The Economic Club of New York

369th Meeting
95th Year

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Chairman, President, and Chief Executive Officer
Duke Energy Corporation

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Questioners: John Lipsky, Chief Economist
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Introduction

Chairman Richard A. Grasso

Welcome, everyone, to 369th meeting of the Economic Club of New York in the 95th year of the club's existence. I'm delighted, as Chairman of the club by night – by day I'm Dick Grasso, host of The Gong Show – to welcome all of you to this very special evening. Tonight, we have two extraordinary speakers, each of which will make a 15-minute or so presentation to be followed in the tradition of the club by questions to be asked by two of our experts who have joined us. As your chairman, it is my privilege and honor to introduce our special guests this evening.

We will begin with Rick Priory, Chairman, President, and Chief Executive Officer of Duke Energy. I've had the privilege of knowing Rick since the creation of Duke Energy back in 1997. At that time, we celebrated the merger of Duke Power with PanEnergy creating one of the energy industry's first and most successful convergence alignments. As you might guess, Rick chose to celebrate by coming to the New York Stock Exchange, and having done that, he had no choice but to allow me once again to coattail as we did by ringing the opening bell to celebrate the creation of this great new company.

Duke Energy is the largest producer of natural gas liquids in the U.S., a top tier gas and power marketer, and a proven success story. There's no secret to why the company has done so well. Great companies share a common trait – deeply ingrained business values and a culture of

integrity that begins at the very top of the organization. Duke Energy's track record has not gone unnoticed. In 2001, the company was named the Most Admired Energy Company by *Fortune* magazine. And Rick, of course, has been the guiding hand behind Duke Energy's success.

He was President and Chief Operating Officer of Duke Power prior to its merger with PanEnergy. And he is a veteran of the company now for some 26 years, having joined in 1976 as a design engineer. Rick is a magna cum laude graduate of the West Virginia Institute of Technology and received a Master of Science degree in engineering from Princeton University. Rick serves on North Carolina Governor Mike Easley's Business Council and is also a member of the National Petroleum Council and the Business Roundtable.

Before hitting home runs in the business world, Rick had the chance to pursue his childhood love of baseball earning a tryout with the New York Mets. He lost out unfortunately to Ron Swoboda. However, Rick, based on the Mets' performance this year, I understand that the ownership of the club would once again like you to come to spring training. Ladies and gentlemen, I'm honored to introduce you to my friend, Duke Energy's Chairman and President, Rick Priory. (Applause)

Richard B. Priory

Chairman, President, Chief Executive Officer

Duke Energy Corporation

Well, thanks Dick, and good evening. Heavens knows, I talked to Ron Swoboda about a year and a half ago, and he was doing well. He was in Louisiana, invited me down to play golf, believe it or not. He doesn't play much baseball anymore.

Well, good evening again. When I told my wife I'd be speaking at the Economic Club this evening, she was very quick to acknowledge the appropriateness of all of that. She really does consider me sort of a walking economic indicator. My hairline's obviously had a recession. If you look carefully, you'll see my waistline has been inflating. And really every time I look at my company stock, you guessed it, I experience a deep depression. But despite all that, I'm really delighted to be here and really to share the program with my good friend, Jeff Immelt. In today's business environment, you know, it's often best for CEOs of public companies, of course, to travel in pairs. (Laughter)

Well, the ties that connect our two companies precede both Jeff and myself. Thomas Edison's first successful test of the light bulb occurred in 1879 in his New Jersey laboratory. And from that spark of ingenuity, of course, grew the company that we all fondly know now as the General Electric Company. And it was just a few years after that, that a couple of entrepreneurs began the work of turning Mr. Edison's idea into power for the textile communities in North and South Carolina. That pair, by the name of Dr. Gill Wiley and Buck Duke, were able to truly see the promise in Edison's light bulb and how it could really change the future. And, of course, the vision of those two individuals eventually grew into what we now call Duke Energy.

Electricity really did capture the imagination of many others across the country. New industries were born. The existing businesses realized new levels of productivity. Schools, hospitals, and homes benefitted as well. And, as you know, life was made easier and fuller. And I think most would agree, life was made better.

A century later, Jeff and I stand at the helm of those two companies that grew from the ingenuity of those early business pioneers. And while the corporate helm isn't quite as comfortable a place today as it might have been then, it does remain in my opinion truly honorable and privileged service. The business has been judged in some very harsh ways in recent days. You know something's amiss when you see more CEOs appearing on America's Most Wanted than on Wall Street Week.

And, you know, we brought much of that upon ourselves when you stop to think of it. But what saddens me most, and what really does anger and alarm me about the almost daily news of wrongdoing that we're picking up in the press these days is the resulting breach of trust that's growing in the institution of business and in the marketplace that business supports and stimulates. That truly is the real risk here. And I want to be very clear on that tonight. As business is being harshly judged, so too is the very foundation of capitalism that this country operates on. And therein lies my gravest concern that in our quest to root out the problems that confront us today we truly do risk crippling a very key construct of progress and prosperity in this country.

Now, it's not enough obviously for Jeff and me or any other CEO to stand up here and make corporate pledges to clean living. You've probably heard those before. We've got to make an affirmative case for the system, the actual market system that we operate, that delivers, not just shiny, new products, and profits, but opportunity and advancements for millions and millions of people. American capitalism has done tremendous good for our nation and for our world. The gains of science and technology are advanced by a system that rewards innovation. And our system ensures that good ideas go far, that wealth, health, and education are dispersed widely. We know also that the capitalistic model is often envied and certainly emulated across the globe. Our greatest export isn't energy or pharmaceuticals, reality TV, or Taco Bells. It really is the notion and the ideal that a community of minds competitively challenged and fairly rewarded can truly make our lives easier, fuller, and better.

