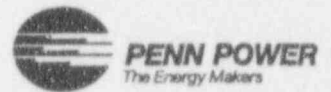


ANNUAL REPORT 1994



9505300367 940518
PDR ADOCK 05000334
I PDR

CONTENTS

Selected Financial Data	1
Management's Discussion and Analysis	2
Operating Statistics	5
Statements of Income	6
Balance Sheets	7
Statements of Capitalization	8
Statements of Retained Earnings	9
Statements of Capital Stock and Other Paid-In Capital	9
Statements of Cash Flows	10
Statements of Taxes	11
Notes to Financial Statements	12
Report of Independent Public Accountants	19
Directors and Officers	20

COMPANY PROFILE

Pennsylvania Power Company provides electric service to more than 141,000 customers in western Pennsylvania. The Company furnishes electric service in 139 communities, as well as rural areas, and also sells electric energy at wholesale to five municipalities. Its service area has an estimated population of 340,000. The Company, with headquarters in New Castle, Pennsylvania, is a wholly owned subsidiary of Ohio Edison Company.

In August, we were saddened by the passing of Company President Robert L. Kensinger. Mr. Kensinger, 59, served as president since 1991 and served the Ohio Edison System since 1960. We will long remember his contribution to the Companies, the utility industry, and the communities we serve.

The Board named H. Peter Burg president, on an interim basis. Mr. Burg continues serving as senior vice president and chief financial officer of Ohio Edison and a member of the boards of directors of both Companies.

SELECTED FINANCIAL DATA

Pennsylvania Power Company

	1994	1993	1992	1991	1990
	(Dollars in thousands)				
Operating Revenues	\$ 301,965	\$ 292,084	\$ 315,458	\$ 321,845	\$ 318,056
Operating Income	\$ 63,668	\$ 62,777	\$ 66,525	\$ 81,102	\$ 65,992
Net Income	\$ 31,260	\$ 21,317	\$ 30,956	\$ 40,197	\$ 25,519
Earnings on Common Stock	\$ 25,896	\$ 15,454	\$ 24,457	\$ 32,475	\$ 15,537
Return on Average Common Equity	10.0%	5.9%	9.2%	12.2%	5.7%
Cash Dividends on Common Stock	\$ 21,386	\$ 21,386	\$ 27,676	\$ 27,676	\$ 27,676
Total Assets	\$1,193,198	\$1,180,983	\$ 986,158	\$1,022,099	\$1,091,090
CAPITALIZATION:					
Common Stockholder's Equity	\$ 258,973	\$ 254,782	\$ 261,518	\$ 266,058	\$ 262,059
Preferred Stock—					
Not Subject to Mandatory Redemption	50,905	50,905	41,905	41,905	41,905
Subject to Mandatory Redemption	15,000	20,500	30,362	34,282	38,722
Long-Term Debt	424,457	440,555	398,630	408,443	431,146
Total Capitalization	\$ 749,335	\$ 766,742	\$ 732,415	\$ 750,688	\$ 773,832
CAPITALIZATION RATIOS:					
Common Stockholder's Equity	34.6%	33.2%	35.7%	35.4%	33.9%
Preferred Stock—					
Not Subject to Mandatory Redemption	6.8	6.6	5.7	5.6	5.4
Subject to Mandatory Redemption	2.0	2.7	4.2	4.6	5.0
Long-Term Debt	56.6	57.5	54.4	54.4	55.7
Total Capitalization	100.0%	100.0%	100.0%	100.0%	100.0%

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

RESULTS OF OPERATIONS

We accomplished a great deal in 1994 as we continued preparing for the significant changes expected to take place in the electric utility industry.

Our net income increased significantly in 1994 compared to the prior year, which was down by almost \$10,000,000 from 1992. The 1993 results included a \$17,029,000 after-tax write-off for the termination of Perry Unit 2 and the expected resolution of fuel cost recovery issues. The effect of the write-off was partially offset by a \$5,653,000 after-tax credit from the cumulative effect of a change in accounting to accrue metered but unbilled revenue (see Note 2).

Our ongoing commitment to cost control is producing good results. Total operation and maintenance expenses in 1994 were lower than any year since 1988. Through Performance Initiatives -- an ongoing effort to control costs and encourage continuous improvement throughout our Company -- we identified cost-saving opportunities. As a result of this review, operating efficiencies were identified and the workforce has been reduced by more than 7 percent since the beginning of 1994 through voluntary retirements, layoffs and normal attrition. By the end of 1994, we were serving about 14,000 more customers than at the end of 1984, with approximately 600 fewer employees. In 1984, our customer-employee ratio was 70 to 1. That ratio has improved to 113 customers per employee at the end of 1994. In February 1993, our Board of Directors reduced the quarterly common stock dividend to \$.85 per share from the previous level of \$1.10 per share. These are just a few cost-cutting efforts we've taken to strengthen our operations, financial results and cash position.

Despite lower total kilowatt-hour sales, operating revenues increased 3.4% from 1993 levels, which were 7.4% lower than 1992. Higher revenues in 1994 were attributable to higher sales volume in the retail sector. The following table

summarizes the sources of changes in operating revenues for 1994 and 1993 as compared to the previous year:

	1994	1993
	(In millions)	
Change in Sharon Steel revenue	\$ —	\$(20.5)
Change in retail kilowatt-hour sales	15.7	9.4
Change in average retail electric price	(3.8)	(3.1)
Sales to utilities	(2.5)	(7.7)
Other	0.5	(1.5)
Net Increase (Decrease)	\$ 9.9	\$(23.4)

An improving local economy helped us achieve 1994's higher operating revenues, which occurred despite milder weather during the second half of the year, compared with 1993. The shutdown of Sharon Steel in November 1992 substantially reduced our operating revenues in 1993 compared with the previous year. We added more than 2,000 new retail customers in 1994 after gaining nearly 1,700 customers the previous year. Our retail kilowatt-hour sales were up 6.8% in 1994, following a 10.2% drop in 1993. Residential sales rose 6.6% in 1994, following a 5.2% gain the previous year. Commercial sales followed the same trend, increasing 7.2% and 6.2% in 1994 and 1993, respectively. Industrial sales posted a healthy 6.7% increase in 1994 because of strong demand in the primary metals industry. This result came after a slight increase in 1993, excluding the effects of Sharon Steel. Lower demand for bulk power and generating capacity constraints reduced our opportunity sales to other utilities in 1994 and 1993, falling 23.2% and 28.1%, respectively. As a result of these factors, total kilowatt-hour sales were down 1.3% compared with 1993 sales, which were 15.6% lower than the prior year.

Because of lower kilowatt-hour sales, we spent less on fuel and purchased power in 1994, compared with the prior year. The 1993 amount also included a \$4,950,000 charge for the expected resolution of fuel cost recovery issues (see Note 1).

We experienced higher nuclear expenses in 1994 and 1993, mainly due to corrective maintenance work at the Perry Plant. Due to mechanical failures and an extended refueling outage in 1994, Perry's availability was below expected levels during both years. The plant's operator developed a comprehensive plan that is expected to improve Perry's performance. A major

portion of the corrective action plan was completed during the 1994 outage, and the remainder will be implemented during Perry's next refueling, which is scheduled for early 1996. The plant returned to service on August 14, 1994, and ran continuously for the remainder of the year.

Our other operating costs were up in 1994 because of an \$8,400,000 charge for a voluntary retirement program offered to eligible employees in connection with the Performance Initiatives program. We also recognized a \$4,300,000 charge in 1993 for a similar program. Both 1994 and 1993 results include higher expenses associated with the January 1, 1993, adoption of Statement of Financial Accounting Standards (SFAS) No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." In 1992, we recognized a \$13,900,000 provision for uncollectible accounts, which affects the comparison with 1993 and 1994.

