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R. ALEXANDER GLENN
Deputy General Counsel - Florida

VIA HAND DELIVERY

October 6, 2006

Ms. Blanca S. Bayó, Director
Division of the Commission Clerk and
Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Application of Progress Energy Florida, Inc. for authority to issue and sell securities during the twelve months ending December 31, 2007.

Dear Ms. Bayó:

Enclosed for filing is the original certified and five (5) uncertified copies of Progress Energy Florida, Inc.'s Application for authority to issue and sell securities during the twelve months ending December 31, 2007.

Please acknowledge your receipt of the above filing on the enclosed copy of this letter and return to the undersigned. Thank you for your assistance in this matter.

Sincerely,

R. Alexander Glenn Lms

R. Alexander Glenn

RAG/lms
Enclosures
Progress Energy Florida, Inc.
106 E. College Avenue
Suite 800
Tallahassee, FL 32301

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FPSC BUREAU OF REGISTRATION

DOCUMENT NUMBER-DATE

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FPSC-COMMISSION CLERK

DOCKET NO. 060672 -

FLORIDA PUBLIC SERVICE COMMISSION

TALLAHASSEE, FLORIDA

APPLICATION OF

PROGRESS ENERGY FLORIDA, INC.

(FORMERLY, FLORIDA POWER CORPORATION)

FOR AUTHORITY TO ISSUE AND SELL

SECURITIES DURING THE TWELVE MONTHS ENDING DECEMBER 31, 2007

PURSUANT TO SECTION 366.04, FLORIDA STATUTES,

AND CHAPTER 25-8, FLORIDA ADMINISTRATIVE CODE

Address communications in connection with this Application to:

Thomas R. Sullivan
Treasurer
Progress Energy Florida, Inc.
c/o Progress Energy, Inc.
410 S. Wilmington Street
Raleigh, NC 27601

R. Alexander Glenn
Deputy General Counsel
Progress Energy Service Company, LLC,
Counsel to Progress Energy Florida, Inc.
100 Central Avenue, Suite CX1D
St. Petersburg, FL 33701

DOCUMENT NUMBER-DATE

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FPSC-COMMISSION CI FRK

Dated: October 4, 2006

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

IN RE: APPLICATION OF PROGRESS
ENERGY FLORIDA, INC. FOR
AUTHORITY TO ISSUE AND
SELL SECURITIES DURING THE
TWELVE MONTHS ENDING
DECEMBER 31, 2007 PURSUANT
TO SECTION 366.04, FLORIDA
STATUTES, AND CHAPTER 25-8,
FLORIDA ADMINISTRATIVE
CODE.

The Applicant, Progress Energy Florida, Inc., formerly Florida Power Corporation (herein called the "Company"), respectfully requests authority from the Florida Public Service Commission (herein called the "Commission"), to issue, sell or otherwise incur during 2007 up to \$1.5 billion of any combination of equity securities and long-term debt securities and other long-term obligations (exclusive of bank loans issued under the Company's long-term credit facilities as mentioned below). Additionally, the Company requests authority to issue, sell or otherwise incur during 2007 and 2008 up to \$1 billion outstanding at any time of short-term debt securities and other obligations, which amount shall be in addition to and in excess of the amount the Company is authorized to issue pursuant to Section 366.04, Florida Statutes, which permits the Company to issue short-term securities aggregating to more than five percent of the par value of the Company's other outstanding securities.

The Company is wholly-owned by Florida Progress Corporation ("Florida Progress"), which is wholly-owned by Progress Energy, Inc. ("Progress Energy"). The

Company hereby applies for requisite authority for these proposed financings, pursuant to Section 366.04, Florida Statutes, by submitting the following information in the manner and form prescribed in Chapter 25-8, Florida Administrative Code, including the required Exhibits A-C.

CONTENTS OF APPLICATION

- (1) The exact name of the Company and address of its principal business office is as follows:

Progress Energy Florida, Inc.
100 Central Avenue, Suite CX1D
St. Petersburg, Florida 33701

(2) The Company was incorporated in Florida in 1899 and reincorporated in Florida in 1943. The Company is continuing its corporate existence pursuant to its Amended Articles of Incorporation, as amended (the "Articles of Incorporation"), a copy of which was filed as Exhibit A to the Application of Florida Power Corporation For Authority To Issue And Sell Securities During The Twelve Months Ending December 31, 1994 (Docket No. 931029-EI) and is incorporated herein by reference. The Company's financial statement schedules required under Sections 25-8.003 (1)(a)-(b), Florida Administrative Code, are filed herewith as Exhibits A (6) (i) and (ii) and B (1) and (2), respectively.

(3) The name and address of the persons authorized to receive notices and communications with respect to this Application are as follows:

Thomas R. Sullivan
Treasurer
Progress Energy Florida, Inc.
c/o Progress Energy, Inc.
410 S. Wilmington Street
Raleigh, NC 27601

R. Alexander Glenn
Deputy General Counsel
Progress Energy Service Company, LLC
Counsel to Progress Energy Florida, Inc.
100 Central Avenue, Suite CX1D
St. Petersburg, FL 33701

(4)(a) A statement detailing information concerning each class and series of the Company's capital stock and long-term debt is contained in Exhibit C attached hereto.

(b) The amount held as reacquired securities: The Company does not hold any reacquired securities. From time to time, the Company has redeemed certain outstanding first mortgage bonds and shares of its cumulative preferred stock, but such bonds and shares are canceled upon redemption or reacquisition. Under the Company's Articles of Incorporation, all or any shares of Preferred Stock or Preference Stock redeemed or acquired by the Company may thereafter be reissued or otherwise disposed of at any time, subject to limitations imposed by law and in the Articles of Incorporation.

(c) The amount pledged by the applicant: From time to time the Company issues First Mortgage Bonds that are secured by the lien of its Indenture, dated as of January 1, 1944 with JPMorgan Chase Bank, N.A. as successor trustee, as supplemented by supplemental indentures (the "Mortgage"). The Mortgage constitutes a first mortgage lien, subject only to permitted encumbrances and liens, on substantially all of the fixed properties owned by the Company except miscellaneous properties that are specifically excepted. After-acquired property is covered by the lien of the Mortgage, subject to existing liens at the time such property is acquired.

(d) The amount owned by affiliated corporations: All of the Company's

outstanding common stock (100 shares) is owned by the Company's parent, Florida Progress. The Company has no other stock or debt owned by affiliated corporations. See paragraph (10) hereof.

(e) The amount held in any fund: None.

(5) The Company seeks authority to issue and sell and/or exchange equity securities and issue, sell, exchange and/or assume short-term or long-term debt securities and/or to assume liabilities or obligations as guarantor, endorser or surety during the period covered by the Application. The Company ultimately may issue any combination of the types of securities described below, subject to the aggregate dollar limitations requested in this Application.

(5)(a)(1) The kind and the nature of the securities that the Company seeks authority to issue and sell during 2007 (and 2008 with respect to short-term debt securities and obligations), are equity securities and short-term and long-term debt securities and other obligations, including, but not limited to, borrowings from banks which are participants in credit facilities the Company may establish from time to time, uncommitted bank facilities and affiliate loans which are available through Progress Energy's utility money pool facility. The Company also seeks authority to enter into interest rate derivative contracts to remove financial risk associated with its existing and future debt obligations.

The equity securities that the Company may issue include cumulative preferred stock, preference stock, or warrants, options or rights to acquire such securities, or other equity securities, with such par values, terms and conditions and relative rights and preferences as are deemed appropriate by the Company and permitted by its Articles of Incorporation, as they may be amended from time to time.

The Company also may enter into preferred securities financings that may have various structures, including a structure whereby the Company would establish and make an equity investment in a special purpose trust, limited partnership or other entity. The entity would offer preferred securities to the public and lend the proceeds to the Company. The Company would issue debt securities to the entity equal to the aggregate of its equity investment and the amount of preferred securities issued. The Company may also guarantee, among other things, the distributions to be paid by the entity to the holders of the preferred securities.

Short-term debt securities and obligations may include notes to be sold in the commercial paper market ("commercial paper"), loans from affiliates and bank loans, credit agreements or other forms of securities and debt obligations, with maturities of less than one year.

The long-term debt securities and obligations may take the form of first mortgage bonds, debentures, medium-term notes or other notes, loans from affiliates and bank loans, installment contracts, credit agreements, securitization of storm cost receivables or other forms of securities and debt obligations, whether secured or unsecured, with maturities greater than one year. In addition, the Company may enter into options, rights, interest rate swaps or other derivative instruments. The Company also may enter into installment purchase and security agreements, loan agreements, or other arrangements with political subdivisions of the State of Florida or pledge debt securities or issue guarantees in connection with such political subdivisions' issuance, for the ultimate benefit of the Company, or pollution control revenue bonds, solid waste disposal revenue bonds, industrial development revenue bonds, variable rate demand notes, or other "private activity bonds"

with maturities ranging from one to forty years, bond anticipation notes, or commercial paper. Such obligations may or may not bear interest exempt from federal tax.

The Company also may enter into nuclear fuel leases and various agreements that provide financial or performance assurances to third parties on behalf of the Company's subsidiaries. These agreements include guarantees, standby letters of credit and surety bonds. The agreements are entered into primarily to support or enhance the credit worthiness otherwise attributed to a subsidiary on a stand-alone basis. Specific purposes of the agreements include supporting payments of trade payables, securing performance under contracts and lease obligations, providing workers' compensation coverage, obtaining licenses, permits and rights-of-way and supporting other payments that are subject to contingencies.

The manner of issuance and sale of securities will be dependent upon the type of securities being offered, the type of transaction in which the securities are being issued and sold and market conditions at the time of the issuance and sale. Securities may be issued through negotiated underwritten public offerings, public offerings at competitive biddings, private sales or sales through agents, and may be issued in both domestic and foreign markets. Credit agreements may be with banks or other lenders. The Company's commercial paper will be for terms up to but not exceeding nine months from the date of issuance. The commercial paper may be sold at a discount, including the underwriting discount of the commercial paper dealer, at rates comparable to interest rates being paid in the commercial paper market by borrowers of similar creditworthiness. The Company plans to refund, retire or redeem from time to time outstanding commercial paper and short-term

borrowings, which mature on a regular basis, with preferred stock, first mortgage bonds, medium-term notes, or other long-term securities and debt obligations.

(5)(a)(2) Contemplated to be included as long-term or short-term debt securities, as appropriate, are borrowings from banks and other lenders under the Company's credit facilities, as those may be entered into and amended from time to time. The Company's current facility is a \$450 million five-year revolving credit agreement with a group of banks. Borrowings under the facility are available for general corporate purposes, including support of the Company's commercial paper program. The current five-year facility will expire on March 28, 2010.

(5)(b) The maximum principal amount of short-term securities and obligations proposed to be issued, sold, or otherwise incurred during 2007 and 2008 is \$1 billion outstanding at any time, including commercial paper, bank loans or moneypool borrowings, which amount shall be in addition to and in excess of the amount the Company is authorized to issue pursuant to Section 366.04, Florida Statutes, which permits the Company to issue short-term securities aggregating not more than five percent of the par value of the Company's other outstanding securities. The maximum principal amount of equity securities, long-term debt securities and other long-term obligations (exclusive of bank loans issued under the Company's long-term credit facilities as mentioned above) proposed to be issued, sold, or otherwise incurred during 2007 is \$1.5 billion.

The Company will file a consummation report with the Commission in compliance with Rule 25-8.009, Florida Administrative Code, within 90 days after the close of the 2007 calendar year to report any securities issued during that year.

(5)(c) On September 30, 2006, the estimate of the interest rates for securities

proposed to be issued by the Company were as follows (with reference to current rates for comparable securities):

1. 10-year BBB+ rated senior unsecured debt: 5.70%.
2. 10-year A- rated first mortgage bonds: 5.55%.
3. Second-tier 30-day commercial paper sold through dealers
(on a bond equivalent basis): 5.35%.
4. Prime interest rate: 8.25%.

The actual interest rates to be paid by the Company during 2007 will be determined by the market conditions at the time of issuance.

(6) The net proceeds to be received from the sale of the additional securities will be added to the Company's general funds and may be used to provide additional electric facilities during 2007 pursuant to the Company's construction program, to repay maturing long-term debt or short-term unsecured debt, to refund, retire or redeem existing obligations, or for other corporate purposes.

A more detailed statement of the Projected Sources and Uses of Funds during 2007 is included as Exhibit B(1) attached hereto. The Company's construction program is developed from its long-range plan to determine needed construction facilities. While the final 2007 Construction Budget is not yet available, the Company's most recently approved construction expenditures forecast excluding Allowance for Funds Used During Construction ("AFUDC") for 2007 is approximately \$1.5 billion. A detailed listing of this 2007 construction program excluding AFUDC is found in Exhibit B(2) attached hereto. These construction estimates are subject to periodic review and revision to adjust for such factors as changing economic conditions, environmental requirements, regulatory matters

and changing customer usage patterns.

(7) Based on the reasons shown in sections (5) and (6) above, the Company submits that the proposed financings are consistent with the proper performance by the Company of service as a public utility, will enable and permit the Company to perform that service, are compatible with the public interest and are reasonably necessary and appropriate for such purposes.

(8) R. Alexander Glenn, Deputy General Counsel for the Company, or his duly appointed successor, will pass upon the legality of the securities involved herein. His office address is:

Progress Energy Florida, Inc.
100 Central Avenue
Suite CX1D
St. Petersburg, Florida 33701

(9) Except for those issuances of securities that are exempt from the registration requirements of the Securities Act of 1933, the issue and sale of the various securities involved herein will require the filing of Registration Statements with the United States Securities and Exchange Commission ("SEC"), 100 F Street N.E., Washington, DC 20549. A copy of each Registration Statement that has been or will be filed with the SEC will be included with the Company's annual Consummation Report relating to the sale of securities registered thereunder. No other state or federal regulatory body has jurisdiction over the transactions proposed herein, although certain state securities or "blue sky" laws may require the filing of registration statements, consents to service of process or other documents with applicable state securities commissions, including in particular the Florida Division of

Securities and Investor Protection, 101 E. Gaines St., Tallahassee, FL 32399; the Nevada Department of State, Securities Division, 555 East Washington Avenue, 5th Floor, Las Vegas, NV 89101; the New York Department of Law, Bureau of Investor Protection and Securities, 120 Broadway, 23rd Floor, New York, NY 10271; and the Oregon Department of Consumer & Business Services, Division of Finance & Corporate Securities, Labor & Industries Building, Salem, OR 97310.

(10) The measure of control or ownership exercised by or over the Company by any other public utility is set forth below. The Company is a wholly owned subsidiary of Florida Progress, a public utility holding company. On November 30, 2000, all the outstanding shares of Florida Progress common stock were acquired by CP&L Energy, Inc., a North Carolina corporation, which subsequently changed its name to Progress Energy in a statutory share exchange pursuant to the terms of an Amended and Restated Agreement and Plan of Exchange dated as of August 22, 1999, Amended and Restated as of March 3, 2000 (the “Agreement”).

Following the closing of the share exchange, Progress Energy became a registered holding company under the Public Utility Holding Company Act of 1935 (the “Act”). Progress Energy retained Florida Progress as a wholly owned subsidiary and Florida Progress continues to own all of the issued and outstanding common stock of the Company. Thus, Progress Energy indirectly owns all of the common stock of the Company. Florida Progress remains generally exempt from registration under the Act and attendant regulation because its utility operations are primarily intrastate. On February 8, 2006, the Act was repealed, and the Public Utility Holding Company Act of 2005 was enacted.

(11) The following Exhibits are filed herewith and made a part hereof:

- Exhibit A (6)(i) The financial statements and accompanying footnotes as they appear in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, and filed with the SEC in file no. 1-15929 on March 10, 2006.
- Exhibit A (6)(ii) The financial statements and accompanying footnotes as they appear in the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006, and filed with the SEC in file no. 1-15929 on August 9, 2006.
- Exhibit B(1) Projected Sources and Uses of Funds Statement for 2007.
- Exhibit B(2) Preliminary Construction Expenditures for 2007.
- Exhibit C Capital Stock and Funded Debt of the Company as of September 30, 2006.

WHEREFORE, the Company hereby respectfully requests that the Commission enter its Order approving this Application for authority to issue and sell securities during the twelve months ending December 31, 2007, and more specifically, to order that:

- (a) The request of Progress Energy Florida, Inc. to issue and sell securities during the twelve months ending December 31, 2007, pursuant to Section 366.04, Florida Statutes, and Chapter 25-8, Florida Administrative Code (the "Application") is granted;
- (b) Progress Energy Florida, Inc. is authorized to issue, sell, or otherwise incur during 2007 up to \$1.5 billion of any combination of equity securities and long-term debt securities and other long-term obligations (exclusive of bank loans issued under the Company's long-term credit facilities as mentioned above). Additionally, the Company requests authority to issue, sell or otherwise incur during 2007 and 2008 up to \$1 billion outstanding at any time of short-term debt


securities and other obligations, which amount shall be in addition to and in excess of the amount the Company is authorized to issue pursuant to Section 366.04, Florida Statutes, which permits the Company to issue short-term securities aggregating to more than five percent of the par value of the Company's other outstanding securities.

- (c) The kind and nature of the securities that Progress Energy Florida, Inc. is authorized to issue during 2007 (and 2008 with respect to short-term debt securities and obligations) are equity securities and short-term and long-term debt securities and other obligations, as set forth in the Company's Application;
- (d) Progress Energy Florida, Inc. shall file a Consummation Report in accordance with Rule 25-8.009, Florida Administrative Code, within 90 days after the close of the 2007 calendar year.

[The remainder of this page was intentionally left blank.]

Respectfully submitted this
4th day of October, 2006

PROGRESS ENERGY FLORIDA, INC.

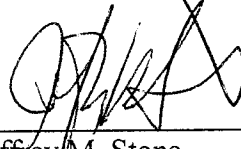
By: 
Thomas R. Sullivan
Treasurer

*[Signature page for Progress Energy Florida's 2006 Application for Authority to Issue and
Sell Securities]*

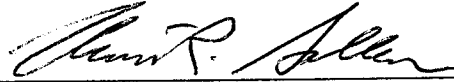
STATE OF NORTH CAROLINA)
)
COUNTY OF WAKE)

CERTIFICATION OF APPLICATION AND EXHIBITS

Each of the undersigned, Jeffrey M. Stone and Thomas R. Sullivan, being first duly sworn, deposes and says that he is the Chief Accounting Officer, and the Treasurer, respectively, of PROGRESS ENERGY FLORIDA, INC., the Applicant herein; that he has read the foregoing application and exhibits of said Progress Energy Florida, Inc. and knows the contents thereof; and certifies that the same are true and correct to the best of his knowledge and belief.



Jeffrey M. Stone
Chief Accounting Officer

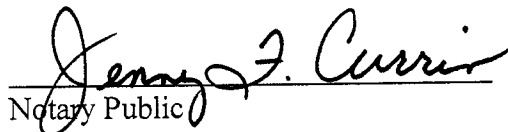


Thomas R. Sullivan
Treasurer

STATE OF NORTH CAROLINA)
)
COUNTY OF WAKE)

The foregoing instrument was acknowledged before me this 4th day of October, 2006, by Jeffrey M. Stone and Thomas R. Sullivan, who are personally known to me and who did take an oath.

(Seal)


Notary Public

Jenny F. Currin
Printed Name
My Commission Expires 12/13/2010

Exhibit A(6)(i)

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following financial statements, supplementary data and financial statement schedules are included herein:

Progress Energy, Inc.

Reports of Independent Registered Public Accounting Firm

Consolidated Statements of Income for the Years Ended December 31, 2005, 2004 and 2003

Consolidated Balance Sheets at December 31, 2005 and 2004

Consolidated Statements of Cash Flows for the Years Ended December 31, 2005, 2004 and 2003

Consolidated Statements of Changes in Common Stock Equity for the Years Ended December 31, 2005, 2004 and 2003

Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2005, 2004 and 2003

Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc. (PEC)

Reports of Independent Registered Public Accounting Firm

Consolidated Statements of Income for the Years Ended December 31, 2005, 2004 and 2003

Consolidated Balance Sheets at December 31, 2005 and 2004

Consolidated Statements of Cash Flows for the Years Ended December 31, 2005, 2004 and 2003

Consolidated Statements of Changes in Common Stock Equity for the Years Ended December 31, 2005, 2004 and 2003

Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2005, 2004 and 2003

Florida Power Corporation d/b/a Progress Energy Florida, Inc. (PEF)

Reports of Independent Registered Public Accounting Firm

Statements of Income for the Years Ended December 31, 2005, 2004 and 2003

Balance Sheets at December 31, 2005 and 2004

Statements of Cash Flows for the Years Ended December 31, 2005, 2004 and 2003

Statements of Changes in Common Stock Equity for the Years Ended December 31, 2005, 2004 and 2003

Statements of Comprehensive Income for the Years Ended December 31, 2005, 2004 and 2003

Combined Notes to the Financial Statements for Progress Energy, Inc., Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc. and Florida Power Corporation d/b/a Progress Energy Florida, Inc.

Note 1 - Organization and Summary of Significant Accounting Policies

Note 2 - New Accounting Standards

Note 3 - Divestitures

Note 4 - Acquisitions and Business Combinations

Note 5 - Property, Plant and Equipment

Note 6 - Current Assets

Note 7 - Regulatory Matters

Note 8 - Goodwill and Other Intangible Assets

Note 9 - Impairments of Long-Lived Assets and Investments

Note 10 - Equity

Note 11 - Preferred Stock of Subsidiaries - Not Subject to Mandatory Redemption

Note 12 - Debt and Credit Facilities

Note 13 - Investments and Fair Value of Financial Instruments

Note 14 - Income Taxes

Note 15 - Contingent Value Obligations
 Note 16 - Benefit Plans
 Note 17 - Severance
 Note 18 - Risk Management Activities and Derivatives Transactions
 Note 19 - Related Party Transactions
 Note 20 - Financial Information by Business Segment
 Note 21 - Other Income and Other Expense
 Note 22 - Environmental Matters
 Note 23 - Commitments and Contingencies
 Note 24 - Condensed Consolidating Statements
 Note 25 - Subsequent Event
 Note 26 - Quarterly Financial Data (Unaudited)

Each of the preceding combined notes to the financial statements of the Progress Registrants are applicable to Progress Energy, Inc. but not to each of PEC and PEF. The following table sets forth which notes are applicable to each of PEC and PEF.

Registrant	Applicable Notes
PEC	1, 2, 5 through 10, 12 through 14, 16 through 23 and 26
PEF	1 through 10, 12 through 14, 16 through 23 and 26

Consolidated Financial Statement Schedules for the Years Ended December 31, 2005, 2004 and 2003:

Report of Independent Registered Public Accounting Firm on Financial Statement Schedule - Progress Energy, Inc.
 Schedule II - Valuation and Qualifying Accounts - Progress Energy, Inc.
 Report of Independent Registered Public Accounting Firm on Financial Statement Schedule - Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc.
 Schedule II - Valuation and Qualifying Accounts - Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc.
 Report of Independent Registered Public Accounting Firm on Financial Statement Schedule - Florida Power Corporation d/b/a Progress Energy Florida, Inc.
 Schedule II - Valuation and Qualifying Accounts - Florida Power Corporation d/b/a Progress Energy Florida, Inc.

All other schedules have been omitted as not applicable or are not required because the information required to be shown is included in the Financial Statements or the Combined Notes to the Financial Statements.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF PROGRESS ENERGY, INC.

We have audited the accompanying consolidated balance sheets of Progress Energy, Inc., and its subsidiaries (the Company) at December 31, 2005 and 2004, and the related consolidated statements of income, comprehensive income, changes in common stock equity, and cash flows for each of the three years in the period ended December 31, 2005. 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 the 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 and Note 18 to the consolidated financial statements, in 2005 the Company adopted Statement of Financial Accounting Standards No. 123R and Financial Accounting Standards Board Interpretation No. 47 and in 2003 the Company adopted Statement of Financial Accounting Standards No. 143 and Derivatives Implementation Group Issue C20.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting at December 31, 2005, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 6, 2006, expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP

Raleigh, North Carolina
March 6, 2006

PROGRESS ENERGY, INC.
CONSOLIDATED STATEMENTS of INCOME

(in millions except per share data)

Years ended December 31	2005	2004	2003
Operating revenues			\$
Electric	\$7,945	\$7,153	6,741
Diversified business	2,163	1,372	1,058
Total operating revenues	10,108	8,525	7,799
Operating expenses			
Utility			
Fuel used in electric generation	2,359	2,011	1,695
Purchased power	1,048	868	862
Operation and maintenance	1,770	1,475	1,421
Depreciation and amortization	922	878	883
Taxes other than on income	460	425	405
Other	(37)	(13)	(8)
Diversified business			
Cost of sales	2,075	1,179	929
Depreciation and amortization	152	157	126
(Gain)/loss on the sale of assets	(34)	(63)	1
Other	108	164	141
Total operating expenses	8,823	7,081	6,455
Operating income	1,285	1,444	1,344
Other income (expense)			
Interest income	17	14	11
Impairment of investments	(1)	-	(21)
Other, net	(5)	(12)	(27)
Total other income (expense)	11	2	(37)
Interest charges			
Net interest charges	653	634	614
Allowance for borrowed funds used during construction	(13)	(6)	(7)
Total interest charges, net	640	628	607
Income from continuing operations before income tax and minority interest	656	818	700
Income tax (benefit) expense	(45)	106	(113)
Income from continuing operations before minority interest	701	712	813
Minority interest in subsidiaries' loss, net of tax	(26)	(17)	2
Income from continuing operations	727	729	811
Discontinued operations, net of tax	(31)	30	(5)
Cumulative effect of changes in accounting principles, net of tax	1	-	(24)
Net income	\$697	\$759	\$782
Average common shares outstanding - basic	247	242	237
Basic earnings per common share			
Income from continuing operations	\$2.95	\$3.01	\$3.42
Discontinued operations, net of tax	(0.13)	0.12	(0.02)
Cumulative effect of changes in accounting principles, net of tax	-	-	(0.10)
Net income	\$2.82	\$3.13	\$3.30
Diluted earnings per common share			
Income from continuing operations	\$2.94	\$3.00	\$3.40
Discontinued operations, net of tax	(0.12)	0.12	(0.02)
Cumulative effect of changes in accounting principles, net of tax	-	-	(0.10)

Net income	\$2.82	\$3.12	\$3.28
Dividends declared per common share			

See Notes to Progress Energy, Inc. Consolidated Financial Statements.

PROGRESS ENERGY, INC.
CONSOLIDATED BALANCE SHEETS

(in millions)

December 31

2004

ASSETS

Utility plant

Utility plant in service	\$ 22,940	\$ 22,103
Accumulated depreciation	(9,602)	(8,783)
Utility plant in service, net	13,338	13,320
Held for future use	12	13
Construction work in progress	813	799
Nuclear fuel, net of amortization	279	231
Total utility plant, net	14,442	14,363

Current assets

Cash and cash equivalents	606	56
Short-term investments	191	82
Receivables, net	1,103	896
Inventory	866	822
Deferred fuel cost	602	229
Deferred income taxes	50	112
Assets of discontinued operations	109	685
Prepayments and other current assets	211	150
Total current assets	3,738	3,032

Deferred debits and other assets

Regulatory assets	854	1,064
Nuclear decommissioning trust funds	1,133	1,044
Diversified business property, net	1,880	1,773
Miscellaneous other property and investments	477	444
Goodwill	3,719	3,719
Prepaid pension costs	-	42
Intangibles, net	302	336
Other assets and deferred debits	478	227
Total deferred debits and other assets	8,843	8,649
Total assets	\$ 27,023	\$ 26,044

CAPITALIZATION AND LIABILITIES

Common stock equity

Common stock without par value, 500 million shares authorized, 252 and 247 million shares issued and outstanding, respectively	\$ 5,571	\$ 5,360
Unearned restricted shares (1 million shares) (Note 10B)	-	(13)
Unearned ESOP shares (3 and 3 million shares, respectively)	(63)	(76)
Accumulated other comprehensive loss	(104)	(164)
Retained earnings	2,634	2,526
Total common stock equity	8,038	7,633
Preferred stock of subsidiaries - not subject to mandatory redemption	93	93
Minority interest	43	36
Long-term debt, affiliate	270	270
Long-term debt, net	10,176	9,251
Total capitalization	18,620	17,283

Current liabilities

Current portion of long-term debt	513	349
Accounts payable	678	625
Interest accrued	208	219
Dividends declared	152	145
Short-term obligations	175	684

Customer deposits	200	180
Liabilities of discontinued operations	40	186
Other current liabilities	879	695
Total current liabilities	2,845	3,083
Deferred credits and other liabilities		
Noncurrent income tax liabilities	278	648
Accumulated deferred investment tax credits	163	176
Regulatory liabilities	2,527	2,654
Asset retirement obligations	1,249	1,265
Accrued pension and other benefits	870	633
Other liabilities and deferred credits	471	302
Total deferred credits and other liabilities	5,558	5,678
Commitments and contingencies (Notes 22 and 23)		
Total capitalization and liabilities	\$ 27,023	\$ 26,044

See Notes to Progress Energy, Inc. Consolidated Financial Statements.

PROGRESS ENERGY, INC.
CONSOLIDATED STATEMENTS of CASH FLOWS

(in millions)

Years ended December 31	2005	2004	2003
Operating activities			
Net income	\$ 697	\$ 759	\$ 782
Adjustments to reconcile net income to net cash provided by operating activities			
Loss (income) from discontinued operations	31	(30)	5
Gain on sale of operating assets	(71)	(76)	(7)
Impairment of long-lived assets and investments	1	-	21
Cumulative effect of changes in accounting principles, net	(1)	-	24
Charges for voluntary enhanced retirement program	159	-	-
Depreciation and amortization	1,195	1,153	1,110
Deferred income taxes	(351)	(65)	(304)
Investment tax credit	(13)	(14)	(16)
Deferred fuel credit	(317)	(19)	(133)
Other adjustments to net income	160	125	89
Cash provided (used) by changes in operating assets and liabilities			
Receivables	(187)	(4)	(136)
Inventories	(143)	(90)	(26)
Prepayments and other current assets	(20)	2	37
Accounts payable	145	(21)	11
Other current liabilities	213	80	119
Regulatory assets and liabilities	(74)	(234)	26
Other operating activities	50	(1)	(14)
Net cash provided by operating activities	1,474	1,565	1,588
Investing activities			
Gross utility property additions	(1,080)	(998)	(972)
Diversified business property additions	(206)	(169)	(448)
Nuclear fuel additions	(126)	(101)	(117)
Proceeds from sales of discontinued operations and other assets, net of cash divested	475	373	579
Purchases of available-for-sale securities and other investments	(3,985)	(3,134)	(3,792)
Proceeds from sales of available-for-sale securities and other investments	3,845	3,248	3,529
Acquisition of intangibles	(3)	(1)	(200)
Other investing activities	(37)	(29)	5
Net cash used in investing activities	(1,117)	(811)	(1,416)
Financing activities			
Issuance of common stock	208	73	304
Proceeds from issuance of long-term debt, net	1,642	421	1,539
Net (decrease) increase in short-term indebtedness	(509)	680	(696)
Retirement of long-term debt	(564)	(1,353)	(810)
Dividends paid on common stock	(582)	(558)	(541)
Other financing activities	32	6	16
Net cash provided (used) by financing activities	227	(731)	(188)
Cash (used) provided by discontinued operations			
Operating activities	(13)	44	123
Investing activities	(21)	(46)	(126)
Financing activities	-	-	-
Net increase (decrease) in cash and cash equivalents	550	21	(19)
Cash and cash equivalents at beginning of year	56	35	54
Cash and cash equivalents at end of year	\$ 606	\$ 56	\$ 35
Supplemental disclosures of cash flow information			

Cash paid during the year - interest (net of amount capitalized)	\$ 644	\$ 657	\$ 643
income taxes (net of refunds)	\$ 168	\$ 189	\$ 177

See Notes to Progress Energy, Inc. Consolidated Financial Statements.

PROGRESS ENERGY, INC.

CONSOLIDATED STATEMENTS of CHANGES in COMMON STOCK EQUITY

(in millions except per share data)	Common Stock Outstanding Shares Amount	Unearned Restricted Shares	Unearned ESOP Shares	Accumulated Other Comprehensive (Loss) Income	Retained Earnings	Total Common Stock Equity	
Balance, December 31, 2002	238	\$ 4,951	\$ (21)	\$ (102)	\$ (238)	\$ 2,087	\$ 6,677
Net income	-	-	-	-	782	782	
Other comprehensive income	-	-	-	188	-	188	
Comprehensive income						970	
Issuance of shares	8	305	-	-	-	305	
Stock options exercised		4	-	-	-	4	
Purchase of restricted stock		(1)	(7)	-	-	(8)	
Restricted stock expense recognition	-	-	10	-	-	10	
Cancellation of restricted shares		(1)	1	-	-	--	
Allocation of ESOP shares		12	-	13	-	25	
Dividends (\$2.26 per share)		-	-	-	(539)	(539)	
Balance, December 31, 2003	246	5,270	(17)	(89)	(50)	2,330	7,444
Net income	-	-	-	-	759	759	
Other comprehensive loss	-	-	-	(114)	-	(114)	
Comprehensive income						645	
Issuance of shares	1	62	-	-	-	62	
Stock options exercised		18	-	-	-	18	
Purchase of restricted stock		-	(7)	-	-	(7)	
Restricted stock expense recognition		-	7	-	-	7	
Cancellation of restricted shares		(4)	4	-	-	-	
Allocation of ESOP shares		14	-	13	-	27	
Dividends (\$2.32 per share)		-	-	-	(563)	(563)	
Balance, December 31, 2004	247	5,360	(13)	(76)	(164)	2,526	7,633
Net income	-	-	-	-	697	697	
Other comprehensive income	-	-	-	60	-	60	
Comprehensive income						757	
Issuance of shares	5	199	-	-	-	199	
Presentation reclassification - SFAS 123R adoption		(13)	13	-	-	-	
Stock options exercised		8	-	-	-	8	
Purchase of restricted stock		(8)	-	-	-	(8)	
Restricted stock expense recognition		3	-	-	-	3	
Allocation of ESOP shares		12	-	13	-	25	
Stock-based compensation expense		10	-	-	-	10	
Dividends (\$2.38 per share)		-	-	-	(589)	(589)	
Balance, December 31, 2005	252	\$ 5,571	\$ -	\$ (63)	\$ (104)	\$ 2,634	\$ 8,038

PROGRESS ENERGY, INC.

CONSOLIDATED STATEMENTS of COMPREHENSIVE INCOME

(in millions)

Years ended December 31	2005	2004	2003
Net income	\$ 697	\$ 759	\$ 782
Other comprehensive income (loss)			
Reclassification adjustment for amounts included in net income:			
Change in cash flow hedges (net of tax expense of \$26, \$16 and \$11, respectively)	46	26	19
Foreign currency translation adjustments included in discontinued operations	(6)	-	-

Minimum pension liability adjustment included in discontinued operations (net of tax expense of \$1)	1	-	-
Changes in net unrealized losses on cash flow hedges (net of tax (expense) benefit of (\$26), \$10 and \$7, respectively)	37	(18)	(12)
Reclassification of minimum pension liability to regulatory assets (net of tax expense of \$2)	-	4	-
Minimum pension liability adjustment (net of tax benefit (expense) of \$22, \$78 and (\$112), respectively)	(19)	(130)	177
Foreign currency translation and other (net of tax expense of \$1, \$- and \$-, respectively)	1	4	4
Other comprehensive income (loss)	60	(114)	188
Comprehensive income	\$ 757	\$ 645	\$ 970

ee Notes to Progress Energy, Inc. Consolidated Financial Statements.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF CAROLINA POWER & LIGHT COMPANY d/b/a PROGRESS ENERGY CAROLINAS, INC.:

We have audited the accompanying consolidated balance sheets of Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc., and its subsidiaries (PEC) at December 31, 2005 and 2004, and the related consolidated statements of income, changes in common stock equity, comprehensive income, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of PEC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the 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. PEC is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. An audit includes 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 PEC'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 PEC at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 and Note 18 to the consolidated financial statements, in 2005 PEC adopted Statement of Financial Accounting Standards No. 123R and Financial Accounting Standards Board Interpretation No. 47 and in 2003 PEC adopted Statement of Financial Accounting Standards No. 143 and Derivatives Implementation Group Issue C20.

/s/ Deloitte & Touche LLP

Raleigh, North Carolina
March 6, 2006

CAROLINA POWER & LIGHT COMPANY d/b/a PROGRESS ENERGY CAROLINAS, INC.
CONSOLIDATED STATEMENTS of INCOME

(in millions)			
Years ended December 31	2005	2004	2003
Operating revenues			
Electric	\$ 3,990	\$ 3,628	\$ 3,589
Diversified businesses	1	1	11
Total operating revenues	3,991	3,629	3,600
Operating expenses			
Fuel used in electric generation	1,036	836	825
Purchased power	354	301	296
Operation and maintenance	941	871	782
Depreciation and amortization	561	570	562
Taxes other than on income	178	173	162
Other	(11)	(12)	(8)
Diversified businesses	1	1	4
Total operating expenses	3,060	2,740	2,623
Operating income	931	889	977
Other income (expense)			
Interest income	8	4	6
Impairment of investments	(1)	-	(21)
Other, net	(14)	(1)	(19)
Total other (expense) income	(7)	3	(34)
Interest charges			
Interest charges	197	195	198
Allowance for borrowed funds used during construction	(5)	(3)	(1)
Total interest charges, net	192	192	197
Income before income taxes and cumulative effect of changes in accounting principles	732	700	746
Income tax expense	239	239	241
Income before cumulative effect of changes in accounting principles	493	461	505
Cumulative effect of changes in accounting principles, net of tax	-	-	(23)
Net income	493	461	482
Preferred stock dividend requirement	3	3	3
Earnings for common stock	\$ 490	\$ 458	\$ 479

See Notes to PEC Consolidated Financial Statements.

CAROLINA POWER & LIGHT COMPANY d/b/a PROGRESS ENERGY CAROLINAS, INC.
CONSOLIDATED BALANCE SHEETS

(in millions)

December 31	2005	2004
ASSETS		
Utility plant		
Utility plant in service	\$ 13,994	\$ 13,521
Accumulated depreciation	(6,120)	(5,806)
Utility plant in service, net	7,874	7,715
Held for future use	3	5
Construction work in progress	399	379
Nuclear fuel, net of amortization	203	186
Total utility plant, net	8,479	8,285
Current assets		
Cash and cash equivalents	125	18
Short-term investments	191	82
Receivables, net	518	397
Receivables from affiliated companies	24	20
Inventory	451	401
Deferred fuel cost	261	140
Income taxes receivable	-	59
Prepayments and other current assets	20	65
Total current assets	1,590	1,182
Deferred debits and other assets		
Regulatory assets	421	473
Nuclear decommissioning trust funds	640	581
Miscellaneous other property and investments	188	158
Other assets and deferred debits	184	108
Total deferred debits and other assets	1,433	1,320
Total assets	\$ 11,502	\$ 10,787
CAPITALIZATION AND LIABILITIES		
Common stock equity		
Common stock without par value, authorized 200 million shares, 160 million shares issued and outstanding at December 31	\$ 1,981	\$ 1,975
Unearned ESOP common stock	(63)	(76)
Accumulated other comprehensive loss	(120)	(114)
Retained earnings	1,320	1,287
Total common stock equity	3,118	3,072
Preferred stock - not subject to mandatory redemption	59	59
Long-term debt, net	3,667	2,750
Total capitalization	6,844	5,881
Current liabilities		
Current portion of long-term debt	-	300
Accounts payable	247	254
Payables to affiliated companies	73	83
Notes payable to affiliated companies	11	116
Interest accrued	73	77
Short-term obligations	73	221
Customer deposits	52	45
Taxes accrued	100	-
Current portion of unearned revenue	70	-
Other current liabilities	185	179
Total current liabilities	884	1,275
Deferred credits and other liabilities		
Noncurrent income tax liabilities	814	991
Accumulated deferred investment tax credits	133	140
Regulatory liabilities	1,196	1,052
Asset retirement obligations	949	924
Accrued pension and other benefits	511	428

Other liabilities and deferred credits	1 / 1	90
Total deferred credits and other liabilities	3,774	3,631
Commitments and contingencies (Notes 22 and 23)		
Total capitalization and liabilities	\$ 11,502	\$ 10,787

See Notes to PEC Consolidated Financial Statements.

CAROLINA POWER & LIGHT COMPANY d/b/a PROGRESS ENERGY CAROLINAS, INC.
CONSOLIDATED STATEMENTS of CASH FLOWS

(in millions)			
Years Ended December 31	2005	2004	2003
Operating activities			
Net income	\$ 493	\$ 461	\$ 482
Adjustments to reconcile net income to net cash provided by operating activities			
Impairment of long-lived assets and investments	1	-	21
Charges for voluntary enhanced retirement program	42	-	-
Depreciation and amortization	644	658	654
Cumulative effect of changes in accounting principles, net	-	-	23
Deferred income taxes	(142)	(19)	(69)
Investment tax credit	(8)	(7)	(10)
Deferred fuel (credit) cost	(144)	(56)	33
Other adjustments to net income	68	50	44
Cash provided (used) by changes in operating assets and liabilities			
Receivables	(111)	(4)	10
Receivables from affiliated companies	11	15	28
Inventories	(91)	(22)	(17)
Prepayments and other current assets	9	17	17
Accounts payable	9	34	(56)
Payables to affiliated companies	(13)	(53)	24
Other current liabilities	239	11	58
Regulatory assets and liabilities	2	9	27
Other operating activities	23	(18)	(36)
Net cash provided by operating activities	1,032	1,076	1,233
Investing activities			
Gross utility property additions	(603)	(519)	(445)
Proceeds from sale of assets	14	25	28
Nuclear fuel additions	(79)	(101)	(66)
Purchases of available-for-sale securities and other investments	(1,832)	(2,479)	(3,257)
Proceeds from sales of available-for-sale securities and other investments	1,692	2,592	3,000
Changes in advances to affiliates	-	-	50
Other investing activities	(3)	(3)	(2)
Net cash used in investing activities	(811)	(485)	(692)
Financing activities			
Proceeds from issuance of long-term debt, net	898	-	588
Net (decrease) increase in short-term obligations	(148)	217	(437)
Changes in advances from affiliates	(105)	91	24
Retirement of long-term debt	(300)	(339)	(276)
Dividends paid to parent	(457)	(551)	(443)
Dividends paid on preferred stock	(3)	(3)	(3)
Other financing activities	1	-	-
Net cash used in financing activities	(114)	(585)	(547)
Net increase (decrease) in cash and cash equivalents	107	6	(6)
Cash and cash equivalents at beginning of year	18	12	18
Cash and cash equivalents at end of year	\$ 125	\$ 18	\$ 12
Supplemental disclosures of cash flow information			
Cash paid during the year - interest (net of amount capitalized)	\$ 185	\$ 185	\$ 180
income taxes (net of refunds)	\$ 222	\$ 286	\$ 296

See Notes to PEC Consolidated Financial Statements.

CAROLINA POWER & LIGHT COMPANY d/b/a PROGRESS ENERGY CAROLINAS, INC.
CONSOLIDATED STATEMENTS of CHANGES in COMMON STOCK EQUITY

	Common Stock		Accumulated Other		Retained Earnings	Total Common Stock Equity
(in millions except shares outstanding)	Outstanding Shares	Unearned ESOP Shares	Comprehensive (Loss) Income			
	Amount					
Balance, December 31, 2002	160	\$ 1,930	\$ (102)	\$ (83)	\$ 1,344	\$ 3,089
Net income	-	-	-	-	482	482
Other comprehensive income	-	-	-	76	-	76
Comprehensive income	-	-	-	-	-	558
Equity contribution from parent	-	3	-	-	-	3
Allocation of ESOP shares	-	20	13	-	-	33
Preferred stock dividends at stated rates	-	-	-	-	(3)	(3)
Dividends paid to parent	-	-	-	-	(443)	(443)
Balance, December 31, 2003	160	1,953	(89)	(7)	1,380	3,237
Net income	-	-	-	-	461	461
Other comprehensive loss	-	-	-	(107)	-	(107)
Comprehensive income	-	-	-	-	-	354
Allocation of ESOP shares	-	22	13	-	-	35
Preferred stock dividends at stated rates	-	-	-	-	(3)	(3)
Dividends paid to parent	-	-	-	-	(551)	(551)
Balance, December 31, 2004	160	1,975	(76)	(114)	1,287	3,072
Net income	-	-	-	-	493	493
Other comprehensive loss	-	-	-	(6)	-	(6)
Comprehensive income	-	-	-	-	-	487
Stock-based compensation expense	-	3	-	-	-	3
Allocation of ESOP shares	-	20	13	-	-	33
Noncash dividend to parent	-	(17)	-	-	-	(17)
Preferred stock dividends at stated rates	-	-	-	-	(3)	(3)
Dividends paid to parent	-	-	-	-	(457)	(457)
Balance, December 31, 2005	160	\$ 1,981	\$ (63)	(120)	\$ 1,320	\$ 3,118

CAROLINA POWER & LIGHT COMPANY d/b/a PROGRESS ENERGY CAROLINAS, INC.
CONSOLIDATED STATEMENTS of COMPREHENSIVE INCOME

(in millions)			
Years ended December 31	2005	2004	2003
Net income	\$ 493	\$ 461	\$ 482
Other comprehensive income (loss)			
Changes in net unrealized losses on cash flow hedges (net of tax (expense) benefit of (\$2), \$1 and (\$1), respectively)	3	(1)	3
Reclassification adjustment for amounts included in net income (net of tax expense of \$-)	1	-	1
Minimum pension liability adjustment (net of tax benefit (expense) of \$7, \$68 and (\$47), respectively)	(12)	(106)	72
Other (net of tax expense of \$1)	2	-	-
Other comprehensive (loss) income	(6)	(107)	76
Comprehensive income	\$ 487	\$ 354	\$ 558

See Notes to PEC Consolidated Financial Statements.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDER OF FLORIDA POWER CORPORATION d/b/a PROGRESS ENERGY FLORIDA, INC.:

We have audited the accompanying balance sheets of Florida Power Corporation d/b/a Progress Energy Florida, Inc. (PEF) at December 31, 2005 and 2004, and the related statements of income, changes in common stock equity, comprehensive income, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of PEF's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the 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. PEF is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. An audit includes 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 PEF'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 financial statements present fairly, in all material respects, the financial position of PEF at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, in 2005 PEF adopted Statement of Financial Accounting Standards No. 123R and Financial Accounting Standards Board Interpretation No. 47 and in 2003 PEF adopted Statement of Financial Accounting Standards No. 143.

/s/ Deloitte & Touche LLP

Raleigh, North Carolina
March 6, 2006

FLORIDA POWER CORPORATION d/b/a PROGRESS ENERGY FLORIDA
STATEMENTS of INCOME

(in millions)

Years ended December 31	2005	2004	2003
Operating revenues	\$3,955	\$ 3,525	\$ 3,152
Operating expenses			
Fuel used in electric generation	1,323	1,175	870
Purchased power	694	567	566
Operation and maintenance	852	630	640
Depreciation and amortization	334	281	307
Taxes other than on income	279	254	241
Other	(26)	(2)	-
Total operating expenses	3,456	2,905	2,624
Operating income	499	620	528
Other income			
Interest income	1	-	-
Other, net	7	3	7
Total other income	8	3	7
Interest charges			
Interest charges	134	117	97
Allowance for borrowed funds used during construction	(8)	(3)	(6)
Total interest charges, net	126	114	91
Income before income taxes	381	509	444
Income tax expense	121	174	147
Net income	260	335	297
Preferred stock dividend requirement	2	2	2
Earnings for common stock	\$ 258	\$ 333	\$ 295

See Notes to PEF Financial Statements.

BALANCE SHEETS

(in millions)

December 31	2005	2004
ASSETS		
Utility plant		
Utility plant in service	\$ 8,756	\$ 8,387
Accumulated depreciation	(3,434)	(2,978)
Utility plant in service, net	5,322	5,409
Held for future use	9	8
Construction work in progress	414	420
Nuclear fuel, net of amortization	76	45
Total utility plant, net	5,821	5,882
Current assets		
Cash and cash equivalents	218	12
Receivables, net	331	266
Receivables from affiliated companies	11	16
Deferred income taxes	12	42
Inventory	311	290
Deferred fuel cost	341	89
Derivative assets	77	-
Prepayments and other current assets	23	1
Total current assets	1,324	716
Deferred debits and other assets		
Regulatory assets	351	524
Debt issuance costs	22	21
Nuclear decommissioning trust funds	493	463
Miscellaneous other property and investments	47	46
Prepaid pension cost	200	234
Other assets and deferred debits	60	38
Total deferred debits and other assets	1,173	1,326
Total assets	\$ 8,318	\$ 7,924
CAPITALIZATION AND LIABILITIES		
Common stock equity		
Common stock without par value, 60 million shares authorized, 100 shares issued and outstanding	\$ 1,097	\$ 1,081
Retained earnings	1,498	1,240
Total common stock equity	2,595	2,321
Preferred stock - not subject to mandatory redemption	34	34
Long-term debt, net	2,554	1,912
Total capitalization	5,183	4,267
Current liabilities		
Current portion of long-term debt	48	48
Accounts payable	237	262
Payables to affiliated companies	101	80
Notes payable to affiliated companies	13	178
Short-term obligations	102	293
Customer deposits	148	135
Interest accrued	42	46
Other current liabilities	101	115
Total current liabilities	792	1,157
Deferred credits and other liabilities		
Noncurrent income tax liabilities	433	489
Accumulated deferred investment tax credits	30	35
Regulatory liabilities	1,189	1,362
Asset retirement obligations	290	337
Accrued pension and other benefits	257	201
Other liabilities and deferred credits	144	76
Total deferred credits and other liabilities	2,343	2,500
Commitments and contingencies (Notes 22 and 23)		

Total capitalization and liabilities

\$ 8,318

\$ 7,924

See Notes to PEF Financial Statements.

FLORIDA POWER CORPORATION d/b/a PROGRESS ENERGY FLORIDA
STATEMENTS of CASH FLOWS

(in millions)

Years ended December 31	2005	2004	2003
Operating activities			
Net income	\$ 260	\$ 335	\$ 297
Adjustments to reconcile net income to net cash provided by operating activities			
Gain on sale of operating assets	(26)	(1)	-
Charges for voluntary enhanced retirement program	92	-	-
Depreciation and amortization	367	310	314
Deferred income taxes and investment tax credits, net	(50)	110	(25)
Deferred fuel (credit) cost	(173)	37	(167)
Other adjustments to net income	45	(13)	(4)
Cash provided (used) by changes in operating assets and liabilities			
Receivables	(70)	(20)	(7)
Receivables from affiliated companies	4	(8)	36
Inventories	(34)	(36)	(32)
Prepayments and other current assets	(22)	2	-
Accounts payable	52	13	12
Payables to affiliated companies	21	14	(7)
Other current liabilities	(7)	11	35
Regulatory assets and liabilities	(76)	(243)	(1)
Other operating activities	47	22	(3)
Net cash provided by operating activities	430	533	448
Investing activities			
Gross utility property additions	(496)	(492)	(526)
Nuclear fuel additions	(47)	-	(51)
Proceeds from sale of assets	43	-	1
Purchases of available-for-sale securities and other investments	(405)	(569)	(441)
Proceeds from sale of available-for-sale securities and other investments	405	569	441
Other investing activities	(6)	(4)	(2)
Net cash used in investing activities	(506)	(496)	(578)
Financing activities			
Proceeds from issuance of long-term debt, net	744	56	935
Net (decrease) increase in short-term obligations	(191)	293	(258)
Retirement of long-term debt	(102)	(43)	(476)
Changes in advances from affiliates	(165)	(185)	126
Dividends paid to parent	-	(155)	(203)
Dividends paid on preferred stock	(2)	(2)	(2)
Other financing activities	(2)	1	2
Net cash provided (used) by financing activities	282	(35)	124
Net increase (decrease) in cash and cash equivalents	206	2	(6)
Cash and cash equivalents at beginning of year	12	10	16
Cash and cash equivalents at end of year	\$ 218	\$ 12	\$ 10
Supplemental disclosures of cash flow information			
Cash paid during the year - interest (net of amount capitalized)	\$ 131	\$ 118	\$ 104
income taxes (net of refunds)	\$ 185	\$ 57	\$ 177

See Notes to PEF Financial Statements.

FLORIDA POWER CORPORATION d/b/a PROGRESS ENERGY FLORIDA
STATEMENTS of CHANGES in COMMON STOCK EQUITY

(in millions except shares outstanding)	Common Stock Outstanding Shares	Amount	Accumulated Other Comprehensive (Loss) Income	Retained Earnings	Total Common Stock Equity
Balance, December 31, 2002	100	\$ 1,081	\$ (3)	\$ 970	\$ 2,048
Net income		-	-	297	297
Other comprehensive loss		-	(1)	-	(1)
Comprehensive income					296
Preferred stock dividends at stated rates		-	-	(2)	(2)
Dividends paid to parent		-	-	(203)	(203)
Balance, December 31, 2003	100	1,081	(4)	\$ 1,062	2,139
Net income		-	-	335	335
Other comprehensive income		-	4	-	4
Comprehensive income					339
Preferred stock dividends at stated rates		-	-	(2)	(2)
Dividends paid to parent		-	-	(155)	(155)
Balance, December 31, 2004	100	1,081	-	1,240	2,321
Net income		-	-	260	260
Comprehensive income					260
Stock-based compensation expense		1	-	-	1
Noncash contribution from parent		15	-	-	15
Preferred stock dividends at stated rates		-	-	(2)	(2)
Balance, December 31, 2005	100	\$ 1,097	\$ -	\$ 1,498	\$ 2,595

FLORIDA POWER CORPORATION d/b/a PROGRESS ENERGY FLORIDA
STATEMENTS of COMPREHENSIVE INCOME

(in millions)	2005	2004	2003
Years ended December 31			
Net income	\$ 260	\$ 335	\$ 297
Other comprehensive income (loss)			
Reclassification of minimum pension liability to regulatory assets (net of tax expense of \$2)	-	4	-
Minimum pension liability adjustment (net of tax benefit of \$1)	-	-	(1)
Other comprehensive income (loss)	-	4	(1)
Comprehensive income	\$ 260	\$ 339	\$ 296

See Notes to PEF Financial Statements.

PROGRESS ENERGY, INC.
CAROLINA POWER & LIGHT COMPANY d/b/a/ PROGRESS ENERGY CAROLINAS, INC.
FLORIDA POWER CORPORATION d/b/a/ PROGRESS ENERGY FLORIDA, INC.
COMBINED NOTES TO FINANCIAL STATEMENTS

In this report, Progress Energy [which includes Progress Energy, Inc. holding company (the Parent) and its regulated and nonregulated subsidiaries on a consolidated basis] is at times referred to as “we,” “us” or “our.” When discussing Progress Energy’s financial information, it necessarily includes the results of PEC and PEF (collectively, the Utilities). The term “Progress Registrants” refers to each of the three separate registrants: Progress Energy, PEC and PEF. The information in these combined notes relates to each of the Progress Registrants as noted in the Index to the Combined Notes. However, neither of the Utilities makes any representation as to information related solely to Progress Energy or the subsidiaries of Progress Energy other than itself.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization

Progress Energy, Inc.

The Parent is a holding company headquartered in Raleigh, N.C. Prior to February 8, 2006, the Parent was registered under the Public Utility Holding Company Act of 1935 (PUHCA), as amended. As such, we were subject to the regulatory provisions of PUHCA. Subsequent to February 8, 2006, the Parent is subject to additional regulation by the Federal Energy Regulatory Commission (FERC) as a result of legislation passed in 2005.

Our reportable segments are: PEC, PEF, Progress Ventures, and Coal and Synthetic Fuels. Our PEC and PEF segments are engaged in the generation, transmission, distribution and sale of electricity in portions of North Carolina, South Carolina and Florida. Our Progress Ventures segment is involved in nonregulated electric generation and energy marketing activities and natural gas drilling and production. Our Coal and Synthetic Fuels segment is involved in the production and sale of coal-based solid synthetic fuel as defined under the Internal Revenue Code (the Code), coal terminal services, and fuel transportation and delivery. Through our other business units, we engage in other nonregulated business areas, including telecommunications, which are included in our Corporate and Other segment (Corporate and Other).

Our Rail Services operations were reclassified to discontinued operations in the first quarter of 2005 (See Note 3B). During the fourth quarter of 2005, our coal mining operations were reclassified to discontinued operations (See Note 3A). Our Rail Services and coal mining operations are not included in the results from continuing operations during the periods reported.

During 2005, we realigned our segments based on the manner in which management currently reviews these operations. Prior year periods have been restated for our segment realignments. See Note 20 for further information about our segments.

PEC

PEC is a public service corporation primarily engaged in the generation, transmission, distribution and sale of electricity in portions of North Carolina and South Carolina. PEC’s subsidiaries are involved in insignificant nonregulated business activities. PEC is subject to the regulatory provisions of the North Carolina Utilities Commission (NCUC), the Public Service Commission of South Carolina (SCPSC), the United States Nuclear Regulatory Commission (NRC), the FERC as well as the provisions of PUHCA prior to February 8, 2006 due to PEC being a wholly owned subsidiary of Progress Energy.

PEF

PEF is a public service corporation primarily engaged in the generation, transmission, distribution and sale of electricity in west central Florida. PEF is subject to the regulatory provisions of the Florida Public Service

Commission (FPSC), the NRC, the FERC as well as the provisions of PUHCA prior to February 8, 2006 due to PEF being a wholly owned subsidiary of Progress Energy.

B. Basis of Presentation

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and include the activities of the Parent and our majority-owned and controlled subsidiaries. The Utilities are subsidiaries of Progress Energy and as such their financial condition and results of operations and cash flows are also consolidated, along with our nonregulated subsidiaries, in our consolidated financial statements. Noncontrolling interests in subsidiaries along with the income or loss attributed to these interests are included in minority interest in both the Consolidated Balance Sheets and in the Consolidated Statements of Income. The results of operations for minority interest are reported on a net of tax basis if the underlying subsidiary is structured as a taxable entity.

Unconsolidated investments in companies over which we do not have control, but have the ability to exercise influence over operating and financial policies (generally 20 to 50 percent ownership), are accounted for under the equity method of accounting. These investments are primarily in limited liability corporations and limited liability partnerships, and the earnings from these investments are recorded on a pre-tax basis (See Note 21). Other investments are stated principally at cost. These equity and cost method investments are included in miscellaneous other property and investments in the Consolidated Balance Sheets. See Note 13 for more information about our investments.

Diversified business revenues and expenses represent the operating activities of our consolidated nonregulated operations, which are primarily comprised of the Progress Ventures and Coal and Synthetic Fuels segments. These operations are separate and distinct businesses from the Utilities.

Significant intercompany balances and transactions have been eliminated in consolidation except as permitted by Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71), which provides that profits on intercompany sales to regulated affiliates are not eliminated if the sales price is reasonable and the future recovery of the sales price through the ratemaking process is probable.

These combined notes accompany and form an integral part of Progress Energy's and PEC's consolidated financial statements and PEF's financial statements.

Certain amounts for 2004 and 2003 have been reclassified to conform to the 2005 presentation.

C. Consolidation of Variable Interest Entities

We consolidate all voting interest entities in which we own a majority voting interest and all variable interest entities for which we are the primary beneficiary in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 46R, "Consolidation of Variable Interest Entities - An Interpretation of ARB No. 51" (FIN No. 46R).

Progress Energy

In addition to the variable interests listed below for PEC and PEF, we have interests through other subsidiaries in variable interest entities for which we are not the primary beneficiary. These arrangements include investments in five limited liability partnerships and limited liability corporations. At December 31, 2005, the aggregate additional maximum loss exposure that we could be required to record in our income statement as a result of these arrangements was approximately \$8 million, which represents our net remaining investment in these entities. The creditors of these variable interest entities do not have recourse to our general credit in excess of the aggregate maximum loss exposure.

PEC

PEC is the primary beneficiary of and consolidates two limited partnerships that qualify for federal affordable housing and historic tax credits under Section 42 of the Code. At December 31, 2005, the total assets of the two entities were \$38 million, the majority of which are collateral for the entities' obligations and are included in miscellaneous other property and investments in the Consolidated Balance Sheets.

PEC has an interest in and consolidates a limited partnership that invests in 17 low-income housing partnerships that qualify for federal and state tax credits. PEC has requested the necessary information to determine if the 17 partnerships are variable interest entities or to identify the primary beneficiaries; all entities from which the necessary financial information was requested declined to provide the information to PEC and PEC has applied the information scope exception in FIN No. 46R, paragraph 4(g), to the 17 partnerships. PEC has no direct exposure to loss from the 17 partnerships; PEC's only exposure to loss is from its investment of less than \$1 million in the consolidated limited partnership. PEC will continue its efforts to obtain the necessary information to fully apply FIN No. 46R to the 17 partnerships. PEC believes that if the limited partnership is determined to be the primary beneficiary of the 17 partnerships, the effect of consolidating the 17 partnerships would not be significant to PEC's Consolidated Balance Sheets.

PEC also has an interest in one power plant resulting from long-term power purchase contracts. Our only significant exposure to variability from these contracts results from fluctuations in the market price of fuel used by the entity's plants to produce the power purchased by PEC. We are able to recover these fuel costs under PEC's fuel clause. Total purchases from this counterparty were approximately \$44 million, \$42 million and \$37 million in 2005, 2004 and 2003, respectively. The generation capacity of the entity's power plant is approximately 835 MW. PEC has requested the necessary information to determine if the power plant owner is a variable interest entity or to identify the primary beneficiary. The entity declined to provide us with the necessary financial information and PEC has applied the information scope exception in FIN No. 46R, paragraph 4(g), to the power plant. PEC believes that if it is determined to be the primary beneficiary of the entity, the effect of consolidating the entity would result in increases to total assets, long-term debt and other liabilities, but would have an insignificant or no impact on PEC's common stock equity, net earnings or cash flows. However, because PEC has not received any financial information from the counterparty, the impact cannot be determined at this time.

PEC also has interests in several other variable interest entities for which PEC is not the primary beneficiary. These arrangements include investments in approximately 22 limited liability partnerships, limited liability corporations and venture capital funds and two building leases with special-purpose entities. At December 31, 2005, the aggregate maximum loss exposure that PEC could be required to record in its income statement as a result of these arrangements totals approximately \$23 million, which primarily represents our net remaining investment in these entities. The creditors of these variable interest entities do not have recourse to the general credit of PEC in excess of the aggregate maximum loss exposure.

PEF

PEF has interests in three variable interest entities for which PEF is not the primary beneficiary. These arrangements include investments in one limited liability corporation, one venture capital fund and one building lease with a special-purpose entity. At December 31, 2005, the aggregate maximum loss exposure that PEF could be required to record in its income statement as a result of these arrangements was approximately \$1 million. The creditors of these variable interest entities do not have recourse to the general credit of PEF in excess of the aggregate maximum loss exposure.

D. Significant Accounting Policies

USE OF ESTIMATES AND ASSUMPTIONS

In preparing consolidated financial statements that conform to GAAP, management must make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at

the date of the consolidated financial statements, and amounts of revenues and expenses reflected during the reporting period. Actual results could differ from those estimates.

REVENUE RECOGNITION

We recognize revenue when it is realized or realizable and earned when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; our price to the buyer is fixed or determinable; and collectability is reasonably assured. We recognize electric utility revenues as service is rendered to customers. Operating revenues include unbilled electric utility revenues earned when service has been delivered but not billed by the end of the accounting period. Diversified business revenues are generally recognized at the time products are shipped or as services are rendered. Leasing activities are accounted for in accordance with SFAS No. 13, "Accounting for Leases." Revenues related to design and construction of wireless infrastructure are recognized upon completion of services for each completed phase of design and construction. Revenues from the sale of oil and gas production are recognized when title passes, net of royalties. Customer prepayments are recorded as deferred revenue and recognized as revenues as the services are provided.

FUEL COST DEFERRALS

Fuel expense includes fuel costs or recoveries that are deferred through fuel clauses established by the Utilities' regulators. These clauses allow the Utilities to recover fuel costs and portions of purchased power costs through surcharges on customer rates. These deferred fuel costs are recognized in revenues and fuel expenses as they are billable to customers.

EXCISE TAXES

The Utilities collect from customers certain excise taxes levied by the state or local government upon the customers. The Utilities account for excise taxes on a gross basis. The amount of gross receipts tax, franchise taxes and other excise taxes included in electric operating revenues and taxes other than on income in the statements of income for the years ended December 31 were as follows:

(in millions)	2005	2004	2003
Progress Energy	\$ 258	\$ 240	\$ 217
PEC	91	89	81
PEF	167	151	136

STOCK-BASED COMPENSATION

Prior to July 2005, we accounted for stock-based compensation under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25), and related interpretations in accounting for our stock-based compensation costs. In addition, we followed the disclosure requirements contained in SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123), as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" (SFAS No. 148). Effective July 1, 2005, we adopted the fair value recognition provisions of SFAS No. 123R, "Accounting for Stock-Based Compensation" (SFAS No. 123R), for stock-based compensation utilizing the modified prospective transition method (See Note 10B).

RELATED PARTY TRANSACTIONS

Our subsidiaries provide and receive services, at cost, to and from the Parent and its subsidiaries, in accordance with agreements approved by the SEC pursuant to Section 13(b) of the PUHCA. The costs of the services are billed on a direct-charge basis, whenever possible, and on allocation factors for general costs that cannot be directly attributed. In the subsidiaries' financial statements, billings from affiliates are capitalized or expensed depending on the nature of the services rendered. The repeal of PUHCA effective February 8, 2006, and subsequent regulation by the FERC is not anticipated to change our current intercompany services.

UTILITY PLANT

Utility plant in service is stated at historical cost less accumulated depreciation. We capitalize all construction-related direct labor and material costs of units of property as well as indirect construction costs. Certain costs that would otherwise not be capitalized under GAAP are capitalized in accordance with regulatory treatment. The cost of renewals and betterments is also capitalized. Maintenance and repairs of property (including planned major maintenance activities), and replacements and renewals of items determined to be less than units of property, are charged to maintenance expense as incurred, with the exception of nuclear outages at PEF. Pursuant to a regulatory order, PEF accrues for nuclear outage costs in advance of scheduled outages, which occur every two years. The cost of units of property replaced or retired, less salvage, is charged to accumulated depreciation. Removal or disposal costs that do not represent asset retirement obligations under SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS No. 143), are charged to a regulatory liability.

