Spectra Energy Corp.
Form 10-Q
May 15, 2007
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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 March 31, 2007

¨ **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 1-33007

SPECTRA ENERGY CORP

(Exact Name of Registrant as Specified in its Charter)

Delaware	**20-5413139**
(State or other jurisdiction of incorporation)	**(IRS Employer Identification No.)**

5400 Westheimer Court

Houston, Texas 77056

(Address of principal executive offices, including zip code)

713-627-5400

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has 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 registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ¨ No x

Number of shares of Common Stock, $0.001 par value, outstanding as of May 4, 2007: 631,828,569

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SPECTRA ENERGY CORP

FORM 10-Q FOR THE QUARTER ENDED

MARCH 31, 2007

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management s beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as anticipate, believe, intend, estimate, expect, continue, should, could, may, predict, will, potential, forecast, and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

state, federal and foreign legislative and regulatory initiatives that affect cost and investment recovery, have an effect on rate structure, and affect the speed at and degree to which competition enters the natural gas industries;

the outcomes of litigation and regulatory investigations, proceedings or inquiries;

the weather and other natural phenomena, including the economic, operational and other effects of hurricanes and storms;

the timing and extent of changes in commodity prices, interest rates and foreign currency exchange rates;

general economic conditions, including any potential effects arising from terrorist attacks and any consequential hostilities or other hostilities;

changes in environmental, safety and other laws and regulations;

the results of financing efforts, including the ability to obtain financing on favorable terms, which can be affected by various factors, including credit ratings and general economic conditions;

declines in the market prices of equity securities and resulting funding requirements for defined benefit pension plans;

growth in opportunities, including the timing and success of efforts to develop domestic and international pipeline, storage, gathering, processing and other infrastructure projects and the effects of competition;

the performance of natural gas transmission and storage, distribution, and gathering and processing facilities;

the extent of success in connecting natural gas supplies to gathering, processing and transmission systems and in connecting to expanding gas markets;

the effect of accounting pronouncements issued periodically by accounting standard-setting bodies;

- conditions of the capital markets and equity markets during the periods covered by the forward-looking statements;

- the ability to successfully complete merger, acquisition or divestiture plans; regulatory or other limitations imposed as a result of a merger, acquisition or divestiture; and the success of the business following a merger, acquisition or divestiture; and

- the ability to operate effectively as a stand-alone, publicly-traded company.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Spectra Energy Corp has described. Spectra Energy Corp undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

SPECTRA ENERGY CORP

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In millions, except per share amounts)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Operating Revenues		
Transportation and storage of natural gas	$ 519	$ 515
Distribution of natural gas	658	722
Other	224	248
Total operating revenues	1,401	1,485
Operating Expenses		
Natural gas and petroleum products purchased	562	640
Operating, maintenance and other	258	307
Depreciation and amortization	122	123
Property and other taxes	40	58
Total operating expenses	982	1,128
Gains on Sales of Other Assets and Other, net	1	28
Operating Income	420	385
Other Income and Expenses		
Equity in earnings of unconsolidated affiliates	90	154
Other income and expenses, net	16	7
Total other income and expenses	106	161
Interest Expense	155	143
Minority Interest Expense	16	11
Earnings From Continuing Operations Before Income Taxes	355	392
Income Tax Expense from Continuing Operations	119	148
Income From Continuing Operations	236	244
Loss From Discontinued Operations, net of tax		(22)
Net Income	$ 236	$ 222

Common Stock Data		
Weighted-average shares outstanding		
Basic	631	not applicable
Diluted	634	not applicable
Earnings per shares		
Basic	$ 0.37	not applicable
Diluted	$ 0.37	not applicable
Dividends per share	$ 0.22	not applicable

See Notes to Consolidated Financial Statements

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SPECTRA ENERGY CORP

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In millions)

	March 31, 2007	December 31, 2006
ASSETS		
Current Assets		
Cash and cash equivalents	$ 596	$ 299
Receivables	769	779
Inventory	156	397
Other	95	150
Total current assets	1,616	1,625
Investments and Other Assets		
Investments in unconsolidated affiliates	1,707	1,618
Goodwill	3,527	3,507
Other	424	221
Total investments and other assets	5,658	5,346
Property, Plant and Equipment		
Cost	15,760	15,639
Less accumulated depreciation and amortization	3,345	3,245
Net property, plant and equipment	12,415	12,394
Regulatory Assets and Deferred Debits	1,023	980
Total Assets	$ 20,712	$ 20,345

See Notes to Consolidated Financial Statements

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SPECTRA ENERGY CORP

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In millions, except per-share amounts)

	March 31, 2007	December 31, 2006
LIABILITIES AND STOCKHOLDERS / MEMBER S EQUITY		
Current Liabilities		
Accounts payable	$ 305	$ 246
Notes payable and commercial paper	728	349
Taxes accrued	135	214
Interest accrued	148	149
Current maturities of long-term debt	553	550
Other	510	850
Total current liabilities	2,379	2,358
Long-term Debt	7,723	7,726
Deferred Credits and Other Liabilities		
Deferred income taxes	2,912	2,980
Other	1,523	1,077
Total deferred credits and other liabilities	4,435	4,057
Commitments and Contingencies		
Minority Interests	569	565
Stockholders / Member s Equity		
Preferred Stock, $0.001 par, 22 million shares authorized, no shares outstanding at March 31, 2007 and December 31, 2006		
Common Stock, $0.001 par, one billion shares authorized, 631 million and one thousand shares outstanding at March 31, 2007 and December 31, 2006, respectively	1	
Additional paid-in capital	4,588	
Retained earnings	71	
Member s equity		4,598
Accumulated other comprehensive income	946	1,041
Total stockholders / member s equity	5,606	5,639
Total Liabilities and Stockholders / Member s Equity	$ 20,712	$ 20,345

See Notes to Consolidated Financial Statements

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SPECTRA ENERGY CORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In millions)

	Three Months Ended March 31, 2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 236	$ 222
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	124	166
Gains on sales of investments in commercial and multi-family real estate		(26)
Gains on sales of equity investments and other assets		(11)
Deferred income taxes	74	(143)
Minority interest	16	15
Equity in earnings of unconsolidated affiliates	(90)	(175)
Dividends received from unconsolidated affiliates	8	131
Contribution to company-sponsored pension plans	(11)	(11)
Other	(106)	207
Net cash provided by operating activities	251	375
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(111)	(221)
Investment expenditures	(64)	(68)
Acquisitions, net of cash acquired		(90)
Purchases of available-for-sale securities		(4,413)
Proceeds from sales and maturities of available-for-sale securities		4,866
Net proceeds from the sales of equity investments and other assets	1	28
Proceeds from the sales of commercial and multi-family real estate		56
Settlement of net investment hedges and other investing derivatives		(36)
Other		(6)
Net cash provided by (used in) investing activities	(174)	116
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from the issuance of long-term debt		6
Payments for the redemption of long-term debt	(19)	(39)
Increase (decrease) in notes payable and commercial paper	379	(84)
Distributions to minority interests	(4)	(157)
Contributions from minority interests		137
Advances to parent		(89)
Dividends paid	(139)	
Other	3	4
Net cash provided by (used in) financing activities	220	(222)
Net increase in cash and cash equivalents	297	269
Cash and cash equivalents at beginning of period	299	491

