10 CFR 50.75(e)(1)(iii)(B)

Progress Energy

PO Box 1551
411 Fayetteville Street Mall
Raleigh NC 27602

Serial: PE&RAS-05-079
August 29, 2005

United States Nuclear Regulatory Commission
ATTENTION: Document Control Desk
Washington, DC 20555-0001

BRUNSWICK STEAM ELECTRIC PLANT, UNIT NOS. 1 AND 2
DOCKET NOS. 50-325 AND 50-324 / LICENSE NOS. DPR-71 AND DPR-62

SUBMITTAL OF 10-Q REPORT

Ladies and Gentlemen:

Carolina Power & Light Company, now doing business as Progress Energy Carolinas, Inc., submits the enclosed quarterly 10-Q Report for Progress Energy, Inc. for the quarterly period ended June 30, 2005.

Submittal to the NRC of financial reports filed with the U.S. Securities and Exchange Commission is required by the parent company guarantees used to provide financial assurance of decommissioning funds for the Brunswick Steam Electric Plant, Unit Nos. 1 and 2, pursuant to 10 CFR 50.75(e)(1)(iii)(B). This requirement was written into the parent company guarantees pursuant to the guidance in Appendix B-6.5 of Regulatory Guide 1.159.

This document contains no new regulatory commitment.

Please contact me at (919) 546-6901 if you need additional information concerning this report.

Sincerely,

Chris Burton

Chris Burton
Manager - Performance
Evaluation & Regulatory Affairs

HAS

Enclosure:

M004

c:

without enclosure:

W. D. Travers, Regional Administrator – Region II
USNRC Resident Inspector – BSEP, Unit Nos. 1 and 2
B. L. Mozafari, NRR Project Manager – BSEP, Unit Nos. 1 and 2
M. A. Dusaniwskyj, USNRC NRR/DRIP/RPRP

J. A. Sanford - North Carolina Utilities Commission
G. Thigpen – North Carolina Utilities Commission
S. Watson – North Carolina Utilities Commission
B. Hall – North Carolina Department of Environmental and Natural Resources

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2005

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to ________.

Commission File Number	Exact name of registrants as specified in their charters, state of incorporation, address of principal executive offices, and telephone number	I.R.S. Employer Identification Number
1-15929	**Progress Energy, Inc.** 410 South Wilmington Street Raleigh, North Carolina 27601-1748 Telephone: (919) 546-6111 State of Incorporation: North Carolina	56-2155481
1-3382	**Carolina Power & Light Company** **d/b/a Progress Energy Carolinas, Inc.** 410 South Wilmington Street Raleigh, North Carolina 27601-1748 Telephone: (919) 546-6111 State of Incorporation: North Carolina	56-0165465

NONE
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days. Yes X No __

Indicate by check mark whether Progress Energy, Inc. (Progress Energy) is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes X No __

Indicate by check mark whether Carolina Power & Light Company is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes __ No X

Indicate the number of shares outstanding of each of the issuers' classes of common stock, as of the latest practicable date. As of July 31, 2005, each registrant had the following shares of common stock outstanding:

Registrant	Description	Shares
Progress Energy	Common Stock (Without Par Value)	251,227,350
PEC	Common Stock (Without Par Value)	159,608,055 (all of which were held by Progress Energy, Inc.)

This combined Form 10-Q is filed separately by two registrants: Progress Energy and Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc. (PEC). Information contained herein relating to either individual registrant is filed by such registrant solely on its own behalf. Each registrant makes no representation as to information relating exclusively to the other registrant.

PROGRESS ENERGY, INC. AND PROGRESS ENERGY CAROLINAS, INC.
FORM 10-Q – For the Quarter Ended June 30, 2005

GLOSSARY OF TERMS

The following abbreviations or acronyms used in the text of this combined Form 10-Q are defined below:

TERM	DEFINITION
401(k)	Progress Energy 401(k) Savings and Stock Ownership Plan
AFUDC	Allowance for funds used during construction
the Agreement	Stipulation and Settlement Agreement related to retail rate matters
ARO	Asset retirement obligation
Bcf	Billion cubic feet
Btu	British thermal unit
CAIR	Clean Air Interstate Rule
CAMR	Clean Air Mercury Rule
CCO	Competitive Commercial Operations business segment
CERCLA or Superfund	Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended
The City	The City of Winter Park, Florida
Code	Internal Revenue Code
Colona	Colona Synfuel Limited Partnership, LLLP
the Company	Progress Energy, Inc. and subsidiaries
CP&L	Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc.
CR3	Crystal River Unit No. 3
CVO	Contingent value obligation
DOE	United States Department of Energy
DWM	North Carolina Department of Environment and Natural Resources, Division of Waste Management
ECRC	Environmental Cost Recovery Clause
EITF	Emerging Issues Task Force
EMCs	Electric Membership Cooperatives
EPA of 1992	Energy Policy Act of 1992
FASB	Financial Accounting Standards Board
FDEP	Florida Department of Environment and Protection
FERC	Federal Energy Regulatory Commission
FIN No. 45	Financial Accounting Standards Board (FASB) Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others"
FIN No. 46R	FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51"
Florida Progress or FPC	Florida Progress Corporation
FPSC	Florida Public Service Commission
Fuels	Fuels business segment
GAAP	Accounting Principles Generally Accepted in the United States of America
Global	U.S. Global LLC
the holding company	Progress Energy Corporate
IRS	Internal Revenue Service
Jackson	Jackson Electric Membership Corporation
LIBOR	London Inter Bank Offering Rate
MACT	Maximum Achievable Control Technology
Medicare Act	Medicare Prescription Drug, Improvement and Modernization Act of 2003
MGP	Manufactured Gas Plant
MW	Megawatt
MWh	Megawatt-hour
NCNG	North Carolina Natural Gas Corporation
NCUC	North Carolina Utilities Commission
NEIL	Nuclear Electric Insurance Limited
Norfolk Southern	Norfolk Southern Railway Company
NOx	Nitrogen Oxide

NOx SIP Call	EPA rule which requires 22 states including North Carolina and South Carolina (but excluding Florida) to further reduce nitrogen oxide emissions.
NRC	United States Nuclear Regulatory Commission
Nuclear Waste Act	Nuclear Waste Policy Act of 1982
NYMEX	New York Mercantile Exchange
O&M	Operation and Maintenance Expense
OPEB	Postretirement benefits other than pensions
PEC	Progress Energy Carolinas, Inc., formerly referred to as Carolina Power & Light Company
PEC Electric	PEC Electric business segment made up of the utility operations and excludes operations of nonregulated subsidiaries
PEF	Progress Energy Florida, formerly referred to as Florida Power Corporation
PESC	Progress Energy Service Company
PFA	IRS Prefiling Agreement
PLR	Private Letter Ruling
Progress Energy	Progress Energy, Inc.
Progress Fuels	Progress Fuels Corporation, formerly Electric Fuels Corporation
Progress Rail	Progress Rail Services Corporation
Progress Ventures	Business unit of Progress Energy primarily made up of nonregulated energy generation and marketing activities, as well as gas, coal and synthetic fuel operations
PRP	Potentially responsible party, as defined in CERCLA
PTC	Progress Telecommunications Corporation
PT LLC	Progress Telecom, LLC
PUHCA	Public Utility Holding Company Act of 1935, as amended
PVI	Progress Energy Ventures, Inc. (formerly referred to as CPL Energy Ventures, Inc.)
Rail Services	Rail Services business segment
RCA	Revolving credit agreement
ROE	Return on Equity
SCPSC	Public Service Commission of South Carolina
SEC	United States Securities and Exchange Commission
Section 29	Section 29 of the Internal Revenue Service Code
Service Company	Progress Energy Service Company, LLC
SFAS	Statement of Financial Accounting Standards
SFAS No. 5	Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies"
SFAS No. 71	Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation"
SFAS No. 109	Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes"
SFAS No. 123R	Statement of Financial Accounting Standards No. 123R, "Accounting for Stock-Based Compensation"
SFAS No. 133	Statement of Financial Accounting Standards No. 133, "Accounting for Derivative and Hedging Activities"
SFAS No. 138	Statement of Financial Accounting Standards No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities – An Amendment of FASB Statement No. 133"
SFAS No. 143	Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations"
SFAS No. 148	Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure – An Amendment of FASB Statement No. 123"
Smokestacks Act	North Carolina Clean Smokestacks Act enacted in June 2002
SO_2	Sulfur dioxide
SRS	Strategic Resource Solutions Corp.
STB	Surface Transportation Board
the Trust	FPC Capital I

SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS

This combined report contains forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The matters discussed throughout this combined Form 10-Q that are not historical facts are forward-looking and, accordingly, 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.

In addition, forward-looking statements are discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations" including, but not limited to, statements under the sub-heading "Results of Operations" about trends and uncertainties, "Liquidity and Capital Resources" about future liquidity requirements and "Other Matters" about the Company's synthetic fuel facilities.

Any forward-looking statement is based on information current as of the date of this report and speaks only as of the date on which such statement is made, and neither Progress Energy, Inc. (Progress Energy or the Company) nor Progress Energy Carolinas, Inc. (PEC) undertakes any obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made.

Examples of factors that you should consider with respect to any forward-looking statements made throughout this document include, but are not limited to, the following: the impact of fluid and complex government laws and regulations, including those relating to the environment; deregulation or restructuring in the electric industry that may result in increased competition and unrecovered (stranded) costs; the uncertainty regarding the timing, creation and structure of regional transmission organizations; weather conditions that directly influence the demand for electricity; the Company's timing of recovery of the costs associated with the four hurricanes that impacted our service territory in 2004 or the ability to recover through the regulatory process other future significant weather events; recurring seasonal fluctuations in demand for electricity; fluctuations in the price of energy commodities and purchased power; economic fluctuations and the corresponding impact on the Company and its subsidiaries' commercial and industrial customers; the ability of the Company's subsidiaries to pay upstream dividends or distributions to it; the impact on the facilities and the businesses of the Company from a terrorist attack; the inherent risks associated with the operation of nuclear facilities, including environmental, health, regulatory and financial risks; the ability to successfully access capital markets on favorable terms; the ability of the Company to maintain its current credit ratings and the impact on the Company's financial condition and ability to meet its cash and other financial obligations in the event its credit ratings are downgraded below investment grade; the impact that increases in leverage may have on the Company; the impact of derivative contracts used in the normal course of business by the Company; investment performance of pension and benefit plans; the Company's ability to control costs, including pension and benefit expense, and achieve its cost management targets for 2007; the availability and use of Internal Revenue Code Section 29 (Section 29) tax credits by synthetic fuel producers and the Company's continued ability to use Section 29 tax credits related to its coal-based solid synthetic fuel businesses; the impact to the Company's financial condition and performance in the event it is determined the Company is not entitled to previously taken Section 29 tax credits; the impact of the proposed accounting pronouncement regarding uncertain tax positions; the impact that future crude oil prices may have on the value of the Company's Section 29 tax credits; the outcome of Progress Energy Florida's (PEF) rate proceeding in 2005 regarding its future base rates; the Company's ability to manage the risks involved with the operation of its nonregulated plants, including dependence on third parties and related counter-party risks, and a lack of operating history; the Company's ability to manage the risks associated with its energy marketing operations; the outcome of any ongoing or future litigation or similar disputes and the impact of any such outcome or related settlements; and unanticipated changes in operating expenses and capital expenditures. Many of these risks similarly impact the Company's subsidiaries.

These and other risk factors are detailed from time to time in the Company's and PEC's filings with the United States Securities and Exchange Commission (SEC). Many, but not all, of the factors that may impact actual results are discussed in the Risk Factors sections of Progress Energy's and PEC's annual reports on Form 10-K for the year ended December 31, 2004, which were filed with the SEC on March 16, 2005. All such factors are difficult to predict, contain uncertainties that may materially affect actual results and may be beyond the control of Progress Energy and PEC. New factors emerge from time to time, and it is not possible for management to predict all such factors, nor can it assess the effect of each such factor on Progress Energy and PEC.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PROGRESS ENERGY, INC.
CONSOLIDATED INTERIM FINANCIAL STATEMENTS
June 30, 2005

UNAUDITED CONSOLIDATED STATEMENTS of INCOME

	Three Months Ended June 30		Six Months Ended June 30	
(in millions except per share data)	2005	2004	2005	2004
Operating revenues				
Utility	$ 1,768	$ 1,721	$ 3,551	$ 3,406
Diversified business	565	402	980	723
Total operating revenues	2,333	2,123	4,531	4,129
Operating expenses				
Utility				
Fuel used in electric generation	529	468	1,079	961
Purchased power	217	219	415	402
Operation and maintenance	543	372	949	735
Depreciation and amortization	207	207	415	409
Taxes other than on income	108	109	225	214
Diversified business				
Cost of sales	539	388	934	699
Depreciation and amortization	43	42	82	83
Other	31	31	63	61
Total operating expenses	2,217	1,836	4,162	3,564
Operating income	116	287	369	565
Other income (expense)				
Interest income	4	4	8	6
Other, net	19	(3)	21	(25)
Total other income (expense)	23	1	29	(19)
Interest charges				
Net interest charges	168	157	334	318
Allowance for borrowed funds used during construction	(4)	(2)	(7)	(3)
Total interest charges, net	164	155	327	315
(Loss) income from continuing operations before income tax and minority interest	(25)	133	71	231
Income tax benefit	22	12	23	14
(Loss) income from continuing operations before minority interest	(3)	145	94	245
Minority interest in subsidiaries' loss, net of tax	9	1	17	
Income from continuing operations	6	146	111	245
Discontinued operations, net of tax	(7)	8	(19)	17
Net (loss) income	$ (1)	$ 154	$ 92	$ 262
Average common shares outstanding	246	242	245	242
Basic earnings per common share				
Income from continuing operations	$ 0.02	$ 0.60	$ 0.45	$ 1.01
Discontinued operations, net of tax	(0.03)	0.03	(0.08)	0.07
Net (loss) income	$(0.01)	$ 0.63	$ 0.37	$ 1.08
Diluted earnings per common share				
Income from continuing operations	$ 0.02	$ 0.60	$ 0.45	$ 1.01
Discontinued operations, net of tax	(0.03)	0.03	(0.08)	0.07
Net (loss) income	$(0.01)	$ 0.63	$ 0.37	$ 1.08
Dividends declared per common share	$ 0.590	$ 0.575	$ 1.180	$ 1.150

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

PROGRESS ENERGY, INC.
UNAUDITED CONSOLIDATED BALANCE SHEETS

(in millions) ASSETS	June 30 2005	December 31 2004
Utility Plant		
Utility plant in service	$22,320	$ 22,103
Accumulated depreciation	(9,341)	(8,783)
Utility plant in service, net	12,979	13,320
Held for future use	6	13
Construction work in progress	1,001	799
Nuclear fuel, net of amortization	230	231
Total utility plant, net	14,216	14,363
Current assets		
Cash and cash equivalents	141	56
Short-term investments	40	82
Receivables, net	995	911
Inventory	801	805
Deferred fuel cost	231	229
Deferred income taxes	100	114
Assets of discontinued operations	-	577
Prepayments and other current assets	235	174
Total current assets	2,543	2,948
Deferred debits and other assets		
Regulatory assets	1,001	1,064
Nuclear decommissioning trust funds	1,081	1,044
Diversified business property, net	1,917	1,838
Miscellaneous other property and investments	502	444
Goodwill	3,719	3,719
Intangibles, net	321	337
Other assets and deferred debits	346	262
Total deferred debits and other assets	8,887	8,708
Total assets	$ 25,646	$ 26,019
CAPITALIZATION AND LIABILITIES		
Common stock equity		
Common stock without par value, 500 million shares authorized, 251 and 247 million shares issued and outstanding, respectively	$ 5,540	$ 5,360
Unearned restricted shares	(16)	(13)
Unearned ESOP shares	(63)	(76)
Accumulated other comprehensive loss	(113)	(164)
Retained earnings	2,327	2,526
Total common stock equity	7,675	7,633
Preferred stock of subsidiaries-not subject to mandatory redemption	93	93
Minority interest	41	36
Long-term debt, affiliate	270	270
Long-term debt, net	9,041	9,251
Total capitalization	17,120	17,283
Current liabilities		
Current portion of long-term debt	848	349
Accounts payable	576	630
Interest accrued	221	219
Dividends declared	147	145
Short-term obligations	403	684
Customer deposits	189	180
Liabilities of discontinued operations	-	152
Other current liabilities	666	703
Total current liabilities	3,050	3,062
Deferred credits and other liabilities		
Noncurrent income tax liabilities	532	625
Accumulated deferred investment tax credits	170	176
Regulatory liabilities	2,451	2,654
Asset retirement obligations	1,229	1,282
Other liabilities and deferred credits	1,094	937
Total deferred credits and other liabilities	5,476	5,674
Commitments and contingencies (Note 14)		
Total capitalization and liabilities	$ 25,646	$ 26,019

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,	2005	2004
Operating activities		
Net income	$ 92	$ 262
Adjustments to reconcile net income to net cash provided by operating activities:		
Discontinued operations, net of tax	19	(17)
Charges for voluntary enhanced retirement program	158	-
Depreciation and amortization	556	549
Deferred income taxes	(132)	(203)
Investment tax credit	(6)	(6)
Tax levelization	63	43
Deferred fuel cost	-	13
Other adjustments to net income	61	27
Cash provided (used) by changes in operating assets and liabilities:		
Receivables	(60)	(138)
Inventory	(90)	(2)
Prepayments and other current assets	(27)	(18)
Accounts payable	76	72
Other current liabilities	(68)	230
Regulatory assets and liabilities	(59)	10
Other	(3)	80
Net cash provided by operating activities	580	902
Investing activities		
Gross utility property additions	(539)	(473)
Diversified business property additions	(130)	(93)
Nuclear fuel additions	(67)	(47)
Proceeds from sales of subsidiaries and other investments, net of cash divested	436	94
Purchases of short-term investments	(2,804)	(651)
Proceeds from sales of short-term investments	2,846	853
Other	(41)	(37)
Net cash used in investing activities	(299)	(354)
Financing activities		
Issuance of common stock	171	59
Issuance of long-term debt	792	1
Net (decrease) increase in short-term indebtedness	(281)	524
Retirement of long-term debt	(517)	(865)
Dividends paid on common stock	(289)	(278)
Other	(42)	(61)
Net cash used in financing activities	(166)	(520)
Cash used by discontinued operations:		
Operating activities	(26)	(4)
Investing activities	(4)	(8)
Financing activities	-	-
Net increase in cash and cash equivalents	85	16
Cash and cash equivalents at beginning of period	56	35
Cash and cash equivalents at end of period	$ 141	$ 51

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

PROGRESS ENERGY, INC.
NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

A. 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 statements. Because the accompanying consolidated interim financial statements do not include all of the information and footnotes required by GAAP for annual statements, they should be read in conjunction with the audited financial statements for the period ended December 31, 2004, and notes thereto included in Progress Energy's Form 10-K for the year ended December 31, 2004.

In accordance with the provisions of Accounting Principles Board Opinion (APB) No. 28, "Interim Financial Reporting," 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. Income tax expense was increased by $60 million and $5 million for the three months ended June 30, 2005 and 2004, respectively. Income tax expense was increased by $63 million and $43 million for the six months ended June 30, 2005 and 2004, respectively. The income tax provisions for the Company differ from amounts computed by applying the Federal statutory tax rate to income before income taxes, primarily due to the recognition of synthetic fuel tax credits.

PEC and PEF collect from customers certain excise taxes levied by the state or local government upon the customers. PEC and PEF account for excise taxes on a gross basis. For the three months ended June 30, 2005 and 2004, gross receipts tax, franchise taxes and other excise taxes of approximately $58 million and $61 million, respectively, are included in utility revenues and taxes other than on income in the Consolidated Statements of Income. For the six months ended June 30, 2005 and 2004, excise taxes of approximately $114 million for both periods are included in utility revenues and taxes other than on income in the Consolidated Statements of Income.

The amounts included in the consolidated interim financial statements are unaudited but, in the opinion of management, reflect all normal recurring adjustments necessary to fairly present the Company's 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 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, disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses reflected during the reporting period. Actual results could differ from those estimates. Certain amounts for 2004 have been reclassified to conform to the 2005 presentation.

B. Stock-Based Compensation

The Company measures compensation expense for stock options as the difference between the market price of its common stock and the exercise price of the option at the grant date. The exercise price at which options are granted by the Company equals the market price at the grant date, and accordingly, no compensation expense has been recognized for stock option grants. For purposes of the pro forma disclosures required by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure – an Amendment of FASB Statement No. 123" (SFAS No. 148), the estimated fair value of the Company's stock options is amortized to expense over the options' vesting period. The following table illustrates the effect on net income and earnings per share if the fair value method had been applied to all outstanding and unvested awards in each period:

(in millions except per share data)	Three Months Ended June 30		Six Months Ended June 30	
	2005	2004	2005	2004
Net (loss) income, as reported	$ (1)	$ 154	$ 92	$ 262
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	1	3	2	6
Pro forma net (loss) income	$ (2)	$ 151	$ 90	$ 256
Basic earnings per share				
As reported	$ (0.01)	$ 0.63	$ 0.37	$ 1.08
Pro forma	$ (0.01)	$ 0.62	$ 0.36	$ 1.06
Fully diluted earnings per share				
As reported	$ (0.01)	$ 0.63	$0.37	$ 1.08
Pro forma	$ (0.01)	$ 0.62	$ 0.36	$ 1.05

The Company is planning to begin expensing stock options in the third quarter of 2005 (See Note 2).

C. Consolidation of Variable Interest Entities

The Company consolidates all voting interest entities in which it owns a majority voting interest and all variable interest entities for which it is the primary beneficiary in accordance with FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities – An Interpretation of ARB No. 51" (FIN No. 46R). The Company 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 Internal Revenue Code (Code). As of June 30, 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.

The Company has an interest in a limited partnership that invests in 17 low-income housing partnerships that qualify for federal and state tax credits. The Company also has interests in two power plants resulting from long-term power purchase contracts. The Company has requested the necessary information to determine if the 17 partnerships and the two power plant owners are variable interest entities or to identify the primary beneficiaries; all three entities declined to provide the Company with the necessary financial information. Therefore, the Company has applied the information scope exception in FIN No. 46R, paragraph 4(g) to the 17 partnerships and the two power plants. The Company believes that if it is determined to be the primary beneficiary of any 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 the Company's common stock equity, net earnings or cash flows.

The Company also has interests in several other variable interest entities for which the Company is not the primary beneficiary. These arrangements include investments in approximately 28 limited partnerships, limited liability corporations and venture capital funds and two building leases with special-purpose entities. The aggregate maximum loss exposure at June 30, 2005, that the Company could be required to record in its income statement as a result of these arrangements totals approximately $38 million. The creditors of these variable interest entities do not have recourse to the general credit of the Company in excess of the aggregate maximum loss exposure.

2. IMPACT OF NEW ACCOUNTING STANDARDS

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

On July 14, 2005, the Financial Accounting Standards Board (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. The Company currently accounts for uncertain tax benefits in accordance with SFAS No. 5, "Accounting for Contingencies" (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. The exposure draft has a 60-day public comment period ending September 12, 2005. As currently drafted, the proposed interpretation would apply to all uncertain tax positions and be effective for the Company on December 31, 2005.

As discussed in Note 14, the Internal Revenue Service (IRS) field auditors have recommended that the Section 29 tax credits generated by the Company's Earthco facilities, totaling $1.1 billion through June 30, 2005, be disallowed. The Company disagrees with the field audit team's findings and has requested that the National Office of the IRS review this issue. The Company has not yet determined how the proposed interpretation would impact its various income tax positions, including the status of the Earthco tax credits. Depending on the provisions of the FASB's final interpretation and the Company's facts and circumstances that exist at the date of implementation, including the Company's assessment of the probability of sustaining any currently recorded and future tax benefits, the proposed interpretation could have a material adverse impact on the Company's financial position and results of operations.

SFAS NO. 123 (REVISED 2004), "SHARE-BASED PAYMENT" (SFAS NO. 123R)

In December 2004, the FASB issued SFAS No. 123R, which revises SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." The key requirement of SFAS No. 123R is that the cost of share-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. Previously, entities could elect to continue accounting for such awards at their grant date intrinsic value under APB Opinion No. 25, and the Company made that election. The intrinsic value method resulted in the Company recording no compensation expense for stock options granted to employees (See Note 1B).

