" What happened in 2002 and where do we go from here? "

RICHARD B. PRIORY
CHAIRMAN OF THE BOARD
CHIEF EXECUTIVE OFFICER

TO OUR SHAREHOLDERS:

The year 2002 was one of enormous challenge – for our company, our industry and the economy at large. And it was a year of disappointment for shareholders who have come to rely on Duke Energy's ability to provide steady returns.

Our best efforts and outlook proved no match for the harsh realities of 2002: An economy of fits and starts, unprecedented turmoil in the U.S. merchant energy sector, accelerating upheaval in both credit and equity markets, and an unrelenting bear market all combined to create the greatest crisis in investor confidence and public trust since the Depression.

External factors were certainly challenging. And while we marshaled all of our resources and knowledge to address the dynamic changes within our sector, we were not fully prepared to deal with eroding market conditions. Our forecasts for U.S. power supply and demand missed the mark, and collapsing markets left us long in power supply and overexposed to a dramatic drop in the price of electricity.

Our reported year-end earnings per share were $1.22, including the effect of certain charges related to ice storm damage, restructuring costs, and goodwill and asset impairments. Without those charges, ongoing earnings were $1.88 per share. Our stock price fell from a 52-week high of $39.80 to $19.54 at year-end. Total return to shareholders, including dividends paid during the year and the decrease in our stock price, declined 48 percent in 2002.

If the law of gravity prevailed in 2002, so did the theory of relativity. Amid a landscape of fallen merchant energy providers, Duke Energy has fared comparatively well. We are among the few in our sector to retain investment-grade credit ratings. Our Duke Power and Duke Energy Gas Transmission businesses provided reliable earnings and solid cash flow, helping compensate for the sharp downturn in our merchant energy business.

I'm proud of our staying power, our operational performance in the face of adversity, and our steadfast commitment to value creation. But there are no bragging rights in basic business survival – and we're never content with "better than most." So this letter and the commentary that follows will address what happened in 2002 – and, more importantly, what we're doing to manage through the current economic and market weakness and ensure we are well positioned for the future.

WHAT HAPPENED IN 2002?

The young merchant energy sector, which had enjoyed an enormous upswing in previous years, experienced its first major down cycle in 2002. The turn was stunning, swift and severe.

Some regions that had capacity shortfalls just a year ago experienced a rapid upsurge in supply. We had focused on the development activities of large, established generators, but we underestimated the build-out efforts of some smaller local and regional energy merchants. Rapid additions to generating capacity, coupled with the extended economic downturn, resulted in a sharp decline in power margins and volatility.

In the wake of the Enron bankruptcy, credit rating agencies focused more intently on cash and coverage ratios for all companies, but particularly for the energy sector. As business conditions worsened, companies faced enormous increases in their capital costs, and in many cases were shut out of the capital markets. The dramatic credit decline of many energy customers and wholesale market participants reduced the size, length and volume of energy transactions in the marketplace.

Finally, regulatory uncertainty, changes in accounting standards and securities laws, investigations and litigation further discouraged investment and confidence in our sector. Moreover, this occurred in the context of an alarming crisis of trust in business in general, brought on by accounting missteps and improprieties, allegations of business scandals and growing skepticism about the effectiveness of corporate governance.

All of these factors converged to create dramatic changes in the energy marketplace, and to substantially reduce the earnings opportunity for our merchant energy businesses Duke Energy North America (DENA) and Duke Energy International (DEI). Our total reported earnings before interest and taxes (EBIT) of $2.87 billion fell $1.39 billion short of 2001 EBIT of $4.26 billion. Ongoing 2002 EBIT (excluding one-time charges) was $3.62 billion, compared to $4.34 billion in 2001 – primarily due to substantially lower results at DENA.

WHERE DO WE GO FROM HERE?

As eager as we are to put 2002 behind us, we're realistic enough to know that we'll be grappling with weak market conditions through at least 2003. The slow pace of economic recovery, imbalance between electricity supply and demand, and regulatory and legal uncertainties facing our industry paint a sober view of the year ahead.

We therefore expect earnings per share of between $1.35 and $1.60 in 2003 (before one-time charges for the implementation of new required accounting standards).

We are committed to growing profits from our core regulated businesses.

Duke Energy benefits from the balance within our portfolio between stable businesses like Duke Power and Duke Energy Gas Transmission – and the more cyclical merchant energy and Field Services businesses. These are supplemented by smaller but healthy contributors like Crescent Resources, which delivers solid performance in fluctuating business cycles. While our regulated businesses are not immune to weakness in the economy, they are robust and are expected to generate some 80 percent of our earnings in 2003.

