

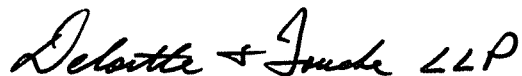
INDEPENDENT AUDITORS' REPORT

Public Service Company of North Carolina, Incorporated

We have audited the accompanying consolidated balance sheets of Public Service Company of North Carolina, Incorporated and subsidiaries (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in common equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standard Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.



February 27, 2009

Public Service Company of North Carolina, Incorporated
Consolidated Balance Sheets

December 31, (Thousands of Dollars)	2008	2007
Assets		
Gas Utility Plant	\$1,236,348	\$1,164,889
Accumulated Depreciation	(256,412)	(244,390)
Acquisition Adjustment	209,824	209,824
Gas Utility Plant, Net	1,189,760	1,130,323
Nonutility Property and Investments, Net	27,713	27,830
Current Assets:		
Cash and cash equivalents	7,352	2,220
Receivables, net of allowance for uncollectible accounts of \$802 and \$832	149,025	118,983
Receivables-affiliated companies	9,215	11,158
Inventories (at average cost):		
Stored gas	117,193	90,338
Materials and supplies	6,667	8,411
Regulatory assets	-	22,735
Derivative financial instruments	6,056	-
Other	1,303	1,507
Total Current Assets	296,811	255,352
Deferred Debits and Other Assets:		
Due from parent-pension asset and other benefits	22	1,498
Regulatory assets	35,435	54,819
Other	3,233	3,519
Total Deferred Debits and Other Assets	38,690	59,836
Total	\$1,552,974	\$1,473,341

December 31, (Thousands of dollars)	2008	2007
Capitalization and Liabilities		
Capitalization:		
Common equity	\$613,508	\$592,447
Long-term debt, net	416,548	263,378
Total Capitalization	1,030,056	855,825
Current Liabilities:		
Short-term borrowings	45,800	156,900
Current portion of long-term debt	3,200	3,200
Accounts payable	55,760	66,749
Accounts payable-affiliated companies	6,533	5,112
Customer deposits & customer prepayments	22,230	19,035
Taxes accrued	203	9,225
Interest accrued	5,912	5,739
Distributions/dividends declared	5,700	5,600
Derivative financial instruments	2,531	5,505
Deferred income taxes, net	360	814
Other	6,170	4,809
Total Current Liabilities	154,399	282,688
Deferred Credits and Other Liabilities:		
Deferred income taxes, net	126,289	112,561
Deferred investment tax credits	321	506
Due to parent-postretirement & other benefits	27,965	23,416
Regulatory liabilities	187,142	178,204
Asset retirement obligations	19,244	12,074
Other	7,558	8,067
Total Deferred Credits and Other Liabilities	368,519	334,828
Commitments and Contingencies (Note 8)	-	-
Total	\$1,552,974	\$1,473,341

See Notes to Consolidated Financial Statements.

Public Service Company of North Carolina, Incorporated
Consolidated Statements of Income

For the Years Ended December 31, (Thousands of Dollars)	2008	2007
Operating Revenues	\$670,270	\$577,310
Cost of Gas	457,361	377,918
<u>Gross Margin</u>	<u>212,909</u>	<u>199,392</u>
Operating Expenses:		
Operation and maintenance	88,778	83,880
Depreciation and amortization	35,531	36,974
Other taxes	8,949	8,596
<u>Total Operating Expenses</u>	<u>133,258</u>	<u>129,450</u>
Operating Income	79,651	69,942
Other Income (Expense):		
Other revenues	17,512	16,494
Other expenses	(10,947)	(9,248)
Gain on sale of assets	-	25
Allowance for equity funds used during construction	733	711
Interest charges, net of AFC of \$441 and \$402	(23,880)	(26,424)
<u>Total Other Expense</u>	<u>(16,582)</u>	<u>(18,442)</u>
Income Before Income Taxes and Earnings from Equity Method		
Investments	63,069	51,500
Income Tax Expense	(25,002)	(20,258)
<u>Income Before Earnings from Equity Method Investments</u>	<u>38,067</u>	<u>31,242</u>
<u>Earnings from Equity Method Investments</u>	<u>3,749</u>	<u>4,137</u>
<u>Net Income</u>	<u>\$41,816</u>	<u>\$35,379</u>

See Notes to Consolidated Financial Statements.

