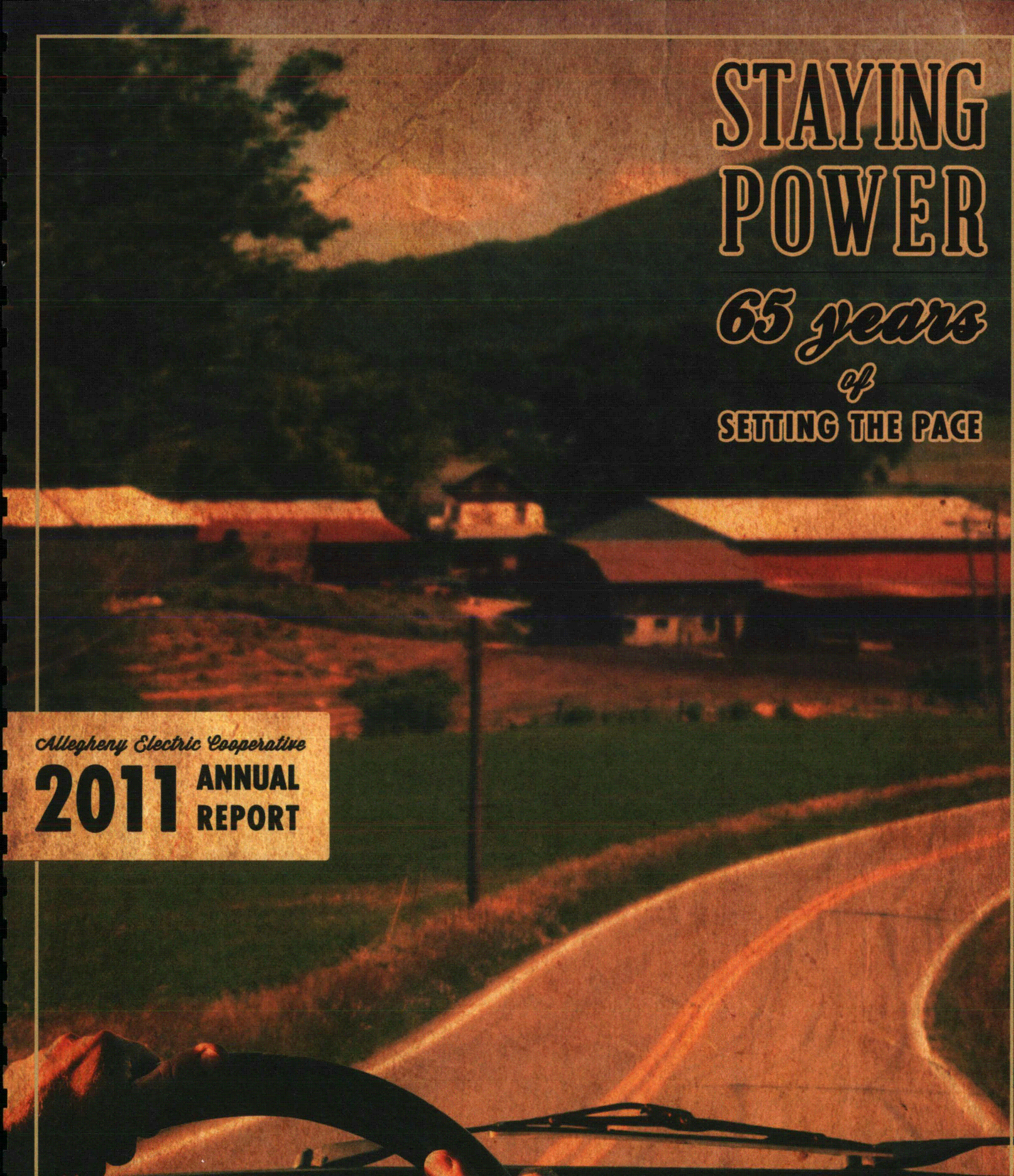
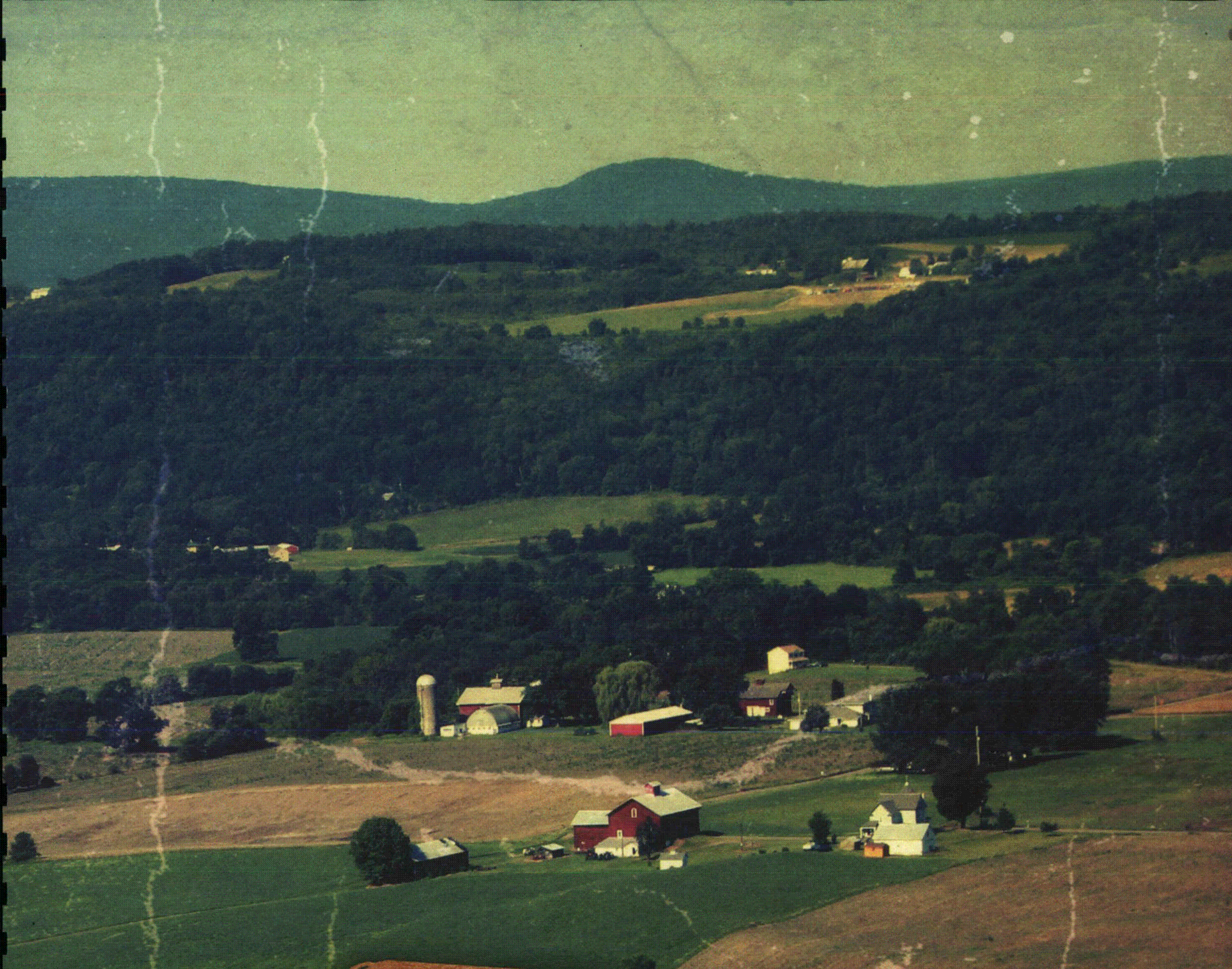


STAYING POWER

65 years of SETTING THE PACE

Allegheny Electric Cooperative

2011 ANNUAL REPORT



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№ 065

setting the pace

In 2011, Allegheny Electric Cooperative, Inc. distinguished itself as a leader in a competitive energy environment, adding to its legacy of service and reliability – while setting the pace for others to follow.

As the clock struck midnight on December 31, 2010, a new era began in Pennsylvania – one that opened the electric generation market in the state to full competition. This occurred as the remaining caps on electric utility generation rates – initiated under the electric restructuring process that began in the mid-1990s – were lifted at the close of 2010.

With the removal of rate caps, generation suppliers now operate in a fully competitive environment where rates can be influenced by industry and market changes.

DR. JAMES DAVIS
Board Chairman

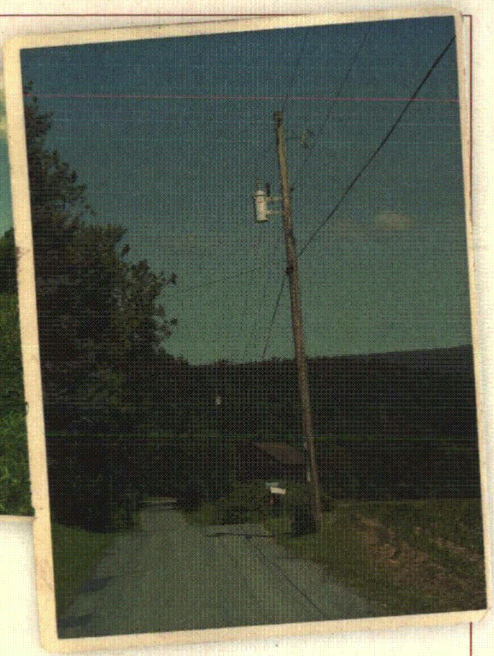
FRANK BETLEY
President & CEO

Several investor-owned utilities (IOUs) have experienced rate increases as they adjust to market-based rates. These IOUs are also seeing the emergence of alternative electric generation suppliers (EGSs) entering their service territories and marketing to their customers. Customers now have the option to switch generation providers. This era of "Electric Choice" has changed the landscape of power supply in the region.

