

**BEFORE THE
UNITED STATES SENATE**

COMMITTEE ON ENERGY AND NATURAL RESOURCES

**TESTIMONY OF THE HONORABLE JAMES Y. KERR, II
COMMISSIONER, NORTH CAROLINA UTILITIES COMMISSION
ON BEHALF OF THE
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS**

ON

**“Adequacy of State and Federal Regulatory Structures for Governing Electric
Utility Holding Companies”**

May 1, 2008



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Good morning Chairman Bingaman, Ranking Member Domenici, Members of this Committee, and distinguished panelists.

My name is Jim Kerr. I am a member of the North Carolina Utilities Commission (“NCUC”). I am also the immediate past President of the National Association of Regulatory Utility Commissioners (“NARUC”), and I am testifying today on behalf of that organization. In addition, my testimony reflects the views of the NCUC and provides some detailed information concerning our approach to issues raised in this hearing and the GAO Report. On behalf of NARUC and the NCUC, I very much appreciate the opportunity to appear before you this morning.

I ask that my testimony be made a part of the record and I will summarize our views.

NARUC is a quasi-governmental, non-profit organization founded in 1889. Our membership includes the State public utility commissions serving all States and territories. NARUC’s mission is to serve the public interest by improving the quality and effectiveness of public utility regulation. Our members regulate the retail rates and services of electric, gas, water, and telephone utilities. We are obligated under the laws of our respective States to ensure the establishment and maintenance of such utility services as may be required by the public convenience and necessity and to ensure that such services are provided under rates and subject to terms and conditions of service that are just, reasonable, and non-discriminatory.

Introduction

The Energy Policy Act of 2005 (“EPAAct 2005”) repealed the Public Utility Holding Company Act of 1935 (“PUHCA 1935”) and enacted the Public Utility Holding Company Act of 2005 (“PUHCA 2005”). EPAAct 2005 also expanded the Federal Energy Regulatory Commission’s (“FERC” or the “Commission”) merger and corporate review authority under Federal Power Act (“FPA”) Section 203.

PUHCA 1935 repeal opened the door for new and different corporate combinations, including the ownership of utilities by complex international holding companies or private equity firms. At the same time, the repeal did not fundamentally alter the manner in which State commissions regulate.

State regulatory commissions have traditionally had jurisdiction over the regulation of utilities in various areas, including mergers and acquisitions, affiliate transactions, audits, and financial reporting. The repeal of PUHCA 1935 did not change the States’ authority in these areas. In fact, EPAAct 2005 explicitly gave State Commissions authority to obtain the books and records of a public utility in a holding company system, the holding company or any associate company or affiliate.

State commissions have the obligation under State law to ensure the establishment and maintenance of such energy utility services as may be required by the public

convenience and necessity. We have to ensure that such services are provided at rates and conditions that are just, reasonable and nondiscriminatory for all consumers.

State commissions have powerful regulatory tools to protect customers. Each State has extensive ratemaking authority, and in the exercise of the same, has the right to disallow recovery in rates of inappropriate or improper costs, including those deemed to represent cross-subsidies. The exercise of State merger review authority provides a means to protect consumer interests by imposing conditions on any proposed transaction. In fact, the broad statutory mandates to uphold the public interest and ensure reliable service at just and reasonable rates have allowed State commissions to establish specific consumer protections not directly spelled out under their broad statutory authority.

Coordination with FERC

The Report by the Government Accountability Office (“GAO”), Recent Changes In Law Call for Improved Vigilance by FERC, GAO-08-289 (February 2008)(“GAO Report” or Report”) concluded with a number of recommendations to the FERC Chairman.¹ One of the recommendations stated that the Chairman should develop “a better means of collaborating with [S]tate regulators to leverage resources already applied to enforcement efforts and to capitalize on [S]tate regulators’ unique knowledge. As part

¹ GAO Report, Recent Changes In Law Call for Improved Vigilance by FERC, GAO-08-289 (February 2008) at 31-32.

of this effort, FERC may want to consider identifying a liaison, or liaisons, for [S]tate regulators to contact and to serve as a focal point(s).”²

NARUC has had an extensive and constructive working relationship with FERC, and welcomes the recommendation of the GAO Report in this regard. Currently, we have three State/FERC Collaboratives that cover cross-jurisdictional areas: demand response, competitive procurement and smart grid. These initiatives have involved all members of the FERC and Senior Staff and a broad cross-section of State Commissioners and Staff. These efforts have been collegial, informative and productive. In short, the relationship and precedent exists to explore to continue working together in this particular case.

FERC’s implementing regulations under EPAct 2005 have been respectful of State authority. FERC has said that where there is State authority in the area of merger review and cross-subsidization protections, that authority should be recognized. For example, as to reviews under FPA Section 203, the FERC policy is to accept State cross-subsidization protections unless there is evidence that additional measures are needed to protect wholesale customers or if there is a regulatory gap because the State lacks authority in the area. This approach properly coordinates federal and State merger review to avoid unnecessary conflict and potential claim of federal preemption.

² Id.

Responses to the GAO Report

The following sections will focus on responding to the issues covered in the GAO Report’s survey of State commissions. The issues covered in the State survey are (1) State Review of Mergers, (2) State Regulation of Affiliate Transactions and Cross-Subsidies, (3) Financial Protections or Ring-Fencing (4) Audits, Access to Books and Records, and Financial Reporting; and (5) Status of State Resources. The GAO recognized that most of the State commissions have authority which they exercise in these areas.

We note that the detail of the State responses to specific questions depended on the respondent. Further research into State Commission practices were conducted with GAO Staff’s visits to four States only.³ In addition, responses and observations were provided from non-State commission entities, such as officials from the financial community,⁴ an “expert” with “extensive experience with FERC and several [S]tate public utility commissions”,⁵ a “consultant whose firm does numerous affiliate transaction audits in many [S]tates”,⁶ “utility experts”;⁷ a “president of an audit company”;⁸ and “representatives from two consumer groups”.⁹ These points were not

³ Id. at 26.

⁴ Id. at 24.

⁵ Id. at 26.

⁶ Id.

⁷ Id. at 28.

⁸ Id.

⁹ Id. at 27.

made to be critical of the GAO Report, but to recognize the difficulty in responding with precision to the Survey responses.

(1) State Review of Mergers

Almost all States have specific authority to review mergers and similar corporate transactions. The GAO Report recognized that even for the two States that do not have direct merger review authority, these States were able to use other State Commission authority to conduct such reviews.¹⁰ Each State will apply its merger authority to the facts and circumstances of the merger transaction at hand.

The merger statute in my home State of North Carolina is fairly typical: It prohibits any transfer affecting a public utility without approval from the NCUC.¹¹ Such approval will be given “if justified by the public convenience and necessity”. The “public convenience and necessity” standard has been described by the North Carolina courts as “a relative or elastic theory rather than an abstract or absolute rule”.¹²

¹⁰ The GAO Report survey concluded that only 3 States (Florida, Indiana, Texas) out of the responding 50 States lack authority to review mergers. GAO Report, Recent Changes In Law Call for Improved Vigilance by FERC, GAO-08-289 (February 2008) at 22. The Report notes that after completion of the survey, one State (Texas) subsequently obtained approval from its legislature to review and approve future electric utility mergers.

¹¹ N.C. Gen. Stat. 62-111.

¹² State ex. rel. North Carolina Utilities Commission v. Casey, 245 N.C. 297, 96 S.E.2d 8 (N.C. 1957).

According to the leading North Carolina case construing our transfer statute, the NCUC is required to “inquire into all aspects of anticipated service and rates occasioned and engendered by the proposed transfer” in deciding the issues raised by a merger application.¹³ The ultimate decision must be made by analyzing “the facts of each case”. This amounts to a requirement that we utilize a “totality of the circumstances” or an ad hoc balancing test in review merger applications.

While the repeal of PUHCA 1935 has not fundamentally altered our authority or ability to review merger applications, our merger analysis has been affected in a limited number of ways:

- (1) We have not had to impose conditions that attempted to preclude PUHCA 1935-related preemption under the *Ohio Power* decision;
- (2) We have had to beef up our accounting-related conditions to account for the absence of certain accounting practices that would have otherwise been required by PUHCA 1935; and
- (3) We have had to impose financial protection conditions to account for the absence of various limitations and protections that had been provided for by PUHCA 1935.

Other than the above and a widening scope of the types of transactions that can be presented to the NCUC for review and approval, PUHCA 1935 repeal has had little impact on the manner to which we handle merger-related proceedings.

¹³ State ex. rel. Utilities Commission v. Village of Pinehurst, 115 P.U.R.4th 558, 393 S.E.2d 111 (N.C.App. 1996).

To be sure, the NCUC tries to provide applicants with some idea of the nature of our concerns in preparation for filing an application for a merger or similar business combination transaction. As a matter of decisional law, we have attempted to put some further meat on the statutory test in our decisions. Several of our prior orders provide that a merger should be approved, whether as proposed or as conditioned, as long as:

- (1) The proposed transfer has no known adverse impact on the rates and service of the utility;
- (2) Customers are protected from potential harm as much as possible; and
- (3) Customers are provided with sufficient benefits as a result of the transfer to offset any potential costs, risks and harms.

We have required applicants to file cost/benefit and market power studies. The obvious purpose of this request is to ensure that a particular proposal will not have a harmful anticompetitive effect on North Carolina retail ratepayers and to provide us some idea of the extent of any cost savings from a particular merger.

As a general proposition, we have tended to ascertain if a proposed transaction makes broad business sense. If it does, we determine what, if anything, needs to be done through the adoption of conditions to ensure that customers are not harmed and that the benefits are commensurate with the potential costs, risks, and harms. Because of the fact that the broad business justification for most of the transactions before us is relatively apparent, most of our Orders tend to focus on the development of appropriate conditions.

For your review and information I have attached an Appendix which illustrates in greater detail how the NCUC reviewed the Duke Energy Corporation/Cinergy Corporation merger (“Duke/Cinergy merger”) after the repeal of PUHCA 1935. For example, the NCUC adopted: (1) certain conditions relating to accounting rules and affiliate transactions; (2) conditions intended to preserve the utility’s access to capital and to ensure that the utility is not utilized solely as a source of funding for unrelated holding company activities; and (3) certain rate-related transactions intended to require the utility to share the cost savings predicted to result from the transaction. All these conditions had the simple purpose of preserving the ability of the NCUC to regulate the utility in the same way that it always had.

(2) State Regulation of Affiliate Transactions and Cross-Subsidies

With regard to affiliate transactions and authority to prevent potential cross-subsidies, the GAO reported that almost all the State commissions regulate affiliate transactions or regular reporting of such transactions, or both.¹⁴ In fact, the Report said that 49 of the reporting 50 States have some type of authority to approve, review and audit transactions between utilities and their affiliated companies.¹⁵

¹⁴ GAO Report, Recent Changes In Law Call for Improved Vigilance by FERC, GAO-08-289 (February 2008) at 25.

¹⁵ Id. at 9, 25. The Report noted that 27 States reported that under their authority, affiliate transactions did not require prior State commission approval, but could be reviewed and disallowed later. Id. at 25. The findings were that 41 States require utilities to report affiliate transactions at least annually, or more frequently. Id.

In North Carolina, we have specific statutory authority to review affiliate transactions. The majority of potential affiliate contracts are subject to being reviewed and declared void if found to be unjust or unreasonable and made for the purpose or with the effect of concealing, transferring or dissipating the earnings of the utility. In addition, prior to paying any kind of compensation to the listed types of affiliated companies for services, the utility must obtain the Commission's approval to pay the compensation. All affiliated costs and expenses are subject to being audited and disallowed within the context of a general rate case.

In our most recent merger proceeding we required that an independent audit be conducted no less than every two years of the affiliate transactions undertaken pursuant to the affiliate agreements associated with the merger. The audit includes both the holding company's and the utility's compliance with all conditions imposed by the Commission concerning affiliate company transactions, including the propriety of the transfer pricing of goods and services between and/or among the utility and its affiliates.

In addition, a number of State Commissions – Arkansas, California,¹⁶ Kansas,¹⁷ Maryland¹⁸ and New Jersey -- have opened proceedings to address measures for ratepayer protection post-PUHCA 1935 repeal.

¹⁶ Order Instituting Rulemaking Concerning Relationship Between California Energy Utilities and Their Holding Companies and Non-Regulated Affiliates, Docket No. R. 05-10-030, October 27, 2005. The GAO Report cited to California's work to increase its authority to oversee affiliate transactions. GAO Report, Recent Changes In Law Call for Improved Vigilance by FERC, GAO-08-289 (February 2008) at 25.

