Blazing a Trail Through the Competitive Wilderness

1999 Annual Report

Allegheny Electric Cooperative, Inc.

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About Allegheny Electric Cooperative, Inc.

Allegheny Electric Cooperative, Inc. provides wholesale power to 14 electric distribution cooperatives in Pennsylvania and New Jersey. Allegheny's member cooperatives, in turn, provide electricity to more than 200,000 meters, representing 600,000 ultimate consumers.

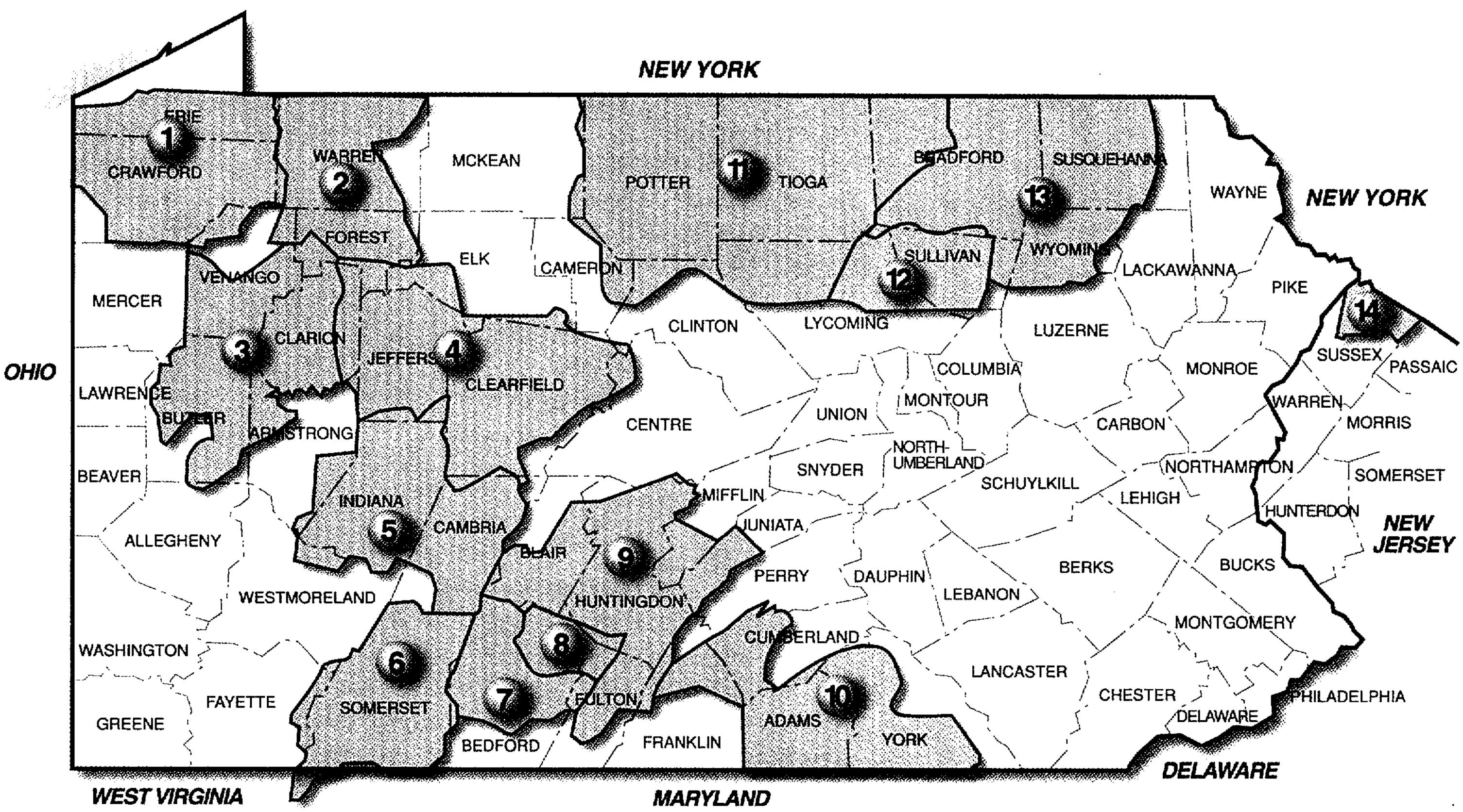
Allegheny is owned and controlled by the 14 distribution cooperatives, which govern its activities. Each member cooperative has one seat on Allegheny's board, ensuring that Allegheny's actions best serve the consumers who depend on the cooperatives for electricity.

Allegheny's member cooperatives own and maintain approximately 12.5 percent of the electric distribution lines in Pennsylvania, covering nearly one-third of the state's land area in 41 counties. These lines, an essential component of business and industry, represent one of the Commonwealth's largest non-governmental investments in rural infrastructure.

Allegheny also provides wholesale power to American Cooperative Services, a cooperative, state-licensed electric generation supplier that sells electricity to retail consumers in Pennsylvania.

Starting in 1997 and continuing through 1999, Allegheny has hosted the "Pennsylvania Project," an initiative of the Alliance for Cooperative Energy Services (ACES). Made up of Allegheny's fellow generation and transmission (G&T) cooperatives, ACES is investigating ways to better coordinate existing resources.

Five ACES-member G&Ts provided Allegheny with financial and staff resources to learn — from scratch — how to prepare their systems for electric competition. The help received from Buckeye Power, based in Columbus, Ohio; East Kentucky Power Cooperative, based in Winchester, Ky.; Hoosier Energy REC, headquartered in Bloomington, Ind.; Raleigh, N.C.-based North Carolina Electric Membership Corporation; and Columbia, S.C.-based Central Electric Power Cooperative has proved invaluable. Allegheny and our member cooperatives express heartfelt gratitude and thanks to these G&Ts for their assistance.



1 Northwestern Rural Electric Cooperative Association, Inc.
2 Warren Electric Cooperative, Inc.
3 Central Electric Cooperative, Inc.
4 United Electric Cooperative, Inc.
5 Southwest Central Rural Electric Cooperative Corporation
6 Somerset Rural Electric Cooperative, Inc.
7 Bedford Rural Electric Cooperative, Inc.
8 New Enterprise Rural Electric Cooperative, Inc.
9 Valley Rural Electric Cooperative, Inc.
10 Adams Electric Cooperative, Inc.
11 Tri-County Rural Electric Cooperative, Inc.
12 Sullivan County Rural Electric Cooperative, Inc.
13 Claverack Rural Electric Cooperative, Inc.
14 Sussex Rural Electric Cooperative, Inc.

A Message From The Chairman & President and CEO

In the unexplored wilderness of electric competition, Allegheny Electric Cooperative, Inc. (Allegheny) is a trailblazer. Through our position as the wholesale power supplier to electric distribution cooperatives in Pennsylvania and New Jersey — two states at the forefront of establishing competitive retail power markets — we have opened a pathway to success that electric co-ops across the nation will soon travel.

Following the enactment of Pennsylvania's Electricity Generation Customer Choice and Competition Act (Act 138) in December 1996 (New Jersey's electric competition law was signed in February 1999), we identified three things that had to be done to prepare Allegheny and our sister service organization, the Pennsylvania Rural Electric Association (PREA), for the new utility environment —reshape the organizations, build mechanisms to compete on the open market and restructure Allegheny's debt. Accomplishing them proved a herculean undertaking by all involved — from the Allegheny and PREA boards of directors and staff to local co-op directors and general managers. Each initiative required full member support to implement.

On reorganization, Allegheny and PREA look very different than they did two years ago. We've cut our overhead costs 50 percent and staff 40 percent. Allegheny rates have dropped 22 percent from their high point in 1992 — our wholesale rates are now at their lowest level since 1985.

The vehicle we developed to compete on the open market is American Cooperative Services (American) — the retail generation supply affiliate of Allegheny and member co-ops. In just a little over a year of operation, American has acquired more than 70 megawatts of private power company load, making it larger than most Allegheny member distribution cooperatives, individually. This growth is on target with projections.

On debt restructuring, we adopted several strategies that have allowed us to offer a competitive rate for power while maintaining control over all our generation assets — a critical element in a competitive world. Thanks to success in these three areas, we have opened up new opportunities that were not available to us previously. Most importantly, we have developed the flexibility to adapt quickly to market changes.

In an era of deregulation, it is also critically important for cooperatives to work together and maintain ties to legislators and regulators. Our success in this arena was evident during 1999 when Pennsylvania Gov. Tom Ridge, a champion of electric competition, addressed nearly 1,000 electric co-op representatives from 14 New England, Mid-Atlantic and Midwest states on September 8 in Pittsburgh, Pa. The Governor specifically thanked PREA, Allegheny and our member electric cooperatives for supporting passage of Act 138 — a law, he noted, that had put nearly $1 billion back into the pockets of Keystone State consumers.

The year also saw us resolve a dispute with GPU Energy, a private power company, over "phantom power" stemming from customer choice pilot programs conducted by two of our member distribution co-ops. GPU Energy contended that, under a 1993 power contract with Allegheny, it was entitled to bill Allegheny for electricity provided by electric generation suppliers (EGSs) to co-op consumers under retail competition.

In March, Allegheny challenged the practice before the Federal Energy Regulatory Commission. After months of negotiations, GPU agreed to refund all phantom power amounts charged during the pilots and discontinue the practice.

Also during the year, GPU agreed to dedicate funds to fix Allegheny-identified delivery point problem areas and to develop reliability standards as part of its Pennsylvania Public Utility Commission-facilitated restructuring plan for moving into a competitive utility marketplace.

