver to the Trustee an instrument in which such Paying Agent shall agree with the Trustee, subject to the provisions of this Section, that such Paying Agent shall:

(a) hold all sums held by it for the payment of the principal of and premium, if any, or interest, if any, on such Securities in trust for the benefit of the Persons entitled thereto until such sums shall be paid to such Persons or otherwise disposed of as herein provided;

(b) give the Trustee notice of any failure by the Company (or any other obligor upon such Securities) to make any payment of principal of or premium, if any, or interest, if any, on such Securities; and

(c) at any time during the continuance of any such failure, upon the written request of the Trustee, forthwith pay to the Trustee all sums so held in trust by such Paying Agent and furnish to the Trustee such information as it possesses regarding the names and addresses of the Persons entitled to such sums.

The Company may at any time pay, or by Company Order direct any Paying Agent to pay, to the Trustee all sums held in trust by the Company or such Paying Agent, such sums to be held by the Trustee upon the same trusts as those upon which such sums were held by the Company or such Paying Agent and, if so stated in a Company Order delivered to the Trustee, in accordance with the provisions of Article Seven; and, upon such payment by any Paying Agent to the Trustee, such Paying Agent shall be released from all further liability with respect to such money.

Any money deposited with the Trustee or any Paying Agent, or then held by the Company, in trust for the payment of the principal of and premium, if any, or interest, if any, on any Security and remaining unclaimed for two years after such principal and premium, if any, or interest, if any, has become due and payable shall to the extent permitted by law be paid to the Company on Company Request, or, if then held by the Company, shall be discharged from such trust; and, upon such payment or discharge, the Holder of such Security shall, as an unsecured general creditor and not as the Holder of an Outstanding Security, look only to the Company for payment of the amount so due and payable and remaining unpaid unless the applicable law provides otherwise, and all liability of the Trustee or such Paying Agent with respect to such trust money, and all liability of the Company as trustee thereof, shall thereupon cease; provided, however, that the Trustee or such Paying Agent, before being required to make any such payment to the Company, may at the expense of the Company cause to be mailed, on one occasion only, notice to such Holder that such money remains unclaimed and that, after a date specified therein, which shall not be less than thirty (30) days from the date of such mailing, any unclaimed balance of such money then remaining will be paid to the Company.

#### **SECTION 7.04. CORPORATE EXISTENCE.**

Subject to the rights of the Company under Article Twelve, the Company shall do or cause to be done all things necessary to preserve and keep in full force and effect its legal existence as a corporation.

#### **SECTION 7.05. ANNUAL OFFICER'S CERTIFICATE AS TO COMPLIANCE.**

Not later than October 1 in each year, commencing October 1, 2009, the Company shall deliver to the Trustee an Officer's Certificate which need not comply with the requirements of Section 1.04, executed by the principal executive officer, the principal financial officer or the principal accounting officer of the Company, as to such officer's knowledge of the Company's compliance with all conditions and covenants under this Indenture, such compliance to be determined without regard to any period of grace or requirement of notice under this Indenture, and making any other statements as may be required by the provisions of Section 314(a)(4) of the Trust Indenture Act.

#### **SECTION 7.06. WAIVER OF CERTAIN COVENANTS.**

The Company may omit in any particular instance to comply with any term, provision or condition set forth in (a) Section 7.02 or any additional covenant or restriction specified with respect to the Securities of any series, or any Tranche thereof, as contemplated by Section 3.01, if before the time for such compliance the Holders of a majority in aggregate principal amount of the Outstanding Securities of all series and Tranches with respect to which compliance with Section 7.02 or such additional covenant or restriction is to be omitted, considered as one class, shall, by Act of such Holders, either waive such compliance in such instance or generally waive compliance with such term, provision or condition and (b) Section 7.04, 7.05 or Article Twelve if before the time for such compliance the Holders of a majority in principal amount of Securities Outstanding under this Indenture shall, by Act of such Holders, either waive such compliance in such instance or generally waive compliance with such term, provision or condition; but, in the case of (a) or (b), no such waiver shall extend to or affect such term, provision or condition

except to the extent so expressly waived, and, until such waiver shall become effective, the obligations of the Company and the duties of the Trustee in respect of any such term, provision or condition shall remain in full force and effect.

[END OF ARTICLE SEVEN]

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**ARTICLE EIGHT.**  
**SATISFACTION AND DISCHARGE**

**SECTION 8.01. SATISFACTION AND DISCHARGE OF SECURITIES.**

Any Security or Securities, or any portion of the principal amount thereof, shall be deemed to have been paid and no longer Outstanding for all purposes of this Indenture, and the entire indebtedness of the Company in respect thereof shall be deemed to have been satisfied and discharged, if there shall have been irrevocably deposited with the Trustee or any Paying Agent (other than the Company), in trust:

(a) money in an amount which shall be sufficient, or

(b) in the case of a deposit made prior to the Maturity of such Securities or portions thereof, Eligible Obligations, which shall not contain provisions permitting the redemption or other prepayment thereof at the option of the issuer thereof, the principal of and the interest on which when due, without any regard to reinvestment thereof, will provide moneys which, together with the money, if any, deposited with or held by the Trustee or such Paying Agent, shall be sufficient in the written opinion of a firm of independent certified public accountants delivered to the Trustee, or

(c) a combination of (a) or (b) which shall be sufficient in the opinion of such firm, to pay when due the principal of and premium, if any, and interest, if any, due and to become due on such Securities or portions thereof on or prior to Maturity; provided, however, that in the case of the provision for payment or redemption of less than all the Securities of any series or Tranche, such Securities or portions thereof shall have been selected by the Trustee as provided herein and, in the case of a redemption of all or less than all the Securities of any series or Tranche, the notice requisite to the validity of such redemption shall have been given or irrevocable authority shall have been given by the Company to the Trustee to give such notice, under arrangements satisfactory to the Trustee; and provided, further, that the Company shall have delivered to the Trustee and such Paying Agent:

(x) if such deposit shall have been made prior to the Maturity of such Securities, a Company Order stating that the money and Eligible Obligations deposited in accordance with this Section shall be held in trust, as provided in Section 8.03;

(y) an Officer's Certificate and Opinion of Counsel, each stating that all conditions precedent herein provided for relating to the deemed payment and, if the Officer's Certificate described in clause (z) below shall have been delivered, satisfaction and discharge of such Securities have been complied with; and

(z) if the Company intends such deposit to satisfy and discharge its indebtedness in respect of such Securities or portions thereof prior to the Maturity of such Securities or portion thereof, an Officer's Certificate stating the Company's intention that, upon delivery of such Officer's Certificate, its indebtedness in respect of such Securities or portions thereof will have been satisfied and discharged as contemplated in this Section.

Upon the deposit of money or Eligible Obligations, or both, in accordance with this Section, together with the documents required by clauses (x), (y) and (z) above, the Trustee shall, upon receipt of a Company Request, acknowledge in writing that the Security or Securities or portions thereof with respect to which such deposit was made are deemed to have been paid for all purposes of this Indenture and that the entire indebtedness of the Company in respect thereof has been satisfied and discharged as contemplated in this Section. In the event that all of the conditions set forth in the preceding paragraph shall have been satisfied in respect of any Securities or portions thereof except that, for any reason, the Officer's Certificate specified in clause (z) shall not have been delivered, such Securities or portions thereof shall nevertheless be deemed to have been paid for all purposes of this Indenture, and the Holders of such Securities or portions thereof shall nevertheless be no longer entitled to the benefits provided by this Indenture, the Lien of this Indenture, or any of the covenants of the Company under Article Seven (except the covenants contained in Sections 7.02 and 7.03) or any other covenants made in respect of such Securities or portions thereof as contemplated by Section 3.01 or Section 13.01(b), but the indebtedness of the Company in respect of such Securities or portions thereof shall not be deemed to have been satisfied and discharged prior to Maturity for any other purpose and the Holders of such Securities or portions thereof shall continue to be entitled to look to the Company for payment of the indebtedness represented thereby; and, upon Company Request, the Trustee shall acknowledge in writing that such Securities or portions thereof are deemed to have been paid for all purposes of this Indenture.

If payment at or prior to Stated Maturity of less than all of the Securities of any series, or any Tranche thereof, is to be provided for in the manner and with the effect provided in this Section, the Trustee shall select such Securities, or portions of principal amount thereof, in the manner specified by Section 5.03 for selection for redemption of less than all the Securities of a series or Tranche.

In the event that Securities which shall be deemed to have been paid for purposes of this Indenture, and, if such is the case, in respect of which the Company's indebtedness shall have been satisfied and discharged, all as provided in this Section, do not mature and are not to be redeemed within the sixty (60) day period commencing with the date of the deposit of moneys or Eligible Obligations, as aforesaid, the Company shall, as promptly as practicable, give a notice, in the same manner as a notice of redemption with respect to such Securities, to the Holders of such Securities to the effect that such deposit has been made and the effect thereof.

Notwithstanding that any Securities shall be deemed to have been paid for purposes of this Indenture, as aforesaid, the obligations of the Company and the Trustee in respect of such Securities under Sections 3.04, 3.05, 3.06, 5.04, 7.02, 7.03, 10.07 and 10.15 and this Article shall survive such deemed payment and any related satisfaction and discharge.

The Company shall pay, and shall indemnify the Trustee or any Paying Agent with which Eligible Obligations shall have been deposited as provided in this Section against, any tax, fee or other charge imposed on or assessed against such Eligible Obligations or the principal or interest received in respect of such Eligible Obligations, including, but not limited to, any such tax payable by any entity deemed, for tax purposes, to have been created as a result of such deposit.

Anything herein to the contrary notwithstanding, (a) if, at any time after a Security would be deemed to have been paid for purposes of this Indenture, and, if such is the case, the Company's indebtedness in respect thereof would be deemed to have been satisfied and discharged, pursuant to this Section (without regard to the provisions of this paragraph), the Trustee or any Paying Agent, as the case may be, (i) shall be required to return the money or Eligible Obligations, or combination thereof, deposited with it as aforesaid to the Company or its representative under any applicable Federal or State bankruptcy, insolvency or other similar law, or (ii) is unable to apply any money in accordance with this Article with respect to any Securities by reason of any order or judgment of any court or Governmental Authority enjoining, restraining or otherwise prohibiting such application, such Security shall thereupon be deemed retroactively not to have been paid and any satisfaction and discharge of the Company's indebtedness in respect thereof shall retroactively be deemed not to have been effected, and such Security shall be deemed to remain Outstanding and (b) any satisfaction and discharge of the Company's indebtedness in respect of any Security shall be subject to the provisions of the last paragraph of Section 7.03.

#### **SECTION 8.02. SATISFACTION AND DISCHARGE OF INDENTURE.**

This Indenture shall upon Company Request cease to be of further effect (except as hereinafter expressly provided), and the Trustee, at the expense of the Company, shall execute such instruments as the Company shall reasonably request to evidence and acknowledge the satisfaction and discharge of this Indenture, when:

- (a) no Securities remain Outstanding hereunder;
- (b) the Company has paid or caused to be paid, or made provision acceptable to the Trustee for payment of, all other sums payable hereunder by the Company; and
- (c) the Company has delivered to the Trustee an Officer's Certificate and an Opinion of Counsel, each containing the statements required by Section 1.04;

provided, however, that if, in accordance with the last paragraph of Section 8.01, any Security, previously deemed to have been paid for purposes of this Indenture, shall be deemed retroactively not to have been so paid, this Indenture shall thereupon be deemed retroactively not to have been satisfied and discharged, as aforesaid, and to remain in full force and effect, and the Company shall execute and deliver such instruments as the Trustee shall reasonably request to evidence and acknowledge the same.

Notwithstanding anything to the contrary expressed or implied in this Indenture, the fact that no Securities are Outstanding hereunder at any particular time and that the Company has paid or caused to be paid, or made provision acceptable to Trustee for payment of, all other sums payable hereunder by the Company, shall not operate to render void this Indenture, or any amendment or supplement hereto, nor will the same be deemed a release, satisfaction or discharge of this Indenture, or any amendment or supplement hereto. This Indenture, as amended and supplemented, shall remain in full force until recordation of appropriate instrument(s) of satisfaction and discharge executed by the Trustee in accordance with this

Section following a Company Request and the Company's delivery of the Officer's Certificate and Opinion of Counsel set forth in paragraph (c) above.

Notwithstanding the satisfaction and discharge of this Indenture as aforesaid, the obligations of the Company and the Trustee under Sections 3.04, 3.05, 3.06, 5.04, 7.02, 7.03, 10.07 and 10.15 and this Article shall survive such satisfaction and discharge.

Upon satisfaction and discharge of this Indenture as provided in this Section, the Trustee shall assign, transfer and turn over to the Company, subject to the lien provided by Section 10.07, any and all money, securities and other property then held by the Trustee for the benefit of the Holders of the Securities (other than money and Eligible Obligations held by the Trustee pursuant to Section 8.03) and shall execute and deliver to the Company such instruments as, in the judgment of the Company, shall be necessary, desirable or appropriate to effect or evidence the satisfaction and discharge of this Indenture.

#### **SECTION 8.03. APPLICATION OF TRUST MONEY.**

Neither the Eligible Obligations nor the money deposited pursuant to Section 8.01, nor the principal or interest payments on any such Eligible Obligations, shall be withdrawn or used for any purpose other than, and shall be held in trust for, the payment of the principal of and premium, if any, and interest, if any, on the Securities or portions of principal amount thereof in respect of which such deposit was made, all subject, however, to the provisions of Section 7.03; provided, however, that so long as there shall not have occurred and be continuing an Event of Default, any cash received from such principal or interest payments on such Eligible Obligations, if not then needed for such purpose, shall, to the extent practicable and upon Company Request be invested in Eligible Obligations of the type described in clause (b) in the first paragraph of Section 8.01 maturing at such times and in such amounts as shall be sufficient, together with any other moneys and the proceeds of any other Eligible Obligations then held by the Trustee, in the written opinion of a firm of independent certified public accountants delivered to the Trustee, to pay when due the principal of and premium, if any, and interest, if any, due and to become due on such Securities or portions thereof on and prior to the Maturity thereof, and interest earned from such reinvestment shall be paid over to the Company as received, free and clear of any trust, lien or pledge under this Indenture (except the lien provided by Section 10.07); and provided, further, that, so long as there shall not have occurred and be continuing an Event of Default, any moneys held in accordance with this Section on the Maturity of all such Securities in excess of the amount required to pay the principal of and premium, if any, and interest, if any, then due on such Securities shall be paid over to the Company free and clear of any trust, lien or pledge under this Indenture (except the lien provided by Section 10.07); and provided, further, that if an Event of Default shall have occurred and be continuing, moneys to be paid over to the Company pursuant to this Section shall be held until such Event of Default shall have been waived or cured.

At any time before or after depositing any money or Eligible Obligations with the Trustee under this Article, the Company may by written notice to the Trustee irrevocably waive any or all of its rights (1) to any residual interest in such money or Eligible Obligations, including any interest earned or excess amounts, (2) to instruct the Trustee to sell or purchase Eligible Obligations or otherwise invest money or proceeds held in trust pursuant to this Section, (3) to

provide investment advice to the Trustee with respect to such money or Eligible Obligations, (4) to provide to the Trustee instructions or advice of counsel for the Company as to matters arising in connection with the Trustee's servicing of the trust established pursuant to this Section with respect to such money or Eligible Obligations, or (5) to any involvement with such money, Eligible Obligations or the trust established pursuant to this Section.

[END OF ARTICLE EIGHT]

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**ARTICLE NINE.**  
**EVENTS OF DEFAULT; REMEDIES**

**SECTION 9.01. EVENTS OF DEFAULT.**

“**Event of Default**” means any one of the following events:

(a) failure to pay any interest on any Security when it becomes due and payable and continuance of such default for a period of 30 days; provided, however, that no such default shall constitute an “Event of Default” if the Company has made a valid extension of the interest payment period with respect to the Securities of the series of which such Security is a part, if so provided as contemplated by Section 3.01; or

(b) failure to pay the principal of or premium, if any, on any Security when it becomes due and payable; provided, however, that no such default shall constitute an “Event of Default” if the Company has made a valid extension of the Maturity of the Securities of the series of which such Security is a part, if so provided as contemplated by Section 3.01; or

(c) failure to perform or breach of, any covenant or warranty of the Company in this Indenture (other than a covenant or warranty a default in the performance of which or breach of which is elsewhere in this Section specifically addressed) and continuance of such default or breach for a period of 90 days after there has been given, by registered or certified mail, to the Company by the Trustee, or to the Company and the Trustee by the Holders of at least 35% in aggregate principal amount of the Outstanding Securities, a written notice specifying such default or breach and requiring it to be remedied and stating that such notice is a “**Notice of Default**” hereunder, unless the Trustee, or the Trustee and the Holders of a principal amount of Securities not less than the principal amount of Securities the Holders of which gave such notice, as the case may be, shall agree in writing to an extension of such period prior to its expiration; provided, however, that the Trustee, or the Trustee and the Holders of such principal amount of Securities, as the case may be, shall be deemed to have agreed to an extension of such period if corrective action is initiated by the Company within such period and is being diligently pursued; or

(d) the entry by a court having jurisdiction in the premises of (1) a decree or order for relief in respect of the Company in an involuntary case or proceeding under any applicable Federal or State bankruptcy, insolvency, reorganization or other similar law or (2) a decree or order adjudging the Company a bankrupt or insolvent, or approving as properly filed a petition by one or more Persons other than the Company seeking reorganization, arrangement, adjustment or composition of or in respect of the Company under any applicable Federal or State bankruptcy, insolvency or similar law, or appointing a custodian, receiver, liquidator, assignee, trustee, sequestrator or other similar official for the Company or for any substantial part of its property, or ordering the winding up or liquidation of its affairs, and any such decree or order for relief or any such other decree or order shall have remained unstayed and in effect for a period of 90 consecutive days;

(e) the commencement by the Company of a voluntary case or proceeding under any applicable Federal or State bankruptcy, insolvency, reorganization or other similar law or of any other case or proceeding to be adjudicated a bankrupt or insolvent, or the consent by the Company to the entry of a decree or order for relief in respect of the Company in a case or proceeding under any applicable Federal or State bankruptcy, insolvency, reorganization or other similar law or to the commencement of any bankruptcy or insolvency case or proceeding against the Company, or the filing by the Company of a petition or answer or consent seeking reorganization or relief under any applicable Federal or State bankruptcy, insolvency, reorganization or similar law, or the consent by the Company to the filing of such petition or to the appointment of or taking possession by a custodian, receiver, liquidator, assignee, trustee, sequestrator or similar official of the Company or of any substantial part of its property, or the making by the Company of an assignment for the benefit of creditors, or the admission by the Company in writing of its inability to pay its debts generally as they become due, or the authorization of such action by the Board of Directors of the Company; or

(f) any other Event of Default provided for as contemplated by Section 3.01(o).

#### **SECTION 9.02. ACCELERATION OF MATURITY; RESCISSION AND ANNULMENT.**

If an Event of Default shall have occurred and be continuing, then in every such case the Trustee or the Holders of not less than 35% in principal amount of the Outstanding Securities may declare the principal amount (or, if any of the Securities of such series are Discount Securities, such portion of the principal amount of such Securities as may be specified in the terms thereof as contemplated by Section 3.01) of all of the Securities to be due and payable immediately, by a notice in writing to the Company (and to the Trustee if given by Holders), and upon receipt by the Company of notice of such declaration such principal amount (or specified amount) together with premium, if any, and accrued and unpaid interest shall become immediately due and payable.

At any time after such a declaration of acceleration of the maturity of the Securities then Outstanding shall have been made, but before any sale of any of the Mortgaged Property has been made and before a judgment or decree for payment of the money due shall have been obtained by the Trustee as provided in this Article, the Event or Events of Default giving rise to such declaration of acceleration shall, without further act, be deemed to have been cured, and such declaration and its consequences shall, without further act, be deemed to have been rescinded and annulled, if

(a) the Company shall have paid or deposited with the Trustee a sum sufficient to pay

(i) all overdue interest, if any, on all Securities then Outstanding;

(ii) the principal of and premium, if any, on any Securities then Outstanding which have become due otherwise than by such declaration of acceleration and interest thereon at the rate or rates prescribed therefor in such Securities;

(iii) to the extent that payment of such interest is lawful, interest upon overdue interest at the rate or rates prescribed therefor in such Securities;

(iv) all amounts due to the Trustee under Section 10.07; and

(b) all Events of Default, other than the non-payment of the principal of Securities of such series which shall have become due solely by such declaration of acceleration, shall have been cured or waived as provided in Section 9.13.

No such rescission shall affect any subsequent Event of Default or impair any right consequent thereon.

#### **SECTION 9.03. COLLECTION OF INDEBTEDNESS AND SUITS FOR ENFORCEMENT BY TRUSTEE.**

If an Event of Default described in clause (a) or (b) of Section 9.01 shall have occurred and be continuing, the Company shall, upon demand of the Trustee, pay to it, for the benefit of the Holders of the Securities with respect to which such Event of Default shall have occurred and be continuing, the whole amount then due and payable on such Securities for principal and premium, if any, and interest, if any, and, to the extent permitted by law, interest on premium, if any, and on any overdue principal and interest, at the rate or rates prescribed therefor in such Securities, and, in addition thereto, such further amount as shall be sufficient to cover any amounts due to the Trustee under Section 10.07.

If the Company shall fail to pay such amounts forthwith upon such demand, the Trustee, in its own name and as trustee of an express trust, may institute a judicial proceeding for the collection of the sums so due and unpaid, may prosecute such proceeding to judgment or final decree and may enforce the same against the Company or any other obligor upon such Securities and collect the moneys adjudged or decreed to be payable in the manner provided by law out of the property of the Company or any other obligor upon such Securities, wherever situated.

If an Event of Default shall have occurred and be continuing, the Trustee may in its discretion proceed to protect and enforce its rights and the rights of the Holders of Securities by such appropriate judicial proceedings as the Trustee shall deem necessary to protect and enforce any such rights, whether for the specific enforcement of any covenant or agreement in this Indenture or in aid of the exercise of any power granted herein, or to enforce any other proper remedy.

#### **SECTION 9.04. TRUSTEE MAY FILE PROOFS OF CLAIM.**

In case of the pendency of any receivership, insolvency, liquidation, bankruptcy, reorganization, arrangement, adjustment, composition or other judicial proceeding relative to the Company or any other obligor upon the Securities or the property of the Company or of such other obligor or their creditors, the Trustee (irrespective of whether the principal of the Securities shall then be due and payable as therein expressed or by declaration or otherwise and irrespective of whether the Trustee shall have made any demand on the Company for the payment of overdue principal or interest) shall be entitled and empowered, by intervention in such proceeding or otherwise,

(a) to file and prove a claim for the whole amount of principal, premium, if any, and interest, if any, owing and unpaid in respect of the Securities and to file such other papers or

documents as may be necessary or advisable in order to have the claims of the Trustee (including any claim for amounts due to the Trustee under Section 10.07) and of the Holders allowed in such judicial proceeding, and

(b) to collect and receive any moneys or other property payable or deliverable on any such claims and to distribute the same; and any custodian, receiver, assignee, trustee, liquidator, sequestrator or other similar official in any such judicial proceeding is hereby authorized by each Holder to make such payments to the Trustee and, in the event that the Trustee shall consent to the making of such payments directly to the Holders, to pay to the Trustee any amounts due it under Section 10.07.

Nothing herein contained shall be deemed to authorize the Trustee to authorize or consent to or accept or adopt on behalf of any Holder any plan of reorganization, arrangement, adjustment or composition affecting the Securities or the rights of any Holder thereof or to authorize the Trustee to vote in respect of the claim of any Holder in any such proceeding.

#### **SECTION 9.05. TRUSTEE MAY ENFORCE CLAIMS WITHOUT POSSESSION OF SECURITIES.**

All rights of action and claims under this Indenture or the Securities may be prosecuted and enforced by the Trustee, without the possession of any of the Securities or the production thereof in any proceeding relating thereto, and any such proceeding instituted by the Trustee shall be brought in its own name as trustee of an express trust, and any recovery of judgment shall, after provision for the payment of the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel, be for the ratable benefit of the Holders in respect of which such judgment has been recovered.

#### **SECTION 9.06. APPLICATION OF MONEY COLLECTED.**

Any money or other property collected or received by the Trustee pursuant to this Article, or otherwise distributable under this Article in respect of the Company's obligations under this Indenture, shall be applied in the following order, to the extent permitted by law, at the date or dates fixed by the Trustee and, in case of the distribution of such money on account of principal or premium, if any, or interest, if any, upon presentation of the Securities in respect of which or for the benefit of which such money shall have been collected and the notation thereon of the payment if only partially paid and upon surrender thereof if fully paid:

**First:** To the payment of all amounts due the Trustee under Section 10.07;

**Second:** To the payment of the amounts then due and unpaid upon the Securities for principal of and premium, if any, and interest, if any, in respect of which or for the benefit of which such money has been collected, ratably, without preference or priority of any kind, according to the amounts due and payable on such Securities for principal, premium, if any, and interest, if any, respectively; and

**Third:** To the payment of the remainder, if any, to the Company or to whomsoever may be lawfully entitled to receive the same or as a court of competent jurisdiction may direct.