For example, the New Jersey Board of Public Utilities (“BPU”) approved new regulations with the goal of providing additional protection for the State’s electric and natural gas customers.¹⁹ The New Jersey BPU developed the regulations after analyzing what changes should be made to offset the protections lost at the federal level with the repeal of PUHCA 1935.²⁰

As these examples show, each State commission must address for itself how it wishes to balance allowing additional investment while also ensuring consumer protections. Each State must be allowed to structure the scope of ratepayer protections that will fulfill its statutory duty and public interest charge.

(3) Financial Protections or Ring-Fencing

PUHCA 1935 provided protection to ratepayers against a variety of financial risks caused by the creation of a holding company, such as draining the utility of cash and using it for collateral and diversification into non-core, risky businesses. With the repeal of PUHCA 1935, none of these federal limitations and protections remains in effect.

¹⁷ In the Matter of the Investigation of Affiliate and Ring-Fencing Rules Applicable to all Kansas Electric and Gas Public Utilities, Docket No. 06-GMIX-181-GIV, May 14, 2007.

¹⁸ Commission Staff Analysis of Ringfencing Measures for Investor-Owned Electric and Gas Utilities, Maryland Public Service Commission, February 18, 2005.

¹⁹ Affiliate Relations, Fair Competition and Accounting Standards, Public Utility Holding Company Standards and Related Reporting Requirements, Docket Number AX05070641 (September 18, 2006).

²⁰ Id.

Even before the repeal of PUHCA 1935, many States sought to protect ratepayers from risks associated with utilities being acquired by holding companies, including diversification into non-utility businesses. Although it has become common practice for electric utilities to diversify into non-utility and foreign businesses, this diversification carries an increased risk. NARUC believes that this risk should not be borne or shifted to the customers of the regulated utility, since the beneficiaries of these investments are the shareholders.

States use a variety of mechanisms to effectively guard against improper cross-subsidization. One approach is to craft “ring-fencing” protections. The goal of ring-fencing is to build structural and financial protections around utility subsidiaries within a holding company system in order to insulate these subsidiaries from potential risks and negative impacts created by affiliates.²¹ Rating agencies have looked favorably on ring-fencing provisions established through State regulatory policies.

Perhaps the most well-known instance of a State using ring-fencing to protect a utility from potential holding company risks occurred when the Public Utility Commission of Oregon saved Portland General Electric Company (“PGE”) from the adverse effects of the Enron bankruptcy. Despite Enron’s historic collapse, PGE was

²¹ Some examples of ring-fencing provisions are: (1) requirement that regulated utilities maintain a separate corporate entity; (2) utility to have its own Board of Directors and management; (3) utility’s accounts and records kept separately from those of affiliates; (4) independent cash management and debt for utilities; (5) State commission approval before securities can be issued; (6) limits on dividends (7) minimum equity requirements; (8) periodic ring-fencing reports.

able to maintain its financial integrity because of the actions taken by the State to “ring-fence” or protect the utility from Enron’s other business ventures.

Another State approach is a “mini-PUHCA” – a tool that attempts to recreate PUHCA 1935 at the State level. The Wisconsin Utilities Holding Company Act (“WUHCA”)²² is a well-known example of statutory ring-fencing. In implementing the State law, the Wisconsin Public Service Commission (“PSCW”) has adopted a three-pronged approach to address cross-subsidization: (1) imposing restrictions, (2) implementing reporting requirements, and (3) conducting compliance audits of holding company transactions and operations.

(4) Audits, Access to Books and Records, and Financial Reporting

As the GAO Report notes, each State Commission’s audit process is unique.²³ The Report recognized that for the 4 States GAO Staff visited, those States put “special emphasis on auditing affiliate transactions”.²⁴

FERC and State regulators already collaborate on audit review. We will continue to work with our federal colleagues on improving audits of affiliated transactions and cross-subsidies.

²² Wis. Stat. § 196.795.

²³ GAO Report, Recent Changes In Law Call for Improved Vigilance by FERC, GAO-08-289 (February 2008) at 9, 25-26.

²⁴ Id. at 27.

The GAO concluded that all States regularly require financial reports from utilities and are able to obtain access to the financial books and records of these utilities.²⁵ The Report said that all 49 responding States require utilities to at least provide financial reports.²⁶ GAO added that States have access to utility companies' financial books and records in order to review affiliate transactions.²⁷

NARUC advocated the explicit EAct 2005 authority for State access to needed books and records. Access to the books and records to verify transactions directly affecting a company's regulated utility operations is of vital importance to State commissions. Requests for such access by a State commission, its staff, or its authorized agents are presumably valid, material, and relevant, with the burden falling to the company to prove otherwise.

The GAO concludes, however, that some States do not have such direct access to books and records of holding companies or affiliated nonutility companies.²⁸ The reasons vary.²⁹ State Commissions will continue to work on ways to improve their access to this information. FERC's detailed accounting and increased transparency in its record retention policies for holding companies and centralized service companies assists in improving States access to needed information from utility companies and their affiliates.

²⁵ Id.

²⁶ Id. at 9, 27.

²⁷ Id. at 9.

²⁸ Id. at 9, 27-28.

²⁹ Id.

(5) Status of State Resources

GAO reported that some States reported that they needed additional staffing and funding to respond to changes in their oversight responsibility.³⁰ At the same time, the Report recognized that States have gained over 2 years of experience since EPAAct 2005 was passed.³¹

States have been and will continue to collaborate and expand on their knowledge base. NARUC's Meetings, which occur three times a year, have featured various PUHCA and utility merger panels. NARUC's Staff Subcommittee on Accounting and Finance has also produced publications³² and sponsored meeting panels on these topics. This Staff Subcommittee collaborated with GAO Staff on the State survey. The National Regulatory Research Institute ("NRRI") has published various briefing documents to educate State Commissioners on key issues arising from PUHCA 1935 repeal and the changing utility merger landscape.³³

States can better coordinate with their State colleagues on a regional basis, as well as with FERC, in regulating these increasingly complex multi-State utility companies.

³⁰ Id. at 9, 29-30.

³¹ Id. at 29.

³² See, e.g., Ring Fencing Mechanisms for Insulating a Utility in a Holding Company System, NARUC Staff Subcommittee on Accounting and Finance, July 27, 2003.

³³ See e.g., Implications of EPAAct 2005 for State Commissions, The National Regulatory Research Institute, October 2005; Repeal of the Public Utility Holding Company Act of 1935: Implications and Options for State Commissions, The National Regulatory Research Institute, August 2006; Private Equity Buyouts of Public Utilities: Preparation for Regulators, The National Regulatory Research Institute, December 2007.

State commissions can work with their respective legislatures to improve the status of State resources.

Conclusion

In our view, NARUC's members have performed admirably in their oversight responsibilities in the short time since passage of EPAct 2005. In light of the challenges identified by GAO, there will be more work ahead to insure continued oversight of mergers in the utility sector, particularly given the vastly different resources available to the various States. We are confident that with FERC's continued cooperation and collaboration, as well as the academic resources NARUC's members have with NRRI the States will be ready for the challenge.

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North Carolina Utilities Commission
Review of the Duke/Cinergy Merger

The North Carolina Utilities Commission (NCUC) was one of five state commissions that reviewed the merger transaction between Duke Energy Corporation (headquartered in North Carolina and operating regulated electricity service in North and South Carolina), and Cinergy Corporation (headquartered in Ohio and operating regulated electricity and natural gas service in Ohio, Indiana, and Kentucky), in 2005. In order to further illustrate the manner in which a state might address the issues raised in this hearing and the GAO Report, a summary of the NCUC's approach to its review and approval of this transaction is being provided.

The Duke/Cinergy merger involved the following issues¹:

- (1) It involved the adoption of a more rational structure for Duke, which had used a "utility at the top" form of corporate structure that we, and many others, had found confusing and somewhat difficult to regulate;
- (2) It did not seem to pose a significant risk of increasing wholesale market power in markets from which the utilities serving North Carolina purchased power;
- (3) It represented a return by Duke to a business strategy that was focused on the successful provision of regulated electric service as compared to the one that it had previously followed that led to it becoming heavily involved in the merchant generation business;

¹ NCUC Docket No. E-7, Sub 795.

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(4) Although Duke retained some of the benefits of diversification, that diversification primarily was obtained through the operation of multiple regulated electric utilities rather than through the operation of a multitude of different business entities engaged in differing business activities; and

(5) It involved the opportunity for cost savings as the result of both economies of scale and the implementation of best practices stemming from the different strengths of each company.

As a result, no party to that merger proceeding overtly opposed approval of the proposed transaction, although some urged the adoption of more extensive conditions than the ones that we ultimately approved. The parties to this proceeding tended to focus on the necessity for imposing regulatory conditions to address a number of recurrent issues, many of which are raised in the GAO Report. Issues of concern included:

- (1) The danger of preemption of our regulatory authority;
- (2) The dangers that would result from the increased degree of accounting complexity that would result from the creation of a larger company;
- (3) The dangers resulting from the increasing volume of affiliate transactions which would inevitably result from the proposed merger;
- (4) The dangers resulting from the impact of the use of the holding company structure on the regulated utility's access to adequate capital;

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- (5) The risk that the regulated utility would be treated as a “cash cow” for the remainder of the holding company system; and
- (6) Ensuring that customers had adequate opportunity to benefit from the cost savings that were predicted to ensue from consummation of the proposed transactions.

The NCUC did adopt a number of conditions in our Final Order,² many of which were agreed to by all parties, including Duke. With the exception of specific ring fencing conditions, the conditions we imposed were fairly typical of, although considerably more detailed than, the conditions that the NCUC has imposed in similar proceedings in the past decade or so.

First, we adopted a series of conditions intended to prevent utilities from claiming in future proceedings that we had surrendered jurisdiction over certain subjects pursuant to the filed-rate doctrine, other provisions of the Federal Power Act, or any other provision of federal law.³ Second, we adopted certain

² NCUC Docket No. E-2, Sub 795, Order Approving Merger Subject to Regulatory Conditions and Code of Conduct, dated March 24, 2006. See Attachment A for list of 76 Regulatory Conditions and Attachment B for Code of Conduct.

³ The utilities had to agree : (1) to submit affiliate contracts for approval regardless of the right to claim preemption; (2) to submit financing transactions involving or affecting the utility for approval regardless of the ability to claim preemption; (3) that the NCUC has the right to make appropriate cost allocation decisions and to make appropriate ratemaking adjustments in accordance with State law regardless of the utility's ability to claim preemption; (4) to continue to plan, size and operate its generating system for the purpose of serving retail native load and traditional wholesale customers in the same manner as the utility has historically planned and operated its system; (5) assume all risks associated with the utility's involvement in wholesale market activities, including the risk that generating capacity used for wholesale purposes will be deemed excess for interstate retail ratemaking purposes; and (6) to seek and obtain authorization from the NCUC before joining a Regional Transmission Organization.

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conditions relating to accounting rules and affiliate transactions.⁴ Third, we adopted conditions intended to preserve the regulated utility's access to capital and to ensure that the utility is not utilized solely as a source of funding for unrelated holding company activities.⁵ Finally, we adopted certain rate-related conditions intended to require the utility to share the cost savings predicted to result from the transaction.⁶ Although these conditions were lengthy and detailed, all had a relatively simple purpose and most were intended to preserve the ability of the NCUC to regulate the utility in the same way that it always had prior to the consummation of the merger.⁷

More specifically, for example, the NCUC adopted conditions to ensure that the utility is not utilized solely as a source of funding for unrelated holding company activities. These conditions required that the regulated utility:

- (1) Provide detailed capital structure information;

⁴ These conditions are discussed under the State regulation of Affiliate Transaction and Cross-Subsidies section of the Testimony.

⁵ These conditions are discussed under the Financial Protection section of the Testimony.

⁶ These conditions are discussed in the Conclusion section of the Testimony.

⁷ We rejected requests to impose other, perhaps more onerous conditions, such as: (1) requiring the utility to impute a carbon dioxide cost in the course of selecting new electric generating resources; (2) requiring the utility to develop a comprehensive global warming management plan; (3) requiring greater specificity in the definition of instances in which particular utility actions would implicate NCUC jurisdiction; (4) asserting a greater degree of regulatory authority over the corporate parent; (5) expanding the scope of the required affiliate transaction audit to include all affiliated transactions rather than the transactions occurring pursuant to the affiliate contracts approved in connection with the proposed merger; and (6) requiring a greater reduction in retail rates in order to require the sharing of a larger portion of the savings that were believed to result from the proposed transaction, effectively giving customers rate relief based on unregulated as well as regulated net merger savings.

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- (2) Use an adjusted cost rate for long term debt in its rate-related filings in the event that the merger had an adverse impact on the utility's cost of debt;
- (3) Manage its business with the intention of maintaining an investment grade debt rating, with the NCUC having the right to take appropriate action if the regulated utility's investment rate falls below that level;
- (4) Have access to sufficient debt and equity capital to ensure the provision of adequate service, with the NCUC having the right to take appropriate action if that is not done;
- (5) Limit cumulative distributions to the holding company to existing retained earnings and future earnings;
- (6) Prohibit investments in unregulated activities in excess of a specified amount without 30 days notice to the NCUC.

