

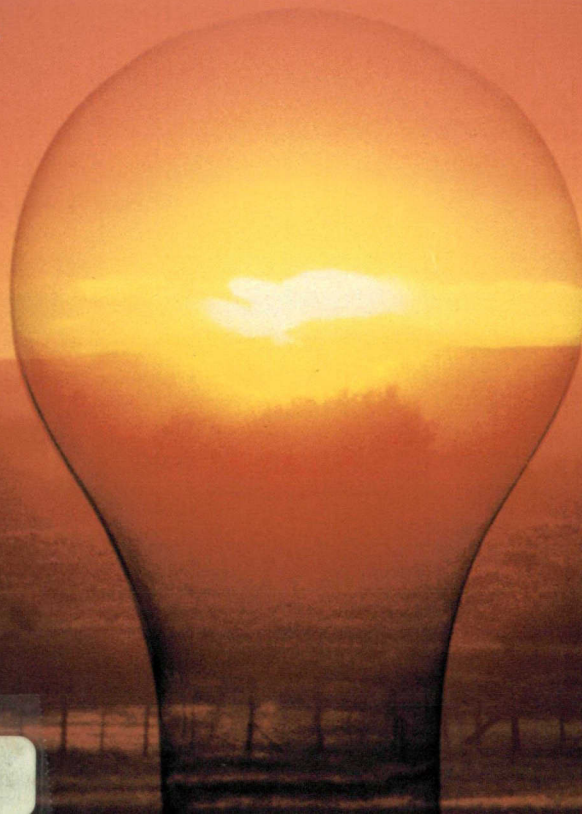
Duke Power Company 1986 Annual Report

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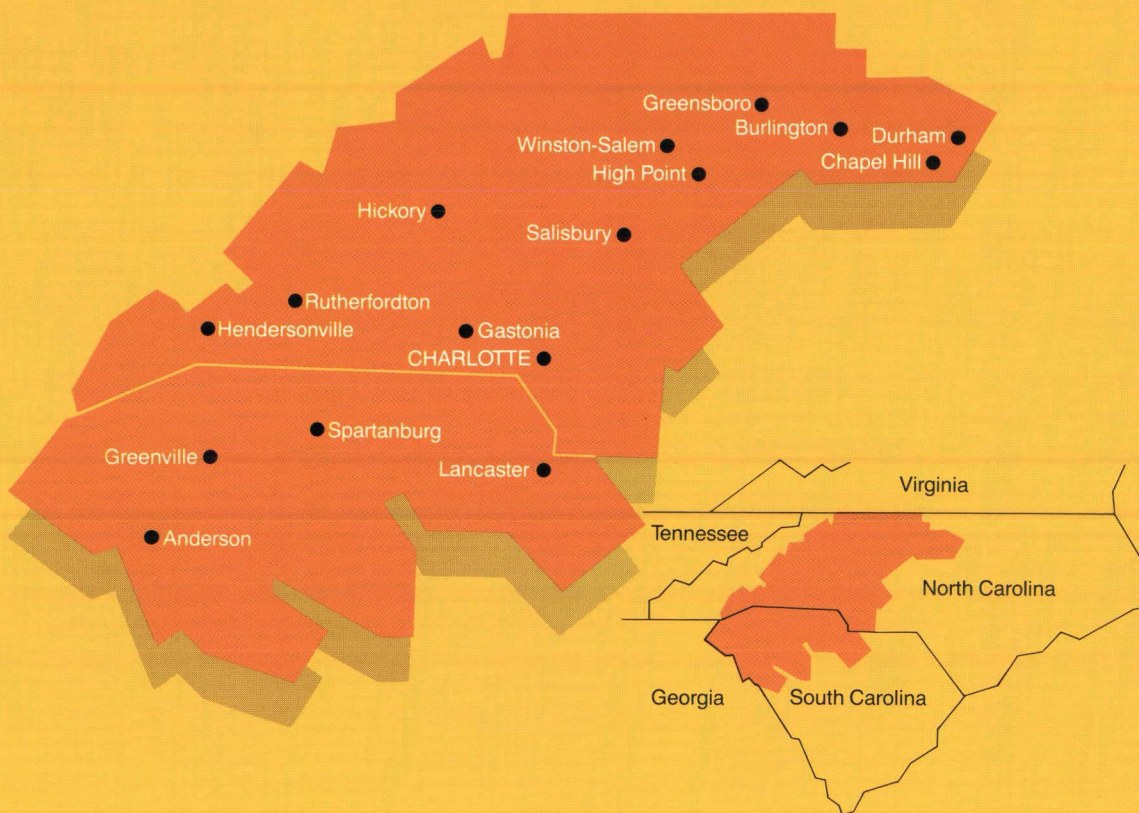
The electric utility industry is entering a new, dynamic era that will reward those companies with innovative approaches to the marketplace. Already Duke Power is using its many talents and resources to map a course for the future. A roundtable discussion by Duke's Executive Committee on the future of the electric utility industry is featured beginning on page 13.

Duke Power is the nation's seventh largest investor-owned electric utility. It is headquartered in Charlotte, N.C., near the center of a 20,000-square-mile service area in North Carolina and South Carolina.

In 1986, Duke Power's three nuclear stations, eight coal-fired plants and 26 hydroelectric facilities produced more than 60.5 billion kilowatt-hours of electricity for nearly 1.5 mil-

lion customers. About 70 percent of sales were in North Carolina and 30 percent in South Carolina. Electric revenues for the year totaled \$3.4 billion.

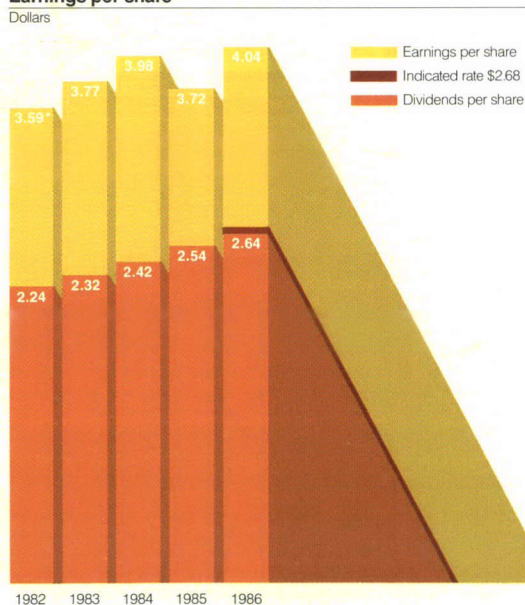
Duke serves its retail customers through 97 district and branch offices. The Company also sells power to bulk users at wholesale and contractual rates.



Financial Highlights

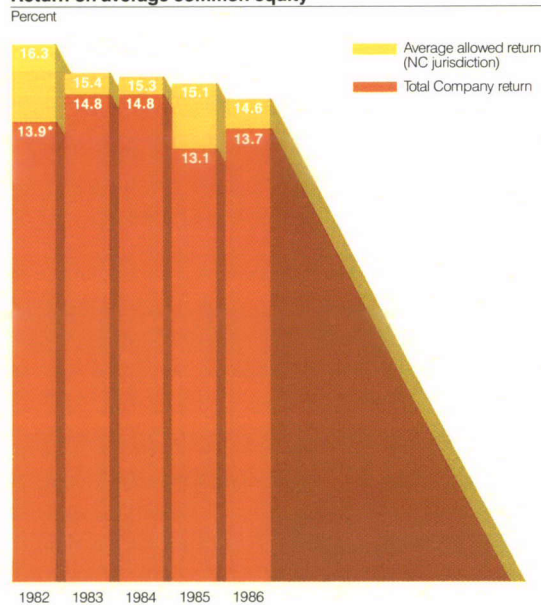
	1986	1985	Percent increase (decrease)
Kilowatt-hour sales	60,513,229,000	56,058,479,000	7.9
Electric revenues	\$3,400,933,000	\$2,898,911,000	17.3
Earnings for common stock	\$ 409,067,000	\$ 376,681,000	8.6
Common Stock Data			
Average shares outstanding	101,220,000	101,178,000	—
Earnings per share	\$4.04	\$3.72	8.6
Dividends per share	\$2.64	\$2.54	3.9
Book value per share (year-end)	\$30.34	\$28.98	4.7
Return on average common equity	13.7%	13.1%	4.6
Plant construction costs	\$ 690,352,000	\$ 657,172,000	5.0
Total electric plant, net	\$6,638,751,000	\$6,392,161,000	3.9
Peak load (Kw)			
Summer	12,471,000	11,204,000	11.3
Winter	12,586,000	12,687,000	(0.8)

Earnings per share



*Including extraordinary item (gain on retirement of bonds)—\$0.52.

Return on average common equity



*Excluding extraordinary item—gain on retirement of bonds—and provision for loss.

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To Our Shareholders

From the perspective gained by the passage of more time, 1986 may well be looked back upon as a paramount year in Duke Power's history. Among your Company's 1986 achievements, the more significant are:

■ Earnings for common stock reached a record \$409.1 million, or \$4.04 a share.

■ Catawba Unit 2, the last of seven large nuclear generating units, all designed and built by your Company's in-house team of experts, was completed and brought into commercial service ahead of schedule and at lower cost than any other nuclear unit of the same vintage.

■ Following 12 consecutive years of operating the most efficient fossil-fired generation in the nation, your employees operated our eight coal-burning plants at new record efficiency levels in 1986.

■ Our average customer was without electric service only 34 minutes in 1986, a record reliability of 99.99 percent and testimony to our employees' commitment to quality and responsiveness.

■ Catawba Unit 2 was found by regulatory commissions to have been prudently built and its capacity needed for our customers. Its costs are fairly covered in rates in all jurisdictions.

■ Your employees made even greater strides in productivity by meeting seven of 10 stringent performance goals.

■ Nuclear power generated 53 percent of our electricity, saving our customers \$375 million in fuel costs.

■ At year-end we benefited our customers by volunteering a 2.3 percent rate decrease effective January 1, 1987, to pass on income tax savings expected in 1987 due to the Tax Reform Act.

■ Our diversified businesses continued to grow in scope and volume, and on January 1, 1987, our successful engineering services business was incorporated into a new subsidiary, Duke Engineering & Services, Inc.

SHAPING THE FUTURE

Beyond these achievements, 1986 was a year of preparation for a future that will be markedly different from the past. As 1987 begins, we face an exciting combination of challenges and opportunities.

Our greatest challenge is to be customer-driven, meeting our goal of holding the line on prices while enhancing profitability. We must continue to find new, innovative ways to reduce costs while maintaining the reliability of our electric service.

Also, we will continue to minimize requirements for new capital by controlling the growth of summer peak demand, by extending the life of our older coal-fired plants and by adding cost-effective peaking capacity when needed. These efforts should make our existing baseload capacity sufficient to serve our customers into the 21st century.

We must also continue quality operation of our nuclear plants and provide leadership to enhance nuclear safety worldwide.

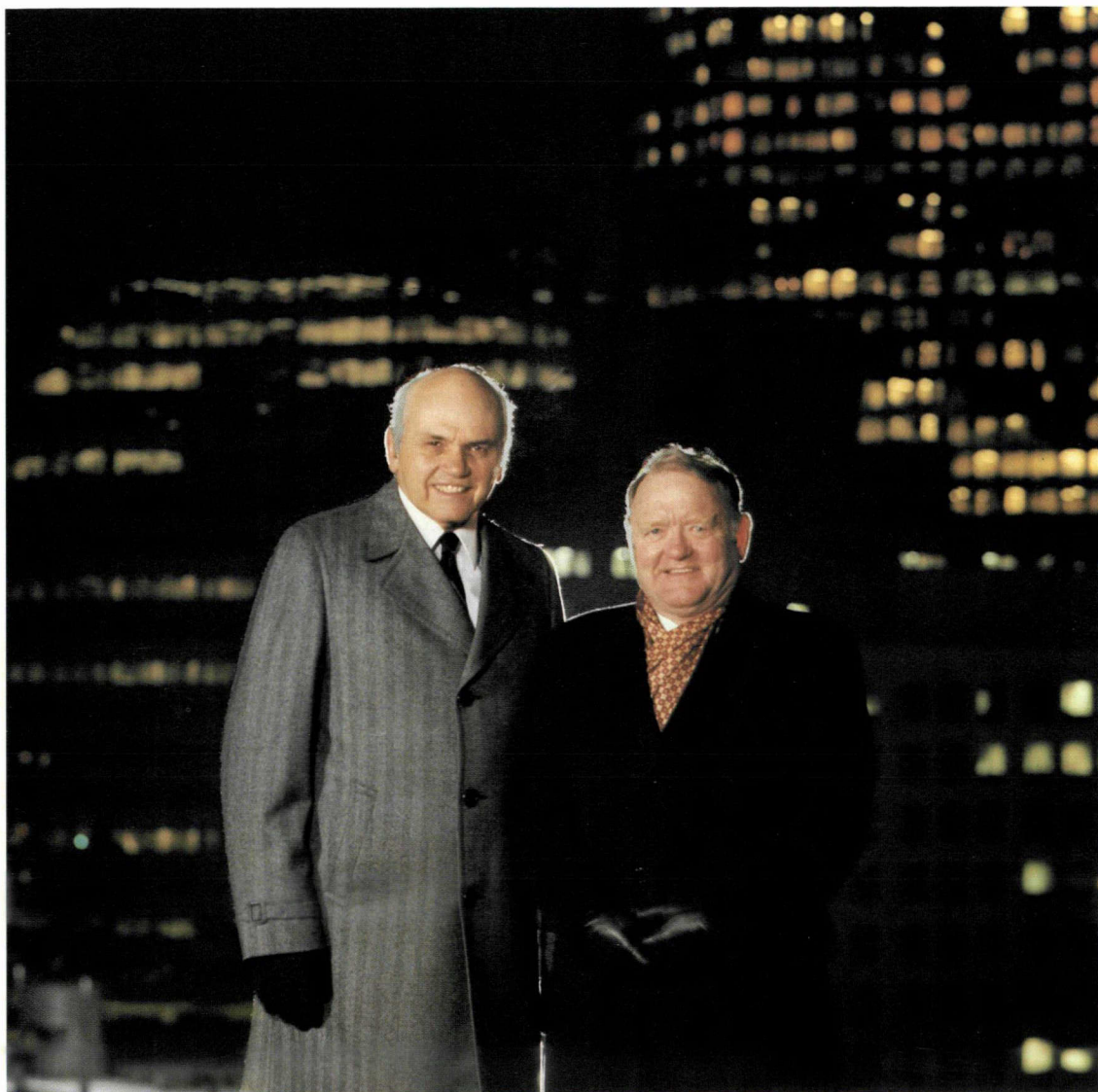
Future success also requires that we prevail in court appeals by intervenors seeking to overturn our two most recent North Carolina retail rate increases. Those appeals are being considered by the North Carolina Supreme Court. Because of uncertainty over the outcome, our auditors, Deloitte Haskins & Sells, have qualified their opinion on our 1985 and 1986 financial statements.

Finally, we must set a course for the future that will position your Company to shape whatever change is to come to the electric utility industry, to the benefit of both customer and investor. Your management's views on the future of Duke Power and our industry are discussed in a special section of this year's report, beginning on page 13.

CHANGES ON THE BOARD

At our annual meeting last April we welcomed to the Board of Directors George Dean Johnson, Jr., partner in the Spartanburg, S.C., law firm of Johnson, Smith, Hibbard, Wildman and Dennis. His legal knowledge and experience will serve the Company well.

We are most grateful to Robert C. Edwards and Maceo A. Sloan for their years of service



Douglas W. Booth

William S. Lee

on our board. Both retired in 1986 after serving for 20 years and seven years, respectively.

We also thank Austin C. Thies, Executive Vice President of Transmission, Distribution and Electric Operations, who retired in July as an officer and director. Austin served Duke Power well for 40 years, contributing in ample measure to the Company's superlative technical performance.

We're proud of the efforts of all our 20,000 employees. They brought us success in 1986, and we're confident that their talents and innovation will continue to make your Company successful in the future.

Thank all of you for your support. As we

build together for a stronger Duke Power Company, we welcome your interest.

William S. Lee

William S. Lee
*Chairman of the Board and
Chief Executive Officer*

Douglas W. Booth

Douglas W. Booth
*President and
Chief Operating Officer*

February 13, 1987

FINANCIAL RESULTS

Earnings per share of common stock rose 8.6 percent to \$4.04 in 1986 from \$3.72. Earnings for common stock totaled \$409.1 million, up from the \$376.7 million earned in 1985.

The favorable results reflected substantially higher electricity sales. About 2.7 percent of 1986 energy sales were attributable to summer heat and winter cold in excess of normal weather and extensive drought in Duke's service area.

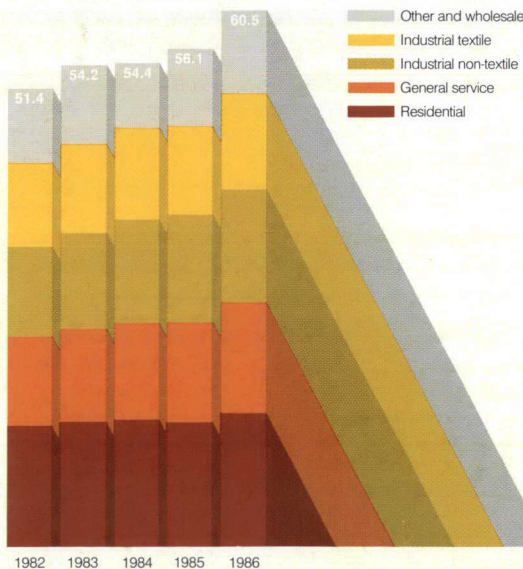
The Company's 1986 earnings represent a 13.7 percent return on common equity, up from 13.1 percent in 1985.

Earnings coverage of fixed charges increased to 4.26 times from 3.87 times in 1985, exceeding the Company's goal of 4 times.