We also provided a reserve for deferred postretirement benefit costs (see Note 1) in 1994, which was responsible for the change in net amortization of regulatory assets compared to 1993. The change between 1993 and 1992 was due to the deferral of incremental costs resulting from the adoption of SFAS No. 106.

Lower depreciation expense in 1994 and 1993 reflects depreciation rates that were reduced in 1993 as a result of an updated depreciation study filed with the Pennsylvania Public Utility Commission. The study took into consideration extended useful lives of certain generation and distribution facilities.

The electric utility industry is subject to the same inflationary pressures as those experienced by other industries. To the extent that we incur additional costs or receive benefits resulting from the effects of inflation, those effects are generally reflected in our electric rates through the traditional rate making process.

CAPITAL RESOURCES AND LIQUIDITY

Because of higher revenues and aggressive cost controls, cash generated from operations was 75% higher in 1994 than it was ten years ago. In addition, capital expenditures have dropped dramatically during the ten-year period.

For the second straight year, we improved our cash position compared to the end of the prior year. All cash requirements for 1994 were met with internally generated funds, with cash and temporary investments increasing by nearly

\$29,400,000 during the year. All of our financing activities during the year were for refunding purposes.

We had about \$42,000,000 of cash and temporary investments and no short-term indebtedness on December 31, 1994. We also had \$5,000,000 of unused short-term bank lines of credit, and \$32,000,000 of bank facilities that provide for borrowings on a short-term basis at the banks' discretion.

At the end of 1994, we had the capability to issue \$79,000,000 principal amount of first mortgage bonds and \$46,000,000 of preferred stock. However, our projections indicate no need to issue new long-term securities in 1995.

During 1994, we spent about \$26,000,000 on our construction program (excluding nuclear fuel). We estimate our construction program and capital lease requirements for the period 1995-1999 to be about \$138,000,000 (excluding nuclear fuel), of which approximately \$28,000,000 applies to 1995. We also have cash requirements of approximately \$69,000,000 for the 1995-1999 period to meet maturities of, and sinking fund requirements for, long-term debt. Of that amount, approximately \$15,000,000 applies to 1995.

Investments for additional nuclear fuel during the 1995-1999 period are estimated to be approximately \$29,000,000, of which about \$4,000,000 applies to 1995. During the same periods, our nuclear fuel investments are expected to be reduced by approximately \$39,000,000 and \$9,000,000, respectively, as the nuclear fuel is consumed.

The Central Area Power Coordination Group (CAPCO) companies filed suit against Westinghouse Electric Corporation in 1991, alleging that six steam generators supplied by Westinghouse for the Beaver Valley Plant are defective and that replacement could be required earlier than the 40-year design life. A federal court rejected the claims of the CAPCO companies in December 1994, after a three-month trial. The CAPCO companies have appealed the verdict. The plant's operator has no current plans to replace the steam generators and is evaluating the feasibility of applying new technologies to repair the generators. If the generators need to be replaced and the companies decide to do so, the capital costs to the CAPCO companies could range from \$100,000,000 to \$150,000,000 per unit. That estimate is based upon costs other utilities have experienced. We have a 17.5% interest in Beaver Valley Unit 1.

OUTLOOK

We will be facing many competitive challenges in the years ahead as the electric utility industry becomes more deregulated and more energy suppliers enter the marketplace. Retail wheeling, which would allow retail customers to purchase electricity from other energy producers, would be one of those challenges if legislators choose to move in that direction. In any event, changing market forces make it imperative that we continue to find ways to reduce costs and increase revenues.

Effective operation of the nuclear facilities we jointly own will help meet these competitive challenges. Proper planning to eventually decommission those facilities is also important to our competitive position. Beginning in 1995, we plan to increase our annual funding of the decommissioning obligation. Also, the staff of the Securities and Exchange Commission (SEC) has raised questions regarding the recognition, measurement and classification of decommissioning costs in the financial statements of electric utilities. Any future SEC actions are uncertain at this time (see Note 1).

We currently serve five municipalities at wholesale. Four of them signed new service agreements in 1994. Two of the agreements expire in March 1997, and the other two will be in effect until September 1999. The fifth municipality has received bids from third parties for power and filed a request with the Federal Energy Regulatory Commission (FERC) in September 1994 to require us to provide transmission services. On January 25, 1995, FERC ordered us to provide transmission services to the municipality and directed both parties to resolve the pricing, terms and conditions of this service. If we cannot reach an agreement with the municipality on these issues by April 5, 1995, FERC will establish the final terms. Sales to this municipality were approximately \$1,468,000 in 1994.

The Clean Air Act Amendments of 1990, discussed in Note 7, require significant reductions of sulfur dioxide and nitrogen oxides from our coal-fired generating units by 1995 and additional emission reductions by 2000. We are well-positioned to meet the 1995 requirements at minimal costs, and we are pursuing cost-effective compliance strategies for meeting the reduction requirements that begin in 2000.

Through the Performance Initiatives program, we have identified substantial savings that will better position us to successfully compete in the

future. In addition, the program ensures that an economic value added-based justification will be required for capital expenditures. We are also conducting studies to identify other opportunities to increase revenues and operating efficiency. The focus of the entire organization is to improve our competitive position through these activities.

OPERATING STATISTICS

Pennsylvania Power Company

	1994	1993	1992	1991	1990
REVENUE FROM ELECTRIC SALES (Thousands):					
Residential	\$112,809	\$107,593	\$104,133	\$103,009	\$ 99,979
Commercial	69,263	65,332	62,554	61,172	58,646
Industrial	64,512	61,760	82,145	87,908	88,407
Other	9,024	8,751	8,633	8,645	8,269
Subtotal	255,608	243,436	257,465	260,734	255,301
Parent Company	8,884	8,759	15,311	14,576	16,591
Other Utilities	22,290	24,935	26,073	26,369	26,718
Total	<u>\$286,782</u>	<u>\$277,130</u>	<u>\$298,849</u>	<u>\$301,679</u>	<u>\$298,610</u>
REVENUE FROM ELECTRIC SALES:					
Residential	39.3%	38.8%	34.9%	34.1%	33.5%
Commercial	24.2	23.6	20.9	20.3	19.6
Industrial	22.5	22.3	27.5	29.1	29.6
Other	3.1	3.1	2.9	2.9	2.8
Subtotal	89.1	87.8	86.2	86.4	85.5
Parent Company	3.1	3.2	5.1	4.8	5.6
Other Utilities	7.8	9.0	8.7	8.8	8.9
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
KILOWATT-HOUR SALES (Millions):					
Residential	1,178	1,105	1,050	1,061	1,019
Commercial	891	831	782	772	732
Industrial	1,293	1,212	1,674	1,823	1,795
Other	148	139	138	138	135
Subtotal	3,510	3,287	3,644	3,794	3,681
Parent Company	468	469	786	556	743
Other Utilities	466	748	906	790	847
Total	<u>4,444</u>	<u>4,504</u>	<u>5,336</u>	<u>5,140</u>	<u>5,271</u>
CUSTOMERS SERVED:					
Residential	124,951	123,316	121,879	120,537	119,530
Commercial	15,966	15,593	15,348	15,127	14,948
Industrial	219	221	235	243	257
Other	98	97	100	100	117
Total	<u>141,234</u>	<u>139,227</u>	<u>137,562</u>	<u>136,007</u>	<u>134,852</u>
Average Annual Residential Kilowatt-Hours Used	9,501	9,017	8,672	8,839	8,585
Retail Price per Kilowatt-Hour (Cents)	7.37	7.49	7.66	7.89	7.09
Kilowatt-Hours Generated (Millions)	3,964	4,190	4,659	4,135	4,525
Peak Load (Megawatts)	710	690	734	739	700
Cost of Fuel per Million Btu	\$ 1.20	\$ 1.28	\$ 1.26	\$ 1.32	\$ 1.27
Generating Capability:					
Coal	72.1%	74.6%	74.6%	74.6%	74.6%
Oil	3.0	2.8	2.8	2.8	2.8
Nuclear	24.9	22.6	22.6	22.6	22.6
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
SOURCES OF ELECTRIC GENERATION:					
Coal	69.6%	76.8%	68.3%	72.9%	68.4%
Nuclear	30.4	23.2	31.7	27.1	31.6
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
NUMBER OF EMPLOYEES					
	<u>1,255</u>	<u>1,355</u>	<u>1,432</u>	<u>1,432</u>	<u>1,658</u>