As written, SFAS No. 123R had an original effective date of July 1, 2005 for the Company. In April 2005, the SEC delayed the effective date for public companies, which resulted in a required effective date of January 1, 2006 for the Company. The SEC delayed the effective date due to concerns that implementation in mid-year could make compliance more difficult and make comparisons of quarterly reports more difficult. The Company is planning to implement SFAS No. 123R during the third quarter of 2005, effective as of July 1, 2005. The Company will implement the standard using the required modified prospective method. Under that method, the Company will record compensation expense under SFAS No. 123R for all awards it grants after the effective date, and it will record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the effective date. In 2004, the Company made the decision to cease granting stock options and replaced that compensation with alternative forms of compensation. Therefore, the amount of stock option expense expected to be recorded in 2005 is below the amount that would have been recorded if the stock option program had continued. Assuming a July, 1 2005 effective date, the Company expects to record approximately $3 million of pre-tax expense for stock options in 2005.

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

On March 30, 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations," an interpretation of SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS No. 143). The interpretation 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 that is conditional on a future event if the liability's fair value can be reasonably estimated. The interpretation also provides additional guidance for evaluating whether sufficient information is available to make a reasonable estimate of the fair value. The interpretation is effective for the Company no later than December 31, 2005. The Company has not yet determined the impact of the interpretation on its financial position, results of operations or liquidity.

3. DIVESTITURES

Progress Rail Divestiture

On March 24, 2005, the Company completed the sale of Progress Rail to One Equity Partners LLC, a private equity firm unit of J.P. Morgan Chase & Co. Gross cash proceeds from the sale are estimated to be approximately $430 million, consisting of $405 million base proceeds plus an estimated working capital adjustment. Proceeds from the sale were used to reduce debt.

Based on the estimated gross proceeds associated with the sale of $430 million, the Company recorded an estimated after-tax loss on disposal of $19 million during the six months ended June 30, 2005. The Company anticipates adjustments to the loss on the divestiture during the third quarter of 2005 related to employee benefit settlements and the finalization of the working capital adjustment and other operating estimates.

The accompanying consolidated interim 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 the Company's operations. Interest expense allocated for the three months ended June 30, 2004 was $4 million. Interest expense allocated for the six months ended June 30, 2005 and 2004 was $4 million and $8 million, respectively. The Company ceased recording depreciation upon classification of the assets as discontinued operations in February 2005. After-tax depreciation expense recorded by Progress Rail during the three months ended June 30, 2004 was $3 million. After-tax depreciation expense during the six months ended June 30, 2005 and 2004 was $3 million and $5 million, respectively. Results of discontinued operations were as follows:

	Three Months Ended June 30		Six Months Ended June 30	
(in millions)	2005	2004	2005	2004
Revenues	$ –	$ 285	$ 358	$ 524
Earnings before income taxes	$ –	$ 14	$ 8	$ 27
Income tax expense	–	7	3	11
Net earnings from discontinued operations	–	7	5	16
Estimated loss on disposal of discontinued operations, including income tax benefit of $0 and $14 for the three and six months ended June 30, 2005, respectively	(7)	–	(24)	–
(Loss) earnings from discontinued operations	$ (7)	$ 7	$ (19)	$ 16

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 discussion of the Company's guarantees at Note 14B. The ultimate resolution of these matters could result in adjustments to the loss on sale in future periods.

The major balance sheet classes included in assets and liabilities of discontinued operations in the Consolidated Balance Sheet as of December 31, 2004 are as follows:

(in millions)	
Accounts receivable	$ 172
Inventory	177
Other current assets	15
Total property, plant and equipment, net	174
Total other assets	39
Assets of discontinued operations	$ 577
Accounts payable	$ 113
Accrued expenses	39
Liabilities of discontinued operations	$ 152

In February 2004, the Company sold the majority of the assets of Railcar Ltd., a subsidiary of Progress Rail, to The Andersons, Inc. for proceeds of approximately $82 million.

NCNG Divestiture

In October 2002, the Company announced the Board of Directors' approval to sell North Carolina Natural Gas Corporation (NCNG) and the Company's equity investment in Eastern North Carolina Natural Gas Company to Piedmont Natural Gas Company, Inc. On September 30, 2003, the Company completed the sale. During the three months ended June 30, 2004, the Company recorded an additional gain after taxes of approximately $1 million related to deferred taxes on the loss from the NCNG sale.

Winter Park Divestiture

As discussed in Note 5, PEF sold certain electric distribution assets to the City of Winter Park, Florida on June 1, 2005.

4. ACQUISITIONS

In May 2005, Winchester Production Company, Ltd., an indirectly wholly owned subsidiary of Progress Fuels Corporation, acquired an interest in approximately 11 natural gas producing wells and proven reserves of approximately 25 billion cubic feet equivalent from a privately-owned company headquartered in Texas. In addition to the natural gas reserves, the transaction also included a 50% interest in the gas gathering systems related to these reserves. The total cash purchase price for the transaction was $46 million.

5. REGULATORY MATTERS

PEF Retail Rate Matters

On July 14, 2005, the Florida Public Service Commission (FPSC) issued an order authorizing PEF to recover $232 million, 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 will allow PEF to include a charge of approximately $3.27 on the average residential monthly customer bill beginning August 1, 2005. The ruling by the FPSC approved the majority of the Company's request with two exceptions: the reclassification of $8 million from operation and maintenance expense (O&M) to utility plant and reclassification of $17 million as normal O&M expense. As a result of these adjustments, approximately $17 million was charged to O&M expense in June 2005, representing the retail portion of these adjustments.

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. The Company currently estimates that it has incurred an additional $18 million in costs in excess of the amount requested in the petition. The difference between the actual costs and the amount requested will be trued-up in September 2005, subject to FPSC approval, and the impact will be included in customer bills beginning January 1, 2006.

On June 1, 2005, Florida Governor Jeb Bush signed into law a bill that would allow utilities to petition the FPSC to use securitized bonds to recover storm related costs. PEF intends to ask the FPSC for approval to issue securitized debt. This arrangement would benefit the Company by providing immediate cash recovery of the hurricane costs and would benefit the customer by providing a longer recovery period, which would reduce the price impact on monthly bills. Assuming FPSC approval, PEF expects the process to take six to nine months.

On June 1, 2005, the City of Winter Park, Florida (the City) acquired PEF's electric distribution system that serves the City for approximately $42 million. PEF transferred the distribution system to the City on June 1, 2005 and recognized a pre-tax gain of approximately $25 million on the transaction, which is included in other, net on the Consolidated Statements of Income. This amount is subject to adjustment pending accumulation of the final capital expenditures incurred since arbitration. The Company also recorded a regulatory liability of $8 million for stranded cost revenues which will be amortized to revenues over the next six years in accordance with the provisions of the transfer agreement with the City.

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 has requested a $206 million annual increase in base rates effective January 1, 2006. PEF's request for an increase in base rates reflects an increase in operational costs with (i) the addition of Hines 2 generation facility into base rates rather than the Fuel Clause as was permitted under the terms of existing Stipulation and Settlement Agreement (the Agreement), (ii) completion of the Hines 3 generation facility, (iii) the need, in light of recent history, to replenish PEF's depleted storm reserve on a going-forward basis by adjusting the annual accrual, (iv) the expected infrastructure investment necessary to meet high customer expectations, coupled with the demands placed on PEF's system due to strong customer growth, (v) significant additional costs including increased depreciation and fossil dismantlement expenses and (vi) general inflationary pressures.

Hearings on the base rate proceeding are scheduled for September 7 through September 16, 2005, and a final decision is expected by the end of 2005. Although the Company cannot predict the outcome of this matter, an adverse outcome could negatively impact the Company's and PEF's financial condition and results of operations.

The FPSC requires that PEF perform a depreciation study no less than every four years. PEF filed a depreciation study with the FPSC on April 29, 2005, as part of the Company's base rate filing, which will increase depreciation expense by $14 million beginning in 2006 if approved by the FPSC. The Company cannot predict the outcome or impact of this matter. PEF reduced its estimated removal costs to take into account the estimates used in the depreciation study. This resulted in a downward revision in the PEF estimated removal costs, a component of regulatory liabilities, and equal increase in accumulated depreciation of approximately $401 million.

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 the Company's base rate filing. The new study calls for an increase in the annual accrual of $10 million beginning in 2006. PEF's retail reserve for fossil plant dismantlement was approximately $133 million at June 30, 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 Company cannot predict the outcome or impact of this matter.

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 Nuclear Plant Unit No. 3 (CR3) with the FPSC on April 29, 2005 as part of the Company's base rate filing. PEF's estimate is based on prompt 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 approximately $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 study supports a continuation of that suspension. The Company cannot predict the outcome or impact of this matter.

PEC Retail Rate Matters

On April 27, 2005, PEC filed for an increase in the fuel rate charged to its South Carolina retail customers with the Public Service Commission of South Carolina (SCPSC). PEC requested the increase for underrecovered 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 underrecovered fuel costs over a three-year period ending June 30, 2008, 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 of $55 million, or 12 percent, in PEC's rates was effective July 1, 2005.

On June 3, 2005, PEC filed for an increase in the fuel rate charged to its North Carolina retail customers with the North Carolina Utilities Commission (NCUC). PEC asked the NCUC to approve a $276 million, or 11 percent, increase in rates. PEC requested the increase for underrecovered fuel costs for the previous 12 months and to meet future expected fuel costs. If approved, the increase would take effect October 1, 2005.

On July 25, 2005, PEC, the NCUC Public Staff and the Carolina Industrial Group for Fair Utility Rates jointly filed a proposed settlement agreement with the NCUC to resolve issues concerning PEC's 2005 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 all of its fuel cost undercollections that occurred during the test year ended March 31, 2005 over a one-year period beginning October 1, 2005. Under the proposed settlement, 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. In recognition of the likely undercollection that will result during the year ending September 30, 2006, 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 until such amounts have been collected. Hearings on this matter are scheduled for August 2005 with an order due in September 2005. If approved, the increase would take effect October 1, 2005. The Company cannot predict the outcome of this matter.

6. EQUITY AND COMPREHENSIVE INCOME

A. Earnings Per Common Share

A reconciliation of the weighted-average number of common shares outstanding for basic and dilutive earnings per share purposes is as follows:

(in millions)	Three Months Ended June 30 2005	2004	Six Months Ended June 30 2005	2004
Weighted-average common shares – basic	246	242	245	242
Restricted stock awards	1	1	1	1
Weighted-average shares – fully dilutive	247	243	246	243

B. Comprehensive Income

(in millions)	Three Months Ended June 30 2005	2004
Net (loss) income	$ (1)	$ 154
Other comprehensive income (loss):		
Reclassification adjustments included in net income:		
Change in cash flow hedges (net of tax expense of $2 and $3, respectively)	3	4
Changes in net unrealized gains on cash flow hedges (net of tax expense of $26 and $0, respectively)	44	2
Foreign currency translation adjustment and other	(1)	(1)
Other comprehensive income	$ 46	$ 5
Comprehensive income	$ 45	$ 159

	Six Months Ended June 30	
(in millions)	2005	2004
Net income	$ 92	$ 262
Other comprehensive income (loss):		
Reclassification adjustments included in net income:		
Change in cash flow hedges (net of tax expense of $3 and $5, respectively)	5	8
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 (losses) on cash flow hedges (net of tax expense (benefit) of $31 and ($8), respectively)	50	(15)
Foreign currency translation adjustment and other	1	1
Other comprehensive income (loss)	$ 51	$ (6)
Comprehensive income	$ 143	$ 256

C. Common Stock

At December 31, 2004, the Company had approximately 63 million shares of common stock authorized by the Board of Directors that remained unissued and reserved. In 2002, the Board of Directors authorized meeting the requirements of the Progress Energy 401(k) Savings and Stock Ownership Plan and the Investor Plus Stock Purchase Plan with original issue shares. For the three and six months ended June 30, 2005, the Company issued approximately 2.6 million shares and 3.9 million shares, respectively, under these plans for net proceeds of approximately $111 million and $169 million, respectively.

7. DEBT AND CREDIT FACILITIES AND FINANCING ACTIVITIES

Changes to the Company's debt and credit facilities since December 31, 2004, discussed in Note 13 of the Company's 2004 Annual Report on Form 10-K, are described below.

In January 2005, the Company used proceeds from the issuance of commercial paper to pay off $260 million of revolving credit agreement (RCA) loans, which included $90 million at PEC and $170 million at PEF.

On January 31, 2005, Progress Energy, Inc. entered into a new $600 million RCA, which was to expire on December 30, 2005. This facility was added to provide additional liquidity, to the extent necessary, during 2005 due in part to the uncertainty of the timing of storm restoration cost recovery from the hurricanes in Florida during 2004. On February 4, 2005, $300 million was drawn under the new facility to reduce commercial paper and pay off the remaining amount of loans outstanding under other RCA facilities, which consisted of $160 million at Progress Energy and $55 million at PEF. As discussed below, the maximum size of this RCA was reduced to $300 million on March 22, 2005 and subsequently terminated on May 16, 2005.

On March 22, 2005, PEC issued $300 million of First Mortgage Bonds, 5.15% Series due 2015, and $200 million of First Mortgage Bonds, 5.70% Series due 2035. The net proceeds from the sale of the bonds were used to pay at maturity $300 million of PEC's 7.50% Senior Notes on April 1, 2005 and reduce the outstanding balance of PEC's commercial paper. Pursuant to the terms of the Progress Energy $600 million RCA, commitments were reduced to $300 million, effective March 22, 2005.

In March 2005, Progress Energy, Inc.'s $1.1 billion five-year credit facility was amended to increase the maximum total debt to total capital ratio from 65% to 68% due to the potential impacts of a proposed interpretation of SFAS No. 109 regarding accounting rules for uncertain tax positions (See Note 2).

On March 28, 2005, PEF entered into a new $450 million five-year RCA with a syndication of financial institutions. The RCA will be used to provide liquidity support for PEF's issuances of commercial paper and other short-term obligations. The RCA will expire on March 28, 2010. The new $450 million RCA replaced PEF's $200 million three-year RCA and $200 million 364-day RCA, which were each terminated effective March 28, 2005. Fees and interest rates under the $450 million RCA are to be determined based upon the credit rating of PEF's long-term unsecured senior non-credit enhanced debt, currently rated as A3 by Moody's Investor Services (Moody's) and BBB by Standard and Poor's (S&P). The RCA includes a defined maximum total debt to capital ratio of 65%. The RCA also contains various cross-default and other acceleration provisions, including a cross-default provision for defaults of indebtedness in excess of $35 million. The RCA does not include a material adverse change representation for borrowings or a financial covenant for interest coverage, which had been provisions in the terminated agreements.

On March 28, 2005, PEC entered into a new $450 million five-year RCA with a syndication of financial institutions. The RCA will be used to provide liquidity support for PEC's issuances of commercial paper and other short-term obligations. The RCA will expire on June 28, 2010. The new $450 million RCA replaced PEC's $285 million three-year RCA and $165 million 364-day RCA, which were each terminated effective March 28, 2005. Fees and interest rates under the $450 million RCA are to be determined based upon the credit rating of PEC's long-term unsecured senior non-credit enhanced debt, currently rated as Baa1 by Moody's and BBB by S&P. The RCA includes a defined maximum total debt to capital ratio of 65%. The RCA also contains various cross-default and other acceleration provisions, including a cross-default provision for defaults of indebtedness in excess of $35 million. The RCA does not include a material adverse change representation for borrowings, which had been a provision in the terminated agreements.

In May 2005, Progress Energy, Inc. used proceeds from the issuance of commercial paper to pay off $300 million of its $600 million RCA.

On May 16, 2005, PEF issued $300 million of First Mortgage Bonds, 4.50% Series due 2010. The net proceeds from the sale of the bonds were used to reduce the outstanding balance of commercial paper. Pursuant to the terms of the Progress Energy $600 million RCA, commitments were completely reduced and the RCA was terminated, effective May 16, 2005.

On July 1, 2005, PEF paid at maturity $45 million of its 6.72% Medium-Term Notes, Series B with short-term debt proceeds.

On July 28, 2005, PEC filed a shelf registration statement with the SEC to provide an additional $1.0 billion of capacity in addition to the $400 million remaining on PEC's current shelf registration statement. The shelf registration statement will allow PEC to issue various securities, including First Mortgage Bonds, Senior Notes, Debt Securities and Preferred Stock.

On July 28, 2005, PEF filed a shelf registration statement with the SEC to provide an additional $1.0 billion of capacity in addition to the $450 million remaining on PEF's current shelf registration statement. The shelf registration statement will allow PEF to issue various securities, including First Mortgage Bonds, Debt Securities and Preferred Stock.

8. BENEFIT PLANS

The Company and some of its subsidiaries have a noncontributory defined benefit retirement (pension) plan for substantially all full-time employees. The Company also has supplementary defined benefit pension plans that provide benefits to higher-level employees. In addition to pension benefits, the Company and some of its subsidiaries 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 three and six months ended June 30 are:

Three Months Ended June 30 (in millions)	Pension Benefits		Other Postretirement Benefits	
	2005	2004	2005	2004
Service cost	$ 15	$ 13	$ 3	$ 4
Interest cost	29	28	8	8
Expected return on plan assets	(37)	(37)	(1)	(1)
Amortization of actuarial loss	6	5	1	1
Other amortization, net	1	-	-	1
Net periodic cost	$ 14	$ 9	$ 11	$ 13
Additional cost / (benefit) recognition (a)	(4)	(4)	1	1
Net periodic cost recognized	$ 10	$ 5	$ 12	$ 14

Six Months Ended June 30 (in millions)	Pension Benefits		Other Postretirement Benefits	
	2005	2004	2005	2004
Service cost	$ 30	$ 27	$ 6	$ 8
Interest cost	57	55	16	17
Expected return on plan assets	(73)	(75)	(3)	(2)
Amortization of actuarial loss	12	11	2	2
Other amortization, net	1	-	1	1
Net periodic cost	$ 27	$ 18	$ 22	$ 26
Additional cost / (benefit) recognition (a)	(8)	(8)	1	1
Net periodic cost recognized	$ 19	$ 10	$ 23	$ 27

(a) Relates to the acquisition of FPC. See Note 17B of Progress Energy's Form 10-K for year ended December 31, 2004.

In addition, in the second quarter of 2005 the Company recorded costs for special termination benefits related to its voluntary enhanced retirement program (see Note 10) of approximately $122 million for pension benefits and $19 million for other postretirement benefits. These charges resulted in a $37 million decrease in prepaid pension assets, which is included in other assets and deferred debits, and a $104 million increase in pension and OPEB liabilities, which are included in other liabilities and deferred credits on the Consolidated Balance Sheets.

9. RISK MANAGEMENT ACTIVITIES AND DERIVATIVE TRANSACTIONS

Progress Energy and its subsidiaries are exposed to various risks related to changes in market conditions. The Company has 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 its risk policy, the Company 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. The Company minimizes 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 the consolidated financial position or consolidated results of operations of the Company. See Note 18 to the Company's Annual Report on Form 10-K for the year ended December 31, 2004.

A. Commodity Derivatives

General

Most of the Company's 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 DIG Issue C20, "Scope Exceptions: Interpretation of the Meaning of Not Clearly and Closely Related in Paragraph 10(b) regarding Contracts with a Price Adjustment Feature." The related liability is being amortized to earnings over the term of the related contract (See Note 12). As of June 30, 2005 and December 31, 2004, the remaining liability was $23 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. The Company manages open positions with strict policies that limit its exposure to market risk and require daily reporting to management of potential financial exposures. The Company recorded pre-tax losses of less than $1 million and $2 million on such contracts for the three months ended June 30, 2005 and 2004, respectively. The Company recorded a $2 million pre-tax gain and a $14 million pre-tax loss on such contracts for the six months ended June 30, 2005 and 2004, respectively. The Company did not have material outstanding positions in such contracts as of June 30, 2005 and December 31, 2004, other than those receiving regulatory accounting treatment, as discussed below.

PEF has derivative instruments related to its exposure to price fluctuations on fuel oil purchases. These instruments receive regulatory accounting treatment. Unrealized gains and losses are recorded in regulatory liabilities and regulatory assets, respectively. As of June 30, 2005, the fair values of these instruments were a $60 million short-term derivative asset position included in other current assets and a $22 million long-term derivative asset position included in other assets and deferred debits. As of December 31, 2004, the fair values of these 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

Progress Energy's nonregulated 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 for the Company's 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 for the three and six months ending June 30, 2005 and 2004, was not material to the Company's results of operations.

The fair values of commodity cash flow hedges as of June 30, 2005 and December 31, 2004, were as follows:

(in millions)	June 30, 2005	December 31, 2004
Fair value of assets	$ 96	$ –
Fair value of liabilities	(24)	(15)
Fair value, net	$ 72	$ (15)

The following table presents selected information related to the Company's commodity cash flow hedges as of June 30, 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]
Commodity cash flow hedges	10	$ 44	$ (9)

[a] Hedges in fair value liability positions have a maximum term of less than two years and hedges in fair value asset positions have a maximum term of 10 years.
[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.

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

The Company uses cash flow hedging strategies to reduce exposure to changes in cash flow due to fluctuating interest rates. The Company uses 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 as of June 30, 2005 and December 31, 2004, were as follows:

(in millions)	June 30, 2005	December 31, 2004
Interest rate cash flow hedges	$ (3)	$ (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 for the three and six months ending June 30, 2005 and 2004, was not material to the Company's results of operations.

The following table presents selected information related to the Company's interest rate cash flow hedges included in OCI as of June 30, 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]
Interest rate cash flow hedges	Less than one	$ (17)	$ (3)

[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.

As of June 30, 2005 and December 31, 2004, the Company had $300 million notional and $331 million notional, respectively, of 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. As of June 30, 2005 and December 31, 2004, the Company had $150 million notional of interest rate fair value hedges.

10. SEVERANCE COSTS

On February 28, 2005, as part of a previously announced cost management initiative, the Company approved a workforce restructuring which is expected to be completed in September 2005 and result in a reduction of approximately 450 positions. The cost management initiative is designed to permanently reduce by $75 million to $100 million the projected growth in the Company's 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, the Company incurred approximately $176 million of pre-tax charges for severance and postretirement benefits during the six months ended June 30, 2005, as described below.

The Company 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. The workforce restructuring expense was computed 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 quarter of 2005, the Company decreased its estimated severance costs by $13 million 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 is as follows:

(in millions)	
Balance as of January 1, 2005	$ 5
Severance costs accrued	31
Adjustments	(13)
Payments	(2)
Balance as of June 30, 2005	**$ 21**

The Company recorded a $141 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 8). In addition, the Company recorded a $17 million charge for early retirement incentives to be paid over time to certain employees.

The cost management initiative charges are subject to revision in future quarters based on completion of the workforce restructuring and the potential additional impacts that the early retirements and outplacements may have on the Company's postretirement plans. Such revisions may be significant and may adversely impact the Company's results of operations in future periods. In addition, the Company expects to incur certain incremental costs for recruiting and staff augmentation activities that cannot be quantified at this time.

11. FINANCIAL INFORMATION BY BUSINESS SEGMENT

The Company's reportable segments include: Progress Energy Carolinas Electric (PEC Electric), Progress Energy Florida (PEF), Competitive Commercial Operations (CCO), Fuels and Synthetic Fuels.

PEC Electric and PEF are primarily engaged in the generation, transmission, distribution and sale of electric energy in portions of (i) North Carolina and South Carolina and (ii) Florida, respectively. These electric operations are subject to the rules and regulations of the FERC, the NCUC, the SCPSC, the FPSC and the United States Nuclear Regulatory Commission (NRC). These electric operations also distribute and sell electricity to other utilities, primarily on the east coast of the United States.

Fuels is engaged in natural gas production in Texas and Louisiana, coal mining, coal terminal services and fuel transportation and delivery in Kentucky, West Virginia and Virginia.

CCO is primarily engaged in nonregulated electric generation operations and marketing activities in Georgia, North Carolina and Florida.

Synthetic Fuel operations include the production and sale of coal-based solid synthetic fuel (as defined under the Internal Revenue Code) and the operation of synthetic fuel facilities for outside parties in West Virginia, Virginia and Kentucky. See Note 14 for more information.

In addition to these reportable operating segments, the Company has Corporate and other activities that include holding company and service company operations as well as other nonregulated business areas. These nonregulated business areas include telecommunications and energy service operations 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." The profit or loss of the identified segments plus the loss of Corporate and Other represents the Company's total income from continuing operations.

Prior to 2005, Rail Services was reported as a separate segment. In connection with the divestiture of Progress Rail (see Note 3), the operations of Rail Services were reclassified to discontinued operations in the first quarter of 2005 and therefore are not included in the results from continuing operations during the periods reported. In addition, Synthetic Fuel activities were reported in the Fuels segment prior to 2005 and now are considered a separate reportable segment. These reportable segment changes reflect the current reporting structure. For comparative purposes, the prior year results have been restated to conform to the current presentation.

