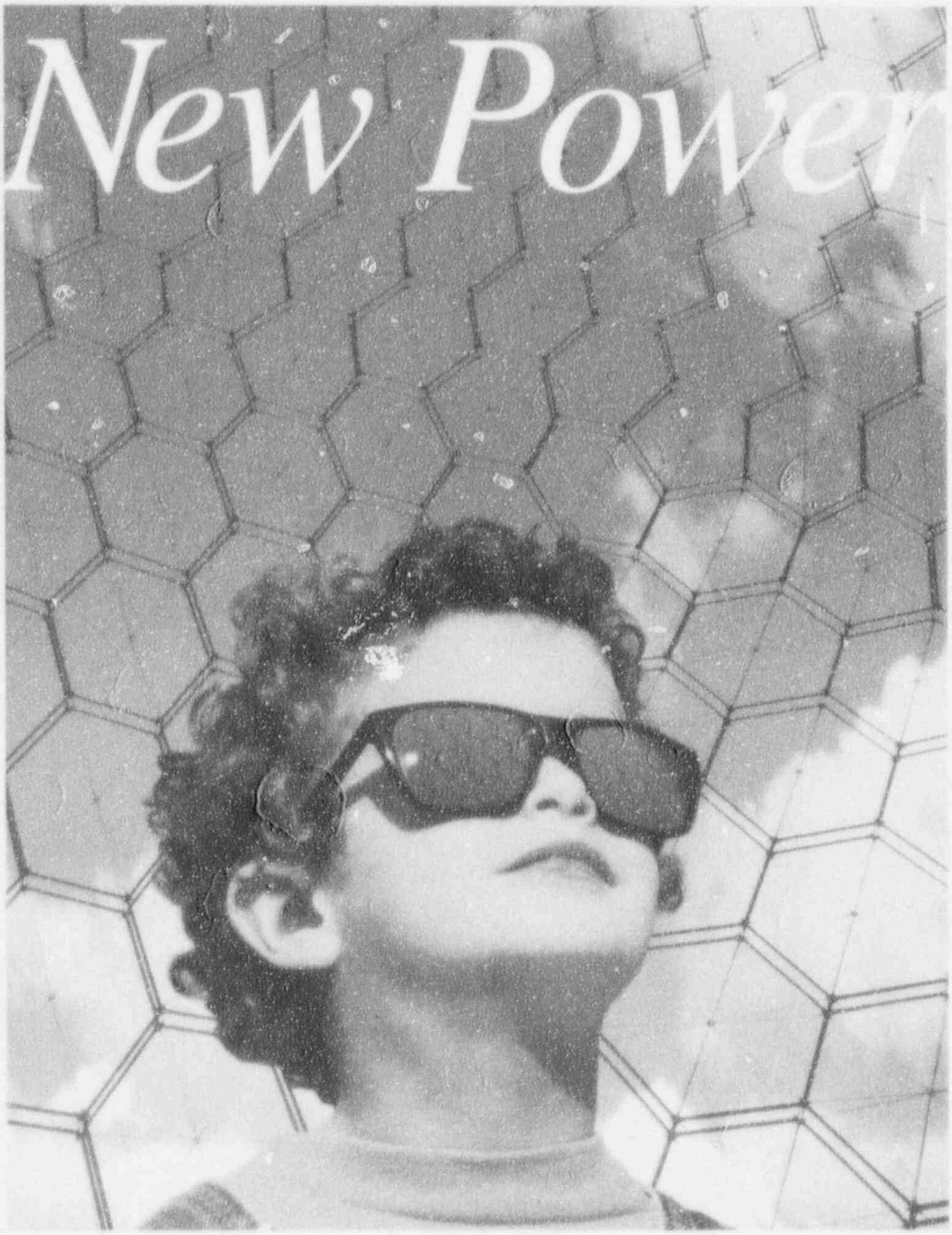

1996 Annual Report

The Cleveland Electric Illuminating Company

A SUBSIDIARY OF CENTERIOR ENERGY CORPORATION

About Cleveland Electric

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The Company, a wholly owned subsidiary of Centerior Energy Corporation, was incorporated under the laws of the State of Ohio in 1892 and provides electric service to a 1,700-square mile area of northeastern Ohio. Although the principal city in its service area is Cleveland, the Company derives about 77% of its total electric retail revenues from customers outside the city. The Company's 3,282 employees serve about 741,000 customers.

This report includes discussions regarding the pending merger of Centerior Energy Corporation and Ohio Edison Company to form FirstEnergy Corp. On March 27, 1997, common stock share owners of both companies approved the merger. Various aspects of the merger still remain subject to approval by certain regulatory agencies. The merger is expected to be consummated in late 1997, at which time the Company would become a wholly owned subsidiary of FirstEnergy Corp.

Executive Offices

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c/o Centerior Energy Corporation
6200 Oak Tree Boulevard
Independence, OH
Telephone: (216) 622-9800

Mail Address

The Cleveland Electric Illuminating Company
P.O. Box 5000
Cleveland, OH 44101

General information about the Company
and Centerior Energy Corporation is available on the Internet at
http://www.centerior.com

Directors

Robert J. Farling, Chairman and Chief Executive Officer of the Company and The Toledo Edison Company and Chairman, President and Chief Executive Officer of Centerior Energy Corporation and Centerior Service Company.

Murray R. Edelman, President of the Company, Vice Chairman of The Toledo Edison Company and Executive Vice President of Centerior Energy Corporation and Centerior Service Company.

Fred J. Lange, Jr., Vice President of the Company, President of The Toledo Edison Company and Senior Vice President of Centerior Energy Corporation and Centerior Service Company.

Officers

Chairman and Chief Executive Officer	*Robert J. Farling*
President	*Murray R. Edelman*
Vice President & Chief Financial Officer	*Terrence G. Linnert*
Vice President	*Jacquita K. Hauserman*
Vice President	*Fred J. Lange, Jr.*
Vice President	*Gary R. Leidich*
Regional Vice President – Eastern	*Jack A. Kline*
Regional Vice President – Central	*David W. Whitehead*
Treasurer	*David M. Blank*
Controller	*E. Lyle Pepin*
Secretary	*Janis T. Percio*

The Cover: Photograph is from our "New Power" advertising campaign.

Printed on recycled paper

Management's Financial Analysis

Outlook

Strategic Plan

In early 1994, Centerior Energy Corporation (Centerior Energy), along with The Cleveland Electric Illuminating Company (Company) and The Toledo Edison Company (Toledo Edison), created a strategic plan to achieve the twin goals of strengthening their financial conditions and improving their competitive positions. The Company and Toledo Edison are the two wholly owned electric utility subsidiaries of Centerior Energy. The plan's objectives relate to the combined operations of all three companies. To meet these goals, we seek to maximize share owner return on Centerior Energy common stock, achieve profitable revenue growth, become a leader in customer satisfaction, build a winning employee team and attain increasingly competitive supply costs. During 1996, the third year of the eight-year plan, we made strong gains toward reaching some plan objectives but need significant improvement on others.

A major step taken to reach the twin goals was Centerior Energy's agreement to merge with Ohio Edison Company (Ohio Edison) to form a new holding company called FirstEnergy Corp. (FirstEnergy). The proposed merger, combined with good operating performance, a successful price increase and the accelerated paydown of debt, resulted in a significant stock price gain, such that the total return to Centerior Energy common stock share owners during 1996 was 33%. The merger is expected to better position the merged companies to meet coming competitive challenges.

Revenue growth is a key objective of the plan, from pricing actions as well as market expansion.

In April 1996, The Public Utilities Commission of Ohio (PUCO) approved in full the $119 million price increases requested by the Company and Toledo Edison ($84 million and $35 million, respectively). The primary purpose of the increases was to provide additional revenues to recover all the costs of providing electric service, including deferred costs, and provide a fair return to Centerior Energy common stock share owners. The additional revenues also provided cash to accelerate the redemption of debt and preferred stock.

For the second year in a row, the Company's total kilowatt-hour sales increased. Although kilowatt-hour sales to our retail customers decreased by 1% compared to 1995 results, our wholesale sales increased by 27% from 1995 as a result of the good availability of our generating units and a more aggressive bulk power marketing effort. Adjusted for weather, kilowatt-hour sales to residential and commercial customers increased by 1% and 0.8%, respectively, from 1995.

Another key element of our revenue strategy is to offer long-term contracts to large industrial customers who might otherwise consider changing power suppliers. During 1996, we renewed and extended for as long as ten years contracts with many of our large industrial customers, including the five largest. While this strategy has resulted in lower prices for these customers, in the long run, it is expected to maximize share owner value by retaining our customer base in a changing industry. Prior to these renewals, 61% of our industrial base rate (nonfuel) revenues under contract was scheduled for renewal before 1999. Following the renewals, the comparable percentage is 18%. At year-end 1996, 51% of our industrial base rate revenues was under long-term contracts.

Our continued emphasis on economic development activities is adding to our opportunities for revenue growth. In 1996, we gained commitments on 24 economic development projects, representing almost $6 million in new and retained annual base rate revenues and nearly 4,000 new and retained jobs for Northeast Ohio.

Under the strategic plan, Centerior Energy and its subsidiaries are structured in six strategic business groups to better focus on competitiveness. During 1996, the Company reduced employment from about 3,600 to 3,300. Further reduction in our work force to about 3,100 is planned by year-end 1997. We also plan to reduce expenditures for operation and maintenance activities (exclusive of fuel and purchased power expenses) and capital projects from $593 million in 1996 to approximately $560 million in 1997 by continuing to streamline operations. We will continue to reduce our unit cost of fuel used for generating electricity, while safely improving the operating performance of our generation facilities.

Reducing fixed financing costs is another primary objective in strengthening our financial and competitive position. In 1996, we reduced our fixed obligations for debt, preferred stock and generation facilities leases (partially offset by the new accounts receivable securitization) by $145 million. See Notes 1(j) and 2. Interest expense and preferred dividends dropped $10 million. In the last three years, fixed obligations were reduced by $246 million.

In 1996, we reported earnings available for common stock of $78 million compared to $141 million in 1995. The decline in reported earnings is primarily attributable to the delay in implementing our price increase until late April, while we began at the end of 1995 to charge earnings for operating expenses and amortization of deferrals which the price increase was designed to recover. The price increase contributed approximately $33 million (after tax) more cash to our earnings in 1996. The change in regulatory accounting measures resulted in an $85 million decrease in reported earnings for 1996 versus 1995. In addition, 1996 results included a noncash charge against earnings of $11 million after tax for the disposition of inventory. Excluding these factors, basic earnings from operations in 1996 were the same as in 1995; however, the quality of reported earnings improved. The full benefit of our $84 million price increase, substantial reductions in operation and maintenance expenses and a continuing decline in interest charges are expected to result in improvement in earnings and cash flow from operations in 1997.

Pending Merger with Ohio Edison

On September 16, 1996, Centerior Energy announced its merger with Ohio Edison in a stock-for-stock transaction. Centerior Energy share owners will receive 0.525 of a share of FirstEnergy common stock for each share of Centerior Energy common stock owned, while Ohio Edison share owners will receive one share of FirstEnergy common stock for each share of Ohio Edison common stock owned. Following the merger, FirstEnergy will directly hold all of the issued and outstanding common stock of the Company, Toledo Edison and Ohio Edison.

FirstEnergy plans to account for the merger as a purchase in accordance with generally accepted accounting principles. If FirstEnergy elects to apply, or "push down", the effects of purchase accounting to the financial statements of the Company and Toledo Edison, the Company and Toledo Edison would record adjustments to: (1) reduce the carrying value of nuclear generating plant by $1.25 billion to fair value; (2) recognize goodwill of $865 million; (3) reduce common stock equity by $401 million; (4) reset retained earnings of the Company and Toledo Edison to zero; and (5) reduce the related deferred federal income tax liability by $438 million. These amounts reflect FirstEnergy's estimates of the pro forma combined adjustments for the Company and Toledo Edison as of September 30, 1996. The actual adjustments to be recorded could be materially different from these estimates. FirstEnergy has not decided whether to push down the effects of purchase accounting to the financial statements of the Company and Toledo Edison if the merger with Ohio Edison is completed, nor has FirstEnergy estimated the allocations between the two companies if push-down accounting is elected.

We believe that the merger will create a company that is better positioned to compete in the electric utility industry than either Centerior Energy or Ohio Edison could on a stand-alone basis, enhancing long-term share owner value and providing customers with reliable service at more stable and competitive prices.

The combination of Centerior Energy and Ohio Edison is a natural alliance of two companies with adjoining service areas who already share many major generating units. FirstEnergy expects to reduce costs, maximize efficiencies and increase management flexibility in order to enhance revenues, cash flows and earnings and be a more effective competitor in the increasingly competitive electric utility industry.