STATEMENTS OF INCOME

Pennsylvania Power Company

For the Years Ended December 31,

	1994	1993 (In thousands)	1992
OPERATING REVENUES	<u>\$301,965</u>	<u>\$292,084</u>	<u>\$315,458</u>
OPERATING EXPENSES AND TAXES:			
Fuel and purchased power	59,529	67,312	80,303
Nuclear operating costs	33,480	30,162	24,588
Other operating costs	<u>65,424</u>	<u>61,125</u>	<u>67,578</u>
Total operation and maintenance expenses	158,433	158,599	172,469
Provision for depreciation	29,108	29,260	30,856
Amortization (deferral) of net regulatory assets	4,339	(4,339)	2,377
General taxes	23,137	22,591	22,162
Income taxes	<u>23,280</u>	<u>23,196</u>	<u>21,069</u>
Total operating expenses and taxes	<u>238,297</u>	<u>229,307</u>	<u>248,933</u>
OPERATING INCOME	<u>63,668</u>	<u>62,777</u>	<u>66,525</u>
OTHER INCOME AND EXPENSE:			
Perry Unit 2 termination (Note 3)	—	(24,458)	—
Income tax benefit from Perry Unit 2 termination	—	10,293	—
Other	<u>1,811</u>	<u>1,542</u>	<u>781</u>
Total other income (expense)	<u>1,811</u>	<u>(12,623)</u>	<u>781</u>
TOTAL INCOME	<u>65,479</u>	<u>50,154</u>	<u>67,306</u>
NET INTEREST:			
Interest on long-term debt	32,130	33,208	35,707
Interest on nuclear fuel obligations	519	401	457
Allowance for borrowed funds used during construction	(728)	(772)	(678)
Other interest expense	<u>2,298</u>	<u>1,653</u>	<u>864</u>
Net interest	<u>34,219</u>	<u>34,490</u>	<u>36,350</u>
INCOME BEFORE CUMULATIVE EFFECT OF A CHANGE IN			
ACCOUNTING	31,260	15,664	30,956
Cumulative effect to January 1, 1993, of a change in			
accounting for unbilled revenues (net of income taxes of			
\$4,108,000) (Note 2)	<u>—</u>	<u>5,653</u>	<u>—</u>
NET INCOME	31,260	21,317	30,956
PREFERRED STOCK DIVIDEND REQUIREMENTS	<u>5,364</u>	<u>5,863</u>	<u>6,499</u>
EARNINGS ON COMMON STOCK	<u>\$ 25,896</u>	<u>\$ 15,454</u>	<u>\$ 24,457</u>

The accompanying Notes to Financial Statements are an integral part of these statements.

BALANCE SHEETS

Pennsylvania Power Company

At December 31,

1994

1993

(In thousands)

ASSETS

UTILITY PLANT:

In service, at original cost	\$1,215,831	\$1,209,961
Less—Accumulated provision for depreciation	410,508	394,530
	<u>805,323</u>	<u>815,431</u>

Construction work in progress—

Electric plant	11,226	10,996
Nuclear fuel	12,389	8,604
	<u>23,615</u>	<u>19,600</u>
	<u>828,938</u>	<u>835,031</u>

OTHER PROPERTY AND INVESTMENTS

	<u>8,777</u>	<u>15,064</u>
--	--------------	---------------

CURRENT ASSETS:

Cash and cash equivalents	17,200	12,819
Notes receivable from parent company (Note 6)	25,000	—
Accounts receivable—		
Customers (less accumulated provisions of \$515,000 and \$559,000, respectively, for uncollectible accounts)	32,745	28,122
Parent company	20,777	19,737
Other	12,823	17,427
Materials and supplies, at average cost—		
Fuel	5,384	4,350
Other	11,655	12,088
Prepayments	2,048	4,868
	<u>127,632</u>	<u>99,411</u>

DEFERRED CHARGES:

Regulatory assets	219,726	222,301
Other	8,125	9,176
	<u>227,851</u>	<u>231,477</u>
	<u>\$1,193,198</u>	<u>\$1,180,983</u>

CAPITALIZATION AND LIABILITIES

CAPITALIZATION (See Statements of Capitalization):

Common stockholder's equity	\$ 258,973	\$ 254,782
Preferred stock—		
Not subject to mandatory redemption	50,905	50,905
Subject to mandatory redemption	15,000	20,500
Long-term debt—		
Associated companies	15,155	16,401
Other	409,302	424,154
	<u>749,335</u>	<u>766,742</u>

CURRENT LIABILITIES:

Currently payable preferred stock and long-term debt—		
Associated companies	9,318	10,216
Other	15,126	1,788
Accounts payable—		
Associated companies	9,440	7,755
Other	25,276	32,680
Accrued taxes	15,421	6,658
Accrued interest	10,108	9,924
Other	21,473	14,308
	<u>106,162</u>	<u>83,329</u>

DEFERRED CREDITS:

Accumulated deferred income taxes	277,542	273,319
Accumulated deferred investment tax credits	32,209	33,560
Other	27,950	24,033
	<u>337,701</u>	<u>330,912</u>

COMMITMENTS, GUARANTEES AND CONTINGENCIES (Notes 4 & 7)

	<u>\$1,193,198</u>	<u>\$1,180,983</u>
--	--------------------	--------------------

The accompanying Notes to Financial Statements are an integral part of these balance sheets.

STATEMENTS OF CAPITALIZATION

Pennsylvania Power Company

At December 31,

(Dollars in thousands, except per share amounts)

					1994	1993
COMMON STOCKHOLDER'S EQUITY:						
Common stock, \$30 par value, 6,500,000 shares authorized, 6,290,000 shares outstanding					\$188,700	\$188,700
Other paid-in capital					(600)	(310)
Retained earnings (Note 5a)					70,873	66,392
Total common stockholder's equity					<u>258,973</u>	<u>254,782</u>
	Number of Shares		Optional			
	Outstanding		Redemption Price			
	1994	1993	Per Share	Aggregate		
PREFERRED STOCK (Note 5b):						
Cumulative, \$100 par value—						
Authorized 1,200,000 shares						
Not Subject to Mandatory Redemption:						
4.24%	40,000	40,000	\$ 103.13	\$ 4,125	4,000	4,000
4.25%	41,049	41,049	105.00	4,310	4,105	4,105
4.64%	60,000	60,000	102.98	6,179	6,000	6,000
7.64%	60,000	60,000	101.42	6,085	6,000	6,000
7.75%	250,000	250,000	100.00	25,000	25,000	25,000
8.00%	<u>58,000</u>	<u>58,000</u>	102.07	<u>5,920</u>	<u>5,800</u>	<u>5,800</u>
Total not subject to mandatory redemption	<u>509,049</u>	<u>509,049</u>		<u>\$ 51,619</u>	<u>50,905</u>	<u>50,905</u>
Subject to Mandatory Redemption (Note 5c):						
7.625%	150,000	150,000	\$ 107.63	\$ 16,144	15,000	15,000
11.00%	—	3,616	—	—	—	362
13.00%	—	60,000	—	—	—	6,000
Redemption within one year					—	(862)
Total subject to mandatory redemption	<u>150,000</u>	<u>213,616</u>		<u>\$ 16,144</u>	<u>15,000</u>	<u>20,500</u>
LONG-TERM DEBT (Note 5d):						
First mortgage bonds—						
9.000% due 1996					50,000	50,000
9.740% due 1999-2019					20,000	20,000
7.500% due 2003					40,000	40,000
6.375% due 2004					50,000	50,000
6.625% due 2004					20,000	20,000
8.500% due 2022					50,000	50,000
7.625% due 2023					<u>40,000</u>	<u>40,000</u>
Total first mortgage bonds					<u>270,000</u>	<u>270,000</u>
Secured notes—						
4.750% due 1998					850	850
6.080% due 2000					23,000	23,000
5.400% due 2013					1,000	1,000
12.000% due 2014					—	12,700
8.125% due 2015					14,250	14,250
5.400% due 2017					10,600	10,600
7.150% due 2017					17,925	17,925
5.900% due 2018					16,800	16,800
8.100% due 2018					10,300	10,300
8.100% due 2020					5,200	5,200
7.150% due 2021					14,482	14,482
6.150% due 2023					12,700	—
6.450% due 2027					14,500	14,500
5.450% due 2028					6,950	6,950
5.950% due 2029					<u>238</u>	<u>238</u>
Total secured notes					<u>148,795</u>	<u>148,795</u>
Other obligations—						
Nuclear fuel					24,120	25,891
Capital leases (Note 4)					<u>7,456</u>	<u>8,690</u>
Total other obligations					<u>31,576</u>	<u>34,583</u>
Net unamortized discount on debt					<u>(1,470)</u>	<u>(1,681)</u>
Long-term debt due within one year					<u>(24,444)</u>	<u>(11,142)</u>
Total long-term debt					<u>424,457</u>	<u>440,555</u>
TOTAL CAPITALIZATION					<u>\$749,335</u>	<u>\$766,742</u>