	Revenues					
(in millions)	Unaffiliated	Intersegment	Total	Postretirement and Severance Charges	Income from Continuing Operations	Assets
FOR THE THREE MONTHS ENDED JUNE 30, 2005						
PEC Electric	**$ 860**	**$ -**	**$ 860**	**$ 46**	**$ 68**	**$ 10,830**
PEF	**908**	**-**	**908**	**93**	**10**	**7,742**
Fuels	**178**	**335**	**513**	**4**	**12**	**813**
CCO	**158**	**-**	**158**	**1**	**(3)**	**1,755**
Synthetic Fuels	**213**	**-**	**213**	**-**	**23**	**290**
Corporate and Other	**16**	**126**	**142**	**1**	**(104)**	**17,456**
Eliminations	**-**	**(461)**	**(461)**	**-**	**-**	**(13,240)**
Consolidated totals	**$ 2,333**	**$ -**	**$ 2,333**	**$ 145**	**$ 6**	**$ 25,646**
FOR THE THREE MONTHS ENDED JUNE 30, 2004						
PEC Electric	$ 861	$ –	$ 861	$ 5	$ 97	
PEF	860	–	860	-	84	
Fuels	146	273	419	-	17	
CCO	72	–	72	-	5	
Synthetic Fuels	161	2	163	-	36	
Corporate and Other	23	104	127	-	(93)	
Eliminations	–	(379)	(379)	-	–	
Consolidated totals	$ 2,123	$ –	$ 2,123	$ 5	$ 146	

(in millions)	Revenues: Unaffiliated	Revenues: Intersegment	Revenues: Total	Postretirement and Severance Charges	Income from Continuing Operations	Assets
FOR THE SIX MONTHS ENDED JUNE 30, 2005						
PEC Electric	$ 1,795	$ –	$ 1,795	$ 60	$ 184	$ 10,830
PEF	1,756	–	1,756	107	53	7,742
Fuels	314	642	956	6	23	813
CCO	222	–	222	2	(9)	1,755
Synthetic Fuels	411	–	411	–	22	290
Corporate and Other	33	227	260	1	(162)	17,456
Eliminations	–	(869)	(869)	–	–	(13,240)
Consolidated totals	$ 4,531	$ –	$ 4,531	$ 176	$ 111	$ 25,646
FOR THE SIX MONTHS ENDED JUNE 30, 2004						
PEC Electric	$ 1,762	$ –	$ 1,762	$ 5	$ 213	
PEF	1,644	–	1,644	1	133	
Fuels	252	539	791	–	27	
CCO	105	–	105	–	(3)	
Synthetic Fuels	326	6	332	–	72	
Corporate and Other	40	201	241	–	(197)	
Eliminations	–	(746)	(746)	–	–	
Consolidated totals	$ 4,129	$ –	$ 4,129	$ 6	$ 245	

12. OTHER INCOME AND OTHER EXPENSE

Other income and expense includes interest income and other income and expense items as discussed below. The components of other, net as shown on the accompanying Consolidated Statements of Income are as follows:

(in millions)	Three Months Ended June 30 2005	Three Months Ended June 30 2004	Six Months Ended June 30 2005	Six Months Ended June 30 2004
Other income				
Nonregulated energy and delivery services income	$ 11	$ 7	$ 17	$ 12
DIG Issue C20 Amortization (see Note 9)	2	2	3	4
Investment gains	-	2	3	4
Income from equity investments	3	-	5	-
Gain on sale of distribution assets (see Note 5)	25	-	25	-
AFUDC equity	5	2	9	4
Other	3	8	8	14
Total other income	$ 49	$ 21	$ 70	$ 38
Other expense				
Nonregulated energy and delivery services expenses	$ 5	$ 5	$ 10	$ 9
Donations	5	2	11	10
Investment losses	-	3	-	3
Contingent value obligations unrealized loss	-	5	-	13
Loss from equity investments	4	4	10	7
Write-off of non-trade receivables	-	-	-	7
FERC audit settlement	7	-	7	-
Other	9	5	11	14
Total other expense	$ 30	$ 24	$ 49	$ 63
Other, net	$ 19	$ (3)	$ 21	$ (25)

Nonregulated energy and delivery services include power protection services and mass-market programs (surge protection, appliance services and area light sales) and delivery, transmission and substation work for other utilities.

FERC audit settlement includes amounts approved by the FERC on May 25, 2005, to settle the FERC Staff's Audit of PEC's and PEF's compliance with the FERC's Standards of Conduct and Code of Conduct. In the settlement, PEC and PEF agreed to make certain operational and organizational changes and to provide their retail and wholesale customers a one-time credit of approximately $7 million which was recorded as other expense in the second quarter of 2005. PEC recorded $4 million of the settlement and PEF recorded the remaining $3 million.

13. ENVIRONMENTAL MATTERS

The Company is subject to federal, state and local regulations addressing hazardous and solid waste management, air and water quality and other environmental matters. See Note 22 of the Company's 2004 Annual Report on Form 10-K for a more detailed, historical discussion of these federal, state, and local regulations.

HAZARDOUS AND SOLID WASTE MANAGEMENT

The provisions of the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (CERCLA), authorize the EPA to require the cleanup of hazardous waste sites. This statute imposes retroactive joint and several liabilities. Some states, including North Carolina and South Carolina and Florida, have similar types of legislation. The Company and its subsidiaries are periodically notified by regulators, including the EPA and various state agencies, of their involvement or potential involvement in sites that may require investigation and/or remediation. There are presently several sites with respect to which the Company has been notified by the EPA, the State of North Carolina or the State of Florida of its potential liability, as described below in greater detail. The Company also is currently in the process of assessing potential costs and exposures at other sites. For all sites, as the assessments are developed and analyzed, the Company will accrue costs for the sites to the extent the costs are probable and can be reasonably estimated. A discussion of sites by legal entity follows.

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.

The Company has filed claims with its general liability insurance carriers to recover costs arising from actual or potential environmental liabilities. Almost all claims have been settled and a few are still pending. While the Company cannot predict the outcome of these matters, the outcome is not expected to have a material effect on the consolidated financial position or results of operations.

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.

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, North Carolina. The EPA offered PEC and a number of other PRPs the opportunity to negotiate cleanup of the site and reimbursement of less than $2 million to the EPA for EPA's past expenditures in addressing conditions at the site. PEC and other PRP's are in discussions with the EPA to reach an agreement. However, as an agreement among PRPs has not yet been reached, it is not possible at this time to reasonably estimate the total amount of PEC's obligation for remediation of the Ward Transformer site. If an agreement cannot be reached, the EPA could issue a unilateral order requiring cleanup of the site. The Company cannot predict the outcome of this matter.

As of June 30, 2005 and December 31, 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:

(in millions)	June 30, 2005	December 31, 2004
Insurance fund	$ 4	$ 7
Transferred from North Carolina Natural Gas Corporation at time of sale	2	2
Total accrual for environmental sites	$ 6	$ 9

The insurance fund in the table above was established when PEC received insurance proceeds 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. For the three and six months ended June 30, 2005, PEC made no additional accruals, received no insurance proceeds, and spent approximately $1 million and $3 million, respectively, related to environmental remediation.

This accrual has been recorded on an undiscounted basis. PEC measures its liability for these sites based on available evidence including its experience in investigating and remediating environmentally impaired sites. The process often involves assessing and developing cost-sharing arrangements with other PRPs. PEC will accrue costs for the sites to the extent its 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, PEC cannot determine the total costs that may be incurred in connection with the remediation of all sites at this time. It is anticipated that sufficient information will become available for several sites during 2005 to allow a reasonable estimate of PEC's obligation for those sites to be made.

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 the Company's coal-fired plants located in the state. The Company has reviewed the permit conditions, which could significantly restrict the reuse of coal ash and result in higher ash management costs and plans to adjudicate the permit conditions. The Company cannot predict the outcome of this matter.

PEF

As of June 30, 2005 and December 31, 2004, PEF'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 fifteen years, were:

(in millions)	June 30, 2005	December 31, 2004
Remediation of distribution and substation transformers	$ 22	$ 27
MGP and other sites	18	18
Total accrual for environmental sites	$ 40	$ 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. PEF expects to have completed its review of distribution transformer sites 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 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 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. In 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. For the three and six months ended June 30, 2005, PEF made no additional accruals or material expenditures and received no insurance proceeds.

These accruals have been recorded on an undiscounted basis. PEF measures its liability for these sites based on available evidence including its experience in investigating and remediating environmentally impaired sites. This process often includes assessing and developing cost-sharing arrangements with other PRPs. 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 advanced to the stage where a reasonable estimate of the remediation costs can be made, at this time PEF is unable to provide an estimate of its obligation to remediate these sites beyond what is currently accrued. As more activity occurs at these sites, PEF will assess the need to adjust the accruals. It is anticipated that sufficient information will become available in 2005 to make a reasonable estimate of PEF's obligation for one of the MGP sites.

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. The Company is in the process of assessing the impact of this rule.

Florida Progress Corporation

In 2001, FPC established an accrual to address indemnities and retained an environmental liability associated with the sale of its Inland Marine Transportation business. In 2003, the accrual was reduced to $4 million based on a change in estimate. As of June 30, 2005 and December 31, 2004, the remaining accrual balance was approximately $3 million. Expenditures related to this liability were not material to the Company's financial condition for the three and six months ended June 30, 2005. FPC measures its liability for these exposures based on estimable and probable remediation scenarios.

Certain historical sites are being addressed voluntarily by FPC. An immaterial accrual has been established to address investigation expenses related to these sites. At this time, the Company cannot determine the total costs that may be incurred in connection with these sites.

Progress Rail

On March 24, 2005, the Company closed on the sale of its Progress Rail subsidiary. In connection with the sale, the Company incurred indemnity obligations related to certain pre-closing liabilities, including certain environmental matters (see discussion under Guarantees in Note 14B).

AIR QUALITY

The Company is subject to various current and proposed federal, state, and local environmental compliance laws and regulations, which may result in increased planned capital expenditures and operating and maintenance costs. Significant updates to these laws and regulations and related impacts to the Company since December 31, 2004, are discussed below. Additionally, Congress is considering legislation that would require reductions in air emissions of NOx, SO_2, carbon dioxide 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 the Company's consolidated financial position or results of operations. Control equipment that will be installed on North Carolina fossil generating facilities as part of the North Carolina Clean Smokestacks Act (Smokestacks Act), enacted in 2002 and discussed below, may address some of the issues outlined above. However, the Company cannot predict the outcome of the matter.

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. The Company was 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 other 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 cost through rate adjustments or similar mechanisms.

Total capital expenditures to meet the requirements of the final rule under Section 110 of the Clean Air Act (NOx SIP Call) in North and South Carolina could reach approximately $370 million. This amount also includes the cost to install NOx controls under North Carolina's and South Carolina's programs to comply with the federal 8-hour ozone standard. However, further technical analysis and rulemaking may result in requirements for additional controls at some units. To date, the Company has spent approximately $324 million related to these projected amounts. Increased operation and maintenance costs relating to the NOx SIP Call are not expected to be material to the Company's results of operations. Further controls are anticipated as electricity demand increases. Parties unrelated to the Company 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 NOx SIP Call. The Company cannot predict the outcome of this matter for the impact to its nonregulated operations in Georgia.

The Company projects that its capital costs to meet emission targets for NOx and SO_2 from coal-fired power plants under the Smokestacks Act, will total approximately $895 million by the end of 2013. PEC has expended approximately $190 million of these capital costs through June 30, 2005. The Smokestacks Act requires PEC to amortize 70% of the original cost estimate of $813 million, during a five-year rate freeze period. PEC recognized amortization of $27 million and $54 million, respectively, for the three and six months ended June 30, 2005, and has recognized $302 million in cumulative amortization through June 30, 2005. The remaining amortization requirement will be recorded over the future period ending December 31, 2007. The law permits PEC the flexibility to vary the amortization schedule for recording the compliance costs from zero up to $174 million of amortization expense per year. The NCUC will hold a hearing prior to December 31, 2007, to determine cost recovery amounts for 2008 and future periods. O&M expense will significantly increase due to the additional materials, personnel and general maintenance associated with the equipment. O&M expenses are recoverable through base rates, rather than as part of this program. The Company cannot predict the future regulatory interpretation, implementation or impact of this law.

On March 10, 2005, the EPA issued the final Clean Air Interstate Rule (CAIR). The EPA's rule requires 28 states, including North Carolina, South Carolina, Georgia and Florida, and the District of Columbia to reduce NOx and SO_2 emissions in order to attain state NOx and SO_2 emissions levels. Installation of additional air quality controls is likely to be needed to meet the CAIR requirements. The Company is in the process of determining compliance plans and the cost to comply with the rule. The air quality controls already installed for compliance with the NOx SIP Call and currently planned by the Company to comply with the Smokestacks Act will reduce the costs required to meet the CAIR requirements for the Company's North Carolina units. The Company preliminarily estimates compliance costs for PEF could be approximately $1.0 billion over the next ten years. PEF has joined a coalition of Florida utilities that has filed a challenge to CAIR as it applies to Florida. A petition for reconsideration and stay and a petition for judicial review of CAIR were filed on July 11, 2005. The Company cannot predict the outcome of this matter.

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 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. NOx and SO_2 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 NOx and SO_2 under CAIR. The Company is in the process of determining compliance plans and the cost to comply with the CAMR. Installation of additional air quality controls is likely to be needed to meet the CAMR's requirements. The de-listing rule has been challenged by a number of parties; the resolution of the challenges could impact the Company's final compliance plans and costs.

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 the Company's pollution control equipment proposals will be required adding time and cost to the overall project.

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.

On May 6, 2005, PEF filed a petition with the FPSC through the ECRC program for recovery of costs associated with the development and implementation of an integrated strategy to comply with the CAIR and CAMR. PEF is developing an integrated compliance strategy for the CAIR and CAMR rules because NOx and SO_2 controls also are effective in reducing mercury emissions. PEF estimates the program costs for 2005 to be approximately $2 million for preliminary engineering activities and strategy development work necessary to determine the Company's integrated compliance strategy. PEF projects approximately $62 million in program costs for 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 2005 and 2006. PEF expects to incur significant additional capital and O&M costs to achieve compliance with the CAIR and CAMR through 2015 and beyond. The timing and extent of the costs for future projects will depend upon the final compliance strategy.

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 will hold a 60-day public comment period from the date that the proposal is published in the Federal Register and must take final action by March 15, 2006. The Company cannot predict the outcome of this matter.

In a decision issued July 15, 2005, 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 carbon dioxide emissions under the Clean Air Act. The court in a 2-1 decision, held that the EPA Administrator properly exercised his discretion in denying the request for regulation.

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 PEC and PEF in the immediate and extended future.

Based on new cost information and changes to the estimated time frame of expenditures since December 31, 2004, the Company has revised the estimated amounts and time period for expenditures to meet Section 316(b) requirements of the Clean Water Act. The Company currently estimates that from 2005 through 2010 the range of expenditures will be approximately $80 million to $110 million. The range includes $15 million to $25 million at PEC and $65 million to $85 million at PEF.

OTHER ENVIRONMENTAL MATTERS

The Kyoto Protocol was adopted in 1997 by the United Nations to address global climate change by reducing emissions of carbon dioxide 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. A number of carbon dioxide emissions control proposals have been advanced in Congress. Reductions in carbon dioxide emissions to the levels specified by the Kyoto Protocol and some legislative proposals could be materially adverse to the Company's consolidated financial position or results of operations if associated costs of control or limitation cannot be recovered from customers. The Company favors the voluntary program approach recommended by the Bush administration and continually evaluates options for the reduction, avoidance and sequestration of greenhouse gases. However, the Company cannot predict the outcome of this matter.

Progress Energy has announced its plan to issue a report on the Company's activities associated with current and future environmental requirements. The report will include a discussion of the environmental requirements that the Company currently faces and expects to face in the future with respect to its air emissions. The report is expected to be issued by March 31, 2006.

14. COMMITMENTS AND CONTINGENCIES

Contingencies and significant changes to the commitments discussed in Note 23 of the Company's 2004 Annual Report on Form 10-K are described below.

A. Purchase Obligations

As part of Progress Energy's ordinary course of business, it enters into various long and short term contracts for fuel requirements at its generating plants. Through June 30, 2005, contracts procured through PEC have increased the Company's aggregate purchase obligations for fuel and purchased power by approximately $709 million as compared to the amount stated in the Company's Form 10-K for the year ended December 31, 2004. The increase primarily covers the period ranging from 2005 through 2009. A majority of the contracts related to the increase in purchase obligations for fuel and purchased power are for future coal purchases primarily with fixed prices.

B. Guarantees

As a part of normal business, Progress Energy and certain wholly-owned subsidiaries 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. As of June 30, 2005, the Company does 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 Consolidated Balance Sheets.

As of June 30, 2005, the Company has 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 its non-wholly 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 the Company has received timely notice, the Company's indemnity obligations may extend beyond the notice period. Certain environmental indemnifications related to the sale of synthetic fuel operations have no limitations as to time or maximum potential future payments. Other guarantees and indemnifications have an estimated maximum exposure of approximately $152 million. As of June 30, 2005, the Company has recorded liabilities related to guarantees and indemnifications to third-parties of $27 million. Management does not believe conditions are likely for significant performance under these agreements in excess of the recorded liabilities.

C. Insurance

PEC and PEF 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 plant.

D. Other Commitments

As discussed in Note 23B of the Progress Energy annual report on Form 10-K for the year ended December 31, 2004, the Company has certain future commitments related to four synthetic fuel facilities purchased that provide for contingent payments (royalties). The Company has exercised its right in the related agreements to escrow those payments if certain conditions in the agreements were met. The Company previously accrued and retained 2004 and 2003 royalty payments of approximately $41 million and $49 million, respectively. In May 2005, these funds were placed into escrow upon establishment of the necessary escrow accounts.

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 Corporation subsidiaries that purchased the Earthco facilities (Progress Fuels subsidiaries). The plaintiffs also named Progress Energy, Inc. as a defendant. The plaintiffs' complaint is that periodic payments otherwise due to them under the sales arrangement with the Progress Fuels subsidiaries are, contrary to the sales agreement, being escrowed pending the outcome of the ongoing IRS audit of the Earthco facilities. The Progress Fuels subsidiaries believe that the parties' agreements allow for the payments to be escrowed in such event 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 $87 million, which reflects periodic payments that would have been paid to the plaintiffs beginning April 30, 2003 through July 31, 2005. This amount will increase as future periodic payments are made to the escrow which would otherwise have been payable to the plaintiffs. The Company and the Progress Fuels subsidiaries intend to vigorously defend their actions, but cannot predict the outcome of this matter.

E. Other Contingencies

1. Pursuant to the Nuclear Waste Policy Act of 1982, the predecessors to PEF and PEC entered into contracts with the U.S. Department of Energy (DOE) under which the DOE agreed to begin taking spent nuclear fuel (SNF) 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, PEC and PEF 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 SNF from various Progress Energy facilities on or before January 31, 1998. 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 SNF are currently pending in the Court of Federal Claims.

The DOE and the PEC/PEF parties 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 SNF and high level waste (HLW) by which the Government was contractually obligated to accept contract holders' SNF and/or HLW, 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 2005. Resolution of these issues in other cases could facilitate agreements by the parties in the PEC/PEF 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.

On February 27, 2004, PEC requested to have its license for the Independent Spent Fuel Storage Installation at the Robinson Plant extended by 20 years with an exemption request for an additional 20-year extension. Its current license is due to expire in August 2006. On March 30, 2005, the NRC issued the 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, Crystal River Unit No. 3 (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.

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, Nevada. In January 2003, the State of Nevada, Clark County, Nevada, and the City of 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. The EPA is currently reworking the standard but has not stated when the work will be complete. 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. Also in November 2004, Congressional negotiators approved $577 million for fiscal year 2005 for the Yucca Mountain project, approximately $300 million less than requested by the DOE but approximately the same as approved in 2004. 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 Company cannot predict the outcome of this matter.

2. In 2001, PEC entered into a contract to purchase coal from Dynegy Marketing and Trade (DMT). After DMT experienced financial difficulties, including credit ratings downgrades by certain credit reporting agencies, PEC requested credit enhancements in accordance with the terms of the coal purchase agreement in July 2002. When DMT did not offer credit enhancements, as required by a provision in the contract, PEC terminated the contract in July 2002.

PEC initiated a lawsuit seeking a declaratory judgment that the termination was lawful. DMT counterclaimed, stating the termination was a breach of contract and an unfair and deceptive trade practice. On March 23, 2004, the United States District Court for the Eastern District of North Carolina ruled that PEC was liable for breach of contract, but ruled against DMT on its unfair and deceptive trade practices claim. On April 6, 2004, the Court entered a judgment against PEC in the amount of approximately $10 million. The Court did not rule on DMT's request under the contract for pending legal costs.

On May 4, 2004, PEC authorized its outside counsel to file a notice of appeal of the April 6, 2004 judgment, and on May 7, 2004, the notice of appeal was filed with the United States Court of Appeals for the Fourth Circuit. On June 8, 2004, DMT filed a motion to dismiss PEC's appeal on the ground that it was untimely. On July 20, 2005, the appellate court denied DMT's motion to dismiss and ruled that the time for PEC to appeal had not yet expired. The appellate court remanded the case to the trial court for further proceedings.

In the first quarter of 2004, PEC recorded a liability for the judgment of approximately $10 million and a regulatory asset for the probable recovery through its fuel adjustment clause. The Company cannot predict the outcome of this matter.

3. On February 1, 2002, PEC filed a complaint with the Surface Transportation Board (STB) challenging the rates charged by Norfolk Southern Railway Company (Norfolk Southern) for coal transportation to certain generating plants. In a decision served in December, 2003, the STB found that the challenged rates exceeded maximum reasonable rate levels and prescribed lower rates. In a

subsequent decision on reconsideration the STB concluded that the rates had not been shown to be unreasonable, following which PEC requested the STB to consider requiring that the rates be phased in over a period of time. During the course of the complaint process, PEC accrued a liability of $42 million. The liability was comprised of $23 million of reparations remitted to PEC by Norfolk Southern that were subject to refund and an additional $19 million, of which $17 million was recorded as deferred fuel cost on the Consolidated Balance Sheet. This matter has now been settled by mutual agreement, and the STB has issued an order dismissing the case. As a result of the settlement, PEC reversed the previously recorded deferred fuel cost and settled the remaining obligations for the approximate amount previously accrued. The settlement had an immaterial impact on the Company's results of operations.

4. The Company, through its subsidiaries, is a majority owner in five entities and a minority owner in one entity that owns facilities that produce coal-based solid synthetic fuel as defined under the Internal Revenue Code (Code). The production and sale of the synthetic fuel from these facilities qualify for tax credits under Section 29 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. The amount of Section 29 tax credits that the Company is allowed to claim in any calendar year is limited by the amount of the Company's regular federal income tax liability. Synthetic fuel tax credit amounts allowed but not utilized are carried forward indefinitely as deferred alternative minimum tax credits. All entities have received PLRs from the IRS with respect to their synthetic fuel operations. However, these PLRs do not address the placed-in-service date determination. The PLRs do not limit the production on which synthetic fuel credits may be claimed. Total Section 29 credits generated to date (including those generated by FPC prior to its acquisition by the Company) are approximately $1.6 billion, of which $719 million have been used to offset regular federal income tax liability and $839 million are being carried forward as deferred alternative minimum tax credits. Also, $27 million has not been recognized due to the decrease in tax liability resulting from expenses incurred for the 2004 hurricane damage and loss on sale of Progress Rail. The current Section 29 tax credit program expires at the end of 2007.

The sale of Progress Rail in 2005 (see Note 3) resulted in a capital loss for tax purposes. Capital losses that are not offset with capital gains generated in 2005 will be carried back to reduce the regular federal income tax liability in 2004. The estimated impact of the sale resulted in approximately $17 million in tax credits no longer being realized and reflected as a deferred tax asset.

IRS PROCEEDINGS

In September 2002, all of Progress Energy's majority-owned synthetic fuel entities were accepted into the IRS's Pre-Filing Agreement (PFA) program in lieu of the ordinary IRS audit process. The PFA program allows taxpayers to voluntarily accelerate the IRS exam process in order to seek resolution of specific issues.

