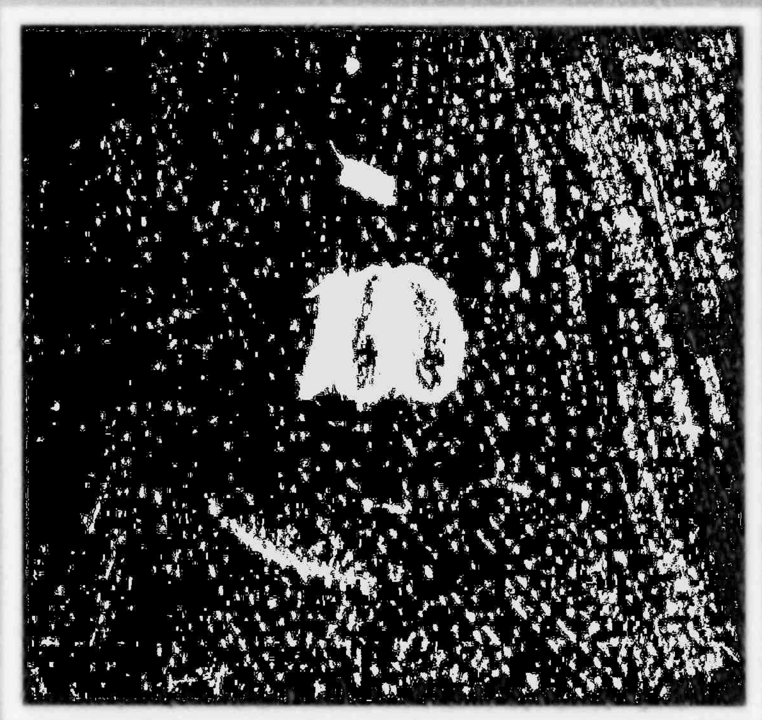
# ATLANTIC ELECTRIC



## 1985 ANNUAL REPORT

## ABOUT THE COMPANY

Atlantic City Electric Company is the official name of the Company as it appears in the Articles of Incorporation. The Company also uses the registered trade name Atlantic Electric in various shareholder and customer publications and in its daily operations.

**Corporate Address**

P.O. Box 1264
1199 Black Horse Pike
Pleasantville, New Jersey 08232
(609) 645-4100

## NOTICE OF ANNUAL MEETING

The 1986 Annual Meeting of Shareholders will be held on Wednesday, April 23, 1986 at the Quail Hill Inn, Smithville, New Jersey. A Notice of Annual Meeting will be mailed in March to those shareholders entitled to vote.

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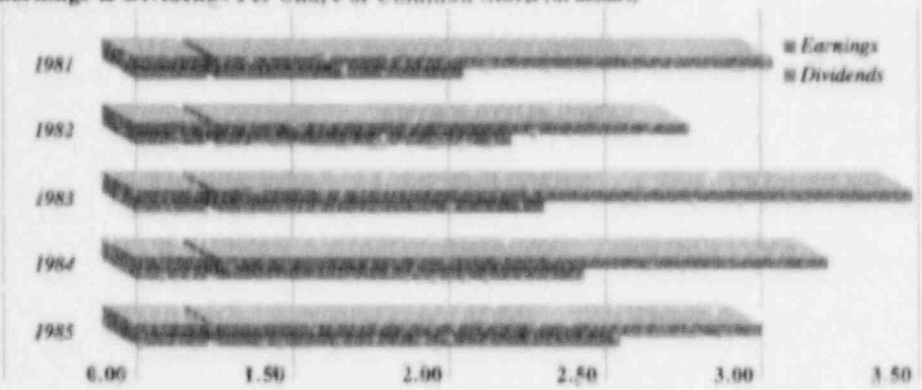
## ABOUT THE COVER

This year's cover design represents a significant milestone for the Company. The Electric Light Company of Atlantic City and the Bridgeton Electric Light Company were each incorporated in 1886. Over the one hundred years which followed, these and other companies grew, merged and matured into Atlantic Electric, which today provides service for more than one million people in Southern New Jersey.

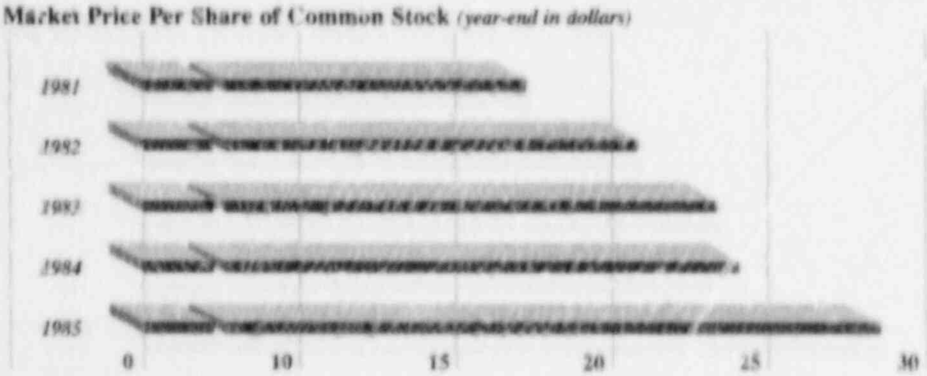
**Results of Operations 1985-1983**

| | 1985 | % Change 1985-1984 | 1984 | % Change 1984-1983 | 1983 |
|---|---|---|---|---|---|
| Electric Operating Revenues (000's) | **$ 579,733** | 5.5 | $ 549,531 | 6.3 | $ 517,142 |
| Operating Expenses (000's) | **$ 490,327** | 7.0 | $ 458,140 | 8.0 | $ 424,040 |
| Net Income (000's) | **$ 60,519** | (4.4) | $ 63,277 | (4.3) | $ 66,152 |
| Earnings Per Common Share | **$ 3.00** | (6.3) | $ 3.20 | (8.0) | $ 3.48 |
| Dividends Paid Per Common Share | **$ 2.53** | 4.5 | $ 2.42 | 5.2 | $ 2.30 |
| Total Assets (000's) | **$1,299,633** | 6.5 | $1,220,503 | 7.1 | $1,139,978 |
| Cash Construction Expenditures (000's) | **$ 94,017** | 11.1 | $ 84,630 | 13.7 | $ 74,457 |
| Sales of Electricity (KWH) (000's) | **6,199,672** | 2.4 | 6,053,791 | 3.5 | 5,851,434 |
| Price Paid Per KWH—(All Customers) | **9.481¢** | 5.4 | 8.999¢ | 7.6 | 8.360¢ |
| Total Customer Service Installations (Year-end) | **417,625** | 2.5 | 407,277 | 2.2 | 398,526 |
| Number of Shareholders—Common Stock (Year-end) | **48,635** | 2.5 | 47,446 | (1.8) | 48,299 |
| Number of Employees (Year-end) | **2,099** | 4.3 | 2,012 | .9 | 1,995 |
| Book Value | **$ 24.76** | 2.0 | $ 24.27 | 2.9 | $ 23.58 |

**Earnings & Dividends Per Share of Common Stock** *(in dollars)*




**Market Price Per Share of Common Stock** *(year-end in dollars)*



# TO OUR SHAREHOLDERS:

Reporting to you upon the completion of 1985, we can cite major accomplishments for the year, and opportunities for the future from a vantage point unique in the Company's history.

Earnings per share for 1985 totaled \$3.00, compared with \$3.20 per share achieved in 1984. This decrease in earnings resulted from the fact that, despite our efforts, base rate relief has not kept pace with general increases in the costs of providing service.

After consideration of earnings prospects and the importance of steady dividend performance, the Board of Directors raised the quarterly dividend rate last June by 2½ cents, to 64½ cents. With this increase, the dividends paid per share in 1985 amounted to \$2.53.

***This represents the thirty-third consecutive year of growth in dividends paid.***

Our annual dividend rate is now \$2.58 per share.

Energy sales to our customers increased 2.4% in 1985, to a total 6.2 billion kilowatt-hours. We have witnessed renewed strength in our residential and commercial customer segments: The average number of residential customers for the year grew by more than 8,700 and we recorded an increase of more than 600 commercial customers. A new system peak demand of 1,432 megawatts was recorded in August. This new peak represents an increase of 10.2% over the peak recorded in 1984, and it is 6.3% higher than the Company's record peak set in 1983.

We have been quite successful in the management of fuel and purchased power costs. In 1985, such costs per kilowatt-hour declined by 8.3% from the year earlier. And for 1986, our energy adjustment rates, reflecting the costs of fuel and purchased power borne by our customers, have been reduced by approximately \$44 million.

***For the second year in a row, coal and nuclear sources of power provided more than 80% of total system requirements.***

Several records for generating unit and station performance were set in 1985, and Salem Unit 1, one of our jointly-owned nuclear units, established an all-time national record for power output produced by a unit in a calendar year.

E. D. Huggard, J. D. Feehan

The only generating capacity which we have under construction is a 5% interest in the Hope Creek Nuclear Generating Station. Construction of the unit is virtually finished. Fuel loading and testing are yet to be completed, and Public Service Electric and Gas Company, which owns the other 95% of the unit and is responsible for its construction, has advised the Company that Hope Creek should be operational in late 1986. A cost containment agreement for the Hope Creek unit was approved by the New Jersey Board of Public Utilities in 1983. It established a targeted in-service date of December 1986 and a targeted cost for the plant at the time it would begin commercial operation. The agreement provided for incentives and penalties based upon the final cost of the unit. Our portion of the originally targeted amount was approximately $198 million, and at December 31, 1985 we had recorded approximately $204 million of costs. Our cost of the unit at completion is currently expected to be approximately $226 million. Based upon developments to date, we do not currently expect that the cost containment provisions will have a significant negative impact on earnings.

Improvement and support of corporate earnings depend upon receiving adequate base rate relief. We are continuing our efforts to obtain the needed increases in base rates. Our appeal from the BPU's denial of rate relief in August 1984, and the affirmance of the BPU's action by the New Jersey Superior Court, have now been taken to New Jersey Supreme Court. Last April, we filed requests with the BPU for rate increases in two phases: a first phase, in the amount of $63.3 million, to reflect more current cost levels; and the second phase, for a net amount of $28.5 million, to recover costs associated with the forthcoming operation of Hope Creek. We anticipate a decision by the BPU on the first-phase request in the first quarter of 1986, and are seeking to have the second-phase increase timed to coincide with the commercial start-up of the Hope Creek unit.

The legislature in New Jersey has mandated periodic management audits of electric and gas utilities in the State, and the Company was among the first to have a comprehensive management audit completed in 1985. On balance, the findings of the independent auditors confirmed the effectiveness and efficiency of the Company's operations.

***The audit report noted that decisions and actions by corporate management have saved customers hundreds of millions of dollars.***

Audit recommendations suggested the potential for a modest reduction in overall expenses. Many corporate projects designed to cut costs and improve efficiency had already been underway at the time of the audit, and other efforts based upon the audit findings and recommendations have been started.

In large measure, we would characterize 1985 as a year of reflection and assessment of future opportunities. While others evaluated us in a management audit, we took a closer look at ourselves and set out to enhance our operating and planning practices. We have worked to better understand our customers' needs, making changes within the organization to more effectively meet those needs. And, we have taken a closer look at our business environment, observing that deregulation, competition and changing technology are having ever greater effects upon our industry.

Almost a century ago, the Electric Light Company of Atlantic City and the Bridgeton Electric Light Company were formed. Customers sought out these corporate predecessors of ours for the service and convenience that electric lighting could provide, and not the electricity that was produced. As we celebrate a centennial of service, we do well to remind ourselves of that fact, and to find in it the essence of success which lies ahead. We believe that the years to come are filled with challenges and opportunities for the Company. Our future progress will be built upon a competitive spirit, with renewed emphasis on service, performance and the effective management of costs. The Company's commitment to be alert to the opportunities of the future, and its ability to respond to them and manage them, will guide it toward the success of a new century.

For the Board of Directors,

J D Feehan

J. D. Feehan
Chairman of the Board

E D Huggard

E. D. Huggard
President and Chief Executive Officer

January 31, 1986

# CUSTOMERS AND SERVICE

The continuing success of Atlantic Electric depends on its ability to measure and interpret customers' needs, and then to dedicate resources to meet those needs.

In early 1985, the Company's efforts to assess customers' needs was supported by means of a residential customer attitude survey. It provided important information on public perceptions of energy use, conservation and the Company. Customers said they preferred coal-fired generation and conservation as the means of avoiding future energy shortages. Although customers indicated an increased awareness of the importance of conservation, there was no increase in the reported level of action taken by them to save energy. The survey results suggested that more immediate economic incentives may be needed to encourage conservation efforts. Generally, customers appeared to hold a more favorable opinion of the Company than in the past. However, survey results indicated that we may be able to improve customers' perceptions regarding corporate profits and the value of electricity.

The responses to a separate 1985 appliance saturation survey of residential customers, and comparison with prior years' responses, helped us identify trends with respect to household characteristics and energy use. Although single family homes remain the dominant type of housing, there has been a shift in new housing units to multiple-family dwellings, such as condominiums and apartments. There has also been a shift from the use of oil to electricity for central heating, while changes in the use of natural gas have varied slightly over a five-year period. Electricity currently appears to be the predominant heating source in duplexes, condominiums and townhouses. Survey information with respect to changes in appliance usage helps us to address customer needs, forecast future energy requirements and identify additional opportunities for marketing conservation programs.

For 1985, the Company sought to greatly expand customer participation in its various conservation programs. Some improvements over the 1984 levels of participation were noted, although 1985 results did not meet all of our goals. During the year, the Company made changes to make it easier for customers to select our conservation services, and to provide greater incentives for them to do so. We introduced shop-at-home convenience for customers desiring our Seal-Up program services. In addition, we offered to install electric water heater insulation wraps at no charge, giving us the opportunity to offer other quick and inexpensive conservation measures. In 1985, over 2,000 residential customers took advantage of various Seal-Up services. More than 7,000 home energy audits were performed, and more than 200 other customers took advantage of energy audits available through a new Commercial and Apartment Conservation Program.

For the first time in several years, the Company conducted a survey of commercial customers to examine the relationship of energy use at various types of businesses to factors such as floor space, lighting, heating and cooling needs. A better understanding of these relationships will assist the Company in forecasting the future

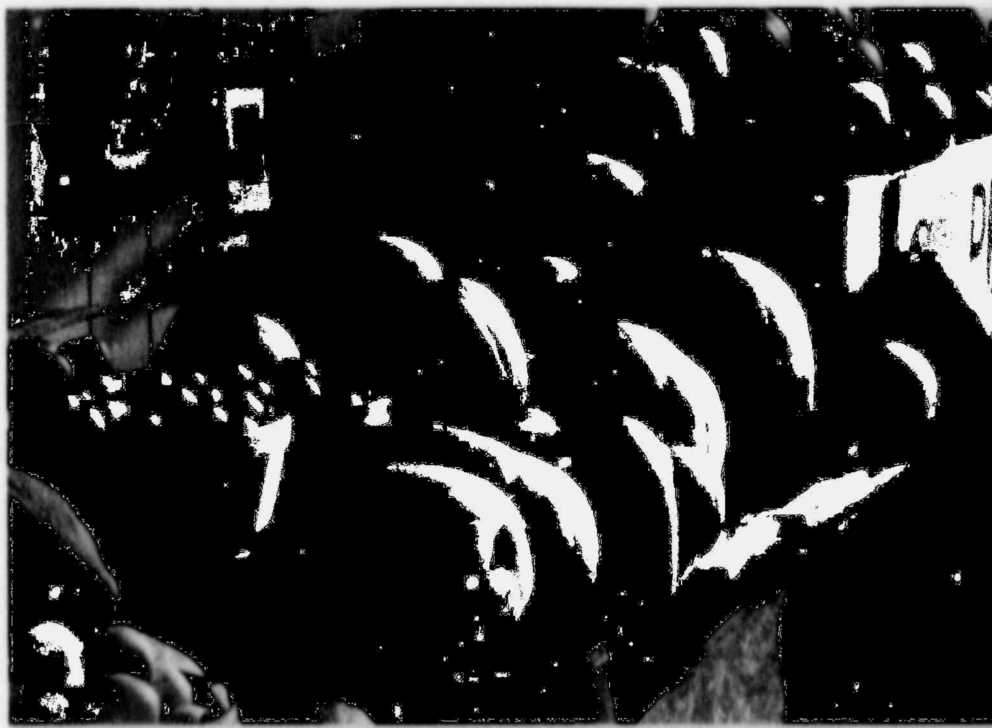
**The Atlantic City skyline has become a familiar scene of America's most visited city.**

needs of this rapidly growing segment of our customer base, as well as aiding in the development of better energy management services.

Concern with improving customer service was exemplified with the opening of two pilot customer courtesy centers in 1985. The results of a special telephone poll had overwhelmingly indicated that personalized customer service at remote locations could complement the Company's centralized customer service operation. Visitors to these centers have access to a full range of services, from help with energy conservation to bill payment assistance. The experience with these two trial locations will be used to guide decisions on the potential opening of additional customer courtesy centers.

Offering various rate schedules enables the Company to meet specific customer needs. Recently the Company re-established a street lighting tariff which gives communities the choice of renting or owning energy-efficient street lighting. In 1985, a small group of residential customers agreed to participate in a one-year pilot program to test the effectiveness of time-of-use rates. These rates are intended to provide an incentive for customers to shift energy usage from times of peak demand, thereby reducing the need for costly additional generating capacity.

The Company's concerns with regulation are not only related to securing necessary rate relief, but are also related to the interests of its customers. One of the proceedings continuing through 1985 has involved the allocation of charges for electric service, and the Company has asked the Board of Public Utilities to reconsider a decision which the Company believes would adversely affect a majority of its customer classes and the economic vitality of the service area. In another State regulatory forum, a proposal was made which would ban the use of electric resistance heating in favor of natural gas. The proposal was ultimately withdrawn, following efforts by the Company to demonstrate the cost-effectiveness of electric heating, and the need to afford customers a choice of home heating methods.



**Roadside stands have become a trademark of the southern portion of the "Garden State."**

In September 1985, Hurricane Gloria struck our service area. Company personnel were able to restore 95% of the customers affected by the storm in less than 24 hours. Once the situation in Southern New Jersey was controlled, volunteers from

**Employees of the Safety Department volunteer their time to explain high voltage hazards.**

the Company work force went to help restore service to Long Island Lighting Company customers, who were more seriously hit by the hurricane.

For the Company, community involvement has long been an extension of customer service. In 1985, the Speakers Bureau made over 240 presentations to community organizations and schools on such topics as energy conservation, electrical safety and environmental concerns. Also in 1985, the Company began supporting Childwatch, by distributing information on missing children in monthly customer mailings. The Good Neighbor Fund, now in its third year, helps deserving South Jersey residents meet winter heating costs. In the summer months, the Company has opened its doors at the B. L. England Generating Station to let visitors "see electricity being made." Employees in radio-equipped Company vehicles have helped summon life-saving services and assistance in emergencies such as car accidents and fires through its Radio Watch Program. For customers with limited financial resources, the Company has participated in town meetings to discuss the availability of free or low-cost weatherization services.

The new customer courtesy centers provide an extra opportunity for personal contact out in the service area.

## OPERATIONS

For 1985, the Company's cost of fuel and purchased power per kilowatt-hour, by far the largest single element of the cost of service, declined by 8.3%. Output from our nuclear sources of energy improved substantially during the year and, together with our coal-fired sources, helped contain the cost of energy. In 1985, Salem Unit 1, one of our jointly-owned nuclear units, set a new record for 277 consecutive days' operation, and it also set an all-time national record for energy generated by a unit in a calendar year. Nuclear power purchased under contract from Pennsylvania Power & Light Company in 1985 was double the 1984 amount, due to the start-up of Susquehanna Unit 2 in February. That unit set a record in 1985 for the most power produced by reactors of its type. In addition, both of the jointly-owned, coal-fired Keystone and Conemaugh Stations set new records for plant output. Compared with the use of oil-fired power generation, the use of relatively low-cost coal and nuclear fuel saved the Company and its customers more than $136 million in 1985.

Units 1 and 2 at the B. L. England Station are the largest of the Company's coal-fired units. There are certain unusual weather conditions which can create a downwash of plant emissions in the nearby area. In order to assure compliance with regulatory requirements, many alternative operating configurations were evaluated, and the Company decided that con-

The Company's open house tours at B. L. England Station provide an opportunity for visitors to see how electricity is made.

Opportunities to provide friendly, personalized service may be found at every customer location.

struction of a 475-foot chimney would be the most effective means of responding to the situation. The new stack will be designed to replace the three smaller ones now at the station.

Several studies were conducted in 1985 to identify additional ways to reduce the costs of providing electricity. We examined the feasibility of modifying some of the Company's oil-fired generating units so that they could be cycled to more economically follow changes in system energy requirements. Based upon results of another study completed in 1985, plans have been made to modify a second unit at Deepwater Station to enable it to burn natural gas when it is available and economical to do so.

In 1985, a new computerized maintenance management system was selected for use starting in 1986 by the Company's production department. This system will aid in planning maintenance work by identifying tool and material requirements,

Cogeneration may prove to be an effective means of providing energy to hospitals.

Growth in the Company's service territory includes the construction of modern and efficient public buildings, such as the Atlantic County Office Building and Atlantic City Free Public Library.

setting work standards, and formalizing maintenance procedures. Savings are expected through reductions in maintenance overtime, contractor costs and improvements in generating unit availability.

By replacing major unit components, the useful life of existing generating facilities can be extended, and costly additions of new generating capacity can be delayed or reduced. In 1985, major studies were begun to identify situations at the B. L. England and Deepwater Stations where the replacement or refurbishment of major generating unit components would result in improved efficiency and availability, as well as longer operating life.

The Company's transmission system was strengthened in 1985 with the rebuilding and upgrading of the Corson-Sherman 69,000 volt transmission line to 138,000 volts. This project will serve to reduce power line energy losses and improve system reliability. Import reliability was also increased in 1985 with the inception of a program to install back-up power transformers at the Company's Sickler, Silver Lake and Mickleton Substations.

# ENERGY SYSTEM PLANNING

In effect, our customers are buying necessities and conveniences such as lighting, heating and air conditioning. Some of these "end-uses" can be provided by other means. The potential for substitution, together with deregulation and technological developments, present many challenges and opportunities for the Company. Our planning process has been developed to enable us to recognize the options created by this changing business environment.

**K-Tron Corporation, a major manufacturer of digital weighing systems, has found the Company's service area ideal for expansion.**

**One of our customers, Airwork Corporation, is an industry leader in contract maintenance and repair of gas turbine engines for aircraft and industrial applications.**

Different techniques for controlling demand and energy usage from the customer's side of the meter can have a wide range of effects upon the costs and forms of customer service, as well as the financial well-being of the Company. A special study to investigate demand-side management was completed in late 1985, and the results will aid us in developing effective strategies for managing growth and delivering services desired by customers at the lowest reasonable cost.

One of the methods which should be helpful in controlling costly growth in peak demand is the direct control of appliance load. In 1985, the Company enlisted more than 500 residential customers in its "Peak Saver Club," to test the effectiveness of radio-controlled switches for air conditioners and electric water heaters. When demand approaches a peak level, the Company will be able to turn these appliances off and on for short periods without perceptible discomfort or inconvenience. Test operation of the radio-controlled system will begin in 1986, and results from the trial program will be used to determine the value of offering the service to more customers.

Cogeneration involves the production of electricity and other forms of energy, such as hot water and steam. Successful applications of cogeneration may help reduce the need for other more costly forms of generating capacity. For more than 50 years, the Company has provided cogeneration services to DuPont. Additional cogeneration opportunities in the service territory are dependent upon customers' use of steam and hot water. In 1985, the Company supported cogeneration feasibility studies at more than 20 mid-sized commercial and industrial facilities. The Company also helped fund a major study of the cogeneration potential of a district hot water heating system in Atlantic City. Such a system appeared to be feasible, and the Company is involved in more detailed negotiations with the project sponsor. Major cogeneration opportunities with certain large industrial customers are also being evaluated.

One of the more promising future alternate energy technologies is photovoltaic generation. This means of converting solar energy directly into electricity may prove to be cost-effective by the early 1990's. For years, the Company has been collecting local solar data and reviewing developments in solar technology. In 1985, the Company combined the results of its data gathering with findings of an alternate energy technology study to develop a better assessment of the potential of this technology. The Company has plans for further research in solar energy, and would hope to confirm the commercial feasibility of photovoltaic generation in our service area by means of test programs and joint ventures.

The Company has also studied the feasibility of using refuse-derived fuel at its generating facilities. These studies responded to the interest and concerns of municipalities seeking to manage waste disposal and have helped develop criteria for the safe and efficient use of this potential source of energy.

## CORPORATE FINANCE AND ADMINISTRATION

Transfer agent and registrar services were brought completely in-house in late 1985 to provide more timely and efficient turnaround of shareholder transactions. Last year, a cross-section of shareholders participated in a survey which has helped us know them better, understand their investment objectives and get feedback on shareholder publications.

The Company's 1985 financing program included the issuance of both long-term debt and Common Stock. In October, we sold $70 million of 30-year First Mortgage Bonds with an annual interest rate of 11½%. We were unable to secure an allocation of the State's limited tax-exempt financing capacity for financing Hope Creek pollution control facilities in 1985, but we are continuing to seek the necessary allocation in 1986. During 1985, we issued a total of 423,305 shares of Common Stock for approximately $11.2 million, through the Dividend Reinvestment and Stock Purchase Plan and the Employee Stock Ownership Plan. Over the last 10 years, the Dividend Reinvestment and Stock Purchase Plan has been effective in raising more than $62.6 million of equity capital, while providing a convenient means for shareholders to buy additional shares of Common Stock. With the Company's reduced needs for capital and the expiration of Federal tax benefits afforded dividends reinvested in new shares of stock, the Company amended the Plan in late 1985. Beginning in 1986, reinvested dividends are being applied to the purchase of shares in the open market.

**Personalized shareholder service has been enhanced this year by bringing all transfer agent and registrar functions in-house.**

The first phase of an Integrated Customer Service System was implemented in 1985. Scheduled for completion in 1987, it is designed to allow quicker response to customers' billing inquiries, improve recordkeeping accuracy, and provide for more timely responses to service order requests.

This past year, the Company completed its evaluation and selection of a new automated general ledger accounting system. When implemented as an integral part of the Cost Center Management System currently being developed, it will provide more detailed budget information, and help establish clear-cut lines of cost control responsibility.

Company-wide performance indicators were established in 1985 to keep track of progress in achieving long-term goals. Approximately 20 indicators were selected to measure performance in such areas as service reliability, safety and dividend growth. The use of performance indicators is now being expanded to include measurements at the departmental level.

Atlantic Electric's promotion of safe work habits involves not only formal training, but also informal recognition, encouragement and group incentives. One of the most far-reaching safety training programs in the Company's history, the Confidence with Chemicals Program, briefed more than 1,400 employees in the safe handling of potentially hazardous chemicals. Dinners have been used by the Company to honor employees working together to set new safety records. In 1985, several operating groups celebrated more than ten years without a lost-time accident, with one of them setting a record of more than sixteen years.

Throughout 1985, the Company has sponsored and encouraged various employee programs designed to promote self-confidence, healthful lifestyles and general well-being. Voluntary skill refresher courses proved to be a source of accomplishment and incentive for many of our employees to pursue more advanced education. The Company made available its facilities for a program promoting good eating habits and sensible weight control, and an after-hours aerobic exercise program was started by employees at Company headquarters.

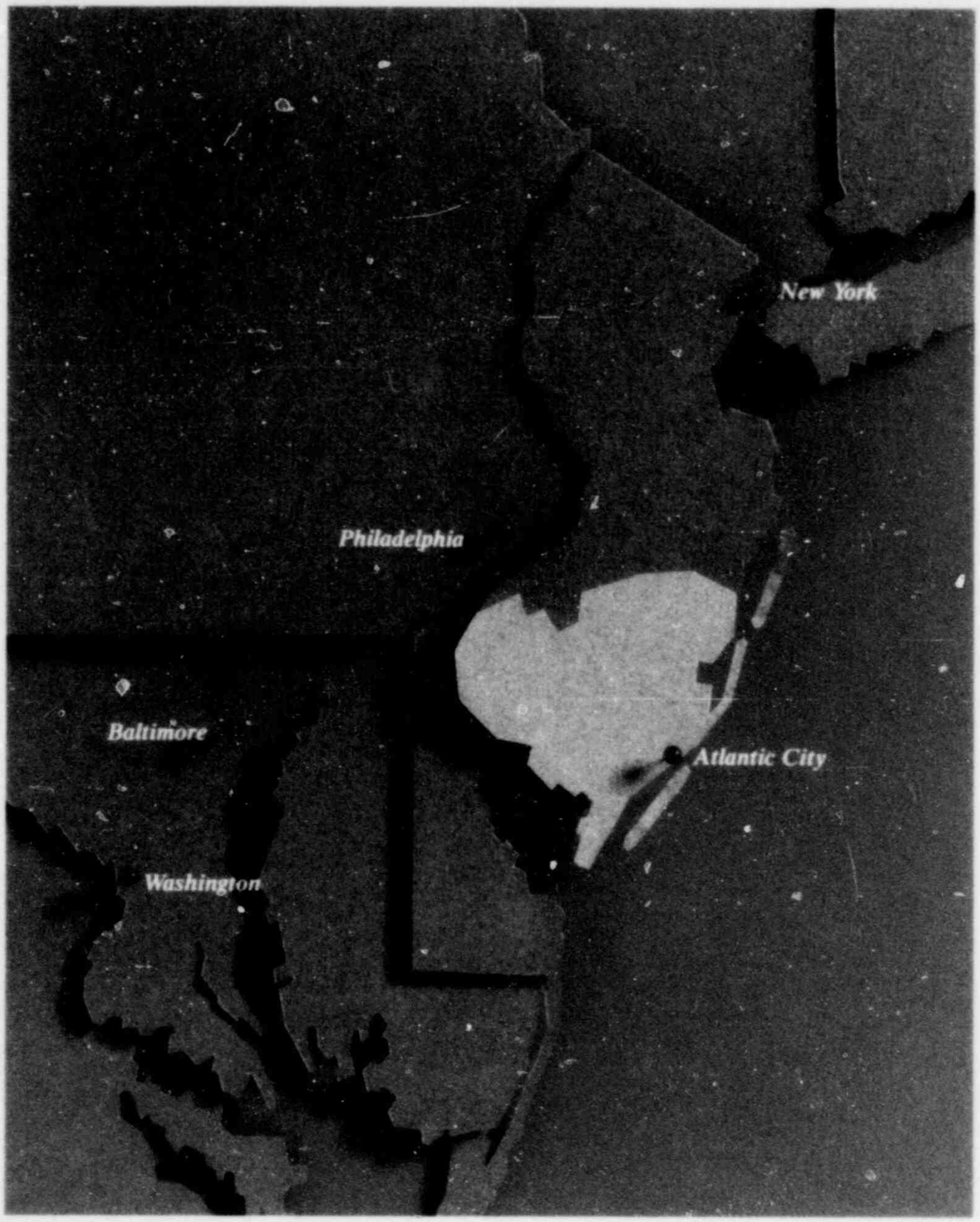
**Laser scanning techniques permit rapid, accurate gathering of information for meter records.**

A comprehensive employee attitude survey was conducted by the Company in 1985. Almost 1,800 physical workers and office personnel responded to the survey, which covered such matters as work relations, communication, pay and opportunity for growth and advancement. The results have suggested some areas for improvement, and will also be used as a benchmark for comparison with future surveys.