FirstEnergy anticipates the merger will result in net savings for the combined companies of approximately $1 billion over ten years, in addition to the impact of cost reduction programs underway at both companies. The additional savings, which probably could not be achieved without the merger, will result primarily from the reduction of duplicative functions and positions, joint dispatch of generating facilities and procurement efficiencies. FirstEnergy expects reductions in labor costs to comprise slightly over half the estimated savings. In addition, FirstEnergy expects to reduce system-wide debt by at least $2.5 billion through the year 2000, yielding additional long-term savings in the form of lower interest expense.

The Company's share of the $1 billion of savings will permit the Company to reduce prices to its customers as discussed below under FirstEnergy Rate Plan. Absent the merger, the Company plans to achieve savings as well, but at a lower level, which is expected to allow prices to be frozen at current levels until at least 2002 despite inflationary pressures.

Various aspects of the merger are subject to the approval of the Federal Energy Regulatory Commission (FERC) and other regulatory authorities. Common stock share owners of Centerior Energy and Ohio Edison are expected to vote on approval of the merger agreement on March 27, 1997. The merger must be approved by the affirmative votes of the share owners of at least two-thirds of the outstanding shares of Ohio Edison common stock and a majority of the outstanding shares of Centerior Energy common stock. The merger is expected to be effective in late 1997.

FirstEnergy Rate Plan

On January 30, 1997, the PUCO approved a Rate Reduction and Economic Development Plan (Plan) for the Company and Toledo Edison to be effective upon the consummation of the Centerior Energy and Ohio Edison merger. The Plan would be null and void if the merger is not consummated. The rate order granting the April 1996 price increase will remain in full force and effect during the pendency of the merger or if the merger is not consummated.

The Plan calls for a base rate freeze through 2005 (except to comply with any significant changes in environmental, regulatory or tax laws), followed by an immediate $310 million (which represents a decrease of approximately 15% from current levels) base rate reduction in 2006 (the Company's share is expected to be $217 million); interim reductions beginning seven months after consummation of the merger of $3 per month increasing to $5 per month per residential customer by July 1, 2001; $105 million for economic development and energy efficiency programs (the Company's share is expected to be $70 million); earnings caps for regulatory purposes for the Company and Toledo Edison; a commitment by FirstEnergy for a reduction, for regulatory accounting purposes, in nuclear and regulatory assets by the end of 2005 of at least $2 billion more than it otherwise would be, through revaluing facilities or accelerating depreciation and amortization; and a freeze in fuel cost factors until December 31, 2005, subject to PUCO review at year-end 2002 and annual inflation adjustments. The Plan permits the Company and Toledo Edison to dispose of generating assets subject to notice and possible PUCO approval, and to enter into associated power purchase arrangements.

Total price savings for the Company's customers of about $280 million are anticipated over the term of the Plan, as summarized below, excluding potential economic development benefits and assuming that the merger takes place on December 31, 1997. The total price savings for customers of the Company and Toledo Edison are expected to be about $391 million.

Year	Amount (millions of dollars)
1998	$ 15
1999	27
2000	31
2001	39
2002	42
2003	42
2004	42
2005	42
Total	$280

Under the Plan's earnings cap, the Company and Toledo Edison will be permitted to earn up to an 11.5% return on common stock equity for regulatory purposes during calendar years prior to 2000, 12% during calendar years 2000 and 2001, and 12.59% during calendar years 2001 through 2005. The regulatory return on equity is generally expected to be lower than the return on equity calculated for financial reporting purposes due to the calculation methodology defined by the Plan and, as discussed in the next paragraph, anticipated differences in accounting for the Plan for financial reporting versus regulatory purposes. If for any calendar year the regulatory return on equity exceeds the specified level, the excess will be credited to customers, first through a reduction in Percentage of Income Payment Plan (PIPP) arrearages and then as a credit to base rates. PIPP is a deferred payment program for low-income residential customers.

The Plan requires, for regulatory purposes, a revaluation of or an accelerated reduction in the investment in nuclear plant and certain regulatory assets of the Company and Toledo Edison (excluding amounts due from customers for future federal income taxes) by at least $2 billion by the end of 2005. FirstEnergy has not yet determined each company's estimated share of the $2 billion. Only a portion of the $2 billion of accelerated costs is expected to be charged against the two companies' earnings for financial reporting purposes by 2005.

FirstEnergy believes that the Plan will not provide for the full recovery of costs and a fair return on investment associated with the nuclear operations of the Company and Toledo Edison. Pursuant to the PUCO's order, FirstEnergy is required to submit to the PUCO staff the regulatory accounting and cost recovery details for implementing the Plan. After approval of such details by the PUCO staff, FirstEnergy expects that the Company and Toledo Edison will discontinue the application of Statement of Financial Accounting Standards (SFAS) 71 for their nuclear operations if and when consummation of the merger becomes probable. The remainder of their business is expected to continue to comply with the provisions of SFAS 71. At the time the merger is probable, the Company and Toledo Edison would be required to write off certain of their regulatory assets for financial reporting purposes. The write-off amounts would be determined at that time. FirstEnergy estimates the write-off amounts for the Company and Toledo Edison will total approximately $750 million. The Company's share of the write-off is expected to be about two-thirds of this amount. Under the Plan, some or all of this write-off cannot be applied toward the $2 billion regulatory commitment discussed above. For financial reporting purposes, nuclear generating units are not expected to be impaired. If events cause either the Company or Toledo Edison or both companies to conclude they no longer meet the criteria for applying SFAS 71 for the remainder of their business, they would be required to write off their remaining regulatory assets and measure all other assets for impairment. For a discussion of the criteria for complying with SFAS 71, see Note 7(a).

April 1996 Rate Order

In its April 1996 order, the PUCO granted price increases of $84 million and $35 million in annualized revenues to the Company and Toledo Edison, respectively. The Company and Toledo Edison intend to freeze rates at existing levels until at least 2002, although they are not precluded from requesting further price increases. In the order, the PUCO provided for recovery of all regulatory assets in the approved rates, and the Company and Toledo Edison continue to comply with the provisions of SFAS 71.

In connection with its order, the PUCO recommended that the Company and Toledo Edison write down certain assets for regulatory purposes by an aggregate of $1.25 billion through 2001. If the merger is consummated, the Company and Toledo Edison believe acceleration of $2 billion of costs under the Plan would fully satisfy this recommendation. The Company and Toledo Edison agree with the concept of accelerating the recognition of costs and the recovery of assets as such concept is consistent with the strategic objective to become more competitive. However, the Company and Toledo Edison believe that such acceleration must also be consistent with the reduction of debt and the opportunity for Centerior Energy common stock share owners to receive a fair return on their investment. Consideration of whether to implement a plan responsive to the PUCO's recommendation to revalue assets by $1.25 billion is pending the merger with Ohio Edison.

Notwithstanding the pending merger with Ohio Edison and discussions with regulators concerning the effect of the Plan on the Company's nuclear generating assets, we believe it is reasonable to expect that rates will be set at levels that will recover all current and anticipated costs associated with the Company's nuclear operations, including all associated regulatory assets, and such rates can be charged to and collected from customers. If there is a change in our evaluation of the competitive environment, regulatory framework or other factors, or if the PUCO significantly reduces the value of the Company's assets or reduces the approved return on common stock equity of 12.59% and overall rate of return of 10.06%, or both, for future regulatory purposes, the Company may be required to record material charges to earnings.

Merger of Toledo Edison into the Company

In October 1996, the FERC authorized the merger of Toledo Edison into the Company. The merger agreement between Centerior Energy and Ohio Edison requires the approval of Ohio Edison prior to consummation of the proposed merger of Toledo Edison into the Company. Ohio Edison has not yet made a decision. See Note 16.

Competition

Structural changes in the electric utility industry from actions by both federal and state regulatory bodies are continuing to place downward pressure on prices and increase competition for customers. The Company's nuclear plant licenses have required open-access transmission for its wholesale customers for 20 years. More recently, the Federal Energy Policy Act of 1992 initiated broader access to utility transmission systems and, in 1996, the FERC adopted rules relating to open-access transmission services. The open-access rules require utilities to deliver power from other utilities or generation sources to their wholesale customers at nondiscriminatory prices.

A number of states have enacted transition legislation which provides for introduction of competition for retail electric business and recovery of stranded investment. Several groups in Ohio are studying the possible introduction of retail wheeling and stranded investment recovery. Retail wheeling occurs when a customer obtains power from a utility company other than its local utility. The term "stranded investment" generally refers to fixed costs approved for recovery under traditional regulatory methods that would become unrecoverable, or "stranded", as a result of legislative changes which allow for widespread competition. The PUCO is sponsoring discussions among a group of business, utility and consumer interests to explore ways of promoting competitive options without unduly harming the interests of utility company share owners or customers. The PUCO also has introduced two pilot projects, both intended as initial steps to introduce competitive elements into the Ohio electric utility business.

A bill to restructure the electric utility industry in Ohio has been introduced in the Ohio House of Representatives. A bipartisan committee from both legislative houses has been formed to study the issue. Centerior Energy presented the Company's model for customer choice, called Energy Choice, to the PUCO discussion group in August 1996. Under this model, full retail competition should be introduced by 2002, but two essential elements, recovery of stranded investment and levelization of tax burdens among energy suppliers, must be resolved in the interim to assure share owners' recovery of and a fair return on their investments.

Although competitive pressures are increasing, the traditional regulatory framework remains in place and is expected to continue for the foreseeable future. We cannot predict when and to what extent retail wheeling or other forms of competition will be allowed. We believe that pure competition (unrestricted retail wheeling for all customer classifications) is at least several years away and that any transition to pure competition will be in phases. The FERC and the PUCO have acknowledged the need to provide at least partial recovery of stranded investment as greater competition is permitted and, therefore, we believe that there will be a mechanism developed for the recovery of at least some stranded investment. However, due to the uncertainty involved, there is a risk in connection with the introduction of retail wheeling that some of the Company's assets may not be fully recovered.

Competition from municipal electric suppliers for retail business in our service area is producing both favorable and unfavorable results in our business. Through aggressive door-to-door campaigns, we have been successful in limiting the number of conversions of our customers to Cleveland Public Power (CPP) under its ongoing expansion plan. CPP is the largest municipal supplier in our service area. In 1996, we reached agreements to serve a number of large Cleveland commercial customers, including some previously served by CPP. We continue to pursue legal remedies to halt illegal municipal expansion in our service area.

The merger with Ohio Edison and the benefits of the Plan to our customers are expected to better position us to deal with the structural changes taking place in the industry and to improve our competitive position with respect to municipalization.

Nuclear Operations

The Company has interests in three nuclear generating units — Davis-Besse Nuclear Power Station (Davis-Besse), Perry Nuclear Power Plant Unit 1 (Perry Unit 1) and Beaver Valley Power Station Unit 2 (Beaver Valley Unit 2). Toledo Edison operates Davis-Besse and the Company operates Perry Unit 1.

All three units were out of service temporarily for refueling during 1996; thus, plant availability factors for Davis-Besse, Perry Unit 1 and Beaver Valley Unit 2 were 85%, 76% and 70%, respectively, for 1996. The 1994-1996 availability factors for the units were 91%, 72%, and 85%, for Davis-Besse, Perry Unit 1 and Beaver Valley Unit 2, respectively. The comparable industry averages for a three-year period (as of August 31, 1996) are 82% for pressurized water reactors such as Davis-Besse and Beaver Valley Unit 2 and 78% for boiling water reactors such as Perry Unit 1. Davis-Besse established a plant record with its 509-day continuous run at or near full capacity before shutting down for its scheduled refueling outage in April 1996.

A significant part of the strategic plan involves ongoing efforts to increase the availability and lower the cost of production of our nuclear units. In 1996, we continued our progress toward increasing long-term unit availability while continuing to lower production costs. The goal of our nuclear improvement program is to replicate Davis-Besse's operational excellence and cost reduction gains at Perry Unit 1, while improving performance ratings.

Our nuclear units may be impacted by activities or events beyond our control. Operating nuclear units have experienced unplanned outages or extensions of scheduled outages because of equipment problems or new regulatory requirements. A major accident at a nuclear facility anywhere in the world could cause the Nuclear Regulatory Commission (NRC) to limit or prohibit the operation or licensing of any domestic nuclear unit. If one of our nuclear units is taken out of service for an extended period for any reason, including an accident at such unit or any other nuclear facility, we cannot predict whether regulatory authorities would impose unfavorable rate treatment. Such treatment could include taking our affected unit out of rate base, thereby not permitting us to recover our investment in and earn a return on it, or disallowing certain construction or maintenance costs. An extended outage coupled with unfavorable rate treatment could have a material adverse effect on our financial condition, cash flows and results of operations. Premature plant closings could also have a material adverse effect on our financial condition, cash flows and results of operations because the estimated cost to decommission a plant exceeds the current funding in the decommissioning trust.

