SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1996-11-14** | Period of Report: **1996-09-30**
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DQE INC

CIK:**846930**| IRS No.: **251598483** | State of Incorp.:**PA** | Fiscal Year End: **1231**
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SIC: **4911** Electric services

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[CONFORMED]

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 September 30, 1996

[_] 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
1-10290

DQE, Inc.
(Exact name of registrant as specified in its charter)

Pennsylvania	25-1598483
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Cherrington Corporate Center, Suite 100
500 Cherrington Parkway, Coraopolis, Pennsylvania 15108-3184
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (412) 262-4700

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 report), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ___

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

DQE Common Stock, no par value - 77,195,881 shares outstanding as of September 30, 1996 and 77,206,010 shares outstanding as of October 31, 1996.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

DQE
CONDENSED STATEMENT OF CONSOLIDATED INCOME
(Thousands of Dollars, Except Per Share Amounts)
(Unaudited)

<TABLE>
<CAPTION>

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1996	1995	1996	1995
<S>	<C>	<C>	<C>	<C>
Operating Revenues				
Sales of Electricity:				
Customers - net	$294,470	$312,562	$818,536	$827,143
Utilities	14,599	15,356	45,641	39,872
Total Sales of Electricity	309,069	327,918	864,177	867,015
Other	26,361	19,346	65,128	61,898
Total Operating Revenues	335,430	347,264	929,305	928,913
Operating Expenses				
Fuel and purchased power	61,126	66,466	178,986	174,391
Other operating	73,708	77,081	215,883	221,028
Maintenance	19,554	21,185	58,922	61,044
Depreciation and amortization	53,709	53,486	166,517	152,687
Taxes other than income taxes	22,442	23,518	65,405	66,758
Total Operating Expenses	230,539	241,736	685,713	675,908
OPERATING INCOME	104,891	105,528	243,592	253,005
OTHER INCOME	16,978	12,714	48,618	39,049
INTEREST AND OTHER CHARGES	28,807	26,258	81,183	81,462
INCOME BEFORE INCOME TAXES	93,062	91,984	211,027	210,592
INCOME TAXES	35,650	36,715	72,338	78,737
NET INCOME	$ 57,412	$ 55,269	$138,689	$131,855
AVERAGE NUMBER OF COMMON SHARES OUTSTANDING (Thousands of Shares)	77,194	77,533	77,391	77,718

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EARNINGS PER SHARE OF COMMON STOCK	$0.74	$0.72	$1.79	$1.70
DIVIDENDS DECLARED PER SHARE OF COMMON STOCK	$0.32	$0.30	$0.96	$0.89

</TABLE>

See notes to condensed consolidated financial statements.

DQE
CONDENSED CONSOLIDATED BALANCE SHEET
(Thousands of Dollars)
(Unaudited)

<TABLE>
<CAPTION>

<S>	September 30, 1996 <C>	December 31, 1995 <C>
ASSETS		
Current assets:		
Cash and temporary cash investments	$ 245,137	$ 24,767
Receivables	150,113	125,768
Other current assets, principally materials and supplies	96,952	86,851
Total current assets	492,202	237,386
Long-term investments	485,703	440,916
Property, plant and equipment	4,756,108	4,746,113
Less: Accumulated depreciation and amortization	(1,771,707)	(1,685,877)
Property, plant and equipment - net	2,984,401	3,060,236
Other non-current assets:		
Regulatory assets	643,800	671,928
Other	51,936	48,377
Total other non-current assets	695,736	720,305
TOTAL ASSETS	$ 4,658,042	$ 4,458,843
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Notes payable	$ 9,880	$ 35,098
Current maturities and sinking fund requirements	23,819	71,379
Accounts payable	77,667	90,941
Accrued liabilities	75,283	52,063
Dividends declared	27,213	27,825

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Other	7,793	9,191
Total current liabilities	221,655	286,497
Deferred income taxes - net	829,565	801,631
Deferred investment tax credits	104,645	115,760
Capital lease obligations	28,787	34,546
Deferred income	190,127	221,740
Other	223,014	197,973
Commitments and contingencies (Note 4)		
Capitalization:		
Long-term debt	1,467,050	1,400,993
Preferred and preference stock of subsidiaries:		
Non-redeemable preferred stock	213,608	63,608
Non-redeemable preference stock, Plan Series A	29,127	29,615
Total preferred and preference stock before deferred employee stock ownership plan (ESOP) benefit (involuntary liquidation values of $242,598 and $93,086 exceed par by $28,306 and $28,781, respectively)	242,735	93,223
Deferred ESOP benefit	(20,246)	(22,257)
Total preferred and preference stock of subsidiaries	222,489	70,966
Common shareholders' equity:		
Common stock - no par value (authorized - 187,500,000 shares; issued - 109,679,154 shares)	985,244	997,461
Retained earnings	763,420	698,986
Less treasury stock (at cost) (32,483,273 and 32,123,601 shares, respectively)	(377,954)	(367,710)
Total common shareholders' equity	1,370,710	1,328,737
Total capitalization	3,060,249	2,800,696
TOTAL LIABILITIES AND CAPITALIZATION	$ 4,658,042	$ 4,458,843

</TABLE>

See notes to condensed consolidated financial statements.

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DQE

CONDENSED STATEMENT OF CONSOLIDATED CASH FLOWS

(Thousands of Dollars)

(Unaudited)

<TABLE>
<CAPTION>

	Nine Months Ended September 30,	
	1996	1995
<S>	<C>	<C>
Cash Flows from Operating Activities		
Operations	$ 320,144	$ 275,540
Changes in working capital other than cash	(26,510)	33,207
Other - net	(1,724)	40,944
Net Cash Provided by Operating Activities	291,910	349,691
Cash Flows Used in Investing Activities		
Capital expenditures	(62,730)	(57,871)
Long-term investments - net	(39,809)	(113,379)
Other - net	(3,587)	(2,428)
Net Cash Used in Investing Activities	(106,126)	(173,678)
Cash Flows Provided by (Used in) Financing Activities		
Decrease in notes payable - net	(25,218)	(2,157)
Issuance (redemption) of preferred and preference stock	150,000	(26,732)
Dividends on common stock	(74,255)	(68,833)
Increase (reductions) of long-term obligations - net	2,130	(81,236)
Repurchase of common stock	(11,717)	(21,271)
Other - net	(6,354)	(642)
Net Cash Provided by (Used in) Financing Activities	34,586	(200,871)
Net increase (decrease) in cash and temporary cash investments	220,370	(24,858)
Cash and temporary cash investments at beginning of period	24,767	50,058
Cash and temporary cash investments at end of period	$ 245,137	$ 25,200

Non-Cash Investing Activities

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Equity funding obligations recorded	$ 23,046	$ 10,123
	==========	==========

</TABLE>
See notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Except for historical information contained herein, the matters discussed in this Quarterly Report on Form 10-Q are forward-looking statements that involve risks and uncertainties including, but not limited to, economic, competitive, governmental and technological factors affecting DQE and its subsidiaries' (the Company's) operations, markets, products, services and prices, and other factors discussed in the Company's filings with the Securities and Exchange Commission (SEC).

1. CONSOLIDATION, RECLASSIFICATIONS AND ACCOUNTING POLICIES

DQE is an energy services holding company formed in 1989. Its subsidiaries are Duquesne Light Company (Duquesne), Duquesne Enterprises (DE), DQE Energy Services (DES) and Montauk. DQE and its subsidiaries are collectively referred to as "the Company."

Duquesne is an electric utility engaged in the production, transmission, distribution and sale of electric energy and is the largest of DQE's subsidiaries. DE makes strategic investments related to DQE's core energy business. These investments enhance DQE's capabilities as an energy provider, increase asset utilization, and act as a hedge against changing business conditions. DES is a diversified energy services company offering a wide range of energy solutions for industrial, utility and consumer markets worldwide. DES initiatives include energy facility development and operations, independent power production, gas and electric energy/fuel management and utility management services. Montauk is a financial services company that makes long-term investments and provides financing for the Company's market-driven business activities.