SETTING THE PACE

On January 1, 2011, Allegheny Electric Cooperative, Inc. (Allegheny), the power provider for 14 electric distribution cooperatives in Pennsylvania and New Jersey, entered this era with the lowest generation rate in the two states. Unlike the IOUs, who sold off or transferred ownership of their generation assets under electric restructuring, Allegheny held onto its power resources. Today, this strong foundation in self-owned, baseload generation resources provides approximately two-thirds of our energy needs, leaving Allegheny and its member cooperatives much less affected by market volatility than the IOUs. As a result, Allegheny is able to deliver a very competitive rate on a consistent basis.

As IOUs suddenly had to contend with market-influenced rate increases and competition from EGSs, Allegheny's members enjoyed continued rate stability with a generation rate that set the pace for the rest of the region. In fact, Allegheny continued to deliver wholesale rates that were lower than they were in 1987 – on an actual basis, without adjusting for inflation.



Throughout 2011, Allegheny maintained this pace – with no power suppliers able to match Allegheny's rate. Given the competitive generation market today, this is a striking achievement, and one in which our cooperative program can take great pride.

This strong rate position reflects another solid year for Allegheny's performance as a generation and transmission (G&T) cooperative. Thanks to our diversified "Patchwork Quilt" of power resources, Allegheny enjoys tremendous flexibility in operational and financial matters. Having this innovative approach to power supply management in place played a key role in handling an extended maintenance outage in 2011 at our Susquehanna Steam Electric Station nuclear facility in Luzerne County. Despite the outage, we were able to quickly secure alternative power resources to maintain reliability and mitigate the impact on rates – thanks to the responsiveness and agility our Patchwork Quilt approach provides.

Also in 2011, we took advantage of a timely opportunity to become the owners of the Raystown Hydroelectric Project in Huntingdon County – a facility we have leased since it became operational in 1988. Through our strong position, we were able to respond quickly to this opportunity to acquire the facility, which has been a reliable source of renewable energy for us over the years.

SIXTY-FIVE YEARS IN THE MAKING

Year after year, this strength is evident in Allegheny's continued positive financial performance. In 2011, Allegheny recorded another year of excellent financial results. Highlighted by better-than-expected margins, our strong financial position allowed the retirement of $3.5 million in patronage capital to our members in 2011, bringing the total retired since 2006 to more than $20 million. Further, Allegheny assigned over $12 million to members as patronage capital for 2011.

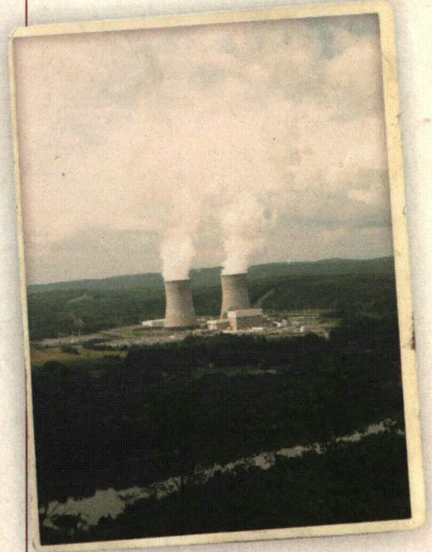
Since its inception in 1946, Allegheny has returned 28 percent of its total assigned margins to members in the form of capital credit retirements. This exceeds the national G&T average of 24.8 percent – and another indication of Allegheny's solid financial position.

That's a legacy of service and reliability that is hard to find these days. Energy companies seem to come and go, but 65 years later, Allegheny Electric Cooperative is still here and thriving. We're sticking to our core mission of delivering a reliable source of power at a competitive rate – and we're doing it better than anyone else in the region.

As Allegheny enters this new era in electric generation, there is no doubt the energy industry will continue to change. Through all the changes of the past 65 years, Allegheny has proved it has the staying power to be a leader in this industry. Moving ahead, we look forward to setting the pace for many years to come.

Allegheny in 2011 continued to show the strength of its innovative Patchwork Quilt strategy of power supply management. The strategy involves securing power in different amounts, from different sources, for different periods of time. Developed over the past several years, the plan helps further diversify Allegheny's power resources – all the more prudent, given the volatility of the energy market and difficult economic climate of the past few years.

The Patchwork Quilt plan adds complementary pieces to a solid foundation of Allegheny-owned or -controlled power resources. Combined with a strong financial position, Allegheny enjoys tremendous flexibility in being able to react to market changes and operational issues, including maintenance outages at our facilities. That strength allowed Allegheny in 2011 to continue to successfully achieve our core mission of stable and affordable wholesale power rates for our member cooperatives in Pennsylvania and New Jersey.



Here is a look at Allegheny's 2011 power supply portfolio:

SUSQUEHANNA STEAM ELECTRIC STATION

Allegheny owns 10 percent of the Susquehanna Steam Electric Station (SSES), a 2,501-megawatt, two-unit nuclear power plant located in Luzerne County, Pa. PPL Susquehanna, a division of Allentown, Pa.-based PPL Corporation, owns the remaining 90 percent and operates the boiling water reactor facility.

In 2011, this 10 percent share of SSES provided 1.74 billion kilowatt-hours of electricity to Pennsylvania and New Jersey electric cooperatives. Considering dual unit outages, the capacity factor of Unit 1 was 84.1 percent; Unit 2 achieved a calendar year capacity factor of 71.9 percent. This corresponds to an average annual composite capacity factor for the facility of 78 percent.

Both units experienced outages in 2011. Unit 1, considered by the Nuclear Regulatory Commission since 2010 to be the largest boiling water reactor in terms of thermal power and generating capacity, was offline for 39 days for replacement of turbine blades. The planned refueling outage of 40 days for Unit 2 was extended to 89 days for turbine blade replacements as well.

The extended power uprate for Unit 2, which increased the plant's output to a nominal 1,250 MW of electricity, also was completed during the refueling outage.

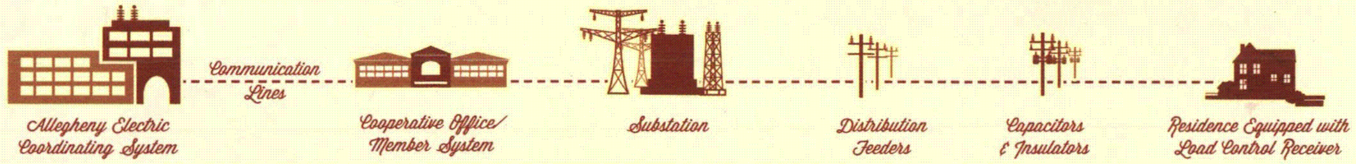
RAYSTOWN HYDROELECTRIC PROJECT

Allegheny's Raystown Hydroelectric Project is a two-unit, 21-megawatt, run-of-river hydropower facility located at Raystown Lake and Dam in Huntingdon County, Pa. Thanks to favorable weather conditions, Raystown had a near-record production year in 2011, providing approximately 113 million kilowatt-hours and equating to 3.6 percent of Allegheny's requirements for the year. The plant maintained a 99 percent availability.

In October of 2011, Allegheny successfully completed the purchase of the lease agreement that has been in place

how it works :

Coordinated Load Management System



since 1988 for the Raystown hydropower facility. As a result of the purchase, Allegheny became the lease owner while continuing in the position of the lessee. Staff began efforts to eliminate other lease structure components and to reflect Allegheny as the sole Federal Energy Regulatory Commission hydro license holder.

Allegheny staff operates the hydroelectric project in close cooperation with the Baltimore District of the U.S. Army Corps of Engineers, which controls water releases from Raystown Lake, the largest man-made body of water in Pennsylvania.

NEW YORK POWER AUTHORITY

Since 1966, Allegheny has purchased power generated by hydroelectric projects located along the Niagara and St. Lawrence rivers in upstate New York. Both facilities are operated by the New York Power Authority (NYPA).

In 2011, Allegheny received an allocation of 33 megawatts from the projects for the benefit of the 14 member cooperatives. Since 1966, it is estimated that NYPA generation has saved the electric distribution cooperatives $357 million ($10.8 million in 2011), compared to the cost of purchasing the same amount of electricity from other sources.

LOAD MANAGEMENT

In 1986, Allegheny and its member electric distribution cooperatives in Pennsylvania and New Jersey launched the Coordinated Load Management System (CLMS) to reduce electricity consumption during peak demand periods.

By shifting use of residential water heaters, electric thermal units, dual fuel home heating systems and other special equipment in the homes of volunteer cooperative consumer-members to off-peak hours, the CLMS improves system efficiency, cuts costly demand and transmission charges Allegheny and its member cooperatives must pay for purchased power, and reduces the need for new generating capacity. The system reduces transmission zone peaks and, during summer peaks, reduces Allegheny's capacity obligation under procedures established by the PJM Interconnection.

Over the past year, the CLMS reduced cooperative purchased power costs by more than $5.3 million, bringing total net power cost savings achieved since December 1986 to more than $107.1 million. Currently, 204 substations are being utilized for load control with approximately 50,600 load control receivers installed on appliances (mostly water heaters) in the homes of electric cooperative consumer-members.