Cash and cash equivalents at end of period	$ 596	$ 760

See Notes to Consolidated Financial Statements

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SPECTRA ENERGY CORP

CONSOLIDATED STATEMENTS OF STOCKHOLDERS / MEMBER S EQUITY

AND COMPREHENSIVE INCOME

(Unaudited)

(In millions)

					Accumulated Other Comprehensive Income					
	Common Stock	Additional Paid-in Capital	Retained Earnings	Member s Equity	Foreign Currency Translation Adjustments	Net Gains (Losses) on Cash Flow Hedges	Minimum Pension Liability Adjustment	FAS 158 Adjustment	Other	Total
December 31, 2005	$	$	$	$ 10,848	$ 783	$ (86)	$ (60)	$	$ 19	$ 11,504
Net income				222						222
Other comprehensive income										
Foreign currency translation adjustment					59					59
Reclassification into earnings from cash flow hedges						14				14
Other									16	16
Total comprehensive income										311
Other, net				(3)						(3)
March 31, 2006	$	$	$	$ 11,067	$ 842	$ (72)	$ (60)	$	$ 35	$ 11,812
December 31, 2006	$	$	$	$ 4,598	$ 1,156	$ (6)	$	$ (109)	$	$ 5,639
Net income			236							236
Other comprehensive income										
Foreign currency translation adjustment					28					28
Total comprehensive income										264
Conversion to Spectra Energy Corp	1	4,597		(4,598)						
FIN 48 implementation			(26)							(26)
Transfer of net assets and liabilities from Duke Energy		1						(115)		(114)

Common stock dividends			(139)							(139)
Employee benefits		(10)						(8)		(18)
March 31, 2007	$ 1	$ 4,588	$ 71	$	$ 1,184	$ (6)	$	$ (232)	$	$ 5,606

See Notes to Consolidated Financial Statements

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SPECTRA ENERGY CORP

Notes to Consolidated Financial Statements

(Unaudited)

1. General

Nature of Operations. Spectra Energy Corp, through its subsidiaries and equity affiliates (collectively, Spectra Energy), owns and operates a large and diversified portfolio of complementary natural gas-related energy assets and is one of North America s leading midstream natural gas companies. Spectra Energy operates in three key areas of the natural gas industry: transmission and storage, distribution, and gathering and processing. Spectra Energy provides transportation and storage of natural gas to customers in various regions of the Eastern and Southeastern United States, the Maritime Provinces and the Pacific Northwest in the United States and Canada, and in the province of Ontario, Canada. Spectra Energy also provides natural gas sales and distribution services to retail customers in Ontario, and natural gas gathering and processing services to customers in Western Canada. In addition, Spectra Energy owns a 50% interest in DCP Midstream, LLC (DCP Midstream, formerly Duke Energy Field Services, LLC), one of the largest natural gas gatherers and processors in the United States.

Spin-off from Duke Energy Corporation. On January 2, 2007, Duke Energy Corporation (Duke Energy) completed the spin-off of its natural gas businesses, primarily comprised of the Natural Gas Transmission and Field Services business segments of Duke Energy that were owned through Duke Energy s then wholly-owned subsidiary, Spectra Energy Capital, LLC (Spectra Capital, formerly Duke Capital LLC). Duke Energy contributed its ownership interests in Spectra Capital to Spectra Energy and all of the outstanding common stock of Spectra Energy was distributed to Duke Energy s shareholders. Duke Energy s shareholders received one share of Spectra Energy common stock for every two shares of Duke Energy common stock, resulting in the issuance of approximately 631 million shares of Spectra Energy on January 2, 2007.

Basis of Presentation. The accompanying consolidated financial statements include the accounts of Spectra Energy Corp, its majority-owned subsidiaries where Spectra Energy has control and those variable interest entities where Spectra Energy is the primary beneficiary. As a result of the spin-off of the natural gas businesses of Duke Energy to Duke Energy s shareholders, Spectra Capital is treated as the predecessor entity to Spectra Energy for financial statement and reporting purposes. Accordingly, the 2006 information presented herein for Spectra Energy is that of Spectra Capital. Additionally, in anticipation of the spin-off, and as further described in Note 3, Spectra Capital implemented an internal reorganization in December 2006 in which the operations and assets of Spectra Capital that were not associated with the natural gas businesses were contributed by Spectra Capital to Duke Energy or its subsidiaries. The 2006 results of operations of most of these transferred businesses are included in Loss from Discontinued Operations, net of tax in the accompanying Consolidated Statements of Operations. Corporate service companies that were transferred to Duke Energy in December 2006 are reported within continuing operations since corporate services are being provided in 2007 to support the operations of Spectra Energy. Information presented for 2006 in the Consolidated Statements of Cash Flows does not include any reclassifications or adjustments to amounts historically reported for these transferred businesses.

These financial statements should be read in conjunction with the consolidated financial statements included in Spectra Energy s Annual Report on Form 10-K for the year ended December 31, 2006. These financial statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present Spectra Energy s results of operations and financial position. Amounts reported in the interim Consolidated Statements of Operations are not necessarily indicative of amounts expected for the respective annual periods due to the effects of seasonal temperature variations on energy consumption primarily in the gas distribution operations of Spectra Energy, as well as changing commodity prices on certain of the processing operations and other factors.

Use of Estimates. To conform with generally accepted accounting principles (GAAP) in the United States, management makes estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and Notes to Consolidated Financial Statements. Although these estimates are based on management s best available knowledge at the time, actual results could differ.

Reclassifications. As a result of the spin-off and the related realignment of Spectra Energy s business segments as discussed in Note 2, the components of Operating Revenues on the Consolidated Statements of Operations for the 2006 period have been reclassified to conform to the current reporting presentation. In addition, $112 million of balancing gas has been reclassified from Deferred Debits to Other Assets on the Consolidated Balance Sheet at December 31, 2006 to conform to the current reporting presentation.

