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See Financial Repts

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Pennsylvania Power & Light Company
Two North Ninth Street • Allentown, PA 18101 • 215 / 770-5151

Harold W. Keiser
Senior Vice President-Nuclear
215/770-4194

APR - 2 1990

Dr. Thomas E. Murley
Office of Nuclear Reactor Regulation
U.S. Nuclear Regulatory Commission
Washington, D.C. 20555

SUSQUEHANNA STEAM ELECTRIC STATION
ANNUAL FINANCIAL REPORT
PLA-3370 FILE R41-2A

Docket Nos. 50-387
and 50-388

Dear Dr. Murley:

In accordance with 10CFR50.71(b), enclosed is the 1989 Annual Report for Pennsylvania Power & Light Company. Also enclosed is the 1989 Annual Financial Report including certified financial statements for Allegheny Electric Cooperative, Inc. covering the period November 1, 1988 through October 31, 1989.

Very truly yours,

H. W. Keiser

Enclosures

cc: NRC Document Control Desk (original)
NRC Region I
Mr. G. Scott Barber, NRC Sr. Resident Inspector
Mr. M. C. Thadani, NRC Project Manager

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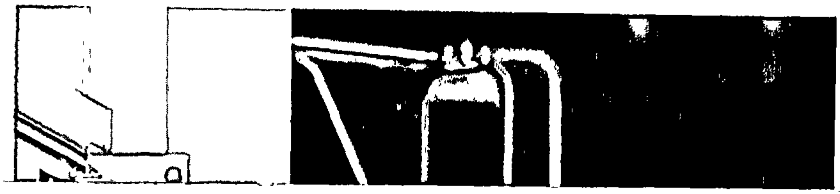
PENNSYLVANIA POWER & LIGHT COMPANY

ANNUAL REPORT 1989

Pursuing Operational Excellence



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-NOTICE-

"I've been a lineman for a lot of years. I set high standards for myself and I take pride in doing a job right — the first time. There are a lot of people at PP&L like that. Each of us, in our own way, is going to make this company grow and prosper in the '90s."

Barry Peters, *Lineman Leader*, Carlisle, Pa.

Corporate Mission

To meet our customers' ongoing needs for economical and reliable electric service in ways that merit the trust and confidence of the public.

Corporate Long-Term Objectives

- Maintain the prices that consumers pay for PP&L electric service significantly below the average price of electricity paid by Pennsylvania and other regional customers and, over the long term, hold increases in the average price of PP&L electric service below the rise in the general rate of inflation.
- Achieve a quality of customer service that is among the best when compared with other major electric utilities.
- Achieve excellence in the safe, reliable and efficient operation and support of our nuclear units that results in national recognition for having one of the best nuclear operations in the country.
- Hold peak growth rate to a level that permits us to defer the need for additional central-station generation into the 21st century.
- Achieve and maintain a return on average common equity that places PP&L in the top quartile of Salomon Brothers 100 Electric Utilities.
- Achieve and maintain a double A bond rating.
- Maintain a level of availability for our generating plants that is in the top quartile of similar plants in the United States.
- Meet applicable safety, public health and environmental standards for construction, operation and maintenance of our facilities.
- Achieve a safety record that is the best among comparable electric utility companies.
- Maintain an employee compensation structure that is consistent with overall corporate performance and that recognizes individual contributions.
- Keep PP&L's delivered price for bituminous coal below the median of the regional comparison group of utilities.

Cover

Lineman Barry Peters typifies the employee attitude that helped PP&L record its best year ever. He and the other employees shown on pages 10-17 relate how they personally will help PP&L stay competitive and be successful in the '90s. They are representative of 8,100 other employees in PP&L jobs throughout Central Eastern Pennsylvania.

Annual Meeting

See page 46 for details regarding PP&L's 1990 annual meeting to be held April 25 on the Goodman Campus of Lehigh University, Bethlehem, Pa.

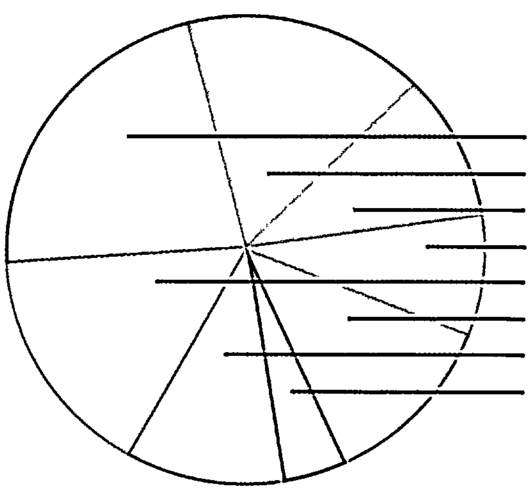
Contents

Highlights

	1989	1988	1988-1989 % Change	1987
Operating Data (in thousands)				
Total Energy Sales, Kilowatt-hours	**34,672,025**	33,766,133	2.7	32,205,298
System Energy Sales, Kilowatt-hours (a)	**28,402,145**	27,946,511	1.6	26,336,906
Interchange Power Sales, Kilowatt-hours	**9,919,749**	11,304,024	(12.2)	13,014,796
Electricity Generated, Kilowatt-hours	**43,658,166**	44,290,213	(1.4)	44,561,913
Net System Capacity, Kilowatts (c) (d)	**7,864**	7,479	5.1	7,499
Winter Peak Demand, Kilowatts	**6,000**	5,566(b)	7.8	5,591(b)
Financial Data (in thousands)				
Operating Revenues	**$2,356,446**	$2,213,903	6.4	$2,090,244
Operating Income	**$618,850**	$605,051	2.3	$590,637
Net Income	**$353,436**	$332,042	6.4	$302,461
Common Dividends Declared	**$215,386**	$207,193	4.0	$200,003
Common Equity (c)	**$2,139,338**	$2,049,831	4.4	$1,969,971
Capital Provided by Investors (c)	**$5,526,408**	$5,547,932	(0.4)	$5,582,757
Construction Expenditures	**$279,765**	$308,876	(9.4)	$258,534
Construction Work in Progress (c)	**$115,799**	$177,333	(34.7)	$141,960
Property, Plant and Equipment—Net (c)	**$6,866,642**	$6,841,584	0.4	$6,767,214
Total Assets (c)	**$7,598,968**	$7,524,648	1.0	$7,457,346
Per Common Share				
Earnings	**$4.05**	$3.73	8.6	$3.32
Dividends Declared	**$2.86**	$2.76	3.6	$2.68
Market Price (c)	**$ 42⅞**	$36⅛	18.7	$33
Book Value (c)	**$28.36**	$27.23	4.1	$26.26
Other Information				
Return on Average Common Equity	**14.62%**	13.86%	5.5	12.78%
Times Interest Earned Before Income Taxes	**2.78**	2.65	4.9	2.62
Number of Customers (c)	**1,143,591**	1,122,628	1.9	1,097,518
Common Shares Outstanding (c)	**75,422,739**	75,248,455	0.2	74,972,322
Number of Common Shareowners (c)	**132,197**	137,450	(3.8)	141,843
Number of Employees (c)	**8,108**	8,306	(2.4)	8,301

(a) Excludes contractual sales to other utilities.
(b) Winter peaks were reached early in the subsequent year.
(c) At year end.
(d) Total generating capacity plus firm capacity purchases less firm capacity sales.

Where the PP&L Income Dollar Went in 1989



Income includes revenues, other income and the allowance for funds used during construction.

Chairman's Letter

"Our goal is to be the best electric utility in the country."

A year ago, I was telling you that 1988 was our best year ever. Because of a lot of good PP&L people, 1989 was even better. Kilowatt-hour sales, revenues, earnings and dividends for 1989 were at their highest levels in our 69-year history.

These results give us additional confidence that the strategy we put in place in the '80s continues to fuel our success — and leaves us exceptionally well-positioned to face the challenges of the '90s. **Briefly, our strategy is based on our commitment to marketing and economic development, effective cost management and operational excellence.**

I'll review the key principles of this strategy later in this letter. First, I want to call your attention to the lineman on the cover and the other PP&L people pictured in this report. They are relating how their efforts will help us stay competitive and continue our success into the '90s. And there are some 8,100 others like them in our 10,000-square-mile service area. Their individual pride, their professionalism, and their pursuit of operational excellence at every level are what breathe life into our strategy and allow us to report our most successful year ever.

Sales and Earnings

We continued to market electricity aggressively in 1989. Our marketing people worked with businesses to solve their energy needs in ways that made them more competitive and improved their profits. Also, electric applications have helped enhance the lifestyles of many customers. Our service-area electric sales were up 1.6 percent. Commercial sales led the pace for a 4.5 percent increase. Residential sales rose 2.1 percent while industrial use was down .9 percent — principally because of a 16.9 percent decline in sales to steel manufacturers. Excluding sales to steel manufacturers, industrial sales rose 1.7 percent.

Sales of capacity and related energy to other utility companies, which began in 1983, continue to be an important part of our marketing mix.

Our strong generating capacity position allowed us to add another dimension to our revenues by entering into a number of new bulk-power transactions with other utilities. These transactions added about $23 million to our 1989 revenues.

Higher customer sales, sales to other utilities, along with effective cost management and refinancing of high-cost securities at a lower cost, combined to boost our earnings to $4.05 a share — 32 cents more than a year ago.

Marketing

We set challenging goals for ourselves in 1989 — and exceeded our own expectations. In all they do, our marketing and economic development people start with the strong sense of customer service that is the foundation of our corporate mission.

They market solutions to our customers' energy problems. They help them find ways to use electricity to improve their standards of living. They succeeded magnificently in 1989. The application of our marketing programs resulted in an increase in annualized sales of about 1 billion kilowatt-hours. In spite of tough competition, our domination of the residential heating market continued. About 74 percent of all new dwellings in our service area were all-electric.

We helped bring more than 14,000 net new jobs to Central Eastern Pennsylvania as part of our economic development efforts in partnership with individuals, agencies and local, regional and state governments.

Operations

The people who operate and maintain our power plants kept our generating units among the best-performing in the nation again in 1989.

The Nuclear Regulatory Commission again gave near-perfect marks for operations at our Susquehanna nuclear plant in its Systematic Assessment of Licensee Performance. This kind of consistent evaluation ranks Susquehanna among the best nuclear operations in the U.S.

The two Susquehanna units combined to generate 13.8 billion kilowatt-hours of electricity — almost 14 percent above their goal. This performance came in a year when both units went through refueling outages, which were finished ahead of schedule and under budget. Excluding the refueling outage, Unit 1 operated at an 87.8 percent operating capacity factor, while Unit 2 came in at 92.8 percent — well above expectations.

"We set challenging goals for ourselves in 1989 — and exceeded our own expectations."

Our fossil-fueled and hydroelectric units also performed very well again last year. On the average, those units were available nearly 80 percent of the time to operate at their rated capacity. This is better than the performance of similar units in the industry.

Outlook for the '90s

The integrated strategic plan that is serving us so well is based on strong marketing and economic development, effective cost management and operational excellence.

Behind the strategy are five key principles that I'd like to outline for you.

- First, our obligation to serve is the foundation of everything we do. The debate continues on a national basis on proposals to restructure our industry. Our obligation to serve our customers has unique value and we will not relinquish it to others. At PP&L we consider the obligation to serve a privilege, which we will not compromise.
- Second, we will stick to the business of being an electric utility. Our goal is to be the best electric utility in the country. Diversification into unrelated businesses would only divert our attention from the mission and objectives listed on the inside front cover — and from what we do best.
- Third, we will work very hard to retain control of the generation and transmission system your dollars have helped build. Without that control, we cannot meet our obligation to serve.
- The fourth principle is that bulk-power sales to other utilities are an essential component of our efforts to maintain base-rate stability. We have developed new nontraditional forms of bulk-power transactions that have increased revenues by about $23 million. That is on top of the $271 million in traditional contract sales to other utilities. We've seen this sales segment grow from zero percent of our revenues in 1982 to about 12.5 percent in 1989. These sales have become a significant factor in our improved financial performance.
- Last, we feel state regulators are in a better position than federal regulators to understand and act on local and regional issues. To this end, we'll work to shape regulatory policy that is in the best interest of our various publics.

Facing Future Challenges

We expect that the quality of our service will assume even greater importance in the '90s. Satisfying customers is the essential element of meeting our mission.

Achieving the revenue growth that is part of our strategy depends on reliable service and stable rates. These are the key factors in our success as a marketing company. Achieving revenue growth by increasing rates is the option of last resort. Indeed, as we entered 1990 our rates were still slightly lower than they were five years ago. We met our pledge to not raise base rates in the last-half of the '80s and we are striving to extend that pledge into 1993 and beyond.

In regard to non-utility generation, we will pay no more than is required by law or regulation and we will diligently enforce the terms and conditions of power purchase agreements made under terms of the federal Public Utility Regulatory Policies Act of 1978.

PP&L must retain control of its transmission system to assure reliability and quality of service. We must work to defeat proposals that would make transmission access mandatory or permit special-interest transmission wheeling of power.

We are in a good position to serve our customers effectively in either a fully regulated or partially deregulated world. That's because our strategy is to continue to be the low-cost, high-quality producer of electric power that our customers have come to rely on.

In any case, our adaptability will continue to be a strong asset. We successfully met the challenge of the '80s. We look forward to the '90s with a sense of confidence of purpose and direction.

You have provided the investment capital for us to build our assets to $7.6 billion. PP&L people have used those assets well — with a strong sense of customer service. We thank you for your commitment. We plan to continue to do the things that have brought us success.

Respectfully submitted,

Robert K. Campbell
March 1, 1990

Interview with Chief Financial Officer—Charles E. Russoli

Charles E. Russoli, 56, is executive vice president and chief financial officer for PP&L. He also serves on the company's Corporate Management Committee and is a member of the board of directors. He joined PP&L in 1955 and served in a number of Financial Department positions before being named vice president-Finance in 1979. He was appointed senior vice president-Financial in 1984, and became an executive vice president and director in 1986.

***Question:* How does PP&L's financial strategy interrelate with its corporate strategy of marketing and economic development, effective cost management and operational excellence?**

Russoli: Simply put, our financial strategy is to continue working to enhance our financial health under various business conditions and without base-rate increases. We see financial health as a combination of improving liquidity and earnings, minimizing financial risk to our investors and strengthening our balance sheet.

Good financial health is essential for the company to continue to provide economical and reliable electric service and to permit it to make economic decisions that are in the long-term interest of shareowners, customers and employees. It's the culmination of all our people practicing effective cost management, pursuing operational excellence in every job and continuing initiatives that will have a positive effect on increasing sales, staying competitive and offering the very best in customer service.

***Question:* What are your strategic priorities?**

Russoli: We are committed to a strategy that keeps our electric utility operations as our primary operating business. We have no intention of taking the route others have taken to increase return, that is, diversification into unrelated businesses. The diversification record in our industry has not been impressive. After evaluating the available alternatives, we have concluded that our shareowners could have more to lose than to gain in this type of diversification effort.

This doesn't mean that we won't be assessing investment opportunities which are allied to our core business. But it does mean that we expect to benefit more from sticking to what we do best — generating and selling electricity.

***Question:* Is all this consistent with the need to increase shareowner value?**

Russoli: The record of the past few years seems to bear this out. By maintaining our focus on the electric business and not letting ourselves be diverted—and there have been opportunities to do so—PP&L is healthier financially than it ever has been. Key financial indicators—earnings, common stock dividends, common stock price and book value— have reached their highest year-end levels ever. As an added note, our cash flow is among the strongest in the electric utility industry.

***Question:* What's behind this good financial health?**

Russoli: The fact is, we adapted well to changing conditions and turned challenges to our advantage. The foundation goes back to the mid-1980s. As we completed our two nuclear units in 1983 and 1985, we had generating capacity well beyond our needs. The growth projections, made before the 10-year construction period for those units began, simply did not materialize. The increase in demand fell behind our ability to provide electric energy.

We took that available generating capacity, the cost of which was not recovered in rates charged our customers, and packaged it for sale through capacity and energy contracts and other nontraditional capacity-related transactions with other utilities. Today, this type of business with other utilities is producing a good return and bolstering our earnings. And, importantly, the capacity was sold to other utilities under arrangements that will return this valuable asset to us in the years ahead to meet our customers' growing demand.

Question: **What other things did you do in the '80s that are paying off today?**

Russolt: We turned to aggressive marketing and economic development to give us steadily increasing revenues. We re-emphasized effective cost management and challenged every employee to work smarter and cut costs. Also, we took advantage of a break in the capital markets and aggressively refinanced high-cost securities with lower-cost issues. This combination — increasing revenues and controlling costs — should keep us in a competitive position in the 1990s.

All of these efforts have greatly improved our financial health — without having to apply for increased base rates.

"Our board of directors recognizes the importance of compensating investors for the funds they provide. We plan to continue our pattern of dividend increases . . ."

Question: **What are the prospects for price stability and a delay in requesting a base-rate increase in the '90s?**

Russolt: We are setting the stage to extend our successes of the '80s into the '90s. Our financial health is strongly linked to the vitality of the communities we serve. To the extent we can offer stable, competitive electric energy rates, it will be a positive factor in attracting new business and industry to our service territory. That would open up more jobs and should enhance the economic base of our communities. This should result in a cycle of prosperity that will feed back into higher sales of our product and enable us to achieve an objective of not having a base-rate increase until the 1993-95 period.

Question: **How will shareowners share in this success?**

Russolt: We have had a consistent record of dividend increases in the 1980s. Even when our liquidity was strained during the period when we were financing a massive construction program, we borrowed money to maintain that record. Our board of directors recognizes the importance of compensating investors for the funds they provide. We plan to continue our pattern of dividend increases that are usually considered by the board during the first quarter of each year.

Question: **What are your capacity expansion and financing plans for the next five years?**

Russolt: We don't see the need for additional large central-station generation until the next century, so there isn't the large financing requirement usually associated with those projects. The $325-350 million we'll be spending annually to upgrade facilities and meet new customers' needs will be paid for with cash generated in our business. Not having to finance this construction lowers our cost of doing business. This is just an extension of what we are doing in the company to keep costs down.

There is another benefit of being in a strong generating capacity position and not having to build large new generation for a while. This will give us time to sort out new technologies and new options of providing generation. Many other utilities are short on generation and must make important decisions now. We are fortunate that we'll be able to benefit from seeing a lot of those decisions play themselves out.

Additionally, our diversity of fuels among coal, nuclear, oil and hydro gives us comfort that we are in a good position to withstand possible dislocations of fuel supplies in the '90s.

Question: **What is your financial exposure from the Clean Air proposals being considered by Congress?**

Russolt: From a financial point of view, we are in a much better position than we were a decade ago. Also, our asset base is $7.6 billion compared to about $4 billion a decade ago. Because we are working from a much larger base, we can handle more easily the construction costs resulting from proposed legislation to combat acid rain.

The legislation proposed by the Bush administration calls for the reduction of sulfur emissions in two phases — the first to be effective by 1996, and the second by 2001. Compliance with the first phase would require about a 3 percent increase above the amount our customers now pay for electricity. Costs for the second phase translate into about an 8-10 percent increase requirement beyond the 3 percent increase for the first phase.

Frankly, we believe that the legislation is premature. A major study of the subject, commissioned by Congress and conducted at a cost of about $500 million by the National Acid Precipitation Assessment Program, has been under way since 1980 and the final report is expected to be released this fall. We believe that any legislative effort would benefit from the study in its final form. But, of course, we'll comply with any legislation that is enacted.

Question: **Anything else on the horizon?**

Russolt: For the time being, we don't see any serious problems headed our way that we can't handle. If there are some that we don't see, though, I'm confident that we'll be able to adapt in the '90s as we did in the '80s.

Year In Review — What Made News at PP&L in 1989

Here are highlights of what made news at PP&L in 1989. For a detailed review of the company's financial condition and a discussion of the results of 1989 operations, please see the information beginning on page 18.

JANUARY

- PP&L sells $125 million of new first mortgage bonds through underwriters to yield 10.07 percent. This sale provides the funding for the redemption of $125 million of 13.5 percent Series Bonds in April.

FEBRUARY

- An estimated 800 people — including representatives of federal, state, county and municipal agencies — participate in annual nuclear emergency drill for Susquehanna plant. PP&L's ability to protect public health and safety satisfactorily demonstrated by the drill — the first-ever where the exact day and time were kept from participants.
- The company increases the quarterly common stock dividend from 69 to 71.5 cents per share in recognition of increased shareowner investment and improved earnings.

MARCH

- Operators shut down Unit 1 at Susquehanna nuclear plant to begin its fourth refueling and inspection outage. The shutdown ends the unit's most successful fuel cycle, during which it generated 10.5 billion kilowatt-hours of electricity and operated at an 85 percent capacity factor.

APRIL

- The company announces plans for a Consolidated Customer Contact Center in the Allentown area to handle all telephone answering, accounts receivable and billing functions. The move is expected to result in an improved level of customer service and annual savings in excess of $1 million a year.

MAY

- Joining colleagues from 29 countries around the world, PP&L becomes a charter signer, in the U.S.S.R., for the establishment of the World Association of Nuclear Operators. Modeled on the U.S. Institute of Nuclear Power Operations, WANO is a significant step in terms of the safe and reliable operation of the world's nuclear facilities.

JUNE

- PP&L joins the 10 other power pool member companies twice in June in reducing voltage by 5 percent on its distribution network to stretch out electric supply and protect power reserves. Although the company has plenty of power to meet its customers' needs, hot, humid weather and increased air-conditioner use make for slim power reserves in areas served by the Pennsylvania-New Jersey-Maryland Interconnection.
- Susquehanna Unit 1 resumes generating electricity June 10, ending its fourth refueling and inspection outage six days ahead of schedule. During the outage, plant workers replaced about one-quarter of the 764 nuclear fuel assemblies in the reactor vessel and performed 3,400 maintenance tasks and inspections.
- The Public Utility Commission, in its annual Consumer Services Activities report, ranks PP&L No. 1 in customer service among the state's electric utilities. The PUC's Bureau of Consumer Services each year measures all of Pennsylvania's utilities in various customer service categories.