Allowance for funds used during construction (AFUDC) represents the estimated debt and equity costs of capital funds necessary to finance the construction of new regulated assets. As prescribed in the regulatory uniform system of accounts, AFUDC is charged to the cost of the plant. The equity funds portion of AFUDC is credited to other income and the borrowed funds portion is credited to interest charges.

ASSET RETIREMENT OBLIGATIONS

Effective January 1, 2003, we adopted the guidance in SFAS No. 143 to account for legal obligations associated with the retirement of certain tangible long-lived assets. The present values of retirement costs for which we have a legal obligation are recorded as liabilities with an equivalent amount added to the asset cost and depreciated over an appropriate period. The liability is then accreted over time by applying an interest method of allocation to the liability. As discussed in Note 2, effective December 31, 2005, we also adopted FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" (FIN No. 47), which clarified certain requirements of SFAS No. 143.

The adoption of SFAS No. 143 and FIN No. 47 had no impact on the income of the Utilities as the effects were offset by the establishment of regulatory assets and regulatory liabilities pursuant to SFAS No. 71 (See Note 7A) and in accordance with orders issued by the NCUC, the SCPSC and the FPSC.

DEPRECIATION AND AMORTIZATION - UTILITY PLANT

For financial reporting purposes, substantially all depreciation of utility plant other than nuclear fuel is computed on the straight-line method based on the estimated remaining useful life of the property, adjusted for estimated salvage (See Note 5A). Pursuant to their rate-setting authority, the NCUC, SCPSC and FPSC can also grant approval to accelerate or reduce depreciation and amortization of utility assets (See Note 7).

Amortization of nuclear fuel costs is computed primarily on the units-of-production method. In the Utilities' retail jurisdictions, provisions for nuclear decommissioning costs are approved by the NCUC, the SCPSC and the FPSC and are based on site-specific estimates that include the costs for removal of all radioactive and other structures at the site. In the wholesale jurisdictions, the provisions for nuclear decommissioning costs are approved by the FERC.

CASH AND CASH EQUIVALENTS

We consider cash and cash equivalents to include unrestricted cash on hand, cash in banks and temporary investments purchased with a maturity of three months or less.

INVENTORY

We account for inventory, including emission allowances, using the average cost method. Inventories are valued at the lower of average cost or market.

REGULATORY ASSETS AND LIABILITIES

The Utilities' operations are subject to SFAS No. 71, which allows a regulated company to record costs that have been or are expected to be allowed in the ratemaking process in a period different from the period in which the costs would be charged to expense by a nonregulated enterprise. Accordingly, the Utilities record assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for nonregulated entities. These regulatory assets and liabilities represent expenses deferred for future recovery from customers or obligations to be refunded to customers and are primarily classified in the Consolidated Balance Sheets as regulatory assets and regulatory liabilities (See Note 7A). The regulatory assets and liabilities are amortized consistent with the treatment of the related cost in the ratemaking process.

DIVERSIFIED BUSINESS PROPERTY

Diversified business property is stated at cost less accumulated depreciation. If an impairment is recognized on an asset, the fair value becomes its new cost basis. The costs of renewals and betterments are capitalized. The cost of repairs and maintenance is charged to expense as incurred. For properties other than oil and gas properties, depreciation is computed on a straight-line basis using the estimated useful lives disclosed in Note 5B. Depletion of mineral rights is provided on the units-of-production method based upon the estimates of recoverable amounts of clean mineral.

We use the full-cost method to account for our oil and gas properties. Under the full-cost method, substantially all productive and nonproductive costs incurred in connection with the acquisition, exploration and development of oil and gas reserves are capitalized. These capitalized costs include the costs of all unproved properties and internal costs directly related to acquisition and exploration activities. The amortization base also includes the estimated future cost to develop proved reserves. Except for costs of unproved properties and major development projects in progress, all costs are amortized using the units-of-production method on a country-by-country basis over the life of our proved reserves. Accordingly, all property acquisition, exploration, and development costs of proved oil and gas properties, including the costs of abandoned properties, dry holes, geophysical costs and annual lease rentals are capitalized as incurred, including internal costs directly attributable to such activities. Related interest expense incurred during property development activities is capitalized as a cost of such activity. Net capitalized costs of unproved property are reclassified as proved property and well costs when related proved reserves are found. Costs to operate and maintain wells and field equipment are expensed as incurred. In accordance with Rule 4-10 of Regulation S-X, sales or other dispositions of oil and gas properties are accounted for as adjustments to capitalized costs, with no gain or loss recorded unless certain significance tests are met.

GOODWILL AND INTANGIBLE ASSETS

Goodwill is subject to at least an annual assessment for impairment by applying a two-step, fair value-based test. This assessment could result in periodic impairment charges. Intangible assets are being amortized based on the economic benefit of their respective lives.

UNAMORTIZED DEBT PREMIUMS, DISCOUNTS AND EXPENSES

Long-term debt premiums, discounts and issuance expenses are amortized over the terms of the debt issues. Any expenses or call premiums associated with the reacquisition of debt obligations by the Utilities are amortized over the applicable lives using the straight-line method consistent with ratemaking treatment (See Note 7A).

INCOME TAXES

We and our affiliates file a consolidated federal income tax return. The consolidated income tax of Progress Energy is allocated to PEC and PEF in accordance with the Intercompany Income Tax Allocation Agreement (Tax Agreement). The Tax Agreement provides an allocation that recognizes positive and negative corporate taxable income. The Tax Agreement provides for an equitable method of apportioning the carryover of uncompensated tax benefits, which primarily relate to deferred synthetic fuel tax credits. Since 2002, Progress Energy tax benefits not related to acquisition interest expense have been allocated to profitable subsidiaries in accordance with a PUHCA

order. Except for the allocation of these Progress Energy tax benefits, income taxes are provided as if PEC and PEF filed separate returns. Due to the repeal of PUHCA, effective February 8, 2006, we will stop allocating these tax benefits.

Deferred income taxes have been provided for temporary differences. These occur when there are differences between the book and tax carrying amounts of assets and liabilities. Investment tax credits related to regulated operations have been deferred and are being amortized over the estimated service life of the related properties. Credits for the production and sale of synthetic fuel are deferred as alternative minimum tax credits to the extent they cannot be or have not been utilized in the annual consolidated federal income tax returns, and are included in income tax expense (benefit) in the Consolidated Statements of Income. Interest expense on tax deficiencies is included in net interest charges in the Consolidated Statements of Income.

DERIVATIVES

We account for derivative instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133), as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities - An Amendment of FASB Statement No. 133" (SFAS No. 138), and SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (SFAS No. 149). SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. SFAS No. 133 requires that an entity recognize all derivatives as assets or liabilities in the balance sheet and measure those instruments at fair value, unless the derivatives meet the SFAS No. 133 criteria for normal purchases or normal sales and are designated as such. We generally designate derivative instruments as normal purchases or normal sales whenever the SFAS No. 133 criteria are met. If normal purchase or normal sale criteria are not met, we will generally designate the derivative instruments as cash flow or fair value hedges if the related SFAS No. 133 hedge criteria are met. During 2003, the FASB reconsidered an interpretation of SFAS No. 133. See Note 18 for the effect of the interpretation and additional information regarding risk management activities and derivative transactions.

LOSS CONTINGENCIES AND ENVIRONMENTAL LIABILITIES

We accrue for loss contingencies, including uncertain tax benefits, in accordance with SFAS No. 5, "Accounting for Contingencies" (SFAS No. 5). Under SFAS No. 5, contingent losses such as unfavorable results of litigation are recorded when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. Tax reserves are recorded for uncertain tax benefits when it is probable that the tax position will be disallowed and the amount of the disallowance can be reasonably estimated. Unless otherwise required by GAAP, we do not accrue legal fees when a contingent loss is initially recorded, but rather when the legal services are actually provided.

As discussed in Note 22, we accrue environmental remediation liabilities when the criteria for SFAS No. 5 have been met. Environmental expenditures that relate to an existing condition caused by past operations and that have no future economic benefits are expensed. Accruals for estimated losses from environmental remediation obligations generally are recognized no later than completion of the remedial feasibility study. Such accruals are adjusted as additional information develops or circumstances change. Costs of future expenditures for environmental remediation obligations are not discounted to their present value. Recoveries of environmental remediation costs from other parties are recognized when their receipt is deemed probable. Environmental expenditures that have future economic benefits are capitalized in accordance with our asset capitalization policy.

IMPAIRMENT OF LONG-LIVED ASSETS AND INVESTMENTS

As discussed in Note 9, we account for impairment of long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144). We review the recoverability of long-lived tangible and intangible assets whenever indicators exist. Examples of these indicators include current period losses, combined with a history of losses or a projection of continuing losses, or a significant decrease in the market price of a long-lived asset group. If an indicator exists for assets to be held and used, then the asset group is tested for recoverability by comparing the carrying value to the sum of undiscounted expected future cash flows directly attributable to the asset group. If the asset group is not recoverable through undiscounted cash flows or the

asset group is to be disposed of, then an impairment loss is recognized for the difference between the carrying value and the fair value of the asset group.

We review our investments to evaluate whether or not a decline in fair value below the carrying value is an other-than-temporary decline. We consider various factors, such as the investee's cash position, earnings and revenue outlook, liquidity and management's ability to raise capital in determining whether the decline is other-than-temporary. If we determine that an other-than-temporary decline exists in the value of its investments, it is our policy to write-down these investments to fair value.

Under the full-cost method of accounting for oil and gas properties, total capitalized costs are limited to a ceiling based on the present value of discounted (at 10%) future net revenues using current prices, plus the lower of cost or fair market value of unproved properties. The ceiling test takes into consideration the prices of qualifying cash flow hedges as of the balance sheet date. If the ceiling (discounted revenues) is not equal to or greater than total capitalized costs, we are required to write-down capitalized costs to this level. We perform this ceiling test calculation every quarter. No write-downs were required in 2005, 2004 or 2003.

SUBSIDIARY STOCK TRANSACTIONS

Gains and losses realized as a result of common stock sales by our subsidiaries are recorded in the Consolidated Statements of Income, except for any transactions that must be credited directly to equity in accordance with the provisions of Staff Accounting Bulletin No. 51, "Accounting for Sales of Stock by a Subsidiary."

2. NEW ACCOUNTING STANDARDS

See Note 10B for information regarding our third quarter 2005 implementation of SFAS No. 123R.

FASB EXPOSURE DRAFT ON ACCOUNTING FOR UNCERTAIN TAX POSITIONS, AN INTERPRETATION OF SFAS NO. 109, "ACCOUNTING FOR INCOME TAXES"

On July 14, 2005, the FASB issued an exposure draft of a proposed interpretation of SFAS No. 109, "Accounting for Income Taxes" (SFAS No. 109), that would address the accounting for uncertain tax positions. The proposed interpretation would require that uncertain tax benefits be probable of being sustained in order to record such benefits in the consolidated financial statements. We currently account for uncertain tax benefits in accordance with SFAS No. 5. Under SFAS No. 5, contingent losses are recorded when it is probable that the tax position will not be sustained and the amount of the disallowance can be reasonably estimated. During subsequent deliberations in November 2005, the FASB voted to tentatively adopt a more-likely-than-not criterion that the uncertain tax position will be sustained rather than the original probable criterion. As originally drafted, the proposed interpretation would apply to all uncertain tax positions and would have been effective for us on December 31, 2005. However, on January 11, 2006, the FASB voted to delay the effective date of the final interpretation until the first annual period beginning after December 15, 2006, which for us would be January 1, 2007. The FASB has publicly stated that it expects to issue the final interpretation in the first quarter of 2006. We have not yet determined how the proposed interpretation would impact our various income tax positions.

FASB INTERPRETATION NO. 47, "ACCOUNTING FOR CONDITIONAL ASSET RETIREMENT OBLIGATIONS"

As discussed in Note 1D, we adopted FIN No. 47, an interpretation of SFAS No. 143, as of December 31, 2005. FIN No. 47 clarifies that a legal obligation to perform an asset retirement activity that is conditional on a future event is within the scope of SFAS No. 143. Accordingly, an entity is required to recognize a liability for the fair value of an asset retirement obligation (ARO) that is conditional on a future event if the liability's fair value can be reasonably estimated. FIN No. 47 also provides additional guidance for evaluating whether sufficient information is available to make a reasonable estimate of the fair value.

Upon implementation of FIN No. 47 we recognized additional ARO liabilities for asbestos abatement costs. In accordance with SFAS No. 143, we recorded a liability for the present value of our legal obligations and recorded an additional amount to the asset cost to be depreciated over an appropriate period. Cumulative accretion and

accumulated depreciation were recognized for the time period from the date of the obligating event giving rise to the liability to the date of the adoption of FIN No. 47. For assets acquired through acquisition, the cumulative effect was based on the acquisition date. As stated in Note 1D, the adoption of FIN No. 47 had no impact on the income of the Utilities as the effects were offset by the establishment of a net regulatory asset/liability pursuant to SFAS No. 71 (See Note 7A) and in accordance with orders issued by the NCUC, the SCPSC and the FPSC.

The following table summarizes the effect of the implementation of FIN No. 47 on the financial statements of Progress Energy, PEC and PEF as of December 31, 2005.

(in millions)	ARO Liability	Net Asset Retirement Cost	Net Regulatory Asset/(Liability)
Progress Energy	\$ 50	\$ 15	\$ (8)
PEC	23	5	2
PEF	27	4	(4)

Asbestos abatement costs previously included in regulatory liabilities were reclassified upon implementation of FIN No. 47 and included in the calculation of these AROs at December 31, 2005. The amounts reclassified were \$16 million and \$27 million for PEC and PEF, respectively, for a cumulative total of \$43 million for Progress Energy.

3. DIVESTITURES

A. Coal Mines Divestiture

On November 14, 2005, our board of directors approved a plan to divest of five subsidiaries of Progress Fuels Corporation (Progress Fuels) engaged in the coal mining business. The coal mining operations are expected to be sold by the end of 2006. As a result, the accompanying consolidated financial statements have been restated for all periods presented to reflect the coal mining operations as discontinued operations. Interest expense has been allocated to discontinued operations based on the net assets of the coal mines, assuming a uniform debt-to-equity ratio across our operations. Interest expense allocated was \$3 million for each of the years ended December 31, 2005, 2004 and 2003. We ceased recording depreciation expense upon classification of the coal mining operations as discontinued operations in November 2005. After-tax depreciation expense during the years ended December 31, 2005, 2004 and 2003 was \$10 million, \$9 million and \$9 million, respectively. Results of discontinued operations for the years ended December 31 were as follows:

(in millions)	2005	2004	2003
Revenues	\$ 180	\$ 158	\$ 181
Loss before income taxes	\$ 16	\$ 17	\$ 18
Income tax benefit	5	12	7
Net loss from discontinued operations	\$ 11	\$ 5	\$ 11

B. Progress Rail Divestiture

On March 24, 2005, we completed the sale of Progress Rail Services Corporation (Progress Rail) to One Equity Partners LLC, a private equity firm unit of J.P. Morgan Chase & Co. Gross cash proceeds from the sale were approximately \$429 million, consisting of \$405 million base proceeds plus a working capital adjustment. Proceeds from the sale were used to reduce debt.

Based on the gross proceeds associated with the sale of \$429 million, we recorded an estimated after-tax loss on disposal of \$25 million during the year ended December 31, 2005.

The accompanying consolidated financial statements have been restated for all periods presented to reflect the operations of Progress Rail as discontinued operations. Interest expense has been allocated to discontinued operations based on the net assets of Progress Rail, assuming a uniform debt-to-equity ratio across our operations. Interest expense allocated for the years ended December 31, 2005, 2004 and 2003 was \$4 million, \$16 million and \$18 million, respectively. We ceased recording depreciation upon classification of Progress Rail as discontinued

operations in February 2005. After-tax depreciation expense during the years ended December 31, 2005, 2004 and 2003 was \$3 million, \$10 million and \$9 million, respectively. Results of discontinued operations for the years ended December 31 were as follows:

(in millions)	2005	2004	2003
Revenues	\$ 358	\$ 1,127	\$ 847
Earnings before income taxes	\$ 8	\$ 50	\$ 23
Income tax expense	3	21	9
Net earnings from discontinued operations	5	29	14
Estimated loss on disposal of discontinued operations, including income tax benefit of \$15 in 2005	(25)	-	-
(Loss) earnings from discontinued operations	\$ (20)	\$ 29	\$ 14

In connection with the sale, Progress Fuels and Progress Energy provided guarantees and indemnifications of certain legal, tax and environmental matters to One Equity Partners, LLC. See Note 23C for a general discussion of guarantees. The ultimate resolution of these matters could result in adjustments to the loss on sale in future periods.

In February 2004, we sold the majority of the assets of Railcar Ltd., a subsidiary of Progress Rail, to The Andersons, Inc. for proceeds of approximately \$82 million before transaction costs and taxes of approximately \$13 million. In 2002, we had recognized pre-tax impairment of \$59 million to write-down the assets to our estimated fair value less costs to sell. In July 2004, we sold the remaining assets, which had been classified as held for sale, to a third party for net proceeds of \$6 million.

C. Net Assets of Discontinued Operations

Included in net assets of discontinued operations are the assets and liabilities of the coal mining operations and Progress Rail. The major balance sheet classes included in assets and liabilities of discontinued operations in the Consolidated Balance Sheet at December 31, 2005 and 2004 were as follows:

(in millions)	2005	2004
Accounts receivable	\$ 12	\$ 189
Inventory	6	181
Other current assets	4	19
Total property, plant and equipment, net	73	240
Total other assets	14	56
Assets of discontinued operations	\$ 109	\$ 685
Accounts payable	\$ 9	\$ 119
Other current liabilities	11	47
Long-term liabilities	20	20
Liabilities of discontinued operations	\$ 40	\$ 186

D. Divestiture of Winter Park Distribution Assets

As discussed in Note 7C, PEF sold certain electric distribution assets to Winter Park, Fla. (Winter Park), on June 1, 2005.

E. Sale of Natural Gas Assets

In December 2004, we sold certain gas-producing properties and related assets owned by Winchester Production Company, Ltd. (Winchester Production), an indirectly wholly owned subsidiary of Progress Fuels, which is included in the Progress Ventures segment. Net proceeds of approximately \$251 million were used to reduce debt. Because the sale significantly altered the ongoing relationship between capitalized costs and remaining proved reserves, under the full-cost method of accounting, the pre-tax gain of \$56 million was recognized in earnings rather than as a reduction of the basis of our remaining oil and gas properties. The pre-tax gain has been included in (gain)/loss on

the sale of assets in the Consolidated Statements of Income.

F. Divestiture of Synthetic Fuel Partnership Interests

In two June 2004 transactions, Progress Fuels sold a combined 49.8 percent partnership interest in Colona Synfuel Limited Partnership, LLLP (Colona), one of its synthetic fuel facilities. Substantially all proceeds from the sales will be received over time, which is typical of such sales in the industry. Gain from the sales will be recognized on a cost-recovery basis. The book value of the interests sold totaled approximately \$5 million. In the event that the synthetic fuel tax credits from the Colona facility are reduced, including an increase in the price of oil that could limit or eliminate synthetic fuel tax credits, the amount of proceeds realized from the sale could be significantly impacted (See Note 23D).

G. Mesa Hydrocarbons, Inc., Divestiture

In October 2003, we sold certain gas-producing properties owned by Mesa Hydrocarbons, LLC, a wholly owned subsidiary of Progress Fuels. Net proceeds were approximately \$97 million. Because we utilize the full-cost method of accounting for our oil and gas operations, the pre-tax gain of approximately \$18 million was applied to reduce the basis of our other U.S. oil and gas investments and will prospectively result in a reduction of the amortization rate applied to those investments as production occurs.

H. NCNG Divestiture

On September 30, 2003, we sold North Carolina Natural Gas Corporation (NCNG) and our equity investment in Eastern North Carolina Natural Gas Company (ENCNG) to Piedmont Natural Gas Company, Inc. Net proceeds from the sale of NCNG of approximately \$443 million were used to reduce debt.

The consolidated financial statements have been restated for all periods presented for the discontinued operations of NCNG. The net income of these operations is reported as discontinued operations in the Consolidated Statements of Income. Interest expense of \$10 million for the year ended December 31, 2003, has been allocated to discontinued operations based on the net assets of NCNG, assuming a uniform debt-to-equity ratio across our operations. Results of discontinued operations for the years ended December 31 were as follows:

(in millions)	2004	2003
Revenues	\$ -	\$ 284
Earnings before income taxes	\$ -	\$ 6
Income tax expense	-	2
Net earnings from discontinued operations	-	4
Gain/(Loss) on disposal of discontinued operations, including applicable income tax benefit / (expense) of \$6 and \$1, respectively	6	(12)
Earnings (loss) from discontinued operations	\$ 6	\$ (8)

NCNG did not have any discontinued operating results for the year ended December 31, 2005.

During 2004, we recorded an additional tax gain of approximately \$6 million due to final tax adjustments related to the divestiture of NCNG.

The sale of ENCNG resulted in net proceeds of \$7 million and a pre-tax loss of \$2 million, which is included in other, net on the Consolidated Statements of Income for the year ended December 31, 2003.

4. ACQUISITIONS AND BUSINESS COMBINATIONS

A. Acquisition of Natural Gas Reserves - 2005

In May 2005, Winchester Production, an indirectly wholly owned subsidiary of Progress Fuels, acquired a 50 percent interest in approximately 11 natural gas producing wells and proven reserves of approximately 25 billion cubic feet equivalent (Bcf) from a privately owned company headquartered in Texas. In addition to the natural gas reserves, the transaction also included a 50 percent interest in the gas gathering systems related to these reserves. The total cash purchase price for the transaction was \$46 million. The pro forma results of operations reflecting the acquisition would not be materially different than the reported results of operations for 2005, 2004 or 2003.

B. Progress Telecommunications Corporation Transaction

In December 2003, Progress Telecommunications Corporation (PTC) and Caronet, Inc. (Caronet), both wholly owned subsidiaries of Progress Energy, and EPIK Communications, Inc. (EPIK), a wholly owned subsidiary of Odyssey Telecorp, Inc. (Odyssey), contributed substantially all of their assets and transferred certain liabilities to Progress Telecom, LLC (PT LLC), a subsidiary of PTC as a noncash activity that is not reflected on our consolidated statements of cash flows. Subsequently, the stock of Caronet was sold to an affiliate of Odyssey for \$2 million in cash and Caronet became a wholly owned subsidiary of Odyssey. Following consummation of all the transactions described above, PTC held a 55 percent ownership interest in, and is the parent of, PT LLC. Odyssey held a combined 45 percent ownership interest in PT LLC through EPIK and Caronet. The accounts of PT LLC have been included in the Consolidated Financial Statements since the transaction date.

The transaction was accounted for as a partial acquisition of EPIK through the issuance of the stock of a consolidated subsidiary. The contributions of PTC's and Caronet's net assets were recorded at their carrying values of approximately \$31 million. EPIK's contribution was recorded at its estimated fair value of \$22 million using the purchase method. No gain or loss was recognized on the transaction. The EPIK purchase price was initially allocated as follows: property and equipment - \$27 million; other current assets - \$9 million; current liabilities - \$21 million; and goodwill - \$7 million. During 2004, PT LLC developed a restructuring plan to exit certain leasing arrangements of EPIK and finalized its valuation of acquired assets and liabilities. Management considered a number of factors, including valuations and appraisals, when making these determinations. Based on the results of these activities, the preliminary purchase price allocation for EPIK was revised as follows at December 31, 2004: property and equipment - \$36 million; other current assets - \$7 million; intangible assets - \$1 million; current liabilities - \$18 million; and exit costs - \$4 million. The exit costs consist primarily of lease termination penalties and noncancelable lease payments made after certain leased properties are vacated. The pro forma results of operations reflecting the acquisition would not be materially different than the reported results of operations for 2003.

See Note 25 for information on the recent agreement to sell our interest in PT LLC.

C. Acquisition of Natural Gas Reserves - 2003

During 2003, Progress Fuels entered into several independent transactions to acquire approximately 200 natural gas-producing wells with proven reserves of approximately 190 Bcf from Republic Energy, Inc., and three other privately owned companies, all headquartered in Texas. The total cash purchase price for the transactions was \$168 million. The pro forma results of operations reflecting the acquisition would not be materially different from the reported results of operations for the year ended December 31, 2003.

D. Acquisition of Wholesale Energy Contract

In May 2003, Progress Energy Ventures, Inc. (PVI) entered into a definitive agreement with Williams Energy Marketing and Trading, a subsidiary of The Williams Companies, Inc., to acquire a long-term full-requirements power supply agreement at fixed prices with Jackson Electric Membership Corporation (Jackson), located in Jefferson, Georgia. The agreement required a \$188 million cash payment to Williams Energy Marketing and Trading in exchange for assignment of the Jackson supply agreement; the \$188 million cash payment was recorded as an intangible asset and is being amortized based on the economic benefit of the contract (See Note 8). The power

supply agreement terminates in 2015, with a first refusal right to extend for five years. The agreement includes the use of 640 MW of contracted Georgia System generation comprised of nuclear, coal, gas and pumped-storage hydro resources. PVI expects to supplement the acquired resources with open market purchases and with its own intermediate and peaking assets in Georgia to serve Jackson's forecasted 1,100 MW peak demand in 2005 growing to a forecasted 1,700 MW demand by 2015.

5. PROPERTY, PLANT AND EQUIPMENT

A. Utility Plant

The balances of electric utility plant in service at December 31 are listed below, with a range of depreciable lives (in years) for each:

(in millions)	Depreciable Lives	Progress Energy		PEC		PEF	
		2005	2004	2005	2004	2005	2004
Production plant	7-33	\$ 12,470	\$ 11,966	\$ 8,241	\$ 7,954	\$ 4,039	\$ 3,818
Transmission plant	30-75	2,353	2,282	1,264	1,212	1,089	1,070
Distribution plant	12-50	7,015	6,749	3,838	3,701	3,177	3,047
General plant and other	8-75	1,102	1,106	651	654	451	452
Utility plant in service		\$ 22,940	\$ 22,103	\$ 13,994	\$ 13,521	\$ 8,756	\$ 8,387

Generally, electric utility plant at PEC and PEF, other than nuclear fuel, is pledged as collateral for the first mortgage bonds of PEC and PEF, respectively (See Note 12C).

AFUDC represents the estimated debt and equity costs of capital funds necessary to finance the construction of new regulated assets. As prescribed in the regulatory uniform systems of accounts, AFUDC is charged to the cost of the plant. The equity funds portion of AFUDC is credited to other income, and the borrowed funds portion is credited to interest charges. Regulatory authorities consider AFUDC an appropriate charge for inclusion in the rates charged to customers by the Utilities over the service life of the property. The composite AFUDC rate for PEC's electric utility plant was 5.6% in 2005, 7.2% in 2004 and 4.0% in 2003, respectively. The composite AFUDC rate for PEF's electric utility plant was 7.8% in 2005, 2004 and 2003.

Our depreciation provisions on utility plant, as a percent of average depreciable property other than nuclear fuel, were 2.5%, 2.2% and 2.5% in 2005, 2004 and 2003, respectively. The depreciation provisions related to utility plant were \$556 million, \$463 million and \$517 million in 2005, 2004 and 2003, respectively. In addition to utility plant depreciation provisions, depreciation and amortization expense also includes decommissioning cost provisions, ARO accretion, cost of removal provisions (See Note 5D), regulatory approved expenses (See Notes 7 and 22) and Clean Smokestacks Act amortization (See Note 7B).

Amortization of nuclear fuel costs, including disposal costs associated with obligations to the U.S. Department of Energy (DOE) and costs associated with obligations to the DOE for the decommissioning and decontamination of enrichment facilities, for the years ended December 31, 2005 and 2004 were \$140 million and for the year ended December 31, 2003 was \$143 million. This amortization expense is included in fuel used for electric generation in the Consolidated Statements of Income.

PEC's depreciation provisions on utility plant, as a percent of average depreciable property other than nuclear fuel, were 2.7% in 2005, 2.1% in 2004, and 2.7% in 2003. The depreciation provisions related to utility plant were \$365 million, \$275 million and \$345 million in 2005, 2004 and 2003, respectively. In addition to utility plant depreciation provisions, depreciation and amortization expense also includes decommissioning cost provisions, ARO accretion, cost of removal provisions (See Note 5D), regulatory approved expenses (See Note 7) and Clean Smokestacks Act amortization (See Note 7B).

During 2004, PEC met the requirements of both the NCUC and the SCPSC for the implementation of two depreciation studies that allowed the utility to reduce the rates used to calculate depreciation expense. The annual reduction in depreciation expense is approximately \$82 million. The reduction is due primarily to extended lives at each of PEC's nuclear units. The reduced depreciation rates were effective January 1, 2004.

PEF's depreciation provisions on utility plant, as a percent of average depreciable property other than nuclear fuel, were 2.3% in 2005, 2004 and 2003. The depreciation provisions related to utility plant were \$191 million, \$188 million and \$172 million in 2005, 2004 and 2003, respectively. In addition to utility plant depreciation provisions, depreciation and amortization expense also includes decommissioning cost provisions, ARO accretion, cost of removal provisions (See Note 5D) and regulatory approved expenses (See Notes 7 and 22).

During 2005, PEF performed a depreciation study as required by the FPSC no less than every four years. Implementation of the depreciation study will decrease the rates used to calculate depreciation expense with a resulting decrease in annual depreciation expense of \$26 million beginning in 2006 (See Note 7C).

Amortization of nuclear fuel costs, including disposal costs associated with obligations to the DOE and costs associated with obligations to the DOE for the decommissioning and decontamination of enrichment facilities, for the years ended December 31, 2005, 2004 and 2003 was \$109 million, \$106 million and \$112 million, respectively, for PEC and \$31 million, \$34 million and \$31 million, respectively, for PEF. These costs were included in fuel used for electric generation in the Statements of Income.

B. Diversified Business Property

Progress Energy

The balances of diversified business property at December 31 are listed below, with a range of depreciable lives for each:

(in millions)	2005	2004
Equipment (3-25 years)	\$ 146	\$ 129
Nonregulated generation plant and equipment (3-40 years)	1,330	1,302
Land and mineral rights	40	36
Buildings and plants (5-40 years)	70	70
Oil and gas properties (units-of-production)	493	334
Telecommunications equipment (5-20 years)	99	80
Rail equipment (3-20 years)	37	36
Marine equipment (3-35 years)	88	87
Computers, office equipment and software (3-10 years)	8	13
Construction work in progress	12	18
Accumulated depreciation	(443)	(332)
Diversified business property, net	\$ 1,880	\$ 1,773

Our nonregulated businesses capitalize interest costs under SFAS No. 34, "Capitalization of Interest Costs." During the years ended December 31, 2005, 2004 and 2003, respectively, we capitalized \$4 million, \$7 million and \$20 million, respectively, of our interest cost of \$656 million, \$641 million and \$634 million, respectively. Capitalized interest for 2005 and 2004 is related to the expansion of natural gas operations. Capitalized interest in 2003 is related to the expansion of the Progress Ventures nonregulated generation portfolio. Capitalized interest is included in diversified business property, net on the Consolidated Balance Sheets. Diversified business depreciation expense was \$116 million for December 31, 2005 and 2004 and \$91 million for December 31, 2003.

PEC

Net diversified business property was \$7 million at both December 31, 2005 and 2004. These amounts consist primarily of buildings and equipment that are being depreciated over periods ranging from 10 to 40 years. Accumulated depreciation was \$2 million at both December 31, 2005 and 2004. Diversified business depreciation

expense was less than \$1 million in both 2005 and 2004 and \$1 million in 2003. Net diversified business property is included in miscellaneous other property and investments on the Consolidated Balance Sheets.

C. Joint Ownership of Generating Facilities

PEC and PEF hold ownership interests in certain jointly owned generating facilities. Each is entitled to shares of the generating capability and output of each unit equal to their respective ownership interests. Each also pays its ownership share of additional construction costs, fuel inventory purchases and operating expenses, except in certain instances where agreements have been executed to limit certain joint owners' maximum exposure to the additional costs (See Note 22B). PEC's and PEF's share of expenses for the jointly owned facilities is included in the appropriate expense category. The co-owner of Intercession City Unit P11 (P11) has exclusive rights to the output of the unit during the months of June through September. PEF has that right for the remainder of the year. PEC's and PEF's ownership interests in the jointly owned generating facilities are listed below with related information at December 31:

2005 (in millions)		Company	Plant	Accumulated	Constructio
Subsidiary	Facility	Ownership Interest	Investment	Depreciation	n Work in Progress
PEC	Mayo	83.83%	\$ 518	\$ 255	\$ 1
PEC	Harris	83.83%	3,181	1,459	17
PEC	Brunswick	81.67%	1,614	921	23
PEC	Roxboro Unit 4	87.06%	355	153	10
PEF	Crystal River Unit 3	91.78%	808	493	48
PEF	Intercession City Unit P11	66.67%	24	4	-

2004 (in millions)		Company	Plant	Accumulated	Construction
Subsidiary	Facility	Ownership Interest	Investment	Depreciation	Work in Progress
PEC	Mayo	83.83%	\$ 516	\$ 249	\$ 1
PEC	Harris	83.83%	3,185	1,387	13
PEC	Brunswick	81.67%	1,624	888	28
PEC	Roxboro Unit 4	87.06%	323	147	1
PEF	Crystal River Unit 3	91.78%	889	443	9
PEF	Intercession City Unit P11	66.67%	22	7	8

In the tables above, plant investment and accumulated depreciation are not reduced by the regulatory disallowances related to the Shearon Harris Nuclear Plant (Harris), which are not applicable to the joint owner's ownership interest in Harris.

D. Asset Retirement Obligations

At December 31, 2005 and 2004, the asset retirement costs related to nuclear decommissioning of irradiated plant, net of accumulated depreciation, totaled \$31 million and \$46 million, respectively, for PEC and \$36 million at December 31, 2004 for PEF. No costs related to nuclear decommissioning of irradiated plant were recorded in 2005 at PEF. At December 31, 2005 and 2004, additional PEF-related asset retirement costs, net of accumulated depreciation, of \$137 million and \$193 million, respectively, were recorded at Progress Energy. Funds set aside in the Utilities' nuclear decommissioning trust funds for the nuclear decommissioning liability totaled \$640 million and \$580 million at December 31, 2005 and 2004, respectively, for PEC and \$493 million and \$464 million, respectively, for PEF. Net nuclear decommissioning trust unrealized gains are included in regulatory liabilities (See Note 7A).

PEC's decommissioning cost provisions, which are included in depreciation and amortization expense, were \$31 million in 2005, 2004 and 2003. Management believes that decommissioning costs that have been and will be recovered through rates by PEC and PEF will be sufficient to provide for the costs of decommissioning. Expenses recognized for the disposal or removal of utility assets that are not SFAS No. 143 asset retirement obligations, which

are included in depreciation and amortization expense, were \$90 million, \$83 million and \$86 million in 2005, 2004 and 2003, respectively, for PEC and \$78 million, \$77 million and \$72 million in 2005, 2004 and 2003, respectively, for PEF.

The Utilities recognize removal, nonirradiated decommissioning and dismantlement of fossil generation plants costs in regulatory liabilities on the Consolidated Balance Sheets (See Note 7A). At December 31, such costs consisted of:

(in millions)	<u>Progress</u>		<u>PEC</u>		<u>PEF</u>	
	2005	2004	2005	2004	2005	2004
Removal costs	\$ 1,316	\$ 1,606	\$ 661	\$ 601	\$ 655	\$ 1,005
Nonirradiated decommissioning costs	132	131	71	70	61	61
Dismantlement costs	123	144	-	-	123	144
Non-ARO cost of removal	\$ 1,571	\$ 1,881	\$ 732	\$ 671	\$ 839	\$ 1,210

The NCUC requires that PEC update its cost estimate for nuclear decommissioning every five years. PEC's most recent site-specific estimates of decommissioning costs were developed in 2004, using 2004 cost factors, and are based on prompt dismantlement decommissioning, which reflects the cost of removal of all radioactive and other structures currently at the site, with such removal occurring after operating license expiration. These decommissioning cost estimates also include interim spent fuel storage costs associated with maintaining spent nuclear fuel on site until such time that it can be transferred to a DOE facility (See Note 23D). These estimates, in 2004 dollars, were \$569 million for Unit No. 2 at Robinson Nuclear Plant (Robinson), \$418 million for Brunswick Unit No. 1, \$444 million for Brunswick Unit No. 2, and \$775 million for Harris. The estimates are subject to change based on a variety of factors including, but not limited to, cost escalation, changes in technology applicable to nuclear decommissioning and changes in federal, state or local regulations. The cost estimates exclude the portion attributable to North Carolina Eastern Municipal Power Agency (Power Agency), which holds an undivided ownership interest in Brunswick and Harris. NRC operating licenses held by PEC currently expire in December 2014 and September 2016 for Brunswick Units No. 2 and No. 1, respectively. An application to extend these licenses 20 years was submitted in October 2004. The NRC operating license held by PEC for Harris currently expires in October 2026. An application to extend this license 20 years is expected to be submitted in the fourth quarter of 2006. On April 19, 2004, the NRC announced that it renewed the operating license for Robinson for an additional 20 years through July 2030.

The FPSC requires that PEF update its cost estimate for nuclear decommissioning every five years. PEF filed a new site-specific estimate of decommissioning costs for the Crystal River Unit No. 3 (CR3) with the FPSC on April 29, 2005, as part of PEF's base rate filing. PEF's estimate is based on prompt dismantlement decommissioning and includes interim spent fuel storage costs associated with maintaining spent nuclear fuel on site until such time that it can be transferred to a DOE facility (See Note 23D). The estimate, in 2005 dollars, is \$614 million and is subject to change based on a variety of factors including, but not limited to, cost escalation, changes in technology applicable to nuclear decommissioning and changes in federal, state or local regulations. The cost estimate excludes the portion attributable to other co-owners of CR3. The NRC operating license held by PEF for CR3 currently expires in December 2016. An application to extend this license 20 years is expected to be submitted in the first quarter of 2009. As part of this new estimate and assumed license extension, PEF reduced its asset retirement cost net of accumulated depreciation and its ARO liability by approximately \$36 million and \$88 million, respectively. In addition, we reduced PEF-related asset retirement costs, net of accumulated depreciation, by an additional \$53 million at Progress Energy. Retail and wholesale accruals on PEF's reserves for nuclear decommissioning were previously suspended through December 2005 under the terms of the Agreement and the new Base Rate Settlement continues that suspension.

The FPSC requires that PEF update its cost estimate for fossil plant dismantlement every four years. PEF filed an updated fossil dismantlement study with the FPSC on April 29, 2005, as part of its base rate filing. The new study called for an increase in the annual accrual of \$10 million beginning in 2006. PEF's reserve for fossil plant dismantlement was approximately \$145 million at December 31, 2005, including amounts in the ARO liability for asbestos abatement, discussed below. Retail accruals on PEF's reserves for fossil plant dismantlement were previously suspended through December 2005 under the terms of PEF's existing Agreement. The Base Rate

Settlement continued the suspension of PEF's collection from customers of the expenses to dismantle fossil plants (See Note 7C).

Upon implementation of FIN No. 47 as of December 31, 2005, the Utilities recognized additional ARO liabilities for asbestos abatement costs (See Note 2).

We have identified but not recognized AROs related to electric transmission and distribution and telecommunications assets as the result of easements over property not owned by us. These easements are generally perpetual and require retirement action only upon abandonment or cessation of use of the property for the specified purpose. The ARO is not estimable for such easements, as we intend to utilize these properties indefinitely. In the event we decide to abandon or cease the use of a particular easement, an ARO would be recorded at that time.

Our nonregulated AROs relate to the synthetic fuel operations and gas production of Progress Fuels. The related asset retirement costs, net of accumulated depreciation, totaled \$10 million and \$4 million at December 31, 2005 and 2004, respectively.

The following table shows the changes to the AROs during the years ended December 31. Additions relate primarily to additional reclamation obligations at coal mine operations of Progress Fuels and asbestos abatement at the Utilities. Revisions to prior estimates of the regulated ARO related to PEC remeasuring the nuclear decommissioning costs of irradiated plants to take into account updated site-specific decommissioning cost studies, which are required by the NCUC every five years. Revisions to prior estimates of the PEF regulated ARO are related to the updated cost estimate for nuclear decommissioning described above.

(in millions)	Progress Energy		PEC	PEF
	Regulated	Nonregulated		
Asset retirement obligations at January 1, 2004	\$ 1,251	\$ 5	\$ 932	\$ 319
Additions	-	1	-	-
Accretion expense	73	-	55	18
Revisions to prior estimates	(63)	(2)	(63)	-
Asset retirement obligations at December 31, 2004	1,261	4	924	337
Additions	50	6	23	27
Accretion expense	65	-	51	14
Revisions to prior estimates	(137)	-	(49)	(88)
Asset retirement obligations at December 31, 2005	\$ 1,239	\$ 10	\$ 949	\$ 290

The cumulative effect of initial adoption of SFAS No. 143 related to nonregulated operations was \$1 million of income, which is included in cumulative effect of change in accounting principles, net of tax on the Consolidated Statements of Income for the year ended December 31, 2003.

E.. Insurance

The Utilities are members of Nuclear Electric Insurance Limited (NEIL), which provides primary and excess insurance coverage against property damage to members' nuclear generating facilities. Under the primary program, each company is insured for \$500 million at each of its respective nuclear plants. In addition to primary coverage, NEIL also provides decontamination, premature decommissioning and excess property insurance with limits of \$1.75 billion on each nuclear plant.

Insurance coverage against incremental costs of replacement power resulting from prolonged accidental outages at nuclear generating units is also provided through membership in NEIL. Both PEC and PEF are insured under NEIL, following a 12-week deductible period, for 52 weeks in the amount of \$3.5 million per week at each plant. An additional 110 weeks of coverage is provided at 80 percent of the above weekly amount. For the current policy period, the companies are subject to retrospective premium assessments of up to approximately \$30.7 million with respect to the primary coverage, \$36.5 million with respect to the decontamination, decommissioning and excess property coverage, and \$23 million for the incremental replacement power costs coverage, in the event covered losses at insured facilities exceed premiums, reserves, reinsurance and other NEIL resources. Pursuant to regulations

of the NRC, each company's property damage insurance policies provide that all proceeds from such insurance be applied, first, to place the plant in a safe and stable condition after an accident and, second, to decontaminate, before any proceeds can be used for decommissioning, plant repair or restoration. Each company is responsible to the extent losses may exceed limits of the coverage described above.

Both of the Utilities are insured against public liability for a nuclear incident up to \$10.76 billion per occurrence. Under the current provisions of the Price Anderson Act, which limits liability for accidents at nuclear power plants, each company, as an owner of nuclear units, can be assessed for a portion of any third-party liability claims arising from an accident at any commercial nuclear power plant in the United States. In the event that public liability claims from an insured nuclear incident exceed \$300 million (currently available through commercial insurers), each company would be subject to pro rata assessments of up to \$100.1 million for each reactor owned per occurrence. Payment of such assessments would be made over time as necessary to limit the payment in any one year to no more than \$15 million per reactor owned.

Under the NEIL policies, if there were multiple terrorism losses occurring within one year, NEIL would make available one industry aggregate limit of \$3.2 billion, along with any amounts it recovers from reinsurance, government indemnity or other sources up to the limits for each claimant. If terrorism losses occurred beyond the one-year period, a new set of limits and resources would apply. For nuclear liability claims arising out of terrorist acts, the primary level available through commercial insurers is now subject to an industry aggregate limit of \$300 million. The second level of coverage obtained through the assessments discussed above would continue to apply to losses exceeding \$300 million and would provide coverage in excess of any diminished primary limits due to terrorist acts.

The Utilities self-insure their transmission and distribution lines against loss due to storm damage and other natural disasters. PEF accrues \$6 million annually to a storm damage reserve pursuant to a regulatory order and may defer losses in excess of the reserve (See Note 7A).

6. CURRENT ASSETS

A. Receivables

Income tax receivables and interest income receivables are not included in receivables. These amounts are included in prepaids and other current assets on the Consolidated Balance Sheet. At December 31 receivables were comprised of:

	<u>Progress</u> <u>Energy</u>		<u>PEC</u>		<u>PEF</u>	
(in millions)	2005	2004	2005	2004	2005	2004
Trade accounts receivable	\$ 713	\$ 499	\$ 336	\$ 240	\$ 263	\$ 195
Unbilled accounts receivable	282	271	158	155	60	66
Notes receivable	76	97	-	-	-	-
Other receivables	45	23	28	12	14	7
Unbilled other receivables	6	28	-	-	-	-
Allowance for doubtful accounts receivable	(19)	(22)	(4)	(10)	(6)	(2)
Total receivables	\$ 1,103	\$ 896	\$ 518	\$ 397	\$ 331	\$ 266

B. Inventory

At December 31 inventory was comprised of:

	<u>Progress Energy</u>		<u>PEC</u>		<u>PEF</u>	
(in millions)	2005	2004	2005	2004	2005	2004
Fuel for production	\$ 329	\$ 235	\$ 185	\$ 127	\$ 136	\$ 104
Inventory for sale	61	49	-	-	-	-
Materials and supplies	441	517	240	263	166	176
Emission allowances	35	21	26	11	9	10
Total current inventory	\$ 866	\$ 822	\$ 451	\$ 401	\$ 311	\$ 290

Materials and supplies amounts above exclude long-term combustion turbine inventory amounts included in other assets and deferred debits for Progress Energy and PEC of \$44 million at December 31, 2005 and none at December 31, 2004.

Emission allowances above exclude long-term emission allowances included in other assets and deferred debits for Progress Energy, PEC and PEF of \$14 million, \$13 million, and \$1 million, respectively, at December 31, 2005 and none at December 31, 2004.

7. REGULATORY MATTERS

A. Regulatory Assets and Liabilities

As regulated entities, the Utilities are subject to the provisions of SFAS No. 71. Accordingly, the Utilities record certain assets and liabilities resulting from the effects of the ratemaking process that would not be recorded under GAAP for nonregulated entities. The Utilities' ability to continue to meet the criteria for application of SFAS No. 71 may be affected in the future by competitive forces and restructuring in the electric utility industry. In the event that SFAS No. 71 no longer applies to a separable portion of our operations, related regulatory assets and liabilities would be eliminated unless an appropriate regulatory recovery mechanism was provided. Additionally, these factors could result in an impairment of utility plant assets as determined pursuant to SFAS No. 144.

At December 31 the balances of regulatory assets (liabilities) were as follows:

Progress Energy

(in millions)	2005	2004
Deferred fuel cost - current (Note 7B and 7C)	\$ 602	\$ 229
Deferred fuel cost - long-term (Note 7B and 7C)	31	107
Deferred impact of ARO - PEC (Note 1D)	281	305
Income taxes recoverable through future rates (Note 14)	81	84
Loss on reacquired debt (Note 1D)	50	53
Storm deferral (Notes 7B and 7C)	227	316
Postretirement benefits (Note 16B)	88	74
Other	96	125
Total long-term regulatory assets	854	1,064
Deferred energy conservation cost - current	(10)	(8)
Non-ARO cost of removal (Note 5D)	(1,571)	(1,881)
Deferred impact of ARO - PEF (Note 1D)	(225)	(221)
Net nuclear decommissioning trust unrealized gains (Note 5D)	(251)	(224)
Postretirement benefits (Note 16B)	-	(45)
Clean Smokestacks Act compliance (Note 7B)	(317)	(248)
Derivative mark-to-market adjustment (Note 18A)	(122)	(2)
Other	(41)	(33)
Total long-term regulatory liabilities	(2,527)	(2,654)
Net regulatory liabilities	\$ (1,081)	\$ (1,369)

PEC

(in millions)	2005	2004
Deferred fuel cost - current (Note 7B)	\$ 261	\$ 140
Deferred fuel cost - long-term (Note 7B)	31	28
Deferred impact of ARO (Note 1D)	281	305
Income taxes recoverable through future rates (Note 14)	22	36
Loss on reacquired debt (Note 1D)	21	22
Storm deferral (Note 7B)	19	25
Other	47	57
Total long-term regulatory assets	421	473
Non-ARO cost of removal (Note 5D)	(732)	(671)
Net nuclear decommissioning trust unrealized gains (Note 5D)	(135)	(125)
Clean Smokestacks Act compliance (Note 7B)	(317)	(248)
Other	(12)	(8)
Total long-term regulatory liabilities	(1,196)	(1,052)
Net regulatory liabilities	\$ (514)	\$ (439)

(in millions)	2005	2004
Deferred fuel cost - current (Note 7C)	\$ 341	\$ 89
Deferred fuel cost - long-term (Note 7C)	-	79
Storm deferral (Note 7C)	208	291
Income taxes recoverable through future rates (Note 14)	59	49
Loss on reacquired debt (Note 1D)	29	31
Postretirement benefits	7	7
Other	48	67
Total long-term regulatory assets	351	524
Deferred energy conservation cost - current	(10)	(8)
Non-ARO cost of removal (Note 5D)	(839)	(1,210)
Deferred impact of ARO (Note 1D)	(80)	(26)
Net nuclear decommissioning trust unrealized gains (Note 5D)	(116)	(99)
Derivative mark-to-market adjustment (Note 18A)	(122)	(2)
Other	(32)	(25)
Total long-term regulatory liabilities	(1,189)	(1,362)
Net regulatory liabilities	\$ (507)	\$ (757)

Except for portions of deferred fuel costs, all regulatory assets earn a return or the cash has not yet been expended, in which case the assets are offset by liabilities that do not incur a carrying cost. We expect to fully recover these assets and refund these liabilities through customer rates under current regulatory practice.

B. PEC Retail Rate Matters

FUEL COST RECOVERY

On April 27, 2005, PEC filed for an increase in the fuel rate charged to its South Carolina retail customers with the SCPSC. PEC requested the \$99 million increase for under-recovered fuel costs for the previous 15 months and to meet future expected fuel costs. On June 23, 2005, the SCPSC approved a settlement agreement filed jointly by PEC and all other parties to the proceeding. The settlement agreement levelizes the collection of under-recovered fuel costs over a three-year period and allows PEC to charge and recover carrying costs on the monthly unpaid balance, beginning July 1, 2006, at an interest rate of 6% compounded annually. An annual increase in PEC's rates of \$55 million, or 12 percent, was effective July 1, 2005. Residential electric bills increased by \$7.29 per 1,000 kWhs for fuel cost recovery. The South Carolina deferred fuel balance at December 31, 2005, was \$38 million, of which \$21 million will be collected after 2006 in accordance with the settlement agreement and therefore has been classified as a long-term regulatory asset.

On June 3, 2005, PEC filed for an increase in the fuel rate charged to its North Carolina retail customers with the NCUC. PEC requested that the NCUC approve an annual increase of \$276 million, or 11 percent. PEC requested the increase for under-recovered fuel costs for the previous 12 months and to meet future expected fuel costs. On September 26, 2005, the NCUC approved a settlement agreement proposed by PEC and other parties to the proceeding. In the settlement, PEC will collect all of its fuel cost under-collections that occurred during the test year ended March 31, 2005, over a one-year period beginning October 1, 2005. PEC agreed to reduce its proposed billing increment, designed to collect future fuel costs, in order to address customer concerns regarding the magnitude of the proposed increase. The NCUC approved an annual increase of \$133 million, an average increase of 5 percent. In recognition of the likely under-collection that will result during the year ending September 30, 2006, PEC is allowed to calculate and collect interest at 6% on the difference between its collection factor in the original request to the NCUC and the factor included in the settlement agreement until such amounts have been collected. Effective October 1, 2005, residential electric bills increased by \$3.71 per 1,000 kilowatt-hours (kWhs) for fuel cost recovery. At December 31, 2005, PEC's North Carolina retail fuel costs were under-recovered by \$254 million. This amount was comprised of \$244 million eligible for recovery in 2006 and \$10 million deferred from a 2001 NCUC order that cannot be collected until 2007 and therefore has been classified as a long-term regulatory asset.

In 2004 and 2003, PEC obtained SCPSC and NCUC approval of fuel factors in annual fuel-adjustment proceedings. The NCUC approved an annual increase of \$62 million and \$20 million, respectively, by orders issued in September 2004 and 2003. The SCPSC approved PEC's petition each year and the changes were insignificant.

STORM COST RECOVERY

In February 2004, PEC filed with the SCPSC seeking permission to defer expenses incurred from the first quarter 2004 winter storm. In September 2004, the SCPSC approved PEC's request to defer the costs and amortize them ratably over five years beginning in January 2005. Approximately \$9 million related to storm costs was deferred in 2004. PEC recognized \$2 million of South Carolina storm amortization during 2005.

In October 2003, PEC filed with the NCUC seeking permission to defer expenses incurred from Hurricane Isabel and the February 2003 winter storms. In December 2003, the NCUC approved PEC's request to defer the costs associated with Hurricane Isabel and the February 2003 winter storms and amortize them over a period of five years. PEC charged approximately \$24 million in 2003 from Hurricane Isabel and from winter storms to the deferred account. PEC recognized \$5 million, \$5 million and \$3 million of North Carolina storm amortization during 2005, 2004 and 2003, respectively.

OTHER MATTERS

The NCUC and SCPSC have approved proposals to accelerate cost recovery of PEC's nuclear generating assets beginning January 1, 2000, and continuing through 2009. The aggregate minimum and maximum amounts of cost recovery are \$530 million and \$750 million, respectively. Accelerated cost recovery of these assets resulted in no additional expense in 2005, 2004 or 2003. Through December 31, 2005, PEC recorded total accelerated depreciation of \$403 million.

The North Carolina Clean Smokestacks Act (Clean Smokestacks Act) enacted in June 2002 requires state utilities to reduce emissions of nitrogen oxide (NO_x) and sulfur dioxide (SO₂) from coal-fired plants. The law provides that the utilities shall amortize and recover the original estimated costs (subject to adjustment by the NCUC) associated with meeting the new emission standards over a seven-year period beginning January 1, 2003. The legislation provides for significant flexibility in the amount of annual amortization recorded, which allows the utilities to vary the amount amortized within certain limits. This flexibility provides a utility with the opportunity to consider the impacts of other factors on its regulatory return on equity (ROE) when setting the amortization amount for each year. PEC recognized \$147 million, \$174 million and \$74 million of Clean Smokestacks Act amortization during 2005, 2004 and 2003, respectively. This legislation freezes PEC's base rates in North Carolina through December 31, 2007, subject to certain conditions (See Note 22B).

In conjunction with our acquisition of Florida Progress Corporation (Florida Progress), PEC reached a settlement with the Public Staff of the NCUC in which it agreed to provide \$20 million of credits to its nonreal-time pricing customers including \$6 million in both 2005 (the last year the agreed-upon credits were provided) and 2004 and \$5 million in 2003.

C. PEF Retail Rate Matters

STORM COST RECOVERY

On July 14, 2005, the FPSC issued an order authorizing PEF to recover \$232 million over a two-year period, including interest, of the costs it incurred and previously deferred related to PEF's restoration of power to customers associated with the four hurricanes in 2004. The ruling allowed PEF to include a charge of approximately \$3.27 on the average residential monthly customer bill of 1,000 kWhs beginning August 1, 2005. The ruling by the FPSC approved the majority of PEF's requests with two exceptions: the reclassification of \$8 million of previously deferred costs to utility plant and the reclassification of \$17 million of previously deferred costs as normal operation and maintenance (O&M) expense, which was expensed in the second quarter of 2005. In 2005, PEF recorded approximately \$50 million of amortization associated with the recovery of these storm costs.

The amount included in the original petition requesting recovery of \$252 million in November 2004 was an estimate, as actual total costs were not known at that time. On September 12, 2005, PEF filed a true-up to the original amount requested. PEF incurred an additional \$19 million in costs in excess of the amount requested in the original petition. This increase was partially offset by a \$6 million of adjustments due to allocating a higher portion of the costs to the wholesale jurisdiction and refining the FPSC adjustments. On November 9, 2005, as part of the action taken by the FPSC on PEF's pass-through clause cost recovery discussed below, the recovery of this difference was administratively approved by the FPSC, subject to audit by the FPSC staff. The net impact was included in customer bills beginning January 1, 2006.

On June 1, 2005, the governor of Florida signed into law a bill that allows utilities to petition the FPSC to use securitized bonds to recover storm-related costs. PEF is reviewing whether it will seek FPSC approval to issue securitized debt to recover any outstanding balance of its 2004 storm costs and to replenish its storm reserve fund, or to continue the current replenishment of its storm reserve fund through base rates and a surcharge mechanism. If PEF seeks recovery through securitization and assuming FPSC approval, PEF expects the process to take six to nine months to complete.

PASS-THROUGH CLAUSE COST RECOVERY

On November 9, 2005, the FPSC approved PEF's filed request seeking a total increase of \$605 million over 2005 to recover rising fuel costs as well as costs related to other pass-through clauses and surcharges. Fuel costs of \$560 million and certain purchased power costs of \$42 million were the largest component of the total increase. The fuel cost increase includes \$17 million from 2004 under-recoveries, \$222 million from 2005 under-recoveries and a \$321 million increase for 2006. Beginning January 1, 2006, residential electric bills increased by \$11.78 per 1,000 kWhs each billing cycle through December 31, 2006. At December 31, 2005, PEF was under-recovered in fuel and capacity costs by \$341 million.

To encourage energy conservation, the FPSC's ruling allows PEF to implement a two-tiered fuel rate for residential customers that charges a lower rate for the first 1,000 kWhs and a higher rate for each additional kWh.

BASE RATE SETTLEMENT

On April 29, 2005, PEF submitted minimum filing requirements, based on a 2006 projected test year, to initiate a base rate proceeding regarding its future base rates. In its filing, PEF requested a \$206 million annual increase in base rates effective January 1, 2006. On September 7, 2005, the FPSC approved an agreement (Base Rate Settlement) that maintains PEF's base rates at their current level through late 2007, except as modified elsewhere in the Base Rate Settlement. The new base rates took effect the first billing cycle of January 2006 and will remain in effect through the last billing cycle of December 2009 with PEF having sole option to extend through the last billing cycle of June 2010.

Under the Base Rate Settlement, PEF will continue to collect a return on and depreciation of Hines Unit 2 through the fuel clause, as was permitted under the terms of the existing Stipulation and Settlement Agreement (the Agreement), through late 2007 when it will be transferred into base rates. This transfer will correspond with the in-service dates of the Hines Unit 4, which will also be recovered through a base rate increase. PEF began recovering the cost of its Hines Unit 3 through existing base rates when it was placed into service in November 2005, similar to other utility property additions.

The Base Rate Settlement authorizes PEF to recover certain costs through clauses, such as the continued recovery of post-9/11 security costs through the capacity clause and the carrying costs of coal inventory in transit and coal procurement costs through the fuel clause.

The Base Rate Settlement also provides for revenue sharing between PEF and its customers. In 2006, PEF will refund two-thirds of retail, base revenues between the \$1.499 billion threshold and the \$1.549 billion cap and 100 percent of revenues above the \$1.549 billion cap. Both the threshold and cap will be adjusted annually for rolling average 10-year retail kWh sales growth.

The Base Rate Settlement authorizes PEF to include an adjustment to increase common equity for the impact of Standard & Poor's (S&P's) imputed off-balance sheet debt for future capacity payments to qualifying facilities and other entities under long-term purchase power agreements. This adjusted capital structure will be used for surveillance reporting with the FPSC and pass-through clause return calculations. PEF will use an authorized 11.75 percent ROE for cost recovery clauses and AFUDC. In addition, PEF's adjusted equity ratio will be capped at 57.83 percent. If PEF's regulatory ROE falls below 10 percent, and for certain other events, PEF is authorized to petition the FPSC for a base rate increase.

The FPSC requires that PEF perform a depreciation study no less frequently than every four years. PEF filed a depreciation study for the FPSC's approval on April 29, 2005, as part of its base rate filing, which would increase depreciation expense by \$14 million beginning in 2006. PEF reduced its estimated removal costs to take into account the estimates used in the depreciation study. This resulted in a downward revision in PEF's estimated removal costs, a component of regulatory liabilities, and an equal increase in accumulated depreciation of \$401 million. On September 7, 2005, the FPSC approved a modification to the study that resulted in a decrease to the filed report of \$40 million. Consequently, the impact of the rate changes in the depreciation study will decrease annual depreciation expense by \$26 million beginning in 2006.

The FPSC requires that PEF update its cost estimate for fossil plant dismantlement every four years. PEF filed an updated fossil dismantlement study with the FPSC on April 29, 2005, as part of its base rate filing. The new study called for an increase in the annual accrual of \$10 million beginning in 2006. PEF's reserve for fossil plant dismantlement, including amounts in the ARO liability for asbestos abatement, was \$145 million at December 31, 2005. Retail accruals on PEF's reserves for fossil plant dismantlement were previously suspended through December 2005 under the terms of PEF's existing Agreement. The Base Rate Settlement continued the suspension of PEF's collection from customers of the expenses to dismantle fossil plants.

The FPSC requires that PEF update its cost estimate for nuclear decommissioning every five years. PEF filed a new site-specific estimate of decommissioning costs for CR3 with the FPSC on April 29, 2005, as part of PEF's base rate filing. PEF's estimate is based on prompt dismantlement decommissioning. The estimate, in 2005 dollars, is \$614 million and is subject to change based on a variety of factors including, but not limited to, cost escalation, changes in technology applicable to nuclear decommissioning and changes in federal, state or local regulations. The cost estimate excludes the portion attributable to other co-owners of CR3. The NRC operating license held by PEF for CR3 currently expires in December 2016. An application to extend this license 20 years is expected to be submitted in the first quarter of 2009. As part of this new estimate and assumed license extension, PEF reduced its ARO liability by \$88 million. Retail accruals on PEF's reserves for nuclear decommissioning were previously suspended through December 2005 under the terms of the Agreement and the new Base Rate Settlement continues that suspension.

FRANCHISE MATTERS

On June 1, 2005, Winter Park acquired PEF's electric distribution system that serves Winter Park for approximately \$42 million. On June 1, 2005, PEF transferred the distribution system to Winter Park and recognized a pre-tax gain of approximately \$25 million on the transaction, which is included as an offset to other utility expense on the Statements of Income. This amount was decreased \$1 million in the third quarter of 2005 upon accumulation of the final capital expenditures incurred since arbitration. PEF also recorded a regulatory liability of \$8 million for stranded cost revenues, which will be amortized to revenues over six years in accordance with the provisions of the transfer agreement with Winter Park. In June 2004, Winter Park executed a wholesale power supply contract with PEF with a five-year term and a renewal option.

OTHER MATTERS

On June 29, 2004, the FPSC approved a Stipulation and Settlement Agreement, executed on April 29, 2004, by PEF, the Office of Public Counsel and the Florida Industrial Power Users Group. The stipulation and settlement resolved the issue pending before the FPSC regarding the costs PEF will be allowed to recover through its Fuel and Purchased Power Cost Recovery clause in 2004 and beyond for waterborne coal deliveries by PEF's affiliated coal

supplier, Progress Fuels. The settlement sets fixed per ton prices based on point of origin for all waterborne coal deliveries in 2004, and establishes a market-based pricing methodology for determining recoverable waterborne coal transportation costs through a competitive solicitation process or market price proxies in 2005 and thereafter. The settlement reduces the amount that PEF will charge to the Fuel and Purchased Power Cost Recovery clause for waterborne transportation by approximately \$11 million beginning in 2004.

On November 3, 2004, the FPSC approved PEF's petition for Determination of Need for the construction of a fourth unit at PEF's Hines Energy Complex. Hines Unit 4 is needed to maintain electric system reliability and integrity and to continue to provide adequate electricity to its ratepayers at a reasonable cost. Hines Unit 4 will be a combined cycle unit with a generating capacity of 461 MW (summer rating). The estimated total in-service cost of Hines Unit 4 is \$286 million, and the unit is planned for commercial operation in December 2007. If the actual cost is less than the estimate, customers will receive the benefit of such cost under-runs. Any costs that exceed this estimate will not be recoverable absent extraordinary circumstances as found by the FPSC in subsequent proceedings.

D. Regional Transmission Organizations

In 2000, the FERC issued Order No. 2000 regarding regional transmission organizations (RTOs). This Order set minimum characteristics and functions that RTOs must meet, including independent transmission service. In October 2000, as a result of Order 2000, PEC, along with Duke Energy Corporation and South Carolina Electric & Gas Company, filed an application with the FERC for approval of an RTO, GridSouth. In July 2001, the FERC issued an order provisionally approving GridSouth. However, in July 2001, the FERC issued orders recommending that companies in the southeastern United States engage in mediation to develop a plan for a single RTO. PEC participated in the mediation. On August 11, 2005, the GridSouth participants notified the FERC that they had terminated the GridSouth project. By order issued October 20, 2005, the FERC terminated the GridSouth proceeding. PEC has \$33 million invested in GridSouth related to startup costs at December 31, 2005. PEC expects to recover these startup costs.

The FPSC ruled in December 2001 that the formation of GridFlorida by the three major investor-owned utilities in Florida, including PEF, was prudent but ordered changes in the structure and market design of the proposed organization. In September 2002, the FPSC set a hearing for market design issues; this order was appealed to the Florida Supreme Court by the consumer advocate of the state of Florida. In June 2003, the Florida Supreme Court dismissed the appeal without prejudice. In September 2003, the FERC held a Joint Technical Conference with the FPSC to consider issues related to formation of an RTO for peninsular Florida. In December 2003, the FPSC ordered further state proceedings and established a collaborative workshop process to be conducted during 2004. In June 2004, the workshop process was abated pending completion of a cost-benefit study. On December 12, 2005, the final report of the cost-benefit study was issued. The study concluded that the GridFlorida RTO was not cost effective. The study further segregated the costs and benefits between FPSC jurisdictional and nonjurisdictional customers, concluding that the jurisdictional customers would incur even more costs and benefits would be shifted to nonjurisdictional customers. In light of the findings and conclusions of the cost-benefit study, on January 27, 2006, the GridFlorida applicants filed a motion to withdraw the compliance filing and filed a petition to close the docketed proceeding. The Florida Municipal Power Agency and Seminole Electric Power Cooperative have submitted a filing in opposition to this motion. The FPSC has released a schedule that indicates that they will issue an order on this motion by April 24, 2006. The GridFlorida applicants are currently in discussions to determine whether there are cost-effective alternatives to the GridFlorida proposal that could be implemented in peninsular Florida. PEF has fully recovered its startup costs in GridFlorida from retail ratepayers.