All material intercompany balances and transactions have been eliminated in the preparation of the condensed consolidated financial statements.

In the opinion of management, the unaudited condensed consolidated financial statements included in this report reflect all adjustments that are necessary for a fair presentation of the results of interim periods and are normal, recurring adjustments. Prior-period financial statements were reclassified to conform with the 1996 presentation.

These statements should be read with the financial statements and notes included in the Annual Report on Form 10-K filed with the SEC for the year ended December 31, 1995. The results of operations for the three and nine months ended September 30, 1996 are not necessarily indicative of the results that may be expected for the full year. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. The reported amounts of revenues and expenses during the reporting period may also be affected by the estimates and assumptions

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management is required to make. Actual results could differ from those estimates.

The Company is subject to the accounting and reporting requirements of the SEC. In addition, the Company's electric utility operations are subject to the regulation of the Pennsylvania Public Utility Commission (PUC) and the Federal Energy Regulatory Commission (FERC). As a result, the consolidated financial statements contain regulatory assets and

liabilities in accordance with Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation (SFAS No. 71), and reflect the effects of the ratemaking process. Such effects concern mainly the time at which various items enter into the determination of net income in accordance with the principle of matching costs and revenues. (See "Rate Matters," Note 3, below.)

The Company's long-term investments include certain investments in marketable securities. In accordance with Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities, these investments are classified as available-for-sale and are stated at market value. The amounts of unrealized holding losses on investments at September 30, 1996 and December 31, 1995 are $8.6 million and $4.4 million. Reduced for deferred income taxes, net unrealized holding losses on investments are $5.0 million and $2.6 million at September 30, 1996 and December 31, 1995.

2. RECEIVABLES

Components of receivables for the periods indicated are as follows:

<TABLE>
<CAPTION>

	September 30, 1996	September 30, 1995	December 31, 1995
	(Amounts in Thousands of Dollars)		
<S>	<C>	<C>	<C>
Direct customer accounts receivable	$107,419	$110,963	$103,821
Other utility receivables	36,626	17,216	22,441
Other receivables	25,585	35,149	25,164
Less: Allowance for uncollectible accounts	(19,517)	(20,082)	(18,658)
Receivables less allowance for uncollectible accounts	150,113	143,246	132,768
Less: Receivables sold	-	-	(7,000)
Total Receivables	$150,113	$143,246	$125,768

</TABLE>

The Company and an unaffiliated corporation have an agreement that entitles the Company to sell, and the corporation to purchase, on an ongoing basis, up to $50.0 million of accounts receivable. At September 30, 1996 and 1995, the Company had not sold any receivables to the unaffiliated corporation. At

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December 31, 1995, the Company had sold $7.0 million of receivables to the unaffiliated corporation. The accounts receivable sales agreement, which expires in June 1997, is one of many sources of funds available to the Company. The Company may attempt to extend the agreement or to replace the facility with a similar arrangement or to eliminate it upon expiration.

3. RATE MATTERS

On October 31, 1996 the sale of the Company's ownership interest in the Ft. Martin Power Station (Ft. Martin) was completed. In accordance with the PUC order approving the Company's plan for the sale of its ownership interest in Ft. Martin, the Company will not increase its base rates for a five-year period through the year 2000. In addition, the Company will record a five-year annual $5.0 million credit to the Energy Cost Rate Adjustment Clause (ECR) and cap energy costs beginning April 1, 1997 through the remainder of the plan period. (See "Ft. Martin Plan" discussion on page 8.)

Regulatory Assets

As a result of the application of SFAS No. 71, the Company records regulatory assets on its consolidated balance sheet. The regulatory assets represent probable future revenue to the Company because provisions for these costs are currently included, or are expected to be included, in charges to electric utility customers through the ratemaking process.

The Company's electric utility operations currently satisfy the SFAS No. 71 criteria. However, a company's electric utility operations or a portion of such operations could cease to meet these criteria for various reasons, including a change in the PUC or the FERC regulations. Should the Company's electric utility operations cease to meet the SFAS No. 71 criteria, the Company would be required to write off any regulatory assets or liabilities for those operations that no longer meet these requirements. Management will continue to evaluate significant changes in the regulatory and competitive environment in order to assess the Company's overall compliance with the criteria of SFAS No. 71.

The components of regulatory assets for the periods presented are as follows:

<TABLE>
<CAPTION>

<S>	September 30, 1996 <C>	December 31, 1995 <C>
	(Amounts in Thousands of Dollars)	
Regulatory tax receivable	$404,409	$414,543
Unamortized debt costs (a)	94,656	98,776
Deferred rate synchronization costs (see below)	42,149	51,149
Beaver Valley Unit 2 sale/leaseback premium (b)	30,435	31,564
Deferred employee costs (c)	29,194	31,218
Extraordinary property loss	0	8,300
Deferred nuclear maintenance outage costs	16,002	6,776
DOE decontamination and decommissioning receivable	10,010	10,687
Deferred coal costs	11,303	12,753
Other	5,642	6,162

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Total Regulatory Assets	$643,800	$671,928

</TABLE>

(a) The premiums paid to reacquire debt prior to scheduled maturity dates are deferred for amortization over the life of the debt issued to finance the reacquisitions.
(b) The premium paid to refinance the Beaver Valley Unit 2 lease was deferred for amortization over the life of the lease.
(c) Includes amounts for recovery of accrued compensated absences and accrued claims for workers' compensation.

With respect to the financial statement presentation of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, the Company reflects the amortization of the regulatory tax receivable resulting from reversals of deferred taxes as depreciation and amortization expense. Reversals of accumulated deferred income taxes - net are included in income taxes.

Deferred Rate Synchronization Costs

In 1987, the PUC approved the Company's petition to defer initial operating and other costs of Perry Unit 1 and Beaver Valley Unit 2 (BV Unit 2). The Company deferred the costs incurred from the date the units went into commercial operation until the date a rate order was issued. In its rate order, the PUC postponed ruling on whether these costs would be recoverable from the Company's electric utility customers. The Company is not earning a return on the deferred costs.

In accordance with the PUC order approving the Company's plan for the sale of its ownership interest in Ft. Martin, the Company has expensed $9.0 million related to the depreciation portion of deferred rate synchronization costs. The Company's approved plan also provides for the amortization of the remaining $42.1 million of deferred rate synchronization costs over a ten-year period. (See "Ft. Martin Plan" discussion, below.)

Property Held for Future Use

In 1986, the PUC approved the Company's request to remove Phillips Power Station (Phillips) and a portion of Brunot Island Power Station (BI) from service and from rate base. The Company expects to recover its investment in BI through future electricity sales. The Company believes its investment in BI will be necessary in order to meet future business needs as outlined in the Company's plans for optimizing generation resources. A portion of the proceeds of the sale of Ft. Martin is expected to be used to fund reliability enhancements to BI combustion turbines. The reliability enhancements are contingent upon the projects meeting a least-cost test versus other potential sources of peaking capacity. (See "Ft. Martin Plan" discussion below.) The Company is analyzing the effects of retail choice on its future generating requirements and specifically whether Phillips will be able to operate in this new competitive marketplace. The Company is also investigating other opportunities to recover its investment and associated costs of Phillips, including the possible sale of the station. In the event that market demand, transmission access or rate recovery do not support the utilization or sale of these plants, the Company may have to write off part or all of these

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investments and associated costs. At September 30, 1996, the Company's net of tax investment in Phillips and BI held for future use was $53.2 million and $27.6 million, respectively.