In February 2004, subsidiaries of the Company finalized execution of the Colona Closing Agreement with the IRS concerning their Colona synthetic fuel facilities. The Colona Closing Agreement provided that the Colona facilities were placed in service before July 1, 1998, which is one of the qualification requirements for tax credits under Section 29. The Colona Closing Agreement further provides that the fuel produced by the Colona facilities in 2001 is a "qualified fuel" for purposes of the Section 29 tax credits. This action concluded the PFA program with respect to Colona.

In July 2004, Progress Energy was notified that the IRS field auditors anticipated taking an adverse position regarding the placed-in-service date of the Company's four Earthco synthetic fuel facilities. Due to the IRS auditors' position, the IRS decided to exercise its right to withdraw from the PFA program with Progress Energy. With the IRS's withdrawal from the PFA program, the review of Progress Energy's Earthco facilities is back on the normal procedural audit path of the Company's tax returns.

On October 29, 2004, Progress Energy received the IRS field auditors' preliminary report concluding that the Earthco facilities had not been placed in service before July 1, 1998, and that the tax credits generated by those facilities should be disallowed. The Company disagrees with the field audit team's factual findings and believes that the Earthco facilities were placed in service before July 1, 1998. The Company also believes that the report applies an inappropriate legal standard concerning what constitutes "placed in service." The Company intends to contest the field auditors' findings and their proposed disallowance of the tax credits.

Because of the disagreement between the Company and the field auditors as to the proper legal standard to apply, the Company believes that it is appropriate and helpful to have this issue reviewed by the National Office of the IRS, just as the National Office reviewed the issues involving chemical change. Therefore, the Company is asking the National Office to review the issue and clarify the legal standard and has initiated this process with the National Office. The Company believes that the appeals process, including proceedings before the National Office, could take up to two years to complete; however, it cannot control the actual timing of resolution and cannot predict the outcome of this matter.

Through June 30, 2005, the Company, on a consolidated basis, has used or carried forward approximately $1.1 billion of tax credits generated by Earthco facilities. If these credits were disallowed, the Company's one-time exposure for cash tax payments would be $300 million (excluding interest), and earnings and equity would be reduced by approximately $1.1 billion, excluding interest. These amounts have not been reduced for the use of any escrowed amounts to satisfy a potential disallowance of these tax credits (see Note 14D). Progress Energy's amended $1.13 billion credit facility includes a covenant that limits the maximum debt-to-total capital ratio to 68%. This ratio includes other forms of indebtedness such as guarantees issued by PGN, letters of credit and capital leases. As of June 30, 2005, the Company's debt-to-total capital ratio was 59.1% based on the credit agreement definition for this ratio. The impact on this ratio of reversing approximately $1.1 billion of tax credits and paying $300 million for taxes would be an increase of the ratio to 63.2%.

The Company believes that it is complying with all the necessary requirements to be allowed such credits under Section 29, and, although it cannot provide certainty, it believes that it will prevail in these matters. The Company has no current plans to alter its synthetic fuel production schedule for 2005 or future years as a result of the IRS field auditors' report. However, should the Company fail to prevail in these matters, there could be material liability for previously used or carried forward Section 29 tax credits, with a material adverse impact on earnings and cash flows.

As discussed in Note 8F of the Progress Energy annual report on Form 10-K for the year ended December 31, 2004, the Company implemented changes in its capitalization policies for its Energy Delivery business units in PEC and PEF effective January 1, 2005. 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 Company has requested a method change from the IRS. If the IRS does not grant the Company's request, the Company cannot predict how the IRS would suggest that the method change be applied. However, the application of the method change to past periods could be reflected in a cumulative adjustment to taxable income in 2005, which likely would have a material impact on income from synthetic fuel tax credits.

PROPOSED ACCOUNTING RULES FOR UNCERTAIN TAX POSITIONS

On July 14, 2005, the Financial Accounting Standards Board (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. The Company currently accounts for uncertain tax benefits in accordance with SFAS No. 5, "Accounting for Contingencies" (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. The exposure draft has a 60-day public comment period ending September 12, 2005. As currently drafted, the proposed interpretation would apply to all uncertain tax positions and be effective for the Company on December 31, 2005.

As discussed above, the IRS field auditors have recommended that the Section 29 tax credits generated by the Company's Earthco facilities, totaling $1.1 billion through June 30, 2005, be disallowed. The Company has not yet determined how the proposed interpretation would impact its various income tax positions, including the status of the Earthco tax credits. Depending on the provisions of the FASB's final interpretation and the Company's facts and circumstances that exist at the date of implementation, including the Company's assessment of the probability of sustaining any currently recorded and future tax benefits, the proposed interpretation could have a material adverse impact on the Company's financial position and results of operations.

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 the Company's synthetic fuel operations. Progress Energy provided information in connection with this investigation. The Company cannot predict the outcome of this matter.

IMPACT OF CRUDE OIL PRICES

Although the Internal Revenue Code Section 29 tax credit program is expected to continue through 2007, recent unprecedented increases in the price of oil could limit the amount of those credits or eliminate them entirely for one or more of the years following 2004. 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 tax credits are reduced for that year. Also, if the Annual Average Price increases high enough (the Phase Out Price), the Section 29 tax credits are eliminated for that year. For 2004, the Threshold Price was $51.35 per barrel and the Phase Out Price was $64.47 per barrel. 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 tax credits are reduced will depend on where the Average Annual Price falls in that continuum. For example, for 2004, if the Annual Average Price had been $57.91 per barrel, there would have been a 50% 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 its calculations three months after the year in question ends. Thus, the Annual Average Price for calendar year 2004 was published on April 6, 2005, and the Annual Average Price for 2004 did not reach the Threshold Price for 2004. Consequently, the amount of the Company's 2004 Section 29 tax credits was not adversely affected by oil prices.

The Company estimates 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 $5 to $6 lower than the corresponding monthly New York Mercantile Exchange (NYMEX) settlement price for light sweet crude oil. Through July 31, 2005, the average NYMEX contract settlement price for light sweet crude oil was $51.90 per barrel and the average futures price for the remainder of 2005 was $61.86 per barrel. The Company estimates that NYMEX settlement price would have to average approximately $69 per barrel for the remainder of 2005 for the Threshold Price to be reached.

The Company estimates 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 $5 to $6 lower than the corresponding monthly NYMEX settlement price for light sweet crude oil. As of July 31, 2005, the average NYMEX futures price for light sweet crude oil for calendar year 2006 was $63.17 per barrel. Based upon the estimated 2006 Threshold Price and Phase Out prices, if oil prices for 2006 remained at the July 31, 2005 average futures price level of $63.17

per barrel for the entire year in 2006, the Company currently estimates that the Section 29 tax credit amount for 2006 would be reduced by approximately 35% to 40%.

The Company cannot predict with any certainty the Annual Average Price for 2005 or beyond. Therefore, it cannot predict whether the price of oil will have a material effect on its synthetic fuel business after 2004. However, if during 2005 through 2007, oil prices remain at historically high levels or increase, the Company's synthetic fuel business may be adversely affected for those years, and, depending on the magnitude of such increases in oil prices, the adverse affect for those years could be material and could have an impact on the Company's synthetic fuel results of operations and production plans.

In response to the historically high oil prices to date in 2005, the Company adjusted its planned production schedule for its synthetic fuel plants by shifting some of its production planned for April and May 2005 to the second half of 2005. If oil prices rise and stay at levels high enough to cause a phase out of tax credits, the Company may reduce planned production or suspend production at some or all of its synthetic fuel facilities.

SALE OF PARTNERSHIP INTEREST

In June 2004, the Company, through its subsidiary Progress Fuels, sold in two transactions a combined 49.8% partnership interest in Colona Synfuel Limited Partnership, LLLP, 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 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. Based on projected production and tax credit levels, the Company anticipates receiving total gross proceeds of approximately $22 million in 2005, approximately $32 million in 2006, approximately $34 million in 2007 and approximately $10 million through the second quarter of 2008. 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. As of June 30, 2005, a pre-tax gain on monetization of $6 million has been deferred. Assuming oil prices stay at current levels, the Company anticipates that this gain will be recognized later this year.

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

CAROLINA POWER & LIGHT COMPANY
d/b/a PROGRESS ENERGY CAROLINAS, INC.
CONSOLIDATED INTERIM FINANCIAL STATEMENTS
June 30, 2005

UNAUDITED CONSOLIDATED STATEMENTS of INCOME

	Three Months Ended June 30		Six Months Ended June 30	
(in millions)	2005	2004	2005	2004
Operating revenues				
Electric	$ 860	$ 861	$ 1,795	$ 1,762
Diversified business	1	1	1	1
Total operating revenues	861	862	1,796	1,763
Operating expenses				
Fuel used in electric generation	216	193	464	417
Purchased power	73	80	140	142
Operation and maintenance	260	226	484	435
Depreciation and amortization	130	127	259	254
Taxes other than on income	42	45	88	88
Total operating expenses	721	671	1,435	1,336
Operating income	140	191	361	427
Other income (expense)				
Interest income	1	1	3	2
Other, net	(2)	4	(1)	(8)
Total other (expense) income	(1)	5	2	(6)
Interest charges				
Interest charges	50	47	102	96
Allowance for borrowed funds used during construction	(2)	-	(3)	(1)
Total interest charges, net	48	47	99	95
Income before income tax	91	149	264	326
Income tax expense	24	53	81	115
Net income	$ 67	$ 96	$ 183	$ 211
Preferred stock dividend requirement	-	-	1	1
Earnings for common stock	$ 67	$ 96	$ 182	$ 210

See Notes to Consolidated Interim Financial Statements.

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

(in millions) ASSETS	June 30 2005	December 31 2004
Utility plant		
Utility plant in service	$ 13,738	$ 13,521
Accumulated depreciation	(5,940)	(5,806)
Utility plant in service, net	7,798	7,715
Held for future use	5	5
Construction work in progress	440	379
Nuclear fuel, net of amortization	163	186
Total utility plant, net	8,406	8,285
Current assets		
Cash and cash equivalents	14	18
Short-term investments	18	82
Receivables, net	397	397
Receivables from affiliated companies	12	20
Inventory	399	390
Deferred fuel cost	138	140
Prepayments and other current assets	107	135
Total current assets	1,085	1,182
Deferred debits and other assets		
Regulatory assets	496	473
Nuclear decommissioning trust funds	608	581
Miscellaneous other property and investments	212	158
Other assets and deferred debits	157	108
Total deferred debits and other assets	1,473	1,320
Total assets	$ 10,964	$ 10,787
CAPITALIZATION AND LIABILITIES		
Common stock equity		
Common stock without par value, authorized 200 million shares, 160 million shares issued and outstanding	$ 1,991	$ 1,975
Unearned ESOP common stock	(63)	(76)
Accumulated other comprehensive loss	(111)	(114)
Retained earnings	1,240	1,287
Total common stock equity	3,057	3,072
Preferred stock - not subject to mandatory redemption	59	59
Long-term debt, net	3,263	2,750
Total capitalization	6,379	5,881
Current liabilities		
Current portion of long-term debt	-	300
Accounts payable	202	254
Payables to affiliated companies	67	83
Notes payable to affiliated companies	67	116
Short-term obligations	142	221
Customer deposits	48	45
Other current liabilities	271	256
Total current liabilities	797	1,275
Deferred credits and other liabilities		
Noncurrent income tax liabilities	993	991
Accumulated deferred investment tax credits	137	140
Regulatory liabilities	1,147	1,052
Asset retirement obligations	950	924
Other liabilities and deferred credits	561	524
Total deferred credits and other liabilities	3,788	3,631
Commitments and contingencies (Note 12)		
Total capitalization and liabilities	$ 10,964	$ 10,787

See Notes to Consolidated Interim Financial Statements.

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

(in millions) Six Months Ended June 30,	2005	2004
Operating activities		
Net income	$ 183	$ 211
Adjustments to reconcile net income to net cash provided by operating activities:		
Charges for voluntary enhanced retirement program	42	-
Depreciation and amortization	301	297
Deferred income taxes	7	4
Investment tax credit	(3)	(4)
Deferred fuel credit	(36)	(13)
Other adjustments to net income	11	12
Cash provided (used) by changes in operating assets and liabilities:		
Receivables	3	-
Receivables from affiliated companies	8	16
Inventory	(46)	26
Prepayments and other current assets	(17)	7
Accounts payable	(3)	7
Payables to affiliated companies	(16)	(59)
Other current liabilities	27	61
Other	(6)	47
Net cash provided by operating activities	455	612
Investing activities		
Gross property additions	(303)	(243)
Nuclear fuel additions	(33)	(47)
Net contributions to nuclear decommissioning trust	(18)	(18)
Purchases of short-term investments	(1,136)	(651)
Proceeds from sales of short-term investments	1,200	853
Other investing activities	(6)	4
Net cash used in investing activities	(296)	(102)
Financing activities		
Issuance of long-term debt, net	495	–
Net (decrease) increase in short-term obligations	(79)	64
Net change in intercompany notes	(49)	1
Retirement of long-term debt	(300)	(339)
Dividends paid to parent	(229)	(228)
Dividends paid on preferred stock	(1)	(1)
Net cash used in financing activities	(163)	(503)
Net (decrease) increase in cash and cash equivalents	(4)	7
Cash and cash equivalents at beginning of period	18	12
Cash and cash equivalents at end of period	$ 14	$ 19

See Notes to Consolidated Interim Financial Statements.

1. BASIS OF PRESENTATION

A. 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 statements. Because the accompanying consolidated interim financial statements do not include all of the information and footnotes required by GAAP for annual statements, they should be read in conjunction with the audited financial statements for the period ended December 31, 2004 and notes thereto included in Progress Energy Carolinas, Inc.'s (PEC) Form 10-K for the year ended December 31, 2004.

In accordance with the provisions of Accounting Principles Board Opinion (APB) No. 28, "Interim Financial Reporting," 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. Income tax expense was increased by $3 million for the three and six months ended June 30, 2005.

PEC collects from customers certain excise taxes levied by the state or local government upon the customer. PEC accounts for excise taxes on a gross basis. For the three months ended June 30, 2005 and 2004, gross receipts tax and other excise taxes of approximately $20 million and $23 million, respectively, are included in electric revenue and taxes other than on income on the Consolidated Statements of Income. For the six months ended June 30, 2005 and 2004, gross receipts tax and other excise taxes of approximately $41 million and $45 million, respectively, are included in electric revenue and taxes other than income on the Consolidated Statements of Income.

The amounts included in the consolidated interim financial statements are unaudited but, in the opinion of management, reflect all normal recurring adjustments necessary to fairly present PEC's 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 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, disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses reflected during the reporting period. Actual results could differ from those estimates. Certain amounts for 2004 have been reclassified to conform to the 2005 presentation.

B. Stock-Based Compensation

PEC measures compensation expense for stock options as the difference between the market price of Progress Energy's common stock and the exercise price of the option at the grant date. The exercise price at which options are granted by Progress Energy equals the market price at the grant date, and accordingly, no compensation expense has been recognized for stock option grants. For purposes of the pro forma disclosures required by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure – an Amendment of FASB Statement No. 123" (SFAS No. 148), the estimated fair value of PEC's stock options is amortized to expense over the options' vesting period. The following table illustrates the effect on net income and earnings per share if the fair value method had been applied to all outstanding and unvested awards in each period:

(in millions)	Three Months Ended June 30 2005	Three Months Ended June 30 2004	Six Months Ended June 30 2005	Six Months Ended June 30 2004
Net Income, as reported	$ 67	$ 96	$ 183	$ 211
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	1	2	2	4
Pro forma net income	$ 66	$ 94	$ 181	$ 207

PEC is planning to begin expensing stock options in the third quarter of 2005 (See Note 2).

C. Consolidation of Variable Interest Entities

PEC consolidates all voting interest entities in which it owns a majority voting interest and all variable interest entities for which it is the primary beneficiary in accordance with FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities – An Interpretation of ARB No. 51" (FIN No. 46R). 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 Internal Revenue Code (Code). As of June 30, 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 a limited partnership that invests in 17 low-income housing partnerships that qualify for federal and state tax credits. PEC also has interests in two power plants resulting from long-term power purchase contracts. PEC has requested the necessary information to determine if the 17 partnerships and the two power plant owners are variable interest entities or to identify the primary beneficiaries; all three entities declined to provide PEC with the necessary financial information. Therefore, PEC has applied the information scope exception in FIN No. 46R, paragraph 4(g) to the 17 partnerships and the two power plants. PEC believes that if it is determined to be the primary beneficiary of any 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 22 limited partnerships, limited liability corporations and venture capital funds and two building leases with special-purpose entities. The aggregate maximum loss exposure at June 30, 2005, that PEC could be required to record in its income statement as a result of these arrangements totals approximately $24 million. 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.

2. NEW ACCOUNTING STANDARDS

STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 123 (REVISED 2004), "SHARE-BASED PAYMENT" (SFAS NO. 123R)

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123R, which revises SFAS No. 123, "Accounting for Stock-Based Compensation" and supersedes Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." The key requirement of SFAS No. 123R is that the cost of share-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. Previously, entities could elect to continue accounting for such awards at their grant date intrinsic value under APB Opinion No. 25, and PEC made that election. The intrinsic value method resulted in PEC recording no compensation expense for stock options granted to employees (See Note 1B).

As written, SFAS No. 123R had an original effective date of July 1, 2005 for PEC. In April 2005, the SEC delayed the effective date for public companies, which resulted in a required effective date of January 1, 2006 for PEC. The SEC delayed the effective date due to concerns that implementation in mid-year could make compliance more difficult and make comparisons of quarterly reports more difficult. PEC is planning to implement SFAS No. 123R during the third quarter of 2005, effective as of July 1, 2005. PEC will implement the standard using the required modified prospective method. Under that method, PEC will record compensation expense under SFAS No. 123R for all awards it grants after the effective date, and it will record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the effective date. In 2004, Progress Energy made the decision to cease granting stock options and replaced that compensation with alternative forms of compensation. Therefore, the amount of stock option expense expected to be recorded in 2005 is below the amount that would have been recorded if the stock option program had continued. Assuming a July 1, 2005 effective date, PEC expects to record approximately $1 million of pre-tax expense for stock options in 2005.

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

On March 30, 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations," an interpretation of SFAS No. 143, "Accounting for Asset Retirement Obligations." The interpretation 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 that is conditional on a future event if the liability's fair value can be reasonably estimated. The interpretation also provides additional guidance for evaluating whether sufficient information is available to make a reasonable estimate of the fair value. The interpretation is effective for PEC no later than December 31, 2005. PEC has not yet determined the impact of the interpretation on its financial position, results of operations or liquidity.

3. REGULATORY MATTERS

On April 27, 2005, PEC filed for an increase in the fuel rate charged to its South Carolina retail customers with the Public Service Commission of South Carolina (SCPSC). PEC requested the increase for underrecovered 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 underrecovered fuel costs over a three-year period ending June 30, 2008, 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 of $55 million, or 12 percent, in PEC's rates was effective July 1, 2005.

On June 3, 2005, PEC filed for an increase in the fuel rate charged to its North Carolina retail customers with the North Carolina Utilities Commission (NCUC). PEC asked the NCUC to approve a $276 million, or 11 percent, increase in rates. PEC requested the increase for underrecovered fuel costs for the previous 12 months and to meet future expected fuel costs.

On July 25, 2005, PEC, the NCUC Public Staff and the Carolina Industrial Group for Fair Utility Rates jointly filed a proposed settlement agreement with the NCUC to resolve issues concerning PEC's 2005 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 all of its fuel cost undercollections that occurred during the test year ended March 31, 2005 over a one-year period beginning October 1, 2005. Under the proposed settlement, 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. In recognition of the likely undercollection that will result during the year ending September 30, 2006, 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 until such amounts have been collected. Hearings on this matter are scheduled for August 2005 with an order due in September 2005. If approved, the increase would take effect October 1, 2005. PEC cannot predict the outcome of this matter.

4. COMPREHENSIVE INCOME

(in millions)	Three Months Ended June 30	
	2005	2004
Net income	$ 67	$ 96
Other comprehensive income:		
Changes in net unrealized gains on cash flow hedges (net of tax expense of $2)	–	3
Other	1	(1)
Other comprehensive income	$ 1	$ 2
Comprehensive income	$ 68	$ 98

(in millions)	Six Months Ended June 30	
	2005	2004
Net income	$ 183	$ 211
Other comprehensive income:		
Changes in net unrealized gains on cash flow hedges (net of tax expense of $1 and $2, respectively)	2	3
Other	1	–
Other comprehensive income	$ 3	$ 3
Comprehensive income	$ 186	$ 214

5. DEBT AND CREDIT FACILITIES AND FINANCING ACTIVITIES

Changes to PEC's debt and credit facilities since December 31, 2004, discussed in Note 9 of PEC's 2004 Annual Report on Form 10-K, are described below.

In January 2005, PEC used proceeds from the issuance of commercial paper to pay off $90 million of revolving credit agreement (RCA) loans.

On March 22, 2005, PEC issued $300 million of First Mortgage Bonds, 5.15% Series due 2015, and $200 million of First Mortgage Bonds, 5.70% Series due 2035. The net proceeds from the sale of the bonds were used to pay at maturity $300 million of PEC's 7.50% Senior Notes on April 1, 2005 and reduce the outstanding balance of commercial paper.

On March 28, 2005, PEC entered into a new $450 million five-year RCA with a syndication of financial institutions. The RCA will be used to provide liquidity support for PEC's issuances of commercial paper and other short-term obligations. The RCA will expire on June 28, 2010. The new $450 million RCA replaced PEC's $285 million three-year RCA and $165 million 364-day RCA, which were each terminated effective March 28, 2005. Fees and interest rates under the $450 million RCA are to be determined based upon the credit rating of PEC's long-term unsecured senior non-credit enhanced debt, currently rated as Baa1 by Moody's and BBB by S&P. The RCA includes a defined maximum total debt to capital ratio of 65%. The RCA also contains various cross-default and other acceleration provisions, including a cross-default provision for defaults of indebtedness in excess of $35 million. The RCA does not include a material adverse change representation for borrowings, which had been a provision in the terminated agreements.

On July 28, 2005, PEC filed a shelf registration statement with the SEC to provide an additional $1.0 billion of capacity in addition to the $400 million remaining on PEC's current shelf registration statement. The shelf registration statement will allow PEC to issue various securities, including First Mortgage Bonds, Senior Notes, Debt Securities and Preferred Stock.

6. BENEFIT PLANS

PEC has a noncontributory defined benefit retirement (pension) plan for substantially all full-time employees. PEC also has supplementary defined benefit pension plans that provide benefits to higher-level employees. In addition to pension benefits, PEC provides 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 three and six months ended June 30 are:

Three Months Ended June 30 (in millions)	Pension Benefits 2005	Pension Benefits 2004	Other Postretirement Benefits 2005	Other Postretirement Benefits 2004
Service cost	$ 7	$ 6	$ 2	$ 2
Interest cost	13	13	4	4
Expected return on plan assets	(16)	(17)	(1)	(1)
Amortization, net	2	-	-	1
Net periodic cost	$ 6	$ 2	$ 5	$ 6

Six Months Ended June 30 (in millions)	Pension Benefits 2005	Pension Benefits 2004	Other Postretirement Benefits 2005	Other Postretirement Benefits 2004
Service cost	$ 13	$ 12	$ 3	$ 4
Interest cost	27	26	8	8
Expected return on plan assets	(31)	(34)	(2)	(2)
Amortization, net	4	1	1	2
Net periodic cost	$ 13	$ 5	$ 10	$ 12

In addition, in the second quarter of 2005, PEC recorded special termination benefits related to the voluntary enhanced retirement program (see Note 8) of approximately $21 million for pension benefits and $8 million for other postretirement benefits. These charges resulted in a $29 million increase in pension and OPEB liabilities, which are included in other liabilities and deferred credits on the Consolidated Balance Sheets.

7. RISK MANAGEMENT ACTIVITIES AND DERIVATIVE TRANSACTIONS

PEC is exposed to various risks related to changes in market conditions. PEC's parent, Progress Energy, has 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 its risk management policy, PEC 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. PEC minimizes 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 the consolidated financial position or consolidated results of operations of PEC. See Note 13 to PEC's Annual Report on Form 10-K for the year ended December 31, 2004.

A. Commodity Derivatives

General

Most of PEC's 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 DIG Issue C20, "Scope Exceptions: Interpretation of the Meaning of Not Clearly and Closely Related in Paragraph 10(b) regarding Contracts with a Price Adjustment Feature." The related liability is being amortized to earnings over the term of the related contract (See Note 10). As of June 30, 2005 and December 31, 2004, the remaining liability was $23 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. PEC manages open positions with strict policies that limit its exposure to market risk and require daily reporting to management of potential financial exposures. Gains and losses from such contracts were not material to results of operations during the three and six months ending June 30, 2005 and 2004, and PEC did not have material outstanding positions in such contracts at June 30, 2005 and December 31, 2004.