The NCUC also adopted certain conditions relating to accounting rules and affiliate transactions, such as a requirement that the regulated utility:

- (1) Continue to make utility books and records and appropriate holding company records available for review to the NCUC and the statutory public advocate;
- (2) Comply with a NCUC-approved Code of Conduct, which includes provisions requiring the use of asymmetric pricing in connection with affiliate transactions in many instances;
- (3) File a cost allocation manual detailing cost allocation methods;

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- (4) Provide an annual report of affiliate transactions and certain information about those transactions to the NCUC on an annual basis; and
- (5) Obtain a comprehensive third-party independent audit at least every two years of affiliate transactions involving the utility, with the cost of that audit, subject to limited exceptions, to be treated as a below the line expense.

The NCUC also adopted certain rate-related conditions intended to require the regulated utility to share the cost savings predicted to result from the transaction and to have other effects, such as requirements that the regulated utility:

- (1) Transition to using an actual capital structure for purposes of reporting incorporated in the NCUC's earnings surveillance process;
- (2) Implement a one year across the board rate decrement for all customers in an amount agreed to by Duke based on anticipated net merger-related cost savings, with this decrement to be independent of any fuel-related savings that might flow through the fuel adjustment mechanisms;
- (3) Require an increase in the amount of that decrement to the extent that any other jurisdiction required the utility to flow through a greater percentage of the merger-related savings to customers;
- (4) Contribute certain amounts to various economic development, environmental and educational amounts, with these amounts to be accounted for below the line; and

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(5) Make a filing in the form of prefiled testimony and exhibits explaining why its existing rates were just and reasonable.⁸

Our decision reflects the concerns that have generally governed our treatment of mergers and other transfers. We have attempted to be fair and evenhanded in our treatment of this and similar transactions. Our decision was based on the specific facts before us rather than some global view of how the industry should be structured. However, our approach in this matter illustrates both the typical statutory tools available to State commissions and the manner in which they might be applied in this context.

⁸ This condition leads to the commencement and resolution of a general rate case proceeding in 2007. NCUC Docket No. E-7, Sub 828.

ATTACHMENT A

REGULATORY CONDITIONS DOCKET NO. E-7, SUB 795

A. DEFINITIONS

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

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

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

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

Commission: The North Carolina Utilities Commission.

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

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

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

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

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

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

FERC: The Federal Energy Regulatory Commission.

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

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

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

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

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

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

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

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

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

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

B. PROTECTION FROM PREEMPTION

1. With respect to transactions between Duke Power and its Affiliates and to Affiliate Contracts, the following requirements and procedures shall apply:
 - (a) Duke Power shall not engage in any such transactions without first filing the proposed Affiliate Contract with the Commission that memorializes any such dealings and taking such actions and obtaining from the Commission such decisions as are required under North Carolina law. Duke Power shall submit each proposed Affiliate Contract to the Public Staff for informal review at least ten days before filing it with the Commission. No additional advance notice is required for agreements that Duke Power intends to file pursuant to G.S. 62-153 unless the agreements are to be filed with the FERC, in which case subsection (c) applies.
 - (b) All Affiliate Contracts to which Duke Power is a party shall provide the following:
 - (i) Duke Power's participation in the agreement is voluntary, Duke Power is not obligated to take or provide services or make any purchases or sales pursuant the agreement, and

- Duke Power may elect to discontinue its participation in the agreement at its election after giving any required notice;
- (ii) Duke Power may not make or incur a charge under the agreement except in accordance with North Carolina law and the rules, regulations and orders of the Commission promulgated thereunder;
 - (iii) Duke Power may not seek to reflect in rates any (A) costs incurred under the agreement exceeding the amount allowed by the Commission or (B) revenue level earned under the agreement less than the amount imputed by the Commission; and
 - (iv) Duke Power will not assert in any forum that the Commission's authority to assign, allocate, make pro-forma adjustments to or disallow revenues and costs for retail ratemaking and regulatory accounting and reporting purposes is preempted and will bear the full risk of any preemptive effects of federal law with respect to the agreement.
- (c) The following shall apply to all proposed Affiliate Contracts and any proposed amendments to existing Affiliate Contracts to which Duke Power is a party or which involve costs that will be assigned or allocated to Duke Power that are required or intended to be filed with the FERC:
- (i) In order to enable the Commission to determine if it has jurisdiction over the proposed Affiliate Contract or amendment and how it will exercise its jurisdiction, Duke Power shall file a notice and a copy of the proposed Affiliate Contract or amendment with the Commission 30 days prior to a filing covered by this condition being made with the FERC. A copy shall be provided to the Public Staff at the time of the filing.
 - (ii) If an objection to Duke Power proceeding with the filing with the FERC is filed pursuant to the procedures set out in Regulatory Condition No. 59(b), the proposed filing shall not be made with the FERC until the Commission issues an order resolving the objection.
 - (iii) Filings of advance notices and copies of Affiliate Contracts and amendments to existing Affiliate Contracts pursuant to this subsection shall be in addition to filings required by G.S. 62-153, and the burden of proof as to those filings shall be as provided by statute.
- (d) Duke Power shall certify that neither Duke Power, Duke Energy Corporation, any Affiliate, nor any Nonpublic Utility Operation has made any filing with the FERC or any other federal regulatory

agency inconsistent with the foregoing. Such certification shall be repeated annually on the anniversary of the first certification.

2. With respect to any financing transaction involving Duke Power, Duke Energy Corporation or any of its Affiliates, the following shall apply:
 - (a) With respect to any financing transaction between Duke Power and Duke Energy Corporation or any one or more of its other Affiliates, any contract memorializing such transaction shall provide that Duke Power may not enter into any such financing transaction except in accordance with North Carolina law and the rules, regulations and orders of the Commission promulgated thereunder; and
 - (b) With respect to any financing transaction (i) between and among any of the Affiliates if such contracts are reasonably likely to have an Effect on Duke Power's Rates or Service, or (ii) between Duke Power and any Affiliate, any contract memorializing such transaction shall provide that Duke Power may not include the effects of any capital structure or debt or equity costs associated with such financing transaction in its North Carolina retail cost of service or rates except as allowed by the Commission.
3. At the time the Merger is closed, Duke Power shall own and control all assets or portions thereof used for the generation, transmission, and distribution of electric power to its North Carolina retail customers (with the exception of assets used to provide power purchased by Duke Power at wholesale). With respect to the transfer by Duke Power to any entity, affiliated or not, of the control of, operational responsibility for, or ownership of such assets with a gross book value in excess of ten million dollars (\$10 million), the following shall apply:
 - (a) Duke Power shall provide notice with the Commission pursuant to Regulatory Condition No. 59(b) at least 30 days in advance of the proposed transfer;
 - (b) Any contract memorializing such a transfer shall provide the following:
 - (i) Duke Power may not commit to or carry out the transfer except in accordance with all applicable law, and the rules, regulations and orders of the Commission promulgated thereunder; and
 - (ii) Duke Power may not include in its North Carolina cost of service or rates the value of the transfer, whether or not subject to federal law, except as allowed by the Commission in accordance with North Carolina law; and

- (c) Any filing with the FERC in connection with any transfer of control, operational responsibility or ownership that involves or otherwise affects Duke Power shall include the commitments in (b)(i) and (ii), above, and shall request that the FERC include language in its approval order(s) to the effect that its approval of the application in no way affects the right of the North Carolina Commission to review and determine the value of such asset transfer and establishing the value of the asset transfer for purposes of determining the rates for services rendered to Duke Power's North Carolina retail customers.
- 4. Subject to additional restrictions set forth in the Code of Conduct approved by this Commission, Duke Power shall not purchase electricity (or related ancillary services) from Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation under circumstances where the total all-in costs, including, but not limited to, generation, transmission, ancillary costs, distribution, and delivery point costs, incurred (whether directly or through allocation) exceed fair Market Value for comparable service, nor shall it sell electricity (or related ancillary services) to Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation for less than fair Market Value; provided, however, that such restrictions shall not apply to emergency transactions.
- 5. Duke Power shall retain the obligation to pursue least cost integrated resource planning for its Retail Native Load Customers and remain responsible for its own resource adequacy subject to Commission oversight in accordance with North Carolina law. Duke Power shall determine the appropriate self-built or purchased power resources to be used to provide future generating capacity and energy to its Retail Native Load Customers, including the siting considered appropriate for such resources, on the basis of the benefits and costs of such siting and resources specifically to Duke Power's Retail Native Load Customers.
- 6. The planning and dispatch of Duke Power system generation and purchased power resources subsequent to the Merger shall ensure that Duke Power's Retail Native Load Customers receive the benefits of those resources, including priority of service, to meet their electricity needs. Duke Power shall continue to serve its Retail Native Load Customers in North Carolina with the lowest-cost power it can reasonably generate or purchase from other sources before making power available for sales to customers that are not Retail Native Load Customers.
- 7. The following provisions shall apply to Duke Power's participation in the wholesale market subsequent to the issuance of the Commission's Order in Docket No. E-7, Sub 795:

- (a) To the extent that Duke Power proposes to enter into wholesale power contracts that grant native load priority to the following historically served customers: Schedule 10A Customers, Town of Highlands, WCU, the electric membership cooperatives (EMCs) within Duke's control area, North Carolina Municipal Power Agency No. 1, Piedmont Municipal Power Agency, and Saluda River Electric Cooperative, Inc., Duke Power is not required to file an advance notice with the Commission or receive its approval. Subject to the conditions set out in subsection (d) below, the retail native loads of these historically served wholesale customers shall be considered Duke Power's Retail Native Load Customers for purposes of Regulatory Condition Nos. 5 and 6; provided, however, that this subsection applies only to the same types of supplemental load and backstand requirements services that were historically provided to the Catawba Joint Owners under the Catawba Interconnection Agreements between Duke Power and the Catawba Joint Owners prior to 2001, which, for the North Carolina Electric Membership Corporation, only includes the EMCs within Duke Power's control area.
- (b) Before granting native load priority to a wholesale customer other than as provided for in subsection (a) above or to other companies' retail customers, Duke Power must provide 30 days' advance notice of its intent to grant native load priority and to treat the retail native load of a proposed wholesale customer as if it were Duke Power's retail native load pursuant to Regulatory Condition Nos. 5 and 6. The advance notice provisions of Regulatory Condition No. 59(b) apply.
- (c) To the extent that Duke Power's proposed wholesale power contracts or other sales of energy and capacity are at less than native load priority, then no advance notice is required and no approval by the Commission is needed. For purposes of this condition, "native load priority" is defined as power supply service being provided or electricity otherwise being sold with a priority of service equivalent to that planned for and provided by Duke Power to its Retail Native Load Customers.
- (d) The following conditions apply to all wholesale contracts (including master and service agreements under Duke Power's market-based rate tariff) that are entered into by Duke Power, as seller, subsequent to the date of the Commission's order approving the Merger in this docket:
 - (i) The Commission retains the right to assign, allocate, and make pro-forma adjustments with respect to the revenues and costs associated with Duke Power's wholesale contracts for

both retail ratemaking and regulatory accounting and reporting purposes.

- (ii) Entry into wholesale contracts that grant native load priority or otherwise obligate Duke Power to construct generating facilities or make commitments to purchase capacity and energy to meet those contractual commitments constitutes acceptance by Duke Power, Duke Energy Corporation, and any Affiliates or Nonpublic Utility Operations thereof of the risks that investments in generating facilities or commitments to purchase capacity and energy to meet such contractual commitments and maintain an adequate reserve margin throughout the term of such contracts may become uneconomic sunk costs that are not recoverable from Duke Power's retail ratepayers. In a future Commission retail proceeding in which cost recovery is at issue, Duke Power shall (1) not claim that it does not bear this risk, and (2) acknowledge that the Commission retains full authority under Chapter 62 to disallow such costs as not used and useful and to allocate or assign such costs away from retail customers. For purposes of this condition, capacity will be considered used and useful and not excess capacity to the extent the Commission determines such capacity is needed by Duke Power to meet the expected peak load of Duke Power's Retail Native Load Customers in the near term future plus a reserve margin comparable to that currently being used or otherwise considered appropriate by the Commission.
- (iii) Duke Power shall not assert before the FERC or any federal or state court that (1) transactions entered into pursuant to Duke Power's cost- or market-based rate authority or (2) the filing with, or acceptance for filing by, the FERC of any wholesale power contract imply a cost allocation methodology that is binding on the Commission, require the pass-through of any costs or revenues under the filed rate doctrine, or preempt the Commission's authority to assign, allocate, make pro-forma adjustments to, or disallow the revenues and costs associated with, Duke Power's wholesale contracts for both retail ratemaking and regulatory accounting and reporting purposes.
- (iv) Duke Power shall not assert before any federal or state court that the exercise of authority by the Commission to assign, allocate, make pro forma adjustments to, or disallow the costs and revenues associated with Duke Power's wholesale contracts for retail ratemaking and regulatory accounting and reporting purposes in itself constitutes an undue burden on interstate commerce or otherwise violates the Commerce Clause of the United States Constitution. However, Duke

Power retains the right to argue that a specific exercise of authority by the Commission violates the Commerce Clause based upon specific evidence of undue interference with interstate commerce.

