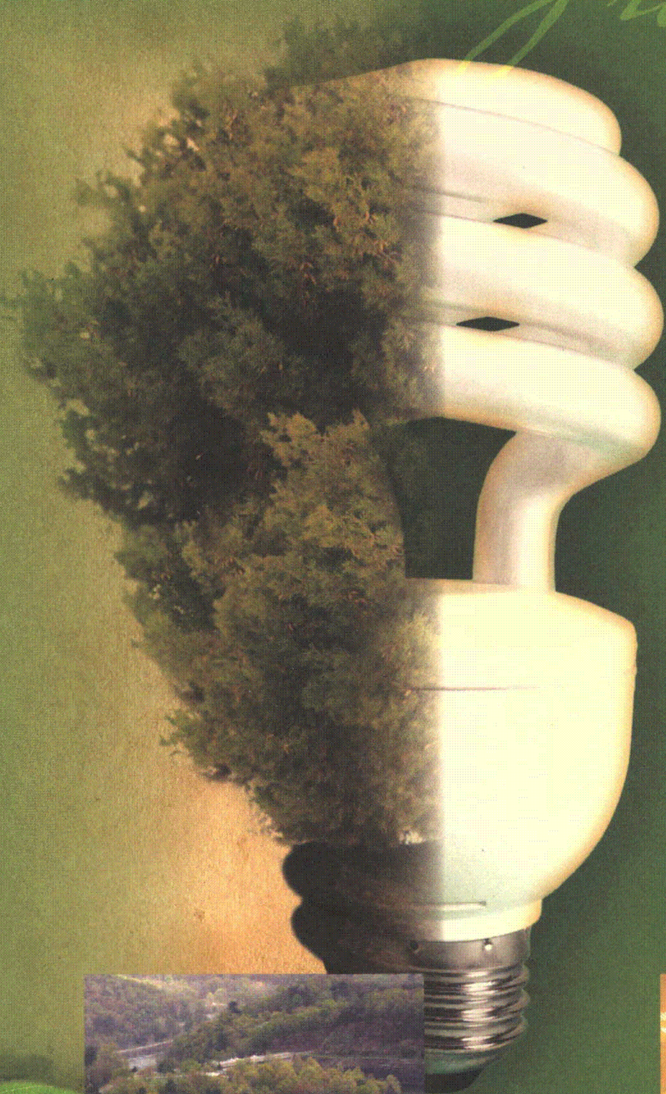
Sustainable Growth



Allegheny Electric cooperative, inc.

two thousand eight annual report

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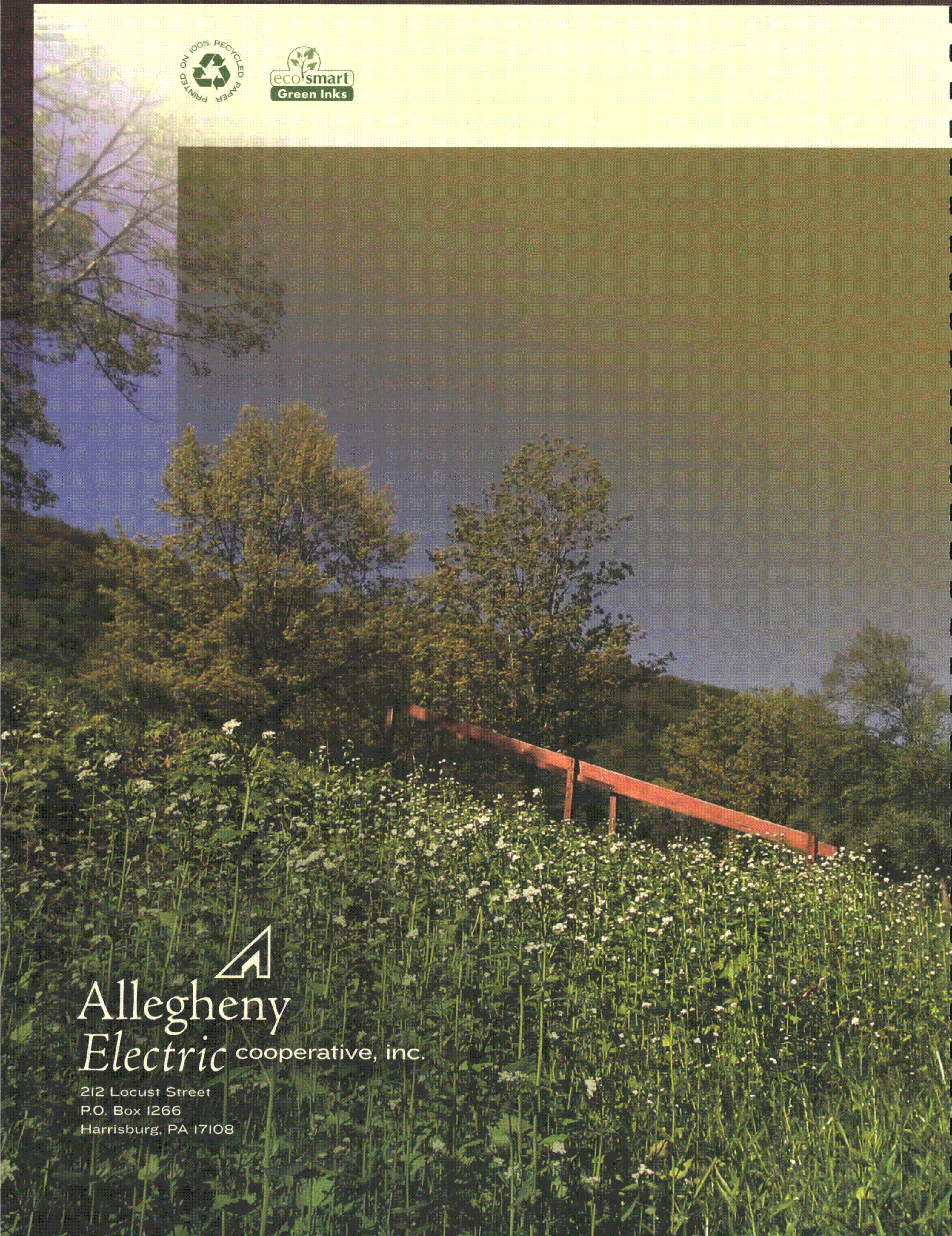


Allegheny Electric cooperative, inc.
212 Locust Street
P.O. Box 1266
Harrisburg, PA 17108

contents

A Message from the Board Chairman and President & CEO

HIGHLY EFFECTIVE LONG-TERM STRATEGIES AND MEMBER-FOCUSED ENERGY INITIATIVES HAVE ESTABLISHED A SOLID FOUNDATION FOR STABILITY, GROWTH AND FUTURE SUCCESS AT ALLEGHENY ELECTRIC COOPERATIVE, INC. (ALLEGHENY).

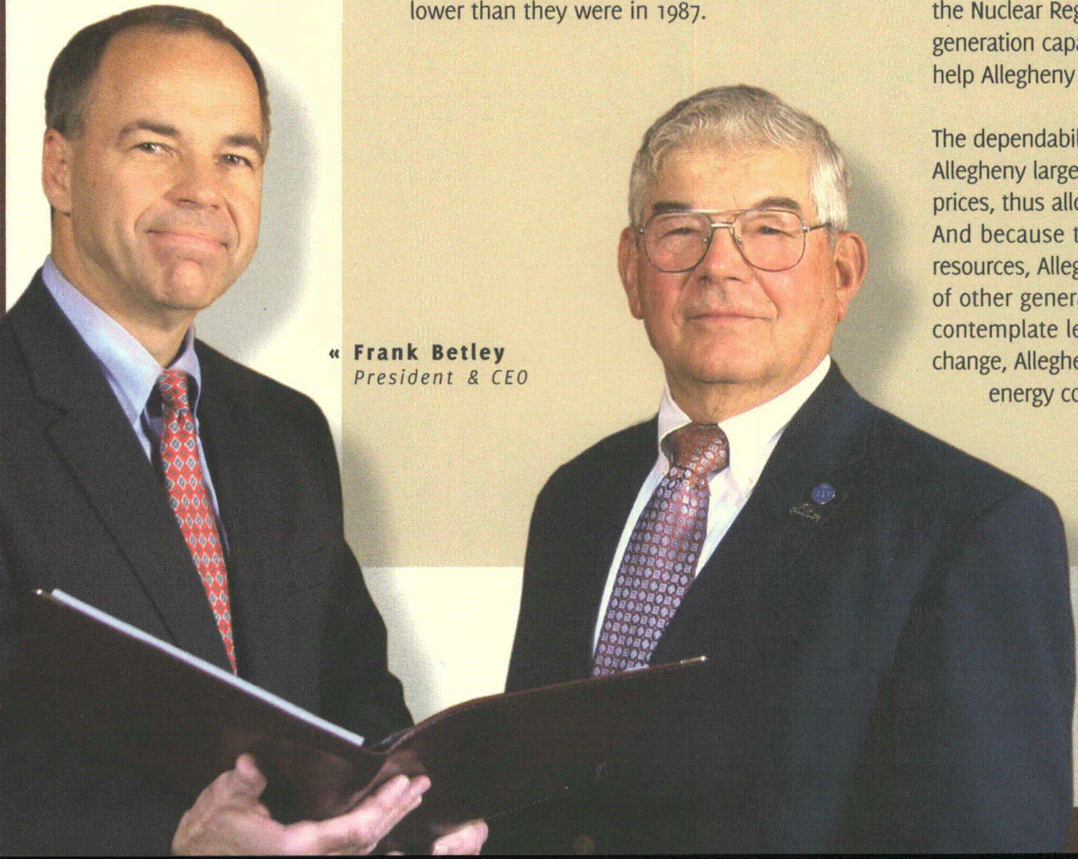
More than ever, 2008 showed us the importance of sound planning and prudent business decisions. In a year of unprecedented market upheaval, Allegheny was left largely unaffected by the global economic downturn that impacted businesses and industries worldwide. With better-than-expected margins and a positive power outlook, Allegheny emerged from 2008 fiscally strong and exceptionally well-positioned to meet the energy needs of tomorrow.

Allegheny's ability to weather these turbulent times is a testament to its commitment to member-focused cooperative principles. Since 1946, the generation and transmission cooperative has been dedicated to providing its member cooperatives a reliable supply of energy at a competitive price. Today, thanks to decisions that continue to put our members first, we can take pride in excellent operating performance, positive financial results and wholesale rates that are lower than they were in 1987.

Over the years, these director-driven decisions have enabled Allegheny to take on bold energy initiatives. Thirty years ago, Allegheny made a major investment in nuclear power – when nuclear was not the sought-after energy source it is today – and secured a 10 percent ownership share of the Susquehanna Steam Electric Station (SSES) nuclear power plant near Berwick, Pa. Twenty years ago, Allegheny put the Raystown Hydroelectric Project (Raystown) in Huntingdon County, Pa., into commercial operation. We also receive additional hydropower through long-term contracts with the New York Power Authority.