E. FERC Market Power Mitigation

In April 2004, the FERC issued two orders concerning utilities' ability to sell wholesale electricity at market-based rates. In the first order, the FERC adopted two new interim screens for assessing potential generation market power of applicants for wholesale market-based rates, and described additional analyses and mitigation measures that could be presented if an applicant does not pass one of these interim screens. In July 2004, the FERC issued an order on rehearing affirming its conclusions in the April order. In the second order, the FERC initiated a rulemaking to consider whether the FERC's current methodology for determining whether a public utility should be allowed to sell wholesale electricity at market-based rates should be modified in any way. PEF does not have market-based rate

authority for wholesale sales in peninsular Florida. Given the difficulty PEC believed it would experience in passing one of the interim screens, on September 6, 2005, PEC filed revisions to its market-based rate tariffs restricting them to sales outside PEC's control area and peninsular Florida and a new cost-based tariff for sales within PEC's control area. The FERC has accepted these revised tariffs.

F. Energy Delivery Capitalization Practice

We reviewed our capitalization policies for the Utilities' distribution operations (Energy Delivery) in 2004. That review indicated that in the areas of outage and emergency work not associated with major storms and allocation of indirect costs, both PEC and PEF should revise the way that they estimate the amount of capital costs associated with such work. Effective January 1, 2005, we implemented changes that included more detailed classification of outage and emergency work resulting in more precise estimation and implemented a process to retest accounting estimates on an annual basis. As a result of the changes in accounting estimates for the outage and emergency work and indirect costs, a lesser proportion of PEC's and PEF's costs will be capitalized on a prospective basis. The combined impact for the Utilities in 2005 was to expense approximately \$63 million of costs that would have been capitalized under the previous policies. Of this total, \$26 million related to PEC and \$37 million related to PEF. Pursuant to SFAS No. 71, the Utilities informed the state regulators having jurisdiction over them of this change and that the new estimation process was implemented effective January 1, 2005. We also requested and received a method change from the Internal Revenue Service (IRS) during 2005.

8. GOODWILL AND OTHER INTANGIBLE ASSETS

We perform annual goodwill impairment tests in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). Goodwill impairment was tested for both the PEC and PEF segments in the second quarters of 2004 and 2005; each test indicated no impairment.

For our Progress Ventures segment, the goodwill impairment tests are performed at the reporting unit level of our Effingham, Monroe, Walton and Washington nonregulated generation plants (Georgia Region), which is one level below the Progress Ventures segment. We performed the annual goodwill impairment test for our Georgia Region reporting unit in the first quarters of 2005 and 2004, each of which indicated no impairment. In response to changing gas and electricity prices that have a significant impact on the future cash flows of our Georgia Region operations, we also performed an interim goodwill impairment test for the Progress Ventures goodwill in the third and fourth quarters of 2005, each of which indicated no impairment. However, as part of our evaluation of certain business opportunities in the first quarter of 2006, we performed an interim impairment test for the \$64 million of goodwill, which indicated the fair value of the Georgia Region was less than its carrying value. As required by SFAS No. 142, we are currently performing the second step of the impairment test, which compares the implied fair value of the goodwill with the recorded goodwill. While the results of the second step of the impairment test are currently unknown, the effects could range from no change to the recorded goodwill value to a potential write-off of \$64 million.

Under SFAS No. 142, all goodwill is assigned to our reporting units that are expected to benefit from the synergies of the business combination. The changes in the carrying amount of goodwill, by reportable segment, for the years ended December 31 were as follows:

(in millions)	PEC	PEF	Progress Ventures	Corporate and Other	Total
Balance at January 1, 2003	\$ 1,922	\$ 1,733	\$ 64	\$ -	\$ 3,719
Acquisitions	-	-	-	7	7
Balance at December 31, 2003	1,922	1,733	64	7	3,726
Purchase accounting adjustment	-	-	-	(7)	(7)
Balance at December 31, 2004	1,922	1,733	64	-	3,719
Balance at December 31, 2005	\$ 1,922	\$ 1,733	\$ 64	\$ -	\$ 3,719

In December 2003, \$7 million in goodwill was recorded based on a preliminary purchase price allocation as part of the PTC partial acquisition of EPIK and was reported in the Corporate and Other segment. As discussed in Note 4B, we revised the preliminary EPIK purchase price allocation as of September 2004, and the \$7 million of goodwill was reallocated to certain tangible assets acquired based on the results of valuations and appraisals.

The gross carrying amount and accumulated amortization of the intangible assets at December 31 were as follows:

(in millions)	2005		2004	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Synthetic fuel intangibles	\$ 134	\$ (98)	\$ 134	\$ (80)
Power agreements acquired	188	(19)	188	(6)
Other	112	(15)	111	(11)
Total	\$ 434	\$ (132)	\$ 433	\$ (97)

In June 2004, we sold, in two transactions, a combined 49.8 percent partnership interest in Colona, one of our synthetic fuel operations. Approximately \$6 million in synthetic fuel intangibles and \$3 million in related accumulated amortization were included in the sale of the partnership interest.

All of our intangibles, except minimum pension liability adjustments, are subject to amortization. Synthetic fuel intangibles represent intangibles for synthetic fuel technology. These intangibles are being amortized on a straight-line basis until the expiration of tax credits under Section 29/45K in December 2007 (See Note 23D). The intangibles related to power agreements acquired are being amortized based on the economic benefits of the contracts (See Notes 4D). Other intangibles are primarily acquired customer contracts, permits that are amortized over their respective lives and minimum pension liability adjustments.

PEC had intangible assets related to minimum pension liability adjustments of \$17 million and \$18 million at December 31, 2005 and 2004, respectively. PEF had intangible assets related to minimum pension liability adjustments of \$2 million at December 31, 2005.

Amortization expense recorded on intangible assets for the years ended December 31, 2005, 2004 and 2003 was \$35 million, \$42 million and \$36 million, respectively. The estimated annual amortization expense for intangible assets for 2006 through 2010 is approximately \$36 million, \$37 million, \$18 million, \$18 million and \$19 million, respectively.

9. IMPAIRMENTS OF LONG-LIVED ASSETS AND INVESTMENTS

We apply SFAS No. 144 for the accounting and reporting of impairment or disposal of long-lived assets. In 2005 and 2003, we recorded pre-tax long-lived asset and investment impairments and other charges of \$1 million and \$38 million, respectively. PEC recorded pre-tax long-lived asset and investment impairments and other charges of \$1 million and \$21 million, respectively, in 2005 and 2003. No impairments were recorded in 2004.

A. Long-Lived Assets

Due to the reduction in coal production, we evaluated Kentucky May coal mine's long-lived assets in 2003. Fair value was determined based on discounted cash flows. As a result of this review, we recorded asset impairments of \$17 million on a pre-tax basis during the fourth quarter of 2003. As discussed in Note 3A, all amounts directly related to the coal mines are included in discontinued operations on the consolidated statements of income. Due to rising current and future oil prices, in the third and fourth quarters of 2005 we tested our synthetic fuel plant assets for impairment. These tests indicated that the assets were recoverable and no impairment charge was recorded. See Note 23D for additional information.

B. Investments

We evaluate declines in value of investments under the criteria of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS No. 115), and Emerging Issues Task Force (EITF) Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairments and Its Application to Certain Investments" (EITF 03-1). Declines in fair value to below the cost basis judged to be other than temporary on available-for-sale securities are included in impairments of investments. See Note 13 for additional information.

We continually review PEC's affordable housing investment (AHI) portfolio for impairment. As a result of various factors including continued operating losses of the AHI portfolio and management issues arising at certain properties within the AHI portfolio, we recorded impairment charges of \$1 million and \$18 million on a pre-tax basis in 2005 and 2003, respectively. PEC also recorded an impairment of \$3 million for a cost investment in 2003. No impairments were recorded in 2004.

10. EQUITY

A. Common Stock

Progress Energy

At December 31, 2005 and 2004, we had 500 million shares of common stock authorized under our charter, of which 252 million shares and 247 million shares, respectively, were outstanding. At December 31, 2005 and 2004, we had approximately 58 million shares and 63 million shares, respectively, of common stock authorized by the board of directors that remained unissued and reserved, primarily to satisfy the requirements of our stock plans. In 2002, the board of directors authorized meeting the requirements of the Progress Energy 401(k) Savings and Stock Ownership Plan (401(k)) and the Investor Plus Stock Purchase Plan with original issue shares. During 2005, 2004 and 2003, respectively, we issued approximately 4.6 million, 1.4 million and 7.5 million shares, respectively, under these plans for net proceeds of approximately \$199 million, \$62 million and \$305 million, respectively. We continue to meet the requirements of the restricted stock plan with issued and outstanding shares.

There are various provisions limiting the use of retained earnings for the payment of dividends under certain circumstances. At December 31, 2005, there were no significant restrictions on the use of retained earnings (See Note 12).

PEC

At December 31, 2005 and 2004, PEC was authorized to issue up to 200 million shares of common stock. All shares issued and outstanding are held by Progress Energy. There are various provisions limiting the use of retained earnings for the payment of dividends under certain circumstances. At December 31, 2005, there were no significant restrictions on the use of retained earnings. See Note 12 for additional dividend restrictions related to PEC.

PEF

At December 31, 2005 and 2004, PEF was authorized to issue up to 60 million shares of common stock. All PEF common shares issued and outstanding are indirectly held by Progress Energy. There are various provisions limiting the use of retained earnings for the payment of dividends under certain circumstances. At December 31, 2005, there were no significant restrictions on the use of retained earnings. See Note 12 for additional dividend restrictions related to PEF.

B. Stock-Based Compensation

EMPLOYEE STOCK OWNERSHIP PLAN

We sponsor the 401(k) for which substantially all full-time nonbargaining unit employees and certain part-time nonbargaining unit employees within participating subsidiaries are eligible. Participating subsidiaries as of January

1, 2003, were PEC, PEF, PTC, PVI, Progress Fuels (corporate employees) and Progress Energy Service Company, LLC (PESC). Effective December 19, 2003, (the PT LLC/EPIK merger date), PTC no longer participates in the 401(k). The 401(k), which has matching and incentive goal features, encourages systematic savings by employees and provides a method of acquiring Progress Energy common stock and other diverse investments. The 401(k), as amended in 1989, is an Employee Stock Ownership Plan (ESOP) that can enter into acquisition loans to acquire Progress Energy common stock to satisfy 401(k) common share needs. Qualification as an ESOP did not change the level of benefits received by employees under the 401(k). Common stock acquired with the proceeds of an ESOP loan is held by the 401(k) Trustee in a suspense account. The common stock is released from the suspense account and made available for allocation to participants as the ESOP loan is repaid. Such allocations are used to partially meet common stock needs related to matching and incentive contributions and/or reinvested dividends. All or a portion of the dividends paid on ESOP suspense shares and on ESOP shares allocated to participants may be used to repay ESOP acquisition loans. To the extent used to repay such loans, the dividends are deductible for income tax purposes. Also, beginning in 2002, the dividends paid on ESOP shares that are either paid directly to participants or used to purchase additional shares which are subsequently allocated to participants, are fully deductible for income tax purposes.

There were 2.9 million and 3.5 million ESOP suspense shares at December 31, 2005 and 2004, respectively, with a fair value of \$126 million and \$156 million, respectively. ESOP shares allocated to plan participants totaled 11.4 million and 12.6 million at December 31, 2005 and 2004, respectively. Our matching and incentive goal compensation cost under the 401(k) is determined based on matching percentages and incentive goal attainment as defined in the plan. Such compensation cost is allocated to participants' accounts in the form of Progress Energy common stock, with the number of shares determined by dividing compensation cost by the common stock market value at the time of allocation. We currently meet common stock share needs with open market purchases, with shares released from the ESOP suspense account and with newly issued shares. Costs for incentive goal compensation are accrued during the fiscal year and typically paid in shares in the following year, while costs for the matching component are typically met with shares in the same year incurred. Matching and incentive costs, which were met and will be met with shares released from the suspense account, totaled approximately \$18 million, \$21 million and \$20 million for the years ended December 31, 2005, 2004 and 2003, respectively. Total matching and incentive costs totaled approximately \$30 million, \$32 million and \$35 million for the years ended December 31, 2005, 2004 and 2003, respectively. We have a long-term note receivable from the 401(k) Trustee related to the purchase of common stock from us in 1989. The balance of the note receivable from the 401(k) Trustee is included in the determination of unearned ESOP common stock, which reduces common stock equity. ESOP shares that have not been committed to be released to participants' accounts are not considered outstanding for the determination of earnings per common share. Interest income on the note receivable and dividends on unallocated ESOP shares are not recognized for financial statement purposes.

PEC's matching and incentive costs, which were met and will be met with shares released from the suspense account, totaled approximately \$11 million, \$12 million and \$11 million for the years ended December 31, 2005, 2004 and 2003, respectively. Matching and incentive costs totaled approximately \$17 million, \$18 million and \$16 million for the years ended December 31, 2005, 2004 and 2003, respectively.

PEF

PEF's matching and incentive costs, which were met and will be met with shares released from the suspense account, totaled approximately \$4 million, \$5 million and \$4 million for the years ended December 31, 2005, 2004 and 2003, respectively. Matching and incentive costs totaled approximately \$6 million, \$7 million and \$10 million for the years ended December 31, 2005, 2004 and 2003, respectively.

NEW ACCOUNTING FOR STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No. 123R, which revises SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB Opinion No. 25). The key requirement of SFAS No. 123R is that the cost of stock-based awards

to employees will be measured based on an award's fair value at the grant date, with such cost to be amortized over the appropriate service period, net of estimated forfeitures. Previously, entities could elect to continue accounting for such awards at their grant date intrinsic value under APB Opinion No. 25, and we made that election. The intrinsic value method resulted in our recording no compensation expense for stock options granted to employees. Also, as previously allowed, we recognized the expense effects of forfeitures as they occurred. SFAS No. 123R also changes prospectively the presentation of certain stock-based compensation excess income tax benefits in the statement of cash flows, with such excess tax benefits shown as financing cash inflows rather than operating cash inflows.

We adopted SFAS No. 123R as of July 1, 2005, using the required modified prospective method. Under that method, we will record compensation expense under SFAS No. 123R for all awards granted after July 1, 2005, and will record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that were outstanding at July 1, 2005. For awards with graded-vesting features, we will recognize expense using the grading-vesting method alternative in SFAS No. 123R. As a result of the adoption of SFAS No. 123R, on a prospective basis, we will not show unearned restricted shares as a negative component of common stock equity; rather, such amounts will be included in the determination of common stock presented in the Consolidated Balance Sheets. In addition, on a prospective basis, for new awards that effectively vest upon an employee's retirement eligibility, we will recognize expense over a vesting period based on the effective vesting date. Previously, we recognized expense over a vesting period based on the stated vesting date.

Progress Energy

Adoption of SFAS No. 123R resulted in our recognizing approximately \$3 million of pre-tax expense for stock options during the year ended December 31, 2005, which would not have been recognized under the prior accounting treatment. We curtailed our stock option program in 2004 and replaced that compensation program with other programs. Therefore, the amount of stock option expense recorded in 2005 is below the amount that would have been recorded if the stock option program had continued. Additionally, we recognized a cumulative pre-tax benefit from the accounting change of approximately \$1 million, which reflects the cumulative impact of estimating forfeitures in the determination of period expense for other stock-based compensation plans, rather than recording the effect of forfeitures as they occur. As a result of the adoption of SFAS No. 123R, on a prospective basis we will not show unearned restricted shares as a negative component of common stock equity; rather, such amounts will be included in the determination of common stock presented in the Consolidated Balance Sheets. The adoption of SFAS No. 123R did not have a material impact on our income, earnings per share or our presentation of cash flows for the year ended December 31, 2005.

PEC

PEC participates in the Progress Energy stock option and other stock-based compensation plans and its adoption of SFAS No. 123R resulted in the recognition of approximately \$1 million of pre-tax expense for stock options for the year ended December 31, 2005, which would not have been recognized under the prior accounting treatment. Additionally, PEC recognized an immaterial amount of cumulative pre-tax benefit from the accounting change which reflects the cumulative impact of estimating forfeitures in the determination of period expense for other stock-based compensation plans, rather than recording the effect of forfeitures as they occur. The adoption of SFAS No. 123R did not have a material impact on PEC's income or PEC's presentation of cash flows for the year ended December 31, 2005.

PEF

PEF participates in the Progress Energy stock option and other stock-based compensation plans and its adoption of SFAS No. 123R resulted in the recognition of approximately \$1 million of pre-tax expense for stock options for the year ended December 31, 2005, which would not have been recognized under the prior accounting treatment. Additionally, PEF recognized an immaterial amount of cumulative pre-tax benefit from the accounting change which reflects the cumulative impact of estimating forfeitures in the determination of period expense for other stock-based compensation plans, rather than recording the effect of forfeitures as they occur. The adoption of SFAS No. 123R did not have a material impact on PEF's income or PEF's presentation of cash flows for the year ended December 31, 2005.

STOCK OPTIONS

Pursuant to our 1997 Equity Incentive Plan and 2002 Equity Incentive Plan, amended and restated as of July 10, 2002, we may grant options to purchase shares of Progress Energy common stock to directors, officers and eligible employees for up to 5 million and 15 million shares, respectively. Generally, options granted to employees vest one-third per year with 100 percent vesting at the end of year three, while options granted to directors vest 100 percent at the end of one year. The options expire 10 years from the date of grant. All option grants have an exercise price equal to the fair market value of our common stock on the grant date. As noted above, we have ceased granting stock options. An immaterial number of stock options were granted in 2004 and no stock options have been granted in 2005. We issue new shares of common stock to satisfy the exercise of previously issued stock options.

Progress Energy

A summary of the status of our stock options at December 31, 2005, and changes during the year then ended, is presented below:

(option quantities in millions)	Number of Options	Weighted-Average Exercise Price
Options outstanding, January 1	7.4	\$43.57
Granted	-	-
Forfeited	(0.1)	\$44.12
Canceled	(0.1)	\$43.75
Exercised	(0.2)	\$42.70
Options outstanding, December 31	7.0	\$43.58
Options exercisable, December 31	6.0	\$43.40

The options outstanding at December 31, 2005, had a weighted-average remaining contractual life of 6.6 years and an aggregate intrinsic value of \$5 million. The options exercisable at December 31, 2005, had a weighted-average remaining contractual life of 6.4 years and an aggregate intrinsic value of \$5 million.

The total intrinsic value of options exercised during the year ended December 31, 2004, was \$1 million. Total intrinsic value of options exercised during the years ended December 31, 2005 and 2003, was less than \$1 million in each year.

Compensation cost, for pro forma purposes prior to the adoption of SFAS No. 123R and for expense purposes subsequent to the adoption, is measured at the grant date based on the fair value of the award and is recognized over the vesting period. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

	2004	2003
Risk-free interest rate	4.22%	4.25%
Dividend yield	5.19%	4.75%
Volatility factor	20.30%	22.28%
Weighted-average expected life of the options (in years)	10	10

Dividend yield and the volatility factor were calculated using three years of historical trend information. The expected term was based on the contractual life of the options.

Stock option expense totaling \$3 million was recognized in income during the year ended December 31, 2005, with a recognized tax benefit of \$1 million. No compensation cost related to stock options was capitalized during the year.

As previously indicated, we did not record stock option expense prior to the adoption of SFAS No. 123R as of July 1, 2005. The following table illustrates the effect on our net income and earnings per share if the fair value method had been applied to all outstanding and nonvested awards in each period:

(in millions except per share data)	2005	2004	2003
Net income, as reported	\$ 697	\$ 759	\$ 782
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	2	10	11
Pro forma net income	\$ 695	\$ 749	\$ 771
Earnings per share			
Basic - as reported	\$ 2.82	\$ 3.13	\$ 3.30
Basic - pro forma	2.81	3.09	3.25
Diluted - as reported	2.82	3.12	3.28
Diluted - pro forma	2.81	3.08	3.24

At December 31, 2005, there was \$2 million of total unrecognized compensation cost related to nonvested stock options that will be recognized over one year.

Cash received from the exercise of stock options totaled \$8 million, \$18 million and \$4 million, respectively, during the years ended December 31, 2005, 2004 and 2003. The actual tax benefit for tax deductions from stock option exercises for the years ended December 31, 2005, 2004 and 2003 was not significant.

PEC

Stock option expense totaling \$1 million was recognized in income during the year ended December 31, 2005, with a recognized tax benefit of less than \$1 million. No compensation cost related to stock options was capitalized during the year. At December 31, 2005, there was \$1 million of total unrecognized compensation cost related to nonvested stock options which will be recognized over one year.

As previously indicated, we did not record stock option expense prior to the adoption of SFAS No. 123R as of July 1, 2005. The following table illustrates the effect on our net income if the fair value method had been applied to all outstanding and nonvested awards in each period:

(in millions)	2005	2004	2003
Net income, as reported	\$493	\$461	\$482
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	2	7	6
Pro forma net income	\$491	\$454	\$476

PEF

Stock option expense totaling \$1 million was recognized in income during the year ended December 31, 2005, with a recognized tax benefit of less than \$1 million. No compensation cost related to stock options was capitalized during the year. At December 31, 2005, there was less than \$1 million of total unrecognized compensation cost related to nonvested stock options which will be recognized over one year.

As previously indicated, we did not record stock option expense prior to the adoption of SFAS No. 123R as of July 1, 2005. The following table illustrates the effect on our net income if the fair value method had been applied to all outstanding and nonvested awards in each period:

(in millions)	2005	2004	2003
Net income, as reported	\$260	\$335	\$297
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	1	2	2
Pro forma net income	\$259	\$333	\$295

OTHER STOCK-BASED COMPENSATION PLANS

We have additional compensation plans for our officers and key employees that are stock-based in whole or in part. The two primary active stock-based compensation programs are the Performance Share Sub-Plan (PSSP) and the Restricted Stock Awards (RSA) program, both of which were established pursuant to our 1997 Equity Incentive Plan and were continued under our 2002 Equity Incentive Plan, as amended and restated as of July 10, 2002.

We granted cash-settled PSSP awards prior to 2005. Beginning in 2005, we are granting stock-settled PSSP awards. Under the terms of the cash-settled PSSP, our officers and key employees are granted a target number of performance shares on an annual basis that vest over a three-year consecutive period. Each performance share has a value that is equal to, and changes with, the value of a share of Progress Energy common stock, and dividend equivalents are accrued on, and reinvested in, the performance shares. The PSSP has two equally weighted performance measures, both of which are based on our results as compared to a peer group of utilities. The outcome of the performance measures can result in an increase or decrease from the target number of performance shares granted. Compensation expense is recognized over the vesting period based on the estimated fair value of the award, which is periodically updated based on expected ultimate cash payout, and is reduced by estimated forfeitures. The stock-settled PSSP is similar to the cash-settled PSSP, except that we distribute common stock shares to participants equivalent to the number of performance shares that ultimately vest. Also, the fair value of the stock-settled award is generally established at the grant date based on the fair value of common stock on that date, with certain subsequent adjustments related to our results as compared to the peer group of utilities. PSSP cash-settled liabilities totaling \$5 million, \$7 million and \$6 million were paid in the years ended December 31, 2005, 2004 and 2003, respectively. In 2005, we granted 540,588 stock-settled performance shares having a weighted-average grant date fair value of \$44.24, with no forfeitures as of December 31, 2005.

The RSA program allows us to grant shares of restricted common stock to our officers and key employees. The restricted shares generally vest on a graded vesting schedule over a minimum of three years. Compensation expense, which is based on the fair value of common stock at the grant date, is recognized over the applicable vesting period, with corresponding increases in common stock equity. Restricted shares are not included as shares outstanding in the basic earnings per share calculation until the shares are no longer forfeitable. A summary of the status of the nonvested restricted stock shares at December 31, 2005, and changes during the year then ended, is presented below:

	Number of Restricted Shares	Weighted-Average Grant Date Fair Value
Beginning balance	645,176	\$42.32
Granted	192,800	42.56
Vested	(149,934)	38.75
Forfeited	(99,734)	42.53
Ending balance	588,308	\$43.27

The weighted-average grant date fair value of restricted stock granted during the years ended December 31, 2004 and 2003, was \$46.95 and \$39.53, respectively.

The total fair value of restricted stock vested during the years ended December 31, 2005, 2004 and 2003 was \$7 million, \$16 million and \$6 million, respectively. Cash expended to purchase shares for the restricted stock program totaled \$8 million, \$7 million and \$7 million during the years ended December 31, 2005, 2004 and 2003, respectively.

Our Consolidated Statements of Income included total recognized expense for other stock-based compensation plans of \$10 million for the year ended December 31, 2005, with a recognized tax benefit of \$4 million. The total expense recognized on our Consolidated Statements of Income for other stock-based compensation plans was \$10 million for the year ended December 31, 2004, with a recognized tax benefit of \$4 million. The total expense recognized on our Consolidated Statements of Income for other stock-based compensation plans was \$27 million for the year ended December 31, 2003, with a recognized tax benefit of \$10 million. No compensation cost related to other stock-based compensation plans was capitalized.

At December 31, 2005, there was \$34 million of total unrecognized compensation cost related to nonvested other stock-based compensation plan awards, which is expected to be recognized over a weighted-average period of 2.2 years.

PEC

Our Consolidated Statements of Income included total recognized expense for other stock-based compensation plans of \$7 million for the year ended December 31, 2005, with a recognized tax benefit of \$3 million. The total expense recognized on our Consolidated Statements of Income for other stock-based compensation plans was \$7 million for the year ended December 31, 2004, with a recognized tax benefit of \$3 million. The total expense recognized on our Consolidated Statements of Income for other stock-based compensation plans was \$15 million for the year ended December 31, 2003, with a recognized tax benefit of \$6 million. No compensation cost related to other stock-based compensation plans was capitalized.

PEF

Our Statements of Income included total recognized expense for other stock-based compensation plans of \$3 million for the year ended December 31, 2005, with a recognized tax benefit of \$1 million. The total expense recognized on our Statements of Income for other stock-based compensation plans was \$2 million for the year ended December 31, 2004, with a recognized tax benefit of \$1 million. The total expense recognized on our Statements of Income for other stock-based compensation plans was \$7 million for the year ended December 31, 2003, with a recognized tax benefit of \$3 million. No compensation cost related to other stock-based compensation plans was capitalized.

C. Earnings Per Common Share

Basic earnings per common share is based on the weighted-average number of common shares outstanding. Diluted earnings per share includes the effect of the nonvested portion of restricted stock awards and the effect of stock options outstanding.

A reconciliation of the weighted-average number of common shares outstanding for the years ended December 31 for basic and dilutive purposes follows:

(in millions)	2005	2004	2003
Weighted-average common shares - basic	246.6	242.2	237.2
Restricted stock awards	.3	.8	1.0
Stock options	.1	.1	-
Weighted-average shares - fully diluted	247.0	243.1	238.2

There are no adjustments to net income or to income from continuing operations between the calculations of basic and fully diluted earnings per common share. ESOP shares that have not been committed to be released to participants' accounts are not considered outstanding for the determination of earnings per common share. The weighted-average shares totaled 3.0 million, 3.6 million and 4.1 million for the years ended December 31, 2005,

2004 and 2003, respectively. There were 2.9 million, 3.0 million and 5.3 million stock options outstanding at December 31, 2005, 2004 and 2003, respectively, which were not included in the weighted-average number of shares for computing the fully diluted earnings per share because they were antidilutive.

D. Accumulated Other Comprehensive Loss

Components of accumulated other comprehensive loss, net of tax, at December 31 were as follows:

(in millions)	<u>Progress Energy</u>		<u>PEC</u>	
	2005	2004	2005	2004
Gain (loss) on cash flow hedges	\$ 55	\$ (28)	\$ (3)	\$ (7)
Minimum pension liability adjustments	(160)	(142)	(119)	(107)
Foreign currency translation and other	1	6	2	-
Total accumulated other comprehensive loss	\$ (104)	\$ (164)	\$ (120)	\$ (114)

11. PREFERRED STOCK OF SUBSIDIARIES - NOT SUBJECT TO MANDATORY REDEMPTION

All of our preferred stock was issued by our subsidiaries and was not subject to mandatory redemption. At December 31, 2005 and 2004, preferred stock outstanding consisted of the following:

(Dollars in millions, except share and per share data)	Shares			
	Authorized	Out	Redemption Price	Total
<u>PEC</u>				
Cumulative, no par value \$5 Preferred Stock	300,000			
\$5 Preferred		236,997	\$110.00	\$ 24
Cumulative, no par value Serial Preferred Stock	20,000,000			
\$4.20 Serial Preferred		100,000	102.00	10
\$5.44 Serial Preferred		249,850	101.00	25
Cumulative, no par value Preferred Stock A	5,000,000	-	-	-
No par value Preference Stock	10,000,000	-	-	-
Total PEC				59
<u>PEF</u>				
Cumulative, \$100 par value Preferred Stock	4,000,000			
4.00% \$100 par value Preferred		39,980	\$104.25	4
4.40% \$100 par value Preferred		75,000	102.00	8
4.58% \$100 par value Preferred		99,990	101.00	10
4.60% \$100 par value Preferred		39,997	103.25	4
4.75% \$100 par value Preferred		80,000	102.00	8
Cumulative, no par value Preferred Stock	5,000,000	-	-	-
\$100 par value Preference Stock	1,000,000	-	-	-
Total PEF				34
Total preferred stock of subsidiaries				\$ 93

12. DEBT AND CREDIT FACILITIES

A. Debt and Credit Facilities

At December 31 our long-term debt consisted of the following (maturities and weighted-average interest rates at December 31, 2005):

(in millions)		2005	2004
<u>Progress Energy, Inc.</u>			
Senior unsecured notes, maturing 2006-2031	6.78%	\$ 4,300	\$ 4,300
Draws on revolving credit agreement, expiring 2009		-	160
Unamortized fair value hedge gain, net		(3)	12
Unamortized premium and discount, net		(19)	(23)
Current portion of long-term debt		(404)	-
Long-term debt, net		3,874	4,449

PEC

First mortgage bonds, maturing 2006-2033	5.76%	2,200	1,600
Pollution control obligations, maturing 2017-2024	3.21%	669	669
Unsecured notes, maturing 2012	6.50%	500	500
Medium-term notes, maturing 2008	6.65%	300	300
Miscellaneous notes		22	-
Unamortized premium and discount, net		(24)	(19)
Current portion of long-term debt		-	(300)
Long-term debt, net		3,667	2,750

PEF

First mortgage bonds, maturing 2008-2033	5.39%	1,630	1,330
Pollution control obligations, maturing 2018-2027	3.07%	241	241
Senior unsecured notes, maturing 2008	4.88%	450	-
Medium-term notes, maturing 2006-2028	6.77%	289	337
Draws on revolving credit agreement, expiring 2006		-	55
Unamortized premium and discount, net		(8)	(3)
Current portion of long-term debt		(48)	(48)
Long-term debt, net		2,554	1,912

Florida Progress Funding Corporation (See Note 24)

Debt to affiliated trust, maturing 2039	7.10%	309	309
Unamortized premium and discount, net		(39)	(39)
Long-term debt, net		270	270

Progress Capital Holdings, Inc.

Medium-term notes, maturing 2006-2008	6.84%	140	140
Miscellaneous notes		2	1
Current portion of long-term debt		(61)	(1)
Long-term debt, net		81	140
Progress Energy consolidated long-term debt, net		\$ 10,446	\$ 9,521

At December 31, 2005, we had committed lines of credit used to support our commercial paper borrowings. At December 31, 2005, we had no outstanding borrowings under our credit facilities. For 2004, outstanding borrowings under Progress Energy, Inc.'s 364-day credit facility are included in short-term obligations. Outstanding borrowings under all other credit facilities are included in long-term debt in 2004. At December 31, 2004, we had \$260 million outstanding under our credit facilities classified as short-term obligations at a weighted-average interest rate of 3.18%. We are required to pay minimal annual commitment fees to maintain our credit facilities.

The following table summarizes our revolving credit agreements (RCAs) and available capacity at December 31, 2005:

(in millions)	Description	Total	Outstanding	Reserved(a)	Available
Progress Energy, Inc.	Five-year (expiring 8/5/09)	\$ 1,130	\$ -	\$ (150)	\$ 980
PEC	Five-year (expiring 6/28/10)	450	-	(73)	377
PEF	Five-year (expiring 3/28/10)	450	-	(102)	348
Total credit facilities		\$ 2,030	\$ -	\$ (325)	\$ 1,705

- (a) To the extent amounts are reserved for commercial paper outstanding, they are not available for additional borrowings. In addition, at December 31, 2005 and 2004, Progress Energy, Inc. had a total amount of \$150 million reserved for backing of letters of credit. At December 31, 2005, the actual amount of letters of credit issued was \$33 million.

In addition to the committed RCAs at December 31, 2005, we had an \$800 million 364-day credit agreement, which was restricted for the retirement of \$800 million of 6.75% Senior Notes due March 1, 2006. On March 1, 2006, Progress Energy, Inc. retired \$800 million of its 6.75% Senior Notes, thus effectively terminating the 364-day credit agreement.

The following table summarizes our outstanding commercial paper and other short-term debt classified as short-term obligations and related weighted-average interest rates at December 31, 2005 and 2004:

(in millions)	2005	2004
Progress Energy, Inc.	-	\$ - 2.75%
PEC	4.65%	73 2.77%
PEF	4.75%	102 2.80%
Progress Energy, consolidated	4.71%	\$ 175 2.77%
		\$ 424

The following table presents the aggregate maturities of long-term debt at December 31, 2005:

(in millions)	Progress Energy Consolidated	PEC	PEF
2006	\$ 513	\$ -	\$ 48
2007	674	200	89
2008	1,277	300	532
2009	401	400	-
2010	406	6	300
Thereafter	7,781	2,785	1,641
Total	\$ 11,052	\$ 3,691	\$ 2,610

At December 31, 2005, we classified \$397 million, related to the retirement of \$800 million in Progress Energy, Inc. 6.75% Senior Notes on March 1, 2006, as long-term debt. Settlement of this obligation is not expected to require the use of working capital in 2006 as we have the intent and ability to refinance this debt on a long-term basis.

On January 13, 2006, Progress Energy, Inc. issued \$300 million of 5.625% Senior Notes due 2016 and \$100 million of Series A Floating Rate Senior Notes due 2010, receiving net proceeds of \$397 million. These senior notes are unsecured. Interest on the Floating Rate Senior Notes will be based on three-month LIBOR plus 45 basis points and will be reset quarterly. We used the net proceeds from the sale of these senior notes and a combination of available cash and commercial paper proceeds to retire the \$800 million aggregate principal amount of our 6.75% Senior Notes on March 1, 2006. Pending the application of the proceeds described above, we invested the net proceeds in short-term, interest-bearing, investment-grade securities.

B. Covenants and Default Provisions

FINANCIAL COVENANTS

Progress Energy, Inc.'s, PEC's and PEF's credit lines contain various terms and conditions that could affect the ability to borrow under these facilities. These include maximum debt to total capital ratios (leverage), a minimum interest coverage ratio, material adverse change clauses and cross-default provisions.

All of the credit facilities include a defined maximum total debt to total capital ratio. At December 31, 2005, the maximum and calculated ratios for the Progress Registrants, pursuant to the terms of the agreements, were as follows:

Company	Maximum Ratio	Actual Ratio (a)
Progress Energy, Inc.	68%	60.7%
PEC	65%	55.2%
PEF	65%	50.9%

(a) Indebtedness as defined by the bank agreements includes certain letters of credit and guarantees that are not recorded on the Consolidated Balance Sheets.

Progress Energy, Inc.'s five-year credit facility has a financial covenant for interest coverage. The covenant requires Progress Energy, Inc.'s earnings before interest, taxes, and depreciation and amortization to interest expense ratio to be at least 2.5 to 1. For the year ended December 31, 2005, the ratio was 3.9 to 1.

MATERIAL ADVERSE CHANGE CLAUSE

Pursuant to the terms of Progress Energy, Inc.'s five-year credit facility, even in the event of a material adverse change (MAC) in our financial condition, we may continue to borrow funds so long as the proceeds are used to repay maturing commercial paper balances. The other credit facilities of Progress Energy, Inc., PEC, and PEF do not include a provision under which lenders could refuse to advance funds in the event of a MAC.

CROSS-DEFAULT PROVISIONS

Each of these credit agreements contains cross-default provisions for defaults of indebtedness in excess of the following thresholds: \$50 million for Progress Energy, Inc. and \$35 million each for PEC and PEF. Under these provisions, if the applicable borrower or certain subsidiaries of the borrower fail to pay various debt obligations in excess of their respective cross-default threshold, the lenders could accelerate payment of any outstanding borrowing and terminate their commitments to the credit facility. Progress Energy, Inc.'s cross-default provision applies only to Progress Energy, Inc. and its significant subsidiaries, as defined in the credit agreement, (i.e., PEC, Florida Progress, PEF, Progress Capital Holdings, Inc. and PVI). PEC's and PEF's cross-default provisions apply only to defaults of indebtedness by PEC and its subsidiaries and PEF, respectively, not other affiliates of PEC and PEF.

Additionally, certain of Progress Energy, Inc.'s long-term debt indentures contain cross-default provisions for defaults of indebtedness in excess of amounts ranging from \$25 million to \$50 million; these provisions apply only to other obligations of Progress Energy, Inc., primarily commercial paper issued by the Parent, not its subsidiaries. In the event that these indenture cross-default provisions are triggered, the debt holders could accelerate payment of approximately \$4.3 billion in long-term debt. Certain agreements underlying our indebtedness also limit our ability to incur additional liens or engage in certain types of sale and leaseback transactions.

OTHER RESTRICTIONS

Neither Progress Energy, Inc.'s Articles of Incorporation nor any of its debt obligations contain any restrictions on the payment of dividends. Certain documents restrict the payment of dividends by Progress Energy, Inc.'s subsidiaries as outlined below.

PEC

PEC's mortgage indenture provides that, as long as any first mortgage bonds are outstanding, cash dividends and distributions on its common stock and purchases of its common stock are restricted to aggregate net income available for PEC since December 31, 1948, plus \$3 million, less the amount of all preferred stock dividends and distributions, and all common stock purchases, since December 31, 1948. At December 31, 2005, none of PEC's retained earnings was restricted.

In addition, PEC's Articles of Incorporation provide that cash dividends on common stock shall be limited to 75 percent of net income available for dividends if common stock equity falls below 25 percent of total capitalization, and to 50 percent if common stock equity falls below 20 percent. At December 31, 2005, PEC's common stock equity was approximately 45.6 percent of total capitalization.

PEF

PEF's mortgage indenture provides that it will not pay any cash dividends upon its common stock, or make any other distribution to the stockholders, except a payment or distribution out of net income of PEF subsequent to December 31, 1943. At December 31, 2005, none of PEF's retained earnings was restricted.

In addition, PEF's Articles of Incorporation provide that no cash dividends or distributions on common stock shall be paid, if the aggregate amount thereof since April 30, 1944, including the amount then proposed to be expended, plus all other charges to retained earnings since April 30, 1944, exceed all credits to retained earnings since April 30, 1944, plus all amounts credited to capital surplus after April 30, 1944, arising from the donation to PEF of cash or securities or transfers of amounts from retained earnings to capital surplus. At December 31, 2005, none of PEF's cash dividends or distributions on common stock was restricted.

PEF's Articles of Incorporation also provide that cash dividends on common stock shall be limited to 75 percent of net income available for dividends if common stock equity falls below 25 percent of total capitalization, and to 50 percent if common stock equity falls below 20 percent. On December 31, 2005, PEF's common stock equity was approximately 50.1 percent of total capitalization.

C. Collateralized Obligations

PEC's and PEF's first mortgage bonds are collateralized by their respective mortgage indentures. Each mortgage constitutes a first lien on substantially all of the fixed properties of the respective company, subject to certain permitted encumbrances and exceptions. Each mortgage also constitutes a lien on subsequently acquired property. At December 31, 2005, PEC and PEF had a total of approximately \$2.869 billion and \$1.871 billion, respectively, of first mortgage bonds outstanding, including those related to pollution control obligations. Each mortgage allows the issuance of additional mortgage bonds upon the satisfaction of certain conditions.

D. Guarantees of Subsidiary Debt

See Note 19 on related party transactions for a discussion of obligations guaranteed or secured by affiliates.

E. Hedging Activities

We use interest rate derivatives to adjust the fixed and variable rate components of our debt portfolio and to hedge cash flow risk related to commercial paper and fixed-rate debt to be issued in the future. See discussion of risk management activities and derivative transactions at Note 18.

13. INVESTMENTS AND FAIR VALUE OF FINANCIAL INSTRUMENTS

A. Investments

At December 31, 2005 and 2004, we had investments in various debt and equity securities, cost investments, company-owned life insurance and investments held in trust funds as follows:

(in millions)	<u>Progress Energy</u>		<u>PEC</u>		<u>PEF</u>	
	2005	2004	2005	2004	2005	2004
Nuclear decommissioning trust (See Note 5D)	\$ 1,133	\$ 1,044	\$ 640	\$ 581	\$ 493	\$ 463
Investments in equity securities (a)	7	3	6	3	1	-
Equity method investments (b)	27	26	15	15	-	-
Cost investments (c)	13	14	1	1	-	-
Benefit investment trusts (d)	77	76	1	1	-	-
Company-owned life insurance (d)	153	145	97	93	39	34
Marketable debt securities (e)	191	82	191	82	-	-
Total	\$ 1,601	\$ 1,390	\$ 951	\$ 776	\$ 533	\$ 497

- (a) Certain investments in equity securities that have readily determinable market values, and for which we do not have control, are accounted for as available-for-sale securities at fair value in accordance with SFAS No. 115 (See Note 1). These investments are included in miscellaneous other property and investments in the Consolidated Balance Sheets.
- (b) Investments in unconsolidated companies are included in the Consolidated Balance Sheets in miscellaneous other property and investments using the equity method of accounting (See Note 1). These investments are primarily in limited liability corporations and limited partnerships, and the earnings from these investments are recorded on a pre-tax basis (See Note 21).
- (c) Investments stated principally at cost are included in miscellaneous other property and investments in the Consolidated Balance Sheets.
- (d) Investments in company-owned life insurance and other benefit plan assets are included in miscellaneous other property and investments in the Consolidated Balance Sheets and approximate fair value due to the short maturity of the instruments.
- (e) PEC actively invests available cash balances in various financial instruments, such as tax-exempt debt securities that have stated maturities of 20 years or more. These instruments provide for a high degree of liquidity through arrangements with banks that provide daily and weekly liquidity and 7-, 28- and 35-day auctions that allow for the redemption of the investment at its face amount plus earned income. As PEC intends to sell these instruments within one year or less, generally within 30 days, from the balance sheet date, they are classified as short-term investments.

B. Fair Value of Financial Instruments

Progress Energy

DEBT

The carrying amount of our long-term debt, including current maturities, was \$10.959 billion and \$9.870 billion at December 31, 2005 and 2004, respectively. The estimated fair value of this debt, as obtained from quoted market prices for the same or similar issues, was \$11.491 billion and \$10.843 billion at December 31, 2005 and 2004, respectively.

INVESTMENTS

Certain investments in debt and equity securities that have readily determinable market values, and for which we do not have control, are accounted for as available-for-sale securities at fair value in accordance with SFAS No. 115. These investments include investments held in trust funds, pursuant to NRC requirements, to fund certain costs of decommissioning nuclear plants (See Note 5D). These nuclear decommissioning trust funds are primarily invested in stocks, bonds and cash equivalents that are classified as available-for-sale. Nuclear decommissioning trust funds are presented on the Consolidated Balance Sheets at amounts that approximate fair value. Fair value is obtained from quoted market prices for the same or similar investments. In addition to the nuclear decommissioning trust funds, we hold other debt and equity investments classified as available-for-sale in miscellaneous other property and investments on the Consolidated Balance Sheets at amounts that approximate fair value. Our available-for-sale securities at December 31, 2005 and 2004 are summarized below. Net nuclear decommissioning trust fund unrealized gains are included in regulatory liabilities (See Note 7A).

2005				
(in millions)	Book Value	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Equity securities	\$ 411	\$ 257	\$ 5	\$ 663
Debt securities	680	7	7	680
Cash equivalents	18	-	-	18
Total	\$ 1,109	\$ 264	\$ 12	\$ 1,361

2004				
(in millions)	Book Value	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Equity securities	\$ 387	\$ 219	\$ 6	\$ 600
Debt securities	538	12	2	548
Cash equivalents	17	-	-	17
Total	\$ 942	\$ 231	\$ 8	\$ 1,165

At December 31, 2005, the fair value of available-for-sale debt securities by contractual maturity was (in millions):

Due in one year or less	\$ 15
Due after one through five years	138
Due after five through 10 years	151
Due after 10 years	376
Total	\$ 680

Selected information about our sales of available-for-sale securities during the years ended December 31 is presented below. Realized gains and losses were determined on a specific identification basis.

(in millions)	2005	2004	2003
Proceeds	\$ 2,053	\$ 3,200	\$ 3,374
Realized gains	26	55	21
Realized losses	19	24	25

The following table presents the fair value and gross unrealized losses of our available-for-sale securities at December 31 aggregated by the length of time the securities have been in a continuous loss position.

2005 (in millions)	<u>12 Months or Less</u>		<u>Greater than 12 Months</u>		<u>Total</u>	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equity securities	\$ 653	\$ 3	\$ 10	\$ 2	\$ 663	\$ 5
Debt securities	653	7	27	-	680	7
Cash equivalents	18	-	-	-	18	-
Total	\$ 1,324	\$ 10	\$ 37	\$ 2	\$ 1,361	\$ 12

2004 (in millions)	<u>12 Months or Less</u>		<u>Greater than 12 Months</u>		<u>Total</u>	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equity securities	\$ 587	\$ 3	\$ 13	\$ 3	\$ 600	\$ 6
Debt securities	546	2	2	-	548	2
Cash equivalents	17	-	-	-	17	-
Total	\$ 1,150	\$ 5	\$ 15	\$ 3	\$ 1,165	\$ 8

PEC

DEBT

The carrying amount of PEC's long-term debt, including current maturities, was \$3.667 billion and \$3.050 billion at December 31, 2005 and 2004, respectively. The estimated fair value of this debt, as obtained from quoted market prices for the same or similar issues, was \$3.789 billion and \$3.307 billion at December 31, 2005 and 2004, respectively.

INVESTMENTS

External trust funds have been established to fund certain costs of nuclear decommissioning (See Note 5D). These nuclear decommissioning trust funds are invested in stocks, bonds and cash equivalents and are classified as available-for-sale. Nuclear decommissioning trust funds are presented at amounts that approximate fair value. Fair value is obtained from quoted market prices for the same or similar investments. In addition to the nuclear decommissioning trust fund, PEC holds other debt and equity investments classified as available-for-sale in miscellaneous other property and investments on the Consolidated Balance Sheets at amounts that approximate fair value. PEC's available-for-sale securities at December 31, 2005 and 2004 are summarized below. Net nuclear decommissioning trust fund unrealized gains are included in regulatory liabilities (See Note 7A).

2005

(in millions)	Book Value	Unrealized Gains	Unrealized Losses	Fair Value
Equity securities	\$ 222	\$ 141	\$ 4	\$ 359
Debt securities	465	4	4	465
Cash equivalents	10	-	-	10
Total	\$ 697	\$ 145	\$ 8	\$ 834

(in millions)	Book Value	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Equity securities	\$ 208	\$ 123	\$ 5	\$ 326
Debt securities	319	7	1	325
Cash equivalents	12	-	-	12
Total	\$ 539	\$ 130	\$ 6	\$ 663

At December 31, 2005, the fair value of available-for-sale debt securities by contractual maturity was (in millions):

Due in one year or less	\$ 4
Due after one through five years	78
Due after five through 10 years	80
Due after 10 years	303
Total	\$ 465

Selected information about PEC's sales of available-for-sale securities during the years ended December 31 is presented below. Realized gains and losses were determined on a specific identification basis.

(in millions)	2005	2004	2003
Proceeds	\$ 1,678	\$ 2,584	\$ 2,990
Realized gains	13	24	10
Realized losses	8	20	12

The following table presents the fair value and gross unrealized losses of PEC's available-for-sale securities at December 31 aggregated by the length of time the securities have been in a continuous loss position.

2005	12 Months Or Less		Greater Than 12 Months		Total	
(in millions)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equity securities	\$ 349	\$ 2	\$ 10	\$ 2	\$ 359	\$ 4
Debt securities	451	4	14	-	465	4
Cash equivalents	10	-	-	-	10	-
Total	\$ 810	\$ 6	\$ 24	\$ 2	\$ 834	\$ 8

2004	12 Months Or Less		Greater Than 12 Months		Total	
(in millions)	Fair Value	Unrealized Losses	Fair value	Unrealized Losses	Fair Value	Unrealized Losses
Equity securities	\$ 315	\$ 2	\$ 11	\$ 3	\$ 326	\$ 5
Debt securities	323	1	2	-	325	1
Cash equivalents	12	-	-	-	12	-
Total	\$ 650	\$ 3	\$ 13	\$ 3	\$ 663	\$ 6

PEF

DEBT

The carrying amount of PEF's long-term debt, including current maturities, was \$2.602 billion and \$1.960 billion at December 31, 2005 and 2004, respectively. The estimated fair value of this debt, as obtained from quoted market prices for the same or similar issues, was \$2.635 billion and \$2.080 billion at December 31, 2005 and 2004, respectively.

INVESTMENTS

External trust funds have been established to fund certain costs of nuclear decommissioning (See Note 5D). These nuclear decommissioning trust funds are invested in stocks, bonds and cash equivalents and are classified as available-for-sale. Nuclear decommissioning trust funds are presented on the Balance Sheets at amounts that approximate fair value. Fair value is obtained from quoted market prices for the same or similar investments. PEF's available-for-sale securities at December 31, 2005 and 2004 are summarized below. Net nuclear decommissioning trust fund unrealized gains are included in regulatory liabilities (See Note 7A).

2005

(in millions)	Book Value	Unrealized Gains	Unrealized Losses	Fair Value
Equity securities	\$ 189	\$ 116	\$ 1	\$ 304
Debt securities	182	3	2	183
Cash equivalents	5	-	-	5
Total	\$ 376	\$ 119	\$ 3	\$ 492

2004

(in millions)	Book Value	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Equity securities	\$ 179	\$ 96	\$ 1	\$ 274
Debt securities	183	5	1	187
Cash equivalents	5	-	-	5
Total	\$ 367	\$ 101	\$ 2	\$ 466

At December 31, 2005, the fair value of available-for-sale debt securities by contractual maturity was (in millions):

Due in one year or less	\$ 3
Due after one through five years	53
Due after five through 10 years	54
Due after 10 years	73
Total	\$ 183

Selected information about PEF's sales of available-for-sale securities for the years ended December 31 is presented below. Realized gains and losses were determined on a specific identification basis.

(in millions)	2005	2004	2003
Proceeds	\$ 330	\$ 529	\$ 295
Realized gains	13	30	10
Realized losses	10	3	12

The following table presents the fair value and gross unrealized losses of PEF's available-for-sale securities at December 31 aggregated by the length of time the securities have been in a continuous loss position.

	<u>12 Months Or Less</u>		<u>Greater Than 12 Months</u>		<u>Total</u>	
2005	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(in millions)						
Equity securities	\$ 304	\$ 1	\$ -	\$ -	\$ 304	\$ 1
Debt securities	173	2	10	-	183	2
Cash equivalents	5	-	-	-	5	-
Total	\$ 482	\$ 3	\$ 10	\$ -	\$ 492	\$ 3

	<u>12 Months Or Less</u>		<u>Greater Than 12 Months</u>		<u>Total</u>	
2004	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(in millions)						
Equity securities	\$ 272	\$ 1	\$ 2	\$ -	\$ 274	\$ 1
Debt securities	187	1	-	-	187	1
Cash equivalents	5	-	-	-	5	-
Total	\$ 464	\$ 2	\$ 2	\$ -	\$ 466	\$ 2

14. INCOME TAXES

We provide deferred income taxes for temporary differences. These occur when there are differences between book and tax carrying amounts of assets and liabilities. Investment tax credits related to regulated operations have been deferred and are being amortized over the estimated service life of the related properties. To the extent that the establishment of deferred income taxes under SFAS No. 109 is different from the recovery of taxes by the Utilities through the ratemaking process, the differences are deferred pursuant to SFAS No. 71. A regulatory asset or liability has been recognized for the impact of tax expenses or benefits that are recovered or refunded in different periods by the Utilities pursuant to rate orders.

Progress Energy

Accumulated deferred income tax assets (liabilities) at December 31 were:

(in millions)	2005	2004
Deferred income tax assets		
Asset retirement obligation liability	\$ 135	\$ 169
Compensation accruals	101	99
Deferred revenue	54	8
Derivative instruments	-	25
Environmental remediation liability	27	21
Income taxes refundable through future rates	179	115
Postretirement and pension benefits	275	188
Unbilled revenue	30	35
Other	112	128
Federal income tax credit carry forward	957	778
State net operating loss carry forward (net of federal expense)	45	26
Valuation allowance	(39)	(25)
Total deferred income tax assets	1,876	1,567
Deferred income tax liabilities		
Accumulated depreciation and property cost differences	(1,420)	(1,513)
Deferred fuel recovery	(89)	(68)
Deferred storm costs	(94)	(141)
Derivative instruments	(74)	-
Income taxes recoverable through future rates	(187)	(181)
Investments	(31)	--
Prepaid pension costs	-	(16)
Other	(65)	(65)
Total deferred income tax liabilities	(1,960)	(1,984)
Total net deferred income tax liabilities	\$ (84)	\$ (417)

The above amounts were classified in the Consolidated Balance Sheets as follows:

(in millions)	2005	2004
Current deferred income tax assets	\$ 50	\$ 112
Noncurrent deferred income tax assets, included in other assets and deferred debits	30	14
Current deferred income tax liabilities, included in other current liabilities	(1)	-
Noncurrent deferred income tax liabilities, included in noncurrent income tax liabilities	(163)	(543)
Total net deferred income tax liabilities	\$ (84)	\$ (417)

Total noncurrent income tax liabilities on the Consolidated Balance Sheets at December 31, 2005 and 2004 include \$115 million and \$105 million, respectively, related to probable tax liabilities on which we accrue interest that would be payable with the related tax amount in future years.

At December 31, 2005, the federal income tax credit carry forward includes \$925 million of alternative minimum tax credits that do not expire and \$32 million of general business credits that will expire during the period 2022 through 2025. The alternative minimum tax credit carry forward at December 31, 2005, includes \$3 million that would be limited if a change in ownership were to occur with respect to certain indirect wholly owned subsidiary companies.

At December 31, 2005, we had gross state net operating loss carry forwards of \$901 million that will expire during the period 2009 through 2024.

Valuation allowances have been established due to the uncertainty of realizing certain future state tax benefits. We established additional valuation allowances of \$14 million during 2005. We believe it is more likely than not that the results of future operations will generate sufficient taxable income to allow for the utilization of the remaining deferred tax assets.

We establish accruals for certain tax contingencies when, despite our belief that our tax return positions are fully supported, we believe that certain positions may be challenged and that it is probable our positions may not be fully sustained. We are under continuous examination by the IRS and other tax authorities and we account for potential losses of tax benefits in accordance with SFAS No. 5. At December 31, 2005 and 2004, we had recorded \$60 million of tax contingency reserves, excluding accrued interest and penalties, which were included in other current liabilities on the Consolidated Balance Sheets.

Considering all tax contingency reserves, we do not expect the resolution of these matters to have a material impact on our financial position or result of operations. The tax contingency reserves relate primarily to capitalization and basis issues.

Reconciliations of our effective income tax rate to the statutory federal income tax rate for the years ended December 31 follow:

	2005	2004	2003
Effective income tax rate	(6.8)%	12.9%	(16.2)%
State income taxes, net of federal benefit	(3.4)	(6.9)	(3.8)
Minority interest	(1.9)	(1.0)	0.1
Federal tax credits	43.6	26.7	50.6
Investment tax credit amortization	2.0	1.7	2.3
Employee stock ownership plan dividends	1.9	1.8	2.1
Domestic manufacturing deduction	1.3	-	-
Other differences, net	(1.7)	(0.2)	(0.1)
Statutory federal income tax rate	35.0%	35.0%	35.0%

Our effective income tax rate is favorably impacted by federal tax credits resulting from synthetic fuel production.

Income tax expense (benefit) applicable to continuing operations for the years ended December 31 was comprised of:

(in millions)	2005	2004	2003
Current - federal	\$ 351	\$ 238	\$ 297
- state	75	72	57
Deferred - federal	(137)	14	(86)
- state	(32)	16	(19)
State net operating loss carry forward	(6)	(5)	-
Synthetic fuel tax credit	(283)	(215)	(346)
Investment tax credit	(13)	(14)	(16)
Total income tax expense (benefit)	\$ (45)	\$ 106	\$(113)

Total income tax expense (benefit) applicable to continuing operations excluded the following:

- ☐ ☐ ☐ Less than \$1 million of deferred tax expense and \$16 million of deferred tax benefit related to the cumulative effect of changes ☐ in accounting principle recorded net of tax during 2005 and 2003, respectively. There was no cumulative effect of changes in accounting principle recorded during 2004.
- ☐ ☐ Taxes related to discontinued operations recorded net of tax for 2005, 2004 and 2003, which are presented separately in Notes ☐ 3A and 3B.
- ☐ ☐ ☐ Taxes related to other comprehensive income recorded net of tax for 2005, 2004 and 2003, which are presented separately in the ☐ Consolidated Statements of Comprehensive Income.
- ☐ ☐ Current tax benefit of \$2 million related to excess tax deductions resulting from vesting of restricted stock and exercises of ☐ nonqualified stock options, which was recorded in common stock during 2005. Less than \$1 million was recorded in common stock for excess tax deductions during 2004. There was no amount recorded in common stock for excess tax deductions during 2003.

Through our subsidiaries, we are a majority owner in five entities and a minority owner in one entity that owns facilities that produce synthetic fuel as defined under the Code. The production and sale of the synthetic fuel from these facilities qualifies for tax credits under Section 29/45K if certain requirements are satisfied (See Note 23D).

Accumulated deferred income tax assets (liabilities) at December 31 were:

(in millions)	2005	2004
Deferred income tax assets:		
Asset retirement obligation liability	\$ 131	\$ 137
Compensation accruals	46	49
Deferred revenue	55	-
Income taxes refundable through future rates	54	49
Postretirement and pension benefits	155	136
Other	49	80
Federal income tax credit carry forward	20	20
Total deferred income tax assets	510	471
Deferred income tax liabilities:		
Accumulated depreciation and property cost differences	(952)	(1,037)
Deferred fuel recovery	(67)	(54)
Income taxes recoverable through future rates	(129)	(134)
Investments	(61)	(59)
Other	(27)	(39)
Total deferred income tax liabilities	(1,236)	(1,323)
Total net deferred income tax liabilities	\$ (726)	\$ (852)

The above amounts were classified in the Consolidated Balance Sheets as follows:

(in millions)	2005	2004
Current deferred income tax assets, included in prepayments and other current assets	\$ -	\$ 36
Current deferred income tax liabilities, included in other current liabilities	(4)	-
Noncurrent deferred income tax liabilities, included in noncurrent income tax liabilities	(722)	(888)
Total net deferred income tax liabilities	\$ (726)	\$ (852)

Total noncurrent income tax liabilities on the Consolidated Balance Sheets at December 31, 2005 and 2004 include \$92 million and \$103 million, respectively, related to probable tax liabilities, on which PEC accrues interest that would be payable with the related tax amount in future years.

At December 31, 2005, the federal income tax credit carry forward includes \$20 million of general business credits that will expire during the period 2022 through 2025.

At December 31, 2005 and 2004, PEC had recorded \$2 million and less than \$1 million, respectively, of tax contingency reserves, excluding accrued interest and penalties, which were included in taxes accrued on the Consolidated Balance Sheets.

Considering all tax contingency reserves, PEC does not expect the resolution of these matters to have a material impact on its financial position or result of operations. The tax contingency reserves relate primarily to capitalization and basis issues.

Reconciliations of PEC's effective income tax rate to the statutory federal income tax rate for the years ended December 31 follow:

	2005	2004	
Effective income tax rate	32.7%	34.1%	32.3%
State income taxes, net of federal benefit	(2.1)	(2.9)	(1.9)
Investment tax credit amortization	1.1	1.1	1.4
Domestic manufacturing deduction	0.7	-	-
Progress Energy tax benefit allocation	2.9	3.0	3.0
Other differences, net	(0.3)	(0.3)	0.2
Statutory federal income tax rate	35.0%	35.0%	35.0%

Income tax expense (benefit) applicable to continuing operations for the years ended December 31 was comprised of:

(in millions)	2005	2004	2003
Current - federal	\$ 343	\$ 232	\$ 283
- state	45	33	37
Deferred - federal	(120)	(18)	(56)
- state	(21)	(1)	(13)
Investment tax credit	(8)	(7)	(10)
Total income tax expense	\$ 239	\$ 239	\$ 241

Total income tax expense (benefit) applicable to continuing operations excluded the following:

- ☐ ☐ ☐ Less than \$1 million of deferred tax expense and \$15 million of deferred tax benefit related to the cumulative effect of changes in accounting principle recorded net of tax during 2005 and 2003, respectively. There was no cumulative effect of changes in accounting principle recorded during 2004.
- ☐ ☐ Taxes related to other comprehensive income recorded net of tax for 2005, 2004 and 2003, which are presented separately in the Consolidated Statements of Comprehensive Income.
- ☐ ☐ ☐ Current tax benefit of \$1 million related to excess tax deductions resulting from vesting of restricted stock and exercises of nonqualified stock options, which was recorded in common stock during 2005. Less than \$1 million was recorded in common stock for excess tax deductions during 2004. There was no amount recorded in common stock for excess tax deductions during 2003.

PEC and each of its wholly owned subsidiaries have entered into the Tax Agreement with Progress Energy (See Note 1D). PEC's intercompany tax payable was approximately \$74 million at December 31, 2005. PEC's intercompany tax receivable was approximately \$62 million at December 31, 2004.

Accumulated deferred income tax assets (liabilities) at December 31 were:

(in millions)	2005	2004
Deferred income tax assets		
Asset retirement obligation liability	\$ 3	\$ 32
Income taxes refundable through future rates	123	49
Postretirement and pension benefits	85	78
Unbilled revenue	30	35
Other	68	85
Total deferred income tax assets	309	279
Deferred income tax liabilities		
Accumulated depreciation and property cost differences	(401)	(403)
Deferred fuel recovery	(21)	(13)
Deferred storm costs	(87)	(131)
Derivative instruments	(45)	(1)
Income taxes recoverable through future rates	(28)	(21)
Investments	(45)	(38)
Prepaid pension costs	(61)	(89)
Other	(25)	(30)
Total deferred income tax liabilities	(713)	(726)
Total net deferred income tax liabilities	\$ (404)	\$ (447)

The above amounts were classified in the Balance Sheets as follows:

(in millions)	2005	2004
Current deferred income tax assets	\$ 12	\$ 42
Noncurrent deferred income tax liabilities, included in noncurrent income tax liabilities	(416)	(489)
Total net deferred income tax liabilities	\$ (404)	\$ (447)

Total noncurrent income tax liabilities on the Balance Sheets at December 31, 2005 and 2004, include \$17 million and less than \$1 million, respectively, related to probable tax liabilities on which PEF accrues interest that would be payable with the related tax amount in future years.

At December 31, 2005 and 2004, PEF had recorded \$7 million of tax contingency reserves, excluding accrued interest and penalties, which were included in other current liabilities on the Balance Sheets.

Considering all tax contingency reserves, PEF does not expect the resolution of these matters to have a material impact on its financial position or result of operations. The tax contingency reserves relate primarily to capitalization and basis issues.

Reconciliations of PEF's effective income tax rate to the statutory federal income tax rate for the years ended December 31 follow:

	2005	2004	2003
Effective income tax rate	31.8%	34.2%	33.1%
State income taxes, net of federal benefit	(3.3)	(3.5)	(3.5)
Investment tax credit amortization	1.4	1.2	1.4
Domestic manufacturing deduction	0.9	-	-
Progress Energy tax allocation benefit	3.2	2.5	2.7
Other differences, net	1.0	0.6	1.3
Statutory federal income tax rate	35.0%	35.0%	35.0%

Income tax expense (benefit) applicable to continuing operations for the years ended December 31 was comprised of:

(in millions)	2005	2004	2003
Current - federal	\$ 146	\$ 55	\$ 145
- state	25	9	27
Deferred - federal	(39)	98	(16)
- state	(6)	18	(3)
Investment tax credit	(5)	(6)	(6)
Total income tax expense (benefit)	\$ 121	\$ 174	\$ 147

Total income tax expense (benefit) applicable to continuing operations excluded the following:

- ☐ Less than \$1 million of deferred tax expense related to the cumulative effect of changes in accounting principle recorded net of ☐ tax during 2005. There was no cumulative effect of changes in accounting principle recorded during 2004 or 2003.
- ☐ ☐ Taxes related to other comprehensive income recorded net of tax for 2005, 2004 and 2003, which are presented separately in the Statements of Comprehensive Income.
- ☐ ☐ Less than \$1 million of current tax benefit related to excess tax deductions resulting from vesting of restricted stock and exercises of nonqualified stock options, which was recorded in common stock during 2005 and 2004. There was no amount recorded in common stock for excess tax deductions during 2003.

PEF has entered into the Tax Agreement with Progress Energy (See Note 1D) and its intercompany tax payable was approximately \$7 million and \$21 million at December 31, 2005 and 2004, respectively.

