

financial review

Allegheny Energy, Inc.

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FACTORS THAT MAY AFFECT FUTURE RESULTS

Management's discussion and analysis of financial condition and results of operations contains forecast information items that are "forward-looking statements" as defined in the *Private Securities Litigation Reform Act of 1995*. These include statements with respect to deregulation activities and movements toward competition in states served by Allegheny Energy, Inc. (the Company) and results of operations. All such forward-looking information is necessarily only estimated. There can be no assurance that actual results will not materially differ from expectations. Actual results have varied materially and unpredictably from past expectations.

Factors that could cause actual results to differ materially include, among other matters, electric utility restructuring, including ongoing state and federal activities; developments in the legislative, regulatory, and competitive environments in which the Company operates, including regulatory proceedings affecting rates charged by the Company's subsidiaries; environmental, legislative, and regulatory changes; future economic conditions; earnings retention and dividend payout policies; the Company's ability to compete in unregulated energy markets; and other circumstances that could affect anticipated revenues and costs such as significant volatility in the market price of wholesale power and fuel for electric generation, unscheduled maintenance or repair requirements, weather, and compliance with laws and regulations.

Business Strategy Generation of electricity will continue to be a core component of the Company's business. The Company's goal is to grow generation through building and buying generating facilities. The energy delivery (wires and pipes) business will also continue to be an important part of the Company's business which the Company plans to expand. Existing nonutility businesses, primarily telecommunications, that are closely tied to our core business will continue to be developed.

The Company's settlement agreement in Pennsylvania permitted West Penn Power Company (West Penn) to transfer 3,778 megawatts (MW) of generating capacity at net book value to a new, unregulated, wholly owned subsidiary of the Company. The recent settlement in Maryland will allow about 1,300 MW of additional generating capacity to be transferred at net book value in 2000. The Company is seeking to transfer the remaining generating assets in Ohio, Virginia, and West Virginia to its unregulated subsidiary at book value in deregulation proceedings in these jurisdictions. The unregulated electric supply is being sold in both the wholesale and retail competitive marketplaces, allowing greater earnings growth potential, subject to market risk, while allowing us to capitalize on the Company's strengths in the generation business.

SIGNIFICANT EVENTS IN 1999, 1998, AND 1997

Maryland Deregulation On September 23, 1999, a settlement agreement between The Potomac Edison Company (Potomac Edison), the Staff of the Maryland Public Service Commission (Maryland PSC), and other parties working to implement customer choice and deregulation of electric generation for Potomac Edison in Maryland was filed with the Maryland PSC. On December 23, 1999, the Maryland PSC approved the settlement agreement, which provides nearly all of Potomac Edison's 211,000 Maryland customers with the ability to choose an electric generation supplier starting July 1, 2000.

As a result of the Maryland settlement agreement, Potomac Edison discontinued the application of the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation," for the electric generation portion of its Maryland operations and has adopted SFAS No. 101, "Accounting for the Discontinuation of Application of FASB Statement No. 71." Accordingly, Potomac Edison recorded an extraordinary charge of \$26.9 million (\$17.0 million after taxes) during the fourth quarter of 1999. This write-off reflects the impairment of certain electric generation assets as determined by applying SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," and the write-off of generation-related net regulatory assets. See Notes B and C to the consolidated financial statements for details of the settlement agreement and other information about the deregulation process.

See Electric Energy Competition on page 38 for more information regarding restructuring in Maryland.

Pennsylvania Deregulation On November 19, 1998, the Pennsylvania Public Utility Commission (Pennsylvania PUC) approved a settlement agreement between West Penn—the Company's Pennsylvania electric utility subsidiary—and parties to West Penn's restructuring proceedings related to legislation in Pennsylvania to provide customer choice of electric suppliers and deregulate electricity generation.

As a result of the May 29, 1998, Pennsylvania PUC order and as revised by the November 19, 1998, settlement agreement, West Penn determined in 1998 that, under the provisions of SFAS No. 101, an extraordinary charge of \$466.9 million (\$275.4 million after taxes) was required to reflect a write-off of certain disallowances. Charges of \$40.3 million (\$23.7 million after taxes) related to the West Penn revenue refund and energy program payments were also recorded in 1998.

Under the terms of the Pennsylvania settlement agreement, two-thirds of West Penn's customers were permitted to choose an alternate generation supplier beginning in January 1999. All West Penn customers were permitted to do so beginning in January 2000. They were able to remain as West Penn customers at West Penn's capped generation rates or to alternate back and forth. Under the law, all electric utilities, including

West Penn, retain the responsibility of electricity provider of last resort to all customers in their respective franchise territories who do not choose an alternate supplier. See Notes B and C to the consolidated financial statements for details of the settlement agreement and other information about the deregulation process.

See Electric Energy Competition on page 38 for more information regarding the restructuring in Pennsylvania.

Nonutility Sales of Electricity Since 1997, the Company has been marketing electric energy to customers in deregulated markets. During 1999, the Company's energy supply business sold 2,912,273 megawatt-hours (MWh) of electricity to customers in deregulated retail markets and 21,374,732 MWh to customers in deregulated wholesale markets. During 1999, West Penn's former generation customers purchased 2,522,611 MWh of electricity from alternative energy suppliers as a result of customer choice in Pennsylvania.

Unregulated Generating Subsidiary During 1999, the Company obtained the necessary regulatory approvals to form an unregulated generating subsidiary, Allegheny Energy Supply Company, LLC (Allegheny Energy Supply). During the fourth quarter of 1999, West Penn transferred its deregulated generating capacity, which totaled 3,778 MW, to Allegheny Energy Supply at book value as allowed by the final settlement in West Penn's Pennsylvania restructuring case. In addition, Allegheny Energy Supply purchased from AYP Energy, Inc. (AYP Energy) its 276 MW of merchant capacity at Fort Martin Unit No. 1.

Recapitalization In 1999, the Company completed the following steps in its recapitalization process for West Penn concurrent with the implementation of deregulation of electric generation in Pennsylvania:

- \$600 million of transition bonds were issued in November 1999;
- \$525 million of first mortgage bonds were called or redeemed during the year;
- \$79.7 million of preferred stock was called or redeemed in July 1999; and
- West Penn revised its Articles of Incorporation to provide greater financial flexibility.

During 1999, West Penn reacquired all of its outstanding first mortgage bonds. As a result, the Company incurred an extraordinary charge of \$17.0 million (\$10.0 million after taxes) during the fourth quarter of 1999. The extraordinary charge was the result of premiums paid to reacquire the first mortgage bonds as compared to the carrying value of the bonds.

In addition, the Company repurchased 12 million shares of its outstanding common stock for \$398.4 million, and Potomac Edison also called \$16.4 million of preferred stock. Potomac Edison also plans to revise its Articles of Incorporation to provide greater financial flexibility.

Additional Generation In 1999, the Company installed two 44-MW simple-cycle gas combustion turbines in Springdale Borough in Allegheny County, Pennsylvania, at a cost of approximately \$46 million. These units are unregulated merchant plants and became operational at the end of 1999. Both run on either No. 2 diesel oil or natural gas. As part of the installation, existing gas lines were upgraded and 500,000 gallons of oil storage capacity will be built. Transmission facilities at the site and the nearby interconnections were also upgraded. The generation output is being sold into the competitive power markets in the eastern United States. These combustion turbines will be transferred to Allegheny Energy Supply in the first quarter of 2000 or as soon thereafter that the necessary regulatory approval can be obtained from the Securities and Exchange Commission (SEC).

Allegheny Energy Supply is purchasing additional combustion turbines that will add 220 MW to our fleet in 2000 at a cost of approximately \$120 million. Also, Allegheny Energy Supply is building a 540-MW combined-cycle generating plant at Springdale, Pennsylvania, at a cost of \$235 million. The new facility will include two gas-fired combustion turbines and a steam turbine. All are expected to be operational and providing power for sale into competitive markets in 2003.

Another new project is the anticipated development of a 100-MW generation project in Warren County in northwestern Pennsylvania. A memorandum of understanding was signed with Foster Wheeler Power Systems, Inc. (Foster Wheeler) and United Refining Company (United Refining). The project will include an upgrade by Foster Wheeler to United Refining's facility in the city of Warren, Pennsylvania, with the installation of a petroleum coker and associated equipment.

The generation project, if it is developed as planned, will be co-owned by Allegheny Energy Supply, Foster Wheeler, and United Refining. It will incorporate circulating fluidized-bed technology and use waste by-products from the petroleum coking process in the production of electricity for the refinery and for sale in the open market. Excess capacity from the generation will be marketed by Allegheny Energy Supply, and steam produced by the project will be used by the refinery. Construction expenditures for the entire project are estimated at up to \$300 million, of which Allegheny Energy Supply's share is estimated at up to \$100 million based on the participation of all three potential co-owners or up to \$150 million if one of the other potential co-owners elects not to participate. Construction is anticipated to begin in early 2001. The memorandum of understanding to develop the facility has been signed by all the parties, but a satisfactory feasibility study, acceptable financing terms and conditions, permitting, and execution of definitive project agreements are necessary before construction can begin.

Acquisitions In December 1999, Monongahela Power Company (Monongahela Power), one of the Company's West Virginia subsidiaries, purchased from UtiliCorp United Inc. headquartered in Kansas City, Missouri, the assets of West Virginia Power, an electric and natural gas distribution company located adjacent

to Monongahela Power's service territory in southern West Virginia, for approximately \$95 million. As part of the transaction, Monongahela Power signed a 20-year option agreement with UtiliCorp United's subsidiary, Aquila Energy, for gas supply to Monongahela Power. Electricity is being supplied under an existing contract with American Electric Power until December 31, 2001, and thereafter will be supplied from the existing generation of the Company or from the market. Consumers will benefit from a six-year freeze of natural gas base rates and a three-year freeze of electric rates, with a reduction in electric rates in 2003 to rates now offered by Monongahela Power. The acquisition included 26,000 electric and 24,000 natural gas customers, 1,989 miles of electric distribution lines, 670 miles of gas pipelines, and 1,360 square miles of electric and 500 square miles of gas service territory. West Virginia Power has approximately 120 employees.

In conjunction with the acquisition of West Virginia Power's assets, the Company purchased for \$2.1 million the assets of a heating, ventilation, and air conditioning business with approximately 10,000 customers and 52 employees.

In December 1999, Allegheny Communications Connect, Inc., the telecommunications subsidiary of Allegheny Ventures, Inc., purchased for \$3.1 million approximately 10% of Genosys Technology Management Inc., a recently formed network operation center services company. The new enterprise will enable the Company to provide value-added services, such as around-the-clock network monitoring and maintenance services, to customers of its growing fiber optic network.

Monongahela Power also plans to purchase Mountaineer Gas Company, a natural gas sales, transportation, and distribution company serving southern West Virginia and the northern and eastern panhandles of West Virginia, from Energy Corporation of America for \$323 million (which includes the assumption of approximately \$100 million in existing debt). The planned acquisition also includes the assets of Mountaineer Gas Services, which operates natural gas-producing properties, natural gas-gathering facilities, and intrastate transmission pipelines. Mountaineer Gas has 490 employees, approximately 200,000 residential, commercial, and industrial gas customers, 3,926 miles of gas pipeline, and 11.7 billion cubic feet of gas storage. The completion of the transaction is conditioned upon, among other things, the

approvals of the Public Service Commission of West Virginia (W.Va. PSC) and the SEC. The companies anticipate that regulatory approval could be received by mid-2000.

PURPA Power Project Terminations On August 26, 1997, and December 3, 1997, West Penn announced that it had negotiated agreements to buy out and settle disputes with developers of proposed power plants (the Milesburg and Washington Power projects) for \$15 million and \$48 million, respectively, reducing costs over the proposed 30- and 33-year lives of the projects by an estimated \$1.4 billion. The disputed projects were being developed under the *Public Utility Regulatory Policies Act of 1978 (PURPA)* and would have required West Penn to buy 43 MW and 80 MW of capacity and energy, respectively, over the lives of the projects at prices well above current market price estimates. In 1999, the Company settled for \$5 million litigation by another developer alleging failure by the Company to comply with PURPA regulations.

Articles of Incorporation As a result of the passage of Maryland legislation affecting corporate governance of companies incorporated in the state, the Board of Directors by resolution in July 1999 amended the Company's Articles of Incorporation. The Board resolution adopted a provision creating three classes of directors of nearly even size, with the term of each director continuing for the full initial term of the class to which he or she is designated; a provision that directors cannot be removed from the Board except by a two-thirds vote of all votes entitled to be cast by shareholders in an election of directors; that vacancies may be filled only by the Board and for the full remainder of the term; and that the number of directors may be fixed only by the Board.

Proposed Merger with DQE, Inc. See Note D to the consolidated financial statements for information about the proposed merger with DQE, Inc.

Electric Industry Restructuring See Electric Energy Competition on page 38 for ongoing information regarding electric industry restructuring.

REVIEW OF OPERATIONS

Earnings Summary

	Earnings			Basic and Diluted Earnings Per Average Share		
	1999	1998	1997	1999	1998	1997
<i>(Millions of dollars except per share data)</i>						
Operations:						
Utility	\$236.5	\$ 283.3	\$295.7	\$2.03	\$ 2.32	\$2.42
Nonutility	48.9	(20.3)	(14.4)	.42	(.17)	(.12)
Consolidated income before extraordinary charges	285.4	263.0	281.3	2.45	2.15	2.30
Extraordinary charges, net (Notes B, C, and F to consolidated financial statements)	(27.0)	(275.4)		(.23)	(2.25)	
Consolidated net income (loss)	\$258.4	\$ (12.4)	\$281.3	\$2.22	\$ (.10)	\$2.30

The decrease in 1999 earnings from utility operations, before extraordinary charges, reflects the deregulation of two-thirds of West Penn's electric generation effective January 1, 1999, as approved by the Pennsylvania PUC's restructuring order for West Penn. Accordingly, the operating results for these assets are classified as nonutility in 1999. The 1999 utility operations also reflect higher operation and maintenance expenses, including the write-off of \$19.7 million of merger-related costs and \$16.2 million of costs from a long dormant pumped-storage generation project. The decrease in 1998 earnings from utility operations, before extraordinary charges, reflects \$23.7 million of costs, after taxes, related to the Pennsylvania restructuring settlement.

In 1999, earnings from nonutility operations, before extraordinary charges, increased consolidated net income by \$48.9 million, an increase of \$69.2 million over 1998's loss. This increase in nonutility earnings reflects the sale of generation from two-thirds of West Penn's generation assets into deregulated markets as discussed under Sales and Revenues and improved results

over 1998 performance in such markets. The 1998 increase in the losses from nonutility operations, before extraordinary charges, resulted from AYP Energy sales commitments for energy in excess of owned generating capacity which required settlement by open market purchases during periods of high wholesale prices. Also contributing to the nonutility losses in 1998 and 1997 were losses of \$1.7 million and \$1.4 million, respectively, by Allegheny Energy Solutions for its participation in the Pennsylvania pilot program (see Note B to the consolidated financial statements for more information about the pilot program).

Extraordinary charges in 1999 and 1998 resulted from the Maryland and Pennsylvania electric utility restructuring orders as discussed in Notes B and C to the consolidated financial statements and the redemption of debt by West Penn in 1999 related to the securitization of stranded costs as discussed in Note F to the consolidated financial statements.

Earnings per share in 1999 increased \$.11 per share due to the Company's common stock repurchase program.

Sales and Revenues Total operating revenues for 1999, 1998, and 1997 were as follows:

OPERATING REVENUES

(Millions of dollars)

	1999	1998	1997
Operating revenues:			
Utility revenues:			
Regulated	\$2,168.4	\$2,201.2	\$2,203.0
Choice	34.3	14.0	2.5
Bulk power	22.5	69.8	39.6
Transmission and other energy services	48.5	45.2	41.1
Total utility revenues	2,273.7	2,330.2	2,286.2
Nonutility revenues:			
Retail and other	156.0	31.7	4.9
Bulk power	731.4	215.3	80.9
Total nonutility revenues	887.4*	247.0	85.8
Elimination between utility and nonutility	(352.7)	(.8)	(2.5)
Total operating revenues	\$2,808.4	\$2,576.4	\$2,369.5

*Nonutility operating revenues include \$57.1 million in 1999 of allocated Competitive Transition Charge revenues to compensate for certain transition costs transferred to nonutility operations.

The decrease in regulated revenues (regulated revenues include revenues from West Penn customers eligible to choose an alternate energy supplier but electing not to do so) in 1999 was due primarily to Pennsylvania deregulation, which gave two-thirds of West Penn's regulated customers the ability to choose another energy supplier and to a reduction in Potomac Edison's Maryland rates as part of a settlement agreement. In 1999, 2,522,611 MWh of electric energy was supplied to West Penn customers by alternative energy suppliers, which represented only 11% of West Penn's total MWh sales. The decrease to regulated revenues was offset in part by colder winter weather in 1999, which

led to increased residential kilowatt-hour (kWh) sales and revenues. Utility regulated revenues in 1998 included a \$25.1 million rate refund, pursuant to the terms of the Pennsylvania restructuring settlement agreement. Excluding this rate decrease, utility regulated revenues increased \$23.3 million in 1998, primarily due to increased kWh sales to commercial and industrial customers. The increase in 1998 was also due to an increase in the number of customers.

