

Public Service Company of North Carolina, Incorporated  
Condensed Consolidated Balance Sheets  
(Unaudited)

Thousands of dollars	June 30, 2008	December 31, 2007
<hr/>		
Assets		
Gas Utility Plant	\$1,204,823	\$1,164,889
Accumulated Depreciation	(249,745)	(244,390)
Acquisition Adjustment	209,824	209,824
<hr/> Gas Utility Plant, Net	<hr/> 1,164,902	<hr/> 1,130,323
 Nonutility Property and Investments, Net	 27,367	 27,830
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Current Assets:		
Cash and cash equivalents	4,150	2,220
Receivables, net of allowance for uncollectible accounts of \$1,061 and \$832	52,068	118,983
Receivables-affiliated companies	3,203	11,158
Inventories (at average cost):		
Stored gas	80,376	90,338
Materials and supplies	6,376	8,411
Regulatory assets	19,102	22,735
Derivative financial instruments	19,588	-
Other	752	1,507
<hr/> Total Current Assets	<hr/> 185,615	<hr/> 255,352
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Deferred Debits and Other Assets:		
Due from parent-pension asset and other benefits	623	1,498
Regulatory assets	45,357	54,819
Other	2,870	3,519
<hr/> Total Deferred Debits and Other Assets	<hr/> 48,850	<hr/> 59,836
<hr/> Total	<hr/> <hr/> \$1,426,734	<hr/> <hr/> \$1,473,341

Public Service Company of North Carolina, Incorporated  
Condensed Consolidated Balance Sheets (continued)  
(Unaudited)

Thousands of dollars	June 30, 2008	December 31, 2007
<b>Capitalization and Liabilities</b>		
<b>Capitalization:</b>		
Common Equity	\$610,499	\$592,447
Long-term Debt, net	260,049	263,378
<b>Total Capitalization</b>	<b>870,548</b>	<b>855,825</b>
<b>Current Liabilities:</b>		
Short-term borrowings	98,600	156,900
Current portion of long-term debt	3,200	3,200
Accounts payable	49,345	66,749
Accounts payable-affiliated companies	8,363	5,112
Customer deposits & customer prepayments	13,190	19,035
Taxes accrued	1,489	9,225
Interest accrued	5,739	5,739
Distributions/dividends declared	5,600	5,600
Derivative financial instruments	-	5,505
Deferred income taxes, net	575	814
Other	4,305	4,809
<b>Total Current Liabilities</b>	<b>190,406</b>	<b>282,688</b>
<b>Deferred Credits and Other Liabilities:</b>		
Deferred income taxes, net	114,715	112,561
Deferred investment tax credits	413	506
Due to parent-postretirement and other benefits	23,753	23,416
Regulatory liabilities	206,867	178,204
Asset retirement obligations	12,433	12,074
Other	7,599	8,067
<b>Total Deferred Credits and Other Liabilities</b>	<b>365,780</b>	<b>334,828</b>
Commitments and Contingencies (Note 4)	-	-
<b>Total</b>	<b>\$1,426,734</b>	<b>\$1,473,341</b>

See Notes to Condensed Consolidated Financial Statements.

Public Service Company of North Carolina, Incorporated  
Condensed Consolidated Statements of Income  
(Unaudited)

Thousands of dollars	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Operating Revenues	\$89,332	\$86,309	\$366,699	\$330,225
Cost of Gas	54,734	52,498	248,974	216,647
Gross Margin	34,598	33,811	117,725	113,578
Operating Expenses:				
Operation and maintenance	21,954	21,424	44,470	42,834
Depreciation and amortization	9,234	9,432	18,492	18,863
Other taxes	2,389	2,234	4,880	4,553
Total Operating Expenses	33,577	33,090	67,842	66,250
Operating Income	1,021	721	49,883	47,328
Other Income (Expense):				
Other revenues	4,191	3,576	8,655	7,818
Other expenses	(2,811)	(1,855)	(5,580)	(4,184)
Allowance for equity funds used during construction	101	154	335	288
Interest charges, net of AFC of \$52 and \$155	(5,398)	(6,141)	(11,524)	(12,803)
Total Other Expense	(3,917)	(4,266)	(8,114)	(8,881)
Income (Loss) Before Income Taxes and Earnings from				
Equity Method Investments	(2,896)	(3,545)	41,769	38,447
Income Tax Expense (Benefit)	(1,044)	(1,331)	16,556	15,109
Income (Loss) Before Earnings from Equity Method				
Investments	(1,852)	(2,214)	25,213	23,338
Earnings from Equity Method Investments	948	1,039	1,834	2,085
Net Income (Loss)	\$(904)	\$(1,175)	\$27,047	\$25,423

See Notes to Condensed Consolidated Financial Statements.