Most of the power used by cooperative consumers in Pennsylvania is delivered to cooperative distribution systems across GPU Energy lines. But wear and tear on these lines has resulted in an unacceptably high number of outages in some cooperative service areas.

To solve the problem, GPU Energy will spend $49 million over an 11-year period to repair poles and wires, as well as maintain GPU facilities that serve points where cooperative power is delivered. Allegheny and its members play will a central role in this effort by identifying problem areas and directing where GPU improvements are made.

Work on the projects, however, couldn't begin until co-ops and GPU settled on reliability standards that should promise fewer outages. The standards we negotiated with GPU take into account the nature of each service region, delivery voltage and number and duration of outages. Absolute reliability standards were developed for various delivery points served by GPU, while average reliability standards were created for each of GPU's eight customer operation centers that interface with cooperative facilities.

When applied to actual outage data, the standards result in GPU having to perform root-cause analyses on transmission lines and circuits serving 26 delivery points. Those 26 delivery points accounted for 72 percent of all cooperative consumer-member hours of power supply-related service interruptions.

In October, Allegheny's efforts to ensure that our computer systems and operations were Year 2000 (Y2K) ready received a stamp of approval from the federal government. That's when two consultants from the North American Electric Reliability Council (NERC), on behalf of the U.S. Department of Energy, conducted a Y2K inspection of our offices in Harrisburg, Pa.

Their conclusion — Allegheny was not only Y2K compliant, but had put together one of the best plans seen for dealing with computer glitches that could arise from the date change to January 1, 2000.

The visit was aimed at verifying Y2K information that electric utilities were voluntarily supplying NERC — information that NERC in turn used to update Energy Department officials on the Y2K status of the electric industry. Allegheny was one of a handful of U.S. utilities randomly chosen to participate in the review.

The NERC consultants praised our "excellent documentation of related planning, excellent allocation of internal and external resources, correct reporting of Y2K compliance prior to the NERC due date of June 30, 1999, coordination of planning with the Pennsylvania Emergency Management Agency, a well organized and thorough inventory of equipment, and early identification of business versus mission critical systems."

When the evaluation was complete, Allegheny received a Level 3 on NERC's Y2K risk-rating scale — the best possible score.

As the competitive electric market evolves, we envision that generation and transmission cooperatives like Allegheny will need to integrate operations to reduce risk and costs — in essence, to become more efficient and effective. This process may lead some to question whether electric cooperatives can really compete.

Here at Allegheny, we feel such concerns are like a tree branch hitting an electric line on a windy night — "blips" that will pass. As a trailblazer, we can with confidence tell rural consumers that we have taken the steps necessary to ensure that electric cooperatives will be there for them during the transition from a monopoly to an open electricity market. The road to a competitive future is now clear.

From left to right: Alston A. Teeter, Chairman of the Board and Frank M. Betley, President and CEO

The State of Competition In Pennsylvania and New Jersey

When Gov. Tom Ridge signed Pennsylvania's Electricity Generation Customer Choice and Competition Act (Act 138) into law on December 3, 1996, the Keystone State became the fourth in the nation to deregulate its electric utility industry. Since then, a total of 22 states have adopted electric competition laws, while several others are promoting "power shopping" through regulation.

But Pennsylvania — by every measure — has become the nation's leader in creating a robust retail electricity market. During the first year of retail access in the state (competitive supplies of power began flowing on January 1, 1999), a total of 507,058 private power company customers switched to an alternate electric generation supplier (EGSs), according to data released by the Pennsylvania Office of Consumer Advocate.

In all, 408,414 residential, 94,188 commercial and 4,456 industrial consumers bought power from new suppliers, saving more than $1 billion.

EGS-served load totaled close to 7,500 megawatts, with 934 megawatts of that amount being residential, 3,062 megawatts commercial and 3,492 megawatts industrial. Outside suppliers were serving roughly 42 percent of all GPU Energy load, 39 percent of PECO Energy load, 24 percent of Duquesne Light load, 20 percent of PPL Utilities load, 19 percent of Penn Power load and 13 percent of Allegheny Power load.

Reflecting higher price-to-compare credits available, 17 percent of PECO Energy and nearly 14 percent of Duquesne Light residential customers had changed suppliers, with the residential tally falling off dramatically for the other major private power companies.

Out of the state's seven large power companies, GPU Energy and UGI had all of their load enrolled in competition during 1999. Allegheny Power, Duquesne Light and PECO Energy had two-thirds and Penn Power, one-third, of customers in all classes eligible to shop. PPL Utilities had 100 percent of its residential and two-thirds of its commercial and industrial customers phased in for choice.

While all electric co-op consumer-members were eligible to shop for power, no EGSs marketed in co-op service territories during the year (see sidebar).

In New Jersey, Garden State legislators on January 28 approved the first electric utility competition law in the nation that also opened up the state's natural gas business to competition at the same time. The 123-page bill, which leaves most implementation

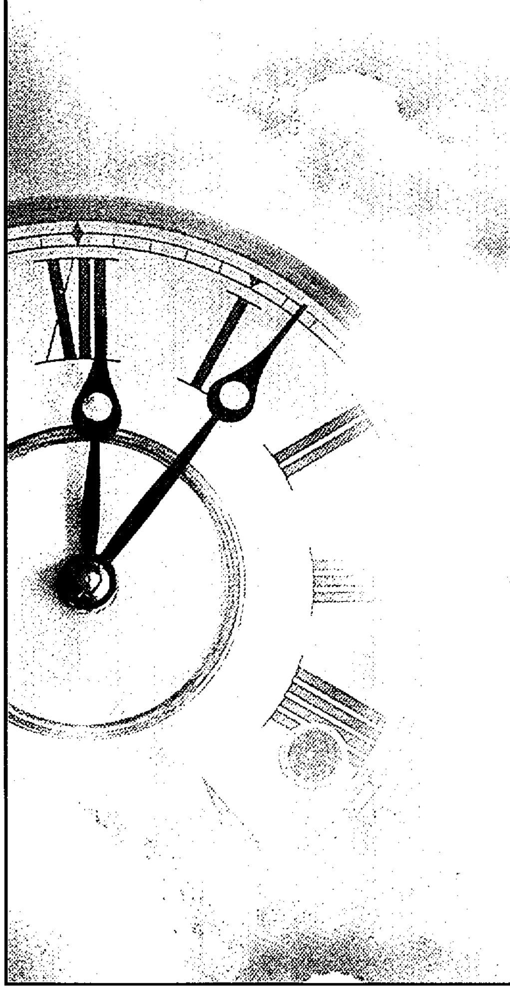
details to the New Jersey Board of Public Utilities (BPU), exempts the state's lone electric co-op — Sussex REC — as well as the state's nine municipal electric systems from competition unless they market outside of their service territories.

Under the legislation signed into law by Gov. Christie Todd Whitman, consumers of the state's four private power companies were given the ability to choose an alternate electric generation supplier by August 1, 1999. However, the BPU delayed the start of competition until November 14 to make sure utility electronic data exchange systems were ready.

Retail suppliers began soliciting New Jersey business as of August 1, although only a handful expressed any desire to sell to residential customers.

Electric customers were also provided an immediate 5 percent rate cut in the measure, as well as reductions totaling 10 percent over the next three years. These were in addition to a 6 percent cut, phased in over four years, that consumers are already seeing as a result of utility tax changes enacted in 1998. With all the rate cuts taken together, New Jersey electric consumers will save an estimated $1 billion a year over the next four years, including $703 million from rate reductions and $422 million from the tax code changes.

Why EGSs Aren't (Yet) Selling In Co-op Service Areas



During 1998, while most private power companies were engaged in the rigmarole of selecting a portion of their customers to shop for power on January 1, 1999, Pennsylvania's 13 electric co-ops took a novel approach — they decided to let ALL of their consumer-members shop on that date. The decision stemmed from the core principles of cooperative business practice — since all co-op members are equal, all should be given the chance to pick a new company to supply them with electric generation at the same time.

And from customer choice pilot programs conducted by two electric co-ops in 1998, it appeared that several retail electric generation suppliers (EGSs) had an interest in selling to Keystone State cooperative consumers. However, participating EGSs chose not to sell electricity in electric cooperative service areas after the pilots ended on December 31.

So January 1, 1999, came and went with no EGSs willing to market to electric cooperative consumers. As the year progressed, the situation did not change.

In short, cooperative consumers discovered that electric choice works both ways — you don't have to choose a supplier and suppliers don't have to choose you.

The reluctance by EGSs to serve electric cooperative consumers, though, did not come as a great shock. Cooperative service areas, for the most part, are rural, spread out and have a high percentage of residential consumers who use smaller amounts of power than their private power company counterparts.

Since EGSs are in business to make money, the lack of large commercial and industrial customers in rural areas means lower profit potential compared to other market opportunities. Many generation suppliers also are start-up companies that need to make money quickly. It's natural they would focus energies on selling to commercial and industrial accounts, as well as to residential customers in high-density communities with high electricity costs.

This leads to the defining reason why EGSs are not marketing in electric cooperative territories — the very competitive generation price delivered to cooperative consumers' meters, around 4 cents per kilowatt-hour. This low price makes it extremely difficult for an EGS to come in and offer a better deal.