JULY

- Hot, humid weather late in July stretches power supplies thin in the power pool serving Pennsylvania, New Jersey and Maryland. PP&L participates in 5 percent voltage reduction. The company's customers are just shy of breaking the old peak summer demand record set in 1988.

- The Institute of Nuclear Power Operations renews accreditation of the training programs at Susquehanna nuclear plant. The Susquehanna Training program was the first to be accredited and the first to have its accreditation renewed — after a review by the accrediting board of the National Academy for Nuclear Training.

AUGUST

- PP&L's first post-war generating plant turns 40 years old. Prudent planning has kept the Sunbury Steam Electric Station updated and upgraded through the years, so that today it runs virtually as well as when it was put into service. A four-year upgrade of plant controls with a modern, digital computer control system was completed in 1988.

SEPTEMBER

- Three PP&L consumer programs are honored by the Edison Electric Institute in its Common Goals Award competition. The annual awards recognize utility companies that have developed outstanding consumer programs designed to find solutions to problems shared by utilities and their customers.
- Susquehanna Unit 2 shut down to begin its third refueling and inspection outage. In the second fuel cycle, which began in spring of 1988, the unit operated at a capacity factor of 93 percent and generated more than 10.3 billion kilowatt-hours of electricity.

OCTOBER

- The Nuclear Regulatory Commission lauds Susquehanna plant's emphasis on a strong safety culture in its latest SALP (Systematic Assessment of Licensee Performance) report.
- PP&L sells $250 million of new first mortgage bonds through underwriters to yield 9.27 percent. This sale — the largest sale of securities in PP&L's history — provides funding for the redemption of higher-cost debt securities.

NOVEMBER

- PP&L's Montour Preserve wildlife education and land management programs recognized by the Pennsylvania Game Commission's annual "Working Together for Wildlife" award.
- The company announces a "Fitness for Duty Program" to begin at the Susquehanna nuclear plant in January 1990. The new random drug and alcohol testing program was developed in response to new NRC regulations.
- Two severe windstorms four days apart disrupt power to more than 200,000 of PP&L's 1.1 million customers in mid-November. Customer service, construction and distribution line workers perform yeoman service under trying conditions to restore electric service. Outside help was not available under mutual assistance pacts as virtually all utilities in the Northeast faced similar problems.
- Susquehanna Unit 2 returns to service two days ahead of its 11-week refueling outage goal. About one-quarter of its nuclear fuel assemblies were replaced, 3,300 maintenance and inspection tasks and 50 modifications were completed while the unit was out of service.

DECEMBER

- The company's stewardship of its land holdings earns a first-place award in the "Take Pride in Pennsylvania" program of the Pennsylvania Department of Environmental Resources' Bureau of State Parks. The awards are made to organizations committed to ensuring wise use and protection of the commonwealth's natural, cultural, historical and recreational resources.
- PP&L customers set four new all-time peak demand records during an unusually severe cold spell in mid-December. The new peak of 6 million kilowatts broke the mark set nearly two years ago. Because of its high concentration of electric heat customers, PP&L is a winter-peaking company in a summer-peaking power pool.

PP&L People Continue Award-winning Performance

PP&L's sixth year of aggressive marketing and economic development activities produced goal-busting statistics for the company, as well as state and national recognition.

- Total energy sales for 1989 were 34.7 billion kilowatt-hours — the highest level ever.
- Sales to PP&L customers were 28.4 billion kilowatt-hours — an increase of 1.6 percent over 1988.
- A record 6.3 billion kilowatt-hours of electric energy were sold to other utilities through contractual arrangements.
- More than a billion kilowatt-hours in annualized new sales were attributable to aggressive PP&L marketing and economic development activities.

PP&L marketing specialists continued their domination of competitions at the state and national levels.

PP&L people earned two first-place awards and a third-place, and six others were named finalists in

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Director/Officer Changes in 1989

The following changes occurred among the board of directors and officers during 1989. Additional information on directors and officers, including ages and years of service, can be found on page 48.

- Roswell Brayton Sr. and Edgar L. Dessen retired from the board of directors on April 26, 1989, the date of the company's annual meeting. Mr. Brayton, chairman of the board of Woolrich, Inc., Woolrich, Pa., had been a director since 1980. Dr. Dessen, a physician-radiologist in Hazleton, Pa., had been a director since 1966.
- Clifford L. Jones, president of the Pennsylvania Chamber of Business and Industry, Harrisburg, was elected to the board, effective Feb. 1, 1989.
- Elmer D. Gates, president and chief executive officer of Fuller Company, Bethlehem, was elected to the board, effective Sept. 1, 1989.
- William J. Flood, secretary-treasurer, director and co-owner of Highway Equipment Supply Co. of Harrisburg and Hazleton, was elected to the board, effective Jan. 1, 1990.

- Brent S. Shunk, vice president-Lancaster Division, retired on April 1, 1989, after a 43-year career with PP&L.
- Joseph C. Krum, director-Marketing & Economic Development, was named vice president-Lancaster Division, effective April 1, 1989.
- William F. Hecht, vice president-Marketing and Customer Services, was appointed vice president-Power Production & Engineering, effective May 5, 1989. He was appointed senior vice president-System Power & Engineering and became a member of the company's Corporate Management Committee, effective Sept. 1, 1989.
- Grayson E. McNair, vice president-System Power, was appointed vice president-Marketing & Customer Services, effective May 5, 1989.
- Francis A. Long, manager-System Planning, was appointed vice president-Power Supply, effective May 5, 1989.
- Gennaro D. Caliendo, vice president and general counsel, was appointed senior vice president, general counsel and secretary, effective June 1, 1989. He also serves as a member of the Corporate Management Committee.
- Linda Curry Bartholomew, senior director and economist-Public Affairs, was appointed vice president-Public Affairs, effective June 1, 1989.
- Edward M. Nagel, vice president and secretary, was appointed

the 1989 Edison Electric Institute's residential marketing competition. In the industrial and commercial competition, company engineers received first- and third-place awards and nine were finalists.

On a state level, three out of six annual awards given by the Pennsylvania Electric Association in the residential category went to PP&L marketing people, along with seven of 13 awards in the industrial and commercial category.

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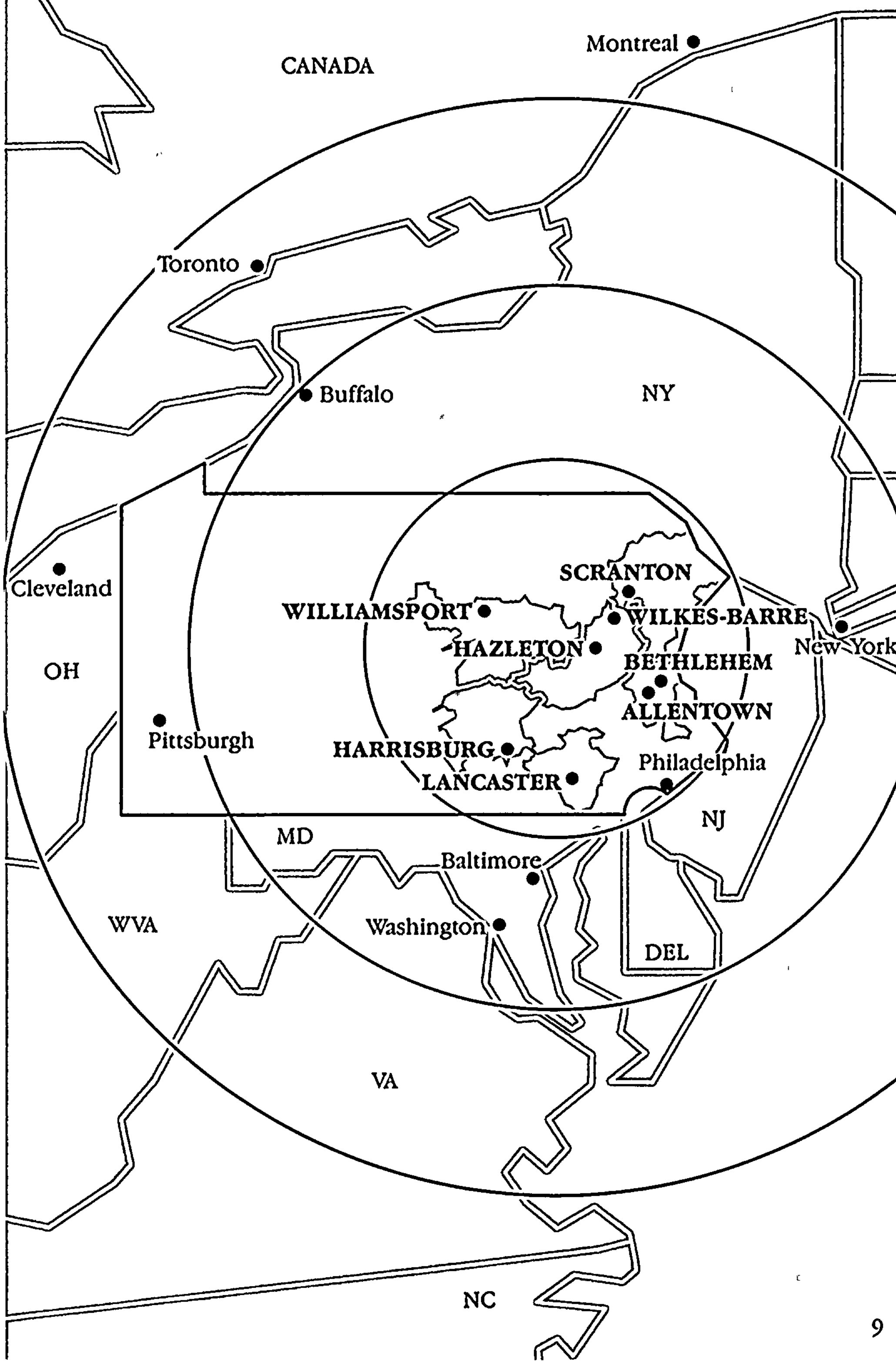
vice president-Federal Policy, effective June 1, 1989.

- John R. Menichini, Marketing & Energy Services manager in Harrisburg, was appointed vice president-Harrisburg Division, effective Sept. 1, 1989. He succeeds Charles J. Green, who died July 16. Mr. Green, had been employed by PP&L for 29 years.
- Merlin F. Hertzog, executive vice president-Corporate Services, and a member of the company's Corporate Management Committee, concluded a 30-year career with PP&L when he retired for health reasons on Sept. 1, 1989. He also retired as a member of the board of directors, on which he had served since 1984.
- John T. Kauffman, executive vice president-Operations, was appointed executive vice president and chief operating officer, effective Oct. 1, 1989.
- Charles E. Russoli, executive vice president-Financial, was appointed executive vice president and chief financial officer, effective Oct. 1, 1989.
- Edward F. Reis, director-Corporate Planning, was appointed vice president-Corporate Planning, effective Jan. 1, 1990.
- Robert G. Byram, superintendent of Susquehanna Steam Electric Station, was appointed vice president-Nuclear Operations, effective Jan. 1, 1990.

The Hub of America's Largest Metropolitan Marketplace

Pennsylvania Power & Light Co., based in Allentown, Pa., provides electric service to more than 1.1 million homes and businesses throughout a 10,000-square-mile area in 29 counties of Central Eastern Pennsylvania. Principal cities in the PP&L service area are Allentown, Bethlehem, Harrisburg, Hazleton, Lancaster, Scranton, Wilkes-Barre and Williamsport. The area is at the heart of the nation's largest industrial and commercial market area. More than 70 million consumers live within a 300-mile radius.



Bill Simmendinger, *Construction Lineman,* Allentown Area

Power Supply

"My job is to help build, and repair, the high-voltage transmission lines that get electricity from our power plants to a local distribution system where it will be used by PP&L's customers. Working high up on a steel tower, around lines carrying high-voltage electricity, can be dangerous. But, we're trained for safe production — and we look out for each other. My biggest concern is to make sure I get through each day safely — and to help see that the guy working next to me does also."

"It's taken long years of training to put me at the controls of a $4 billion nuclear power plant. We stick to procedures. There's only one right way to operate here."

Joseph Brokus,
Plant Control Operator,
Susquehanna Plant

"I spend more time planning a maintenance outage than it takes to do it. When a unit's lost generation costs $200,000 a day, you don't want to lose time spinning your wheels."

Roger Hoffman,
Construction Foreman,
Montour Plant

"Without fuel, this generating unit won't run. I make sure we have a good supply of coal and coke going in this end, so electricity keeps coming out the other end."

Cliff Aukamp,
Foreman-Coal Yard,
Holtwood Plant

"A power plant is a complicated maze of systems and machinery. I try to maintain every piece of equipment as if it belonged to me — it's a very personal commitment."

Roy Burton,
Senior Power Production Engineer,
Sunbury Plant

Shelley Ortiz,
Customer Service Instructor,
Allentown

Operations

"PP&L last year made a commitment to open a consolidated Customer Contact Center in 1990, in the Allentown area, to serve all of our million-plus customers. We'll operate with extended business hours to provide an improved level of customer service to those we serve. We're devising training programs that will help our people be ready for any type of inquiry, request for service, or emergency repair call that comes in on our phones. We'll be ready when those phones start ringing."

"Our operating workers depend on their vehicles as much as any tool they have to get the job done. I make sure the trucks are ready to go out whenever they're needed."

Donald Peters,
Transportation Mechanic,
Allentown

"We've got to be ready with a new electric service when the customer needs it. It doesn't happen overnight. We plan our end so we're there when the customer calls."

Donald Meyers,
Distribution Technician,
Wilkes-Barre

"Our linemen's very lives depend on their safety equipment. I try to inspect and maintain it as if someone in my family were going to be using it."

Rosella Gardecki,
Lab Assistant,
Hazleton

"The way I treat our customers every day will create impressions of PP&L that last for years — I try to keep them satisfied that we're there to help them."

John McCarthy,
Customer Contact Representative,
Bloomsburg

John Wilt, *Economic Development Director,* Harrisburg

Marketing

"The success of this company is closely tied to the economic well-being of the communities we serve. We don't just provide power. We identify properties that would be attractive to new commerce and industry. We recruit businesses, assist them in their plant location needs and make it easy for them to move to Central Eastern Pennsylvania. Once I get a chance to show them the work ethic here, the hospitable climate for business, and our reliable supply of electricity at a stable cost — they convince themselves they should be here."

"When people come to us for information about how to heat and cool electrically, they're looking for solutions. My job is to help come up with answers that will satisfy them."

Alicia Orbin,
Supervisor-Residential Marketing,
Scranton

"The people who run this school concentrate on providing educational services. I make sure they don't have to worry about power supply problems."

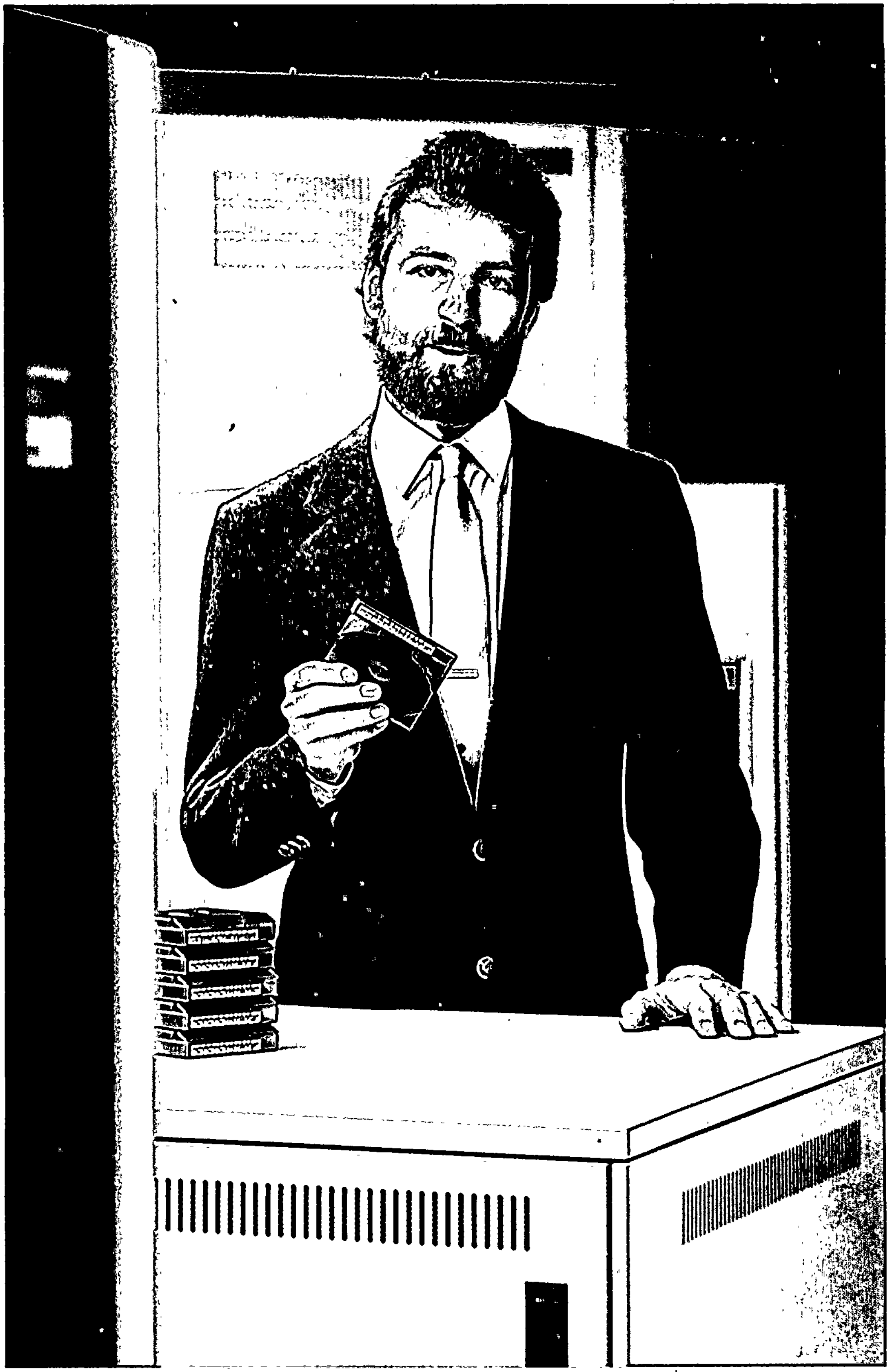
Rudyard Cooper,
Business Consultant,
Allentown

"Every time a new commercial establishment breaks ground, we're in competition with gas or oil to meet their energy needs. I'm there to convince them electricity is best."

Karen Sheehe,
Power Engineer,
Lancaster

"We're not just out there on a regional or national basis, looking to attract new businesses to our service area. I help see that we compete on an international scale."

Robert Boyle,
International Director-Economic Development,
Allentown



Joseph Dadura, *Senior Computer Operator,* Allentown

Support

"Time is money. No business can afford to send out bills, pay invoices or keep track of millions of pieces of data and information the way we did a generation ago. I'm here to tend to the electronics that take on work tasks we couldn't possibly cope with otherwise. My job is just as vital to PP&L's success as that lineman out there hooking up a new customer . . . and I take it just as seriously."

"Without this drawing, a job coming up at our Martins Creek power plant just couldn't be done. I'm in partnership with the crew that will do the job."

Gail Bartley,
Senior Drafter,
Allentown

"More than 1,800 employees in our General Office count on people like me to provide a comfortable workplace. I help keep them productive."

Fred Browning,
Building Utilities Mechanic,
Allentown

"My talents make it easier for our engineers to do their jobs. Those of us in support positions can see a part of ourselves in every completed job."

Diane Hausman,
Steno/Clerk,
Allentown

"No matter who calls here, whether they own one share or thousands, I try to provide the prompt, courteous attention deserved by owners of our company."

Tom Andrew,
Supervisor-Investor Records,
Allentown

Review of the Company's Financial Condition and Results of Operations

Results of Operations

Earnings

Earnings per share of common stock were $4.05 in 1989, $3.73 in 1988 and $3.32 in 1987. The improvement in 1989 earnings can be attributed to the same factors that had a positive impact on earnings in recent years — growth in system sales reflecting aggressive marketing and economic development programs, effective cost management and the refinancing of high-cost securities at a lower cost. In addition, the Company's strong generating capacity has enabled it to add another dimension of revenues by entering into a number of new capacity-related and transmission entitlement transactions in 1989 with other electric utilities.

Extremes in weather conditions can have a significant effect on earnings for a period. The extremely cold weather in December 1989 increased energy sales and earnings for the last quarter of 1989. However, with relatively mild weather during the earlier part of the year, sales for 1989 were at about the level the Company would have experienced with normal temperatures throughout the year. By comparison, an extremely cold first quarter of 1988 and an extended period of hot weather in the summer of 1988 added about 540 million kwh to 1988 sales which increased earnings per share by about 20 cents in 1988.

Earnings for 1987 were reduced by about 10 cents per share due to a nonrecurring accrual for the refund in 1988 of approximately $17.5 million collected from customers in prior periods for certain taxes and energy costs.