- (v) Except as provided in the foregoing conditions, Duke Power retains the right to challenge the lawfulness of any Commission order issued in connection with the assignment, allocation, pro-forma adjustments to, or disallowances of the revenues and costs associated with Duke Power's wholesale contracts for retail ratemaking and regulatory accounting and reporting purposes on any other grounds, including but not limited to the right outlined in G.S. 62-94(b).
8. Neither Duke Power, Duke Energy Corporation, another Affiliate, nor a Nonpublic Utility Operation shall assert that approval by the FERC of market-based rates, transfers of generating facilities, or any matter that involves Affiliates in any way preempts the Commission's authority to determine the reasonableness or prudence of Duke Power's decisions with respect to supply-side resources, demand-side management, or any other aspect of resource adequacy.
 9. No agreement shall be entered into, nor shall any filing be made with the FERC, by or on behalf of Duke Power, that (a) commits Duke Power to, or involves it in, joint planning, coordination, or operation of generation, transmission, or distribution facilities with one or more Affiliates, or (b) otherwise alters Duke Power's obligations with respect to these Regulatory Conditions, absent explicit approval of the Commission.
 10. Duke Power, Duke Energy Corporation, the other Affiliates, and the Nonpublic Utility Operations shall file notice with the Commission 30 days prior to filing with the FERC any agreement, tariff, or other document or any proposed amendments, modifications, or supplements to any such document having the potential to (a) affect Duke Power's cost of service for its pre-merger system power supply resources or transmission system; (b) be interpreted as involving Duke Power in joint planning, coordination or operation of generation or transmission facilities with one or more Affiliates; or (c) otherwise affect Duke Power's rates or service. The advance notice provisions of Regulatory Condition No. 59(b) apply; provided, however, that, to the extent the filing with the FERC is not to be made by Duke Power, the advance notice procedures shall be for the purpose of a Commission determination as to whether the filing is reasonably likely to have an Effect on Duke Power's Rates or Service.
 11. Any contract or filing regarding Duke Power's membership in or withdrawal from an RTO or comparable entity must be contingent upon state regulatory approval.

12. If the FERC does not approve Section 3.2 of the OATT Attachment K and Section 4.5 in Duke Power's Independent Entity Agreement (IE Agreement) dated July 22, 2005, both of which were filed in FERC Docket No. ER05-1236-000 on July 22, 2005, or makes any change that would make the Independent Entity a FERC-jurisdictional entity or otherwise affect the Commission's jurisdiction over the transmission component of Duke Power's retail service or rates, then Duke shall withdraw the filing and exercise its right to terminate the IE Agreement, absent an order from the Commission explicitly relieving Duke Power of this obligation.
13. Neither Duke Power, Duke Energy Corporation, another Affiliate, nor a Nonpublic Utility Operation shall assert in any forum, with respect to any contract or transaction in which Duke Power is involved or any contract or transaction involving Duke Energy Corporation, any other Affiliate, or any Nonpublic Utility Operation that may have an Effect on Duke Power's Rates or Service, that the Commission is in any way preempted from exercising any authority it has under North Carolina law as to:
 - (a) reviewing the reasonableness of any Affiliate commitment entered into by Duke Power, or from disallowing the costs of, or imputing revenues related to such commitment to, Duke Power;
 - (b) exercising its authority over financings or from setting rates based on the capital structure, corporate structure, debt costs, or equity costs that it finds to be appropriate for ratemaking purposes;
 - (c) reviewing the reasonableness of any commitment entered into by Duke Power to transfer an asset, mandating, approving or otherwise regulating a transfer of assets, or scrutinizing and establishing the value of the asset transfers for purposes of determining the rates for services rendered to Duke Power's retail customers; or
 - (d) otherwise exercising any lawful authority it may have.

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

14. Duke Power, Duke Energy Corporation, the other Affiliates, and the Nonpublic Utility Operations shall (a) bear the full risk of any preemptive effects of federal law with respect to any contract, transaction, or commitment entered into or made by Duke Power or which may otherwise

affect Duke Power's operations, service, or rates and (b) shall take all actions as may be reasonably necessary and appropriate to hold North Carolina ratepayers harmless from rate increases, foregone opportunities for rate decreases or any other effects of such preemption. Such actions include, but are not limited to, filing with and making reasonable efforts to obtain approval from the FERC or other applicable federal entity of such commitments as the Commission deems reasonably necessary to prevent such preemptive effects.

15. The following provisions shall apply:
 - (a) Whenever the FERC issues rules regarding PUHCA 2005 or other rules reasonably likely to affect these Regulatory Conditions, Duke Power shall meet promptly with the Public Staff and negotiate in good faith whether and how these Regulatory Conditions might be or have been affected by such rules, and whether changes are necessary to maintain their intended protections. In the event the Public Staff and Duke Power are unable to reach agreement within a reasonable time after the issuance of final rules, the unresolved issues shall be submitted to the Commission for resolution. Any proposed changes to these Regulatory Conditions must be approved by the Commission.
 - (b) If PUHCA 2005 is amended, revised, or replaced by future legislation, Duke Power shall meet with the Public Staff promptly after the passage of such legislation and negotiate in good faith whether and how these conditions have been affected by such legislation, and whether changes are necessary to maintain their intended protections. In the event the Public Staff and Duke Power are unable to reach agreement within a reasonable time after passage of such legislation, the unresolved issues shall be submitted to the Commission for resolution. Any proposed changes to these Regulatory Conditions must be approved by the Commission.
16. Upon a decision by FERC on the petition for rehearing pending in Docket No. EC05-103-000, Duke Power shall meet promptly with the Public Staff and negotiate in good faith whether and how these Regulatory Conditions might be or have been affected by such order, and whether changes are necessary to maintain their intended protections. In the event the parties are unable to reach agreement within a reasonable time, the unresolved issues shall be submitted to the Commission for resolution.
17. In addition to the filing requirements of Commission Rule R8-27 and all other applicable statutes and Commission Rules, Duke Power shall, on a quarterly basis, file with the Commission the following: (a) a list of all

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

C. COST ALLOCATIONS AND RATEMAKING

18. Subject to additional provisions set forth in the Code of Conduct approved by this Commission, Duke Power shall take the following actions in connection with procuring goods and services for its utility operations from Affiliates or Nonpublic Utility Operations and providing goods and services to its Affiliates or Nonpublic Utility Operations:
- (a) Duke Power shall not seek to recover from its retail customers any costs that exceed fair Market Value for any service provided to Duke Power from Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation.
 - (b) Duke Power shall seek out and buy all goods and services from the lowest cost qualified provider of comparable goods and services, and shall have the burden of proving that all goods and services procured from its Affiliates or Nonpublic Utility Operations have been procured on terms and conditions comparable to the most favorable terms and conditions reasonably available in the relevant market, which shall include a showing that comparable goods or services could not have been procured at a lower price from qualified non-Affiliate sources or that Duke Power could not have provided the services or goods itself on the same basis at a lower cost. To this end, Duke Power must conduct periodic market price studies for goods and services it receives from Duke Energy Corporation, Duke Energy Shared Services, another Affiliate, or a Nonpublic Utility Operation.
 - (c) Duke Power shall have the burden of proving that all goods and services provided to Duke Energy Shared Services, Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation have been provided on the terms and conditions comparable to the most

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

- (d) The evaluation of providers of goods and services and the comparison of goods and services to Market Value required by the Regulatory Condition may take into consideration qualitative as well as quantitative factors. To the extent that comparable goods or services provided to Duke Power or by Duke Power are not commercially available, this Regulatory Condition shall not apply.
- 19. For the purposes of North Carolina retail accounting, reporting, and ratemaking, the Commission may, after appropriate notice and hearing or other appropriate opportunity for Duke Power to be heard, issue future orders relating to Duke Power's cost of service as the Commission may determine is necessary to ensure that Duke Power's operations and transactions with its Affiliates and Nonpublic Utility Operations are consistent with the Regulatory Conditions and Code of Conduct approved by the Commission, and with any other applicable decision of the Commission.
- 20. With regard to goods and services provided by Duke Power to Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations, and to goods and services, including Shared Services, provided to Duke Power by Duke Energy Shared Services, Duke Energy Corporation (should Duke Energy Corporation be allowed to provide any such goods or services), any other Affiliate, or any Nonpublic Utility Operation, the following conditions shall apply:
 - (a) No later than 60 days prior to the expected close of the Merger, Duke Power shall file pursuant to G.S. 62-153 final forms of service agreements that authorize the provision and receipt of non-power goods or services between and among Duke Power, its Affiliates or Nonpublic Utility Operations, the list(s) of goods and services it intends to take from Duke Energy Shared Services, and the basis for the determination of such list(s) and election of such services. All such lists that involve payment of fees or other compensation by Duke Power shall require acceptance and authorization by the Commission, and shall be subject to any other Commission action required or authorized by North Carolina law and the Rules and orders of the Commission.

- (b) No later than 30 days after such filing, the Public Staff shall file its response to Duke Power's filing, which shall include a recommendation as to how the Commission should proceed. If no Commission order is issued by the close of the Merger, Duke Power may operate on an interim basis, subject to ongoing Commission review, pursuant to the agreements as filed and make payments, subject to refund, as provided for therein.
- (c) The services rendered by Duke Power to its Affiliates and Nonpublic Utility Operations and the services received by Duke Power from its Affiliates and Nonpublic Utility Operations pursuant to these agreements, the costs and benefits assigned or allocated in connection with such services, and the determination or calculation of the bases and factors utilized to assign or allocate such costs and benefits, as well as Duke Power's compliance with its Commission approved-Code of Conduct and all Regulatory Conditions placed upon it by the Commission, shall remain subject to ongoing review. These agreements shall be subject to any Commission action required or authorized by North Carolina law and the Rules and orders of the Commission.
- (d) No later than one month after the closing date of the Merger, Duke Power shall file with the Commission all newly-created cost allocation manuals (CAMs) and revisions to existing CAMs, including CAMs related to Shared Services provided by Duke Energy Shared Services. The CAMs referred to herein are those intended to govern the assignment and allocation of direct, indirect, and other costs associated with goods and services (i) provided by Duke Power to Duke Energy Corporation, Duke Energy Shared Services, other Affiliates, and the Nonpublic Utility Operations, or (ii) by those entities to Duke Power and to each other (to the extent they may affect Duke Power's cost of service to its North Carolina retail electric Customers) and shall include a full description thereof, including a detailed review of common costs to be allocated and allocation factors to be used. The following additional provisions shall apply:
 - (i) The CAM(s) shall be updated annually, and the revised CAM(s) shall be filed with the Commission no later than March 31 of the year that the CAM(s) are to be in effect. Duke Power shall review allocation factors every two years, and the result of such review shall be filed with the Commission; and
 - (ii) Interim changes shall be made to the CAM(s), if and when necessary, and shall be filed with the Commission. No changes shall be made to the cost allocations, cost allocation methodologies, or related accounting entries associated with goods and services (including Shared Services provided by

Duke Energy Shared Services) provided to or by Duke Energy Corporation, other Affiliates, and the Nonpublic Utility Operations until Duke Power has given 15 days notice to the Commission of the proposed changes.

- (e) No later than 30 days after the closing date of the Merger, Duke Power shall file with the Commission pursuant to G.S. 62-153 the list(s) of goods and services (1) it intends to offer to Duke Energy Corporation, Duke Energy Shared Services, other Affiliates, and the Nonpublic Utility Operations, and (2) it intends to take from Duke Energy Corporation, other Affiliates, and the Nonpublic Utility Operations (excluding Shared Services provided by Duke Energy Shared Services, which are required to be filed pursuant to subsection (a) above), and the basis for the determination of such list(s) and election of such services. All such lists that involve payment of fees or other compensation by Duke Power shall require acceptance and authorization by the Commission, and shall be subject to any other Commission action required or authorized by North Carolina law and the Rules and orders of the Commission. The following additional provisions shall apply:
 - (i) The list(s) of goods and services, including the list required by subsection (a) above, shall be updated annually, and the revised list(s) shall be filed with the Commission no later than March 31 of the year that they are to be in effect; and
 - (ii) Interim changes shall be made to the list(s) of goods and services, if and when necessary, and shall be filed with the Commission. No changes shall be made to the list(s) of goods and services until Duke Power has given 15 days notice to the Commission of the proposed changes.
- (f) With respect to interim changes to the CAM(s) or the list(s) of goods and services, for which 15 days notice to the Commission is required, the following procedures shall apply: Before the end of the notice period, the Public Staff shall file a response and make a recommendation as to how the Commission should proceed. If the Commission has not issued an order within 30 days of the end of the notice period, Duke Power may proceed with the changes but shall be subject to any fully adjudicated Commission order on the matter.
- (g) The advance notice provisions of Regulatory Condition No. 59(b) do not apply to any of the filings made pursuant to this condition.
- (h) The Service Agreements, the CAM(s) and the assignments and allocations of costs pursuant thereto, the biannual allocation factor reviews, the list(s) and the goods and services provided pursuant

thereto, and the changes to these documents shall be subject to ongoing Commission review, and Commission action if appropriate.