Serving more than 2 million customers in North Carolina and South Carolina, Duke Power continued to provide a solid stream of earnings in 2002. The business delivered EBIT of $1.61 billion in 2002, just slightly down from 2001 EBIT of $1.63 billion. The stability of these earnings and cash flows is directly linked to Duke Power's consistent, best-in-class performance. Operational excellence was evident in our 2002 performance, with our three nuclear stations achieving an unprecedented level of productivity, and our fossil and hydroelectric plants reaching record levels of commercial availability.

We were pleased by the passage of North Carolina's clean air legislation in 2002. Thanks to the hard work of the state's governor, legislators, regulators, environmentalists and electric utilities, a constructive plan was adopted that allows us to recover the costs of installing additional environmental controls at our fossil-fueled generating stations. Most importantly, the new legislation will result in significantly reduced emission levels. The legislation will freeze Duke Power electricity rates at their current levels for the next five years, while maintaining the company's stable earnings and cash flows.

Duke Energy Gas Transmission performed exceptionally well, contributing $1.17 billion in EBIT for 2002, a 92 percent increase over 2001 EBIT of $608 million. We completed a major expansion of our gas transmission business with the acquisition of Westcoast Energy in Canada, which added significant gas pipeline, storage and field services capacity, as well as a local distribution company serving 1.1 million residential customers. The transaction closed on March 14, 2002, and the Westcoast business contributed $416 million in EBIT for the year. We expect that contribution to increase as we connect major supply basins with growing markets on both sides of the border. And responding to demand growth in key eastern U.S. markets, we undertook pipeline expansion projects to serve Florida, Tennessee, North Carolina, Virginia, Massachusetts, New York and New Jersey.

We are addressing issues in our merchant energy business.

We are resolutely focused on reducing our exposure in the merchant energy business. After contributing $1.49 billion of EBIT in 2001, DENA contributed only $165 million of EBIT in 2002. We took decisive action last year – deferring construction projects, renegotiating the terms of our turbine purchases and halting most new development efforts.

We realigned and substantially reduced our merchant energy organization. And, by consolidating our North American sales and marketing functions, we are gaining significant economies of scale. Additionally, we developed consistent policies, practices and systems, including enhanced controls to improve our monitoring and reporting capabilities.

While the wholesale energy industry is still reeling from the loss of so many participants, low market volatility and low liquidity, we view sales and marketing as an integral aspect of a competitive energy marketplace. Our energy professionals market energy commodities, manage risk, provide reliability and promote price transparency for our customers worldwide.

We are committed to preserving the value merchant energy provides – reliable power supply, competitive pricing and efficient, well-run plants. Going forward, there will be fewer but stronger suppliers in the merchant field – well capitalized, able to survive through market ups and downs, skilled in risk management, diversified to sustain earnings, with assets to back their commitments. And Duke Energy intends to be at the head of the pack.

Just as merchant energy suffered in the U.S., international energy markets saw a downturn last year as well. DEI reported an EBIT loss of $102 million for 2002, due primarily to goodwill and other asset impairments associated with changing market conditions in Europe and Latin America – and business decisions we made to respond to those conditions. We have exited the power trading business in Europe and we pulled back on development plans in Brazil. We are concentrating our efforts this year on organic growth within our international business, emphasizing sales and marketing of capacity from our generation facilities and pipelines.

Discipline is our watchword for 2003.

We are focused on cash generation and capital management, limiting discretionary spending and reducing debt. To provide the financial flexibility needed to manage through near-term cycles, we've reduced planned capital expenditures by more than half to $3 billion in 2003. We expect cash from operations and asset sales to fund our capital expenditures and dividends, reducing the need for outside financing.

For 76 consecutive years we have paid quarterly dividends on our common stock. Our dividend delivered a 5.8 percent yield in 2002, and our plans for 2003 fully support the dividend at its current level of $1.10 per share.

We will continue to divest non-strategic assets when we can capture value. In addition to power plant and pipeline sales in 2002, we sold two businesses – Duke Engineering & Services and DukeSolutions – to companies with strategies better aligned with their capabilities.

We are reducing our workforce as we restructure to accommodate market changes and capture additional efficiencies. Consistent with the reductions, we've streamlined accountabilities and strengthened our focus on business operations. These changes are expected to reduce future costs by about $150 million annually.

We are maintaining a solid balance sheet.

Despite a difficult 2002, we maintain a strong balance sheet and sound credit ratings, good cash flow, a diverse earnings base and solid risk management.

For the past two decades, we've demonstrated our commitment to maintaining the sound financial ratios that support a solid credit rating. Even though our corporate ratings on unsecured debt were reduced in 2002, they remain among the strongest in the electric and gas sector.

Investors today are hungry for more detailed financial information, and we are striving to provide new levels of transparency and context in our financial reporting. We are providing additional metrics associated with our sales and marketing operations, and new levels of detail related to cash flow, balance sheet and income statements in our quarterly and annual reporting.

We are accountable for our actions.