Public Service Company of North Carolina, Incorporated  
Condensed Consolidated Statements of Cash Flows  
(Unaudited)

Thousands of dollars	Six Months Ended June 30,	
	2008	2007
<b>Cash Flows From Operating Activities:</b>		
Net income	\$27,047	\$25,423
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation and amortization	17,952	18,243
Allowance for equity funds used during construction	(335)	(288)
Excess earnings, net from equity method investments	(54)	(648)
Cash provided (used) by changes in certain assets and liabilities:		
Receivables, net	74,780	78,676
Inventories	11,253	19,625
Other regulatory assets	646	(2,262)
Other regulatory liabilities	(436)	(436)
Accounts payable	(7,020)	(36,277)
Deferred income taxes, net	1,906	2,408
Taxes accrued	(7,736)	(5,415)
Changes in gas cost adjustment clauses	8,458	(16,769)
Changes in other assets	2,083	1,902
Changes in other liabilities	(6,387)	(5,744)
Net Cash Provided From Operating Activities	122,157	78,438
<b>Cash Flows From Investing Activities:</b>		
Construction expenditures, net of AFC	(50,328)	(43,918)
Proceeds from sale of assets	90	-
Net Cash Used For Investing Activities	(50,238)	(43,918)
<b>Cash Flows From Financing Activities:</b>		
Short-term borrowings, net	(58,300)	(31,300)
Contributions from parent	2,711	2,835
Retirement of long-term debt	(3,200)	(3,200)
Distributions/dividends	(11,200)	(8,154)
Net Cash Used for Financing Activities	(69,989)	(39,819)
Net Increase (decrease) in Cash and Cash Equivalents	1,930	(5,299)
Cash and Cash Equivalents, January 1	2,220	6,038
Cash and Temporary Investments, June 30	\$4,150	\$739
<b>Supplemental Cash Flow Information:</b>		
Cash paid for - Interest (net of capitalized interest of \$155 and \$178)	\$10,722	\$11,512
Income taxes	25,145	20,533
<b>Noncash Investing and Financing Activities:</b>		
Accrued construction expenditures	2,475	3,828

See Notes to Condensed Consolidated Financial Statements.

**PUBLIC SERVICE COMPANY OF NORTH CAROLINA, INCORPORATED**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**June 30, 2008**  
**(Unaudited)**

The following notes should be read in conjunction with the Notes to Consolidated Financial Statements appearing in Public Service Company of North Carolina, Incorporated's (PSNC Energy, and together with its consolidated subsidiaries, the Company) financial statements for the year ended December 31, 2007. These are interim financial statements and, due to the seasonality of the Company's business and matters that may occur during the rest of the year, the amounts reported in the Condensed Consolidated Statements of Operations are not necessarily indicative of amounts expected for the full year. In the opinion of management, the information furnished herein reflects all adjustments, all of a normal recurring nature, which are necessary for the fair statement of the results for the interim periods reported.

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Basis of Accounting**

The Company accounts for its regulated utility operations, assets and liabilities in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) 71, "*Accounting for the Effects of Certain Types of Regulation*." SFAS 71 requires cost-based rate-regulated utilities to recognize in their financial statements certain revenues and expenses in different time periods than do enterprises that are not rate-regulated. As a result, the Company has recorded regulatory assets and regulatory liabilities summarized as follows.

Thousands of dollars	June 30, 2008	December 31, 2007
<b>Regulatory Assets:</b>		
Under-collections - gas cost adjustment clause	\$ 36,007	\$ 48,564
Environmental remediation costs	8,412	9,011
Asset retirement obligations	9,915	9,519
Deferred employee benefit plan costs	7,175	7,464
Other	2,950	2,996
<b>Total Regulatory Assets</b>	<b>\$ 64,459</b>	<b>\$ 77,554</b>
<b>Regulatory Liabilities:</b>		
Over-collections - gas cost adjustment clause	\$ 25,011	\$ 4,018
Other asset removal costs	179,503	171,397
Other	2,353	2,789
<b>Total Regulatory Liabilities</b>	<b>\$ 206,867</b>	<b>\$ 178,204</b>

Under- and over-collections—gas cost adjustment clause represents amounts under- or over-collected from customers pursuant to the Company's Rider D mechanism approved by the North Carolina Utilities Commission (NCUC). This mechanism allows the Company to recover all prudently incurred gas costs and certain uncollectible expenses related to gas cost. Included in these amounts are regulatory assets or liabilities from realized and unrealized gains and losses arising from the Company's natural gas hedging program.