#### **SECTION 9.07. LIMITATION ON SUITS.**

No Holder shall have any right to institute any proceeding, judicial or otherwise, with respect to this Indenture, or for the appointment of a receiver or trustee, or for any other remedy hereunder, unless:

- (a) such Holder shall have previously given written notice to the Trustee of a continuing Event of Default;
- (b) the Holders of a majority in aggregate principal amount of the Outstanding Securities shall have made written request to the Trustee to institute proceedings in respect of such Event of Default in its own name as Trustee hereunder;
- (c) such Holder or Holders shall have offered to the Trustee indemnity satisfactory to it against the costs, expenses and liabilities to be incurred in compliance with such request;
- (d) the Trustee for 60 days after its receipt of such notice, request and offer of indemnity shall have failed to institute any such proceeding; and
- (e) no direction inconsistent with such written request shall have been given to the Trustee during such 60-day period by the Holders of a majority in aggregate principal amount of the Outstanding Securities;

it being understood and intended that no one or more of the Holders of any Securities shall have any right in any manner whatever by virtue of, or by availing of, any provision of this Indenture to affect, disturb or prejudice the rights of any other Holders or to obtain or to seek to obtain priority or preference over any other Holders or to enforce any right under this Indenture, except in the manner herein provided and for the equal and ratable benefit of all Holders.

#### **SECTION 9.08. UNCONDITIONAL RIGHT OF HOLDERS TO RECEIVE PRINCIPAL, PREMIUM AND INTEREST.**

Notwithstanding any other provision in this Indenture, the Holder of any Security shall have the right, which is absolute and unconditional, to receive payment of the principal of and premium, if any, and (subject to Section 3.07) interest, if any, on such Security on the Stated Maturity or Maturities expressed in such Security (or, in the case of redemption, on the Redemption Date) and to institute suit for the enforcement of any such payment, and such rights shall not be impaired without the consent of such Holder.

#### **SECTION 9.09. RESTORATION OF RIGHTS AND REMEDIES.**

If the Trustee or any Holder has instituted any proceeding to enforce any right or remedy under this Indenture and such proceeding shall have been discontinued or abandoned for any reason, or shall have been determined adversely to the Trustee or to such Holder, then and in every such case, subject to any determination in such proceeding, the Company, the Trustee and such Holder shall be restored severally and respectively to their former positions hereunder and thereafter all rights and remedies of the Trustee and such Holder shall continue as though no such proceeding had been instituted.

**SECTION 9.10. RIGHTS AND REMEDIES CUMULATIVE.**

Except as otherwise provided in the last paragraph of Section 3.06, no right or remedy herein conferred upon or reserved to the Trustee or to the Holders is intended to be exclusive of any other right or remedy, and every right and remedy shall, to the extent permitted by law, be cumulative and in addition to every other right and remedy given hereunder or now or hereafter existing at law or in equity or otherwise. The assertion or employment of any right or remedy hereunder, or otherwise, shall not prevent the concurrent assertion or employment of any other appropriate right or remedy.

**SECTION 9.11. DELAY OR OMISSION NOT WAIVER.**

No delay or omission of the Trustee or of any Holder to exercise any right or remedy accruing upon any Event of Default shall impair any such right or remedy or constitute a waiver of any such Event of Default or any acquiescence therein. Every right and remedy given by this Article or by law to the Trustee or to the Holders may be exercised from time to time, and as often as may be deemed expedient, by the Trustee or by the Holders, as the case may be.

**SECTION 9.12. CONTROL BY HOLDERS OF SECURITIES.**

If an Event of Default shall have occurred and be continuing, the Holders of a majority in principal amount of the Outstanding Securities shall have the right to direct the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred on the Trustee, with respect to such Securities; provided, however, that

(a) such direction shall not be in conflict with any rule of law or with this Indenture, and could not involve the Trustee in personal liability in circumstances where indemnity would not, in the Trustee's sole discretion, be adequate, and

(b) the Trustee may take any other action deemed proper by the Trustee which is not inconsistent with such direction.

**SECTION 9.13. WAIVER OF PAST DEFAULTS.**

The Holders of not less than a majority in principal amount of the Outstanding Securities may on behalf of the Holders of all the Securities waive any past default hereunder and its consequences, except a default

(a) in the payment of the principal of or premium, if any, or interest, if any, on any Outstanding Security, or

(b) in respect of a covenant or provision hereof which under Section 13.02 cannot be modified or amended without the consent of the Holder of each Outstanding Security of any series or Tranche affected.

Upon any such waiver, such default shall cease to exist, and any and all Events of Default arising therefrom shall be deemed to have been cured, for every purpose of this Indenture; but no

such waiver shall extend to any subsequent or other default or impair any right consequent thereon.

#### **SECTION 9.14. UNDERTAKING FOR COSTS.**

The Company and the Trustee agree, and each Holder by his acceptance thereof shall be deemed to have agreed, that any court may in its discretion require, in any suit for the enforcement of any right or remedy under this Indenture, or in any suit against the Trustee for any action taken, suffered or omitted by it as Trustee, the filing by any party litigant in such suit of an undertaking to pay the costs of such suit, and that such court may in its discretion assess reasonable costs, including reasonable attorneys' fees, against any party litigant in such suit, having due regard to the merits and good faith of the claims or defenses made by such party litigant but the provisions of this Section shall not apply to any suit instituted by the Company, to any suit instituted by the Trustee, to any suit instituted by any Holder, or group of Holders, holding in the aggregate more than 10% in aggregate principal amount of the Securities then Outstanding, or to any suit instituted by any Holder for the enforcement of the payment of the principal of or premium, if any, or interest, if any, on any Security on or after the Stated Maturity or Maturities expressed in such Security (or in the case of redemption, on or after the Redemption Date).

#### **SECTION 9.15. WAIVER OF USURY, STAY OR EXTENSION LAWS.**

The Company covenants (to the extent that it may lawfully do so) that it will not at any time insist upon, or plead, or in any manner whatsoever claim or take the benefit or advantage of, any usury, stay or extension law wherever enacted, now or at any time hereafter in force, which may affect the covenants or the performance of this Indenture; and the Company (to the extent that it may lawfully do so) hereby expressly waives all benefit or advantage of any such law and covenants that it will not hinder, delay or impede the execution of any power herein granted to the Trustee, but will suffer and permit the execution of every such power as though no such law had been enacted.

#### **SECTION 9.16. RECEIVER AND OTHER REMEDIES.**

If an Event of Default shall have occurred and, during the continuance thereof, the Trustee shall have commenced judicial proceedings to enforce any right under this Indenture, the Trustee shall, to the extent permitted by law, be entitled, as against the Company, to the appointment of a receiver of the Mortgaged Property and subject to the rights, if any, of others to receive collections from former, present or future customers of the rents, issues, profits, revenues and other income thereof, and whether or not any receiver is appointed, the Trustee shall be entitled to retain possession and control of, and to collect and receive the income from cash, securities and other personal property held by the Trustee hereunder. In addition, upon the occurrence and during the continuance of an Event of Default, the Trustee shall be entitled to all remedies available to mortgagees and secured parties under the Uniform Commercial Code or any other applicable law.

#### **SECTION 9.17. ENTRY UPON MORTGAGED PROPERTY.**

If an Event of Default shall have occurred and be continuing, the Company, upon demand of the Trustee and if and to the extent permitted by law, shall forthwith surrender to the Trustee the actual possession of, and the Trustee, by such officers or agents as it may appoint, may enter upon and take possession of, the Mortgaged Property; and the Trustee may hold, operate and manage the Mortgaged Property and make all needful repairs and such renewals, replacements, betterments and improvements as to the Trustee shall seem prudent; and the Trustee may receive, subject to the rights of others, if any, with respect thereto, the rents, issues, profits, revenues and other income of the Mortgaged Property; and, after deducting the costs and expenses of entering, taking possession, holding, operating and managing the Mortgaged Property, as well as payments for insurance and taxes and other proper charges upon the Mortgaged Property prior to the Lien of this Indenture and reasonable compensation to itself, its agents and counsel, the Trustee may apply the same as provided in Section 9.06. Whenever all that is then due in respect of the principal of and premium, if any, and interest, if any, on the Securities and under any of the terms of this Indenture shall have been paid and all defaults hereunder shall have been cured, the Trustee shall surrender possession of the Mortgaged Property to the Company.

#### **SECTION 9.18. POWER OF SALE; SUITS FOR ENFORCEMENT.**

If an Event of Default shall have occurred and be continuing, the Trustee, by such officers or agents as it shall appoint, with or without entry, in its discretion may, subject to the provisions of Section 9.12 and if and to the extent permitted by law:

(a) sell, subject to any mandatory requirements of applicable law, the Mortgaged Property as an entirety, or in such parcels as the Holders of a majority in principal amount of the Securities then Outstanding shall in writing request, or in the absence of such request, as the Trustee may determine, to the highest bidder at public auction at such place and at such time (which sale may be adjourned by the Trustee from time to time in its discretion by announcement at the time and place fixed for such sale, without further notice) and upon such terms as the Trustee may fix and briefly specify in a notice of sale to be published once in each week for four successive weeks prior to such sale in an Authorized Publication in each Place of Payment for the Securities of each series; or

(b) proceed to protect and enforce its rights and the rights of the Holders of Securities under this Indenture by sale pursuant to judicial proceedings or by a suit, action or proceeding in equity or at law or otherwise, whether for the specific performance of any covenant or agreement contained in this Indenture or in aid of the execution of any power granted in this Indenture or for the foreclosure of this Indenture or for the enforcement of any other legal, equitable or other remedy, as the Trustee, being advised by counsel, shall deem most effectual to protect and enforce any of the rights of the Trustee or the Holders of Securities.

#### **SECTION 9.19. INCIDENTS OF SALE.**

Upon any sale of any of the Mortgaged Property, whether made under the power of sale hereby given or pursuant to judicial proceedings, to the extent permitted by law:



(a) the principal amount (or, if any of the Securities are Discount Securities, such portion of the principal amount of such Securities as may be specified in the terms thereof as contemplated by Section 3.01) of all Outstanding Securities, if not previously due, shall at once become and be immediately due and payable, together with premium, if any, and accrued interest, if any, thereon;

(b) any Holder or Holders of Securities or the Trustee may bid for and purchase the property offered for sale, and upon compliance with the terms of sale may hold, retain and possess and dispose of such property, without further accountability, and may, in paying the purchase money therefor, deliver any Outstanding Securities or claims for interest thereon in lieu of cash to the amount which shall, upon distribution of the net proceeds of such sale, be payable thereon, and such Securities, in case the amounts so payable thereon shall be less than the amount due thereon, shall be returned to the Holders thereof after being appropriately stamped to show partial payment;

(c) the Trustee may make and deliver to the purchaser or purchasers a good and sufficient deed, bill of sale and instrument of assignment and transfer of the property sold;

(d) the Trustee is hereby irrevocably appointed the true and lawful attorney of the Company, in its name and stead, to make all necessary deeds, bills of sale and instruments of assignment and transfer of the property so sold; and for that purpose it may execute all necessary deeds, bills of sale and instruments of assignment and transfer, and may substitute one or more persons, firms or corporations with like power, the Company hereby ratifying and confirming all that its said attorney or such substitute or substitutes shall lawfully do by virtue hereof; but, if so requested by the Trustee or by any purchaser, the Company shall ratify and confirm any such sale or transfer by executing and delivering to the Trustee or to such purchaser or purchasers all proper deeds, bills of sale, instruments of assignment and transfer and releases as may be designated in any such request;

(e) all right, title, interest, claim and demand whatsoever, either at law or in equity or otherwise, of the Company of, in and to the property so sold shall be divested and such sale shall be a perpetual bar both at law and in equity against the Company, its successors and assigns, and against any and all persons claiming or who may claim the property sold or any part thereof from, through or under the Company; and

(f) the receipt of the Trustee or of the officer or agent making such sale shall be a sufficient discharge to the purchaser or purchasers at such sale for his or their purchase money and such purchaser or purchasers and his or their assigns or personal representatives shall not, after paying such purchase money and receiving such receipt, be obliged to see to the application of such purchase money, or be in anywise answerable for any loss, misapplication or non-application thereof.

[END OF ARTICLE NINE]

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**ARTICLE TEN.  
THE TRUSTEE**

**SECTION 10.01. CERTAIN DUTIES AND RESPONSIBILITIES.**

(a) The Trustee shall have and be subject to all the duties and responsibilities specified with respect to an indenture trustee in the Trust Indenture Act and no implied covenants or obligations shall be read into this Indenture against the Trustee. For purposes of Sections 315(a) and 315(c) of the Trust Indenture Act, the term “default” is hereby defined as an Event of Default which has occurred and is continuing.

(b) No provision of this Indenture shall require the Trustee to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder, or in the exercise of any of its rights or powers, if it shall have reasonable grounds for believing that repayment of such funds or adequate indemnity against such risk or liability is not reasonably assured to it.

(c) Notwithstanding anything contained in this Indenture to the contrary, the duties and responsibilities of the Trustee under this Indenture shall be subject to the protections, exculpations and limitations on liability afforded to an indenture trustee under the provisions of the Trust Indenture Act. For the purposes of Sections 315(b) and 315(d)(2) of the Trust Indenture Act, the term “responsible officer” is defined as a Responsible Officer (as herein defined).

(d) Whether or not therein expressly so provided, every provision of this Indenture relating to the conduct or affecting the liability of or affording protection to the Trustee shall be subject to the provisions of this Section.

**SECTION 10.02. NOTICE OF DEFAULTS.**

The Trustee shall give notice of any default hereunder known to the Trustee in the manner and to the extent required to do so by the Trust Indenture Act, unless such default shall have been cured or waived; provided, however, that in the case of any default of the character specified in Section 9.01(c), no such notice to Holders shall be given until at least 60 days after the occurrence thereof. For the purpose of this Section, the term “default” means any event which is, or after notice or lapse of time, or both, would become, an Event of Default.

**SECTION 10.03. CERTAIN RIGHTS OF TRUSTEE.**

Subject to the provisions of Section 10.01 and to the applicable provisions of the Trust Indenture Act:

(a) the Trustee may conclusively rely and shall be fully protected in acting or refraining from acting upon any resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, note, other evidence of indebtedness or other paper or document believed by it to be genuine and to have been signed or presented by the proper party or parties;

(b) any request or direction of the Company mentioned herein shall be sufficiently evidenced by a Company Request or Company Order, or as otherwise expressly provided herein, and any resolution of the Board of Directors may be sufficiently evidenced by a Board Resolution;

(c) whenever in the administration of this Indenture the Trustee shall deem it desirable that a matter be proved or established prior to taking, suffering or omitting any action hereunder, the Trustee (unless other evidence be herein specifically prescribed) may, in the absence of bad faith on its part, conclusively rely upon an Officer's Certificate;

(d) the Trustee may consult with counsel and the written advice of such counsel or any Opinion of Counsel shall be full and complete authorization and protection in respect of any action taken, suffered or omitted by it hereunder in good faith and in reliance thereon;

(e) the Trustee shall be under no obligation to exercise any of the rights or powers vested in it by this Indenture at the request or direction of any Holder pursuant to this Indenture, unless such Holder shall have offered to the Trustee reasonable security or indemnity against the costs, expenses and liabilities which might be incurred by it in compliance with such request or direction;

(f) the Trustee shall not be bound to make any investigation into the facts or matters stated in any resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, note, other evidence of indebtedness or other paper or document, but the Trustee, in its discretion, may make such further inquiry or investigation into such facts or matters as it may see fit, and, if the Trustee shall determine to make such further inquiry or investigation, it shall (subject to applicable legal requirements) be entitled to examine, during normal business hours, the books, records and premises of the Company, personally or by agent or attorney;

(g) the Trustee may execute any of the trusts or powers hereunder or perform any duties hereunder either directly or by or through agents or attorneys and the Trustee shall not be responsible for any misconduct or negligence on the part of any agent or attorney appointed with due care by it hereunder;

(h) the Trustee shall not be charged with knowledge of any default (as defined in Section 10.02) or Event of Default (other than an interest or principal payment default; provided that the Trustee is the principal Paying Agent) unless either (1) a Responsible Officer of the Trustee shall have actual knowledge of such default or Event of Default or (2) written notice of such default or Event of Default shall have been given to the Trustee by the Company or any other obligor on such Securities, or by any Holder of such Securities;

(i) the rights, privileges, protections, immunities and benefits given to the Trustee, including, without limitation, its right to be indemnified, are extended to, and shall be enforceable by, the Trustee in each of its capacities hereunder;

(j) the Trustee shall not be liable for any action taken, suffered or omitted to be taken by it in good faith and reasonably believed by it to be authorized or within the discretion or rights or powers conferred upon it by this Indenture; and

(k) in no event shall the Trustee be responsible or liable for special, indirect, or consequential loss or damage of any kind whatsoever (including, without limitation, loss of profit) irrespective of whether the Trustee has been advised of the likelihood of such loss or damage and regardless of the form of action.

**SECTION 10.04. NOT RESPONSIBLE FOR RECITALS, ISSUANCE OF SECURITIES, ETC.**

The recitals contained herein and in the Securities (except the Trustee's certificates of authentication) shall be taken as the statements of the Company, and neither the Trustee nor any Authenticating Agent assumes responsibility for their correctness. The Trustee makes no representations as to the value or condition of the Mortgaged Property, the title of the Company to the Mortgaged Property, the security afforded by the Lien of this Indenture, the validity or genuineness of any securities deposited with the Trustee hereunder, or the validity or sufficiency of this Indenture or of the Securities. Neither the Trustee nor any Authenticating Agent shall be accountable for the use or application by the Company of Securities or the proceeds thereof or any money paid to the Company hereunder. The Trustee shall not be responsible for perfecting or maintaining the perfection of any security interest granted to it hereunder or for filing, re-filing, recording or re-recording any notice or other document in any public office at any time or times or for seeing to the insurance of the Mortgaged Property or for paying or causing the payment of any taxes owing in connection therewith.

**SECTION 10.05. MAY HOLD SECURITIES.**

Each of the Trustee, any Authenticating Agent, any Paying Agent, any Security Registrar or any other agent of the Company, in its individual or any other capacity, may become the owner or pledgee of Securities and, subject to Sections 10.08 and 10.13, may otherwise deal with the Company with the same rights it would have if it were not the Trustee, Authenticating Agent, Paying Agent, Security Registrar or such other agent.

**SECTION 10.06. MONEY HELD IN TRUST.**

Money held by the Trustee in trust hereunder need not be segregated from other funds, except to the extent required by law. The Trustee shall be under no liability for interest on or investment of any money received by it hereunder except as expressly provided herein or otherwise agreed with, and for the sole benefit of, the Company.

**SECTION 10.07. COMPENSATION AND REIMBURSEMENT.**

The Company shall

(a) pay to the Trustee from time to time reasonable compensation for all services rendered by it hereunder (which compensation shall not be limited by any provision of law in regard to the compensation of a trustee of an express trust);

(b) except as otherwise expressly provided herein, reimburse the Trustee upon its request for all reasonable expenses, disbursements and advances reasonably incurred or made by the Trustee in accordance with any provision of this Indenture (including the reasonable

compensation and the expenses and disbursements of its agents and counsel), except to the extent that any such expense, disbursement or advance may be attributable to the Trustee's negligence, willful misconduct or bad faith; and

(c) indemnify the Trustee for, and hold it harmless from and against, any loss, liability or expense (including under environmental laws) reasonably incurred by it arising out of or in connection with the acceptance or administration of the trust or trusts hereunder or the performance of its duties hereunder, including the reasonable costs and expenses of defending itself against any claim or liability in connection with the exercise or performance of any of its powers or duties hereunder except to the extent any such loss, liability or expense may be attributable to its negligence, willful misconduct or bad faith.

As security for the performance of the obligations of the Company under this Section, the Trustee shall have a lien prior to the Securities upon the Mortgaged Property and all property and funds held or collected by the Trustee as such, other than property and funds held in trust under Section 8.03 (except moneys payable to the Company as provided in Section 8.03).

In addition and without prejudice to the rights provided to the Trustee under any of the provisions of this Indenture or under applicable law, when the Trustee incurs expenses or renders services in connection with an Event of Default specified in Section 9.01(d) or Section 9.01(e), the expenses (including the reasonable charges and expenses of its counsel) and the compensation for the services are intended to constitute expenses of administration under any applicable Federal and State bankruptcy, insolvency or other similar law.

The Company's obligations under this Section 10.07 and the Lien referred to in this Section 10.07 shall survive the resignation or removal of the Trustee, the discharge of the Company's obligations under Article Eight of this Indenture and/or the termination of this Indenture.

"Trustee" for purposes of this Section 10.07 shall include any predecessor Trustee; provided, however, that the negligence, willful misconduct or bad faith of any Trustee hereunder shall not affect the rights of any other Trustee hereunder.

#### **SECTION 10.08. DISQUALIFICATION; CONFLICTING INTERESTS.**

If the Trustee shall have or acquire any conflicting interest within the meaning of the Trust Indenture Act, it shall either eliminate such conflicting interest or resign to the extent, in the manner and with the effect, and subject to the conditions, provided in the Trust Indenture Act and this Indenture. For purposes of Section 310(b)(1) of the Trust Indenture Act and to the extent permitted thereby, the Trustee, in its capacity as trustee in respect of the Securities of any series, shall not be deemed to have a conflicting interest arising from its capacity as trustee in respect of the Securities of any other series issued under this Indenture. Nothing herein shall prevent the Trustee from filing with the Commission the application referred to in the second to last paragraph of Section 310(b) of the Trust Indenture Act.

**SECTION 10.09. CORPORATE TRUSTEE REQUIRED; ELIGIBILITY.**

There shall at all times be a Trustee hereunder which shall be:

(a) a corporation organized and doing business under the laws of the United States of America, any State thereof or the District of Columbia, authorized under such laws to exercise corporate trust powers, having a combined capital and surplus of at least \$50,000,000 and subject to supervision or examination by Federal, State or District of Columbia authority; or

(b) if and to the extent permitted by the Commission by rule, regulation or order upon application, a corporation or other Person organized and doing business under the laws of a foreign government, authorized under such laws to exercise corporate trust powers, having a combined capital and surplus of at least \$50,000,000 or the Dollar equivalent of the applicable foreign currency and subject to supervision or examination by authority of such foreign government or a political subdivision thereof substantially equivalent to supervision or examination applicable to United States institutional trustees; and

in either case, qualified and eligible under this Article and the Trust Indenture Act. If such corporation publishes reports of condition at least annually, pursuant to law or to the requirements of such supervising or examining authority, then for the purposes of this Section, the combined capital and surplus of such corporation shall be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published. If at any time the Trustee shall cease to be eligible in accordance with the provisions of this Section and the Trust Indenture Act, it shall resign immediately in the manner and with the effect hereinafter specified in this Article.

**SECTION 10.10. RESIGNATION AND REMOVAL; APPOINTMENT OF SUCCESSOR.**

(a) No resignation or removal of the Trustee and no appointment of a successor Trustee pursuant to this Article shall become effective until the acceptance of appointment by the successor Trustee in accordance with the applicable requirements of Section 10.11.

(b) The Trustee may resign at any time by giving written notice thereof to the Company. If the instrument of acceptance by a successor Trustee required by Section 10.11 shall not have been delivered to the resigning or removed Trustee within 30 days after the giving of such notice of resignation or receipt by the Trustee of notice of such removal, the resigning or removed Trustee may petition any court of competent jurisdiction for the appointment of a successor Trustee.

(c) The Trustee may be removed at any time by Act of the Holders of a majority in principal amount of the Outstanding Securities delivered to the Trustee and the Company.

(d) If at any time:

(i) the Trustee shall fail to comply with Section 10.08 after written request therefor by the Company or by any Holder who has been a bona fide Holder for at least six months, or

(ii) the Trustee shall cease to be eligible under Section 10.09 or Section 310(a) of the Trust Indenture Act and shall fail to resign after written request therefor by the Company or by any such Holder, or

(iii) the Trustee shall become incapable of acting or shall be adjudged a bankrupt or insolvent or a receiver of the Trustee or of its property shall be appointed or any public officer shall take charge or control of the Trustee or of its property or affairs for the purpose of rehabilitation, conservation or liquidation, then, in any such case, (x) the Company by Board Resolutions may remove the Trustee with respect to all Securities or (y) subject to Section 9.14, any Holder who has been a bona fide Holder for at least six months may, on behalf of himself and all others similarly situated, petition any court of competent jurisdiction for the removal of the Trustee with respect to all Securities and the appointment of a successor Trustee or Trustees.

(e) If the Trustee shall resign, be removed or become incapable of acting, or if a vacancy shall occur in the office of Trustee for any cause (other than as contemplated by clause (y) in subsection (d) or this Section), the Company, by Board Resolutions, shall promptly appoint a successor Trustee and shall comply with the applicable requirements of Section 10.11. If, within one year after such resignation, removal or incapability, or the occurrence of such vacancy, a successor Trustee shall be appointed by Act of the Holders of a majority in principal amount of the Outstanding Securities delivered to the Company and the retiring Trustee, the successor Trustee so appointed shall, forthwith upon its acceptance of such appointment in accordance with the applicable requirements of Section 10.11, become the successor Trustee and to that extent supersede the successor Trustee appointed by the Company. If no successor Trustee shall have been so appointed by the Company or the Holders and accepted appointment in the manner required by Section 10.11, any Holder who has been a bona fide Holder of a Security for at least six months may, on behalf of itself and all others similarly situated, petition any court of competent jurisdiction for the appointment of a successor Trustee.