21. Notwithstanding any of the provisions contained in these Regulatory Conditions, to the extent the allocations adopted by the Commission when compared to the allocations adopted by the other State commissions with ratemaking authority as to a Utility Affiliate of Duke Power result in significant trapped costs related to “non-power goods or administrative or management services provided by an associate company organized specifically for the purpose of providing such goods or services to any public utility in the same holding company system,” including Duke Power, Duke Power may, after the effective date of the Energy Policy Act of 2005 (PUHCA 2005), request pursuant to Section 1275(b) of Subtitle F in Title XII of PUHCA 2005 that the FERC “review and authorize the allocation of the costs for such goods and services to the extent relevant to that associate company.” Such review and authorization shall have whatever effect it is determined to have under the law. The quoted language in this condition is taken directly from Section 1275(b) of Subtitle F in Title XII of PUHCA 2005. The terms “associate company” and “holding company system” are defined in Sections 1262(2) and 1262(9), respectively, of Subtitle F in Title XII of PUHCA 2005 and have the same meanings for purposes of this condition.
22. Transactions between Duke Power and Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations, and other transactions among Affiliates if such transactions are reasonably likely to have a significant Effect on Duke Power’s Rates or Service, shall be reviewed at least annually by Duke Energy Corporation’s internal auditors. To the extent external audits of the transactions are conducted, Duke Power shall make available such audits for review by the Public Staff and the Commission. Duke Power shall make available for review by the Public Staff and the Commission all workpapers relating to internal audits and all other internal audit workpapers, if any, related to affiliate transactions, and shall not oppose Public Staff and Commission requests to review relevant external audit workpapers.
23. For North Carolina retail electric cost of service/ratemaking purposes, Duke Power electric system costs shall be assigned or allocated among retail and wholesale jurisdictions based on reasonable and appropriate cost causation principles. Assignment or allocation of costs to the North Carolina retail jurisdiction shall not be adversely affected by the manner and amount of recovery of electric system costs from the Catawba Joint Owners as a result of agreements between Duke Power and the Catawba Joint Owners. For cost of service/ratemaking purposes, North Carolina retail ratepayers will be held harmless from any cost assignment or

allocation of costs resulting from the agreements between Duke Power and the Catawba Joint Owners.

24. Neither Duke Power, Duke Energy Corporation, any other Affiliate, nor a Nonpublic Utility Operation shall assert that any interested party is prohibited from seeking the inclusion in future rate proceedings of cost savings that may be realized as a result of the Merger.
25. Direct expenses associated with costs to achieve the Merger shall be excluded from retail cost of service for ratemaking purposes. Duke Power shall bear the burden of proof to demonstrate in its first rate case after closing of the Merger that any capital costs, such as system integration costs, associated with costs to achieve the merger that Duke seeks to recover from the North Carolina retail customers are to the benefit of North Carolina retail customers. The North Carolina portion of costs to achieve merger savings shall be reflected in Duke Power's North Carolina ES-1 report as recorded on its books and records under generally accepted accounting principles. To the extent a one-year rate decrement is approved, the rate decrement's impact may be spread evenly over five years in the ES-1 report, commencing with the date the rate decrement is implemented. However, Duke Power shall include as a footnote in the ES-1 report the merger related costs to achieve that were expensed during the relevant period. If the merger is not consummated, neither the cost of any termination payment nor the receipt of a termination payment between Duke Energy and Cinergy shall be allocated to Duke Power's books. Nor shall Duke Power's North Carolina retail customers otherwise bear any direct expenses or costs associated with a failed merger.
26. The revenues from certain Duke Power electric utility wholesale transactions are (a) assigned or allocated in part to Duke Power's North Carolina retail operations and (b) treated in part as a credit to jurisdictional fuel expenses in Duke Power's annual North Carolina retail fuel proceedings. To the extent commitments to Duke Power's wholesale customers relating to the Merger are made by or imposed upon Duke Power, the effects of which serve to (a) decrease the net bulk power revenues ordered to be shared by the Commission in Docket No. E-7, Sub 751, (b) increase the North Carolina retail cost of service, or (c) increase North Carolina retail fuel costs under reasonable cost assignment and allocation practices approved or allowed by the Commission, those effects shall not be recognized for North Carolina retail cost of service or ratemaking purposes.
27. To the extent that other such commitments are made by or imposed upon Duke Power, Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation relating to the Merger, either through an offer, a settlement, or as a result of a regulatory order, the effects of which serve

to increase the North Carolina retail cost of service or North Carolina retail fuel costs under reasonable cost allocation practices, the effects of these commitments shall not be recognized for North Carolina retail ratemaking purposes.

28. Any acquisition adjustment that results from the Merger shall be excluded from Duke Power's utility accounts and treated for regulatory accounting, reporting, and ratemaking purposes so that it does not affect Duke Power's North Carolina retail electric rates and charges.
29. Duke Power, Duke Energy Corporation, the other Affiliates, and all of the Nonpublic Utility Operations shall take all such actions as may be reasonably necessary and appropriate to hold North Carolina retail ratepayers harmless from effects of the Merger, including rate increases or foregone opportunities for rate decreases, and other effects otherwise adversely impacting North Carolina retail customers.
30. Duke Power's North Carolina retail customers shall be held harmless from all current and prospective liabilities of Cinergy Corp. and its subsidiaries including, but not limited to, the litigation involving manufactured gas plant sites, asbestos claims, environmental compliance, pensions and other employee benefits, and taxes.
31. Duke Power shall file an annual report of affiliated transactions with the Commission in the format prescribed by the Commission in Docket No. E-7, Sub 694. The report shall be filed on or before May 30 of each year, for activity through December 31 of the preceding year. Changes may be made, if and when deemed necessary, to the required affiliated transaction reporting requirements and submitted to the Commission for approval.
32. Periodic comprehensive third-party independent audits of the affiliate transactions undertaken pursuant to the affiliate agreements filed in this docket (as subsequently re-filed in accordance with Regulatory Condition No. 20 and allowed to go into effect by the Commission) shall be conducted no less often than every two years. The independent auditor shall have sufficient access to the books and records of Duke Power, Duke Energy Corporation, other Affiliates, and all of the Nonpublic Utility Operations to perform the audits. The scope of the audits shall include Duke Energy Corporation's and Duke Power's compliance with all conditions ordered herein concerning affiliate company transactions, including the propriety of the transfer pricing of goods and services between and/or among Duke Power and its affiliates, that is, Duke Energy Corporation, other Affiliates, and all of the Nonpublic Utility Operations. Duke Power and the Public Staff shall confer and jointly identify one or more proposed independent auditors. Other parties shall have an opportunity to comment and propose additional auditors. Selection of the independent auditor shall be made by

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

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

Nonpublic Utility Operations, or other circumstances that necessitate such changes.

D. CODE OF CONDUCT

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

E. FINANCE/CORPORATE GOVERNANCE

35. Duke Energy Corporation shall maintain its books and records so that any net equity investment in Cinergy Corp. or its subsidiaries (or their successors) by Duke Energy Corporation or any of its Affiliates can be identified and made available on an ongoing basis. This information shall be provided to the Public Staff upon its request.
36. Duke Energy Corporation and Duke Power shall keep their respective accounting books and records in a manner that will allow all capital structure components and cost rates of the cost of capital to be identified easily and clearly for each entity on a separate basis. This information shall be provided to the Public Staff upon its request.
37. Duke Power shall keep its books and records so that the amount of Duke Energy Corporation's equity investment and member's equity in Duke Power can be identified and made available upon request on an ongoing basis. This information shall be provided to the Public Staff upon request.
- 37a. Effective upon consummation of the merger and beginning with the quarterly report due for the first 12-month reporting period beginning concurrent therewith or subsequent thereto, whichever shall first occur, Duke Power shall begin transitioning to its actual capital structure for purposes of calculating and reporting its quarterly North Carolina retail jurisdictional earnings in its NCUC ES-1 Reports to the Commission. Said transition shall be accomplished by use of a consistent, uniform, systematic approach applied on a quarterly basis such that exclusive use of the Company's actual capital structure will be fully phased in and reflected in the Company's NCUC ES-1 Report for the 12-month period ending June 30, 2007.¹ Once fully phased in, the information to be submitted as part and parcel of, or in conjunction with, the NCUC ES-1 Reports shall include, among other things, a calculation of the 13-month

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

average actual capital structure utilized in such reports, with the individual capital components (long-term debt, member's and/or common equity, etc.) on a total-company basis shown separately and in total. NCUC ES-1 Reports filed by Duke Power during the phase-in shall clearly disclose and reflect the methodology employed by Duke Power in calculating the 13-month average capital structure utilized therein. In recognition of the change in its organizational structure that will result upon consummation of the merger, Duke Power shall, following the merger, continue to provide to the Commission and/or the Public Staff all financial and operational information which is currently being provided on an ongoing basis by Duke Energy Corporation. Duke Power shall base such reports primarily on the corporate entity Duke Power.

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

38. To the extent the cost rates of any of Duke Power's long-term debt (more than one year) or short-term debt (one year or less) are or have been adversely affected, through a ratings downgrade or otherwise, by the Merger, a replacement cost rate to remove the effect shall be used for all purposes affecting any of Duke Power's retail rates and charges. This replacement cost rate shall be applicable to all financings, refundings, and refinancings taking place following the change in ratings. This procedure shall be effective through Duke Power's next general rate case. As part of Duke Power's next general rate case, any future procedure relating to a replacement cost calculation will be determined. This condition does not indicate a preference for a specific debt rating for Duke Power within the intended investment grade range provided for in Regulatory Condition No. 43 on current or prospective bases.
39. Within 90 days from the date of redemption of current Duke Energy Corporation's preferred stock, announced via a press release dated November 14, 2005, Duke Energy Corporation or Duke Power shall file a report with the Commission identifying the source(s) of funds used to execute the redemption and describing all costs, fees, etc., that are associated with the redemption.
40. Duke Power shall identify as clearly as possible long-term debt (of more than one year's duration) that it issues in connection with its regulated utility operations and capital requirements or to replace existing debt.

41. With respect to all proposed financing transactions, the following shall apply:
- (a) For all types of financings for which Duke Power (or its subsidiaries, if any) are the issuers of the respective securities, Duke Power (or its subsidiaries, if any) shall request approval from the Commission to the extent required by G.S. 62-160 through G.S. 62-169 and Commission Rule R1-16. Generally, the format of these filings should be consistent with past practices. A “shelf registration” approach (similar to Docket No. E-7, Sub 727) may be requested.
 - (b) For all types of financings by Duke Energy Corporation, other than short-term debt as described in G.S. 62-167, the following shall apply:
 - (i) On or before January 15 of each year, Duke Energy Corporation shall file with the Commission and serve on the Public Staff an advance confidential plan of all securities issuances that are anticipated to occur during that calendar year. For 2006, an advance confidential plan shall be filed as soon as possible after the merger is consummated. The annual confidential plan shall include a description of all financings that Duke Energy Corporation reasonably believes may occur during the applicable calendar year. A description for each financing shall include the best estimates of the following: type of security; estimate of cost rate (e.g., interest rate for debt); amount of proceeds; brief description of the purpose/reason for issue; and amount of proceeds, if any, that may flow to Duke Power.
 - (ii) If at any time material changes to the financing plans included in the filed plan appear likely, Duke Energy Corporation shall file a revised 30-day advance confidential plan that specifically addresses such changes with the Commission and serve such notice on the Public Staff.
 - (iii) At the time of the confidential plan filings identified above, Duke Energy Corporation shall also file a non-confidential notice that states that a confidential plan has been filed in compliance with Regulatory Condition No. 41.
 - (iv) Duke Energy Corporation may proceed with equity issuances upon the filing of the confidential plan. However, actual debt issuances shall not occur until 30 days after the advance confidential plan or revised plans are filed. In the event it is not feasible for Duke Energy Corporation to file a revised advance confidential plan for a material change 30 days in advance, such plan shall be filed by a date that allows adequate time for review or a debt issuance shall be delayed to allow such review.