Hazardous Waste Disposal Sites

The Company has been named as a "potentially responsible party" (PRP) for three sites listed on the Superfund National Priorities List (Superfund List) and is aware of its potential involvement in the cleanup of several other sites. Allegations that the Company disposed of hazardous waste at these sites, and the amount involved, are often unsubstantiated and subject to dispute. Federal law provides that all PRPs for a particular site be held liable on a joint and several basis. If the Company were held liable for 100% of the cleanup costs of all the sites referred to above, the cost could be as high as $300 million. However, we believe that the actual cleanup costs will be substantially lower than $300 million, that the Company's share of any cleanup costs will be substantially less than 100% and that most of the other PRPs are financially able to contribute their share. The Company has accrued a liability totaling $7 million at December 31, 1996 based on estimates of the costs of cleanup and its proportionate responsibility for such costs. We believe that the ultimate outcome of these matters will not have a material adverse effect on our financial condition, cash flows or results of operations.

A new Statement of Position issued by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants, Inc. effective January 1, 1997 provides guidance on the recognition and disclosure of environmental remediation liabilities. Adoption of the statement in 1997 is not expected to have a material adverse effect on our financial condition or results of operations.

Common Stock Dividends

Centerior Energy's common stock dividend has been funded in recent years primarily by common stock dividends paid by the Company. The declaration and payment of future common stock dividends is at the discretion of the Company's Board of Directors, subject to applicable legal restrictions. In 1994, Centerior Energy lowered its common stock dividend which reduced its cash outflow by over $110 million annually. This action, in turn, reduced the common stock cash dividend demand on the Company. The Company used the increased retained cash to redeem debt and preferred stock more quickly than would otherwise be the case. In 1996, Centerior Energy increased its common stock cash dividend demand on the Company to fund its common stock dividend and other corporate activities. See Capital Resources and Liquidity-Liquidity below.

Capital Resources and Liquidity

1994-1996 Cash Requirements

We need cash for normal corporate operations (including the payment of dividends), retirement of maturing securities, and an ongoing program of constructing and improving facilities to meet demand for electric service and to comply with government regulations. Our cash construction expenditures totaled $164 million in 1994, $148 million in 1995 and $104 million in 1996. Our debt and preferred stock maturities and sinking fund requirements totaled $62 million in 1994, $282 million in 1995 and $176 million in 1996. In addition, we optionally redeemed $341 million of securities in the 1994-1996 period, including $143 million of tax-exempt issues refunded in 1995.

In July 1996, Centerior Funding Corporation (Centerior Funding), the Company's wholly owned subsidiary, issued $150 million in AAA-rated accounts receivable-backed investor certificates due in 2001 with an interest rate of 7.2%. The Company's share of the net proceeds from the accounts receivable securitization was used to redeem higher-cost securities and for general corporate purposes.

As a result of these activities, the embedded cost of the Company's debt at the end of 1996 declined to 8.83% versus 8.88% in 1995 and 8.96% in 1994.

The Company also utilized short-term borrowings to help meet its cash needs. The Company had $112 million of notes payable to affiliates at December 31, 1996.

The Company is a party to a $125 million revolving credit facility which was renewed in May 1996 for a one-year term. In 1996, portions of the nuclear fuel lease financing vehicles for the Company and Toledo Edison matured: $84 million of intermediate-term notes in September and a $150 million letter of credit supporting short-term borrowing in October. These facilities were replaced by $100 million of intermediate-term notes and a $100 million two-year letter of credit. The net reduction in the facility size results from lower nuclear fuel financing requirements.

1997 and Beyond Cash Requirements

Our anticipated 1997 cash requirements for construction are $110 million. Debt and preferred stock maturities and sinking fund requirements are $145 million. Of this amount, $70 million are for a tax-exempt issue secured by first mortgage bonds and subject to optional tender by the owners on November 1, 1997, which we expect to replace with a similar issue at a substantially lower interest rate. We expect to meet remaining requirements with internal cash generation and cash reserves. We also expect to be able to optionally redeem more debt and preferred stock in 1997 than we did in 1996.

We expect to meet all of our 1998-2001 cash requirements with internal cash generation. Estimated cash requirements for our construction program during this period total $496 million. Debt and preferred stock maturities and sinking fund requirements total $445 million for the same period. If economical, additional securities may be redeemed with funding expected to be provided through internal cash generation.

Consummation of the merger with Ohio Edison is expected to reduce the Company's cash construction requirements and improve its ability to redeem fixed obligations.

Liquidity

Net cash flow from operating activities in 1996 was significantly increased from 1995 by implementation of the price increase effective in April 1996. Most of the net proceeds from our accounts receivable securitization of $65 million were used to redeem other higher-cost securities, producing net savings in our overall cost of borrowing. In 1996, we reduced our fixed obligations for debt, preferred stock and generation facilities leases (partially offset by the new accounts receivable securitization) by $145 million. At year-end 1996, we had $30 million in cash and temporary cash investments, down from $70 million at year-end 1995.

Additional first mortgage bonds may be issued by the Company under its mortgage on the basis of property additions, cash or refundable first mortgage bonds. If the applicable interest coverage test is met, the Company may issue first mortgage bonds on the basis of property additions and, under certain circumstances, refundable bonds. At December 31, 1996, the Company would have been permitted to issue approximately $666 million of additional first mortgage bonds. If FirstEnergy elects to apply purchase accounting to the Company if the merger with Ohio Edison is completed, the Company's first mortgage bond capacity would be adversely affected.

The Company also is able to raise funds through the sale of preferred and preference stock. There are no restrictions on the Company's ability to issue preferred or preference stock.

The Company and Toledo Edison have $273 million in financing vehicles to support their nuclear fuel leases, $83 million of which mature in 1997. Replacement financing for the maturing issues may not be needed in 1997. The Company is a party to a $125 million revolving credit facility which is expected to be renewed when it matures in May 1997.

Current credit ratings for the Company are as follows:

	Standard & Poor's Corporation	Moody's Investors Service, Inc.
First mortgage bonds	BB	Ba2
Subordinate debt	B+	Ba3
Preferred stock	B	b2

Following the FirstEnergy merger announcement, both rating agencies placed the Company's securities on credit watch with positive implications.

Federal law prohibits the Company from paying dividends out of capital accounts. The Company has since 1993 declared and paid preferred and common stock dividends out of appropriated current net income included in retained earnings. At the times of such declarations and payments, the Company had a deficit in its retained earnings. At December 31, 1996, the Company had $130 million of appropriated retained earnings for the payment of dividends.

As part of a routine audit, the FERC is considering statements which it requested and received from the Company and Toledo Edison supporting the payment of dividends out of appropriated current net income included in retained earnings while total retained earnings were a deficit. At December 31, 1996, the Company's retained earnings deficit was $276 million. The final disposition of this issue is a factor expected to be considered by FirstEnergy in deciding whether to apply purchase accounting to the Company and Toledo Edison, one effect of which would be to reset deficit retained earnings to zero. If the merger is not consummated or if FirstEnergy determines not to apply purchase accounting to the two companies, the Company and Toledo Edison intend to continue to support their position and pursue all available alternatives to allow them to continue the declaration and payment of dividends.

Results of Operations

1996 vs. 1995

Factors contributing to the 1.2% increase in 1996 operating revenues are as follows:

Increase (Decrease) in Operating Revenues	Millions of Dollars
Base Rates	$ 51
KWH Sales Volume and Mix	(41)
Wholesale Revenues	14
Fuel Cost Recovery Revenues	(9)
Miscellaneous Revenues	6
Total	$ 21

The increase in 1996 base rates revenues resulted primarily from the April 1996 rate order issued by the PUCO for the Company as discussed under Outlook-April 1996 Rate Order and in Note 7(b). Renegotiated contracts for certain large industrial customers resulted in a decrease in base revenues which partially offset the effect of the general price increase. For the second year in a row, total kilowatt-hour sales increased. Total sales increased 1.3% because of a 27% increase in wholesale sales, the result of the good availability of our generating units and a more aggressive bulk power marketing effort. Residential and commercial kilowatt-hour sales decreased 2.1% and 0.6%, respectively, primarily because of the cooler summer weather in 1996. On a weather-normalized basis, residential and commercial sales increased 1% and 0.8%, respectively. Industrial kilowatt-hour sales decreased 0.2% primarily because of fewer sales to large automotive manufacturers. Lower 1996 fuel cost recovery revenues resulted from favorable changes in the fuel cost factors. The weighted average of these fuel cost factors decreased approximately 3%. Miscellaneous revenues increased in 1996 primarily because of new revenues relating to a generating plant lease agreement in effect for four months during the year. The parties canceled the agreement because the FERC insisted on terms which were not economic to the parties.

For 1996, operating revenues were 32% residential, 32% commercial, 29% industrial and 7% other, and kilowatt-hour sales were 23% residential, 28% commercial, 37% industrial and 12% other. The average prices per kilowatt-hour for residential, commercial and industrial customers were 11.34, 9.67 and 6.57 cents, respectively.

Operating expenses increased 4.4% in 1996. The cessation of the Rate Stabilization Program deferrals and the commencement of their amortization in December 1995 resulted in the increase in the net amortization of deferred operating expenses. See Note 7(d). Depreciation and amortization expenses increased primarily because of a $7 million net increase in depreciation related to changes in depreciation rates, as discussed in Note 1(e), and the cessation of the accelerated amortization of unrestricted investment tax credits under the Rate Stabilization Program, which was reported in 1995 as a $6 million reduction of depreciation. Other operation and maintenance expenses in 1996 included a $17 million one-time charge for the disposition of inventory as part of a reengineering of the supply chain process. Reengineering the supply chain process increases the use of technology, consolidates warehousing and uses just-in-time purchase and delivery. Federal income taxes decreased as a result of lower pretax operating income.

A nonoperating loss resulted in 1996 primarily from costs related to the accounts receivable securitization, as discussed in Note 1(j), and the Company's share of merger-related expenses. The deferral of carrying charges related to the Rate Stabilization Program ended in November 1995. The federal income tax credit for nonoperating income increased in 1996 accordingly.

Interest charges and preferred dividend requirements decreased in 1996 because of the redemption of securities and refundings at favorable terms in 1996 and 1995.

1995 vs. 1994

Factors contributing to the 4.2% increase in 1995 operating revenues are as follows:

Increase (Decrease) in Operating Revenues	Millions of Dollars
KWH Sales Volume and Mix	$ 52
Wholesale Revenues	11
Fuel Cost Recovery Revenues	19
Miscellaneous Revenues	(11)
Total	$ 71

Industrial kilowatt-hour sales increased 0.3% in 1995, but sales grew 2.4% excluding reductions at two low-margin steel producers (representing 7.6% of industrial revenues). Residential and commercial kilowatt-hour sales increased 2.8% and 3%, respectively, primarily because of the hot summer weather, although there was about 2% nonweather-related growth in commercial kilowatt-hour sales. Other sales increased 36% because of a 58% increase in wholesale sales due principally to the hot summer and good availability of our generating units. Weather accounted for approximately $24 million of the $41 million increase in 1995 base rate revenues. Higher 1995 fuel cost recovery revenues resulted from an increase in the fuel cost factors. The weighted average of these fuel cost factors increased approximately 7%. Miscellaneous revenues decreased in 1995 primarily because the 1994 amount included the billings to other utility owners and lessees for overhead expenses related to the 1994 refueling and maintenance outage of the jointly owned Perry Unit 1.

For 1995, operating revenues were 32% residential, 32% commercial, 29% industrial and 7% other, and kilowatt-hour sales were 24% residential, 28% commercial, 38% industrial and 10% other. The average prices per kilowatt-hour for residential, commercial and industrial customers were 11.04, 9.47 and 6.54 cents, respectively. The changes from 1994 were not significant.

Operating expenses increased 5.3% in 1995. Fuel and purchased power expenses increased as higher fuel expense was partially offset by lower purchased power expense. The higher fuel expense was attributable to increased generation and more amortization of previously deferred fuel costs than the amount amortized in 1994. The higher other operation and maintenance expenses resulted primarily from charges for an ongoing inventory reduction program and the recognition of costs associated with preliminary engineering studies. Federal income taxes increased as a result of higher pretax operating income. Taxes, other than federal income taxes, increased primarily due to property tax increases resulting from plant additions, real estate valuation increases and a nonrecurring tax credit recorded in 1994.

Report of Independent Public Accountants

To the Share Owners and
Board of Directors of
The Cleveland Electric Illuminating Company:

We have audited the accompanying consolidated balance sheet and consolidated statement of capitalization of The Cleveland Electric Illuminating Company (a wholly owned subsidiary of Centerior Energy Corporation) and subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of income, retained earnings and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Cleveland Electric Illuminating Company and subsidiaries as of December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles.