The Company raised its quarterly cash dividend on common stock to 67 cents a share from 65 cents, effective with dividends paid in the third quarter. The increase raised the Company's indicated annual dividend to \$2.68 from \$2.60. This marked the 11th consecutive year that Duke Power has raised its common stock dividend.

Sales

Billions of KWH

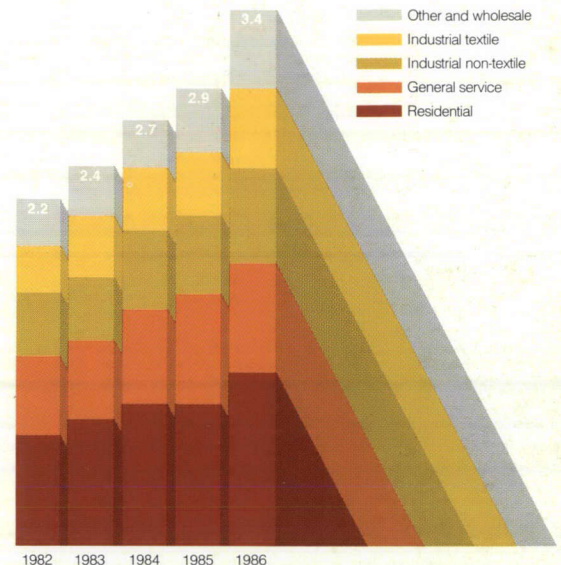


SALES AND CUSTOMERS

Electric sales in 1986 rose to 60.5 billion kilowatt-hours, a 7.9 percent increase over 1985.

Electric revenues

Billions of dollars



Residential sales rose by 9.8 percent over 1985, with much of the increase coming in the third quarter as unusually hot weather prompted increased use of air conditioners.

Sales to commercial and general service customers rose 8.6 percent.

Sales to textile customers showed a strong 6.4 percent gain in 1986 as the Carolinas' textile industry continued to recover despite unabated competition from imports. Sales to non-textile industrial customers climbed 6.2 percent over 1985 as the Piedmont Carolinas region continued healthy economic growth.

Wholesale and other energy sales rose 8.2 percent over 1985.

Residential customers accounted for 26 percent of the Company's electric sales in 1986. General service and commercial customers accounted for 20 percent, non-textile industrial customers accounted for 21 percent and textile customers 18 percent. Wholesale and other energy sales accounted for 15 percent.

Duke Power completed its nuclear construction program in 1986 when Unit 2 of Catawba Nuclear Station entered commercial service. The two-unit, 2,290,000-kilowatt station was built at less than half the average cost of nuclear plants of the same vintage and can produce enough electricity to light and power more than a half million homes.



More than 43,600 new customers joined Duke's system in 1986, a 3 percent increase. At year-end the Company was serving nearly 1.5 million customers, representing a population of about 4.4 million.

RATE ADJUSTMENTS

Electric rates were raised in all jurisdictions in the fourth quarter of 1986 to reflect the commercial operation of Catawba Unit 2, new safety and environmental facilities at Oconee Nuclear Station and increased operating costs.

The Company subsequently volunteered a 2.3 percent rate decrease, which was approved effective January 1, 1987. The decrease passed on to customers the Company's expected 1987 income tax savings due to the Tax Reform Act of 1986.

On October 31, the North Carolina Utilities Commission approved a 6.73 percent, or \$133.1 million, retail rate increase. The Commission allowed a 13.4 percent return on common equity. The Company had requested a \$289.3 million increase. That request was later amended to an 11.9 percent, or \$236.5 million, increase that would have allowed a 14 percent return on common equity.

In South Carolina, The Public Service Commission (PSC) approved a 9.55 percent, or \$79.1 million, rate increase on November 5.

The PSC's order allows a 13 percent return on common equity. The Company's original South Carolina request was for a \$137.8 million increase. That request was later amended to a 14.4 percent, or \$119.9 million, increase allowing a 14 percent return on common equity.

The Federal Energy Regulatory Commission, which regulates the Company's rates to wholesale customers, allowed an interim rate increase on November 2 of 8.3 percent, or \$4.5 million.

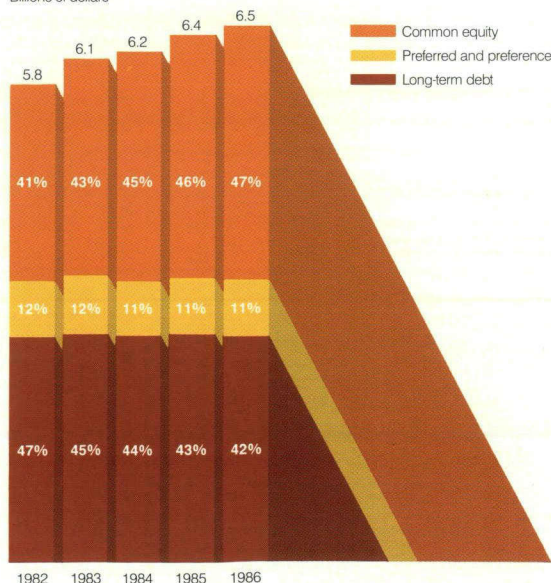
Both the North Carolina and South Carolina commissions allowed recovery of all costs associated with Catawba Unit 2, although some of those costs will be recovered on a levelized basis.

In North Carolina, the costs of power purchased in declining amounts from the Catawba joint owners will be recovered on a levelized basis over the entire 10- and 15-year contract periods. In South Carolina, recovery of the costs incurred over the first half of the 10- and 15-year contracts will be levelized.

In both Carolinas, the Company proposed and the commissions approved smaller increases to industrial customers than to other classes of customers, closing the gap between rates of return from each class of customer and helping industrial customers compete in worldwide markets.

Intervenors in North Carolina appealed the rate orders covering both Catawba Unit 1 and Catawba Unit 2 to the North Carolina Supreme Court, where they are pending.

Capital structure (Excludes current maturities)
Billions of dollars



FINANCING

For the fourth consecutive year, Duke Power offered no new common stock and anticipates no need to do so in the next few years. The Company plans to continue to acquire shares on the open market as needed for its Dividend Reinvestment Plan and customer and employee stock purchase plans.

The powerhouse for Bad Creek Hydroelectric Station will be built in a mammoth underground cavern being blasted out of rock in the foothills of South Carolina. Bad Creek will produce 1,000,000 kilowatts of electricity during periods of peak demand when its four units enter service in 1991 and 1992.



The Company took advantage of lower interest rates by refunding over \$500 million of bonds and preferred stock during the first half of 1986. These refundings will save the Company and its customers more than \$17 million in 1987.

As of December 31, Duke's capitalization consisted of 42 percent long-term debt, 11 percent preferred and preference stocks and 47 percent common equity. This ratio is consistent with Company goals.

CONSTRUCTION

Catawba Unit 2 near Rock Hill, S.C., began producing power commercially on August 19.

The Nuclear Regulatory Commission issued a full-power license to Catawba on May 15, 1986. It generated its first electricity during testing on May 18.

Work on Catawba spanned 12 years. The plant was completed months ahead of its scheduled 1987 completion date, contributing to its lower-than-expected cost. Final cost of the two-unit, 2,290,000-kilowatt station came to \$1,560 per kilowatt of capacity, less than half the average \$3,126-per-kilowatt cost of comparable plants built in the United States during the same time frame.

Construction of Bad Creek Hydroelectric Station, just above Lake Jocassee in Oconee

County, S.C., continued in 1986. On December 31 the pumped-storage hydro plant was about 15.7 percent complete. The first two units of the four-unit, 1,000,000-kilowatt plant are scheduled for service in 1991. The remaining two units are scheduled for completion in 1992.

Pumped-storage hydro plants are used to produce peaking power. They store energy by pumping water from a lower reservoir to a higher one during periods of lower electricity demand at nights and on weekends. The water is released to generate electricity when demand is high.

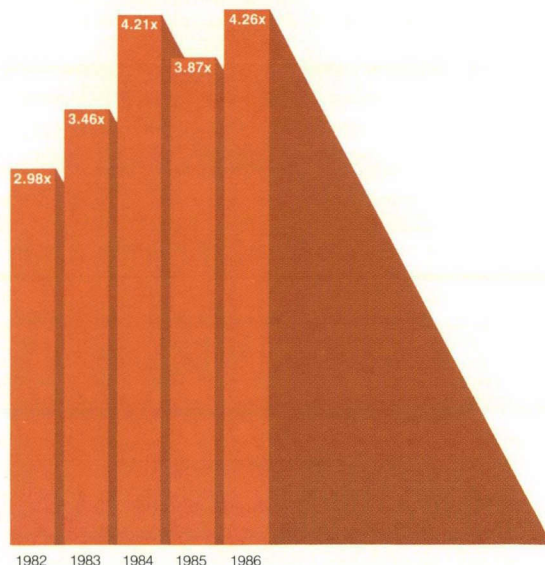
GENERATION AND CAPACITY

The Company's nuclear units continued their excellent operations in 1986, generating 53 percent of Duke Power's electricity, down slightly from 54 percent in both 1984 and 1985.

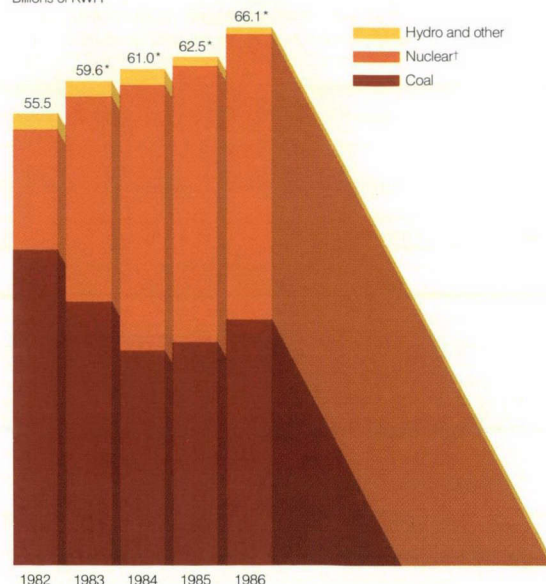
The Company's eight coal-fired generating stations produced 46 percent of its power, up from 44 percent in 1985. Hydroelectric plants supplied 1 percent, down from 2 percent, reflecting the severe drought in 1986.

Duke's seven-reactor nuclear system operated at a capacity factor of 61 percent in 1986, down from 68 percent in 1985. The lower capacity factor resulted from maintenance outages and refuelings.

Earnings coverage of fixed charges
SEC method



Net generation
Billions of KWH



*Excludes interchange power with Catawba joint owners.
†Includes 100% of Catawba generation for 1985 and 1986.

As of December 31, the Company's generating capacity totaled 15,614,000 kilowatts. Nuclear units accounted for 46 percent of the Company's total capacity, coal-fired units 41 percent and hydroelectric and combustion turbine plants 13 percent.

GENERATING EFFICIENCY

For the 12th straight year Duke Power's system of eight coal-fired generating stations was recognized by *Electric Light & Power (EL&P)* magazine as the most efficient in the nation in 1985.

Also, Duke's Belews Creek Unit 2 was the country's single most efficient coal unit in 1985, the latest year for which *EL&P* compiled rankings. In service since December 1975, the 1,120,000-kilowatt unit is the newest coal-fired unit on Duke's system. One of Belews Creek's two units has been ranked first in the country five times since 1976.

In all, five of the Company's coal-fired units placed in the top seven of *EL&P*'s survey of more than 2,000 units. The 630,000-kilowatt Marshall Unit 3, which was the nation's most efficient in 1984, placed second in the country in 1985.

For nine of the last 10 years, a Duke unit has led the nation's investor-owned utilities in operating efficiency.

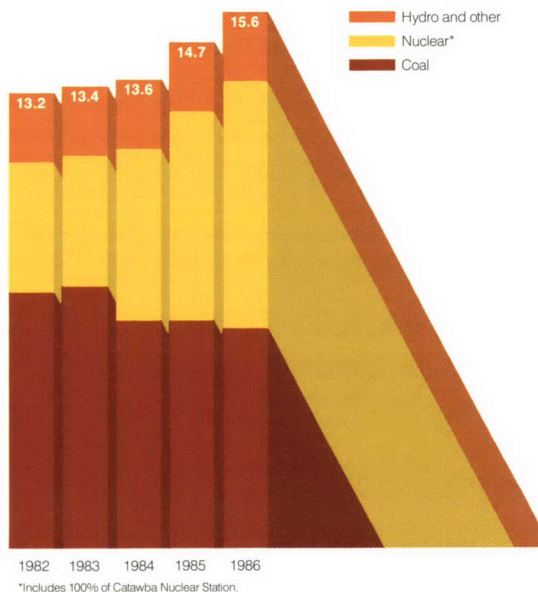
The magazine ranks the generating systems of the country's 100 largest investor-owned utilities according to heat rate, or the number of British Thermal Units (Btus) needed to produce a kilowatt-hour of electricity. The lower the Btus, the better the heat rate.

Duke's coal-fired system set a national heat rate record of 9,300 Btus in 1985, the year of *EL&P*'s ranking, and bettered that in 1986 with a heat rate of 9,261.

Duke Power's nuclear units were also recognized for their efficiency in 1985. In a Nuclear Regulatory Commission report on the country's multi-unit nuclear plants, Duke's McGuire and Oconee nuclear stations ranked first and third, respectively, in fuel efficiency.

The efficient operation of Duke's generating system meant substantial savings for the Company's customers. Had the entire

Generation capacity
Millions of KWH



system, coal and nuclear, operated only as efficiently as the average system ranked by *EL&P*, fuel costs would have been \$60 million higher in 1985.

PEAK DEMAND AND ENERGY MANAGEMENT

Record heat in Duke's service area in July led to four successive summer peak records for electricity use as customers fought the heat with air conditioners.

The ultimate peak was 12,471,000 kilowatts of demand on July 21. That was 7.9 percent higher than the previous summer peak of 11,554,000 kilowatts set on August 23, 1983. The winter peak demand in 1986 was 12,586,000 kilowatts on January 28, which was still below the all-time peak of 12,687,000 kilowatts set on January 21, 1985.

The new summer peak would have been higher if it had not been for the Company's energy management programs. Duke Power reduced projected growth in the 1986 summer peak by 334,000 kilowatts and the winter peak by 468,000 kilowatts, both exceeding Company targets.

Since 1976 Duke's energy management program has reduced the projected growth in the summer peak by 2.5 million kilowatts and

the winter peak by 3.2 million kilowatts. The goal is to reduce the summer peak by 4.8 million kilowatts and the winter peak by 6.1 million kilowatts by the year 2000, thus avoiding the need to invest in several major new power plants.

In addition to holding down peak demand, Duke's energy management programs aim to increase sales of electricity off peak.

Promotion of off-peak sales includes special pricing schedules, the Safe Light outdoor lighting program, Half-Price Water Heating during off-peak periods, and high-efficiency heat pumps.

EMPLOYEE INCENTIVE PROGRAM

Duke Power's 20,000 employees achieved seven of 10 primary corporate goals plus the bonus goal of cost reduction in the Employee Incentive Goals Program in 1986. This achievement saved the Company and its customers millions of dollars.

Duke employees met or surpassed goals in cost reduction, safety/disabling injuries, customer service reliability, affirmative action, energy management, fossil system heat rate, personal health, and quality of nuclear operations.

Since the Employee Incentive Program was started in 1981, employees have met 50 of 63 corporate goals for a success rate of nearly 80 percent.

Achieving corporate goals during the year earns employees an additional contribution to the Stock Purchase-Savings Program for Employees.

Ten challenging goals, plus the bonus cost reduction goal, have been set for 1987.

INVESTOR PLANS

Duke Power resumed promotion of its Customer Stock Purchase Plan in the spring of 1986.

The promotion generated more than 100,000 customer responses during the year. Nearly 11,000 customers were participating in the plan at year-end, investing \$7.2 million in Duke Power.

At year-end 23 percent of common share-

holders and 11 percent of preferred shareholders were participating in Duke's Dividend Reinvestment Plan, reinvesting nearly \$22.4 million in dividends in the Company.

More shareholders took advantage of two other services, Direct Deposit of Cash Dividends and the Small Shares Repurchase Service.

The Direct Deposit service assures timely receipt of dividend payments because the Company automatically credits dividends to shareholders' checking, savings or money market accounts the same day dividends are paid. At year-end, 8 percent of common shareholders and 9 percent of preferred shareholders took advantage of the service.

Under the Small Shares Repurchase Service the Company will buy the stock of shareholders owning fewer than 50 shares of common stock. The service enables shareholders to sell their shares without incurring brokerage fees.

