

Joint Interests in Fossil Power Stations

	Sammis Unit 7	Bruce Mansfield			Eastlake Unit 5
		Unit 1	Unit 2	Unit 3	
Duquesne	31.20%	29.30%	8.00%	13.74%	31.20%
Ohio Edison Company	* 48.00%	60.00%	39.30%	35.60%	-
Pennsylvania Power Company (a)	20.80%	* 4.20%	* 6.80%	* 6.28%	-
CEI (b)	-	6.50%	28.60%	24.47%	* 68.80%
Toledo Edison Company (b)	-	-	17.30%	19.91%	-

*Denotes Operator

(a) Subsidiary of Ohio Edison Company

(b) Subsidiary of Centerior Energy Corporation

On September 13, 1996, Ohio Edison Company and Centerior Energy Corporation entered into an agreement and plan of merger to form FirstEnergy Corporation. The regulatory approval process for the proposed merger is expected to take approximately 12 to 18 months.

Property Held for Future Use

In 1986, the PUC approved the Company's request to remove Phillips Power Station (Phillips) and a portion of BI from service and from rate base. In accordance with the Company's Mitigation Plan, 112 MWs related to BI Units 2a and 2b were moved from *property held for future use* to *electric plant in service* in 1996. The Company expects to recover its investment in BI Units 3 and 4, which remain in *property held for future use* through future electricity sales. The Company believes its investment in BI will be necessary in order to meet future business needs. A portion of the proceeds of the sale of Ft. Martin is expected to be used to fund reliability enhancements to the BI Unit 3 combustion turbine. The reliability enhancements are contingent upon the projects meeting a least-cost test versus other potential sources of peaking capacity. (See "Mitigation Plan" discussion on page 32.) The Company is analyzing the effects of customer choice on its future generating requirements. The Company is planning to seek recovery of its investment and associated costs of Phillips through a CTC. (See "Competition" discussion on page 38.) In the event that market demand, transmission access or rate recovery do not support the utilization of these plants, the Company may have to write off part or all of these investments and associated costs. At December 31, 1996, the Company's net of tax investment in Phillips and BI held for future use was \$53.6 million and \$17.2 million.

Employees

At December 31, 1996, DQE and its subsidiaries had 3,810 employees, including 1,157 employees at the Company-operated Beaver Valley Power Station (BVPS). In November 1996, the Company reached an agreement on a three-year contract extension through September 30, 2001 with the International Brotherhood of Electrical Workers, which represents approximately 2,000 of the Company's employees.

Electric Utility Operations

The Company's fossil plants operated at 76 percent availability in 1996 and 1995. The Company's nuclear plants operated at 76 percent availability in 1996 and 83 percent in 1995. The timing and duration of scheduled maintenance and refueling outages, as well as the duration of forced outages, affect the availability of power stations. The Company normally experiences its peak demand in the summer. The 1996 customer system peak demand of 2,463 MW occurred on August 7, 1996.

The Company's plan for optimizing generation resources is designed to reduce under-utilized generating capacity and employ cost-effective sources of peaking capacity. The sale of the Company's ownership interest in Ft. Martin reduced in-service capacity by 276 MW. In conjunction with the sale, the Company returned 112 MW of peaking capacity at BI to *electric plant in service*. Additionally, through potential reliability enhancements to the BI Unit 3 combustion turbine, the Company could return to service another 56 MW of oil-fired peaking capacity. (See "Property Held for Future Use" discussion above.)

The Company has a 13.74 percent ownership interest in Perry Unit 1, a nuclear generating unit located in Ohio and operated by CEI. CEI management has advised the Company that the Perry Course of Action (PCA), an action plan submitted to the NRC in 1993, was completed at the end of the unit's fifth refueling outage in the spring of 1996. Perry Unit 1 has followed the PCA with the Perry Plan for Excellence, which is the long-term phase of the unit's performance improvement program. The Company will continue to monitor closely the status of the performance improvement program.

Fossil Fuel

The Company believes that sufficient coal for its coal-fired generating units will be available from various sources to satisfy its requirements for the foreseeable future. During 1996, approximately 2.4 million tons of coal were consumed at the Company's two wholly owned coal-fired stations, Cheswick Power Station (Cheswick) and Elrama Power Station (Elrama).

The Company owns Warwick Mine, an underground mine located approximately 83 river miles from Pittsburgh. At December 31, 1996, the Company's net investment in the mine was \$11.4 million. The Company estimates that, at December 31, 1996, its economically recoverable coal reserves at Warwick Mine were in excess of 1.5 million tons. The unaffiliated contract operator at Warwick Mine encountered adverse geologic conditions late in 1996 that resulted in a significant change to the mining plan. Commencing in 1997, the operator will be producing approximately 15 percent of the amount previously mined, or 360,000 tons of coal per year, for exclusive use at Elrama. The Company will purchase the remaining coal on the open market. This change should not impact the Company's ability to recover all of its investment in Warwick Mine, the \$2.6 million of unrecovered system-wide cost of coal which excludes the Bruce Mansfield Power Station (Bruce Mansfield), or to accrue funds for future liabilities. It is anticipated that this effort will be successfully completed by March 31, 2000 when the system-wide coal cost cap expires. The current estimated liability for mine closing, including final site reclamation, mine water treatment and certain labor liabilities is \$34.1 million, and the Company has recorded a liability on the consolidated balance sheet of approximately \$20.2 million toward these costs.

During 1996, 69 percent of the Company's coal supplies were provided by contracts including Warwick Mine, with the remainder satisfied through purchases on the spot market. The Company had four long-term contracts in effect at December 31, 1996 that, in combination with spot market purchases, are expected to furnish an adequate future coal supply. The Company does not anticipate any difficulty in replacing or renewing these contracts as they expire from 1997 through 2002. At December 31, 1996, the Company's wholly owned and jointly owned generating units had on hand an average coal supply of 45 days.

The PUC has established two market price coal cost standards for the Company. One applies only to coal delivered at Bruce Mansfield. The other, the system-wide coal cost standard, applies to coal delivered to the remainder of the Company's system. Both standards are updated monthly to reflect prevailing market prices of similar coal. The PUC has directed the Company to defer recovery of the delivered cost of coal to the extent that such cost exceeds generally prevailing market prices for similar coal, as determined by the PUC. The PUC allows deferred amounts to be recovered from customers when the delivered costs of coal fall below such PUC-determined prevailing market prices. The Company's obligations to pay certain debt service costs associated with the Bruce Mansfield coal supply will end on January 1, 2000. The Bruce Mansfield coal cost-capping mechanism does not expire until the recovery of all deferrals has been resolved. The Company believes that Bruce Mansfield deferrals may increase through the end of this decade and then be reduced to zero by the end of the year 2002. The unrecovered cost of Bruce Mansfield coal was \$9.6 million and the unrecovered cost of the remainder of the system-wide coal was \$2.6 million at December 31, 1996. The Company believes that all deferred coal costs will be recovered.

Nuclear Fuel

The cycle of production and utilization of nuclear fuel consists of (1) mining and milling of uranium ore and processing the ore into uranium concentrates, (2) converting uranium concentrates to uranium hexafluoride, (3) enriching the uranium hexafluoride, (4) fabricating fuel assemblies, (5) utilizing the nuclear fuel in the generating station reactor and (6) storing and disposing of spent fuel.

Adequate supplies of uranium and conversion services are under contract for the Company's requirements for its jointly owned/leased nuclear units through June and December 1997, respectively. Enrichment services are supplied under a 1984 United States Enrichment Corporation Utility Services Contract entered into for a period of 30 years by the Company for joint interests in Perry Unit 1, BV Unit 1 and BV Unit 2. Under the terms and conditions of this contract, the Company is committed to 100 percent of its enrichment needs through 1999; the Company has terminated, at zero cost, all of its enrichment services requirements for fiscal years 2000 through 2005. The Company continues to review the need for further enrichment services for the years 2006 through 2014 and may terminate these future years' services under the contract. Fuel fabrication contracts are in place to supply reload requirements for the next 18-month cycle for BV Unit 1 and BV Unit 2 and the next fifteen 18-month cycles for Perry Unit 1. The Company will make arrangements for future uranium supply and related services, as required.

Each utility company is responsible for financing its proportionate share of the costs of nuclear fuel for each nuclear unit in which it has an ownership or leasehold interest. The Company's nuclear fuel costs, which are amortized to reflect fuel consumed, are charged to fuel expense and are currently recovered through rates. The Company estimates that, over the next three years, the expenditures for new fuel will exceed the amortization of nuclear fuel consumed by approximately \$4.4 million. The actual nuclear fuel costs to be financed and amortized will be influenced by such factors as changes in interest rates; lengths of the respective fuel cycles; reload cycle design; and changes in nuclear material costs and services, the prices and availability of which are not known at this time. Such costs may also be influenced by other events not presently foreseen.

Nuclear Decommissioning

The PUC ruled that recovery of the decommissioning costs for BV Unit 1 could begin in 1977, and that recovery for BV Unit 2 and Perry Unit 1 could begin in 1988. The Company expects to decommission BV Unit 1, BV Unit 2 and Perry Unit 1 no earlier than the expiration of each plant's operating license in 2016, 2027 and 2026. At the end of its operating life, BV Unit 1 may be placed in safe storage until BV Unit 2 is ready to be decommissioned, at which time the units may be decommissioned together.

Based on site-specific studies finalized in 1992 for BV Unit 2, and in 1994 for BV Unit 1 and Perry Unit 1, the Company's share of the total estimated decommissioning costs, including removal and decontamination costs, currently being used to determine the Company's cost of service, is \$122 million for BV Unit 1, \$35 million for BV Unit 2, and \$67 million for Perry Unit 1. A study will be performed in 1997 to update the Company's estimated decommissioning costs of BV Unit 1 and BV Unit 2.

On July 18, 1996, the PUC issued a *Proposed Policy Statement Regarding Nuclear Decommissioning Cost Estimation and Cost Recovery* for the purpose of obtaining comments from the public. The proposed policy includes guidelines for a site-specific study to estimate the cost of decommissioning. Guidelines require that studies be performed at least every five years, address radiological and non-radiological costs, and include a contingency factor of not more than 10 percent. Under the proposed policy, annual decommissioning funding levels are based on an annuity calculation recognizing inflation in the cost estimates and earnings on fund assets. With respect to the transition to a competitive generation market, the Customer Choice Act requires that utilities include a plan to mitigate any shortfall in decommissioning trust fund payments for the life of the facility with any future decommissioning filings. Consistent with this requirement, the Company has increased its nuclear decommissioning funding by \$5 million under the PUC-approved plan for the sale of the Company's ownership interest in Ft. Martin. (See "Mitigation Plan" discussion on page 32.) These additional annual contributions bring the total annual funding to approximately \$9 million. Also, on October 17, 1996, the PUC adopted an Accounting Order filed by the Company to recognize the increased funding as part of the Company's cost of service. The Company expects to receive approval from the Internal Revenue Service (IRS) for qualification of 100 percent of additional nuclear decommissioning trust funding for BV Unit 2 and Perry Unit 1, and 79 percent for BV Unit 1.

The Company records nuclear decommissioning expense under the category of *depreciation and amortization* expense and accrues a liability, equal to that amount, for nuclear decommissioning costs. Funding for nuclear decommissioning costs is deposited in external, segregated trust accounts and may be invested in a portfolio of corporate common stock and debt securities, municipal bonds, certificates of deposit and United States government securities. Trust fund earnings increase the fund balance and the recorded liability. The market value of the aggregate trust fund balances at December 31, 1996 totaled approximately \$33.7 million. On the Company's consolidated balance sheet, the decommissioning trusts have been reflected in *other long-term investments*, and the related liability has been recorded as *other non-current liabilities*.

Nuclear Insurance

The *Price-Anderson Amendments to the Atomic Energy Act of 1954* limit public liability from a single incident at a nuclear plant to \$8.9 billion. The maximum available private primary insurance of \$200 million has been purchased by the Company. Additional protection of \$8.7 billion would be provided by an assessment of up to \$79.3 million per incident on each nuclear unit in the United States. The Company's maximum total possible assessment, \$59.4 million, which is based on its ownership or leasehold interests in three nuclear generating units, would be limited to a maximum of \$7.5 million per incident per year. This assessment is subject to indexing for inflation and may be subject to state premium taxes. If funds prove insufficient to pay claims, the United States Congress could impose other revenue-raising measures on the nuclear industry.

The Company's share of insurance coverage for property damage, decommissioning and decontamination liability is \$1.2 billion. The Company would be responsible for its share of any damages in excess of insurance coverage. In addition, if the property damage reserves of Nuclear Electric Insurance Limited (NEIL), an industry mutual insurance company that provides a portion of this coverage, are inadequate to cover claims arising from an incident at any United States nuclear site covered by that insurer, the Company could be assessed retrospective premiums totaling a maximum of \$7.3 million.

In addition, the Company participates in a NEIL program that provides insurance for the increased cost of generation and/or purchased power resulting from an accidental outage of a nuclear unit. Subject to the policy limit, the coverage provides for 100 percent of the estimated incremental costs per week during the 52-week period starting 21 weeks after an accident and 80 percent of such estimate per week for the following 104 weeks, with no coverage thereafter. If NEIL's losses for this program ever exceed its reserves, the Company could be assessed retrospective premiums totaling a maximum of \$3.5 million.

**Spent Nuclear
Fuel Disposal**

The *Nuclear Waste Policy Act of 1982* established a policy for handling and disposing of spent nuclear fuel and a policy requiring the establishment of a final repository to accept spent nuclear fuel. Electric utility companies have entered into contracts with the United States Department of Energy (DOE) for the permanent disposal of spent nuclear fuel and high-level radioactive waste in compliance with this legislation. The DOE has indicated that its repository under these contracts will not be available for acceptance of spent nuclear fuel before 2010. On July 23, 1996, the U.S. Court of Appeals for the District of Columbia Circuit, in response to a suit brought by 25 electric utilities and 18 states and state agencies, unanimously ruled that the DOE has a legal obligation to begin taking spent nuclear fuel by January 31, 1998. The DOE has not yet established an interim or permanent storage facility, and has indicated that it will be unable to begin acceptance of spent nuclear fuel for disposal by January 31, 1998. Further, Congress is considering amendments to the *Nuclear Waste Policy Act of 1982* that could give the DOE authority to proceed with the development of a federal interim storage facility. In the event the DOE does not begin accepting spent nuclear fuel, existing on-site spent nuclear fuel storage capacities at BV Unit 1, BV Unit 2 and Perry Unit 1 are expected to be sufficient until 2016 (end of operating license), 2013 and 2011.

On January 31, 1997, the Company joined 35 other electric utilities and 46 states, state agencies and regulatory commissions in filing a suit in the U.S. Court of Appeals for the District of Columbia against the DOE. The suit requests the court to suspend the utilities' payments into the Nuclear Waste Fund and to place future payments into an escrow account until the DOE fulfills its obligation to accept spent nuclear fuel. Significant additional expenditures for the storage of spent nuclear fuel at BV Unit 2 and Perry Unit 1 could be required if the DOE does not fulfill its obligation to accept spent nuclear fuel.

**Uranium Enrichment
Decontamination
and
Decommissioning**

Nuclear reactor licensees in the United States are assessed annually for the decontamination and decommissioning of DOE uranium enrichment facilities. Assessments are based on the amount of uranium a utility had processed for enrichment prior to enactment of the *National Energy Policy Act of 1992* (NEPA) and are to be paid by such utilities over a 15-year period. At December 31, 1996, the Company's liability for contributions was approximately \$9.3 million (subject to an inflation adjustment). Contributions, when made, are currently recovered from electric utility customers through the ECR.

**Environmental
Matters**

The *Comprehensive Environmental Response, Compensation and Liability Act of 1980 and the Superfund Amendments and Reauthorization Act of 1986* (Superfund) established a variety of informational and environmental action programs. The United States Environmental Protection Agency (EPA) informed the Company of its potential involvement in three hazardous waste sites. The Company reached agreements to make de minimus financial payments in 1995 related to two sites in order to resolve any associated liability. Related to the remaining site, the Company believes that available defenses, along with other factors (including overall limited involvement, low estimated remediation costs and other solvent, potentially responsible parties) will limit any potential liability that the Company may have for cleanup costs. The Company believes that any settlement or associated costs related to the remaining site will not have a materially adverse effect on its financial position, results of operations or cash flows.

As required by Title V of the *Clean Air Act Amendments (Clean Air Act)*, the Company filed comprehensive air operating permit applications for Cheswick, Elrama, BI and Phillips during the last half of 1995. These applications are still pending approval. The Company also filed its Title IV Phase II *Clean Air Act* compliance plan with the PUC on December 27, 1995.

Although the Company believes it has satisfied all of the Phase I Acid Rain Program requirements of the *Clean Air Act*, Phase II Acid Rain Program requires significant additional reductions of sulfur dioxide (SO₂) and oxides of nitrogen (NO_x) by the year 2000. The Company currently has 662 MW of nuclear capacity and 1,187 MW of coal capacity equipped with SO₂ emission-reducing equipment (including 300 MW of *property held for future use* at Phillips). Through the year 2000, the Company is considering a combination of compliance methods that include fuel switching; increased use of, and improvements in, SO₂ emission-reducing equipment; low NO_x burner technology; and the purchase of emission allowances for those remaining stations not in compliance.

In addition to the Title IV Acid Rain Program requirements, the Company is responsible for additional NO_x reduction requirements to meet Ozone Ambient Air Quality Standards under Title I of the *Clean Air Act*. Flue gas conditioning and post-combustion NO_x reduction technologies may be employed if economically justified. Also, the Company is examining and developing innovative emissions technologies designed to reduce costs. The Company continues to work with the operators of its jointly owned stations to implement cost-effective compliance strategies to meet these requirements.

The Company is closely monitoring other potential future air quality programs and air emission control requirements that could result from more stringent ambient air quality and emission standards for SO₂ and NO_x particulates and other by-products of coal combustion. The Company expects the Pennsylvania Department of Environmental Protection (DEP) to finalize in 1997 a regulation to implement the additional NO_x control requirements that were recommended by the Ozone Transport Commission. The estimated costs to comply with this program have been included in the Company's capital cost estimates through the year 2000. Since other potential programs are in various stages of discussion and consideration, it is impossible to make reasonable estimates of the potential costs and impacts, if any. The Company currently estimates that additional capital costs to comply with *Clean Air Act* requirements through the year 2000 will be approximately \$20 million.

The Company has developed, patented and installed low NO_x burner technology for the Elrama boilers. These cost-effective NO_x reduction systems installed on the Elrama roof fired boilers were specified as the benchmark for the industry for this class of boilers in the EPA's final Group II rule-making. The Company is also currently evaluating additional low-cost, developmental NO_x reduction technologies at Cheswick and Elrama. An Artificial Neural Network control system enhancement, co-sponsored by the Electric Power Research Institute and the Company, will be demonstrated at Cheswick. The Gas Research Institute and the Company are sponsoring a targeted natural gas reburn demonstration at Elrama. Both demonstrations were initiated in 1996 and will be completed in 1997.

In 1992, the DEP issued *Residual Waste Management Regulations* governing the generation and management of non-hazardous residual waste, such as coal ash. The Company is assessing the sites it utilizes and has developed compliance strategies that are currently under review by the DEP. Capital costs of \$2.5 million were incurred by the Company in 1996 to comply with these DEP regulations. Based on information currently available, an additional \$2.8 million will be spent in 1997. The additional capital cost of compliance through the year 2000 is estimated, based on current information, to be \$15 million. This estimate is subject to the results of groundwater assessments and DEP final approval of compliance plans.

The Company is involved in various other environmental matters. The Company believes that such matters, in total, will not have a materially adverse effect on its financial position, results of operations or cash flows.

Outlook

Competition

The electric utility industry continues to undergo fundamental change in response to open transmission access and increased availability of energy alternatives. Under historical PUC ratemaking, regulated electric utilities were granted exclusive geographic franchises to sell electricity in exchange for making investments and incurring obligations to serve customers under the then-existing regulatory framework. Through the ratemaking process, those prudently incurred costs were recovered from customers, along with a return on the investment. Additionally, certain operating costs were approved for deferral for future recovery from customers. As a result of this historical ratemaking process, utilities have assets recorded on their balance sheets at above-market costs and have commitments to purchase power at above-market prices (transition costs).

In Pennsylvania, under the Customer Choice Act which became effective on January 1, 1997, consumers in a utility's traditional franchised territory will ultimately be able to purchase electricity at market prices from a variety of electric generation suppliers. Before the phase-in to customer choice begins in 1999, the PUC expects utilities to take vigorous steps to mitigate transition costs as much as possible without increasing the price they currently charge customers. The PUC will determine what portion of a utility's remaining transition costs will be recoverable from customers through a CTC. This charge will be paid by consumers who choose alternative generation suppliers as well as customers who choose their franchised utility. The CTC could last as long as 2005, providing a utility a total of up to nine years to recover transition costs. An overall four-and-one-half year price cap will be imposed on the transmission and distribution charges of existing electric utility companies. Additionally, existing electric utility companies may not increase the generation price component of prices as long as transition costs are being recovered, with certain exceptions. If a utility ultimately is unable to recover its transition costs within this pricing structure and timeframe, the costs will be written off.

The Company has already been effective in mitigating its exposure to transition costs. As the following table demonstrates, generating plant, decommissioning and related regulatory asset costs have been reduced by approximately \$400 million during the past two years. These reductions have resulted from a variety of strategies, such as selling generating assets, accelerating recovery of fixed costs, increasing nuclear decommissioning charges and reducing capitalized costs. The Company expects to continue these steps to address its remaining transition costs. The Customer Choice Act provides another option to mitigate transition costs. With PUC approval, utilities are permitted to issue transition bonds with a maturity of 10 years or less. Proceeds can be used to reduce transition costs. The Company is currently reviewing this alternative as well as others to further mitigate its transition costs. (See "Regulation" and "Rate Matters" discussions on pages 27 and 31.)

Potential Transition Costs

	December 31, 1996	January 1, 1995
	<i>(Amounts in Millions of Dollars)</i>	
Nuclear plant	\$ 910.5	\$1,149.0
Generation-related regulatory assets	417.9	495.8
BV Unit 2 lease	399.1	401.0
Unfunded generating plant decommissioning	299.5	371.0
Phillips	78.3	78.3
Warwick Mine	15.3	25.0
Purchase power contracts	—	—
Total	\$2,120.6	\$2,520.1

Any estimate of transition costs, including those in the table above, is forward-looking and is highly dependent on estimates of the future market prices for electric power. Higher market prices for electricity reduce transition cost exposure, while lower market prices increase exposure. As part of its transition filing, the Company is proposing to make a long-term sale of electricity during the transition period to determine the market rate for power. In addition to market-related impacts, any estimate of the ultimate level of transition costs also depends on, among other things, the extent to which such costs are deemed recoverable by the PUC, the ongoing level of the Duquesne's costs of operations, regional and national economic conditions, and growth of the Duquesne's sales. Duquesne anticipates making its transition filing, including the identification of potential transition costs, as required by the PUC by August 1, 1997. The PUC is expected to rule on the Company's ability to recover these costs through a CTC by May 1, 1998. The Company believes, based upon prior rulings of the PUC, that it is entitled to recover substantially all of its transition costs, but cannot predict the outcome of this regulatory process. In the event that the PUC rules that any or all of these transition costs cannot be recovered through a CTC mechanism or the Company fails to satisfy the requirements of *SFAS No. 71*, these costs will be written off. As the Company has substantial exposure to transition costs relative to its size, significant transition cost write-offs could

have a materially adverse effect on the Company's financial position, results of operations and cash flows. Various financial covenants and restrictions could be violated if substantial write-off of assets or recognition of liabilities occurs.

In addition to the mitigation of transition costs, the Company has been preparing for competition in a variety of ways. In 1989, a holding company structure was formed to add flexibility to the Company's strategy for managing assets. With this structure the Company has been able to pursue new business opportunities that have capitalized on the Company's leadership in engineering, energy production and the application of technology. The Company's market-driven businesses have grown in a manner that complements its core business. The Company has also been building its financial strength through the retirement and refinancing of *long-term debt* and the repurchase of stock. In 1995, the Company's restrictive first mortgage bond indenture was replaced with a new indenture with more flexible provisions and the Company completed a 3-for-2 stock split. In 1996, the Company issued MIPS to further add to its financial flexibility and creditworthiness.

Meanwhile, the Company has better positioned its electric utility business for competition through improving operations and enhancing customer relations. In recognition of impending industry competition and in an effort to optimize its generation resources, in 1989 the Company signed a contract with Delmarva Power for a bulk power sale for a period of 20 years. This initiative would have resulted in the refurbishment and return to service of the Company's cold-reserved generating stations. Following the plan's failure to receive regulatory approval, in 1990 the Company announced a second long-term power sale initiative to restart these power plants. This plan would have provided significant impetus to economic development in Pennsylvania as well as providing the Company's customers with substantial benefits in the form of lower rates. The Company's efforts to upgrade and maintain the cold-reserved units have enabled the Company to utilize the BI units to meet peak demand during periods of extreme weather in recent years and have enabled the BI units to more quickly return to service as part of the Ft. Martin sale. In 1991, Duquesne reorganized into strategic business units along market lines and instituted cost reduction targets for capital, operation and maintenance, and inventory expenditures. As part of this process, workforce reductions were achieved primarily through attrition; since 1989 Duquesne has reduced its number of employees by 25 percent. Recently, Duquesne signed a three-year contract extension with its bargaining unit employees through September 2001. Throughout the period, Duquesne has been aggressively reducing its fuel costs, achieving a 13 percent reduction in the unit cost of fuel since 1990. These measures have enabled Duquesne to reduce its rates by nearly 36 percent, in real terms, since 1990. When considering the price freeze component of Duquesne's Mitigation Plan, prices will have declined by nearly 50 percent in real terms during the decade of the 1990s. From a customer relations standpoint, Duquesne negotiated long-term contracts with more than 30 key industrial and commercial customers and was recognized in 1996 for its economic development efforts in attracting major new industrial expansions. In 1995, Duquesne became one of the first electric utilities in the country to offer a full customer service guarantee and also guaranteed to match any competing electricity supplier's price for new businesses or for the expansion of existing businesses. Duquesne also is offering to customers increased bill-paying options, including an advanced technology service that enables customers to electronically receive and pay their electric bills. This service assists major customers just as its earlier Electriccheck option helped smaller commercial and residential customers. Additionally, Duquesne will be positioned to offer customers a wide range of new services with the Customer Advanced Reliability System (CARS). Utility customers will be linked to CARS by encoder receiver transmitters contained in new or retrofitted electric meters. Data communications offered by this technology are expected to result in improved reliability, security, and customer satisfaction.

At the national level, in 1996 the FERC issued two related final rules that address the terms on which electric utilities will be required to provide wholesale suppliers of electric energy with non-discriminatory access to the utility's wholesale transmission system. The first rule, Order No. 888, requires each public utility that owns, controls or operates interstate transmission facilities to file a tariff offering unbundled transmission services containing non-rate terms that conform to the FERC's pro forma tariff. Order No. 888 also allows full recovery of prudently incurred costs from departing customers. FERC deferred to state regulators with respect to retail access, recovery of retail transition costs and the scope of state regulatory jurisdiction. The second rule, Order No. 889, prohibits transmission owners and their affiliates from gaining preferential access to information concerning transmission and establishes a code of conduct to ensure the complete separation of a utility's wholesale power marketing and transmission operation functions.

Finally, the FERC simultaneously issued a new *Notice of Proposed Rulemaking* (NOPR) on *Capacity Reservation Open Access Transmission Tariffs* (CRT), which would require all market participants to reserve firm capacity rights between designated receipt and delivery points. If adopted, the CRT would replace the open access pro forma tariff implemented in Order No. 888. (See "Transmission Access" discussion below.)