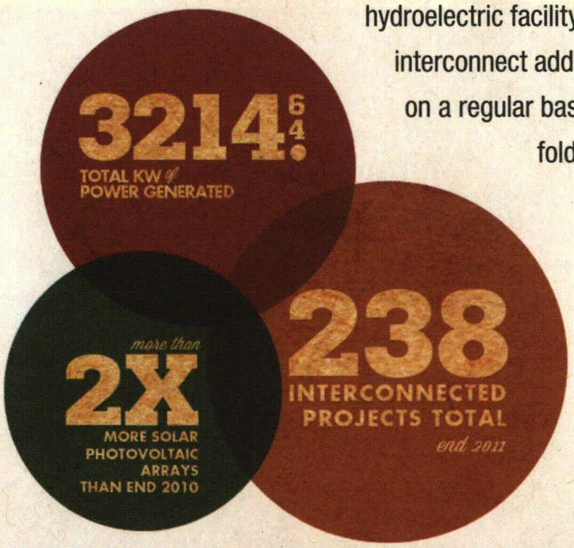
Beginning in 2007, Allegheny took steps to update the system. New CLMS-related equipment was placed on-line beginning in 2008 and by the end of 2009, Allegheny's member cooperatives were in the process of installing new field equipment in their respective substations. At the end of 2011, field equipment installations were completed at 159 of the 204 substations. The participating member cooperatives have also installed 20,248 new vendor load control switches. These new switches are currently controlled by Allegheny.

Clean Power COMMITMENT

Allegheny and its 14 member cooperatives continue to be very active in meeting consumer-members' desires to support energy efficiency, clean and renewable energy generation, and a secure energy future for electric cooperatives. In addition to Allegheny's investments in clean and carbon-free nuclear and hydro-power resources, and our demand-side efficiency measures, here are some of our other initiatives for a better environment:

INTERCONNECTED PROJECTS

Allegheny and its member distribution cooperatives actively worked with cooperative consumer-members who were considering the addition of renewable energy projects to their homes or businesses. By the end of 2011, there were 238 consumer-member-owned renewable energy projects that had been interconnected, including six digesters, 47 wind turbines, 184 solar photovoltaic arrays, and one small hydroelectric facility. We expect to interconnect additional projects on a regular basis. See map on foldout, next page.

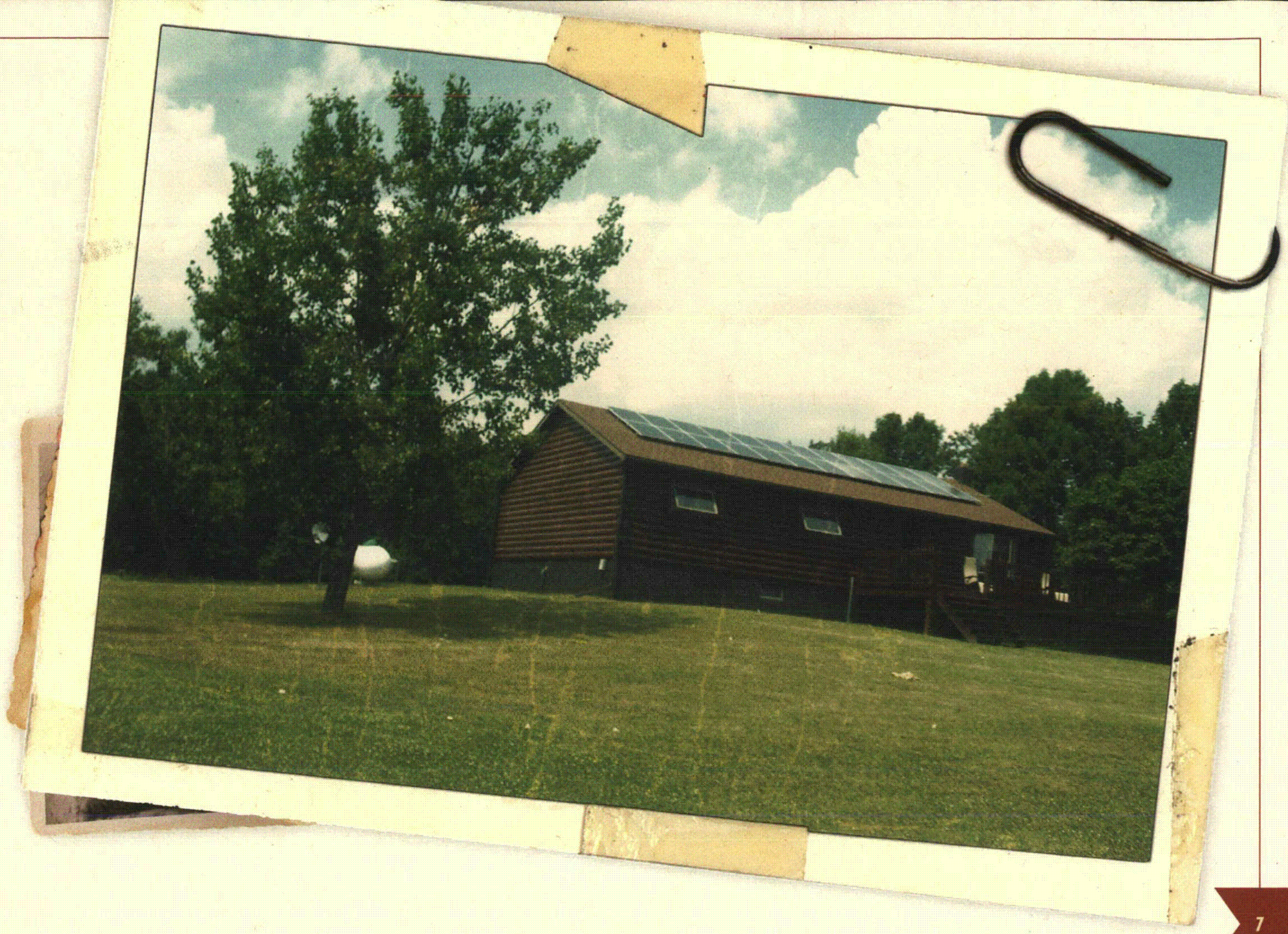


RENEWABLE ENERGY ASSISTANCE PROGRAM

As a positive partner in the Commonwealth's alternative energy initiatives, Allegheny provides a program to assist cooperative consumer-members who want to install a clean energy generation system at their home, farm or business. The Renewable Energy Assistance Program (REAP) provides grants to electric distribution cooperatives to help cover various interconnection costs, such as metering equipment and distribution transformers. The program also pays for certain transitional costs to help ensure that other electric cooperative consumer-members do not subsidize the operation or installation of small renewable energy generation systems – such as anaerobic digesters, wind turbines or solar units. Since 2006, REAP has provided nearly $345,000 in interconnection grants among 11 member cooperatives. In many ways, REAP reflects the electric cooperative tradition of members helping members, and continues to strengthen Allegheny's history of addressing environmental and energy challenges in a cost-effective and fair way.

ENVIRONMENTALLY FRIENDLY HYDROELECTRIC POWER

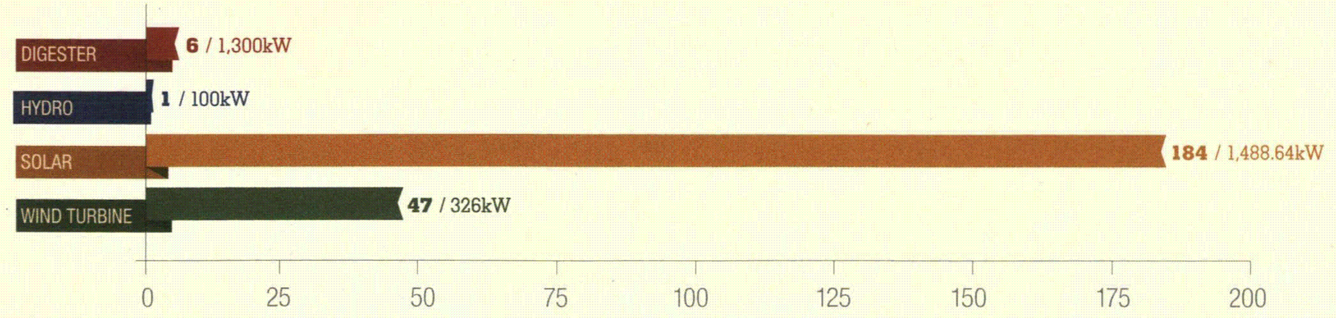
In July 2009, our Raystown Hydroelectric Project was recognized as a Pennsylvania Tier 1 renewable generation resource by the Commonwealth's Alternative Energy Program Administrator. The certification as a Tier 1 resource allows Allegheny to market renewable energy certificates (RECs) generated by the plant to other load-serving entities



in the Commonwealth. Allegheny can also market Raystown RECs as Class II resources in New Jersey. Revenue from the sale of Raystown Hydroelectric Project RECs provides funding for our Renewable Energy Assistance Program. This follows the plant's 2007 certification as a low-impact hydroelectric facility by the Low Impact Hydropower Institute. Raystown is the first and remains the only hydro plant in Pennsylvania to earn this distinction for environmental stewardship.

Since 1966, through long-term contracts with the New York Power Authority, Allegheny has also enjoyed a steady flow of clean, reliable power generated by hydroelectric projects located along the Niagara and St. Lawrence rivers in upstate New York. The low-cost power has saved consumers millions, while also reducing the need to secure alternative (and more costly) generation.