Capacity-Related and Transmission Entitlement Transactions

The Company's strong generating capacity position enabled it to enter into a number of capacity-related transactions during 1989 with other electric utilities. These transactions include (i) the sale of capacity credits but no energy to other utilities in the Pennsylvania-New Jersey-Maryland Interconnection (PJM) to enable them to satisfy their PJM contractual capacity obligations and (ii) agreements with non-PJM utilities for the reservation of output during certain periods from the Company's Martins Creek oil-fired units with the option to purchase energy from those units. The Company also entered into arrangements whereby other PJM utilities can purchase the Company's entitlements to use the PJM transmission system to import energy from utilities outside PJM.

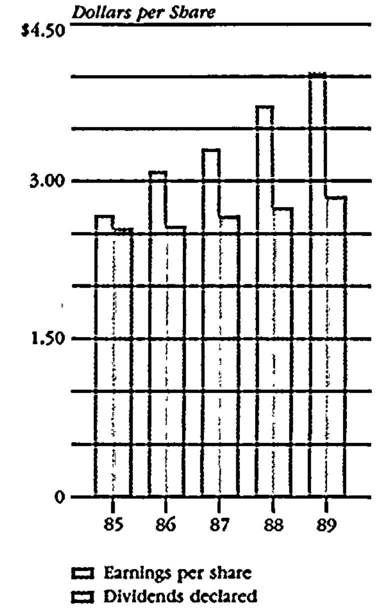
The revenues from these transactions, other than revenues applicable to sales of energy from the Martins Creek units which serve to reduce the Company's Energy Cost Rate (ECR), amounted to $23.3 million in 1989, and increased earnings by about 19 cents per share of common stock. The agreements relating to the reservation of output from the Martins Creek units are currently pending before the Federal Energy Regulatory Commission (FERC). In addition, the Company has entered into an agreement for the sale of additional capacity credits and energy effective June 1, 1990 pending state regulatory commission action and FERC approval.

The market for the capacity-related transactions is still evolving and the amount of revenues from such transactions depends on many factors, including the demand for electricity on the purchasing utility's system, the ability of the transmission system to accommodate these transactions and the availability of the purchasing utility's generating capability. The length of the arrangements varies. The Company is in the process of negotiating additional transactions, and as a result, it is difficult to predict the amount of revenue the Company will ultimately realize from these transactions. However, based on contractual arrangements currently in effect or pending regulatory approval, the Company estimates that it will realize revenues of about $31 million from these transactions in 1990, which equates to earnings of about 25 cents per share of common stock.

Electric Energy Sales

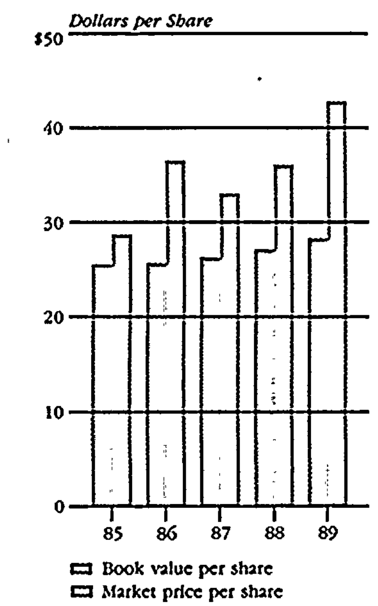
System, or service area, sales were 28.4 billion kwh in 1989, an increase of 0.5 billion kwh, or 1.6%, over 1988. This increase was primarily

Earnings and Dividends Per Share



Earnings per share of $4.05 for 1989 were 51% higher than in 1985.

Common Stock Book Value vs. Market Price (Year End)



The market-to-book ratio increased from 112% for 1985 to 151% for 1989.

attributable to strong commercial sales, reflecting in part the effects of the Company's aggressive marketing and economic development programs and extremely cold weather in December which resulted in a substantial increase in the use of electricity for heating. Sales to residential and commercial customers increased 205 million kwh, or 2.1%, and 353 million kwh, or 4.5%, respectively. Sales to industrial customers decreased 76 million kwh, or 0.9%.

The decrease in sales to industrial customers was due to a 205 million kwh, or 16.9%, reduction in sales to customers in the steel manufacturing sector, generally reflecting reduced production due to the softening of the market for steel products. Sales to other industrial customers increased 129 million kwh, or 1.7%.

One measure of the success of the Company's marketing and economic development programs is the annual level of additional energy sales that are expected to be realized from these programs. These additional sales generally will be realized over at least a two-year period, and possibly longer if a major commercial or industrial customer is involved. The annual level of additional sales estimated from these programs was 640 million kwh in 1987, 862 million kwh in 1988 and 1.0 billion kwh in 1989. The goal for 1990 is annual sales of 930 million kwh.

The Company has faced increased competition from other fuel sources for certain energy applications. In addition, certain large commercial and industrial customers have considered self-generation of electricity. The Company has been successful in meeting this competition. About 74% of all new dwellings in the Company's service territory were all-electric in 1989. No major customers have changed their source of supply for electricity during the past three years. The Company expects to continue into the 1990s the marketing and economic development activities that have been successful in the last several years.

On a weather-normalized basis, the Company estimates that system sales for 1989 were 28.4 billion kwh, an increase of 1.0 billion kwh, or 3.7% over weather-normalized system sales for 1988. The Company currently anticipates weather-normalized system sales of approximately 29.5 billion kwh for 1990, an increase of 1.1 billion kwh, or 3.7%, over 1989 weather-normalized system sales.

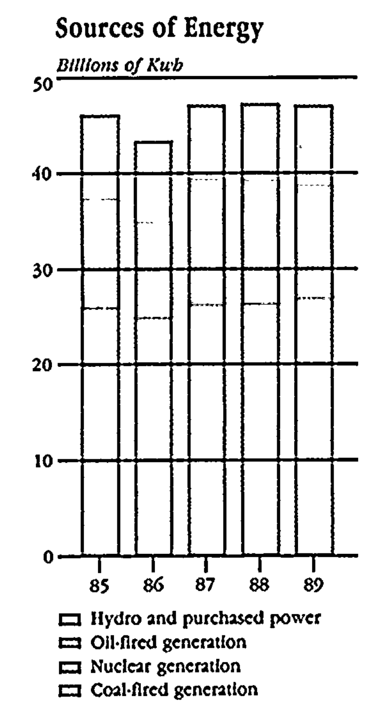
Total electric energy sales, which include contractual sales to other utilities, were 34.7 billion kwh, or 2.7%, higher in 1989 than in 1988. Contractual sales to other utilities represent the energy sold to Atlantic City Electric Company (Atlantic) from the nuclear-fueled Susquehanna Steam Electric Station, the energy sold to Jersey Central Power & Light Company (JCP&L) from all of the Company's generating units and the energy sold to other utilities pursuant to agreements relating to the reservation of output from the Martins Creek oil-fired units. These contractual sales were about 6.3 billion kwh in 1989, or 7.8% higher than in 1988.

Operating Revenues

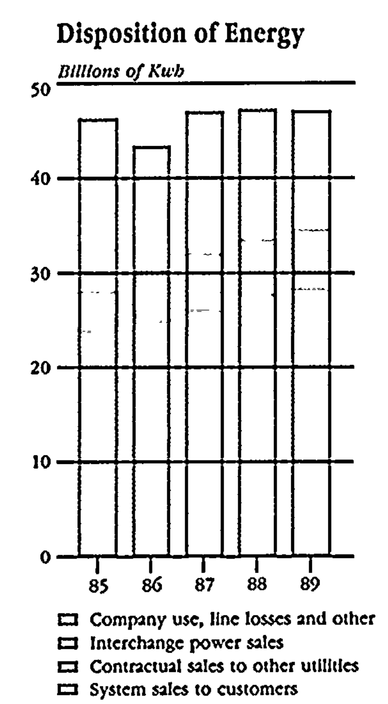
Total operating revenues increased $142.5 million, or 6.4%, in 1989 over 1988. Details of changes in operating revenues from the prior year are shown in the schedule on page 20.

Tariffs subject to Pennsylvania Public Utility Commission (PUC) jurisdiction accounted for approximately 84% of the Company's revenues in 1989. The remaining 16% of revenues are regulated by the FERC. The FERC also regulates interchange power sales which are classified as a credit to operating expenses.

Billings to customers under PUC jurisdiction include: (i) base rate charges; (ii) supplemental charges or credits for energy costs over or under the levels included in base rates; and (iii) during 1987 and 1988, a state tax adjustment surcharge and an Income Tax Adjustment (ITA) credit which reduced retail customers' bills for the effect of lower income taxes resulting from the Tax Reform Act of 1986 (Tax Act). Effective January 1, 1989, the ITA credit associated with the current year's tax expense was rolled into base rates.



Fuel diversity provides greater assurance of a reliable energy supply.



System sales grew at a 4.2% annual rate from 1985 to 1989.

The Company has set an objective of not increasing retail base rates for electricity until the 1993-1995 period. This price stability will help foster prosperity among communities served and, at the same time, enhance the Company's financial strength through increased energy sales. The last base rate increase for PUC jurisdictional customers went into effect in April 1985.

Billings to FERC jurisdictional customers, excluding contractual sales to other utilities and capacity-related and transmission entitlement transactions, include base rate charges and a supplemental charge or credit for fuel costs over or under the level included in base rates. The last base rate increase for FERC jurisdictional customers went into effect in December 1988. Contractual sales to other utilities are regulated by the FERC. Sales to Atlantic and JCP&L are made at a price covering the Company's cost of service, including a return on investment, while energy sales relating to the reservation of output from the Martins Creek oil-fired units are generally made at a price equal to the cost of fuel plus an amount to reflect foregone interchange savings. Capacity-related and transmission entitlement transactions are also regulated by the FERC and are made at a price negotiated by the Company and the purchaser.

Changes in Operating Revenues

	1989	1988	1987
		(Millions of Dollars)	
Electric			
Wholesale rate increase	$ 3.3	$ 0.3	
Depreciation changes	(8.6)		
State tax adjustment surcharge and roll-in to base rates	2.0	16.5	$(31.0)
Income tax adjustment and roll-in to base rates	(7.0)	(67.1)	(55.2)
Recovery of fuel and energy costs	45.7	93.0	(50.0)
Change in customer usage	50.6	85.8	52.0
Contractual sales to other utilities	31.7	(10.6)	(16.7)
Capacity-related and transmission entitlement transactions	23.3		
Other	1.6	5.5	0.7
Total electric	142.6	123.4	(100.2)
Other	(0.1)	0.3	0.3
Total	$142.5	$123.7	$(99.9)

Net Cost of Energy

In 1989, the net cost of energy was $521 million, an increase of $67 million over 1988. The increase primarily was due to higher sales of electricity to customers and increased purchases of energy from non-utility electric generators.

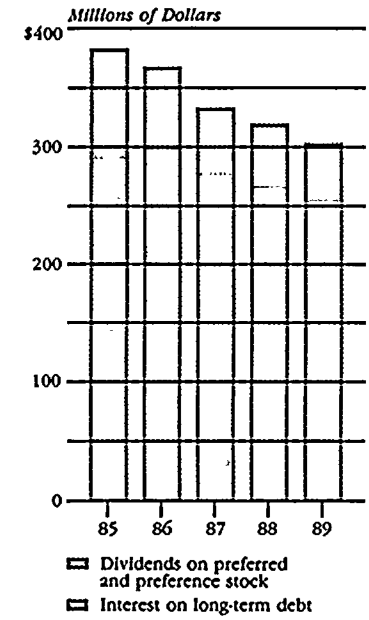
Output from the Company's generating units in 1989 was 43.7 billion kwh, a decrease of 0.6 billion kwh compared with 1988. The decrease principally is due to: (i) lower output from the Susquehanna station because both units were out of service to be refueled in 1989 while only one unit was refueled in 1988 and (ii) less output from the Martins Creek oil-fired units because of reduced demand for those units by interconnected utilities.

Other Operation, Maintenance and Depreciation

Other operation and maintenance costs increased $32.4 million, or 5.3%, over 1988 primarily reflecting increases in wages and benefits, non-routine maintenance at the Company's fossil-fueled generating facilities and an increase in the provision for uncollectible accounts.

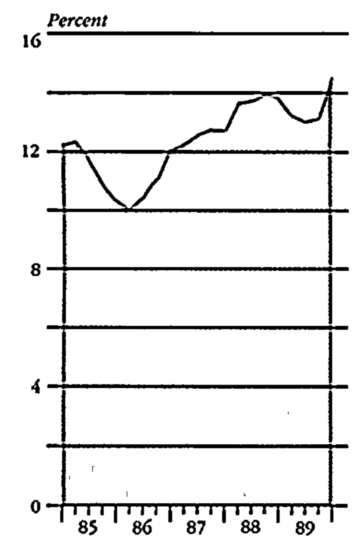
Higher depreciation in 1989 reflects the normal annual increase associated with the method of depreciating the Susquehanna station and the depreciation of new property, plant and equipment placed in service. As approved by the PUC and FERC, the depreciation expense for the

Cost of Long-Term Debt and Preferred and Preference Stock



Interest and dividend costs have decreased $79 million from 1985 through 1989.

Return on Average Common Equity*
(12 Months Ended Each Quarter)



Return on average common equity of 14.6% for 1989 shows a substantial improvement over 1985.

Susquehanna station will increase annually through the year 1998. At that time, depreciation is scheduled to switch to the straight-line method at a level substantially less than the amount expected in 1998.

Income Taxes

Total income tax expense for 1989 increased by $16.0 million over 1988 due to higher taxable income. The decline in total income tax expense from $229 million in 1987 to $188 million in 1988 primarily was due to the lower federal income tax rate included in the Tax Act. The reduction in income tax expense due to the Tax Act resulted in lower rates for the Company's customers.

The Tax Act also repealed the investment tax credit. At December 31, 1989, approximately $44 million of unused investment and payroll-based tax credits were available to offset future federal income tax liabilities.

Lower Financing Costs

The retirement of high-cost securities during the years 1986-1989 with cash generated from operations and refinancing has allowed the Company to reduce interest on long-term debt and dividends on preferred and preference stock to $304 million in 1989 from $367 million in 1986, a decrease of $63 million in the last three years.

The Company expects to undertake substantially less refinancing of high-cost securities in the next few years than it did during the 1986-1989 period because the current level of interest rates would not make such refinancings economical. As a result, the rate of decline in interest expense and dividends on preferred and preference stock experienced during the past few years is not expected to continue.

Financial Condition

Capital Expenditure Requirements

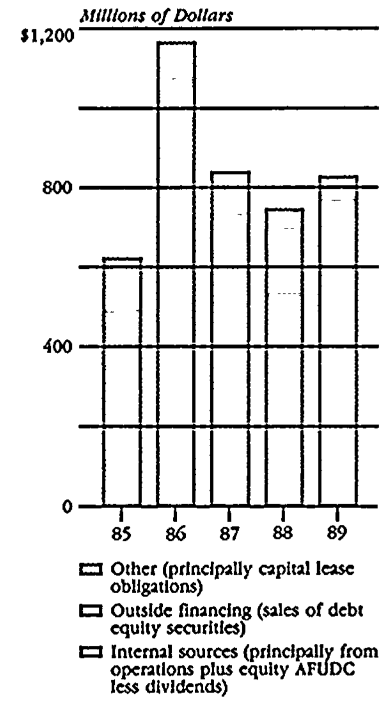
The schedule below shows the Company's actual capital expenditures for electric utility operations for the years 1987-1989 and current projections for the years 1990-1992. Construction expenditures during the three years 1987-1989 totaled about $850 million and are expected to be about $1.0 billion during the three years 1990-1992.

Capital Expenditure Requirements (a)

	Actual 1987	Actual 1988	Actual 1989	Projected 1990	Projected 1991	Projected 1992
	(Millions of Dollars)					
Construction expenditures						
Generating facilities	$102	$126	$109	$111	$127	$130
Transmission and distribution facilities	106	129	131	156	178	175
Environmental	21	26	15	13	8	7
Other	30	28	25	40	39	39
	259	309	280	320	352	351
Nuclear fuel owned and leased	40	46	33	47	51	47
Other leased property	20	13	12	23	19	9
Total	$319	$368	$325	$390	$422	$407

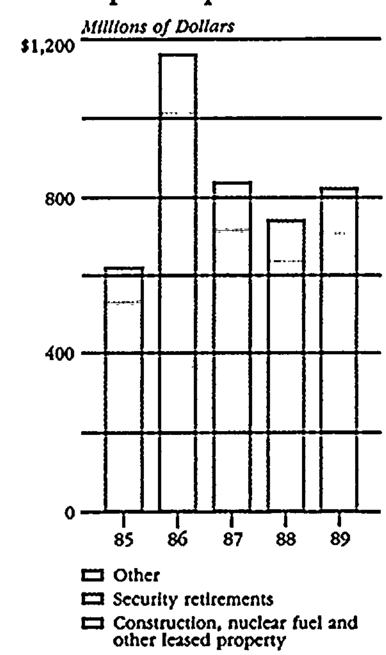
(a) Capital expenditure plans are revised from time to time to reflect changes in conditions. Actual expenditures may vary from those projected because of changes in plans, cost fluctuations, environmental regulations and other factors. The estimates for 1990-1992 do not include any expenditures for compliance with possible future acid rain legislation. As currently proposed by the Bush Administration, this legislation would not require the Company to make any substantial capital expenditures until the mid-to-late 1990s. Construction expenditures include AFUDC which is expected to be $15 million or less in each of the years 1990-1992.

Sources of Capital



Funds from internal sources increased substantially during the period from 1985 through 1989.

Capital Requirements



Security retirements, including refinancing higher cost issues, accounted for most of the changes in capital requirements.

Financing and Liquidity

During the three years 1987-1989, the Company issued about $800 million of securities and also incurred $199 million of obligations under capital leases (primarily nuclear fuel). The Company's 1989 financing program involved the sale of $375 million of first mortgage bonds and the issuance of $7 million of common stock for the Employee Stock Ownership Plan. These funds were used primarily to retire $343 million of debt and $28 million of preferred and preference stock, with $329 million of those securities being redeemed early.

Internally generated funds during the next three years are expected to essentially meet the Company's needs for construction expenditures, retirement of maturing long-term debt and preferred and preference stock sinking fund requirements, which are expected to aggregate about $1.1 billion. Outside financing will be undertaken primarily to provide funds for the early retirement of high-cost securities. The exact amount, nature and timing of any such sales of securities will be determined in the light of market conditions and other factors.

The Company's plans to issue securities during the next three years are not expected to be limited by earnings or other issuance tests. To enhance financing flexibility, the Company maintains a revolving credit arrangement with a group of banks. The Company can borrow up to $185 million under this arrangement, which is maintained principally as a back-up for commercial paper issued by the Company. The Company also maintains bank lines of credit aggregating $32 million. A subsidiary maintains a $100 million revolving credit arrangement. No borrowings were outstanding at the end of 1989 under these arrangements.

Current Financial Condition

The Company's overall financial condition continued to improve in 1989. Earnings per share of common stock, at $4.05, exceeded last year's previous record high of $3.73. The Company earned a 14.62% return on average common equity. The allowance for funds used during construction (AFUDC), a non-cash credit to income, accounted for only about 5% of earnings. AFUDC is expected to remain low for an extended period of time because the Company currently does not have any major long-term construction projects planned for the balance of this century.

The ratio of the Company's pre-tax income to interest charges increased slightly from 2.7 times in 1988 to 2.8 times in 1989. The Company has increased common stock dividends each year from an annual per share rate of $2.68 in 1987 to $2.86 in 1989. The ratio of the market price to book value of common stock was 151% at the end of 1989 compared to 133% at the end of 1988.

Termination of Coal-Mining Operations

The Company plans to phase out subsidiary coal-mining operations in the early 1990s. The investment in coal, mining equipment and other facilities amounting to $50 million at December 31, 1989 is expected to be recovered through the cost of coal produced. However, the Company cannot predict whether regulatory action, proposed legislation related to health care benefits for miners or other events could affect its plans for these mines, possibly resulting in an adverse impact on the Company's earnings.

Proposed Acid Rain Legislation

Under pending federal legislation proposed by the Bush Administration dealing with acid rain, the Company currently estimates that increased costs to meet specified Phase I sulfur dioxide emission levels by January 1, 1996 would require rate increases of about 3% (based on 1989 revenue levels). The Company anticipates the increased costs would be recoverable through the ECR included in the Company's PUC tariffs, the fuel adjustment clause included in the Company's FERC tariffs and pursuant to the contracts under which the Company sells capacity and energy to other utilities. An estimated 8% to 10% increase (based on 1989 revenue levels) above the 3% increase expected to result from Phase I compliance would be required to meet more stringent Phase II emission levels by January 1, 2001.

The Company currently estimates that no substantial construction expenditures would be required to comply with Phase I requirements and that construction expenditures of about $1 billion would be required between 1996 and 2000 to comply with Phase II requirements. Under current Pennsylvania law, construction work in progress for non-revenue producing assets, such as pollution control equipment, can be included in rate base. The Company will not be able to determine the exact method of compliance, or the cost thereof and its impact on customer rates, until such legislation is enacted and implementing regulations are adopted by the appropriate regulatory bodies.

Industry Restructuring Initiatives

The FERC and others are considering certain issues which could significantly affect the structure and competitive business environment of the electric utility industry. These issues include, among others, deregulation, transmission system access, voluntary bidding arrangements for providing new generating capacity and the role of independent power producers in supplying electric power. The Company is carefully monitoring these issues but is unable to predict their ultimate outcome or what impact, if any, they may have on the Company's operations. However, the Company believes that its strong generating capacity position, competitively priced electricity and good customer service place it in a position to adapt to any changes that may arise from these initiatives.