Today, more than 65 percent of our energy supply comes from these clean, reliable and relatively low-cost nuclear and hydropower resources. In 2008, generation levels exceeded expectations at both Raystown and SSES, with the Susquehanna plant achieving record generation results. In January 2008, we received the welcome news that the Nuclear Regulatory Commission approved a generation capacity increase for SSES, which will help Allegheny meet future energy needs.

The dependability of these resources has kept Allegheny largely shielded from volatile fossil-fuel prices, thus allowing us to keep our rates stable. And because these are non-carbon-emitting resources, Allegheny avoids the "carbon spotlight" of other generation sources. As lawmakers contemplate legislation to confront climate change, Allegheny's early investment in clean energy continues to pay dividends.



« **Frank Betley**
President & CEO

« **Lowell Friedline**
Board Chairman

This commitment to clean energy did not stop with our investment in generation sources. In the pursuit of even greater efficiencies, Allegheny launched its Coordinated Load Management System (CLMS) in 1986. The system works by shifting electricity use of water heaters and heating systems in the homes of volunteer consumers from times of peak demand to off-peak hours. The measure improves system efficiency, cuts costly demand charges and reduces the need for new generating capacity – supporting Allegheny's long-held belief that the cleanest kilowatt-hour is the one never generated.

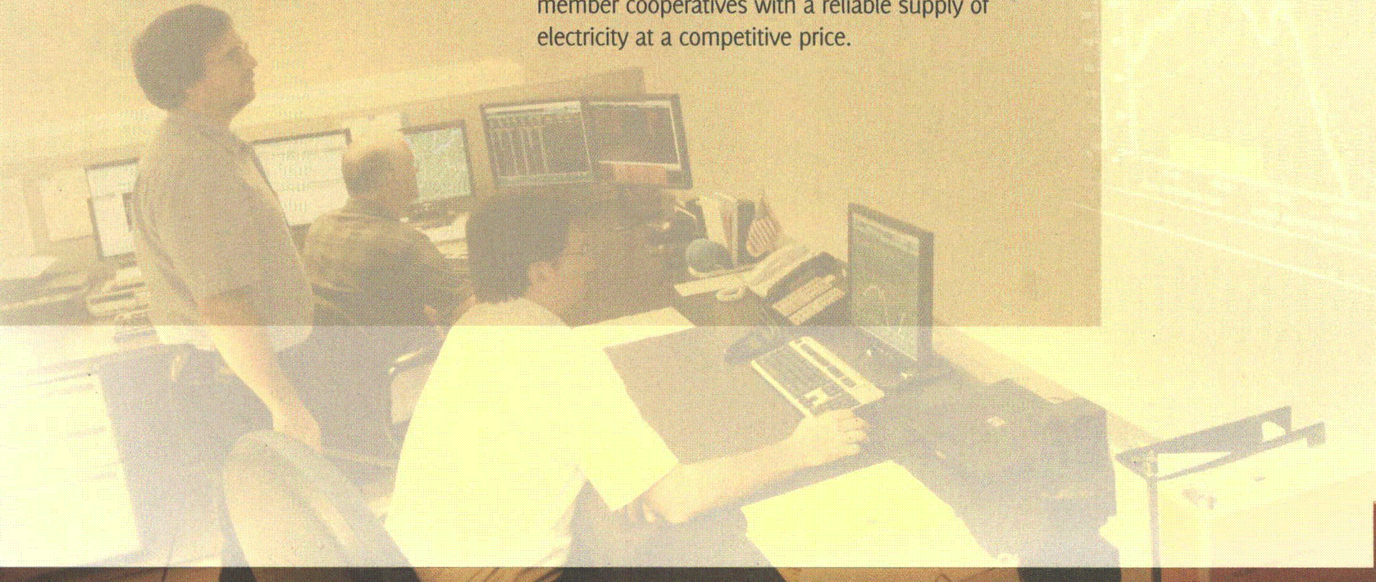
In 2008, Allegheny carried out major upgrades to its CLMS infrastructure, further enhancing capabilities of the system for load control and for members' advanced metering systems. To date, the demand-side measure has resulted in power costs savings of more than $90 million, and has been hailed by legislators and governmental agencies as the "right approach" to addressing energy issues.

Allegheny's approach to power procurement has also been viewed as an industry model. In 2007, we launched our "Patchwork Quilt" strategy of power supply management. This strategy, in development for a number of years, involves entering into multiple energy and capacity agreements for different amounts and for different lengths of time. By diversifying in this way, we are not dependent on any single source for our power supply. Because Allegheny is in such a favorable position with respect to our own power resources, we are able to evaluate a number of different possibilities and take advantage of the best opportunities that arise.

While approximately two-thirds of our energy comes from self-owned generation resources and long-term contracts, the remainder has been acquired through a power supply agreement in place since 2001. That agreement, originally with the Williams Power Company and later assumed by Bear Energy LP/JPMorgan Chase, expired at the end of 2008. The Patchwork Quilt strategy ensures an adequate, reliable and diversified supply of power beyond 2008. Because of the volatility of today's energy markets, Allegheny has been praised by industry and government officials for this forward-thinking approach.

In 2008 we continued to look ahead, developing innovative strategies to ensure future energy needs are met. In addition to exploring more baseload generation options, Allegheny laid the groundwork to deploy a number of distributed generation systems throughout cooperative service areas. These systems could prove highly beneficial by reducing transmission peaks and by lessening our capacity obligations. They could also serve as an emergency source of energy, helping to get power back to consumer-members in the event of transmission outages.

As we look back at 2008, we can see that our planning, initiatives and strategic approach have served us well during this exceptionally turbulent time. Moving forward, we can be confident in the knowledge that our strength comes from focusing on one thing: a commitment to providing our member cooperatives with a reliable supply of electricity at a competitive price.



Raystown
Hydroelectric Project

the Year in Review: 2008 Allegheny annual report

AT THE END OF 2008, ALLEGHENY'S LONG-TERM POWER SUPPLY AGREEMENT, ESTABLISHED IN 2001 WITH THE WILLIAMS POWER COMPANY AND LATER ASSUMED BY BEAR ENERGY LP/JPMORGAN CHASE, CAME TO AN END. THIS CONTRACT SERVED ALLEGHENY AND ITS MEMBERS WELL FOR A NUMBER OF YEARS, PROVIDING A STEADY SOURCE OF POWER TO SUPPLEMENT ALLEGHENY'S DIVERSE MIX OF SELF-OWNED GENERATION AND DEMAND-SIDE MANAGEMENT CAPABILITIES.

MOVING FORWARD, ALLEGHENY IS REPLACING THIS SOURCE THROUGH AN INNOVATIVE "PATCHWORK QUILT" STRATEGY OF POWER SUPPLY PROCUREMENT, WHICH ENTAILS SECURING POWER IN DIFFERENT AMOUNTS, FROM DIFFERENT SOURCES, FOR DIFFERENT PERIODS OF TIME. DEVELOPED OVER THE PAST SEVERAL YEARS, THIS STRATEGY HELPS FURTHER DIVERSIFY ALLEGHENY'S POWER RESOURCES – ALL THE MORE PRUDENT, GIVEN THE VOLATILITY OF THE ENERGY MARKET IN RECENT YEARS AND CURRENT ECONOMIC CONDITIONS.

THE PATCHWORK QUILT PLAN WILL ADD PIECES TO A SOLID FOUNDATION OF POWER RESOURCES, HELPING ALLEGHENY ACHIEVE ITS CORE MISSION OF STABLE AND AFFORDABLE WHOLESALE POWER RATES FOR OUR MEMBER COOPERATIVES IN PENNSYLVANIA AND NEW JERSEY.

HERE IS A LOOK AT ALLEGHENY'S POWER SUPPLY PORTFOLIO:

Raystown Hydroelectric Project:

Allegheny's Raystown Hydroelectric Project (Raystown) is a two-unit, 21-megawatt, run-of-river hydropower facility located at Raystown Lake and Dam in Huntingdon County, Pa. In 2008, Raystown provided a better-than-expected 86 million kilowatt-hours, equating to 2.7 percent of Allegheny's requirements for the year. The plant maintained a 98.9 percent availability.

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

Susquehanna Steam Electric Station:

Allegheny owns 10 percent of the Susquehanna Steam Electric Station (SSES), a 2,400-megawatt, two-unit nuclear power plant located in Luzerne County, Pa. PPL Susquehanna, a division of Allentown, Pa.-based PPL Corporation, owns the remaining 90 percent and operates the boiling water reactor facility.

In 2008, this 10 percent share of SSES provided a record 1.9 billion kilowatt-hours of electricity to Pennsylvania and New Jersey electric cooperatives, surpassing the previous record of 1.82 billion kilowatt-hours set in 2005. The capacity factor of SSES Unit 1, with a refueling outage, was 84.7 percent; Unit 2 was 97.4 percent. This works out to an average annual composite capacity factor for the facility of 91 percent.

Both Unit 1 and Unit 2 run on a 24-month refueling cycle, and both are in the process of being uprated by approximately 14 percent. The uprate is scheduled to be completed in 2010.

New York Power Authority:

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

In 2008, Allegheny received an allocation of 33 megawatts from the projects for the benefit of its 14 member cooperatives in Pennsylvania and New Jersey.

Since 1966, it is estimated that NYPA generation has saved Pennsylvania and New Jersey electric distribution cooperatives more than $325 million, compared to the cost of purchasing the same amount of electricity from other sources.

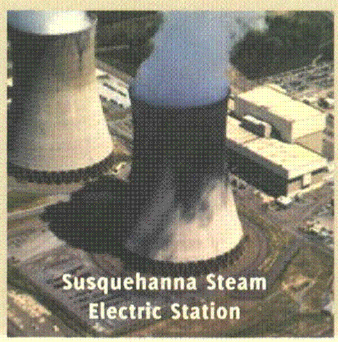
Load Management:

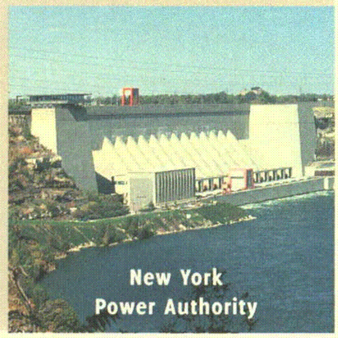
In 1986, Allegheny and its member electric distribution cooperatives in Pennsylvania and New Jersey launched the Coordinated Load Management System (CLMS) to reduce electricity consumption during peak demand periods.

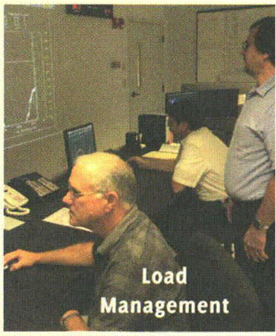
By shifting use of residential water heaters, electric thermal storage units, dual fuel home heating systems, and other special equipment in the homes of volunteer cooperative consumer-members to off-peak hours, the CLMS improves system efficiency, cuts costly demand charges cooperatives must pay for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

In 2008, the CLMS reduced cooperative purchased power costs by more than $3.4 million, bringing total net power cost savings achieved since December 1986 to more than $90 million. Currently, 201 substations are being utilized for load control with more than 47,353 load control receivers installed on appliances (mostly water heaters) in the homes of electric cooperative consumer-members.