Arthur Andersen LLP

Cleveland, Ohio
February 14, 1997

Income Statement

	For the years ended December 31,		
	1996	1995	1994
		(millions of dollars)	
Operating Revenues	$1,790	$1,769	$1,698
Operating Expenses			
Fuel and purchased power (1)	408	413	391
Other operation and maintenance	426	418	394
Generation facilities rental expense, net	56	56	56
Total operation and maintenance	890	887	841
Depreciation and amortization	210	196	195
Taxes, other than federal income taxes	230	230	218
Amortization of deferred operating expenses, net	26	(36)	(34)
Federal income taxes	75	94	82
	1,431	1,371	1,302
Operating Income	359	398	396
Nonoperating Income (Loss)			
Allowance for equity funds used during construction	2	2	4
Other income and deductions, net	(10)	2	6
Deferred carrying charges	—	29	25
Federal income taxes—credit (expense)	6	(2)	(4)
	(2)	31	31
Income Before Interest Charges	357	429	427
Interest Charges			
Debt interest	242	248	247
Allowance for borrowed funds used during construction	(2)	(3)	(5)
	240	245	242
Net Income	117	184	185
Preferred Dividend Requirements	39	43	45
Earnings Available for Common Stock	$ 78	$ 141	$ 140

(1) Includes purchased power expense of $105 million, $102 million and $111 million in 1996, 1995 and 1994, respectively, for all purchases from Toledo Edison.

Retained Earnings

	For the years ended December 31,		
	1996	1995	1994
		(millions of dollars)	
Retained Earnings (Deficit) at Beginning of Year	$(193)	$(262)	$(280)
Additions			
Net income	117	184	185
Deductions			
Dividends declared:			
Common stock	(161)	(74)	(122)
Preferred stock	(39)	(41)	(45)
Net Increase (Decrease)	(83)	69	18
Retained Earnings (Deficit) at End of Year	$(276)	$(193)	$(262)

The accompanying notes are an integral part of these statements.

Balance Sheet

	December 31, 1996	December 31, 1995
	(millions of dollars)	
ASSETS		
Property, Plant and Equipment		
Utility plant in service	$6,938	$6,872
Less: accumulated depreciation and amortization	2,252	2,094
	4,686	4,778
Construction work in progress	57	73
	4,743	4,851
Nuclear fuel, net of amortization	113	122
Other property, less accumulated depreciation	54	58
	4,910	5,031
Current Assets		
Cash and temporary cash investments	30	70
Amounts due from customers and others, net	181	152
Amounts due from affiliates	6	5
Unbilled revenues	9	79
Materials and supplies, at average cost		
Owned	52	101
Under consignment	24	—
Taxes applicable to succeeding years	182	184
Other	14	7
	498	598
Regulatory and Other Assets		
Regulatory assets	1,350	1,398
Nuclear plant decommissioning trusts	76	61
Other	44	64
	1,470	1,523
Total Assets	$6,878	$7,152

The accompanying notes are an integral part of this statement.

	December 31, 1996	December 31, 1995
	(millions of dollars)	
CAPITALIZATION AND LIABILITIES		
Capitalization		
Common stock equity	$1,045	$1,127
Preferred stock		
With mandatory redemption provisions	186	215
Without mandatory redemption provisions	238	241
Long-term debt	2,441	2,666
	3,910	4,249
Current Liabilities		
Current portion of long-term debt and preferred stock	145	177
Current portion of nuclear fuel lease obligations	52	55
Accounts payable	83	89
Accounts and notes payable to affiliates	171	64
Accrued taxes	316	296
Accrued interest	52	59
Other	59	56
	878	796
Deferred Credits and Other Liabilities		
Unamortized investment tax credits	176	184
Accumulated deferred federal income taxes	1,306	1,298
Unamortized gain from Bruce Mansfield Plant sale	296	311
Accumulated deferred rents for Bruce Mansfield Plant	99	92
Nuclear fuel lease obligations	74	86
Retirement benefits	73	65
Other	66	71
	2,090	2,107
Total Capitalization and Liabilities	$6,878	$7,152

Cash Flows

	For the years ended December 31,		
	1996	1995	1994
	(millions of dollars)		
Cash Flows from Operating Activities (1)			
Net Income	$ 117	$ 184	$ 185
Adjustments to Reconcile Net Income to Cash from Operating Activities:			
Depreciation and amortization	210	196	195
Deferred federal income taxes	25	56	50
Unbilled revenues	5	(7)	27
Deferred fuel	7	9	(20)
Deferred carrying charges	—	(29)	(25)
Leased nuclear fuel amortization	46	71	55
Amortization of deferred operating expenses, net	26	(36)	(34)
Allowance for equity funds used during construction	(2)	(2)	(4)
Changes in amounts due from customers and others, net	(4)	(6)	10
Net proceeds from accounts receivable securitization	65	—	—
Changes in materials and supplies	25	10	2
Changes in accounts payable	(6)	1	(34)
Changes in working capital affecting operations	11	(17)	3
Other noncash items	(7)	—	4
Total Adjustments	401	246	229
Net Cash from Operating Activities	518	430	414
Cash Flows from Financing Activities (2)			
Notes payable to affiliates	107	(53)	58
First mortgage bond issues	—	443	46
Maturities, redemptions and sinking funds	(290)	(460)	(116)
Nuclear fuel lease obligations	(52)	(58)	(60)
Dividends paid	(200)	(117)	(142)
Premiums, discounts and expenses	(1)	(11)	(1)
Net Cash from Financing Activities	(436)	(256)	(215)
Cash Flows from Investing Activities (2)			
Cash applied to construction	(104)	(148)	(164)
Interest capitalized as allowance for borrowed funds used during construction	(2)	(3)	(5)
Contributions to nuclear plant decommissioning trusts	(12)	(13)	(14)
Other cash applied	(4)	(6)	(27)
Net Cash from Investing Activities	(122)	(170)	(210)
Net Change in Cash and Temporary Cash Investments	(40)	4	(11)
Cash and Temporary Cash Investments at Beginning of Year	70	66	77
Cash and Temporary Cash Investments at End of Year	$ 30	$ 70	$ 66

(1) Interest paid (net of amounts capitalized)	*$ 237*	*$ 214*	*$ 208*
Federal income taxes paid	*$ 30*	*$ 66*	*$ 15*

(2) Increases in Nuclear Fuel and Nuclear Fuel Lease Obligations in the Balance Sheet resulting from the noncash capitalizations under nuclear fuel agreements are excluded from this statement.

The accompanying notes are an integral part of this statement.

Statement of Capitalization

	1996 Shares Outstanding	Current Call Price Per Share	December 31, 1996	December 31, 1995
			(millions of dollars)	
COMMON STOCK EQUITY:				
Common shares, without par value: 105 million authorized; 79.6 million outstanding in 1996 and 1995			$1,241	$1,241
Other paid-in capital			80	79
Retained earnings (deficit)			(276)	(193)
Total Common Stock Equity			1,045	1,127
PREFERRED STOCK:				
Without par value, 4,000,000 preferred shares authorized				
Subject to mandatory redemption:				
$ 7.35 Series C	120,000	$ 101.00	12	13
88.00 Series E	12,000	1,011.48	12	15
9.125 Series N	150,000	100.00	15	30
91.50 Series Q	53,572	1,000.00	54	64
88.00 Series R	50,000	—	50	50
90.00 Series S	74,000	—	73	73
			216	245
Less: Current maturities			30	30
Total Preferred Stock, with Mandatory Redemption Provisions			186	215
Not subject to mandatory redemption:				
$ 7.40 Series A	500,000	101.00	50	50
7.56 Series B	450,000	102.26	45	45
Adjustable Series L	474,000	100.00	46	49
42.40 Series T	200,000	—	97	97
Total Preferred Stock, without Mandatory Redemption Provisions			238	241
LONG-TERM DEBT:				
First mortgage bonds:				
7.625% due 2002			195	245
7.375% due 2003			100	100
9.500% due 2005			300	300
8.750% due 2005			75	75
10.880% due 2006			—	50
9.250% due 2009			50	50
8.375% due 2011			125	125
8.375% due 2012			75	75
9.375% due 2017			300	300
10.000% due 2020			100	100
9.000% due 2023			150	150
			1,470	1,570
Tax-exempt issues secured by first mortgage bonds:				
7.000% due 2006-2009			64	64
6.000% due 2011**			6	6
6.000% due 2011**			2	2
6.200% due 2013			48	48
8.000% due 2013			79	79
3.500% due 2015**			40	40
6.000% due 2017**			1	1
3.500% due 2018**			73	73
6.000% due 2020**			41	41
6.000% due 2020**			9	9
9.750% due 2022***			70	70
6.850% due 2023			30	30
8.000% due 2023			73	73
7.625% due 2025			54	54
7.750% due 2025			45	45
7.700% due 2025			44	44
			679	679

The accompanying notes are an integral part of this statement.

	December 31, 1996	December 31, 1995
	(millions of dollars)	
LCNG-TERM DEBT: (Continued)		
Medium-term notes secured by first mortgage bonds:		
8.700% due 1996	—	20
9.100% due 1996	—	32
9.110% due 1996	—	13
9.000% due 1996	—	13
9.140% due 1996	—	12
9.050% due 1996	—	10
8.950% due 1996	—	40
9.450% due 1997	43	43
9.000% due 1998	5	5
8.870% due 1998	10	10
8.260% due 1998	2	2
8.330% due 1998	25	25
8.170% due 1998	11	11
8.150% due 1998	8	8
8.160% due 1998	5	5
9.250% due 1999	52	52
9.300% due 1999	25	25
7.670% due 1999	3	3
7.250% due 1999	12	12
7.850% due 1999	25	25
7.770% due 1999	17	17
8.290% due 1999	10	10
9.200% due 2001	15	15
7.420% due 2001	10	20
9.050% due 2001	5	5
8.680% due 2001	15	15
8.540% due 2001	3	3
8.560% due 2001	4	4
8.550% due 2001	5	5
7.850% due 2002	5	5
8.130% due 2002	28	28
7.750% due 2003	15	15
9.520% due 2021	8	8
	366	516
Tax-exempt notes:		
6.500% due 1996	—	3
5.500% due 1997	*	*
6.700% due 2006	20	21
5.700% due 2008	7	8
6.700% due 2011	6	6
5.875% due 2012	14	14
	47	52
Bank loans secured by subordinate mortgage:		
7.500% due 1996	—	2
Unamortized premium (discount), net	(6)	(6)
	2,556	2,813
Less: Current maturities	115	147
Total Long-Term Debt	2,441	2,666
TOTAL CAPITALIZATION	$3,910	$4,249

** Denotes debt of less than $1 million.*
*** Denotes variable rate issue with December 31, 1996 interest rate shown.*
**** Subject to optional tender by the owners on November 1, 1997.*

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies

(a) General

The Company is an electric utility serving Northeast Ohio and a wholly owned subsidiary of Centerior Energy. The Company's financial statements have historically included the accounts of the Company's wholly owned subsidiaries, which in the aggregate were not material. In 1995, the Company formed a wholly owned subsidiary, Centerior Funding, to serve as the transferor in connection with an accounts receivable securitization completed in 1996 as discussed in Note 1(j). In 1994, the Company transferred its investments in three wholly owned subsidiaries to Centerior Energy at cost ($26 million) via property dividends. All significant intercompany items have been eliminated in consolidation.

The Company follows the Uniform System of Accounts prescribed by the FERC and adopted by the PUCO. Rate-regulated utilities are subject to SFAS 71 which governs accounting for the effects of certain types of rate regulation. Pursuant to SFAS 71, certain incurred costs are deferred for recovery in future rates. See Note 7(a).

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. The estimates are based on an analysis of the best information available. Actual results could differ from those estimates.

The Company is a member of the Central Area Power Coordination Group (CAPCO). Other members are Toledo Edison, Duquesne Light Company, Ohio Edison and its wholly owned subsidiary, Pennsylvania Power Company. The members have constructed and operate generation and transmission facilities for their joint use.

(b) Related Party Transactions

Operating revenues, operating expenses and interest charges include those amounts for transactions with affiliated companies in the ordinary course of business operations.

The Company's transactions with Toledo Edison are primarily for firm power, interchange power, transmission line rentals and jointly owned power plant operations and construction. See Notes 2 and 3. As discussed in Note 1(j), beginning in May 1996, Centerior Funding began serving as the transferor in connection with the accounts receivable securitization for the Company and Toledo Edison.

Centerior Service Company (Service Company), a wholly owned subsidiary of Centerior Energy, provides management, financial, administrative, engineering, legal and other services at cost to the Company and other affiliated companies. The Service Company billed the Company $149 million, $141 million and $136 million in 1996, 1995 and 1994, respectively, for such services.