Utility choice revenues for 1999 represent transmission and distribution revenues from West Penn franchised customers (customers in West Penn's territory) who chose another supplier to

provide their energy needs. In 1999, less than 2% of West Penn's customers chose alternate energy suppliers. The Company's nonutility supply business had the primary objective of selling the output from the two-thirds of West Penn's generation that had been freed up by the *Electricity Generation Customer Choice and Competition Act (Customer Choice Act)* in Pennsylvania.

In 1998 and 1997, the choice revenues represent the 5% of previously fully bundled customers (full service customers) who participated in the Pennsylvania pilot program that began November 1, 1997, and continued through December 31, 1998, and were required to buy energy from an alternate supplier. To assure participation in the pilot program, pilot participants received an energy credit from their local utility and a price for energy pursuant to an agreement with an alternate supplier. The credit established by the Pennsylvania PUC was artificially high to encourage customer shopping, and, as a result, West Penn incurred a revenue loss of \$8.6 million for the pilot. The Pennsylvania PUC has approved West Penn's pilot compliance filing and thus has indicated its intent to treat the revenue loss as a regulatory asset.

On August 7, 1998, the Virginia State Corporation Commission (Virginia SCC) approved an agreement reached between Potomac Edison and the Staff of the Virginia SCC which reduced base rates for Virginia customers beginning September 1, 1998, by about \$2.5 million annually. The review of rates was required by an annual information filing in Virginia.

On February 25, 1999, the Virginia SCC approved Potomac Edison's rate reduction request, which decreased the fuel portion of Virginia customers' bills by approximately 7.6% (a decrease in annual fuel revenue of about \$2.2 million). The decrease is primarily due to refunding a prior overrecovery of fuel costs, coupled with a small decrease in projected energy costs. The new rates were effective with bills rendered on or after March 9, 1999.

On May 21, 1999, the Virginia SCC approved an agreement reached between Potomac Edison and the staff of the Virginia SCC which reduced base rates for Virginia customers effective June 1, 1999, by about \$3 million annually. The review of rates is required by an annual information filing in Virginia.

On February 26, 1999, the W.Va. PSC entered an order to initiate a fuel review proceeding to establish a fuel increment in rates for Potomac Edison and Monongahela Power to be effective July 1, 1999, through June 30, 2000. The parties have exchanged proposals which continue to be discussed. If an agreement is not reached, the proposed fuel rates which would increase Monongahela Power's fuel rates by \$10.9 million and decrease Potomac Edison's fuel rates by \$8.0 million will become effective March 15, 2000.

On November 8, 1999, Potomac Edison filed with the Maryland PSC a request to decrease the fuel portion of Maryland customers' bills by about \$6.4 million annually. The requested decrease is primarily due to greater efficiencies, lower fuel costs, and increased nonaffiliated generation and transmission sales. The new fuel rates were effective with bills rendered on or after December 7, 1999, subject to refund, based on the outcome of proceedings before the Maryland PSC.

On October 27, 1998, the Maryland PSC approved a settlement agreement for Potomac Edison. Under the terms of that agreement, Potomac Edison increased its rates \$13 million in 1999, will increase its rates an additional \$13 million in 2000, and an additional increase of \$13 million will go into effect in 2001 (a \$79 million total revenue increase during 1999 through 2001). The increases are designed to recover additional costs of about \$131 million over the 1999 through 2001 period for capacity purchases from the AES Warrior Run cogeneration project, net of alleged over-earnings of \$52 million for the same period. The net effect of these changes over the 1999 through 2001 time frame results in a pre-tax income reduction of \$12 million in 1999, \$21 million in 2000, and \$19 million in 2001. Also, Potomac Edison will share, on a 50% customer, 50% shareholder basis, earnings above a return on equity of 11.4% in Maryland for 1999 and 2000. This sharing will occur through an annual true-up. Potomac Edison's 1999 revenues reflect an estimated obligation for shared earnings above an 11.4% return on equity.

Utility-related revenues reflect not only changes in kWh sales and base rate changes, but also any changes in revenues from fuel and energy cost adjustment clauses (fuel clauses) which are still applicable in all Company jurisdictions served, except for Pennsylvania. Effective July 1, 2000, Potomac Edison's Maryland jurisdiction will also cease to have a fuel clause under the terms of the September 23, 1999, settlement agreement. Changes in fuel revenues in jurisdictions for which a fuel clause continues to exist have no effect on consolidated net income because increases and decreases in fuel and purchased power costs and sales of transmission services and bulk power are passed on to customers by adjustment of customers' bills through fuel clauses.

Effective May 1, 1997, as a result of the Customer Choice Act, West Penn obtained Pennsylvania PUC authorization to set its fuel clause to zero and to roll its then-applicable fuel clause rates into base rates. Thereafter, West Penn assumed the risks and benefits of changes in fuel and purchased power costs and sales of transmission services and bulk power. Effective July 1, 2000, Potomac Edison will assume similar risks and benefits for its Maryland jurisdiction.

The 1999 decrease in revenues from utility bulk power was due to the movement of generation available for sale from regulated utility to nonutility. The 1998 increase in revenues from utility bulk power and transmission and other energy services sales was due to increased sales that occurred primarily in the second quarter as a result of warm weather which increased the demand and price for energy. In 1998, revenues from utility transmission and other energy services were affected by a revenue refund resulting from a reduction in the Company's standard transmission rate and rates for ancillary services which were approved by the Federal Energy Regulatory Commission (FERC). A provision for these rate reductions was recorded in 1998, with the revenues refunded to customers in the first quarter of 1999.

Revenues from utility operations transmission and other energy services in 1998 increased, despite decreased transmission services activity. The increase in revenues was due in part to transmission services reservation charges paid to the Company by others for the right to transmit energy.

In June and July 1999 and June and July 1998, certain events combined to produce significant volatility in the spot prices for electricity at the wholesale level. These events included extremely hot weather, generation unit outages, and transmission constraints. Wholesale prices for electricity rose from a normal range of \$25 to \$40 per MWh to as high as \$3,500 to \$7,000 per MWh. The potential exists for such volatility to significantly affect the Company's operating results. The effect may be either positive or negative, depending on whether the Company's subsidiaries are net buyers or sellers of electricity during such periods, the open commitments which exist at such times, and whether the effects of such transactions by the Company's utility subsidiaries are included in fuel or energy cost recovery clauses in their respective jurisdictions. The effect of such price volatility in June

and July of 1998 differed between the Company's utility and nonutility subsidiaries, but was insignificant in total. The effect in 1999 was to measurably increase earnings in total for the Company even though individual subsidiary experiences were again diverse.

Nonutility revenues have increased primarily because of bulk power sales to nonaffiliated companies and new sales in Pennsylvania's competitive marketplace. The Company's supply business officially began supplying unregulated electricity to retail customers in Pennsylvania and wholesale customers throughout eastern North America on January 1, 1999. Allegheny Energy Supply also engages in other transactions in the unregulated marketplace to sell electricity to both wholesale and retail customers.

The elimination (see page 32) between utility and nonutility revenues is necessary to remove the effect of affiliated revenues, primarily sales of power.

See Note B to the consolidated financial statements for information regarding the Competitive Transition Charge.

OPERATING EXPENSES

Fuel expenses for 1999, 1998, and 1997 were as follows:

FUEL EXPENSES

(Millions of dollars)

	1999	1998	1997
Utility operations	\$ 355.5	\$545.4	\$535.7
Nonutility operations	180.2	21.1	24.2
Total fuel expenses	\$ 535.7	\$566.5	\$559.9

Total fuel expenses decreased 5% in 1999 due to a 7% decrease in average fuel prices offset by a 2% increase related to kWhs generated. The decrease in fuel expenses for utility operations and the increase in fuel expenses for nonutility operations in 1999 were due to the fuel expenses associated with the two-thirds of West Penn's freed up generation being marketed as part of nonutility operations.

Purchased power and exchanges, net, represents power purchases from and exchanges with other companies and purchases from qualified facilities under PURPA and consists of the following items:

PURCHASED POWER AND EXCHANGES, NET

(Millions of dollars)

	1999	1998	1997
Utility operations:			
Purchased power:			
From PURPA generation*	\$ 104.1	\$129.0	\$134.8
Other	395.8	50.0	41.2
Total purchased power for utility operations	499.9	179.0	176.0
Power exchanges, net	(2.6)	(.7)	.3
Nonutility operations purchased power	390.1	210.5	43.5
Elimination	(356.0)		
Purchased power and exchanges, net	\$ 531.4	\$388.8	\$219.8
*PURPA cost (cents per kWh)	4.8¢	5.4¢	5.6¢

Utility purchased power from PURPA generation decreased \$24.9 million in 1999. This decrease reflects a \$11.1 million reduction related to West Penn's purchase commitment at costs in excess of the market value of the AES Beaver Valley PURPA contract. This reduction reflects the amortization of the adverse purchased power commitment reserve recorded in 1998, which is net of the Competitive Transition Charge revenue recovery in conjunction with deregulation proceedings in Pennsylvania. The decrease in purchased power also includes a \$12.5 million reduction in the purchase price for that contract due to a scheduled capacity rate decrease defined annually in the contract. The decrease in utility purchased power from PURPA generation in 1998 was due primarily to reduced generation at hydroelectric plants due to river flow. PURPA purchased power costs may be reduced by \$197 million during the period 1999 through 2016 related to the AES Beaver Valley contract as a result of the 1998 extraordinary charge. See Notes B and C to the consolidated financial statements for further information.

The increase in other utility operations purchased power in 1999 was due primarily to West Penn's purchase of power from its nonutility affiliate, Allegheny Energy Supply, in order to provide energy to the two-thirds of its customers eligible to choose an alternate supplier, but who elected not to do so. The increase in other utility operations purchased power in 1998 resulted primarily from increased purchases for sales. An increase in market prices caused by volatility in the spot

prices for electricity at the wholesale level in the second and third quarters of 1998 also contributed to the increase.

The increase in nonutility purchases in 1999 was due to increased purchases for sale to its utility affiliate and to take advantage of transaction opportunities in the market. The increase in nonutility purchases in 1998 was due primarily to an increase in volume attributable to AYP Energy's increased participation in the market.

The elimination as shown on page 34 between utility and nonutility purchased power is necessary to remove the effect of affiliated purchased power expenses.

The AES Warrior Run PURPA cogeneration contract in Potomac Edison's Maryland service territory will increase the cost of power purchases by about \$60 million annually. Commencement of operation was scheduled for October 1999. Pre-commencement testing is not completed. Although AES Warrior Run has until October 1, 2000, to complete pre-commencement testing, it is anticipated that it will be in commercial operation in the first quarter of 2000. The Maryland PSC has approved Potomac Edison's full recovery of the AES Warrior Run purchased power costs as part of the September 23, 1999, settlement agreement. See Sales and Revenues starting on page 32 for more information on the settlement agreement.

Other operation expenses for 1999, 1998, and 1997 were as follows:

OTHER OPERATION EXPENSES

<i>(Millions of dollars)</i>	1999	1998	1997
Utility operations	\$346.7	\$319.2	\$292.3
Nonutility operations	72.4	18.2	16.7
Elimination	(29.7)		
Total other operation expenses	\$389.4	\$337.4	\$309.0

The increase in total other operation expenses in 1999 of \$52.0 million was due primarily to recording \$19.7 million in merger-related costs previously deferred and \$16.2 million related to a pumped-storage generation project no longer considered useful, increases in salaries and wages of \$8.0 million, \$5.0 million for costs associated with settling litigation concerning a PURPA project, and increased allowances for uncollectible accounts of \$2.1 million. The increase in utility other operation expenses in 1998 was due primarily to increased expenses related to competition and the Pennsylvania restructuring order (\$24.3 million).

See Note B to the consolidated financial statements for additional information related to Pennsylvania restructuring. Nonutility other operation expenses reflect increased business activity.

The elimination between utility and nonutility operation expenses is primarily to remove the effect of affiliated transmission purchases.

Maintenance expenses for 1999, 1998, and 1997 were as follows:

MAINTENANCE EXPENSES

<i>(Millions of dollars)</i>	1999	1998	1997
Utility operations	\$182.6	\$212.3	\$227.1
Nonutility operations	40.9	5.3	3.5
Total maintenance expenses	\$223.5	\$217.6	\$230.6

Total maintenance expenses increased \$5.9 million in 1999 due primarily to increased maintenance and renovations of general plant structures of \$5.1 million. The decrease in utility maintenance and the increase in nonutility maintenance was due to the maintenance associated with the two-thirds of West Penn generation which is now deregulated and being classified as nonutility maintenance. The decrease in utility maintenance in 1998 was due primarily to a management program to postpone such expenses for the year in response to limited sales growth in the first quarter due to the warm winter weather. The Company postponed these expenses primarily by extending the time between maintenance outages and experienced no measurable effect on system performance. The increase in nonutility maintenance expense in 1998 was primarily related to a 1998 planned outage for maintenance of Unit No. 1 of the Fort Martin Power Station.

Maintenance expenses represent costs incurred to maintain the power stations, the transmission and distribution (T&D) system and general plant, and to reflect routine maintenance of equipment and rights-of-way, as well as planned major repairs and unplanned expenditures, primarily from forced outages at the power stations and periodic storm damage on the T&D system. Variations in maintenance expenses result primarily from unplanned events and planned major projects, which vary in timing and magnitude depending upon the length of time equipment has been in service without a major overhaul and the amount of work found necessary when the equipment is dismantled.

Depreciation and amortization expenses for 1999, 1998, and 1997 were as follows:

DEPRECIATION AND AMORTIZATION EXPENSES

<i>(Millions of dollars)</i>	1999	1998	1997
Utility operations	\$198.0	\$264.6	\$259.1
Nonutility operations	59.5	5.8	6.6
Total depreciation and amortization expenses	\$257.5	\$270.4	\$265.7

Total depreciation and amortization expenses in 1999 decreased \$12.9 million due primarily to a \$24.6 million reduction related to a 1998 write-down of West Penn's share of costs in excess of the fair value of the Allegheny Generating Company (AGC) pumped-storage project. Depreciation expense will be reduced \$234 million during the period 1999 through 2016 from the historical depreciation amounts as a result of the AGC plant impairment charge recorded as an extraordinary charge in 1998 by West Penn. Absent this decrease, depreciation

expense would have risen due to increased investment.

Higher utility depreciation in 1998 resulted from increased investment. In 1999, utility and nonutility depreciation expense reflects the movement of depreciation expense associated with the two-thirds of West Penn's generation transferred from utility operations to nonutility operations.

Taxes other than income taxes for 1999, 1998, and 1997 were as follows:

TAXES OTHER THAN INCOME TAXES

<i>(Millions of dollars)</i>	1999	1998	1997
Utility operations	\$157.9	\$187.7	\$181.4
Nonutility operations	32.4	6.9	5.6
Total taxes other than income taxes	\$190.3	\$194.6	\$187.0

Total taxes other than income taxes decreased \$4.3 million in 1999 primarily due to an adjustment which increased 1998's West Virginia Business and Occupation Taxes by \$1.4 million related to a previous period, lower capital stock taxes relating to the 1998 asset write-down as a result of Pennsylvania restructuring, and decreased gross receipts taxes, partially offset by higher FICA taxes. The increase in total taxes other than income taxes in 1998

was due primarily to increased West Virginia Business and Occupation Taxes resulting from an adjustment for a prior period and increased property taxes. Utility and nonutility taxes other than income taxes reflect the movement of taxes other than income taxes associated with the two-thirds of West Penn's generation transferred from utility operations to nonutility operations.

The 1999 decrease in federal and state income taxes of \$4.0 million was primarily due to tax benefits related to plant removal costs, offset in part by increased taxable income. Note G to the consolidated financial statements provides a further analysis of income tax expenses.

The increase in allowance for borrowed funds used during construction of \$1.6 million in 1999 reflects an increase in construction activity financed by short-term debt. The allowance for borrowed funds used during construction component of the formula receives greater weighting when short-term debt increases. The decrease in allowance for other than borrowed funds used during construction of \$2.8 million in 1998 reflects

lower-cost short-term debt financing. The decrease also reflects adjustments of prior periods.

The decrease in other income, net, of \$6.6 million in 1999, was primarily due to a \$4.3 million insurance settlement received in 1998. The decrease in other income, net, of \$9.8 million in 1998, was primarily due to 1997 increases for an interest refund on a tax-related contract settlement (\$8.3 million after taxes) and income on the sale of land (\$2.8 million after taxes) offset in part by a \$4.3 million insurance settlement received in 1998.

Interest on long-term debt and other interest for 1999, 1998, and 1997 were as follows:

INTEREST EXPENSE

<i>(Millions of dollars)</i>	1999	1998	1997
Interest on long-term debt:			
Utility operations	\$126.0	\$151.0	\$162.8
Nonutility operations	29.2	10.1	10.8
Total interest on long-term debt	155.2	161.1	173.6
Other interest:			
Utility operations	27.9	19.4	14.4
Nonutility operations	3.7		
Total other interest	31.6	19.4	14.4
Total interest expense	\$186.8	\$180.5	\$188.0

The decrease in total interest on long-term debt in 1999 of \$5.9 million and in 1998 of \$12.5 million resulted from reduced average long-term debt outstanding and, in 1998, also from lower interest rates.