After more than 20 years of helping Allegheny and its member cooperatives reduce peak consumption, the system was ready for an upgrade. Allegheny took steps in 2007 to begin updating CLMS-related equipment, and new equipment was placed on-line in 2008 to provide greater system efficiencies.


Susquehanna Steam Electric Station


New York Power Authority

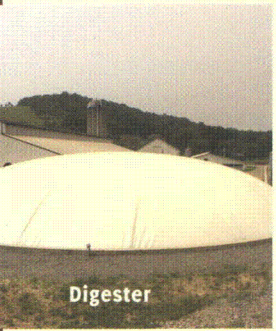

Load Management

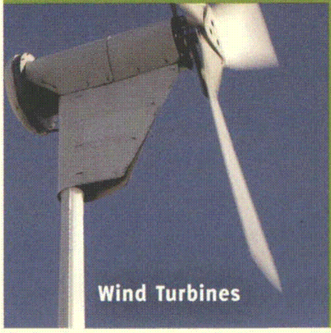
Clean Power Commitment

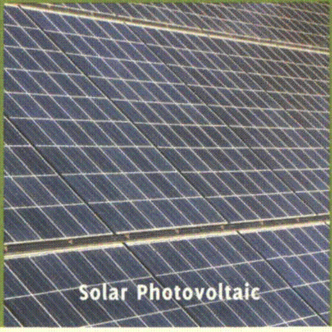
ALLEGHENY AND ITS 14 MEMBER COOPERATIVES IN PENNSYLVANIA AND NEW JERSEY HAVE BEEN VERY ACTIVE IN MEETING MEMBERS' DESIRE TO SUPPORT ENERGY EFFICIENCY, CLEAN AND RENEWABLE ENERGY GENERATION, AND A SECURE ENERGY FUTURE FOR ELECTRIC COOPERATIVES. IN ADDITION TO OUR INVESTMENTS IN CLEAN AND CARBON-FREE NUCLEAR AND HYDROPOWER RESOURCES, AND OUR DEMAND-SIDE EFFICIENCY MEASURES, HERE ARE SOME OF OUR OTHER INITIATIVES FOR A BETTER ENVIRONMENT:

- **INTERCONNECTED PROJECTS:** ALLEGHENY AND ITS MEMBER DISTRIBUTION COOPERATIVES ACTIVELY FOLLOWED UP WITH COOPERATIVE CONSUMER-MEMBERS WHO WERE CONSIDERING THE ADDITION OF RENEWABLE ENERGY PROJECTS TO THEIR HOMES OR BUSINESSES. BY THE END OF 2008, THERE WERE 43 CONSUMER-MEMBER-OWNED RENEWABLE ENERGY PROJECTS THAT HAD BEEN INTERCONNECTED, INCLUDING FIVE DIGESTERS, 22 WIND TURBINES, 15 SOLAR PHOTOVOLTAIC, AND ONE SMALL HYDROELECTRIC FACILITY. ADDITIONAL PROJECTS ARE EXPECTED TO BE INTERCONNECTED ON A REGULAR BASIS.

- **RENEWABLE ENERGY ASSISTANCE PROGRAM:** AS A POSITIVE PARTNER IN THE COMMONWEALTH'S ALTERNATIVE ENERGY INITIATIVES, ALLEGHENY PROVIDES A PROGRAM TO ASSIST COOPERATIVE CONSUMER-MEMBERS WHO WANT TO INSTALL A CLEAN ENERGY GENERATION SYSTEM AT THEIR HOME OR FARM. ESTABLISHED IN 2005, THE RENEWABLE

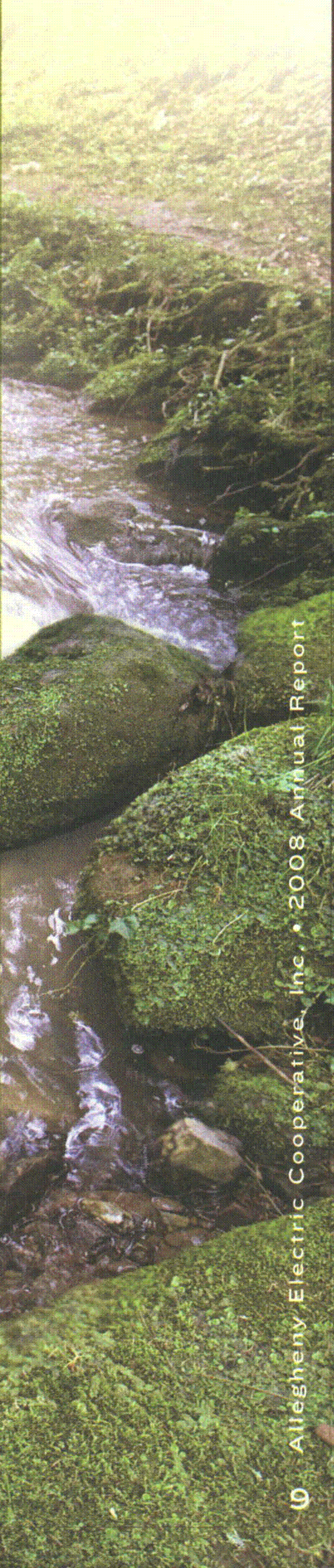

Digester


Wind Turbines


Solar Photovoltaic

ENERGY ASSISTANCE PROGRAM (REAP) PROVIDES GRANTS TO ELECTRIC DISTRIBUTION COOPERATIVES TO HELP COVER VARIOUS INTERCONNECTION COSTS, SUCH AS METERING EQUIPMENT AND DISTRIBUTION TRANSFORMERS. IT ALSO PAYS FOR CERTAIN TRANSITIONAL COSTS TO HELP ENSURE THAT OTHER ELECTRIC COOPERATIVE CONSUMER-MEMBERS ARE NOT REQUIRED TO SUBSIDIZE THE OPERATION OR INSTALLATION OF A SMALL RENEWABLE ENERGY GENERATION SYSTEM — WHETHER IT IS AN ANAEROBIC DIGESTER, WINDMILL OR SOLAR UNIT. IN MANY WAYS, REAP REFLECTS THE ELECTRIC COOPERATIVE TRADITION OF MEMBERS HELPING MEMBERS, AND ADDS A NEW CHAPTER TO ALLEGHENY'S HISTORY OF ADDRESSING ENVIRONMENTAL AND ENERGY CHALLENGES IN A COST-EFFECTIVE AND FAIR WAY.

- **LOW IMPACT CERTIFICATION AT RAYSTOWN:** IN 2007, ALLEGHENY'S RAYSTOWN HYDROELECTRIC PROJECT EARNED THE DISTINCTION OF BEING THE FIRST HYDROELECTRIC PLANT IN PENNSYLVANIA TO BE CERTIFIED AS A LOW IMPACT HYDROELECTRIC FACILITY BY THE LOW IMPACT HYDROPOWER INSTITUTE (LIHI). THE PROJECT HAD TO MEET THE INSTITUTE'S ENVIRONMENTALLY RIGOROUS CRITERIA FOR CERTIFICATION, WHICH ADDRESSES RIVER FLOW, WATER QUALITY, FISH PASSAGE AND PROTECTION, WATERSHED HEALTH, ENDANGERED SPECIES PROTECTION, CULTURAL RESOURCES, RECREATION USE AND ACCESS, AND WHETHER OR NOT THE DAM ITSELF HAS BEEN RECOMMENDED FOR REMOVAL. THE ENTIRE PROCESS, WHICH TOOK SEVERAL MONTHS, REQUIRED EXTENSIVE RESEARCH AND PREPARATION, AND INVOLVED COMPREHENSIVE REVIEWS BY STATE AND FEDERAL NATURAL RESOURCE AGENCIES, AS WELL AS THE LIHI GOVERNING BOARD. THIS CERTIFICATION REFLECTS ALLEGHENY'S HIGH STANDARD OF ENVIRONMENTAL STEWARDSHIP.

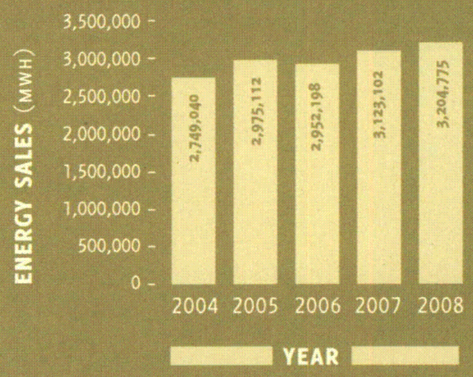


Allegheny at a Glance

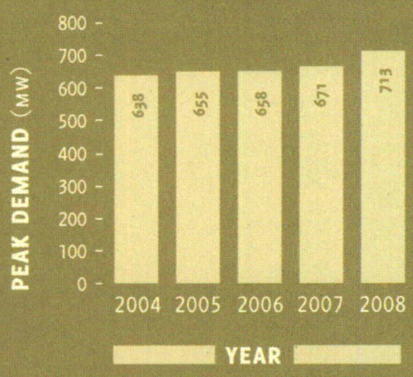
2008 FACT SHEET

ENERGY SALES	3,204,775 MWh
TOTAL OPERATING REVENUE	$149,525,000
Net Margins	$9,159,000
Total Assets	$413,473,000
BUDGETED SYSTEM RATE	57.4 mills per kWh
TOTAL RETAIL CONSUMERS	230,277
2008 PEAK DEMAND	713 MW
MILES OF TRANSMISSION LINE	85