- (v) Within 15 days after the filing of an advance confidential plan or revised plan, the Public Staff shall file a confidential report with the Commission with respect to whether any debt issuances require approval pursuant to G.S. 62-160 through G.S. 62-169 and Commission Rule R1-16 and shall recommend that the Commission issue an order deciding how to proceed. Duke Energy Corporation shall have seven days in which to respond to the report. If the Commission determines that any debt issuance requires approval, the Commission shall issue an order requiring the filing of an application and no issuance shall occur until the Commission approves the application. If the Commission determines that no debt issuance requires approval, the Commission shall issue an order so ruling. At the end of the notice period, Duke Energy Corporation may proceed with the debt issuance, but shall be subject to any fully adjudicated Commission order on the matter; provided, however, that nothing herein shall affect the applicability of G.S. 62-170 or other similar provision to such securities or obligations.
 - (vi) On or before April 15 of each year, Duke Energy Corporation shall file with the Commission a report on all financings that were executed for the previous calendar year. The actual reports should include the same information as required above for the advance plans plus the actual issuance costs.
 - (c) If a filing with the Securities and Exchange Commission or other federal agency will be made in connection with a securities issuance, the notice shall describe such filing(s) and indicate the approximate date on which it would occur.
 - (d) All securities issuances or financings that are associated with a merger, acquisition, or other business combination shall be filed in conjunction with the information requirements and deadlines stated in Regulatory Condition No. 54.
 - (e) The advance notice provisions of Regulatory Condition No. 59(b) do not apply to any of the filings made pursuant to this condition.
42. These conditions do not supersede any orders or directives of the Commission regarding the issuance of specific securities by Duke Power or Duke Energy Corporation. The approval of the Merger by the Commission does not restrict the Commission's right to review, and by order to adjust, Duke Power's cost of capital for ratemaking purposes for the effect(s) of the securities-related transactions associated with the Merger.

43. Duke Power shall manage its business with the intention of maintaining an investment grade debt rating on all of its rated debt issuances with all of its debt rating agencies. If Duke Power's debt rating falls to the lowest level still considered investment grade at the time, Duke Power shall provide notice to the Commission and Public Staff within five (5) days of such change and an explanation as to why the downgrade occurred. Within 45 days of such notice, Duke Power shall meet with the Commission and the Public Staff and provide information regarding the steps it intends to take to maintain and improve its debt rating. The advance notice provisions of Regulatory Condition No. 59(b) do not apply to this Condition.
44. Duke Energy Corporation and Duke Power shall ensure that Duke Power has sufficient access to equity and debt capital to enable Duke Power to adequately fund and maintain its current and future generation, transmission, and distribution systems and otherwise meet the service needs of its customers at a reasonable cost.
45. Duke Power shall limit cumulative distributions paid to Duke Energy Corporation subsequent to the Merger to (i) the amount of Retained Earnings on the day prior to the closure of the Merger, plus (ii) any future earnings recorded by Duke Power subsequent to the Merger.
46. Duke Power shall not invest in a non-regulated utility asset or any non-utility business venture exceeding \$50 million dollars in purchase price or gross book value to Duke Power unless it provides 30 days' advance notice, to which the advance notice provisions of Regulatory Condition No. 59(b) shall apply. Purchases of assets, including land, that will be held with a definite plan for future use in providing Electric Services in Duke Power's franchise area shall be excluded from this advance notice requirement.
47. By April 15 of each year, Duke Energy Corporation shall provide to the Commission and the Public Staff a report summarizing Duke Energy Corporation's investment in exempt wholesale generators (EWGs) and foreign utility companies (FUCOs) in relation to its level of consolidated retained earnings and consolidated total capitalization at the end of the preceding year. Exempt wholesale generator and foreign utility company are defined in Section 1262(6) of Subtitle F in Title XII of PUHCA 2005 and have the same meanings for purposes of this condition.
48. Duke Power shall borrow short-term funds in the financial markets or through the "Utility Money Pool Agreement" (Utility MPA), provided that the Utility MPA (a) is modified to exclude Tri-State Improvement Company; and (b) continues to provide that no loans through the Utility Money Pool will be made to, and no borrowings through the Utility Money Pool will be made by, Duke Energy Corporation and Cinergy Corporation.

If, after December 31, 2008, certain of The Cincinnati Gas & Electric Company's generation assets are not dedicated to serving retail load in its service territory and are not subject to the rate stabilization plan (as approved in Case 03-93-ATA) or traditional regulation, then Duke Power shall obtain Commission approval to continue to participate in the Utility MPA. Duke Power shall acquire its long-term debt funds through the financial markets, and shall neither borrow from nor lend to, on a long-term basis, Duke Energy Corporation or any of its other Affiliates. To the extent that Duke Power borrows on short-term or long-term bases in the financial markets and it is feasible to obtain a debt rating, its debt shall be rated under its own name.

49. Duke Energy Corporation shall comply with New York Stock Exchange Listing Standards with respect to the composition of its Board of Directors.
50. Duke Energy Corporation shall notify the Commission subsequent to Board approval and as soon as practicable following any public announcement of any investment in a regulated or non-regulated business representing five (5) percent or more of Duke Energy Corporation's market capitalization. The advance notice provisions of Regulatory Condition No. 59(b) do not apply to this Condition.
51. If an Affiliate of Duke Power experiences a default on an obligation that is material to Duke Energy Corporation or files for bankruptcy, and such bankruptcy is material to Duke Energy Corporation, Duke Power shall notify the Commission in advance, if possible, or as soon as possible, but not later than ten days from such event. The advance notice provisions of Regulatory Condition No. 59(b) do not apply to this Condition.
52. By March 31 of the first calendar year following the close of the Merger and each March 31 thereafter, Duke Power shall file an annual report in the format provided hereinafter. Duke Power and the Public Staff shall meet and reach agreement as to the list of Affiliates for purposes of this Annual Report that constitute Significant Affiliates and Duke Power shall file this list with the Commission. In the event the Public Staff and Duke Power are unable to reach agreement within a reasonable time, both shall file their proposed lists and submit the unresolved issues to the Commission for resolution. Thereafter, the list shall be updated as appropriate on an annual basis.

ANNUAL REPORT ON CORPORATE
GOVERNANCE AND FINANCE

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

1. Provide a complete, detailed organizational chart that identifies Duke Power and each Significant Affiliate, including major groups and departments. State the business purpose of each company and each major group and each department within each company. Changes from the report for the immediately preceding year shall be summarized at the beginning of the report.
2. Identify all Significant Affiliates that are considered to constitute non-regulated investments and provide each company's total capitalization, the percentage it represents of Duke Energy Corporation's total non-regulated investments, and the percentage it represents of Duke Energy Corporation's total investments. Changes from the report for the immediately preceding year shall be summarized at the beginning of the report.
3. Provide an assessment of the risks that each unregulated Significant Affiliate could pose to Duke Power based upon current business activities of those affiliates and any contemplated significant changes to those activities.
4. Provide a description of Duke Power's and each Significant Affiliate's actual capital structure. In addition, describe Duke Energy Corporation's and Duke Power's goals for Duke Power's capital structure and plans for achieving such goals.
5. Provide a complete description of all protective measures (other than those provided for by the Regulatory Conditions adopted in Docket No. E-7, Sub 795) in effect between Duke Power and any of its Affiliates and a description of how each measure operates. This should include, but not be limited to, mitigation of Duke Power's exposure in the event of a bankruptcy proceeding involving any affiliate(s).
6. Provide a list of corporate officers and other key personnel that are shared between Duke Power and any Affiliate, along with a description of each person's position(s) with, and duties and responsibilities to each entity.

7. Provide a calculation of Duke Energy Corporation's total market capitalization as of December 31 of the preceding year for common equity, preferred stock, and debt.
53. The cost of capital conditions included herein shall also apply to Duke Power's determination of its maximum allowable AFUDC rate, the rate of return applied to any of Duke Power's deferral accounts and regulatory assets and liabilities that accrue a return, and any other component of Duke Power's cost of service impacted by the cost of debt.
- 53a. Duke Power shall carry forward to its post-merger balance sheet, among other things, the balances, without adjustment(s), in all accounts of the following nature: regulatory liability; deferred credit, including deferred income tax; reserve; valuation; and over-accrued liability accounts, if any, applicable and/or reasonably attributable to Duke Energy's regulated electric utility operations which existed prior to consummation of the merger. Further, Duke Energy shall promptly, where appropriate, distribute to Duke Power any and all payments, refunds, dividends, other distributions, etc., received by Duke Energy subsequent to the merger that have arisen from and/or are attributable to payments, distributions, etc., having been made by its regulated electric utility operations prior to the merger, including such funds received as a result of retrospective and/or other insurance plans.

F. FUTURE PROPOSED MERGERS

54. For all proposed mergers, acquisitions, or other business combinations involving Duke Energy Corporation, Duke Power, other Affiliates, or the Nonpublic Utility Operations, the following conditions shall apply:
 - (a) For any proposed merger, acquisition, or other business combination by or affecting Duke Power, Duke Power shall file an application for approval pursuant to G.S. 62-111(a) at least 180 days before the proposed closing date for such merger, acquisition, or other business combination.
 - (b) For any proposed merger, acquisition, or other business combination that is believed not to affect Duke Power but which involves Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations and which has a transaction value exceeding \$1 billion:
 - (i) Advance notification shall be filed with the Commission at least 90 days prior to the proposed closing date for such proposed merger, acquisition or other business combination. The advance notification is intended to provide the Commission an opportunity to determine whether the proposed merger, acquisition, or other business combination

is reasonably likely to affect Duke Power so as to require approval pursuant to G.S. 62-111(a). The notification shall contain sufficient information to enable the Commission to make such a determination. If the Commission determines that such approval is required, the 180-day advance filing requirement in subsection (a), above, shall not apply.

- (ii) Any interested party may file comments within 45 days of the filing of the advance notification.
- (iii) If timely comments are filed, the Public Staff shall place the matter on a Commission Staff Conference agenda as soon as possible, but in no event later than 15 days after the comments are filed, and shall recommend that the Commission issue an order deciding how to proceed. If the Commission determines that the merger, acquisition, or other business combination requires approval pursuant to G.S. 62-111(a), the Commission shall issue an order requiring the filing of an application, and no closing can occur until and unless the Commission approves the proposed merger, acquisition, or business combination. If the Commission determines that the merger, acquisition, or other business combination does not require approval pursuant to G.S. 62-111(a), the Commission shall issue an order so ruling. At the end of the notice period, if no order has been issued, Duke Energy Corporation, any other Affiliate, or the Nonpublic Utility Operation may proceed with the merger, acquisition, or other business combination but shall be subject to any fully-adjudicated Commission order on the matter.
- (iv) The advance notice provisions of Regulatory Condition No. 59(b) do not apply to any of the filings made pursuant to this Condition.

G. STRUCTURE/ORGANIZATION

- 55. Duke Power shall file notice with the Commission 30 days prior to the initial transfer or any subsequent transfer of any services, functions, departments, employees, rights, obligations, assets, or liabilities from Duke Power to Duke Energy Shared Services, Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation that potentially would have a significant effect on Duke Power's public utility operations. The advance notice provisions of Regulatory Condition No. 59(b) apply to this Condition.
- 56. The benefits, costs, and associated risks of the Merger and the operation of Duke Power under a holding company structure shall continue to be subject to Commission review. To the extent the Commission has

authority under North Carolina law, it may order lawful modifications to the structure or operations of Duke Energy Corporation, Duke Energy Shared Services, another Affiliate, or a Nonpublic Utility Operation, and to take whatever action the Commission deems necessary to protect Duke Power's North Carolina retail customers, including, but not limited to, modifications necessary to address changes in the electric industry.

57. Duke Power shall meet and consult with, and provide requested relevant data to, the Public Staff, at least semiannually through 2010, unless there is agreement between Duke Power and the Public Staff that no meeting is necessary, regarding plans for significant changes in Duke Power's or Duke Energy Corporation's organization, structure (including RTO developments), and activities; the expected or potential impact of such changes on Duke Power's retail rates, operations and service; and proposals for assuring that such plans do not adversely affect Duke Power's North Carolina retail electric customers. To the extent that proposed significant changes are planned for any Affiliate's or Nonpublic Utility Operation's organization, structure, or activities, then Duke Power's plans and proposals for assuring that those plans do not adversely affect its customers must be included in these meetings. Duke Power or the Public Staff may initiate meetings more frequently if significant events or other changes require. Duke Power shall inform the Public Staff promptly of any such events and changes.
58. Duke Power shall provide to the Public Staff, 30 days prior to finalization, the Tax Sharing Agreement, any plans to consolidate Duke Energy Corporation's and Cinergy Corp.'s employee benefit plans, and any other similar agreements and plans.