The Company is aware of the foregoing state and federal regulatory and business uncertainties and is attempting to position itself to operate in a more competitive environment.

Transmission Access

In March 1994, the Company submitted, pursuant to the *Federal Power Act*, two separate "good faith" requests for transmission service with APS and the Pennsylvania-New Jersey-Maryland Interconnection Association (PJM Companies). Because of a lack of progress on pricing and other issues, the Company subsequently filed with the FERC applications for transmission service. In May 1995, the FERC instructed APS and the PJM Companies to provide transmission service to the Company and directed the parties to negotiate specific rates, terms and conditions. No terms were agreed to, and briefs were filed with the FERC outlining the areas of disagreement. The matter is now pending before the FERC. In July 1996, the Company filed with the FERC a request for acceptance of a capacity reservation tariff to replace the previously filed FERC Order No. 888 pro forma tariff. (See "Competition" discussion on page 38.) The Company's tariff proposes to adopt marginal cost pricing for transmission service on the Company transmission system. In February 1997, the FERC rejected the Company's tariff filing, but permitted the Company to request a hearing to determine whether the Company's tariff is just and reasonable as well as consistent with or superior to the Order No. 888 pro forma tariff. The Company has requested such a hearing.

The Company is currently evaluating the impact of FERC regulatory actions on these proceedings. The Company cannot predict the final outcome of these proceedings.

Beaver Valley Power Station (BVPS) Steam Generators

BVPS's two units are equipped with steam generators designed and built by Westinghouse Electric Corporation (Westinghouse). Similar to other Westinghouse nuclear plants, outside diameter stress corrosion cracking (ODSCC) has occurred in the steam generator tubes of both units. The units continue to operate at 100 percent reactor power although 15 percent of BV Unit 1 and 2 percent of BV Unit 2 steam generator tubes have been removed from service. Material acceleration in the rate of ODSCC could lead to a loss in plant efficiency and significant repairs or replacement of BV Unit 1 steam generators. The total replacement cost of the BV Unit 1 steam generators is estimated at \$125 million, \$59 million of which would be the Company's responsibility. The earliest that the BV Unit 1 steam generators could be replaced during a scheduled refueling outage is the fall of 2000.

Other

Retirement Plan Measurement Assumptions

The Company increased the discount rate used to determine the projected benefit obligation on the Company's retirement plans at December 31, 1996 to 7.5 percent. The assumed change in future compensation levels and assumed rate of return on plan assets were also increased to reflect current market and economic conditions. The effects of these changes on the Company's retirement plan obligations are reflected in the amounts shown in "Employee Benefits," Note N to the consolidated financial statements, on page 61. The resulting change in related expenses for subsequent years is not expected to be material.

Except for historical information contained herein, the matters discussed in this annual report are forward-looking statements which involve risks and uncertainties including, but not limited to, economic, competitive, governmental and technological factors affecting the Company's operations, markets, products, services and prices and other factors discussed in the Company's filings with the Securities and Exchange Commission.

**Report of
Independent
Certified Public
Accountants**

To the Directors and Shareholders of DQE:

We have audited the accompanying consolidated balance sheet of DQE and its subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of DQE and its subsidiaries as of December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

Deloitte & Touche LLP
Pittsburgh, Pennsylvania
January 28, 1997

**Report of the
Audit Committee
of the Board of
Directors of DQE**

The Audit Committee, composed entirely of non-employee directors, meets regularly with the independent certified public accountants and the internal auditors to discuss results of their audit work, their evaluation of the adequacy of the internal accounting controls and the quality of financial reporting.

In fulfilling its responsibilities in 1996, the Audit Committee recommended to the Board of Directors, subject to shareholder approval, the selection of the Company's independent certified public accountants. The Audit Committee reviewed the overall scope and details of the independent certified public accountants' and internal auditors' respective audit plans and reviewed and approved the independent certified public accountants' general audit fees and non-audit services.

Audit Committee meetings are designed to facilitate open communications with internal auditors and independent certified public accountants. To ensure auditor independence, both the independent certified public accountants and the internal auditors have full and free access to the Audit Committee.

The Audit Committee of the Board of Directors of DQE

STATEMENT OF CONSOLIDATED INCOME

(Thousands of Dollars, Except Per Share Amounts)

		Year Ended December 31,		
		1996	1995	1994
Operating Revenues	Sales of Electricity:			
	Residential	\$ 405,392	\$ 414,291	\$ 401,246
	Commercial	489,646	491,789	490,309
	Industrial	190,723	190,689	195,852
	Provision for doubtful accounts	(10,582)	(13,430)	(11,890)
	Net customer revenues	1,075,179	1,083,339	1,075,517
	Utilities	58,292	55,963	58,295
	Total Sales of Electricity	1,133,471	1,139,302	1,133,812
	Other	91,724	80,860	90,098
		Total Operating Revenues	1,225,195	1,220,162
Operating Expenses	Fuel and purchased power	236,924	231,968	244,135
	Other operating	298,977	292,997	329,177
	Maintenance	78,386	81,516	79,488
	Depreciation and amortization	222,928	202,558	165,912
	Taxes other than income taxes	85,974	88,658	88,331
		Total Operating Expenses	923,189	897,697
Operating Income	Operating Income	302,006	322,465	316,867
	Other Income	74,790	52,314	42,924
	Interest and Other Charges	110,270	107,555	110,002
	Income Before Income Taxes	266,526	267,224	249,789
	Income Taxes	87,388	96,661	92,973
Net Income	Net Income	\$ 179,138	\$ 170,563	\$ 156,816

Average Number of Common Shares				
	Outstanding (Thousands of Shares)	77,349	77,674	79,046

Earnings Per Share	Earnings Per Share of Common Stock	\$2.32	\$2.20	\$1.98
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Dividends Declared	Dividends Declared Per Share of Common Stock	\$1.30	\$1.21	\$1.13
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See notes to consolidated financial statements.

STATEMENT OF CONSOLIDATED RETAINED EARNINGS

(Thousands of Dollars)

	1996	1995	1994
Balance at beginning of year	\$ 698,986	\$ 622,072	\$ 554,604
Net income	179,138	170,563	156,816
Dividends declared	(100,517)	(93,649)	(89,348)
Balance at end of year	\$ 777,607	\$ 698,986	\$ 622,072

See notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEET

Assets

	<i>(Thousands of Dollars)</i>	
	<i>As of December 31,</i>	
	1996	1995
Current Assets:		
Cash and temporary cash investments	\$ 410,978	\$ 24,767
Receivables:		
Electric customer accounts receivable	92,475	103,821
Other utility receivables	22,402	22,441
Other receivables	33,936	25,164
Less: Allowance for uncollectible accounts	(18,688)	(18,658)
Receivables less allowance for uncollectible accounts	130,125	132,768
Less: Receivables sold	—	(7,000)
Total Receivables - Net	130,125	125,768
Materials and supplies (at average cost):		
Coal	19,097	25,454
Operating and construction	52,669	53,298
Total Materials and Supplies	71,766	78,752
Other current assets	9,359	8,099
Total Current Assets	622,228	237,386
Long-Term Investments:		
Affordable housing	150,270	116,784
Leveraged leases	134,133	87,834
Other leases	85,893	106,916
Gas reserves	79,916	69,435
Other	68,477	59,947
Total Long-Term Investments	518,689	440,916
Property, Plant and Equipment:		
Electric plant in service	4,275,110	4,265,161
Construction work in progress	45,059	38,134
Property held under capital leases	99,608	133,381
Property held for future use	190,821	216,633
Other	176,872	92,804
Gross property, plant and equipment	4,787,470	4,746,113
Less: Accumulated depreciation and amortization	(1,969,945)	(1,685,877)
Total Property, Plant and Equipment - Net	2,817,525	3,060,236
Other Non-Current Assets:		
Regulatory assets	636,816	678,700
Other	43,734	41,605
Total Other Non-Current Assets	680,550	720,305
Total Assets	\$4,638,992	\$4,458,843

See notes to consolidated financial statements.

**Liabilities and
Capitalization**

	<i>(Thousands of Dollars)</i>	
	<i>As of December 31,</i>	
	1996	1995
Current Liabilities:		
Notes payable	\$ 749	\$ 35,098
Current maturities and sinking fund requirements	72,831	71,379
Accounts payable	96,230	90,941
Accrued liabilities	58,044	52,063
Dividends declared	28,633	27,825
Other	4,075	9,191
Total Current Liabilities	260,562	286,497
Non-Current Liabilities:		
Deferred income taxes – net	759,089	801,631
Deferred investment tax credits	106,201	115,760
Capital lease obligations	28,407	34,546
Deferred income	189,293	221,740
Other	240,763	197,973
Total Non-Current Liabilities	1,323,753	1,371,650
Commitments and Contingencies (Notes B through N)		
Capitalization:		
Long-Term Debt	1,439,746	1,400,993
Preferred and Preference Stock of Subsidiaries:		
Non-redeemable preferred stock	213,608	63,608
Non-redeemable preference stock	28,997	29,615
Total preferred and preference stock before deferred employee stock ownership plan (ESOP) benefit	242,605	93,223
Deferred ESOP benefit	(19,533)	(22,257)
Total Preferred and Preference Stock of Subsidiaries	223,072	70,966
Common Shareholders' Equity:		
Common stock – no par value (authorized – 187,500,000 shares; issued – 109,679,154 shares)	990,502	997,461
Retained earnings	777,607	698,986
Treasury stock (at cost) (32,406,135 and 32,123,601 shares)	(376,250)	(367,710)
Total Common Shareholders' Equity	1,391,859	1,328,737
Total Capitalization	3,054,677	2,800,696
Total Liabilities and Capitalization	\$4,638,992	\$4,458,843

See notes to consolidated financial statements.

STATEMENT OF CONSOLIDATED CASH FLOWS

		(Thousands of Dollars)			
		Year Ended December 31,			
		1996	1995	1994	
Cash Flows from Operating Activities	Net income	\$179,138	\$170,563	\$156,816	
	Principal non-cash charges (credits) to net income:				
	Depreciation and amortization	222,928	202,558	165,912	
	Capital lease, nuclear fuel and investment amortization	53,166	38,847	36,320	
	Deferred income taxes and investment tax credits - net	(60,719)	(22,120)	(11,342)	
	Phase-in revenues and carrying charges recovered	—	—	28,621	
	Investment income	(16,125)	(3,475)	(4,277)	
	Changes in working capital other than cash	(1,033)	46,527	(31,891)	
	Other - net	282	21,151	29,418	
	Net Cash Provided from Operating Activities	377,637	454,051	369,627	
Cash Flows from Investing Activities	Sale of generating station	169,100	—	—	
	Capital expenditures	(101,150)	(94,164)	(121,085)	
	Long-term investments	(71,419)	(187,719)	(66,698)	
	Proceeds from disposition of investments	17,661	—	—	
	Payment for purchase of GSF Energy, net of cash acquired	(24,234)	—	—	
	Other - net	(1,898)	(3,854)	(12,321)	
		Net Cash Used in Investing Activities	(11,940)	(285,737)	(200,104)
Cash Flows from Financing Activities	Issuance of long-term debt	85,000	65,000	114,110	
	Issuance of preferred stock	150,000	—	—	
	(Decrease) increase in notes payable	(28,637)	(20,236)	32,530	
	Dividends on common stock	(100,517)	(93,649)	(89,348)	
	Repurchase of common stock	(11,717)	(21,271)	(23,307)	
	Reductions of long-term obligations:				
	Preferred and preference stock	—	(29,732)	(39,958)	
	Long-term debt	(50,812)	(56,114)	(114,835)	
	Capital leases	(19,326)	(26,373)	(33,522)	
	Other - net	(3,477)	(11,230)	2,631	
		Net Cash Provided from (Used in) Financing Activities	20,514	(193,605)	(151,699)
		Net increase (decrease) in cash and temporary cash investments	386,211	(25,291)	17,824
		Cash and temporary cash investments at beginning of year	24,767	50,058	32,234
	Cash and temporary cash investments at end of year	\$410,978	\$ 24,767	\$ 50,058	
SUPPLEMENTAL CASH FLOW INFORMATION					
Cash Paid During the Year	Interest (net of amount capitalized)	\$ 95,702	\$ 99,954	\$105,900	
	Income taxes	\$ 91,641	\$ 82,884	\$ 84,753	
Non-Cash Investing and Financing Activities	Capital lease obligations recorded	\$ 13,050	\$ 14,961	\$ 16,909	
	Equity funding obligations recorded	\$ 36,716	\$ 21,827	\$ —	
	Preferred stock issued in conjunction with long-term investments	\$ —	\$ 3,000	\$ —	

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A. Summary of Significant Accounting Policies

Consolidation

DQE is an energy services holding company. Its subsidiaries are Duquesne Light Company (Duquesne), Duquesne Enterprises (DE), DQE Energy Services (DES), DQEnergy Partners and Montauk. DQE and its subsidiaries are collectively referred to as "the Company."

Duquesne is an electric utility engaged in the production, transmission, distribution and sale of electric energy and is the largest of DQE's subsidiaries. DE makes strategic investments beneficial to DQE's core energy business. These investments enhance DQE's capabilities as an energy provider, increase asset utilization, and act as a hedge against changing business conditions. DES is a diversified energy services company offering a wide range of energy solutions for industrial, utility and consumer markets worldwide. DES initiatives include energy facility development and operation, domestic and international independent power production, and the production and supply of innovative fuels. DQEnergy Partners was formed in December 1996 to align DQE with strategic partners to capitalize on opportunities in the dynamic energy services industry. These alliances enhance the utilization and value of DQE's strategic investments and capabilities while establishing DQE as a total energy provider. Montauk is a financial services company that makes long-term investments and provides financing for the Company's other market-driven businesses and their customers.

All material intercompany balances and transactions have been eliminated in the preparation of the consolidated financial statements.

Basis of Accounting

The Company is subject to the accounting and reporting requirements of the United States Securities and Exchange Commission (SEC). In addition, the Company's electric utility operations are subject to regulation by the Pennsylvania Public Utility Commission (PUC) and the Federal Energy Regulatory Commission (FERC) under the *Federal Power Act* with respect to rates for interstate sales, transmission of electric power, accounting and other matters.

The Company's consolidated financial statements report regulatory assets and liabilities in accordance with *Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation (SFAS No. 71)*, and reflect the effects of the current ratemaking process. In accordance with *SFAS No. 71*, the Company's consolidated financial statements reflect regulatory assets and liabilities consistent with cost-based, pre-competition ratemaking regulations. (See "Rate Matters," Note F, on page 51.)

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

Revenues from Sales of Electricity

Meters are read monthly and electric utility customers are billed on the same basis. Revenues are recorded in the accounting periods for which they are billed, with the exception of energy cost recovery revenues. (See "Energy Cost Rate Adjustment Clause (ECR)" discussion below.)

The Company's Electric Service Territory

The Company's utility operations provide electric service to customers in Allegheny County, including the City of Pittsburgh, Beaver County and Westmoreland County. This represents approximately 800 square miles in southwestern Pennsylvania, located within a 500-mile radius of one-half of the population of the United States and Canada. The population of the area served by the Company's electric utility operations, based on 1990 census data, is approximately 1,510,000, of whom 370,000 reside in the City of Pittsburgh. In addition to serving approximately 580,000 direct customers, the Company's utility operations also sell electricity to other utilities.

Energy Cost Rate Adjustment Clause (ECR)

Through the ECR, the Company recovers (to the extent that such amounts are not included in base rates) nuclear fuel, fossil fuel and purchased power expenses and, also through the ECR, passes to its customers the profits from short-term power sales to other utilities (collectively, ECR energy costs). Nuclear fuel expense is recorded on the basis of the quantity of electric energy generated and includes such costs as the fee imposed by the United States Department of Energy (DOE) for future disposal and ultimate storage and disposition of spent nuclear fuel. Fossil fuel expense includes the costs of coal, natural gas and fuel oil used in the generation of electricity.

On the Company's statement of consolidated income, these ECR revenues are included as a component of *operating revenues*. For ECR purposes, the Company defers fuel and other energy expenses for recovery, or refunding, in subsequent years. The deferrals reflect the difference between the amount that the Company is currently collecting from customers and its actual ECR energy costs. The PUC annually reviews the Company's ECR energy costs for the fiscal year April through March, compares them to previously projected ECR energy costs, and adjusts the ECR for over- or under-recoveries and for two PUC-established coal cost standards. (See "Deferred Coal Costs" and "Warwick Mine Costs" discussions, Note F, on pages 52 and 53.)

Over- or under-recoveries from customers are recorded in the consolidated balance sheet as payable to, or receivable from, customers. At December 31, 1996 and 1995, \$1.8 million and \$5.8 million were payable to customers and shown as *other current liabilities*.

Under the *Electricity Generation Customer Choice and Competition Act* (Customer Choice Act), the Company may replace the ECR effective April 1, 1997 by rolling its ECR energy costs into its base rates. The effect of this change would be to provide to the Company an opportunity to further mitigate its deferred energy costs based upon its ability to manage its energy costs. Under the Company's PUC-approved Mitigation Plan, the level of energy cost recovery is capped at 1.47 cents per kilowatt-hour (KWH) through May 2001. To the extent that projections do not support recovery of previously deferred costs through this pricing mechanism, these costs would become transition costs subject to recovery through a competitive transition charge (CTC). (See "Customer Choice Act" and "Mitigation Plan" discussions, Note F, on page 51.)

Maintenance

Incremental *maintenance* expense incurred for refueling outages at the Company's nuclear units is deferred for amortization over the period between refueling outages (generally 18 months). The Company accrues, over the periods between outages, anticipated expenses for scheduled major fossil generating station outages. Maintenance costs incurred for non-major scheduled outages and for forced outages are charged to expense as such costs are incurred.

Depreciation and Amortization

Depreciation of *property, plant and equipment*, including plant-related intangibles, is recorded on a straight-line basis over the estimated remaining useful lives of properties. Amortization of other intangibles is recorded on a straight-line basis over a five-year period. Depreciation and amortization of other properties are calculated on various bases.

The Company records decommissioning costs under the category of *depreciation and amortization* expense and accrues a liability, equal to that amount, for nuclear decommissioning expense. On the Company's consolidated balance sheet, the decommissioning trusts have been reflected in *other long-term investments*, and the related liability has been recorded as *other non-current liabilities*. (See "Nuclear Decommissioning" discussion, Note J, on page 56.)

The Company's electric utility operations' composite depreciation rate increased from 3.5 percent to 4.25 percent effective May 1, 1996 and 3.0 percent to 3.5 percent effective January 1, 1995. Also in 1996, the Company expensed \$9 million related to the depreciation portion of deferred rate synchronization costs in conjunction with the Company's Mitigation Plan.

Income Taxes

The Company uses the *liability method* in computing deferred taxes on all differences between book and tax bases of assets. These book/tax differences occur when events and transactions recognized for financial reporting purposes are not recognized in the same period for tax purposes. The deferred tax liability or asset is also adjusted in the period of enactment for the effect of changes in tax laws or rates.

For its electric utility operations, the Company recognizes a *regulatory asset* for the deferred tax liabilities that are expected to be recovered from customers through rates. (See "Rate Matters," Note F, and "Income Taxes," Note H, on pages 51 and 54.)

The Company reflects the amortization of the regulatory tax receivable resulting from reversals of deferred taxes as *depreciation and amortization* expense. Reversals of accumulated *deferred income taxes* are included in *income tax* expense.

When applied to reduce the Company's income tax liability, investment tax credits related to electric utility property generally are deferred. Such credits are subsequently reflected, over the lives of the related assets, as *reductions to income tax* expense.

Property, Plant and Equipment

The asset values of the Company's electric utility properties are stated at original construction cost, which includes related payroll taxes, pensions and other fringe benefits, as well as administrative and general costs. Also included in original construction cost is an allowance for funds used during construction (AFC), which represents the estimated cost of debt and equity funds used to finance construction.

Additions to, and replacements of, property units are charged to plant accounts. Maintenance, repairs and replacement of minor items of property are recorded as expenses when they are incurred. The costs of electric utility properties that are retired (plus removal costs and less any salvage value) are charged to *accumulated depreciation and amortization*.

Substantially all of the Company's electric utility properties are subject to a first mortgage lien.

Asset Impairment

The effects of adopting *Statement of Financial Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of (SFAS No. 121)*, on January 1, 1996 did not have a material impact on the Company's financial position, results of operations or cash flows, based on the current regulatory structure in which it operates. As competitive factors influence pricing in the utility industry, this assessment may change in the future. The general requirements of *SFAS No. 121* apply to non-current assets and require impairment to be considered whenever evidence suggests that it is no longer probable that future cash flows in an amount at least equal to the asset book value will result.

Stock-Based Compensation

Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS No. 123) encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in *Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees*, and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock. Compensation cost for stock appreciation rights is recorded annually based on the quoted market price of the Company's stock at the end of the period.

Temporary Cash Investments

Temporary cash investments are short-term, highly liquid investments with original maturities of three or fewer months. They are stated at market, which approximates cost. The Company considers temporary cash investments to be cash equivalents.

Reclassifications

The 1995 and 1994 consolidated financial statements have been reclassified to conform with accounting presentations adopted during 1996.

B. Receivables

The Company and an unaffiliated corporation have an agreement that entitles the Company to sell, and the corporation to purchase, on an ongoing basis, up to \$50 million of accounts receivable. The Company had no receivables sold at December 31, 1996. At December 31, 1995, the Company had sold \$7 million of receivables to the unaffiliated corporation. The accounts receivable sales agreement, which expires in June 1997, is one of many sources of funds available to the Company. The Company has not determined, but may attempt to extend the agreement or to replace the facility with a similar arrangement or to eliminate it upon expiration.

C. Changes in Working Capital Other than Cash

Changes in Working Capital Other than Cash (Net of GSF Energy Acquisition)

	1996	1995	1994
	<i>(Amounts in Thousands of Dollars)</i>		
Receivables	\$ (1,946)	\$ 34,341	\$ 9,928
Materials and supplies	1,286	9,994	2,932
Other current assets	(948)	3,126	(25,701)
Accounts payable	4,691	7,087	(4,455)
Other current liabilities	(4,116)	(8,021)	(14,595)
Total	\$ (1,033)	\$ 46,527	\$(31,891)

D. Property, Plant and Equipment

In addition to its wholly owned generating units, the Company, together with other electric utilities, has an ownership or leasehold interest in certain jointly owned units. The Company is required to pay its share of the construction and operating costs of the units. The Company's share of the operating expenses of the units is included in the statement of consolidated income.

Generating Units at December 31, 1996

Unit	Generating Capability (Megawatts)	Net Utility Plant (Millions of Dollars)	Fuel Source
Cheswick	570	\$ 120.2	Coal
Elrama (a)	487	98.0	Coal
Eastlake Unit 5	186	39.4	Coal
Sammus Unit 7	187	49.5	Coal
Bruce Mansfield Unit 1 (a)	228	65.5	Coal
Bruce Mansfield Unit 2 (a)	62	18.9	Coal
Bruce Mansfield Unit 3 (a)	110	49.8	Coal
Beaver Valley Unit 1 (b)	385	215.9	Nuclear
Beaver Valley Unit 2 (c)(d)	113	14.3	Nuclear
Beaver Valley Common Facilities		153.2	
Perry Unit 1 (e)	164	398.5	Nuclear
Brunot Island (f)	178	23.1	Fuel Oil
Total	2,670	1,246.3	
Property held for future use:			
Brunot Island (f)	128	28.5	Fuel Oil
Phillips (a)	300	78.3	Coal
Total Generating Units	3,098	\$1,353.1	

- (a) The unit is equipped with flue gas desulfurization equipment.
- (b) The Nuclear Regulatory Commission (NRC) has granted a license to operate through January 2016.
- (c) On October 2, 1987, the Company sold its 13.74 percent interest in Beaver Valley Unit 2 and leased it back; the sale was exclusive of transmission and common facilities. Amounts shown represent facilities not sold and subsequent leasehold improvements.
- (d) The NRC has granted a license to operate through May 2027.
- (e) The NRC has granted a license to operate through March 2026.
- (f) A portion of the proceeds of the sale of the Ft. Martin Power Station is expected to be used to fund reliability enhancements to the Brunot Island (BI) Unit 3 combustion turbine. The reliability enhancements are contingent upon the projects meeting a least-cost test versus other potential sources of peaking capacity. BI Units 2a and 2b were moved from *property held for future use to electric plant in service* in 1996, in accordance with the Company's Mitigation Plan. (See "Mitigation Plan" discussion, Note F, on page 51.)

E. Long-Term Investments

The Company makes equity investments in affordable housing and gas reserve partnerships as a limited partner. At December 31, 1996, the Company had investments in 26 affordable housing funds and five gas reserve partnerships. The Company is the lessor in six leveraged lease arrangements involving mining equipment, rail equipment, a fossil generating station, a waste-to-energy facility and natural gas processing equipment. These leases expire in various years beginning in 2004 through 2033. The residual value of the equipment at the end of the lease terms is approximately 3 percent of the original cost. The Company's aggregate investment represents 16 percent of the aggregate original cost of the property and is secured by guarantees of each lessee's parent or affiliate. The remaining 84 percent was financed by non-recourse debt provided by lenders who have been granted, as their sole remedy in the event of default by the lessees, an assignment of rentals due under the leases and a security interest in the leased property. This debt amounted to \$553 million and \$364 million at December 31, 1996 and 1995.

Net Leveraged Lease Investments at December 31

	1996	1995
	<i>(Amounts in Thousands of Dollars)</i>	
Rentals receivable (net of non-recourse debt)	\$215,358	\$113,641
Estimated residual value of leased assets	22,029	26,470
Less: Unearned income	(103,254)	(52,277)
Leveraged lease investments	134,133	87,834
Less: Deferred taxes arising from leveraged leases	(59,781)	(42,392)
Net Leveraged Lease Investments	\$ 74,352	\$ 45,442

The Company's *other leases* include investments in fossil generating stations, a waste-to-energy facility, computers, vehicles and equipment. The Company's *other* investments are primarily in assets of nuclear decommissioning trusts and marketable securities, primarily of Exide Electronics Group, Inc. In accordance with *Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS No. 115)*, these investments are classified as available-for-sale and are stated at market value. The amount of unrealized holding losses related to marketable securities at both December 31, 1996 and 1995 was \$4.4 million (\$2.6 million net of tax). *Deferred income* primarily relates to the Company's *other* lease investments. Deferred amounts will be recognized as income over the lives of the underlying investments over periods generally not exceeding five years.

F. Rate Matters

Customer Choice Act

Under the Customer Choice Act, which went into effect on January 1, 1997, Pennsylvania has become a leader in customer choice. The Customer Choice Act will enable Pennsylvania's electric utility customers to purchase electricity at market prices from a variety of electric generation suppliers (customer choice). Electric utility restructuring will be accomplished through a two-stage process consisting of a pilot period (running through 1998) and a phase-in period (1999 through 2001). Before the phase-in to customer choice begins in 1999, the PUC expects utilities to take vigorous steps to mitigate transition costs as much as possible without increasing the price they currently charge customers. The PUC will determine what portion of a utility's remaining transition costs will be recoverable from customers through a CTC. This charge will be paid by consumers who choose alternative generation suppliers as well as customers who choose their franchised utility. The CTC could last as long as 2005, providing a utility a total of up to nine years to recover transition costs. An overall four-and-one-half year price cap will be imposed on the transmission and distribution charges of existing electric utility companies. Additionally, existing electric utility companies may not increase the generation price component of prices as long as transition costs are being recovered, with certain exceptions. If a utility ultimately is unable to recover its transition costs within this pricing structure and timeframe, the costs will be written off.

