

Duke
Power
Company

1985
Annual
Report

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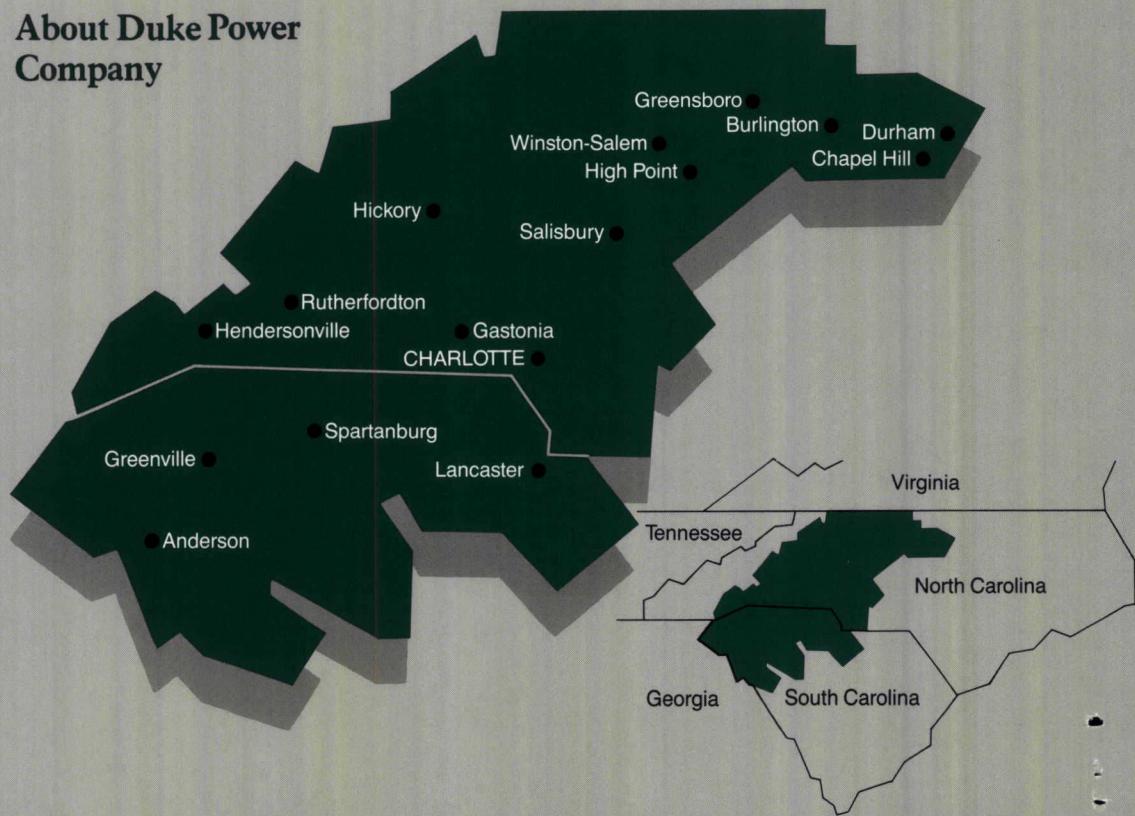
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About the Cover

Stands of virgin timber dominate the Coon Branch Natural Area along the White Water River in northwestern South Carolina. The land, purchased by the Company in 1910, is one of three natural areas permanently protected under long-term leases between Duke Power and the Society of American Foresters. Land preservation is one facet of Duke Power's tradition of environmental stewardship, described in a special section beginning on page 13.

About Duke Power Company



Duke Power is the seventh largest investor-owned electric utility in the nation, with a 20,000-square-mile service area in North Carolina and South Carolina. Duke's three nuclear stations, eight coal-fired plants and 26 hydroelectric facilities provide electricity to more than 1.4 million customers.

Duke's retail customers are served through

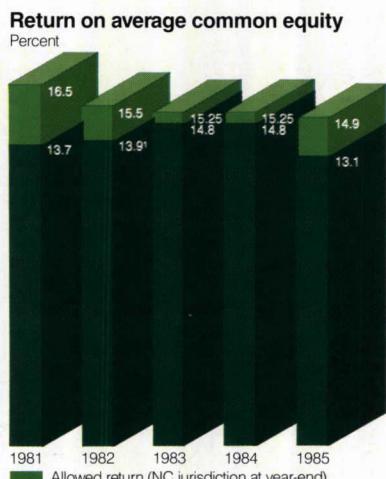
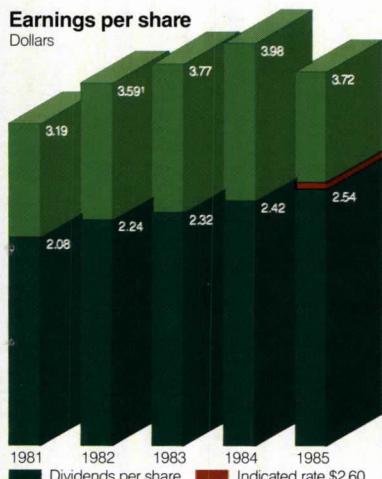
96 district and branch offices. The Company also sells electricity at wholesale and contractual rates to bulk users.

Sales totaled 56.1 billion kilowatt-hours in 1985, with approximately 70 percent derived from North Carolina and 30 percent from South Carolina. Revenues totaled \$2.9 billion.

Duke is headquartered in Charlotte, N.C.

Financial Highlights

	1985	1984	Percent increase (decrease)
Kilowatt-hour sales	56,058,479,000	54,399,254,000	3.0
Electric revenues	\$2,898,911,000	\$2,710,015,000	7.0
Earnings for common stock	\$ 376,681,000	\$ 399,545,000	(5.7)
Common Stock Data			
Average shares outstanding	101,178,000	100,346,000	0.8
Earnings per share	\$3.72	\$3.98	(6.5)
Dividends per share	\$2.54	\$2.42	5.0
Book value per share (year-end)	\$28.98	\$27.80	4.2
Return on average common equity	13.1%	14.8%	(11.5)
Plant construction costs	\$ 657,172,000	\$ 644,754,000	1.9
Total electric plant, net	\$6,392,161,000	\$6,152,618,000	3.9
Peak load (Kw)			
Summer	11,204,000	11,043,000	1.5
Winter	12,687,000	10,863,000	16.8



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and Officers



William S. Lee

Douglas W. Booth

To Our Shareholders:

Duke Power faced major challenges in 1985, while at the same time achieving a number of long-sought goals. First, the challenges.

- Earnings per share of common stock decreased to \$3.72 from \$3.98 in 1984 — the first decline in 10 years.
- Completion of Unit 1 of Catawba Nuclear Station required the Company to ask for substantial increases in rates to its customers.
- Kilowatt-hour sales to textile customers declined 2 percent, reflecting the severe pressure of imports on that industry.
- Several hundred employees were laid off as our nuclear construction program neared completion.
- The Company continued to carry canceled nuclear plants as non-earning assets, and we earned returns substantially below our cost of capital on financial investments.
- Efforts to repeal the outdated Public Utilities Holding Company Act and to modify certain provisions of the Federal Power Act met stiff resistance in Congress.

We are acting vigorously to deal with those challenges within our control and to shape those others outside the Company's direct control, all in the interests of our shareholders and customers.

Earnings Per Share Decrease

The 6.5 percent decrease in earnings per share resulted from a combination of factors: higher maintenance costs, reduced nuclear performance, a larger investment in low-yielding securities, and lower-than-projected kilowatt-hour sales.

The increase in maintenance costs reflects more extensive maintenance requirements at some of our older plants as well as the addition of new plants. Those costs are not yet fully reflected in rates.

While our nuclear units performed well by industry standards in 1985, they fell short of their record performance of 1984. The difference had a significant impact on year-to-year earnings results.

Following the December 1984 sale of a portion of Unit 1 of the Catawba Nuclear Sta-

tion, our investment in generating plants was substantially reduced. The funds received from that sale have been invested in securities that offer a lower return than capital invested in generating plants. Eventually this money will be used for utility projects or diversified business opportunities.

In addition to the decline in sales to textile customers, sales to residential customers fell slightly, reflecting unseasonably mild weather. Total kilowatt-hour sales, including electricity supplied to joint owners of the Catawba Nuclear Station, rose 1.7 percent in 1985.

Earnings from subsidiaries, other non-utility businesses and investment income contributed 54 cents to earnings per share, up 22.7 percent from 44 cents in 1984.

Total return on average common equity decreased to 13.1 percent, compared with 14.8 percent in 1984.

Both return on equity and earnings per share have been negatively affected during the past few years because we have not been allowed to recover carrying costs on the unamortized portion of our investment in the canceled Cherokee and Perkins nuclear stations.

Key Rate Increases Granted

This year of difficult challenges was also marked by several landmark successes. In two of the most important rate cases the Company has ever filed, we were granted rate increases in both North Carolina and South Carolina to cover all our costs for Catawba Unit 1.

Although some of these costs are being recovered on a levelized basis, receiving fair treatment on this initial Catawba rate case was especially important to the Company's long-term financial health.

Despite strong opposition from intervenors, regulatory commissions determined that our decision to build Catawba was prudent and that the unit's generation is needed to meet the expanding energy needs of the Piedmont Carolinas. The commissions also ruled that the Company's decision to sell portions of the plant to groups of municipal and electric cooperative customers was in the best interest of all Duke Power customers.

The Company plans to file this spring for rate increases to reflect commercial operation of Catawba Unit 2.

Catawba Begins Operation

Along with the rate increases, the year's most notable accomplishment was the commercial operation of Catawba Unit 1.

We're proud to report that we brought the 1,145,000-kilowatt unit into service on June 29 at the lowest cost per kilowatt of any initial unit of a nuclear plant of similar vintage in the nation.

This achievement is particularly gratifying in view of the difficult economic and regulatory conditions we faced during the decade of its construction.

As Catawba Unit 1 was starting commercial service, Catawba Unit 2 was undergoing hot functional testing, which simulates operating conditions. The testing was completed in October, and uranium fuel is expected to be loaded into the reactor in the spring of 1986.

Unit 2 is expected to generate its first electricity during testing this summer and could begin commercial operation as early as this fall.

Completion of Catawba Unit 2 will mark the end of one of the largest and most successful nuclear plant construction programs in the nation. The course we began in 1967 with our first Oconee unit proved to be more difficult than we expected, but we met the challenges and succeeded even in the face of ever-changing regulations and near-crippling inflation.

Although completion of our nuclear construction is good news for shareholders and customers, it did require us to lay off several hundred of our experienced, highly skilled construction employees. Fortunately, we were able to place nearly 300 others in available Company positions through the end of 1985.

Other Challenges

The Company and the entire electric utility industry face several political challenges that eluded resolution in 1985.

We were unable to persuade Congress to repeal the Public Utilities Holding Company

Act of 1935, which we feel significantly impairs the flexibility of holding companies and their subsidiaries operating in more than one state. The abuses the act originally addressed are now controlled by other, more effective means.

Congress also failed to modify provisions of the Federal Power Act, which in some circumstances give preference for hydroelectric licenses to public entities, such as municipalities, over investor-owned utilities. The provisions would deny the customers of investor-owned utilities access to low-cost hydroelectric power when the licenses come up for renewal.

We will continue to work in support of these changes, because they would benefit both our customers and our investors.

Congress did pass legislation in late December that set a schedule for states to build regional sites for the disposal of low-level radioactive waste. The new law assures the Company continued access to its current disposal site in South Carolina and provides for a new regional site by 1993.

Duke Power faces another challenge in increasingly fierce competition from natural gas utilities. The Company's share of new residential space and water heating connections declined to approximately 55 percent and 80 percent, respectively, in 1985. Duke has stepped up efforts to increase its penetration in these markets.

Employees Earn Awards

As we worked to meet the challenges of 1985, our employees were recognized for outstanding performance in several areas. Chief among these honors was the Edison Electric Institute's 1984 Edison Award — our industry's highest honor. The award cited Duke for excellence in nuclear plant design, construction and operation, along with our effective Power in Citizenship voter-awareness campaign.

The Edison Award is given each year for a "distinguished contribution to the develop-

ment of the electric light and power industry for the convenience of the public and the benefit of all." It is the second time in our history we have won this special honor.

Winning the Edison Award is a tribute to our 20,000 employees. Their expertise and dedication are unsurpassed.

Employee excellence also earned one of the nation's highest awards for environmental protection — a 1984 Conservation Achievement Award from the National Wildlife Federation, the country's largest conservation organization.

The Federation called the Company's environmental staff and programs among the best in America. Our long-standing commitment to environmental stewardship is the focus of a special section of this year's report, beginning on page 13.

These awards, along with continuing efficiency records in building and operating our generating facilities, result from the outstanding performance of members of the Duke Power team.

Finally, we would like to welcome Dr. Robert Albright, president of Johnson C. Smith University, to the Board of Directors. His abilities as an educator, administrator and civic leader will provide an important contribution to the Company.

Thank you for your continued support. Let us hear from you if you have questions about your Company.



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



Douglas W. Booth
*President and
Chief Operating Officer*

February 14, 1986



For the second time in its history, Duke Power won the Edison Award, the electric utility industry's highest honor. The award, presented by the Edison Electric Institute, praised Duke for excellence in the design, construction, and operation of nuclear power plants and for its successful voter-awareness program, Power In Citizenship.

Year In Review

Financial Results

Earnings per share of common stock decreased 6.5 percent to \$3.72 in 1985 from \$3.98 in 1984. Total earnings for common stock were \$376.7 million, down from \$399.5 million.

The decline in earnings resulted primarily from higher maintenance costs, reduced nuclear performance, a larger investment in low-yielding securities and lower-than-projected kilowatt-hour sales.

Earnings from subsidiaries, other non-utility businesses and investment income contributed \$54.2 million to total earnings, compared with \$44.2 million in 1984.

Total return on common equity decreased to 13.1 percent, down from 14.8 percent.

Earnings coverage of fixed charges decreased to 3.87 times from 4.21 in 1984, slipping below the Company's goal of four times.