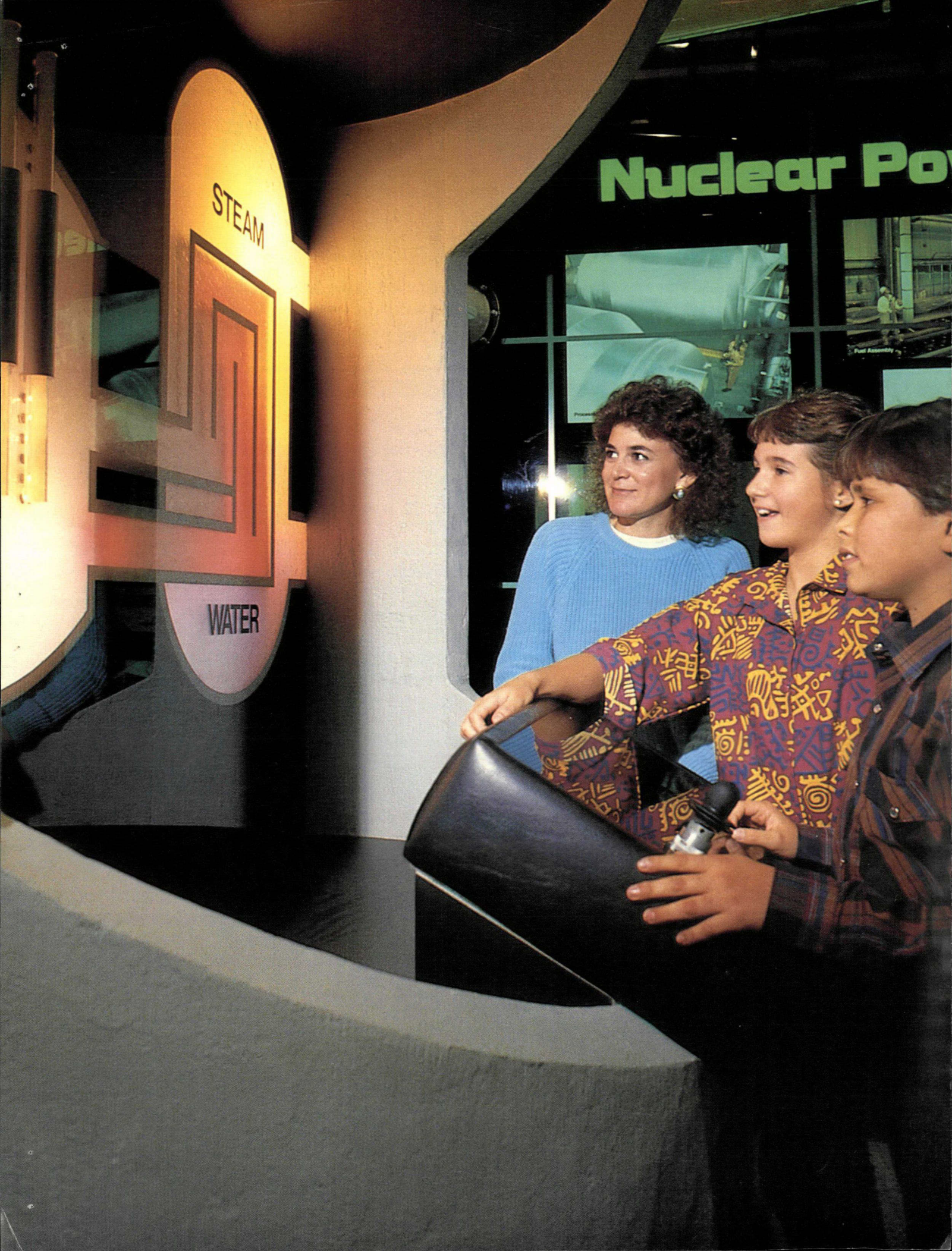
CITIZENSHIP AND SERVICE

Duke Power and its employees continued a tradition of contributing to communities in the service area. Duke's "Power in Education" program won a special citation from President Reagan in 1986. It was the second consecutive year that a Duke Power program won recognition in the President's Citation Program for Private Sector Initiatives.

The President recognized Duke for its efforts to marshal the resources of business and industry in the Piedmont Carolinas to support public education. As part of the award, Duke can fly "C" flags, which stand for "We Can" and "We Care," over its facilities.

Duke employees gave generously to United Way campaigns throughout the service area in 1986, pledging more than \$2.2 million. Employee and corporate contributions together made Duke Power the largest single contributor to United Way campaigns in

The Energy Explorium at Lake Norman near McGuire Nuclear Station offers entertaining and educational exhibits on electricity generation and use. The Explorium makes information about the latest generating technology easily accessible to the communities served by the plant.



STEAM

WATER

Nuclear Power

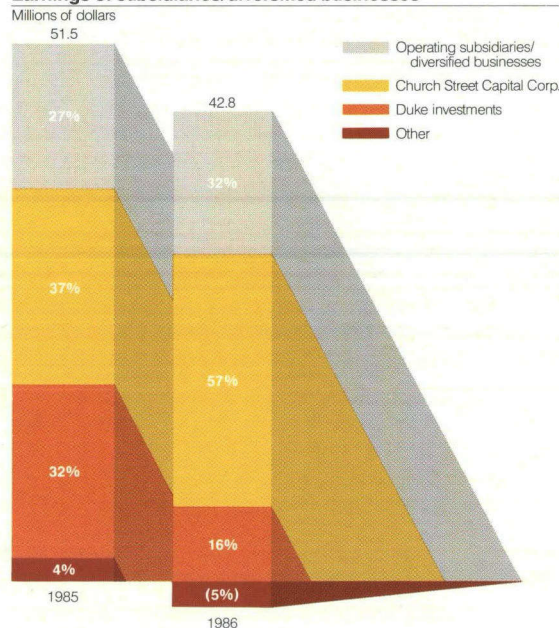
North Carolina and South Carolina for the third consecutive year.

Company employees also contributed more than \$195,000 to 172 colleges and universities through Duke's Matching Gifts Program.

Duke also offered its Share the Warmth and Community Challenge Heating Fund programs to help low-income customers pay winter heating bills. Through Share the Warmth, introduced in 1985, Duke shareholders match customer contributions up to \$400,000.

The five-year-old Community Challenge program matches money raised by service organizations in the Piedmont Carolinas by pledging \$1 for every \$3 donated by those organizations. The Company raised its maximum contribution to the program during 1986-87 to \$350,000 from \$300,000.

Earnings of subsidiaries/diversified businesses



SUBSIDIARIES/DIVERSIFIED BUSINESSES

Subsidiaries and diversified businesses earned \$42.8 million, down from the \$51.5 million earned in 1985. The decrease was caused primarily by lower investment income.

On January 1, 1987, the Company created a new subsidiary, Duke Engineering & Services, Inc. to take over the activities of the Management and Technical Services (MATS) organization. The new subsidiary was capitalized with an investment of \$4.7 million,

representing the net earnings of MATS since its inception in 1982. MATS markets engineering and other services to outside companies. It worked on 93 projects for 50 clients in 1986.

One of Duke Engineering's initial projects is designing a 49,900-kilowatt cogeneration facility that will supply space and water heating for the U.S. Army's Fort Drum in upstate New York. Excess electricity from the plant will be sold to the Niagara Mohawk Power Company.

Crescent Land & Timber Corp., Duke Power's land management subsidiary, expanded its efforts in commercial real estate in 1986. Crescent completed or had under construction four projects during the year and continued to market its Lakemont Business Park, Greenway business and industrial parks, and Avenue of the Carolinas retail complex, all near the Carowinds theme park south of Charlotte, N.C.

Crescent was formed in 1969 to manage Duke's 270,000 acres of non-utility property. The subsidiary supplies timber for the furniture, home-building and paper industries. In 1986, Crescent harvested 36 million boardfeet of timber and 67,500 cords of pulpwood.

The Sales Division of Mill-Power Supply Company continued its expansion in the high-technology market in 1986, opening a Mill-Power Technologies facility in Greensboro, N.C. Mill-Power Technologies was formed in 1984 to sell energy management equipment, programmable controls and computer equipment. The Greensboro facility will serve markets in North Carolina and Virginia.

Mill-Power also acts as Duke Power's purchasing agent. Mill-Power's Purchasing Division bought more than \$1 billion in equipment, fuel, supplies and services for Duke in 1986.

Church Street Capital Corp., formed in 1985 to invest money derived from the depreciation of generating plants and from the sale of portions of Catawba Nuclear Station, reduced its level of investments in 1986. However, the corporation was able to increase its overall return on those investments.

Future Directions



Duke Power's Executive Committee talked about these and other issues in a roundtable discussion about the Company's future directions. On the following pages are their thoughts.

"We're simply going to keep unnecessary costs out of our operations."



William S. Lee, Chairman and Chief Executive Officer

Q: Mr. Lee, where is Duke Power Company headed in the future?

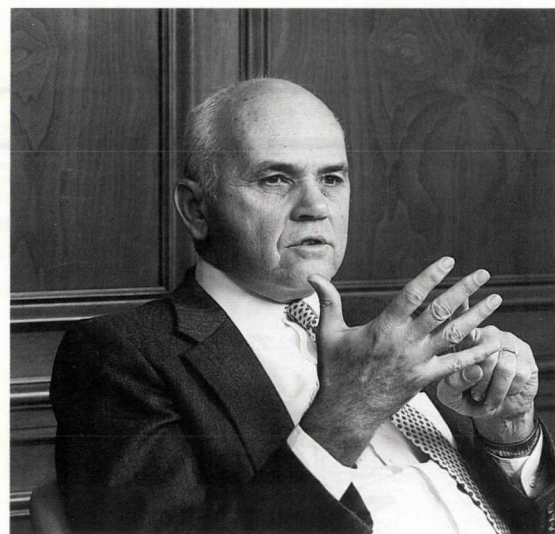
WILLIAM S. LEE: We want to be the best there is in the electric utility business, and that will be our principal focus as we move into the years ahead. We will remain heavily committed to our core business, which is providing reliable electricity to our customers at reasonable cost. In diversifying beyond that we will look at other opportunities always in the light of whether they will enhance shareholder value without negative impact on our electric customers.

Q: Does Duke face any changes in its day-to-day challenges?

LEE: The biggest immediate change is that we no longer have the tremendous financing needs we faced during our large construction program. That program, which saw the completion of seven nuclear units over 20 years, was necessary to meet the economic growth of the Carolinas. We've done that, and now we have sufficient baseload capacity in place into the next century. Our main purpose now is to be excellent and cost-effective in the electric utility business and to turn diversified opportunities into successful ventures.

Q: Is there any theme that you want to emphasize in managing the company?

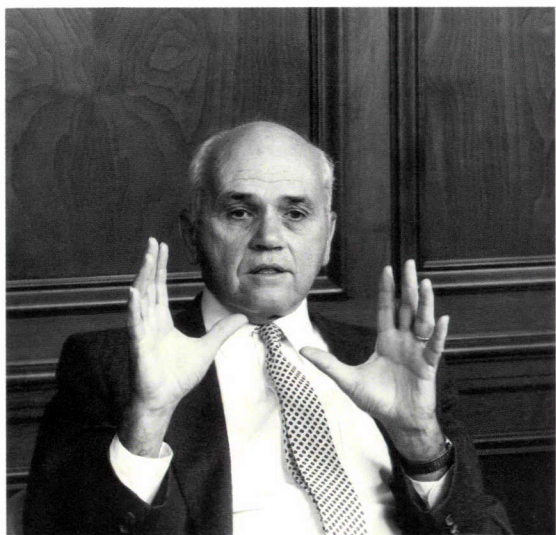
DOUGLAS W. BOOTH: We want to emphasize a company culture that is customer-driven. That will be essential as competition in our industry intensifies. As a low-cost producer of electricity we start with an initial advantage. We're going to remain a low-cost producer by setting our price first and then operating the company in such a way that we can make a satisfactory profit at that price without detracting from service to our customers. We're simply going to keep unnecessary costs out of our operations. Our employees have identified ways to save millions of dollars since we began our Corporate Goals Program in 1981, and we expect to do even better. We will seek to avoid rate increases and put our focus on customer service. We will devise ways for earning a satisfactory profit within that framework.



Douglas W. Booth, President and Chief Operating Officer

Q: Does Duke Power have specific strategies for increasing profits in the future?

WILLIAM H. GRIGG: The Company has a four-point business plan for addressing that. We plan to continue to reduce costs as stringently as we can, continue to operate our system as efficiently as we have in the past, increase our kilowatt-hour sales and expand our non-utility income.



Booth

Q: *How can you increase kilowatt-hour sales?*

BOOTH: We have launched an aggressive marketing program to sell more energy without accelerating growth in our summer peak demand. For instance, our goal is to increase our share of the residential heating market from 41 percent to 50 percent. We'll do this by promoting high-efficiency electric heat pumps, both to builders of new homes and to owners of existing homes. We're also promoting expanded use of residential outdoor lighting. On another front we're exploring the possibility of increasing temporary bulk power sales off peak, primarily to other utilities.

Q: *You mentioned expanding non-utility income. What are your thoughts here?*

LEE: We will expand the activities of our subsidiaries, but our philosophy on diversification won't change. We will focus on those areas where we have expertise.

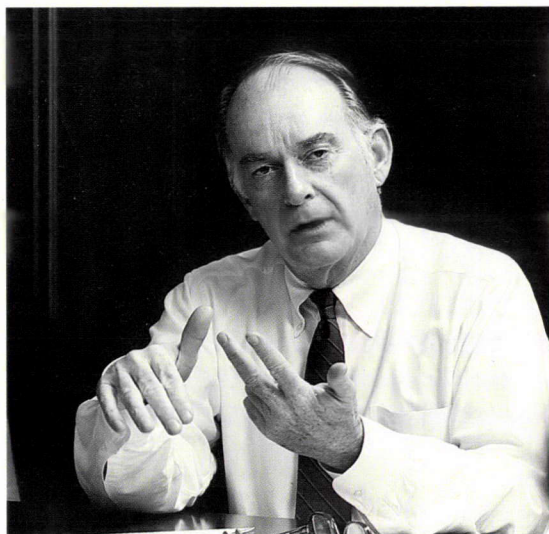
Q: *Duke has a land management subsidiary, Crescent Land & Timber Corp., and Mill-Power Supply Company, a subsidiary that sells electrical equipment. Will their roles be increased?*

GRIGG: They will expand, but in an orderly way. Crescent owns some 270,000 acres of land in our service area. For many

years it has operated a forestry management business. More recently, it has identified property that is suitable for other commercial use and is now developing an office park, an industrial park and a number of other retail centers. It is also engaged in several joint ventures, including a hotel north of Charlotte. To date, Crescent's commercial ventures have been quite successful.

Mill-Power has been in the electrical equipment sales business for some 75 years. In 1984 it established its Mill-Power Technologies division to sell and service micro-processor-based computer systems and equipment, programmable controls, and other high-technology products and applications. We expect that to be Mill-Power's fastest growing business.

Our basic approach to diversification is to invest only in businesses in which we have experience and expertise — in other words, where we will have something to bring to the venture other than just money. It's expertise we're marketing, for instance, with our newest subsidiary, Duke Engineering & Services, Inc., which we formed on January 1 of this year.

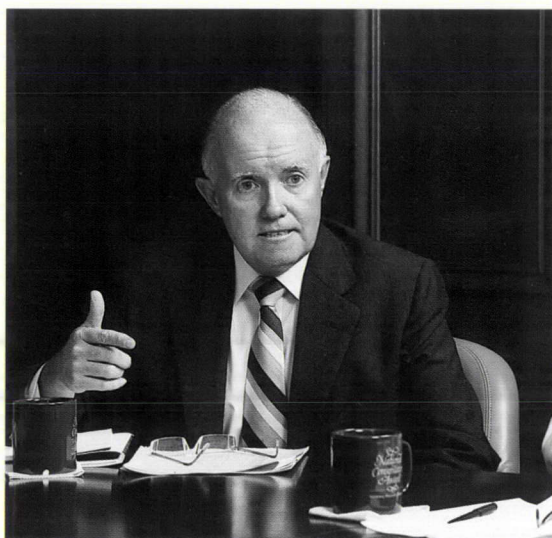


William H. Grigg, Executive Vice President,
Finance and Administration

"Our goal is to increase our share of the residential heating market from 41 percent to 50 percent."

"We see cogeneration as an opportunity and not as a threat."

WARREN H. OWEN: Duke Engineering incorporates our Management and Technical Services, or MATS, business as a subsidiary. MATS has been very successful. We think the opportunity is there for continued growth because other companies recognize our experience and ability in engineering, construction and operations. With the new subsidiary we now have some flexibility and access to resources which might allow even faster growth. You know, Duke Power has been designing its own power plants for more than 80 years, so we have something very substantial to sell.



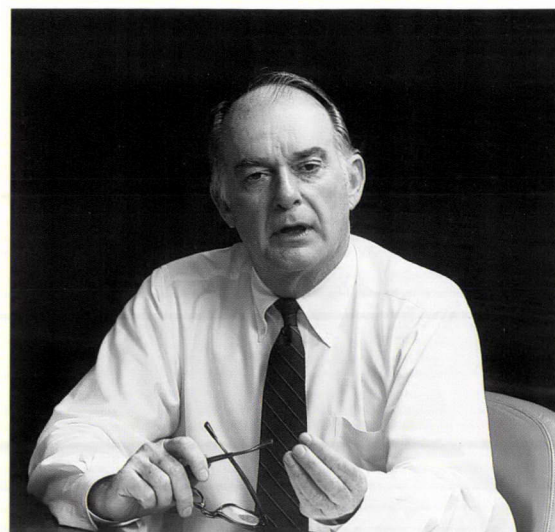
Warren H. Owen, Executive Vice President, Engineering, Construction and Production Group

Q: What do you expect Duke Engineering to contribute to corporate earnings?

OWEN: Last year MATS made almost \$3 million before taxes, and with expanded activities we should do even better. We can compete and make a nice profit there.

Q: Has Duke Engineering had any difficulty competing with large engineering firms?

OWEN: Not at all. We have been successful with more than 60 percent of the proposals we have made. That's very competitive with the acceptance rate of any engineering organization.



Grigg

Q: What is Duke Engineering's largest project?

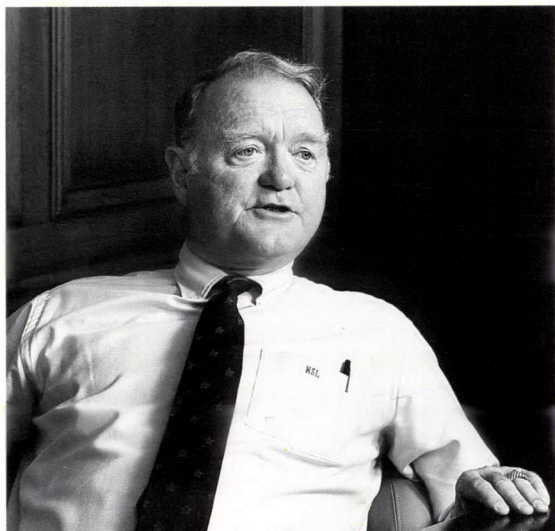
GRIGG: They are designing a 49,900-kilowatt cogeneration project that will produce hot water for the U.S. Army at Fort Drum, N.Y., and sell excess electricity to Niagara Mohawk. We have a \$2 million equity investment in that project. We view cogeneration as an opportunity for us to win design contracts and to make investments, such as in Fort Drum. I think you will see more of that in the future.