Environmental remediation costs represent costs associated with the assessment and cleanup of manufactured gas plant (MGP) sites currently or formerly owned by the Company. Costs incurred prior to June 30, 2006, of which \$1.6 million remain, are being recovered through rates over a period ending October 2009. In addition, management believes that costs incurred subsequent to June 30, 2006, which total \$2.3 million, net of insurance recoveries, and the estimated remaining costs to be incurred of \$4.5 million, will be recoverable through rates.

Asset retirement obligations (ARO) represents the regulatory asset associated with conditional AROs recorded as required by SFAS 143, "*Accounting for Asset Retirement Obligations*," and Financial Accounting Standards Board Interpretation (FIN) 47, "*Accounting for Conditional Asset Retirement Obligations*."

Deferred employee benefit plan costs represent amounts of pension and other postretirement benefit costs which were accrued as liabilities under provisions of SFAS 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*," but which are expected to be recovered through rates.

Other asset removal costs represent net collections through depreciation rates of estimated costs to be incurred for the future retirement of assets.

The NCUC has reviewed and approved through specific orders the items shown as regulatory assets, though some of the items may include costs which are awaiting specific rate consideration. In recording these costs as regulatory assets, management believes the costs will be allowable under existing rate-making concepts that are embodied in current rate orders received by the Company. However, ultimate recovery is subject to NCUC approval. In the future, as a result of deregulation or other changes in the regulatory environment, the Company may no longer meet the criteria for continued application of SFAS 71 and could be required to write off its regulatory assets and liabilities. Such an event could have a material adverse effect on the Company's results of operations, liquidity or financial position in the period the write-off would be recorded.

#### B. Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss totaled \$1.1 million and \$0.6 million as of June 30, 2008 and December 31, 2007, respectively.

#### C. Related Party Transactions

The Company records as cost of gas the storage and transportation costs charged by equity-method investees. For the six months ended June 30, 2008 and 2007, these costs totaled \$7.0 million and \$3.9 million, respectively. The Company owed these investees \$1.2 million at June 30, 2008 and December 31, 2007. The Company received cash distributions from equity investees of \$1.8 million and \$1.4 million for the six months ended June 30, 2008 and 2007, respectively.

During the six months ended June 30, 2008 and 2007, the Company made sales to an affiliate of natural gas and transportation services of \$12.1 million and \$14.4 million, respectively.

#### D. New Accounting Matters

SFAS 161, “*Disclosure about Derivative Instruments and Hedging Activities*,” was issued in March 2008. SFAS 161 requires enhanced disclosures about an entity’s derivative and hedging activities to include how derivative instruments are accounted for and the effect of such activities on the Company’s financial statements. SFAS 161 is effective for fiscal years beginning after November 15, 2008. The Company has not determined what impact, if any, the adoption will have on the Company’s results of operations, cash flows or financial position. The Company believes it will likely be required to provide additional disclosures as part of future financial statements.

SFAS 159, “*The Fair Value Option for Financial Assets and Financial Liabilities*,” was issued in February 2007. SFAS 159 allows entities to measure at fair value many financial instruments and certain other assets and liabilities that are not otherwise required to be measured at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company has not elected to measure at fair value any permitted items that are not otherwise required to be measured at fair value. As a result, SFAS 159 has not had an impact on the Company’s results of operations, cash flows or financial position.

The Company adopted SFAS 157, “*Fair Value Measurements*,” in the first quarter of 2008 for financial assets and liabilities and for nonfinancial assets and liabilities recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). As permitted by FASB Staff Position 157-2 (FSP FAS 157-2), the Company will adopt SFAS 157 for all other nonfinancial assets and liabilities in the first quarter of 2009. SFAS 157 establishes a framework for measuring the fair value of assets and liabilities recognized in the financial statements in periods subsequent to initial recognition. The initial adoption of SFAS 157 did not impact the Company’s results of operations, cash flows or financial position.