Other interest expense reflects changes in the levels of short-term debt maintained by the companies throughout the year, as well as the associated interest rates. The increase in other interest expense of \$12.2 million in 1999 resulted primarily from the increase in short-term debt outstanding in conjunction with the repurchase of the Company's common stock that began in the first quarter of 1999.

Dividends on the preferred stock of the subsidiaries decreased due to the redemption by Potomac Edison and West Penn of their cumulative preferred stock on September 30, 1999, and July 15, 1999, respectively.

The redemption premiums on preferred stock of the subsidiaries represents the premiums paid by Potomac Edison and West Penn to retire their cumulative preferred stock.

The extraordinary charge in 1999 of \$43.9 million (\$27.0 million after taxes) was required to reflect a write-off of \$26.9 million (\$17.0 million after taxes) of certain disallowances in the Maryland PSC's December 1999 order and \$17.0 million (\$10.0 million after taxes) for the difference between the reacquisition price and the net carrying amount of first mortgage bonds repurchased with proceeds from the sale of transition bonds as a result of

the deregulation process in Pennsylvania. The extraordinary charge in 1998 of \$466.9 million (\$275.4 million after taxes) was required to reflect a write-off of certain disallowances in the Pennsylvania PUC's May and November 1998 orders. See Notes B, C, and F to the consolidated financial statements for additional information.

FINANCIAL CONDITION, REQUIREMENTS, AND RESOURCES

Liquidity and Capital Requirements To meet cash needs for operating expenses, the payment of interest and dividends, retirement of debt and certain preferred stocks, and for their construction programs, the companies have used internally generated funds and external financings, such as the sale of common and preferred stock, debt instruments, installment loans, and lease arrangements. The timing and amount of external financings depend primarily upon economic and financial market conditions, the companies' cash needs, and capitalization ratio objectives. The availability and cost of external financings depend upon the financial health of the companies seeking those funds and market conditions.

Capital expenditures, primarily construction, of all of the subsidiaries in 1999 were \$413 million and, for 2000 and 2001, are estimated at \$419 million and \$431 million, respectively. In addition, in 1999 Monongahela Power acquired the assets of West Virginia Power for approximately \$95 million, and, in 2000,

Monongahela Power also plans to purchase Mountaineer Gas Company for approximately \$323 million (which includes the assumption of approximately \$100 million in existing debt). The 2000 and 2001 estimated expenditures include \$115 million and \$136 million, respectively, for construction of environmental control technology. Future nonutility construction expenditures will reflect additions of generating capacity to sell into deregulated markets. It is the Company's goal to constrain future utility construction spending to the approximate level of depreciation currently in rates. As described under Environmental Issues starting on page 40, the subsidiaries could potentially face significant mandated increases in construction expenditures and operating costs related to environmental issues. Whether the regulated utility subsidiaries can continue to meet the majority of their construction needs with internally generated cash is largely dependent upon the outcome of these issues. The subsidiaries also have additional capital requirements for debt maturities (see Note M to the consolidated financial statements).

Internal Cash Flow Internal generation of cash, consisting of cash flows from operations reduced by dividends, was \$415 million in 1999, compared with \$381 million in 1998. Current rate levels and reduced levels of construction expenditures permitted the utility subsidiaries to finance all of their construction expenditures in 1999 and 1998 with internal cash flow.

Dividends paid on common stock in each of the years 1999 and 1998 were \$1.72 per share. The dividend payout ratio in 1999 of 64.6%, excluding the extraordinary and other charges, decreased from the 73.5% ratio in 1998, excluding the extraordinary charge and the Pennsylvania settlement costs.

Financing The Company did not issue any common stock in 1999 or 1998. The Company began a stock repurchase program in 1999 to repurchase common stock worth up to \$500 million from time to time at price levels the Company deems attractive. The Company repurchased 12 million shares of its common stock in 1999 at an aggregate cost of \$398.4 million (an average cost of \$33.20 per share). The shares for its Dividend Reinvestment and Stock Purchase Plan, Employee Stock Ownership and Savings Plan, Restricted Stock Plan for Outside Directors, and Performance Share Plan were purchased on the open market.

Short-term debt is used to meet temporary cash needs and increased \$382.3 million to \$641.1 million in 1999. At December 31, 1999, unused lines of credit with banks were \$435 million.

The Company and its subsidiaries anticipate meeting their 2000 cash needs through internal cash generation, cash on hand, short-term borrowings as necessary, external financings, and by issuing debt to refinance maturing first mortgage bonds. In 1999, West Penn issued \$600 million of transition bonds with varying average lives ranging from one to eight years with a weighted average cost of 6.887% to "securitize" transition costs related to its restructuring settlement described in Note B to the consolidated

financial statements. During 1999, West Penn reacquired all of its outstanding \$525 million of first mortgage bonds.

West Penn called or redeemed all outstanding shares of its cumulative preferred stock with a combined par value of \$79.7 million plus redemption premiums of \$3.3 million on July 15, 1999, with proceeds from new \$84-million five-year unsecured medium-term notes issued in the second quarter at a 6.375% coupon rate. Potomac Edison called all outstanding shares of its cumulative preferred stock with a combined par value of \$16.4 million plus redemption premiums of \$.5 million on September 30, 1999, with funds on hand. The redemption of the preferred stock allowed West Penn to revise its Articles of Incorporation, providing greater financial flexibility in restructuring debt. Potomac Edison also plans to revise its Articles of Incorporation.

In April 1999, Monongahela Power, Potomac Edison, and West Penn issued \$7.7 million, \$9.3 million, and \$13.83 million, respectively, of 5.50% 30-year pollution control revenue notes to Pleasants County, West Virginia. In December 1999, Monongahela Power issued \$110 million of 7.36% unsecured medium-term notes, due in January 2010, in part to finance the purchase of West Virginia Power.

In October 1999, AYP Energy prepaid \$30 million of its bank loan, reducing the obligation from \$160 million to \$130 million. In December 1999, the \$130 million debt obligation was assigned to Allegheny Energy Supply.

The Company's and West Penn's aggregate limit of short-term debt financing was increased in accordance with SEC authorization on May 19, 1999, and October 8, 1999, respectively. The Company's limit increased from \$400 million to \$750 million through December 31, 2007, to enhance its ability to participate in evolving energy markets resulting from deregulation and, upon application and approval, to support acquisition and diversification plans. West Penn's limit increased from \$182 million to \$500 million through December 31, 2001, related to meeting the requirements of restructuring in Pennsylvania.

The long-term debt due within one year at December 31, 1999, of \$189.7 million represents \$65 million of Monongahela Power 5% first mortgage bonds due April 1, 2000, \$75 million of Potomac Edison 5% first mortgage bonds due March 1, 2000, and \$49.7 million of West Penn Funding, LLC, transition bonds due on various dates. The transition bonds are supported by an Intangible Transition Charge (ITC) that replaces a portion of the Competitive Transition Charge customers pay. The proceeds from the ITC will be used to pay the principal and interest on these transition bonds, as well as other associated expenses.

SIGNIFICANT CONTINUING ISSUES

Electric Energy Competition The electricity supply segment of the electric utility industry in the United States is becoming increasingly competitive. The national *Energy Policy Act of 1992* deregulated the wholesale exchange of power within the electric industry by permitting the FERC to compel electric utilities to allow third parties to sell electricity to wholesale customers over their transmission systems. Since 1992, the wholesale electricity

market has become more competitive as companies are engaging in nationwide power trading. In addition, an increasing number of states have taken active steps toward allowing retail customers the right to choose their electricity supplier. The Company has been an advocate of federal legislation to create competition in the retail electricity markets to avoid regional dislocations and ensure level playing fields. Legislation before the U.S. Congress to restructure the nation's electric utility industry cleared an important hurdle on October 28, 1999, when a House Commerce Committee subcommittee gave its approval to a bill. The bill will now move on to the full Commerce Committee, where it will be considered in 2000.

In the absence of federal legislation, state-by-state implementation of deregulation of electric generation is under way. The five states in which the Company's utility operating companies serve customers are at various stages of implementation or investigation of programs that allow customers to choose their electric supplier. Pennsylvania is furthest along with a retail program in place, while Maryland, Ohio, and Virginia passed legislation in 1999 to implement retail choice. West Virginia continues to actively study this issue. On December 23, 1999, the Maryland PSC approved a settlement agreement for Potomac Edison to implement generation competition in Maryland.

Activities at the Federal Level The Company continues to seek enactment of federal legislation to bring choice to all retail electric customers, deregulate the generation and sale of electricity on a national level, and create a more liquid, free market for electric power. Fully meeting challenges in the emerging competitive environment will be difficult for the Company unless certain outmoded and anti-competitive laws, specifically the *Public Utility Holding Company Act of 1935 (PUHCA)* and Section 210 (Mandatory Purchase Provisions) of PURPA, are repealed or significantly revised. The Company continues to advocate the repeal of PUHCA and Section 210 of PURPA on the grounds that they are obsolete and anti-competitive and that PURPA results in utility customers paying above-market prices for power. H.R. 2944, which was sponsored by U.S. Representative Joe Barton, was favorably reported out of the House Commerce Subcommittee on Energy and Power. While the bill does not mandate a date certain for customer choice, several key provisions favored by the Company are included in the legislation, including an amendment that allows existing state restructuring plans and agreements to remain in effect. Other provisions address important Company priorities by repealing PUHCA and the mandatory purchase provisions of PURPA. Consensus remains elusive, with significant hurdles remaining in both houses of Congress. It is too early to tell whether momentum on the issue will result in legislation in 2000.

Maryland Activities On April 8, 1999, Maryland Governor Glendening signed the legislation that will bring competition to Maryland's electric generation market, beginning July 1, 2000. The Maryland PSC is in the process of implementing the new

law. Final Electric Restructuring Roundtable reports were filed with the Maryland PSC on May 3, 1999, and legislative-style hearings were held last summer on the reports. The Company filed testimony in Maryland's investigation into transition costs, price protection, and unbundled rates, and a consensus settlement agreement was achieved with no protest by any of the parties participating in the negotiations. The agreement was filed on September 23, 1999, and a hearing before the Commission was held on October 14, 1999. On December 23, 1999, the Maryland PSC issued an order approving the settlement. Potomac Edison filed an application on December 15, 1999, to transfer its Maryland generating assets at book value to an affiliate under Section 7-508 of the *Electric Customer Choice and Competition Act of 1999*. A Maryland PSC decision approving the transfer of the generating assets is due by July 1, 2000. See Note B to the consolidated financial statements for additional information related to Maryland restructuring.

Ohio Activities On June 22, 1999, the Ohio General Assembly passed legislation to restructure its electric utility industry. Governor Taft added his signature soon thereafter, and all of the state's customers will be able to choose their electricity supplier starting January 1, 2001, beginning a five-year transition to market rates. Total electric rates will be frozen over that period, and residential customers are guaranteed a 5% cut in the generation portion of their rate. The determination of stranded cost recovery will be handled by the Public Utilities Commission of Ohio (Ohio PUC). On January 3, 2000, Monongahela Power filed a transition plan with the Ohio PUC, including its claim for recovery of stranded costs of \$21.3 million. The Ohio PUC is expected to hold hearings on Monongahela Power's transition plan filing and issue a decision by October 2000.

The Ohio legislation stipulates that an entity independent of the utilities shall own or control transmission facilities after the start of competitive retail electric service on January 1, 2001, but not later than December 31, 2003. Customer protections were kept intact with a low-income assistance plan and a one-time forgiveness of past debts for low-income and handicapped customers. In regard to renewable energy, the bill requires that electric generators purchase excess electricity from small businesses and homes using renewable energy sources.

Pennsylvania Activities In December 1996, Pennsylvania enacted the Customer Choice Act to restructure its electric industry to create retail access to a competitive electric energy supply market. Approximately 45% of the Company's retail revenues were from its Pennsylvania subsidiary, West Penn. On May 29, 1998 (as amended on November 19, 1998), the Pennsylvania PUC granted final approval to West Penn's restructuring plan. As of January 2, 2000, all electricity customers in Pennsylvania had the right to choose their electric suppliers. Two-thirds of all retail customers had a choice throughout 1999, the first year of retail choice following a pilot program. The number of customers who have switched suppliers and the amount of electrical load transferred in

Pennsylvania far exceed that of any other state so far. However, for the Company, only about 12,700 of its 656,000 Pennsylvania customers eligible to shop in 1999 have chosen an alternate energy supplier. The Company has retained about 98% of its Pennsylvania customers through December 31, 1999. More than 100 electric generation suppliers have been licensed to sell to retail customers in Pennsylvania. See Notes B and C to the consolidated financial statements for additional information related to Pennsylvania restructuring.

Virginia Activities On March 25, 1999, Governor Gilmore signed the *Virginia Electric Utility Restructuring Act (Restructuring Act)* passed by the Virginia General Assembly. All utilities must submit a restructuring plan by January 1, 2001, to be effective on January 1, 2002. Customer choice will be phased in beginning on January 1, 2002, with full customer choice by January 1, 2004. The Legislative Transition Task Force on Electric Utility Restructuring, which was established by the Restructuring Act to oversee the implementation of customer choice, held hearings in the summer and fall of 1999 on a number of issues concerning the implementation of retail competition in Virginia. Parties have also been working with the Virginia SCC Staff to develop the rules governing the proposed retail pilot programs of other utilities in the state.

West Virginia Activities In March 1998, legislation was passed by the West Virginia Legislature that directed the W.Va. PSC to meet with all interested parties to develop a restructuring plan which would meet the dictates and goals of the legislation. Interested parties formed a Task Force that met during 1998, but the Task Force was unable to reach a consensus on a model for restructuring. The W.Va. PSC held hearings in August 1999 that addressed certification, licensing, bonding, reliability, universal service, consumer protection, code of conduct, subsidies, and stranded costs. The W.Va. PSC on December 20, 1999, released for comment and hearings a modified version of a proposal submitted by members of the Task Force, including Monongahela Power and Potomac Edison, following the August 1999 hearings that could open full retail competition as early as January 1, 2001. The production of power would be deregulated and electricity rates would be frozen for four years with rates gradually transitioning to market rates over the six years thereafter. After hearings in January 2000, the W.Va. PSC submitted a restructuring plan endorsed by members of the Task Force, including Monongahela Power and Potomac Edison, to the Legislature for approval.

Accounting for the Effects of Price Deregulation In July 1997, the Emerging Issues Task Force (EITF) of the FASB released Issue No. 97-4, "Deregulation of the Pricing of Electricity—Issues Related to the Application of FASB Statement Nos. 71 and 101," which concluded that utilities should discontinue application of SFAS No. 71 for the generation portion of their business when a deregulation plan is in place and its terms are known. In accordance with guidance of EITF Issue No. 97-4,

the Company has discontinued the application of SFAS No. 71 to its electric generation business in Pennsylvania and Maryland. The legislation passed in Ohio and Virginia established definitive processes for transition to deregulation and market-based pricing for electric generation. However, the deregulation plans and their terms in Ohio and Virginia will not be known until relevant regulatory proceedings are complete and final orders are received. The Company is unable to predict the effect of discontinuing SFAS No. 71 in Ohio and Virginia, but it may be required to write off unrecoverable regulatory assets, impaired assets, and uneconomic commitments. Also, the Company is unable to predict the outcome of the deregulation process in West Virginia until further actions are taken by the Legislature and the W.Va. PSC.

Environmental Issues In the normal course of business, the subsidiaries are subject to various contingencies and uncertainties relating to their operations and construction programs, including legal actions and regulations and uncertainties related to environmental matters.

The significant costs of complying with Title IV (acid rain) provisions of Phase I of the *Clean Air Act Amendments of 1990 (CAAA)* have been incurred and are included in the cost of the related generation facilities. The Company estimates that its banked emission allowances will allow it to comply with Phase II sulfur dioxide (SO₂) limits through 2005. Studies to evaluate cost-effective options to comply with Phase II emission limits beyond 2005, including those available in connection with the emission allowance trading market, are continuing.

Title I of the CAAA established an Ozone Transport Commission to ascertain additional nitrogen oxides (NO_x) reductions to allow the Ozone Transport Region (OTR) to meet the ozone National Ambient Air Quality Standards (NAAQS). Under terms of a Memorandum of Understanding (MOU) among the OTR states, the subsidiaries' generating stations located in Maryland and Pennsylvania were required to reduce NO_x emissions by approximately 55% from the 1990 baseline emissions, with a compliance date of May 1999. Further reductions of 75% from the 1990 baseline may be required by May 2003 under Phase III of the MOU. However, this reduction will most likely be superseded by the proposed NO_x *State Implementation Plan (SIP)* call rule discussed below. If reductions of 75% are required, installation of post-combustion control technologies would be very expensive. Pennsylvania and Maryland promulgated regulations to implement Phase II of the MOU in November 1997 and May 1998, respectively. However, as a result of litigation, the Maryland regulation was revised to postpone compliance to May 2000.