As the competitive marketplace evolves and large power loads make their supply decisions, suppliers will turn to rural residents to continue building their market share. But the delay in EGS activity will benefit Pennsylvania electric cooperative consumers. Here's why:

- Electricity prices will stabilize and begin to fall as power plant investments are paid off.
- Electric cooperatives will know which suppliers are reliable and will be around for the long haul.
- Data exchange, metering and billing problems currently being experienced by EGSs and local distribution companies will be ironed out and solved for the most part.
- Suppliers will have identified which new packages of services besides electricity they can effectively market.

American Cooperative Services

Based on research showing that the cooperative model would be a hit among private power company consumers as they began shopping for power, Pennsylvania and New Jersey electric co-ops in 1998 formed an electric generation supply arm called American Cooperative Services (American). A member of Allegheny, American blends Allegheny's power supply expertise with the hands-on customer service and marketing experience of local co-ops.

Because it is non-profit, American is able to offer many private power company customers a lower rate for electric generation than they would pay by staying with their host utility.

A Touchstone Energy® cooperative, American is actively selling electricity to consumers served by two private power companies — GPU Energy and PECO Energy. It is one of roughly 90 state-licensed electric generation suppliers (EGSs) competing for retail customers in the Commonwealth and the only cooperative EGS selling to rural consumers.

American celebrated its first year of business during 1999 and experienced strong growth. More than 20,000 customers who shopped for power contacted American via its call center (877/567-CO-OP), Web site (www.american-cs.com), or by fax and letters, with 7,000 in all rate classes (1,504 residential and 5,496 commercial/industrial), amounting to 72 megawatts of load, choosing the cooperative option.

One of those who switched was Starbucks Coffee Company in York, Pa. When Starbucks engineer George Thompson was asked early in 1999 to select the company's electricity supplier, he asked 24 EGSs for bids.

In the end, Thompson chose American. While American's rates were the lowest of the 24, he says the retail supplier offered something else as well — the co-op difference.

"I had never heard of electric cooperatives before," admits Thompson, who soon was convinced that cooperatives could extend their consumer-friendly philosophy to American clients. To be sure, he conducted a test: For each company he considered, he noted the way clerks and customer service representatives answered the phone, how long it took for them to return calls and how interested the employees seemed in having his business. Again, American came out on top.

"Some companies were very interested in our business and some were not," says Thompson, whose roasting plant imports green coffee, roasts and packages it and distributes it to Starbucks stores east of the Rocky Mountains. "Why they weren't, I'm not exactly sure."

American also makes it a point to welcome homeowners — something of a rarity among EGSs doing business in Pennsylvania. Most alternate suppliers have elected to serve only large commercial and industrial accounts.

As the year closed, the Pennsylvania Food Merchants Association (PFMA) and the Pennsylvania Convenience Store Council (PCSC) — as part of their efforts to expand membership benefits — endorsed American as the electric supplier of choice for member stores in the GPU Energy and PECO Energy service areas. The groups selected American, "an organization built on the consumer-friendly business philosophy of cooperatives," over other EGSs because of its track record in providing reliable, competitively priced electricity to consumers and its commitment to customer service and support.

PFMA and PCSC, sister service associations based in Camp Hill, Pa., represent more than 1,900 members that operate approximately 6,500 grocery and convenience stores in the Commonwealth.

Susquehanna Steam Electric Station

Allegheny owns 10 percent of the Susquehanna Steam Electric Station (SSES), a 2,200-megawatt, two-unit nuclear power plant located in Luzerne County, Pa. PPL Utilities, a private power company based in Allentown, Pa., owns the remaining 90 percent and operates the boiling water facility.

In fiscal 1999, SSES provided 1.62 billion kilowatt-hours of electricity at delivery to Allegheny, supplying 63.7 percent of cooperative power supply needs. The capacity factor of SSES Unit 1 was 91.8 percent; Unit 2 was 83.1 percent. This works out to an average annual composite capacity factor for the facility of 87.5 percent.

Also during the year, SSES Unit 2 returned to service following its 10th scheduled refueling and maintenance outage. During the outage, workers replaced about 35 percent of the unit's uranium fuel — 280 bundles — and completed about 2,300 separate maintenance jobs.

Both Unit 1 and Unit 2 now run on a 24-month refueling cycle; previously the reactors were refueled every 18 months. The longer-run cycle is made possible through an improved fuel design with a higher energy content. (Refueling outages occur in the spring when electricity demand is lower.)

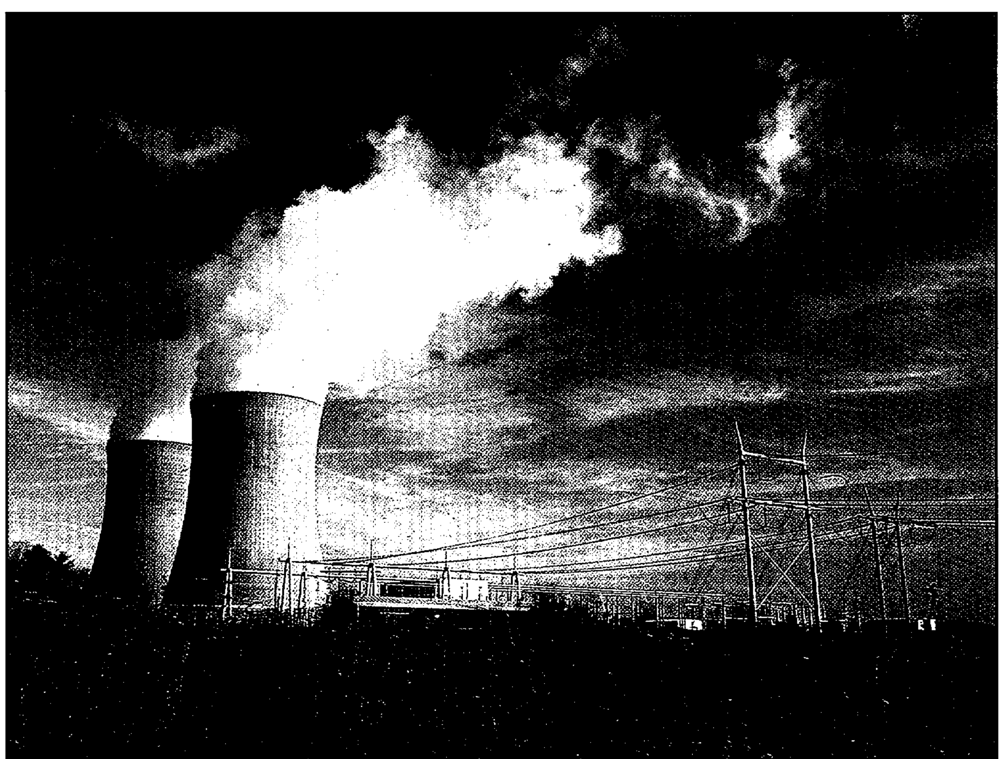
On July 7, the federal Nuclear Regulatory Commission (NRC) — after reviewing disclosure forms — declared that computers controlling safety systems at SSES were free of Year 2000 (Y2K) problems and that the facility was "Y2K ready."

As the year drew to a close, the first of 14 carefully planned, week-long transfers of used nuclear fuel from cooling pools to an interim dry-storage area was completed at SSES. Dry storage was needed since space in the plant's two cooling pools (one next to each reactor) will be filled by early 2001. (The 39-foot-deep pools can hold up to 2,840 used fuel bundles.)

The initial movement involved spent Unit 1 fuel assemblies — consisting of 80 separate fuel rods holding uranium pellets — that have been cooling for at least 10 years. As a first step, the assemblies were isolated inside 15-foot-long, 85-ton, airtight, helium-filled stainless steel canisters.

The canisters were then placed inside 30-inch-thick concrete modules on an above-ground pad located behind the Unit 1 cooling tower. The pad can accommodate up to 105 of the horizontal storage modules.

The fuel will remain in dry storage until the U.S. government opens a permanent, central nuclear waste repository at Yucca Mountain, Nev. — a project that electric co-op consumers in Pennsylvania and New Jersey have paid more than $20 million to support, but which won't be completed until at least 2010, 12 years later than required under a 1982 federal law.



New York Power Authority

Non-profit electric cooperatives and legitimate municipal electric systems within economic transmission distance receive first right, or preference, to a portion of the electric power generated at the publicly owned Niagara Power Project operated by the New York Power Authority (NYPA). A 1990 contract gives Allegheny rights to this low-cost hydropower through June 30, 2001. In late 1999, the NYPA Board of Trustees extended the contract through October 31, 2003.

During 1999, Allegheny — in its capacity as Bargaining Agent for Pennsylvania — addressed several NYPA power supply issues. As the year dawned, a new transmission contract between Allegheny and Niagara Mohawk, a private power company, for wheeling NYPA power took effect. The deal will save Allegheny and member co-ops up to $490,000 annually and will result in savings to other Pennsylvania utilities that receive NYPA power as well.