At June 30, 2008, the fair value measurements, and the level within the fair value hierarchy of SFAS 157 in which the measurements fall, were as follows:

Millions of dollars	Fair Value Measurements at June 30, 2008 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:			
Derivative instruments	\$20	-	-
Liabilities:			
Derivative instruments	23	-	-

## 2. RATE AND OTHER REGULATORY MATTERS

The Company’s rates are established using a benchmark cost of gas approved by the NCUC, which may be modified periodically to reflect changes in the market price of natural gas. The Company revises its tariffs with the NCUC as necessary to track these changes and accounts for any over- or under-collections of the delivered cost of gas in its deferred accounts for subsequent rate consideration. The NCUC reviews the Company’s gas purchasing practices annually.

On August 13, 2008, the Company entered into a stipulation agreement with the Public Staff of the NCUC and the Carolina Utility Customers Association relating to the Company's pending general rate case application filed on March 31, 2008. The agreement provides for an increase in the Company's annual natural gas margin revenues of \$9.1 million, offset by an \$8.4 million reduction in fixed gas costs, for a net annual increase in rates and charges to customers of \$0.7 million. The stipulating parties agreed to the Company's implementation of a customer usage tracker (CUT), a rate decoupling mechanism that breaks the link between revenues and the amount of natural gas sold. The CUT would allow the Company to periodically adjust its base rates for residential and commercial customers based on customer consumption. The stipulating parties also agreed that the Company should be allowed to recover \$750,000 of expenditures incurred for its proposed conservation initiatives. The agreement will be submitted to the NCUC during a public hearing on August 26, 2008. If approved by the NCUC, the agreement would become effective on November 1, 2008.

In May 2007, the NCUC approved the Company's request to eliminate the use of its current dual residential customer rate structure and replace it with a single residential rate. The NCUC also ordered that the Company establish a new residential rate structure by November 1, 2007. In October 2007, the NCUC approved the Company's request to implement a residential service rate which has a winter/summer differential of 6 cents per therm, effective November 1, 2007. The higher winter rate will help recover costs associated with operating the pipeline system during high customer demand. These changes in the rate structure had no impact on 2007 earnings.

### **3. FINANCIAL INSTRUMENTS**

The Company's hedging program for natural gas purchases is designed to reduce price volatility to firm customers. Premiums, transaction fees, margin requirements and any realized and unrealized gains or losses are recorded in deferred accounts as a regulatory asset or liability for the over- or under-recovery of gas costs. As of June 30, 2008, the Company had net deferred realized losses of \$22.6 million and net deferred unrealized gains of \$23.1 million.

The Company uses an interest rate swap agreement to manage interest rate risk. This swap agreement provides for the Company to pay variable and receive fixed interest payments and is designated as a fair value hedge of a debt instrument. The fair value of the interest rate swap is recorded within other deferred debits on the balance sheet. The resulting credit serves to reflect the hedged long-term debt at its fair value. Periodic receipts or payments related to the interest rate swap is credited or charged to interest expense as incurred. At June 30, 2008, the estimated fair value of the Company's swap was \$0.4 million (gain) related to a notional amount of \$12.8 million.

The Company utilizes asset management and supply service agreements with counterparties for certain of its natural gas storage facilities. At June 30, 2008, such counterparties held 51% of the Company's total natural gas inventory with a carrying value of \$38.6 million, through either capacity release or agency relationships. Under the terms of the asset management agreements, the Company receives storage asset management fees and, in certain instances, a share of profits. The agreements expire at various times through March 31, 2009.

#### **4. COMMITMENTS AND CONTINGENCIES**

The Company is responsible for environmental cleanup at five sites in North Carolina on which manufactured gas plant (MGP) residuals are present or suspected. The Company's actual remediation costs for these sites will depend on a number of factors, such as actual site conditions, third-party claims, and recoveries from other potentially responsible parties. The Company has recorded a liability and associated regulatory asset of \$4.5 million, which reflects its estimated remaining liability at June 30, 2008. Any cost allocable to the Company arising from the remediation of these sites is expected to be recoverable through rates.

The Company is also engaged in various other claims and litigation incidental to its business operations which management anticipates will be resolved without a material adverse impact on the Company's results of operations, cash flows or financial condition.