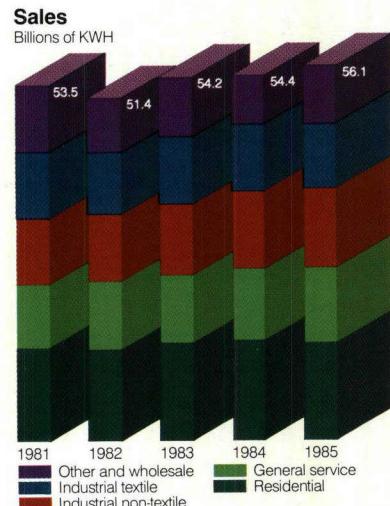
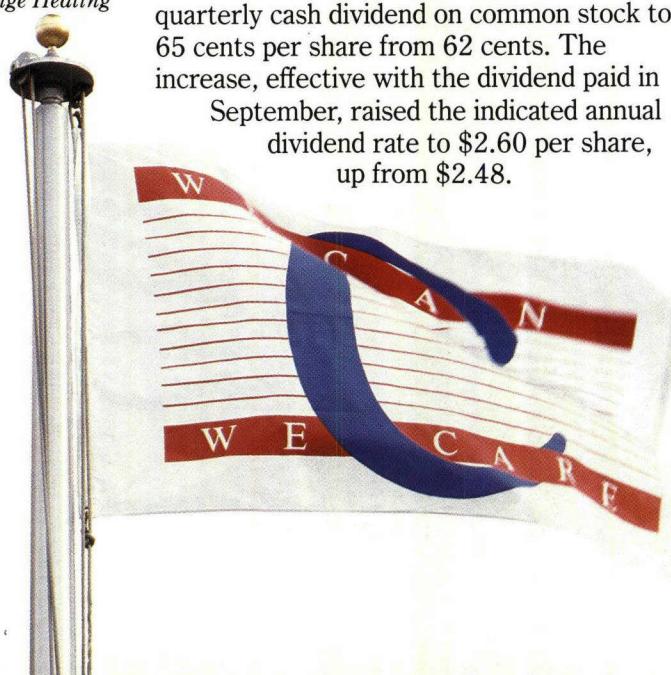
Duke generated 62 percent of its capital requirements internally in 1985. The Company's goal is to fund 50 percent or more of capital needs from internal sources.

At year-end Duke's capital structure consisted of 43 percent long-term debt, 11 percent preferred and preference stocks, and 46 percent common equity. This ratio is consistent with Company goals.

In July the Board of Directors raised the quarterly cash dividend on common stock to 65 cents per share from 62 cents. The increase, effective with the dividend paid in

September, raised the indicated annual dividend rate to \$2.60 per share, up from \$2.48.

"We Can, We Care" are the words inscribed on the "C" flag, presented by President Reagan in recognition of Duke Power's "exceptional contributions to volunteerism" through its Low-Income Weatherization and Community Challenge Heating Fund programs.



Duke has increased its quarterly cash dividend for 10 consecutive years. The Company's practice is to raise the dividend regularly and maintain a payout ratio of about 65 percent.

Financial Statements and Notes begin on page 22.

Sales and Customers

Total kilowatt-hour sales, including electricity supplied to joint owners of the Catawba Nuclear Station, rose 1.7 percent in 1985.

Sales excluding certain portions of the transactions with the joint owners of Catawba totaled 56.1 billion kilowatt-hours, compared with 54.4 billion in 1984. However, sales to the Company's retail and wholesale customers were essentially flat.

Sales to general service and non-textile industrial customers increased 3.8 percent and 1.9 percent, respectively, reflecting continued economic expansion in the Piedmont Carolinas. Residential sales decreased 1.7 percent because of mild weather.

Sales to textile customers dropped 2 percent. The decrease reflects plant closings and production cutbacks forced on that industry by pressure from textile imports.

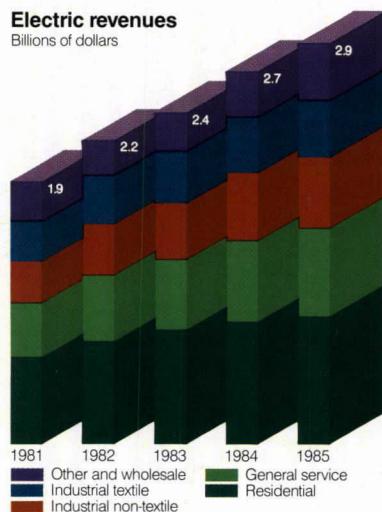
Wholesale and other energy sales rose 21 percent.

Of the Company's total kilowatt-hour sales in 1985, residential customers accounted for 25 percent, general service customers 20

percent, non-textile industrial customers 21 percent and textile customers 18 percent. Wholesale and other energy sales accounted for the remaining 16 percent.

More than 43,700 customers were added to the Duke system in 1985 — the largest annual increase in 20 years. As of December 31 Duke served more than 1.4 million customers, up 3.1 percent over a year ago.

For additional information on sales and customers, see page 40.



Rates and Regulation

Utilities commissions in both North Carolina and South Carolina approved increases in the Company's retail electric rates in 1985, primarily to cover commercial operation of Unit 1 of the Catawba Nuclear Station.

The North Carolina Utilities Commission granted a 9.1 percent, or \$157.7 million, increase effective September 17. The commission allowed the Company the opportunity to earn a 14.9 percent rate of return on common equity.

On October 8 The Public Service Commission of South Carolina approved a 10.75 percent, or \$78.4 million, increase with a 14.75 percent rate of return.

In each case the commissions allowed the Company to recover all costs associated with Catawba Unit 1, although some costs will be recovered on a leveled basis. Duke's 12.5 percent ownership interest in Catawba was

included in rate base. The Company was permitted to recover, over the next 7½ years in South Carolina and 15 years in North Carolina, certain costs of power purchased from other Catawba owners.

Some of the intervenors in the North Carolina rate case have appealed parts of that commission's decision to the North Carolina Supreme Court.

Duke originally requested a 19.65 percent, or \$340 million, increase in North Carolina with a return on common equity of 16.25 percent. The Company subsequently revised its request to 16.9 percent, or \$293 million, lowering the requested return to 15.25 percent in light of a decline in interest rates. The revised request also reflected adjustments for the actual commercial operation date of Catawba Unit 1.

The Company had sought a 19.87 percent, or \$143 million, increase in South Carolina with a return on common equity of 16.25 percent. This was later adjusted to 17.3 percent, or \$124.5 million, with a 15.25 percent return.

In each state the Company had requested recovery of all costs of Catawba Unit 1 without levelization.

Retail rate increase requests will be filed in both North Carolina and South Carolina in the spring of 1986 to reflect commercial operation of Catawba Unit 2.

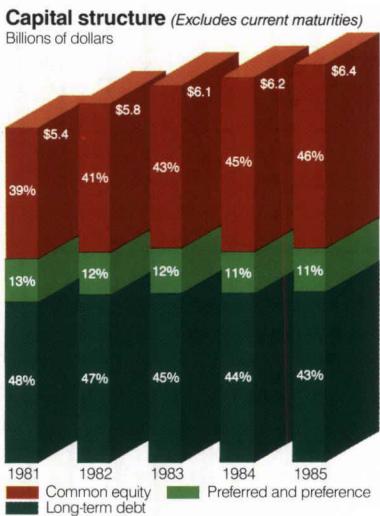
See Note 2 on page 27 for additional information.

Financing

For the third consecutive year, Duke marketed no new offerings of common stock in 1985, and no sales of any kind are planned for the near future.

Taking advantage of lower interest rates, Duke issued \$125 million of new bonds in April and used part of the proceeds to refund the entire \$100 million of its 14½ percent bonds due in 2010. The new bonds carry a 12½ percent interest rate and mature in 2015. Replacing the old bonds will result in approximately \$23 million in savings for the Company's customers over the next 25 years.

The remainder of the proceeds was used in connection with the March retirement of 14½

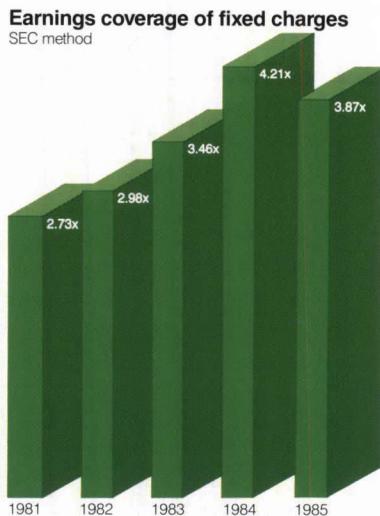


percent bonds due in 1987.

In December the Company issued \$50 million of 10½ percent bonds due in 2015. The proceeds were used in January 1986 to refund the entire \$50 million of outstanding 13½ percent bonds due in 2010. Replacing the 13½ percent bonds with 10½ percent bonds will save the Company's customers approximately \$23 million over the next 25 years.

Duke may issue additional long-term debt over the next several years in order to retire other high-interest issues, if market conditions permit.

See pages 39 and 40 for additional information.



Construction

Duke Power moved within a step of completing its nuclear plant construction program in 1985.

Unit 1 of the Catawba Nuclear Station, located in York County, S.C., began commercial operation in June after more than 11 years of construction.

At Catawba Unit 2, Duke completed hot functional testing, which simulates operating conditions. Fuel is expected to be loaded into the reactor this spring. Pending licensing by the Nuclear Regulatory Commission, the unit is expected to begin commercial operation in the fall of 1986.

In January 1986 the Company announced a \$163 million reduction in the estimated cost of the two Catawba units. The 2,290,000-kilowatt plant is expected to be completed at a cost of \$1,632 per kilowatt, down from an earlier projection of \$1,703. Catawba will be the nation's lowest-cost nuclear station to be completed in 1986.

Work on Bad Creek Hydroelectric Station, located just above Lake Jocassee in Oconee County, S.C., was about 7.3 percent complete at year-end. Units 1 and 2 of the four-unit, 1,000,000-kilowatt, pumped-storage facility are scheduled for operation in 1991. Units 3 and 4 are slated for service in 1992.

Pumped-storage hydro plants pump water from a lower reservoir to an upper reservoir at night and on weekends to generate power at times of peak electric demand.

Generation and Capacity

Duke Power generated more than half of its electricity with nuclear power in 1985 for the second consecutive year.

Nuclear units produced 54 percent of total system generation, the same as in 1984.

Duke's network of eight coal-fired stations produced 44 percent of the Company's power, up from 43 percent in 1984. Hydroelectric plants and combustion turbine units supplied 2 percent of total generation, down from 3 percent.

Catawba Unit 1 contributed 4.3 billion kilowatt-hours of electricity to total generation this past year. The 1,145,000-kilowatt unit generated its first electricity during testing

January 22, 1985,
and began com-
mercial operation
June 29.



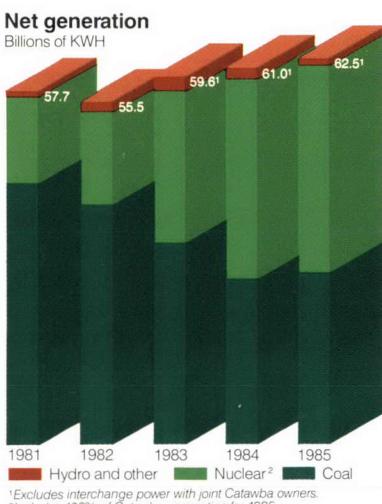
Although Duke's nuclear system did not operate at 1984's record levels, its performance in 1985 continued to outpace the industry average. The six-reactor system achieved an overall capacity factor of 68 percent, down from 76 percent, but well above the industry average of approximately 60 percent.

(Capacity factor refers to the amount of electricity a unit produces in relation to the amount it theoretically could produce if operated at full power without interruption.)

Oconee Nuclear Station led all Duke nuclear stations with a 75 percent capacity factor. Oconee Unit 1 led all individual units with a capacity factor of 94 percent.

Oconee Unit 2 completed a world-record run of 439 consecutive days of operation on February 21, 1985. The 860,000-kilowatt unit generated more than 8.6 billion kilowatt-hours of electricity during the period.

Duke Power's generating capacity as of December 31, 1985, totaled 14,739,000 kilowatts. It consisted of 6,603,000 kilowatts of coal-fired capability, 6,085,000 kilowatts of nuclear power, 1,452,000 kilowatts of hydroelectric power and 599,000 kilowatts of combustion turbine units. Coal-fired units represented 45 percent of total capacity, nuclear units 41 percent, hydroelectric plants 10 percent and combustion turbines 4 percent.



Generating Efficiency

Duke Power operated the most efficient coal-fired electric generating system in the nation again in 1984, according to *Electric Light & Power* magazine's most recent survey of the country's 100 largest investor-owned electric utilities.

The Company's network of eight coal-fired power plants has ranked first in efficiency in the annual survey 13 of the past 15 years.

Unit 3 of Duke's Marshall Steam Station was named the nation's most efficient individual coal unit for the second consecutive year. Six of the Company's coal units placed among the top nine in the survey of more than 2,000 units.

If Duke's coal-fired generating system had operated at the average efficiency of the systems surveyed, fuel costs would have been \$76 million higher in 1984.

Marshall, Duke's second largest coal-fired power plant, celebrated its 20th anniversary in 1985. The four-unit, 2,030,000-kilowatt station has led the nation in generating efficiency 13 times in its history, placing second five times and third twice. It has generated more than 215 billion kilowatt-hours of electricity.

Duke's McGuire and Oconee nuclear stations ranked as the two most fuel-efficient nuclear stations in the nation in 1984, according to data published by the Nuclear Regulatory Commission.

Rated individually, the Company's five operating nuclear units placed among the eight most efficient units in the country.

If Duke's nuclear system had operated at the average efficiency of all nuclear systems in the United States in 1984, fuel costs would have been approximately \$48 million higher.

Peak Demand/Energy Management

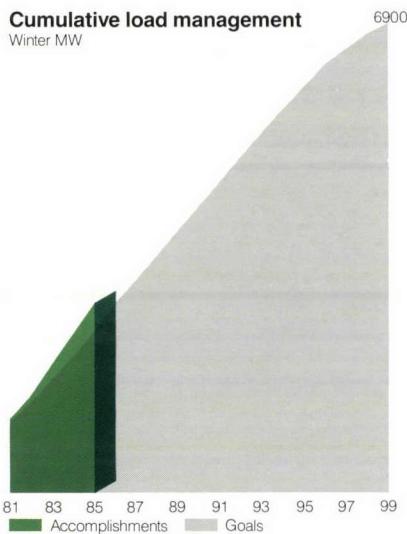
Customer demand on Duke's generating system hit an all-time peak of 12,687,000 kilowatts on January 21, 1985, when record cold temperatures chilled the Carolinas.

Babcock and Wilcox, manufacturer of the nuclear steam system at Oconee Nuclear Station, presented Duke Power with a gold clock in honor of the world record set by Oconee Unit 2 in early 1985 for 439 days of uninterrupted operation.



For the 11th consecutive year, Duke's coal-fired generating system was ranked first in the nation in fuel efficiency.

The new peak was 9.8 percent above the previous all-time peak of 11,554,000 kilowatts set August 23, 1983, and 16.8 percent above the 1984 winter peak of 10,863,000 kilowatts.