H. PROCEDURES

59. Except to the extent a condition, Commission order, rule, or statute specifically provides otherwise, the following procedures shall apply with respect to all filings made pursuant to these Regulatory Conditions:
 - (a) All filings pursuant to the Regulatory Conditions shall be made as follows:
 - (i) Regulatory Condition filings that do not involve advance notices shall be made in Docket No. E-7, Sub 795A.
 - (ii) Each filing for which the Regulatory Conditions require an advance notice shall be assigned a new, separate Sub docket. Such a filing shall state what condition and notice period are involved and whether other regulatory approvals are required and shall be in the format of a pleading, with a caption, a title, allegations of the activities to be undertaken,

and a verification. Advance notices may be filed under seal if necessary.

- (b) The following additional procedures shall apply to all advance notices filed pursuant to Condition Nos. 1, 3, 7(b), 10, 46, and 55:
 - (i) Advance notices of activities to be undertaken shall not be filed until sufficient details have been decided upon to allow for meaningful discovery as to the proposed activities.
 - (ii) The Chief Clerk shall distribute a copy of advance notice filings to each Commissioner and to appropriate members of the Commission Staff and Public Staff.
 - (iii) Duke Power shall serve such advance notices on each party to Docket No. E-7, Sub 795, that has filed a request to receive them with the Commission within 30 days of the issuance of an order approving the Merger in this docket. These parties may participate in the advance notice proceedings without petitioning to intervene. Other interested persons shall be required to follow the Commission's usual intervention procedures.
 - (iv) To effectuate this Regulatory Condition, Duke Power shall serve pertinent information on all parties at the time it serves the advance notice. No later than 90 days after the closing date of the Merger, Duke shall have solicited input from the parties to Docket No. E-7, Sub 795, and shall have developed and circulated to those parties lists of pertinent information to be provided in each type of advance notice proceeding. Should Duke and any party not agree as to the adequacy of these lists, they shall take the matter to the Commission for resolution. During the advance notice period, a free exchange of information is encouraged, and parties may request additional relevant information. If Duke Power objects to a discovery request, Duke Power and the requesting party shall try to resolve the matter. If the parties are unable to resolve the matter, Duke Power may file a motion for a protective order with the Commission.
 - (v) The Public Staff shall investigate and file a response with the Commission no later than 15 days before the notice period expires. Any other interested party may also file a response within the notice period. Duke Power may file a reply to the response(s).

- (vi) The basis for any objection to the activities to be undertaken shall be stated with specificity. The objection shall allege grounds for a hearing, if such is desired.
- (vii) If neither the Public Staff nor any other party files an objection to the activities, no Commission order shall be issued, and the Sub docket in which the advance notice was filed may be closed.
- (viii) If the Public Staff or any other party files a timely objection to the activities to be undertaken by Duke Power, the Public Staff shall place the matter on a Commission Staff Conference agenda as soon as possible, but in no event later than two weeks after the objection is filed, and shall recommend that the Commission issue an order deciding how to proceed as to the objection. The Commission reserves the right to extend an advance notice period by order should the Commission need additional time to deliberate or investigate any issue. At the end of the notice period, if no order, whether procedural or substantive, has been issued, Duke Power, Duke Energy Corporation, any other Affiliate, or the Nonpublic Utility Operation may proceed with the activity to be undertaken, but shall be subject to any fully-adjudicated Commission order on the matter.
- (ix) If the Commission schedules a hearing on an objection, the party filing the objection shall bear the burden of proof at the hearing.
- (x) The precedential effect of advance notice proceedings, like most issues of *res judicata*, will be decided on a fact-specific basis.
- (xi) If some other Commission filing or Commission approval is required by statute, notice pursuant to a Regulatory Condition alone does not satisfy the statutory requirement.
- (xii) Duke Power, the Public Staff, or any party may move for a waiver if exigent circumstances in a particular case justify such.

I. SERVICE QUALITY

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

J. TAX

61. Under any tax sharing agreement, Duke Power shall not seek to recover from its North Carolina retail ratepayers any tax costs that exceed Duke Power's tax liability calculated as if it were a stand-alone, taxable entity for tax purposes.
62. The appropriate portion of any income tax benefits associated with Duke Energy Shared Services shall accrue to North Carolina retail operations for regulatory accounting, reporting, and ratemaking purposes.

K. NANTAHALA

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

L. GENERAL

65. In accordance with North Carolina law, the Commission and the Public Staff shall continue to have access to the books and records of Duke

Power, Duke Energy Corporation, other Affiliates, and the Nonpublic Utility Operations.

66. Duke Energy Corporation shall make available in Charlotte, North Carolina, all Duke Power financial books and records.
67. All previously issued Commission orders applicable prior to the Merger to Duke Energy Corporation, to Duke Power as a division of Duke Energy Corporation, to Nantahala as an area or division of Duke Power, or to Nantahala Power and Light Company shall remain applicable to Duke Power after the Merger, unless superseded by Commission order. Within 30 days of the Commission's Order approving the Merger, Duke Energy shall file a list of the conditions imposed by the Commission in Docket Nos. E-7, Subs 557, 596, 694, and 700, as well as in other dockets, that have not been superseded by these Regulatory Conditions. The Public Staff and other parties shall have 30 days to file responses. The Commission will then determine which of the previously approved conditions remain in effect. The advance notice provisions of Regulatory Condition No. 59(b) do not apply to this Condition.
68. These Regulatory Conditions are based on the general power and authority granted to the Commission in Chapter 62 of the North Carolina General Statutes to control and supervise the public utilities of the State. The Regulatory Conditions either (a) constitute specific exercises of the Commission's authority, (b) provide mechanisms that enable the Commission to determine in advance the extent of its authority and jurisdiction over proposed activities of and transactions involving Duke Power, Duke Energy Corporation, other Affiliates or Nonpublic Utility Operations, or (c) protect the Commission's jurisdiction from federal preemption and its effects. Pursuant to these conditions, Duke Power, Duke Energy Corporation, and other Affiliates waive certain of their federal rights as specified in these Regulatory Conditions, but do not otherwise agree that the Commission has authority other than as provided for in Chapter 62. Other than as provided for, or explicitly prohibited, in these conditions, Duke Energy Corporation, Duke Power, and its Affiliates retain the right to challenge the lawfulness of any Commission order issued pursuant to or relating to these Regulatory Conditions on the basis that such order exceeds the Commission's statutory authority under North Carolina law or the other grounds listed in G.S. 62-94(b).
69. These Regulatory Conditions are not intended to and do not purport to impose legal obligations on entities in which Duke Energy Corporation does not directly or indirectly have a controlling voting interest.
70. Duke Power, Duke Energy Corporation and its Affiliates may request a waiver of any aspect of these Regulatory Conditions if exigent

circumstances in a particular case justify such by filing a request for waiver with the Commission for approval.

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

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

- 73. Duke Power shall implement a one-year across-the-board decrement to rates for the benefit of its North Carolina retail customers in the amount of \$117,517,000. In addition, any fuel-related savings associated with the Merger shall be flowed through to Duke Power's North Carolina retail customers pursuant to G.S. 62-133.2.
- 74. Following the approval of the Merger by the state commissions of Kentucky, Ohio, and South Carolina and approval of the affiliate agreements filed with the Indiana Utility Regulatory Commission in connection with the Merger, any sharing mechanisms pursuant to which Merger savings are shared with retail customers in each of these states will be reviewed to identify the utility whose electric retail customers will receive the largest percentage of the net merger savings to be achieved over the first five years after closing of the Merger allocated to that utility. If the application of that percentage to the net savings allocable to North Carolina retail would result in a greater savings sharing than that which has been allocated to North Carolina customers, then the rate reduction described in Regulatory Condition No. 73 for North Carolina retail customers will be increased to match the application of that percentage to the net savings allocable to North Carolina retail customers. Application of this methodology is intended to ensure that North Carolina retail customers receive the benefit of a "Most Favored Nation" status with regard to the sharing of net merger savings among the states named above. In no event will the application of the methodology cause North Carolina retail customers' share of net merger savings to be reduced.
- 75. Duke Power shall, as a condition to approval of the Merger, contribute \$12,000,000 to various energy- and environmental-related and economic- and educationally-beneficial programs, said funds to be distributed as follows: \$6,000,000 to Duke Power's Share the Warmth, Cooling Assistance, and Fan-Heat Relief programs; \$2,000,000 for conservation and energy efficiency programs (to be submitted to the Commission for

approval); \$2,000,000 to the Community College Grant Fund; and \$2,000,000 to NC GreenPower. These contributions shall be made by Duke Power on or before June 30, 2006. Such contributions shall not be charged to Duke Power's regulated utility operations, but shall be borne by the Company's shareholders.

76. As a condition to approval of the Merger, the North Carolina Utilities Commission shall in 2007, initiate an investigation pursuant to G.S. 62-130(d), 62-133, and 62-136(a) to determine whether Duke Power's existing rates and charges are unjust and unreasonable and, as part of this investigation, shall require Duke Power to either (1) file a general rate case (including prefiled testimony and exhibits) in North Carolina pursuant to G.S. 62-137 or (2) show cause in the form of prefiled testimony and exhibits why the Company's existing rates and charges should not be found unjust and unreasonable. The test period for this proceeding shall be the twelve-month period ending December 31, 2006, with appropriate adjustments. Duke Power shall make its filing, including a Rate Case Information Report - NCUC Form E-1, not later than June 1, 2007. Any rate changes proposed by Duke Power shall be proposed to become effective on January 1, 2008. To the extent the \$117,517,000 one-year rate decrement flowed through by Duke Power to its North Carolina retail customers is deferred, with plans or provisions for amortization over future periods pursuant to Regulatory Condition No. 25, no portion of such amount, including amortization thereof, will be eligible for recovery as a component of Duke Power's North Carolina retail rates set prospectively following consummation of the Merger. In particular, no allowance for same will be included in the test-year cost of service developed for purposes of the general rate case proceeding to be instituted pursuant to this Regulatory Condition; nor will any portion of such amount be recoverable from Duke Power's North Carolina retail ratepayers by means of a rate rider or otherwise. Nor will any portion of the net merger savings attributed to shareholders by Duke Energy be eligible for recovery from North Carolina retail ratepayers in base rates, rate riders, or other cost recovery mechanisms set prospectively subsequent to consummation of the Merger. This investigation shall be consolidated with the investigation and hearing the Commission is required to undertake for Duke Power pursuant to G.S. 62-133.6(d) and (f) to review the Company's environmental compliance costs.

DOCKET NO. E-7, SUB 795

CODE OF CONDUCT

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

I. DEFINITIONS

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

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

Commission: The North Carolina Utilities Commission.

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

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

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

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

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

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

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

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

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

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

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

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

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

This Code does not address whether or not this term includes joint or shared utility/non-utility operations such as a network for power line communications.

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

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

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

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

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

II. GENERAL

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

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

III. STANDARDS OF CONDUCT

A. Independence and Information Sharing

- 1. Separation – Duke Power, Duke Energy Corporation, and the other Affiliates shall operate independently of each other and in physically separate locations to the maximum extent practicable. Duke Power, Duke Energy Corporation, and each of the other Affiliates shall maintain separate books and records. Each of Duke Power’s Nonpublic Utility Operations shall maintain separate records from those of Duke Power’s public utility operations to ensure appropriate cost allocations and any arm’s-length-transaction requirements.**
2. Disclosure of Customer Information:
 - (a) Upon request, and subject to the restrictions and conditions contained herein, Duke Power may provide Customer Information to Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation under the same terms and conditions that such information is provided to non-Affiliates.
 - (b) Except as provided in Section III.A.2.(f) below, Customer Information shall not be disclosed to any person or company, without the Customer’s consent, and then only to the extent specified by the Customer. Consent to disclosure of Customer Information to Affiliates or Nonpublic Utility Operations may be obtained by means of written authorization, electronic authorization or recorded verbal authorization upon providing the Customer with the information set forth in Attachment A; provided, however, that Duke Power retains such authorization for verification purposes for as long as the authorization remains in effect.
 - (c) If the Customer allows or directs Duke Power to provide Customer Information to Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation, then Duke Power shall ask the Customer if he, she, or it would like the Customer Information to be provided to one or more non-Affiliates. If the Customer directs Duke Power to provide Customer Information to one or more non-Affiliates, the Customer Information shall be disclosed to all entities designated by the Customer contemporaneously and in the same manner.
 - (d) Sections III.A.2.(a), 2.(b), and 2.(c) herein shall be permanently posted on Duke Power’s website.