Ft. Martin Plan

On October 31, 1996 the sale of the Company's ownership interest in Ft. Martin was completed. The sale and a plan to be funded in part by the proceeds of the Ft. Martin transaction were approved by the PUC on May 23, 1996. Under the approved plan, the Company will not increase its base rates for a period of five years through the year 2000. In addition, the Company recorded in October 1996 a one-time reduction of approximately $130.0 million in the book value of the Company's nuclear plant investment. The proceeds from the sale are expected to be used to fund reliability enhancements to the BI combustion turbines and to reduce the Company's capitalization. The approved plan also provides for an increase of $25.0 million in depreciation and amortization expense in 1996, $50.0 million in 1997 and $75.0 million in 1998 related to the Company's nuclear investment, as well as additional annual contributions to its nuclear plant decommissioning funds of $5.0 million, without any increase in existing electric rates. Also, the Company will record an annual $5.0 million credit to the ECR during the plan period to compensate the Company's electric utility customers for lost profits from any short-term power sales foregone by the sale of its ownership interest in Ft. Martin. In addition to the annual credit of $5.0 million to the ECR, the Company will cap energy costs beginning April 1, 1997 through the remainder of the plan period, at a historical five-year average of 1.47 cents per kilowatt hour. In accordance with the approved plan, the Company has expensed $9.0 million related to the depreciation portion of the $51.1 million of deferred rate synchronization costs associated with BV Unit 2 and Perry Unit 1. Upon final transfer of its ownership interest in Ft. Martin, the Company began to amortize the remaining $42.1 million of deferred rate synchronization costs over a ten-year period. (See "Deferred Rate Synchronization Costs" discussion on page 7.) Finally, the

Company's approved plan also provides for annual assistance of $0.5 million to low-income customers.

4. COMMITMENTS AND CONTINGENCIES

Construction

The Company estimates that it will spend, excluding the Allowance for Funds Used During Construction (AFC) and nuclear fuel, approximately $90.0 million on electric utility construction during 1996. This estimate also excludes any potential expenditures for reliability enhancements to the BI combustion turbines. (See "Ft. Martin Plan" discussion, Note 3, on page 8.)

Nuclear-Related Matters

The Company operates two nuclear units and has an ownership interest in a third. The operation of a nuclear facility involves special risks, potential liabilities and specific regulatory and safety requirements. Specific information about risk management and potential liabilities is discussed below.

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Nuclear Decommissioning. The PUC ruled that recovery of the decommissioning costs for Beaver Valley Unit 1 (BV Unit 1) could begin in 1977, and that recovery for BV Unit 2 and Perry Unit 1 could begin in 1988. The Company expects to decommission BV Unit 1, BV Unit 2 and Perry Unit 1 no earlier than the expiration of each plant's operating license in 2016, 2027 and 2026, respectively. BV Unit 1 will be placed in safe storage until the expiration of the BV Unit 2 operating license, at which time the units may be decommissioned together.

Based on site-specific studies finalized in 1992 for BV Unit 2 and in 1994 for BV Unit 1 and Perry Unit 1, the Company's share of the total estimated decommissioning costs, including removal and decontamination costs, currently being used to determine the Company's cost of service is $121.7 million for BV Unit 1, $35.2 million for BV Unit 2 and $67.1 million for Perry Unit 1.

In conjunction with an August 18, 1994 PUC Accounting Order, the Company has increased the annual contribution to its decommissioning trusts by approximately $2.0 million, to bring the total annual funding to approximately $4.0 million per year. On July 18, 1996, the PUC issued a Proposed Policy Statement Regarding Nuclear Decommissioning Cost Estimation and Cost Recovery for the purpose of obtaining comments from the public. The proposed policy includes guidelines for a site-specific study to estimate the cost of decommissioning. These studies need to be performed at least every five years addressing radiological and non-radiological costs and include a contingency factor of not more than 10 percent. Under the proposed policy, annual decommissioning funding levels are based on an annuity calculation recognizing inflation in the cost estimates and earnings on fund assets. Utilities may be permitted to update their annual decommissioning trust fund payments through accounting petitions, a change in base rates, or a non-earnings related change in base rates under the proposed policy. With respect to the transition to a competitive generation market, the proposed policy recommends that utilities include a plan to mitigate any shortfall in decommissioning trust fund payments for the life of the facility with any future decommissioning filings. In response to this recommendation, the Company has taken steps to currently fund its nuclear decommissioning obligation. The PUC approved the Company's plan for the sale of its

ownership interest in Ft. Martin, which provides for additional annual contributions to its nuclear decommissioning funds of $5.0 million without any increase in existing electric utility rates. (See "Ft. Martin Plan" discussion, Note 3, on page 8.) Also, on October 17, 1996 the PUC adopted an Accounting Order filed by the Company to recognize the increased funding as part of the Company's cost of service. The Company is currently seeking approval from the Internal Revenue Service to allow for this additional funding of its decommissioning trusts.

The Company records decommissioning expense under the category of depreciation and amortization and accrues a liability equal to that amount for nuclear decommissioning expense. Such nuclear decommissioning funds are deposited in external, segregated trust accounts. The funds are invested in a portfolio of municipal bonds, certificates of deposit and United States government securities having a weighted average duration of four to seven years. Trust fund earnings increase the fund balance and the recorded liability. The market value of the aggregate trust fund balances at September 30, 1996 totaled approximately $32.0 million. On the Company's consolidated balance sheet, the decommissioning trusts have been reflected in long-term investments, and the

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related liability has been recorded as other non-current liabilities.

Nuclear Insurance. The Price-Anderson Amendments to the Atomic Energy Act of 1954 limit public liability from a single incident at a nuclear plant to $8.9 billion. The maximum available private primary insurance of $200.0 million has been purchased by the Company. Additional protection of $8.7 billion would be provided by an assessment of up to $79.3 million per incident on each nuclear unit in the United States. The Company's maximum total assessment, $59.4 million, which is based on its ownership or leasehold interests in three nuclear generating units, would be limited to a maximum of $7.5 million per incident per year. This assessment is subject to indexing for inflation and may be subject to state premium taxes. If funds prove insufficient to pay claims, the United States Congress could impose other revenue-raising measures on the nuclear industry.

The Company's share of insurance coverage for property damage, decommissioning and decontamination liability is $1.2 billion. The Company would be responsible for its share of any damages in excess of insurance coverage. In addition, if the property damage reserves of Nuclear Electric Insurance Limited (NEIL), an industry mutual insurance company that provides a portion of this coverage, are inadequate to cover claims arising from an incident at any United States nuclear site covered by that insurer, effective November 15, 1996, the Company could be assessed retrospective premiums totaling a maximum of $7.3 million.

In addition, the Company participates in a NEIL program that provides insurance for the increased cost of generation and/or purchased power resulting from an accidental outage of a nuclear unit. Subject to the policy limit, the coverage provides for 100 percent of the estimated incremental costs per week during the 52-week period starting 21 weeks after an accident and 80 percent of such estimate per week for the following 104 weeks with no coverage thereafter. If NEIL's losses for this program ever exceed its reserves, the Company could be assessed retrospective premiums totaling a maximum of $3.5 million.

Beaver Valley Power Station (BVPS) Steam Generators. BVPS's two units are equipped with steam generators designed and built by Westinghouse Electric Corporation (Westinghouse). Similar to other Westinghouse nuclear plants, outside diameter stress corrosion cracking (ODSCC) has occurred in the steam generator tubes of both units. BV Unit 1, which was placed in service in 1976, has required removal of approximately 15 percent of its steam generator tubes from service through a process called plugging. However, BV Unit 1 continues to operate at 100 percent reactor power and has the ability to return tubes to service by repairing them through a process called sleeving. To date, no tubes at either BV Unit 1 or BV Unit 2 have been sleeved. BV Unit 2, which was placed in service eleven years after BV Unit 1, has not yet exhibited the

degree of ODSCC experienced at BV Unit 1. Approximately 2 percent of BV Unit 2's tubes are plugged; however, it is too early in the life of the unit to determine the extent to which ODSCC may become a problem.

The Company has undertaken certain measures, such as increased inspections, water chemistry control and tube plugging, to minimize the operational impact of and to reduce susceptibility to ODSCC. Although the Company has taken these steps to allay the effects of ODSCC, the inherent potential for future ODSCC in steam generator tubes of the Westinghouse design still exists. Material acceleration in the rate of ODSCC could lead to a loss of plant efficiency,

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significant repairs or the possible replacement of BV Unit 1's steam generators. The total replacement cost of BV Unit 1's steam generators is currently estimated at approximately $125.0 million. The Company would be responsible for $59.0 million of this total, which includes the cost of equipment removal and replacement steam generators but excludes replacement power costs. The earliest that BV Unit 1's steam generators could be replaced is 1999.