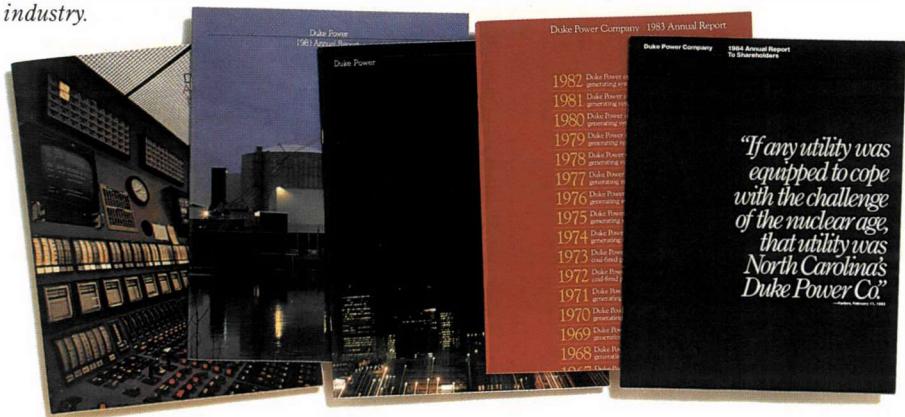
The Company hit its summer peak for 1985, 11,204,000 kilowatts, on September 10. This was 1.5 percent above the 1984 summer peak of 11,043,000 kilowatts.

Although an all-time peak was set in 1985, efforts to curtail growth in peak demand continued to surpass Company targets.

Through energy management and conservation programs, the Company cut the growth of summer peak demand by 384,000 kilowatts and winter peak demand by 487,000 kilowatts in 1985.

Since its inception in 1976, Duke's energy management program has reduced summer peak by 2.2 million kilowatts and winter peak by 2.8 million kilowatts. The Company's goal is to reduce summer peak by 5.4 million kilo-

Over the past five years, Duke Power's annual reports to shareholders have been honored as among the best in the utility industry.



watts and winter peak by 6.9 million kilowatts by the year 2000.

Employee Incentive Program

Duke's 20,000 employees achieved six of 10 goals in the Employee Incentive Goals Program in 1985, saving the Company and its customers millions of dollars.

In addition to a cost-reduction bonus goal, employees met or surpassed targets in power plant design and construction, coal-fired generating efficiency, affirmative action, energy management and personal health.

Since the program began in 1981, employees have achieved 42 of 52 corporate goals — a success rate of greater than 80 percent.

The Company bases additional contributions to the Stock Purchase Savings Program for Employees on the number of goals achieved.

Ten new incentive goals, plus a bonus goal for cost reduction, have been set for 1986.



Investor Plans

The Company developed two new services in 1985 for its shareholders: Direct Deposit of Cash Dividends and the Small Shares Repurchase Service.

All shareholders will be contacted by mid-summer and given the opportunity to sign up for Direct Deposit of Cash Dividends. Through the service, dividend payments will be automatically credited to checking, savings or money market accounts the same day the dividend is paid.

Small Shares Repurchase began in January 1986 and is available to shareholders owning fewer than 50 shares of common stock. The service ensures that eligible shareholders who wish to sell their holdings may do so without paying brokerage fees that otherwise might make such sales uneconomical.

To increase regional ownership of its common stock, the Company will begin promoting its Customer Stock Purchase Plan again this

spring. The promotion effort will continue throughout the year.

More than 6,700 Duke Power customers bought shares through the plan in 1985, investing more than \$4.5 million in the Company.

At year-end 23 percent of common shareholders and 11 percent of preferred shareholders were participating in the Dividend Reinvestment Plan, investing an additional \$24 million during the year.

Duke provided shares of common stock for all its investor plans in 1985 through stock market purchases.

As a result, dividends invested in additional shares of common stock through the Dividend Reinvestment and Stock Purchase Plan and the Customer Stock Purchase Plan no longer qualified for federal income tax deferral after January 1, 1985.

The Company is continuing to pay all commissions and administrative costs of its investor plans.

- Shares for various employee stock plans have been provided through stock market purchases since 1983. By purchasing shares in the stock market for all investor programs, the Company avoided issuing nearly 3 million new shares in 1985.

Community Service

Duke Power introduced a second program in 1985 to raise money to help low-income families pay winter heating bills. Through the program, called Share the Warmth, the Company included in electric bills a one-time appeal for customer donations.

Duke shareholders matched individual donations up to an overall total of \$400,000. Customer and Company contributions together made more than \$652,000 available for home heating assistance.

The new program was a companion to Duke's four-year-old Community Challenge Heating Fund, which matches money raised by various service organizations systemwide. The Company doubled its contribution to that fund for the winter of 1985-86 to \$300,000. By pledging \$1 for every \$3 donated by other sources, the Company would help make up to an additional \$1.2 million available.

In 1985 Duke Power and its employees contributed more than \$2.7 million to United Way through local campaigns across the service area. This made the Duke Power team the largest single contributor in North Carolina and South Carolina for the second year in a row.

Duke's extensive community service efforts earned it special recognition from the President of the United States in 1985.

President Reagan presented the Company with a commendation from his Citation Program for Private Sector Initiatives at White House ceremonies June 14. The award honored Duke for "exceptional contributions to volunteerism," specifically its Low-Income Weatherization Program and its Community Challenge Heating Fund.

As part of the award, the Company received "C" flags, which stand for "We Can" and "We Care," to fly over its facilities.

Duke was also recognized for contributions to education and the arts. Both North Carolina and South Carolina honored the Company for its Power in Education program, a comprehensive effort to marshal the resources of business and industry to support public education in the Carolinas.

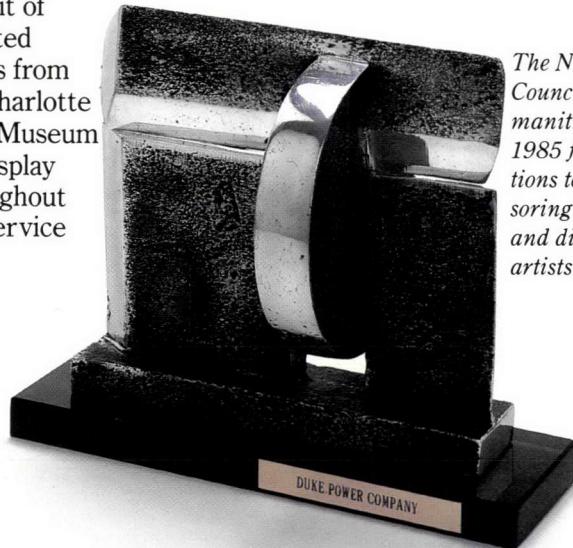
The program is building a systemwide coalition between business and education with Duke serving as the catalyst.

The North Carolina Governor's Award in the Arts and the Humanities was presented to Duke for exhibiting the works of local artists in its offices and for organizing a traveling exhibit of selected

works from the Charlotte Mint Museum for display throughout the service area.



Duke employees led all other groups in North Carolina and South Carolina in 1985 for United Way contributions and frequently top the rolls of Red Cross blood donors.



The N.C. Governor's Business Council on the Arts and Humanities recognized Duke in 1985 for exceptional contributions to the arts, including sponsoring a traveling art exhibit and displaying works of local artists in Company offices.

Subsidiaries/Unregulated Businesses

Duke Power's subsidiaries and other unregulated businesses continued to expand their activities in 1985.

Duke's Management and Technical Services (MATS) organization, formed in 1982 to market engineering, construction and other services to outside companies, worked on 106 projects for 53 clients in 1985. Major projects included designing a low-level radioactive waste treatment facility, designing cogeneration plants and modernizing a hydroelectric station.

Crescent Land & Timber Corp.

MATS was also awarded a \$13 million contract to design an experimental coal-fired boiler for a joint demonstration project sponsored by Duke, the Tennessee Valley Authority, the Electric Power Research Institute and others.

MATS has nearly 400,000 hours of work contracted for 1986 and 1987. The organization completed more than 280,000 work hours in 1985.

Duke formed a new wholly owned subsidiary, Church Street Capital Corp., in 1985 to make intermediate-term investments with funds earmarked for future utility projects or diversified business opportunities.

The funds were primarily derived from depreciation of generating plants and the sale of a portion of the Catawba Nuclear Station.

Crescent Land & Timber Corp., Duke's land management subsidiary, embarked on additional development projects in 1985,

including a joint venture to build a \$4.5 million Holiday Inn north of Charlotte, N.C. Crescent also completed a 100,000-square-foot, "build-to-suit" facility at its Greenway Industrial Park south of Charlotte.

Established in 1969 to manage approximately 270,000 acres of Duke's non-utility property, Crescent is a major supplier of timber for furniture, home-building and paper industries in the Piedmont Carolinas. The company harvested 38.5 million board feet of timber and 72,900 cords of pulpwood and planted 3.5 million seedlings in 1985.

Mill-Power Supply Company's Sales Division, one of the largest electrical wholesale distributors in the Southeast, continued its growth in the high-technology market by opening a 10,000-square-foot industrial computer training and display center for its Mill-Power Technologies Department. Formed in 1984, Technologies' product lines include energy management equipment, programmable controllers, and computer equipment and systems.

Mill-Power's Sales Division, with headquarters and warehouse facilities in Charlotte, N.C., also operates distribution centers in Greensboro, N.C., Greenville, S.C., and Lancaster, S.C., and sales offices in Hickory, N.C., and Kinston, N.C.

Established in 1910 to supply equipment to textile mills and other industries converting to electricity, Mill-Power also acts as Duke Power's purchasing agent. In 1985 the subsidiary's purchasing division purchased approximately \$1 billion in equipment, fuel, supplies and services for Duke.

Protecting the Environment: When Good Citizenship Is Good Business



Fragile, beautiful, and endangered, the whooping crane is the symbol of the Conservation Achievement Award presented to Duke Power by the National Wildlife Federation. Duke's commitment to protecting the environment is highlighted in a special feature, which begins on the following page.



More than 60 years ago Duke Power became one of the nation's first electric utilities to establish its own environmental program. Today the Company is still proving that an electric utility can fulfill its mandate to provide electricity at all times to everyone who needs it without upsetting the intricate work of nature.

Duke invests in the environment because it's good business as well as good citizenship. The rewards include power plants that operate cleanly and efficiently, a quality of life that encourages economic development in the service area, and the satisfaction of helping preserve the Piedmont Carolinas as a good place to live, to work and to play.

Duke inherited its commitment to environmental stewardship from its founders, including James B. Duke, who believed that a healthy environment helps attract new customers and keep old customers satisfied. The Company's first environmental program was launched in 1923 when a renowned public health expert was hired to battle mosquitoes on Duke Power lakes.

Duke now has a staff of more than 175 environmental scientists, technicians and engineers whose full-time job is to monitor and safeguard the air, water and other natural resources surrounding the Company's 37 generating plants. They also conduct environmental impact studies for future facilities. To carry out this mission, Duke Power has invested in the finest available chemical, biological, and physical and health science laboratories — all housed at the Company's Applied Science Center just north of Charlotte, N.C.

The Company's goal is to set standards of excellence in environmental stewardship that often go beyond regulatory requirements.

Duke's environmental activities have earned the respect of North Carolina and South Carolina conservation agencies. The Company also won national recognition in 1985 when the National Wildlife Federation honored Duke's efforts with a Conservation Achievement Award, one of the highest honors for environmental protection and the first the Federation has ever awarded to a corporation for its overall environmental program.

The 4 million-member conservation organization, the nation's largest, described Duke's



program as "an acknowledged national role model for environmental responsibility in the private sector." The Federation also credited Duke for assembling "the largest and best in-house environmental staff among the nation's electric utilities."

The knowledge Duke has accumulated through its environmental work has saved the Company millions of dollars in the construction and operation of its power plants. Duke has found many times over that conserving natural resources also conserves financial resources.

Enhancing the Environment by Design

Duke Power's Keowee-Toxaway Complex in northwestern South Carolina exemplifies the Company's ability to wed ecology with economy. The Company put its environmental know-how to work at Keowee-Toxaway to create one of the world's most efficient energy production areas. Duke's understanding of reservoir dynamics made it possible to plan in advance the combination of three hydroelectric stations and a cooling water reservoir into one generating complex. At the same time, the Company developed one of the most scenic recreation areas in the Carolinas.

Keowee-Toxaway, designed and built by Duke's own work force, includes the Oconee Nuclear Station and the Jocassee and Keowee hydroelectric stations. When the third hydro station, Bad Creek, is completed in the 1990s, the complex will be capable of producing more than 4,330,000 kilowatts of electricity.

Duke's environmental expertise not only made possible the construction of this finely tuned network of power plants, but also helped the Company meet a



A long-exposure photograph capturing the movement of water over large, moss-covered rocks in a forest stream. The water appears as soft, white, flowing strokes between the dark, textured stones. Sunlight filters through the surrounding trees, creating bright highlights and deep shadows. The overall scene is one of natural beauty and tranquility.

*From its founding,
Duke Power has
striven to preserve
the natural beauty
of the Piedmont
Carolina's while
providing the re-
gion with the elec-
tricity that pow-
ered an economic
transformation.*



series of challenges that arose during nearly 20 years of construction. In some instances, actions taken to protect the environment produced direct cost savings.

For example, Duke scientists carrying out field studies found a rare species of wildflower: the Oconee bell. To preserve the flower's habitat, Duke cleared only the tops of hills for transmission towers, leaving undisturbed the lush, green mountain glens where the Oconee bell flourishes. While saving the flowers, the approach also saved the Company \$73,000 in clearing costs.

Duke's efforts to preserve temperature patterns in Lake Jocassee that allow both trout and black bass to thrive also helped solve a construction problem: what to do with rock excavated from the Bad Creek project. The rock is being used to build an underwater dam, or weir, in one arm of Lake Jocassee. The weir will help protect Jocassee's record-sized brown trout from damaging changes in temperature and water flow in its cold-water habitat deep in the lake, while allowing largemouth and smallmouth bass, crappie and other fish to live in warmer layers of water above.

Duke Power not only protected the natural resources of the Keowee-Toxaway region, but also enhanced them.

As part of the Keowee-Toxaway project, Duke built a 43-mile segment of the Foothills Trail, which offers hikers a spectacular view of Whitewater Falls, the highest cascade in the Eastern United States. Winding through more than 60,000 acres of timberland and natural wilderness, the trail features carefully engineered suspension bridges spanning deep ravines and well-stocked trout streams. The

trail also offers camp sites, lake access areas and a specially designed two-mile section for the handicapped.

Thousands of hikers, boaters, hunters and fishermen are drawn to the area each year to enjoy more than 25,000 acres of Duke's man-made lakes and hundreds of miles of unspoiled forests.

Duke gave the same attention to the environment in 1963 when it



created the largest body of fresh water in North Carolina: Lake Norman, near Charlotte, N.C. The 32,500-acre lake powers the Cowans Ford Hydroelectric Station and also provides cooling water to the Marshall Steam Station and McGuire Nuclear Station.

Lake Norman has become a major economic asset for the four counties that border it. In less than a quarter of a century, the beauty of the lake's 520 miles of shoreline has attracted a year-round community of almost 25,000 residents. On any given weekend, sailors race in colorful regattas and drop anchor in secluded coves. And each year thousands of fishermen are attracted to the lake by the prospect of netting one of the lake's renowned striped bass, stocked each year by

the North Carolina Wildlife Commission.