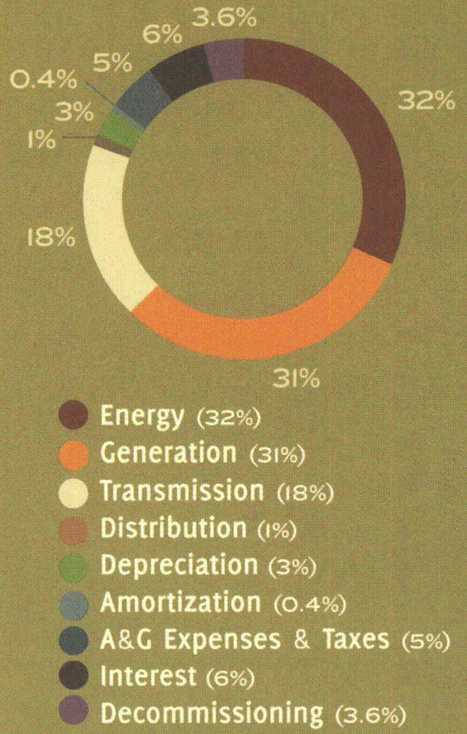
HISTORIC ENERGY SALES | 2004-2008



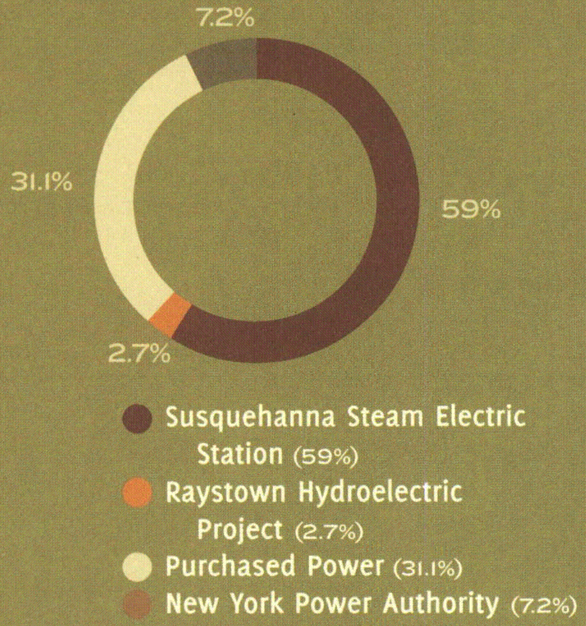
PEAK DEMAND | 2004-2008



ALLEGHENY 2008 OPERATING EXPENSES



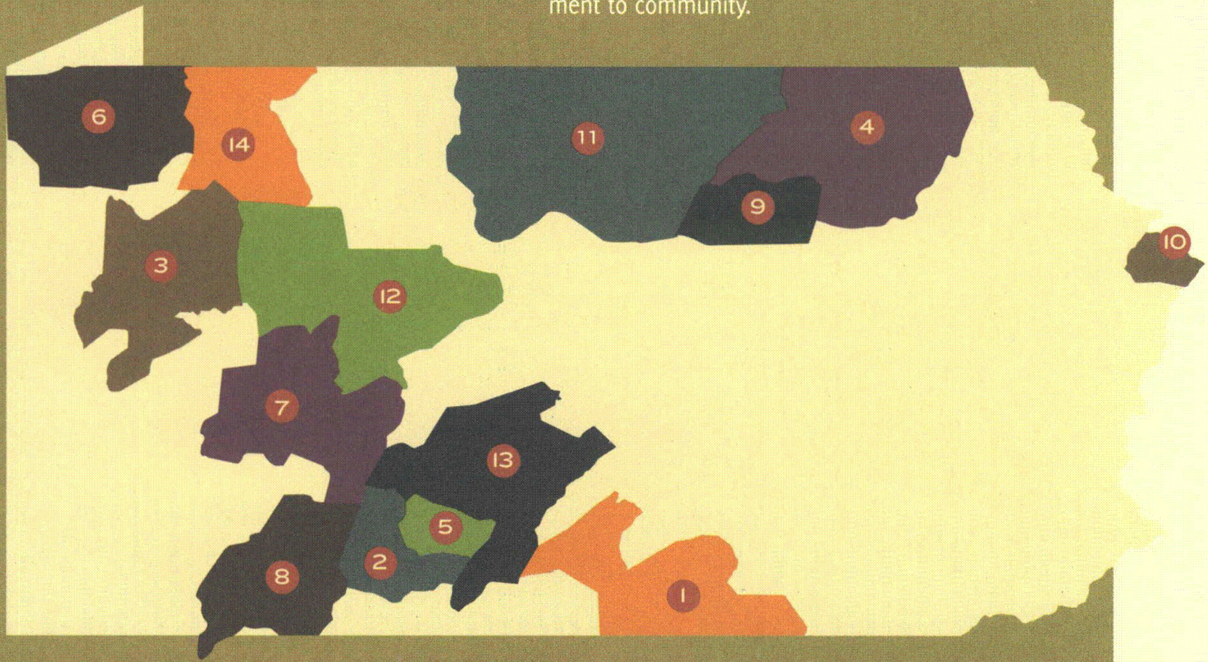
ALLEGHENY 2008 SOURCES OF ENERGY



About Allegheny Electric Cooperative, Inc.

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

The cooperative electric systems comprising the Allegheny "family" maintain approximately 12.5 percent of all electric distribution lines in Pennsylvania, spanning one-third of the Commonwealth in 41 counties. New Jersey's lone electric cooperative maintains roughly 1 percent of the Garden State's total miles of line. Through these facilities, Allegheny member cooperatives deliver electricity to more than 220,000 homes, farms, small businesses, and industries with a combination of integrity, accountability, innovation, and commitment to community.



ALLEGHENY ELECTRIC COOPERATIVE, INC. TERRITORY

1 | Adams Electric Cooperative, Inc.
Gettysburg, Pa.

2 | Bedford Rural Electric Cooperative, Inc
Bedford, Pa.

3 | Central Electric Cooperative, Inc.
Parker, Pa.

4 | Claverack Rural Electric Cooperative, Inc.
Wysox, Pa.

5 | New Enterprise Rural Electric Cooperative, Inc.
New Enterprise, Pa.

6 | Northwestern Rural Electric Cooperative Association, Inc.
Cambridge Springs, Pa.

7 | REA Energy Cooperative, Inc.
Indiana, Pa.

8 | Somerset Rural Electric Cooperative, Inc.
Somerset, Pa.

9 | Sullivan County Rural Electric Cooperative, Inc.
Forksville, Pa.

10 | Sussex Rural Electric Cooperative, Inc.
Sussex, N.J.

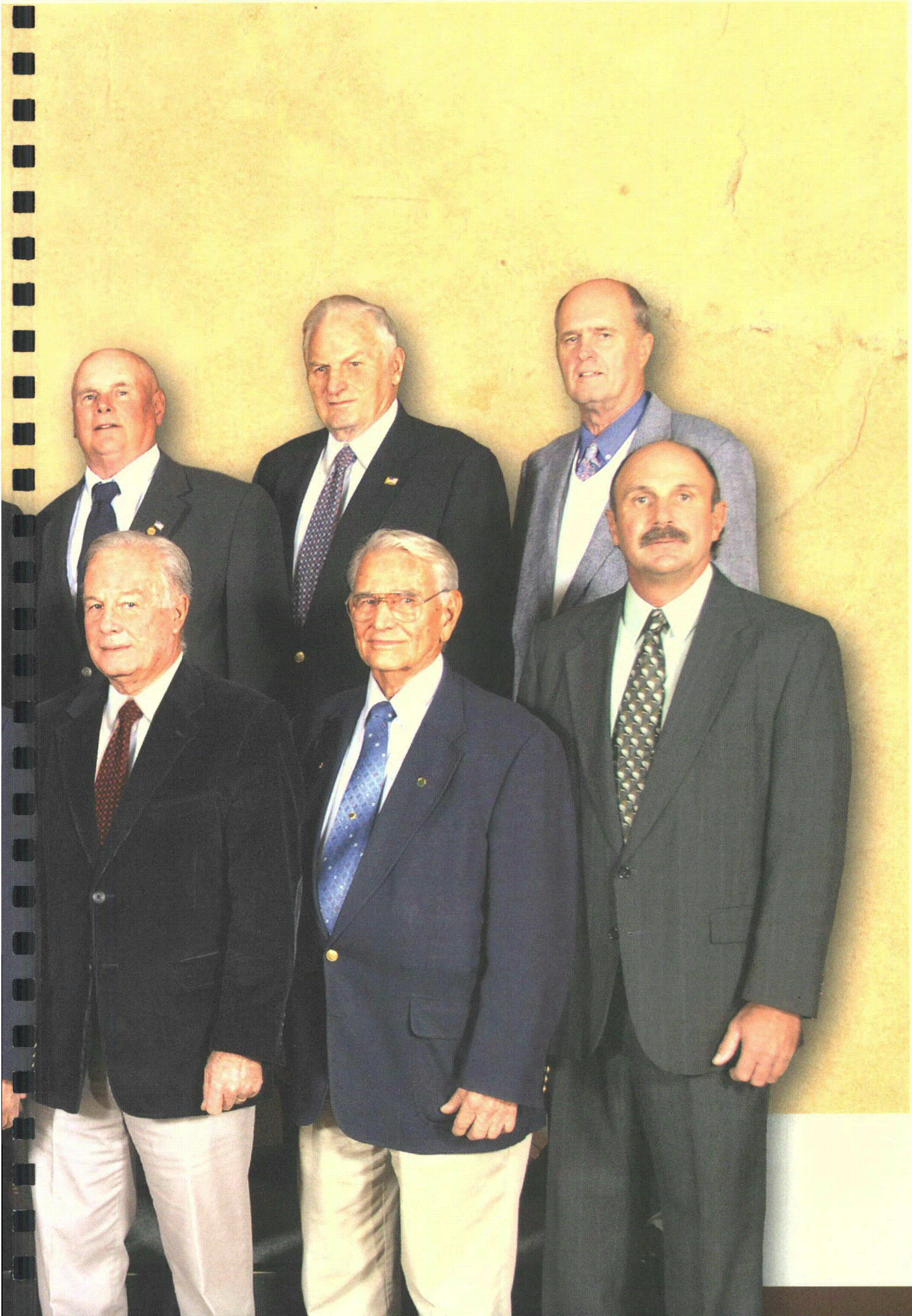
11 | Tri-County Rural Electric Cooperative, Inc.
Mansfield, Pa.

12 | United Electric Cooperative, Inc.
DuBois, Pa.

13 | Valley Rural Electric Cooperative, Inc.
Huntingdon, Pa.

14 | Warren Electric Cooperative, Inc
Youngsville, Pa.

Board of Directors



BACK ROW, FROM LEFT:

Dave Turner, Director, Warren Electric; Jay Grove, Director, Adams Electric; Kathryn Cooper-Winters, Director, Northwestern RECA; Herman Blakley, Director, REA Energy; Tom Elliott, Director, Claverack REC; Thomas Webb, Director, Sussex REC; C. Robert Koontz, Director, Bedford REC.

FRONT ROW (L-R):

Curtin Rakestraw II, Director, Sullivan County REC; Robert Holmes, Allegheny Board Secretary, Director, Valley REC; Stephen Marshall, Allegheny Board Treasurer, Director, United Electric; Lowell Friedline, Allegheny Board Chairman, Director, Somerset REC; Dr. James Davis, Allegheny Board Vice Chairman, Director, Tri-County Rural Electric; Robert Guyer, Director, New Enterprise REC; Richard Weaver, Director, Central Electric.

Allegheny Electric Cooperative, Inc. Accountants' Report and Consolidated Financial Statements —December 31, 2008 and 2007

contents

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CPAs & Advisors

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Decatur, IL 62525-1580
217.429.2411 Fax 217.429.6109 www.bkd.com

Independent Accountants' Report

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

We have audited the accompanying consolidated balance sheets of Allegheny Electric Cooperative, Inc. (Cooperative) as of December 31, 2008 and 2007, and the related consolidated statements of margin, members' equities, and cash flows for the years then ended. These financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Allegheny Electric Cooperative, Inc. as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

April 13, 2009

Allegheny Electric Cooperative, Inc.