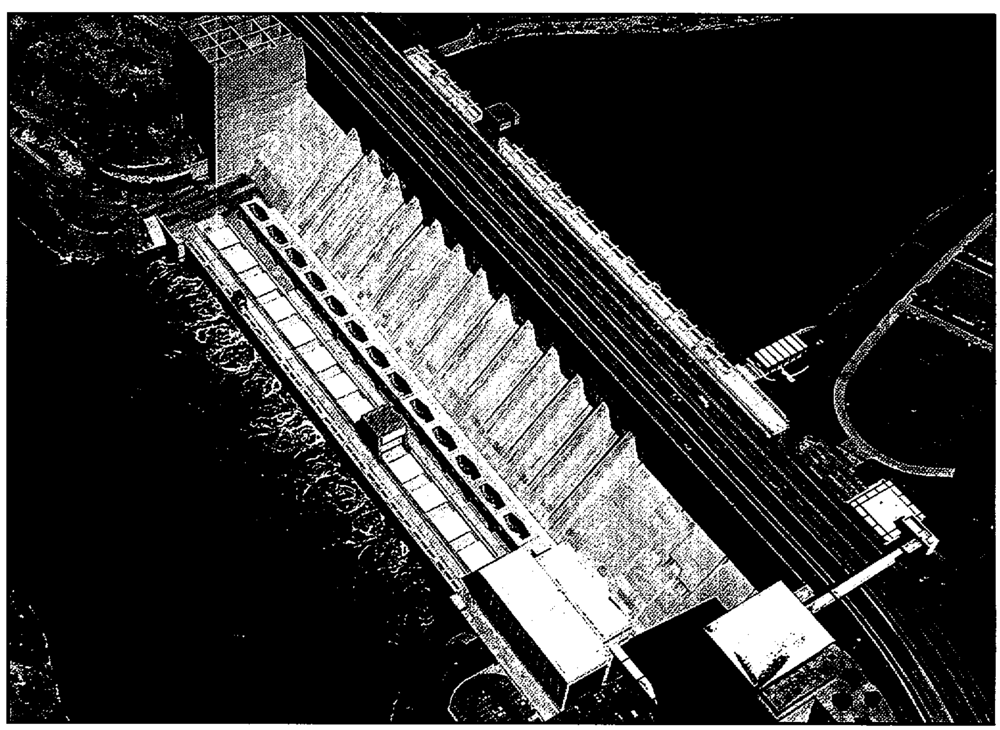
In July, the Allegheny Board of Directors also approved changes to the schedules under which non-cooperative Pennsylvania recipients of NYPA power are billed. The changes stemmed from the new transmission contract with Niagara Mohawk as well as imposition by the Pennsylvania-New Jersey-Maryland Interconnection of an open access tariff that affects wheeling of NYPA power in the state.

The revised schedules are more recipient-specific, with transmission and power supply arrangements more individualized than in the past. They also include a one-time surcharge to reimburse Allegheny for a percentage of staff time and expenses connected with handling recent NYPA issues.

Keystone State utilities besides Allegheny that receive NYPA power include private power companies GPU Energy, PECO Energy and PPL Utilities, as well as 10 municipal electric systems — Berlin, Elwood City, Ephrata, Grove City, Hooversville, Kutztown, Lansdale, Lehighton, Schuylkill Haven and Weatherly.

Pennsylvania's allocation of NYPA power currently stands at 47.9 megawatts (MW) from the Niagara Power Project and 20.3 MW from the St. Lawrence Power Project. Out of this, Allegheny receives nearly 42 MW (41 MW from Niagara and 1 MW from St. Lawrence).

Since Allegheny began purchasing it in 1966, NYPA power has saved member electric cooperatives more than $262 million compared to the cost of buying the same power from other sources. NYPA accounts for approximately 10 percent of Allegheny's energy needs, but only 5 percent of its power costs.



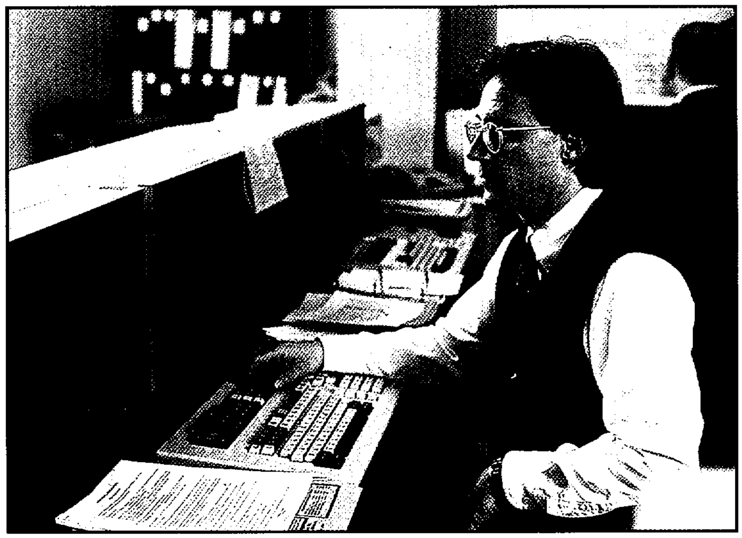
Coordinated Load Management

Allegheny has long recognized the importance of demand-side management as a component of integrated resource planning. In 1986, Allegheny and member cooperatives launched the Coordinated Load Management System (CLMS) to reduce demand peaks at co-op substations.

By shifting electricity use of residential water heaters, electric thermal storage units, dual fuel home heating systems and other special appliances from peak demand periods to times of lesser demand, CLMS improves system efficiency, cuts costly demand charges that Allegheny and member co-ops must pay for purchased power and reduces the need for new generating capacity.

In 1999, CLMS saved Allegheny and member co-ops $5.4 million.

Since December 1986, CLMS has reduced co-op purchased power costs by nearly $44 million. Currently, 182 substations are equipped for CLMS and more than 42,000 load control receivers have been installed on appliances, mostly water heaters, in the homes of volunteer co-op consumers.CLMS was used for the first time during the summer to reduce Allegheny's capacity obligation under new procedures of the Pennsylvania-New Jersey-Maryland Interconnection (PJM). The action took place during PJM's five highest system load days.

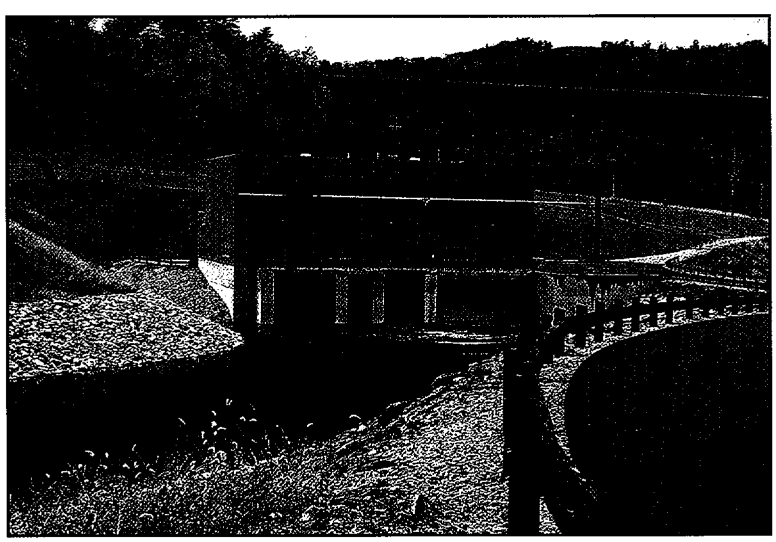


Raystown Hydroelectric Project

The Raystown Hydroelectric Project, William F. Matson Generating Station, is a two-unit, 21-megawatt, run-of-river hydropower facility located at Lake Raystown & Dam in Huntingdon County, Pa. On average, the plant generates approximately 3.3 percent of the energy Allegheny supplies to member cooperatives.

Due to record drought that affected the Mid-Atlantic region, Raystown in fiscal 1999 provided approximately 54.4 million kilowatt-hours at delivery, 33 percent below projections based on historic average water flow. Plant availability of 99.6 percent was recorded, significantly above the small hydro industry average.