Public Service Company of North Carolina, Incorporated
Consolidated Statements of Cash Flows

For the Years Ended December 31, (Thousands of Dollars)	2008	2007
Cash Flows From Operating Activities:		
Net income	\$41,816	\$35,379
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation and amortization	35,997	35,894
Gain on sale of assets	-	(25)
Allowance for equity funds used during construction	(733)	(711)
Excess earnings, net of distributions from equity method investments	(85)	(37)
Cash provided (used) by changes in certain assets and liabilities:		
Receivables, net	(19,170)	(5,694)
Inventories	(26,589)	(796)
Other regulatory assets	1,177	1,806
Other regulatory liabilities	(740)	(743)
Accounts payable	(2,849)	(13,017)
Deferred income taxes, net	13,572	9,088
Taxes accrued	(9,022)	3,506
Changes in gas cost adjustment clauses	31,300	(24,203)
Changes in other assets	(2,984)	5,008
Changes in other liabilities	5,752	(5,403)
Net Cash Provided From Operating Activities	67,442	40,052
Cash Flows From Investing Activities:		
Construction expenditures, net of AFC	(84,580)	(93,837)
Proceeds from sale of assets	90	-
Net Cash Used For Investing Activities	(84,490)	(93,837)
Cash Flows From Financing Activities:		
Short-term borrowings - affiliate	1,000	-
Short-term borrowings, net	(111,100)	32,200
Proceeds from issuance of debt	156,000	-
Contributions from parent	1,580	40,321
Repayment of debt	(3,200)	(3,200)
Distributions/dividends	(22,100)	(19,354)
Net Cash Provided From Financing Activities	22,180	49,967
Net Increase (Decrease) in Cash and Cash Equivalents	5,132	(3,818)
Cash and Cash Equivalents, January 1	2,220	6,038
Cash and Cash Equivalents, December 31	\$7,352	\$2,220
Supplemental Cash Flow Information:		
Cash paid for - Interest (net of capitalized interest of \$441 and \$402)	\$21,757	\$23,941
Income taxes	21,913	33,398
Noncash Investing and Financing Activities:		
Accrued construction expenditures	1,890	9,608

See Notes to Consolidated Financial Statements.

Public Service Company of North Carolina, Incorporated
Consolidated Statement of Changes in Common Equity

(Thousands)	Common Stock		Capital in Excess of Par	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Total Common Equity
	Shares	Amount				
Balance at December 31, 2006	1	\$1	\$630,792	(\$1,204)	(\$91,965)	\$537,624
Comprehensive Income (Loss):						
Net Income					35,379	35,379
Unrealized Loss on Hedging Activities				(119)		(119)
Deferred Benefit of Employee Benefit Plans, net of taxes \$455				696		696
Total Comprehensive Income				577	35,379	35,956
Contributions from Parent, net			40,321			40,321
Cash Distributions/Dividends Declared			(21,454)			(21,454)
Balance at December 31, 2007	1	\$1	\$649,659	(\$627)	(\$56,586)	\$592,447
Comprehensive Income (Loss):						
Net Income					41,816	41,816
Deferred Cost of Employee Benefit Plans, net of taxes \$(88)				(135)		(135)
Total Comprehensive Income (Loss)				(135)	41,816	41,681
Contributions from Parent, net			1,580			1,580
Cash Distributions/Dividends Declared			(22,200)			(22,200)
Balance at December 31, 2008	1	\$1	\$629,039	(\$762)	(\$14,770)	\$613,508

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization and Principles of Consolidation

Public Service Company of North Carolina, Incorporated (PSNC Energy, and together with its consolidated subsidiaries, the Company), a public utility, was organized as a North Carolina corporation in 1938. Effective January 1, 2000, SCANA Corporation (SCANA), a South Carolina holding company, acquired the Company. As a result, the Company became a wholly owned subsidiary of SCANA, incorporated under the laws of South Carolina. The Company is engaged predominantly in the purchase, sale, transportation and distribution of natural gas to residential, commercial and industrial customers in North Carolina.

