

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

Thousands of dollars	September 30, 2008	December 31, 2007
Assets		
Gas Utility Plant	\$1,224,168	\$1,164,889
Accumulated Depreciation	(254,459)	(244,390)
Acquisition Adjustment	209,824	209,824
Gas Utility Plant, Net	1,179,533	1,130,323
Nonutility Property and Investments, Net	27,957	27,830
Current Assets:		
Cash and cash equivalents	17,891	2,220
Receivables, net of allowance for uncollectible accounts of \$1,208 and \$832	40,859	118,983
Receivables-affiliated companies	3,015	11,158
Inventories (at average cost):		
Stored gas	132,228	90,338
Materials and supplies	6,556	8,411
Regulatory assets	18,483	22,735
Derivative financial instruments	7,102	-
Other	242	1,507
Total Current Assets	226,376	255,352
Deferred Debits and Other Assets:		
Due from parent-pension asset and other benefits	207	1,498
Regulatory assets	44,798	54,819
Other	2,693	3,519
Total Deferred Debits and Other Assets	47,698	59,836
Total	\$1,481,564	\$1,473,341

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

Thousands of dollars	September 30, 2008	December 31, 2007
Capitalization and Liabilities		
Capitalization:		
Common Equity	\$600,157	\$592,447
Long-term Debt, net	385,134	263,378
Total Capitalization	985,291	855,825
Current Liabilities:		
Short-term borrowings	53,100	156,900
Current portion of long-term debt	3,200	3,200
Accounts payable	32,831	66,749
Accounts payable-affiliated companies	21,066	5,112
Customer deposits & customer prepayments	19,400	19,035
Taxes accrued	-	9,225
Interest accrued	3,663	5,739
Distributions/dividends declared	5,300	5,600
Derivative financial instruments	-	5,505
Deferred income taxes, net	642	814
Other	6,679	4,809
Total Current Liabilities	145,881	282,688
Deferred Credits and Other Liabilities:		
Deferred income taxes, net	116,118	112,561
Deferred investment tax credits	367	506
Due to parent-postretirement and other benefits	23,043	23,416
Regulatory liabilities	190,476	178,204
Asset retirement obligations	12,613	12,074
Other	7,775	8,067
Total Deferred Credits and Other Liabilities	350,392	334,828
Commitments and Contingencies (Note 5)	-	-
Total	\$1,481,564	\$1,473,341

See Notes to Condensed Consolidated Financial Statements.

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

Thousands of dollars	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Operating Revenues	\$75,679	\$61,841	\$442,377	\$392,065
Cost of Gas	48,897	35,202	297,871	251,850
Gross Margin	26,782	26,639	144,506	140,215
Operating Expenses:				
Operation and maintenance	20,550	20,341	65,020	63,174
Depreciation and amortization	9,249	9,457	27,742	28,319
Other taxes	1,988	2,146	6,867	6,699
Total Operating Expenses	31,787	31,944	99,629	98,192
Operating Income (Loss)	(5,005)	(5,305)	44,877	42,023
Other Income (Expense):				
Other revenues	3,991	3,822	12,647	11,641
Other expenses	(2,540)	(2,525)	(8,121)	(6,709)
Allowance for equity funds used during construction	236	175	572	464
Interest charges, net of AFC of \$110 and \$119	(5,864)	(6,874)	(17,388)	(19,677)
Total Other Expense	(4,177)	(5,402)	(12,290)	(14,281)
Income (Loss) Before Income Taxes and Earnings from Equity Method Investments	(9,182)	(10,707)	32,587	27,742
Income Tax Expense (Benefit)	(3,551)	(4,065)	13,005	11,045
Income (Loss) Before Earnings from Equity Method Investments	(5,631)	(6,642)	19,582	16,697
Earnings from Equity Method Investments	944	1,075	2,778	3,159
Net Income (Loss)	\$(4,687)	\$(5,567)	\$22,360	\$19,856

See Notes to Condensed Consolidated Financial Statements.

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

Thousands of dollars	Nine Months Ended September 30,	
	2008	2007
Cash Flows From Operating Activities:		
Net income	\$22,360	\$19,856
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation and amortization	26,927	27,404
Allowance for equity funds used during construction	(572)	(464)
Excess earnings, net from equity method investments	(94)	(17)
Cash provided (used) by changes in certain assets and liabilities:		
Receivables, net	86,176	73,533
Inventories	(41,181)	(6,216)
Other regulatory assets	981	936
Other regulatory liabilities	(498)	(504)
Accounts payable	(26,067)	(35,152)
Deferred income taxes, net	3,354	8,837
Taxes accrued	(9,225)	(5,720)
Changes in gas cost adjustment clauses	1,728	(30,169)
Changes in other assets	3,239	(2,318)
Changes in other liabilities	761	(2,252)
Net Cash Provided From Operating Activities	67,889	47,754
Cash Flows From Investing Activities:		
Construction expenditures, net of AFC	(71,777)	(68,127)
Proceeds from sale of assets	90	-
Net Cash Used For Investing Activities	(71,687)	(68,127)
Cash Flows From Financing Activities:		
Short-term borrowings - affiliate	16,500	12,800
Short-term borrowings, net	(103,800)	18,200
Proceeds from issuance of debt	125,000	-
Contributions from parent	1,768	1,289
Retirement of long-term debt	(3,200)	(3,200)
Distributions/dividends	(16,800)	(13,754)
Net Cash Provided From Financing Activities	19,468	15,335
Net Increase (decrease) in Cash and Cash Equivalents	15,670	(5,038)
Cash and Cash Equivalents, January 1	2,220	6,038
Cash and Temporary Investments, September 30	\$17,890	\$1,000
Supplemental Cash Flow Information:		
Cash paid for - Interest (net of capitalized interest of \$264 and \$297)	\$18,107	\$19,469
Income taxes	23,084	24,122
Noncash Investing and Financing Activities:		
Accrued construction expenditures	1,211	2,974

See Notes to Condensed Consolidated Financial Statements.

PUBLIC SERVICE COMPANY OF NORTH CAROLINA, INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 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	September 30, 2008	December 31, 2007
Regulatory Assets:		
Under-collections - gas cost adjustment clause	\$35,863	\$48,564
Environmental remediation costs	8,109	9,011
Asset retirement obligations	10,115	9,519
Deferred employee benefit plan costs	6,278	7,464
Other	2,916	2,996
Total Regulatory Assets	\$63,281	\$77,554
Regulatory Liabilities:		
Over-collections - gas cost adjustment clause	\$5,651	\$4,018
Other asset removal costs	182,534	171,397
Other	2,291	2,789
Total Regulatory Liabilities	\$190,476	\$178,204

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. 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 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 \$0.5 million and \$0.6 million as of September 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 nine months ended September 30, 2008 and 2007, these costs totaled \$10.6 million and \$11.6 million, respectively. The Company owed these investees \$1.2 million at September 30, 2008 and December 31, 2007. The Company received cash distributions from equity investees of \$2.7 million and \$3.1 million for the nine months ended September 30, 2008 and 2007, respectively.

During the nine months ended September 30, 2008 and 2007, the Company made sales to an affiliate of natural gas and transportation services of \$12.6 million and \$14.6 million, respectively.

At September 30, 2008, the Company owed an affiliate \$16.5 million arising from consolidated cash management money pool borrowings.

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 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, “*Effective Date of FASB Statement No. 157*” (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. In addition, 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 impact the Company’s disclosure of fair value.

At September 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 September 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	\$7	\$1	-
Liabilities:			
Derivative instruments	3	1	-

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 the customer usage tracker (CUT), a rate decoupling mechanism that breaks the link between revenues and the amount of natural gas sold. 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 are effective for services rendered on or after November 1, 2008.

3. LIQUIDITY

Amounts outstanding under lines of credit that are classified as long-term borrowings appear in the chart below. At September 30, 2008 and December 31, 2007, the Company had available the following lines of credit and other borrowings outstanding:

Millions of dollars	September 30, 2008	December 31, 2007
Lines of credit:		
Committed long-term (expire December 2011)		
Total	\$250	\$250
Used	125	-
Weighted average interest rate	3.38%	-
Short-term borrowings outstanding:		
Commercial paper (270 or fewer days)	\$53	\$157
Weighted average interest rate	3.00%	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 provide 14.3% of the aggregate \$250 million 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.

4. 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 September 30, 2008, the Company had net deferred realized losses of \$22.9 million and net deferred unrealized gains of \$2.8 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 September 30, 2008, the estimated fair value of the Company's swap was \$0.5 million (gain) related to a notional amount of \$12.8 million.

The Company utilizes asset management and supply service agreements with counterparties for certain natural gas storage facilities. At September 30, 2008, such counterparties held 24% of the Company's total natural gas inventory with a carrying value of \$29 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 supply service agreements. The agreements expire at various times through March 31, 2009.

5. 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 September 30, 2008. The Company expects to recover through rates any costs, net of insurance recoveries, allocable to the Company arising from the remediation of these sites.

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.