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

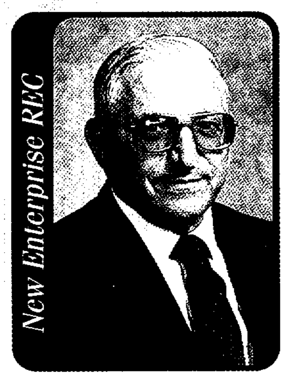


Allegheny Board of Directors

Alston Teeter
Chairman

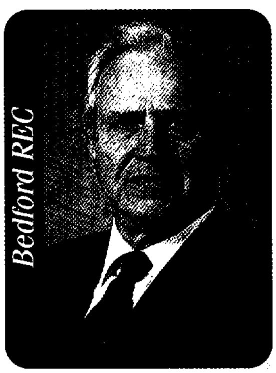
Lowell Friedline
Vice Chairman

Stephen Marshall
Secretary

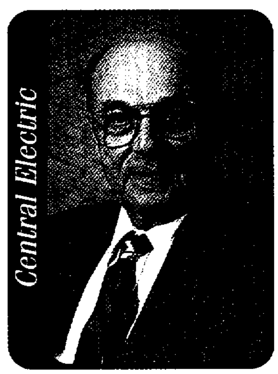


John Ritchey
Treasurer

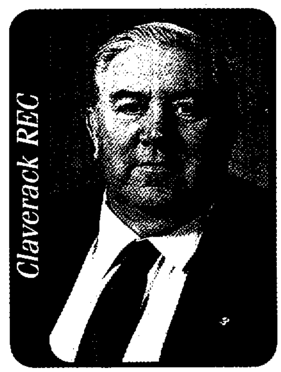
David Cowan
Director



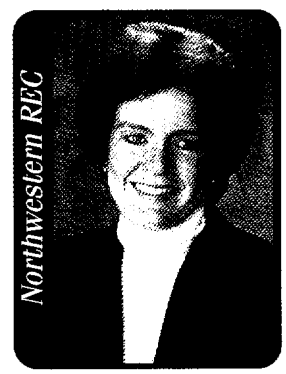
Wayne Hillegass
Director



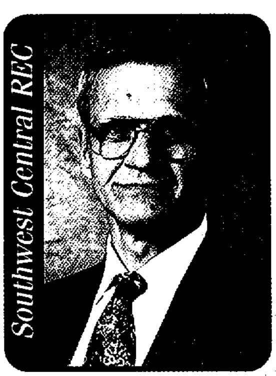
George Francisco
Director



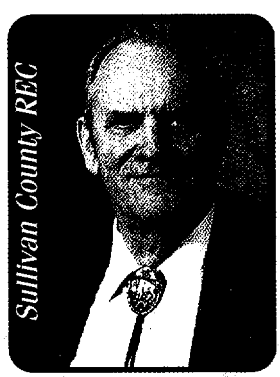
John McNamara
Director



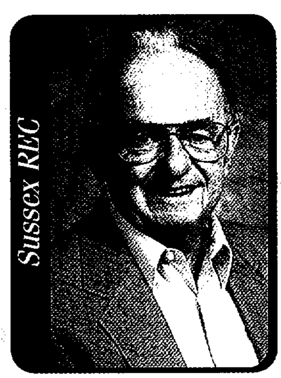
Kathryn Cooper
Director



Sam Eckenrod
Director

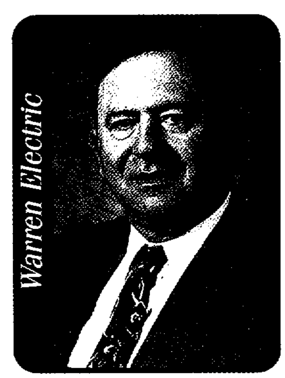


John Anstadt
Director



James Henderson
Director

Earl Parsons
Director



Dave Turner
Director

Allegheny Electric Cooperative, Inc.

Financial Statements for the Years Ended October 31, 1999 and 1998 and Independent Auditors' Report

A Touchstone Energy™ Partner

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ALLEGHENY ELECTRIC COOPERATIVE, INC.

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Allegheny Electric Cooperative, Inc.

We have audited the accompanying balance sheets of Allegheny Electric Cooperative, Inc. as of October 31, 1999 and 1998, and the related statements of operations, of equities (deficiencies), and of cash flows for the years then ended. These financial statements are the responsibility of Allegheny Electric Cooperative, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such financial statements present fairly, in all material respects, the financial position of Allegheny Electric Cooperative, Inc. as of October 31, 1999 and 1998, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 21, 2000 on our consideration of Allegheny Electric Cooperative, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with Governmental Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Deloitte + Touche LLP

January 21, 2000

ALLEGHENY ELECTRIC COOPERATIVE, INC.

BALANCE SHEETS
OCTOBER 31, 1999 AND 1998
(In Thousands)

ASSETS	1999	1998
ELECTRIC UTILITY PLANT:		
In service	$717,811	$715,232
Construction work-in-process	3,702	3,093
Nuclear fuel in process	3,305	4,047
	724,818	722,372
Less accumulated depreciation and amortization	633,222	626,724
	91,596	95,648
OTHER ASSETS AND INVESTMENTS:		
Nonutility property, at cost (net of accumulated depreciation of $3,355 in 1999 and $3,121 in 1998)	4,680	4,805
Investments in associated organizations	971	4,310
Notes receivable from members, less current portion	153	785
Other investments	29,489	18,795
Other noncurrent assets	293	326
	35,586	29,021
CURRENT ASSETS:		
Cash and cash equivalents	13,945	16,416
Accounts receivable, including accounts receivable from members of $19,171 in 1999 and $18,857 in 1998	26,266	21,470
Inventories	3,761	4,082
Other current assets	1,262	998
	45,234	42,966
DEFERRED CHARGES:		
Capital retirement asset	280,532	311,000
Other	3,303	3,673
	283,835	314,673
	$456,251	$482,308

EQUITIES (DEFICIENCIES) AND LIABILITIES

	1999	1998
EQUITIES (DEFICIENCIES):		
Memberships	$ 3	$ 3
Donated capital	38	38
Patronage capital	34,122	34,122
Other margins and equities (deficiencies)	(42,073)	(51,607)
Net unrealized gains	2,177	1,857
	(5,733)	(15,587)
LONG-TERM DEBT, Less current portion	377,635	416,881
CURRENT LIABILITIES:		
Current portion of long-term debt	38,070	31,090
Accounts payable and accrued expenses	14,329	20,573
Accounts payable to members	829	(147)
	53,228	51,516
OTHER LIABILITIES AND DEFERRED CREDITS:		
Accrued nuclear decommissioning	23,093	20,152
Accrued decontamination and decommissioning of nuclear fuel	1,873	2,201
Deferred income tax obligation from safe harbor lease	4,807	5,740
Other deferred credits	1,348	1,405
	31,121	29,498
	$456,251	$482,308

See notes to financial statements.

ALLEGHENY ELECTRIC COOPERATIVE, INC.

STATEMENTS OF OPERATIONS
YEARS ENDED OCTOBER 31, 1999 AND 1998
(In Thousands)

	1999	1998
OPERATING REVENUE, Including sales to members of $126,384 in 1999 and $131,672 in 1998, net of discounts to members in 1999 of $2,354 and in 1998 of $13,171.	$ 128,680	$ 124,356
OPERATING EXPENSES:		
Purchased power	29,694	27,003
Transmission:		
Operation	15,411	13,592
Maintenance	16	16
Production:		
Operation	20,992	21,427
Maintenance	7,094	7,756
Fuel	9,397	8,637
Depreciation	3,503	20,703
Amortization of Capital Retirement Asset	30,467	
Taxes	3,625	5,566
Administrative and general	5,867	11,168
	126,066	115,868
OPERATING MARGIN BEFORE INTEREST AND OTHER DEDUCTIONS	2,614	8,488
INTEREST AND OTHER DEDUCTIONS:		
Impairment loss on SSES, net of amounts recoverable from Capital Retirement Asset		21,040
Impairment loss on unamortized FFB debt repurchase premium		7,726
Interest expense, net of allowance for funds used during construction of $122 in 1999 and $869 in 1998	6,047	30,890
Other deductions, net	979	1,887
	7,026	61,543
Operating loss	(4,412)	(53,055)
NONOPERATING MARGINS:		
Net nonoperating rental income	1,045	943
Interest income	2,343	2,376
Other	993	905
	4,381	4,224
MARGIN BEFORE EXTRAORDINARY ITEMS	(31)	(48,831)
EXTRAORDINARY GAIN	9,565	
NET MARGIN (LOSS)	$ 9,534	$ (48,831)

See notes to financial statements.

ALLEGHENY ELECTRIC COOPERATIVE, INC.

STATEMENTS OF EQUITIES (DEFICIENCIES)
YEARS ENDED OCTOBER 31, 1999 AND 1998
(In Thousands)

	Memberships	Donated Capital	Patronage Capital	Other Margins and Equities (Deficiencies)	Net Unrealized Gains (Losses)	Total
BALANCE, OCTOBER 31, 1997	$ 3	$ 38	$ 34,122	$ (2,776)	$ 661	$ 32,048
Change in unrealized gains (losses), net					1,196	1,196
Net loss	—	—	—	(48,831)	—	(48,831)
BALANCE, OCTOBER 31, 1998	3	38	34,122	(51,607)	1,857	(15,587)
Change in unrealized gains (losses), net					320	320
Net margin	—	—	—	9,534	—	9,534
BALANCE, OCTOBER 31, 1999	$ 3	$ 38	$ 34,122	$(42,073)	$ 2,177	$ (5,733)

See notes to financial statements.

ALLEGHENY ELECTRIC COOPERATIVE, INC.

STATEMENTS OF CASH FLOWS
YEARS ENDED OCTOBER 31, 1999 AND 1998
(In Thousands)

	1999	1998
OPERATING ACTIVITIES:		
Net margin (loss) Before Extraordinary Items	$ (31)	$ (48,831)
Adjustments to reconcile net margin (loss) net cash provided by operating activities:		
Impairment loss on SSES, net of amount recoverable from Capital Retirement Asset		21,040
Impairment loss on unamortized FFB debt repurchase premium		7,726
Depreciation and fuel amortization	10,385	27,823
Amortization of deferred charges and deferred credits	30,838	(435)
(Gain) loss on sale of other investments	191	104
Changes in assets and liabilities which provided (used) cash:		
Accounts receivable	(4,796)	(728)
Inventories	321	514
Other current and noncurrent assets	(231)	(700)
Accounts payable and accrued expenses	(6,244)	8,709
Accounts payable to members	976	(904)
Other liabilities and deferred credits	1,554	2,962
Net cash provided by operating activities	32,963	17,280
INVESTING ACTIVITIES:		
Additions to electric utility plant and nonutility property	(12,756)	(7,866)
Redemption (purchase) of investments in associated organizations	2,598	(288)
Decrease in notes receivable from members	632	684
Purchases of other investments	(15,255)	(12,078)
Proceeds from sale of other investments	15,064	5,236
Net cash used in investing activities	(9,417)	(14,312)
FINANCING ACTIVITIES -		
Payments on long-term debt	(26,017)	(14,269)
Net cash used in financing activities	(26,017)	(14,269)
DECREASE IN CASH AND CASH EQUIVALENTS	(2,471)	(11,301)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	16,416	27,717
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 13,945	$ 16,416

See notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business and Operations - Allegheny Electric Cooperative, Inc. ("Allegheny") is a rural electric cooperative utility established under the laws of the Commonwealth of Pennsylvania. Financing assistance has been provided by the U.S. Department of Agriculture, Rural Utilities Service (RUS) formerly known as the Rural Electrification Administration (REA) and, therefore, Allegheny is subject to certain rules and regulations promulgated for rural electric borrowers by RUS. Allegheny is a generation and transmission cooperative, providing power supply to 14 owner/members who are rural electric distribution cooperative utilities providing electric power to consumers in certain areas of Pennsylvania and New Jersey and a member which is a non-profit cooperative corporation which is a licensed electric generation supplier in Pennsylvania. Allegheny's primary operating asset is its 10% undivided interest in the Susquehanna Steam Electric Station (SSES), a 2,200 megawatt, two-unit nuclear power plant, co-owned by Pennsylvania Power and Light Company (PP&L) (See Note 3).