(f) So long as no event which is, or after notice or lapse of time, or both, would become, an Event of Default shall have occurred and be continuing, and except with respect to a Trustee appointed by Act of the Holders of a majority in principal amount of the Outstanding Securities pursuant to subsection (e) of this Section, if the Company shall have delivered to the Trustee (i) a Board Resolution appointing a successor Trustee, effective as of a date specified therein, and (ii) an instrument of acceptance of such appointment, effective as of such date, by such successor Trustee in accordance with Section 10.11, the Trustee shall be deemed to have resigned as contemplated in subsection (b) of this Section, the successor Trustee shall be deemed to have been appointed by the Company pursuant to subsection (e) of this Section and such appointment shall be deemed to have been accepted as contemplated in Section 10.11, all as of such date, and all other provisions of this Section and Section 10.11 shall be applicable to such resignation, appointment and acceptance except to the extent inconsistent with this subsection (f).

(g) The Company shall give notice of each resignation and each removal of the Trustee and each appointment of a successor Trustee to all Holders of Securities in the manner provided in Section 1.08. Each notice shall include the name of the successor Trustee and the address of its Corporate Trust Office.

**SECTION 10.11. ACCEPTANCE OF APPOINTMENT BY SUCCESSOR.**

(a) In case of the appointment hereunder of a successor Trustee, every such successor Trustee so appointed shall execute, acknowledge and deliver to the Company and to the retiring Trustee an instrument accepting such appointment, and thereupon the resignation or removal of the retiring Trustee shall become effective and such successor Trustee, without any further act, deed or conveyance, shall become vested with all the rights, powers, trusts and duties of the retiring Trustee; but, on the request of the Company or the successor Trustee, such retiring Trustee shall, upon payment of all sums owed to it, execute and deliver an instrument transferring to such successor Trustee all the rights, powers and trusts of the retiring Trustee and shall duly assign, transfer and deliver to such successor Trustee all property and money held by such retiring Trustee hereunder, subject nevertheless to its Lien provided for in Section 10.07.

(b) Upon request of any such successor Trustee, the Company shall execute any instruments for more fully and certainly vesting in and confirming to such successor Trustee all such rights, powers and trusts referred to in subsection (a) of this Section.

(c) No successor Trustee shall accept its appointment unless at the time of such acceptance such successor Trustee shall be qualified and eligible under this Article.

**SECTION 10.12. MERGER, CONVERSION, CONSOLIDATION OR SUCCESSION TO BUSINESS.**

Any corporation into which the Trustee may be merged or converted or with which it may be consolidated, or any corporation resulting from any merger, conversion or consolidation to which the Trustee shall be a party, or any corporation succeeding to all or substantially all the corporate trust business of the Trustee, shall be the successor of the Trustee hereunder, provided such corporation shall be otherwise qualified and eligible under this Article, without the execution or filing of any paper or any further act on the part of any of the parties hereto. In case any Securities shall have been authenticated, but not delivered, by the Trustee then in office, any successor by merger, conversion or consolidation to such authenticating Trustee may adopt such authentication and deliver the Securities so authenticated with the same effect as if such successor Trustee had itself authenticated such Securities.

**SECTION 10.13. PREFERENTIAL COLLECTION OF CLAIMS AGAINST COMPANY.**

If the Trustee shall be or become a creditor of the Company or any other obligor upon the Securities (other than by reason of a relationship described in Section 311(b) of the Trust Indenture Act), the Trustee shall be subject to any and all applicable provisions of the Trust Indenture Act regarding the collection of claims against the Company or such other obligor. For purposes of Section 311(b) of the Trust Indenture Act (a) the term "cash transaction" shall have the meaning provided in Rule 11b-4 under the Trust Indenture Act, and (b) the term "self-liquidating paper" shall have the meaning provided in Rule 11b-6 under the Trust Indenture Act.



#### **SECTION 10.14. CO-TRUSTEE AND SEPARATE TRUSTEES.**

At any time or times, for the purpose of meeting the legal requirements of any applicable jurisdiction, the Company and the Trustee shall have power to appoint, and, upon the written request of the Trustee or of the Holders of at least 35% in principal amount of the Securities then Outstanding, the Company shall for such purpose join with the Trustee in the execution and delivery of all instruments and agreements necessary or proper to appoint, one or more Persons approved by the Trustee either to act as co-trustee, jointly with the Trustee, or to act as separate trustee, in either case with such powers as may be provided in the instrument of appointment, and to vest in such Person or Persons, in the capacity aforesaid, any property, title, right or power deemed necessary or desirable, subject to the other provisions of this Section.

If the Company does not join in such appointment within 15 days after the receipt by it of a request so to do, or if an Event of Default shall have occurred and be continuing, the Trustee alone shall have power to make such appointment.

Should any written instrument or instruments from the Company be required by any co-trustee or separate trustee to more fully confirm to such co-trustee or separate trustee such property, title, right or power, any and all such instruments shall, on request, be executed, acknowledged and delivered by the Company.

Every co-trustee or separate trustee shall, to the extent permitted by law, but to such extent only, be appointed subject to the following conditions:

(a) the Securities shall be authenticated and delivered, and all rights, powers, duties and obligations hereunder in respect of the custody of securities, cash and other personal property held by, or required to be deposited or pledged with, the Trustee hereunder, shall be exercised solely, by the Trustee;

(b) the rights, powers, duties and obligations hereby conferred or imposed upon the Trustee in respect of any property covered by such appointment shall be conferred or imposed upon and exercised or performed either by the Trustee or by the Trustee and such co-trustee or separate trustee jointly, as shall be provided in the instrument appointing such co-trustee or separate trustee, except to the extent that under any law of any jurisdiction in which any particular act is to be performed, the Trustee shall be incompetent or unqualified to perform such act, in which event such rights, powers, duties and obligations shall be exercised and performed by such co-trustee or separate trustee.

(c) the Trustee at any time, by an instrument in writing executed by it, with the concurrence of the Company, may accept the resignation of or remove any co-trustee or separate trustee appointed under this Section, and, if an Event of Default shall have occurred and be continuing, the Trustee shall have power to accept the resignation of, or remove, any such co-trustee or separate trustee without the concurrence of the Company. Upon the written request of the Trustee, the Company shall join with the Trustee in the execution and delivery of all instruments and agreements necessary or proper to effectuate such resignation or removal. A successor to any co-trustee or separate trustee so resigned or removed may be appointed in the manner provided in this Section;

(d) no co-trustee or separate trustee hereunder shall be personally liable by reason of any act or omission of the Trustee, or any other such trustee hereunder, and the Trustee shall not be personally liable by reason of any act or omission of any such co-trustee or separate trustee; and

(e) any Act of Holders delivered to the Trustee shall be deemed to have been delivered to each such co-trustee and separate trustee.

#### **SECTION 10.15. APPOINTMENT OF AUTHENTICATING AGENT.**

The Trustee may appoint an Authenticating Agent or Agents with respect to the Securities of one or more series, or any Tranche thereof, which shall be authorized to act on behalf of the Trustee to authenticate Securities of such series or Tranche issued upon original issuance, exchange, registration of transfer or partial redemption thereof or pursuant to Section 3.06, and Securities so authenticated shall be entitled to the benefits of this Indenture and shall be valid and obligatory for all purposes as if authenticated by the Trustee hereunder. Wherever reference is made in this Indenture to the authentication and delivery of Securities by the Trustee or the Trustee's certificate of authentication, such reference shall be deemed to include authentication and delivery on behalf of the Trustee by an Authenticating Agent and a certificate of authentication executed on behalf of the Trustee by an Authenticating Agent. Each Authenticating Agent shall be acceptable to the Company and shall at all times be a corporation organized and doing business under the laws of the United States of America, any State or territory thereof or the District of Columbia or the Commonwealth of Puerto Rico, authorized under such laws to act as Authenticating Agent, having a combined capital and surplus of not less than \$50,000,000 and subject to supervision or examination by Federal or State authority. If such Authenticating Agent publishes reports of condition at least annually, pursuant to law or to the requirements of said supervising or examining authority, then for the purposes of this Section, the combined capital and surplus of such Authenticating Agent shall be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published. If at any time an Authenticating Agent shall cease to be eligible in accordance with the provisions of this Section, such Authenticating Agent shall resign immediately in the manner and with the effect specified in this Section.

Any corporation into which an Authenticating Agent may be merged or converted or with which it may be consolidated, or any corporation resulting from any merger, conversion or consolidation to which such Authenticating Agent shall be a party, or any corporation succeeding to the corporate agency or corporate trust business of an Authenticating Agent, shall continue to be an Authenticating Agent, provided such corporation shall be otherwise eligible under this Section, without the execution or filing of any paper or any further act on the part of the Trustee or the Authenticating Agent.

An Authenticating Agent may resign at any time by giving written notice thereof to the Trustee and the Company. The Trustee may at any time terminate the agency of an Authenticating Agent by giving written notice thereof to such Authenticating Agent and the Company. Upon receiving such a notice of resignation or upon such a termination, or in case at any time such Authenticating Agent shall cease to be eligible in accordance with the provisions of this Section, the Trustee may appoint a successor Authenticating Agent which shall be

acceptable to the Company. Any successor Authenticating Agent upon acceptance of its appointment hereunder shall become vested with all the rights, powers and duties of its predecessor hereunder, with like effect as if originally named as an Authenticating Agent. No successor Authenticating Agent shall be appointed unless eligible under the provisions of this Section.

The Company agrees to pay to each Authenticating Agent, from time to time, reasonable compensation for its services under this Section.

The provisions of Sections 3.08, 10.04 and 10.05 shall be applicable to each Authenticating Agent.

If an appointment with respect to the Securities of one or more series, or any Tranche thereof, shall be made pursuant to this Section, the Securities of such series or Tranche may have endorsed thereon, in addition to the Trustee's certificate of authentication, an alternate certificate of authentication substantially in the following form:

This is one of the Securities of the series designated therein referred to in the within-mentioned Indenture.

THE BANK OF NEW YORK MELLON TRUST  
COMPANY, N.A., As Trustee

By [Name of Authenticating Agent],  
As Authenticating Agent

By \_\_\_\_\_  
Authorized Officer

If all of the Securities of a series may not be originally issued at one time, and if the Trustee does not have an office capable of authenticating Securities upon original issuance located in a Place of Payment where the Company wishes to have Securities of such series authenticated upon original issuance, the Trustee, if so requested by the Company in writing (which writing need not comply with Section 1.04 and need not be accompanied by an Opinion of Counsel), shall appoint, in accordance with this Section and in accordance with such procedures as shall be acceptable to the Trustee, an Authenticating Agent having an office in a Place of Payment designated by the Company with respect to such series of Securities.

[END OF ARTICLE TEN]

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**ARTICLE ELEVEN.**

**HOLDERS' LISTS AND REPORTS BY TRUSTEE AND COMPANY**

**SECTION 11.01. LISTS OF HOLDERS.**

Semiannually, not later than April 1 and October 1 in each year, commencing October 1, 2009 and at such other times as the Trustee may request in writing, the Company shall furnish or cause to be furnished to the Trustee information as to the names and addresses of the Holders, and the Trustee shall preserve such information and similar information received by it in any other capacity and afford to the Holders access to information so preserved by it, all to such extent, if any, and in such manner as shall be required by the Trust Indenture Act; provided, however, that no such list need be furnished so long as the Trustee shall be the Security Registrar.

**SECTION 11.02. REPORTS BY TRUSTEE AND COMPANY.**

The Trustee shall transmit to the Holders, the Commission and each securities exchange upon which any Securities are listed, on or before July 1, 2009, and on or before the first day of July in each year thereafter, a report as of the last preceding fifteenth day of May, with respect to any events and other matters described in Section 313(a) of the Trust Indenture Act, which may have occurred within the previous 12 months (but if no event has occurred within such period no report need be transmitted), in such manner and to the extent required by the Trust Indenture Act. The Trustee shall transmit to the Holders, the Commission and each securities exchange upon which any Securities are listed, and the Company shall file with the Trustee (within 30 days after filing with the Commission in the case of reports which pursuant to Section 314(a) of the Trust Indenture Act must be filed with the Commission and furnished to the Trustee) and transmit to the Holders, such information, reports and other documents, if any, at such times and in such manner, as shall be required by Section 314(a) of the Trust Indenture Act. The Company shall notify the Trustee of the listing of any Securities on any securities exchange and of any delisting thereof.

Delivery of such reports, information and documents to the Trustee is for informational purposes only, and the Trustee's receipt of such shall not constitute notice or constructive notice of any information contained therein or determinable from information contained therein, including the Company's compliance with any of its covenants hereunder (as to which the Trustee is entitled to rely exclusively on Officer's Certificates).

The Company shall file with the Trustee (within thirty (30) days after filing with the Commission in the case of reports that pursuant to Section 314(a) of the Trust Indenture Act must be filed with the Commission and furnished to the Trustee) and transmit to the Holders, such information, reports and other documents, if any, at such times and in such manner, as shall be required by Section 314(a) of the Trust Indenture Act.

[END OF ARTICLE ELEVEN]

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**ARTICLE TWELVE.**

**CONSOLIDATION, MERGER, CONVEYANCE, OR OTHER TRANSFER**

**SECTION 12.01. COMPANY MAY CONSOLIDATE, ETC., ONLY ON CERTAIN TERMS.**

The Company shall not consolidate with or merge into any other corporation, or convey or otherwise transfer, or lease, as or substantially as an entirety the Mortgaged Property to any Person, unless:

(a) the corporation formed by such consolidation or into which the Company is merged or the Person which acquires by conveyance or other transfer, or which leases, as or substantially as an entirety such Mortgaged Property shall be a corporation organized and existing under the laws of the United States, any State or Territory thereof or the District of Columbia (such corporation being hereinafter sometimes called the “**Successor Company**”) and shall execute and deliver to the Trustee an indenture supplemental hereto, in form recordable and reasonably satisfactory to the Trustee, which:

(i) in the case of a consolidation, merger, conveyance or other transfer, or in the case of a lease if the term thereof extends beyond the last Stated Maturity of the Securities then Outstanding, contains an express assumption by the Successor Company of the due and punctual payment of the principal of and premium, if any, and interest, if any, on all the Securities then Outstanding and the performance and observance of every covenant and condition of this Indenture to be performed or observed by the Company, and

(ii) in the case of a consolidation, merger, conveyance or other transfer contains a grant, conveyance, transfer and mortgage by the Successor Company, of the same tenor of the Granting Clauses herein,

(A) confirming the Lien of this Indenture on the Mortgaged Property (as constituted immediately prior to the time such transaction became effective) and subjecting to the Lien of this Indenture all property, real, personal and mixed, thereafter acquired by the Successor Company which shall constitute an improvement, extension or addition to the Mortgaged Property (as so constituted) or a renewal, replacement or substitution of or for any part thereof, and,

(B) at the election of the Successor Company, subjecting to the Lien of this Indenture such property, real, personal or mixed, in addition to the property described in subclause (A) above, then owned or thereafter acquired by the Successor Company as the Successor Company shall, in its sole discretion, specify or describe therein,

and the Lien confirmed or created by such grant, conveyance, transfer and mortgage shall have force, effect and standing similar to those which the Lien of this Indenture would have had if the Company had not been a party to such consolidation, merger, conveyance or other transfer and

had itself, after the time such transaction became effective, purchased, constructed or otherwise acquired the property subject to such grant, conveyance, transfer and mortgage;

(b) in the case of a lease, such lease shall be made expressly subject to termination at any time during the continuance of an Event of Default, by (i) the Company or the Trustee and (ii) the purchaser of the property so leased at any sale thereof hereunder, whether such sale be made under the power of sale hereby conferred or pursuant to judicial proceedings;

(c) the Company shall have delivered to the Trustee an *Officer's Certificate* and an *Opinion of Counsel* each of which shall state that such consolidation, merger, conveyance or other transfer or lease, and such supplemental indenture, comply with this Article and that all conditions precedent herein provided for relating to such transaction have been complied with; and

(d) immediately after giving effect to such transaction (and treating any debt that becomes an obligation of the Successor Company as a result of such transaction as having been incurred by the Successor Company at the time of such transaction), no Default or Event of Default shall have occurred and be continuing.

As used in this Article and in Section 17.09(d), the terms "improvement", "extension" and "addition" shall be limited to (a) with respect to real property subject to the Lien of this Indenture, any item of personal property which has been so affixed or attached to such real property as to be regarded a part of such real property under applicable law and (b) with respect to personal property subject to the Lien of this Indenture, any improvement, extension or addition to such personal property which (i) is made to maintain, renew, repair or improve the function of such personal property and (ii) is physically installed in or affixed to such personal property.

#### **SECTION 12.02. SUCCESSOR COMPANY SUBSTITUTED.**

Upon any consolidation or merger or any conveyance or other transfer of, as or substantially as an entirety the Mortgaged Property in accordance with Section 12.01, the Successor Company shall succeed to, and be substituted for, and may exercise every power and right of, the Company under this Indenture with the same effect as if such Successor Company had been named as the "Company" herein. Without limiting the generality of the foregoing:

(a) all property of the Successor Company then subject to the Lien of this Indenture, of the character described in Section 1.03, shall constitute Property Additions;

(b) the Successor Company may execute and deliver to the Trustee, and thereupon the Trustee shall, subject to the provisions of Article Sixteen, authenticate and deliver, Securities upon any basis provided in Article Sixteen; and

(c) the Successor Company may, subject to the applicable provisions of this Indenture, cause Property Additions to be applied to any other Authorized Purpose.

All Securities executed by the Successor Company, and authenticated and delivered by the Trustee, shall in all respects be entitled to the benefit of the Lien of this Indenture equally and

ratably with all Securities executed, authenticated and delivered prior to the time such consolidation, merger, conveyance or other transfer became effective.

**SECTION 12.03. EXTENT OF LIEN HEREOF ON PROPERTY OF SUCCESSOR COMPANY.**

Unless, in the case of a consolidation, merger, conveyance or other transfer contemplated by Section 12.01, the indenture supplemental hereto contemplated in Section 12.01 or in Article Thirteen expressly provides otherwise, neither this Indenture nor such supplemental indenture shall become or be, or be required to become or be, a Lien upon any of the properties:

(a) owned by the Successor Company or any other party to such transaction (other than the Company) immediately prior to the time of effectiveness of such transaction; or

(b) acquired by the Successor Company at or after the time of effectiveness of such transaction;

except, in either case, properties (other than Excepted Property) acquired from the Company in or as a result of such transaction and improvements, extensions and additions to such properties and renewals, replacements and substitutions of or for any part or parts thereof.

**SECTION 12.04. RELEASE OF COMPANY UPON CONVEYANCE OR OTHER TRANSFER.**

In the case of a conveyance or other transfer to any Person or Persons as contemplated in Section 12.01, upon the satisfaction of all the conditions specified in Section 12.01 the Company (such term being used in this Section without giving effect to such transaction) shall be released and discharged from all obligations and covenants under this Indenture and on and under all Securities then Outstanding (unless the Company shall have delivered to the Trustee an instrument in which it shall waive such release and discharge) and, upon request by the Company, the Trustee shall acknowledge in writing that the Company has been so released and discharged.

**SECTION 12.05. MERGER INTO COMPANY; EXTENT OF LIEN HEREOF.**

(a) Nothing in this Indenture shall be deemed to prevent or restrict any consolidation or merger after the consummation of which the Company would be the surviving or resulting corporation or any conveyance or other transfer, or lease, of any part of the Mortgaged Property which does not constitute the entirety or substantially the entirety of the Mortgaged Property.

(b) Unless, in the case of a consolidation or merger described in subsection (a) of this Section, an indenture supplemental hereto shall otherwise provide, this Indenture shall not become or be, or be required to become or be, a Lien upon any of the properties acquired by the Company in or as a result of such transaction or any improvements, extensions or additions to such properties or any renewals, replacements or substitutions of or for any part or parts thereof.

**SECTION 12.06. TRANSFER OF LESS THAN SUBSTANTIALLY ALL.**

A conveyance, transfer or lease by the Company of any part of the Mortgaged Property shall not be deemed to constitute the conveyance, transfer or lease as, or substantially as, an entirety of the Mortgaged Property for purposes of this Indenture if the Fair Value of the Mortgaged Property retained by the Company exceeds one hundred fifty percent (150%) of the aggregate principal amount of all Outstanding Securities and any other outstanding debt of the Company secured by a Purchase Money Lien that ranks equally with, or senior to, the Securities with respect to such Mortgaged Property. Such Fair Value shall be established by the delivery to the Trustee of an Independent Expert's Certificate stating the Independent Expert's opinion of such Fair Value as of a date not more than 90 days before or after such conveyance, transfer or lease. This Article is not intended to limit the Company's conveyances, transfers or leases of less than substantially the entirety of the Mortgaged Property.

[END OF ARTICLE TWELVE]

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**ARTICLE THIRTEEN.  
SUPPLEMENTAL INDENTURES**

**SECTION 13.01. SUPPLEMENTAL INDENTURES WITHOUT CONSENT OF HOLDERS.**

Without the consent of any Holders, the Company and the Trustee, at any time and from time to time, may enter into one or more indentures supplemental hereto, in form satisfactory to the Trustee, for any of the following purposes:

- (a) to evidence the succession of another Person to the Company and the assumption by any such successor of the covenants of the Company herein and in the Securities all as provided in Article Twelve; or
- (b) to add one or more covenants of the Company or other provisions for the benefit of the Holders of the Securities or to surrender any right or power herein conferred upon the Company (and if such is the case, stating that such covenants are to be in effect for only so long as a particular series of Securities, or one or more Tranches thereof, shall be Outstanding); or
- (c) to add any additional Events of Default (and if such is the case, stating that such additional Events of Default are to be in effect for only so long as a particular series of Securities, or one or more Tranches thereof, shall be Outstanding); or
- (d) to change or eliminate any provision of this Indenture or to add any new provision to this Indenture; provided, however, that if such change, elimination or addition shall adversely affect the interests of the Holders of Securities of any series or Tranche Outstanding on the date of such supplemental indenture in any material respect, such change, elimination or addition shall become effective with respect to such series or Tranche only pursuant to the provisions of Section 13.02 hereof or when no Security of such series or Tranche remains Outstanding; or
- (e) to provide additional collateral security for the Securities; or
- (f) to establish the form or terms of Securities of any series or Tranche as contemplated by Sections 2.01 and 3.01; or
- (g) to provide for the authentication and delivery of bearer securities and coupons appertaining thereto representing interest, if any, thereon and for the procedures for the registration, exchange and replacement thereof and for the giving of notice to, and the solicitation of the vote or consent of, the holders thereof, and for any and all other matters incidental thereto; or
- (h) to evidence and provide for the acceptance of appointment hereunder by a separate or successor Trustee with respect to the Securities and to add to or change any of the provisions of this Indenture as shall be necessary to provide for or facilitate the administration of the trusts hereunder by (1) more than one Trustee, pursuant to the requirements of Section 10.14, or (2) a successor Trustee, pursuant to the requirements of Section 10.11(b); or

(i) to provide for the procedures required to permit the Company to utilize, at its option, a non-certificated system of registration for all, or any series or Tranche of, the Securities; or

(j) to change any place or places where (1) the principal of and premium, if any, and interest, if any, on all or any series of Securities, or any Tranche thereof, shall be payable, (2) all or any series of Securities, or any Tranche thereof, may be surrendered for registration of transfer, (3) all or any series of Securities, or any Tranche thereof, may be surrendered for exchange and (4) notices and demands to or upon the Company in respect of all or any series of Securities, or any Tranche thereof, and this Indenture may be served;

(k) to amend and restate this Indenture, as originally executed and delivered and as it may have been subsequently amended, in its entirety, but with such additions, deletions and other changes as shall not adversely affect the interests of the Holders of Securities of any series or Tranche in any material respect; or

(l) to cure any ambiguity, to correct or supplement any provision herein which may be defective or inconsistent with any other provision herein, or to make any other changes to the provisions hereof or to add other provisions with respect to matters or questions arising under this Indenture, provided that such other changes or additions shall not materially adversely affect the interests of the Holders of Securities of any series or Tranche in any material respect.

Without limiting the generality of the foregoing, if the Trust Indenture Act as in effect at the Execution Date or at any time thereafter shall be amended and

(x) if any such amendment shall require one or more changes to any provisions hereof or the inclusion herein of any additional provisions, or shall by operation of law be deemed to effect such changes or incorporate such provisions by reference or otherwise, this Indenture shall be deemed to have been amended so as to conform to such amendment to the Trust Indenture Act, and the Company and the Trustee may, without the consent of any Holders, enter into an indenture supplemental hereto to evidence such amendment hereof; or

(y) if any such amendment shall permit one or more changes to, or the elimination of, any provisions hereof which, at the Execution Date or at any time thereafter, are required by the Trust Indenture Act to be contained herein or are contained herein to reflect any provision of the Trust Indenture Act as in effect at such date, this Indenture may be amended to effect such changes or elimination, and the Company and the Trustee may, without the consent of any Holders, enter into an indenture supplemental hereto to effect such changes or elimination or evidence such amendment.