Index of Financial Data

Independent Auditors' Report

Deloitte & Touche

Certified Public Accountants

One World Trade Center
New York, New York 10048

To the Shareowners and Board of Directors
of Pennsylvania Power & Light Company:

We have audited the accompanying consolidated balance sheets of Pennsylvania Power & Light Company and its subsidiaries as of December 31, 1989 and 1988 and the related consolidated statements of income, earnings reinvested, and of cash flows for each of the three years in the period ended December 31, 1989. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Pennsylvania Power & Light Company and its subsidiaries at December 31, 1989 and 1988 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1989 in conformity with generally accepted accounting principles.

Deloitte & Touche

February 5, 1990

Management's Report on Responsibility for Financial Statements

The management of Pennsylvania Power & Light Company is responsible for the preparation, integrity and objectivity of the financial statements and all other sections of this annual report. The financial statements were prepared in accordance with generally accepted accounting principles and the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission. In preparing the financial statements, management makes informed estimates and judgments of the expected effects of events and transactions based upon currently available facts and circumstances. Management believes that the financial statements are free of material misstatement and reflect fairly the financial position, results of operations and cash flows of the Company.

The Company's financial statements have been audited by Deloitte & Touche, successor by merger to Deloitte Haskins & Sells, independent certified public accountants, whose report with respect to the financial statements appears on page 23 of this report. Deloitte Haskins & Sells' appointment as auditors was previously ratified by the shareowners. Management has made available to Deloitte & Touche all the Company's financial records and related data, as well as the minutes of shareowners' and directors' meetings. Management believes that all representations made to Deloitte & Touche during its audit were valid and appropriate.

The Company maintains a system of internal control designed to provide reasonable, but not absolute, assurance as to the integrity and reliability of the financial statements, the protection of assets from unauthorized use or disposition and the prevention and detection of fraudulent financial reporting. The concept of reasonable assurance recognizes that the cost of a system of internal control should not exceed the benefits derived and that there are inherent limitations in the effectiveness of any system of internal control.

Fundamental to the control system is the selection and training of qualified personnel, an organizational structure that provides appropriate segregation of duties, the utilization of written policies and procedures and the continual monitoring of the system for compliance. In addition, the Company maintains an internal auditing program to evaluate the Company's system of internal control for adequacy, application and compliance. Management considers the internal auditors' and Deloitte & Touche's recommendations concerning its system of internal control and has taken actions which are believed to be cost-effective in the circumstances to respond appropriately to these recommendations. Management believes that the Company's system of internal control is adequate to accomplish the objectives discussed in this report.

The Board of Directors, acting through its Audit Committee, oversees management's responsibilities in the preparation of the financial statements. In performing this function, the Audit Committee, which is composed of seven independent directors, meets periodically with management, the internal auditors and the independent certified public accountants to review the work of each. Deloitte & Touche and the internal auditors have free access to the Audit Committee and to the Board of Directors, without management present, to discuss internal accounting control, auditing and financial reporting matters.

Management also recognizes its responsibility for fostering a strong ethical climate so that the Company's affairs are conducted according to the highest standards of personal and corporate conduct. This responsibility is characterized and reflected in the Company's Standards of Integrity, which is publicized throughout the Company. The Standards of Integrity addresses: the necessity of ensuring open communication within the Company; potential conflicts of interest; compliance with all applicable laws, including those relating to financial disclosure; and the confidentiality of proprietary information. The Company maintains a systematic program to assess compliance with these policies.

Robert K. Campbell
Robert K. Campbell,
Chairman, President and Chief Executive Officer

C E Russoli
C. E. Russoli,
Executive Vice President and Chief Financial Officer

Consolidated Statement of Income
PENNSYLVANIA POWER & LIGHT COMPANY AND SUBSIDIARIES

	1989	1988	1987
		(Thousands of Dollars)	
Operating Revenues (Note 2)	$2,356,446	$2,213,903	$2,090,244
Operating Expenses			
Operation			
Fuel	625,993	624,332	636,872
Power purchases	171,437	111,920	101,552
Interchange power sales	(275,996)	(281,501)	(366,556)
Net cost of energy	521,434	454,751	371,868
Other	411,525	388,846	352,161
Maintenance	234,063	224,368	218,959
Depreciation (Notes 2 and 3)	222,536	234,283	222,655
Deferred depreciation (Notes 2 and 3)	(23,475)	(47,784)	(52,427)
Income taxes (Note 6)	207,189	191,245	235,689
Taxes, other than income	164,324	163,143	150,702
	1,737,596	1,608,852	1,499,607
Operating Income	618,850	605,051	590,637
Other Income and (Deductions)			
Allowance for equity funds used during construction (Note 1)	2,728	4,923	3,473
Income tax credits (Note 6)	3,514	3,570	7,136
Other—net	4,227	2,210	(1,400)
	10,469	10,703	9,209
Income Before Interest Charges	629,319	615,754	599,846
Interest Charges			
Long-term debt	255,223	267,430	278,732
Short-term debt and other	31,799	26,892	30,728
Allowance for borrowed funds used during construction and interest capitalized (Note 1)	(11,139)	(10,610)	(12,075)
	275,883	283,712	297,385
Net Income	353,436	332,042	302,461
Dividends on Preferred and Preference Stock	48,418	52,177	54,426
Earnings Applicable to Common Stock	$ 305,018	$ 279,865	$ 248,035
Earnings Per Share of Common Stock (a)	$ 4.05	$ 3.73	$ 3.32
Average Number of Shares Outstanding (thousands)	75,314	75,071	74,644
Dividends Declared Per Share of Common Stock	$ 2.86	$ 2.76	$ 2.68

(a) Based on average number of shares outstanding.

See accompanying Schedules and Notes to Financial Statements.

Consolidated Balance Sheet at December 31

PENNSYLVANIA POWER & LIGHT COMPANY AND SUBSIDIARIES

Assets	1989	1988
	(Thousands of Dollars)	
Property, Plant and Equipment		
Electric utility plant in service—at original cost	$7,885,110	$7,590,085
Accumulated depreciation (Notes 2 and 3)	(1,963,658)	(1,787,284)
Deferred depreciation (Notes 2 and 3)	277,241	253,922
	6,198,693	6,056,723
Construction work in progress—at cost	115,799	177,333
Nuclear fuel owned and leased—net of amortization (Note 8)	264,008	303,620
Other leased property—net of amortization (Note 8)	74,902	78,770
Electric utility plant—net	6,653,402	6,616,446
Other property—net of depreciation, amortization and depletion (1989, $127,113; 1988, $114,054)	213,240	225,138
	6,866,642	6,841,584
Investments		
Associated company—at equity	20,211	20,171
Nuclear plant decommissioning trust fund (Note 1)	37,393	28,181
Other—at cost or less	20,816	16,345
	78,420	64,697
Current Assets		
Cash and cash equivalents (Note 1)	8,260	6,091
Accounts receivable (less reserve: 1989, $21,793; 1988, $14,765)		
Customers	189,253	179,631
Interchange power sales	17,578	29,656
Other	15,600	12,305
Unbilled revenues	84,206	68,836
Fuel (coal and oil)—at average cost	99,879	106,324
Materials and supplies—at average cost	34,638	35,137
Common stock held for dividend reinvestment plan—at cost (Note 7)	9,967	9,524
Other	50,660	36,527
	510,041	484,031
Deferred Debits		
Utility plant carrying charges—net of amortization (Note 1)	27,190	27,826
Unamortized debt expense and reacquired debt costs	65,265	49,768
Mine development costs—net of amortization	13,454	20,034
Other	37,956	36,708
	143,865	134,336
	$7,598,968	$7,524,648

See accompanying Schedules and Notes to Financial Statements.

Liabilities	1989	1988
	(Thousands of Dollars)	
Capitalization		
Common equity		
Common stock	$1,340,224	$1,334,424
Capital stock expense	(12,596)	(12,672)
Earnings reinvested	811,710	728,079
	2,139,338	2,049,831
Preferred and preference stock		
With sinking fund requirements	409,990	438,290
Without sinking fund requirements	231,375	231,375
Long-term debt	2,622,907	2,599,840
	5,403,610	5,319,336
Current Liabilities		
Commercial paper	10,000	93,000
Bank loans and other notes	85,429	108,652
Long-term debt due within one year	27,369	26,944
Capital lease obligations due within one year (Note 8)	87,736	74,275
Accounts payable	107,079	113,536
Taxes accrued	39,908	29,387
Interest accrued	74,291	70,950
Dividends payable	65,836	64,434
Energy revenues to be refunded	63,095	70,652
Other	90,614	98,030
	651,357	749,860
Deferred Credits and Other Noncurrent Liabilities		
Deferred investment tax credits (Note 6)	263,754	238,112
Deferred income taxes (Note 6)	913,700	821,054
Capital lease obligations (Note 8)	255,176	298,531
Accrued nuclear plant decommissioning costs (Note 1)	38,624	29,293
Other	72,747	68,462
	1,544,001	1,455,452
Commitments and Contingent Liabilities (Note 14)		
	$7,598,968	$7,524,648

See accompanying Schedules and Notes to Financial Statements.

Consolidated Statement of Cash Flows
PENNSYLVANIA POWER & LIGHT COMPANY AND SUBSIDIARIES

	1989	1988	1987
		(Thousands of Dollars)	
Cash Flows From Operating Activities			
Net income	**$ 353,436**	$ 332,042	$ 302,461
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation	**220,375**	204,687	188,246
Amortization of property under capital leases	**82,138**	85,655	88,267
Deferred income taxes and investment tax credits	**106,693**	101,944	148,683
Equity component of AFUDC	**(2,728)**	(4,923)	(3,473)
Change in current assets and current liabilities excluding cash			
Accounts receivable	**(1,788)**	(10,210)	(4,678)
Unbilled and refundable electric revenues	**(22,927)**	22,962	69,338
Materials and supplies	**499**	1,587	(4,203)
Fuel inventories	**6,445**	42,231	(2,901)
Accounts payable	**(6,457)**	10,595	8,010
Accrued interest and taxes	**13,862**	(10,533)	(30,006)
Other	**(24,380)**	4,344	239
Other operating activities—net	**25,790**	9,194	(99)
Net cash provided by operating activities	**750,958**	789,575	759,884
Cash Flows From Investing Activities			
Property, plant and equipment expenditures	**(307,688)**	(341,577)	(292,195)
Proceeds from sales of nuclear fuel to trust	**31,809**	21,669	63,154
Proceeds from contract settlement			8,730
Other investing activities—net	**5,715**	1,609	6,238
Net cash used in investing activities	**(270,164)**	(318,299)	(214,073)
Cash Flows From Financing Activities			
Issuance of long-term debt	**375,000**	250,000	
Issuance of preferred stock			150,000
Issuance of common stock	**6,884**	9,686	16,387
Retirement of long-term debt	**(350,300)**	(210,295)	(265,687)
Retirement of preferred and preference stock	**(28,300)**	(57,300)	(129,649)
Payments on capital lease obligations	**(85,697)**	(89,123)	(93,488)
Dividends paid	**(262,401)**	(259,223)	(251,497)
Net increase (decrease) in short-term debt	**(106,223)**	(96,669)	54,733
Costs associated with issuance and retirement of securities	**(27,308)**	(17,461)	(25,471)
Other financing activities—net	**(280)**	(237)	55
Net cash used in financing activities	**(478,625)**	(470,622)	(544,617)
Net Increase In Cash and Cash Equivalents	**2,169**	654	1,194
Cash and Cash Equivalents at Beginning of Period	**6,091**	5,437	4,243
Cash and Cash Equivalents at End of Period	**$ 8,260**	$ 6,091	$ 5,437
Supplemental Disclosures of Cash Flow Information			
Cash paid during the year for			
Interest (net of amount capitalized)	**$ 255,425**	$ 272,064	$ 296,744
Income taxes	**$ 86,837**	$ 95,494	$ 99,836

See accompanying Schedules and Notes to Financial Statements.

Schedule of Taxes

PENNSYLVANIA POWER & LIGHT COMPANY AND SUBSIDIARIES

	1989	1988	1987
	(Thousands of Dollars)		
Income Tax Expense (Note 6)			
Included in operating expenses			
Provision—Federal	$ 85,634	$ 62,285	$ 63,468
State	30,853	27,328	23,680
	116,487	89,613	87,148
Deferred—Federal	75,418	73,184	112,185
State	1,368	975	6,338
	76,786	74,159	118,523
Investment tax credit, net—Federal	13,916	27,473	30,018
	207,189	191,245	235,689
Included in other income and deductions			
Provision (credit)—Federal	(18,661)	(3,139)	(6,127)
State	(844)	(743)	(1,151)
	(19,505)	(3,882)	(7,278)
Deferred—Federal	15,853	301	(201)
State	138	11	343
	15,991	312	142
	(3,514)	(3,570)	(7,136)
Total income tax expense—Federal	172,160	160,104	199,343
State	31,515	27,571	29,210
	$203,675	$187,675	$228,553
Detail of deferred taxes in operating expenses			
Tax depreciation	$ 95,475	$ 93,119	$107,249
Reacquired debt costs	6,148	3,248	5,801
Unbilled revenues	(8,142)	(8,142)	(6,500)
Other	(16,695)	(14,066)	11,973
	$ 76,786	$ 74,159	$118,523
Reconciliation of Income Tax Expense			
Indicated federal income tax on pre-tax income at statutory tax rate (1989, 34%; 1988, 34%; 1987, 39.95%)	$189,418	$176,704	$212,140
Increase (decrease) due to:			
State income taxes	22,205	19,310	19,478
Depreciation differences not normalized	9,497	10,227	10,258
Amortization of investment tax credit	(13,017)	(9,954)	(8,477)
AFUDC (Note 1)	(927)	(1,674)	(1,388)
Other	(3,501)	(6,938)	(3,458)
	14,257	10,971	16,413
Total income tax expense	$203,675	$187,675	$228,553
Effective income tax rate	36.6%	36.1%	43.0%
Taxes, Other Than Income			
State gross receipts	$ 83,804	$ 83,847	$ 83,203
State utility realty	34,782	35,294	26,513
State capital stock	23,795	23,379	21,827
Social security and other	21,943	20,623	19,159
	$164,324	$163,143	$150,702

See accompanying Notes to Financial Statements.

Schedule of Capital Stock at December 31

PENNSYLVANIA POWER & LIGHT COMPANY AND SUBSIDIARIES

	Outstanding 1989	Outstanding 1988	Shares Outstanding 1989	Shares Authorized
	(Thousands of Dollars)			
Preferred Stock—$100 par, cumulative (a)				
4½%	$ 53,019	$ 53,019	530,189	629,936
Series	463,146	481,246	4,631,456	10,000,000
	$ 516,165	$ 534,265		
Preference Stock—no par, cumulative (a)	$ 125,200	$ 135,400	1,252,000	5,000,000
Common Stock—no par (a)	$1,340,224	$1,333,339	75,422,739	85,000,000
Employee Subscriptions (employee stock ownership plan)		1,085		
	$1,340,224	$1,334,424		

Details of Preferred and Preference Stock (b)

	Outstanding 1989	Outstanding 1988	Shares Outstanding 1989	Optional Redemption Price Per Share 1989	Sinking Fund Provisions (c) Shares to be Redeemed Annually	Redemption Period
	(Thousands of Dollars)					
With Sinking Fund Requirements						
Series Preferred						
6.875% (d)	$ 50,000	$ 50,000	500,000	$106.88	100,000	1993-1997
7.00% (d)	100,000	100,000	1,000,000	107.00	200,000	1993-1997
7.375% (d)	50,000	50,000	500,000	107.38	25,000	1993-2012
7.40%	22,400	24,000	224,000	102.66	16,000	1990-2003
7.82% (d)	50,000	50,000	500,000	107.82	100,000	1993-1997
7.927% (e)	12,000	15,000	120,000	100.00	30,000	1990-1993
8.00%	32,500	35,000	325,000	103.20	25,000	1990-2002
8.00%, Second		2,000				
8.75% (d)	45,000	48,000	450,000	104.77	30,000	1990-2004
9.24% (d)	37,890	43,890	378,900	103.00	30,000	1990-2002
Preference						
$8.625 (e)	10,200	20,400	102,000	None	102,000	1990
	$409,990	$438,290				
Without Sinking Fund Requirements						
4½% Preferred	$ 53,019	$ 53,019	530,189	$110.00		
Series Preferred						
3.35%	4,178	4,178	41,783	103.50		
4.40%	22,878	22,878	228,773	102.00		
4.60%	6,300	6,300	63,000	103.00		
8.60%	22,237	22,237	222,370	104.00		
9.00%	7,763	7,763	77,630	104.00		
Preference						
$8.00	35,000	35,000	350,000	101.00		
$8.40	40,000	40,000	400,000	101.00		
$8.70	40,000	40,000	400,000	101.00		
	$231,375	$231,375				

See accompanying Notes to Financial Statements.

Increases (Decreases) in Capital Stock *(Thousands of Dollars)*

	1989		1988		1987	
	Shares	Amount	Shares	Amount	Shares	Amount
Common Stock—issued under employee stock ownership plan	174,284	$ 6,885	276,133	$ 9,686	459,525	$ 16,387
Series Preferred Stock						
6.875%					500,000	50,000
7.375%					500,000	50,000
7.40%	(16,000)	(1,600)	(16,000)	(1,600)	(16,000)	(1,600)
7.75%			(120,000)	(12,000)	(120,000)	(12,000)
7.82%					500,000	50,000
7.927%	(30,000)	(3,000)				
8.00%	(25,000)	(2,500)	(25,000)	(2,500)	(25,000)	(2,500)
8.00%, Second	(20,000)	(2,000)	(20,000)	(2,000)	(20,000)	(2,000)
8.25%			(200,000)	(20,000)	(100,000)	(10,000)
8.75%	(30,000)	(3,000)	(30,000)	(3,000)	(30,000)	(3,000)
9.24%	(60,000)	(6,000)	(60,000)	(6,000)	(60,000)	(6,000)
Preference Stock						
$8.625	(102,000)	(10,200)	(102,000)	(10,200)	(102,000)	(10,200)
$11.00					(323,492)	(32,349)
$11.60					(500,000)	(50,000)

Decreases in Preferred and Preference Stocks represent: (i) the redemption of stock pursuant to sinking fund requirements, or (ii) shares redeemed pursuant to optional redemption provisions.

(a) Each share of preferred, preference and common stock entitles the holders to one vote on any question presented to any shareowners' meeting.

(b) The involuntary liquidation price of the preferred and preference stock is $100 per share. The optional voluntary liquidation price is the optional redemption price per share in effect, except for the 4½ % Preferred and the $8.625 Series Preference Stocks for which such price is $100 per share (plus in each case any unpaid dividends). Liquidation payments on preferred stock have priority to such payments on the preference stock.

(c) The aggregate amount of sinking fund redemption requirements through 1994 are (thousands of dollars): 1990, $22,190; 1991, $13,100; 1992, $13,100; 1993, $55,600; 1994, $52,600.

(d) On certain sinking fund redemption dates, additional shares may be redeemed up to the number of shares required to be redeemed annually.

(e) Because certain federal income tax benefits have been lost to corporate holders of these stocks, the Company may be required to make indemnity payments sufficient to provide the holders with an agreed upon effective yield after federal income taxes. After giving effect to a $1.2 million indemnity payment made in connection with the January 1, 1990 redemption of the $8.625 Series Preference Stock, the Company estimates that future indemnity payments that could be claimed are less than $1 million.

See accompanying Notes to Financial Statements.

Schedule of Long-Term Debt at December 31

PENNSYLVANIA POWER & LIGHT COMPANY AND SUBSIDIARIES

Company	Outstanding 1989	1988	Maturity (b)
	(Thousands of Dollars)		
First Mortgage Bonds (a)			
12⅛%		$ 10,000	February 1, 1989
16½%		7,000	August 1, 1989
12⅛%	$ 10,000	10,000	February 1, 1990
16½%	8,500	8,500	August 1, 1990
12⅛% (c)	10,000	10,000	February 1, 1991
4⅝%	30,000	30,000	December 1, 1991
12⅛% (c)	10,000	10,000	February 1, 1992
12⅛% (c)	10,000	10,000	February 1, 1993
4⅝%	30,000	30,000	March 1, 1994
13½% (d)		125,000	April 1, 1994
5⅝% to 9⅝%	515,000	515,000	1995-1999
7¼% to 9¼%	345,000	345,000	2000-2004
8¼% to 9¾%	475,000	475,000	2005-2009
12¾% (e)		125,000	2010-2014
9% to 12%	875,000	500,000	2015-2019
First Mortgage Pollution Control Bonds (a)			
5⅝% Series A	16,595	17,495	(f)
7⅞% to 8⅛% Series C	20,000	20,000	(f)
11¼% to 11½% Series D	70,000	70,000	(f)
10⅝% Series E	37,750	37,750	March 1, 2014
10⅝% Series F	115,500	115,500	September 1, 2014
9⅜% Series G	55,000	55,000	July 1, 2015
	2,633,345	2,526,245	
Other Long-Term Debt			
Secured term notes (g)		75,000	March 31, 1991
Miscellaneous promissory notes	232	346	1990-1995
	2,633,577	2,601,591	
Unamortized (discount) and premium—net	(22,576)	(21,511)	
	2,611,001	2,580,080	
Less amount due within one year	18,539	17,114	
	2,592,462	2,562,966	
Subsidiaries			
Notes (h)	39,275	46,704	1990-1996
Less amount due within one year	8,830	9,830	
	30,445	36,874	
Total long-term debt	$2,622,907	$2,599,840	

(a) Substantially all owned electric utility plant is subject to the lien of the Company's first mortgage.
(b) Aggregate long-term debt maturities through 1994 are (thousands of dollars): 1990, $27,369; 1991, $46,469; 1992, $16,650; 1993, $17,339; 1994, $33,338. Maximum sinking fund requirements aggregate $31.1 million through 1994 and may be met with property additions or retirement of bonds.
(c) In February 1990, the Company redeemed $30 million principal amount of First Mortgage Bonds, 12⅛% Series due 1991-1993.
(d) In April 1989, the Company redeemed $125 million principal amount of First Mortgage Bonds, 13½% Series due 1994.
(e) In December 1989, the Company redeemed $125 million principal amount of First Mortgage Bonds, 12¾% Series due 2014.
(f) Bonds mature annually as follows (thousands of dollars): (i) Series A on May 1, 1992, $195; 1993-2002, $900; 2003, $7,400 (ii) Series C on April 1, 2000, $4,000; 2006-2009, $2,000; 2010, $8,000 (iii) Series D on November 1, 2002, $15,000; 2012, $55,000.
(g) In November 1989, the Company prepaid the remaining $75 million of secured term notes and the mortgage securing those notes has been satisfied.
(h) Various fixed rates ranging from 6% to 12%. During 1989, subsidiary companies retired $7.4 million of maturing notes.