Wiser men than I will end up assessing the morality and the market faults that brought us here to this turbulent time. I'm not a theologian, an economist, a pundit, or a politician. I am but a measly engineer. Engineers design, we build, and we fix, and then, of course, to the consternation of our wives and husbands, we then redesign, we rebuild, we take things apart so that we can fix them once again. And really it's from that perspective that I speak this evening with the idea that capitalism in many ways must be rebuilt and restored to its civic roots. So where do we start?

Well, we start – from an engineering perspective; we always begin with the groundwork. We

begin with the foundation. And in my mind, there's sort of two foundational pillars upon which commerce, capitalism, and the working society are actually built. And those two pillars are trust and market stability. They stand together and they're connected and they're very much inter-dependent. Trust is a fundamental principle of capitalism. Certainly investors trust business to be faithful stewards of their dollars. They entrust us to deliver a fair return, to operate prudently, and of course, to behave ethically.

You know, in his second inaugural address following the excesses of the 1920s and then the depression of the 1930s, a very famous New Yorker by the name of Franklin Roosevelt once said, "We've always known that heedless self-interest was bad morals. We now know that it's also bad economics." Well, I think that observation truly rings true today and just as true as it did 65 years ago. The self-interest of certain companies and individuals clearly has dealt a harsh blow to the reputation of business and to the marketplace in which more Americans than ever are active, investing participants.

Investors, analysts, and business alike must all take a longer view of value and face the reality that stratospheric, short-term results are simply not sustainable, and for that matter, for this marketplace, they're often not very healthy. We should have learned that lesson from history over and over, but the dot.com bust I guess has confirmed the weakness of our collective memories once again. And if we ignore it, after this, shame on us.

If we are to re-earn investor confidence and then restore rationality and legitimacy to the marketplace, we really do need to renew our dedication and our commitment to accountability, discipline, candor, and leadership. Those principles support and sustain trust – the very framework of this marketplace and precisely what it depends upon.

Well, first, let me mention accountability. Business must set about the work – and many of them have – of cleaning up their own corporate backyards. That work requires, of course, brutal, self-critical honesty. And if there are stink weeds in the garden, we can't pretend they smell like gardenias. We've got to prune out the excesses, the deception, and any practice that threatens the moral roots of the organization. The Sarbanes-Oxley Act, a set of new rules also set forth by the New York Stock Exchange, Dick, NASDAQ, and the Securities Exchange Commission, provide, I think, a very good framework for the steps that business must take. And I certainly commend the intent behind those initiatives.

But trust in business can't be rebuilt from Washington. I think we all know that. Trust in business can only be rebuilt by business in the executive offices, on our trading floors, on our plants, and on our factory floors. None of us, of course, want to take the heat for problems outside our own organization. But in today's environment, public opinion – as we all know – is painted with a broad, sweeping brush, and using a palette that consists of tar and feathers these days.

When one company stands charged, we are all considered guilty until proven otherwise. You know the nuclear industry learned this story, or learned this lesson, about 20 years ago in response to the accident at Three Mile Island. It was dramatically clear to us then as it is today that our industry is only as strong as its weakest link. You know it didn't matter at all to the world that Duke Power's plants had operated without incident. No one really cared. Every nuclear operator suffered the same crisis, and every one of us was responsible for moving the industry really beyond that accident.

From that accountability came disciplined action, and let me just stress the self-discipline that we saw play out. The nuclear industry couldn't and wouldn't wait for the government to set the standards. The industry needed to step forward to promote the very highest level of safety, reliability, and excellence. And we did, creating the Institute for Nuclear Power Operations, or referred to today as INPO, which every nuclear utility in the industry voluntarily joined, and still, I might add, are voluntary members of INPO.

INPO established benchmarks of excellence in operations and members of the institute audited one another's plants against very rigorous standards. Our audits were thorough, they were candid, they were tough, and they were constructive. They idea was to create value and to improve the system. Today, our plants across the nation are safer. Our personnel are better trained. And the exchange of experience amongst the industry is much, much more productive than it had been prior to those actions.

Now here's another very recent example of business leaders coalescing really to speed solutions to the marketplace. In May, Duke Energy became a founding member of the Committee of Chief Risk Officers, which is an active coalition of nearly 30 companies engaged in the physical and financial trading of energy. The creation of the committee reflects the very rapid growth of the energy merchant business and also the need for a commonly understood and accepted risk-management process for that business. The committee is hard at work in four key areas – best practices, governance and control, external communications, and valuation standards.

And those of you in the financial profession, and I know there's a lot of you here tonight, may recognize the model for this organization. In 1978, there was a group, I think headquartered here in New York, that was called The Group of Thirty, that was formed to develop standards and address issues related to financial derivatives at that time. And at that time, the derivatives industry was probably at about the same stage of development that energy trading really is today – relatively immature, evolving, and not at all widely understood by the public.

Today, the Committee of Chief Risk Officers' focus on best practices will go a long way in helping others understand and to be able to evaluate those merchant energy activities and also the companies that are engaged in those activities. Now will the committee exert the level of leadership, discipline, and peer pressure that we saw with INPO? I don't know. Time will only tell. But I can tell you that there's a team of very concerned, very highly competent business

people that are truly committed to that task. So I really do hold great hope that they're going to make a difference.

We are all frustrated by the apparent lack of corporate and personal accountability that we witnessed in the press lately. We've been hearing about it. I think we all need to withhold judgment until due process runs its course. But we shouldn't at all hold off on renewing the responsibilities that accompany and define leadership in our industries.

