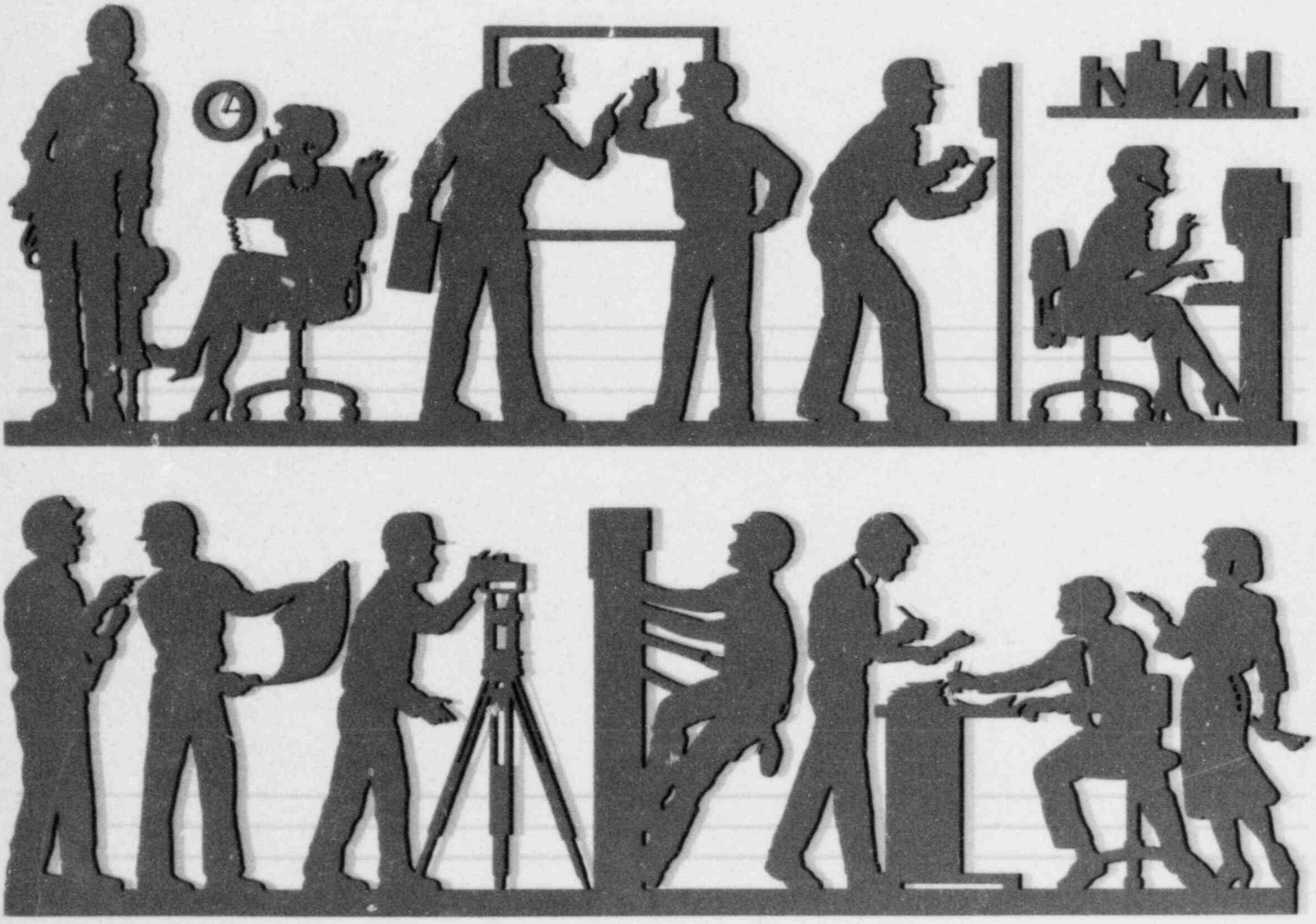
The Cleveland Electric Illuminating Company

1985 ANNUAL REPORT



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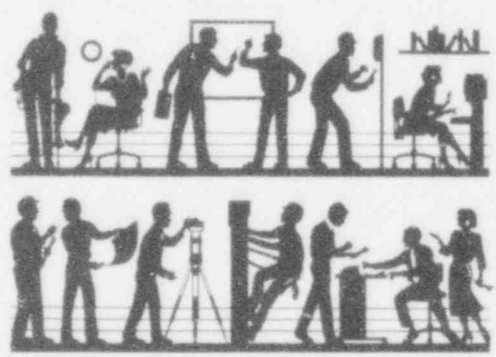


COVER
Our 6,500 employees <u>are</u> The Illuminating Company to the people of Northeast Ohio. Some work as line mechanics, engineers, secretaries, plant technicians or accountants. Others are meter readers, computer programmers, electrical testers, environmental specialists or customer service representatives. On the job, our employees are committed to professional excellence. Off the job, they participate in community service. For these reasons, our employees are the Company's most important resource.

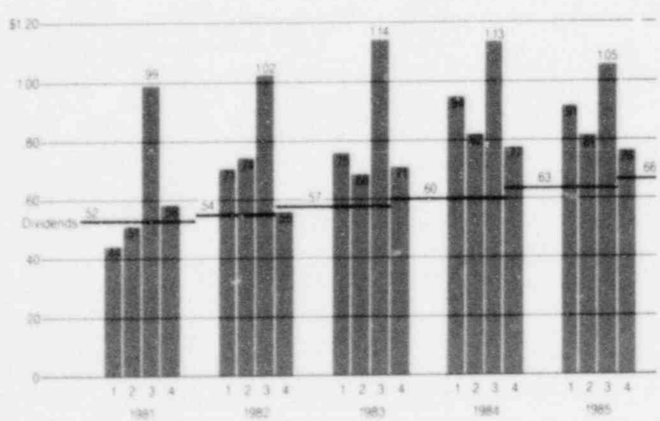
1985 HIGHLIGHTS

- On June 25, the Company and The Toledo Edison Company announced plans to affiliate under a newly formed holding company, Centerior Energy Corporation. Share owners of both companies overwhelmingly approved this plan at special meetings held on November 26.
- Common Stock quarterly dividend per share was increased 3¢ effective on November 15. Total payment of $2.55 per share represents a 4.9% increase over 1984.
- Earnings increased 8.4% in 1985, reaching $269 million. However, earnings per share for the year were $3.53, down slightly from 1984's record high.
- Perry Unit 1 and common facilities construction and testing were essentially completed in 1985. The unit is expected to begin providing electric service to our customers later in 1986.
- A record $83 million was raised through the Dividend Reinvestment and Stock Purchase Plan, including over $14 million from nearly 6,400 IRA investors. Total Plan participation reached 73,260, or 53%, of Company share owners.
- A $19.5 million (1.6%) retail electric rate increase became effective in March 1985; an application for a $210 million (16.8%) electric rate increase was filed in July.

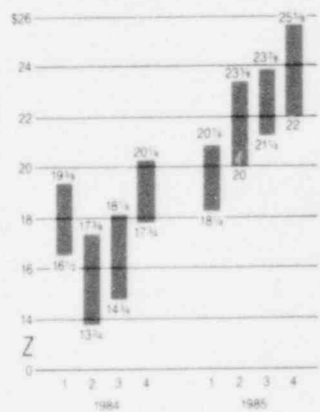
FINANCIAL HIGHLIGHTS

	1985	1984	Percent Change
Earnings Per Share of Common Stock	$ 3.53	$ 3.64	(3.0)
Dividends Paid Per Share of Common Stock	$ 2.55	$ 2.43	4.9
Book Value Per Share of Common Stock – Year End	$ 22.46	$ 21.51	4.4
Common Stock Share Owners – Year End	131,684	131,998	(0.2)
Common Stock Shares Outstanding – Year End	78,522,668	74,040,175	6.1
Operating Revenues (000)	$1,253,990	$1,215,353	3.2
Operating Expenses (000)	$ 994,841	$ 953,242	4.4
Net Income (000)	$ 310,703	$ 291,632	6.5
Earnings Available for Common Stock (000)	$ 269,236	$ 248,279	8.4
Return on Average Common Equity	16.0%	16.8%	(4.8)
Kilowatthour Sales (Millions of Kilowatthours)			
Residential	4,408	4,446	(0.9)
Commercial	4,516	4,397	2.7
Industrial	7,981	7,997	(0.2)
Other	414	433	(4.4)
Total	17,319	17,273	0.3
Employees – Year End	6,484	5,830	11.2

Quarterly Earnings and Dividends Per Share of Common Stock

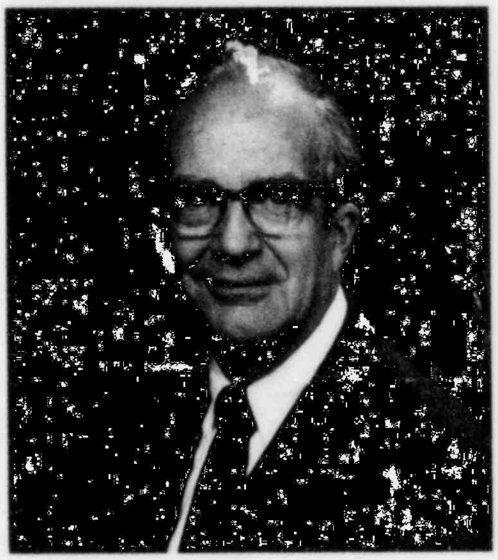


Quarterly High and Low Prices of Common Stock

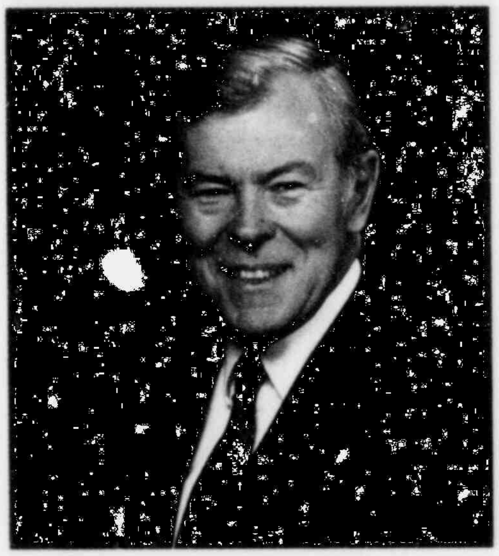


LETTER TO SHARE OWNERS

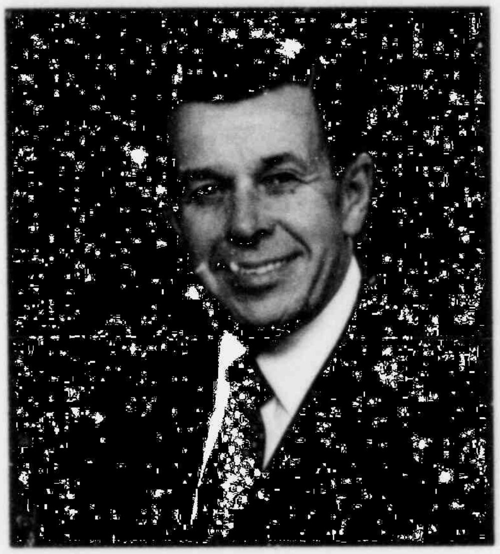
Robert M. Ginn



Richard A. Miller



Harold L. Williams



Dear Share Owner:

Nineteen-eighty-five was one of the most eventful years in Company history. We essentially completed construction on the first unit of the Perry Nuclear Power Plant and began the testing program leading up to fuel load. We made significant strides in improving customer services and our community relations. We increased the dividend for the 27th consecutive year. Crowning these achievements was announcement of our plan to affiliate with The Toledo Edison Company.

The announcement attracted national attention in the energy industry and the financial community. In the eyes of many experts, the affiliation has established our Company and Toledo Edison as forerunners in an inevitable trend toward fewer, larger electric systems. *Business Week* magazine predicts that our affiliation will become a model for other utility combinations.

These responses were noteworthy. More gratifying to us, however, was your solid endorsement of the affiliation. Of the shares voted last November at special meetings of our Company and Toledo Edison, more than 96 percent favored the affiliation.

At this writing, we are awaiting approval of the affiliation from the Securities and Exchange Commission. We have urged the SEC to act as soon as possible so that we can have the affiliation in effect by the end of the first quarter of 1986. Once that occurs, our Company and Toledo Edison will become wholly-owned subsidiaries of a holding company—Centerior Energy Corporation. Share owners of Company common stock will become owners of Centerior Energy. With assets of more than $9 billion, Centerior Energy will rank among the top 20 electric utilities in the nation.

The affiliation is our management's carefully considered response to a dilemma facing many electric utilities nationwide. We must continue to ensure reliable electric service at an affordable price in the face of increased costs, uncertain regulation and unpredictable environmental demands. We believe that pooling our human expertise and physical resources with those of Toledo Edison will allow greater efficiencies and significant cost savings impossible for either company to achieve alone. In documents filed with the SEC in November, we estimated that the affiliation would save the equivalent of $90 million a year over the next 15 years.

The affiliation was the big news of 1985, but it should not overshadow two other achievements.

One is the completion of Unit 1 of the Perry Nuclear Power Plant. Construction on this 1,205 megawatt unit consistently has been a success story in today's troubled nuclear energy industry. We give equal credit to our fine nuclear management team, the employees assigned to the Perry Project and all other Company people whose extra effort allowed us to concentrate so many resources on Perry.

Company employees also deserve the credit for another major success of 1985. Thanks to them, our customers and our community believe in us. Among those customers are more than 60,000 Company share owners. Employee responsiveness to customer needs has improved the quality of our service. As one indicator, the Company in 1985 again had the lowest rate of customer complaints before The Public Utilities Commission of Ohio of any major electric utility in the state. Increased employee involvement with community organizations is proving to Northeast Ohioans that their electric company is more than an energy supplier. We're also a neighbor and a friend.

These highlights and others of 1985 are discussed in more depth on the pages that follow. We believe this Annual Report reflects the prudence, flexibility and innovative thinking that have been the trademark of your Company's management team. You may be sure of that same quality of management when you become owners of Centerior Energy.

The Illuminating Company has recorded many successes in its 105 year history. We attribute those successes to our unswerving commitment to excellence in dealing with our customers, our share owners and our community. You have our assurance that those traditions will be the cornerstone of Centerior Energy Corporation.

Sincerely,

Robert M. Ginn

Robert M. Ginn
Chairman

Richard A. Miller

Richard A. Miller
President

Harold L. Williams

Harold L. Williams
Executive Vice President

February 20, 1986

Commitment to customers. Commitment to share owners. Commitment to the community of Northeast Ohio. These are the cornerstones of The Illuminating Company. Translating these commitments into action each day of the year are 6,500 Company employees. They bring to the task their own brands of professionalism. They share their Company's commitment to excellence.

THE CENTERIOR COMMITMENT

A momentous announcement

On June 25, 1985, our Company and The Toledo Edison Company announced plans to affiliate under a holding company. It was named Centerior Energy Corporation later in the year. Centerior Energy's projected assets of more than $9 billion will place this corporation among the top 20 electric utilities in the nation.

The affiliation symbolizes our commitments to customers, to share owners and to the communities we serve. A two-company pooling of facilities and resources will help assure our customers of continued service reliability with costs kept lower over the long term than would be possible without the affiliation. A reliable, financially strong utility organization will help Northern Ohio achieve business and industrial growth. Share owners will benefit from the ultimately stronger position of an affiliated enterprise serving a larger and more diverse geographic area.

Common stock share owners of our Company and Toledo Edison expressed their overwhelming support at special meetings in November when they voted their shares more than 19 to one in favor of affiliation. Once it becomes effective, the Company's share owners are to receive 1.11 Centerior Energy common shares in exchange for each Company common share.

Representatives from our Company and Toledo Edison have worked to obtain regulatory approvals of the affiliation. At this writing, only one step remains—approval from the Securities and Exchange Commission. An affiliation between electric utilities requires a positive finding by the SEC that it is in the public interest. We are confident our affiliation meets that criterion.

Structure is defined

Centerior Energy Corporation, through its service company, will provide overall management from headquarters in the Greater Cleveland area. Our Company and Toledo Edison will be wholly-owned subsidiaries of Centerior Energy. They will function as separate operating companies. Each will have its own electric rates. Each will retain responsibility for most operations, customer services and marketing.

The Centerior Energy organization will enable customers and share owners to enjoy all the benefits to be gained from a larger entity. Our Company and Toledo Edison will continue to serve their respective territories. This will enable each company to retain the high level of responsiveness inherent in existing customer relations.

A third subsidiary, Centerior Service Company, will provide the two operating companies those services that can best be performed by a single entity.

In August 1985, our Company and Toledo Edison retained the management consulting firm McKinsey & Company to help plan and implement the affiliation.

Task forces of key management people were formed to study key issues and make recommendations in the following areas: administration; engineering and operations; legal, governmental and public affairs; finance and accounting; and strategic planning. The task force approach enabled the direct involvement of the 200 employees from our Company and Toledo Edison most familiar with those areas. The efforts of these people have helped us maximize the benefits we expect to realize from affiliation.

The organization

The Centerior Energy management team has the experience, ability and expertise needed to make the enterprise succeed.

Company Chairman Robert M. Ginn will be Chairman and Chief Executive Officer of Centerior Energy and all three of its subsidiaries. Company President Richard A. Miller will be President of the holding company and the service company. Experienced executives from our Company and Toledo Edison will head the principal functions of the service company.

Centerior Energy's management will be kept lean and its structure sufficiently flexible to meet changing conditions and enable quick responses to new challenges.

While Mr. Ginn will remain Chairman and Chief Executive Officer of The Illuminating Company, Robert J. Farling, currently Vice President – Administrative Services, will become President.

Share owners overwhelmingly approved affiliation of the Company with The Toledo Edison Company under a holding company, Centerior Energy Corporation. Of the shares voted at the special meeting of share owners in November, over 90 percent were in favor of affiliation. CX will be the New York Stock Exchange trading symbol for Centerior Energy common stock.

COMMITMENT TO CUSTOMERS

Perry Unit 1 highlights nuclear program

We promise our customers reliable electric service. Helping us keep that promise is Unit 1 of the Perry Nuclear Power Plant—the largest construction project in Company history. Construction is essentially complete on the 1,205 megawatt unit. At presstime for this Report, we were awaiting permission to load fuel. The equipment testing and Nuclear Regulatory Commission staff review necessary before fuel can be loaded were nearing completion. Perry Unit 1 soon will help serve some seven million people.

Those people are our customers and those of Perry's co-owners, the four other utilities in the Central Area Power Coordination Group. Our Company is the plant's builder and operator and owns a 31 percent, or 375 megawatt, share of the output.

Throughout 1985, Perry Unit 1 continued to pass all required tests and inspections. On January 31, 1986, the unit passed one unexpected test. On that date, Northeast Ohio was shaken by an unusually strong earthquake for this area, but one well within the capabilities of the Perry Plant. The plant suffered no significant damage. Readings from seismic instruments in the plant will afford our industry the unique opportunity to confirm earthquake design criteria for nuclear power plants.

The construction of Perry Unit 1 has been one of the success stories of the nation's nuclear energy industry. Our construction has consistently received good marks from the NRC. Our quality assurance program is one of the best in the nation. We have not been subject to any regulatory fines, massive re-inspections of equipment or project-wide shutdowns. Perry reflects the skill and dedication of many hundreds of Company people and thousands of engineers and crafts workers.

We are confident that expenditures at Perry have been prudent in light of the inflation, high interest rates and regulatory changes that have prevailed since we began construction. A study of Perry costs by The Public Utilities Commission of Ohio is scheduled to be completed in mid-1986.

Our generating capacity will be increased later by Beaver Valley Unit 2. We own a 25 percent, 204 megawatt share of that unit which is being built in Pennsylvania by the Duquesne Light Company. One of our key construction executives from the Perry Plant now is on loan to this project. Beaver Valley Unit 2 is about 91 percent complete. The unit is scheduled for completion around the end of 1987.

The CAPCO companies continue to defer a decision on the second unit of the Perry Plant on which construction has been suspended. We are keeping open this option for serving future energy needs. The 1,205 megawatt unit is 58 percent complete, including its share of facilities in common with Perry Unit 1. (See Note M of "Notes to Consolidated Financial Statements" for a discussion of Perry Unit 2.)

Power supply is reinforced

As one of the main benefits of our affiliation with Toledo Edison, we expect to pool our generating capacity, thus delaying the need for new generating units beyond our current construction program. Also helping to delay future construction requirements are our power supply employees who continue a comprehensive testing and maintenance effort to keep existing generating units in good operating condition. We spent $16 million on this effort in 1985. It is no small task. Nearly 30 percent of our generating capacity comes from units 30 years old or more. Even the most intensive efforts by our people cannot always prevent lengthy maintenance downtime for those units. We were forced to purchase power from other utilities to serve our capacity needs on more than 90 days in 1985. Our shortage of available capacity will be greatly relieved when Perry Unit 1 goes into commercial operation.