Preserving Through Efficiency

Not only has Duke Power designed and built a network of power plants with the environment in mind, but it also operates those plants to minimize their impact on nature. In operations, as with design and construction, Duke's environmental expertise has been a major factor in making the Company's plants more efficient and economical.

Duke's understanding of the aquatic environment of its lakes has produced improvements in power plant performance that save millions of dollars in fuel costs each year. That same understanding allows Duke to protect the habitat of the 75 species of fish that live in the 24 lakes across its system.

Duke engineers took advantage of water temperature patterns in Lake Norman and Lake Keowee, for instance, to design "skimmer walls" for the Marshall Steam Station and Oconee Nuclear Station, allowing the



Duke not only protects the natural resources of its service area, it also enhances them by creating recreational opportunities such as its 43-mile segment of the Foothills Trail along the North Carolina-South Carolina border.



plants to draw cooling water from the bottom of the lakes. The cold bottom water increases the fuel efficiency of the plants.

Skimmer walls also minimize the thermal effects of using lake water for plant cooling, protecting delicate aquatic life. Water drawn into the plant for cooling is heated in the process, and using cold bottom water keeps the temperature of the water returned to the lake as low as possible. The warm water around the discharge from the plant also encourages winter production of the threadfin shad on which bass feed.

Duke's ability to manage the water temperature in its lakes convinced federal officials to allow the Company to operate McGuire Nuclear Station without cooling towers — saving an estimated \$193 million in capital and operating costs over the life of the plant. Duke environmentalists studied water patterns for nine years to demonstrate that McGuire could use Lake Norman as a source of cooling water without interfering with aquatic life.

The Company manages not only water temperatures to protect the lakes' environment, but also water levels. Duke administers a lake-level stabilization program at five of its lakes to enhance the spawning activity of important gamefish such as largemouth bass. The program minimizes shifts in lake levels until the peak spawning period is over.

While the Company's environmental knowledge has enhanced the efficiency of its plants, that efficiency in turn has played a major role in protecting the environment.

The unprecedented efficiency of Duke's eight coal-fired plants has not only saved millions of dollars in fuel costs, but has also helped keep the Carolinas' air clean. By squeezing the most energy from each ton of

coal it burns, Duke limits two of the major by-products of coal-fired generation: sulfur dioxide and fly ash.

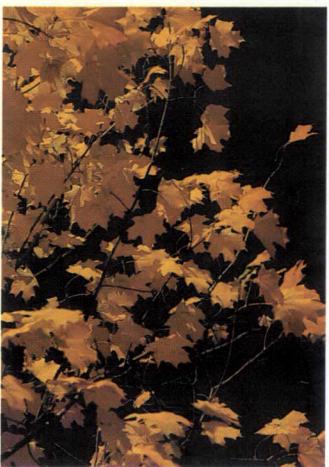
Duke Power also burns low-sulfur coal, maintaining one of the lowest sulfur emission rates per kilowatt of electricity of any utility in the nation. Through these efforts, the Company has been able to avoid the expense of installing scrubbers to control sulfur-dioxide emissions.

Electrostatic precipitators on Duke's coal plants trap most of the fly ash before it goes up the stack. The trapped ash is waste, but it isn't wasted. It's collected, and some is sold for making concrete and concrete products.

Duke has also invested in a cleaner environment by investing in nuclear power. Nuclear plants are the cleanest form of large-scale conventional generation, and nearly 50 percent of the Company's generating capacity is now nuclear. Like Duke's coal plants, the McGuire and Oconee nuclear plants have been among the most fuel efficient in the nation, getting the most power possible from the uranium mined while minimizing the nuclear waste produced.

Duke Power is at the forefront in applying technology to limit and compact nuclear waste, linking economy and ecology in yet another area. By reducing the volume of low-level radioactive waste, such as contaminated clothing and tools, Duke both saves money and limits the material that must be handled in disposal sites.

The radioactive waste treatment system at McGuire Nuclear Station saved Duke an estimated \$3.2 million in disposal costs in one year alone. The system has consistently reduced the volume of low-level radioactive waste to amounts below the industry average. The cost savings for waste disposal at McGuire are expected to be matched at Oconee, where Duke will soon complete a two-





As Duke developed hydroelectric power across the Piedmont Carolinas, it created playgrounds of many rivers and lakes. On the Green River near Hendersonville, N.C., Duke operates a hydroelectric station and outdoor enthusiasts enjoy tubing and rafting.



story, 56,000-square-foot radioactive waste treatment facility.

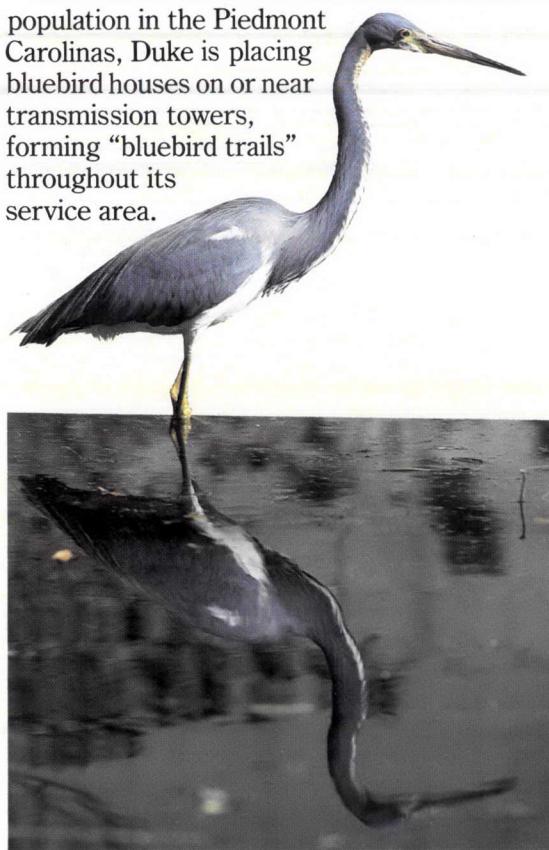
Duke's conservation ethic is company-wide. By recycling scrap, transformer oil, coal ash and even office paper, the Company saves an estimated \$2.5 million annually. These efforts were recognized in 1985 in an award presented by the New York-based National Recycling Coalition.

Going Beyond Business

Duke Power's commitment to the environment goes beyond the day-to-day production of power. In its role as a corporate citizen, Duke searches for ways to lend its knowledge and resources to enhancing the habitat of the Piedmont Carolinas.

By planting selected varieties of vegetation along its power line rights-of-way, Duke not only helps control erosion, but also provides food and shelter for rabbits, quail and other animals. These wildlife strips have been sown on nearly 69,000 acres of Duke's transmission corridors.

In an effort to bolster the Eastern bluebird population in the Piedmont Carolinas, Duke is placing bluebird houses on or near transmission towers, forming "bluebird trails" throughout its service area.



Interested Duke employees are volunteering their own time to build the houses.

Duke is providing special nesting sites for osprey to encourage these birds of prey to live on Lake Norman and Mountain Island Lake. The Company works closely with the Carolina Raptor Center, a non-profit organization that protects, rehabilitates and improves habitats for birds of prey.



Meeting the Challenges Ahead

Duke Power is committed to building on its tradition of environmental stewardship by putting its experience and expertise to work in dealing with the environmental issues of the '80s and beyond.

Chief among these is the question of acid rain. Even though, in 20 years of monitoring, Duke scientists have found no evidence of increased acidity in its lakes, the Company is designing an experimental coal-fired plant that holds promise for eliminating sulfur-dioxide emissions. The joint demonstration project with the Tennessee Valley Authority, the Electric Power Research Institute and others will use a unique process called atmospheric fluidized-bed combustion.

Duke is also researching technologies to neutralize and reduce the volume of both low-level and high-level nuclear wastes. The Company is supporting both federal and state efforts to safely dispose of nuclear waste in permanent, licensed government sites.

A Promise to Live By

We will honor and protect environmental quality and human welfare in the area we serve."

Duke Power makes this commitment in its Statement of Purpose. More than a pledge, this statement reflects a tradition that has guided the Company in every facet of its business.

Environmental stewardship was a cornerstone of Duke's founders' philosophy. Duke has earned a reputation as a steward of the environment. It's a reputation that the Company intends to keep.



Lake Norman, just north of Charlotte, N.C., has become a mecca for recreation and with 25,000 year-round residents is one of the fastest growing areas in the Carolinas. Duke built the 32,500-acre lake in 1963 to power a hydroelectric plant and later provide cooling water for a coal-fired plant and a nuclear station, seen in the background.

Statements of Income

Duke Power Company

Dollars in Thousands	Year ended December 31,	1985	1984	1983
Electric revenues (Notes 1 and 2)		\$2,898,911	\$2,710,015	\$2,420,252
Electric expenses				
Operation				
Fuel used in electric generation (Note 1)	719,254	683,563	739,829	
Net interchange and purchased power (credit) (Note 3)	107,145	(36,408)	(19,819)	
Wages, benefits and materials	435,701	393,448	350,162	
Maintenance of plant facilities	260,361	207,951	187,267	
Depreciation and amortization (Notes 1 and 5)	319,295	303,429	209,750	
General taxes (Note 1)	141,343	194,095	173,826	
Income taxes (Notes 1 and 6)	387,777	415,836	330,023	
Total electric expenses	2,370,876	2,161,914	1,971,038	
Electric operating income	528,035	548,101	449,214	
Other income (Notes 1, 4 and 6)				
Allowance for equity funds used during construction	62,741	98,711	144,048	
Earnings of subsidiaries, net	12,186	17,221	10,415	
Other, net	68,965	33,834	5,391	
Income taxes — other, net	(20,434)	(29,180)	(3,037)	
Income taxes — credit	40,363	42,209	56,184	
Total other income	163,821	162,795	213,001	
Income before interest deductions	691,856	710,896	662,215	
Interest deductions				
Interest on long-term debt	267,345	276,520	272,349	
Other interest	3,926	3,075	6,766	
Allowance for borrowed funds used during construction (credit) (Note 1)	(17,008)	(30,030)	(48,177)	
Total interest deductions	254,263	249,565	230,938	
Net income	437,593	461,331	431,277	
Dividends on preferred and preference stocks	60,912	61,786	62,600	
Earnings for common stock	\$ 376,681	\$ 399,545	\$ 368,677	
Common stock data				
Average shares outstanding (thousands)	101,178	100,346	97,784	
Earnings per share	\$3.72	\$3.98	\$3.77	
Dividends per share	\$2.54	\$2.42	\$2.32	

See Notes to Financial Statements.

Statements of Changes in Financial Position

Duke Power Company

Dollars in Thousands

	Year ended December 31,	1985	1984	1983
Sources of Funds (See Note 12)				
Operations				
Net income	\$ 437,593	\$ 461,331	\$ 431,277	
Non-fund items:				
Depreciation and amortization (Notes 1 and 5)	462,400	469,711	324,608	
Deferred income taxes and investment tax credit, net of amortization (Note 6)	141,105	103,800	333,045	
Allowance for equity funds used during construction	(62,741)	(98,711)	(144,048)	
Other, net	(68,563)	(13,137)	(6,073)	
Total funds from operations	<u>909,794</u>	<u>922,994</u>	<u>938,809</u>	
Funds from financing and sale of assets				
First and refunding mortgage bonds (Note 1)	172,404	—	—	
Proceeds from the sale of an interest in the Catawba Nuclear Station	—	457,086	—	
Issuance of common stock	—	37,194	84,326	
Issuance of pollution-control bonds	34,114	60,720	45,648	
Nuclear fuel trusts	57,638	84,461	60,645	
Total funds from financing and sale of assets	<u>264,156</u>	<u>639,461</u>	<u>190,619</u>	
Change in short-term position and other marketable securities				
Total sources of funds	<u>294,222</u>	<u>(690,038)</u>	<u>(182,800)</u>	
	<u>\$1,468,172</u>	<u>\$ 872,417</u>	<u>\$ 946,628</u>	
Applications of Funds				
Construction expenditures	\$ 594,431	\$ 546,043	\$ 535,678	
Long-term debt retired, capital stock reacquired	235,292	138,652	81,097	
Dividends paid	317,907	304,577	289,564	
Change in working capital*	308,500	(386,086)	45,389	
Other applications, net	12,042	269,231	(5,100)	
Total applications of funds	<u>\$1,468,172</u>	<u>\$ 872,417</u>	<u>\$ 946,628</u>	
Change in Working Capital:				
Increase/(Decrease) in current assets				
Cash	\$ (3,011)	\$ 5,158	\$ (3,457)	
Receivables	(18,011)	30,092	69,906	
Refundable income taxes	—	(41,209)	41,209	
Materials and supplies	53,735	(21,334)	(34,850)	
Prepayments	6,633	(2,243)	1,475	
Decrease/(Increase) in current liabilities				
Accounts payable	(6,016)	(36,812)	(28,633)	
Nuclear fuel disposal costs payable	122,003	(122,003)	—	
Taxes accrued	161,141	(158,001)	4,974	
Interest accrued and other liabilities	(7,974)	(39,734)	(5,235)	
Increase/(Decrease) in working capital*	<u>\$ 308,500</u>	<u>\$(386,086)</u>	<u>\$ 45,389</u>	

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

See Notes to Financial Statements.