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2. Business Segments

As a result of the reorganization and spin-off of Spectra Energy from Duke Energy on January 2, 2007, Spectra Energy now manages its business in four reportable segments: U.S. Transmission, Distribution, Western Canada Transmission & Processing and Field Services. The remainder of Spectra Energy s business operations is presented as Other, and consists of unallocated corporate costs, a wholly-owned captive insurance subsidiary, employee benefit plan assets and liabilities, and other miscellaneous activities.

Spectra Energy s chief operating decision maker regularly reviews financial information about each of these business units in deciding how to allocate resources and evaluate performance. All of the business units are considered reportable segments under Statement of Financial Accounting Standards (SFAS) No. 131, Disclosures about Segments of an Enterprise and Related Information. There is no aggregation within Spectra Energy s defined business segments. Comparative 2006 data has been revised to conform to Spectra Energy s new business segments.

U.S. Transmission segment provides transportation and storage of natural gas for customers in various regions of the Eastern and Southeastern United States and the Maritime Provinces in Canada. The natural gas transmission and storage operations in the U.S. are primarily subject to the Federal Energy Regulatory Commission s (FERC s) rules and regulations.

Distribution provides retail natural gas distribution service in Ontario, Canada, as well as natural gas transportation and storage services to other utilities and energy market participants in Ontario, Quebec and the United States. These services are provided by Union Gas Limited (Union Gas), and are primarily subject to the rules and regulations of the Ontario Energy Board (OEB).

Western Canada Transmission & Processing provides transportation of natural gas, natural gas gathering and processing services, and natural gas liquid (NGL) extraction, fractionation, transportation, storage and marketing to customers in Western Canada and the northern tier of the United States. This segment conducts business primarily through the BC Pipeline and Field Services operations, which are primarily subject to the rules and regulations of Canada s National Energy Board (NEB), the Empress System and the Midstream business, which owns a 46% interest in the operations of the Spectra Energy Income Fund (the Income Fund).

Field Services gathers, compresses, processes, transports, trades and markets, and stores natural gas; and fractionates, transports, gathers, treats, processes, trades and markets, and stores NGLs. It conducts operations primarily through DCP Midstream, which is owned 50% by ConocoPhillips and 50% by Spectra Energy. Field Services gathers raw natural gas through gathering systems located in seven major natural gas producing regions: Permian, Mid-Continent, East Texas-North Louisiana, South Texas, Central Texas, Rocky Mountain and Gulf Coast.

Spectra Energy s reportable segments offer different products and services and are managed separately as business units. Management evaluates segment performance based on earnings before interest and taxes (EBIT) from continuing operations, after deducting minority interest expense related to those profits.

On a segment basis, EBIT excludes discontinued operations, represents all profits from continuing operations (both operating and non-operating) before deducting interest and taxes, and is net of the minority interest expense related to those profits. Cash, cash equivalents and short-term investments are managed centrally by Spectra Energy, so the associated realized and unrealized gains and losses from foreign currency transactions and interest and dividend income on those balances are excluded from the segments EBIT.

Transactions between reportable segments are accounted for on the same basis as unaffiliated revenues and expenses in the accompanying Consolidated Financial Statements.

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Business Segment Data (a)

Three Months Ended March 31, 2007	Unaffiliated Revenues	Intersegment Revenues	Total Revenues	Segment EBIT / Consolidated Earnings from Continuing Operations before Income Taxes
		(in millions)		
U.S. Transmission	$ 376	$ 1	$ 377	$ 220
Distribution	713		713	144
Western Canada Transmission & Processing	311		311	74
Field Services				82
Total reportable segments	1,400	1	1,401	520
Other	1	6	7	(15)
Eliminations		(7)	(7)	
Interest expense				(155)
Interest income and other (b)				5
Total consolidated	$ 1,401	$	$ 1,401	$ 355
Three Months Ended March 31, 2006				
U.S. Transmission	$ 397	$	$ 397	$ 235
Distribution	769		769	118
Western Canada Transmission & Processing	312		312	82
Field Services				144
Total reportable segments	1,478		1,478	579
Other	7		7	(49)
Interest expense				(143)
Interest income and other (b)				5
Total consolidated	$ 1,485	$	$ 1,485	$ 392

(a) Segment results exclude results of any discontinued operations.
(b) Other includes foreign currency transaction gains and losses, and additional minority interest expense not allocated to the segment results.

Segment assets in the following table exclude all intercompany assets.

Segment Assets

	March 31,	December 31,

	2007	2006
	(in millions)	
U.S. Transmission	$ 7,701	$ 7,611
Distribution	4,388	4,420
Western Canada Transmission & Processing	4,026	3,960
Field Services	1,250	1,231
Total reportable segments	17,365	17,222
Other (a)	3,729	3,352
Reclassifications (b)	(382)	(229)
Total consolidated assets	$ 20,712	$ 20,345

(a) Primarily goodwill associated with the acquisition of Westcoast Energy, Inc. in 2002.

(b) Primarily the netting of cash pools at the consolidated level, where appropriate.

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3. Discontinued Operations

In anticipation of the spin-off, Spectra Capital implemented an internal reorganization in December 2006 in which the operations and assets of Spectra Capital that were not associated with the natural gas businesses were contributed by Spectra Capital to Duke Energy or its subsidiaries. Operations transferred include International Energy, Spectra Capital s effective 50% interest in Crescent and certain operations within Other, primarily Duke Energy Trading and Marketing, LLC, DukeNet Communications, LLC, Duke Energy Merchants, LLC and Spectra Capital s 50% interest in Duke/Fluor Daniel. In April 2006, Spectra Capital transferred its ownership interest in Duke Energy North America s (DENA s) Midwestern generation assets to a Duke Energy subsidiary. In addition, in 2005, Duke Energy s Board of Directors authorized and directed management to execute the sale or disposition of substantially all of former DENA s remaining assets and contracts outside the Midwestern United States and certain contractual positions related to the Midwestern assets. Spectra Energy does not anticipate significant continuing involvement in any of the businesses transferred to Duke Energy or sold to third parties. Therefore, the results of operations for the three months ended March 31, 2006 for these operations have been reflected as discontinued operations in the accompanying Consolidated Statements of Operations. No gain or loss was recognized on the transfer of operations to Duke Energy as the transfers were among entities under common control. Information presented for 2006 in the Consolidated Statements of Cash Flows does not include any reclassifications or adjustments to amounts historically reported for these transferred businesses.

The results of operations of these transferred businesses are summarized in the following table as Loss From Discontinued Operations, net of tax, in the Consolidated Statements of Operations.