The President's Award was established to recognize outstanding achievement by employees. The award for 1985 was presented to one of the Company's customer service

**The production of reports to shareholders and members of the financial community involves a coordinated team effort of financial, accounting and production skills.**

employees for the interested, caring approach she has demonstrated to customers. Her spirit of thoughtfulness and dedication to customer service were cited as the strengths, shared by all of her fellow employees, upon which the future prosperity of Atlantic Electric's customers and shareholders will be built.




Atlantic Electric's service territory, representing the southern one-third of the State of New Jersey, is situated near such major cities as New York, Philadelphia, Baltimore and Washington, D.C. The majority of our customers are residential and commercial.

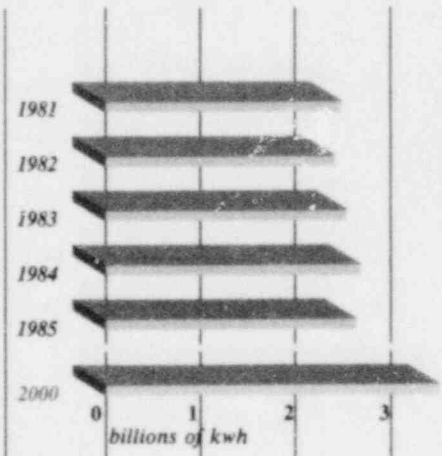
Tourism plays a major part in the economy of the eastern shore, while commercial and light industrial customers are situated in the western part of our territory. Farming and agriculture continue as a significant customer base in the central and western regions of our service area.

## CUSTOMERS AT-A-GLANCE

### RESIDENTIAL

The average number of Atlantic Electric residential customers increased 2.6% in 1985, while average use per customer declined 2.8%. Over 9,100 new dwelling units were connected in 1985, of which 36% were electrically heated. The majority of 1985 new home construction occurred in the eastern part of the service area.

| | 1985 | 2000 | Est. 1985-2000 Annual Growth Rate |
|---|---|---|---|
| Energy (billion kwh) | 2.638 | 3.473 | 1.85% |
| Peak (Mw) | 680 | 874 | 1.69% |

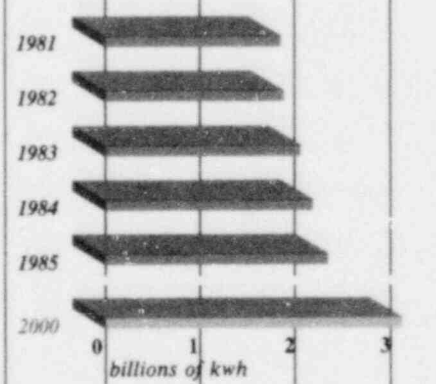



| | average customer use (000 kwh) | % of total sales |
|---|---|---|
| 1981 | 7.8 | 44 |
| 1982 | 7.4 | 43 |
| 1983 | 7.7 | 43 |
| 1984 | 7.9 | 44 |
| 1985 | 7.6 | 43 |
| 2000 | 7.5 | 44 |

### COMMERCIAL

Sales to commercial customers increased 6.9% in 1985. Eleven casino-hotels were in operation at year-end. Sales to that segment increased almost 19% from 1984 and represented almost 6% of total energy sales. Approximately 1,700 of the 44,256 commercial customers engaged in farming and related activities during 1985.

| | 1985 | 2000 | Est. 1985-2000 Annual Growth Rate |
|---|---|---|---|
| Energy (billion kwh) | 2.299 | 3.094 | 2.00% |
| Peak (Mw) | 562 | 765 | 2.08% |

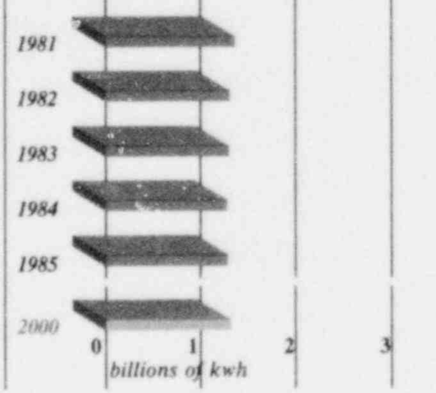



| | average customer use (000 kwh) | % of total sales |
|---|---|---|
| 1981 | 42.8 | 33 |
| 1982 | 44.2 | 34 |
| 1983 | 46.8 | 35 |
| 1984 | 49.3 | 35 |
| 1985 | 51.9 | 37 |
| 2000 | 65.0 | 40 |

### INDUSTRIAL & OTHER

The Company's 1,020 industrial customers are located primarily in the inland and western portions of the service area. Industries include the manufacture of chemical, glass, plastic and rubber products. Sales to this segment increased slightly in 1985.

| | 1985 | 2000 | Est. 1985-2000 Annual Growth Rate |
|---|---|---|---|
| Energy (billion kwh) | 1.263 | 1.282 | 0.10% |
| Peak (Mw) | 190 | 198 | 0.28% |




| | average customer use (000 kwh) | % of total sales |
|---|---|---|
| 1981 | 1240.0* | 23 |
| 1982 | 1197.0* | 23 |
| 1983 | 1200.4* | 22 |
| 1984 | 1179.7* | 21 |
| 1985 | 1181.3* | 20 |
| 2000 | 1204.9* | 16 |

*Industrial customers only

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## GENERAL

The nature of the Company's operations is capital intensive. We invest a significant amount of our funds in property and plant to generate, transmit and distribute electric energy service to our customers. At December 31, 1985 our gross investment in property and plant was over $1.4 billion. As a utility, our business is generally subject to regulation by the New Jersey Board of Public Utilities (BPU), including regulation of the rates which are charged for providing electric service. The Company's ability to finance its construction program, maintain service reliability, meet its working capital requirements and provide a fair rate of return on investment to its shareholders is dependent upon adequate rate relief.

## LIQUIDITY AND CAPITAL RESOURCES

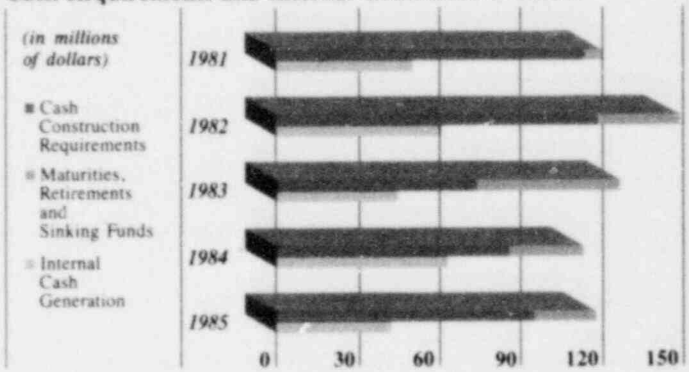
### Construction Program

During 1985, cash construction expenditures aggregated $94 million, which is an 11% increase from the $85 million expenditure level experienced in 1984 and a 27% increase from the $74 million level in 1983. Included in the above amounts are cash construction expenditures associated with the Company's 5% interest in the Hope Creek Generating Station, the only additional generating capacity of the Company under construction. Such cash construction expenditures amounted to $31 million in 1985, and $23 million in each of the years 1984 and 1983. The five-year (1986-1990) cash construction expenditures are currently projected to be $388 million. The construction program has been developed in response to the need to improve or replace existing production plant, upgrade our transmission and distribution system and provide for projected growth. The current forecast of peak load growth for the period 1986-1990 is 2.1% per year.

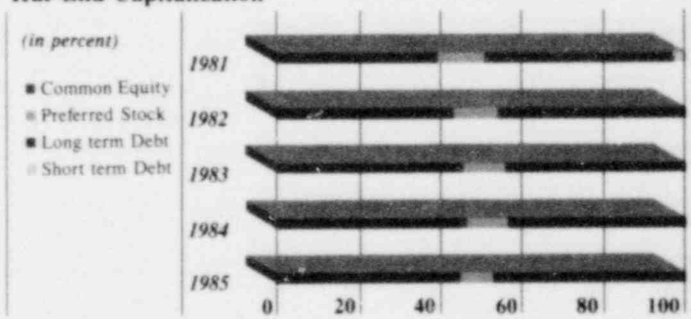
### Financing Program

In 1985, the Company's external financings totaled $81.2 million, represented by $70.0 million of First Mortgage Bonds, $10.8 million of Common Stock issued through the Dividend Reinvestment and Stock Purchase Plan (DRP) and $.4 million of Common Stock issued through the Employee Stock Ownership Plan (ESOP). In 1984, $54.4 million was raised in the capital markets, with three pollution control series of First Mortgage Bonds totalling $42.2 million; $11.4 million of Common Stock sold through the DRP and $.8 million of Common Stock sold through the ESOP. In 1983, $64.3 million was raised in the capital markets from the sale of $50 million of First Mortgage Bonds, $11.7 million of Common Stock sold

**Cash Requirements and Internal Generation of Funds**




**Year-End Capitalization**




through the DRP and $2.6 million of Common Stock sold through the ESOP. Interim financing of our construction program and working capital needs was provided by the issuance of short term debt.

Approximately 41% of the cash requirements for construction, debt maturities and sinking fund requirements during the period 1983-1985 was generated from operations after deductions for dividends and working capital needs, but exclusive of changes in temporary cash investments. The Company estimates that with adequate rate relief, more than 70% of its total cash construction requirements, debt maturities and sinking fund requirements will be generated internally during the five-year period from 1986-1990. Additional cash requirements will be satisfied through external financing. Capitalization ratios at December 31, 1985 are 47% long term debt, 45% common equity and 8% preferred stock. The Company will continue to use short term debt financing on an interim basis and currently maintains aggregate lines of credit of $115 million.

Provisions of the Company's charter, mortgage and debenture agreements can limit, in certain cases, the amount and types of additional financing which may be employed. Estimated additional funding capacities at December 31, 1985, giving effect to such provisions, would amount to more than $400 million for First Mortgage Bonds, or $150 million for Preferred Stock or $140 million for unsecured debt, and may not necessarily be additive.

## RESULTS OF OPERATIONS

The tabulation on page 36 includes key historical indicators which are helpful in evaluating the performance of the Company over the past five years.

### Earnings

Earnings per share of Common Stock, based on the weighted average number of shares outstanding, were $3.00 in 1985, compared to $3.20 in 1984 and $3.48 in 1983. The decrease in earnings per share in 1985 and 1984 is attributable to increases in operating expenses without corresponding rate relief. In addition to rate relief, our earnings are sensitive to other changes in revenues and expenses as discussed below.

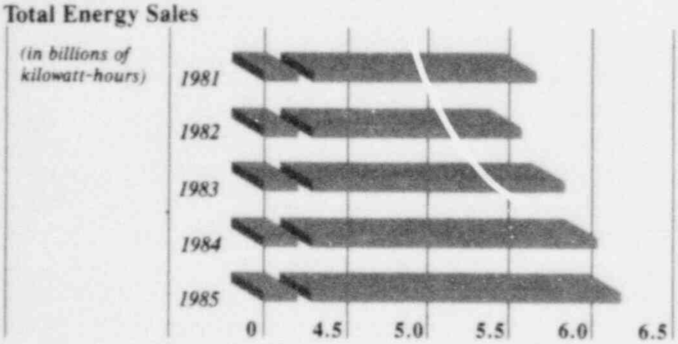
### Revenues

Operating revenues increased by 5.5% in 1985 to $579.7 million compared to $549.5 million in 1984. The 1984 level of revenues represented a 6.3% increase compared to 1983. These overall increases reflect the net results of base revenue increases, changes in Levelized Energy Clause revenues and changes in kilowatt-hour sales. The effects of the above factors on 1985 and 1984 revenues are shown below:

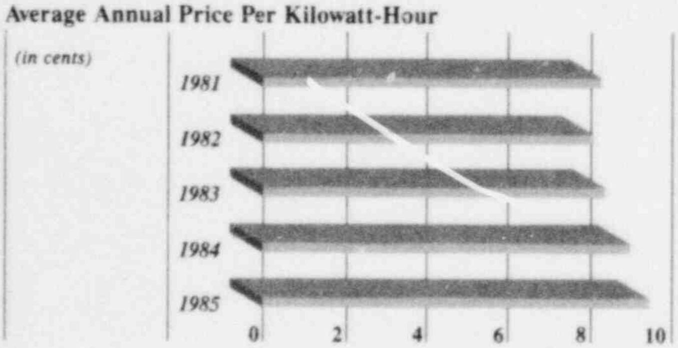
| *(Thousands of Dollars)* | 1985 | | 1984 | |
|---|---|---|---|---|
| Base Revenues | $24,142 | 4.4% | $12,971 | 2.4% |
| Levelized Energy Clause | (7,039) | (1.3) | 1,972 | .4 |
| Kilowatt-hour Sales | 13,099 | 2.4 | 17,446 | 3.5 |
| Increase | $30,202 | 5.5% | $32,389 | 6.3% |

Future changes in operating revenues will reflect the timeliness and adequacy of rate relief, general economic conditions in our service area and the results of load management and conservation programs.

**Total Energy Sales**




**Average Annual Price Per Kilowatt-Hour**




### Sales

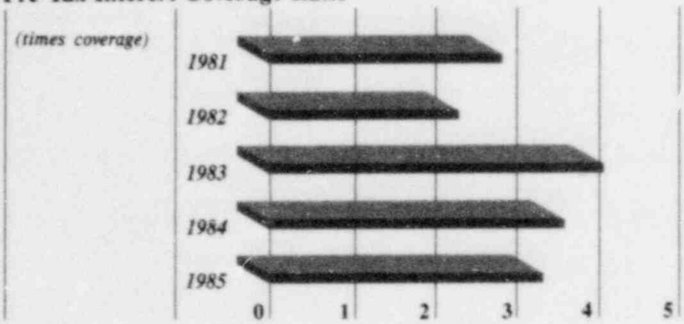
Changes in kilowatt-hour sales are generally due to changes in the average number of customers and average customer use, which is also affected by weather conditions.

Energy sales statistics, stated as percentage changes from prior years, are shown below:

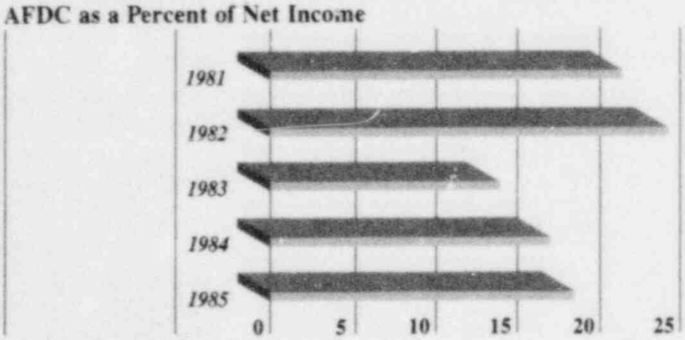
| | Increase (Decrease) from Prior Year | | | | | |
|---|---|---|---|---|---|---|
| | 1985 | | | 1984 | | |
| Customer Class | Sales | Average Use | Average # of Cust. | Sales | Average Use | Average # of Cust. |
| Residential | (.3)% | (2.8)% | 2.6% | 4.0% | 2.0% | 2.0% |
| Commercial | 6.9 | 5.4 | 1.5 | 6.5 | 5.4 | 1.1 |
| Industrial | .6 | .1 | .5 | (2.3) | (1.8) | (.5) |
| Other | (2.4) | (4.2) | 1.8 | (3.0) | (2.2) | (1.1) |
| Total | 2.4 | — | 2.5 | 3.5 | 1.6 | 1.9 |

The 2.4% and 3.5% increase in total kilowatt-hour sales in 1985 and 1984, respectively, is largely attributable to the number of new customers added to the Company's system in those years, and increased commercial activity in the service territory. Sales to residential customers in 1985 remained virtually unchanged from 1984 which, in turn, had increased 4.0% from 1983. In 1985, mild weather conditions and a lower average use per customer acted to offset the effects of an average of 8,700 new residential customers. In 1984, the effects of 6,500 new customers, together with an increased use per customer, resulted in increased kilowatt-hour sales. Sales to commercial customers increased 6.9% and 6.5% in 1985 and 1984, respectively. Business activities related to the expansion of the hotel/casino industry contributed to this commercial sales growth in both years. Sales to industrial customers increased by .6% in 1985 and declined 2.3% in 1984 as the result of changes in the number of customers and changes

**Pre-Tax Interest Coverage Ratio**




**AFDC as a Percent of Net Income**




in the use of energy. Overall, however, the combined effects of the changes in our sales and rates have resulted in an increase in revenues per kilowatt-hour of 2.3% in 1985 compared to 1984 and 4.2% in 1984 compared to 1983.

**Costs and Expenses**

Total operating expenses increased 7.0% in 1985 compared to 1984. The 1984 operating expenses represented an increase of 8.0% compared to 1983. Excluding depreciation and taxes, operating expenses rose to $332.8 million in 1985, an increase of 6.9% over 1984, which had increased 13% from 1983.

Net Energy Costs reflect the amount of energy produced, as well as the various fuel and purchased power sources used to produce it. Information on the sources and costs per kilowatt-hour of energy are set forth in the accompanying graph. In 1984, Net Energy Costs were reduced by $6,969,000 reflecting the deferral of fuel costs incurred in excess of revenues collected under the fuel clause effective for that year. For 1985, Net Energy Costs include $5,865,000 of previously Deferred Energy Costs representing fuel costs recovered under our energy clause. At December 31, 1985 $4,466,000 is shown on the balance sheet as Deferred Energy Revenues associated with the current energy clause.

The Company's annual fuel, interchange and purchased power costs reflect changes in availability of low-cost generation from Company-owned and purchased sources, as well as changes in the needs of other utilities participating in energy interchange. Certain costs associated with purchased power are deferred on the balance sheet since rates are levelized to collect these costs over the 17-year life of the PP&L Agreements (see Note 3 to the Financial Statements).

Power production operation and maintenance costs include the cost of maintenance of both wholly- and jointly-owned generating units. In addition, the Company has embarked on an aggressive program to upgrade our production and other facilities to insure efficiency and extend service life. Other operation and maintenance costs consist of the price of materials, supplies and services, as well as wages and employee benefits.

Changes in depreciation expense generally represent changes in the amounts of electric utility plant in service and the respective in-service dates.

The components of federal income taxes are detailed in the notes to the financial statements.

Interest charges before the allowance for borrowed funds used during construction rose to $41.6 million in 1985 compared to $40.3 million in 1984, and $37.0 million in 1983. The increase of $3.3 million in interest expense in 1984 from the 1983 level reflects a full year's effect of interest on the Company's 11⅞% First Mortgage Bonds which were issued in November 1983, the issuance in 1984 of an aggregate $42.2 million principal amount of several pollution control series of First Mortgage Bonds, and higher average short term borrowing rates, offset by the retirement and maturities of First Mortgage Bonds and by lower average short term debt outstanding. The increase of $1.3 million in interest expense in 1985 from the 1984 level reflects a full year's effect of interest expense associated with the pollution control series of First Mortgage Bonds issued in 1984, the issuance of $70 million principal amount of 11½% First Mortgage Bonds issued in October 1985 and higher average short term debt outstanding, offset by the maturities of First Mortgage Bonds and lower average short term borrowing rates. Interest rates on our debt offerings are sensitive to the timing at which such financings are undertaken. Pollution control series of bonds and variable rate debt have been used to moderate the general upward pressures on interest rates. The embedded cost of our long term debt at December 31, 1985, was 9.6%, compared to 9.2% in 1984 and 1983.

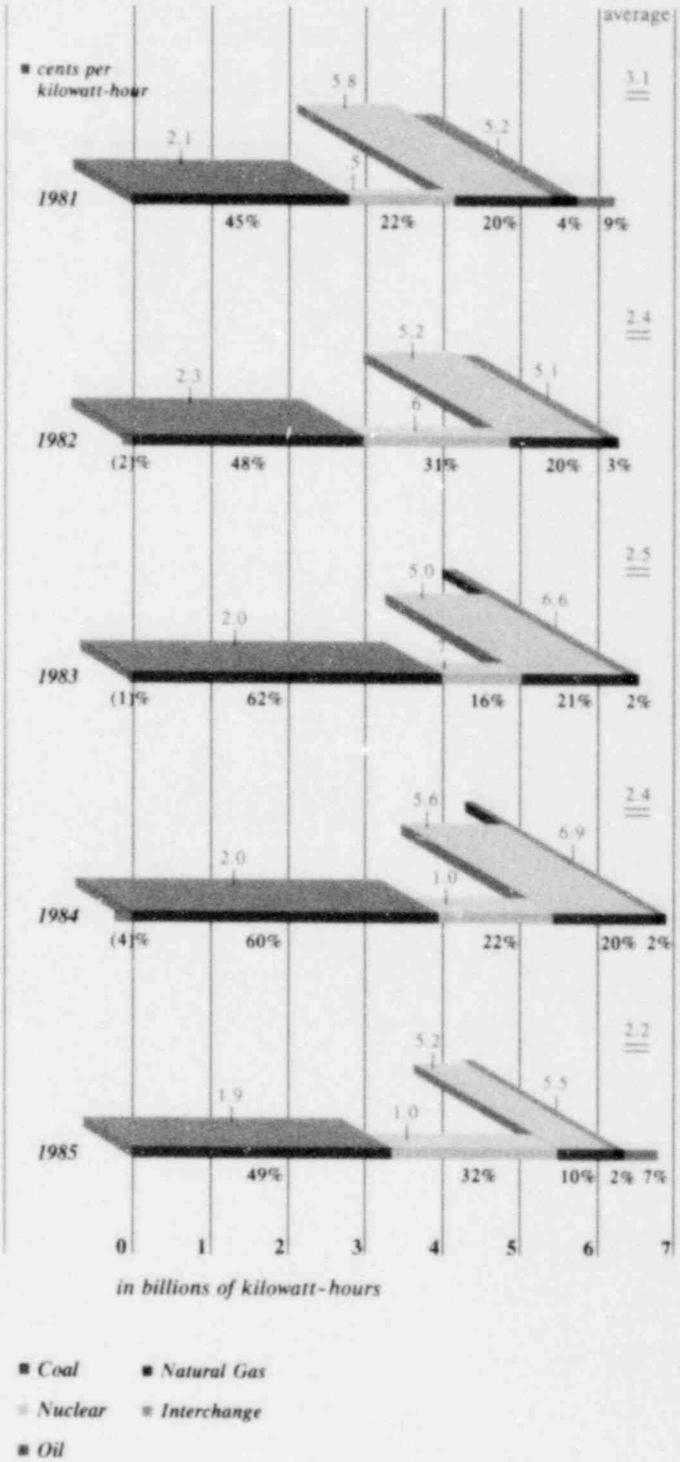
The Allowance for Funds Used During Construction (AFDC) including both the Borrowed Funds portion, which is used to reduce interest charges, and the Equity Funds portion, shown under Other Income, was $11.2 million in 1985 compared to $10.8 million in 1984 and $9.2 million in 1983. The increases are due to increases in the average balances of construction work in progress. AFDC as a percent of net income for 1985, 1984 and 1983 was 18.5%, 17.0% and 13.9%, respectively.

**Inflation**
Supplementary unaudited financial information showing the estimated effects of inflation on the Company's operations is shown on pages 34 through 36. These data, which should be viewed as estimates of the approximate effects of inflation, rather than as precise measures, demonstrate the need to control costs and the responsibility for regulatory agencies to provide timely and adequate rate relief.

**Accounting Standards**
The Financial Accounting Standards Board has issued an Exposure Draft of a Proposed Accounting Standard entitled "Regulated Enterprises—Accounting for Phase-in Plans, Abandonments, and Disallowances of Plant Costs" which is a proposed amendment to existing accounting standards for regulated enterprises, including electric utilities such as the Company. This proposal, if adopted in its present form, would modify current accounting standards for the types of events enumerated. While the Company is still evaluating this proposal, it believes its operating results and financial position will be impacted if applied to certain past events such as the abandonment of Hope Creek Unit No. 2.

The Company intends to submit written comments to the Financial Accounting Standards Board concerning this proposal.

**Total Sources and Costs of Energy**



## REPORT OF MANAGEMENT

The management of Atlantic City Electric Company is responsible for the financial statements presented herein. These financial statements were prepared by management in conformity with generally accepted accounting principles applicable to public utilities which are consistent in all material respects with the accounting prescribed by the State of New Jersey, Board of Public Utilities and the Federal Energy Regulatory Commission. In preparing the financial statements, management made informed judgments and estimates relating to events and transactions being reported.

The Company has established a system of internal accounting and financial controls and procedures designed to insure that the financial records reflect the transactions of the Company and that assets are safeguarded. This system is examined by management on a continuing basis for effectiveness and efficiency and is reviewed on a regular basis by an internal audit staff that reports directly to the Audit Committee of the Board of Directors.

The financial statements have been examined by Deloitte Haskins & Sells, Certified Public Accountants. The auditors provide an objective, independent review as to management's discharge of its responsibilities insofar as they relate to the fairness of reported operating results and financial condition. Their examination includes procedures believed by them to provide reasonable assurance that the financial statements are not misleading and includes a review of the Company's system of internal accounting and financial controls and a test of transactions.

The Board of Directors has oversight responsibility for determining that management has fulfilled its obligation in the preparation of financial statements and the ongoing examination of the Company's system of internal accounting controls. The Audit Committee, which is composed solely of outside directors, meets regularly with management, Deloitte Haskins & Sells and the internal audit staff to discuss accounting, auditing and financial reporting matters. The Audit Committee reviews the program of audit work performed by the internal audit staff. To insure auditor independence, both Deloitte Haskins & Sells and the internal audit staff have complete and free access to the Audit Committee.

## AUDITORS' OPINION

**Deloitte Haskins Sells**
Certified Public Accountants

One World Trade Center
New York, New York 10048

To the Shareholders and the Board of Directors
of Atlantic City Electric Company:

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

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

Deloitte Haskins & Sells

January 31, 1986

| | For the Years Ended December 31 | | |
|---|---|---|---|
| *(Thousands of Dollars Except Per Share Amounts)* | 1985 | 1984 | 1983 |
| **Operating Revenues—Electric** | $579,733 | $549,531 | $517,142 |
| **Operating Expenses:** | | | |
| Energy: | | | |
| Fuel | 133,437 | 178,681 | 167,988 |
| Interchange | 17,272 | (15,558) | (1,697) |
| Deferred Costs | 5,865 | (6,969) | (15,055) |
| Net Energy | 156,574 | 156,154 | 151,236 |
| Purchased Power-Exclusive of Fuel | 42,636 | 28,905 | 12,435 |
| Power Production-Operation and Maintenance | 55,329 | 56,124 | 48,794 |
| Other Operation and Maintenance | 78,236 | 69,989 | 62,800 |
| Depreciation and Amortization | 41,985 | 38,318 | 38,383 |
| New Jersey Gross Receipts and Franchise Taxes | 71,100 | 60,769 | 55,324 |
| Federal Income Tax Expense | 36,308 | 41,227 | 48,728 |
| Other Taxes | 8,159 | 6,654 | 6,340 |
| Total Operating Expenses | 490,327 | 458,140 | 424,040 |
| **Operating Income** | 89,406 | 91,391 | 93,102 |
| **Other Income:** | | | |
| Allowance for Equity Funds Used During Construction | 5,216 | 4,821 | 4,320 |
| Miscellaneous Income—Net | 1,502 | 1,424 | 833 |
| Total Other Income | 6,718 | 6,245 | 5,153 |
| **Income Before Interest Charges** | 96,124 | 97,636 | 98,255 |
| **Interest Charges:** | | | |
| Interest on Long Term Debt | 39,604 | 38,231 | 33,795 |
| Interest on Short Term Debt | 1,565 | 1,861 | 2,669 |
| Other Interest Expense | 416 | 204 | 535 |
| Total Interest Charges | 41,585 | 40,296 | 36,999 |
| Allowance for Borrowed Funds Used During Construction | (5,980) | (5,937) | (4,896) |
| Net Interest Charges | 35,605 | 34,359 | 32,103 |
| **Net Income** | 60,519 | 63,277 | 66,152 |
| **Retained Earnings at Beginning of Year** | 161,629 | 148,454 | 128,825 |
| | 222,148 | 211,731 | 194,977 |
| **Dividends Declared:** | | | |
| Cumulative Preferred Stock | 6,282 | 6,949 | 7,171 |
| Common Stock | 46,220 | 43,153 | 39,352 |
| Total Dividends Declared | 52,502 | 50,102 | 46,523 |
| **Retained Earnings at End of Year** | $169,646 | $161,629 | $148,454 |
| **Earnings for Common Stock:** | | | |
| Net Income | $ 60,519 | $ 63,277 | $ 66,152 |
| Less Preferred Dividend Requirements | 6,369 | 6,968 | 7,201 |
| Balance Available for Common Stock | $ 54,150 | $ 56,309 | $ 58,951 |
| **Average Number of Shares of Common Stock Outstanding** (in thousands) | 18,069 | 17,581 | 16,923 |
| **Per Common Share:** | | | |
| Earnings | $ 3.00 | $ 3.20 | $ 3.48 |
| Dividends Declared | $ 2.555 | $ 2.45 | $ 2.32 |
| Dividends Paid | $ 2.53 | $ 2.42 | $ 2.30 |

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

# STATEMENT OF CHANGES IN FINANCIAL POSITION

| | For the Years Ended December 31 | | |
|---|---|---|---|
| *(Thousands of Dollars)* | 1985 | 1984 | 1983 |
| **Source of Funds:** | | | |
| Funds from Operations: | | | |
| Net Income | $ 60,519 | $ 63,277 | $ 66,152 |
| Principal Non-Cash Charges (Credits) to Income: | | | |
| Depreciation and Amortization | 41,985 | 38,318 | 38,383 |
| Allowance for Funds Used During Construction | (11,196) | (10,758) | (9,216) |
| Deferred Federal Income Taxes—Net | 16,865 | 20,304 | 18,359 |
| Investment Tax Credit Adjustments—Net | 7,261 | 2,765 | 6,114 |
| Other—Net | 738 | 264 | 1,353 |
| Total Funds from Operations | 116,172 | 114,170 | 121,145 |
| Funds from Outside Sources: | | | |
| Long Term Debt | 70,000 | 42,200 | 50,000 |
| Pollution Control Funds (Held) Released by Trustees | 7,718 | (5,539) | 7,885 |
| Subtotal | 77,718 | 36,661 | 57,885 |
| Sale of Common Stock | 11,515 | 12,487 | 15,060 |
| Total Funds from Outside Sources | 89,233 | 49,148 | 72,945 |
| Other—Net | 1,802 | (2,517) | (1,978) |
| Total Source of Funds | $207,207 | $160,801 | $192,112 |
| **Application of Funds:** | | | |
| Gross Additions to Utility Plant | $105,213 | $ 95,388 | $ 83,673 |
| Allowance for Funds Used During Construction | (11,196) | (10,758) | (9,216) |
| Net | 94,017 | 84,630 | 74,457 |
| Dividends on Preferred Stock | 6,282 | 6,949 | 7,171 |
| Dividends on Common Stock | 46,220 | 43,153 | 39,352 |
| Retirement and Maturity of Long Term Debt | 10,000 | 26,000 | 50,300 |
| Unrecovered Purchased Power Costs | 14,680 | 6,530 | 11,450 |
| Unrecovered Nuclear Fuel Advances | 5,215 | — | — |
| Conversion of Preferred Stock | 353 | 267 | 711 |
| Redemption of Preferred Stock | 11,850 | 2,100 | 2,100 |
| Increase (Decrease) in Working Capital* | 18,590 | (8,828) | 6,571 |
| Total Application of Funds | $207,207 | $160,801 | $192,112 |
| **Increase (Decrease) in Working Capital*** | | | |
| Cash and Cash Items | $ 14,245 | $ (751) | $(11,616) |
| Accounts Receivable | 6,247 | 6,576 | 6,858 |
| Unbilled Revenue | 3,076 | (1,340) | 5,671 |
| Fuel | (2,614) | 10,657 | (5,146) |
| Materials and Supplies | (569) | 597 | 974 |
| Nuclear Fuel Disposal Costs | 8,481 | (8,481) | — |
| Deferred Energy Costs and Revenue | (22,190) | 6,967 | 26,626 |
| Accounts Payable | 630 | (5,261) | (1,647) |
| Taxes Accrued | 6,850 | (3,923) | (3,831) |
| Deferred Taxes | 1,136 | (2,589) | (7,557) |
| Other | 3,298 | (11,280) | (3,761) |
| Increase (Decrease) in Working Capital | $ 18,590 | $ (8,828) | $ 6,571 |

*Excludes Short Term Debt, Notes and Current Maturities of Long Term Debt and Cumulative Preferred Stock Subject to Mandatory Redemption.

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

# BALANCE SHEET

| (Thousands of Dollars) | December 31 1985 | 1984 |
|---|---|---|
| **Assets** | | |
| **Electric Utility Plant:** | | |
| In Service: | | |
| Production | $ 553,253 | $ 515,637 |
| Transmission | 200,517 | 190,969 |
| Distribution | 345,177 | 326,466 |
| General | 63,590 | 52,987 |
| Total | 1,162,537 | 1,086,059 |
| Less Accumulated Depreciation | 330,895 | 300,037 |
| Net | 831,642 | 786,022 |
| Construction Work in Progress | 237,310 | 216,026 |
| Land Held for Future Use | 6,849 | 6,957 |
| Nuclear Fuel | — | 628 |
| Electric Utility Plant—Net | 1,075,801 | 1,009,633 |
| **Non Utility Property and Investments** | 4,298 | 5,901 |
| **Pollution Control Construction Funds** | 2,871 | 11,076 |
| **Current Assets:** | | |
| Cash and Working Funds | 5,379 | 5,234 |
| Temporary Cash Investments | 18,500 | 4,400 |
| Accounts Receivable: | | |
| Utility Service | 42,899 | 36,276 |
| Miscellaneous | 8,386 | 8,662 |
| Allowance for Doubtful Accounts | (1,600) | (1,500) |
| Unbilled Revenues | 26,401 | 23,325 |
| Fuel (at average cost) | 29,828 | 32,442 |
| Materials and Supplies (at average cost) | 17,223 | 17,792 |
| Prepayments | 8,382 | 5,066 |
| Unrecovered Nuclear Fuel Disposal Costs | — | 2,407 |
| Deferred Energy Costs—Net | — | 17,724 |
| Total Current Assets | 155,398 | 151,828 |
| **Deferred Debits:** | | |
| Property Abandonment Costs | 19,878 | 17,029 |
| Unrecovered Purchased Power Costs | 32,660 | 17,980 |
| Unamortized Debt Expense | 5,220 | 4,343 |
| Other | 3,507 | 2,713 |
| Total Deferred Debits | 61,265 | 42,065 |
| **Total Assets** | $1,299,633 | $1,220,503 |

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

| | December 31 | |
|---|---|---|
| *(Thousands of Dollars)* | 1985 | 1984 |
| **Liabilities and Capitalization** | | |
| **Capitalization:** | | |
| Common Shareholders' Equity: | | |
| Common Stock | $ 54,771 | $ 53,464 |
| Premium on Capital Stock | 229,287 | 219,078 |
| Capital Stock Expense | (1,607) | (1,660) |
| Retained Earnings | 169,646 | 161,629 |
| Total Common Shareholders' Equity | 452,097 | 432,511 |
| Cumulative Preferred Stock Not Subject to Mandatory Redemption | 41,353 | 41,706 |
| Cumulative Preferred Stock Subject to Mandatory Redemption | 34,100 | 49,550 |
| Long Term Debt | 437,462 | 412,462 |
| Total Capitalization | 965,012 | 936,229 |
| **Current Liabilities:** | | |
| Current Portion: | | |
| Cumulative Preferred Stock Subject to Mandatory Redemption | 5,050 | 1,450 |
| Long Term Debt | 45,000 | 10,000 |
| Accounts Payable | 28,755 | 29,385 |
| Taxes Accrued | 5,372 | 12,222 |
| Interest Accrued | 12,865 | 11,721 |
| Dividends Declared | 13,224 | 12,757 |
| Customer Deposits | 2,945 | 2,737 |
| Deferred Taxes | 17,747 | 18,883 |
| Nuclear Fuel Disposal Costs | — | 10,888 |
| Deferred Energy Revenues—Net | 4,466 | — |
| Other | 5,681 | 7,482 |
| Total Current Liabilities | 141,105 | 117,525 |
| **Deferred Credits:** | | |
| Deferred Investment Tax Credits | 65,412 | 58,151 |
| Deferred Income Taxes | 120,464 | 103,599 |
| Other | 7,640 | 4,999 |
| Total Deferred Credits | 193,516 | 166,749 |
| **Commitments and Contingent Liabilities (Note 11)** | | |
| **Total Liabilities and Capitalization** | $1,299,633 | $1,220,503 |

## NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

**Regulation**
The accounting policies and rates of the Company are subject to the regulations of the State of New Jersey, Board of Public Utilities (BPU) and in certain respects to the Federal Energy Regulatory Commission (FERC). All significant accounting policies and practices used in the determination of rates are also used for financial reporting purposes. The financial statements are prepared on the basis of the Uniform System of Accounts prescribed by FERC.

**Operating Revenues**
Revenues are recognized when electric energy services are rendered, and include estimates for amounts unbilled at the end of the period for energy used subsequent to the last billing cycle.

**Electric Utility Plant**
Property is stated at original cost. Generally the plant is subject to a first mortgage lien. The cost of property additions, including replacement of units of property and betterments, is capitalized. Included in certain additions is an Allowance for Funds Used During Construction (AFDC) which is defined in the applicable regulatory system of accounts as the cost during the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used. AFDC has been calculated using a rate of 8.5% and was semi-annually compounded on Hope Creek Unit No. 1 expenditures beginning in 1984. Such rates are less than the maximum allowed by FERC.

**Deferred Energy Costs and Revenues**
The Company has a Levelized Energy Clause which is based on projected energy costs and includes a provision for prior period under or over recoveries. The recovery of energy costs is made through levelized monthly charges over the period of projection. Any under or over recoveries are deferred in balance sheet accounts as a current asset or current liability as appropriate. These deferrals are recognized in the Statement of Income during the period in which they are subsequently recovered through the clause.

**Depreciation**
The Company provides for straight-line depreciation based on the estimated remaining life of transmission and distribution property and, based on the estimated average service life, for all other depreciable property. Depreciation applicable to nuclear plant includes amounts provided for decommissioning. The overall composite rate of depreciation was approximately 3.7% for 1985, 3.6% for 1984 and 3.7% for 1983. Accumulated depreciation is charged with the cost of depreciable property retired together with removal costs less salvage and other recoveries.

**Nuclear Fuel**
Fuel costs associated with the Company's participation in jointly-owned nuclear generating stations, including a provision for estimated spent fuel disposal costs, are charged to Fuel Expense based on the units of thermal energy produced.

**Federal Income Taxes**
The Company provides deferred Federal Income Taxes on all significant current transactions for which the timing of reporting differs for book and tax purposes. Investment tax credits, which are used to reduce current federal income taxes, are deferred on the balance sheet and are recognized in book income over the life of the related property.

**Retirement Plan**
The Company has a noncontributory defined benefit retirement plan covering all regular employees. The Company's policy is to fund pension costs as accrued. Costs of the plan are determined actuarially under the aggregate cost method.

**Property Abandonment Costs**
These costs consist principally of the Company's unamortized investment in Hope Creek Unit No. 2, a nuclear generating unit which was cancelled in 1981, offshore nuclear units which were cancelled in 1978 and unrecovered nuclear fuel advances associated with three uranium supply contracts which were terminated in 1985.

The Hope Creek Unit No. 2 investment is being amortized over a 15-year period that began in 1983. The investment in the offshore nuclear units is being amortized over a 20-year period that began in 1979. Unrecovered nuclear fuel advances are being amortized, subject to BPU approval of their recovery, over 5 years, beginning in 1985. The unamortized amounts are $12,765,000, $2,745,000, and $4,172,000, respectively, at December 31, 1985.

**Unrecovered Purchased Power Costs**
These represent purchased capacity costs, relating to the Company's purchased power agreements with Pennsylvania Power & Light Company, which are not being recovered currently, but for which recovery has been specifically provided in a levelized component of future rates.

**Other**
Debt premium, discount and expenses are amortized over the life of the related debt. Gains and losses relating to reacquired debt are recognized currently.

Certain 1984 and 1983 amounts have been reclassified to conform with 1985 presentations.

## NOTE 2. FEDERAL INCOME TAX

Federal income tax expense is less than the amount computed by applying the statutory rate on book income subject to tax for the following reasons:

| | Years Ended December 31 | | |
|---|---|---|---|
| (Thousands of Dollars) | 1985 | 1984 | 1983 |
| Net Income | $60,519 | $ 63,277 | $ 66,152 |
| Federal Income Tax Expense (as below) | 36,317 | 41,876 | 49,061 |
| Book Income Subject to Tax | $96,836 | $105,153 | $115,213 |
| Income Tax Computed at the Statutory Rate | $44,544 | $ 48,370 | $ 52,998 |
| Items for which deferred taxes are not provided: | | | |
| Difference between Tax and Book Depreciation | 2,801 | (250) | 1,896 |
| Allowance for Funds Used During Construction | (5,029) | (4,832) | (4,211) |
| Capitalized Overheads | (1,209) | (1,221) | (1,245) |
| Investment Tax Credits | (2,178) | (1,842) | (1,775) |
| Other | (2,612) | 1,651 | 1,398 |
| Total Federal Income Tax Expense | $36,317 | $ 41,876 | $ 49,061 |
| Components of Federal Income Tax Expense: | | | |
| Federal Income Taxes Currently Payable | $12,956 | $ 15,512 | $ 15,072 |
| Deferred Federal Income Taxes: | | | |
| Liberalized Depreciation | 11,899 | 18,335 | 10,438 |
| Unbilled Revenues | 1,415 | (616) | 2,609 |
| Unrecovered Purchased Power Costs | 6,753 | 3,004 | 5,267 |
| Deferred Energy Costs | (2,551) | 3,205 | 4,948 |
| Other | (1,787) | (1,034) | 2,654 |
| Deferred Investment Tax Credits | 7,261 | 2,765 | 6,114 |
| Employee Stock Ownership Plan Credits | 371 | 705 | 1,959 |
| Total Deferred Federal Income Tax Expense | 23,361 | 26,364 | 33,989 |
| Total Federal Income Tax Expense | 36,317 | 41,876 | 49,061 |
| Less Federal Income Taxes Included in Other Income | 9 | 649 | 333 |
| Federal Income Taxes Included in Operating Expenses | $36,308 | $ 41,227 | $ 48,728 |

In 1984, the Company filed amended federal income tax returns for 1981 and 1982 reflecting the election of the Asset Guideline Repair Allowance. The effect of this election is included in Deferred Federal Income Taxes—Liberalized Depreciation and Deferred Investment Tax Credits.

The Company purchased tax benefits on equipment having an aggregate tax basis of approximately $10,400,000 and $2,900,000 in 1983 and 1982, respectively. These tax benefits include depreciation and investment tax credits.

The Company's federal income tax returns for 1981 and prior years have been examined by the Internal Revenue Service (IRS) and the Company's federal income tax liabilities for all years through 1976 have been determined and settled. The IRS has proposed certain deficiencies in tax for the years 1977 through 1981. The Company has protested the proposed deficiencies and is of the opinion that the final settlement of its federal income tax liabilities for these years will not have a material adverse effect on its results of operations or financial position.

At December 31, 1985 the cumulative amount of deferred income taxes which have not been provided on timing differences, principally depreciation, amounted to approximately $85,000,000 computed at the current statutory rate of 46%.

## NOTE 3. RATE MATTERS

**Base Rate Case Decisions**
During the three year period ended December 31, 1985 base rate case decisions of the New Jersey Board of Public Utilities (BPU) are shown below:

| Date of Petition | Amount Requested | Date Effective | Amount Approved | Increase In Revenue | Test Year |
|---|---|---|---|---|---|
| | *(millions)* | | *(millions)* | | |
| January 1983 | $ 30.8 | October 7, 1983 | $ 24.5 | 4.5% | September 30, 1982 |
| October 1983 | 25.3 | August 17, 1984 | — | — | December 31, 1983 |
| October 1984 | 24.1 | February 13, 1985 | 24.0 | 4.3% | September 30, 1982 |

The October 1983 increase relates to the first half of the purchase of 125 megawatts of capacity and related energy from Pennsylvania Power & Light Company (PP&L) under two Capacity and Energy Sales Agreements (the PP&L Agreements), which commenced with the start of commercial operation of PP&L's Susquehanna Unit 1. The PP&L Agreements provide for the purchase by the Company of capacity and energy from the Susquehanna Units through September 30, 1991, and then from certain PP&L coal-fired units through September 30, 2000. Through September 30, 1991, the estimated costs to be incurred by the Company for purchases of capacity and associated energy from the Susquehanna Units will exceed the levelized costs to be recovered by the Company from its customers. Such unrecovered costs will be accumulated and deferred. Such costs are included in the balance sheet as Unrecovered Purchased Power Costs along with related provision for deferred taxes. The level of rates approved by the BPU is designed to enable the Company to recover these deferred costs and associated carrying charges during the balance of the 17-year period. The stipulation provided that any difference between actual costs incurred by the Company under the agreements and the estimated costs on which the increased rates were based will be recognized in future base rate proceedings if such costs are found to be reasonable. The BPU order prescribes a revenue reduction formula in the event that both Susquehanna Units fail to meet a combined minimum performance standard established by the stipulation which could subject the Company, under the most adverse circumstances, to a revenue reduction not to exceed $15,000,000 per unit per year.

In August 1984 the BPU denied the Company's October 1983 request for the $25,300,000 increase in base rates. The BPU, in denying rate relief, made several adjustments to the Company's requested rate base, test year operating income and rate of return, providing for an overall rate of return of 11.35% and a return on common equity of 14.30%. Prior to the BPU decision, the Company had been authorized to earn an overall rate of return of 11.7% and a return on common equity of 15.0%. In November 1985, the decision by the BPU was affirmed by the New Jersey Superior Court. The Company has filed a request with the New Jersey Supreme Court for review of the appellate ruling. The Company cannot predict the final outcome of the proceedings or the ultimate effect upon the Company.

The February 1985 increase relates to the second half of the Company's agreements with PP&L and commenced with the start of commercial operation of PP&L's Susquehanna Unit 2.

In April 1985 the Company filed a petition requesting a net increase of $91,850,000 to be implemented in two phases. The first phase request, for $63,316,000, is related to increased operations and maintenance costs and capital investment, and is based upon a test year of September 30, 1985. The Company anticipates a decision on this request in the first quarter of 1986. The second phase request, for a net increase of $28,534,000, relates to the Company's 5% ownership in the Hope Creek Generating Station, and would become effective upon commercial operation of the unit.

**Energy Clauses**
The Company's energy clauses are reviewed annually by the BPU and the most recent decisions are shown below:

| Date of Petition | Amount Requested | Date Effective | Amount Approved |
|---|---|---|---|
| | *(millions)* | | *(millions)* |
| October 1983 | $ 28.1 | January 20, 1984 | $ 28.1 |
| October 1984 | 25.4 | February 13, 1985 | 4.8 |
| September 1985 | (37.1) | January 1, 1986 | (44.0) |

As part of the February 1985 energy clause approval, $1,639,000 of the costs associated with an extended outage of Salem Unit 1 during 1983 were excluded from recovery, and $4,298,000 of Deferred Energy Costs were reclassified to Unrecovered Purchased Power Costs. The Company also agreed to defer $7,500,000 of Deferred Energy Costs, relating to costs associated with certain nuclear unit outages in 1984.

As part of the January 1986 energy clause approval, the Company agreed to expense $3,975,000 of replacement power costs associated with maintenance and repair outages at Peach Bottom Unit 2 and Salem Unit 2. Also, the Company agreed to increase the deferral of $7,500,000 of Deferred Energy Costs to $12,179,000.

These costs represent the Company's pro rata impact of BPU findings in proceedings related to other co-owners with respect to replacement power costs associated with certain outages at the Salem Nuclear Generating Station (see Note 11).

## NOTE 4. RETIREMENT BENEFITS

The cost to the Company in providing a retirement plan for its employees was $6,465,000, $7,555,000 and $6,563,000 in 1985, 1984 and 1983, respectively. Approximately 80% of these costs were charged to operating expense and the remaining 20%, which was associated with construction labor, was charged to the cost of new utility plant.

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 8% for 1985 and 7% for 1984. The Company's Plan is in compliance with the Employee Retirement Income Security Act of 1974 as amended.

A comparison of accumulated plan benefits and plan net assets (including purchased annuity contract amounts) for the Company's Plan, as of the most recent actuarial valuation dates, is as follows:

| | January 1 | |
|---|---|---|
| *(Thousands of Dollars)* | 1985 | 1984 |
| Actuarial present value of accumulated plan benefits: | | |
| Vested | $ 84,563 | $ 86,758 |
| Nonvested | 4,459 | 3,846 |
| Total | $ 89,022 | $ 90,604 |
| Net Assets available for benefits | $121,778 | $115,596 |

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for retired employees. Substantially all of the Company's employees may become eligible for those benefits if they reach normal retirement age while working for the Company. Those and similar benefits for active employees are provided through insurance companies and other plan providers whose premiums and related plan costs are based on the benefits paid during the year. The Company recognizes the cost of providing those benefits by expensing the annual insurance premiums and related plan costs. The cost of providing those benefits for retirees totalled $992,000 for 1985 and $845,000 for 1984.

In December 1985 the Financial Accounting Standards Board adopted an accounting standard which will require the Company to modify the financial accounting and reporting for its retirement plan beginning in 1987. The Company believes the adoption of this new standard will not have a material adverse effect on its results of operations or financial position.

## NOTE 5. JOINTLY-OWNED GENERATING STATIONS

The Company participates with other utilities in the construction and operation of several electric production facilities.

The amounts shown represent the Company's share of each plant at December 31, and includes an allowance for funds used during construction.

| Station | Energy Source | Company's Share | Electric Plant in Service | | Construction Work in Progress | | Generation | |
|---|---|---|---|---|---|---|---|---|
| | | | 1985 | 1984 | 1985 | 1984 | 1985 | 1984 |
| | | | *(Thousands of Dollars)* | | | | *(MWH)* | |
| Keystone | Coal | 2.47% | $ 7,306 | $ 6,893 | $ 976 | $ 798 | 258,436 | 237,233 |
| Conemaugh | Coal | 3.83 | 12,355 | 11,684 | 210 | 332 | 400,790 | 423,653 |
| Peach Bottom | Nuclear | 7.51 | 91,010 | 77,292 | 2,490 | 8,873 | 420,469 | 738,447 |
| Salem | Nuclear | 7.41 | 160,977 | 154,806 | 2,605 | 4,751 | 1,039,420 | 395,037 |
| Hope Creek | Nuclear | 5.00 | — | — | 203,656 | 162,676 | — | — |

The operators of the Salem and Peach Bottom Nuclear Generating Stations entered into contracts with the United States Department of Energy for spent nuclear fuel disposal. These contracts require the payment of a one-time fee related to the Company's ownership interest in the Salem and Peach Bottom Stations, which was made in June 1985, as well as ongoing quarterly charges. Current recovery of these spent nuclear fuel disposal costs is provided as part of the Company's energy clause.

The Company provides its own financing during the construction period for its share of the jointly-owned plants and includes its share of direct operations and maintenance expenses in its Statement of Income.

## NOTE 6. INVESTMENT IN OPERATING SUBSIDIARY

The Company's investment in Deepwater Operating Company (Deepwater), a wholly-owned subsidiary which operates generating and process steam units owned by the Company, was $3,291,000 at December 31, 1985 and 1984. The principal asset of Deepwater is working capital in which the equity of the Company is fairly represented by its investment. The net production costs of Deepwater are included in the Company's accounts classified as to operation, maintenance and taxes.

## NOTE 7. COMMON STOCK

As of December 31, 1985 and 1984, the Company's Common Stock included 25,000,000 authorized shares of Common Stock ($3 par value).

| Shares Issued and Outstanding: | 1985 | 1984 | 1983 |
|---|---|---|---|
| Beginning of Year | 17,821,346 | 17,250,882 | 16,574,021 |
| Dividend Reinvestment and Stock Purchase Plan | 408,999 | 525,118 | 535,614 |
| Employee Stock Ownership Plan | 14,306 | 36,009 | 116,347 |
| Conversion of Preferred Stock | 12,358 | 9,337 | 24,900 |
| End of year | 18,257,009 | 17,821,346 | 17,250,882 |
| At $3 Par Value | $54,771,027 | $53,464,038 | $51,752,646 |

Premium on Capital Stock was credited in 1985 and 1984 with $10,209,000 and $10,799,000, respectively, representing the excess of proceeds over the par value of shares of Common Stock issued, sold and converted. At December 31, 1985 there were 57,179 shares of Common Stock authorized for issuance pursuant to the Employee Stock Ownership Plan and 47,375 shares of Common Stock reserved for the conversion of 5⅞% Convertible Series of Preferred Stock.

## NOTE 8. CUMULATIVE PREFERRED STOCK

The Company has authorized 799,979 shares of Cumulative Preferred Stock, $100 Par Value, 2,000,000 shares of No Par Preferred Stock and 3,000,000 shares of Preference Stock, No Par Value. Unissued shares may, or may not, possess mandatory redemption characteristics upon issuance. In certain circumstances, if dividends on issued Preferred Stock are in arrears, voting rights for the election of a majority of the Board of Directors becomes operative.

## NOTE 8(A).

Cumulative Preferred Stock Not Subject To Mandatory Redemption:

| $100 Par Value-Cumulative and Non-participating shares issued and outstanding: | | December 31 1985 | 1984 | Current Redemption Price Per Share |
|---|---|---|---|---|
| | | (Thousands of Dollars) | | |
| Series: | | | | |
| 4% | 77,000 Shares | $ 7,700 | $ 7,700 | $105.50 |
| 4.10% | 72,000 Shares | 7,200 | 7,200 | 101.00 |
| 4.35% | 15,000 Shares | 1,500 | 1,500 | 101.00 |
| 4.35% | 36,000 Shares | 3,600 | 3,600 | 101.00 |
| 4.75% | 50,000 Shares | 5,000 | 5,000 | 101.00 |
| 5% | 50,000 Shares | 5,000 | 5,000 | 100.00 |
| 5⅞% | Convertible Series: | | | |
| | 13,530 Shares (1985) | 1,353 | — | 101.50 |
| | 17,061 Shares (1984) | — | 1,706 | |
| 7.52% | 100,000 Shares | 10,000 | 10,000 | 104.89 |
| Total | | $41,353 | $41,706 | |

Cumulative Preferred Stock Not Subject to Mandatory Redemption is redeemable solely at the option of the Company upon payment of the redemption price plus accumulated and unpaid dividends to the date fixed for redemption. Premium on such Preferred Stock was $93,000 at December 31, 1985 and 1984.

The 5⅞% Convertible Series, of which 3,531 and 2,668 shares were converted in 1985 and 1984, respectively, is convertible, subject to adjustment in certain events, into Common Stock at the rate of 3.5 shares of Common Stock for each share of Preferred.

## NOTE 8(B).

Cumulative Preferred Stock Subject To Mandatory Redemption:

| Shares Issued and Outstanding: | | Par Value | December 31 1985 | 1984 | Current Redemption Price Per Share | Refunding Restricted Prior to |
|---|---|---|---|---|---|---|
| | | | (Thousands of Dollars) | | | |
| Series: | | | | | | |
| 8.40% | 100,000 Shares (1984) | $100 | — | $10,000 | | |
| 9.96% | 104,000 Shares (1985) | 100 | $10,400 | — | $106.06 | |
| | 120,000 Shares (1984) | | — | 12,000 | | |
| $8.25 | 87,500 Shares (1985) | None | 8,750 | — | 106.56 | November 1, 1987 |
| | 90,000 Shares (1984) | | — | 9,000 | | |
| $9.45 | 200,000 Shares | None | 20,000 | 20,000 | 104.20 | November 1, 1989 |
| | | | 39,150 | 51,000 | | |
| Less Portion due within one year | | | 5,050 | 1,450 | | |
| Total | | | $34,100 | $49,550 | | |

On February 1, 1985, the Company redeemed 8,000 shares of the 8.40% Preferred Stock series through the operation of the sinking fund and optional redemption provisions at a redemption price of $100 per share. On August 2, 1985 the Company reacquired all of the then outstanding shares (92,000) of this series, with an aggregate par value of $9,200,000 for $9,177,000.

On August 1 of each year 8,000 shares of the 9.96% Series must be redeemed through the operation of a sinking fund at a redemption price of $100 per share. At the option of the Company, an additional 8,000 shares may be redeemed on any sinking fund date, without premium, up to 40,000 shares in the aggregate. The Company redeemed 16,000 shares at par in 1985 and 1984 through the operation of the sinking fund and optional redemption provisions. As of December 31, 1985 the Company had redeemed the maximum 40,000 shares pursuant to the optional redemption without premium provisions.

On November 1 of each year, 2,500 shares of the $8.25 No Par Preferred Stock Series must be redeemed through the operation of a sinking fund at a redemption price of $100 per share. At the option of the Company, not more than an additional 2,500 shares may be redeemed on any sinking fund date without premium. The Company redeemed 2,500 and 5,000 shares at par in 1985 and 1984, respectively.

On November 1, 1986, and annually thereafter, 40,000 shares of the $9.45 No Par Preferred Stock Series must be redeemed through the operation of a sinking fund at a redemption price of $100 per share. At the option of the Company, not more than an additional 40,000 shares may be redeemed on any sinking fund date, without premium, up to 50,000 shares in the aggregate.

The annual minimum sinking fund provisions of the above series aggregate $5,050,000 each year from 1986 through 1990.

## NOTE 9. LONG TERM DEBT

| | December 31, | |
|---|---|---|
| *(Thousands of Dollars)* | 1985 | 1984 |
| First Mortgage Bonds: | | |
| 3⅛% Series due (March 1) 1985 | — | $ 10,000 |
| 4½% Series due (January 1) 1987 | $ 10,000 | 10,000 |
| 3⅞% Series due (April 1) 1988 | 10,000 | 10,000 |
| 4½% Series due (April 1) 1989 | 2,775 | 2,775 |
| 4½% Series due (March 1) 1991 | 10,000 | 10,000 |
| 4½% Series due (July 1) 1992 | 10,350 | 10,350 |
| 4⅝% Series due (March 1) 1993 | 9,540 | 9,540 |
| 11⅞% Series due (November 1) 1993 | 50,000 | 50,000 |
| 5⅛% Series due (February 1) 1996 | 9,980 | 9,980 |
| 8⅞% Series due (September 1) 2000 | 19,000 | 19,000 |
| 8% Series due (May 1) 2001 | 27,000 | 27,000 |
| 7½% Series due (April 1) 2002 | 20,000 | 20,000 |
| 7¾% Series due (June 1) 2003 | 29,976 | 29,976 |
| 7⅝% Pollution Control Series due (January 1) 2005 | 6,500 | 6,500 |
| 6⅝% Pollution Control Series due (December 1) 2006 | 2,500 | 2,500 |
| 12⅞% Series due (January 1) 2010 | 63,750 | 63,750 |
| 11⅝% Pollution Control Series due (May 1) 2011 | 39,000 | 39,000 |
| 10½% Pollution Control Series B due (July 15) 2012 | 850 | 850 |
| Adjustable Rate Pollution Control Series A due (April 15) 2014 (7¼% Until 4-15-87) | 18,200 | 18,200 |
| 10½% Pollution Control Series C due (July 15) 2014 | 23,150 | 23,150 |
| 11½% Series due (October 1) 2015 | 70,000 | — |
| Total | 432,571 | 372,571 |
| Debentures: | | |
| 5¼% Sinking Fund Debentures due (February 1) 1996 | 2,267 | 2,267 |
| 7¼% Sinking Fund Debentures due (May 1) 1998 | 2,619 | 2,619 |
| Total | 4,886 | 4,886 |
| Notes—Variable Rate Notes due (April 30) 1986 | 45,000 | 45,000 |
| Unamortized Premium and Discount—Net | 5 | 5 |
| Total | 482,462 | 422,462 |
| Less Long Term Debt due within one year | 45,000 | 10,000 |
| Total | $437,462 | $412,462 |

Deposits in sinking funds for retirement of debentures are required on February 1 of each year through 1995 for the 5¼% debentures, and on May 1 of each year through 1997 for the 7¼% debentures in amounts in each case sufficient to redeem $100,000 principal amount plus, at the election of the Company, up to an additional $100,000 principal amount in each year. At December 31, 1985 the Company had reacquired and cancelled $1,233,000 and $1,081,000 principal amount of the 5¼% and 7¼% debentures, respectively, toward its requirements for 1986 and subsequent periods.

A sinking fund requirement of $3,000,000 each year relative to the 12⅝% First Mortgage Bonds begins in 1986 and continues through 2009. The Company also has the option to redeem an additional $3,000,000 principal amount on any sinking fund date without premium. At December 31, 1985 the Company had reacquired and cancelled $11,250,000 principal amount of the 12⅝% Series which may be applied toward its requirements for 1986 and subsequent periods. On January 1, 1986 the Company redeemed an additional $6,000,000 of these bonds through the operation of the sinking fund and optional redemption provisions. Current sinking fund requirements of $750,000 in connection with certain First Mortgage Bonds outstanding may be satisfied by certification of property additions as provided for in the related mortgage indentures.

The aggregate amount of debt maturities, in addition to sinking fund requirements, of all long term debt outstanding at December 31, 1985 are $45,000,000 in 1986, $10,000,000 in 1987 and 1988, and $2,775,000 in 1989. No maturities of long term debt occur in 1990.

## NOTE 10. SHORT TERM DEBT AND COMPENSATING BALANCES

As of December 31, 1985, the Company had bank lines of credit available for use of $115,000,000. The Company is required, with respect to $15,000,000 of these credit lines, to maintain average compensating balances of $487,500. These compensating balances are maintained in demand deposits which are not legally restricted. The Company is in compliance with such compensating balance arrangements. With respect to the remaining available credit lines, the Company pays commitment fees (generally ¼%) for which charges amounted to $235,000 for 1985, $242,000 for 1984 and $269,000 for 1983. The Company had no outstanding short term debt at December 31, 1985, 1984 or 1983. Additional information regarding short term debt follows:

| *(Thousands of Dollars)* | 1985 | 1984 | 1983 |
|---|---|---|---|
| For the year ended— | | | |
| Maximum amount of total short term debt at any month-end: | | | |
| Commercial Paper | $55,700 | $35,000 | $50,000 |
| Notes Payable to Banks | $10,000 | — | $ 7,000 |
| Average amount of short term debt (based on daily outstanding balances): | | | |
| Commercial Paper | $19,905 | $17,519 | $23,954 |
| Notes Payable to Banks | $ 4,239 | $ 301 | $ 2,567 |
| Weighted daily average interest rates on short term debt: | | | |
| Commercial Paper | 7.9% | 10.6% | 9.0% |
| Notes Payable to Banks | 8.1% | 9.2% | 9.3% |

## NOTE 11. COMMITMENTS AND CONTINGENCIES

**Construction Program**

Total cash construction expenditures for 1986 are estimated at approximately $86,082,000, which includes $18,796,000 for jointly-owned facilities. Current commitments for the construction of major production and transmission facilities amount to approximately $12,380,000 of which it is estimated approximately $8,905,000 will be expended in 1986. These amounts exclude allowance for funds used during construction and customer contributions.

**Nuclear Insurance Programs**

The Company is a member of certain insurance programs which provide coverage for property damage to members' nuclear generating plants. Facilities at the Peach Bottom and Salem Stations are insured against property damage losses up to $1.1 billion per site under these programs.

The Company is also a member of an insurance program which provides insurance coverage for the cost of replacement power during prolonged outages of nuclear units caused by certain specific conditions. Under the property and replacement power insurance programs, the Company could be assessed retrospective premiums in the event the insurers' losses exceed their reserves. As of December 31, 1985, the maximum amount of retrospective premiums the Company could be assessed for losses during the current policy year was $8.2 million under these programs.

In the event of a nuclear incident at any of the facilities covered by the federal government's third-party liability indemnification program, the Company could be assessed up to $2.1 million per incident, but not more than $4.2 million in a calendar year, in the event more than one incident is experienced.

**Purchase Power Agreements**

The Company has an arrangement for a limited term purchase of energy and capacity from Allegheny Power System which was effective for 1985 and subject to annual extensions. The Company also has agreements to purchase certain capacity and energy output from units of Pennsylvania Power & Light Company.

**Hope Creek Cost Containment**

The Company owns 5% of the the Hope Creek Nuclear Generating Station, currently under construction by Public Service Electric & Gas Company (PSE&G), which owns the other 95% of the unit. In July 1983 the BPU approved an Agreement between the Company, PSE&G, the New Jersey Department of Energy and the New Jersey Department of the Public Advocate which establishes a program to contain the continuing construction costs of Hope Creek, which is currently 99% complete as to physical construction and approximately 93% complete as to start-up, and scheduled for completion in the second half of 1986. The cost containment agreement established a targeted in-service date of December 1986 and a targeted cost of $3.7952 billion, and provides for penalties for overruns based on the final cost of the unit. The Company's portion of the originally targeted cost is approximately $198.1 million, including the Allowance for Funds Used During Construction (AFDC). However, the targeted amount may be subject to adjustment on account of changes in the regulatory treatment of Construction Work In Progress and AFDC, as well as changes due to certain extraordinary events not contemplated by the parties in 1983. At December 31, 1985 the Company's costs associated with Hope Creek amount to approximately $204 million and the Company has recently been advised by PSE&G that the estimated overall cost for Hope Creek is expected to be between $4.15 and $4.30 billion. The Company cannot predict the final cost of the Hope Creek unit, the date of commencement of commercial operation, or the ultimate effects thereof on its operations. However, Management believes the final outcome of this matter will not have a material adverse effect on the Company's financial position.

**Nuclear Plant Outages**

The BPU has deferred consideration of $12,179,000 of replacement power costs associated with certain nuclear outages relating to generator failures at Salem Station pending the development of the record on such outages in the next energy clause adjustment proceeding of the operator of the station, Public Service Electric & Gas Company. The co-owners of the station have instituted litigation against the supplier of the affected equipment. The Company cannot predict the outcome of this matter or its ultimate effect on the Company.

**Nuclear Fuel**

The Company's contractual liability to purchase nuclear fuel from Pearl Fuel Corporation for Salem and Hope Creek Generating Stations as of December 31, 1985 was approximately $31,000,000. Under certain conditions of termination, the Company will be required to purchase all nuclear fuel then existing at a price which will allow Pearl Fuel Corporation to recover its net investment costs. Nuclear fuel requirements for Peach Bottom Generating Station are being provided by the operating company through a fuel purchase contract. The Company is responsible for payment of its share of fuel consumed and related operating costs and interest expense. These costs are included in fuel expense.

## NOTE 12. LEASES

The Company has certain obligations which, in accordance with criteria established by the Financial Accounting Standards Board (FASB), are capital leases, but are accounted for as operating leases in accordance with the ratemaking treatment. An accounting standard issued by the FASB requires that the Company record such leases on its balance sheet by 1987. Recording capital leases would not have a material effect on assets or liabilities, and would not affect income, since the total amortization of the leased assets and the interest on the lease obligation would equal the rental expense currently allowed for ratemaking purposes. Rentals charged to operating expenses for the years ended December 31 were as follows:

| *(Thousands of Dollars)* | 1985 | 1984 | 1983 |
|---|---|---|---|
| Nuclear Fuel | $11,800 | $ 8,457 | $ 6,364 |
| Other | 4,511 | 4,759 | 5,268 |
| Total | $16,311 | $13,216 | $11,632 |

The future minimum rental commitments under all non-cancelable lease agreements are not significant.

## NOTE 13. SUPPLEMENTARY INCOME STATEMENT INFORMATION

Operating expenses include maintenance costs of $43,378,000, $39,247,000 and $35,066,000 for 1985, 1984 and 1983 respectively. Charges to income for royalties and advertising are less than 1% of gross revenue.

## NOTE 14. QUARTERLY FINANCIAL RESULTS (UNAUDITED)

Quarterly financial data, reflecting all adjustments necessary in the opinion of the Company for a fair presentation of such amounts, are as follows:

| Quarter | Operating Revenues | Operating Income | Net Income | Earnings For Common Stock | Earnings Per Share |
|---|---|---|---|---|---|
| *(Thousands of Dollars Except Per Share Amounts)* | | | | | |
| 1985 | | | | | |
| 1st | $140,491 | $19,104 | $12,658 | $10,962 | $ .61 |
| 2nd | 134,214 | 15,683 | 8,866 | 7,176 | .40 |
| 3rd | 180,411 | 35,630 | 27,815 | 26,283 | 1.45 |
| 4th | 124,617 | 18,989 | 11,180 | 9,729 | .53 |
| | $579,733 | $89,406 | $60,519 | $54,150 | $3.00(1) |
| 1984 | | | | | |
| 1st | $133,649 | $21,527 | $15,360 | $13,588 | $ .78 |
| 2nd | 125,073 | 18,448 | 11,431 | 9,660 | .55 |
| 3rd | 163,929 | 36,275 | 28,330 | 26,586 | 1.51 |
| 4th | 126,880 | 15,141 | 8,156 | 6,475 | .36 |
| | $549,531 | $91,391 | $63,277 | $56,309 | $3.20 |

(1)The individual quarters may not add to the total due to the increasing average number of Common shares outstanding at the end of each quarter.

The revenues of the Company are subject to seasonal fluctuations due to increased sales and higher residential rates during the summer months.

## SUPPLEMENTARY INFORMATION CONCERNING THE EFFECTS OF CHANGING PRICES (UNAUDITED)

The following supplementary information about the effects of changing prices is presented in accordance with standards issued by the Financial Accounting Standards Board (FASB). The Company cautions readers on using this information to draw any conclusions concerning the Company or its operations, since the Company's rates are subject to regulation. Additionally, this information is still considered experimental in nature and under continuing review by the FASB. The Company has expressed its views to the FASB concerning these disclosures and has made certain recommendations it believes would simplify both the presentation and understanding of the effects of inflation on a business enterprise. The effects of changing prices are calculated by adjusting the financial data for changes in specific prices of the components of the Company's utility plant by applying the Handy-Whitman Index of Public Utility Construction Costs to historical cost by vintage years, reflecting the current cost of replacing resources actually used in the Company's operations.

## STATEMENT OF INCOME FROM CONTINUING OPERATIONS ADJUSTED FOR CHANGING PRICES

(In Average 1985 Dollars)

Results of Operations:

| *(Thousands of Dollars)* | Year Ended December 31, 1985 | |
|---|---|---|
| | Historical | At Current Cost |
| Operating Revenues | $579,733 | $579,733 |
| Operating Expenses: | | |
| Operation and Maintenance Expenses | 412,034 | 412,034 |
| Depreciation and Amortization Expense | 41,985 | 89,273 |
| Federal Income Tax Expense | 36,308 | 36,308 |
| Other | 28,887 | 28,887 |
| Income from Continuing Operations | $ 60,519 | $ 13,231 |

Depreciation and amortization expense expressed in current cost amounts were determined using the rates and methods used for computing book depreciation and amortization applied to utility plant balances re-expressed in terms of current costs.

Operating revenues and expenses, other than depreciation and amortization, were incurred ratably during the year and are, in effect, stated in average 1985 dollars. Income taxes were not adjusted because the present tax laws do not allow a deduction for depreciation and amortization adjusted for the impact of inflation. Therefore, the Company's effective tax rate rises from 37.5% under the historical cost basis to 73.3% under current cost basis.

This supplementary information should not be used to assess the probability of future cash flows when existing utility plant is replaced. The estimates do not reflect the effects of the regulatory process nor the specific plans of the Company for the replacement or modernization of utility plant. A meaningful estimate of the estimated level of future capital expenditures is set forth on page 15 of the annual report.

**Current Year Effect of Increased Price Levels**

*(Thousands of Dollars)*

| | |
|---|---|
| Increase in General Price Levels on Utility Plant Held | $63,611 |
| Increases in Specific Prices on Utility Plant Held | 29,406 |
| Excess of Increase in General Price Levels Over Increases in Specific Prices | $34,205 |

At December 31, 1985 the cost of utility plant, net of accumulated depreciation was $1,835,324,000 on a current cost basis, while historical cost was $1,075,801,000. The accumulated provision for depreciation and amortization under the current cost method was estimated for each major class of utility plant (production, transmission, distribution and general plant) by multiplying the respective cost data by a percentage representing the expired life of existing facilities of each class at December 31, 1985.

Fuel inventories, the cost of fossil fuels used in generation, have not been restated from their historical cost. New Jersey regulation controls fuel costs, through the operation of a levelized energy clause, such that recovery is ultimately limited to actual cost. For this reason fuel inventories are effectively monetary assets.

**Net Utility Plant Costs Recoverable**

Under rate making prescribed by the regulatory commissions to which the Company is subject, only the historical cost of utility plant is recoverable in revenues as depreciation. Therefore, the excess of the cost of utility plant stated in terms of current cost over the historical cost of plant is not presently recoverable. Due to this feature, the value of utility plant and its effect on income from continuing operations adjusted for changing prices must be considered in terms of its net recoverable cost which is historical cost. While the rate making process gives no recognition to the current cost of replacing utility plant, based on past practices the Company believes it will be allowed to earn a return on the increased cost of its net investment when replacement of facilities actually occurs.

**Current Year Decline in Purchasing Power of Net Amounts Owed**

The current year decline in purchasing power of net amounts owed was $28,980,000. During a period of inflation, holders of monetary assets such as cash and receivables suffer a loss of general purchasing power while holders of monetary liabilities, generally long term debt, experience a gain because debt will be repaid in dollars having less purchasing power. The Company's gain from the decline in purchasing power of its net amounts owed is primarily attributable to the substantial amount of debt and cumulative preferred stock subject to mandatory redemption which has been used to finance utility plant. This gain, however, should not be considered as providing funds to the Company, since the Company is limited under rate making procedure to the recovery only of its embedded cost of debt.

# FIVE-YEAR COMPARISON OF SELECTED FINANCIAL DATA INCLUDING UNAUDITED SUPPLEMENTARY DATA ADJUSTED FOR CHANGING PRICES



Thousands of Dollars Except Per Share Amounts—
Current Cost Amounts Expressed in 1981 Dollars

| | Years Ended December 31 | | | | |
|---|---|---|---|---|---|
| | 1985 | 1984 | 1983 | 1982 | 1981 |
| Operating Revenue | | | | | |
| —historical | $ 579,733 | $ 549,531 | $ 517,142 | $ 444,178 | $ 469,683 |
| —trended in 1981 dollars | 490,128 | 481,016 | 471,925 | 418,231 | 469,683 |
| Income from Continuing Operations | | | | | |
| —historical | $ 60,519 | $ 63,277 | $ 66,152 | $ 49,055 | $ 46,988 |
| —at current cost (a) | 11,186 | 15,740 | 19,846 | 3,805 | 7,648 |
| Income from Continuing Operations per Share of Common Stock (b) | | | | | |
| —historical | $ 3.00 | $ 3.20 | $ 3.48 | $ 2.76 | $ 3.03 |
| —at current cost | .32 | .55 | .79 | (.21) | .01 |
| Effective Income Tax Rate | | | | | |
| —historical | 37.5% | 39.8% | 42.6% | 35.5% | 36.8% |
| —current cost basis | 76.5 | 82.3 | 94.7 | 112.7 | 102.3 |
| Excess of Increases in General Price Levels Over Increases in Specific Prices (a) | $ 28,918 | $ 49,792 | $ 290 | $ (6,724) | $ (25,204) |
| Decline in Purchasing Power of Amounts Owed (a) | $ 24,501 | $ 26,795 | $ 16,948 | $ 20,401 | $ 39,572 |
| Net Assets at Year End | | | | | |
| —historical | $ 493,450 | $ 474,217 | $ 448,894 | $ 414,834 | $ 338,846 |
| —trended in average 1981 dollars | 410,179 | 408,270 | 402,895 | 386,460 | 327,892 |
| Net Income as a Percent of Operating Revenue (b) | | | | | |
| —historical | 10.44% | 11.51% | 12.79% | 11.04% | 10.00% |
| —trended in 1981 dollars | 8.83 | 10.07 | 11.67 | 10.40 | 10.00 |
| Earned Rate of Return on Shareholders' Equity | | | | | |
| —historical | 11.98% | 13.02% | 14.49% | 11.20% | 12.21% |
| —trended in 1981 dollars | 10.13 | 11.40 | 13.22 | 10.55 | 12.21 |
| Total Assets at Year End | | | | | |
| —historical | $1,299,633 | $1,220,503 | $1,139,978 | $1,077,969 | $1,013,789 |
| Long Term Debt and Cumulative Preferred Stock Subject to Mandatory Redemption | | | | | |
| —historical | $ 521,612 | $ 473,462 | $ 459,366 | $ 462,470 | $ 447,389 |
| Dividends Declared per Share of Common Stock | | | | | |
| —historical | $ 2.555 | $ 2.45 | $ 2.32 | $ 2.24 | $ 2.08 |
| —trended in 1981 dollars | 2.16 | 2.14 | 2.12 | 2.11 | 2.08 |
| Market Price per Common Share at Year End | | | | | |
| —historical | $ 28.50 | $ 24.13 | $ 23.25 | $ 20.75 | $ 17.25 |
| —trended in 1981 dollars | 24.48 | 21.47 | 21.56 | 19.98 | 17.25 |
| Average Consumer Price Index | 322.2 | 311.2 | 298.5 | 289.3 | 272.4 |

Certain comparative per share data trended in 1985 dollars (without adjustment of earnings for the pro forma effects of inflation on depreciation amounts) are as follows:

| | 1985 | 1984 | 1983 | 1982 | 1981 |
|---|---|---|---|---|---|
| Earnings (b) | $ 3.00 | $ 3.31 | $ 3.76 | $ 3.07 | $ 3.58 |
| Dividends Declared | 2.555 | 2.54 | 2.50 | 2.49 | 2.46 |
| Market Price (Year End) | 28.50 | 24.99 | 25.10 | 23.26 | 20.08 |

(a) These amounts will differ from those shown in Statement of Income From Continuing Operations Adjusted for Changing Prices because a different base year has been used in the data presented above (1981) and in the changing price information (1985) in order to illustrate the impact of changing prices in alternative forms.

(b) Income from Continuing Operations, Net Income and Earnings Per Share data for 1982 include the cumulative effect of a change in accounting method.

**Where should I send inquiries concerning my investment in Atlantic City Electric Company?**

The Company staffs an Investor Records Department which serves as recordkeeping agent, dividend disbursing agent and also as Transfer Agent for Common and Preferred Stocks. Correspondence concerning such matters as the replacement of dividend checks or stock certificates, address changes, transfer of Common and Preferred Stock certificates, Dividend Reinvestment and Stock Purchase Plan inquiries or any general information about the Company should be addressed to:

Atlantic City Electric Company
Investor Records Department
P.O. Box 1334, 1199 Black Horse Pike
Pleasantville, New Jersey 08232
Telephone (609) 645-4506 or (609) 645-4507

Mr. M. R. Meyer, Secretary, is the Corporate Officer responsible for all investor services—Mr. R. E. Moeller is Manager of Investor Services and Mrs. M. T. Lindsay is Supervisor of Shareholder Recordkeeping.

**Does the Company have a Dividend Reinvestment and Stock Purchase Plan?**

Yes. The Plan allows shareholders and employees to automatically invest their cash dividends and/or optional cash payments in shares of the Company's Common Stock. Holders of record of Common Stock interested in enrolling in the Plan should contact the Investor Records Department. See our address above.

**Where is the Company stock listed?**

Common Stock and 5⅞% Cumulative Convertible Preferred Stock are listed on the New York Stock Exchange. The Company's Common Stock is also listed on the Pacific and Philadelphia Stock Exchanges. The trading symbol of the Company's Common Stock is ATE; however, newspaper listings generally use AtCyEl.

The high and low sales prices of the Common Stock as reported in the Wall Street Journal as New York Stock Exchange—Composite Transactions for the periods indicated were as follows:

| | 1985 | | 1984 | |
|---|---|---|---|---|
| | High | Low | High | Low |
| First Quarter | 25¼ | 23¾ | 23½ | 20¼ |
| Second Quarter | 29¼ | 24¼ | 21⅜ | 19⅞ |
| Third Quarter | 29¼ | 25⅝ | 23 | 20⅜ |
| Fourth Quarter | 29¾ | 26 | 25 | 22½ |

**Is additional information about the Company available?**

The annual report to the Securities and Exchange Commission on Form 10-K and other reports containing financial data are available to shareholders. Specific requests should be addressed to Mr. M. R. Meyer, Secretary, or the Investor Records Department, at the address shown above.

**Who is the trustee and interest paying agent for the Company's Bonds and Debentures?**

First Mortgage Bond recordkeeping and interest disbursing are performed by Irving Trust Company, One Wall Street, New York, New York 10015. Debenture services are performed by First Fidelity Bank, N.A., 765 Broad Street, Newark, New Jersey 07101.

**When are dividends paid?**

The proposed record dates and payable dates for upcoming dividends on Common Stock are as follows:

| Record Dates | Payable Dates |
|---|---|
| March 20, 1986 | April 15, 1986 |
| June 19, 1986 | July 15, 1986 |
| September 18, 1986 | October 15, 1986 |
| December 18, 1986 | January 15, 1987 |

The following table indicates dividends paid in 1985 and 1984 on Common Stock:

| | 1985 | 1984 |
|---|---|---|
| First Quarter | $ .62 | $ .59 |
| Second Quarter | $ .62 | $ .59 |
| Third Quarter | $ .645 | $ .62 |
| Fourth Quarter | $ .645 | $ .62 |
| Annual Total | $2.53 | $2.42 |

Dividends paid on Common Stock in 1985 and 1984 were fully taxable.

| | 1985 | 1984 | 1983 | 1982 |
|---|---|---|---|---|
| **Facilities for Service** | | | | |
| Total Utility Plant (Thousands) | $1,406,696 | $1,309,670 | $1,226,165 | $1,153,321 |
| Gross Additions to Utility Plant (Thousands) | $ 105,213 | $ 95,388 | $ 83,673 | $ 126,893 |
| Pole Miles of Transmission and Distribution Lines | 6,977 | 6,958 | 6,925 | 6,918 |
| Generating Capacity (Kilowatts) (a) (b) | 1,605,700 | 1,594,200 | 1,594,200 | 1,531,200 |
| Maximum Utility System Demand—kw | 1,432,000 | 1,298,800 | 1,346,700 | 1,264,200 |
| Capacity Reserve at Time of Peak (% of Instal. Gen.) | 10.8% | 18.5% | 15.5% | 17.4% |
| Energy Supply (Thousands of kwh): | | | | |
| Net Generation | 5,817,254 | 6,237,724 | 5,913,196 | 5,676,118 |
| Purchased and Interchanged—Net | 1,049,393 | 393,175 | 579,488 | 466,667 |
| Total System Load | 6,866,647 | 6,630,899 | 6,492,684 | 6,142,785 |
| **Electric Sales** (Thousands of kwh) | | | | |
| Residential | 2,638,121 | 2,646,813 | 2,545,351 | 2,415,292 |
| Commercial | 2,298,895 | 2,150,464 | 2,019,468 | 1,894,535 |
| Industrial | 1,204,971 | 1,197,392 | 1,225,637 | 1,218,520 |
| All Others | 57,685 | 59,122 | 60,978 | 63,770 |
| Total | 6,199,672 | 6,053,791 | 5,851,434 | 5,592,117 |
| **Residential Electric Service** (Average per Customer) | | | | |
| Amount of Electricity used during the year (kwh) | 7,643 | 7,866 | 7,715 | 7,444 |
| Revenue for a year's service | $ 778.77 | $ 783.47 | $ 735.66 | $ 644.77 |
| Revenue per Kilowatt-hour | 10.19¢ | 9.96¢ | 9.54¢ | 8.66¢ |
| **Customer Data** (Average) | | | | |
| Residential With Electric Heating | 68,871 | 65,261 | 62,272 | 59,319 |
| Residential Without Electric Heating | 276,305 | 271,207 | 267,642 | 265,124 |
| Total Residential | 345,176 | 336,468 | 329,914 | 324,443 |
| Commercial | 44,256 | 43,615 | 43,152 | 42,885 |
| Industrial | 1,020 | 1,015 | 1,021 | 1,018 |
| Other | 554 | 544 | 549 | 627 |
| Total Customers | 391,006 | 381,642 | 374,636 | 368,973 |
| Total Service Locations | 417,625 | 407,277 | 398,526 | 391,989 |
| Population Served | 1,142,000 | 1,112,000 | 1,092,000 | 1,069,000 |
| **Financial Data** (Thousands of Dollars) | | | | |
| Energy Revenues: | | | | |
| Residential | $ 268,814 | $ 263,612 | $ 242,705 | $ 209,191 |
| Commercial | 209,830 | 190,435 | 175,520 | 154,792 |
| Industrial | 80,392 | 79,123 | 76,109 | 71,255 |
| All Others | 10,315 | 10,405 | 10,133 | 9,255 |
| Total Energy Revenues | 569,401 | 543,575 | 504,467 | 444,493 |
| Unbilled Revenues—Net | 3,076 | (1,340) | 5,671 | (6,795) |
| Other Electric Revenue | 7,256 | 7,296 | 7,004 | 6,480 |
| Total | $ 579,733 | $ 549,531 | $ 517,142 | $ 444,178 |
| **Investor Information** | | | | |
| Earnings per Average Common Share | $ 3.00 | $ 3.20 | $ 3.48 | $ 2.76(c) |
| Average Number of Shares Outstanding (In Thousands) | 18,069 | 17,581 | 16,923 | 15,116 |
| Dividends Paid on Common Stock | $ 2.53 | $ 2.42 | $ 2.30 | $ 2.20 |
| Dividend Payout Ratio | 84% | 76% | 66% | 80% |
| Book Value Per Share (Year End) | $ 24.76 | $ 24.27 | $ 23.58 | $ 22.45 |
| Price Earnings Ratio (Year End) | 10 | 8 | 7 | 8 |
| Times Fixed Charges Earned (before income taxes) | 3.33 | 3.61 | 4.11 | 2.27(c) |
| **Shareholders and Employees** (Year End) | | | | |
| Common Shareholders | 48,635 | 47,446 | 48,299 | 48,790 |
| Employees | 2,099 | 2,012 | 1,995 | 2,022 |

(a) Excludes capacity allocated to a large industrial customer

(b) Includes unit purchase of capacity under contracts with Pennsylvania Power & Light Company (commencing in 1983) and Delmarva Power & Light Company (from 1980 through 1984).

(c) Earnings calculation includes the cumulative effect of an accounting change. Financial ratio is computed excluding the cumulative effect.

| 1981 | 1980 | 1979 | 1978 | 1977 | 1976 | 1975 |
|---|---|---|---|---|---|---|
| $1,064,928 | $ 962,052 | $ 870,075 | $ 802,473 | $ 753,269 | $ 710,343 | $ 675,617 |
| $ 123,318 | $ 97,330 | $ 72,773 | $ 58,073 | $ 48,733 | $ 41,702 | $ 46,745 |
| 6,910 | 6,879 | 6,831 | 6,786 | 6,735 | 6,696 | 6,645 |
| 1,524,600 | 1,431,600 | 1,384,700 | 1,414,700 | 1,414,700 | 1,334,700 | 1,334,700 |
| 1,263,800 | 1,261,700 | 1,192,600 | 1,177,400 | 1,176,000 | 1,030,300 | 1,069,400 |
| 17.1% | 11.9% | 13.9% | 16.7% | 16.9% | 22.8% | 19.9% |
| 5,302,023 | 5,533,178 | 5,397,338 | 5,625,988 | 5,293,019 | 4,918,906 | 4,715,357 |
| 946,241 | 643,106 | 464,143 | 130,037 | 224,169 | 324,196 | 190,852 |
| 6,248,264 | 6,176,284 | 5,861,481 | 5,756,025 | 5,517,188 | 5,243,102 | 4,906,209 |
| 2,480,225 | 2,514,738 | 2,411,732 | 2,377,202 | 2,221,250 | 2,070,766 | 1,938,724 |
| 1,849,863 | 1,769,208 | 1,580,384 | 1,586,097 | 1,478,559 | 1,392,029 | 1,346,216 |
| 1,279,724 | 1,286,205 | 1,255,304 | 1,250,636 | 1,220,260 | 1,143,170 | 1,036,755 |
| 65,555 | 63,753 | 60,799 | 60,705 | 58,866 | 57,667 | 56,465 |
| 5,675,367 | 5,633,904 | 5,308,219 | 5,274,640 | 4,978,935 | 4,663,632 | 4,378,160 |
| 7,751 | 8,003 | 7,849 | 7,951 | 7,653 | 7,320 | 7,018 |
| $ 670.66 | $ 536.99 | $ 439.92 | $ 406.18 | $ 378.36 | $ 349.64 | $ 329.25 |
| 8.65¢ | 6.71¢ | 5.61¢ | 5.11¢ | 4.94¢ | 4.78¢ | 4.69¢ |
| 56,100 | 52,225 | 48,339 | 44,387 | 40,318 | 37,581 | 35,235 |
| 263,904 | 261,988 | 258,941 | 254,592 | 249,927 | 245,296 | 241,019 |
| 320,004 | 314,213 | 307,280 | 298,979 | 290,245 | 282,877 | 276,254 |
| 43,219 | 43,267 | 43,219 | 42,672 | 42,033 | 41,170 | 40,608 |
| 1,032 | 1,041 | 1,048 | 1,034 | 1,047 | 1,071 | 1,100 |
| 634 | 654 | 667 | 673 | 676 | 681 | 684 |
| 364,889 | 359,175 | 352,214 | 343,358 | 334,001 | 325,799 | 318,646 |
| 386,046 | 379,242 | 371,362 | 362,131 | 352,205 | 343,147 | 336,105 |
| 1,056,000 | 1,037,000 | 1,015,000 | 990,000 | 961,000 | 937,000 | 915,000 |
| $ 214,614 | $ 168,733 | $ 135,178 | $ 121,440 | $ 109,818 | $ 98,904 | $ 90,956 |
| 156,624 | 115,973 | 88,819 | 80,539 | 73,354 | 66,354 | 63,544 |
| 82,908 | 60,512 | 47,590 | 42,185 | 40,885 | 36,438 | 34,974 |
| 9,700 | 7,836 | 6,624 | 5,973 | 5,630 | 5,406 | 4,881 |
| 463,846 | 353,054 | 278,211 | 250,137 | 229,687 | 207,102 | 194,355 |
| 5,837 | 5,337 | 4,895 | 4,921 | 5,308 | 4,925 | 4,724 |
| $ 469,683 | $ 358,391 | $ 283,106 | $ 255,058 | $ 234,995 | $ 212,027 | $ 199,079 |
| $ 3.03 | $ 2.62 | $ 2.36 | $ 2.21 | $ 2.06 | $ 2.60 | $ 2.41 |
| 13,034 | 12,372 | 11,980 | 10,791 | 10,630 | 9,747 | 9,490 |
| $ 2.04 | $ 1.90 | $ 1.765 | $ 1.67 | $ 1.62 | $ 1.56 | $ 1.51 |
| 67% | 73% | 75% | 76% | 79% | 60% | 63% |
| $ 22.40 | $ 22.22 | $ 21.63 | $ 21.27 | $ 20.71 | $ 20.25 | $ 19.34 |
| 6 | 6 | 7 | 8 | 11 | 9 | 7 |
| 2.84 | 3.03 | 3.62 | 3.62 | 3.17 | 3.14 | 2.88 |
| 48,424 | 47,762 | 48,194 | 44,490 | 43,826 | 42,516 | 39,232 |
| 2,035 | 1,968 | 1,903 | 1,797 | 1,739 | 1,714 | 1,741 |

# BOARD OF DIRECTORS

**ELEANOR S. DANIEL**
*Self-employed, Vice President and director of several real estate corporations*

**RICHARD M. DICKE**
*Counselor-at-law, partner of the law firm of Simpson Thacher & Bartlett*

**JOHN D. FEEHAN**
*Chairman of the Board of the Company*

**JOS. MICHAEL GALVIN, JR.**
*President and Chief Executive Officer of Salem County Memorial Hospital*

**GERALD A. HALE**
*President of HHH, Inc., an investment and management company*

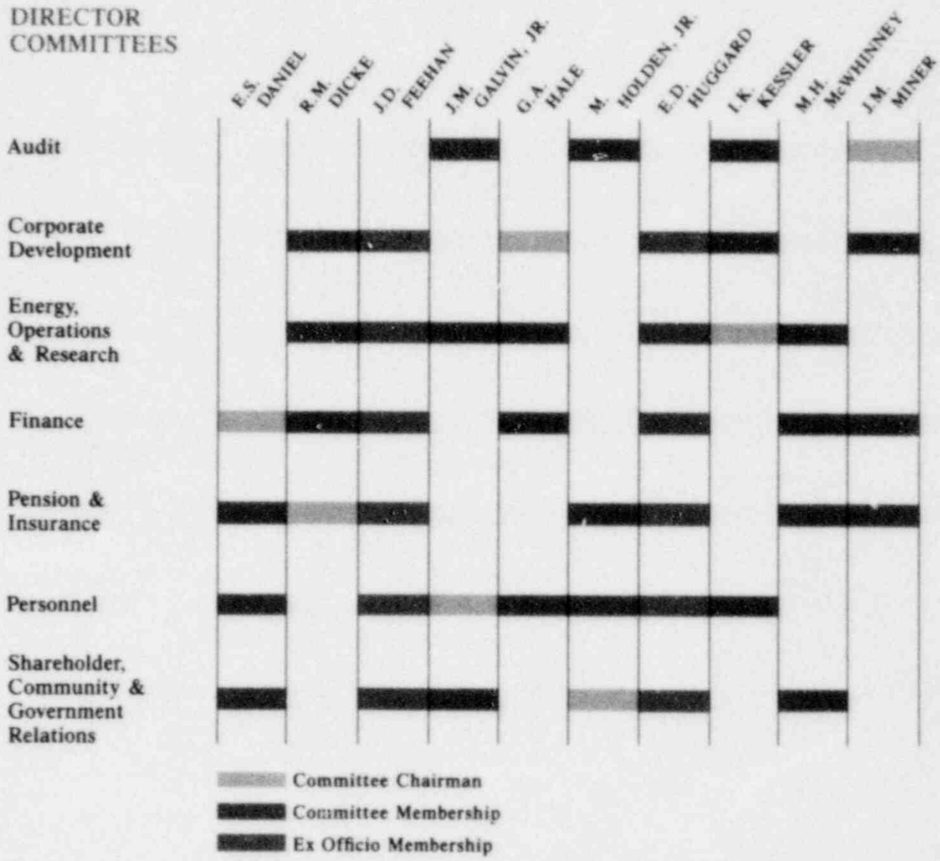
**MATTHEW HOLDEN, JR.**
*Professor of Government and Foreign Affairs, University of Virginia*

**E. DOUGLAS HUGGARD**
*President and Chief Executive Officer of the Company*

**IRVING K. KESSLER**
*Retired. Former Executive Vice President, RCA Corporation*

**MADELINE H. McWHINNEY**
*President of Dale, Elliott & Company, a management consulting firm providing services to the banking industry*

**JOHN M. MINER**
*Financial Consultant*



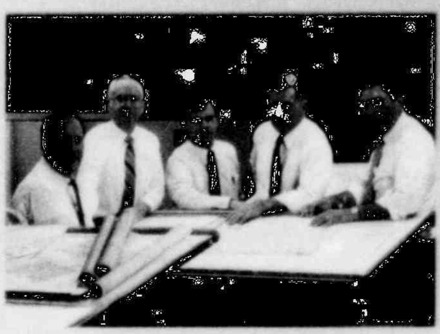

# OFFICERS

| | Years of Service | | Years of Service | | Years of Service |
|---|---|---|---|---|---|
| **E. DOUGLAS HUGGARD**<br>*President and Chief Executive Officer* | 30 | **DAVID V. BONEY**<br>*Vice President—Customer and Community Services* | 31 | **JOSEPH T. KELLY, JR.**<br>*Assistant Vice President—Operations* | 35 |
| **JERROLD L. JACOBS**<br>*Senior Vice President—Operations and Engineering* | 24 | **JOHN F. BORN**<br>*Vice President—Electric Operations* | 33 | **HENRY K. LEVARI, JR.**<br>*Vice President—Corporate Planning* | 14 |
| **MICHAEL A. JARRETT**<br>*Senior Vice President—Corporate Services* | 10 | **LANCE E. COOPER**<br>*Vice President—Control and Assistant Treasurer* | 3 | **J. DAVID McCANN**<br>*Vice President, Treasurer and Assistant Secretary* | 13 |
| **BRIAN A. PARENT**<br>*Senior Vice President—Planning and Rates* | 18 | **THOMAS E. FREEMAN**<br>*Vice President—Human Resources* | 5 | **MARTIN R. MEYER**<br>*Secretary and Assistant Treasurer* | 37 |
| **J. G. SALOMONE**<br>*Senior Vice President—Finance and Accounting* | 9 | **MEREDITH I. HARLACHER, JR.**<br>*Vice President—Engineering* | 20 | **HENRY C. SCHWEMM, JR.**<br>*Vice President—Production* | 16 |

*Front:* J. D. Feehan, M. H. McWhinney, J. M. Galvin, Jr., I. K. Kessler
*Back:* J. M. Miner, R. M. Dicke, E. S. Daniel, M. Holden, Jr., E. D. Huggard;
G. A. Hale *not shown*

*Left to right:* J. D. McCann, M. R. Meyer, L. E. Cooper, J. G. Salomone

*Left to right:* B. A. Parent, H. K. Levari, Jr.

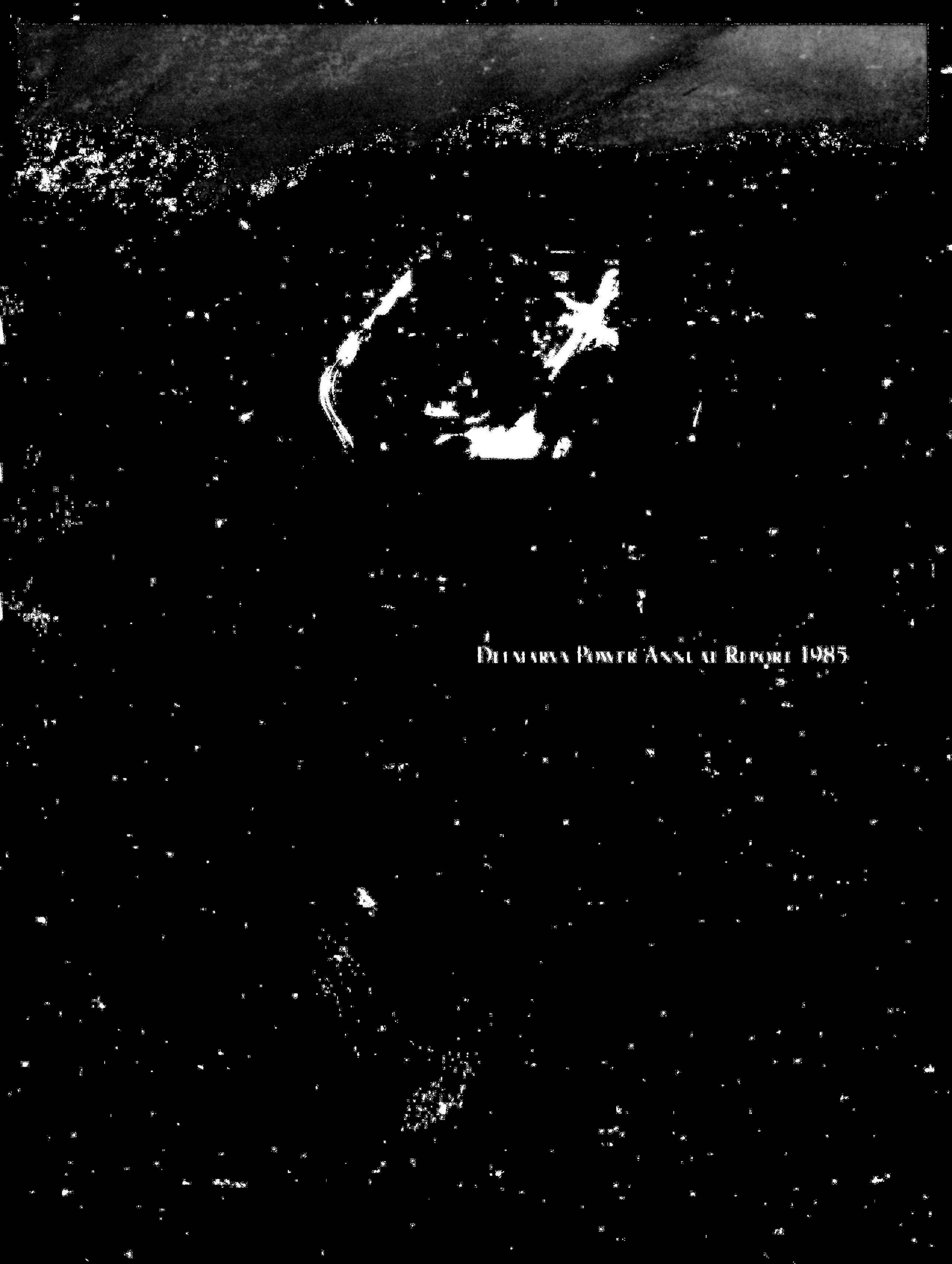


*Left to right:* H. C. Schwemm, Jr., J. F. Born, M. I. Harlacher, Jr., J. T. Kelly, Jr., J. L. Jacobs

*Left to right:* M. A. Jarrett, D. V. Boney, T. E. Freeman

*Design: Mueller & Wister*
*Photography: Kelly/Mooney*
*Cover Photo: Michael Weiss*

ATLANTIC ELECTRIC


Delmarva Power Annual Report 1985

*On the cover: Downtown Wilmington, a vibrant commercial center.*

3
To Our Stockholders

*Our report this year is designed to reflect another year's good work and confidence gained through sustained performance.*

6
The Stockholders' Perspective

*Delmarva Power is a financially healthy company with well running facilities and a balanced fuel mix.*

8
The Customers' Perspective

*Competitive and flexible pricing is the cornerstone of Delmarva Power's plan to meet an uncertain future.*

10
The Employees' Perspective

*To seek innovation, the company has developed a method for involving more employees in decisions affecting their jobs.*

12
The Community's Perspective

*Energy and employees work together to help improve the quality of life on the Delmarva Peninsula.*

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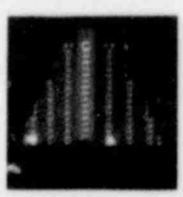
The Future

*Earnings growth will require continued sales improvement, cost control, productivity gains, and supplemental outside investments.*



| Financial Highlights | 1985 | 1984 | Percent Increase (Decrease) |
|---|---|---|---|
| Revenues | $ 722.8 million | $ 702.6 million | 2.9 |
| Net Income | $ 96.6 million | $ 92.1 million | 4.9 |
| Earnings Per Share | $ 2.76 | $ 2.63 | 4.9 |
| Dividends Declared | $ 1.945 | $ 1.83 | 6.3 |
| Common Stock Outstanding Average Shares | 30,481,925 | 30,248,482 | 0.8 |
| Common Stock Book Value | $ 18.43 | $ 17.70 | 4.1 |
| Construction Expenditures | $ 94.9 million | $ 79.5 million | 19.4 |
| Internally Generated Funds | $ 151.3 million | $ 110.5 million | 36.9 |
| Electric Sales | 8.53 billion kwh | 8.31 billion kwh | 2.6 |
| Electric Customer (average) | 314,013 | 303,965 | 3.3 |
| Average Residential Usage | 8,059 kwh | 8,283 kwh | (2.7) |
| Gas Sales | 15.71 million mcf | 17.24 million mcf | (8.9) |
| Gas Customers (average) | 75,103 | 74,319 | 1.1 |
| Average Residential Usage | 79.7 mcf | 88.8 mcf | (10.2) |

## To Our Stockholders

The record shows that 1985 was another good, solid, building block year. However, upon reflection, 1985 was more than that. It was a year where sustained performance generated increased confidence among employees.

**Highlights are:** • Earnings increased for the fifth consecutive year. • There were no electric rate increases in the service territory. • Customer approval ratings increased for the third consecutive year. • Delmarva Power generating plants performed above national averages. • Employee safety records showed continued significant improvements. • Employee participation programs continued to mature and yield innovative ideas. • New outside investments increased earnings. • Our report this year is designed to reflect another year's good work and confidence gained through sustained performance. This performance and confidence is important to you now as a shareholder or customer because in 1986, we will begin to make some decisions concerning energy supply for the mid 1990s. These decisions will be complex because of changing forces in the economy. Employees will be able to look ahead and focus on these challenges with the confidence that they can perform their current jobs well.

*Work crews in Centreville, Maryland, begin each day with "tailgate" sessions designed to promote safety, efficiency and participation.*

• However, management is concerned about committing to a new power plant now for several reasons. • The construction costs will be large. Around the country, large building programs have become financial and emotional albatrosses for utilities. A new plant in 1996 is projected to cost $3,800 per kilowatt which is more than six times the cost of the Indian River Unit 4 completed in 1980. Total costs are estimated to be three quarters of a billion dollars. • Also, for several years in this letter, concerns have been expressed about the lessons learned in the railroad industry. Large capital investments can be devalued quickly by technology breakthroughs and structural changes within an industry. • Finally, utility barometers are sending contradictory signals. Forces such as increasing summer peaks indicate building while other forces such as wheeling and cogeneration indicate delay.

• So, in 1986, we will be asking ourselves, do we need another plant in 1996 or can it be postponed through a combination of various energy management techniques? What are the benefits if our assumptions turn out to be correct? What are the consequences if they turn out to be wrong?

• While future capacity planning will be emphasized this year, the company has been preparing for the 1990s in other ways including: **Price control** • Competitive pricing is crucial for staying ahead of emerging competition. Delmarva Power has established one of the lowest average electric prices in the region through reducing dependence on oil from 53% in 1979 to 20% in 1985, reducing workforce, consolidating facilities, and developing a participative workstyle which encourages innovative ideas to contain costs without reducing quality. **Technology review** • We will invest $50 million over the next ten years, to keep old plants running longer than planned rather than replace them with e costly new units. **Investment expansion** • Earnings not now needed to finance construction are being used to upgrade facilities in advance of any major building program and to invest in related projects outside the utility business which can achieve returns greater than the principal business. • The next few years will be challenging and exciting. We must plan carefully for the long-run needs of our customers. At the same time, we must find ways to maintain earnings growth in face of modest projected growth in assets and no increase in authorized returns. The 1985 performance shows that employees have the know-how and confidence to perform their current jobs well and take on these challenges. I appreciate their efforts and look forward to working with them as Delmarva Power continues to prepare for the next decade.

***Our report this year is designed to reflect another year's good work and confidence gained through sustained performance.***

Sincerely,

Nev Curtis

NEV CURTIS February 11, 1986

# The Stockholders' Perspective

**Earnings Improve** • In 1985, earnings increased 4.9% to $2.76. Quarterly dividends increased by 5.2% to 50½ cents for an indicated annual rate of $2.02. The price of common stock increased from $22 to $27⅞.


Energy helps people enjoy the Delmarva Peninsula.

• The company paid for all of its construction expenses with its own cash. The AFUDC ratio, a key indicator for financial analysis, remained low at 3.1% of net income. The company's bond rating, in differing technical terms from the differing agencies, is a solid AA.

**Facilities Run Well** • Delmarva Power's energy system is in good shape. The generating reserves are 27%. The company sells power to the PJM interconnection and to other companies, reducing costs by more than $14 million. Transmission and distribution facilities are in excellent condition. • The company's wholly-owned coal and oil fired plants ran well again this year. The average company availability rate was 88% compared to the most recent industry average of 84%. • On August 15, a new company peak of 1,795 megawatts was set during abnormally hot weather.

When adjusted for weather, the new peak is in line with company forecasts. • The fuel mix is balanced: 65% coal; 20% oil; and 15% nuclear fuel at nuclear plants partially owned by Delmarva Power but run by other companies. • The gas system is capable of growing without major improvements. Gas supplies are plentiful and should remain competitively priced.

*Delmarva Power is a financially healthy company with well running facilities and a balanced fuel mix.*

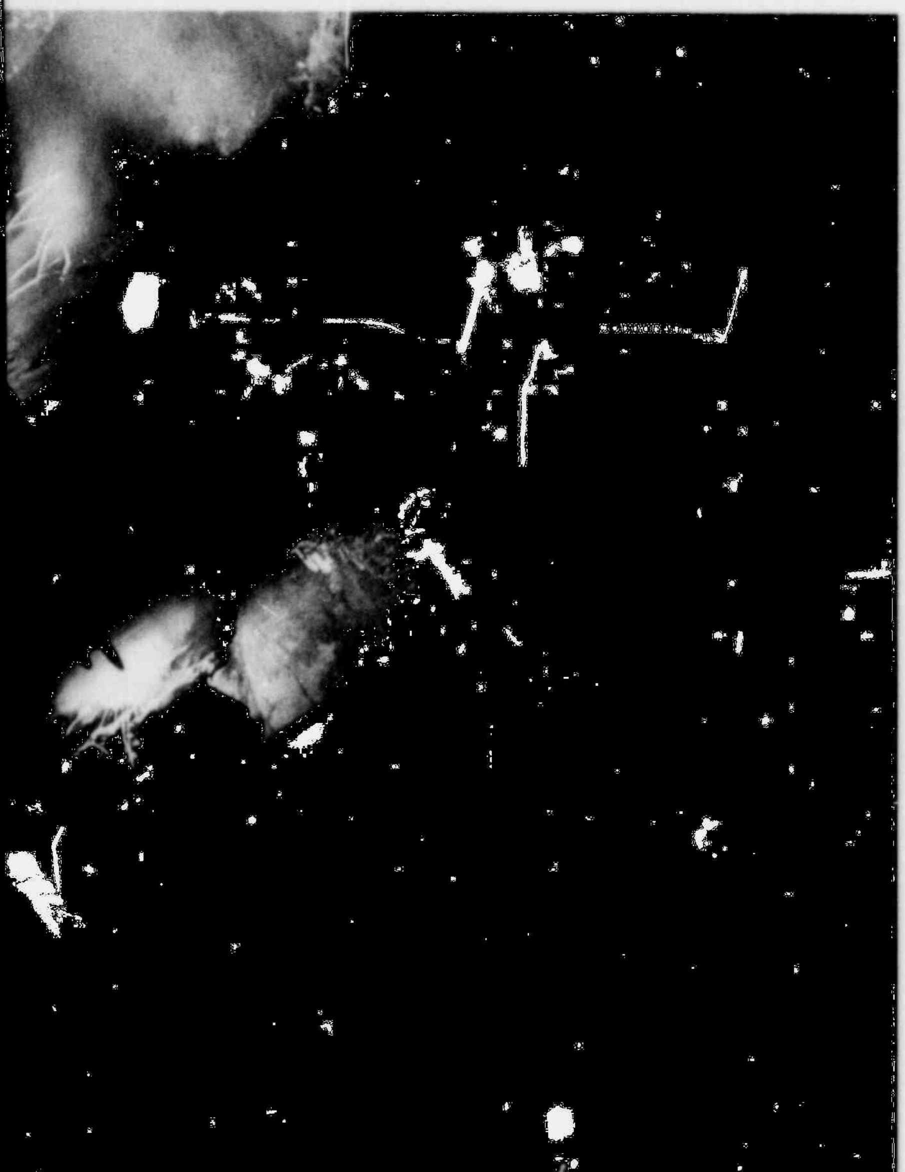
• Because of the rapid increase in data processing needs and the presently cramped quarters, the company announced plans to build by 1987 a $20 million computer center on company property at Christiana, Delaware. The computer center along with anticipated environmental control investments in the last half of the decade may mean that the company may have to seek external financing earlier than previously thought but not in 1986.

**Moderate Growth Expected** • Electric sales grew 2.6% in 1985, mainly because of the continued strong economy in the service area. • Gas sales decreased 8.9% from 1984 because of milder weather and increased competition from declining oil prices.

**Refinancings Completed** • In order to lower the cost of capital to the company and its customers, the company completed a 30-year bond sale at an attractive interest rate of 10⅛%. The money from this sale was used to replace called and tendered preferred stocks which had higher rates and to refinance maturing debt.

**Investments Grow** • In 1985, the company expanded supplemental investments to include participation in leveraged leases involving financing of three pieces of equipment, an airplane and two communication satellites. Corporate investments contributed 20 cents per share to earnings in 1985 compared to 12 cents in 1984.

*The sparks from the welding show progress toward the completion of a new coal pulverizer project at the Edge Moor Power Station. Such investment at existing facilities is a key part of the company's strategy to keep the price of electricity as low as reasonably possible.*



# The Customers' Perspective

*Special efforts were made this year to provide businesses, as those in downtown Wilmington, with useful energy information.*

Competitive Prices • Delmarva Power employees have demonstrated that they can hold the line on prices.

*Competitive and flexible pricing is the cornerstone of Delmarva Power's plan to meet an uncertain future.*

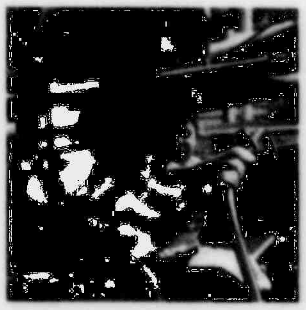
• In 1985, there were no rate increases throughout the service territory, and none are expected in 1986. • Delmarva Power's average prices for energy rank low in the region. In cents/kWh: New York, 13.03; Newark, NJ, 9.21; Boston, 8.79; Philadelphia, 8.79; Delmarva Peninsula, 6.99; and Baltimore, 6.57. Rankings of natural gas prices (in cents/ccf) are New York, 79.95; Philadelphia, 67.81; Newark, NJ, 67.33; Boston, 60.81; and Wilmington, 60.16. • These achievements are important to face developing competition such as wheeling, co-generation, and imported power.

**Bill Form Revised** • In 1985, the company completed a key project designed to improve customer understanding of its product and cost. The format of the monthly electric and gas bills was revised to include new information and highlight other information that would be of most use to the customer. Customers participated in the development of the new bill format and contributed several major suggestions which were used. In the 1985 customer survey, 81 percent of those polled considered the improvements excellent or good.

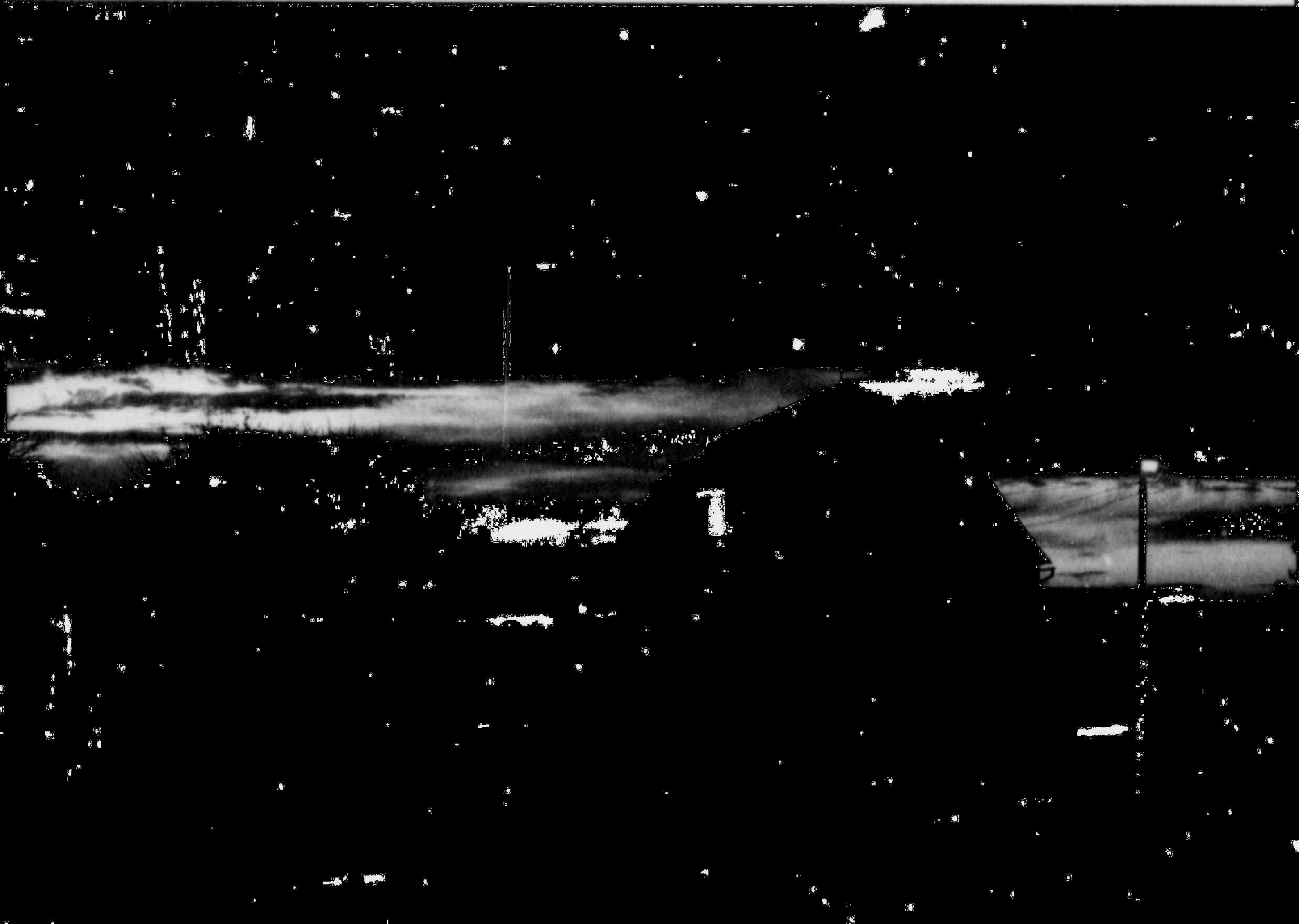
**Customer Opinion Improves** • Customer follow-up surveys completed in 1985 show that while there is always room for improvement, customer service workers at Delmarva Power generally do their job well and find ways to do better. In the gas business for example, 97% of the customers surveyed rated the overall performance of the servicemen who visited their home as excellent or good. Customers in the Wilmington area were more likely to reach a representative the first time they telephoned (90%) than in 1984 (75%). • As a result of these and other efforts in price and customer service, 71 percent of customers gave Delmarva Power a favorable rating in the 1985 customer survey compared to 66 percent in 1984 and 59 percent in 1983.

*The diverse blend of customers on the Delmarva Peninsula is a strength. The varied energy needs of farms, cities, homes, and resorts provide balance to the system and less vulnerability during extreme fluctuations in the national economy. This customer's farm is in central Delaware.*

Educational programs help future customers recognize the value of energy.



A whirling ride on a hot summer day brings fun at the shore.



## The Employees' Perspective

*The company's 2,570 employees work to provide energy at the lowest reasonable price.*

*Donald Myers continues to operate his crane at the Delaware City Power Plant. In October 1985, Texaco and the company agreed to a five-year extension of Texaco's option to purchase the Delaware City generating station. The 94-megawatt plant provides steam and electricity to Texaco's nearby refinery and electricity to other Delmarva Power customers.*

out a lost-time accident—a significant achievement in this work environment. • This is an example of the excellent 1985 safety record. Recordable injuries decreased 12% to 50, lost-time injuries decreased 64% to 5, and lost workdays decreased 83% to 71. • In 1982, the company's safety program was strengthened in an effort to reduce accidents and to spare employees and their families the accompanying pain and anxiety. Then, the company ranked near the bottom in safety performance among companies in the Southeastern Electric Exchange. In 1985, Delmarva Power ranked first in its group in the safety performance and fleet safety contests.

***To seek innovation, the company has developed a method for involving more employees in decisions affecting their jobs.***

**Participation, Involvement, Concern** • In an effort to seek innovative ideas and solutions in a changing business, the company, during the last three years, has developed and refined a method for involving more employees in the decisions affecting their jobs. • While progress can still be made in this area, by the end of 1985, 1,045 employees had received at least the first level of training and had undertaken more than 2,100 innovative projects with the techniques they had learned. • The long-term goal of this program is to encourage the ideas of the individual and to recognize the benefits of teamwork.

**Hurricane Gloria Response** • Employees deserve special commendation for their efforts to restore power and serve customers after Hurricane Gloria delivered a glancing but powerful punch to the Delmarva Peninsula. The last of 50,000 customers without electricity were restored within 51 hours after the storm. Customer letters complimented Delmarva Power employees on their high level of preparation for this storm. Customer letters from Long Island, where Delmarva Power employees also worked, were especially appreciative of the time Delmarva Power workers sacrificed from their families to help them.

**Personnel** • Senior Vice President and Director Frank A. Cook retired after 14 years of distinguished service with the company. His technical expertise and friendly support will be missed.

ENVIRONMENTAL PROTECTION • ON JULY 16, 1985, ED LARMORE, VIENNA POWER PLANT EQUIPMENT OPERATOR, RELEASED THE FIRST OF 26,000 STRIPED BASS FINGERLINGS INTO THE NANTICOKE RIVER NEAR VIENNA, MARYLAND.

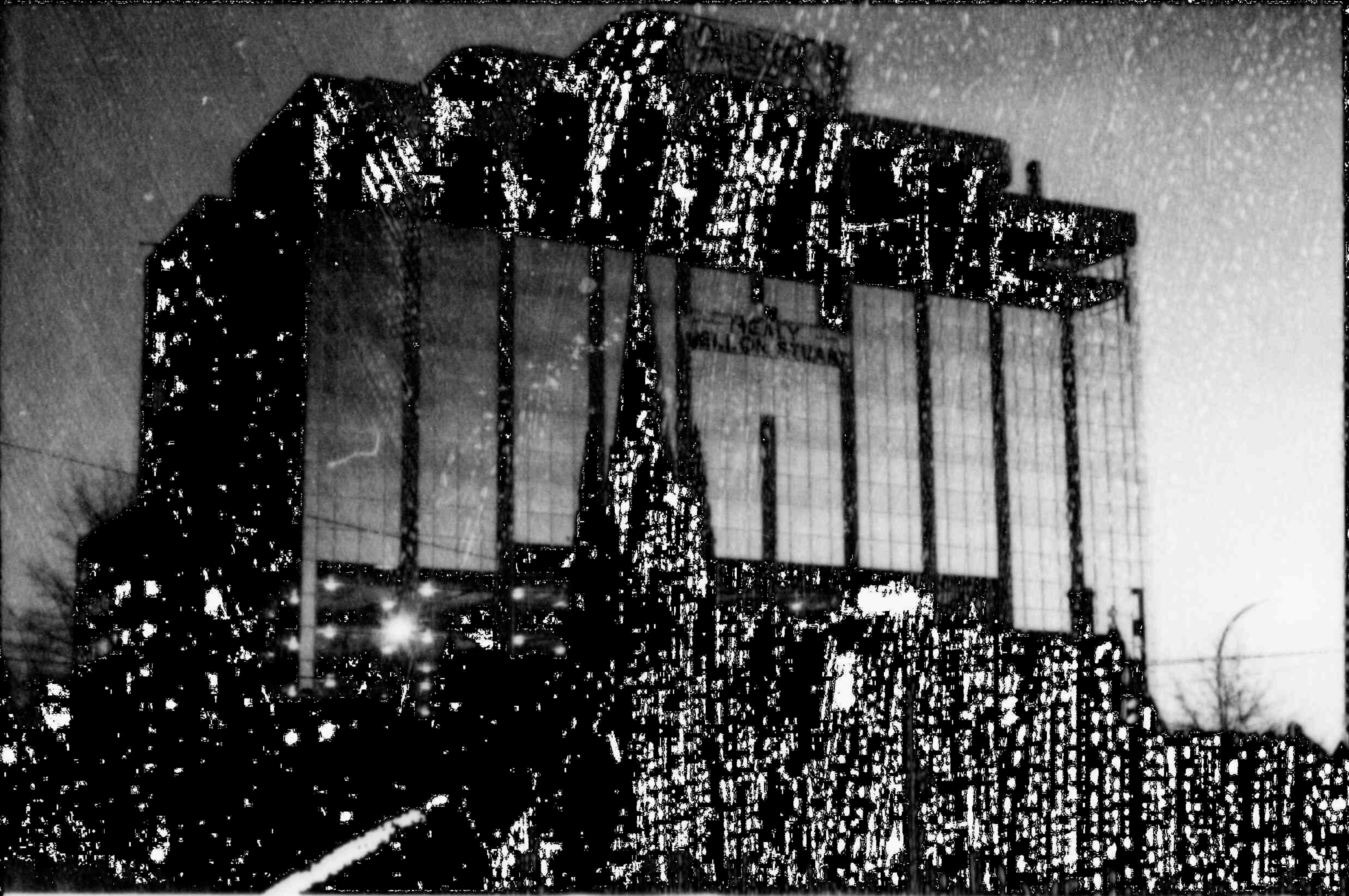
*Energy and employees work together to help improve the quality of life on the Delmarva Peninsula.*

• He participated in the first harvest from a fish brooding pond built by the company and maintained by employees on their own time. It was one of many efforts where Delmarva Power employees went beyond their jobs to help improve the quality of life on the Delmarva Peninsula. • In keeping with its commitment to provide energy with as little intrusion into the environment as possible, the company maintained its schedule well ahead of the 1988 federal deadline to remove capacitors containing PCBs from distribution lines. So far, 98% of them have been removed.

COMMUNITY ACTIVITIES • In April, 1985, Delmarva Power employees who dispatch work and who drive company vehicles were honored at a luncheon in the East Room of the White House by President Ronald Reagan for their efforts to help people in trouble through the Radio Watch program. • While Delmarva Power employees have always used their equipment to summon aid for people, in 1983 the company sought to increase awareness of this service by developing a logo and advertising it. In 1985, the company began informing children about Radio Watch through a campaign in the schools. Dispatchers also broadcast descriptions supplied by police of missing children. • People in the community use this service about twice a day to call for help in situations ranging from a flat tire to serious accidents. • In other activities, the Good Neighbor Energy Fund, raised more than $144,000 in customer and stockholder contributions to help people having trouble paying their energy bills. • Employees again exceeded their goal in contributions to the United Way and volunteered countless hours to community activities.

*The Honorable George Romney and President Ronald Reagan present Marty Duffy, manager, consumer affairs, with a medal honoring Delmarva Power employees for Radio Watch.*

*The company helps promote area economic development by participating with state and local governments throughout the peninsula in their development efforts and advocating fair rate structures which help businesses maintain a competitive edge. The commercial sector is growing as symbolized by the new building of Chase Manhattan Bank (USA) N.A. which is rising by Wilmington's Trinity Episcopal Church.*



[illegible]

INFORMATIONAL ACTIVITIES • The company helps customers understand energy and how to use it wisely through a variety of informational programs including the monthly newsletter, Energy News Journal, [illegible] the semi-[illegible] newsletter Silver Bulletin, home building information [illegible] Super [illegible] Speakers Bureau, and the face to face help from customer service and marketing representatives.

[illegible]

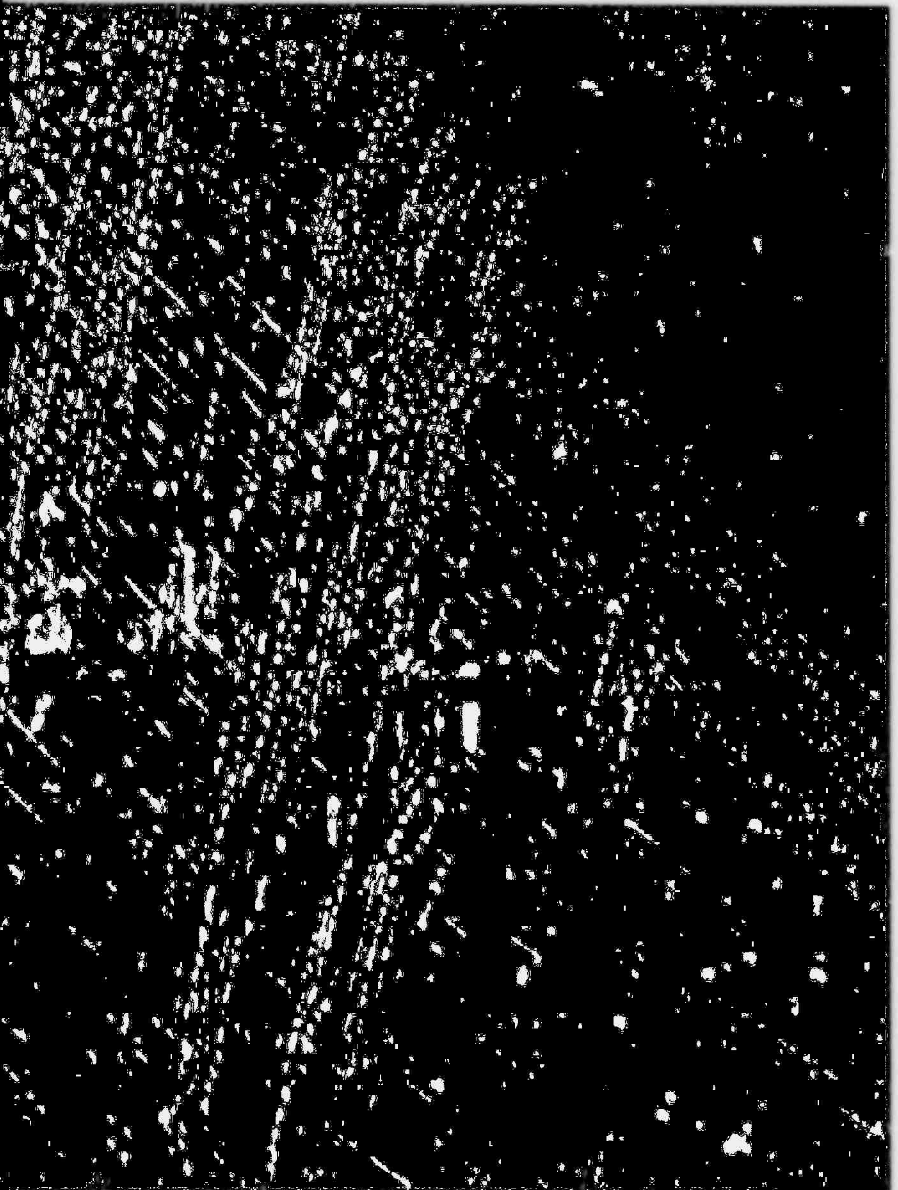
# The Future

**Facilities** • In 1986, the company will develop a plan to displace the growth of 200 megawatts of summer peak demand and 80 megawatts of winter peak demand so the next power plant can be delayed for at least five years.

• The company will examine in detail whether several strategies to control customer demands can together help achieve that goal. To provide flexibility if demand should increase at unexpected rates, the company will also evaluate the possibility of re-activating, in an environmentally acceptable manner, Edge Moor Unit 1 and Unit 2 (70 megawatts each) with either natural gas or coal as the fuel.

*Earnings growth will require continued sales improvement, cost control, productivity gains, and supplemental outside investments.*

**Earnings and Prices** • Utility earnings are not expected to increase as much as in the recent past for several reasons. The company does not plan significant new earnings-producing investments in facilities for the short term. Rates are not likely to increase because allowed returns are being achieved generally. Also, since interest rates have declined, regulators are unlikely to increase the authorized rate of return. • While competitive pricing continues to be the cornerstone of Delmarva Power's plan to meet future competition, upward pressure on prices in the late 1980s will come from increasing environmental expenses and the need to upgrade facilities. • Earnings growth and price control will require continued sales improvement, cost control, productivity gains, and supplemental outside investments.



**The Service Territory** • The Delmarva Peninsula is close enough to East Coast urban centers to benefit from their markets and financial centers yet remote enough to have its own identity and quality of life. • Delmarva Power provides electric service throughout most of the 5,700-square-mile Delmarva Peninsula which includes Delaware, portions of nine Eastern Shore counties in Maryland, and two Eastern Shore counties in Virginia. The company also distributes natural gas in a 275-square-mile area in northern Delaware. To serve this area, Delmarva Power maintains an electric system with 2,277 megawatts of generation capacity, 1,306 miles of transmission lines, and 9,051 miles of distribution lines, and a natural gas system with 1,047 miles of gas main.

*The lights shine brightly at Ocean City, Maryland. To provide such energy, Delmarva Power owns and operates four major fossil fuel power plants within the service territory and shares ownership of two coal plants and two nuclear plants outside the service territory. Division headquarters are in Christiana, Delaware, and Salisbury, Maryland, and corporate headquarters are in Wilmington, Delaware.*

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## Selected Financial Data

(Dollars in Thousands)

| | For the Years Ended December 31 | 1985 | 1984 | 1983 | 1982 | 1981 |
|---|---|---|---|---|---|---|
| **Operating** | Operating Revenues | \$ 722,834 | \$ 702,593 | \$ 649,799 | \$ 636,666 | \$ 608,504 |
| | Operating Income | 135,515 | 133,209 | 129,138 | 116,573 | 107,325 |
| | Net Income | 96,638 | 92,110 | 85,063 | 73,571 | 58,711 |
| **Earnings and Dividends** | Earnings Per Share | 2.76 | 2.63 | 2.45 | 2.13 | 1.78 |
| | Dividends Declared on Common Stock | 1.945 | 1.83 | 1.68 | 1.595 | 1.535 |
| | Average Shares Outstanding (000) | 30,482 | 30,248 | 29,541 | 28,489 | 25,747 |
| | Total Assets | 1,674,770 | 1,591,630 | 1,533,263 | 1,509,771 | 1,460,529 |
| | Construction Expenditures[1] | 94,923 | 79,488 | 76,036 | 110,646 | 84,206 |
| | Internal Generation of Funds | 151,349 | 110,485 | 117,582 | 77,061 | 72,346 |
| **Capitalization** | Long Term Debt[2] | 638,090 | 567,761 | 567,935 | 592,615 | 596,219 |
| | Preferred Stock without mandatory redemption | 105,000 | 105,000 | 105,000 | 105,000 | 105,000 |
| | Preferred Stock with mandatory redemption[3] | 5,992 | 47,836 | 49,383 | 50,000 | 50,000 |
| | Common Equity | 561,811 | 539,650 | 503,513 | 468,073 | 437,080 |
| | Total | \$1,310,893 | \$1,260,247 | \$1,225,831 | \$1,215,688 | \$1,188,299 |
| **Capitalization Ratios** | Long Term Debt | 49% | 43% | 46% | 49% | 50% |
| | Preferred Stock without mandatory redemption | 8% | 8% | 9% | 9% | 9% |
| | Preferred Stock with mandatory redemption | 0% | 4% | 4% | 4% | 4% |
| | Common Equity | 43% | 45% | 41% | 38% | 37% |
| | Total | 100% | 100% | 100% | 100% | 100% |
| **Electric/Gas Sales** | Electric Sales (Kwh 000) | 8,530,520 | 8,308,233 | 7,878,476 | 7,249,442 | 7,395,324 |
| | Gas Sales (Mcf 000) | 15,708 | 17,239 | 16,449 | 15,604 | 16,520 |

[1] Excludes Allowance for Funds Used During Construction
[2] Includes long-term debt due within one year
[3] Includes mandatory redemption due within one year

# Financial Review and Analysis

## Results of Operations

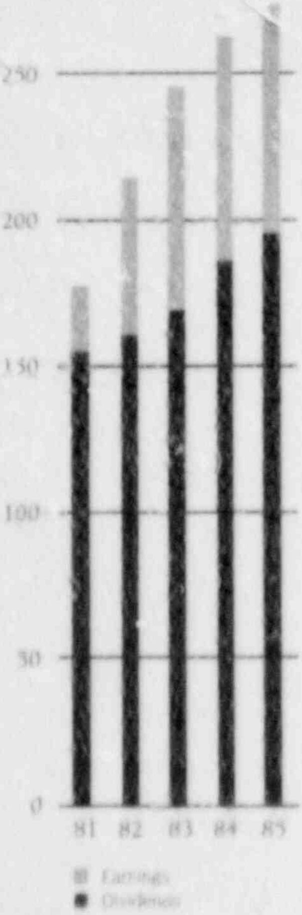
### Earnings

Delmarva Power & Light Company's financial performance and strength continued to improve in 1985. Earnings per share of common stock were $2.76 for 1985, an increase of 13¢ or 4.9% from 1984. Contributing to the higher 1985 earnings level were higher electric sales, additional amortization of the credit arising from the sale of contracts (Summit), and increased investment income. The 1984 increase of 18¢ in earnings per share to $2.63 was primarily attributable to increased sales which resulted from a strong economy in the service territory and cold-winter weather conditions.

### Dividends

In December 1985, the Board of Directors increased the quarterly dividend 5.2% to 50.5¢ per share, the ninth consecutive annual increase. The current indicated annual dividend rate has increased to $2.02 per share from $1.92 per share. This increase reflects a dividend policy which is to gradually increase dividends on an annual basis, earnings permitting, and thus provide stockholders with a fair and competitive return on their investment.

Earnings and Dividends Declared
(cents)




### Electric Revenues and Sales

Electric revenues, net of fuel, increased $12.3 million or 3.0% in 1985 and $19.4 million or 4.9% in 1984. The increases in both years are net of refunds to Delaware retail electric customers. Refunds of $14.7 million in 1985 and $5.8 million in 1984 were designed to bring earned rates of return in line with authorized rates of return, as sales of electricity were greater than projected in both years.

The increase in 1985 and 1984 net revenues was achieved primarily through increased sales, with the company reaching an all-time peak load of 1,795 megawatts in August 1985. The increase in 1985 volume was primarily attributable to higher sales in the commercial and resale classes. A 4.4% increase in commercial sales was partially due to an expansion of the banking and financial services sector in Delaware. Some additional commercial customers were also gained through the ripple effect associated with increased residential construction in the beach areas. The resale class experienced a 7.3% sales growth principally because of a growing residential market that is dominated by electrical heat in the municipalities served by the company.

The increase in 1984 volume-related electric revenues was largely due to higher sales in the residential and commercial classes, which increased mainly as a result of the improved 1984 economy and colder winter weather conditions in the first quarter of 1984.

# Financial Review and Analysis

## Gas Revenues and Sales

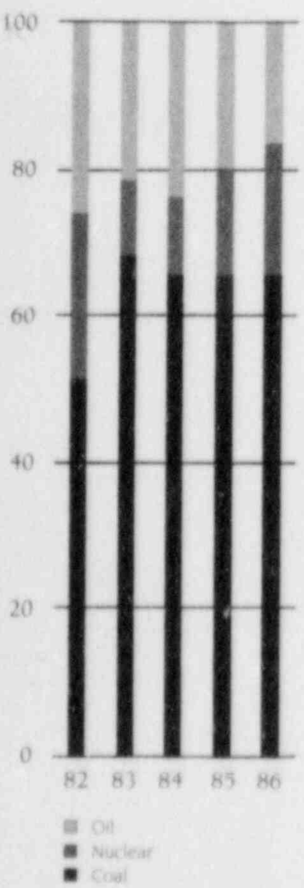
1985 gas revenues, net of fuel costs, increased 2.6% due to increased rates which were partially offset by an 8.9% decrease in sales. Industrial sales declined 8.0% due to switching to alternate fuels and decreased production levels. Residential space-heating sales decreased 9.3%, principally due to milder than normal winter weather conditions in the first quarter of 1985.

1984 net gas revenues increased 7.8% chiefly due to higher sales. Residential space-heating sales increased 11.3% in 1984, reflecting an increase in customers and the cold weather in early 1984. Commercial sales increased 11.0% reflecting an improved economy.

## Rate Regulation

The company is subject to regulation with respect to its retail sales of electricity by the Delaware and Maryland Public Service Commissions and the Virginia State Corporation Commission, which have broad powers over rate matters, accounting and terms of service. The Federal Energy Regulatory Commission (FERC) exercises jurisdiction with respect to the company's accounting systems and policies and the transmission and sale at wholesale (resale) of electric energy in interstate commerce.

Generation Fuel Mix
(percent)




On January 29, 1985 the company announced a plan to voluntarily refund a minimum of $7.5 million of 1984 revenues to Delaware electric retail customers. After reviewing the final 1984 results, the Delaware Public Service Commission (DPSC) ruled that an additional $7.2 million should be refunded. Also, the company recommended and the Commission agreed that Delaware electric retail rates should be reduced approximately 1% or $3.6 million annually, effective as of June 28, 1985.

Rate increases were filed in the company's other retail jurisdictions in 1984 and were structured to recover increases in operating costs and to improve the return on utility investment. During the fourth quarter of 1984, rate increases were granted in Virginia for $449,000 or 2.7% and in Maryland for $4.8 million or 3.9%. On March 5, 1985, the DPSC granted a $3.5 million or 3.7% rate increase in gas revenues.

In December 1985, the company reached a tentative settlement with all resale customers to refund $3.5 million. The tentative agreement would have provided for a reduction in resale rates for the period covering July 1985 through December 1986. On February 6, 1986, the company was informed by some of the resale customers that the tentative settlement was not acceptable. The company is currently awaiting further action on the part of the resale customers.

## Fuel Mix

In 1985 generation from coal, nuclear and oil sources was 65%, 15% and 20% respectively. Nuclear generation increased 29% due to higher availability of nuclear units. The effective customer fuel cost, which includes fuel, interchange and purchased power costs, remained low at 1.94¢/kWh in 1985 and was 1.96¢/kWh in 1984 and 1983.

# Financial Review and Analysis

### Operating Expenses

Other operation and maintenance expenses have increased since 1983 primarily as a result of higher payroll and associated benefits, the higher cost of jointly-owned nuclear generating units, and increased steam service expenses, which are billed and reflected in steam revenues. The 1985 increases were partially offset by an additional $2.5 million amortization of the credit arising from the sale of contracts (Summit), which resulted from an out-of-court tax settlement.

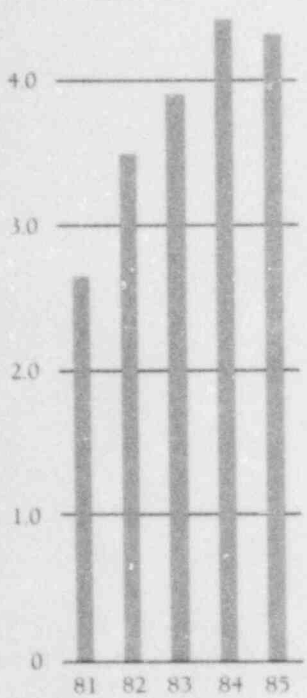
During 1984, both Salem Units #1 and #2 were removed from service due to electric generator failures. Salem Unit #1 was returned to service in October 1984 and Unit #2 was returned to service in April 1985. There was an extended outage at Peach Bottom #2 from April 1984 to July 1985 due to piping replacement. Peach Bottom #3 was removed from service in July 1985 for refueling and a piping inspection and is anticipated to begin operating again by the end of the first quarter of 1986.

## Impact of Inflation

Supplementary unaudited financial information showing the estimated effects of inflation on the company's operations is shown in Note 12 of the Financial Statements. This data should be viewed as estimates of the approximate effects of inflation, rather than as precise measures.

## Liquidity and Capital Resources

Ratio of Earnings to Fixed Interest Charges
(SEC method)




### Financing and Capitalization

The company is committed to maintaining its financial strength and flexibility and believes that it is important to have a strong capital structure. The company's financial strength is evidenced by its continuing high ratio of earnings to fixed charges, which was 4.3 in 1985. The company's financial flexibility was demonstrated through the refinancing of $41.9 million of preferred stock with long-term debt. This refinancing will reduce the company's cost of capital and will enhance the company's ability to issue additional preferred stock in subsequent years, if necessary.

In December 1985, the company temporarily borrowed $55 million to redeem 100% of the company's 12.56% preferred stock series and approximately 68% of its 9% preferred stock series; the remaining funds were used to retire $10 million of $3\frac{1}{2}$% Series First Mortgage and Collateral Trust Bonds. In January 1986 the company issued $60 million of $10\frac{1}{2}$% Series First Mortgage and Collateral Trust Bonds, which mature in January 2016. The proceeds from the bond issuance were used to repay the $55 million bank loan, with the balance being applied to general corporate cash requirements.

Due to continued improvements in cash flow, and to control the increasing equity position, the company further modified its Dividend Reinvestment and Common Share Purchase Plan (DRIP). Effective January 1985, all reinvested dividends are being used to purchase shares on the open market.

During 1985 Standard & Poor's increased the company's preferred stock credit rating from A+ to AA−. Credit ratings on the company's first mortgage bonds remained at a high level in 1985, due to the company's continued strong financial performance. The company's bond rating is the equivalent of a strong AA in the language of the different raters.

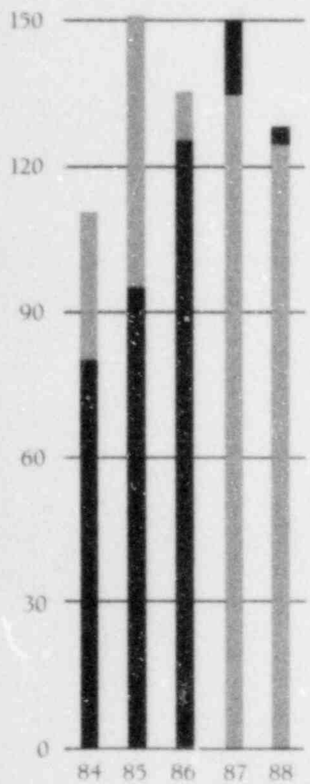
## FINANCING AND CAPITALIZATION (CONTINUED)

In September 1985, the company issued, through the Delaware Economic Development Authority, $33.5 million of Variable Rate Demand Exempt Facilities Revenue Bonds—Series 1985. The proceeds were primarily used to refinance $33 million of tax-exempt revenue notes, classified as a term loan agreement as of December 31, 1984.

During 1985, Delmarva Capital Investments, Inc., a subsidiary, borrowed $25 million and invested the proceeds in satellite and aircraft leveraged leases. See the related discussion under "Liquidity."

## CAPITAL AND CONSTRUCTION REQUIREMENTS

Construction Expenditures and Internally Generated Funds
(millions of dollars)




For the period 1983-1985, the company had total capital requirements of $493 million, including $250 million for construction (excluding AFUDC). During the same period, $379 million was generated internally which represents 77% of the capital requirements and 151% of the construction requirements. Capital requirements for the period 1986-1988 are estimated to be $474 million, including $404 million for construction (excluding AFUDC). The company presently anticipates that, for the period 1986-1988, internally generated funds will be $396 million which equals 84% of the total capital requirements and 98% of its construction requirements. The higher level of estimated construction expenditures during 1986-1988 in comparison to 1983-1985 results from the company's plans to build a computer center, increased investment in environmental protection facilities and upgrading of various facilities. Actual construction expenditures may vary from the above estimates due to, among other factors, the rate of inflation, regulation and legislation, rates of load growth, licensing and construction delays, results of rate proceedings, and the cost and availability of capital.

The company estimates that its annual energy and peak load growth for the next 10 years will be at a rate of 1.84% and 0.6%, respectively. The company's present generating capacity of 2,277 megawatts provides a reserve of 27% against its company peak of 1,795 megawatts experienced in the summer of 1985. In 1984 the company peak was 1,624 megawatts. Although the company continues to plan for new generation, it is actively considering alternatives to a central power station due to the high cost of building a new power plant. The company has a goal to develop a plan to delay, by at least five years, the in-service date of its next generation unit which is currently scheduled for the mid 1990's. The company continues to be committed to maintaining a high degree of flexibility as long as possible in its planning to meet future capacity requirements.

The company has the ability to issue commercial paper supported by adequate lines of credit to meet fluctuations in working capital requirements as well as the interim financing necessary for construction projects. The company has lines of credit with banks in the amount of $44.5 million. These lines are available for bank loans and to secure commercial paper borrowings as the need arises. At December 31, 1985, the company had no commercial paper outstanding.

## Report of Management on the Financial Statements

### Liquidity

The company's liquidity is affected principally by the construction program and, to a lesser degree, by other capital requirements such as maturing debt and sinking fund requirements. As a result of lower construction expenditures and improved financial condition, financial investments increased from $27.6 million in 1984 to $72 million in 1985 with no short term debt outstanding at the end of either year.

In order to utilize cash generated from ongoing operations beyond construction requirements, the company has invested in both energy related and financial opportunities. During 1985, the company invested $32.1 million of equity capital in a wholly-owned subsidiary, Delmarva Capital Investments, Inc., which has arranged borrowings and generated cash internally to provide an investment portfolio of $71.6 million. On December 31, 1985, these investments included $34.6 million in marketable securities, $9.8 million in a Boeing 747 aircraft lease and $27.2 million in satellite leases with GTE Corporation and RCA Corporation, both of which are currently in operation. These investments are designed to provide yields higher than those earned on the company's utility business.

### Report of Management

The consolidated financial statements of Delmarva Power & Light Company have been prepared by company personnel in conformity with generally accepted accounting principles, based upon currently available facts and circumstances and management's best estimates and judgements of the expected effects of events and transactions. It is the responsibility of management to assure the integrity and objectivity of such financial statements and to assure that these statements fairly report the financial position of the company and the results of its operations.

Delmarva Power & Light Company maintains a system of internal controls designed to provide reasonable, but not absolute, assurance of the reliability of the financial records and the protection of assets. The internal control system is supported by written administrative policies, a program of internal audits, and procedures to assure the selection and training of qualified personnel.

These financial statements have been examined by Coopers & Lybrand, independent certified public accountants. Their examination was conducted in accordance with generally accepted auditing standards which include a review of internal accounting controls to determine the nature, timing and extent of auditing procedures, as well as such other procedures they deem necessary to produce reasonable assurance as to the fairness of the company's financial statements and to enable them to express an opinion thereon.

The audit committee of the Board of Directors, composed of outside Directors only, meets with management, internal auditors and the independent accountants to review accounting, auditing and financial reporting matters. The independent accountants are appointed by the Board on recommendation of the audit committee, subject to shareholder approval.

Nevius M. Curtis
Chairman of the Board and
Chief Executive Officer

Roger D. Campbell
Vice President, Treasurer and
Chief Financial Officer

## Quarterly Common Stock Dividends and Price Ranges

### Common Stock

The company's common stock is listed on the New York and Philadelphia Stock Exchanges and has unlisted trading privileges on the Cincinnati, Midwest and Pacific Stock Exchanges.

The company had 58,824 holders of common stock as of December 31, 1985.

The company's Certificate of Incorporation and the Mortgage and Deed of Trust securing the company's outstanding bonds contain restrictions on the payment of dividends on common stock which would become applicable if its capital and retained earnings fall below certain specified levels or if preferred stock dividends become in arrears.

The retained earnings available for dividends on common stock as of December 31, 1985 were approximately $143,810,000 under the most restrictive of these provisions.

| | 1985 | | | 1984 | | |
|---|---|---|---|---|---|---|
| | Dividend Declared | Price High | Price Low | Dividend Declared | Price High | Price Low |
| First Quarter | $.48 | 23 7/8 | 21 | $.45 | 19 5/8 | 17 5/8 |
| Second Quarter | .48 | 26 1/2 | 22 7/8 | .45 | 18 3/8 | 17 1/4 |
| Third Quarter | .48 | 26 5/8 | 22 3/4 | .45 | 20 7/8 | 17 3/4 |
| Fourth Quarter | .505 | 28 1/4 | 22 5/8 | .48 | 22 3/8 | 20 1/8 |

## Report of Independent Certified Public Accountants

To the Board of Directors and Stockholders
Delmarva Power & Light Company
Wilmington, Delaware

We have examined the consolidated balance sheets and statements of capitalization of Delmarva Power & Light Company as of December 31, 1985 and 1984, and the related consolidated statements of income, changes in common stockholders' equity and sources of funds for construction expenditures for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Delmarva Power & Light Company at December 31, 1985 and 1984 and the consolidated results of their operations and sources of funds for construction expenditures for each of the three years in the period ended December 31, 1985 in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

1900 Three Mellon Bank Center
Philadelphia, Pennsylvania
February 7, 1986

# Consolidated Statements of Income

(Dollars in Thousands)

| | For the Years Ended December 31 | 1985 | 1984 | 1983 |
|---|---|---|---|---|
| Operating Revenues | Electric | $ 605,581 | $ 584,163 | $ 542,252 |
| | Gas | 95,256 | 101,578 | 94,358 |
| | Steam | 21,997 | 16,852 | 13,189 |
| | | 722,834 | 702,593 | 649,799 |
| Operating Expenses | Operation: | | | |
| | Fuel for electric generation | 240,901 | 278,474 | 275,117 |
| | Net interchange and purchased power | ( 63,962) | (108,011) | (108,654) |
| | Purchased gas | 69,847 | 74,082 | 72,475 |
| | Deferred energy costs | ( 2,549) | ( 2,345) | ( 24,507) |
| | Other operation | 121,105 | 108,001 | 107,496 |
| | Maintenance | 59,406 | 56,752 | 53,781 |
| | Depreciation | 53,981 | 53,702 | 49,596 |
| | Taxes on income | 77,836 | 77,577 | 67,584 |
| | Taxes other than income | 30,754 | 31,152 | 27,773 |
| | | 587,319 | 569,384 | 520,661 |
| Operating Income | | 135,515 | 133,209 | 129,138 |
| Other Income | Allowance for other funds used during construction | 2,428 | 2,780 | 2,447 |
| | Other, net | 6,382 | 3,243 | 2,440 |
| | | 8,810 | 6,023 | 4,887 |
| Income Before Interest Charges | | 144,325 | 139,232 | 134,025 |
| Interest Charges | Long-term debt | 47,236 | 45,815 | 45,697 |
| | Short-term debt and other | 1,059 | 2,090 | 3,999 |
| | Allowance for borrowed funds used during construction | ( 608) | ( 783) | ( 734) |
| | | 47,687 | 47,122 | 48,962 |
| Earnings | Net Income | 96,638 | 92,110 | 85,063 |
| | Dividends on preferred stock | 12,599 | 12,662 | 12,818 |
| | Earnings applicable to common stock | $ 84,039 | $ 79,448 | $ 72,245 |
| Common Stock | Average shares outstanding (thousands) | 30,482 | 30,248 | 29,341 |
| | Earnings per average share | $ 2.76 | $ 2.63 | $ 2.45 |
| | Dividends declared per share | $ 1.945 | $ 1.83 | $ 1.68 |

See accompanying Notes to Consolidated Financial Statements.

# Consolidated Statements of Sources of Funds for Construction Expenditures

(Dollars in Thousands)

| | For the Years Ended December 31 | 1985 | 1984 | 1983 |
|---|---|---|---|---|
| Sources of Funds | Provided from operations: | | | |
| | Net Income | $ 96,638 | $ 92,110 | $ 85,063 |
| | Less—Preferred dividends declared | 12,599 | 12,662 | 12,818 |
| | —Common dividends declared | 59,287 | 55,361 | 49,668 |
| | Earnings reinvested during the year | 24,752 | 24,087 | 22,577 |
| | Items not requiring (providing) funds: | | | |
| | Depreciation | 61,183 | 58,464 | 56,599 |
| | Amortization of credit arising from sale of contracts | (7,202) | ( 4,762) | ( 7,003) |
| | Amortization of nuclear fuel | 6,594 | 2,071 | 2,394 |
| | Allowance for funds used during construction | (3,036) | ( 3,563) | ( 3,181) |
| | Investment tax credit adjustments, net | 21,878 | 2,253 | 3,495 |
| | Deferred income taxes, net | 47,462 | 31,935 | 42,701 |
| | Income from leveraged leases | (2,307) | — | — |
| | Loss on uranium mine advances | 2,025 | — | — |
| | Funds provided from operations | 151,349 | 110,485 | 117,582 |
| | External financing: | | | |
| | Long-term debt: | | | |
| | Variable rate demand series | 33,500 | 15,500 | — |
| | Term loan | (33,000) | ( 5,500) | 15,500 |
| | Other long-term debt | 80,000 | — | — |
| | Common stock | — | 11,921 | 12,863 |
| | Redemption of long-term debt | (10,100) | (10,100) | (40,100) |
| | Redemption of preferred stock | (44,387) | ( 1,418) | ( 617) |
| | Externally financed funds | 26,013 | 10,403 | (12,354) |
| | Other sources (uses): | | | |
| | Decrease (increase) in working capital* | (65,809) | (29,557) | (17,709) |
| | Construction funds held by trustee | 6,392 | ( 4,933) | ( 1,041) |
| | Investment in leveraged leases | (36,959) | — | — |
| | Refundable taxes and interest | 32,322 | ( 2,188) | ( 2,603) |
| | Credit arising from sale of contracts | ( 4,690) | ( 926) | 850 |
| | Other, net | (13,695) | ( 3,796) | ( 8,669) |
| | Other sources (uses) | (82,439) | (41,400) | (29,172) |
| Construction Expenditures | (excluding allowance for funds used during construction) | $ 94,923 | $ 79,488 | $ 76,056 |
| Decrease (increase) in working capital* | Marketable securities | $(32,308) | $(19,754) | $( 4,314) |
| | Accounts receivable | 33 | ( 3,050) | ( 7,586) |
| | Deferred fuel costs, net | ( 2,537) | ( 1,831) | (23,126) |
| | Inventories | 13,997 | (15,114) | 5,428 |
| | Refundable taxes and interest | (35,303) | — | — |
| | Accounts payable | 6,885 | ( 5,865) | 7,993 |
| | Taxes accrued | ( 4,455) | 6,842 | ( 4,488) |
| | Interest accrued | 2,532 | 908 | ( 1,016) |
| | Other, net | (14,653) | 8,307 | 9,400 |
| | Total | $(65,809) | $(29,557) | $(17,709) |

*Other than long-term debt due and preferred stock redeemable within one year and current deferred income taxes.
See accompanying Notes to Consolidated Financial Statements.

## Consolidated Balance Sheets

| Assets | (Dollars in Thousands) As of December 31 | 1985 | 1984 |
|---|---|---|---|
| Utility Plant— at original cost | Electric | $1,624,881 | $ 1,555,174 |
| | Gas | 90,956 | 83,104 |
| | Steam | 24,389 | 24,143 |
| | Common | 80,541 | 71,391 |
| | | 1,820,767 | 1,733,812 |
| | Less: Accumulated depreciation | 535,873 | 488,987 |
| | Net utility plant in service | 1,284,894 | 1,244,825 |
| | Plant held for future use | 15,297 | 15,022 |
| | Construction work in progress | 33,184 | 36,372 |
| | Nuclear fuel, at amortized cost | 19,796 | 24,955 |
| | | 1,353,171 | 1,321,174 |
| Nonutility Property and Other Investments | Net nonutility property, at cost | 34,805 | 5,385 |
| | Construction funds held by trustee | 9,186 | 15,578 |
| | | 43,991 | 20,963 |
| Current Assets | Cash | 17,408 | 16,673 |
| | Marketable securities, at cost | 59,956 | 27,648 |
| | Accounts receivable: | | |
| | Customers | 49,037 | 48,839 |
| | Other | 24,337 | 24,568 |
| | Inventories, at average cost: | | |
| | Fuel (coal, oil and gas) | 55,694 | 68,364 |
| | Materials and supplies | 20,648 | 21,975 |
| | Prepayments | 4,236 | 3,776 |
| | Deferred fuel costs, net | 1,488 | (1,049) |
| | Refundable taxes and interest | 35,303 | — |
| | | 268,107 | 210,794 |
| Deferred Charges and Other Assets | Refundable taxes and interest | — | 32,322 |
| | Unamortized debt expense | 5,368 | 4,827 |
| | Other | 4,133 | 1,550 |
| | | 9,501 | 38,699 |
| | Total | $ 1,674,770 | $1,591,630 |

See accompanying Notes to Consolidated Financial Statements.

## Consolidated Balance Sheets

(Dollars in Thousands)

| Capitalization And Liabilities | As of December 31 | 1985 | 1984 |
|---|---|---|---|
| **Capitalization** (see Statements of Capitalization) | Common stock | $ 102,876 | $ 102,876 |
| | Additional paid-in capital | 235,798 | 235,473 |
| | Retained earnings | 223,137 | 201,301 |
| | Total common stockholders' equity | 561,811 | 539,650 |
| | Preferred stock: | | |
| | Without mandatory redemption | 105,000 | 105,000 |
| | With mandatory redemption | 5,192 | 47,036 |
| | Long-term debt | 637,940 | 557,661 |
| | | 1,309,943 | 1,249,347 |
| **Current Liabilities** | Long-term debt due and preferred stock redeemable within one year | 950 | 10,900 |
| | Accounts payable | 33,129 | 26,244 |
| | Taxes accrued | 16,181 | 20,636 |
| | Interest accrued | 22,729 | 20,197 |
| | Dividends declared | 15,393 | 14,631 |
| | Nuclear fuel disposal costs | — | 10,888 |
| | Deferred income taxes, net | 755 | (1,661) |
| | Other | 10,440 | 15,026 |
| | | 99,577 | 116,861 |
| **Deferred Credits And Other Liabilities** | Credit arising from sale of contracts | 16,057 | 27,949 |
| | Deferred income taxes, net | 174,746 | 128,444 |
| | Deferred investment tax credits | 70,416 | 65,386 |
| | Other | 4,031 | 3,643 |
| | | 265,250 | 225,422 |
| **Other** | Commitments and Contingencies (Notes 6 and 10) | | |
| | Total | $1,674,770 | $1,591,630 |

See accompanying Notes to Consolidated Financial Statements

## Consolidated Statements of Capitalization

(Dollars in Thousands)

| | As of December 31 | 1985 | | 1984 | |
|---|---|---|---|---|---|
| Common Stockholders' Equity | Common stock, par value $3.375 per share authorized 35,000,000 shares, outstanding 30,481,925 shares | $ 102,876 | | $ 102,876 | |
| | Additional paid-in capital | 235,798 | | 235,473 | |
| | Retained earnings | 223,137 | | 201,301 | |
| | Total Common Stockholders' Equity | 561,811 | 43% | 539,650 | 43% |
| Cumulative Preferred Stock | Par value $25 per share, 3,000,000 shares authorized, none outstanding | | | | |
| | Par value $100 per share, 1,800,000 shares authorized | | | | |
| | Without Mandatory Redemption: | | | | |
| | Series — Shares Issued | | | | |
| | 3.70%-4.56% — 240,000 | 24,000 | | 24,000 | |
| | 5.00%-7.84% — 330,000 | 33,000 | | 33,000 | |
| | 7.88%-8.96% — 480,000 | 48,000 | | 48,000 | |
| | Preferred Stock without Mandatory Redemption | 105,000 | 8% | 105,000 | 8% |
| | With Mandatory Redemption: | | | | |
| | 9.00% Series* — 59,916 and 192,000 shares | 5,992 | | 19,200 | |
| | 12.56% Series — 0 and 300,000 shares | — | | 30,000 | |
| | | 5,992 | | 49,200 | |
| | Less: Reacquired preferred shares held in treasury (at cost) | — | | 1,364 | |
| | | 5,992 | 0% | 47,836 | 4% |
| | Less: Amount to be redeemed within one year | 800 | | 800 | |
| | Preferred Stock with Mandatory Redemption | 5,192 | | 47,036 | |
| Long-Term Debt | First Mortgage and Collateral Trust Bonds: | | | | |
| | Maturity — Interest Rates | | | | |
| | Dec. 1, 1985 — 3½% | — | | 10,000 | |
| | Jun. 1, 1988 — 3⅞% | 25,000 | | 25,000 | |
| | 1994-1997 — 4⅝%-6⅜% | 50,000 | | 50,000 | |
| | 1998-2002 — 7%-11¼% | 158,100 | | 158,100 | |
| | 2003-2007 — 6.6%-11% | 121,250 | | 121,250 | |
| | 2008-2011 — 9⅜%-12% | 111,900 | | 111,900 | |
| | | 466,250 | | 476,250 | |
| | Pollution Control Notes: | | | | |
| | Series, 1973 5.7% effective rate, due 1986-1993 | 7,700 | | 7,800 | |
| | Series, 1976 7.3% effective rate, due 1992-2006 | 34,500 | | 34,500 | |
| | | 42,200 | | 42,300 | |
| | Variable Rate Demand Series, due 2014-2015 | 49,000 | | 15,500 | |
| | Other Long-Term Debt | 80,000 | | — | |
| | Term Loan | — | | 33,000 | |
| | Unamortized premium and discount, net | 640 | | 711 | |
| | | 638,090 | 49% | 567,761 | 45% |
| | Long-term debt due within one year | ( 150) | | (10,100) | |
| | Total Long-Term Debt | 637,940 | | 557,661 | |
| | Total Capitalization | $1,309,943 | 100% | $1,249,347 | 100% |

*Redemption price at December 31, 1985 is $107. See accompanying Notes to Consolidated Financial Statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN COMMON STOCKHOLDERS' EQUITY

(Dollars in Thousands)

| | For the Three Years Ended December 31, 1985 | Common Shares | Par Value | Additional Paid-in Capital | Retained Earnings | Total |
|---|---|---|---|---|---|---|
| BALANCE AS OF JANUARY 1, 1983 | | 29,048,445 | $ 98,039 | $215,397 | $154,637 | $468,073 |
| | Net income | | | | 85,063 | 85,063 |
| | Cash dividends declared | | | | | |
| | Common stock ($1.68) | | | | (49,668) | (49,668) |
| | Preferred stock | | | | (12,818) | (12,818) |
| | Issuance of common stock: | | | | | |
| | Dividend Reinvestment and Common Share Purchase Plan | 792,737 | 2,675 | 10,526 | | 13,201 |
| | Common stock expense | | | ( 338) | | ( 338) |
| BALANCE AS OF DECEMBER 31, 1983 | | 29,841,182 | 100,714 | 225,585 | 177,214 | 503,513 |
| | Net income | | | | 92,110 | 92,110 |
| | Cash dividends declared | | | | | |
| | Common stock ($1.83) | | | | (55,361) | (55,361) |
| | Preferred stock | | | | (12,662) | (12,662) |
| | Issuance of common stock: | | | | | |
| | Dividend Reinvestment and Common Share Purchase Plan | 640,743 | 2,162 | 9,838 | | 12,050 |
| | Gain on retirement of preferred stock | | | 125 | | 125 |
| | Common stock expense | | | ( 125) | | ( 125) |
| BALANCE AS OF DECEMBER 31, 1984 | | 30,481,925 | 102,876 | 235,473 | 201,301 | 539,650 |
| | Net income | | | | 96,638 | 96,638 |
| | Cash dividends declared | | | | | |
| | Common stock ($1.945) | | | | (59,287) | (59,287) |
| | Preferred stock | | | | (12,599) | (12,599) |
| | Net loss on retirement of preferred stock | | | 325 | ( 2,916) | ( 2,591) |
| BALANCE AS OF DECEMBER 31, 1985 | | 30,481,925 | $102,876 | $235,798 | $223,137 | $561,811 |

See accompanying Notes to Consolidated Financial Statements.

# Notes to Consolidated Financial Statements

## 1. Significant Accounting Policies

### Financial Statements

The consolidated financial statements include the accounts of the company and its totally-held subsidiaries, Delmarva Energy Company, Delmarva Industries Inc., and Delmarva Capital Investments, Inc. and its subsidiaries. In conformity with generally accepted accounting principles, the accounting policies reflect the economic effects of rate decisions issued by regulatory commissions having jurisdiction over the company.

Certain reclassifications, not affecting income, have been made to amounts reported in prior years to conform to the presentations used in 1985.

### Revenues

Revenues are recorded at the time billings are rendered to customers on a monthly cycle basis and include rate increases permitted to be billed subject to refund pending final approval. At the end of each month, there is an amount of unbilled electric and gas service which has been rendered from the last meter reading to the month-end.

### Fuel Costs

Fuel costs (electric and gas) are deferred and charged to operations on the basis of fuel costs included in customer billings under the company's tariffs, which are subject to periodic regulatory review and approval.

### Depreciation and Maintenance

The annual provision for depreciation is computed on the straight-line basis using composite rates by classes of depreciable property. Provision for the costs of decommissioning of nuclear plant is made to the extent of the net cost of removal allowed for rate purposes (approximately 20% of plant cost). The relationship of the annual provision for depreciation for financial accounting purposes to average depreciable property was 3.6% for 1985 and 3.4% for 1984 and 1983.

The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expenses. A replacement of a unit of property is accounted for as an addition to and a retirement from utility plant. The original cost of the property retired is charged to accumulated depreciation together with the net cost of removal. For income tax purposes, the cost of removing retired property is deducted as an expense.

### Nuclear Fuel

The company's share of nuclear fuel costs relating to jointly-owned nuclear generating stations is charged to fuel expense on a unit of production basis, which includes a factor for spent nuclear fuel disposal costs pursuant to the Nuclear Waste Policy Act of 1982. The company is collecting future storage and disposal costs for spent fuel as authorized by the regulatory commissions in each jurisdiction and is paying such amounts quarterly to the Department of Energy.

### INCOME TAXES

Deferred income taxes result from timing differences in the recognition of certain income and expenses for tax and financial accounting purposes. The principal items accounting for deferred income taxes are: (1) use of the Accelerated Cost Recovery System and other accelerated depreciation methods for income tax purposes, (2) deferred fuel and gas production costs deducted currently for income tax purposes, and (3) other timing differences involving the capitalization of certain taxes and overhead costs.

Investment tax credits utilized to reduce federal income taxes are deferred and generally amortized over the useful lives of the related utility plant. Additional tax credits in 1983, 1984 and 1985 related to an Employee Stock Ownership Plan do not affect net income and are recorded as liabilities until the contribution is made to the Plan.

### ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION

Allowance for funds used during construction (AFUDC) is a non-cash item and is defined in the regulatory system of accounts as the "net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds so used." AFUDC is segregated into two components: (1) the interest on debt component ("allowance for borrowed funds used during construction"), which is net of taxes and classified as a credit to interest charges, and (2) the common stock equity and preferred dividend component ("allowance for other funds used during construction"), which is classified as an item of other income. AFUDC is considered a cost of utility plant with a concurrent credit to income. It is excluded from taxable income for tax purposes. The rates used in determining AFUDC, which includes semi-annual compounding, were 9.2% in 1985, 9.0% in 1984 and 7.8% in 1983.

## 2. TAXES ON INCOME

Income tax expense for 1985, 1984 and 1983 is as follows:

(Dollars in Thousands)

| | 1985 | 1984 | 1983 |
|---|---|---|---|
| Operations: | | | |
| Federal: Current | $32,557 | $36,131 | $16,557 |
| Deferred | 28,638 | 27,380 | 36,654 |
| State: Current | 6,320 | 6,560 | 4,345 |
| Deferred | 4,978 | 4,555 | 6,047 |
| Investment tax credit adjustments, net | 5,343 | 2,951 | 3,981 |
| Other income: Current | (29,788) | 1,528 | 816 |
| Deferred | 13,846 | — | — |
| Investment tax credit adjustments, net | 12,608 | — | — |
| Total | $74,502 | $79,105 | $68,400 |

Investment tax credits utilized to reduce federal income taxes payable amounted to $24,992,000 in 1985, $6,890,000 in 1984 and $7,654,000 in 1983. The amounts for 1985, 1984 and 1983 include Employee Stock Ownership Plan credits of $535,000, $707,000 and $360,000, respectively.

## 2. TAXES ON INCOME
(continued)

The following is a reconciliation of the difference between income tax expense and the amount computed by multiplying income before tax by the federal statutory rate:

(Dollars in Thousands)

| | 1985 | | 1984 | | 1983 | |
|---|---|---|---|---|---|---|
| | Amount | Rate | Amount | Rate | Amount | Rate |
| Statutory income tax expense | $78,725 | 46% | $78,758 | 46% | $70,594 | 46% |
| Increase (Decrease) in taxes resulting from: | | | | | | |
| Exclusion of AFUDC for income tax purposes | (1,397) | (1) | (1,639) | (1) | (1,463) | (1) |
| Depreciation not normalized | 5,026 | 3 | 2,490 | 1 | ( 171) | — |
| ITC amortized to income | (7,041) | (4) | (3,939) | (2) | (3,673) | (2) |
| State income taxes, net of federal tax benefit | 6,031 | 4 | 6,067 | 3 | 5,682 | 4 |
| Amortization of credit arising from sale of contracts | (3,313) | (2) | (2,190) | (1) | (3,221) | (2) |
| Other, net | (3,529) | (2) | ( 442) | — | 652 | — |
| Income tax expense | $74,502 | 44% | $79,105 | 46% | 68,400 | 45% |

The components of deferred income taxes relate to the following tax effects of timing differences between book and tax income:

(Dollars in Thousands)

| | 1985 | 1984 | 1983 |
|---|---|---|---|
| Depreciation | $33,394 | $18,887 | $19,251 |
| Deferred energy costs | 1,163 | 954 | 12,480 |
| Capitalized overhead costs | 1,432 | 1,508 | 1,648 |
| Nuclear fuel disposal costs | — | — | 5,675 |
| Pollution control amortization | 3,629 | 3,687 | 3,548 |
| ADR repair allowance | 4,295 | 4,863 | — |
| Other, net | 3,549 | 2,036 | 99 |
| Total | $47,462 | $31,935 | $42,701 |

The company has not provided deferred income taxes of approximately $123 million on cumulative timing differences arising before the adoption of full tax normalization for ratemaking purposes by the regulatory authorities. The company is currently collecting the unnormalized taxes in its Delaware and resale electric rate jurisdictions, and in the gas jurisdiction on a levelized basis, over the life of the related plant facilities. For the other jurisdictions, it is anticipated that the amounts will be recovered for rate purposes when paid.

The company's federal income tax returns have been examined for the years 1975 through 1981. During 1985, the company reached a stipulated Tax Court settlement with the government regarding the taxation of the proceeds from the sale of contracts for a nuclear steam supply system (Summit). Pursuant to the decision, the net proceeds are taxable at a rate that approximates a capital gains tax rate, which resulted in a federal and state tax liability and interest of approximately $35.1 million, principally paid in prior years. As of December 31, 1985, approximately $15.4 million of net federal and state taxes and interest are refundable to the company resulting from the reversal of the previous tax treatment applied to the sale of the contracts. As more fully discussed in Note 7, the net proceeds, which were classified as a deferred credit on the balance sheet, are being amortized. The Tax Court decision and resulting adjustment to the deferred credit did not have a material effect on the company's financial position or results of operations.

(Dollars in Thousands)

## 3. Taxes Other Than Income

| | 1985 | 1984 | 1983 |
|---|---|---|---|
| Delaware utility | $12,168 | $13,732 | $12,341 |
| Property | 6,784 | 6,652 | 6,483 |
| Other gross receipts | 5,799 | 4,995 | 4,149 |
| Payroll, franchise and other | 6,003 | 5,773 | 4,800 |
| Total | $30,754 | $31,152 | $27,773 |

## 4. Pension Plan and Post-Retirement Benefits

The company has a trusteed noncontributory pension plan covering all regular employees. Pension contributions for 1985, 1984 and 1983 were $3,284,000, $2,354,000 and $4,400,00, respectively. The contributions provide for normal cost and amortization of prior service costs over periods of five to twenty-five years.

The actuarial present value of accumulated plan benefits, determined as of January 1, 1985, was $94,410,000 for vested benefits and $15,638,000 for accrued nonvested benefits. The market value of net assets, at that date, available for plan benefits were $201,398,000. The actuarial present value of accumulated plan benefits, determined as of January 1, 1984 was $80,311,000 for vested benefits and $13,816,000 for accrued nonvested benefits. The market value of net assets, at that date, available for plan benefits were $191,062,000. The assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 8.0% for 1985 and 1984.

The company provides certain health care and life insurance benefits for retired employees. Substantially all of the company's employees may become eligible for these benefits if they reach normal retirement age while still working for the company. The company recognizes the cost of providing these benefits by expensing the insurance claims as they are paid. These costs totalled $2,094,000, $1,640,000 and $2,075,000 for 1985, 1984 and 1983, respectively.

## 5. Capitalization

### Retained Earnings

The current first mortgage bond indenture restricts the amount of consolidated retained earnings available for cash dividend payments on common stock to $35,000,000 plus accumulations after June 30, 1978, which available amount at December 31, 1985 was approximately $143,810,000.

### Preferred Stock

The annual preferred dividend requirements on all outstanding preferred stock at December 31, 1985 are $7,761,000. If preferred dividends are in arrears the company may not declare common stock dividends or acquire its common stock.

### Without Mandatory Redemption

These series may be redeemed at the option of the company at any time, in whole or in part, at the various redemption prices fixed for each series (ranging from $103 to $106 at December 31, 1985).

# Notes to Consolidated Financial Statements

## With Mandatory Redemption

(1) The company redeemed 15,900 shares of the 9% series in December 1985 at $100 per share. Eight thousand of the 15,900 shares were required to be redeemed by the sinking fund and the remaining 7,900 shares were redeemed under an option of the sinking fund. Through a tender offer for the 9% series the company purchased, at $103 per share, 99,834 shares in December 1985 and 3,150 shares in January 1986. (2) The 300,000 shares of the 12.56% series were called and purchased by the company at $108.38 in December 1985. (3) Under certain conditions the 9% series may also be redeemed at the option of the company. (4) Mandatory sinking fund redemptions are $800,000 per year during the next five years. As of December 31, 1985, all shares previously held in the Treasury were retired.

## Long-Term Debt

(1) Sinking fund provisions with respect to substantially all issues of the First Mortgage and Collateral Trust Bonds require that there be deposited annually with the Trustee cash equal to one percent (1%) of the greatest aggregate principal amount at any one time outstanding. There shall be credited against such cash requirements (a) an amount not exceeding sixty percent (60%) of the bondable value of property additions which the company then elects to make the basis of this credit, and (b) the aggregate principal amount of bonds which might then be made the basis of the authentication and delivery of bonds and which the company then elects to make the basis of this credit. For the years 1983-1985, the company elected to certify property additions to satisfy its sinking fund requirements equal to 1% of each series as permitted by the indenture. (2) Substantially all utility plant of the company now or hereafter owned is subject to the lien of the related Mortgage and Deed of Trust. (3) Pursuant to a bank loan agreement the company has a $33,000,000 revolving credit commitment through November 1, 1989, convertible into a term loan due November 1, 1992. The loan agreement requires a commitment fee of ½% on any unused portion of the revolving credit commitment and term loans may be prepaid at any time without penalty and would bear interest at 100% of the prime rate. (4) On September 26, 1985, the company issued, through the Delaware Economic Development Authority, $33,500,000 of Variable Rate Demand Exempt Facilities Revenue Bonds—Series 1985 (Variable Rate Demand Series 1985), due September 1, 2015. The proceeds were primarily used to refinance $33,000,000 of tax-exempt revenue notes. This series was collateralized with $37,000,000 First Mortgage Bonds due September 1, 2015, which secure repayment of principal and accrued interest. The interest rates on the Variable Rate Demand Series 1985, by election of the company, are subject to change daily, weekly, or under specified conditions, annually, on the basis of prevailing rates. The Variable Rate Demand Series 1985 and the $15,500,000 Variable Rate Demand Gas Facilities Revenue Bonds-Series 1984 have put options for the bondholders whereby the bonds can be presented for payment at specified times. The bonds can be sold by the remarketing agent. The company has sufficient long-term financing arrangements available to redeem any bonds not remarketed. In recognition of the long-term financing capability, both the 1985 and 1984 series of these bonds have been classified as long-term debt. (5) During 1985, a subsidiary of Delmarva Capital Investments, Inc. entered into a loan agreement to borrow up to $25,000,000 at a rate of 10%. The loan matures on February 19, 1989 and may be prepaid at anytime, in some instances subject to a penalty. At December 31, 1985, $25,000,000 was outstanding under this agreement. (6) During December 1985 the company temporarily borrowed $55,000,000 from a bank in order to redeem $44,711,000 of preferred stock (including acquisition costs) and retire $10 million of 3½% Series First Mortgage and Collateral Trust Bonds. On January 15, 1986,

### LONG-TERM DEBT (CONTINUED)

the company issued $60,000,000 of 10⅛% Series First Mortgage and Collateral Trust Bonds, due January 1, 2016. The proceeds from the bond issuance were used to repay the $55,000,000 bank loan in January 1986, with the balance being applied to general corporate cash requirements. As of December 31, 1985, the bank loan was classified as long-term debt in recognition of refinancing the loan through issuance of the bonds. (7) Maturities of long-term debt during the next five years are 1986—$150,000; 1987—$150,000; 1988—$25,150,000; 1989—$25,150,000; 1990—$150,000. (8) The annual interest requirements on all borrowings classified as long-term debt at December 31, 1985 are $55,355,000.

### UNAMORTIZED DEBT DISCOUNT, PREMIUM AND EXPENSE

These amounts are amortized on a straight-line basis over the lives of the long-term debt issues to which they pertain.

## 6. COMMITMENTS

The company estimates that approximately $125,689,000, excluding AFUDC, will be expended for construction purposes in 1986. The company also has commitments under long-term fuel supply contracts.

Under SFAS No. 71, regulated industries were required to adopt the lease accounting requirements of SFAS No. 13 for all capital leases commencing on or after January 1, 1983. The company's capital leases commencing after January 1, 1983, were not material and, therefore, were not recorded. All capital leases, including leases commencing prior to January 1983, were treated as operating leases. However, if capital leases had been recorded on the balance sheet, related assets and liabilities would have increased by $8,609,000 and $13,324,000 at December 31, 1985 and 1984, respectively.

Minimum commitments as of December 31, 1985 under all non-cancellable lease agreements are as follows:

| | |
|---|---|
| 1986 | $ 4,202,000 |
| 1987 | 3,203,000 |
| 1988 | 2,503,000 |
| 1989 | 1,003,000 |
| 1990 | 507,000 |
| Remainder | 3,642,000 |
| Total | $15,060,000 |

The total minimum rental commitments are applicable to the following types of property: railroad coal cars, $1,387,000; distribution facilities, $4,792,000; other, principally transportation and computer equipment, $8,881,000. Rentals charged to operating expenses aggregated $6,634,000 in 1985, $6,213,000 in 1984 and $6,677,000 in 1983.

Nuclear fuel requirements for Peach Bottom Generating Station are being provided by the operating company through a fuel purchase contract. The company is responsible for payment of its share of fuel consumed and interest expense. Nuclear fuel expense totalled $4,520,000 in 1985, $6,072,000 in 1984 and $4,283,000 in 1983.

## 6. Commitments (continued)

The company has an agreement providing for the availability of fuel storage and pipeline facilities through 1999. Under the agreement, the company must make specified minimum payments monthly, which totaled $1,682,000 in 1985, $1,912,000 in 1984 and $2,101,000 in 1983. The amount of required payments is $2,060,000 in 1986, $1,749,000 in 1987, $1,206,000 in 1988, $1,056,000 in 1989, $812,000 in 1990 and $11,435,000 between 1991 and 1999.

## 7. Sale of Contracts for Nuclear Plant

The proceeds received by the company for the sale in 1975 of the contracts for a nuclear steam supply system (Summit) and related fuel, net of related plant expenditures which are considered of no future value to the company, are classified as a deferred credit in the balance sheet. The credit has been reduced by applicable income taxes and related interest (See Note 2). The company has obtained regulatory approval for this accounting treatment. As a result of ratemaking orders commencing in 1982, the company is amortizing the net credit in all retail jurisdictions over approximately five years and is recording the credit for financial reporting purposes as a reduction in depreciation expense. Amounts amortized in 1985, 1984 and 1983 were $7,202,000, $4,762,000 and $7,003,000, respectively, which includes, in 1985 and 1983 amortization of $2,500,000 and $3,818,000 for the resale jurisdiction.

## 8. Short-Term Debt and Lines of Credit

As of December 31, 1985, the company had unused bank lines of credit of $44,500,000 and is generally required to pay commitment fees for these lines. Such lines of credit are periodically reviewed by the company, at which time they may be renewed or cancelled.

## 9. Jointly-Owned Plant

Information with respect to the company's share of jointly-owned plant, including nuclear fuel for the Salem plant, as of December 31, 1985 is as follows:

(Dollars in Thousands)

| | Ownership Share | Plant in Service | Accumulated Depreciation | Construction Work in Progress |
|---|---|---|---|---|
| Nuclear: | | | | |
| Peach Bottom | 7.51% | $ 90,530 | $26,384 | $ 2,156 |
| Salem | 7.41% | 190,486 | 52,820 | 11,381 |
| Coal-Fired: | | | | |
| Keystone | 3.70% | 10,701 | 4,158 | 1,199 |
| Conemaugh | 3.72% | 13,699 | 5,430 | 165 |
| Total | | $305,416 | $88,792 | $14,901 |

The company provides its own financing for its share of improvements to jointly-owned plant. In addition, the company is a joint guarantor of loans ($760,000 proportionate share) advanced for operation of the coal mines that supply the Keystone plant. The company's share of operating and maintenance expenses of the jointly-owned plant is included in the corresponding expenses in the statements of income.

## 10. Contingencies

### a) FERC Rate Case

In December 1985, the company reached a tentative settlement with all resale customers to refund \$3.5 million, which would have reduced resale rates for the period covering July 1985 through December 1986. Accordingly, a revenue reserve of \$1.2 million was established as of December 31, 1985. On February 6, 1986, the company was informed by some of the resale customers that the tentative settlement was not acceptable. The company is awaiting further action by the resale customers. In the opinion of management, the ultimate disposition of this matter will not have a material effect on the company's financial position or results of operations.

### b) Plant Held for Future Use

In 1982,the company delayed the construction schedule for the coal-fired Nanticoke #1 (formerly Vienna #9) generating unit. The plant is now scheduled to begin commercial operation in the mid 1990's. The decision is based on the company's current load forecast, which indicates a lower rate of growth in the coming decade than had previously been projected. The net investment of \$14,424,000 is classified as plant held for future use and is anticipated to be recoverable through the normal ratemaking process.

### c) Nuclear Insurance

The company's insurance coverages applicable to its nuclear power units are as follows:

(Millions of Dollars)

| Type and Source of Coverage | Maximum Coverage | Maximum Retrospective Assessment for a Single Incident |
|---|---|---|
| Public Liability: | | |
| Private | \$160 | None |
| Price Anderson Assessment[1] | 480 | \$1.5[2] |
| | \$640[3] | |
| Property Damage:[4] | | |
| Peach Bottom[5] | \$585 | — |
| Salem[6] | \$585 | \$2.8 |
| All units[7] | \$525 | \$1.3 |
| Replacement Power: | | |
| Nuclear Electric Insurance Limited (NEIL)[8] | \$3.0 | \$2.2 |

[1] Retrospective premium program under the Price-Anderson liability provisions of the Atomic Energy Act of 1954 as amended. Subject to retrospective assessment with respect to loss from an incident at any licensed nuclear reactor in the United States. [2] Maximum assessment would be \$3,000,000 in the event of more than one incident in any year. [3] Limit of liability under the Price-Anderson Act for each nuclear incident. [4] The company is a self insurer, to the extent of its ownership interest, for any property loss in excess of the stated amounts. [5] For property damage to the Peach Bottom nuclear plant facilities, the company and its co-owners have private insurance up to \$585 million. [6] Nuclear Mutual Limited, a utility-owned mutual insurance company with which the company and the Salem nuclear facility co-owners are members. Maximum retrospective assessment is ten times annual premium with respect to loss at any nuclear generating station insured by the mutual insurance company. [7] All units are insured by Nuclear Electric Insurance Limited (NEIL II) for losses in excess of \$500 million. Maximum retrospective assessment is seven and a half times the annual premiums. [8] Utility owned mutual insurance company with which the company is a member which provides coverage against extra expense incurred in obtaining replacement power during prolonged accidental outages of nuclear power units. Maximum weekly indemnity for 52 weeks which commences after the first 26 weeks of an outage. Also provides \$1,500,000 weekly for an additional 52 weeks. Maximum retrospective assessment is five times annual premiums.

### d) Other

The company is involved in certain other legal and administrative proceedings before various courts and governmental agencies concerning rates, environmental issues, fuel contracts and other matters. In the opinion of management, the ultimate disposition of these proceedings will not have a material effect on the company's financial position or results of operations.

## 11. SEGMENT INFORMATION

Segment information with respect to electric, gas and steam operations was as follows:

(Dollars in Thousands)

| | 1985 | 1984 | 1983 |
|---|---|---|---|
| Operating Revenues: | | | |
| Electric | $ 605,581 | $ 584,163 | $ 542,252 |
| Gas | 95,256 | 101,578 | 94,358 |
| Steam | 21,997 | 16,852 | 13,189 |
| Total | $ 722,834 | $ 702,593 | $ 649,799 |
| Operating Income: | | | |
| Electric | $ 127,148 | $ 125,200 | $ 122,993 |
| Gas | 6,604 | 6,616 | 4,928 |
| Steam | 1,763 | 1,393 | 1,217 |
| Total | $ 135,515 | $ 133,209 | $ 129,138 |
| Utility Plant:(1)(2) | | | |
| Electric | $1,284,062 | $1,257,728 | $1,242,145 |
| Gas | 64,967 | 59,097 | 51,033 |
| Steam | 4,142 | 4,349 | 4,924 |
| | 1,353,171 | 1,321,174 | 1,298,102 |
| Other Identifiable Assets: | | | |
| Electric | 99,348 | 157,437 | 106,347 |
| Gas | 29,985 | 42,685 | 12,361 |
| Steam | 413 | 440 | 471 |
| | 129,746 | 200,562 | 119,179 |
| Assets Not Allocated | 191,853 | 69,894 | 115,982 |
| Total Assets | $1,674,770 | $1,591,630 | $1,533,263 |
| Depreciation Expense:(3) | | | |
| Electric | $ 56,577 | $ 54,255 | $ 52,530 |
| Gas | 3,699 | 3,310 | 3,173 |
| Steam | 907 | 899 | 896 |
| Total | $ 61,183 | $ 58,464 | $ 56,599 |
| Construction Expenditures:(4) | | | |
| Electric | $ 86,073 | $ 69,233 | $ 70,927 |
| Gas | 8,382 | 10,109 | 5,070 |
| Steam | 468 | 146 | 59 |
| Total | $ 94,923 | $ 79,488 | $ 76,056 |

(1) Includes plant held for future use, construction work in progress and allocation of common utility property.

(2) Stated net of the respective accumulated provisions for depreciation.

(3) Excludes amortization of credit arising from sale of contracts.

(4) Excludes allowance for funds used during construction.

Operating income by segments is reported in accordance with generally accepted accounting and ratemaking principles within the utility industry and, accordingly, includes each segment's proportionate share of taxes on income and general corporate expenses.

## 12. SUPPLEMENTARY INFORMATION TO DISCLOSE THE EFFECTS OF CHANGING PRICES (UNAUDITED)

The following supplementary financial information, as prescribed by the Financial Accounting Standards Board in Statement No. 33, as amended, is supplied for the purpose of providing information about the effects of changing prices on the company's operations. The information should be viewed as an estimate of the approximate effect of inflation rather than as a precise measure.

Current cost amounts reflect the change in specific prices of plant from the date the plant was acquired to the present. The current cost of utility plant represents the estimated cost of replacing existing plant assets and was determined by indexing existing plant by the Handy-Whitman Index of Public Utility Construction Costs. Constant dollar amounts represent historical costs stated in terms of dollars of equal purchasing power, as measured by the Consumer Price Index for All Urban Consumers, and differ from current cost amounts to the extent that prices in general have increased more or less rapidly than specific prices.

Supplementary Financial Data Adjusted for the Effects of Changing Prices
(Dollars in Thousands)

| For the Year ended December 31, | Historical Cost | Current Cost (Average 1985 Dollars) |
|---|---|---|
| Operating Revenues | $722,834 | $722,834 |
| Operating Expenses: | | |
| Operation and Maintenance | 424,748 | 424,748 |
| Depreciation | 61,183 | 116,142 |
| Amortization—Summit | (7,202) | (7,202) |
| Taxes | 108,590 | 108,590 |
| Other Income—Net | (8,810) | (8,810) |
| Interest Charges | 47,687 | 47,687 |
| Net Income[1] | $ 96,638 | $ 41,679 |
| Earnings per common share (after preferred dividend requirements)[2] | $ 2.76 | $ 0.95 |
| Increase in current cost of utility plant held during the year[3] | | $ 26,308 |
| Adjustment to net recoverable cost | | 61,394 |
| Effect of increase in general price level | | (79,549) |
| Excess of increase in current costs after adjustment to net recoverable cost over increase in general price level | | 8,153 |
| Purchasing power gain on net amounts owed | | 21,441 |
| Net | | $ 29,594 |

[1] Including the adjustment to net recoverable cost, the income on a current cost basis for 1985 would have been $103,073.

[2] Excluding adjustment to net recoverable cost.

[3] At December 31, 1985, the current cost of net utility plant was $2,265,170 while historical cost was $1,353,171.

## 12. SUPPLEMENTARY INFORMATION (continued)

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

(In Thousands[1] of Average 1985 Dollars)

| For the Years ended December 31 | 1985 | 1984 | 1983 | 1982 | 1981 |
|---|---|---|---|---|---|
| Operating revenues | | | | | |
| Historical cost dollars | $722,834 | $702,593 | $649,799 | $636,666 | $608,504 |
| Constant dollars | 722,834 | 727,428 | 701,626 | 709,560 | 719,750 |
| Net income | | | | | |
| Current costs | 41,679 | 49,331 | 34,128 | 25,065 | 17,774 |
| Earnings per common share | | | | | |
| Current costs | .95 | 1.20 | .72 | .41 | .12 |
| Net assets at year end[2] | | | | | |
| Historical cost dollars | 666,811 | 644,650 | 608,513 | 573,073 | 542,080 |
| Current costs | 655,619 | 656,467 | 646,006 | 631,478 | 620,455 |
| Excess of increase in current costs over increase in general price level[3] | 8,153 | (10,515) | 5,848 | 4,033 | (71,210) |
| Purchasing power gain on net amounts owed | 21,441 | 25,914 | 24,489 | 25,276 | 59,185 |
| Cash dividends declared per common share | | | | | |
| Historical cost dollars | $ 1.945 | $ 1.83 | $ 1.68 | $ 1.595 | $ 1.535 |
| Constant dollars | 1.945 | 1.89 | 1.81 | 1.78 | 1.82 |
| Market price per common share at year-end | | | | | |
| Historical cost dollars | 27.88 | 22.00 | 19.25 | 16.38 | 12.63 |
| Constant dollars | 27.41 | 22.40 | 20.44 | 18.05 | 14.46 |
| Average Consumer Price Index (1967 = 100) | 322.2 | 311.2 | 298.4 | 289.1 | 272.4 |

[1] Except per share amounts

[2] At net recoverable cost

[3] After adjustment to net recoverable cost

As required by Statement No. 33, the current provisions for depreciation on the current cost amounts of utility plant were determined by applying the company's depreciation rates to the indexed plant amounts, even though depreciation is limited to recovery of historical costs as further discussed below. Other operating expenses were either not required to be adjusted or were not adjusted due to rate-making considerations.

The company, by holding monetary assets such as cash and receivables, loses purchasing power during periods of inflation because these items can purchase less at a future date. Conversely, by holding monetary liabilities, primarily long-term debt, payments in the future will be made with dollars having less purchasing power. For the years 1981-1985, the company's monetary liabilities exceeded monetary assets which resulted in a purchasing power gain on net amounts owed during the year.

The rate regulatory process limits the company to the recovery of the historical cost of plant. Therefore, the excess of the cost of plant stated in terms of current cost over the historical cost of plant is not presently recoverable in rates as depreciation and is reflected as a reduction to net recoverable cost. Based on past practices, however, the company believes it will be allowed to earn on the increased cost of its facilities when replacement actually occurs.

## 12. SUPPLEMENTARY INFORMATION (continued)

Since the gain from the decline in purchasing power is attributable to long-term debt which has been used to finance utility plant, the reduction of utility plant to net recoverable amount is netted against the purchasing power gain on net amounts owed during the year.

## 13. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The quarterly data presented below reflect all adjustments necessary in the opinion of the company for a fair presentation of the interim results. Quarterly data normally vary seasonably with temperature variations, differences between summer and winter rates, the timing of rate orders and the scheduled downtime and maintenance of electric generating units.

| Quarter Ended | Operating Revenue | Operating Income | Net Income | Earnings Applicable to Common Stock | Average Shares Outstanding | Earnings per Average Share |
|---|---|---|---|---|---|---|
| | (Dollars in Thousands) | | | | (in Thousands) | |
| 1985 | | | | | | |
| March 31 | $198,788 | $ 36,946 | $27,114 | $23,964 | 30,482 | $0.79 |
| June 30 | 161,093 | 29,416 | 20,582 | 17,433 | 30,482 | 0.57 |
| September 30 | 196,352 | 43,496 | 34,235 | 31,085 | 30,482 | 1.02 |
| December 31 | 166,601 | 25,657 | 14,707 | 11,557 | 30,482 | 0.38 |
| | $722,834 | $135,515 | $96,638 | $84,039 | 30,482 | $2.76 |
| 1984 | | | | | | |
| March 31 | $190,185 | $ 36,823 | $25,996 | $22,809 | 30,003 | $0.76 |
| June 30 | 164,181 | 29,957 | 19,130 | 15,954 | 30,172 | 0.53 |
| September 30 | 188,901 | 42,862 | 33,092 | 29,937 | 30,337 | 0.99 |
| December 31 | 159,326 | 23,567 | 13,892 | 10,748 | 30,482 | 0.35 |
| | $702,593 | $133,209 | $92,110 | $79,448 | 30,248 | $2.63 |

In the fourth quarter of 1984, adjustments for a voluntary Delaware revenue refund and other regulatory items were recorded. The effect of these adjustments reduced fourth quarter net income by approximately $4,200,000 (14¢ per share).

In the second quarter of 1985, adjustments were recorded for the additional Delaware electric retail revenue refund for 1984 and additional amortization of the credit arising from the sale of contracts, which resulted from an out-of-court tax settlement. The effect of these adjustments reduced second quarter net income by approximately $1,100,000 (4¢ per share).

In the fourth quarter of 1985, the company wrote-off its share of advances under uranium supply contracts that were terminated and also accrued for a resale revenue refund. The effect of these adjustments reduced fourth quarter net income by approximately $2,063,000 (7¢ per share).

# Consolidated Statistics

| 10 Years of Review | | 1985 | 1984 | 1983 | 1982 |
|---|---|---|---|---|---|
| **Electric Revenues** (thousands) | Residential | $ 212,254 | $205,910 | $193,021 | $183,258 |
| | Commercial | 168,957 | 156,507 | 140,809 | 137,434 |
| | Industrial | 135,141 | 128,833 | 126,703 | 127,441 |
| | Other utilities, etc. | 79,399 | 79,235 | 68,991 | 73,469 |
| | Miscellaneous revenues | 9,830 | 13,678 | 12,728 | 13,168 |
| | Total electric revenues | $ 605,581 | $584,163 | $542,252 | $534,770 |
| **Electric Sales** (1,000 kilowatt-hours) | Residential | 2,256,922 | 2,249,270 | 2,136,265 | 2,026,398 |
| | Commercial | 2,163,685 | 2,073,457 | 1,844,324 | 1,729,863 |
| | Industrial | 2,606,466 | 2,569,572 | 2,600,492 | 2,255,673 |
| | Other utilities, etc. | 1,501,447 | 1,415,934 | 1,297,395 | 1,237,508 |
| | Total electric sales | 8,530,520 | 8,308,233 | 7,878,476 | 7,249,442 |
| **Electric Customers** (end of period) | Residential | 283,911 | 275,175 | 267,357 | 260,371 |
| | Commercial | 33,189 | 31,548 | 30,525 | 29,966 |
| | Industrial | 893 | 929 | 949 | 741 |
| | Other utilities, etc. | 492 | 502 | 434 | 434 |
| | Total electric customers | 318,485 | 308,154 | 299,265 | 291,512 |
| **Gas Revenues** (thousands) | Residential | $ 39,224 | $ 40,933 | $ 36,694 | $ 36,505 |
| | Commercial | 17,901 | 18,663 | 16,527 | 15,792 |
| | Industrial | 19,762 | 22,940 | 23,232 | 20,112 |
| | Interruptible | 17,419 | 18,098 | 17,026 | 11,733 |
| | Other utilities, etc. | 130 | 160 | 115 | 53 |
| | Miscellaneous revenues | 820 | 784 | 764 | 552 |
| | Total gas revenues | $ 95,256 | $101,578 | $ 94,358 | $ 84,747 |
| **Gas Sales** (million cubic feet) | Residential | 5,622 | 6,213 | 5,640 | 6,062 |
| | Commercial | 2,742 | 2,971 | 2,677 | 2,768 |
| | Industrial | 3,579 | 4,245 | 4,378 | 4,108 |
| | Interruptible | 3,734 | 3,769 | 3,723 | 2,656 |
| | Other utilities, etc. | 31 | 41 | 31 | 10 |
| | Total gas sales | 15,708 | 17,239 | 16,449 | 15,604 |
| **Gas Customers** (end of period) | Residential | 70,804 | 70,183 | 69,608 | 69,092 |
| | Commercial | 4,417 | 4,233 | 4,075 | 4,057 |
| | Industrial | 160 | 165 | 160 | 166 |
| | Interruptible | 15 | 19 | 19 | 18 |
| | Other utilities, etc. | 1 | 1 | 1 | 1 |
| | Total gas customers | 75,397 | 74,601 | 73,863 | 73,334 |
| **Refinery Service** | Electricity delivered (1,000 kilowatt-hours) | 335,260 | 298,203 | 309,043 | 322,804 |
| | Steam delivered (1,000 pounds) | 6,238,829 | 6,683,335 | 6,965,904 | 7,778,929 |

| 1981 | 1980 | 1979 | 1978 | 1977 | 1976 | 1975 | Average Annual Compounded % Rate of Growth |
|---|---|---|---|---|---|---|---|
| $164,919 | $144,637 | $115,381 | $105,237 | $ 97,691 | $ 80,416 | $ 77,069 | 10.66 |
| 123,099 | 112,166 | 91,798 | 82,796 | 74,641 | 60,111 | 58,169 | 11.25 |
| 129,601 | 116,401 | 98,023 | 83,972 | 76,801 | 64,458 | 64,141 | 7.74 |
| 73,602 | 63,698 | 53,782 | 40,840 | 38,974 | 34,896 | 35,606 | 8.35 |
| 12,898 | 7,025 | 4,682 | 5,261 | 3,461 | 2,398 | 4,370 | 8.44 |
| $504,119 | $443,927 | $363,666 | $318,106 | $291,568 | $242,279 | $239,355 | 9.73 |
| 1,996,647 | 2,046,546 | 1,968,452 | 1,979,624 | 1,924,723 | 1,787,663 | 1,672,180 | 3.04 |
| 1,660,147 | 1,648,776 | 1,598,299 | 1,568,600 | 1,495,796 | 1,412,259 | 1,359,673 | 4.77 |
| 2,454,685 | 2,429,842 | 2,624,438 | 2,418,527 | 2,277,630 | 2,260,661 | 2,142,151 | 1.98 |
| 1,283,845 | 1,335,216 | 1,300,611 | 1,281,498 | 1,207,941 | 1,199,155 | 1,218,785 | 2.11 |
| 7,395,324 | 7,460,380 | 7,491,800 | 7,248,249 | 6,906,090 | 6,659,738 | 6,392,789 | 2.93 |
| 255,646 | 246,887 | 242,745 | 237,925 | 233,106 | 230,579 | 221,780 | 2.50 |
| 29,450 | 28,162 | 27,998 | 28,421 | 29,648 | 28,345 | 27,345 | 1.96 |
| 788 | 821 | 874 | 858 | 921 | 1,002 | 923 | (.33) |
| 434 | 440 | 478 | 480 | 561 | 550 | 545 | (1.02) |
| 286,318 | 276,310 | 272,095 | 267,684 | 264,236 | 260,476 | 250,593 | 2.43 |
| $ 34,123 | $ 26,525 | $ 25,719 | $ 28,370 | $ 21,829 | $ 18,826 | $ 15,365 | 9.83 |
| 14,344 | 10,342 | 8,954 | 10,154 | 7,133 | 6,062 | 4,676 | 14.37 |
| 22,259 | 12,404 | 9,884 | 10,191 | 6,950 | 5,984 | 4,343 | 16.36 |
| 11,711 | 9,293 | 4,440 | 716 | 169 | 1,301 | 1,211 | 30.55 |
| 61 | 46 | 55 | 93 | 49 | 44 | 33 | 14.70 |
| 572 | 430 | 270 | 116 | 103 | 31 | 45 | 53.68 |
| $ [illegible] | $ 59,040 | $ 49,322 | $ 49,640 | $ 36,233 | $ 32,248 | $ 25,673 | 14.01 |
| 6,193 | 6,321 | 6,423 | 6,941 | 6,751 | 6,956 | 6,540 | (1.50) |
| 2,704 | 2,683 | 2,415 | 2,593 | 2,439 | 2,586 | 2,429 | 1.22 |
| 4,809 | 3,937 | 3,388 | 3,290 | 2,811 | 3,264 | 2,849 | 2.31 |
| 2,802 | 2,738 | 1,720 | 319 | 81 | 953 | 1,073 | 13.28 |
| 12 | 14 | 16 | 29 | 17 | 20 | 18 | 5.59 |
| 16,520 | 15,693 | 13,962 | 13,172 | 12,099 | 13,779 | 12,909 | 1.98 |
| 68,608 | 67,784 | 66,631 | 66,364 | 66,231 | 67,754 | 68,160 | 0.38 |
| 3,967 | 3,846 | 3,712 | 3,773 | 3,738 | 4,154 | 4,189 | 0.53 |
| 167 | 155 | 131 | 163 | 163 | 198 | 198 | (2.11) |
| 16 | 16 | 16 | 21 | 21 | 21 | 21 | (3.31) |
| 1 | 1 | 1 | 1 | 1 | 1 | 1 | — |
| 72,752 | 71,802 | 70,491 | 70,322 | 70,154 | 72,128 | 72,569 | 0.38 |
| 343,063 | 328,420 | 262,159 | 270,006 | 289,049 | 318,389 | 297,282 | 1.21 |
| 7,673,420 | 7,570,944 | 6,378,705 | 6,016,095 | 4,888,366 | 5,301,421 | 5,517,000 | 1.24 |

# Officers, Directors and Shareholder Information

**NEVIUS M. CURTIS**
Chairman of the Board
and Chief Executive Officer

**HOWARD E. COSGROVE**
Executive Vice President

**FRANK A. COOK**
Senior Vice President

**H. RAY LANDON**
Senior Vice President

**HARLAND M. WAKEFIELD, JR.**
Senior Vice President

**ROGER D. CAMPBELL**
Vice President, Treasurer
and Chief Financial Officer

**WAYNE A. LYONS**
Vice President

**DONALD E. CAIN**
Division Vice President
Northern Division

**DONALD T. CONNELLY**
Secretary

**RICHARD H. EVANS**
Vice President, Corporate
Communications

**PAUL S. GERRITSEN**
Vice President, Regulatory
Practices

**CHARLES MARCHYSHYN**
Comptroller

**FRANK J. PERRY, JR.**
Vice President, Gas Division

**THOMAS S. SHAW, JR.**
Vice President, Production

**D. WAYNE YERKES**
Division Vice President
Southern Division

**EXECUTIVE COMMITTEE**
Nevius M. Curtis, Chairman;
Oscar L. Carey; William G.
Simeral; Dr. E. Arthur Trabant;
Harland M. Wakefield, Jr.

**AUDIT COMMITTEE**
Oscar L. Carey, Chairman;
John R. Cooper; James O. Pippin, Jr.

**NOMINATING COMMITTEE**
Dr. E. Arthur Trabant, Chairman;
Nevius M. Curtis; Sally V. Hawkins

**COMPENSATION COMMITTEE**
William G. Simeral, Chairman;
Oscar L. Carey; Nevius M. Curtis;
David D. Wakefield

**INVESTMENT COMMITTEE**
David D. Wakefield, Chairman;
James O. Pippin, Jr.; Nevius M. Curtis

**CHARLOTTE LEE CANNON**
Director of H. P. Cannon & Son, Inc.
(warehousing) Bridgeville, Delaware

**OSCAR L. CAREY**
President and Director of
Larmar Corporation (general
real estate and home builders)
Salisbury, Maryland

**FRANK A. COOK**
Senior Vice President of
the Company
Frank A. Cook has retired as senior vice president and a director of the company. Mr. Cook joined the company in 1972 as manager of electric production and held several management positions during his years of service. He was elected to the Board of directors in 1982.

**JOHN R. COOPER**
Manager of Environmental Affairs
and Occupational Health
Petrochemicals Department of
E. I. du Pont de Nemours &
Company (a diversified chemical,
energy and specialty products
company) Wilmington, Delaware

**SALLY V. HAWKINS**
Director, President and Chief Executive
Officer of Delaware Broadcasting
Company and President and General
Manager of Station WILM (radio
broadcasting) Wilmington, Delaware

**JAMES O. PIPPIN, JR.**
President and Director of the Centreville
National Bank of Maryland, Centreville,
Maryland

**WILLIAM G. SIMERAL**
Director and Executive Vice President
and a member of the Executive
Committee of E. I. du Pont de Nemours
& Company (a diversified chemical,
energy and specialty products
company) Wilmington, Delaware

**DR. E. ARTHUR TRABANT**
President of the University of Delaware,
Newark, Delaware

**DAVID D. WAKEFIELD**
Director and President of Morgan Bank
(Delaware) Wilmington, Delaware;
Chairman of Morgan Christiana
Corporation, Wilmington, Delaware;
Director of Continental American
Life Insurance Company,
Wilmington, Delaware

**HARLAND M. WAKEFIELD, JR.**
Senior Vice President of
the Company

**TRUSTEES**
First Mortgage and Collateral Trust
Bonds—Chemical Bank,
New York, New York

Pollution Control Revenue Bonds—
Mellon Bank (DE) N.A.
Wilmington, Delaware

Bank of Delaware,
Wilmington, Delaware

Wilmington Trust Company,
Wilmington, Delaware

Irving Trust Company
New York, New York

**TRANSFER AGENTS AND REGISTRARS**
Preferred Stock—
Wilmington Trust Company
Financial Services Division
Rodney Square North
Wilmington, Delaware 19890

Common Stock—
Wilmington Trust Company
Financial Services Division
Rodney Square North
Wilmington, Delaware 19890

Manufacturers Hanover Trust Company
Stock Transfer Department
P.O. Box 24935
Church Street Station
New York, New York 10249

**STOCK SYMBOL**
Common Stock, DEW—listed on
the New York and Philadelphia
Stock Exchanges.

**REGULATORY COMMISSIONS**
Federal Energy Regulatory Commission,
825 North Capitol Street, N.E.,
Washington, D.C. 20426

Delaware Public Service Commission,
1560 S. du Pont Highway,
Dover, Delaware 19901

Maryland Public Service Commission,
American Building,
231 East Baltimore Street,
Baltimore, Maryland 21202

Virginia State Corporate Commission,
P.O. Box 1197,
Richmond, Virginia 23209

**CORPORATE ADDRESS**
Delmarva Power
800 King Street, P.O. Box 231
Wilmington, Delaware 19899
Telephone (302) 429-3011

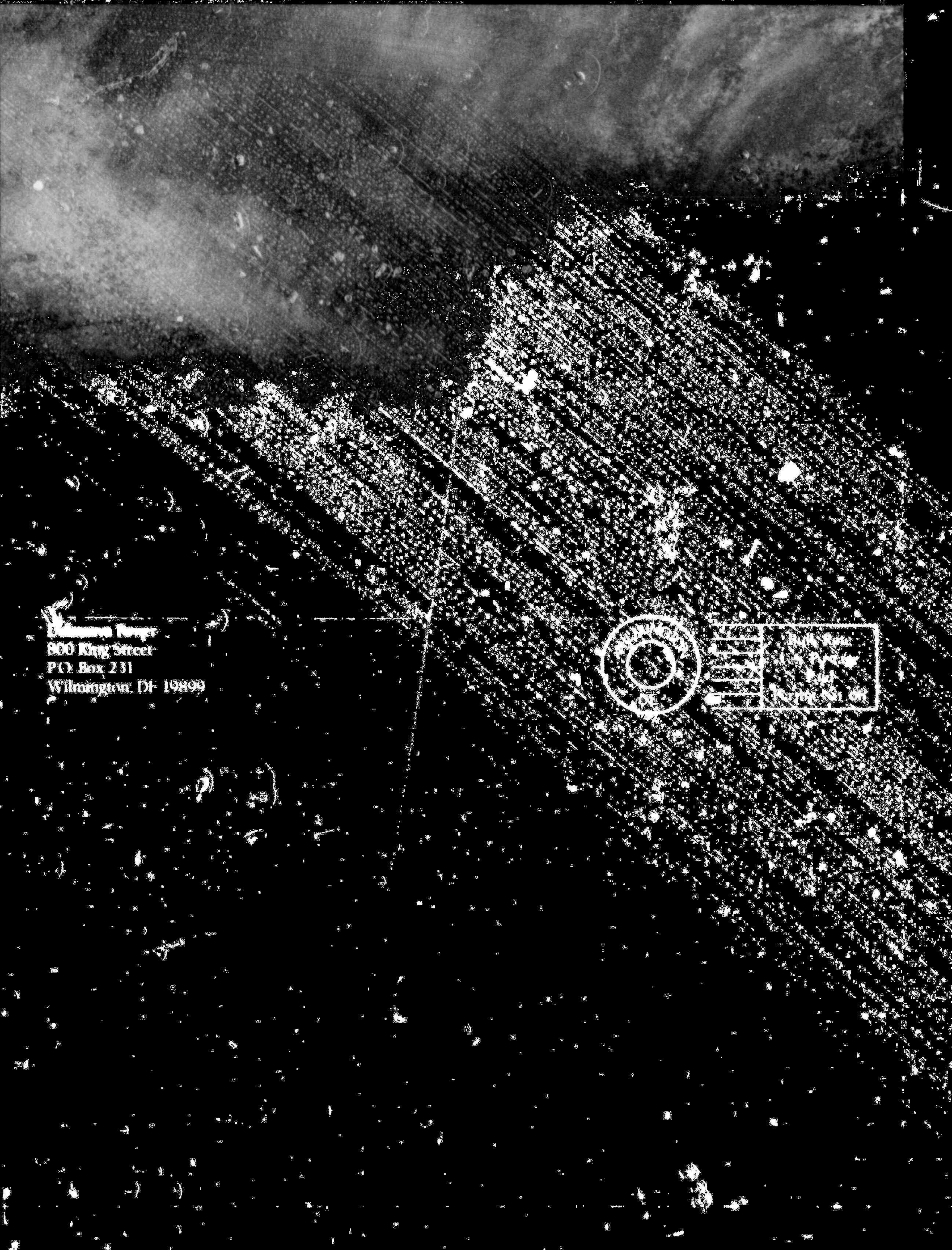
### Annual Meeting

The Annual Meeting will be held on April 29 at 11:00 a.m., in the Clayton Hall, University of Delaware, Newark, Delaware.

### Additional Reports

To supplement information in this Annual Report, a Financial and Statistical Review (1975-1985) and the Form 10-K are available upon request. Please write to Stockholder Relations, Delmarva Power, 800 King Street, P.O. Box 231, Wilmington, Delaware 19899.

Art Direction & Design: Teresa Zimmerman, Photography: John Carter III, Cover Illustration: Pamela Patrick Higgins



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P.O. Box 231
Wilmington, DE 19899