Duke Energy's resilience in trying times and in good times is as much an outcome of corporate character as corporate performance. Integrity, trust, credibility and respect have been cornerstones of our company for nearly a century. And we are accountable for ensuring that any challenge to that foundation – any breach of ethics or misconduct – is addressed swiftly and resolutely.

For me, one of the most disappointing events of the year was finding instances where we did not meet our own high standards for conduct. We identified a small number of round-trip transactions that appear to have been conducted with no legitimate business purpose. While those instances were isolated and immaterial to earnings or revenue, we were forceful and forthright in our response: We have taken appropriate disciplinary actions and instituted new levels of control and accountability throughout our organization.

We have worked hard to reaffirm and communicate the values that Duke Energy stands for. Leadership sets the example for ethical conduct, and all employees are held accountable. Each year, every Duke Energy officer and employee reviews our Code of Business Ethics as we recommit ourselves to preserving and building our company's reputation. Additionally, each of our energy marketing and risk control professionals signs a statement acknowledging in detail their commodity trading responsibilities at Duke Energy.

Another issue that grabbed headlines in 2002 was an inquiry into specific Duke Power regulatory accounting entries. Our own review and an outside audit resulted in the identification of unintentional errors – and the need for improved communication with the North Carolina and South Carolina utility commissions. Reconciling our conviction that we had acted in good faith with the need to move forward, we reached a settlement agreement with both commissions, and are cooperating with the Department of Justice as they review this issue as well.

We were gratified at year-end by the decision of the U.S. District Court in the Southern District of New York to dismiss, in all respects, a number of class-action lawsuits regarding round-trip transactions. And we were also pleased when a federal judge in California dismissed a lawsuit filed by a Washington plaintiff against our company and other California generators, alleging antitrust and unfair business practices under California state law.

Let me be clear here: Duke Energy will not tolerate unethical business conduct. If we find instances of wrongdoing, we will take swift corrective action. We will be equally vigilant in defending our corporate character against false allegations, misconceptions and the potent dynamic of "headline risk." We will continue to defend ourselves vigorously as we respond with facts and candor to questions about our operations, our principles and our character.

We call upon our deep and principled management capability.

The right mix of skills and experience allowed us to redefine our corporate organization to respond to the market realities of 2002. The appointment of Fred Fowler to the role of Duke Energy's president and chief operating officer was a strong and definitive move by our Board of Directors. Fred brings tremendous operational leadership, financial rigor and a solid track record of delivering results in both key areas. Congratulations and our deepest thanks to Bill Coley, who retired in February as president of Duke Power and as a member of Duke Energy's Board of Directors. Bill provided strong leadership within our company and our community over the course of a distinguished 37-year career with the company. We wish him well.

These significant changes at the highest level of our company resulted in a number of positive moves within our operating businesses: Ruth Shaw succeeds Bill Coley as president of Duke Power; Tom O'Connor now serves as president of Duke Energy Gas Transmission; Rob Ladd is president of Duke Energy North America; Richard McGee continues as president of Duke Energy International; and Jimmy Mogg continues as chairman, president and CEO of Duke Energy Field Services. In making these changes and related realignments, we drew upon deep management bench strength and the talent needed to move us forward with good direction and momentum.

We are governed by an engaged and exacting Board of Directors. As more stringent governance standards have been proposed on many different fronts, we are in compliance with current standards and intend to meet all future requirements. We welcome Michael Phelps to our board, and thank Dennis Hendrix and Harold Hook for their years of dedicated service.

We are focused on the future.

2002 certainly taught us all the inherent dangers associated with a market bubble. It also brought renewed appreciation for timeless attributes like real assets, cash flow, sustainable earnings, operational know-how, reliable performance and customer service. We were reminded of the value and safeguards that diversification brings to the portfolios of individual investors and to companies like Duke Energy. And we are more focused on clarity and candor in reporting and assessing corporate performance.

Duke Energy's stock price will rebound, of that I am confident. Predicting a recovery date is more difficult. Triggers that will prompt the return of a robust energy marketplace include economic recovery, a narrowing of electricity reserve margins in the U.S., the restoration of financial liquidity to our sector, certainty around new and proposed accounting and governance standards, and the credit health of energy customers and partners.

2002 was a tremendously trying chapter in Duke Energy's 99-year history. But it was prologue, not epilogue. We've taken decisive action to weather the current cycle and to be ready to act on the growth opportunities that will emerge. We are relying on the fundamentals: Unyielding business values and operating principles. Strong, consistent value from core assets. Effective, conservative financial management. Solid, day-to-day execution. Reliable reporting driven not only by the new rules of the road – but also by our best judgment and highest intentions.

Our industry is far too vital to suffer a prolonged crisis of confidence. Duke Energy is focused not only on pulling our company through a tough time, but also on doing our part to restore order, accountability and honor to our critical sector. I hope that you will continue to stay the course with us, and I thank you for your confidence, which we work hard every day to both re-earn and reward.

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RICHARD B. PRIORY MARCH 12, 2003