Mitigation Plan

The Company has taken a number of steps to mitigate its potential transition costs. In addition to the steps taken during the last 10 years to prepare for competition, effective January 1, 1995, the Company accelerated its rate of depreciation on its fixed nuclear assets without seeking a rate increase to recover the additional costs. On October 31, 1996, the sale of the Company's ownership interest in the Ft. Martin Power Station (Ft. Martin) was completed. Ft. Martin Unit 1 was owned 50 percent by Duquesne and 50 percent by its operator, Allegheny Power System. The sale and a plan, to be funded in part by the proceeds of the Ft. Martin transaction, were approved by the PUC on May 23, 1996. Under the approved plan, the Company will not increase its base rates for a period of five years through May 2001. In addition, the Company recorded in October 1996 a one-time reduction of approximately \$130 million in the book value of the Company's nuclear plant investment. The proceeds from the sale are expected to be used to fund reliability enhancements to the BI Unit 3 combustion turbine and to reduce the Company's capitalization. The approved plan also provides for incremental increases of \$25 million in *depreciation and amortization* expense in 1996, 1997 and 1998 related to the Company's nuclear investment, as well as additional annual contributions to its nuclear plant decommissioning funds of \$5 million, without any increase in existing electric rates. Also, the Company will record an annual \$5 million credit to the ECR during the plan period to compensate the Company's electric utility customers for lost profits from any short-term power sales foregone by the sale of its ownership interest in Ft. Martin. In addition, the Company will cap energy costs, beginning April 1, 1997 through the remainder of the plan period, at a historical five-year average of 1.47 cents per KWH. In accordance with the approved plan, the Company has expensed \$9 million related to the depreciation portion of the deferred rate synchronization costs associated with Beaver Valley Unit 2 (BV Unit 2) and Perry Unit 1. The Company's approved plan provides for the amortization of the remaining deferred rate synchronization costs over a 10-year period. At December 31, 1996, the unamortized portion of these costs totaled \$41.4 million, net of deferred fuel savings related to the two units. (See "Deferred Rate Synchronization Costs" discussion on page 52.) Finally, the Company's approved plan also provides for annual assistance of \$0.5 million to low-income customers.

Regulatory Assets

As a result of the application of *SFAS No. 71*, the Company records *regulatory assets* on its consolidated balance sheet. The *regulatory assets* represent probable future revenue to the Company because provisions for these costs are currently included, or are expected to be included, in charges to electric utility customers through the ratemaking process.

A company's electric utility operations or a portion of such operations could cease to meet the *SFAS No. 71* criteria for various reasons, including a change in the FERC regulations or the competition-related changes in the PUC regulations. (See "Customer Choice Act" discussion on page 51.) The Company currently believes its electricity generating assets and related regulatory assets continue to satisfy these criteria in light of the transition to competitive generation under the Customer Choice Act. Should any portion of the Company's electric utility operations be deemed to no longer meet the *SFAS No. 71* criteria, the Company may be required to write off any above-market cost assets, the recovery of which is uncertain, and any regulatory assets or liabilities for those operations that no longer meet these requirements.

Regulatory Assets at December 31

	1996	1995
	<i>(Amounts in Thousands of Dollars)</i>	
Regulatory tax receivable (Note H)	\$394,131	\$414,543
Unamortized debt costs (Note K)(a)	93,299	98,776
Deferred rate synchronization costs (see below)	41,446	51,149
Beaver Valley Unit 2 sale/leaseback premium (Note I)(b)	30,059	31,564
Deferred employee costs (c)	29,589	31,218
Deferred nuclear maintenance outage costs (Note A)	13,462	6,776
Deferred coal costs (see below)	12,191	12,753
DOE decontamination and decommissioning receivable (Note J)	9,779	10,687
Extraordinary property loss (d)	—	8,300
Other	12,860	12,934
Total Regulatory Assets	\$636,816	\$678,700

- (a) The premiums paid to reacquire debt prior to scheduled maturity dates are deferred for amortization over the life of the debt issued to finance the reacquisitions.
- (b) The premium paid to refinance the BV Unit 2 lease was deferred for amortization over the life of the lease.
- (c) Includes amounts for recovery of accrued compensated absences and accrued claims for workers' compensation.
- (d) During the third quarter of 1996, the Company completed recovery of its investment in Perry Unit 2.

Deferred Rate Synchronization Costs

In 1987, the PUC approved the Company's petition to defer initial operating and other costs of BV Unit 2 and Perry Unit 1. The Company deferred the costs incurred from November 1987, when the units went into commercial operation, until March 1988, when a rate order was issued. In its rate order, the PUC postponed ruling on whether these costs would be recoverable from the Company's electric utility customers. The Company is not earning a return on the deferred costs. (See "Mitigation Plan" discussion on page 51.)

Deferred Coal Costs

The PUC has established two market price coal cost standards for the Company. One applies only to coal delivered at the Bruce Mansfield Power Station (Bruce Mansfield). The other, the system-wide coal cost standard, applies to coal delivered to the remainder of the Company's system. Both standards are updated monthly to reflect prevailing market prices of similar coal. The PUC has directed the Company to defer recovery of the delivered cost of coal to the extent that such cost exceeds generally prevailing market prices for similar coal, as determined by the PUC. The PUC allows deferred amounts to be recovered from customers when the delivered costs of coal fall below such PUC-determined prevailing market prices.

In 1990, the PUC approved a joint petition for settlement that clarified certain aspects of the system-wide coal cost standard. The Company has exercised options to extend the coal cost standard through March 2000. The unrecovered cost of Bruce Mansfield coal was \$9.6 million and \$8.4 million, and the unrecovered cost of the remainder of the system-wide coal was \$2.6 million and

\$4.4 million at December 31, 1996 and 1995. The Company believes that all deferred coal costs will be recovered.

Warwick Mine Costs

The 1990 joint petition for settlement also recognized costs at the Company's Warwick Mine, which had been excluded from rate base since 1981, and allowed for recovery of such costs, including the costs of ultimately closing the mine. (See "Deferred Coal Costs" discussion on page 52.) In 1990, the Company entered into an agreement under which an unaffiliated company will operate the mine until March 2000 and sell the coal produced. Production began in late 1990. The contract operator at Warwick Mine encountered adverse geologic conditions late in 1996 that resulted in a significant change to the mining plan. Commencing in 1997, the operator will be producing approximately 15 percent of the amount previously mined, or 360,000 tons of coal per year, for exclusive use at the Elrama Power Station (Elrama). The Company will purchase the remaining coal on the open market. In the past year, the Warwick Mine supplied slightly less than one-fifth of the coal used in the production of electricity at the Company's wholly owned and jointly owned plants. This change should not impact the Company's ability to recover all of its investment in Warwick Mine, the \$2.6 million of unrecovered system-wide cost of coal which excludes Bruce Mansfield, or to accrue funds for future liabilities. It is anticipated that this effort will be successfully completed by March 31, 2000 when the system-wide coal cost cap expires.

Costs at the Warwick Mine and the Company's investment in the mine are expected to be recovered through the cost of coal in the ECR. Recovery is subject to the system-wide coal cost standard and the cap agreed to as part of the Company's Mitigation Plan. The Company also has an opportunity to earn a return on its investment in the mine through the cost of coal during the period of the system-wide coal cost standard, including extensions. At December 31, 1996, the Company's net investment in the mine was \$11.4 million. The current estimated liability for mine closing, including final site reclamation, mine water treatment and certain labor liabilities, is \$34.1 million, and the Company has recorded a liability on the consolidated balance sheet of approximately \$20.2 million toward these costs.

Property Held for Future Use

In 1986, the PUC approved the Company's request to remove Phillips Power Station (Phillips) and a portion of Brunot Island (BI) from service and from rate base. In accordance with the Company's Mitigation Plan, 112 MWs related to BI Units 2a and 2b were moved from *property held for future use* to *electric plant in service* in 1996. The Company expects to recover its investment in BI Units 3 and 4, which remain in *property held for future use* through future electricity sales. The Company believes its investment in BI will be necessary in order to meet future business needs. A portion of the proceeds of the sale of Ft. Martin is expected to be used to fund reliability enhancements to the BI Unit 3 combustion turbine. The reliability enhancements are contingent upon the projects meeting a least-cost test versus other potential sources of peaking capacity. (See "Mitigation Plan" discussion on page 51.) The Company is analyzing the effects of customer choice on its future generating requirements. The Company is planning to seek recovery of its investment and associated costs of Phillips through a CTC. In the event that market demand, transmission access or rate recovery do not support the utilization of these plants, the Company may have to write off part or all of these investments and associated costs. At December 31, 1996, the Company's net of tax investment in Phillips and BI held for future use was \$53.6 million and \$17.2 million.

G. Short-Term Borrowing and Revolving Credit Arrangements

At December 31, 1996, the Company had two extendible revolving credit arrangements, including a \$125 million facility expiring in June 1997 and a \$150 million facility expiring in October 1997. Interest rates can, in accordance with the option selected at the time of the borrowing, be based on prime, Eurodollar or certificate of deposit rates. Commitment fees are based on the unborrowed amount of the commitments. Both credit facilities contain two-year repayment periods for any amounts outstanding at the expiration of the revolving credit periods. At December 31, 1996, there were no short-term borrowings outstanding. At December 31, 1995, short-term borrowings were \$35 million. The weighted average interest rate applied to such borrowings was 6.5 percent.

H. Income Taxes

The annual federal corporate income tax returns have been audited by the Internal Revenue Service (IRS) for the tax years through 1992. The tax years 1993 through 1995 remain subject to IRS review. The Company does not believe that final settlement of the federal income tax returns for the years 1991 through 1995 will have a materially adverse effect on its financial position, results of operations or cash flows.

Deferred Tax Assets (Liabilities) at December 31

	1996	1995
	<i>(Amounts in Thousands of Dollars)</i>	
Investment tax credits unamortized	\$ 44,067	\$ 48,033
Gain on sale/leaseback of BV Unit 2	61,131	64,124
Tax benefit - long-term investments	174,935	214,000
Other	19,952	41,509
Deferred tax assets	300,085	367,755
Property depreciation	(785,950)	(871,539)
Regulatory assets	(150,346)	(172,008)
Loss on reacquired debt unamortized	(33,331)	(35,340)
Other	(89,547)	(90,499)
Deferred tax liabilities	(1,059,174)	(1,169,386)
Net Deferred Tax Liabilities	\$ (759,089)	\$ (801,631)

Income Taxes

		1996	1995	1994
		<i>(Amounts in Thousands of Dollars)</i>		
Currently payable:	Federal	\$103,525	\$ 88,866	\$ 70,908
	State	44,582	29,915	33,407
Deferred - net:	Federal	(36,286)	(8,649)	(13,198)
	State	(14,874)	(5,640)	(72,662)
Investment tax credits deferred - net		(9,559)	(7,831)	(5,982)
Tax rate adjustment - regulatory tax receivable (a)		—	—	80,500
Income Taxes		\$ 87,388	\$ 96,661	\$ 92,973

(a) During 1994, the statutory Pennsylvania income tax rate was reduced from 12.25 percent to 9.99 percent. This resulted in a net decrease of \$80.5 million in deferred tax liabilities and a corresponding reduction in the regulatory receivable.

Total *income taxes* differ from the amount computed by applying the statutory federal income tax rate to *income before income taxes* and before preferred and preference dividends of subsidiaries.

Income Tax Expense Reconciliation

	1996	1995	1994
	<i>(Amounts in Thousands of Dollars)</i>		
Computed federal income tax at statutory rate	\$ 94,752	\$ 95,591	\$ 89,524
Increase (decrease) in taxes resulting from:			
State income taxes, net of federal income tax benefits	19,310	15,779	(25,516)
Amortization of deferred investment tax credits	(9,559)	(7,831)	(5,982)
Adjustment to regulatory receivable, net of federal tax	—	—	52,325
Revenue requirement adjustment to regulatory taxes	—	—	(12,178)
Other	(17,115)	(6,878)	(5,200)
Total Income Tax Expense	\$ 87,388	\$ 96,661	\$ 92,973

I. Leases

The Company leases nuclear fuel, a portion of a nuclear generating plant, certain office buildings, computer equipment, and other property and equipment.

Capital Leases at December 31

	1996	1995
	<i>(Amounts in Thousands of Dollars)</i>	
Nuclear fuel	\$ 79,103	\$112,573
Electric plant	20,505	20,808
Total	99,608	133,381
Less: Accumulated amortization	(47,670)	(74,874)
Property Held Under Capital Leases - Net (a)	\$ 51,938	\$ 58,507

(a) Includes \$2,618 in 1996 and \$2,910 in 1995 of capital leases with associated obligations retired.

In 1987, the Company sold and leased back its 13.74 percent interest in BV Unit 2; the sale was exclusive of transmission and common facilities. The total sales price of \$537.9 million was the appraised value of the Company's interest in the property. The Company subsequently leased back its interest in the unit for a term of 29.5 years. The lease provides for semi-annual payments and is accounted for as an operating lease. The Company is responsible under the terms of the lease for all costs of its interest in the unit. In December 1992, the Company participated in the refinancing of collateralized lease bonds to take advantage of lower interest rates and reduce the annual lease payments. The bonds were originally issued in 1987 for the purpose of partially financing the lease of BV Unit 2. In accordance with the BV Unit 2 lease agreement, the Company paid the premiums of approximately \$36.4 million as a supplemental rent payment to the lessors. This amount was deferred and is being amortized over the remaining lease term. At December 31, 1996, the deferred balance was approximately \$30.1 million.

Leased nuclear fuel is amortized as the fuel is burned and charged to *fuel and purchased power* expense on the statement of consolidated income. The amortization of all other leased property is based on rental payments made. These lease-related expenses are charged to *operating expenses* on the statement of consolidated income.

Summary of Rental Payments

	1996	1995	1994
	<i>(Amounts in Thousands of Dollars)</i>		
Operating leases	\$59,503	\$57,617	\$56,437
Amortization of capital leases	19,378	26,705	33,596
Interest on capital leases	3,703	4,332	4,996
Total Rental Payments	\$82,584	\$88,654	\$95,029

Future Minimum Lease Payments

	Operating Leases	Capital Leases
	<i>(Amounts in Thousands of Dollars)</i>	
Year Ended December 31,		
1997	\$ 58,000	\$ 24,186
1998	57,799	11,380
1999	57,757	6,516
2000	57,682	4,166
2001	56,925	2,481
2002 and thereafter	846,851	18,555
Total Minimum Lease Payments	\$1,135,014	\$ 67,284
Less: Amount representing interest		(17,964)
Present value of minimum lease payments for capital leases (a)		\$ 49,320

(a) Includes current obligations of \$20.9 million at December 31, 1996.

Future minimum lease payments for capital leases are related principally to the estimated use of nuclear fuel financed through leasing arrangements and building leases. Future minimum lease payments for operating leases are related principally to BV Unit 2 and certain corporate offices.

Future payments due to the Company, as of December 31, 1996, under subleases of certain corporate office space are approximately \$4.5 million in 1997, \$4.6 million in 1998 and \$18.5 million thereafter.

J. Commitments and Contingencies

Construction

The Company estimates that it will spend, excluding AFC and nuclear fuel, approximately \$110 million, \$110 million and \$95 million for electric utility construction during 1997, 1998 and 1999. These estimates also exclude any potential expenditures for reliability enhancements to the BI Unit 3 combustion turbine. (See "Mitigation Plan" discussion, Note F, on page 51.)

Nuclear-Related Matters

The Company has an ownership interest in three nuclear units, two of which it operates. The operation of a nuclear facility involves special risks, potential liabilities, and specific regulatory and safety requirements. Specific information about risk management and potential liabilities is discussed below.

Nuclear Decommissioning. The PUC ruled that recovery of the decommissioning costs for Beaver Valley Unit 1 (BV Unit 1) could begin in 1977, and that recovery for BV Unit 2 and Perry Unit 1 could begin in 1988. The Company expects to decommission BV Unit 1, BV Unit 2 and Perry Unit 1 no earlier than the expiration of each plant's operating license in 2016, 2027 and 2026. At the end of its operating life, BV Unit 1 may be placed in safe storage until BV Unit 2 is ready to be decommissioned, at which time the units may be decommissioned together.

Based on site-specific studies finalized in 1992 for BV Unit 2, and in 1994 for BV Unit 1 and Perry Unit 1, the Company's share of the total estimated decommissioning costs, including removal and decontamination costs, currently being used to determine the Company's cost of service, is \$122 million for BV Unit 1, \$35 million for BV Unit 2, and \$67 million for Perry Unit 1. A study will be performed in 1997 to update the Company's estimated decommissioning costs of BV Unit 1 and BV Unit 2.

On July 18, 1996, the PUC issued a *Proposed Policy Statement Regarding Nuclear Decommissioning Cost Estimation and Cost Recovery* for the purpose of obtaining comments from the public. The proposed policy includes guidelines for a site-specific study to estimate the cost of decommissioning. Guidelines require that studies be performed at least every five years, address radiological and non-radiological costs, and include a contingency factor of not more than 10 percent. Under the proposed policy, annual decommissioning funding levels are based on an annuity calculation recognizing inflation in the cost estimates and earnings on fund assets. With respect to the transition to a competitive generation market, the Customer Choice Act requires that utilities include a plan to mitigate any shortfall in decommissioning trust fund payments for the life of the facility with any future decommissioning filings. Consistent with this requirement, the Company has increased its nuclear decommissioning funding by \$5 million under the PUC-approved plan for the sale of the Company's ownership interest in Ft. Martin. (See "Mitigation Plan" discussion, Note F, on page 51.) These additional annual contributions bring the total annual funding to approximately \$9 million. Also, on October 17, 1996, the PUC adopted an Accounting Order filed by the Company to recognize the increased funding as part of the Company's cost of service. The Company expects to receive approval from the IRS for qualification of 100 percent of additional nuclear decommissioning trust funding for BV Unit 2 and Perry Unit 1, and 79 percent for BV Unit 1.

Funding for nuclear decommissioning costs is deposited in external, segregated trust accounts and may be invested in a portfolio of corporate common stock and debt securities, municipal bonds, certificates of deposit and United States government securities. Trust fund earnings increase the fund balance and the recorded liability. The market value of the aggregate trust fund balances at December 31, 1996 totaled approximately \$33.7 million.

Nuclear Insurance. The *Price-Anderson Amendments* to the *Atomic Energy Act of 1954* limit public liability from a single incident at a nuclear plant to \$8.9 billion. The maximum available private primary insurance of \$200 million has been purchased by the Company. Additional protection of \$8.7 billion would be provided by an assessment of up to \$79.3 million per incident on each nuclear unit in the United States. The Company's maximum total possible assessment, \$59.4 million, which is based on its ownership or leasehold interests in three nuclear generating units, would be limited to a maximum of \$7.5 million per incident per year. This assessment is subject to indexing for inflation and may be subject to state premium taxes. If funds prove insufficient to pay claims, the United States Congress could impose other revenue-raising measures on the nuclear industry.

The Company's share of insurance coverage for property damage, decommissioning and decontamination liability is \$1.2 billion. The Company would be responsible for its share of any damages in excess of insurance coverage. In addition, if the property damage reserves of Nuclear Electric Insurance Limited (NEIL), an industry mutual insurance company that provides a portion of this coverage, are inadequate to cover claims arising from an incident at any United States nuclear site covered by that insurer, the Company could be assessed retrospective premiums totaling a maximum of \$7.3 million.

In addition, the Company participates in a NEIL program that provides insurance for the increased cost of generation and/or purchased power resulting from an accidental outage of a nuclear unit. Subject to the policy limit, the coverage provides for 100 percent of the estimated incremental costs per week during the 52-week period starting 21 weeks after an accident and 80 percent of such estimate per week for the following 104 weeks, with no coverage thereafter. If NEIL's losses for this program ever exceed its reserves, the Company could be assessed retrospective premiums totaling a maximum of \$3.5 million.

Beaver Valley Power Station (BVPS) Steam Generators. BVPS's two units are equipped with steam generators designed and built by Westinghouse Electric Corporation (Westinghouse). Similar to other Westinghouse nuclear plants, outside diameter stress corrosion cracking (ODSCC) has occurred in the steam generator tubes of both units. BV Unit 1, which was placed in service in 1976, has required removal of approximately 15 percent of its steam generator tubes from service through a process called "plugging." However, BV Unit 1 continues to operate at 100 percent reactor power and has the ability to return tubes to service by repairing them through a process called "sleeving." To date, no tubes at either BV Unit 1 or BV Unit 2 have been sleeved. BV Unit 2, which was placed in service 11 years after BV Unit 1, has not yet exhibited the degree of ODSCC experienced at BV Unit 1. Approximately 2 percent of BV Unit 2's tubes are plugged; however, it is too early in the life of the unit to determine the extent to which ODSCC may become a problem.

The Company has undertaken certain measures, such as increased inspections, water chemistry control and tube plugging, to minimize the operational impact of and to reduce susceptibility to ODSCC. Although the Company has taken these steps to allay the effects of ODSCC, the inherent potential for future ODSCC in steam generator tubes of the Westinghouse design still exists. Material acceleration in the rate of ODSCC could lead to a loss of plant efficiency, significant repairs or the possible replacement of the BV Unit 1 steam generators. The total replacement cost of the BV Unit 1 steam generators is currently estimated at \$125 million. The Company would be responsible for \$59 million of this total, which includes the cost of equipment removal and replacement steam generators but excludes replacement power costs. The earliest that the BV Unit 1 steam generators could be replaced during a scheduled refueling outage is the fall of 2000.

BV Unit 1 completed its 11th refueling outage on May 11, 1996. The outage lasted 49 days and was the shortest refueling outage in the history of the unit. During the outage, various inspections of the unit's steam generators were made, including examinations using a new "Plus Point" probe. As a result of these inspections, the Company returned to service tubes that had previously been plugged. Following the refueling outage, 85 percent of the steam generator tubes were in service, approximately 1 percent more than at the beginning of the outage.

BV Unit 2 completed its sixth refueling outage on December 16, 1996. The outage lasted 107 days due to unanticipated repairs to two residual heat removal pumps and reactor head vent valves. Various inspections of the unit's steam generators, including inspections using the Plus Point probe, were completed. Upon completion of the outage, approximately 98 percent of the unit's steam generator tubes remained in service.

The Company continues to explore all viable means of managing ODSCC, including new repair technologies, and plans to continue to perform 100 percent tube inspections during future refueling outages, which occur at, approximately, 18-month intervals for each unit. The Company will continue to monitor and evaluate the condition of the BVPS steam generators.

Spent Nuclear Fuel Disposal. The *Nuclear Waste Policy Act of 1982* established a policy for handling and disposing of spent nuclear fuel and a policy requiring the establishment of a final repository to accept spent nuclear fuel. Electric utility companies have entered into contracts with the DOE for the permanent disposal of spent nuclear fuel and high-level radioactive waste in compliance with this legislation. The DOE has indicated that its repository under these contracts will not be available for acceptance of spent nuclear fuel before 2010. On July 23, 1996, the U.S. Court of Appeals for the District of Columbia Circuit, in response to a suit brought by 25 electric utilities and 18 states and state agencies, unanimously ruled that the DOE has a legal obligation to begin

taking spent nuclear fuel by January 31, 1998. The DOE has not yet established an interim or permanent storage facility, and has indicated that it will be unable to begin acceptance of spent nuclear fuel for disposal by January 31, 1998. Further, Congress is considering amendments to the *Nuclear Waste Policy Act of 1982* that could give the DOE authority to proceed with the development of a federal interim storage facility. In the event the DOE does not begin accepting spent nuclear fuel, existing on-site spent nuclear fuel storage capacities at BV Unit 1, BV Unit 2 and Perry Unit 1 are expected to be sufficient until 2016 (end of operating license), 2013 and 2011.

On January 31, 1997, the Company joined 35 other electric utilities and 46 states, state agencies and regulatory commissions in filing a suit in the U.S. Court of Appeals for the District of Columbia against the DOE. The suit requests the court to suspend the utilities' payments into the Nuclear Waste Fund and to place future payments into an escrow account until the DOE fulfills its obligation to accept spent nuclear fuel. Significant additional expenditures for the storage of spent nuclear fuel at BV Unit 2 and Perry Unit 1 could be required if the DOE does not fulfill its obligation to accept spent nuclear fuel.

Uranium Enrichment Decontamination and Decommissioning. Nuclear reactor licensees in the United States are assessed annually for the decontamination and decommissioning of DOE uranium enrichment facilities. Assessments are based on the amount of uranium a utility had processed for enrichment prior to enactment of the *National Energy Policy Act of 1992* (NEPA) and are to be paid by such utilities over a 15-year period. At December 31, 1996, the Company's liability for contributions was approximately \$9.3 million (subject to an inflation adjustment). Contributions, when made, are currently recovered from electric utility customers through the ECR.

Fossil Decommissioning

In Pennsylvania, current ratemaking does not allow utilities to recover future decommissioning costs through depreciation charges during the operating life of fossil-fired generating stations. In 1996, the Financial Accounting Standard Board issued an exposure draft, *Accounting for Certain Liabilities Related to Closure or Removal of Long-Lived Assets*. The primary effect of this exposure draft would be to change the way the Company accounts for nuclear and fossil decommissioning costs. The exposure draft calls for recording the present value of estimated future cash flows to decommission the Company's nuclear and fossil power plants as an increase to asset balances and as a liability. This amount is currently estimated to be \$299.5 million. The Company will seek to recover these costs through a CTC.

Guarantees

The Company and the other owners of Bruce Mansfield have guaranteed certain debt and lease obligations related to a coal supply contract for Bruce Mansfield. At December 31, 1996 the Company's share of these guarantees was \$20.3 million. The prices paid for the coal by the companies under this contract are expected to be sufficient to meet debt and lease obligations to be satisfied in the year 2000. (See "Deferred Coal Costs" discussion, Note F, on page 52.) The minimum future payments to be made by the Company solely in relation to these obligations are \$5.9 million in 1997, \$5.6 million in 1998, \$5.3 million in 1999, and \$4.2 million in 2000. The Company's total payments for coal purchased under the contract were \$26.9 million in 1996, \$28.9 million in 1995, and \$23.3 million in 1994.

As part of the Company's investment portfolio in affordable housing, the Company has received fees in exchange for guaranteeing a minimum defined yield to third-party investors. A portion of the fees received has been deferred to absorb any required payments with respect to these transactions. Based on an evaluation of the underlying housing projects, the Company believes that such deferrals are ample for this purpose.

Residual Waste Management Regulations

In 1992, the Pennsylvania Department of Environmental Protection (DEP) issued *Residual Waste Management Regulations* governing the generation and management of non-hazardous residual waste, such as coal ash. The Company is assessing the sites it utilizes and has developed compliance strategies that are currently under review by the DEP. Capital costs of \$2.5 million were incurred by the Company in 1996 to comply with these DEP regulations. Based on information currently available, an additional \$2.8 million will be spent in 1997. The additional capital cost of compliance through the year 2000 is estimated, based on current information, to be \$15 million. This estimate is subject to the results of groundwater assessments and DEP final approval of compliance plans.

Employees

In November 1996, the Company reached an agreement on a three-year contract extension through September 30, 2001 with the International Brotherhood of Electrical Workers (IBEW), which represents approximately 2,000 of the Company's employees.

Other

The Company is involved in various other legal proceedings and environmental matters. The Company believes that such proceedings and matters, in total, will not have a materially adverse effect on its financial position, results of operations or cash flows.

K. Long-Term Debt

The pollution control notes arise from the sale of bonds by public authorities for the purposes of financing construction of pollution control facilities at the Company's plants or refunding previously issued bonds. The Company is obligated to pay the principal and interest on these bonds. For certain of the pollution control notes, there is an annual commitment fee for an irrevocable letter of credit. Under certain circumstances, the letter of credit is available for the payment of interest on, or redemption of, all or a portion of the notes.