#### **SECTION 13.02. SUPPLEMENTAL INDENTURES WITH CONSENT OF HOLDERS.**

Subject to the provisions of Section 13.01, with the consent of the holders of not less than a majority in aggregate principal amount of the Securities of all series then Outstanding under this Indenture, considered as one class, by Act of said Holders delivered to the Company and the Trustee, the Company, when authorized by a Board Resolution, and the Trustee may enter into an indenture or indentures supplemental hereto for the purpose of adding any provisions to, or changing in any manner or eliminating any of the provisions of, this Indenture; provided,

however, that if there shall be Securities of more than one series Outstanding hereunder and if a proposed supplemental indenture shall directly affect the rights of the Holders of Securities of one or more, but less than all, of such series, then the consent only of the Holders of a majority in aggregate principal amount of the Outstanding Securities of all series so directly affected, considered as one class, shall be required; and provided, further, that if the Securities of any series shall have been issued in more than one Tranche and if the proposed supplemental indenture shall directly affect the rights of the Holders of Securities of one or more, but less than all, of such Tranches, then the consent only of the Holders of a majority in aggregate principal amount of the Outstanding Securities of all Tranches so directly affected, considered as one class, shall be required; and provided, further, that no such supplemental indenture shall, without the consent of the Holder of each Outstanding Security of each series or Tranche so directly affected,

(a) change the Stated Maturity of the principal of, or any installment of principal of or interest on, any Security (other than pursuant to the terms thereof), or reduce the principal amount thereof or the rate of interest thereon (or the amount of any installment of interest thereon) or change the method of calculating such rate or reduce any premium payable upon the redemption thereof, or reduce the amount of the principal of a Discount Security that would be due and payable upon a declaration of acceleration of the Maturity thereof pursuant to Section 9.02, or change the coin or currency (or other property), in which any Security or any premium or the interest thereon is payable, or impair the right to institute suit for the enforcement of any such payment on or after the Stated Maturity thereof (or, in the case of redemption, on or after the Redemption Date), or

(b) permit the creation of any Lien ranking prior to the Lien of this Indenture with respect to the Mortgaged Property or terminate the Lien of this Indenture on the Mortgaged Property or deprive such Holder of the benefit of the security of the Lien of this Indenture, or

(c) reduce the percentage in principal amount of the Outstanding Securities of any series or any Tranche thereof, the consent of the Holders of which is required for any such supplemental indenture, or the consent of the Holders of which is required for any waiver of compliance with any provision of this Indenture or of any default hereunder and its consequences, or reduce the requirements of Section 14.04 for quorum or voting, or

(d) modify any of the provisions of this Section, Section 7.06 or Section 9.13 with respect to the Securities of any series, or any Tranche thereof, except to increase the percentages in principal amount referred to in this Section or such other Sections or to provide that other provisions of this Indenture cannot be modified or waived without the consent of the Holder of each Outstanding Security affected thereby.

A supplemental indenture entered into pursuant to this Section which (x) changes or eliminates any covenant or other provision of this Indenture which is to remain in effect only so long as there shall be Outstanding, Securities of one or more particular series, or one or more Tranches thereof, or (y) modifies the rights of the Holders of Securities of such series or Tranches with respect to such covenant or other provision, shall be deemed not to affect the rights under this Indenture of the Holders of Securities of any other series or Tranche.

It shall not be necessary for any Act of Holders under this Section to approve the particular form of any proposed supplemental indenture, but it shall be sufficient if such Act shall approve the substance thereof.

Anything in this Indenture to the contrary notwithstanding, if the Officer's Certificate, supplemental indenture or Board Resolution, as the case may be, establishing the Securities of any series or Tranche shall provide that the Company may make certain specified additions, changes or eliminations to or from the Indenture which shall be specified in such Officer's Certificate, supplemental indenture or Board Resolution establishing such series or Tranche, (a) the Holders of Securities of such series or Tranche shall be deemed to have consented to a supplemental indenture containing such additions, changes or eliminations to or from the Indenture which shall be specified in such Officer's Certificate, supplemental indenture or Board Resolution establishing such series or Tranche, (b) no Act of such Holders shall be required to evidence such consent and (c) such consent may be counted in the determination of whether or not the Holders of the requisite principal amount of Securities shall have consented to such supplemental indenture.

#### **SECTION 13.03. EXECUTION OF SUPPLEMENTAL INDENTURES.**

In executing, or accepting the additional trusts created by, any supplemental indenture permitted by this Article or the modifications thereby of the trusts created by this Indenture, the Trustee shall be entitled to receive, and (subject to Section 10.01) shall be fully protected in relying upon, an Opinion of Counsel and an Officer's Certificate stating that the execution of such supplemental indenture is authorized or permitted by this Indenture and containing the statements required by Section 1.04. The Trustee may, but shall not be obligated to, enter into any such supplemental indenture which adversely affects the Trustee's own rights, duties, immunities or liabilities under this Indenture or otherwise.

#### **SECTION 13.04. EFFECT OF SUPPLEMENTAL INDENTURES.**

Upon the execution of any supplemental indenture under this Article, this Indenture shall be modified in accordance therewith, and such supplemental indenture shall form a part of this Indenture for all purposes; and every Holder of Securities theretofore or thereafter authenticated and delivered hereunder shall be bound thereby. Any supplemental indenture permitted by this Article may restate this Indenture in its entirety, and, upon the execution and delivery thereof, any such restatement shall supersede this Indenture as theretofore in effect for all purposes.

#### **SECTION 13.05. CONFORMITY WITH TRUST INDENTURE ACT.**

Every supplemental indenture executed pursuant to this Article shall conform to the requirements of the Trust Indenture Act as then in effect.

#### **SECTION 13.06. REFERENCE IN SECURITIES TO SUPPLEMENTAL INDENTURES.**

Securities of any series, or any Tranche thereof, authenticated and delivered after the execution of any supplemental indenture pursuant to this Article may, and shall if required by the Trustee, bear a notation in form approved by the Company as to any matter provided for in such supplemental indenture. If the Company shall so determine, new Securities of any series, or any

Tranche thereof, so modified as to conform, in the opinion of the Trustee and the Company, to any such supplemental indenture may be prepared and executed by the Company, and authenticated and delivered by the Trustee in exchange for Outstanding Securities of such series or Tranche.

**SECTION 13.07. MODIFICATION WITHOUT SUPPLEMENTAL INDENTURE.**

To the extent, if any, that the terms of any particular series of Securities shall have been established in or pursuant to a Board Resolution or an Officer's Certificate pursuant to a supplemental indenture or Board Resolution as contemplated by Section 3.01, and not in an indenture supplemental hereto, additions to, changes in or the elimination of any of such terms may be effected by means of a supplemental Board Resolution or Officer's Certificate pursuant to a Board Resolution or a supplemental indenture and complying with the requirements of Section 1.04, as the case may be, delivered to, and accepted by, the Trustee in writing; provided, however, that such supplemental Board Resolution or Officer's Certificate shall not be accepted by the Trustee or otherwise be effective unless all conditions set forth in this Indenture which would be required to be satisfied if such additions, changes or elimination were contained in a supplemental indenture shall have been appropriately satisfied. Upon the written acceptance thereof by the Trustee, any such supplemental Board Resolution or Officer's Certificate shall be deemed to be effective and constitute part of the Indenture and a supplemental indenture hereunder, including for purposes of Section 17.14. Such acceptance shall be conveyed by a written instrument signed by a Responsible Officer of the Trustee.

[END OF ARTICLE THIRTEEN]

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**ARTICLE FOURTEEN.**  
**MEETINGS OF HOLDERS; ACTION WITHOUT MEETING**

**SECTION 14.01. PURPOSES FOR WHICH MEETINGS MAY BE CALLED.**

A meeting of Holders of Securities of one or more, or all, series, or any Tranche or Tranches thereof, may be called at any time and from time to time pursuant to this Article to make, give or take any request, demand, authorization, direction, notice, consent, waiver or other action provided by this Indenture to be made, given or taken by Holders of Securities of such series or Tranches.

**SECTION 14.02. CALL, NOTICE AND PLACE OF MEETINGS.**

(a) The Trustee may at any time call a meeting of Holders of Securities of one or more, or all, series, or any Tranche or Tranches thereof, for any purpose specified in Section 14.01, to be held at such time and at such place in the Borough of Manhattan, The City of New York, as the Trustee shall determine, or, with the approval of the Company, at any other place. Notice of every such meeting, setting forth the time and the place of such meeting and in general terms the action proposed to be taken at such meeting, shall be given, in the manner provided in Section 1.08, not less than 21 nor more than 180 days prior to the date fixed for the meeting.

(b) If the Trustee shall have been requested to call a meeting of the Holders of Securities of one or more, or all, series, or any Tranche or Tranches thereof, by the Company or by the Holders of 35% in aggregate principal amount of all of such series and Tranches, considered as one class, for any purpose specified in Section 14.01, by written request setting forth in reasonable detail the action proposed to be taken at the meeting, and the Trustee shall not have given the notice of such meeting within 21 days after receipt of such request or shall not thereafter proceed to cause the meeting to be held as provided herein, then the Company or the Holders of Securities of such series and Tranches in the amount above specified, as the case may be, may determine the time and the place in the Borough of Manhattan, The City of New York, or in such other place as shall be determined or approved by the Company, for such meeting and may call such meeting for such purposes by giving notice thereof as provided in subsection (a) of this Section.

(c) Any meeting of Holders of Securities of one or more, or all, series, or any Tranche or Tranches thereof, shall be valid without notice if the Holders of all Outstanding Securities of such series or Tranches are present in person or by proxy and if representatives of the Company and the Trustee are present, or if notice is waived in writing before or after the meeting by the Holders of all Outstanding Securities of such series, or any Tranche or Tranches thereof or by such of them as are not present at the meeting in person or by proxy, and by the Company and the Trustee.

**SECTION 14.03. PERSONS ENTITLED TO VOTE AT MEETINGS.**

To be entitled to vote at any meeting of Holders of Securities of one or more, or all, series, or any Tranche or Tranches thereof, a Person shall be (a) a Holder of one or more Outstanding Securities of such series or Tranches, or (b) a Person appointed by an instrument in

writing as proxy for a Holder or Holders of one or more Outstanding Securities of such series or Tranches by such Holder or Holders. The only Persons who shall be entitled to attend any meeting of Holders of Securities of any series or Tranche shall be the Persons entitled to vote at such meeting and their counsel, any representatives of the Trustee and its counsel and any representatives of the Company and its counsel.

#### **SECTION 14.04. QUORUM; ACTION.**

The Persons entitled to vote a majority in aggregate principal amount of the Outstanding Securities of the series and Tranches with respect to which a meeting shall have been called as hereinbefore provided, considered as one class, shall constitute a quorum for a meeting of Holders of Securities of such series and Tranches; provided, however, that if any action is to be taken at such meeting which this Indenture expressly provides may be taken by the Holders of a specified percentage, which is less than a majority, in principal amount of the Outstanding Securities of such series and Tranches, considered as one class, the Persons entitled to vote such specified percentage in principal amount of the Outstanding Securities of such series and Tranches, considered as one class, shall constitute a quorum. In the absence of a quorum within one hour of the time appointed for any such meeting, the meeting shall, if convened at the request of Holders of Securities of such series and Tranches, be dissolved. In any other case the meeting may be adjourned for such period as may be determined by the chairman of the meeting prior to the adjournment of such meeting. In the absence of a quorum at any such adjourned meeting, such adjourned meeting may be further adjourned for such period as may be determined by the chairman of the meeting prior to the adjournment of such adjourned meeting. Except as provided by Section 14.05(e), notice of the reconvening of any meeting adjourned for more than 30 days shall be given as provided in Section 14.02(a) not less than ten days prior to the date on which the meeting is scheduled to be reconvened. Notice of the reconvening of an adjourned meeting shall state expressly the percentage, as provided above, of the principal amount of the Outstanding Securities of such series and Tranches which shall constitute a quorum.

Except as limited by Section 13.02, any resolution presented to a meeting or adjourned meeting duly reconvened at which a quorum is present as aforesaid may be adopted only by the affirmative vote of the Holders of a majority in aggregate principal amount of the Outstanding Securities of the series and Tranches with respect to which such meeting shall have been called, considered as one class; provided, however, that, except as so limited, any resolution with respect to any action which this Indenture expressly provides may be taken by the Holders of a specified percentage, which is less than a majority, in principal amount of the Outstanding Securities of such series and Tranches, considered as one class, may be adopted at a meeting or an adjourned meeting duly reconvened and at which a quorum is present as aforesaid by the affirmative vote of the Holders of such specified percentage in principal amount of the Outstanding Securities of such series and Tranches, considered as one class.

Any resolution passed or decision taken at any meeting of Holders of Securities duly held in accordance with this Section shall be binding on all the Holders of Securities of the series and Tranches with respect to which such meeting shall have been held, whether or not present or represented at the meeting.

**SECTION 14.05. ATTENDANCE AT MEETINGS; DETERMINATION OF VOTING RIGHTS; CONDUCT AND ADJOURNMENT OF MEETINGS.**

(a) Attendance at meetings of Holders of Securities may be in person or by proxy; and, to the extent permitted by law, any such proxy shall remain in effect and be binding upon any future Holder of the Securities with respect to which it was given unless and until specifically revoked by the Holder or future Holder of such Securities before being voted.

(b) Notwithstanding any other provisions of this Indenture, the Trustee may make such reasonable regulations as it may deem advisable for any meeting of Holders of Securities in regard to proof of the holding of such Securities and of the appointment of proxies and in regard to the appointment and duties of inspectors of votes, the submission and examination of proxies, certificates and other evidence of the right to vote, and such other matters concerning the conduct of the meeting as it shall deem appropriate. Except as otherwise permitted or required by any such regulations, the holding of Securities shall be proved in the manner specified in Section 1.06 and the appointment of any proxy shall be proved in the manner specified in Section 1.06. Such regulations may provide that written instruments appointing proxies, regular on their face, may be presumed valid and genuine without the proof specified in Section 1.06 or other proof.

(c) The Trustee shall, by an instrument in writing, appoint a temporary chairman of the meeting, unless the meeting shall have been called by the Company or by Holders as provided in Section 14.02(b), in which case the Company or the Holders of Securities of the series and Tranches calling the meeting, as the case may be, shall in like manner appoint a temporary chairman. A permanent chairman and a permanent secretary of the meeting shall be elected by vote of the Persons entitled to vote a majority in aggregate principal amount of the Outstanding Securities of all series and Tranches represented in person or by proxy at the meeting, considered as one class.

(d) At any meeting each Holder or proxy shall be entitled to one vote for each \$1,000 principal amount of Securities held or represented by him; provided, however, that no vote shall be cast or counted at any meeting in respect of any Security challenged as not Outstanding and ruled by the chairman of the meeting to be not Outstanding. The chairman of the meeting shall have no right to vote, except as a Holder of a Security or proxy.

(e) Any meeting duly called pursuant to Section 14.02 at which a quorum is present may be adjourned from time to time by Persons entitled to vote a majority in aggregate principal amount of the Outstanding Securities of all series and Tranches represented at the meeting, considered as one class; and the meeting may be held as so adjourned without further notice.

**SECTION 14.06. COUNTING VOTES AND RECORDING ACTION OF MEETINGS.**

The vote upon any resolution submitted to any meeting of Holders shall be by written ballots on which shall be subscribed the signatures of the Holders or of their representatives by proxy and the principal amounts and serial numbers of the Outstanding Securities, of the series and Tranches with respect to which the meeting shall have been called, held or represented by them. The permanent chairman of the meeting shall appoint two inspectors of votes who shall count all votes cast at the meeting for or against any resolution and who shall make and file with



the secretary of the meeting their verified written reports of all votes cast at the meeting. A record, in duplicate, of the proceedings of each meeting of Holders shall be prepared by the secretary of the meeting and there shall be attached to said record the original reports of the inspectors of votes on any vote by ballot taken thereat and affidavits by one or more persons having knowledge of the facts setting forth a copy of the notice of the meeting and showing that said notice was given as provided in Section 14.02 and, if applicable, Section 14.04. Each copy shall be signed and verified by the affidavits of the permanent chairman and secretary of the meeting and one such copy shall be delivered to the Company, and another to the Trustee to be preserved by the Trustee, the latter to have attached thereto the ballots voted at the meeting. Any record so signed and verified shall be conclusive evidence of the matters therein stated.

**SECTION 14.07. ACTION WITHOUT MEETING.**

In lieu of a vote of Holders at a meeting as hereinbefore contemplated in this Article, any request, demand, authorization, direction, notice, consent, waiver or other action may be made, given or taken by Holders by one or more written instruments as provided in Section 1.06.

[END OF ARTICLE FOURTEEN]

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**ARTICLE FIFTEEN.**

**IMMUNITY OF INCORPORATORS, SHAREHOLDERS, OFFICERS AND DIRECTORS**

**SECTION 15.01. LIABILITY SOLELY CORPORATE.**

No recourse shall be had for the payment of the principal of or premium, if any, or interest, if any, on any Securities or any part thereof, or for any claim based thereon or otherwise in respect thereof, or of the indebtedness represented thereby, or upon any obligation, covenant or agreement under this Indenture, against any incorporator, shareholder, member, limited partner, officer, manager or director, as such, past, present or future of the Company or of any predecessor or successor of the Company (either directly or through the Company or a predecessor or successor of the Company), whether by virtue of any constitutional provision, statute or rule of law, or by the enforcement of any assessment or penalty or otherwise; it being expressly agreed and understood that this Indenture and all the Securities are solely corporate obligations, and that no personal liability whatsoever shall attach to, or be incurred by, any incorporator, shareholder, member, limited partner, officer, manager or director, past, present or future, of the Company or of any predecessor or successor of the Company, either directly or indirectly through the Company or any predecessor or successor of the Company, because of the indebtedness hereby authorized or under or by reason of any of the obligations, covenants or agreements contained in this Indenture or in any of the Securities or to be implied herefrom or therefrom, and that any such personal liability is hereby expressly waived and released as a condition of, and as part of the consideration for, the execution of this Indenture and the issuance of the Securities.

[END OF ARTICLE FIFTEEN]

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**ARTICLE SIXTEEN.  
ISSUANCE OF SECURITIES**

**SECTION 16.01. GENERAL.**

The Trustee shall authenticate and deliver Securities, for original issue, at one time or from time to time in accordance with the Company Order referred to below, only pursuant to Section 16.02, 16.03 or 16.04.

**SECTION 16.02. ISSUANCE OF SECURITIES ON THE BASIS OF PROPERTY ADDITIONS.**

(a) Securities of any one or more series may be authenticated and delivered on the basis of Property Additions which do not constitute Funded Property in an aggregate principal amount not exceeding sixty-six and two-thirds percent (66-2/3%) of the balance of the Cost or the Fair Value to the Company of such Property Additions (whichever shall be less) after making any deductions and any additions pursuant to Section 1.03(b).

(b) Securities of any series shall be authenticated by the Trustee on the basis of Property Additions and delivered in accordance with one or more Company Orders, all without compliance with any of the conditions, provisions and limitations set forth in Sections 16.03 and 16.04, upon receipt by the Trustee of:

(i) the documents with respect to the Securities of such series specified in Section 3.03;

(ii) an Expert's Certificate dated as of a date not more than ninety (90) days prior to the date of the related Company Order,

(1) describing the property designated by the Company, in its discretion, to be made the basis of the authentication and delivery of such Securities (such description of property to be made by reference, at the election of the Company, either to specified items, units and/or elements of property or portions thereof, on a percentage or Dollar basis, or to properties reflected in specified accounts or subaccounts in the Company's books of account or portions thereof, on a Dollar basis), and stating the Cost of such property;

(2) stating that all such property constitutes Property Additions;

(3) stating that such Property Additions are desirable for use in the conduct of the business, or one of the businesses, of the Company;

(4) stating that such Property Additions, to the extent of the Cost or Fair Value to the Company thereof (whichever is less) to be made the basis of the authentication and delivery of such Securities, do not constitute Funded Property;

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(5) stating what part, if any, of such Property Additions includes property which within six months prior to the date of acquisition thereof by the Company had been used or operated by others than the Company in a business similar to that in which it has been or is to be used or operated by the Company and stating whether or not, in the judgment of the signers, the Fair Value of such Property Additions to the Company, as of the date of such certificate, is less than Twenty-five Thousand Dollars (\$25,000) and whether or not such Fair Value is less than one percent (1%) of the aggregate principal amount of Securities then Outstanding;

(6) stating, in the judgment of the signers, the Fair Value to the Company, as of the date of such certificate, of such Property Additions, except any thereof with respect to the Fair Value to the Company of which a statement is to be made in an Independent Expert's Certificate pursuant to clause (iii) below;

(7) stating the amount required to be deducted under Section 1.03(b)(i) and the amounts elected to be added by the Company under Section 1.03(b)(ii) in respect of Funded Property retired by the Company;

(8) if any property included in such Property Additions is subject to a Lien of the character described (I) in clause (f) of the definition of Permitted Liens, stating that such Lien does not, in the judgment of the signers, materially impair the use by the Company of the Mortgaged Property considered as a whole for the purposes for which it is held by the Company, or (II) in clause (i)(ii) of the definition of Permitted Liens, stating that such Lien does not, in the judgment of the signers, materially impair the use by the Company of such property for the purposes for which it is held by the Company or (III) in clause (p)(ii) of the definition of Permitted Liens, stating that the enforcement of such Lien would not, in the judgment of the signers, adversely affect the interests of the Company in such property in any material respect;

(9) stating the lower of the Cost or the Fair Value to the Company of such Property Additions, after the deductions therefrom and additions thereto specified in such Expert's Certificate pursuant to clause (7) above;

(10) stating the aggregate principal amount of the Securities to be authenticated and delivered on the basis of such Property Additions (such amount not to exceed sixty-six and two-thirds percent (66-2/3%) of the amount stated pursuant to clause (9) above);

(iii) in case any Property Additions are shown by the Expert's Certificate provided for in clause (ii) above to include property which, within six months prior to the date of acquisition thereof by the Company, had been used or operated by others than the Company in a business similar to that in which it has been or is to be used or operated by the Company and such certificate does not show the Fair Value thereof to the Company, as of the date of such certificate, to be less than Twenty-five Thousand Dollars (\$25,000) or less than one percent (1%) of the aggregate principal amount of Securities then

Outstanding, an Independent Expert's Certificate stating, in the judgment of the signer, the Fair Value to the Company, as of the date of such Independent Expert's Certificate, of (X) such Property Additions which have been so used or operated and (at the option of the Company) as to any other Property Additions included in the Expert's Certificate provided for in clause (ii) above and (Y) in case such Independent Expert's Certificate is being delivered in connection with the authentication and delivery of Securities, any property so used or operated which has been subjected to the Lien of this Indenture since the commencement of the then current calendar year as the basis for the authentication and delivery of Securities and as to which an Independent Expert's Certificate has not previously been furnished to the Trustee;

(iv) Opinion of Counsel to the effect that:

(1) this Indenture constitutes, or, upon the delivery of, and/or the filing and/or recording in the proper places and manner of, the instruments of conveyance, assignment or transfer, if any, specified in said opinion, will constitute, a Lien on all the Property Additions to be made the basis of the authentication and delivery of such Securities, subject to no Lien thereon prior to the Lien of this Indenture except Permitted Liens; and

(2) the Company has corporate authority to operate such Property Additions; and

(v) copies of the instruments of conveyance, assignment and transfer, if any, specified in the Opinion of Counsel provided for in clause (iv) above.

### **SECTION 16.03. ISSUANCE OF SECURITIES ON THE BASIS OF RETIRED SECURITIES.**

(a) Securities of any one or more series may be authenticated and delivered on the basis of, and in an aggregate principal amount not exceeding the aggregate principal amount of, Retired Securities.

(b) Securities of any series shall be authenticated by the Trustee on the basis of Retired Securities and delivered in accordance with one or more Company Orders, all without compliance with any of the conditions, provisions and limitations set forth in Sections 16.02 and 16.04, upon receipt by the Trustee of:

(i) the documents with respect to the Securities of such series specified in Section 3.03; and

(ii) an Officer's Certificate stating that Retired Securities, specified by series, in an aggregate principal amount not less than the aggregate principal amount of Securities to be authenticated and delivered, have theretofore been authenticated and delivered and, as of the date of such Officer's Certificate, constitute Retired Securities and are the basis for the authentication and delivery of such Securities.

**SECTION 16.04. ISSUANCE OF SECURITIES ON THE BASIS OF DEPOSIT OF CASH.**

(a) Securities of any one or more series may be authenticated and delivered on the basis of, and in an aggregate principal not exceeding the amount of, any cash deposited with the Trustee for such purpose.

(b) Securities of any series shall be authenticated by the Trustee on the basis of the deposit of cash and delivered in accordance with one or more Company Orders, all without compliance with any of the conditions, provisions and limitations set forth in Sections 16.02 and 16.03, upon receipt by the Trustee of:

(i) such deposit of cash; and

(ii) the documents with respect to the Securities of such series specified in Section 3.03.

(c) All cash deposited with the Trustee under the provisions of this Section shall be held by the Trustee as a part of the Mortgaged Property and may be withdrawn from time to time by the Company, upon application of the Company to the Trustee, in an amount equal to the aggregate principal amount of Securities to the authentication and delivery of which the Company shall be entitled under any of the provisions of this Indenture by virtue of compliance with all applicable provisions of this Indenture (except as hereinafter in this subsection (c) otherwise provided).

Upon any such application for withdrawal, the Company shall comply with all applicable provisions of this Article relating to the authentication and delivery of Securities except that the Company shall not in any event be required to deliver the documents specified in Section 3.03.

Any withdrawal of cash under this subsection (c) shall operate as a waiver by the Company of its right to the authentication and delivery of the Securities on which it is based and such Securities may not thereafter be authenticated and delivered hereunder. Any Property Additions which have been made the basis of any such right to the authentication and delivery of Securities so waived shall be deemed to have been made the basis of the withdrawal of such cash; any Retired Securities which have been made the basis of any such right to the authentication and delivery of Securities so waived shall be deemed to have been made the basis of the withdrawal of such cash.