Q: Cogenerators are displacing the power produced by some utilities and eating into their sales. What role do you see cogeneration playing here? Is there a danger that Duke Power will face competition from cogeneration projects in its service area?

LEE: We see cogeneration as an opportunity and not as a threat. MATS has designed several cogeneration projects, three of which are already in service in the Southeast. They aren't in our service area and, quite honestly, it is hard to make cogeneration profitable in our service area. That's because what utilities must pay for power produced by a cogeneration plant is based on what it would have cost the local utility to produce the electricity itself. It is very tough to compete with Duke Power economically in producing electricity.

Q: Mr. Lee, you mentioned new opportunities a little earlier. What other opportunities do you foresee for Duke Power?

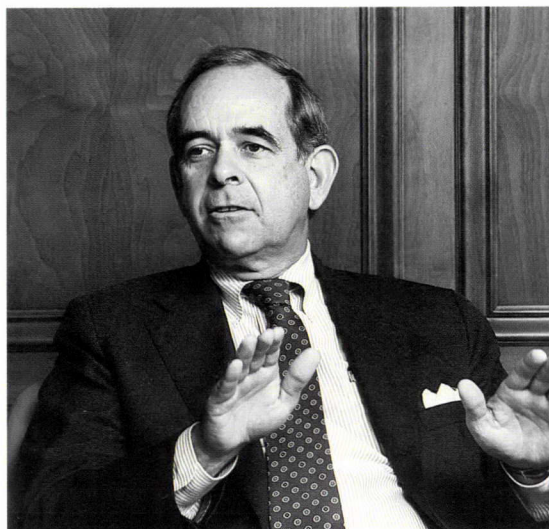
LEE: It's possible that the day is coming when sources of power supply will be deregulated. We see an opportunity there for Duke Power Company when the need for power begins to grow faster again in our region. A low-cost producer could build and own an unregulated generating plant and have an opportunity to make a profit through bulk power sales to other utilities. Now, if you look in the Southeast, you'll find one company that's able to install generation at lower cost than anyone else and is able to operate that generation at higher efficiency than anyone else. That company is Duke Power. We think this is one of the most promising areas that could possibly open up to us in the future.



Lee

GRIGG: What would be happening there is deregulation at the generation level, but continued regulation at the retail level. This would be different from a shared ownership venture, like our Catawba station, where a number of utilities jointly own a power plant. With an unregulated generating plant the owners would be free to sell bulk power in a competitive market at a market-determined price. The price paid by the ultimate customer would still be regulated.

OWEN: That kind of deregulation is like what we saw in the natural gas industry, where supply was deregulated at the well-head, but the distribution companies remained regulated. If you were to build an unregulated power plant you would probably want to set up a separate company in order to arrange project financing.



Steve C. Griffith, Jr., Senior Vice President and General Counsel

STEVE C. GRIFFITH, JR.: In that type of situation, if you have some investors with a lot of guts, they could put up the money, build a power plant and offer electricity for sale to anyone who wanted to buy it. If you have demand for power, then you can make a lot of money. If you don't have demand, you can't make much.

Q: What changes in current law would be necessary to set up a separate company to build a power plant whose electricity could be sold at an unregulated price?

LEE: We think it would probably require an amendment to the Federal Power Act and possibly changes in the Public Utilities Holding Company Act, which we feel is outdated and useless. Bill Grigg chaired the national group that attempted to bring about repeal or amendment of the Holding Company Act, but so far Congress has failed to act.

"It's possible that the day is coming when sources of power supply will be deregulated."

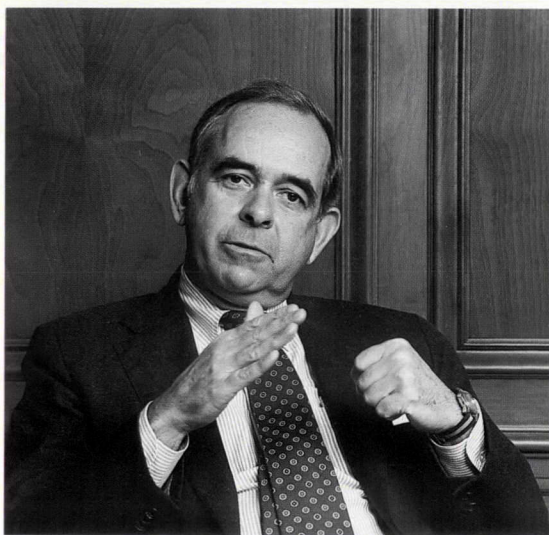
"I think our neighbors realize that they can benefit from our ability to design, build and operate plants at lower cost."

Q: Are there other reasons why the utility industry is interested in repeal of the Holding Company Act?

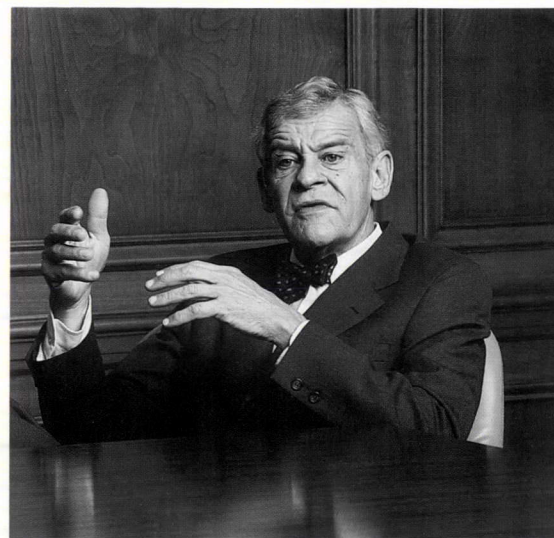
GRIFFITH: The act is an anachronism and is not needed anymore. In order to form a holding company we would have to become registered under the act and then we would be prohibited from engaging in businesses not related to the utility business. That raises the question of what would happen to Mill-Power Supply or Crescent Land & Timber.

Q: Is Duke interested in forming a holding company?

GRIFFITH: Yes. It would enable us to separate our utility business from our other businesses for the purpose of regulation and setting rates. We would not be handing regulatory commissions a consolidated balance sheet and operating statements that show all our income from all our operations. But under current law, we would consider forming a holding company only under the most extraordinary circumstances, such as acquiring another utility or acquiring generation facilities outside our service area.



Griffith



John D. Hicks, Senior Vice President, Public Affairs

Q: Will Duke and the industry continue to push for repeal of the act?

JOHN D. HICKS: We expect it will be repealed some day because it's useless. There probably will be another attempt this year but I don't know whether it will be as strong a push as our last one.

Q: What new areas of opportunity exist for Duke without regulatory changes?

OWEN: Very much in our thinking, and of growing interest among other utilities, is the idea of a joint venture to build and operate a regional power plant. This, unlike the unregulated power plant that Bill Grigg talked about earlier, would be owned jointly by several utilities. As we move into the future and we begin to look at the year 2000, most of us will need additional baseload capacity, and regional interest is growing in that idea.

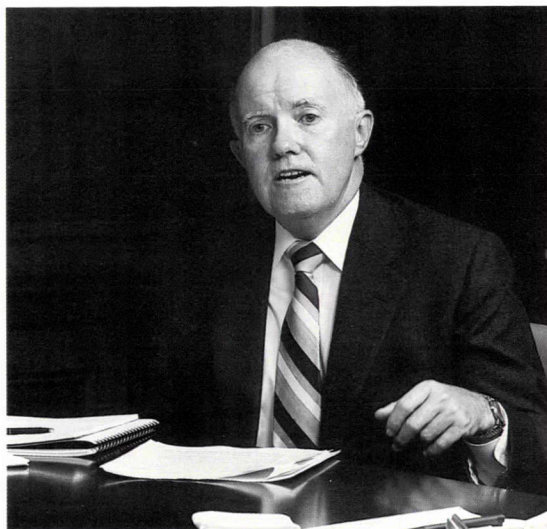
Q: What has been the reaction of other utilities to a joint venture?

BOOTH: I think our neighbors realize that they can benefit from our ability to design, build and operate plants at lower cost. They also realize that with a joint-venture plant they wouldn't have to bring on larger units than their load growth justifies at one time. Whereas initially we talked in terms of

baseload generation for a joint-venture plant, what we're finding we all need now is peaking power. So now there is a possibility of joint venturing pumped-storage capacity sometime in the future.

OWEN: We happen to have in our service area excellent topography for pumped-storage facilities, much better than most of our neighboring utilities. With pumped storage you pump water from a lower reservoir to a higher one during off-peak periods and then let the water flow back through when you need peaking power. The foothills area in the western part of North Carolina and South Carolina is ideal for that.

LEE: There is also a possibility of some temporary joint ventures. Duke could build something in excess of its needs and temporarily lease the capacity to someone else, who in turn could postpone building their own plant. Duke would later grow into the project.



Owen

Q: So Duke is considering pumped storage for peaking capacity. What about new nuclear power plants for baseload generation? Is that option still alive?

HICKS: Not unless we get two important pieces of legislation. We must get the Price-Anderson Act renewed. That's the law that sets a cap on the liability for nuclear power plants, and it expires in August. Right now that coverage is capped at \$695 million, and we must get it renewed at some level that the industry can accept, or we will entirely shut off the nuclear option in the future. The other legislation is one-step licensing for standardized nuclear power plants. Now we have a long process to get a construction permit and then the same process 10 years later to get an operating license. It will take federal legislation to get nuclear back on track, and it must get back on track because coal and uranium are the only major fuels that can provide our nation's future electricity.



Lee

Q: Just what capacity requirements does Duke foresee?

OWEN: As we've said, we have sufficient baseload capacity into the early part of the next century. All our studies clearly indicate that what we need for a substantial period is peaking capacity. It complements what we have and will make our future generating system even more flexible and economical.

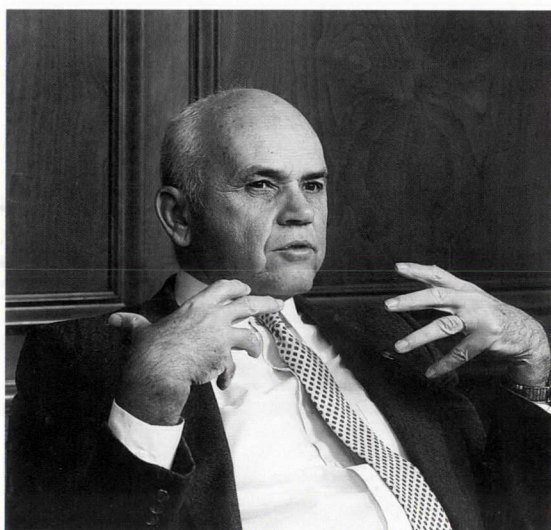
"It will take federal legislation to get nuclear back on track, and it must get back on track."

"Mandatory wheeling will undoubtedly be an issue in the current session of Congress."

Q: We talked briefly about competition. Let's talk some more about that. How much competition for customers do you see coming?

LEE: There are real, unresolved problems with that. One is the public service obligation and the other is the technical problem of controlling the flow of electricity. Electricity is not like natural gas, which you can push along a pipe to a designated customer.

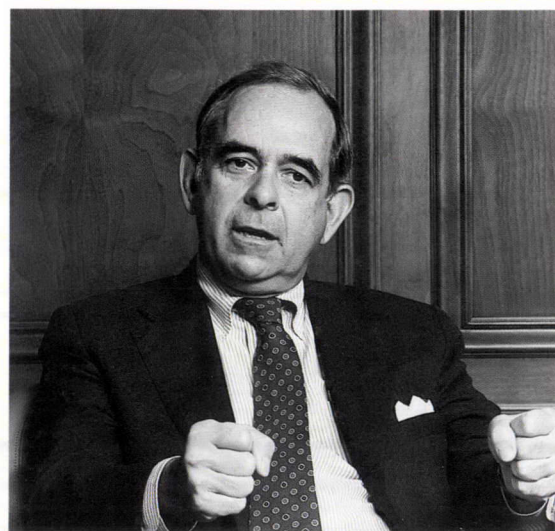
BOOTH: That's right. You cannot sell electricity to a customer on your neighbor's system unless your neighbor agrees to reduce generation by the same amount you increase it to serve that customer. That is not in your neighbor's best interest, so we think that legislation would be necessary to require that.



Booth

Q: How would your public service obligation inhibit your ability to compete for customers?

LEE: If a customer is in our service area, we have an obligation to serve that customer. Suppose another utility took that customer from us and then for some reason collapsed and was unable to continue service. Who then has the commitment or obligation to serve that customer? Us, because the customer is in our service area? Or the utility that had taken that customer from us? That's an unanswered question.



Griffith

Q: What would it take to compete for customers outside the service area?

GRIFFITH: For that to work the utility that is serving that customer must be willing to deliver our power, or as we say in our industry, wheel it to the customer, at a reasonable price. You would have to have a legal requirement that all electric utilities offer a competitive rate for wheeling.

Q: What are the chances that Congress or someone else would require utilities to wheel one another's power at competitive rates?

HICKS: Mandatory wheeling will undoubtedly be an issue in the current session of Congress. They have indicated they will address the issue, but we don't know just what wrinkles any final legislation will have.

Q: Where does Duke Power stand on the issue of mandatory wheeling?

HICKS: We're not taking any position on that issue yet. It's not something we're pushing, and it's not something we're resisting. We're just sitting back and taking a look at it right now. But if it does come, we're in better shape than almost anybody because of our ability to design and build our own power plants and generate electricity at competitive costs.

GRIFFITH: You know, Congress is not always the initiator of these things. I think what is going to happen is some utility is going to say, "We want to sell electricity beyond our neighbor, who is not giving us a fair rate for wheeling it. And we're going to court." When that happens, the courts can decide it, and I think the courts will decide in favor of wheeling.

Q: Deregulation and increased competition have come to a lot of other industries, from airlines to banking to telephones. Other than changes in wheeling regulations, what are the prospects for deregulation of the electric utility industry?

HICKS: I think that's going to move very slowly. Deregulation would be such a major restructuring of our industry, and our industry is so very important, that I doubt very seriously that there will be any major deregulation of electric utilities during this session of Congress.

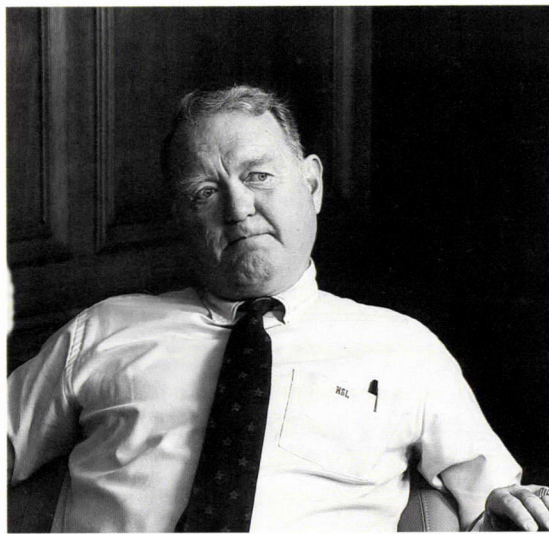


Hicks

Q: Is Duke Power prepared for deregulation if and when it comes to electric utilities?

LEE: There may still be unanswered technical, political and economic questions concerning deregulation. But I think you will see

Duke anticipating and shaping change and not being dragged along by it. From an attitude point of view, we are willing to compete, head-to-head, under any circumstances, with anybody, as long as it's fair competition.



Lee

Q: Some analysts have observed that there seem to be too many electric utilities and that a period of consolidation is inevitable. Does Duke see itself acquiring other utilities?

LEE: Perhaps so, if the deal offers particular synergisms and would enhance shareholder value without negative impact on our existing electric customers. We have studied both being an acquirer and an acquiree. Considering Duke's present size, consolidation to seek economies of scale would not offer much to us.

Q: Would Duke acquire a non-utility company?

LEE: Yes, if it meets our criteria. It must show promise of enhancing value to our shareholders, be an activity related to our expertise, be available at the right price, and not adversely affect our electric customers.

"I think you will see Duke anticipating and shaping change and not being dragged along by it."

"Prudence says that if you're going to expand, you expand into areas in which you are expert."

Q: Some utilities are diversifying through acquisitions simply because they have to find some way to put their cash to work. What are Duke's plans for its cash?

GRIGG: We presently have a little more than \$375 million in cash. We expect to use most of it on construction of the Bad Creek Hydroelectric Station, for improvements to our transmission and distribution systems and to fund the deferred purchased power expenses associated with the Catawba Nuclear Station. In the meantime, the money is being managed conservatively by Church Street Capital Corp., a subsidiary we formed to direct our intermediate-term investments.



Grigg

Q: Summing up, then, we shouldn't look for any surprises from Duke Power, should we? Is it fair to say that Duke will concentrate on doing well what it already does?

GRIGG: Yes, we plan to employ our cash mostly in our core business, the electric utility business. We will be looking for other opportunities, but prudence says that if you're going to expand, you expand into areas in which you are expert, areas where you can bring something to the table other than just money. That is how we believe we achieve the best value for our investors, while at the same time providing our customers with the kind of quality service they expect.



Lee

LEE: By a number of measures we stand among the very best in our business, but we know how far we still have to go. The efforts of our 20,000 employees have given this Company the excellence it has today. They are dedicated now to making Duke Power a customer-driven company that provides low-cost, quality service which will allow us to compete effectively in the years ahead.