Balance Sheets

Duke Power Company

Dollars in Thousands	December 31,	1985	1984
Assets			
Electric plant (at original cost — Notes 1, 3, 11 and 14)			
Electric plant in service	\$8,609,284	\$7,810,094	
Less accumulated depreciation and amortization	<u>3,034,473</u>	<u>2,646,266</u>	
Electric plant in service, net	5,574,811	5,163,828	
Construction work in progress	<u>817,350</u>	<u>988,790</u>	
Total electric plant, net	<u><u>6,392,161</u></u>	<u><u>6,152,618</u></u>	
Other property and investments			
Other property — at cost (less accumulated depreciation: 1985 — \$7,790; 1984 — \$7,423)	39,951	38,774	
Investments in and advances to subsidiaries (Note 1)	<u>88,812</u>	<u>77,785</u>	
Other investments (Note 1)	<u>195,981</u>	<u>22,596</u>	
Total other property and investments	<u><u>324,744</u></u>	<u><u>139,155</u></u>	
Current assets			
Cash (Note 7)	2,743	5,754	
Short-term investments	<u>351,637</u>	<u>815,628</u>	
Receivables (less allowance for losses: 1985 — \$4,004; 1984 — \$4,030)	<u>244,658</u>	<u>262,669</u>	
Materials and supplies — at average cost			
Coal	150,085	114,787	
Other	<u>126,268</u>	<u>107,831</u>	
Prepayments	<u>14,706</u>	<u>8,073</u>	
Total current assets	<u><u>890,097</u></u>	<u><u>1,314,742</u></u>	
Deferred debits			
Canceled construction projects (Notes 5 and 14)	341,214	395,519	
Purchased capacity costs (Note 3)	<u>41,872</u>	<u>—</u>	
Debt expense, being amortized over terms of related debt (Note 1)	<u>16,946</u>	<u>4,068</u>	
Other	<u>17,129</u>	<u>12,716</u>	
Total deferred debits	<u><u>417,161</u></u>	<u><u>412,303</u></u>	
Total assets	<u><u>\$8,024,163</u></u>	<u><u>\$8,018,818</u></u>	
Capitalization and Liabilities			
Capitalization (See Statements of Capitalization)	<u><u>\$6,350,042</u></u>	<u><u>\$6,214,754</u></u>	
Current liabilities			
Accounts payable	159,125	153,109	
Nuclear fuel disposal costs payable (Note 1)	<u>—</u>	<u>122,003</u>	
Taxes accrued (Note 1)	<u>52,923</u>	<u>214,064</u>	
Interest accrued	<u>86,539</u>	<u>88,114</u>	
Other	<u>77,217</u>	<u>67,668</u>	
Total	<u><u>375,804</u></u>	<u><u>644,958</u></u>	
Current maturities of long-term debt and preferred stocks	<u>133,342</u>	<u>119,819</u>	
Total current liabilities	<u><u>509,146</u></u>	<u><u>764,777</u></u>	
Accumulated deferred income taxes (Notes 1 and 6)	<u><u>775,333</u></u>	<u><u>683,023</u></u>	
Deferred credits and other liabilities			
Investment tax credit (Notes 1 and 6)	353,227	329,376	
Other	<u>36,415</u>	<u>26,888</u>	
Total deferred credits and other liabilities	<u><u>389,642</u></u>	<u><u>356,264</u></u>	
Commitments and contingencies (Notes 5 and 14)	<u><u>—</u></u>	<u><u>—</u></u>	
Total capitalization and liabilities	<u><u>\$8,024,163</u></u>	<u><u>\$8,018,818</u></u>	

See Notes to Financial Statements.

Statements of Capitalization and Retained Earnings

Duke Power Company

Dollars in Thousands	December 31,	1985	1984
Capitalization			
Common stock equity (Note 8)			
Common stock, no par, 150,000,000 shares authorized; 101,193,802 shares outstanding for 1985 and 101,152,724 shares outstanding for 1984	\$1,860,623	\$1,859,639	
Retained earnings	1,071,814	952,360	
Total common stock equity	2,932,437	2,811,999	
Preferred and preference stocks without sinking fund requirements (Note 9)			
Preferred stocks with sinking fund requirements (Note 10)	419,552	420,534	
Long-term debt (Note 11)			
First and refunding mortgage bonds	2,614,136	2,530,506	
Promissory note due subsidiary, 16½% — due 1989	58,725	58,725	
Term note, floating rate — due 1987	21,000	21,000	
Term note, floating rate — due 1985	—	2,000	
Capitalized leases	87,537	90,877	
Nuclear fuel trusts	85,000	125,000	
Unamortized debt discount and premium, net	(18,415)	(17,894)	
Current maturities of long-term debt	(126,942)	(113,419)	
Total long-term debt	2,721,041	2,696,795	
Total capitalization	\$6,350,042	\$6,214,754	

	Year ended December 31,	1985	1984	1983
Retained Earnings				
Balance — Beginning of year				
Balance — Beginning of year	\$ 952,360	\$ 795,512	\$ 653,981	
Add — Net income	437,593	461,331	431,277	
Total	1,389,953	1,256,843	1,085,258	
Deduct				
Dividends				
Common stock	256,995	242,791	226,964	
Preferred and preference stocks	60,912	61,786	62,600	
Capital stock transactions, net	232	(94)	182	
Total deductions	318,139	304,483	289,746	
Balance — End of year	\$1,071,814	\$ 952,360	\$ 795,512	

See Notes to Financial Statements.

Notes To Financial Statements

Duke Power Company

Note 1. Summary of Significant Accounting Policies

A. Additions to Electric Plant

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

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

B. Allowance for Funds Used During Construction (AFUDC)

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

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

AFUDC, which is compounded semiannually, was calculated on average embedded rates (net of applicable income taxes) of 9.9 percent for 1985, 9.65 percent for 1984 and 9.45 percent for 1983.

C. Depreciation and Amortization

Provisions for depreciation are recorded using the straight-line method. The year-end composite weighted-average depreciation rates were 3.58 percent for 1985, 3.56 percent for 1984 and 3.47 percent for 1983. All coal-fired generating units are depreciated at the rate of 3.57 percent. Nuclear units are depreciated at a rate of 4 percent, which includes an allowance for decommissioning costs.

Amortization of nuclear fuel and disposal costs is included in "Fuel used in electric generation"

in the Statements of Income. The amortization is recorded using the unit-of-production method.

Under provisions of the Nuclear Waste Policy Act of 1982, the Company began making payments to the Department of Energy (DOE) in 1983 for the disposal of nuclear fuel. These payments are based on nuclear generation on and after April 7, 1983. The Company has fulfilled its obligation for disposal costs of nuclear fuel consumed prior to April 7, 1983, by a payment in June 1985 of approximately \$122,000,000 to the DOE.

D. Subsidiaries

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

method. (See "Subsidiaries," page 41.) Retained earnings as of December 31, 1985, include \$80,058,000 of undistributed earnings of unconsolidated subsidiaries. Dividends received from unconsolidated subsidiaries were \$2,200,000 in 1985, \$2,300,000 in 1984 and \$2,250,000 in 1983.

E. Income Taxes

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

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

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

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

F. Fuel Cost Adjustment Procedures

Fuel costs are reviewed semiannually in the wholesale and South Carolina retail jurisdictions, with provisions for changing such costs in base rates. These jurisdictions allow the Company to adjust for past over- or under-recovery of costs. Therefore the Company reflects in revenues the

difference between actual fuel costs incurred and fuel costs recovered through base rates.

In the North Carolina retail jurisdiction, the level of fuel costs in rates is revised and set in each general rate case proceeding. A hearing to review fuel costs in base rates is required annually.

G. Retirement of Bonds

The Company used the proceeds from the April 1, 1985, issuance of first and refunding mortgage bonds to redeem existing higher cost debt obligations. As a result of the redemption on May 6,

1985, the Company paid a premium of \$13,200,000. The premium is being amortized on a monthly basis over the life of the new bonds, which are due in the year 2015.

H. Other Investments

Other investments, which consist primarily of marketable securities as of December 31, 1985, are stated at the lower of cost or market value.

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

I. Franchise and Sales Taxes

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

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

Note 2. Rate Matters

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

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

A summary of all general rate increases requested or implemented by the Company since January 1, 1983, is as follows:

Jurisdiction and Date Filed	Requested Revenues	Revenues	% of Request	Approved % of Increase Over Previous Revenues	Rate Order Effective	End of 12-Month Test Period
N.C. retail						
February 1983	\$112.9	\$ 76.2	67.5	5.18	September 1983	September 30, 1982
November 1983	212.8	131.0	61.6	8.40	June 1984	June 30, 1983
February 1985 (a)	340.0	157.7	46.4	9.10	September 1985	June 30, 1984
S.C. retail						
February 1982	99.4	40.7	40.9	7.10	March 1983	June 30, 1982
September 1983	136.0	99.7	73.3	17.40	March 1984	April 30, 1983
April 1985	143.0	78.4	54.8	10.75	October 1985	June 30, 1984
FERC wholesale (b)						
August 1982	44.1	26.0	59.0	8.70	June 1983	December 31, 1983
December 1983	9.5	8.0	84.2	9.60	October 1984	December 31, 1984
July 1985	9.2	5.2(c)	—	—	Pending	December 31, 1986

(a) Under appeal.

(b) FERC wholesale filings beginning December 1983 do not include the North Carolina Municipal Power Agency Number 1, the North Carolina Electric Membership Corporation and the Saluda River Electric Cooperative, Inc. Beginning in July 1985, FERC wholesale filings also do not include the Piedmont Municipal Power Agency. These municipalities and electric cooperatives previously purchased interests in the Catawba Nuclear Station. (See Note 3.) Sales to these entities, which previously represented a majority of the Company's wholesale revenues, are now set through contractual agreements.

(c) This increase has been agreed upon by the Company and its wholesale customers, subject to FERC acceptance.

Note 3. Joint Ownership of Generating Facilities

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

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

Owner	Ownership Interest in the Station	Date of Sale
North Carolina Municipal Power Agency Number 1 (NCMPA No. 1)	37.5%	November 29, 1978
North Carolina Electric Membership Corporation (NCEMC)	28.125%	February 6, 1981
Saluda River Electric Cooperative, Inc. (Saluda River)	9.375%	February 6, 1981
Piedmont Municipal Power Agency (PMPA)	12.5%	December 20, 1984

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

The Company retained a 12.5 percent ownership interest in Catawba. As of December 31, 1985, \$255,400,000 had been transferred to "Electric plant in service," representing the Company's investment in Unit 1 and initial core nuclear fuel for that unit. Accumulated depreciation and amortization of \$8,800,000 associated with the amount transferred to "Electric plant in service" had been recorded as of year-end. "Construction work in progress" as of December 31, 1985, included \$201,300,000, representing the Company's remaining investment in Catawba.

Under the terms of the 1984 sale to PMPA, the Company received \$457,086,000 at closing and a note for \$13,800,000 payable upon commercial operation of Catawba Unit 1, which occurred June 29, 1985.

In connection with the joint ownership, the Company has entered into contractual agreements with the buyers to purchase annually declining percentages of the generating capacity and energy from the plant. The agreements are effective beginning with the commercial operation of each unit. Catawba Unit 2 is scheduled for commercial operation in fall 1986. Such agreements were established for 15 years for NCMPA No. 1 and PMPA and 10 years for NCEMC and Saluda River.

Energy cost payments will be based on variable operating costs, a function of the generation of the plant. Capacity payments will be based on the fixed costs of the plant. The estimated purchased capacity obligations through 1990 are \$431,073,000 for 1986, \$612,566,000 for 1987,

\$572,149,000 for 1988, \$531,247,000 for 1989 and \$509,236,000 for 1990. These estimates are based on an in-service date of fall 1986 for Catawba Unit 2.

The Company was granted recovery in current rates for the fuel, operating and maintenance costs associated with the purchases of capacity and energy in its most recent rate orders from the North Carolina Utilities Commission and The Public Service Commission of South Carolina. These rate orders granted recovery on a levelized basis of the capital costs of capacity purchased from the joint owners. The Company will recover the capital costs over a 15-year period in its North Carolina retail jurisdiction and a 7½-year period in its South Carolina retail jurisdiction. The portion of capital costs not recovered through current rates is being accumulated and the Company is recording a carrying charge on the accumulated balance. The Company will begin recovering the accumulated balance when the capacity payments drop below the levelized revenues.

For the year ended 1985 a total of \$224,600,000 was recorded for the purchases of capacity and energy from the joint owners. This amount, net of the cost of capacity purchased not reflected in current rates, is included in "Net interchange and purchased power" in the Statements of Income. As of December 31, 1985, \$22,400,000 (\$11,400,000 net of income taxes) associated with the levelization of capital costs had been accumulated in the Balance Sheets as a component of "Purchased capacity costs."

Note 4. Other Income

For the years ended December 31, 1985 and 1984, the Company recorded investment income of \$51,700,000 and \$36,700,000, respectively (\$34,900,000 and \$18,600,000 net of income taxes, respectively) as a component of "Other, net" in the Statements of Income. The income

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

**Note 5.
Canceled
Construction
Projects**

The Cherokee and Perkins nuclear stations have been canceled. All jurisdictions have permitted recovery of the costs incurred through April 30, 1983. These costs are being amortized principally over a 10-year period beginning October 1983. The Company intends to seek recovery of the remaining incurred costs. (See Note 14.)

As of December 31, 1985 and 1984, the balances for these canceled projects, net of amortization, were \$544,145,000 and \$611,971,000, respectively (\$341,214,000 and \$395,519,000 net of income tax benefits, respectively). (See Note 6.)

**Note 6.
Income Tax
Expense**

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

	1985	1984	1983
Electric Expenses			
Current income taxes			
Federal	\$200,884	\$271,960	\$ 701
State	<u>36,506</u>	<u>47,876</u>	<u>(966)</u>
	<u>237,390</u>	<u>319,836</u>	<u>(265)</u> (a)
Deferred taxes, net			
Excess tax over book depreciation	87,362	67,107	79,890
Capitalized taxes, employee benefits, etc.	12,487	10,337	8,999
Cancellation of Cherokee Nuclear Station (b)	(7,422)	(2,234)	210,329
Catawba purchased capacity costs	37,700	—	—
Other	677	1,959	44,942 (c)
	<u>130,804</u>	<u>77,169</u>	<u>344,160</u>
Investment tax credit			
Deferred	40,729	37,381	— (a)
Amortization of deferrals (credit)	<u>(21,146)</u>	<u>(18,550)</u>	<u>(13,872)</u>
	<u>19,583</u>	<u>18,831</u>	<u>(13,872)</u>
Total electric expenses	<u>387,777</u>	<u>415,836</u>	<u>330,023</u>
Other Income			
Income taxes — other, net	20,434	91,497 (d)	3,037
Income taxes — (credit)	<u>(40,363)</u>	<u>(42,209)</u>	<u>(56,184)</u>
Total other income	<u>(19,929)</u>	<u>49,288</u>	<u>(53,147)</u> (a)
Total income tax expense	<u>\$367,848</u>	<u>\$465,124</u>	<u>\$276,876</u>

- (a) Current income tax expense for 1983 is a credit principally due to the cancellation of all units of the Cherokee Nuclear Station and the deduction of the Company's liability under the Duke/Department of Energy Spent Nuclear Fuel Disposal Contract. This tax loss eliminated all investment tax credit utilization for 1983.
- (b) Represents deferred income tax expense related to the cancellation of all units of the Cherokee Nuclear Station. The related deferred income tax credits have been classified as a reduction of "Canceled construction projects" in the Balance Sheets. (See Note 5.)
- (c) Deferred income tax expense for 1983 includes \$51,260,000, primarily related to the reversal of deferred income tax expense for prior period liabilities under the Duke/Department of Energy Spent Nuclear Fuel Disposal Contract.
- (d) Includes \$62,317,000 resulting from the sale of assets in December 1984. Such income taxes, which are included in "Other, net" in the Statements of Income, reflect a taxable gain in excess of book gain resulting principally from the treatment of AFUDC. (See Note 3.)

Total current income taxes were \$226,712,000 for 1985, \$376,949,000 for 1984 and \$(56,186,000) for 1983. Of these amounts, state income taxes were \$34,692,000 for 1985, \$57,587,000 for 1984 and \$(7,981,000) for 1983.

Total deferred income taxes were \$121,553,000 for 1985, \$69,344,000 for 1984 and \$346,934,000 for 1983. Of these amounts, deferred state income taxes were \$13,178,000 for 1985, \$7,687,000 for 1984 and \$42,773,000 for 1983.