(d) If at any time the Company shall so direct, any sums deposited with the Trustee under the provisions of this Section may be used or applied to the purchase, payment or redemption of Securities in the manner and subject to the conditions provided in clauses (d) and (e) of Section 17.06.

[END OF ARTICLE SIXTEEN]

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**ARTICLE SEVENTEEN.**

**POSSESSION, USE AND RELEASE OF MORTGAGED PROPERTY**

**SECTION 17.01. QUIET ENJOYMENT.**

Unless one or more Events of Default shall have occurred and be continuing, the Company shall be permitted to possess, use and enjoy the Mortgaged Property (except, to the extent not herein otherwise provided, such cash and securities as are expressly required to be deposited with the Trustee).

**SECTION 17.02. DISPOSITIONS WITHOUT RELEASE.**

Unless an Event of Default shall have occurred and be continuing, the Company may at any time and from time to time, without any release or consent by, or report to, the Trustee:

(a) sell or otherwise dispose of, free from the Lien of this Indenture, any machinery, equipment, apparatus, towers, transformers, poles, lines, cables, conduits, ducts, conductors, meters, regulators, holders, tanks, retorts, purifiers, odorizers, scrubbers, compressors, valves, pumps, mains, pipes, service pipes, fittings, connections, services, tools, implements, or any other fixtures or personalty, then subject to the Lien hereof, which shall have become old, inadequate, obsolete, worn out, unfit, unadapted, unserviceable, undesirable or unnecessary for use in the operations of the Company upon replacing the same by, or substituting for the same, similar or analogous property, or other property performing a similar or analogous function or otherwise obviating the need therefor, having a Fair Value to the Company at least equal to that of the property sold or otherwise disposed of and subject to the Lien hereof, subject to no Liens prior hereto except Permitted Liens and any other Liens to which the property sold or otherwise disposed of was subject;

(b) cancel or make changes or alterations in or substitutions for any and all easements, servitudes, rights-of-way and similar rights and/or interests;

(c) grant, free from the Lien of this Indenture, easements, ground leases or rights-of-way in, upon, over and/or across the property or rights-of-way of the Company for the purpose of roads, pipe lines, transmission lines, distribution lines, communication lines, railways, removal or transportation of coal, lignite, gas, oil or other minerals or timber, and other like purposes, or for the joint or common use of real property, rights-of-way, facilities and/or equipment; provided, however, that such grant shall not materially impair the use of the property or rights-of-way for the purposes for which such property or rights-of-way are held by the Company; and

(d) terminate, abandon, surrender, cancel, release, modify or dispose of any franchises, licenses or permits that are Mortgaged Property; provided that such action is, in the opinion of the Company, necessary, desirable or advisable in the conduct of the business of the Company, and; provided further that any franchises, licenses or permits that become Mortgaged Property by the operation of the First Granting Clause and thereafter, in the opinion of the Company, cease to be necessary for the operation of the Mortgaged Property shall automatically cease to be subject to the Lien of this Indenture, without any release or consent, or report to, the Trustee.

**SECTION 17.03. RELEASE OF FUNDED PROPERTY.**

Unless an Event of Default shall have occurred and be continuing, the Company may obtain the release of any part of the Mortgaged Property, or any interest therein, which constitutes Funded Property, other than Funded Cash held by the Trustee, and the Trustee shall release all its right, title and interest in and to the same from the Lien hereof, upon receipt by the Trustee of:

- (a) a Company Order requesting the release of such property and transmitting therewith a form of instrument or instruments to effect such release;
- (b) an Officer's Certificate stating that, to the knowledge of the signer, no Event of Default has occurred and is continuing;
- (c) an Expert's Certificate made and dated not more than ninety (90) days prior to the date of such Company Order:
  - (i) describing the property to be released;
  - (ii) stating the Fair Value, in the judgment of the signers, of the property to be released;
  - (iii) stating the Cost of the property to be released (or, if the Fair Value to the Company of such property at the time the same became Funded Property was certified to be an amount less than the Cost thereof, then such Fair Value, as so certified, in lieu of Cost); and
  - (iv) stating that, in the judgment of the signers, such release will not impair the security under this Indenture in contravention of the provisions hereof;
- (d) an amount in cash to be held by the Trustee as part of the Mortgaged Property, equal to the amount, if any, by which the amount referred to in clause (c)(iii) above exceeds the aggregate of the following items:
  - (i) an amount equal to the aggregate principal amount of any obligations secured by Purchase Money Lien delivered to the Trustee, to be held as part of the Mortgaged Property, subject to the limitations hereafter in this Section set forth;
  - (ii) an amount equal to the Cost or Fair Value to the Company (whichever is less), after making any deductions and any additions pursuant to Section 1.03, of any Property Additions not constituting Funded Property described in an Expert's Certificate, dated not more than ninety (90) days prior to the date of the Company Order requesting such release and complying with clause (ii) and, to the extent applicable, clause (iii) in Section 16.02(b), delivered to the Trustee; provided, however, that the deductions and additions contemplated by Section 1.03 shall not be required to be made if such Property Additions were acquired, made or constructed on or after the ninetieth (90th) day preceding the date of such Company Order;



(iii) one hundred fifty percent (150%) of the aggregate principal amount of Securities to the authentication and delivery of which the Company shall be entitled under the provisions of Section 16.03, by virtue of compliance with all applicable provisions of Section 16.03 (except as hereinafter in this Section otherwise provided); provided, however, that such release shall operate as a waiver by the Company of the right to the authentication and delivery of such Securities and, to such extent, no such Securities may thereafter be authenticated and delivered hereunder; and any Securities which could have been the basis of such right to the authentication and delivery of Securities so waived shall be deemed to have been made the basis of such release of property;

(iv) any amount in cash and/or an amount equal to the aggregate principal amount of any obligations secured by Purchase Money Lien that, in either case, is evidenced to the Trustee by a certificate of the trustee or other holder of a Lien prior to the Lien of this Indenture to have been received by such trustee or other holder in accordance with the provisions of such Lien in consideration for the release of such property or any part thereof from such Lien, all subject to the limitations hereafter in this Section set forth;

(v) one hundred fifty percent (150%) of the aggregate principal amount of any Outstanding Securities delivered to the Trustee (other than Securities authenticated and delivered pursuant to Section 16.04); and

(vi) any taxes and expenses incidental to any sale, exchange, dedication or other disposition of the property to be released;

provided, however, that no obligations secured by Purchase Money Lien upon any property being released from the Lien hereof shall be used as a credit in connection with such release unless all obligations secured by such Purchase Money Lien shall be delivered to the Trustee or to the trustee or other holder of a Lien prior to the Lien of this Indenture;

(e) if the release is on the basis of Property Additions or on the basis of the right to the authentication and delivery of Securities under Section 16.03, all documents contemplated below in this Section; and

(f) if the release is on the basis of the delivery to the Trustee or to the trustee or other holder of a prior Lien of obligations secured by Purchase Money Lien, all documents contemplated below in this Section, to the extent required.

If and to the extent that the release of property is, in whole or in part, based upon Property Additions (as permitted under the provisions of clause (d)(ii) in the first paragraph of this Section), the Company shall, subject to the provisions of said clause (d)(ii) and except as hereafter in this paragraph provided, comply with all applicable provisions of this Indenture as if such Property Additions were to be made the basis of the authentication and delivery of Securities equal in principal amount to sixty-six and two-thirds percent (66-2/3%) of the Cost (or, as to property of which the Fair Value to the Company at the time the same became Funded Property was certified to be an amount less than the Cost thereof, such Fair Value, as so certified,

in lieu of Cost) of that portion of the property to be released which is to be released on the basis of such Property Additions, as shown by the Expert's Certificate required by clause (c) in the first paragraph of this Section; provided, however, that the Cost of any Property Additions received or to be received by the Company in whole or in part as consideration in exchange for the property to be released shall for all purposes of this Indenture be deemed to be the amount stated in the Expert's Certificate provided for in clause (c) in the first paragraph of this Section to be the lower of Cost or Fair Value of the property to be released (x) plus the amount of any cash and the fair market value of any other consideration, further to be stated in such Expert's Certificate, paid and/or delivered or to be paid and/or delivered by, and the amount of any obligations assumed or to be assumed by, the Company in connection with such exchange as additional consideration for such Property Additions and/or (y) less the amount of any cash and the fair market value of any other consideration, which shall also be stated in such Expert's Certificate, received or to be received by the Company in connection with such exchange in addition to such Property Additions. If and to the extent that the release of property is in whole or in part based upon the right to the authentication and delivery of Securities under Section 16.03 (as permitted under the provisions of clause (d)(iii) in the first paragraph of this Section), the Company shall, except as hereafter in this paragraph provided, comply with all applicable provisions of Section 16.03 relating to such authentication and delivery. Notwithstanding the foregoing provisions of this paragraph, in no event shall the Company be required to deliver the documents specified in Section 3.03.

If the release of property is, in whole or in part, based upon the delivery to the Trustee or the trustee or other holder of a Lien prior to the Lien of this Indenture of obligations secured by Purchase Money Lien, the Company shall deliver to the Trustee:

(x) an Officer's Certificate (i) stating that no event has occurred and is continuing which entitles the holder of such Purchase Money Lien to accelerate the maturity of the obligations, if any, outstanding thereunder and (ii) reciting the aggregate principal amount of obligations, if any, then outstanding thereunder in addition to the obligations then being delivered in connection with the release of such property and the terms and conditions, if any, on which additional obligations secured by such Purchase Money Lien are permitted to be issued; and

(y) an Opinion of Counsel stating that, in the opinion of the signer, (i) such obligations are valid obligations, entitled to the benefit of such Purchase Money Lien equally and ratably with all other obligations, if any, then outstanding thereunder, (ii) that such Purchase Money Lien constitutes, or, upon the delivery of, and/or the filing and/or recording in the proper places and manner of, the instruments of conveyance, assignment or transfer, if any, specified in such opinion, will constitute, a Lien upon the property to be released, subject to no Lien prior thereto except Liens generally of the character of Permitted Liens and such Liens, if any, as shall have existed thereon immediately prior to such release as Liens prior to the Lien of this Indenture, (iii) if any obligations in addition to the obligations being delivered in connection with such release of property are then outstanding, or are permitted to be issued, under such Purchase Money Lien, (A) that such Purchase Money Lien constitutes, or, upon the delivery of, and/or the filing and/or recording in the proper places and manner of, the instruments of conveyance, assignment or transfer, if any, specified in such opinion, will constitute, a Lien upon all other property, if any, purporting to be subject thereto, subject to no Lien prior thereto except Liens generally of the character of Permitted Liens and (B) that the terms of such Purchase Money Lien, as then in

effect, do not permit the issuance of obligations thereunder except on the basis of property generally of the character of Property Additions, the retirement or deposit of outstanding obligations, the deposit of prior Lien obligations or the deposit of cash.

If the Opinion of Counsel provided to the Trustee pursuant to clause (y) above is conditioned upon the filing and/or recording of any instruments of conveyance, assignment or transfer, the Company shall promptly cause such instruments to be filed and/or recorded in the proper places and manner and shall deliver to the Trustee evidence of such filing and/or recording promptly upon receipt of such evidence by the Company.

If (a) any property to be released from the Lien of this Indenture under any provision of this Article (other than Section 17.07) is subject to a Lien prior to the Lien hereof and is to be sold, exchanged, dedicated or otherwise disposed of subject to such prior Lien and (b) after such release, such prior Lien will not be a Lien on any property subject to the Lien hereof, then the Fair Value of such property to be released shall be deemed, for all purposes of this Indenture, to be the value thereof unencumbered by such prior Lien less the principal amount of the indebtedness secured by such prior Lien.

Any Outstanding Securities delivered to the Trustee pursuant to clause (d) in the first paragraph of this Section shall, upon receipt of a Company Order, forthwith be canceled by the Trustee. Any cash and/or obligations deposited with the Trustee pursuant to the provisions of this Section 17.03, and the proceeds of any such obligations, shall be held as part of the Mortgaged Property and shall be withdrawn, released, used or applied in the manner, to the extent and for the purposes, and subject to the conditions, provided in Section 17.06.

Anything in this Indenture to the contrary notwithstanding, if property to be released constitutes Funded Property in part only, the Company shall obtain the release of the part of such property which constitutes Funded Property under this Section 17.03 and obtain the release of the part of such property which does not constitute Funded Property under Section 17.04. In such event, (a) the application of Property Additions in the release under this Section 17.03 as contemplated in clause (d)(ii) in the first paragraph thereof shall be taken into account in clause (v) or clause (vi), whichever may be applicable, of the Expert's Certificate described in clause (c) in Section 17.04 and (b) the Trustee shall, at the election of the Company, execute and deliver a separate instrument of release with respect to the property released under each of such Sections or a consolidated instrument of release with respect to the property released under both of such Sections considered as a whole.

#### **SECTION 17.04. RELEASE OF MORTGAGED PROPERTY NOT CONSTITUTING FUNDED PROPERTY.**

Unless an Event of Default shall have occurred and be continuing, the Company may obtain the release of any part of the Mortgaged Property, or any interest therein, which does not constitute Funded Property, and the Trustee shall release all its right, title and interest in and to the same from the Lien hereof, upon receipt by the Trustee of:

(a) a Company Order requesting the release of such property and transmitting therewith a form of instrument or instruments to effect such release;

(b) an Officer's Certificate describing the property to be released and stating that, to the knowledge of the signer, no Event of Default has occurred and is continuing;

(c) an Expert's Certificate, made and dated not more than ninety (90) days prior to the date of such Company Order:

(i) describing the property to be released;

(ii) stating the Fair Value, in the judgment of the signers, of the property to be released;

(iii) stating the Cost of the property to be released;

(iv) stating that the property to be released does not constitute Funded Property;

(v) if true, stating either (A) that the aggregate amount of the Cost or Fair Value to the Company (whichever is less) of all Property Additions which do not constitute Funded Property (excluding the property to be released), after making deductions therefrom and additions thereto of the character contemplated by Section 1.03, is not less than zero (0) or (B) that the Cost or Fair Value (whichever is less) of the property to be released does not exceed the aggregate Cost or Fair Value to the Company (whichever is less) of Property Additions acquired, made or constructed on or after the ninetieth (90th) day prior to the date of the Company Order requesting such release;

(vi) if neither of the statements contemplated in subclause (v) above can be made, stating the amount by which zero (0) exceeds the amount referred to in subclause (v)(A) above (showing in reasonable detail the calculation thereof); and

(vii) stating that, in the judgment of the signers, such release will not impair the security under this Indenture in contravention of the provisions hereof; and

(d) if the Expert's Certificate required by clause (c) above contains neither of the statements contemplated in subclause (c)(v) above, an amount in cash, to be held by the Trustee as part of the Mortgaged Property, equal to the amount, if any, by which the lower of (i) the Cost or Fair Value (whichever shall be less) of the property to be released and (ii) the amount shown in subclause (c)(vi) above exceeds the aggregate of items of the character described in subclauses (iii) and (v) of clause (d) in the first paragraph of Section 17.03 that the Company then elects to use as a credit under this Section 17.04 (subject, however, to the same limitations and conditions with respect to such items as are set forth in Section 17.03).

Any Outstanding Securities delivered to the Trustee pursuant to clause (d) above shall forthwith be canceled by the Trustee.

#### **SECTION 17.05. RELEASE OF MINOR PROPERTIES.**

Notwithstanding the provisions of Sections 17.03 and 17.04, unless an Event of Default shall have occurred and be continuing, the Company may obtain the release from the Lien hereof

of any part of the Mortgaged Property, or any interest therein, and the Trustee shall whenever from time to time requested by the Company in a Company Order transmitting therewith a form of instrument or instruments to effect such release, and without requiring compliance with any of the provisions of Section 17.03 or 17.04, release from the Lien hereof all the right, title and interest of the Trustee in and to the same provided that the lower of the aggregate Cost or Fair Value of the property to be so released on any date in a given calendar year, together with all other property theretofore released pursuant to this Section 17.05 in such calendar year, shall not exceed the greater of (a) Ten Million Dollars (\$10,000,000) and (b) three percent (3%) of the aggregate principal amount of Securities then Outstanding. Prior to the granting of any such release, there shall be delivered to the Trustee (x) an Officer's Certificate stating that, to the knowledge of the signer, no Event of Default has occurred and is continuing and (y) an Expert's Certificate stating, in the judgment of the signers, the Fair Value of the property to be released, the aggregate Fair Value of all other property theretofore released pursuant to this Section in such calendar year and, as to Funded Property, the Cost thereof (or, if the Fair Value to the Company of such property at the time the same became Funded Property was certified to be an amount less than the Cost thereof, then such Fair Value, as so certified, in lieu of Cost), and that, in the judgment of the signers, the release thereof will not impair the security under this Indenture in contravention of the provisions hereof. On or before December 31st of each calendar year, the Company shall deposit with the Trustee an amount in cash equal to the aggregate Cost of the properties constituting Funded Property so released during such year (or, if the Fair Value to the Company of any particular property at the time the same became Funded Property was certified to be an amount less than the Cost thereof, then such Fair Value, as so certified, in lieu of Cost); provided, however, that no such deposit shall be required to be made hereunder to the extent that cash or other consideration shall, as indicated in an Officer's Certificate delivered to the Trustee, have been deposited with the trustee or other holder of a Lien prior to the Lien of this Indenture in accordance with the provisions thereof; and provided, further, that the amount of cash so required to be deposited may be reduced, at the election of the Company, by the items specified in clause (d) in the first paragraph of Section 17.03, subject to all of the limitations and conditions specified in such Section, to the same extent as if such property were being released pursuant to Section 17.03. Any cash deposited with the Trustee under this Section may thereafter be withdrawn, used or applied in the manner, to the extent and for the purposes, and subject to the conditions, provided in Section 17.06.

**SECTION 17.06. WITHDRAWAL OR OTHER APPLICATION OF FUNDED CASH; PURCHASE MONEY OBLIGATIONS.**

Subject to the provisions of Section 16.04 and except as hereafter in this Section provided, unless an Event of Default shall have occurred and be continuing, any Funded Cash held by the Trustee, and any other cash which is required to be withdrawn, used or applied as provided in this Section,

(a) may be withdrawn from time to time by the Company to the extent of an amount equal to the Cost or the Fair Value to the Company (whichever is less) of Property Additions not constituting Funded Property, after making any deductions and additions pursuant to Section 1.03, described in an Expert's Certificate, dated not more than ninety (90) days prior to the date of the Company Order requesting such withdrawal and complying with clause (ii) and, to the extent applicable, clause (iii) in Section 16.02(b), delivered to the Trustee; provided, however,

that the deductions and additions contemplated by Section 1.03 shall not be required to be made if such Property Additions were acquired, made or constructed on or after the ninetieth (90th) day preceding the date of such Company Order;

(b) may be withdrawn from time to time by the Company in an amount equal to the aggregate principal amount of Securities to the authentication and delivery of which the Company shall be entitled under the provisions of Section 16.03 hereof, by virtue of compliance with all applicable provisions of Section 16.03 (except as hereinafter in this Section otherwise provided); provided, however, that such withdrawal of cash shall operate as a waiver by the Company of the right to the authentication and delivery of such Securities and, to such extent, no such Securities may thereafter be authenticated and delivered hereunder; and any such Securities which were the basis of such right to the authentication and delivery of Securities so waived shall be deemed to have been made the basis of such withdrawal of cash;

(c) may be withdrawn from time to time by the Company in an amount equal to the aggregate principal amount of any Outstanding Securities delivered to the Trustee;

(d) may, upon the request of the Company, be used by the Trustee for the purchase of Securities in the manner, at the time or times, in the amount or amounts, at the price or prices and otherwise as directed or approved by the Company, all subject to the limitations hereafter in this Section set forth; or

(e) may, upon the request of the Company, be applied by the Trustee to the payment (or provision therefor pursuant to Article Eight) at Stated Maturity of any Securities or to the redemption (or similar provision therefor) of any Securities which are, by their terms, redeemable, in each case of such series as may be designated by the Company, any such redemption to be in the manner and as provided in Article Five and in such Securities, all subject to the limitations hereafter in this Section set forth.

Such moneys shall, from time to time, be paid or used or applied by the Trustee, as aforesaid, upon the request of the Company in a Company Order, and upon receipt by the Trustee of an Officer's Certificate stating that, to the knowledge of the signer, no Event of Default has occurred and is continuing. If and to the extent that the withdrawal of cash is based upon Property Additions (as permitted under the provisions of clause (a) above), the Company shall, subject to the provisions of said clause (a) and except as hereafter in this paragraph provided, comply with all applicable provisions of this Indenture as if such Property Additions were made the basis for the authentication and delivery of Securities equal in principal amount to the cash so to be withdrawn. If and to the extent that the withdrawal of cash is based upon the right to the authentication and delivery of Securities (as permitted under the provisions of clause (b) above), the Company shall, except as hereafter in this paragraph provided, comply with all applicable provisions of Section 16.03 relating to such authentication and delivery. Notwithstanding the foregoing provisions of this paragraph, in no event shall the Company be required to deliver the documents specified in Section 3.03.

Notwithstanding the generality of clauses (d) and (e) above, no cash to be applied pursuant to such clauses shall be applied to the payment of an amount in excess of the principal amount of any Securities to be purchased, paid or redeemed except to the extent that the

aggregate principal amount of all Securities theretofore, and of all Securities then to be, purchased, paid or redeemed pursuant to such clauses is not less than the aggregate cost for principal of, premium, if any, and accrued interest, if any, on and brokerage commissions, if any, with respect to, such Securities.

Any Outstanding Securities delivered to the Trustee pursuant to clause (c) in the first paragraph of this Section shall, upon request by the Company, forthwith be canceled by the Trustee.

Any obligations secured by Purchase Money Lien delivered to the Trustee in consideration of the release of property from the Lien of this Indenture, together with any evidence of such Purchase Money Lien held by the Trustee, shall be released from the Lien of this Indenture and delivered to or upon the order of the Company upon payment by the Company to the Trustee of an amount in cash equal to the aggregate principal amount of such obligations less the aggregate amount theretofore paid to the Trustee (by the Company, the obligor or otherwise) in respect of the principal of such obligations.

The principal of and interest on any such obligations secured by Purchase Money Lien held by the Trustee shall be paid to the Trustee as and when the same become payable. The interest received by the Trustee on any such obligations shall be deemed not to constitute Funded Cash and shall be remitted to the Company; provided, however, that if an Event of Default shall have occurred and be continuing, such proceeds shall be held as part of the Mortgaged Property until such Event of Default shall have been cured or waived.

The Trustee shall have and may exercise all the rights and powers of any owner of such obligations and of all substitutions therefor and, without limiting the generality of the foregoing, may collect and receive all insurance moneys payable to it under any of the provisions thereof and apply the same in accordance with the provisions thereof, may consent to extensions thereof at a higher or lower rate of interest, may join in any plan or plans of voluntary or involuntary reorganization or readjustment or rearrangement and may accept and hold hereunder new obligations, stocks or other securities issued in exchange therefor under any such plan. Any discretionary action which the Trustee may be entitled to take in connection with any such obligations or substitutions therefor shall be taken, so long as no Event of Default shall have occurred and be continuing, in accordance with a Company Order, and, during the continuance of an Event of Default, in its own discretion.

Anything herein to the contrary notwithstanding, the Company may irrevocably waive all right to the withdrawal pursuant to this Section of, and any other rights with respect to, any obligations secured by Purchase Money Lien held by the Trustee, and the proceeds of any such obligations, by delivery to the Trustee of a Company Order:

(x) specifying such obligations and stating that the Company thereby waives all rights to the withdrawal thereof and of the proceeds thereof pursuant to this Section, and any other rights with respect thereto; and

(y) directing that the principal of such obligations be applied as provided in clause (e) in the first paragraph of this Section, specifying the Securities to be paid or redeemed or for the payment or redemption of which payment is to be made.

Following any such waiver, the interest on any such obligations shall be applied to the payment of interest, if any, on the Securities to be paid or redeemed or for the payment or redemption of which provision is to be made, as specified in the aforesaid Company Order, as and when such interest shall become due from time to time, and any excess funds remaining from time to time after such application shall be applied to the payment of interest on any other Securities as and when the same shall become due. Pending any such application, the interest on such obligations shall be invested in Investment Securities as shall be selected by the Company and specified in written instructions delivered to the Trustee. The principal of any such obligations shall be applied solely to the payment of principal of the Securities to be paid or redeemed or for the payment or redemption of which provision is to be made, as specified in the aforesaid Company Order. Pending such application, the principal of such obligations shall be invested in Eligible Obligations as shall be selected by the Company and specified in written instructions delivered to the Trustee. The obligation of the Company to pay the principal of such Securities when the same shall become due at maturity, shall be offset and reduced by the amount of the proceeds of such obligations then held, and to be applied, by the Trustee in accordance with this paragraph.