15. CONTINGENT VALUE OBLIGATIONS

In connection with the acquisition of Florida Progress during 2000, the Parent issued 98.6 million contingent value obligations (CVOs). Each CVO represents the right of the holder to receive contingent payments based on the performance of four synthetic fuel facilities purchased by subsidiaries of Florida Progress in October 1999. The payments, if any, would be based on the net after-tax cash flows the facilities generate. The CVO liability is adjusted to reflect market price fluctuations. The unrealized loss/gain recognized due to these market fluctuations is recorded in other, net on the Consolidated Statements of Income (See Note 21). The liability, included in other liabilities and deferred credits, at December 31, 2005 and 2004, was \$7 million and \$13 million, respectively.

16. BENEFIT PLANS

A. Postretirement Benefits

We have a noncontributory defined benefit retirement plan for substantially all full-time employees that provides pension benefits. We also have supplementary defined benefit pension plans that provide benefits to higher-level employees. In addition to pension benefits, we provide contributory other postretirement benefits (OPEB), including certain health care and life insurance benefits, for retired employees who meet specified criteria. We use a measurement date of December 31 for our pension and OPEB plans.

COSTS OF BENEFIT PLANS

Prior service costs and benefits are amortized on a straight-line basis over the average remaining service period of active participants. Actuarial gains and losses in excess of 10 percent of the greater of the projected benefit obligation or the market-related value of assets are amortized over the average remaining service period of active participants.

To determine the market-related value of assets, we use a five-year averaging method for a portion of its pension assets and fair value for the remaining portion. We have historically used the five-year averaging method. When we acquired Florida Progress in 2000, we retained the Florida Progress historical use of fair value to determine market-related value for Florida Progress pension assets.

The components of the net periodic benefit cost for the years ended December 31 were:

Progress Energy

(in millions)	<u>Pension Benefits</u>			<u>Other Postretirement Benefits</u>		
	2005	2004	2003	2005	2004	2003
Service cost	\$ 47	\$ 54	\$ 52	\$ 9	\$ 12	\$ 15
Interest cost	117	110	108	33	31	33
Expected return on plan assets	(147)	(155)	(144)	(5)	(5)	(4)
Amortization of actuarial loss	35	21	25	8	4	5
Other amortization, net	1	-	-	1	1	4
Net periodic cost	53	30	41	46	43	53
Additional cost (benefit) recognition (a)	(15)	(16)	(18)	2	2	2
Net periodic cost recognized	\$ 38	\$ 14	\$ 23	\$ 48	\$ 45	\$ 55

(a) Relates to the acquisition of Florida Progress (See Note 16B).

In addition to the net periodic cost reflected above, in 2005, we recorded costs for special termination benefits related to the voluntary enhanced retirement program (See Note 17) of \$123 million for pension benefits and \$19 million for other postretirement benefits. In 2003, we also recorded curtailment and settlement effects related to the disposition of NCNG, which are reflected in income/(loss) from discontinued operations in the Consolidated Statements of Income. These effects included a pension-related loss of \$13 million and an OPEB-related gain of \$1 million.

PEC

(in millions)	Pension Benefits			Other Postretirement Benefits		
	2005	2004	2003	2005	2004	2003
Service cost	\$ 22	\$ 24	\$ 23	\$ 4	\$ 6	\$ 7
Interest cost	53	52	51	17	15	15
Expected return on plan assets	(62)	(69)	(70)	(4)	(4)	(3)
Amortization of actuarial loss	10	1	-	5	2	2
Other amortization, net	1	-	-	1	1	3
Net periodic cost	\$ 24	\$ 8	\$ 4	\$ 23	\$ 20	\$ 24

In addition to the net periodic cost reflected above, in 2005, PEC recorded costs for special termination benefits related to the voluntary enhanced retirement program (See Note 17) of \$21 million for pension benefits and \$8 million for other postretirement benefits.

PEF

(in millions)	Pension Benefits			Other Postretirement Benefits		
	2005	2004	2003	2005	2004	2003
Service cost	\$ 16	\$ 21	\$ 19	\$ 3	\$ 4	\$ 5
Interest cost	48	43	41	13	13	15
Expected return on plan assets	(73)	(73)	(58)	(1)	(1)	(1)
Amortization of actuarial loss	8	2	5	2	1	1
Other amortization, net	(1)	(1)	(2)	4	4	4
Net periodic cost (benefit)	\$ (2)	\$ (8)	\$ 5	\$ 21	\$ 21	\$ 24

In addition to the net periodic cost and benefit reflected above, in 2005 PEF recorded costs for special termination benefits related to the voluntary enhanced retirement program (See Note 17) of \$84 million for pension benefits and \$7 million for other postretirement benefits.

The following weighted-average actuarial assumptions were used by Progress Energy in the calculation of its net periodic cost:

	Pension Benefits			Other Postretirement Benefits		
	2005	2004	2003	2005	2004	2003
Discount rate	5.70%	6.30%	6.60%	5.70%	6.30%	6.60%
Rate of increase in future compensation						
Bargaining	3.50%	3.50%	3.50%	-	-	-
Nonbargaining	-	-	4.00%	-	-	-
Supplementary plans	5.25%	5.00%	4.00%	-	-	-
Expected long-term rate of return on plan assets	9.00%	9.25%	9.25%	8.25%	8.50%	8.45%

The weighted-average actuarial assumptions used by PEC and PEF were not materially different from the assumptions above, as applicable, except that the expected long-term rate of return on PEF's OPEB plan assets was 5.0% for all years presented.

The expected long-term rates of return on plan assets were determined by considering long-term historical returns for the plans and long-term projected returns based on the plans' target asset allocation. For all pension plan assets and a substantial portion of OPEB plans assets, those benchmarks support an expected long-term rate of return between 9.0% and 9.5%. The Progress Registrants have chosen to use an expected long-term rate of 9.0%, the low end of the range, beginning in 2005.

PREPAID/ACCRUED BENEFIT COSTS

Reconciliations of the changes in the Progress Registrants' benefit obligations and the funded status follow:

Progress Energy

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2005	2004	2005	2004
Projected benefit obligation at January 1	\$ 1,961	\$ 1,772	\$ 538	\$ 472
Service cost	47	54	9	12
Interest cost	117	110	33	31
Benefit payments	(182)	(98)	(33)	(23)
Plan amendment	-	21	-	-
Special termination benefits	123	-	19	-
Actuarial loss (gain)	98	102	84	46
Obligation at December 31	2,164	1,961	650	538
Fair value of plan assets at December 31	1,770	1,774	76	70
Funded status	(394)	(187)	(574)	(468)
Unrecognized transition obligation	-	-	9	10
Unrecognized prior service cost	23	24	5	6
Unrecognized net actuarial loss	570	530	170	94
Minimum pension liability adjustment	(546)	(470)	-	-
Accrued cost at December 31, net (See Note 16B)	\$ (347)	\$ (103)	\$ (390)	\$ (358)

The net accrued pension cost of \$347 million at December 31, 2005, is included in accrued pension and other benefits in the Consolidated Balance Sheets. The net accrued pension cost of \$103 million at December 31, 2004, is recognized in the Consolidated Balance Sheets as prepaid pension cost of \$42 million and accrued benefit cost of \$145 million, which is included in accrued pension and other benefits. The defined benefit pension plans with accumulated benefit obligations in excess of plan assets had projected benefit obligations totaling \$2.16 and \$1.72 billion at December 31, 2005 and 2004, respectively. Those plans had accumulated benefit obligations totaling \$2.12 and \$1.71 billion at December 31, 2005 and 2004, respectively, and plan assets of \$1.77 and \$1.57 billion at December 31, 2005 and 2004, respectively. The total accumulated benefit obligation for pension plans was \$2.12 and \$1.90 billion at December 31, 2005 and 2004, respectively. The accrued OPEB cost is included in accrued pension and other benefits in the Consolidated Balance Sheets.

A minimum pension liability adjustment of \$546 million was recorded at December 31, 2005. This adjustment resulted in a charge of \$23 million to intangible assets, a \$180 million charge to a pension-related regulatory liability (See Note 16B), an \$83 million charge to a regulatory asset pursuant to an FPSC order and a pre-tax charge of \$260 million to accumulated other comprehensive loss, a component of common stock equity. A minimum pension liability adjustment of \$470 million was recorded at December 31, 2004. This adjustment resulted in a charge of \$24 million to intangible assets, a \$150 million charge to a pension-related regulatory liability (See Note 16B), a \$67 million charge to a regulatory asset pursuant to an FPSC order and a pre-tax charge of \$229 million to accumulated other comprehensive loss, a component of common stock equity.

(in millions)	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	2005	2004	2005	2004
Obligation at January 1	\$ 928	\$ 837	\$ 262	\$ 218
Service cost	22	24	4	6
Interest cost	53	52	17	15
Plan amendment	-	14	-	-
Benefit payments	(94)	(50)	(14)	(5)
Actuarial loss (gain)	39	51	56	28
Special termination benefits	21	-	8	-
Obligation at December 31	969	928	333	262
Fair value of plan assets at December 31	731	753	49	45
Funded status	(238)	(175)	(284)	(217)
Unrecognized transition obligation	-	-	8	9
Unrecognized prior service cost	17	18	-	-
Unrecognized net actuarial (gain) loss	201	181	87	36
Minimum pension liability adjustment	(212)	(194)	-	-
Accrued cost at December 31, net	\$ (232)	\$ (170)	\$ (189)	\$ (172)

The net accrued pension cost of \$232 and \$170 million at December 31, 2005 and 2004, respectively, is included in accrued pension and other benefits in the Consolidated Balance Sheets. The defined benefit pension plans with accumulated benefit obligations in excess of plan assets had projected benefit obligations totaling \$969 and \$928 million at December 31, 2005 and 2004, respectively. Those plans had accumulated benefit obligations totaling \$963 and \$923 million, at December 31, 2005 and 2004, respectively, and plan assets of \$731 and \$753 million at December 31, 2005 and 2004, respectively. The total accumulated benefit obligation for pension plans was \$963 and \$923 million at December 31, 2005 and 2004, respectively. The accrued OPEB cost is included in accrued pension and other benefits in the Consolidated Balance Sheets.

A minimum pension liability adjustment of \$212 million was recorded at December 31, 2005. This adjustment resulted in a charge of \$17 million to intangible assets, included in other assets and deferred debits, and a pre-tax charge of \$195 million to accumulated other comprehensive loss, a component of common stock equity. A minimum pension liability adjustment of \$194 million was recorded at December 31, 2004. This adjustment resulted in a charge of \$18 million to intangible assets, included in other assets and deferred debits, and a pre-tax charge of \$176 million to accumulated other comprehensive loss, a component of common stock equity.

(in millions)	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	2005	2004	2005	2004
Obligation at January 1	\$ 767	\$ 701	\$ 232	\$ 217
Service cost	16	21	3	4
Interest cost	48	43	13	13
Plan amendment	-	2	-	-
Benefit payments	(61)	(37)	(18)	(17)
Special termination benefits	85	-	7	-
Actuarial loss (gain)	41	37	22	15
Obligation at December 31	896	767	259	232
Fair value of plan assets at December 31	895	868	22	20
Funded status	(1)	101	(237)	(212)
Unrecognized transition obligation	-	-	24	27
Unrecognized prior service cost (benefit)	(12)	(14)	5	6
Unrecognized net actuarial (gain) loss	132	112	49	29
Minimum pension liability adjustment	(8)	(7)	-	-
Prepaid (accrued) cost at December 31, net	\$ 111	\$ 192	\$ (159)	\$ (150)

The PEF net prepaid pension cost of \$111 and \$192 million at December 31, 2005 and 2004, respectively, is included in the Balance Sheets as prepaid pension cost of \$200 million and \$234 million, respectively, and accrued benefit cost of \$89 million and \$42 million, respectively, which is included in accrued pension and other benefits. The PEF defined benefit pension plans with accumulated benefit obligations in excess of plan assets had projected benefit obligations totaling \$341 and \$41 million at December 31, 2005 and 2004, respectively. Those plans had accumulated benefit obligations totaling \$306 million and \$39 million, respectively, and plan assets of \$217 million at December 31, 2005, and no plan assets at December 31, 2004. PEF's total accumulated benefit obligation for pension plans was \$860 million and \$718 million at December 31, 2005 and 2004, respectively. Accrued other postretirement benefit cost is included in accrued pension and other benefits in PEF's Balance Sheets.

PEF recorded a minimum pension liability adjustment of \$8 million at December 31, 2005. This adjustment resulted in a charge of \$1 million to intangible assets, included in other assets and deferred debits, and a charge of \$7 million to a regulatory asset. PEF recorded a minimum pension liability adjustment of \$7 million at December 31, 2004, with a corresponding charge of \$7 million to a regulatory asset.

The following weighted-average actuarial assumptions were used in the calculation of our year-end obligations:

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	2005	2004	2005	2004
Discount rate	5.65%	5.90%	5.65%	5.90%
Rate of increase in future compensation				
Bargaining	3.50%	3.50%	-	-
Supplementary plans	5.25%	5.25%	-	-
Initial medical cost trend rate for pre-Medicare Act benefits	-	-	8.25%	7.25%
Initial medical cost trend rate for post-Medicare Act benefits	-	-	8.25%	7.25%
Ultimate medical cost trend rate	-	-	5.00%	5.00%
Year ultimate medical cost trend rate is achieved	-	-	2013	2008

The weighted-average actuarial assumptions for PEC and PEF were the same or were not significantly different from those indicated above, as applicable.

Our primary defined benefit retirement plan for nonbargaining employees is a "cash balance" pension plan as defined in EITF Issue No. 03-4, "Determining the Classification and Benefit Attribution Method for a 'Cash Balance' Pension Plan." Therefore, effective December 31, 2003, we began to use the traditional unit credit method for purposes of measuring the benefit obligation of this plan. Under the traditional unit credit method, no assumptions are included about future changes in compensation, and the accumulated benefit obligation and projected benefit obligation are the same.

MEDICAL COST TREND RATE SENSITIVITY

The medical cost trend rates were assumed to decrease gradually from the initial rates to the ultimate rates. The effects of a 1 percent change in the medical cost trend rate are shown below.

(in millions)	Progress Energy	PEC	PEF
1 percent increase in medical cost trend rate			
Effect on total of service and interest cost	\$ 5	\$ 2	\$ 2
Effect on postretirement benefit obligation	65	33	26
1 percent decrease in medical cost trend rate			
Effect on total of service and interest cost	(4)	(2)	(2)
Effect on postretirement benefit obligation	(54)	(28)	(22)

ASSETS OF BENEFIT PLANS

In the plan asset reconciliation tables that follow, substantially all employer contributions represent benefit payments made directly from the Progress Registrants' assets except for the 2004 pension amount. The remaining benefit payments were made directly from plan assets. In 2004, we made a required contribution of approximately \$24 million directly to pension plan assets. In 2004, PEC made a contribution to pension plan assets of approximately \$20 million, which represented its allocated share of the required Progress Energy contribution. The OPEB benefit payments presented in the plan asset reconciliation tables that follow represent the net cost after participant contributions. Participant contributions represent approximately 20 percent of gross benefit payments for Progress Energy, 30 percent for PEC and 10 percent for PEF.

Reconciliations of the fair value of plan assets at December 31 follow:

<u>Progress Energy</u>		<u>Other Postretirement Benefits</u>	
	<u>Pension Benefits</u>		
(in millions)	2005	2004	2005
Fair value of plan assets at January 1	\$ 1,774	\$ 1,631	\$ 70
Actual return on plan assets	170	211	5
Benefit payments	(182)	(98)	(33)
Employer contributions	8	30	34
Fair value of plan assets at December 31	\$ 1,770	\$ 1,774	\$ 76

<u>PEC</u>		<u>Other Postretirement Benefits</u>	
	<u>Pension Benefits</u>		
(in millions)	2005	2004	2005
Fair value of plan assets at January 1	\$ 753	\$ 693	\$ 45
Actual return on plan assets	71	89	4
Benefit payments	(94)	(50)	(14)
Employer contributions	1	21	14
Fair value of plan assets at December 31	\$ 731	\$ 753	\$ 49

PEF (in millions)	Pension Benefits		Other Postretirement Benefits	
	2005	2004	2005	2004
Fair value of plan assets at January 1	\$ 868	\$ 802	\$ 20	\$ 18
Actual return on plan assets	85	101	-	1
Benefit payments	(61)	(37)	(18)	(17)
Employer contributions	3	2	19	18
Fair value of plan assets at December 31	\$ 895	\$ 868	\$ 21	\$ 20

The asset allocation for the benefit plans at the end of 2005 and 2004 and the target allocation for the plans, by asset category, are presented in the following tables. The pension benefit plan allocations and targets are consistent for all Progress Registrants.

Asset Category	Pension Benefits		
	Target Allocation	Percentage of Plan Assets at Year End	
	2006	2005	2004
Equity - domestic	40%	44%	47%
Equity - international	15%	22%	21%
Debt - domestic	20%	13%	9%
Debt - international	10%	8%	11%
Other	15%	13%	12%
Total	100%	100%	100%

Progress Energy Asset Category	Other Postretirement Benefits		
	Target Allocations	Percentage of Plan Assets at Year End	
	2006	2005	2004
Equity - domestic	28%	32%	34%
Equity - international	11%	16%	15%
Debt - domestic	43%	37%	35%
Debt - international	7%	6%	8%
Other	11%	9%	8%
Total	100%	100%	100%

PEC Asset Category	Target Allocations	Percentage of Plan Assets at Year End	
	2006	2005	2004
	2006	2005	2004
Equity - domestic	40%	44%	47%
Equity - international	15%	22%	21%
Debt - domestic	20%	13%	9%
Debt - international	10%	8%	11%
Other	15%	13%	12%
Total	100%	100%	100%

PEF Asset Category	Target Allocations	Percentage of Plan Assets at Year End	
	2006	2005	2004
	2006	2005	2004
Debt - domestic	100%	100%	100%

For pension plan assets and a substantial portion of OPEB plan assets, the Progress Registrants set target allocations among asset classes to provide broad diversification to protect against large investment losses and excessive

volatility, while recognizing the importance of offsetting the impacts of benefit cost escalation. In addition, external investment managers who have complementary investment philosophies and approaches are employed to manage the assets. Tactical shifts (plus or minus 5 percent) in asset allocation from the target allocations are made based on the near-term view of the risk and return tradeoffs of the asset classes.

CONTRIBUTION AND BENEFIT PAYMENT EXPECTATIONS

In 2006, we expect to make \$10 million of contributions directly to pension plan assets and \$1 million of discretionary contributions directly to the OPEB plan assets. The expected benefit payments for the pension benefit plan for 2006 through 2010 and in total for 2011 through 2015, in millions, are approximately \$164, \$124, \$127, \$133, \$137 and \$789, respectively. The expected benefit payments for the OPEB plan for 2006 through 2010 and in total for 2011 through 2015, in millions, are approximately \$41, \$43, \$45, \$46, \$48 and \$245, respectively. The expected benefit payments include benefit payments directly from plan assets and benefit payments directly from our assets. The benefit payment amounts reflect our net cost after any participant contributions. We expect to begin receiving prescription drug-related federal subsidies in 2006, and the expected subsidies for 2006 through 2010 and in total for 2011 through 2015, in millions, are approximately \$3, \$3, \$3, \$4, \$4 and \$30, respectively.

In 2006, PEC expects to make \$1 million in contributions directly to pension plan assets. The expected benefit payments for the pension benefit plan for 2006 through 2010 and in total for 2011 through 2015, in millions, are approximately \$79, \$56, \$58, \$62, \$64 and \$383, respectively. The expected benefit payments for the OPEB plan for 2006 through 2010 and in total for 2011 through 2015, in millions, are approximately \$19, \$20, \$21, \$22, \$23, and \$128, respectively. The expected benefit payments include benefit payments directly from plan assets and benefit payments directly from PEC assets. The benefit payment amounts reflect the net cost to PEC after any participant contributions. PEC expects to begin receiving prescription drug-related federal subsidies in 2006, and the expected subsidies for 2006 through 2010 and in total for 2011 through 2015, in millions, are approximately \$1, \$1, \$2, \$2, \$2 and \$15, respectively.

In 2006, PEF expects to make \$9 million of contributions to pension plan assets and \$1 million of discretionary contributions to OPEB plan assets. The expected benefit payments for the pension benefit plan for 2006 through 2010 and in total for 2011 through 2015, in millions, are approximately \$63, \$53, \$53, \$54, \$54 and \$295, respectively. The expected benefit payments for the OPEB plan for 2006 through 2010 and in total for 2011 through 2015, in millions, are approximately \$19, \$20, \$20, \$20, \$20 and \$96, respectively. The expected benefit payments include benefit payments directly from plan assets and benefit payments directly from PEF's assets. The benefit payment amounts reflect the net cost to PEF after any participant contributions. PEF expects to begin receiving prescription drug-related federal subsidies in 2006, and the expected subsidies for 2006 through 2010 and in total for 2011 through 2015, in millions, are approximately \$1, \$2, \$2, \$2, \$2 and \$13, respectively.

B. Florida Progress Acquisition

During 2000, we completed our acquisition of Florida Progress. Florida Progress' pension and OPEB liabilities, assets and net periodic costs are reflected in the above information as appropriate. Certain of Florida Progress' nonbargaining unit benefit plans were merged with our benefit plans effective January 1, 2002.

PEF continues to recover qualified plan pension costs and OPEB costs in rates as if the acquisition had not occurred. Accordingly, a portion of the accrued OPEB cost reflected in the Progress Energy table above has a corresponding regulatory asset at December 31, 2005, and 2004 (See Note 7A). As indicated in the Progress Energy minimum pension adjustment information, a pension-related regulatory liability was charged, and fully eliminated, at December 31, 2005. At December 31, 2004, a portion of the Progress Energy prepaid pension cost has a corresponding regulatory liability (See Note 7A). Pursuant to its rate treatment, PEF recognized additional periodic pension credits and additional periodic OPEB costs, as indicated in the Progress Energy net periodic cost information above.

17. SEVERANCE

On February 28, 2005, we approved a workforce restructuring that resulted in a reduction of approximately 450 positions. The cost-management initiative is designed to permanently reduce by \$75 million to \$100 million our projected growth in annual O&M expenses by the end of 2007. In addition to the workforce restructuring, the cost-management initiative included a voluntary enhanced retirement program. In connection with this initiative, we incurred approximately \$164 million of pre-tax charges for severance and postretirement benefits during the year ended December 31, 2005, as described below. The workforce restructuring concluded on December 1, 2005.

Progress Energy

We recorded \$31 million of severance expense during the first quarter of 2005 for the workforce restructuring and implementation of an automated meter reading initiative at PEF based on the approximate number of positions to be eliminated. During the second quarter of 2005, 1,447 employees eligible for participation in the voluntary enhanced retirement program elected to participate. Consequently, in the second and fourth quarters of 2005, we decreased our estimated severance costs by \$13 million each quarter due to the impact of the employees electing participation in the voluntary enhanced retirement program. The severance expenses are primarily included in O&M expense on the Consolidated Statements of Income.

The accrued severance expense will be paid over time. The activity in the severance liability was as follows:

(in millions)	
Balance as of January 1, 2005	\$ 5
Severance costs accrued	31
Adjustments	(26)
Payments	(4)
Balance at December 31, 2005	\$ 6

During 2005, we recorded a \$141 million charge in the second quarter and a \$1 million charge in the third quarter related to postretirement benefits that will be paid over time to eligible employees who elected to participate in the voluntary enhanced retirement program (See Note 16). In addition, we recorded a \$17 million charge for early retirement incentives to be paid over time to certain employees.

PEC

In connection with the cost-management initiative, PEC incurred approximately \$55 million of pre-tax charges for severance and postretirement benefits during the year ended December 31, 2005, as described below.

PEC recorded \$14 million of severance expense during the first quarter of 2005 for the workforce restructuring based on the approximate number of positions to be eliminated. This amount included approximately \$4 million of severance costs allocated from PESC. During the second quarter of 2005, 553 PEC employees eligible for participation in the voluntary enhanced retirement program elected to participate. Consequently, in the second and fourth quarters of 2005, PEC decreased its estimated severance costs by \$6 million and \$5 million, respectively, due to the impact of the employees electing participation in the voluntary enhanced retirement program. These amounts included approximately \$2 million of decreased severance costs allocated from PESC. The severance expenses are primarily included in O&M expense on the Consolidated Statements of Income.

The accrued severance expense will be paid over time. The activity in the severance liability was as follows:

(in millions)	
Balance as of January 1, 2005	\$ 2
Severance costs accrued	10
Adjustments	(9)
Payments	(1)
Balance at December 31, 2005	\$ 2

PEC recorded a \$29 million charge in the second quarter of 2005 related to postretirement benefits that will be paid over time to eligible employees who elected to participate in the voluntary enhanced retirement program (See Note 16). PEC also recorded a \$13 million charge for early retirement incentives which will be paid over time to certain employees. In addition, PEC recorded approximately \$10 million of postretirement benefits and early retirement incentives allocated from PESC during the year ended December 31, 2005.

PEF

In connection with the cost-management initiative, PEF incurred approximately \$102 million of pre-tax charges for severance and postretirement benefits during the year ended December 31, 2005, as described below.

PEF recorded \$14 million of severance expense during the first quarter of 2005 for the workforce restructuring and implementation of an automated meter reading initiative at PEF based on the approximate number of positions to be eliminated. This amount included approximately \$3 million of severance costs allocated from PESC. During the second quarter of 2005, 680 of PEF's employees eligible for participation in the voluntary enhanced retirement program elected to participate. Consequently, in the second and fourth quarters of 2005, PEF decreased its estimated severance costs by \$5 million and \$6 million, respectively, due to the impact of the employees electing participation in the voluntary enhanced retirement program. These amounts included approximately \$2 million of decreased severance costs allocated from PESC. The severance expenses are primarily included in O&M expense on the Statements of Income.

The accrued severance expense will be paid over time. The activity in the severance liability was as follows:

(in millions)	
Balance as of January 1, 2005	\$ -
Severance costs accrued	11
Adjustments	(9)
Payments	(1)
Balance at December 31, 2005	\$ 1

During 2005, PEF recorded a \$90 million charge in the second quarter and a \$1 million charge in the third quarter related to postretirement benefits that will be paid over time to eligible employees who elected to participate in the voluntary enhanced retirement program (See Note 16). In addition, PEF recorded approximately \$8 million of charges for postretirement benefits and early retirement incentives allocated from PESC during the year ended December 31, 2005.

18. RISK MANAGEMENT ACTIVITIES AND DERIVATIVES TRANSACTIONS

We are exposed to various risks related to changes in market conditions. We have a risk management committee that includes senior executives from various business groups. The risk management committee is responsible for administering risk management policies and monitoring compliance with those policies by all subsidiaries. Under our risk policy, we may use a variety of instruments, including swaps, options and forward contracts, to manage exposure to fluctuations in commodity prices and interest rates. Such instruments contain credit risk if the counterparty fails to perform under the contract. We minimize such risk by performing credit reviews using, among other things, publicly available credit ratings of such counterparties. Potential nonperformance by counterparties is

not expected to have a material effect on our financial position or results of operations. Additionally, in the normal course of business, some of our affiliates may enter into hedge transactions with one another.

A. Commodity Derivatives

GENERAL

Most of our commodity contracts are not derivatives pursuant to SFAS No. 133, "Accounting for Derivative and Hedging Activities" (SFAS No. 133), or do not qualify as normal purchases or sales pursuant to SFAS No. 133. Therefore, such contracts are not recorded at fair value.

In 2003, PEC recorded a \$38 million pre-tax (\$23 million after-tax) fair value loss transition adjustment pursuant to the provisions of FASB Derivatives Implementation Group Issue C20, "Interpretation of the Meaning of Not Clearly and Closely Related in Paragraph 10(b) regarding Contracts with a Price Adjustment Feature" (DIG Issue C20). The related liability is being amortized to earnings over the term of the related contract (See Note 21). At December 31, 2005 and 2004, the remaining liability was \$19 million and \$26 million, respectively.

ECONOMIC DERIVATIVES

Derivative products, primarily electricity and natural gas contracts, may be entered into from time to time for economic hedging purposes. While management believes the economic hedges mitigate exposures to fluctuations in commodity prices, these instruments are not designated as hedges for accounting purposes and are monitored consistent with trading positions. We manage open positions with strict policies that limit our exposure to market risk and require daily reporting to management of potential financial exposures. Gains and losses from such contracts were not material to our or the Utilities' results of operations during 2005, 2004 and 2003. PEC did not have material outstanding positions in such contracts at December 31, 2005 and 2004. We and PEF did not have material outstanding positions in such contracts at December 31, 2005 and 2004, other than those receiving regulatory accounting treatment at PEF, as discussed below.

PEF has derivative instruments related to its exposure to price fluctuations on fuel oil and natural gas purchases. These instruments receive regulatory accounting treatment. Unrealized gains and losses are recorded in regulatory liabilities and regulatory assets, respectively, until the contracts are settled. Once settled, any realized gains or losses are passed through the fuel clause. At December 31, 2005, the fair values of the instruments were a \$77 million short-term derivative asset position included in other current assets, a \$45 million long-term derivative asset position included in other assets and deferred debits and a \$6 million long-term derivative liability position included in other liabilities and deferred credits. At December 31, 2004, the fair values of the instruments were a \$2 million long-term derivative asset position included in other assets and deferred debits and a \$5 million short-term derivative liability position included in other current liabilities.

CASH FLOW HEDGES

Our subsidiaries designate a portion of commodity derivative instruments as cash flow hedges under SFAS No. 133. The objective for holding these instruments is to hedge exposure to market risk associated with fluctuations in the price of natural gas and power for our forecasted purchases and sales. Realized gains and losses are recorded net in operating revenues or operating expenses, as appropriate. The ineffective portion of commodity cash flow hedges was not material to our or the Utilities' results of operations for 2005, 2004 and 2003.

The fair values of commodity cash flow hedges at December 31 were as follows:

(in millions)	Progress Energy		PEC		PEF	
	2005	2004	2005	2004	2005	2004
Fair value of assets	\$ 170	\$ -	\$ 7	\$ -	\$ -	\$ -
Fair value of liabilities	(58)	(15)	(4)	\$ -	\$ -	\$ -
Fair value, net	\$ 112	\$ (15)	\$ 3	\$ -	\$ -	\$ -

The following table presents selected information related to commodity cash flow hedges at December 31, 2005:

(term in years/ millions of dollars)	Maximum Term(a)			Accumulated Other Comprehensive Income/ (Loss), net of Tax			Portion Expected to be Reclassified to Earnings during the Next 12 Months(b)		
	Progress Energy	PEC	PEF	Progress Energy	PEC	PEF	Progress Energy	PEC	PEF
Commodity cash flow hedges	9	1	-	\$ 69	\$ 2	\$ -	\$ (17)	\$ 2	\$ -

(a) The majority of hedges in fair value liability positions are currently classified as short-term and the majority of hedges in fair value asset positions are currently classified as long-term.

(b) Due to the volatility of the commodities markets, the value in accumulated other comprehensive income/(loss) (OCI) is subject to change prior to its reclassification into earnings.

At December 31, 2004, we had \$9 million of after-tax deferred losses in OCI related to commodity cash flow hedges. The Utilities had no open commodity cash flow hedges or amounts recorded in OCI related to commodity cash flow hedges.

B. Interest Rate Derivatives - Fair Value or Cash Flow Hedges

We use cash flow hedging strategies to reduce exposure to changes in cash flow due to fluctuating interest rates. We use fair value hedging strategies to reduce exposure to changes in fair value due to interest rate changes. The notional amounts of interest rate derivatives are not exchanged and do not represent exposure to credit loss. In the event of default by the counterparty, the risk in these transactions is the cost of replacing the agreements at current market rates.

The fair values of open interest rate hedges at December 31 were as follows:

(in millions)	Progress Energy		PEC		PEF	
	2005	2004	2005	2004	2005	2004
Interest rate cash flow hedges	\$ 1	\$ (2)	\$ -	\$ (2)	\$ -	\$ -
Interest rate fair value hedges	\$ (2)	\$ 3	\$ -	\$ -	\$ -	\$ -

CASH FLOW HEDGES

Gains and losses from cash flow hedges are recorded in OCI and amounts reclassified to earnings are included in net interest charges as the hedged transactions occur. Amounts in OCI related to terminated hedges are reclassified to earnings as the interest expense is recorded. The ineffective portion of interest rate cash flow hedges was not material to our or the Utilities' results of operations for 2005, 2004 and 2003.

The following table presents selected information related to interest rate cash flow hedges included in OCI at December 31, 2005:

(term in years/ millions of dollars)	Maximum Term			Accumulated Other Comprehensive Income/ (Loss), net of Tax (a)			Portion Expected to be Reclassified to Earnings during the Next 12 Months (b)		
	Progress Energy	PEC	PEF	Progress Energy	PEC	PEF	Progress Energy	PEC	PEF
Interest rate cash flow hedges	1	-	-	\$ (13)	\$ (5)	\$ -	\$ (2)	\$ -	\$ -

(a) Includes amounts related to terminated hedges.

(b) Actual amounts that will be reclassified to earnings may vary from the expected amounts presented above as a result of changes in interest rates.

At December 31, 2005 and 2004, we had \$100 million notional and \$331 million notional, respectively, of interest rate cash flow hedges. The Utilities had no open interest rate cash flow hedges at December 31, 2005. At December 31, 2004, PEC had \$131 million notional of open interest rate cash flow hedges and PEF had no open interest rate cash flow hedges.

FAIR VALUE HEDGES

For interest rate fair value hedges, the change in the fair value of the hedging derivative is recorded in net interest charges and is offset by the change in the fair value of the hedged item. At December 31, 2005 and 2004, we had \$150 million notional of interest rate fair value hedges. At December 31, 2005 and 2004, the Utilities had no open interest rate fair value hedges.

At December 31, 2005 and 2004, we had a \$2 million loss and a \$9 million gain, respectively, of basis adjustments in long-term debt related to terminated interest rate fair value hedges, which are being amortized over periods ending in 2006 through 2008 coinciding with the maturities of the related debt instruments.

19. RELATED PARTY TRANSACTIONS

As a part of normal business, we enter into various agreements providing financial or performance assurances to third parties. These agreements are entered into primarily to support or enhance the creditworthiness otherwise attributed to a subsidiary on a stand-alone basis, thereby facilitating the extension of sufficient credit to accomplish the subsidiaries' intended commercial purposes. Our guarantees include performance obligations under power supply agreements, tolling agreements, transmission agreements, gas agreements, fuel procurement agreements and trading operations. Our guarantees also include standby letters of credit, surety bonds and guarantees in support of nuclear decommissioning. At December 31, 2005, the Parent had issued \$1.56 billion of guarantees for future financial or performance assurance on behalf of its subsidiaries. This includes \$300 million of guarantees of certain payments of two wholly owned indirect subsidiaries (See Note 24). We do not believe conditions are likely for significant performance under the guarantees of performance issued by or on behalf of affiliates. To the extent liabilities are incurred as a result of the activities covered by the guarantees, such liabilities are included in the Consolidated Balance Sheet.

Our subsidiaries provide and receive services, at cost, to and from the Parent and its subsidiaries, in accordance with agreements approved by the SEC pursuant to Section 13(b) of the PUHCA. The repeal of PUHCA effective February 8, 2006, and subsequent regulation by the FERC is not anticipated to change our current intercompany services. Services include purchasing, human resources, accounting, legal, transmission and delivery support, engineering materials, contract support, loaned employees payroll costs, construction management and other centralized administrative, management and support services. The costs of the services are billed on a direct-charge basis, whenever possible, and on allocation factors for general costs that cannot be directly attributed. Billings from affiliates are capitalized or expensed depending on the nature of the services rendered. Amounts receivable from

and/or payable to affiliated companies for these services are included in receivables from affiliated companies and payables to affiliated companies on the Balance Sheets.

PESC provides the majority of the affiliated services under the approved agreements. Services provided by PESC during 2005, 2004 and 2003 to PEC amounted to \$202 million, \$209 million and \$184 million, respectively, and services provided to PEF were \$169 million, \$165 million and \$153 million, respectively.

PEC and PEF also provide and receive services at cost. Services provided by PEC to PEF during 2005, 2004 and 2003 amounted to \$54 million, \$52 million and \$35 million, respectively. Services provided by PEF to PEC during 2005, 2004 and 2003 amounted to \$14 million, \$16 million and \$7 million, respectively.

At December 31, 2005, the Parent's guarantees include \$169 million to support nuclear decommissioning. PEC determined that its external funding levels did not fully meet the nuclear decommissioning financial assurance levels required by the NRC; therefore, PEC obtained the Parent's guarantee.

PEC and PEF participate in an internal money pool, operated by Progress Energy, to more effectively utilize cash resources and to reduce outside short-term borrowings. The money pool is also used to settle intercompany balances. The weighted-average interest rate for the money pool was 3.77%, 1.72% and 1.47% at December 31, 2005, 2004 and 2003, respectively. Amounts payable to the money pool are included in notes payable to affiliated companies on the Balance Sheets. PEC and PEF recorded insignificant interest expense related to the money pool for all the years presented.

Strategic Resource Solutions Corp. and its subsidiary, which were wholly owned until 2004, managed subcontracts for PEC. Amounts for 2004 and 2003 were not significant.

Progress Fuels sells coal to PEF for an insignificant profit. These intercompany revenues and expenses are eliminated in consolidation; however, in accordance with SFAS No. 71 profits on intercompany sales to regulated affiliates are not eliminated if the sales price is reasonable and the future recovery of sales price through the ratemaking process is probable. Sales, net of insignificant profits, of \$402 million, \$331 million and \$347 million for the years ended December 31, 2005, 2004 and 2003, respectively, are included in fuel used in electric generation on the Consolidated Statements of Income. Beginning in 2006, PEF will enter into coal contracts on its own behalf.

We sold NCNG to Piedmont Natural Gas Company, Inc. on September 30, 2003 (See Note 3H). Prior to disposition, NCNG sold natural gas to affiliates. During the year ended December 31, 2003, gas sales from NCNG to PEC amounted to \$11 million. The gas sales for 2003 indicated above exclude any sales subsequent to September 2003. These revenues are included in discontinued operations on the Consolidated Statements of Income.

PEC and its wholly owned subsidiaries and PEF have entered into the Tax Agreement with the Parent (See Note 14).

20. FINANCIAL INFORMATION BY BUSINESS SEGMENT

Our reportable segments are: PEC, PEF, Progress Ventures and Coal and Synthetic Fuels. During 2005, we realigned our segments due to changes in the operations of certain businesses and the reclassification of our coal mining business to discontinued operations. These changes are consistent with the manner in which management currently reviews our operations. Prior year periods have been restated for our segment realignments.

Our PEC and PEF business segments are primarily engaged in the generation, transmission, distribution and sale of electricity in portions of North Carolina, South Carolina and Florida. Prior to December 2005, we disclosed a PEC Electric segment that was comprised of utility operations and excluded immaterial operations of PEC's nonregulated subsidiaries, which were included in Corporate and Other. Management has realigned the PEC segment to review the PEC operations on a consolidated basis as the results of operations and financial position are not materially different between PEC Electric and PEC.

Our Progress Ventures segment is comprised of Competitive Commercial Operations (CCO) and natural gas operations (Gas) and is involved in nonregulated electric generation and energy marketing activities and natural gas

drilling and production in Texas and Louisiana. Prior to December 2005, CCO had been reported as a separate segment and Gas was included within our previously reported Fuels segment. Progress Ventures' legal structure is not currently aligned with the functional management and financial reporting of the Progress Ventures segment.

Our Coal and Synthetic Fuels segment is involved in the production and sale of coal-based solid synthetic fuel as defined under the Code, coal terminal services, and fuel transportation and delivery. Operations involving coal terminals and synthetic fuels activities were included within our previously reported Fuels segment prior to 2005. The remaining portions of our previously reported Fuels segment are included within Coal and Synthetic Fuels due to their operational relationship with the segment's activities and their relative immateriality.

In addition to the reportable operating segments, the Corporate and Other segment includes the operations of the Parent and PESC as well as other nonregulated business areas. These nonregulated business areas include telecommunications and other nonregulated subsidiaries that do not separately meet the disclosure requirements of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" (SFAS No. 131). Included in the 2004 losses is a \$43 million pre-tax (\$29 million after-tax) settlement agreement that Strategic Resource Solutions Corp. (SRS) reached with the San Francisco United School District related to civil proceedings. The profit or loss of the identified segments plus the profit or loss of Corporate and Other represents our total income from continuing operations.

Prior to its divestiture in 2005, Rail Services was reported as a separate segment (See Note 3B). The operations of Rail Services were reclassified to discontinued operations in the first quarter of 2005. During the fourth quarter of 2005, we reclassified our coal mining operations as discontinued operations (See Note 3A). Prior to 2005, our coal mining operations were included within our previously reported Fuels segment. Our Rail Services and coal mining operations are not included in the results from continuing operations during the periods reported. Assets and capital and investment expenditures of discontinued operations are not included in the tables presented below.

Products and services are sold between the various reportable segments. All intersegment transactions are at cost except for transactions between PEF and the Coal and Synthetic Fuel segment, which are at rates set by the FPSC. In accordance with SFAS No. 71, profits on intercompany sales between PEF and the Coal and Synthetic Fuel segment are not eliminated if the sales price is reasonable and the future recovery of sales price through the ratemaking process is probable. The profits realized for 2005, 2004 and 2003 were not significant. Income tax expense (benefit) by segment includes the Parent's allocation to profitable subsidiaries of income tax benefits not related to acquisition interest expense in accordance with the Tax Agreement. Due to the repeal of PUHCA, the Parent will stop allocating these tax benefits in 2006.

In the following tables, capital and investment expenditures include property additions, acquisitions of nuclear fuel and other capital investments.

(in millions)	PEC	PEF	Progress Ventures	Coal and Synthetic Fuels	Corporate and Other	Eliminations	Totals
Year ended December 31, 2005							
Revenues							
Unaffiliated	\$ 3,991	\$ 3,955	\$ 853	\$ 1,242	\$ 67	\$ -	\$ 10,108
Intersegment	-	-	-	402	447	(849)	-
Total revenues	3,991	3,955	853	1,644	514	(849)	10,108
Depreciation and amortization	561	334	94	38	47	-	1,074
Total interest charges, net	192	126	5	34	372	(89)	640
Postretirement and severance charges	55	102	1	5	1	-	164
Impairment of long-lived assets and investments	(1)	-	-	-	-	-	(1)
Income tax expense (benefit)	239	121	7	(350)	(62)	-	(45)
Segment profit (loss)	490	258	21	169	(211)	-	727
Total assets	11,502	8,318	2,371	472	18,024	(13,773)	26,914
Capital and investment expenditures	682	543	183	16	29	(19)	1,434

Year ended December 31, 2004

Revenues							
Unaffiliated	\$ 3,629	\$ 3,525	\$ 401	\$ 899	\$ 71	\$ -	\$ 8,525
Intersegment	-	-	-	331	440	(771)	-
Total revenues	3,629	3,525	401	1,230	511	(771)	8,525
Depreciation and amortization	570	281	101	38	45	-	1,035
Total interest charges, net	192	114	11	37	360	(86)	628
Postretirement and severance charges	2	-	-	1	-	-	3
Income tax expense (benefit)	239	174	55	(280)	(82)	-	106
Segment profit (loss)	458	333	81	88	(231)	-	729
Total assets	10,787	7,924	2,086	542	17,590	(13,570)	25,359
Capital and investment expenditures	620	492	154	10	26	(12)	1,290

Year ended December 31, 2003

Revenues							
Unaffiliated	\$ 3,600	\$ 3,152	\$ 285	\$ 716	\$ 46	\$ -	\$ 7,799
Intersegment	-	-	-	347	440	(787)	-
Total revenues	3,600	3,152	285	1,063	486	(787)	7,799
Depreciation and amortization	562	307	78	35	27	-	1,009
Total interest charges, net	197	91	6	29	378	(94)	607
Impairment of long-lived assets and investments	(21)	-	-	-	-	-	(21)
Income tax expense (benefit)	241	147	25	(434)	(47)	(45)	(113)
Segment profit (loss)	502	295	54	190	(230)	-	811
Total assets	10,938	7,280	2,195	599	17,802	(13,368)	25,446
Capital and investment expenditures	511	577	606	24	19	-	1,737

21. OTHER INCOME AND OTHER EXPENSE

Other income and expense includes interest income, impairment of investments, and other income and expense items as discussed below. Nonregulated energy and delivery services include power protection services and mass market programs such as surge protection, appliance services and area light sales, and delivery, transmission and substation work for other utilities. AFUDC equity represents the estimated equity costs of capital funds necessary to finance the construction of new regulated assets. The components of other, net as shown on the accompanying Statements of Income for the years ended December 31 were as follows:

Progress Energy

(in millions)	2005	2004	2003
<u>Other income</u>			
Nonregulated energy and delivery services income	\$ 32	\$ 28	\$ 26
DIG Issue C20 amortization (Note 18A)	7	9	2
Contingent value obligation unrealized gain (Note 15)	6	9	-
Investment gains	7	4	12
Income from equity investments	1	3	-
AFUDC equity	16	12	14
Other	15	13	15
Total other income	84	78	69
<u>Other expense</u>			
Nonregulated energy and delivery services expenses	24	21	20
Donations	18	15	15
Investment losses	-	1	6
Contingent value obligation unrealized loss (Note 15)	-	-	9
Loss from equity investments	7	8	31
Loss on debt extinguishment and interest rate collars	-	15	-
FERC audit settlement	7	-	-
Indemnification liability (Note 22B)	16	-	-
Other	17	30	15
Total other expense	89	90	96
Other, net - Progress Energy	\$ (5)	\$ (12)	\$ (27)

PEC

(in millions)	2005	2004	2003
<u>Other income</u>			
Nonregulated energy and delivery services income	\$ 12	\$ 11	\$ 12
DIG Issue C20 amortization (Note 18A)	7	9	2
Income from equity investments	1	3	-
AFUDC equity	3	4	2
Other	10	13	2
Total other income	33	40	18
<u>Other expense</u>			
Nonregulated energy and delivery services expenses	\$ 9	\$ 9	\$ 9
Donations	8	7	6
Losses from equity investments	-	3	16
FERC audit settlement	4	-	-
Indemnification liability (Note 22B)	16	-	-
Other	10	22	6
Total other expense	47	41	37
Other, net - PEC	\$ (14)	\$ (1)	\$ (19)

(in millions)	2005	2004	2003
Other income			
Nonregulated energy and delivery services income	\$ 20	\$ 17	\$ 15
Investment gains	2	1	2
AFUDC equity	13	7	12
Total other income	35	25	29
Other expense			
Nonregulated energy and delivery services expenses	14	12	11
Donations	10	9	9
FERC audit settlement	3	-	-
Other	1	1	2
Total other expense	28	22	22
Other, net - PEF	\$ 7	\$ 3	\$ 7

22. ENVIRONMENTAL MATTERS

We are subject to federal, state and local regulations addressing hazardous and solid waste management, air and water quality and other environmental matters.

A. Hazardous and Solid Waste Management

The provisions of the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (CERCLA), authorize the Environmental Protection Agency (EPA) to require the cleanup of hazardous waste sites. This statute imposes retroactive joint and several liabilities. Some states, including North Carolina, South Carolina and Florida, have similar types of statutes. We are periodically notified by regulators, including the EPA and various state agencies, of our involvement or potential involvement in sites that may require investigation and/or remediation. There are presently several sites with respect to which we have been notified of our potential liability by the EPA, the state of North Carolina or the state of Florida, as described below in greater detail. Various organic materials associated with the production of manufactured gas, generally referred to as coal tar, are regulated under federal and state laws. PEC and PEF are each potentially responsible parties (PRPs) at several manufactured gas plant (MGP) sites. We are also currently in the process of assessing potential costs and exposures at other sites. A discussion of sites by legal entity follows below.

We record accruals for probable and estimable costs related to environmental sites on an undiscounted basis. We measure our liability for these sites based on available evidence including our experience in investigating and remediating environmentally impaired sites. The process often involves assessing and developing cost-sharing arrangements with other PRPs. For all sites, as assessments are developed and analyzed, we will accrue costs for the sites to the extent our liability is probable and the costs can be reasonably estimated. Because the extent of environmental impact, allocation among PRPs for all sites, remediation alternatives (which could involve either minimal or significant efforts), and concurrence of the regulatory authorities have not yet reached the stage where a reasonable estimate of the remediation costs can be made, we cannot determine the total costs that may be incurred in connection with the remediation of all sites at this time. It is probable that current estimates will change and additional losses, which could be material, may be incurred in the future.

PEC and PEF filed claims with general liability insurance carriers to recover costs arising from actual or potential environmental liabilities for remediation of certain sites. No material claims are currently pending. We may file further claims with respect to sites for which claims were not previously presented.

Progress Energy

In addition to the Utilities' sites, discussed under "PEC" and "PEF" below, our environmental sites include the following related to our nonregulated operations.

In 2001, we, through our Progress Fuels subsidiary, established an accrual to address indemnities and retained an environmental liability associated with the sale of our Inland Marine Transportation business. In 2003, the accrual was reduced to \$4 million based on a change in estimate. At December 31, 2005 and 2004, the remaining accrual balance was approximately \$3 million. Expenditures related to this liability were not material to our financial condition during 2005 and 2004.

We are voluntarily addressing certain historical sites. An immaterial accrual has been established to address investigation expenses related to these sites. At this time, the total costs that may be incurred in connection with these sites cannot be determined.

On March 24, 2005, we completed the sale of our Progress Rail subsidiary. In connection with the sale, we incurred indemnity obligations related to certain pre-closing liabilities, including certain environmental matters (See discussion under Guarantees in Note 23C).

PEC

There are nine former MGP sites and a number of other sites associated with PEC that have required or are anticipated to require investigation and/or remediation.

In September 2005, the EPA advised PEC that it had been identified as a PRP at the Carolina Transformer site located in Fayetteville, N.C. The EPA offered PEC and a number of other PRPs the opportunity to share the reimbursement of approximately \$36 million to the EPA for past expenditures in addressing conditions at the site. Although a loss is considered probable, an agreement among PRPs has not been reached; consequently, it is not possible at this time to reasonably estimate the total amount of PEC's obligation for remediation of the Carolina Transformer site. PEC may file claims with respect to this site. The outcome of this matter cannot be predicted.

During the fourth quarter of 2004, the EPA advised PEC that it had been identified as a PRP at the Ward Transformer site located in Raleigh, N.C. The EPA offered PEC and a number of other PRPs the opportunity to negotiate cleanup of the site and reimbursement to the EPA for EPA's past expenditures in addressing conditions at the site. In September 2005, PEC and several other PRPs signed a settlement agreement, which requires the participating PRPs to provide approximately \$5 million to cover the cleanup cost and repay less than \$1 million of EPA's past costs. PEC has accrued its portion of these estimated costs. Based upon additional assessment work performed at the site during the first quarter of 2006, it is probable that additional costs beyond the EPA's original cost estimate will be incurred. However, the range of additional losses cannot be determined at this time. PEC may file claims with respect to this site. The outcome of this matter cannot be predicted.

At December 31, 2005 and 2004, PEC's accruals for probable and estimable costs related to various environmental sites, which are included in other liabilities and deferred credits and are expected to be paid out over one to five years, were \$7 million and \$9 million, respectively. The amount includes insurance fund proceeds that PEC received to address costs associated with environmental liabilities related to its involvement with some sites. All eligible expenses related to these sites are charged against a specific fund containing these proceeds. During 2005, PEC spent approximately \$6 million, accrued approximately \$4 million and received no insurance proceeds related to environmental remediation. During 2004, PEC spent approximately \$2 million related to environmental remediation.

On March 30, 2005, the North Carolina Division of Water Quality renewed a PEC permit for the continued use of coal combustion products generated at any of its coal-fired plants located in the state. Following review of

the permit conditions, which could significantly restrict the reuse of coal ash and result in higher ash management costs, the permit was adjudicated. The outcome of this matter cannot be predicted.

PEF

At December 31, 2005 and 2004, PEF's accruals for probable and estimable costs related to various environmental sites, which were included in other liabilities and deferred credits and are expected to be paid out over one to 15 years, were:

(in millions)	2005	2004
Remediation of distribution and substation transformers	\$ 20	\$ 27
MGP and other sites	18	18
Total accrual for environmental sites	\$ 38	\$ 45

PEF has received approval from the FPSC for recovery of costs associated with the remediation of distribution and substation transformers through the Environmental Cost Recovery Clause (ECRC). Under agreements with the Florida Department of Environmental Protection (FDEP), PEF is in the process of examining distribution transformer sites and substation sites for potential equipment integrity issues that could result in the need for mineral oil-impacted soil remediation. PEF has reviewed a number of distribution transformer sites and all substation sites. Based on changes to the estimated time frame for review of distribution transformer sites, PEF currently expects to have completed its review by the end of 2007. Should further sites be identified, PEF believes that any estimated costs would also be recovered through the ECRC. For the years ended December 31, 2005 and 2004, PEF accrued approximately \$2 million and \$19 million, respectively, and spent approximately \$9 million and \$4 million, respectively, related to the remediation of transformers. PEF has recorded a regulatory asset for the probable recovery of these costs through the ECRC.

The amounts for MGP and other sites, in the table above, relate to two former MGP sites and other sites associated with PEF that have required or are anticipated to require investigation and/or remediation. For the year ended December 31, 2005, PEF made no material accruals, spent approximately \$1 million, and received approximately \$1 million of additional insurance proceeds. For the year ended December 31, 2004, PEF received approximately \$12 million in insurance claim settlement proceeds and recorded a related accrual for associated environmental expenses, as these insurance proceeds are restricted for use in addressing costs associated with environmental liabilities.

In Florida, a risk-based corrective action (RBCA, known as Global RBCA) rule was developed by the FDEP and adopted at the February 2, 2005, Environmental Review Commission hearing. Risk-based corrective action generally means that the corrective action prescribed for contaminated sites can correlate to the level of human health risk imposed by the contamination at the property. The Global RBCA rule expands the use of the risk-based corrective action to all contaminated sites in the state that are not currently in one of the state's waste cleanup programs and has the potential for making future cleanups in Florida more costly to complete. The effective date of the Global RBCA rule was April 17, 2005.

B. Air Quality

We are subject to various current and proposed federal, state and local environmental compliance laws and regulations, which may result in increased planned capital expenditures and O&M expenses. Significant updates to these laws and regulations and related impacts to us since December 31, 2004, are discussed below. Additionally, Congress is considering legislation that would require additional reductions in air emissions of NO_x, SO₂, carbon dioxide (CO₂) and mercury. Some of these proposals establish nationwide caps and emission rates over an extended period of time. This national multipollutant approach to air pollution control could involve significant capital costs that could be material to our financial position or results of operations. Control equipment that will be installed on North Carolina coal-fired generating facilities as part of the Clean Smokestacks Act, enacted in 2002 and discussed below, may address some of the issues outlined above as they relate to PEC. However, the outcome of the matter cannot be predicted.

The EPA is conducting an enforcement initiative related to a number of coal-fired utility power plants in an effort to determine whether changes at those facilities were subject to NSR requirements or New Source Performance Standards under the Clean Air Act. We were asked to provide information to the EPA as part of this initiative and cooperated in supplying the requested information. The EPA initiated civil enforcement actions against unaffiliated utilities as part of this initiative. Some of these actions resulted in settlement agreements calling for expenditures by these unaffiliated utilities in excess of \$1.0 billion. These settlement agreements have generally called for expenditures to be made over extended time periods, and some of the companies may seek recovery of the related costs through rate adjustments or similar mechanisms.

On June 24, 2005, the Court of Appeals for the District of Columbia Circuit rendered a decision in a suit regarding EPA's NSR rules. As part of the decision, the court struck down a provision excluding pollution control projects from NSR requirements. As a result of this decision, additional regulatory review of our pollution control equipment proposals will be required, adding time and cost to the overall project.

NO_x SIP CALL RULE UNDER SECTION 110 OF THE CLEAN AIR ACT (NO_x SIP CALL)

The NO_x SIP Call is an EPA rule that requires 22 states, including North Carolina, South Carolina and Georgia, to further reduce nitrogen oxide emissions. The NO_x SIP Call is not applicable to Florida. Total capital costs to meet the requirements of the final rule under the NO_x SIP Call in North Carolina and South Carolina could reach approximately \$355 million at PEC, of which approximately \$336 million has been incurred through December 31, 2005. This amount also includes the cost to install NO_x controls under North Carolina's and South Carolina's programs to comply with the federal eight-hour ozone standard. However, further technical analysis and rulemaking may result in requirements for additional controls at some units. Increased O&M expenses relating to the NO_x SIP Call are not expected to be material to our or PEC's results of operations.

Parties unrelated to us have undertaken efforts to have Georgia excluded from the rule and its requirements. Georgia has not yet submitted a state implementation plan to comply with the Section 110 NO_x SIP Call. The outcome of this matter and the impact to our nonregulated operations in Georgia cannot be predicted.

CLEAN SMOKESTACKS ACT

In June 2002, the Clean Smokestacks Act was enacted in North Carolina requiring the state's electric utilities to reduce the emissions of NO_x and SO₂ from their North Carolina coal-fired power plants in phases by 2013. PEC currently has approximately 5,100 MW of coal-fired generation capacity in North Carolina that is affected by the Clean Smokestacks Act. In April 2005, PEC filed its annual estimate with the NCUC of the total capital expenditures to meet emission targets for NO_x and SO₂ from coal-fired plants under the Clean Smokestacks Act of approximately \$895 million. We now project that our total capital expenditures to meet these emission targets will be in a range of approximately \$1.1 billion to \$1.4 billion by the end of 2013, of which approximately \$286 million has been spent through December 31, 2005. This increase is primarily due to the higher cost and revised quantities of construction materials, such as concrete and steel, refinement of cost and scope estimates for the current projects, and increases in the estimated inflation factor applied to future project costs. We are evaluating various design, technology, and new generation options that could materially reduce the expenditures required by the Clean Smokestacks Act.

Two of the coal-fired generation plants impacted by the Clean Smokestacks Act are jointly owned. The joint owners pay their ownership share of construction costs. In 2005, PEC entered into a contract with the joint owner of certain facilities at the Mayo and Roxboro plants to limit their aggregate costs associated with capital expenditures to comply with the Clean Smokestacks Act to approximately \$38 million. PEC recognized a \$16 million liability in the fourth quarter of 2005, based upon the current estimate for Clean Smokestacks Act compliance. As capital cost projections change, it is reasonably possible that additional losses, which could be material, may be incurred in the future.

The Clean Smokestacks Act also freezes the utilities' base rates for five years, which ends in 2007, unless there are extraordinary events beyond the control of the utilities or unless the utilities persistently earn a return substantially in excess of the rate of return established and found reasonable by the NCUC in the utilities' last general rate case. The Clean Smokestacks Act requires PEC to amortize \$569 million, representing 70 percent of the original cost estimate of \$813 million, during the five-year rate freeze period. PEC recognized amortization of \$147 million, \$174 million and \$74 million for the years ended December 31, 2005, 2004 and 2003, respectively, and has recognized \$395 million in cumulative amortization through December 31, 2005. The remaining amortization requirement of \$174 million will be recorded over the two-year period ending December 31, 2007. The Clean Smokestacks Act permits PEC the flexibility to vary the amortization schedule for recording of the compliance costs from none up to \$174 million per year. The NCUC will hold a hearing prior to December 31, 2007, to determine cost recovery amounts for 2008 and future periods.

Pursuant to the Clean Smokestacks Act, PEC entered into an agreement with the state of North Carolina to transfer to the state certain NO_x and SO₂ emissions allowances that result from compliance with the collective NO_x and SO₂ emissions limitations set out in the Clean Smokestacks Act. The Clean Smokestacks Act also required the state to undertake a study of mercury and CO₂ emissions in North Carolina. O&M expenses will significantly increase due to the additional personnel, materials and general maintenance associated with the equipment. O&M expenses are recoverable through base rates, rather than as part of this program. The future regulatory interpretation, implementation or impact of the Clean Smokestacks Act cannot be predicted.

CLEAN AIR INTERSTATE RULE (CAIR) AND MERCURY RULE

On March 10, 2005, the EPA issued the final CAIR. The EPA's rule requires 28 states, including North Carolina, South Carolina, Georgia and Florida, and the District of Columbia to reduce NO_x and SO₂ emissions in order to reduce levels of fine particulate matter and impacts to visibility. The CAIR sets emission limits to be met in two phases beginning in 2009 and 2015, respectively, for NO_x and beginning in 2010 and 2015, respectively, for SO₂.

PEF has joined a coalition of Florida utilities that has filed a challenge to the CAIR as it applies to Florida. A petition for reconsideration and stay and a petition for judicial review of the CAIR were filed on July 11, 2005. On October 27, 2005, the DC Circuit Court issued an order granting the motion for stay of the proceedings. On December 2, 2005, the EPA announced a reconsideration of four aspects of the CAIR, including its applicability to Florida. While we consider it unlikely that this challenge would eliminate the compliance requirements of the CAIR, it could potentially reduce or delay our costs to comply with the CAIR. The outcome of this matter cannot be predicted.

On March 15, 2005, the EPA finalized two separate but related rules: the Clean Air Mercury Rule (CAMR) that sets emissions limits to be met in two phases beginning in 2010 and 2018, respectively, and encourages a cap and trade approach to achieving those caps, and a de-listing rule that eliminated any requirement to pursue a maximum achievable control technology (MACT) approach for limiting mercury emissions from coal-fired power plants. NO_x and SO₂ controls also are effective in reducing mercury emissions. However, according to the EPA the second phase cap reflects a level of mercury emissions reduction that exceeds the level that would be achieved solely as a co-benefit of controlling NO_x and SO₂ under CAIR.

The de-listing rule has been challenged by a number of parties; the resolution of the challenges could impact our final compliance plans and costs. On October 21, 2005, the EPA announced a reconsideration of the CAMR. The outcome of this matter cannot be predicted.

In conjunction with the proposed mercury rule, the EPA proposed a MACT standard to regulate nickel emissions from residual oil-fired units. The EPA withdrew the proposed nickel rule in March 2005.

We are in the process of determining compliance plans and the cost to comply with the CAIR and CAMR. Installation of additional air quality controls is likely to be needed to meet the CAIR and the CAMR requirements. Compliance costs at PEF are eligible for consideration for recovery through the ECRC. The outcome of future petitions for recovery through the ECRC cannot be predicted.

The air quality controls needed to meet compliance with the NOx SIP Call and Clean Smokestacks Act will reduce the costs to meet the CAIR requirements for our North Carolina units at PEC. We currently estimate the total additional compliance costs related to CAIR for PEC could be in a range of approximately \$100 million to \$200 million. We will continue to review these estimates as compliance plans are further developed. The timing and extent of the costs for future projects will depend upon the final compliance strategy.

We expect PEF to incur significant additional capital and O&M expenses to achieve compliance with the CAIR and CAMR through 2018. We currently estimate the total compliance costs for PEF could be as much as approximately \$1.4 billion, of which approximately \$2 million has been incurred through December 31, 2005. We will continue to review these estimates as compliance plans are further developed. The timing and extent of the costs for future projects will depend upon the final compliance strategy. We are evaluating various design, technology, and new generation options that could reduce change PEF's costs required by the CAIR and CAMR.

On October 14, 2005, the FPSC approved PEF's petition for the recovery of costs associated with the development and implementation of an integrated strategy to comply with the CAIR and CAMR through the ECRC. PEF is developing an integrated compliance strategy for the CAIR and CAMR rules because NOx and SO₂ controls are effective in reducing mercury emissions. Program costs for 2005 were approximately \$2 million for preliminary engineering activities and strategy development work necessary to determine our integrated compliance strategy. PEF currently projects to spend approximately \$51 million in capital costs to comply with the CAIR and CAMR programs in 2006. These costs may increase or decrease depending upon the results of the engineering and strategy development work. Among other things; subsequent rule interpretations, equipment availability, or the unexpected acceleration of the initial NOx or other compliance dates could require acceleration of some projects and therefore result in additional costs in 2006.

CLEAN AIR VISIBILITY RULE

On June 15, 2005, the EPA issued the final Clean Air Visibility Rule (CAVR). The EPA's rule requires states to identify facilities, including power plants, built between 1962 and 1977 with the potential to produce emissions that affect visibility in 156 specially protected areas. To help restore visibility in those areas, states must require the identified facilities to install Best Available Retrofit Technology (BART) to control their emissions. Depending on the approach taken by the states, the reductions associated with BART would begin to take effect in 2014. CAVR included EPA's determination that compliance with the NOx and SO₂ requirements of CAIR may be used by states as a BART substitute. We expect that our compliance plans to comply with the CAIR and the CAMR will fulfill BART obligations, but the states could require the installation of additional air quality controls if they do not achieve reasonable progress on improving visibility. The outcome of this matter cannot be predicted.

NORTH CAROLINA ATTORNEY GENERAL PETITION UNDER SECTION 126 OF THE CLEAN AIR ACT

In March 2004, the North Carolina Attorney General filed a petition with the EPA, under Section 126 of the Clean Air Act, asking the federal government to force coal-fired power plants in 13 other states, including South Carolina, to reduce their NOx and SO₂ emissions. The state of North Carolina contends these out-of-state emissions interfere with North Carolina's ability to meet national air quality standards for ozone and particulate matter. On August 1, 2005, the EPA issued a proposed response denying the petition. The EPA's rationale for denial is that compliance with CAIR will reduce the emissions from surrounding states sufficiently to address North Carolina's concerns. The EPA must take final action by March 15, 2006. The outcome of this matter cannot be predicted.

NATIONAL AMBIENT AIR QUALITY STANDARDS (NAAQS)

On December 21, 2005, the EPA announced proposed changes to the NAAQS for particulate matter. The EPA proposed to lower the 24-hour standard for particulate matter less than 2.5 microns in diameter from 65 micrograms per cubic meter to 35 micrograms per cubic meter. In addition, the EPA proposed to establish a new 24-hour standard of 70 micrograms per cubic meter for particulate matter that is between 2.5 and 10 microns in diameter. The EPA also proposed to eliminate the current standards for particulate matter less than 10 microns in diameter. The EPA is scheduled to finalize the standards by September 27, 2006. The changes could ultimately result in increased costs for installation of additional pollution controls at facilities operated by PEC and PEF. The outcome of this matter cannot be predicted.