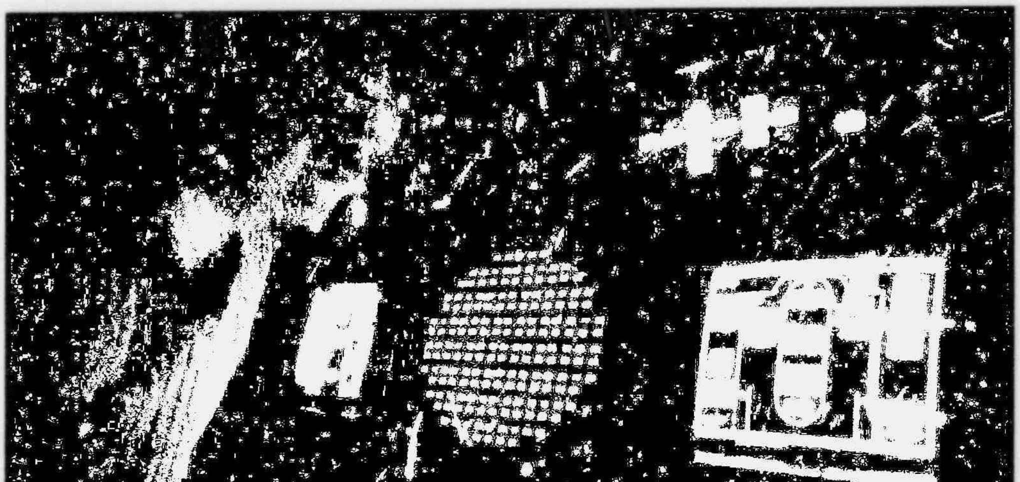
A recently completed improvement project on Unit 9 of the Avon Lake Plant also will help increase available capacity. Avon 9 is our largest generating facility. Conversion to a balanced draft operation has increased the 650 megawatt unit's availability to produce electricity. A new precipitator allows Avon 9 to operate at full capacity while keeping fly ash emissions below government limits. Total cost of this project was $90 million, nearly equal to the $92 million it cost to build Avon 9 which began operating in 1970.

The Company spent $14 million on pollution control projects in 1985 to protect the air and water around our power plants. That brings to $500 million the amount we have spent on environmental improvement in the past dozen years. This Company and its employees are committed to protecting the environment.

Our customers have many questions about the Perry Nuclear Power Plant and nuclear power. Keeping them informed about the progress and promise of this modern energy source is the job of Elizabeth Shaw, public affairs representative, who has a bachelor of science degree in physics from the Massachusetts Institute of Technology. She has appeared before many civic, business, social and educational groups and has given talks on radio and television.

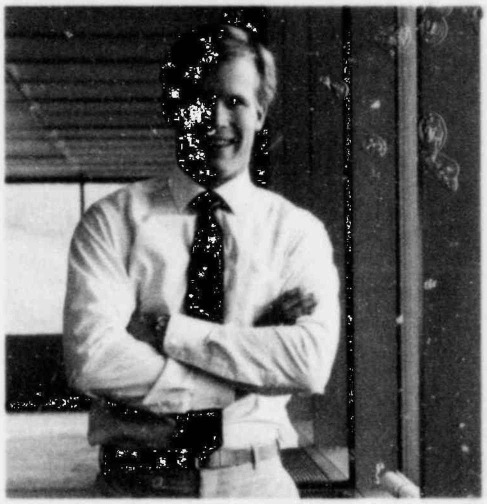
Davis-Besse undergoes improvements

A major setback in 1985 occurred at the Davis-Besse Nuclear Power Station which we co-own with Toledo Edison. The plant was forced off line in mid-year following a series of equipment failures. No escape of radiation, no injuries and no significant equipment damage occurred.

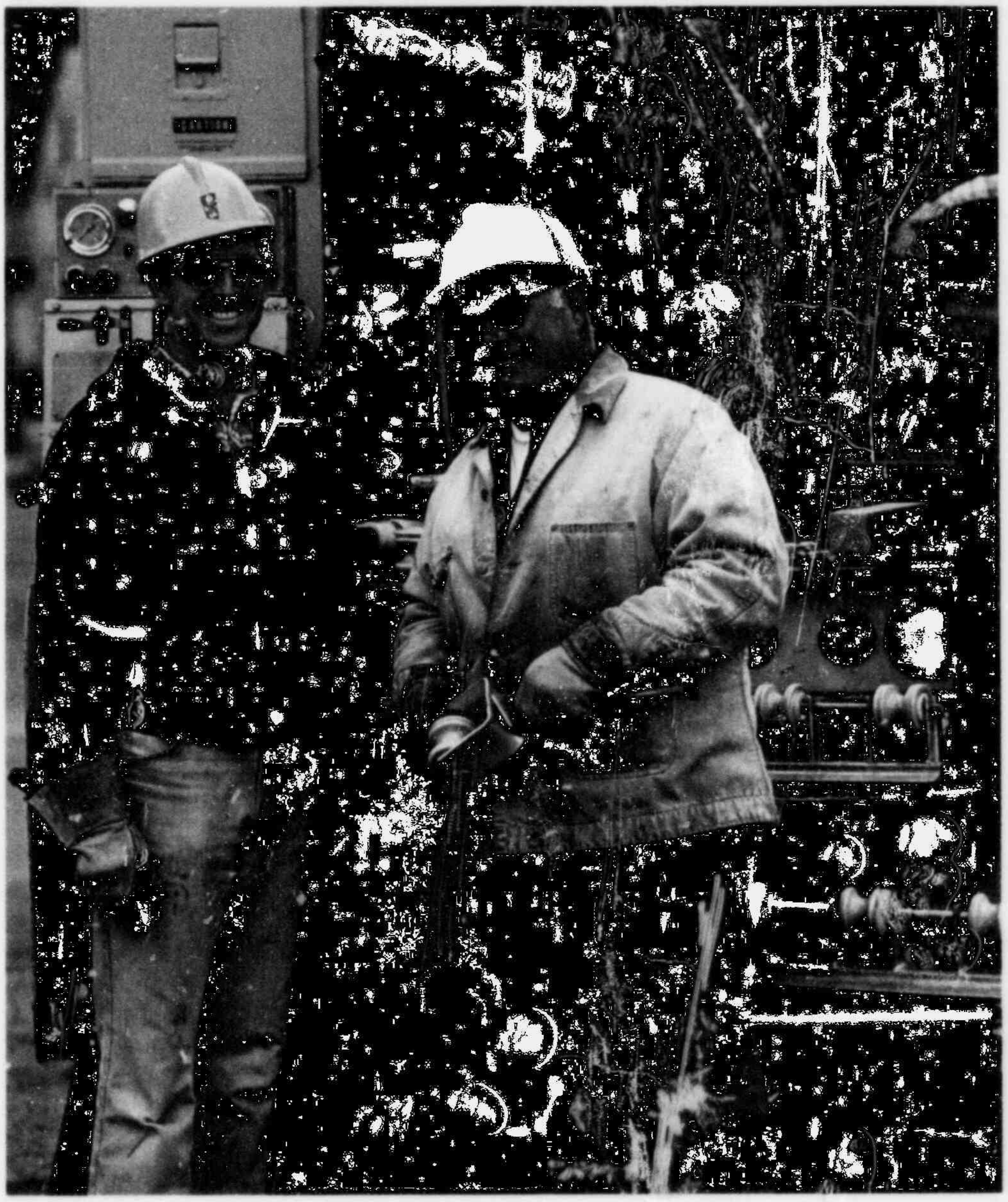


Bernard Panfil is one of 49 employees licensed to operate the Perry Nuclear Power Plant. Each of those people has completed some 2,100 hours of training, about the same as the hours required for a four-year college degree. All have passed the rigorous testing program administered by the Nuclear Regulatory Commission.

Our Company exists to serve the electricity needs of its customers, a responsibility our employees help us meet in many ways. Jim Milbaugh, an Industrial Marketing representative, advises industrial customers on how to use electricity more efficiently so they can increase productivity while minimizing total energy costs. In this way, Company sales improve while we help local businesses remain competitive for the economic benefit of our service area.



Our engineers develop and apply technologies that will ensure customers of the most reliable service at the lowest possible cost. Engineers Bud Arhar (left) and Mike Bussey are using a model to determine the best equipment configuration for a $40 million balanced draft conversion project at the Company's Eastlake Plant.



Most Northeast Ohio consumers are familiar with the Company's advertising slogan, "We're the Energy Makers—Your Neighbors and Friends". Line mechanics Dave Ross (right) and Harry Wolff exemplify that Company slogan. When storms strike, they're on the scene quickly to repair power lines and restore electric service. Thanks to these employees and others like them, Northeast Ohioans know the Company cares about its customers.

The NRC cited Toledo Edison, the plant's builder and operator, for inattention to detail in the maintenance of plant equipment and levied a $900,000 fine against Toledo Edison—a fine which our Company shares as 51 percent owner of Davis-Besse.

Just prior to the plant shutdown, Toledo Edison had retained one of the country's leading nuclear experts, who has developed a comprehensive improvement program. Toledo Edison expects that the 866 megawatt plant should be returned to service late in April 1986, at the earliest. We are confident that Toledo Edison's present course of action will help ensure future good performance from Davis-Besse.

The PUCO has authorized a consultant to determine whether the June 9 incident at Davis-Besse resulted from imprudent management. The consultant also will help the PUCO determine whether replacement power costs can be recovered from customers of our Company and Toledo Edison.

Service reliability improved

We continue seeing positive results from the preventive maintenance, tree-trimming and upgrading projects carried out by our distribution services employees. Customers experienced fewer service interruptions in 1985 than in previous years with similar weather conditions.

The Company invested $50 million in 1985 to upgrade and expand transmission and distribution facilities. This will help ensure continued reliability.

Our service crews achieved distinction beyond the boundaries of Northeast Ohio in 1985. Some 150 line mechanics went on repair missions to Michigan and to the East Coast to help restore electric service following severe storms. Combined, these efforts represented 22,000 working hours by Company employees. These people earned high praise for their good work and gained valuable experience for use in our own service area.

"How thankful we are to have had one of your crews working on our street," wrote one Long Island couple. "They were wonderful. You can be very proud."

Today's workforce

Today's employees are well-trained and highly skilled. They also demonstrate a continuing commitment to self-improvement. Some 325 of our people attended college under the Company's Tuition Refund and Loan Program during 1985 to study toward degrees in job-related subjects. More than 1,000 employees attended Company training and development programs geared to specific job needs. Another 1,000 participated in special Perry Plant training. Under Company auspices, accredited degree programs in nuclear energy disciplines have been established at or near Company facilities.

More than 500 employees took computer training courses in 1985 to keep pace with the increased computerization of Company activities. We recently opened a new, $2 million computer center that provides more efficient data processing for customer services, construction activities, the Perry Plant and many other functions.

Employee cost-cutting efforts in 1985 yielded impressive results. Through the Operations Improvement Program, more than 2,000 employees suggested improvements in Company operations that represent about $6 million in annual savings. That program has been in place for 31 years. In that time, employees have produced total savings of over $60 million.

COMMITMENT TO SHARE OWNERS

Common dividend is raised

Nineteen-eighty-five was the 27th consecutive year of dividend increases for our common share owners. Effective in November, the Company raised the regular quarterly dividend from 63 to 66 cents per share for a new indicated annual rate of $2.64. No other electric utility in Ohio and only nine other major investor-owned electric utilities in the nation have a record of 27 or more consecutive years of dividend increases.

Sales remain level

Kilowatthour sales for 1985 remained about par with the solid levels gained in 1984, a year of growth. We had hoped for continued growth in 1985. We are pleased, however, that Northeast Ohio's economy has maintained the level achieved after rebounding from the recession of the early part of the decade.

Industrial sales remained about the same; commercial sales were up about three percent and residential sales were down about one percent. Because of moderate temperatures in 1985, residential sales did not increase as we expected.

Marketing programs promote future sales

The long-term outlook is for a moderate but steady growth in sales. We project a two percent annual increase in electricity demand over the next 20 years. That will total about a 50 percent increase by the end of that period.

We have a comprehensive marketing program to stimulate economic growth. As one example, we have helped local industries stay competitive by developing special electricity rates tailored to help these customers minimize costs while maximizing productivity. Our top eight industrial customers consume 20 percent of the Company's total kilowatthour output. Rate incentives help to keep these customers in Northeast Ohio and retain some 25,000 jobs.

Our market research people have expanded their monitoring of economic trends and customer service needs. Aided by this information, marketing representatives advise industries and other businesses on electrical applications that can boost productivity while holding down total energy costs. The Company helps local enterprises remain competitive while increasing our kilowatthour sales.

In the residential sector in 1985, we responded aggressively to heightened competition from the natural gas industry with a three-pronged approach: mass media communications informed customers of the value of electricity; a quarter-million consumers saw Company employees demonstrate the benefits of all electric living at shows; and our marketing specialists conducted meetings and seminars with builders, realtors and heating contractors. Residential construction is on the rise. The number of single-family homes constructed in 1985 increased by 4.5 percent over 1984.

We encourage business leaders nationwide to consider our area in their relocation or expansion plans. As part of this effort, we sponsored a video presentation in 1985 that stresses the locational advantages and business opportunities in Northeast Ohio.

Earnings for 1985

Earnings were $269 million, or $3.53 per share, in 1985, compared to 1984 earnings of $248 million, or $3.64 per share. Earnings per share declined mainly because of a 12 percent increase in the number of outstanding common shares in 1985. The increase in shares helped us finance our construction program while maintaining a balanced capital structure. Prior to 1985, earnings per share increased for four consecutive years reaching a record high in 1984.

Contributing to 1985 earnings was an increase in the allowance for funds used

Jane Ling, an associate systems analyst, has a behind-the-scenes job that can have a big impact on our future service to customers. She helps design the computer programs that track such data as construction expenditures and electricity usage. This information is used to determine future electricity demand and our readiness to meet it.

A 35-year Company veteran, line mechanic leader Rich Thomas has served Company customers in all kinds of weather. A line mechanic's experience is invaluable. It also can be shared. In 1985, some 150 employees went to Michigan and the East Coast to help our sister utilities restore electric service in the wake of devastating storms.

A line mechanic's work isn't all above ground. Frank DiLorenzo uses a specially designed device to dig a hole for a new utility pole. In 1985, the Company spent $50 million to upgrade its transmission and distribution facilities for continued reliability of service to customers.

Good customer service is personified by Sarah Schwendler. She helps direct the work of tree-trimming crews that keep power lines free from the destructive effects of overgrown limbs and branches. Sarah brings a personal touch to this work by explaining to customers why tree-trimming is necessary and by answering their questions.

during construction (AFUDC), the non-cash credit to income that reflects the cost of funds invested in new facilities not yet in rate base. Also contributing, to a lesser extent, was a $19.5 million, 1.6 percent rate increase effective March 12, 1985. This was a disappointing response by the PUCO to our request for a $180 million, 15 percent rate increase. That increase would have helped phase into rates our big investment in new generating capacity.

On July 1, 1985, we began deferring AFUDC on Perry Unit 2, the unit on which construction has been suspended and whose future is uncertain. The AFUDC deferral will minimize the future adverse impact on earnings should that unit be cancelled and its costs not recovered through rates. This deferral did not affect cash flow but did reduce 1985 earnings per share by about 23 cents.

Rate case pending

On July 2, 1985, we filed for a 16.8 percent, $210 million rate increase to go into effect in the second quarter of 1986. About 40 percent of the increase reflects the anticipated annual operating costs for Perry Unit 1. Another 20 percent reflects construction work in progress (CWIP) for that unit. We were denied CWIP in the rate case decided in March 1985. We will request Perry Unit 1's full inclusion in rate base in a future rate case.

The Company has not had a significant rate increase since January 1983. Since then, there have been several reductions in fuel costs and one across-the-board rate reduction. Even with the 1.6 percent increase granted in March 1985, the average residential consumer of 500 kilowatthours a month is paying only about one percent more for electricity than was paid three years ago. Meanwhile, the cost of living has increased about 11 percent over the three-year period.

Our customers have long benefited from the low-cost generating units built during the 1940s and '50s. These units now must be replaced at today's higher costs. An impact on rates is inevitable.

Production Engineering technician Tom Farmer (left) and inspector Bruce Schmidt check progress on an installation at the Company's Avon Lake Plant. These people and their coworkers are helping the Company to comply with environmental regulations and improve the operation and maintenance of power plants through replacement or refurbishment of equipment

We expect that impact to occur over the next few years as Perry Unit 1 and Beaver Valley Unit 2 come on line. The impact will not be comparable, however, to that experienced by other utilities who have full ownership in costly new units. The Company owns only a 31 percent share of Perry and a 25 percent share of the Beaver Valley unit. Our limited ownership and the time lag between completion dates will ease the impact of those units on rates. Further, Ohio law allows a phase-in to spread the cost of new facilities among separate rate cases over a period of years.

Construction budget is set

Our estimated construction budget for the 1986-1990 period ranges from $1.9 billion to $2.5 billion. The lower estimate assumes no significant spending on Perry Unit 2; the higher estimate assumes resumed construction beginning in 1988. The new 1986-1990 budget is about the same as last year's 1985-1989 forecast. Decreases in spending for Perry Unit 1, now essentially complete, have been offset by increases in other major components of the construction program and by cost increases resulting from inflation.

About two-thirds of the five-year construction budget will be applied to generating facilities, primarily the upgrading of fossil fuel units and completion of Beaver Valley Unit 2. The remainder will go toward transmission, distribution and general facilities and toward pollution control projects.

We have set the 1986 construction budget at $580 million, compared to $606 million spent in 1985.

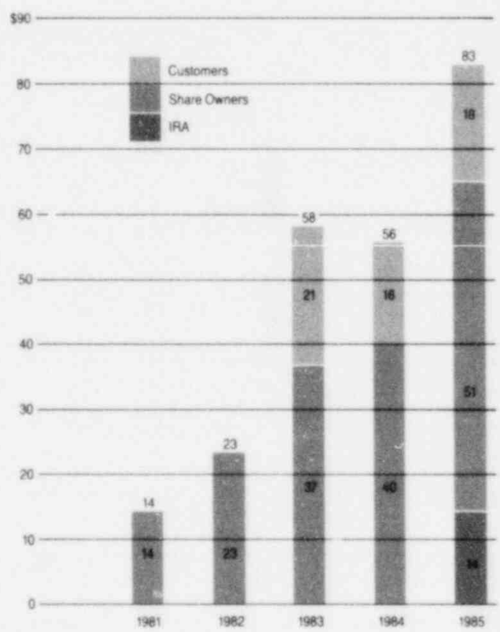
Financing plans for 1986

We expect to raise $350 million in 1986 compared to $385 million raised in 1985.

We plan the sale of about $200 million of first mortgage bonds in at least two separate issues. Further, we expect to raise about $50 million through the sale of preferred stock. We expect common stock equity needs to be answered mainly by the Dividend Reinvestment Plan, including the customer stock purchase and IRA programs, and our employee stock plans. Once the affiliation with Toledo Edison becomes effective, our common equity capital needs will be met through retained earnings from our operations and sales of common stock by Centerior Energy Corporation.

Our 1985 financings included about $150 million from the sale of first mortgage bonds; about $90 million from sales by public authorities of tax-exempt bonds to finance pollution control facilities and $49 million from the public sale of adjustable rate preferred stock. In addition, about $94 million came from our Dividend Reinvestment Plan and from employee stock purchase plans. Also in

Dollars Raised Through Dividend Reinvestment and Stock Purchase Plan
(millions)



1985, the Company completed a $150 million back-up, revolving credit arrangement with 17 participating banks to ensure that funds will be available to complete our construction program. At this time, we have no plans to use this arrangement.

We ended 1985 with a capital structure of 41 percent common equity, 48 percent debt and 11 percent preferred and preference stock. We are continuing to obtain favorable terms for our borrowings thanks to this balanced structure and to the innovative strategies of our finance people.

Credit ratings remain investment grade

The Company's securities remain above minimum investment grade. However, two major agencies lowered their ratings on our bonds and preferred stock in reaction to the disappointing rate increase we received in 1985.

Moody's lowered to Baa2 its ratings on our first mortgage bonds, secured pollution control notes and preferred stock. They did not change our P2 commercial paper rating. Standard & Poor's lowered its ratings on our first mortgage bonds and secured pollution control notes to BBB, our preferred stock to BBB– and our commercial paper to A3.