Long-Term Debt at December 31

	Interest Rate	Maturity	Principal Outstanding (Amounts in Thousands of Dollars)	
			1996	1995
First mortgage bonds	4.75%-8.75%	1997-2025	\$ 853,000 (a)	\$ 903,000 (b)
Pollution control notes	(c)	2009-2030	417,985	417,985
Sinking fund debentures	5%	2010	4,891	5,703
Term loans	6.47%-7.47%	2000-2001	150,000	65,000
Miscellaneous			17,785	13,462
Less: Unamortized debt discount and premium - net			(3,915)	(4,157)
Total Long-Term Debt			\$1,439,746	\$1,400,993

(a) Excludes \$50.0 million related to current maturities on November 15, 1997.

(b) Excludes \$50.0 million related to a current maturity on May 15, 1996.

(c) The pollution control notes have adjustable interest rates. The interest rates at year-end averaged 3.7 percent in 1996 and 3.9 percent in 1995.

At December 31, 1996, sinking fund requirements and maturities of long-term debt outstanding for the next five years were \$51.1 million in 1997, \$76.3 million in 1998, \$81.9 million in 1999, \$166.7 million in 2000, and \$86.8 million in 2001.

Total interest costs incurred were \$103.9 million in 1996, \$107.7 million in 1995, and \$110.7 million in 1994. Interest costs attributable to long-term debt and other interest were \$99.4 million, \$102.4 million and \$105.1 million in 1996, 1995 and 1994, respectively. Interest costs incurred also include \$4.5 million, \$5.3 million and \$5.6 million attributable to capital leases in 1996, 1995 and 1994, respectively. Of these amounts, \$0.8 million in 1996, \$1.0 million in 1995, and \$0.6 million in 1994 were capitalized as AFC. Debt discount or premium and related issuance expenses are amortized over the lives of the applicable issues.

During 1994, the Company's BV Unit 2 lease arrangement was amended to reflect an increase in federal income tax rates. At the same time, the associated letter of credit securing the lessor's equity interest in the unit was increased from \$188 million to \$194 million and the term of the letter of credit was extended to 1999. If certain specified events occur, the letter of credit could be drawn down by the owners, the leases could terminate, and collateralized lease bonds (\$391.8 million at December 31, 1996) would become direct obligations of the Company.

At December 31, 1996 and 1995, the Company was in compliance with all of its debt covenants.

At December 31, 1996, the fair value of the Company's long-term debt, including current maturities and sinking fund requirements, estimated on the basis of quoted market prices for the same or similar issues or current rates offered to the Company for debt of the same remaining maturities, was \$1,492.5 million. The principal amount included in the Company's consolidated balance sheet is \$1,495.6 million.

	Call Price Per Share	(Shares and Amounts in Thousands)			
		1996		1995	
		Shares	Amount	Shares	Amount
Preferred Stock Series:					
3.75% (a) (b) (c)	\$51.00	148	\$ 7,407	148	\$ 7,407
4.00% (a) (b) (c)	51.50	550	27,486	550	27,486
4.10% (a) (b) (c)	51.75	120	6,012	120	6,012
4.15% (a) (b) (c)	51.73	132	6,643	132	6,643
4.20% (a) (b) (c)	51.71	100	5,021	100	5,021
\$2.10 (a) (b) (c)	51.84	159	8,039	159	8,039
9.00% (d)	—	—	3,000	—	3,000
8.375% (e)	—	6,000	150,000	—	—
Total Preferred Stock		7,209	213,608	1,209	63,608
Preference Stock Series: (f)					
Plan Series A (c) (g)	37.18	817	28,997	834	29,615
Total Preference Stock		817	28,997	834	29,615
Deferred ESOP benefit			(19,533)		(22,257)
Total Preferred and Preference Stock			\$223,072		\$70,966

- (a) Preferred stock: 4,000,000 authorized shares; \$50 par value; cumulative
- (b) \$50 per share involuntary liquidation value
- (c) Non-redeemable
- (d) 500 authorized shares; 10 issued \$300,000 par value; involuntary liquidation value \$300,000 per share; mandatory redemption beginning August 2000

- (e) Cumulative Monthly Income Preferred Securities, Series A: 6,000,000 authorized shares; \$25 involuntary liquidation value
- (f) Preference stock: 8,000,000 authorized shares; \$1 par value cumulative
- (g) \$35.50 per share involuntary liquidation value

Holder of Duquesne's preferred stock are entitled to cumulative quarterly dividends. If four quarterly dividends on any series of preferred stock are in arrears, holders of the preferred stock are entitled to elect a majority of Duquesne's board of directors until all dividends have been paid. Holders of Duquesne's preference stock are entitled to receive cumulative quarterly dividends if dividends on all series of preferred stock are paid. If six quarterly dividends on any series of preference stock are in arrears, holders of the preference stock are entitled to elect two of Duquesne's directors until all dividends have been paid. At December 31, 1996, Duquesne had made all dividend payments. Preferred and preference dividends of subsidiaries included in *interest and other charges* were \$12.1 million, \$5.9 million and \$6.0 million in 1996, 1995 and 1994. Total preferred and preference stock had involuntary liquidation values of \$242,467 and \$93,086, which exceeded par by \$28,180 and \$28,781 at December 31, 1996 and 1995.

In December 1991, the Company established an Employee Stock Ownership Plan (ESOP) to provide matching contributions for a 401(k) Retirement Savings Plan for Management Employees. (See "Employee Benefits," Note N, on page 61.) The Company issued and sold 845,070 shares of preference stock, plan series A to the trustee of the ESOP. As consideration for the stock, the Company received a note valued at \$30 million from the trustee. The preference stock has an annual dividend rate of \$2.80 per share, and each share of the preference stock is exchangeable for one and one half shares of DQE common stock. At December 31, 1996, \$19.5 million of preference stock issued in connection with the establishment of the ESOP had been offset, for financial statement purposes, by the recognition of a deferred ESOP benefit. Dividends on the preference stock and cash contributions from the Company are used to repay the ESOP note. The Company made cash contributions of approximately \$1.4 million for 1996, \$1.6 million for 1995, and \$2.2 million for 1994. These cash contributions were the difference between the ESOP debt service and the amount of dividends on ESOP shares (\$2.3 million in 1996 and 1995, and \$2.4 million in 1994). As shares of preference stock are allocated to the accounts of participants in the ESOP, the Company recognizes compensation expense, and the amount of the deferred compensation benefit is amortized. The Company recognized compensation expense related to the 401(k) plans of \$2.3 million in 1996, \$2.3 million in 1995, and \$1.8 million in 1994. Outstanding preferred and preference stock is generally callable, on notice of not less than 30 days, at stated prices plus accrued dividends. None of the remaining Duquesne preferred or preference stock issues has mandatory purchase requirements.

M. Common Stock

Changes in the Number of Shares of DQE Common Stock Outstanding

	1996	1995	1994
	(Amounts in Thousands of Shares)		
Outstanding as of January 1	77,556	78,459	79,518
Reissuance from treasury stock	157	83	116
Repurchase of common stock	(440)	(986)	(1,175)
Outstanding as of December 31	77,273	77,556	78,459

The Company has continuously paid dividends on *common stock* since 1953 and in each of the last 10 years has increased its dividend paid per share. The Company's annualized dividends per share were \$1.36, \$1.28 and \$1.17 at December 31, 1996, 1995 and 1994. During 1996, the Company paid a quarterly dividend of \$0.32 per share on each of January 1, April 1, July 1 and October 1. The quarterly dividend declared in the fourth quarter of 1996 was increased from \$0.32 to \$0.34 per share payable January 1, 1997.

Dividends may be paid on the Company's *common stock* to the extent permitted by law and as declared by the board of directors. However, payments of dividends on Duquesne's common stock may be restricted by Duquesne's obligations to holders of preferred and preference stock pursuant to Duquesne's *Restated Articles* of incorporation. No dividends or distributions may be made on Duquesne's common stock if Duquesne has not paid dividends or sinking fund obligations on its preferred or preference stock. Further, the aggregate amount of Duquesne's common stock dividend payments or distributions may not exceed certain percentages of *net income* if the ratio of *total common shareholders' equity* to *total capitalization* is less than specified percentages. As all of Duquesne's common stock is owned by the Company, to the extent that Duquesne cannot pay common dividends, the Company may not be able to pay dividends to its common shareholders. No part of the *retained earnings* of the Company was restricted at December 31, 1996.

N. Employee Benefits

Retirement Plans

The Company maintains retirement plans to provide pensions for all eligible employees. Upon retirement, an employee receives a monthly pension based on his or her length of service and compensation. The cost of funding the pension plan is determined by the unit credit actuarial cost method. The Company's policy is to record this cost as an expense and to fund the pension plans by an amount that is at least equal to the minimum funding requirements of the *Employee Retirement Income Security Act of 1974 (ERISA)* but that does not exceed the maximum tax-deductible amount for the year. Pension costs charged to expense or construction were \$11.9 million for 1996, \$6.1 million for 1995, and \$8.9 million for 1994.

Funded Status of the Retirement Plans and Amounts Recognized on the Consolidated Balance Sheet at December 31

	1996	1995
	(Amounts in Thousands of Dollars)	
Actuarial present value of benefits rendered to date:		
Vested benefits	\$413,109	\$378,344
Non-vested benefits	22,551	19,110
Accumulated benefits obligations based on compensation to date	435,660	397,454
Additional benefits based on estimated future salary levels	61,438	53,757
Projected benefits obligation	497,098	451,211
Fair market value of plan assets	525,871	490,870
Projected benefits obligation under plan assets	\$ 28,773	\$ 39,659
Unrecognized net gain	\$128,382	\$124,794
Unrecognized prior service cost	(43,790)	(37,535)
Unrecognized net transition liability	(13,853)	(15,665)
Net pension liability per consolidated balance sheet	(41,966)	(31,935)
Total	\$ 28,773	\$ 39,659
Assumed rate of return on plan assets	8.25%	8.00%
Discount rate used to determine projected benefits obligation	7.50%	7.00%
Assumed change in compensation levels	5.25%	5.00%

Pension assets consist primarily of common stocks, United States obligations and corporate debt securities.

Components of Net Pension Cost

	1996	1995	1994
	<i>(Amounts in Thousands of Dollars)</i>		
Service cost (benefits earned during the year)	\$ 12,209	\$ 9,953	\$ 12,482
Interest on projected benefits obligation	32,597	30,063	28,221
Return on plan assets	(58,173)	(99,246)	1,967
Net amortization and deferrals	25,312	65,316	(33,783)
Net Pension Cost	\$ 11,945	\$ 6,086	\$ 8,887

Retirement Savings Plan and Other Benefit Options

The Company sponsors separate 401(k) retirement plans for its management and bargaining unit employees.

The 401(k) Retirement Savings Plan for Management Employees provides that the Company will match employee contributions to a 401(k) account up to a maximum of 6 percent of an employee's eligible salary. The Company match consists of a \$0.25 base match per eligible contribution dollar and an additional \$0.25 incentive match per eligible contribution dollar, if Board-approved targets are achieved. The 1996 incentive target for management was accomplished. The Company is funding its matching contributions to the 401(k) Retirement Savings Plan for Management Employees with payments to an ESOP established in December 1991. (See "Preferred and Preference Stock of Subsidiaries," Note L, on page 60.)

The 401(k) Retirement Savings Plan for IBEW Represented Employees provides that, beginning in 1995, the Company will match employee contributions to a 401(k) account up to a maximum of 4 percent of an employee's eligible salary. The Company match consists of a \$0.25 base match per eligible contribution dollar and an additional \$0.25 incentive match per eligible contribution dollar, if certain targets are met. In 1996, these incentive targets were not met by the Company's union-represented employees.

The Company's shareholders have approved a long-term incentive plan through which the Company may grant management employees options to purchase, during the years 1987 through 2006, up to a total of 7.5 million shares of the Company's common stock at prices equal to the fair market value of such stock on the dates the options were granted. At December 31, 1996, approximately 3.1 million of these shares were available for future grants.

As of December 31, 1996, 1995 and 1994, active grants totaled 1,698,000; 2,159,000; and 2,118,000 shares. Exercise prices of these options ranged from \$8.2084 to \$30.875 at December 31, 1996, and from \$8.2084 to \$27.625 at December 31, 1995, and from \$8.2084 to \$23.0833 at December 31, 1994. Expiration dates of these grants ranged from 1997 to 2006 at December 31, 1996; from 1997 to 2005 at December 31, 1995; and from 1997 to 2004 at December 31, 1994. As of December 31, 1996, 1995 and 1994, stock appreciation rights (SARs) had been granted in connection with 984,000; 1,202,000; and 1,190,000 of the options outstanding. During 1996, 715,000 SARs were exercised; 267,000 options were exercised at prices ranging from \$8.2084 to \$20.3334; and 150 options were cancelled. During 1995, 367,000 SARs were exercised; 133,000 options were exercised at prices ranging from \$8.2084 to \$21.6667; and 28,000 options were cancelled. During 1994, 1,254,000 SARs were exercised; 339,000 options were exercised at prices ranging from \$8.2084 to \$18.9167; and 80,000 options were cancelled. Of the active grants at December 31, 1996, 1995 and 1994, 668,000; 929,000; and 918,000 were not exercisable.

Other Post-Retirement Benefits

In addition to pension benefits, the Company provides certain health care benefits and life insurance for some retired employees. Substantially all of the Company's full-time employees may, upon attaining the age of 55 and meeting certain service requirements, become eligible for the same benefits available to retired employees. Participating retirees make contributions, which are adjusted annually, to the health care plan. The life insurance plan is non-contributory. Company-provided health care benefits terminate when covered individuals become eligible for Medicare benefits or reach age 65, whichever comes first. The Company funds actual expenditures for obligations under the plans on a "pay-as-you-go" basis. The Company has the right to modify or terminate the plans.

The Company accrues the actuarially determined costs of the aforementioned post-retirement benefits over the period from the date of hire until the date the employee becomes fully eligible for benefits. The Company has elected to amortize the transition liability over 20 years.

Components of Post-Retirement Cost

	1996	1995
	<i>(Amounts in Thousands of Dollars)</i>	
Service cost (benefits earned during the period)	\$1,182	\$1,315
Interest cost on accumulated benefit obligation	2,046	2,340
Amortization of the transition obligation over 20 years	1,700	1,700
Other	(812)	(582)
Total Post-Retirement Cost	\$4,116	\$4,773

The accumulated postretirement benefit obligation comprises the present value of the estimated future benefits payable to current retirees and a pro rata portion of estimated benefits payable to active employees after retirement.

Funded Status of Post-Retirement Plan at December 31

	1996	1995
	<i>(Amounts in Thousands of Dollars)</i>	
Actuarial present value of benefits:		
Retirees	\$ 8,840	\$ 7,359
Fully eligible active plan participants	3,829	3,187
Other active plan participants	26,352	21,935
Accumulated post-retirement benefit obligation	39,021	32,481
Fair market value of plan assets	—	—
Accumulated benefit obligation in excess of plan assets	\$(39,021)	\$(32,481)
Unrecognized net actuarial gains	\$ 2,874	\$ 8,427
Unrecognized net transition liability	(27,198)	(28,898)
Post-retirement liability per consolidated balance sheet	(14,697)	(12,010)
Total	\$(39,021)	\$(32,481)
Discount rate used to determine projected benefit obligation	7.50%	7.00%
Health care cost trend rates:		
For year beginning January 1	6.96%	8.80%
Ultimate rate in the year 2000	6.00%	5.50%
Effect of a one percent increase in health care cost trend rates:		
On accumulated projected benefit obligation	\$ 2,920	\$ 3,228
On aggregate of annual service and interest costs	\$ 391	\$ 435

O. Quarterly Financial Information (Inaudited)

Summary of Selected Quarterly Financial Data (Thousands of Dollars, Except Per Share Amounts)

[The quarterly data reflect seasonal weather variations in the utility's service territory.]

1996	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating Revenues (a)	\$300,518	\$293,357	\$335,430	\$295,890
Operating Income (a)	71,316	67,385	104,891	58,414
Net Income	42,305	38,972	57,412	40,449
Earnings Per Share	0.55	0.50	0.74	0.53
Stock Price:				
High	31½	28¾	28¾	30¾
Low	27½	25¾	27	27
1995	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating Revenues (a)	\$298,277	\$283,372	\$347,264	\$291,249
Operating Income (a)	80,607	66,870	105,528	69,460
Net Income	40,901	35,685	55,269	38,708
Earnings Per Share	0.52	0.46	0.72	0.50
Stock Price:				
High	22¾	25	26¾	30¾
Low	19¾	21¾	23½	26½

(a) Restated to conform with presentations adopted during 1996.

DAVID D. MARSHALL, 44. *President and Chief Executive Officer.* Previously held senior executive positions in finance at Central Vermont Public Service. Joined the Company in 1985. Directorships included on page 6.

GARY L. SCHWASS, 51. *Executive Vice President and Chief Financial Officer.* Previously served in a variety of senior executive positions in finance and management with Consumers Power Company. Joined the Company in 1985. Directorships include Chair, Western Pennsylvania Development Credit Corporation (promotes small business through lending activities), and Vice President and Treasurer, Holy Family Foundation (supports families in crisis).

DIANNA L. GREEN, 50. *Senior Vice President.* Previously held senior management positions with Xerox Corporation. Joined the Company in 1988. Directorships include PNC Bank; Phipps Conservatory; Chair, Urban League of Pittsburgh; and Board President, the Whale's Tale (helps troubled youth).

JAMES D. MITCHELL, 45. *Vice President.* Previously held senior financial positions with Duquesne Light and U.S. West, Inc. Joined the Company in 1988. Directorships include Three Rivers Youth (helps troubled teenagers).

VICTOR A. ROQUE, 50. *Vice President and General Counsel.* Formerly Vice President, General Counsel and Secretary for Orange and Rockland Utilities. Joined the Company in 1994. Directorships include Pennsylvania Chamber of Business and Industry (economic development), Hill House Association (provider of social services) and United Way Good Neighbors Advisory Committee. Member, Salvation Army Greater Pittsburgh Advisory Board.

JACK E. SAXER, JR., 53. *Vice President.* Previously held senior financial positions with Gulf Oil and Chevron. Joined the Company in 1989. Directorships include Point Venture (venture capital) and Pittsburgh Consumer Health Coalition (healthcare advocacy for the disadvantaged).

DIANE S. EISMONT, 52
Corporate Secretary

DONALD J. CLAYTON, 42
Treasurer

DEBORRAH E. BECK, 39
Assistant Controller

JOAN S. SENCHYSHYN, 58
Assistant Secretary

MORGAN K. O'BRIEN, 36
Controller

DUQUESNE LIGHT COMPANY OFFICERS

DAVID D. MARSHALL, 44
President and Chief Executive Officer

GARY L. SCHWASS, 51
Senior Vice President and Chief Financial Officer

JAMES E. CROSS, 50
President, Generation Group

DIANNA L. GREEN, 50
Senior Vice President, Customer Operations

GARY R. BRANDENBERGER, 59
Vice President, Power Supply

WILLIAM J. DELEO, 46
Vice President, Marketing and Corporate Performance

VICTOR A. ROQUE, 50
Vice President and General Counsel

DONALD J. CLAYTON, 42
Treasurer

DIANE S. EISMONT, 52
Corporate Secretary and Assistant General Counsel

MORGAN K. O'BRIEN, 36
Controller

JACK E. SAXER, JR., 53
Assistant Vice President, Administration

SALLY K. WADE, 43
Assistant Vice President, Human Resources

FRED R. ALLISON, 47
Assistant Controller

MARK S. DADAY, 36
Assistant Treasurer

WILLIAM F. FIELDS, 46
Assistant Treasurer

JOAN S. SENCHYSHYN, 58
Assistant Secretary

JAMES E. WILSON, 31
Assistant Controller

DUQUESNE ENTERPRISES OFFICERS

THOMAS A. HURKMANS, 31
President

ANTHONY J. VILLIOTTI, 50
Vice President, Treasurer and Controller

H. DONALD MORINE, 59
President, Allegheny Development Corp. and Property Ventures, Ltd.

JOHN L. WEINHOLD, 60
Vice President, Property Ventures, Ltd.

MONTAUK OFFICERS

JAMES D. MITCHELL, 45
President

DONALD J. CLAYTON, 42
Vice President

WILLIAM F. FIELDS, 46
Treasurer

LYDIA E. YORK, 37
Vice President

JAMES E. WILSON, 31
Controller

DQE ENERGY SERVICES OFFICERS

ALEXIS TSAGGARIS, 48
President

JOHN J. DROZDOWSKI, 41
Treasurer and Controller

DQENERGY PARTNERS OFFICERS

JOHN W. WELCH, 45
President

JOHN J. DROZDOWSKI, 41
Treasurer and Controller

DQE SHAREHOLDER REFERENCE GUIDE

COMMON STOCK

Trading Symbol: DQE
Stock Exchanges Listed and Traded:
New York, Philadelphia, Chicago
Number of Common Shareholders of Record at
Year-End: 76,521

DQE INTERNET HOME PAGE

A variety of shareholder and customer information is available on DQE's home page on the World Wide Web. You also can interact with us via electronic mail. Our address is <http://www.dqe.com>. The site is best viewed using the latest version of Netscape software.

SHAREHOLDER DIRECT

Shareholders and potential investors are invited to call 1-888-247-0401 for the latest information on earnings and dividends.

SHAREHOLDER SERVICES/ASSISTANCE

By telephone, representatives are available from 7:30 a.m. to 4:30 p.m. (Eastern time) to assist you with the following services:

- Direct purchase of initial shares
- Direct deposit of dividends
- Automatic cash contributions
- Dividend reinvestment
- Stock transfer
- Unreceived dividend payment
- Change of address
- Lost stock certificate

Please feel free to call at other times. Our Message Center will record your message and our staff will follow up on the next business day.

FINANCIAL COMMUNITY INQUIRIES

Analysts, investment managers and brokers should direct their inquiries to 1-412-393-4133; FAX 1-412-393-6571. Written inquiries should be sent to the Investor Relations Department at the address below.

DIVIDEND TAX STATUS

The company estimates that all common stock dividends paid in 1996 are taxable as dividend income. This estimate is subject to audit by the Internal Revenue Service.

The DQE logo is a registered trademark of the Company.

WeatherWiseSM, WeatherProof Energy BillSM and Secure EnergySM are service marks of the Company.

E-FuelTM is a trademark of CQ Inc.

The Heinz logo is the registered trademark of H.J. Heinz Company.

DQE and its affiliated companies are Equal Opportunity Employers.

ELECTRI STOCK

The following investor services are available through DQES dividend reinvestment and stock purchase plan:

DIRECT PURCHASE OF DQE STOCK

DQE offers non-shareholders the ability to purchase stock directly through the company. Call or write for a prospectus on this popular program.

AUTOMATIC CASH CONTRIBUTIONS

Through this program, current reinvestment plan participants can make regular cash contributions to purchase additional shares of DQE common stock by having funds automatically withdrawn from their bank accounts.

OTHER FEATURES AND SERVICES

- Purchase and sale of plan shares at nominal commissions
- Acceptance of certificates for safekeeping
- Re-registration of some or all of a shareholder's holdings
- Creation of new accounts as gifts for family, friends or institutions your support, including a complimentary gift certificate upon request

STOCK CERTIFICATE TRANSFERS

Individuals who are not participants in the dividend reinvestment plan and who want to transfer stock certificates should send their certificates and related documents to our transfer agent:

First National Bank of Boston
c/o Boston EquiServe
P.O. Box 8040
Boston, MA 02266-8040

Dividend reinvestment plan participants who want to transfer their shares should send their certificates and related documents to DQE, Shareholder Relations, at the address below.

DIRECT DEPOSIT OF DIVIDENDS

Your DQE quarterly dividends can be deposited automatically into a personal checking or savings account. Call Shareholder Relations toll-free for more information.

DQE
Shareholder Relations
Box 68
Pittsburgh, PA 15230-0068

Toll-free: 1-800-247-0400
In Pittsburgh: 393-6167
FAX: 1-412-393-6087



Shareholder Relations
Box 68
Pittsburgh, PA 15230-0068

Item No: H-13
Page 249 of 422

Item No: H-13
Witness: D. J. Clayton
Page 249A of 422

DUQUESNE LIGHT COMPANY

Attachment No. 6 - DQE Proxy Statement



DQE

Cherrington Corporate Center
500 Cherrington Parkway
Coraopolis, PA 15108-3184
(412) 262-4700

June 25, 1997

Dear Stockholder:

You are cordially invited to attend the annual meeting of stockholders (the "DQE Meeting") of DQE, Inc., a Pennsylvania corporation ("DQE"), to be held on August 7, 1997, at 11:00 a.m., local time, at the Manchester Craftsmen's Guild Auditorium, 1815 Metropolitan Street, Pittsburgh, Pennsylvania 15233.

At the DQE Meeting, you will be asked to consider and vote on a proposal to approve a business combination (the "Merger") between DQE and a corporation to be formed as a wholly owned subsidiary of Allegheny Power System, Inc. ("APS") which will result in DQE becoming a wholly owned subsidiary of APS and each DQE stockholder receiving 1.12 shares (the "Exchange Ratio") of APS common stock for each share of DQE common stock ("DQE Common Stock"). Upon consummation of the Merger, former stockholders of DQE will own approximately 42% of the outstanding shares of APS, which will have changed its name to Allegheny Energy, Inc.

The Board of Directors of DQE has received the written opinion, dated the date of the Joint Proxy Statement/Prospectus that accompanies this letter, of its financial advisor, Credit Suisse First Boston Corporation, to the effect that, as of such date and based upon and subject to certain matters stated in such opinion, the Exchange Ratio was fair to the holders of DQE Common Stock from a financial point of view.

YOUR BOARD HAS UNANIMOUSLY DETERMINED THAT THE MERGER IS IN THE BEST INTERESTS OF DQE AND ITS STOCKHOLDERS. ACCORDINGLY, YOUR BOARD UNANIMOUSLY RECOMMENDS THAT STOCKHOLDERS VOTE FOR ITS APPROVAL.

More detailed information concerning the Merger, together with financial and other information concerning the businesses of DQE and APS, is included in the enclosed Joint Proxy Statement/Prospectus. I urge you to review this material carefully.

In addition, at the DQE Meeting, you will be asked to consider and vote upon a proposal to amend the Amended Articles of Incorporation of DQE to cause Pennsylvania Business Corporation Law §§ 2541-2548 (the "Pennsylvania Control Transactions Statute") to be inapplicable to DQE (the "Control Transactions Amendment"); to elect four directors to the Board of Directors of DQE to serve until the annual meeting of DQE's stockholders in the year 2000 (the "Director Proposal"); to consider and vote upon a proposal to approve the appointment by the Board of Directors of DQE of Deloitte & Touche LLP as independent public accountants to audit the books of DQE for the year ending December 31, 1997 (the "Accountant Proposal"); and to consider and vote upon a proposal from a stockholder of DQE (the "Stockholder Proposal"), if presented at the DQE meeting. Notwithstanding the approval of the Control Transactions Amendment by the stockholders of DQE, DQE will not file the Control Transactions Amendment until all other conditions to the Merger have been satisfied or waived. Therefore, even if there is stockholder approval of the Control Transactions Amendment, if the Merger does not occur, the Control Transactions Amendment will not have become effective, and DQE will remain subject to the Pennsylvania Control Transactions Statute.

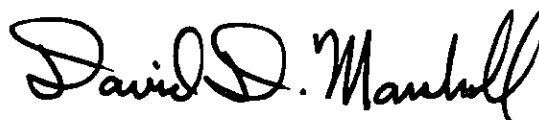
YOUR BOARD UNANIMOUSLY RECOMMENDS ADOPTION OF THE CONTROL TRANSACTIONS AMENDMENT, THE DIRECTOR PROPOSAL AND THE ACCOUNTANT PROPOSAL AND UNANIMOUSLY RECOMMENDS VOTING AGAINST THE STOCKHOLDER PROPOSAL.

The affirmative vote of a majority of the votes cast at the DQE Meeting is necessary for approval of the Merger. The votes required with respect to the other matters to be acted upon at the DQE Meeting are described in the attached Joint Proxy Statement/Prospectus.