See accompanying Notes to Financial Statements.

Consolidated Statement of Earnings Reinvested
PENNSYLVANIA POWER & LIGHT COMPANY AND SUBSIDIARIES

	1989	1988	1987
	(Thousands of Dollars)		
Balance, January 1	$ 728,079	$657,383	$622,537
Add Net Income	353,436	332,042	302,461
	1,081,515	989,425	924,998
Deduct			
Cash dividends declared			
Preferred stock—at required annual rates	37,898	40,777	40,368
Preference stock—at required annual rates	10,520	11,400	14,058
Common stock—per share: 1989, $2.86; 1988, $2.76; 1987, $2.68	215,386	207,193	200,003
Costs associated with the redemption of stock (Note 13)	6,001	1,976	13,186
	269,805	261,346	267,615
Balance, December 31	$ 811,710	$728,079	$657,383

See accompanying Schedules and Notes to Financial Statements.

Notes to Financial Statements

1. Summary of Significant Accounting Policies

Accounting Records

Accounting records for utility operations are maintained in accordance with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC) and adopted by the Pennsylvania Public Utility Commission (PUC).

Principles of Consolidation

All wholly owned subsidiaries (principally involved in coal mining, holding coal reserves and oil pipeline operations) have been consolidated in the accompanying financial statements and all significant intercompany transactions have been eliminated. Income and expenses of subsidiaries not related to utility operations have been classified under other income and deductions on the Consolidated Statement of Income.

The investment in Safe Harbor Water Power Corporation (Safe Harbor), of which the Company owns one-third of the outstanding capital stock representing one-half of the voting securities, is recorded using the equity method of accounting. The Company's principal transaction with Safe Harbor is the purchase of electricity amounting to (millions of dollars): 1989, $9.6; 1988, $9.5 and 1987, $11.8. Under equity accounting, the operations of Safe Harbor resulted in additional income to the Company of (millions of dollars): 1989, $2.6; 1988, $2.6 and 1987, $3.3.

Utility Plant and Depreciation

Additions to utility plant and replacement of units of property are capitalized at cost. The cost of units of property retired or replaced is removed from utility plant accounts and charged to accumulated depreciation. Expenditures for maintenance and repairs of property and the cost of replacing items determined to be less than units of property are charged to operating expense.

For financial statement purposes, depreciation is being provided over the estimated useful lives of property and is computed using a straight-line method for all property except the Susquehanna Steam Electric Station. Current PUC and FERC rate orders provide for an increasing amount of annual depreciation for the Susquehanna station until the late 1990s, at which time depreciation is scheduled to switch to the straight-line method. Provisions for depreciation, as a percent of average depreciable property, approximated 2.7% in 1989, 2.6% in 1988 and 2.5% in 1987.

Based on PUC and FERC rate orders, the annual depreciation charge for Susquehanna was increased effective December 1, 1988 for wholesale customers and effective January 1, 1989 for retail customers to comply with the phase-in plan accounting rules as adopted by the Financial Accounting Standards Board (FASB). Straight-line depreciation is used for property

placed in service at Susquehanna after December 31, 1988. The Company also lengthened the depreciable lives of certain fossil-fueled generating stations and adopted the remaining life depreciation technique in its PUC rate filing. (See Notes 2 and 3.)

Utility Plant Carrying Charges

Carrying charge accruals on certain facilities for the Susquehanna and Martins Creek generating stations are recorded as deferred debits in accordance with a FERC order. These amounts are being amortized to expense over the remaining lives of the stations.

Nuclear Decommissioning and Fuel Disposal

An annual provision for decommissioning costs of the Susquehanna station, equal to the amount allowed for ratemaking purposes, is charged to operating expense. Such amounts are invested in a trust fund which can be used only for future decommissioning costs.

The U.S. Department of Energy (DOE) is responsible for the permanent storage and disposal of spent nuclear fuel removed from nuclear reactors. The Company currently pays DOE a fee for future disposal services and recovers such costs in customer rates.

Premium on Reacquired Long-Term Debt

As provided in the Uniform System of Accounts, the premium paid and expenses incurred to redeem long-term debt are deferred and amortized over the life of the new debt issue or the remaining life of the retired debt when the redemption is not financed by a new issue.

Allowance for Funds Used During Construction

As provided in the Uniform System of Accounts, the cost of funds used to finance construction projects is capitalized as part of construction cost. The components of allowance for funds used during construction (AFUDC) shown on the Consolidated Statement of Income under other income and deductions and interest charges are non-cash items equal to the cost of funds capitalized during the period. The Company records deferred income taxes for the tax effect of the difference between the amount of construction interest capitalized through AFUDC and the amount capitalized for tax purposes.

AFUDC serves to offset on the Consolidated Statement of Income the interest charges on debt and dividends on preferred and preference stock incurred to finance construction. In addition, a return on common equity used to finance construction is imputed.

Capital Leases

Leased property capitalized on the Consolidated Balance Sheet is recorded at the present value of future lease payments and is amortized so that the total of interest on the lease obligation and amortization of the leased property equals the rental expense allowed for ratemaking purposes. (See Note 8.)

Revenues

Electric revenues are recorded based on the amounts of electricity delivered to customers through the end of each accounting period. This includes amounts customers will be billed for electricity delivered from the time meters were last read to the end of the respective period.

The Company's PUC tariffs contain an Energy Cost Rate (ECR) under which customers are billed an estimated amount for fuel and other energy costs. Any difference between the actual and estimated amount for such costs is collected from or refunded to customers in a subsequent period. Revenues applicable to ECR billings are recorded at the level of actual energy costs and the difference is recorded as payable to or receivable from customers.

The Company applied an Income Tax Adjustment (ITA) credit to PUC customers' bills to reflect the reduction in income tax expense due to the Tax Reform Act of 1986 (Tax Act) during 1987 and 1988. Effective January 1, 1989, the ITA credit applied to customers' bills for the reduction in the current year's tax expense was rolled into base rates. (See Note 2.)

Income Taxes

The Company and its wholly owned subsidiaries file a consolidated federal income tax return. Income taxes are allocated to operating expenses and other income and deductions on the Consolidated Statement of Income.

Deferred income taxes are recorded for timing differences between book and taxable income to the extent they are permitted in rate determinations by regulatory agencies. The principal item for which deferred taxes are not currently recorded is the difference between tax depreciation and book depreciation related to property placed in service prior to 1981.

Investment and payroll-based tax credits result in a reduction of federal income taxes payable. The investment tax credits are deferred when utilized and amortized over the average lives of the related property. The Tax Act repealed the investment tax credit effective December 31, 1985, except for tax credits applicable to transition property, and also repealed the payroll-based tax credit for years after 1986.

In December 1987, the FASB issued new accounting rules that will affect deferred income taxes recorded by the Company. These rules are effective for fiscal years beginning after December 15, 1991. (See Note 6.)

Pension Plan

The Company has a noncontributory pension plan covering substantially all employees and subsidiary mining companies have noncontributory pension plans for substantially all non-bargaining full-time employees. Funding is based upon actuarially determined computations that take into account the amount deductible for income tax purposes and the

minimum contribution required under the Employee Retirement Income Security Act of 1974. (See Note 11.)

Cash Equivalents

The Company considers all highly liquid debt instruments purchased with original maturities of three months or less to be cash equivalents for purposes of the Consolidated Statement of Cash Flows.

Reclassification

Certain amounts from prior years' financial statements have been reclassified to conform to the current year presentation.

2. Rate Matters

In March 1989, the PUC permitted the Company's 1989-90 ECR to become effective, as filed, on April 1, 1989. A group of industrial customers filed a complaint with respect to the 1989 ECR filing generally opposing the Company's recovery on a current basis through the ECR of the cost of power purchased from certain non-utility generating companies. In June 1989, a PUC Administrative Law Judge (ALJ) issued a recommended decision granting the Company's motion to dismiss the complaint. In August, the PUC in a 2 to 2 tie vote was unable to decide whether to accept the ALJ's recommended decision and the complaint remains pending before the PUC. The Company cannot predict the ultimate outcome of this proceeding.

In November 1988, the FERC accepted for filing a $3.5 million rate increase request for wholesale customers effective December 1, 1988. The new rates reflect a change in the depreciation of the Susquehanna station to comply with the provisions of Statement of Financial Accounting Standards (SFAS) 92, "Regulated Enterprises—Accounting for Phase-in Plans," (see Note 3) with respect to wholesale tariffs.

In December 1988, the PUC approved two rate filings made by the Company related to changes in depreciation and State Tax Adjustment Surcharge (STAS) and ITA tax issues. These changes produced an overall net reduction in operating expenses which in turn produced a corresponding net reduction in the Company's annual retail rates of approximately $13.6 million effective January 1, 1989.

The depreciation changes approved by the PUC were principally: (i) an increase in annual depreciation for the Susquehanna station to comply with the provisions of SFAS 92 and (ii) a decrease in annual depreciation associated with a lengthening of the depreciable lives of certain fossil-fueled generating plants to reflect the Company's commitment to continue the operation of these plants beyond the depreciable lives previously reflected in rates.

The PUC also approved the Company's request to roll into base rates part of the STAS credit and the ITA credit associated with the current year's tax expense. An ITA credit to refund a 1988 overcollection terminated at the end of 1989.

3. Rate Phase-in Plan

In the fourth quarter of 1988, the PUC and the FERC accepted the Company's requests to increase the annual depreciation for the Susquehanna station to comply with SFAS 92, which established new accounting rules for rate phase-in plans associated with a major newly constructed generating plant. As a result, in 1988 the Company adopted application of SFAS 92 for financial reporting purposes. The difference between straight-line depreciation and the amount of depreciation for Susquehanna reflected in electric rates is shown as deferred depreciation on the Consolidated Statement of Income and the Consolidated Balance Sheet. The adoption of SFAS 92 had no effect on net income or common equity.

4. Deferral of Susquehanna Operating and Carrying Costs

In accordance with orders of the PUC, the Company deferred certain operating and capital costs, net of energy savings, associated with Units 1 and 2 at the Susquehanna station. The costs deferred were incurred from the date the units were placed in commercial operation until the effective dates of the rate increases reflecting operation of the units. The deferred costs plus related deferred income taxes totaled $39.2 million at December 31, 1989. The Company expects to ultimately recover this amount in rates charged to customers. Such recovery will be subject to PUC review and approval. No return is being accrued on the deferred costs.

5. Sales to Other Electric Utilities

The Company provides Atlantic City Electric Company (Atlantic) with 125,000 kilowatts of capacity and energy from the Susquehanna station and Jersey Central Power and Light Company (JCP&L) with 945,000 kilowatts of generating capacity and energy from all of the Company's generating units. Sales to Atlantic began in 1983 and expire in 1991, when another agreement provides Atlantic with 125,000 kilowatts of capacity and energy from the Company's coal-fired stations until the year 2000. Sales to JCP&L began in 1985 and will continue at the 945,000 kilowatt level through 1995, with the amount then declining uniformly each year until the end of the agreement in 1999.

The Company has an agreement with Baltimore Gas and Electric Company (BG&E) under which BG&E will purchase 125,000 kilowatts of the Company's share of capacity and related energy from the Susquehanna station. Sales to BG&E will begin in October 1991, immediately following the expiration of the current agreement with Atlantic, and will continue through May 2001.

These three agreements provide that sales are to be made at a price equal to the Company's cost of providing service, which includes a return on the Company's investment in generating capacity.

In addition to these bulk power contractual sales, the Company has entered into agreements with BG&E and General Public Utilities Service Corporation (GPU) for the sale of capacity credits from the Company's system capacity. These capacity credits are used by the other utilities to meet their installed capacity obligation in the Pennsylvania-New Jersey-Maryland Interconnection (PJM). The price received for these sales is based on a percentage of the rate the utilities would have paid to purchase installed capacity under the PJM arrangement.

The maximum amount of capacity credits to be sold to BG&E varies from time to time through the year 2001, and the amount sold will depend on BG&E's needs. GPU has agreed to purchase 293,000 kilowatts of capacity credits from June 1, 1990 through May 31, 1991 and 390,000 kilowatts from June 1, 1991 through May 31, 1995. The agreement with GPU will become effective upon compliance with certain conditions, including no adverse determinations by state regulatory commissions and acceptance of the agreement by the FERC.

The Company has also entered into arrangements with several utilities outside the PJM for the reservation of output from the oil-fired units at the Company's Martins Creek station during certain periods of time. Specific deliveries of energy are requested by the purchasing utility as needed during the reservation period.

Arrangements have been entered into whereby other PJM utilities can purchase the Company's entitlements to use the PJM transmission system to import energy from utilities outside PJM. These sales generally occurred through monthly auctions in 1989, but the Company has recently entered into agreements which provide for the sale of transmission entitlements to other utilities for extended periods of time at negotiated prices.

During 1989, revenue from the sale of capacity credits, the reservation of output from the Martins Creek oil-fired units and the sale of transmission entitlements totaled $23.3 million.

6. Income Taxes

Total federal income tax expense was reduced in 1987 and further reduced in 1988 primarily as a result of the lower federal income tax rate included in the Tax Act. The net reduction in federal income tax expense due to the Tax Act has been reflected in lower rates to the Company's customers.

The Company estimates that approximately $40 million of investment and $4 million of payroll-based tax credits will be available to reduce federal income tax liabilities in 1990 and future years. The carryforward period for the unused credits at December 31, 1989 expires in the years 1999 to 2004.

In accordance with PUC rate treatment, the Company has not recorded deferred income taxes for certain timing differences. The cumulative net amount of such timing differences for which deferred income taxes have not been recorded approximated $556 million at December 31, 1989. The Company would expect to recover through electric revenues the taxes when due in future years.

In December 1987, the FASB issued SFAS 96, "Accounting for Income Taxes," which established new accounting rules that will change the manner in which income tax expense is determined for accounting purposes. Prior accounting rules utilized a deferred method while SFAS 96 utilizes a liability method under which deferred tax liabilities are recorded and adjusted for the effect of a change in tax law or rates. The FASB has delayed the effective date for SFAS 96 to fiscal years beginning after December 15, 1991. The Company does not intend to adopt SFAS 96 until the revised effective date because the FASB is considering amendments that could affect implementation of the statement.

It is expected that when the Company adopts SFAS 96, an increase in the deferred tax liability will be recorded for tax benefits previously flowed through to customers and for other temporary tax differences. The increased tax liability will be offset by a corresponding asset representing the future revenue ex-

pected to be provided through the ratemaking process to pay for the tax liability.

Because the Tax Act lowered the maximum corporate federal income tax rate from 46% to 34%, most entities when adopting SFAS 96 will be required to adjust their deferred income tax reserves to reflect the lower tax rate. However, the Tax Act essentially prohibits utilities from adjusting, to the 34% tax rate, certain deferred tax reserves related to depreciation. As a result, when the Company adopts SFAS 96, no substantial reduction in existing deferred income tax reserves is expected because of the lower federal tax rate.

7. Stock Held For Dividend Reinvestment Plan

At December 31, 1989, the Company temporarily held 234,228 shares of Common Stock which were acquired in the open market and distributed to participants in the Dividend Reinvestment Plan in January 1990.

8. Leases

The Company and a subsidiary have entered into capital leases consisting of the following (thousands of dollars):

	December 31	
	1989	**1988**
Nuclear fuel, net of accumulated amortization (1989, $176,695; 1988, $190,645)	$263,477	$288,834
Vehicles, oil storage tanks and other property, net of accumulated amortization (1989, $67,920; 1988, $64,451)	79,434	83,972
Net property under capital leases	$342,911	$372,806

Capital lease obligations incurred for the acquisition of nuclear fuel and other property were (millions of dollars): 1989, $55.8; 1988, $46.7 and 1987, $96.8.

Nuclear fuel lease payments, which are charged to expense as the fuel is used for the generation of electricity, were (millions of dollars): 1989, $86.1; 1988, $84.5 and 1987, $86.7. Future nuclear fuel lease payments will be based on the quantity of electricity produced by the Susquehanna units. The maximum amount of unamortized nuclear fuel leasable under current arrangements is $350 million.

Future minimum lease payments under capital leases in effect at December 31, 1989 (excluding nuclear fuel) would aggregate $103.2 million, including $23.7 million in imputed interest. During the five years ending 1994, such payments would decrease from $22.5 million per year to $10.5 million per year.

Interest on capital lease obligations was recorded as operating expenses on the Consolidated Statement of Income in the following amounts (millions of dollars): 1989, $25.2; 1988, $20.3 and 1987, $19.2.

Generally, capital leases contain renewal options and obligate the Company and a subsidiary to pay maintenance, insurance and other related costs. Various operating leases have also been entered into which are not material with respect to the Company's financial position.

9. Coal-Mining Operations

The Company purchased approximately $163 million of coal from certain subsidiary companies in 1989 at prices equal to the cost of mining. The cost of coal purchased is included in the energy costs collected from customers. The cost of coal purchased from subsidiaries (particularly coal from the Greenwich mines) has generally been higher than the cost of coal purchased from other sources.

All the coal produced at the Greenwich mines is delivered to the Company's Montour generating station and currently accounts for approximately 45% of the coal delivered to Montour. The PUC has adopted a standard based on the cost of coal purchased by other Pennsylvania electric utilities against which the

cost of all coal delivered to Montour is measured. The standard covers the two-year period from April 1, 1988 through March 1990. Unless the standard is continued beyond March 1990, the net amount of any costs in excess of the standard during this two-year period will be returned to PUC customers through the Company's 1991-1992 ECR. Data as to the standard is available for the period April 1, 1988 through August 31, 1989. For this period, the cost of coal delivered to Montour was less than the standard.

Plans have been adopted which will result in phasing out subsidiary coal-mining operations in the early 1990s. The Company expects that over this period investments in coal, mining equipment and other facilities will be recovered and that coal will be produced at prices that will be recovered in electric rates. However, the Company cannot predict whether regulatory action, proposed legislation related to health care benefits for miners or other events could affect its plans for these mines, possibly resulting in an adverse impact on the Company's earnings.

At December 31, 1989, the capital investment in subsidiary coal-mining operations amounted to about $50 million, a decrease of about $14 million from the end of 1988.

10. Credit Arrangements

The Company issues commercial paper and, from time to time, borrows from banks to provide short-term funds required for general corporate purposes. In addition, certain subsidiaries also borrow from banks to provide short-term funds. Bank borrowings generally bear interest at rates negotiated at the time of the borrowing.

Revolving credit arrangements are maintained with a group of banks in return for the payment of commitment fees. The line of credit is maintained principally as a back-up for the Company's commercial paper. Effective November 1, 1989, the Company reduced the line of credit from $200 million to $185 million. Any loans made under these credit arrangements would mature on June 30, 1992 and, at the option of the Company, interest rates would be based upon certificate of deposit rates, Eurodollar deposit rates or the prime rate. In addition, a subsidiary of the Company has a revolving credit arrangement with a group of banks as a back-up for short-term borrowings. The banks have agreed to lend the subsidiary up to $100 million on a revolving basis in return for the payment of commitment fees. Interest rates for borrowings would be based on the London interbank offered rate in effect at the time of the borrowing. No borrowings were outstanding at December 31, 1989 under these revolving credit arrangements.

The Company also maintains lines of credit aggregating $32 million with various banks in return for the maintenance of compensating balances or the payment of commitment fees. No borrowings were outstanding at the end of 1989 under these credit lines.

Commitment fees incurred were (millions of dollars): 1989, $0.5; 1988, $0.6 and 1987, $0.7.

11. Pension Plan and Other Postemployment Benefits

The Company has a noncontributory defined benefit pension plan (Plan) covering substantially all employees. Benefits are based upon a participant's earnings and length of participation in the Plan, subject to meeting certain minimum requirements.

The Company also has a Supplemental Executive Retirement Plan (SERP) for certain management employees. Benefits are based on the employees' service and earnings as defined in the SERP. The SERP is a non-qualified plan under the Internal Revenue Code and has no advanced funding. Benefit payments are made directly by the Company to retired employees or their beneficiaries. At December 31, 1989, the projected benefit obligation of the SERP was approximately $6.9 million.

The components of the Company's net periodic pension cost were (thousands of dollars):

	1989	1988	1987
Service cost—benefits earned during the period	$ 25,542	$ 23,510	$ 23,578
Interest cost	33,895	30,682	27,453
Actual return on plan assets	(119,572)	(56,381)	(21,365)
Net amortization and deferral	77,420	19,528	(12,217)
Net periodic pension cost	$ 17,285	$ 17,339	$ 17,449

The net periodic pension cost charged to operating expenses was $10.8 million in 1989 and $10.9 million each in 1988 and 1987. The balance was charged to construction and other accounts.