	Operating Revenues	Pre-tax Earnings (Loss)	Income Tax Expense (Benefit)	Income (Loss) From Discontinued Operations, Net of Tax
		(in millions)		
Three Months Ended March 31, 2006				
Commercial Power	$ 15	$ (12)	$ 1	$ (13)
International Energy	231	56	24	32
Crescent	71	35	13	22
Other	480	(106)	(43)	(63)
Total consolidated	$ 797	$ (27)	$ (5)	$ (22)

The following significant transactions of Spectra Energy, the impacts of which are included in Loss From Discontinued Operations, net of tax on the Consolidated Statements of Income, occurred during the three months ended March 31, 2006.

Acquisitions. During the first quarter of 2006, International Energy closed on two transactions which resulted in the acquisition of an additional 27% interest in the Aguaytia Integrated Energy Project, located in Peru, for $31 million ($18 million net of cash acquired). Also during the first quarter of 2006, DENA acquired the remaining one-third interest in Bridgeport Energy LLC from United Bridgeport Energy LLC for $71 million.

Dispositions. Transactions to sell or terminate certain of DENA s contract portfolio, including transportation contracts, during the first quarter of 2006 resulted in pre-tax losses of approximately $160 million during the three months ended March 31, 2006. Also during the first quarter of 2006, DENA paid cash consideration of $600 million to Barclays, the purchaser of substantially all of the remaining commodity, energy marketing and management contracts of DENA, and Barclays returned to Spectra Capital the net cash collateral of $540 million that had been posted by DENA. These net payments are reflected within Operating Cash Flows in the Consolidated Statements of Cash Flows.

During the first quarter of 2006, Crescent s commercial and multi-family real estate sales resulted in $56 million of proceeds that are included in Cash Flows from Investing Activities within the Consolidated Statements of Cash Flows, and $26 million of net pre-tax gains in Loss From Discontinued Operations on the Consolidated Statements of Operations.

Impairments. In the first quarter of 2006, based on management s best estimate of recoverability, International Energy recorded a pre-tax allowance of $19 million ($12 million after tax) against a receivable due from the 2003 purchaser of International Energy s European operations.

As a result of a settlement, a pre-tax write-up of the receivable of $9 million ($5 million after tax) was recorded in the second quarter of 2006 as a reduction in the valuation allowance. In July 2006, International Energy received the settlement proceeds.

4. Dispositions

There were no significant sales of assets during the three months ended March 31, 2007. For the three months ended March 31, 2006, U.S. Transmission s sale of certain Stone Mountain natural gas gathering system assets resulted in proceeds of $18 million, reflected in Net Proceeds from the Sales of Equity Investments and Other Assets in the Consolidated Statements of Cash Flows, and a pre-tax gain of $5 million which was recorded in Gains on Sales of Other Assets and Other, net in the accompanying Consolidated Statements of Operations. Also in 2006, U.S. Transmission s sale of certain stock received as consideration for the settlement of a customer s transportation contracts resulted in proceeds of $24 million, reflected in Other Cash Flows from Operating Activities in the Consolidated Statements of Cash Flows, and a pre-tax gain of $24 million, of which $23 million was recorded in Gains on Sales of Other Assets and Other, net in the Consolidated Statements of Operations. See Note 8 for further discussion.

5. Income Taxes

Spectra Energy adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on January 1, 2007. As a result of the implementation of FIN 48, Spectra Energy recognized an increase of $26 million in the liability for uncertain tax benefits, which was accounted for as a cumulative effect decrease to the January 1, 2007 balance of retained earnings. As of the date of adoption and after the impact of recognizing the increase in the liability noted above, Spectra Energy s unrecognized tax benefits totaled $75 million. Of this, $59 million would reduce the annual effective income tax rate if recognized. During the three months ended March 31, 2007, Spectra Energy recorded an increase in unrecognized tax benefits of $4 million, of which $3 million resulted in a charge to earnings.

Prior to January 1, 2007, Spectra Energy was included in the consolidated federal income tax return and certain combined and unitary state tax returns of Duke Energy. In connection with the spin-off, Spectra Energy indemnified Duke Energy for Spectra Energy s share of taxes on such returns. Accordingly, obligations of $28 million for uncertain federal and state income tax positions for periods in which Spectra Energy was included in a Duke Energy consolidated, combined or unitary filing have been recorded as guarantee obligations under FIN 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, within Other Deferred Credits on the Consolidated Balance Sheet as of March 31, 2007. Spectra Energy has no liability to Duke Energy for federal income tax liabilities prior to 1999 and for state income tax liabilities prior to 1997 as those tax years have been closed.

Spectra Energy also files numerous returns in Canada and in a number of states where it is directly liable to the tax jurisdictions for tax assessments. Spectra Energy is no longer open to Canadian tax issues prior to 2001 or for state income tax matters prior to 1997 as those tax years have been closed. The Canadian tax authorities commenced audits of certain Canadian income tax returns in the first quarter of 2005 for tax years ranging from 2002 through 2004. To date, there are no proposed adjustments that will have a material impact on Spectra Energy s consolidated results of operations or financial position. Spectra Energy does not anticipate a change to the total amount of unrecognized tax benefits due to the settlement of audits or the expiration of statutes of limitations prior to March 31, 2008 that would be material to its consolidated financial position.

Spectra Energy recognizes potential accrued interest and penalties related to unrecognized tax benefits within its global operations as interest expense and as other expense, respectively. In conjunction with the adoption of FIN 48, Spectra Energy accrued $13 million for the payment of cumulative interest and penalties at January 1, 2007.

The effective tax rate for income from continuing operations for the three months ended March 31, 2007 was 34% as compared to 38% for the same period in 2006. The decrease primarily relates to taxable foreign dividends realized in the 2006 period as well as certain corporate and debt costs in the 2006 first quarter for which no tax benefit was received by Spectra Capital since there was not a tax-sharing arrangement in place with Duke Energy until April 2006.

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6. Comprehensive Income

Comprehensive income includes net income and all other non-owner changes in equity. Components of comprehensive income are presented below:

	Three Months Ended March 31, 2007	2006
	(in millions)	
Net income	$ 236	$ 222
Other comprehensive income		
Foreign currency translation adjustments	28	59
Reclassification into earnings from cash flow hedges (a)		14
Other (b)		16
Other comprehensive income, net of tax	28	89
Total comprehensive income	$ 264	$ 311

(a) Net of $9 million tax expense for the three months ended March 31, 2006.
(b) Net of $8 million tax expense for the three months ended March 31, 2006.

7. Earnings per Common Share

Basic earnings per common share (EPS) is computed by dividing earnings available for common stockholders by the weighted-average number of common shares outstanding during the period. Diluted EPS is computed by dividing earnings available for common stockholders by the diluted weighted-average number of common shares outstanding during the period. Diluted EPS reflects the potential dilution that could occur if securities or other agreements to issue common stock, such as stock options, stock-based performance unit awards and phantom stock awards, were exercised, settled or converted into common stock.