The accompanying Consolidated Financial Statements include the accounts of PSNC Energy and its subsidiary companies, Clean Energy Enterprises, Inc., PSNC Blue Ridge Corporation, and PSNC Cardinal Pipeline Company. Investments in other affiliates in which the Company has the ability to exercise influence over operating and financial policies are accounted for under the equity method. Significant intercompany balances and transactions have been eliminated in consolidation.

B. 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, as of December 31, 2008, the Company has recorded regulatory assets and regulatory liabilities summarized as follows.

Thousands of dollars	December 31,	
	2008	2007
Regulatory Assets:		
Environmental remediation costs	\$ 7,814	\$ 9,011
Asset retirement obligations	14,192	9,519
Deferred employee benefit plan costs	10,412	7,464
Other	3,017	51,560
Total Regulatory Assets	\$ 35,435	\$ 77,554
Regulatory Liabilities:		
Other asset removal costs	\$ 185,093	\$ 171,397
Other	2,049	6,807
Total Regulatory Liabilities	\$ 187,142	\$ 178,204

Environmental remediation costs represent costs associated with the assessment and cleanup of manufactured gas plant (MGP) sites currently or formerly owned by the Company. Remediation costs totaling \$3.5 million are being recovered over a three-year period beginning November 2008. In addition, management believes that estimated remaining costs 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 regulatory assets for 2007 includes \$48.6 million in customer under-collections. Customer under-collections have been reclassified to accounts receivables for 2008.

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

The North Carolina Utilities Commission (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.

C. Utility Plant

Utility plant is stated substantially at original cost. The costs of additions, renewals and betterments to utility plant, including direct labor, material and indirect charges for engineering, supervision and an allowance for funds used during construction, are added to utility plant accounts. The original cost of utility property retired or otherwise disposed of is removed from utility plant accounts and generally charged to accumulated depreciation. The costs of repairs, replacements and renewals of items of property determined to be less than a unit of property or that do not increase the asset's life or functionality are charged to maintenance expense.

D. Allowance for Funds Used During Construction (AFC)

AFC is a noncash item that reflects the period cost of capital devoted to plant under construction. This accounting practice results in the inclusion of, as a component of construction cost, the costs of debt and equity capital dedicated to construction investment. AFC is included in rate base investment and depreciated as a component of plant cost in establishing rates for utility services. The Company has calculated AFC using composite rates of 12.4% and 12.5% for the years ended December 31, 2008 and 2007, respectively.

E. Revenue Recognition

Revenues are recorded during the accounting period in which services are provided to customers, and include estimated amounts for natural gas delivered and facilities charges not yet billed. Unbilled revenues totaled \$46.1 million and \$41.3 million as of December 31, 2008 and 2007, respectively.

The Company's Purchase Gas Adjustment (Rider D) mechanism authorizes the recovery of all prudently incurred gas costs from customers. Any difference in amounts paid and collected for these costs is deferred for subsequent refund to or collection from customers, with interest. Realized and unrealized gains and losses from the Company's hedging activities are also included in the Rider D mechanism. Additionally, the Company can recover its margin losses on negotiated gas sales to certain large commercial/industrial customers in a manner authorized by the NCUC. The Company may also recover certain gas costs related to uncollectible accounts. Pursuant to the operation of Rider D, at December 31, 2008 and December 31, 2007, the Company had undercollected from customers \$4.2 million, net, and \$44.5 million, net, respectively.