Note 6.
**Income Tax
Expense (continued)**

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

	1985	1984	1983
Income taxes on pretax income at the statutory federal rate of 46%	\$370,503	\$426,169	\$325,751
Increase (reduction) in tax resulting from:			
Allowance for all funds used during construction (AFUDC)	(36,685)	(59,220)	(88,424)
Amortization of electric investment tax credit deferrals	(21,146)	(18,550)	(13,872)
AFUDC in book depreciation/amortization	42,575	45,298	23,884
State income taxes, net of federal income tax benefit	25,320	35,832	18,874
Increase in tax expense primarily because of excess of tax gain over book profit on sale of assets	—	27,280	—
Other items, net	(12,719)	8,315	10,663
Total income tax expense (see page 29)	<u>\$367,848</u>	<u>\$465,124</u>	<u>\$276,876</u>

Note 7.
**Short-Term
Borrowings**

The Company had unused short-term credit facilities of \$316,050,000 with 59 commercial banks as of December 31, 1985, and \$319,500,000 with 60 commercial banks as of December 31, 1984. Included in these credit facilities is \$40,000,000 allocated to the 1984 issue of annual tender, pollution-control revenue bonds. The facilities are on a fee basis and/or a compensating-balance basis, with total average balance requirements of \$1,362,500 for 1985 and \$1,372,000 for 1984.

There were no short-term borrowings during 1985 and 1984.

As of December 31, 1983, the Company had short-term credit facilities of \$385,400,000 with 67 commercial banks. The average amount of short-term debt outstanding during 1983 was \$30,951,000. The maximum amount outstanding during 1983 was \$111,210,000. The weighted-average interest rate for that year was 8.92 percent computed on a daily basis.

Note 8.
Common Stock and Retained Earnings

Common Stock

A summary of issuances of shares of common stock is as follows (dollars in thousands):

Year	Proceeds	Shares Issued
1985	\$ —	—
1984	37,194	1,451,607
1983	84,326	3,605,980

During the past three years, the Company began using stock-market purchases to satisfy the requirements of certain stock plans. For the next several years, the Company anticipates using

stock-market purchases to satisfy the requirements of all its stock plans and intends to issue new shares of common stock only for the conversion of preference stock. (See Note 9.)

As of December 31, 1985, a total of 4,764,013 shares was reserved for issuance to stock plans and for the conversion of preference stock.

Retained Earnings

As of December 31, 1985, none of the Company's retained earnings were restricted as to the declaration or payment of dividends.

Note 9.
Preferred and Preference Stocks Without Sinking Fund Requirements

The following shares of stock were authorized with or without sinking fund requirements as of December 31, 1985 and 1984:

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

The outstanding Preference Stock, 6 3/4% Convertible Series AA, is convertible into shares of common stock at the adjusted conversion price of

\$23.89 per share, with each share of preference stock valued at \$100 par. The conversion price is subject to certain adjustments designed to protect the conversion privilege against dilution. In 1985, 1984 and 1983, shares of preference stock were converted into shares of common stock as follows:

Year	Preference Shares	Common Shares
1985	9,819	41,078
1984	16,136	67,510
1983	18,868	78,936

Preferred and preference stocks without sinking fund requirements as of December 31, 1985 and 1984, were as follows (dollars in thousands):

Rate/Series	Year Issued	Shares Outstanding	1985	1984
4.50% C	1964	350,000	\$ 35,000	\$ 35,000
5.72% D	1966	350,000	35,000	35,000
6.72% E	1968	350,000	35,000	35,000
8.70% F	1970	600,000	60,000	60,000
8.20% G	1971	600,000	60,000	60,000
7.80% H	1972	600,000	60,000	60,000
8.28% K	1977	500,000	50,000	50,000
8.84% M	1978	400,000	40,000	40,000
15.40% A	1982	1,600,000	40,000	40,000
6 3/4%, AA Convertible	1969	45,527	4,552	—
		55,346	—	5,534
Total			\$419,552	\$420,534

Note 10. Preferred Stocks With Sinking Fund Requirements

The following shares of stock were authorized with or without sinking fund requirements as of December 31, 1985 and 1984:

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

Preferred stocks with sinking fund requirements as of December 31, 1985 and 1984, were as follows (dollars in thousands):

Rate/Series	Year Issued	Shares Outstanding	1985	1984
7.35% I	1973	552,000	\$ 55,200	\$ —
		576,000	—	57,600
8.20% J	1977	420,000	42,000	—
		440,000	—	44,000
8.375% L	1978	440,000	44,000	—
		460,000	—	46,000
8.84% N	1979	467,500	46,750	—
		483,750	—	48,375
11.00% O	1980	500,000	50,000	50,000
10.76% A	1975	2,040,000	51,000	—
		2,100,000	—	52,500

Less: Preferred shares reacquired for current and future sinking fund requirements (at cost)

	Shares Reacquired
10.76% A	72,500 (1,702) —
8.84% N	120,000 — (2,891)
11.00% O	30,050 (2,607) — (2,529)
	32,500 13,750 (1,229) (1,229)

Less: Current sinking fund requirements

7.35% I	(2,400) (2,400)
8.20% J	(2,000) (2,000)
8.375% L	(2,000) (2,000)
Total	\$277,012 \$285,426

The annual sinking fund requirements through 1990, net of amounts reacquired, are \$6,400,000 in 1986, \$7,832,000 in 1987, \$10,900,000 in 1988, 1989 and 1990, with some additional redemptions permitted at the Company's option.

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

Note 11. Long-Term Debt

First and refunding mortgage bonds outstanding as of December 31, 1985 and 1984, were as follows (dollars in thousands):

Substantially all electric plant was mortgaged as of December 31, 1985.

On October 2, 1984, the Company transferred certain U.S. government securities to an irrevocable trust for the defeasance of \$32,850,000 of its 14 $\frac{3}{8}$ percent first and refunding mortgage bonds. The cash flow from this trust was sufficient to fund the scheduled principal and interest payments on these bonds. Accordingly, in 1984 this amount was removed from the balance sheet. The entire series of 14 $\frac{3}{8}$ percent bonds was retired on March 1, 1985.

The annual maturities of long-term debt (including sinking fund requirements and capitalized

lease principal payments) through 1990 are \$126,942,000 in 1986, \$60,020,000 in 1987, \$56,268,000 in 1988, \$70,227,000 in 1989 and \$86,933,000 in 1990.

Annual maturities through 1990 include amounts relating to the \$85 million in outstanding obligations under the Company's two nuclear fuel trusts. The maturities are based on estimated fuel consumption. Instead of making cash payments, the Company intends to transfer title of additional nuclear fuel to the trusts as fuel is consumed.

Note 12. Reclassification

On the Statements of Changes in Financial Position, certain prior year information has been re-

classified to conform with 1985 classifications.

Note 13. Retirement Plan

The Company and two of its subsidiaries have a non-contributory, defined benefit retirement plan covering substantially all their employees. The Company's policy is to fund pension costs accrued. Total pension expense, including trustee fees, amounted to \$31,491,000 in 1985, \$32,828,000 in 1984 and \$33,137,000 in 1983. In 1983 the plan was amended to provide for certain plan changes, including increased benefits for retired employees and survivor benefits. The plan was changed in 1984 to include the Early Retire-

ment Supplement Plan, a one-time early retirement offer to eligible employees. In addition, certain amendments were made to the plan in 1985; including changes in requirements for both creditable service and vesting service. The effect of these changes did not significantly increase the Company's pension cost.

A comparison of accumulated plan benefits and plan net assets as of December 31, 1984, the date of the latest actuarial report, and December 31, 1983, is as follows (dollars in thousands):

	1984	1983
Actuarial present value of accumulated plan benefits		
Vested	\$340,329	\$310,185
Non-Vested	<u>87,400</u>	<u>71,011</u>
Total	<u>\$427,729</u>	<u>\$381,196</u>
Net assets available for benefits	<u>\$447,665</u>	<u>\$421,556</u>

The weighted-average assumed rate of return used to determine the actuarial present value of accumulated plan benefits was 8.8 percent in

1984 and 8.6 percent in 1983. The actuarial present value of accumulated plan benefits does not consider future salary increases.

Note 14. Commitments and Contingencies

A. Construction Program

Projected construction and nuclear fuel costs, excluding costs related to portions of the Catawba Nuclear Station that have been sold, are \$2.02 billion and \$521 million, respectively, for 1986 through 1988. The program is subject to periodic review and revisions, and actual construction costs may vary from such estimates. Cost variances are due to various factors, including revised load estimates, outcome of licensing and environmental matters, and cost and availability of capital.

B. Nuclear Insurance

The Company's public liability for claims resulting from any nuclear incident is limited to \$650 million under provisions of the Price-Anderson Act, which provides for nuclear liability insurance up to that amount. Under these provisions the Company could be assessed up to \$5 million for each of its licensed reactors for a nuclear incident involving any licensed facility in the nation, and up to \$10 million a year for each, if more than one nuclear incident occurred. Legislation is pending in Congress which could increase the limitation liability and the amount the Company could be assessed for each of its licensed reactors. As of December 31, 1985, the Company had six licensed reactors.

The Company is a member of Nuclear Mutual Limited (NML), which provides property damage coverage for certain of the Company's nuclear facilities. If NML's losses ever exceeded its reserves, the Company would be liable, on a pro rata basis, for additional assessments of up to \$71 million. This amount represents 10 times the Company's annual premium to NML.

The Company is also a member of Nuclear Electric Insurance Limited (NEIL), which provides insurance for the increased cost of generation and/or purchased power resulting from an accidental outage of a nuclear unit. If NEIL's losses ever exceeded its reserves, the Company would be liable, on a pro rata basis, for additional assessments of up to \$39 million. This amount represents five times the Company's annual premium to NEIL.

The Company purchases \$525 million of property damage insurance through NEIL's Excess Property Insurance Program. The Company also

purchased an additional \$85 million of property damage insurance through a pool of stock and mutual insurance companies. These coverages are in addition to the \$500 million of coverage provided by the Company's underlying property damage policies issued through NML. If losses ever exceeded the accumulated funds available to NEIL for the Excess Property Insurance Program, the Company would be liable, on a pro rata basis, for additional assessments of up to \$28 million. This amount represents 7.5 times the Company's annual premium for excess property insurance.

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

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

C. Other

The Financial Accounting Standards Board in December 1985 issued an Exposure Draft of a proposed statement of Financial Accounting Standards which, if adopted in its current form, would require the Company to write down to present value its canceled construction projects. This write-down would be required because the Company's recovery of these projects through rates does not include a return on the outstanding canceled construction balances. The resulting write-down to present value, if required, could be recorded by restating prior years' financial statements.

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

Auditors' Opinion

Duke Power Company:

We have examined the balance sheets and the statements of capitalization of Duke Power Company as of December 31, 1985 and 1984, and the related statements of income, retained earnings and changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of the

Company at December 31, 1985 and 1984, and the results of its operations and the changes in its financial position for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis.

Deloitte Haskins & Sells

Deloitte Haskins & Sells
Certified Public Accountants

Charlotte, North Carolina
February 14, 1986

Responsibility for Financial Statements

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

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

as they perform their assigned functions. The Company's accounting controls are continually reviewed for effectiveness. In addition, written policies, standards and procedures, and a strong internal audit program augment the Company's accounting controls.

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

Norman P. Morrow

Norman P. Morrow
Controller

Management's Discussion and Analysis of Results of Operations and Financial Condition

Results of Operations

Over the past five years Duke Power Company has achieved significantly greater financial strength and flexibility. However, in 1985 the Company was unable to maintain the steady rate of growth in corporate earnings experienced over the previous four years, as 1985 earnings per share declined by 6.5 percent to \$3.72.

Despite the decline in earnings in 1985, the Company maintained sound credit ratings on its fixed-income securities. The Company also continued its practice of increasing the common stock dividend annually.

Earnings and Dividends

Earnings per share for the year 1985 decreased 6.5 percent from 1984, and the earned return on average common equity fell to 13.1 percent from 14.8 percent last year. Earnings declined from 1984 primarily because of lower than projected kilowatt-hour sales, a somewhat lower level of nuclear performance than that experienced in 1984 and higher maintenance costs. In addition, the Company's investments in securities yielded a lower return than investments in utility plant.

Over the five-year period, however, earnings per share increased at an annual rate of 4 percent, to \$3.72 in 1985 from \$3.19 in 1981.

Common dividends paid increased at an annual rate of 5 percent, to \$2.54 per share in 1985 from \$2.08 in 1981. Indicated annual dividends per share rose to \$2.60 in 1985, up 5 percent from the level at the end of 1984.

Revenues and Sales

Higher rates and kilowatt-hour sales increased electric revenues at an annual rate of 11 percent from 1981 to 1985. Kilowatt-hour sales, including electricity delivered to joint owners of the Catawba Nuclear Station, have increased at an annual rate of 2 percent over the five-year period primarily because of economic expansion in the Piedmont Carolinas. Sales have fluctuated somewhat from year to year with the economic cycles in the early 1980s and abnormal weather patterns.

In 1985, kilowatt-hour sales, including electricity delivered to joint owners of the Catawba Nuclear Station, were 2 percent higher than in 1984. However, sales to the Company's retail and wholesale customers were essentially flat. Sales to residential customers declined 2 percent as a result of unseasonably mild weather. Sales to textile customers were 2 percent below 1984. However, sales to this customer group increased during the last four months of 1985. Kilowatt-hour sales to non-textile industrial customers continued to increase, rising 2 percent above the 1984 level.

Operating Expenses

Over the past five years non-fuel operating and maintenance expenses increased principally because of the addition of three nuclear units, increased maintenance at both nuclear and coal-fired stations, additional Nuclear Regulatory Commission requirements, and inflation. (See "Selected Financial Data — Effects of Changing Prices," page 42.) These factors caused non-fuel operating and maintenance expenses to rise at an annual rate of 15 percent from 1981 to 1985.

Fuel expense has fluctuated during the past five years primarily because of changes in generation mix and fuel prices. After decreasing for three consecutive years, fuel expense in 1985 increased 5 percent over 1984, primarily because refuelings caused the level of nuclear performance during the year to fall short of the record level achieved in 1984. Also, while experiencing outages at some of its more efficient coal-fired units, the Company was forced to rely more on its smaller, less efficient coal units. Decreased fuel expense in 1984 and 1983 resulted from higher nuclear generation, while decreased levels of production brought about by low demand resulted in a decline in 1982 fuel expense. Fuel expense increased in 1981 because the unit price of fuel rose.

"Net interchange and purchased power" expense increased significantly in 1985. The increase was principally the result of purchased power agreements with the joint owners of the Catawba Nuclear Station. (See Note 3, "Notes to Financial Statements.")