The accompanying Notes to Financial Statements are an integral part of these statements.

STATEMENTS OF RETAINED EARNINGS

Avania Power Company

For the Years Ended December 31,

	1994	1993	1992
		(In thousands)	
Balance at beginning of year	\$ 66,392	\$ 72,777	\$ 77,317
Net income	31,260	21,317	30,956
	<u>97,652</u>	<u>94,094</u>	<u>108,273</u>
Cash dividends on common stock	21,386	21,386	27,676
Cash dividends on preferred stock	5,035	5,639	6,448
Premium on redemption of preferred stock	358	677	1,372
	<u>26,779</u>	<u>27,702</u>	<u>35,496</u>
Balance at end of year (Note 5a)	<u>\$ 70,873</u>	<u>\$ 66,392</u>	<u>\$ 72,777</u>

STATEMENTS OF CAPITAL STOCK AND OTHER PAID-IN CAPITAL

	Common Stock			Preferred Stock			
	Number of Shares	Par Value	Other Paid-In Capital	Not Subject to Mandatory Redemption		Subject to Mandatory Redemption	
				Number of Shares (Dollars in thousands)	Par Value	Number of Shares	Par Value
Balance, January 1, 1992	6,290,000	\$188,700	\$ 41	419,049	\$41,905	379,016	\$37,902
Sale of 7.625% Preferred Stock						150,000	15,000
Redemptions—							
8.24% Series						(5,000)	(500)
10.50% Series						(100,000)	(10,000)
11.00% Series						(8,000)	(800)
11.50% Series						(15,000)	(1,500)
13.00% Series						(10,000)	(1,000)
15.00% Series						(54,400)	(5,440)
Balance, December 31, 1992	6,290,000	188,700	41	419,049	41,905	336,616	33,662
Sale of 7.75% Preferred Stock			(345)	250,000	25,000		
Redemptions—							
8.24% Series						(45,000)	(4,500)
8.48% Series			(6)	(80,000)	(8,000)		
9.16% Series				(80,000)	(8,000)		
11.00% Series						(8,000)	(800)
11.50% Series						(60,000)	(6,000)
13.00% Series						(10,000)	(1,000)
Balance, December 31, 1993	6,290,000	188,700	(310)	509,049	50,905	213,616	21,362
Minimum liability for unfunded retirement benefits			(290)				
Redemptions—							
11.00% Series						(3,616)	(362)
13.00% Series						(60,000)	(6,000)
Balance, December 31, 1994	<u>6,290,000</u>	<u>\$188,700</u>	<u>\$(600)</u>	<u>509,049</u>	<u>\$50,905</u>	<u>150,000</u>	<u>\$15,000</u>

The accompanying Notes to Financial Statements are an integral part of these statements.

STATEMENTS OF CASH FLOWS

Pennsylvania Power Company

For the Years Ended December 31,

	1994	1993	1992
		(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 31,260	\$ 21,317	\$ 30,956
Adjustments to reconcile net income to net cash from operating activities:			
Provision for depreciation	29,108	29,260	30,856
Nuclear fuel and lease amortization	10,656	8,812	13,866
Deferred income taxes, net	7,578	10,261	(446)
Investment tax credits, net	(1,351)	(1,361)	(959)
Deferred revenue	—	—	19,517
Allowance for equity funds used during construction	(408)	(237)	(114)
Deferred fuel costs, net	(4,091)	199	2,745
Cumulative effect of an accounting change for unbilled revenues	—	(5,653)	—
Perry Unit 2 termination	—	24,458	—
Other	7,219	—	2,377
Internal cash before dividends	79,971	87,056	98,798
Receivables	(1,059)	(5,974)	19,077
Materials and supplies	(601)	4,666	(3,870)
Accounts payable	(1,686)	4,196	(8,886)
Other	28,171	(6,178)	(11,560)
Net cash provided from operating activities	104,796	83,766	93,559
CASH FLOWS FROM FINANCING ACTIVITIES:			
New Financing—			
Preferred stock	—	24,654	15,000
Long-term debt	11,868	149,867	102,914
Notes payable, net	—	—	7,000
Redemptions and Repayments—			
Preferred stock	6,687	28,970	20,612
Long-term debt	23,655	145,809	137,343
Notes payable, net	—	15,000	—
Dividend Payments—			
Common stock	21,386	21,386	27,676
Preferred stock	5,035	5,639	6,448
Net cash used for financing activities	44,895	42,283	67,165
CASH FLOWS FROM INVESTING ACTIVITIES:			
Property additions	30,072	31,328	26,465
Loan to parent	25,000	—	—
Other	448	999	344
Net cash used for investing activities	55,520	32,327	26,809
Net increase (decrease) in cash and cash equivalents	4,381	9,156	(415)
Cash and cash equivalents at beginning of year	12,819	3,663	4,078
Cash and cash equivalents at end of year	\$ 17,200	\$ 12,819	\$ 3,663
SUPPLEMENTAL CASH FLOWS INFORMATION:			
Cash paid during the year—			
Interest (net of amounts capitalized)	\$ 31,738	\$ 32,391	\$ 37,111
Income taxes	19,873	10,403	31,312

The accompanying Notes to Financial Statements are an integral part of these statements.