Prior to November 1, 2008, the Company's gas rate schedules for residential, small commercial and small industrial customers included a weather normalization adjustment (WNA), which minimized fluctuations in gas revenues due to abnormal weather conditions. Effective November 1, 2008, the Company was authorized by the NCUC to implement a customer usage tracker (CUT), which allows the Company to periodically adjust its base rates for residential and commercial customers based on average per customer consumption whether impacted by weather or other factors. Concurrent with implementation of the CUT, the Company's WNA was discontinued. The Company establishes its commodity cost of gas for large commercial and industrial customers on the basis of market prices for natural gas as approved by the NCUC.

F. Depreciation and Amortization

Depreciation rates for utility plant are approved by the NCUC. The Company is required to conduct a depreciation study every five years and propose new depreciation rates for approval. The last depreciation study was conducted in 2005, and new depreciation rates were approved effective November 1, 2006.

Provisions for depreciation and amortization are recorded using the straight-line method and are based on the estimated service lives of the various classes of property. The composite weighted average depreciation rates for utility plant assets were 3.1% and 3.3% for 2008 and 2007, respectively.

G. Income and Other Taxes

The Company is included in the consolidated federal income tax return of SCANA. Under a joint consolidated income tax allocation agreement, each SCANA subsidiary's current and deferred tax expense is computed on a stand-alone basis. Deferred tax assets and liabilities are recorded for the tax effects of all significant temporary differences between the book basis and tax basis of assets and liabilities at currently enacted rates. Deferred tax assets and liabilities are adjusted for changes in such rates through charges or credits to regulatory assets or liabilities if they are expected to be recovered from, or passed through to, customers; otherwise, they are charged or credited to income tax expense. Also, under provisions of the income tax allocation agreement, certain tax benefits of the parent holding company are distributed in cash to tax paying affiliates, including the Company, in the form of capital contributions. Under such provisions, the Company received net capital contributions from parent of \$1.6 million in 2008 and \$0.3 million in 2007.

The Internal Revenue Service (IRS) has completed examinations of SCANA's federal returns through 2004, and SCANA's federal returns through 2004 are closed for additional assessment. The Company also files various applicable state income tax returns. With a few exceptions, the Company is no longer subject to state income tax examinations by tax authorities for years before 2005.

In connection with the initial adoption of FIN 48 effective January 1, 2007, the Company recognized no material adjustment in the liability for unrecognized income tax benefits. No material changes have occurred subsequent to adoption. The Company recognizes interest accrued related to unrecognized tax benefits within interest expense and recognizes tax penalties within other expenses. The Company has not accrued any significant amount of interest expense or tax penalties in 2008 or 2007.

The Company records excise taxes billed and collected, as well as local franchise and similar taxes, as liabilities until they are remitted to the respective taxing authority. Accordingly, no such taxes are included in revenues or expenses in the statements of income.

H. Debt Premium, Discount and Expense, Unamortized Loss on Reacquired Debt

The Company records long-term debt premium and discount in long-term debt and amortizes them as components of interest charges over the terms of the respective debt issues. Other issuance expense and gains or losses on reacquired debt that is refinanced are recorded in other deferred debits or credits and amortized over the term of the replacement debt.

I. Environmental

The Company maintains an environmental assessment program to identify and evaluate current and former operations sites that could require environmental cleanup. As site assessments are initiated, estimates are made of the amount of expenditures, if any, deemed necessary to investigate and clean up each site. These estimates are refined as additional information becomes available; therefore, actual expenditures could differ significantly from the original estimates. Amounts estimated and accrued to date for site assessments and cleanup relate solely to regulated operations. Such amounts are recorded in deferred debits and amortized with recovery provided through rates.

J. Cash and Cash Equivalents

The Company considers temporary cash investments having original maturities of three months or less to be cash equivalents. These cash equivalents are generally in the form of commercial paper, certificates of deposit, repurchase agreements, treasury bills and notes.

K. 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 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. 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. In addition, Financial Accounting Standards Board (FASB) Staff Position 157-3 (FSP FAS 157-3), "*Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*," issued on October 10, 2008, did not affect the Company's disclosure of fair value. See Note 7.