BV Unit 1 completed its 11th refueling outage on May 11, 1996. The outage lasted 49 days and was the shortest refueling outage in the history of the unit. During the outage, various inspections of the unit's steam generators were made, including examinations using a new "Plus Point" probe. As a result of these inspections, the Company returned to service tubes that had previously been plugged. Following the refueling outage, 85 percent of the steam generator tubes were in service, approximately 1 percent more than at the beginning of the outage.

BV Unit 2 began its 6th refueling outage on August 30, 1996. Various inspections of the unit's steam generators, including inspections using the "Plus Point" probe, have been completed. Upon completion of the outage, approximately 98 percent of the unit's steam generator tubes will be in service. Unanticipated repairs to two residual heat removal pumps will extend the outage by approximately six weeks. The unit is expected to return to service in late November.

The Company continues to explore all viable means of managing ODSCC, including new repair technologies, and plans to continue to perform 100 percent tube inspections during future refueling outages, which occur at approximately 18 month intervals for each unit. The Company will continue to monitor and evaluate the condition of the BVPS steam generators.

Spent Nuclear Fuel Disposal. The Nuclear Waste Policy Act of 1982 established a policy for handling and disposing of spent nuclear fuel and a policy requiring the established final repository to accept spent fuel. Electric utility companies have entered into contracts with the Department of Energy (DOE) for the permanent disposal of spent nuclear fuel and high-level radioactive waste in compliance with this legislation. The DOE has indicated that its repository under these contracts will not be available for acceptance of spent fuel before 2010 at the earliest. On July 23, 1996, the U. S. Court of Appeals for the District of Columbia Circuit, in response to a suit brought by 25 electric utilities and 18 states and state agencies, unanimously ruled that the DOE has a legal obligation to begin taking spent fuel by January 31, 1998. The DOE has not yet established an interim or permanent storage facility, and it is uncertain whether the DOE will be able to accept spent nuclear fuel by January 31, 1998. Further, Congress is considering amendments to the Nuclear Waste Policy Act of 1982 that could give the DOE authority to proceed with the development of a federal interim storage facility. In the event the DOE does not begin accepting fuel, existing on-site fuel storage capacities at BV Unit 1, BV Unit 2 and Perry Unit 1 are expected to be sufficient until 2016, 2010 and 2011, respectively.

Uranium Enrichment Decontamination and Decommissioning Fund. Nuclear reactor licensees in the United States are assessed annually for the decontamination and decommissioning of DOE uranium enrichment facilities. Assessments are based on the amount

of uranium a utility had processed for enrichment prior to enactment of the

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National Energy Policy Act of 1992 (NEPA) and are to be paid by such utilities over a 15-year period. At September 30, 1996, the Company's liability for contributions was approximately $9.9 million (subject to an inflation adjustment). Contributions, when made, are recovered from electric utility customers through the ECR.

Guarantees

The Company and the owners of Bruce Mansfield Power Station have guaranteed certain debt and lease obligations related to a coal supply contract for the Bruce Mansfield plant. At September 30, 1996, the Company's share of these guarantees was $20.3 million. The prices paid for the coal by the companies under this contract are expected to be sufficient to meet debt and lease obligations to be satisfied in the year 2000. The minimum future payments to be made by the Company solely in relation to these obligations total $21.0 million at September 30, 1996.

As part of the Company's investment portfolio in affordable housing, the Company has received fees in exchange for guaranteeing a minimum defined yield to third party investors. A portion of the fees received has been deferred to absorb any required payments with respect to these transactions. Based on an evaluation of the underlying housing projects, it is management's belief that such deferrals are ample for this purpose.

Residual Waste Management Regulations

In 1992, the Pennsylvania Department of Environmental Protection (DEP) issued Residual Waste Management Regulations governing the generation and management of non-hazardous residual waste, such as coal ash. The Company is assessing the sites it utilizes and has developed compliance strategies that are now under review by the DEP. Capital compliance costs of $3.0 million were incurred by the Company in 1995 to comply with these DEP regulations; on the basis of information currently available, an additional $2.5 million will be incurred in 1996. The expected additional capital cost of compliance through the year 2000 is estimated, based on current information, to be approximately $25.0 million. This estimate is subject to the results of ground water assessments and DEP final approval of compliance plans.

Employees

In November 1996, the Company reached an agreement on a three year contract extension with the International Brotherhood of Electrical Workers, which represents approximately 2,000 of the Company's employees. The contract expires September 30, 2001.

Other

The Company is involved in various other legal proceedings and environmental matters. The Company believes that such proceedings and matters, in total, will not have a materially adverse effect on its financial position, results of operations or cash flows.

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

Part I, Item 2 of this Quarterly Report on Form 10-Q should be read in conjunction with DQE and its subsidiaries' (the Company's) Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) for the year ended December 31, 1995 and the Company's condensed consolidated financial statements, which are set forth on pages 2 through 13 in Part I, Item 1 of this Report.

General

DQE is an energy services holding company formed in 1989. Its subsidiaries are Duquesne Light Company (Duquesne), Duquesne Enterprises (DE), DQE Energy Services (DES) and Montauk. DQE and its subsidiaries are collectively referred to as "the Company."

Duquesne is an electric utility engaged in the production, transmission, distribution and sale of electric energy and is the largest of DQE's subsidiaries. DE makes strategic investments related to DQE's core energy business. These investments enhance DQE's capabilities as an energy provider, increase asset utilization, and act as a hedge against changing business conditions. DES is a diversified energy services company offering a wide range of energy solutions for industrial, utility and consumer markets worldwide. DES initiatives include energy facility development and operations, independent power production, gas and electric energy/fuel management and utility management services. Montauk is a financial services company that makes long-term investments and provides financing for the Company's market-driven business activities.

The Company's Electric Operations

The Company's utility operations provide electric service to customers in Allegheny County, including the City of Pittsburgh, and Beaver County. This represents approximately 800 square miles in southwestern Pennsylvania, located within a 500-mile radius of one-half of the population of the United States and Canada. The population of the area served by the Company's electric utility operations, based on 1990 census data, is approximately 1,510,000, of whom 370,000 reside in the City of Pittsburgh. In addition to serving approximately 580,000 direct customers, the Company's utility operations also sell electricity to other utilities.

Regulation

The Company's electric utility operations are subject to regulation of the Pennsylvania Public Utility Commission (PUC), as well as to regulation by the Federal Energy Regulatory Commission (FERC) under the Federal Power Act with respect to rates for interstate sales, transmission of electric power, accounting and other matters.

The Company's electric utility operations are also subject to regulation of

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the Nuclear Regulatory Commission (NRC) under the Atomic Energy Act of 1954, as amended, with respect to the operation of its jointly owned/leased nuclear power plants, Beaver Valley Unit 1 (BV Unit 1), Beaver Valley Unit 2 (BV Unit 2) and Perry Unit 1. The Company is also subject to the accounting and reporting requirements of the SEC.

The Company's consolidated financial statements report regulatory assets and liabilities in accordance with Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation (SFAS No. 71), and reflect the effects of the ratemaking process. In accordance with SFAS No. 71, the Company's consolidated financial statements reflect regulatory assets and liabilities based on current cost-based ratemaking regulations. The regulatory assets represent probable future revenue to the Company because provisions for these costs are currently included, or are expected to be included, in charges to electric utility customers through the ratemaking process.

The Company's electric utility operations currently satisfy the SFAS No. 71 criteria. However, a company's utility operations or a portion of such operations could cease to meet these criteria for various reasons, including a change in the PUC or the FERC regulations. (See "Competition" discussion on page 19.) Should the Company's electric utility operations cease to meet the SFAS No. 71 criteria, the Company would be required to write off any regulatory assets or liabilities for those operations that no longer meet these requirements. Management will continue to evaluate significant changes in the regulatory and competitive environment in order to assess the Company's overall compliance with the criteria of SFAS No. 71.