(c) Revenues

Customers are billed on a monthly cycle basis for their energy consumption based on rate schedules or contracts authorized by the PUCO. An accrual is made at the end of each month to record the estimated amount of unbilled revenues for kilowatt-hours sold in the current month but not billed by the end of that month.

A fuel factor is added to the base rates for electric service. This factor is designed to recover from customers the costs of fuel and most purchased power. It is reviewed and adjusted semiannually in a PUCO proceeding. See Management's Financial Analysis — Outlook-FirstEnergy Rate Plan.

(d) Fuel Expense

The cost of fossil fuel is charged to fuel expense based on inventory usage. The cost of nuclear fuel, including an interest component, is charged to fuel expense based on the rate of consumption. Estimated future nuclear fuel disposal costs are being recovered through base rates.

The Company defers the differences between actual fuel costs and estimated fuel costs currently being recovered from customers through the fuel factor. This matches fuel expenses with fuel-related revenues.

Owners of nuclear generating plants are assessed by the federal government for the cost of decontamination and decommissioning of nuclear enrichment facilities operated by the United States Department of Energy. The assessments are based upon the amount of enrichment services used in prior years and cannot be imposed for more than 15 years (to 2007). The Company has accrued a liability for its share of the total assessments. These costs have been recorded as a regulatory asset since the PUCO is allowing the Company to recover the assessments through its fuel cost factors. See Note 7(a).

(e) Depreciation and Decommissioning

The cost of property, plant and equipment is depreciated over their estimated useful lives on a straight-line basis. In its April 1996 rate order, the PUCO approved changes in depreciation rates for the Company. An increase in the depreciation rate for nuclear property from 2.5% to 2.88% increased annual depreciation expense approximately $13 million. A reduction in the composite depreciation rate for nonnuclear property from 3.34% to 3.23% decreased annual depreciation expense by approximately $3 million. The changes in depreciation rates were effective in April 1996 and resulted in a $7 million net increase in 1996 depreciation expense.

The Company accrues the estimated costs of decommissioning its three nuclear generating units. The accruals are required to be funded in an external trust. The PUCO requires that the expense and payments to the external trusts be determined on a levelized basis by dividing the unrecovered decommissioning costs in current dollars by the remaining years in the licensing period of each unit. This methodology requires that the net earnings on the trusts be reinvested therein with the intent of having net earnings offset inflation. The PUCO requires that the estimated costs of decommissioning and the funding level be reviewed at least every five years.

In April 1996, pursuant to the PUCO rate order, the Company decreased its annual decommissioning expense accruals to $12 million from the $13 million level in 1995. The accruals are reflected in current rates. The accruals are based on adjustments to updated, site-specific studies for each of the units completed in 1993 and 1994. These estimates reflect the DECON method of decommissioning (prompt decontamination), and the locations and cost characteristics specific to the units, and include costs associated with decontamination and dismantlement for each of the units. The estimate for Davis-Besse also includes the cost of site restoration. The adjustments to the updated studies which reduced the annual accruals beginning in April 1996 were attributable to changed assumptions on radioactive waste burial cost estimates and the exclusion of site restoration costs for Perry Unit 1 and Beaver Valley Unit 2. After the decommissioning of these units in the future, the two plant sites may be usable for new power production facilities or other industrial purposes.

The revised estimates for the units in current dollars and in dollars at the time of license expiration, assuming a 4% annual inflation rate, are as follows:

Generating Unit	License Expiration Year	Amount	Future Amount
		(millions of dollars)	
Davis-Besse	2017	$176	$ 451
Perry Unit 1	2026	132	482
Beaver Valley Unit 2	2027	54	203
Total		$362	$1,136

The classification, Accumulated Depreciation and Amortization, in the Balance Sheet at December 31, 1996 includes $85 million of decommissioning costs previously expensed and the earnings on the external trust funding. This amount exceeds the Balance Sheet amount of the external Nuclear Plant Decommissioning Trusts because the reserve began prior to the external trust funding. The trust earnings are recorded as an increase to the trust assets and the related component of the decommissioning reserve (included in Accumulated Depreciation and Amortization).

The staff of the Securities and Exchange Commission has questioned certain of the current accounting practices of the electric utility industry, including those of the Company, regarding the recognition, measurement and classification of decommissioning costs for nuclear generating stations in the financial statements. In response to these questions, the Financial Accounting Standards Board (FASB) is reviewing the accounting for removal costs, including decommissioning. If current accounting practices are changed, the annual provision for decommissioning could increase; the estimated cost for decommissioning could be recorded as a liability rather than as accumulated depreciation; and trust fund income from the external decommissioning trusts could be reported as investment income rather than as a reduction to decommissioning expense. The FASB issued an exposure draft on the subject on February 7, 1996 and continues to review the subject.

(f) Property, Plant and Equipment

Property, plant and equipment are stated at original cost less amounts disallowed by the PUCO. Construction costs include related payroll taxes, retirement benefits, fringe benefits, management and general overheads and allowance for funds used during construction (AFUDC). AFUDC represents the estimated composite debt and equity cost of funds used to finance construction. This noncash allowance is credited to income. The AFUDC rate was 10.32% in 1996, 10.33% in 1995 and 9.68% in 1994.

Maintenance and repairs for plant and equipment are charged to expense as incurred. The cost of replacing plant and equipment is charged to the utility plant accounts. The cost of property retired plus removal costs, after deducting any salvage value, is charged to the accumulated provision for depreciation.

(g) Deferred Gain from Sale of Utility Plant

The sale and leaseback transaction discussed in Note 2 resulted in a net gain for the sale of the Bruce Mansfield Generating Plant (Mansfield Plant). The net gain was deferred and is being amortized over the term of the leases. The amortization and the lease expense amounts are reported in the Income Statement as Generation Facilities Rental Expense, Net.

(h) Interest Charges

Debt Interest reported in the Income Statement does not include interest on obligations for nuclear fuel under construction. That interest is capitalized. See Note 6.

Losses and gains realized upon the reacquisition or redemption of long-term debt are deferred, consistent with the regulatory rate treatment. See Note 7(a). Such losses and gains are either amortized over the remainder of the original life of the debt issue retired or amortized over the life of the new debt issue when the proceeds of a new issue are used for the debt redemption. The amortizations are included in debt interest expense.

(i) Federal Income Taxes

The Company uses the liability method of accounting for income taxes in accordance with SFAS 109. See Note 8. This method requires that deferred taxes be recorded for all temporary differences between the book and tax bases of assets and liabilities. The majority of these temporary differences are attributable to property-related basis differences. Included in these basis differences is the equity component of AFUDC, which will increase future tax expense when it is recovered through rates. Since this component is not recognized for tax purposes, the Company must record a liability for its tax obligation. The PUCO permits recovery of such taxes from customers when they become payable. Therefore, the net amount due from customers through rates has been recorded as a regulatory asset and will be recovered over the lives of the related assets. See Note 7(a).

Investment tax credits are deferred and amortized over the lives of the applicable property as a reduction of depreciation expense.

(j) Accounts Receivable Securitization

In May 1996, the Company and Toledo Edison began to sell on a daily basis substantially all of their retail customer accounts receivable and unbilled revenue receivables to Centerior Funding pursuant to a five-year asset-backed securitization agreement.

In July 1996, Centerior Funding completed a public sale of \$150 million of receivables-backed investor certificates in a transaction that qualifies for sale accounting treatment for financial reporting purposes. Costs associated with the sale totaling \$5 million in 1996 are included in Other Income and Deductions, Net in the Income Statement. These costs are expected to be \$11 million annually over the remaining period.

(k) Materials and Supplies

In December 1996, the Company sold substantially all of its materials and supplies and fossil fuel inventories for certain generating units and other storage locations to an independent entity at book value. The buyer now provides all of these inventories under a consignment arrangement. In accordance with SFAS 49 accounting for product financing arrangements, the inventories continue to be reported as assets in the Balance Sheet even though the buyer owns the inventories since the Company has guaranteed to be a buyer of last resort.

(2) Utility Plant Sale and Leaseback Transactions

The Company and Toledo Edison are co-lessees of 18.26% (150 megawatts) of Beaver Valley Unit 2 and 6.5% (51 megawatts), 45.9% (358 megawatts) and 44.38% (355 megawatts) of Units 1, 2 and 3 of the Mansfield Plant, respectively. These leases extend through 2017 and are the result of sale and leaseback transactions completed in 1987.

Under these leases, the Company and Toledo Edison are responsible for paying all taxes, insurance premiums, operation and maintenance expenses, and all other similar costs for their interests in the units sold and leased back. They may incur additional costs in connection with capital improvements to the units. The Company and Toledo Edison have options to buy the interests back at certain times at a premium and at the end of the leases for the fair market value at that time or to renew the leases. The leases include conditions for mandatory termination (and possible repurchase of the leasehold interests) upon certain events of default.

As co-lessee with Toledo Edison, the Company is also obligated for Toledo Edison's lease payments. If Toledo Edison is unable to make its payments under the Beaver Valley Unit 2 and Mansfield Plant leases, the Company would be obligated to make such payments. No such payments have been made on behalf of Toledo Edison.

Future minimum lease payments under the operating leases at December 31, 1996 are summarized as follows:

Year	For the Company	For Toledo Edison
	(millions of dollars)	
1997	$ 63	$ 102
1998	63	102
1999	70	108
2000	76	111
2001	75	111
Later Years	1,170	1,696
Total Future Minimum Lease Payments	$1,517	$2,230

Rental expense is accrued on a straight-line basis over the terms of the leases. The amount recorded in 1996, 1995 and 1994 as annual rental expense for the Mansfield Plant leases was $70 million. See Note 1(g). Amounts charged to expense in excess of the lease payments are classified as Accumulated Deferred Rents in the Balance Sheet.

The Company is buying 150 megawatts of Toledo Edison's Beaver Valley Unit 2 leased capacity entitlement. Purchased power expense for this transaction was $99 million, $98 million and $108 million in 1996, 1995 and 1994, respectively. We anticipate that this purchase will continue indefinitely. The future minimum lease payments through 2017 associated with Beaver Valley Unit 2 aggregate $1.265 billion.

(3) Property Owned with Other Utilities and Investors

The Company owns, as a tenant in common with other utilities and those investors who are owner-participants in various sale and leaseback transactions (Lessors), certain generating units as listed below. Each owner owns an undivided share in the entire unit. Each owner has the right to a percentage of the generating capability of each unit equal to its ownership share. Each utility owner is obligated to pay for only its respective share of the construction costs and operating expenses. Each Lessor has leased its capacity rights to a utility which is obligated to pay for such Lessor's share of the construction costs and operating expenses. The Company's share of the operating expenses of these generating units is included in the Income Statement. The Balance Sheet classification of Property, Plant and Equipment at December 31, 1996 includes the following facilities owned by the Company as a tenant in common with other utilities and Lessors:

Generating Unit	Ownership Megawatts (% Share)	Property, Plant and Equipment (Exclusive of Nuclear Fuel)	Accumulated Depreciation
		(millions of dollars)	
Seneca Pumped Storage	351 (80.00%)	$ 65	$ 24
Eastlake Unit 5	411 (68.80)	161	—
Davis-Besse	454 (51.38)	711	250
Perry Unit 1	371 (31.11)	1,774	392
Beaver Valley Unit 2 and Common Facilities (Note 2)	201 (24.47)	1,279	319
Total		$3,990	$985

Depreciation for Eastlake Unit 5 has been accumulated with all other nonnuclear depreciable property rather than by specific units of depreciable property.

(4) Construction and Contingencies

(a) Construction Program

The estimated cost of the Company's construction program for the 1997-2001 period is $624 million, including AFUDC of $17 million and excluding nuclear fuel.

The Clean Air Act Amendments of 1990 (Clean Air Act) require, among other things, significant reductions in the emission of sulfur dioxide and nitrogen oxides by fossil-fueled generating units. Our strategy provides for compliance primarily through greater use of low-sulfur coal at some of our units and the use of emission allowances. Total capital expenditures from 1994 through 1996 in connection with Clean Air Act compliance amounted to $32 million. The plan will require additional capital expenditures over the 1997-2006 period of approximately $25 million for nitrogen oxide control equipment and other plant process modifications. In addition, higher fuel and other operation and maintenance expenses will be incurred. Recently proposed particulate and ozone ambient standards have the potential to increase future compliance costs.

(b) Hazardous Waste Disposal Sites

The Company is aware of its potential involvement in the cleanup of three sites listed on the Superfund List and several other sites. The Company has accrued a liability totaling $7 million at December 31, 1996 based on estimates of the costs of cleanup and its proportionate responsibility for such costs. We believe that the ultimate outcome of these matters will not have a material adverse effect on our financial condition, cash flows or results of operations. See Management's Financial Analysis — Outlook-Hazardous Waste Disposal Sites.