The Ozone Transport Assessment Group issued its final report in June 1997 and recommended that the Environmental Protection Agency (EPA) consider a range of NO_x controls between existing CAAA Title IV controls and the less stringent of an 85% reduction from the 1990 emission rate or 0.15 lb/mmBtu. The EPA initiated the regulatory process to adopt the recommendations

and issued its final NO_x SIP call rule on September 24, 1998. The EPA's SIP call rule finds that 22 eastern states (including Maryland, Pennsylvania, and West Virginia) and the District of Columbia are all contributing significantly to ozone nonattainment in downwind states. The final rule declares that this downwind nonattainment will be eliminated (or sufficiently mitigated) if the upwind states reduce their NO_x emissions by an amount that is precisely set by the EPA on a state-by-state basis. The final SIP call rule requires that all state-adopted NO_x reduction measures must be incorporated into SIPs by September 24, 1999, and must be implemented by May 1, 2003. The Company's compliance with these requirements would require the installation of post-combustion control technologies on most, if not all, of the subsidiaries' power stations. The Company continues to work with other coal-burning utilities and other affected constituencies in coal-producing states to challenge this EPA action. While the SIP call is being litigated, the Company is making preliminary plans to comply by applying NO_x reduction facilities to existing units at various power stations.

In August 1997, eight northeastern states filed Section 126 petitions with the EPA requesting the immediate imposition of up to an 85% NO_x reduction from utilities located in the Midwest and Southeast (West Virginia included). The petitions claim NO_x emissions from these upwind sources are preventing their attainment with the ozone standard. In December 1997, the petitioning states and the EPA signed a Memorandum of Agreement to address these petitions in conjunction with the related SIP call. In May 1999, the EPA issued a technical approval of the petition and, in December 1999, granted final approval of four of the petitions. The Section 126 petition rulemaking is also under litigation.

The EPA is required by law to regularly review the NAAQS for criteria pollutants. Recent court orders in litigation by the American Lung Association have expedited these reviews. The EPA in 1996 decided not to revise the SO₂ and NO_x standards. Revisions to particulate matter and ozone standards were proposed by the EPA in 1996 and finalized in July 1997. However, the revised standards were legally challenged, and, in May 1999, the District of Columbia Circuit Court of Appeals remanded the revised standards back to the EPA for further consideration. Also, in May 1999, the EPA promulgated final regional haze regulations to improve visibility in Class I federal areas (national parks and wilderness areas). If eventually upheld in court, subsequent state regulations could require additional reduction of SO₂ and/or NO_x emissions from the subsidiaries' facilities. The effect on the Company of revision to any of these standards or regulations is unknown at this time, but could be substantial.

The final outcome of the revised ambient standards, Phase III of the MOU, SIP call rule, and Section 126 petitions cannot be determined at this time. All are being challenged by rulemaking, petition, and/or the litigation process. Implementation dates are also uncertain at this time, but could be as early as 2003, which would require substantial capital expenditures in the 2000 through 2003 period. The Company's construction forecast

includes the expenditure of \$358 million of capital costs during the 2000 through 2003 period to comply with the SIP call. In addition, \$12 million was spent in 1999.

Global climate change is alleged to be the result of the atmospheric accumulation of certain gases collectively referred to as greenhouse gases (GHG), the most significant of which is carbon dioxide (CO₂). Human activities, particularly combustion of fossil fuels, are alleged to be responsible for this accumulation of GHG. The Clinton Administration has signed an international treaty called the Kyoto Protocol, which would require the United States to reduce emissions of GHG by 7% from 1990 levels in the 2008 through 2012 time period. The United States Senate must ratify the Kyoto Protocol before it enters into force. The Senate passed a resolution in 1997 that placed two conditions on entering into any international climate change treaty. First, any treaty must include all nations, and, second, any treaty must not cause serious harm to the United States' economy. The Kyoto Protocol does not appear to satisfy either of these conditions, and, therefore, the Clinton Administration has withheld it from consideration by the Senate. Because coal combustion in power plants produces about 33% of the United States' CO₂ emissions, implementation of the Kyoto Protocol would raise considerable uncertainty about the future viability of coal as a fuel source for new and existing power plants. The Company has taken numerous voluntary, precautionary steps to address the issue of global climate change.

Many uncertainties remain in the global climate change debate, including the relative contributions of human activities and natural processes, the extremely high potential costs of extensive mitigation efforts, and the significant economic and social disruptions which may result from a large-scale reduction in the use of fossil fuels. The Company will continue to explore cost-effective opportunities to improve efficiency and performance.

The Company actively participates in climate-related research programs and is responsive to the voluntary guidelines suggested in the national *Energy Policy Act of 1992*, under Section 1605(b), directed toward reducing, controlling, avoiding, and sequestering greenhouse gases. The Company has taken many concrete steps to reduce greenhouse gases and help stimulate a business climate that encourages improved efficiency, performance, electrical loss reductions, and cost-effectiveness.

The EPA had identified Monongahela Power, Potomac Edison, and West Penn as potentially responsible parties, along with approximately 175 others, in a Superfund site subject to cleanup. A final determination has not been made for the Company's share of the remediation costs based on the amount of materials sent to the site. Monongahela Power, Potomac Edison, and West Penn have also been named as defendants along with multiple other defendants in pending asbestos cases involving one or more plaintiffs. The Company believes that provisions for liability and insurance recoveries are such that final resolution of these claims will not have a material effect on its financial position (see Note P to the consolidated financial statements for additional information).

On Earth Day 1997, President Clinton announced the expansion of the federal *Emergency Planning and Community Right-to-Know Act (RTK)* reporting to include electric utilities, limited to facilities that combust coal and/or oil for the purpose of generating power for distribution in commerce. The purpose of RTK is to provide site-specific information on chemical releases to the air, land, and water. On June 4, 1999, the Company joined with other members of the Edison Electric Institute in reporting power station releases to the public. Packets of information about the Company's releases were provided to the news media in the Company's service area and posted on the Company's web site. The Company filed its first RTK-related report with the EPA in advance of the July 1, 1999, deadline, reporting 18 million pounds of total releases for calendar year 1998.

The Attorney General of the State of New York and the Attorney General of the State of Connecticut in their letters dated September 15, 1999, and November 3, 1999, respectively, notified the Company of their intent to commence civil actions against the Company and/or its subsidiaries alleging violations at the Fort Martin Power Station under the federal *Clean Air Act*, which requires existing power plants that make major modifications to comply with the same emission standards applicable to new power plants. Similar actions may be commenced by other governmental authorities in the future. Fort Martin is a station located in West Virginia and is now jointly owned by Allegheny Energy Supply, Monongahela Power, and Potomac Edison. Both Attorneys General stated their intent to seek injunctive relief and penalties. In addition, the Attorney General of the State of New York in his letter indicated that he may assert claims under the State common law of public nuisance seeking to recover, among other things, compensation for alleged environmental damage caused in New York by the operation of Fort Martin Power Station. At this time, the Company and its subsidiaries are not able to determine what effect, if any, these actions threatened by the Attorneys General of New York and Connecticut may have on them.

Regional Transmission Organization In adopting its Rule 2000, the FERC defined requirements for transmission facility owners to participate in some form of Regional Transmission Organization. Additionally, the state jurisdictions within which the Company operates have, to different degrees, started to define their transition to a competitive marketplace. As part of this, they have identified transmission as a key link to making the electricity market efficient. The nature of this issue is at least regional in scope. As a result, any solution will need to be one that satisfies a diverse group of stakeholders. The Company has actively participated in this debate and continues to evaluate the available options to provide its customers with the most reliable, cost-effective service while maintaining a clear focus on the financial interests of its shareholders.

Energy Risk Management The Company is exposed through one of its nonutility subsidiaries, Allegheny Energy Supply, to a variety of commodity-driven risks associated with energy trading activities. Market risk arises from the potential for changes in the value of energy related to price and volatility of the market. These risks are reduced by using the Company's generation assets to back positions on physical transactions. Credit risk represents the potential loss that the Company would incur as a result of non-performance by counterparties in honoring their contractual commitments. These risks can influence earnings, cash flows, and the ability to provide value to shareholders.

The Company has a Corporate Energy Risk Control Policy adopted by the Board of Directors and monitored by an Exposure Management Committee of senior management. An independent risk management function is responsible for insuring compliance with the Policy. A value at risk model is used to measure the market exposure resulting from trading activities. Value at risk is a statistical model that attempts to predict risk of loss based on historical market price and volatility data over a given period of time. The credit standing of counterparties is established through the evaluation of the prospective counterparty's financial condition, specified collateral requirements where deemed necessary, and the use of standardized agreements which facilitate the netting of cash flows associated with a single counterparty. Financial conditions of existing counterparties are monitored on an ongoing basis. Market exposure and credit risk have established aggregate and counterparty limits that are monitored within the guidelines of the Company's Energy Risk Control Policy.

Fort Martin Power Station Unit No. 1, a stand-alone unit owned by an unregulated subsidiary, AYP Energy, was transferred to Allegheny Energy Supply. Transfer of this generation asset mitigates the trading risk that exists with a single generating unit.

Derivative Instruments and Hedging Activities In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Company will be required to recognize derivatives as defined by SFAS No. 133 on the balance sheet at fair value. The Company is evaluating the effect of adopting SFAS No. 133 on its results of operations and financial position which will be completed during the year 2000. Accounting for changes in the fair value of a derivative depends on the intended use of the derivative and whether the instrument meets the requirements for designation as a hedge. The Company expects to adopt SFAS No. 133 no later than January 1, 2001.

Consolidated Statement of Income

Allegheny Energy, Inc.

Year ended December 31	1999	1998	1997
<i>(Thousands of dollars except per share data)</i>			
Operating revenues:*			
Utility	\$2,273,727	\$2,329,450	\$2,283,697
Nonutility	534,714	246,986	85,794
Total operating revenues	2,808,441	2,576,436	2,369,491
Operating expenses:			
Operation:			
Fuel	535,674	566,453	559,939
Purchased power and exchanges, net	531,431	388,758	219,837
Deferred power costs, net	41,577	(6,639)	(22,916)
Other	389,406	337,440	308,991
Maintenance	223,538	217,559	230,602
Depreciation and amortization	257,456	270,379	265,750
Taxes other than income taxes	190,271	194,583	186,978
Federal and state income taxes	164,441	168,396	168,073
Total operating expenses	2,333,794	2,136,929	1,917,254
Operating income	474,647	439,507	452,237
Other income and deductions:			
Allowance for other than borrowed funds used during construction	1,840	1,553	4,393
Other income, net	1,605	8,180	18,016
Total other income and deductions	3,445	9,733	22,409
Income before interest charges, preferred dividends, preferred redemption premiums, and extraordinary charge, net	478,092	449,240	474,646
Interest charges, preferred dividends, and preferred redemption premiums:			
Interest on long-term debt	155,198	161,057	173,568
Other interest	31,612	19,395	14,409
Allowance for borrowed funds used during construction and interest capitalized	(5,070)	(3,471)	(3,907)
Dividends on preferred stock of subsidiaries	7,183	9,251	9,280
Redemption premiums on preferred stock of subsidiaries	3,780		
Total interest charges, preferred dividends, and preferred redemption premiums	192,703	186,232	193,350
Consolidated income before extraordinary charge	285,389	263,008	281,296
Extraordinary charge, net	(26,968)	(275,426)	
Consolidated net income (loss)	\$ 258,421	\$ (12,418)	\$ 281,296
Common stock shares outstanding (average)	116,237,443	122,436,317	122,208,465
Basic and diluted earnings per average share:			
Consolidated income before extraordinary charge	\$2.45	\$ 2.15	\$2.30
Extraordinary charge, net	(.23)	(2.25)	
Consolidated net income (loss)	\$2.22	\$ (.10)	\$2.30

*Excludes intercompany sales between utility and nonutility.
See accompanying notes to consolidated financial statements.

Consolidated Statement of Cash Flows

Allegheny Energy, Inc.

Year ended December 31	1999	1998*	1997*
<i>(Thousands of dollars)</i>			
Cash flows from operations:			
Consolidated net income (loss)	\$ 258,421	\$ (12,418)	\$ 281,296
Extraordinary charge, net of taxes	26,968	275,426	
Consolidated income before extraordinary charge	285,389	263,008	281,296
Depreciation and amortization	257,456	270,379	265,750
Amortization of adverse purchase power contract	(11,146)		
Deferred revenues	34,849		
Deferred investment credit and income taxes, net	40,035	20,998	66,362
Deferred power costs, net	41,577	(6,639)	(22,916)
Allowance for other than borrowed funds used during construction	(1,840)	(1,553)	(4,393)
Internal restructuring liability		(5,504)	(50,597)
PURPA project buyout			(48,000)
Write-off of merger-related and generation project costs	35,862		
Changes in certain assets and liabilities:			
Accounts receivable, net	(77,679)	15,365	(6,052)
Materials and supplies	2,209	(12,852)	(1,385)
Accounts payable	80,224	23,118	(17,172)
Taxes accrued	7,798	14,312	(3,653)
Benefit plans' investments	(6,700)	(7,994)	(16,277)
Prepayments	(19,158)		
Restructuring settlement rate refund	(25,100)		
Other, net	(25,516)	18,544	35,663
	618,260	591,182	478,626
Cash flows from investing:			
Utility construction expenditures (less allowance for other than borrowed funds used during construction)	(264,365)	(227,809)	(280,255)
Nonutility construction expenditures and investments	(147,160)	(6,205)	(829)
Acquisition of businesses	(98,714)		
	(510,239)	(234,014)	(281,084)
Cash flows from financing:			
Sale of common stock			16,706
Repurchase of common stock	(398,407)		
Retirement of preferred stock	(96,086)		
Issuance of long-term debt	824,143	211,952	
Retirement of long-term debt	(555,000)	(419,780)	(46,892)
Funds on deposit with trustees and restricted funds	(13,279)		
Short-term debt, net	382,258	52,436	49,971
Cash dividends paid on common stock	(203,225)	(210,591)	(210,195)
	(59,596)	(365,983)	(190,410)
Net change in cash and temporary cash investments	48,425	(8,815)	7,132
Cash and temporary cash investments at January 1	17,559	26,374	19,242
Cash and temporary cash investments at December 31	\$ 65,984	\$ 17,559	\$ 26,374
Supplemental cash flow information			
Cash paid during the year for:			
Interest (net of amount capitalized)	\$ 170,498	\$ 171,719	\$ 178,121
Income taxes	124,180	145,053	108,519

See accompanying notes to consolidated financial statements.

*Certain amounts have been reclassified for comparative purposes.

Consolidated Balance Sheet

Allegheny Energy, Inc.

As of December 31	1999	1998*
<i>(Thousands of dollars)</i>		
Assets		
Property, plant, and equipment:		
Utility plant	\$ 6,547,533	\$ 8,041,628
Nonutility plant	2,060,423	187,309
Construction work in progress	231,763	166,330
	8,839,719	8,395,267
Accumulated depreciation	(3,632,568)	(3,395,603)
	5,207,151	4,999,664
Investments and other assets:		
Excess of cost over net assets acquired	42,584	15,077
Benefit plans' investments	94,168	87,468
Nonutility investments	15,252	9,361
Other	1,479	1,566
	153,483	113,472
Current assets:		
Cash and temporary cash investments	65,984	17,559
Accounts receivable:		
Electric service	383,316	294,877
Other	12,273	17,712
Allowance for uncollectible accounts	(26,975)	(19,560)
Materials and supplies—at average cost:		
Operating and construction	92,560	99,439
Fuel	62,280	57,610
Prepaid taxes	58,190	56,658
Deferred income taxes	30,477	21,868
Other, including current portion of regulatory assets	31,205	30,788
	709,310	576,951
Deferred charges:		
Regulatory assets	663,847	704,506
Unamortized loss on reacquired debt	41,825	48,671
Other	76,825	91,931
	782,497	845,108
Total	\$ 6,852,441	\$ 6,535,195
Capitalization and liabilities		
Capitalization:		
Common stock, other paid-in capital, retained earnings, less treasury stock (at cost)	\$ 1,695,325	\$ 2,033,889
Preferred stock	74,000	170,086
Long-term debt and QUIDS	2,254,463	2,179,288
	4,023,788	4,383,263
Current liabilities:		
Short-term debt	641,095	258,837
Long-term debt due within one year	189,734	
Accounts payable	233,331	153,107
Taxes accrued:		
Federal and state income	20,699	17,442
Other	67,292	62,751
Interest accrued	34,979	35,945
Adverse power purchase commitments	24,895	22,622
Other, including current portion of regulatory liabilities	96,510	101,239
	1,308,535	651,943
Deferred credits and other liabilities:		
Unamortized investment credit	116,971	125,396
Deferred income taxes	920,943	882,779
Regulatory liabilities	78,743	80,354
Adverse power purchase commitments	303,935	328,830
Other	99,526	82,630
	1,520,118	1,499,989
Commitments and contingencies (Note P)		
Total	\$ 6,852,441	\$ 6,535,195

*Certain amounts have been reclassified for comparative purposes.
See accompanying notes to consolidated financial statements.

Consolidated Statement of Capitalization

Allegheny Energy, Inc.