TOTAL INTERCONNECTED PROJECTS *(end 2011)* :: 238



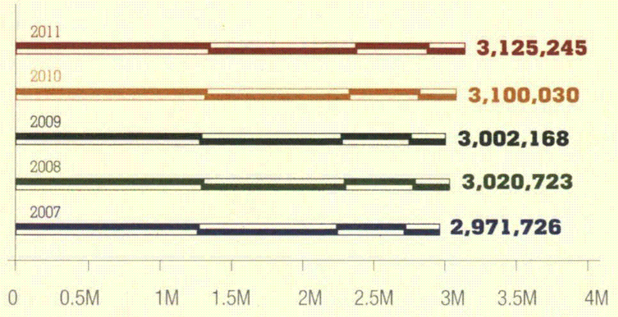
NUMBER OF UNITS
3214.64 TOTAL kW

open here to learn more about our interconnected projects

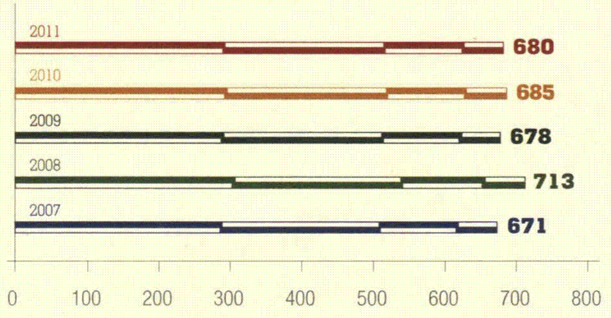
ABOUT ALLEGHENY ELECTRIC COOPERATIVE, INC.

Electricity — powering our lives each day with heat, light, sound and motion. At Allegheny Electric Cooperative, Inc., a dedicated and experienced team of board members, management, and employees makes certain that wholesale electricity is provided round-the-clock to 14 member electric distribution cooperatives in Pennsylvania and New Jersey. In turn, those 14 member distribution cooperatives own and control Allegheny.

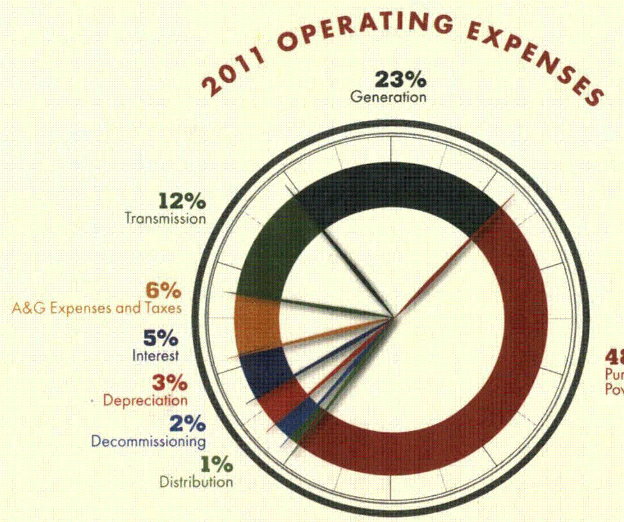
The cooperative electric systems comprising the Allegheny "family" maintain approximately 12.5 percent of all electric distribution lines in Pennsylvania, spanning one-third of the Commonwealth in 42 counties. New Jersey's lone electric cooperative maintains roughly 1 percent of the Garden State's total miles of line. Through these facilities, Allegheny member cooperatives deliver electricity to more than 230,000 homes, farms, small businesses, and industries with a combination of integrity, accountability, innovation, and commitment to community.

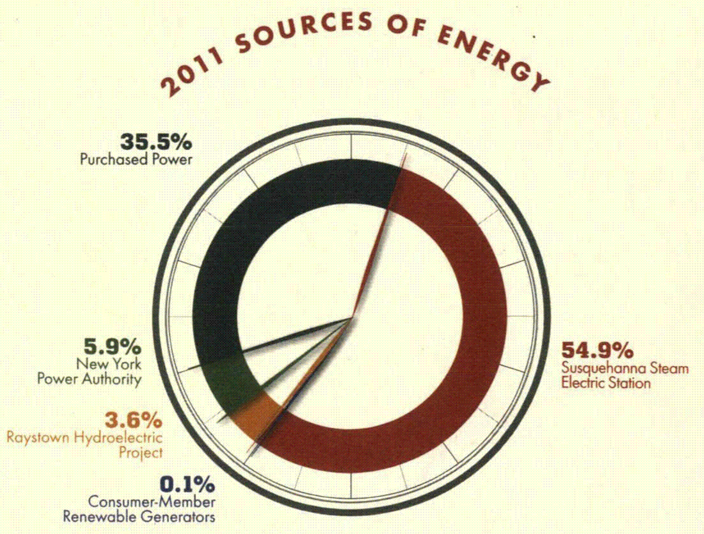


HISTORIC ENERGY SALES TO MEMBERS (MWh)
2007–2011



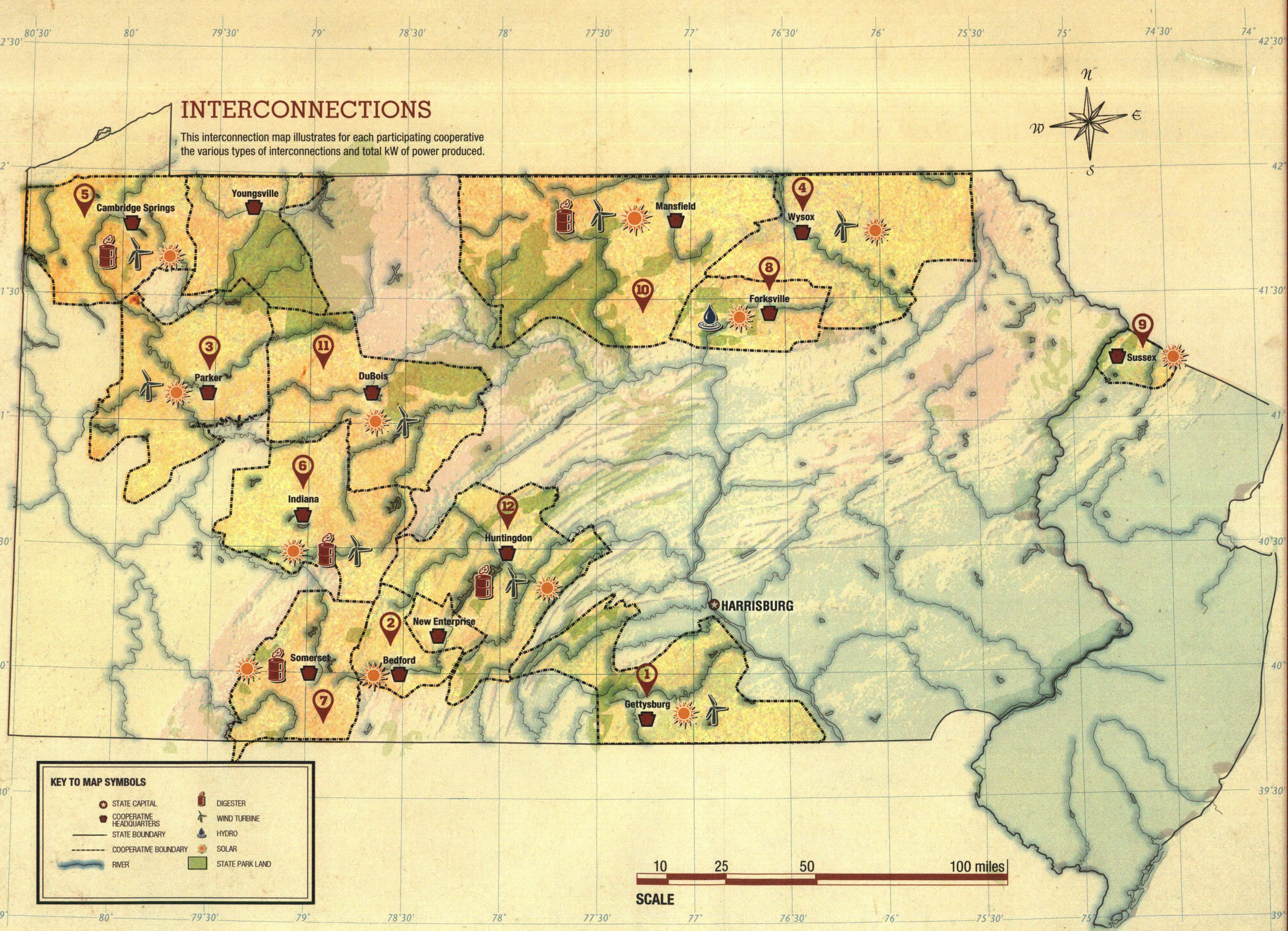
PEAK DEMAND (MW)
2007–2011





INTERCONNECTIONS

This interconnection map illustrates for each participating cooperative the various types of interconnections and total kW of power produced.