Consolidated Balance Sheets

December 31, 2008 and 2007

(In Thousands)

Assets

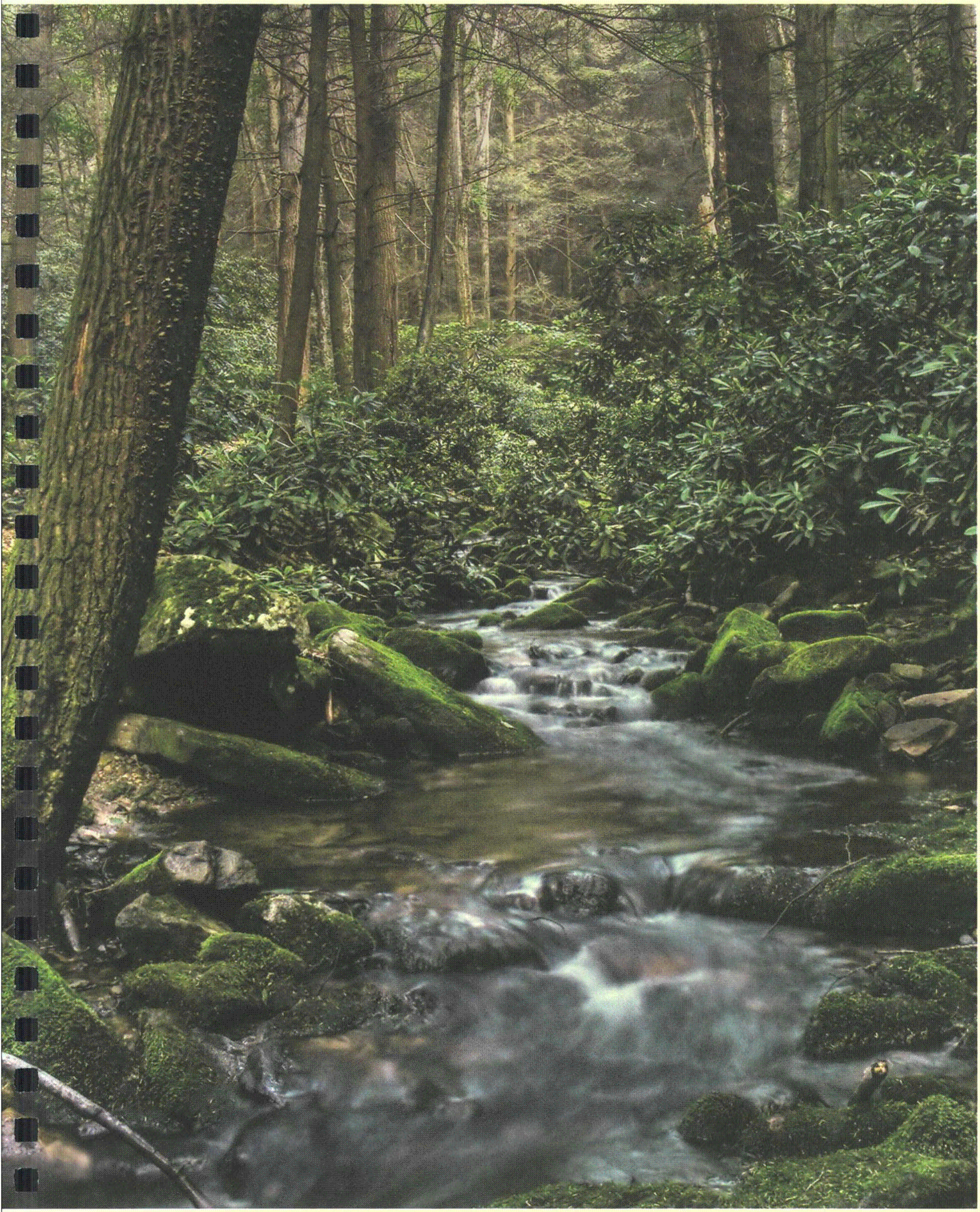
		2008		2007
Electric Utility Plant, at cost				
In service (see Note 2)	$	823,657	$	805,891
Less accumulated depreciation		(698,531)		(695,664)
		125,126		110,227
Construction work in progress		14,548		16,771
Nuclear fuel in process (see Notes 1 and 3)		21,631		19,421
Net electric utility plant (see Notes 1, 2 and 3)		161,305		146,419
Investments and Other Assets				
Investments in associated organizations (see Note 4)		17,733		24,833
Nuclear Decommissioning Trust (NDT) (see Notes 1 and 6)		53,732		60,858
Notes receivable, members, less current portion (see Note 5)		-		5
Non-utility property, at cost (net of accumulated depreciation of $5,870 in 2008 and $6,665 in 2007)		3,837		4,125
Deferred tax asset, net (see Note 11)		16,370		18,013
Other noncurrent assets		5,038		28
		96,710		107,862
Current Assets				
Cash and cash equivalents		21,876		36,474
Investments (see Note 4)		76,568		35,395
Derivative investment (see Note 7)		7,240		4,236
Accounts receivable, members (see Note 1)		19,198		15,869
Accounts receivable, affiliated organizations		76		82
Other receivables		413		280
Inventories (see Note 1)		7,721		7,087
Other current assets		6,502		4,736
Total current assets		139,594		104,159
Deferred Charges (see Note 8)				
Capital retirement asset		10,290		10,900
Deferred asset plan - NDT investments		5,525		-
Other		49		61
		15,864		10,961
	$	413,473	$	369,401

Members' Equities and Liabilities

	2008	2007
Members' Equities (see Note 1)		
Membership fees	$ 3	$ 3
Patronage capital	43,781	32,151
Donated capital	38	38
Unrestricted net assets	100	100
Retained earnings	9,159	14,861
Members' equities	53,081	47,153
Accumulated other comprehensive income	3,081	6,096
Total equities	56,162	53,249
Asset Retirement Obligation (see Note 9)	131,615	126,553
Long-Term Debt (see Note 10)	123,977	128,186
Current Liabilities		
Current installments of long-term debt	4,208	10,705
Accounts payable and accrued expenses	13,330	12,771
Accounts payable, affiliated organization	148	103
Total current liabilities	17,686	23,579
Other Liabilities and Deferred Revenue		
Deferred income tax obligation from safe harbor lease (see Note 16)	1,234	1,543
Financial transmission rights (see Note 7)	7,240	4,236
Deferred credits (see Note 15)	75,559	32,055
	84,033	37,834
	$ 413,473	$ 369,401

Allegheny Electric Cooperative, Inc.
Consolidated Statements of Margin
Years Ended December 31, 2008 and 2007
(In Thousands)

	2008	2007
Operating Revenues	$ 149,525	$ 177,701
Operating Expenses		
Operations		
Purchased capacity and energy costs	45,242	52,525
Transmission		
Operation	25,588	19,183
Maintenance	353	480
Production		
Operation	23,013	22,128
Maintenance	11,271	10,853
Fuel	8,850	9,165
	114,317	114,334
Depreciation	4,382	6,823
Accretion of asset retirement obligation	5,062	4,867
Amortization of capital retirement asset	610	25,710
Administrative and general	10,968	9,848
Property and other taxes	682	571
	136,021	162,153
Operating Margin Before Interest and Other Expenses	13,504	15,548
Other Revenues and (Expenses)		
Litigation settlement (see Note 20)	1,242	-
Interest expense	(8,692)	(10,133)
Other deductions, net	(1,335)	(1,310)
	(8,785)	(11,443)
Operating Margin	4,719	4,105
Non-operating Margins		
Net nonoperating rental income	1,423	1,310
Interest income	5,619	6,825
Other income (expense)	(2,602)	2,621
	4,440	10,756
Net Margin	9,159	14,861
Other Comprehensive Margin		
Unrealized appreciation (depreciation) in investments	(3,015)	738
Comprehensive Margin	$ 6,144	$ 15,599



Allegheny Electric Cooperative, Inc.

Consolidated Statements of Members' Equities
Years Ended December 31, 2008 and 2007
(In Thousands)

	Membership Fees	Donated Capital	Patronage Capital
Balance, January 1, 2007	$ 3	$ 38	$ 30,430
Patronage capital retirement	-	-	(3,938)
Patronage capital assignment	-	-	5,659
Comprehensive margin			
Net margin	-	-	-
Change in unrealized appreciation on investments	-	-	-
Balance, December 31, 2007	3	38	32,151
Patronage capital retirement	-	-	(3,231)
Patronage capital assignment	-	-	11,390
Patronage capital - NDT (earnings) losses	-	-	3,471
Comprehensive margin			
Net margin	-	-	-
Change in unrealized depreciation on investments	-	-	-
Balance, December 31, 2008	$ 3	$ 38	$ 43,781

Unrestricted Net Assets	Retained Earnings	Total Members' Equities	Accumulated Other Comprehensive Margin	Total Equities
$ 100	$ 5,659	$ 36,230	$ 5,358	$ 41,588
-	-	(3,938)	-	(3,938)
-	(5,659)	-	-	-
-	14,861	14,861	-	14,861
-	-	-	738	738
100	14,861	47,153	6,096	53,249
-	-	(3,231)	-	(3,231)
-	(11,390)	-	-	-
-	(3,471)	-	-	-
-	9,159	9,159	-	9,159
-	-	-	(3,015)	(3,015)
$ 100	$ 9,159	$ 53,081	$ 3,081	$ 56,162

Allegheny Electric Cooperative, Inc.

Consolidated Statements of Cash Flows

Years Ended December 31, 2008 and 2007

(In Thousands)

	2008	2007
Operating Activities		
Net margin	$ 9,159	$ 14,861
Items not requiring cash		
Depreciation and fuel amortization	11,098	13,137
Amortization of capital asset retirement	610	25,710
Accretion of asset retirement obligation	5,062	4,867
Deferred income taxes	1,643	(18,013)
Other than temporary losses	6,454	-
Change in		
Investments in associated organizations	7,100	(412)
Accounts receivable, members	(3,321)	6,256
Other receivables	(141)	(15)
Inventories	(634)	(156)
Derivative investment	(3,004)	2,210
Other current and non-current assets	(6,776)	(2,542)
Accounts payable and accrued expenses	559	(2,781)
Accounts (receivable) payable, affiliated organizations	51	(114)
Other liabilities and deferred charges	35,161	27,054
Net cash provided by operating activities	63,021	70,062
Investing Activities		
Additions to electric utility plant and non-utility property, net	(25,696)	(28,362)
Payments received on notes receivable, members	5	22
Purchase of investments, net	(41,884)	(20,619)
Proceeds from (purchase of) other investments	3,893	(5,711)
Net cash used in investing activities	(63,682)	(54,670)
Financing Activities		
Principal payments on long-term debt	(10,706)	(32,357)
Patronage capital retirement	(3,231)	(3,938)
Net cash used in financing activities	(13,937)	(36,295)
Net Decrease in Cash and Cash Equivalents	(14,598)	(20,903)
Cash and Cash Equivalents, Beginning of Year	36,474	57,377
Cash and Cash Equivalents, End of Year	$ 21,876	$ 36,474
Supplemental Cash Flows Information		
Interest paid	$ 8,808	$ 10,481
Income tax paid (received)	(1,900)	1,882

Allegheny Electric Cooperative, Inc.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Allegheny Electric Cooperative, Inc. (Cooperative) is a rural electric cooperative corporation established under the laws of the Commonwealth of Pennsylvania. The Cooperative finances 100% of its outstanding debt with the National Rural Utilities Cooperative Finance Corporation (CFC).