#### **SECTION 17.07. RELEASE OF PROPERTY TAKEN BY EMINENT DOMAIN, ETC.**

Should any of the Mortgaged Property, or any interest therein, be taken by exercise of the power of eminent domain or be sold to an entity possessing the power of eminent domain under a threat to exercise the same, and should the Company elect not to obtain the release of such property pursuant to other provisions of this Article, the Trustee shall, upon request of the Company evidenced by a Company Order transmitting therewith a form of instrument or instruments to effect such release, release from the Lien hereof all its right, title and interest in and to the property so taken or sold (or with respect to an interest in property, subordinate the Lien hereof to such interest), upon receiving (a) an Opinion of Counsel to the effect that such property has been taken by exercise of the power of eminent domain or has been sold to an entity possessing the power of eminent domain under threat of an exercise of such power, (b) an Officer's Certificate stating the amount of net proceeds received or to be received for such property so taken or sold, and the amount so stated shall be deemed to be the Fair Value of such property for the purpose of any notice to the Holders of Securities, (c) if any portion of such property constitutes Funded Property, an Expert's Certificate stating the Cost thereof (or, if the Fair Value to the Company of such portion of such property at the time the same became Funded Property was certified to be an amount less than the Cost thereof, then such Fair Value, as so certified, in lieu of Cost) and (d) if any portion of such property constitutes Funded Property, a deposit by the Company of an amount in cash equal to the Cost or Fair Value stated in the Expert's Certificate delivered pursuant to clause (c) above; provided, however, that the amount required to be so deposited shall not exceed the portion of the net proceeds received or to be received for such property so taken or sold which is allocable on a pro-rata or other reasonable basis to the portion of such property constituting Funded Property; and provided, further, that no such deposit shall be required to be made hereunder if the proceeds of such taking or sale shall, as indicated in an Officer's Certificate delivered to the Trustee, have been deposited with the



trustee or other holder of a Lien prior to the Lien of this Indenture. Any cash deposited with the Trustee under this Section may thereafter be withdrawn, used or applied in the manner, to the extent and for the purposes, and subject to the conditions, provided in Section 17.06.

#### **SECTION 17.08. DISCLAIMER OR QUITCLAIM.**

In case the Company has sold, exchanged, dedicated or otherwise disposed of, or has agreed or intends to sell, exchange, dedicate or otherwise dispose of, or a Governmental Authority has ordered the Company to divest itself of, any Excepted Property or any other property not subject to the Lien hereof, or the Company desires to disclaim or quitclaim title to property to which the Company does not purport to have title, the Trustee shall, from time to time, disclaim or quitclaim such property upon receipt by the Trustee of the following:

(a) a Company Order requesting such disclaimer or quitclaim and transmitting therewith a form of instrument to effect such disclaimer or quitclaim;

(b) an Officer's Certificate describing the property to be disclaimed or quitclaimed; and

(c) an Opinion of Counsel stating the signer's opinion that such property is not subject to the Lien hereof or required to be subject thereto by any of the provisions hereof and complying with the requirements of Section 1.04 of this Indenture.

#### **SECTION 17.09. MISCELLANEOUS.**

(a) The Expert's Certificate as to the Fair Value of property to be released from the Lien of this Indenture in accordance with any provision of this Article, and as to the non-impairment, by reason of such release, of the security under this Indenture in contravention of the provisions hereof, shall be made by an Independent Expert if the Fair Value of such property and of all other property released since the commencement of the then current calendar year, as set forth in the certificates required by this Indenture, is ten percent (10%) or more of the aggregate principal amount of the Securities at the time Outstanding; but such Expert's Certificate shall not be required to be made by an Independent Expert in the case of any release of property if the Fair Value thereof, as set forth in the certificates required by this Indenture, is less than Twenty-five Thousand Dollars (\$25,000) or less than one percent (1%) of the aggregate principal amount of the Securities at the time Outstanding. To the extent that the Fair Value of any property to be released from the Lien of this Indenture shall be stated in an Independent Expert's Certificate, such Fair Value shall not be required to be stated in any other Expert's Certificate delivered in connection with such release.

(b) No release of property from the Lien of this Indenture effected in accordance with the provisions, and in compliance with the conditions, set forth in this Article and in Sections 1.04 and 1.05 shall be deemed to impair the security of this Indenture in contravention of any provision hereof.

(c) If the Mortgaged Property shall be in the possession of a receiver or trustee, lawfully appointed, the powers hereinbefore conferred upon the Company with respect to the release of any part of the Mortgaged Property or any interest therein or the withdrawal of cash

may be exercised, with the approval of the Trustee, by such receiver or trustee, notwithstanding that an Event of Default may have occurred and be continuing, and any request, certificate, appointment or approval made or signed by such receiver or trustee for such purposes shall be as effective as if made by the Company or any of its officers or appointees in the manner herein provided; and if the Trustee shall be in possession of the Mortgaged Property under any provision of this Indenture, then such powers may be exercised by the Trustee in its discretion notwithstanding that an Event of Default may have occurred and be continuing.

(d) If the Company shall retain any interest in any property released from the Lien of this Indenture as provided in Section 17.03, 17.04 or 17.05, this Indenture shall not become or be, or be required to become or be, a Lien upon such property or such interest therein or any improvements, extensions or additions to such property or renewals, replacements or substitutions of or for such property or any part or parts thereof unless the Company shall execute and deliver to the Trustee an indenture supplemental hereto, in recordable form, containing a grant, conveyance, transfer and mortgage thereof. As used in this subsection, the terms "improvements", "extensions" and "additions" shall be limited as set forth in Section 12.01.

(e) Notwithstanding the occurrence and continuance of an Event of Default, the Trustee, in its discretion, may release from the Lien hereof any part of the Mortgaged Property or permit the withdrawal of cash, upon compliance with the other conditions specified in this Article in respect thereof.

(f) No purchaser or grantee of property purporting to have been released hereunder shall be bound to ascertain the authority of the Trustee to execute the instrument or instruments of release, or to inquire as to any facts required by the provisions hereof for the exercise of such authority; nor shall any purchaser or grantee of any property or rights permitted by this Article to be sold, granted, exchanged, dedicated or otherwise disposed of, be under obligation to ascertain or inquire into the authority of the Company to make any such sale, grant, exchange, dedication or other disposition.

#### **SECTION 17.10. PRESERVATION OF LIEN.**

The Company shall maintain and preserve the Lien of this Indenture so long as any Securities shall remain Outstanding, subject, however, to the provisions of Article Thirteen and Article Seventeen.

#### **SECTION 17.11. MAINTENANCE OF PROPERTIES.**

The Company shall cause (or, with respect to property owned in common with others, make reasonable effort to cause) the Mortgaged Property, considered as a whole, to be maintained and kept in good condition, repair and working order and shall cause (or, with respect to property owned in common with others, make reasonable effort to cause) to be made such repairs, renewals, replacements, betterments and improvements thereof, as, in the judgment of the Company, may be necessary in order that the operation of the Mortgaged Property, considered as a whole, may be conducted in accordance with common industry practice; provided, however, that nothing in this Section shall prevent the Company from discontinuing, or

causing the discontinuance of, the operation and maintenance of any portion of the Mortgaged Property if such discontinuance is in the judgment of the Company desirable in the conduct of its business; and provided, further, that nothing in this Section shall prevent the Company from selling, transferring or otherwise disposing of, or causing the sale, transfer or other disposition of, any portion of the Mortgaged Property in compliance with the other Sections of this Indenture.

#### **SECTION 17.12. PAYMENT OF TAXES; DISCHARGE OF LIENS.**

The Company shall pay all taxes and assessments and other governmental charges lawfully levied or assessed upon the Mortgaged Property, or upon any part thereof, or upon the interest of the Trustee in the Mortgaged Property, before the same shall become delinquent, and shall observe and conform in all material respects to all valid requirements of any Governmental Authority relative to the Mortgaged Property and all covenants, terms and conditions upon or under which any of the Mortgaged Property is held; and the Company shall not suffer any Lien to be created upon the Mortgaged Property, or any part thereof, prior to or on parity with the Lien of this Indenture, other than Permitted Liens; provided, however, that nothing in this Section contained shall require the Company (i) to observe or conform to any requirement of Governmental Authority or to cause to be paid or discharged, or to make provision for, any such Lien, or to pay any such tax, assessment or governmental charge so long as the validity thereof shall be contested in good faith and by appropriate legal proceedings or (ii) to pay, discharge or make provisions for any tax, assessment or other governmental charge, the validity of which shall not be so contested if adequate security for the payment of such tax, assessment or other governmental charge and for any penalties or interest which may reasonably be anticipated from failure to pay the same shall be given to the Trustee; and provided, further, that nothing in this Section shall prohibit the issuance or other incurrence of additional indebtedness, or the refunding of outstanding indebtedness, secured by any Lien prior to the Lien hereof which is permitted under this Section to continue to exist.

#### **SECTION 17.13. INSURANCE.**

(a) The Company shall (i) keep or cause to be kept all the Mortgaged Property insured against loss by fire, to the extent that property of similar character is usually so insured by companies similarly situated and operating like properties, to a reasonable amount, by reputable insurance companies, the proceeds of such insurance (except as to any loss of Excepted Property and except as to any particular loss less than the greater of (A) Twenty Million Dollars (\$20,000,000) and (B) three percent (3%) of the principal amount of Securities Outstanding on the date of such particular loss) to be made payable, subject to applicable law, to the Trustee as the interest of the Trustee may appear, or to the trustee or other holder of any Lien prior hereto upon property subject to the Lien hereof, if the terms thereof require such payment or (ii) in lieu of or supplementing such insurance in whole or in part, adopt some other method or plan of protection against loss by fire at least equal in protection to the method or plan of protection against loss by fire of companies similarly situated and operating properties subject to similar fire hazards or properties on which an equal primary fire insurance rate has been set by reputable insurance companies; and if the Company shall adopt such other method or plan of protection, it shall, subject to applicable law (and except as to any loss of Excepted Property and except as to any particular loss less than the greater of (X) Twenty Million Dollars (\$20,000,000) and (Y)

three percent (3%) of the principal amount of Securities Outstanding on the date of such particular loss) pay to the Trustee on account of any loss covered by such method or plan an amount in cash equal to the amount of such loss less any amounts otherwise paid to the Trustee in respect of such loss or paid to the trustee or other holder of any Lien prior hereto upon property subject to the Lien hereof in respect of such loss if the terms thereof require such payment. Any cash so required to be paid by the Company pursuant to any such method or plan shall for the purposes of this Indenture be deemed to be proceeds of insurance. In case of the adoption of such other method or plan of protection, the Company shall furnish to the Trustee a certificate of an actuary or other qualified person appointed by the Company with respect to the adequacy of such method or plan.

Anything herein to the contrary notwithstanding, the Company may have fire insurance policies with (i) a deductible provision in a dollar amount per occurrence not exceeding the greater of (A) Twenty Million Dollars (\$20,000,000) and (B) three percent (3%) of the principal amount of the Securities Outstanding on the date such policy goes into effect, and/or (ii) co-insurance or self insurance provisions with a dollar amount per occurrence not exceeding thirty percent (30%) of the loss proceeds otherwise payable; provided, however, that the dollar amount described in clause (i) above may be exceeded to the extent such dollar amount per occurrence is below the deductible amount in effect as to fire insurance (X) on property of similar character insured by companies similarly situated and operating like property or (Y) on property as to which an equal primary fire insurance rate has been set by reputable insurance companies.

(b) All moneys paid to the Trustee by the Company in accordance with this Section or received by the Trustee as proceeds of any insurance, in either case on account of a loss on or with respect to Funded Property, shall, subject to any Lien prior hereto upon property subject to the Lien hereof, be held by the Trustee and, subject as aforesaid, shall be paid by it to the Company to reimburse the Company for an equal amount expended or committed for expenditure in the rebuilding, renewal and/or replacement of or substitution for the property destroyed or damaged, upon receipt by the Trustee of:

(i) a Company Request requesting such payment,

(ii) an Expert's Certificate:

(A) describing the property so damaged or destroyed;

(B) stating the Cost of such property (or, if the Fair Value to the Company of such property at the time the same became Funded Property was certified to be an amount less than the Cost thereof, then such Fair Value, as so certified, in lieu of Cost) or, if such damage or destruction shall have affected only a portion of such property, stating the allocable portion of such Cost or Fair Value;

(C) stating the amounts so expended or committed for expenditure in the rebuilding, renewal, replacement of and/or substitution for such property; and

(D) stating the Fair Value to the Company of such property as rebuilt or renewed or as to be rebuilt or renewed and/or of the replacement or substituted property, and if

(a) within six months prior to the date of acquisition thereof by the Company, such property has been used or operated, by a person or persons other than the Company, in a business similar to that in which it has been or is to be used or operated by the Company, and

(b) the Fair Value to the Company of such property as set forth in such Expert's Certificate is not less than Twenty-five Thousand Dollars (\$25,000) and not less than one percent (1%) of the aggregate principal amount of the Securities at the time Outstanding,

the Expert making the statement required by this clause (D) shall be an Independent Expert, and

(iii) an Opinion of Counsel stating that, in the opinion of the signer, the property so rebuilt or renewed or to be rebuilt or renewed, and/or the replacement property, is or will be subject to the Lien hereof.

Any such moneys not so applied within thirty-six (36) months after its receipt by the Trustee, or in respect of which notice in writing of intention to apply the same to the work of rebuilding, renewal, replacement or substitution then in progress and uncompleted shall not have been given to the Trustee by the Company within such thirty-six (36) months, or which the Company shall at any time notify the Trustee is not to be so applied, shall thereafter be withdrawn, used or applied in the manner, to the extent and for the purposes, and subject to the conditions, provided in Section 17.06; provided, however, that if the amount of such moneys shall exceed the amount stated pursuant to clause (B) in the Expert's Certificate referred to above, the amount of such excess shall not be deemed to be Funded Cash, shall not be subject to Section 17.06 and shall be remitted to or upon the order of the Company upon the withdrawal, use or application of the balance of such moneys pursuant to Section 17.06.

Anything in this Indenture to the contrary notwithstanding, if property on or with respect to which a loss occurs constitutes Funded Property in part only, the Company may, at its election, obtain the reimbursement of insurance proceeds attributable to the part of such property which constitutes Funded Property under this subsection (b) and obtain the reimbursement of insurance proceeds attributable to the part of such property which does not constitute Funded Property under subsection (c) of this Section 17.13.

(c) All moneys paid to the Trustee by the Company in accordance with this Section or received by the Trustee as proceeds of any insurance, in either case on account of a loss on or with respect to property which does not constitute Funded Property, shall, subject to the requirements of any Lien prior hereto upon property subject to the Lien hereof, be held by the Trustee and, subject as aforesaid, shall be paid by it to the Company upon receipt by the Trustee of:

(i) a Company Request requesting such payment;

(ii) an Expert's Certificate stating:

(A) that such moneys were paid to or received by the Trustee on account of a loss on or with respect to property which does not constitute Funded Property; and

(B) if true, either (I) that the aggregate amount of the Cost or Fair Value to the Company (whichever is less) of all Property Additions which do not constitute Funded Property (excluding, to the extent of such loss, the property on or with respect to which such loss was incurred), after making deductions therefrom and additions thereto of the character contemplated by Section 1.03, is not less than zero (0) or (II) that the amount of such loss does not exceed the aggregate Cost or Fair Value to the Company (whichever is less) of Property Additions acquired, made or constructed on or after the ninetieth (90th) day prior to the date of the Company Request requesting such payment; or

(C) if neither of the statements contemplated in subclause (B) above can be made, the amount by which zero (0) exceeds the amount referred to in subclause (B)(I) above (showing in reasonable detail the calculation thereof); and

(iii) if the Expert's Certificate required by clause (ii) above contains neither of the statements contemplated in clause (ii)(B) above, an amount in cash, to be held by the Trustee as part of the Mortgaged Property, equal to the amount shown in clause (ii)(C) above.

To the extent that the Company shall be entitled to withdraw proceeds of insurance pursuant to this subsection (c), such proceeds shall be deemed not to constitute Funded Cash.

(d) Whenever under the provisions of this Section the Company is required to deliver moneys to the Trustee and at the same time shall have satisfied the conditions set forth herein for payment of moneys by the Trustee to the Company, there shall be paid to or retained by the Trustee or paid to the Company, as the case may be, only the net amount.

#### **SECTION 17.14. RECORDING, FILING, ETC.**

The Company shall cause this Indenture and all indentures and instruments supplemental hereto (or notices, memoranda or financing statements as may be recorded or filed to place third parties on notice thereof) to be promptly recorded and filed and re-recorded and re-filed in such manner and in such places, as may be required by law in order fully to preserve and protect the security of the Holders of the Securities and all rights of the Trustee and to perfect and maintain the perfection of any security interest granted to the Trustee hereunder or thereunder, and shall furnish to the Trustee:

(a) promptly after the execution and delivery of this Indenture and of each supplemental indenture, an Opinion of Counsel either stating that in the opinion of such counsel this Indenture or such supplemental indenture (or any other instrument, resolution, certificate, notice, memorandum or financing statement in connection therewith) has been properly recorded and filed, so as to make effective the Lien intended to be created hereby or thereby and to perfect

any security interest granted to the Trustee hereunder or thereunder, and reciting the details of such action, or stating that in the opinion of such counsel no such action is necessary to make such Lien effective or to perfect such security interest. The Company shall be deemed to be in compliance with this subsection (a) if (i) the Opinion of Counsel herein required to be delivered to the Trustee shall state that this Indenture or such supplemental indenture (or any other instrument, resolution, certificate notice, memorandum or financing statement in connection therewith) has been received for record or filing in each jurisdiction in which it is required to be recorded or filed and that, in the opinion of such counsel (if such is the case), such receipt for record or filing makes effective the Lien intended to be created by this Indenture or such supplemental indenture or perfects such security interest, and (ii) such opinion is delivered to the Trustee within such time, following the Execution Date or the date of execution and delivery of such supplemental indenture, as shall be practicable having due regard to the number and distance of the jurisdictions in which this Indenture or such supplemental indenture (or such other instrument, resolution, certificate, notice, memorandum or financing statement in connection therewith) is required to be recorded or filed; and

(b) on or before October 1 of each year, beginning October 1, 2009, an Opinion of Counsel stating either (i) that in the opinion of such counsel such action has been taken, since the date of the most recent Opinion of Counsel furnished pursuant to this subsection (b) or the first Opinion of Counsel furnished pursuant to subsection (a) of this Section, with respect to the recording, filing, re-recording, and re-filing of this Indenture and of each indenture supplemental to this Indenture (or any other instrument, resolution, certificate, notice, memorandum or financing statement in connection therewith), as is necessary to maintain the effectiveness of the Lien hereof and to maintain the perfection of any security interest granted to the Trustee hereunder, and reciting such action, or (ii) that in the opinion of such counsel no such action is necessary to maintain the effectiveness of such Lien or the perfection of such security interest.

The Company shall execute and deliver such supplemental indenture or indentures and such further instruments and do such further acts as may be necessary or proper to carry out the purposes of this Indenture and to make subject to the Lien hereof any property hereafter acquired, made or constructed and intended to be subject to the Lien hereof, and to transfer to any new trustee or trustees or co-trustee or co-trustees, the estate, powers, instruments or funds held in trust hereunder.

This Indenture is a "utility mortgage" as defined in Ohio Revised Code Section 1701.66 and, as more fully set forth in the Second Granting Clause above, is intended to encumber after-acquired property.

This Indenture constitutes a fixture filing within the meaning of Ohio Revised Code Section 1309.502 and covers goods which are or may become fixtures related to the real property encumbered by this Indenture and any amendments or supplements hereto.

[END OF ARTICLE SEVENTEEN]

This instrument may be executed in any number of counterparts, each of which so executed shall be deemed to be an original, but all such counterparts shall together constitute but one and the same instrument.

IN WITNESS WHEREOF, the parties hereto have caused this Indenture to be duly executed as of the day and year first above written.

**DUKE ENERGY OHIO, INC.**

By /s/ M. Allen Carrick  
M. Allen Carrick  
Assistant Treasurer  
-127-

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**THE BANK OF NEW YORK MELLON TRUST  
COMPANY, N.A., as Trustee**

By /s/ Van K. Brown  
Van K. Brown  
Vice President  
-128-

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Acknowledged and agreed solely as to the matters set forth in clauses (a) and (d) of the "Recitals of the Company":

**THE BANK OF NEW YORK MELLON,**  
as Resigning Trustee

By /s/ Kimberly P. Davidson  
Kimberly P. Davidson  
Vice President

STATE OF NORTH CAROLINA        )  
  ) ss:  
COUNTY OF MECKLENBURG        )

BE IT REMEMBERED, that on this 23rd day of March, 2009, before me, the undersigned, a notary public in and for the County and State aforesaid, duly commissioned and qualified, personally appeared M. Allen Carrick, personally known to me to be the same person whose name is subscribed to the foregoing instrument, and personally known to me to be an Assistant Treasurer of Duke Energy Ohio, Inc., an Ohio corporation, and acknowledged that he signed and delivered said instrument as his free and voluntary act as such Assistant Treasurer, and as the free and voluntary act of said Duke Energy Ohio, Inc., for the uses and purposes therein set forth; in pursuance of the power and authority granted to him by resolution of the Board of Directors of said Company.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal the day and year aforesaid.

(NOTARIAL SEAL)

\_\_\_\_\_  
*/s/ Heather Paige Blum*  
*Notary Public*

My commission expires 1/9/2013

STATE OF GEORGIA            )  
  ) ss:  
COUNTY OF FULTON         )

BE IT REMEMBERED, that on this \_\_\_\_ day of March, 2009, before me, the undersigned, a notary public in and for the County and State aforesaid, duly commissioned and qualified, personally appeared Van K. Brown, personally known to me to be the same person whose name is subscribed to the foregoing instrument, and personally known to me to be a Vice President of The Bank of New York Mellon Trust Company, N.A., a national banking association, and acknowledged that he signed and delivered said instrument as his free and voluntary act as such Vice President, and as the free and voluntary act of said The Bank of New York Mellon Trust Company, N.A., for the uses and purposes therein set forth; in pursuance of the power and authority granted to him by the bylaws of said association.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal the day and year aforesaid.

(NOTARIAL SEAL)

\_\_\_\_\_  
*/s/ Inna Rueve*  
*Notary Public*

**EXHIBIT A**

RECORDING DATA

DUKE ENERGY OHIO, INC.

(formerly The Cincinnati Gas & Electric Company)

MORTGAGE AND SUPPLEMENTAL INDENTURES

A-1

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**EXHIBIT B**

REAL PROPERTY ACQUIRED BETWEEN DECEMBER 1, 1985,  
THE DATE OF THE TWENTY-FIFTH SUPPLEMENTAL INDENTURE,  
AND THE DATE OF THIS FORTIETH SUPPLEMENTAL INDENTURE

B-1

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**EXHIBIT C**  
**SCHEDULE OF REAL PROPERTY HOLDINGS**  
C-1

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This instrument was prepared by:

Bradley C. Arnett, Esq.  
Frost Brown Todd LLC  
2200 PNC Center  
201 East Fifth Street  
Cincinnati, Ohio 45202



**DUKE ENERGY OHIO, INC.**  
**\$450,000,000 FIRST MORTGAGE BONDS,**  
**5.45% SERIES, DUE APRIL 1, 2019**  
***UNDERWRITING AGREEMENT***

March 18, 2009

Barclays Capital Inc.  
Deutsche Bank Securities Inc.  
SunTrust Robinson Humphrey, Inc.  
UBS Securities LLC

As Representatives of the several Underwriters

c/o Barclays Capital Inc.  
745 Seventh Avenue  
New York, New York 10019

Ladies and Gentlemen:

1. *Introductory.* DUKE ENERGY OHIO, INC., an Ohio corporation (the “Company”), proposes, subject to the terms and conditions stated herein, to issue and sell \$450,000,000 aggregate principal amount of First Mortgage Bonds, 5.45% Series, Due April 1, 2019 (the “Bonds”). The Bonds will be issued under and secured by a First Mortgage dated as of August 1, 1936 (the “Original Mortgage”), between the Company and The Bank of New York Mellon Trust Company, N.A., as successor trustee (the “Trustee”), as supplemented and amended from time to time, which will be amended and restated in its entirety by a Fortieth Supplemental Indenture, to be dated as of March 23, 2009 (the “Fortieth Supplemental Indenture” and together with the Original Mortgage (as supplemented and amended) the “Indenture”). Barclays Capital Inc., Deutsche Bank Securities Inc., SunTrust Robinson Humphrey, Inc. and UBS Securities LLC (the “Representatives”) are acting as representatives of the several underwriters named on Schedule A hereto (together with the Representatives, the “Underwriters”).