1 Adams Electric Cooperative, Inc.
112 | 2
960.78 total kW

2 Bedford Rural Electric Cooperative, Inc.
1
3.5 total kW

3 Central Electric Cooperative, Inc.
5 | 1
31.24 total kW

4 Claverack Rural Electric Cooperative, Inc.
21 | 15
241.20 total kW

5 Northwestern Rural Electric Cooperative Association, Inc.
5 | 7 | 1
677.85 total kW

6 REA Energy Cooperative, Inc.
6 | 1 | 1
138.75 total kW

7 Somerset Rural Electric Cooperative, Inc.
3 | 2
479.84 total kW

8 Sullivan County Rural Electric Cooperative, Inc.
6 | 1
142.43 total kW

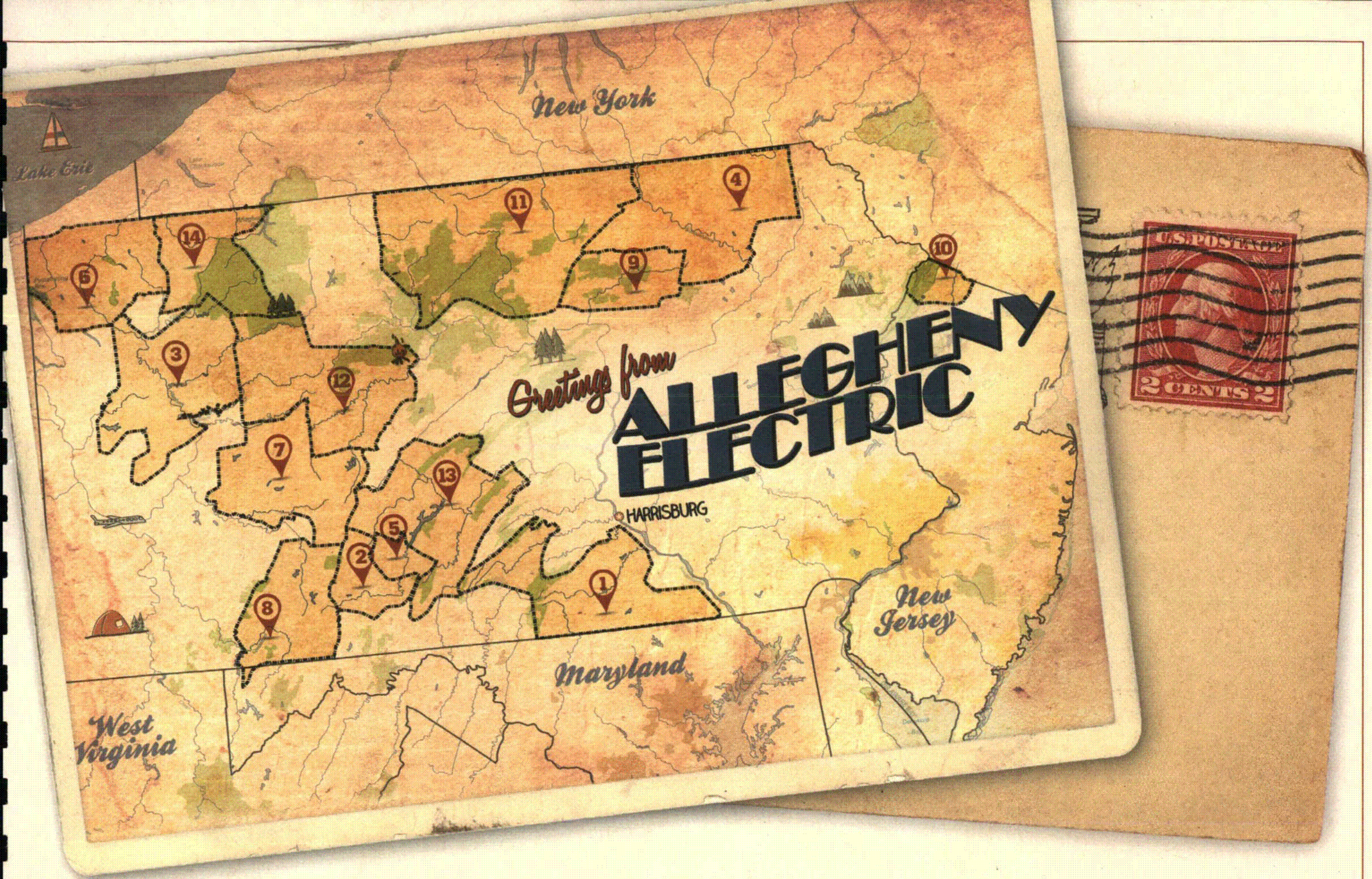
9 Sussex Rural Electric Cooperative, Inc.
5
34.28 total kW

10 Tri-County Rural Electric Cooperative, Inc.
7 | 4 | 1
221.46 total kW

11 United Electric Cooperative, Inc.
5 | 8
51.5 total kW

12 Valley Rural Electric Cooperative, Inc.
8 | 9 | 1
231.81 total kW

3214.64 TOTAL kW



ALLEGHENY ELECTRIC COOPERATIVE, INC. TERRITORY

1. **Adams Electric Cooperative, Inc.**
Gettysburg, Pa.
2. **Bedford Rural Electric Cooperative, Inc.**
Bedford, Pa.
3. **Central Electric Cooperative, Inc.**
Parker, Pa.
4. **Claverack Rural Electric Cooperative, Inc.**
Wysox, Pa.
5. **New Enterprise Rural Electric Cooperative, Inc.**
New Enterprise, Pa.
6. **Northwestern Rural Electric Cooperative Association, Inc.**
Cambridge Springs, Pa.
7. **REA Energy Cooperative, Inc.**
Indiana, Pa.
8. **Somerset Rural Electric Cooperative, Inc.**
Somerset, Pa.
9. **Sullivan County Rural Electric Cooperative, Inc.**
Forksville, Pa.
10. **Sussex Rural Electric Cooperative, Inc.**
Sussex, N.J.
11. **Tri-County Rural Electric Cooperative, Inc.**
Mansfield, Pa.
12. **United Electric Cooperative, Inc.**
DuBois, Pa.
13. **Valley Rural Electric Cooperative, Inc.**
Huntingdon, Pa.
14. **Warren Electric Cooperative, Inc.**
Youngsville, Pa.

2011 FACT SHEET

ENERGY SALES *to* MEMBERS
3,125,245 MWh

NET MARGINS
$15,323,000

TOTAL CONSOLIDATED *Operating Revenue*
$227,937,000

TOTAL ASSETS
$470,446,000

85 MILES *of* TRANSMISSION LINE

TOTAL *Retail Customers*
230,995

SYSTEM RATE
5.93 *cents per kWh*

2011 PEAK DEMAND
680 MW

Allegheny Electric Cooperative, Inc.

2011 BOARD of DIRECTORS

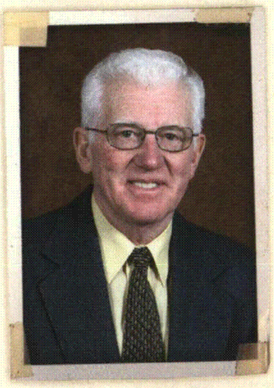
Dr. James Davis
Chairman
Director, Tri-County REC

Curtin Rakestraw II
Vice Chairman
Director, Sullivan County REC

Jay Grove
Secretary
Director, Adams EC

Kathryn Cooper-Winters
Treasurer
Director, Northwestern RECA

Robert Guyer
Director, New Enterprise REC



Herman Blakley
Director, REA Energy

Lowell Friedline
Director, Somerset REC

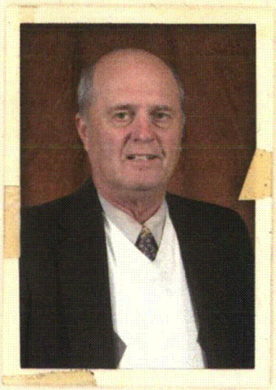
Allegheny Electric Cooperative, Inc.

2011 SENIOR MANAGEMENT TEAM

Frank Betley
President & CEO

Laurence Bladen
Vice President
Strategic & Corporate Services

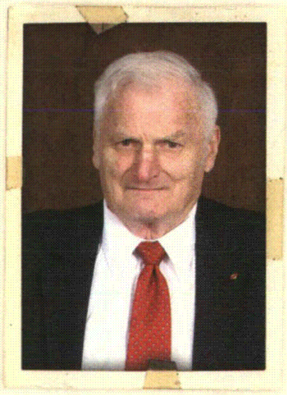
Stephen Brame
Vice President
Public Affairs &
Member Services