(5) Nuclear Operations and Contingencies

(a) Operating Nuclear Units

The Company's three nuclear units may be impacted by activities or events beyond our control. An extended outage of one of our nuclear units for any reason, coupled with any unfavorable rate treatment, could have a material adverse effect on our financial condition, cash flows and results of operations. See the discussion of these and other risks in Management's Financial Analysis — Outlook-Nuclear Operations.

(b) Nuclear Insurance

The Price-Anderson Act limits the public liability of the owners of a nuclear power plant to the amount provided by private insurance and an industry assessment plan. In the event of a nuclear incident at any unit in the United States resulting in losses in excess of the level of private insurance (currently $200 million), the Company's maximum potential assessment under that plan would be $85 million per incident. The assessment is limited to $11 million per year for each nuclear incident. These assessment limits assume the other CAPCO companies contribute their proportionate share of any assessment for the generating units that they have an ownership or leasehold interest in.

The utility owners and lessees of Davis-Besse, Perry and Beaver Valley also have insurance coverage for damage to property at these sites (including leased fuel and cleanup costs). Coverage amounted to $1.3 billion for Davis-Besse and $2.75 billion for each of the Perry and Beaver Valley sites as of January 1, 1997. Damage to property could exceed the insurance coverage by a substantial amount. If it does, the Company's share of such excess amount could have a material adverse effect on its financial condition, cash flows and results of operations. In addition, the Company can be assessed a maximum of $12 million under these policies during a policy year if the reserves available to the insurer are inadequate to pay claims arising out of an accident at any nuclear facility covered by the insurer.

The Company also has extra expense insurance coverage. It includes the incremental cost of any replacement power purchased (over the costs which would have been incurred had the units been operating) and other incidental expenses after the occurrence of certain types of accidents at our nuclear units. The amounts of the coverage are 100% of the estimated extra expense per week during the 52-week period starting 21 weeks after an accident and 80% of such estimate per week for the next 104 weeks. The amount and duration of extra expense could substantially exceed the insurance coverage.

(6) Nuclear Fuel

Nuclear fuel is financed for the Company and Toledo Edison through leases with a special-purpose corporation. The total amount of financing currently available under these lease arrangements is $273 million ($173 million from intermediate-term notes and $100 million from bank credit arrangements). The intermediate-term notes mature in the 1997 through 2000 period. The bank credit arrangements terminate in October 1998. The special-purpose corporation may not need alternate financing in 1997 to replace $83 million of maturing intermediate-term notes. At December 31, 1996, $129 million of nuclear fuel was financed for the Company. The Company and Toledo Edison severally lease their respective portions of the nuclear fuel and are obligated to pay for the fuel as it is consumed in a reactor. The lease rates are based on various intermediate-term note rates, bank rates and commercial paper rates.

The amounts financed include nuclear fuel in the Davis-Besse, Perry Unit 1 and Beaver Valley Unit 2 reactors with remaining lease payments for the Company of $49 million, $51 million and $18 million, respectively, at December 31, 1996. The nuclear fuel amounts financed and capitalized also included interest charges incurred by the lessors amounting to $3 million in 1996, $4 million in 1995 and $7 million in 1994. The estimated future lease amortization payments for the Company based on projected consumption are $52 million in 1997, $40 million in 1998, $38 million in 1999, $35 million in 2000 and $34 million in 2001.

(7) Regulatory Matters

(a) Regulatory Accounting Requirements and Regulatory Assets

The Company is subject to the provisions of SFAS 71 and has complied with its provisions. SFAS 71 provides, among other things, for the deferral of certain incurred costs that are probable of future recovery in rates. We monitor changes in market and regulatory conditions and consider the effects of such changes in assessing the continuing applicability of SFAS 71. Criteria that could give rise to discontinuation of the application of SFAS 71 include: (1) increasing competition which significantly restricts the Company's ability to charge prices which allow it to recover operating costs, earn a fair return on invested capital and recover the amortization of regulatory assets and (2) a significant change in the manner in which rates are set by the PUCO from cost-based regulation to some other form of regulation. Regulatory assets represent probable future revenues to the Company associated with certain incurred costs, which it will recover from customers through the rate-making process.

Effective January 1, 1996, the Company adopted SFAS 121 which imposes stricter criteria for carrying regulatory assets than SFAS 71 by requiring that such assets be probable of recovery at each balance sheet date. The criteria under SFAS 121 for plant assets require such assets to be written down if the book value exceeds the projected net future undiscounted cash flows.

Regulatory assets in the Balance Sheet are as follows:

	December 31,	
	1996	1995
	(millions of dollars)	
Amounts due from customers for future federal income taxes, net	$ 634	$ 651
Unamortized loss on reacquired debt	58	61
Pre-phase-in deferrals*	320	331
Rate Stabilization Program deferrals	300	313
Other	38	42
Total	$1,350	$1,398

* Represent deferrals of operating expenses and carrying charges for Perry Unit 1 and Beaver Valley Unit 2 in 1987 and 1988 which are being amortized over the lives of the related property.

As of December 31, 1996, customer rates provide for recovery of all the above regulatory assets. The remaining recovery periods for about $1.2 billion of the regulatory assets approximate 30 years. The remaining recovery periods for the rest of the regulatory assets generally range from about two to 20 years. Regulatory liabilities in the Balance Sheet at December 31, 1996 and 1995 totaled $24 million and $17 million, respectively.

(b) Rate Order

On April 11, 1996, the PUCO issued an order for the Company and Toledo Edison granting price increases aggregating $119 million in annualized revenues ($84 million for the Company and $35 million for Toledo Edison). The PUCO rate order provided for recovery of all costs to provide regulated services, including amortization of regulatory assets, in the approved prices. The new prices were implemented in late April 1996. The average price increase for the Company's customers was 4.9% with the actual percentage increase depending upon the customer class. The Company and Toledo Edison intend to freeze prices through at least 2002, although they are not precluded from requesting further price increases.

The PUCO also recommended that the Company and Toledo Edison reduce the value of their assets for regulatory purposes by an aggregate $1.25 billion through 2001. This represents an incremental reduction beyond the normal level in nuclear plant and regulatory assets. Implementation of the price increases was not contingent upon a revaluation of assets. The PUCO invited the Company and Toledo Edison to file a proposal to effectuate the PUCO's recommendation and expressed a willingness to consider alternatives to its recommendation. The PUCO stated in its order that failure by the Company and Toledo Edison to follow the recommendation could result in a PUCO-ordered write-down of assets for regulatory purposes. The PUCO approved a return on common stock equity of 12.59% and an overall rate of return of 10.06% for both companies. However, the PUCO also indicated the authorized return could be lowered by the PUCO if the Company and Toledo Edison do not implement the recommendation. In August 1996, various intervenors appealed the PUCO rate order to the Ohio Supreme Court. The Company and Toledo Edison did not appeal the order to the Ohio Supreme Court. In connection with the PUCO order discussed in Management's Financial Analysis — Outlook-FirstEnergy Rate Plan, certain parties agreed to request a stay of their appeals until completion of the pending merger with Ohio Edison.

(c) Assessment

The Company and Toledo Edison agree with the concept of accelerating the recognition of costs and recovery of assets as such concept is consistent with the strategic objective to become more competitive. However, the Company and Toledo Edison believe that such acceleration must also be consistent with the reduction of debt and the opportunity for Centerior Energy common stock share owners to receive a fair return on their investment. Consideration of whether to implement a plan responsive to the PUCO's recommendation to revalue assets by $1.25 billion is pending the merger with Ohio Edison.

We have evaluated the Company's markets, regulatory conditions and ability to bill and collect the approved prices, and conclude that the Company continues to comply with the provisions of SFAS 71 and its regulatory assets remain probable of recovery. If there is a change in our evaluation of the competitive environment, regulatory framework or other factors, or if the PUCO significantly reduces the value of the Company's assets or reduces the approved return on common stock equity of 12.59% and overall rate of return of 10.06%, or both, for future regulatory purposes, the Company may be required to record material charges to earnings. In particular, if we determine that the Company no longer meets the criteria for SFAS 71, the Company would be required to record a before-tax charge to write off the regulatory assets shown above. In the more likely event that only a portion of operations (such as nuclear operations) no longer meets the criteria of SFAS 71, a write-off would be limited to regulatory assets that are not reflected in the Company's cost-based prices established for the remaining regulated operations. In addition, we would be required to evaluate whether the changes in the competitive and regulatory environment which led to discontinuing the application of SFAS 71 to some or all of the Company's operations would also result in a write-down of property, plant and equipment pursuant to SFAS 121.

See Management's Financial Analysis — Outlook-FirstEnergy Rate Plan for a discussion of a regulatory plan for the Company and Toledo Edison and its effect on their compliance with SFAS 71.

(d) Rate Stabilization Program

The Rate Stabilization Program that the PUCO approved in October 1992 allowed the Company to defer and subsequently amortize and recover certain costs not being recovered in rates at that time. Recovery of both the costs no longer being deferred and the amortization of the 1992-1995 deferrals began in late April 1996 with the implementation of the price increase granted by the PUCO as discussed above. The cost deferrals recorded in 1995 and 1994 pursuant to the Rate Stabilization Program were $76 million and $70 million, respectively. The amortization of the deferrals began in December 1995. The total amortization was $12 million and $1 million in 1996 and 1995, respectively.

The regulatory accounting measures under the Rate Stabilization Program also provided for the accelerated amortization of certain benefits during the 1992-1995 period. The total annual amount of such accelerated benefits was $28 million in both 1995 and 1994.

(8) Federal Income Tax

The components of federal income tax expense recorded in the Income Statement were as follows:

	1996	1995	1994
	(millions of dollars)		
Operating Expenses:			
Current	$ 55	$49	$ 53
Deferred	20	45	29
Total Charged to Operating Expenses	75	94	82
Nonoperating Income:			
Current	(11)	(9)	(17)
Deferred	5	11	21
Total Expense (Credit) to Nonoperating Income	(6)	2	4
Total Federal Income Tax Expense	$ 69	$96	$ 86

The deferred federal income tax expense results from the temporary differences that arise from the different years when certain expenses are recognized for tax purposes as opposed to financial reporting purposes. Such temporary differences relate principally to depreciation and deferred operating expenses and carrying charges.

Federal income tax, computed by multiplying income before taxes by the 35% statutory rate, is reconciled to the amount of federal income tax recorded on the books as follows:

	1996	1995	1994
	(millions of dollars)		
Book Income Before Federal Income Tax	$186	$280	$271
Tax on Book Income at Statutory Rate	$ 65	$ 98	$ 95
Increase (Decrease) in Tax:			
Depreciation	8	8	6
Rate Stabilization Program	—	(18)	(18)
Other items	(4)	8	3
Total Federal Income Tax Expense	$ 69	$ 96	$ 86

The Company joins in the filing of a consolidated federal income tax return with its affiliated companies. The method of tax allocation reflects the benefits and burdens realized by each company's participation in the consolidated tax return, approximating a separate return result for each company.

For tax reporting purposes, the Perry Nuclear Power Plant Unit 2 (Perry Unit 2) abandonment was recognized in 1994 and resulted in a $204 million loss with a corresponding $71 million reduction in federal income tax liability. Because of the alternative minimum tax (AMT), $40 million of the $71 million was realized in 1994. The remaining $31 million will not be realized until 1999. Additionally, a repayment of approximately $29 million of previously allowed investment tax credits was recognized in 1994.

Under SFAS 109, temporary differences and carryforwards resulted in deferred tax assets of $420 million and deferred tax liabilities of $1.726 billion at December 31, 1996 and deferred tax assets of $425 million and deferred tax liabilities of $1.723 billion at December 31, 1995. These are summarized as follows:

	December 31,	
	1996	1995
	(millions of dollars)	
Property, plant and equipment	$1,482	$1,468
Deferred carrying charges and operating expenses	134	139
Net operating loss carryforwards	(26)	(67)
Investment tax credits	(95)	(99)
Sale and leaseback transactions	(121)	(123)
Other	(68)	(20)
Net deferred tax liability	$1,306	$1,298

For tax purposes, net operating loss (NOL) carryforwards of approximately $74 million are available to reduce future taxable income and will expire in 2009. The 35% tax effect of the NOLs is $26 million. Additionally, AMT credits of $174 million that may be carried forward indefinitely are available to reduce future tax.

(9) Retirement Benefits

(a) Retirement Income Plan

Centerior Energy sponsors jointly with its subsidiaries a noncontributing pension plan (Centerior Pension Plan) which covers all employee groups. The amount of retirement benefits generally depends upon the length of service. Under certain circumstances, benefits can begin as early as age 55. The funding policy is to comply with the Employee Retirement Income Security Act of 1974 guidelines.