2. *Representations and Warranties of the Company.* As of the date hereof, as of the Applicable Time (as defined below) and as of the Closing Date the Company represents and warrants to, and agrees with, the several Underwriters that:

- (a) A registration statement (No. 333-146483-01), including a prospectus, relating to the Bonds and certain other securities has been filed with the Securities and Exchange Commission (the “Commission”) under the Securities Act of 1933, as amended (the “1933 Act”); such registration statement and any post-effective
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amendment thereto, each in the form heretofore delivered to you, became effective upon filing with the Commission pursuant to Rule 462 of the rules and regulations of the Commission under the 1933 Act (the "1933 Act Regulations"). The base prospectus filed as part of such registration statement, as amended and supplemented immediately prior to the Applicable Time, is hereinafter called the "Base Prospectus"; the preliminary prospectus supplement specifically relating to the Bonds immediately prior to the Applicable Time filed with the Commission pursuant to Rule 424(b) of the 1933 Act Regulations is hereinafter called the "Preliminary Prospectus"; the various parts of such registration statement, including all exhibits thereto and including the prospectus supplement relating to the Bonds that is filed with the Commission and deemed by virtue of Rule 430B of the 1933 Act Regulations to be part of such registration statement, each as amended at the time such part of the registration statement became effective, are hereinafter collectively called the "Registration Statement"; the form of the final prospectus relating to the Bonds filed with the Commission pursuant to Rule 424(b) of the 1933 Act Regulations in accordance with Section 5(a) hereof is hereinafter called the "Prospectus" and any information included in such Prospectus that was omitted from the Registration Statement at the time it became effective but that is deemed to be a part of and included in the Registration Statement pursuant to Rule 430B is referred to as "Rule 430B Information"; any reference herein to the Base Prospectus, the Preliminary Prospectus or the Prospectus shall be deemed to refer to and include the documents incorporated by reference therein pursuant to Item 12 of Form S-3 under the 1933 Act, as of the date of such prospectus; any reference to any amendment or supplement to the Base Prospectus, the Preliminary Prospectus or the Prospectus shall be deemed to refer to and include any post-effective amendment to the Registration Statement, the prospectus supplement relating to the Bonds filed with the Commission pursuant to Rule 424(b) under the 1933 Act and any documents filed under the Securities Exchange Act of 1934, as amended (the "1934 Act"), and incorporated therein, in each case after the date of the Base Prospectus, the Preliminary Prospectus or the Prospectus, as the case may be; any reference to any amendment to the Registration Statement shall be deemed to include any annual report of the Company filed pursuant to Section 13(a) or 15(d) of the 1934 Act after the effective date of the Registration Statement that is incorporated by reference in the Registration Statement. For purposes of this Agreement, the term "Applicable Time" means 4:09 p.m. (New York City Time) on the date hereof.

- (b) No stop order suspending the effectiveness of the Registration Statement has been issued and no proceeding for that purpose or pursuant to Section 8A of the 1933 Act has been initiated or threatened by the Commission.
  - (c) The Registration Statement, the Base Prospectus, the document or documents specified in Item 3 of Schedule B hereto (such document or documents, the "Permitted Free Writing Prospectus"), the Preliminary Prospectus and the Prospectus conform or will conform, and any amendments or supplements thereto will conform, in all material respects to the requirements of the 1933 Act and the 1933 Act Regulations; the Registration Statement as of its original effective date,
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at each deemed effective date with respect to the Underwriters pursuant to Rule 430B(f)(2) of the 1933 Act Regulations and at the Closing Date (as defined in Section 3), did not and will not contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein not misleading; the Prospectus and any amendment or supplement thereto, at the time the Prospectus or any such amendment or supplement is issued and at the Closing Date, will not include any untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading; and the Base Prospectus, the Preliminary Prospectus and the Permitted Free Writing Prospectus (collectively, the "Pricing Disclosure Package"), all considered together, as of the Applicable Time, did not include any untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading; provided, however, the Company makes no representation or warranty to the Underwriters with respect to any statements or omissions made in reliance upon and in conformity with written information furnished to the Company by the Representatives on behalf of the Underwriters specifically for use in the Registration Statement, the Prospectus, the Preliminary Prospectus or the Permitted Free Writing Prospectus.

- (d) The Permitted Free Writing Prospectus specified on Schedule B hereto as of its issue date and at all subsequent times through the completion of the public offer and sale of the Bonds (or until any earlier date that the Company notifies the Underwriters as described in Section 5(f)) did not and will not include any information that conflicts with the information contained in the Registration Statement, the Base Prospectus, the Preliminary Prospectus or the Prospectus that has not been superseded or modified.
  - (e) At the earliest time the Company or another offering participant made a bona fide offer (within the meaning of Rule 164(h)(2) of the 1933 Act Regulations) of the Bonds, the Company was not an "ineligible issuer" as defined in Rule 405 of the 1933 Act Regulations. The Company is, and was at the time of the initial filing of the Registration Statement, eligible to use Form S-3 under the 1933 Act.
  - (f) The documents incorporated or deemed to be incorporated by reference in the Registration Statement, the Pricing Disclosure Package and the Prospectus, at the time they were filed or hereafter are filed with the Commission, complied or will comply, as the case may be, in all material respects with the requirements of the 1934 Act and the rules and regulations of the Commission thereunder (the "1934 Act Regulations") and, when read together with the other information in the Prospectus, (a) at the time the Registration Statement became effective, (b) at the Applicable Time and (c) on the Closing Date, did not and will not contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.
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- (g) The Company's most recent Annual Report on Form 10-K meets the conditions specified in General Instruction I(1) of the General Instructions for Form 10-K, and any Quarterly Report filed on Form 10-Q by the Company after the filing of the Company's most recent Annual Report on Form 10-K meets the conditions specified in General Instruction H(1) of the General Instructions for Form 10-Q.
  - (h) The compliance by the Company with all of the provisions of this Agreement has been duly authorized by all necessary corporate action, and the consummation of the transactions herein contemplated will not conflict with or result in a breach or violation of any of the terms or provisions of, or constitute a default under, any indenture, mortgage, deed of trust, loan agreement or other agreement or instrument to which the Company or any of its subsidiaries is a party or by which any such party is bound or to which any of their respective properties or assets are subject that would have a material adverse effect on the business, financial condition or results of operations of the Company and its subsidiaries, taken as a whole; nor will such consummation result in any violation of the provisions of the Company's Amended Articles of Incorporation or Amended Articles of Consolidation (collectively, "Articles") or the Company's Regulations ("Regulations") or any statute or any order, rule or regulation of any court or governmental agency or body having jurisdiction over the Company or any of its subsidiaries or any of their respective properties that would have a material adverse effect on the business, financial condition or results of operations of the Company and its subsidiaries, taken as a whole. No consent, approval, authorization, order, registration or qualification of or with any such court or governmental agency or body is required for the consummation by the Company of the transactions contemplated by this Agreement, except for authorization by the Public Utilities Commission of Ohio ("PUCO") and registration of the offer and sale of the Bonds under the 1933 Act, qualification of the Indenture under the Trust Indenture Act of 1939 (the "1939 Act") and such consents, approvals, authorizations, registrations or qualifications as may be required under state securities or Blue Sky laws in connection with the purchase and distribution of the Bonds by the Underwriters.
  - (i) This Agreement has been duly authorized, executed and delivered by the Company.
  - (j) The Original Mortgage has been duly authorized, executed and delivered by the Company and duly qualified under the 1939 Act. The Fortieth Supplemental Indenture, to be dated as of March 23, 2009, has been duly authorized by the Company, and when executed and delivered by the Company (assuming the due authorization, execution and delivery thereof by the Trustee), the Indenture will constitute a valid and legally binding instrument of the Company, enforceable against the Company in accordance with its terms, except as (i) the enforceability thereof may be limited by bankruptcy, insolvency, or similar laws affecting creditors' rights generally, and (ii) the rights of acceleration and the availability of equitable remedies may be limited by equitable principles of general applicability.
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- (k) The Bonds have been duly authorized by the Company and when executed by the Company, authenticated by the Trustee (in the manner provided in the Indenture) and delivered against payment therefor will constitute valid and legally binding obligations of the Company, enforceable against the Company in accordance with their terms, except as (i) the enforceability thereof may be limited by bankruptcy, insolvency, or similar laws affecting creditors' rights generally, and (ii) the rights of acceleration and the availability of equitable remedies may be limited by equitable principles of general applicability.
- (l) The Company (i) is a corporation duly incorporated and validly existing in good standing under the laws of the State of Ohio and (ii) is duly qualified to do business in each jurisdiction where the failure to be so qualified would materially adversely affect the ability of the Company to perform its obligations under this Agreement, the Indenture or the Bonds.
- (m) The Company's only "significant subsidiary" within the meaning of Rule 405 of the 1933 Act Regulations is Duke Energy Kentucky, Inc.

3. *Purchase, Sale and Delivery of Bonds.* On the basis of the representations, warranties and agreements herein contained, but subject to the terms and conditions herein set forth, the Company agrees to sell to the Underwriters, and the Underwriters agree, severally and not jointly, to purchase from the Company, at a purchase price of 99.310% of the principal amount of the Bonds plus accrued interest from March 23, 2009, the respective principal amount of Bonds set forth opposite the name of each Underwriter on Schedule A hereto plus the respective principal amount of additional Bonds which each such Underwriter may become obligated to purchase pursuant to the provisions of Section 8 hereof. The Underwriters hereby also agree to make a payment to the Company in an aggregate amount equal to \$900,000, including in respect of expenses incurred by the Company in connection with the offering of the Bonds.

Payment of the purchase price for the Bonds to be purchased by the Underwriters and the payment referred to above shall be made at the offices of Frost Brown Todd LLC, 2200 PNC Center, 201 East Fifth Street, Cincinnati, Ohio 45202-4182, or at such other place as shall be mutually agreed upon by the Representatives and the Company, at 10:00 a.m., New York City time, on March 23, 2009, or such other time and date as shall be mutually agreed upon in writing by the Representatives and the Company (the "Closing Date"). All other documents referred to herein that are to be delivered at the Closing Date shall be delivered at that time at the offices of Sidley Austin LLP, 787 Seventh Avenue, New York, NY 10019. Payment shall be made to the Company by wire transfer of immediately available funds to a bank account designated by the Company, against delivery of the Bonds, in fully registered form, to the Representatives for the respective accounts of the Underwriters. The Bonds shall be delivered in the form of one or more global certificates in aggregate denomination equal to the aggregate principal amount of Bonds upon original issuance, and registered in the name of Cede & Co., as nominee for The Depository Trust Company ("DTC").

4. *Offering by the Underwriters.* It is understood that the several Underwriters propose to offer the Bonds for sale to the public as set forth in the Pricing Disclosure Package and the Prospectus.

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5. *Covenants of the Company.* The Company covenants and agrees with the several Underwriters that:

- (a) The Company will cause the Preliminary Prospectus and the Prospectus to be filed pursuant to and in compliance with Rule 424(b) of the 1933 Act Regulations; the Company will advise the Underwriters promptly of (x) the filing of any amendment or supplement to the Registration Statement, the Base Prospectus, the Preliminary Prospectus or the Prospectus, and (y) the institution by the Commission of any stop order proceedings in respect of the Registration Statement. The Company will use its best efforts to prevent the issuance of any such stop order and to obtain as soon as possible its lifting, if issued.
  - (b) If at any time when a prospectus relating to the Bonds (or the notice referred to in Rule 173(a) of the 1933 Act Regulations) is required to be delivered under the 1933 Act any event occurs as a result of which the Pricing Disclosure Package or the Prospectus as then amended or supplemented would include an untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading, or if it is necessary at any time to amend the Pricing Disclosure Package or the Prospectus to comply with the 1933 Act, the Company promptly will prepare and file with the Commission an amendment, a supplement or an appropriate document pursuant to Section 13 or 14 of the 1934 Act which will correct such statement or omission or which will effect such compliance.
  - (c) The Company, during the period when a prospectus relating to the Bonds is required to be delivered under the 1933 Act, will timely file all documents required to be filed with the Commission pursuant to Section 13 or 14 of the 1934 Act.
  - (d) Without the prior consent of the Underwriters, the Company has not made and will not make any offer relating to the Bonds that would constitute a “free writing prospectus” as defined in Rule 405 of the 1933 Act Regulations, other than the Permitted Free Writing Prospectus; each Underwriter, severally and not jointly, represents and agrees that, without the prior consent of the Company, it has not made and will not make any offer relating to the Bonds that would constitute a “free writing prospectus” as defined in Rule 405 of the 1933 Act Regulations, other than a Permitted Free Writing Prospectus or a free writing prospectus that is not required to be filed by the Company pursuant to Rule 433 of the 1933 Act Regulations (“Rule 433”); any such free writing prospectus (which shall include the pricing term sheet discussed in Section 5(e) below), the use of which has been consented to by the Company and the Underwriters, is specified in Item 3 of Schedule B hereto. The Company represents that it has treated and agrees that it will treat each Permitted Free Writing Prospectus as an “issuer free writing prospectus,” as defined in Rule 433, and has complied and will comply with the requirements of Rule 433 applicable to any Permitted Free Writing Prospectus, including timely filing with the Commission where required, legending and record keeping.
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- (e) The Company agrees to prepare a pricing term sheet specifying the terms of the Bonds not contained in the Preliminary Prospectus, substantially in the form of Schedule C hereto and approved by the Representatives on behalf of the Underwriters, and to file such pricing term sheet as an “issuer free writing prospectus” pursuant to Rule 433 prior to the close of business two business days after the date hereof.
  - (f) The Company agrees that if at any time following the issuance of a Permitted Free Writing Prospectus any event occurs as a result of which such Permitted Free Writing Prospectus would conflict with the information (not superseded or modified) in the Registration Statement, the Pricing Disclosure Package or the Prospectus or would include an untrue statement of a material fact or omit to state any material fact necessary in order to make the statements therein, in light of the circumstances then prevailing, not misleading, the Company will give prompt notice thereof to the Underwriters and, if requested by the Underwriters, will prepare and furnish without charge to each Underwriter a free writing prospectus or other document, the use of which has been consented to by the Underwriters, which will correct such conflict, statement or omission; provided, however, that this covenant shall not apply to any statements or omissions made in reliance upon and in conformity with written information furnished to the Company by the Representatives on behalf of the Underwriters specifically for use in the Registration Statement, the Pricing Disclosure Package or the Prospectus.
  - (g) The Company will timely make generally available to its securityholders as soon as practicable an earnings statement for the purposes of the last paragraph of Section 11(a) of the 1933 Act.
  - (h) The Company will furnish to you, without charge, copies of the Registration Statement (three of which will include all exhibits other than those incorporated by reference), the Pricing Disclosure Package and the Prospectus, and all amendments and supplements to such documents, in each case as soon as available and in such quantities as you reasonably request.
  - (i) The Company will arrange or cooperate in arrangements for the qualification of the Bonds for sale under the laws of such jurisdictions as you designate and will continue such qualifications in effect so long as required for the distribution; provided, however, that the Company shall not be required to qualify as a foreign corporation or to file any general consent to service of process under the laws of any state where it is not now so subject.
  - (j) The Company will pay all expenses incident to the performance of its obligations under this Agreement including (i) the printing and filing of the Registration Statement and the printing of this Agreement and any Blue Sky Survey, (ii) the preparation and printing of certificates for the Bonds, (iii) the issuance and delivery of the Bonds as specified herein, (iv) the fees and disbursements of counsel for the Underwriters in connection with the qualification of the Bonds under the securities laws of any jurisdiction in accordance with the provisions of
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Section 5(i) and in connection with the preparation of the Blue Sky Survey (such fees not to exceed \$5,000), (v) the printing and delivery to the Underwriters, in quantities as hereinabove referred to, of copies of the Registration Statement and any amendments thereto, of the Preliminary Prospectus, of the Prospectus, of any Permitted Free Writing Prospectus and any amendments or supplements thereto, (vi) any fees charged by independent rating agencies for rating the Bonds, (vii) any fees and expenses in connection with the listing of the Bonds on the New York Stock Exchange, (viii) any filing fee required by the Financial Industry Regulatory Authority, (ix) the costs of any depository arrangements for the Bonds with DTC or any successor depository and (x) the costs and expenses of the Company relating to investor presentations on any "road show" undertaken in connection with the marketing of the offering of the Bonds, including, without limitation, expenses associated with the production of road show slides and graphics, fees and expenses of any consultants engaged in connection with the road show presentations with the prior approval of the Company, travel and lodging expenses of the Underwriters and officers of the Company and any such consultants, and the cost of any aircraft chartered in connection with the road show; provided, however, the Underwriters shall reimburse a portion of the costs and expenses referred to in this clause (x).

6. *Conditions of the Obligations of the Underwriters.* The obligations of the several Underwriters to purchase and pay for the Bonds will be subject to the accuracy of the representations and warranties on the part of the Company herein, to the accuracy of the statements of officers of the Company made pursuant to the provisions hereof, to the performance by the Company of its obligations hereunder and to the following additional conditions precedent:

- (a) The Prospectus shall have been filed by the Company with the Commission pursuant to Rule 424(b) within the applicable time period prescribed for such filing by the 1933 Act Regulations, and each Permitted Free Writing Prospectus shall have been filed by the Company with the Commission pursuant to Rule 433 within the applicable time period prescribed for such filing by the 1933 Act Regulations (to the extent so required).
  - (b) On or after the Applicable Time and prior to the Closing Date, no stop order suspending the effectiveness of the Registration Statement shall have been issued and no proceedings for that purpose or pursuant to Section 8A of the 1933 Act shall have been instituted or, to the knowledge of the Company or you, shall be threatened by the Commission.
  - (c) On or after the Applicable Time and prior to the Closing Date, the rating assigned by Moody's Investors Service, Inc. or Standard & Poor's Ratings Services (or any of their successors) to any debt securities or preferred stock of the Company as of the date of this Agreement shall not have been lowered.
  - (d) Since the respective most recent dates as of which information is given in the Pricing Disclosure Package and the Prospectus and up to the Closing Date, there
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shall not have been any material adverse change in the condition of the Company and its subsidiaries, taken as a whole, financial or otherwise, except as reflected in or contemplated by the Pricing Disclosure Package and the Prospectus, and since such dates and up to the Closing Date, there shall not have been any material transaction entered into by the Company other than transactions contemplated by the Pricing Disclosure Package and the Prospectus and transactions in the ordinary course of business, the effect of which in your reasonable judgment is so material and adverse as to make it impracticable or inadvisable to proceed with the public offering or the delivery of the Bonds on the terms and in the manner contemplated by the Pricing Disclosure Package and the Prospectus.

- (e) You shall have received an opinion of Richard G. Beach, Esq., Assistant General Counsel of Duke Energy Business Services, LLC, the service company affiliate of the Company, dated the Closing Date, to the effect that:
- (i) The Company is a corporation duly organized and validly existing in good standing under the laws of the State of Ohio, with power and authority (corporate and other) to own its properties and conduct its business as described in the Pricing Disclosure Package and the Prospectus and to enter into and perform its obligations under this Agreement.
  - (ii) The Company is duly qualified to do business in each jurisdiction in which the ownership or leasing of its property or the conduct of its business requires such qualification, except where the failure would not, singularly or in the aggregate, reasonably be expected to have a material adverse effect on the consolidated financial position, stockholder's equity, results of operations, business or prospects of the Company and its subsidiaries, taken as a whole, and to own and operate the properties in use in such business.
  - (iii) Each of the Company's subsidiaries is duly organized and validly existing in good standing under the laws of the jurisdiction of its organization and has due corporate and governmental authority to carry on the business in which it is engaged, except where the failure would not, singularly or in the aggregate, reasonably be expected to have a material adverse effect on the consolidated financial position, stockholder's equity, results of operations, business or prospects of the Company and its subsidiaries, taken as a whole, and to own and operate the properties in use in such businesses.
  - (iv) The execution, delivery and performance of this Agreement, the Indenture and the Bonds and compliance by the Company with its obligations under this Agreement, the Indenture and the Bonds will not conflict with, or result in any charge or encumbrance upon any of the assets of the Company (other than pursuant to the Indenture) pursuant to the terms of, or constitute a default under, any agreement, indenture or instrument known to such counsel, or result in a violation of the Articles or
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Regulations of the Company (as in effect on the Closing Date) or any order, rule or regulation (also as in effect on the Closing Date) of any court or governmental agency having jurisdiction over the Company, and the issuance of the Bonds in accordance with the Indenture and the sale of the Bonds in accordance with this Agreement, do not and will not result in any violation by the Company of any of the terms or provisions of the Articles or Regulations, or of the Indenture, or any mortgage or other agreement or instrument known to such counsel by which the Company is bound.

- (v) The Indenture is in due and proper form, has been duly and validly authorized by all necessary corporate action, has been duly executed and delivered by the Company, qualified under the 1939 Act, and, assuming due authorization, execution and delivery by the Trustee, the Indenture is a valid and binding instrument of the Company, enforceable in accordance with its terms, except as (i) the enforceability thereof may be limited by bankruptcy, insolvency, or similar laws affecting creditors' rights generally, and (ii) the rights of acceleration and the availability of equitable remedies may be limited by equitable principles of general applicability.
  - (vi) The issue of the Bonds by the Company in accordance with the terms of the Indenture has been duly authorized by all necessary corporate action; when duly executed by the Company, authenticated by the Trustee and delivered to and paid for by the Underwriters pursuant to this Agreement, the Bonds will constitute the legal, valid and binding obligations of the Company enforceable in accordance with their terms, secured by the lien of and entitled to the benefits provided by the Indenture, except as (i) the enforceability thereof may be limited by bankruptcy, insolvency, or similar laws affecting creditors' rights generally, and (ii) the rights of acceleration and the availability of equitable remedies may be limited by equitable principles of general applicability.
  - (vii) The Company has good and marketable title to the properties, rights and assets described in and conveyed by the Indenture and not released by the Trustee from the lien thereof prior to the time of delivery of the Bonds, subject only to the lien of the Indenture and to "permitted liens" as defined in the Indenture; the description in the Indenture of such properties, rights and assets is adequate to constitute the Indenture a lien thereon; the Indenture complies with all applicable laws of the State of Ohio (wherein the properties subjected or intended to be subject to the lien of the Indenture are located), including all applicable recording laws, and, subject only to the matters referred to above, constitutes a valid and direct first lien on such properties, rights and assets, which include substantially all of the Company's tangible electric transmission and distribution utility property located in Ohio, together with the Company's recorded easements and rights of way, franchises, licenses, permits, grants,
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immunities, privileges and rights that are used or useful in the operation of such property; and all tangible electric transmission and distribution utility property located in Ohio acquired by the Company subsequent to the time of issuance of the Bonds will be subject to the lien of the Indenture, subject, however, to "permitted liens" as defined in the Indenture.

- (viii) The Indenture other than the Fortieth Supplemental Indenture has been duly filed for record in such manner and in such places as are required by law in order to give constructive notice of, and to establish, preserve and protect the lien of, the Indenture on all property of the Company of every kind referred to in the Indenture as subject to the lien thereof.
- (ix) Except as referred to in the Pricing Disclosure Package and the Prospectus, there is no action, suit or proceeding, inquiry or investigation, at law or in equity or before or by any court, public board or body, pending or, to such counsel's knowledge, threatened against or affecting the Company, wherein an unfavorable decision, ruling or finding would (i) materially and adversely affect the condition (financial or otherwise), results of operations, business or properties of the Company or (ii) materially and adversely affect the transactions contemplated by this Agreement, or which would adversely affect the validity or enforceability of the Indenture or the Bonds. The descriptions in the Registration Statement, the Pricing Disclosure Package and the Prospectus of any legal or governmental proceedings are accurate and fairly present the information required to be shown, and such counsel does not know of any litigation or any legal or governmental proceeding instituted or threatened against the Company or any of its properties that would be required to be disclosed in the Registration Statement, the Pricing Disclosure Package or the Prospectus and is not so disclosed.
- (x) An order of the PUCO relating to the issuance of the Bonds has been duly entered and, to such counsel's knowledge, has not been modified or repealed in any respect and is in full force and effect. The issuance and sale of the Bonds to the Underwriters are in conformity with the terms of such order. Except as may be required under the 1933 Act or the securities or Blue Sky laws of any jurisdiction, no further consent, approval, authorization or order of, or registration or filing with, any court or governmental or public agency, authority or body is required with respect to the Company for the execution, delivery and performance of this Agreement, the Indenture or the Bonds, the issuance by the Company of the Bonds or the consummation by the Company of the transactions contemplated by this Agreement, the Indenture or the Bonds.

In addition, such counsel shall state that no facts have come to such counsel's attention that have caused such counsel to believe that the Registration Statement, at the Applicable Time, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to

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make the statements therein not misleading, or that the Prospectus, as of its date and as of the Closing Date, contained or contains an untrue statement of a material fact or omitted or omits to state a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading (except that in each case such counsel need not express an opinion as to the financial statements and other financial data included or incorporated by reference therein or excluded therefrom). Such counsel shall further state that, in addition, no facts have come to such counsel's attention that have caused such counsel to believe that the Pricing Disclosure Package, as of the Applicable Time, contained an untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading (except that such counsel need not express an opinion as to the financial statements and other financial data included or incorporated by reference therein or excluded therefrom).

Such counsel shall expressly authorize the Underwriters to rely on such counsel's opinion dated the Closing Date delivered to the Trustee pursuant to the Indenture.

In rendering the foregoing opinion, such counsel may state that such counsel does not express any opinion concerning any law other than the laws of the State of Ohio and the Commonwealth of Kentucky.

- (f) You shall have received an opinion of Frost Brown Todd LLC, counsel to the Company, dated the Closing Date, to the effect that:
- (i) The Fortieth Supplemental Indenture has been duly authorized, executed and delivered by the Company, and assuming due authorization, execution and delivery by the Trustee, the Indenture is a valid and binding instrument of the Company enforceable in accordance with its terms, except as (i) the enforceability thereof may be limited by bankruptcy, insolvency or similar laws affecting creditors' rights generally, and (ii) the rights of acceleration and the availability of equitable remedies may be limited by equitable principles of general applicability.
  - (ii) The Bonds have been duly authorized, and when duly executed by the Company, authenticated by the Trustee and delivered to and paid for by the Underwriters pursuant to this Agreement, will be valid and binding obligations of the Company enforceable in accordance with their terms, except as (i) the enforceability thereof may be limited by bankruptcy, insolvency or similar laws affecting creditors' rights generally and (ii) the rights of acceleration and the availability of equitable remedies may be limited by equitable principles of general applicability.
  - (iii) This Agreement has been duly authorized, executed and delivered by the Company.
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- (iv) The statements made in the Preliminary Prospectus and the Prospectus under the captions “Description of the Mortgage Bonds” and “Certain U.S. Federal Income Tax Considerations for Non-U.S. Holders” in each case insofar as such statements constitute summaries of the legal matters, documents or proceedings referred to therein, accurately and fairly summarize the matters referred to therein in all material respects.
- (v) The Company is not, and solely after giving effect to the offering and sale of the Bonds and the application of the proceeds thereof as described in the Prospectus, will not be subject to registration and regulation as an “investment company” as such term is defined in the Investment Company Act of 1940, as amended.