Now here's a story sort of outside the bounds of energy and business, but it does drive home the need for very active and very vigilant leadership. When the Titanic sank in 1912, there was a lesser known cruise ship by the name of The Californian and it was sort of floating about 20 miles away at the time. The ship's proximity meant that it could easily have saved the 1,500 lives that were lost and really change the course of history. Unfortunately, The Californian did not respond to the Titanic's distress signals because the radio dispatcher was simply not on duty at that time. Of course, you know the moral of the story. We can't afford to be asleep at the switch. We must be responsive. We must be vigilant. We must be alert to the state of our own ship, the course of others, as well as the sea changes that are occurring all around us.

Being at the helm means being accountable for your actions and also for your company's actions. As leaders, we're responsible for setting ethical standards and fostering a corporate culture in which integrity is valued and expected in every, every single instance. You know my business

card says I'm Duke's CEO, and that means of course that I'm Duke's Chief Executive Officer, but it also means that I'm its Chief Ethics Officer as well. Accountability, discipline, candor, leadership, in my opinion, those really are the basic building blocks of trust.

Now, as I said at the onset, corporate values are a foundational pillar of capitalism, but there's a second pillar that I mentioned as well that's been equally shaken this year, and it really does deserve our attention – and that's market stability. To be able to preserve the many benefits of capitalism, we need to ensure that our markets are structured to work fairly and on behalf of all participants. And we need to give them the latitude to go ahead and work. Some see the ethical implosion of a handful of business people as good reason to radically regulate, to tighten the reins, and to impose hastily constructed controls. Now, I'm not going to stand up here and argue even for a moment that change isn't needed. But I will caution about counterproductive measures and the unintended consequences that they so often create.

Competitive markets too often take the heat for problems that are well outside their scope. In my industry, to look just at recent history alone, first it was the California power crisis, even though the real culprit there was not a competitive marketplace at all, but rather an extreme supply and demand imbalance. And a so-called reform regime layered on top of that, that in fact kept the market from working. You know, no matter, California was erroneously construed as proof that we need to abandon deregulation of the markets and to return to a more tightly regulated energy industry. Temporary price caps were put into place which interfered with proper market signals.

Price caps in energy or any other commodity business are not wise or a desirable long-term solution. I think most everybody in this room knows that. They actually reverse much of the progress towards building an efficient, free market. When price signals were allowed to work in California, you know the market did respond. Higher prices for electricity clearly dampened demand in very measurable ways and encouraged development of new power plants. Folks adjusted the thermostat; market response was significant enough to move the needle on the demand meter down by more than 10%. What a dramatic change occurred in California when all was said and done. The state still needs a longer term solution that will really correct that supply and demand imbalance and restore market stability. But I submit that the market, despite political tampering, prevailed in California. It sent the right signals and those signals were eventually heeded.

Price gaps are but one example of the ill-effects of market intervention. Let me mention just one other issue that deeply concerns me and threatens the foundation of our market today. There's an effort afoot, again this turns out in California, to overturn long-term energy contracts. Energy companies negotiated with buyers to provide power at fixed costs. We should all be gravely concerned about the principle at play here. It really is an issue that's much bigger than this industry, and for that matter any single state. In fact, it gets to the very heart of our market system. The sanctity of contracts must, must be protected. When contracts are entered into in good faith, when they're broken and even threatened, the fracture to our economic system goes

deep and it can spread very far. And then the refrain, of course, gets familiar here, breach of trust and market failure.

So let's move from the California crisis to the fall of Enron. At its peak, Enron handled some one in four wholesale transactions for electricity and natural gas. So when the crash came, grave concerns were expressed as to whether the overall economy, let alone just the energy industry, would weather such a hit to a key market player. Lots and lots of dialogue on that subject prior to the collapse. But the market turned out, in the end, to be much wiser than those who would have rushed in to try to save this market. When the Enron online trading exchange shut down, other trading companies quickly stepped in ensuring uninterrupted trading and power supply. Trades continued, customers were served, infrastructure and systems remained intact. The marketplace corrected itself for the loss of its largest player. And this is not to say that there aren't more corrections that are needed in that market before all is said and done. There certainly are and they are happening.

But the lesson is that free markets, the cornerstone of capitalism, are powerfully self-correcting and sometimes unfortunately brutally so. But they exert a Darwinian force that ensures strength and resilience. Heavy-handed government intervention doesn't restore order. It often will distort and impair market activity. The micro-management that some now demand is really just the opposite, I think, of what we actually need. Whenever we completely try to shield market players from the consequences of risk, we end up really destroying the fundamental governors of the

market itself – and those governors being caution, transparency, the law of supply and demand, and the balance of risk and reward.

So let me be real clear here. I am not at all opposed to a thoughtful and constructive regulatory framework. In fact, I believe it's absolutely essential to make markets work. But I believe that the healthy approach in today's review of business is really scrutiny of logic – not skepticism – reform based on reason, and not reflex, and business change guided by value and not an overwrought marketplace.

Just two weeks ago, we saw a very positive change in the accounting rules that in my opinion is an important signpost really in the effort to restore investor trust in the energy business, the energy trading business. The Emerging Issues Task Force of the Financial Accounting Standards Board – believe me, I won't go deep into this, don't worry – rescinded a rule that they had put into place, I guess in 1998, called 98-10. That particular rule, when they put it in place, made mark-to-market accounting the default treatment for all energy contracts. So everything went into basically mark-to-market accounting unless you could show through a whole bunch of criteria that it could be placed over into accrual accounting. It seemed odd to me.

The rule, I think, was neither practical nor was it wise and its application has frankly confounded me for years. It was a rule that seemed to encourage the quest towards instant profits. It may have appealed to the accounting theorists and the fear value theorists, if you will, but its practical

application clearly fell short of inspiring confidence in this emerging industry. Now, with the rescinding of 98-10, mark-to-market accounting will be far more narrowly applied and it will enable us now to return to a solid, traditional, more acceptable approach in which profits are simply recorded as contracts are settled, and not before. Now I'm not often excited in any kind of a positive way about accounting rule changes, but I've got to tell you, this is really a good one and I'm delighted to see it happen.