The funded status of the Company's Plan was (thousands of dollars):

	December 31 1989	1988
Fair value of plan assets	$ 668,125	$567,192
Actuarial present value of benefit obligations:		
Vested benefits	308,454	285,417
Nonvested benefits	1,862	2,012
Accumulated benefit obligation	310,316	287,429
Effect of projected future compensation	156,938	140,238
Projected benefit obligation	467,254	427,667
Plan assets in excess of projected benefit obligation	200,871	139,525
Unrecognized transition assets (being amortized over 23 years)	(90,395)	(94,915)
Unrecognized prior service cost	5,085	(591)
Unrecognized net gain	(129,957)	(42,030)
(Accrued) prepaid expense	$ (14,396)	$ 1,989

The weighted average discount rate and rate of increase in future compensation used in determining the 1989 actuarial present value of the projected benefit obligation were 7.5% and 6.4%, respectively. The expected long-term rate of return on Plan assets was 7.5%. Plan assets consist primarily of common stocks, government and corporate bonds and temporary cash investments.

Subsidiary mining companies have noncontributory defined benefit pension plans covering substantially all non-bargaining, full-time employees which are fully funded primarily by group annuity contracts with insurance companies. Substantially all union employees of these subsidiaries are covered by a pension plan administered by the Trustees of the United Mine Workers of America (UMWA) Health and Retirement Funds. The pension cost for non-bargaining employees together with contributions to the UMWA Health and Retirement Funds for 1989, 1988 and 1987 aggregated $3.7 million, $3.8 million and $7.4 million, respectively. Unfunded vested benefits of employees participating in the UMWA Health and Retirement Funds have not been determined.

Subsidiary mining companies are liable under federal and state laws to pay black lung benefits to claimants and dependents, with respect to approved claims, and are members of a trust which was established to facilitate payment of such liabilities. The actuarially determined expense for black lung benefits for 1989, 1988 and 1987 was $0.5 million, $1.2 million and $3.7 million, respectively.

Substantially all employees of the Company and its subsidiaries will become eligible for certain health care and life insurance benefits upon retirement. The Company recognizes the cost of these benefits for retired employees when premiums are paid. However, the subsidiary mining companies include in an accrual for future mine closing costs an amount to pay for such benefits after mining operations have ended. The cost of retiree health and life insurance benefits recognized as expense by the Company and its subsidiaries was approximately (millions of dollars): 1989, $4.7; 1988, $4.7 and 1987, $3.6.

In February 1989, the FASB proposed new rules for accounting for the costs of these benefits. The FASB proposal would require accrual, during the years that the employees render the necessary service, of the expected cost of providing those benefits. The Company cannot predict what final accounting rules the FASB may adopt; however, based on the Company's current postretirement health care benefits, the proposed accounting rules would increase the annual cost of providing for these benefits by an amount which has not been determined, but could be substantial.

The Company has an Employee Stock Ownership Plan (ESOP) for all full-time employees having more than one year of service. Contributions to the ESOP through 1989 were funded with investment tax credits previously available to the Company under Federal law to acquire shares of the Company's Common Stock. The Company expects that the allocation of shares purchased with these tax credits will be substantially completed in 1991. The ESOP was amended, effective January 1, 1990, to require that dividends on shares credited to participants' accounts be paid in cash. This will permit the Company to deduct the amount of those dividends for income tax purposes and to contribute to the ESOP shares having a cost equal to the tax savings resulting from that deduction and contribution.

12. Jointly Owned Facilities

At December 31, 1989, the Company individually or through a subsidiary owned undivided interests in the following facilities (millions of dollars):

	Generating Stations			Merrill Creek Reservoir
	Susquehanna	Keystone	Conemaugh	
Ownership interest	90.00%	12.34%	11.39%	8.37%
Electric utility plant in service	$3,919	$43	$44	
Other property				$20
Accumulated depreciation	262	19	18	1
Construction work in progress	15	3	1	1

Each participant in these facilities provides its own financing. The Company receives a portion of the total output of the generating stations equal to its percentage ownership. The Company's share of fuel and other operating costs associated with the stations is reflected on the Consolidated Statement of Income. The Merrill Creek Reservoir provides water during periods of low river flow to replace water from the Delaware River used by the Company and other utilities in the production of electricity.

13. Preferred Stock Litigation Settlement

As of July 1989, the claims of certain former holders of the 10.75%, 11.00% and 14.00% Series Preferred Stock related to the redemption of those shares in December 1986 were settled and legal proceedings instituted against the Company by those holders were dismissed. The settlements provided for the Company to make payments totaling approximately $4 million to the former holders which was substantially less than the redemption premiums the holders claimed the Company was liable to pay. These payments were charged to retained earnings as a cost of redeeming the stock and accordingly, had no effect on earnings applicable to common stock.

14. Commitments and Contingent Liabilities

The Company's construction expenditures are estimated to aggregate $320 million in 1990, $352 million in 1991 and $351 million in 1992, including AFUDC. See "Capital Expenditure Requirements" on page 21 for additional information.

The Company is a member of certain insurance programs which provide coverage for property damage to members' nuclear generating plants. Facilities at the Susquehanna station are insured against property damage losses up to $2.0 billion under these programs. The Company is also a member of an insurance program which provides insurance coverage for the cost of replacement power during prolonged outages of nuclear units caused by certain specified

conditions. Under the property and replacement power insurance programs, the Company could be assessed retrospective premiums in the event the insurers' losses exceed their reserves. The maximum amount the Company could be assessed under these programs at December 31, 1989 was about $12 million.

In 1987, the Nuclear Regulatory Commission (NRC) amended its regulations to require that any proceeds of property damage insurance be segregated and used, first, to place and maintain the reactor in a safe and stable condition and, second, to complete required decontamination operations before any insurance proceeds would be made available to the Company or the trustee under the mortgage. Under these regulations, such requirements were to be incorporated in the Company's on-site property damage insurance policies for the Susquehanna station before October 1988. The NRC, however, is in the process of revising its regulations to postpone the implementation of these requirements to April 1990. In the interim, the NRC has granted an extension for compliance under the existing regulations. The Company is unable to predict what effect the revised regulations may have at the time insurance proceeds would be paid.

The Company's public liability for claims resulting from a nuclear incident at the Susquehanna plant is limited to about $7.8 billion under provisions of The Price Anderson Amendments Act of 1988 (the Act). The Company is protected against this liability by a combination of commercial insurance and an industry assessment program. A utility's liability under the assessment program will be indexed not less than once during each five year period for inflation and will be subject to an additional surcharge of 5% in the event the total amount of public claims and costs exceeds the basic assessment. In the event of a nuclear incident at any of the reactors covered by the Act, the Company could be assessed up to $126 million per incident, payable at a rate of $20 million per year, plus the additional 5% surcharge, if applicable.

There is currently pending in Congress legislation sponsored by the Bush Administration dealing with acid rain. Under the Bush Administration proposal, sulfur dioxide emissions must meet specified Phase I levels by January 1, 1996 and must meet more stringent Phase II emission levels by January 1, 2001. In addition, currently unspecified reductions of nitrogen oxide emission levels must be made by the January 1, 2001 compliance date proposed for Phase II.

The Company currently expects that it will be able to meet the Phase I sulfur dioxide standards by switching to low sulfur coal processed through coal cleaning plants. In addition, the Company may have to limit the capacity factors of certain of its affected units and, to the extent permitted by the legislation, take advantage of trading emission allowances among its generating units or with other utility companies. The Company estimates that the cost of compliance with the proposed Phase I standards would require an increase in customer rates of about 3% (based on 1989 revenue levels) and anticipates that the increased costs would be recoverable through the ECR included in the Company's PUC tariffs, the fuel adjustment clause included in the Company's FERC tariffs and pursuant to the contracts under which the Company sells capacity and energy to other utilities.

To meet the Phase II sulfur dioxide standards, the Company expects it would be required to install scrubbers on about 75% of its coal-fired generating capacity as well as to continue its Phase I compliance activities on the balance of its coal-fired generating capacity. In addition, low-nitrogen oxide burners may have to be installed on all of the Company's coal-fired generating units to meet the as yet unspecified nitrogen oxide emission limitations contemplated by the proposed legislation. The cost of compliance with the proposed Phase II standards is currently estimated to require an increase in customer rates (based on 1989 revenue levels) of 8% to 10% above the 3% increase expected to result from Phase I compliance. Under current Pennsylvania law, construction work in progress for nonrevenue producing assets, such as capital expenditures for pollution control equipment, can be claimed in rate base.

In addition to the legislation being proposed by the Bush Administration, there are other bills currently pending in Congress dealing with clean air issues, including acid rain. The Company will not be able to determine the exact method of compliance, or the cost thereof and its impact on customer rates, until legislation is enacted and implementing regulations are adopted by the appropriate regulatory bodies.

In complying with statutes, regulations and actions by regulatory bodies involving environmental matters, including the areas of water and air quality, hazardous and solid waste handling and disposal and toxic substances, the Company may be required to modify, replace or cease operating certain of its facilities. The Company may also incur substantial capital expenditures and operating expenses in amounts which are not now determinable.

At December 31, 1989, the Company had guaranteed $18 million of obligations of certain unconsolidated companies.

Selected Financial and Operating Data

	1989	1988	1987	1986
CONSOLIDATED OPERATIONS				
Income Items—thousands				
Operating revenues	$2,356,446	$2,213,903	$2,090,244	$2,190,128
Operating income	618,850	605,051	590,637	597,529
Net income (a)	353,436	332,042	302,461	300,108
Earnings applicable to common stock (a)	305,018	279,865	248,035	231,051
Balance Sheet Items—thousands (b)				
Electric utility plant in service—net	$6,198,693	$6,056,723	$5,970,000	$5,815,838
Construction work in progress	115,799	177,333	141,960	224,426
Other property, plant and equipment—net	552,150	607,528	655,254	691,820
Total assets	7,598,968	7,524,648	7,457,346	7,413,105
Long-term debt	2,650,276	2,626,784	2,587,500	2,849,972
Preferred and preference stock				
With sinking fund requirements	409,990	438,290	495,590	475,239
Without sinking fund requirements	231,375	231,375	231,375	231,375
Common equity	2,139,338	2,049,831	1,969,971	1,915,649
Short-term debt	95,429	201,652	298,321	243,588
Total capital provided by investors	5,526,408	5,547,932	5,582,757	5,715,823
Financial Ratios				
Return on average common equity—% (a)	14.62	13.86	12.78	12.11
Embedded cost rates (b)				
Long-term debt—%	9.80	10.15	10.31	10.53
Preferred and preference stock—%	7.62	7.66	7.77	8.33
Times interest earned before income taxes	2.78	2.65	2.62	2.69
Ratio of earnings to fixed charges—total enterprise basis (c)	2.69	2.57	2.53	2.58
Depreciation as % of average depreciable property	2.7	2.6	2.5	2.3
Common Stock Data				
Number of shares outstanding—thousands				
Year-end	75,423	75,248	74,972	74,513
Average	75,314	75,071	74,644	74,513
Earnings per share (a)	$ 4.05	$ 3.73	$ 3.32	$ 3.10
Dividends declared per share	$ 2.86	$ 2.76	$ 2.68	$ 2.58
Book value per share (b)	$28.36	$27.23	$26.26	$25.71
Market price per share (b)	$ 42⅞	$ 36⅛	$ 33	$ 36½
Dividend payout rate—% (a)	71	74	81	83
Dividend yield—% (d)	7.33	7.70	7.37	7.30
Price earnings ratio (a) (d)	9.63	9.61	10.95	11.39
ELECTRIC OPERATIONS				
Revenue Data				
By class of service—thousands				
Residential	$ 776,673	$ 768,051	$ 737,066	$ 714,753
Commercial	612,762	592,023	572,623	557,216
Industrial	488,691	495,968	492,491	473,488
Other energy sales	80,144	75,507	74,228	74,047
System sales	1,958,270	1,931,549	1,876,408	1,819,504
Contractual sales to other utilities	296,499	264,760	275,339	292,044
Total from energy sales billed	2,254,769	2,196,309	2,151,747	2,111,548
Unbilled revenues—net	39,628	(18,187)	(84,888)	52,344
Other operating revenues	60,373	34,073	21,900	25,033
Total electric operating revenues	$2,354,770	$2,212,195	$2,088,759	$2,188,925
Average price per kwh billed—cents				
Residential	7.72	7.79	8.05	8.15
Commercial	7.40	7.46	7.68	7.78
Industrial	5.60	5.64	5.84	5.93
Total for ultimate customers	6.97	7.02	7.23	7.34
Total for all customers	6.50	6.50	6.68	6.94
Total for system sales	6.89	6.91	7.12	7.25

(a) 1981 net income and earnings applicable to common stock include a nonrecurring credit related to an accounting change, while indicated financial ratios and common stock data for that year are computed excluding the nonrecurring credit from earnings.
(b) Year-end.

1985	1984	1983	1982	1981	1980	1979	1979-1989 % Change
$1,977,981	$1,564,542	$1,250,071	$1,221,379	$1,134,903	$ 886,727	$ 861,985	173.4
536,115	418,689	300,563	236,430	227,044	180,782	194,026	219.0
290,613	318,903	296,011	278,886	244,077	179,759	182,198	94.0
199,327	226,758	210,173	210,572	183,182	120,384	133,532	128.4
$5,776,687	$3,856,738	$3,842,826	$2,107,651	$2,049,418	$1,949,904	$1,881,006	229.5
161,684	2,020,780	1,730,223	2,923,744	2,312,289	1,874,397	1,473,187	(92.1)
699,448	733,002	670,239	582,740	496,739	394,003	346,263	59.5
7,255,918	7,231,058	6,744,180	6,152,976	5,410,245	4,654,055	4,087,511	85.9
2,664,564	2,674,036	2,477,700	2,417,244	2,261,767	1,920,269	1,656,286	60.0
691,010	738,027	714,830	621,634	544,231	510,800	441,400	(7.1)
231,375	231,375	231,375	231,375	231,375	231,375	231,375	
1,905,700	1,896,987	1,767,949	1,643,695	1,435,437	1,250,717	1,113,441	92.1
247,260	278,652	351,194	324,664	321,481	162,315	101,884	(6.3)
5,739,909	5,819,077	5,543,048	5,238,612	4,794,291	4,075,476	3,544,386	55.9
10.42	12.30	12.29	13.60	12.74	10.38	12.91	13.2
11.23	11.11	10.98	10.80	10.84	10.71	9.32	5.2
10.02	9.94	9.66	9.41	8.93	8.49	8.43	(9.6)
2.28	2.24	2.20	1.94	1.79	1.92	2.42	14.9
2.19	2.06	2.05	1.81	1.77	1.90	2.40	12.1
2.3	2.7	2.9	3.4	3.4	3.3	3.3	(18.2)
74,513	74,513	70,335	66,461	58,447	50,627	43,497	73.4
74,513	72,767	68,642	62,809	53,912	45,598	40,231	87.2
$ 2.68	$ 3.12	$ 3.06	$ 3.35	$ 3.17	$ 2.64	$ 3.32	22.0
$ 2.56	$ 2.48	$ 2.40	$ 2.32	$ 2.24	$ 2.12	$ 2.04	40.2
$25.58	$25.46	$25.12	$24.71	$24.52	$24.68	$25.57	10.9
$ 28¾	$ 25⅛	$ 20⅝	$ 21	$ 17⅛	$ 15⅝	$ 17¾	141.5
96	80	79	70	72	82	62	14.5
9.81	11.00	10.48	11.95	13.34	12.01	10.38	(29.4)
9.76	7.24	7.48	5.79	5.30	6.68	5.92	62.7
$ 634,669	$ 591,922	$ 529,911	$ 503,557	$ 411,668	$ 349,714	$ 341,987	127.1
492,686	441,651	386,617	363,233	292,984	246,024	232,610	163.4
438,427	411,533	367,950	347,726	295,006	245,513	244,265	100.1
64,223	59,526	47,275	47,731	39,484	28,480	27,664	189.7
1,630,005	1,504,632	1,331,753	1,262,247	1,039,142	869,731	846,526	131.3
232,598	31,809	18,494					
1,862,603	1,536,441	1,350,247	1,262,247	1,039,142	869,731	846,526	166.4
78,545	(9,725)	(119,539)	(61,652)	76,884			
30,059	29,960	12,972	12,708	10,142	10,595	9,941	507.3
$1,971,207	$1,556,676	$1,243,680	$1,213,303	$1,126,168	$ 880,326	$ 856,467	174.9
7.60	7.00	6.51	6.26	5.09	4.34	4.24	82.1
7.32	6.77	6.32	6.11	4.97	4.28	4.19	76.6
5.55	5.07	4.83	4.75	3.70	3.10	3.00	86.7
6.85	6.30	5.91	5.74	4.59	3.90	3.79	83.9
6.62	6.27	5.86	5.66	4.53	3.87	3.75	73.3
6.77	6.23	5.83	5.66	4.53	3.87	3.75	83.7

(c) Computed using earnings and fixed charges of the Company and all of its affiliated companies. Fixed charges consist of interest on short- and long-term debt, other interest charges, interest on capital lease obligations and the estimated interest component of other rentals.
(d) Based on average of month-end market prices.

Selected Financial and Operating Data

	1989	1988	1987	1986
ELECTRIC OPERATIONS (Continued)				
Sales Data				
Customers (a)	1,143,591	1,122,628	1,097,518	1,073,146
Average annual residential kwh use	10,064	10,059	9,565	9,344
Electric energy sales billed—millions of kwh				
Residential	10,061	9,856	9,157	8,771
Commercial	8,285	7,932	7,457	7,159
Industrial	8,723	8,799	8,438	7,986
Other	1,333	1,360	1,285	1,170
System sales	28,402	27,947	26,337	25,086
Contractual sales to other utilities	6,270	5,819	5,868	5,339
Total electric energy sales billed	34,672	33,766	32,205	30,425
Sources of energy sold—millions of kwh				
Generated				
Coal-fired steam stations	27,104	26,607	26,465	25,151
Nuclear steam station (b)	11,916	12,867	13,285	10,151
Oil-fired steam station	3,817	4,186	4,095	5,453
Combustion turbines and diesels (oil)	107	57	28	17
Hydroelectric stations	714	573	689	739
	43,658	44,290	44,562	41,511
Power purchases	3,586	3,027	2,707	2,032
Interchange power sales	(9,920)	(11,304)	(13,015)	(11,281)
Company use, line losses and other	(2,652)	(2,247)	(2,049)	(1,837)
Total electric energy sales billed	34,672	33,766	32,205	30,425
Generation Data				
Net system capacity—thousands of kw (a) (c)	7,864	7,479	7,499	7,519
Winter peak demand—thousands of kw (d)	6,000	5,566	5,591	5,154
Generation by fuel source—%				
Coal	62.1	60.1	59.4	60.6
Nuclear (b)	27.3	29.0	29.8	24.4
Oil	9.0	9.6	9.3	13.2
Hydroelectric	1.6	1.3	1.5	1.8
Steam station availability—%				
Coal-fired	81.1	81.3	83.3	78.8
Nuclear (b)	72.1	77.7	80.4	61.7
Oil-fired	76.3	90.1	84.7	84.7
Steam station capacity factor—%				
Coal-fired	74.6	73.1	72.9	69.3
Nuclear (b)	72.0	77.7	80.5	61.3
Oil-fired	26.6	29.1	28.5	38.0
Fuel Cost Data				
Cost per kwh generated—cents				
Coal-fired steam stations	1.61	1.64	1.63	1.67
Nuclear steam station (b)	0.58	0.56	0.56	0.58
Oil-fired steam station	3.03	2.76	3.23	2.96
Combustion turbines and diesels (oil)	5.95	5.89	6.51	7.81
Average	1.46	1.44	1.46	1.57
Cost of fossil fuel received at steam stations				
Coal—per ton	$39.04	$39.52	$39.30	$40.17
Crude and residual oil—per barrel	$17.71	$15.95	$18.51	$16.83
Capitalization Ratios—%				
Long-term debt	48.3	47.9	46.9	50.4
Short-term debt	0.2	1.7	3.1	2.1
Preferred and preference stock	11.9	12.4	13.5	12.8
Common equity	39.6	38.0	36.5	34.7
Times Interest Earned Before Income Taxes	2.88	2.73	2.71	2.80
Employees (a)	8,108	8,306	8,301	8,339

(a) Year-end.
(b) The Company's first nuclear unit was placed in commercial operation on June 8, 1983 and the second unit on February 12, 1985.