Results of Operations

Seasonality

The quarterly results are not necessarily indicative of full-year operations because of seasonal fluctuations. Sales of electricity to customers by the Company's electric utility operations tend to increase during the warmer summer and colder winter seasons because of greater customer use of electricity for cooling and heating.

In the near term, weather conditions and the overall level of business activity in the Company's electric utility geographic area are expected to continue to be the primary factors affecting sales of electricity to customers. In the long-term, the Company's electric sales may also be affected by increased competition in the electric utility industry. (See "Competition" discussion on page 19.)

Operating Revenues

Total operating revenues decreased $11.8 million during the third quarter of 1996 and remained constant during the first nine months of 1996 as compared to the third quarter of 1995 and the first nine months of 1995.

Total sales of electricity decreased $18.8 million and $2.8 million during the third quarter of 1996 and the first nine months of 1996 as compared to the same periods in 1995. Cooler summer temperatures during 1996 resulted in lower

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customer revenues in the third quarter from residential and commercial customers of 11.8 percent and 2.8 percent. Revenue from sales of electricity to other utilities decreased $0.8 million in the third quarter of 1996 when compared to the corresponding quarter of 1995 due to increased price competition resulting from additional power being marketed by other utilities. Direct customer revenues from residential and commercial customers during the first nine months of 1996 were 2.2 percent and 0.5 percent lower than for the same period of 1995 primarily due to cooler summer temperatures during 1996. Revenues from sales of electricity to other utilities increased $5.8 million for the first nine

months of 1996 as compared to the same period in 1995. Scheduled outages at Elrama, Cheswick, and Mansfield, as well as a forced outage at Ft. Martin, reduced generation available for sales to other utilities during the first nine months of 1995.

Other operating revenues increased $7.0 million during the third quarter of 1996 as compared to 1995 and increased $3.2 million during the first nine months of 1996 as compared to 1995. The third quarter of 1996 increase was primarily due to increased revenues at Chester Engineers (Chester), a wholly owned subsidiary of DE, and due to increased billings to the other joint owners of BV Unit 2 in connection with the 6th refueling outage. The year-to-date results were primarily attributable to the increased revenues at Chester.

Operating Expenses

Total operating expenses decreased $11.2 million and increased $9.8 million during the third quarter of 1996 and the first nine months of 1996 as compared to the same periods in 1995.

Fuel and purchased power expense was $5.3 million lower in the third quarter of 1996 when compared to the third quarter of 1995 primarily due to a 29 percent decrease in the kilowatt hours purchased. In the first nine months of 1996, as compared to the first nine months of 1995, fuel and purchased power expense increased $4.6 million. This increase can be primarily attributed to a 4.4 percent increase in kilowatt hour sales which was partially offset by the third quarter of 1996 decrease in kilowatt hours purchased.

Other operating expenses were $3.4 million and $5.1 million lower for the third quarter of 1996 and for the first nine months of 1996 when compared to the same periods in 1995. The decreases are primarily due to cost reductions at the Company's utility operations. Additionally, the Company recorded operating reserves related to discontinued environmental business units.

Maintenance expenses decreased $1.6 million when comparing the third quarters of 1996 and 1995 and $2.1 million when comparing the first nine months of 1996 and 1995. The decreases are primarily due to lower refueling outage costs. The lower expenses for the first nine months of 1996 also result from fewer fossil station outages in 1996.

Depreciation and amortization expense was consistent when comparing the third quarter of 1996 to the third quarter of 1995 and increased $13.8 million when comparing the first nine months of 1996 to the first nine months of 1995. During the third quarter of 1996, the Company completed recovery of its investment in Perry Unit 2, the construction of which was abandoned by the Company in 1986. The resultant decrease in amortization expense, combined with other lower

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amortization costs, offset the Company's increase in depreciation related to the Ft. Martin Plan. The increase for the first nine months of 1996 resulted from the increased depreciation costs as well as $9.0 million which was expensed related to the depreciation portion of deferred rate synchronization costs in conjunction with the sale of its ownership interest in Ft. Martin. (See "Ft. Martin Plan" discussion on page 18.)

Other Income

The $4.3 million and $9.6 million increases in the third quarter of 1996 and the first nine months of 1996 in other income are primarily related to income from long-term investments that were made since the third quarter of 1995. During the first quarter of 1995 a pre-tax gain of approximately $7.2 million was recorded related to the acquisition of International Power

Machines (IPM) by Exide Electronics Group (Exide).

Interest and Other Charges

Interest and other charges increased $2.5 million when comparing the third quarter of 1996 to the third quarter of 1995 and were consistent when comparing the first nine months of 1996 to the first nine months of 1995. The increase in the current quarter was primarily due to the payment of $3.1 million in dividends related to the Monthly Income Preferred Securities that were issued in May 1996. (See Liquidity and Capital Resources, below.) The increase was partially offset by decreased interest as the result of retirement and refinancing of long-term debt.

Liquidity and Capital Resources

Financing

The Company expects to meet its current obligations and debt maturities through the year 2000 with funds generated from operations and through new financings. At September 30, 1996, the Company was in compliance with all of its debt covenants.

All of the Company's First Collateral Trust Bonds have been issued under a mortgage indenture established in April 1992. All First Collateral Trust Bonds became first mortgage bonds when the Company's 1947 first mortgage bond indenture was retired in the third quarter of 1995 following the maturity of the last bond series issued under that indenture.

On May 14, 1996, Duquesne Capital L.P., a Delaware special-purpose limited partnership whose sole general partner is Duquesne, issued in aggregate $150.0 million principal amount of 8-3/8% Cumulative Monthly Income Preferred Securities, Series A, with a stated liquidation value of $25. A portion of the proceeds was used to retire $50.0 million of long-term debt maturing May 15, 1996. The Company intends to apply the remaining proceeds to the purchase or redemption of outstanding securities and for general corporate purposes.

On June 24, 1996, the Company entered into a five-year bank term loan for

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$10.0 million at a 7.5 percent annual rate of interest. The term loan pays interest semi-annually.

Also on June 24, 1996, the Company extended one of its two revolving credit agreements to June 23, 1997, and increased the facility from $100.0 million to $125.0 million. Interest rates can, in accordance with the option selected at the time of borrowing, be based on prime, Eurodollar or certificate of deposit rates. Commitment fees are based on the unborrowed amount of the commitment. The credit facility contains a two-year repayment period for any amounts outstanding at the expiration of the revolving credit period.

In June 1996, a $50.0 million accounts receivable sales arrangement was extended to June 25, 1997. The Company and an unaffiliated corporation have an agreement that entitles the Company to sell, and the corporation to purchase, on an ongoing basis, up to $50.0 million of accounts receivable. The Company may attempt to extend the agreement or to replace the facility with a similar one or to eliminate it upon expiration.

On July 24, 1996, the Company entered into an additional five-year bank term loan for $50.0 million at a 7.3 percent annual rate of interest. The term loan pays interest semi-annually.

On October 4, 1996, the Company extended its other revolving credit agreement of $150.0 million to October 3, 1997. Interest rates can, in accordance with the option selected at the time of the borrowing, be based on prime, Eurodollar or certificate of deposit rates. Commitment fees are based on the unborrowed amount of the commitment. The credit facility contains a two-year repayment period for any amounts outstanding at the expiration of the revolving credit period.

On October 7, 1996, the Company entered into a $25.0 million, five-year term loan at an effective interest rate of 7.02 percent.

Investing

The Company's market-driven long-term investments focus in five principle areas: affordable housing, natural gas reserves, lease investments, environmental services and energy solution investments. Investments in leases for the nine months ended September 30, 1996 and 1995, were $47.0 million and $60.0 million. The Company invested $3.1 million and $33.9 million in affordable housing funds during the nine months ended September 30, 1996 and 1995. The Company also invested $5.4 million and $21.0 million in natural gas reserve partnerships during the nine months ended September 30, 1996 and 1995. In the third quarter of 1996, the Company invested $3.0 million in a fuel cell company.