Statements of Income

Duke Power Company

Dollars in Thousands	Year ended December 31,	1986	1985	1984
Electric revenues (Notes 1 and 2)		\$3,400,933	\$2,898,911	\$2,710,015
Electric expenses				
Operation				
Fuel used in electric generation (Note 1)		726,151	719,254	683,563
Net interchange and purchased power (credit) (Note 3)		378,377	107,145	(36,408)
Wages, benefits and materials		488,631	435,701	393,448
Maintenance of plant facilities		291,164	260,361	207,951
Depreciation and amortization (Notes 1 and 11)		327,844	319,295	303,429
General taxes (Note 1)		166,385	141,343	194,095
Income taxes (Notes 1 and 5)		437,605	387,777	415,836
Total electric expenses		<u>2,816,157</u>	<u>2,370,876</u>	<u>2,161,914</u>
Electric operating income		<u>584,776</u>	<u>528,035</u>	<u>548,101</u>
Other income (Notes 1, 4 and 5)				
Allowance for equity funds used during construction		52,444	62,741	98,711
Earnings of subsidiaries, net		9,736	10,101	14,706
Other, net		38,059	71,050	36,349
Income taxes — other, net		(4,522)	(20,434)	(29,180)
Income taxes — credit		32,163	40,363	42,209
Total other income		<u>127,880</u>	<u>163,821</u>	<u>162,795</u>
Income before interest deductions		<u>712,656</u>	<u>691,856</u>	<u>710,896</u>
Interest deductions				
Interest on long-term debt		252,503	267,345	276,520
Other interest		5,764	3,926	3,075
Allowance for borrowed funds used during construction (credit) (Note 1)		(13,445)	(17,008)	(30,030)
Total interest deductions		<u>244,822</u>	<u>254,263</u>	<u>249,565</u>
Net income		467,834	437,593	461,331
Dividends on preferred and preference stocks		<u>58,767</u>	<u>60,912</u>	<u>61,786</u>
Earnings for common stock		\$ 409,067	\$ 376,681	\$ 399,545
Common stock data				
Average shares outstanding (thousands)		101,220	101,178	100,346
Earnings per share		<u>\$4.04</u>	<u>\$3.72</u>	<u>\$3.98</u>
Dividends per share		<u>\$2.64</u>	<u>\$2.54</u>	<u>\$2.42</u>

See Notes to Financial Statements.

Statements of Changes in Financial Position

Duke Power Company

Dollars in Thousands	Year ended December 31,	1986	1985	1984
Sources of Funds				
Operations				
Net income		\$ 467,834	\$ 437,593	\$ 461,331
Non-fund items:				
Depreciation and amortization (Notes 1 and 11)		502,151	484,527	469,711
Deferred income taxes and investment tax credit, net of amortization (Note 5)		161,596	141,105	103,800
Allowance for equity funds used during construction		(52,444)	(62,741)	(98,711)
Purchased capacity levelization (Note 3)		(77,258)	(22,440)	—
Other, net		(71,963)	(68,250)	(13,137)
Total funds from operations		<u>929,916</u>	<u>909,794</u>	<u>922,994</u>
Funds from financing and sale of assets				
Issuance of first and refunding mortgage bonds		394,006	172,404	—
Issuance of preferred stock		98,612	—	—
Nuclear fuel trusts		57,597	57,638	84,461
Issuance of pollution-control bonds		7,251	34,114	60,720
Proceeds from the sale of an interest in the Catawba Nuclear Station		—	—	457,086
Issuance of common stock		—	—	37,194
Total funds from financing and sale of assets		<u>557,466</u>	<u>264,156</u>	<u>639,461</u>
Change in short-term position and other marketable securities		<u>149,866</u>	<u>294,222</u>	<u>(690,038)</u>
Total sources of funds		<u>\$1,637,248</u>	<u>\$1,468,172</u>	<u>\$ 872,417</u>
Applications of Funds				
Construction expenditures		\$ 637,908	\$ 594,431	\$ 546,043
Long-term debt, capital stocks retired or reacquired		672,239	247,192	138,652
Dividends paid		325,991	317,907	304,577
Change in working capital*		49,356	308,500	(386,086)
Other applications, net		(48,246)	142	269,231
Total applications of funds		<u>\$1,637,248</u>	<u>\$1,468,172</u>	<u>\$ 872,417</u>
Change in Working Capital:				
Increase/(Decrease) in current assets				
Cash		\$ 871	\$ (3,011)	\$ 5,158
Receivables		81,257	(18,011)	30,092
Refundable income taxes		—	—	(41,209)
Materials and supplies		(43,366)	53,735	(21,334)
Prepayments		371	6,633	(2,243)
Decrease/(Increase) in current liabilities				
Accounts payable		16,086	(6,016)	(36,812)
Nuclear fuel disposal costs payable		—	122,003	(122,003)
Taxes accrued		(51,359)	161,141	(158,001)
Interest accrued and other liabilities		45,496	(7,974)	(39,734)
Change in working capital*		<u>\$ 49,356</u>	<u>\$ 308,500</u>	<u>\$(386,086)</u>

*Excludes change in short-term position and change in current maturities of long-term debt and preferred stock.

See Notes to Financial Statements.

Balance Sheets

Duke Power Company

Dollars in Thousands

December 31,

1986

1985

Assets

Electric plant (at original cost — Notes 1, 3, 10 and 14)

Electric plant in service	\$9,445,032	\$8,609,284
Less accumulated depreciation and amortization	3,407,345	3,034,473
Electric plant in service, net	6,037,687	5,574,811
Construction work in progress	601,064	817,350
Total electric plant, net	6,638,751	6,392,161

Other property and investments

Other property — at cost (less accumulated depreciation: 1986 — \$8,248; 1985 — \$7,790)	40,100	39,951
Investments in and advances to subsidiaries (Note 1)	85,153	88,812
Other investments, primarily marketable securities — at cost or less (Note 1)	289,721	254,356
Total other property and investments	414,974	383,119

Current assets

Cash (Note 6)	3,614	2,743
Short-term investments	113,129	293,262
Receivables (less allowance for losses: 1986 — \$3,867; 1985 — \$4,004)	325,915	244,658
Materials and supplies — at average cost		
Coal	84,137	150,085
Other	148,850	126,268
Prepayments	15,077	14,706
Total current assets	690,722	831,722

Deferred debits

Canceled construction projects (Notes 11 and 14)	296,016	341,214
Purchased capacity costs (Note 3)	101,160	41,872
Debt expense, primarily refinancing costs, being amortized over terms of related debt (Note 1)	62,106	16,946
Other	23,000	17,129
Total deferred debits	482,282	417,161

Total assets

\$8,226,729 \$8,024,163

Capitalization and Liabilities

Capitalization (See Statements of Capitalization)	\$6,514,700	\$6,350,042
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Current liabilities

Accounts payable	143,039	159,125
Taxes accrued (Note 1)	104,282	52,923
Interest accrued	68,542	86,539
Other	49,718	77,217
Total	365,581	375,804
Current maturities of long-term debt and preferred stocks	38,911	133,342
Total current liabilities	404,492	509,146

Accumulated deferred income taxes (Notes 1 and 5)

913,426 775,333

Deferred credits and other liabilities

Investment tax credit (Notes 1 and 5)	341,124	353,227
Other	52,987	36,415
Total deferred credits and other liabilities	394,111	389,642

Commitments and contingencies (Note 14)

Total capitalization and liabilities

\$8,226,729 \$8,024,163

See Notes to Financial Statements.

Statements of Capitalization and Retained Earnings

Duke Power Company

Dollars in Thousands

December 31,

1986

1985

Capitalization

Common stock equity (Note 7)

Common stock, no par, 150,000,000 shares authorized; 101,235,772 shares outstanding for 1986 and 101,193,802 shares outstanding for 1985

Retained earnings	<u>1,210,229</u>	<u>1,071,814</u>
Total common stock equity	<u>3,071,857</u>	<u>2,932,437</u>

Preferred and preference stocks without sinking fund requirements (Note 8) 468,550 419,552

Preferred stocks with sinking fund requirements (Note 9) 221,991 277,012

Long-term debt (Note 10)

First and refunding mortgage bonds	2,635,790	2,614,136
Promissory note due subsidiary, 16½%	—	58,725
Term note, floating rate	—	21,000
Capitalized leases	83,890	87,537
Nuclear fuel trusts	85,000	85,000
Unamortized debt discount and premium, net (Note 1)	(20,112)	(18,415)
Current maturities of long-term debt	<u>(32,266)</u>	<u>(126,942)</u>
Total long-term debt	<u>2,752,302</u>	<u>2,721,041</u>

Total capitalization \$6,514,700 \$6,350,042

Dollars in Thousands

Year ended December 31,

1986

1985

1984

Retained Earnings

Balance — Beginning of year \$1,071,814 \$ 952,360 \$ 795,512

Add — Net income 467,834 437,593 461,331

Total 1,539,648 1,389,953 1,256,843

Deduct

Dividends

Common stock 267,224 256,995 242,791

Preferred and preference stocks 58,767 60,912 61,786

Capital stock transactions, net 3,428 232 (94)

Total deductions 329,419 318,139 304,483

Balance — End of year \$1,210,229 \$1,071,814 \$ 952,360

See Notes to Financial Statements.

Notes To Financial Statements

Duke Power Company

Note 1. Summary of Significant Accounting Policies

A. Additions to Electric Plant

The Company capitalizes all construction-related direct labor and materials as well as indirect construction costs. Indirect costs include general engineering, taxes and the cost of money (allowance for funds used during construction). The cost of renewals and betterments of units of property is

capitalized. The cost of repairs and replacements representing less than a unit of property is charged to electric expenses. The original cost of property retired, together with removal costs less salvage value, is charged to accumulated depreciation.

B. Allowance for Funds Used During Construction (AFUDC)

AFUDC represents the estimated debt and equity costs of capital funds that are necessary to finance the construction of new facilities. AFUDC, a non-cash, non-operating item, is recognized as a cost of "Construction work in progress," with offsetting credits to "Other income" and "Interest deductions." After construction is completed, a utility is

permitted to recover these capital costs, including a fair return, through their inclusion in rate base and in the provision for depreciation.

AFUDC, which is compounded semiannually, was calculated on average embedded rates (net of applicable income taxes) of 9.63 percent for 1986, 9.90 percent for 1985 and 9.65 percent for 1984.

C. Depreciation and Amortization

Provisions for depreciation are recorded using the straight-line method. The year-end composite weighted-average depreciation rates were 3.60 percent for 1986, 3.58 percent for 1985 and 3.56 percent for 1984. All coal-fired generating units are depreciated at the rate of 3.57 percent. Nuclear units are depreciated at a rate of 4 percent, which includes an allowance for decommissioning costs.

Amortization of nuclear fuel is included in "Fuel used in electric generation" in the Statements of Income. The amortization is recorded using the

unit-of-production method.

Under provisions of the Nuclear Waste Policy Act of 1982, the Company has entered into contracts with the Department of Energy (DOE) for the disposal of nuclear fuel. Payments made to the DOE for disposal costs are based on nuclear generation and are included in "Fuel used in electric generation" in the Statements of Income. The Company fulfilled its obligation for disposal costs of nuclear fuel consumed prior to April 7, 1983, by a payment in June 1985 of approximately \$122,000,000 to the DOE.

D. Subsidiaries

The Company's financial statements reflect consolidation of its wholly owned subsidiary, Church Street Capital Corp., formed in February 1985. All intercompany transactions have been eliminated in consolidation. Investments in other wholly owned subsidiaries have been accounted for by the equity method. (See "Subsidiaries," page 43.)

Retained earnings as of December 31, 1986, include \$89,118,000 of undistributed earnings of unconsolidated subsidiaries. Dividends received from unconsolidated subsidiaries were \$1,000,000 in 1986, \$2,200,000 in 1985 and \$2,300,000 in 1984.

E. Income Taxes

The Company and its subsidiaries file a consolidated federal income tax return. Income taxes are allocated to each company based on its separate company taxable income or loss.

Income taxes are allocated to non-electric operations under "Other income" and to electric operating expense. The "Income taxes — credit" classified under "Other income" results from tax deductions of interest costs relating primarily to investments in CWIP, canceled construction

projects, and short-term and intermediate-term investments.

Deferred income taxes are provided for timing differences between book and tax income, principally resulting from accelerated tax depreciation, levelization of purchased power payments, and capitalized taxes and employee benefits. Investment tax credits are deferred and amortized over the useful lives of the related properties.

F. Unamortized Debt Premium, Discount and Expense

Expenses incurred in connection with the issuance of presently outstanding long-term debt, and premiums and discounts relating to such debt, are being amortized over the lives of the

respective issues. Also, any expenses or call premiums associated with refinancing higher cost debt obligations are being amortized over the lives of the new issues of long-term debt.

Note 1.
Summary of
Significant
Accounting Policies
(continued)

G. Fuel Cost Adjustment Procedures

Fuel costs are reviewed semiannually in the wholesale and South Carolina retail jurisdictions, with provisions for changing such costs in base rates. In the North Carolina retail jurisdiction, a review of fuel costs in rates is required annually and during general rate case proceedings.

All jurisdictions allow the Company to adjust for past over- or under-recovery of fuel costs.

H. Other Investments

Other investments, which consist primarily of marketable securities, are stated at the lower of

Therefore, the Company reflects in revenues the difference between actual fuel costs incurred and fuel costs recovered through base rates. The North Carolina Utilities Commission ordered the Company to follow these deferred accounting procedures in its August 1986 order, which was effective for periods beginning January 1, 1986.

cost or market value. At year-end, the cost of these securities approximated market value.

I. Franchise and Sales Taxes

The North Carolina state franchise tax rate was changed effective January 1, 1985, in compliance with North Carolina state law. The statute reduced the franchise tax rate from 6 percent to 3.22 percent and imposed a 3 percent sales tax on the sales of electricity in North Carolina. This reduction in the franchise tax rate is reflected in

reduced revenues and reduced general taxes in the Statements of Income. The Company is acting as an agent for the state government in the collection of sales tax and is accumulating the amount as a component of "Taxes accrued" in the Balance Sheets. The Company remits both the sales tax and the franchise tax quarterly.

Note 2.
Rate Matters

The North Carolina Utilities Commission and The Public Service Commission of South Carolina must approve rates for retail sales within their respective states. The Federal Energy Regulatory Commission (FERC) must approve the Company's rates for sales to wholesale customers. The

revenues shown below (in millions of dollars) are annualized on the basis of the filing test year.

A summary of all general rate increases requested or implemented by the Company since January 1, 1984, is as follows:

Jurisdiction and Date Filed	Requested Revenues	Revenues	% of Request	Approved % of Increase Over Previous Revenues	Rate Order Effective	End of 12-Month Test Period
N.C. retail						
November 1983	\$212.8	\$131.0	61.6	8.40	June 1984	June 30, 1983
February 1985 (a)	340.0	157.7	46.4	9.10	September 1985	June 30, 1984
March 1986 (a)	289.3	133.1	46.0	6.73	October 1986	December 31, 1985
S.C. retail						
September 1983	136.0	99.7	73.3	17.40	March 1984	April 30, 1983
April 1985	143.0	78.4	54.8	10.75	October 1985	June 30, 1984
May 1986	137.8	79.1	57.4	9.55	November 1986	December 31, 1985
FERC wholesale (b)						
December 1983	9.5	8.0	84.2	9.60	October 1984	December 31, 1984
July 1985	9.2	5.2	56.5	10.50	March 1986	December 31, 1986
August 1986 (c)	6.4	4.5	71.0	8.30	Pending	December 31, 1987

(a) Under appeal. (See Note 14.)

(b) FERC wholesale filings do not include the North Carolina Municipal Power Agency Number 1, the North Carolina Electric Membership Corporation and the Saluda River Electric Cooperative, Inc. Beginning in July 1985, FERC wholesale filings also do not include the Piedmont Municipal Power Agency. These municipalities and electric cooperatives previously purchased interests in the Catawba Nuclear Station. (See Note 3.) Sales to these entities, which previously represented a majority of the Company's wholesale revenues, are now set through contractual agreements.

(c) This increase was implemented in November 1986 through an interim rate order from FERC. This increase is subject to refund and approval.

**Note 3.
Joint Ownership
of Generating
Facilities**

The Company has sold interests in both units of the Catawba Nuclear Station. The owners of portions of the 2,290,000-kilowatt Catawba

Nuclear Station and supplemental information regarding their ownership are as follows:

Owner	Ownership Interest in the Station	Date of Sale
North Carolina Municipal Power Agency Number 1 (NCMPA)	37.5%	November 29, 1978
North Carolina Electric Membership Corporation (NCEMC)	28.125%	February 6, 1981
Saluda River Electric Cooperative, Inc. (Saluda River)	9.375%	February 6, 1981
Piedmont Municipal Power Agency (PMPA)	12.5%	December 20, 1984

Each participant has provided its own financing for its ownership interest in the plant.

The Company retains a 12.5 percent ownership interest in Catawba. As of December 31, 1986, \$478,800,000 of "Electric plant in service" represents the Company's investment in Units 1 and 2 and nuclear fuel for those units. Accumulated depreciation and amortization of \$25,100,000 associated with Catawba had been recorded as of year-end.

Under the terms of the 1984 sale to PMPA, the Company received \$457,086,000 at closing and a note for \$13,800,000 which was paid during 1985 after the commercial operation of Catawba Unit 1.

In connection with the joint ownership, the Company has entered into contractual agreements with the other joint owners to purchase annually declining percentages of the generating capacity and energy from the plant. The agreements were effective beginning with the commercial operation of each unit. Unit 1 and Unit 2 began commercial operation in June 1985 and August 1986, respectively. Such agreements were established for 15 years for NCMPA and PMPA and 10 years for NCEMC and Saluda River.