As of December 31	Thousands of dollars		Capitalization ratios	
	1999	1998	1999	1998
Common stock:				
Common stock of Allegheny Energy, Inc.—				
\$1.25 par value per share, 260,000,000 shares authorized,				
122,436,317 shares issued, 110,436,317 shares outstanding				
	\$ 153,045	\$ 153,045		
Other paid-in capital	1,044,085	1,044,085		
Retained earnings	896,602	836,759		
Treasury stock (at cost)—12,000,000 shares	(398,407)			
Total	1,695,325	2,033,889	42.1%	46.4%
Preferred stock of subsidiaries—cumulative, par value				
\$100 per share, authorized 38,878,611 shares:				
	December 31, 1999			
Series	Shares Outstanding	Regular Call Price Per Share		
4.40–4.80%	190,000	\$103.50 to \$106.50	19,000	65,086
\$5.88–\$7.73	550,000	\$100.00 to \$102.86	55,000	65,000
Auction				40,000
Total (annual dividend requirements \$5,037)			74,000	170,086
			1.9%	3.9%
Long-term debt and QUIDS of subsidiaries:				
First mortgage bonds:	December 31, 1999			
Maturity	Interest Rate—%			
2000	5 ⁵ / ₈ – 5 ⁷ / ₈		140,000	140,000
2002–2004	7 ³ / ₈		25,000	175,000
2006–2007	7 ¹ / ₄ – 8		75,000	120,000
2021–2025	7 ⁵ / ₈ – 8 ⁵ / ₈		480,000	810,000
Transition bonds due 2000–2008	6.32–6.98		600,000	
Debentures due 2003–2023	5 ⁵ / ₈ – 6 ⁷ / ₈		150,000	150,000
Quarterly Income Debt Securities due 2025	8.00		155,457	155,457
Secured notes due 2003–2029	4.70–6.875		399,130	368,300
Unsecured notes due 2002–2012	4.35–5.10		23,695	23,695
Installment purchase obligations due 2003	4.50		19,100	19,100
Medium-term debt due 2001–2010	5.56–7.36		401,025	237,025
Unamortized debt discount and premium, net			(13,937)	(19,289)
Total (annual interest requirements \$165,938)			2,454,470	2,179,288
Less amounts on deposit with trustees			(10,273)	
Less current maturities			(189,734)	
Total			2,254,463	2,179,288
Total capitalization			\$4,023,788	\$4,383,263
			56.0%	49.7%
			100.0%	100.0%

See accompanying notes to consolidated financial statements.

Consolidated Statement of Common Equity

Allegheny Energy, Inc.

Year ended December 31	Thousands of Dollars					
	Shares Outstanding	Common Stock	Other Paid-In Capital	Retained Earnings (Note H)	Treasury Stock	Total Common Equity
Balance at January 1, 1997	121,840,327	\$152,300	\$1,028,124	\$ 988,667		\$2,169,091
Sale of common stock, net of expenses:						
Dividend Reinvestment and Stock Purchase Plan, Employee Stock Ownership and Savings Plan, and Performance Share Plan						
	595,990	745	15,961			16,706
Consolidated net income				281,296		281,296
Dividends on common stock of the Company (declared)				(210,195)		(210,195)
Balance at December 31, 1997	122,436,317	\$153,045	\$1,044,085	\$1,059,768		\$2,256,898
Consolidated net loss				(12,418)		(12,418)
Dividends on common stock of the Company (declared)				(210,591)		(210,591)
Balance at December 31, 1998	122,436,317	\$153,045	\$1,044,085	\$ 836,759		\$2,033,889
Consolidated net income				258,421		258,421
Treasury stock	(12,000,000)				\$(398,407)	(398,407)
Dividends on common stock of the Company (declared)				(198,578)		(198,578)
Balance at December 31, 1999	110,436,317	\$153,045	\$1,044,085	\$ 896,602	\$(398,407)	\$1,695,325

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Allegheny Energy, Inc.

(These notes are an integral part of the consolidated financial statements.)

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Allegheny Energy, Inc. (the Company) is a utility holding company and its principal business segments are utility and nonutility operations. The utility subsidiaries, Monongahela Power Company (Monongahela Power), The Potomac Edison Company (Potomac Edison), and West Penn Power Company (West Penn), collectively now doing business as Allegheny Power, are engaged in the generation (except West Penn), purchase, transmission, distribution, and sale of electric energy and are subject to federal and state regulation including the *Public Utility Holding Company Act of 1935 (PUHCA)*. The markets for the subsidiaries' regulated electric retail sales are in Pennsylvania, West Virginia, Maryland, Virginia, and Ohio. In 1999, revenues from the 50 largest electric utility customers provided approximately 15% of the consolidated retail revenues. Nonutility operations consist of the Company's unregulated energy supply business, with the primary objective of selling electricity into the competitive marketplace, and Allegheny Ventures, Inc. (Allegheny Ventures), a wholly owned subsidiary which develops new business opportunities, with an emphasis on telecommunications and energy-related products and services. Unregulated energy supply includes the Company's existing generation as deregulation is implemented in the five states where the Company's traditional utility business has operated and new generating capacity to be constructed or acquired by the Company. In November 1999, the Company formed Allegheny Energy Supply Company, LLC (Allegheny Energy Supply), a wholly owned nonutility generating subsidiary, to consolidate its unregulated energy supply business.

Allegheny Energy Supply was formed when West Penn transferred its deregulated generating capacity of 3,778 megawatts (MW) at book value to Allegheny Energy Supply, as allowed by the final settlement in West Penn's Pennsylvania restructuring case. Allegheny Energy Supply also purchased from AYP Energy, Inc. (AYP Energy) its 276 MW of merchant capacity at Fort Martin Unit No. 1.

The Company's nonutility subsidiaries operate primarily in the Mid-Atlantic region. In 1999, 82% of nonutility revenues were from bulk power sales. Nonutility operations may be subject to federal regulation, but are not subject to state regulation of rates.

See Note B for significant changes in the Pennsylvania and Maryland regulatory environment. Certain amounts in the December 31, 1998, consolidated balance sheet and in the December 31, 1998, and 1997 consolidated statement of cash flows have been reclassified for comparative purposes. Significant accounting policies of the Company and its subsidiaries are summarized below.

Consolidation The Company owns all of the outstanding common stock of its subsidiaries. The consolidated financial statements include the accounts of the Company and all subsidiary companies after elimination of intercompany transactions.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that affect the reported amounts of assets, liabilities, revenues, expenses, and disclosures of contingencies during the reporting period, which in the normal course of business are subsequently adjusted to actual results.

Revenues Revenues, including amounts resulting from the application of fuel and energy cost adjustment clauses, are recognized in the same period in which the related electric services are provided to customers. Revenues from nonutility activities are recorded in the period earned.

Deferred Power Costs, Net The costs of fuel, purchased power, and certain other costs, and revenues from sales to other utilities and power marketers, including transmission services, are deferred until they are either recovered from or credited to customers under fuel and energy cost-recovery procedures in Maryland, Ohio, Virginia, and West Virginia. West Penn discontinued this practice in Pennsylvania, effective May 1, 1997, and Potomac Edison will discontinue this practice in Maryland, effective July 1, 2000.

Property, Plant, and Equipment Utility property, plant, and equipment are stated at original cost, less contributions in aid of construction, except for capital leases, which are recorded at present value. Costs include direct labor and material; allowance for funds used during construction on utility property for which construction work in progress is not included in rate base; and indirect costs such as administration, maintenance, and depreciation of transportation and construction equipment, postretirement benefits, taxes, and other benefits related to employees engaged in construction.

The cost of depreciable utility property units retired, plus removal costs less salvage, are charged to accumulated depreciation by the utility subsidiaries that apply the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation."

Nonutility property, plant, and equipment are stated at original cost for self-constructed assets. Property acquired from others is stated at fair market value when acquired. West Penn transferred its deregulated generation plant to Allegheny Energy Supply at book value. Nonutility property is depreciated by the straight-line method over its estimated useful life.

For the nonutility subsidiaries, the cost and accumulated depreciation of property, plant, and equipment retired or otherwise disposed of are removed from related accounts and included in the determination of the gain or loss on disposition.

The Company capitalizes the cost of software developed for internal use. These costs are amortized on a straight-line basis over a five-year period beginning upon a project's completion.

Allowance for Funds Used During Construction (AFUDC) and Capitalized Interest AFUDC, an item that does not represent current cash income, is defined in applicable regulatory systems of accounts as including “the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used.” AFUDC is recognized by the utility subsidiaries as a cost of utility property, plant, and equipment. Rates used by the utility subsidiaries for computing AFUDC in 1999, 1998, and 1997 averaged 6.83%, 7.78%, and 8.59%, respectively.

For nonutility construction, which began after January 1, 1998, the Company capitalizes interest costs in accordance with SFAS No. 34, “Capitalizing Interest Costs.” The interest capitalization rates in 1999 and 1998 were 7.14% and 7.45%, respectively.

Depreciation and Maintenance Depreciation expense is determined generally on a straight-line method based on estimated service lives of depreciable properties and amounted to approximately 3.2% of average depreciable property in 1999 and 3.3% in each of the years 1998 and 1997. The cost of maintenance and of certain replacements of property, plant, and equipment is charged principally to operating expenses.

Investments The Company records the acquisition cost in excess of net assets acquired as an investment in goodwill. Goodwill recorded prior to 1966 is not being amortized because, in management’s opinion, there has been no reduction in its value. Goodwill related to the acquisition of West Virginia Power Company in December 1999 will be amortized over 40 years.

Benefit plans’ investments primarily represent the estimated cash surrender values of purchased life insurance on qualifying management employees under executive life insurance and supplemental executive retirement plans.

Temporary Cash Investments For purposes of the consolidated statement of cash flows, temporary cash investments with original maturities of three months or less, generally in the form of commercial paper, certificates of deposit, and repurchase agreements, are considered to be the equivalent of cash.

Regulatory Assets and Liabilities In accordance with SFAS No. 71, the Company’s consolidated financial statements

include certain assets and liabilities resulting from cost-based ratemaking regulation.

Income Taxes Financial accounting income before income taxes differs from taxable income principally because certain income and deductions for tax purposes are recorded in the financial income statement in another period. Deferred tax assets and liabilities represent the tax effect of temporary differences between the financial statement and tax basis of assets and liabilities computed using the most current tax rates.

The Company has deferred the tax benefit of investment tax credits. Investment tax credits are amortized over the estimated service lives of the related properties.

Postretirement Benefits The Company’s subsidiaries have a noncontributory, defined benefit pension plan covering substantially all employees, including officers. Benefits are based on the employee’s years of service and compensation. The funding policy is to contribute annually at least the minimum amount required under the *Employee Retirement Income Security Act* and not more than can be deducted for federal income tax purposes. Plan assets consist of equity securities, fixed income securities, short-term investments, and insurance contracts.

The Company’s subsidiaries also provide partially contributory medical and life insurance plans for eligible retirees and dependents. Medical benefits, which make up the largest component of the plans, are based upon an age and years-of-service vesting schedule and other plan provisions. Subsidized medical coverage is not provided in retirement to employees hired on or after January 1, 1993. The funding policy is to contribute the maximum amount that can be deducted for federal income tax purposes. Funding of these benefits is made primarily into Voluntary Employee Beneficiary Association trust funds. Medical benefits are self-insured. The life insurance plan is paid through insurance premiums.

Comprehensive Income SFAS No. 130, “Reporting Comprehensive Income,” effective for 1998, established standards for reporting comprehensive income and its components (revenues, expenses, gains, and losses) in the financial statements. The Company does not have any elements of other comprehensive income to report in accordance with SFAS No. 130.

NOTE B: INDUSTRY RESTRUCTURING

Maryland Deregulation On September 23, 1999, Potomac Edison filed a settlement agreement (covering its stranded cost quantification mechanism, price protection mechanism, and unbundled rates) with the Maryland Public Service Commission (Maryland PSC). The agreement was signed by all parties active in the case, except Eastalco, which stated that it would not oppose it. The settlement agreement, which was approved by the Maryland PSC on December 23, 1999, includes the following provisions:

- The ability for nearly all of our 211,000 Maryland customers to have the option of choosing an electric generation supplier starting July 1, 2000.
- The transfer of Potomac Edison’s Maryland jurisdictional generating assets to a nonutility affiliate at book value as of July 1, 2000.
- A reduction in base rates of 7% (\$10.4 million each year totaling \$72.8 million) for residential customers from 2002

through 2008. A reduction in base rates of one-half of 1% (\$1.5 million each year totaling \$10.5 million) for the majority of commercial and industrial customers from 2002 through 2008.

- Standard Offer Service (provider of last resort) will be provided to residential customers during a transition period from July 1, 2000, to December 31, 2008, and to all other customers during a transition period of July 1, 2000, to December 31, 2004.
- A cap on generation rates for residential customers from 2002 through 2008. Generation rates for non-residential customers are capped from 2002 through 2004.
- A cap on transmission and distribution rates for all customers from 2002 through 2004.
- Unless Potomac Edison is subject to significant changes that would materially affect Potomac Edison's financial condition, the parties agree not to seek a reduction in rates which would be effective prior to January 1, 2005.
- The recovery of all purchased power costs incurred as a result of the contract to buy generation from the AES Warrior Run cogeneration facility.
- The establishment of a fund (not to exceed \$.001 per kilowatt-hour (kWh) for residential customers) for the development and use of energy-efficient technologies.

The Maryland PSC on December 23, 1999, also approved Potomac Edison's unbundled rates covering the period 2000 through 2008.

Pennsylvania Deregulation In December 1996, Pennsylvania enacted the *Electricity Generation Customer Choice and Competition Act (Customer Choice Act)* to restructure the electric industry in Pennsylvania to create retail access to a competitive electric energy supply market. Approximately 45% of the Company's retail revenues were from its Pennsylvania subsidiary, West Penn. On August 1, 1997, West Penn filed with the Pennsylvania Public Utility Commission (Pennsylvania PUC) a comprehensive restructuring plan to implement full customer choice of electricity suppliers as required by the Customer Choice Act. The filing included a plan for recovery of transition costs through a Competitive Transition Charge (CTC).

On May 29, 1998 (as amended on November 19, 1998), the Pennsylvania PUC granted final approval to West Penn's restructuring plan, which included the following provisions:

- Established an average shopping credit for West Penn customers who shop for the generation portion of electricity services.
- Provided two-thirds of West Penn's customers the option of selecting a generation supplier on January 2, 1999, with all customers able to shop on January 2, 2000.
- Required a rate refund from 1998 revenue (about \$25 million) via a 2.5% rate decrease throughout 1999, accomplished by an equal percentage decrease for each rate class.
- Provided that customers have the option of buying electricity from West Penn at capped generation rates through 2008, and that transmission and distribution rates are capped

through 2005, except that the capped rates are subject to certain increases as provided for in the Public Utility Code.

- Prohibited complaints challenging West Penn's regulated transmission and distribution rates through 2005.
- Provided about \$15 million of West Penn funding for the development and use of renewable energy and clean energy technologies, energy conservation, energy efficiency, etc.
- Permitted recovery of \$670 million in transition costs plus return over 10 years beginning in January 1999 for West Penn.
- Allowed for income recognition of transition cost recovery in the earlier years of the transition period to reflect the Pennsylvania PUC's projections that electricity market prices are lower in the earlier years.
- Granted West Penn's application to issue bonds to securitize up to \$670 million in transition costs and to provide 75% of the associated savings to customers, with 25% available to shareholders.
- Authorized the transfer of West Penn's generating assets to a nonutility affiliate at book value. Subject to certain time-limited exceptions, the nonutility business can compete in the unregulated energy market in Pennsylvania.

As a result of the May 29, 1998, Pennsylvania PUC order and the November 19, 1998, settlement agreement, an extraordinary charge of \$466.9 million (\$275.4 million after taxes) was recorded in 1998 to reflect a write-off of costs determined to be unrecoverable in connection with the deregulation proceedings in Pennsylvania. 1998 also reflects additional charges of \$40.3 million (\$23.7 million after taxes) related to the West Penn revenue refund and energy program payments. See Note C for additional details.

Starting in 1999, West Penn unbundled its rates to reflect separate prices for the supply charge, the CTC, and transmission and distribution charges. While supply is open to competition, West Penn continues to provide regulated transmission and distribution services to customers in its service area at rates approved by the Pennsylvania PUC and the Federal Energy Regulatory Commission (FERC). West Penn is the electricity provider of last resort for those customers who decide not to choose another electricity supplier.

The Pennsylvania PUC order authorized annual recovery of "transition costs" from distribution customers as follows:

Year	Amount (Millions of dollars)
1999	\$122
2000	121
2001	115
2002	113
2003	112
2004	104
2005	99
2006	98
2007	97
2008	97

These amounts represent the recovery of \$670 million in transition costs plus a return on the unrecovered investment.

Actual transition revenues billed to customers in 1999 totaled \$101 million. The Company has recorded a regulatory asset of \$20 million for the difference in the authorized CTC revenues, adjusted for \$1 million securitization savings to be shared with customers, and the actual transition revenues billed to customers. The Pennsylvania PUC has approved the recovery of this regulatory asset through a true-up mechanism currently in process.