Promptly after the Merger is consummated you will be sent a letter of transmittal with instructions for surrendering your certificates representing shares of DQE Common Stock. *Please do not send your share certificates until you receive these materials.*

In order that your shares may be represented at the DQE Meeting, you are urged to complete, sign, date and promptly return the accompanying Proxy in the enclosed envelope, whether or not you plan to attend the DQE Meeting. If you attend the DQE Meeting and desire to revoke your Proxy in writing and vote in person, you may do so; in any event, a Proxy may be revoked in a writing delivered to the Corporate Secretary of DQE at any time before it is voted. Your prompt response will be appreciated.

Sincerely,

A handwritten signature in black ink that reads "David D. Marshall". The signature is written in a cursive style with a large, stylized "D" at the beginning.

DAVID D. MARSHALL
President and Chief Executive Officer



DQE

Cherrington Corporate Center
500 Cherrington Parkway
Coraopolis, PA 15108-3184
(412) 262-4700

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD ON AUGUST 7, 1997**

To the Stockholders of DQE, Inc.:

NOTICE IS HEREBY GIVEN that the annual meeting of stockholders (the "DQE Meeting") of DQE, a Pennsylvania corporation ("DQE"), has been called by the Board of Directors of DQE (the "DQE Board") and will be held at the Manchester Craftsmen's Guild Auditorium, 1815 Metropolitan Street, Pittsburgh, Pennsylvania 15233 at 11:00 a.m., local time, on August 7, 1997, to consider and vote upon the following matters described in the accompanying Joint Proxy Statement/Prospectus:

1. To consider and vote upon a proposal to adopt the Agreement and Plan of Merger, dated as of April 5, 1997 (the "Merger Agreement"), among DQE, Allegheny Power System, Inc., a Maryland corporation ("APS"), and AYP Sub, Inc., which is to be formed as a Pennsylvania corporation and a wholly owned subsidiary of APS ("Merger Sub"), pursuant to which Merger Sub will be merged with and into DQE and DQE will become a wholly owned subsidiary of APS, and to approve the transactions provided for in the Merger Agreement;
2. To consider and vote upon a proposal to amend the Amended Articles of Incorporation of DQE to make §§ 2541-2548 of the Pennsylvania Business Corporation Law inapplicable to DQE.
3. To elect four directors to the DQE Board to serve until the annual meeting of stockholders of DQE in the year 2000 or until their respective successors have been chosen and qualified;
4. To consider and vote upon a proposal to approve the appointment, by the DQE Board, of Deloitte & Touche LLP as independent public accountants to audit the books of DQE for the year ending December 31, 1997;
5. To consider and vote upon a proposal from a stockholder of DQE, if presented at the DQE Meeting; and
6. To transact such other business as may properly come before the DQE Meeting or any adjournments or postponements thereof.

The Board of Directors of DQE has fixed the close of business on June 16, 1997, as the record date for the determination of stockholders entitled to notice of, and to vote at, the DQE Meeting, and only stockholders of record at such time will be entitled to notice of, and to vote at, the DQE Meeting.

A form of Proxy and a Joint Proxy Statement/Prospectus containing more detailed information with respect to the matters to be considered at the DQE Meeting (including the Merger Agreement attached as Appendix A thereto) accompany and form a part of this notice.

Whether or not you plan to attend the DQE Meeting, please promptly complete, sign, date and return the enclosed Proxy in the enclosed addressed, postage-prepaid envelope. If you attend the DQE Meeting and desire to revoke your Proxy in writing and vote in person, you may do so; in any event, a Proxy may be revoked in a writing delivered to the Corporate Secretary of DQE at any time before it is voted.

By Order of the Board of Directors

DIANE S. EISMONT
Corporate Secretary

Coraopolis, Pennsylvania
June 25, 1997

The Proxy Solicitor for DQE, Inc.:

Beacon Hill Partners, Inc.
90 Broad Street
New York, NY 10004

Call Toll Free: 1-800-253-3814
Call Collect: 1-212-843-8500

YOUR VOTE IS IMPORTANT. PLEASE SIGN, DATE AND RETURN YOUR PROXY.

Joint Proxy Statement
of
ALLEGHENY POWER SYSTEM, INC.
and
DQE, INC.

Item No: H-13
Page 254 of 422

Prospectus
of
ALLEGHENY POWER SYSTEM, INC.

This Joint Proxy Statement/Prospectus is being furnished to stockholders of Allegheny Power System, Inc., a Maryland corporation ("APS"), in connection with the solicitation of proxies by the Board of Directors of APS from holders of outstanding shares of common stock, par value \$1.25 per share, of APS ("APS Common Stock"), for use at the special meeting of stockholders of APS to be held on August 7, 1997 and at any adjournments or postponements thereof (the "APS Special Meeting"). This Joint Proxy Statement/Prospectus is also being furnished to the stockholders of DQE, Inc., a Pennsylvania corporation ("DQE"), in connection with the solicitation of proxies by the Board of Directors of DQE (the "DQE Board") from holders of outstanding shares of common stock, no par value, of DQE ("DQE Common Stock") for use at the annual meeting of stockholders of DQE to be held on August 7, 1997 and at any adjournments or postponements thereof (the "DQE Meeting," and, together with the APS Special Meeting, the "Stockholders Meetings").

At the APS Special Meeting, the holders of APS Common Stock will be asked to consider and vote upon proposals (i) to approve the issuance of shares of APS Common Stock contemplated by the Agreement and Plan of Merger, dated as of April 5, 1997 (the "Merger Agreement"), among DQE, APS and AYP Sub, Inc., which is to be formed as a Pennsylvania corporation and a wholly owned subsidiary of APS ("Merger Sub") and (ii) to approve an amendment to the Restated Charter of APS to change the name of APS to Allegheny Energy, Inc. The Merger Agreement is attached as Appendix A to this Joint Proxy Statement/Prospectus and is incorporated herein by reference.

At the DQE Meeting, the holders of DQE Common Stock will be asked (i) to consider and vote upon a proposal to adopt the Merger Agreement and to approve the transactions contemplated by the Merger Agreement, (ii) to consider and vote upon a proposal to amend the Articles of Incorporation, effective January 5, 1989, as amended, of DQE (the "DQE Articles") to cause the Pennsylvania Business Corporation Law §§ 2541 - 2548 (the "Pennsylvania Control Transactions Statute") to be inapplicable to DQE, (iii) to elect four directors to the DQE Board to serve until the annual meeting of stockholders of DQE in the year 2000, (iv) to consider and vote upon a proposal to approve the appointment of Deloitte & Touche LLP as independent accountants of DQE for the year ending December 31, 1997, and (v) to consider and vote upon a proposal from a stockholder of DQE, if presented at the DQE Meeting.

The Merger Agreement provides for the merger of Merger Sub with and into DQE (the "Merger"). DQE will be the corporation surviving the Merger and will become a wholly owned subsidiary of APS. Upon the Merger becoming effective, each share of DQE Common Stock issued and outstanding immediately prior to such time (other than shares of DQE Common Stock owned by APS, Merger Sub or any other direct or indirect subsidiary of APS and shares of DQE Common Stock that are owned by DQE or any direct or indirect subsidiary of DQE, in each case not held on behalf of third parties, and which are not shares of DQE Common Stock held by Duquesne Light Company, a subsidiary of DQE, to provide for redemption of such subsidiary's preference shares pursuant to the terms of such subsidiary's 401(k) plan or to provide benefits under another employee benefit plan of such subsidiary (collectively, the "Excluded Shares")) will be converted into the right to receive, and become exchangeable for, 1.12 shares of APS Common Stock. See "The Merger — Terms of the Merger."

APS has filed a Registration Statement on Form S-4 (including exhibits and amendments thereto, the "Registration Statement") pursuant to the Securities Act of 1933, as amended (the "Securities Act"), covering the maximum number of shares of APS Common Stock estimated to be issuable upon consummation of the Merger. APS has registered 90,557,682 shares of APS Common Stock under the Registration Statement. This Joint Proxy Statement/Prospectus constitutes the respective Proxy Statements of APS and DQE relating to the solicitation of proxies for use at their respective Stockholders Meetings and the Prospectus of APS filed as part of the Registration Statement. The information contained in this Joint Proxy Statement/Prospectus with respect to APS and its subsidiaries has been supplied by APS, and the information with respect to DQE and its subsidiaries has been supplied by DQE. This Joint Proxy Statement/Prospectus and the proxy cards are first being provided to holders of shares of APS Common Stock and DQE Common Stock on or about June 30, 1997.

**THE SECURITIES TO BE ISSUED PURSUANT TO THIS JOINT PROXY STATEMENT/PROSPECTUS
HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE
COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND
EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON
THE ACCURACY OR ADEQUACY OF THIS JOINT PROXY STATEMENT/PROSPECTUS.
ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.**

The date of this Joint Proxy Statement/Prospectus is June 25, 1997

AVAILABLE INFORMATION

Each of APS and DQE is subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and, in accordance therewith, files reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). The reports, proxy statements and other information filed by APS and DQE with the SEC can be inspected and copied at the SEC's public reference room located at Room 1024 Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549, and at the public reference facilities in the SEC's regional offices located at: 7 World Trade Center, 13th Floor, New York, New York 10048, and Suite 1400, Citicorp Center, 500 West Madison Street, Chicago, Illinois 60661. Copies of such material can be obtained at prescribed rates by writing to the Securities and Exchange Commission, Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549 and can be accessed electronically on the SEC's Web site at <http://www.sec.gov>. The shares of APS Common Stock are listed on the New York Stock Exchange (the "NYSE"), the Chicago Stock Exchange (the "CSE"), the Pacific Exchange, Inc. (the "PEI") and the Amsterdam Stock Exchange (the "AMSE"); and the shares of DQE Common Stock are listed on the NYSE, the CSE and the Philadelphia Stock Exchange (the "PHSE"). As such, the periodic reports, proxy statements and other information filed by APS and DQE may be inspected at the offices of those exchanges as follows: (i) the NYSE, at 20 Broad Street, New York, New York 10005; (ii) the CSE, at One Financial Place, 444 LaSalle Street, Chicago, Illinois 60605; (iii) with respect to APS, the PEI, at 301 Pine Street, San Francisco, California 94101; (iv) with respect to APS, the AMSE, at Bevrsplein 5, P.O. Box 19163, 1000 GD Amsterdam, The Netherlands; and (v) with respect to DQE, the PHSE, at 1900 Market Street, Philadelphia, Pennsylvania 19103.

This Joint Proxy Statement/Prospectus is also being furnished to holders of DQE Common Stock for the purposes of electing four directors to the Board of Directors of DQE and of considering and voting upon certain other matters. Certain information with respect to these proposals is being furnished only to the holders of DQE Common Stock. See "Other Information for the DQE Meeting," which is included only in the Joint Proxy Statement/Prospectus being mailed to holders of DQE Common Stock.

APS has filed a Registration Statement with the SEC under the Securities Act with respect to the shares of APS Common Stock issuable upon consummation of the Merger. This Joint Proxy Statement/Prospectus does not contain all of the information set forth in the Registration Statement, certain parts of which are omitted in accordance with the rules and regulations of the SEC. The Registration Statement, including any amendments, schedules and exhibits thereto, is available for inspection and copying as set forth above. Summaries of the contracts or other documents referred to herein are summaries of the material provisions thereof and are not necessarily complete and in each instance reference is made to the copy of such contract or other document filed as an exhibit to the Registration Statement.

INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

This Joint Proxy Statement/Prospectus incorporates documents by reference that are not presented herein or delivered herewith. Documents relating to APS, excluding exhibits to such documents unless such exhibits are specifically incorporated by reference in such documents, are available without charge upon request to Eileen Beck, Secretary, Allegheny Power System, Inc., 10435 Downsville Pike, Hagerstown, Maryland 21740. Telephone requests may be directed to Eileen Beck, Secretary, at (301) 790-3400. Documents relating to DQE, excluding exhibits to such documents unless such exhibits are specifically incorporated by reference herein, are available without charge upon request to Diane Eismont, Corporate Secretary, DQE, Inc., Box 68, Pittsburgh, Pennsylvania 15230-0068. Telephone requests may be directed to Diane Eismont, Corporate Secretary, at (412) 393-6080. In order to ensure timely delivery of any such document, any request should be made by July 31, 1997.

The following documents filed with the SEC by APS (File No. 1-267) are incorporated herein by reference: (a) APS' Annual Report on Form 10-K for the year ended December 31, 1996 (the "1996 APS 10-K"); (b) APS' Current Report on Form 8-K, dated April 5, 1997 and (c) APS' Quarterly Report on Form 10-Q for the quarter ended March 31, 1997.

The following documents filed with the SEC by DQE (File No. 1-10290) are incorporated herein by reference: (a) DQE's Annual Report on Form 10-K for the fiscal year ended December 31, 1996 (the "1996 DQE 10-K"); (b) DQE's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997; (c) DQE's Current Report on Form 8-K, dated April 9, 1997; and (d) the description of DQE Common Stock contained in DQE's Registration Statement on Form 8-B/A-1, dated May 1, 1995.

All documents filed by either APS or DQE pursuant to Section 13(a), 13(c), 14 or 15(d) of the Exchange Act subsequent to the date hereof and prior to the date of the applicable Stockholders Meeting and any adjournment or postponement thereof shall be deemed to be incorporated herein by reference and to be a part hereof from the date of such filing. Any statement contained herein or in a document incorporated or deemed to be incorporated herein by reference shall be deemed to be modified or superseded for purposes hereof to the extent that a statement contained herein or in any other subsequently filed document which also is, or is deemed to be, incorporated herein by reference modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed to constitute a part hereof, except as so modified or superseded.

No person is authorized to give any information or to make any representations not contained in this Joint Proxy Statement/Prospectus or in the documents incorporated herein by reference in connection with the solicitation and the offering made hereby and, if given or made, such information or representation should not be relied upon as having been authorized by APS or DQE. This Joint Proxy Statement/Prospectus does not constitute an offer to sell, or a solicitation of an offer to purchase, the securities offered by this Joint Proxy Statement/Prospectus, or the solicitation of a proxy from any person, in any jurisdiction in which it is unlawful to make such offer, solicitation of an offer or proxy solicitation. Neither the delivery of this Joint Proxy Statement/Prospectus nor any distribution of the securities made under this Joint Proxy Statement/Prospectus hereunder shall, under any circumstances, create an implication that there has been no change in the affairs of APS or DQE since the date of this Joint Proxy Statement/Prospectus other than as set forth in the documents incorporated herein by reference.

TABLE OF CONTENTS

	<u>Page</u>
Available Information	ii
Incorporation of Certain Information by Reference	ii
Summary	1
The Companies	1
The Stockholders Meetings	2
The Merger	3
The Merger Agreement	6
Certain Regulatory Matters	9
Interests of Certain Persons in the Merger	10
Accounting Treatment	10
Resale of APS Common Stock	11
Dividends	11
Certain Federal Income Tax Consequences	11
Certain Related Agreements	11
Certain Effects of the Merger on the Rights of Holders of DQE Common Stock	12
APS Charter Amendment	12
Amendment to the DQE Articles	12
Comparative Stock Prices	13
Selected Unaudited Historical and Pro Forma Combined Financial Data	14
Notes to Selected Unaudited Historical and Pro Forma Combined Financial Data	16
The Stockholders Meetings	17
General	17
Date, Place and Time	17
Record Dates	18
Votes Required	18
Voting and Revocation of Proxies	19
Solicitation of Proxies	20
The Companies	20
Prior Contacts Between the Companies	21
The Merger	21
General	21
Terms of the Merger	22
Effective Time	22
Exchange of Certificates	22
Appraisal Rights	24
Background of the Merger	25
Reasons for the Merger; Recommendations of the Boards of Directors	26
Synergies	28
Opinions of Financial Advisors	28
Management and Operations Following the Merger	36
Cautionary Statement Concerning Forward-Looking Statements	36
The Merger Agreement	37
Representations and Warranties	37
Conduct of Business Pending the Merger; Certain Covenants; Acquisition Proposals	38
Conditions	41
Modification or Amendment; Waiver of Conditions; Extension	42

	<u>Page</u>
Termination	42
Certain Termination Fees	44
Expenses	45
Stock Options	45
Nuclear Matters	45
Certain Regulatory Provisions	45
New York Stock Exchange Listing; De-Listing of DQE Common Stock	46
Certain Regulatory Matters	46
HSR Act	46
Federal Power Act	46
PUHCA	46
Nuclear Regulatory Commission	47
Pennsylvania Public Utility Commission	47
Maryland Public Service Commission	48
Other Regulatory Matters	48
Power Supply Agreement	48
Effects of Certain Regulatory Trends	48
Interests of Certain Persons in the Merger	49
Directors and Officers	49
Severance Agreements	49
DQE, Inc. Long-Term Incentive Plan	50
Director and Officer Indemnification and Insurance	51
Accounting Treatment	51
Resale of APS Common Stock	51
Dividends	52
Certain Federal Income Tax Consequences of the Merger	52
General	52
Consequences to DQE Stockholders	53
Fractional Shares	53
Consequences to DQE, APS, Merger Sub and Holders of APS Common Stock	53
Certain Related Agreements	54
Stock Option Agreement	54
Letter Agreement	56
Unaudited Pro Forma Combined Financial Information of APS and DQE	57
Notes to Unaudited Pro Forma Combined Financial Information	76
Description of APS Capital Stock	77
APS Common Stock	77
Comparison of Certain Rights of the Holders of APS Common Stock and DQE Common Stock	77
General	77
Size and Classification of the Board of Directors	78
Election and Removal of Directors; Filling of Vacancies on the Board of Directors	78
Duties of Directors	79
Meetings of Stockholders	80
Action by Written Consent	81
Stockholder Proposals and Stockholder Nominations of Directors	81
Amendment of Charter and Bylaws	82
Required Vote for Authorization of Certain Actions	83
Appraisal and Dissenters' Rights	84

	<u>Page</u>
State Anti-Takeover Statutes	85
Indemnification of Officers and Directors	88
Fair Price and Anti-Greenmail Provisions in the Charter Documents	89
Conflict-of-Interest Transactions	90
The APS Charter Amendment	90
Amendment to the DQE Articles	91
Other Information for the DQE Meeting	91
Election of Directors	92
Nominees for Directors	92
Standing Directors	93
Directors' Fees and Plans	94
The DQE Board and Its Committees	95
Beneficial Ownership of Securities of DQE	96
Compensation Committee Report on Executive Compensation	97
Section 16(a) Beneficial Ownership Reporting Compliance	101
Compensation Committee Interlocks and Insider Participation	101
Performance Graph	102
Compensation	103
Retirement Plan	106
Employment and Change of Control	107
Approval of Appointment of Independent Public Accountants	107
Proposal of a DQE Stockholder	108
Management's Statement in Opposition	109
Other Matters	110
Experts	110
Validity of Shares	110
Stockholder Proposals	111
APPENDIX A: Agreement and Plan of Merger, dated as of April 5, 1997, among DQE, Inc., Allegheny Power System, Inc. and AYP Sub, Inc.	A-1
APPENDIX B: Opinion of Merrill Lynch & Co., dated as of June 25, 1997	B-1
APPENDIX C: Opinion of Credit Suisse First Boston Corporation, dated as of June 25, 1997	C-1
APPENDIX D: Sections 2541-2548 of the Pennsylvania Business Corporation Law	D-1
APPENDIX E: Form of Amendment to the DQE Articles	E-1

SUMMARY

The following is a summary of certain information contained elsewhere in this Joint Proxy Statement/Prospectus. It does not purport to be complete and is qualified in its entirety by reference to the full text of this Joint Proxy Statement/Prospectus, including the Appendices attached hereto and the documents incorporated herein by reference. Stockholders are urged to read this Joint Proxy Statement/Prospectus in its entirety. The information contained in this Joint Proxy Statement/Prospectus with respect to Allegheny Power System, Inc. ("APS") and AYP Sub, Inc., which is to be formed as a Pennsylvania corporation and a wholly owned subsidiary of APS ("Merger Sub"), has been supplied by APS, and the information with respect to DQE, Inc. ("DQE," and sometimes hereinafter referred to, with respect to the period following the Merger (as defined below), as the "Surviving Corporation") has been supplied by DQE. Neither APS nor DQE is responsible for inaccuracies, if any, in the information furnished by the other party for use herein.

The Companies

APS

APS is a registered electric utility holding company which in 1996 had operating revenues of approximately \$2.3 billion. At December 31, 1996, APS had total assets of approximately \$6.6 billion. APS was incorporated in 1925 in Maryland and owns, directly or indirectly, various regulated and unregulated subsidiaries. APS' primary subsidiaries are engaged principally in the generation, transmission, distribution and sale of electric energy. Its subsidiaries' properties, which are interconnected and are operated as a single integrated electric utility system, are located in Maryland, Ohio, Pennsylvania, Virginia and West Virginia and provide energy to customers in portions of each of those states. APS provides electric service to nearly 1.4 million customers in an area of about 29,000 square miles.

The mailing address of APS' principal executive offices is 10435 Downsville Pike, Hagerstown, Maryland 21740, and its telephone number is (301) 790-3400.

DQE

DQE is an energy services holding company incorporated in 1989 in Pennsylvania which owns various regulated and unregulated subsidiaries. DQE's subsidiaries include (i) an electric utility engaged in the production, transmission, distribution and sale of electrical energy, (ii) a company that makes strategic investments related to DQE's core energy business, (iii) a company that offers energy solutions to customers in domestic and international markets such as energy facility development, operation and maintenance and independent power production, (iv) a company formed to explore strategic business opportunities in the energy industry, and (v) a financial services company that makes long-term investments and provides financing for DQE's services and products. DQE's electric utility provides electric service to customers in a service territory of about 800 square miles in southwestern Pennsylvania, comprised of parts of Allegheny County (including the City of Pittsburgh), and parts of Beaver County and Westmoreland County. This electric utility provides service to about 580,000 customers in this service area and its revenues account for the majority of DQE's revenue. In 1996, DQE had operating revenues of approximately \$1.2 billion. At December 31, 1996, DQE had total assets of approximately \$4.6 billion.

Duquesne Light Company, a subsidiary of DQE ("Duquesne Light"), owns interests in three nuclear facilities. Duquesne Light owns a 13.74% interest in Perry Power Station Unit 1 ("Perry Unit 1"), a 47.50% interest in Beaver Valley Power Station Unit 1 ("Beaver Valley 1") and a 13.74% interest in Beaver Valley Power Station Unit 2 ("Beaver Valley 2") (each, a "Nuclear Facility" and, collectively, the "Nuclear Facilities").

Allegheny Development Corporation ("ADC") is a wholly owned subsidiary of Duquesne Enterprises, Inc. which, in turn, is a wholly owned subsidiary of DQE. ADC is an electric utility company engaged in the business of owning facilities to provide complete energy services. Upon approval by the Securities and Exchange Commission ("SEC"), ADC will assign to DH Energy, Inc. (a wholly owned subsidiary of DQE Energy Services, Inc. ("DES")) all of its rights and obligations under certain agreements, and DH

Energy, Inc. will become a public utility company pursuant to the Public Utility Holding Company Act of 1935, as amended (the "PUHCA").

In addition, DES will shortly be forming a new wholly owned subsidiary, MT Energy, Inc. ("MT"). Upon SEC approval, MT will, among other things, enter into an Operation and Maintenance Services Agreement with ADC, and become a public utility company pursuant to the PUHCA.

The mailing address of DQE's principal executive offices is 500 Cherrington Parkway, Coraopolis, Pennsylvania 15108, and its telephone number is (412) 262-4700.

Merger Sub

Merger Sub is to be formed as a wholly owned subsidiary of APS solely for the purpose of effecting the merger of Merger Sub with and into DQE (the "Merger"). The mailing address of Merger Sub's principal executive offices will be 10435 Downsville Pike, Hagerstown, Maryland 21740, and its telephone number will be (301) 790-3400.

The Stockholders Meetings

APS

The special meeting of stockholders of APS (the "APS Special Meeting") to consider and vote upon (i) the approval of the issuance of the shares of Common Stock, par value \$1.25 per share, of APS ("APS Common Stock") as contemplated by the Agreement and Plan of Merger, dated as of April 5, 1997 (the "Merger Agreement"), among DQE, APS and Merger Sub, and (ii) the approval of an amendment to the Restated Charter of APS (the "APS Charter") to change the name of APS to Allegheny Energy, Inc. (the "Charter Amendment") will be held on August 7, 1997 at 1:00 p.m., local time, at Howard Johnson of Hagerstown, 1718 Underpass Way, Hagerstown, Maryland 21740. Only holders of record of APS Common Stock at the close of business on June 30, 1997 (the "APS Record Date") will be entitled to vote at the APS Special Meeting. At June 1, 1997, there were 122,111,567 shares of APS Common Stock outstanding and entitled to vote. Each share of APS Common Stock is entitled to one vote.

The affirmative vote of a majority of the votes cast at the APS Special Meeting is necessary for the approval of the issuance of the shares of APS Common Stock pursuant to the Merger Agreement. The affirmative vote of a majority of the total number of shares of APS Common Stock outstanding is necessary for adoption of the Charter Amendment.

As of June 1, 1997, directors and executive officers of APS and their affiliates beneficially owned an aggregate of 75,272 shares of APS Common Stock (including shares which may be acquired within 60 days upon exercise of stock options) or less than 0.1% of the shares of APS Common Stock outstanding on such date. The directors and executive officers of APS have indicated their intention to vote their shares of APS Common Stock in favor of approval of the issuance of the shares of APS Common Stock as contemplated by the Merger Agreement and in favor of approval of the Charter Amendment.

DQE

The annual meeting of stockholders of DQE (the "DQE Meeting") (i) to consider and vote upon adoption of the Merger Agreement and approval of the transactions contemplated thereby, (ii) to consider and vote upon a proposal to amend the DQE Articles to cause §§2541-2548 (the "Pennsylvania Control Transactions Statute") of the Pennsylvania Business Corporation Law (the "PBCL") to be inapplicable to DQE (the "Control Transactions Amendment"), (iii) to elect four directors to the Board of Directors of DQE (the "DQE Board") to serve until the annual meeting of stockholders of DQE in the year 2000, (iv) to consider and vote upon the approval of the appointment by the DQE Board of Deloitte & Touche LLP ("Deloitte & Touche") as independent public accountants to audit the books of DQE for the year ending December 31, 1997 (the "Accountant Proposal") and (v) to consider and vote upon a proposal from a stockholder of DQE, if presented at the DQE Meeting (the "Stockholder Proposal") will be held on August 7, 1997 at 11:00 a.m., local time, at the Manchester Craftsmen's Guild Auditorium, 1815 Metropoli-

tan Street, Pittsburgh, Pennsylvania 15233. Only holders of record of DQE Common Stock at the close of business on June 16, 1997 (the "DQE Record Date") will be entitled to vote at the DQE Meeting. On June 16, 1997, there were 77,408,557 shares of Common Stock, no par value, of DQE ("DQE Common Stock") outstanding and entitled to vote. Each share of DQE Common Stock is entitled to one vote.

The affirmative vote of a majority of the votes cast at the DQE Meeting is necessary for the adoption of the Merger Agreement and approval of the transactions contemplated thereby. With respect to the election of directors of DQE, the four persons receiving the highest number of votes will be elected as directors of DQE. The affirmative vote of a majority of the votes cast at the DQE Meeting is necessary for adoption of the Control Transactions Amendment, the Accountant Proposal and the Stockholder Proposal.

Stockholders of DQE have cumulative voting rights with respect to the election of directors of DQE.

Holders of preferred stock or other capital stock of Duquesne Light or any of the other subsidiaries of DQE will not have voting rights with respect to any of the matters to be acted upon at the DQE Meeting. The terms of such preferred stock or other capital stock will not be affected by the Merger.