C. Robert Koontz
Director, Bedford REC

Richard Weaver
Director, Central EC

Thomas Elliott
Director, Claverack REC



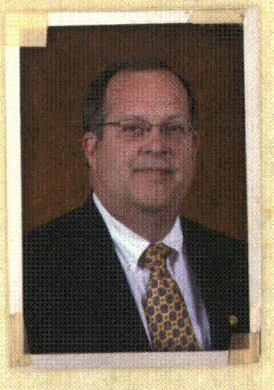
Thomas Webb
Director, Sussex REC

Stephen Marshall
Director, United Electric

Robert Holmes
Director, Valley REC

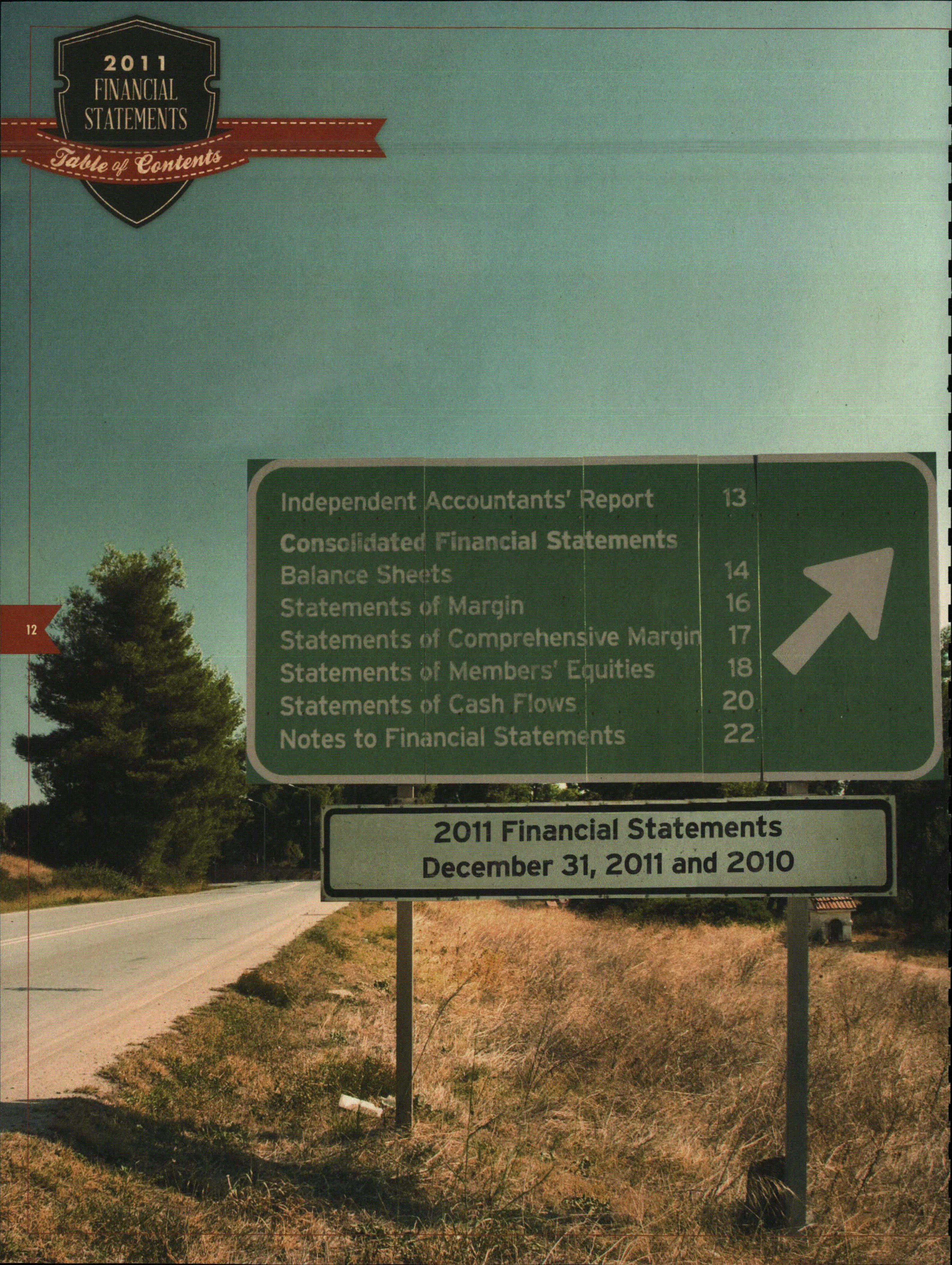
Dave Turner
Director, Warren EC

Craig Colantoni
Vice President
Finance & Accounting



David Dulick
General Counsel

Todd Sallade
Vice President
Power Supply & Engineering



BKD LLP
CPAs & Advisors

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Decatur, IL 62525-1580
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Independent Accountants' Report

Board of Directors
Allegheny Electric Cooperative, Inc.
Harrisburg, Pennsylvania

We have audited the accompanying consolidated balance sheets of Allegheny Electric Cooperative, Inc. (Cooperative) as of December 31, 2011 and 2010, and the related consolidated statements of margin, comprehensive margin, members' equities, and cash flows for the years then ended. These financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Allegheny Electric Cooperative, Inc. as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

April 24, 2012

CONSOLIDATED BALANCE SHEETS

{IN THOUSANDS}

DECEMBER 31, 2011 AND 2010

ASSETS	2011	2010
Electric Utility Plant, at cost		
In service (see Note 2)	$ 918,250	$ 868,151
Less accumulated depreciation	(723,994)	(710,597)
	194,256	157,554
Construction work in progress	6,737	10,940
Nuclear fuel in process (see Notes 1 and 3)	32,110	29,235
Net electric utility plant (see Notes 1, 2 and 3)	233,103	197,729
Investments and Other Assets		
Investments in associated organizations (see Note 4)	27,490	27,556
Nuclear Decommissioning Trust (NDT) (see Notes 1 and 5)	79,497	73,080
Non-utility property, at cost (net of accumulated depreciation of $6,563 in 2011 and $6,254 in 2010)	5,824	4,171
Assets of consolidated variable interest entity		
Non-utility property, at cost (net of accumulated depreciation of $1,058 in 2011 and $1,052 in 2010)	15	21
Deferred tax assets, net (see Note 10)	9,357	12,927
Derivative investments (see Note 6)	4,665	10,677
Other noncurrent assets	435	11,435
	127,283	139,867
Current Assets		
Cash and cash equivalents	15,207	31,345
Investments (see Notes 1 and 4)	45,264	57,167
Derivative investments (see Note 6)	10,843	30,087
Accounts receivable, members (see Note 1)	17,062	16,560
Accounts receivable, affiliated organization	-	4
Other receivables	1,738	825
Inventories (see Note 1)	8,669	8,516
Other current assets	1,541	2,582
Assets of consolidated variable interest entities		
Cash and cash equivalents	860	543
Accounts receivable, affiliated organization	14	174
Other receivables	9	10
Other current assets	1,139	755
Total current assets	102,346	148,568
Deferred Charges (see Note 7)		
Capital retirement asset	-	957
Deferred asset plan - NDT investments	3,869	3,315
Deferred asset plan - forward swaps	3,832	6,886
Other	13	25
	7,714	11,183
Total assets	**$ 470,446**	**$ 497,347**

MEMBERS' EQUITIES AND LIABILITIES	2011	2010
Members' Equities (see Note 1)		
Membership fees	$ 3	$ 3
Patronage capital	59,939	54,369
Donated capital	38	38
Unrestricted net assets	100	100
Retained earnings	15,323	9,123
Members' equities	75,403	63,633
Accumulated other comprehensive income	15,352	14,158
Total equities	90,755	77,791
Asset Retirement Obligation (see Note 8)	148,050	142,355
Long-Term Debt (see Note 9)	165,119	152,401
Current Liabilities		
Current installments of long-term debt	7,164	5,858
Financial transmission rights (see Note 6)	4,665	7,618
Derivative liability - forward swaps (see Note 6)	9,097	25,524
Accounts payable and accrued expenses	18,029	19,080
Accounts payable, affiliated organization	10	3
Liabilities of consolidated variable interest entities		
Accounts payable and accrued expenses	1,488	1,996
Accrued postretirement benefit cost (see Note 13)	311	216
Accounts payable, affiliated organization	88	88
Total current liabilities	40,852	60,383
Other Liabilities and Deferred Revenue		
Deferred income tax obligation from safe harbor lease (see Note 15)	308	617
Financial transmission rights (see Note 6)	5,577	5,412
Derivative liability - forward swaps (see Note 6)	-	9,097
Deferred credits (see Note 16)	19,785	49,291
	25,670	64,417
Total liabilities and members' equities	**$ 470,446**	**$ 497,347**

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS of MARGIN

{IN THOUSANDS}

years ended DECEMBER 31, 2011 AND 2010

	2011	2010
Operating Revenues	$ 227,937	$ 204,921
Operating Expenses		
Operations		
Purchased capacity and energy costs	109,453	97,160
Transmission		
Operation	28,307	23,871
Maintenance	310	255
Production		
Operation	26,816	25,177
Maintenance	15,018	13,160
Fuel	10,847	10,586
Depreciation	6,631	5,822
Accretion of asset retirement obligation	5,695	5,475
Amortization of capital retirement asset	957	54
Administrative and general	12,234	11,676
Property and other taxes	547	728
Total Operating Expenses Before Interest	216,815	193,964
Operating Margin Before Interest Expense	11,122	10,957
Interest Expense	(10,445)	(10,467)
Operating Margin	677	490
Non-operating Margins		
Non-operating rental income	1,489	1,399
Non-operating rental expense	(1,442)	(1,367)
Interest income	5,504	6,061
Settlement proceeds	6,818	-
Capital credits and other income	2,277	2,540
	14,646	8,633
Net Margin	**$ 15,323**	**$ 9,123**

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS of COMPREHENSIVE MARGIN

{IN THOUSANDS}

	2011	2010
Net Margin	**$ 15,323**	**$ 9,123**
Other Comprehensive Margin		
Postretirement benefit plan	(77)	17
Unrealized appreciation in investments	1,271	4,444
Comprehensive Margin	**$ 16,517**	**$ 13,584**

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS of MEMBERS' EQUITIES

{IN THOUSANDS}

years ended DECEMBER 31, 2011 AND 2010

	MEMBERSHIP FEES	DONATED CAPITAL	PATRONAGE CAPITAL
Balance, January 1, 2010	$ 3	$ 38	$ 49,462
Patronage capital retirement	-	-	(3,010)
Patronage capital assignment	-	-	7,058
Patronage capital - NDT (earnings) losses	-	-	859
Net margin	-	-	-
Transfer of postretirement benefit obligation	-	-	-
Other comprehensive margin	-	-	-
Balance, December 31, 2010	3	38	54,369
Patronage capital retirement	-	-	(3,553)
Patronage capital assignment	-	-	6,262
Patronage capital - NDT (earnings) losses	-	-	2,861
Net margin	-	-	-
Other comprehensive margin	-	-	-
Balance, December 31, 2011	**$ 3**	**$ 38**	**$ 59,939**

UNRESTRICTED NET ASSETS	RETAINED EARNINGS	TOTAL MEMBERS' EQUITIES	ACCUMULATED OTHER COMPREHENSIVE MARGIN	TOTAL EQUITIES
$ 100	$ 7,917	$ 57,520	$ 9,826	$ 67,346
-	-	(3,010)	-	(3,010)
-	(7,058)	-	-	-
-	(859)	-	-	-
-	9,123	9,123	-	9,123
-	-	-	(129)	(129)
-	-	-	4,461	4,461
100	9,123	63,633	14,158	77,791
-	-	(3,553)	-	(3,553)
-	(6,262)	-	-	-
-	(2,861)	-	-	-
-	15,323	15,323	-	15,323
-	-	-	1,194	1,194
$ 100	**$ 15,323**	**$ 75,403**	**$ 15,352**	**$ 90,755**