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

PEC uses cash flow hedging strategies to reduce exposure to changes in cash flow due to fluctuating interest rates. PEC uses 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.

Cash Flow Hedges

Gains and losses from cash flow hedges are recorded in accumulated other comprehensive income (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 for the three and six months ending June 30, 2005 and 2004, was not material to PEC's results of operations. As of June 30, 2005, PEC had $5 million of after-tax deferred losses in OCI related to terminated hedges, of which an immaterial amount is expected to be reclassified to earnings within the next 12 months.

During the first quarter of 2005, PEC terminated all of its cash flow hedges which were open at December 31, 2004, and had no open interest rate cash flow hedges as of June 30, 2005. As of December 31, 2004, PEC had $131 million notional of open interest rate cash flow hedges.

Fair Value Hedges

As of June 30, 2005 and December 31, 2004, PEC had no open interest rate fair value hedges.

8. SEVERANCE COSTS

On February 28, 2005, as part of a previously announced cost management initiative, Progress Energy approved a workforce restructuring which is expected to be completed in September 2005. In addition to the workforce restructuring, the cost management initiative included a voluntary enhanced retirement program. In connection with this initiative, PEC incurred approximately $60 million of pre-tax charges for severance and postretirement benefits during the six months ended June 30, 2005, as described below.

PEC recorded $14 million of severance expense during the first quarter of 2005 for the workforce restructuring. The workforce restructuring expense was computed based on the approximate number of positions to be eliminated. This amount included approximately $4 million of severance costs allocated from Progress Energy Service Company (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 quarter of 2005, PEC decreased its estimated severance costs by $7 million due to the impact of the employees electing participation in the voluntary enhanced retirement program. This amount 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 is as follows:

(in millions)	
Balance as of January 1, 2005	$ 2
Severance costs accrued	10
Adjustments	(5)
Payments	-
Balance as of June 30, 2005	**$ 7**

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 6). 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.

The cost management initiative charges are subject to revision in future quarters based on completion of the workforce restructuring and the potential additional impacts that the early retirements and outplacements may have on the postretirement plans. Such revisions may be significant and may adversely impact PEC's results of operations in future periods. In addition, PEC expects to incur certain incremental costs for recruiting and staff augmentation activities that cannot be quantified at this time.

9. FINANCIAL INFORMATION BY BUSINESS SEGMENT

PEC's operations consist primarily of the PEC Electric segment which is engaged in the generation, transmission, distribution and sale of electric energy primarily in portions of North Carolina and South Carolina. These electric operations are subject to the rules and regulations of the FERC, the NCUC, the SCPSC and the NRC. PEC Electric also distributes and sells electricity to other utilities, primarily on the east coast of the United States.

The Other segment, the operations of which are primarily in the eastern United States, is made up of other nonregulated business areas that do not separately meet the disclosure requirements of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" and consolidation entities and eliminations.

The financial information for PEC segments for the three months ended June 30, 2005 and 2004, is as follows:

(in millions)	2005			2004		
	PEC Electric	**Other**	**Total**	**PEC Electric**	**Other**	**Total**
Total revenues	$ 860	$ 1	$ 861	$ 861	$ 1	$ 862
Postretirement and severance charges	46		46	5		5
Segment profit (loss)	68	(1)	67	97	(1)	96

The financial information for PEC segments for the six months ended June 30, 2005 and 2004 is as follows:

(in millions)	2005			2004		
	PEC Electric	Other	Total	PEC Electric	Other	Total
Total revenues	$ 1,795	$ 1	$ 1,796	$ 1,762	$ 1	$ 1,763
Postretirement and severance charges	60	-	60	5	-	5
Segment profit (loss)	184	(2)	182	213	(3)	210

10. OTHER INCOME AND OTHER EXPENSE

Other income and expense includes interest income and other income and expense items as discussed below.. The components of other, net as shown on the accompanying Consolidated Statements of Income for the three and six months ended June 30, 2005 and 2004, are as follows:

(in millions)	Three Months Ended June 30 2005	2004	Six Months Ended June 30 2005	2004
Other income				
Nonregulated energy and delivery services income	$ 7	$ 3	$ 9	$ 5
DIG Issue C20 Amortization (See Note 7)	2	2	3	4
AFUDC equity	1	1	2	2
Other	2	6	5	5
Total other income	$ 12	$ 12	$ 19	$ 16
Other expense				
Nonregulated energy and delivery services expenses	$ 2	$ 2	$ 4	$ 4
Donations	2	1	5	5
Write-off of non-trade receivables	-	-	-	7
FERC Audit Settlement	4	-	4	-
Other	6	5	7	8
Total other expense	$ 14	$ 8	$ 20	$ 24
Other, net	$ (2)	$ 4	$ (1)	$ (8)

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.

FERC audit settlement includes amounts approved by the FERC on May 25, 2005, to settle the FERC Staff's Audit of PEC's compliance with the FERC's Standards of Conduct and Code of Conduct. In the settlement, PEC agreed to make certain operational and organizational changes and to provide its retail and wholesale customers a one-time credit of approximately $4 million which was recorded as other expense in the second quarter of 2005.

11. ENVIRONMENTAL MATTERS

PEC is subject to federal, state and local regulations addressing hazardous and solid waste management, air and water quality and other environmental matters. See Note 17 of PEC's 2004 Annual Report on Form 10-K for a more detailed, historical discussion of these federal, state, and local regulations.

HAZARDOUS AND SOLID WASTE MANAGEMENT

The provisions of the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (CERCLA), authorize the EPA to require the cleanup of hazardous waste sites. This statute imposes retroactive joint and several liabilities. Some states, including North Carolina and South Carolina, have similar types of legislation. PEC is periodically notified by regulators, including the EPA and various state agencies, of their involvement or potential involvement in sites that may require investigation and/or remediation. There are presently several sites with respect to which PEC has been notified by the EPA and the State of North Carolina of its potential liability, as described below in greater detail. PEC is also currently in the process of assessing potential costs and exposures at other sites. For all sites, as assessments are developed and analyzed, PEC will accrue costs for the sites to the extent the costs are probable and can be reasonably estimated.

Various organic materials associated with the production of manufactured gas, generally referred to as coal tar, are regulated under federal and state laws. The principal regulatory agency that is responsible for a specific former manufactured gas plant (MGP) site depends largely upon the state in which the site is located. There are several MGP sites to which PEC has some connection. In this regard, PEC and other potentially responsible parties (PRPs) are participating in, investigating and, if necessary, remediating former MGP sites with several regulatory agencies, including, but not limited to, the U.S. Environmental Protection Agency (EPA) and the North Carolina Department of Environment and Natural Resources, Division of Waste Management (DWM).

PEC filed claims with its general liability insurance carriers to recover costs arising from actual or potential environmental liabilities. All claims have been settled other than with insolvent carriers. These settlements have not had a material effect on the consolidated financial position or results of operations.

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.

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, North Carolina. The EPA offered PEC and a number of other PRPs the opportunity to negotiate cleanup of the site and reimbursement of less than $2 million to the EPA for EPA's past expenditures in addressing conditions at the site. PEC and other PRP's are in discussions with the EPA to reach an agreement. However, as an agreement among PRPs has not yet been reached, it is not possible at this time to reasonably estimate the total amount of PEC's obligation for remediation of the Ward Transformer site. If an agreement cannot be reached, the EPA could issue a unilateral order requiring cleanup of the site. PEC cannot predict the outcome of this matter.

As of June 30, 2005 and December 31, 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:

(in millions)	June 30, 2005	December 31, 2004
Insurance fund	$ 4	$ 7
Transferred from North Carolina Natural Gas Corporation at time of sale	2	2
Total accrual for environmental sites	$ 6	$ 9

The insurance fund in the table above was established when PEC received insurance proceeds to address costs associated with environmental liabilities related to its involvement with some sites. All eligible expenses related to these are charged against a specific fund containing these proceeds. For the three and six months ended June 30, 2005, PEC made no additional accruals, received no insurance proceeds, and spent approximately $1 million and $3 million, respectively, related to environmental remediation.

This accrual has been recorded on an undiscounted basis. PEC measures its liability for these sites based on available evidence including its experience in investigating and remediating environmentally impaired sites. The process often involves assessing and developing cost-sharing arrangements with other PRPs. PEC will accrue costs for the sites to the extent its 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, PEC cannot determine the total costs that may be incurred in connection with the remediation of all sites at this time. It is anticipated that sufficient information will become available for several sites during 2005 to allow a reasonable estimate of PEC's obligation for those sites to be made.

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 the Company's coal-fired plants located in the state. The Company has reviewed the permit conditions, which could significantly restrict the reuse of coal ash and result in higher ash management costs and plans to adjudicate the permit conditions. The Company cannot predict the outcome of this matter.

AIR QUALITY

PEC is subject to various current and proposed federal, state, and local environmental compliance laws and regulations, which may result in increased planned capital expenditures and operating and maintenance costs. Significant updates to these laws and regulations and related impacts to PEC since December 31, 2004, are discussed below. Additionally, Congress is considering legislation that would require reductions in air emissions of NOx, SO_2, carbon dioxide 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 PEC's consolidated financial position or results of operations. Control equipment that will be installed on North Carolina fossil generating facilities as part of the North Carolina Clean Smokestacks Act (Smokestacks Act), enacted in 2002 and discussed below, may address some of the issues outlined above. However, PEC cannot predict the outcome of the matter.

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. The Company was 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 other 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 cost through rate adjustments or similar mechanisms.

Total capital expenditures to meet the requirements of the final rule under Section 110 of the Clean Air Act (NOx SIP Call) in North Carolina and South Carolina could reach approximately $370 million. This amount also includes the cost to install NOx controls under North Carolina's and South Carolina's programs to comply with the federal 8-hour ozone standard. However, further technical analysis and rulemaking may result in requirements for additional controls at some units. PEC has spent approximately $324 million to date related to these projected amounts. Increased operation and maintenance costs relating to the NOx SIP Call are not expected to be material to PEC's results of operations. Further controls are anticipated as electricity demand increases.

PEC projects that its capital costs to meet emission targets for NOx and SO_2 from coal-fired power plants under the Smokestacks Act, will total approximately $895 million by the end of 2013. PEC has expended approximately $190 million of these capital costs through June 30, 2005. The Smokestacks Act requires PEC to amortize 70% of the original cost estimate of $813 million, during a five-year rate freeze period. PEC recognized amortization of $27 million and $54 million, respectively, for the three and six months ended June 30, 2005, and has recognized $302 million in cumulative amortization through June 30, 2005. The remaining amortization requirement will be recorded over the future period ending December 31, 2007. The law permits PEC the flexibility to vary the amortization schedule for recording the compliance costs from zero up to $174 million of amortization expense per year. The NCUC will hold a hearing prior to December 31, 2007, to determine cost recovery amounts for 2008 and future periods. O&M expense will increase due to the additional materials, personnel and general maintenance associated with the equipment. O&M expenses are recoverable through base rates, rather than as part of this program. PEC cannot predict the future regulatory interpretation, implementation or impact of this law.

On March 10, 2005, the EPA issued the final Clean Air Interstate Rule (CAIR). The EPA's rule requires 28 states, including North Carolina and South Carolina, and the District of Columbia to reduce NOx and SO2 emissions in order to attain state NOx and SO2 emissions levels. Installation of additional air quality controls is likely to be needed to meet the CAIR requirements. PEC is in the process of determining compliance plans and the cost to comply with the rule. The air quality controls already installed for compliance with the NOx SIP Call and currently planned by PEC to comply with the Smokestacks Act will reduce the costs required to meet the CAIR requirements for PEC's North Carolina units.

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 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. NOx and SO_2 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 NOx and SO_2 under CAIR. PEC is in the process of determining compliance plans and the cost to comply with the CAMR. Installation of additional air quality controls is likely to be needed to meet the CAMR's requirements. The de-listing rule has been challenged by a number of parties; the resolution of the challenges could impact PEC's final compliance plans and costs.

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 the Company's pollution control equipment proposals will be required adding time and cost to the overall project.

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.

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 SO_2 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 will hold a 60-day public comment period from the date that the proposal is published in the Federal Register and must take final action by March 15, 2006. PEC cannot predict the outcome of this matter.

In a decision issued July 15, 2005, 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 carbon dioxide emissions under the Clean Air Act. The court in a 2-1 decision, held that the EPA Administrator properly exercised his discretion in denying the request for regulation.

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 PEC in the immediate and extended future.

Based on new cost information and changes to the estimated time frame of expenditures since December 31, 2004, PEC has revised the estimated amounts and time period for expenditures to meet Section 316(b) requirements of the Clean Water Act. PEC currently estimates that from 2005 through 2010 the range of expenditures will be approximately $15 million to $25 million.

OTHER ENVIRONMENTAL MATTERS

The Kyoto Protocol was adopted in 1997 by the United Nations to address global climate change by reducing emissions of carbon dioxide 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. A number of carbon dioxide emissions control proposals have been advanced in Congress. Reductions in carbon dioxide emissions to the levels specified by the Kyoto Protocol and some legislative proposals could be materially adverse to PEC's consolidated financial position or results of operations if associated costs of control or limitation cannot be recovered from customers. PEC favors the voluntary program approach recommended by the Bush administration and continually evaluates options for the reduction, avoidance and sequestration of greenhouse gases. However, PEC cannot predict the outcome of this matter.

Progress Energy has announced its plan to issue a report on the Company's activities associated with current and future environmental requirements. The report will include a discussion of the environmental requirements that PEC currently faces and expects to face in the future with respect to its air emissions. The report is expected to be issued by March 31, 2006.

12. COMMITMENTS AND CONTINGENCIES

Contingencies and significant changes to the commitments discussed in Note 18 of PEC's 2004 Annual Report on Form 10-K are described below.

A. Purchase Obligations

As part of PEC's ordinary course of business, it enters into various long and short term contracts for fuel requirements at its generating plants. Through June 30, 2005, these contracts have increased the Company's aggregate purchase obligations for fuel and purchased power by approximately $709 million as compared to the amount stated in the Company's Form 10-K for the year ended December 31, 2004. The increase primarily covers the period ranging from 2005 through 2009. A majority of the contracts related to the increase in purchase obligations for fuel and purchased power are for future coal purchases primarily with fixed prices.

B. Guarantees

As a part of normal business, PEC enters into various agreements providing future financial or performance assurances to third parties, which are outside the scope of Financial Accounting Standards Board (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. As of June 30, 2005, PEC does 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 Consolidated Balance Sheets. As of June 30, 2005, PEC had no guarantees issued on behalf of unconsolidated subsidiaries or other third parties.

C. Insurance

PEC is a member 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, PEC is insured for $500 million at each of its 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 plant.

D. Other Contingencies

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

DOE failed to begin taking spent nuclear fuel by January 31, 1998. In January 2004, PEC 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 SNF from various PEC facilities on or before January 31, 1998. 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 PEC parties 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 SNF and high level waste (HLW) by which the Government was contractually obligated to accept contract holders' SNF and/or HLW, 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 2005. Resolution of these issues in other cases could facilitate agreements by the parties in the PEC 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.

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

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, Nevada. In January 2003, the State of Nevada, Clark County, Nevada, and the City of 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. The EPA is currently reworking the standard but has not stated when the work will be complete. 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. Also in November 2004, Congressional negotiators approved $577 million for fiscal year 2005 for the Yucca Mountain project, approximately $300 million less than requested by the DOE but approximately the same as approved in 2004. 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. PEC cannot predict the outcome of this matter.

2. In 2001, PEC entered into a contract to purchase coal from Dynegy Marketing and Trade (DMT). After DMT experienced financial difficulties, including credit ratings downgrades by certain credit reporting agencies, PEC requested credit enhancements in accordance with the terms of the coal purchase agreement in July 2002. When DMT did not offer credit enhancements, as required by a provision in the contract, PEC terminated the contract in July 2002.

PEC initiated a lawsuit seeking a declaratory judgment that the termination was lawful. DMT counterclaimed, stating the termination was a breach of contract and an unfair and deceptive trade practice. On March 23, 2004, the United States District Court for the Eastern District of North Carolina ruled that PEC was liable for breach of contract, but ruled against DMT on its unfair and deceptive trade practices claim. On April 6, 2004, the Court entered a judgment against PEC in the amount of approximately $10 million. The Court did not rule on DMT's request under the contract for pending legal costs.

On May 4, 2004, PEC authorized its outside counsel to file a notice of appeal of the April 6, 2004 judgment, and on May 7, 2004, the notice of appeal was filed with the United States Court of Appeals for the Fourth Circuit. On June 8, 2004, DMT filed a motion to dismiss PEC's appeal on the ground that it was untimely. On July 20, 2005, the appellate court denied DMT's motion to dismiss and ruled that the time for PEC to appeal had not yet expired. The appellate court remanded the case to the trial court for further proceedings.

PEC recorded a liability for the judgment of approximately $10 million and a regulatory asset for the probable recovery through its fuel adjustment clause in the first quarter of 2004. PEC cannot predict the outcome of this matter.

3. On February 1, 2002, PEC filed a complaint with the Surface Transportation Board (STB) challenging the rates charged by Norfolk Southern Railway Company (Norfolk Southern) for coal transportation to certain generating plants. In a decision served in December, 2003, the STB found that the challenged rates exceeded maximum reasonable rate levels and prescribed lower rates. In a subsequent decision on reconsideration the STB concluded that the rates had not been shown to be unreasonable, following which PEC requested the STB to consider requiring that the rates be phased in over a period of time. During the course of the complaint process, PEC accrued a liability of $42 million. The liability was comprised of $23 million of reparations remitted to PEC by Norfolk Southern that were subject to refund and an additional $19 million, of which $17 million was recorded as deferred fuel cost on the Consolidated Balance Sheet. This matter has now been settled by mutual agreement, and the STB has issued an order dismissing the case. As a result of the settlement, PEC reversed the previously recorded deferred fuel cost and settled the remaining obligations for the approximate amount previously accrued. The settlement had an immaterial impact on PEC's results of operations.

4. PEC is involved in various litigation matters in the ordinary course of business, some of which involve substantial amounts. Where appropriate, accruals and disclosures have been made in accordance with SFAS No. 5, "Accounting for Contingencies," to provide for such matters. In the opinion of management, the final disposition of pending litigation would not have a material adverse effect on PEC's consolidated results of operations or financial position.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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" for a discussion of the factors that may impact any such forward-looking statements made herein and the Risk Factors sections of Progress Energy's and Progress Energy Carolina's (PEC) annual report on Form 10-K for the year ended December 31, 2004.

Amounts reported in the interim Consolidated 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 2004 Form 10-K.

RESULTS OF OPERATIONS

The Company's reportable business segments and their primary operations include:

- Progress Energy Carolinas Electric (PEC Electric) – primarily engaged in the generation, transmission, distribution and sale of electricity in portions of North Carolina and South Carolina;
- Progress Energy Florida (PEF) – primarily engaged in the generation, transmission, distribution and sale of electricity in portions of Florida;
- Competitive Commercial Operations (CCO) – engaged in nonregulated electric generation operations and marketing activities primarily in Georgia, North Carolina and Florida;
- Fuels – primarily engaged in natural gas production in Texas and Louisiana, coal mining, coal terminal services and fuel transportation and delivery in Kentucky, West Virginia and Virginia; and
- Synthetic Fuels – engaged in the production and sale of coal-based solid synthetic fuels and the operation of synthetic fuel facilities for outside parties in Kentucky, West Virginia and Virginia.

The Corporate and Other category includes other businesses engaged in other nonregulated business areas, including telecommunications, primarily in the eastern United States, energy services operations and holding company results, which do not meet the requirements for separate segment reporting disclosure.

Prior to 2005, Rail Services was reported as a separate segment. In connection with the divestiture of Progress Rail (see Note 3 of the Progress Energy Consolidated Interim Financial Statements), the operations of Rail Services were reclassified to discontinued operations in the first quarter of 2005 and therefore are no longer a reportable segment. In addition, synthetic fuel activities were reported in the Fuels segment prior to 2005 and now are considered a separate reportable segment. These reportable segment changes reflect the current reporting structure. For comparative purposes, the prior year results have been restated to conform to the current presentation.

In this section, earnings and the factors affecting earnings for the three and six months ended June 30, 2005 as compared to the same periods in 2004 are discussed. The discussion begins with a summarized overview of the Company's consolidated earnings, which is followed by a more detailed discussion and analysis by business segment.

OVERVIEW

For the quarter ended June 30, 2005, Progress Energy's net loss was $1 million, or $(0.01) per share, compared to net income of $154 million, or $0.63 per share, for the same period in 2004. The decrease in net income as compared to prior year was due primarily to:

- Postretirement and severance charges recorded throughout the Company related to the cost management initiative.
- Unfavorable weather at both utilities.
- Unfavorable retail usage in Florida.
- The write-off of unrecoverable storm costs in Florida.
- The change in accounting estimates for certain Energy Delivery capital costs.

- Decreased nonregulated generation earnings.
- Decreased synthetic fuel earnings.
- The impact of tax levelization.

Partially offsetting these items were:

- Utility customer growth in the Carolinas and Florida.
- Favorable wholesale sales in both the Carolinas and Florida.
- Gain recorded on the sale of distribution system in Florida.
- Reduced losses recorded on contingent value obligations.

For the six months ended June 30, 2005, Progress Energy's net income was $92 million, or $0.37 per share, compared to $262 million, or $1.08 per share for the same period in 2004. The decrease in net income as compared to prior year was due primarily to:

- Postretirement and severance charges recorded throughout the Company related to the cost management initiative.
- Unfavorable weather at both utilities.
- Unfavorable retail usage in Florida.
- The write-off of unrecoverable storm costs in Florida.
- The change in accounting estimates for certain Energy Delivery capital costs.
- Decreased nonregulated generation earnings.
- Decreased synthetic fuel earnings.
- The impact of tax levelization.

Partially offsetting these items were:

- Utility customer growth in the Carolinas and Florida.
- Favorable wholesale sales in both the Carolinas and Florida.
- Gain recorded on the sale of distribution assets in Florida.
- Reduced losses recorded on contingent value obligations.

Basic earnings per share decreased in 2005 due in part to the factors outlined above. Dilution related to the issuances of an aggregate of approximately 4 million and 1 million shares of common stock under the Company's Investor Plus Stock Purchase Plan and employee benefit programs for the year to date in 2005 and the year ended December 31, 2004, respectively, also reduced basic earnings per share by $0.01 and $0.02 for the three and six months ended June 30, 2005, respectively.

The Company's segments contributed the following profits or losses for the three and six months ended June 30, 2005 and 2004:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
Business Segment	2005	2004	2005	2004
PEC Electric	$ 68	$ 97	$ 184	$ 213
PEF	10	84	53	133
Fuels	12	17	23	27
CCO	(3)	5	(9)	(3)
Synthetic Fuel	23	36	22	72
Total Segment Profit	110	239	273	442
Corporate & Other	(104)	(93)	(162)	(197)
Income from continuing operations	6	146	111	245
Discontinued operations, net of tax	(7)	8	(19)	17
Net income	$ (1)	154	$ 92	$ 262

COST MANAGEMENT INITIATIVE

On February 28, 2005, as part of a previously announced cost management initiative, the Company approved a workforce restructuring which is expected to be completed in September 2005 and result in a reduction of approximately 450 positions. The cost management initiative is designed to permanently reduce by $75 million to $100 million the projected growth in the Company's annual operation and maintenance (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, the Company incurred approximately $176 million of pre-tax charges for severance and postretirement benefits during the six months ended June 30, 2005, as described below.

The Company 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. The workforce restructuring expense was computed 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 quarter of 2005, the Company decreased its estimated severance costs by $13 million 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 and will be paid over time.

The Company recorded a $141 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 8 to the Progress Energy Consolidated Interim Financial Statements for additional information on postretirement benefits. In addition, the Company recorded a $17 million charge for early retirement incentives to be paid over time to certain employees.

The cost management initiative charges are subject to revision in future quarters based on completion of the workforce restructuring and the potential additional impacts that the early retirements and outplacements may have on the Company's postretirement plans. Such revisions may be significant and may adversely impact the Company's results of operations in future periods. In addition, the Company expects to incur certain incremental costs for recruiting and staff augmentation activities that cannot be quantified at this time.