The order also authorized recognition of an additional CTC regulatory asset (Additional CTC Regulatory Asset) as follows:

Year	Amount (Millions of dollars)
1999	\$25
2000	45
2001	60
2002	50

To the extent that West Penn records any or all of the Additional CTC Regulatory Asset, it will be amortized in 2005 through 2008. This Additional CTC Regulatory Asset was approved by the Pennsylvania PUC to reduce the adverse effects, if any, that competition will have on West Penn during the years 1999 to 2002. No Additional CTC Regulatory Asset was recorded by West Penn as of December 31, 1999.

Prior to 1999, the Pennsylvania Customer Choice Act, required all electric utilities in Pennsylvania to establish and administer retail access pilot programs under which customers representing 5% of the load of each rate class would choose an electricity supplier other than their own local franchise utility. The pilot programs began on November 1, 1997, and continued

through December 31, 1998. As ordered by the Pennsylvania PUC, pilot participants received an energy credit to their bills from their local utility and paid an alternate supplier for energy. To assure participation in the pilot program, the credit established by the Pennsylvania PUC was artificially high (greater than West Penn's generation costs), with the result that West Penn suffered a loss of \$8.6 million. West Penn mitigated the loss by competing for sales to pilot participants of other utilities as an alternate supplier. The Pennsylvania PUC approved West Penn's pilot compliance filing and thus has indicated its intent to treat the net revenue loss as a regulatory asset subject to review and potential rate recovery. Accordingly, West Penn deferred the net revenue loss as a regulatory asset.

On August 12, 1999, West Penn filed its Competitive Transition Charge Reconciliation Statement pursuant to the settlement agreement approved by the Pennsylvania PUC. The reconciliation shows a seven-month under-collection and its potential effects on the CTC rate effective January 1, 2000. The seven-month transition cost under-collection for the period ended July 31, 1999, was \$15.9 million.

On November 2, 1999, West Penn, the Office of Consumer Advocate, West Penn Industrial Intervenors, and the Commission's Office of Trial Staff filed a Joint Petition for Approval of Settlement Agreement. The agreement proposed that West Penn use the savings from securitization during the remainder of 1999 and during 2000 to recover the existing 1999 CTC underrecovery and the expected increase in year 2000 CTC underrecovery due to lower than projected energy sales. On December 16, 1999, the Pennsylvania PUC approved the joint petition for settlement allowing West Penn to collect the 1999 CTC underrecovery.

NOTE C: ACCOUNTING FOR THE EFFECTS OF PRICE DEREGULATION

In 1997, the Emerging Issues Task Force (EITF) issued EITF No. 97-4, "Deregulation of the Pricing of Electricity—Issues Related to the Application of FASB Statement Nos. 71 and 101." The EITF agreed that, when a rate order that contains sufficient detail for the enterprise to reasonably determine how the transition plan will affect the separable portion of its business whose pricing is being deregulated is issued, the entity should cease to apply SFAS No. 71 to that separable portion of its business.

On December 23, 1999, the Maryland PSC approved a settlement agreement dated September 23, 1999, setting forth the transition plan to deregulate electric generation for Potomac Edison's Maryland jurisdiction. As required by EITF 97-4,

Potomac Edison discontinued the application of SFAS No. 71 for its Maryland jurisdiction electric generation operations in the fourth quarter of 1999. As a result, Potomac Edison recorded under the provisions of SFAS No. 101, "Accounting for the Discontinuation of Application of FASB Statement No. 71," an extraordinary charge of \$26.9 million (\$17.0 million after taxes), reflecting the impairment of certain generating assets as determined under SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," based on the expected future cash flows and net regulatory assets associated with generating assets that will not be collected from customers as shown below:

<i>(Millions of dollars)</i>	Gross	Net-of-Tax
Impaired generating assets	\$14.5	\$ 9.9
Net regulatory assets	12.4	7.1
Total 1999 extraordinary charge	\$26.9	\$17.0

On May 29, 1998, the Pennsylvania PUC issued an order approving a transition plan for West Penn. This order was subsequently amended by a settlement agreement approved by the Pennsylvania PUC on November 19, 1998. Based on the Pennsylvania PUC order and subsequent settlement agreement, West Penn discontinued the application of SFAS No. 71 to its generation operations in the second quarter of 1998.

West Penn recorded under the provisions of SFAS No. 101 an extraordinary charge of \$466.9 million (\$275.4 million after

taxes) in 1998 to reflect the disallowances of certain costs in the Pennsylvania PUC's May 29, 1998, order, as revised by the Pennsylvania PUC-approved November 19, 1998, settlement agreement. The charge reflects adverse power purchase commitments (commitments to purchase power at prices above market prices for electricity), the impairment of the investment in the Bath County pumped-storage plant, and net regulatory assets that will not be collected from customers under the Pennsylvania PUC's order and settlement agreement as follows:

<i>(Millions of dollars)</i>	Gross	Net-of-Tax
AES Beaver Valley nonutility generation contract	\$ 197.5	\$ 116.5
Impairment of Bath County pumped-storage plant	165.6	97.7
Net regulatory assets	103.8	61.2
Total 1998 extraordinary charge	\$ 466.9	\$ 275.4

On December 31, 1999, the Company's reserve for adverse power purchase commitments was \$328.8 million based on the Company's forecast of future energy revenues and other factors. A change in the estimated energy revenues or other factors could have a material effect on the amount of the reserve for adverse power purchases.

See Note B for additional information regarding the transition plans approved in Maryland and Pennsylvania.

In addition to the 1998 extraordinary charge, West Penn recorded an additional charge against income in 1998 of \$40.3 million (\$23.7 million after taxes) associated with a rate refund and development of renewable energy programs as required by the Pennsylvania settlement agreement.

The Consolidated Balance Sheet includes the amounts listed below for assets, primarily generation, not subject to SFAS No. 71.

<i>(Millions of dollars)</i>	December 1999	December 1998
Property, plant, and equipment at original cost	\$ 2,690.1	\$1,969.6
Amounts under construction included above	101.8	39.2
Accumulated depreciation	(1,239.0)	(870.8)

NOTE D: PROPOSED MERGER

On April 7, 1997, the Company and DQE, Inc. (DQE), parent company of Duquesne Light Company in Pittsburgh, Pennsylvania, announced that they had agreed to merge in a tax-free, stock-for-stock transaction (Merger Agreement).

At separate meetings held on August 7, 1997, the shareholders of the Company and DQE approved the merger. The Company and DQE made all necessary regulatory filings. Since then, the Company and DQE received approval of the merger from the Nuclear Regulatory Commission, the Pennsylvania PUC, and the FERC. The Pennsylvania PUC and the FERC approvals were subject to conditions acceptable to the Company. In addition, while not required, the Maryland PSC and the Public Utilities Commission of Ohio have indicated their approval.

On October 5, 1998, DQE notified the Company that it had unilaterally decided to terminate the merger. In response, the Company filed with the United States District Court for the Western District of Pennsylvania on October 5, 1998, a lawsuit for specific performance of the Merger Agreement or, alternatively, damages. The District Court held a trial on October 20 through 28, 1999,

without a jury, on the issues of whether DQE's termination of the Merger Agreement breached the agreement and whether the Company is entitled to specific performance. On December 3, 1999, the Court handed down a decision which found that DQE did not breach the April 1997 Merger Agreement. The Court accordingly found in favor of DQE and granted judgment in favor of DQE on all claims and all requests for injunctive relief. On December 14, 1999, the Company appealed the District Court's judgment to the United States Court of Appeals for the Third Circuit, and, on December 16, 1999, the Company filed a Motion for Expedited Treatment of the Appeal requesting that briefings be completed by February 25, 2000, and that arguments be scheduled promptly following the completion of briefings. On December 29, 1999, the Third Circuit granted the Motion for Expedited Treatment.

As a result of the December 3, 1999, Court decision, the Company recorded a charge against income of \$19.7 million (\$11.8 million after taxes) in the fourth quarter of 1999 for merger-related costs previously deferred.

NOTE E: ACQUISITIONS

In December 1999, Monongahela Power acquired the assets of West Virginia Power for approximately \$95 million. In conjunction with this acquisition, the Company purchased the assets of a heating, ventilation, and air conditioning business for \$2.1 million. The acquisition increased property, plant, and equipment and accumulated depreciation by \$105.0 million and \$35.4 million, respectively. Also, \$27.5 million was recorded as the excess of cost over net assets acquired.

In December 1999, Monongahela Power agreed to acquire Mountaineer Gas Company for \$323 million, which includes the assumption of approximately \$100 million of existing debt. Completion of the transaction is conditioned upon, among other things, certain regulatory approvals which may be obtained by mid-2000.

NOTE F: EXTRAORDINARY CHARGE ON LOSS ON REACQUIRED DEBT

During 1999, West Penn reacquired \$525 million of outstanding first mortgage bonds and recorded a loss of \$17.0 million (\$10.0 million after taxes) associated with this transaction. In accordance with Accounting Principles Board (APB) Opinion

No. 26, "Early Extinguishment of Debt," and SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt," this amount is classified as an extraordinary item in the consolidated statement of income.

NOTE G: INCOME TAXES

Details of federal and state income tax provisions are:

<i>(Thousands of dollars)</i>	1999	1998	1997
Income taxes—current:			
Federal	\$100,724	\$114,319	\$ 87,394
State	26,156	33,385	23,960
Total	126,880	147,704	111,354
Income taxes—deferred, net of amortization	48,461	28,920	74,565
Income taxes—deferred, extraordinary charge	(16,885)	(191,480)	
Amortization of deferred investment credit	(8,426)	(7,922)	(8,203)
Total income taxes	150,030	(22,778)	177,716
Income taxes—charged to other income and deductions	(2,474)	(306)	(9,643)
Income taxes—credited to extraordinary charge	16,885	191,480	
Income taxes—charged to operating income	\$164,441	\$168,396	\$168,073

The total provision for income taxes is different from the amount produced by applying the federal income statutory tax

rate of 35% to financial accounting income, as set forth below:

<i>(Thousands of dollars)</i>	1999	1998	1997
Income before preferred stock dividends and redemption premiums, income taxes, and extraordinary charge	\$460,793	\$440,655	\$458,649
Amount so produced	\$161,278	\$154,229	\$160,527
Increased (decreased) for:			
Tax deductions for which deferred tax was not provided:			
Lower tax depreciation	6,500	6,700	14,200
Plant removal costs	(9,100)	(2,400)	(1,700)
State income tax, net of federal income tax benefit	14,100	20,200	11,700
Amortization of deferred investment credit	(8,426)	(7,922)	(8,203)
Other, net	89	(2,411)	(8,451)
Total	\$164,441	\$168,396	\$168,073

The provision for income taxes for the extraordinary charges is different from the amount produced by applying

the federal income statutory tax rate of 35% to the gross amount, as set forth below:

<i>(Thousands of dollars)</i>	1999	1998
Extraordinary charge before income taxes	\$ 43,853	\$ 466,905
Amount so produced	\$ 15,349	\$ 163,417
Increased for state income tax, net of federal income tax benefit	1,536	28,063
Total	\$ 16,885	\$ 191,480

Federal income tax returns through 1995 have been examined and substantially settled. At December 31, the deferred

tax assets and liabilities consisted of the following:

<i>(Thousands of dollars)</i>	1999	1998
Deferred tax assets:		
Recovery of transition costs	\$ 141,844	\$ 154,530
Unamortized investment tax credit	72,845	77,213
Tax interest capitalized	35,760	35,375
Postretirement benefits other than pensions	31,662	31,047
Contributions in aid of construction	23,387	23,643
Unbilled revenue	13,105	13,380
Revenue refund		10,301
Deferred power costs, net	16,741	8,736
Reserve for uncollectibles	10,044	7,904
Other	47,472	39,878
	392,860	402,007
Deferred tax liabilities:		
Book vs. tax plant basis differences, net	1,207,465	1,174,453
Other	75,861	88,465
	1,283,326	1,262,918
Total net deferred tax liabilities	890,466	860,911
Portion above included in current assets	30,477	21,868
Total long-term net deferred tax liabilities	\$ 920,943	\$ 882,779

NOTE H: DIVIDEND RESTRICTION

Supplemental indentures relating to certain outstanding bonds of Monongahela Power contain dividend restrictions under the most restrictive of which \$68,974,000 of the Company's consolidated retained earnings at December 31, 1999, is not available for cash dividends on Monongahela Power's common stock,

except that a portion thereof may be paid as cash dividends where concurrently an equivalent amount of cash is received by Monongahela Power as a capital contribution or as the proceeds of the issue and sale of shares of its common stock.

NOTE I: PENSION BENEFITS AND POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

Net periodic (credit) cost for pension and postretirement benefits other than pensions (principally health care and life insurance) for employees and covered dependents, of which approximately

30% was (credited) charged to plant construction, included the following components:

	Pension Benefits			Postretirement Benefits Other Than Pensions		
	1999	1998	1997	1999	1998	1997
<i>(Thousands of dollars)</i>						
Components of net periodic (credit) cost:						
Service cost	\$15,350	\$ 14,316	\$ 12,435	\$ 2,677	\$ 2,566	\$ 2,619
Interest cost	47,068	46,743	43,060	13,418	14,346	15,244
Expected return on plan assets	(65,456)	(61,280)	(57,404)	(6,217)	(6,163)	(4,705)
Amortization of unrecognized transition (asset) obligation	(3,146)	(3,146)	(3,146)	6,433	6,433	6,433
Amortization of prior service cost	2,386	2,360	1,441			
Recognized net actuarial gain				(119)		
Periodic (credit) cost	(3,798)	(1,007)	(3,614)	16,192	17,182	19,591
Reversal of previous deferrals		760	760			
Net periodic (credit) cost	\$ (3,798)	\$ (247)	\$ (2,854)	\$ 16,192	\$ 17,182	\$ 19,591

The discount rates and rates of compensation increases used in determining the benefit obligations at September 30, 1999, 1998, and 1997, and the expected long-term rate of return

on assets in each of the years 1999, 1998, and 1997 were as follows:

	1999	1998	1997	1999	1998	1997
Discount rate	7.50%	7.00%	7.25%	7.50%	7.00%	7.25%
Expected return on plan assets	9.00%	9.00%	9.00%	8.25%	8.25%	8.25%
Rate of compensation increase	4.50%	4.00%	4.25%	4.50%	4.00%	4.25%

For postretirement benefits other than pensions measurement purposes, a health care cost trend rate of 6.5% for 2000 and beyond and plan provisions which limit future medical and life insurance benefits were assumed. Because of the plan

provisions which limit future benefits, the assumed health care cost trend rate has a limited effect on the amounts reported. A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

	1-Percentage-Point Increase	1-Percentage-Point Decrease
<i>(Thousands of dollars)</i>		
Effect on total of service and interest cost components	\$ 300	\$ (289)
Effect on postretirement benefit obligation	\$2,609	\$(2,635)

The amounts (prepaid) accrued at December 31, using a measurement date of September 30, included the following components:

(Thousands of dollars)	Pension Benefits		Postretirement Benefits Other Than Pensions	
	1999	1998	1999	1998
Change in benefit obligation:				
Benefit obligation at beginning of year	\$692,937	\$ 664,695	\$196,282	\$202,274
Service cost	15,350	14,316	2,677	2,566
Interest cost	47,068	46,743	13,418	14,346
Plan amendments		360		
Actuarial (gain) loss	(21,369)	8,573	(20,159)	(14,296)
Benefits paid	(42,458)	(41,750)	(10,894)	(8,608)
Benefit obligation at December 31	691,528	692,937	181,324	196,282
Change in plan assets:				
Fair value of plan assets at beginning of year	801,348	786,159	74,773	73,363
Actual return on plan assets	50,914	49,091	10,864	965
Employer contribution	7,848	7,848	4,406	2,451
Benefits paid	(42,458)	(41,750)	(5,766)	(2,006)
Fair value of plan assets at December 31	817,652	801,348	84,277	74,773
Plan assets (in excess of) less than benefit obligation	(126,124)	(108,411)	97,047	121,509
Unrecognized transition asset (obligation)	3,152	6,298	(83,627)	(90,060)
Unrecognized net actuarial gain	115,193	108,366	46,140	21,453
Unrecognized prior service cost due to plan amendments	(20,428)	(22,814)		
Fourth quarter contributions and benefit payments			(6,203)	(5,227)
(Prepaid) accrued at December 31	\$ (28,207)	\$ (16,561)	\$ 53,357	\$ 47,675

The pension unrecognized transition asset is being amortized over 14 years beginning January 1, 1987, and the postretirement

benefits other than pensions unrecognized transition obligation is being amortized over 20 years beginning January 1, 1993.

NOTE J: STOCK-BASED COMPENSATION

Under the Company's Long-term Incentive Plan, options may be granted to officers and key employees. A total of 10 million shares of the Company's common stock have been authorized for issuance under the Long-term Incentive Plan. The Long-term Incentive Plan, which was implemented during 1998, provides vesting periods of one to seven years, with options remaining exercisable until 10 years from the date of grant. There were no exercisable options at December 31, 1999. As permitted by SFAS No. 123, "Accounting for Stock-Based Compensation," the Company follows APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for employee stock options. Under APB No. 25, because the exercise price of stock options awarded under the Company's Long-term Incentive Plan equals or exceeds the market price of the underlying stock on the date of grant, no compensation expense is recognized. Disclosure of pro-forma

information regarding net income and earnings per share is required by SFAS No. 123. The information presented has been determined as if the stock options had been accounted for under the fair value method of that statement. The weighted average fair value of the 1999 options was \$5.07 per share. The fair values were estimated at the date of grant using the Black-Scholes option pricing model, with the following weighted average assumptions: risk-free interest rate was 6.24%, expected lives of 10 years, expected stock volatility of 22.83%, and dividend yield of 5.83%.