In rendering the foregoing opinions, such counsel may state that it has relied as to certain factual matters on information obtained from public officials, officers and representatives of the Company and has assumed that the signatures on all documents examined by it are genuine, and that such counsel has not independently verified such factual matters or assumptions. In addition, such counsel may assume matters governed by New York law.

You shall also have received a statement of Frost Brown Todd LLC, dated the Closing Date, to the effect that:

- (1) no facts have come to such counsel’s attention that have caused such counsel to believe that the documents filed by the Company under the 1934 Act and the 1934 Act Regulations that are incorporated by reference in the Registration Statement, the Pricing Disclosure Package and the Prospectus, were not, on their face, appropriately responsive in all material respects to the requirements of the 1934 Act and the 1934 Act Regulations (except that in each case such counsel need not express any view as to the financial statements, schedules and other financial information included or incorporated by reference therein or excluded therefrom or the Form T-1);
  - (2) the Registration Statement, at the Applicable Time, and the Prospectus, as of its date, appeared on their face to be appropriately responsive in all material respects to the requirements of the 1933 Act and the 1933 Act Regulations (except that in each case such counsel need not express any view as to the financial statements, schedules and other financial information included or incorporated by reference therein or excluded therefrom or the Form T-1); and
  - (3) no facts have come to such counsel’s attention that have caused such counsel to believe that the Registration Statement, at the Applicable Time, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that the Prospectus, as of its date and as of the Closing Date, contained or contains an untrue statement of a
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material fact or omitted or omits to state a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading (except that in each case such counsel need not express any view as to the financial statements, schedules and other financial information included or incorporated by reference therein or excluded therefrom or the Form T-1).

Such counsel shall further state that, in addition, no facts have come to such counsel's attention that have caused such counsel to believe that the Pricing Disclosure Package, as of the Applicable Time, contained an untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading (except that in each case such counsel need not express any view as to the financial statements, schedules and other financial information included or incorporated by reference therein or excluded therefrom or the Form T-1).

In addition, such statement shall confirm that the Prospectus has been filed with the Commission within the time period required by Rule 424(b) of the 1933 Act Regulations and any required filing of a Permitted Free Writing Prospectus pursuant to Rule 433 of the 1933 Act Regulations has been made with the Commission within the time period required by Rule 433(d) of the 1933 Act Regulations. Such statement shall further state that the Registration Statement became effective upon filing under the 1933 Act and the Indenture has been qualified under the 1939 Act, and that such counsel has been orally advised by the Commission that no stop order suspending the effectiveness of the Registration Statement has been issued and, to such counsel's knowledge, no proceedings for that purpose have been instituted or are pending or threatened by the Commission.

In addition, such counsel may state that such counsel does not pass upon, or assume any responsibility for, the accuracy, completeness or fairness of the statements contained or incorporated by reference in the Registration Statement, the Pricing Disclosure Package or the Prospectus and has made no independent check or verification thereof (except to the limited extent referred to in Section 6(f)(iv) above).

- (g) You shall have received opinions and statements of Sidley Austin LLP, counsel for the Underwriters, dated the Closing Date, as to such matters as you may reasonably request; the Company shall have furnished Sidley Austin LLP with such documents as it reasonably requests for the purpose of enabling it to satisfy such request. In giving its opinion, Sidley Austin LLP may rely on the opinions of Richard G. Beach, Esq., Assistant General Counsel of Duke Energy Business Services, LLC, the service company affiliate of the Company and Frost Brown Todd LLC (or other appropriate counsel reasonably satisfactory to the Representatives) as to matters of Ohio law and Mr. Beach as to matters of Kentucky law.
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- (h) On or after the date hereof, there shall not have occurred any of the following: (i) a suspension or material limitation in trading in securities generally or of the securities of Duke Energy Corporation on the New York Stock Exchange; or (ii) a general moratorium on commercial banking activities in New York declared by either Federal or New York State authorities or a material disruption in commercial banking services or securities settlement or clearance services in the United States; or (iii) the outbreak or escalation of hostilities involving the United States or the declaration by the United States of a national emergency or war, if the effect of any such event specified in this subsection (h) in your reasonable judgment makes it impracticable or inadvisable to proceed with the public offering or the delivery of the Bonds on the terms and in the manner contemplated in the Pricing Disclosure Package and the Prospectus. In such event there shall be no liability on the part of any party to any other party except as otherwise provided in Section 7 hereof and except for the expenses to be borne by the Company as provided in Section 5(j) hereof.
  - (i) You shall have received a certificate of the Chairman of the Board, the President, any Vice President, the Secretary or an Assistant Secretary and any financial or accounting officer of the Company, dated the Closing Date, in which such officers, to the best of their knowledge after reasonable investigation, shall state that the representations and warranties of the Company in this Agreement are true and correct as of the Closing Date, that the Company has complied with all agreements and satisfied all conditions on its part to be performed or satisfied at or prior to the Closing Date, that the conditions specified in Section 6(c) and Section 6(d) have been satisfied, and that no stop order suspending the effectiveness of the Registration Statement has been issued and no proceedings for that purpose have been instituted or are threatened by the Commission.
  - (j) At the time of the execution of this Agreement, you shall have received a letter dated such date, in form and substance satisfactory to you, from Deloitte & Touche LLP, the Company's independent public accountants, containing statements and information of the type ordinarily included in accountants' "comfort letters" to underwriters with respect to the financial statements and certain financial information contained in or incorporated by reference in the Registration Statement, the Pricing Disclosure Package and the Prospectus, including specific references to inquiries regarding any increase in long-term debt, decrease in net current assets (defined as current assets less current liabilities) or stockholder's equity, and decrease in revenues or net income for the period subsequent to the latest financial statements incorporated by reference in the Registration Statement, as of a specified date not more than three business days prior to the date of this Agreement.
  - (k) At the Closing Date, you shall have received from Deloitte & Touche LLP, a letter dated as of the Closing Date, to the effect that they reaffirm the statements made in the letter furnished pursuant to subsection (j) of this Section 6, except that the specified date referred to shall be not more than three business days prior to the Closing Date.
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- (l) An appropriate order from the PUCO necessary to permit the issue and sale of the Bonds as contemplated hereby and containing no material provision or condition which is unacceptable to the Company or the Underwriters shall be in effect and no proceedings to suspend the effectiveness of such order shall be pending or threatened.

The Company will furnish you with such conformed copies of such opinions, certificates, letters and documents as you reasonably request.

*7. Indemnification.* The Company agrees to indemnify and hold harmless each Underwriter, their respective officers and directors, and each person, if any, who controls any Underwriter within the meaning of Section 15 of the 1933 Act, as follows:

- (i) against any and all loss, liability, claim, damage and expense whatsoever arising out of any untrue statement or alleged untrue statement of a material fact contained in the Registration Statement (or any amendment thereto) including the Rule 430B Information, or the omission or alleged omission therefrom of a material fact required to be stated therein or necessary to make the statements therein not misleading or arising out of any untrue statement or alleged untrue statement of a material fact contained in the Preliminary Prospectus, the Pricing Disclosure Package, the Prospectus (or any amendment or supplement thereto) or any Permitted Free Writing Prospectus, or the omission or alleged omission therefrom of a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading, unless such statement or omission or such alleged statement or omission was made in reliance upon and in conformity with written information furnished to the Company by the Representatives on behalf of the Underwriters expressly for use in the Registration Statement (or any amendment thereto), the Preliminary Prospectus, the Pricing Disclosure Package, the Prospectus (or any amendment or supplement thereto) or any Permitted Free Writing Prospectus;
  - (ii) against any and all loss, liability, claim, damage and expense whatsoever to the extent of the aggregate amount paid in settlement of any litigation, commenced or threatened, or of any claim whatsoever based upon any such untrue statement or omission or any such alleged untrue statement or omission, if such settlement is effected with the written consent of the Company; and
  - (iii) against any and all expense whatsoever reasonably incurred in investigating, preparing or defending against any litigation, commenced or threatened, or any claim whatsoever based upon any such untrue statement or omission, or any such alleged untrue statement or omission, to the extent that any such expense is not paid under (i) or (ii) of this Section 7.
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In no case shall the Company be liable under this indemnity agreement with respect to any claim made against any Underwriter or any such controlling person unless the Company shall be notified in writing of the nature of the claim within a reasonable time after the assertion thereof, but failure so to notify the Company shall not relieve it from any liability which it may have otherwise than under subsections 7(a) and 7(d). The Company shall be entitled to participate at its own expense in the defense, or if it so elects within a reasonable time after receipt of such notice, to assume the defense of any suit brought to enforce any such claim, but if it so elects to assume the defense, such defense shall be conducted by counsel chosen by it and approved by the Underwriter or Underwriters or controlling person or persons, or defendant or defendants in any suit so brought, which approval shall not be unreasonably withheld. In any such suit, any Underwriter or any such controlling person shall have the right to employ its own counsel, but the fees and expenses of such counsel shall be at the expense of such Underwriter or such controlling person unless (i) the Company and such Underwriter shall have mutually agreed to the employment of such counsel, or (ii) the named parties to any such action (including any impleaded parties) include both such Underwriter or such controlling person and the Company and such Underwriter or such controlling person shall have been advised by such counsel that a conflict of interest between the Company and such Underwriter or such controlling person may arise and for this reason it is not desirable for the same counsel to represent both the indemnifying party and also the indemnified party (it being understood however, that the Company shall not, in connection with any one such action or separate but substantially similar or related actions in the same jurisdiction arising out of the same general allegations or circumstances, be liable for the reasonable fees and expenses of more than one separate firm of attorneys for all such Underwriters and all such controlling persons, which firm shall be designated in writing by you). The Company agrees to notify you within a reasonable time of the assertion of any claim against it, any of its officers or directors or any person who controls the Company within the meaning of Section 15 of the 1933 Act, in connection with the sale of the Bonds.

- (b) Each Underwriter severally agrees that it will indemnify and hold harmless the Company, its directors and each of the officers of the Company who signed the Registration Statement and each person, if any, who controls the Company within the meaning of Section 15 of the 1933 Act to the same extent as the indemnity contained in subsection (a) of this Section 7, but only with respect to statements or omissions made in the Registration Statement (or any amendment thereto), the Preliminary Prospectus, the Pricing Disclosure Package, the Prospectus (or any amendment or supplement thereto) or any Permitted Free Writing Prospectus, in reliance upon and in conformity with written information furnished to the Company by the Representatives on behalf of the Underwriters expressly for use in the Registration Statement (or any amendment thereto), the Preliminary Prospectus, the Pricing Disclosure Package, the Prospectus (or any amendment or supplement thereto) or any Permitted Free Writing Prospectus. In case any action shall be brought against the Company or any person so indemnified based on the Registration Statement (or any amendment thereto), the Preliminary Prospectus, the Pricing Disclosure Package, the Prospectus (or any amendment or supplement thereto) or any Permitted Free Writing Prospectus, and in respect of which indemnity may be sought against any Underwriter, such Underwriter shall have the rights and duties given to the Company, and the Company and each person so
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indemnified shall have the rights and duties given to the Underwriters, by the provisions of subsection (a) of this Section 7.

- (c) No indemnifying party shall, without the prior written consent of the indemnified party, effect any settlement of any pending or threatened proceeding in respect of which any indemnified party is or could have been a party and indemnity could have been sought hereunder by such indemnified party, unless such settlement includes an unconditional release of such indemnified party from all liability on claims that are the subject matter of such proceeding, and does not include a statement as to or an admission of fault, culpability or a failure to act by or on behalf of any indemnified party.
  - (d) If the indemnification provided for in this Section 7 is unavailable to or insufficient to hold harmless an indemnified party in respect of any and all loss, liability, claim, damage and expense whatsoever (or actions in respect thereof) that would otherwise have been indemnified under the terms of such indemnity, then each indemnifying party shall contribute to the amount paid or payable by such indemnified party as a result of such loss, liability, claim, damage or expense (or actions in respect thereof) in such proportion as is appropriate to reflect the relative benefits received by the Company on the one hand and the Underwriters on the other from the offering of the Bonds. If however, the allocation provided by the immediately preceding sentence is not permitted by applicable law, or if the indemnified party failed to give the notice required above, then each indemnifying party shall contribute to such amount paid or payable by such indemnified party in such proportion as is appropriate to reflect not only such relative benefits but also the relative fault of the Company on the one hand and the Underwriters on the other in connection with the statements or omissions which resulted in such loss, liability, claim, damage or expense (or actions in respect thereof), as well as any other relevant equitable considerations. The relative benefits received by the Company on the one hand and the Underwriters on the other shall be deemed to be in the same proportion as the total net proceeds from the offering (before deducting expenses) received by the Company bear to the total compensation received by the Underwriters in respect of the underwriting discount as set forth in the table on the cover page of the Prospectus. The relative fault shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission or alleged omission to state a material fact relates to information supplied by the Company on the one hand or the Underwriters on the other and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission. The Company and the Underwriters agree that it would not be just and equitable if contribution pursuant to this Section 7 were determined by pro rata allocation (even if the Underwriters were treated as one entity for such purpose) or by any other method of allocation which does not take account of the equitable considerations referred to above in this Section 7. The amount paid or payable by an indemnified party as a result of the losses, liabilities, claims, damages or expenses (or actions in respect thereof) referred to above in this Section 7 shall be deemed to include any legal or other expenses
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reasonably incurred by such indemnified party in connection with investigating or defending any such action or claim. Notwithstanding the provisions of this Section 7, no Underwriter shall be required to contribute any amount in excess of the amount by which the total price at which the Bonds underwritten by it and distributed to the public were offered to the public exceeds the amount of any damages which such Underwriter has otherwise been required to pay by reason of such untrue or alleged untrue statement or omission or alleged omission. No person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the 1933 Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentation. The Underwriters' obligations to contribute are several in proportion to their respective underwriting obligations and not joint.

8. *Default by One or More of the Underwriters.* If any Underwriter shall default in its obligation to purchase the principal amount of the Bonds which it has agreed to purchase hereunder on the Closing Date, you may in your discretion arrange for you or another party or other parties to purchase such Bonds, as applicable, on the terms contained herein. If within thirty-six hours after such default by any Underwriter you do not arrange for the purchase of such Bonds, then the Company shall be entitled to a further period of thirty-six hours within which to procure another party or other parties satisfactory to you to purchase such Bonds on such terms. In the event that, within the respective prescribed periods, you notify the Company that you have so arranged for the purchase of such Bonds, or the Company notifies you that it has so arranged for the purchase of such Bonds, you or the Company shall have the right to postpone such Closing Date for a period of not more than seven days, in order to effect whatever changes may thereby be made necessary in the Registration Statement or the Prospectus, or in any other documents or arrangements, and the Company agrees to file promptly any amendments to the Registration Statement, the Pricing Disclosure Package or the Prospectus which may be required. The term "Underwriter" as used in this Agreement shall include any person substituted under this Section 8 with like effect as if such person had originally been a party to this Agreement with respect to such Bonds.

- (a) If, after giving effect to any arrangements for the purchase of the Bonds of a defaulting Underwriter or Underwriters by you or the Company as provided in subsection (a) above, the aggregate amount of such Bonds which remains unpurchased does not exceed one-tenth of the aggregate amount of all the Bonds to be purchased at such Closing Date, then the Company shall have the right to require each non-defaulting Underwriter to purchase the amount of Bonds which such Underwriter agreed to purchase hereunder at such Closing Date and, in addition, to require each non-defaulting Underwriter to purchase its pro rata share (based on the amount of Bonds which such Underwriter agreed to purchase hereunder) of the Bonds of such defaulting Underwriter or Underwriters for which such arrangements have not been made; but nothing herein shall relieve a defaulting Underwriter from liability for its default.
  - (b) If, after giving effect to any arrangements for the purchase of the Bonds of a defaulting Underwriter or Underwriters by you or the Company as provided in subsection (a) above, the aggregate amount of such Bonds which remains
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unpurchased exceeds one-tenth of the aggregate amount of all the Bonds to be purchased at such Closing Date, or if the Company shall not exercise the right described in subsection (b) above to require non-defaulting Underwriters to purchase Bonds of a defaulting Underwriter or Underwriters, then this Agreement shall thereupon terminate, without liability on the part of any non-defaulting Underwriter or the Company, except for the expenses to be borne by the Company as provided in Section 5(j) hereof and the indemnity and contribution agreement in Section 7 hereof; but nothing herein shall relieve a defaulting Underwriter from liability for its default.

9. *Representations and Indemnities to Survive Delivery.* The respective indemnities, agreements, representations, warranties and other statements of the Company or its officers and of the several Underwriters set forth in or made pursuant to this Agreement will remain in full force and effect, regardless of any investigation, or statement as to the results thereof, made by or on behalf of any Underwriter or the Company, or any of its officers or directors or any controlling person, and will survive delivery of and payment for the Bonds.

10. *Reliance on Your Acts.* In all dealings hereunder, the Representatives shall act on behalf of each of the Underwriters, and the Company shall be entitled to act and rely upon any statement, request, notice or agreement on behalf of any Underwriter made or given by the Representatives.

11. *No Fiduciary Relationship.* The Company acknowledges and agrees that (i) the purchase and sale of the Bonds pursuant to this Agreement is an arm's-length commercial transaction between the Company on the one hand, and the Underwriters on the other hand, (ii) in connection with the offering contemplated hereby and the process leading to such transaction, each Underwriter is and has been acting solely as a principal and is not the agent or fiduciary of the Company or its shareholders, creditors, employees, or any other party, (iii) no Underwriter has assumed or will assume an advisory or fiduciary responsibility in favor of the Company with respect to the offering contemplated hereby or the process leading thereto (irrespective of whether such Underwriter has advised or is currently advising the Company on other matters) and no Underwriter has any obligation to the Company with respect to the offering contemplated hereby except the obligations expressly set forth in this Agreement, (iv) the Underwriters and their respective affiliates may be engaged in a broad range of transactions that involve interests that differ from those of the Company, and (v) the Underwriters have not provided any legal, accounting, regulatory or tax advice with respect to the transaction contemplated hereby and the Company has consulted its own legal, accounting, regulatory and tax advisors to the extent it deemed appropriate.

12. *Notices.* All communications hereunder will be in writing and, if sent to the Underwriters, will be mailed or telecopied and confirmed to Barclays Capital Inc., 200 Park Avenue, New York, New York 10166, Attention: Investment Grade Syndicate (Fax no.: (212) 412-7305; Deutsche Bank Securities Inc., 60 Wall Street, 4th Floor, New York, New York 10005, Attention: General Counsel (Fax no.: (212) 797-4561); SunTrust Robinson Humphrey, Inc., 303 Peachtree Street, 24<sup>th</sup> Floor, Atlanta, GA 30308, Attention: High Grade Debt Capital Markets (Fax no.: (404) 588-7005); and UBS Securities LLC, 677 Washington Blvd., Stamford, CT 06901, Attention: Fixed Income Syndicate (Fax no.: 203-718-0475), or if sent to the

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Company, will be mailed or telecopied and confirmed to it at 526 S. Church Street, Charlotte, NC 28202, and the contact is M. Allen Carrick, Assistant Treasurer, fax no 704-382-9544. Any such communications shall take effect upon receipt thereof.

13. *Business Day.* As used herein, the term “business day” shall mean any day when the Commission’s office in Washington, D.C. is open for business.

14. *Successors.* This Agreement shall inure to the benefit of and be binding upon the Underwriters and the Company and their respective successors. Nothing expressed or mentioned in this Agreement is intended or shall be construed to give any person, firm or corporation, other than the parties hereto and their respective successors and the controlling persons, officers and directors referred to in Section 7 and their respective successors, heirs and legal representatives, any legal or equitable right, remedy or claim under or in respect of this Agreement or any provision herein contained; this Agreement and all conditions and provisions hereof being intended to be and being for the sole and exclusive benefit of the parties hereto and their respective successors and said controlling persons, officers and directors and their respective successors, heirs and legal representatives, and for the benefit of no other person, firm or corporation. No purchaser of Bonds from any Underwriter shall be deemed to be a successor or assign by reason merely of such purchase.

15. *Counterparts.* This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, but all of which together shall constitute one and the same instrument.

16. *Applicable Law.* This Agreement shall be governed by, and construed in accordance with, the laws of the State of New York.

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If the foregoing is in accordance with your understanding, kindly sign and return to us two counterparts hereof, and upon confirmation and acceptance by the Underwriters, this letter and such confirmation and acceptance will become a binding agreement between the Company, on the one hand, and each of the Underwriters, on the other hand, in accordance with its terms.

Very truly yours,

DUKE ENERGY OHIO, INC.

By: /s/ M. Allen Carrick  
Name: M. Allen Carrick  
Title: Assistant Treasurer

The foregoing Underwriting Agreement is hereby confirmed and accepted as of the date first above written:

BARCLAYS CAPITAL INC.

/s/ Yukari Saegusa  
Name: Yukari Saegusa  
Title: Managing Director

DEUTSCHE BANK SECURITIES INC.

/s/ Ryan Montgomery  
Name: Ryan Montgomery  
Title: Director, Deutsche Bank Securities Inc.

/s/ Ben-Zion Smilchensky  
Name: Ben-Zion Smilchensky  
Title: Managing Director,  
Deutsche Bank Securities Inc.

SUNTRUST ROBINSON HUMPHREY, INC.

/s/ Christopher S. Grumbowski  
Name: Christopher S. Grumbowski  
Title: Director

UBS SECURITIES LLC

/s/ Christopher Forshner  
Name: Christopher Forshner  
Title: Managing Director

/s/ Mark Spadaccini  
Name: Mark Spadaccini  
Title: Associate Director

For themselves and as Representatives of the several Underwriters named on Schedule A hereto.

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**SCHEDULE A**

Underwriter	Principal Amount of Bonds to be Purchased
Barclays Capital Inc.	\$ 63,000,000
Deutsche Bank Securities Inc.	112,500,000
SunTrust Robinson Humphrey, Inc.	112,500,000
UBS Securities LLC	112,500,000
Banca IMI S.p.A.	24,750,000
Scotia Capital (USA) Inc.	24,750,000
Total	\$ 450,000,000

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**SCHEDULE B**

**PRICING DISCLOSURE PACKAGE**

Item

- 1) Base Prospectus
- 2) Preliminary Prospectus Supplement dated March 18, 2009
- 3) Permitted Free Writing Prospectuses
  - a) Pricing Term Sheet attached as Schedule C hereto

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**SCHEDULE C**

*Filed pursuant to Rule 433  
March 18, 2009*

*Relating to  
Preliminary Prospectus Supplement dated March 18, 2009 to  
Prospectus dated October 3, 2007  
Registration Statement No. 333-146483-01*

**Duke Energy Ohio, Inc.  
\$450,000,000 First Mortgage Bonds, 5.45% Series, Due April 1, 2019**

Pricing Term Sheet

Issuer:	Duke Energy Ohio, Inc.
Ratings (Moody's/ S&P)*:	A3/A (positive/positive)
Settlement:	March 23, 2009; T+3
Interest Payment Dates:	April 1 and October 1, commencing October 1, 2009
Security Description:	First Mortgage Bonds, 5.45% Series, Due April 1, 2019
Principal Amount:	\$450,000,000
Maturity:	April 1, 2019
Coupon:	5.45%
Benchmark Treasury:	2.75% due February 15, 2019
Benchmark Treasury Yield:	2.955%
Spread to Benchmark Treasury:	+250 bps
Yield to Maturity:	5.455%
Initial Price to Public:	99.960% per Bond
Redemption Provisions Make-Whole Call:	T + 40 bps
CUSIP:	26442E AA8
ISIN:	US26442EAA82
Book-Running Managers:	Barclays Capital Inc. Deutsche Bank Securities Inc.

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SunTrust Robinson Humphrey, Inc.  
UBS Securities LLC

Co-Managers:

Banca IMI S.p.A.  
Scotia Capital (USA) Inc.

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\* Security ratings are not recommendations to buy, sell or hold securities. The ratings are subject to change or withdrawal at any time by the respective credit rating agencies.

The issuer has filed a registration statement (including a prospectus) with the SEC for the offering to which this communication relates. Before you invest, you should read the prospectus in that registration statement and other documents the issuer has filed with the SEC for more complete information about the issuer and this offering. You may get these documents for free by visiting EDGAR on the SEC Web site at [www.sec.gov](http://www.sec.gov). Alternatively, the issuer, any underwriter or any dealer participating in the offering will arrange to send you the prospectus if you request it by calling Barclays Capital Inc. toll-free at 1-888-227-2275, ext. 2663, Deutsche Bank Securities Inc. at 1-800-503-4611, SunTrust Robinson Humphrey, Inc. at 1-800-685-4786 or UBS Securities LLC at 1-877-827-6444, ext. 561-3884.

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