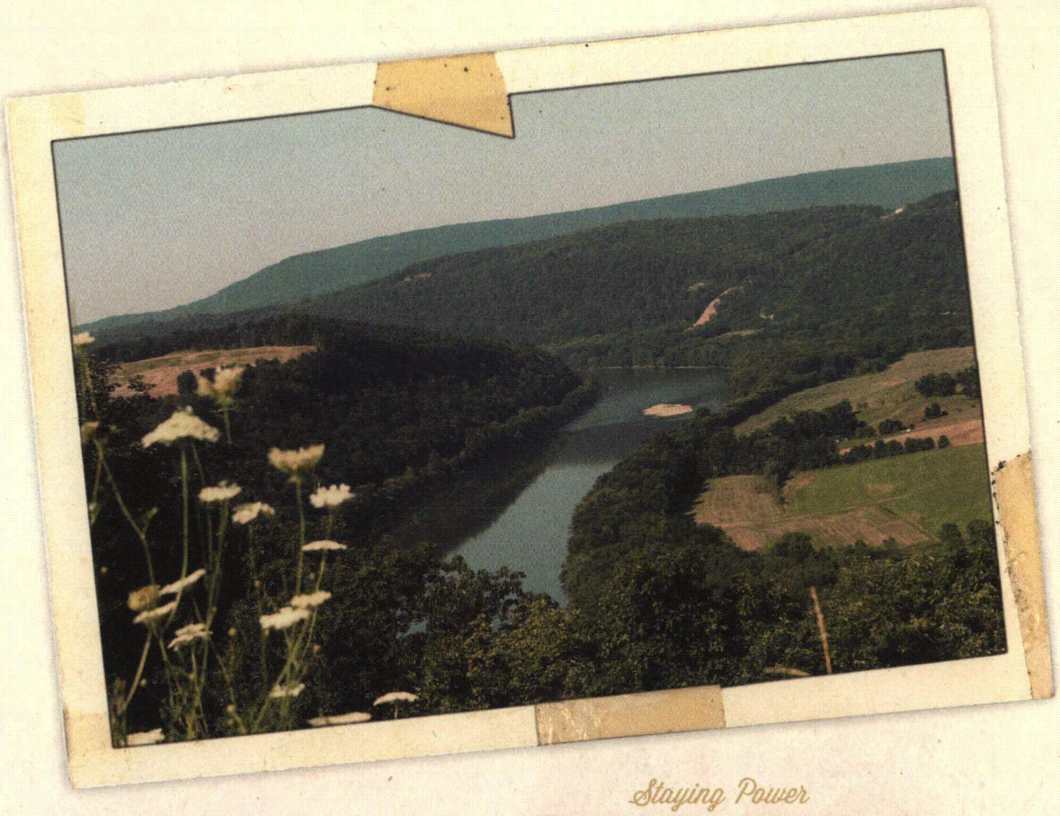
See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS of CASH FLOWS

(IN THOUSANDS)

years ended DECEMBER 31, 2011 AND 2010

	2011	2010
Operating Activities		
Net margin	$ 15,323	$ 9,123
Items not requiring (providing) cash		
Depreciation and fuel amortization	16,294	14,498
Amortization of capital retirement asset	957	53
Accretion of asset retirement obligation	5,695	5,475
Deferred income taxes	3,570	(1,069)
Loss on disposal of equipment	393	9
Other than temporary losses	909	-
Change in		
Investments in associated organizations	66	12
Accounts receivable, members	(502)	(69)
Other receivables	(912)	(359)
Inventories	(153)	2,702
Derivative investments	25,256	(11,594)
Other current and non-current assets	11,657	(1,865)
Accounts payable and accrued expenses	(1,559)	1,872
Accounts payable, affiliated organizations	171	(196)
Derivative liability - forward swaps	(25,524)	9,334
Financial transmission rights	(2,788)	(23)
Accrued postretirement benefit	18	-
Other liabilities and deferred charges	(27,303)	(7,798)
Net cash provided by operating activities	21,568	20,105



	2011	2010
Investing Activities		
Additions to electric utility plant and non-utility property, net	(43,742)	(31,016)
Proceeds from investments, net	11,640	18,325
Purchase of other investments	(5,792)	(5,836)
Net cash used in investing activities	(37,894)	(18,527)
Financing Activities		
Principal payments on long-term debt	(5,942)	(5,468)
Proceeds from issuance of long-term debt	10,000	-
Patronage capital retirement	(3,553)	(3,010)
Net cash provided by (used in) financing activities	505	(8,478)
Net Decrease in Cash and Cash Equivalents	(15,821)	(6,900)
Cash and Cash Equivalents, Beginning of Year	31,888	38,788
Cash and Cash Equivalents, End of Year	**$ 16,067**	**$ 31,888**
Supplemental Cash Flows Information		
Interest paid	$ 10,438	$ 10,521
Income tax received (paid)	200	(375)
Plant purchased with long-term debt	9,966	-

See Notes to Consolidated Financial Statements

NOTE 1: NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Allegheny Electric Cooperative, Inc. (Cooperative) is a rural electric cooperative corporation established under the laws of the Commonwealth of Pennsylvania. The Cooperative extends unsecured credit to its members, with credit extended to two members of 18% and 13%, respectively, and one member of 18% of accounts receivable at December 31, 2011 and 2010, respectively. The Cooperative either finances or obtains approval for 100 percent of its outstanding debt with the National Rural Utilities Cooperative Finance Corporation (CFC).

The Cooperative is a generation and transmission cooperative. The member cooperatives' primary service areas are rural areas throughout much of Pennsylvania and a portion of New Jersey. The Cooperative's primary operating asset is its 10 percent undivided interest in the Susquehanna Steam Electric Station (SSES), a 2,501-megawatt, two-unit nuclear power plant, co-owned by a subsidiary of PPL Corporation (PPL).

The Board of Directors of the Cooperative, elected by its members, has full authority to establish electric rates to its member cooperatives. Rates are established on a cost of service basis. The Cooperative's Board of Directors has established a deferred revenue account to offset future increases in power supply costs.

Principles of Consolidation

The financial statements include the accounts of the Cooperative and a variable interest entity, Continental Electric Cooperative Services, Inc. (CCS), of which the Cooperative has determined it is the primary beneficiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

Variable Interest Entity and Change in Accounting Principle

A legal entity is referred to as a variable interest entity (VIE) if any of the following conditions exist: (1) the total equity investment at risk is insufficient to permit the legal entity to finance its activities without additional subordinated financial support from other parties, or (2) the entity has equity investors who cannot make significant decisions about the entity's operations or who do not absorb their proportionate share of the expected losses or receive the expected returns of the entity.

A VIE's primary beneficiary is the entity that has the power to direct the VIE's significant activities and has an obligation to absorb losses or the right to receive benefits that could be potentially significant to the VIE.

A VIE must be consolidated by the Cooperative if it is deemed to be the primary beneficiary of the VIE.

All facts and circumstances are taken into consideration when determining whether the Cooperative has variable interests that would deem it the primary beneficiary and, therefore, require consolidation of the related VIE or otherwise rise to the level where disclosure would provide useful information to the users of the Cooperative's financial statements. In many cases, it is qualitatively clear whether the Cooperative has the power to direct the activities significant to the VIE. In other cases, a more detailed qualitative analysis and possibly a quantitative analysis are required to make such a determination.

The Cooperative monitors the consolidated VIE to determine if any reconsideration events have occurred that could cause it to no longer be a VIE. The Cooperative reconsiders whether it is the primary beneficiary of a VIE on an ongoing basis. A previously consolidated VIE is deconsolidated when the Cooperative ceases to be the primary beneficiary or the entity is no longer a VIE.

CCS is considered to be a variable interest entity and the Cooperative is determined to be the primary beneficiary of CCS. As such, the assets, liabilities, and results of operations have been consolidated into these financial statements.

Basis of Accounting

The Cooperative substantially maintains its accounting records in accordance with the Federal Energy Regulatory Commission's (FERC) uniform system of accounts as modified and adopted by the U.S. Department of Agriculture, Rural Utilities Service (RUS).

In accordance with FERC guidelines, the Cooperative also maintains its accounts in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 980, *Regulated Operations*.

Deregulation

Pennsylvania retail electric customers have the choice of selecting the power supplier, or generator, from which they buy electricity. The ability to choose alternative energy suppliers has not significantly affected the Cooperative's operations or ability to recover its costs through future rates charged to its members.

On a regular basis, the Cooperative re-evaluates its application of FASB ASC Topic 980, *Regulated Operations*, and Topic 980-20, *Discontinuation of Rate Regulated Accounting*. The Cooperative has determined that regulatory assets and liabilities should continue to be accounted for under the provisions of Topic 980 because it is reasonable to assume that the Cooperative will continue to be able to charge and collect its cost of service-based rates.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 report, and the reported amounts of revenues and expenses during the years then ended. Actual results could differ from those estimates.

Electric Utility Plant

Electric utility plant is carried at cost. Depreciation of electric utility plant is provided over the estimated useful lives of the respective assets on a straight-line basis, except for nuclear fuel, as follows:

Nuclear Utility Plant Production	**Remaining License Life (Extended to 2044)**
Transmission	2.75%
General plant	3%-12.5%
Nuclear fuel	Units of heat production
Non-Nuclear Utility Plant	3%-33%
Hydroelectric Production Plant	5%

Maintenance and repairs of property, and replacements and renewals of items determined to be less than units of property are charged to expense. Replacements and renewals of items considered to be units of property are charged to the property accounts. At the time properties are disposed of, the original cost, plus cost of removal less salvage of such property, is charged to accumulated depreciation.

Non-utility Property

Non-utility property acquisitions are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is charged to expense on a straight-line basis over the estimated useful life of each asset.