C. Water Quality

As a result of the operation of certain control equipment needed to address the air quality issues outlined above, new wastewater streams may be generated at the affected facilities. Integration of these new wastewater streams into the existing wastewater treatment processes may result in permitting, construction and treatment requirements imposed on the Utilities in the immediate and extended future.

Section 316(b) of the Clean Water Act requires assessment of the environmental effect of withdrawal of water at our facilities. We are conducting studies and currently estimate that total compliance costs through 2010 to meet Section 316(b) requirements of the Clean Water Act will be approximately \$70 million to \$95 million, of which an immaterial amount has been incurred through December 31, 2005. The range includes approximately \$5 million to \$10 million at PEC and approximately \$65 million to \$85 million at PEF.

The majority of compliance costs associated with water quality requirements for PEF are eligible for consideration for recovery through the ECRC. The outcome of future petitions for recovery through the ECRC cannot be predicted.

D. Other Environmental Matters

GLOBAL CLIMATE CHANGE

The Kyoto Protocol was adopted in 1997 by the United Nations to address global climate change by reducing emissions of CO₂ and other greenhouse gases. The treaty went into effect on February 16, 2005. The United States has not adopted the Kyoto Protocol, and the Bush administration has stated it favors voluntary programs. There are proposals to address global climate change that would regulate CO₂ and other greenhouse gases. Reductions in CO₂ emissions to the levels specified by the Kyoto Protocol and some additional proposals could be materially adverse to our financial position or results of operations if associated costs of control or limitation cannot be recovered from customers. We have articulated principles that we believe should be incorporated into any global climate change policy. While the outcome of this matter cannot be predicted, we are taking voluntary action on this important issue as part of our commitment to environmental stewardship and responsible corporate citizenship.

In a decision issued July 15, 2005, a three-judge panel of the U.S. Court of Appeals for the District of Columbia Circuit denied petitions for review filed by several states, cities and organizations seeking the regulation by the EPA of CO₂ emissions under the Clean Air Act. In a 2-1 decision, the court held that the EPA administrator properly exercised his discretion in denying the request for regulation. Officials from five states and the District of Columbia asked the full U.S. Court of Appeals for the D.C. Circuit to review the decision made by the three-judge panel. On December 2, 2005, the U.S. Court of Appeals denied the request for rehearing. On March 2, 2006, the petitioners filed a petition for writ of certiorari with the U.S. Supreme Court, seeking a review of the U.S. Court of Appeals decision. The outcome of this matter cannot be predicted.

In 2005, we initiated a study to assess the impact of constraints on CO₂ and other air emissions. We plan to issue this report by March 31, 2006. While we participate in the development of a national climate change

policy framework, we will continue to actively engage others in our region to develop consensus-based solutions, as we did with the 2002 North Carolina Clean Smokestacks Act.

23. COMMITMENTS AND CONTINGENCIES

A. Purchase Obligations

At December 31, 2005, the following table reflects contractual cash obligations and other commercial commitments in the respective periods in which they are due:

Progress Energy

(in millions)	2006	2007	2008	2009	2010	Thereafter
Fuel	\$ 2,786	\$ 2,287	\$ 1,031	\$ 695	\$ 268	\$ 1,165
Purchased power	471	477	448	414	364	4,308
Construction obligations	74	28	-	-	-	-
Other purchase obligations	89	90	76	64	41	232
Total	\$ 3,420	\$ 2,882	\$ 1,555	\$ 1,173	\$ 673	\$ 5,705

PEC

(in millions)	2006	2007	2008	2009	2010	Thereafter
Fuel	\$ 881	\$ 849	\$ 443	\$ 304	\$ 151	\$ 593
Purchased power	124	122	85	86	43	508
Other Purchase Obligations	14	21	20	-	-	-
Total	\$ 1,019	\$ 992	\$ 548	\$ 390	\$ 194	\$ 1,101

PEF

(in millions)	2006	2007	2008	2009	2010	Thereafter
Fuel	\$ 545	\$ 544	\$ 343	\$ 265	\$ 104	\$ 572
Purchased power	343	355	363	328	321	3,800
Construction obligations	74	28	-	-	-	-
Other purchase obligations	34	36	32	43	19	74
Total	\$ 996	\$ 963	\$ 738	\$ 636	\$ 444	\$ 4,446

FUEL AND PURCHASED POWER

Through our subsidiaries, we have entered into various long-term contracts for coal, oil, gas and nuclear fuel. Our payments under these commitments were \$3.070 billion, \$2.033 billion and \$1.645 billion for 2005, 2004 and 2003, respectively. PEC's total payments under these commitments for its generating plants were \$964 million, \$477 million and \$562 million in 2005, 2004 and 2003, respectively. PEF's payments totaled \$505 million, \$375 million and \$209 million in 2005, 2004 and 2003, respectively.

Both PEC and PEF have ongoing purchased power contracts with certain cogenerators (qualifying facilities or QFs) with expiration dates ranging from 2006 to 2025. These purchased power contracts generally provide for capacity and energy payments.

Pursuant to the terms of the 1981 Power Coordination Agreement, as amended, between PEC and Power Agency, PEC is obligated to purchase a percentage of Power Agency's ownership capacity of, and energy from, Harris. In 1993, PEC and Power Agency entered into an agreement to restructure portions of their contracts covering power supplies and interests in jointly owned units. Under the terms of the 1993 agreement, PEC increased the amount of capacity and energy purchased from Power Agency's ownership interest in Harris, and the buyback period was extended six years through 2007. The estimated minimum annual payments for these purchases, which reflect

capacity and energy costs, total approximately \$34 million. These contractual purchases totaled \$37 million, \$39 million and \$36 million for 2005, 2004 and 2003, respectively.

PEC has a long-term agreement for the purchase of power and related transmission services from Indiana Michigan Power Company's Rockport Unit No. 2 (Rockport). The agreement provides for the purchase of 250 MW of capacity through 2009 with estimated minimum annual payments of approximately \$44 million, representing capital-related capacity costs. Total purchases (including energy and transmission use charges) under the Rockport agreement amounted to \$71 million, \$62 million and \$66 million for 2005, 2004 and 2003, respectively.

PEC executed two long-term agreements for the purchase of power from Broad River LLC's Broad River facility (Broad River). One agreement provides for the purchase of approximately 500 MW of capacity through 2021 with an original minimum annual payment of approximately \$16 million, primarily representing capital-related capacity costs. The second agreement provided for the additional purchase of approximately 335 MW of capacity through 2022 with an original minimum annual payment of approximately \$16 million representing capital-related capacity costs. Total purchases for both capacity and energy under the Broad River agreements amounted to \$44 million, \$42 million and \$37 million in 2005, 2004 and 2003, respectively.

PEC has various pay-for-performance contracts with QFs for approximately 354 MW of capacity expiring at various times through 2014. Payments for both capacity and energy are contingent upon the QFs' ability to generate. Payments made under these contracts were \$112 million in 2005, \$90 million in 2004 and \$113 million in 2003.

PEF has long-term contracts for approximately 489 MW of purchased power with other utilities, including a contract with The Southern Company for approximately 414 MW of purchased power annually through 2015. Total purchases, for both energy and capacity, under these agreements amounted to \$175 million, \$128 million and \$126 million for 2005, 2004 and 2003, respectively. Minimum purchases under these contracts, representing capital-related capacity costs, are approximately \$64 million annually through 2009, \$54 million for 2010 and \$38 million annually thereafter through 2015.

PEF has ongoing purchased power contracts with certain QFs for 812 MW of capacity with expiration dates ranging from 2006 to 2025. Energy payments are based on the actual power taken under these contracts. Capacity payments are subject to the qualifying facilities meeting certain contract performance obligations. In most cases, these contracts account for 100 percent of the generating capacity of each of the facilities. All commitments have been approved by the FPSC. Total capacity purchases under these contracts amounted to \$262 million, \$247 million and \$244 million for 2005, 2004 and 2003, respectively. At December 31, 2005, minimum expected future capacity payments under these contracts were \$279 million, \$289 million, \$297 million, \$262 million and \$267 million for 2006 through 2010, respectively, and \$3.6 billion thereafter. The FPSC allows the capacity payments to be recovered through a capacity cost recovery clause, which is similar to, and works in conjunction with, energy payments recovered through the fuel cost recovery clause.

On December 2, 2004, PEF entered into precedent and related agreements with Southern Natural Gas Company (SNG), Florida Gas Transmission Company (FGT), and BG LNG Services, LLC for the supply of natural gas and associated firm pipeline transportation to augment PEF's gas supply needs for the period from May 1, 2007, to April 30, 2027. The total cost to PEF associated with the agreements is approximately \$4.0 billion. The transactions are subject to several conditions precedent, some of which have been satisfied, which include obtaining the FPSC's approval of the agreements, the completion and commencement of operation of the necessary related expansions to SNG's and FGT's respective natural gas pipeline systems, and other standard closing conditions. Due to the conditions in the agreements, the estimated costs associated with these agreements are not included in the contractual cash obligations table above.

In January 2006, PEF entered into a conditional contract with Gulfstream Gas System, L.L.C. (Gulfstream) for firm pipeline transportation capacity to augment PEF's gas supply needs for the period from September 1, 2008 through December 31, 2031. The total cost to PEF associated with this agreement is approximately \$1.0 billion. The transaction is subject to several conditions precedent, including the completion and commencement of operation of the necessary related expansions to Gulfstream's natural gas pipeline system, and other standard closing conditions.

Due to the timing of this agreement the estimated costs associated with this agreement are not included in the contractual cash obligations table above.

CONSTRUCTION OBLIGATIONS

We have purchase obligations related to various capital construction projects. Our total payments under these contracts were \$91 million, \$108 million and \$158 million for 2005, 2004 and 2003, respectively. At December 31, 2005, PEC has no construction obligations. Total purchases by PEC under various combustion turbine construction obligations were \$5 million and \$21 million for 2004 and 2003, respectively. PEC did not have any purchases related to construction obligations in 2005. PEF has purchase obligations related to various plant capital projects at the Hines Energy Complex. Total payments under PEF's contracts were \$91 million, \$102 million and \$137 million for 2005, 2004 and 2003, respectively. PEF's future obligations under these contracts are \$74 million for 2006 and \$28 million for 2007.

OTHER PURCHASE OBLIGATIONS

We have entered into various other contractual obligations primarily related to service contracts for operational services entered into by PESC, parts and services contracts, and a PEF service agreement related to the Hines Energy Complex. Our payments under these agreements were \$97 million, \$58 million and \$31 million for 2005, 2004 and 2003, respectively.

On December 31, 2002, PEC and PVI entered into a contractual commitment to purchase at least \$11 million and \$4 million, respectively, of capital parts by December 31, 2010. During 2005, 2004 and 2003, no capital parts have been purchased under this contract.

PEC has various purchase obligations related to reactor vessel head replacements, power uprates and spent fuel storage. Total purchases under these contracts were \$13 million for 2005, \$17 million for 2004 and \$3 million for 2003. Future purchase obligations are \$7 million for 2006.

PEF has long-term service agreements for the Hines Energy Complex. Total payments under these contracts were \$8 million, \$11 million and \$3 million for 2005, 2004 and 2003, respectively. Future obligations under these contracts are \$14 million, \$11 million, \$16 million, \$14 million and \$19 million for 2006 through 2010, respectively, with approximately \$74 million payable thereafter.

PEF has various purchase obligations and contractual commitments related to the purchase and replacement of machinery. Total payments under these contracts were \$34 million for 2005. Future obligations under these contracts are \$20 million and \$25 million in 2006 and 2007, respectively, and \$6 million in 2008 and 2009.

PVI has purchase obligations with two counterparties for pipeline capacity through 2018 and 2028. Payments under these agreements were \$15 million, \$13 million and \$6 million for 2005, 2004 and 2003, respectively. Future obligations under these contracts are approximately \$16 million for 2006 through 2010 and approximately \$117 million payable thereafter.

B. Leases

We lease office buildings, computer equipment, vehicles, railcars and other property and equipment with various terms and expiration dates. Some rental payments for transportation equipment include minimum rentals plus contingent rentals based on mileage. These contingent rentals are not significant. Our rent expense under operating leases totaled \$48 million, \$57 million and \$54 million for 2005, 2004 and 2003, respectively. Our purchased power expense under agreements classified as operating leases were approximately \$14 million in 2005, \$25 million in 2004 and \$5 million in 2003.

PEC's rent expense under operating leases totaled \$24 million for 2005 and \$20 million for 2004 and 2003. These amounts include rent expense allocated from PESC of \$7 million for 2005 and \$10 million for 2004 and 2003. Purchased power expense under agreements classified as operating leases were approximately \$11 million during 2005, \$25 million during 2004 and \$5 million during 2003.

PEF's rent expense under operating leases totaled \$11 million, \$14 million and \$17 million during 2005, 2004 and 2003, respectively. These amounts include rent expense allocated from PESC to PEF of \$7 million for 2005 and \$10 million for 2004 and 2003. Purchased power expense under agreements classified as operating leases was approximately \$3 million during 2005.

Assets recorded under capital leases at December 31 consisted of:

(in millions)	Progress Energy		PEC	
	2005	2004	2005	2004
Buildings	\$ 30	\$ 30	\$ 30	\$ 30
Equipment and other	27	2	-	-
Less: Accumulated amortization	(12)	(11)	(12)	(11)
Total	\$ 45	\$ 21	\$ 18	\$ 19

At December 31, 2005, minimum annual payments, excluding executory costs such as property taxes, insurance and maintenance, under long-term noncancelable operating and capital leases were:

(in millions)	Progress Energy		PEC		PEF	
	Capital	Operating	Capital	Operating	Capital	Operating
2006	\$ 4	\$ 76	\$ 2	\$ 36	\$ -	\$ 25
2007	4	88	2	31	-	45
2008	4	88	3	31	-	48
2009	4	85	2	30	-	47
2010	4	71	3	18	-	47
Thereafter	21	298	14	158	-	102
	41	\$ 706	26	\$ 304	-	\$ 314
Less amount representing imputed interest	(12)		(7)		-	
Present value of net minimum lease payments under capital leases	\$ 29		\$ 19		\$ -	

In 2003, we entered into a new operating lease for a building, for which minimum annual rental payments are included in the table above. The lease terms provide for no rental payments during the last 15 years of the lease, during which period \$53 million of rental expense will be recorded in the Consolidated Statements of Income.

In 2005, PEF entered into an agreement for a new capital lease beginning in 2007 for a building that is currently under construction. The lease calls for annual payments of approximately \$6 million from 2007 through 2026 for a total of approximately \$110 million. The lease term provides for no payments during the last 20 years of the lease.

Excluding the Utilities, we are also a lessor of land, buildings and other types of properties we own under operating leases with various terms and expiration dates. The leased buildings are depreciated under the same terms as other buildings included in diversified business property. Minimum rentals receivable under noncancelable leases for 2006 through 2010 are approximately \$40 million, \$24 million, \$17 million, \$13 million and \$4 million, respectively, with \$24 million receivable thereafter. Rents received under these operating leases totaled \$66 million, \$60 million and \$45 million for 2005, 2004 and 2003, respectively.

The Utilities are lessors of electric poles, streetlights and other facilities. PEC's minimum rentals under noncancelable leases are \$10 million for 2006 and none thereafter. Rents received are contingent upon usage and totaled \$31 million, \$32 million and \$31 million for 2005, 2004 and 2003, respectively.

PEF's rents received are based on a fixed minimum rental where price varies by type of equipment and totaled \$63 million for 2005 and 2004 and \$56 million for 2003. Minimum rentals receivable (excluding streetlights) under noncancelable leases for 2006 is \$5 million and none thereafter. Streetlight rentals were \$42 million, \$40 million and \$38 million for 2005, 2004 and 2003, respectively. Future streetlight rentals would approximate 2005 revenues.

C. Guarantees

As a part of normal business, we enter into various agreements providing future financial or performance assurances to third parties, which are outside the scope of FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN No. 45). These agreements are entered into primarily to support or enhance the creditworthiness otherwise attributed to Progress Energy or our subsidiaries on a stand-alone basis, thereby facilitating the extension of sufficient credit to accomplish the subsidiaries' intended commercial purposes (See Note 19). Our guarantees include performance obligations under power supply agreements, tolling agreements, transmission agreements, gas agreements, fuel procurement agreements and trading operations. Our guarantees also include standby letters of credit, surety bonds and guarantees in support of nuclear decommissioning. At December 31, 2005, we do not believe conditions are likely for significant performance under these guarantees. To the extent liabilities are incurred as a result of the activities covered by the guarantees, such liabilities are included in the accompanying Balance Sheets.

At December 31, 2005, we have issued guarantees and indemnifications of certain legal, tax and environmental matters to third parties in connection with sales of businesses and for timely payment of obligations in support of our nonwholly owned synthetic fuel operations. Related to the sales of businesses, the notice period extends until 2012 for the majority of matters provided for in the indemnification provisions. For matters for which we receive timely notice, our indemnity obligations may extend beyond the notice period. Certain environmental indemnifications have no limitations as to time or maximum potential future payments. Other guarantees and indemnifications have an estimated maximum exposure of approximately \$152 million. Additionally, in 2005 PEC entered into a contract with the joint owner of certain facilities at the Mayo and Roxboro plants to limit their aggregate costs associated with capital expenditures to comply with the Clean Smokestacks Act and recognized a \$16 million liability related to this indemnification (See Note 22B). At December 31, 2005, we have recorded liabilities related to guarantees and indemnifications to third parties of approximately \$41 million. As current estimates change, it is possible that additional losses related to guarantees and indemnifications to third parties, which could be material, may be recorded in the future.

In addition, the Parent has issued \$300 million of guarantees of certain payments of two wholly owned indirect subsidiaries (See Note 24).

D. Other Commitments and Contingencies

1. Spent Nuclear Fuel Matters

Pursuant to the Nuclear Waste Policy Act of 1982, the predecessors to the Utilities entered into contracts with the DOE under which the DOE agreed to begin taking spent nuclear fuel by no later than January 31, 1998. All similarly situated utilities were required to sign the same standard contract.

The DOE failed to begin taking spent nuclear fuel by January 31, 1998. In January 2004, the Utilities filed a complaint in the United States Court of Federal Claims against the DOE, claiming that the DOE breached the Standard Contract for Disposal of Spent Nuclear Fuel by failing to accept spent nuclear fuel from our various facilities on or before January 31, 1998. Our damages due to the DOE's breach will be significant, but have yet to be determined. Approximately 60 cases involving the government's actions in connection with spent nuclear fuel are currently pending in the Court of Federal Claims.

The DOE and the Utilities have agreed to a stay of the lawsuit, including discovery. The parties agreed to, and the trial court entered, a stay of proceedings, in order to allow for possible efficiencies due to the resolution of legal and factual issues in previously filed cases in which similar claims are being pursued by other plaintiffs. These issues may include, among others, so-called "rate issues," or the minimum mandatory schedule for the acceptance of spent

nuclear fuel and high-level waste by which the government was contractually obligated to accept contract holders' spent nuclear fuel and/or high-level waste, and issues regarding recovery of damages under a partial breach of contract theory that will be alleged to occur in the future. These issues have been or are expected to be presented in the trials or appeals that are currently scheduled to occur during 2006. Resolution of these issues in other cases could facilitate agreements by the parties in the Utilities' lawsuit, or at a minimum, inform the court of decisions reached by other courts if they remain contested and require resolution in this case. In July 2005, the parties jointly requested a continuance of the stay through December 15, 2005, which the trial court granted. Subsequently, the trial court continued the stay until March 17, 2006.

In July 2002, Congress passed an override resolution to Nevada's veto of the DOE's proposal to locate a permanent underground nuclear waste storage facility at Yucca Mountain, Nev. In January 2003, the state of Nev.; Clark County, Nevada; and Las Vegas petitioned the U.S. Court of Appeals for the District of Columbia Circuit for review of the Congressional override resolution. These same parties also challenged the EPA's radiation standards for Yucca Mountain. On July 9, 2004, the Court rejected the challenge to the constitutionality of the resolution approving Yucca Mountain, but ruled that the EPA was wrong to set a 10,000-year compliance period in the radiation protection standard. In August 2005, the EPA issued new proposed standards. The proposed standards include a 1,000,000-year compliance period in the radiation protection standard. Comments were due November 21, 2005, and are being reviewed by the EPA. The EPA has not scheduled a date for issuance of revised proposed standards. The DOE originally planned to submit a license application to the NRC to construct the Yucca Mountain facility by the end of 2004. However, in November 2004, the DOE announced it would not submit the license application until mid-2005 or later. The DOE did not submit the license application in 2005 and has not provided a new target date for submission of the license application. Congress approved \$450 million for fiscal year 2006 for the Yucca Mountain project, approximately \$201 million less than requested by the DOE. The DOE has acknowledged that a working repository will not be operational until sometime after 2010, but the DOE has not identified a new target date. The Utilities cannot predict the outcome of this matter.

On February 27, 2004, PEC requested to have its license for the Independent Spent Fuel Storage Installation at Robinson extended by 20 years with an exemption request for an additional 20-year extension. Its current license expires in August 2006 and on March 30, 2005, the NRC issued a 40-year license renewal.

With certain modifications and additional approval by the NRC, including the installation of onsite dry storage facilities at Robinson and Brunswick, PEC's spent nuclear fuel storage facilities will be sufficient to provide storage space for spent fuel generated on PEC's system through the expiration of the operating licenses for all of PEC's nuclear generating units.

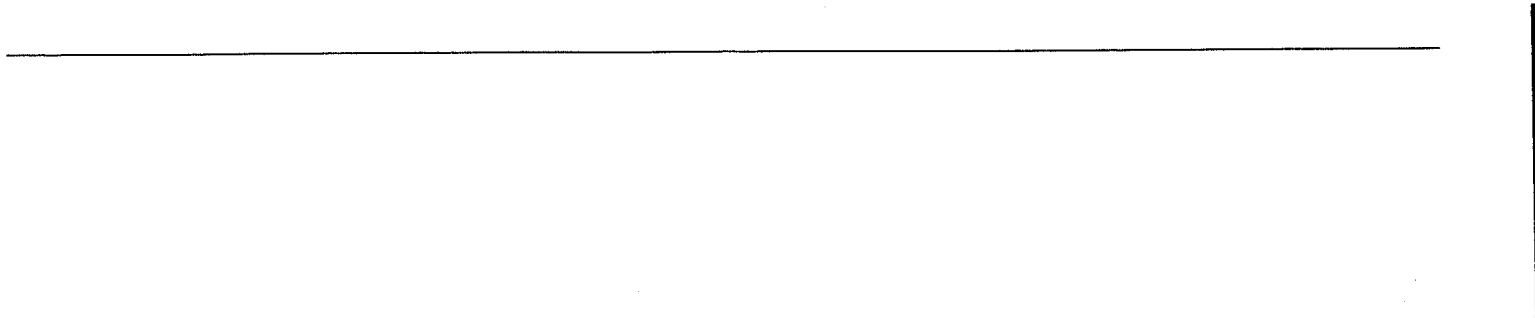
With certain modifications and additional approval by the NRC, including the installation of onsite dry storage facilities at PEF's nuclear unit, CR3, PEF's spent nuclear fuel storage facilities will be sufficient to provide storage space for spent fuel generated on PEF's system through the expiration of the operating license for CR3.

2. Synthetic Fuel Matters

Through our subsidiaries, we are a majority owner in five entities and a minority owner in one entity that own facilities that produce coal-based solid synthetic fuel as defined under Section 29 of the Code (Section 29). The production and sale of the synthetic fuel from these facilities qualify for tax credits under Section 29/45K if certain requirements are satisfied, including a requirement that the synthetic fuel differs significantly in chemical composition from the coal used to produce such synthetic fuel and that the fuel was produced from a facility that was placed in service before July 1, 1998. Qualifying synthetic fuel facilities entitle their owners to federal income tax credits based on the barrel of oil equivalent of the synthetic fuel produced and sold by these plants.

On August 8, 2005, the Energy Policy Act of 2005 (EPACT) was signed into law. This new federal law contains key provisions affecting the electric power industry, including the redesignation of the Section 29 tax credit as a general business credit under Section 45K of the Code (Section 45K). The previous amount of Section 29 tax credits that we were allowed to claim in any calendar year through December 31, 2005, was limited by the amount of our regular federal income tax liability. Section 29 tax credit amounts allowed but not utilized are currently carried forward indefinitely as deferred alternative minimum tax credits. The redesignation of

Section	29	tax	credits	as	a	Section
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45K general business credit was effective on January 1, 2006, and removes the regular federal income tax liability limit on synthetic fuel production and subjects the credits to a 20-year carry forward period. This provision would allow us to produce synthetic fuel to a higher level than we have historically produced should we choose to do so.

Total Section 29 credits generated through December 31, 2005 (including those generated by Florida Progress prior to our acquisition), are approximately \$1.7 billion, of which \$819 million has been used to offset regular federal income tax liability and \$922 million is being carried forward as deferred alternative minimum tax credits. The current synthetic fuel tax credit program expires at the end of 2007.

IRS PROCEEDINGS

In July 2004, we were notified that the IRS field auditors anticipated taking an adverse position regarding the placed-in-service date of the Earthco facilities. On October 29, 2004, we received the IRS field auditors' preliminary report concluding that the Earthco facilities had not been placed in service before July 1, 1998, and proposing that the tax credits generated by those facilities be disallowed.

During October 2005, we and the IRS field auditors filed briefs with the National Office for the purpose of receiving technical advice on whether our Earthco facilities were placed in service prior to July 1, 1998, in order to determine if our synthetic fuel tax credits are allowable under Section 29 of the Internal Revenue Code. During February 2006, the IRS field auditors verbally informed us that the IRS National Office concluded that our four Earthco synthetic fuel facilities met the placed-in-service requirement. The IRS field auditors also indicated that, once they receive written confirmation of the National Office's conclusion, the IRS field auditors will close their audit without any disallowance of tax credits. On February 28, 2006, we received our copy of the National Office Technical Advice Memorandum that concludes that the Earthco facilities met the placed-in-service requirement.

PERMANENT SUBCOMMITTEE

In October 2003, the United States Senate Permanent Subcommittee on Investigations began a general investigation concerning synthetic fuel tax credits claimed under Section 29. The investigation is examining the utilization of the credits, the nature of the technologies and fuels created, the use of the synthetic fuel and other aspects of Section 29 and is not specific to our synthetic fuel operations. Progress Energy provided information in connection with this investigation. We cannot predict the outcome of this matter.

IMPACT OF CRUDE OIL PRICES

Although the Section 29/45K tax credit program is expected to continue through 2007, recent market conditions, world events and catastrophic weather events have increased the volatility and level of oil prices that could limit the amount of those credits or eliminate them entirely for the years following 2005. This possibility is due to a provision of Section 29 that provides that if the average wellhead price per barrel for unregulated domestic crude oil for the year (the Annual Average Price) exceeds a certain threshold price (the Threshold Price), the amount of Section 29/45K tax credits is reduced for that year. Also, if the Annual Average Price increases high enough (the Phase-out Price), the Section 29/45K tax credits are eliminated for that year. The Threshold Price and the Phase-out Price are adjusted annually for inflation. Synthetic fuel is not economical to produce absent the associated tax credits.

If the Annual Average Price falls between the Threshold Price and the Phase-out Price for a year, the amount by which Section 29/45K tax credits are reduced will depend on where the Annual Average Price falls in that continuum. For example, for 2004, the Threshold Price was \$51.35 per barrel and the Phase-out Price was \$64.47 per barrel. If the Annual Average Price had been \$57.91 per barrel, there would have been a 50 percent reduction in the amount of Section 29 tax credits for that year.

The secretary of the Treasury calculates the Annual Average Price based on the Domestic Crude Oil First Purchases Prices published by the Energy Information Agency (EIA). Because the EIA publishes its information on a three-month lag, the secretary of the Treasury finalizes the calculations three months after the year in question ends. Thus, the Annual Average Price for calendar year 2005 is expected to be published in early April 2006.

We estimate that the 2005 Threshold Price will be approximately \$52 per barrel and the Phase-out Price will be approximately \$65 per barrel, based on an estimated 2005 inflation adjustment. The monthly Domestic Crude Oil First Purchases Price published by the EIA has recently averaged approximately \$5 lower than the corresponding monthly New York Mercantile Exchange (NYMEX) settlement price for light sweet crude oil. Through December 31, 2005, the average NYMEX contract settlement price for light sweet crude oil was \$55 per barrel. Assuming that the \$5 average differential between the Domestic Crude Oil First Purchases Price published by the EIA and the NYMEX settlement price continued through December 31, 2005, we do not currently believe that the 2005 Annual Average Price will cause a phase-out of the synthetic fuel tax credits in 2005.

We estimate that the 2006 Threshold Price will be approximately \$52 per barrel and the Phase-out Price will be approximately \$66 per barrel, based on estimated inflation adjustments for 2005 and 2006. The monthly Domestic Crude Oil First Purchases Price published by the EIA has recently averaged approximately \$5 lower than the corresponding monthly NYMEX settlement price for light sweet crude oil. As of January 31, 2006, the average NYMEX futures price for light sweet crude oil for calendar year 2006 was \$69 per barrel. Based upon the estimated 2006 Threshold Price and Phase-out Price, if oil prices for 2006 remained at the January 31, 2006, average futures price level of \$69 per barrel for the entire year in 2006, we currently estimate that the synthetic fuel tax credit amount for 2006 would be reduced by approximately 75 percent to 85 percent. Therefore, the estimated value of 2006 tax credits of approximately \$27 per ton would be reduced to approximately \$4 to \$7 per ton for any synthetic fuel produced in 2006.

In November 2005, the U.S. Senate passed Senate Bill 2020, The Tax Relief Act of 2005, which includes proposed modifications to the Section 29/45K synthetic fuel tax credit program. This legislation would provide synthetic fuel producers with additional certainty around future synthetic fuel production decisions. The proposed modifications include amendments of the phase-out calculation and the annual inflation adjustment for the value of the synthetic fuel tax credits. Under Senate Bill 2020, the Annual Average Price, Threshold Price and the Phase-out Price for 2006 and 2007 would be based on the calculated amounts for the previous calendar year. In addition, the annual inflation adjustment for the synthetic fuel tax credits for 2005, 2006 and 2007 would be eliminated. The U.S. House version of the Tax Reconciliation bill does not include these same provisions. The differences in the Senate and House versions of the bill will be reconciled in conference. We cannot predict with any certainty the likelihood of this legislation passing.

As noted above, we do not currently believe that the 2005 Annual Average Price will cause a phase-out of the synthetic fuel tax credits related to synthetic fuel production in 2005. Therefore, if the provisions of Senate Bill 2020 regarding changes to the Section 29/45K synthetic fuel tax credit program were enacted into law, there would be no phase-out of these tax credits in calendar year 2006. However, we cannot predict with any certainty the price of oil for 2006 or 2007 and, therefore, we cannot predict what impact, if any, this proposed legislation would have on the value of tax credits in 2007.

Our future synthetic fuel production levels for 2006 and 2007 remain uncertain because we cannot predict with any certainty the Annual Average Price of oil for 2006 or 2007 or the likelihood of legislation modifying the phase-out calculation being enacted into law. If oil prices for 2006 remained at the January 31, 2006, average futures price level of \$69 per barrel for the entire year in 2006, it is unlikely that we would produce significant amounts of synthetic fuel in 2006 and could potentially forfeit credits associated with any 2006 synthetic fuel production. This could have a material adverse impact on our results of operations. We will continue to monitor the level of oil prices and retain the ability to adjust production based on future oil price levels.

Due to the significant uncertainty surrounding our synthetic fuel production in 2006 and 2007 based on the current level of oil prices, we evaluated our synthetic fuel and other related operating long-lived assets for impairment during the third quarter and fourth quarter of 2005. We determined that no impairment of these assets was required. However, an increase in oil prices or a decrease in future synthetic fuel production and cash flows could require additional impairment evaluations in the future, which could result in a future impairment of these assets, which have total carrying values as of December 31, 2005, of approximately \$111 million. The majority of these assets will be fully depreciated by the end of 2007, the scheduled end of the synthetic fuel tax credit program. The outcome of this matter cannot be determined.

SALE OF PARTNERSHIP INTEREST

In June 2004, through our subsidiary Progress Fuels, we sold in two transactions a combined 49.8 percent partnership interest in Colona, one of our synthetic fuel facilities. Substantially all proceeds from the sales will be received over time, which is typical of such sales in the industry. Gains from the sales will be recognized on a cost recovery basis as the facility produces and sells synthetic fuel and when there is persuasive evidence that the sales proceeds have become fixed or determinable and collectability is reasonably assured. Gain recognition is dependent on the synthetic fuel production qualifying for Section 29 tax credits and the value of such tax credits as discussed above. Until the gain recognition criteria are met, gains from selling interests in Colona will be deferred. It is possible that gains will be deferred in the first, second and/or third quarters of each year until there is persuasive evidence that no tax credit phase-out will occur for the applicable calendar year. This could result in shifting earnings from earlier quarters to later quarters in a calendar year. In the event that the synthetic fuel tax credits from the Colona facility are reduced, including an increase in the price of oil that could limit or eliminate synthetic fuel tax credits, the amount of proceeds realized from the sale could be significantly impacted. We recognized a pre-tax gain on monetization of \$30 million during 2005 based on the remote possibility of any phase-out of the synthetic fuel tax credits in 2005. A portion of this gain had been deferred through the third quarter of 2005.

CONTINGENT ROYALTY PAYMENTS

We have certain future commitments related to four synthetic fuel facilities purchased that provide for contingent payments (royalties). The related agreements and their amendments require the payment of minimum annual royalties of approximately \$7 million for each plant through 2007. We recorded a liability (included in other liabilities and deferred credits on the Consolidated Balance Sheets) and a deferred asset (included in other assets and deferred debits in the Consolidated Balance Sheets), each of approximately \$50 million and \$73 million at December 31, 2005 and 2004, respectively, representing the minimum amounts due through 2007, discounted at 6.05%. At December 31, 2005 and 2004, the portions of the asset and liability recorded that were classified as current were approximately \$26 million. The deferred asset will be amortized to expense each year as synthetic fuel sales are made. The maximum amounts payable under these agreements remain unchanged. Future expected annual minimum royalty payments are approximately \$26 million for 2006 and 2007. We have exercised our right under the related agreements to escrow those payments if certain conditions in the agreements were met, as more fully described below.

On May 15, 2005, the original owners of the Earthco synthetic fuel facilities filed suit in New York state court alleging breach of contract against the Progress Fuels subsidiaries that purchased the Earthco facilities (Progress Fuels Subsidiaries). The plaintiffs also named us as a defendant. The plaintiffs' allege that periodic payments due to them under the sales arrangement with the Progress Fuels Subsidiaries are being improperly withheld and escrowed. The Progress Fuels Subsidiaries believe that the parties' agreements allow for the payments to be escrowed in the event of an audit, investigation or other proceeding under which the IRS can disallow the tax credits associated with the Earthco facilities. They also believe that the agreements allow for the use of such escrowed amounts to satisfy any potential disallowance of tax credits that arises out of such an event. Currently, the escrowed amount in question is \$97 million, which reflects periodic payments that would have been paid to the plaintiffs beginning April 30, 2003, through January 31, 2006. This amount will increase as future periodic payments are made to the escrow, which would otherwise have been payable to the plaintiffs. Plaintiffs filed a partial summary judgment motion in December 2005 seeking payment of the escrowed money. The Progress Fuels Subsidiaries oppose the motion and will file opposition papers, which are not yet due. The parties are now engaged in discovery.

In addition, a number of our subsidiaries and affiliates are parties to two lawsuits arising out of an Asset Purchase Agreement dated as of October 19, 1999, by and among U.S. Global LLC (Global), Earthco, certain affiliates of Earthco (collectively the Earthco Sellers), EFC Synfuel LLC (which is owned indirectly by Progress Energy, Inc.) and certain of its affiliates, including Solid Energy LLC, Solid Fuel LLC, Ceredo Synfuel LLC, Gulf Coast Synfuel LLC (currently named Sandy River Synfuel LLC) (collectively the Progress Affiliates), as amended by an amendment to Purchase Agreement as of August 23, 2000 (the Asset Purchase Agreement). Global has asserted that pursuant to the Asset Purchase Agreement it is entitled to an interest in two synthetic fuel facilities currently owned by the Progress Affiliates, and an option to purchase additional interests in the two synthetic fuel facilities.

The first suit, U.S. Global LLC v. Progress Energy, Inc. et al., was filed in the Circuit Court for Broward County, Fla., in March 2003 (the Florida Global Case). The Florida Global Case asserts claims for breach of the Asset Purchase Agreement and other contract and tort claims related to the Progress Affiliates' alleged interference with Global's rights under the Asset Purchase Agreement. The Florida Global Case requests an unspecified amount of compensatory damages, as well as declaratory relief. Following briefing and argument on a number of dispositive motions on successive versions of Global's complaint, on August 16, 2004, the Progress Affiliates answered the Fourth Amended Complaint by generally denying all of Global's substantive allegations and asserting numerous affirmative defenses. The parties are currently engaged in discovery in the Florida Global Case.

The second suit, Progress Synfuel Holdings, Inc. et al. v. U.S. Global, LLC, was filed by the Progress Affiliates in the Superior Court for Wake County, N.C., seeking declaratory relief consistent with our interpretation of the Asset Purchase Agreement (the North Carolina Global Case). Global was served with the North Carolina Global Case on April 17, 2003.

On May 15, 2003, Global moved to dismiss the North Carolina Global Case for lack of personal jurisdiction over Global. In the alternative, Global requested that the court decline to exercise its discretion to hear the Progress Affiliates' declaratory judgment action. On August 7, 2003, the Wake County Superior Court denied Global's motion to dismiss and entered an order staying the North Carolina Global Case, pending the outcome of the Florida Global Case. The Progress Affiliates appealed the Superior court's order staying the case. By order dated September 7, 2004, the North Carolina Court of Appeals dismissed the Progress Affiliates' appeal.

The Progress Affiliates believe that the parties' agreements allow for the payments due to Global to be escrowed in the event of an audit, investigation or other proceeding under which the IRS can disallow the tax credits and also allow for the use of such escrowed amounts to satisfy any potential disallowance of tax credits that arises out of such an event. Currently, the escrowed amount in question is \$37 million, which reflects periodic payments that would have been paid to the plaintiffs beginning April 30, 2003, through January 31, 2006. This amount will increase as future periodic payments are made to the escrow that would otherwise have been payable to the plaintiffs.

We cannot predict the outcome of these matters, but will vigorously defend against the allegations.

3. Franchise Matters

PEF has largely resolved its outstanding franchise matters. In August 2005, the cities of Edgewood, Fla. (1,400 customers), and Maitland, Fla. (7,000 customers), approved new 30-year electric utility franchise agreements with PEF. In November 2005, the 2,500 customer town of Belleair, Fla., voted to reject a referendum to municipalize, but has not yet signed a new utility franchise agreement with PEF. As previously noted, in accordance with the terms of an arbitration panel's award issued in May 2003 and after satisfying regulatory and operational requirements, Winter Park acquired from PEF the electric distribution system that serves Winter Park (14,000 customers) and PEF transferred the distribution system to Winter Park on June 1, 2005. In addition, Winter Park executed a wholesale power supply contract with PEF with a five-year term and a renewal option (See Note 7C).

4. Other Litigation Matters

We and our subsidiaries are involved in various litigation matters in the ordinary course of business, some of which involve substantial amounts. Where appropriate, we have made accruals and disclosures in accordance with SFAS No. 5 to provide for such matters. In the opinion of management, the final disposition of pending litigation would not have a material adverse effect on our consolidated results of operations or financial position.

24. CONDENSED CONSOLIDATING STATEMENTS

Presented below are the condensed consolidating Statements of Income, Balance Sheets and Cash Flows as required by Rule 3-10 of Regulation S-X. In September 2005, we issued our guarantee of certain payments of two wholly owned indirect subsidiaries, FPC Capital I (the Trust) and Florida Progress Funding Corporation (Funding Corp.). Our guarantees are in addition to the previously issued guarantees of our wholly owned subsidiary, Florida Progress.

The Trust, a finance subsidiary, was established in 1999 for the sole purpose of issuing \$300 million of 7.10% Cumulative Quarterly Income Preferred Securities due 2039, Series A (Preferred Securities) and using the proceeds thereof to purchase from Funding Corp. \$300 million of 7.10% Junior Subordinated Deferrable Interest Notes due 2039 (Subordinated Notes). The Trust has no other operations and its sole assets are the Subordinated Notes and Notes Guarantee (as discussed below). Funding Corp. is a wholly owned subsidiary of Florida Progress and was formed for the sole purpose of providing financing to Florida Progress and its subsidiaries. Funding Corp. does not engage in business activities other than such financing and has no independent operations. Since 1999, Florida Progress has fully and unconditionally guaranteed the obligations of Funding Corp. under the Subordinated Notes (the Notes Guarantee). In addition, Florida Progress guaranteed the payment of all distributions related to the \$300 million Preferred Securities required to be made by the Trust, but only to the extent that the Trust has funds available for such distributions (the Preferred Securities Guarantee). The Preferred Securities Guarantee, considered together with the Notes Guarantee, constitutes a full and unconditional guarantee by Florida Progress of the Trust's obligations under the Preferred Securities. The Preferred Securities and Preferred Securities Guarantee are listed on the New York Stock Exchange.

The Subordinated Notes may be redeemed at the option of Funding Corp. at par value plus accrued interest through the redemption date. The proceeds of any redemption of the Subordinated Notes will be used by the Trust to redeem proportional amounts of the Preferred Securities and common securities in accordance with their terms. Upon liquidation or dissolution of Funding Corp., holders of the Preferred Securities would be entitled to the liquidation preference of \$25 per share plus all accrued and unpaid dividends thereon to the date of payment. The yearly interest expense is \$21 million and is reflected in the Consolidated Statements of Income.

We have guaranteed the payment of all distributions related to the Trust's Preferred Securities. As of December 31, 2005, the Trust had outstanding 12 million shares of the Preferred Securities with a liquidation value of \$300 million. Our guarantees are joint and several, full and unconditional and are in addition to the joint and several, full and unconditional guarantees previously issued to the Trust and Funding Corp. by Florida Progress. Our subsidiaries have provisions restricting the payment of dividends to the Parent in certain limited circumstances and, as disclosed in Note 12B, there were no restrictions on PEC's or PEF's retained earnings.

The Trust is a special-purpose entity and in accordance with the provisions of FIN No. 46R, we deconsolidated the Trust on December 31, 2003. The deconsolidation was not material to our financial statements and resulted in recording an additional equity investment in the Trust of approximately \$9 million, an increase in outstanding debt of approximately \$8 million and a gain of approximately \$1 million relating to the cumulative effect of a change in accounting principle. Separate financial statements and other disclosures concerning the Trust have not been presented because we believe that such information is not material to investors.

In the following tables, the Parent column includes the financial results of the parent holding company only. The Subsidiary Guarantor column includes the financial results of Florida Progress. The Other column includes the consolidated financial results of all other nonguarantor subsidiaries and elimination entries for all intercompany transactions. All applicable corporate expenses have been allocated appropriately among the guarantor and nonguarantor subsidiaries.

Condensed Consolidating Statement of Income
Year Ended December 31, 2005

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Operating revenues				
Electric	\$ -	\$ 3,955	\$ 3,990	\$ 7,945
Diversified business	-	1,496	667	2,163
Total operating revenues	-	5,451	4,657	10,108
Operating expenses				
Utility				
Fuel used in electric generation	-	1,323	1,036	2,359
Purchased power	-	694	354	1,048
Operation and maintenance	12	852	906	1,770
Depreciation and amortization	-	334	588	922
Taxes other than on income	4	279	177	460
Other	-	(26)	(11)	(37)
Diversified business				
Cost of sales	-	1,338	737	2,075
Depreciation and amortization	-	79	73	152
Other	-	41	33	74
Total operating expenses	16	4,914	3,893	8,823
Equity in earnings of consolidated subsidiaries	884	-	(884)	-
Other income (expense), net	66	(4)	(51)	11
Interest charges, net	300	178	162	640
Income (loss) from continuing operations before income tax and minority interest	634	355	(333)	656
Income tax (benefit) expense	(63)	(40)	58	(45)
Minority interest in subsidiaries' loss, net of tax	-	(26)	-	(26)
Income (loss) from continuing operations	697	421	(391)	727
Discontinued operations, net of tax	-	(47)	16	(31)
Cumulative effect of changes in accounting principles, net of tax	-	-	1	1
Net income (loss)	\$ 697	\$ 374	\$ (374)	\$ 697

Condensed Consolidating Statement of Income
Year Ended December 31, 2004

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Operating revenues				
Electric	\$ -	\$ 3,525	\$ 3,628	\$ 7,153
Diversified business	-	1,125	247	1,372
Total operating revenues	-	4,650	3,875	8,525
Operating expenses				
Utility				
Fuel used in electric generation	-	1,175	836	2,011
Purchased power	-	567	301	868
Operation and maintenance	10	630	835	1,475
Depreciation and amortization	-	281	597	878
Taxes other than on income	(2)	254	173	425
Other	-	(2)	(11)	(13)
Diversified business				
Cost of sales	-	981	198	1,179
Depreciation and amortization	-	78	79	157
Other	-	17	84	101
Total operating expenses	8	3,981	3,092	7,081
Equity in earnings of consolidated subsidiaries	940	-	(940)	-
Other income (expense), net	65	(4)	(59)	2
Interest charges, net	295	162	171	628
Income (loss) from continuing operations before income tax and minority interest	702	503	(387)	818
Income tax (benefit) expense	(57)	61	102	106
Minority interest in subsidiaries' loss, net of tax	-	(17)	-	(17)
Income (loss) from continuing operations	759	459	(489)	729
Discontinued operations, net of tax	-	15	15	30
Net income (loss)	\$ 759	\$ 474	\$ (474)	\$ 759

Condensed Consolidating Statement of Income
Year Ended December 31, 2003

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Operating revenues				
Electric	\$ -	\$ 3,152	\$ 3,589	\$ 6,741
Diversified business	-	830	228	1,058
Total operating revenues	-	3,982	3,817	7,799
Operating expenses				
Utility				
Fuel used in electric generation	-	870	825	1,695
Purchased power	-	566	296	862
Operation and maintenance	19	640	762	1,421
Depreciation and amortization	-	307	576	883
Taxes other than on income	2	241	162	405
Other	-	-	(8)	(8)
Diversified business				
Cost of sales	-	736	193	929
Depreciation and amortization	-	62	64	126
Other	-	80	62	142
Total operating expenses	21	3,502	2,932	6,455
Equity in earnings of consolidated subsidiaries	1,039	-	(1,039)	-
Other income (expense), net	47	(8)	(76)	(37)
Interest charges, net	319	142	146	607
Income (loss) from continuing operations before income tax and minority interest	746	330	(376)	700
Income tax (benefit) expense	(36)	(112)	35	(113)
Minority interest in subsidiaries' income, net of tax	-	2	-	2
Income (loss) from continuing operations	782	440	(411)	811
Discontinued operations, net of tax	-	7	(12)	(5)
Cumulative effect of changes in accounting principles, net of tax	-	-	(24)	(24)
Net income (loss)	\$ 782	\$ 447	\$ (447)	\$ 782

Condensed Consolidating Balance Sheet
December 31, 2005

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Utility plant, net	\$ -	\$ 5,821	\$ 8,621	\$ 14,442
Current assets				
Cash and cash equivalents	239	241	126	606
Short-term investments	-	-	191	191
Receivables from affiliated companies	713	-	(713)	-
Deferred fuel cost	-	341	261	602
Assets of discontinued operations	-	107	2	109
Other current assets	22	1,069	1,139	2,230
Total current assets	974	1,758	1,006	3,738
Deferred debits and other assets				
Investment in consolidated subsidiaries	11,594	-	(11,594)	-
Goodwill	-	2	3,717	3,719
Other assets and deferred debits	13	2,174	2,937	5,124
Total deferred debits and other assets	11,607	2,176	(4,940)	8,843
Total assets	\$ 12,581	\$ 9,755	\$ 4,687	\$ 27,023
Capitalization				
Common stock equity	\$ 8,038	\$ 3,039	\$ (3,039)	\$ 8,038
Preferred stock of subsidiaries - not subject to mandatory redemption	-	34	59	93
Minority interest	-	38	5	43
Long-term debt, affiliate	-	440	(170)	270
Long-term debt, net	3,873	2,636	3,667	10,176
Total capitalization	11,911	6,187	522	18,620
Current liabilities				
Current portion of long-term debt	404	109	-	513
Notes payable to affiliated companies	-	315	(315)	-
Short-term obligations	-	102	73	175
Liabilities of discontinued operations	-	40	-	40
Other current liabilities	245	855	1,017	2,117
Total current liabilities	649	1,421	775	2,845
Deferred credits and other liabilities				
Noncurrent income tax liabilities	-	60	218	278
Regulatory liabilities	-	1,189	1,338	2,527
Accrued pension and other benefits	12	307	551	870
Other liabilities and deferred credits	9	591	1,283	1,883
Total deferred credits and other liabilities	21	2,147	3,390	5,558
Total capitalization and liabilities	\$ 12,581	\$ 9,755	\$ 4,687	\$ 27,023

Condensed Consolidating Balance Sheet
December 31, 2004

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Utility plant, net	\$ -	\$ 5,882	\$ 8,481	\$ 14,363
Current assets				
Cash and cash equivalents	5	24	27	56
Short-term investments	-	-	82	82
Receivables from affiliated companies	1,415	5	(1,420)	-
Deferred fuel cost	-	89	140	229
Assets of discontinued operations	-	696	(11)	685
Other current assets	23	920	1,037	1,980
Total current assets	1,443	1,734	(145)	3,032
Deferred debits and other assets				
Investment in consolidated subsidiaries	11,061	-	(11,061)	-
Goodwill	-	2	3,717	3,719
Other assets and deferred debits	16	2,068	2,846	4,930
Total deferred debits and other assets	11,077	2,070	(4,498)	8,649
Total assets	\$ 12,520	\$ 9,686	\$ 3,838	\$ 26,044
Capitalization				
Common stock equity	\$ 7,633	\$ 2,681	\$ (2,681)	\$ 7,633
Preferred stock of subsidiaries - not subject to mandatory redemption	-	34	59	93
Minority interest	-	32	4	36
Long-term debt, affiliate	-	809	(539)	270
Long-term debt, net	4,449	2,052	2,750	9,251
Total capitalization	12,082	5,608	(407)	17,283
Current liabilities				
Current portion of long-term debt	-	49	300	349
Notes payable to affiliate companies	-	431	(431)	-
Short-term obligations	170	293	221	684
Liabilities of discontinued operations	-	186	-	186
Other current liabilities	245	931	688	1,864
Total current liabilities	415	1,890	778	3,083
Deferred credits and other liabilities				
Noncurrent income tax liabilities	-	64	584	648
Regulatory liabilities	-	1,362	1,292	2,654
Accrued pension and other benefits	10	248	375	633
Other liabilities and deferred credits	13	514	1,216	1,743
Total deferred credits and other liabilities	23	2,188	3,467	5,678
Total capitalization and liabilities	\$ 12,520	\$ 9,686	\$ 3,838	\$ 26,044

Condensed Consolidating Statement of Cash Flows
Year Ended December 31, 2005

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Net cash provided by operating activities	\$ 257	\$ 515	\$ 702	\$ 1,474
Investing activities				
Gross utility property additions	-	(496)	(584)	(1,080)
Diversified business property additions	-	(190)	(16)	(206)
Nuclear fuel additions	-	(47)	(79)	(126)
Proceeds from sales of discontinued operations and other assets, net of cash divested	-	462	13	475
Purchases of available-for-sale securities and other investments	(1,702)	(405)	(1,878)	(3,985)
Proceeds from sales of available-for-sale securities and other investments	1,702	405	1,738	3,845
Changes in advances to affiliates	702	5	(707)	-
Contributions to consolidated subsidiaries	(13)	-	13	-
Acquisition of intangibles	-	-	(3)	(3)
Other investing activities	1	(26)	(12)	(37)
Net cash provided (used) by investing activities	690	(292)	(1,515)	(1,117)
Financing activities				
Issuance of common stock	208	-	-	208
Proceeds from issuance of long-term debt, net	-	744	898	1,642
Net decrease in short-term indebtedness	(170)	(191)	(148)	(509)
Retirement of long-term debt	(160)	(473)	69	(564)
Dividends paid on common stock	(582)	-	-	(582)
Dividends paid to parent	-	(2)	2	-
Changes in advances from affiliates	-	(101)	101	-
Contributions from parent	-	11	(11)	-
Other financing activities	(9)	40	1	32
Net cash (used) provided by financing activities	(713)	28	912	227
Cash used by discontinued operations				
Operating activities	-	(13)	-	(13)
Investing activities	-	(21)	-	(21)
Financing activities	-	-	-	-
Net increase in cash and cash equivalents	234	217	99	550
Cash and cash equivalents at beginning of year	5	24	27	56
Cash and cash equivalents at end of year	\$ 239	\$ 241	\$ 126	\$ 606

Condensed Consolidating Statement of Cash Flows
Year Ended December 31, 2004

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Net cash provided by operating activities	\$ 653	\$ 571	\$ 341	\$ 1,565
Investing activities				
Gross utility property additions	-	(482)	(516)	(998)
Diversified business property additions	-	(150)	(19)	(169)
Nuclear fuel additions	-	-	(101)	(101)
Proceeds from sales of discontinued operations and other assets, net of cash divested	-	343	30	373
Purchases of available-for-sale securities and other investments	-	(569)	(2,565)	(3,134)
Proceeds from sales of available-for-sale securities and other investments	-	569	2,679	3,248
Changes in advances to affiliates	27	(5)	(22)	-
Contributions to consolidated subsidiaries	(15)	-	15	-
Acquisition of intangibles	-	-	(1)	(1)
Other investing activities	-	(23)	(6)	(29)
Net cash provided (used) by investing activities	12	(317)	(506)	(811)
Financing activities				
Issuance of common stock	73	-	-	73
Proceeds from issuance of long-term debt, net	365	56	-	421
Net increase in short-term indebtedness	170	293	217	680
Retirement of long-term debt	(705)	(68)	(580)	(1,353)
Dividends paid on common stock	(558)	-	-	(558)
Dividends paid to parent	-	(340)	340	-
Changes in advances from affiliates	-	(209)	209	-
Contributions from parent	-	12	(12)	-
Other financing activities	(5)	13	(2)	6
Net cash (used) provided by financing activities	(660)	(243)	172	(731)
Cash provided (used) by discontinued operations				
Operating activities	-	44	-	44
Investing activities	-	(46)	-	(46)
Financing activities	-	-	-	-
Net increase in cash and cash equivalents	5	9	7	21
Cash and cash equivalents at beginning of year	-	15	20	35
Cash and cash equivalents at end of year	\$ 5	\$ 24	\$ 27	\$ 56

Condensed Consolidating Statement of Cash Flows
Year Ended December 31, 2003

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Net cash provided by operating activities	\$ 524	\$ 517	\$ 547	\$ 1,588
Investing activities				
Gross utility property additions	-	(526)	(446)	(972)
Diversified business property additions	-	(302)	(146)	(448)
Nuclear fuel additions	-	(51)	(66)	(117)
Proceeds from sales of discontinued operations and other assets, net of cash divested	451	100	28	579
Purchases of available-for-sale securities and other investments	-	(441)	(3,351)	(3,792)
Proceeds from sales of available-for-sale securities and other investments	-	441	3,088	3,529
Changes in advances to affiliates	(327)	(16)	343	-
Contributions to consolidated subsidiaries	(411)	-	411	-
Acquisition of intangibles	-	-	(200)	(200)
Other investing activities	(1)	(15)	21	5
Net cash used in investing activities	(288)	(810)	(318)	(1,416)
Financing activities				
Issuance of common stock	304	-	-	304
Proceeds from issuance of long-term debt, net	-	935	604	1,539
Net decrease in short-term indebtedness	-	(258)	(438)	(696)
Retirement of long-term debt	-	(534)	(276)	(810)
Dividends paid on common stock	(541)	-	-	(541)
Dividends paid to parent	-	(301)	301	-
Changes in advances from affiliates	-	274	(274)	-
Contributions from parent	-	168	(168)	-
Other financing activities	-	-	16	16
Net cash (used) provided by financing activities	(237)	284	(235)	(188)
Cash provided (used) by discontinued operations				
Operating activities	-	123	-	123
Investing activities	-	(126)	-	(126)
Financing activities	-	-	-	-
Net decrease in cash and cash equivalents	(1)	(12)	(6)	(19)
Cash and cash equivalents at beginning of year	1	27	26	54
Cash and cash equivalents at end of year	\$ -	\$ 15	\$ 20	\$ 35

25. SUBSEQUENT EVENT

On January 25, 2006, we signed a definitive agreement to sell PT LLC to Level 3 Communications, Inc. (Level 3) for a purchase price of approximately \$137 million, with half of the proceeds in cash and half in Level 3 common stock. We expect to use net cash proceeds of \$70 million from the sale of our interest in PT LLC to reduce debt.

The sale is expected to close by mid-2006, and is subject to various closing conditions customary to such transactions. We expect to report PT LLC as a discontinued operation in the first quarter of 2006. The carrying amounts for the assets and liabilities of the discontinued operations disposal group included in the Consolidated Balance Sheets as of December 31 were as follows:

(in millions)	2005	2004
Total current assets	\$ 12	\$ 16
Total property, plant and equipment, net	79	75
Total other assets	23	39
Total current liabilities	8	15
Total long-term liabilities	35	34
Minority interest	24	21

26. QUARTERLY FINANCIAL DATA (UNAUDITED)

Results of operations for an interim period may not give a true indication of results for the year. In the opinion of management, all adjustments necessary to fairly present amounts shown for interim periods have been made. Summarized quarterly financial data was as follows:

Progress Energy

(in millions except per share data)	First (a)(b)	Second (a)(b)	Third (a)(b)	Fourth (a)(b)
2005				
Operating revenues	\$ 2,168	\$ 2,295	\$ 3,067	\$ 2,578
Operating income	252	143	558	332
Income from continuing operations before cumulative effect of changes in accounting principles	104	7	459	157
Net income	93	(1)	450	155
Common stock data				
Basic earnings per common share				
Income from continuing operations before cumulative effect of changes in accounting principles	0.43	0.03	1.86	0.63
Net income	0.38	(0.01)	1.82	0.62
Diluted earnings per common share				
Income from continuing operations before cumulative effect of changes in accounting principles	0.43	0.03	1.85	0.63
Net income	0.38	(0.01)	1.81	0.62
Dividends declared per common share	0.590	0.590	0.590	0.605
Market price per share - High	45.33	45.83	46.00	45.50
- Low	40.63	40.61	41.90	40.19
2004				
Operating revenues	\$ 1,987	\$ 2,085	\$ 2,445	\$ 2,008
Operating income	283	288	567	306
Income from continuing operations before cumulative effect of changes in accounting principles	102	145	287	195
Net income	108	154	303	194
Common stock data				
Basic earnings per common share				
Income from continuing operations before cumulative effect of changes in accounting principles	0.42	0.59	1.18	0.81
Net income	0.45	0.63	1.25	0.80
Diluted earnings per common share				
Income from continuing operations before cumulative effect of changes in accounting principles	0.42	0.59	1.18	0.81
Net income	0.45	0.63	1.24	0.80
Dividends declared per common share	0.575	0.575	0.575	0.590
Market price per share - High	47.95	47.50	44.32	46.10
- Low	43.02	40.09	40.76	40.47

(a) Operating results have been restated for discontinued operations.

(b) Certain amounts have been reclassified to conform with current period presentation.

In the opinion of management, all adjustments necessary to fairly present amounts shown for interim periods have been made. Results of operations for an interim period may not give a true indication of results for the

year. First quarter 2005 includes \$31 million recorded for estimated severance expense for workforce restructuring and implementation of an automated meter reading initiative at PEF (See Note 17). Second quarter 2005 includes a \$141 million charge related to postretirement benefits for employees participating in the voluntary enhanced retirement program (See Note 17). The 2004 amounts were restated for discontinued operations (See Notes 3A and 3B). Fourth quarter 2004 includes a \$31 million after-tax gain on sale of natural gas assets (See Note 3E) and \$90 million of Section 29 tax credits being recorded (See Note 23D). Third quarter 2004 includes reversal of \$79 million of Section 29 tax credits (See Note 23D).

PEC

Summarized quarterly financial data was as follows:

(in millions)	First (a)	Second (a)	Third (a)	Fourth (a)
2005				
Operating revenues	\$ 935	\$ 861	\$ 1,185	\$ 1,010
Operating income	221	140	343	227
Net income	116	67	184	126
2004				
Operating revenues	\$ 901	\$ 862	\$ 1,014	\$ 852
Operating income	236	192	320	141
Net income	115	96	175	75

(a) Certain amounts have been reclassified to conform with current period presentation.

In the opinion of management, all adjustments necessary to fairly present amounts shown for interim periods have been made. Results of operations for an interim period may not give a true indication of results for the year. First quarter 2005 includes \$14 million recorded for estimated severance expense for workforce restructuring (See Note 17). Second quarter 2005 includes a \$29 million charge related to postretirement benefits for employees participating in the voluntary enhanced retirement program (See Note 17). Fourth quarter 2004 includes \$99 million of Clean Smokestacks Act amortization. Fourth quarter 2003 includes impairment of investments of \$21 million (\$13 million after-tax) (See Note 7). Fourth quarter 2003 includes a cumulative effect for DIG Issue C20 of \$38 million (\$23 million after-tax) (See Note 13).

PEF

Summarized quarterly financial data was as follows:

(in millions)	First (a)	Second (a)	Third (a)	Fourth (a)
2005				
Operating revenues	\$ 848	\$ 908	\$ 1,227	\$ 972
Operating income	89	51	247	112
Net income	44	10	151	55
2004				
Operating revenues	\$ 784	\$ 860	\$ 1,029	\$ 852
Operating income	103	157	245	115
Net income	50	84	140	61

(a) Certain amounts have been reclassified to conform with current period presentation.

In the opinion of management, all adjustments necessary to fairly present amounts shown for interim periods have been made. Results of operations for an interim period may not give a true indication of results for the year. First quarter 2005 includes \$14 million recorded for estimated severance expense for workforce restructuring and implementation of an automated meter reading initiative (See Note 17). Second quarter 2005 includes a \$90 million charge related to postretirement benefits for employees participating in the voluntary enhanced retirement program (See Note 17).

Exhibit A(6)(ii)

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PROGRESS ENERGY, INC.
CONSOLIDATED INTERIM FINANCIAL STATEMENTS
June 30, 2006

UNAUDITED CONSOLIDATED STATEMENTS of INCOME

(in millions except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Operating revenues				
Electric	\$ 2,082	\$ 1,768	\$ 4,067	\$ 3,551
Diversified business	417	497	858	856
Total operating revenues	2,499	2,265	4,925	4,407
Operating expenses				
Utility				
Fuel used in electric generation	709	529	1,399	1,079
Purchased power	260	217	489	415
Operation and maintenance	417	543	833	949
Depreciation and amortization	234	207	462	415
Taxes other than on income	120	108	239	225
Other	-	(25)	(2)	(25)
Diversified business				
Cost of sales	398	492	800	853
Depreciation and amortization	33	32	65	59
Impairment of assets (Notes 6 and 7)	91	-	155	-
Gain on the sale of assets	-	-	(7)	(4)
Other	28	26	50	55
Total operating expenses	2,290	2,129	4,483	4,021
Operating income	209	136	442	386
Other income (expense)				
Interest income	7	4	24	8
Other, net	11	(6)	9	(5)
Total other income (expense)	18	(2)	33	3
Interest charges				
Net interest charges	173	163	351	325
Allowance for borrowed funds used during construction	(2)	(4)	(4)	(7)
Total interest charges, net	171	159	347	318
Income (loss) from continuing operations before income tax and minority interest	56	(25)	128	71
Income tax expense (benefit)	35	(23)	48	(25)
Income (loss) from continuing operations before minority interest	21	(2)	80	96
Minority interest in subsidiaries' (income) loss, net of tax	(7)	8	(14)	16
Income from continuing operations	14	6	66	112
Discontinued operations, net of tax	(61)	(7)	(68)	(20)
Net (loss) income	\$ (47)	\$ (1)	\$ (2)	\$ 92
Average common shares outstanding - basic	250	246	250	245
Basic earnings per common share				
Income from continuing operations	\$ 0.06	\$ 0.02	\$ 0.26	\$ 0.46
Discontinued operations, net of tax	(0.25)	(0.03)	(0.27)	(0.09)
Net (loss) income	\$ (0.19)	\$ (0.01)	\$ (0.01)	\$ 0.37
Diluted earnings per common share				
Income from continuing operations	\$ 0.06	\$ 0.02	\$ 0.26	\$ 0.46
Discontinued operations, net of tax	(0.25)	(0.03)	(0.27)	(0.09)
Net (loss) income	\$ (0.19)	\$ (0.01)	\$ (0.01)	\$ 0.37
Dividends declared per common share	\$ 0.605	\$ 0.590	\$ 1.210	\$ 1.180

PROGRESS ENERGY, INC.