PROGRESS ENERGY CAROLINAS ELECTRIC

PEC Electric contributed segment profits of $68 million and $97 million for the three months ended June 30, 2005 and 2004, respectively. Results for 2005 were unfavorably impacted by higher O&M costs primarily due to postretirement and severance costs associated with the cost management initiative and unfavorable weather. These unfavorable items were partially offset by favorable customer growth and usage and increased wholesale revenues.

PEC Electric contributed segment profits of $184 million and $213 million for the six months ended June 30, 2005 and 2004, respectively. Results for 2005 were unfavorably impacted by higher O&M costs primarily due to postretirement and severance costs associated with the cost management initiative and the change in accounting estimates for certain Energy Delivery capital costs and unfavorable weather.. These unfavorable items were partially offset by favorable customer growth and usage and increased wholesale revenues.

Three months ended June 30, 2005 compared to the three months ended June 30, 2004

Revenues

PEC Electric's revenues for the three months ended June 30, 2005 and 2004, and the percentage change by customer class are as follows:

(in millions of $)	Three Months Ended June 30,			
Customer Class	2005	Change	% Change	2004
Residential	$ 272	$ (12)	(4.2)	$ 284
Commercial	214	1	0.5	213
Industrial	164	3	1.9	161
Governmental	18	(1)	(5.3)	19
Total retail revenues	668	(9)	(1.3)	677
Wholesale	154	15	10.8	139
Unbilled	15	(9)	-	24
Miscellaneous	23	2	9.5	21
Total electric revenues	$ 860	$ (1)	(0.1)	$ 861
Less:				
Pass-through fuel revenues	(238)	(16)	(7.2)	(222)
Revenues excluding fuel	$ 622	$ (17)	(2.7)	$ 639

PEC Electric's energy sales for the three months ended June 30, 2005 and 2004, and the amount and percentage change by customer class are as follows:

(in millions of kWh)	Three Months Ended June 30,			
Customer Class	2005	Change	% Change	2004
Residential	3,285	(240)	(6.8)	3,525
Commercial	3,087	(85)	(2.7)	3,172
Industrial	3,230	(50)	(1.5)	3,280
Governmental	314	(23)	(6.8)	337
Total retail energy sales	9,916	(398)	(3.9)	10,314
Wholesale	3,341	227	7.3	3,114
Unbilled	235	(169)	-	404
Total kWh sales	13,492	(340)	(2.5)	13,832

PEC Electric's revenues, excluding recoverable fuel revenues of $238 million and $222 million for the three months ended June 30, 2005 and 2004, respectively, decreased $17 million. The decrease in revenues is attributable primarily to unfavorable weather offset partially by favorable retail growth and usage and increased wholesale revenues. The impact of weather is $28 million unfavorable with cooling degree days 36% below prior year. Favorable growth and usage of $6 million was driven by an increase in the number of customers as of June 30, 2005 compared to June 30, 2004 of 28,000. The increase in wholesale revenues less fuel of $3 million was driven primarily by the impact of increased capacity under contract.

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 $289 million for the three months ended June 30, 2005, which represents a $16 million increase compared to the same period in the prior year. Fuel used in electric generation increased $23 million to $216 million compared to the prior year. This increase is due to an increase in fuel used in generation of $17 million due primarily to higher fuel costs which are being driven primarily by rising coal, oil and natural gas prices. In addition, deferred fuel expense increased $6 million due to the write-off of $5 million in deferred fuel costs as a result of the South Carolina annual fuel hearing. Purchased power expense decreased $7 million to $73 million compared to the prior year. Prior year purchased power costs were higher due to plant outages during periods of favorable weather during the second quarter of 2004.

Operations and Maintenance (O&M)

O&M expenses were $260 million for the three months ended June 30, 2005, which represents a $34 million increase compared to the same period in 2004. Postretirement and severance expenses related to the cost management initiative increased O&M expenses by $46 million during 2005. This is an increase of $41 million compared to the same period in 2004 as prior year expenses include $5 million related to a separate initiative. In addition, O&M expenses increased $6 million related to the change in accounting estimates for certain Energy Delivery capital costs. See discussion of change in Energy Delivery capitalization practice in Note 8F of the Progress Energy annual report on Form 10-K for the year ended December 31, 2004. These unfavorable items were partially offset by decreased plant outage costs of $12 million compared to the same period of 2004, which included a nuclear plant outage.

Depreciation and Amortization

Depreciation and amortization expense was $130 million for the three months ended June 30, 2005, which represents a $3 million increase compared to the same period in 2004. The increase is attributable to higher NC Clean Air amortization of $12 million and higher depreciation for assets placed in service of $1 million. These increases were partially offset by a reduction in depreciation expense of $10 million related to the depreciation studies filed in 2004. Depreciation rates are the same for 2005 and 2004; however, the 2004 year to date retroactive adjustment for the new rates adopted related to the expanded lives of the nuclear units was made in November 2004.

Other income, net

Other income, net has decreased $4 million for the three months ending June 30, 2005, as compared to the same period in the prior year. This fluctuation is due primarily to the FERC Code of Conduct audit settlement reached in 2005 that required $4 million to be refunded to customers (see discussion in Note 12 to the Progress Energy Consolidated Interim Financial Statements).

Income tax expense

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 $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 swings 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. The remaining fluctuation in income tax expense is attributable to reduced earnings compared to prior year.

Six months ended June 30, 2005 compared to the six months ended June 30, 2004

Revenues

PEC Electric's revenues for the six months ended June 30, 2005 and 2004, and the percentage change by customer class are as follows:

(in millions of $)	Six Months Ended June 30,			
Customer Class	2005	Change	% Change	2004
Residential	$ 646	$ (9)	(1.4)	$ 655
Commercial	428	8	1.9	420
Industrial	313	5	1.6	308
Governmental	38	-	-	38
Total retail revenues	1,425	4	0.3	1,421
Wholesale	328	33	11.2	295
Unbilled	(3)	(4)	-	1
Miscellaneous	45	-	-	45
Total electric revenues	$ 1,795	$ 33	1.9	$ 1,762
Less:				
Pass-through fuel revenues	(509)	(49)	(10.7)	(460)
Revenues excluding fuel	$ 1,286	$ (16)	(1.2)	$ 1,302

PEC Electric's energy sales for the six months ended June 30, 2005 and 2004, and the amount and percentage change by customer class are as follows:

(in millions of kWh)	Six Months Ended June 30,			
Customer Class	2005	Change	% Change	2004
Residential	**7,957**	(309)	(3.7)	8,266
Commercial	**6,167**	(63)	(1.0)	6,230
Industrial	**6,161**	(112)	(1.8)	6,273
Governmental	**642**	(40)	(5.9)	682
Total retail energy sales	**20,927**	(524)	(2.4)	21,451
Wholesale	**7,278**	374	5.4	6,904
Unbilled	**(67)**	(87)	-	20
Total kWh sales	**28,138**	(237)	(0.8)	28,375

PEC Electric's revenues, excluding recoverable fuel revenues of $509 million and $460 million for the six months ended June 30, 2005 and 2004, respectively, decreased $16 million. The decrease in revenues is attributable primarily to unfavorable weather offset partially by favorable retail growth and usage and increased wholesale revenues. The impact of weather is $47 million unfavorable with cooling degree days 37% below prior year. Favorable growth and usage of $26 million was driven by an increase in the number of customers as of June 30, 2005 compared to June 30, 2004 of 28,000. The increase in wholesale revenues less fuel of $5 million was driven primarily by the impact of increased capacity under contract.

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 $604 million for the six months ended June 30, 2005, which represents a $45 million increase compared to same period in the prior year. Fuel used in electric generation increased $47 million to $464 million compared to June 30, 2004. This increase is due to an increase in fuel used in generation of $70 million due primarily to higher coal, oil and natural gas costs. The increase in fuel used in generation was offset by a reduction in deferred fuel expense of $24 million as a result of the under-recovery of current period fuel costs offset partially by the write-off of $5 million in deferred fuel costs as a result of the South Carolina annual fuel hearing. Purchased power expense decreased $2 million to $140 million compared to prior year.

Operations and Maintenance (O&M)

O&M expenses were $484 million for the six months ended June 30, 2005, which represents a $49 million increase compared to the same period in 2004. Postretirement and severance expenses related to the cost management initiative increased O&M expenses by $60 million during 2005. This is an increase of $55 million compared to the same period in 2004 as prior year expenses included $5 million related to a separate initiative. In addition, O&M expenses increased $12 million related to the change in accounting estimates for certain Energy Delivery capital costs. See discussion of change in Energy Delivery capitalization practice in Note 8F of the Progress Energy annual report on Form 10-K for the year ended December 31, 2004. These unfavorable items were partially offset by decreased plant outage costs of $8 million compared to 2004, which included an additional planned nuclear plant outage. In addition, results for 2004 included $6 million of costs associated with an ice storm that hit the Carolinas service territory in the first quarter of 2004.

Depreciation and Amortization

Depreciation and amortization expense was $259 million for the six months ended June 30, 2005, which represents a $5 million increase compared to the same period in 2004. The increase is attributable to higher NC Clean Air amortization of $23 million and higher depreciation for assets placed in services of $3 million. These increases were partially offset by a reduction in depreciation expense of $21 million related to the depreciation studies filed in 2004. Depreciation rates are the same for 2005 and 2004; however, the 2004 year to date retroactive adjustment for the new rates adopted related to the expanded lives of the nuclear units was made in November 2004.

Other income, net

Other income, net has increased $8 million for the six months ending June 30, 2005 as compared to the same period in the prior year. This increase is due primarily to a write-off of $7 million of non-trade receivables in the prior year.

Income tax expense

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 $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 swings 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. The remaining fluctuation in income tax expense is attributable primarily to reduced earnings compared to prior year.

PROGRESS ENERGY FLORIDA

PEF contributed segment profits of $10 million and $84 million for the three months ended June 30, 2005 and 2004, respectively. The decrease in profits for the three months ended June 30, 2005 when compared to 2004 is primarily due to higher O&M expenses (as a result of postretirement and severance costs, the write-off of unrecovered storm costs and the change in accounting estimates for certain Energy Delivery capital costs), the impact of milder weather and lower average retail usage per customer, partially offset by higher wholesale sales, favorable provision for rate refund, favorable retail customer growth and the gain on the sale of the Winter Park distribution system.

PEF contributed segment profits of $53 million and $133 million for the six months ended June 30, 2005 and 2004, respectively. The decrease in profits for the six months ended June 30, 2005 when compared to 2004 is primarily due to higher O&M expenses (as a result of postretirement and severance costs, the write-off of unrecovered storm costs and the change in accounting estimates for certain Energy Delivery capital costs), lower average usage per retail customer and the impact of milder weather partially offset by higher wholesale sales, favorable provision for rate refund, favorable retail customer growth and the gain on the sale of the Winter Park distribution system.

<u>Three months ended June 30, 2005 as compared to the three months ended June 30, 2004</u>

Revenues

PEF's electric revenues for the three months ended June 30, 2005 and 2004, and the amount and percentage change by customer class are as follows:

(in millions of $)	Three Months Ended June 30,			
Customer Class	2005	Change	% Change	2004
Residential	$ 431	$ 9	2.1	$ 422
Commercial	227	13	6.1	214
Industrial	71	5	7.6	66
Governmental	57	5	9.6	52
Retail revenue sharing	2	5	-	(3)
Total retail revenues	788	37	4.9	751
Wholesale	68	15	28.3	53
Unbilled	18	(6)	-	24
Miscellaneous	34	2	6.3	32
Total electric revenues	$ 908	$ 48	5.6	$ 860
Less:				
Pass-through revenues	(527)	(49)	(10.3)	(478)
Revenues excluding pass-through revenues	$ 381	$ (1)	(0.3)	$ 382

PEF's electric energy sales for the three months ended June 30, 2005 and 2004, and the amount and percentage change by customer class are as follows:

(in millions of kWh)	Three Months Ended June 30,			
Customer Class	2005	Change	% Change	2004
Residential	4,341	(164)	(3.6)	4,505
Commercial	2,888	(53)	(1.8)	2,941
Industrial	1,040	(11)	(1.0)	1,051
Governmental	762	11	1.5	751
Total retail energy sales	9,031	(217)	(2.3)	9,248
Wholesale	1,318	225	20.6	1,093
Unbilled	428	(362)	-	790
Total kWh sales	10,777	(354)	(3.2)	11,131

PEF's revenues, excluding recoverable fuel and other pass-through revenues of $527 million and $478 million for the three months ended June 30, 2005 and 2004, respectively, decreased $1 million. The decrease in revenues is due to unfavorable average usage per retail customer of $13 million and the impact of milder weather of $5 million with heating degree days and cooling degree days 43% and 7% below prior year, respectively. These decreases were partially offset by favorable provision for rate refund of $5 million (due to lower base revenues as discussed above and a higher revenue sharing threshold in 2005), favorable retail customer growth of $6 million and favorable wholesale revenues of $4 million. Wholesale revenue favorability is attributable primarily to new contracts entered into subsequent to June 2004.

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 $457 million for the three months ended June 30, 2005, which represents a $42 million increase compared to prior year. This increase is due to increases in fuel used in electric generation and purchased power expenses of $37 million and $5 million, respectively. Increased fuel costs in the current year account for $12 million of the increase in fuel used in electric generation. The remaining increase was due to an increase in deferred fuel expense as recovery of fuel expenses in the current year was greater than in the prior year. In December 2004, the FPSC approved PEF's request for a cost recovery adjustment in its annual filing due to the rising cost of fuel. Fuel recovery rates increased effective January 1, 2005. The increase in purchased power expense was primarily due to higher prices of purchases in the current year as a result of increased fuel costs.

Operations and Maintenance (O&M)

O&M expenses were $288 million for the three months ended June 30, 2005, which represents an increase of $136 million, when compared to the $152 million incurred during the three months ended June 30, 2004. Postretirement and severance expense related to the cost management initiative increased O&M costs by $93 million during 2005. In addition, PEF wrote-off $17 million of unrecoverable storm costs associated with the 2004 hurricanes (see Note 5 to the Progress Energy Consolidated Interim Financial Statements). O&M expense also increased $9 million related to the change in accounting estimates for certain Energy Delivery capital costs. See discussion of change in Energy Delivery capitalization practice in Note 8F of the Progress Energy annual report on Form 10-K for the year ended December 31, 2004. The remaining increase in O&M expense is attributable to higher environmental cost recovery expenses (primarily emission allowances) of $6 million and a $3 million bad debt reserve recorded during the period. The environmental cost recovery expenses are pass-through expenses and have no impact on earnings.

Other income, net

Other income, net has increased $24 million for the three months ended June 30, 2005 as compared to the prior year. This increase was due primarily to the pre-tax gain recognized on the sale of the Winter Park distribution system of $25 million (see Note 5 to the Progress Energy Consolidated Interim Financial Statements). In addition, the equity component of the allowance for funds used during construction increased $3 million as a result of the Hines Unit 3 & Unit 4 construction projects. These favorable items were offset partially by the FERC Code of Conduct audit settlement that required $3 million to be refunded to customers (see discussion in Note 12 to the Progress Energy Consolidated Interim Financial Statements).

Interest charges, net

Total interest charges, net increased $4 million to $32 million for the three months ended June 30, 2005 as compared to $28 million for the three months ended June 30, 2004. This increase is due primarily to additional commercial paper and internal money pool borrowings related to unrecovered storm costs.

Income tax expense

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 $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 swings 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. The remaining fluctuation in income tax expense is attributable to reduced earnings compared to prior period.

<u>Six months ended June 30, 2005 as compared to six months ended June 30, 2004</u>

Revenues

PEF's electric revenues for the six months ended June 30, 2005 and 2004, and the amount and percentage change by customer class are as follows:

(in millions of $)	Six Months Ended June 30,			
Customer Class	2005	Change	% Change	2004
Residential	$ 861	$ 37	4.5	$ 824
Commercial	428	33	8.4	395
Industrial	134	6	4.7	128
Governmental	110	11	11.1	99
Retail revenue sharing	-	7	-	(7)
Total retail revenues	1,533	94	6.5	1,439
Wholesale	142	22	18.3	120
Unbilled	13	(5)	-	18
Miscellaneous	68	1	1.5	67
Total electric revenues	$ 1,756	$ 112	6.8	$1,644
Less:				
Pass-through revenues	(1,028)	(103)	(11.1)	(925)
Revenues excluding pass-through revenues	$ 728	$ 9	1.3	$ 719

PEF's electric energy sales for the six months ended June 30, 2005 and 2004, and the amount and percentage change by customer class are as follows:

(in millions of kWh)	Six Months Ended June 30,			
Customer Class	2005	Change	% Change	2004
Residential	8,688	(109)	(1.2)	8,797
Commercial	5,459	28	0.5	5,431
Industrial	1,981	(93)	(4.5)	2,074
Governmental	1,471	48	3.4	1,423
Total retail energy sales	17,599	(126)	(0.7)	17,725
Wholesale	2,655	240	9.9	2,415
Unbilled	325	(330)	-	655
Total kWh sales	20,579	(216)	(1.0)	20,795

PEF's revenues, excluding recoverable fuel and other pass-through revenues of $1.028 billion and $925 million for the six months ended June 30, 2005 and 2004, respectively, increased $9 million. The increase in revenues is due to favorable retail customer growth, increased wholesale revenues and the favorable provision for rate refund of $12 million, $11 million and $7 million, respectively. Wholesale revenue improvement is attributable primarily to new contracts entered into subsequent to May 2004. These increases were partially offset by lower average usage per retail customer of $12 million and the impact of milder weather in the current year of $7 million with heating degree days 18% below the prior year. In addition, weaker industrial sales reduced revenues $2 million.

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 $890 million for the six months ended June 30, 2005, which represents an $85 million increase compared to prior year. This increase is due to increases in fuel used in electric generation and purchased power expenses of $70 million and $15 million, respectively. Higher system requirements and increased fuel costs in the current year account for $52 million of the increase in fuel used in electric generation. The remaining increase was due to an increase in deferred fuel expense as recovery of fuel expenses in the current year was greater than in the prior year. In December 2004, the FPSC approved PEF's request for a cost recovery adjustment in its annual filing due to the rising cost of fuel. Fuel recovery rates increased effective January 1, 2005. The increase in purchased power expense was primarily due to higher prices of purchases in the current year as a result of increased fuel costs.

Operations and Maintenance (O&M)

O&M expenses were $477 million for the six months ended June 30, 2005, which represents an increase of $165 million, when compared to the $312 million incurred during the six months ended June 30, 2004. Postretirement and severance costs associated with the cost management initiative increased O&M costs by $107 million during 2005. In addition, PEF wrote-off $17 million of unrecoverable storm costs associated with the 2004 hurricanes (see Note 5 to the Progress Energy Consolidated Interim Financial Statements). O&M expense also increased $17 million related to the change in accounting estimates for certain Energy Delivery capital costs. See discussion of change in Energy Delivery capitalization practice in Note 8F of the Progress Energy annual report on Form 10-K for the year ended December 31, 2004. O&M expense increased $11 million due to higher environmental cost recovery expenses (primarily emission allowances). The environmental cost recovery expenses are pass-through expense and have no impact on earnings. The remaining increase in O&M expense is attributable to an $8 million workers compensation benefit adjustment recorded in 2005 as a result of an actuarial study.

Other income, net

Other income, net has increased $28 million for the six months ended June 30, 2005 as compared to the prior year. This increase was due primarily to the pre-tax gain recognized on the sale of the Winter Park distribution system of $25 million (see Note 5 to the Progress Energy Consolidated Interim Financial Statements). In addition, the equity component of the allowance for funds used during construction increased $5 million as a result of the Hines Unit 3 & Unit 4 construction projects. These favorable items were offset partially by the FERC Code of Conduct audit settlement that required $3 million to be refunded to customers (see discussion in Note 12 to the Progress Energy Consolidated Interim Financial Statements).

Interest charges, net

Total interest charges, net increased $6 million to $64 million for the six months ended June 30, 2005 as compared to $58 million for the six months ended June 30, 2004. This increase is due primarily to additional commercial paper and internal money pool borrowings related to unrecovered storm costs.

Income tax expense

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 $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 swings 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. The remaining fluctuation in income tax expense is attributable to reduced earnings compared to prior year.

DIVERSIFIED BUSINESSES

The Company's diversified businesses consist of the Fuels segment, the CCO segment and the Synthetic Fuels segment. These businesses are explained in more detail below.

FUELS

The Fuels' segment operations include natural gas production, coal extraction and terminal operations. The following summarizes Fuels' segment profits for the three and six months ended June 30, 2005 and 2004:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	2005	2004	2005	2004
Gas production	$ 12	$ 12	$ 24	$25
Coal fuel and other operations	–	5	(1)	2
Segment Profits	$ 12	$ 17	$ 23	$ 27

Natural Gas Operations

Natural gas operations generated profits of $12 million for both of the three months ended June 30, 2005 and 2004, and $24 million and $25 million for the six months ended June 30, 2005 and 2004, respectively. The decrease in gas earnings compared to prior year is attributable to reduced production as a result of the sale of gas assets in 2004 offset partially by higher natural gas prices. In addition, results for the six months ended June 30, 2005 were negatively impacted by a reduction in capitalized interest of $3 million pre-tax. In December 2004, the Company sold certain gas-producing properties and related assets owned by Winchester Production Company, Ltd., a subsidiary of Progress Fuels (North Texas gas operations). The following summarizes the gas production, revenues and gross margins for the three and six months ended June 30, 2005 and 2004 by production facility:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Production in Bcf equivalent				
East Texas/LA gas operations	6.0	4.9	11.4	9.0
North Texas gas operations	-	2.7	-	5.3
Total Production	6.0	7.6	11.4	14.3
Revenues in millions				
East Texas/LA gas operations	$ 39	$ 27	$ 72	$ 48
North Texas gas operations	–	13	-	27
Total Revenues	$ 39	$ 40	$ 72	$ 75
Gross Margin				
in millions of $	$ 30	$ 33	$ 58	$ 60
As a % of revenues	77%	83%	81%	80%

Coal Fuel and Other Operations

Coal fuel and other operations earnings were essentially break even for the three months ended June 30, 2005 compared to segment profits of $5 million for the three months ended June 30, 2004. The decrease in earnings compared to the prior period is due to higher coal mining costs (due to rising prices of fuel and steel) and reduced sales volumes due to the expiration of several contracts in the current year. In addition, results were unfavorably impacted by postretirement and severance costs of $4 million pre-tax recorded during 2005 related to the cost management initiative.

Coal fuel and other operations generated segment losses of $1 million for the six months ended June 30, 2005 compared to segment profit of $2 million for the six months ended June 30, 2004. The decrease in earnings of $3 million is due primarily to higher coal mining costs of $11 million pre-tax (due to rising prices of fuel and steel) , a workers compensation accrual adjustment booked during the first quarter of 2005 of $5 million pre-tax and postretirement and severance costs of $6 million pre-tax as a part of the cost management initiative. This unfavorability was partially offset by increased revenues as a result of higher coal prices.

The Company is exploring strategic alternatives regarding the Fuels' coal mining business, which could include divesting these assets. As of June 30, 2005, the carrying value of long-lived assets of the coal mining business was $69 million. The Company cannot currently predict the outcome of this matter.

COMPETITIVE COMMERCIAL OPERATIONS

CCO's operations generated segment losses of $3 million for the three months ended June 30, 2005 compared to segment profit of $5 million in the prior year. The decrease in earnings compared to prior year is due primarily to a reduction in gross margin of $13 million pre-tax ($8 million after-tax) offset partially by favorable interest expense. Contract margins are unfavorable compared to prior year due to the expiration of certain tolling agreements and lower at-market sales. This margin unfavorability was partially offset by increased earnings from new full-requirements contracts and increased load on an existing contract. In addition, interest expense decreased $3 million pre-tax ($2 million after-tax) compared to the prior period due to the termination of CCO's Genco financing arrangement in December 2004.

CCO's operations generated segment losses of $9 million for the six months ended June 30, 2005 compared to segment losses of $3 million in the prior period. The increase in losses compared to prior year is due primarily to a reduction in gross margin of $15 million pre-tax ($9 million after-tax) offset partially by favorable depreciation and amortization expense and interest expense. Contract margins are unfavorable compared to prior year due to the expiration of certain tolling agreements and lower at-market sales. This unfavorability was partially offset by increased earnings from new full-requirements contracts and increased load on an existing contract. In addition, results in the current year included $2 million pre-tax ($1 million after-tax) in postretirement and severance costs associated with the cost management initiative. Depreciation and amortization expenses decreased $4 million pre-tax ($2 million after-tax) as a result of the expiration of certain acquired contracts that were subject to amortization. Interest expense decreased $5 million pre-tax ($2 million after-tax) due to the termination of the Genco financing arrangement in December 2004.