Company cited for investor relations

A continuing source of pride to the Company is our investor relations program. Two recent successes are the customer stock purchase program started in 1983 and the IRA program started late in 1984. They have helped increase to some 60,000 the known number of customers who own shares of Company stock. These individuals now take a dual interest in their local electric company.

Many of them lend their voices to ours when utility-related issues come before public forums.

In November, our Company received the prestigious Arthur R. Roalman award from the National Investor Relations Institute in recognition of these two highly innovative and successful programs. The award is a tribute to all employees involved in the various phases of investor relations.

COMMITMENT TO COMMUNITY

Company tradition takes on new dimensions

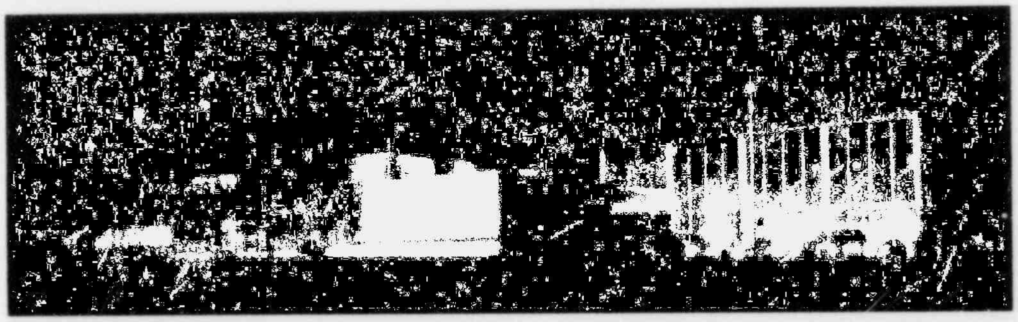
Your Company traditionally has recognized that a corporation sustained by the community owes some contributions to the well-being of that community. For decades, we have worked vigorously for community betterment. Nineteen-eighty-five, however, was a banner year.

Much of the credit rightfully belongs to our 6,500 employees. On the job and off, they helped win new friends and new respect for The Illuminating Company team.

Special services benefit our service area

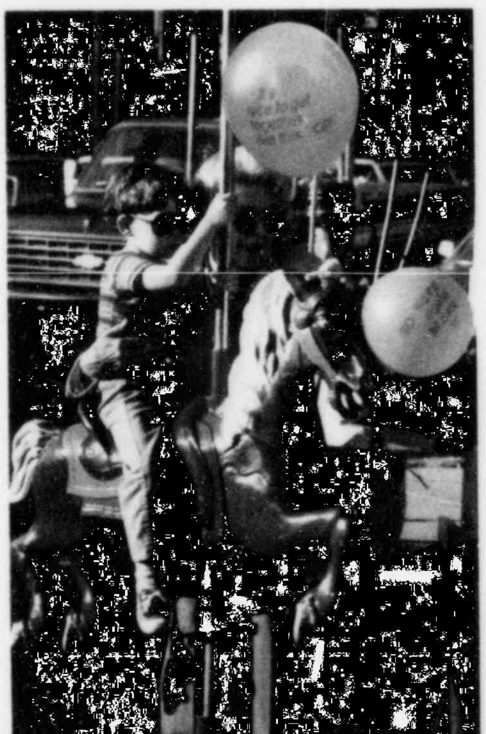
We began several new programs in 1985 specially targeted to the well-being of area residents. A Streetlight Hotline hastens streetlight repairs and keeps neighborhoods well-lighted and safe. An outdoor lighting promotion improves the security around homes and businesses. A Safety Watch program encourages our employees to make immediate reports of safety hazards and emergencies using the Company's communications network when appropriate.

Energy is an important subject in today's classroom. The Company in 1985 provided a combined total of 120,000 booklets, films and computer programs to teachers for classroom use. We gave to school children 30,000 book bags with electrical safety coloring books and 100,000 book covers printed with emergency telephone numbers. We helped provide parents with



Northeast Ohio is home to many architecturally attractive buildings. To brighten up and show off these local assets, the Company and the General Electric Company are jointly sponsoring a lighting campaign called "Building Pride in the North Coast." Through this beautification program, the sponsors provide lighting design and cash incentives to qualifying customers.

Over 50 buildings in Northeast Ohio, many designated as historic landmarks, project an image of warmth, security and pride because of facade lighting. Shown are: Independence City Hall (top); the LTV Research Center (middle); Severance Hall, home of the world-renowned Cleveland Orchestra (lower right).



During 1985, hundreds of Company employees volunteered to pass out helpful information about electric service at dozens of neighborhood festivals. Our balloons were a big hit with the youngsters, who also benefit from other Company service programs. These include teaching children safety around electricity, providing parents with identification cards for youngsters to be used in case the children become missing and giving school children book covers and book bags printed with emergency phone numbers.

identification cards for their youngsters in case a child becomes lost or is missing. Employee volunteers took special demonstrations to some 800 classrooms in 1985 to help teach 20,000 elementary school students how to stay safe around electricity.

The Company has increased its contacts with senior citizens. We provided them with 20,000 calendars and songbooks in 1985. We have expanded communications with seniors through a new newsletter, *CEI Connection*. It contains tips on energy management, household economies and other news of interest. The newsletter is being distributed to 30,000 senior citizens throughout our service area.

Working for a better community

Many Northeast Ohioans know our employees for their involvement in service organizations, hospitals and senior citizen centers, and for their work as volunteer fire fighters, paramedics, Little League coaches and tutors for disadvantaged youngsters.

The Company continues its Community Involvement Program to encourage such volunteerism. The program provides Company assistance to service projects in which employees are involved. In 1985, more than 100 service groups received help.

More than 200 employees attended some 25 neighborhood festivals during the summer of 1985 to meet directly with residents and answer their questions about our electric service. Among other items, the employees distributed 25,000 packets of literature to customers and 50,000 balloons to youngsters.

Wrote one festival organizer: "I want to thank The Illuminating Company for its support of our festival. Over 6,000 people attended and your donation of balloons for our youths helped make it a most colorful day."

As we responded to a similar letter, "We value working with groups of citizens who are doing good things for the community. The challenge before us all is to build on the spirit of cooperation, keep it burning and keep it working."

Making news nationwide in 1985 were the 26 Company employees who represented Greater Cleveland in a national "Corporate Sports Battle" to raise money for charity. Our athletes outscored all other Greater Cleveland companies in a local competition and placed a respectable eighth in the national competition at South Padre Island, Texas.

Our employees further demonstrated their community commitment in 1985 by donating $1 million to the area's United Way campaigns. The Company made a total corporate contribution of more than $1.3 million to various civic, educational, cultural, health and welfare organizations.

Extra effort wins recognition

Our community commitment earned special recognitions in 1985. One was a corporate leadership award from the Greater Cleveland Council for Economic Opportunities. The second, a human relations award from the National Conference of Christians and Jews, was presented to Company Chairman Robert M. Ginn for being in the forefront of the movement to combat prejudice and promote equal opportunity. Mr. Ginn accepted the award on behalf of the Company's officers, employees and retirees whom he credited for being long-time activists in that movement.

Our Company also was named "Employer of the Year" by the Vocational Guidance and Rehabilitation Services agency for a program to help train handicapped persons and, when possible, place them in Company jobs.

The Company is strengthening its stature in the Northeast Ohio community thanks to outstanding support from employees. We are proud to be recognized as a leading corporate citizen. It is a role the Company intends to maintain.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Capital Resources and Liquidity

Our on-going program of constructing new facilities to meet anticipated demand for electric service, to replace aging facilities and to comply with pollution control regulations requires a substantial investment of capital. Over the years 1983-1985, the capital requirements for our construction program totaled approximately $1.7 billion, excluding nuclear fuel. This amount includes an allowance for funds used during construction (AFUDC) which is explained in Note A of "Notes to Consolidated Financial Statements." See Notes M and N of "Notes to Consolidated Financial Statements" regarding risks associated with the construction of nuclear generating units and the recovery of costs through the regulatory process.

We finance our construction program through funds generated internally as well as from funds obtained from external sources. Over the past three years, about 55% of the money used for construction was raised externally through bank borrowings and security sales. At year end 1985, we had on hand about $85,102,000 of cash and temporary cash investments.

Expenditures for our 1986-1990 construction program, as discussed elsewhere in this Annual Report, are estimated to be $1.9 billion (including AFUDC, but excluding nuclear fuel). However, assuming construction of Perry 2 resumes in 1988 with completion in 1994, this estimate increases to $2.5 billion. The construction program does not take into account any changes which might be made after the proposed affiliation with The Toledo Edison Company (Toledo Edison) described in Note B of "Notes to Consolidated Financial Statements" becomes effective. Substantial additional expenditures may be necessary, however, if we are required to modify or add to our existing facilities to comply with future pollution control regulations. Assuming adequate and timely rate relief, we expect to finance about one-third to one-half of our construction program over the 1986-1990 period through the issuance of securities, with larger proportions in the earlier years.

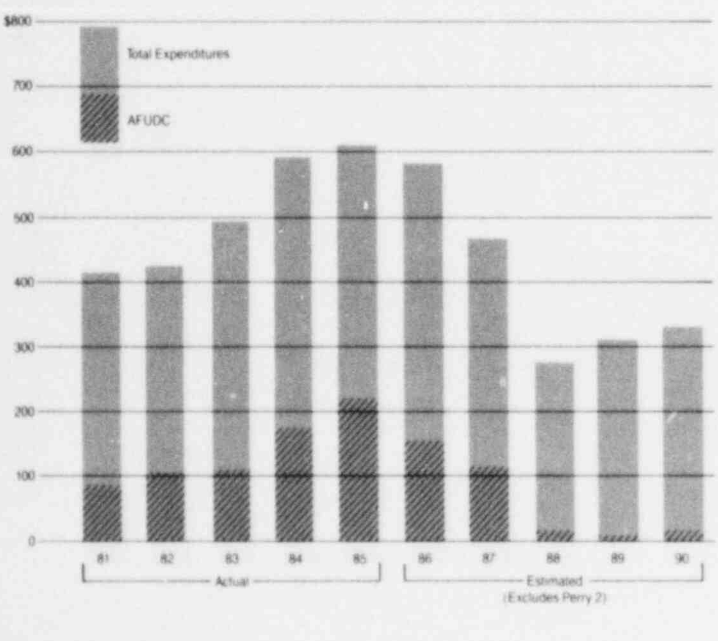
Moody's Investors Service and Standard & Poor's Corporation lowered their ratings on certain of our securities during the year. This increased our borrowing costs in 1985. These downratings are discussed elsewhere in this Annual Report.

We continue to seek fair rate levels from The Public Utilities Commission of Ohio (PUCO). Our ability to finance is contingent upon obtaining sufficient and timely rate increases from the PUCO. Without adequate rates, we cannot earn a fair return for our common share owners. Inadequate rates also would impair our ability to generate funds internally and could result in even lower ratings on our securities. In March 1985, the PUCO granted us an increase in electric rates of $19,500,000, or 1.6%. We had requested an increase of $180,000,000. In July 1985, we filed an application with the PUCO for an increase in electric rates of $210,000,000, or 16.8%. An order is expected in the second quarter of 1986. See "Results of Operations" and Note N of "Notes to Consolidated Financial Statements" for discussions of our recent rate increases and other rate matters.

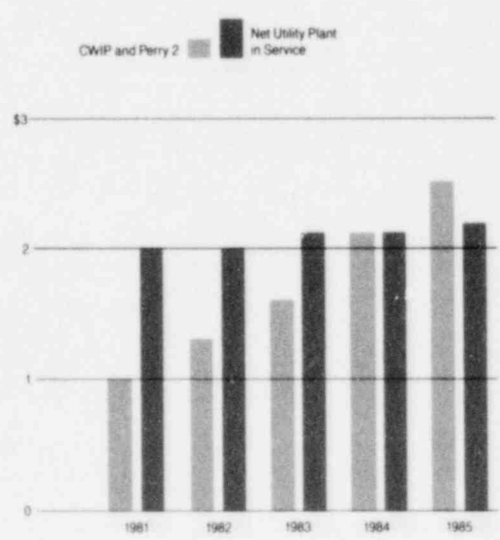
Our financing plans are designed to achieve a capitalization structure of 40-42% common equity, a maximum of 48% debt and 10-12% Preferred and Preference Stock. At year end 1985, our capitalization structure was 41% common equity, 48% debt and 11% Preferred and Preference Stock.

We sold Common Stock at prices below book value in 1983, 1984 and the first half of 1985. We did this because we needed to raise new capital and still maintain a good balance of debt and equity. These sales resulted in the dilution of the book value of outstanding common shares. However, from about mid-year 1985, sales of stock through our share owner, customer and

Construction Expenditures Including AFUDC
(millions)



Construction Work in Progress and Net Utility Plant in Service
(billions)



employee stock purchase plans have been at prices above book value due to strengthened market prices for our Common Stock. If and when our affiliation with Toledo Edison becomes effective, our future requirements for common equity capital will be met through retained earnings from our operations and Common Stock sales by Centerior Energy Corporation.

Financing plans for 1986 are discussed elsewhere in this Annual Report. Specific financing plans beyond 1986 have not been determined.

Over the 1986-1990 period, in addition to our construction program financing needs, we must refinance $349,205,000 of maturing debt and Preferred Stock. Also, we are required to offer to purchase $108,200,000 of Preferred and Preference Stock during the same period. See Notes F, H and I of "Notes to Consolidated Financial Statements" for further information regarding our First Mortgage Bonds and Preferred and Preference Stock. A portion of the securities maturing in the next five years will be refinanced with higher cost funds which could raise our embedded cost of capital.

The amount of First Mortgage Bonds we can issue is limited by our Mortgage and Deed of Trust. See Note F of "Notes to Consolidated Financial Statements" for a discussion regarding the amount of additional First Mortgage Bonds we were permitted to issue at December 31, 1985. There are no restrictions on the issuance of additional authorized Preferred and Preference Stock. However, as part of our June 25, 1985 agreement to affiliate with Toledo Edison, we have agreed that, prior to March 16, 1986, we will not issue more than $60,000,000 of additional Preferred and Preference Stock, of which we sold $50,000,000 of Preferred Stock in November 1985, and will not have more than 81,600,000 shares of Common Stock outstanding. At December 31, 1985, there were 78,522,668 shares of outstanding Common Stock.

We use short-term financing such as bank lines of credit and the sale of commercial paper to give us flexibility in timing our long-range financings. Money raised through these short-term arrangements is primarily used to finance temporarily our construction program. We have a total short-term borrowing capacity of $186,300,000 in the form of bank lines of credit and revolving loan commitments. Generally, these lines are held in reserve to ensure that we will be able to pay off commercial paper when it becomes due. In addition to these short-term borrowing arrangements, a $150,000,000 revolving credit facility was put in place in 1985 to serve as a back-up source of funds for our construction program. See Notes F and K of "Notes to Consolidated Financial Statements" for details of our credit arrangements.

Results of Operations

The chart below shows the factors which have affected our electric revenues in each of the last five years.

1985

Northeast Ohio's economy remained steady in 1985 after rebounding strongly in 1983 and 1984 from the recession earlier in the decade. This stability resulted in our total kilowatthour sales in 1985 being about the same as in 1984.

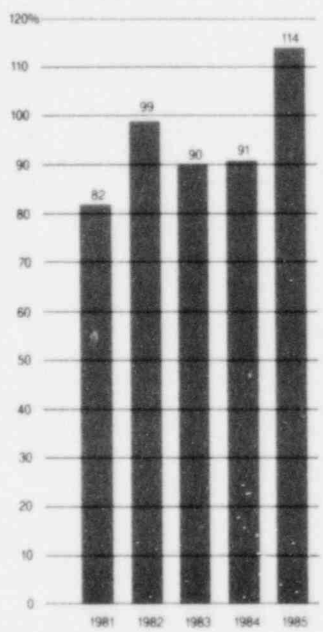
After two years of growth, kilowatthour sales to our industrial customers in 1985 were about the same as the 1984 level. Although we experienced increased sales in the automobile and aircraft parts and equipment sectors, this growth was offset by a decline in sales to the primary metals industry.

Sales to our residential customers declined 1% in 1985 despite a slight increase in the number of customers. Expected growth did not materialize because of moderate temperatures in the second and third quarters of 1985. We had the coolest summer in 13 years.

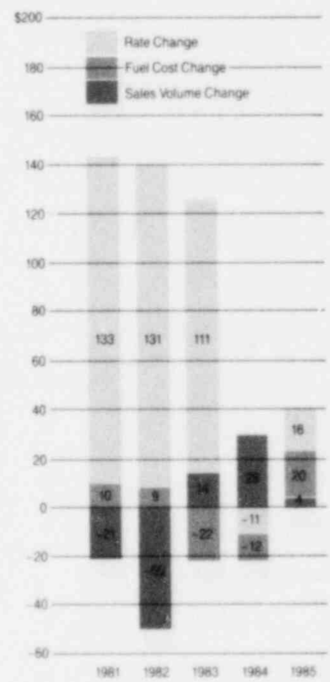
Even with the cooler summer, sales to our commercial customers increased 3% in 1985. This increase was due to a modest growth in the number of customers, primarily office buildings and medical facilities.

Earnings per share were $3.53 in 1985, a decline of 3% from 1984. The primary reasons for this decline were a 12% increase in the number of common shares outstanding during the year and an accounting deferral of AFUDC for Perry 2 which began July 1, 1985. The AFUDC deferral did not affect cash flow, but it did result in 1985 earnings per share being about 23 cents lower than they otherwise would have been. The impact of

Ratio of Market Price to Book Value (Year End)



Sources of Electric Revenue Increases (millions)



these items on our 1985 earnings per share was offset, in part, by the 1.6% increase in electric rates which the PUCO granted us in March 1985 and by continued growth in AFUDC (aside from that deferred for Perry 2) resulting from increased investment in construction work in progress, principally for Perry 1 and Beaver Valley 2. AFUDC was 82% of our 1985 earnings. For a further discussion of AFUDC and information concerning the status of AFUDC accruals for Perry 2, see Notes A and M, respectively, of "Notes to Consolidated Financial Statements."

Fuel and purchased power expense in 1985 was up 12% from the 1984 level, accounting for about 35% of our total operating expenses. Total fuel expense for the year increased 9% over 1984 because we used more costly fossil-fueled generation to replace some of the lower cost nuclear generation lost due to an outage at the Davis-Besse Nuclear Power Station and an increase in the net deferred fuel component. Nuclear generation accounted for only 6% of our total net generation in 1985 versus 13% in 1984. See Note A—Fuel of "Notes to Consolidated Financial Statements" for a discussion of deferred fuel costs.

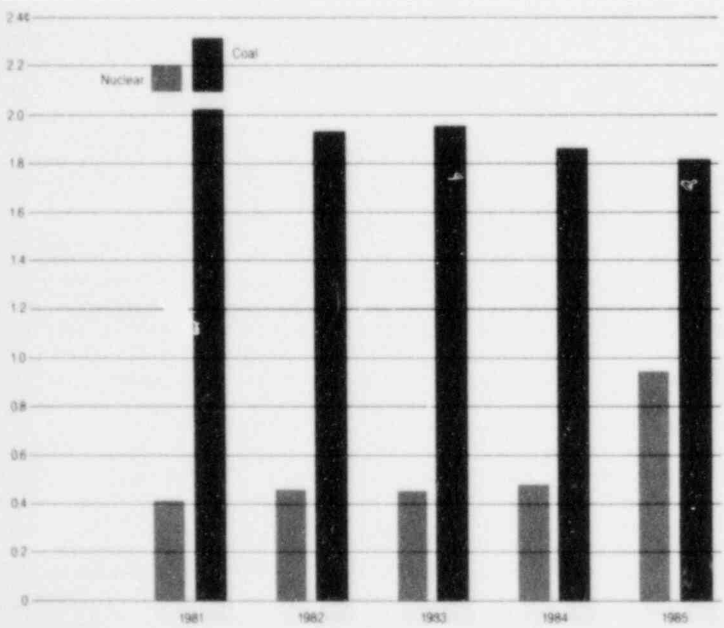
In 1985, our net purchased power expense was up 40% from 1984 primarily because of our need to replace a portion of the generation lost due to outages at major generating units, including Davis-Besse.

Increased interest payments also reduced earnings per share. The ratio of earnings to fixed charges (SEC method) in 1985 decreased to 2.6 from 3.1 in 1984.

1984

Total kilowatthour sales in 1984 were up 4% over 1983. The recovery in our local economy in 1984, particularly in the manufacturing sector, was a significant factor in that year's 6% gain in sales to our industrial customers. In addition, we also experienced gains in residential and commercial sales in the year of 1% and 3%, respectively. The improving economy along with harsh weather in early 1984, which offset the effect of a relatively mild summer that year, contributed to the increases in the residential and commercial sectors.