Allegheny maintains its accounting records in accordance with the Federal Energy Regulatory Commission's uniform system of accounts as modified and adopted by RUS.

Electric Utility Plant and Depreciation - Electric utility plant is stated at cost, which includes an allowance for funds used during construction. The straight-line method of depreciation is used for all assets, except nuclear fuel. The cost of units of property retired or replaced is removed from utility plant accounts and charged to accumulated depreciation.

Nuclear Fuel - Nuclear fuel is charged to fuel expense based on the quantity of heat produced for electric generation. Under the Nuclear Waste Policy Act of 1982, the U.S. Department of Energy (DOE) is responsible for the permanent storage and disposal of spent nuclear fuel removed from nuclear reactors. Allegheny currently pays to Pennsylvania Power & Light Company (PP&L), co-owner of SSES, its portion of DOE fees for such future disposal services.

Cost of Decommissioning Nuclear Plant – Allegheny's portion of the estimated cost of decommissioning SSES is approximately $80.4 million and is being accrued over the estimated useful life of the plant. Decommissioning costs are included in rates.

Amounts funded to The Nuclear Decommissioning Trust Funds for the years ended October 31, 1999 and 1998 were $9.4 million and $6.4 million, respectively. As required by the Nuclear Regulatory Commission (NRC), Allegheny has maintained a Decommissioning Trust Fund (Trust Fund B) which is restricted for use to ultimately decommission SSES.

Accrued nuclear decommissioning as of October 31, 1999 and 1998 was $23.0 million and $20.1 million, respectively.

Allowance for Funds Used During Construction - Allowance for funds used during construction represents the cost of directly related borrowed funds used for construction of or additions to an electric utility plant. The allowance is capitalized as a component of the cost of electric utility plant while under construction.

Investments in Associated Organizations - Investments in associated organizations are carried at cost.

Preliminary Surveys - Costs of preliminary surveys for potential development projects are recorded as deferred charges. If construction of a project results from such surveys, the deferred charges are transferred to the cost of the facilities. If a preliminary survey is abandoned, the costs incurred are charged to operations when the project is determined to be abandoned.

Cash Equivalents - For purposes of the statements of cash flows, Allegheny considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Cash equivalents are carried at cost.

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

Other Investments - Allegheny accounts for debt and equity securities included in other investments under the provisions of SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities.* Management determines the proper classification of debt and equity securities at the time of purchase. As of October 31, 1999 and 1998, all securities covered by SFAS 115 were designated as available for sale. Accordingly, these securities are stated at fair value, with net unrealized gains and losses reported as a separate component of equities. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the statements of operations.

Patronage Capital and Other Margins and Equities (Deficiencies) - Allegheny had established an unallocated equity account, Other Margins and Equities (Deficiencies), as a result of charges against income. These charges against income were recorded as deficiencies in an unallocated equity account since the amount is not allocable to Allegheny's members. Subsequent net margins recognized by Allegheny are required by RUS to be used to reduce the deficiencies.

Rates and Regulatory Assets and Liabilities – The Board of Directors of Allegheny has full authority to establish electric rates subject to approval by RUS. Rates are established on a cost of service basis.

Allegheny records deferred charges and credits in accordance with SFAS 71, *Accounting for the Effects of Certain Types of Regulation,* for costs or credits that will be recovered in the future from its members or be held for the future benefit of its members. If Allegheny were to terminate application of SFAS 71, all such amounts deferred would be recognized in the statement of operations at that time.

On December 3, 1996, House Bill No. 1509, Pennsylvania's "Electricity Generation Customer Choice and Competition Act" was signed by the Governor of Pennsylvania, with an effective date of January 1,1998 as Act No. 138 of 1996. This Act enabled retail electric customers, including consumer-members of Pennsylvania's thirteen rural electric cooperatives, to choose the power supplier, or generator, from which they buy electricity.

The Financial Accounting Standards Board (FASB) Emerging Issues Task Force (EITF) has issued EITF Issue No. 97-4, *Deregulation of the Pricing of Electricity – Issues Related to the Application of FASB Statement No. 71, Accounting for the Effects of Certain Types of Regulation, and No. 101, Regulated Enterprises – Accounting for the Discontinuation of Application of FASB Statement No. 71.* EITF No. 97-4 provides guidance for determining when an entity should cease applying SFAS 71 and to what extent stranded costs and regulatory assets and liabilities should continue to be recognized. Allegheny reviewed the provisions set forth in EITF No. 97-4 and determined that regulatory assets and liabilities should continue to be accounted for under the provisions of SFAS 71 because management believes that it is reasonable to assume that Allegheny will be able to charge and collect its cost of service-based rates.

Revenues - Revenues from the sale of electricity are recorded based on billings to members and on contracts and scheduled power usages, as appropriate.

Income Taxes - Allegheny complies with SFAS No. 109, *Accounting for Income Taxes,* which requires recognition of deferred tax assets and liabilities resulting from the deferred tax consequences of temporary differences in recognition of assets, liabilities, income and expense for financial reporting and income tax reporting. The resulting deferred tax assets and liabilities are established based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income.

Investment tax credits, other than those sold through the safe harbor lease arrangement, are accounted for under the flow-through method whereby credits are recognized as a reduction of income tax expense in the year in which the credit is utilized for tax purposes.

Utilization of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassification – Certain prior year amounts have been reclassified to conform to the current year presentation.

2. ELECTRIC UTILITY PLANT IN SERVICE

Electric utility plant in service consists of the following as of October 31, 1999 and 1998:

	Depreciation/ Amortization, Lives/Rates	1999	1998
		(In Thousands)	
Nuclear Utility Plant:			
Production	39 years	$ 537,520	$ 537,385
Transmission	2.75 %	41,554	46,200
General plant	3% - 12.5%	1,045	864
Nuclear fuel	Heat production	127,956	122,525
		708,075	706,974
Non-Nuclear Utility Plant	3% - 33%	9,736	8,258
Total		$ 717,811	$ 715,232

Under the provisions of SFAS 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of,* Allegheny performed an impairment test on its electric generation assets. Based on the future projected cash flows for the use of the asset, the fair value of Allegheny's ten percent undivided interest in SSES, including the carrying value of the plant, related inventories and liabilities was determined to be $55,645,000 as of October 31, 1998. As a result, Allegheny determined the loss on the write-down of SSES to be $332,040,207. A portion of the loss, $311,000,000, is expected to be recovered in future rates and, therefore, was recorded as a regulatory asset referred to as the Capital Retirement Assets (see Note 7). The remaining portion of the loss, $21,040,207, was recorded as an impairment loss in the statement of operations for the fiscal year ended October 31, 1998.

To maintain the details of the gross costs of its plant for regulatory purposes, Allegheny has recorded the adjustment to reduce the asset in the accumulated depreciation account.

3. SUSQUEHANNA STEAM ELECTRIC STATION

Allegheny owns a 10% undivided interest in SSES. PP&L owns the remaining 90%. Both participants provide their own financing. Allegheny's portion of SSES' gross assets, which includes electric utility plant in service, construction and nuclear fuel in progress, totaled $700 million and $691 million as of October 31, 1999 and 1998, respectively. Allegheny's share of anticipated costs for ongoing construction and nuclear fuel for SSES is estimated to be approximately $53 million over the next five years. Allegheny receives a portion of the total SSES output equal to its percentage ownership. SSES accounted for 64% and 67% of the total kilowatts sold by Allegheny during 1999 and 1998, respectively. The balance sheets and statements of operations reflect Allegheny's respective share of assets, liabilities and operations associated with SSES.

4. INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations, at cost, consists of the following as of October 31, 1999 and 1998:

	1999	1998
	(In Thousands)	
National Rural Utilities Cooperative Finance Corporation (CFC Subordinated Term Certificates, bearing interest from 0% to 5%, maturing January 1, 2014 through October 1, 2080	$ 642	$ 3,784
National Rural Utilities CFC Capital Term Certificates	9	187
Other	320	339
	$ 971	$ 4,310

Allegheny is required to maintain these investments pursuant to certain loan and guarantee agreements. As part of a debt restructuring completed on March 29, 1999, discussed in Note 8, Allegheny redeemed for $2,598,000 CFC term certificates with a carrying value of $3,098,401.