The Cooperative is a generation and transmission cooperative. The member cooperatives' primary service areas are rural areas throughout much of Pennsylvania and a portion of New Jersey. The Cooperative extends unsecured credit to its members. The Cooperative's primary operating asset is its 10% undivided interest in the Susquehanna Steam Electric Station (SSES), a 2,355-megawatt, two-unit nuclear power plant, co-owned by a subsidiary of PPL Corporation (PPL).

The Board of Directors of the Cooperative, appointed by its members, has full authority to establish electric rates to its member cooperatives. Rates are established on a cost of service basis. Beginning in 2007, the Cooperative's Board of Directors has established a deferred revenue account to offset future increases in power supply costs after 2008.

Principles of Consolidation

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

Basis of Accounting

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

In accordance with FERC guidelines, the Cooperative also maintains its accounts in accordance with Statement of Financial Accounting Standards Board (FASB) No. 71, *Accounting for the Effects of Certain Types of Regulation*.

Deregulation

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

On a regular basis, the Cooperative reevaluates its application of FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, and No. 101, *Regulated Enterprises – Accounting for the Discontinuation of Application of FASB Statement No. 71.* The Cooperative has determined that regulatory assets and liabilities should continue to be accounted for under the provisions of FASB No. 71 because it is reasonable to assume that the Cooperative will continue to be able to charge and collect its cost of service-based rates.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial report and the reported amounts of revenues and expenses during the years then ended. Actual results could differ from those estimates.

Electric Utility Plant

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

Nuclear Utility Plant	
Production	Remaining License Life
Transmission	2.75%
General plant	3% - 12.5%
Nuclear fuel	Units of heat production
Non-Nuclear Utility Plant	3% - 33%

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

Property and Equipment

Property and equipment are depreciated on a straight-line basis over the estimated useful life of each asset.

Nuclear Fuel

Nuclear fuel is charged to fuel expense based on the quantity of heat produced for electric generation. Under the Nuclear Waste Policy Act of 1982, the U.S. Department of Energy (DOE) is responsible for the permanent storage and disposal of spent nuclear fuel removed from nuclear reactors. The Cooperative currently pays to PPL its portion of DOE fees for such future disposal services.

Other Investments

Debt and equity securities for which the Cooperative has no immediate plan to sell but may be sold in the future are classified as available for sale and carried at fair value. Unrealized gains and losses are recorded in members' equities.

Realized gains and losses, based on the specifically identified cost of the security, are included in net income.

Cash and Cash Equivalents

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

The Cooperative places its cash and temporary investments with high quality financial institutions. For purposes of the statements of cash flows, the Cooperative considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Cash equivalents are carried at cost.

One or more of the financial institutions holding the Cooperative's cash accounts are participating in the FDIC's Transaction Account Guarantee Program. Under the program through December 31, 2009, all noninterest-bearing transaction accounts at these institutions are fully guaranteed by the FDIC for the entire amount in the account.

For financial institutions opting out of the FDIC's Transaction Account Guarantee Program or interest-bearing cash accounts, the FDIC's insurance limits increased to $250,000, effective October 3, 2008. The increase in federally insured limits is currently set to expire on December 31, 2009. At December 31, 2008, the Cooperative's cash accounts exceeded federally insured limits by approximately $19,375,000, which was held at the following institutions:

National Rural Utilities Cooperative Finance Corporation Commercial paper	$ 18,000,000
M&T Bank Sweep and money market	1,375,000
	$ 19,375,000

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

Accounts Receivable and Notes Receivable

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

Notes receivable are stated at their outstanding principal amount. At December 31, 2008, the Cooperative recorded an allowance of $8,464 against the notes receivable. These notes are included in other receivables on the balance sheets.

Inventories

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

Patronage Capital

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

Income Taxes

Deferred tax assets and liabilities are recognized for the tax effects of differences between the financial statement and tax bases of assets and liabilities. A valuation allowance is established to reduce deferred tax assets if it is more likely than not that a deferred tax asset will not be realized.

Allegheny Electric Cooperative, Inc.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Uncertain Tax Positions

In accordance with Financial Accounting Standards Board (FASB) Staff Position No. FIN 48-3, the Cooperative has elected to defer the effective date of FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, until its fiscal year ended December 31, 2009. The Cooperative has continued to account for any uncertain tax positions in accordance with literature that was authoritative immediately prior to the effective date of FIN 48, such as FASB Statement No. 109, *Accounting for Income Taxes*, and FASB Statement No. 5, *Accounting for Contingencies*.

Revenue Recognition

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

Impairment of Long-Lived Assets

The Cooperative reviews the carrying amount of an asset for possible impairment whenever events or changes in circumstances indicate that such amounts may not be recoverable. For the years ended 2008 and 2007, no such circumstances were noted.

Note 2: Electric Utility Plant in Service

	2008	2007
	(In thousands)	
Nuclear Utility Plant		
Production	$ 590,650	$ 578,949
Transmission	41,232	41,232
General plant	3,289	3,102
Nuclear fuel	176,809	168,784
	811,980	792,067
Non-Nuclear Utility Plant	11,677	13,824
Total	$ 823,657	$ 805,891

Note 3: Susquehanna Steam Electric Station

The Cooperative owns a 10% undivided interest in SSES. PPL owns the remaining 90%. Both participants provide their own financing. The Cooperative's portion of SSES's gross assets, which includes electric utility plant in service, construction and nuclear fuel in progress, totaled $624 million and $614 million as of December 31, 2008 and 2007, respectively. The Cooperative's share of anticipated costs for ongoing construction and nuclear fuel for SSES is estimated to be approximately $125.1 million over the next five years. The Cooperative receives a portion of the total SSES output equal to its percentage ownership. SSES accounted for approximately 59% of the total kilowatt hours sold by the Cooperative during the years ended December 31, 2008 and 2007, respectively. The balance sheets and statements of income reflect the Cooperative's respective share of assets, liabilities and operations associated with SSES.

Note 4: Investments

Associated Organizations

	2008	2007
	(In thousands)	
National Rural Utilities Cooperative Finance Corporation (CFC) Subordinated Term Certificate, bearing interest at 5.52%, maturing February 1, 2008[1]	$ -	$ 7,145
National Rural Utilities Cooperative Finance Corporation (CFC) Subordinated Term Certificates, bearing interest at 5.8%, maturing January 1, 2026[1]	16,491	16,576
National Rural Utilities Cooperative Finance Corporation (CFC) Subordinated Term Certificates, bearing interest from 0% to 5%, maturing January 1, 2014[1]	258	300
Other	984	812
	$ 17,733	$ 24,833

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

Temporary Investments

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

	2008	2007
	(In thousands)	
Certificates of deposit		
Amortized cost	$ 2,193	$ -
Unrealized gains	5	-
	2,198	-
Debt securities		
Amortized cost	52,451	35,507
Realized losses	(422)	-
Unrealized gains	325	85
Unrealized losses	(549)	(197)
	51,805	35,395
Equity securities		
Amortized cost	1,071	-
Realized losses	(506)	-
	565	-
Total investments at fair value	54,568	-
Commercial paper, at cost with National Rural Utilities Cooperative Finance Corporation	22,000	-
	$ 76,568	$ 35,395

Maturities of temporary investments at December 31, 2008:

	Amortized Cost	Approximate Fair Value
	(In thousands)	
One year or less	$ 64,193	$ 63,271
After one through five years	13,522	13,297
	$ 77,715	$ 76,568

The Cooperative recorded other-than-temporary impairments on specific debt securities and all mutual fund securities. The cost-basis of these investments has been adjusted to reflect recognition of this impairment. Total other-than-temporary impairment reflected in the statement of margins for 2008 was $929,000 for these temporary investments.

Note 5: Notes Receivable from Members

Notes receivable from members arise from the lease of load management equipment to the member cooperatives. Such notes bear interest at a variable rate (5.40% and 7.25% as of December 31, 2008 and 2007, respectively) and mature on March 31, 2009. Notes receivable from members were $10,000 and $26,000 as of December 31, 2008 and 2007, respectively. These notes are broken out into their current and long-term maturities and included in accounts receivable and notes receivable on the balance sheets.

Note 6: Nuclear Decommissioning Trust

The Nuclear Decommissioning Trust consists of the following as of December 31, 2008 and 2007:

	December 31, 2008				
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Realized Losses	Fair Value
	(In thousands)				
Decommissioning Trust Fund A:					
Money market funds	$ 1,355	$ -	$ -	$ -	$ 1,355
U.S. Government securities	6,219	536	(3)	-	6,752
Corporate bonds	4,334	151	(73)	(102)	4,310
Other obligations	413	10	-	(2)	421
Common stocks	8,778	579	-	(1,851)	7,506
	21,099	1,276	(76)	(1,955)	20,344
NRC mandated Decommissioning Trust Fund B:					
Money market funds	1,078	-	-	-	1,078
U.S. Government securities	12,231	836	(2)	-	13,065
Corporate bonds	6,691	91	(108)	(256)	6,418
Other obligations	254	17	-	(7)	264
Common stocks	14,604	1,266	-	(3,307)	12,563
	34,858	2,210	(110)	(3,570)	33,388
Total	$ 55,957	$ 3,486	$ (186)	$ (5,525)	$ 53,732

	December 31, 2007			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Decommissioning Trust Fund A:				
Cash	$ 361	$ -	$ -	$ 361
U.S. Government securities	6,939	108	-	7,047
Corporate bonds	3,606	52	(5)	3,653
Other obligations	884	10	-	894
Common stocks	9,907	1,937	(114)	11,730
	21,697	2,107	(119)	23,685
NRC mandated Decommissioning Trust Fund B:				
Cash	1,276	-	-	1,276
U.S. Government securities	10,666	170	(3)	10,833
Corporate bonds	5,793	72	(5)	5,860
Other obligations	950	14	(6)	958
Common stocks	14,269	4,205	(228)	18,246
	32,954	4,461	(242)	37,173
Total	$ 54,651	$ 6,568	$ (361)	$ 60,858

Certain investments in debt and equity securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2008 and 2007, was $14.3 million and $11.1 million, respectively. These declines primarily resulted from increases in market interest rates prior to the balance sheet date and the failure of certain investments to meet projected earnings targets. The gross unrealized losses at December 31, 2008 for a period of less than 12 months were $162,000 and for a period greater than 12 months was $25,000. The gross unrealized losses at December 31, 2007 for a period of less than 12 months were $332,000 and for a period greater than 12 months was $29,000.