Fuel Costs
(per kilowatthour)



Earnings per share in 1984 reached a record level of $3.64, up 11% from 1983 earnings. Contributing to this increase were higher kilowatthour sales, higher AFUDC and the impact of a cost control program which we implemented in early 1983 and which continued into 1984. Increases in AFUDC, which amounted to 69% of our 1984 earnings, were partially offset by increases in payments of interest and Preferred Stock dividends and a greater number of outstanding common shares.

In 1984, our fuel and purchased power expense was 6% lower than in 1983. The primary reason for this decrease was an 11% reduction in total fuel expense resulting from lower unit fuel costs, greater efficiency in generating unit operations and a decrease in the net deferred fuel component. Davis-Besse contributed 13% of our total net generation that year. Partially offsetting the lower fuel expense in 1984 was an increase in net purchased power expense due to increased demand for energy and generating unit outages during the year.

The ratio of earnings to fixed charges (SEC method) declined slightly to 3.1 in 1984 from 3.2 in 1983.

1983

The economic recovery in our service area which began in 1983 contributed to a 6% increase in our kilowatthour sales to industrial customers. The improved economy, as well as an extremely hot summer in 1983, also benefited our residential and commercial sales. Sales to our residential and commercial customers were up 2% over 1982. Total kilowatthour sales for the year were up 3% from the previous year.

In January 1983, the PUCO granted us a 7.4% increase in electric rates. Subsequently, our electric rates were reduced 1% in October 1983. Our net rate increase and higher kilowatthour sales in 1983, in conjunction with the cost control program we implemented that year and higher AFUDC, helped push earnings per share to $3.28, a 9% increase over the 1982 level.

Total fuel and purchased power expense in 1983 was up slightly from 1982. Despite the impact of higher kilowatthour sales in 1983, total fuel expense declined 3% because of lower unit fuel costs. Fifteen percent of our total net generation was nuclear in 1983. The decrease in fuel expense was offset by an increase in net purchased power expense that year over 1982.

AFUDC accounted for 55% of our 1983 earnings. The ratio of earnings to fixed charges (SEC method) rose to 3.2 in 1983.

For a discussion of how we are affected by inflation, see "Supplementary Information Concerning the Effects of Inflation."

MANAGEMENT'S STATEMENT OF RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of The Cleveland Electric Illuminating Company is responsible for the consolidated financial statements which appear in this Annual Report. The statements were prepared in accordance with generally accepted accounting principles. Under these principles some amounts must be recorded based on estimates. Such estimates are based on an analysis of the best information available.

We maintain a system of internal accounting controls. The control procedures are designed to assure that the financial records are reasonably complete and accurate. They also are designed to help protect the assets and their related records. We make an effort to ensure that the costs of our control procedures do not exceed the benefits.

We have an internal audit program which monitors the internal accounting controls. This program is designed to examine whether the controls are adequate and effective. Also, an examination of the financial statements is conducted by Price Waterhouse, independent accountants, whose opinion appears below.

The Board of Directors of the Company is responsible for determining whether management and the independent accountants are carrying out their responsibilities. The Board has appointed an Audit Committee, comprised entirely of outside directors. The responsibilities of the Audit Committee are described elsewhere in this Annual Report.

REPORT OF INDEPENDENT ACCOUNTANTS

Price Waterhouse

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

We have examined the consolidated balance sheet and the statement of capitalization of The Cleveland Electric Illuminating Company and its subsidiaries at December 31, 1985 and 1984 and the related consolidated statements of income, retained earnings, and of changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note M to the consolidated financial statements, the Company cannot now predict:

(a) when, if ever, or at what cost Perry 2 will be completed; and, if not completed, whether The Public Utilities Commission of Ohio will allow recovery of costs associated with the Unit; and

(b) whether regulatory actions by The Public Utilities Commission of Ohio with respect to the Company's investment in Perry 1 and/or Beaver Valley 2 will have a material adverse effect on its financial position or results of operation.

In our opinion, subject to the effects on the 1985 and 1984 financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in item (a) of the preceding paragraph been known and on the 1985 financial statements of such adjustments, if any, as might have been required had the outcome of the additional uncertainties discussed in item (b) of the preceding paragraph been known, the financial statements referred to above present fairly the financial position of The Cleveland Electric Illuminating Company and its subsidiaries as of December 31, 1985 and 1984, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles consistently applied.

Cleveland, Ohio
February 10, 1986

Price Waterhouse

Tired of Paying High Income Taxes?

Looking for a More Energetic Investment?

Plug into a Company IRA

You May Also Participate in The Dividend Reinvestment Plan

A *Company IRA* allows you to combine the high return available on Company common stock with IRA tax benefits. The *Company IRA* has all the tax benefits of other IRAs:

- Deduction of your investment from taxable income
- Deferral of taxes on both your dividends and capital gains

PLUS

- Potential for growth in dividends paid
- Potential for capital gains
- No brokerage commissions or maintenance fees on investments

You may make contributions into your *Company IRA* by check, direct deposit of dividends paid on other Company stock and direct deposit of proceeds from the sale of common stock held for you by the Company in a dividend reinvestment plan account.

The Dividend Reinvestment Plan allows you to:

- Increase your investment in the Company without brokerage commissions
- Automatically reinvest dividends on all or any part of your Company stock and invest cash
- Continue to receive your dividends and invest only cash
- Deposit your common stock certificates with the Company for safekeeping

Put more energy into your IRA and other investment activity—*plug into a Company IRA and the Dividend Reinvestment Plan.*

For complete information, mark the appropriate box on the attached card and indicate your name and mailing address. You are not obligated to participate in either program.

To obtain complete information about the Company's *Dividend Reinvestment Plan* and the *Company IRA*, mark the appropriate box and indicate your name and mailing address.

Please send me information regarding:

☐ DRP ☐ Company IRA ☐ Both

Name (Please Print)

Street

City State Zip Code

Mail this card today. No postage necessary.

NO POSTAGE
NECESSARY
IF MAILED
IN THE
UNITED STATES

BUSINESS REPLY MAIL

FIRST CLASS PERMIT NO. 2392 CLEVELAND, OHIO

POSTAGE WILL BE PAID BY ADDRESSEE

The Cleveland Electric Illuminating Company
Share Owner Services
P.O. Box 5000
Cleveland, Ohio 44101-2000

Dear Share Owner:

If you receive duplicate copies of Company mailings in your household and have no need for the extra copies, you will help us economize by completing and returning this card.

Your instructions will eliminate all duplicate mailings except dividend checks and proxies.

Your help is appreciated.

Sincerely,
E. L. Pepin
Secretary
The Illuminating Company

Please discontinue duplicate mailings now coming to this address.

Name (Please Print)

Street

City State Zip Code

Eliminate Mailings to Account(s) No. ____ Continue Mailings to Account No. ____

(Account number appears on your dividend check stub or DRP statement of account)

Signature of share owner(s)

Do not return this form if you presently receive only one copy of each mailing in your household.

If you would like to receive a copy of The Toledo Edison Company's 1985 Annual Report, please complete and return this card.

Mail this card today. No postage necessary.

Name (Please Print)

Street

City State Zip Code

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The Cleveland Electric Illuminating Company
Share Owner Services
P.O. Box 5000
Cleveland, Ohio 44101-2000

INCOME STATEMENT

The Cleveland Electric Illuminating Company and Subsidiaries

	For the Year Ended December 31, 1985	1984	1983
	(Thousands of Dollars)		
OPERATING REVENUES			
Electric	$1,240,885	$1,200,465	$1,194,162
Steam	13,105	14,888	16,154
Total Operating Revenues	1,253,990	1,215,353	1,210,316
OPERATING EXPENSES			
Operation			
Fuel	312,229	285,188	320,792
Purchased power	39,625	28,224	12,185
Other	214,246	190,563	182,439
	566,100	503,975	515,416
Maintenance	96,448	90,325	88,029
Depreciation and amortization	96,995	95,274	94,196
Taxes, other than Federal income tax	133,348	132,313	126,883
Federal income tax	101,950	131,355	127,430
Total Operating Expenses	994,841	953,242	951,954
NET OPERATING INCOME	259,149	262,111	258,362
NONOPERATING INCOME			
Allowance for equity funds used during construction	162,907	130,421	87,052
Other income and deductions, net	(4,844)	3,680	3,805
Federal income tax — credit	48,608	35,099	23,291
Total Nonoperating Income	206,671	169,200	114,148
INCOME BEFORE INTEREST CHARGES	465,820	431,311	372,510
INTEREST CHARGES			
Long-term debt	210,891	177,246	151,257
Short-term bank loans, commercial paper and other	1,399	3,618	2,717
Allowance for borrowed funds used during construction	(57,173)	(41,185)	(27,490)
Total Interest Charges	155,117	139,679	126,484
NET INCOME	310,703	291,632	246,026
Dividend requirements on preferred and preference stock	41,467	43,353	38,426
EARNINGS AVAILABLE FOR COMMON STOCK	$ 269,236	$ 248,279	$ 207,600
EARNINGS PER COMMON SHARE	$ 3.53	$ 3.64	$ 3.28
DIVIDENDS DECLARED PER COMMON SHARE	$ 2.55	$ 2.43	$ 2.31

RETAINED EARNINGS STATEMENT

	For the Year Ended December 31, 1985	1984	1983
	(Thousands of Dollars)		
BALANCE AT BEGINNING OF YEAR	$ 471,163	$ 388,217	$ 325,463
ADDITIONS			
Net income	310,703	291,632	246,026
DEDUCTIONS			
Dividends declared			
Preferred stock	37,637	39,799	33,636
Preference stock	3,314	4,197	4,418
Common stock	193,238	164,690	145,077
Costs of issuing equity securities	6	—	141
Total Deductions	234,195	208,686	183,272
BALANCE AT END OF YEAR	$ 547,671	$ 471,163	$ 388,217

The accompanying notes are an integral part of these financial statements.

BALANCE SHEET AT DECEMBER 31

The Cleveland Electric Illuminating Company and Subsidiaries

	December 31, 1985	December 31, 1984
	(Thousands of Dollars)	
ASSETS		(Restated)
PROPERTY AND PLANT		
Utility plant		
Electric in service	$3,043,525	$2,864,332
Steam in service	45,580	44,561
	3,089,105	2,908,893
Less accumulated depreciation and amortization	874,366	798,979
	2,214,739	2,109,914
Construction work in progress	2,165,501	1,791,662
Perry 2	358,666	321,988
	4,738,906	4,223,564
Nuclear fuel lease and trust arrangements	300,523	260,819
Other property, less accumulated depreciation	35,328	27,859
	5,074,757	4,512,242
POLLUTION CONTROL CONSTRUCTION FUNDS — unexpended	53,454	61,422
CURRENT ASSETS		
Cash and temporary cash investments	85,102	130,711
Amounts due from customers and others, net	131,542	116,477
Materials and supplies, at average cost	31,784	31,028
Fossil fuel inventory, at average cost	51,241	78,033
Taxes applicable to succeeding years	105,121	101,678
Other	3,863	3,802
	408,653	461,729
DEFERRED CHARGES		
Unamortized costs of terminated projects	44,083	46,089
Accumulated deferred Federal income taxes	6,991	7,597
Other	62,622	30,763
	113,696	84,449
	$5,650,560	$5,119,842
CAPITALIZATION AND LIABILITIES		
CAPITALIZATION (See statement of Capitalization)		
Long-term debt	$2,099,660	$1,883,648
Serial preferred stock		
With mandatory redemption provisions	280,467	247,218
Without mandatory redemption provisions	144,021	144,021
Serial preference stock with mandatory redemption provisions	34,200	45,600
Common stock equity	1,763,720	1,592,810
	4,322,068	3,913,297
OTHER NONCURRENT LIABILITIES, primarily nuclear fuel lease and trust obligations	300,176	257,166
CURRENT LIABILITIES		
Current portion of long-term debt and preferred stock	48,161	49,483
Notes payable to banks and others	—	19,100
Accounts payable	130,238	143,378
Accrued payroll and vacations	20,622	17,904
Federal income taxes	5,672	10,860
Other taxes	135,636	129,402
Interest	45,231	40,272
Current portion of nuclear fuel lease obligations	23,366	17,596
Other	9,080	6,932
	418,006	434,927
DEFERRED CREDITS		
Unamortized investment tax credits	277,336	265,365
Accumulated deferred Federal income taxes	271,834	215,362
Reserve for Perry 2 allowance for funds used during construction	17,962	—
Other	43,178	33,725
	610,310	514,452
COMMITMENTS AND CONTINGENCIES — See Note M		
	$5,650,560	$5,119,842

The accompanying notes are an integral part of these financial statements.

CAPITALIZATION AT DECEMBER 31

The Cleveland Electric Illuminating Company and Subsidiaries

	1985	1984	1985	1984
	(Thousands of Dollars)		(Percent of Capitalization)	
LONG-TERM DEBT(a)				
First mortgage bonds — maturing through 2020 at rates of 3% to 16⅝% (Less $30,000,000 in 1985 and $43,291,000 in 1984 classified as current)	$1,868,970	$1,609,800		
Collateral pledge notes(b)	—	47,120		
Term bank loans — maturing 1986-1993 at variable rates that averaged 9.59% in 1985 and 11.49% in 1984 (Less $10,000,000 in 1985 classified as current)	165,000	175,000		
Pollution control notes — maturing through 2012 at rates of 5.6% to 6.7% (Less $410,000 in 1985 and 1984 classified as current)	56,610	57,020		
Other — net	9,080	(5,292)		
Total Long-term Debt	2,099,860	1,883,648	48	48

SERIAL PREFERRED AND PREFERENCE STOCK — cumulative, without par value, 4,000,000 and 3,000,000 authorized shares, respectively

Preferred Stock without mandatory redemption provisions

Series	Annual Dividend Rate	1985 Shares Outstanding	1985	1984
A	$7.40	500,000	50,000	50,000
B	$7.56	450,000	45,071	45,071
L	(c)	500,000	48,950	48,950
			144,021	144,021

Preferred and Preference Stock with mandatory redemption provisions (Less $7,751,000 in 1985 and $5,782,000 in 1984 classified as current)

Series	Annual Dividend Rate	1985 Shares Outstanding	Annual Mandatory Redemption Provisions(d): Beginning on	Price	Shares to be Redeemed	Shares to be Redeemed at Holders' Option	1985	1984
Preferred:								
C	$ 7.35	220,000	8-1-84	$ 100	10,000	—	22,000	23,000
E	$ 88.00	42,000	6-1-81	$1,000	3,000	—	42,000	45,000
F	$ 75.00	50,000	11-1-85(e)	$1,000	—	16,667	50,000	50,000
G	$ 80.00	24,000	8-1-84(e)	$1,000	—	8,000	24,000	32,000
H	$ 145.00	24,936	6-1-85	$1,000	1,782	—	24,936	26,718
I	$ 145.00	29,531	6-1-86	$1,000	1,969	—	29,531	31,500
J	$ 113.50	29,000	6-1-87	$1,000	5,800	—	29,000	29,000
K	$ 113.50	10,000	6-1-91	$1,000	10,000	—	10,000	10,000
M	(f)	500,000	11-1-91	$ 100	100,000	—	49,000	—
							280,467	247,218
Preference:								
1	$ 77.50	34,200	4-1-84(e)	$1,000	—	11,400	34,200	45,600

	1985	1984	1985	1984
Total Preferred and Preference Stock	458,688	436,839	11	11
COMMON STOCK EQUITY				
Common shares, without par value, 105,000,000 authorized; 78,522,668 and 74,040,175 outstanding in 1985 and 1984, respectively	1,216,049	1,121,647		
Retained earnings(g)	547,671	471,163		
Total Common Stock Equity	1,763,720	1,592,810	41	41
TOTAL CAPITALIZATION	$4,322,068	$3,913,297	100	100

(a) Long-term debt matures during the next five years as follows: $40,410,000 in 1986 (classified as a current liability on the consolidated Balance Sheet), $13,410,000 in 1987, $14,410,000 in 1988, $124,510,000 in 1989 and $94,510,000 in 1990.

(b) The collateral pledge notes shown as outstanding in 1984 were exchanged for first mortgage bonds in November 1985.

(c) The dividend rate is adjustable based on the highest of certain factors but it cannot be more than 13% or less than 7%. The average rate was 10.78% in 1985 and 12.89% in 1984.

(d) Amounts to be paid for preferred stock which must be redeemed during the next five years are: $7,751,000 in 1986 (classified as a current liability on the consolidated Balance Sheet) and $13,551,000 in 1987, 1988, 1989 and 1990. In addition, the Company must offer to purchase preferred and preference stock having a total redemption price up to $36,067,000 in both 1986 and 1987, $36,066,000 in 1988 and none in 1989 and 1990.

(e) This is the date the Company must offer to redeem. Any resulting redemption would occur four months later.

(f) The dividend rate is adjustable based on the highest of certain factors but it cannot be more than 13.50% or less than 7.00%. The average rate was 9.27% in 1985.

(g) As of December 31, 1985 and 1984 there was no restriction on the right of the Company to pay dividends in any amount up to all of the earnings retained in the business.

The accompanying notes are an integral part of these financial statements.

CHANGES IN FINANCIAL POSITION

The Cleveland Electric Illuminating Company and Subsidiaries

	For the Year Ended December 31,		
	1985	1984	1983
		(Thousands of Dollars)	
FINANCIAL RESOURCES PROVIDED		(Restated)	(Restated)
Net income	$ 310,703	$ 291,632	$ 246,026
Items not affecting working capital			
Depreciation and amortization	98,209	95,625	94,336
Deferred Federal income tax	68,218	73,467	89,125
Allowance for equity funds used during construction	(162,907)	(130,421)	(87,052)
Other	1,340	783	620
Total financial resources provided from operations	315,563	331,086	343,055
Sales of securities			
First mortgage bonds	238,950	337,900	125,000
Preferred stock	49,000	—	48,950
Common stock	94,401	154,377	65,638
Total sales of securities	382,351	492,277	239,588
Term bank loans and collateral pledge notes	3,100	72,750	37,270
Nuclear fuel lease obligations	39,704	44,211	70,553
Pollution control funds expended	96,918	66,196	—
Reserve for Perry 2 AFUDC	17,962	—	—
Working capital decrease(a)	50,807	—	59,957
Other	13,780	—	7,591
Total Financial Resources Provided	$ 920,185	$1,006,520	$ 758,014
FINANCIAL RESOURCES USED			
Additions to utility plant	$ 605,705	$ 582,288	$ 490,705
Allowance for equity funds used during construction	(162,907)	(130,421)	(87,052)
	442,798	451,867	403,653
Retirement of debt and preferred stock	87,983	78,810	99,105
Dividends	234,189	208,686	183,130
Pollution control construction funds deposited	88,950	109,000	840
Deferred fuel costs	—	9,790	—
Nuclear fuel leases	39,704	44,211	70,553
Decrease in short-term debt and other borrowings	—	—	40
Working capital increase(a)	—	84,560	—
Other	26,561	19,596	693
Total Financial Resources Used	$ 920,185	$1,006,520	$ 758,014
SUMMARY OF CHANGES IN WORKING CAPITAL(a)			
Cash and temporary cash investments	$ (45,609)	$ 88,018	$ (16,624)
Amounts due from customers and others, net	15,085	4,549	10,070
Fossil fuel inventory	(26,792)	19,163	(16,533)
Taxes applicable to succeeding years	3,443	1,794	12,754
Accounts payable and accrued payroll and vacations	10,422	(23,965)	(30,782)
Federal income and other taxes payable	(1,046)	(2,945)	(17,157)
Other	(6,290)	(2,054)	(1,685)
Change in Working Capital	$ (50,807)	$ 84,560	$ (59,957)

(a) Other than short-term borrowings, current portion of long-term debt and current portion of nuclear fuel lease obligations.

The accompanying notes are an integral part of these financial statements.

NOTE A — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Our accounting records are maintained in conformity with the Uniform System of Accounts as prescribed by the Federal Energy Regulatory Commission (FERC) and adopted by The Public Utilities Commission of Ohio (PUCO).

Consolidation

Our financial statements include the accounts of wholly-owned subsidiaries, which in the aggregate are immaterial.

Property and Plant

Electric and Steam Utility Plant is carried on the books at original cost as defined by the FERC. The costs of maintenance and repairs are charged to Operating Expense as incurred. The cost of replacing or improving property is charged to Property and Plant. The cost of property retired, plus any removal cost, less any salvage realized, is charged to Accumulated Depreciation and Amortization.