The following table presents Spectra Energy s basic and diluted EPS calculations and reconciles the weighted-average number of common shares outstanding to the diluted weighted-average number of common shares outstanding for the three months ended March 31, 2007.

Three Months Ended March 31, 2007	Income	Average Shares	EPS
	(in millions, except per-share amounts)		
Income from continuing operations basic	$ 236	631	$ 0.37
Effect of dilutive securities:			
Stock options and unvested stock		3	
Income from continuing operations diluted	$ 236	634	$ 0.37

Weighted-average shares outstanding, basic earnings per share and diluted earnings per share for the three months ended March 31, 2006 are not presented since Spectra Capital, the predecessor entity of Spectra Energy for financial reporting purposes, was a wholly owned subsidiary of Duke Energy during the 2006 period. As discussed in Note 1, approximately 631 million shares of Spectra Energy common stock were issued to Duke Energy shareholders on January 2, 2007 in connection with the spin-off.

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Certain options and unvested stock awards related to approximately six million shares as of March 31, 2007 were not included in the effect of dilutive securities in the above table because either the option exercise prices were greater than the average market price of the common shares during those periods, or performance measures related to the awards had not yet been met.

8. Marketable Securities

On January 2, 2007, Duke Energy distributed to Spectra Energy certain corporate assets and liabilities, including $96 million of marketable securities held in a grantor trust account associated with captive insurance losses of approximately the same amount transferred to Spectra Energy. These securities are classified as Other Assets and the associated insurance loss reserves are classified in Other Deferred Credits on the Consolidated Balance Sheet as of March 31, 2007.

During the three months ended March 31, 2006, Spectra Energy s U.S. Transmission business unit received shares of stock as consideration for settlement of a customer s transportation contracts. The market value of the equity securities, determined by quoted market prices on the date of receipt, of approximately $23 million is reflected in Gains on Sales of Other Assets and Other, net in the Consolidated Statements of Operations for the three months ended March 31, 2006. During the three months ended March 31, 2006, these securities were sold and an additional gain of $1 million was recognized in Other Income and Expenses, net in the Consolidated Statements of Operations.

9. Inventory

Natural gas inventories primarily relate to the distribution business in Canada and are valued at costs approved by the OEB. The difference between the approved price and the actual cost of gas purchased is recorded in either accounts receivable or other current liabilities for future disposition with customers, subject to approval by the OEB. The remaining inventory is recorded at the lower of cost or market value, primarily using the average cost method.

Components of Inventory

	March 31, 2007	December 31, 2006
	(in millions)	
Natural gas	$ 49	$ 290
Materials and supplies	95	90
Petroleum products	12	17
Total inventory	$ 156	$ 397

10. Investments in Unconsolidated Affiliates

Spectra Energy s most significant investment in unconsolidated affiliates is the 50% investment in DCP Midstream, which is accounted for under the equity method of accounting. The following represents summary financial information for DCP Midstream, presented at the 100% ownership level.

	Three Months Ended March 31,	
	2007	2006
	(in millions)	
Operating revenues	$ 2,890	$ 3,309
Operating expenses	2,686	2,994
Operating income	204	315
Net income	164	291

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11. Goodwill

As a result of the change in reportable segments discussed in Note 2 resulting from the spin-off from Duke Energy, Spectra Energy has allocated the outstanding goodwill amounts as of March 31, 2007 between the new reportable segments as follows:

	(in millions)
U.S. Transmission	$ 2,296
Distribution	296
Western Canada Transmission & Processing	935
Total goodwill	$ 3,527

Changes in goodwill since December 31, 2006 primarily related to foreign currency translation impacts on the goodwill arising from the 2002 acquisition of Westcoast Energy, Inc., and were not material in total.

12. Debt and Credit Facilities

Credit Facilities Summary	Expiration Date	Credit Facilities Capacity	Outstanding as of March 31, 2007 Commercial Paper	Letters of Credit (in millions)	Total
Spectra Energy Capital, LLC					
$600 multi-year syndicated (a,b)	June 2010	$ 600	$ 378	$ 16	$ 394
$350 364-day syndicated (b)	November 2007	350	350		350
Total		950	728	16	744
Westcoast Energy, Inc.					
$174 multi-year syndicated (c)	June 2011	174			
Union Gas Limited					
$347 364-day syndicated (d)	June 2007	347			
Total		$ 1,471	$ 728	$ 16	$ 744

(a) Credit facility contains an option allowing borrowing up to the full amount of the facility on the day of initial expiration for up to one year.
(b) Credit facility contains a covenant that requires the debt-to-total capitalization ratio to not exceed 65%.
(c) Credit facility is denominated in Canadian dollars totaling 200 million Canadian dollars and contains a covenant that requires the debt-to-total capitalization ratio to not exceed 75%.
(d) Credit facility is denominated in Canadian dollars totaling 400 million Canadian dollars and contains a covenant that requires the debt-to-total capitalization ratio to not exceed 75%. The facility also contains an option at maturity allowing for the conversion of all outstanding loans to a term loan repayable up to one year after maturity date, not to exceed 18 months from the date of draw.

It is currently anticipated that Spectra Capital will replace its two existing credit facilities with a new $1.5 billion credit facility. It is also Spectra Energy s intent to replace the Union Gas credit facility that expires in June 2007.

Spectra Energy s debt and credit agreements contain various financial and other covenants. Failure to meet those covenants beyond applicable grace periods could result in accelerated maturity and/or termination of the agreements. As of March 31, 2007, Spectra Energy believes it was in compliance with those covenants. In addition, some agreements may allow for acceleration of payments or termination of the agreements due to an event of default of other significant indebtedness of the borrower or some of its subsidiaries. None of the debt or credit agreements contain material adverse change clauses.

Certain debt agreements of Maritimes & Northeast Pipeline L.P. (78% owned by Spectra Energy), of which $226 million was outstanding at March 31, 2007, require that a deliverability report prepared by an Independent Reserve Engineer on the status of natural gas reserves be provided to the lender s collateral agent and note trustee prior to November 27, 2007. Should this report demonstrate a sufficient level of natural gas reserves, no action will be required. If the report indicates an insufficient level of reserves, the loan agreements require that certain amounts be escrowed until sufficient cash balances have accumulated to retire the full amount of the associated outstanding debt at maturity or until a later report is provided indicating that reserves are available in quantities sufficient to eliminate the need to maintain such amounts in escrow.

On April 9, 2007, Spectra Energy and Spectra Capital filed an automatic shelf registration statement with the SEC to register the issuance of an unspecified amount of various equity securities by Spectra Energy and various debt securities by Spectra Capital.