1985	1984	1983	1982	1981	1980	1979	1979-1989 % Change
1,055,546	1,039,381	1,026,144	1,013,623	1,006,570	999,525	987,005	15.9
9,034	9,282	9,051	9,039	9,157	9,205	9,353	7.6
8,354	8,454	8,138	8,045	8,088	8,056	8,066	24.7
6,728	6,527	6,119	5,946	5,893	5,743	5,554	49.2
7,907	8,117	7,623	7,324	7,968	7,910	8,135	7.2
1,082	1,043	968	982	1,005	784	800	66.6
24,071	24,141	22,848	22,297	22,954	22,493	22,555	25.9
4,048	357	209					
28,119	24,498	23,057	22,297	22,954	22,493	22,555	53.7
26,237	26,695	26,885	25,477	24,841	26,596	26,487	2.3
11,534	6,295	4,509	293				
4,316	4,121	5,581	3,186	4,705	5,692	5,777	(33.9)
18	32	45	13	32	33	37	189.2
612	747	700	612	622	533	799	(10.6)
42,717	37,890	37,720	29,581	30,200	32,854	33,100	31.9
3,716	3,765	3,880	1,414	744	1,415	2,124	68.8
(16,235)	(15,377)	(16,405)	(6,900)	(6,274)	(9,798)	(11,089)	(10.5)
(2,079)	(1,780)	(2,138)	(1,798)	(1,716)	(1,978)	(1,580)	67.8
28,119	24,498	23,057	22,297	22,954	22,493	22,555	53.7
7,513	7,484	7,494	6,546	6,546	6,546	6,546	20.1
4,981	5,519	4,869	4,489	5,207	4,945	4,427	35.5
61.4	70.4	71.3	86.1	82.2	81.0	80.0	(22.4)
27.0	16.6	11.9	1.0				
10.2	11.0	14.9	10.8	15.7	17.4	17.6	(48.9)
1.4	2.0	1.9	2.1	2.1	1.6	2.4	(33.3)
78.6	75.2	78.8	79.1	74.7	78.7	76.6	5.9
70.7	66.7	67.7					
87.2	68.0	75.8	80.4	73.4	79.6	80.0	(4.6)
72.3	73.3	74.0	70.2	68.4	73.0	73.1	2.1
70.5	65.7	67.5					
30.0	28.6	38.8	22.2	32.8	39.5	40.2	(33.8)
1.78	1.75	1.68	1.77	1.64	1.40	1.30	23.8
0.61	0.54	0.66					
5.02	5.31	5.23	5.62	5.75	4.55	3.20	(5.3)
9.31	9.82	10.21	10.74	10.51	7.89	4.68	27.1
1.81	1.98	2.15	2.20	2.30	1.96	1.65	(11.5)
$42.00	$42.75	$39.37	$42.32	$39.59	$33.78	$30.70	27.2
$28.42	$31.32	$29.79	$30.94	$33.47	$26.44	$18.81	(5.8)
47.1	46.7	45.1	46.7	47.6	46.9	46.2	4.5
1.7	1.9	3.6	3.2	3.9	1.5	0.9	(77.8)
16.7	17.4	17.9	17.1	17.0	19.2	19.9	(40.2)
34.5	34.0	33.4	33.0	31.5	32.4	33.0	20.0
2.37	2.35	2.29	2.05	1.91	2.06	2.64	9.1
8,433	8,386	8,160	8,208	7,999	7,702	7,590	6.8

(c) Total generating capacity plus firm capacity purchases less firm capacity sales.
(d) The winter peaks shown were reached early in the subsequent year for years except 1989.

The following information is provided as a service to shareowners and other investors. **For any questions you may have or additional information you may require about PP&L or your investments in the company, please feel free to call the toll-free number listed below, or write to:**

George I. Kline, Manager
Investor Services Department
Pennsylvania Power & Light Co.
Two North Ninth Street
Allentown, Pa. 18101

Toll-Free Phone Number: For information regarding your investor account, or other inquiries, call toll-free: 800-322-9532 when calling from inside Pennsylvania, or 800-345-3085 when calling from outside Pennsylvania.

Annual Meeting: The annual meeting of shareowners is held each year on the fourth Wednesday of April. The 1990 annual meeting will be held at 1:30 p.m. on Wednesday, April 25, 1990, at Lehigh University's Stabler Arena located on the Lower Saucon Valley Goodman Campus complex—south of Bethlehem and west of Hellertown, Pa. A reservation card for meeting attendance is included with shareowners' proxy material.

Proxy Material: A proxy statement, a proxy and a reservation card for the company's annual meeting are mailed in a package which includes the annual report. This material was mailed beginning March 15, 1990, to all shareowners of record as of March 9, 1990.

Dividends: For 1990, the declaration of dividends is considered by the board or its executive committee, on February 28, May 23, August 22 and November 28, for payment on April 1, July 1 and October 1, 1990, and January 1, 1991, respectively. Dividend checks are mailed ahead of those dates with the intention they arrive as close as possible to the payment dates.

Record Dates: The 1990 record dates for dividends are March 9, June 8, September 10 and December 10.

Direct Deposit of Dividends: Shareowners may choose to have their dividend checks deposited directly into their checking or savings account. Quarterly dividend payments are electronically credited on the dividend date, or the first business day thereafter.

Dividend Reinvestment Plan: Shareowners may choose to have dividends on their common, preferred or preference stocks reinvested in PP&L common stock instead of receiving the dividend by check.

Certificate Safekeeping: Shareowners participating in the Dividend Reinvestment Plan may choose to have their common stock certificates forwarded to the company for safekeeping. These shares will be registered in the name of the company as agent for plan participants and will be credited to the participant's account. Dividends paid on any shares held in the plan will be reinvested.

Lost Dividend or Interest Checks: Dividend or interest checks lost by investors, or those which may be lost in the mail, will be replaced if the check has not been located by the 10th business day following the payment date.

Transfer of Stock or Bonds: Stock or bonds may be transferred from one name to another or to a new account in the name of another person. Please call or write regarding transfer instructions.

Bondholder Information: Much of the information and many of the procedures detailed here for shareowners also apply to bondholders. Questions related to bondholder accounts should be directed to Investor Services.

Lost Stock or Bond Certificates: Please call or write to Investor Services for an explanation of the procedure to replace lost stock or bond certificates.

Publications: Several publications are prepared each year and sent to all investors of record and to others who request their names be placed on our mailing lists. These publications are:

Annual Report—published and mailed to all shareowners of record in mid-March.

Shareowners' Newsletter—an easy-to-read newsletter containing current items of interest to shareowners—published and mailed at the beginning of each quarter. Additionally, a special year-end edition containing unaudited results of the year's operations is mailed in early February.

Quarterly Review—published in May, August and November to provide quarterly financial information to investors.

Periodic Mailings: Letters from the company regarding new investor programs, special items of interest, or other pertinent information are mailed on a non-scheduled basis as necessary.

Duplicate Mailings: Annual reports and other investor publications are mailed to each investor account. If you have more than one account, or there is more than one investor in your household, you may call or write to request that only one publication be delivered to your address. Please provide account numbers for all duplicate mailings.

Form 10-K and PP&L Profile: The company's annual report filed with the Securities and Exchange Commission on Form 10-K is available about mid-March. The PP&L Profile, a 10-year statistical review containing in-depth information about the company, is available in May. Investors may obtain a copy of these publications, at no cost, by calling or writing to Investor Services.

Listed Securities:

New York Stock Exchange
Common Stock (Code: PPL)
4½% Preferred Stock (Code: PPLPRB)
4.40% Series Preferred Stock (Code: PPLPRA)
8.60% Series Preferred Stock (Code: PPLPRG)
9.24% Series Preferred Stock (Code: PPLPRM)
Preference Stock, $8.00 Series (Code: PPLPRJ)
Preference Stock, $8.40 Series (Code: PPLPRH)
Preference Stock, $8.70 Series (Code: PPLPRI)

Philadelphia Stock Exchange
Common Stock
4½% Preferred Stock
3.35% Series Preferred Stock
4.40% Series Preferred Stock
4.60% Series Preferred Stock
8.60% Series Preferred Stock
9% Series Preferred Stock
9.24% Series Preferred Stock
Preference Stock, $8.00 Series
Preference Stock, $8.40 Series
Preference Stock, $8.70 Series

Fiscal Agents:

Stock Transfer Agents and Registrars
First Chicago Trust Company of New York
30 West Broadway
New York, New York 10007-2192

Pennsylvania Power & Light Co.
Investor Services-Stock Transfer

Dividend Disbursing Office and Dividend Reinvestment Plan Agent
Pennsylvania Power & Light Co.
Vice President and Treasurer

Mortgage Bond Trustee
Morgan Guaranty Trust Company of New York
c/o First Chicago Trust Company of New York
30 West Broadway
New York, New York 10007-2192

Bond Interest Paying Agent
Pennsylvania Power & Light Co.
Investor Services Department

Quarterly Financial, Common Stock Price and Dividend Data (Unaudited)

	For the Quarters Ended (a)			
	March 31	June 30	Sept. 30	Dec. 31
	(Thousands of Dollars, Except Per Share Amounts)			
1989				
Operating revenues	$613,068	$532,767	$548,584	$662,027
Operating income	168,319	131,514	145,898	173,119
Net income	101,249	64,720	79,405	108,062
Earnings applicable to common stock	88,957	52,527	67,380	96,154
Earnings per common share (b)	1.18	0.70	0.89	1.27
Dividends declared per common share (c)	0.715	0.715	0.715	0.715
Price per common share				
High	36⅜	39⅝	41¼	42⅞
Low	34¼	34⅝	38¼	40⅛
1988				
Operating revenues	$607,353	$521,601	$532,851	$552,098
Operating income	180,143	135,921	145,366	143,621
Net income	111,637	68,421	76,217	75,767
Earnings applicable to common stock	98,041	54,980	63,590	63,254
Earnings per common share (b)	1.31	0.73	0.85	0.84
Dividends declared per common share (c)	0.69	0.69	0.69	0.69
Price per common share				
High	37⅞	37½	36⅜	37
Low	33⅛	33⅝	33¾	34¼

(a) The Company's electric utility business is seasonal in nature with peak sales periods generally occurring in the winter months. Accordingly, comparisons among quarters of a year may not be indicative of overall trends and changes in operations.

(b) The sum of the quarterly amounts may not equal annual earnings per share due to changes in the number of common shares outstanding during the year or rounding.

(c) The Company has paid quarterly cash dividends on its common stock in every year since 1946. The dividends paid per share in 1989 and 1988 were $2.835 and $2.74, respectively. The most recent regular quarterly dividend paid by the Company was 71¼ cents per share (equivalent to $2.86 per annum) paid January 1, 1990. Future dividends will be dependent upon future earnings, financial requirements and other factors.

Officers and Directors

Officers

ROBERT K. CAMPBELL 59 (13), *Chairman, President and Chief Executive Officer*
JOHN T. KAUFFMAN 63 (39), *Executive Vice President and Chief Operating Officer*
CHARLES E. RUSSOLI 56 (34), *Executive Vice President and Chief Financial Officer*
GENNARO D. CALIENDO, 49 (21), *Senior Vice President, General Counsel and Secretary*
WILLIAM F. HECHT 46 (25), *Senior Vice President-System Power & Engineering*
HAROLD W. KEISER 46 (9), *Senior Vice President-Nuclear*
BRUCE D. KENYON 46 (13), *Senior Vice President-Division Operations*

LINDA CURRY BARTHOLOMEW 41 (19), *Vice President-Public Affairs*
JOHN R. BIGGAR 45 (20), *Vice President-Finance*
ROBERT G. BYRAM 44 (13), *Vice President-Nuclear Operations*
JOHN M. CHAPPELEAR 51 (11), *Vice President-Investments and Pensions*
ROBERT S. GOMBOS 46 (24), *Vice President-Human Resource & Development*
RONALD E. HILL 47 (25), *Vice President and Comptroller*
JOHN P. KIERZKOWSKI 50 (18), *Vice President and Treasurer*
JOSEPH C. KRUM 52 (30), *Vice President-Lancaster Division*
FRANCIS A. LONG 49 (26), *Vice President-Power Supply*
CARL R. MAIO 63 (40), *Vice President-Lehigh Division*
GRAYSON E. McNAIR 49 (27), *Vice President-Marketing & Customer Services*
JOHN R. MENICHINI 42 (21), *Vice President-Harrisburg Division*
EDWARD M. NAGEL 63 (37), *Vice President-Federal Policy*
HERBERT D. NASH JR. 63 (41), *Vice President-Central Division*
CLAIR W. NOLL 56 (29), *Vice President-Procurement & Computer Services*
EDWARD F. REIS 59 (33), *Vice President-Corporate Planning*
JOHN E. ROTH 61 (35), *Vice President-Northern Division*
JOHN H. SAEGER 51 (29), *Vice President-Susquehanna Division*
JEAN A. SMOLICK 55 (37), *Assistant Secretary*
PAULINE L. VETOVITZ 43 (25), *Assistant Secretary*
HELEN J. WOLFER 61 (42), *Assistant Secretary and Assistant Treasurer*
Numbers indicate age and years of service ( ) as of March 1, 1990.

Corporate Management Committee: Robert K. Campbell, chairman; John T. Kauffman, Charles E. Russoli, Gennaro D. Caliendo, William F. Hecht, Harold W. Keiser and Bruce D. Kenyon, with Edward F. Reis serving as the committee's executive secretary.

Directors

CLIFFORD L. ALEXANDER JR. 56 (14), Washington, D.C., *President, Alexander & Associates Inc. Consultants to business, government and industry*
JEFFREY J. BURDGE 67 (7), Camp Hill, *Chairman of the Board, Harsco Corporation. Manufacturer of processed and fabricated metals*
ROBERT K. CAMPBELL 59 (13), Allentown, *Chairman, President and Chief Executive Officer*
EDWARD DONLEY 68 (7), Allentown, *Chairman, Executive Committee, Air Products and Chemicals Inc. Manufacturer of industrial and commercial gases and chemicals*
WILLIAM J. FLOOD 54 (*), Hazleton, *Secretary-Treasurer, Highway Equipment & Supply Co. Supplier of heavy equipment for highway construction and industry*
REV. DANIEL G. GAMBET, O.S.F.S. 60 (3), Center Valley, *President, Allentown College of St. Francis de Sales*
ELMER D. GATES 60 (*), Bethlehem, *President and Chief Executive Officer, Fuller Company. Manufacturer of plants, machinery and equipment for industry*
HARRY A. JENSEN 71 (14), Lancaster, *former Director and former Chief Executive Officer, Armstrong World Industries Inc. Manufacturer of interior furnishings and specialty products*
CLIFFORD L. JONES 62 (1), Harrisburg, *President, Pennsylvania Chamber of Business and Industry*
JOHN T. KAUFFMAN 63 (11), Allentown, *Executive Vice President and Chief Operating Officer*
RUTH LEVENTHAL 49 (1), Middletown, *Provost and Dean, Penn State Harrisburg (The Capital College)*
RALPH W. RICHARDSON JR. 72 (10), State College, *Consultant, agricultural and environmental sciences*
NORMAN ROBERTSON 62 (20), Pittsburgh, *Senior Vice President and Chief Economist, Mellon Bank, N.A.*
CHARLES E. RUSSOLI 56 (3), Allentown, *Executive Vice President and Chief Financial Officer*
DAVID L. TRESSLER 53 (8), Scranton, *Chairman of the Board and Chief Executive Officer, Northeastern Bank of Pennsylvania*
Numbers indicate age and years of service ( ) on PP&L board as of March 1, 1990.
*Less than one year.

Executive Committee: Robert K. Campbell, chairman; Clifford L. Alexander, Jr., Harry A. Jensen and Norman Robertson

Audit Committee: David L. Tressler, chairman; Clifford L. Alexander, Jr., William J. Flood, Daniel G. Gambet, Elmer D. Gates, Ruth Leventhal and Ralph W. Richardson, Jr.

Corporate Responsibility Committee: Jeffrey J. Burdge, chairman; Daniel G. Gambet, Clifford L. Jones, Ruth Leventhal and David L. Tressler.

Management Development and Compensation Committee: Edward Donley, chairman; Clifford L. Alexander, Jr., Jeffrey J. Burdge, Elmer D. Gates and Norman Robertson.

Nominating Committee: Ralph W. Richardson, Jr., chairman; Jeffrey J. Burdge, Edward Donley, William J. Flood, Harry A. Jensen and Clifford L. Jones.

Board of Directors

Pictured here are the outside, non-employee members of PP&L's board.


Alexander


Burdge


Donley


Flood

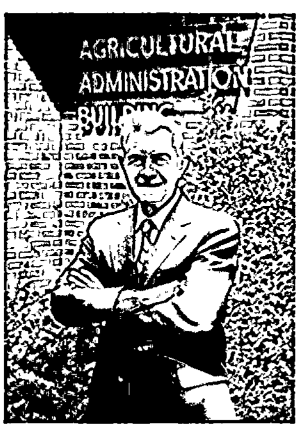

Gambet


Gates


Jensen


Jones


Leventhal

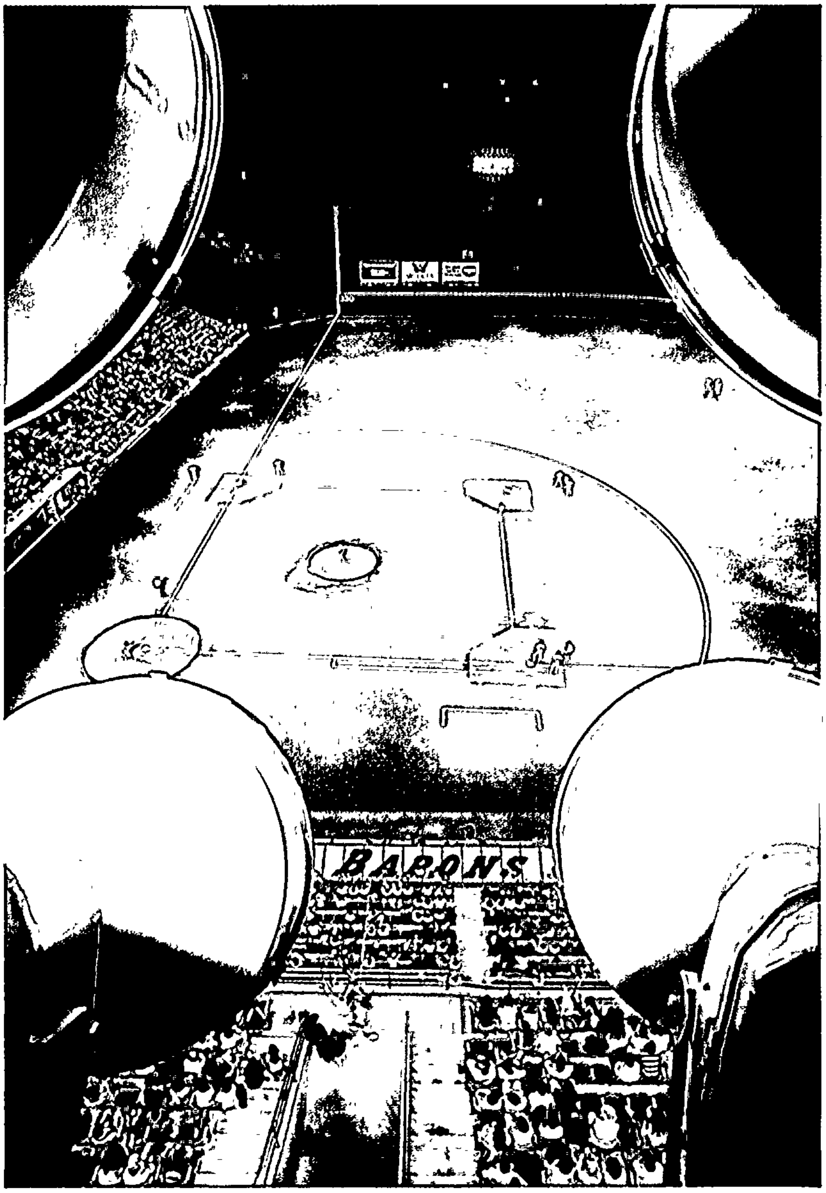


Richardson


Robertson


Tressler

PP&L Pennsylvania Power & Light Company
Two North Ninth Street • Allentown, PA 18101 • 215 / 770-5151



Triple A minor league baseball arrived in Scranton in a major way in 1989. The completion in April of the new 8,600-seat Lackawanna County multi-purpose stadium brought one step closer the dream of a business and recreation renaissance for the Scranton-Wilkes-Barre area of the Susquehanna River Valley. With a home stand of 73 games played under the lights, the Scranton Red Barons — farm team for the Philadelphia Phillies — proved a formidable force in minor league baseball. The stadium also hosted 100 other sports and entertainment events in 1989.

LITHO IN U.S.

Audited Financial Statements and
Other Financial Information

Allegheny Electric Cooperative, Inc.

October 31, 1989

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Ernst & Young

Audited Financial Statements and
Other Financial Information

ALLEGHENY ELECTRIC COOPERATIVE, INC.

October 31, 1989

Audited Financial Statements

Other Financial Information

Ernst & Young

300 Locust Court
212 Locust Street
Harrisburg, Pennsylvania 17101
Telephone: (717) 232-7575

REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying balance sheets of Allegheny Electric Cooperative, Inc. as of October 31, 1989 and 1988, and the related statements of operations and patronage capital and cash flows for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Allegheny Electric Cooperative, Inc. at October 31, 1989 and 1988, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Ernst + Young

Harrisburg, Pennsylvania
January 12, 1990

BALANCE SHEETS

ALLEGHENY ELECTRIC COOPERATIVE, INC.

	October 31 1989	October 31 1988
	(In Thousands)	
ASSETS		
ELECTRIC UTILITY PLANT--Note C		
In service--Note B	$ 610,308	$ 595,959
Construction work in process	10,274	6,939
Nuclear fuel in process	6,679	13,075
	627,261	615,973
Less accumulated depreciation and amortization	88,725	70,829
	538,536	545,144
OTHER ASSETS AND INVESTMENTS		
Nonutility property, at cost (net of accumulated depreciation of $1,323 in 1989 and $1,183 in 1988)	5,056	5,084
Investments in associated organizations--Note D	4,277	4,247
Other noncurrent assets	2,689	4,989
	12,022	14,320
CURRENT ASSETS		
Cash and short-term investments of $35,144 in 1989 and $39,668 in 1988	34,735	39,679
Accounts receivable from members	9,329	9,264
Other accounts receivable	5,069	5,147
Other current assets	738	650
	49,871	54,740
	$ 600,429	$ 614,204

	October 31 1989	1988
	(In Thousands)	
EQUITIES AND LIABILITIES		
EQUITIES		
Memberships	$ 3	$ 3
Donated capital	51	51
Patronage capital	38,940	36,387
	38,994	36,441
LONG-TERM DEBT, less current portion--Note F	489,919	496,569
CURRENT LIABILITIES		
Notes payable--Note E	27,800	33,380
Current portion of long-term debt--Note F	8,803	7,151
Accounts payable and accrued expenses	9,407	12,665
Accounts payable to members	5,003	5,403
	51,013	58,599
DEFERRED CREDITS		
Deferred income tax benefits from safe harbor lease--Note G	12,942	13,689
Other deferred credits	7,561	8,906
	20,503	22,595
	$ 600,429	$ 614,204

See notes to financial statements.