L. Related Party Transactions

The Company has related party transactions with its equity method investees. The Company records as cost of gas the storage and transportation costs charged by these investees. These costs totaled \$14.1 million and \$15.0 million in 2008 and 2007, respectively. The Company owed these investees \$1.2 million at December 31, 2008 and December 31, 2007. The Company received cash distributions from equity investees of \$3.7 million and \$4.1 million during 2008 and 2007, respectively.

The Company had sales to an affiliate for natural gas and transportation services of approximately \$21 million and \$22 million during 2008 and 2007, respectively.

At December 31, 2008, an affiliate owed the Company \$4.2 million, net, for natural gas and transportation services. At December 31, 2008, the Company owed an affiliate \$1 million arising from consolidated cash management money pool borrowings.

M. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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 October 24, 2008, the NCUC granted the Company an annual increase in natural gas margin revenues of approximately \$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 approximately \$0.7 million. The Company was authorized to implement a customer usage tracker (CUT). The CUT will allow the Company to periodically adjust its base rates for residential and commercial customers based on average per customer consumption. The new rates were effective for services rendered on or after November 1, 2008.

In December 2008, in connection with the Company's 2008 Annual Prudence Review, the NCUC determined that the Company's gas costs, including all hedging transactions, were reasonable and prudently incurred during the 12-month review period ended March 31, 2008.

In October 2006, the NCUC granted PSNC Energy an annual increase in retail natural gas margin revenues of approximately \$15.2 million, or 2.6%, which was offset by a \$9.2 million decrease in fixed-gas cost revenues, for an overall increase of \$6 million, or 1.0%. The rates were based on an allowed overall rate of return of 8.9%, and became effective for services rendered on or after November 1, 2006. In connection with the rate increase, the NCUC approved PSNC Energy's recovery through rates, over a three-year period, of certain costs for environmental remediation and pipeline integrity management.

3. EMPLOYEE BENEFIT PLANS

The Company participates in SCANA's noncontributory defined benefit pension plan, which covers substantially all permanent employees. SCANA's pension plan benefits for employees of the Company are calculated using a cash balance formula under which employees earn benefits through monthly compensation and interest credits. SCANA's policy has been to fund the plan to the extent permitted by applicable federal income tax regulations as determined by an independent actuary. The Company also participates in SCANA's plan to provide certain unfunded health care and life insurance benefits to active and retired employees. Retirees share in a portion of their medical care cost and are provided life insurance benefits at no charge. The cost of postretirement benefits other than pensions are accrued during the years the employees render the service necessary to be eligible for the applicable benefits.

For the years ended December 31, 2008 and 2007, the Company's net periodic benefit cost was \$1.9 million and \$1.8 million, respectively, for the pension plan, and net periodic benefit cost was \$2.9 million and \$3.1 million, respectively, for the postretirement plan.

4. LONG-TERM DEBT

Long-term debt by type with related weighted average interest rates and maturities at December 31 is as follows:

Thousands of dollars	Maturity	2008		2007	
		Balance	Rate	Balance	Rate
Medium-Term Notes (unsecured)	2011	\$ 150,000	6.63%	\$ 150,000	6.63%
Senior Debentures ^(a)	2012-2026	112,800	7.39%	116,000	7.43%
Borrowings Under Credit Agreements	2011	156,000	1.72%	-	
Fair value of interest rate swaps		948		578	
Total debt		419,748		266,578	
Current maturities of long-term debt		(3,200)		(3,200)	
Total long-term debt, net		\$ 416,548		\$ 263,378	

^(a) Includes \$12.8 million and \$16.0 million of fixed rate debt hedged by a variable interest rate swap for 2008 and 2007, respectively.

Annual amounts of long-term debt maturities are \$3.2 million for the years 2009 and 2010; \$309.2 million for the year 2011; and \$3.2 million for the years 2012 and 2013.