13. Regulatory Matters

Union Gas. In April 2007, Union Gas applied to the OEB for the annual disposition of its non-commodity deferral account balances including the proposed disposition of $11 million in earnings sharing reported for 2006. A hearing and decision on this application are expected later this year. Commodity-related deferral account balances are addressed quarterly through a separate OEB process.

On November 7, 2006, Union Gas received a decision from the OEB on the regulation of rates for gas storage services in Ontario. As a result of its finding that the market for storage services is competitive, the OEB will not regulate the rates for storage services to customers outside Union Gas franchise area or the rates for new storage services to customers within its franchise area. Existing storage services to customers within Union Gas franchise area will continue to be provided at regulated cost-based rates. Since the issuance of the decision, five parties who participated in the storage regulation proceeding have appealed various aspects of the decision to the OEB. The OEB heard submissions during a hearing held in March 2007 regarding whether those parties have met the threshold for an appeal review. The OEB s decision is expected in 2007.

In December 2006, the OEB issued a final rate order for new rates effective January 1, 2007. The average rate increase is approximately 3.1% and includes the impact of an increase in the common equity component of Union s capital structure from 35% to 36% and a decrease in the allowed return on equity from 9.63% to 8.54%.

BC Pipeline and Field Services. On April 26, 2007, the NEB approved BC Pipeline s final 2007 transmission tolls. In March 2007, the NEB approved the recovery of certain costs associated with the Southern Mainline expansion project.

14. Commitments and Contingencies

Environmental

Spectra Energy is subject to international, federal, state and local regulations regarding air and water quality, hazardous and solid waste disposal and other environmental matters. These regulations can be changed from time to time, imposing new obligations on Spectra Energy.

Remediation activities. Like others in the energy industry, Spectra Energy and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Spectra Energy operations, sites formerly owned or used by Spectra Energy entities, and sites owned by third parties. Remediation typically involves management of contaminated soils and may involve groundwater remediation. Managed in conjunction with relevant international, federal, state and local agencies, activities vary with site conditions and locations, remedial requirements, complexity and sharing of responsibility. If remediation activities involve statutory joint and several liability provisions, strict liability, or cost recovery or contribution actions, Spectra Energy or its affiliates could potentially be held responsible for contamination caused by other parties. In some instances, Spectra Energy may share liability associated with contamination with other potentially responsible parties, and may also benefit from insurance policies or contractual indemnities that cover some or all cleanup costs. All of these sites generally are managed in the normal course of business or affiliate operations. Management believes that completion or resolution of these matters will not have a material adverse effect on Spectra Energy s consolidated results of operations, financial position or cash flows.

Extended Environmental Activities, Accruals. Included in Other Current Liabilities and Other Deferred Credits and Other Liabilities on the Consolidated Balance Sheets were accruals related to extended environmental-related activities totaling $20 million as of March 31, 2007 and $21 million as of December 31, 2006. These accruals represent Spectra Energy s provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Management believes that completion or resolution of these matters will not have a material adverse effect on Spectra Energy s consolidated results of operations, financial position or cash flows.

Litigation

In connection with the transfer of certain businesses from Spectra Energy to Duke Energy in December 2006 as described in Note 3, certain litigation matters that had previously involved Spectra Energy were transferred to Duke Energy. Spectra Energy does not have any future exposure or obligations related to such matters, and accordingly, such matters are not discussed below.

Sonatrach/Sonatrading Arbitration. In an arbitration proceeding that commenced in January 2001 in London, England, Duke Energy LNG Sales Inc. (Duke LNG) claimed that Sonatrach, the Algerian state-owned energy company, together with its subsidiary, Sonatrading Amsterdam B.V. (Sonatrading), breached their shipping obligations under a liquefied natural gas (LNG) purchase agreement and related transportation agreements (the LNG Agreements) relating to Duke LNG s purchase of LNG from Algeria and its transportation by LNG tanker to Lake Charles, Louisiana. Duke LNG sought damages of approximately $27 million. Sonatrading and Sonatrach claimed that Duke LNG had repudiated the LNG Agreements by allegedly failing to diligently perform LNG marketing obligations. Sonatrading and Sonatrach sought damages of approximately $250 million. In 2003, the arbitration tribunal issued a Partial Award on liability issues and found that Sonatrach and Sonatrading breached their obligations to provide shipping. The tribunal also found that Duke LNG breached the LNG Purchase Agreement by failing to perform marketing obligations. A hearing on damages was concluded in March 2006, and the tribunal issued its award on damages on November 30, 2006. Duke LNG was awarded approximately $20 million, plus interest, for Sonatrach s breach of its shipping obligations. Sonatrach and Sonatrading were awarded an unspecified amount that management believes will, when calculated, be substantially less than the amount awarded to Duke LNG, and result ultimately in a net positive, but immaterial, award to Duke LNG. Duke LNG s rights and obligations pertaining to this matter were retained by Spectra Energy in connection with the spin-off in January 2007.

Duke Energy Retirement Cash Balance Plan. A class action lawsuit was filed in federal court in South Carolina against Duke Energy and the Duke Energy Retirement Cash Balance Plan. Six causes of action are alleged, including violations of the Employee Retirement Income Security Act of 1974 (ERISA) and the Age Discrimination in Employment Act. These allegations arise out of the conversion of the Duke Power Company Employees Retirement Plan into the Duke Power Company Retirement Cash Balance Plan. The plaintiffs seek to represent present and former participants in the Duke Energy Retirement Cash Balance Plan. This group is estimated to include approximately 36,000 persons. Duke Energy filed its answer in March 2006. A second class action lawsuit was filed in federal court in South Carolina, alleging similar claims and seeking to represent the same class of defendants. The second case has been voluntarily dismissed, without prejudice, and effectively has been consolidated with the first case. It is not possible to predict with certainty whether Spectra Energy will incur any liability or to estimate the damages, if any, that might be incurred in connection with this matter. Spectra Energy has agreed to share these liabilities with Duke Energy in connection with the spin-off in January 2007.

Other Litigation and Legal Proceedings. Spectra Energy and its subsidiaries are involved in other legal, tax and regulatory proceedings in various forums arising in the ordinary course of business, including matters regarding contract, royalty, measurement and payment claims, some of which involve substantial monetary amounts. Spectra Energy has insurance coverage for certain of these losses should they be incurred. Management believes that the final disposition of these proceedings will not have a material adverse effect on Spectra Energy s consolidated results of operations, financial position or cash flows.