Depreciation

We report depreciation expense on our income statement as a current cost of doing business to account for the normal using up of our property. Depreciation is deducted in equal amounts over the estimated useful life of the property. For example, if we estimate that an item will be useful for 10 years, we charge one-tenth of its cost to depreciation expense each year. However, in the case of the Davis-Besse Nuclear Power Station (Davis-Besse), we utilize the units-of-production depreciation method which bases depreciation on the ratio of the amount of electrical energy it produces in the accounting period to its total estimated energy production during its useful life. We intend to use the units-of-production depreciation method on our investment in Perry 1.

Terminated Projects

Costs associated with terminated nuclear generating units are being amortized over a period approximating 15 years, which began in 1983. See Note E.

Allowance for Funds Used During Construction

The PUCO and the FERC allow us to include as part of the total cost of constructing new assets the cost of money paid on funds which are tied up in construction projects. This is called Allowance for Funds Used During Construction (AFUDC).

When a construction project is completed, or to the extent the PUCO allows it in rate base after it is at least 75% completed, the funds invested in it are no longer considered tied up in construction and we stop recording AFUDC. The cost of the project at that time, including AFUDC, is treated as a new asset and is included in a subsequent rate case to determine the rates we charge our customers for service. Because the resulting rates include a factor for all these costs, we are being allowed to recover in cash all costs of the property including AFUDC, over the useful life of the property.

The amount of AFUDC for an accounting period is determined by applying a rate of AFUDC to the funds tied up in construction. The annual AFUDC percentage rate is determined by a formula set by the FERC. The rate represents an average of the cost of money paid on funds tied up in construction. The rate is compounded semiannually. The part of the rate which represents interest is reduced to recognize that interest is tax deductible.

The amount of AFUDC is reflected in two parts of our income statement: an addition to Nonoperating Income as the Allowance for Equity Funds Used During Construction and a reduction of Interest Charges as the Allowance for Borrowed Funds Used During Construction. On the balance sheet, the AFUDC becomes part of Construction Work in Progress.

The amount of AFUDC recorded in each accounting period varies. The variation occurs because of (1) the number of dollars spent on construction both during and prior to the accounting period, (2) the length of the construction period and (3) the rate used in computing AFUDC. The rates were 10.73% in 1985, 10.66% in 1984 and 10.35% in 1983.

Federal Income Tax

The depreciation expense we report on our income statement is different from the depreciation expense we use to calculate Federal income tax. There are several reasons for this difference. First, AFUDC and certain overheads are excluded from the cost of assets which we are allowed to depreciate for tax purposes. However, these costs are included in the cost of assets we depreciate on our income statement (book depreciation). Second, the portion of depreciation expense representing nuclear unit decommissioning costs (see Note D) is not deductible for tax purposes until cash payments are made. Third, the period of time over which the Internal Revenue Service (IRS) allows the cost of assets to be depreciated is shorter than the period of time (useful life) we use. Finally, the IRS allows some of the depreciation we are entitled to in future years to be used early. Beginning with property additions made in October 1976, the tax reductions resulting from these differences are not applied to reduce tax expense on the income statement in the periods we obtain them. They are deferred for allocation to income over the useful life of property through an accounting procedure called normalization. At December 31, 1985, the cumulative net amount of income tax timing differences for which deferred income taxes have not been provided amounted to about $500,000,000.

When we place new property in service during the year, the IRS allows us a credit against taxes due for 10% of the investment we have made in the new asset. This is called the investment tax credit. We record Federal income tax on our income statement as though it were not reduced by this credit. We recognize the tax savings from this credit over the life of the property involved through the normalization procedure.

Our Federal income taxes are lowered because we can deduct our interest charges from income. This reduction of taxes is split between Net Operating Income and Total Nonoperating Income. The tax reductions resulting from interest actually paid on funds invested in property currently being constructed are recorded in Total Nonoperating Income. The tax reductions of interest paid on all other funds are recorded in Net Operating Income.

Revenues

Customer meters are read or estimated and billed on a monthly basis. Operating revenues are recorded in the accounting period during which the meters are read.

A fuel factor is added to our base rates for electric service. This fuel factor is designed to recover from customers what we actually pay for fuel. It is changed every six months after a hearing before the PUCO. Our steam fuel rate is adjusted each month for what we paid for fuel in the preceding month.

Fuel

When we make a payment for coal or oil, it is recorded on the balance sheet as Fossil Fuel Inventory. When we make a lease payment for nuclear fuel, we record it on the balance sheet as a deferred charge. As the fossil and nuclear fuel is used, we transfer the cost to the income statement as fuel expense. Nuclear fuel expense also includes a factor for the cost of the ultimate disposal of spent nuclear fuel and interest which is being recovered through rates.

Any difference between the cost of fuel actually used and the amount collected from customers through the fuel factor in rates is deferred. The deferred amount is taken into account to adjust the fuel factor for a subsequent six-month period.

Accounts Receivable

Amounts due from customers and others was reduced by the allowance for uncollectible accounts of $4,426,000 and $3,226,000 in 1985 and 1984, respectively.

NOTE B — PENDING AFFILIATION

We and The Toledo Edison Company (Toledo Edison) entered into an agreement on June 25, 1985 to affiliate under a new holding company, Centerior Energy Corporation (Centerior). Centerior will provide overall management, planning and policymaking for the two electric utilities. The affiliation was approved by the Common Stock share owners of both companies on November 26, 1985. Under the terms of the agreement, our share owners will receive 1.11 shares of Centerior's Common Stock in exchange for each share of our Common Stock held. Holders of Toledo Edison Common Stock will receive one share of Centerior's Common Stock in exchange for each share of Toledo Edison Common Stock held. Other than Common Stock, no other securities or financial obligations of ours or Toledo Edison's will be affected. Approval of the affiliation by the Securities and Exchange Commission (SEC) is pending. We expect that the SEC will act on the affiliation by late March 1986. See "Combined Pro Forma Summary Financial Information" for selected historical pro forma data.

NOTE C — FEDERAL INCOME TAX

Federal income tax, computed by multiplying the income before taxes by the statutory rate of 46%, is reconciled to the amount of Federal income tax recorded on our books as follows:

	1985 (Thousands of Dollars)	% of Pre-Tax Income	1984 (Thousands of Dollars)	% of Pre-Tax Income	1983 (Thousands of Dollars)	% of Pre-Tax Income
Book income before Federal income tax	$364,045		$387,887		$350,165	
Tax on book income at statutory rate	167,461	46.0	178,428	46.0	161,056	46.0
Decreases in tax due to:						
Allowance for funds used during construction	101,237	27.8	78,939	20.4	52,689	15.0
Other items	12,882	3.5	3,233	0.8	4,228	1.3
	114,119	31.3	82,172	21.2	56,917	16.3
Total Federal income tax expense	$ 53,342	14.7	$ 96,256	24.8	$104,139	29.7

Federal income tax expense is shown in the income statement as follows:

	1985	1984	1983
	(Thousands of Dollars)		
Operating Expenses			
Current tax provision	$ 45,531	$ 56,029	$ 38,309
Changes in accumulated deferred Federal income tax:			
Accelerated depreciation and amortization	20,077	23,957	20,727
Nuclear fuel interest charges	10,118	—	—
Other items	6,234	4,594	3,387
Investment tax credit deferred, less amounts amortized	19,990	46,775	65,007
Total charged to operating expenses	101,950	131,355	127,430
Nonoperating Income			
Current tax provision	(46,239)	(33,240)	(22,763)
Deferred tax provision	(2,369)	(1,859)	(528)
Total Federal income tax expense	$ 53,342	$ 96,256	$104,139

The income tax we paid in 1985 and 1984 was reduced by investment tax credits of $30,013,000 and $54,881,000, respectively. Investment tax credits which are available and have not been used are approximately $13,000,000. These unused credits may be used to reduce tax liability through the year 2000.

NOTE D — DEPRECIATION

We compute book depreciation on all of our utility plant, with the exception of Davis-Besse, using the straight-line method of deducting from revenue the total cost of property in equal installments each year over its estimated useful life. The amount depreciated takes into account our estimate of the money expected to be received when we dispose of the property (salvage) and our estimate of the cost of dismantling and removing it (removal cost).

When a nuclear plant is retired from service, we will have additional costs called decommissioning costs. For Davis-Besse, decommissioning is assumed to occur in 2011 when the radioactive components and structure are expected to be sealed in a vault-like enclosure. At a later date, the entire facility would be removed from the site. The depreciation for Davis-Besse which we currently record on the books and recover in rates includes a factor for our share of these decommissioning costs. The factor used during the 1983 through 1985 period was authorized by the PUCO in 1980 and is based on an estimate of $27,000,000 representing decommissioning costs expressed in 1980 dollars. The PUCO allows us to update periodically the cost estimate and the depreciation factor. An adjustment to these items is under review in connection with our current rate proceeding (see Note N).

At December 31, 1985, the reserve for Accumulated Depreciation and Amortization includes $4,556,000 for such decommissioning costs. There are no restrictions on the use of amounts currently being recovered for decommissioning from customers through rates.

Annual depreciation provisions as a percentage of the depreciable cost of plant are as follows:

	1985	1984	1983
Electric Plant	3.3%	3.3%	3.4%
Steam Plant	2.6%	2.6%	2.6%

NOTE E — TERMINATED PROJECTS

In January 1980, the Central Area Power Coordination Group (CAPCO) companies terminated their plans to construct four nuclear generating units which were in various stages of construction start-up. Our rate case orders provide specific revenue to recover these costs through the method used to calculate the allowed rate of return on rate base and authorize us to amortize the unamortized terminated unit costs. Ohio law does not permit recovery of these costs through rates as an operating expense. The unamortized costs of the terminated units are not included in our rate base.

NOTE F — FIRST MORTGAGE BONDS AND OTHER BORROWING ARRANGEMENTS

Condensed information on outstanding First Mortgage Bonds is as follows:

Year of Maturity	Interest Rate	At December 31, 1985	At December 31, 1984
		(Thousands of Dollars)	
1985	2.75 %	$ —	$ 25,000
1985-A	11.50 %	—	18,291
1986	3.375%	25,000	25,000
1986-A and B	5.25 %	5,000	5,000
1989	3.00 %	20,000	20,000
1989-A	15.25 %	40,000	40,000
1989-B	14.375%	50,000	50,000
1990	7.125%	60,000	60,000
1991 through 1995	11.47 % (a)	240,774	238,705
1996 through 2000	11.28 % (a)	23,020	12,675
2001 through 2005	10.93 % (a)	169,020	93,675
2006 through 2010	9.23 % (a)	239,190	228,845
2011 through 2020	10.68 % (a)	1,026,966	835,900
		1,898,970	1,653,091
Less amounts classified as current		30,000	43,291
		$1,868,970	$1,609,800

(a) Percentages are weighted average rates for the period.

The First Mortgage Bonds are issued under our Mortgage which places a first lien on almost all the property we own and franchises we hold to secure the repayment of the First Mortgage Bonds.

The issuance of additional First Mortgage Bonds is limited by two provisions of the Mortgage. This amount fluctuates depending upon the remaining amount of bondable property and upon earnings and interest rates. In addition, disallowances or cancellations might affect this amount. Under the more restrictive of these provisions, we would have been permitted at December 31, 1985 to issue approximately $1,013,000,000 of additional First Mortgage Bonds. If Perry 2 had been cancelled at the end of 1985, this amount would have been about $251,000,000 less.

In November 1985, we arranged a bank revolving credit agreement providing for borrowings of up to $150,000,000. This agreement serves as a back-up source of funds for our construction program. Interest rates on borrowings under the agreement will vary depending upon the amount of the current borrowing, total borrowings then outstanding and, at our option, may be based upon the prevailing prime rate or certain other interest measurements. We must pay commitment fees of approximately 0.3% on the average daily unused portion of the credit agreement. At our option, all obligations outstanding at March 31, 1988 may be converted into an amortizable three-year term loan.

NOTE G — LEASES

We have existing agreements for the leasing of certain vehicles, unit trains, other equipment, buildings and nuclear fuel.

During 1985, we implemented the provisions of Statements of Financial Accounting Standards (SFAS) No. 13 and No. 71 which require that we account for certain leased assets as though we owned them. Our nuclear fuel leasing arrangements resulted in an increase in the assets and liabilities reported on our balance sheet. We restated the balance sheet for prior periods to reflect this adjustment. These adjustments had no effect on the results of operations.

When the PUCO determines what rates are to be charged to our customers, it treats the rents on leases as an operating expense. Accordingly, we record those rents as an operating expense on the income statement. All the rental payments we make for nuclear fuel and unit trains are recorded initially in balance sheet fuel accounts. As the fuel is used, these costs are transferred to fuel expense on the income statement. We paid rent of $7,345,000 in 1985, $14,767,000 in 1984 and $12,388,000 in 1983 for nuclear fuel and unit train leases. Lease payments under all other leases were not material.

Some of our leases have noncancellable terms of more than one year. We have to make the following payments under these leases after December 31, 1985:

Year	Amount (Thousands of Dollars)
1986	$ 3,038
1987	2,564
1988	1,736
1989	1,576
1990	1,576
Later Years	3,184
Total	$ 13,674

We did not include in the above table the payments we must make under our nuclear fuel leasing arrangements. Since the payments are made when fuel is used, we do not know the exact timing or total amount of the rental payments. See "Nuclear Fuel" under Note M for a description of our nuclear fuel leases and commitments and an estimate of lease payments over the next five years.

NOTE H — SERIAL PREFERRED AND PREFERENCE STOCK WITH MANDATORY REDEMPTION PROVISIONS

We have assured the owners of our Series F Preferred Stock a minimum dividend return of 6.96% on their investment after deducting any Federal income tax on the dividends received on the stock. If certain income tax laws are changed such that their after-tax return is lower, we would have the option to do one of two things: buy back the Series F at $1,000 per share plus accrued dividends or exchange Series F for a new series of preferred stock with a dividend rate high enough to provide a 6.96% after-tax return.

We have the right to buy back and retire shares of Serial Preferred and Preference Stock which have mandatory redemption provisions. The redemption prices (plus dividends accrued to the redemption dates) are as follows:

Series	Price at December 31, 1985	Through	Eventual Minimum
Preferred:			
C	$ 103.00	7-31-88	$ 100.00
E	$1,088.00	5-31-86	$1,000.00
F	$1,015.00	2-28-86	$1,000.00
G	$1,017.78	11-30-86	$1,000.00
H	(a)	5-31-91	$1,000.00
I	(b)	5-31-92	$1,000.00
J	(c)	5-31-87	$1,000.00
M	$ 109.27	10-31-86	$ 100.00
Preference:			
1	$1,012.92	7-31-86	$1,000.00

(a) Beginning June 1, 1990 at $1,068.68.
(b) Beginning June 1, 1991 at $1,068.68.
(c) Beginning June 1, 1986 at $1,050.44.

We can exercise our right to buy back Series E Preferred Stock before June 1, 1986 only under certain conditions. Series E cannot be redeemed prior to June 1, 1986 as part of a refunding involving the use of proceeds of sales of debt, other preferred stock or stock ranking higher than the Series E with an effective annual cost of less than 8.8%. In addition, we may not refund through the sale of stock which is junior to the Series E.

The following shares of Serial Preferred and Preference Stock with mandatory redemption provisions were bought back and retired during the three years ended December 31, 1985:

Series	1985	1984	1983
Preferred:			
C	10,000	10,000	—
E	3,000	3,000	3,000
G	8,000	8,000	—
H	1,782	—	—
Preference:			
1	11,400	11,400	—

During the three years ended December 31, 1985, we sold only one series of Serial Preferred Stock with mandatory redemption provisions. We sold 500,000 shares of Series M priced at $100 per share in November 1985.

There are no restrictions on our right to issue and sell authorized shares of Serial Preferred or Preference Stock after March 16, 1986.

NOTE I — SERIAL PREFERRED STOCK WITHOUT MANDATORY REDEMPTION PROVISIONS

In December 1983, we sold 500,000 shares of Series L Preferred Stock which did not have mandatory redemption provisions. Series L cannot be redeemed prior to January 1, 1989 as part of a refunding involving the use of the proceeds of sales of debt or preferred stock with an effective annual cost of less than the annual dividend of the Series L.

We have the right to buy back and retire Serial Preferred Stock which does not have mandatory redemption provisions. The redemption prices (plus dividends accrued to the redemption dates) are as follows:

Series	Price at December 31, 1985	Through	Eventual Minimum
A	$102.50	11-30-86	$101.00
B	$103.78	7-31-87	$102.26
L	$109.69(a)	12-31-85(a)	$100.00

(a) The redemption price of Series L changed on January 1, 1986 to $108.02 which remains in effect until December 31, 1986.

NOTE J — COMMON STOCK

Shares of Common Stock sold during the three years ended December 31, 1985 were as follows:

	1985	1984	1983
Public Sale	—	5,000,000	—
Dividend Reinvestment and Stock Purchase Plan (a)	3,922,080	3,329,015	3,021,125
Employee Savings Plan	393,842	419,318	298,584
Employee Thrift Plan	95,961	92,538	71,767
Key Employee Incentive Stock Plan	31,427	335	20,471
1978 Key Employee Stock Option Plan	39,183	880	11,560
Total Shares	4,482,493	8,842,086	3,423,507

(a) Includes shares sold under the customer stock purchase and IRA programs.

With the exception of the Employee Thrift Plan which was terminated as of December 16, 1985, the various stock plans listed above will continue after the pending affiliation. Thrift Plan participants are now eligible to participate in the Employee Savings Plan.

Stock options held by employees to purchase unissued shares of Common Stock under the Key Employee Incentive Stock Plan and the 1978 Key Employee Stock Option Plan are granted at 100% of the fair market value on the date of the grant. The shares which were actually bought during the three years ended December 31, 1985 were sold at option prices ranging from $15.63 to $20.25. Shares under outstanding options held by employees were as follows:

	Key Employee Incentive Stock Plan (a)		
	1985	1984	1983
Options Outstanding at December 31			
Shares	52,718	87,645	122,601
Option Price	$18.59 to $22.43	$18.59 to $22.43	$17.63 to $22.43

	1978 Key Employee Stock Option Plan		
	1985	1984	1983
Options Outstanding at December 31			
Shares	541,672	519,727	389,007
Option Price	$15.63 to $23.00	$15.63 to $20.25	$15.69 to $20.25

(a) Under the terms of the Key Employee Incentive Stock Plan, no further options may be granted. Accordingly, only those shares relating to options outstanding at December 31, 1985 may be issued.

Under the terms of the agreement to affiliate, our share owners will receive 1.11 shares of Centerior's Common Stock in exchange for each share of our Common Stock held.

We calculate earnings per share based on the average number of shares outstanding throughout the year. The weighted average shares outstanding in each of the last three years are as follows:

1983	63,213,562
1984	68,190,548
1985	76,289,172

Our agreement to affiliate prohibits more than 81,600,000 shares of Common Stock to be outstanding prior to March 16, 1986.

NOTE K — SHORT-TERM BORROWING ARRANGEMENTS

Available bank credit arrangements are as follows:

Type	At December 31, 1985	1984
	(Thousands of Dollars)	
Bank lines of credit (borrowings at or near prime interest rate)	$156,300	$156,300
Eurodollar revolving credit agreement	$30,000	$30,000
Variable interest note agreements	—	$20,000

Any borrowings under the Eurodollar agreement are made and paid back in U.S. dollars. There are no requirements that minimum cash balances (compensating balances) be maintained at the banks involved. However, a fee of 3/16% to 3/8% per year is paid on any unused part of this borrowing agreement. The interest rate on borrowings is 3/8% to 5/8% (depending on usage) above the rate which specified banks pay for Eurodollar deposits in the London interbank market.

Commercial paper outstanding is backed by at least an equal amount of unused bank lines of credit to ensure our ability to repay them. There were no such borrowings at December 31, 1985.

Most borrowings under short-term bank lines of credit do not require compensating balances but do require a fee of approximately 0.3% per year to be paid on any unused portion of the lines of credit. For those bank lines without fee requirements, the average daily cash balance in our bank accounts satisfied informal compensating balance arrangements under which we maintain balances at banks depending on what we borrow.

NOTE L — PROPERTY OWNED WITH OTHER UTILITIES

Some of the generating units which we own or are building are owned with other utilities. Each company owns an undivided share in the entire unit. All the owners are tenants in common. This means that each company has the right to a percentage of the generating capability of each unit equal to its ownership share. We are obligated to pay for our share of the construction and operating costs of each unit. We are not responsible for the other owners' shares. See "Construction Program" under Note M.