Growth of Financial Assets and Non-Utility Earnings

Non-utility earnings continued to grow in 1985, increasing 23 percent over 1984. The increase is largely because of dividend and interest income earned from the Company's investment in short-term and intermediate-term securities. The Company made these investments with the proceeds from the December 1984 sale of a portion of the Catawba Nuclear Station. The Company will use the invested funds to lessen its anticipated financing requirements over the next several years. The return earned on these low-risk investments is substantially less than the return on the investment in utility property.

Other components of the Company's non-utility earnings are subsidiary earnings, appliance sales, and Management and Technical Services income. In 1985, non-utility earnings were 14 percent of total Company earnings, compared with 11 percent in 1984.

Liquidity and Resources

Other

Allowance for funds used during construction (AFUDC) was 21 percent of earnings for common stock in 1985, a decrease from an average of 54 percent for 1981 through 1984. Completion of

Rate Increases

The North Carolina Utilities Commission issued a rate order in September 1985 granting the Company a 9.1 percent increase in revenues and a rate of return on common equity of 14.9 percent. The Public Service Commission of South Carolina, in an October 1985 rate order, granted the Company a 10.75 percent increase in revenues with a rate of return on common equity of 14.75 percent. An application for a rate increase with respect to the Company's wholesale customers was filed in July 1985. The Company and its wholesale customers have agreed upon a \$5.2 million increase, subject to acceptance by the Federal Energy Regulatory Commission. The Company filed these rate increase requests in all three jurisdictions primarily to recover its investment in Unit 1 of the Catawba Nuclear Station and payments related to the purchased power contracts with the other joint owners of the station.

The rate orders in the Company's retail jurisdictions permitted the Company to recover in current rates its investment in Catawba Unit 1 and the fuel, operating and maintenance costs associated with contractual purchases of energy and capacity from the Catawba buyers. The contracts relating to the sales of portions of the station obligate the Company to make payments on an annually declining percentage basis to the electric cooperatives and municipalities. Regulatory treatment of these contracts provides revenue to cover the capital costs of purchased capacity on a levelized basis. This treatment results in the Company having to fund portions of the payments until these costs, including carrying charges, are recovered at a later date. The Company will begin to recover the accumulated costs and carrying charges when the amount of capacity payments drops below the levelized revenues.

From 1981 to 1985 the Company was granted retail rate increases allowing approximately 56 percent of requested additional revenues. Rate increases during this period included recovery of the Company's investment in Catawba Unit 1 and in both units of the McGuire Nuclear Station, higher rates of return on common equity, compensation for increased purchased power and operating expenses, and recovery for the amortization of two canceled nuclear projects.

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

three nuclear units, sales of portions of the Catawba Nuclear Station and cancellation of two nuclear projects caused AFUDC to decline during 1981 through 1985.

Capital Structure

The Company's capital structure at year-end was 46 percent common equity, 43 percent long-term debt, and 11 percent preferred and preference stocks. The capitalization was substantially the same as year-end 1984 and was consistent with the Company's long-term financial goals.

In January 1985 the Company's Customer Stock Purchase Plan and its Dividend Reinvestment and Stock Purchase Plan began purchasing common stock on the stock market to satisfy the requirements of these plans. Consequently, dividends reinvested by shareholders in these plans no longer qualify for tax-deferred treatment. The Company does not plan to issue new common shares in the near future, except to convert outstanding Preference Stock, 6 3/4% Convertible Series AA. (For additional stock information, see "Long-Term Financings and Sale of Assets," page 39.)

Fixed Charges Coverage

Fixed charges coverage, using the Securities and Exchange Commission method, decreased to 3.87 times at year-end from 4.21 times in 1984. For the year ended December 1985, pretax earnings were lower than in 1984 principally due to the effects of the Catawba sale in that year. This decline caused the coverage to fall below the Company's goal of 4.00 times. The Company has refinanced higher cost debt obligations, which will help to increase the coverage.

Funds From Operations

Funds from operations accounted for 62 percent of the total applications of funds in 1985. The percentage of internally generated funds declined from 1984, primarily because the Company refinanced existing higher cost debt and made a lump-sum payment to the Department of Energy for nuclear fuel disposal costs in June 1985. The Company also had to fund the portions of purchased capacity payments not currently collected in rates. In addition, internally generated funds in 1984 included the proceeds from the sale of a portion of the Catawba Nuclear Station. The percentage of internally generated funds is still above the Company's long-term goal of 50 percent.

Additional Funds

The Company obtained additional funds during the past five years from the sale of \$534 million in first and refunding mortgage bonds, \$38 million

in preferred stock and \$357 million in common stock. Proceeds from the sale of common stock include funds acquired from the issuance in 1982 of \$73 million of common stock in a non-cash exchange for bonds.

The Company took advantage of opportunities to reduce interest expenses in 1985. In January the Company reduced the obligations of one of its nuclear fuel trusts by \$40 million. Also, the Company refinanced several debt obligations during the year at lower interest rates.

The Company, on December 23, 1985, issued \$50 million principal amount of its First and Refunding Mortgage Bonds, 10½ percent Series B due 2015. The proceeds were applied to the January 13, 1986, redemption of \$50 million principal amount First and Refunding Mortgage Bonds, 13½ percent Series B due 2010. Total funds needed to redeem the 13½ percent Series B bonds were \$55.5 million.

On April 1, 1985, the Company issued \$125 million principal amount of its First and Refunding Mortgage Bonds, 12½ percent Series due 2015. The proceeds were applied to the May 6, 1985, redemption of the \$100 million principal amount First and Refunding Mortgage Bonds, 14% percent Series due 2010. The total amount required to redeem the 2010 Series bonds was \$115.8 million. Portions of the proceeds were also used in connection with the March 1, 1985, redemption of the First and Refunding Mortgage Bonds, 14½ percent Series due 1987.

The entire Series of the 14½ percent bonds, totaling \$50 million, was retired by the Company on March 1, 1985. The Company had transferred

certain U.S. government securities to an irrevocable trust in October 1984 for the defeasance of \$32.9 million of these bonds, with the balance necessary for the retirement provided largely from the proceeds of the issuance of the 12½ percent bonds.

The Company may issue additional debt obligations over the next several years to purchase or redeem existing higher cost debt. Issuance of the debt will depend on favorable market conditions.

The Company received \$978 million from the sales of portions of the Catawba Nuclear Station in 1984 and 1981. The Company retains a 12.5 percent ownership interest in the two-unit station.

In February 1985 the Company formed Church Street Capital Corp., a wholly owned subsidiary, for the purpose of investing the Company's temporary cash funds. The subsidiary is consolidated for financial statement purposes. As of December 31, 1985, the consolidated entity had approximately \$352 million in short-term investments and \$170 million in intermediate-term investments.

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

The leveled recovery of purchased power obligations under contracts with the joint owners of the Catawba Nuclear Station will result in payments by the Company over the next five years exceeding the amounts collected in rates for such power by approximately \$461 million.

Capital Needs

Property Additions and Retirements

Additions to property and nuclear fuel of \$657 million and retirements of \$28 million resulted in a net increase in gross plant of \$629 million in 1985.

Since January 1, 1981, additions to property, including nuclear fuel, of \$3.5 billion and retirements of \$1.6 billion have resulted in a net increase in gross plant of \$1.9 billion. The amount of retirements was unusually large primarily because portions of the Catawba Nuclear Station were sold and the Cherokee and Perkins nuclear projects were canceled.

Construction and Other Expenditures

Plant construction costs declined during the period 1981 through 1985. The primary reasons for this decline were the completion of three generating units in this five-year period (McGuire Unit 1 in 1981; McGuire Unit 2 in 1984; and Catawba Unit 1 in 1985) and the sale of portions of the Catawba Nuclear Station. As of December 31, 1985, construction work in progress (CWIP) was below \$1.0

billion for the second consecutive year. CWIP is expected to exceed \$1.0 billion in the late 1980s primarily because of increased construction expenditures at Bad Creek Hydroelectric Station.

Expenditures for construction of major generating facilities and for nuclear fuel were approximately 21 percent of the total applications of funds during 1985, a decrease from 34 percent for 1984 and 45 percent for 1981. Additional major applications of funds were required for the expansion and replacement of transmission and distribution facilities and for the redemption of maturing and re-funded securities.

Future Construction Program

Projected construction and nuclear fuel costs, excluding costs related to portions of the Catawba Nuclear Station that have been sold, are \$2.5 billion for the three-year period 1986 through 1988. Compared with the previous five years, major plant construction costs projected for 1986 through 1988 will constitute a lower percentage of

the Company's total applications of funds.

Major generating units still under construction are the four units of the Bad Creek Hydroelectric Station. Catawba Unit 2 is undergoing pre-operational testing and is planned for commercial operation in fall 1986.

The Company's portion of the estimated construction and initial core nuclear fuel costs for Unit 2 of Catawba is \$240 million, and total estimated costs for the station are \$495 million. As of December 31, 1985, \$201 million had been spent on the Company's portion of Unit 2, increasing to \$457 million the total amount incurred to date for the

station's construction and initial core nuclear fuel.

Construction of Bad Creek Hydroelectric Station, a 1,000,000-kilowatt pumped-storage facility located in northwestern South Carolina, continued in 1985. Units 1 and 2 are scheduled for completion in 1991 and Units 3 and 4 in 1992. As of December 31, 1985, \$78.3 million of the total estimated cost of \$1.0 billion had been expended on the project.

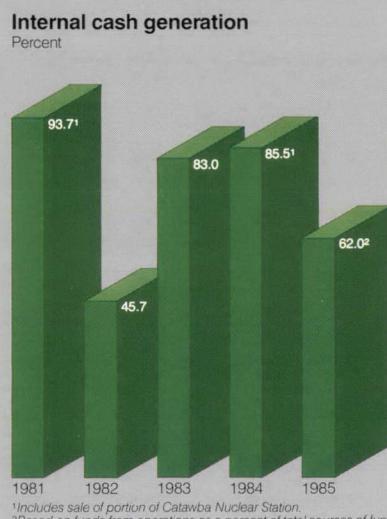
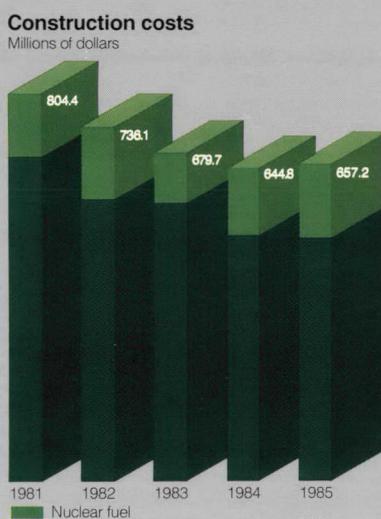
After completing Catawba Unit 2 and Bad Creek, the Company currently has no plans to place a new generating plant in service before the mid-1990s.

Significant Trends

The Company's financial position and results of operations could be affected by several factors in the coming years. The most significant of these is whether the Company will receive timely and adequate increases in rates to cover the increased expenses associated with the commercial operation of Catawba Unit 2 and the additional costs of capacity the Company is contractually obligated to purchase from the other Catawba owners upon the commercial operation of that unit. Additionally, as operating and maintenance expenses increase, the Company will need timely and adequate recovery in future rates. Continued growth in the Company's non-utility operations, along with further economic expansion throughout the service territory, could have a positive impact on total Company earnings.

Other factors that could have an impact on the

Company include the resolution of certain issues being addressed by the Financial Accounting Standards Board (FASB) and the North Carolina Utilities Commission (NCUC). The FASB has proposed accounting which, if implemented, would require the Company to write down to present value its canceled construction projects since the Company's recovery of these canceled projects through rates does not include a return on the unrecovered balance. The resulting write-down to present value, if required, could be recorded by restating prior years' financial statements. Also, the resolution by the NCUC of the treatment of over- or under-recovery of fuel costs in the North Carolina retail jurisdiction could have an impact on future results of operations and the financial position of the Company.



Long-Term Financings and Sale of Assets

Duke Power Company

To meet its capital requirements, the Company has financed with long-term debt and equity securities and has raised additional capital through other types of financings plus the sale of certain assets. In March 1983 the Company introduced the Customer Stock Purchase Plan, which enables customers to purchase common stock without paying brokerage fees. Financings and sale of assets from 1983 through 1985 were as follows (dollars in thousands):

	Average price per share	1985 Net proceeds	1984 Net proceeds	1983 Net proceeds
Financings				
Common stock				
Dividend Reinvestment and Stock Purchase Plan				
(1,188,333 shares)	\$25.70	\$ 30,539		
(1,226,818 shares)	23.56		\$ 28,903	
Customer Stock Purchase Plan				
(263,274 shares)	25.28	6,655		
(403,911 shares)	23.37		9,439	
Stock Purchase-Savings Program for Employees				
(1,831,618 shares)	23.32		42,712	
Employees' Stock Ownership Plan				
(143,633 shares)	22.78			3,272
Total common stock			<u>37,194</u>	<u>84,326</u>
Long-term debt				
First and refunding mortgage bonds				
10½% Series B due 2015 (Issued December 23, 1985)	\$ 49,279			
12½% Series due 2015 (Issued April 1, 1985)	<u>123,125</u>			
Pollution-control series	<u>34,114</u>	60,720	45,648	
Total	<u>206,518</u>	60,720	45,648	
Nuclear fuel trusts		<u>57,638</u>	84,461	60,645
Total long-term debt	<u>264,156</u>	145,181	106,293	
Total financings	<u>264,156</u>	182,375	190,619	
Sale of assets				
Sale of an interest in the Catawba Nuclear Station			457,086	
Total long-term financings and sale of assets	<u>\$264,156</u>	<u>\$639,461</u>	<u>\$190,619</u>	