UNAUDITED CONSOLIDATED BALANCE SHEETS

		June 30, 2006	December 31, 2005
(in millions)			
ASSETS			
Utility plant			
Utility plant in service	\$	23,240	\$ 22,940
Accumulated depreciation		(9,854)	(9,602)
Utility plant in service, net		13,386	13,338
Held for future use		12	12
Construction work in progress		1,060	813
Nuclear fuel, net of amortization		249	279
Total utility plant, net		14,707	14,442
Current assets			
Cash and cash equivalents		264	606
Short-term investments		95	191
Receivables, net		998	1,099
Inventory		948	848
Deferred fuel cost		449	602
Deferred income taxes		44	50
Assets of discontinued operations		384	722
Prepayments and other current assets		154	209
Total current assets		3,336	4,327
Deferred debits and other assets			
Regulatory assets		825	854
Nuclear decommissioning trust funds		1,181	1,133
Diversified business property, net		1,309	1,318
Miscellaneous other property and investments		478	476
Goodwill		3,655	3,719
Intangibles, net		234	277
Other assets and deferred debits		429	478
Total deferred debits and other assets		8,111	8,255
Total assets	\$	26,154	\$ 27,024
CAPITALIZATION AND LIABILITIES			
Common stock equity			
Common stock without par value, 500 million shares authorized, 253 and 252 million shares issued and outstanding, respectively	\$	5,653	\$ 5,571
Unearned ESOP shares (2 and 3 million shares, respectively)		(50)	(63)
Accumulated other comprehensive loss		(87)	(104)
Retained earnings		2,328	2,634
Total common stock equity		7,844	8,038
Preferred stock of subsidiaries - not subject to mandatory redemption		93	93
Minority interest		16	43
Long-term debt, affiliate		270	270
Long-term debt, net		9,822	10,176
Total capitalization		18,045	18,620
Current liabilities			
Current portion of long-term debt		460	513
Accounts payable		654	676
Interest accrued		199	208
Dividends declared		153	152
Short-term obligations		-	175
Customer deposits		214	200
Liabilities of discontinued operations		32	91
Other current liabilities		808	871
Total current liabilities		2,520	2,886
Deferred credits and other liabilities			
Noncurrent income tax liabilities		246	277
Accumulated deferred investment tax credits		157	163
Regulatory liabilities		2,500	2,527

Asset retirement obligations	1,279	1,249
Accrued pension and other benefits	904	870
Other liabilities and deferred credits	503	432
Total deferred credits and other liabilities	5,589	5,518
Commitments and contingencies (Note 14)		
Total capitalization and liabilities	\$ 26,154	\$ 27,024

See Notes to Progress Energy, Inc. Consolidated Interim Financial Statements.

PROGRESS ENERGY, INC.

UNAUDITED CONSOLIDATED STATEMENTS of CASH FLOWS

(in millions)

Six Months Ended June 30

	2006	2005
Operating activities		
Net (loss) income	\$ (2)	\$ 92
Adjustments to reconcile net (loss) income to net cash provided by operating activities		
Discontinued operations, net of tax	68	20
Impairment of assets (Notes 6 and 7)	155	-
Charges for voluntary enhanced retirement program	-	158
Depreciation and amortization	575	534
Deferred income taxes	(28)	(137)
Investment tax credit	(6)	(6)
Tax levelization	19	63
Deferred fuel cost	170	-
Other adjustments to net income	113	65
Cash provided (used) by changes in operating assets and liabilities		
Receivables	85	(67)
Inventories	(107)	(125)
Prepayments and other current assets	(5)	15
Accounts payable	(6)	75
Other current liabilities	(8)	(59)
Regulatory assets and liabilities	4	(52)
Other operating activities	18	(47)
Net cash provided by operating activities	1,045	529
Investing activities		
Gross utility property additions	(669)	(539)
Diversified business property additions	(92)	(120)
Nuclear fuel additions	(62)	(67)
Proceeds from sales of discontinued operations and other assets, net of cash divested	221	444
Purchases of available-for-sale securities and other investments	(956)	(3,205)
Proceeds from sales of available-for-sale securities and other investments	1,126	3,229
Other investing activities	(14)	(23)
Net cash used in investing activities	(446)	(281)
Financing activities		
Issuance of common stock	60	171
Proceeds from issuance of long-term debt, net	397	792
Net decrease in short-term indebtedness	(175)	(281)
Retirement of long-term debt	(802)	(517)
Dividends paid on common stock	(303)	(289)
Cash distributions to minority interests of consolidated subsidiary	(74)	-
Other financing activities	(41)	(24)
Net cash used in financing activities	(938)	(148)
Cash provided (used) by discontinued operations		
Operating activities	4	(1)
Investing activities	(7)	(14)
Financing activities	-	-
Net (decrease) increase in cash and cash equivalents	(342)	85
Cash and cash equivalents at beginning of period	606	56
Cash and cash equivalents at end of period	\$ 264	\$ 141

See Notes to Progress Energy, Inc. Consolidated Interim Financial Statements.

CAROLINA POWER & LIGHT COMPANY
d/b/a PROGRESS ENERGY CAROLINAS, INC.
CONSOLIDATED INTERIM FINANCIAL STATEMENTS
June 30, 2006

UNAUDITED CONSOLIDATED STATEMENTS of INCOME

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Operating revenues				
Electric	\$ 935	\$ 860	\$ 1,913	\$ 1,795
Diversified business	1	1	1	1
Total operating revenues	936	861	1,914	1,796
Operating expenses				
Fuel used in electric generation	262	216	558	464
Purchased power	80	73	144	140
Operation and maintenance	248	260	504	484
Depreciation and amortization	129	130	255	259
Taxes other than on income	44	42	90	88
Other	(1)	-	-	-
Total operating expenses	762	721	1,551	1,435
Operating income	174	140	363	361
Other income (expense)				
Interest income	4	1	11	3
Other, net	(1)	(2)	(2)	(1)
Total other income (expense)	3	(1)	9	2
Interest charges				
Interest charges	57	50	114	102
Allowance for borrowed funds used during construction	-	(2)	(1)	(3)
Total interest charges, net	57	48	113	99
Income before income tax	120	91	259	264
Income tax expense	44	24	97	81
Net income	76	67	162	183
Preferred stock dividend requirement	-	-	1	1
Earnings for common stock	\$ 76	\$ 67	\$ 161	\$ 182

See Notes to PEC Consolidated Interim Financial Statements.

CAROLINA POWER & LIGHT COMPANY
d/b/a PROGRESS ENERGY CAROLINAS, INC.
UNAUDITED CONSOLIDATED BALANCE SHEETS

	December 31,	
(in millions)	June 30, 2006	2005
ASSETS		
Utility plant		
Utility plant in service	\$ 14,184	\$ 13,994
Accumulated depreciation	(6,298)	(6,120)
Utility plant in service, net	7,886	7,874
Held for future use	3	3
Construction work in progress	463	399
Nuclear fuel, net of amortization	185	203
Total utility plant, net	8,537	8,479
Current assets		
Cash and cash equivalents	156	125
Short-term investments	50	191
Receivables, net	441	518
Receivables from affiliated companies	14	24
Inventory	481	451
Deferred fuel cost	271	261
Prepayments and other current assets	42	20
Total current assets	1,455	1,590
Deferred debits and other assets		
Regulatory assets	395	421
Nuclear decommissioning trust funds	669	640
Miscellaneous other property and investments	194	188
Other assets and deferred debits	174	184
Total deferred debits and other assets	1,432	1,433
Total assets	\$ 11,424	\$ 11,502
CAPITALIZATION AND LIABILITIES		
Common stock equity		
Common stock without par value	\$ 2,002	\$ 1,981
Unearned ESOP common stock	(50)	(63)
Accumulated other comprehensive loss	(122)	(120)
Retained earnings	1,311	1,320
Total common stock equity	3,141	3,118
Preferred stock - not subject to mandatory redemption	59	59
Long-term debt, net	3,668	3,667
Total capitalization	6,868	6,844
Current liabilities		
Accounts payable	221	247
Payables to affiliated companies	64	73
Notes payable to affiliated companies	23	11
Interest accrued	75	73
Short-term obligations	-	73
Customer deposits	56	52
Taxes accrued	10	100
Other current liabilities	294	255
Total current liabilities	743	884
Deferred credits and other liabilities		
Noncurrent income tax liabilities	803	814
Accumulated deferred investment tax credits	130	133
Regulatory liabilities	1,207	1,196
Asset retirement obligations	978	949
Accrued pension and other benefits	531	511
Other liabilities and deferred credits	164	171
Total deferred credits and other liabilities	3,813	3,774
Commitments and contingencies (Note 14)		
Total capitalization and liabilities	\$ 11,424	\$ 11,502

CAROLINA POWER & LIGHT COMPANY
d/b/a PROGRESS ENERGY CAROLINAS, INC.

UNAUDITED CONSOLIDATED STATEMENTS of CASH FLOWS

(in millions)

Six Months Ended June 30

	2006	2005
Operating activities		
Net income	\$ 162	\$ 183
Adjustments to reconcile net income to net cash provided by operating activities		
Charges for voluntary enhanced retirement program	-	42
Depreciation and amortization	295	301
Deferred income taxes and investment tax credits, net	36	4
Deferred fuel cost (credit)	7	(36)
Other adjustments to net income	69	42
Cash provided (used) by changes in operating assets and liabilities		
Receivables	76	3
Receivables from affiliated companies	20	17
Inventories	(36)	(64)
Prepayments and other current assets	5	1
Accounts payable	11	(3)
Payables to affiliated companies	(11)	(16)
Other current liabilities	(115)	35
Other operating activities	(16)	(54)
Net cash provided by operating activities	503	455
Investing activities		
Gross utility property additions	(307)	(303)
Nuclear fuel additions	(56)	(33)
Purchases of available-for-sale securities and other investments	(453)	(1,344)
Proceeds from sales of available-for-sale securities and other investments	578	1,390
Other investing activities	(3)	(6)
Net cash used in investing activities	(241)	(296)
Financing activities		
Proceeds from issuance of long-term debt, net	-	495
Net decrease in short-term indebtedness	(73)	(79)
Changes in advances from affiliates	12	(49)
Retirement of long-term debt	-	(300)
Dividends paid to parent	(169)	(229)
Dividends paid on preferred stock	(1)	(1)
Net cash used in financing activities	(231)	(163)
Net increase (decrease) in cash and cash equivalents	31	(4)
Cash and cash equivalents at beginning of period	125	18
Cash and cash equivalents at end of period	\$ 156	\$ 14

See Notes to PEC Consolidated Interim Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA, INC.
INTERIM FINANCIAL STATEMENTS
June 30, 2006

UNAUDITED STATEMENTS of INCOME

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Operating revenues	\$ 1,147	\$ 908	\$ 2,154	\$ 1,756
Operating expenses				
Fuel used in electric generation	447	313	841	615
Purchased power	180	144	345	275
Operation and maintenance	178	288	344	477
Depreciation and amortization	98	71	193	141
Taxes other than on income	76	66	149	133
Other	1	(25)	(2)	(25)
Total operating expenses	980	857	1,870	1,616
Operating income	167	51	284	140
Other income (expense)				
Interest income	3	-	8	-
Other, net	3	(1)	2	2
Total other income (expense)	6	(1)	10	2
Interest charges				
Interest charges	40	34	80	68
Allowance for borrowed funds used during construction	(2)	(2)	(3)	(4)
Total interest charges, net	38	32	77	64
Income before income taxes	135	18	217	78
Income tax expense	48	8	77	24
Net income	87	10	140	54
Preferred stock dividend requirement	-	-	1	1
Earnings for common stock	\$ 87	\$ 10	\$ 139	\$ 53

See Notes to PEF Interim Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA, INC.
UNAUDITED BALANCE SHEETS

(in millions)	June 30, 2006	December 31, 2005
ASSETS		
Utility plant		
Utility plant in service	\$ 8,872	\$ 8,756
Accumulated depreciation	(3,506)	(3,434)
Utility plant in service, net	5,366	5,322
Held for future use	9	9
Construction work in progress	597	414
Nuclear fuel, net of amortization	64	76
Total utility plant, net	6,036	5,821
Current assets		
Cash and cash equivalents	77	218
Short-term investments	45	-
Receivables, net	368	331
Receivables from affiliated companies	10	11
Deferred income taxes	30	12
Inventory	397	311
Deferred fuel cost	178	341
Prepayments and other current assets	71	100
Total current assets	1,176	1,324
Deferred debits and other assets		
Regulatory assets	343	351
Debt issuance costs	21	22
Nuclear decommissioning trust funds	512	493
Miscellaneous other property and investments	45	47
Prepaid pension costs	208	200
Other assets and deferred debits	65	60
Total deferred debits and other assets	1,194	1,173
Total assets	\$ 8,406	\$ 8,318
CAPITALIZATION AND LIABILITIES		
Common stock equity		
Common stock without par value	\$ 1,098	\$ 1,097
Retained earnings	1,519	1,498
Total common stock equity	2,617	2,595
Preferred stock - not subject to mandatory redemption	34	34
Long-term debt, net	2,554	2,554
Total capitalization	5,205	5,183
Current liabilities		
Current portion of long-term debt	48	48
Accounts payable	303	237
Payables to affiliated companies	80	101
Notes payable to affiliated companies	24	13
Short-term obligations	-	102
Customer deposits	158	148
Interest accrued	38	42
Other current liabilities	194	101
Total current liabilities	845	792
Deferred credits and other liabilities		
Noncurrent income tax liabilities	432	433
Accumulated deferred investment tax credits	27	30
Regulatory liabilities	1,159	1,189
Asset retirement obligations	291	290
Accrued pension and other benefits	268	257
Other liabilities and deferred credits	179	144
Total deferred credits and other liabilities	2,356	2,343
Commitments and contingencies (Note 14)		

Total capitalization and liabilities

\$ 8,406 \$ 8,318

See Notes to PEF Interim Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA, INC.
UNAUDITED STATEMENTS of CASH FLOWS

(in millions)

Six Months Ended June 30	2006	2005
Operating activities		
Net income	\$ 140	\$ 54
Adjustments to reconcile net income to net cash provided by operating activities		
Charges for voluntary enhanced retirement program	-	90
Depreciation and amortization	207	158
Deferred income taxes and investment tax credits, net	(22)	(55)
Deferred fuel cost	163	36
Other adjustments to net income	10	23
Cash (used) provided by changes in operating assets and liabilities		
Receivables	(43)	(42)
Receivables from affiliated companies	2	5
Inventories	(87)	(35)
Prepayments and other current assets	8	(4)
Accounts payable	51	34
Payables to affiliated companies	(21)	10
Other current liabilities	81	18
Regulatory assets and liabilities	2	(54)
Other operating activities	(4)	6
Net cash provided by operating activities	487	244
Investing activities		
Gross utility property additions	(371)	(253)
Nuclear fuel additions	(6)	(34)
Proceeds from sale of assets	3	42
Purchases of available-for-sale securities and other investments	(329)	(177)
Proceeds from sales of available-for-sale securities and other investments	284	177
Changes in advances to affiliates	-	(26)
Other investing activities	1	(4)
Net cash used in investing activities	(418)	(275)
Financing activities		
Proceeds from issuance of long-term debt, net	-	297
Net decrease in short-term indebtedness	(102)	(32)
Retirement of long-term debt	(2)	(57)
Changes in advances from affiliates	11	(178)
Dividends paid to parent	(118)	-
Dividends paid on preferred stock	(1)	(1)
Other financing activities	2	-
Net cash (used) provided by financing activities	(210)	29
Net decrease in cash and cash equivalents	(141)	(2)
Cash and cash equivalents at beginning of period	218	12
Cash and cash equivalents at end of period	\$ 77	\$ 10

See Notes to PEF Interim Financial Statements.

PROGRESS ENERGY, INC.
CAROLINA POWER & LIGHT COMPANY d/b/a/ PROGRESS ENERGY CAROLINAS, INC.
FLORIDA POWER CORPORATION d/b/a PROGRESS ENERGY FLORIDA, INC.
COMBINED NOTES TO INTERIM FINANCIAL STATEMENTS

INDEX TO APPLICABLE NOTES TO FINANCIAL STATEMENTS BY REGISTRANT

Each of the following combined notes to the interim financial statements of the Progress Registrants are applicable to Progress Energy, Inc. but not to each of PEC and PEF. The following table sets forth which notes are applicable to each of PEC and PEF.

<u>Registrant</u>	<u>Applicable Notes</u>
PEC	1, 2, 4 through 6, 8 through 10, and 12 through 14
PEF	1, 2, 4 through 6, 8 through 10, and 12 through 14

PROGRESS ENERGY, INC.
CAROLINA POWER & LIGHT COMPANY d/b/a/ PROGRESS ENERGY CAROLINAS, INC.
FLORIDA POWER CORPORATION d/b/a PROGRESS ENERGY FLORIDA, INC.
COMBINED NOTES TO INTERIM FINANCIAL STATEMENTS

In this report, Progress Energy, which includes Progress Energy, Inc. holding company (the Parent) and its regulated and nonregulated subsidiaries on a consolidated basis, is at times referred to as “we,” “us” or “our.” When discussing Progress Energy’s financial information, it necessarily includes the results of Carolina Power & Light Company d/b/a/ Progress Energy Carolinas, Inc. (PEC) and Florida Power Corporation d/b/a/ Progress Energy Florida, Inc. (PEF) (collectively, the Utilities). The term “Progress Registrants” refers to each of the three separate registrants: Progress Energy, PEC and PEF. The information in these combined notes relates to each of the Progress Registrants as noted in the Index to the Combined Notes. However, neither of the Utilities makes any representation as to information related solely to Progress Energy or the subsidiaries of Progress Energy other than itself.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization

The Parent is a holding company headquartered in Raleigh, N.C. and is subject to the regulatory provisions of the Federal Energy Regulatory Commission (FERC).

Our reportable segments are: PEC, PEF, Progress Ventures, and Coal and Synthetic Fuels. Our PEC and PEF segments are primarily engaged in the generation, transmission, distribution and sale of electricity. Our Progress Ventures segment is primarily engaged in nonregulated electric generation, energy marketing activities and natural gas drilling and production. Our Coal and Synthetic Fuels segment is primarily engaged in the production and sale of coal-based solid synthetic fuel as defined under the Internal Revenue Code (the Code), the operation of synthetic fuel facilities for third parties, and coal terminal services. On May 22, 2006, we idled our synthetic fuel facilities (See Note 6). Through our other business units, we engage in other nonregulated business areas, which are included in our Corporate and Other segment (Corporate and Other).

PEC and PEF are public service corporations. PEC’s service territory covers portions of North Carolina and South Carolina and PEF’s covers portions of Florida. PEC’s subsidiaries are involved in insignificant nonregulated business activities. PEC is subject to the regulatory provisions of the North Carolina Utilities Commission (NCUC) and the Public Service Commission of South Carolina (SCPSC); PEF is subject to the regulatory provisions of the Florida Public Service Commission (FPSC). Both of the Utilities are subject to regulation by the United States Nuclear Regulatory Commission (NRC) and the FERC.

B. Basis of Presentation

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for annual financial statements. The December 31, 2005 condensed balance sheet data was derived from audited financial statements but does not include all disclosures required by GAAP. Because the accompanying interim financial statements do not include all of the information and footnotes required by GAAP for annual financial statements, they should be read in conjunction with the audited financial statements and notes thereto included in the Progress Registrants’ annual report on Form 10-K for the fiscal year ended December 31, 2005 (2005 Form 10-K).

In accordance with the provisions of Accounting Principles Board (APB) Opinion No. 28, “Interim Financial Reporting” (APB No. 28), GAAP requires companies to apply a levelized effective tax rate to interim periods that is consistent with the estimated annual effective tax rate. The intra-period tax allocation, which will have no impact on total year net income, maintains an effective tax rate consistent with the estimated annual effective tax rate. The fluctuations in the effective tax rate for interim periods are primarily due to the recognition of synthetic fuel tax credits and seasonal fluctuations in energy sales and earnings from the Utilities. Income tax expense was increased (decreased) for the Progress Registrants for the three and six months ended June 30, 2006 and 2005, as follows:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Progress Energy	\$ 3	\$ 60	\$ 19	\$ 63
PEC	(2)	3	(1)	3
PEF	-	8	-	8

The Utilities collect from customers certain excise taxes levied by the state or local government upon the customers. The Utilities account for excise taxes on a gross basis. The amount of gross receipts tax, franchise taxes and other excise taxes included in electric revenues and taxes other than on income in the statements of income are as follows:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Progress Energy	\$ 69	\$ 58	\$ 134	\$ 114
PEC	21	20	43	41
PEF	48	38	91	73

The amounts included in these financial statements are unaudited but, in the opinion of management, reflect all normal recurring adjustments necessary to fairly present the Progress Registrants' financial position and results of operations for the interim periods. Due to seasonal weather variations and the timing of outages of electric generating units, especially nuclear-fueled units, the results of operations for interim periods are not necessarily indicative of amounts expected for the entire year or for future periods.

In preparing financial statements that conform with GAAP, management must make estimates and assumptions that affect the reported amounts of assets and liabilities, the reported amounts of revenues and expenses and the disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Certain amounts for 2005 have been reclassified to conform to the 2006 presentation.

C. Consolidation of Variable Interest Entities

We consolidate all voting interest entities in which we own a majority voting interest and all variable interest entities for which we are the primary beneficiary in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 46R, "Consolidation of Variable Interest Entities - An Interpretation of ARB No. 51" (FIN 46R).

Progress Energy

In addition to the variable interests listed below for PEC and PEF, we have interests through other subsidiaries in several variable interest entities for which we are not the primary beneficiary. These arrangements include investments in five limited liability partnerships and limited liability corporations. At June 30, 2006, the aggregate additional maximum loss exposure that we could be required to record in our income statement as a result of these arrangements was approximately \$8 million, which represents our net remaining investment in the entities. The creditors of these variable interest entities do not have recourse to our general credit in excess of the aggregate maximum loss exposure.

PEC

PEC is the primary beneficiary of and consolidates two limited partnerships that qualify for federal affordable housing and historic tax credits under Section 42 of the Code. At June 30, 2006, the total assets of the two entities were \$38 million, the majority of which are collateral for the entities' obligations and are included in miscellaneous other property and investments in the Consolidated Balance Sheets.

PEC has an interest in and consolidates a limited partnership that invests in 17 low-income housing partnerships that qualify for federal and state tax credits. PEC also has an interest in one power plant resulting from long-term power purchase contracts. PEC has requested the necessary information to determine if the 17 partnerships and the power plant owner are variable interest entities or to identify the primary beneficiaries; all entities from which the necessary financial information

was requested declined to provide the information to PEC and accordingly, PEC has applied the information scope exception in FIN No. 46R, paragraph 4(g), to the 17 partnerships and the power plant. PEC believes that if it is determined to be the primary beneficiary of these entities, the effect of consolidating the entities would result in increases to total assets, long-term debt and other liabilities, but would have an insignificant or no impact on PEC's common stock equity, net earnings or cash flows.

PEC also has interests in several other variable interest entities for which PEC is not the primary beneficiary. These arrangements include investments in approximately 20 limited liability partnerships, limited liability corporations and venture capital funds and two building leases with special-purpose entities. At June 30, 2006, the aggregate maximum loss exposure that PEC could be required to record on its income statement as a result of these arrangements totals approximately \$23 million, which primarily represents its net remaining investment in these entities. The creditors of these variable interest entities do not have recourse to the general credit of PEC in excess of the aggregate maximum loss exposure. See Note 2 of the 2005 Form 10-K for additional information.

PEF

PEF has interests in two variable interest entities for which PEF is not the primary beneficiary. These arrangements include investments in one venture capital fund and one building lease with a special-purpose entity. At June 30, 2006, the aggregate maximum loss exposure that PEF could be required to record in its income statement as a result of these arrangements was approximately \$1 million. The creditors of these variable interest entities do not have recourse to the general credit of PEF in excess of the aggregate maximum loss exposure.

2. NEW ACCOUNTING STANDARDS

FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes"

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). Enterprises must adopt FIN 48 through an adjustment to retained earnings at the beginning of their first fiscal year that begins after December 15, 2006, which for us would be January 1, 2007. FIN 48 applies to all tax positions within the scope of SFAS No. 109, "Accounting for Income Taxes." A two-step process is required for the application of FIN 48; recognition of the tax benefit based on a "more likely than not" threshold and measurement of the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. FIN 48 also provides guidance on the related derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. We have not yet evaluated how FIN 48 will impact our various income tax positions and results of operations.

3. DIVESTITURES

A. DeSoto and Rowan Generation Facilities

On May 2, 2006, our board of directors approved a plan to divest of two subsidiaries of Progress Ventures, Inc., DeSoto County Generating Co., LLC (DeSoto) and Rowan County Power, LLC (Rowan). DeSoto owns a 320 MW dual-fuel combustion turbine electric generation facility in DeSoto County, Florida and Rowan owns a 925 MW dual-fuel combined cycle and combustion turbine electric generation facility in Rowan County, N.C. On May 8, 2006, we entered into definitive agreements to sell DeSoto and Rowan, including certain existing power supply contracts, to Southern Power Company, a subsidiary of Southern Company, for gross purchase prices of approximately \$80 million and \$325 million, respectively. We expect to use the proceeds from the sales to reduce debt and for other corporate purposes.

The sale of DeSoto closed in the second quarter of 2006. The sale of Rowan is expected to close during the third quarter of 2006 and is subject to state and federal regulatory approvals and customary closing conditions. We recorded an after-tax loss on the sale of DeSoto of \$30 million and an estimated after-tax loss on the sale of Rowan of \$32 million.

The accompanying consolidated financial statements have been restated for all periods presented to reflect the operations of DeSoto and Rowan as discontinued operations. Interest expense has been allocated to discontinued operations based on their respective net assets, assuming a uniform debt-to-equity ratio across our operations. Interest expense allocated for the three

months ended June 30, 2006 and 2005 was \$3 million and \$4 million, respectively. Interest expense allocated for each of the six months ended June 30, 2006 and 2005 was \$7 million. We ceased recording depreciation upon classification of the assets as discontinued operations in May 2006. After-tax depreciation expense recorded by DeSoto and Rowan during the three months ended June 30, 2006 and 2005 totaled \$1 million and \$2 million, respectively. After-tax depreciation expense recorded by DeSoto and Rowan during the six months ended June 30, 2006 and 2005 totaled \$3 million and \$4 million, respectively. Results of discontinued operations were as follows:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues	\$ 8	\$ 15	\$ 14	\$ 25
(Loss) Earnings before income taxes	(2)	1	(7)	(1)
Income tax benefit (expense)	1	(2)	1	(2)
Net loss from discontinued operations	(1)	(1)	(6)	(3)
Estimated loss on disposal of discontinued operations, including income tax benefit of \$38	(62)	-	(62)	-
Loss from discontinued operations	\$ (63)	\$ (1)	\$ (68)	\$ (3)

B. Progress Telecom, LLC

On March 20, 2006, we completed the sale of Progress Telecom, LLC (PT LLC) to Level 3 Communications, Inc. (Level 3). We received gross proceeds comprised of cash of \$69 million and approximately 20 million shares of Level 3 common stock valued at an estimated \$66 million on the date of the sale. Our net proceeds from the sale of approximately \$70 million, after consideration of minority interest, were used to reduce debt. Prior to the sale, we had a 51 percent interest in PT LLC. See Note 12 for a discussion of the subsequent sale of the Level 3 stock.

Based on the gross proceeds associated with the sale and after consideration of minority interest, we recorded an after-tax gain on disposal of \$24 million during the three months ended March 31, 2006. During the three months ended June 30, 2006, we recorded an additional after-tax gain of \$5 million in connection with certain tax matters resulting in a total after-tax gain of \$29 million for the six months ended June 30, 2006.

The accompanying consolidated financial statements have been restated for all periods presented to reflect the operations of PT LLC as discontinued operations. Interest expense has been allocated to discontinued operations based on the net assets of PT LLC, assuming a uniform debt-to-equity ratio across our operations. Interest expense allocated for the six months ended June 30, 2005 was \$1 million. Interest expense allocated for the three months ended June 30, 2005 was less than \$1 million. We ceased recording depreciation upon classification of the assets as discontinued operations in January 2006. After-tax depreciation expense recorded by PT LLC during the six months ended June 30, 2006 and 2005 was \$1 million and \$4 million, respectively. After-tax depreciation expense recorded for the three months ended June 30, 2005 was \$2 million. Results of discontinued operations were as follows:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues	\$ -	\$ 16	\$ 18	\$ 32
Earnings before income taxes and minority interest	2	3	3	3
Income tax expense	-	-	(4)	-
Minority interest	(1)	(1)	(4)	(1)
Net earnings (loss) from discontinued operations	1	2	(5)	2
Estimated gain on disposal of discontinued operations, including income tax benefit (expense) of \$4 and \$(9), respectively, and minority interest of \$36	5	-	29	-
Earnings from discontinued operations	\$ 6	\$ 2	\$ 24	\$ 2

In connection with the sale, PEC and PEF provided indemnification against costs associated with certain asset performances to Level 3. See general discussion of guarantees at Note 14A. The ultimate resolution of these matters could result in adjustments to the gain on sale in future periods.

C. Progress Rail Divestiture

On March 24, 2005, we completed the sale of Progress Rail Services Corporation (Progress Rail) to One Equity Partners LLC, a private equity firm unit of J.P. Morgan Chase & Co. Gross cash proceeds from the sale were approximately \$429 million, consisting of \$405 million base proceeds plus a working capital adjustment. Proceeds from the sale were used to reduce debt.

Based on the gross proceeds associated with the sale, we recorded an estimated after-tax loss on disposal of \$24 million during the six months ended June 30, 2005. During the remainder of 2005, we recorded an additional loss of \$1 million after finalizing the working capital adjustment and other operating estimates. During the six months ended June 30, 2006, we recorded an additional after-tax loss on disposal of \$3 million in connection with guarantees and indemnifications provided by Progress Fuels Corporation (Progress Fuels) and Progress Energy for certain legal, tax and environmental matters to One Equity Partners, LLC. The ultimate resolution of these matters could result in adjustments to the loss on sale in future periods. See general discussion of guarantees at Note 14A.

The accompanying consolidated financial statements reflect the operations of Progress Rail as discontinued operations. Interest expense has been allocated to discontinued operations based on the net assets of Progress Rail, assuming a uniform debt-to-equity ratio across our operations. Interest expense allocated for the six months ended June 30, 2005 was \$4 million. We ceased recording depreciation upon classification of the assets as discontinued operations in February 2005. After-tax depreciation expense during the six months ended June 30, 2005 was \$3 million. Results of discontinued operations were as follows:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues	\$ -	\$ -	\$ -	\$ 358
Earnings before income taxes	-	-	-	8
Income tax expense	-	-	-	(3)
Net earnings from discontinued operations	-	-	-	5
Estimated loss on disposal of discontinued operations, including income tax benefit of \$2 and \$2 for 2006, respectively, and \$- and \$14 for 2005, respectively	(3)	(7)	(3)	(24)
Loss from discontinued operations	\$ (3)	\$ (7)	\$ (3)	\$ (19)

D. Coal Mines Divestiture

On November 14, 2005, our board of directors approved a plan to divest five subsidiaries of Progress Fuels engaged in the coal mining business. On May 1, 2006, we sold certain net assets of three of our coal mining businesses to Alpha Natural Resources, LLC for gross proceeds of \$23 million plus an estimated \$4 million working capital adjustment. As a result, during the six months ended June 30, 2006, we recorded an after-tax loss of \$17 million on the sale of these assets. The remaining coal mining operations are expected to be sold by the end of 2006.

The accompanying consolidated financial statements have been restated for all periods presented to reflect the coal mining operations as discontinued operations. Interest expense has been allocated to discontinued operations based on the net assets of the coal mines, assuming a uniform debt-to-equity ratio across our operations. Interest expense allocated was \$1 million for the three months ended June 30, 2005. Interest expense allocated was \$1 million for each of the six months ended June 30, 2006 and 2005. We ceased recording depreciation expense upon classification of the coal mining operations as discontinued operations in November 2005. After-tax depreciation expense during the three months and six months ended June 30, 2005 was \$3 million and \$5 million, respectively. Results of discontinued operations were as follows:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues	\$ 24	\$ 44	\$ 59	\$ 94
Earnings (loss) before income taxes	1	(2)	(6)	(1)
Income tax benefit	-	1	2	1
Net earnings (loss) from discontinued operations	1	(1)	(4)	-
Estimated loss on disposal of discontinued operations, including income tax benefit of \$5 and \$13	(2)	-	(17)	-
Loss from discontinued operations	\$ (1)	\$ (1)	\$ (21)	\$ -

E. Net Assets of Discontinued Operations

Included in net assets of discontinued operations are the assets and liabilities of Rowan and the remaining coal mining operations at June 30, 2006 and the assets and liabilities of DeSoto and Rowan, PT LLC and the five coal mining operations at December 31, 2005. The major balance sheet classes included in assets and liabilities of discontinued operations in the Consolidated Balance Sheet were as follows:

(in millions)	June 30, 2006	December 31, 2005
Accounts receivable	\$ 14	\$ 18
Inventory	16	25
Other current assets	2	5
Total property, plant and equipment, net	341	659
Total other assets	11	15
Assets of discontinued operations	\$ 384	\$ 722
Accounts payable	\$ 2	\$ 12
Accrued expenses	10	21
Long-term liabilities	20	58
Liabilities of discontinued operations	\$ 32	\$ 91

4. REGULATORY MATTERS

A. PEC Retail Rate Matters

FUEL COST RECOVERY

On May 3, 2006, PEC filed with the SCPSC for an increase in the fuel rate charged to its South Carolina customers for under-recovered fuel costs and to meet future expected fuel costs. On June 16, 2006, the SCPSC approved a settlement agreement filed jointly by PEC and all other parties to the proceedings. The settlement agreement provided for a \$23 million, or 4.6 percent, increase in rates. The increase was \$4 million less than PEC originally requested due to adjustment of future fuel cost estimates agreed upon during settlement. Effective July 1, 2006, residential electric bills increased by \$3.01 per 1,000 kWhs for fuel cost recovery.

On June 2, 2006, PEC filed with the NCUC for an increase in the fuel rate charged to its North Carolina customers. PEC asked the NCUC to approve a \$292 million, or 11.0 percent, increase in rates. PEC requested the increase for under-recovered fuel costs and to meet future expected fuel costs. If the fuel rate increase is approved, residential electric bills would increase by \$8.04 per 1,000 kWhs for fuel cost recovery beginning October 1, 2006. We cannot predict the outcome of this matter.

On July 25, 2006, PEC, the NCUC Public Staff and Carolinas Industrial Group for Fair Utility Rates II jointly filed a proposed settlement agreement with the NCUC to resolve issues concerning PEC's 2006 North Carolina fuel adjustment proceeding. Other intervening parties to the fuel proceeding have not agreed to the proposed settlement. The settlement proposes that PEC collect its fuel cost undercollection over a three-year period beginning October 1,

2006. Under the proposed settlement, PEC agreed to reduce its proposed billing rate during the year ending September 30, 2007. PEC would be allowed to calculate and collect interest at 6% on the difference between its collection factor in the original request to the NCUC and the factor included in the proposed settlement agreement. Also included in the settlement are increased billing rates for the 2007 and 2008 proceedings that will recover the undercollected fuel balance over the three-year period. These rates are subject to change based upon market conditions. Hearings on this matter are scheduled for August 9, 2006 with an order expected in September 2006. If approved, the increase would take effect October 1, 2006. We cannot predict the outcome of this matter.

B. PEF Retail Rate Matters

STORM COST RECOVERY

On June 1, 2005, the governor of Florida signed into law a bill that allows utilities to petition the FPSC to use securitized bonds to recover storm-related costs. PEF has decided not to pursue the issuance of securitized bonds either to recover its 2004 storm-related costs or to replenish its storm reserve fund. PEF's base rates provide \$6 million annually for storm reserve replenishment. On April 25, 2006, PEF entered into a settlement agreement with the interveners in its storm cost recovery docket that would allow PEF to extend its current two-year storm surcharge, which equals approximately \$3.61 on the average residential monthly customer bill of 1,000 kWhs, for an additional 12-month period. The extension would replenish the existing storm reserve by an estimated additional \$130 million. In the event future storms cause the reserve to be depleted, the settlement would further allow PEF to automatically collect from customers 80 percent of any future depletion of the storm reserve pending the FPSC's ultimate review and determination of the actual costs incurred and recoverable by PEF. The FPSC has the right to review PEF's storm costs for prudence and has the authority to determine the manner and timing of recovery. The parties have sought the FPSC's approval of the settlement and the matter is scheduled for the FPSC's August 29, 2006 meeting. We cannot predict the outcome of this matter.

OTHER MATTERS

On November 3, 2004, the FPSC approved PEF's petition for Determination of Need for the construction of a fourth unit at PEF's Hines Energy Complex and associated transmission infrastructure. Hines Unit 4, which has a projected commercial operation date of December 2007, is needed to maintain electric system reliability and integrity and to continue to provide adequate electricity to ratepayers. The estimated total in-service cost of Hines Unit 4 approved as part of the Determination of Need was \$286 million. If the actual cost is less than the original estimate, customers will receive the benefit of cost under-runs. Any costs that exceed the original estimate will not be recoverable absent extraordinary circumstances as found by the FPSC in subsequent proceedings. The current estimate of in-service cost exceeds the initial project estimate by approximately 10 percent due to what we believe to be extraordinary circumstances. Therefore, we believe that it is not probable that recovery of these costs will be disallowed by the FPSC in subsequent proceedings. We cannot predict the outcome of this matter.

C. Other Matters

REGIONAL TRANSMISSION ORGANIZATION

PEF was one of three major investor-owned Florida utilities that formed a regional transmission organization (RTO), GridFlorida, in 2000. A cost-benefit study conducted during 2005 concluded that the GridFlorida RTO was not cost effective for jurisdictional customers and shifted benefits to nonjurisdictional customers. In light of these findings, the GridFlorida applicants filed a motion to withdraw the GridFlorida compliance filing and filed a petition to close the docketed proceeding on January 27, 2006. At a hearing held on April 18, 2006, the FPSC approved the request to close the docketed proceeding and the docket was closed effective May 9, 2006. The closing of the docketed proceeding did not impact PEF's results of operations as PEF has fully recovered its GridFlorida startup costs from retail ratepayers. GridFlorida was dissolved on June 12, 2006. In light of the FPSC's decision, the FERC also terminated its docket on June 19, 2006.

NUCLEAR LICENSE RENEWAL

On June 26, 2006, PEC's Brunswick Nuclear Plant (Brunswick) received 20-year extensions from the NRC on the operating licenses for its two nuclear reactors. The operating license of Unit 1 extends until 2036 and Unit 2 until

5. EQUITY AND COMPREHENSIVE INCOME

A. Earnings Per Common Share

A reconciliation of our weighted-average number of common shares outstanding for basic and dilutive earnings per share purposes follows:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Weighted-average common shares - basic	250	246	250	245
Net effect of dilutive stock-based compensation plans	1	1	-	1
Weighted-average shares - fully dilutive	251	247	250	246

B. Comprehensive Income

Progress Energy

(in millions)	Three Months Ended June 30,	
	2006	2005
Net loss	\$ (47)	\$ (1)
Other comprehensive income (loss)		
Reclassification adjustments included in net income		
Change in cash flow hedges (net of tax expense of \$1 and \$2, respectively)	3	3
Changes in net unrealized gains on cash flow hedges (net of tax expense of \$9 and \$26, respectively)	5	44
Other (net of tax (benefit) expense of (\$2) and \$1, respectively)	(5)	(1)
Other comprehensive income	3	46
Comprehensive (loss) income	\$ (44)	\$ 45

(in millions)	Six Months Ended June 30,	
	2006	2005
Net (loss) income	\$ (2)	\$ 92
Other comprehensive (loss) income		
Reclassification adjustments included in net income		
Change in cash flow hedges (net of tax (benefit) expense of (\$1) and \$3, respectively)	(1)	5
Foreign currency translation adjustments included in discontinued operations	-	(6)
Minimum pension liability adjustment included in discontinued operations (net of tax expense of \$1)	-	1
Changes in net unrealized gains on cash flow hedges (net of tax expense of \$16 and \$31, respectively)	18	50
Other (net of tax expense of \$- and \$1, respectively)	-	1
Other comprehensive income	17	51
Comprehensive income	\$ 15	\$ 143

PEC

(in millions)	Three Months Ended June 30,	
	2006	2005
Net income	\$ 76	\$ 67
Other comprehensive (loss) income		
Changes in net unrealized gains on cash flow hedges (net of tax benefit of \$1)	(2)	-
Other (net of tax benefit of \$- and \$-, respectively)	(1)	1
Other comprehensive (loss) income	(3)	1
Comprehensive income	\$ 73	\$ 68

(in millions)	Six Months Ended June 30,	
	2006	2005
Net income	\$ 162	\$ 183
Other comprehensive (loss) income		
Changes in net unrealized gains on cash flow hedges (net of tax (benefit) expense of (\$1) and \$1, respectively)	(2)	2
Other (net of tax benefit of \$- and \$-, respectively)	-	1
Other comprehensive (loss) income	(2)	3
Comprehensive income	\$ 160	\$ 186

PEF

Comprehensive income and net income for PEF for the three months ended June 30, 2006 and 2005 were \$87 million and \$10 million, respectively, and for the six months ended June 30, 2006 and 2005 were \$140 million and \$54 million, respectively.

C. Common Stock

At December 31, 2005, we had 500 million shares of common stock authorized under our charter, of which approximately 252 million were outstanding. For the three months ended June 30, 2006 and 2005, respectively, we issued approximately 0.7 million shares and 2.6 million shares of common stock resulting in approximately \$32 million and \$111 million in proceeds, net of purchases of restricted shares, primarily to meet the requirements of the Progress Energy 401(k) Savings and Stock Ownership Plan (401(k) Plan) and the Investor Plus Stock Purchase Plan. For the six months ended June 30, 2006 and 2005, respectively, we issued approximately 1.4 million shares and 4.0 million shares of common stock resulting in approximately \$60 million and \$171 million in proceeds, net of purchases of restricted shares. Included in these amounts were approximately 1.0 million shares and 3.9 million shares for net proceeds of approximately \$46 million and \$169 million, respectively, to meet the requirements of the 401(k) Plan and the Investor Plus Stock Purchase Plan. At December 31, 2005, we had approximately 58 million unissued shares of common stock reserved, primarily to satisfy the requirements of our stock plans. In 2002, the board of directors authorized meeting the requirements of the 401(k) Plan and the Investor Plus Stock Purchase Plan with original issue shares.

D. Stock-Based Compensation

As discussed in Note 10 of the 2005 Form 10-K, we adopted SFAS No. 123R, "Share-Based Payment" (SFAS No. 123R), as of July 1, 2005, using the required modified prospective method. Under that method we began recording compensation expense as of July 1, 2005. Previously, entities could elect to continue accounting for such awards at their grant date intrinsic value under APB Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25), and we made that election. The intrinsic value method resulted in our recording no compensation expense for stock options granted to employees. We curtailed our stock option program in 2004 and replaced that compensation program with other programs.

Progress Energy

The information below should be read in conjunction with the plan descriptions and other pertinent information disclosed in Note 10 of the 2005 Form 10-K. The following table illustrates the effect on our net income and earnings per share if the fair value method had been applied to all outstanding and nonvested awards during the three and six months ended June 30, 2005:

(in millions except per share data)	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net (loss) income, as reported	\$ (1)	\$ 92
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	1	2
Pro forma net (loss) income	\$ (2)	\$ 90
(Loss) Earnings per share		
Basic - as reported	\$ (0.01)	\$ 0.37
Basic - pro forma	\$ (0.01)	\$ 0.36
Diluted - as reported	\$ (0.01)	\$ 0.37
Diluted - pro forma	\$ (0.01)	\$ 0.36

PEC

PEC participates in Progress Energy's stock option and other stock-based compensation plans. The information below should be read in conjunction with the plan descriptions and other pertinent information disclosed in Note 10 of the 2005 Form 10-K. The following table illustrates the effect on PEC's net income if the fair value method had been applied to all outstanding and nonvested awards during the three and six months ended June 30, 2005:

(in millions)	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net income, as reported	\$ 67	\$ 183
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	1	2
Pro forma net income	\$ 66	\$ 181

PEF

PEF participates in Progress Energy's stock option and other stock-based compensation plans. The information below should be read in conjunction with the plan descriptions and other pertinent information disclosed in Note 10 of the 2005 Form 10-K. The following table illustrates the effect on PEF's net income if the fair value method had been applied to all outstanding and nonvested awards during the three and six months ended June 30, 2005:

(in millions)	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net income, as reported	\$ 10	\$ 54
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	-	1
Pro forma net income	\$ 10	\$ 53

6. GOODWILL AND OTHER INTANGIBLE ASSETS

As discussed in Note 8 of the 2005 Form 10-K, we perform annual goodwill impairment tests in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142).

For our Progress Ventures segment, the goodwill impairment tests were performed at the reporting unit level of our

Effingham, Monroe, Walton and Washington nonregulated generation plants (Georgia Region), which is one level below the Progress Ventures segment. As a result of our evaluation of certain business opportunities that may impact the future cash flows of our Georgia Region operations, we performed an interim goodwill impairment test during the first quarter of 2006. We estimated the fair value of that reporting unit using the expected present value of future cash flows. As a result of that test, we recognized a pre-tax goodwill impairment charge of \$64 million (\$39 million after-tax) during the first quarter of 2006, which is reported within impairment of assets on the Consolidated Statements of Income.

Under SFAS No. 142, all goodwill is assigned to our reporting units that are expected to benefit from the synergies of the business combination. The changes in the carrying amount of goodwill, by reportable segment, were as follows:

(in millions)		PEC		PEF		Progress Ventures		Total
Balance at January 1, 2005	\$	1,922	\$	1,733	\$	64	\$	3,719
Balance at December 31, 2005		1,922		1,733		64		3,719
Impairment		-		-		(64)		(64)
Balance at June 30, 2006	\$	1,922	\$	1,733	\$	-	\$	3,655

The gross carrying amount and accumulated amortization of intangible assets at June 30, 2006 and December 31, 2005 were as follows:

(in millions)	June 30, 2006		December 31, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Synthetic fuel intangibles	\$ 107	\$ (107)	\$ 134	\$ (98)
Power agreements acquired	188	(27)	188	(19)
Other	86	(13)	84	(12)
Total	\$ 381	\$ (147)	\$ 406	\$ (129)

We apply SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144), for the accounting and reporting of impairment or disposal of long-lived assets. We have monitored our synthetic fuel intangibles for impairment and had previously determined that no impairment of these assets was required. On May 22, 2006, we idled our synthetic fuel facilities due to significant uncertainty surrounding synthetic fuel production. With the idling of these facilities, we performed another impairment evaluation of the intangible assets, which were comprised primarily of capitalized acquisition costs (See Note 7 for impairment of related long-lived assets). The impairment test considered numerous factors including, among other things, continued high oil prices, the continued uncertainty of whether federal legislation will be enacted that would provide assurance that tax credits would exist for 2006 production and the continued "idle" state of our synthetic fuel facilities. We estimated the fair value using the expected present value of future cash flows. Based on the results of the impairment test, we recorded a pre-tax impairment charge of \$27 million (\$17 million after-tax) during the quarter ended June 30, 2006, which is reported within impairment of assets on the Consolidated Statements of Income. This charge represents the entirety of the synthetic fuels intangible assets; these assets had been reported within the Coal and Synthetic Fuels segment.

Certain intangible assets with net carrying values of \$25 million at December 31, 2005, related to DeSoto and Rowan, were reclassified to net assets of discontinued operations during the second quarter of 2006.

7. IMPAIRMENT OF LONG-LIVED ASSETS

Concurrent with the synthetic fuels intangibles impairment evaluation discussed in Note 6, we also performed an impairment evaluation of related long-lived assets during the second quarter of 2006. Based on the results of the impairment test, we recorded a pre-tax impairment charge of \$64 million (\$38 million after-tax) during the quarter ended June 30, 2006, which is reported within impairment of assets on the Consolidated Statements of Income. This charge represents the entirety of the asset carrying value of our synthetic fuel manufacturing facilities, as well as a portion of the asset carrying value associated with the river terminals at which the synthetic fuel manufacturing facilities are located. These assets had been reported within the Coal and Synthetic Fuels segment.

8. DEBT AND CREDIT FACILITIES AND FINANCING ACTIVITIES

Changes to Progress Energy's, PEC's and PEF's debt and credit facilities and financing activities since December 31, 2005, are described below.

On January 13, 2006, Progress Energy issued \$300 million of 5.625% Senior Notes due 2016 and \$100 million of Series A Floating Rate Senior Notes due 2010. These senior notes are unsecured. Interest on the Floating Rate Senior Notes will be based on three-month London Inter Bank Offering Rate (LIBOR) plus 45 basis points and will be reset quarterly. We used the net proceeds from the sale of these senior notes and a combination of available cash and commercial paper proceeds to retire the \$800 million aggregate principal amount of our 6.75% Senior Notes on March 1, 2006. Prior to the application of proceeds as described above, we invested the net proceeds in short-term, interest-bearing, investment-grade securities.

Progress Energy entered into a new \$800 million 364-day credit agreement on November 21, 2005, which was restricted for the retirement of \$800 million of 6.75% Senior Notes due March 1, 2006. On March 1, 2006, we retired \$800 million of our 6.75% Senior Notes, thus effectively terminating the 364-day credit agreement.

On March 31, 2006, Progress Energy, as a well-known seasoned issuer, filed a shelf registration statement with the SEC. The registration statement became effective upon filing with the SEC and will allow Progress Energy to issue an indeterminate number or amount of various securities, including Senior Debt Securities, Junior Subordinated Debentures, Common Stock, Preferred Stock, Stock Purchase Contracts, Stock Purchase Units, and Trust Preferred Securities and Guarantees. The board of directors has authorized the issuance and sale of up to \$1 billion aggregate principal amount of various securities off this new shelf registration statement, in addition to the \$679 million of various securities which were not sold from our prior shelf registration statement. Therefore, effective March 31, 2006, Progress Energy has the authority to issue and sell up to \$1.679 billion aggregate principal amount of various securities.

On May 3, 2006, Progress Energy restructured its existing \$1.13 billion five-year revolving credit agreement (RCA) with a syndication of financial institutions. The new RCA is scheduled to expire on May 3, 2011, and is replacing an existing \$1.13 billion five-year facility, which was terminated effective May 3, 2006. The Progress Energy RCA will continue to be used to provide liquidity support for Progress Energy's issuances of commercial paper and other short-term obligations. The new RCA still includes a defined maximum total debt to capital ratio of 68 percent and contains various cross-default and other acceleration provisions. However, the new RCA no longer includes a material adverse change representation for borrowings or a financial covenant for interest coverage. Fees and interest rates under the RCA will continue to be determined based upon the credit rating of Progress Energy's long-term unsecured senior noncredit-enhanced debt, currently rated as Baa2 by Moody's and BBB- by S&P.

On May 3, 2006, PEC's five-year \$450 million credit facility was amended to take advantage of favorable market conditions and reduce the pricing associated with the facility. Fees and interest rates under the RCA will continue to be determined based upon the credit rating of PEC's long-term unsecured senior noncredit-enhanced debt, currently rated as Baa1 by Moody's and BBB- by S&P. The amended PEC RCA is still scheduled to expire on June 28, 2010.

On May 3, 2006, PEF's five-year \$450 million credit facility was amended to take advantage of favorable market conditions and reduce the pricing associated with the facility. Fees and interest rates under the RCA will continue to be determined based upon the credit rating of PEF's long-term unsecured senior noncredit-enhanced debt, currently rated as A3 by Moody's and BBB- by S&P. The amended PEF RCA is still scheduled to expire on March 28, 2010.

9. BENEFIT PLANS

We have a noncontributory defined benefit retirement plan for substantially all full-time employees that provides pension benefits. We also have supplementary defined benefit pension plans that provide benefits to higher-level employees. In addition to pension benefits, we provide contributory other postretirement benefits (OPEB), including certain health care and life insurance benefits, for retired employees who meet specified criteria. The components of the net periodic benefit cost for the respective Progress Registrants for the three and six months ended June 30 were:

	Pension Benefits		Other Postretirement Benefits	
	Three Months Ended June 30,			
(in millions)	2006	2005	2006	2005
Service cost	\$ 12	\$ 15	\$ 2	\$ 3
Interest cost	29	29	9	8
Expected return on plan assets	(36)	(37)	(1)	(1)
Amortization of actuarial loss	9	6	2	1
Other amortization, net	-	1	-	-
Net periodic cost	14	14	12	11
Additional (benefit) cost recognition ^(a)	(3)	(4)	1	1
Net periodic cost recognized	\$ 11	\$ 10	\$ 13	\$ 12

(in millions)	Pension Benefits		Other Postretirement Benefits	
	Six Months Ended June 30,			
	2006	2005	2006	2005
Service cost	\$ 23	\$ 30	\$ 4	\$ 6
Interest cost	58	57	17	16
Expected return on plan assets	(72)	(73)	(3)	(3)
Amortization of actuarial loss	18	12	5	2
Other amortization, net	1	1	1	1
Net periodic cost	28	27	24	22
Additional (benefit) cost recognition ^(a)	(7)	(8)	1	1
Net periodic cost recognized	\$ 21	\$ 19	\$ 25	\$ 23

^(a) Relates to the acquisition of Florida Progress. See Note 16B to the 2005 Form 10-K.

In addition, in the second quarter of 2005, the Company recorded costs for special termination benefits related to its voluntary enhanced retirement program of approximately \$122 million for pension benefits and \$19 million for other postretirement benefits.

PEC

	Pension Benefits		Other Postretirement Benefits	
	Three Months Ended June 30,			
(in millions)	2006	2005	2006	2005
Service cost	\$ 6	\$ 7	\$ 1	\$ 2
Interest cost	13	13	5	4
Expected return on plan assets	(15)	(16)	(1)	(1)
Amortization of actuarial loss	3	1	1	-
Other amortization, net	-	1	-	-
Net periodic cost	\$ 7	\$ 6	\$ 6	\$ 5

(in millions)	Pension Benefits		Other Postretirement Benefits	
	Six Months Ended June 30,			
	2006	2005	2006	2005
Service cost	\$ 11	\$ 13	\$ 2	\$ 3
Interest cost	25	27	9	8
Expected return on plan assets	(29)	(31)	(2)	(2)
Amortization of actuarial loss	7	2	2	1
Other amortization, net	1	2	1	-
Net periodic cost	\$ 15	\$ 13	\$ 12	\$ 10

In addition, in the second quarter of 2005, PEC recorded special termination benefits related to the voluntary enhanced retirement program of approximately \$21 million for pension benefits and \$8 million for other postretirement benefits.

PEF

	Pension Benefits		Other Postretirement Benefits	
	Three Months Ended June 30,			
(in millions)	2006	2005	2006	2005
Service cost	\$ 4	\$ 6	\$ 1	\$ 1
Interest cost	12	11	3	3
Expected return on plan assets	(19)	(18)	-	-
Amortization of actuarial loss	2	-	-	-
Other amortization, net	-	-	1	1
Net periodic (benefit) cost	\$ (1)	\$ (1)	\$ 5	\$ 5

	Pension Benefits		Other Postretirement Benefits	
	Six Months Ended June 30,			
(in millions)	2006	2005	2006	2005
Service cost	\$ 8	\$ 11	\$ 2	\$ 2
Interest cost	25	22	7	7
Expected return on plan assets	(37)	(36)	(1)	-
Amortization of actuarial loss	3	1	1	-
Other amortization, net	(1)	-	2	2
Net periodic (benefit) cost	\$ (2)	\$ (2)	\$ 11	\$ 11

In addition, in the second quarter of 2005, PEF recorded costs for special termination benefits related to the voluntary enhanced retirement program of approximately \$83 million for pension benefits and \$7 million for other postretirement benefits.

10. RISK MANAGEMENT ACTIVITIES AND DERIVATIVE TRANSACTIONS

We are exposed to various risks related to changes in market conditions. We have a Risk Management Committee comprised of senior executives from various functional areas. The Risk Management Committee is responsible for administering risk management policies and monitoring compliance with those policies by all subsidiaries. Under our risk policy, we may use a variety of instruments, including swaps, options and forward contracts, to manage exposure to fluctuations in commodity prices and interest rates. Such instruments contain credit risk for nonperformance by the counterparty. We minimize such risk by performing credit reviews using, among other things, publicly available credit

ratings of such counterparties. Potential nonperformance by counterparties is not expected to have a material effect on our financial position or results of operations. Additionally, in the normal course of business, some of our affiliates may enter into hedge transactions with one another. See Note 18 to the 2005 Form 10-K.

A. Commodity Derivatives

GENERAL

Most of our commodity contracts are not derivatives pursuant to SFAS No. 133, "Accounting for Derivative and Hedging Activities" (SFAS No. 133), or qualify as normal purchases or sales pursuant to SFAS No. 133. Therefore, such contracts are not recorded at fair value.

In 2003, PEC recorded a \$38 million pre-tax (\$23 million after-tax) fair value loss transition adjustment pursuant to the provisions of FASB Derivatives Implementation Group Issue C20, "Interpretation of the Meaning of Not Clearly and Closely Related in Paragraph 10(b) regarding Contracts with a Price Adjustment Feature" (DIG Issue C20). The related liability is being amortized to earnings over the term of the related contract (See Note 12). At June 30, 2006 and December 31, 2005, the remaining liability was \$17 million and \$19 million, respectively.

ECONOMIC DERIVATIVES

Derivative products, primarily electricity and natural gas contracts, may be entered into from time to time for economic hedging purposes. While management believes the economic hedges mitigate exposures to fluctuations in commodity prices, these instruments are not designated as hedges for accounting purposes and are monitored consistent with trading positions. We manage open positions according to established policies and guidelines that limit our exposure to market risk and require daily reporting to management of financial exposures. Gains and losses from such contracts were not material to our or the Utilities' results of operations for the three and six months ended June 30, 2006 and 2005. PEC did not have material outstanding positions in such contracts at June 30, 2006 or December 31, 2005. We and PEF did not have material outstanding positions in such contracts at June 30, 2006 or December 31, 2005, other than those receiving regulatory accounting treatment at PEF, as described below.

PEF has derivative instruments related to its exposure to price fluctuations on fuel oil and natural gas purchases. These instruments receive regulatory accounting treatment. Unrealized gains and losses are recorded in regulatory liabilities and regulatory assets, respectively, until the contracts are settled. Once settled, any realized gains or losses are passed through the fuel clause. At June 30, 2006, the fair values of these instruments were a \$55 million short-term derivative asset position included in other current assets, a \$48 million long-term derivative asset position included in other assets and deferred debits, a \$15 million short-term derivative liability position included in other current liabilities and a \$53 million long-term derivative liability position included in other liabilities and deferred credits on the Balance Sheets. At December 31, 2005, the fair values of the instruments were a \$77 million short-term derivative asset position included in other current assets, a \$45 million long-term derivative asset position included in other assets and deferred debits and a \$49 million long-term derivative liability position included in other liabilities and deferred credits on the Balance Sheets.

CASH FLOW HEDGES

We designate a portion of commodity derivative instruments as cash flow hedges under SFAS No. 133. The objective for holding these instruments is to hedge exposure to market risk associated with fluctuations in the price of natural gas and power for our forecasted purchases and sales. Realized gains and losses are recorded net in operating revenues or operating expenses, as appropriate. During the three months ending June 30, 2006, \$7 million in after-tax deferred losses were reclassified to earnings due to discontinuance of the related cash flow hedges in anticipation of the sale of our gas business (See Note 16). The ineffective portion of commodity cash flow hedges for the three and six months ended June 30, 2006 and 2005, was not material to our or the Utilities' results of operations.

The fair values of our commodity cash flow hedges at June 30, 2006 and December 31, 2005, were as follows:

(in millions)	June 30, 2006			December 31, 2005		
	Progress Energy	PEC	PEF	Progress Energy	PEC	PEF
Fair value of assets	\$ 145	\$ -	\$ -	\$ 170	\$ 7	\$ -
Fair value of liabilities	(1)	-	-	(58)	(4)	-
Fair value, net	\$ 144	\$ -	\$ -	\$ 112	\$ 3	\$ -

The following table presents selected information related to our commodity cash flow hedges at June 30, 2006:

(term in years/ dollars in millions)	Maximum Term ^(a)			Accumulated Other Comprehensive Income/(Loss), net of tax ^(b)			Portion Expected to be Reclassified to Earnings during the Next 12 Months ^(c)		
	Progress Energy	PEC	PEF	Progress Energy	PEC	PEF	Progress Energy	PEC	PEF
Commodity cash flow hedges	9	-	-	\$ 78	\$ -	\$ -	\$ (6)	\$ -	\$ -

^(a) The majority of hedges in fair value asset positions are currently classified as long-term.

^(b) Includes amounts related to de-designated hedges.

^(c) Due to the volatility of the commodities markets, the value in accumulated other comprehensive income/(loss) is subject to change prior to its reclassification into earnings.

At December 31, 2005, we had \$69 million of after-tax deferred income and PEC had \$2 million in after-tax deferred income recorded in accumulated other comprehensive income/(loss) related to commodity cash flow hedges. PEF had no amount recorded in accumulated other comprehensive income/(loss) related to commodity cash flow hedges.

B. Interest Rate Derivatives - Fair Value or Cash Flow Hedges

We use cash flow hedging strategies to reduce exposure to changes in cash flow due to fluctuating interest rates. We use fair value hedging strategies to reduce exposure to changes in fair value due to interest rate changes. The notional amounts of interest rate derivatives are not exchanged and do not represent exposure to credit loss. In the event of default by the counterparty, the risk in these transactions is the cost of replacing the agreements at current market rates.

The fair values of interest rate hedges at June 30, 2006 and December 31, 2005, were as follows:

(in millions)	June 30, 2006			December 31, 2005		
	Progress Energy	PEC	PEF	Progress Energy	PEC	PEF
Interest rate cash flow hedges	\$ -	\$ -	\$ -	\$ 1	\$ -	\$ -
Interest rate fair value hedges	(5)	-	-	(2)	-	-

CASH FLOW HEDGES

Gains and losses from cash flow hedges are recorded in accumulated other comprehensive income/(loss) and amounts reclassified to earnings are included in net interest charges as the hedged transactions occur. Amounts in accumulated other comprehensive income/(loss) related to terminated hedges are reclassified to earnings as the interest expense is recorded. The ineffective portion of interest rate cash flow hedges for the three months ended June 30, 2006 and 2005, was not material to our or the Utilities' results of operations.

The following table presents selected information related to interest rate cash flow hedges at June 30, 2006:

(term in years/ dollars in millions)	Maximum Term			Accumulated Other Comprehensive Income/ (Loss), net of Tax ^(a)			Portion Expected to be Reclassified to Earnings during the Next 12 Months		
	Progress Energy	PEC	PEF	Progress Energy	PEC	PEF	Progress Energy	PEC	PEF
Interest rate cash flow hedges	-	-	-	\$ (12)	\$ (5)	\$ -	\$ (2)	\$ (1)	\$ -

^(a) Amounts relate to terminated hedges.

PEC entered into a \$50 million forward starting swap on June 2, 2006, and PEF entered into a \$50 million forward starting swap on June 6, 2006, to mitigate exposure to interest rate risk on their respective anticipated fixed rate debt issuances in 2007. These swaps were designated as cash flow hedges as of July 1, 2006. The fair value of these swaps was not material at June 30, 2006.

At December 31, 2005, we had \$13 million of after-tax deferred loss and PEC had \$5 million in after-tax deferred loss recorded in accumulated other comprehensive income/(loss) related to interest rate cash flow hedges. PEF had no amount recorded in accumulated other comprehensive income/(loss) related to interest rate cash flow hedges.

At December 31, 2005, we had \$100 million notional of interest rate cash flow hedges, which were settled in the first quarter of 2006. The Utilities had no open interest rate cash flow hedges at December 31, 2005.

FAIR VALUE HEDGES

For interest rate fair value hedges, the change in the fair value of the hedging derivative is recorded in net interest charges and is offset by the change in the fair value of the hedged item. At June 30, 2006, and December 31, 2005, we had \$150 million notional of interest rate fair value hedges and the Utilities had no open interest rate fair value hedges.

11. FINANCIAL INFORMATION BY BUSINESS SEGMENT

Our reportable segments are: PEC, PEF, Progress Ventures, and Coal and Synthetic Fuels.

Our PEC and PEF business segments are primarily engaged in the generation, transmission, distribution and sale of electricity in portions of North Carolina, South Carolina and Florida. These electric operations also distribute and sell electricity to other utilities, primarily on the east coast of the United States.

Our Progress Ventures segment is primarily engaged in nonregulated electric generation, energy marketing activities and natural gas drilling and production (See Note 16).

Our Coal and Synthetic Fuels segment is primarily engaged in the production and sale of coal-based solid synthetic fuel (as defined under the Code), the operation of synthetic fuel facilities for third parties, and coal terminal services. On May 22, 2006, we idled our synthetic fuel facilities due to significant uncertainty surrounding synthetic fuel production. See Notes 6 and 7 for additional information.

In addition to the reportable operating segments, the Corporate and Other segment includes the operations of the Parent and Progress Energy Service Company, LLC (PESC) as well as other nonregulated business areas. These nonregulated business areas do not separately meet the disclosure requirements of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" (SFAS No. 131). The profit or loss of the identified segments plus the profit or loss of Corporate and Other represents our total income from continuing operations.