- (e) No Duke Power employee who is transferred to Duke Energy Corporation or another Affiliate will be permitted to copy or otherwise compile any Customer Information for use by such entity except pursuant to written permission from the Customer, as reflected by a signed Data Disclosure Authorization. Duke Power shall not transfer any employee to Duke Energy Corporation or another Affiliate for the purpose of disclosing or providing Customer Information to such entity.
 - (f) Notwithstanding the prohibitions established by this Section III.A.2, Duke Power may disclose Customer Information to Duke Energy Shared Services, any other Affiliate, a Nonpublic Utility Operation or a non-affiliated third party without customer consent, but only to the extent necessary for the Affiliate, Nonpublic Utility Operation or non-affiliated third party to provide goods or services to Duke Power and upon their explicit agreement to protect the confidentiality of such Customer Information.
 - (g) Duke Power shall take appropriate steps to store Customer Information in such a manner as to limit access to only those persons permitted to receive it and shall require all persons with access to such information to protect its confidentiality.
 - (h) Duke Power shall establish guidelines for its employees and representatives to follow with regard to complying with this Section III.A.2.
3. The disclosure of Confidential Systems Operation Information of Duke Power (referred to hereinafter as "Information") shall be governed as follows:
- (a) Such Information shall not be disclosed by Duke Power to an Affiliate or a Nonpublic Utility Operation unless it is disclosed to all competing non-Affiliates contemporaneously and in the same manner. Disclosure to non-Affiliates is not required when disclosure to Affiliates or Nonpublic Utility Operations meets one of the following exceptions:
 - (i) A state or federal regulatory agency or court having jurisdiction over the disclosure of such Information requires the disclosure;
 - (ii) The Information is provided to employees of Duke Energy Shared Services pursuant to a service agreement filed with the Commission pursuant to G.S. 62-153;
 - (iii) The Information is provided to employees of Duke Power's Utility Affiliates for the purpose of sharing best practices and otherwise improving the provision of regulated utility service;
 - (iv) The Information is provided to an Affiliate pursuant to an agreement filed with the Commission pursuant to G.S. 62-153, provided that the agreement specifically describes the types of Information to be disclosed;

- (v) Disclosure is otherwise essential to enable Duke Power to provide Electric Services to its Customers; or
- (vi) Disclosure of the Information is necessary for compliance with the Sarbanes-Oxley Act of 2002.

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

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

- (i) The types of Information disclosed and the name(s) of the Affiliate(s) to which it is being, or has been, disclosed;**
- (ii) The reasons for the disclosure; and**
- (iii) Whether the disclosure is intended to be a one-time occurrence or an ongoing process.**

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

B. Nondiscrimination

1. Duke Power employees and representatives will not unduly discriminate against non-Affiliated entities.
2. Duke Power shall not provide any preference to Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation, nor to any customers of such an entity, as compared to non-Affiliates or their customers, in responding to requests for Electric Services or in providing Electric Services. Moreover, neither Duke Power, Duke Energy Corporation, nor any of the other Affiliates will represent to any person or entity that Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation will receive any such preference.
3. Duke Power shall apply the provisions of its tariffs equally to Duke Energy Corporation, the other Affiliates, the Nonpublic Utility Operations, and non-Affiliates.

4. Duke Power shall process all similar requests for Electric Services in the same timely manner, whether requested on behalf of Duke Energy Corporation, another Affiliate, a Nonpublic Utility Operation, or a non-Affiliated entity.
5. No personnel or representatives of Duke Power, Duke Energy Corporation, or another Affiliate shall indicate, represent, or otherwise give the appearance to another party that Duke Energy Corporation or another Affiliate speaks on behalf of Duke Power; provided however, that this prohibition does not apply to employees of Duke Energy Shared Services providing Shared Services or to employees of another Affiliate to the extent explicitly provided for in an affiliate agreement that has been accepted by the Commission. In addition, no personnel or representatives of a Nonpublic Utility Operation shall indicate, represent, or otherwise give the appearance to another party that they speak on behalf of Duke Power's regulated public utility operations.
6. No personnel or representatives of Duke Power, Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation shall indicate, represent, or otherwise give the appearance to another party that any advantage to that party with regard to Electric Services exists as the result of that party dealing with Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation, as compared with a non-Affiliate.
7. Duke Power shall not condition or otherwise tie the provision or terms of any Electric Services to the purchasing of any goods or services from, or the engagement in business of any kind with, Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation.
8. When any employee or representative of Duke Power receives a request for information from or provides information to a Customer about goods or services available from Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation, the employee or representative must advise the Customer that such goods or services may also be available from non-Affiliated suppliers.
9. Disclosure of Customer Information to Duke Energy Corporation, another Affiliate, a Nonpublic Utility Operation, or a non-Affiliated entity shall be governed by Section III.A.2 of this Code of Conduct.

C. Marketing

1. The public utility operations of Duke Power may engage in joint sales, joint sales calls, joint proposals, or joint advertising (a joint marketing arrangement) with its Utility Affiliates and with its Nonpublic Utility Operations, subject to compliance with other provisions of this Code of Conduct and any conditions or restrictions that the Commission may hereafter establish. Duke Power may not otherwise engage in such joint activities with Affiliates without making such opportunities available to comparable third parties.
2. Neither Duke Energy Corporation nor any of the other Affiliates may use Duke Power's name or logo(s) in any communications unless a disclaimer is included that states the following:
 - (a) "[Duke Energy Corporation/Affiliate] is not the same company as Duke Power, and [Duke Energy Corporation/Affiliate] has separate management and separate employees";
 - (b) "[Duke Energy Corporation/Affiliate] is not regulated by the North Carolina Utilities Commission or in any way sanctioned by the Commission";
 - (c) "Purchasers of products or services from [Duke Energy Corporation/Affiliate] will receive no preference or special treatment from Duke Power"; and
 - (d) "A customer does not have to buy products or services from [Duke Energy Corporation/Affiliate] in order to continue to receive the same safe and reliable electric service from Duke Power."

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

- (a) "[Nonpublic Utility Operation] is not part of the regulated services offered by Duke Power and is not in any way sanctioned by the North Carolina Utilities Commission";
- (b) "Purchasers of products or services from [Nonpublic Utility Operation] will receive no preference or special treatment from Duke Power"; and
- (c) "A customer does not have to buy products or services from [Nonpublic Utility Operation] in order to continue to receive the same safe and reliable electric service from Duke Power."

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

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

1. Cross-subsidies involving Duke Power, on the one hand, and Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations, on the other, are prohibited.
2. All costs incurred by Duke Power personnel or representatives for or on behalf of Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations shall be charged to the entity responsible for the costs.
3. As a general guideline, with regard to the transfer prices charged for goods and services, including the use or transfer of personnel, exchanged between and among Duke Power, Duke Energy Corporation, the other Affiliates, and the Nonpublic Utility Operations, to the extent such prices affect Duke Power's operations or costs of utility service, the following conditions shall apply:
 - (a) Except as otherwise provided for in this Section III.D, for untariffed goods and services provided by Duke Power to Duke Energy Corporation, an Affiliate, or a Nonpublic Utility Operation, the transfer price paid to Duke Power shall be set at the higher of Market Value or Duke Power's Fully Distributed Cost.
 - (b) Except as otherwise provided for in this Section III.D, for goods and services provided, directly or indirectly, by Duke Energy Corporation, an Affiliate, or a Nonpublic Utility Operation to Duke Power, the transfer price(s) charged by Duke Energy Corporation, the Affiliate, and the Nonpublic Utility Operation to Duke Power shall be set at the lower of Market Value or Duke Energy Corporation's, the Affiliate's, or the Nonpublic Utility Operation's Fully Distributed Cost(s). If Duke Power does not engage in competitive solicitation and instead obtains the goods or services from Duke Energy Corporation, an Affiliate, or a Nonpublic Utility Operation, Duke Power shall implement adequate processes to comply with this condition and ensure that in each case Duke Power's Customers receive service at the lowest reasonable cost.
 - (c) Tariffed goods and services provided by Duke Power to Duke Energy Corporation, an Affiliate, or a Nonpublic Utility Operation shall be provided at the same prices and terms that are made available to Similarly Situated Customers under the applicable tariff.
 - (d) Subject to and in compliance with all conditions placed upon Duke Power by the Commission, including the Regulatory Conditions imposed in Docket No. E-7, Sub 795, and subject to a case-by-case acceptance by the Commission of an affiliate agreement, untariffed non-power, non-generation, or non-fuel goods and services provided by Duke Power to

its Utility Affiliates or by the Utility Affiliates to Duke Power, which for a single item or a single transaction amount to \$100,000 or less, shall be transferred at the supplier's Fully Distributed Cost, if cost-beneficial to the recipient. Fully Distributed Cost pricing for items/transactions pursuant to this paragraph shall be limited to an aggregate annual amount of \$7,500,000. Transfers above either the single item/transaction limit or the aggregate annual limit shall be priced according to Sections III.D.3.(a) and III.D.3.(b) of this Code of Conduct.

4. To the extent that Duke Power, Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations receive Shared Services from Duke Energy Shared Services, these Shared Services may be jointly provided to Duke Power, Duke Energy Corporation, the Affiliates, or the Nonpublic Utility Operations on a fully distributed cost basis, provided that the taking of such Shared Services by Duke Power is cost beneficial on a service-by-service (e.g., accounting management, human resources management, legal services, tax administration, public affairs) basis to Duke Power and is undertaken pursuant to the provisions of Regulatory Condition No. 18 approved by the Commission in Docket E-7, Sub 795. Charges for such Shared Services shall be allocated in accordance with the cost allocation manual(s) filed with the Commission pursuant to Regulatory Condition No. 20, subject to any revisions or other adjustments that may be found appropriate by the Commission on an ongoing basis.
5. Duke Power and its Affiliates may capture economies-of-scale in joint purchases of goods and services (excluding the purchase of natural gas, coal, and electricity or ancillary services intended for resale) if such joint purchases result in cost savings to Duke Power's Customers. Duke Power, PSI Energy, Inc., and Union Light, Heat and Power Company may capture economies-of-scale in joint purchases of coal, if such joint purchases result in cost savings to Duke Power's Customers. Notwithstanding the foregoing, if any of the coal jointly purchased by Duke Power, PSI Energy, Inc., and Union Light, Heat and Power Company is transferred to or utilized by another Affiliate within 12 months of the joint purchase, Duke Power will file a notification of such with the Commission.

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

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

7. Costs that Duke Power incurs in assembling, compiling, preparing, or furnishing requested Customer Information or Confidential Systems Operation Information for or to Duke Energy Corporation, other Affiliates, Nonpublic Utility Operations, or non-Affiliates shall be recovered from the requesting party pursuant to Section III.D.3 of this Code of Conduct.
8. Any technology or trade secrets developed, obtained, or held by Duke Power in the conduct of regulated operations will not be transferred to Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation without just compensation and 60-days prior notification to the Commission; provided however, that Duke Power may request a waiver of this requirement from the Commission if circumstances warrant. In no case, however, shall the notice period requested be less than 20 business days.
9. Duke Power shall receive compensation from Duke Energy Corporation, other Affiliates, and the Nonpublic Utility Operations for intangible benefits, if appropriate.

E. Regulatory Oversight

1. The State's existing requirements regarding affiliate transactions, as set forth in G.S. 62-153, shall continue to apply to all transactions between Duke Power, Duke Energy Corporation, and the other Affiliates.
2. The books and records of Duke Power, Duke Energy Corporation, the other Affiliates, and the Nonpublic Utility Operations shall be open for examination by the Commission, its staff, and the Public Staff as provided in G.S. 62-34, 62-37, and 62-51.
3. To the extent North Carolina law, the orders and rules of the Commission, and the Regulatory Conditions permit Duke Energy Corporation, an Affiliate, or a Nonpublic Utility Operation to supply Duke Power with Natural Gas Services or other Fuel and Purchased Power Supply Services used by Duke Power to supply electricity, and to the extent such Natural Gas Services or other Fuel and Purchased Power Supply Services are so supplied, Duke Power shall demonstrate in its annual fuel adjustment clause proceeding that each such acquisition was prudent and the price was reasonable.

F.

Utility Billing Format

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

G.

Complaint Procedure

1. Duke Power shall establish complaint procedures to resolve potential complaints that arise due to the relationship of Duke Power with Duke Energy Corporation, its other Affiliates, and its Nonpublic Utility Operations. The complaint procedures shall provide for the following:
 - (a) Verbal and written complaints shall be referred to a designated representative of Duke Power.
 - (b) The designated representative shall provide written notification to the complainant within 15 days that the complaint has been received.
 - (c) Duke Power shall investigate the complaint and communicate the results or status of the investigation to the complainant within 60 days of receiving the complaint.
 - (d) Duke Power shall maintain a log of complaints and related records and permit inspection of documents (other than those protected by the attorney/client privilege) by the Commission, its staff, or the Public Staff.
2. Notwithstanding the provisions of Section III.G.1, any complaints received through Duke Energy Corporation's EthicsLine (or successor), which is a confidential mechanism available to the employees of the Duke Energy Corporation holding company system, shall be handled in accordance with procedures established for EthicsLine.
3. These complaint procedures do not affect a complainant's right to file a formal complaint or otherwise address questions to the Commission.

CODE OF CONDUCT

ATTACHMENT A

DUKE POWER CUSTOMER INFORMATION DISCLOSURE AUTHORIZATION

For Disclosure to Affiliates:

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

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

For Disclosure to Nonpublic Utility Operations:

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

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