Under SFAS No. 123, pro-forma consolidated net income for common stock for the Company would be \$258,166,000, or \$255,000 less than the amount reported for 1999. On a pro-forma basis, the Company's 1999 basic and diluted earnings per share would remain at \$2.22 per common share. There were no stock options issued prior to 1999. During 1999, the Company

granted 1,119,200 stock options at a weighted average exercise price of \$31.351. There were no stock options exercised or forfeited during 1999. A summary of the stock options outstanding at December 31, 1999, is as follows: range of exercise prices was \$30.1875 to \$33.8125, weighted average exercise price was \$31.351, shares outstanding were 1,119,200, and average remaining contractual life was 10 years.

Under the Company's Long-term Incentive Plan (formerly the Performance Share Plan), certain officers of the Company and its subsidiaries may receive awards based on meeting specific shareholder and customer performance rankings. The Company recognized compensation expense in 1999, 1998, and 1997 of \$1.1 million, \$2.0 million, and \$1.1 million, respectively.

NOTE K: REGULATORY ASSETS AND LIABILITIES

Certain of the Company's utility operations are subject to the provisions of SFAS No. 71. Regulatory assets represent probable future revenues associated with deferred costs that are expected to be recovered from customers through the ratemaking process. Regulatory liabilities represent probable

future reductions in revenues associated with amounts that are to be credited to customers through the ratemaking process. Regulatory assets, net of regulatory liabilities, reflected in the consolidated balance sheet at December 31 relate to:

<i>(Thousands of dollars)</i>	1999	1998
Long-term assets (liabilities), net:		
Income taxes, net	\$306,247	\$317,745
Pennsylvania stranded cost recovery (CTC)	251,903	280,388
Pennsylvania CTC true-up	20,004	
Pennsylvania pilot deferred revenue	9,040	6,726
Postretirement benefits	6,229	6,229
Pennsylvania tax increases	3,520	
Storm damage	850	2,101
Demand-side management	184	8,157
Deferred revenues	(14,900)	
Other, net	2,027	2,806
Subtotal	585,104	624,152
Deferred power costs, net (reported in other deferred charges/credits)	(9,990)	(2,455)
Subtotal	575,114	621,697
Current assets (liabilities), net (reported in other current assets/liabilities):		
CTC recovery	23,957	17,372
Income taxes, net	1,847	1,847
Deferred power costs, net	(12,880)	7,211
Deferred revenues	(19,949)	
Subtotal	(7,025)	26,430
Net regulatory assets	\$568,089	\$648,127

Future deregulation proceedings in Ohio, Virginia, and West Virginia may affect the ratemaking treatment of the net regulatory assets related to generation in these jurisdictions. See Notes B and C starting on pages 49 and 51, respectively,

for a discussion of deregulation plans approved in Pennsylvania and Maryland. At this time, the Company cannot determine the effect of deregulation plans in Ohio, Virginia, and West Virginia.

NOTE L: FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts and estimated fair value of financial instruments at December 31 were as follows:

<i>(Thousands of dollars)</i>	1999		1998	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
Temporary cash investments	\$ 44,831	\$ 44,831	\$ 882	\$ 882
Life insurance contracts	94,168	94,168	87,468	87,468
Liabilities:				
Short-term debt	641,095	641,095	258,837	258,837
Long-term debt and QUIDS	2,468,407	2,370,723	2,198,577	2,307,081
Interest rate swap			1,528	3,831
Option contract for interest rate swap			5,717	5,717

The carrying amount of temporary cash investments, as well as short-term debt, approximates the fair value because of the short maturity of those instruments. The fair value of the life insurance contracts was estimated based on cash surrender value. The fair value of long-term debt and QUIDS was estimated based on actual market prices or market prices of similar

issues. The fair value of the swap and option contract was estimated based on the present value of future cash flows associated with these instruments. The swap and option were terminated in June 1999.

The Company had no financial instruments held or issued for trading purposes.

NOTE M: CAPITALIZATION

Common Stock In March 1999, the Company announced a stock repurchase program that authorized the repurchase of common stock worth up to \$500 million from time to time at price levels the Company deems attractive. The Company purchased 12 million shares of its common stock in 1999 at an aggregate cost of \$398.4 million.

Preferred Stock West Penn called or redeemed all outstanding shares of its cumulative preferred stock with a combined par value of \$79.7 million plus redemption premiums of \$3.3 million

on July 15, 1999, with proceeds from new \$84-million five-year unsecured medium-term notes issued in the second quarter at a 6.375% coupon rate. Potomac Edison called all outstanding shares of its cumulative preferred stock with a combined par value of \$16.4 million plus redemption premiums of \$.5 million on September 30, 1999, with funds on hand. Monongahela Power's outstanding preferred stock is entitled on voluntary liquidation to its then current call price and on involuntary liquidation to \$100 a share.

Long-Term Debt and QUIDS Maturities for long-term debt in thousands of dollars for the next five years are: 2000, \$189,734; 2001, \$187,283; 2002, \$134,105; 2003, \$250,071; and 2004, \$157,714. Substantially all of the properties of Monongahela Power and Potomac Edison are held subject to the lien securing their first mortgage bonds. Some properties are also subject to a second lien securing certain pollution control and solid waste

disposal notes. During 1999, West Penn reacquired all of its outstanding \$525 million of first mortgage bonds.

In November 1999, West Penn Funding, LLC, issued \$600 million of transition bonds as authorized by the Pennsylvania PUC (see Note B). The transition bonds are secured by the collection of transition costs through a nonby-passable charge to customers in the West Penn service area.

NOTE N: SHORT-TERM DEBT

To provide interim financing and support for outstanding commercial paper, lines of credit have been established with several banks. The Company and its regulated subsidiaries have fee arrangements on all of their lines of credit and no compensating balance requirements. At December 31, 1999,

unused lines of credit with banks were \$435 million. In addition to bank lines of credit, an internal money pool accommodates intercompany short-term borrowing needs, to the extent that certain of the regulated companies have funds available. Short-term debt outstanding for 1999 and 1998 consisted of:

<i>(Thousands of dollars)</i>	1999	1998
Balance and interest rate at end of year:		
Commercial paper	\$641,095 – 5.98%	\$208,837 – 5.40%
Notes payable to banks		50,000 – 5.40%
Average amount outstanding and interest rate during the year:		
Commercial paper	418,166 – 5.41%	171,393 – 5.60%
Notes payable to banks	25,098 – 5.22%	44,789 – 5.62%

NOTE O: BUSINESS SEGMENTS

The Company's principal business segments are utility and nonutility operations. The utility subsidiaries, Monongahela Power, Potomac Edison, and West Penn, collectively now do business as Allegheny Power. Allegheny Power is involved in the delivery (transmission and distribution) and procurement of electric energy subject to federal and state traditional utility

price regulation. Also, Allegheny Power is involved in generation of electric energy in jurisdictions which have not yet implemented deregulation of electric generation. Nonutility operations consist primarily of the Company's energy supply business, now Allegheny Energy Supply. Also included in nonutility operations is Allegheny Ventures, a wholly owned subsidiary of the

Company, which develops new business opportunities, including telecommunications. Since January 1, 1999, the Company's supply business has the primary objective of selling the output of the West Penn generation that has been freed up by the Customer Choice Act in Pennsylvania and is no longer regulated by the Pennsylvania PUC. In November 1999, the Company formed a new nonutility generating company, Allegheny Energy Supply. West Penn transferred its deregulated generating capacity, which totaled 3,778 MW, at book value as allowed by the final settlement in West Penn's Pennsylvania restructuring case.

Allegheny Energy Supply also purchased from AYP Energy its 276 MW of merchant capacity at Fort Martin Unit No. 1.

Business segment information for 1999, 1998, and 1997 is summarized below. Transactions between affiliates are recognized at prices which approximate market value. Significant transactions between reportable segments are eliminated to reconcile the segment information to consolidated amounts. The identifiable assets information does not reflect the elimination of intercompany balances or transactions which are eliminated in the Company's consolidated financial statements.

<i>(Thousands of dollars)</i>	1999	1998	1997
Operating revenues:			
Utility	\$2,273,727	\$2,330,261	\$2,286,175
Nonutility	887,387	246,986	85,794
Eliminations	(352,673)	(811)	(2,478)
Depreciation and amortization:			
Utility	197,955	264,609	259,145
Nonutility	59,501	5,770	6,605
Federal and state income taxes:			
Utility	131,225	178,929	177,581
Nonutility	33,216	(10,533)	(9,508)
Operating income:			
Utility	395,425	449,762	457,267
Nonutility	79,222	(10,255)	(5,030)
Interest charges, preferred dividends, and preferred redemption premiums:			
Utility	160,934	176,073	182,564
Nonutility	31,871	10,159	10,786
Eliminations	(102)		
Consolidated income before extraordinary charge:			
Utility	236,472	283,323	295,653
Nonutility	48,917	(20,315)	(14,357)
Extraordinary charge, net:			
Utility	26,968	275,426	
Identifiable assets:			
Utility	5,293,394	6,321,777	6,442,512
Nonutility	1,559,047	213,418	211,579
Capital expenditures:			
Utility	266,205	229,362	284,648
Utility—acquisition of businesses	98,714		
Nonutility	147,160	6,205	829

See Notes C and F for a discussion of extraordinary charges, net.

NOTE P: COMMITMENTS AND CONTINGENCIES

Construction and Capital Program The subsidiaries have entered into commitments for their construction and capital programs for which expenditures are estimated to be \$419 million for 2000 and \$431 million for 2001. In addition, in 2000, Monongahela Power plans to purchase Mountaineer Gas Company for approximately \$323 million (which includes the assumption of approximately \$100 million in existing debt). Construction expenditure levels in 2002 and beyond will depend upon, among other things, the strategy eventually selected for complying with Phase II of the *Clean Air Act Amendments of 1990 (CAAA)* and the extent to which environmental initiatives currently being considered become mandated. The Company estimates that its banked emission allowances will allow it to comply with Phase II sulfur dioxide (SO₂) limits through 2005. Studies to evaluate cost-effective options to comply with Phase II SO₂ limits beyond 2005, including those available in connection with the emission allowance trading market, are continuing.

Environmental Matters and Litigation The companies are subject to various laws, regulations, and uncertainties as to environmental matters. Compliance may require them to incur substantial additional costs to modify or replace existing and proposed equipment and facilities and may adversely affect the cost of future operations.

The Environmental Protection Agency (EPA) issued its final regional nitrogen oxides (NO_x) *State Implementation Plan (SIP)* call rule on September 24, 1998. The EPA's SIP call rule found that 22 eastern states (including Maryland, Pennsylvania, and West Virginia) and the District of Columbia are all contributing significantly to ozone nonattainment in downwind states. The final rule declares that this downwind nonattainment will be eliminated (or sufficiently mitigated) if the upwind states reduce their NO_x emissions by an amount that is precisely set by the EPA on a state-by-state basis. The final SIP call rule requires that all state-adopted NO_x reduction measures must be incorporated into SIPs by September 1999 and must be implemented by May 1, 2003. However, the EPA's NO_x SIP call regulation is currently under litigation in the District of Columbia Circuit Court of Appeals, and a decision is expected by spring 2000. The Company's compliance with these requirements would require the installation of post-combustion control technologies on most, if not all, of its power stations at a cost of approximately \$370 million. The Company continues to work with other coal-burning utilities and other affected constituencies in coal-producing states to challenge this EPA action.

On March 4, 1994, Monongahela Power, Potomac Edison, and West Penn received notice that the EPA had identified them as potentially responsible parties (PRPs) under the *Comprehensive*

Environmental Response, Compensation, and Liability Act of 1980, as amended, with respect to a Superfund Site. There are approximately 175 other PRPs involved. A final determination has not been made for the Company's share of the remediation costs based on the amount of materials sent to the site. However, the Company estimates that its share of the cleanup liability will not exceed \$1 million, which has been accrued as a liability at December 31, 1999.

Monongahela Power, Potomac Edison, and West Penn have also been named as defendants along with multiple other defendants in pending asbestos cases involving multiple plaintiffs. While the Company believes that all of the cases are without merit, the Company cannot predict the outcome of the litigation. The Company has accrued a reserve of \$5.8 million as of December 31, 1999, related to the asbestos cases as the potential cost to settle the cases to avoid the anticipated cost of defense.

The Attorney General of the State of New York and the Attorney General of the State of Connecticut in their letters dated September 15, 1999, and November 3, 1999, respectively, notified the Company of their intent to commence civil actions against the Company or certain of its subsidiaries alleging violations at the Fort Martin Power Station under the federal *Clean Air Act*, which requires existing power plants that make major modifications to comply with the same emission standards applicable to new power plants. Similar actions may be commenced by other governmental authorities in the future. Fort Martin is a station located in West Virginia and is now jointly owned by Allegheny Energy Supply, Monongahela Power, and Potomac Edison. Both Attorneys General stated their intent to seek injunctive relief and penalties. In addition, the Attorney General of the State of New York in his letter indicated that he may assert claims under the State common law of public nuisance seeking to recover, among other things, compensation for alleged environmental damage caused in New York by the operation of Fort Martin Power Station. At this time, the Company and its subsidiaries are not able to determine what effect, if any, these actions threatened by the Attorneys General of New York and Connecticut may have on them.

In the normal course of business, the Company and its subsidiaries become involved in various legal proceedings. The Company and its subsidiaries do not believe that the ultimate outcome of these proceedings will have a material effect on their financial position.

Leases The Company's lease obligations as of December 31, 1999, and 1998 were not material.

Report of Management

The management of the Company is responsible for the information and representations in the Company's financial statements. The Company prepares the financial statements in accordance with generally accepted accounting principles based upon available facts and circumstances and management's best estimates and judgments of known conditions.

The Company maintains an accounting system and related system of internal controls designed to provide reasonable assurance that the financial records are accurate and that the Company's assets are protected. The Company's staff of internal auditors conducts periodic reviews designed to assist management in maintaining the effectiveness of internal control procedures.



Alan J. Noia
*Chairman, President,
and Chief Executive Officer*

PricewaterhouseCoopers LLP, an independent accounting firm, audits the financial statements and expresses its opinion on them. The independent accountants perform their audit in accordance with generally accepted auditing standards.

The Audit Committee of the Board of Directors, which consists of three outside Directors, meets periodically with management, internal auditors, and PricewaterhouseCoopers LLP to review the activities of each in discharging their responsibilities. The internal audit staff and PricewaterhouseCoopers LLP have free access to all of the Company's records and to the Audit Committee.



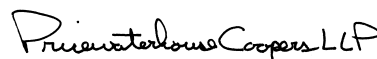
Michael P. Morrell
*Senior Vice President
and Chief Financial Officer*

Report of Independent Accountants

To the Board of Directors and the Shareholders
of Allegheny Energy, Inc.

In our opinion, the accompanying consolidated balance sheets, consolidated statements of capitalization and of common equity and the related consolidated statements of income and of cash flows present fairly, in all material respects, the financial position of Allegheny Energy, Inc. and its subsidiaries at December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.



*Pittsburgh, Pennsylvania
February 3, 2000*

Condensed Financial Statements

Year ended December 31, 1999	Monongahela Power Company	The Potomac Edison Company	West Penn Power Company and Subsidiaries	Allegheny Energy Supply Company, LLC	Allegheny Energy, Inc. and Subsidiaries
<i>(Thousands of dollars)</i>					
Balance sheets					
Assets					
Property, plant, and equipment:					
At original cost*	\$2,173,603	\$2,322,104	\$1,597,484	\$2,060,040	\$ 8,839,719
Accumulated depreciation	(958,867)	(998,710)	(506,416)	(940,672)	(3,632,568)
	1,214,736	1,323,394	1,091,068	1,119,368	5,207,151
Excess of cost over net assets acquired	26,325				42,584
Cash and temporary cash investments	3,826	34,509	19,288	1,668	65,984
Other current assets	228,393	173,171	272,600	245,802	643,326
Regulatory assets	145,176	46,121	467,982		663,847
Other	75,262	61,656	13,827	83,325	229,549
Total	\$1,693,718	\$1,638,851	\$1,864,765	\$1,450,163	\$ 6,852,441
<i>*Includes construction work in progress</i>	\$ 46,138	\$ 53,354	\$ 45,450	\$ 86,147	\$ 231,763
Capitalization and liabilities					
Common stock, other paid-in capital, retained earnings, less treasury stock (at cost)					
	\$ 578,951	\$ 700,422	\$ 79,658	\$ 512,699	\$ 1,695,325
Preferred stock	74,000				74,000
Long-term debt and QUIDS	503,741	510,344	966,026	356,239	2,254,463
Short-term debt	28,650			21,200	641,095
Other current liabilities	216,353	208,327	259,635	224,158	667,440
Unamortized investment credit	14,007	17,720	21,847	18,199	116,971
Deferred income taxes	248,987	159,351	211,369	128,639	920,943
Regulatory liabilities	13,961	25,319	15,126		78,743
Adverse power purchase commitments			303,935	185,626	303,935
Other	15,068	17,368	7,169	3,403	99,526
Total	\$1,693,718	\$1,638,851	\$1,864,765	\$1,450,163	\$ 6,852,441
Statements of income					
Operating revenues	\$ 673,335	\$ 753,257	\$1,354,203	\$ 140,874	\$ 2,808,441
Operating expenses	554,298	617,535	1,160,434	130,408	2,333,794
Operating income	119,037	135,722	193,769	10,466	474,647
Other income and deductions	7,178	8,518	9,654	1,159	3,445
Income before interest charges, preferred dividends, preferred redemption premiums, and extraordinary charge, net	126,215	144,240	203,423	11,625	478,092
Interest charges, preferred dividends, and preferred redemption premiums	38,925	44,728	70,680	2,093	192,703
Balance for common stock before extraordinary charge, net	87,290	99,512	132,743	9,532	285,389
Extraordinary charge, net		(16,949)	(10,018)		(26,968)
Balance for common stock	\$ 87,290	\$ 82,563	\$ 122,725	\$ 9,532	\$ 258,421

Note: Allegheny Energy Supply Company, LLC, started operations on November 18, 1999.