	Three months ended June 30,		Six months ended June 30,	
(in millions)	2005	2004	2005	2004
Total revenues	$ 158	$ 72	$ 222	$ 105
Gross margin				
In millions of $	$ 29	$ 42	$ 50	$ 65
As a % of revenues	18%	58%	23%	62%
Segment losses	$ (3)	$ 5	$ (9)	$ (3)

The Company has contracts for its planned production capacity, which includes callable resources from the cooperatives, of approximately 77% for 2005, approximately 81% for 2006 and approximately 75% for 2007. The Company continues to seek opportunities to optimize its nonregulated generation portfolio.

SYNTHETIC FUEL

The synthetic fuel operations generated segment profits of $23 million and $36 million for the three months ended June 30, 2005 and 2004, and $22 million and $72 million for the six months ended June 30, 2005 and 2004, respectively. The production and sale of coal-based solid synthetic fuel generate operating losses, but qualify for tax credits under Section 29 of the Code, which typically more than offset the effect of such losses. See Note 14 to the Progress Energy Consolidated Interim Financial Statements.

The operations resulted in the following for the three and six months ended June 30, 2005 and 2004:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	2005	2004	2005	2004
Tons sold	2.3	2.7	4.3	5.7
Operating losses, excluding tax credits	$ (39)	$ (35)	$ (77)	$ (77)
Tax credits generated, net	62	71	99	149
Segment profits	$ 23	$ 36	$ 22	$ 72

Synthetic fuels' earnings for the three months ended June 30, 2005 as compared to the prior period were negatively impacted by lower sales and higher production costs. The decrease in sales is due primarily to an internal change in the quarterly production schedule in 2005 compared to 2004.

Synthetic fuels' earnings for the six months ended June 30, 2005 as compared to the prior period were negatively impacted by lower sales and the forfeiture of tax credits as a result of the sale of Progress Rail. The decrease in sales year over year is primarily attributable to an internal change in the quarterly production schedule in 2005 compared to 2004. The sale of Progress Rail resulted in a capital loss for tax purposes, therefore $17 million of previously recorded tax credits were forfeited during the current year. See Note 14 to the Progress Energy Consolidated Interim Financial Statements for further discussion.

In response to the historically high oil prices to date in 2005, the Company adjusted its planned production schedule for its synthetic fuel plant by shifting some of its production planned for April and May 2005 to the second half of 2005. If oil prices rise and stay at levels high enough to cause a phase out of tax credits, the Company may reduce planned production or suspend production at some or all of its synthetic fuel facilities.

CORPORATE & OTHER

Corporate & Other consists of the operations of Progress Energy Holding Company (the holding company), Progress Energy Service Company and other consolidating and non-operating entities. Corporate & Other also includes other nonregulated business areas including the telecommunications operations of Progress Telecom, LLC (PT LLC) and the operations of Strategic Resource Solutions (SRS). PT LLC operations provide broadband capacity services, dark fiber and wireless services in Florida and the eastern United States. SRS was engaged in providing energy services to industrial, commercial and institutional customers to help manage energy costs primarily in the southeastern United States. During 2004, SRS sold its subsidiary, Progress Energy Solutions (PES). With the disposition of PES, the Company exited this business area.

Other nonregulated business areas

Other nonregulated businesses contributed segment losses of $2 million for the three months ended June 30, 2005 compared to segment losses of $31 million for the three months ended June 30, 2004. This favorability is due primarily to a reduction in losses at SRS. During the second quarter of 2004 SRS recorded the litigation settlement reached with the San Francisco United School District related to civil proceedings. In June 2004, SRS reached a settlement with the District which settled all outstanding claims for approximately $43 million pre-tax ($29 million after-tax).

Other nonregulated businesses contributed segment losses of $2 million for the six months ended June 30, 2005 compared to segment losses of $35 million for the six months ended June 30, 2004. This favorability is due primarily to the reduction of losses at SRS as discussed above.

Corporate Services

Corporate Services (Corporate) includes the operations of the Holding Company, the Service Company and consolidation entities, as summarized below:

	Three Months Ended June 30,		Six Months Ended June 30,	
Income (expense) in millions	2005	2004	2005	2004
Other interest expense	$ (72)	$ (67)	$ (143)	$ (140)
Contingent value obligations	–	(5)	-	(13)
Tax levelization	(49)	(5)	(52)	(43)
Tax reallocation	(9)	(9)	(19)	(18)
Other income taxes	32	28	62	59
Other	(4)	(4)	(8)	(7)
Segment profit (loss)	$ (102)	$ (62)	$ (160)	$ (162)

Other interest expense increased $5 million compared to $67 million for the three months ended June 30, 2004 and increased $3 million compared to $140 million for the six months ended June 30, 2004. Interest expense increased during the current periods due to increased rates on commercial paper borrowings, interest rate swaps and additional expenses incurred related to draw downs on revolving credit agreements.

Progress Energy issued 98.6 million contingent value obligations (CVOs) in connection with the 2000 FPC acquisition. Each CVO represents the right to receive contingent payments based on the performance of four synthetic fuel facilities owned by Progress Energy. The payments, if any, are based on the net after-tax cash flows the facilities generate. At June 30, 2005 and 2004, the CVOs had fair market values of approximately $13 million and $36 million, respectively. Progress Energy recorded unrealized losses of $0.5 million and $5 million for the three months ended June 30, 2005 and 2004, respectively, to record the changes in fair value of the CVOs, which had average unit prices of $0.14 and $0.36 at June 30, 2005 and 2004, respectively. Progress Energy recorded an unrealized loss of $13 million for the six months ended June 30, 2004. 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 $49 million and $5 million for the three months ended June 30, 2005 and 2004, and $52 million and $43 million for the six months ended June 30, 2005 and 2004, respectively, in order to maintain an effective tax rate consistent with the estimated annual rate. The tax credits associated with the Company's synthetic fuel operations primarily drive the required levelization amount. Fluctuations in estimated annual earnings and tax credits can also cause large swings 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.

DISCONTINUED OPERATIONS

On March 24, 2005, the Company completed the sale of Progress Rail to One Equity Partners LLC, a private equity firm unit of J.P. Morgan Chase & Co. Gross cash proceeds from the sale are estimated to be approximately $430 million, consisting of $405 million base proceeds plus an estimated working capital adjustment. Proceeds from the sale were used to reduce debt. The accompanying consolidated interim financial statements have been restated for all periods presented for the discontinued operations of Progress Rail. See Notes 3 and 14B to the Progress Energy Consolidated Interim Financial Statements for additional discussion.

Rail discontinued operations resulted in losses of $7 million for the three months ended June 30, 2005 compared to profits of $7 million for the three months ended June, 2004. Earnings for 2005 include an adjustment of $7 million to the estimated after-tax loss on the sale related to working capital adjustments and other revisions of operating estimates. Results for 2004 include three months of operations. Results for the three months ended June 30, 2005 do not include any income or loss from operations as the sale closed in the first quarter. See discontinued earnings summary included at Note 3 to the Progress Energy Consolidated Interim Financial Statements.

Rail discontinued operations resulted in losses of $19 million for the six months ended June 30, 2005 compared to profits of $16 million for the six months ended June 30, 2004. Earnings for 2005 include an estimated after-tax loss on the sale of $24 million. Results for 2004 included six months of earnings activity compared to only three months in 2005.

NCNG discontinued operations contributed $1 million of net income for the three and six months ended June 30, 2004. The sale of NCNG to Piedmont Natural Gas Company closed in 2003; however, during the three and six months ended June 30, 2004, the Company recorded an additional gain of $1 million after tax related to deferred taxes on the loss from the sale.

LIQUIDITY AND CAPITAL RESOURCES

Progress Energy, Inc.

Progress Energy is a registered holding company and, as such, has no operations of its own. The Company's primary cash needs at the holding company level are its common stock dividend and interest expense and principal payments on its $4.3 billion of senior unsecured debt. The ability to meet these needs is dependent on its access to the capital markets, the earnings and cash flows of its two electric utilities and nonregulated subsidiaries, and the ability of those subsidiaries to pay dividends or repay funds to Progress Energy.

Cash Flows from Operations

Net cash provided by operating activities decreased $322 million for the six months ended June 30, 2005, when compared to the corresponding period in the prior year. The decrease in operating cash flow was due primarily to a $313 million increase in working capital requirements. The increase in working capital requirements was primarily driven by $90 million in synthetic fuel royalty payments (see Note 14D), a $71 million difference in PEC's coal inventory fluctuations, $73 million due to timing of tax payments at PEF, and a $32 million reduction in tax liabilities related to the loss on disposal of Rail. See Note 3 to the Progress Energy Consolidated Interim Financial Statements.

Investing Activities

Net cash used in investing activities decreased by $55 million for the six months ended June 30, 2005, when compared to the corresponding period in the prior year. The decrease is due primarily to $405 million in proceeds from the sale of Progress Rail in March 2005, compared to $94 million in proceeds from the sale of assets during the six months ended June 30, 2004. See Note 3 to the Progress Energy Consolidated Interim Financial Statements. This was partially offset by $160 million of lower net proceeds from short-term investments, $86 million in additional capital expenditures for utility property and nuclear fuel additions, and the purchase of natural gas assets for $46 million at Progress Fuels in May 2005. See Note 4 to the Progress Energy Consolidated Interim Financial Statements.

Financing Activities

Net cash used in financing activities was $166 million for the six months ended June 30, 2005, compared to $520 million for the six months ended June 30, 2004, or a net decrease of $354 million. The change in cash used in financing activities was due primarily to the March 1, 2004 maturity of $500 million 6.55% senior unsecured notes. These notes were paid with cash and commercial paper capacity which was created from the sale of assets during 2003.

In January 2005, the Company used proceeds from the issuance of commercial paper to pay off $260 million of revolving credit agreement (RCA) loans, which included $90 million at PEC and $170 million at PEF.

On January 31, 2005, Progress Energy, Inc. entered into a new $600 million RCA, which was to expire on December 30, 2005. This facility was added to provide additional liquidity, to the extent necessary, during 2005 due in part to the uncertainty of the timing of storm restoration cost recovery from the hurricanes in Florida during 2004. On February 4, 2005, $300 million was drawn under the new facility to reduce commercial paper and pay off the remaining amount of loans outstanding under other RCA facilities, which consisted of $160 million at Progress Energy and $55 million at PEF. As discussed below, the maximum size of this RCA was reduced to $300 million on March 22, 2005 and subsequently terminated on May 16, 2005.

On March 22, 2005, PEC issued $300 million of First Mortgage Bonds, 5.15% Series due 2015, and $200 million of First Mortgage Bonds, 5.70% Series due 2035. The net proceeds from the sale of the bonds were used to pay at maturity $300 million of PEC's 7.50% Senior Notes on April 1, 2005 and reduce the outstanding balance of PEC's commercial paper. Pursuant to the terms of the Progress Energy $600 million RCA, commitments were reduced to $300 million, effective March 22, 2005.

In March 2005, Progress Energy, Inc.'s $1.1 billion five-year credit facility was amended to increase the maximum total debt to total capital ratio from 65% to 68% due to the potential impacts of a proposed interpretation of SFAS No. 109 regarding accounting rules for uncertain tax positions (See Note 2).

On March 28, 2005, PEF entered into a new $450 million five-year RCA with a syndication of financial institutions. The RCA will be used to provide liquidity support for PEF's issuances of commercial paper and other short-term obligations. The RCA will expire on March 28, 2010. The new $450 million RCA replaced PEF's $200 million three-year RCA and $200 million 364-day RCA, which were each terminated effective March 28, 2005. Fees and interest rates under the $450 million RCA are to be determined based upon the credit rating of PEF's long-term unsecured senior non-credit enhanced debt, currently rated as A3 by Moody's Investor Services (Moody's) and BBB by Standard and Poor's (S&P). The RCA includes a defined maximum total debt to capital ratio of 65%. The RCA also contains various cross-default and other acceleration provisions, including a cross-default provision for defaults of indebtedness in excess of $35 million. The RCA does not include a material adverse change representation for borrowings or a financial covenant for interest coverage, which had been provisions in the terminated agreements.

On March 28, 2005, PEC entered into a new $450 million five-year RCA with a syndication of financial institutions. The RCA will be used to provide liquidity support for PEC's issuances of commercial paper and other short-term obligations. The RCA will expire on June 28, 2010. The new $450 million RCA replaced PEC's $285 million three-year RCA and $165 million 364-day RCA, which were each terminated effective March 28, 2005. Fees and interest rates under the $450 million RCA are to be determined based upon the credit rating of PEC's long-term unsecured senior non-credit enhanced debt, currently rated as Baa1 by Moody's and BBB by S&P. The RCA includes a defined maximum total debt to capital ratio of 65%. The RCA also contains various cross-default and other acceleration provisions, including a cross-default provision for defaults of indebtedness in excess of $35 million. The RCA does not include a material adverse change representation for borrowings, which had been a provision in the terminated agreements.

In May 2005, Progress Energy, Inc. used proceeds from the issuance of commercial paper to pay off $300 million of its $600 million RCA.

On May 16, 2005, PEF issued $300 million of First Mortgage Bonds, 4.50% Series due 2010. The net proceeds from the sale of the bonds were used to reduce the outstanding balance of commercial paper. Pursuant to the terms of the Progress Energy $600 million RCA, commitments were completely reduced and the RCA was terminated, effective May 16, 2005.

On July 1, 2005, PEF paid at maturity $45 million of its 6.72% Medium-Term Notes, Series B with short-term debt proceeds.

On July 28, 2005, PEC filed a shelf registration statement with the SEC to provide an additional $1.0 billion of capacity in addition to the $400 million remaining on PEC's current shelf registration statement. The shelf registration statement will allow PEC to issue various securities, including First Mortgage Bonds, Senior Notes, Debt Securities and Preferred Stock.

On July 28, 2005, PEF filed a shelf registration statement with the SEC to provide an additional $1.0 billion of capacity in addition to the $450 million remaining on PEF's current shelf registration statement. The shelf registration statement will allow PEF to issue various securities, including First Mortgage Bonds, Debt Securities and Preferred Stock.

For the six months ended June 30, 2005, the Company issued approximately 4.0 million shares representing approximately $171 million in proceeds from its Investor Plus Stock Purchase Plan and its employee benefit and stock option plans, net of purchases of restricted shares. For the year 2005, the Company expects to realize approximately $200 million aggregate amount from the sale of stock through these plans.

Future Liquidity and Capital Resources

As of June 30, 2005, there were no material changes in the Company's "Capital Expenditures," "Other Cash Needs," "Credit Facilities," or "Credit Rating Matters" as compared to those discussed under in Item 7 of the Form 10-K, other than "Environmental Matters" and as described below and under "Financing Activities."

As of June 30, 2005, the current portion of long-term debt was $848 million, which the Company expects to fund from proceeds from the sale of Progress Rail, issuances of new long-term debt, commercial paper borrowings and/or issuance of new equity securities.

The amount and timing of future sales of company securities will depend on market conditions, operating cash flow, asset sales and the specific needs of the Company. The Company may from time to time sell securities beyond the amount needed to meet 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.

On April 29, 2005, PEF made its initial filing with the FPSC seeking annual base revenue increase of $206 million. See Note 4 to the Progress Energy Consolidated Interim Financial Statements. Hearings for this proceeding are expected to occur during the third quarter of 2005. A final ruling from the FPSC is expected in December 2005 with new rates in effect January 2006.

On June 21, 2005, the FPSC ruled that PEF will recover $232 million of storm costs over a two-year period. PEF's initial petition was for $252 million. The final order was received on July 14, 2005.

On June 1, 2005, Florida Governor Jeb Bush signed into law a bill that would allow utilities to petition the FPSC to use securitized bonds to recover storm related costs. PEF intends to ask the FPSC for approval to issue securitized debt. This arrangement would benefit the Company by providing immediate cash recovery of the hurricane costs and would benefit the customer by providing a longer recovery period, which will reduce the price impact on monthly bills. Assuming FPSC approval, PEF expects the process to take six to nine months to complete.

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

The Company's off-balance sheet arrangements and contractual obligations are described below.

Guarantees

As a part of normal business, Progress Energy and certain wholly owned subsidiaries enter into various agreements providing future financial or performance assurances to third parties that are outside the scope of Financial Accounting Standards Board (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 and subsidiaries on a stand-alone basis, thereby facilitating the extension of sufficient credit to accomplish the subsidiaries' intended commercial purposes. The Company's guarantees include performance obligations under power supply agreements, tolling agreements, transmission agreements, gas agreements, fuel procurement agreements and trading operations. The Company's guarantees also include standby letters of credit, surety bonds and guarantees in support of nuclear decommissioning. As of June 30, 2005, the Company had issued $1.3 billion of guarantees for future financial or performance assurance. The Company does 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), ratings triggers, monthly netting of exposure and/or payments and offset provisions in the event of a default. As of June 30, 2005, no guarantee obligations had been triggered. If the guarantee obligations were triggered, the maximum amount of liquidity requirements to support ongoing operations within a 90-day period, associated with guarantees for the Company's nonregulated portfolio and power supply agreements was $437 million. The Company believes that it would be able to meet this obligation with cash or letters of credit.

As of June 30, 2005, the Company has 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 its non-wholly 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 the Company has received timely notice, the Company's indemnity obligations may extend beyond the notice period. Certain environmental indemnifications related to the sale of synthetic fuel operations have no limitations as to time or maximum potential future payments. Other guarantees and indemnifications have an estimated maximum exposure of approximately $152 million. As of June 30, 2005, the Company has recorded liabilities related to guarantees and indemnifications to third-parties of $27 million. Management does not believe conditions are likely for significant performance under these agreements in excess of the recorded liabilities.

Market Risk and Derivatives

Under its risk management policy, the Company 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 9 to the Progress Energy Consolidated Interim Financial Statements and Item 3, "Quantitative and Qualitative Disclosures about Market Risk," for a discussion of market risk and derivatives.

Contractual Obligations

As part of Progress Energy's ordinary course of business, it enters into various long and short term contracts for fuel requirements at its generating plants. Through June 30, 2005, contracts procured through PEC have increased the Company's aggregate purchase obligations for fuel and purchased power by approximately $709 million as compared to the amount stated in the Company's Form 10-K for the year ended December 31, 2004. The increase primarily covers the period ranging from 2005 through 2009. A majority of the contracts related to the increase in purchase obligations for fuel and purchased power are for future coal purchases primarily with fixed prices.

OTHER MATTERS

Synthetic Fuels Tax Credits

The Company has substantial operations associated with the production of coal-based solid synthetic fuels. The production and sale of these products qualifies for federal income tax credits so long as certain requirements are satisfied. These operations are subject to numerous risks.

Although the Company believes that it operates its synthetic fuel facilities in compliance with applicable legal requirements for claiming the credits, its four Earthco facilities are under audit by the IRS. IRS field auditors have taken an adverse position with respect to the Company's compliance with one of these legal requirements, and if the Company fails to prevail with respect to this position, it could incur significant liability and/or lose the ability to claim the benefit of tax credits carried forward or generated in the future. Similarly, in July 2005 the Financial Accounting Standards Board issued proposed new accounting rules that would require that uncertain tax benefits (such as those associated with the Earthco plants) be probable of being sustained in order to be recorded on the financial statements; if adopted as currently drafted, this provision could have an adverse financial impact on the Company. See Note 2 to the Progress Energy Consolidated Interim Financial Statements.

The Company's ability to utilize tax credits is dependent on having sufficient tax liability. Any conditions that reduce the Company's tax liability, such as weather, could also diminish the Company's ability to utilize credits, including those previously generated, and the synthetic fuel is generally not economical to produce absent the credits. Finally, the tax credits associated with synthetic fuels may be phased out if market prices for crude oil exceed certain prices.

The Company's synthetic fuel operations and related risks are described in more detail in Note 14 to the Progress Energy Consolidated Interim Financial Statements and in the Risk Factors section of Progress Energy's Annual Report on Form 10-K for the year ended December 31, 2004, which was filed with the SEC on March 16, 2005.

PEF Rate Case Filing

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 has requested a $206 million annual increase in base rates effective January 1, 2006. PEF's request for an increase in base rates reflects an increase in operational costs with (i) the addition of Hines 2 generation facility into base rates rather than the Fuel Clause as was permitted under the terms of existing Stipulation and Settlement Agreement (the Agreement), (ii) completion of the Hines 3 generation facility, (iii) the need, in light of recent history, to replenish PEF's depleted storm reserve on a going-forward basis by adjusting the annual accrual, (iv) the expected infrastructure investment necessary to meet high customer expectations, coupled with the demands placed on PEF's system due to strong customer growth, (v) significant additional costs including increased depreciation and fossil dismantlement expenses and (vi) general inflationary pressures.

Hearings on the base rate proceeding are scheduled from September 7 through September 16, 2005, and a final decision is expected by the end of 2005. Although the Company cannot predict the outcome of this matter, an adverse outcome could negatively impact the Company's and PEF's financial condition and results of operations.

PEF Storm Cost Filing

On July 14, 2005, the Florida Public Service Commission (FPSC) issued an order authorizing PEF to recover $232 million, including interest, of the costs it incurred and previously deferred related to PEF's restoration of power associated with the four hurricanes in 2004. The ruling will allow PEF to include a charge of approximately $3.27 on the average residential monthly customer bill beginning August 1, 2005. The ruling by the FPSC approved the majority of the Company's request with two exceptions: the reclassification of $8 million from O&M to utility plant and reclassification of $17 million as normal O&M expense. As a result of these adjustments, approximately $17 million was charged to O&M expense in June 2005, representing the retail portion of these adjustments.

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. The Company currently estimates that it has incurred an additional $18 million in costs over and above the amount requested in the petition. The difference between the actual costs and the amount requested will be trued-up in September 2005, subject to FPSC approval, and the impact will be included in customer bills beginning January 1, 2006.

On June 1, 2005, Florida Governor Jeb Bush signed into law a bill that would allow utilities to petition the FPSC to use securitized bonds to recover storm related costs. PEF intends to ask the FPSC for approval to issue securitized debt. This arrangement would benefit the Company by providing immediate cash recovery of the hurricane costs and would benefit the customer by providing a longer recovery period, which will reduce the price impact on monthly bills. Assuming FPSC approval, PEF expects the process to take six to nine months to complete.

Energy Bill

On July 29, 2005, the U.S. Senate gave the final approval for comprehensive energy policy legislation. This bill provides tax changes for the utility industry, incentives for emissions reductions, and federal insurance and incentives to build new nuclear power plants. The U.S. House passed the measure on July 28, 2005, and President Bush is expected to sign the legislation into law on or about August 8, 2005.

The bill contains key provisions affecting the electric power industry, including provisions on nuclear security and nuclear regulatory risk insurance, repeal of the Public Utility Holding Company Act (PUHCA), and protection for native retail load customers of utilities that are not in regional transmission organizations. It gives the Federal Energy Regulatory Commission (FERC) "backstop" transmission siting authority as well as increased utility merger oversight. The bill also provides incentives and funding for clean coal technologies and initiatives to voluntarily reduce greenhouse gases and redesignates the Section 29 tax credit as a general business credit.

The Company is reviewing the new energy bill legislation and cannot currently predict what impact the proposed law would have on its financial condition and results of operations.

Franchise Litigation

Two cities, Edgewood and Belleair, with a total of approximately 4,000 customers, have litigation pending against PEF in two circuit courts in Florida. As discussed below, proceedings against PEF by a third city, the City of Winter Park, Florida, were concluded in the second quarter of 2005. As previously reported, the lawsuits principally seek (1) a declaratory judgment that the cities have the right to purchase PEF's electric distribution system located within the municipal boundaries of the cities, (2) a declaratory judgment that the value of the distribution system must be determined through arbitration, and (3) injunctive relief requiring PEF to continue to collect from PEF's customers, and remit to the cities, franchise fees during the pending litigation, as long as PEF continues to occupy the cities' rights-of-way to provide electric service, notwithstanding the expiration of the franchise ordinances under which PEF had agreed to collect such fees. The circuit courts in those cases have entered orders requiring arbitration to establish the purchase price of PEF's electric distribution system within five cities. Two appellate courts have upheld those circuit court decisions and authorized the cities to determine the value of PEF's electric distribution system within those cities, which orders have been upheld by the appellate courts.