As of June 16, 1997, directors and executive officers of DQE and their affiliates beneficially owned an aggregate of 633,161 shares of DQE Common Stock (including shares which may be acquired within 60 days upon exercise of stock options) or less than 1% of the shares of DQE Common Stock outstanding on such date. The directors and executive officers of DQE have indicated their intention to vote their shares of DQE Common Stock in favor of adoption of the Merger Agreement and approval of the transactions contemplated thereby. The directors and executive officers of DQE have also indicated their intention to vote their shares of DQE Common Stock in favor of the directors nominated by the DQE Board and in favor of the Control Transactions Amendment and the Accountant Proposal and **against** the Stockholder Proposal.

For additional information relating to the Stockholders Meetings, see "The Stockholders Meetings."

The Merger

This section describes certain aspects of the Merger. The following description does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, which is attached as Appendix A to this Joint Proxy Statement/Prospectus and is incorporated herein by reference. *All holders of DQE Common Stock and holders of APS Common Stock are urged to read the Merger Agreement in its entirety.*

General

The Merger Agreement provides for a business combination of APS and DQE in which DQE will become a wholly owned subsidiary of APS and each issued and outstanding share of DQE Common Stock will be converted into the right to receive, and become exchangeable for, 1.12 shares of APS Common Stock (the "Exchange Ratio"). Upon consummation of the Merger, holders of DQE Common Stock immediately prior to the Merger will own approximately 42% of the outstanding shares of APS Common Stock after the Merger (based on the number of shares of APS Common Stock and DQE Common Stock outstanding as of June 1, 1997, and June 16, 1997, respectively).

Terms of the Merger

Subject to the satisfaction of the conditions set forth in the Merger Agreement, Merger Sub will be merged with and into DQE, and the holders of shares of DQE Common Stock (other than shares of DQE Common Stock owned by APS, Merger Sub or any other direct or indirect Subsidiary (as defined below) of APS and shares of DQE Common Stock that are owned by DQE or any direct or indirect Subsidiary of DQE, in each case not held on behalf of third parties, and which are not shares of DQE Common Stock held by Duquesne Light, to provide for redemption of Duquesne Light's preference shares pursuant to the terms of Duquesne Light's 401(k) plan or to provide benefits under another employee benefit plan of Duquesne Light (collectively, the "Excluded Shares")) will be issued APS Common Stock in a transaction intended to qualify as a "pooling of interests" for accounting purposes and as a reorganization within the meaning of

Section 368(a) of the Internal Revenue Code of 1986, as amended (the "Code"), for federal income tax purposes. As used herein, the term "Subsidiary" means, with respect to APS, DQE or Merger Sub, as the case may be, any entity whether incorporated or unincorporated, in which APS, DQE or Merger Sub, as the case may be, owns, directly or indirectly, at least a majority of the outstanding voting securities or other equity interests having the power to elect a majority of directors, or otherwise direct the management and policies, of such entity. Each outstanding share of APS Common Stock will remain outstanding and be unaffected by the Merger.

No fractional shares of APS Common Stock will be issued in the Merger. Instead, the Merger Agreement provides that each holder of DQE Common Stock who would otherwise be entitled to receive a fractional share of APS Common Stock will be entitled to receive, in lieu thereof, cash representing such holder's proportionate interest in a share of APS Common Stock based on the closing price of a share of APS Common Stock, as reported in *The Wall Street Journal*, New York City edition, on the trading day immediately prior to the Effective Time (as defined below).

At the Effective Time, all shares of DQE Common Stock credited to participants' accounts under the Dividend Reinvestment and Stock Purchase Plan of DQE (the "DQE DRSP") will be converted into a number of shares of APS Common Stock determined by multiplying the number of such shares of DQE Common Stock by the Exchange Ratio. All such shares of APS Common Stock will be held in the participants' accounts, with individual participant's accounts in the DQE DRSP being credited with fractional shares of APS Common Stock. See "The Merger — Terms of the Merger."

Effective Time

The Merger will become effective at the time when Articles of Merger effecting the Merger (the "Pennsylvania Articles of Merger") have been duly filed with the Department of State of the Commonwealth of Pennsylvania (the "Effective Time") as provided in Section 1927 of the PBCL. See "The Merger — Effective Time."

Exchange of Certificates

Holders of DQE Common Stock should NOT send their certificates to the Exchange Agent until they receive transmittal materials from the Exchange Agent. Holders of APS Common Stock will not exchange their certificates.

Promptly after the Effective Time, the Exchange Agent (as defined in the Merger Agreement) will mail to each holder of DQE Common Stock (other than the Excluded Shares) a letter of transmittal with instructions for exchanging certificates representing shares of DQE Common Stock (each a "DQE Certificate") in exchange for certificates representing shares of APS Common Stock (each an "APS Certificate") and obtaining cash in lieu of any fractional share of APS Common Stock. See "The Merger — Terms of the Merger."

Appraisal Rights

Holders of APS Common Stock will not be entitled to any dissenters' or appraisal rights under the Maryland General Corporation Law (the "MGCL") as a result of the matters to be voted upon at the APS Special Meeting. Holders of DQE Common Stock will not be entitled to any dissenters' or appraisal rights under the merger and appraisal rights provisions of the PBCL as a result of any of the matters to be voted on at the DQE Meeting. DQE does not believe holders of DQE Common Stock would be entitled to receive the appraisal-like rights conferred by the Pennsylvania Control Transactions Statute even if the Control Transactions Amendment is not approved. However, because there is no controlling precedent interpreting this aspect of the Pennsylvania Control Transactions Statute, DQE is seeking approval of the Control Transactions Amendment in order to remove any possible uncertainty or legal challenge. See "The Merger — Appraisal Rights."

Reasons for the Merger; Recommendations of the Boards of Directors — APS

The APS Board has determined unanimously that the Merger Agreement and the transactions contemplated thereby are advisable for, fair to, and in the best interests of, APS' stockholders. Accordingly, the APS Board has unanimously approved the Merger Agreement and unanimously recommends that the stockholders of APS vote **FOR** approval of the issuance of the shares of APS Common Stock as contemplated by the Merger Agreement. The recommendation of the APS Board is based on a number of strategic, operating and financial factors as described in "The Merger — Reasons for the Merger; Recommendations of the Boards of Directors — APS."

Reasons for the Merger; Recommendations of the Boards of Directors — DQE

The DQE Board has determined unanimously that the terms of the Merger are fair to, and in the best interests of, stockholders of DQE and has unanimously approved the Merger Agreement and the transactions contemplated thereby and unanimously recommends that the stockholders of DQE vote **FOR** adoption of the Merger Agreement. The recommendation of the DQE Board is based on a number of strategic, operating and financial factors as described in "The Merger — Reasons for the Merger; Recommendations of the Boards of Directors — DQE." In considering the recommendation of the DQE Board, holders of DQE Common Stock should be aware that certain members of DQE's management and the DQE Board have other interests in the Merger in addition to the interests which holders of DQE Common Stock have generally. The DQE Board was aware of these other interests and considered them, among other matters, in approving the Merger Agreement and the transactions contemplated thereby, including the Merger. See "Interests of Certain Persons in the Merger" and "The Merger — Management and Operations Following the Merger."

Opinions of Financial Advisors

APS

Merrill Lynch & Co. ("Merrill Lynch") has delivered to the Board of Directors of APS ("APS Board") its written opinion, dated as of the date of this Joint Proxy Statement/Prospectus, to the effect that, as of such date, the Exchange Ratio was fair from a financial point of view to the holders of APS Common Stock. See "The Merger — Opinions of Financial Advisors — APS." A copy of the opinion of Merrill Lynch, dated as of the date of this Joint Proxy Statement/Prospectus, which sets forth the assumptions made, procedures followed, matters considered and limitations on the scope of the review by Merrill Lynch in rendering its opinion, is attached as Appendix B to this Joint Proxy Statement/Prospectus. Holders of APS Common Stock are urged to, and should, read Merrill Lynch's opinion in its entirety.

DQE

Credit Suisse First Boston Corporation ("CSFB") has acted as financial advisor to DQE in connection with the Merger and has rendered to the DQE Board a written opinion, dated the date of this Joint Proxy Statement/Prospectus, to the effect that, as of such date and based upon and subject to certain matters stated in such opinion, the Exchange Ratio was fair to the holders of DQE Common Stock from a financial point of view. The opinion of CSFB is directed to the DQE Board and relates only to the fairness of the Exchange Ratio from a financial point of view, does not address any other aspect of the proposed Merger or any related transaction and does not constitute a recommendation to any stockholder as to how any stockholder should vote at the DQE Meeting. See "The Merger — Opinions of Financial Advisors — DQE." A copy of the opinion of CSFB, dated the date of this Joint Proxy Statement/Prospectus, which describes the procedures followed, assumptions made, matters considered and limitations on the review undertaken in connection with such opinion, is attached hereto as Appendix C and should be read carefully and in its entirety.

Management and Operations Following the Merger

The Merger Agreement provides that, from and after the Effective Time, the APS Board will be composed of 15 directors, of which six will be designated by DQE and nine will be designated by APS prior to the Effective Time, in each case to serve until their successors have been duly elected or appointed and

qualified or until their earlier death, resignation or removal in accordance with the APS Charter and the Bylaws of APS ("APS Bylaws"). As of the date hereof, neither DQE nor APS has determined whom it will designate to be directors of APS following the Effective Time, but each of DQE and APS currently intends to nominate persons from among the members of their respective boards of directors at the Effective Time. In addition, the Merger Agreement provides that, following the Effective Time, the chairmen of certain committees of the APS Board will be selected from among the DQE designees and the chairmen of other committees will be selected from among the APS designees. See "Interests of Certain Persons in the Merger — Directors and Officers."

The Merger Agreement further provides that, from and after the Effective Time, Alan J. Noia will be the Chairman and Chief Executive Officer of APS and David D. Marshall will be the President and Chief Operating Officer of APS.

The Merger Agreement also provides that, from and after the Effective Time, APS' corporate headquarters will remain in Maryland and substantial operations of Subsidiaries of APS, including the Surviving Corporation, will remain in the Pittsburgh, Pennsylvania area. See "The Merger — Management and Operations Following the Merger."

The Merger Agreement

This section describes certain aspects of the Merger Agreement. The following description does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, which is attached as Appendix A to this Joint Proxy Statement/Prospectus and is incorporated herein by reference. *All holders of DQE Common Stock and APS Common Stock are urged to read the Merger Agreement in its entirety.*

Representations and Warranties

The Merger Agreement contains various representations and warranties of DQE, APS and Merger Sub, certain of which are qualified by a material adverse effect standard. See "The Merger Agreement — Representations and Warranties."

Conduct of Business Pending the Merger

The Merger Agreement provides that during the period of time from the date of the Merger Agreement until the Effective Time, unless approved in writing by the other party or unless expressly contemplated by the Merger Agreement, the Stock Option Agreement, dated as of April 5, 1997, between DQE and APS (the "Stock Option Agreement"), the respective budgets of DQE and APS (which have been submitted by DQE to APS and by APS to DQE), or as required by applicable Law (as defined under "— Modification or Amendment; Waiver of Conditions; Extension"), each of DQE and APS will, among other things, conduct its and its Subsidiaries' businesses in the ordinary and usual course, will not pay dividends in excess of certain prescribed amounts and will not take any action or omit to take any action that would prevent the Merger from qualifying for "pooling of interests" accounting treatment or as a "reorganization" within the meaning of Section 368(a) of the Code. See "The Merger Agreement — Conduct of Business Pending the Merger; Certain Covenants; Acquisition Proposals — Interim Operations" for a discussion of restrictions on APS, DQE and their respective Subsidiaries with respect to the conduct of their businesses prior to the Effective Time.

Acquisition Proposals

The Merger Agreement also provides that, except as contemplated by the budgets submitted by DQE to APS and by APS to DQE and except as expressly contemplated by the Merger Agreement, neither DQE nor APS nor any of their respective Subsidiaries will, and DQE and APS will not authorize or permit their officers, directors, employees, agents or other representatives retained by them or any of their Subsidiaries, respectively, (i) to solicit, initiate or encourage, or take any other action designed to facilitate, directly or indirectly, any inquiries or the making of any proposal with respect to a merger, reorganization, share exchange, consolidation or similar transaction involving, or, other than in the ordinary course of business, any

purchase of all or any significant portion of assets or any equity securities of, DQE or APS, as applicable, or of any of their respective Subsidiaries (any such proposal or offer being referred to as an "Acquisition Proposal" and any such transaction or purchase being referred to as an "Acquisition Transaction") or (ii) to participate in any discussions or negotiations relating to any Acquisition Proposal or Acquisition Transaction. In certain situations the terms of the Merger Agreement will not prohibit either DQE or APS (A) from furnishing information with respect to it and its Subsidiaries to any person pursuant to a customary confidentiality agreement and (B) from participating in negotiations regarding such Acquisition Proposal. See "The Merger Agreement — Conduct of Business Pending the Merger, Certain Covenants; Acquisition Proposals — Acquisition Proposals."

In addition, the Merger Agreement provides that, except as expressly permitted by the Merger Agreement, neither the APS Board nor the DQE Board, as applicable, nor any committee thereof will (i) withdraw or modify, or propose publicly to withdraw or modify, in a manner adverse to the other party to the Merger Agreement, the approval or recommendation by such board of directors or such committee of the Merger or the approval and adoption of the matters relating to the Merger to be considered at the APS Special Meeting, in the case of APS, and the DQE Meeting, in the case of DQE; (ii) approve or recommend, or propose publicly to approve or recommend, any Acquisition Proposal other than the Merger; or (iii) cause or permit APS or DQE, as applicable, to enter into any letter of intent, agreement in principle, acquisition agreement or other similar agreement or understanding (each, an "Acquisition Agreement") related to any Acquisition Proposal. Notwithstanding the foregoing provisions of the Merger Agreement, in certain situations the proscribed actions may be taken. APS and DQE have also each agreed in the Merger Agreement that in situations in which it is permitted to enter into an Acquisition Agreement, it will not enter into a binding Acquisition Agreement until at least the sixteenth business day after it has provided the notice to APS or DQE, as applicable, required by the Merger Agreement. The Merger Agreement also provides that if any party receives an Acquisition Proposal it will immediately advise the other party orally and in writing of such Acquisition Proposal, any request for information, the material terms and conditions of such request or Acquisition Proposal and the identity of the Person making such request or Acquisition Proposal. In addition, APS and DQE have agreed that if either has received an Acquisition Proposal it will keep the other party reasonably informed of the status and details of any such Acquisition Proposal. See "The Merger Agreement — Conduct of Business Pending the Merger, Certain Covenants; Acquisition Proposals."

Conditions

The respective obligations of DQE, APS and Merger Sub to effect the Merger are subject to the satisfaction or waiver at or prior to the Effective Time of a number of conditions, including the following: (i) approval of the Merger Agreement by holders of DQE Common Stock and by APS as the sole stockholder of Merger Sub and the approval of the issuance of APS Common Stock as contemplated by the Merger Agreement by holders of APS Common Stock; (ii) the authorization for listing on the New York Stock Exchange (the "NYSE") upon official notice of issuance of the shares of APS Common Stock to be issued in the Merger; (iii) expiration or termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act, as amended, and the rules promulgated thereunder (the "HSR Act"), and the receipt of all necessary Governmental Consents (as defined under "The Merger Agreement — Conditions") having been obtained on terms not reasonably likely to have a Material Adverse Effect (as defined under "The Merger Agreement — Representations and Warranties") on either DQE or APS; (iv) there being no statute, rule, regulation, judgment, decree, injunction or other order in effect that restrains, enjoins or otherwise prohibits consummation of the transactions contemplated by the Merger Agreement; (v) APS and DQE having received from APS' independent accounting firm a letter to the effect that the Merger will qualify for "pooling of interests" accounting treatment; (vi) APS and DQE having obtained the consent or approval of each person whose consent or approval is required to consummate the transactions contemplated by the Merger Agreement and the Stock Option Agreement under any contract to which APS or DQE or any of their Subsidiaries is a party; (vii) APS and DQE having received the opinions of their respective counsels to the effect that the Merger will be treated for federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Code, and that each of APS, Merger Sub and DQE will be a party to that reorganization within the meaning of Section 368(b) of the Code; (viii) APS having received an Affiliate

Letter (as defined under "Resale of APS Common Stock") from each person identified as an affiliate of DQE pursuant to the Merger Agreement; (ix) the absence of any change in the financial condition, properties, business or results of operations of either APS or DQE that would be reasonably likely to have a Material Adverse Effect on it; and (x) DQE and APS each having received from their respective independent public accounting firms customary "comfort" letters. See "The Merger Agreement — Conditions."

Modification or Amendment; Waiver of Conditions; Extension

The Merger Agreement provides that, subject to the provisions of applicable law, ordinance, regulation, judgment, order, decree, arbitration, award, license or permit of any Governmental Entity (each a "Law," and collectively, "Laws"), the parties to the Merger Agreement may modify or amend the Merger Agreement by written agreement executed and delivered by duly authorized officers of the respective parties. The Merger Agreement also provides that the conditions to each of the parties' obligations to consummate the Merger are for the sole benefit of such party and at any time prior to the Effective Time, such party may waive such conditions in whole or in part or extend the time for the performance of any of the obligations or other acts of the other parties thereto, to the extent permitted by applicable Law.

Termination

The Merger Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time (a) by mutual written consent of DQE, APS and Merger Sub, by action of the DQE Board and the APS Board, respectively, or (b) by action of the DQE Board or the APS Board if (i) the Merger has not been consummated by October 5, 1998, which may be extended for six months under certain circumstances (the "Termination Date"); (ii) any Governmental Consents (as defined under "The Merger Agreement — Conditions") have been made or obtained by Final Orders (as defined under "The Merger Agreement — Termination") which contain terms or conditions that would cause any of the conditions relating to regulatory consents not to be satisfied; (iii) any statute, rule, regulation, judgment, decree, injunction or other order (whether temporary, preliminary or permanent) that has been enacted, issued, promulgated, enforced or entered by any court or Governmental Entity (as defined under "The Merger Agreement — Representations and Warranties") of competent jurisdiction is in effect and restrains, enjoins or otherwise prohibits consummation of the transactions contemplated by the Merger Agreement (collectively, an "Order") provided, that it has become final and non-appealable; (iv) the necessary vote of DQE's stockholders to effectuate the Merger has not been obtained at the DQE Meeting, including any adjournments thereof; or (v) the necessary vote of APS' stockholders to effectuate the Merger has not been obtained at the APS Special Meeting, including any adjournments thereof. The Merger Agreement provides that the right to terminate the Merger Agreement pursuant to clause (i), (ii), (iv) or (v) above will not be available to any party that has breached in any material respect its obligations under the Merger Agreement in any manner that has contributed to the failure of the Merger to be consummated. See "The Merger Agreement — Termination."

Further, the Merger Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time by action of the DQE Board or the APS Board, as applicable: (a) subject to and in accordance with the termination provisions of the Merger Agreement relating to Acquisition Proposals; or (b) if (i) the APS Board or the DQE Board, as applicable, has withdrawn or adversely modified its approval or recommendation of the Merger Agreement or failed to reconfirm its recommendation of the Merger Agreement after a written request by DQE or APS, as applicable, to do so, (ii) there has been a material breach by APS or Merger Sub, on the one hand, or DQE, on the other hand, of any representation, warranty, covenant or agreement contained in the Merger Agreement that is not curable or, if curable, is not cured within 30 days after written notice of such breach is given by DQE or APS, as applicable, to the party committing such breach, or (iii) APS or DQE, as applicable, or any of their affiliates, representatives or agents, takes any of the actions that would be proscribed by certain provisions of the Merger Agreement which restrict APS' or DQE's, as applicable, conduct with respect to Acquisition Proposals. See "The Merger Agreement — Conduct of Business Pending the Merger. Certain Covenants; Acquisition Proposals — Acquisition Proposals."

In the event of termination of the Merger Agreement and the abandonment of the Merger, the Merger Agreement (other than certain provisions of the Merger Agreement relating to expenses and confidentiality and other than as described below under "The Merger Agreement — Certain Termination Fees") will become void and of no effect with no liability to any party thereto (or any of its directors, officers, employees, agents, legal and financial advisors or other representatives); *provided, however*, except as otherwise provided therein, no such termination will relieve any party thereto of any liability or damages resulting from any breach of the Merger Agreement.

If the Merger is terminated under certain specified circumstances, certain termination fees are payable by one party to the other. See "The Merger Agreement — Certain Termination Fees."

Stock Options

At the Effective Time, each outstanding option to purchase DQE Common Stock (a "DQE Option") under DQE's Long-Term Incentive Savings Plan, DRSP and 1996 Stock Plan for Non-Employee Directors and the Performance Incentive Program for DQE and its Subsidiaries (the "DQE Stock Plans"), whether vested or unvested, will be deemed to constitute an option to acquire, on the same terms and conditions as were applicable under such DQE Option, the same number of shares of APS Common Stock as the holder of such DQE Option would have been entitled to receive pursuant to the Merger had such holder exercised such option in full immediately prior to the Effective Time, at a price per share of APS Common Stock equal to (y) the aggregate exercise price for DQE Common Stock otherwise purchasable pursuant to such DQE Option divided by (z) the number of full shares of APS Common Stock deemed purchasable pursuant to such DQE Option. In addition, pursuant to the Merger Agreement, APS has agreed to assume, effective as of the Effective Time, each DQE Option in accordance with the terms of the DQE Stock Plan under which it was issued and the stock option agreement by which it is evidenced. See "The Merger Agreement — Stock Options."

Nuclear Matters

The Merger Agreement provides that, at least quarterly prior to the Effective Time, DQE, upon request by APS, will cause its President — Generation Group and its Chief Nuclear Officer to attend a meeting of the APS Board and provide APS' directors with such oral and written information concerning the Nuclear Facilities and DQE's nuclear generation program as such directors and/or the Chief Financial Officer of APS may reasonably request. In addition, prior to the Effective Time, APS is entitled to designate one person who will be a director of APS or will be a person expert in nuclear matters to attend and participate in each meeting of the Nuclear Review Committee of the DQE Board. See "The Merger Agreement — Nuclear Matters."

Certain Regulatory Matters

Under the HSR Act, certain transactions, including the Merger, may not be consummated unless certain waiting period requirements have been satisfied. APS and DQE will each file a Premerger Notification and Report Form (a "Notification and Report Form") pursuant to the HSR Act with the Antitrust Division of the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC"). At any time before or after the Effective Time, the FTC, the DOJ or others could take action under the antitrust laws with respect to the Merger, including seeking to enjoin the consummation of the Merger, to rescind the Merger or to require divestiture of substantial assets of APS or DQE. There can be no assurance that a challenge to the Merger on antitrust grounds will not be made or, if such a challenge is made, that it would not be successful.

In addition, DQE and/or APS are or may be required to file notices with, and to obtain the approval and consents of, the SEC pursuant to the PUHCA, the Federal Energy Regulatory Commission ("FERC") pursuant to the Federal Power Act of 1920, as amended (the "Power Act"), the Nuclear Regulatory Commission ("NRC") pursuant to the Atomic Energy Act of 1954, as amended ("AEA"), the Pennsylvania Public Utility Commission ("PAPUC") and the Maryland Public Service Commission (the "MPSC"). See "Certain Regulatory Matters."

Interests of Certain Persons in the Merger

Certain members of the management of DQE and the DQE Board who have interests in the Merger in addition to their interests as holders of DQE Common Stock participated in the negotiation of the terms of the Merger Agreement. The DQE Board considered these interests in reaching its conclusion that the Merger Agreement and the transactions contemplated thereby are fair to and in the best interests of DQE and its stockholders, customers and employees and the communities which it serves.

Directors and Officers

The Merger Agreement provides that the APS Board will, upon consummation of the Merger, be composed of 15 directors, of which six will be designated by DQE and nine will be designated by APS. Pursuant to the Merger Agreement, after the Effective Time, Alan J. Noia will be Chairman and Chief Executive Officer of APS and David D. Marshall will be President and Chief Operating Officer of APS.

Severance Agreements

DQE has entered into severance agreements with 13 officers of DQE and its affiliates, including seven executive officers of DQE. See "Interests of Certain Persons in the Merger — Severance Agreements."

DQE Long-Term Incentive Plan

Upon the adoption of the Merger Agreement by the holders of DQE Common Stock, certain options to purchase shares of DQE Common Stock held by DQE officers will vest pursuant to the terms of the DQE Stock Plan under which they were granted. See "Interests of Certain Persons in the Merger — DQE, Inc. Long-Term Incentive Plan."

Director and Officer Indemnification and Insurance

Pursuant to the Merger Agreement, APS has agreed that from and after the Effective Time it will indemnify and hold harmless each present and former director and officer of DQE or any of its Subsidiaries (when acting in such capacity) against any costs or expenses (including reasonable attorneys' fees), judgments, fines, losses, claims, damages or liabilities incurred in connection with any claim, action, suit, proceeding or investigation, whether civil, criminal, administrative or investigative, arising out of matters existing or occurring at or prior to the Effective Time, whether asserted or claimed prior to, at or after the Effective Time, to the fullest extent that DQE or such Subsidiary is permitted under the law of its jurisdiction of incorporation and the Articles of Incorporation of DQE, effective January 5, 1989, as amended (the "DQE Articles") and the Bylaws of DQE (the "DQE Bylaws") in effect on the date of the Merger Agreement to indemnify such person. In addition, the Merger Agreement provides that the Surviving Corporation will maintain DQE's existing officers' and directors' liability insurance ("D&O Insurance") for a period of six years after the Effective Time so long as the annual premium therefor is not in excess of 200% of the last annual premium paid prior to the date of the Merger Agreement (the "Current Premium"); *provided, however,* that if the existing D&O Insurance expires, is terminated or canceled during such six-year period, the Surviving Corporation will use its reasonable efforts to obtain as much D&O Insurance as can be obtained for the remainder of such period for a premium not in excess (on an annualized basis) of 200% of the Current Premium.

Accounting Treatment

Consummation of the Merger is conditioned upon the receipt by each of APS and DQE of a letter from its independent public accountants, Price Waterhouse LLP and Deloitte & Touche, respectively, stating that the Merger, in their respective opinions, will qualify as a "pooling of interests" for accounting purposes. See "The Merger Agreement — Conditions." Under this method of accounting, APS will restate its consolidated financial statements at the Effective Time to include the assets, liabilities, stockholders' equity and results of operations of DQE. It is anticipated that, upon consummation of the Merger, the fiscal year of the combined company will be the calendar year. See "Accounting Treatment."

Resale of APS Common Stock

The shares of APS Common Stock issuable to stockholders of DQE in connection with the Merger will be freely transferable by the holders thereof except for those shares held by holders who may be deemed to be "affiliates" of DQE. See "Resale of APS Common Stock."

Dividends

It is presently anticipated that, following the Effective Time, the current \$1.72 annual dividend per share of APS Common Stock will be maintained or increased, subject to evaluation from time to time by the APS Board based on APS' results of operations, financial condition, capital requirements, future business prospects, regulatory environment and such other considerations as the APS Board deems relevant. However, no assurance can be given that such dividend will be maintained or increased.

Certain Federal Income Tax Consequences

The Merger is intended to qualify for federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Code. Assuming the Merger so qualifies as a reorganization within the meaning of Section 368(a) of the Code, in general, no gain or loss will be recognized by holders of DQE Common Stock with respect thereto on the surrender of their DQE Common Stock in exchange for APS Common Stock, except with respect to cash received in lieu of fractional shares, and no gain or loss will be recognized by APS or DQE. Under the Merger Agreement it is a condition precedent to the respective obligations of APS and DQE to consummate the Merger that each of APS and DQE will have received an opinion of its respective counsel, dated as of the Closing Date (as defined in the Merger Agreement), to the effect that the Merger will constitute a reorganization within the meaning of Section 368(a) of the Code and that each of DQE, APS and Merger Sub will be a party to the reorganization within the meaning of Section 368(b) of the Code. For a further discussion of the federal income tax consequences of the Merger, see "Certain Federal Income Tax Consequences of the Merger."