Utility Plant at December 31, 1985 includes the following facilities owned as tenants in common with other utilities:

	Company Ownership		
Facility	Percent	Electric Plant in Service	Construction Work in Progress
		(Thousands of Dollars)	
Davis-Besse	51.38	$468,232	$ 18,871
Bruce Mansfield 1	6.50	26,097	135
Bruce Mansfield 2	28.60	117,750	613
Bruce Mansfield 3	24.47	156,812	409
Beaver Valley 2	24.47	—	796,692
Perry 1 and Common Facilities	31.11	—	1,279,681
Eastlake 5	68.80	115,471	2,187
Seneca Pumped Storage Hydroelectric Plant	80.00	56,421	1,793
		$940,783	$2,100,381

We also have a 31.11% ownership in Perry 2. Our investment in Perry 2 was $358,666,000 at December 31, 1985. As described in Note M, construction activities were suspended in 1985.

Separate depreciation records are kept for Davis-Besse property and Seneca property. The accumulated depreciation for Davis-Besse at December 31, 1985 was $85,317,000. The accumulated depreciation for Seneca at December 31, 1985 was $14,456,000. Depreciation on all other in-service property owned with other utilities has been accumulated on an account basis along with all other depreciable property rather than by specific units of depreciable property. Our share of the operating expense of properties owned with others is included in our income statement.

We have entered into an agreement with Ohio Edison Company (Ohio Edison) whereby they will make firm power purchases of 80 megawatts of our 375 megawatt ownership interest in Perry 1 over an 18 month period, commencing with initial commercial operation of the unit.

NOTE M — COMMITMENTS AND CONTINGENCIES

Construction Program

We carry on a continuous program of constructing facilities needed to meet anticipated demand for electric service, to replace aging facilities and to comply with pollution control regulations. We project a 2% annual increase in peak electrical demand in our service area. Compounded over the next 20 years, that growth would result in about a 50% increase in demand. The major part of our construction program is our share of three nuclear generating unit projects–Perry 1 and 2 and Beaver Valley 2. They are being constructed by the five CAPCO companies, including the Company, Duquesne Light Company (Duquesne), Ohio Edison, Pennsylvania Power Company and Toledo Edison. The scheduling, voluntary delay or cancellation of a project must be approved by all of the CAPCO companies. We are responsible for constructing Perry 1 and 2 and Duquesne is responsible for constructing Beaver Valley 2 for the CAPCO companies. As described below, construction of Perry 2 has been suspended. Our share of these three units and the amounts we invested in them (including AFUDC) at December 31, 1985 are set forth in Note L.

For the 1986-1990 period, our estimated construction budget is $1,900,000,000. However, assuming construction of Perry 2 resumes in 1988 with completion in 1994, this estimate increases to $2,500,000,000. In addition to completing Perry 1 and Beaver Valley 2, we are studying various alternatives to meet future generation capacity needs. The alternatives include, among others, combinations of the following: completing Perry 2, our share of which is 375 megawatts; constructing new generating units using new technologies currently being developed; extending the useful life of some existing generating capacity and utilizing long-term power purchases. The current construction program does not take into account any changes which might be made after the proposed affiliation with Toledo Edison described in Note B becomes effective.

Perry 1 — Construction of Perry 1 and the facilities to be used in common with Perry 2 is essentially complete. The equipment testing and Nuclear Regulatory Commission (NRC) staff review necessary before fuel can be loaded are nearing completion and we are awaiting permission to load fuel. Additional time (a minimum of six months after the commencement of fuel load) will be required before the unit achieves commercial operation. (See Note N for a discussion of the potential ratemaking and financial reporting implications of this event.) The experience of the electric utility industry has shown that events can occur which could significantly delay achievement of any of the steps in the start-up process.

In operating license proceedings, the Atomic Safety and Licensing Board of the NRC has decided in our favor on all issues raised by intervenors. Intervenors have appealed portions of the decision to an appeal board of the NRC. While we cannot give assurances as to the outcome of the appeals,we believe that the appeals should be resolved in our favor.

On January 31, 1986, an earthquake occurred which measured approximately 5.0 on the Richter scale and which was centered about 10 miles south of the Perry Nuclear Power Plant. Inspections of Perry 1 have found no damage to any safety systems, structures or components. Based on preliminary investigations, the earthquake did not exceed the Plant's seismic design capability. We filed a report with the NRC detailing an analysis of the earthquake.

Subsequent to the earthquake, several groups separately petitioned the NRC to investigate the adequacy of the seismic design of Perry 1. One of the groups also requested the NRC to review our proposed affiliation with Toledo Edison relative to the two companies' financial qualifications under 10 CFR Part 140 of the NRC's regulations. We cannot predict what actions, if any, the NRC might take. However, we believe that the seismic design of Perry 1 complies with NRC regulations and, although we cannot give assurances, we believe that an operating license should be issued.

The cost (including AFUDC) of our 375 megawatt share of Perry 1 and the common facilities is $1,280,000,000 as of December 31, 1985. We estimate that the cost will increase about $600,000 each day in 1986 until it achieves commercial operation.

Beaver Valley 2 — Beaver Valley 2 is about 91% complete and is scheduled for completion around the end of 1987. In October 1985, Duquesne advised us that its current review of the estimated cost of Beaver Valley 2 indicates that the cost, including AFUDC, of our 204 megawatt share will increase from about $1,000,000,000 to about $1,087,000,000. No change is expected to be made in the scheduled completion date. While we cannot give assurances, we believe that an operating license will be issued.

Perry 2 — Perry 2, exclusive of the common facilities, is about 44% complete. Including its share of the common facilities, Perry 2 is about 58% complete. Construction of Perry 2 was suspended in 1985 by the CAPCO companies pending future consideration of several alternatives which include resumption of full construction, with a revised estimated cost and completion date, mothballing or cancellation. Many factors will be taken into account in making the decision. These include the increasing costs of construction, the high cost and difficulty of financing, the increased risks associated with nuclear construction and licensing, including the future stability of NRC regulations, the regulatory climate as it will affect the ability to recover the unit's costs through rates on a timely basis and the alternative means of providing generating capacity. Also being considered are the potentially greater capacity needs nationwide, particularly in our region, due to larger-than-anticipated demand and cancellations of generating projects by other electric utilities, the probable high cost of retrofitting fossil fuel units to satisfy possible acid rain pollution control regulations and the incremental cost of completing Perry 2. The timing of a decision on Perry 2 will depend on developments relating to the above factors and possibly others.

We continue to capitalize AFUDC for Perry 2 because we believe that cost should be recovered through rates if and when the unit is completed. However, if Perry 2 is cancelled, recovery of AFUDC for the unit would be less certain. Therefore, we started on July 1, 1985 to credit AFUDC for Perry 2 to a balance sheet deferred credit reserve instead of continuing to credit it to income. Such deferral does not affect cash flow, but it does cause an equal reduction in reported earnings from what they otherwise would be. Earnings were reduced by about $18,000,000, or 23¢ per share, in 1985 and will continue to be reduced by about $3,000,000 per month in 1986.

If Perry 2 is cancelled, we will seek authorization from the PUCO to recover our investment in that unit in rates over a period of years. Ohio regulation currently allows recovery of such costs as described in Note E. Other methods of recovery also may be available. However, we have no assurance that recovery would be allowed if Perry 2 were cancelled. If, at the time of such a cancellation, it appears unlikely that recovery would be allowed, then our investment in Perry 2 would have to be written off, after adjustment for taxes. The amount to be written off would be reduced to exclude equipment usable for Perry 1 or elsewhere for other purposes and the deferred credit reserve discussed previously. We estimate such a write-off as of December 31, 1985 would have been about $225,000,000, after taxes. Based on our current financial position and level of annual income, a write-off of such a magnitude would have a material adverse effect on income in the period in which it were to occur and on retained earnings, but our ability to continue paying dividends would not be impaired solely because of such a write-off.

In September 1983, the Ohio Office of Consumers' Counsel (OCC), the City of Cleveland, the Commissioners of Geauga County, Ohio, and certain community groups petitioned the PUCO and the Ohio Power Siting Board to investigate the need for Perry 2. Under some circumstances, the request of the petitioners, were it to be granted, could require cancellation of the unit.

Other Nuclear Construction Program Risks — Nuclear generating projects in the electric utility industry have experienced substantial cost increases, construction delays and licensing difficulties. These have been caused by various factors, including inflation, required design changes and rework, allegedly faulty construction, objections by groups and governmental officials, limits on the ability to finance, limits on the use of proceeds of security issues, difficulty in obtaining needed rate increases, reduced forecasts of energy requirements and economic conditions. This experience indicates that the risk of significant cost increases, delays and licensing difficulties remains present through to completion of any project, including Perry 1 and 2 and Beaver Valley 2. A major accident at any nuclear plant could have a material adverse effect on the operation, construction or licensing of the nuclear units of the CAPCO companies.

The successful completion of the CAPCO construction program requires the continuing ability of the CAPCO companies to pay for their shares. To do so, each CAPCO company must continue to obtain adequate and timely rate increases. There can be no assurance that such rate increases always will be forthcoming or that some other event will not adversely affect financial markets or nuclear projects generally, or a CAPCO company or nuclear project in particular, so as to impair the ability of a CAPCO company to pay for its share. If any CAPCO company does not pay its share, any or all of the other CAPCO companies could, as a practical matter, be forced to accept a solution involving substantial losses or additional financial burdens.

The PUCO issued an order on April 30, 1985 to investigate whether generic criteria should be established for determining whether excess generating capacity exists in an electric utility's system. We, the OCC and other interested parties have submitted comments on this matter to the PUCO. In addition, the PUCO continues its study of statewide central dispatch for Ohio's regulated electric utilities focusing on the long-term effects of central dispatch and methods for implementation.

Regulatory authorities in other jurisdictions have increasingly undertaken proceedings to determine whether recovery in rates of part of the cost of completed construction projects should be disallowed or deferred. Some have disallowed significant portions of costs based on audits which alleged imprudent management. Some have disallowed or deferred costs on the basis that new capacity was not needed (excess capacity). Some have deferred costs, in part, so as to mitigate the size of rate increases by ordering "phase-in" plans. In other cases, these actions are only proposed and have not been ordered.

On April 30, 1985, the PUCO issued an order starting an investigation to determine whether any Perry 1 costs are excessive due to imprudent management. The OCC has intervened in this proceeding. The PUCO has hired the consulting firms of Touche Ross & Co. and the Nielson-Wurster Group to help in its investigation, which is expected to be completed in mid-1986.

As with other nuclear units started 10 to 15 years ago, Perry 1 has undergone major design changes and retrofits necessary to satisfy constantly changing NRC requirements. This has taken place over a period in which substantial inflation of construction and financing costs also occurred. We believe that expenditures for Perry 1 have been prudent in the light of these circumstances.

The Pennsylvania Public Utility Commission (PaPUC) has ordered that a consultant, Canatom, be retained to investigate for the PaPUC whether any costs of Beaver Valley 2 were imprudently incurred. Beaver Valley 2 is among the highest cost nuclear units in terms of cost per kilowatt due, in part, to its extended construction period. We believe the delays in the completion of Beaver Valley 2 from its original schedule were prudently incurred in order to meet the changing generation requirements of the CAPCO companies or were of a nature that were beyond our control, including changing NRC requirements. Any PaPUC order will not directly apply to us. However, it is possible that the PUCO also will investigate the prudency of the costs of Beaver Valley 2 (and Perry 2, if completed) incurred by us.

The PUCO has not indicated whether it will make any determination from its Perry 1 investigation in a generic hearing or whether it will make its determination in a future rate case in which Perry 1 costs are being considered. Similarly, we cannot predict when the PUCO might make any determination with respect to Beaver Valley 2. The earliest rate case when the issues of disallowance or deferral of recovery of our investments in each unit might be considered is in the first rate case filed after each unit is in service. We also cannot now predict what regulatory action, if any, the PUCO might take with respect to our investment in Perry 1 or Beaver Valley 2.

In accordance with current generally accepted accounting principles, a disallowance of property costs from rate base may not, in itself, require an immediate charge to income. Rather, such an event would be reported as a decrease in income over the life of the property. However, the Financial Accounting Standards Board (FASB) currently is considering changes, which are proposed to be retroactive in nature, in SFAS 71. The changes relate to accounting for the valuation of plant abandonment costs, disallowances and gradual allowances (phase-in) of new plant construction costs and operating costs by regulators. We do not know what changes, if any, will be made in SFAS 71. However, certain changes might require us to record a loss with respect to terminated projects we are currently amortizing, unless there is a change in the current PUCO rate treatment of such costs (see Note E).

The changes might require immediate recognition of disallowance of costs, if any, of Perry 1 or Beaver Valley 2 which may be determined by the PUCO to be imprudently incurred. Also, a reduction might be required in reported income in the future should the PUCO adopt phase-in plans for Perry 1 or Beaver Valley 2 which do not meet specific cost recovery criteria (see Note N).

In summary, the likelihood of a significantly adverse event or regulatory action occurring in any of the above risk areas described in connection with our construction program varies. So does the potential severity of any adverse impact. Any such event or regulatory action could have a material adverse effect on our financial position or results of operations.

Davis-Besse Nuclear Power Station Outage

Davis-Besse, which is operated by Toledo Edison and owned jointly with us, was shut down June 9, 1985 due to the failure of the plant's main and auxiliary feedwater supply system. There were no injuries or radiation leaks and the shutdown resulted in negligible damage. Toledo Edison must receive NRC approval prior to resuming operations.

Both the NRC and Toledo Edison undertook extensive investigations to determine the causes of the June 9 event and corrective actions to be taken. The NRC issued a report on the June 9 event with the major conclusion being that the underlying cause of the event was Toledo Edison's inattention to detail in the maintenance of plant equipment. The significance of the event from a safety standpoint was that multiple equipment failures involving back-up safety equipment occurred. The NRC staff has proposed a fine to emphasize the seriousness with which the NRC views the occurrence of the violations and to ensure that Toledo Edison maintains an effective and aggressive management system to prevent such violations.

Toledo Edison submitted an extensive report to the NRC stating the results of its investigation and describing corrective action that has been and is being taken to correct the problems identified by the NRC. The report stated that an electrically powered, larger feedwater pump will be installed to provide an additional source of cooling water. Additional capital improvements are to be completed to improve Toledo Edison's training and maintenance programs. Also, a new organizational structure with up to 240 additional employees will be installed with more emphasis on training, maintenance and planning activities.

On February 6, 1986, an official of the NRC stated that the earliest the plant will be approved for restart is late April 1986. However, it is possible that the plant may be out of service longer.

We are replacing the output we normally would receive from our 445 megawatt ownership share of Davis-Besse with more costly generation from our own non-nuclear generating units, supplemented by wholesale power purchases as necessary. We believe we will have or will be able to obtain sufficient power to meet our service area needs until the unit is back in service. Whether we will be able to recover the additional power costs will be determined by the PUCO in a fuel clause hearing which at the earliest will be held in December 1986.

In Toledo Edison's fuel clause proceeding in the fall of 1985, the OCC requested the PUCO to disallow recovery of such additional power purchase costs on the ground that the June 9 event was the result of imprudent management by Toledo Edison. The PUCO has approved a stipulation among Toledo Edison, ourselves, OCC and the staff of the PUCO to postpone consideration of the OCC's request until late 1986. In the meantime, a consultant will be engaged by the PUCO to evaluate whether the June 9 event and the ensuing outage was caused, in whole or in part, by imprudent management by Toledo Edison. The consultant will also determine the cost of the added fuel and purchased power incurred because of the outage and the extent to which those costs already have been recovered from our customers and those of Toledo Edison. The consultant's report is to be filed with the PUCO by August 15, 1986. The report will not be binding on the PUCO or any of the parties.

The stipulation also provides that if the PUCO finds that some or all of the resulting fuel and purchased power costs should be refunded to customers due to imprudent management, then interest would be added to the costs to be refunded. The refund would be made by reducing the fuel factor allowed over a period about equal to the period over which the costs were collected. Final resolution of this matter is not expected to have a material adverse effect on future results of operations.

Purchases

Construction materials and services must be ordered in advance so that they will be on hand when needed. At December 31, 1985, such commitments amounted to:

Construction program (including Perry 1 and 2 and Beaver Valley 2)	$250,000,000
Nuclear material acquisition and processing into fuel	$200,000,000

These commitments can usually be cancelled. Often the manufacturers must be paid for labor and materials already spent and sometimes a penalty also must be paid.

Nuclear Fuel

We have lease and trust arrangements to finance nuclear material and fuel including the commitments stated above. We believe that our nuclear fuel will provide an adequate supply lasting into the mid-1990s. Substantial additional nuclear material will have to be obtained in the future to supply fuel for the remaining useful life of Perry 1, Beaver Valley 2 and Davis-Besse. More nuclear material and fuel will be required if Perry 2 is completed.

The maximum amount which can be financed by us under one leasing arrangement is $280,000,000. It is a long-term lease that allows the lenders to cancel their financing commitments after three years' notice. One of the lenders with a $65,000,000 commitment has cancelled effective in November 1988. Our share of the other arrangement, which includes leases and a trust combined, is $90,000,000, subject to cancellation by the lender after one year's notice.

The lease and borrowing rates are based on bank prime and commercial paper rates. The amounts capitalized included charges incurred by the lessor amounting to $22,019,000 in 1985, $25,212,000 in 1984 and $16,477,000 in 1983. Under the leases, rental payments are made as the fuel is burned in a reactor. Estimated lease payments are $33,000,000 in 1986, $44,000,000 in 1987, $49,000,000 in both 1988 and 1989 and $53,000,000 in 1990. As these payments are made, the amount of credit available to the lessor is renewed and becomes available to satisfy other nuclear fuel commitments.

At December 31, 1985, a total of $300,523,000 has been invested under the leases and the trust in nuclear material and costs of processing it into fuel. This includes nuclear fuel in the Davis-Besse reactor with a remaining cost of $38,173,000 as of December 31, 1985. Rental payments are being made when the fuel is consumed in the reactor.

Guarantees

Under two long-term coal purchase arrangements, we have agreed to guarantee the loan and lease obligations of two mining companies. At December 31, 1985, the principal amount of the mining companies' loan and lease obligations guaranteed by the Company was $84,137,000. Under one of these arrangements, we are required to pay the mining company any actual out-of-pocket idle-mine expenses, as advance payments for coal, when the mines are idle for reasons beyond the control of the mining company.

Nuclear Unit Liability

The owners of Davis-Besse maintain a nuclear insurance program to the maximum extent currently available. The maximum coverages at February 10, 1986 for a nuclear incident at Davis-Besse included $650,000,000 of nuclear liability coverage for injury to persons and their property and $1,135,000,000 for damage to the owners' property, including leased fuel and clean-up costs. The Price-Anderson amendments to the Atomic Energy Act limit the owners' nuclear liability to the amount of the nuclear liability coverage. The current Price-Anderson legislation expires in 1987 and bills to amend it, including proposals to substantially increase or eliminate the limitation on liability provisions, have been introduced in Congress. Damage to our property, leased fuel and clean-up costs combined could exceed the property insurance by a substantial amount and could have a material adverse effect on our financial condition. The owners also are obligated to pay retrospective premiums up to $10,000,000 per year to cover any liability insurance claims arising out of a nuclear incident at any nuclear unit in the United States and up to $8,030,000 per nuclear incident to cover any property damage insurance claims. It is our intention to obtain similar insurance for Perry 1 and 2 and Beaver Valley 2.

We have insurance coverage of $1,341,000 per week for the cost of any replacement power purchased during the 52-week period starting 26 weeks after the occurrence of certain types of incidents at Davis-Besse and $671,000 per week for the next 52 weeks. The cost and duration of replacement power could substantially exceed the insurance coverage. Also, we are obligated to pay retrospective premiums up to $2,818,000 per nuclear incident to cover any replacement power insurance claims arising out of a nuclear incident at any nuclear unit in the United States. It is our intention to obtain similar insurance for Perry 1 and 2 and Beaver Valley 2. Replacement power purchased due to the June 9, 1985 event at Davis-Besse is not covered by such insurance because the plant's continued shutdown is due to NRC order.

Lawsuits

Several lawsuits and governmental actions are pending in addition to those described above. We believe, based on the opinion of our counsel, that the ultimate disposition of these other matters will not have a material adverse effect on our financial condition or results of operations.

NOTE N — RATE MATTERS

Effective March 12, 1985, the PUCO granted us an increase in electric rates of $19,500,000, or 1.6%. We had requested an increase of $180,000,000. The allowed rate of return is 12.99% on rate base and 16.85% on common stock equity. The PUCO did not allow any construction work in progress (CWIP) in rate base for Perry 1. Previously, we had been receiving approximately $30,000,000 of annual revenue for Perry 1 CWIP which had been included in rate base.