The Cooperative recorded other-than-temporary impairments on all equity securities and specific debt securities. The cost-basis of these investments has been adjusted to reflect the recognition of this impairment. Under FASB No. 71, *Accounting for the Effects of Certain Types of Regulation*, the Cooperative has elected to defer these losses and pass them on to members through the future rate structure. As of December 31, 2008, total deferred charges for the Nuclear Decommissioning Trust other-than-temporary impairment were $5,525,000.

Allegheny Electric Cooperative, Inc.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

Note 7: Financial Transmission Rights

The Cooperative is issued Financial Transmission Rights (FTRs) by PJM Interconnection LLC, (PJM). These FTRs have been found to meet the FASB Statement No. 133, *Accounting for* Derivative *Instruments and Hedging Activities,* definition of a derivative, and therefore must have special derivative accounting procedures applied to them.

The Cooperative received an entitlement of FTRs. FTRs are defined from a "source" node to a "sink" node (path) for a specific amount of megawatts of electric power. The holder of an FTR is entitled to receive whole or partial offsets of transmission congestion charges that arise when that specific path is congested. The purpose of the FTR mechanism is to act as a hedge against volatile congestion charges.

Market values of FTRs are only observable based on the clearing prices of the FTRs in annual, seasonal and monthly auctions. The expected value of FTRs fluctuates based on seasonal expectations of the supply and demand of energy for each specific path. Significant assumptions and modeling projections are necessary to value FTRs. The expected FTR values are considered in the rate-making process and therefore the fair value of FTRs are recognized on the balance sheet and recorded as deferred income under FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation.* The fair value of FTRs was $7,240,000 and $4,236,000 as of December 31, 2008 and 2007 for the remainder of the current PJM planning periods that end May 31, 2009 and 2008 and beyond.

Note 8: Deferred Charges

Deferred charges consist of the following regulatory assets as of December 31, 2008 and 2007.

	2008	2007
	(In thousands)	
Capital retirement asset	$ 10,290	$ 10,900
Deferred asset plan - NDT investments	5,525	-
Safe harbor lease closing costs	49	61
	$ 15,864	$ 10,961

Based on agreements signed by the 14 member distribution cooperatives on March 29, 1999, with an effective date of January 1, 1999, and amended in 2004 and 2006, a portion of the SSES impairment writedown that took place in 1998 has been recognized as a regulatory asset and is referred to as the capital retirement asset. Under these agreements, the Cooperative will recover from members certain financing costs related primarily to the Cooperative's investment in SSES in the amount of $311 million no later than December 31, 2009.

Note 9: Asset Retirement Obligation

Amounts collected from the Cooperative's members for decommissioning, less applicable taxes, are deposited in external trust funds for investment and can only be used for future decommissioning costs. The fair value of the nuclear decommissioning trust was $53.7 million and $60.9 million for the years ended December 31, 2008 and 2007, respectively.

The changes in the carrying amounts of asset retirement obligations were as follows (in thousands):

	2008	2007
	(In thousands)	
Beginning balance	$ 126,553	$ 121,686
Accretion expense	5,062	4,867
Ending balance	$ 131,615	$ 126,553

The amount of actual obligation could differ materially from the estimates reflected in these financial statements.

Allegheny Electric Cooperative, Inc.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Note 10: Long-Term Debt

	2008	2007
	(In thousands)	
CCS Note payable – payable in monthly installments with interest rates ranging from 0% to .90%; final payment January 2009, secured by transportation equipment	$ -	$ 7
Note payable CFC, payable in varying quarterly installments beginning April 2008, plus interest at 6.8%, final payment January 2014	19,450	21,700
Note payable CFC, payable in varying quarterly installments beginning April 2014, plus interest at 6.9%, final payment January 2021	38,600	38,600
Note payable CFC, payable in varying quarterly installments beginning April 2021, plus interest at 7.0%, final payment April 2025	39,700	39,700
Note payable CFC, payable in varying quarterly installments beginning July 2006, plus interest at 6.8%, final payment January 2014	2,925	3,400
Note payable CFC, payable in varying quarterly installments beginning April 2014, plus interest at 6.9%, final payment January 2021	5,800	5,800
Note payable CFC, payable in varying quarterly installments beginning April 2021, plus interest at 7.0%, final payment April 2025	6,200	6,200
Note payable CFC, payable in varying quarterly installments beginning July 2006, plus interest at 7.25%, final payment October 2025	13,371	13,759
Note payable CFC, payable in varying quarterly installments beginning July 2006, plus interest at 7.25%, final payment October 2025	2,139	2,201
Note payable CFC, payable in varying quarterly installments beginning July 2006, plus interest at 6.8%, final payment January 2008	-	6,450
Note payable CFC, payable in varying quarterly installments beginning July 2006, plus interest at 6.9%, final payment January 2008	-	1,074
Total long-term debt	128,185	138,891
Less current installments	4,208	10,705
Long-term debt, net of current installments	$ 123,977	$ 128,186

The Cooperative has an additional available borrowing balance with CFC totaling $45,716,500 at December 31, 2008.

The Cooperative has a $35,000,000 operating line of credit with CFC that expires on March 31, 2011. There were no outstanding borrowings against this line as of December 31, 2008 and 2007. The interest rate on the line of credit fluctuates as established by CFC, but shall not exceed the prime rate plus one percent (4.25% at December 31, 2008).

Future maturities of all long-term debt are as follows (in thousands):

2009	$ 4,208
2010	4,469
2011	4,858
2012	5,074
2013	5,369
Thereafter	104,207

The Cooperative is required by covenant to maintain an annual debt service coverage ratio. The Cooperative was in compliance with the applicable covenant as of December 31, 2008 and 2007, respectively.

During 2008 and 2007, the Cooperative incurred interest costs of $8,692,000 and $10,133,000, respectively.

Note 11: Income Taxes

As of December 31, 2008 and 2007, the Cooperative had available nonmember net operating loss carryforwards of approximately $46 and $55 million, respectively for tax reporting purposes expiring in 2009 through 2019, and alternative minimum tax credit carryforwards of approximately $1,050,000 and $950,000 respectively, which carries forward indefinitely.

There was no provision for federal income taxes at December 31, 2008 and 2007. The Cooperative is not subject to state income taxes.

Temporary differences that give rise to deferred tax balances are principally attributable to fixed asset basis, safe harbor lease treatment, gain on installment sale, and financial statement accruals. Deferred tax assets also include the effect of net operating loss carryforwards. The temporary differences and the carryforward items produce a deferred tax asset at December 31, 2008 and 2007, of approximately $19 and $23 million, respectively. Realization of the net deferred tax asset is contingent upon the Cooperative's future earnings. A valuation allowance of approximately $3 and $5 million, respectively, has been established against this asset because it has been determined that this portion of the deferred tax asset more likely than not will be unrealized. The Cooperative will include the utilization of the net deferred tax asset of $16 million and $18 million at December 31, 2008 and 2007, respectively, in future rates charged to members. Therefore, a deferred credit has been recorded equal to the net deferred tax asset under FASB No. 71, *Accounting for the Effects of Certain Types of Regulation.*

Note 12: Related Party Transaction

Two affiliated organizations, the Pennsylvania Rural Electric Association (PREA) and CCS have provided the Cooperative with certain management, general, and administrative services including dues, on a cost reimbursement basis. The costs for services provided by PREA were $947,000 and $879,000 for the years ended December 31, 2008 and 2007, respectively.

Note 13: Employee Benefit Plans

All employment relationships are through CCS, the consolidated variable interest entity of the Cooperative. CCS's leave policies provide for payment of unused leave at a discounted rate after the end of each calendar year for 2008 and 2007. A provision has been recorded for this liability.

The Cooperative through CCS, participates in a multi-employer defined-benefit pension plan and a 401(k) defined-contribution plan covering substantially all of its employees. The Cooperative makes annual contributions to the Plans equal to the amount accrued for pension expense. Total pension expense for both plans amounted to $1,311,000 and $1,154,000 for the years ended December 31, 2008 and 2007, respectively.

The Cooperative, through CCS, has an employment agreement, which contains a funded deferred compensation agreement, with its President & CEO.

Note 14: Commitments and Contingencies

Power Supply and Transmission Agreements

The Cooperative has entered into power supply and transmission agreements with various service providers. A significant number of these agreements are umbrella type agreements and do not bind the Cooperative to enter into any type of transaction.

As of December 31, 2008, there were several significant capacity and energy transactions under these agreements. However, energy deliveries under those contracts do not begin until January 1, 2009.

Under one of the umbrella agreements, the Cooperative purchased capacity for the period June 1, 2007 through May 31, 2008 in a series of transactions. These transactions contained specific quantities of capacity, all of which were needed to serve the Cooperative's load.

A summary of the power supply agreements are as follows:

New York Power Authority

This contract meets a portion of the Cooperative's base load and peaking requirements and its delivered cost to the Cooperative's members is below market. The current contract terminates in August 2025 for the Niagara Project. The current contract for the St. Lawrence Project expires in 2017.

Williams Energy Marketing & Trading, Inc./ Bear Energy/JP Morgan

Effective on April 1, 2001, the Cooperative entered into an arrangement with Williams Energy Marketing and Trading, Inc. (Williams). The arrangement provided that Williams received the output of all power from the Cooperative's owned and controlled generating resources and Williams in turn essentially supplied all of the Cooperative's load requirements. The agreement with Williams was assigned to Bear Energy (Bear) in late 2007 and then to JP Morgan Chase (JP Morgan) in March 2008. The agreement with Williams/Bear/JP Morgan terminated on December 31, 2008.

The Williams/Bear/JP Morgan agreement contained certain hourly and monthly energy caps. Energy provided above these thresholds was purchased at market prices. The Williams/Bear/JP Morgan agreement also contained thresholds related to output from the Cooperative's resources. If the Cooperative failed to provide energy sufficient to meet the thresholds, the balance was purchased from Williams/Bear/JP Morgan or other parties at market prices.

The Williams/Bear/JP Morgan agreement required the Cooperative to provide credit support in the amount of $9 million. The National Rural Utilities Cooperative Finance Corporation (CFC) issued an irrevocable standby letter of credit on behalf of the Cooperative in the amount of $9 million in favor of Williams/Bear/JP Morgan. The letter of credit was valid until March 31, 2009.

Allegheny Electric Cooperative, Inc.
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Future Power Supply

Since June 2007, the Cooperative issued periodic Requests for Proposal (RFP) for energy and/or capacity products for varying quantities and terms between one and five years beginning in 2009. By mid-2008, the Cooperative had entered into power purchase agreements with various counterparties for a combination of around-the-clock, on-peak and off-peak energy and call option products that would meet nearly 95 percent of its projected energy requirements in 2009.

The Cooperative entered into an agreement on December 18, 2008, that will provide the remainder of Allegheny's energy requirements for 2009. The transition to the new suppliers occurred smoothly on January 1, 2009.