Certain Related Agreements

Stock Option Agreement

In connection with the Merger Agreement and the Merger, APS and DQE entered into the Stock Option Agreement, pursuant to which DQE granted to APS an option (the "Option") to purchase up to 15,379,007 shares of DQE Common Stock under certain circumstances at an initial cash price per share of DQE Common Stock equal to \$27.850. The Stock Option Agreement provides that in no event will the number of shares of DQE Common Stock for which the Option is exercisable exceed 19.9% of DQE Common Stock issued and outstanding at the time of exercise. See "Certain Related Agreements — Stock Option Agreement."

APS may exercise its Option, in whole or in part, if, but only if, a Triggering Event (as defined under "Certain Related Agreements — Stock Option Agreement") has occurred prior to the occurrence of an Exercise Termination Event (as defined under "Certain Related Agreements — Stock Option Agreement"); *provided* that APS sends DQE a written notice of such exercise within 180 days following the first such Triggering Event. See "Certain Related Agreements — Stock Option Agreement."

The Stock Option Agreement also provides that APS may require DQE to repurchase the Option from APS in certain circumstances. See "Certain Related Agreements — Stock Option Agreement." The Stock Option Agreement further provides that the Total Profit (as defined under "Certain Related Agreements — Stock Option Agreement") of APS in such repurchase will not exceed \$20,000,000. See "Certain Related Agreements — Stock Option Agreement."

Letter Agreement

APS and DQE have also entered into a Letter Agreement, dated April 5, 1997 (the "Letter Agreement"). The Letter Agreement provides that, in certain circumstances upon a termination of the

Merger Agreement, APS will pay a fee to DQE of up to \$20,000,000, based upon the difference between the market value of 19.9% of the outstanding shares of APS Common Stock on the date of an applicable termination and the market value of such shares on April 4, 1997. See "Certain Related Agreements — Letter Agreement."

Certain Effects of the Merger on the Rights of Holders of DQE Common Stock

Holders of DQE Common Stock who receive APS Common Stock pursuant to the Merger will have certain rights as stockholders of APS that are different from those rights they had as stockholders of DQE. For a comparison of certain provisions of the APS Charter, the APS Bylaws and the MGCL with the DQE Articles, the DQE Bylaws and the PBCL, see "Comparison of Certain Rights of the Holders of APS Common Stock and DQE Common Stock."

APS Charter Amendment

The APS Board has determined that the Charter Amendment is advisable for APS whether or not the Merger is effectuated. Stockholders of APS should not be affected in any way by this change of name. Further, stockholders of APS will not be required to take any actions, following the APS Special Meeting, to effect the Charter Amendment; stock certificates representing shares of APS Common Stock will not need to be exchanged for new stock certificates. **The APS Board unanimously recommends that the holders of APS Common Stock vote FOR the Charter Amendment.** See "The APS Charter Amendment."

Amendment to the DQE Articles

The DQE Board has determined that the Control Transactions Amendment, which would amend the DQE Articles to make the Pennsylvania Control Transactions Statute inapplicable to DQE, is advisable for DQE. DQE does not believe holders of DQE Common Stock would be entitled to any rights under the Pennsylvania Control Transactions Statute as a result of the Merger, but because there is no controlling precedent interpreting this portion of the Pennsylvania Control Transactions Statute, DQE is recommending the Control Transactions Amendment in order to remove any possible uncertainty or legal challenge. If the Pennsylvania Control Transactions Statute were applicable to the Merger, holders of DQE Common Stock would have the right following the Merger to demand payment for the fair value of their DQE Common Stock as determined in accordance with the Pennsylvania Control Transactions Statute. Such payments could adversely affect the ability of APS and DQE to account for the Merger as a "pooling of interests" for accounting purposes. Notwithstanding the approval of the Control Transactions Amendment by the stockholders of DQE, DQE will not file the Control Transactions Amendment until all of the conditions to the Merger have been satisfied or waived. Therefore, even if there is stockholder approval of the Control Transactions Amendment, if the Merger does not occur, the Control Transactions Amendment will not have become effective, and DQE will remain subject to the Pennsylvania Control Transactions Statute. A copy of the Control Transactions Amendment is attached as Appendix E to this Joint Proxy Statement/Prospectus. **The DQE Board unanimously recommends that the holders of DQE Common Stock vote FOR the Control Transactions Amendment.**

COMPARATIVE STOCK PRICES

APS Common Stock and DQE Common Stock are each listed on the NYSE, as well as on certain other exchanges. APS is listed under the symbol "AYP" and DQE is listed under the symbol "DQE". The following table sets forth, for the periods indicated, the high and low sale prices per share of APS Common Stock and DQE Common Stock as reported on the NYSE Composite Transactions Tape during the periods listed.

Calendar Quarter	APS Common Stock		DQE Common Stock	
	High	Low	High	Low
1995				
First Quarter	\$24 ³ / ₈	\$21 ¹ / ₂	\$22 ³ / ₈	\$19 ³ / ₈
Second Quarter	25 ³ / ₈	22 ³ / ₄	25	21 ³ / ₈
Third Quarter	26	22 ⁷ / ₈	26 ³ / ₈	23 ¹ / ₂
Fourth Quarter	29 ¹ / ₄	25 ¹ / ₂	30 ³ / ₄	26 ¹ / ₂
1996				
First Quarter	30 ⁷ / ₈	28	31 ¹ / ₂	27 ¹ / ₂
Second Quarter	31 ¹ / ₁₆	28 ¹ / ₂	28 ⁷ / ₈	25 ³ / ₄
Third Quarter	31	29	28 ³ / ₄	27
Fourth Quarter	31 ¹ / ₈	28 ⁷ / ₈	30 ³ / ₈	27
1997				
First Quarter	31 ³ / ₈	29 ¹ / ₈	29 ³ / ₈	27 ³ / ₄
Second Quarter (through June 24, 1997)	30 ³ / ₈	25 ¹ / ₂	29 ³ / ₄	26 ¹ / ₂

On April 4, 1997, the last trading day before the public announcement of the Merger Agreement, the closing prices of APS Common Stock and DQE Common Stock as reported on the NYSE Composite Transactions Tape were \$29.75 per share and \$27.125 per share, respectively. Based on the Exchange Ratio, the pro forma equivalent per share value of DQE Common Stock on April 4, 1997, was \$33.32 per share. The pro forma equivalent per share value of DQE Common Stock on any date equals the closing sale price of APS Common Stock on such date, as reported on the NYSE Composite Transaction Tape, multiplied by the Exchange Ratio.

On June 24, 1997, the closing sale prices of APS Common Stock and DQE Common Stock as reported on the NYSE Composite Transactions Tape were \$26.4375 per share and \$28 per share (\$29.61 on a pro forma equivalent per share basis), respectively.

Holders of shares of DQE Common Stock and APS Common Stock are urged to obtain current quotations for the market prices of APS Common Stock and DQE Common Stock.

No assurance can be given as to the market prices of APS Common Stock or DQE Common Stock at the Effective Time. The Exchange Ratio is fixed in the Merger Agreement. As a result, the market value of APS Common Stock that holders of DQE Common Stock will receive upon consummation of the Merger may vary significantly from the market value of the shares of APS Common Stock that holders of DQE Common Stock would receive if the Merger were consummated and holders of DQE Common Stock received shares of APS Common Stock on the date of this Joint Proxy Statement/Prospectus.

SELECTED UNAUDITED HISTORICAL AND PRO FORMA COMBINED FINANCIAL DATA

The following table presents selected historical financial data of APS and DQE and selected unaudited pro forma combined financial data after giving effect to the Merger as a "pooling of interests." APS' and DQE's selected historical data for each of the five years in the period ended December 31, 1996 and the three months ended March 31, 1997 have been derived from financial statements filed with the SEC. The pro forma combined financial data are presented for illustrative purposes only and are not necessarily indicative of the financial position or operating results that would have occurred or that will occur upon consummation of the Merger. The pro forma combined financial data do not give effect to any cost savings which may result from the integration of APS' and DQE's operations. Additionally, the pro forma combined financial data do not include any transaction costs relating to the Merger, nor do they consider any reorganization costs that might occur as a result of the Merger. The following selected financial data should be read in conjunction with the notes thereto and with the related historical and pro forma combined financial statements and notes thereto incorporated by reference or included herein. See "Available Information," "Incorporation of Certain Information by Reference" and "Unaudited Pro Forma Combined Financial Information of APS and DQE."

Selected Historical Financial Data

	APS					
	Three Months Ended March 31, 1997	Year Ended December 31,				
		1996	1995	1994	1993	1992
(Dollars in Millions, Except Per Share Amounts)						
Income Statement Data						
Total Revenue	\$ 615	\$2,328	\$2,315	\$2,185	\$2,051	\$1,963
Operating Expenses	<u>491</u>	<u>1,937</u>	<u>1,893</u>	<u>1,802</u>	<u>1,676</u>	<u>1,607</u>
Income from Operations (c)	124	391	422	383	375	356
Income before Cumulative Effect of Accounting Change	78	210	240	220	216	204
Cumulative Effect of Accounting Change (a)	<u>—</u>	<u>—</u>	<u>—</u>	<u>43</u>	<u>—</u>	<u>—</u>
Net Income (c)	\$ 78	\$ 210	\$ 240	\$ 263	\$ 216	\$ 204
Earnings Per Share before Effect of Accounting Change	\$ 0.64	\$ 1.73	\$ 2.00	\$ 1.86	\$ 1.88	\$ 1.83
Cumulative Effect of Accounting Change (a)	<u>—</u>	<u>—</u>	<u>—</u>	<u>0.37</u>	<u>—</u>	<u>—</u>
Earnings Per Share after Effect of Accounting Change	\$ 0.64	\$ 1.73	\$ 2.00	\$ 2.23	\$ 1.88	\$ 1.83
Dividends Declared Per Share of APS Common Stock	\$ 0.43	\$ 1.69	\$ 1.65	\$ 1.64	\$ 1.63	\$ 1.61
Balance Sheet Data						
Total Assets	\$6,618	\$6,619	\$6,447	\$6,362	\$5,949	\$5,039
Capitalization						
Long-Term Debt	\$2,307	\$2,397	\$2,273	\$2,179	\$2,008	\$1,952
Preferred/Preference Stock	170	170	170	325	276	278
Common Shareholders' Equity	<u>2,202</u>	<u>2,169</u>	<u>2,130</u>	<u>2,059</u>	<u>1,956</u>	<u>1,828</u>
Total Capitalization	\$4,679	\$4,736	\$4,573	\$4,563	\$4,240	\$4,058
Book Value Per Share of APS						
Common Stock	\$18.04	\$17.80	\$17.65	\$17.26	\$16.62	\$16.05

Selected Historical Financial Data
DQE

	Three Months Ended March 31, 1997	Year Ended December 31,				
		1996	1995	1994	1993	1992
(Dollars in Millions, Except Per Share Amounts)						
Income Statement Data						
Total Revenue	\$ 301	\$1,225	\$1,220	\$1,224	\$1,183	\$1,153
Operating Expenses	226	923	898	907	870	809
Income from Operations	75	302	322	317	313	344
Income before Cumulative Effect of Accounting Changes	45	179	171	157	141	142
Cumulative Effect of Accounting Changes (a)	—	—	—	—	3	—
Net Income	\$ 45	\$ 179	\$ 171	\$ 157	\$ 144	\$ 142
Earnings Per Share before Effect of Accounting Changes	\$ 0.58	\$ 2.32	\$ 2.20	\$ 1.98	\$ 1.77	\$ 1.78
Cumulative Effect of Accounting Changes (a)	\$ —	\$ —	\$ —	\$ —	\$ 0.04	\$ —
Earnings Per Share after Effect of Accounting Changes	\$ 0.58	\$ 2.32	\$ 2.20	\$ 1.98	\$ 1.81	\$ 1.78
Dividends Declared Per Share of DQE Common Stock	\$ 0.34	\$ 1.30	\$ 1.21	\$ 1.13	\$ 1.08	\$ 1.03
Balance Sheet Data						
Total Assets	\$4,623	\$4,639	\$4,459	\$4,427	\$4,550	\$3,778
Capitalization						
Long-Term Debt	\$1,402	\$1,440	\$1,401	\$1,378	\$1,417	\$1,413
Preferred/Preference Stock	224	223	71	95	133	132
Common Shareholders' Equity	1,409	1,392	1,329	1,277	1,231	1,171
Total Capitalization	\$3,035	\$3,055	\$2,801	\$2,750	\$2,781	\$2,716
Book Value Per Share of DQE						
Common Stock	\$18.22	\$18.01	\$17.13	\$16.27	\$15.47	\$14.75

**Selected Unaudited Pro Forma Financial Data
APS and DQE**

	Three Months Ended March 31, 1997	Year Ended December 31,		
		1996	1995	1994
(Dollars in Millions, Except Per Share Amounts and Percentages)				
Income Statement Data (b)				
Total Revenue	\$ 909	\$ 3,546	\$ 3,535	\$ 3,398
Operating Expenses	666	2,718	2,638	2,561
Income from Operations (c)	243	828	897	837
Net income(c)	119	393	409	383
Earnings Per Share (d)	\$ 0.57	\$ 1.89	\$ 1.98	\$ 1.85
Dividends Per Share of Common Stock (d)	\$ 0.38	\$ 1.47	\$ 1.41	\$ 1.37
Dividend Payout Ratio (f)	75.4%	91.0%	—	—
Equivalent DQE Pro Forma Per Share Data				
Earnings Per Share (e)	\$ 0.64	\$ 2.12	\$ 2.21	\$ 2.07
Dividends Per Share of Common Stock (e)	\$ 0.43	\$ 1.65	\$ 1.58	\$ 1.53
Balance Sheet Data (b)				
Total Assets	\$11,269	\$11,290	\$10,941	\$10,819
Capitalization				
Long-Term Debt	\$ 3,709	\$ 3,837	\$ 3,674	\$ 3,556
Preferred/Preference Stock	394	393	241	265
Common Shareholders' Equity	3,621	3,535	3,429	3,308
Total Capitalization	\$ 7,724	\$ 7,765	\$ 7,344	\$ 7,129
Book Value Per Share of Common Stock (d)	\$ 17.37	\$ 16.96	\$ 16.52	\$ 15.96
Equivalent DQE Pro Forma Per Share Data				
Book Value Per Share of Common Stock (e)	\$ 19.45	\$ 19.00	\$ 18.50	\$ 17.88

Notes to Selected Unaudited Historical and Pro Forma Combined Financial Data

- (a) The 1994 amount of \$43 million (\$.37 per share) represents the cumulative effect of a change in APS' accounting to provide for the accrual of revenue for services rendered but unbilled. The 1993 amount of \$3 million (\$.04 per share) represents DQE's net cumulative effect for changes in accounting for the adoption of "Statement of Financial Accounting Standards No. 109, Income Taxes" (\$8.0 million) and the cumulative effect of accounting for maintenance costs by accruing over the periods between outages for anticipated expenses of scheduled major fossil generating station outages (\$5.4 million).
- (b) The revenues, expenses, assets, liabilities and equity of APS and DQE have been reclassified where appropriate to conform to the presentation expected to be used by the combined company in the future. See "Unaudited Pro Forma Combined Financial Information of APS and DQE."
- (c) Income/earnings for the year ended December 31, 1996 and December 31, 1995 include pretax charges of \$103.9 million and \$23.4 million, respectively, related to restructuring activities.
- (d) Pro forma per common share amounts give effect to the conversion of each share of DQE Common Stock outstanding into 1.12 shares of APS Common Stock. See "The Merger Agreement" and "Unaudited Pro Forma Combined Financial Information of APS and DQE."
- (e) Represents the pro forma equivalent of one share of DQE Common Stock calculated by multiplying the pro forma information by the Exchange Ratio.
- (f) Calculated by dividing the current annual dividend rate of APS per share by pro forma earnings per share. The \$1.72 current dividend rate per share represents the dividend rate APS expects to maintain or increase following the Merger. However, no assurance can be given that such dividend rate will be maintained or increased.

THE STOCKHOLDERS MEETINGS

General

APS

This Joint Proxy Statement/Prospectus is being furnished to holders of APS Common Stock in connection with the solicitation of proxies by the APS Board for use at the APS Special Meeting, to be held on August 7, 1997, and any adjournments or postponements thereof, to consider and vote upon (i) the approval of the issuance of APS Common Stock contemplated by the Merger Agreement and (ii) the approval of the Charter Amendment, and to transact such other business as may properly come before the APS Special Meeting or any adjournments or postponements thereof.

The APS Board has unanimously approved the Merger Agreement and the Charter Amendment and unanimously recommends that APS stockholders vote FOR the approval of the issuance of shares of APS Common Stock pursuant to the Merger Agreement and vote FOR the Charter Amendment.

Each copy of this Joint Proxy Statement/Prospectus mailed to holders of APS Common Stock is accompanied by a form of proxy for use at the APS Special Meeting.

DQE

This Joint Proxy Statement/Prospectus is also being furnished to holders of DQE Common Stock in connection with the solicitation of proxies by the DQE Board for use at the DQE Meeting, to be held on August 7, 1997, and any adjournments or postponements thereof, (i) to consider and vote upon the adoption of the Merger Agreement and approval of the transactions contemplated thereby, (ii) to consider and vote upon the approval of the Control Transactions Amendment, (iii) to elect four directors to the DQE Board to serve until the annual meeting of stockholders of DQE in the year 2000, (iv) to consider and vote upon the approval of the Accountant Proposal, (v) to consider and vote upon the Stockholder Proposal if presented at the DQE Meeting and (vi) to transact such other business as may properly come before the DQE Meeting or any adjournments or postponements thereof.

The DQE Board has unanimously approved the Merger Agreement and unanimously recommends that stockholders of DQE vote FOR the adoption of the Merger Agreement and approval of the transactions contemplated thereby. The DQE Board unanimously recommends that stockholders of DQE vote FOR the Control Transactions Amendment, vote FOR the directors nominated by the DQE Board for election to the DQE Board, vote FOR the Accountant Proposal and vote AGAINST the Stockholder Proposal.

Each copy of this Joint Proxy Statement/Prospectus mailed to holders of DQE Common Stock is accompanied by a form of proxy for use at the DQE Meeting.

This Joint Proxy Statement/Prospectus is also furnished to DQE stockholders as a prospectus in connection with the issuance by APS of shares of APS Common Stock contemplated by the Merger Agreement.

Date, Place and Time

The APS Special Meeting will be held at Howard Johnson of Hagerstown, 1718 Underpass Way, Hagerstown, Maryland 21740 on August 7, 1997 at 1:00 p.m., local time.

The DQE Meeting will be held at the Manchester Craftsmen's Guild Auditorium, 1815 Metropolitan Street, Pittsburgh, Pennsylvania 15233 on August 7, 1997 at 11:00 a.m., local time.

Record Dates

APS

The Executive Committee of the APS Board has fixed the close of business on June 30, 1997 as the APS Record Date for the determination of the holders of APS Common Stock entitled to receive notice of and to vote at the APS Special Meeting and at any adjournments or postponements thereof.

DQE

The DQE Board has fixed the close of business on June 16, 1997 as the DQE Record Date for the determination of the holders of DQE Common Stock entitled to receive notice of and to vote at the DQE Meeting and at any adjournments or postponements thereof.

Votes Required

APS

As of June 1, 1997, there were 122,111,567 shares of APS Common Stock issued and outstanding. Each share of APS Common Stock outstanding on the APS Record Date is entitled to one vote upon each matter properly submitted at the APS Special Meeting. The affirmative vote of a majority of the votes cast at the APS Special Meeting is necessary for the approval of the issuance of the shares of APS Common Stock contemplated by the Merger Agreement. The affirmative vote of a majority of the total number of shares of APS Common Stock outstanding is necessary for approval of the Charter Amendment.

Under the rules of the NYSE, in order to approve these proposals, the total number of votes cast (whether for or against) with respect to such matter must be in excess of 50% of the outstanding shares of APS Common Stock. Abstentions will be counted as present for the purposes of determining whether a quorum is present. Any abstention or broker non-vote will have the effect of reducing the aggregate number of shares of APS Common Stock voting and the number of shares of APS Common Stock required to approve the issuance of shares of APS Common Stock contemplated by the Merger Agreement. With respect to the Charter Amendment, any abstention or broker non-vote will have the same effect as a negative vote. Under the rules of the NYSE, brokers who hold shares in street name for customers will not have authority to vote either on the issuance of shares of APS Common Stock contemplated by the Merger or on the Charter Amendment, unless they receive specific instructions from beneficial owners.

As of June 1, 1997, directors and executive officers of APS and their affiliates beneficially owned an aggregate of 75,272 shares of APS Common Stock (including shares which may be acquired within 60 days upon exercise of employee stock options), or less than 0.1% of the shares of APS Common Stock outstanding on such date. The directors and executive officers of APS have indicated their intention to vote their shares of APS Common Stock in favor of approval of the issuance of the shares of APS Common Stock contemplated by the Merger Agreement and in favor of approval of the Charter Amendment.

As of June 16, 1997, the directors and executive officers of DQE owned no shares of APS Common Stock.

See "— Interests of Certain Persons in the Merger."

DQE

As of June 16, 1997, there were 77,408,557 shares of DQE Common Stock issued and outstanding. Other than with respect to the election of directors, each share of DQE Common Stock outstanding on the DQE Record Date is entitled to one vote upon each matter properly submitted at the DQE Meeting. The affirmative vote of a majority of the votes cast at the DQE Meeting is necessary for the adoption of the Merger Agreement and the approval of the transactions contemplated thereby. With respect to the election of directors, the four persons receiving the highest number of votes will be elected as directors. The affirmative vote of a majority of the votes cast at the DQE Meeting is necessary for the adoption of the Control Transactions Amendment, the Accountant Proposal and the Stockholder Proposal.

Stockholders of DQE have cumulative voting rights with respect to the election of directors of DQE. Cumulative voting entitles each stockholder of DQE to as many votes as is equal to the number of whole shares of DQE Common Stock held by such stockholder, multiplied by the number of directors to be elected. Each stockholder may cast all of those votes for a single nominee or may distribute them among two or more nominees.

Holders of preferred stock or capital stock of Duquesne Light or any of the other subsidiaries of DQE will not have voting rights with respect to any of the matters to be acted upon at the DQE Meeting. The terms of such preferred stock or other capital stock will not be affected by the Merger.

The presence in person or by proxy at the DQE Meeting of the holders entitled to vote a majority of the outstanding shares of DQE Common Stock is necessary to constitute a quorum for the transaction of business. Abstentions will be counted as present for the purposes of determining whether a quorum is present. Any abstention or broker non-vote will have (i) the effect of reducing the aggregate number of shares of DQE Common Stock required to adopt (a) the Merger Agreement and approve the transactions required thereby, (b) the Accountant Proposal and (c) the Stockholder Proposal, and (ii) no effect on the election of directors of DQE. Under the rules of the NYSE, brokers who hold shares in street name for customers will have no authority to vote on the Merger, the Control Transactions Amendment or the Stockholder Proposal, unless they receive specific instructions from beneficial owners. Such brokers, however, may vote in the election of directors or on the Accountant Proposal without having received specific instructions from beneficial owners.

As of June 16, 1997, directors and executive officers of DQE and its affiliates beneficially owned an aggregate of 633,161 shares of DQE Common Stock (including shares which may be acquired within 60 days upon exercise of employee stock options) or less than 1% of the shares of DQE Common Stock outstanding on such date. The directors and executive officers of DQE have indicated their intention to vote their shares of DQE Common Stock in favor of adoption of the Merger Agreement and approval of the transactions contemplated thereby. The directors and executive officers of DQE have also indicated their intention to vote their shares of DQE Common Stock in favor of the directors nominated by the DQE Board, the Control Transactions Amendment and the Accountant Proposal and against the Stockholder Proposal.

As of June 1, 1997, directors and executive officers of APS owned no shares of DQE Common Stock. See "Interests of Certain Persons in the Merger."

Voting and Revocation of Proxies

Shares of APS Common Stock and DQE Common Stock represented by a proxy properly signed and received at or prior to the appropriate Stockholders Meeting, unless subsequently revoked, will be voted in accordance with the instructions thereon. **If a proxy is signed and returned without indicating any voting instructions, shares of APS Common Stock represented by the proxy will be voted FOR the proposal to approve the issuance of shares of APS Common Stock contemplated by the Merger Agreement and will be voted FOR the proposal to adopt the Charter Amendment, and shares of DQE Common Stock represented by a proxy properly signed and received will be voted FOR the proposal to adopt the Merger Agreement and to approve the transactions contemplated thereby, FOR the election as a director of DQE of each of the persons nominated for director of DQE by the DQE Board, FOR the Control Transactions Amendment, FOR the Accountant Proposal and AGAINST the Stockholder Proposal.** Votes for election of directors will be cumulated selectively (at the discretion of the holders of such stockholder's proxy) among those nominees for director for whom the stockholder has not withheld authority to vote. Any proxy given pursuant to this solicitation may be revoked by the person giving it at any time before the proxy is voted by filing a duly executed revocation with the Secretary of APS, for stockholders of APS, or with the Corporate Secretary of DQE, for stockholders of DQE, prior to or at the appropriate Stockholders Meeting or, in the case of stockholders of APS, by the execution of a subsequent proxy in favor of another person. All written notices of revocation and other communications with respect to revocation of APS proxies should be addressed as follows: Allegheny Power System, Inc., 10435 Downsville Pike, Hagerstown, Maryland 21740, Attention: Secretary. All written notices of revocation and other communications with respect to revocation of DQE

proxies should be addressed as follows: DQE, Inc., 411 Seventh Avenue, 15th Floor, Pittsburgh, Pennsylvania 15219, Attention: Secretary.

Holders of DQE Common Stock will be entitled to present matters for consideration at the DQE Meeting. Holders of APS Common Stock would be entitled to present matters for consideration at the APS Special Meeting, if additional proposals are permitted at the APS Special Meeting and, in such a situation, the stockholder complies with the applicable provisions of the APS Bylaws. See "Comparison of Certain Rights of the Holders of APS Common Stock and DQE Common Stock — Meetings of Stockholders — APS," and "— Stockholder Proposals and Stockholder Nominations of Directors — APS."

The APS Board and the DQE Board are not currently aware of any business to be acted upon at their respective Stockholders Meetings other than as described herein. If, however, other matters are properly brought before either Stockholders Meeting, or any adjournments or postponements thereof, the persons appointed as proxies will have discretion to vote or act thereon according to their best judgment. Such adjournment may be for the purpose of soliciting additional proxies. Shares represented by proxies voting against the issuance of shares of APS Common Stock contemplated by the Merger Agreement, in the case of APS, and against the adoption of the Merger Agreement and the approval of the transactions contemplated thereby, in the case of DQE, will be voted against a proposal to adjourn the respective Stockholder Meeting for the purpose of soliciting additional proxies. Neither APS nor DQE currently intends to seek an adjournment of its respective Stockholder Meeting.

Solicitation of Proxies

In addition to solicitation by mail, directors, officers and employees of APS and DQE, none of whom will be specifically compensated for such services, may solicit proxies from the stockholders of APS and DQE, respectively, personally or by telephone, telecopy, telegram or other forms of communication. Brokerage houses, nominees, fiduciaries and other custodians will be requested to forward soliciting materials to beneficial owners and will be reimbursed for their reasonable expenses incurred in sending proxy materials to beneficial owners.

In addition, APS and DQE have retained MacKenzie Partners, Inc. and Beacon Hill Partners, Inc., respectively, to assist in the solicitation of proxies from their respective stockholders. The fees to be paid to such firms for such services by each of APS and DQE are not expected to exceed \$15,000 and \$10,000, respectively, plus, in each case, reasonable out-of-pocket costs and expenses. APS and DQE each will bear its own expenses in connection with the solicitation of proxies for its Stockholders Meeting, except that each will pay one-half of all printing and filing costs and expenses incurred in connection with the Registration Statement and this Joint Proxy Statement/Prospectus.