Energy cost payments are based on variable operating costs, a function of the generation of the plant. Capacity payments are based on the fixed costs of the plant. The estimated purchased capacity obligations through 1991 are \$549,961,000 for 1987, \$493,674,000 for 1988, \$457,532,000 for 1989, \$439,655,000 for 1990 and \$424,428,000 for 1991.

The North Carolina Utilities Commission granted the Company recovery on a levelized basis

of the capital costs and fixed operating and maintenance costs of capacity purchased from the joint owners over a 15-year period. The Public Service Commission of South Carolina allowed the Company recovery on a levelized basis of the capital costs of capacity purchased over a 7 1/2-year period. The Federal Energy Regulatory Commission granted the Company recovery on a levelized basis of the capital costs of capacity purchased from the joint owners over a 15-year period for Unit 1. Recovery for Unit 2 has been requested. As provided in current rates in all jurisdictions, the Company recovers the costs of purchased energy and the portions of purchased capacity not being levelized. The portion of costs not recovered through current rates is being accumulated and the Company is recording a carrying charge on the accumulated balance. The Company will start to recover the accumulated balance when the capacity payments drop below the levelized revenues.

For the years ended December 31, 1986 and 1985, the Company recorded purchased capacity and energy costs from the joint owners of \$515,800,000 and \$224,600,000, respectively. These amounts, net of the cost of capacity purchased not reflected in current rates, are included in "Net interchange and purchased power" in the Statements of Income. As of December 31, 1986 and 1985, \$101,160,000 and \$41,872,000 net of income taxes, respectively, associated with the costs of capacity purchased not reflected in current rates had been accumulated in the Balance Sheets as "Purchased capacity costs."

**Note 4.
Other Income**

For the years ended December 31, 1986 and 1985, the Company recorded investment income of \$34,000,000 and \$58,000,000, respectively (\$29,900,000 and \$38,700,000 net of income taxes, respectively) as a component of "Other,

net" in the Statements of Income. The income is primarily from dividends and interest on securities. The taxes associated with investment income are recorded as components of "Income taxes — other, net" in the Statements of Income.

**Note 5.
Income Tax
Expense**

Income tax expense consisted of the following (dollars in thousands):

	1986	1985	1984
Income taxes related to electric expenses			
Current income taxes			
Federal	\$241,150	\$200,884	\$271,960
State	37,862	36,506	47,876
	<u>279,012</u>	<u>237,390</u>	<u>319,836</u>
Deferred taxes, net			
Excess tax over book depreciation	89,325	87,362	67,107
Capitalized taxes, employee benefits, etc.	17,023	12,487	10,337
Catawba purchased capacity costs	52,942	37,700	—
Other	6,691	(6,745)	(275)
	<u>165,981</u>	<u>130,804</u>	<u>77,169</u>
Investment tax credit			
Deferred	16,801	40,729	37,381
Amortization of deferments (credit)	(24,189)	(21,146)	(18,550)
	<u>(7,388)</u>	<u>19,583</u>	<u>18,831</u>
Total income taxes related to electric expenses	<u>437,605</u>	<u>387,777</u>	<u>415,836</u>
Income taxes related to other income			
Income taxes — other, net	4,522	20,434	91,497*
Income taxes — (credit)	(32,163)	(40,363)	(42,209)
Total income taxes related to other income	<u>(27,641)</u>	<u>(19,929)</u>	<u>49,288</u>
Total income tax expense	<u>\$409,964</u>	<u>\$367,848</u>	<u>\$465,124</u>

* Includes \$62,317,000 resulting from the sale of assets in December 1984. Such income taxes, which are included in "Other, net" in the Statements of Income, reflect a taxable gain in excess of book gain resulting principally from the treatment of AFUDC. (See Note 3.)

Total current income taxes were \$248,368,000 for 1986, \$226,712,000 for 1985 and \$376,949,000 for 1984. Of these amounts, state income taxes were \$33,876,000 for 1986, \$34,692,000 for 1985 and \$57,587,000 for 1984.

Total deferred income taxes were \$168,984,000 for 1986, \$121,553,000 for 1985 and \$69,344,000 for 1984. Of these amounts, deferred state income taxes were \$20,060,000 for 1986, \$13,178,000 for 1985 and \$7,687,000 for 1984.

Income taxes differ from amounts computed by applying the statutory tax rate to pretax income as follows (dollars in thousands):

	1986	1985	1984
Income taxes on pretax income at the statutory federal rate of 46%	\$403,787	\$370,503	\$426,169
Increase (reduction) in tax resulting from:			
Allowance for all funds used during construction (AFUDC)	(30,309)	(36,685)	(59,220)
Amortization of electric investment tax credit deferrals	(24,189)	(21,146)	(18,550)
AFUDC in book depreciation/amortization	43,679	42,575	45,298
State income taxes, net of federal income tax benefit	28,848	25,320	35,832
Increase in tax expense primarily because of excess of tax gain over book profit on sale of assets	—	—	27,280
Other items, net	(11,852)	(12,719)	8,315
Total income tax expense (see above)	<u>\$409,964</u>	<u>\$367,848</u>	<u>\$465,124</u>

**Note 6.
Short-Term
Borrowings**

The Company had unused short-term credit facilities of \$306,150,000 with 56 commercial banks as of December 31, 1986, \$316,050,000 with 59 commercial banks as of December 31, 1985, and \$319,500,000 with 60 commercial banks as of December 31, 1984. Included in these credit facilities is \$40,000,000 allocated to the 1984 issue of an-

nual tender, pollution-control revenue bonds. The facilities are on a fee basis and/or a compensating-balance basis, with total average balance requirements of \$1,351,500 for 1986, \$1,362,500 for 1985, and \$1,372,000 for 1984. There were no short-term borrowings during 1986, 1985 and 1984.

**Note 7.
Common Stock and
Retained Earnings**

Common Stock

During the past two years, the Company used stock market purchases to satisfy the requirements of its stock plans. The only issuance of common stock, other than conversions, in the past three years was in 1984 when 1,451,607 shares were issued with proceeds of \$37,194,000. For the next several years, the Company anticipates using stock market purchases to satisfy the requirements of all its stock plans and intends to

issue new shares of common stock only for the conversion of preference stock. (See Note 8.)

As of December 31, 1986, a total of 4,722,043 shares was reserved for issuance to stock plans and for the conversion of preference stock.

Retained Earnings

As of December 31, 1986, none of the Company's retained earnings were restricted as to the declaration or payment of dividends.

**Note 8.
Preferred and
Preference Stocks
Without Sinking
Fund Requirements**

The following shares of stock were authorized with or without sinking fund requirements as of December 31, 1986 and 1985:

	Par Value	Shares
Preferred Stock	\$100	10,000,000
Preferred Stock A	25	10,000,000
Preference Stock	100	1,500,000

The outstanding Preference Stock, 6¾% Convertible Series AA, is convertible into shares of common stock at the adjusted conversion price of \$23.89 per share, with each share of preference stock valued at \$100 par. The conversion price is subject to certain adjustments designed to protect the conversion privilege against dilution. In 1986, 1985 and 1984, shares of preference stock were

converted into shares of common stock as follows:

Year	Preference Shares	Common Shares
1986	10,032	41,970
1985	9,819	41,078
1984	16,136	67,510

The Company has issued 500,000 shares of Adjustable Rate Preferred Stock, Series A, with a par value of \$100 per share. The dividend rate is adjusted quarterly based on a percentage of the highest rate among certain U.S. Treasury rates. However, in no event will the dividend rate for any dividend period be less than 5.50 percent per annum or greater than 10.50 percent per annum. This rate was 5.73 percent per annum at December 31, 1986.

Preferred and preference stocks without sinking fund requirements as of December 31, 1986 and 1985, were as follows (dollars in thousands):

Rate/Series	Year Issued	Shares Outstanding	1986	1985
4.50% C	1964	350,000	\$ 35,000	\$ 35,000
5.72% D	1966	350,000	35,000	35,000
6.72% E	1968	350,000	35,000	35,000
8.70% F	1970	600,000	60,000	60,000
8.20% G	1971	600,000	60,000	60,000
7.80% H	1972	600,000	60,000	60,000
8.28% K	1977	500,000	50,000	50,000
8.84% M	1978	400,000	40,000	40,000
15.40% A	1982	1,600,000	40,000	40,000
Adjustable Rate A	1986	500,000	50,000	—
6¾%, AA Convertible	1969	35,495	3,550	—
		45,527	—	4,552
Total			\$468,550	\$419,552

In January 1987 the Company announced plans to call for redemption its 15.40% Series A. The Company plans to issue additional preferred stock in early 1987 to fund this redemption.

**Note 9.
Preferred Stocks
With Sinking Fund
Requirements**

The following shares of stock were authorized with or without sinking fund requirements as of December 31, 1986 and 1985:

	Par Value	Shares
Preferred Stock	\$100	10,000,000
Preferred Stock A	25	10,000,000
Preference Stock	100	1,500,000

Preferred stocks with sinking fund requirements as of December 31, 1986 and 1985, were as follows (dollars in thousands):

Rate/Series	Year Issued	Shares Outstanding	1986	1985
7.35% I	1973	528,000	\$ 52,800	\$ —
		552,000	—	55,200
8.20% J	1977	400,000	40,000	—
		420,000	—	42,000
8.375% L	1978	420,000	42,000	—
		440,000	—	44,000
8.84% N	1979	451,250	45,125	—
		467,500	—	46,750
11.00% O	1980	500,000	—	50,000
10.76% A	1975	2,040,000	—	51,000
7.875% P	1986	500,000	50,000	—
Less: Preferred shares reacquired for current and future sinking fund requirements (at cost)				
		Shares Reacquired		
10.76% A		72,500	—	(1,702)
8.84% N		13,800	(1,289)	—
		30,050	—	(2,607)
11.00% O		13,750	—	(1,229)
Less: Current sinking fund requirements				
7.35% I			(2,400)	(2,400)
8.20% J			(2,000)	(2,000)
8.375% L			(2,000)	(2,000)
8.84% N			(245)	—
Total			<u>\$221,991</u>	<u>\$277,012</u>

The annual sinking fund requirements through 1991, net of amounts reacquired, are \$6,645,000 in 1987 and \$8,025,000 in 1988, 1989, 1990 and 1991, with some additional redemptions permitted at the Company's option.

The call provisions for the outstanding preferred and preference stocks specify various redemption prices not exceeding 115 percent of par values, plus accumulated dividends to the redemption date.

Note 10.
Long-Term Debt

First and refunding mortgage bonds outstanding as of December 31, 1986 and 1985, were as follows (dollars in thousands):

Series	Year Due	1986	1985	Series	Year Due	1986	1985
3 $\frac{5}{8}$ %	1986	\$ —	\$ 30,000	(continued)			
12%	1990	—	75,000	9 $\frac{1}{2}$ %	2005	\$ 92,800	\$ 92,800
15 $\frac{1}{8}$ %	1991	100,000	100,000	8 $\frac{3}{8}$ %	2006	96,850	96,850
4 $\frac{1}{2}$ %	1992	50,000	50,000	8 $\frac{1}{8}$ %	2007	119,500	119,500
4 $\frac{1}{4}$ % B	1992	50,000	50,000	9 $\frac{3}{8}$ %	2008	120,610	120,610
11%	1994	—	64,250	10 $\frac{1}{8}$ %	2009	145,050	145,050
4 $\frac{1}{2}$ %	1995	40,000	40,000	10 $\frac{7}{8}$ % B	2009	148,000	148,000
8 $\frac{1}{2}$ % B	1995	125,000	—	13 $\frac{1}{8}$ % B	2010	—	50,000
7 $\frac{7}{8}$ %	1996	100,000	—	14 $\frac{1}{2}$ %	2012	16,282	125,000
5 $\frac{3}{8}$ %	1997	72,600	72,600	12 $\frac{5}{8}$ %	2015	67,517	125,000
6 $\frac{3}{8}$ %	1998	68,500	68,500	10 $\frac{1}{8}$ % B	2015	50,000	50,000
7%	1999	56,075	56,075	9%	2016	175,000	—
8% B	1999	64,739	64,739				
8 $\frac{1}{2}$ %	2000	69,244	69,244	<i>Pollution-Control</i>			
8 $\frac{5}{8}$ % B	2000	95,635	95,635	6 $\frac{5}{8}$ %	1988	25,000	25,000
7 $\frac{1}{2}$ %	2001	97,900	97,900	9 $\frac{1}{8}$ %	2013	77,000	77,000
7 $\frac{3}{8}$ % B	2001	38,050	38,050	4 $\frac{3}{4}$ % (1986)	2014	40,000	40,000
7 $\frac{3}{4}$ %	2002	78,100	78,100	5 $\frac{1}{4}$ % (1985)			
7 $\frac{3}{8}$ % B	2002	67,900	67,900	Less: Funds held			
7 $\frac{3}{4}$ %	2003	94,872	94,872	in trust		(107)	(7,212)
8 $\frac{1}{8}$ % B	2003	98,050	98,050				
9 $\frac{3}{4}$ %	2004	95,623	95,623	Total		<u>\$2,635,790</u>	<u>\$2,614,136</u>

Substantially all electric plant was mortgaged as of December 31, 1986.

The annual maturities of long-term debt, including capitalized lease principal payments, through 1991 are \$32,266,000 in 1987, \$64,063,000 in 1988, \$26,753,000 in 1989, \$5,182,000 in 1990 and \$5,664,000 in 1991.

Annual maturities through 1991 include amounts relating to the \$85 million in outstanding obligations under the Company's two nuclear fuel trusts. The maturities are based on estimated fuel consumption. Instead of making cash payments,

the Company intends to transfer title of additional nuclear fuel to the trusts as fuel is consumed.

In early 1987 the Company announced plans to call for redemption its 15 $\frac{1}{8}$ % Series due 1991 and its 10 $\frac{7}{8}$ % Series B due 2009. The Company plans to issue additional long-term debt in early 1987 to fund these redemptions. Accordingly, the 15 $\frac{1}{8}$ % Series is not included in the annual maturities listed above.

**Note 11.
Canceled
Construction
Projects**

The Cherokee and Perkins Nuclear Stations were canceled. All jurisdictions have permitted recovery of the incurred costs. These costs are being amortized principally over a 10-year period beginning October 1983. (See Note 14.)

As of December 31, 1986 and 1985, the balances for these canceled projects, net of amortization, were \$472,339,000 and \$544,145,000, respectively (\$296,016,000 and \$341,214,000 net of income tax benefits, respectively).

The Financial Accounting Standards Board in December 1986 issued a statement of Financial

Accounting Standards that may cause the Company to write down to present value its canceled construction projects. This write-down would be required because the Company's recovery of these projects through rates does not include a return on the outstanding canceled construction balances. Implementation of this statement is not required until 1988. The Company is currently evaluating the impact of this statement and does not anticipate that the new accounting requirements will have a significant effect on its results of operations or financial position.

**Note 12.
Reclassification**

In the Statements of Income, Statements of Changes in Financial Position, and Balance Sheets,

certain prior year information has been reclassified to conform with 1986 classifications.

**Note 13.
Retirement
Plan**

The Company and its operating subsidiaries have a non-contributory, defined benefit retirement plan covering substantially all their employees. The Company's policy is to fund pension costs accrued. Total pension expense, including trustee fees, amounted to \$28,815,000 in 1986, \$31,491,000 in 1985 and \$32,828,000 in 1984. The plan was changed in 1984 to include the Early Retirement Supplement Plan, a one-time early retirement offer to eligible employees. In addition, certain

amendments were made to the plan in 1985, including changes in requirements for both creditable service and vesting service. The effect of these changes did not significantly increase the Company's pension cost.

A comparison of accumulated plan benefits and plan net assets as of December 31, 1985, the date of the latest actuarial report, and December 31, 1984, is as follows (dollars in thousands):

	1985	1984
Actuarial present value of accumulated plan benefits		
Vested	\$407,467	\$340,329
Non-Vested	121,510	87,400
Total	<u>\$528,977</u>	<u>\$427,729</u>
Net assets available for benefits	<u>\$557,922</u>	<u>\$447,665</u>

The weighted-average assumed rate of return used to determine the actuarial present value of accumulated plan benefits was 7.5 percent in 1985 and 8.8 percent in 1984. The actuarial present value of accumulated plan benefits does not consider future salary increases.

The Financial Accounting Standards Board

issued a statement in 1985 which will require the Company to change its method of determining pension expense. The Company will begin implementation of this statement in 1987 and does not anticipate that the accounting requirements will have a significant effect on its results of operations or financial position.

Note 14.
Commitments and
Contingencies

A. Construction Program

Projected construction and nuclear fuel costs are \$2.14 billion and \$491 million, respectively, for 1987 through 1989. The program is subject to periodic review and revisions, and actual construction costs incurred may vary from such estimates. Cost variances are due to various factors, including revised load estimates, outcome of licensing and environmental matters, and cost and availability of capital.

B. Nuclear Insurance

The Company's public liability for claims resulting from any nuclear incident is limited to \$695 million under provisions of the Price-Anderson Act, which provides for nuclear liability insurance up to that amount. Under these provisions the Company could be assessed up to \$5 million for each of its licensed reactors for a nuclear incident involving any licensed facility in the nation, and up to \$10 million a year for each, if more than one nuclear incident occurred. Legislation is pending in Congress that could increase the limitation liability and the amount the Company could be assessed for each of its licensed reactors. As of December 31, 1986, the Company had seven licensed reactors.

The Company is a member of Nuclear Mutual Limited (NML), which provides property damage coverage for certain of the Company's nuclear facilities. If NML's losses ever exceeded its reserves, the Company would be liable, on a pro rata basis, for additional assessments of up to \$70 million. This amount represents 10 times the Company's annual premium to NML.