STATEMENTS OF TAXES

Pennsylvania Power Company

For the Years Ended December 31,

	1994	1993	1992
		(In thousands)	
GENERAL TAXES:			
State gross receipts	\$11,024	\$10,754	\$10,523
Real and personal property	6,699	6,712	6,762
State capital stock	2,440	2,000	2,252
Social security and unemployment	2,590	2,643	2,067
Other	384	482	458
Total general taxes	<u>\$23,137</u>	<u>\$22,591</u>	<u>\$22,162</u>
PROVISION FOR INCOME TAXES:			
Currently payable—			
Federal	\$11,040	\$ 3,292	\$14,933
State	7,066	716	7,551
	<u>18,106</u>	<u>4,008</u>	<u>22,484</u>
Deferred, net—			
Federal	8,088	10,035	254
State	(510)	4,291	(700)
	<u>7,578</u>	<u>14,326</u>	<u>(446)</u>
Investment tax credits, net of amortization	<u>(1,351)</u>	<u>(1,361)</u>	<u>(959)</u>
Total provision for income taxes	<u>\$24,333</u>	<u>\$16,973</u>	<u>\$21,079</u>
INCOME STATEMENT CLASSIFICATION OF PROVISION FOR INCOME TAXES:			
Operating expenses	\$23,280	\$23,196	\$21,069
Other income	1,053	(10,331)	10
Cumulative effect of a change in accounting	—	4,108	—
Total provision for income taxes	<u>\$24,333</u>	<u>\$16,973</u>	<u>\$21,079</u>
RECONCILIATION OF FEDERAL INCOME TAX EXPENSE AT STATUTORY RATE TO TOTAL PROVISION FOR INCOME TAXES:			
Book income before provision for income taxes	<u>\$55,593</u>	<u>\$38,290</u>	<u>\$52,035</u>
Federal income tax expense at statutory rate	<u>\$19,458</u>	<u>\$13,402</u>	<u>\$17,692</u>
Increases (reductions) in taxes resulting from:			
State income taxes, net of federal income tax benefit	4,261	3,255	4,522
Amortization of investment tax credits	(1,351)	(1,361)	(2,279)
Excess of book over tax depreciation, net	—	—	2,863
Amortization of tax regulatory assets	2,231	2,376	—
Other, net	(266)	(699)	(1,719)
Total provision for income taxes	<u>\$24,333</u>	<u>\$16,973</u>	<u>\$21,079</u>
SOURCES OF DEFERRED INCOME TAXES:			
Excess of tax over book depreciation, net			\$ 1,370
Difference between tax and book revenue, net			(6,835)
Deferred fuel costs			(1,042)
Deferred loss on reacquired debt, net			1,605
Amortization of deferred interest on leased nuclear fuel			(1,144)
Alternative minimum tax credits utilized			5,843
Pension costs			1,329
Recoverable tax surcharge costs			(978)
Other, net			(594)
Net deferred income taxes			<u>\$ (446)</u>
ACCUMULATED DEFERRED INCOME TAXES AT DECEMBER 31:			
Property basis differences	\$178,345	\$171,581	
Allowance for equity funds used during construction	39,921	41,091	
Deferred nuclear expense	8,914	8,914	
Customer receivables for future income taxes	55,498	56,736	
Unamortized investment tax credits	(13,557)	(14,124)	
Other	8,421	9,121	
Net deferred income tax liability	<u>\$277,542</u>	<u>\$273,319</u>	

The accompanying Notes to Financial Statements are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Company, a wholly owned subsidiary of Ohio Edison Company (Edison), follows the accounting policies and practices prescribed by the Pennsylvania Public Utility Commission (PPUC) and the Federal Energy Regulatory Commission (FERC).

REVENUES—The Company's retail customers are metered on a cycle basis. Revenue was recognized for electric service based on meters read through the end of the year for years prior to 1993. Beginning in 1993, revenue is recognized to include unbilled sales through the end of the year (see Note 2).

Receivables from customers include sales to residential, commercial and industrial customers located in the Company's service area and sales to wholesale customers. There was no material concentration of receivables at December 31, 1994 or 1993, with respect to any particular segment of the Company's customers.

FUEL COSTS—The Company recovers fuel and net purchased power costs not otherwise recovered through base rates from its customers through an annual "levelized" energy cost rate (ECR). The ECR, which includes adjustment for any over or under collection from customers, is recalculated each year. Accordingly, the Company defers the difference between actual energy costs and the amounts currently recovered from its customers.

In March 1993, the Office of Consumer Advocate (OCA) filed a complaint against the Company with the PPUC regarding the Company's ECR. The complaint objected to the elimination of certain contractual arrangements for the sale of generating capacity to Edison. In the past, sales under these arrangements were included in the ECR calculation, and the OCA alleged the elimination of the arrangements increased the Company's recoverable energy costs. The Company recognized a charge of approximately \$4,950,000 (\$2,864,000 after-tax) in the fourth quarter of 1993 relating to the expected resolution of this issue. The PPUC ordered the Company to begin refunding the \$4,950,000 to customers by reducing its ECR from April 1, 1994 through March 31, 1997.

UTILITY PLANT AND DEPRECIATION—

Utility plant reflects the original cost of construction, including payroll and related costs such as taxes, employee benefits, administrative and general costs and financing costs (allowance for funds used during construction).

The Company provides for depreciation on a straight-line basis at various rates over the estimated lives of property included in plant in service. The annual composite rate for electric plant was 2.7% in 1994 and 1993 and 3.0% in 1992. Effective in 1993, the annual composite rate was reduced as a result of the Company's depreciation study filed with the PPUC which took into consideration extended useful lives of certain generation and distribution facilities.

The Company recognizes approximately \$300,000 annually (as depreciation expense) for future decommissioning costs applicable to its ownership interest in two nuclear generating units. The Company's share of the future obligation to decommission these units is approximately \$70,000,000 in current dollars and (using a 2.8% escalation rate) approximately \$142,000,000 in future dollars. The estimated obligation (based on site specific studies) and the escalation rate were developed using information obtained from consultants. Payments for decommissioning are expected to begin in 2016, when actual decommissioning work begins. The Company has recovered approximately \$2,676,000 for decommissioning through its electric rates from customers through December 31, 1994; such amounts are reflected in the reserve for depreciation on the Balance Sheet. If the actual costs of decommissioning the units exceed the accumulated amounts recovered from customers, the Company expects that difference will be recoverable from its customers. The Company has approximately \$3,900,000 invested in external decommissioning trust funds as of December 31, 1994. Earnings on these funds are reinvested with a corresponding increase to the depreciation reserve. The Company has also recognized an estimated liability of approximately \$4,400,000 related to decontamination and decommissioning of nuclear enrichment facilities operated by the United States Department of Energy (DOE), as required by the Energy Policy Act of 1992. The Company recovers these costs through its ECR.

The staff of the Securities and Exchange Commission has raised questions regarding the recognition, measurement and classification of

decommissioning costs for nuclear generating stations in the financial statements of electric utilities. In response to these questions, the Financial Accounting Standards Board (FASB) has agreed to review the accounting for nuclear decommissioning costs. If current electric utility industry accounting practices for decommissioning are changed: (1) annual provisions for decommissioning could increase; (2) the full estimated cost for decommissioning could be recorded as a liability rather than as accumulated depreciation; and (3) income from the external decommissioning trusts could be reported as investment income. The FASB's review is expected to be completed in 1995.

COMMON OWNERSHIP OF

GENERATING FACILITIES—The

Company and other Central Area Power Coordination Group (CAPCO) companies own, as tenants in common, various power generating facilities. Each of the companies is obligated to pay a share of the costs associated with any jointly owned facility in the same proportion as its ownership interest. The Company's portion of operating expenses associated with jointly owned facilities is included in the corresponding operating expenses on the Statements of Income. The amounts reflected on the Balance Sheet under utility plant at December 31, 1994, include the following:

Generating Units	Utility Plant in Service	Accumulated Provision for Depreciation	Construc- tion Work in Progress	Company's Owner- ship Interest
(In thousands)				
W. H. Sammis #7	\$ 57,100	\$ 18,400	\$ 100	20.80%
Bruce Mansfield #1, #2 and #3	90,700	39,000	1,400	5.76%
Beaver Valley #1	224,700	88,400	900	17.50%
Perry #1	339,700	55,600	200	5.24%
Total	\$712,200	\$201,400	\$2,600	

NUCLEAR FUEL—OES Fuel, Incorporated (OES Fuel), a wholly owned subsidiary of Edison, is the sole lessor for the Company's nuclear fuel requirements.

Minimum lease payments during the next five years are estimated to be as follows:

1995	\$8,965,000
1996	5,672,000
1997	4,876,000
1998	2,912,000
1999	676,000

The Company amortizes the cost of nuclear fuel based on the rate of consumption. The Company's electric rates include amounts for the future disposal of spent nuclear fuel based upon the formula used to compute payments to the DOE.