Prudent regulatory oversight is a critical component of the market system and we can all point to some good examples of positive participation, kind of like that one. But business cannot, and it should not, of course, abdicate responsibility for ethical conduct. And government should not attempt to legislate morality. It won't work. We all share in the accountability for what's gone wrong and in the stewardship going forward. And as business leaders, we can't afford to focus energies, our energies really, solely on the defense of a single company or a troubled sector. There are legions of lawyers everywhere applying their work to those particular areas. But it really is the workers and the investors and the pensioners of our country who really need our best defense. And they need our best defense – our best defense is an able and united defense of the capitalistic system that creates jobs, creates prosperity, innovation, and equity.

Capitalism, free and open markets, the spirit of initiative – however you want to characterize the economic force and the creative surge of our great country – business at its best has done tremendous good for our world. And it has the capacity to do far greater if we're diligent in

protecting its principles and its promises. So with that, thank you very much. I've enjoyed having the opportunity to speak with you. (Applause)

Chairman Richard A. Grasso: Rick, thank you very much for those insightful and very powerful messages. Ladies and gentlemen, it is now my honor and privilege to present the second of tonight's extraordinary business leaders, General Electric's Chairman and Chief Executive, Jeff Immelt. Since its listing on the New York Stock Exchange 110 years ago, GE has become one of the most well-respected and most valued companies in the world. For the better part of a decade, GE has led the ranks of the most valued on the New York Stock Exchange with its current market capitalization approaching some $300 billion. The company has always been a company by which all measure their own success.

When Charles Dow created his very famous index in 1896, GE was one of the 12 companies he chose to represent overall economic and marketplace performance. Today, General Electric is the only original component of that great index. From aircraft engines to consumer products to asset and real estate management, GE is a proven leader across all sectors in which it operates. And as a leader in good corporate governance, GE has been at the forefront of pro-investor initiatives.

Jeff and his colleagues at General Electric were among the first to support the initiatives of the markets, the New York Stock Exchange, Special Committee on Corporate Accountability, the Securities and Exchange Commission's new initiatives of disclosure and obligations of officers

and directors and stood strongly behind the adoption of the Sarbanes-Oxley Act. GE, in addition, was one of the very first in the corporate community to embrace expensing of stock options. And just recently, Jeff and his colleagues have added two new independent directors to their board. It truly exemplifies the leadership that GE brings to its products and services and to setting the tone to restore public trust and confidence in the greatest economic system the world has ever known.

Jeff assumed the role of Chairman and CEO in September of 2001. Previously he was President and Chairman-elect from November of 2000. He began his career at General Electric two decades ago, held a series of very critical leadership positions throughout the company, and most importantly in its plastics division. Jeff has an undergraduate degree from Dartmouth and an MBA from Harvard, serves as a board member of Catalyst, a non-profit organization devoted to advancing women in business. GE, of course, is a great American institution and clearly Jeff Immelt reflects the greatness of that company in all that he does. Jeff, I commend you for your leadership in bringing GE to the forefront of implementing necessary steps to bring the public's mind back around to understanding how special a system we have in this great country of ours. Ladies and gentlemen, I'm privileged to introduce the 9th Chairman in the 124-year history of the General Electric Company, my good friend, Jeff Immelt. (Applause)

Jeffrey R. Immelt

Chairman and Chief Executive Officer

General Electric Company

Thank you Dick. I'd like to just end the suspense tonight. I have an announcement to make. I'm not running for governor of New York, but I will be back to you in 30 minutes if I change my mind. I appreciate the chance to be here this evening. And thank you to Dick for his kind introduction. Dick and the New York Stock Exchange are to be commended for their leadership in restoring trust this year. And I'm glad to be here tonight with Rick Priory. Rick is a valued partner and friend. Our companies have grown in the power generation business.

This has been a wild ride over the last five years. The industry has gone from a power shortage in a regulated market to a power surplus in a deregulated market in nearly the blink of an eye. Neither of us could have predicted this wild ride. But we trust each other and this is important when industries go through good times and bad. We know our companies will be around for a long time and trust helps us both win, and trust is what we're talking about tonight.

Now I am a CEO and I truly love my company. I don't believe the letters stand for Cheat, Evade, and Overcompensate. There's been an amazing transformation in the respect for the title. During the 90s, the positive media coverage for CEOs grew by 25% and institutional investors would say that 35% of their valuations were solely based on the CEO. Four years ago, a *Time* magazine poll said that seven of the ten most powerful Americans were CEOs. Now seven of ten people think that a CEO is less honest than a normal person. We're right down at the bottom of the heap with telemarketers. (Laughter)

Corporate leadership has lost the benefit of the doubt. The vision of an executive being led away in handcuffs has been all too common, and the public doesn't differentiate between the good and the bad. At first your temptation is to laugh off the comments, not to take it personally. But then you think a little bit more, and you say, I have to take it personally. Just like Dick Grasso and Rick Priory, any leader has to take it personally. Trust is easily broken. It can be destroyed by a few. But trust can only be restored collectively by all of us in the entire system.

Now right now business leaders have two reasons to lie awake at night – performing in a tough economy and restoring public trust. The economic environment is challenging but not hopeless. And even today there are opportunities to position for long-term growth. GE has strong businesses and industries that are essential to society and the company is well positioned. And we look at this as a fabulous time to invest in the future and that's what we're doing. Now I'm not an economist and, like you, I get most of my knowledge from CNBC, or at least I hope you do, but we do see a lot because of the breadth of our company and the places we do business. And we're really preparing our company for a period of slow economic growth.