The Company is also a member of Nuclear Electric Insurance Limited (NEIL), which provides insurance for the increased cost of generation and/or purchased power resulting from an accidental outage of a nuclear unit. If NEIL's losses ever exceeded its reserves, the Company would be liable, on a pro rata basis, for additional assessments of up to \$21 million. This amount represents five times the Company's annual premium to NEIL.

The Company purchases \$575 million of property damage insurance through NEIL's Excess Property Insurance Program. The Company also purchased an additional \$85 million of property damage insurance through a pool of stock and mutual insurance companies. These coverages are in

addition to the \$500 million of coverage provided by the Company's underlying property damage policies issued through NML. If losses ever exceeded the accumulated funds available to NEIL for the Excess Property Insurance Program, the Company would be liable, on a pro rata basis, for additional assessments of up to \$28 million. This amount represents 7.5 times the Company's annual premium for \$500 million of excess property insurance.

In addition to the coverage through NEIL's Excess Property Insurance Program, the Company placed \$585 million through a pool of stock and mutual insurance companies for primary and excess property insurance coverage associated with its interest in the Catawba Nuclear Station.

The joint owners of Catawba will assume their pro rata share of any liability for claims resulting from a nuclear incident. The Company is being reimbursed by the other joint owners for certain expenses associated with nuclear insurance premiums paid by the Company.

C. Other

The Company is involved in legal, tax and regulatory proceedings before various courts and agencies regarding matters arising in the ordinary course of business, some of which involve substantial amounts. Except as discussed below, management is of the opinion that the final disposition of these proceedings will not have a materially adverse effect on the Company's results of operations or financial position.

Certain parties have appealed the 1985 and 1986 rate orders of the North Carolina Utilities Commission to the North Carolina Supreme Court. The appellants have raised numerous issues in these appeals, including the Commission's findings and conclusions related to the treatment of nuclear plant abandonments. An adverse ruling in these cases could have a significant impact on the Company's results of operations and financial position. While the Company is of the opinion that there is an adequate legal and factual basis for each aspect of the North Carolina Utilities Commission's decisions in the two cases, the Company cannot presently determine the ultimate resolution of the appeals.

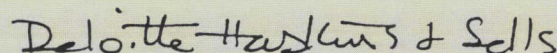
Auditors' Opinion

Duke Power Company:

We have examined the balance sheets and the statements of capitalization of Duke Power Company as of December 31, 1986 and 1985, and the related statements of income, retained earnings and changes in financial position for each of the three years in the period ended December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed more fully in Note 14, certain parties have appealed the decision of the North Carolina Utilities Commission in the Company's 1985 and 1986 general rate increases. The ultimate outcome of the appeals is uncertain at this time. In our report dated February 14, 1986, our opinion on the 1985 and 1984 financial statements referred to above was unqualified; however, in view of the uncertainty referred to above, our present opinion on such financial statements, as expressed herein, is different from that expressed in our previous report.

In our opinion, subject to the effects on the financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, the financial statements referred to above present fairly the financial position of the Company at December 31, 1986 and 1985, and the results of its operations and the changes in its financial position for each of the three years in the period ended December 31, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.



Deloitte Haskins & Sells
Certified Public Accountants

Charlotte, North Carolina
February 13, 1987

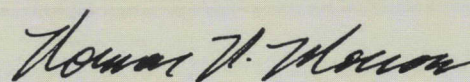
Responsibility for Financial Statements

The financial statements of Duke Power Company are prepared by management, which is responsible for their integrity and objectivity. The statements are prepared in conformity with generally accepted accounting principles appropriate in the circumstances to reflect in all material respects the substance of events and transactions which should be included. The other information in the annual report is consistent with the financial statements. In preparing these statements, management makes informed judgments and estimates of the expected effects of events and transactions that are currently being reported.

The Company's system of internal accounting control is designed to provide reasonable assurance that assets are safeguarded and transactions are executed according to management's authorization. Internal accounting controls also provide reasonable assurance that transactions are recorded properly, so that financial statements can be prepared according to generally accepted accounting principles. In addition, the Company's accounting controls provide reasonable assurance that errors or irregularities which could be material to the financial statements are prevented or are detected by employees within a timely period as they perform their assigned functions. The

Company's accounting controls are continually reviewed for effectiveness. In addition, written policies, standards and procedures, and a strong internal audit program augment the Company's accounting controls.

The Board of Directors pursues its oversight role for the financial statements through the audit committee, which is composed entirely of directors who are not employees of the Company. The audit committee meets with management and internal auditors periodically to review the work of each group and to monitor each group's discharge of its responsibilities. The audit committee also meets periodically with the Company's independent auditors, Deloitte Haskins & Sells. The independent auditors have free access to the audit committee and the Board of Directors to discuss internal accounting control, auditing and financial reporting matters without the presence of management.



Norman P. Morrow
Controller

Results of Operations

Earnings and Dividends

Earnings per share increased to \$4.04 in 1986 compared to \$3.72 in 1985. The 9 percent increase primarily resulted from higher kilowatt-hour sales related to unusual weather patterns. These higher sales also caused the earned return on common equity to rise to 13.7 percent from 13.1 percent in 1985.

Over the past five years, earnings per share increased at an annual rate of 3 percent, from \$3.59 in 1982 to \$4.04 in 1986. Earnings for 1982 included an extraordinary gain of \$.52 per share from the exchange of common stock for outstanding bonds.

The Company continued its practice of increasing the common stock dividend annually. Common dividends per share paid over the past five years increased to \$2.64 in 1986 from \$2.24 in 1982, increasing at an annual rate of 4 percent. Indicated annual dividends per share increased to \$2.68 in 1986, up 3 percent from 1985.

Revenues and Sales

Electric revenues increased at an annual rate of 11 percent from 1982 to 1986 primarily because of increases in rates and kilowatt-hour sales. Economic expansion in the Piedmont Carolinas and abnormal weather conditions have caused kilowatt-hour sales, including electricity delivered to joint owners of the Catawba Nuclear Station, to increase at an annual rate of 5 percent.

Kilowatt-hour sales for 1986, including deliveries to the Catawba joint owners, increased 7 percent over 1985. Sales to residential customers rose 10 percent from 1985. Sales to textile customers were 6 percent higher in 1986, reflecting the continued recovery in the textile industry. New industries and expansion of existing industries in our service area caused sales to other industrial customers to rise 6 percent above 1985.

Operating Expenses

Increased production requirements to meet higher kilowatt-hour sales have caused operating expenses to rise over the past five years. The addition of three nuclear units, increased maintenance at both nuclear and coal-fired stations, additional Nuclear Regulatory Commission requirements and inflation have caused non-fuel operating and maintenance expenses to rise at an annual rate of 11 percent since 1982.

Over the past five years, fuel expense has fluctuated primarily because of changes in the generation mix. During this period, the Company

placed three nuclear units in service. In 1986, fuel expense increased 1 percent over 1985 primarily because maintenance outages at the nuclear stations resulted in the Company relying more heavily on its coal-fired units. Fuel expense increased in 1985 because of refuelings at the nuclear stations that resulted from a record level of nuclear performance in 1984.

"Net interchange and purchased power" expense increased significantly in 1986 because of the purchased power agreements with the joint owners of the Catawba Nuclear Station. (See Note 3, "Notes to Financial Statements.")

Other

Allowance for funds used during construction (AFUDC) represented 16 percent of earnings for common stock in 1986, decreasing from an average of 40 percent for 1982 through 1985. The decline in AFUDC over the past five years is a result of the completion of three nuclear units, the sale of a portion of Catawba Nuclear Station and the cancellation of two nuclear projects. Because the Bad Creek Hydroelectric Station is the only generating facility under construction, AFUDC will continue to be a relatively small percentage of earnings for common stock over the next several years.

In 1986, earnings from non-utility operations were 10 percent of total Company earnings, compared to 14 percent in 1985. In total, these earnings decreased 17 percent from 1985. Components of non-utility earnings include interest and dividend income, subsidiary earnings, appliance sales and service, and Management and Technical Services income. The decline in non-utility earnings is primarily a result of a decrease in interest and dividend income because the Company had fewer investments in 1986. The Company reduced its investments to fund construction expenditures and deferred purchased power expenses associated with Catawba Nuclear Station.

Through ratemaking procedures, revenues that the Company is allowed to collect from its customers are based on historical information that does not include recovery for the costs of current and future inflation. In past years, earnings have been negatively impacted to the extent that the Company did not receive revenues to recover these current costs. Because the rates of inflation in recent years have decreased, the negative impact on revenues and earnings has not been as significant as in prior years.

Liquidity and Resources

Rate Matters

The North Carolina Utilities Commission issued a rate order in October 1986 granting the Company a 6.73 percent increase in revenues and a 13.4 percent rate of return on common equity. The Public Service Commission of South Carolina, in a November 1986 rate order, granted the Company a 9.55 percent increase in revenues and a 13.0 percent rate of return on common equity. In August 1986 the Company filed an application for a rate increase for its wholesale customers. The Federal Energy Regulatory Commission issued an interim rate order in November 1986 allowing the Company to implement an 8.3 percent increase, subject to refund and approval. The rate increases were requested in all three jurisdictions primarily to recover the Company's investment in Unit 2 of Catawba Nuclear Station and payments related to the purchased power contracts with the joint owners of the station.

The rate orders in the Company's retail jurisdictions permitted the Company to recover in rates its investment in Catawba Unit 2 and the costs associated with contractual purchases of energy and capacity from the Catawba joint owners. The contracts relating to the sales of portions of the station obligate the Company to purchase power from the joint owners on an annually declining basis. In the North Carolina retail jurisdiction, regulatory treatment of these contracts provides revenue for the recovery of the capital costs and the fixed operating and maintenance costs of purchased capacity on a levelized basis. In the South Carolina retail jurisdiction, revenues are provided for the recovery of the capital costs of purchased capacity on a levelized basis, while the fixed operating and maintenance costs are recovered in current rates. The purchased energy costs are recovered through current rates in both retail jurisdictions.

These rate treatments require the Company to fund portions of the purchased power payments until these costs, including carrying charges, are recovered at a later date. The Company will begin to recover the accumulated costs and carrying charges when the purchased capacity payments drop below the levelized revenues.

The Tax Reform Act of 1986 lowers the corporate tax rate over the next two years. To reflect the lower federal income tax rates, the Company implemented a 2.3 percent rate reduction on January 1, 1987, in its retail jurisdictions. The rate reduction was approved by both the North Carolina Utilities Commission and The Public Service

Commission of South Carolina.

In August 1986 the North Carolina Utilities Commission issued an order revising its fuel adjustment methodology, including a factor that effectively allows all prudently incurred fuel costs to be recovered. The order requires the Company to follow deferred accounting for the difference between fuel costs incurred and fuel costs collected through rates.

Retail rate increases, allowing approximately 52 percent of requested additional revenues, were granted to the Company from 1982 through 1986. These rate increases included recovery of the Company's investment in McGuire Unit 2 and in both units of Catawba Nuclear Station, compensation for increased purchased power and operating expenses, and recovery for the amortization of two canceled nuclear projects.

(For additional information on rate matters, see Note 2, "Notes to Financial Statements.")

Capital Structure

The Company's capital structure at year-end was 47 percent common equity, 42 percent long-term debt and 11 percent preferred and preference stocks. The year-end capitalization is consistent with the Company's long-term financial goals.

To satisfy the requirements of various stock purchase plans, the Company purchases common stock on the stock market. The Company has no plans for the public issuance of common stock for the next several years. (For additional stock information, see "Long-Term Financings and Sale of Assets," page 41.)

Fixed Charges Coverage

Coverage of fixed charges, using the Securities and Exchange Commission method, increased to 4.26 times for 1986 compared with 3.87 times in 1985 and is above the Company's goal of 4.00 times. Higher pre-tax earnings and lower interest expense as a result of refinancings in 1986 contributed to the increased coverage.

Funds From Operations

In 1986, funds from operations accounted for 57 percent of the total applications of funds. The percentage of internally generated funds would have been significantly higher if refinancing activities had been excluded. Also, the Company is funding the portions of purchased capacity payments not currently collected in rates. The percentage of internally generated funds still remains above the Company's goal of 50 percent.

Additional Funds

Over the past five years, the Company obtained additional funds from the sale of \$936 million in first and refunding mortgage bonds and \$137 million in preferred stock. Proceeds from the sale of common stock, including the 1982 issuance of common stock in a non-cash exchange for bonds, totaled \$321 million.

Continued favorable market conditions in 1986 prompted the Company to refund several issues of higher cost securities with lower cost securities, reducing financing costs and providing substantial savings to the Company's customers in the years ahead. Refinancing activities lowered the Company's embedded cost of long-term debt from 9.59 percent at the end of 1984 to 8.87 percent at the close of 1986. The Company's embedded cost of preferred stock declined from 8.75 percent at the end of 1984 to 8.21 percent at the end of 1986.

Capital Needs

Property Additions and Retirements

Additions to property and nuclear fuel of \$690 million and retirements of \$70 million resulted in a net increase in gross plant of \$620 million in 1986.

Since January 1, 1982, additions to property and nuclear fuel of \$3.4 billion and retirements of \$1.2 billion have resulted in a net increase in gross plant of \$2.2 billion. Retirements during the period were unusually large because the Company canceled two nuclear projects and sold a portion of Catawba Nuclear Station.

Construction Expenditures

Construction costs for major generating facilities and for nuclear fuel, including AFUDC, declined from \$558 million in 1982 to \$341 million in 1986. These costs declined because the Company placed three nuclear units in commercial operation (McGuire Unit 2 in 1984; Catawba Unit 1 in 1985; and Catawba Unit 2 in 1986), canceled two nuclear projects and sold a portion of Catawba Nuclear Station. Continuing construction expenditures at Bad Creek Hydroelectric Station will cause construction work in progress to rise and exceed \$1 billion in the late 1980s.

During 1986 funds also were required to expand and replace transmission and distribution facilities. These additional facilities provided service to 43,600 new customers which represents a 3 percent increase over 1985.

Other Expenditures

In addition to construction expenditures, the Company has applied its funds to redeem maturing and

During 1986 the Company redeemed or retired \$385 million of long-term debt and issued \$401 million in long-term debt in its place. The Company also retired \$101 million of preferred stock and issued \$99 million in preferred stock. The Company plans to continue its refinancing activities during 1987.

(For additional information on the Company's capitalization, see Notes 7, 8, 9 and 10, "Notes to Financial Statements.")

In 1984 the Company received \$457 million from the sale of a portion of Catawba Nuclear Station to the Piedmont Municipal Power Agency.

In 1985 the Company formed Church Street Capital Corp., a wholly owned subsidiary, to invest the Company's discretionary cash. As of December 31, 1986, the consolidated entity had approximately \$113 million in short-term investments and \$262 million in intermediate-term investments.

refunded securities over the past five years. (See "Liquidity and Resources.")

In June 1985 the Company paid a lump-sum amount of \$122 million to the Department of Energy under the terms of the Nuclear Waste Policy Act of 1982. The payment was for the obligation related to disposal costs for nuclear fuel consumed prior to April 7, 1983.

Over the next five years, payments by the Company to the Catawba joint owners for purchased power will exceed the levelized recovery of those costs in rates by approximately \$340 million.

Future Construction Program

Because the Company has completed its nuclear construction program, construction costs for major generating facilities for 1987 through 1989 will constitute a lower portion of the Company's total applications of funds compared to the past five years. Projected construction and nuclear fuel costs are \$2.6 billion for the next three years.

Construction of Bad Creek Hydroelectric Station continued in 1986. Units 1 and 2 of the 1,000,000-kilowatt pumped-storage facility are scheduled for completion in 1991, with Units 3 and 4 in 1992. The estimated cost of Bad Creek is \$1.0 billion, with \$158.4 million spent at year-end.

Beyond the completion of Bad Creek, the Company has no commitments to place a new generating plant in service in the near future. Studies indicate a need for peak generating facilities in the 1990s. The Company is currently reviewing its options for meeting that need.

Significant Trends

While the Company's financial performance for 1986 improved over 1985, the ability to maintain and improve this level of financial strength will depend on several factors. Further economic expansion in the Piedmont Carolinas and growth in non-utility operations could have a positive effect on total Company earnings. Moving from a construction program to an operating program, the Company will continue to focus on reducing costs while operating its system as efficiently as it has in the past.

Changes in tax legislation through the Tax Reform Act of 1986 lower the tax rate from 46 percent to 34 percent over the next two years. Initially, these lower tax rates reduce the cost of service to the Company's customers. However, it is premature to say how the Tax Reform Act, when fully implemented, will affect future customer rates. Any adjustments in rates will reflect the full impact of the Tax Reform Act and may include the impact of other expenses related to the cost of service.

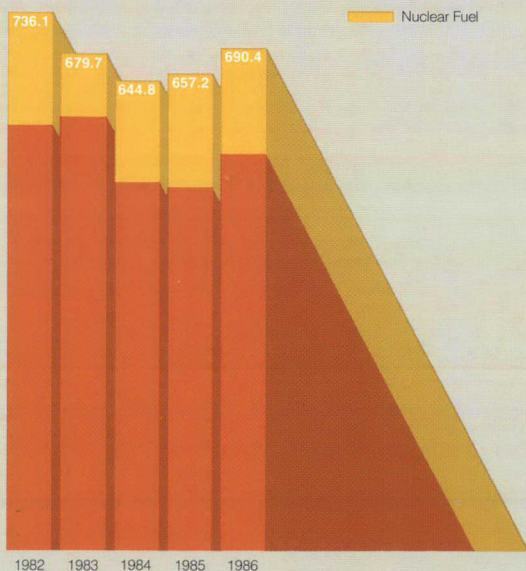
In a move aimed at increasing its non-utility earnings, the Company has turned the operations of the Management and Technical Services division into a wholly owned subsidiary called Duke Engineering & Services, Inc. This subsidiary became active in January 1987.