Under Ohio law, the PUCO has discretion to include CWIP in rate base for construction projects which are at least 75% complete. The amount includable for all projects is limited to 10% of rate base excluding CWIP, except that up to 20% can be included for certain pollution control projects. When the project is completed and included in rate base, an amount equal to the CWIP is excluded from rate base for a period equal to the time it had been included, resulting in lower revenues than would otherwise be the case during that period. During the period of exclusion, the equivalent of AFUDC accrues on the excluded portion to be recovered in rates over the useful life of the completed project. The effect of this provision is to phase into rate base the total cost of a project over a period starting when CWIP is first included in rate base and ending when the exclusion period ends. If a project is cancelled or is not completed within the allowable period (usually 48 months) after inclusion of its CWIP has started, then CWIP must be excluded from rate base. Any revenues which resulted from prior inclusion must be offset against future revenues.

On July 2, 1985, we filed an application with the PUCO requesting an increase in our electric rates of approximately $210,000,000, or 16.8%. Any resulting rate increase would be effective in the second quarter of 1986. The request includes an increase in base rates of $230,000,000 offset by $20,000,000 in projected fuel savings from the operation of Perry 1. The requested increase includes a request for Perry 1 CWIP which would produce $40,000,000 of annual revenue. It also includes annualized operating expenses, such as operation and maintenance expenses, depreciation and taxes for Perry 1, which would produce annual revenue of $96,000,000, some or all of which may be disallowed.

A request will be made in 1986 to defer, for subsequent inclusion in rate base and recovery as an element of cost of service, ongoing financing costs calculated on a basis similar to AFUDC for Perry 1. Such deferral would begin at the time Perry 1 is placed in service and continue until Perry 1 is included in rates as a component of rate base in a subsequent rate case. The PUCO has allowed this procedure in orders issued to other Ohio utilities. Furthermore, to the extent the PUCO denies recovery of certain Perry 1 operating expenses in our pending rate request, we will also seek authority to defer them until they are included in rates. Deferral of financing and operating costs tends to maintain the level of reported earnings but associated cash flow does not occur until a subsequent period when such costs are recovered in rates. The provisions of the FASB's proposed amendments to SFAS 71, discussed in Note M, would require that all deferred amounts be recovered in a period no longer than 10 years. Currently, the PUCO allows recovery of the post-in-service financing cost deferrals over the life of the plant and has not yet addressed the issue of deferring operating expenses. If the PUCO denies our requests or if the FASB proposal were adopted as is and the PUCO did not allow recovery in the 10-year period, the deferral of operating expenses and the post-in-service financing cost would not be permitted. In such an event, our results of operations would be adversely impacted from the time Perry 1 goes in service until rates become effective which reflect the inclusion of Perry 1 in rate base and cost of service. We cannot predict either the outcome of the FASB's review or future actions of the PUCO.

NOTE O — PENSION AND POSTRETIREMENT HEALTH AND LIFE INSURANCE BENEFITS

We pay the full cost of a pension plan for our employees. Under the plan, an employee who has worked at the Company at least 5, 10 or 20 years (depending on the person's age when leaving the Company) can begin receiving a pension benefit at or after age 55. The amount of the person's benefit depends on length of service and earnings. The benefit is reduced by a portion of social security benefits. The benefit of an employee who retires after age 65 is determined as if the individual were age 65, except in the case of a retired employee who has been rehired. If the person retires before age 62, and in certain cases before age 65, the employee's benefit is reduced. The plan also pays benefits when an employee dies or is disabled.

We annually deposit money into the plan to fund the cost of benefits arising from employee service and earnings in the current year. We also deposit money to fund each year a portion of the cost of future benefits arising from past service and earnings because of amendments to the plan. In 1985, our total payment to the fund was $17,400,000. We deposited $15,300,000 in 1984 and 1983. Of these amounts, we recorded on the income statement $10,196,000 in 1985, $9,570,000 in 1984 and $10,211,000 in 1983. The remainder was recorded on the balance sheet, mostly as construction costs.

The amount we deposited into the pension plan is determined by a method known as the entry age normal method. It is used by many private pension plans. This method takes into account estimated increases in employees' future earnings in an effort to levelize the funding of pension benefits over their working lives. The liability of the plan as of January 1, 1985 determined under this method was slightly more than the value of the assets in the plan on that date.

SFAS 36 requires us to disclose accumulated pension plan liability without consideration of future increases in employees' earnings as though the plan were terminated at the dates shown in the table below. Therefore, the disclosures below, required by SFAS 36, compare liability of the plan determined on one basis with assets accumulated on a different basis. We and our pension consultants believe that SFAS 36 disclosures are very misleading because they understate the amount which the entry age normal method tells us should be in the fund now to provide pension benefits as they become payable under a plan intended to continue indefinitely. We are making the following disclosures only because we are required to do so.

	At January 1,	
	1985	1984
	(Millions of Dollars)	
Actuarial present value of accumulated plan benefits under SFAS 36:		
Vested	$172	$167
Nonvested	16	16
Total	$188	$183
Value of assets held in the plan	$350	$296

Under both methods of determining the plan's liability, the one which we use and the SFAS 36 method, we estimated that the earnings of the plan would average about 6½% per year over the life of the plan.

In addition to providing pension benefits, we provide certain health care and life insurance benefits for substantially all employees when they retire with pension benefits. The cost of retiree health care and life insurance benefits is recognized as expense as premiums are paid. Those costs totaled $894,000 in 1985 and $823,000 in 1984.

NOTE P — QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following is a tabulation of the unaudited quarterly results of operations for the two years ended December 31, 1985.

	Quarters Ended			
	March 31	June 30	Sept. 30	Dec. 31
	(Thousands of dollars, except per share amounts)			
1984				
Total operating revenues	$298,597	$298,009	$333,183	$285,563
Net operating income	$ 67,710	$ 60,244	$ 81,814	$ 52,343
Net income	$ 72,878	$ 65,344	$ 87,637	$ 65,772
Earnings available for common stock	$ 61,978	$ 54,396	$ 76,762	$ 55,143
Average common shares	65,693	66,709	67,722	71,919
Earnings per common share	$ .94	$ .82	$ 1.13	$ .77
1985				
Total operating revenues	$316,357	$299,472	$341,588	$296,572
Net operating income	$ 67,068	$ 54,304	$ 80,014	$ 57,763
Net income	$ 78,580	$ 71,972	$ 90,555	$ 69,596
Earnings available for common stock	$ 68,165	$ 61,550	$ 80,580	$ 58,941
Average common shares	74,576	75,747	76,876	77,969
Earnings per common share	$ .91	$ .81	$ 1.05	$ .76

COMBINED PRO FORMA SUMMARY FINANCIAL INFORMATION OF THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND THE TOLEDO EDISON COMPANY *(Unaudited)*

The following tables present selected historical and pro forma combined financial information for CEI and Toledo Edison. The CEI and Toledo Edison historical data are taken or derived from audited financial statements of CEI and Toledo Edison. The pro forma data is unaudited and has been based on accounting for the affiliation as a pooling of interest. The selected pro forma data are not necessarily indicative of the results of operations or the financial condition which would have been reported had the affiliation been in effect during those periods or which may be reported in the future. This data should be read in conjunction with the audited financial statements of both CEI and Toledo Edison.

	December 31,		
	1985	1984	1983
	(Amounts in millions, except per share data)		
CEI — Historical			
Income Statement Data for the 12 months ended:			
Operating revenue	$ 1,254	$ 1,215	$ 1,210
Total AFUDC	$ 220	$ 171	$ 115
Net income	$ 311	$ 291	$ 246
Earnings per common share	$ 3.53	$ 3.64	$ 3.28
Dividends declared per common share	$ 2.55	$ 2.43	$ 2.31
Balance Sheet Data as of:			
Total assets	$ 5,651	$ 5,120	$ 4,425
Long-term debt	$ 2,100	$ 1,884	$ 1,519
Preferred and preference stock:			
With mandatory redemption provisions	$ 314	$ 293	$ 318
Without mandatory redemption provisions	$ 144	$ 144	$ 144
Common stock equity	$ 1,764	$ 1,593	$ 1,355
Book value per common share	$ 22.46	$ 21.51	$ 20.79
Toledo Edison — Historical			
Income Statement Data for the 12 months ended:			
Operating revenue	$ 595(a)	$ 551	$ 504
Total AFUDC	$ 138	$ 118	$ 91
Net income	$ 173	$ 154	$ 128
Earnings per common share	$ 3.54	$ 3.70	$ 3.50
Dividends declared per common share	$ 2.01	$ 2.52	$ 2.46
Balance Sheet Data as of:			
Total assets	$ 3,365	$ 2,936	$ 2,501
Long-term debt	$ 1,339	$ 1,110	$ 985
Preferred and preference stock:			
With mandatory redemption provisions	$ 154	$ 158	$ 94
Without mandatory redemption provisions	$ 230	$ 200	$ 200
Common stock equity	$ 950	$ 814	$ 716
Book value per common share	$ 24.44	$ 23.76	$ 24.12
Pro Forma — CEI and Toledo Edison Combined			
Income Statement Data for the 12 months ended:			
Operating revenue	$ 1,847(a)	$ 1,764	$ 1,712
Total AFUDC	$ 358	$ 289	$ 206
Net income	$ 484	$ 445	$ 374
Earnings per common share (b)	$ 3.29	$ 3.41	$ 3.11
Dividends declared per common share (b)	$ 2.20	$ 2.29	$ 2.19
Balance Sheet Data as of:			
Total assets	$ 9,004	$ 8,050	$ 6,922
Long-term debt	$ 3,439	$ 2,994	$ 2,504
Preferred and preference stock:			
With mandatory redemption provisions	$ 468	$ 451	$ 412
Without mandatory redemption provisions	$ 374	$ 344	$ 344
Common stock equity	$ 2,714	$ 2,407	$ 2,071
Book value per common share (b)	$ 21.53	$ 20.67	$ 20.30

(a) Includes $19.5 million of revenues subject to refund.

(b) After multiplying CEI shares by 1.11.

FINANCIAL AND STATISTICAL REVIEW 1975-1985

The Cleveland Electric Illuminating Company and Subsidiaries

Income Statement
(Thousands of Dollars)

	1985	1984	1983	1982
TOTAL OPERATING REVENUES	1,253,990	1,215,353	1,210,316	1,108,571
Residential	381,979	375,597	385,076	348,757
Commercial	356,108	338,625	334,660	304,801
Industrial	453,555	441,285	430,209	393,794
Other Electric (Includes Sales for Resale)	49,243	44,958	44,217	43,702
Steam Heating	13,105	14,888	16,154	17,517
TOTAL OPERATING EXPENSES	994,841	953,242	951,954	879,644
Fuel and Purchased Power	351,854	313,412	332,977	329,279
Other Operating Expenses	310,694	280,888	270,468	250,591
Depreciation and Amortization	96,995	95,274	94,196	86,588
Taxes Other Than Federal Income Tax	133,348	132,313	126,883	106,804
Federal Income Tax	101,950	131,355	127,430	106,382
NET OPERATING INCOME	259,149	262,111	258,362	228,927
NONOPERATING INCOME	206,671	169,200	114,148	96,669
Allowance for Equity Funds Used During Construction	162,907	130,421	87,052	76,896
Other Income and Deductions	43,764	38,779	27,096	19,773
INCOME BEFORE INTEREST CHARGES	465,820	431,311	372,510	325,596
INTEREST	155,117	139,679	126,484	116,632
Long and Short-term Interest	212,290	180,864	153,974	144,072
Allowance for Borrowed Funds Used During Construction	(57,173)	(41,185)	(27,490)	(27,440)
NET INCOME (a)(b)	310,703	291,632	246,026	208,964
PREFERRED AND PREFERENCE DIVIDEND REQUIREMENTS	41,467	43,353	38,426	38,295
EARNINGS AVAILABLE FOR COMMON STOCK	269,236	248,279	207,600	170,669
TOTAL EARNINGS PER SHARE (a)(b)(c)	$ 3.53	$ 3.64	$ 3.28	$ 3.01
DIVIDENDS PER SHARE (c)	$ 2.55	$ 2.43	$ 2.31	$ 2.19
RETURN ON AVERAGE COMMON EQUITY (%)	16.0	16.8	16.1	15.3

Balance Sheet
Year end
(Thousands of Dollars)

	1985	1984	1983	1982
TOTAL ASSETS	5,650,560	5,119,842	4,425,436	3,966,213
Utility Plant — Total	5,613,272	5,022,543	4,454,788	4,010,532
Accumulated Utility Plant Depreciation and Amortization	(874,366)	(798,979)	(722,492)	(679,890)
Other Property	335,851	288,678	228,153	157,520
Current and Other Assets	575,803	607,600	464,987	478,051
TOTAL CAPITALIZATION AND LIABILITIES	5,650,560	5,119,842	4,425,436	3,966,213
Long-term Debt	2,099,660	1,883,648	1,518,883	1,441,822
Preferred and Preference Stock				
With Mandatory Redemption Provisions	314,667	292,818	318,000	322,000
Without Mandatory Redemption Provisions	144,021	144,021	144,021	95,071
Common Stock Equity	1,763,720	1,592,810	1,355,488	1,227,095
Deferred Federal Income Taxes	549,170	480,727	411,072	322,188
Other Liabilities and Credits	779,322	725,818	677,972	558,037
UTILITY PLANT ADDITIONS (d)	605,705	582,288	490,705	422,170
UTILITY PLANT RETIREMENTS	14,975	14,533	46,449	22,533
NUMBER OF COMMON SHARES (c)	78,522,668	74,040,175	65,198,089	61,774,582
BOOK VALUE PER SHARE (c)	$ 22.4	$ 21.51	$ 20.79	$ 19.86
MARKET PRICE RANGE (c)				
High	$ [illegible]	$ 20¼	$ 23	$ 20
Low	$ [illegible]	$ 13¾	$ 16⅝	$ 14¼

Operating Statistics

	1985	1984	1983	1982
KWHR SALES (Thousands)	17,319,179	17,273,057	16,637,472	16,165,157
Residential	4,407,892	4,446,352	4,412,154	4,335,605
Commercial	4,515,838	4,396,395	4,265,023	4,194,177
Industrial	7,980,862	7,997,000	7,513,673	7,082,261
Other (Includes Sales for Resale)	414,589	433,310	446,622	553,114
ELECTRIC CUSTOMERS — YEAR END	718,504	714,768	712,833	711,222
Residential	647,242	644,904	643,065	641,705
Commercial	63,181	61,934	62,075	61,861
Industrial	7,670	7,521	7,274	7,235
Other	411	409	419	421
RESIDENTIAL SALES DATA				
Average Kwhr per Customer	6,567	6,646	6,608	6,490
Average Revenue per Customer	$ 571.03	$ 563.60	$ 579.49	$ 524.63
Average Revenue per Kwhr	8.70¢	8.48¢	8.77¢	8.08¢
ELECTRIC PRODUCTION				
Net Available for Service Area (Thousands of Kwhr)	19,260,397	19,096,414	18,461,867	17,677,831
Net Generation (Thousands of Kwhr)	16,725,495	16,818,455	17,152,981	17,032,759
Net Received from Others (Thousands of Kwhr)	2,534,902	2,277,959	1,308,886	645,072
BTU per Kwhr of Net Output	10,387	10,416	10,452	10,475
Fuel Cost per Million BTU	172.67¢	163.28¢	169.08¢	174.72¢
Coal Cost per Ton	$ 43.06	$ 44.25	$ 46.66	$ 45.51
Annual Net 60-Min. Max. Load — KW	3,257,000	3,371,000	3,404,000	3,090,000
Net System Capability at Time of Peak — KW (e)	3,244,000	4,329,000	4,441,000	4,699,000
STEAM HEATING				
Sales — Pounds (Thousands)	1,138,263	1,306,626	1,281,499	1,501,077
Customers — Year End	239	256	274	312
EMPLOYEES — YEAR END	6,484	5,830	5,339	5,411

(a) The 1978 net income and earnings per share calculated on a pro forma basis to reflect the units of production method of depreciation are $102,942,503 and $2.31, respectively. The pro forma effect of the adoption of this depreciation method on 1977 was not material.

(b) The 1979 net income and earnings per share are increased by $4,125,000 and $.11, respectively, to include the effect on prior periods of the 1979 change in depreciation method.

(c) Adjusted for the 3-for-2 stock split, effective December 16, 1977.

1981	1980	1979	1978	1977	1976	1975
1,012,930	893,566	824,267	717,092	659,290	543,148	523,165
310,409	268,787	237,612	213,520	200,765	160,015	154,020
263,608	220,677	194,899	172,251	165,049	129,286	121,653
386,805	323,764	322,909	278,405	251,181	197,189	180,890
39,912	65,273	55,799	42,831	31,611	45,730	55,679
12,196	15,065	13,048	10,085	10,684	10,928	10,923
820,226	743,051	688,788	599,289	542,871	441,401	433,614
351,410	360,347	349,027	307,429	265,771	234,107	246,984
224,299	194,881	162,636	140,996	127,330	102,794	94,539
85,294	64,619	59,443	56,774	43,307	35,874	33,046
91,648	81,630	79,455	68,756	58,807	51,925	48,735
67,575	41,574	38,227	25,334	47,656	16,701	10,310
192,704	150,515	135,479	117,803	116,419	101,747	89,551
75,712	62,440	47,621	42,226	49,484	26,346	17,681
48,970	40,873	33,432	29,890	35,265	24,706	16,983
26,742	21,567	14,189	12,336	14,219	1,640	698
268,416	212,955	183,100	160,029	165,903	128,093	107,232
112,682	87,572	69,566	61,016	54,175	46,413	42,464
146,712	112,623	85,299	72,071	67,889	56,750	50,511
(34,030)	(25,051)	(15,733)	(11,055)	(13,714)	(10,337)	(8,047)
155,734	125,383	117,659	99,013	111,728	81,680	64,768
34,917	27,711	25,587	23,575	22,907	18,005	14,696
120,817	97,672	92,072	75,438	88,821	63,675	50,072
$ 2.52	$ 2.26	$ 2.42	$ 2.20	$ 2.91	$ 2.38	$ 2.11
$ 2.08	$ 2.00	$ 1.92	$ 1.84	$ 1.76	$ 1.71	$ 1.65
12.6	11.3	12.0	11.2	15.5	13.7	13.1
3,406,075	3,094,462	2,678,786	2,331,541	2,117,135	1,842,999	1,513,247
3,610,895	3,215,339	2,842,253	2,523,996	2,232,111	1,955,701	1,693,614
(621,353)	(557,859)	(521,175)	(476,983)	(429,150)	(396,338)	(373,851)
23,870	21,137	19,503	15,034	13,753	12,849	9,942
392,663	415,845	338,205	269,494	300,421	270,787	183,542
3,406,075	3,094,462	2,678,786	2,331,541	2,117,135	1,842,999	1,513,247
1,328,404	1,211,528	973,991	920,973	885,899	747,392	673,003
325,000	260,500	232,000	232,000	185,000	135,000	75,000
95,071	95,071	95,071	95,071	95,071	95,071	95,071
1,002,206	912,731	820,411	708,883	633,744	511,333	419,990
236,481	192,452	162,122	140,677	119,299	72,318	63,267
418,913	422,180	395,191	233,937	198,122	281,885	186,916
409,277	398,088	329,869	300,765	286,739	275,524	181,673
13,721	25,002	11,612	8,880	10,329	13,437	14,718
51,054,503	46,288,629	41,271,574	35,995,365	32,388,055	28,347,544	24,351,499
$ 19.63	$ 19.72	$ 19.88	$ 19.69	$ 19.57	$ 18.04	$ 17.25
$ 16½	$ 18½	$ 19⅝	$ 23⅛	$ 22⅝	$ 22⅝	$ 18⅞
$ 13⅜	$ 13½	$ 15½	$ 16⅜	$ 22⅛	$ 17⅜	$ 15½
17,507,864	18,159,754	19,030,453	18,364,437	18,006,428	18,070,291	18,133,826
4,375,732	4,463,147	4,352,983	4,288,865	4,200,116	4,045,158	3,984,004
4,178,459	4,148,990	4,041,134	3,933,586	4,007,123	3,808,897	3,685,878
8,279,700	8,062,172	9,268,600	8,992,919	8,874,796	8,475,983	7,822,419
673,973	1,485,445	1,367,736	1,149,067	984,393	1,740,253	2,641,525
711,325	710,557	708,219	702,538	696,547	693,425	689,133
642,925	642,845	641,856	637,609	632,740	630,581	627,719
60,714	60,070	58,690	57,310	56,241	55,178	53,765
7,261	7,210	7,232	7,167	7,112	7,206	7,190
425	432	441	452	454	460	459
6,548	6,686	6,557	6,517	6,412	6,187	6,116
$ 466.55	$ 405.09	$ 357.86	$ 324.91	$ 307.11	$ 245.16	$ 237.02
7.12¢	6.05¢	5.48¢	5.00¢	4.80¢	3.97¢	3.88¢
18,936,567	18,722,616	19,645,001	19,254,857	19,098,231	18,331,384	17,271,169
17,297,523	15,325,948	17,069,914	16,882,669	18,123,528	16,747,626	16,213,012
1,639,044	3,396,668	2,575,087	2,372,188	974,703	1,583,758	1,058,157
10,582	10,635	10,634	10,536	10,401	10,322	10,454
175.14¢	156.92¢	142.51¢	131.80¢	117.50¢	105.55¢	111.14¢
$ 46.70	$ 39.31	$ 35.20	$ 30.73	$ 25.72	$ 23.98	$ 24.93
3,447,000	3,325,000	3,233,000	3,327,000	3,381,000	3,140,000	3,022,000
4,567,000	4,353,000	4,509,000	4,462,000	4,088,000	3,797,000	3,569,000
1,612,151	1,979,397	2,004,680	2,210,886	2,374,510	2,359,677	2,263,645
337	348	365	369	372	385	399
5,189	4,991	4,963	4,831	4,790	4,840	4,947

(d) Excludes $56,022,606 of terminated projects reclassified to Deferred Charges in 1979.