INCOME TAXES—Details of the total provision for income taxes are shown on the Statements of Taxes. Deferred income taxes result from timing differences in the recognition of revenues and expenses for tax and accounting purposes. All investment tax credits which were deferred when utilized, are being amortized over the estimated life of the related property.

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes," on January 1, 1993, which requires the liability method to be used to account for deferred income taxes. Under this standard, deferred income tax liabilities related to tax and accounting basis differences are recognized at the statutory income tax rates in effect when the liabilities are expected to be paid. The components of accumulated deferred income taxes as of December 31, 1994 and 1993, are disclosed on the Statements of Taxes.

The Company is included in Edison's consolidated federal income tax return. The consolidated tax liability is allocated on a "stand-alone" company basis, with the Company recognizing any tax losses or credits it contributed to the consolidated return. The Company has \$7,000,000 of tax-related receivables due from Edison resulting from its contribution to the consolidated return.

RETIREMENT BENEFITS—The

Company's trustee, noncontributory defined benefit pension plan covers almost all full-time employees. Upon retirement, employees receive a monthly pension based on length of service and compensation. The Company uses the projected unit credit method for funding purposes and was not required to make pension contributions during the three years ended December 31, 1994.

The following sets forth the funded status of the plan and amounts recognized on the Balance Sheets as of December 31:

	1994	1993
	(In thousands)	
Actuarial present value of benefit obligations:		
Vested benefits	\$ 83,789	\$ 78,042
Nonvested benefits	5,862	5,933
Accumulated benefit obligation	\$ 89,651	\$ 83,975
Plan assets at fair value	\$ 114,881	\$ 123,092
Actuarial present value of projected benefit obligation	108,498	107,702
Plan assets in excess of projected benefit obligation	6,383	15,390
Unrecognized net gain	(1,281)	(1,611)
Unrecognized prior service cost	2,347	2,563
Unrecognized net transition asset	(8,426)	(9,479)
Net pension asset (liability)	\$ (977)	\$ 6,863

The assets of the plan consist primarily of common stocks, United States government bonds and corporate bonds. Net pension costs for the three years ended December 31, 1994, were computed as follows:

	1994	1993	1992
	(In thousands)		
Service cost—benefits earned during the period	\$ 3,294	\$ 2,802	\$ 2,828
Interest on projected benefit obligation	5,158	7,281	6,612
Return on plan assets	1,346	(15,653)	(9,336)
Net deferral (amortization)	(14,092)	2,366	(3,652)
Voluntary early retirement program expense	9,134	3,930	—
Net pension cost	\$ 7,840	\$ 726	\$ (3,548)

The assumed discount rate used in determining the actuarial present value of the projected benefit obligation was 8.5% in 1994, 7.5% in 1993 and 9% in 1992. The assumed rate of increase in future compensation levels used to measure this obligation was 4.5% in each year. Expected long-term rates of return on plan assets were assumed to be 10% in 1994 and 11% in 1993 and 1992.

The Company provides a minimum amount of noncontributory life insurance to retired employees in addition to optional contributory insurance. Health care benefits, which include certain employee deductibles and copayments, are also available to retired employees, their dependents and, under certain circumstances, their survivors. The Company pays insurance premiums to cover a portion of these benefits in excess of set limits; all amounts up to the limits are paid by the Company.

In 1993 the Company adopted SFAS No. 106 "Employers' Accounting for Postretirement

Benefits Other Than Pensions," which requires companies to recognize the expected cost of providing other postretirement benefits to employees and their beneficiaries and covered dependents from the time employees are hired until they become eligible to receive those benefits. The Company does not currently fund these future benefits. Costs paid by the Company for retiree health care and life insurance benefits of \$1,411,000 were charged to income in 1992.

The following sets forth the accrued postretirement benefit cost on the Balance Sheets as of December 31:

	1994	1993
	(In thousands)	
Accumulated postretirement benefit obligation allocation:		
Retirees	\$ 28,056	\$ 20,604
Fully eligible active plan participants	1,817	6,794
Other active plan participants	18,263	15,507
Accumulated postretirement benefit obligation	48,136	42,905
Unrecognized transition obligation	(30,588)	(32,287)
Unrecognized net loss	(6,911)	(5,357)
Accrued postretirement benefit cost	\$ 10,637	\$ 5,261

Net periodic postretirement benefit costs for the years ended December 31, 1994 and 1993 were computed as follows:

	1994	1993
	(In thousands)	
Service cost—benefits attributed to the period	\$1,109	\$ 866
Interest cost on accumulated benefit obligation	3,496	3,129
Amortization of transition obligation	1,699	1,699
Amortization of loss	196	—
Voluntary early retirement program expense	669	1,112
Net periodic postretirement benefit cost	7,169	6,806
Benefits paid	1,793	1,545
Increase in accrued postretirement benefit cost	\$5,376	\$5,261

The health care trend rate assumption is 7.89% in the first year gradually decreasing to 3.5% for the year 2008 and later. The discount rates used to compute the accumulated postretirement benefit obligation in 1994 and 1993 were 8.5% and 7.5%, respectively. An increase in the health care trend rate assumption by one percentage point in all years would increase the accumulated postretirement benefit obligation by approximately \$6,900,000 and the aggregate annual service and interest costs by approximately \$800,000.

The PPUC has authorized the Company to defer the incremental costs resulting from adopting SFAS No. 106 (compared to costs computed under the former accounting basis) for future recovery from its retail customers. Similar authorizations relating to other utilities regulated by the PPUC

were appealed by the OCA to the Commonwealth Court of Pennsylvania. The Commonwealth Court has issued conflicting opinions and both cases have been appealed to the Pennsylvania Supreme Court. Due to the uncertainty resulting from these conflicting opinions, the Company provided a reserve in the fourth quarter of 1994 of \$8,728,000 (\$5,066,000 after-tax) against the full amount deferred.

TRANSACTIONS WITH AFFILIATED COMPANIES—

Transactions with affiliated companies are included on the Statements of Income as follows:

	1994	1993	1992
	(In thousands)		
Operating revenues:			
Electric sales to Edison	\$ 8,464	\$ 8,781	\$22,755
Bruce Mansfield Plant administrative and general charges to Edison	6,038	5,652	2,529
Other transactions with Edison	342	355	371
	<u>\$14,844</u>	<u>\$14,788</u>	<u>\$25,655</u>
Fuel and purchased power:			
Power purchased from Edison	\$12,673	\$ 8,667	\$13,936
Nuclear fuel leased from OES Fuel	11,529	10,356	15,199
	<u>\$24,202</u>	<u>\$19,023</u>	<u>\$29,135</u>
Other operating costs:			
Rental of transmission lines from Edison	\$ 1,102	\$ 1,042	\$ 1,172
Data processing services from Edison	2,706	3,307	2,624
Other transactions with Edison	3,908	4,345	2,679
	<u>\$ 7,716</u>	<u>\$ 8,694</u>	<u>\$ 6,475</u>

SUPPLEMENTAL CASH FLOWS

INFORMATION—

All temporary cash investments purchased with an initial maturity of three months or less are reported as cash equivalents on the Balance Sheets. The Company reflects temporary cash investments at cost, which approximates their market value. Noncash financing and investing activities included capital lease transactions amounting to \$7,566,000, \$2,357,000 and \$10,721,000 for the years 1994, 1993 and 1992, respectively.