STATEMENTS OF OPERATIONS AND PATRONAGE CAPITAL

ALLEGHENY ELECTRIC COOPERATIVE, INC.

	Year Ended October 31 1989	1988
	(In Thousands)	
Operating revenue, including sales to members of $114,434 in 1989 and $109,533 in 1988	$ 130,492	$ 133,881
Operating expenses:		
Purchased power	33,359	40,120
Transmission	8,864	7,650
Production	20,865	20,226
Fuel	9,413	8,634
Depreciation	10,316	9,619
Taxes	3,454	3,609
Administrative and general	5,256	4,083
	91,527	93,941
OPERATING MARGIN BEFORE INTEREST AND OTHER DEDUCTIONS	38,965	39,940
Interest and other deductions:		
Interest expense	42,724	44,264
Allowance for funds used during construction	(1,234)	(2,319)
Other deductions (credits), net	(9)	(7)
	41,481	41,938
OPERATING MARGIN (DEFICIT)	(2,516)	(1,998)
Nonoperating margins:		
Net nonoperating rental income (loss)	(23)	(1)
Interest income	4,293	2,891
Other--Note I	52	602
	4,322	3,492
MARGIN BEFORE INCOME TAXES	1,806	1,494
Deferred income tax benefits from safe harbor lease	747	719
NET MARGIN	2,553	2,213
Patronage capital at beginning of year	36,387	34,174
PATRONAGE CAPITAL AT END OF YEAR	$ 38,940	$ 36,387

See notes to financial statements.

STATEMENTS OF CASH FLOWS

ALLEGHENY ELECTRIC COOPERATIVE, INC.

	Year Ended October 31 1989	1988
	(In Thousands)	
OPERATING ACTIVITIES		
Net margin	$ 2,553	$ 2,213
Adjustments to reconcile net margin to net cash provided by operating activities:		
Depreciation and fuel amortization	18,480	17,070
Amortization of gain on sale of electric utility plant	(44)	(20)
Deferred income tax benefits from safe harbor lease	(747)	(719)
Changes in operating assets and liabilities:		
(Increase) decrease in operating assets:		
Noncurrent assets	2,300	(447)
Accounts receivable from members	(65)	(811)
Other accounts receivable	78	(1,684)
Other current assets	(88)	(222)
Increase (decrease) in operating liabilities:		
Accounts payable and accrued expenses	(3,258)	(522)
Accounts payable to members	(400)	2,904
Other deferred credits	(1,301)	303
NET CASH PROVIDED BY OPERATING ACTIVITIES	17,508	18,065
INVESTING ACTIVITIES		
Additions to electric utility plant	(11,876)	(16,785)
Proceeds from sale of electric utility plant, net of expenses	-	30,889
(Increase) reduction in investments in associated organizations	(30)	145
Proceeds from sales of utility and nonutility property	32	-
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(11,874)	14,249
FINANCING ACTIVITIES		
Proceeds from long-term debt	2,259	12,293
Payments on notes payable and long-term debt	(12,837)	(27,439)
Donated capital	-	1
NET CASH USED IN FINANCING ACTIVITIES	(10,578)	(15,145)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(4,944)	17,169
Cash and cash equivalents at beginning of year	39,679	22,510
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 34,735	$ 39,679

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

ALLEGHENY ELECTRIC COOPERATIVE, INC.

October 31, 1989

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Allegheny Electric Cooperative, Inc. (Allegheny) is a rural electric cooperative utility established under the laws of the Commonwealth of Pennsylvania. Financing assistance is provided by the U. S. Department of Agriculture, Rural Electrification Administration (REA) and, therefore, Allegheny is subject to certain rules and regulations promulgated for rural electric borrowers by REA. Allegheny is a generation and transmission cooperative, providing power supply to fourteen owner/members who are rural electric distribution cooperative utilities providing electric power to consumers in certain areas of Pennsylvania and New Jersey.

Allegheny maintains its accounting records in accordance with the Federal Energy Regulatory Commission's chart of accounts as modified and adopted by REA.

Electric Utility Plant and Depreciation: The electric utility plant is stated at cost, which includes an allowance for funds used during construction. Depreciation is provided on the modified sinking fund method for nuclear utility plant production assets and the straight-line method for all other assets, except nuclear fuel. The cost of units of property retired or replaced is removed from utility plant accounts and charged to accumulated depreciation.

Nuclear Fuel: Nuclear fuel usage is charged to fuel expense based on the quantity of heat produced for electric generation. Under the Nuclear Waste Policy Act of 1982, the U. S. Department of Energy (DOE) is responsible for the permanent storage and disposal of spent nuclear fuel removed from nuclear reactors. Allegheny currently pays to Pennsylvania Power & Light Company (PP&L), co-owner of Susquehanna Steam Electric Station (SSES), its portion of DOE fees for such future disposal services.

Cost of Decommissioning Nuclear Plant: Allegheny's portion of the estimated decommissioning costs of SSES is charged to operating expenses over the estimated useful life of the plant.

Allowance for Funds Used During Construction: Allowance for funds used during construction represents the cost of directly related borrowed funds used for construction of electric utility plant. The allowance is capitalized as a component of the cost of electric utility plant while under construction.

Investments in Associated Organizations: Investments in associated organizations are carried at cost.

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--Continued

Preliminary Surveys: Costs of preliminary surveys for potential development projects are recorded as deferred charges in other noncurrent assets. If construction of a project results from such surveys, the deferred charges are transferred to the cost of the facilities. If a preliminary survey is abandoned, the costs incurred are written off.

Cash Equivalents: For purposes of the statements of cash flows, Allegheny considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Short-Term Investments: Short-term investments are carried at cost, plus accrued interest, which approximates market value.

Income Taxes: Investment tax credits, other than those sold through the safe harbor lease arrangement, are accounted for under the flow-through method whereby credits are recognized as a reduction of income tax expense in the year in which the credit is utilized for tax purposes.

The Tax Reform Act of 1986 (the Act), enacted on October 22, 1986, repealed the Investment Tax Credit as of January 1, 1986. Provisions exist within the Act which allow for investment tax credits on certain property referred to as "transition property" placed in service after December 31, 1985. During the years ended October 31, 1989 and 1988, Allegheny placed in service transition property eligible for investment tax credits.

Variations in the customary relationship between pretax accounting income and income tax expense are the result of patronage dividends. Net operating losses for financial and tax reporting purposes differ as a result of timing differences relating primarily to depreciation.

Accounting for Phase-In Plans: In August 1987, the Financial Accounting Standards Board issued Statement No. 92, "Regulated Enterprises - Accounting for Phase-in Plans" (Statement). Use of the modified sinking fund method of depreciation for nuclear utility plant production assets by Allegheny is considered a "phase-in plan" subject to the provisions of the Statement. The Statement will require Allegheny to either recognize an immediate charge against income or retroactively reduce equity for the difference between the modified sinking fund method of depreciation currently used for nuclear utility plant production assets and the straight-line method of depreciation. The difference between these two methods is approximately $31.1 million at October 31, 1989. Allegheny has requested approval from REA to amend its existing phase-in plan to conform to the requirements of the Statement. Adoption of the Statement is required to occur when REA approval is received. Such approval is expected early in 1990.

NOTES TO FINANCIAL STATEMENTS--Continued

ALLEGHENY ELECTRIC COOPERATIVE, INC.

NOTE B--ELECTRIC UTILITY PLANT IN SERVICE

Electric utility plant in service consists of the following:

	Depreciation/ Amortization, Lives/Rates	October 31 1989	1988
		(In Thousands)	
Nuclear Utility Plant:			
Production	39 years	$ 509,469	$ 505,920
Transmission	2.75%	30,191	30,176
General plant	3% - 12.5%	826	827
Nuclear fuel	Heat production	68,388	57,818
Non-Nuclear Utility Plant	3% - 33%	1,434	1,218
	TOTAL	$ 610,308	$ 595,959

NOTE C--SUSQUEHANNA STEAM ELECTRIC STATION

Allegheny owns a 10% undivided interest in SSES. PP&L owns the remaining 90%. Both participants provide their own financing. Allegheny's portion of costs associated with the station totalled $621 million and $612 million at October 31, 1989 and 1988, respectively. Allegheny's share of anticipated costs for ongoing construction and nuclear fuel for SSES are estimated to be approximately $55.6 million over the next five years. Allegheny receives a portion of the total station output equal to its percentage ownership. The statement of operations reflects Allegheny's share of fuel and other operating costs associated with the station.

NOTE D--INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations consist primarily of National Rural Utilities Cooperative Finance Corporation (CFC) patronage capital, "Capital Term Certificates" and "Subordinate Term Certificates," and National Bank for Cooperatives (Co Bank) "C" stock and "E" stock. Certificates bear interest at 3% and 4% and begin maturing in 2014.

Allegheny is required to maintain these investments pursuant to certain loan and guarantee agreements.

NOTES TO FINANCIAL STATEMENTS--Continued

ALLEGHENY ELECTRIC COOPERATIVE, INC.

NOTE E--NOTES PAYABLE

Allegheny has short-term lines of credit available with banks and CFC of $52 million. There were no amounts outstanding at October 31, 1989 or 1988. Interest rates are generally at prime plus 1%.

Notes payable at October 31, 1989 and October 31, 1988 includes $27.8 million and $28.2 million, respectively, relating to Pollution Control Revenue Bonds issued by an Industrial Development Authority on Allegheny's behalf. The bonds are subject to purchase on demand of the holder and remarketing on a "best efforts" basis. Sinking fund redemption is scheduled in varying amounts through 2014, and interest is due monthly at variable rates (5.9% to 8.0% for 1989 and 4.7% to 8.5% for 1988). The bonds are convertible to a fixed interest rate and fixed term at Allegheny's option. $1.8 million of investments included in other noncurrent assets at both October 31, 1989 and 1988 relate to a debt service reserve fund required under the bond indenture. The notes payable balance at October 31, 1988 also included $5.2 million of unsecured commercial paper which matured on January 20, 1989.

Restrictions are imposed under certain short-term credit arrangements including, among other things, maintenance of ratio requirements under existing long-term debt arrangements and limitation of total short-term indebtedness outstanding to an amount not to exceed the remaining unadvanced portion of certain existing REA long-term loan commitments ($52.7 million at October 31, 1989).

NOTE F--LONG-TERM DEBT

Long-term debt consists principally of mortgage notes payable for the electric utility plant to REA and to the United States of America acting through the Federal Financing Bank (FFB) and guaranteed by REA and a mortgage loan payable to CFC relating to nonutility property. Substantially all the assets of Allegheny are pledged as collateral. Long-term debt consists of the following:

	October 31 1989	1988
	(In Thousands)	
Mortgage notes payable to FFB at interest rates varying from 7.329% to 13.820% in 1989 and 7.281% to 13.820% in 1988, due in varying amounts through 2021	$ 491,942	$ 499,103

NOTE F--LONG-TERM DEBT--Continued

	October 31 1989	October 31 1988
	(In Thousands)	
Mortgage loan payable to CFC, payable in various quarterly installments, including interest through January 2015. Variable rates ranged from 9.25% to 11.00% in 1989 and 7.75% to 9.25% in 1988	$ 2,033	$ 2,060
Note payable to CFC, payable in various quarterly installments, including interest through October 2019. Variable rates ranged from 9.5% to 11.0% in 1989	693	-
5% mortgage notes payable to REA due in varying amounts through 2019	4,015	2,498
Other	39	59
	498,722	503,720
Less current portion	8,803	7,151
	$ 489,919	$ 496,569

Allegheny has the option on FFB promissory note advances to elect (subject to REA approval) interim maturity dates of not less than two years nor more than seven years after the date of the advance. At the date of the advance or on the maturity of an interim advance, Allegheny may also designate that it desires a long-term maturity of 34 years after the end of the calendar year in which the advance was made. At October 31, 1989, Allegheny had $44.0 million of advances maturing within one year which it intends to convert to long-term obligations, either by rolling them over for additional two-year periods or extending them to facility life-time financing, in accordance with the mortgage agreement.

Aggregate maturities of long-term debt for the four years subsequent to October 31, 1989 are as follows (in thousands):

1991	$ 10,106
1992	11,316
1993	12,058
1994	12,590

The above maturity schedule reflects management's intent to convert FFB advances with interim maturity dates to long-term debt. Allegheny has used an interest rate it estimates to be an appropriate long-term rate, based on the October 31, 1989 interest rate, to compute the annual principal requirements.

NOTE F--LONG-TERM DEBT--Continued

Allegheny is required by mortgage covenants to maintain certain levels of interest coverage and annual debt service coverage. Allegheny was in compliance with such requirements at October 31, 1989.

During 1989 and 1988, Allegheny incurred interest costs of $42.7 million and $44.3 million, respectively. Interest paid was $42.9 million and $44.4 million, respectively.

NOTE G--INCOME TAXES

At October 31, 1989, Allegheny had available nonmember net operating loss carryforwards of $2.2 million for financial reporting purposes and $155.2 million for tax reporting purposes and investment tax credit carryforwards of approximately $34.1 million for both financial and tax reporting purposes, expiring through 2004. Allegheny also had operating loss carryforwards attributable to member activities of $2.1 million for financial reporting purposes and $152.7 million for tax reporting purposes which may be carried forward indefinitely. Under the Tax Reform Act of 1986, the amount of investment tax credit allowable as a result of a carryforward must be reduced by 35%.

In 1983, Allegheny sold certain investment and energy tax credits and depreciation deductions pursuant to a safe harbor lease. The proceeds from the sale, including interest earned thereon, have been deferred and are being recognized over the term of the lease (30 years). The net proceeds and related interest were required by REA to be used to retire outstanding FFB debt.

Under the terms of the safe harbor lease, Allegheny is contingently liable in varying amounts in the event the lessor's tax benefits are disallowed and in the event of certain other occurrences. The maximum amount for which Allegheny was contingently liable approximated $21 million at October 31, 1989. Payment of this contingent liability has been guaranteed by CFC.

NOTE H--RELATED PARTY TRANSACTIONS

Allegheny has an arrangement with an associated organization, Pennsylvania Rural Electric Association (PREA), under which PREA provides Allegheny with certain management, general, and administrative services on a cost reimbursement basis. Total costs for the services provided for the years ended October 31, 1989 and 1988 were $2.6 million and $2.2 million, respectively.

NOTES TO FINANCIAL STATEMENTS--Continued

ALLEGHENY ELECTRIC COOPERATIVE, INC.

NOTE I--COMMITMENTS AND CONTINGENCIES

Allegheny and PP&L are members of certain insurance programs which provide coverage for property damage to members' nuclear generating plants. Allegheny's portion of the facilities at SSES is insured against property damage losses up to $203.5 million under these programs. Allegheny is also a member of an insurance program which provides coverage for the cost of replacement power during prolonged outages of nuclear units caused by certain specified conditions. Under the property and replacement power insurance programs, Allegheny could be assessed retrospective premiums in the event the insurers' losses exceed their reserves. The maximum amount Allegheny could be assessed under these programs during the current policy year is $.5 million.

Allegheny's public liability for claims resulting from a nuclear incident is currently limited to $780.7 million under provisions of the Price-Anderson Amendments Act of 1988 (Act), which extended the Price-Anderson Act to August 1, 2002. Allegheny is protected against this potential liability by a combination of commercial insurance and an industry retrospective assessment program.

In the event of a nuclear incident at any of the facilities owned by others and covered by the Act, Allegheny could be assessed up to $12.6 million per incident, but not more than $2 million in a calendar year.

Allegheny is currently constructing two transmission facilities which are estimated to cost a total of $4.3 million. Financing is being provided by REA ($3.0 million) and CFC ($1.3 million).

On July 31, 1987, Allegheny entered into an agreement with Sithe Energies USA, Inc. (Sithe) to transfer its interests in the development of the Allegheny River Locks and Dams Number 8 and 9 Hydroelectric Project to Sithe. Interests to be transferred included Allegheny's license granted by the Federal Energy Regulatory Commission (FERC) to construct the hydroelectric project. The agreement calls for three payments to be made by Sithe:

> The first payment, in the amount of $250,000, was received and recorded by Allegheny in November 1987 in exchange for deliverance of evidence of release of any liens or claims against the FERC license.

NOTE I--COMMITMENTS AND CONTINGENCIES--Continued

The second payment, in the amount of $822,000, was accrued at October 31, 1988 and received by Allegheny in April 1989, twelve months subsequent to the date of the execution by Sithe of a power purchase agreement as described below.

The third payment, in the amount of $1.4 million, was contingent upon the execution by Sithe of a power purchase agreement for sale of all or part of the energy and capacity produced by the project and all necessary wheeling and transmission agreements required to effectuate the delivery of the project's power and energy to its purchaser. While Sithe signed a power purchase agreement during 1988, they did not finalize the necessary wheeling and transmission agreements until January 1990. Accordingly, this payment was received and recorded by Allegheny in January 1990 upon finalization of such agreements.

Total payments received and accrued by Allegheny during 1988 under this agreement, net of related costs, resulted in a gain of approximately $582,000, which is included in the 1988 statement of operations. The final payment of $1.4 million will be reported in the 1990 statement of operations.

NOTE J--SALE/LEASEBACK ARRANGEMENT

On June 30, 1988, Allegheny completed the sale and simultaneous leaseback of its hydroelectric generation facility at the Raystown Dam (the Facility). The Facility was sold to Ford Motor Credit Company (Ford) for $32 million in cash. Under terms of the arrangement, Allegheny will lease the Facility from Ford for an initial term of thirty years. Payments under the lease are due in semiannual installments commencing January 10, 1989. At the end of the thirty-year term, Allegheny will have the option to purchase the Facility for an amount equal to the Facility's fair market value. Allegheny also has the option to renew the lease for a five-year fixed rate renewal and three fair market renewal periods, each of which may not be for a term of less than two years. Payments during the fixed rate renewal period are 30% of the average semiannual installments during the initial lease term. Allegheny will retain co-licensee status for the Facility throughout the term of the lease. In 1988, Allegheny originally reported a gain of $3.5 million related to the sale. However, during 1989, Allegheny incurred additional costs totalling $1.6 million which reduced the gain from $3.5 million to $1.9 million. The adjusted gain of $1.9 million will be recognized over the lease term in the same proportion that the annual rental payments relate to total rental payments.

NOTE J--SALE/LEASEBACK ARRANGEMENT--Continued

Cash proceeds from the sale were used by Allegheny to retire $20.6 million of commercial paper, the proceeds of which had been used to partially finance the construction of the Facility, and $1.3 million of mortgage notes payable to FFB.

The payments by Allegheny under this lease were determined in part on the assumption that Ford will be entitled to certain income tax benefits as a result of the sale and leaseback of the Facility. In the event that Ford were to lose all or any portion of such tax benefits, Allegheny would be required to indemnify Ford for the amount of the additional federal income tax payable by Ford as a result of any such loss.

The leaseback of the Facility is accounted for as an operating lease by Allegheny. Future minimum lease payments under this lease, which can vary based on the interest paid on the debt used by Ford to finance the transaction, as of October 31, 1989 are estimated as follows (in thousands):

1990	$ 1,931
1991	1,931
1992	1,931
1993	2,361
1994	2,361
Thereafter	57,414
Total Minimum Lease Payments	$67,929

The future minimum lease payments shown above are for the initial lease term and the five-year renewal period. These payments are based on an assumed interest rate of 8.8% and may fluctuate based on differences between the future interest rate and the assumed interest rate.

Rental expense for this lease totalled $2.0 million for the year ended October 31, 1989 and $669,000 for the year ended October 31, 1988.

Ernst & Young

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REPORT OF INDEPENDENT AUDITORS ON OTHER FINANCIAL INFORMATION

Allegheny Electric Cooperative, Inc.
Harrisburg, Pennsylvania

The audited financial statements of Allegheny Electric Cooperative, Inc. (Allegheny) and our report thereon are presented in the preceding section of this report. The following financial information is presented for purposes of additional analysis and is not a required part of the financial statements of Allegheny. Such information has been subjected to the auditing procedures applied in our audits of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Ernst + Young

Harrisburg, Pennsylvania
January 12, 1990

SCHEDULES OF NONOPERATING RENTAL INCOME (LOSS)

ALLEGHENY ELECTRIC COOPERATIVE, INC.

	Year Ended October 31	
	1989	1988
	(In Thousands)	
INCOME:		
Rental-building	$ 855	$ 818
Rental-parking	63	86
	918	904
EXPENSES:		
Utilities	198	207
Payroll and employee benefits	30	35
Management and leasing fees	26	26
Office and administrative expenses	44	50
Maintenance and repairs	73	66
Real estate taxes	179	169
Insurance	41	43
Interest	209	173
Depreciation	141	136
	941	905
NET NONOPERATING RENTAL INCOME (LOSS)	$ (23)	$ (1)

SCHEDULES OF ADMINISTRATIVE AND GENERAL EXPENSES

ALLEGHENY ELECTRIC COOPERATIVE, INC.

	Year Ended October 31 1989	1988
	(In Thousands)	
Office supplies	$ 189	$ 116
Travel, conventions, and meetings	233	172
Payroll and employee benefits	1,480	1,256
Legal, auditing, and engineering	1,036	851
Association membership dues	45	42
Board meetings, directors' fees, and travel	108	123
Penn Lines	121	100
Information programs	158	91
Rent	203	189
Payroll taxes	102	102
Insurance	54	59
Insurance--SSES	839	869
Insurance--Raystown	140	63
Writeoff of preliminary survey charges	444	-
Miscellaneous	104	50
TOTAL ADMINISTRATIVE AND GENERAL EXPENSES	$ 5,256	$ 4,083