Spectra Energy has exposure to certain legal matters that are described herein. Spectra Energy had recorded reserves of $100 million as of December 31, 2006 related to certain litigation matters that were resolved and paid in January 2007, and had no material reserves as of March 31, 2007. These reserves represent management s best estimate of probable loss as defined by SFAS No. 5, Accounting for Contingencies.

Legal costs related to the defense of loss contingencies are expensed as incurred.

Other Commitments and Contingencies

Algonquin Gas Transmission, LLC (Algonquin), a wholly owned subsidiary, is a 50% equity partner in the Islander East pipeline project, a proposed pipeline that would connect natural gas supplies to markets on Long Island, New York. This project has received FERC and other approvals, and is pending receipt of a Section 401 Water Quality Certificate from the State of Connecticut, which has been denied by the State and is the subject of an appeal before the 2nd Circuit Court of Appeals. Oral arguments on the appeal were heard in April 2007. Management believes that there are sufficient factual and legal bases supporting Spectra Energy s position that the State s denial of certificate was improper. However, if the State s position is ultimately upheld, Islander East and Algonquin will be unable to proceed with the project as it is currently configured. As of March 31, 2007, Islander East, owned 50% by Algonquin, had incurred cumulative development costs of approximately $63 million, and Algonquin had incurred cumulative development costs of approximately $20 million, all associated with the Islander East project. Management expects that certain of the development costs incurred to date, primarily purchased materials, could be utilized by other capital projects of Spectra Energy.

As part of its normal business, Spectra Energy is a party to various financial guarantees, performance guarantees and other contractual commitments to extend guarantees of credit and other assistance to various subsidiaries, investees and other third parties. To varying degrees, these guarantees involve elements of performance and credit risk, which are not included on the Consolidated Balance Sheets. The possibility of Spectra Energy having to honor its contingencies is largely dependent upon future operations of various subsidiaries, investees and other third parties, or the occurrence of certain future events. See Note 15 for further discussion.

15. Guarantees and Indemnifications

Spectra Energy and its subsidiaries have various financial and performance guarantees and indemnifications which are issued in the normal course of business. As discussed below, these contracts include performance guarantees, stand-by letters of credit, debt guarantees, surety bonds and indemnifications. Spectra Energy and its subsidiaries enter into these arrangements to facilitate a commercial transaction with a third party by enhancing the value of the transaction to the third party.

Spectra Capital has issued performance guarantees to customers and other third parties that guarantee the payment and performance of other parties, including certain non-wholly owned entities. In connection with the spin-off of Spectra Energy to Duke Energy shareholders, certain guarantees that were previously issued by Spectra Capital have been assigned to, or replaced by, Duke Energy in 2006. For any remaining guarantees of other Duke Energy obligations, Duke Energy has indemnified Spectra Energy against any losses incurred under these guarantee arrangements.

The maximum potential amount of future payments Spectra Capital could have been required to make under these performance guarantees of non-wholly owned entities and third-party entities as of March 31, 2007 was approximately $911 million, of which approximately $511 million has been indemnified by Duke Energy, as discussed above. Approximately $44 million of the total performance guarantees expire between 2007 and 2009, with the remaining performance guarantees expiring after 2009 or having no contractual expiration. See also Note 5 for further discussion regarding income tax matters between Spectra Energy and Duke Energy.

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Additionally, Spectra Capital has issued joint and several guarantees to some of the Duke/Fluor Daniel (D/FD) project owners, guaranteeing the performance of D/FD under its engineering, procurement and construction contracts and other contractual commitments. Substantially all of these guarantees have no contractual expiration and no stated maximum amount of future payments that Spectra Capital could be required to make. Fluor Enterprises Inc., as 50% owner in D/FD, has issued similar joint and several guarantees to the same D/FD project owners. In accordance with the D/FD partnership agreement, each of the partners is responsible for 50% of any payments to be made under those guarantees.

Westcoast Energy, Inc. (Westcoast), a wholly owned subsidiary, has issued performance guarantees to third parties guaranteeing the performance of unconsolidated entities, such as equity method investments, and of entities previously sold by Westcoast to third parties. These guarantees require Westcoast to make payment to the guaranteed third party upon the failure of such unconsolidated or sold entity to make payment under some of its contractual obligations, such as debt, purchase contracts and leases. Certain guarantees that were previously issued by Westcoast for obligations of entities that remained a part of Duke Energy are considered guarantees of third-party performance, however, Duke Energy has indemnified Spectra Energy against any losses incurred under these guarantee arrangements.

The maximum potential amount of future payments Westcoast could have been required to make under these performance guarantees of non-wholly owned entities and third-party entities as of March 31, 2007 was $98 million, of which $40 million has been indemnified by Duke Energy, as discussed above. Of this amount, $17 million relates to guarantees associated with the debt at Maritimes & Northeast Limited Partnership, a non-wholly owned consolidated entity. Approximately $10 million of the guarantees expire in 2007, with the remainder expiring after 2009 or having no contractual expiration.

Spectra Energy uses bank-issued stand-by letters of credit to secure the performance of non-wholly-owned entities to a third party or customer. Under these arrangements, Spectra Energy has payment obligations to the issuing bank which are triggered by a draw by the third party or customer due to the failure of the non-wholly owned entity to perform according to the terms of its underlying contract. The maximum potential amount of future payments Spectra Energy could have been required to make under these letters of credit was $13 million as of March 31, 2007.

Spectra Energy has entered into various indemnification agreements related to purchase and sale agreements and other types of contractual agreements with vendors and other third parties. These agreements typically cover environmental, tax, litigation and other matters, as well as breaches of representations, warranties and covenants. Typically, claims may be made by third parties for various periods of time, depending on the nature of the claim. Spectra Energy s potential exposure under these indemnification agreements can range from a specified amount, such as the purchase price, to an unlimited dollar amount, depending on the nature of the claim and the particular transaction. Spectra Energy is unable to estimate the total potential amount of future payments under these indemnification agreements due to several factors, such as the unlimited exposure under certain guarantees.

At March 31, 2007, the amounts recorded for the guarantees and indemnifications described above, including the indemnifications by Duke Energy to Spectra Energy, are not material, both individually and in the aggregate.

16. Stock-Based Compensation

Spectra Energy accounts for stock-based awards under the provisions of SFAS No. 123(R), Share-Based Payment, which establishes accounting for stock-based awards exchanged for employee and certain non-employee services. Accordingly, for employee awards, equity classified stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period.

Impact of Spin-off on Equity Compensation Awards of Employees

In connection with the spin-off, on December 19, 2006, Spectra Energy adopted, and Duke Energy as its sole stockholder prior to the spin-off approved, the Spectra Energy Corp 2007 Long-Term Incentive Plan (the 2007 LTIP). The 2007 LTIP provides for the granting of stock options, restricted stock awards and units, unrestricted stock awards and units, and other equity-based awards, to employees and other key individuals who perform services for Spectra Energy. Terms and key provisions of the 2007 LTIP are substantially similar to the terms of the Duke Energy 2006 Long-term Incentive Plan. A maximum of 30 million shares of common stock may be awarded under the 2007 LTIP.