All borrowings with initial maturities of less than one year are defined as financial instruments under generally accepted accounting principles and are reported on the Balance Sheets at cost which approximates their fair market value. The following sets forth the approximate fair value and related carrying amounts of all other long-term debt, preferred stock subject to mandatory

redemption and investments other than cash and cash equivalents as of December 31:

	1994		1993	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(In millions)			
Long-term debt	\$ 419	\$ 384	\$ 419	\$ 438
Preferred stock	\$ 15	\$ 12	\$ 21	\$ 21
Investments other than cash and cash equivalents	\$ 5	\$ 5	\$ 5	\$ 5

The fair values of long-term debt and preferred stock reflect the present value of the cash outflows relating to those securities based on the current call price, the yield to maturity or the yield to call, as deemed appropriate at the end of each respective year. The yields assumed were based on securities with similar characteristics offered by a corporation with credit ratings similar to the Company's ratings. The fair value of investments other than cash and cash equivalents represent cost (which approximates fair value) or the present value of the cash inflows based on the yield to maturity. The yields assumed were based on financial instruments with similar characteristics and terms. All of the Company's financial instruments are for purposes other than trading.

REGULATORY ASSETS—The Company recognizes, as regulatory assets, costs which the FERC and PPUC have authorized for recovery from customers in future periods. Without such authorization, the costs would have been charged to income as incurred. Amounts shown below as being recovered currently would be recovered over approximately 24 years based upon amounts amortized during 1994.

Regulatory assets on the Balance Sheets are comprised of the following:

	1994	1993
	(In thousands)	
Currently being recovered through rates:		
Customer receivables for future income taxes	\$132,012	\$135,197
Property taxes	4,724	4,615
Loss on reacquired debt	11,967	12,551
DOE decommissioning and decontamination costs	4,582	3,192
Deferred fuel costs	7,195	3,590
	<u>160,480</u>	<u>159,145</u>
Not currently recovered through rates:		
Nuclear unit expenses	21,180	21,180
Employee postretirement benefit costs	—	4,339
Perry Unit 2 termination	38,066	37,637
	<u>59,246</u>	<u>63,156</u>
Total	<u>\$219,726</u>	<u>\$222,301</u>

2. CHANGE IN ACCOUNTING FOR UNBILLED REVENUES:

On January 1, 1993, the Company changed its accounting policy to recognize revenue relating to metered sales which remain unbilled at the end of the accounting period. This change was made to more closely match the Company's revenues with the costs of services provided. The effect of this change decreased net income for the year ended December 31, 1993, (before the cumulative effect from periods prior to 1993) by approximately \$900,000. The cumulative effect to January 1, 1993, was \$5,653,000 (net of \$4,108,000 of income taxes). The reported results of operations for the year ended December 31, 1992 would not have been materially different if this new accounting policy had been in effect during that year.

3. PERRY UNIT 2 TERMINATION:

In December 1993, the Company announced that it would not participate in further construction of Perry Unit 2 and abandoned Perry Unit 2 as a possible electric generating plant. The Company expects its Perry Unit 2 investment to be recoverable from its PPUC jurisdictional customers based on Section 520 of the Pennsylvania Public Utility Code. Due to the anticipated delay in commencement of recovery and taking into account the expected PPUC rate treatment, the Company recognized an impairment to its Perry Unit 2 investment of \$24,458,000 in 1993, reducing net income by \$14,165,000.

4. LEASES:

The Company leases certain transmission facilities, computer equipment, office space and other property and equipment under cancelable and noncancelable leases. Consistent with the regulatory treatment, the rental payments for capital and operating leases are charged to operating expenses on the Statements of Income. Such costs for the three years ended December 31, 1994, are summarized as follows:

	1994	1993	1992
	(In thousands)		
Operating leases			
Interest element	\$ 208	\$ 171	\$ 212
Other	893	912	1,032
Capital leases			
Interest element	945	1,070	1,169
Other	1,314	1,273	1,231
Total rental payments	\$3,360	\$3,426	\$3,644

The future minimum lease payments as of December 31, 1994, are:

	Capital Leases	Operating Leases
	(In thousands)	
1995	\$ 2,367	\$ 247
1996	1,793	247
1997	1,547	243
1998	1,351	239
1999	1,179	209
Years thereafter	13,673	3,779
Total minimum lease payments	21,910	\$4,964
Executory costs	4,362	
Net minimum lease payments	17,548	
Interest portion	10,092	
Present value of net minimum lease payments	7,456	
Less current portion	1,229	
Noncurrent portion	\$ 6,227	

5. CAPITALIZATION:

(a) **RETAINED EARNINGS**—Under the Company's Charter, the Company's retained earnings unrestricted for payment of cash dividends on the Company's common stock were \$59,307,000 at December 31, 1994.

(b) **PREFERRED STOCK**—The Company's 7.625% and 7.75% series of preferred stock have restrictions which prevent early redemption prior to October 1997 and July 2003, respectively. All other preferred stock may be redeemed by the Company in whole, or in part, with 30-60 days' notice. The optional redemption price for the 7.625% series shown on the Statements of Capitalization will decline to \$100 per share by 2007.

(c) **PREFERRED STOCK SUBJECT TO MANDATORY REDEMPTION**—The Company's 7.625% series has an annual sinking fund requirement for 7,500 shares beginning on October 1, 2002.

(d) **LONG-TERM DEBT**—The first mortgage indenture and its supplements, which secure all of the Company's first mortgage bonds, serve as direct first mortgage liens on substantially all property and franchises, other than specifically excepted property, owned by the Company. Maturing long-term debt (excluding capital leases) during the next five years are \$14,250,000 in 1995, \$50,000,000 in 1996, \$850,000 in 1998 and \$487,000 in 1999.

The Company's obligations to repay certain pollution control revenue bonds are secured by series of first mortgage bonds and, in some cases, by subordinate liens on the related pollution control facilities.

6. SHORT-TERM FINANCING ARRANGEMENTS:

The Company has lines of credit with banks that provide for borrowings of up to \$5,000,000 under various interest rate options. Short-term borrowings may be made under these lines of credit on the Company's unsecured notes. To assure the availability of these lines, the Company is required to pay annual commitment fees of 0.50%. These lines expire at various times during 1995.

The Company also has a credit agreement with Edison whereby either company can borrow funds from the other by issuing unsecured notes at the prevailing prime or similar interest rate. Under the terms of this agreement the maximum borrowing is limited only by the availability of funds; however, the Company's borrowing under this agreement is currently limited by the PPUC to a total of \$50,000,000. Either company can terminate the agreement with six months' notice.

7. COMMITMENTS, GUARANTEES AND CONTINGENCIES:

CONSTRUCTION PROGRAM—The Company's current forecast reflects expenditures of approximately \$138,000,000 for property additions and improvements from 1995 through 1999, of which approximately \$28,000,000 is applicable to 1995. Investments for additional nuclear fuel during the 1995-1999 period are estimated to be approximately \$29,000,000, of which approximately \$4,000,000 applies to 1995. During the same periods, the Company's nuclear fuel investments are expected to be reduced by approximately \$39,000,000 and \$9,000,000, respectively, as the nuclear fuel is consumed.

NUCLEAR INSURANCE—The Price-Anderson Act limits the public liability relative to a single incident at a nuclear power plant to \$8,920,000,000. The amount is covered by a combination of private insurance and an industry retrospective rating plan. Based on its present ownership interests in Beaver Valley Unit 1 and the Perry Plant, the Company's maximum

potential assessment under the industry retrospective rating plan (assuming the other CAPCO companies were to contribute their proportionate share of any assessments under the retrospective rating plan) would be \$18,000,000 per incident but not more than \$2,300,000 in any one year for each incident.

The Company is also insured as to its interest in Beaver Valley Unit 1 and the Perry Plant under policies issued to the operating company for each plant. Under these policies, up to \$2,750,000,000 is provided for property damage and decontamination and decommissioning costs. The Company has also obtained approximately \$53,100,000 of insurance coverage for replacement power costs for its interests in Perry and Beaver Valley Unit 1. Under these policies, the Company can be assessed a maximum of approximately \$2,600,000 for accidents at any covered nuclear facility occurring during a policy year which are in excess of accumulated funds available to the insurer for paying losses.