5. LINES OF CREDIT AND SHORT-TERM BORROWINGS

At December 31, 2008 and 2007, the Company had available the follow lines of credit and other borrowings outstanding:

Thousands of dollars	2008	2007
Lines of credit:		
Committed long-term (expire December 2011)		
Total	\$ 250,000	\$ 250,000
Used	156,000	-
Weighted average interest rate	1.72%	-
Short-term borrowings outstanding:		
Commercial paper (270 or fewer days)	\$ 45,800	\$ 156,900
Weighted average interest rate	6.15%	5.74%

The committed long-term facilities are revolving lines of credit under credit agreements with a syndicate of banks. Wachovia Bank, National Association and Bank of America, N. A. each provides 14.3% of the aggregate credit facilities, Branch Banking and Trust Company, UBS Loan Finance LLC, Morgan Stanley Bank, and Credit Suisse, each provide 10.9%, and The Bank of New York and Mizuho Corporate Bank, Ltd each provide 9.1%. Four other banks provide the remaining 9.6%. These bank credit facilities support the issuance of commercial paper by the Company. When the commercial paper markets are dislocated (due to either price or availability constraints), the credit facilities are available to support the borrowing needs of the Company.

The Company pays fees to banks as compensation for maintaining committed lines of credit.

6. INCOME TAXES

Total income tax expense attributable to income for 2008 and 2007 is as follows:

Thousands of dollars	2008	2007
Current taxes:		
Federal	\$ 9,720	\$ 10,488
State	2,638	1,662
<u>Total current taxes</u>	<u>12,358</u>	<u>12,150</u>
Deferred taxes, net:		
Federal	10,907	6,362
State	1,922	1,983
<u>Total deferred taxes</u>	<u>12,829</u>	<u>8,345</u>
Investment tax credit amortization	(185)	(237)
<u>Total income tax expense</u>	<u>\$ 25,002</u>	<u>\$ 20,258</u>

The difference between actual income tax expense and the amount calculated from the application of the statutory 35% federal income tax rate to pre-tax income is reconciled as follows:

Thousands of dollars	2008	2007
Net income	\$ 41,816	\$ 35,379
Income tax expense	25,002	20,258
<u>Total pre-tax income</u>	<u>\$ 66,818</u>	<u>\$ 55,637</u>
Income taxes on above at statutory federal income tax rate	\$ 23,386	\$ 19,473
Increases (decreases) attributed to:		
State income taxes (less federal income tax effect)	2,964	2,369
Amortization of federal investment tax credits	(185)	(237)
Excess deferred income taxes refunded to customers	(1,023)	(1,212)
Other differences, net	(140)	(135)
<u>Total income tax expense</u>	<u>\$ 25,002</u>	<u>\$ 20,258</u>

The tax effects of significant temporary differences comprising the Company's net deferred tax liability of \$126.9 million at December 31, 2008 and \$113.4 million at December 31, 2007 (see Note 1G) are as follows:

Thousands of dollars	2008	2007
Deferred tax assets:		
Nondeductible reserves	\$ 5,046	\$ 5,587
Other	5,535	2,881
<u>Total deferred tax assets</u>	<u>10,581</u>	<u>8,468</u>
Deferred tax liabilities:		
Property, plant and equipment	122,024	106,902
Deferred employee benefit plan costs	4,112	2,948
Other	11,094	11,993
<u>Total deferred tax liabilities</u>	<u>137,230</u>	<u>121,843</u>
<u>Net deferred tax liability</u>	<u>\$ 126,649</u>	<u>\$ 113,375</u>

7. FINANCIAL INSTRUMENTS

As required by SFAS 107, "Disclosure about Fair Value of Financial Instruments," financial instruments for which the carrying amount does not equal estimated fair value at December 31, 2008 and 2007 were as follows:

	2008		2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	Thousands of dollars			
Long-term debt	\$263,700	\$264,332	\$266,600	\$284,222

Fair values of long-term debt are based on quoted market prices of the instruments or similar instruments. The carrying values reflect the fair value of a derivative designated as a hedge under SFAS 133 criteria (interest rate swap) based on the settlement value obtained from counterparties. Early settlement of long-term debt may not be possible or may not be considered prudent.