Outlook

Ft. Martin Plan

On October 31, 1996 the sale of the Company's ownership interest in Ft. Martin was completed. The sale and a plan to be funded in part by the proceeds of the Ft. Martin transaction were approved by the PUC on May 23, 1996. Under the approved plan, the Company will not increase its base rates for a period of

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five years through the year 2000. In addition, the Company recorded in October 1996 a one-time reduction of approximately $130.0 million in the book value of the Company's nuclear plant investment. The proceeds from the sale are expected to be used to fund reliability enhancements to the Brunot Island Power Station (BI) combustion turbines and to reduce the Company's capitalization. The approved plan also provides for an increase of $25.0 million in depreciation and amortization expense in 1996, $50.0 million in 1997 and $75.0 million in 1998 related to the Company's nuclear investment, as well as additional annual contributions to its nuclear plant decommissioning funds of $5.0 million, without any increase in existing electric rates. Also, the Company will record an annual $5.0 million credit to the Energy Cost Rate Adjustment Clause (ECR) during the plan period to compensate the Company's electric utility customers for lost profits from any short-term power sales foregone by the sale of its ownership interest in Ft.

Martin. In addition to the annual credit of $5.0 million to the ECR, the Company will cap energy costs beginning April 1, 1997 through the remainder of the plan period, at a historical five-year average of 1.47 cents per kilowatt hour. In accordance with the approved plan, the Company has expensed $9.0 million related to the depreciation portion of the $51.1 million of deferred rate synchronization costs associated with BV Unit 2 and Perry Unit 1. Upon final transfer of its ownership interest in Ft. Martin, the Company began to amortize the remaining $42.1 million of deferred rate synchronization costs over a ten-year period. Finally, the Company's approved plan also provides for annual assistance of $0.5 million to low-income customers.

Deferred Coal Costs

The Company's regulatory assets include deferred coal costs of $11.3 million and $12.8 million at September 30, 1996 and December 31, 1995. The Company believes these deferred costs continue to represent probable future revenues recoverable under all existing energy caps. The Company will continue to monitor significant changes in the regulatory and competitive climate that would affect its ability to recover these costs from electric utility customers. (See "Regulation" discussion on page 14.)

Competition

The electric utility industry is undergoing fundamental change in response to the open transmission access and increased availability of energy alternatives fostered by the National Energy Policy Act of 1992 (NEPA), which has served to increase competition in the industry. These competitive pressures require utilities to offer competitive pricing and terms to retain customers and to develop new markets for the optimal utilization of their generation capacity.

At the national level, on April 24, 1996, the FERC issued two related final rules that address the terms on which electric utilities will be required to provide wholesale suppliers of electric energy with non-discriminatory access to the utility's wholesale transmission system. The first rule, Order No. 888, addresses both open access and stranded cost issues. Each public utility that owns, controls or operates interstate transmission facilities was required to file, no later than July 9, 1996, a tariff that offers unbundled transmission services containing non-rate terms that conform to the FERC's Order No. 888 pro forma tariff and to propose rates for these services. The Company's tariff was timely filed. Order No. 888 also provides for full recovery of those costs that

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were prudently incurred to serve wholesale (and retail-turned wholesale) customers that subsequently leave a utility's system. These costs will be recovered from the departing customers. However, the FERC will not be the forum for recovery of stranded costs arising when retail customers leave a utility's system, even if their new suppliers rely on FERC-jurisdiction transmission services, unless state regulators lack authority under state law to provide for recovery. The rule indicates FERC's willingness to defer to state regulators with respect to retail access, recovery of retail stranded costs and the scope of state regulatory jurisdiction.

The second rule, Order No. 889, is the Open Access Same Time Information rule (OASIS). This rule prohibits transmission owners and their affiliates from gaining preferential access to information concerning transmission and establishes a code of conduct to ensure the complete separation of a utility's wholesale power marketing and transmission operation functions.

Finally, the FERC simultaneously issued a new Notice of Proposed Rulemaking (NOPR) on Capacity Reservation Open Access Transmission Tariffs (CRT), which would require all market participants to reserve firm capacity rights between designated receipt and delivery points. If adopted, the CRT would replace the open access pro forma tariff implemented in Order No. 888. On July 12, 1996, the Company filed with the FERC a request for acceptance of

a CRT to replace the FERC pro forma tariff filed on July 9, 1996. (See "Transmission Access" discussion on page 21.)

In Pennsylvania, the PUC has completed its investigation concerning regulatory reform and has issued a report recommending to the governor and the Pennsylvania General Assembly that retail customers be given a choice of their electric supplier (retail choice). The report also recommends that existing transmission and distribution franchises continue to be regulated by the PUC. In addition, hearings have been held and legislation has been introduced in the Pennsylvania state legislature. A broad group of interested parties led by the Chairman of the PUC has reached a consensus on proposed amendments to previously introduced legislation. This group included legislators, customer groups, consumer advocates, small business advocates, environmental groups, labor representatives, and utility representatives. First, the proposed amendments provide for a transition period of two years, subject to two six-month extensions at the discretion of the PUC, and a two-year phase-in period. Utilities would be required to file transition plans between April 1, 1997 and September 30, 1997. The transition plans would be subject to approval by the PUC and would include the utilities' plans for the recovery and mitigation of stranded costs. Second, excluding the effects of possible extensions, retail choice would be open to 33 percent of all customer classes beginning January 1, 1999, 66 percent of all customer classes beginning January 1, 2000 and 100 percent of all customer classes beginning January 1, 2001. Finally, utilities would have an opportunity to recover stranded costs, as determined by the PUC to be just and reasonable, for recovery from customers through a competitive transition charge for a period not to exceed nine years, unless a longer period is approved by the PUC. The PUC may allow for all or a portion of the stranded costs to be securitized by the issuance of bonds. Cost savings, if any, associated with securitization of stranded costs would reduce prices to customers. An overall 4.5 year price cap would be imposed on electric utility companies. Additionally, an electric utility company may not increase the generation price component as long as stranded costs are being recovered, with certain limited exceptions. The proposed consensus amendments to the legislation

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are expected to be presented to the legislature in November 1996. The Company cannot predict what legislation, if any, may ultimately be enacted.

The Company is aware of the foregoing federal and state regulatory, legislative and business uncertainties and is attempting to position itself to operate in a more competitive environment. Because of the Company's current electric generating configuration, some of its baseload capacity is used less than optimally. The Company is currently considering ways to align its generating capabilities more closely with customer demand. Its current rate structure allows some flexibility in setting rates to retain its customer base and attract new business. In addition, despite the fact that sales to wholesale customers do not account for a significant portion of the Company's revenues, open access transmission offers the Company the opportunity to sell power on a market basis to customers outside of its geographic area.

Open access transmission requirements implicitly create the potential for stranded costs. The Company implemented a $25.0 million annual increase to depreciation and amortization expense in 1995 related to the Company's nuclear investment and continues to further evaluate the accelerated depreciation of its generating assets as one method to guard against the competitive risks of stranded investments. On October 31, 1996 the sale of the Company's ownership interest in Ft. Martin was completed. The PUC approved plan, including the sale of Ft. Martin, provides for an increase of $25.0 million in depreciation and amortization expense in 1996, $50.0 million in 1997 and $75.0 million in 1998 related to the Company's nuclear investment, as well as a one-time write-down in the book value of the Company's nuclear plant investment of approximately $130.0 million. In addition, the Company's plan recognized an immediate expense of $9.0 million of deferred rate synchronization costs and, upon final

transfer of the Company's ownership interest in Ft. Martin, the Company began to amortize the remaining $42.1 million balance over a ten-year period. (See "Ft. Martin Plan" discussion on page 18.) These current and proposed accelerated investment cost recovery measures will be absorbed by the Company without an increase in base rates. Although the Company believes the initiatives will enable it to mitigate these issues, the Company could face the risk of reduced rates of return if unforeseen costs arise and if revenues from sales or if sources of other income prove inadequate to fund those costs.