Consolidated Statistics

Year ended December 31	1999	1998	1997	1996	1995	1994	1989
Summary of operations (Millions of dollars)							
Operating revenues	\$2,808.4	\$2,576.4	\$2,369.5	\$2,327.6	\$2,315.2	\$2,184.6	\$1,790.6
Operation expense	1,498.1	1,286.0	1,065.9	1,013.0	1,024.9	1,017.8	867.0
Maintenance	223.5	217.5	230.6	243.3	249.5	241.9	185.5
Restructuring charges and asset write-offs				103.9	23.4	9.2	
Depreciation	257.5	270.4	265.7	263.2	256.3	223.9	172.3
Taxes other than income	190.3	194.6	187.0	185.4	184.7	183.1	139.5
Taxes on income	164.4	168.4	168.1	128.0	154.2	125.9	89.0
Allowance for funds used during construction	(6.9)	(5.0)	(8.3)	(5.9)	(8.2)	(19.6)	(7.7)
Interest charges, preferred dividends, and preferred redemption premiums	197.7	189.7	197.2	191.1	196.9	184.1	156.0
Other income and deductions	(1.6)	(8.2)	(18.0)	(4.4)	(6.2)	(1.5)	(5.9)
Consolidated income before extraordinary charge and cumulative effect of accounting change	285.4	263.0	281.3	210.0	239.7	219.8	194.9
Extraordinary charge, net ^a	(27.0)	(275.4)					
Cumulative effect of accounting change, net ^b						43.4	
Consolidated net income (loss)	\$ 258.4	\$ (12.4)	\$ 281.3	\$ 210.0	\$ 239.7	\$ 263.2	\$ 194.9
Common stock data ^c							
Shares issued (thousands)	122,436	122,436	122,436	121,840	120,701	119,293	105,579
Treasury shares (thousands)	(12,000)						
Shares outstanding (thousands)	110,436	122,436	122,436	121,840	120,701	119,293	105,579
Average shares outstanding (thousands)	116,237	122,436	122,208	121,141	119,864	118,272	104,787
Earnings per average share: ^d							
Consolidated income before extraordinary charge and cumulative effect of accounting change	\$ 2.45	\$ 2.15	\$ 2.30	\$ 1.73	\$ 2.00	\$ 1.86	\$ 1.86
Extraordinary charge, net ^a	(.23)	(2.25)					
Cumulative effect of accounting change, net ^b						.37	
Consolidated net income (loss)	\$ 2.22	\$ (.10)	\$ 2.30	\$ 1.73	\$ 2.00	\$ 2.23	\$ 1.86
Dividends paid per share	\$ 1.72	\$ 1.72	\$ 1.72	\$ 1.69	\$ 1.65	\$ 1.64	\$ 1.55
Dividend payout ratio ^e	64.6%	73.5%	74.7%	97.5%	82.5%	88.3%	83.3%
Shareholders	44,873	48,869	53,389	58,677	63,280	66,818	68,156
Market price per share:							
High	\$ 35 ³ / ₁₆	\$ 34 ¹⁵ / ₁₆	\$ 32 ¹⁹ / ₃₂	\$ 31 ¹ / ₈	\$ 29 ¹ / ₄	\$ 26 ¹ / ₂	\$ 21 ¹ / ₄
Low	\$ 26 ³ / ₁₆	\$ 26 ⁵ / ₈	\$ 25 ¹ / ₂	\$ 28	\$ 21 ¹ / ₂	\$ 19 ³ / ₄	\$ 17 ¹³ / ₁₆
Close	\$ 26 ¹⁵ / ₁₆	\$ 34 ¹ / ₂	\$ 32 ¹ / ₂	\$ 30 ³ / ₈	\$ 28 ⁵ / ₈	\$ 21 ³ / ₄	\$ 20 ¹⁵ / ₁₆
Book value per share	\$ 15.35	\$ 16.61	\$ 18.43	\$ 17.80	\$ 17.65	\$ 17.26	\$ 14.99
Return on average common equity ^e	16.16%	13.26%	12.63%	9.69%	11.35%	10.96%	12.41%
Capitalization data (Millions of dollars)							
Common stock	\$1,695.3	\$2,033.9	\$2,256.9	\$2,169.1	\$2,129.9	\$2,059.3	\$1,582.4
Preferred stock:							
Not subject to mandatory redemption	74.0	170.1	170.1	170.1	170.1	300.1	235.1
Subject to mandatory redemption						25.2	30.6
Long-term debt and QUIDS	2,254.5	2,179.3	2,193.1	2,397.1	2,273.2	2,178.5	1,578.4
Total capitalization	\$4,023.8	\$4,383.3	\$4,620.1	\$4,736.3	\$4,573.2	\$4,563.1	\$3,426.5
Capitalization ratios:							
Common stock	42.1%	46.4%	48.8%	45.8%	46.6%	45.1%	46.2%
Preferred stock:							
Not subject to mandatory redemption	1.9	3.9	3.7	3.6	3.7	6.6	6.8
Subject to mandatory redemption						.6	.9
Long-term debt and QUIDS	56.0	49.7	47.5	50.6	49.7	47.7	46.1
Total assets (Millions of dollars)	\$6,852.4	\$6,535.2	\$6,654.1	\$6,618.5	\$6,447.3	\$6,362.2	\$4,433.3
Property data (Millions of dollars)							
Gross property	\$8,839.7	\$8,395.3	\$8,451.4	\$8,206.2	\$7,812.7	\$7,586.8	\$5,721.5
Accumulated depreciation	(3,632.6)	(3,395.6)	(3,155.2)	(2,910.0)	(2,700.1)	(2,529.4)	(1,807.1)
Net property	\$5,207.1	\$4,999.7	\$5,296.2	\$5,296.2	\$5,112.6	\$5,057.4	\$3,914.4
Gross additions during year — utility	\$ 266.2	\$ 229.4	\$ 284.7	\$ 289.5	\$ 319.1	\$ 508.3	\$ 302.5
— nonutility	\$ 141.3	\$ 1.8	\$ 1.4	\$ 178.5			
Ratio of provisions for depreciation to depreciable property	3.23%	3.28%	3.34%	3.47%	3.50%	3.32%	3.26%

Consolidated Statistics (continued)

Year ended December 31	1999	1998	1997	1996	1995	1994	1989
Revenues (Millions of dollars) ^f							
Residential	\$ 930.3	\$ 880.6	\$ 892.9	\$ 932.2	\$ 927.0	\$ 863.7	\$ 626.2
Commercial	500.3	501.4	490.5	492.7	493.7	459.3	327.5
Industrial	720.5	753.5	748.1	752.9	770.2	728.0	553.5
Wholesale and street lighting	42.4	69.0	65.1	66.6	59.6	58.7	46.2
Revenues from regular utility customers	2,193.5	2,204.5	2,196.6	2,244.4	2,250.5	2,109.7	1,553.4
Other non-gWh	9.2	9.9	6.4	7.7	6.5	7.1	5.0
Bulk power	22.5	69.8	39.6	22.4	13.0	29.0	189.7
Transmission and other energy services	48.5	45.2	41.1	52.4	45.2	38.8	42.5
Total utility revenues	\$2,273.7	\$2,329.4	\$2,283.7	\$2,326.9	\$2,315.2	\$2,184.6	\$1,790.6
Total nonutility revenues	\$ 887.4	\$ 247.0	\$ 85.8	\$.7			
Sales volumes —gWh							
Residential	13,562	12,939	12,832	13,328	13,003	12,630	11,042
Commercial	8,955	8,626	8,176	8,132	7,963	7,607	6,479
Industrial	19,846	19,675	19,040	18,568	18,457	17,708	16,239
Wholesale and street lighting	1,478	1,409	1,422	1,456	1,304	1,275	1,110
Regular utility transactions	43,841	42,649	41,470	41,484	40,727	39,220	34,870
Bulk power	571	3,037	1,667	966	507	1,086	7,011
Transmission and other energy services	8,450	7,345 ^g	12,367	17,402	14,586	9,405	17,777
Total utility transactions	52,862	53,031	55,504	59,852	55,820	49,711	59,658
Total nonutility transactions	15,854	8,278	3,734	109			
Output and delivery —gWh							
Steam generation	44,776	44,323	43,463	40,067	39,174	38,959	43,497
Hydro and pumped-storage generation	1,648	1,326	1,171	1,348	1,234	1,390	1,774
Pumped-storage input	(1,963)	(1,498)	(1,298)	(1,405)	(1,390)	(1,564)	(1,973)
Purchased power	17,365	11,505	6,485	5,518	5,021	4,136	1,797
Transmission and other energy services	8,450	7,777	12,367	17,402	14,586	9,405	17,777
Combustion turbines	7						
Losses and system uses	(3,066)	(2,124)	(2,950)	(2,969)	(2,805)	(2,615)	(3,214)
Total transactions as above	67,217 ^h	61,309	59,238	59,961	55,820	49,711	59,658
Energy supply							
Generating capability — MW							
Utility-owned	4,451	8,121	8,071	8,070	8,070	8,070	7,906
Nonutility-owned	4,142	276	276				
Nonutility contracts ⁱ	299	299	299	299	299	299	160
Maximum hour peak — MW	7,788 ^j	7,314 ^j	7,423	7,500	7,280	7,153	6,489
Load factor	70.5% ^k	69.1% ^k	68.3%	67.5%	68.3%	66.8%	67.0%
Heat rate — Btus per kWh	9,963	9,939	9,936	9,910	9,970	9,927	9,967
Fuel costs — cents per million Btus	119.61	128.92	130.05	129.22	130.20	141.50	136.70

a Write-off in connection with deregulation proceedings in Maryland and Pennsylvania and costs associated with the reacquisition of first mortgage bonds.

b To record unbilled revenues, net of income taxes.

c Reflects a two-for-one common stock split effective November 4, 1993.

d Basic and diluted earnings per average share.

e Excludes the cumulative effect of the accounting change in 1994, the extraordinary charge, net, and Pennsylvania restructuring activities in 1998, and the extraordinary charge and other charges for merger-related costs and a long dormant pumped-storage generation project in 1999. Includes the effect of internal restructuring in 1995 and 1996.

f Eliminations between utility and nonutility are shown on page 32.

g Excludes 432 gWh delivered to customers participating in the Pennsylvania pilot program that are included in regular utility transactions sales volumes.

h Net of 1,499 gWh eliminated between utility and nonutility.

i Capability available through contractual arrangements with nonutility generators.

j Peak coincident load of all customers provided delivery service within the Company's service territory irrespective of the generation service chosen by the customers therein.

k Based on peak coincident load.

Utility Statistics

Year ended December 31	1999	1998	1997	1996	1995	1994	1989
Customers (thousands)^a							
Residential	1,250.6	1,236.9	1,224.9	1,213.7	1,204.4	1,189.7	1,118.1
Commercial	158.1	154.7	151.5	148.5	146.0	143.0	128.9
Industrial	25.9	25.5	25.2	25.0	24.6	24.2	22.4
Other	1.3	1.3	1.3	1.3	1.3	1.3	1.2
Total customers	1,435.9	1,418.4	1,402.9	1,388.5	1,376.3	1,358.2	1,270.6
Average annual use—kWh per customer^b							
Residential	10,913	10,486	10,521	11,042	10,865	10,682	9,950
All retail service	28,285	28,174	28,647	29,085	28,908	28,205	26,866
Average rate—cents per kWh^b							
Residential	7.03	6.90	6.96	6.99	7.13	6.84	5.67
All retail service	5.45	5.32	5.36	5.46	5.58	5.43	4.48

a Customers in the Company's service territory receiving delivery service.

b Use and rate statistics are calculated based on full service customers (customers receiving both generation and delivery from the Company).

Dividend Declarations Dividends are normally declared on the first Thursday of March, June, September, and December. Record dates are normally the second Monday after the dividend is declared, with payment dates the last business day of March, June, September, and December.

Dividend Reinvestment and Stock Purchase Plan Our Dividend Reinvestment and Stock Purchase Plan provides shareholders with a convenient way to purchase additional shares of the Company's stock. Participants may at the time of each cash dividend payment on the stock have all or part of their dividends automatically invested in additional shares or invest any additional amount they wish between \$50 and \$10,000 in such shares or do both. The offering of shares under the Plan is made only by Prospectus. To get the Prospectus and an Authorization Form to enroll in the Plan, write to Eileen M. Beck, Secretary, Allegheny Energy, Inc., 10435 Downsville Pike, Hagerstown, MD 21740-1766, or ebeck@alleghenyenergy.com.

Annual Meeting The Annual Meeting of Shareholders will be held on the eleventh floor of the World Headquarters of Chase Manhattan Bank, 270 Park Ave., New York, NY, on Thursday, May 11, 2000, at 9:30 a.m.

Form 10-K The Company will provide without charge to each beneficial holder of its common stock, on the written request of such person, a copy of Allegheny Energy's combined Annual Report to the Securities and Exchange Commission on Form 10-K for 1999. Any such request should be directed to Cynthia A. Shoop, Director, Corporate Communications, Allegheny Energy, Inc., 10435 Downsville Pike, Hagerstown, MD 21740-1766, or cshoop@alleghenyenergy.com.

Duplicate Mailings/Direct Deposit of Dividends If you receive duplicate mailings of the Annual Report or wish to have your dividends deposited directly to your banking institution, please notify ChaseMellon Shareholder Services, L.L.C., P.O. Box 3316, South Hackensack, NJ 07606. To speak to a representative responsible for Allegheny Energy, Inc. shareholder accounts, call 1-800-648-8389.

Stock Transfer Agent and Registrar ChaseMellon Shareholder Services, L.L.C., Overpeck Centre, 85 Challenger Road, Ridgefield Park, NJ 07660. The internet address is www.chasemellon.com.

Dividends Paid—Range of Common Stock Prices Per Share

NYSE Composite Transactions	1999				1998			
	Dividend	High	Low	Close	Dividend	High	Low	Close
1st Quarter	43¢	\$34 1/2	\$28 11/16	\$29 1/2	43¢	\$33 9/16	\$30 1/8	\$33 9/16
2nd Quarter	43	35 3/16	29 1/2	32 1/16	43	34	27 5/16	30 1/8
3rd Quarter	43	34 7/8	31	31 7/8	43	31 15/16	26 5/8	31 9/16
4th Quarter	43	33 1/8	26 3/16	26 15/16	43	34 15/16	29 1/2	34 1/2

The high and low prices in 2000 were \$29 and \$25 9/16 through February 3, 2000. The last reported sale on that date was \$28 5/8.

Quarterly Financial Information (Unaudited)

(Millions of dollars)

Quarter Ended	Operating Revenues	Operating Income	Consolidated		Consolidated Net Income (Loss)	Basic and Diluted Earnings Per Average Share		
			Income Before Extraordinary Charge, Net	Extraordinary Charge, Net		Consolidated Income Before Extraordinary Charge, Net	Extraordinary Charge, Net	Consolidated Net Income (Loss)
March 1998	\$645.5	\$124.7	\$78.2		\$ 78.2	\$.64		\$.64
June 1998*	627.6	100.1	53.8	\$(265.4)	(211.6)	.44	\$(2.17)	(1.73)
September 1998	726.6	128.6	82.7		82.7	.68		.68
December 1998*	576.7	86.1	48.3	(10.0)	38.3	.39	(.08)	.31
March 1999	690.0	140.2	97.8		97.8	.80		.80
June 1999	643.4	111.7	64.5		64.5	.55		.55
September 1999	741.4	117.2	71.3		71.3	.63		.63
December 1999**	733.7	105.5	51.8	(27.0)	24.8	.46	(.24)	.22

*Results for the second and fourth quarters of 1998 reflect Pennsylvania restructuring activities.

**Results for the fourth quarter of 1999 reflect charges for Maryland restructuring, retiring debt related to the securitization of Pennsylvania stranded costs, merger-related costs, and a long dormant pumped-storage generation project.