Options granted under the 2007 LTIP are issued with exercise prices equal to the fair market value of Spectra Energy common stock on the grant date, have 10-year terms, and vest immediately or over terms not to exceed five years. Compensation expense related to stock options is recognized over the requisite service period. The requisite service period for stock options is the same as the vesting period, with the exception of retirement eligible employees, who have shorter requisite service periods ending when the employees become retirement eligible.

Restricted, performance and phantom stock awards granted under the 2007 LTIP typically become 100% vested on the three-year anniversary of the grant date. The fair value of the awards granted is measured based on the fair market value of the shares on the date of grant, and the related compensation expense is recognized over the requisite service period which is the same as the vesting period.

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At the time of the spin-off, Duke Energy converted stock options, restricted stock awards, performance awards and phantom stock awards (collectively, Stock-Based Awards) on Duke Energy common stock held by Duke Energy and Spectra Energy employees. One replacement Duke Energy Stock-Based Award and one-half Spectra Energy Stock-Based Award were distributed to each holder of Duke Energy Stock-Based Awards for each award held at the time of the spin-off. In the case of stock options, in accordance with the separation agreements, the option price conversion was based on the pre-distribution Duke Energy closing price of $19.14 relative to the Spectra Energy when-issued closing price of $28.62 on January 3, 2007. The revised awards therefore maintained both the pre-conversion aggregate intrinsic value of each award and the ratio of the exercise price per share to the fair market value per share. Substantially all converted Stock-Based Awards are subject to the terms and conditions applicable to the original Duke Energy stock options, restricted stock awards, performance awards and phantom stock awards. The Spectra Energy Stock-Based Awards resulting from the conversion are considered to have been issued under the 2007 LTIP.

The conversion of Duke Energy stock awards to Spectra Energy stock awards constituted a modification of those stock awards under the provisions of SFAS No. 123(R). However, under the provisions of FASB Staff Position (FSP) No. 123(R)-5, since the modification was made to stock awards issued to employees for instruments that were originally issued as compensation and then modified, and that modification is made to the terms of the instrument solely to reflect an equity restructuring that occurs when the holders are no longer employees, no change in the recognition or the measurement (due to a change in classification) of those instruments occurred as (a) there was no increase in fair value of the awards (the holders were made whole) and (b) all holders of the same class of equity instruments (for example, stock options) were treated in the same manner.

After the spin-off, Spectra Energy will receive all cash proceeds related to the exercise of Spectra Energy stock options held by Duke Energy employees; however, Duke Energy will recognize all associated expense and resulting tax benefits relating to such stock options. Similarly, Spectra Energy will recognize all associated expense and tax benefits relating to Duke Energy awards held by Spectra Energy employees. Spectra Energy recognizes compensation expense, receives all cash proceeds and retains all tax benefits relating to Spectra Energy awards held by Spectra Energy employees.

Stock-based compensation expense follows, the components of which are further described below:

	Three Months Ended March 31 2007	2006 (a)
	(in millions)	
Stock options	$ 1	$ 2
Phantom stock	1	4
Performance awards	1	4
Total	$ 3	$ 10

(a) Allocated from Duke Energy and includes amounts recognized in Loss from Discontinued Operations on the Consolidated Statements of Operations.

Stock Option Activity

	Options (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Life (in years)	Aggregate Intrinsic Value (in millions)
Outstanding at December 31, 2006 (a)	13,357	$ 25	4.3	$ 75
Granted	2,163	26	9.9	
Exercised	(160)	19		
Forfeited or Expired	(114)	33		

Outstanding at March 31, 2007	15,246	$	25	6.7	$	55
Exercisable at March 31, 2007	13,083	$	25	4.0	$	54

(a) Represents the Spectra Energy stock awards resulting from the spin-off conversion ratio, currently held by both Duke Energy and Spectra Energy employees, and reflects the related adjustments to the exercise price.

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In addition to the conversion of the Duke Energy stock options noted above, Spectra Energy granted 2,162,600 non-qualified stock options (fair value of approximately $16 million based on a Black-Scholes model valuation) during the three months ended March 31, 2007. Under the terms of the LTIP, the exercise price of a non-qualified stock option shall not be less than 100% of the fair market value of Spectra Energy common stock on the date of grant, and the maximum option term is 10 years. The options issued in 2007 vest ratably over three years. Spectra Energy issues new shares upon exercising or vesting of share-based awards.

As of March 31, 2007, Spectra Energy expects to recognize $15 million of future compensation cost related to stock options over a weighted-average period of three years.

Performance Awards

Stock-based performance awards outstanding as of the spin-off of Spectra Energy generally vest over three years. Vesting for certain converted stock-based performance awards can occur in three years, at the earliest, if performance is met. The unvested and outstanding performance awards granted contain market conditions based on the total shareholder return (TSR) of Duke Energy stock relative to a pre-defined peer group (relative TSR). Coincident with the spin-off, each outstanding Duke Energy Performance award was converted into a Spectra Energy Performance Share and a Duke Energy Performance Share. Measurement of the TSR will now be based upon the two equity components, weighted 50% each, consisting of Duke Energy common stock and Spectra Energy common stock, using the post-distribution Duke Energy stock price and the post-distribution Spectra Energy stock price, respectively, as the basis of measurement.

The following table summarizes information about stock-based performance awards outstanding at March 31, 2007:

	Shares	Weighted-Average Grant Date Fair Value
Outstanding at December 31, 2006 (a)	2,063,067	$ 23
Vested	(664,114)	21
Forfeited	(69,275)	21
Outstanding at March 31, 2007	1,329,678	23

(a) Represents the Spectra Energy stock awards resulting from the spin-off conversion ratio, currently held by both Duke Energy and Spectra Energy employees.

The total fair value of the shares vested during the three months ended March 31, 2007 was $14 million. As of March 31, 2007, Spectra Energy expects to recognize $7 million of future compensation cost related to performance awards over a weighted-average period of less than one year.

Phantom Stock Awards

Phantom stock awards outstanding as of the spin-off generally vest over periods from immediate to five years.

Stock-based phantom awards granted under the 2007 LTIP generally vest over three years. Spectra Energy awarded 352,500 phantom awards (fair value of approximately $9 million) to employees of Spectra Energy in the three months ended March 31, 2007.

The following table summarizes information about phantom stock awards outstanding at March 31, 2007: