OHIO EDISON ANNUAL REPORT 1986

The Ohio Edison System

Service Area

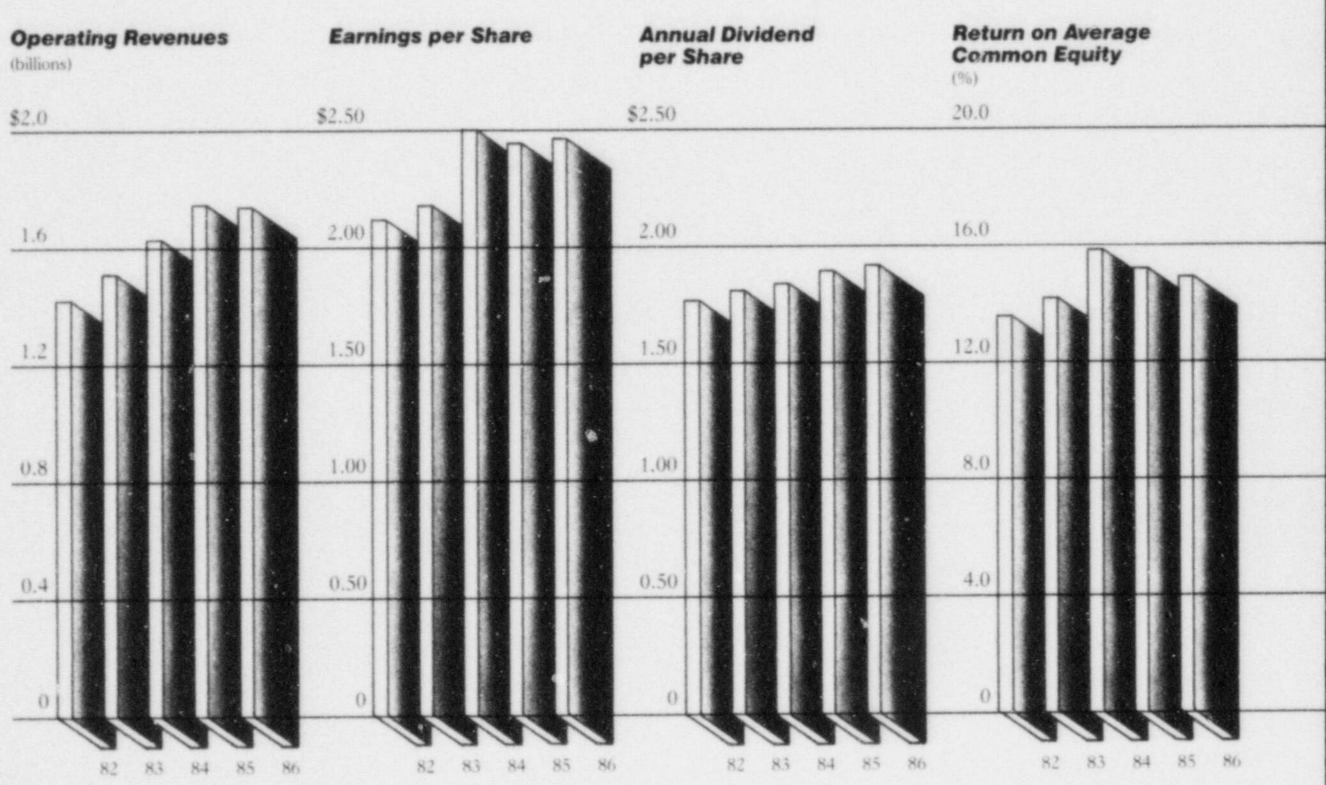
Ohio Edison Company and Pennsylvania Power Company

Contents

Financial Highlights

For the Years Ended December 31	1986	1985	Change
	(In millions, except per share amounts)		
Kilowatt-Hour Sales	**28,165.6**	28,885.7	−2.5%
Operating Revenues	**$1,741.9**	$1,754.7	−0.7%
Fuel Expense	**422.8**	499.2	−15.3%
Operating Income	**392.4**	380.4	+3.2%
Allowance for Funds Used During Construction, Net	**320.8**	287.7	+11.5%
Interest and Other Charges	**410.4**	410.2	—
Net Income	**410.8**	370.7	+10.8%
Earnings on Common Stock	**359.8**	318.1	+13.1%
Earnings per Common Share	**$2.47**	$2.45	+0.8%
Dividends per Common Share*	**$1.92**	$1.88	+2.1%
Dividends on Capital Stock	**$330.8**	$297.1	+11.4%
Capital Expenditures:			
Construction of Facilities	**$717.8**	$765.6	
Nuclear Fuel	**52.0**	52.8	
Other Capital Leases	**6.4**	8.6	
	$776.2	$827.0	−6.1%
Internally Generated Cash	**232.7**	275.3	−15.5%
Net Financing Activities	**370.5**	443.8	−16.5%
Return on Average Common Equity	**14.9%**	15.2%	

*The quarterly dividend was increased to 49 cents per share ($1.96 on an annual basis) beginning with the dividend payable on March 31, 1987.



Our improved operating performance and success in holding down costs helped us achieve a 1986 earnings per share on common stock of $2.47, up from $2.45 in 1985. We accomplished this despite our having 12 percent more common shares outstanding.

Total kilowatt-hour sales to customers in our service area were up nearly 2 percent. Commercial sales increased 5.6 percent, reflecting continued growth of retail and service-related businesses. Residential sales were up 3.7 percent, for the most part due to increases in new home construction and demand for heating and air-conditioning. Industrial sales were off 2.5 percent, mainly because of lengthy strikes that halted operations at the plants of two of our largest industrial customers.

Although off-system kilowatt-hour sales to other utilities produced $138 million in revenues in 1986, those sales were 15.8 percent lower than the previous year. This was largely the result of utilities in the mid-Atlantic region—our primary market—switching back to their own oil-fired generating units when oil prices fell in 1986. Also, three large generating units were placed in service, providing additional power in that region.

These changing market conditions made a major off-system sales agreement with Potomac Electric Power Company (PEPCO) all the more gratifying. The agreement, which is subject to approval by the Federal Energy Regulatory Commission, takes effect June 1, 1987, and should bring in an average of $150 million in annual revenue through the year 2005.

Financial position improves

Our ongoing efforts to improve operating efficiency have been rewarding, especially in power plant operations. Average generating unit availability increased from 60 percent in 1979 to nearly 80 percent in 1986. This performance reduced annual operating costs about $50 million.

We also took advantage of lower interest rates and refinanced more than $210 million of debt during the year. This will save $14 million in annual interest expense.

These and other successful efforts to improve our financial position have enabled us to increase the annual common stock dividend from $1.76 in 1982 to $1.92 in 1986. In February, the Board of Directors again raised the quarterly dividend to 49 cents per share, or $1.96 on an annual basis.

Perry Plant progress

On November 13, 1986, the Nuclear Regulatory Commission (NRC) issued a full-power operating license for Perry Unit 1. The unit moved closer to full commercial operation when, in mid-December, it supplied power to the system for the first time.

As construction at Perry was nearing completion, the Public Utilities Commission of Ohio ordered an independent audit to identify the causes of construction delays and cost increases. In releasing its findings last August, the auditors said the Perry project was well managed. They attributed most of the construction delays and cost increases to factors outside the control of utility company management.

Other concerns about nuclear power plants are often brought up—and must be addressed—as plants approach full operation. The Perry Plant is no exception.

Following an earthquake in northeastern Ohio in January 1986, questions were raised about the possibility of damage to the plant. The NRC conducted a thorough investigation and a congressional subcommittee held a public hearing. Both concluded that the plant did indeed safely withstand the earthquake.

Despite these findings, nearly seven months after the earthquake, Ohio's governor withdrew his support for the Perry emergency evacuation plan. This plan had been developed, tested and approved by the state and had the approval of federal agencies.

In withdrawing his support, the governor cited the accident at the Soviet Union's Chernobyl plant. Even some of the severest critics of nuclear power have conceded that Chernobyl was not built with the margin of safety basic to all U.S. nuclear plants. We believe the extensive safeguards and backup systems built into U.S. plants clearly demonstrate our concern for public safety far beyond what was evident at Chernobyl.

We also believe nuclear power represents a source of energy that must play a growing role in meeting our future energy needs. Oil and natural gas eventually will be in much shorter supply. At some point, nuclear and coal are likely to be the only practical choices for generating the bulk of electric power this country needs to maintain living standards and support future economic growth.

But no new nuclear generating units and only a few coal-fired units have been ordered since 1978. Our nation needs to develop an energy policy that encourages construction of plants to meet future demand and that provides for a reasonable return on investment in those plants. Without it, our industry's continued ability to deliver reliable and economical electric power will be seriously jeopardized.

Staying competitive

Last year I met with many executives who run industrial and commercial businesses in our area. While sharing their concerns for holding down operating costs, improving sales and promoting growth, I assured them that we will never take their business for granted; that we will do everything possible to keep our prices competitive.

The increasing intensity of competition from other energy suppliers is not the only thing that can affect our financial performance. New environmental laws, deregulation, restructuring and diversification could also significantly change our industry over the next few years.

We are prepared to meet these and other challenges without being distracted from our primary objectives: quality service and improved profitability.

Given the considerable achievements of our employees in recent years, I am confident about the future. With our resources, our dedicated people and the continued support of you, our stockholders, we will get the job done.

Justin T. Rogers, Jr.

Justin T. Rogers, Jr.
President

March 1, 1987

Area sales increase

Use of electricity in our service area grew 1.7 percent in 1986, despite lower sales to industrial customers.

Sales to commercial customers showed the largest gain, up 5.6 percent, as retailers and service businesses enjoyed steady growth. Residential sales also grew, by 3.7 percent, mainly from new home construction and higher heating and air-conditioning use.

On July 18, our customers set a new system record for peak energy demand of 4,243 megawatts. The heat and humidity also strained regional supplies of electricity, which was reflected in our sale of 826 megawatts to other utilities.

A 2.5 percent downturn in sales to industrial customers was primarily due to prolonged strikes at facilities of two of our largest steel manufacturing customers. Off-system sales to other utilities fell 15.8 percent as eastern utilities used more of their own oil-fired generation because of depressed oil prices. Also, three generating units placed in service by other utilities supplied additional power to the region. However, long-term contracts secured in 1983 helped us realize $138 million in revenues from off-system sales last year.

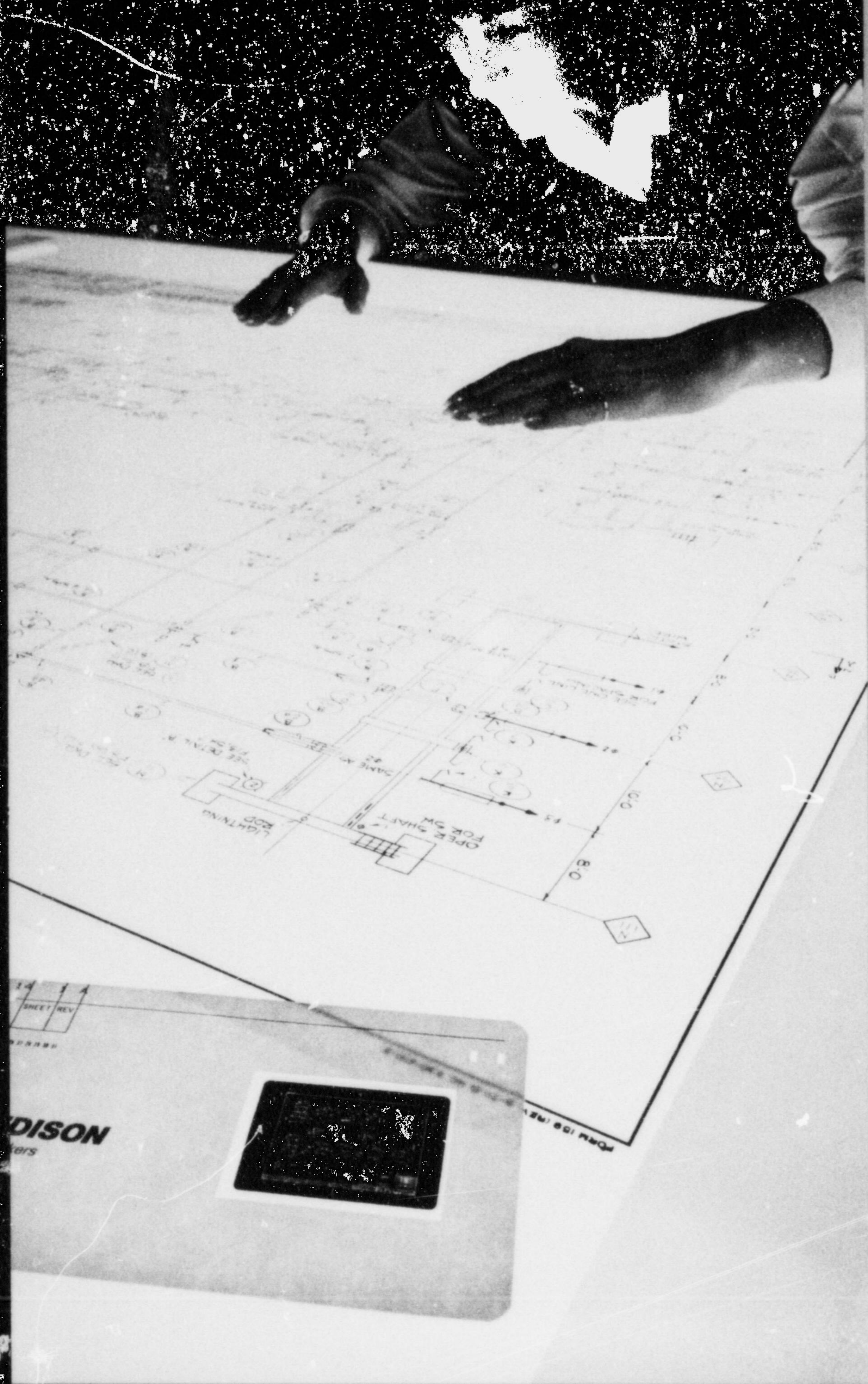
A major new contract, effective June 1, 1987, will assure revenues from off-system sales through the year 2005. The agreement should produce an average of $150 million annually from sales of electricity to the Allegheny Power System for resale to Potomac Electric Power Company, which serves the Washington, D.C., area.

Special programs attract and keep customers

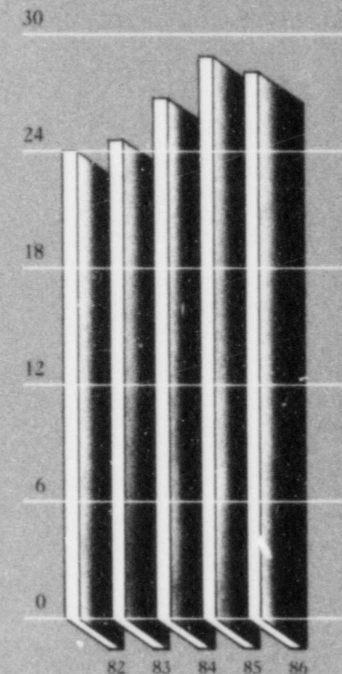
To help steel manufacturers keep prices competitive with foreign suppliers, we offer two special rate options to customers operating electric melting furnaces. In return, these options allow us to interrupt this heavy power demand during the Company's peak

►New technologies have contributed to our improved efficiency and enabled us to generate sources of revenue from nonutility businesses, including microfilm records and fiber optics.

◄A $5.8 million expansion and 200 new jobs qualified Little Tikes Company for special economic development rates, which reduce energy costs for new or growing businesses.



Total Electric Sales
(billions kWh)



demand period if needed for capacity shortfalls, system emergencies or other purposes. This program also helps preserve jobs and the economy in communities where steel plants are located. Thirteen companies signed up for these options in 1986.

Our most successful program is a special five-year price-incentive plan that offers growing businesses significant savings in electricity costs. It has helped persuade 50 companies to build new facilities or expand their operations in our service area. They created more than 2,000 jobs and added $11.4 million to our annual sales revenue. Another 20 companies that qualified to participate in the plan should add 2,000 more jobs and more than $9 million in annual revenue when their facilities are operating.

Expanding home heating sales

In 1986, electric heating was the choice of builders and buyers in 35 percent of new homes in our service area. To gain a larger share of this market, which represents about 5.5 percent of our annual revenues, we have been establishing prices competitive with natural gas and selling the many benefits of electric heating.

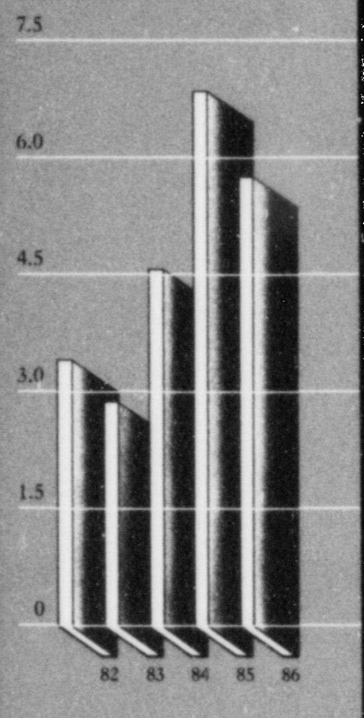
A study conducted in May 1986 showed that annual operating costs of homes with electric baseboard heating and load control were equal to or lower than operating costs of homes heated by gas. A 1985 study showed cost savings for homes with heat pumps and load control over those with gas furnaces and air-conditioning. These studies are helping to convince homeowners that our pricing options make electric heat cost competitive as well as more efficient and comfortable than gas or oil heat.

Customers can also reduce their energy costs with our Power Commander program. In exchange for controllable service, residential and commercial customers receive a reduced electric rate for space and water heating. Interest-free loans are available

►Facilities to develop robotics and train technicians are among the resources available to industrial clients at the Advanced Technologies Center of Lorain County Community College.

◄Kent State University's Liquid Crystal Institute, a leader in the research and application of electronics displays, contributes to our area's high-tech development.

Sales to Other Utilities
(billions kWh)



for load-control systems and electric water heaters that replace gas or oil water heaters.

Trouble-free equipment performance is the goal of our Alternative Plus program, which assures that heat pumps are installed according to the Company's recommended standards. To retain electric heating customers, our Performance Plus program gives customers up to $250 for qualifying repairs and improvements to electric heating systems. Our newest plan, the Heat Pump Performance Check, helps pay for annual service inspections.

Perry Unit 1 licensed

Unit 1 at the Perry Nuclear Power Plant received a full-power license on November 13, 1986, from the Nuclear Regulatory Commission (NRC). With tests continuing at various levels of operation, the unit is expected to reach commercial operation in mid-1987, according to the plant's operator, the Cleveland Electric Illuminating Company.

When Perry Unit 1 reaches the 20 percent generating level, Ohio Edison has been authorized by the Public Utilities Commission of Ohio to begin recovering a portion of the Company's financing costs. Customer bills would increase by about 2 percent, and the new rates would add an estimated $42 million in annual revenue.

In October 1986, the Company withdrew a request for a rate increase that would have primarily covered operating and maintenance expenses, depreciation and taxes for Perry Unit 1. Because of legal and other delays in receiving a full-power operating license, the unit was not expected to be operating at full capacity within the test year approved for the rate case. A new request will be filed in 1987 to recover our investment and operating costs for Perry Unit 1.

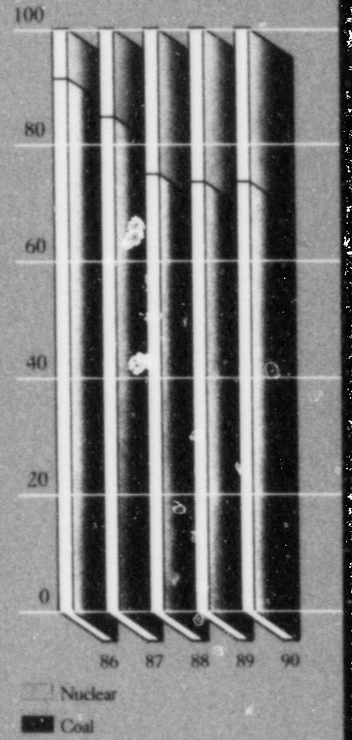
Because of different state regulations, Penn Power has not withdrawn a rate request it filed in June 1986 with the Pennsylvania Public Utility Commission (PPUC). The request

►Perry Unit 1 received its full-power operating license in November 1986 and is undergoing tests that should lead to commercial operation in mid-1987.

◄Customers can reduce energy costs with our Power Commander rate plan, which includes installing radio-receiver units that enable us to control peak demand for electricity.

Sources of Generation

(%)
1986 Actual
1987-1990 Projected



would increase retail electric rates gradually over the next four years. The four equal annual installments would total $70.9 million in annual revenue, reflecting investment and operating costs for Perry Unit 1. However, on February 2, 1987, an administrative law judge recommended a one-time increase of $23.1 million. Penn Power has taken exception with the recommendation and filed a brief with the PPUC.

Ohio Edison and Penn Power own about 35 percent of the 1,205 megawatt Perry Unit 1. Construction of Perry Unit 2 has stopped and all options are being evaluated.

Beaver Valley Unit 2 fuel loading scheduled

Nuclear fuel was delivered to Unit 2 of the Beaver Valley Power Station in September. With major construction and most regulatory reviews completed, fuel is scheduled to be loaded into the reactor in the spring of 1987. In the latest NRC inspection, Beaver Valley Unit 2 received high ratings for safety-related systems and licensing activities. Ohio Edison owns about 42 percent of this 833 megawatt unit, which is being built by Duquesne Light Company.

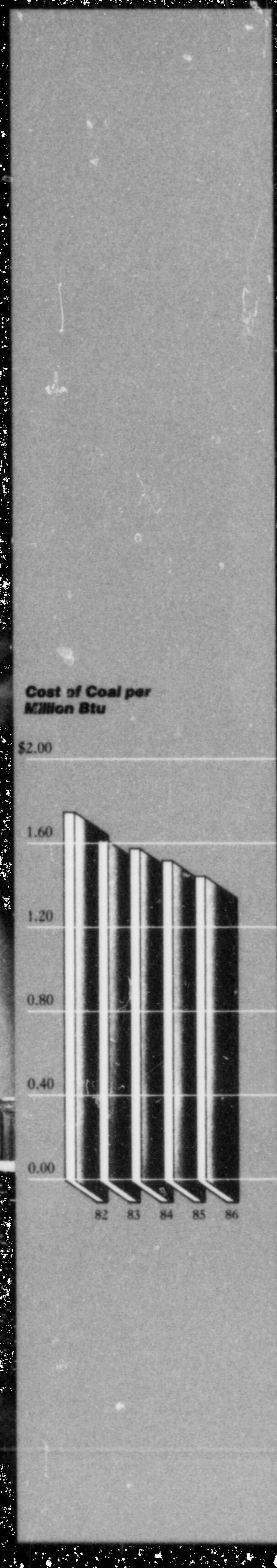
Financing costs reduced

As a result of good earnings performance in recent years, internal financing of construction and system improvements has helped reduce our interest costs. Of the $718 million the Companies raised in 1986 for construction, 33 percent was generated internally. This compares with only 12 percent in 1980. In 1987, we expect internal financing of 32 percent of our $626 million construction budget.

During 1986, we further reduced annual interest costs more than $14 million by replacing some $210 million in high-interest debt with issues at lower rates. We secured our lowest interest rate in nine years by working with a group of Swiss banking institutions. That arrangement, one of the first in

► Centralizing water and coal analyses at a single laboratory has reduced costs for expensive equipment and outside testing, and resulted in greater accuracy.

◄ In a recent survey, nine out of ten customers who experienced a service interruption said that our employees restored service as promptly as possible.


Cost of Coal per Million Btu
$2.00
1.60
1.20
0.80
0.40
0.00
82
83
84
85
86

the country by an electric utility, was completed in May and raised $44 million at an effective rate of 8.6 percent.

Efficiency improves

Aggressive productivity and cost-containment goals continued paying off in 1986. Through improved maintenance programs, redesigned and computer-supported controls and better-trained employees, the generating units we operate achieved nearly 80 percent availability. Improvements made since 1979's availability of just over 60 percent are saving us about $50 million in annual operating costs. Computers and other advanced technology have contributed to more efficient performance in a wide range of other activities as well.

Improved efficiency has also enabled us to use some available resources to earn additional revenue from nonutility business ventures. In just two years, Ohio Edison has secured contracts that have exceeded $573,000 in annual revenue.

We now lease the use of fiber-optic cable along some of our existing transmission and distribution routes to telecommunications companies. Our high-speed computerized bill processing services attracted a major Akron-area company that wanted to improve its cash management. And we've sold services in advanced microfilm processing, environmental consulting, and chemical and metallurgical laboratory analysis.

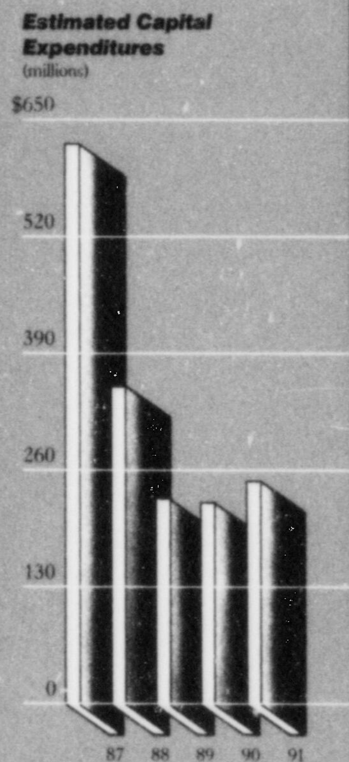
Consolidating some of our operations will help control future costs as well. To reduce the costs of coordinating the local distribution of electricity and repair work, we are combining nine area dispatching offices into one location. This streamlining should lower annual operating costs by about $2 million.

Finding low-cost environmental solutions

We are working on two fronts to achieve cost-effective solutions to environmental

► This silo is for our LIMB project, which is attracting national attention as a test for more economical means of reducing plant sulfur emissions.

◄ Special emphasis on employee safety includes close inspection of about 36,000 insulated gloves each year to make sure they provide reliable protection on the job.


Estimated Capital Expenditures
(millions)
$650
520
390
260
130
0
87
88
89
90
91

problems. The first involves research on new technologies to reduce power-plant emissions. One project, Limestone Injection Multistage Burners (LIMB), reduces sulfur dioxide and nitrogen oxides from power-plant emissions by injecting lime into the boiler and using special burners. The U.S. Department of Energy, U.S. Environmental Protection Agency, state of Ohio, Babcock & Wilcox Company and others have recently expanded LIMB funding from $18 million to $47 million. Success with this and other projects at several of our plants could result in more economical environmental controls and greater use of high-sulfur midwestern coal.

Another environmental project is aimed at reducing the acidity of lakes and streams by treating them with lime. Last year, 15 lakes in the Northeast with high acidic levels received treatments through Living Lakes, Inc. This $20 million program is cosponsored by Ohio Edison, Penn Power and other companies to reduce acidity regardless of the cause and is based on the success of similar work in other countries. The program's goal is to treat about 100 lakes and streams.

Recognizing our commitment to the community

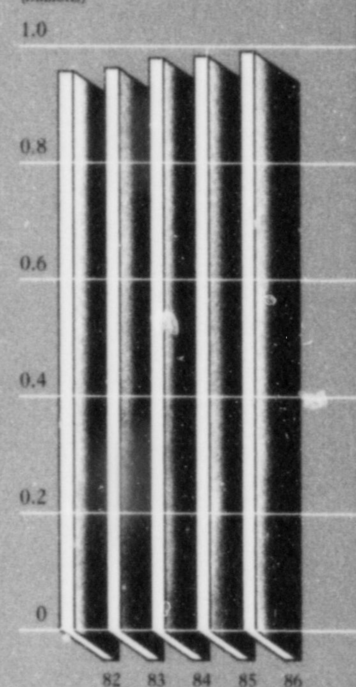
During the year, we continued developing programs that reflect our responsibility to customers, which goes beyond providing reliable service and keeping our product competitively priced.

One example is our Project Reach program, now in its third year. Through 1986, customers and employees made donations, matched by the Companies, raising more than $228,000 to help nearly 4,000 needy families pay a part of their energy bills during the winter months.

To assist the elderly, we introduced our Gatekeeper Program in early 1987. Customer service representatives, meter readers and other employees who have daily contact

► One of the many local volunteer projects created by employees, Adopt-A-Family in our Marion Division provides clothes and toys for the needy at Christmas time.
◄ In service to communities, employees are proud to support volunteer programs like blood drives, donating more than 1,100 pints of blood in 1986.

Customers Served
(millions)



with customers are trained to recognize the special needs of the elderly. An employee who notices that someone may need help contacts the appropriate Area Agency on Aging.

Our CrimeWatch program was expanded in 1986 to give special attention to child safety. CrimeWatch, along with Utility Watch in Pennsylvania, prepares employees to observe and report suspicious activities and emergencies to local police or fire departments. Working with schools, we're letting children know that if they need help, they can get it from our employees.

To help support higher education and the arts, our Matching Gifts Program is matching employee contributions, dollar for dollar, up to $3,000 annually for qualifying educational and cultural institutions. Nearly 75 institutions shared the $14,760 raised in the program's first year.

To help reduce illiteracy and the number of school dropouts — and in the long run improve economic development in our service area — we are leading an effort to enlist local companies in cosponsoring Writing to Read. This program utilizes computers and other educational materials to improve the reading and writing skills of children in kindergarten and elementary school. Children learn how to form words and sentences based on the sounds of individual letters. Ohio Edison is contributing $15,000 to kick off the program.

Beginning in 1986, area educators who develop energy education projects dealing with electricity are eligible for grants of up to $300 from Ohio Edison. The program is designed to support educators who develop innovative energy projects that can be shared by other schools. Thirteen grants were awarded for the 1986-87 school year. Grant winners are selected with help from our Educational Advisory Council, a panel of educators who assist in reviewing and evaluating the nearly 150 free films, booklets and special programs we provide to area schools.

◄ **Child safety activities range from classroom demonstrations to CrimeWatch, which lets children know they can depend on employees if they need to report emergencies.**

Management Report

The consolidated financial statements were prepared by the management of Ohio Edison Company, who take responsibility for their integrity and objectivity. The statements were prepared in conformity with generally accepted accounting principles and are consistent with other financial information appearing elsewhere in this report. Arthur Andersen & Co., independent public accountants, have expressed an opinion on the Company's financial statements, as shown on page 37.

The Company's internal auditors, who are responsible to the Audit Committee of the Board of Directors, review the results and performance of operating units within the Company for adequacy, effectiveness and reliability of accounting and reporting systems, as well as managerial and operating controls.

The Audit Committee consists of four nonemployee directors whose duties include: consideration of the adequacy of the internal controls of the Company and the objectivity of financial reporting; inquiry into the number, extent, adequacy and validity of regular and special audits conducted by independent public accountants and the internal auditors; the recommendation of independent accountants to conduct the normal annual audit and special purpose audits as may be required; and reporting to the Board of Directors the Committee's findings and any recommendation for changes in scope, methods, or procedures of the auditing functions. The Audit Committee held three meetings during 1986.

V. A. Owoc
Executive Vice President
Chief Financial Officer

W. A. Daniels
Comptroller

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

Results of Operations

Operating results for 1986 continued the upward trend of past years. Earnings available for common stock increased by 13.1% over 1985, although a 12.0% increase in the average number of shares of common stock outstanding in 1986 limited the increase in earnings per share to 0.8% and resulted in a slight decline in return on common equity. This increase in earnings occurred, even though the Companies stopped including allowance for funds used during construction (AFUDC) relating to Perry Unit 2 in net income as of July 1, 1985 (see Notes 1 and 7); inclusion of this AFUDC in 1985 and 1984 provided earnings of $.17 and $.26 per share, respectively. In addition, results for 1984 also included a $6,800,000 noncash adjustment to Penn Power's depreciation reserve, which increased earnings per share by $.06.

Operating revenues declined slightly in 1986 due in part to a reduction in the Company's fuel recovery rate. This reduction reflects the Company's continued success in procuring fuel at competitive prices. The following summarizes the sources of the changes in operating revenues during 1986 and 1985:

	1986	1985
	(In millions)	
Sales to Residential, Commercial and Industrial customers:		
Change in kilowatt-hour sales	$ 35.4	$ (11.3)
Increased base rates	34.2	37.8
Change in fuel recovery rates	(59.1)	42.4
Total	10.5	68.9
Provision for revenue refund	(6.5)	—
Sales to utilities	(21.3)	41.9
Sales to all other customers	(0.3)	6.8
Other revenues	4.8	—
Total increase (decrease)	$(12.8)	$117.6

Total kilowatt-hour sales for 1986 were 2.5% lower than 1985. An increase of 1.7% in kilowatt-hour sales to system customers was offset by a 15.8% decrease in sales to other utilities. The increase in kilowatt-hour sales to customers resulted from increases in sales to residential and commercial customers of 3.7% and 5.6%, respectively, offsetting a 2.5% decrease in sales to industrial customers.

On September 25, 1986, a settlement agreement was adopted by the Pennsylvania Public Utility Commission (PPUC) whereby Penn Power is currently making refunds to its customers in connection with certain income taxes normalized in prior years. The effect of this settlement decreased operating revenues and income taxes by $6,547,000 and $7,232,000, respectively, and increased other interest expense by $659,000 resulting in no material effect to net income.

The change in fuel costs during the last two years was attributable to the following factors:

	1986	1985
	(In millions)	
Change in fuel consumption	$(17.0)	$ 49.7
Reduced prices	(21.4)	(10.3)
Difference in net deferred fuel costs	(37.9)	37.0
Total increase (decrease)	$(76.3)	$ 76.4

A refueling outage at Beaver Valley Unit 1 during 1986 was primarily responsible for the increase in maintenance expenses and contributed to the increase in purchased and interchanged power. This contrasts with a decrease in purchased and interchanged power in 1985 when compared to 1984 resulting from an increase in kilowatt-hour generation from the Companies' production facilities in 1985. A reduction of $14,400,000 in pension costs is reflected in other operation expenses for 1986. The reduced pension costs resulted from the Companies' adoption in 1986 of a new pension accounting standard issued by the Financial Accounting Standards Board (FASB). This reduction was in addition to a $6,500,000 reduction in pension costs for 1985 resulting from a change in actuarial assumptions (see Note 1).

The Companies' ongoing construction programs, requiring the continuation of debt financing, resulted in an increase in interest on long-term debt during 1986. Offsetting this increase was a decline in interest on long-term obligations resulting from lower interest rates in 1986. The increase attributable to long-term debt reflects the refinancing of $213,000,000 of long-term debt with an effective annual interest rate of 17.1% and additional borrowings resulting in the issuance of $315,000,000 of new long-term debt with an effective annual interest rate of 10.1%. As the Companies' construction projects proceed and until the projects are placed in service and/or included in rate base, total AFUDC will continue to increase in order to capitalize those financing costs not being recovered through rates.

The electric utility industry is subject to inflationary pressures similar to those experienced by all other industries. To the extent that the Companies incur additional costs or receive benefits resulting from the effects of inflation, it is anticipated that those effects will ultimately be reflected in the Companies' rates.

Capital Resources and Liquidity

Capital requirements in 1986 for the Companies' construction programs, capital leases and nuclear fuel were approximately $776,000,000, of which approximately $422,000,000 was financed externally. Over the last five years these requirements were approximately $4,000,000,000, of which approximately $2,700,000,000 was provided from external sources. The 1987-1991 construction program and capital lease requirements are currently estimated to be $1,700,000,000 (excluding costs of nuclear fuel); additional financing including the issuance of additional common stock and other securities will be necessary to fund a portion of this new construction. The Companies have additional cash requirements of approximately $890,000,000 for the 1987-1991 period to meet maturities of, and sinking fund requirements for, long-term debt, long-term obligations (excluding nuclear fuel), and preferred and preference stock.

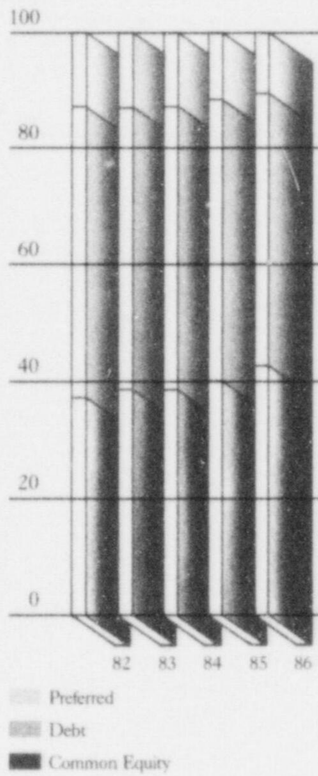
Investments for additional nuclear fuel during the five years 1987-1991 are estimated to be approximately $204,000,000. During that same period, long-term obligations related to nuclear fuel are expected to be reduced by approximately $345,000,000 as the Companies recover such costs through their electric rates.

At December 31, 1986, the Companies had approximately $148,000,000 of cash and temporary cash investments, and approximately $30,000,000 of funds held in escrow from previous pollution control financings. The Companies also have $50,000,000 of short-term bank lines of credit, in addition to a $500,000,000 revolving credit agreement available to the Company, which could be used for interim financing purposes.

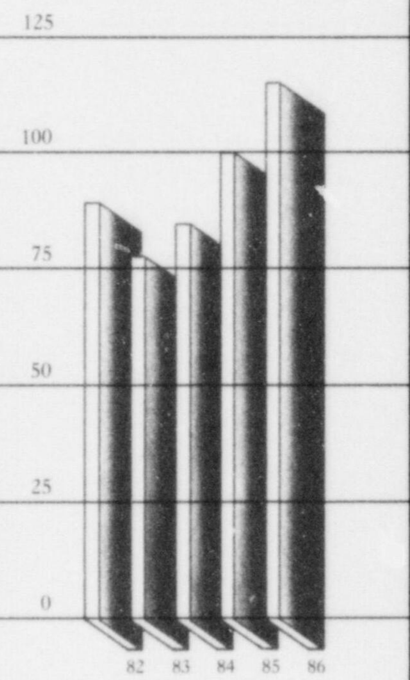
In addition to cash generated internally and available cash resources described above, the Company presently expects to finance its capital needs during 1987 by issuing up to 3,400,000 shares of common stock through the Dividend Reinvestment and Stock Purchase Plan; 5,000,000 additional shares of common stock through public sales; $60,000,000 of preferred stock; and $245,000,000 of long-term debt. The Company is presently exploring the possibility of entering into a sale/leaseback arrangement for a portion of its ownership interest in Perry Unit 1. If the Company proceeds with this arrangement, some or all of this financing may not be needed. Additionally, investments in nuclear fuel of approximately $41,000,000 will be made in 1987 through the incurrence of additional long-term obligations.

Based upon earnings for 1986 and after giving effect to the redemption of $88,300,000 of first mortgage bonds in February 1987, the Company would be permitted, under the

Capitalization
(%)



Ratio of Common Stock Market Price to Book Value
(%)



earnings coverage test contained in its first mortgage indenture, to issue at least $1,071,000,000 principal amount of first mortgage bonds at an assumed interest rate of 10.5%, or under the earnings coverage test contained in its Charter to issue at least $1,308,000,000 of preferred stock at an assumed dividend rate of 10.5%. If it were to issue both first mortgage bonds and preferred stock, some lesser combination of the two would be permitted. The Company is currently able to issue $735,000,000 principal amount of first mortgage bonds against previously retired bonds without the need to meet earnings coverage requirements ($175,000,000 of this amount is reserved for issuance pursuant to the Company's revolving credit agreement referred to above) and $308,000,000 against property additions. If Perry Unit 2 were to be terminated the resulting reduction in property eligible to be pledged would reduce this latter amount to $138,000,000.

Penn Power currently has a rate increase request pending before the PPUC which is designed to produce approximately $70,900,000 in additional annual operating revenues phased in over a four-year period in equal annual installments. On February 2, 1987, the Administrative Law Judge (ALJ) issued his recommended decision to the PPUC in which he recommended a total increase of approximately $23,100,000 (an increase of approximately 13%) to be implemented without the proposed phase-in plan. The ALJ found that the costs incurred in the construction of Perry Unit 1 were reasonable, that no adjustment for imprudence should therefore be made, and that recovery of depreciation expense and operating costs should be allowed. However, a number of other adjustments were recommended, including an adjustment for "excess" capacity by disallowing a common equity return on the portion deemed to be "excess." Penn Power has filed exceptions to the ALJ decision. A PPUC decision is expected in the second quarter of 1987, providing for new rates to become effective upon the commercial operation date of Perry Unit 1, as long as that date is not later than July 17, 1987. If the date is later, Penn Power will either seek an extension for implementing the new rates to coincide with the commercial operation date or file a new rate case. The Company expects to file a rate increase request with the Public Utilities Commission of Ohio to recover its costs for Perry Unit 1 after the unit is in operation.

The Tax Reform Act of 1986 reduced the maximum corporate tax rate from 46% to 34%. The Companies expect that the reduced tax rate will reduce their provision for income taxes that would otherwise have been charged to income in future years. However, the new law repeals the investment tax credit (except for certain transition property), lengthens the tax depreciation lives of certain electric utility property and requires capitalization of construction period interest for all new construction projects. In addition, the law also establishes a new methodology for computing the alternative minimum tax which, in effect, could cause the Companies to pay income tax on the equity portion of AFUDC, which is not taxable income under ordinary circumstances. After giving effect to the reduced rates combined with these other changes, the Companies expect their cash payments for income taxes to increase in the near term from the levels of the past several years. To the extent that alternative minimum tax payments exceed the normal income tax computation, that excess may be carried forward indefinitely as a credit to normal income taxes payable in future years.

The FASB issued an Exposure Draft in 1986 which proposes a change to the accounting for income taxes. If the proposal were adopted, the Companies would be required to write down their net deferred tax balances to reflect the new lower income tax rates. Instead of increasing income due to this potential write down, the Companies would defer these amounts and include them as a reduction to cost of service in future rate proceedings.

Selected Financial Data

	1986	1985	1984	1983	1982
	(In thousands, except per share amounts)				
Operating Revenues	**$1,741,900**	$1,754,749	$1,637,104	$1,515,852	$1,429,626
Operating Income	**392,357**	380,354	342,713	302,751	269,640
Income Before Extraordinary Items	**410,828**	370,685	339,333	272,400	195,571
Net Income	**410,828**	370,685	339,333	272,400	215,729
Earnings on Common Stock	**359,825**	318,073	290,694	227,843	181,496
Earnings per Share of Common Stock (based on weighted average number of shares outstanding during the year)					
Before Extraordinary Items	**2.47**	2.45	2.50	2.22	1.89
Earnings on Common Stock	**2.47**	2.45	2.50	2.22	2.13
Dividends Declared per Share of Common Stock	**1.92**	1.88	1.84	1.80	1.76
Total Assets at December 31	**7,902,704**	7,290,417	6,690,098	5,960,374	5,247,138
Preferred and Preference Stock Subject to Mandatory Redemption	**160,794**	176,694	158,483	158,112	152,560
Long-Term Debt	**2,781,590**	2,691,615	2,449,502	2,132,137	2,005,436
Long-Term Obligations	**859,900**	739,291	822,234	759,843	656,655

Common Stock Data

The Company's Common Stock is listed on the New York and Midwest Stock Exchanges and is traded on other registered exchanges.

Price Range of Common Stock	**1986**		1985	
First Quarter High-Low	**19-7/8**	**15-7/8**	14-7/8	13-1/8
Second Quarter High-Low	**20-3/4**	**17**	15-5/8	14
Third Quarter High-Low	**22-1/2**	**18**	16-1/8	14-3/8
Fourth Quarter High-Low	**21**	**19-1/8**	16-1/2	14-1/2
Yearly High-Low	**22-1/2**	**15-7/8**	16-1/2	13-1/8

Prices are based on reports published in *The Wall Street Journal* for New York Stock Exchange Composite Transactions.

Classification of Holders of Common Stock as of December 31, 1986

	Holders of Record		Shares Held	
	Number	%	Number	%
Individuals	179,548	88.72	55,322,214	36.93
Fiduciaries	19,305	9.54	4,419,299	2.95
Brokers	78	0.04	566,775	0.38
Nominees	288	0.14	86,675,609	57.85
Banks & Financial Institutions	22	0.01	31,814	0.02
Insurance Companies & Other Corporations	1,440	0.71	1,634,904	1.09
Charitable, Religious & Educational Institutions	426	0.21	238,209	0.16
Pensions, Profit Sharing & Other Investment Trusts	1,272	0.63	925,927	0.62
Total	202,379	100.00	149,814,751	100.00

As of January 31, 1987, there were 201,421 holders of 150,313,399 shares of the Company's Common Stock.

Quarterly dividends of 48¢ and 47¢ per share were paid on the Company's Common Stock during 1986 and 1985, respectively. Information regarding retained earnings available for payment of cash dividends is given in Note 4b.

Consolidated Statements of Income

For the Years Ended December 31	**1986**	1985	1984
	(In thousands, except per share amounts)		
Operating Revenues	**$1,741,900**	$1,754,749	$1,637,104
Operating Expenses and Taxes:			
Operation—			
Fuel	**422,830**	499,159	422,805
Purchased and interchanged power, net	**39,388**	30,802	56,659
Other operation expenses	**275,984**	271,142	267,288
Total operation	**738,202**	801,103	746,752
Maintenance	**137,542**	129,295	129,313
Provision for depreciation and amortization	**153,392**	143,377	131,340
General taxes	**143,441**	136,206	136,880
Income taxes	**176,966**	164,414	150,106
Total operating expenses and taxes	**1,349,543**	1,374,395	1,294,391
Operating Income	**392,357**	380,354	342,713
Other Income and Deductions:			
Allowance for equity funds used during construction	**208,360**	176,471	152,567
Miscellaneous, net	**18,666**	27,458	28,928
Income taxes—credit	**89,371**	85,365	82,383
Total other income and deductions	**316,397**	289,294	263,878
Total Income	**708,754**	669,648	606,591
Net Interest and Other Charges:			
Interest on long-term debt	**327,970**	321,017	267,391
Interest on long-term obligations	**65,756**	74,207	89,780
Allowance for borrowed funds used during construction, net of deferred income taxes	**(112,449)**	(111,240)	(104,351)
Other interest expense	**5,438**	4,962	5,473
Subsidiary's preferred stock dividend requirements	**11,211**	10,017	8,965
Net interest and other charges	**297,926**	298,963	267,258
Net Income	**410,828**	370,685	339,333
Preferred and Preference Stock Dividend Requirements	**51,003**	52,612	48,639
Earnings on Common Stock	**$ 359,825**	$ 318,073	$ 290,694
Weighted Average Number of Shares of Common Stock Outstanding	**145,527**	129,926	116,171
Earnings per Share of Common Stock (based on weighted average number of shares outstanding during the year)	**$2.47**	$2.45	$2.50
Dividends Declared per Share of Common Stock	**$1.92**	$1.88	$1.84

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

Consolidated Balance Sheets

At December 31	1986	1985
	(In thousands)	
Assets		
Utility Plant:		
In service, at original cost	$4,370,135	$4,248,800
Less—Accumulated provision for depreciation	1,401,520	1,279,373
	2,968,615	2,969,427
Construction work in progress—		
Electric plant (Note 7)	3,941,558	3,349,998
Nuclear fuel	305,929	289,771
	4,247,487	3,639,769
	7,216,102	6,609,196
Other Property and Investments	9,234	41,104
Current Assets:		
Cash	1,652	2,051
Temporary cash investments, at cost, which approximates market value	146,774	126,382
Receivables—		
Customers (less accumulated provisions of $2,750,000 and $1,319,000, respectively, for uncollectible accounts)	142,304	147,875
Other	30,549	31,722
Materials and supplies, at average cost—		
Fuel	68,719	58,117
Other	50,626	45,953
Prepayments	60,681	50,635
	501,305	462,735
Deferred Charges:		
Deferred fuel costs (Note 7)	4,357	12,741
Property taxes	58,384	56,064
Unamortized costs of terminated construction projects (Note 2)	63,193	73,783
Other	50,129	34,794
	176,063	177,382
	$7,902,704	$7,290,417
Capitalization and Liabilities		
Capitalization (See Consolidated Statements of Capitalization):		
Common stockholders' equity	$2,541,712	$2,234,156
Preferred stock—		
Not subject to mandatory redemption	363,662	376,035
Subject to mandatory redemption	68,000	72,000
Preference stock—		
Not subject to mandatory redemption	50,000	50,000
Subject to mandatory redemption	23,432	34,032
Preferred stock of consolidated subsidiary—		
Not subject to mandatory redemption	41,905	41,905
Subject to mandatory redemption	69,362	70,662
Long-term debt	2,781,590	2,691,615
	5,939,663	5,570,405
Long-Term Obligations:		
Construction energy trust (Note 5)	500,000	400,000
Nuclear fuel (Note 5)	259,696	284,740
Capital leases (Note 3)	100,204	54,551
	859,900	739,291
Current Liabilities:		
Currently payable preferred and preference stock, long-term debt and long-term obligations	158,310	157,543
Notes payable to banks (Note 6)	—	—
Accounts payable	154,221	147,212
Accrued taxes	66,798	55,590
Accrued interest	96,013	94,627
Other	56,300	48,137
	531,642	503,109
Deferred Credits:		
Accumulated deferred income taxes	239,805	181,247
Accumulated deferred investment tax credits	234,105	201,345
Property taxes	58,384	56,064
Fuel costs recovered in advance	19,060	24,618
Other	20,145	14,338
	571,499	477,612
Commitments, Guarantees and Contingencies (Notes 3 and 7)		
	$7,902,704	$7,290,417

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

Consolidated Statements of Capitalization

At December 31	Number of Shares Outstanding 1986	Number of Shares Outstanding 1985	Optional Redemption Price Per Share	Optional Redemption Price Aggregate (In thousands)	1986	1985
					(In thousands)	
Common Stockholders' Equity:						
Common stock, $9 par value, authorized 175,000,000 shares—149,814,751 and 137,089,271 shares outstanding, respectively (Note 4a)					**$1,348,333**	$1,233,804
Other paid-in capital					**722,156**	609,117
Retained earnings (Note 4b)					**471,223**	391,235
Total common stockholders' equity					**2,541,712**	2,234,156
Preferred Stock (Note 4c):						
Cumulative, $100 par value—Authorized 6,000,000 shares						
Not Subject to Mandatory Redemption:						
3.90%-7.24%	973,350	973,350	$103.38-108.00	$102,034	**97,335**	97,335
7.36%-8.20%	800,000	800,000	$104.68-105.35	84,046	**80,000**	80,000
8.64%-9.12%	850,000	850,000	$104.32-106.84	89,806	**85,000**	85,000
Total not subject to mandatory redemption	2,623,350	2,623,350		$275,886	**262,335**	262,335
Subject to Mandatory Redemption (Note 4d):						
10.48%-13.50%	717,290	737,970	$105.24-112.00	$ 76,875	**71,729**	73,797
Redemption within one year					**(3,729)**	(1,797)
Total subject to mandatory redemption					**68,000**	72,000
Cumulative, $25 par value—Authorized 8,000,000 shares						
Not Subject to Mandatory Redemption:						
$3.50 Series	2,000,000	2,000,000	$28.75	$ 57,500	**50,000**	50,000
Series A	53,100	548,000	$25.00	1,327	**1,327**	13,700
Series B	2,000,000	2,000,000	$25.75	51,500	**50,000**	50,000
Total not subject to mandatory redemption	4,053,100	4,548,000		$110,327	**101,327**	113,700
Preference Stock (Note 4c):						
Cumulative, no par value—Authorized 8,000,000 shares						
Not Subject to Mandatory Redemption:						
$3.92 Series	2,000,000	2,000,000	$31.42	$ 62,840	**50,000**	50,000
Subject to Mandatory Redemption (Note 4e):						
$95.00-$102.50 Series	20,700	23,400	$1,044.00-1,070.00	$ 22,009	**20,700**	23,400
$1.80 Series	459,110	981,491	$15.58	7,151	**6,945**	14,845
Redemption within one year					**(4,213)**	(4,213)
Total subject to mandatory redemption	479,810	1,004,891		$ 29,160	**23,432**	34,032
Preferred Stock of Consolidated Subsidiary (Note 4c):						
Cumulative, $100 par value—Authorized 1,200,000 shares						
Not Subject to Mandatory Redemption:						
4.24%-9.16%	419,049	419,049	$102.98-105.20	$ 43,654	**41,905**	41,905
Subject to Mandatory Redemption (Note 4d):						
8.24%-15.00%	706,591	714,528	$103.29-114.23	$ 76,536	**70,659**	71,453
Redemption within one year					**(1,297)**	(791)
Total subject to mandatory redemption					**69,362**	70,662
Long-Term Debt (Note 4f):						
First mortgage bonds:						
Ohio Edison Company—						
7.55% weighted average interest rate, due 1987-1991					**117,116**	198,766
13.21% weighted average interest rate, due 1992-1996					**526,215**	380,215
9.47% weighted average interest rate, due 1997-2001					**166,583**	166,583
8.51% weighted average interest rate, due 2002-2006					**201,918**	201,918
10.99% weighted average interest rate, due 2007-2011					**318,265**	318,265
10.99% weighted average interest rate, due 2012-2016					**142,500**	50,000
					1,472,597	1,315,747
Pennsylvania Power Company—10.25% weighted average interest rate, due 1987-2008					**229,244**	251,622
Total first mortgage bonds					**1,701,841**	1,567,369
Secured notes and obligations:						
Ohio Edison Company—9.93% weighted average interest rate, due 1987-2015					**656,071**	613,125
Amount held by Trustee					**—**	(66,519)
					656,071	546,606
Ohio Edison Finance N.V.—17.25% weighted average interest rate, due 1987					**75,000**	150,000
Pennsylvania Power Company—10.02% weighted average interest rate, due 1988-2015					**134,411**	134,411
Amount held by Trustee					**(2,224)**	(3,592)
					132,187	130,819
Total secured notes and obligations					**863,258**	827,425
Unsecured notes of Ohio Edison Company, 10.59% weighted average interest rate, due 1987-2014					**365,200**	376,000
Amount held by Trustee					**(26,901)**	(48,755)
Total unsecured notes of Ohio Edison Company					**338,299**	327,245
Net unamortized discount on debt					**(20,623)**	(20,343)
Long-term debt due within one year					**(101,185)**	(10,081)
Total long term debt					**2,781,590**	2,691,615
Total Capitalization					**$5,939,663**	$5,570,405

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

Consolidated Statements of Retained Earnings

For the Years Ended December 31	**1986**	1985	1984
		(In thousands)	
Balance at beginning of year	**$391,235**	$317,631	$241,314
Net income	**410,828**	370,685	339,333
	802,063	688,316	580,647
Cash dividends on preferred and preference stock	**50,693**	52,573	49,100
Cash dividends on common stock	**280,147**	244,508	213,916
	330,840	297,081	263,016
Balance at end of year	**$471,223**	$391,235	$317,631

Consolidated Statements of Capital Stock and Other Paid-In Capital

	Common Stock			Preferred and Preference Stock — Not Subject to Mandatory Redemption		Preferred and Preference Stock — Subject to Mandatory Redemption	
	Number of Shares	Par Value	Other Paid-In Capital	Number of Shares	Par or Stated Value	Number of Shares	Par or Stated Value
			(Dollars in thousands)				
Balance, January 1, 1984	108,460,054	$ 976,140	$494,520	7,042,399	$404,240	2,744,254	$161,012
Sale of Common Stock	3,673,400	33,061	13,599	—	—	—	—
Dividend Reinvestment Plan	10,067,071	90,604	23,333	—	—	—	—
Employee Stock Ownership Plan	2,661	24	12	—	—	—	—
Capital Stock Expense	—	—	(2,548)	—	—	—	—
Sale of Series A Class A Preferred Stock	—	—	—	2,050,000	51,250	—	—
Sale of 13.00% Preferred Stock	—	—	—	—	—	100,000	10,000
Conversions and Redemptions—							
$1.80 Series	33,450	301	187	—	—	(33,450)	(506)
$102.50 Series	—	—	—	—	—	(900)	(900)
8.24% Series	—	—	—	—	—	(5,000)	(500)
10.48% Series	—	—	252	—	—	(18,190)	(1,819)
10.76% Series	—	—	218	—	—	(20,000)	(2,000)
11.00% Series	—	—	23	—	—	(4,092)	(409)
Balance, December 31, 1984	122,236,636	1,100,130	529,596	9,092,399	455,490	2,762,622	164,878
Sale of Common Stock	6,076,659	54,690	37,846	—	—	—	—
Dividend Reinvestment Plan	5,102,413	45,922	31,098	—	—	—	—
Capital Stock Expense	—	—	(2,427)	—	—	—	—
Sale of Series B Class A Preferred Stock	—	—	—	2,000,000	50,000	—	—
Sale of 13.50% Preferred Stock	—	—	—	—	—	200,000	20,000
Sale of 11.50% Preferred Stock	—	—	—	—	—	150,000	15,000
Conversions and Redemptions—							
Series A Class A	3,124,160	28,117	9,433	(1,502,000)	(37,550)	—	—
$1.80 Series	549,403	4,945	3,080	—	—	(607,605)	(9,190)
$95.00 Series	—	—	—	—	—	(1,800)	(1,800)
$102.50 Series	—	—	—	—	—	(900)	(900)
8.24% Series	—	—	—	—	—	(5,000)	(500)
10.48% Series	—	—	259	—	—	(18,840)	(1,884)
10.76% Series	—	—	221	—	—	(20,000)	(2,000)
11.00% Series	—	—	11	—	—	(1,088)	(109)
Balance, December 31, 1985	137,089,271	1,233,804	609,117	9,590,399	467,940	2,457,389	183,495
Sale of Common Stock	7,665,704	68,991	71,074	—	—	—	—
Dividend Reinvestment Plan	3,528,014	31,752	37,091	—	—	—	—
Capital Stock Expense	—	—	(1,099)	—	—	—	—
Conversions and Redemptions—							
Series A Class A	1,029,392	9,265	3,108	(494,900)	(12,373)	—	—
$1.80 Series	502,370	4,521	2,853	—	—	(522,381)	(7,900)
$95.00 Series	—	—	—	—	—	(1,800)	(1,800)
$102.50 Series	—	—	—	—	—	(900)	(900)
8.24% Series	—	—	—	—	—	(5,000)	(500)
10.48% Series	—	—	—	—	—	(17,970)	(1,797)
10.76% Series	—	—	11	—	—	(2,710)	(271)
11.00% Series	—	—	1	—	—	(2,937)	(294)
Balance, December 31, 1986	149,814,751	$1,348,333	$722,156	9,095,499	$455,567	1,903,691	$170,033

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

Consolidated Statements of Cash Flow

For the Years Ended December 31	1986	1985	1984
		(In thousands)	
Operating Activities:			
Net Income	**$410,828**	$370,685	$339,333
Principal noncash items—			
Depreciation and amortization	**180,337**	174,107	142,260
Deferred income taxes	**145,183**	97,287	113,551
Investment tax credits, net	**32,764**	55,936	38,026
Provision for revenue refund	**7,206**	—	—
Allowance for equity funds used during construction	**(208,360)**	(176,471)	(152,567)
Deferred fuel costs, net	**2,826**	41,325	4,471
Deferred loss on reacquired debt	**(13,327)**	—	—
Miscellaneous	**6,093**	9,550	552
Net cash provided from operations	**563,550**	572,419	485,626
Dividend Payments:			
Common stock	**280,147**	244,508	213,916
Preferred and preference stock	**50,693**	52,573	49,100
Total cash used for dividends	**330,840**	297,081	263,016
Financing Activities:			
Common stock issued	**228,655**	215,131	161,121
Less: Noncash conversions	**19,747**	45,575	488
Common stock cash proceeds	**208,908**	169,556	160,633
Preferred stock	**—**	85,000	61,250
Long-term debt	**314,344**	212,915	238,000
Long-term obligations	**51,235**	69,124	82,329
Net change in funds held in escrow	**89,995**	123,458	131,653
Miscellaneous	**815**	(2,120)	(2,029)
	665,297	657,933	671,836
Noncash obligations incurred	**(51,235)**	(69,124)	(82,329)
Total cash from new financing	**614,062**	588,809	589,507
Repayments—			
Preferred and preference stock	**25,835**	53,933	6,134
Less: Noncash conversions	**20,273**	46,108	506
Preferred and preference cash repayments	**5,562**	7,825	5,628
Long-term debt	**212,581**	107,590	76,868
Long-term obligations	**25,443**	29,602	15,294
Total cash used for repayments	**243,586**	145,017	97,790
Net cash provided from financing activities	**370,476**	443,792	491,717
Investing Activities:			
Property additions	**776,198**	826,994	868,099
Principal noncash items—			
Allowance for equity funds used during construction	**(208,360)**	(176,471)	(152,567)
Deferred income taxes on allowance for borrowed funds used during construction excluding nuclear fuel	**87,658**	86,310	77,870
Capitalized leases	**(53,050)**	(59,939)	(67,697)
Change in accounts payable	**(1,425)**	34,710	(20,482)
Long-term investments	**(19,500)**	—	—
Miscellaneous	**1,672**	170	3,801
Net cash used for investing activities	**583,193**	711,774	709,024
Net increase in cash and temporary investments	**$ 19,993**	$ 7,356	$ 5,303

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

Consolidated Statements of Taxes

For the Years Ended December 31	1986	1985	1984
		(In thousands)	
General Taxes:			
State gross receipts	**$ 74,253**	$ 71,369	$ 71,044
Real and personal property	**50,006**	47,415	48,717
Social security and unemployment	**13,776**	12,545	12,649
Miscellaneous	**5,406**	4,877	4,470
Total general taxes	**$143,441**	$136,206	$136,880
Provision for Income Taxes:			
Currently payable—			
Federal	**$ 5,569**	$ 19,546	$ 5,778
State	**2,861**	4,382	2,616
Foreign	**65**	214	254
	8,495	24,142	8,648
Deferred, net (see below)—			
Federal	**145,695**	93,585	108,154
State	**(512)**	3,702	5,397
	145,183	97,287	113,551
Investment tax credits, net of amortization	**32,764**	55,936	38,026
Total provision for income taxes	**$186,442**	$177,365	$160,225
Income Statement Classification of Provision for Income Taxes:			
Operating expenses	**$176,966**	$164,414	$150,106
Other income	**(89,371)**	(85,365)	(82,383)
Allowance for borrowed funds used during construction	**98,847**	98,316	92,502
Total provision for income taxes	**$186,442**	$177,365	$160,225
Sources of Deferred Tax Expense:			
Allowance for borrowed funds used during construction, which is credited to plant	**$ 98,847**	$ 98,316	$ 92,502
Excess of tax over book depreciation, net	**66,092**	29,814	25,045
Deferred fuel costs, net	**(1,649)**	(19,055)	(1,805)
Deferred interest on leased nuclear fuel, net	**(11,545)**	(5,488)	(5,824)
Other, net	**(6,562)**	(6,300)	3,633
Net deferred tax expense	**$145,183**	$ 97,287	$113,551
Reconciliation of Federal Income Tax Expense at Statutory Rate to Total Provision for Income Taxes:			
Book income before provision for income taxes	**$597,270**	$548,050	$499,558
Federal income tax expense at statutory rate	**$274,744**	$252,103	$229,797
Increases (reductions) in taxes resulting from—			
Allowance for equity funds used during construction, which does not constitute taxable income	**(95,846)**	(81,177)	(70,181)
Excess of book over tax depreciation	**19,317**	14,534	10,163
Other, net	**(11,773)**	(8,095)	(9,554)
Total provision for income taxes	**$186,442**	$177,365	$160,225

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

Notes to Consolidated Financial Statements

1—Summary of Significant Accounting Policies:

The consolidated financial statements include Ohio Edison Company (Company) and its wholly owned subsidiaries, Pennsylvania Power Company (Penn Power) and Ohio Edison Finance N.V. All significant intercompany transactions have been eliminated. The Company and Penn Power (Companies) follow the accounting policies and practices prescribed by the Public Utilities Commission of Ohio (PUCO), the Pennsylvania Public Utility Commission (PPUC) and the Federal Energy Regulatory Commission (FERC).

Revenues—

The Companies' retail customers are metered on a cycle basis. Revenue is recognized for electric service based on meters read through the end of the month.

Deferred Fuel Costs—

The Company recovers fuel-related costs from its retail customers through an electric fuel component (EFC). The EFC is an estimated fixed rate per kilowatt-hour included on customer bills for a six-month period and is based upon fuel-related costs for the preceding six-month period. Any over or under collection resulting from the operation of the EFC is included as an adjustment to the EFC rate in a subsequent six-month period. Accordingly, the Company defers the difference between actual fuel-related costs incurred and the amounts currently recovered from its customers.

Penn Power recovers fuel costs from its retail customers through an annual "levelized" energy cost rate (ECR). The ECR, which includes adjustment for any over or under collection from customers, is recalculated each year. Accordingly, Penn Power defers the difference between actual energy costs and the amounts currently recovered from its customers. Reference is made to Note 7 with respect to Penn Power's accounting for the cost of coal received from Quarto Mining Company (Quarto).

Utility Plant and Depreciation—

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

The Companies provide for depreciation on a straight-line basis at various rates over the estimated lives of property included in plant in service. The annual composite rates for electric plant were 3.6% in 1986, and 3.5% in 1985 and 1984. The Companies recognize as depreciation expense the estimated decommissioning costs being recovered from their customers applicable to their only nuclear generating unit in service.

Common Ownership of Generating Facilities—

The Companies and other Central Area Power Coordination Group (CAPCO) companies own, as tenants in common, various power generating facilities. Each of the companies is obligated to pay a share of the construction costs of any jointly owned facility in the same proportion as its ownership interest. The Companies' portions of operating expenses associated with these jointly owned facilities are included in the corresponding operating expenses on the Consolidated Statements of Income. The amounts reflected on the Consolidated Balance Sheet under utility plant at December 31, 1986, include the following:

Generating Units	Utility Plant in Service	Accumulated Provision for Depreciation	Construction Work in Progress *(i)*	Companies' Ownership Interest
		(In thousands)		
W. H. Sammis #7	$ 231,400	$ 46,700	$ 1,000	68.80%
Bruce Mansfield #1, #2 and #3	708,800	184,000	1,100	50.68%
Beaver Valley #1 *(ii)*	634,200	169,700	33,000	52.50%
Beaver Valley #2 (Note 5)	—	—	1,598,600	41.88%
Perry #1 and Common Facilities	—	—	1,817,000	35.24%
Perry #2	—	—	399,300	35.24%
Total	$1,574,400	$400,400	$3,850,000	

(i) Excludes nuclear fuel in process which has not yet been assigned to a specific nuclear unit.

(ii) Includes common facilities applicable to Beaver Valley #2.

Nuclear Fuel—

The Companies amortize the cost of nuclear fuel based on the rate of consumption. The Companies' electric rates include amounts for the future disposal of spent nuclear fuel based upon the formula used to compute payments to the United States Department of Energy.

Allowance for Funds Used During Construction (AFUDC)—

AFUDC represents the net financing costs capitalized to construction work in progress during the construction period. AFUDC is not capitalized on that portion of any construction project included in rate base. The borrowed funds portion reflects capitalized interest payments and the equity funds portion represents the noncash capitalization of imputed equity costs which are charged to construction. During 1984 the Company also charged AFUDC to certain projects which were completed but not yet included in rate base, in accordance with a PUCO order. AFUDC varies according to changes in the level of construction work in progress and in the cost of capital. The Companies compute AFUDC utilizing a net of tax rate, which is consistent with the rate treatment. The AFUDC rate related to assets financed only through the incurrence of long-term obligations (see Note 5) is based on actual interest accrued on the obligations during the period. The annual rates used by the Company and Penn Power for all other construction projects approximated 11% and 9.5%, respectively, during the three years ended December 31, 1986.

Income Taxes—

Details of the total provision for income taxes are shown on the Consolidated Statements of Taxes. The deferred income taxes result from timing differences in the recognition of revenues and expenses for tax and accounting purposes.

The Companies allocate the income tax benefit which results from interest expense related to construction work in progress to income taxes–credit included under other income and deductions on the Consolidated Statements of Income.

For income tax purposes, the Companies claim liberalized depreciation and, consistent with the rate treatment, generally provide deferred income taxes. The Companies expect that deferred taxes which have not been provided will be collected from their customers when the taxes become payable, based upon the established rate making practices of the PUCO, the PPUC and the FERC. As of December 31, 1986, the cumulative net income tax timing differences for which deferred income taxes have not been provided were approximately $600,000,000.

Proceeds from the sales of certain tax benefits in accordance with provisions of the Economic Recovery Tax Act of 1981 are being amortized over the life of the related property. Proceeds attributable to investment tax credits were recorded as additional deferred investment tax credits; the remaining amounts were recorded as reductions to utility plant in service.

The Companies defer investment tax credits (ITC) utilized and amortize these credits to income over the estimated life of the related property. The Tax Reform Act of 1986 repealed the ITC effective January 1, 1986, except for certain transition property. As of December 31, 1986, approximately $81,000,000 of unused ITC was available to offset federal income taxes payable for 1987. If the ITC is not utilized for 1987, the amount available to offset federal income taxes payable for years after 1987 would be reduced to $64,000,000 and would expire at the end of 2001.

Retirement Benefits—

The Companies' trusteed, noncontributory defined benefit pension plans cover almost all full-time employees. Upon retirement, employees receive a monthly pension based on length of service and compensation. Prior to July 1, 1985, the Companies funded pension costs accrued using the frozen initial liability actuarial funding method. Effective July 1, 1985, the Companies changed to the projected unit credit method for funding purposes and have not been required to make pension contributions since June 30, 1985. Contributions of $10,300,000 were made during the first six months of 1985. Pension costs in 1985 were reduced by approximately $6,500,000 due primarily to a change from 7.0% to 8.5% in the assumed average annual earnings rate of plan assets and other assumptions.

The Companies adopted the provisions of Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions," as of January 1, 1986. As a result, reported net income for 1986 was approximately $7,800,000 ($.05 per share of common stock) higher than it would have been under the previous accounting standard.

The following sets forth the funded status of the plans and amounts recognized on the Consolidated Balance Sheet at December 31, 1986:

Actuarial present value of benefit obligations:	
Vested benefits	$252,616,000
Nonvested benefits	18,278,000
Accumulated benefit obligation	$270,894,000
Actuarial present value of projected benefit obligation	$356,983,000
Plan assets at fair value	496,464,000
Plan assets in excess of projected benefit obligation	139,481,000
Unrecognized net gain	(26,284,000)
Unrecognized prior service cost	294,000
Unrecognized net transition asset	(113,333,000)
Net pension asset	$ 158,000

The assets of the plans consist primarily of common stocks, United States government bonds and corporate bonds. Net pension cost for 1986 was computed as follows:

Service cost—benefits earned during the period	$13,210,000
Interest on projected benefit obligation	28,371,000
Return on plan assets	(74,424,000)
Deferred return on plan assets	35,666,000
Amortization of transition asset	(7,623,000)
Net pension cost	$ (4,800,000)

The assumed discount rate and rate of increase in future compensation levels used in determining the actuarial present value of the projected benefit obligation were 9% and 7%, respectively. The assumed expected long-term rate of return on plan assets was 9%.

Under the previous pension accounting standard, the Companies' pension costs were $14,986,000 and $20,483,000 in 1985 and 1984, respectively. Of those amounts, $9,829,000 and $14,369,000, respectively, were charged to operating expenses; the balances were charged primarily to construction. Such costs included the amortization of unfunded past service costs on an actuarial basis over 30 years. The actuarial present value of accumulated plan benefits at June 30, 1985, based on an 8% assumed rate of return, totaled $232,364,000, of which $209,898,000 and $22,466,000 represented vested and nonvested benefits, respectively; plan net assets available for benefits at June 30, 1985 were $407,476,000.

The Companies provide a minimum amount of noncontributory life insurance to retired employees in addition to optional contributory insurance features. Health care benefits, which include certain employee deductibles and copayments, are also available to retired employees, their dependents and, under certain circumstances, to their survivors. The Companies pay insurance premiums to cover a portion of these benefits in excess of set limits; all amounts up to the limits are paid by the Companies. Expenses associated with health care and life insurance benefits for retirees amounted to $3,128,000, $3,785,000 and $3,597,000 in 1986, 1985 and 1984, respectively, and are charged to income during the applicable payment periods.

2—Terminated Construction Projects:

In January 1980, the Companies and all other CAPCO companies terminated plans to construct four nuclear generating units. Costs (including settlement of all asserted claims resulting from termination) unrecovered by the Company and Penn Power as of December 31, 1986, applicable to these units amounted to approximately $51,604,000 and $11,589,000, respectively. The Company is recovering these costs from its PUCO jurisdictional customers through an increment to the allowed rate of return in rate cases and Penn Power (and the Company with respect to its FERC jurisdictional customers) is recovering these costs as an operating expense allowance. There is presently an appeal by the Office of Consumer Advocate before the Pennsylvania State Supreme Court regarding Penn Power's recovery of the costs of terminated projects through rates from PPUC jurisdictional customers. Although management cannot predict the outcome of this appeal, it believes the PPUC order permitting recovery of such costs is lawful and should be allowed to stand. The remaining periods of recovery for the Company and Penn Power are approximately 6 and 7 years, respectively. Neither company is earning a return on the unamortized investment. Reference is made to Note 7 with respect to Statement of Financial Accounting Standards No. 90 (SFAS No. 90) in connection with terminated construction projects excluded from rate base.

3—Leases:

The Companies lease a portion of their nuclear fuel requirements, certain transmission facilities, computer equipment, office space and other property and equipment under cancelable and noncancelable leases. Consistent with the regulatory treatment, the rental payments for capital and operating leases are charged to operating expenses on the Consolidated Statements of Income. Such costs for the three years ended December 31, 1986, are summarized as follows:

	1986	1985	1984
		(In thousands)	
Interest on capitalized leases	$ 7,188	$ 9,909	$13,524
Amortization of capital leases	14,687	12,704	15,283
All other leases	10,363	10,764	12,120
Total rental payments	$32,238	$33,377	$40,927

Certain leases entered into prior to January 1, 1983, which would be reflected as capital leases on the Consolidated Balance Sheets, have not yet been capitalized as permitted by Statement of Financial Accounting Standards No. 71. If they had been capitalized, total assets and liabilities would have increased by $23,639,000 and $35,554,000 at December 31, 1986 and 1985, respectively.

The future minimum rental commitments as of December 31, 1986, for leases reported as capital leases and noncancelable operating leases are:

	Capital Leases	Operating Leases
1987	$ 21,777,000	$ 7,612,000
1988	37,771,000	7,072,000
1989	29,019,000	6,693,000
1990	18,030,000	6,465,000
1991	14,775,000	6,172,000
Years thereafter	77,194,000	94,003,000
Total minimum lease payments	$198,566,000	$128,017,000
Executory costs	23,664,000	
Net minimum lease payments	174,902,000	
Interest portion	57,941,000	
Present value of net minimum lease payments	$116,961,000	

4—Capitalization:

(a) Common Stock—

Through the Dividend Reinvestment and Stock Purchase Plan, holders of common, preferred and preference stock can acquire additional shares of the Company's common stock by automatically reinvesting all or a portion of their dividends and by making optional cash payments. Purchases are made at a price equal to 100% of the average closing price for the Company's common stock for each of the five New York Stock Exchange trading days ending on the investment date. At December 31, 1986, the Company had 5,195,721 shares of common stock reserved for issuance under this plan, 1,584,300 shares reserved for issuance under a continuous shelf registration program, 459,110 shares reserved for possible conversion of the $1.80 Preference Stock, 846,448 shares reserved for possible conversion of the Convertible Adjustable Series A Preferred Stock and 497,276 shares reserved for issuance through the payroll-based employee stock ownership plan.

(b) Retained Earnings—

Under the Company's indenture, the Company's consolidated retained earnings unrestricted for payment of cash dividends on the Company's common stock were $399,176,000 at December 31, 1986.

(c) Preferred and Preference Stock—

At the Companies' option, all preferred and preference stock may be redeemed in whole, or in part, at any time upon not less than 30 nor more than 60 days notice, unless otherwise noted. Redemption of all preferred and preference stock issued within the past five years is subject to certain restrictions regarding refunding. The optional redemption prices shown on the Consolidated Statements of Capitalization will decline to eventual minimums per share according to the Charter provisions that establish each series.

The Convertible Adjustable Series A Preferred Stock is convertible into the Company's common stock only during a specified period each quarter and, based upon market price at the time of conversion, is converted to not more than 6.15 shares nor less than 2.08 shares of common stock for each share of preferred stock surrendered for conversion. The Company may, at its option, elect to purchase for cash, in lieu of delivery of common stock, any Convertible Adjustable Series A Preferred Stock surrendered for conversion, subject to certain limitations.

(d) Preferred Stock Subject to Mandatory Redemption—

Annual sinking fund provisions for the Companies' preferred stock, which are retired at $100 per share plus accrued dividends, are as follows:

	Series	Shares	Date	Beginning
Ohio Edison—				
	10.48%	20,000	December 1	(i)
	10.76%	20,000	January 1	(i)
	13.50%	40,000	June 1	1991
Penn Power—				
	8.24%	5,000	December 1	(i)
	11.00%	4,000	January 1	(i)
	15.00%	3,200	July 15	1988
	11.50%	15,000	July 15	1989
	13.00%	5,000	July 1	1990
	11.50%	30,000	September 1	1991
	10.50%	100,000	April 1	2040

(i) Retirements of this series have begun.

The sinking fund requirements for the next five years are:

1987	$5,026,000
1988	5,220,000
1989	6,720,000
1990	7,220,000
1991	14,220,000

(e) Preference Stock Subject to Mandatory Redemption—
The $102.50 Series and $95.00 Series each include provisions for a mandatory sinking fund to retire a minimum of 900 and 1,800 shares, respectively, on July 1 in each year at $1,000 per share plus accrued dividends. The $1.80 Series includes a provision for a mandatory sinking fund to retire a minimum of 100,000 shares on October 1 in each year at $15.125 per share plus accrued dividends. The annual sinking fund requirements are $4,213,000 for 1987 through 1989 and $2,413,000 for 1990 and 1991.

The $1.80 Series is convertible at any time into common stock at a price of $15.125 per share. Holders receive one share of common stock for each share of $1.80 Preference Stock converted, subject to adjustment under certain conditions.

(f) Long-Term Debt—
The mortgages and their supplements, which secure all of the Companies' first mortgage bonds, serve as direct first mortgage liens on substantially all property and franchises, other than specifically excepted property, owned by the Companies.

Based on the amount of bonds authenticated by the Trustees through December 31, 1986, the Companies' annual sinking and improvement fund requirements for all bonds issued under the mortgages amount to $31,131,000. The Company expects to deposit funds in 1987 which will be withdrawn upon the surrender for cancellation of a like principal amount of bonds, which are specifically authenticated for such purposes against unfunded property additions or against previously retired bonds. This method can result in minor increases in the amount of the annual sinking fund requirements. Penn Power expects to satisfy its requirements in 1987 by certifying unfunded property additions at 166-2/3% of the required amount.

As of December 31, 1986, the Companies' sinking fund requirements for certain series of first mortgage bonds and maturing long-term debt for the next five years are:

1987	$101,185,000
1988	96,746,000
1989	74,695,000
1990	119,896,000
1991	82,453,000

The weighted average interest rates shown on the Consolidated Statements of Capitalization relate to long-term debt outstanding at December 31, 1986.

Total secured and unsecured notes outstanding at December 31, 1986 and 1985, exclude $29,125,000 and $1 8,866,000, respectively, of certain pollution control notes, the proceeds of which were then in escrow pending their disbursement for construction of pollution control facilities. The Companies' obligations to repay certain pollution control revenue bonds are secured by several series of first mortgage bonds. A portion of the unsecured notes outstanding are entitled to the benefit of irrevocable bank letters of credit of $213,885,000. To the extent that drawings are made under those letters of credit to pay principal of, or interest on, the pollution control revenue bonds, the Company is entitled to a credit on the notes. The Company pays an annual fee of 5/8% to 7/8% of the amounts of the letters of credit to the issuing banks and is obligated to reimburse the banks for any drawings thereunder.

5—Long-Term Obligations:

Ohio Edison Energy Trust (OEET)—
OEET, which finances part of the Company's investment in Beaver Valley Unit 2, has $500,000,000 of term loans outstanding. The Company has transferred its interest in Beaver Valley Unit 2 (exclusive of common facilities and transmission facilities) to OEET, where the assets are used to secure OEET borrowings. Under recently negotiated amendments, this arrangement has been extended to the earlier of December 31, 1988 or the in-service date of Beaver Valley Unit 2, with amortization of the notes beginning in 1989. The Company presently anticipates payments of $120,000,000 in 1989, $140,000,000 in 1990 and $80,000,000 in 1991.

The Company accrues interest applicable to OEET which is subsequently capitalized, net of income tax effect. The effective average annual interest rates on OEET borrowings were 8.4%, 9.8%, and 11.8% during 1986, 1985 and 1984, respectively.

Nuclear Fuel Financing—
Ohio Edison Fuel Corporation and Pennsylvania Power Fuel Corporation (corporations in which the Companies have no ownership interest) provide funds for the procurement of nuclear fuel on behalf of the Companies. The Companies also participate in arrangements wherein the Central Area Energy Trust (CAET) finances the acquisition of nuclear material that will ultimately be used to fuel various CAPCO

generating units. Under ordinary circumstances, the Companies make payments for the nuclear fuel as it is consumed. Financing on behalf of the Companies of up to $303,000,000 (of which $293,000,000 had been utilized as of December 31, 1986) is currently available through the fuel corporations, either through revolving credit arrangements or the issuance of commercial paper, which is supported by bank letters of credit, or a combination of both. Financing of up to $137,000,000 (of which $85,000,000 had been utilized as of December 31, 1986) is available to CAET on behalf of the Companies, subject to certain limitations.

The Companies accrue interest applicable to the nuclear fuel obligations (for fuel which is not included in utility plant in service) which is subsequently capitalized, net of income tax effect. No direct borrowings have been or are expected to be made against the lines of credit available to the fuel corporations; the fuel corporations have issued and have outstanding commercial paper supported by the lines of credit. To the extent that borrowings are less than the $303,000,000 available under these credit lines, the fuel corporations must pay commitment fees of 1/8% to 1/2% on the available portions of the lines of credit. They also pay fees of 5/8% to 7/8% for the letters of credit on the aggregate amount of outstanding commercial paper. Interest rates on CAET purchase commitments vary from 1-1/8% to 1-1/2% over the interest rate applicable to certain dealer placed commercial paper. The effective average annual interest rates applicable to nuclear fuel obligations were 8.0%, 9.5%, and 11.9% during 1986, 1985 and 1984, respectively.

The Companies presently expect to make payments applicable to these obligations during the next five years as follows:

1987	$31,130,000
1988	33,344,000
1989	35,285,000
1990	33,266,000
1991	39,212,000

6—Bank Lines of Credit and Revolving Credit Agreement:
The Companies have lines of credit with domestic banks that provide for borrowings of up to $50,000,000 at the prevailing prime or similar interest rate. Short-term borrowings may be made under these lines of credit on the Companies' unsecured notes. Penn Power is required to pay commitment fees that vary from 3/8% to 1/2% to assure the availability of its $30,000,000 credit line. All of the Companies' current lines expire December 31, 1987; however, all unused lines may be canceled by the banks.

The Company has a bank revolving credit agreement providing for borrowings of up to $500,000,000. Interest rates on borrowings under the agreement vary depending upon the amount of the current borrowing, total borrowings then outstanding and, at the option of the Company, may be based upon the prevailing prime rate or certain other interest measurements. The Company must pay commitment fees of 1/2% on the average daily unused portion of the credit agreement. In certain circumstances, borrowings under the agreement are required to be secured by the Company's first mortgage bonds. At the Company's option, all obligations outstanding at December 31, 1987, may be converted into an amortizable three-year term loan. The Company has not made any borrowings under this agreement.

7—Commitments, Guarantees and Contingencies:
Construction Program—
The Companies' current budget forecasts reflect expenditures of approximately $1,700,000,000 for property additions and improvements from 1987-1991, of which approximately $626,000,000 is applicable to 1987. These amounts include the capitalization of AFUDC during the construction period only. In addition, the Companies expect to invest approximately $204,000,000 for nuclear fuel during the 1987-1991 period, of which approximately $41,000,000 is applicable to 1987.

Reference is made to "Common Ownership of Generating Facilities" included in Note 1 with respect to the Companies' investments in Beaver Valley Unit 2 and Perry Units 1 and 2, all CAPCO nuclear units. Perry Unit 1 is currently undergoing testing and Beaver Valley Unit 2 is about 98% complete; the status of Perry Unit 2 is discussed below. The Company will be requesting rate recovery for its investments in Perry Unit 1 and Beaver Valley Unit 2, but it cannot predict with any degree of certainty the outcome of the regulatory process.

The CAPCO companies are continuing to review the status of Perry Unit 2. Currently, no significant work is being performed on the unit. As of July 1, 1985, the Companies stopped including AFUDC relating to Unit 2 in net income. Until review of the status of Unit 2 has been completed, there will be no defined schedule for its completion; accordingly, the construction estimates for the 1987-1991 period do not include any amounts applicable to Perry Unit 2 if construction of the unit were to be resumed. Possible alternatives being reviewed with respect to Unit 2 include indefinite suspension of construction on the unit, resumption of work on the unit and termination of the unit. In accordance with the CAPCO arrangements, none of these alternatives may be implemented without the approval of each of the CAPCO companies.

Duquesne Light Company (Duquesne) has claimed a "de facto" abandonment, for rate making purposes, of its 13.74% interest in Perry Unit 2. Duquesne's decision was independently made and does not represent a decision on the part of the Companies to abandon Unit 2 for rate making or any other purposes. Although any future decision on the status of Perry Unit 2 will have to take into account Duquesne's position at the time such a decision is made, the Company does not now know what that position will be and consequently has no way to presently assess its impact.

As of December 31, 1986, the Company and Penn Power had invested approximately $343,500,000 and $55,800,000, respectively, applicable to Perry Unit 2. Delay in the completion of the unit can be expected to increase its total cost by amounts which are not presently determinable. If a decision were made to terminate Unit 2, certain costs which are currently assigned to Unit 2 would be reassigned, where appropriate, to Unit 1. However, cancellation charges payable to contractors and other costs of termination could be incurred. Pending completion of the CAPCO review, the Company is unable to predict whether the construction on Unit 2 will continue or, if continued, on what basis such continuation will proceed.

If construction of Perry Unit 2 is terminated, the Company would seek to recover its investment but cannot now predict whether its investment in Unit 2 applicable to its PUCO jurisdictional customers will be recoverable. If no means of recovery of the costs of Unit 2, in the case of termination, were available to the Company from its PUCO jurisdictional customers and no other basis for recovery could be found or anticipated, the Company would be required to write off the portion of its investment applicable to its PUCO jurisdictional customers. As of December 31, 1986, the Company estimates that the maximum amount of such a write-off would be approximately $210,000,000, net of income tax effect. After giving effect to the final reduction in the maximum corporate income tax rate contained in the Tax Reform Act of 1986, this amount would increase to $220,000,000. The Company does not presently anticipate that a write-off of even this magnitude, if required, would affect its ability to pay common stock dividends at current levels, and studies indicate that the magnitude of any such write-off could be much smaller. If despite its best current information, a much larger write-off were required, depending upon the timing involved, such a write-off could temporarily affect the Company's ability to pay common stock dividends at current levels. Based on their experience to date, the Companies would expect to recover their investments in Unit 2 with respect to their FERC jurisdictional customers if the unit were terminated. Penn Power also believes this should be the case with respect to its PPUC jurisdictional customers, although Penn Power's recovery of the costs of terminated projects through rates is still before the Pennsylvania Supreme Court. Reference is made to SFAS No. 90 discussed below.

Quarto Project—

The Companies, together with the other CAPCO companies, have entered into a long-term coal supply contract with Quarto Mining Company. The CAPCO companies have also agreed to guarantee severally, and not jointly, their proportionate shares of Quarto's debt and lease obligations incurred while developing and equipping the mines. As of December 31, 1986, the Companies' share of the guarantee was $190,526,000.

Under the terms of the coal supply contract, which expires December 31, 1999, the Companies must reimburse Quarto for their shares of the cost of operating the Quarto mines, including those costs associated with mine construction, whether or not they receive coal from Quarto. These payments will permit Quarto, over the life of the contract, to meet the debt and lease obligations it incurred while developing and equipping the mines. The Companies' total payments under this contract, including amounts related to mine construction costs, amounted to $83,106,000, $92,532,000, and $103,464,000 during 1986, 1985 and 1984, respectively. Under the coal supply contract, the Companies' future minimum payments related solely to mine construction costs are:

1987	$ 26,930,000
1988	25,929,000
1989	24,928,000
1990	23,926,000
1991	22,926,000
Years thereafter	151,176,000

Following the end of the development period, Penn Power was ordered by the PPUC to defer recovery of the cost of Quarto coal in excess of generally prevailing market prices. As a result, Penn Power began deferring a portion of the cost of Quarto coal, rather than including such costs in its ECR. As of December 31, 1986, Penn Power's deferred Quarto coal costs amounted to $4,343,000. Although the PPUC issued a subsequent order which found that Penn Power was not imprudent in initiating and continuing the Quarto project, it prescribed a method for recovery of the current cost of Quarto coal and the Quarto coal costs Penn Power had deferred which could result in a substantial underrecovery of Quarto coal costs. Penn Power appealed that order to the Commonwealth Court of Pennsylvania, but the Court upheld the PPUC order. Penn Power's requested review by the Pennsylvania Supreme Court of the Commonwealth Court's decision was denied. Management believes that the ultimate disposition of this matter will not have a material adverse effect upon the Company's consolidated results of operations.

Environmental Matters—

Various federal, state and local authorities regulate the Companies with regard to air and water quality and other environmental matters. The Companies estimate that compliance requires additional capital expenditures of approximately $80,000,000, which is included in the construction estimate given above under "Construction Program" for 1987 through 1991.

On December 5, 1984, the federal Environmental Protection Agency (EPA) denied a petition from the Commonwealth of Pennsylvania and the states of New York and Maine, which sought to force the EPA to make findings under Section 126 of the Clean Air Act. Section 126 provides a remedy for a downwind state that can show adverse impact because air pollution in an upwind state causes nonattainment of air quality standards in the downwind state. The petition complained of excessive particulate and sulfur dioxide (SO_2) emissions from a number of sources in Ohio and other states, including potentially all of the Companies' Ohio plants. Seven northeastern states have appealed the EPA's decision to the U.S. Court of Appeals for the District of Columbia, asking that the decision be reviewed and reversed, modified or set aside. The Company, along with other electric utilities and others, has intervened in the case. The case was argued in December 1985 but a decision has not yet been rendered by the Court. The Company is unable to predict the outcome of these proceedings.

Legislation has been introduced in Congress to address the so-called "acid rain" problem. Various bills introduced would require reductions in SO_2 emissions from utility power plants and other sources located in several states, including Ohio and Pennsylvania. The Company is unable to predict whether legislation will be enacted and, if so, to what extent, if any, the SO_2 emission limits at the Companies' plants would be affected. Substantial changes in the SO_2 emission limits could result in the need for changes in coal supply, significant capital investments in flue gas desulfurization equipment or the closing of some coal-fired generating capacity to assure compliance. If flue gas desulfurization equipment were to be installed on all of their generating units to achieve compliance, a circumstance that may be physically impossible because of space limitations at certain of their plants, the Companies estimate that the capital costs associated with such installation could exceed $1,000,000,000. The Companies expect that any such capital costs, as well as any increased operating costs associated with such equipment, would ultimately be recovered from their customers.

In October 1983, the U.S. Court of Appeals for the District of Columbia reversed several significant portions of the EPA's regulations on the methods used by the EPA to determine the amount of stack height credit for establishing individual source emission limits. In July 1984, the U.S. Supreme Court denied a utility industry request to review the Court of Appeals' decision. On July 8, 1985, the EPA issued new stack height regulations to conform with the court's decision; the new regulations have been appealed to the U.S. Court of Appeals for the District of Columbia by the Companies and others. The Ohio Environmental Protection Agency and the Pennsylvania Department of Environmental Resources must review the emission limits under their respective State Implementation Plans and submit to the EPA for approval any revised limits necessary to conform to the new regulations. Such review could result in more stringent emission limits for some existing plants and increased capital costs and operating expenses. The Companies are studying the regulations and are currently unable to predict their ultimate effect.

Statement of Financial Accounting Standards No. 90—
The Financial Accounting Standards Board (FASB) recently released SFAS No. 90, "Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs." The Statement, which is effective for the Companies January 1, 1988, will require the Companies to reduce the carrying value of the unrecovered costs of four nuclear generating units which were terminated in 1980 (see Note 2) since the unamortized costs are not included in rate base. This adjustment will not have a material adverse effect on the Company's consolidated results of operations. The FASB has indicated that it intends to issue during 1987 a new Exposure Draft of proposed accounting standards to address rate phase-in plans applicable to new generating facilities and possibly other related matters.

8—Summary of Quarterly Financial Data (Unaudited):
The following summarizes certain consolidated operating results for the four quarters of 1986 and 1985.

Three Months Ended	March 31, 1986	June 30, 1986	September 30, 1986	December 31, 1986
	(In thousands, except per share amounts)			
Operating Revenues	$461,451	$421,565	$434,079	$424,805
Operating Expenses and Taxes	347,018	324,394	342,836	335,295
Operating Income	114,433	97,171	91,243	89,510
Other Income and Deductions	74,930	78,459	80,178	82,830
Net Interest and Other Charges	77,162	75,674	74,961	70,129
Net Income	$112,201	$ 99,956	$ 96,460	$102,211
Earnings on Common Stock	$ 98,916	$ 87,106	$ 83,971	$ 89,832
Weighted Average Number of Shares of Common Stock Outstanding	141,221	144,861	147,044	148,981
Earnings per Share of Common Stock	$.70	$.60	$.57	$.60

Three Months Ended	March 31, 1985	June 30, 1985	September 30, 1985	December 31, 1985
	(In thousands, except per share amounts)			
Operating Revenues	$453,354	$418,498	$438,901	$443,996
Operating Expenses and Taxes	353,444	330,808	342,433	347,710
Operating Income	99,910	87,690	96,468	96,286
Other Income and Deductions	72,652	76,583	70,177	69,882
Net Interest and Other Charges	73,780	73,467	76,169	75,547
Net Income	$ 98,782	$ 90,806	$ 90,476	$ 90,621
Earnings on Common Stock	$ 85,866	$ 77,888	$ 77,188	$ 77,131
Weighted Average Number of Shares of Common Stock Outstanding	123,502	127,486	133,026	135,691
Earnings per Share of Common Stock	$.70	$.61	$.58	$.57

Auditors' Report

To the Stockholders and Board of Directors of
Ohio Edison Company:

We have examined the consolidated balance sheets and consolidated statements of capitalization of Ohio Edison Company (an Ohio corporation) and subsidiaries as of December 31, 1986 and 1985, and the related consolidated statements of income, retained earnings, capital stock and other paid-in capital, cash flow and taxes for each of the three years in the period ended December 31, 1986. 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.

Regulatory commissions are examining the impact on customers' rates of nuclear generating units and are raising various concerns, including the level of construction costs of such units and the possible existence of excess generating capacity. These concerns are likely to be addressed by the commissions regulating the Companies with respect to units in which the Companies have an ownership interest. Pennsylvania Power has requested, and the Company will be requesting, recovery for their respective investments in Perry Unit 1 and Beaver Valley Unit 2 in rate proceedings. The outcome of the regulatory process cannot be predicted with any degree of certainty, and accordingly, we are unable to form an opinion as to what extent the Companies' investments will be recoverable.

As discussed in Note 7 to the consolidated financial statements, the continued construction of Perry Unit 2 is currently being reviewed by the CAPCO companies. Possible alternatives being considered include indefinite suspension, resumption of work and termination of the Unit. Because the Company is unable to predict the results of the review, it cannot now predict if construction of Perry Unit 2 will be terminated, and if terminated, whether the investment applicable to its PUCO jurisdictional customers will be recoverable.

In our opinion, subject to the effect on the 1986 and 1985 consolidated financial statements of such adjustments, if any, that might have been required had the outcome of the uncertainties referred to above been known, the financial statements referred to above present fairly the financial position of Ohio Edison Company and subsidiaries as of December 31, 1986 and 1985, and the results of their operations and the statements of cash flow for each of the three years in the period ended December 31, 1986, in conformity with generally accepted accounting principles which, except for the change (with which we concur) in accounting for pension costs (see Note 1), have been applied on a consistent basis.

Arthur Andersen & Co.

ARTHUR ANDERSEN & CO.

New York, N.Y.
February 4, 1987

Consolidated Financial Statistics

	1986	1985	1984	1983	1982	1981	1976
General Financial Information	*(Dollars in thousands, except per share amounts)*						
Total Operating Revenues	**$1,741,900**	$1,754,749	$1,637,104	$1,515,852	$1,429,626	$1,279,649	$ 644,852
Operating Income	**$ 392,357**	$ 380,354	$ 342,713	$ 302,751	$ 269,640	$ 252,381	$ 122,217
Earnings on Common Stock	**$ 359,825**	$ 318,073	$ 290,694	$ 227,843	$ 181,496	$ 163,892	$ 82,777
Ratio of Earnings on Common Stock to Operating Revenues	**20.7%**	18.1%	17.8%	15.0%	12.7%	12.8%	12.8%
Times Interest Earned Before Income Tax	**2.46 x**	2.34 x	2.34 x	2.31 x	2.02 x	2.11 x	2.22 x
Net Utility Plant at December 31	**$7,216,102**	$6,609,196	$5,945,549	$5,206,134	$4,522,733	$3,867,757	$2,115,798
Property Additions	**$ 776,198**	$ 826,994	$ 808,099	$ 771,131	$ 774,233	$ 568,044	$ 325,553
Capitalization at December 31:							
Common Stockholders' Equity	**$2,541,712**	$2,234,156	$1,947,357	$1,711,974	$1,488,371	$1,229,044	$ 635,274
Preferred and Preference Stock Not Subject to Mandatory Redemption	**455,567**	467,940	455,490	404,240	354,240	304,240	261,905
Preferred and Preference Stock Subject to Mandatory Redemption	**160,794**	176,694	158,483	158,112	152,560	151,141	88,000
Long-Term Debt	**2,781,590**	2,691,615	2,449,502	2,132,137	2,005,436	1,759,771	1,087,755
Total Capitalization	**$5,939,563**	$5,570,405	$5,010,832	$4,406,463	$4,000,607	$3,444,196	$2,072,934
Capitalization Ratios at December 31:							
Common Stockholders' Equity	**42.8%**	40.1%	38.9%	38.9%	37.2%	35.7%	30.7%
Preferred and Preference Stock Not Subject to Mandatory Redemption	**7.7**	8.4	9.1	9.1	8.9	8.8	12.6
Preferred and Preference Stock Subject to Mandatory Redemption	**2.7**	3.2	3.1	3.6	3.8	4.4	4.2
Long-Term Debt	**46.8**	48.3	48.9	48.4	50.1	51.1	52.5
Total Capitalization	**100.0%**	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Long-Term Obligations at December 31	**$ 859,900**	$ 739,291	$ 822,234	$ 759,843	$ 656,655	$ 447,484	$ —
Cost of Preferred and Preference Stock Outstanding at December 31	**9.66%**	10.00%	9.87%	9.63%	9.17%	8.37%	7.84%
Cost of Long-Term Debt Outstanding at December 31	**11.05%**	11.45%	11.52%	10.82%	10.69%	9.99%	7.50%
Common Stock Data							
Earnings per Average Common Share	**$2.47**	$2.45	$2.50	$2.22	$2.13	$2.30	$2.14
Return on Average Common Equity	**14.9%**	15.2%	15.9%	14.2%	13.5%	14.6%	14.0%
Dividends Paid per Share	**$1.92**	$1.88	$1.84	$1.80	$1.76	$1.76	$1.67
Common Stock Dividend Payout Ratio	**78%**	77%	74%	81%	83%	77%	78%
Common Stock Dividend Yield at December 31	**9.8%**	11.5%	13.6%	14.7%	12.6%	15.1%	8.1%
Price/Earnings Ratio at December 31	**7.9**	6.7	5.4	5.5	6.6	5.1	9.8
Shares of Common Stock Outstanding at December 31 (000)	**149,815**	137,089	122,237	108,460	96,082	78,676	39,856
Book Value per Common Share at December 31	**$16.97**	$16.30	$15.93	$15.78	$15.49	$15.62	$15.94
Market Price per Common Share at December 31	**$19.50**	$16.375	$13.50	$12.25	$14.00	$11.625	$20.875
Ratio of Market Price to Book Value per Share at December 31	**115%**	100%	85%	78%	90%	74%	131%

Consolidated Operating Statistics

	1986	1985	1984	1983	1982	1981	1976
Revenue From Electric Sales *(Thousands)*:							
Residential	**$ 615,262**	$ 600,481	$ 571,878	$ 540,167	$ 497,941	$ 442,267	$232,433
Commercial	**449,590**	433,445	400,291	385,277	356,325	308,599	155,572
Industrial	**449,392**	476,257	469,112	421,736	383,535	381,162	195,311
Other	**64,345**	64,708	57,921	69,278	67,828	53,993	31,013
Subtotal	**1,578,589**	1,574,891	1,499,202	1,416,458	1,305,629	1,186,021	614,329
Sales to Utilities	**137,994**	159,262	117,385	76,220	101,688	73,966	6,749
Total	**$1,716,583**	$1,734,153	$1,616,587	$1,492,678	$1,407,317	$1,259,987	$621,078
Revenue From Electric Sales—%:							
Residential	**35.8%**	34.6%	35.4%	36.2%	35.4%	35.1%	37.4%
Commercial	**26.2**	25.0	24.7	25.8	25.3	24.5	25.1
Industrial	**26.2**	27.5	29.0	28.3	27.3	30.2	31.4
Other	**3.8**	3.7	3.6	4.6	4.8	4.3	5.0
Subtotal	**92.0**	90.8	92.7	94.9	92.8	94.1	98.9
Sales to Utilities	**8.0**	9.2	7.3	5.1	7.2	5.9	1.1
Total	**100.0%**	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Kilowatt-Hour Sales *(Millions)*:							
Residential	**7,046**	6,791	6,836	6,735	6,733	6,747	6,024
Commercial	**5,560**	5,266	5,101	5,096	4,996	4,917	4,358
Industrial	**8,533**	8,751	9,161	8,386	7,708	9,352	9,262
Other	**1,192**	1,149	1,075	1,211	1,227	1,181	1,171
Subtotal	**22,331**	21,957	22,173	21,428	20,664	22,197	20,815
Sales to Utilities	**5,835**	6,929	4,591	2,917	3,361	2,465	387
Total	**28,166**	28,886	26,764	24,345	24,025	24,662	21,202
Customers Served at December 31:							
Residential	**894,164**	888,107	885,376	878,949	873,877	872,303	824,851
Commercial	**97,383**	96,048	90,810	90,072	89,706	89,231	85,512
Industrial	**2,239**	2,021	1,757	1,003	1,048	1,068	1,111
Other	**802**	892	721	736	724	711	681
Total	**994,588**	987,068	978,664	970,730	965,355	963,313	912,155
Average Annual Residential kWh Usage	**7,924**	7,682	7,762	7,695	7,723	7,760	7,361
Average Residential Price per kWh	**8.73¢**	8.84¢	8.37¢	8.02¢	7.40¢	6.56¢	3.86¢
Cost of Coal per Million Btu	**$1.44**	$1.53	$1.59	$1.62	$1.75	$1.81	$0.93
Generating Capability at December 31:							
Coal	**89.1%**	89.1%	89.1%	89.2%	86.2%	86.3%	87.8%
Oil	**3.0**	3.0	3.0	3.0	6.3	6.2	8.3
Nuclear	**7.9**	7.9	7.9	7.8	7.5	7.5	3.9
Total	**100.0%**	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Sources of Electric Generation:							
Coal	**91.0%**	89.3%	90.4%	89.8%	93.8%	89.9%	94.4%
Oil	**—**	—	—	—	0.1	0.2	4.9
Nuclear	**9.0**	10.7	9.6	10.2	6.1	9.9	0.7
Total	**100.0%**	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Peak Load—Megawatts	**4,243**	4,084	4,093	4,148	4,073	4,148	3,817
Number of Employees at December 31	**7,383**	7,496	7,611	7,702	7,885	7,669	6,241

Stockholder Information

Stockholder Profile

At year end, 202,379 stockholders owned 149.8 million shares of Ohio Edison common stock. Approximately 30 percent are women, 25 percent are men and 34 percent are joint holders. The remaining 11 percent represents trusts, corporations, institutions, brokers and other investment groups.

Nearly 67 percent of common stockholders own less than 300 shares. They live in all 50 states and many foreign countries.

Dividend and Tax Information

Effective the first quarter of 1987, the Company's Board of Directors increased the quarterly common stock dividend to 49 cents per share, or $1.96 on an annual basis. For each quarter of 1986, the Board declared common stock dividends of 48 cents per share.

All common, preferred and preference stock dividends paid in 1986 were taxable for federal income tax purposes. The Tax Reform Act of 1986 has made major changes to the federal tax laws, some of which may be of particular interest to stockholders.

Effective January 1, 1987, the Act terminates the lower tax rate that the tax law had granted to long-term capital gains. So after 1986, long-term capital gains are taxed at the same rates as ordinary income. Also, the $100/$200 dividend exclusion has been eliminated starting with the tax year 1987.

For information regarding these matters, plus the many other changes that may affect your tax situation, we suggest that you consult a tax advisor.

Dividend Reinvestment Plan

By the end of the year, 66,745 stockholders, representing 30 percent of all stockholders, were enrolled in the Company's Dividend Reinvestment and Stock Purchase Plan. They reinvested $51.3 million in dividends and made optional cash payments of $17.5 million to acquire 3.5 million shares of common stock in 1986.

Annual Meeting of Stockholders

Stockholders are invited to attend the 1987 Annual Meeting on Thursday, April 30, at 10 a.m. in the Company's General Office auditorium in Akron, Ohio. Those not attending can vote on the items of business by filling out and returning the proxy card mailed to each stockholder approximately 30 days before the meeting.

Contacting Stockholder Services

For the convenience of stockholders, the Company has toll-free telephone numbers to provide information and assistance. Stockholders are encouraged to call 1-800-321-0468 in Ohio, or 1-800-633-4766 outside Ohio, on Monday through Friday, except holidays, from 8:00 a.m. to 4:30 p.m., eastern time. Callers in the Akron area and in foreign countries should use (216) 384-5509. When calling, please ask for Stockholder Services.

Stockholders may also write directly to Stockholder Services, Ohio Edison Company, 76 South Main Street, Akron, Ohio 44308.

Additional Information

Ohio Edison Company common stock is listed on the New York and Midwest stock exchanges and traded on other registered exchanges under the "OEC" ticker symbol. Newspapers generally use the symbol "OhioEd" in stock listings.

Form 10-K, the 1986 Annual Report to the Securities and Exchange Commission, will be sent without charge to stockholders upon request. For a copy, please write to Gregory F. LaFlame, Secretary, Ohio Edison Company, 76 South Main Street, Akron, Ohio 44308.

Transfer Agent:

Ohio Edison Company
76 South Main Street, Akron, Ohio 44308
Attention Transfer Agent

Registrar:

National City Bank, Akron
One Cascade Plaza, Akron, Ohio 44308

Ohio Edison Directors and Management

Board of Directors

Donald C. Blasius
Chairman and Chief Executive Officer of WCI Home Products Group, White Consolidated Industries, Inc., Columbus, Ohio (air conditioners, kitchen appliances, laundry products and kitchen cabinets). Member, Nominating Committee, Finance Committee.

Dr. Lucille G. Ford
Vice President for Academic Affairs, Ashland College, Ashland, Ohio. Chairman, Nominating Committee; Member, Finance Committee.

Robert L. Loughhead
Chairman of the Board, President and Chief Executive Officer of Weirton Steel Corporation, Weirton, West Virginia (steel products). Chairman, Compensation Committee; Member, Audit Committee.

Glenn H. Meadows
President and Chief Executive Officer of McNeil (Ohio) Corporation, Akron, Ohio (various manufactured products). Member, Compensation Committee, Audit Committee.

William R. Miller
Retired, formerly Vice President of Governmental Personnel Relations, The Goodyear Tire and Rubber Company, Akron, Ohio (rubber and related products). Member, Compensation Committee.

John Nelson
Chairman of the Board and Chief Executive Officer of Commercial Shearing, Inc., Youngstown, Ohio (engineered metal components). Member, Compensation Committee.

Victor A. Owoc
Executive Vice President of Ohio Edison. Member, Finance Committee.

Justin T. Rogers, Jr.
President of Ohio Edison and Chairman of the Board of its subsidiary, Pennsylvania Power. Chairman, Finance Committee; Member, Nominating Committee.

Douglas W. Tschappat
Executive Vice President of Ohio Edison.

Frank C. Watson
President of The Youngstown Welding and Engineering Company, Youngstown, Ohio (nonferrous alloys). Chairman, Audit Committee; Member, Nominating Committee.

William C. Zekan
Chairman of the Board and President of A. Schulman, Inc., Akron, Ohio (custom plastic compounds). Member, Audit Committee.

Director Emeritus

Fred H. Zuck

Officers

Justin T. Rogers, Jr.
President

Victor A. Owoc
Executive Vice President

Douglas W. Tschappat
Executive Vice President

Lynn Firestone
Senior Vice President

David R. Gundry
Senior Vice President

Robert J. McWhorter
Senior Vice President

Russell J. Spetrino
Vice President and General Counsel

Ronald D. Best
Vice President

H. Peter Burg
Vice President

Frank E. Derry
Vice President

John A. Gill
Vice President

James D. Wilson
Vice President

David L. Yeager
Vice President

Mark T. Clark
Treasurer

William A. Daniels
Comptroller

Gregory F. LaFlame
Secretary

Warren G. Fouch
Assistant Comptroller

Joanne Martin
Assistant Secretary

Theodore F. Struck, II
Assistant Treasurer

Harvey L. Wagner
Assistant Comptroller

Division Managers

Anthony N. Gorant
Akron Division

Gary M. Stair
Bay Division

James E. Markle
Lake Erie Division

Malcolm E. Cash
Mansfield Division

Robert L. Kensinger
Marion Division

N. Rod Monahan
Springfield Division

Robert E. Dawson
Stark Division

David C. Bixler, Jr.
Warren Division

Peter A. Fetterolf
Youngstown Division

OHIO**EDISON**
The Energy Makers

76 South Main Street
Akron, Ohio 44308

Bulk Rate
U.S. Postage
PAID
Akron, Ohio
Permit No. 561

Annual Report 1986