The purchased power agreements with Conectiv Energy Supply, Inc. and Exelon Generation Co., LLC. (Exelon) required the Cooperative to post collateral deposits for exposure exceeding specified thresholds. At December 31, 2008, collateral deposits totaled $5,000,000. The Exelon agreement also requires the Cooperative to provide additional credit support in the amount of $5,000,000. CFC issued an irrevocable standby letter of credit on behalf of the Cooperative in the amount of $5,000,000 in favor of Exelon. The letter of credit is valid until November 30, 2009.

SSES Replacement Power Insurance Policy

The Cooperative mitigated a portion of the economic risk of an outage at SSES by purchasing a Replacement Power Insurance Policy from XL Specialty Insurance Company. Under the terms of the policy, if SSES had a forced outage event, the Cooperative would have been reimbursed the cost of replacement power for the insured quantity of 230 MW. Replacement power cost is the total of the loss, in dollars, as calculated by subtracting the insured price of $75/MWh from the market price index (PJM Western Hub LMP) and multiplying that difference by the insured quantity. The policy stipulates that the outage limit for each such forced outage is 90 consecutive days, and the aggregate coverage limit is $25 million. For this coverage, the Cooperative purchased a three year policy terminating December 31, 2010, from XL with an annual premium of $925,000 per year for each of the policy years.

Transmission Service

Transmission service for the Cooperative's load is provided through a hybrid arrangement consisting of the PJM Open Access Transmission Tariff (OATT) and the pre-existing Wheeling and Supplemental Power Agreement with Pennsylvania Electric Company.

Insurance

PPL, as the 90% owner and sole operator of SSES, and the Cooperative, as owner of a 10% undivided interest in SSES, are members of certain insurance programs which provide coverage for property damage to the SSES nuclear generation plant. Under these programs, the plant, as a whole, has property damage coverage for up to $2.75 billion. Additionally, there is 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, PPL and the Cooperative could be assessed retrospective premiums in the event the insurers' losses exceed their reserves. At December 31, 2008, the maximum amount PPL and the Cooperative could jointly be assessed under these programs ranged from $20 million to $40 million annually.

PPL and the Cooperative's public liability for claims resulting from a nuclear incident is currently limited to $12.5 billion under provisions of the Price-Anderson Amendment Acts of 1988.

In the event of a nuclear incident at any of the reactors covered by the Act, PPL and the Cooperative could be assessed up to $111.9 million per reactor per incident, payable at $35 million per year.

Safe Harbor Lease

The Cooperative previously 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 on the statements of operations over the 30-year term lease. The deferred gain was $1.2 million and $1.5 million as of December 31, 2008 and 2007, respectively.

Under the terms of the safe harbor lease, the Cooperative 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 the Cooperative was contingently liable as of December 31, 2008 was approximately $4.3 million. Payment of this contingent liability has been guaranteed by CFC.

Litigation

The Cooperative may be subject to claims and lawsuits that arise primarily in the ordinary course of business. At December 31, 2008, no such claims or lawsuits existed.

Note 15: Deferred Credits

Sale/Leaseback Arrangement

The Cooperative previously completed a sale and leaseback of its hydroelectric generation facility at the Raystown Dam (the Facility). The Facility was sold to a trustee bank representing Ford Motor Credit Company (Ford) for $32.0 million in cash. During 1996, Ford transferred its interest in the Facility to a third party. Under terms of the arrangement, the Cooperative is leasing the Facility for an initial term of 30 years beginning June 1988. Payments under the lease are due in semi-annual installments which commenced January 10, 1989. At the end of the 30-year term, the Cooperative will have the option to purchase the Facility for an amount equal to the Facility's fair market value or for a certain amount fixed by the transaction documents.

The Cooperative 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 semi-annual installments during the initial lease term. The Cooperative will retain co-licensee status for the Facility throughout the term of the lease. The gain of $1.9 million related to the sale is being recognized over the lease term. The unrecognized gain is recorded in other deferred revenue and was $790,000 and $870,000 as of December 31, 2008 and 2007, respectively.

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

The leaseback of the Facility is accounted for as an operating lease by the Cooperative. As of December 31, 2008, future minimum lease payments under this lease, which can vary based on the interest paid on the debt used to finance the transaction, are estimated as follows (in thousands):

2009	$	2,361
2010		2,361
2011		2,361
2012		2,361
2013		2,361
Thereafter		11,804
Total minimum lease payments	$	23,609

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 totaled $2.0 and $1.5 million in years ended December 31, 2008 and 2007, respectively.

Deferred Revenue Plan

On November 8, 2006, the Board approved a Deferred Revenue Plan, which seeks to stabilize members' rates for 2009 and as long as possible thereafter to mitigate the effects of expected increases in rates. The deferral of revenue for 2008 was determined at any amount above $10 million, after excluding earnings from the Nuclear Decommissioning Trust, and for 2007 was determined at 50 percent of the 2007 margin, after excluding earnings from the Nuclear Decommissioning Trust. At December 31, 2008 and 2007, deferred revenues associated with the Deferred Revenue Plan were $57,980,000 and $11,390,000, respectively.

Deferred Credit

With the establishment of a deferred tax asset to record the effect of the temporary differences related to net operating loss carryforwards, fixed asset basis, safe harbor lease treatment, gain on installment sale and financial statement accruals, the Cooperative established a deferred credit of $16 and $18 million for 2008 and 2007, respectively, under FASB No. 71, *Accounting for the Effects of Certain Types of Regulation*. The value of the deferred tax asset is considered in the rate making process as required by FASB No. 71.

Note 16: Government Regulations

The Energy Policy Act of 1992 established, among other things, a fund to pay for the decontamination and decommissioning of three nuclear enrichment facilities operated by DOE. A portion of the fund is to be collected from electric utilities that have purchased enrichment services from DOE and will be in the form of annual special assessments for a period not to exceed more than 15 years. The special assessments are based on a formula that takes into account the amount of enrichment services purchased by the utilities in past periods.

The Cooperative has previously recorded its share of the liability in connection with PPL's recognition of the liability in the accounts of SSES. The Cooperative's share of the liability is $4.4 million. The Cooperative recorded its share of the liability as a deferred charge which is being amortized to expense and paid over 15 years, consistent with the ratemaking treatment. The liability was fully amortized during 2007.

Note 17: Disclosures About Fair Value of Assets

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 has been applied prospectively as of the beginning of the year.

FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Nuclear Decommissioning Trust and Temporary Investments (Available-for-sale Securities)

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government bonds and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include certain collateralized mortgage and debt obligations and certain municipal securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and include auction rate securities.

Financial Transmission Rights

The fair value is estimated using inputs that are observable or that can be corroborated by observable market data and; therefore, are classified within Level 2 of the valuation hierarchy.

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The following table presents the fair value measurements of assets recognized in the accompanying consolidated balance sheet measured at fair value on a recurring basis and the level within the FAS 157 fair value hierarchy in which the fair value measurements fall at December 31, 2008:

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(In thousands)		
Available-for-sale securities				
Nuclear decommissioning trust	$ 53,732	$ 35,187	$ 18,545	$ -
Investments	54,568	16,874	33,616	4,078
Financial transmission rights	7,240	-	7,240	-

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying balance sheet using significant unobservable (Level 3) inputs:

	Debt Security (In thousands)
Balance, January 1, 2008	$ -
Total realized and unrealized gains and losses	
Included in net income	(422)
Included in other comprehensive income	-
Purchases, issuances and settlements	4,500
Transfers in and/or out of Level 3	-
Balance, December 31, 2008	$ 4,078
Total gains or losses for the period included in net income attributable to the change in unrealized gains or losses related to assets and liabilities still held at the reporting date	$ (422)

Allegheny Electric Cooperative, Inc.
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Realized and unrealized gains and losses included in net income for the period from January 1, 2008, through December 31, 2008, are reported in the consolidated statements of income as follows:

	Non-operating Margins Other Income (Expense)
Total gains and losses	$ (422,000)
Change in unrealized gains or losses relating to assets still held at the balance sheet date	-

The following methods were used to estimate the fair value of all other financial instruments not recognized in the accompanying balance sheet.

Cash and Cash Equivalents

The carrying amount approximates fair value.

Investments in Associated Organizations

Fair values of investments in associated organizations approximate their carrying amount.

Notes Receivable, Members

The carrying amount of the Cooperative's notes receivable from members, which primarily relate to sales-type leases, approximates fair value because the notes bear a variable rate of interest which is reset on a frequent basis.

Long-term Debt

The fair value of the Cooperative's fixed rate long-term debt is estimated using discounted cash flows based on current rates offered to the Cooperative for similar debt of the same remaining maturities.

The estimated fair values of the Company's financial instruments at December 31, 2008 and 2007 are as follows (in thousands):

	2008		2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Cash and cash equivalents	$ 21,876	$ 21,876	$ 36,474	$ 36,474
Investments	76,568	76,568	35,395	35,395
Other investments	53,732	53,732	60,858	60,858
Investment in associated organizations	17,733	17,733	24,833	24,833
Derivative investment	7,240	7,240	4,236	4,236
Notes receivable from members	-	-	5	5
Long-term debt	128,185	128,185	138,891	138,891

Note 18: Realty Taxes

The Cooperative's portion of local real estate taxes related to SSES are billed by and paid to PPL. The Cooperative is billed and pays directly to various local tax jurisdictions local real estate taxes on other property that is exclusively owned by the Cooperative.

Note 19: Variable Interest Entity

Continental Electric Cooperative Services, Inc. (CCS) is considered to be a variable interest entity and the Cooperative is determined to be the primary beneficiary of CCS. As such, the assets, liabilities, and results of operations have been consolidated into these financial statements. The general creditors of CCS have no recourse against the general credit of the Cooperative.

Note 20: Litigation Settlement

Effective May 16, 2008, the Cooperative executed a settlement agreement with Allegheny Power to resolve issues relating to a dispute over previous transmission charges. The execution of the settlement agreement resulted in the recognition of previously deferred revenue in the amount of $1,242,000.

Note 21: Current Economic Condition

The current economic environment presents electric cooperatives with unprecedented circumstances and challenges, which in some cases have resulted in large declines in the fair value of investments and other assets. The financial statements have been prepared using values and information currently available to the Cooperative.

Current economic conditions have put additional pressure on many cooperatives and affiliated organizations to meet their financing and liquidity needs. A significant decline in operating revenues could have an adverse impact on the Cooperative's future operating results.

In addition, given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change, resulting in material future adjustments in investment values, allowances for receivables, etc.

Note 22: Future Change in Accounting Principle

Statement of Financial Accounting Standards No. 161

Statement of Financial Accounting Standards No. 161 (FAS 161), Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133, applies to the Cooperative's financial statements for the year beginning January 1, 2009. FAS 161 amends and expands the disclosure requirements in FAS 133 about an entity's derivative instruments and hedging activities.

FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Upon adoption, entities are encouraged, but not required, to provide comparative disclosures for earlier periods. In years after initial adoption, entities must provide comparative disclosures only for periods after initial adoption.

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two thousand eight annual report