Pension costs (credits) for Centerior Energy and its subsidiaries for 1994 through 1996 were comprised of the following components:

	1996	1995	1994
	(millions of dollars)		
Service cost for benefits earned during the period	$ 13	$ 10	$ 13
Interest cost on projected benefit obligation	28	26	26
Actual return on plan assets	(50)	(53)	(2)
Net amortization and deferral	2	9	(34)
Net costs (credits)	$ (7)	$ (8)	$ 3

Pension costs (credits) for the Company and its pro rata share of the Service Company's costs were $(5) million for both 1996 and 1995, and $2 million for 1994.

The following table presents a reconciliation of the funded status of the Centerior Pension Plan. The Company's share of the Centerior Pension Plan's total projected benefit obligation approximates 50%.

	December 31, 1996	December 31, 1995
	(millions of dollars)	
Actuarial present value of benefit obligations:		
Vested benefits	$326	$304
Nonvested benefits	16	2
Accumulated benefit obligation	342	306
Effect of future compensation levels	53	54
Total projected benefit obligation	395	360
Plan assets at fair market value	421	394
Funded status	26	34
Unrecognized net gain from variance between assumptions and experience	(56)	(68)
Unrecognized prior service cost	14	15
Transition asset at January 1, 1987 being amortized over 19 years	(32)	(36)
Net accrued pension liability	$(48)	$(55)

A September 30 measurement date was used for 1996 and 1995 reporting. At December 31, 1996, the settlement (discount) rate and long-term rate of return on plan assets assumptions were 7.75% and 11%, respectively. The long-term rate of annual compensation increase assumption was 3.5% for 1997 and 4% thereafter. At December 31, 1995, the settlement rate and long-term rate of return on plan assets assumptions were 8% and 11%, respectively. The long-term rate of annual compensation increase assumption was 3.5% for 1996 and 1997 and 4% thereafter. At December 31, 1996 and 1995, the Company's net prepaid pension cost included in Regulatory and Other Assets — Other in the Balance Sheet was $15 million and $11 million, respectively.

Plan assets consist primarily of investments in common stock, bonds, guaranteed investment contracts, cash equivalent securities and real estate.

(b) Other Postretirement Benefits

Centerior Energy sponsors jointly with its subsidiaries a postretirement benefit plan which provides all employee groups certain health care, death and other postretirement benefits other than pensions. The plan is contributory, with retiree contributions adjusted annually. The plan is not funded. Under SFAS 106, the accounting standard for postretirement benefits other than pensions, the expected costs of such benefits are accrued during the employees' years of service.

The components of the total postretirement benefit costs for 1994 through 1996 were as follows:

	1996	1995	1994
	(millions of dollars)		
Service cost for benefits earned during the period	$ 1	$ 1	$ 1
Interest cost on accumulated postretirement benefit obligation	12	11	11
Amortization of transition obligation at January 1, 1993 of $104 million over 20 years	5	5	5
Amortization of gain	—	(1)	—
Total costs	$18	$16	$17

These amounts included costs for the Company and its pro rata share of the Service Company's costs.

The accumulated postretirement benefit obligation and accrued postretirement benefit cost for the Company and its share of the Service Company's obligation are as follows:

	December 31, 1996	December 31, 1995
	(millions of dollars)	
Accumulated postretirement benefit obligation attributable to:		
Retired participants	$(108)	$(124)
Fully eligible active plan participants	(3)	(2)
Other active plan participants	(21)	(19)
Accumulated postretirement benefit obligation	(132)	(145)
Unrecognized net gain from variance between assumptions and experience	(31)	(12)
Unamortized transition obligation	74	79
Accrued postretirement benefit cost	$ (89)	$ (78)

The Balance Sheet classification of Retirement Benefits at December 31, 1996 and 1995 includes only the Company's accrued postretirement benefit cost of $73 million and $65 million, respectively, and excludes the Service Company's portion since the Service Company's total accrued cost is carried on its books.

A September 30 measurement date was used for 1996 and 1995 reporting. At December 31, 1996 and 1995, the settlement rate and the long-term rate of annual compensation increase assumptions were the same as those discussed for pension reporting in Note 9(a). At December 31, 1996, the assumed annual health care cost trend rates (applicable to gross eligible charges) were 7.5% for medical and 7% for dental in 1997. Both rates reduce gradually to a fixed rate of 4.75% by 2003. Elements of the obligation affected by contribution caps are significantly less sensitive to the health care cost trend rate than other elements. If the assumed health care cost trend rates were increased by one percentage point in each future year, the accumulated postretirement benefit obligation as of December 31, 1996 would increase by $3 million and the aggregate of the service and interest cost components of the annual postretirement benefit cost would increase by $0.3 million.

(10) Guarantees

The Company has guaranteed certain loan and lease obligations of a coal supplier under a long-term coal supply contract. At December 31, 1996, the principal amount of the loan and lease obligations guaranteed by the Company under the contract was $19 million.

The prices under the contract which includes certain minimum payments are sufficient to satisfy the loan and lease obligations and mine closing costs over the life of the contract. If the contract is terminated early for any reason, the Company would attempt to reduce the termination charges and would ask the PUCO to allow recovery of such charges from customers through the fuel factor. See Management's Financial Analysis — Outlook-FirstEnergy Rate Plan.

(11) Capitalization

(a) Capital Stock Transactions

Preferred stock shares retired during the three years ended December 31, 1996 are listed in the following table.

	1996	1995	1994
	(thousands of shares)		
Subject to Mandatory Redemption:			
$ 7.35 Series C	(10)	(10)	(10)
88.00 Series E	(3)	(3)	(3)
Adjustable Series M	—	(100)	(100)
9.125 Series N	(150)	(111)	(189)
91.50 Series Q	(11)	(11)	—
90.00 Series S	—	(1)	—
Not Subject to Mandatory Redemption:			
Adjustable Series L	(26)	—	—
Total	(200)	(236)	(302)

(b) Equity Distribution Restrictions

Federal law prohibits the Company from paying dividends out of capital accounts. The Company has since 1993 declared and paid preferred and common stock dividends out of appropriated current net income included in retained earnings. At the times of such declarations and payments, the Company had a deficit in its retained earnings. At December 31, 1996, the Company had $130 million of appropriated retained earnings for the payment of dividends. See Management's Financial Analysis — Capital Resources and Liquidity-Liquidity.

(c) Preferred and Preference Stock

Amounts to be paid for preferred stock which must be redeemed during the next five years are $30 million in 1997, $15 million in 1998, $33 million in both 1999 and 2000, and $80 million in 2001.

The annual preferred stock mandatory redemption provisions are as follows:

	Shares To Be Redeemed	Beginning in	Price Per Share
$ 7.35 Series C	10,000	1984	$ 100
88.00 Series E	3,000	1981	1,000
9.125 Series N	150,000	1993	100
91.50 Series Q	10,714	1995	1,000
88.00 Series R	50,000	2001*	1,000
90.00 Series S	18,750	1999	1,000

* All outstanding shares to be redeemed on December 1, 2001.

In 1995, the Company purchased 1,000 shares of Serial Preferred Stock, $90.00 Series S, which reduces the 2002 redemption requirement shown in the above table.

The annualized preferred dividend requirement at December 31, 1996 was $38 million.

The preferred dividend rate on the Company's Series L fluctuates based on prevailing interest rates and market conditions. The dividend rate for this issue was 7% in 1996.

Preference stock authorized for the Company is 3,000,000 shares without par value. No preference shares are currently outstanding.

With respect to dividend and liquidation rights, the Company's preferred stock is prior to its preference stock and common stock, and its preference stock is prior to its common stock.

(d) Long-Term Debt and Other Borrowing Arrangements

Long-term debt which matures or is subject to put options during the next five years is as follows: $115 million in 1997, $68 million in 1998, $149 million in 1999, $5 million in 2000 and $62 million in 2001.

The Company's mortgage constitutes a direct first lien on substantially all property owned and franchises held by the Company. Excluded from the lien, among other things, are cash, securities, accounts receivable, fuel and supplies.

Certain credit agreements of the Company contain covenants relating to fixed charge coverage ratios and limitations on secured financing other than through first mortgage bonds or certain other transactions. The Company was in compliance with all such covenants as of December 31, 1996. The Company and Toledo Edison have letters of credit in connection with the sale and leaseback of Beaver Valley Unit 2 that expire in June 1999. The letters of credit are in an aggregate amount of approximately $225 million and are secured by first mortgage bonds of the Company and Toledo Edison in the proportion of 40% and 60%, respectively.

(12) Short-Term Borrowing Arrangements

Centerior Energy has a $125 million revolving credit facility through May 1997. Centerior Energy and the Service Company may borrow under the facility, with all borrowings jointly and severally guaranteed by the Company and Toledo Edison. Centerior Energy plans to transfer any of its borrowed funds to the Company and Toledo Edison. The credit agreement is secured with first mortgage bonds of the Company and Toledo Edison in the proportion of 40% and 60%, respectively. The credit agreement also provides the participating banks with a subordinate mortgage security interest on the properties of the Company and Toledo Edison. The banks' fee is 0.625% per annum payable quarterly in addition to interest on any borrowings. There were no borrowings under the facility at December 31, 1996. Also, the Company and Toledo Edison may borrow from each other on a short-term basis. At December 31, 1996, the Company had total short-term borrowings of $112 million from its affiliates with a weighted average interest rate of 6.18%.

(13) Financial Instruments

The estimated fair values at December 31, 1996 and 1995 of financial instruments that do not approximate their carrying amounts in the Balance Sheet are as follows:

	December 31,			
	1996		1995	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(millions of dollars)			
Capitalization and Liabilities:				
Preferred Stock, with Mandatory Redemption Provisions	$ 216	$ 220	$ 245	$ 232
Long-Term Debt	2,562	2,630	2,819	2,824

Noncash investments in the Nuclear Plant Decommissioning Trusts are summarized in the following table. In 1996, the Company and Toledo Edison transferred the bulk of their investment assets in existing trusts into Centerior Energy pooled trust funds for the two companies. The December 31, 1996 amounts in the table represent the Company's pro rata share of the fair value of such noncash investments.

	December 31,	
	1996	1995
	(millions of dollars)	
Type of Securities:		
Debt Securities:		
Federal Government	$14	$26
Municipal	—	14
Other	5	—
	19	40
Equity Securities	56	—
Total	$75	$40
Maturities of Debt Securities:		
Due within one year	$—	$ 1
Due in one to five years	10	12
Due in six to 10 years	4	13
Due after 10 years	5	14
Total	$19	$40

The fair value of these trusts is estimated based on the quoted market prices for the investment securities and approximates the carrying value. The fair value of the Company's preferred stock, with mandatory redemption provisions, and long-term debt is estimated based on the quoted market prices for the respective or similar issues or on the basis of the discounted value of future cash flows. The discounted value used current dividend or interest rates (or other appropriate rates) for similar issues and loans with the same remaining maturities.

The estimated fair values of all other financial instruments approximate their carrying amounts in the Balance Sheet at December 31, 1996 and 1995 because of their short-term nature.

(14) Quarterly Results of Operations (Unaudited)

The following is a tabulation of the unaudited quarterly results of operations for the two years ended December 31, 1996.

	Quarters Ended			
	March 31,	June 30,	Sept. 30,	Dec. 31,
	(millions of dollars)			
1996				
Operating Revenues	$428	$434	$506	$422
Operating Income	76	86	121	76
Net Income	17	25	59	16
Earnings Available for Common Stock	7	15	49	6
1995				
Operating Revenues	$410	$424	$526	$408
Operating Income	85	91	145	77
Net Income	34	38	90	23
Earnings Available for Common Stock	23	27	80	12

Earnings for the quarter ended September 30, 1996 were decreased by $11 million as a result of a $17 million charge for the disposition of materials and supplies inventory. The sale and disposal of inventory was part of the reengineering of the supply chain process.

(15) Pending Merger of Centerior Energy and Ohio Edison

On September 13, 1996, Centerior Energy and Ohio Edison entered into an agreement and plan of merger to form a new holding company, FirstEnergy. Following the merger, FirstEnergy will directly hold all of the issued and outstanding common stock of the Company, Toledo Edison and Ohio Edison. As a result of the merger, the common stock share owners of Centerior Energy and Ohio Edison will own all of the issued and outstanding shares of FirstEnergy common stock. Centerior Energy share owners will receive 0.525 of a share of FirstEnergy common stock for each share of Centerior Energy common stock owned. Ohio Edison share owners will receive one share of FirstEnergy common stock for each share of Ohio Edison common stock owned.