Prior to 2006, DeSoto and Rowan were included within the Progress Ventures segment and PT LLC was included within the Corporate and Other segment. In connection with their divestitures (See Notes 3A and 3B, respectively), the operations of (i) DeSoto and Rowan and (ii) PT LLC were reclassified to discontinued operations in the second and first quarters of 2006, respectively, and therefore are not included in the results from continuing operations

during the periods reported. During the fourth quarter of 2005, we reclassified our coal mining operations as discontinued operations (See Note 3D). Income and assets of discontinued operations are not included in the table presented below. For comparative purposes, the prior year results have been restated to conform to the current segment presentation. The cost management initiative charges incurred in 2005 resulted from a workforce restructuring and voluntary enhanced retirement program that was approved in February 2005 and concluded in December 2005. The following information is for the three and six months ended June 30:

(in millions)	Revenues			Cost Management Initiative	Income (loss) from	Assets of
	Unaffiliated	Intersegment	Total		Continuing Operations	Continuing Operations
Three Months Ended June 30, 2006						
PEC	\$ 936	\$ -	\$ 936	\$ -	\$ 76	\$ 11,424
PEF	1,147	-	1,147	-	87	8,406
Progress Ventures	189	-	189	-	(8)	1,738
Coal and Synthetic Fuels	222	84	306	-	(91)	252
Corporate and Other	5	103	108	-	(50)	17,244
Eliminations	-	(187)	(187)	-	-	(13,294)
Totals	\$ 2,499	\$ -	\$ 2,499	\$ -	\$ 14	\$ 25,770

Three Months Ended June 30, 2005

PEC	\$ 861	\$ -	\$ 861	\$ 46	\$ 67	
PEF	908	-	908	93	10	
Progress Ventures	178	-	178	1	6	
Coal and Synthetic Fuels	318	100	418	4	23	
Corporate and Other	-	124	124	1	(100)	
Eliminations	-	(224)	(224)	-	-	
Totals	\$ 2,265	\$ -	\$ 2,265	\$ 145	\$ 6	

	Revenues			Cost	Income (loss) from	Assets of
(in millions)	Unaffiliated	Intersegment	Total	Management Initiative	Continuing Operations	Continuing Operations
Six Months Ended June 30, 2006						
PEC	\$ 1,914	\$ -	\$ 1,914	\$ -	\$ 161	\$ 11,424
PEF	2,154	-	2,154	-	139	8,406
Progress Ventures	393	-	393	-	(43)	1,738
Coal and Synthetic Fuels	456	162	618	-	(77)	252
Corporate and Other	8	192	200	-	(114)	17,244
Eliminations	-	(354)	(354)	-	-	(13,294)
Totals	\$ 4,925	\$ -	\$ 4,925	\$ -	\$ 66	\$ 25,770

Six Months Ended June 30, 2005

PEC	\$ 1,796	\$ -	\$ 1,796	\$ 60	\$ 182	
PEF	1,756	-	1,756	107	53	
Progress Ventures	265	-	265	2	12	
Coal and Synthetic Fuels	590	185	775	6	20	
Corporate and Other	-	224	224	1	(155)	
Eliminations	-	(409)	(409)	-	-	
Totals	\$ 4,407	\$ -	\$ 4,407	\$ 176	\$ 112	

12. OTHER INCOME AND OTHER EXPENSE

Other income and expense includes interest income and other income and expense items as discussed below. Nonregulated energy and delivery services include power protection services and mass market programs such as surge protection, appliance services and area light sales, and delivery, transmission and substation work for other utilities. Allowance for funds used during construction (AFUDC) equity represents the estimated equity costs of capital funds necessary to finance the construction of new regulated assets. Contingent value obligations (CVOs) unrealized loss and gain is due to changes in the fair market value of the liability. See Note 15 to the 2005 Form 10-K for more information on CVOs. The FERC audit settlement includes amounts approved by the FERC on May 25, 2005, to settle the FERC Staff's Audit of compliance with the FERC's Standard of Conduct and Code of Conduct. The components of other, net as shown on the accompanying Statements of Income were as follows:

Progress Energy

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<u>Other income</u>				
Nonregulated energy and delivery services income	\$ 15	\$ 11	\$ 23	\$ 17
DIG Issue C20 amortization (see Note 10)	1	2	2	3
CVOs unrealized gain	3	-	3	-
Gain on sale of Level 3 stock ^(a)	8	-	32	-
Investment gains	-	-	3	1
AFUDC equity	4	5	7	9
Other	3	4	7	12
Total other income	34	22	77	42
<u>Other expense</u>				
Nonregulated energy and delivery services expenses	7	5	13	10
Donations	5	5	12	11
CVOs unrealized loss	-	-	25	-
Loss from equity investments	1	2	1	4
FERC audit settlement	-	7	-	7
Other	10	9	17	15
Total other expense	23	28	68	47
Other, net - Progress Energy	\$ 11	\$ (6)	\$ 9	\$ (5)

^(a) Other income includes gains of \$8 million and \$32 million for the three-month and six-month periods ending June 30, 2006, respectively, from the sale of approximately 20 million shares of Level 3 stock received as part of the sale of our interest in PT LLC (See Note 3B). These gains are prior to the consideration of minority interest.

PEC

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Other income				
Nonregulated energy and delivery services income	\$ 8	\$ 7	\$ 10	\$ 9
DIG Issue C20 amortization (see Note 10)	1	2	2	3
AFUDC equity	1	1	2	2
Other	-	2	3	5
Total other income	10	12	17	19
Other expense				
Nonregulated energy and delivery services expenses	2	2	3	4
Donations	3	2	6	5
FERC audit settlement	-	4	-	4
Other	6	6	10	7
Total other expense	11	14	19	20
Other, net - PEC	\$ (1)	\$ (2)	\$ (2)	\$ (1)

PEF

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Other income				
Nonregulated energy and delivery services income	\$ 7	\$ 4	\$ 13	\$ 8
AFUDC equity	3	4	5	7
Other	-	-	1	1
Total other income	10	8	19	16
Other expense				
Nonregulated energy and delivery services expenses	5	3	10	6
Donations	2	3	6	5
FERC audit settlement	-	3	-	3
Other	-	-	1	-
Total other expense	7	9	17	14
Other, net - PEF	\$ 3	\$ (1)	\$ 2	\$ 2

13. ENVIRONMENTAL MATTERS

We are subject to federal, state and local regulations addressing hazardous and solid waste management, air and water quality and other environmental matters. See Note 22 to the 2005 Form 10-K.

A. Hazardous and Solid Waste Management

The provisions of the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (CERCLA), authorize the Environmental Protection Agency (EPA) to require the cleanup of hazardous waste sites. This statute imposes retroactive joint and several liabilities. Some states, including North Carolina, South Carolina and Florida, have similar types of statutes. We are periodically notified by regulators, including the EPA and various state agencies, of our involvement or potential involvement in sites that may require investigation and/or remediation. There are presently several sites with respect to which we have been notified of our potential liability by the EPA, the state of North Carolina or the state of Florida, as described below in greater detail. Various organic materials associated with the production of manufactured gas, generally referred to as coal tar, are regulated under federal and state laws. PEC and PEF are each potentially responsible parties (PRPs) at several manufactured gas plant (MGP) sites. We are also currently in the process of assessing potential costs and exposures at other sites. A discussion of sites by legal entity follows below.

We record accruals for probable and estimable costs related to environmental sites on an undiscounted basis. We measure our liability for these sites based on available evidence including our experience in investigating and remediating environmentally impaired sites. The process often involves assessing and developing cost-sharing arrangements with other PRPs. For all sites, as assessments are developed and analyzed, we will accrue costs for the sites to the extent our liability is probable and the costs can be reasonably estimated. Because the extent of environmental impact, allocation among PRPs for all sites, remediation alternatives (which could involve either minimal or significant efforts), and concurrence of the regulatory authorities have not yet reached the stage where a reasonable estimate of the remediation costs can be made, we cannot determine the total costs that may be incurred in connection with the remediation of all sites at this time. It is probable that current estimates will change and additional losses, which could be material, may be incurred in the future.

PEC and PEF filed claims with general liability insurance carriers to recover costs arising from actual or potential environmental liabilities for remediation of certain sites. No material claims are currently pending. We plan to file further claims with respect to sites for which claims were not previously presented.

The following table contains information about accruals for environmental remediation expenses described below. At June 30, 2006 and December 31, 2005, accruals for probable and estimable costs related to various environmental sites, which were included in other liabilities and deferred credits were:

Accruals for Environmental Remediation Expenses			
(in millions)		June 30, 2006	December 31, 2005
<u>PEC</u>			
MGP and other sites ^(a)	\$	24	\$ 7
<u>PEF</u>			
Remediation of distribution and substation transformers		53	20
MGP and other sites		18	18
Total PEF environmental remediation accruals ^(b)		71	38
Progress Energy nonregulated operations		3	3
Total Progress Energy environmental remediation accruals	\$	98	\$ 48

^(a) Expected to be paid out over one to five years. PEC is planning to request orders from both the NCUC and SCPSC to defer and amortize the retail portion of certain of these costs, net of insurance proceeds, over a period of years. We cannot predict the outcome of this matter.

^(b) Expected to be paid out over one to fifteen years.

Progress Energy

In addition to the Utilities' sites, discussed under "PEC" and "PEF" below, our environmental sites include the following related to our nonregulated operations.

In 2001, we, through our Progress Fuels subsidiary, established an accrual to address indemnities and retained an environmental liability associated with the sale of our Inland Marine Transportation business. At June 30, 2006 and December 31, 2005, the remaining accrual balance was approximately \$3 million. Expenditures related to this liability were not material during the three and six months ended June 30, 2006 and 2005.

On March 24, 2005, we completed the sale of our Progress Rail subsidiary. In connection with the sale, we incurred indemnity obligations related to certain pre-closing liabilities, including certain environmental matters (See discussion under Guarantees in Note 14A).

PEC

There are currently eight former MGP sites and a number of other sites associated with PEC that have required or are anticipated to require investigation and/or remediation. Three of these sites are in the long-term monitoring phase.

For the three months ended June 30, 2006, PEC made no additional accruals and spent approximately \$1 million, and for the six months ended June 30, 2006, PEC accrued approximately \$21 million and spent approximately \$4

million related to environmental remediation. For the three and six months ended June 30, 2005, PEC made no additional accruals and spent approximately \$1 million and \$3 million, respectively, related to environmental remediation.

In September 2005, the EPA advised PEC that it had been identified as a PRP at the Carolina Transformer site located in Fayetteville, N.C. The EPA offered PEC and a number of other PRPs the opportunity to share in the reimbursement to the EPA of past expenditures in addressing conditions at the site, which are currently approximately \$32 million. In May 2006, a meeting was called by the EPA to discuss a settlement proposal among the PRPs. An agreement among PRPs has not been reached; consequently, it is not possible at this time to reasonably estimate the amount of PEC's share of the reimbursement for remediation of the Carolina Transformer site. PEC may file claims with respect to this site. The outcome of this matter cannot be predicted.

During the fourth quarter of 2004, the EPA advised PEC that it had been identified as a PRP at the Ward Transformer site located in Raleigh, N.C. The EPA offered PEC and a number of other PRPs the opportunity to negotiate cleanup of the site and reimbursement to the EPA for EPA's past expenditures in addressing conditions at the site. In September 2005, PEC and other PRPs signed a settlement agreement, which requires the participating PRPs to remediate the site. In 2005, PEC accrued approximately \$3 million for its portion of the EPA's estimated remediation costs and the EPA's past costs. In March 2006, based upon continuing assessment work performed at the site, PEC recorded an additional \$9 million accrual for its portion of the estimated remediation costs. Actual experience may differ from current estimates and it is probable that estimates will continue to change in the future. PEC plans to file claims with respect to this site. The outcome of this matter cannot be predicted.

In March 2006, based upon newly available data for several of PEC's MGP sites, which had individual site remediation costs ranging from approximately \$2 million to \$4 million, a remediation liability of approximately \$12 million was recorded for the minimum estimated total remediation cost for all of PEC's remaining MGP sites. However, the maximum amount of the range for all the sites cannot be determined at this time as one of the remaining sites is significantly larger than the sites for which we have historical experience.

On March 30, 2005, the North Carolina Division of Water Quality renewed a PEC permit for the continued use of coal combustion products generated at any of its coal-fired plants located in the state. PEC appealed the permit conditions, which could have significantly restricted the reuse of coal ash, resulting in higher ash management costs. Subsequently, based on comments from PEC, the permit was revised, and the appeal was withdrawn on July 11, 2006.

PEF

PEF has received approval from the FPSC for recovery of costs associated with the remediation of distribution and substation transformers through the Environmental Cost Recovery Clause (ECRC). Under agreements with the Florida Department of Environmental Protection (FDEP), PEF is in the process of examining distribution transformer sites and substation sites for mineral oil-impacted soil remediation caused by equipment integrity issues. PEF has reviewed a number of distribution transformer sites and all substation sites. Based on changes to the estimated time frame for review of distribution transformer sites, PEF currently expects to have completed its review by the end of 2008. Should further sites be identified, PEF believes that any estimated costs would also be recovered through the ECRC. For the three and six months ended June 30, 2006, PEF accrued approximately \$1 million and \$39 million, respectively, due to additional sites expected to require remediation and spent approximately \$5 million and \$6 million, respectively, related to the remediation of transformers. For the three and six months ended June 30, 2005, PEF made no additional accruals and spent approximately \$3 million and \$5 million, respectively, related to the remediation of transformers. PEF records a regulatory asset for the probable recovery of these costs through the ECRC.

The amounts for MGP and other sites, in the table above, relate to two former MGP sites and other sites associated with PEF that have required or are anticipated to require investigation and/or remediation. The amounts include approximately \$12 million in insurance claim settlement proceeds received in 2004, which are restricted for use in addressing costs associated with environmental liabilities. For the three and six months ended June 30, 2006 and 2005, PEF made no additional accruals or material expenditures and received no insurance proceeds.

B. Air Quality and Water Quality

We are or may ultimately be subject to various current and proposed federal, state and local environmental compliance laws and regulations, which would likely result in increased planned capital expenditures and O&M expenses. Significant updates to these laws and regulations and related impacts to us since December 31, 2005, are discussed below. Additionally, Congress is considering legislation that would require additional reductions in air emissions of nitrogen oxide (NO_x), sulfur dioxide (SO₂), carbon dioxide (CO₂) and mercury. Some of these proposals establish nationwide caps and emission rates over an extended period of time. This national multi-pollutant approach to air pollution control could involve significant capital costs that could be material to our financial position or results of operations. Control equipment that will be installed pursuant to the provisions of the Clean Smokestacks Act, the Clean Air Interstate Rule (CAIR), and the Clean Air Mercury Rule (CAMR), which are discussed below, may address some of the issues outlined above. However, the outcome of the matter cannot be predicted.

The following tables contain information about estimates of capital expenditures to comply with environmental laws and regulations described below. These costs are eligible for regulatory recovery through either base rates or pass-through clauses. The outcome of future petitions for recovery cannot be predicted. Estimated expenditures for the NO_x SIP Call Rule under Section 110 of the Clean Air Act (NO_x SIP Call) include the cost to install NO_x controls under North Carolina's and South Carolina's programs to comply with the federal eight-hour ozone standard. The air quality controls needed to meet compliance with the NO_x SIP Call and Clean Smokestacks Act will reduce the costs to meet the CAIR requirements for our North Carolina units at PEC. We review our estimates on an ongoing basis. The timing and extent of the costs for future projects will depend upon final compliance strategies.

Progress Energy

Air and Water Quality Estimated Required Environmental Expenditures (in millions)	Estimated Timetable	Total Estimated Expenditures	Spent through June 30, 2006
NO _x SIP Call	2002-2006	\$355	\$344
Clean Smokestacks Act	2002-2013	\$1,100 - \$1,400	404
CAIR/CAMR	2005-2018	\$700 - \$1,600	7
Incremental CAVR BART ^(a)		\$-	-
Incremental NAAQS ^(b)		\$-	-
Total air quality		\$2,155 - \$3,355	755
Clean Water Act Section 316(b)	2005-2010	\$70 - \$95	1
Total air and water quality		\$2,225 - \$3,450	\$756

PEC

Air and Water Quality Estimated Required Environmental Expenditures (in millions)	Estimated Timetable	Total Estimated Expenditures	Spent through June 30, 2006
NO _x SIP Call	2002-2006	\$355	\$344
Clean Smokestacks Act	2002-2013	\$1,100 - \$1,400	404
CAIR/CAMR	2005-2018	\$100 - \$200	1
Incremental CAVR BART ^(a)		\$-	-
Incremental NAAQS ^(b)		\$-	-
Total air quality		\$1,555 - \$1,955	749
Clean Water Act Section 316(b)	2005-2010	\$5 - \$10	-
Total air and water quality		\$1,560 - \$1,965	\$749

Air and Water Quality Estimated Required Environmental Expenditures (in millions)			Spent through June 30, 2006
	Estimated Timetable	Total Estimated Expenditures	
CAIR/CAMR	2005-2018	\$600 - \$1,400	\$6
Incremental CAVR BART ^(a)		\$-	-
Incremental NAAQS ^(b)		\$-	-
Total air quality		\$600 - \$1,400	6
Clean Water Act Section 316(b)	2005-2010	\$65 - \$85	1
Total air and water quality		\$665 - \$1,485	\$7

^(a) Plans for compliance with the CAIR and CAMR are expected to fulfill the Best Available Retrofit Technology (BART) obligations of the Clean Air Visibility Rule (CAVR).

^(b) Compliance plans will be determined upon finalization of the proposed changes to the National Ambient Air Quality Standards (NAAQS) for particulate matter.

NEW SOURCE REVIEW

The EPA is conducting an enforcement initiative related to a number of coal-fired utility power plants in an effort to determine whether changes at those facilities were subject to New Source Review (NSR) requirements or New Source Performance Standards under the Clean Air Act. We were asked to provide information to the EPA as part of this initiative and cooperated in supplying the requested information. The EPA initiated civil enforcement actions against unaffiliated utilities as part of this initiative. Some of these actions resulted in settlement agreements calling for expenditures by these unaffiliated utilities in excess of \$1.0 billion. These settlement agreements have generally called for expenditures to be made over extended time periods, and some of the companies may seek recovery of the related costs through rate adjustments or similar mechanisms. On May 15, 2006, the U.S. Supreme Court agreed to hear an appeal of a decision issued by the U.S. Court of Appeals for the Fourth Circuit, in a case involving an unaffiliated utility, holding that NSR applies to projects that result in an increase in maximum hourly emissions.

On March 17, 2006, the Court of Appeals for the District of Columbia Circuit set aside the EPA's 2003 New Source Review equipment replacement rule. The rule would have provided a more uniform definition of routine equipment replacement. The court had earlier set aside a provision in the NSR rule, which had exempted the installation of pollution control projects from review. The Court denied a request by the EPA for a re-hearing regarding this matter on June 30, 2006. These projects are now subject to NSR requirements, adding time and cost to the installation process.

NO_x SIP CALL RULE UNDER SECTION 110 OF THE CLEAN AIR ACT

The NO_x SIP Call is an EPA rule that requires 22 states, including North Carolina, South Carolina and Georgia, to further reduce nitrogen oxide emissions. The NO_x SIP Call is not applicable to Florida. Further technical analysis and rulemaking may result in requirements for additional controls at some units. Increased O&M expenses relating to the NO_x SIP Call are not expected to be material to our or PEC's results of operations.

Parties unrelated to us have undertaken efforts to have Georgia excluded from the rule and its requirements. Georgia has not yet submitted a state implementation plan to comply with the NO_x SIP Call. The outcome of this matter and the impact to our nonregulated operations in Georgia cannot be predicted.

CLEAN SMOKESTACKS ACT

In June 2002, the Clean Smokestacks Act was enacted in North Carolina requiring the state's electric utilities to reduce the emissions of NO_x and SO₂ from their North Carolina coal-fired power plants in phases by 2013. PEC currently has approximately 5,100 MW of coal-fired generation capacity in North Carolina that is affected by the Clean Smokestacks Act. To meet SO₂ emission targets, PEC plans to install devices that neutralize sulfur compounds formed during coal combustion (scrubbers) on some of its coal-fired units. These devices combine the sulfur in gaseous emissions with other chemicals to form inert compounds, such as gypsum, that are then removed. In March 2006, PEC filed its annual estimate with the NCUC of the total capital expenditures to meet emission targets under the Clean Smokestacks Act of approximately \$1.1 billion to \$1.4 billion by the end of 2013, as shown in the above tables. The increase in estimated total capital expenditures from the original estimate of \$813 million is primarily due

to the higher cost and revised quantities of construction materials, such as concrete and steel, refinement of cost and scope estimates for the current projects, and increases in the estimated inflation factor applied to future project costs. We are evaluating various design, technology, and new generation options that could reduce expenditures required by the Clean Smokestacks Act.

Two of the coal-fired generation plants impacted by the Clean Smokestacks Act are jointly owned. The joint owners pay their ownership share of construction costs. In 2005, PEC entered into a contract with the joint owner of certain facilities at the Mayo and Roxboro plants to limit their aggregate costs associated with capital expenditures to comply with the Clean Smokestacks Act to approximately \$38 million and recognized a related liability. At June 30, 2006 and December 31, 2005, the amount of the liability was \$21 million and \$16 million, respectively, based upon the current estimates for Clean Smokestacks Act compliance. As capital cost projections change, it is reasonably possible that additional losses, which could be material, may be incurred in the future.

The Clean Smokestacks Act also freezes the state's utilities' base rates for five years, which ends in 2007, unless there are extraordinary events beyond the control of the utilities or unless the utilities persistently earn a return substantially in excess of the rate of return established and found reasonable by the NCUC in the utilities' last general rate case. The Clean Smokestacks Act requires PEC to amortize \$569 million, representing 70 percent of the original cost estimate of \$813 million, during the five-year rate freeze period. PEC recognized amortization of \$22 million and \$44 million, respectively, for the three and six months ended June 30 2006, and has recognized \$439 million in cumulative amortization through June 30, 2006. PEC recognized amortization of \$27 million and \$54 million, respectively, for the three and six months ended June 30 2005. The remaining amortization requirement of \$130 million will be recorded over the 18-month period ending December 31, 2007. The Clean Smokestacks Act permits PEC the flexibility to vary the amortization schedule for recording of the compliance costs from none up to \$174 million per year. The NCUC will hold a hearing prior to December 31, 2007, to determine cost recovery amounts for 2008 and future periods.

Pursuant to the Clean Smokestacks Act, PEC entered into an agreement with the state of North Carolina to transfer to the state certain NO_x and SO₂ emissions allowances that result from compliance with the collective NO_x and SO₂ emissions limitations set out in the Clean Smokestacks Act. The Clean Smokestacks Act also required the state to undertake a study of mercury and CO₂ emissions in North Carolina. O&M expenses will significantly increase due to the additional personnel, materials and general maintenance associated with the equipment. O&M expenses are recoverable through base rates, rather than as part of this program. The future regulatory interpretation, implementation or impact of the Clean Smokestacks Act cannot be predicted.

CLEAN AIR INTERSTATE RULE, MERCURY RULE AND CLEAN AIR VISIBILITY RULE

On March 10, 2005, the EPA issued the final CAIR. The EPA's rule requires 28 states, including North Carolina, South Carolina, Georgia and Florida, and the District of Columbia to reduce NO_x and SO₂ emissions in order to reduce levels of fine particulate matter and impacts to visibility. The CAIR sets emission limits to be met in two phases beginning in 2009 and 2015, respectively, for NO_x and beginning in 2010 and 2015, respectively, for SO₂.

PEF has joined a coalition of Florida utilities that has filed a challenge to the CAIR as it applies to Florida. A petition for reconsideration and stay and a petition for judicial review of the CAIR were filed on July 11, 2005. On October 27, 2005, the DC Circuit Court issued an order granting the motion for stay of the proceedings. On December 2, 2005, the EPA announced a reconsideration of four aspects of the CAIR, including its applicability to Florida. On March 16, 2006, the EPA denied all pending reconsiderations, allowing the challenge to proceed. While we consider it unlikely that this challenge would eliminate the compliance requirements of the CAIR, it could potentially reduce or delay our costs to comply with the CAIR. On June 29, 2006, the Florida Environmental Regulation Commission adopted the Florida CAIR, which is very similar to the EPA's model rule. The outcome of this matter cannot be predicted.

On March 15, 2005, the EPA finalized two separate but related rules: the CAMR that sets emissions limits to be met in two phases beginning in 2010 and 2018, respectively, and encourages a cap and trade approach to achieving those caps, and a de-listing rule that eliminated any requirement to pursue a maximum achievable control technology (MACT) approach for limiting mercury emissions from coal-fired power plants. NO_x and SO₂ controls also are effective in reducing mercury emissions. However, according to the EPA the second phase cap reflects a level of mercury emissions reduction that exceeds the level that would be achieved solely as a co-benefit of controlling NO_x.

and SO₂ under CAIR. States are required to adopt mercury rules implementing the CAMR by November 11, 2006, which must be reviewed and approved by the EPA. At June 30, 2006, of the three states in which the Utilities operate, Florida and North Carolina had formally proposed mercury regulations. North Carolina's proposed rule would adopt the EPA's cap-and-trade approach and would require the addition of mercury controls on certain of PEC's North Carolina units that do not have scrubbers by 2023. On June 29, 2006, the Florida Environmental Regulation Commission adopted the Florida CAMR. The Florida rule adopts the EPA's cap-and-trade approach with changes to the EPA's mercury allowance allocations in the rule's first phase. Formal rulemaking in South Carolina is expected to occur in the summer and fall of 2006. The outcome of this matter cannot be predicted.

The de-listing rule has been challenged by a number of parties; the resolution of the challenges could impact our final compliance plans and costs. On October 21, 2005, the EPA announced a reconsideration of the CAMR. On May 31, 2006, the EPA issued a determination confirming the de-listing. Sixteen states have subsequently petitioned for a review of this determination. The outcome of this matter cannot be predicted.

On June 15, 2005, the EPA issued the final CAVR. The EPA's rule requires states to identify facilities, including power plants, built between August 1962 and August 1977 with the potential to produce emissions that affect visibility in 156 specially protected areas. To help restore visibility in those areas, states must require the identified facilities to install BART to control their emissions. Depending on the approach taken by the states, the reductions associated with BART would begin to take effect in 2014. CAVR included the EPA's determination that compliance with the NO_x and SO₂ requirements of CAIR may be used by states as a BART substitute. We expect that our plans for compliance with the CAIR and CAMR will fulfill BART obligations, but the states could require the installation of additional air quality controls if they do not achieve reasonable progress on improving visibility. PEC's BART-eligible units are Asheville Units No. 1 and No. 2, Roxboro Units No. 1, No. 2 and No. 3, and Sutton Unit No. 3. PEF's BART-eligible units are Anclote Unit No. 1, Bartow Unit No. 3, and Crystal River Units No. 1 and No. 2. The outcome of this matter cannot be predicted.

PEC and PEF are each developing an integrated compliance strategy for the CAIR and CAMR rules because NO_x and SO₂ controls are effective in reducing mercury emissions. We are evaluating various design, technology, and new generation options that could reduce PEC's and PEF's costs required by the CAIR and CAMR.

On October 14, 2005, the FPSC approved PEF's petition for the recovery of costs associated with the development and implementation of an integrated strategy to comply with the CAIR and CAMR through the ECRC. On March 31, 2006, PEF filed a series of compliance alternatives with the FPSC to meet these federal environmental rules. PEF's recommended proposed compliance plan includes approximately \$740 million of estimated capital costs expected to be spent through 2016, to plan, design, build and install pollution control equipment at our Anclote and Crystal River plants. We expect this matter to be addressed during the FPSC hearings in November 2006, but cannot predict whether this proposed compliance plan, or another compliance plan, will be approved by the FPSC. These costs may increase or decrease depending upon the results of the engineering and strategy development work and FPSC approval of the final compliance plan. Subsequent rule interpretations, equipment availability, or the unexpected acceleration of the initial NO_x or other compliance dates, among other things, could require acceleration of some projects and therefore result in additional costs in 2006.

NORTH CAROLINA ATTORNEY GENERAL PETITION UNDER SECTION 126 OF THE CLEAN AIR ACT

In March 2004, the North Carolina Attorney General filed a petition with the EPA, under Section 126 of the Clean Air Act, asking the federal government to force coal-fired power plants in 13 other states, including South Carolina, to reduce their NO_x and SO₂ emissions. The state of North Carolina contends these out-of-state emissions interfere with North Carolina's ability to meet national air quality standards for ozone and particulate matter. On March 16, 2006, the EPA issued a final response denying the petition. The EPA's rationale for denial is that compliance with CAIR will reduce the emissions from surrounding states sufficiently to address North Carolina's concerns. On June 26, 2006, the North Carolina Attorney General filed a petition in the U.S. Court of Appeals for the District of Columbia Circuit seeking a review of the agency's final action on the petition. The outcome of this matter cannot be predicted.

On December 21, 2005, the EPA announced proposed changes to the National Ambient Air Quality Standards (NAAQS) for particulate matter. The EPA proposed to lower the 24-hour standard for particulate matter less than 2.5 microns in diameter from 65 micrograms per cubic meter to 35 micrograms per cubic meter. In addition, the EPA proposed to establish a new 24-hour standard of 70 micrograms per cubic meter for particulate matter that is between 2.5 and 10 microns in diameter. The EPA also proposed to eliminate the current standards for particulate matter less than 10 microns in diameter. The EPA is scheduled to finalize the NAAQS standards by September 27, 2006. The changes could ultimately result in increased costs for installation of additional pollution controls at facilities operated by PEC and PEF. The outcome of this matter cannot be predicted.

WATER QUALITY

As a result of the operation of certain control equipment needed to address the air quality issues outlined above, new wastewater streams may be generated at the affected facilities. Integration of these new wastewater streams into the existing wastewater treatment processes may result in permitting, construction and treatment requirements imposed on the Utilities in the immediate and extended future. Section 316(b) of the Clean Water Act requires assessment of the environmental effect of withdrawal of water at our facilities. The outcome of this matter cannot be predicted.

C. Other Environmental Matters

GLOBAL CLIMATE CHANGE

The Kyoto Protocol was adopted in 1997 by the United Nations to address global climate change by reducing emissions of CO₂ and other greenhouse gases. The treaty went into effect on February 16, 2005. The United States has not adopted the Kyoto Protocol, and the Bush administration has stated it favors voluntary programs. There are proposals to address global climate change that would regulate CO₂ and other greenhouse gases. Reductions in CO₂ emissions to the levels specified by the Kyoto Protocol and some additional proposals could be materially adverse to our financial position or results of operations if associated costs of control or limitation cannot be recovered from customers. We have articulated principles that we believe should be incorporated into any global climate change policy. While the outcome of this matter cannot be predicted, we are taking voluntary action on this important issue as part of our commitment to environmental stewardship and responsible corporate citizenship.

In a decision issued July 15, 2005, a three-judge panel of the U.S. Court of Appeals for the District of Columbia Circuit denied petitions for review filed by several states, cities and organizations seeking the regulation by the EPA of CO₂ emissions under the Clean Air Act. In a 2-1 decision, the court held that the EPA administrator properly exercised his discretion in denying the request for regulation. Officials from five states and the District of Columbia asked the full U.S. Court of Appeals for the D.C. Circuit to review the decision made by the three-judge panel. On December 2, 2005, the U.S. Court of Appeals denied the request for rehearing. On March 2, 2006, the petitioners filed a petition for writ of certiorari with the U.S. Supreme Court, seeking a review of the U.S. Court of Appeals decision. On June 26, 2006, the U.S. Supreme Court agreed to review the decision. The outcome of this matter cannot be predicted.

In 2005, we initiated a study to assess the impact of constraints on CO₂ and other air emissions and on March 27, 2006, we issued our report to shareholders for an assessment of global climate change and air quality risks and actions. While we participate in the development of a national climate change policy framework, we will continue to actively engage others in our region to develop consensus-based solutions, as we did with the Clean Smokestacks Act.

14. COMMITMENTS AND CONTINGENCIES

Contingencies and significant changes to the commitments discussed in Note 23 to the 2005 Form 10-K are described below.

A. Guarantees

As a part of normal business, we enter into various agreements providing future financial or performance assurances to third parties, which are outside the scope of FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure

Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others” (FIN No. 45). Such agreements include guarantees, standby letters of credit and surety bonds. At June 30, 2006, we do not believe conditions are likely for significant performance under these guarantees. To the extent liabilities are incurred as a result of the activities covered by the guarantees, such liabilities are included in the accompanying Balance Sheets.

At June 30, 2006, we have issued guarantees and indemnifications of certain asset performance, legal, tax and environmental matters to third parties, including indemnifications made in connection with sales of businesses, and for timely payment of obligations in support of our nonwholly owned synthetic fuel operations. Related to the sales of businesses, the latest notice period extends until 2012 for the majority of legal, tax and environmental matters provided for in the indemnification provisions. Indemnifications for the performance of assets extend to 2016. For matters for which we receive timely notice, our indemnity obligations may extend beyond the notice period. Certain indemnifications have no limitations as to time or maximum potential future payments. In 2005, PEC entered into a contract with the joint owner of certain facilities at the Mayo and Roxboro plants to limit their aggregate costs associated with capital expenditures to comply with the Clean Smokestacks Act and recognized a liability related to this indemnification (See Note 13B). PEC's maximum exposure cannot be determined. At June 30, 2006, the maximum exposure for guarantees and indemnifications for which a maximum exposure is determinable was \$208 million, including \$32 million at PEF. At June 30, 2006 and December 31, 2005, we have recorded liabilities related to guarantees and indemnifications to third parties of approximately \$59 million and \$41 million, respectively. These amounts include \$21 million and \$16 million, respectively, for PEC at June 30, 2006 and December 31, 2005, and \$8 million for PEF at June 30, 2006. PEF had no liabilities related to guarantees and indemnifications to third parties at December 31, 2005. As current estimates change, it is possible that additional losses related to guarantees and indemnifications to third parties, which could be material, may be recorded in the future.

In addition, the Parent has issued \$300 million of guarantees of certain payments of two wholly owned indirect subsidiaries. See Note 15 for additional information.

B. Other Commitments and Contingencies

1. Spent Nuclear Fuel Matters

Pursuant to the Nuclear Waste Policy Act of 1982, the predecessors to the Utilities entered into contracts with the United States Department of Energy (DOE) under which the DOE agreed to begin taking spent nuclear fuel by no later than January 31, 1998. All similarly situated utilities were required to sign the same standard contract.

The DOE failed to begin taking spent nuclear fuel by January 31, 1998. In January 2004, the Utilities filed a complaint in the United States Court of Federal Claims against the DOE, claiming that the DOE breached the Standard Contract for Disposal of Spent Nuclear Fuel by failing to accept spent nuclear fuel from our various facilities on or before January 31, 1998. Our damages due to the DOE's breach will be significant, but have yet to be determined. Approximately 60 cases involving the government's actions in connection with spent nuclear fuel are currently pending in the Court of Federal Claims.

The DOE and the Utilities agreed to, and the trial court entered, a stay of proceedings, in order to allow for possible efficiencies due to the resolution of legal and factual issues in previously filed cases in which similar claims are being pursued by other plaintiffs. These issues may include, among others, so-called “rate issues,” or the minimum mandatory schedule for the acceptance of spent nuclear fuel and high-level waste by which the government was contractually obligated to accept contract holders' spent nuclear fuel and/or high-level waste, and issues regarding recovery of damages under a partial breach of contract theory that will be alleged to occur in the future. These issues have been or are expected to be presented in the trials or appeals that are currently scheduled to occur during 2006 and 2007. Resolution of these issues in other cases could facilitate agreements by the parties in the Utilities' lawsuit, or at a minimum, inform the court of decisions reached by other courts if they remain contested and require resolution in this case. In July 2005, the parties jointly requested a continuance of the stay through December 15, 2005, which the trial court granted. Subsequently, the trial court continued the stay until March 17, 2006. The trial court lifted the stay on March 22, 2006 and discovery has commenced. The trial court's scheduling order, issued on March 23, 2006, included an anticipated trial date in late 2007.

In July 2002, Congress passed an override resolution to Nevada's veto of the DOE's proposal to locate a permanent underground nuclear waste storage facility at Yucca Mountain, Nev. In January 2003, the state of Nevada; Clark

County, Nev.; and Las Vegas petitioned the U.S. Court of Appeals for the District of Columbia Circuit for review of the Congressional override resolution. These same parties also challenged the EPA's radiation standards for Yucca Mountain. On July 9, 2004, the Court rejected the challenge to the constitutionality of the resolution approving Yucca Mountain, but ruled that the EPA was wrong to set a 10,000-year compliance period in the radiation protection standard. In August 2005, the EPA issued new proposed standards. The proposed standards include a 1,000,000-year compliance period in the radiation protection standard. Comments were due November 21, 2005, and are being reviewed by the EPA. The EPA plans to issue a new safety standard for the repository by 2007. The DOE originally planned to submit a license application to the NRC to construct the Yucca Mountain facility by the end of 2004. However, in November 2004, the DOE announced it would not submit the license application until mid-2005 or later. The DOE did not submit the license application in 2005 and recently reported that the license application will not be submitted until after September 2007. Congress approved \$450 million for fiscal year 2006 for the Yucca Mountain project, approximately \$201 million less than requested by the DOE. The DOE has acknowledged that a working repository will not be operational until sometime after 2010. The DOE has not identified a new target date for placing the repository in service, but they have stated that they expect it to be open by 2020. The Utilities cannot predict the outcome of this matter.

With certain modifications and additional approval by the NRC, including the installation of onsite dry storage facilities at Robinson Nuclear Plant (Robinson), Brunswick and Crystal River Unit No. 3 (CR3), the Utilities' spent nuclear fuel storage facilities will be sufficient to provide storage space for spent fuel generated on their respective systems through the expiration of the operating licenses, including any license extensions, for all of their nuclear generating units.

2. Synthetic Fuel Matters

On May 15, 2005, the original owners of the Earthco synthetic fuel facilities filed suit in New York state court alleging breach of contract against the Progress Fuels subsidiaries that purchased the Earthco facilities (Progress Fuels Subsidiaries). The plaintiffs also named us as a defendant. The case is now resolved and dismissed.

The plaintiffs' position in the lawsuit was that periodic payments otherwise due to them under the sales arrangement with the Progress Fuels Subsidiaries were, contrary to the sales agreement, being escrowed pending the outcome of the Internal Revenue Service (IRS) audit of the Earthco facilities. The Progress Fuels Subsidiaries believed that the parties' agreements allowed for the payments to be escrowed in such event and also allowed for the use of such escrowed amounts to satisfy any potential disallowance of tax credits that could have arisen out of such an event. The escrowed amount in question was \$103 million, which reflected periodic payments that would have been paid to the plaintiffs beginning April 30, 2003 through May 18, 2006. In light of the successful outcome of the IRS audit of the Earthco facilities, the parties agreed to resolve the case. The Progress Fuels Subsidiaries paid the plaintiffs the funds held in escrow in exchange for a release of claims and dismissal of the lawsuit, which occurred on May 18, 2006.

A number of our subsidiaries and affiliates are parties to two lawsuits arising out of an Asset Purchase Agreement dated as of October 19, 1999, by and among U.S. Global, LLC (Global), Earthco, certain affiliates of Earthco (collectively the Earthco Sellers), EFC Synfuel LLC (which is owned indirectly by Progress Energy, Inc.) and certain of its affiliates, including Solid Energy LLC, Solid Fuel LLC, Ceredo Synfuel LLC, Gulf Coast Synfuel LLC (currently named Sandy River Synfuel LLC) (collectively the Progress Affiliates), as amended by an amendment to Purchase Agreement as of August 23, 2000 (the Asset Purchase Agreement). Global has asserted that (1) pursuant to the Asset Purchase Agreement it is entitled to an interest in two synthetic fuel facilities currently owned by the Progress Affiliates and an option to purchase additional interests in the two synthetic fuel facilities, (2) that it is entitled to damages because Progress Affiliates prohibited it from procuring purchasers for the synthetic fuel facilities, and (3) that it is entitled to immediate payment of tonnage fees held in escrow (this claim is identical to the position taken by Earthco as described above).

The first suit, U.S. Global, LLC v. Progress Energy, Inc. et al., asserts the above claims in a case filed in the Circuit Court for Broward County, Florida, in March 2003 (the Florida Global Case), and requests an unspecified amount of compensatory damages, as well as declaratory relief. The Progress Affiliates have answered the Complaint by generally denying all of Global's substantive allegations and asserting numerous substantial affirmative defenses. The case is at issue, but neither party has requested a trial. The parties are currently engaged in discovery in the Florida Global Case.

The second suit, Progress Synfuel Holdings, Inc. et al. v. U.S. Global, LLC, was filed by the Progress Affiliates in the Superior Court for Wake County, N.C., seeking declaratory relief consistent with our interpretation of the asset Purchase Agreement (the North Carolina Global Case). Global was served with the North Carolina Global Case on April 17, 2003.

On May 15, 2003, Global moved to dismiss the North Carolina Global Case for lack of personal jurisdiction over Global. In the alternative, Global requested that the court decline to exercise its discretion to hear the Progress Affiliates' declaratory judgment action. On August 7, 2003, the Wake County Superior court denied Global's motion to dismiss, but stayed the North Carolina Global Case, pending the outcome of the Florida Global Case. The Progress Affiliates appealed the Superior court's order staying the case. By order dated September 7, 2004, the North Carolina Court of Appeals dismissed the Progress Affiliates' appeal.

We have escrowed \$41 million that otherwise would have been paid to Global through June 30, 2006. These funds are being escrowed on the same basis as the funds that were escrowed for the original owners of the Earthco facilities as discussed above. We have sent communication to Global regarding the negotiation of terms under which the funds might be released given the successful resolution of the IRS audit of the Earthco facilities.

We cannot predict the outcome of this matter.

3. Other Litigation Matters

We and our subsidiaries are involved in various litigation matters in the ordinary course of business, some of which involve substantial amounts. Where appropriate, we have made accruals and disclosures in accordance with SFAS No. 5 to provide for such matters. In the opinion of management, the final disposition of pending litigation would not have a material adverse effect on our consolidated results of operations or financial position.

15. CONDENSED CONSOLIDATING STATEMENTS

As discussed in Note 24 to the 2005 Form 10-K, we have guaranteed certain payments of two wholly owned indirect subsidiaries, FPC Capital I (the Trust) and Florida Progress Funding Corporation (Funding Corp.) since September 2005. Our guarantees are joint and several, full and unconditional and are in addition to the joint and several, full and unconditional guarantees previously issued to the Trust and Funding Corp. by Florida Progress Corporation (Florida Progress). Our subsidiaries have provisions restricting the payment of dividends to the Parent in certain limited circumstances and as disclosed in Note 12B to the 2005 Form 10-K, there were no restrictions on PEC's or PEF's retained earnings.

The Trust is a special-purpose entity and was deconsolidated in 2003 in accordance with the provisions of FIN No. 46. The deconsolidation was not material to our financial statements. Separate financial statements and other disclosures concerning the Trust have not been presented because we believe that such information is not material to investors.

Presented below are the condensed consolidating Statements of Income, Balance Sheets and Cash Flows as required by Rule 3-10 of Regulation S-X. In these condensed consolidating statements, the Parent column includes the financial results of the parent holding company only. The Subsidiary Guarantor column includes the financial results of Florida Progress. The Other column includes the consolidated financial results of all other non-guarantor subsidiaries and elimination entries for all intercompany transactions. All applicable corporate expenses have been allocated appropriately among the guarantor and non-guarantor subsidiaries. The financial information may not necessarily be indicative of results of operations or financial position had the Subsidiary Guarantor or other non-guarantor subsidiaries operated as independent entities. The accompanying condensed consolidating financial statements have been restated for all periods presented to reflect the operations of the coal mines, PT LLC, DeSoto and Rowan as discontinued operations as described in Note 3.

Condensed Consolidating Statement of Income
Three Months Ended June 30, 2006

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Operating revenues				
Electric	\$ -	\$ 1,147	\$ 935	\$ 2,082
Diversified business	-	274	143	417
Total operating revenues	-	1,421	1,078	2,499
Operating expenses				
Utility				
Fuel used in electric generation	-	447	262	709
Purchased power	-	180	80	260
Operation and maintenance	3	178	236	417
Depreciation and amortization	-	98	136	234
Taxes other than on income	-	76	44	120
Other	-	1	(1)	-
Diversified business				
Cost of sales	-	226	172	398
Depreciation and amortization	-	17	16	33
Impairment of assets	-	44	47	91
Other	-	17	11	28
Total operating expenses	3	1,284	1,003	2,290
Operating (loss) income	(3)	137	75	209
Other income (expense), net	12	9	(3)	18
Interest charges, net	69	49	53	171
(Loss) income from continuing operations before income tax, equity in earnings of consolidated subsidiaries and minority interest	(60)	97	19	56
Income tax (benefit) expense	(26)	36	25	35
Equity in earnings of consolidated subsidiaries	(13)	-	13	-
Minority interest in subsidiaries' income, net of tax	-	7	-	7
(Loss) income from continuing operations	(47)	54	7	14
Discontinued operations, net of tax	-	2	(63)	(61)
Net (loss) income	\$ (47)	\$ 56	\$ (56)	\$ (47)

Condensed Consolidating Statement of Income
Three Months Ended June 30, 2005

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Operating revenues				
Electric	\$ -	\$ 908	\$ 860	\$ 1,768
Diversified business	-	364	133	497
Total operating revenues	-	1,272	993	2,265
Operating expenses				
Utility				
Fuel used in electric generation	-	313	216	529
Purchased power	-	144	73	217
Operation and maintenance	5	288	250	543
Depreciation and amortization	-	71	136	207
Taxes other than on income	-	66	42	108
Other	-	(25)	-	(25)
Diversified business				
Cost of sales	-	344	148	492
Depreciation and amortization	-	16	16	32
Other	-	17	9	26
Total operating expenses	5	1,234	890	2,129
Operating (loss) income	(5)	38	103	136
Other income (expense), net	14	(4)	(12)	(2)
Interest charges, net	75	46	38	159
(Loss) income from continuing operations before income tax, equity in earnings of consolidated subsidiaries and minority interest	(66)	(12)	53	(25)
Income tax benefit	19	4	-	23
Equity in earnings of consolidated subsidiaries	46	-	(46)	-
Minority interest in subsidiaries' loss, net of tax	-	8	-	8
(Loss) income from continuing operations	(1)	-	7	6
Discontinued operations, net of tax	-	(8)	1	(7)
Net (loss) income	\$ (1)	\$ (8)	\$ 8	\$ (1)

Condensed Consolidating Statement of Income
Six Months Ended June 30, 2006

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Operating revenues				
Electric	\$ -	\$ 2,154	\$ 1,913	\$ 4,067
Diversified business	-	556	302	858
Total operating revenues	-	2,710	2,215	4,925
Operating expenses				
Utility				
Fuel used in electric generation	-	841	558	1,399
Purchased power	-	345	144	489
Operation and maintenance	7	344	482	833
Depreciation and amortization	-	193	269	462
Taxes other than on income	-	149	90	239
Other	-	(2)	-	(2)
Diversified business				
Cost of sales	-	482	318	800
Depreciation and amortization	-	35	30	65
Impairment of assets	-	44	111	155
Other	-	24	19	43
Total operating expenses	7	2,455	2,021	4,483
Operating (loss) income	(7)	255	194	442
Other income (expense), net	2	38	(7)	33
Interest charges, net	146	101	100	347
(Loss) income from continuing operations before income tax, equity in earnings of consolidated subsidiaries and minority interest	(151)	192	87	128
Income tax (benefit) expense	(59)	63	44	48
Equity in earnings of consolidated subsidiaries	90	-	(90)	-
Minority interest in subsidiaries' income, net of tax	-	14	-	14
(Loss) income from continuing operations	(2)	115	(47)	66
Discontinued operations, net of tax	-	1	(69)	(68)
Net (loss) income	\$ (2)	\$ 116	\$ (116)	\$ (2)

Condensed Consolidating Statement of Income
Six Months Ended June 30, 2005

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Operating revenues				
Electric	\$ -	\$ 1,756	\$ 1,795	\$ 3,551
Diversified business	-	663	193	856
Total operating revenues	-	2,419	1,988	4,407
Operating expenses				
Utility				
Fuel used in electric generation	-	615	464	1,079
Purchased power	-	275	140	415
Operation and maintenance	9	477	463	949
Depreciation and amortization	-	141	274	415
Taxes other than on income	4	133	88	225
Other	-	(25)	-	(25)
Diversified business				
Cost of sales	-	625	228	853
Depreciation and amortization	-	32	27	59
Other	-	33	18	51
Total operating expenses	13	2,306	1,702	4,021
Operating (loss) income	(13)	113	286	386
Other income (expense), net	32	(5)	(24)	3
Interest charges, net	154	90	74	318
(Loss) income from continuing operations before income tax, equity in earnings of consolidated subsidiaries and minority interest	(135)	18	188	71
Income tax (benefit) expense	(38)	(10)	23	(25)
Equity in earnings of consolidated subsidiaries	189	-	(189)	-
Minority interest in subsidiaries' loss, net of tax	-	16	-	16
Income (loss) from continuing operations	92	44	(24)	112
Discontinued operations, net of tax	-	(34)	14	(20)
Net income (loss)	\$ 92	\$ 10	\$ (10)	\$ 92

Condensed Consolidating Balance Sheet
June 30, 2006

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Utility plant, net	\$ -	\$ 6,036	\$ 8,671	\$ 14,707
Current assets				
Cash and cash equivalents	-	107	157	264
Short-term investments	-	45	50	95
Notes receivables from affiliated companies	310	15	(325)	-
Deferred fuel cost	-	178	271	449
Assets of discontinued operations	-	42	342	384
Other current assets	13	1,105	1,026	2,144
Total current assets	323	1,492	1,521	3,336
Deferred debits and other assets				
Investment in consolidated subsidiaries	11,415	-	(11,415)	-
Goodwill	-	2	3,653	3,655
Other assets and deferred debits	256	2,027	2,173	4,456
Total deferred debits and other assets	11,671	2,029	(5,589)	8,111
Total assets	\$ 11,994	\$ 9,557	\$ 4,603	\$ 26,154
Capitalization				
Common stock equity	\$ 7,844	\$ 3,028	\$ (3,028)	\$ 7,844
Preferred stock of subsidiaries - not subject to mandatory redemption	-	34	59	93
Minority interest	-	11	5	16
Long-term debt, affiliate	-	440	(170)	270
Long-term debt, net	3,520	2,634	3,668	9,822
Total capitalization	11,364	6,147	534	18,045
Current liabilities				
Current portion of long-term debt	351	109	-	460
Notes payable to affiliated companies	-	205	(205)	-
Liabilities of discontinued operations	-	22	10	32
Other current liabilities	233	969	826	2,028
Total current liabilities	584	1,305	631	2,520
Deferred credits and other liabilities				
Noncurrent income tax liabilities	-	12	234	246
Regulatory liabilities	-	1,159	1,341	2,500
Accrued pension and other benefits	12	318	574	904
Other liabilities and deferred credits	34	616	1,289	1,939
Total deferred credits and other liabilities	46	2,105	3,438	5,589
Total capitalization and liabilities	\$ 11,994	\$ 9,557	\$ 4,603	\$ 26,154

Condensed Consolidating Balance Sheet
December 31, 2005

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Utility plant, net	\$ -	\$ 5,821	\$ 8,621	\$ 14,442
Current assets				
Cash and cash equivalents	239	241	126	606
Short-term investments	-	-	191	191
Notes receivables from affiliated companies	467	-	(467)	-
Deferred fuel cost	-	341	261	602
Assets of discontinued operations	-	223	499	722
Other current assets	22	1,057	1,127	2,206
Total current assets	728	1,862	1,737	4,327
Deferred debits and other assets				
Investment in consolidated subsidiaries	11,594	-	(11,594)	-
Goodwill	-	2	3,717	3,719
Other assets and deferred debits	259	2,072	2,205	4,536
Total deferred debits and other assets	11,853	2,074	(5,672)	8,255
Total assets	\$ 12,581	\$ 9,757	\$ 4,686	\$ 27,024
Capitalization				
Common stock equity	\$ 8,038	\$ 3,039	\$ (3,039)	\$ 8,038
Preferred stock of subsidiaries - not subject to mandatory redemption	-	34	59	93
Minority interest	-	38	5	43
Long-term debt, affiliate	-	440	(170)	270
Long-term debt, net	3,873	2,636	3,667	10,176
Total capitalization	11,911	6,187	522	18,620
Current liabilities				
Current portion of long-term debt	404	109	-	513
Notes payable to affiliated companies	-	315	(315)	-
Short-term obligations	-	102	73	175
Liabilities of discontinued operations	-	87	4	91
Other current liabilities	245	843	1,019	2,107
Total current liabilities	649	1,456	781	2,886
Deferred credits and other liabilities				
Noncurrent income tax liabilities	-	62	215	277
Regulatory liabilities	-	1,189	1,338	2,527
Accrued pension and other benefits	12	307	551	870
Other liabilities and deferred credits	9	556	1,279	1,844
Total deferred credits and other liabilities	21	2,114	3,383	5,518
Total capitalization and liabilities	\$ 12,581	\$ 9,757	\$ 4,686	\$ 27,024

Condensed Consolidating Statement of Cash Flows
Six Months Ended June 30, 2006

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Net cash provided by operating activities	\$ 254	\$ 598	\$ 193	\$ 1,045
Investing activities				
Gross utility property additions	-	(362)	(307)	(669)
Diversified business property additions	-	(92)	-	(92)
Nuclear fuel additions	-	(6)	(56)	(62)
Proceeds from sales of discontinued operations and other assets, net of cash divested	-	137	84	221
Purchases of available-for-sale securities and other investments	(163)	(329)	(464)	(956)
Proceeds from sales of available-for-sale securities and other investments	163	383	580	1,126
Changes in advances to affiliates	164	(2)	(162)	-
Other investing activities	(4)	(2)	(8)	(14)
Net cash provided (used) by investing activities	160	(273)	(333)	(446)
Financing activities				
Issuance of common stock	60	-	-	60
Proceeds from issuance of long-term debt	397	-	-	397
Net decrease in short-term indebtedness	-	(102)	(73)	(175)
Retirement of long-term debt	(800)	(2)	-	(802)
Dividends paid on common stock	(303)	-	-	(303)
Dividends paid to parent	-	(163)	163	-
Cash distributions to minority interests of consolidated subsidiary	-	(74)	-	(74)
Changes in advances from affiliates	-	(114)	114	-
Other financing activities	(7)	8	(42)	(41)
Net cash (used) provided by financing activities	(653)	(447)	162	(938)
Cash (used) provided by discontinued operations				
Operating activities	-	(6)	10	4
Investing activities	-	(6)	(1)	(7)
Financing activities	-	-	-	-
Net (decrease) increase in cash and cash equivalents	(239)	(134)	31	(342)
Cash and cash equivalents at beginning of period	239	241	126	606
Cash and cash equivalents at end of period	\$ -	\$ 107	\$ 157	\$ 264

Condensed Consolidating Statement of Cash Flows
Six Months Ended June 30, 2005

(in millions)	Parent	Subsidiary Guarantor	Other	Progress Energy, Inc.
Net cash provided by operating activities	\$ 125	\$ 170	\$ 234	\$ 529
Investing activities				
Gross utility property additions	-	(253)	(286)	(539)
Diversified business property additions	-	(103)	(17)	(120)
Nuclear fuel additions	-	(34)	(33)	(67)
Proceeds from sales of discontinued operations and other assets, net of cash divested	-	443	1	444
Purchases of available-for-sale securities and other investments	(1,665)	(177)	(1,363)	(3,205)
Proceeds from sales of available-for-sale securities and other investments	1,643	177	1,409	3,229
Changes in advances to affiliates	90	(31)	(59)	-
Proceeds from repayment of long-term affiliate debt	369	-	(369)	-
Other investing activities	(11)	(10)	(2)	(23)
Net cash provided (used) by investing activities	426	12	(719)	(281)
Financing activities				
Issuance of common stock	171	-	-	171
Proceeds from issuance of long-term debt	-	297	495	792
Net decrease in short-term indebtedness	(170)	(32)	(79)	(281)
Retirement of long-term debt	(160)	(57)	(300)	(517)
Retirement of long-term affiliate debt	-	(369)	369	-
Dividends paid on common stock	(289)	-	-	(289)
Changes in advances from affiliates	-	(26)	26	-
Other financing activities	(8)	32	(48)	(24)
Net cash (used) provided by financing activities	(456)	(155)	463	(148)
Cash (used) provided by discontinued operations				
Operating activities	-	(15)	14	(1)
Investing activities	-	(13)	(1)	(14)
Financing activities	-	-	-	-
Net increase (decrease) in cash and cash equivalents	95	(1)	(9)	85
Cash and cash equivalents at beginning of period	5	24	27	56
Cash and cash equivalents at end of period	\$ 100	\$ 23	\$ 18	\$ 141

16. SUBSEQUENT EVENT

On July 12, 2006, our board of directors approved a plan to divest of our natural gas drilling and production business (Gas), which includes Winchester Production Company, Westchester Gas Company, Texas Gas Gathering and Talco Midstream Assets. On July 22, 2006, we entered into a definitive agreement to sell Gas to Dallas, Texas-based EXCO Resources, Inc. for \$1.2 billion in gross cash proceeds. Proceeds from the sale will be used to reduce holding company debt and for other corporate purposes.

The transaction is expected to close in October 2006 and is subject to customary closing provisions and adjustments. We expect to report Gas, which is included within our Progress Ventures segment, as discontinued operations in the third quarter of 2006. The carrying amounts for the assets and liabilities of Gas included in the Consolidated Balance Sheet were as follows:

(in millions)	June 30, 2006	December 31, 2005
Total current assets	\$ 38	\$ 52
Total property, plant and equipment, net	528	469
Total other assets	8	8
Total current liabilities	44	68
Total long-term liabilities	93	66
Total capitalization	437	395

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following combined Management's Discussion and Analysis is separately filed by Progress Energy, Inc. (Progress Energy), Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc. (PEC) and Florida Power Corporation d/b/a Progress Energy Florida, Inc. (PEF). Information contained herein relating to PEC and PEF individually is filed by such company on its own behalf. As used in this report, Progress Energy, which includes Progress Energy, Inc. holding company (the Parent) and its regulated and nonregulated subsidiaries on a consolidated basis, is at times referred to as "we", "us" or "our." When discussing Progress Energy's financial information, it necessarily includes the results of PEC and PEF (collectively, the Utilities). The term "Progress Registrants" refers to each of the three separate registrants: Progress Energy, PEC and PEF.

The following Management's Discussion and Analysis contains forward-looking statements that involve estimates, projections, goals, forecasts, assumptions, risks and uncertainties that could cause actual results or outcomes to differ materially from those expressed in the forward-looking statements. Please review "SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS" and Item 1A, "Risk Factors" of Part II herein and in the 2005 Form 10-K for a discussion of the factors that may impact any such forward-looking statements made herein.

Amounts reported in the interim statements of income are not necessarily indicative of amounts expected for the respective annual or future periods due to the effects of seasonal temperature variations on energy consumption and the timing of maintenance on electric generating units, among other factors.

This discussion should be read in conjunction with the accompanying financial statements found elsewhere in this report and in conjunction with the 2005 Form 10-K.

RESULTS OF OPERATIONS

Our reportable business segments and their primary operations include:

- ☐ PEC - primarily engaged in the generation, transmission, distribution and sale of electricity in portions of North Carolina and ☐ South Carolina;
- ☐ PEF - primarily engaged in the generation, transmission, distribution and sale of electricity in portions of Florida; ☐
- ☐ Progress Ventures - primarily engaged in nonregulated electric generation operations and energy marketing activities in Georgia, ☐ as well as natural gas drilling and production in Texas and Louisiana. We have subsequently entered into a definitive agreement to sell our natural gas drilling and production business (See Note 16); and
- ☐ Coal and Synthetic Fuels - primarily engaged in the production and sale of coal-based solid synthetic fuels in Kentucky and West ☐ Virginia, the operation of synthetic fuel facilities for third parties in West Virginia, and coal terminal services in Kentucky and West Virginia. On May 22, 2006, we idled production at our synthetic fuel plants due to significant uncertainty surrounding synthetic fuel production (See Notes 6 and 7 for additional information).

The Corporate and Other segment includes businesses which do not meet the requirements for separate segment reporting disclosure. These businesses are engaged in other nonregulated business areas including holding company operations and Progress Energy Service Company, LLC (PESC) operations.

In 2005, we changed our reportable segments due to changes in the operations of certain businesses and the reclassification of our coal mining business as discontinued operations. In addition, with the sale of our share of Progress Telecom, LLC (PT LLC) in the first quarter of 2006, we reclassified PT LLC's operations as discontinued operations and in the second quarter of 2006, we reclassified two generating facilities' operations previously included in Progress Ventures as discontinued operations. These reportable segment changes reflect the current reporting structure. For comparative purposes, prior year results have been restated to conform to the current presentation. On July 22, 2006, we entered into a definitive agreement to sell our natural gas drilling and production business. As a result we expect to reclassify this portion of Progress Ventures as discontinued operations in the third quarter (See Note 16).

In this section, earnings and the factors affecting earnings for the three and six months ended June 30, 2006 are compared to the same periods in 2005. The discussion begins with a summarized overview of our consolidated earnings, which is followed by a more detailed discussion and analysis by business segment.

OVERVIEW

For the quarter ended June 30, 2006, our net loss was \$47 million, or \$(0.19) per share, compared to net loss of \$1 million, or \$(0.01) per share, for the same period in 2005. The increase in net loss as compared to prior year was due primarily to:

- ☐ The estimated loss on sale of two of our nonregulated plants and the associated valuation allowance recorded against the deferred ☐ tax assets for net operating loss carry forwards.

- ☐ Lower tax credits due to lower synthetic fuel production and higher oil prices.

☐ ☐

- ☐ Impairment of our synthetic fuel assets and a portion of our coal terminal assets primarily due to continued high oil prices.

☐ ☐

- ☐ Additional outage expenses at PEC.

☐ ☐

- ☐ Prior year gain on the sale of our Winter Park distribution assets.

☐ ☐

Partially offsetting these items were:

- ☐ Prior year postretirement and severance expenses related to the 2005 cost-management initiative.

- ☐ The impact of tax levelization.

☐ ☐

- ☐ Favorable retail margin at the Utilities.

☐ ☐

- ☐ Prior year write-off of unrecoverable storm costs at PEF.

☐ ☐

For the six months ended June 30, 2006, our net loss was \$2 million, or \$(0.01) per share, compared to net income of \$92 million, or \$0.37 per share, for the same period in 2005. The decrease in net income as compared to prior year was due primarily to:

- ☐ Lower tax credits due to lower synthetic fuel production and higher oil prices.

☐ ☐

- ☐ The estimated loss on sale of two of our nonregulated plants and the associated valuation allowance recorded against the deferred ☐ tax assets for net operating loss carry forwards.

- ☐ Impairment of our synthetic fuel assets and a portion of our coal terminal assets primarily due to continued high oil prices.

☐ ☐

- ☐ Impairment of goodwill related to our nonregulated plants in Georgia.

☐ ☐

- ☐ Additional outage expenses at PEC.

☐ ☐

- ☐ Unrealized losses recorded on contingent value obligations.

☐ ☐

- ☐ Prior year gain on the sale of our Winter Park distribution assets.

☐ ☐

- ☐ Additional estimated environmental remediation expenses at PEC.

☐ ☐

Partially offsetting these items were:

- ☐ Prior year postretirement and severance expenses related to the 2005 cost-management initiative.
- ☐ The impact of tax levelization.
- ☐ Gain on sale of PT LLC.
- ☐ Increased wholesale margin at PEC.
- ☐ Gain on sale of Level 3 stock acquired as part of the divestiture of PT LLC.
- ☐ Favorable retail margin at PEF.
- ☐ Prior year write-off of unrecoverable storm costs at PEF.
- ☐ The impact of restructuring a long-term coal supply contract at Coal and Synthetic Fuels.

Our segments contributed the following profits or losses for the three and six months ended June 30, 2006 and 2005:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Business Segment				
PEC	\$ 76	\$ 67	\$ 161	\$ 182
PEF	87	10	139	53
Progress Ventures	(8)	6	(43)	12
Coal and synthetic fuels	(91)	23	(77)	20
Total segment profit	64	106	180	267
Corporate and Other	(50)	(100)	(114)	(155)
Income from continuing operations	14	6	66	112
Discontinued operations, net of tax	(61)	(7)	(68)	(20)
Net (loss) income	\$ (47)	\$ (1)	\$ (2)	\$ 92

PROGRESS ENERGY CAROLINAS

PEC contributed segment profits of \$76 million and \$67 million for the three months ended June 30, 2006 and 2005, respectively. The increase in profits for the three months ended June 30, 2006, when compared to the same period in 2005, was primarily due to postretirement and severance expenses incurred in 2005 and favorable retail and wholesale margins. These were partially offset by higher O&M expenses related to outages at nuclear facilities.

PEC contributed segment profits of \$161 million and \$182 million for the six months ended June 30, 2006 and 2005, respectively. The decrease in profits for the six months ended June 30, 2006, when compared to the same period in 2005, was primarily due to higher O&M expenses related to outages at nuclear facilities, additional estimated environmental remediation expenses and unfavorable weather. These were partially offset by postretirement and severance expenses incurred in 2005, favorable wholesale sales and favorable retail customer growth and usage.

Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005

Revenues

PEC's electric revenues for the three months ended June 30, 2006 and 2005, and the percentage change by customer class were as follows:

(in millions)	Three Months Ended June 30,			
	2006	Change	% Change	2005
Customer Class				
Residential	\$ 299	\$ 27	9.9	\$ 272
Commercial	236	22	10.3	214
Industrial	173	9	5.5	164
Governmental	21	3	16.7	18
Total retail revenues	729	61	9.1	668
Wholesale	167	13	8.4	154
Unbilled	14	(1)	-	15
Miscellaneous	25	2	8.7	23
Total electric revenues	935	75	8.7	860
Less: Fuel revenues	(294)	(56)	-	(238)
Revenues excluding fuel	\$ 641	\$ 19	3.1	\$ 622

PEC's energy sales for the three months ended June 30, 2006 and 2005, and the amount and percentage change by customer class were as follows:

(in millions of kWh) Customer Class	Three Months Ended June 30,			2005
	2006	Change	% Change	
Residential	3,438	153	4.7	3,285
Commercial	3,218	131	4.2	3,087
Industrial	3,139	(91)	(2.8)	3,230
Governmental	333	19	6.1	314
Total retail energy sales	10,128	212	2.1	9,916
Wholesale	3,328	(13)	(0.4)	3,341
Unbilled	232	(3)	-	235
Total kWh sales	13,688	196	1.5	13,492

PEC's electric revenues, excluding fuel revenues of \$294 million and \$238 million for the three months ended June 30, 2006 and 2005, respectively, increased \$19 million. The increase in revenues is attributable primarily to favorable retail growth and usage, increased wholesale revenues less fuel and favorable weather. Favorable retail growth and usage of \$10 million was driven by an approximate increase in the average number of customers of 30,000 as of June 30, 2006, compared to June 30, 2005. The increase in wholesale revenues less fuel of \$9 million was driven primarily by the impact of increased capacity under contract, higher excess generation margin due to favorable market conditions and gains on forward sales of excess generation. The impact of weather was \$2 million favorable with cooling degree days 17 percent greater than prior year partially offset by heating degree days 25 percent below prior year.

Expenses

Fuel and Purchased Power

Fuel and purchased power costs represent the costs of generation, which include fuel purchases for generation, as well as energy purchased in the market to meet customer load. Fuel and a portion of purchased power expenses are recovered primarily through cost recovery clauses, and as such, changes in these expenses do not have a material impact on earnings. The difference between fuel and purchased power costs incurred and associated fuel revenues that are subject to recovery is deferred for future collection from or refund to customers.