The Financial Accounting Standards Board has implemented accounting procedures that may cause the Company to write down to present value its canceled construction projects since the Company's recovery of those projects through rates does not include a return on the unrecovered balance. The Company is not required to implement these procedures until 1988. The Company is currently evaluating the impact of this requirement and does not anticipate that the accounting procedures will have a significant effect on the results of its operations or financial position.

Certain parties have appealed the 1985 and 1986 rate orders of the North Carolina Utilities Commission to the North Carolina Supreme Court. The appellants have raised numerous issues in these appeals, including the Commission's findings and conclusions related to the treatment of nuclear plant abandonments. An adverse ruling in these cases could have a significant impact on the Company's results of operations and financial position. While the Company is of the opinion that there is an adequate legal and factual basis for each aspect of the North Carolina Utilities Commission's decisions in the two cases, the Company cannot presently determine the ultimate resolution of the appeals.

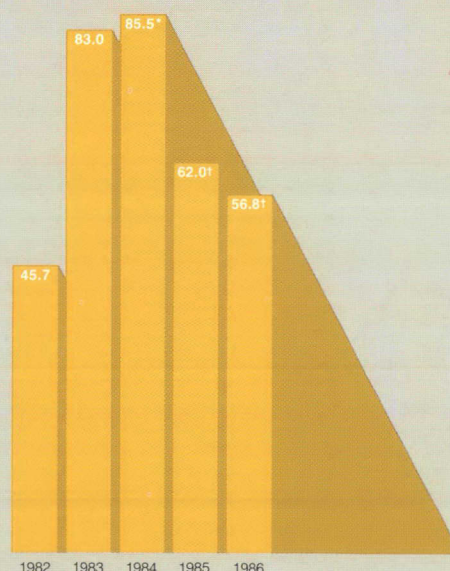
Construction costs

Millions of dollars



Internal cash generation

Percent



*Includes sale of portion of Catawba Nuclear Station.

†Based on funds from operations as a percent of total sources of funds.

Long-Term Financings and Sale of Assets

Duke Power Company

To meet its capital requirements, the Company has financed with long-term debt and equity securities and has raised additional capital through other types of financings plus the sale of certain assets. During 1986 and 1985 favorable market conditions prompted the Company to refund several issues of higher cost securities with lower cost securities in order to reduce financing costs. Financings and sale of assets from 1984 through 1986 were as follows (dollars in thousands):

	Average price per share	1986 Net proceeds	1985 Net proceeds	1984 Net proceeds
Financings				
Common stock				
Dividend Reinvestment and Stock Purchase Plan				
(1,188,333 shares)	\$25.70			\$ 30,539
Customer Stock Purchase Plan				
(263,274 shares)	25.28			6,655
Total common stock				<u>37,194</u>
Preferred stock				
7.875% Series P, \$100 par (500,000 shares issued May 15) . . .		\$ 49,562		
Adjustable Rate Series A, \$100 par (500,000 shares issued May 28)		<u>49,050</u>		
Total preferred stock		<u>98,612</u>		
Long-term debt				
First and refunding mortgage bonds				
7 $\frac{7}{8}$ % Series due 1996 (Issued April 1)		98,812		
9% Series due 2016 (Issued May 15)		171,019		
8 $\frac{1}{2}$ % Series B due 1995 (Issued June 12)		124,175		
10 $\frac{1}{8}$ % Series B due 2015 (Issued December 12)			\$ 49,279	
12 $\frac{5}{8}$ % Series due 2015 (Issued April 1)			123,125	
Pollution-control series		<u>7,251</u>	<u>34,114</u>	60,720
Total		<u>401,257</u>	<u>206,518</u>	60,720
Nuclear fuel trusts		<u>57,597</u>	57,638	84,461
Total long-term debt		<u>458,854</u>	264,156	145,181
Total financings		<u>557,466</u>	264,156	182,375
Sale of assets				
Sale of an interest in the Catawba Nuclear Station				457,086
Total long-term financings and sale of assets		<u>\$557,466</u>	<u>\$264,156</u>	<u>\$639,461</u>

The Company's plans began purchasing stock on the stock market in the following years to satisfy plan requirements:

	Stock market purchases initiated
Employees' Stock Ownership Plan	1983
Stock Purchase-Savings Program for Employees	1984
Dividend Reinvestment and Stock Purchase Plan	1985
Customer Stock Purchase Plan	1985

Selected Financial Data

Duke Power Company

	1986	1985	1984	1983	1982
Condensed statements of income (thousands)					
Electric revenues	\$3,400,933	\$2,898,911	\$2,710,015	\$2,420,252	\$2,244,480
Electric expenses	<u>2,816,157</u>	<u>2,370,876</u>	<u>2,161,914</u>	<u>1,971,038</u>	<u>1,854,712</u>
Electric operating income	584,776	528,035	548,101	449,214	389,768
Other income	<u>127,880</u>	<u>163,821</u>	<u>162,795</u>	<u>213,001</u>	<u>175,048</u>
Income before interest deductions	712,656	691,856	710,896	662,215	564,816
Interest deductions	<u>244,822</u>	<u>254,263</u>	<u>249,565</u>	<u>230,938</u>	<u>214,939</u>
Income before extraordinary item	467,834	437,593	461,331	431,277	349,877
Extraordinary item	—	—	—	—	48,304
Net income	467,834	437,593	461,331	431,277	398,181
Dividends on preferred and preference stocks	<u>58,767</u>	<u>60,912</u>	<u>61,786</u>	<u>62,600</u>	<u>62,164</u>
Earnings for common stock	<u>\$ 409,067</u>	<u>\$ 376,681</u>	<u>\$ 399,545</u>	<u>\$ 368,677</u>	<u>\$ 336,017</u>
Common stock data					
Shares of common stock — year-end (thousands)	101,236	101,194	101,153	99,634	95,949
— average (thousands)	101,220	101,178	100,346	97,784	93,679
Per share of common stock					
Earnings before extraordinary item	\$4.04	\$3.72	\$3.98	\$3.77	\$3.07
Extraordinary item	—	—	—	—	0.52
Earnings	<u>\$4.04</u>	<u>\$3.72</u>	<u>\$3.98</u>	<u>\$3.77</u>	<u>\$3.59</u>
Dividends	\$2.64	\$2.54	\$2.42	\$2.32	\$2.24
Book value — year-end	\$30.34	\$28.98	\$27.80	\$26.26	\$24.89
Market price — high-low	\$52-34 ⁷ / ₈	\$36 ⁷ / ₈ -28 ¹ / ₂	\$30 ¹ / ₈ -22 ¹ / ₄	\$26 ³ / ₈ -21 ³ / ₄	\$24-20 ³ / ₈
— year-end	\$45 ¹ / ₄	\$35 ³ / ₈	\$29	\$25 ¹ / ₈	\$23 ¹ / ₄
Balance sheet data (thousands)					
Total assets	\$8,226,729	\$8,024,163	\$8,018,818	\$7,379,445	\$7,057,780
Long-term debt	\$2,752,302	\$2,721,041	\$2,696,795	\$2,745,889	\$2,712,372
Preferred stocks with sinking fund requirements	\$ 221,991	\$ 277,012	\$ 285,426	\$ 295,053	\$ 304,026
Electric and other statistics					
Kilowatt-hour sales (millions)					
Residential	15,636	14,241	14,493	14,219	13,711
General service	12,312	11,338	10,922	10,339	10,087
Industrial	23,212	21,837	21,821	20,907	19,345
Other energy and wholesale	<u>9,353</u>	<u>8,642</u>	<u>7,163</u>	<u>8,686</u>	<u>8,237</u>
Total kilowatt-hour sales (a)	<u>60,513</u>	<u>56,058</u>	<u>54,399</u>	<u>54,151</u>	<u>51,380</u>
Residential customer data					
Average annual KWH use	12,413	11,659	12,210	12,278	12,065
Average revenue billed per KWH	6.96¢	6.42¢	6.11¢	5.67¢	5.41¢
Source of energy (millions of KWH)					
Generated — Coal	30,249	27,619	26,394	32,466	38,927
— Nuclear (b)	35,044	33,700	32,632	25,059	15,009
— Hydro	771	1,162	1,995	2,114	1,569
— Oil and gas	<u>14</u>	<u>13</u>	<u>—</u>	<u>8</u>	<u>7</u>
Total generation	66,078	62,494	61,021	59,647	55,512
Purchased power and net interchange	<u>(822)</u>	<u>(1,742)</u>	<u>(2,908)</u>	<u>(1,003)</u>	<u>(301)</u>
Total output	65,256	60,752	58,113	58,644	55,211
Less: Catawba joint owners' share	6,261	3,827	—	—	—
Plus: Purchases from Catawba	<u>5,953</u>	<u>3,769</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total sources of energy	64,948	60,694	58,113	58,644	55,211
Line loss and Company usage	<u>4,435</u>	<u>4,636</u>	<u>3,714</u>	<u>4,493</u>	<u>3,831</u>
Total kilowatt-hour sales (a)	<u>60,513</u>	<u>56,058</u>	<u>54,399</u>	<u>54,151</u>	<u>51,380</u>
System average heat rate	9,881	9,900	9,853	9,762	9,666
System load factor	59.8%	55.8%	62.2%	58.6%	56.8%

(a) Excludes a portion of the energy sold to the joint owners of the Catawba Nuclear Station.

(b) Includes 100% of Catawba generation.

Selected Financial Data

Duke Power Company

Quarterly Financial Data

A summary of quarterly financial data for 1986 and 1985 is as follows (dollars in thousands, except per-share data):

	Electric Revenues	Electric Operating Income	Net Income	Earnings Per Share
1986 by quarter				
Fourth	\$842,959	\$124,025	\$ 92,077	\$0.77
Third	940,551	181,979	152,530	1.37
Second	784,016	119,208	89,820	0.73
First	833,407	159,564	133,407	1.17
1985 by quarter				
Fourth	\$717,893	\$111,848	\$ 89,535	\$0.73
Third	751,237	141,416	119,358	1.03
Second	678,332	116,996	93,961	0.78
First	751,449	157,775	134,739	1.18

Generally, quarterly earnings fluctuate with seasonal weather conditions, timing of rate increases, fuel cost adjustment procedures and maintenance of electric generating units, especially nuclear units.

Stock Market Information

The Company had approximately 108,045 holders of record of common stock as of December 31, 1986, and 116,549 holders as of December 31, 1985. During 1986 approximately 49,499,000 shares of common stock were traded, compared with 46,098,900 during the previous year. The Company's common stock prices, as quoted in the New York Stock Exchange Composite Transactions, and dividends paid are as follows:

	Dividends Per Share	Stock Price Range			Dividends Per Share	Stock Price Range	
		High	Low			High	Low
1986 by quarter				1985 by quarter			
Fourth	\$0.67	\$49¾	\$44	Fourth	\$0.65	\$36¾	\$31¾
Third	0.67	52	41¼	Third	0.65	35¾	30
Second	0.65	45½	39½	Second	0.62	35¾	32
First	0.65	41¾	34¾	First	0.62	32¾	28½

Subsidiaries

Dollars in Thousands

Subsidiary Investments

	1986	1985
Property and investments — at cost		
Real estate, recreational and land development	\$44,823	\$39,856
Net current assets, principally investments, receivables and inventories	47,961	54,941
Total assets	92,784	94,797
Deferred income taxes	(7,631)	(5,985)
Total liabilities	(7,631)	(5,985)
Investments in and advances to subsidiaries*	\$85,153	\$88,812

*Reflects the Company's unconsolidated subsidiaries.

Board of Directors

William S. Lee
Chairman and Chief Executive Officer^{1,3,4}

Naomi G. Albanese
*Dean Emeritus School of Home Economics
University of North Carolina at Greensboro²*

Dr. Robert L. Albright
President Johnson C. Smith University²

Douglas W. Booth
President and Chief Operating Officer^{1,4}

Thomas H. Davis
*Chairman of the Executive Committee
Piedmont Aviation, Inc.³*

John L. Fraley
*Chairman of the Board
Carolina Freight Corporation³*

Alester G. Furman, III
*Chairman of the Board
The Furman Co., Inc.⁴*

Steve C. Griffith, Jr.
Senior Vice President and General Counsel¹

William H. Grigg
*Executive Vice President
Finance and Administration^{1,4}*

Paul H. Henson
*Chairman
United Telecommunications, Inc.⁴*

George R. Herbert
President Research Triangle Institute²

John D. Hicks
Senior Vice President Public Affairs¹

George Dean Johnson, Jr.
Partner Johnson, Smith, Hibbard, Wildman and Dennis²

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*Vice Chairman and Director of Public Affairs
Coca-Cola Bottling Co. Consolidated²*

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*Chairman of the Executive Committee NCNB Corporation
Chairman Bankers Trust of South Carolina⁴*

Buck Mickel
*Vice Chairman Fluor Corporation
Chairman Daniel International Corporation³*

Reece A. Overcash, Jr.
*Chairman of the Board and Chief Executive Officer
Associates Corporation of North America⁴*

Warren H. Owen
*Executive Vice President
Engineering, Construction and Production Group¹*

James C. Self
*Chairman of the Executive Committee
Greenwood Mills, Inc.
Trustee
The Duke Endowment⁴*

1. Executive Committee
2. Audit Committee
3. Compensation Committee
4. Finance Committee

Retiring Directors

The following directors retired from Duke Power's board in 1986:

Robert C. Edwards
*Chairman of the Board
Textile Hall Corporation*

Maceo A. Sloan
*Vice Chairman
North Carolina Mutual Life Insurance Company*

Austin C. Thies
*Executive Vice President
Transmission, Distribution and Electric Operations Group*

Officers

William S. Lee
Chairman of the Board and Chief Executive Officer

Douglas W. Booth
President and Chief Operating Officer

William H. Grigg
*Executive Vice President
Finance and Administration*

Warren H. Owen
*Executive Vice President
Engineering, Construction and Production Group*

Henry L. Cranford
*Senior Vice President
Division Operations*

Donald H. Denton, Jr.
*Senior Vice President
Marketing and Rates*

Steve C. Griffith, Jr.
Senior Vice President and General Counsel

John D. Hicks
*Senior Vice President
Public Affairs*

James R. Bavis
Vice President Human Resources

Thomas C. Berry
Vice President Southern Division

Shem K. Blackley, Jr.
Vice President Transmission

Ralph W. Bostian
*Vice President Production
Support Department*

J. Kenneth Clark
*Vice President Corporate
Communications*

William A. Coley
Vice President Central Division

Robert L. Dick
Vice President Construction

George W. Ferguson, Jr.
*Vice President and Deputy
General Counsel*

Excell O. Ferrell, III
Vice President Northern Division

James W. Foster
Vice President Distribution

Elbert N. Hedgepeth, Jr.
Vice President Operation

John F. Lomax
Vice President Western Division

Paul G. Martin
Vice President Eastern Division

John P. O'Keefe
Vice President Taxes

William O. Parker, Jr.
*Vice President Fossil Production
Department*

Richard B. Priory
*Vice President Design
Engineering*

William R. Stimart
Vice President Regulatory Affairs

George E. Stubbins
*Vice President Information
Systems*

Hal B. Tucker
*Vice President Nuclear
Production Department*

Fred E. West, Jr.
Vice President Charlotte Division

James W. White
Vice President General Services

C. Joe Sherrill
*Assistant Vice President
Transmission-Substation
Division*

Lewis F. Camp, Jr.
*Secretary and Associate General
Counsel*

Norman P. Morrow
Controller

Richard J. Osborne
Treasurer

David L. Hauser
Assistant Controller

Eugene C. Sites
Assistant Controller

Hansel D. Whitley
Assistant Controller

Sue A. Becht
Assistant Treasurer

W. Bruce Shannon
Assistant Treasurer

Carolyn R. Duncan
Assistant Secretary

Phyllis T. Simpson
Assistant Secretary

Subsidiaries

Richard C. Ranson
*President
Crescent Land & Timber Corp.*

W. T. Robertson, Jr.
*President
Mill-Power Supply Company*

A. Parks Cobb, Jr.
*President
Duke Engineering & Services, Inc.*

Retiring Officers

The following officers retired in 1986:

Austin C. Thies
*Executive Vice President
Transmission, Distribution and Electric Operations Group*

Duncan E. Lennon
Vice President and Tax Counsel

Dwight B. Moore
Vice President Central Division

Other Information

Notice of annual meeting

The 1987 meeting of holders of Duke Power Company common stock will be held Thursday, April 23, at 10 a.m. in the O.J. Miller Auditorium of the Electric Center, 526 South Church Street, Charlotte N.C.

Transfer agents

All Stocks,
Morgan Shareholder Services
Trust Company
30 West Broadway
New York, N.Y. 10015

Common Stock Only,
Shareholder Services
Duke Power Company
P.O. Box 33189
Charlotte, N.C. 28242

Registrars

All Stocks,
Morgan Shareholder Services
Trust Company
30 West Broadway
New York, N.Y. 10015

Common Stock Only,
First Union National Bank
of North Carolina
212 South Tryon Street
Suite 450
Charlotte, N.C. 28281

Stock exchange listing

Duke Power Company common stock is listed and traded on the New York Stock Exchange. The trading symbol is DUK.

Corporate headquarters

422 South Church Street
P.O. Box 33189
Charlotte, N.C. 28242
704/373-4011

SEC Form 10-K and statistical supplement

Upon request, the Company will provide without charge a copy of its 1986 Annual Report to Shareholders on Form 10-K as filed with the Securities and Exchange Commission. Also available without charge is the Statistical Supplement to the 1986 Annual Report. Requests for these documents should be directed to Rhem Wooten, Investor Relations, Duke Power Company, P.O. Box 33189, Charlotte, N.C. 28242. Shareholders may call Investor Relations at 373-4579 (Charlotte) or at the following toll-free numbers: 1-800-532-0492 (North Carolina); 1-800-438-0142 (elsewhere in the United States).

Duke Power Company

P.O. Box 33189

Charlotte, N.C. 28242

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