Arbitration in the case by the City of Winter Park (the City) was completed in February 2003. That arbitration panel issued an award in May 2003 setting the value of PEF's distribution system within the City (13,000 customers) at approximately $32 million, not including separation and reintegration and construction work in progress, which could add several million dollars to the award. The panel also awarded PEF approximately $11 million in stranded costs, which, according to the award, decrease over time. In September 2003, Winter Park voters passed a referendum that would authorize the City to issue bonds of up to approximately $50 million to acquire PEF's electric distribution system. On April 26, 2004, the City Commission voted to proceed with the acquisition. The City sought and received wholesale power supply bids and on June 24, 2004, executed a wholesale power supply contract with PEF with a five-year term from the date service begins and a renewal option. On May 12, 2004, the City solicited bids to operate and maintain the distribution system and awarded a contract in January 2005. On February 10, 2005, PEF filed a petition with the Florida Public Service Commission (FPSC) to relieve the Company of its statutory obligation to serve customers in Winter Park on June 1, 2005, or at such time when the City is able to provide retail service. On April 19, 2005, the FPSC voted to approve PEF's petition. On June 1, 2005, the City acquired PEF's electric distribution assets that serve the

City for approximately $42 million. PEF transferred the distribution assets to the City on June 1, 2005 and recognized a pre-tax gain of $25 million on the transaction, which is included in other, net on the Consolidated Statements of Income. This amount is subject to true-up pending accumulation of the final capital expenditures since arbitration. PEF also recorded a regulatory liability of $8 million for stranded cost revenues which will be amortized to revenues over the next six years in accordance with the provisions of the transfer agreement with the City.

Arbitration with the 2,500-customer Town of Belleair (the Town) was completed in June 2003. In September 2003, the arbitration panel issued an award in that case setting the value of the electric distribution system within the Town at approximately $6 million. The panel further required the Town to pay to PEF its requested $1 million in separation and reintegration costs and $2 million in stranded costs. The Town has not yet decided whether it will attempt to acquire the system; however, on January 18, 2005, it issued a request for proposals for wholesale power supply and to operate and maintain the distribution system. In March 2005, PEF submitted a bid to supply wholesale power to the Town. The Town received several other proposals for wholesale power and distribution services. In February 2005, the Town Commission also voted to put the issue of whether to acquire the distribution system to a voter referendum. A referendum is scheduled to occur on November 8, 2005. At this time, whether and when there will be further proceedings regarding the Town of Belleair cannot be determined.

Arbitration in the remaining city's litigation (the 1,500-customer City of Edgewood) has not yet been scheduled. On February 17, 2005, the parties filed a joint motion to stay the litigation for a 90-day period during which the parties will discuss potential settlement. In April, the City Council voted to proceed with arbitration and on July 6, 2005, the circuit court referred the matter to arbitration, but did not set an arbitration date. The parties are engaged in settlement discussions and have reached a tentative agreement to resolve the case under which the City of Edgewood would sign a 30-year franchise agreement. At this time, whether and when there will be further proceedings regarding the City of Edgewood cannot be determined.

A fourth city (the 7,000-customer City of Maitland) is contemplating municipalization but has indicated its intent to enter into a new franchise agreement with PEF. Maitland's franchise expires in August 2005. At this time, whether and when there will be further proceedings regarding the City of Maitland cannot be determined.

As part of the above litigation, two appellate courts reached opposite conclusions regarding whether PEF must continue to collect from its customers and remit to the cities "franchise fees" under the expired franchise ordinances. PEF filed an appeal with the Florida Supreme Court to resolve the conflict between the two appellate courts. On October 28, 2004, the Court issued a decision holding that PEF must collect from its customers and remit to the cities franchise fees during the interim period when the city exercises its purchase option or executes a new franchise. The Court's decision should not have a material impact on the Company.

Environmental Matters

The Company is subject to federal, state and local regulations addressing air and water quality, hazardous and solid waste management and other environmental matters. The Company currently estimates total compliance costs, for PEC and PEF combined, related to environmental laws and regulations addressing air and water quality, which will primarily be for capital expenditures, may be in excess of $2.0 billion over ten years. These environmental matters are discussed in detail in Note 13. This discussion identifies specific environmental issues, the status of the issues, accruals associated with issue resolutions and the associated exposures to the Company. The Company accrues costs to the extent they are probable and can be reasonably estimated. It is reasonably possible that additional losses, which could be material, may be incurred in the future..

Progress Energy Carolinas, Inc.

The information required by this item is incorporated herein by reference to the following portions of Progress Energy's Management's Discussion and Analysis of Financial Condition and Results of Operations, insofar as they relate to PEC: RESULTS OF OPERATIONS; LIQUIDITY AND CAPITAL RESOURCES and OTHER MATTERS.

RESULTS OF OPERATIONS

The results of operations for the PEC Electric segment are identical between PEC and Progress Energy. The results of operations for PEC's nonutility subsidiaries for the three and six months ended June 30, 2005 and 2004 are not material to PEC's consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operating activities decreased $157 million for the six months ended June 30, 2005, when compared to the corresponding period in the prior year. The decrease was caused primarily by a change in emission allowance inventory fluctuations of $46 million and a $102 million increase in working capital requirements, primarily driven by a $71 million difference in coal inventory fluctuations.

Cash used in investing activities increased $194 million for the six months ended June 30, 2005, when compared to the corresponding period in the prior year primarily due to lower net proceeds from short-term investments in 2005 compared to 2004.

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

PEC's off-balance sheet arrangements and contractual obligations are described below.

Market Risk and Derivatives

Under its risk management policy, PEC 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 7 to PEC's Consolidated Interim Financial Statements and Item 3, "Quantitative and Qualitative Disclosures About Market Risk," for a discussion of market risk and derivatives.

Contractual Obligations

As part of PEC's ordinary course of business, it enters into various long and short term contracts for fuel requirements at its generating plants. Through June 30, 2005, these contracts have increased the Company's aggregate purchase obligations for fuel and purchased power by approximately $709 million as compared to the amount stated in the Company's Form 10-K for the year ended December 31, 2004. The increase primarily covers the period ranging from 2005 through 2009. A majority of the contracts related to the increase in purchase obligations for fuel and purchased power are for future coal purchases primarily with fixed prices.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Progress Energy, Inc.

Other than described below, the various risks that the Company is exposed to has not materially changed since December 31, 2004.

Progress Energy and its subsidiaries are exposed to various risks related to changes in market conditions. Market risk represents the potential loss arising from adverse changes in market rates and prices. The Company has 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 its risk policy, the Company 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 to the extent that the counterparty fails to perform under the contract. The Company mitigates such risk by performing credit reviews using, among other things, publicly available credit ratings of such counterparties.

Certain market risks are inherent in the Company's financial instruments, which arise from transactions entered into in the normal course of business. The Company's primary exposures are changes in interest rates with respect to its long-term debt and commercial paper, fluctuations in the return on marketable securities with respect to its nuclear decommissioning trust funds, changes in the market value of CVOs, and changes in energy related commodity prices.

Interest Rate Risk

The Company's exposure to changes in interest rates from fixed rate and variable rate long-term debt at June 30, 2005 has changed from December 31, 2004. The total fixed rate long-term debt as of June 30, 2005, was $9.35 billion, with an average interest rate of 6.40% and fair market value of $10.16 billion. The total variable rate long-term debt as of June 30, 2005, was $0.86 billion, with an average interest rate of 2.41% and fair market value of $0.86 billion.

In addition to the Company's variable rate long-term debt, the Company typically has commercial paper and/or loans outstanding under its RCA facilities, which are also exposed to floating interest rates. As of June 30, 2005, approximately 11.4% of consolidated debt, including interest rate swaps, was in floating rate mode compared to 16.1% at the end of 2004.

From time to time, Progress Energy uses interest rate derivative instruments to adjust the mix between fixed and floating rate debt in its debt portfolio, to mitigate its exposure to interest rate fluctuations associated with certain debt instruments, and to hedge interest rates with regard to future fixed rate debt issuances.

The notional amounts of interest rate derivatives are not exchanged and do not represent exposure to credit loss. In the event of default by a counterparty, the risk in the transaction is the cost of replacing the agreements at current market rates. Progress Energy only enters into interest rate derivative agreements with banks with credit ratings of single A or better.

The Company uses a number of models and methods to determine interest rate risk exposure and fair value of derivative positions. For reporting purposes, fair values and exposures of derivative positions are determined as of the end of the reporting period using the Bloomberg Financial Markets system.

In accordance with SFAS No. 133, interest rate derivatives that qualify as hedges are broken into one of two categories, cash flow hedges or fair value hedges. Cash flow hedges are used to reduce exposure to changes in cash flow due to fluctuating interest rates. Fair value hedges are used to reduce exposure to changes in fair value due to interest rate changes.

The following tables summarize the terms, fair market values and exposures of the Company's interest rate derivative instruments:

Cash Flow Hedges:

As of June 30, 2005, Progress Energy had $200 million of pay-fixed swaps to hedge cash flow for commercial paper interest and $100 million of pay-fixed forward starting swaps to hedge cash flow risk with regard to future financing transactions. Under terms of these swap agreements, Progress Energy will pay a fixed rate and receive a floating rate based on either 1-month or 3-month LIBOR, respectively.

Cash Flow Hedges (dollars in millions) Progress Energy, Inc.	**Notional Amount**	**Pay**	**Receive**[b]	**Fair Value**	**Exposure**[c]
Risk hedged as of June 30, 2005:					
Commercial Paper interest rate risk through 2005	$ 200	3.07%	1-month LIBOR	$ 1	$ –
Anticipated 10-year debt issue[d]	$ 100	4.87%	3-month LIBOR	$ (4)	$ (2)
Total	$ 300	3.67%[a]		$ (3)	$ (2)
Risk hedged as of December 31, 2004:					
Commercial Paper interest risk from 2005 through 2008	$ 200	3.07%	1-month LIBOR	$ –	$ –
Progress Energy Carolinas					
Risk hedged as of June 30, 2005:	None				
Risk hedged as of December 31, 2004:					
Anticipated 10-year debt issue	$ 110	4.85%	3-month LIBOR	$ (1)	$ (2)
Rail car lease payment	$ 21	5.17%	3-month LIBOR	$ (1)	$ –
Total	$ 131	4.90%[a]		$ (2)	$ (2)

[a] Weighted average interest rate.
[b] 1-month LIBOR rate was 3.34% as of June 30, 2005, and 2.40% as of December 31, 2004.
3-month LIBOR rate was 3.52% as of June 30, 2005, and 2.56% as of December 31, 2004.
[c] Exposure indicates change in value due to 25 basis point unfavorable shift in interest rates.
[d] Anticipated 10-year debt issue hedges mature on March 1, 2016, and require mandatory cash settlement on March 1, 2006.

Fair Value Hedges:

As of June 30, 2005, Progress Energy had $150 million of fixed rate debt swapped to floating rate debt. Under terms of these swap agreements, Progress Energy will receive a fixed rate and pay a floating rate based on 3-month LIBOR.

Fair Value Hedges (dollars in millions)					
Progress Energy, Inc.	Notional Amount	Receive	Pay[b]	Fair Value	Exposure[c]
Risk hedged as of June 30, 2005:					
5.85% Notes due 10/30/2008	$ 100	4.10%	3-month LIBOR	$ –	$ (1)
7.10% Notes due 3/1/2011	$ 50	4.65%	3-month LIBOR	$ 2	$ (1)
Total	$ 150	4.28%[a]		$ 2	$ (2)
Risk hedged as of December 31, 2004:					
5.85% Notes due 10/30/2008	$ 100	4.10%	3-month LIBOR	$ 1	$ (1)
7.10% Notes due 3/1/2011	$ 50	4.65%	3-month LIBOR	$ 2	$ (1)
Total	$ 150	4.28%[a]		$ 3	$ (2)

[a] Weighted average interest rate.
[b] 3-month LIBOR rate was 3.52% as of June 30, 2005, and 2.56% as of December 31, 2004.
[c] Exposure indicates change in value due to 25 basis point unfavorable shift in interest rates.

Marketable Securities Price Risk

The Company's exposure to return on marketable securities for the nuclear decommissioning trust funds has not changed materially since December 31, 2004.

CVO Market Value Risk

The Company's exposure to market value risk with respect to the CVOs has not changed materially since December 31, 2004.

Commodity Price Risk

The Company is exposed to the effects of market fluctuations in the price of natural gas, coal, fuel oil, electricity and other energy-related products marketed and purchased as a result of its ownership of energy-related assets. The Company's exposure to these fluctuations is significantly limited by the cost-based regulation of PEC and PEF. Each state commission allows electric utilities to recover certain of these costs through various cost recovery clauses to the extent the respective commission determines that such costs are prudent. Therefore, while there may be a delay in the timing between when these costs are incurred and when these costs are recovered from the ratepayers, changes from year to year have no material impact on operating results. In addition, many of the Company's long-term power sales contracts shift substantially all fuel responsibility to the purchaser. The Company also has oil price risk exposure related to synfuel tax credits. See discussion in Note 14E to the Progress Energy Consolidated Interim Financial Statements.

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. The Company manages open positions with strict policies that limit its exposure to market risk and require daily reporting to management of potential financial exposures. The Company recorded pre-tax losses of less than $1 million and $2 million on such contracts for the three months ended June 30, 2005 and 2004, respectively. The Company recorded a $2 million pre-tax gain and a $14 million pre-tax loss on such contracts for the six months ended June 30, 2005 and 2004, respectively. The Company did not have material outstanding positions in such contracts as of June 30, 2005 and December 31, 2004, other than those receiving regulatory accounting treatment, as discussed below.

PEF has derivative instruments related to its exposure to price fluctuations on fuel oil purchases. These instruments receive regulatory accounting treatment. Unrealized gains and losses are recorded in regulatory liabilities and regulatory assets, respectively. As of June 30, 2005, the fair values of these instruments were a $60 million short-term derivative asset position included in other current assets and a $22 million long-term derivative asset position included in other assets and deferred debits. As of December 31, 2004, the fair values of these 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.

The Company uses natural gas hedging instruments to manage a portion of the market risk associated with fluctuations in the future purchase and sales prices of the Company's natural gas. Progress Energy's nonregulated subsidiaries designate a portion of commodity derivative instruments as cash flow hedges under SFAS No. 133. The fair values of commodity cash flow hedges as of June 30, 2005 and December 31, 2004 were as follows:

(in millions)	June 30, 2005	December 31, 2004
Fair value of assets	$ 96	$ –
Fair value of liabilities	(24)	(15)
Fair value, net	$ 72	$ (15)

The Company performs sensitivity analyses to estimate its exposure to the market risk of its commodity positions. The Company's exposure to commodity price risk has not changed materially since December 31, 2004. A hypothetical 10% increase or decrease in quoted market prices in the near term on the Company's derivative commodity instruments would not have had a material effect on the Company's consolidated financial position, results of operations or cash flows as of June 30, 2005.

Refer to Note 9 for additional information with regard to the Company's commodity contracts and use of derivative financial instruments.

Progress Energy Carolinas, Inc.

PEC has certain market risks inherent in its financial instruments, which arise from transactions entered into in the normal course of business. PEC's primary exposures are changes in interest rates with respect to long-term debt and commercial paper, fluctuations in the return on marketable securities with respect to its nuclear decommissioning trust funds, and changes in energy related commodity prices. PEC's exposure to these risks has not materially changed since December 31, 2004.

The information required by this item is incorporated herein by reference to the "Quantitative and Qualitative Disclosures about Market Risk" discussed above insofar as it relates to PEC.

Item 4: Controls and Procedures

Progress Energy, Inc.

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, Progress Energy carried out an evaluation, with the participation of its management, including Progress Energy's Chairman and Chief Executive Officer and Chief Financial Officer, of the effectiveness of Progress Energy's disclosure controls and procedures (as defined under Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, Progress Energy's Chief Executive Officer and Chief Financial Officer concluded that its disclosure controls and procedures are effective to ensure that information required to be disclosed by Progress Energy in the reports that it files or submits under the Exchange Act, is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to Progress Energy's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

On May 24, 2005, Progress Energy announced that Jeffrey M. Stone was appointed to the position of Controller (Chief Accounting Officer) of the Company and its subsidiaries, Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc. and Florida Progress Corporation, effective June 1, 2005. Mr. Stone will also serve as Controller of Florida Power Corporation d/b/a Progress Energy Florida, Inc. and Progress Energy Service Company, LLC. These positions were previously held by Robert H. Bazemore, Jr. since 2000. Mr. Bazemore has been reassigned to the position of Vice President, Capital Planning and Control.

Other than the above-referenced item, there has been no change in Progress Energy's internal control over financial reporting during the quarter ended June 30, 2005, that has materially affected, or is reasonably likely to materially affect, Progress Energy's internal control over financial reporting.

Progress Energy Carolinas, Inc.

Pursuant to the Securities Exchange Act of 1934, PEC carried out an evaluation, with the participation of its management, including PEC's Chairman and Chief Executive Officer and Chief Financial Officer, of the effectiveness of PEC's disclosure controls and procedures (as defined under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, PEC's Chief Executive Officer and Chief Financial Officer concluded that its disclosure controls and procedures are effective to ensure that information required to be disclosed by PEC in the reports that it files or submits under the Exchange Act, is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to PEC's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

On May 24, 2005, Progress Energy announced that Jeffrey M. Stone was appointed to the position of Controller (Chief Accounting Officer) of the Company and its subsidiary, Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc. These positions were previously held by Robert H. Bazemore, Jr. since 2000. Mr. Bazemore has been reassigned to the position of Vice President, Capital Planning and Control for Progress Energy.

Other than the above-referenced item, there has been no change in PEC's internal control over financial reporting during the quarter ended June 30, 2005, that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Legal aspects of certain matters are set forth in Part I, Item 1. For a discussion of certain other legal matters, see Note 14 to the Progress Energy, Inc. Consolidated Interim Financial Statements and Note 12 to the PEC Consolidated Interim Financial Statements.

In re Progress Energy, Inc. Securities Litigation, Master File No. 04-CV-636 (JES)

On February 3, 2004, Progress Energy, Inc. was served with a class action complaint alleging violations of federal security laws in connection with the Company's issuance of Contingent Value Obligations (CVOs). The action was filed by Gerber Asset Management LLC in the United States District Court for the Southern District of New York and names Progress Energy, Inc.'s former Chairman William Cavanaugh III and Progress Energy, Inc. as defendants. The Complaint alleges that Progress Energy failed to timely disclose the impact of the Alternative Minimum Tax required under Sections 55-59 of the Internal Revenue Code (Code) on the value of certain CVOs issued in connection with the Florida Progress Corporation merger. The suit seeks unspecified compensatory damages, as well as attorneys' fees and litigation costs.

On March 31, 2004, a second class action complaint was filed by Stanley Fried, Raymond X. Talamantes and Jacquelin Talamantes against William Cavanaugh III and Progress Energy, Inc. in the United States District Court for the Southern District of New York alleging violations of federal securities laws arising out of the Company's issuance of CVOs nearly identical to those alleged in the February 3, 2004, Gerber Asset Management complaint. On April 29, 2004, the Honorable John E. Sprizzo ordered among other things that (1) the two class action cases be consolidated, (2) Peak6 Capital Management LLC shall serve as the lead plaintiff in the consolidated action, and (3) the lead plaintiff shall file a consolidated amended complaint on or before June 15, 2004.

The lead plaintiff filed a consolidated amended complaint on June 15, 2004. In addition to the allegations asserted in the Gerber Asset Management and Fried complaints, the consolidated amended complaint alleges that the Company failed to disclose that excess fuel credits could not be carried over from one tax year into later years. On July 30, 2004, the Company filed a motion to dismiss the complaint; plaintiff submitted its opposition brief on September 14, 2004. The Court heard oral argument on the Company's motion to dismiss on November 15, 2004. On May 24, 2005, the Court dismissed the litigation with prejudice.

Item 2. Unregistered Sale of Equity Securities and Use of Proceeds

a. RESTRICTED STOCK AWARDS:

(a) Securities Delivered. On April 1, 2005, 72,600 restricted shares of the Company's Common Shares were granted to certain key employees pursuant to the terms of the Company's 2002 Equity Incentive Plan (Plan), which was approved by the Company's shareholders on May 8, 2002. Section 9 of the Plan provides for the granting of Restricted Stock by the Organization and Compensation Committee of the Company's Board of Directors, (the Committee) to key employees of the Company, including its Affiliates or any successor, and to outside directors of the Company. The Common Shares delivered pursuant to the Plan were acquired in market transactions directly for the accounts of the recipients and do not represent newly issued shares of the Company.

(b) Underwriters and Other Purchasers. No underwriters were used in connection with the delivery of Common Shares described above. The Common Shares were delivered to certain key employees of the Company. The Plan defines "key employee" as an officer or other employee of the Company who is selected for participation in the Plan.

(c) Consideration. The Common Shares were delivered to provide an incentive to the employee recipients to exert their utmost efforts on the Company's behalf and thus enhance the Company's performance while aligning the employee's interest with those of the Company's shareholders.

(d) Exemption from Registration Claimed. The Common Shares described in this Item were delivered on the basis of an exemption from registration under Section 4(2) of the Securities Act of 1933. Receipt of the Common Shares required no investment decision on the part of the recipients.

c. ISSUER PURCHASES OF EQUITY SECURITIES FOR SECOND QUARTER OF 2005

Period	(a) Total Number of Shares (or Units) Purchased(1)(2)	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs(1)	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs(1)
April 1 - April 30	72,600	$42.53	N/A	N/A
May 1- May 31	N/A	N/A	N/A	N/A
June 1 - June 30	N/A	N/A	N/A	N/A
Total:	72,600	$42.53	N/A	N/A

(1) As of June 30, 2005, Progress Energy does not have any publicly announced plans or programs to purchase shares of its common stock.

(2) 72,600 shares of our common stock were purchased in open-market transactions in connection with restricted stock awards that were granted to certain key employees pursuant to the terms of the Progress Energy 2002 Equity Incentive Plan, which was approved by Progress Energy's Shareholders on May 8, 2002.

Item 4. Submission of Matters to a Vote of Security Holders

(a) The Annual Meeting of the Shareholders of Progress Energy, Inc. was held on May 11, 2005.

(b) The meeting involved the election of three Class I directors to serve for three-year terms. Proxies for the meeting were solicited pursuant to Regulation 14, there was no solicitation in opposition to management's nominees as listed below, and all nominees were elected.

(c) The total votes for the election of directors were as follows:

Class I (Term Expiring in 2008)	Votes For	Votes Withheld
William O. McCoy	205,913,326	4,398,058
John H. Mullin, III	206,101,396	4,209,988
Carlos A. Saladrigas	206,112,664	4,198,720

The Board of Director proposal to ratify the selection of Deloitte & Touche LLP as the Company's independent registered public accounting firm was approved by the shareholders.

The number of shares voted for the proposal was 205,625,939
The number of shares voted against the proposal was 2,651,127
The number of abstaining votes was 2,034,318

Carolina Power & Light Company, doing business as Progress Energy Carolinas, Inc.

(a) The Annual Meeting of the Shareholders of Carolina Power & Light Company was held on May 11, 2005.

(b) The meeting involved the election of three Class I directors to serve for three-year terms. Proxies for the meeting were solicited pursuant to Regulation 14, there was no solicitation in opposition to management's nominees as listed below, and all nominees were elected.

(c) The total votes for the election of directors were as follows:

Class I (Term Expiring in 2008)	Votes For	Votes Withheld
William O. McCoy	160,129,938	4,171
John H. Mullin, III	160,129,664	4,445
Carlos A. Saladrigas	160,129,764	4,345

The Board of Director proposal to ratify the selection of Deloitte & Touche LLP as the Company's independent registered public accounting firm was approved by the shareholders.

The number of shares voted for the proposal was 160,129,689
The number of shares voted against the proposal was 2,288
The number of abstaining votes was 2,132

Item 6. Exhibits

(a) Exhibits

Exhibit Number	Description	Progress Energy, Inc.	Progress Energy Carolinas, Inc.
10	Amendment to Employment Agreement Between Progress Energy Service Company, LLC and Peter M. Scott III, dated August 5, 2005	X	X
31(a)	Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 – Chairman and Chief Executive Officer	X	X
31(b)	Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 – Executive Vice President and Chief Financial Officer	X	X
32(a)	Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – Chairman and Chief Executive Officer	X	X
32(b)	Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – Executive Vice President and Chief Financial Officer	X	X

SIGNATURES

Pursuant to requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PROGRESS ENERGY, INC.
CAROLINA POWER & LIGHT COMPANY
(Registrants)

Date: August 5, 2005

By: /s/ Geoffrey S. Chatas
Geoffrey S. Chatas
Executive Vice President and
Chief Financial Officer

By: /s/ Jeffrey M. Stone.
Jeffrey M. Stone
Controller and Chief Accounting Officer