FirstEnergy plans to account for the merger as a purchase in accordance with generally accepted accounting principles. If FirstEnergy elects to apply, or "push down", the effects of purchase accounting to the financial statements of the Company and Toledo Edison, the Company and Toledo Edison would record adjustments to: (1) reduce the carrying value of nuclear generating plant by $1.25 billion to fair value; (2) recognize goodwill of $865 million; (3) reduce common stock equity by $401 million; (4) reset retained earnings of the Company and Toledo Edison to zero; and (5) reduce the related deferred federal income tax liability by $438 million. These amounts reflect FirstEnergy's estimates of the pro forma combined adjustments for the Company and Toledo Edison as of September 30, 1996. The actual adjustments to be recorded could be materially different from these estimates. FirstEnergy has not decided whether to push down the effects of purchase accounting to the financial statements of the Company and Toledo Edison if the merger with Ohio Edison is completed, nor has FirstEnergy estimated the allocations between the two companies if push-down accounting is elected.

In addition to the approvals by the share owners of Centerior Energy and Ohio Edison common stock, various aspects of the merger are subject to the approval of the FERC and other regulatory authorities. A rate reduction and economic development plan for the Company and Toledo Edison has been approved by the PUCO. From the date of consummation of the merger through 2006, the plan provides for rate reductions, frozen fuel cost factors, economic development incentive prices, an energy-efficiency program, an earnings cap and an accelerated reduction in nuclear and regulatory assets for regulatory purposes. The plan will require the Company and Toledo Edison to write off certain regulatory assets at the time the merger becomes probable, which is expected to be afte. obtaining the aforementioned approvals of the merger. The write-off amounts for the Company and Toledo Edison to be charged against earnings, estimated by FirstEnergy to total approximately $750 million, will be determined based upon the plan's regulatory accounting and cost recovery details to be submitted by FirstEnergy to the PUCO staff for approval. The Company's share of the write-off is expected to be about two-thirds of this amount.

If the merger is not consummated, the plan would be null and void. See Management's Financial Analysis — Outlook-Pending Merger with Ohio Edison and -FirstEnergy Rate Plan for a discussion of the proposed merger and the plan.

(16) Pending Merger of Toledo Edison into the Company

In March 1994, Centerior Energy announced a plan to merge Toledo Edison into the Company. The merger agreement between Centerior Energy and Ohio Edison requires the approval of Ohio Edison prior to consummation of the proposed merger of Toledo Edison into the Company. Ohio Edison has not yet made a decision. All necessary regulatory approvals have been obtained, except the NRC's approval. This application was withdrawn at the NRC's request pending Ohio Edison's decision whether to complete this merger.

In June 1995, share owners of Toledo Edison's preferred stock approved the merger and share owners of the Company's preferred stock approved the authorization of additional shares of preferred stock. If and when the merger becomes effective, share owners of Toledo Edison's preferred stock will exchange their shares for preferred stock shares of the Company having substantially the same terms. Debt holders of the merging companies will become debt holders of the Company.

For the merging companies, the combined pro forma operating revenues were $2.554 billion, $2.516 billion and $2.422 billion and the combined pro forma net income was $174 million, $281 million and $268 million for the years 1996, 1995 and 1994, respectively. The pro forma data is based on accounting for the merger on a method similar to a pooling of interests. The pro forma data is not necessarily indicative of the results of operations which would have been reported had the merger been in effect during those years or which may be reported in the future. The pro forma data does not reflect any potential effects related to the consummation of the Centerior Energy and Ohio Edison merger. The pro forma data should be read in conjunction with the audited financial statements of both the Company and Toledo Edison.

Financial and Statistical Review

Operating Revenues (millions of dollars)

Year	Residential	Commercial	Industrial	Other	Total Retail	Wholesale	Total Electric	Steam Heating	Total Operating Revenues
1996	$562	571	524	88	1 745	45	1 790	—	$1 790
1995	559	563	523	93	1 738	31	1 769	—	1 769
1994	531	541	508	98	1 678	20	1 698	—	1 698
1993	539	536	510	98	1 683	68	1 751	—	1 751
1992	517	531	530	101	1 679	64	1 743	—	1 743
1986	410	383	461	61	1 315	8	1 323	13	1 336

Operating Expenses (millions of dollars)

Year	Fuel & Purchased Power	Other Operation & Maintenance	Generation Facilities Rental Expense, Net	Depreciation & Amortization	Taxes, Other Than FIT	Amortization of Deferred Operating Expenses, Net	Federal Income Taxes	Total Operating Expenses
1996	$408	426	56	210	230	26	75	$1 431
1995	413	418	56	196	230	(36)	94	1 371
1994	391	394	56	195	218	(34)	82	1 302
1993	423	598 *(a)*	56	182	221	27 *(b)*	22	1 529
1992	434	410	55	179	226	(35)	89	1 358
1986	372	388	—	103	144	—	97	1 104

Income (Loss) (millions of dollars)

Year	Operating Income	AFUDC—Equity	Other Income & Deductions, Net	Deferred Carrying Charges, Net	Federal Income Taxes—Credit (Expense)	Income (Loss) Before Interest Charges
1996	$359	2	(10)	—	6	$ 357
1995	398	2	2	29	(2)	429
1994	396	4	6	25	(4)	427
1993	222	4	(356) *(c)*	(487) *(b)*	270	(347)
1992	385	1	8	59	(5)	448
1986	232	179	(7)	—	65	469

Income (Loss) (millions of dollars)

Year	Debt Interest	AFUDC—Debt	Net Income (Loss)	Preferred & Preference Stock Dividends	Earnings (Loss) Available for Common Stock
1996	$242	(2)	117	39	$ 78
1995	248	(3)	184	43	141
1994	247	(5)	185	45	140
1993	244	(4)	(587)	45	(632)
1992	243	—	205	41	164
1986	232	(63)	300	40	260

(a) Includes early retirement program expenses and other charges of $165 million.

(b) Includes write-off of phase-in deferrals of $636 million, consisting of $117 million of deferred operating expenses and $519 million of deferred carrying charges.

	Electric Sales (millions of KWH)						**Electric Customers** (thousands at year end)				**Residential Usage**		
Year	Residential	Commercial	Industrial	Wholesale	Other	Total	Residential	Commercial	Industrial & Other	Total	Average KWH Per Customer	Average Price Per KWH	Average Revenue Per Customer
1996	4 958	5 908	7 977	2 155	522	21 520	663	71	7	741	7 451	11.34¢	$845.12
1995	5 063	5 946	7 994	1 694	550	21 247	670	72	7	749	7 570	11.04	835.40
1994	4 924	5 770	7 970	1 073	575	20 312	668	72	7	747	7 370	10.79	795.11
1993	4 934	5 634	7 911	2 290	532	21 301	669	71	8	748	7 373	10.93	805.68
1992	4 725	5 467	7 988	1 989	533	20 702	670	71	8	749	7 071	10.94	773.77
1986	4 586	4 744	7 927	121	460	17 838	651	63	9	723	6 810	8.94	611.34

	Load (MW & %)				**Energy** (millions of KWH)					**Fuel**	
					Company Generated						
Year	Net Seasonal Capability	Peak Load	Capacity Margin	Load Factor	Fossil (d)	Nuclear	Total	Purchased Power	Total	Fuel Cost Per KWH	Efficiency—BTU Per KWH
1996	3 922	3 938	(0.4)%	60.6%	14 411	6 829	21 240	1 640	22 880	1.35¢	10 357
1995	4 273	4 049	5.2	58.8	12 684	8 175	20 859	1 673	22 532	1.42	10 504
1994	4 500	3 740	16.9	62.4	12 840	6 405	19 245	2 022	21 267	1.35	10 538
1993	4 500	3 862	14.2	59.9	15 557	5 644	21 201	1 454	22 655	1.37	10 339
1992	4 704	3 605	23.4	63.0	12 715	7 521	20 236	1 649	21 885	1.47	10 456
1986	3 775	3 601	4.6	62.2	16 151	12	16 163	2 984	19 147	1.78	10 464

Investment (millions of dollars)

Year	Utility Plant In Service	Accumulated Depreciation & Amortization	Net Plant	Construction Work In Progress & Perry Unit 2	Nuclear Fuel and Other	Total Property, Plant and Equipment	Utility Plant Additions	Total Assets
1996	$6 938	2 252	4 686	57	167	$4 910	$111	$6 878
1995	6 872	2 094	4 778	73	180	5 031	155	7 152
1994	6 871	2 014	4 857	99	195	5 151	156	7 151
1993	6 734	1 889	4 845	141	243	5 229	175	7 159
1992	6 602	1 728	4 874	501	261	5 636	156	8 123
1986	3 197	952	2 245	3 013	384	5 642	671	6 155

Capitalization (millions of dollars & %)

Year	Common Stock Equity		Preferred & Preference Stock, with Mandatory Redemption Provisions		Preferred Stock, without Mandatory Redemption Provisions		Long-Term Debt		Total
1996	$1 045	27%	186	5%	238	6%	2 441	62%	$3 910
1995	1 127	26	215	5	241	6	2 666	63	4 249
1994	1 058	26	246	6	241	6	2 543	62	4 088
1993	1 040	24	285	7	241	5	2 793	64	4 359
1992	1 865	39	314	6	144	3	2 515	52	4 838
1986	1 844	40	339	7	144	3	2 311	50	4 638

(c) Includes write-off of Perry Unit 2 of $351 million.

(d) Reduced by net energy used by the Seneca Pumped Storage Plant for pumping.

INVESTOR INFORMATION

Share Owner Information

Share Owner Services

Communications regarding stock transfer requirements, lost certificates, dividends and changes of address should be directed to Share Owner Services at Centerior Energy Corporation. Correspondence should be sent to the address indicated below for the Stock Transfer Agent.

To reach Share Owner Services by phone, call:

In Cleveland area: 447-2400

Outside Cleveland area: (800) 433-7794

Please have your account number ready when calling.

Stock Transfer Agent

Centerior Energy Corporation
Share Owner Services
P.O. Box 94661
Cleveland, OH 44101-4661

Stock transfers may be presented at
Harris Trust Company of New York
77 Water Street, 5th Floor
New York, NY 10005

Stock Registrar

KeyBank National Association
Corporate Trust Division
P.O. Box 6477
Cleveland, OH 44101

Investor Relations

Inquiries from security analysts and institutional investors should be directed to Ronald E. Seeholzer, Manager-Investor Relations, at Centerior Energy Corporation, P.O. Box 94661, Cleveland, OH 44101-4661 or by telephone at (216) 447-3339.

Exchange Listings

Preferred Stock Series A, B, L, and Depositary Shares, 1993 Series A, are listed on the New York Stock Exchange.

Dividend Reinvestment and Stock Purchase Plan and Individual Retirement Account (CX•IRA)

Centerior Energy Corporation has a Dividend Reinvestment and Stock Purchase Plan which provides Cleveland Electric share owners of record and other investors a convenient means of purchasing shares of Centerior common stock by investing all or a part of their quarterly dividends as well as making cash investments. In addition, individuals may establish an Individual Retirement Account (IRA) which invests in Centerior common stock through the Plan. Information relating to the Plan and the CX•IRA may be obtained from Share Owner Services.

Independent Public Accountants

Arthur Andersen LLP
Suite 1800
200 Public Square
Cleveland, OH 44114

Environmental Report

The Company will furnish to share owners, without charge, a copy of a report on its environmental performance. Requests should be directed to Share Owner Services.

Form 10-K

The Company will furnish to share owners, without charge, a copy of its most recent annual report to the Securities and Exchange Commission. Requests should be directed to Share Owner Services.

Bondholder Information

First Mortgage Bond Trustee and Paying Agent

The Chase Manhattan Bank, N.A.
Bondholder Services
4 Chase Metrotech Center, Box 3016
Brooklyn, NY 11245
Telephone: (800) 355-2663

We have made forward-looking statements in this Annual Report with respect to the financial condition, results of operations, strategic plan and business of the Company, Centerior Energy and Toledo Edison; and FirstEnergy following the consummation of Centerior Energy's merger with Ohio Edison, which involve certain risks and uncertainties. Forward-looking statements are statements about future performance or results, including any statements using the words "believe," "expect," "anticipate" or similar words. For all of those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following possibilities: (1) expected cost savings from the merger of Centerior Energy and Ohio Edison are not fully realized; (2) regional competitive pressure in the electric utility industry increases significantly; (3) the effects of unanticipated events on the Company's and Toledo Edison's expectations regarding cost recovery or on the carrying value of regulatory assets and on the Company's and Toledo Edison's ability to continue to comply with the provisions of SFAS 71 (as defined herein) cause an impairment of property, plant and equipment or variances from the amounts disclosed; (4) costs or difficulties related to the integration of the businesses of Ohio Edison and Centerior Energy are greater than expected; (5) state and federal regulatory initiatives are implemented that further increase competition, threaten cost and investment recovery or impact rate structures or dividends; and (6) national and regional economic conditions are less favorable than expected.

The Cleveland Electric Illuminating Company
P.O. Box 5000
Cleveland, OH 44101

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