The Company believes that these and similar mitigation strategies will strengthen its position to succeed in a more competitive environment by eliminating the need to charge its electric utility customers in the future for these currently recognized expenses. At this time, however, there is no assurance as to the extent to which the Company's initiatives can or will ultimately eliminate regulatory and other uncertainties associated with increased competition.

In November 1996, the Company reached an agreement on a three year contract extension with the International Brotherhood of Electrical Workers, which represents approximately 2,000 of the Company's employees. It is the Company's intent to provide a stable work force through the transition to a competitive generation market with this contract, expiring September 30, 2001.

Transmission Access

In March 1994, the Company submitted, pursuant to the Federal Power Act, two

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separate "good faith" requests for transmission service with Allegheny Power System (APS) and the Pennsylvania-New Jersey-Maryland Interconnection Association (PJM Companies), respectively. Each request is based on 20-year firm service with flexible delivery points for 300 megawatts of transfer capability over the APS and PJM Companies transmission networks, which together extend from western Pennsylvania to the East Coast. Because of a lack of progress on pricing and other issues, on August 5 and September 16, 1994, the Company filed with the FERC applications for transmission service from the PJM Companies and APS, respectively. The applications are authorized under Section 211 of the Federal Power Act, which requires electric utilities to provide firm wholesale transmission service. In May 1995, the FERC issued proposed orders instructing APS and the PJM Companies to provide transmission service to the Company and directing the parties to negotiate specific rates, terms and conditions. The Company was unable to agree to terms for transmission service with either APS or the PJM Companies. Briefs were filed with the FERC outlining the areas of disagreement among the companies. The matter is now pending before the FERC.

On July 12, 1996, the Company filed with the FERC a request for acceptance of a capacity reservation tariff to replace the FERC pro forma tariff filed on July 9, 1996 (previously discussed in "Competition" on page 19). The tariff is intended to provide for the transition to retail customer choice in Pennsylvania. The Company's tariff proposes to adopt marginal cost pricing for transmission service on the Company transmission system. Marginal cost pricing of transmission service will ensure that generators delivering energy to the Company system will compete on the basis of their relative marginal costs. On September 10, 1996, the FERC issued an order accepting the Company's tariff filing and postponing its effectiveness for five months, or until February 11, 1997, subject to refund.

The Company is currently evaluating the impact of FERC regulatory actions on these proceedings. The Company cannot predict the final outcome of these proceedings.

Generation Resource Optimization

The Company's plans for optimizing generation resources are designed to reduce underutilized generating capacity, promote competition in the wholesale marketplace, maintain stable prices and meet customer-specified levels of service reliability. The Company is committed to exploring firm energy sales to wholesale customers, system power sales, system power sales with specific unit back-up, unit power sales, generating asset sales and any other approach to efficiently managing capacity and energy.

The sale of the Company's ownership interest in Ft. Martin demonstrates the Company's ongoing efforts to optimize the utilization of generation resources. (See "Ft. Martin Plan" discussion on page 18.) The sale is expected to reduce power production costs by employing a cost-effective source of peaking capacity through enhanced reliability of the BI combustion turbines. The reliability enhancements are contingent upon the projects meeting a least-cost test versus other potential sources of peaking capacity. Implementation of the plan will better align the Company's generating capabilities with its native load requirements.

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Except for historical information contained herein, the matters discussed in this Quarterly Report on Form 10-Q are forward-looking statements that involve risks and uncertainties including, but not limited to, economic, competitive, governmental and technological factors affecting the Company's operations, markets, products, services and prices, and other factors discussed in the Company's filings with the SEC.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In September 1995, the Company commenced arbitration against Cleveland Electric Illuminating Company (CEI), seeking damages, a declaratory judgment, termination of the Operating Agreement for Eastlake Power Station Unit 5 (Eastlake), the appointment of a special operations advisor to oversee CEI's operation of Eastlake, partition of the parties' interests in Eastlake through a sale and division of the proceeds, and other equitable relief. The arbitration demand alleged, among other things, the improper allocation by CEI of fuel and related costs; the mismanagement of the administration of the Saginaw coal contract in connection with the closing of the Saginaw mine, which historically supplied coal to Eastlake; and the concealment by CEI of material information, particularly with regard to costs relating to the closing of the Powhattan No. 6 mine contract. The Powhattan No. 6 mine currently supplies coal to Eastlake.

In October 1995, CEI commenced an action against the Company in the Court of Common Pleas, Lake County, Ohio seeking to enjoin the Company from taking any action to effect a partition, through arbitration or otherwise, on the basis of a waiver of partition contained in the deed to the land underlying Eastlake. CEI also seeks monetary damages from the Company for alleged unpaid joint costs in connection with the operation of Eastlake. It is the Company's position that the deed covenant is unenforceable by CEI due to CEI's bad faith conduct toward the Company, as described in the arbitration demand, and because it is indefinite in duration, being tied to the useful life of Eastlake. The Company removed the action to the United States District Court for the Northern District of Ohio, Eastern Division, where it is now pending, and the parties have agreed to litigate all of their disputes in federal court and to waive arbitration. The Company asserted counterclaims in the action identical to the claims made in its arbitration demand and joined CEI's parent, Centerior Energy Corporation, in the claims. Several motions have been made by both parties, among them being motions to dismiss, motions for summary judgment and a motion by the Company for the appointment of a special operations advisor. The court has not ruled on any of the motions.

Subject to these proceedings, the Company is currently soliciting offers for its ownership interest in Eastlake, located near Cleveland, Ohio and operated by Centerior Energy Corporation. The Company's 31.2 percent ownership interest represents 186 megawatts of Eastlake's output capacity.

Item 6. Exhibits and Reports on Form 8-K

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a. Exhibits:

EXHIBIT 10.1 - Resignation Agreement Between DQE and Duquesne Light Company (the Companies) and Wesley W. von Schack

EXHIBIT 27.1 - Financial Data Schedule

b. No Current Report on Form 8-K was filed during the three months ended September 30, 1996.

SIGNATURES

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

DQE
(Registrant)

Date November 14, 1996

/s/ Gary L. Schwass
(Signature)
Gary L. Schwass
Executive Vice President
and Chief Financial Officer

Date November 14, 1996

/s/ Morgan K. O'Brien
(Signature)
Morgan K. O'Brien
Controller and
Principal Accounting Officer

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Exhibit 10.1

August 2, 1996

Mr. Wesley W. von Schack
404 Beaver Road
Sewickley, PA 15143

Dear Mr. von Schack:

This letter sets forth the terms and conditions of your resignation as Chairman of the Board, President and Chief Executive Officer of DQE, Inc. ("DQE") and Duquesne Light Company ("Duquesne Light" and together with DQE sometimes hereinafter called the "Companies") effective August 9, 1996 (the "Effective Date").

Section A below describes your resignation and certain benefits you will be entitled to receive from the Companies in connection therewith. Section B sets forth certain covenants by you to the Companies. Section C contains general terms and conditions.

If you find the terms and conditions set forth in this letter agreement to be acceptable, please sign and date both this original letter and the enclosed duplicate copy hereof in the space provided on the last page and return the duplicate copy to the Company.

Section A. Resignation

1. DQE and Duquesne Light accept and acknowledge your resignation as Chairman of the Board, President and Chief Executive Officer, and as a member of the Board of Directors, of DQE, and your resignation as Chairman of the Board, President and Chief Executive Officer, and as a member of the Board of Directors, of Duquesne Light as of the Effective Date. As soon as practicable following the Effective Date, you shall receive from the Companies, subject to tax withholding as set forth in Subsection 5 Section C hereof, a lump sum payment accrued but previously unpaid salary and a payment of $120,428, representing pro rata portion of your target bonus for fiscal year 1996. For a period of one month after the Effective Date, the Companies shall, at their expense but subject to the customary employee premium contribution, continue your coverage under their medical benefits program.

2. Your resignation is accepted with the consent of the Companies for purposes of the DQE, Inc., Long-Term Incentive Plan (the "LTIP"). It is agreed that all of your stock options granted to and currently held by you are fully awarded, vested and exercisable as of the Effective Date. Except as

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provided in this paragraph, the applicable terms of the LTIP and your stock option agreements with the Companies shall remain in full force and effect.