On the positive side, the consumer continues to spend – boosted by low interest rates, low mortgage rates, and low inflation. The recent consumer confidence numbers are a concern, but low retail prices and high debt capacity should maintain momentum. Government spending is fueling growth in certain industries like defense and we're seeing some early signs of industrial

reinvestment. On the downside, there's excess capacity in almost every industry putting pressure on price and dampening major capital expenditures. Certain industries are feeling residual strains from 9/11 like commercial aviation and insurance, and there remains uncertainty in capital markets about the threat and impact of war.

The rest of the world tracks what we see in the U.S. Europe has slowed noticeably this year and Germany is very tough. And Japan continues on a long-term horizontal slide. China remains the one bright spot, an economy capable of rapid growth based on both domestic consumption and exports. But I don't see a double dip – rather the economy just lacks a spark – the one or two things that will stimulate aggressive reinvestment. And time may turn out to be the only catalyst to create sustainable growth.

But we think it's a time for pragmatic and smart management. You must plan for what you see and not what you hope. You have to limit risk. But most importantly, you've got to reallocate resources and make smart bets on growth. But growth is out there. And we're making investments in healthcare and in China, security, infrastructure, new products and services, and redeploying resources from low value backroom operations into engineering and sales.

In challenging times, investors want management's attention on driving growth. That's what makes these trust issues so important. Until we do trust right, failure on these issues threatens, pressures intellectual energy, resources, and reputational capital. On trust, we can't look at

ourselves as victims. Investors have lost trillions to bad ideas, bad accounting, and bad values. Investors, the press, and analysts are cynical, and they have every right to be. I saw some figures in *Fortune* magazine that really amazed me. In 25 companies that lost 90% of their market cap, 460 insiders pocketed $23 billion for personal gain. Now that's not GE and that's not Duke Energy or IBM or any good company.

We think an important part of the answer is to move decisively on governance issues. So we want to implement the requirements of the Sarbanes-Oxley legislation and the New York Stock Exchange listing requirements quickly and add our own vision for good corporate governance. I want investors – big and small – to know that they can trust us to govern our company effectively. And then they can judge GE by the quality of our business, our strategy, and our execution.

So we're establishing five key themes that will guide GE into the future. And in many ways, these are merely restatements of the values and integrity that bond 300,000 of us together today. And these themes perform with integrity, build a strong and independent board, visibly align executive compensation with investors, increase investor communication, and focus on culture. And I'd like to talk about each one of those just briefly.

First, perform with integrity. Ultimately, trust can only be restored by hitting investor commitments and defining clearly, simply, and realistically how you plan to grow. In most of the

companies that failed, bad accounting hid bad business models. Trust is based on well-defined and understood business models that stand the test of time. At GE, we have a very well-defined business model. We have leadership positions in essential industries with strong customer partnerships. We have common growth initiatives that span the company and create the future. We're one of seven Triple A-rated companies. And we have operating disciplines that focus on meeting commitments and generating cash.

But performance with integrity requires more. Investors need to know that the numbers they see are the product of rigorous oversight. And our Audit Committee leads a process that starts at the top. I review each business six times per year. Each one of our business leaders wraps their financials quarterly using a standard identical to the SEC requirements. We have a 450-person internal audit staff that is constantly reviewing and improving our financial rigor. And one-third of our business leaders have come from that audit staff. We have very strong accounting oversight and principles led by our CFO, Keith Sherin. And we've all grown up in a culture where compliance and integrity come first. That is the kind of unrelenting scrutiny we bring to the numbers and why I have no hesitation to certify our results. If I ever misled investors, I was pretty darn certain I'd get fired, and I thought I'd go to jail. So Sarbanes-Oxley is nothing new.

Number two, build strong and independent boards. I want directors to probe with hard questions which stretch management. And I want board meetings that deal in depth with the core issues confronting GE. By the same token, I expect directors to have even greater involvement and

participation in GE, and understanding our company, and advising the management team. Directors must be our most constructive critics and our wisest counselors. So in the future, all non-employed directors appointed to the board will be independent. Our goal is to have two-thirds of the board independent in total. And we've added three new directors in the last three months – Ralph Larsen from Johnson & Johnson, A.G. Lafley from Proctor & Gamble, and Bob Swieringa from Cornell. In essence, we added two CEOs from great companies with very strong values and cultures, and a world-famous accounting expert. And like our current directors, these are people we can learn from who will stand tall in a battle and have the highest personal integrity.

Now, at the same time, we'll have tougher independent standards for audit and other key committees. Members of our Audit, Compensation, and Governance Committees must be both independent and receive no fees from the company other than director compensation. We'll insist that directors be more involved with the company. We want each director to visit two businesses each year without me or any other corporate management looking over their shoulder. And a member of our Comp Committee will teach mid-level managers ____ once per month. This allows directors to feel our culture and it's retentive to our people to have direct interface with directors.

In addition, our directors will be limited on their memberships to other corporate boards so that more of their focus can be on GE. We'll have a presiding director. This individual will lead three

or more meetings each year for the board without management present. And I'll work with the board to identify priority issues so that it can set its own agenda. And in December we'll commit to a list of strategic risk and integrity issues to be scheduled and discussed during the next year. These are a few of the governance changes GE will implement. We've always had a great board. But in the future, we will work together even more closely as a team. Not because we have to, but because we want to. The best boards develop a sense for culture and character. They smell problems. Rules can help, but openness and trust are the most important ingredients.