The estimated useful lives of non-utility property range from 3 to 50 years.

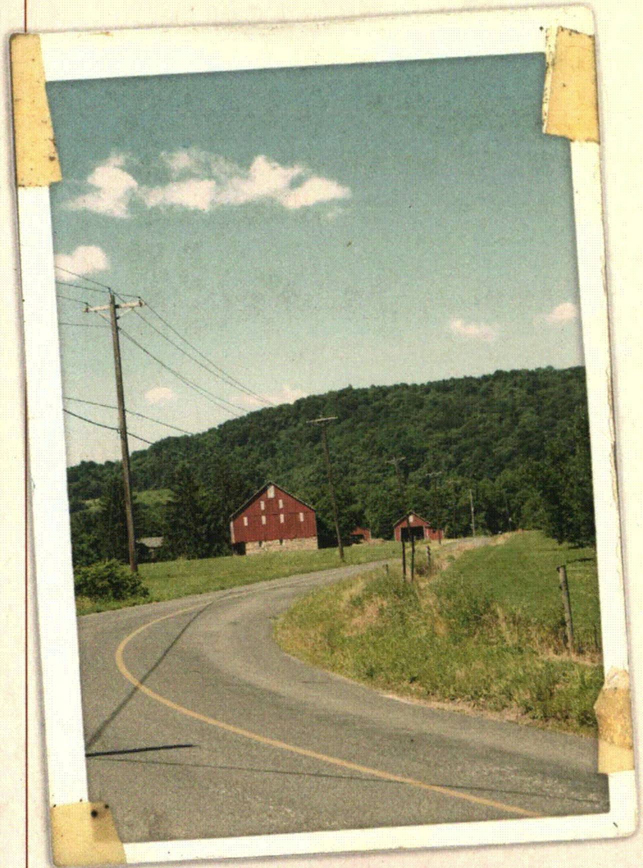
Nuclear Fuel

Nuclear fuel is charged to fuel expense based on the quantity of heat produced for electric generation. Under the Nuclear Waste Policy Act of 1982, the U.S. Department of Energy (DOE) is responsible for the permanent storage and disposal of spent nuclear fuel removed from nuclear reactors. The Cooperative currently pays PPL for its portion of DOE fees for such future disposal services. During 2011, the Cooperative received a cash settlement related to the permanent storage and disposal of spent nuclear fuel as reported in non-operating margins in the consolidated statements of margins.

Investments

Investments are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

For debt securities with fair value below amortized cost when the Cooperative does not intend to sell a debt security, and it is more likely than not, the Cooperative will not have to sell the security before recovery of its cost basis, it recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income.



The Cooperative's consolidated statement of margin as of December 31, 2011, reflects the full impairment (that is, the difference between the security's amortized cost basis and fair value) on debt securities that the Cooperative intends to sell, or would more likely than not be required to sell before the expected recovery of the amortized cost basis. For available-for-sale debt securities that management has no intent to sell and believes that it more likely than not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the noncredit loss is recognized in other comprehensive income. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected based on cash flow projections.

For equity securities, when the Cooperative has decided to sell an impaired available-for-sale security and the entity does not expect the fair value of the security to fully recover before the expected time of the sale, the security is deemed other-than-temporarily impaired in the period in which the decision to sell is made. The Cooperative recognizes an impairment loss when the impairment is deemed other than temporary even if a decision to sell has not been made.

Cash and Cash Equivalents

Cash and cash equivalents consist of bank deposits in federally insured accounts, temporary investments and money market funds.

The Cooperative places its cash and temporary investments with high quality financial institutions. For purposes of the statements of cash flows, the

Cooperative considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Cash equivalents are carried at cost.

Pursuant to legislation enacted in 2010, the FDIC will fully insure all noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012, at all FDIC-insured institutions.

Effective July 21, 2010, the FDIC's insurance limits were permanently increased to $250,000. At December 31, 2011, the Cooperative's cash accounts exceeded federally insured limits by approximately $4,779,000, which was held in a money market fund at Wells Fargo.

The Cooperative's cash and investments are in a variety of financial instruments. The related values as presented in the financial statements are subject to various market fluctuations, which include changes in the equity markets, interest rate environment and the general economic conditions. The Cooperative's credit losses have historically been minimal and within management's expectations.

Accounts Receivable

Accounts receivable are stated at the amount billed to members. Accounts receivable are due in accordance with approved policies. An allowance for doubtful accounts has not been recorded because all accounts receivable are considered fully collectible.

Derivatives

Derivatives are recognized as assets and liabilities on the consolidated balance sheet and measured at fair value. For exchange-traded contracts, fair value is based on quoted market prices. For nonexchange-traded contracts, fair value is based on dealer quotes, pricing models, discounted cash flow methodologies, or similar techniques for which the determination of fair value may require significant management judgment or estimation.

Inventories

The Cooperative accounts for certain power plant spare parts using a deferred inventory method. Under this method, purchases of spare parts under inventory control are included in an inventory account and then charged to the appropriate capital or expense accounts when the parts are used or consumed. Inventories are carried at cost, with cost determined on the average cost method.

Patronage Capital

Current and future margins (excluding earnings from the Nuclear Decommissioning Trust), will be assigned as patronage capital.

Income Taxes

The Cooperative accounts for income taxes in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Cooperative determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Uncertain tax positions are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more-likely-than-not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment. At December 31, 2011 and 2010, no uncertain tax positions have been identified.

The Cooperative would recognize interest and penalties on income taxes, if any, as a component of income tax expense.

Revenue Recognition

Revenue from the sale of electricity to members is recorded based on contracted power usage billed under the Cooperative's current rate schedule.

Comprehensive Margin

Comprehensive margin consists of net margin and other comprehensive margin, net of applicable income taxes. Other comprehensive margin includes unrealized appreciation (depreciation) on available-for-sale securities, unrealized appreciation (depreciation) for which a portion of an other-than-temporary impairment has been recognized in margin, and changes in the funded status of the postretirement plan.

Impairment of Long-Lived Assets

The Cooperative evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate that carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows is expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value. No asset impairment was recognized during the years ended December 31, 2011 and 2010.

NOTE 2: ELECTRIC UTILITY PLANT IN SERVICE

	2011	2010
	(In thousands)	
Production	$ 637,913	$ 604,190
Transmission	41,998	41,232
General plant	4,525	3,842
Nuclear fuel	211,445	198,608
Other	22,369	20,279
Total	**$ 918,250**	**$ 868,151**

NOTE 3: SUSQUEHANNA STEAM ELECTRIC STATION

The Cooperative owns a 10 percent undivided interest in SSES. PPL owns the remaining 90 percent. Both participants provide their own financing. The Cooperative's portion of SSES's gross assets, which includes electric utility plant in service, construction and nuclear fuel in progress, totaled $650 million and $643 million as of

December 31, 2011 and 2010, respectively. The Cooperative's share of anticipated costs for ongoing construction and nuclear fuel for SSES is estimated to be approximately $124 million over the next five years. The Cooperative receives a portion of the total SSES output equal to its percentage ownership. SSES accounted for approximately 55% and 59% of the total kilowatt hours sold by the Cooperative during the years ended December 31, 2011 and 2010, respectively. The balance sheets and statements of margins reflect the Cooperative's respective undivided share of assets, liabilities and operations associated with SSES.

NOTE 4: INVESTMENTS

Associated Organizations

	2011	2010
	(In thousands)	
National Rural Utilities Cooperative Finance Corporation (CFC) Subordinated Term Certificates, bearing interest at 5.8%, maturing January 1, 2026[1]	$ 15,005	$ 15,569
National Rural Utilities Cooperative Finance Corporation (CFC) Subordinated Term Certificates, bearing interest at 3%, maturing January 1, 2014[1]	86	128
National Rural Utilities Cooperative Finance Corporation (CFC) Member Capital Securities, bearing interest at 7.5%, maturing March 24, 2044[1]	10,000	10,000
Other	2,399	1,859
Total	**$ 27,490**	**$ 27,556**

[1] The Cooperative is required to maintain these investments pursuant to certain loan and guarantee agreements. Such investments are carried at cost.

Investments

The Cooperative makes temporary investments of excess corporate funds in investment accounts managed by qualified registered investment advisors. The amortized cost, which includes any premiums or discounts at acquisition, and approximate fair values of these investments are as follows:

	2011	2010
	(In thousands)	
Debt securities		
Amortized cost	$ 39,208	$ 50,061
Realized loss	(187)	-
Unrealized gains	2,477	2,078
Unrealized losses	(214)	(233)
	41,284	51,906
Equity securities		
Amortized cost	4,042	2,447
Unrealized gains	(62)	314
	3,980	2,761
Total investments at fair value	45,264	54,667
Investments, at cost with National Rural Utilities Cooperative Finance Corporation		
Medium term notes	-	2,500
	$ 45,264	**$ 57,167**

The Cooperative's debt securities consist of corporate bonds, an auction rate security, and U.S. government agency securities. Equity securities consist of mutual funds. Corporate bonds in CFC and U.S. government agency securities comprise approximately $19 million and $5 million and $22 million and $6 million of the debt securities in 2011 and 2010, respectively.

Maturities of investments at December 31, 2011:

	Amortized Cost	Approximate Fair Value
	(In thousands)	
One year or less	$ 14,772	$ 14,796
After one through five years	28,291	30,468
	$ 43,063	**$ 45,264**

In 2011, the Cooperative recorded other-than-temporary impairment on a specific debt security. The cost-basis of this investment has been adjusted to reflect recognition of this impairment. Total other-than-temporary impairment reflected in the statement of margins for 2011 was $187,000 for this temporary investment. No other-than-temporary impairment was recorded for 2010.