The Company intends to maintain insurance against nuclear risks as described above so long as it is available. To the extent that replacement power, property damage, decontamination, decommissioning, repair and replacement costs and other such costs arising from a nuclear incident at any of the Company's plants exceed the policy limits of the insurance from time to time in effect with respect to that plant, to the extent a nuclear incident is determined not to be covered by the Company's insurance policies, or to the extent such insurance becomes unavailable in the future, the Company would remain at risk for such costs.

GUARANTEES—The Company, together with the other CAPCO companies, has severally guaranteed certain debt and lease obligations in connection with a coal supply contract for the Bruce Mansfield Plant. As of December 31, 1994, the Company's share of the guarantee (which approximates fair market value) was \$10,952,000. The price under the coal supply contract, which includes certain minimum payments, has been determined to be sufficient to satisfy the debt and lease obligations. The Company's total payments under the coal supply contract amounted to \$10,071,000, \$13,230,000 and \$12,082,000 during 1994, 1993, and 1992, respectively. Under the coal supply contract, the Company's minimum payments in each year during the period 1995 through 1999 are approximately \$4,000,000.

ENVIRONMENTAL MATTERS—Various federal, state and local authorities regulate the Company with regard to air and water quality and other environmental matters. The Company has estimated additional capital expenditures for environmental compliance of approximately \$12,000,000, which is included in the construction forecast under "Construction Program" for 1995 through 1999.

The Clean Air Act Amendments of 1990 require significant reductions of sulfur dioxide (SO₂) and nitrogen oxides (NO_x) from the Company's coal-fired generating units by 1995 and additional emission reductions by 2000. Compliance options include, but are not limited to, installing additional pollution control equipment, burning less-polluting fuel, purchasing emission allowances, operating facilities in a manner that minimizes pollution, and retiring facilities. In a system compliance plan for the Company and Edison submitted to the PPUC and to the Environmental Protection Agency (EPA), the Company stated that SO₂ reductions for the years 1995 through 1999 likely will be achieved by burning lower-sulfur fuel, generating more electricity from lower-emitting plants, and/or purchasing emission allowances. Equipment already installed, or to be installed by May 1995, is expected to provide NO_x reductions sufficient to meet 1995 requirements. Plans for complying with the year 2000 and later reductions have not been finalized. EPA is conducting additional studies which could indicate the need for additional NO_x reductions from the Company's Pennsylvania facilities by the year 2003. The cost of such reductions, if required, may be substantial. The Company continues to evaluate its compliance plan and other compliance options.

The Pennsylvania Department of Environmental Resources has issued regulations dealing with the storage, treatment, transportation and disposal of residual waste such as coal ash and scrubber sludge. These regulations impose additional requirements relating to permitting, ground water monitoring, leachate collection systems, closure, liability insurance and operating matters. The Company is considering various compliance options but is presently unable to determine the ultimate increase in capital and operating costs at existing sites.

Legislative, administrative and judicial actions will continue to change the way that the Company must operate in order to comply with environmental laws and regulations. With respect

to any such changes and to the environmental matters described above, the Company expects that any resulting additional capital costs which may be required, as well as any required increase in operating costs, would ultimately be recovered from its customers.

8. SUMMARY OF QUARTERLY FINANCIAL DATA (UNAUDITED):

The following summarizes certain operating results by quarter for 1994 and 1993.

	March 31, Three Months Ended	June 30, 1994	Sept. 30, 1994	Dec. 31, 1994
	(In thousands)			
Operating Revenues	\$78,358	\$74,700	\$77,055	\$71,852
Operating Expenses and Taxes	60,172	60,997	57,437	59,691
Operating Income	18,186	13,703	19,618	12,161
Other Income	414	522	408	467
Net Interest	8,443	8,448	8,802	8,526
Net Income	\$10,157	\$ 5,777	\$11,224	\$ 4,102
Earnings on Common Stock	\$ 8,801	\$ 4,096	\$10,057	\$ 2,942

	March 31, Three Months Ended	June 30, 1993	Sept. 30, 1993	Dec. 31, 1993
	(In thousands)			
Operating Revenues	\$74,274	\$70,266	\$76,226	\$71,318
Operating Expenses and Taxes	61,272	53,708	56,710	57,617
Operating Income	13,002	16,558	19,516	13,701
Other Income (Expense)	68	200	437	(13,328)
Net Interest	8,549	8,653	8,819	8,469
Income (Loss) Before Cumulative Effect of a Change in Accounting	4,521	8,105	11,134	(8,096)
Cumulative Effect of a Change in Accounting	5,653	-	-	-
Net Income (Loss)	\$10,174	\$ 8,105	\$11,134	\$(8,096)
Earnings (Loss) Applicable to Common Stock	\$ 8,639	\$ 6,571	\$ 9,706	\$(9,462)

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

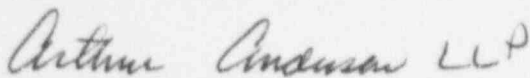
To the Stockholders and Board of Directors of
Pennsylvania Power Company:

We have audited the accompanying balance sheets and statements of capitalization of Pennsylvania Power Company (a Pennsylvania corporation and wholly owned subsidiary of Ohio Edison Company) as of December 31, 1994 and 1993, and the related statements of income, retained earnings, capital stock and other paid-in capital, cash flows and taxes for each of the three years in the period ended December 31, 1994. 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, the financial statements referred to above present fairly, in all material respects, the financial position of Pennsylvania Power Company as of December 31, 1994 and 1993, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1994, in conformity with generally accepted accounting principles.

As discussed in Notes 1 and 2 to the financial statements, effective January 1, 1993, the Company changed its method of accounting for unbilled revenues, income taxes and postretirement benefits other than pensions.



Arthur Andersen LLP

Cleveland, Ohio
February 3, 1995

BOARD OF DIRECTORS

H. Peter Burg

President of the Company, and Senior Vice President and Chief Financial Officer of the Company's parent, Ohio Edison Company, Akron, Ohio.

Robert H. Carlson

Retired, formerly President and Chief Executive Officer of Universal-Rundle Corporation, a plumbing fixture manufacturer, New Castle, Pennsylvania.

James R. Edgerly

Vice President of the Company, New Castle, Pennsylvania.

Willard R. Holland

Chairman of the Board and Chief Executive Officer of the Company, and President and Chief Executive Officer of the Company's parent, Ohio Edison Company, Akron, Ohio.

Joseph J. Nowak

Retired, formerly Vice President of Armco Inc., a manufacturer of steel products, Pittsburgh, Pennsylvania.

Jack E. Reed

Vice President of the Company, New Castle, Pennsylvania.

Richard L. Werner

Chairman of the Board and President of Werner Co., a manufacturer of aluminum extrusions, ladders and scaffolding, Greenville, Pennsylvania.

DIRECTOR EMERITUS

G. Leo Winger

OFFICERS

Willard R. Holland

Chairman of the Board and Chief Executive Officer

H. Peter Burg

President

James R. Edgerly

Vice President

Jack E. Reed

Vice President

Robert P. Wushinske

Vice President, Secretary, Treasurer, and General Counsel

David W. McKean

Comptroller

Randy Scilla

Assistant Secretary and Assistant Treasurer

Mr. Holland is president and chief executive officer and Mr. Burg is senior vice president and chief financial officer of the Company's parent. The principal employment of all other officers is with the Company.

TRANSFER AGENT and REGISTRAR for Preferred Stock:

Office of the Company's parent
Ohio Edison Company
Investor Services
76 South Main Street
Akron, Ohio 44308-1890

PRINCIPAL OFFICES:

1 E. Washington Street
P. O. Box 891
New Castle, Pennsylvania 16103-0891
(412) 652-5531

Pennsylvania Power Company is an equal opportunity employer.

Pennsylvania Power Company
1 E. Washington Street
P. O. Box 891
New Castle, PA 16103-0891
(412) 652-5531

1994 Annual Report