Number three; visibly align executive compensation with investors. We believe that a meritocracy, bound together with performance, management, and systems of integrity, is the best way to protect long-term shareholder interest. However, we've decided to increase the visible ties between our leaders and investors. So going forward we'll implement a stock ownership requirement for the top 23 GE executives. This will be measured as a multiple of the executive salary – as CEO, my multiple will be the highest – and will hold this stock for as long as we work for GE. On top of this, we'll have a stock option holding period. We want to eliminate any appearance that our top leaders would cause a short-term increase in the stock price for personal gain. Therefore, we're instituting a one-year holding period for them on stock option gains in the form of GE stock.

We'll expense stock options, and we've begun using the best available method. This method is clearly not perfect. I didn't understand the Black-Scholes method in college and I don't

understand it today. However, expensing stock options improves the spirit of transparency in our financial systems and so we'll do it. We will still distribute stock options because they align management with investors and retain our best talent. We have more than 40,000 option holders in our company, and in a tough and volatile economy, this team has delivered and been loyal to the company, so options work.

Fourth, we'll increase investor communications. We'll talk about the company externally the way we run it internally. What does this mean? It means giving investors easy to understand financials that tell the story accurately and completely. We have significantly increased the quantity and quality of our financial disclosures and investor interface. We have quarterly conference calls, 25% more investor meetings, a total of more than 200 each year. And some documents, like our 10Q, have doubled in length. This makes these businesses easier to grow internally and simplifies description externally. And by year-end, we'll present each financial service business with its own growth strategy, leverage, and balance sheet.

But I'll be honest, in the short-term more disclosure has not necessarily helped GE. Our strategy is always about the totality of the company, not the pieces. We know how to manage cycles and manage risk, and manage volatility. In addition, disclosure has a connotation of guilt. Frequently it's no news, or it's even good news, but I'm convinced that there will be a long-term gain because I want people to know this company.

And fifth, focus on culture. My last message may not be that reassuring. Despite the good work done by Dick and others in Washington, there are no set of laws or rules that can stop a bad culture. All the public failures have one thing in common – phony heroes who are allowed to operate outside the system. This is what keeps me awake at night at GE, is what happens when the wrong ten employees find each other. And we spend billions of dollars on culture and training and values to keep this from happening. The one thing I know, I absolutely know, is that the wrong ten people aren't in the boardroom or in the leadership team.

We believe in performance and a culture where the best people get the best rewards. But everyone must operate in a system where the company comes first. We all serve under the same integrity policy and compliance program. Our comp plans are broad-based. Our businesses work together and we have one human resource system. When the company wins, we all win.

The CEO must create the culture. And at GE, I encourage our leaders to challenge ideas and strategies. The one thing they take for granted are our intentions – to make GE a better company every day. That's our formula for trust – perform with integrity, build strong and independent boards, visibly align executive compensation with investors, increase investor communication, focus on culture. And later this week, we'll be announcing changes to the way we govern the company, some of which I've mentioned tonight. It's the result of three months of detailed reviews by our board on governance trends and best practices. And it reflects our best effort to restore trust.

So will we get more regulation than we need? Probably. The pendulum will swing too far to reform where investors may not benefit. High integrity leaders will no longer be able to serve on boards due to the appearance of conflict, but appearance counts today, so we move on. Does the fact that we get more reform than we need hurt the system? Absolutely not. We should set the bar high. We feel that the higher standards always help the best companies. And whether it's Sarbanes-Oxley or the New York Stock Exchange rules, we believe the complying early, complying with the spirit, and moving beyond the rules to share best practices benefits all of us. And will the steps we're taking for even stronger governance at GE help the stock right now? I hope so, but probably not. But moving quickly shows our investors that our leadership team is confident and focused on winning in the marketplace.

So what does a CEO do to restore trust? You do your job. And I'm lucky enough to follow in a long line of great GE leaders like Greg Jones and Jack Welch who had a simple goal. Leave the company better than we found it and create an exciting future. The role of the CEO is to build committed organizations focused on serving customers, shareholders, and employees, to develop strategies that drive growth and meet commitments, to build companies that are both good and great, that have passion and compassion.

CEOs must believe in balance. You're never as good as they say you are on your best day or as bad on the worst. In the late 90s when the economy was roaring, caution was cast aside and now

there's mainly cynicism and fear. But we look at the future with great optimism. Tough times and high standards make great companies. And we're confident we'll perform with integrity because that's what GE has always done. Thank you very much. (Applause)

QUESTION AND ANSWER PERIOD

CHAIRMAN RICHARD A. GRASSO: Jeff, thank you so very much for that very thoughtful and, I think, very innovative tour through the initiatives of GE. Not only, as I listen to you, will it be good for General Electric and its owners, but I think it sets the standard for all companies to aspire to and will indeed make our system a better one. So thank you. Ladies and gentlemen, consistent with the club's practice, we have this evening two expert questioners of our two extraordinary business leaders – John Lipsky, Chief Economist at J.P. Morgan Chase and Sam Stovall, Senior Investment Strategist, Standard & Poor's. I'm going to ask John to direct the first question to Rick Priory. John, if you would.

JOHN LIPSKY: Thank you. And again, thanks to both speakers for excellent presentations. Rick, two years ago, Vice President Dick Cheney said that we would need a new power plant every two weeks for the next 20 years. Since then, about ten years' worth of supply appears to have come on line or will be on line shortly. The deregulated power sector seemingly has been transformed into a commodity cycle business with its own booms and busts. Is that an inherent character of the new market? Is it a flaw of regulation? And does it need correction?

