Duke Energy®
Generation Services

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Honorable Kathleen McGinty
Secretary
Pennsylvania Department of Environmental Protection
Harrisburg, PA 17105-8772

Delivered via electronic mail

Dear Secretary McGinty:

As you are aware, Duke Energy is one of the nation's five-largest electric utilities with a market capitalization of $25 billion and serving nearly 4 million customers. In aggregate, Duke owns and operates over 37,000 megawatts of electric generation capacity.

Duke Energy and its predecessor companies, such as Cinergy, have been leaders in the commercial deployment of advanced coal technologies. For example, a Cinergy company was a key participant in the Wabash River coal gasification project. This project was the first application of coal gasification to the repowering of an existing steam turbine plant. More recently, Duke Energy announced that it was exploring the development of the first reference gasification plant based upon advanced coal gasification technology provided by GE. In 2006, this project was awarded $133.5 million in tax credits by the United States Department of Energy under Section 1307 of the 2005 Energy Policy Act.

In conjunction with its leadership role in the electric utility industry with respect to advanced technology, Duke Energy has also been a leader in our industry urging Congress to address climate change issues through establishment of a mandatory economy-wide cap-and-trade program.

Duke Energy's unregulated affiliate, Duke Energy Generation Services ("DEGS") presently owns, operates and manages over 20 energy projects throughout the United States. DEGS has evaluated a number of areas for long-term investment in major, new electric generation projects, and has concluded that Pennsylvania offers significant advantages over other locations. Specifically, Pennsylvania would be appropriate for potential projects utilizing high-sulfur coal, such as Pittsburg #8 coal, and for advanced coal gasification technology with integrated carbon capture and sequestration. This would permit the continued use of coal with strong environmental performance.

However, the risks associated with such projects make their implementation impractical in the absence of long-term power purchase agreements (PPAs). Such contracts also benefit customers by covering a portion of base load requirements. For example:

1. More than 65 percent of the cost of electric power from a new coal-based generating project is associated with the annual capital charge (capital recovery).

2. It is possible to reduce the annual capital charge by extending the term of the PPA and therefore the tenor of the underlying financing.

3. The existence of a long-term PPA itself will reduce the price of power by permitting the developer/owner to increase the level of relatively lower-cost, long-term debt into the capital structure of the transaction, relative to higher cost equity.

Since the passage of the Pennsylvania electric deregulation statute in 1996, the Commonwealth and its electric customers have been able to obtain an economic benefit from the surplus of existing coal-based electric power. However, two forces are now acting to change the market dynamics and therefore the price risk to customers of continuing to rely upon the existing asset base. First, Pennsylvania's economy continues to grow with a consequent increase in demand for electric power (just one percent annual demand growth is equivalent to over 200 megawatts per year). As a result, the surplus of existing coal-based power will fall and reliance upon natural gas-based power will materially increase. Given the volatility inherent in natural gas markets, this trend brings substantial new risks to customers. Second, we expect the future price of coal-fired power will increase as carbon emission limits are imposed and the costs of carbon allowances are incurred by all fossil-fuel power producers.

Given the foregoing, we strongly support your initiative to selectively use long-term power purchase agreements to support the commercial deployment of advanced coal gasification and other technologies with integrated carbon capture and sequestration.

Respectfully yours,

Michael H. Schwartz, PhD
Senior Vice President
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