(e) In 1985, Avon Lake Unit 9 (644,000 KW) and Davis-Besse (445,000 KW) were not available because of renovation and improvements.

STATEMENT OF INCOME FROM CONTINUING OPERATIONS ADJUSTED FOR CHANGING PRICES FOR THE YEAR ENDED DECEMBER 31, 1985 *(Unaudited)*

The Cleveland Electric Illuminating Company and Subsidiaries

	Conventional Historical Cost	Current Cost Average 1985 Dollars
	(Thousands of Dollars)	
Revenue	$1,253,990	$1,253,990
Operation expense	566,100	566,100
Maintenance expense	96,448	96,448
Depreciation and amortization	96,995	235,255
Taxes other than Federal income tax	133,348	133,348
Federal income tax	101,950	101,950
Nonoperating income	(206,671)	(206,667)
Interest expense	155,117	155,117
	943,287	1,081,551
Net income - continuing operations	$ 310,703	$ 172,439(a)
Increase in specific prices of property and plant (b)		$ 80,754
Adjustment to net recoverable cost		135,871
Increase in general prices		(243,322)
Increase in general prices in excess of increase in specific prices after adjustment to net recoverable cost		(26,697)
Gain from decline in purchasing power of net amounts owed		103,122
Net price level adjustment		$ 76,425

(a) Including the adjustment to net recoverable cost, net income for 1985 would have been $308,310,000 in current cost dollars.

(b) At December 31, 1985, the current cost of property, plant and equipment net of accumulated depreciation was $6,817,114,000 while original (net recoverable) cost was $4,738,906,000.

Supplementary Information Concerning the Effects of Inflation

As required by the Financial Accounting Standards Board, we have prepared information on the effects of inflation on operations. The methods used to compute this data are experimental and subject to change by the Board. These data do not reflect the "current value" of our assets. They do not measure all the effects of inflation on our operations or predict our future cash requirements. The effects described herein are not recognized for income tax or ratemaking purposes.

General

Current cost data reflects the cost of current replacement of existing assets. The current cost of assets was estimated by applying the Handy-Whitman Index of Public Utility Construction Costs to the original cost of structures and equipment. Original cost of land was trended using the Consumer Price Index for All Urban Consumers. Certain other property was trended to current cost using other industry indices.

Revenues and Expenses

Revenues and expenses (except for depreciation) were assumed to accumulate evenly throughout the year. No adjustments were made to the figures reported in the primary financial statements. No adjustments were made to Federal income tax expense.

Depreciation

A restated depreciation reserve was used to compute the current cost estimate of property and plant net of depreciation. The reserve was obtained by applying current depreciation rates by account to restated property and plant figures by vintage year. The depreciation provision was obtained by applying current depreciation rates to the average of beginning and end-of-year restated depreciable property.

Materials and Supplies

Balance sheet items such as fuel in stock, materials and supplies were treated as cash type items. Fuel inventory is subject to rapid turnover. As such, the original cost of this item fairly represents its current cost.

Adjustment to Net Recoverable Cost

Under Ohio law, we can recover only what we paid for plant and equipment, so the values of these items under the current cost method were adjusted to reflect the original cost amount.

FIVE-YEAR COMPARISON OF SELECTED SUPPLEMENTARY FINANCIAL DATA ADJUSTED FOR EFFECTS OF CHANGING PRICES (Unaudited)

The Cleveland Electric Illuminating Company and Subsidiaries

	Year Ended December 31,				
	1985	1984	1983	1982	1981
	(Average 1985 dollars in thousands, except per share amounts)				
Revenue					
as reported	$1,253,990	$1,215,353	$1,210,316	$1,108,571	$1,012,930
as adjusted	$1,253,990	$1,258,717	$1,306,850	$1,235,495	$1,198,113
Net Income — Continuing Operations					
as reported	$ 310,703	$ 291,632	$ 246,026	$ 208,964	$ 155,734
as adjusted	$ 172,439	$ 165,815	$ 119,932	$ 90,512	$ 50,888
Income (Loss) per Common Share					
as reported	$ 3.53	$ 3.64	$ 3.28	$ 3.01	$ 2.52
as adjusted	$ 1.72	$ 1.77	$ 1.24	$ 0.85	$ 0.20
Net Assets at Year End					
as reported	$1,763,720	$1,592,810	$1,355,488	$1,227,095	$1,002,206
as adjusted	$1,735,707	$1,626,635	$1,439,005	$1,352,154	$1,147,108
Increase in general prices in excess of increase in specific prices after adjustment to net recoverable cost	$ 26,697	$ 21,577	$ (4,201)	$ (13,615)	$ 145,468
Gain from decline in purchasing power of net amounts owed	$ 103,122	$ 99,639	$ 89,733	$ 86,256	$ 187,802
Cash Dividends Declared per Common Share					
as reported	$ 2.55	$ 2.43	$ 2.31	$ 2.19	$ 2.08
as adjusted	$ 2.55	$ 2.52	$ 2.49	$ 2.44	$ 2.46
Market Price per Common Share at Year End					
as reported	$ 25.50	$ 19.50	$ 18.63	$ 19.75	$ 16.00
as adjusted	$ 25.09	$ 19.91	$ 19.77	$ 21.76	$ 18.31
Average Consumer Price Index	322.2	311.1	298.4	289.1	272.4

Increase in General Prices in Excess of Increase in Specific Prices After Adjustment to Net Recoverable Cost

The increase in general prices as measured by the Consumer Price Index for All Urban Consumers during 1985 exceeded the overall increase in prices of our property and plant. However, when the current cost of plant was adjusted to reflect net recoverable cost, the difference between these price measures was significantly reduced.

Gain from Decline in Purchasing Power of Net Amounts Owed

With inflation, holding cash type assets such as money and receivables results in a loss in purchasing power. Holding cash type liabilities such as debt results in a gain in purchasing power. Preferred stock and deferred tax balances were treated as cash type liabilities for this computation.

Effects of Inflation on the Company

Our 1985 unit sales of electricity were about the same as in 1984. Revenue for 1985 increased, primarily reflecting the increase in fuel and purchased power costs. Revenue measured in average 1985 dollars remained about the same as in the prior year despite an increase in base rates in March 1985. This suggests that inflation, while less significant now than in recent years, continues to affect our business.

Net income from operations once again increased in 1985 on both historical and current cost bases. Earnings per share declined slightly reflecting the increase in common shares outstanding.

These measures of income are different because we are not permitted to recover the higher current cost depreciation through rates. Ohio law restricts recovery of investment through depreciation charges to the original cost of plant. The part of current cost we could not recover was only partly offset by the gain from holding cash type liabilities.

We have to raise new capital to meet growth needs at inflated costs of construction and to replace worn-out items at higher replacement costs. If rate adjustments fail to compensate for the cost of new capital, especially during times of inflation, a regular erosion of the return on equity will occur. As a result, there will be a regular need for rate relief.

We continue to seek proper and timely rate increases and a regulatory environment which is responsive to the effects of inflation on our investment.

BOARD OF DIRECTORS

Leigh Carter
Vice Chairman of the Board and Operating Officer of The BFGoodrich Company, a producer of rubber, tires, chemicals and plastics. Also Chairman of Tremco, Inc., manufacturer of specialty chemical products and a wholly-owned subsidiary of The BFGoodrich Company

Robert M. Ginn
Chairman and Chief Executive Officer of the Company

Roy H. Holdt
Chairman of White Consolidated Industries, Inc., manufacturer of products for the home, principally major appliances, and machinery and equipment for industry

Richard A. Miller
President of the Company

Sister Mary Marthe Reinhard, SND
President of Notre Dame College of Ohio

Karl H. Rudolph
Chairman of the Executive Committee of the Board and retired Chairman and Chief Executive Officer of the Company

Craig R. Smith
Former Chairman of Bendix Automation of Bendix Corporation, a wholly-owned subsidiary of Allied Corporation. Bendix Automation is a producer of machines and accessories for the metalworking industry

Charles E. Spahr
Director of several companies and retired Chairman and Chief Executive Officer of The Standard Oil Company (Ohio), manufacturer of petroleum products, chemicals, plastics and metals and supplier of coal

Herbert E. Strawbridge
Chairman of the Finance Committee and retired Chairman and Chief Executive Officer of The Higbee Company, a department store

Allan J. Tomlinson, Jr.
Former Chairman, President and Chief Executive Officer of SDS Biotech Corporation, a developer of new technologies and products in the field of biotechnology

Richard B. Tullis
Chairman Emeritus of Harris Corporation, manufacturer of communication and information processing equipment

Harold L. Williams
Executive Vice President of the Company

William J. Williams
Director and President of the Northeast Ohio region of Huntington National Bank and director and Executive Vice President of Huntington Bancshares Incorporated

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Ralph M. Besse
Chairman Emeritus of the Board of Directors

Elmer L. Lindseth
Chairman Emeritus of the Board of Directors

PRINCIPAL OFFICERS AND EXECUTIVES

Robert M. Ginn Chairman
Richard A. Miller President
Harold L. Williams Executive Vice President
Murray R. Edelman Vice President-Nuclear
Robert J. Farling Vice President-Administrative Services
John W. Fenker Vice President-Power Supply
Frank A. Kender Vice President-Marketing
Edgar H. Maugans Vice President-Finance
John J. Misic Vice President-Distribution & Services
Alan D. Wright Vice President-Public Affairs & Legal
Alvin Kaplan Vice President-Nuclear Operations Division
Alexander J. Kennedy Division Manager-Steam Power Division
Victor F. Greenslade General Counsel & Director of Governmental Affairs
Charles C. Chopp Controller
Andrew R. Felmer Treasurer
E. Lyle Pepin Secretary

With deep regret, we mark the passing of Newton D. Flack, Division Manager-Steam Power Division, who died in August 1985. He will be remembered for his contributions to the Company and for his professional achievements. His leadership will be missed.

COMMITTEES OF THE BOARD OF DIRECTORS

Audit Committee The Audit Committee recommends to the Board the firm of independent accountants to be retained for the ensuing year and reviews the results of their examination of the Company's financial statements and the audit practices employed by them and the Company. The Committee oversees the establishment and administration by management of effective internal accounting controls and an accounting system designed to produce financial statements which present fairly the financial position of the Company.

Compensation Committee The Compensation Committee reviews and approves the Company's overall Compensation Plan, including the pension and employee stock purchase plans and, in particular, recommends the remuneration of the Chairman, President and all Vice Presidents.

Executive Committee The Executive Committee acts on behalf of the Board at times other than regular Board meetings when it is impracticable to call together the entire Board. The Committee has the same authority as the Board, except that it may not elect officers (other than assistant secretaries and assistant treasurers), fill vacancies on the Board or on the Executive Committee or authorize the issuance of first mortgage bonds.

Finance Committee The Finance Committee reviews and recommends long-range financial policies and objectives and specific actions to achieve these objectives. The Committee, acting for the Company as administrator of the Company's Pension Plan and Investment Program of the Employee Savings Plan, also reviews the investment performance of the pension fund trustee, other pension fund investment managers and the Employee Savings Plan trustee and establishes objectives for the investment of Pension Plan and Employee Savings Plan assets.

Nominating Committee The Nominating Committee recommends to the Board candidates to be nominated for election as directors at the annual meeting and to fill vacancies on the Board. When reviewing potential candidates, the Committee considers suggestions made by share owners.

Nuclear Committee The Nuclear Committee monitors, consults with and makes recommendations to both management and the Board regarding (1) progress of the Perry Nuclear Power Plant and Beaver Valley Power Station Unit 2 construction projects and all objectives and strategies relating to their completion and (2) the operation of all nuclear units in which the Company has an ownership interest or other output entitlement.

Planning Committee The Planning Committee advises and consults with management and the Board on long-range strategic planning. Responsibilities of the Committee include reviewing long-range objectives and the strategies, manpower and overall corporate organization appropriate to meet those objectives.

BOARD OF DIRECTORS COMMITTEE MEMBERS

	Audit	Compensation	Executive	Finance	Nominating	Nuclear	Planning
L. Carter		●			■		■
R. M. Ginn			■	■	■		●
R. H. Holdt		■		■	■		
R. A. Miller				●			■
Sr. M. M. Reinhard	■				■		
K. H. Rudolph			●	■	■		
C. R. Smith	■				■	●	
C. E. Spahr	●			■	■	■	
H. E. Strawbridge	■		■		●		
A. J. Tomlinson, Jr.		■			■	■	■
R. B. Tullis				■	■		
H. L. Williams							■
W. J. Williams	■	■	■		■		

● = Committee Chairman

■ = Committee Member

GENERAL INFORMATION

DIVIDEND REINVESTMENT AND STOCK PURCHASE PLAN

The Company has a Dividend Reinvestment and Stock Purchase Plan which provides share owners of record and other investors a convenient means of purchasing shares of Company common stock by investing a part or all of their quarterly dividends and cash payments without paying any fees. In addition, individuals may establish an Individual Retirement Account (IRA) which invests in Company common stock through the Plan. Information and a prospectus relating to the Plan and the IRA may be obtained from Share Owner Services at the Company.

Form 10-K The Company will furnish to share owners, without charge, a copy of its most recent annual report to the Securities and Exchange Commission (Form 10-K) and, upon payment of a reasonable fee, a copy of each exhibit to Form 10-K. Requests should be directed to the Secretary of the Company.

INDEPENDENT ACCOUNTANTS

Price Waterhouse, 1900 Society Building,
Cleveland, Ohio 44114

BOND TRUSTEE AND REGISTRAR

Morgan Guaranty Trust Company of New York for all series.

Communications regarding bond registration requirements and lost certificates should be directed to Morgan Guaranty Trust Company of New York, 30 West Broadway, New York, N.Y. 10015. Telephone Number (212) 587-6469.

BOND PAYING AGENT

Manufacturers Hanover Trust Company, 40 Wall Street, New York, N.Y. 10015 and AmeriTrust Company National Association, 900 Euclid Avenue, Cleveland, Ohio 44114 — Co-paying agents for the

3⅜% Series due 1986	3⅞% Series due 1993
3% Series due 1989	4⅜% Series due 1994

Morgan Guaranty Trust Company of New York, 30 West Broadway, New York, N.Y. 10015—Paying agent for all other series of bonds.

Inquiries regarding interest payments should be directed to either Manufacturers Hanover Trust Company or Morgan Guaranty Trust Company of New York for the series of bonds for which each acts as paying agent as noted above.

COMMON STOCK

Listed on the New York, Midwest and Pacific Stock Exchanges; unlisted trading on the Boston, Philadelphia-Baltimore-Washington and Cincinnati Stock Exchanges. New York Stock Exchange symbol—CVX.

PREFERRED STOCK

Series A, B and L are listed on the New York Stock Exchange.

REGISTRAR

For Common Stock, Preference Stock and Preferred Stock

AmeriTrust Company National Association
900 Euclid Avenue, Cleveland, Ohio 44114

TRANSFER AGENT

For Common Stock, Preference Stock and Preferred Stock

The Cleveland Electric Illuminating Company
Share Owner Services
P.O. Box 5000, Cleveland, Ohio 44101

Stock transfers may be presented at Wells Fargo Securities Clearance Corporation, 45 Broad Street, New York, N.Y. 10004.

SHARE OWNER INQUIRIES

Communications regarding stock transfer requirements, lost certificates, dividends and changes of address should be directed to Share Owner Services at the Company. To reach Share Owner Services by phone, call the following numbers:

Local calls in Cleveland area	622-9800, ext. 3700
Elsewhere in Ohio	1-800-362-1237
Outside Ohio	1-800-321-3206

Please have your account number ready when calling.

EXECUTIVE OFFICES

Illuminating Building
55 Public Square, Cleveland, Ohio
Telephone Number (216) 622-9800

MAIL ADDRESS

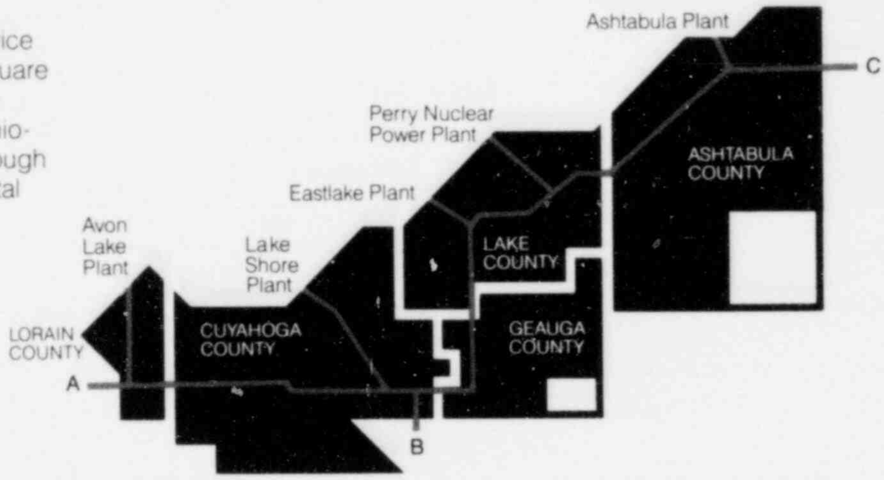
P.O. Box 5000, Cleveland, Ohio 44101

Notice: The annual report and the financial statements herein are for the general information of the share owners of the Company and are not intended to be used in connection with any sale or purchase of securities.

The Company is an equal opportunity employer.

SERVICE AREA

The Company furnishes electric service to an area of approximately 1,700 square miles, extending 100 miles along the south shore of Lake Erie from the Ohio-Pennsylvania border on the east through the city of Avon Lake on the west. Total population served is approximately 1,850,000.



A. Interconnections with Ohio Edison (from Davis-Besse Nuclear Power Station); B. Interconnections with Ohio Edison (from Mansfield and Beaver Valley Plants) and Ohio Power; C. Interconnection with Pennsylvania Electric (from Seneca Pumped Storage Hydroelectric Power Plant—80% owned by the Company).

CAPCO

The Company is a member of the Central Area Power Coordination Group (CAPCO), formed by regional utility companies to assure greater reliability of interconnections, back-up in case of emergencies and better economies of operation. Other members include Duquesne Light Company, Ohio Edison Company, Pennsylvania Power Company and The Toledo Edison Company. The members are constructing power generation and transmission facilities.

Through interconnections shown above with CAPCO members, Pennsylvania Electric Company and Ohio Power Company, the Company's service area is part of an interconnected system linking continental U.S.A. and major portions of Canada. This interconnection network further enhances the reliability and economy of our customers' electric service.

CAPCO GENERATING UNITS

	Project	Expected Net Demonstrated Capability (Kilowatts) Total	Company Share	Year of Scheduled Completion	Construction and Operation Responsibility
Eastlake	■Unit 5	648,000	446,000	In Service	The Illuminating Company
Sammis	■Unit 7	600,000	—0—	In Service	Ohio Edison Company
Mansfield	■Unit 1	780,000	51,000	In Service	Pennsylvania
	Unit 2	780,000	223,000	In Service	Power
	Unit 3	800,000	196,000	In Service	Company
Davis-Besse	●	866,000	445,000	In Service	The Toledo Edison Company
Perry	●Unit 1	1,205,000	375,000	1986	The Illuminating Company
	Unit 2	1,205,000	375,000	Suspended	
Beaver Valley	●Unit 1	810,000	—0—	In Service	Duquesne
	Unit 2	883,000	204,000	1987	Light Company

■Coal-Fired ●Nuclear

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