The Company's hedging program for natural gas purchases is designed to reduce price volatility to firm customers. In an October 2003 order, the NCUC declared the program was reasonable. The Company defers premiums, transaction fees, margin requirements and any realized gains or losses from its hedging program for subsequent recovery from customers. As of December 31, 2008, the Company had deferred realized gains of \$0.5 million.

The Company uses interest rate swap agreements to manage interest rate risk. These swap agreements provide for the Company to pay variable and receive fixed interest payments and are designated as fair value hedges of certain debt instruments. The fair value of interest rate swaps is recorded within other deferred debits on the balance sheet. The resulting credits serve to reflect the hedged long-term debt at its fair value. Periodic receipts or payments related to interest rate swaps are credited or charged to interest expense as incurred. At December 31, 2008, the estimated fair value of the Company's swap was \$0.9 million 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 December 31, 2008, such counterparties held 47% of the Company's natural gas inventory with a value of \$53.5 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. No fees are received under the supply service agreements. The agreements expire at various times through March 31, 2009.

Fair Value Measurement

The Company values commodity derivative assets and liabilities using unadjusted NYMEX prices, and considers such measures of fair value to be Level 1 for exchange traded instruments and Level 2 for over-the-counter instruments. The Company's interest rate swap agreements are valued using broker quotes.

At December 31, 2008, the fair value measurements, and the level within the fair value hierarchy of SFAS 157 in which the measurements fall, were as follows:

Thousands of dollars	Fair Value Measurements at December 31, 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	\$3.5	\$7.1	-
Liabilities:			
Derivative instruments	-	5.6	-

8. COMMITMENTS AND CONTINGENCIES

A. Environmental

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 December 31, 2008. Any cost allocable to the Company arising from the remediation of these sites is expected to be recoverable through rates.

B. Claims and Litigation

The Company is engaged in various claims and litigation incidental to its business operations which management anticipates will be resolved without material loss to the Company.

C. Operating Lease Commitments

The Company is obligated under various operating leases with respect to office space, furniture and equipment. Leases expire at various dates through 2014. Rent expense totaled approximately \$0.4 million and \$0.5 million in 2008 and 2007, respectively. Future minimum rental payments under such leases are as follows:

	Thousands of dollars	
2009	\$	811
2010		687
2011		166
2012		6
2013		2
Thereafter		2
Total	\$	1,674

D. Purchase Commitments

The Company is obligated for purchase commitments that expire at various dates through 2020. Amounts expended for gas supply, transportation, storage and other commitments totaled \$577.2 million and \$474.4 million in 2008 and 2007, respectively. Future payments under such purchase commitments are as follows:

	Thousands of dollars	
2009	\$	228,883
2010		70,905
2011		64,414
2012		42,274
2013		35,539
Thereafter		127,219
Total	\$	569,234

E. Asset Retirement Obligations

In accordance with SFAS 143, "Accounting for Asset Retirement Obligations," as interpreted by FIN 47, "Accounting for Conditional Asset Retirement Obligations," the Company recognizes a liability for the fair value of an asset retirement obligation when incurred if the fair value of the liability can be reasonably estimated. Uncertainty about the timing or method of settlement of a conditional asset retirement obligation is factored into the measurement of the liability when sufficient information exists, but such uncertainty is not a basis upon which to avoid liability recognition.

SFAS 143 applies to the legal obligation associated with the retirement of long-lived tangible assets that result from their acquisition, construction, development and normal operation and relates primarily to the Company's regulated utility operations. As of December 31, 2008, the Company has recorded an ARO of approximately \$19 million for conditional obligations related to transmission and distribution properties. All of the amounts recorded are based upon estimates which are subject to varying degrees of imprecision, particularly since such payments will be made many years in the future.

A reconciliation of the beginning and ending aggregate carrying amount of asset retirement obligations is as follows:

Thousands of dollars	2008	2007
Beginning balance	\$ 12,074	\$ 12,438
Liabilities incurred	544	521
Liabilities settled	(785)	(927)
Accretion expense	718	716
Revisions in estimated cash flows	6,693	(674)
Ending Balance	\$ 19,244	\$ 12,074