3. Your benefits under all qualified and non-qualified retirement and 401(k) plans of the Companies in which you currently participate, including without limitation the Retirement Plan for Employees of Duquesne Light Company, the Supplemental Retirement Plan for Non-Represented Employees of Duquesne Light Company, the Duquesne Light Company 401(k) Retirement Savings Plan for Management Employees and the Duquesne Light Company Pension Service Supplement Plan, are fully vested and nonforfeitable and shall be distributed in accordance with the terms of those plans.

4. Except as expressly provided herein, the Companies shall have no obligations to you of any nature whatsoever following the Effective Date.

Section B. Certain Covenants

1. You acknowledge that all Confidential Information shall at all times remain the property of the Companies and their affiliates (i.e., another company the majority interest of which is owned by DQE or a direct or indirect subsidiary of DQE). "Confidential Information" means all information disclosed to you or known by you as a consequence of or through your employment, which is not generally known in the industry in which the Companies or any affiliate is or may become engaged, about the Companies' or an affiliate's business, products, processes, and services, including but not limited to information relating to research, development, inventions, computer program designs, flow charts, source and object codes, products and services under development, pricing and pricing strategies, marketing and selling strategies, power generating, servicing, purchasing, accounting, engineering, costs and costing strategies, sources of supply, customer lists, customer requirements, business methods or practices, training and training programs, and the documentation thereof. It includes, but is not limited to, proprietary information and trade secrets of the Companies and their affiliates. It will be presumed that information supplied to any of the Companies or their affiliates from outside sources is Confidential Information unless and until it is designated otherwise. You will not at any time directly or indirectly use, divulge, disseminate, disclose, lecture upon, or publish any Confidential Information without having first obtained written permission from the Companies to do so.

2. You covenant and agree that for a period of one (1) year following the Effective Date, you shall not engage, directly or indirectly, whether as principal or as agent, officer, director, employee, consultant, shareholder, or otherwise, alone or in association with any other person, corporation or other entity, in any Competing Business located within a 150 mile radius of the principal place of business of the Companies located in Pittsburgh, Pennsylvania or in the states of Ohio or West Virginia. For purposes of this letter agreement, the term "Competing Business" shall mean any person, corporation or other entity which develops, produces, markets, sells or services (1) any energy product or service, including but not limited to gas or electric

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products or services, and/or (2) any product or service which is the same as or similar to products or services which the Companies or their affiliates developed, produced, marketed, or sold, including but not limited to energy products and services, within the last year prior to the Effective Date. You recognize that the Companies conduct or intend to conduct business within the geographic area set forth herein, and therefore you agree that this restriction is reasonable and necessary to protect the business of the Companies.

3. You agree that for a period of two (2) years following the Effective Date, you shall not, directly or indirectly, solicit the business of, or do business with any customer, supplier, or prospective customer or supplier of the Companies or an affiliate of the Companies with whom you had direct or indirect contact or about whom you may have acquired any knowledge while employed by the Companies.

4. You agree that, for a period of two (2) years following the Effective Date, you shall not, directly or indirectly, solicit or induce, or attempt to solicit or induce, any employee of the Companies or an affiliate of the Companies to leave the Companies or an affiliate for any reason whatsoever, or hire or solicit the services of any employee of the Companies or an affiliate.

5. You acknowledge that the legal remedy available to the Companies and their affiliates for any breach of covenants by you will be inadequate, and, therefore, in the event of any threatened or actual breach of this letter agreement, the Companies or an affiliate shall be entitled to specific enforcement of this letter agreement through injunctive or other equitable relief in a court with appropriate jurisdiction. The existence of any claim or cause of action by you or another against the Companies or an affiliate, whether predicated on this letter agreement

or otherwise, shall not constitute a defense to enforcement by the Companies or an affiliate of this letter agreement.

6. On or as soon as practicable after the Effective Date, you will deliver to the Companies the originals and all copies of notes, sketches, drawings, specifications, memoranda, correspondence, documents, records, notebooks, computer disks and computer tapes and other repositories of Confidential Information and Inventions then in your possession or under your control, whether prepared by you or by others. Upon request by the Companies, you will deliver to the Companies the originals and all copies of Works then in your possession or under your control.

Section C. General Terms

1. You irrevocably and unconditionally release, remit, acquit and discharge the Companies, their respective officers, directors, agents, employees, successors and assigns (separately and collectively "releasees"),

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jointly and individually, from any and all claims, known or unknown, which you, your heirs, successors or assigns have or may have against releasees arising from and during employment, in connection with the execution and delivery of this letter agreement or as a result of termination of your employment, whether those claims are past or present, whether they arise from common law or statute, whether they arise from labor laws or discrimination laws, or any other law, rule or regulation. You specifically acknowledge that this release is applicable to any claim under the AGE DISCRIMINATION IN EMPLOYMENT ACT and the CIVIL RIGHTS ACT OF 1964. This release is for any relief, no matter what such relief is called and no matter what form it takes, including but not limited to wages, back pay, front pay, compensatory damages, punitive damages or damages for pain or suffering, or attorney fees.

2. You acknowledge that you have carefully read this letter agreement and have been advised prior to execution hereof to seek the advice of an attorney, and that this letter agreement so advises you, that you had the opportunity to have an attorney explain to you the terms of the foregoing, that you know and understand the contents of the foregoing, that you execute this document knowingly and voluntarily as your own free act and deed, and that this document was freely negotiated and entered into without fraud, duress or coercion.

3. You acknowledge that you were given adequate time in which to consider whether to execute this letter agreement before being required to make a decision.

4. You will, in all communications, discussions and actions, not express unfavorable views with regard to the Companies, their subsidiaries and other affiliates, and their respective stockholders, directors, officers, employees and agents, past and present. Likewise, the directors and officers of the Companies will not express unfavorable views with regard to you. You and the Companies will keep confidential the terms of this letter agreement except as may be required by law.

5. The parties acknowledge that certain amounts payable pursuant to this letter agreement will be subject to income tax, social security tax and other federal, state and local tax withholdings. The Companies will be entitled to withhold from any payment hereunder the amount of any federal, state and local withholding taxes applicable to the compensation and benefits provided to you under this letter agreement.

6. Any notice or other communication required or permitted under this letter agreement will be effective only if it is in writing and delivered personally or sent by registered or certified mail, postage prepaid, addressed, if to the Company, to 411 Seventh

Avenue, P. O. Box 1930, Pittsburgh, PA 15230, or if to you, to 404 Beaver Road, Sewickley, PA 15143, or to such other address as either party may designate by notice to the other, and will be deemed to be given upon receipt.

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7. If any provision of this letter agreement is determined to be invalid or unenforceable, the balance of this letter agreement will remain in effect, and if any provision is inapplicable to any person or circumstance, it will nevertheless remain applicable to all other persons and circumstances.

8. This letter agreement constitutes the entire understanding of the parties with respect to its subject matter, supersedes all prior agreements and understandings with respect to such subject matter, and may be terminated or amended only by a writing signed by the parties hereto. Without limiting the generality of the foregoing, you and the Companies hereby acknowledge the cancellation and termination in its entirety, effective immediately, of the Employment Agreement, dated as of December 15, 1992, between you and Companies, as amended.

9. The provisions of this letter agreement will be governed by and construed in accordance with the laws of the Commonwealth of Pennsylvania other than the conflict of law provisions of such laws.

10. You agree, upon demand of the Company, to do all acts and execute, deliver and perform all additional documents, instruments and agreements which may be required by the Company to implement the provisions and purposes of this letter agreement.

Very truly yours,

DQE, Inc.

By: /s/ V. A. Roque
Vice President and General Counsel

DUQUESNE LIGHT COMPANY

By: /s/ V. A. Roque
Vice President and General Counsel

Received and accepted by, and intending to be legally bound hereby:

/s/ Wesley W. von Schack	8/5/96
Wesley W. von Schack	Date

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