5. NOTES RECEIVABLE FROM MEMBERS

Notes receivable from members arise from the lease of load management equipment to the member cooperatives. Such notes bear interest at a variable rate (6.65% and 6.00% as of October 31, 1999 and 1998, respectively) and mature at various dates through March 31, 2009. Notes receivable from members were $.9 million and $1.7 million as of October 31, 1999 and 1998, respectively.

6. OTHER INVESTMENTS

Other investments consist of the following as of October 31, 1999 and 1998:

	1999 (In Thousands)			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Decommissioning Trust Fund A:				
Cash	$ 47			$ 47
U.S. Government securities	10,602		$ (189)	10,413
Corporate bonds	2,334		(46)	2,288
Corporate stocks	2,055	$ 132		2,187
	15,038	132	(235)	14,935
NRC mandated Decommissioning Trust Fund B:				
Cash	197			197
U.S. Government securities	2,549		(33)	2,516
Corporate bonds	4,366		(67)	4,299
Other obligations	517		(21)	496
Common stocks	2,846	2,401		5,247
	10,475	2,401	(121)	12,755
Debt Service Reserve Fund - U.S. Government securities	1,799			1,799
Total	$ 27,312	$ 2,533	$ (356)	$ 29,489

	1998			
	(in thousands)			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Decommissioning Trust Fund A:				
Cash	$ 6,563	$ 188		$ 6,751
	6,563	188		6,751
NRC mandated Decommissioning Trust Fund B:				
Cash	141			141
U.S. Government securities	1,776	54	$ (2)	1,828
Corporate bonds	3,878	109	(16)	3,971
Other obligations	523	17	(2)	538
Common stocks	2,418	1,380	(31)	3,767
	8,736	1,560	(51)	10,245
Debt Service Reserve Fund - U.S. Government securities	1,799			1,799
Total	$ 17,098	$ 1,748	$ (51)	$ 18,795

7. DEFERRED CHARGES

Deferred charges consist of the following regulatory assets as of October 31, 1999 and 1998:

	1999	1998
	(In Thousands)	
Capital retirement asset	$ 280,532	$ 311,000
Accrued decontamination and decommissioning of nuclear fuel	2,652	2,809
Low level radiation waste facility costs	492	599
Safe harbor lease closing costs	159	171
Preliminary surveys		94
	$ 283,835	$ 314,673

Based on a membership agreement signed by the fourteen member distribution cooperatives on March 29, 1999, with an effective date of January 1, 1999, a portion of the SSES impairment loss (see Note 2) has been recognized as a regulatory asset, referred to as the Capital Retirement Asset. Under this new agreement, Allegheny will recover in rates certain financing costs related primarily to Allegheny's investment in SSES in the amount of $311,000,000 over a nine-year period.

Allegheny did not include in its rates, that were effective January 1, 1999, amounts to recover the amortization of the FFB debt repurchase premium and does not intend to recover such costs in future years. Therefore, this regulatory asset of approximately $7,726,000 was charged to income during the year ended October 31, 1998.

8. LONG-TERM DEBT

Long-term debt consists principally of advances under mortgage notes payable for electric utility plant to RUS and to the United States of America acting through the Federal Financing Bank (FFB) and guaranteed by RUS. Substantially all of the assets of Allegheny are pledged as collateral. Long-term debt consists of the following as of October 31, 1999 and 1998:

	1999	1998
	(In Thousands)	
Debt settlement note payable to RUS at an interest rate varying from 0.0% to 7.18%, due in varying amounts through 2007	$ 380,905	
6.00% replacement notes payable to RUS due in varying amounts through 2007	3,000	
Advances under mortgage notes payable to FFB at interest rates varying from 4.54% to 10.30% in 1998		$ 409,538
Pollution Control Revenue Bonds, payable semiannually, including interest through 2014. Variable rates ranged from 2.10% to 3.90% in 1999 and. 2.90% to 4.15% in 1998	22,800	23,500
Mortgage loan payable to CFC in various quarterly installments, including interest through January 2015. Variable rates ranged from 6.30% to 6.55% in 1998		1,678
Notes payable to CFC in various quarterly installments, including interest through October 2019. Variable rates ranged from 6.30% to 6.55% in 1998		4,032
5.00% mortgage notes payable to RUS due in varying amounts through 2019.	9,000	9,223
	415,705	447,971
Less current portion (based on restructured debt maturities - see below)	38,070	31,090
	$ 377,635	$ 416,881

Pursuant to the provisions set forth in 7 CFR Part 1717, *Settlement of Debt Owed by Electric Borrowers,* Allegheny entered into a restructuring agreement with RUS on March 29, 1999, with an effective date of January 1, 1999. Under the restructuring, the original advances under the mortgage notes to FFB were replaced with a new note in the amount of $406,000,000. The new note is payable through the year 2009, with an option for two early termination payments in 2007 and 2008. Interest on the new note is 7.18%. Allegheny, however, can receive an interest credit up to the amount of total interest expense based on the number of participating members. Members signing the membership agreement referred to in Note 7 are deemed participating and those not signing are deemed non-participating members. As of March 29, 1999, all of Allegheny's members became participants.

On March 29, 1999, the mortgage loan payable and notes payable to CFC were offset by term certificates that were cancelled by Allegheny in the amount of $2,598,000, with a face value of

$3,098,401. The remaining obligation of $3,000,000 was acquired by RUS. As a result of this transaction, Allegheny has a new outstanding obligation payable to RUS, with an interest rate of 6.00% per annum for nine years.

As part of this restructuring agreement with RUS, a portion of accrued interest on previous notes with FFB was reduced in the amount of $9,565,000 which resulted in an extraordinary gain that was recognized in fiscal year 1999, the year in which the restructuring was consummated.

Long-term Pollution Control Revenue Bonds (Bonds) were issued by an industrial development authority on Allegheny's behalf. The Bonds are subject to purchase on demand of the holder and remarketing on a "best efforts" basis until the Bonds are converted to a fixed interest rate at Allegheny's option. If a fixed interest rate is established for the Bonds, the Bonds will cease to be subject to purchase by the remarketing agent or the trustee. In fiscal 1999 and 1998, the Bonds were collateralized by irrevocable letters of credit from Rabobank Nederland which are backed by a five-year credit facility in the event the bondholders tender the Bonds prior to the conversion to a fixed interest rate and the Bonds cannot be remarketed. The stated amount of the letters of credit are equal to the amount of outstanding Bonds plus an amount equal to 65 days' interest accrued on the Bonds at 12%. The indenture agreement contains various redemption provisions with redemption prices ranging from 100% to 103%. Included in other investments, at both October 31, 1999 and 1998, are $1.8 million of investments which relate to a debt service reserve fund required under the Bond indenture.

Future maturities of all long-term debt for the next five years are as follows (in thousands):

2000	$ 38,070
2001	37,527
2002	35,877
2003	34,063
2004	38,383
Thereafter	231,785

Allegheny is required by mortgage covenants to maintain certain levels of interest coverage and annual debt service coverage. During the year ended October 31, 1998, Allegheny anticipated that it would not be able to meet certain covenants requirements and obtained from RUS, on June 25, 1998, a letter of forbearance with respect to noncompliance. Contemporaneously with the forbearance letter, Allegheny and RUS signed a memorandum of understanding regarding a negotiated settlement of Allegheny's debt. Under the letter, the RUS agreed to forebear exercising its remedies under the various agreements until closing of the settlement which occurred on March 29, 1999. Allegheny was in compliance with the applicable mortgage covenants as of October 31, 1999

Certain of Allegheny's long-term debt is at variable interest rates and is therefore subject to various market and interest rate fluctuations.

During 1999 and 1998, Allegheny incurred interest costs of $6.1 million and $31.6 million, respectively, of which $0.1 million and $0.8 million, respectively, was capitalized as part of the construction of the electric utility plant. Interest paid, net of amounts capitalized, was $6.0 million and $30.8 million, respectively.

9. DEFERRED CREDITS

The balance of deferred credits related to the Raystown lease gain were $1.3 million and $1.4 million at October 31, 1999 and 1998, respectively.

10. INCOME TAXES

At October 31, 1999, Allegheny had available nonmember net operating loss carryforwards of approximately $79 million for tax reporting purposes expiring through 2019 and investment tax credit carryforwards of approximately $11 million expiring through 2004. Allegheny also had net operating loss carryforwards attributable to member activities of approximately $12 million for tax reporting purposes, which may be carried forward indefinitely.

The effect of the Company's restructuring has been considered in determining the deferred tax balances at October 31, 1999. Specifically, the Company's nonmember net operating loss carryforwards have been reduced by approximately $111 million as a result of its March 29, 1999 restructuring agreement with RUS.

Temporary differences that give rise to deferred tax balances are principally attributable to fixed asset basis, gain on installment sale and financial statement accruals. Deferred tax assets also include the effect of net operating loss carryforwards. The temporary differences and the carryforward items produce a net deferred tax asset at year-end. Realization of the net deferred tax asset is contingent upon the Company's future earnings. A valuation allowance has been established against the asset since it has been determined, at present, that it is more likely than not that the net deferred tax asset will not be realized.

11. PENNSYLVANIA PUBLIC UTILITY REALTY TAXES

In December of 1998, the Pennsylvania Department of Revenue issued, pursuant to the Pennsylvania Public Utility Realty Tax Act, (PURTA), additional assessments to PURTA taxpayers in order to cover the shortfall between PURTA tax revenues and the distributions. Allegheny's additional assessment was for $1,868,000 which was appropriately recorded as of October 1998. Allegheny satisfied the 1997 reassessment by applying 1998 prepaid taxes against the assessment.