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

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

Selected Financial Data

Duke Power Company

	1985	1984	1983	1982	1981
Condensed statements of income (thousands)					
Electric revenues	\$2,898,911	\$2,710,015	\$2,420,252	\$2,244,480	\$1,908,454
Electric expenses	<u>2,370,876</u>	<u>2,161,914</u>	<u>1,971,038</u>	<u>1,854,712</u>	<u>1,632,104</u>
Electric operating income	<u>528,035</u>	548,101	449,214	389,768	276,350
Other income	<u>163,821</u>	<u>162,795</u>	<u>213,001</u>	<u>175,048</u>	<u>254,043</u>
Income before interest deductions	<u>691,856</u>	710,896	662,215	564,816	530,393
Interest deductions	<u>254,263</u>	<u>249,565</u>	<u>230,938</u>	<u>214,939</u>	<u>194,142</u>
Income before extraordinary item	<u>437,593</u>	461,331	431,277	349,877	336,251
Extraordinary item	—	—	—	48,304	—
Net income	<u>437,593</u>	461,331	431,277	398,181	336,251
Dividends on preferred and preference stocks	<u>60,912</u>	61,786	62,600	62,164	57,895
Earnings for common stock	<u>\$ 376,681</u>	<u>\$ 399,545</u>	<u>\$ 368,677</u>	<u>\$ 336,017</u>	<u>\$ 278,356</u>
Common stock data					
Shares of common stock — year-end (thousands)	<u>101,194</u>	101,153	99,634	95,949	88,483
— average (thousands)	<u>101,178</u>	100,346	97,784	93,679	87,313
Per share of common stock					
Earnings before extraordinary item	<u>\$3.72</u>	\$3.98	\$3.77	\$3.07	\$3.19
Extraordinary item	—	—	—	0.52	—
Earnings	<u>\$3.72</u>	\$3.98	\$3.77	\$3.59	\$3.19
Dividends	<u>\$2.54</u>	\$2.42	\$2.32	\$2.24	\$2.08
Book value — year-end	<u>\$28.98</u>	\$27.80	\$26.26	\$24.89	\$23.83
Market price — high-low	<u>\$36 7/8-28 1/2</u>	\$30 1/8-22 1/4	\$26 3/8-21 3/4	\$24-20 3/8	\$22 1/2-15 7/8
— year-end	<u>\$35 3/8</u>	\$29	\$25 1/8	\$23 1/4	\$20 5/8
Balance sheet data (thousands)					
Total assets	<u>\$8,024,163</u>	\$8,018,818	\$7,379,445	\$7,057,780	\$6,531,044
Long-term debt	<u>\$2,721,041</u>	\$2,696,795	\$2,745,889	\$2,712,372	\$2,545,094
Preferred stocks with sinking fund requirements	<u>\$ 277,012</u>	\$ 285,426	\$ 295,053	\$ 304,026	\$ 308,674
Electric and other statistics					
Kilowatt-hour sales (millions)					
Residential	<u>14,241</u>	14,493	14,219	13,711	13,861
General service	<u>11,338</u>	10,922	10,339	10,087	9,731
Industrial	<u>21,837</u>	21,821	20,907	19,345	20,667
Other energy and wholesale	<u>8,642</u>	7,163	8,686	8,237	9,289
Total kilowatt-hour sales (a)	<u>56,058</u>	54,399	54,151	51,380	53,548
Residential customer data					
Average annual KWH use	<u>11,659</u>	12,210	12,278	12,065	12,392
Average revenue billed per KWH	<u>6.42¢</u>	6.11¢	5.67¢	5.41¢	4.51¢
Source of energy (millions of KWH)					
Generated — Coal	<u>27,619</u>	26,394	32,466	38,927	42,513
— Nuclear (b)	<u>33,700</u>	32,632	25,059	15,009	14,229
— Hydro	<u>1,162</u>	1,995	2,114	1,569	843
— Oil and gas	<u>13</u>	—	8	7	146
Total generation	<u>62,494</u>	61,021	59,647	55,512	57,731
Purchased power and net interchange	<u>(1,742)</u>	<u>(2,908)</u>	<u>(1,003)</u>	<u>(301)</u>	<u>494</u>
Total output	<u>60,752</u>	58,113	58,644	55,211	58,225
Less: Catawba buyers' ownership	<u>3,827</u>	—	—	—	—
Plus: Purchases from Catawba	<u>3,769</u>	—	—	—	—
Total sources of energy	<u>60,694</u>	58,113	58,644	55,211	58,225
Line loss and Company usage	<u>4,636</u>	<u>3,714</u>	<u>4,493</u>	<u>3,831</u>	<u>4,677</u>
Total kilowatt-hour sales (a)	<u>56,058</u>	<u>54,399</u>	<u>54,151</u>	<u>51,380</u>	<u>53,548</u>
System average heat rate	<u>9,900</u>	9,853	9,762	9,666	9,633
System load factor	<u>55.8%</u>	62.2%	58.6%	56.8%	61.9%

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

(b) Includes 100% of Catawba Unit 1 generation.

Selected Financial Data

Duke Power Company

Quarterly Financial Data

A summary of quarterly financial data for 1985 and 1984 is as follows (dollars in thousands, except per-share data):

	Electric Revenues	Electric Operating Income	Net Income	Earnings Per Share
1985 by quarter				
Fourth	\$717,893	\$111,848	\$ 89,535	\$0.73
Third	751,237	141,416	119,358	1.03
Second	678,332	116,996	93,961	0.78
First	751,449	157,775	134,739	1.18
1984 by quarter				
Fourth	\$680,177	\$129,979	\$ 97,862	\$0.81
Third	729,047	156,746	139,001	1.23
Second	629,483	132,990	101,276	0.86
First	671,308	128,386	123,192	1.08

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

Stock Market Information

The Company had approximately 116,549 holders of record of common stock as of December 31, 1985, and 120,395 holders as of December 31, 1984. During 1985 approximately 46,098,900 shares of common stock were traded, compared with 39,432,900 during the previous year. The Company's common stock prices, as quoted by the New York Stock Exchange, and dividends paid are as follows:

	Dividends Per Share	Stock Price Range			Dividends Per Share	Stock Price Range	
		High	Low			High	Low
1985 by quarter							
Fourth	\$0.65	\$36 $\frac{1}{8}$	\$31 $\frac{1}{2}$	1984 by quarter			
Third	0.65	35 $\frac{1}{8}$	30 $\frac{1}{8}$	Fourth	\$0.62	\$30 $\frac{1}{8}$	\$27 $\frac{1}{8}$
Second	0.62	35 $\frac{3}{4}$	32 $\frac{1}{8}$	Third	0.62	27 $\frac{1}{8}$	24 $\frac{3}{4}$
First	0.62	32 $\frac{1}{8}$	28 $\frac{1}{2}$	Second	0.59	25	22 $\frac{3}{4}$
				First	0.59	26 $\frac{1}{8}$	22 $\frac{1}{4}$

Subsidiaries

Dollars in Thousands

Subsidiary Investments

	1985	1984
Property and investments — at cost		
Real estate, recreational and land development	\$39,856	\$39,323
Net current assets, principally investments, receivables and inventories	54,941	42,485
Total assets	94,797	81,808
Deferred income taxes	(5,985)	(4,023)
Total liabilities	(5,985)	(4,023)
Investments in and advances to subsidiaries*	\$88,812	\$77,785

*Reflects the Company's unconsolidated subsidiaries.

Selected Financial Data

Duke Power Company

Effects of Changing Prices

In recent years, the impact of general inflation and changes in specific prices has caused distortions in traditional accounting measurements of income and capital. Although the rates of inflation in recent years have substantially decreased, the replacement of existing plant capacity occurs at a significantly higher cost than recovered through historical cost depreciation because of the high levels of inflation in previous years. In response to this problem, the Financial Accounting Standards Board requires certain disclosures of the effects of inflation on a company's operations and financial position.

Because the accompanying supplementary information involves various assumptions and approximations, it should be viewed as an estimate of the effects of inflation, rather than a precise measurement.

Constant dollar accounting

Constant dollar accounting reflects the overall decline in the purchasing power of the dollar by restating historical costs in terms of dollars of equal purchasing power.

Current cost accounting

Current cost accounting reflects changes in specific prices of the property used in the Company's operations from the date the property was acquired to the present. This method differs from constant dollar accounting to the extent that costs of specific utility property have increased more or less rapidly than the rate of general inflation. The current cost amounts of plant in service represent the estimated cost for replacing existing plant facilities and were determined by indexing surviving plant costs by internally generated indices or the Handy-Whitman Index of Public Utility Construc-

tion Costs. Since plant facilities are not expected to be replaced precisely in kind, "current cost" does not necessarily represent the replacement cost of existing productive capacity. Current cost depreciation is computed by applying the same rates used in the historical cost statements to the current cost plant amounts.

Effects of rate regulation

Under the Company's present ratemaking procedures, only the historical cost of plant in service is recoverable in rates as depreciation. Therefore, in times of relatively high inflation, the erosion of plant in service resulting from inflation in the current year may be greater than is reflected in current cost adjustments and is reflected as a reduction to net recoverable cost. This reduction was not necessary in 1985, 1984 and 1983 because the level of inflation was less than in previous years.

The Company has significant amounts of long-term debt outstanding which serves as a partial hedge against inflation, as well as other net monetary liabilities, which will be paid back in dollars of less purchasing power. In the accompanying schedules, the gain from decline in purchasing power of net amounts owed results from inflation's effect on obligations to pay cash at a future date.

Other

Income statement items other than depreciation have not been adjusted. The Company's operation and maintenance expenses already include the average effects of changing prices during the period. Therefore, no adjustments have been made to them. No adjustments to income tax expense have been made in computing the impact of inflation since only historical costs are deductible for income tax purposes.

Supplementary Statement of Earnings for Common Stock Adjusted for Changing Prices

Duke Power Company

Dollars in Thousands	Year ended December 31, 1985	Historical dollar	Current cost
Electric revenues	<u>\$2,898,911</u>	<u>\$2,898,911</u>	
Operating expenses	1,262,100	1,262,100	
Maintenance of plant facilities	260,361	260,361	
Depreciation	319,295	571,626	
Taxes	529,120	529,120	
Total electric expenses	<u>2,370,876</u>	<u>2,623,207</u>	
Electric operating income	528,035	275,704	
Other income	<u>163,821</u>	<u>163,821</u>	
Income before interest deductions	691,856	439,525	
Interest deductions	254,263	254,263	
Net income	437,593	185,262	
Dividends on preferred and preference stocks	60,912	60,912	
Earnings for common stock	<u>\$ 376,681</u>	<u>\$ 124,350</u>	
Increase in specific prices (current cost) of utility plant held during the year*		\$ 121,450	
Reduction to net recoverable cost**		—	
Effect of increase in general price level		<u>(360,804)</u>	
Excess of increase in general price level over increase in specific prices		(239,354)	
Gain from decline in purchasing power of net amounts owed		127,494	
Net		<u>\$ (111,860)</u>	

*At December 31, 1985, current cost of electric plant, net of accumulated depreciation, was \$9,782,351,000.

**Due to the decrease in the rates of inflation in recent years, there is no reduction to the net recoverable cost of plant reflected for 1985.

Five-Year Comparison of Selected Supplementary Financial Data Adjusted for the Effects of Changing Prices

In thousands of average 1985 dollars, except per-share figures	1985	1984	1983	1982	1981
Current cost information:					
Income before extraordinary item	\$ 185,262	\$ 205,136	\$ 214,410	\$ 140,069	\$ 171,191
Earnings per share before extraordinary item	1.23	1.41	1.50	0.75	1.17
Net assets at year-end	2,885,862	2,871,715	2,777,544	2,632,026	2,413,850
Decrease in the current cost of electric plant in service, net of inflation, after reduction to net recoverable cost	239,354	267,339	289,189	110,873	312,765
Constant dollar information:					
Electric revenues	2,898,911	2,806,708	2,613,288	2,501,458	2,257,356
Common stock dividends per share	2.54	2.51	2.51	2.50	2.46
Market price per common share at year-end	34.81	29.62	26.67	25.62	23.61
General information:					
Purchasing power gain on net monetary items	127,494	142,833	145,022	162,880	386,682
Average consumer price index	322.2	311.1	298.4	289.1	272.4

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William S. Lee <i>Chairman of the Board and Chief Executive Officer</i>	James R. Bavis <i>Vice President Human Resources</i>	Paul G. Martin <i>Vice President Eastern Division</i>	Norman P. Morrow <i>Controller</i>
Douglas W. Booth <i>President and Chief Operating Officer</i>	Thomas C. Berry <i>Vice President Southern Division</i>	Dwight B. Moore <i>Vice President Central Division</i>	Richard J. Osborne <i>Treasurer</i>
William H. Grigg <i>Executive Vice President Finance and Administration</i>	Shem K. Blackley, Jr. <i>Vice President Transmission</i>	William O. Parker, Jr. <i>Vice President Fossil Production Department</i>	David L. Hauser <i>Assistant Controller</i>
Warren H. Owen <i>Executive Vice President Engineering, Construction and Production Group</i>	Ralph W. Bostian <i>Vice President Production Support Department</i>	Richard B. Priory <i>Vice President Design Engineering</i>	Eugene C. Sites <i>Assistant Controller</i>
Austin C. Thies <i>Executive Vice President Transmission, Distribution and Electric Operations Group</i>	J. Kenneth Clark <i>Vice President Corporate Communications</i>	William R. Stimart <i>Vice President Regulatory Affairs</i>	Hansel D. Whitley <i>Assistant Controller</i>
Henry L. Cranford <i>Senior Vice President Division Operations</i>	William A. Coley <i>Vice President Operation</i>	George E. Stubbins <i>Vice President Information Systems</i>	Sue A. Becht <i>Assistant Treasurer</i>
Donald H. Denton, Jr. <i>Senior Vice President Marketing and Rates</i>	Robert L. Dick <i>Vice President Construction</i>	Hal B. Tucker <i>Vice President Nuclear Production Department</i>	W. Bruce Shannon <i>Assistant Treasurer</i>
Steve C. Griffith, Jr. <i>Senior Vice President and General Counsel</i>	George W. Ferguson, Jr. <i>Vice President and Deputy General Counsel</i>	Fred E. West, Jr. <i>Vice President Charlotte Division</i>	Carolyn R. Duncan <i>Assistant Secretary</i>
John D. Hicks <i>Senior Vice President Public Affairs</i>	Excell O. Ferrell, III <i>Vice President Northern Division</i>	James W. White <i>Vice President General Services</i>	Phyllis T. Simpson <i>Assistant Secretary</i>
	Elbert N. Hedgepeth, Jr. <i>Vice President Distribution</i>	C. Joe Sherrill <i>Assistant Vice President Transmission-Substation Division</i>	Subsidiaries
	Duncan E. Lennon <i>Vice President and Tax Counsel</i>	Lewis F. Camp, Jr. <i>Secretary and Associate General Counsel</i>	Richard C. Ranson <i>President Crescent Land & Timber Corp.</i>
	John F. Lomax <i>Vice President Western Division</i>		W. T. Robertson, Jr. <i>President Mill-Power Supply Company</i>

Other Information**Notice of annual meeting**

The 1986 meeting of holders of Duke Power Company common stock will be held Thursday, April 24, at 10 a.m. in the O.J. Miller Auditorium of the Electric Center, 526 South Church Street, Charlotte N.C.

Transfer agent and registrar

Morgan Guaranty Trust Company
of New York
30 West Broadway
New York, N.Y. 10015

Stock exchange listing

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

Corporate headquarters

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

SEC Form 10-K and statistical supplement

Upon request, the Company will provide without charge a copy of its 1985 Annual Report to Shareholders on Form 10-K as filed with the Securities and Exchange Commission. Also available without charge is the Statistical Supplement to the 1985 Annual Report. Requests for these documents should be directed to Richard Williams, Investor Relations, Duke Power Company, P.O. Box 33189, Charlotte, N.C. 28242. Shareholders may call Investor Relations at 373-4579 (Charlotte) or at the following toll-free numbers: 1-800-532-0492 (North Carolina); 1-800-438-0142 (elsewhere in the United States).

Duke Power Company

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