RICHARD B. PRIORY: Well, I think it's a character of the market we've set up at this point in time. It's a market that is very immature. It's a market that's going through, obviously going through probably the first and the deepest cycle we can imagine it going through at the present time. The name of a good well-run market is where you have counterparties on one side managing the risk and on the other side providing supply into that marketplace. The ability to manage risk and provide supply has been somewhat interfered with as a result of some of the California activities that took place, price controls, and things of that sort. So at this time, I wouldn't call it a nice, neat functioning market at the present time. But I think over time, there's little doubt in my mind that over time that market will rationalize and begin to operate in a much more rational way. Now, with regard to gluts, we certainly do have gluts in certain parts of the country as a result of pricing signals having been sent and investors responding to those pricing signals having been sent. We also have tight areas of the country as well that remain. The market is somewhat depressed, so even in those areas there's a backing off of building capacity. The disappointing thing is that capital markets are such that money really isn't available to build that supply any longer. So the particular glut that you see will probably burn off in the next two or three or four years and it's critically important that we repair that market so that the market is able, viable, and in a position, if you will, to begin the next increment of supply.

CHAIRMAN RICHARD A. GRASSO: Sam, you may direct your question to Jeff, and then I'm going to turn it into a free-for-all between the two of you.

SAM STOVALL: Jeff, well, thank you very much for being here. And I think your comments regarding linking the options to performance of management was very comforting. And to add to that, to what extent do you think that we need to see changes in overall executive compensation and retirement compensation before investor confidence can truly be restored?

JEFFREY R. IMMELT: Did you have anything specific in mind, Sam? (Laughter) Look, I think the way I get paid ought to be transparent. It ought to be known. I can't say that there's any specific formula other than to make sure that people like me and the top leaders of the company are totally aligned with shareholders. And that it's both well known, well, spelled out, and when the company does well, the CEO does well, and investors are rewarded at the same time. So, you know, look, I'm a big believer in transparency. I'm also a big believer that executive compensation needs to be totally linked with performance of the company. Does that need to be reformed? I just, I don't think so. I mean I think in many ways the market does help regulate it and help decide what people get paid and how the whole compensation system works. Should there be a regulator between what the CEO makes and an hourly worker or how the CEO compensation works vis-a-vis other employees, I think what's important, more important over the long term is I think there has to be a relationship between the CEO pay and the other senior leaders of the company. Because at the end of the day, you're in it as a team and you're working together, and I think that has, there has to be some linkage there.

CHAIRMAN RICHARD A. GRASSO: John, we're back to you to either of our two experts.

JOHN LIPSKY: Well, since Jeffrey is standing...well, they're both standing, but why don't I follow on with another question to Jeffrey Immelt. GE states that one of the four keys to its growth is digitization. According to your website, "GE is in the midst of an incredible transformation brought on by the internet explosion. Our pursuit of digitization will rapidly change our dealings with our vendors, partners, and most of all our customers." Moreover, GE states that "Digitization represents a revolution that may be the greatest opportunity for growth that our company has ever seen." Given the investment disappointments in the internet and high-tech sectors, what is the basis for your optimism on this subject? And what do you foresee as its impact on your business strategy?

JEFFREY R. IMMELT: I think that the repudiation of the dot.com bubble was more about the business models associated with the internet than the internet itself. I think the technology, information technology and the internet is the industrial revolution, is transforming companies like GE all around the world. It's basically a work flow tool. And so what it allows companies like GE to do is run our company with a completely different look, having much smaller administrative staffs, being able to redeploy resources internally and having more engineers and salespeople while driving tremendously high levels of productivity. In terms of our customer interface and the way we can grow, it allows us to link very smoothly with our customers, to help their work flow and help them be more productive and grow in the future. But I think the internet

in its essence is primarily a productivity tool that can be utilized by companies in many different ways, but I think it's clearly going to make companies be more productive, lower costs, enable them to redeploy resources towards growth. And I think it's just beginning. I think people can't look at the late 90s and assume that what they saw in these business models had anything to do with the efficacy of the technology which is very strong and just beginning.

CHAIRMAN RICHARD A. GRASSO: Sam, for Rick.

SAM STOVALL: This question actually is for both gentlemen. And in a sense I'm probably preaching to the choir here because GE has paid a dividend since 1899 and Duke has offered one since 1926, yet certainly in the 1990s it became unfashionable for corporate management to focus on dividend growth. So my question is, do you think that Congress should consider eliminating the double taxation of dividends and if they do how might that affect your dividend policy?

RICHARD B. PRIORY: That's a wonderful idea. Well, we have paid a dividend for many, many years. I forget even the consecutive number of years right now. It's critically important to our business model going forward. We did slow down the growth of that dividend, in fact, flattened it for a period of time while the energy industry was being deregulated and we were trying to grow. But the fact of the matter is, it is doubly-taxed. There's no question about that. And certainly if it were not taxed, we could certainly implement a series of efficiencies for

shareholders which are the kind of efficiencies they haven't seen before. So we would be very supportive of that. I see little hope of that, but certainly would be supportive of something in that direction.

JEFFREY R. IMMELT: Again, it would be wonderful to think that that would actually happen. I don't think any of us are putting that much hope in it, but it is something that we should keep pushing for. One of the things we try to do when we meet with investors, that we do frequently, is to say $15 billion, or you know, $15-$20 billion of cash flow, from an investor standpoint, what's the best way to utilize the cash flow? Dividends are something we believe in, we'll keep offering. We have them grow roughly in line with our earnings. That's one great way. We also think a lot of our investors like to redeploy cash flow into doing acquisitions and using other ways to help grow our company for the long term. We think dividends are important, but we also think frequently our investors want to see us reinvest the money for long-term growth and we plan to keep doing that as well.

JOHN LIPSKY: Mr. Priory again. With the policymakers once again talking about a need to review energy policy in terms like energy independence being heard once again, what do you foresee as basic trends in use of energy sources? Is the notion of any significant near-term shift really practical?

