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December 18, 2008

Director
U.S. DOE Loan Guarantee Program Office CF 1.3
1000 Independence Ave., SW
Washington, DC 20585-0121

Director, DOE LGPO

This letter confirms Duke Energy Carolinas, LLC intent to seek a Loan Guarantee pursuant to your solicitation serial no. DE-PS01-08LG00002, dated June 30, 2008 and subsequently assigned Reference Number DE-FOA-0000006. This letter also confirms we have met all mandatory requirements as specified in the Solicitation including Attachments A1 to A3 of the Solicitation. Our Part II Application fee will be wired as per your instructions on 12/19/08.

Based on the NRC schedule, we expect to receive the Lee Nuclear Station COL in approximately the first quarter of 2012. We would plan to execute a term sheet with the DOE as soon as possible thereafter. We hereby agree to notify the DOE of the date on which we intend to be prepared to close with respect to the financing at least six months in advance of the date a Term Sheet would be needed.

Additionally, Attachment A to this cover letter addresses the issues outlined in the DOE letter dated November 26, 2008.

Should we decide to withdraw from consideration for a loan guarantee, we will notify DOE in writing of that decision.

Sincerely,

A handwritten signature in black ink that reads 'David L. Hauser'.

David L. Hauser
Group Executive and Chief Financial Officer

Attachment

ATTACHMENT A:
Duke Energy Carolinas Response to DOE Letter Dated November 26, 2008

Duke Energy Carolinas would like to thank you for your time spent on the analysis of our Part I application and take this opportunity to provide information on issues identified in the DOE letter to Duke Energy Carolinas dated November 26, 2008.

Discussion of issues identified by the DOE:

1) Heavy financial commitments at the parent level for committed construction

Response:

As described under “Project Structure” in response WLS/I/B/1 and elsewhere in the application, a special purpose entity, and not Duke Energy Carolinas, will be obligated on the guaranteed debt financing related to the Lee Nuclear Station project. We do not believe that the capital expenditure commitments referred to in this item will hinder Duke Energy Carolinas’ ability to fund its equity commitments described in the application, nor will they impact the ability of the special purpose entity to repay its debt obligations as described in the application.

Duke Energy Corporation’s five-year capital expenditures program (the “Capital Program”) is comprised primarily of projects and activities that are necessary to maintain adequate and reliable service within the Company’s franchised electric and gas businesses (e.g., Duke Energy Carolinas). Specifically, approximately 75% of the Capital Program relates to franchised electric and gas businesses, with the remainder allocated across commercial power (e.g., wind and biomass), international operations, and corporate related projects. The Company’s franchised electric and gas businesses operate in constructive regulatory environments, many of which have implemented legislation in recent years that will have a beneficial impact on Duke Energy’s ability to maintain a strong financial position during the implementation of the Capital Program.

As part of the Capital Program implementation, Duke Energy Corporation will rely on various regulatory tools available to its franchised electric and gas businesses to a) obtain cost recovery assurance as capital expenditures are incurred, and b) ensure the timely recovery of capital costs, including a return on invested capital. For example, Duke Energy Indiana’s IGCC plant in Indiana (“Edwardsport”) and Duke Energy Carolinas’ coal plant in North Carolina (“Cliffside”) will be subject to the following regulatory model: 1) upfront confirmation of need for the plants by the respective state commissions, 2) construction-phase prudence reviews by the state commissions, through either periodic rate cases or separate regulatory proceedings, and 3) recovery of financing costs incurred during construction (i.e., “CWIP in ratebase”) through either rate riders or periodic base rate adjustments. Such regulatory tools are designed to minimize both a) regulatory disallowance risk and b) regulatory lag associated with the recovery of prudently incurred costs. Duke Energy Carolinas will use this same regulatory model during construction of the Lee Nuclear Station. These measures, along with the Company’s plans to initiate more frequent general rate cases during the next five years,

will be relied upon to ensure that Duke Energy Corporation maintains the earnings and cash flow necessary to successfully execute the Capital Program.

It should also be noted that Duke Energy Corporation's most significant plant expansion projects that have already been authorized by the respective state commissions – i.e., Edwardsport, Cliffside, and multiple gas-fired plants in North Carolina – are all planned for completion by 2012. Therefore, the capital expenditures associated with these projects will be substantially complete prior to the anticipated on-site mobilization for the construction of Lee Nuclear Station.

2) Pending EPA/NSPS litigation not resolved

Response:

The following information will provide some perspective on the potential exposure from the EPA/NSPS litigation:

- **Background:** Two NSR lawsuits were filed in federal court by the United States against what is now Duke Energy. The first suit, originally filed in 1999 against Cinergy Corp. prior to its merger with Duke, is pending in Indiana. The second, filed against Duke Energy Corp., was filed in North Carolina in 2000.
- **Indiana lawsuit:** In the Indiana lawsuit, the EPA alleged that Duke had violated NSR rules regarding NO_x and SO₂ emissions at 13 coal-fired units in five separate coal-fired plants in Indiana and Ohio. On May 22, 2008, the jury returned a verdict in favor of Duke on all but three of the units at a single plant in Indiana (Wabash River), so the scope of the original claim of violations has been greatly reduced. The remedy trial on the three Wabash River units is scheduled to begin on February 2, 2009. One mitigating factor that the court may weigh in any award of damages is the fact that Duke has proposed retirement of the referenced three Wabash units in 2012, when the Edwardsport IGCC power station comes on line.
- **Carolinas lawsuit:** The government's claim alleged violations at 25 coal-fired units in eight separate coal-fired plants in North and South Carolina. The Supreme Court decision in this case that reversed the favorable Fourth Circuit decision only related to whether the violations are to be determined based on annual or hourly output of emissions. It is still possible that Duke will prevail on the merits once this case goes to trial. Additionally, when looking at the scope of the potential liability resulting from a decision in favor of the government, in Duke's favor is the fact that the relief requested in the Carolinas lawsuit has been largely supplanted by legislation passed in North Carolina in 2002, which was supported by Duke. Duke has expended considerable sums in installing scrubbers, SCRs and taken other measures to comply with this "Clean Smokestacks" legislation. These compliance measures have brought the affected

units into compliance not only with Clean Smokestacks, but also with NSR rules. Duke will retire other units named in the government's suit that were not brought up to Clean Smokestacks standards, as required by the North Carolina Utilities Commission order granting a Certificate of Public Convenience and Necessity for Cliffside 6 and the air permit for Cliffside 6. Thus, the potential exposure from the Carolinas lawsuit is greatly reduced; only four units of the original 25 have not been either "scrubbed" to comply with state and federal emissions standards or scheduled for retirement.

- **Possible Rate Recovery:** Duke also believes that there is a reasonable likelihood that it can recover the cost of emissions controls ordered by the federal courts in either lawsuit in rates, further reducing Duke's total potential financial exposure from the NSR litigation in the Carolinas and in Indiana.

In conclusion, based on our current understanding of the Government's position and the required remedial measures, we do not believe that the pending EPA/NSPS litigation creates significant financial or operational exposure for the company. After taking into account jury verdicts, scheduled retirements and emissions-related upgrades, the number and size of the remaining power plants potentially affected by the pending litigation is relatively small. Additionally, we believe that there is a reasonable probability that we may recover in rates any further expenditures for additional pollution control equipment. Consequently, based on the current status of the EPA/NSPS litigation and given our response to remedial requirements that have already been undertaken, we do not believe that the pending EPA/NSPS litigation will impair our ability to support our obligations related to the financing of construction of the Lee Nuclear Station with the support of a DOE Loan Guarantee.

- 3) Deliberate nature of risk management process places company somewhat behind other applicants in the queue for long lead items.**
- 4) Late start in EPC negotiations may hinder construction plan, although this may prove to be a positive factor as noted above**

Response:

As noted in the DOE's letter dated November 26, 2008, ongoing market weakness in credit availability and the attendant economic downturn reinforce the appropriateness of Duke Energy Carolinas' deliberate approach to the Lee Nuclear Station project. Duke Energy Carolinas concluded in early October, 2008, just after filing the Part I Loan Guarantee Application, that finalizing an EPC contract in the short term would be inconsistent with our deliberate approach. The following factors contributed to this conclusion:

- a run-up in commodity prices appeared to be at its peak
- demand for equipment and labor seemed to be outstripping supply
- overall market conditions were placing inordinate upward pressure on pricing of services and materials

Duke Energy Carolinas continues to monitor the factors important to a decision on the optimal timing for finalizing an EPC contract and procuring long lead items. The company believes that current market conditions may improve our position from which to negotiate an EPC contract that includes appropriate sharing of risk between DEC and the WEC/SN consortium.

We are working closely with WEC to monitor the availability of supply chain capacity for long lead items. We believe a 07/18 COD is achievable without current financial commitments for long lead items.

Should the economic downturn dampen demand, Duke Energy Carolinas and its customers could potentially benefit from a COD occurring slightly later than the currently planned 07/18 COD for Unit 1. The benefit would derive from not spending money until necessary and from bringing the generation capacity on line at the appropriate time. Duke Energy Carolinas' generation system is large enough to accommodate slight variations in COD without significantly impairing its ability to satisfy native load.

Duke Energy Carolinas deliberate risk management process resulting in the decision to delay finalizing an EPC contract and the decision to continue monitoring the supply chain for the right time to spend on long lead items, strengthens its ability to cost-effectively enhance its generation fleet with new nuclear generation at the appropriate time.

5) Uncertainty of timing and nature of potential financial investment and PPA agreements

Response:

Duke Energy Carolinas has significantly advanced the business and financial planning for the Lee Nuclear Station project in the instant Application with regard to the timing and nature of the potential financial investment and PPA agreements. Once the NRC COL for Lee Nuclear Station has been issued in approximately Q1 2012 (all dates are proprietary information that Duke Energy Carolinas requests not be released to persons outside the Government except for purposes of review and evaluation), it will be transferred to Newco as the new legal owner of the project. At that time, the DOE Loan Guarantee for Newco would go into effect and Newco would fund the construction of Lee Nuclear Station by borrowing from the Federal Financing Bank 80% of eligible costs with repayments to be made over a 30-year term. The balance of plant costs will be funded with sponsor equity from Duke Energy Carolinas. Subsequent to Newco's formation, Duke Energy Carolinas will make capital contributions or subordinated loans in respect of its equity commitments.

Duke Energy Carolinas expects to fund a large portion of the equity prior to meeting the conditions for funding under the guarantee (which cannot occur prior to receipt of the COL). The balance of equity will fund proportionately with the debt thereafter until the

equity commitment is fully funded. The total proportion of equity to final project costs (eligible and ineligible), is expected to be approximately 25%.

Duke Energy Carolinas' application assumes that part of the state regulatory agreements will include a provision for recovery of construction work in progress (CWIP) financing costs. This will enable the project to service its debt obligations and pay a dividend to the Sponsor(s) during the construction period and will further lower the installed cost of the project (and associated revenue requirement during the operating phase) by eliminating capitalization of interest and reducing (equity) AFUDC. South Carolina has essentially approved such early-recovery, while similar legislation is being considered for North Carolina.

As contemplated, Duke Energy Carolinas will act as a "Receivables Servicer" under a separate agreement to segregate the applicable portion of revenues received from customers and remit these to a trustee acting on behalf of the project lenders. These funds will be used to pay interest on the debt funds used for construction, while remitting the balance periodically to the Sponsor after fully funding all required reserves. This arrangement would cease as the PPA commences at the time of commercial operations.

Consistent with standard project finance practice, it is expected that a number of reserve accounts maintained and disbursed in accordance with the loan agreements, will be funded from proceeds of debt and equity issuance (pre-funded) or from project cash flow. These include a Debt Service Reserve Account (for the current period's scheduled principal/interest), a Major Maintenance (or scheduled outage) Reserve Account and an Insurance Proceeds Account, among others.

Please see response WLS/II/D/1/Financial Analysis for a detailed discussion of the timing and nature of financing agreements, response WLS/II/D/4 for a discussion of Contractual Agreements and response WLS/II/E/1 for a discussion of sources of funds. Also please see Appendix 18 (Summary of EPC Agreement), Appendix 19 (Summary of Alliance Agreement for provision of parts and services), Appendix 20 (Summary of Fuel Fabrication, Technology and Related Services Agreement), Appendix 21 (Summary of Spent Fuel Disposal Contract), Appendix 22 (Term Sheet for Nuclear Development and Operations and Maintenance Agreement), Appendix 23 (Term Sheet for Project Debt Agreement), and Appendix 24 (Term Sheet for Receivable Servicing Agreement) for further details.

With regard to the timing and nature of the Power Purchase and Sale Agreement (PPA), Newco would enter into the PPA's with the Duke Energy Carolinas for Units 1 and Unit 2 of the Lee Nuclear Station at the time that the DOE Loan Guarantee closes in approximately Q3 2011. The two PPA's would be virtually identical and would obligate Duke Energy Carolinas to purchase 100% of the capacity, energy and other products from Newco. The prices for those products would essentially constitute cost-based rates tied to Newco's all in costs of developing and constructing the Lee Nuclear Station. At such time as each unit of Lee Nuclear Station begins commercial operations pursuant to

the NRC COL (approximately Q3 2018 for Unit 1 and Q3 2019 for Unit 2), that unit's PPA will be effective for the sale of 100% of its products to Duke Energy Carolinas.

Please see response WLS/II/D/4 for a discussion of the timing and nature of the PPA's and also Appendix 17 (Term Sheet for PPA).