In 1999 approximately 20 utilities including Allegheny filed suits against the Commonwealth of Pennsylvania challenging provisions of PURTA. The state later amended the PURTA statute and the way in which the tax is calculated retroactive to 1998. Allegheny subsequently received and paid a 1998 PURTA tax bill of approximately $380,000.

Although the final resolution of PURTA issues remains unknown, Allegheny believes that it has recorded appropriate liabilities for any remaining PURTA taxes.

12. RELATED PARTY TRANSACTIONS

Allegheny has an arrangement with an affiliated organization, Pennsylvania Rural Electric Association (PREA), under which PREA provides Allegheny with certain management, general, and administrative services on a cost reimbursement basis. Total costs for the services provided for the years ended October 31, 1999 and 1998 were approximately $5.8 million and $6.4 million, respectively.

Allegheny leases office space to PREA under a year-to-year lease. Rental income was $81,216 and $71,790 for the years ended October 31, 1999 and 1998, respectively.

13. COMMITMENTS AND CONTINGENCIES

Power Supply and Transmission Agreements

Allegheny has entered into power supply and transmission agreements with approximately 45 service providers. A significant amount of these agreements are umbrella type agreements and do not bind Allegheny to enter into any type of transaction. As of October 31, 1999, there were no ongoing transactions under these agreements.

Allegheny has a number of power supply agreements under which it currently purchases capacity and power. These agreements contain no minimum purchase or take or pay provisions. Power supply agreements are as follows:

New York Power Authority – This contract is scheduled to expire on June 30, 2001. This contract meets a portion of Allegheny's base load requirements and its delivered cost to Allegheny's members is below market.

Penelec and West Penn Agreements – These contracts have terms through December 31, 2003 and November 30, 2001, respectively. These contracts enable Allegheny to purchase capacity and energy to exactly meet Allegheny's needs.

PP&L – This contract expires on January 31, 2002. This contract enables Allegheny to purchase capacity and energy to exactly meet Allegheny's needs. Allegheny also has a separate contract with PP&L to reserve and purchase 21 MW of capacity. That contract is used to meet a portion of Allegheny's load in the West Penn area and is coterminous with the West Penn contract.

Power Purchase Sale Contract

On November 30, 1998, Allegheny entered into a Power Purchase Sale Contract with American Cooperative Services, Inc. (the "buyer"), an affiliated entity. Under the contract, Allegheny is required to deliver to the buyer certain amounts of capacity and associated energy, the amounts and prices of which are outlined in a "Transaction Confirmation." Under the Transaction Confirmation, Allegheny will deliver to the buyer 50 mw of capacity and associated energy at capacity rates varying from $55 to $65 per mw-day and energy varying between $22.60 and $60.20 per mwh. The confirmation letter for calendar year 2000 covers American's needs through and expires with the last meter reading date for the December 2000 billing cycle unless otherwise amended.

Line of Credit Agreement

On March 29, 1999, Allegheny entered into a Line of Credit Agreement with American Cooperative Services, Inc. ("American"). Under the terms of the agreement, Allegheny agrees to make advances to American as requested in amounts not to exceed the aggregate of $2,150,000. Beginning in January 2000, all outstanding amounts are to be repaid in equal amount installments. The Line of Credit Agreement expires December 31, 2004.

Insurance

Allegheny and PP&L are members of certain insurance programs which provide coverage for property damage to members' nuclear generating plants. Allegheny's portion of the facilities at SSES is insured against property damage losses up to $275 million under these programs. Allegheny is also a member of an insurance program which provides coverage for the cost of replacement power during prolonged outages of nuclear units caused by certain specified conditions. Under the property and replacement power insurance programs, Allegheny could be assessed retrospective premiums in the event the insurers' losses exceed their reserves. The maximum amount Allegheny could be assessed under these programs during the current policy year is $0.9 million.

Allegheny's public liability for claims resulting from a nuclear incident is currently limited to $892.0 million under provisions of the Price-Anderson Amendments Act of 1988 (Act), which extended the Price-Anderson Act to August 1, 2002. Allegheny is protected against this potential liability by a combination of commercial insurance and an industry retrospective assessment program.

In the event of a nuclear incident at any of the facilities owned by others and covered by the Act, Allegheny could be assessed up to $15.1 million per incident, but not more than $2.0 million in a calendar year.

Safe Harbor Lease

Allegheny previously sold certain investment and energy tax credits and depreciation deductions pursuant to a safe harbor lease. The proceeds from the sale, including interest earned thereon, have been deferred and are being recognized on the statements of operations over the 30-year term lease. The deferred income tax obligations were $4.8 and $5.7 million as of October 31, 1999 and 1998, respectively. The net proceeds and related interest were required by RUS to be used to retire outstanding FFB debt.

Under the term of the safe harbor lease, Allegheny is contingently liable in varying amounts in the event the lessor's tax benefits are disallowed and in the event of certain other occurrences. The maximum amount for which Allegheny was contingently liable as of October 31, 1999 was approximately $12 million. Payment of this contingent liability has been guaranteed by CFC.

Litigation

In the normal course of business, there are various claims and suits pending against Allegheny. In the opinion of Allegheny's management, the amount of such losses that might result from these claims and suits, if any, would not materially affect the financial position or results of operations of Allegheny.

13. SALE/LEASEBACK ARRANGEMENT

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

Allegheny also has the option to renew the lease for a five-year fixed rate renewal and three fair market renewal periods, each of which may not be for a term of less than two years. Payments during the fixed rate renewal period are 30% of the average semi-annual installments during the initial lease term. Allegheny will retain co-licensee status for the Facility throughout the term of the lease. The gain of $1.9 million related to the sale is being recognized over the lease term in the same proportion that the annual rental payments relate to total rental payments. The unrecognized gain is recorded in deferred credits and was $1.3 and $1.4 million as of October 31, 1999 and 1998, respectively.

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

The leaseback of the Facility is accounted for as an operating lease by Allegheny. As of October 31, 1999, future minimum lease payments under this lease, which can vary based on the interest paid on the debt used to finance the transaction, are estimated as follows (in thousands):

2000	$ 2,361
2001	2,361
2002	1,990
2003	2,361
2004	2,281
Thereafter	31,335
Total minimum lease payments	$ 42,689

The future minimum lease payments shown above are for the initial lease term and the five-year renewal period. These payments are based on an assumed interest rate of 8.8% and may fluctuate based on differences between the future interest rate and the assumed interest rate. Rental expense for this lease totaled $1.9 million in each of the years ended October 31, 1999 and 1998.

14. CONCENTRATIONS OF CREDIT RISK

Allegheny is comprised of member rural electric cooperatives, whose operations are located in Pennsylvania and New Jersey. The member cooperatives' primary service areas are small communities located throughout much of rural Pennsylvania and New Jersey.

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

15. GOVERNMENT REGULATIONS

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

Allegheny has previously recorded its share of the liability in connection with PP&L's recognition of the liability in the accounts of SSES. Allegheny's share of the liability is $4.4 million which will be paid over a period of 15 years. Allegheny recorded its share of the liability as a deferred charge which will be amortized to expense over 15 years, consistent with the ratemaking treatment. The remaining liability to be amortized was $1.9 million and $2.2 million as of October 31, 1999 and 1998, respectively.

16. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and Cash Equivalents - The carrying amount reported approximates fair value because of the short maturity of these financial instruments.

Other Investments and Investments in Associated Organizations - The fair value of other investments are estimated based on quoted market prices. Fair values of investments in associated organizations approximate their carrying amount.

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

Long-Term Debt - The carrying amount of Allegheny's variable rate long-term debt approximates fair value. The fair value of Allegheny's fixed rate long-term debt is estimated using discounted cash flows based on current rates offered to Allegheny for similar debt of the same remaining maturities.

Summary of Fair Values - The estimated fair values of Allegheny's financial instruments at October 31, 1999 and 1998, are as follows (in thousands):

	1999		1998	
	Carrying Value	**Fair Value**	**Carrying Value**	**Fair Value**
Cash and cash equivalents	$ 13,945	$ 13,945	$ 16,416	$ 16,416
Other investments	29,489	29,489	18,795	18,795
Investment in associated organizations	971	971	4,310	4,310
Notes receivable from members	945	945	1,708	1,708
Long-term debt	415,705	227,505	447,971	452,816

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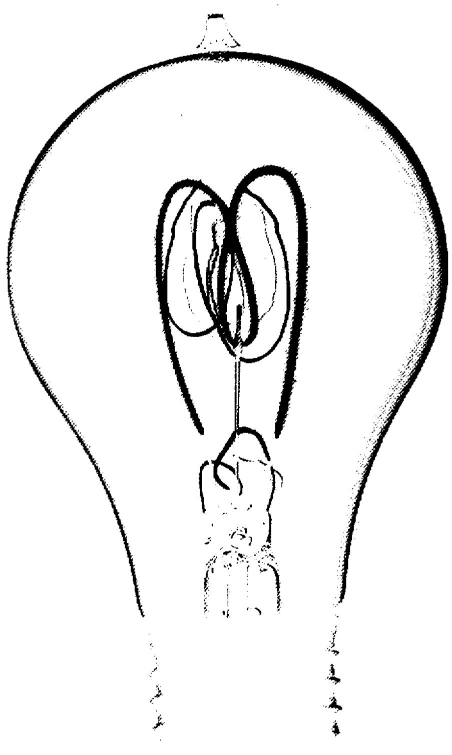

Allegheny
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