RICHARD B. PRIORY: Well, no. I think the fact of the matter is natural gas has been the field

of choice for a number of years. There's little doubt that nuclear is no longer an option in terms of supply. Hydro is no longer an option in terms of supply. Coal is problematic in view of the environmental requirements associated with that. So most certainly that's why the world has flocked, if you will, to natural gas, not only in the United States but elsewhere around the country. There is no doubt that we need additional diversity in that regard and lots of work is going into that. However, if you look at the options as they are today, they really are very, very limited, more limited than any other time in my career in terms of economic options for the purposes of providing supply in this country. And thus, we end up with nonetheless a tremendous dependence upon oil, as you know, which hasn't gotten any better. In fact, it's certainly gotten; we've become more dependent, if you will, on oil. We're certainly getting very, very dependent upon natural gas as well. So diversity of fuel supply is critically important in my business. We've got to have a little coal, you have a little nuclear, a little hydro, a little gas, and a little oil to make this thing work. And we are relatively diversified now, but boy, we need some new options before all is said and done.

SAM STOVALL: Jeff, well, speaking of diversification, you recently stated that China will become a key market and growth driver. Yet, for many companies China has represented a quagmire of red tape, corruption, and weak contractual law. How do you see GE addressing these issues?

JEFFREY R. IMMELT: You know I just think China is going to be the biggest regional

economic factor in the next decade or so. And we actually find China to be a fairly transparent place to do business. You've got a government that's very focused and knows that their role is to raise the standard of living for a billion people and a younger generation that's as capitalistic as anybody in this room. And no matter what the industry is, whether it's, I mean our medical business which is fairly sophisticated, high-tech medical equipment has a $600 million business in China this year, growing 25-30% a year and very profitable. We just announced today a commitment to a regional jet market in China. So my own belief is that it is moving, and that it's moving at a very unmistakable path towards joining the rest of the world by necessity. And you're either going to be big in China or your biggest competitors are going to come from China, but there's nowhere in between. So our goal is to be there and be there fast. Now there's issues. I think it's got a very immature financial system. That's probably the most compelling issue China has today. Sometime between now and the WTO session which is going to be, you know, 2016, 2017, there's going to have to be changes in the financial system. My own belief is that the government, they're smart enough to bring in outsiders from the rest of the world – the big financial companies in New York and elsewhere – to help them do that. Once they get that solved, and I think they will, China is going to be the place to do business. And it is transparent and there are going to be changes made there, and now is the time to get there.

CHAIRMAN RICHARD A. GRASSO: John, we have time for two more, so your final question.

JOHN LIPSKY: Thank you. For both gentlemen, maybe a little bit out of left field. U.S. inflation

is at a 40-year low, but core goods prices are declining as they have for most of the time since 1996 while core services prices have been increasing at a steady annual pace of about 3%. Do you expect these trends to continue and does this influence your attitude about your business strategy?

RICHARD B. PRIORY: Well, I can assure you I'm not an economist, but in terms of consumer spending and what have you, which seems to be kind of holding us up at this point time, we certainly have high hopes that that will continue to keep this economy rolling to a point where other things can turn around. And, you know, I really don't have any idea what the likelihood of the Fed move on Wednesday will create and that sort of thing. So I'll leave it to Jeff to fill in the rest.

JEFFREY R. IMMELT: It's a question on, you know, deflation and inflation. I'm surprised by the core services pricing number myself. I think we've prepared GE for a long-term deflationary environment where pricing pressure is tough, where perfect information, excess capacity, and probably the only two businesses we're in with any pricing power right now are NBC because we've got good shows, and reinsurance because the industry has lost a lot of money in the past. Other than that, it's very tough; we see very tough pricing in every business we're in. And I think that's going to be the world in the next period of time.

CHAIRMAN RICHARD A. GRASSO: Sam, final question of the evening.

SAM STOVALL: Both gentlemen have discussed standardization and its importance on transparency. And to that extent, what is your opinion and stated adoption of core earnings?

RICHARD B. PRIORY: Well, I think we've adopted certainly a disclosure process for core earnings that will remain exactly the same after the guidelines are finished as we had before. We have always laid out very clearly what our earnings are. We don't see any reason to change that. And we have been very forthright on that, perform earnings as well as core earnings. And we lay it out in our disclosures in a way in which nobody could miss it, it seems to me, and it should be very clear to them.

JEFFREY R. IMMELT: I think we're waiting for McGraw-Hill's adoption and then we plan to do it right after that. (Laughter) No, I think the S&P has put forth a nice, an interesting set of challenges and a way to look at it that we shouldn't dispute. You know we have probably 15 or 20 analysts that cover us intensely. Each one of them looks at our company in a different way. We're the most broadly-held stock in the world. People look at our company in a number of different ways, and I think S&P adds a constructive voice to the process. Our goal is to give the data. Follow the rules, give the data. If something becomes an adoptive practice, we should help support it. But it's difficult to pick somebody's favorite. I think our job is to play the game, is to get out front, is to play by the rules, is to give people the data, and not be a negative as different bodies are exploring different ways to look at it, like S&P. I think it's a constructive voice. And

the way we can help support that is by giving good data and continuing, but not by giving 17 line items so that everybody can do it. I think other people can do that. We need to play by the rules, give people the data, let you do the analysis, and not be a pain in the butt, and allow it to get its own resonance.

(APPLAUSE)

CHAIRMAN RICHARD A. GRASSO: I'd like to thank John Lipsky of J.P. Morgan Chase and Sam Stovall from Standard & Poor's for their excellent questions. I certainly want the audience to join me in a warm round of applause for these two extraordinary business leaders who privileged us by being here tonight – Jeff Immelt and Rick Priory. (Applause) Ladies and gentlemen, I thank – on behalf of the trustees of the club – all of you for being here tonight. The meeting of the Economic Club of New York is adjourned. Thank you all very much. Safe home. (Applause)