Fuel and purchased power expenses were \$342 million for the three months ended June 30, 2006, which represents a \$53 million increase compared to the same period in the prior year. Fuel used in electric generation increased \$46 million to \$262 million compared to the prior year. This increase is due to a \$41 million increase in fuel used in generation due primarily to higher fuel costs which are being driven by higher coal, oil and natural gas prices and a change in generation mix primarily due to lower nuclear generation related to nuclear outages. In addition, deferred fuel expense increased \$5 million due to an increase in the fuel recovery rates for North Carolina and South Carolina. Current year purchased power costs were \$7 million higher than the three months ended June 30, 2005, primarily due to higher system requirements and market prices in the second quarter of 2006.

Operation and Maintenance

O&M expenses were \$248 million for the three months ended June 30, 2006, which represents a \$12 million decrease compared to the same period in 2005. O&M expenses decreased \$46 million due to postretirement and severance expense recorded in the prior year related to the 2005 cost-management initiative partially offset by \$26 million related to outages at nuclear facilities and \$2 million due to higher United States Nuclear Regulatory Commission (NRC) fees in 2006.

Total Other Income

Total other income of \$3 million increased \$4 million compared to the three months ended June 30, 2005 primarily due to \$4 million related to the Federal Energy Regulatory Commission (FERC) Code of Conduct audit settlement recorded in the prior year and a \$3 million increase in interest income related to temporary investments partially offset by a \$5 million increase in the indemnification liability recorded for estimated capital costs associated with the

Clean Smokestacks Act expected to be incurred in excess of the maximum billable costs to the joint owner (See Note 13B).

Total Interest Charges, net

Total interest charges, net increased \$9 million for the three months ended June 30, 2006, as compared to the same period in the prior year. This fluctuation is due primarily to the impact of a net increase in long-term debt and higher interest rates on variable rate pollution control bonds.

Income Tax Expense

Income tax expense increased \$20 million for the three months ended June 30, 2006, as compared to the same period in the prior year, primarily due to the impact of higher earnings compared to prior year. Income tax expense also increased due to the allocation of \$5 million of the Parent's tax benefit not related to acquisition interest expense in 2005 that is no longer allocated in 2006. See Corporate and Other below for additional information on the change in the tax benefit allocation in 2006. Accounting principles generally accepted in the United States (GAAP) requires companies to apply a levelized effective tax rate to interim periods that is consistent with the estimated annual effective tax rate. PEC's income tax expense was decreased by \$2 million for the three months ended June 30, 2006 compared to an increase of \$3 million for the three months ended June 30, 2005, in order to maintain an effective tax rate consistent with the estimated annual rate. Fluctuations in estimated annual earnings and the timing of various permanent and temporary deductions can also cause fluctuations in the effective tax rate for interim periods. Therefore, this adjustment will vary each quarter, but will have no effect on net income for the year.

Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005

Revenues

PEC's electric revenues for the six months ended June 30, 2006 and 2005, and the percentage change by customer class were as follows:

(in millions) Customer Class	Six Months Ended June 30,			
	2006	Change	% Change	2005
Residential	\$ 675	\$ 29	4.5	\$ 646
Commercial	462	34	7.9	428
Industrial	336	23	7.3	313
Governmental	41	3	7.9	38
Total retail revenues	1,514	89	6.2	1,425
Wholesale	360	32	9.8	328
Unbilled	(13)	(10)	-	(3)
Miscellaneous	52	7	15.6	45
Total electric revenues	1,913	118	6.6	1,795
Less: Fuel revenues	(612)	(103)	-	(509)
Revenues excluding fuel	\$ 1,301	\$ 15	1.2	\$ 1,286

PEC's energy sales for the six months ended June 30, 2006 and 2005, and the amount and percentage change by customer class were as follows:

(in millions of kWh) Customer Class	Six Months Ended June 30,			2005
	2006	Change	% Change	
Residential	7,856	(101)	(1.3)	7,957
Commercial	6,270	103	1.7	6,167
Industrial	6,071	(90)	(1.5)	6,161
Governmental	653	11	1.7	642
Total retail energy sales	20,850	(77)	(0.4)	20,927
Wholesale	7,286	8	0.1	7,278
Unbilled	(146)	(79)	-	(67)
Total kWh sales	27,990	(148)	(0.5)	28,138

PEC's electric revenues, excluding fuel revenues of \$612 million and \$509 million for the six months ended June 30, 2006 and 2005, respectively, increased \$15 million. The increase in revenues is attributable primarily to increased wholesale revenues less fuel and favorable retail growth and usage, partially offset by unfavorable weather. The increase in wholesale revenues less fuel of \$30 million was driven primarily by the impact of increased capacity under contract, higher excess generation sales due to favorable market conditions and gains on forward sales of excess generation. Favorable retail growth and usage of \$6 million was driven by an approximate increase in the average number of customers of 30,000 as of June 30, 2006, compared to June 30, 2005. The impact of weather was \$13 million unfavorable with heating degree days 12 percent below prior year partially offset by cooling degree days 20 percent greater than last year.

Expenses

Fuel and Purchased Power

Fuel and purchased power expenses were \$702 million for the six months ended June 30, 2006, which represents a \$98 million increase compared to the same period in the prior year. Fuel used in electric generation increased \$94 million to \$558 million compared to the prior year. This increase is due to a \$46 million increase in deferred fuel expense due to an increase in the fuel recovery rates for North Carolina and South Carolina. In addition, fuel used in generation increased \$48 million due primarily to higher fuel costs which are being driven by higher coal, oil and natural gas prices and a change in generation mix primarily due to lower nuclear generation related to nuclear outages. Current year purchased power costs were \$4 million higher than the six months ended June 30, 2005, primarily due to higher prices during the first half of 2006 partially offset by lower system requirements.

Operation and Maintenance

O&M expenses were \$504 million for the six months ended June 30, 2006, which represents a \$20 million increase compared to the same period in 2005. O&M expenses increased \$46 million due to outages at nuclear facilities and \$21 million due to additional estimated environmental remediation expenses (See Note 13A) and \$4 million due to higher NRC fees in 2006. These were partially offset by \$60 million of postretirement and severance expense recorded in the prior year related to the 2005 cost-management initiative.

Depreciation and Amortization

Depreciation and amortization expense was \$255 million for the six months ended June 30, 2006, which represents a \$4 million decrease compared to the same period in 2005. Depreciation expense decreased \$10 million due to lower Clean Smokestacks Act amortization, partially offset by the impact of an increase in the depreciable base.

Total Other Income

Total other income of \$9 million increased \$7 million compared to the six months ended June 30, 2005 primarily due to a \$8 million increase in interest income related to temporary investments and \$4 million related to FERC Code of Conduct audit settlement recorded in the prior year partially offset by a \$5 million increase in the indemnification liability recorded for estimated capital costs associated with the Clean Smokestacks Act expected to be incurred in excess of the maximum billable costs to the joint owner (See Note 13B).

Total Interest Charges, net

Total interest charges, net increased \$14 million for the six months ended June 30, 2006, as compared to the same period in the prior year. This fluctuation is due primarily to the impact of a net increase in long-term debt and higher interest rates on variable rate pollution control bonds.

Income Tax Expense

Income tax expense increased \$16 million for the six months ended June 30, 2006, as compared to the same period in the prior year, primarily due to the allocation of \$11 million of the Parent's tax benefit not related to acquisition interest expense in 2005 that is no longer allocated in 2006 and the \$3 million impact of a 2005 tax credit related to state audit settlements. See Corporate and Other below for additional information on the change in the tax benefit allocation in 2006. GAAP requires companies to apply a levelized effective tax rate to interim periods that is consistent with the estimated annual effective tax rate. PEC's income tax expense was decreased by \$1 million for the six months ended June 30, 2006 compared to an increase of \$3 million for the six months ended June 30, 2005, in order to maintain an effective tax rate consistent with the estimated annual rate. Fluctuations in estimated annual earnings and the timing of various permanent and temporary deductions can also cause fluctuations in the effective tax rate for interim periods. Therefore, this adjustment will vary each quarter, but will have no effect on net income for the year.

PROGRESS ENERGY FLORIDA

PEF contributed segment profits of \$87 million and \$10 million for the three months ended June 30, 2006 and 2005, respectively. The increase in profits for the three months ended June 30, 2006, when compared to the same period in 2005, was primarily due to lower O&M expenses, which included postretirement and severance expenses and the write-off of unrecoverable storm costs in 2005, favorable weather and customer growth and usage partially offset by the gain on sale of utility distribution assets in the prior year and higher interest expense.

PEF contributed segment profits of \$139 million and \$53 million for the six months ended June 30, 2006 and 2005, respectively. The increase in profits for the six months ended June 30, 2006, when compared to the same period in 2005, was primarily due to lower O&M expenses, which included postretirement and severance expenses and the write-off of unrecoverable storm costs in 2005, favorable weather and customer growth and usage partially offset by the gain on sale of utility distribution assets in the prior year and higher interest expense.

Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005

Revenues

PEF's revenues for the three months ended June 30, 2006 and 2005, and the amount and percentage change by customer class were as follows:

(in millions) Customer Class	Three Months Ended June 30,			
	2006	Change	% Change	2005
Residential	\$ 559	\$ 128	29.7	\$ 431
Commercial	291	64	28.2	227
Industrial	91	20	28.2	71
Governmental	74	17	29.8	57
Retail revenue sharing	-	(2)	-	2
Total retail revenues	1,015	227	28.8	788
Wholesale	69	1	1.5	68
Unbilled	23	5	-	18
Miscellaneous	40	6	17.6	34
Total electric revenues	1,147	239	26.3	908
Less: Fuel and other pass-through revenues	(736)	(209)	-	(527)
Revenues excluding fuel and pass-through revenues	\$ 411	\$ 30	7.9	\$ 381

PEF's electric energy sales for the three months ended June 30, 2006 and 2005, and the amount and percentage change by customer class are as follows:

(in millions of kWh) Customer Class	Three Months Ended June 30,			
	2006	Change	% Change	2005
Residential	4,745	404	9.3	4,341
Commercial	3,010	122	4.2	2,888
Industrial	1,100	60	5.8	1,040
Governmental	806	44	5.8	762
Total retail energy sales	9,661	630	7.0	9,031
Wholesale	962	(356)	(27.0)	1,318
Unbilled	779	351	-	428
Total kWh sales	11,402	625	5.8	10,777

PEF's revenues, excluding recoverable fuel and other pass-through revenues of \$736 million and \$527 million for the three months ended June 30, 2006 and 2005, respectively, increased \$30 million. The increase in revenues is primarily due to favorable weather of \$17 million and favorable growth and usage of \$8 million driven by an approximate average net increase in the number of customers of 35,000 for the three months ended June 30, 2006, compared to the three months ended June 30, 2005, even though approximately 14,000 Winter Park customers were transferred from the retail customer class to the wholesale customer class in June of 2005. In addition, wholesale revenues excluding fuel increased by \$2 million due to new contracts in 2005 and 2006, including the addition of Winter Park, and higher demand charges partially offset by the expiration of certain contracts in 2005.

Expenses

Fuel and Purchased Power

Fuel and purchased power costs represent the costs of generation, which include fuel purchases for generation, as well as energy purchased in the market to meet customer load. Fuel and purchased power expenses are recovered primarily through cost recovery clauses, and as such, changes in these expenses do not have a material impact on earnings. The difference between fuel and purchased power costs incurred and associated fuel revenues that are subject to recovery is deferred for future collection from or refund to customers.

Fuel and purchased power expenses were \$627 million for the three months ended June 30, 2006, which represents a \$170 million increase compared to the same period in the prior year. Fuel used in electric generation increased \$134 million to \$447 million compared to the prior year. This increase is due to an \$87 million increase in fuel used in generation due primarily to higher fuel costs which are being driven by higher coal, oil and natural gas prices and an increase in the volume of fuel purchases. In addition, deferred fuel expense increased \$47 million due to an increase in the fuel recovery rates on January 1, 2006. Current year purchased power costs were \$36 million higher than the three months ended June 30, 2005, primarily due to higher system requirements and market prices in the second quarter of 2006 and an increase in capacity recovery rates under the capacity cost recovery clause. The FPSC allows capacity payments to be recovered through a capacity cost recovery clause, which is similar to, and works in conjunction with, energy payments recovered through the fuel cost recovery clause.

Operation and Maintenance

O&M expenses were \$178 million for the three months ended June 30, 2006, which represents a decrease of \$110 million, when compared to the \$288 million incurred during the three months ended June 30, 2005. O&M expenses decreased \$93 million due to postretirement and severance expense recorded in the prior year related to the 2005 cost-management initiative, \$17 million related to the prior year write-off of unrecoverable storm restoration costs and \$5 million related to lower ECRC costs. ECRC costs are pass-through expenses and have no material impact on earnings. These decreases were partially offset by additional expenses related to reliability programs.

Depreciation and Amortization

Depreciation and amortization expense increased \$27 million to \$98 million for the three months ended June 30, 2006. The increase is primarily due to the amortization of \$30 million in storm costs which began in August 2005. Storm cost amortization is a pass-through expense and has no material impact on earnings. In addition, depreciation increased \$2 million due to increases in the depreciable base. These increases were partially offset by the \$4 million impact of rate changes effective January 1, 2006 related to the 2005 depreciation study (See Note 7C of the 2005 Form 10-K).

Taxes other than on Income

Taxes other than on income increased \$10 million to \$76 million compared to the three months ended June 30, 2005. The increase is primarily due to higher gross receipts taxes and franchise taxes due to higher revenues. Gross receipts taxes and franchise taxes are pass-through expenses and have no material impact on earnings.

Other

Other decreased \$26 million from a gain of \$25 million for the three months ended June 30, 2005 to an expense of \$1 million for the three months ended June 30, 2006. The increase is primarily due to the \$25 million prior year gain on the sale of Winter Park distribution assets.

Total Other Income

Total other income increased \$7 million to \$6 million compared to the three months ended June 30, 2005 primarily due to a \$3 million increase in interest income driven by temporary investments and interest on unrecovered storm costs and \$3 million related to FERC Code of Conduct audit settlement recorded in the prior year.

Total Interest Charges, net

Total interest charges, net increased \$6 million for the three months ended June 30, 2006, as compared to the same period in the prior year. This fluctuation is due primarily to the impact of long-term debt balances on interest expense.

Income Tax Expense

Income tax expense increased \$40 million for the three months ended June 30, 2006, as compared to the same period in the prior year, primarily due to higher earnings compared to prior year. In addition, income tax expense increased due to the allocation of \$3 million of the Parent's tax benefit not related to acquisition interest expense in 2005 that

is no longer allocated in 2006. See Corporate and Other below for additional information on the change in the tax benefit allocation in 2006. GAAP requires companies to apply a levelized effective tax rate to interim periods that is consistent with the estimated annual effective tax rate. PEF's income tax expense was not materially impacted for the three months ended June 30, 2006 compared to an increase of \$8 million for the three months ended June 30, 2005, in order to maintain an effective tax rate consistent with the estimated annual rate. Fluctuations in estimated annual earnings and the timing of various permanent and temporary deductions can also cause fluctuations in the effective tax rate for interim periods. Therefore, this adjustment will vary each quarter, but will have no effect on net income for the year.

Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005

Revenues

PEF's revenues for the six months ended June 30, 2006 and 2005, and the amount and percentage change by customer class were as follows:

(in millions) Customer Class	Six Months Ended June 30,			
	2006	Change	% Change	2005
Residential	\$ 1,066	\$ 205	23.8	\$ 861
Commercial	536	108	25.2	428
Industrial	174	40	29.9	134
Governmental	140	30	27.3	110
Retail revenue sharing	1	1	-	-
Total retail revenues	1,917	384	25.0	1,533
Wholesale	137	(5)	(3.5)	142
Unbilled	24	11	-	13
Miscellaneous	76	8	11.8	68
Total electric revenues	2,154	398	22.7	1,756
Less: Fuel and other pass-through revenues	(1,390)	(362)	-	(1,028)
Revenues excluding fuel and pass-through revenues	\$ 764	\$ 36	4.9	\$ 728

PEF's electric energy sales for the six months ended June 30, 2006 and 2005, and the amount and percentage change by customer class are as follows:

(in millions of kWh) Customer Class	Six Months Ended June 30,			
	2006	Change	% Change	2005
Residential	9,056	368	4.2	8,688
Commercial	5,560	101	1.9	5,459
Industrial	2,105	124	6.3	1,981
Governmental	1,527	56	3.8	1,471
Total retail energy sales	18,248	649	3.7	17,599
Wholesale	1,970	(685)	(25.8)	2,655
Unbilled	629	304	-	325
Total kWh sales	20,847	268	1.3	20,579

PEF's revenues, excluding recoverable fuel and other pass-through revenues of \$1.390 billion and \$1.028 billion for the six months ended June 30, 2006 and 2005, respectively, increased \$36 million. The increase in revenues is primarily due to favorable weather of \$18 million, favorable retail growth and usage of \$11 million driven by an approximate average net increase in the number of customers of 33,000 for the six months ended June 30, 2006, compared to the six months ended June 30, 2005, even though approximately 14,000 Winter Park customers were transferred from the retail customer class to the wholesale customer class in June of 2005. These increases were partially offset by a \$2 million decrease in wholesale revenues excluding fuel due to the expiration of certain contracts in 2005 partially offset by new contracts in 2005 and 2006, including the addition of Winter Park, and higher demand charges.

Expenses

Fuel and Purchased Power

Fuel and purchased power expenses were \$1.186 billion for the six months ended June 30, 2006, which represents a \$296 million increase compared to the same period in the prior year. Fuel used in electric generation increased \$226 million to \$841 million compared to the prior year. This increase is due to a \$115 million increase in deferred fuel expense due to an increase in the fuel recovery rates on January 1, 2006. In addition, fuel used in generation increased \$111 million due primarily to higher fuel costs which are being driven by higher coal, oil and natural gas prices and an increase in the volume of fuel purchases. Current year purchased power costs were \$70 million higher than the six months ended June 30, 2005, primarily due to higher system requirements and market prices in the current year as a result of increased fuel costs and an increase in capacity recovery rates under the capacity cost recovery clause. The FPSC allows capacity payments to be recovered through a capacity costs recovery clause, which is similar to, and works in conjunction with, energy payments recovered through the fuel cost recovery clause.

Operation and Maintenance

O&M expenses were \$344 million for the six months ended June 30, 2006, which represents a decrease of \$133 million, when compared to the \$477 million incurred during the six months ended June 30, 2005. O&M expenses decreased \$107 million due to postretirement and severance expense recorded in the prior year related to the 2005 cost-management initiative, \$17 million related to the prior year write-off of unrecovered storm restoration costs and \$10 million related to lower ECRC costs in the current year. ECRC costs are pass-through expenses and have no material impact on earnings.

Depreciation and Amortization

Depreciation and amortization expense increased \$52 million to \$193 million for the six months ended June 30, 2006. The increase is primarily due to the amortization of \$57 million in storm costs which began in August 2005. Storm cost amortization is a pass-through expense and has no material impact on earnings. In addition, depreciation increased \$6 million due to increases in the depreciable base. These increases were partially offset by the \$10 million impact of rate changes effective January 1, 2006 related to the 2005 depreciation study (See Note 7C of the 2005 Form 10-K).

Taxes other than on Income

Taxes other than on income increased \$16 million to \$149 million compared to the six months ended June 30, 2005. The increase is primarily due to higher gross receipts taxes and franchise taxes due to higher revenues. Gross receipts taxes and franchise taxes are pass-through expenses and have no material impact on earnings.

Other

Other decreased \$23 million from a gain of \$25 million for the six months ended June 30, 2005 to a gain of \$2 million for the six months ended June 30, 2006. The decrease is primarily due to the \$25 million prior year gain on the sale of Winter Park distribution assets.

Total Other Income

Total other income increased \$8 million to \$10 million compared to the six months ended June 30, 2005 primarily due to an \$8 million increase in interest income driven by temporary investments and interest on unrecovered storm costs and \$3 million related to FERC Code of Conduct audit settlement recorded in the prior year. These were partially offset by a \$2 million reduction in AFUDC equity primarily due to the completion of Hines Unit 3 during 2005.

Total Interest Charges, net

Total interest charges, net increased \$13 million for the six months ended June 30, 2006, as compared to the same period in the prior year. This fluctuation is due primarily to the impact of higher long-term debt balances on interest expense.

Income Tax Expense

Income tax expense increased \$53 million for the six months ended June 30, 2006, as compared to the same period in the prior year, primarily due to higher earnings compared to prior year. In addition, income tax expense increased due to the allocation of \$7 million of the Parent's tax benefit not related to acquisition interest expense in 2005 that is no longer allocated in 2006. See Corporate and Other below for additional information on the change in the tax benefit allocation in 2006. GAAP requires companies to apply a levelized effective tax rate to interim periods that is consistent with the estimated annual effective tax rate. PEF's income tax expense was not materially impacted for the six months ended June 30, 2006 compared to an increase of \$8 million for the six months ended June 30, 2005, in order to maintain an effective tax rate consistent with the estimated annual rate. Fluctuations in estimated annual earnings and the timing of various permanent and temporary deductions can also cause fluctuations in the effective tax rate for interim periods. Therefore, this adjustment will vary each quarter, but will have no effect on net income for the year.

DIVERSIFIED BUSINESSES

Our diversified businesses consist of the Progress Ventures segment and the Coal and Synthetic Fuels segment. These businesses are explained in more detail below.

PROGRESS VENTURES

The Progress Ventures segment is primarily engaged in nonregulated electric generation operations, energy marketing activities and natural gas drilling and production (Gas). The nonregulated electric generation operations are primarily located in Georgia and service multiple fixed price full-requirements contracts, one of which has a term of 2003 through 2015 with the remaining running from 2005 through 2010. These contracts are primarily served by callable resources from a number of external and Progress Ventures' internal sources. Progress Ventures has also entered into an agreement to provide capacity and associated energy to Georgia Power from 2009 through 2024. In addition, Progress Ventures has entered into an agreement to purchase combined-cycle capacity from Southern Power Company, a subsidiary of Southern Company, from 2009 through 2015. The Gas operations are primarily located in Texas and Louisiana. As described under Recent Developments, we have entered into a definitive agreement to sell Gas.

The following summarizes the quarterly and year-to-date gas production in Bcf equivalent, revenues, gross margin and segment (losses) profits for Progress Ventures:

(\$ in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Gas production in Bcf equivalent	7	6	14	11
Electric revenues	\$ 151	\$ 139	\$ 286	\$ 193
Gas revenues	38	39	107	72
Total revenues	\$ 189	\$ 178	\$ 393	\$ 265
Gross margin				
In millions of \$	\$ 36	\$ 47	\$ 94	\$ 87
As a % of revenues	19%	26%	24%	33%
Segment (losses) profits	\$ (8)	\$ 6	\$ (43)	\$ 12

Progress Ventures revenues increased \$11 million to \$189 million for the three months ended June 30, 2006 compared to same period in 2005. Electric revenues increased \$12 million primarily due to serving an increased load at higher rates on our Georgia contracts. Although electric revenues increased for the three months ended June 30, 2006 due to fixed price full-requirements contracts, margins from these contracts decreased primarily due to higher fuel and power prices. Gas revenues decreased \$1 million primarily due to mark-to-market losses on gas hedges partially offset by increased gas production and higher market prices. The increased mark-to-market losses on the gas hedges are primarily due to the reclassification of deferred losses caused by the discontinuance of the related cash flow hedge accounting due to the anticipated sale of Gas as discussed below in Recent Developments (See Note 10A). The decreased margins on the Georgia contracts and the mark-to-market losses at Gas were the main drivers of

the \$14 million decrease in Progress Venture's segment earnings for the three months ended June 30, 2006 compared to the three months ended June 30, 2005.

Progress Ventures revenues increased \$128 million to \$393 million for the six months ended June 30, 2006 compared to same period in 2005. Electric revenues increased \$93 million primarily due to fixed price full-requirements contracts that began in April 2005 and serving an increased load on a pre-existing contract in Georgia. Although electric revenues increased for the six months ended June 30, 2006 due to fixed price full-requirements contracts, margins from these contracts decreased primarily due to higher fuel and power prices. Gas revenues increased \$35 million primarily due to increased gas production and higher market prices partially offset by mark-to-market losses on gas hedges. The increased mark-to-market losses on the gas hedges are primarily due to the reclassification of deferred losses caused by the discontinuance of the related cash flow hedge accounting due to the anticipated sale of Gas as discussed below in Recent Developments (See Note 10A). In addition to the decreased margins on the Georgia contracts and the mark-to-market losses at Gas, the \$55 million decrease in Progress Venture's segment earnings for the six months ended June 30, 2006 compared to the six months ended June 30, 2005 was unfavorably impacted by the \$64 million pre-tax impairment loss (\$39 million after-tax) on goodwill described below.

In accordance with accounting standards for goodwill, we have monitored the carrying value of our goodwill associated with our Progress Ventures operations. The Progress Ventures electric generation operations were divided into three regions where it had generation plants: South Florida, North Carolina and Georgia. As part of our evaluation of certain business opportunities that may impact the future cash flows of our Georgia Region operations we performed an interim goodwill impairment test during the first quarter of 2006. As a result of this test, we recognized a pre-tax goodwill impairment loss of \$64 million (\$39 million after-tax), the entire amount of goodwill assigned to Progress Ventures (See Note 6). We also entered into a definitive agreement to sell our operations in South Florida and North Carolina and these operations were classified as discontinued operations during the second quarter of 2006 (See Note 3A).

In accordance with accounting standards for long-lived assets, we monitor the carrying value of our long-lived assets associated with our Progress Ventures operations. Future adverse changes in market conditions or changes in business conditions, including the manner in which the remaining long-lived assets are deployed under various strategic alternatives that management is pursuing, could require future impairment evaluations of the \$920 million of remaining long-lived and intangible assets, which could result in a material non-cash impairment charge against earnings.

RECENT DEVELOPMENTS

As part of our strategy to reduce our risk profile and continue our efforts to reduce holding company debt through selected asset sales, we entered into a definitive agreement to sell Gas to Dallas, Texas-based EXCO Resources, Inc. for \$1.2 billion in gross cash proceeds. Proceeds from the sale will be used to reduce holding company debt and for other corporate purposes.

The transaction is expected to close in October 2006 and is subject to customary closing provisions and adjustments. We expect to report Gas as discontinued operations in the third quarter of 2006. As part of this transaction, we will divest of our holdings in Winchester Production Company, Westchester Gas Company, Texas Gas Gathering and Talco Midstream Assets. Specific assets include over 325 Bcf equivalent of proved natural gas reserves, over 350 miles of pipelines, over 500 producing wells and other related assets, all of which are located in Texas and Louisiana.

The following summarizes Progress Ventures' segment (losses) profits by operation and the goodwill impairment discussed above for the three months and six months ended June 30, 2006 and 2005:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Competitive Commercial Operations excluding goodwill impairment	\$ (15)	\$ (6)	\$ (31)	\$ (12)
Goodwill impairment	-	-	(39)	-
Gas operations	7	12	27	24
Segment (losses) profits	\$ (8)	\$ 6	\$ (43)	\$ 12

COAL AND SYNTHETIC FUELS

The Coal and Synthetic Fuels' segment includes synthetic fuels operations and coal terminal operations. The following summarizes Coal and Synthetic Fuels' segment profits:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Synthetic fuel operations	\$ (82)	\$ 23	\$ (79)	\$ 22
Coal terminals and marketing	(1)	9	16	17
Corporate overhead and other operations	(8)	(9)	(14)	(19)
Segment (losses) profits	\$ (91)	\$ 23	\$ (77)	\$ 20

SYNTHETIC FUEL OPERATIONS

The production and sale of synthetic fuels generate operating losses, but qualify for tax credits under Section 29/45K, which typically offset the effect of such losses. Our synthetic fuel operations resulted in the following:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Tons sold	0.5	2.3	1.7	4.3
After-tax losses, excluding tax credits	\$ (25)	\$ (39)	\$ (50)	\$ (77)
After-tax impairment charge	(45)	-	(45)	-
Valuation allowance	(7)	-	(7)	-
Tax credits generated	13	62	48	116
Tax credit inflation adjustment	-	-	10	-
Tax credits reserved due to potential phase-out	(18)	-	(35)	-
Tax credits reversed	-	-	-	(17)
Net (loss) profit	\$ (82)	\$ 23	\$ (79)	\$ 22

Prior to 2006, our synthetic fuel production levels and the amount of tax credits we could claim each year were a function of our projected consolidated regular federal income tax liability. With the redesignation of Section 29 tax credits as Section 45K general business credits, that limitation was removed effective January 1, 2006.

Synthetic fuels' earnings for the three months ended June 30, 2006, as compared to the same period in the prior year, were negatively impacted by the impairment of our synthetic fuel assets, the recording of fewer tax credits in 2006 due to lower production and recording an additional \$18 million tax credit reserve at June 30, 2006 due to high oil prices which increased the potential for a phase-out of tax credits in 2006. In addition, results were unfavorably impacted by the recognition of a valuation allowance recorded against the deferred tax assets for state net operating loss carry forwards. These were partially offset by lower 2006 production which resulted in lower pre-tax losses.

Synthetic fuels' earnings for the six months ended June 30, 2006, as compared to the same period in the prior year, were negatively impacted by the impairment of our synthetic fuel assets, the recording of fewer tax credits in 2006 due to lower production and recording a \$35 million tax credit reserve at June 30, 2006 due to high oil prices which increased the potential for a phase-out of tax credits in 2006. In addition, results were unfavorably impacted by the recognition of a valuation allowance recorded against the deferred tax assets for state net operating loss carry forwards. These were partially offset by the reversal of \$17 million of tax credits in the first quarter of 2005 due to

the loss on sale of Progress Rail, the recording of a \$10 million inflation adjustment to 2005 tax credits and lower 2006 production which resulted in lower pre-tax losses. As a result of the impairment of our synthetic fuel assets, approximately \$12 million of depreciation and amortization expense associated with the impaired assets will not be recorded during the remainder of 2006.

See OTHER MATTERS below for additional information on the impact of oil prices on Section 29/45K tax credits, the results of our interim impairment review and a discussion of uncertainties surrounding our synthetic fuel production in 2006 and 2007.

COAL TERMINALS AND MARKETING

Coal terminals and marketing (Coal) operations blend and transload coal as part of the trucking, rail and barge network for coal delivery. This business also has an operating fee agreement with our synthetic fuel operations for procuring and processing of coal and the transloading and marketing of synthetic fuels. As a result of the relationship with the synthetic fuels operations, fluctuations in Coal's annual earnings are typically related to production volumes at our synthetic fuel plants. Coal operations resulted in a loss of \$1 million for the three months ended June 30, 2006 compared to earnings of \$9 million for the three months ended June 30, 2005. The 2006 loss is driven by the impairment of a portion of Coal's terminal assets which resulted in a pre-tax charge of \$17 million (\$10 million after-tax) for the three months ended June 30, 2006. As a result of this impairment, approximately \$6 million of depreciation expense associated with the impaired assets will not be recorded during the remainder of 2006.

Coal operations contributed earnings of \$16 million and \$17 million for the six months ended June 30, 2006 and 2005, respectively. Coal's results were negatively impacted by the impairment of a portion of Coal's terminal assets which resulted in a pre-tax charge of \$17 million (\$10 million after-tax) and lower revenues related to lower production at our synthetic fuels plants and higher cost of sales due to higher coal prices. These were partially offset by an \$11 million pre-tax reduction in expense related to a restructured coal supply contract and a \$3 million pre-tax gain on the sale of Dixie Fuels Limited (Dixie Fuels). During the first quarter of 2006, one of Coal's supply contracts was restructured resulting in a payment of \$103 million to Coal. These proceeds covered long-term coal supply commitments from 2005 through 2007 and will be recognized over the life of the contract as coal is received and the related inventory is utilized. For the six months ended June 30, 2006, Coal recognized an \$11 million pre-tax reduction in expense related to the restructured coal supply contract for 2005 coal commitments that were not delivered. Future amortization of these proceeds will be wholly offset by the increased contract price and is therefore not expected to materially impact earnings.

See OTHER MATTERS below for additional information on the results of our interim impairment review and its impact on our Coal terminals.

On March 1, 2006, we sold our 65 percent interest in Dixie Fuels for \$16 million to Kirby Corporation which owned the remaining 35 percent interest. Dixie Fuels operated four barge and tugboat units under long-term contracts with PEF and an outside party. Proceeds from the sale were used for debt reduction and other corporate purposes.

CORPORATE OVERHEAD AND OTHER OPERATIONS

Corporate overhead and other operations resulted in after-tax expenses of \$8 million and \$9 million for the three months ended March 31, 2006 and 2005, respectively. The decrease in after-tax expenses for 2006 is primarily due to postretirement and severance expense recorded in the prior year related to the 2005 cost-management initiative. Corporate overhead and other operations recorded after-tax expenses of \$14 million and \$19 million for the six months ended June 30, 2006 and 2005, respectively. The decrease in after-tax expenses for 2006 is primarily due to postretirement and severance expense recorded in the prior year related to the 2005 cost-management initiative.

CORPORATE AND OTHER

The Corporate and Other segment consists of the operations of the Parent, PESC and other consolidating and non-operating entities. Corporate and Other also includes other nonregulated business areas. Corporate and Other income (expense) is summarized below:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Other interest expense	\$ (70)	\$ (69)	\$ (142)	\$ (137)
Contingent value obligations	3	-	(22)	-
Tax levelization	(5)	(49)	(19)	(52)
Tax reallocation	-	(9)	-	(19)
Other income tax benefit	21	32	51	62
Other	1	(5)	18	(9)
Corporate and Other after-tax expense	\$ (50)	\$ (100)	\$ (114)	\$ (155)

Other interest expense, which includes intercompany elimination entries, increased \$1 million to \$70 million for the three months ended June 30, 2006 compared to \$69 million for the three months ended June 30, 2005. Other interest expense, which includes elimination entries, increased \$5 million to \$142 million for the six months ended June 30, 2006 compared to \$137 million for the six months ended June 30, 2005. Interest expense increased primarily due to a decrease in the elimination of intercompany interest expense resulting from lower intercompany debt balances. This was partially offset by having no revolving credit agreement (RCA) balances outstanding or related interest during the six months ended June 30, 2006 compared to \$3 million of interest expense related to outstanding RCA balances during the six months ended June 30, 2005.

Progress Energy issued 98.6 million contingent value obligations (CVOs) in connection with the 2000 acquisition of Florida Progress. Each CVO represents the right of the holder to receive contingent payments based on the performance of four synthetic fuel facilities owned by Progress Energy. The payments, if any, will be based on the net after-tax cash flows the facilities generate. At June 30, 2006 and 2005, the CVOs had fair market values of approximately \$30 million and \$13 million, respectively. We recorded unrealized gains of \$3 million for the three months ended June 30, 2006 and an immaterial unrealized loss for the three months ended June 30, 2005, to record the changes in fair value of the CVOs, which had average unit prices of \$0.30 and \$0.14 at June 30, 2006 and 2005, respectively. We recorded an unrealized loss of \$22 million for the six months ended June 30, 2006. The CVO values at June 30, 2005 were unchanged from the December 31, 2004 values, thus requiring no recognition of unrealized gain or loss for the six months ended June 30, 2005.

GAAP requires companies to apply a levelized effective tax rate to interim periods that is consistent with the estimated annual effective tax rate. Income tax expense was increased by \$5 million and \$49 million for the three months ended June 30, 2006 and 2005, respectively, and \$19 million and \$52 million for the six months ended June 30, 2006 and 2005, respectively, in order to maintain an effective rate consistent with the estimated annual rate. The tax credits associated with our synthetic fuel operations and seasonal fluctuations in our annual earnings primarily drive the fluctuations in the effective tax rate for interim periods. The tax levelization adjustment will vary each quarter, but it will have no effect on net income for the year.

For the three and six months ended June 30, 2006, income tax expense was not increased by the allocation of the Parent's income tax benefits not related to acquisition interest expense to profitable subsidiaries. Due to the repeal of the Public Utility Holding Company Act of 1935, as amended (PUHCA) we will no longer allocate the Parent income tax benefits not related to acquisition interest expense to profitable subsidiaries beginning in 2006. Since 2002, Parent income tax benefits not related to acquisition interest expense were allocated to profitable subsidiaries, in accordance with a PUHCA order. For the three months ended June 30, 2005, income tax expense was increased by \$9 million and for the six months ended June 30, 2005, income tax expense was increased by \$19 million due to the allocation of the Parent's income tax benefit.

For the three months end June 30, 2006, other contributed \$1 million to earnings compared to \$5 million of expense for the same period in 2005. The \$6 million change is primarily due to the pre-tax gain, net of minority interest, on the sale of our remaining interest in Level 3 stock subsequent to the sale of PT LLC (See Notes 3B and 12). For the

six months ended June 30, 2006, other contributed \$18 million to earnings compared to \$9 million of expense in 2005. The \$27 million change is primarily due to the \$17 million pre-tax gain, net of minority interest, on the sale of Level 3 stock. In addition, other changed due to a \$2 million increase in interest income on temporary investments and expenses in 2005 included \$4 million for South Carolina corporate license related to the South Carolina audit settlement.

DISCONTINUED OPERATIONS

DESOTO AND ROWAN GENERATION FACILITIES

On May 2, 2006, our board of directors approved a plan to divest of our DeSoto County Generating Co., LLC (DeSoto) and Rowan County Power, LLC (Rowan) subsidiaries. DeSoto was and Rowan is a subsidiary of Progress Energy Ventures, Inc. DeSoto owns a 320 MW dual-fuel combustion turbine electric generation facility in DeSoto County, Florida and Rowan owns a 925 MW dual-fuel combined cycle and combustion turbine electric generation facility in Rowan County, N.C.. On May 8, 2006, we entered into definitive agreements to sell DeSoto and Rowan, including certain existing power supply contracts, to Southern Power Company, a subsidiary of Southern Company, for a gross purchase price of approximately \$80 million and \$325 million, respectively. We expect to use the proceeds from the sales to reduce debt and for other corporate purposes (See Note 3A).

The sale of DeSoto closed in the second quarter of 2006. The sale of Rowan is expected to close during the third quarter of 2006 and is subject to state and federal regulatory approvals and customary closing conditions. We recorded an after-tax loss on the sale of DeSoto of \$30 million and an estimated after-tax loss on the sale of Rowan of \$32 million. Discontinued DeSoto and Rowan operations had combined losses of \$63 million for the three months ended June 30, 2006 compared to losses of \$1 million for the same period in 2005 and combined losses of \$68 million for the six months ended June 30, 2006 compared to combined losses of \$3 million for the same period in 2005.

PROGRESS TELECOM LLC

On March 20, 2006, we completed the sale of Progress Telecom, LLC (PT LLC) to Level 3. We received gross proceeds comprised of cash of \$69 million and approximately 20 million shares of Level 3 common stock valued at an estimated \$66 million on the date of the sale. Our net proceeds from the sale of \$70 million, after consideration of minority interest, were used to reduce debt. Prior to the sale, we had a 51 percent interest in PT LLC (See Note 3B).

Based on the gross proceeds associated with the sale and after consideration of minority interest, we recorded an estimated after-tax gain on disposal of \$29 million during the six months ended June 30, 2006. Discontinued PT LLC operations had earnings of \$6 million for the three months ended June 30, 2006 compared to \$2 million for the same period in 2005 and earnings of \$24 million for the six months ended June 30, 2006 compared to \$2 million for the same period in 2005.

COAL MINING OPERATIONS

On November 14, 2005, our board of directors approved a plan to divest of five subsidiaries of Progress Fuels engaged in the coal mining business. On May 1, 2006, we sold certain net assets of three of our coal mining businesses to Alpha Natural Resources, LLC for gross proceeds of \$23 million plus an estimated \$4 million working capital adjustment. As a result, during the six months ended June 30, 2006 we recorded an estimated after-tax loss of \$17 million for the sale of these assets. The remaining coal mining operations are expected to be sold by the end of 2006 (See Note 3D).

Discontinued coal mining operations incurred a net loss of \$1 million for both the three months ended June 30, 2006 and 2005 and a net loss of \$21 million for the six months ended June 30, 2006 compared to earnings of less than a million for the same period in 2005. The net loss for the six months ended June 30, 2006 is primarily due to recording a \$17 million after-tax loss on the sale.

On March 24, 2005, we completed the sale of Progress Rail Services Corporation (Progress Rail) to One Equity Partners LLC, a private equity firm unit of J.P. Morgan Chase & Co. Gross cash proceeds from the sale were approximately \$429 million, consisting of \$405 million base proceeds plus a working capital adjustment. Proceeds from the sale were used to reduce debt (See Note 3C).

Rail discontinued operations resulted in losses of \$3 million for the three months ended June 30, 2006 compared to \$7 million for the same period in 2005 and losses of \$3 million for the six months ended June 30, 2006 compared to \$19 million for the same period in 2005.

LIQUIDITY AND CAPITAL RESOURCES

OVERVIEW

Progress Energy, Inc. is a holding company and, as such, has no operations of its own. Our primary cash needs at the Parent level are our common stock dividend and interest and principal payments on our \$3.9 billion of senior unsecured debt. Our ability to meet these needs is dependent on the earnings and cash flows of the Utilities and our nonregulated subsidiaries, and the ability of our subsidiaries to pay dividends or repay funds to us.

Our other significant cash requirements arise primarily from the capital-intensive nature of the Utilities' operations, including expenditures for environmental compliance, and expenditures for our diversified businesses, primarily those of the Progress Ventures segment.

We rely upon our operating cash flow, primarily generated by the Utilities, commercial paper and bank facilities, and our ability to access the long-term debt and equity capital markets for sources of liquidity.

The majority of our operating costs are related to the Utilities. Such costs are recovered from customers in accordance with various rate plans. We are allowed to recover certain fuel, purchased power and other costs incurred by PEC and PEF through their respective recovery clauses. The types of costs recovered through clauses vary by jurisdiction. Fuel price volatility can lead to over- or under-recovery of fuel costs, as changes in fuel prices are not immediately reflected in fuel surcharges due to regulatory lag in setting the surcharges. As a result, fuel price volatility can be both a source of and a use of liquidity resources, depending on what phase of the cycle of price volatility we are experiencing. Changes in the Utilities' fuel and purchased power costs may affect the timing of cash flows, but not materially affect net income.

Cash from operations, asset sales and limited ongoing equity sales from our Investor Plus Stock Purchase Plan and employee benefit and stock option plans are expected to fund capital expenditures and common stock dividends for 2006. We expect to use excess cash proceeds, if any, to reduce debt. To the extent necessary, short-term and long-term debt may also be used as a source of liquidity.

We believe our internal and external liquidity resources will be sufficient to fund our current business plans. Risk factors associated with credit facilities and credit ratings are discussed in the "Risk Factors" section of our 2005 Form 10-K.

The following discussion of our liquidity and capital resources is on a consolidated basis.

CASH FLOWS FROM OPERATIONS

Net cash provided by operating activities increased by \$516 million for the six months ended June 30, 2006, when compared to the corresponding period in the prior year. The increase in operating cash flow was primarily due to a \$170 million increase in the recovery of fuel costs at the Utilities, \$185 million net decrease in working capital and other operating activity needs, and \$64 million of storm restoration costs incurred in the prior year at PEF. In 2005, the Utilities requested and received approval from their respective state commissions for rate increases for fuel cost recovery, including amounts for previous under-recoveries. PEF also received approval from the FPSC authorizing PEF to recover \$245 million over a two-year period, including interest, of the costs it incurred and previously deferred related to PEF's restoration of power to customers associated with the four hurricanes in 2004. See Note 4 for additional information. The decrease in working capital and other operating activity needs was primarily due to

decreases from the change in accounts receivable of \$73 million at PEC and approximately \$80 million at our nonregulated operations primarily due to cessation of our synthetic fuel operations, approximately \$103 million of proceeds received from the restructuring of a long-term coal supply contract, and \$52 million due to fluctuations in emission allowance inventory at PEC. These impacts were partially offset by an \$81 million decrease from the change in accounts payable, primarily driven by reduced purchases at our nonregulated operations.

INVESTING ACTIVITIES

Net cash used in investing activities increased by \$165 million for the six months ended June 30, 2006, when compared to the corresponding period in the prior year. This is due primarily to a \$223 million decrease in proceeds from sales of discontinued operations and other assets for 2006 when compared to the corresponding period in the prior year.

Excluding proceeds from sales of discontinued operations and other assets, cash used in investing activities decreased approximately \$58 million in 2006 when compared with 2005. The decrease is due primarily to a \$146 million increase in net proceeds from available-for-sale securities and other investments, including approximately \$98 million in net proceeds from the sale of Level 3 stock (See Notes 3B and 12), partially offset by \$97 million in additional capital expenditures for property and nuclear fuel additions. Available-for-sale securities and other investments include marketable debt and equity securities and investments held in nuclear decommissioning and benefit investment trusts. The increase in property additions is primarily due to higher spending at the Hines 4 facility and distribution projects at PEF, partially offset by lower spending at the Hines 3 facility.

During the six months ended June 30, 2006, proceeds from sales of discontinued operations and other assets, net of cash divested primarily included approximately \$80 million from the sale of DeSoto (See Note 3A), approximately \$70 million from the sale of PT LLC (See Note 3B), approximately \$27 million from the sale of certain net assets of the coal mining business (See Note 3D), and approximately \$15 million from the sale of Dixie Fuels. During the same period in 2005, proceeds from sales of discontinued operations and other assets primarily included \$393 million in proceeds from the sale of Progress Rail in March 2005, net of cash divested (See Note 3C).

FINANCING ACTIVITIES

Net cash used in financing activities increased by \$790 million for the six months ended June 30, 2006, when compared to the corresponding period in the prior year. The increase in cash used in financing activities was due primarily to a decrease in the proceeds from issuances of long-term debt and common stock and payment of the March 1, 2006 maturity of \$800 million 6.75% senior unsecured notes. These notes were paid with net proceeds from the sale of \$400 million in senior notes, as discussed below, and a combination of cash and commercial paper proceeds.

On January 13, 2006, Progress Energy issued \$300 million of 5.625% Senior Notes due 2016 and \$100 million of Series A Floating Rate Senior Notes due 2010. These senior notes are unsecured. Interest on the Floating Rate Senior Notes will be based on three-month London Inter Bank Offering Rate (LIBOR) plus 45 basis points and will be reset quarterly. We used the net proceeds from the sale of these senior notes and a combination of available cash and commercial paper proceeds to retire the \$800 million aggregate principal amount of our 6.75% Senior Notes on March 1, 2006. Pending the application of proceeds as described above, we invested the net proceeds in short-term, interest-bearing, investment-grade securities.

Progress Energy entered into a new \$800 million 364-day credit agreement on November 21, 2005, which was restricted for the retirement of \$800 million of 6.75% Senior Notes due March 1, 2006. On March 1, 2006, we retired \$800 million of our 6.75% Senior Notes, thus effectively terminating the 364-day credit agreement.

On March 31, 2006, Progress Energy, as a well-known seasoned issuer, filed a shelf registration statement with the SEC. The registration statement became effective upon filing with the SEC and will allow Progress Energy to issue an indeterminate number or amount of various securities, including Senior Debt Securities, Junior Subordinated Debentures, Common Stock, Preferred Stock, Stock Purchase Contracts, Stock Purchase Units, and Trust Preferred Securities and Guarantees. The Board of Directors has authorized the issuance and sale of up to \$1 billion aggregate principal amount of various securities off the new shelf registration statement, in addition to \$679 million of various securities, which were not sold from our prior shelf registration statement. Therefore, effective March 31, 2006,

Progress Energy has the authority to issue and sell up to \$1.679 billion aggregate principal amount of various securities.

On May 3, 2006, Progress Energy restructured its existing \$1.13 billion five-year revolving credit agreement (RCA) with a syndication of financial institutions. The new RCA is scheduled to expire on May 3, 2011, and is replacing an existing \$1.13 billion five-year facility, which was terminated effective May 3, 2006. The Progress Energy RCA will continue to be used to provide liquidity support for Progress Energy's issuances of commercial paper and other short-term obligations. The new RCA still includes a defined maximum total debt to capital ratio of 68 percent and contains various cross-default and other acceleration provisions. However, the new RCA no longer includes a material adverse change representation for borrowings or a financial covenant for interest coverage. Fees and interest rates under the RCA will continue to be determined based upon the credit rating of Progress Energy's long-term unsecured senior noncredit-enhanced debt, currently rated as Baa2 by Moody's and BBB- by S&P.

On May 3, 2006, PEC's five-year \$450 million RCA was amended to take advantage of favorable market conditions and reduce the pricing associated with the facility. Fees and interest rates under the RCA will continue to be determined based upon the credit rating of PEC's long-term unsecured senior noncredit-enhanced debt, currently rated as Baa1 by Moody's and BBB- by S&P. The amended PEC RCA is still scheduled to expire on June 28, 2010.

On May 3, 2006, PEF's five-year \$450 million RCA was amended to take advantage of favorable market conditions and reduce the pricing associated with the facility. Fees and interest rates under the RCA will continue to be determined based upon the credit rating of PEF's long-term unsecured senior noncredit-enhanced debt, currently rated as A3 by Moody's and BBB- by S&P. The amended PEF RCA is still scheduled to expire on March 28, 2010.

For the three months ended June 30, 2006 and 2005, respectively, we issued approximately 0.7 million shares and 2.6 million shares of common stock resulting in approximately \$32 million and \$111 million in proceeds, net of purchases of restricted shares, primarily to meet the requirements of the Progress Energy 401(k) Savings and Stock Ownership Plan (401(k) Plan) and the Investor Plus Stock Purchase Plan. For the six months ended June 30, 2006 and 2005, respectively, we issued approximately 1.4 million shares and 4.0 million shares of common stock resulting in approximately \$60 million and \$171 million in proceeds, net of purchases of restricted shares. Included in these amounts were approximately 1.0 million shares and 3.9 million shares for net proceeds of approximately \$46 million and \$169 million, respectively, to meet the requirements of the 401(k) Plan and the Investor Plus Stock Purchase Plan. For the fiscal year 2006, we expect to realize approximately \$100 million aggregate amount from the sale of stock through these plans.

FUTURE LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2006, there were no material changes in our "Capital Expenditures," "Other Cash Needs," "Credit Facilities," or "Credit Rating Matters" as compared to those discussed under LIQUIDITY AND CAPITAL RESOURCES in Item 7 of the 2005 Form 10-K, other than as described below and above under "Financing Activities."

The amount and timing of future sales of our debt and equity securities will depend on market conditions, operating cash flow, asset sales and our specific needs. We may from time to time sell securities beyond the amount needed to meet our immediate capital requirements in order to allow for the early redemption of long-term debt, the redemption of preferred stock, the reduction of short-term debt or for other general corporate purposes.

At June 30, 2006, the current portion of our long-term debt was \$460 million, which we expect to fund with cash from operations, proceeds from sales of assets and/or commercial paper borrowings. See Notes 3 and 16 for additional information on asset sales.

On June 13, 2006, Fitch Ratings (Fitch) placed the senior unsecured credit ratings of Progress Energy (BBB-), PEC (BBB+) and PEF (BBB+) on Rating Watch Positive. The short-term ratings of PEC and PEF are unaffected. The placement of PGN's ratings on Rating Watch Positive is based on Fitch's expectation that significant holding company reductions of debt and business risk will result from pending and planned asset sales, as well as the successful resolution of the IRS audit of the Earthco synthetic fuel facilities. Should Fitch take a rating action, a one notch upgrade of the holding company's ratings is likely following completion of a rating review, closing of the sales of the DeSoto and Rowan plants and the application of the associated \$405 million of proceeds to parent debt

reduction. The rating review is expected to occur during the third quarter of 2006. On July 25, 2006, S&P affirmed the corporate credit ratings of BBB at Progress Energy, Inc., PEC and PEF and revised each company's outlook to positive from stable. The outlook revision reflects the progress towards our holding company debt reduction plan and expectations of future financial performance at the BBB+ benchmark levels. S&P also improved the Progress Energy's business risk profile to 5 from 6 due to the recently announced sales of the DeSoto and Rowan plants and Gas, as well as, anticipated cash flow benefits related to the idling of our synthetic fuel facilities. We do not expect these changes to have a material impact on our borrowing costs or overall liquidity.

The following regulatory matters may impact our future liquidity and financing activities: PEC's fuel cost recovery as discussed in Note 4, PEF's recovery of storm costs as discussed in Note 4, and filings for recovery of environmental costs as discussed in Note 13.

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

Our off-balance sheet arrangements and contractual obligations are described below.

GUARANTEES

As a part of normal business, we enter into various agreements providing future financial or performance assurances to third parties that are outside the scope of FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN No. 45). These agreements are entered into primarily to support or enhance the creditworthiness otherwise attributed to Progress Energy or our subsidiaries on a stand-alone basis, thereby facilitating the extension of sufficient credit to accomplish the subsidiaries' intended commercial purposes. Our guarantees include performance obligations under power supply agreements, tolling agreements, transmission agreements, gas agreements, fuel procurement agreements and trading operations. Our guarantees also include standby letters of credit, surety bonds and guarantees in support of nuclear decommissioning. At June 30, 2006, we have issued \$1.83 billion of guarantees for future financial or performance assurance. Included in this amount is \$300 million of Parent-issued guarantees of certain payments of two wholly owned indirect subsidiaries (See Note 15). We do not believe conditions are likely for significant performance under the guarantees of performance issued by or on behalf of affiliates.

The majority of contracts supported by the guarantees contain provisions that trigger guarantee obligations based on downgrade events to below investment grade (below BBB- or Baa3) by S&P or Moody's, ratings triggers, monthly netting of exposure and/or payments and offset provisions in the event of a default. At June 30, 2006, no guarantee obligations had been triggered. If the guarantee obligations were triggered, the approximate amount of liquidity requirements to support ongoing operations within a 90-day period, associated with guarantees for Progress Energy's nonregulated portfolio and power supply agreements, was \$639 million. While we believe that we would be able to meet this obligation with cash or letters of credit, if we cannot, our financial condition, liquidity and results of operations will be materially and adversely impacted.

At June 30, 2006, we have issued guarantees and indemnifications of certain asset performance, legal, tax and environmental matters to third parties, including indemnifications made in connection with sales of businesses, and for timely payment of obligations in support of our nonwholly owned synthetic fuel operations as discussed in Note 14A.

MARKET RISK AND DERIVATIVES

Under our risk management policy, we may use a variety of instruments, including swaps, options and forward contracts, to manage exposure to fluctuations in commodity prices and interest rates. See Note 10 and Item 3, "Quantitative and Qualitative Disclosures about Market Risk" of this Form 10-Q, for a discussion of market risk and derivatives.

CONTRACTUAL OBLIGATIONS

As of June 30, 2006, our contractual cash obligations and other commercial commitments have not changed materially from what was reported in the 2005 Form 10-K.

OTHER MATTERS

SYNTHETIC FUELS TAX CREDITS

Historically, we have had substantial operations associated with the production of coal-based solid synthetic fuels as defined under Section 29 of the Code (Section 29). The production and sale of these products qualifies for federal income tax credits so long as certain requirements are satisfied, including a requirement that the synthetic fuel differs significantly in chemical composition from the coal used to produce such synthetic fuel and that the fuel was produced from a facility that was placed in service before July 1, 1998. Qualifying synthetic fuel facilities entitle their owners to federal income tax credits based on the barrel of oil equivalent of the synthetic fuel produced and sold by these plants. The tax credits associated with synthetic fuels in a particular year may be phased out if Annual Average market prices for crude oil exceed certain prices. Synthetic fuel is generally not economical to produce and sell absent the credits. On May 22, 2006, we idled production of synthetic fuel at our synthetic fuel facilities. As discussed below in *IMPACT OF CRUDE OIL PRICES*, the decision to idle production was based on the high level of oil prices and the continued uncertainty of any proposed federal legislation regarding the value of the tax credits received as a result of synthetic fuel production. Resumption of synthetic fuel production would be dependent upon a number of factors, including a reduction in oil prices, the enactment of future federal tax legislation and/or the duration of the current idling.

TAX CREDITS

Legislation enacted in 2005 redesignated the Section 29 tax credit as a general business credit under Section 45K of the Code (Section 45K) effective January 1, 2006. The previous amount of Section 29 tax credits that we were allowed to claim in any calendar year through December 31, 2005, was limited by the amount of our regular federal income tax liability. Section 29 tax credit amounts allowed but not utilized are currently carried forward indefinitely as deferred alternative minimum tax credits. The redesignation of Section 29 tax credits as a Section 45K general business credit removes the regular federal income tax liability limit on synthetic fuel production and subjects the credits to a 20-year carry forward period. This provision would allow us to produce synthetic fuel to a higher level than we have historically produced, should we choose to do so.

Total Section 29/45K credits generated through June 30, 2006 (including those generated by Florida Progress prior to our acquisition), were approximately \$1.8 billion, of which \$869 million has been used to offset regular federal income tax liability, \$896 million is being carried forward as deferred tax credits and \$35 million has been reserved due to the potential phase-out of tax credits due to high oil prices, as described below.

IMPACT OF CRUDE OIL PRICES

Although the Section 29/45K tax credit program is expected to continue through 2007, recent market conditions, world events and catastrophic weather events have increased the volatility and level of oil prices that could limit the amount of those credits or eliminate them entirely for 2006 and 2007. This possibility is due to a provision of Section 29 that provides that if the average wellhead price per barrel for unregulated domestic crude oil for the year (the Annual Average Price) exceeds a certain threshold price (the Threshold Price), the amount of Section 29/45K tax credits is reduced for that year. Also, if the Annual Average Price increases high enough (the Phase-out Price), the Section 29/45K tax credits are eliminated for that year. The Threshold Price and the Phase-out Price are adjusted annually for inflation.

If the Annual Average Price falls between the Threshold Price and the Phase-out Price for a year, the amount by which Section 29/45K tax credits are reduced will depend on where the Annual Average Price falls in that continuum. For example, for 2005, the Threshold Price was \$53.20 per barrel and the Phase-out Price was \$66.78 per barrel. If the Annual Average Price had been \$59.99 per barrel, there would have been a 50 percent reduction in the amount of Section 29 tax credits for that year.

The Department of the Treasury calculates the Annual Average Price based on the Domestic Crude Oil First Purchases Prices published by the Energy Information Agency (EIA). Because the EIA publishes its information on a three-month lag, the secretary of the Treasury finalizes the calculations three months after the year in question ends. The Annual Average Price for calendar year 2005 was published on April 11, 2006. Based on the Annual Average Price of \$50.26, there was no phase-out of our synthetic fuel tax credits in 2005.

We estimate that the 2006 Threshold Price will be approximately \$55 per barrel and the Phase-out Price will be approximately \$69 per barrel, based on an estimated inflation adjustment for 2006. The monthly Domestic Crude Oil First Purchases Price published by the EIA has recently averaged approximately \$6 lower than the corresponding monthly New York Mercantile Exchange (NYMEX) settlement price for light sweet crude oil. Through June 30, 2006, the average NYMEX settlement price for light sweet crude oil was \$67.13 per barrel, and as of June 30, 2006, the average NYMEX futures price for light sweet crude oil for the remainder of calendar year 2006 was \$75.12 per barrel. This results in a weighted-average annual price for light sweet crude oil of approximately \$71.16 per barrel for calendar year 2006. Based upon the estimated 2006 Threshold Price and Phase-out Price, if oil prices for 2006 averaged this weighted price of approximately \$71.16 per barrel for the entire year in 2006, we currently estimate that the synthetic fuel tax credit amount for 2006 would be reduced by approximately 72 percent. Therefore, we reserved 72 percent or approximately \$35 million of the \$48 million in tax credits generated during the first six months of 2006. The NYMEX price of oil for the remainder of 2006 would have to be \$55.16 to have no reduction in value of tax credits generated during 2006 and would have to be \$83.04 to have a full reduction in value. The final calculations of any reductions in the value of the tax credits will not be determined until the end of 2006 when final oil prices are known. Additional fluctuations in oil prices may cause quarterly adjustments to our results of operations and the amount of tax credits we record or reserve, either positive or negative, depending on current and futures oil prices at the end of the quarter, which impact the estimated weighted average annual price of oil for 2006.

Legislation that would have provided synthetic fuel producers with additional certainty around future synthetic fuel production decisions was not included in the Tax Increase Prevention and Reconciliation Act passed in May 2006. However, similar provisions modifying the Section 29/45K synthetic fuel tax credit program may be included in future legislation. We cannot predict the outcome of this matter.

If our synthetic fuel operations remain idle for the balance of 2006 and the 2006 credits earned to date were completely phased out due to high oil prices, then the estimated current year losses through June 30, 2006 from our synthetic fuel operations would be approximately \$92 million, which includes after-tax impairment losses of \$55 million and a reversal of \$13 million of income related to tax credits recorded during the first six months of 2006.

IMPAIRMENT OF SYNTHETIC FUEL AND OTHER RELATED LONG-LIVED ASSETS

We have monitored our synthetic fuel and other related operating long-lived assets for impairment and previously determined that no impairment of these assets was required. With the idling of these facilities during the second quarter of 2006, we performed another impairment evaluation. The impairment test considered numerous factors, including, among other things, continued high oil prices, the continued uncertainty of whether federal legislation will be enacted that would provide assurance that tax credits would exist for 2006 production and the continued "idle" state of our synthetic fuel facilities. Based on the results of the impairment test, we recorded pre-tax impairment charges of \$91 million (\$55 million after-tax) during the quarter ended June 30, 2006 (See Notes 6 and 7). These charges represent the entirety of the asset carrying value of our synthetic fuel intangible assets and manufacturing facilities, as well as a portion of the asset carrying value associated with the river terminals at which the synthetic fuel manufacturing facilities are located.

PERMANENT SUBCOMMITTEE

In October 2003, the United States Senate Permanent Subcommittee on Investigations began a general investigation concerning synthetic fuel tax credits claimed under Section 29. The investigation is examining the utilization of the credits, the nature of the technologies and fuels created, the use of the synthetic fuel, and other aspects of Section 29 and is not specific to our synthetic fuel operations. Progress Energy provided information in connection with this investigation. We cannot predict the outcome of this matter.

SALE OF PARTNERSHIP INTEREST

In June 2004, through our subsidiary Progress Fuels, we sold in two transactions a combined 49.8 percent partnership interest in Colona, one of our synthetic fuel facilities. Substantially all proceeds from the sales will be received over time, which is typical of such sales in the industry. Gains from the sales will be recognized on a cost recovery basis as the facility produces and sells synthetic fuel and when there is persuasive evidence that the sales proceeds have become fixed or determinable and collectability is reasonably assured. Gain recognition is dependent on the synthetic fuel production qualifying for Section 29/45K tax credits and the value of such tax credits as

Exhibit B(1)

Exhibit B(1)

PROGRESS ENERGY FLORIDA, INC.
PRELIMINARY PROJECTION OF SOURCES AND USES OF FUNDS
(In Millions)

	12 Months Ending December 31, 2007
OPERATING ACTIVITIES	\$ <u>694</u>
INVESTING ACTIVITIES:	
Construction Expenditures	<u>(1,527)</u>
Other Investing Activities	<u>(65)</u>
Total	<u>(1,592)</u>
FINANCING ACTIVITIES:	
Issuance / (Retirement) of Long-Term Debt	<u>340</u>
Increase (Decrease) in Short-Term Debt	<u>305</u>
Equity Contributions from / (Dividends to) Parent, net	<u>255</u>
Preferred Dividends	<u>(2)</u>
Total	<u>898</u>
TOTAL INCREASE (DECREASE) IN CASH	\$ <u><u>0</u></u>

Exhibit B(2)

PROGRESS ENERGY FLORIDA, INC.
PRELIMINARY CONSTRUCTION EXPENDITURES FOR 2007
(In Millions)

<u>BUDGET CLASSIFICATION</u>	<u>PRELIMINARY BUDGET</u>
PRODUCTION PLANT	1,079
TRANSMISSION PLANT	197
DISTRIBUTION PLANT	235
GENERAL PLANT	16
TOTAL LESS AFUDC	\$ <u>1,527</u>

Exhibit C

Exhibit C

PROGRESS ENERGY FLORIDA, INC.
CAPITAL STOCK AND LONG-TERM DEBT
As Of September 30, 2006

<u>Title of Class</u>	<u>Shares Authorized</u>	<u>Shares Outstanding</u>	<u>Amount Outstanding</u>
Common Stock without par value	60,000,000	100 ¹	N/A
Cumulative Preferred Stock (Par Value \$100):			
4.00% Series	40,000	39,980	\$ 3,998,000
4.40% Series	75,000	75,000	7,500,000
4.58% Series	100,000	99,990	9,999,000
4.60% Series	40,000	39,997	3,999,000
4.75% Series	80,000	80,000	<u>8,000,000</u>
Total Cumulative Preferred Stock Outstanding			\$ <u>33,496,700</u>
First Mortgage Bonds:			
6-7/8% Series, due 2008			\$ 80,000,000
4.50% Series, due 2010			300,000,000
6.65% Series, due 2011			300,000,000
4.80% Series, due 2013			425,000,000
5.10% Series, due 2015			300,000,000
5.90% Series, due 2033			225,000,000
Citrus County 2002, Series - A, Due 2027			108,550,000
Citrus County 2002, Series - B, Due 2022			100,115,000
Citrus County 2002, Series - C, Due 2018			<u>32,200,000</u>
Total First Mortgage Bonds Outstanding			<u>\$1,870,865,000</u>

¹All of the Company's outstanding shares of common stock are owned beneficially and of record by the Company's parent, Florida Progress Corporation.

Senior Unsecured Notes:

Series A Floating Rate Senior Notes, due 2008	\$ <u>450,000,000</u>
Total Senior Unsecured Notes Outstanding	\$ <u>450,000,000</u>

Medium-Term Notes:

6.81%, due 2007	\$ 85,000,000
6.67%, due 2008	7,150,000
6.75%, due 2028	<u>150,000,000</u>
Total Medium-Term Notes Outstanding	\$ <u>242,150,000</u>

Total Long-Term Debt Outstanding:	<u><u>\$2,563,015,000</u></u>
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