DQE STOCKHOLDERS SHOULD NOT SEND DQE COMMON STOCK CERTIFICATES WITH THEIR PROXY CARDS.

THE COMPANIES

APS

APS is a registered electric utility holding company which in 1996 had operating revenues of approximately \$2.3 billion. At December 31, 1996, APS had total assets of approximately \$6.6 billion. APS was incorporated in 1925 in Maryland and owns, directly or indirectly, various regulated and unregulated subsidiaries. APS' primary subsidiaries are engaged principally in the generation, transmission, distribution and sale of electric energy. Its subsidiaries' properties, which are interconnected and operated as a single integrated electric utility system, are located in Maryland, Ohio, Pennsylvania, Virginia and West Virginia and provide energy to customers in portions of each of those states. APS provides electric service to nearly 1.4 million customers in an area of about 29,000 square miles.

DQE

DQE is an energy services holding company incorporated in 1989 in Pennsylvania which owns various regulated and unregulated subsidiaries. DQE's subsidiaries include (i) an electric utility engaged in the production, transmission, distribution and sale of electrical energy, (ii) a company that makes strategic investments related to DQE's core energy business, (iii) a company that offers energy solutions to customers in domestic and international markets such as energy facility development, operation and maintenance and independent power production, (iv) a company formed to explore strategic business opportunities in the energy industry, and (v) a financial services company that makes long-term investments and provides financing for DQE's services and products. DQE's electric utility provides electric service to customers in a service territory of about 800 square miles in southwestern Pennsylvania, comprised of parts of Allegheny County (including the City of Pittsburgh) and parts of Beaver County and Westmoreland County. This electric utility provides service to about 580,000 customers in this service area, and its revenues account for the majority of DQE's revenue.

Duquesne Light owns a 13.74% interest in Perry Unit 1, a 47.50% interest in Beaver Valley 1 and a 13.74% interest in Beaver Valley 2.

ADC is a wholly owned subsidiary of Duquesne Enterprises, Inc., which, in turn, is a wholly owned subsidiary of DQE. ADC is an electric utility company engaged in the business of owning facilities to provide complete energy services. Upon approval by the SEC, ADC will assign to DH Energy, Inc. all of its rights and obligations under certain agreements, and DH Energy, Inc. will become a public utility company pursuant to the PUHCA.

In addition, DES will shortly be forming MT. Upon SEC approval, MT will, among other things, enter into an Operation and Maintenance Services Agreement with ADC, and become a public utility company pursuant to the PUHCA.

Merger Sub

Merger Sub is to be formed by APS as a wholly owned subsidiary of APS solely for the purpose of effecting the Merger.

PRIOR CONTACTS BETWEEN THE COMPANIES

In October 1996, AYP Energy, Inc., an indirect wholly owned Subsidiary of APS, purchased Duquesne Light's 50% interest in Unit No. 1 of the Fort Martin Power Station for a price of approximately \$170 million pursuant to an agreement entered into in November 1995. In addition, APS and DQE are parties to several power exchange and regulatory agreements.

THE MERGER

This section describes certain aspects of the Merger. The following description does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, which is attached as Appendix A to this Joint Proxy Statement/Prospectus and is incorporated herein by reference. All holders of DQE Common Stock and holders of APS Common Stock are urged to read the Merger Agreement in its entirety. For a further description of the Merger Agreement, see "The Merger Agreement."

General

The Merger Agreement provides for a business combination between APS and DQE in which, subject to the satisfaction of the conditions therein, the Merger will be effected, DQE will become a wholly owned Subsidiary of APS, and the holders of DQE Common Stock, other than the Excluded Shares, will be issued APS Common Stock in a transaction intended to qualify as a "pooling of interests" for accounting purposes and as a "reorganization" within the meaning of Section 368(a) of the Code for federal income tax purposes. In the Merger, each outstanding share of DQE Common Stock (other than the Excluded Shares) will be

converted into the right to receive, and become exchangeable for, 1.12 shares of APS Common Stock. Each outstanding share of APS Common Stock will remain outstanding and be unaffected by the Merger. As a result of the Merger, holders of DQE Common Stock immediately prior to the Merger will own approximately 42% of the outstanding APS Common Stock after the Merger (based on the number of shares of APS Common Stock and DQE Common Stock outstanding as of June 1, 1997, and June 16, 1997, respectively).

Terms of the Merger

At the Effective Time, APS, Merger Sub and DQE will consummate the Merger in which Merger Sub will be merged with and into DQE, and the separate corporate existence of Merger Sub will thereupon cease. DQE, as the Surviving Corporation, will be a wholly owned subsidiary of APS and will continue to be governed by the laws of the Commonwealth of Pennsylvania. The Merger Agreement provides that the articles of incorporation of DQE in effect immediately prior to the Effective Time will remain the articles of incorporation of the Surviving Corporation. The Merger Agreement provides that the bylaws of Merger Sub in effect at the Effective Time shall be the bylaws of the Surviving Corporation following the Merger.

At the Effective Time, each issued and outstanding share of DQE Common Stock (other than the Excluded Shares) will be converted into the right to receive, and become exchangeable for, 1.12 shares of APS Common Stock, and the right, if any, to receive cash in lieu of any fractional share into which such shares of DQE Common Stock have been converted (as described below) and any distribution or dividend with a record date after the Effective Time, in each case without interest. By virtue of the Merger, the Excluded Shares shall cease to be outstanding and shall be canceled and retired without payment of any consideration.

If at any time during the period between the date of the Merger Agreement and the Effective Time there is a change in the number of shares of APS Common Stock or securities convertible or exchangeable into or exercisable for shares of APS Common Stock issued and outstanding as a result of a reclassification, stock split, stock dividend or distribution, or other similar transaction, the Exchange Ratio will be equitably adjusted.

No fractional shares of APS Common Stock will be issued in the Merger. Instead, the Merger Agreement provides that each holder of DQE Common Stock who would otherwise have been entitled to receive a fractional share of APS Common Stock will be entitled to receive, in lieu thereof, cash representing such holder's proportionate interest in a share of APS Common Stock, based on the closing price of such shares as reported in *The Wall Street Journal*, New York City edition, on the trading day immediately prior to the Effective Time.

The DQE DRSP provides that dividends on DQE Common Stock of plan participants will be used to purchase shares of DQE Common Stock at market value and also permits participants to invest in additional shares of DQE Common Stock through optional cash payments. The DQE DRSP credits whole shares and fractional shares of DQE Common Stock to participants' accounts. At the Effective Time, all shares of DQE Common Stock credited to participants' accounts under the DQE DRSP will be converted into a number of shares of APS Common Stock determined by multiplying the number of such shares of DQE Common Stock by the Exchange Ratio. All such shares of APS Common Stock will be held in the participants' accounts, with individual participants' accounts in the DQE DRSP being credited with fractional shares of APS Common Stock.

Effective Time

The Merger will become effective at the time when the Pennsylvania Articles of Merger have been duly filed with the Department of State of the Commonwealth of Pennsylvania as provided in Section 1927 of the PBCL.

Exchange of Certificates

Pursuant to the Merger Agreement, promptly after the Effective Time, the Surviving Corporation will cause the Exchange Agent to mail to each holder of DQE Common Stock (other than holders of the

Excluded Shares) (i) a letter of transmittal specifying that delivery will be effected, and risk of loss and title to the DQE Certificates will pass, only upon delivery of the DQE Certificates (or affidavits of loss in lieu thereof) to the Exchange Agent, such letter of transmittal to be in such form and to have such other provisions as APS and DQE may reasonably agree, and (ii) instructions for use in effecting the surrender of the DQE Certificates in exchange for (A) APS Certificates and (B) any unpaid dividends and other distributions and cash in lieu of fractional shares. Upon surrender of a DQE Certificate for cancellation to the Exchange Agent together with such letter of transmittal, duly executed, the holder of such DQE Certificate will be entitled to receive in exchange therefor (x) an APS Certificate representing the number of whole shares of APS Common Stock that such holder is entitled to receive pursuant to the Merger Agreement, (y) a check in the amount (after giving effect to any required tax withholdings) of (A) any cash in lieu of fractional shares plus (B) any unpaid non-stock dividends and any other dividends or other distributions that such holder has the right to receive pursuant to the Merger Agreement, and the DQE Certificate so surrendered will forthwith be canceled. No interest will be paid or will have accrued on any amount payable upon due surrender of the DQE Certificates. DQE Certificates surrendered by "affiliates" of DQE, as determined pursuant to the Merger Agreement, will be exchanged in accordance with the above procedure after APS receives from the "affiliate" a written agreement not to transfer the shares of APS Common Stock received in the exchange, except as permitted in the written agreement.

In the event of a transfer of ownership of DQE Common Stock that is not registered in the transfer records of DQE, an APS Certificate representing the proper number of shares of APS Common Stock, together with a check for any cash to be paid upon due surrender of the DQE Certificate and any other dividends or distributions in respect thereof, may be issued and/or paid to such a transferee if the DQE Certificate formerly representing such shares of DQE Common Stock is presented to the Exchange Agent, accompanied by all documents required to evidence and effect such transfer and to evidence that any applicable stock transfer taxes have been paid. If any APS Certificate is to be issued in a name other than that in which the DQE Certificate surrendered in exchange therefor is registered, it will be a condition of such exchange that the person or entity requesting such exchange pay any transfer or other taxes required by reason of the issuance of APS Certificates in a name other than that of the registered holder of the DQE Certificate surrendered, or establish to the satisfaction of APS or the Exchange Agent that such tax has been paid or is not applicable.

All APS Common Stock issued in connection with the Merger will be deemed issued and outstanding as of the Effective Time and whenever a dividend or other distribution is declared by APS in respect of the APS Common Stock, the record date for which is at or after the Effective Time, that declaration will include dividends or other distributions in respect of all shares issuable pursuant to this Agreement. No dividends or other distributions in respect of the APS Common Stock will be paid to any holder of any unsurrendered DQE Certificate until such DQE Certificate is surrendered for exchange in accordance with the provisions of the Merger Agreement. Subject to applicable Laws, following surrender of any such Certificate, there will be issued and/or paid to the holder of the APS Certificates issued in exchange therefor, without interest, (A) at the time of such surrender, the dividends or other distributions with a record date after the Effective Time theretofore payable with respect to such whole shares of APS Common Stock and not paid and (B) at the appropriate payment date, the dividends or other distributions payable with respect to such whole shares of APS Common Stock with a record date after the Effective Time but with a payment date subsequent to surrender.

In addition, pursuant to the Merger Agreement, holders of unsurrendered DQE Certificates will be entitled to vote after the Effective Time at any meeting of APS stockholders the number of whole shares of APS Common Stock represented by such DQE Certificates, regardless of whether such holders have exchanged their DQE Certificates.

After the Effective Time, there will be no transfers on the stock transfer books of DQE of shares of DQE Common Stock that were outstanding immediately prior to the Effective Time.

In the event any DQE Certificate is lost, stolen or destroyed, upon the making of an affidavit of that fact by the person claiming such DQE Certificate to be lost, stolen or destroyed and, if required by APS, the

posting by such person of a bond in customary amount as indemnity against any claim that may be made against it with respect to such DQE Certificate, the Exchange Agent will issue in exchange for such lost, stolen or destroyed DQE Certificate the shares of APS Common Stock and any cash payable and any unpaid dividends or other distributions in respect of APS Common Stock pursuant to the Merger Agreement upon due surrender of and delivery pursuant to the Merger Agreement in respect of the DQE Common Stock to which such Certificate relates.

HOLDERS OF DQE COMMON STOCK SHOULD NOT SEND THEIR CERTIFICATES TO THE EXCHANGE AGENT UNTIL TRANSMITTAL MATERIALS ARE RECEIVED FROM THE EXCHANGE AGENT. HOLDERS OF APS COMMON STOCK WILL NOT EXCHANGE THEIR CERTIFICATES.

Appraisal Rights

Holders of APS Common Stock will not be entitled to any dissenters' or appraisal rights under the MGCL as a result of the matters to be voted upon at the APS Special Meeting. Holders of DQE Common Stock will not be entitled to any dissenters' or appraisal rights under the merger and appraisal rights provisions of the PBCL as a result of any of the matters to be voted on at the DQE Meeting.

Pursuant to the terms of the Merger Agreement, DQE has agreed that the provisions of the Pennsylvania Control Transactions Statute will be inapplicable to DQE at the Effective Time. DQE believes that the Pennsylvania Control Transactions Statute is inapplicable to the Merger even if the Control Transactions Amendment is not approved, but in the absence of controlling legal precedent is seeking approval of the Control Transactions Amendment. In the event that the Control Transactions Amendment were not approved and the Pennsylvania Control Transactions Statute were applicable to the Merger, APS could have the right not to consummate the Merger, although APS and DQE have not determined how to proceed under such circumstances. If applicable, the Pennsylvania Control Transactions Statute provides, in effect, that any holder of DQE Common Stock who objects to the Merger will be entitled to the rights and remedies provided in the Pennsylvania Control Transactions Statute. In connection with their consideration of the Merger, holders of DQE Common Stock are being asked to approve the Control Transactions Amendment.

The Pennsylvania Control Transactions Statute provides, among other things, that any holder of shares of a corporation subject to the statute (as DQE is today) that becomes the subject of a control transaction (as defined in the Pennsylvania Control Transactions Statute) who shall object to the transaction shall be entitled to the rights and remedies provided by the Pennsylvania Control Transactions Statute. A control transaction is the acquisition, subject to certain specified exemptions, of voting power over voting shares entitled to cast at least 20% of the votes that all stockholders would be entitled to cast in an election of directors. The controlling person is required to give prompt notice that a control transaction has occurred to each stockholder of record and a Pennsylvania court, accompanied by a petition requesting that the court determine the fair value of the voting shares. The Pennsylvania Control Transactions Statute also sets out procedures to be followed for determining such fair value for holders of voting shares to receive such payment.

Although DQE does not believe the Pennsylvania Control Transactions Statute is applicable to statutory mergers, such as the Merger, it could have the effect of deterring an acquisition by any person of 20% or more of the shares of DQE Common Stock without acquiring, or offering to acquire, all of the shares of DQE Common Stock. Notwithstanding the approval of the Control Transactions Amendment by the stockholders of DQE, DQE will not file the Control Transactions Amendment until all other conditions to the Merger have been satisfied or waived. Therefore, even if there is stockholder approval of the Control Transactions Amendment, if the Merger does not occur, the Control Transactions Amendment will not have become effective, and DQE will remain subject to the Pennsylvania Control Transactions Statute.

The foregoing description of the Pennsylvania Control Transactions Statute is qualified in its entirety by reference to the text of the Pennsylvania Control Transactions Statute which is attached as Appendix D to this Joint Proxy Statement/Prospectus.

Background of the Merger

The electric utility industry throughout the United States is in the early stages of dramatic changes that are intended to bring competition to what has been, since the electric industry's inception, a collection of regional monopolies. These changes have been brought about in part through the adoption of the Energy Policy Act of 1992 and through orders 888 and 889 of the FERC. In addition, in Pennsylvania, where DQE has all of its electric utility business and APS has a substantial portion of its electric utility business, the trend to bring about competition led to the enactment in late 1996 of the Electricity Generation Customer Choice and Competition Act, 66 Pa. Cons. Stat. § 2801 et seq. (the "Pennsylvania Restructuring Legislation"), which provides, among other things, for a phase in of competition for retail electric customers in Pennsylvania and an opportunity for recovery of certain capital costs ("stranded costs") incurred by utilities in a regulated environment that are not likely to be recoverable through prices charged in a competitive environment. In light of these developments, both the APS Board and the DQE Board have been engaged in reviews of steps they might take to best position their respective companies to take advantage of the changes occurring in the electric utility industry.

In late 1996, the chief executive officers of APS and DQE met on several occasions and had several phone conversations to discuss a possible combination between APS and DQE. As a result of these contacts, APS and DQE agreed in December of 1996 to commence a process of due diligence and to determine if a mutually desirable transaction could be agreed upon. These early contacts concluded with understandings that APS was open to the idea of negotiating an exchange ratio that would give holders of DQE Common Stock a premium to its market trading price, that the board of directors of the combined company could include representation from the DQE Board approximately equivalent to the percentage ownership of DQE stockholders in the combined company after the Merger and that APS saw a good fit for DQE management in APS after the Merger.

An initial meeting of APS and DQE managements and their respective legal and financial advisors was held in late December 1996, at which time important areas of due diligence were identified and a subsequent mutual due diligence presentation was scheduled. After this December meeting, APS and DQE began the organization of due diligence information regarding their respective companies for review by the other. In mid-January 1997, the senior managements of APS and DQE met and each gave a business overview presentation to the other party and its legal and financial advisors and responded to questions. Thereafter, representatives of APS and DQE performed financial, operating and legal due diligence investigations on the other party and throughout January through April 1997, negotiated the legal and financial terms of the Merger. In addition, APS retained legal counsel experienced in nuclear-related matters, a firm of consulting nuclear engineers and a retired nuclear utility executive to assist APS in its due diligence investigation of the Nuclear Facilities.

The negotiations of the terms of the Merger Agreement focused most intensely upon the number of shares of APS Common Stock into which each share of DQE Common Stock would be converted in the Merger, the status of events concerning the Nuclear Facilities, whether contractual language relating to an adverse regulatory or operating event at the Nuclear Facilities that does not give rise to a material adverse effect on DQE should give APS a right not to consummate the Merger or result in a reduction in the Exchange Ratio, the circumstances under which the terms of regulatory approvals could give APS, or APS and DQE, a right not to consummate the Merger, the circumstances under which termination fees would be payable and the amount of those fees, and the circumstances under which either party could negotiate with a third party regarding an alternative merger proposal or terminate the Merger Agreement to accept such a proposal. During the week of March 31, 1997, an understanding with respect to potentially mutually agreeable positions on the principal issues was reached, and thereafter documentation was finalized, due diligence was completed and the APS Board and the DQE Board each approved the Merger and related matters at respective meetings held late in the day on April 4, 1997, following presentations from their respective senior managements and their legal and financial advisors (including descriptions of the Merger Agreement by their respective legal advisors) and after having received the fairness opinions of their respective financial advisors.

Reasons for the Merger; Recommendations of the Boards of Directors

APS

The APS Board has unanimously determined that the terms of the Merger Agreement and the transactions contemplated thereby are advisable for, fair to, and in the best interests of, APS and its stockholders. In reaching this determination, the APS Board concluded that the Merger offered an opportunity to increase the long-term value of stockholders' investment in APS over what that value would have been had APS not agreed to the Merger, and that such opportunity more than offsets the risks inherent in the Merger. In reaching this conclusion, the APS Board considered that:

(i) the Merger would better position APS to take advantage of changes in the electric utility industry by expanding its service territory and number of customers served by combining its existing service territories with DQE's contiguous service territories;

(ii) APS management has historically been better than its peer companies at managing electric generation, transmission and distribution and its belief that the Merger would permit the combined management to utilize this expertise over greater amounts of generation and distribution;

(iii) based upon reports from its outside advisors and APS management and publicly available materials regarding DQE, DQE management has historically been better than its peer companies in developing unregulated businesses and the APS Board's belief that the Merger would permit the combined management to utilize this expertise as a part of a bigger, financially stronger enterprise;

(iv) the terms of the recently enacted Pennsylvania restructuring legislation and the significant mitigation efforts already undertaken by DQE would permit DQE to recover such stranded costs associated with DQE's investment in the Nuclear Facilities as determined to be just and reasonable by the PAPUC; and

(v) the synergies estimated by the managements of APS and DQE appear to be achievable.

In reaching the determination that the terms of the Merger were advisable for, fair to and in the best interests of APS and its stockholders, the APS Board also considered a number of additional factors, including its knowledge of APS' business and discussions with APS' management concerning the results of APS' management's due diligence investigation of DQE, the economic and regulatory environment, strategic, operational and financial opportunities and risks associated with the Merger and the terms of the Merger Agreement, the historical, current and 30-day average market prices of DQE Common Stock and the opinion of APS' financial advisor, Merrill Lynch, to the effect that, as of the date of such opinion, the Exchange Ratio was fair from a financial point of view to the holders of APS Common Stock. The APS Board also considered certain risks and potential disadvantages associated with the Merger, including the acquisition of interests in the Nuclear Facilities and the fact that APS has historically avoided ownership of nuclear power plants, the possibility that APS would be unable to retain, after the Merger, the senior management of DQE responsible for DQE's unregulated businesses, the risk that the projected synergies will not be realized in the amounts expected or that they will be offset by unanticipated increases in expenses or revenue losses, the management distractions necessarily associated with a business combination of the magnitude of the Merger and the potential disruption to the businesses of APS and DQE, along with the risk that the transaction might not be completed as a result of a failure to satisfy the conditions to the Merger Agreement.

The foregoing discussion of the information and factors which were given weight by the APS Board is not intended to be exhaustive but is believed to include all material factors considered by the APS Board. The APS Board did not assign specific weights to the foregoing factors and individual directors may have given different weights to different factors. After considering all such factors, the APS Board unanimously determined that the terms of the Merger Agreement and the transactions contemplated thereby are advisable for, fair to, and in the best interests of, APS and its stockholders and unanimously recommends to its stockholders that they approve the issuance of shares of APS Common Stock pursuant to the Merger Agreement.

THE APS BOARD UNANIMOUSLY RECOMMENDS THAT APS STOCKHOLDERS VOTE FOR APPROVAL OF THE ISSUANCE OF SHARES OF APS COMMON STOCK PURSUANT TO THE MERGER AGREEMENT.

DQE

The DQE Board has unanimously approved the Merger Agreement and the transactions contemplated thereby, having determined that the terms of the Merger Agreement and the transactions contemplated thereby are fair to, and in the best interests of, its stockholders. In reaching this determination, the DQE Board concluded that the Merger was likely to increase the value of its stockholders' investment in DQE over what DQE could probably achieve on its own. In reaching this conclusion, the DQE Board considered that:

(i) the Merger will allow the combined company to meet the challenges of the increasingly competitive environment in the utility industry more effectively than DQE could on its own because it will have the critical mass necessary to compete in a deregulated utility environment, including an expanded customer base from which to grow unregulated activities, a stronger financial and operational position and less nuclear exposure;

(ii) the estimated synergies from the Merger should improve DQE's financial performance due to savings from the elimination of duplicate activities and by creating improved operating efficiencies and lower capital costs;

(iii) the Merger will permit stockholders of DQE to benefit from the combined company's flexibility and leverage in financing its operations and its enhanced ability to take advantage of future strategic opportunities and to reduce its exposure to changes in economic conditions in any segment of its business;

(iv) the combined service territories of DQE and APS will be more geographically diverse than the service territory of DQE alone, reducing DQE's exposure to changes in economic, competitive or climatic conditions, as well as providing a larger regional platform from which to expand DQE's customer base;

(v) APS' winter-peaking, low-cost, efficient operations, and suburban and rural customer base, will complement DQE's summer-peaking operations and urban customer base;

(vi) DQE's current customers will receive a wider range of energy-related products and services; and

(vii) DQE's mix of regulated and unregulated energy products and services provides a strategic fit with APS' core businesses.

In reaching the determination that the terms of the Merger were fair to, and in the best interests of, stockholders of DQE, the DQE Board also considered a number of additional factors, including its knowledge of DQE's business and discussions with DQE's management concerning the results of DQE's due diligence investigation of APS, the economic and regulatory environment, strategic, operational and financial opportunities open to DQE, the terms of the Merger Agreement, the historical and current market prices of DQE Common Stock and APS Common Stock and the opinion of DQE's financial advisor, CSFB, to the effect that, as of the date of such opinion and based upon and subject to certain matters stated therein, the Exchange Ratio was fair to the holders of DQE Common Stock from a financial point of view. The DQE Board also considered certain risks and potential disadvantages associated with the Merger, including the risk that the estimated synergies will not be realized in the amounts expected or that they will be offset by unanticipated increases in expenses or revenue losses, the management distractions necessarily associated with a business combination of the magnitude of the Merger and the potential disruption to the businesses of APS and DQE, along with the risk that the transaction might not be completed as a result of a failure to satisfy the conditions to the Merger Agreement, and the fact that certain members of DQE's management and the DQE Board had other interests in the Merger in addition to the interests which holders of DQE Common Stock have generally.

The foregoing discussion of the information and factors which were given weight by the DQE Board is not intended to be exhaustive but is believed to include all material factors considered by the DQE Board. The DQE Board did not assign specific weights to the foregoing factors and individual Directors may have given different weights to different factors. After considering all such factors, the DQE Board unanimously approved the Merger Agreement and unanimously recommends to its stockholders that they approve the adoption of the Merger Agreement and the transactions contemplated thereby.

THE DQE BOARD UNANIMOUSLY RECOMMENDS THAT DQE STOCKHOLDERS VOTE FOR ADOPTION OF THE MERGER AGREEMENT AND APPROVAL OF THE TRANSACTIONS CONTEMPLATED THEREBY.

Synergies

APS and DQE have jointly studied the estimated synergies arising out of a combination of their companies. The companies estimated that the Merger could result in savings of approximately \$1 billion over the 10-year period from 1998 to 2008, taking into account the costs estimated to be necessary to achieve such synergies. The savings are expected to come from elimination of duplicate activities (including labor and corporate and administrative programs), improved operating efficiencies and lower capital costs. The labor reductions would be achieved from a combination of reduced hiring, attrition and targeted voluntary reduction programs.

Holders of APS Common Stock or DQE Common Stock should note that the analyses employed in developing these savings estimates were based upon various assumptions that involve judgments with respect to economic conditions, inflation rates, regulatory treatment, weather conditions, financial market conditions, interest rates and other factors which are each difficult to predict and beyond the control of DQE and APS. Accordingly, although the APS Board and DQE Board believe that reasonable assumptions were used to develop these estimates of synergies, there can be no assurance that these estimates will approximate the future experience of the combined company or the extent to which it can realize these synergies. See "The Merger — Cautionary Statement Concerning Forward-Looking Statements."

Opinions of Financial Advisors

APS

On April 4, 1997, Merrill Lynch delivered its oral opinion to the APS Board, which was subsequently confirmed in a written opinion dated as of that date and as of the date of this Joint Proxy Statement/Prospectus (the "Merrill Lynch Opinion"), to the effect that, as of such dates, and based upon the assumptions made, matters considered and limits of review set forth in such opinion, the Exchange Ratio was fair to holders of APS Common Stock from a financial point of view.

A copy of the Merrill Lynch Opinion, dated as of the date of this Joint Proxy Statement/Prospectus, which sets forth the assumptions made, matters considered and certain limitations on the scope of review undertaken by Merrill Lynch, is attached as Appendix B to this Joint Proxy Statement/Prospectus. Holders of APS Common Stock are urged to, and should, read such opinion in its entirety. The Merrill Lynch Opinion is directed only to the fairness of the Exchange Ratio from a financial point of view to the holders of APS Common Stock and does not constitute a recommendation to any APS stockholder as to how such stockholder should vote at the APS Special Meeting. The summary of the Merrill Lynch Opinion set forth in this Joint Proxy Statement/Prospectus is qualified in its entirety by reference to the full text of such opinion.

In arriving at the Merrill Lynch Opinion, Merrill Lynch, among other things: (1) reviewed APS' Annual Reports, Form 10-Ks and related financial information for the three-fiscal-year period ended December 31, 1996 and certain other filings made with the SEC, including proxy statements, Form 8-Ks and registration statements, during the last three years; (2) reviewed DQE's Annual Reports, Form 10-Ks and related financial information for the three-fiscal-year period ended December 31, 1996 and certain other filings made with the SEC, including proxy statements, Form 8-Ks and registration statements, during the last three years; (3) reviewed certain information, including financial forecasts, relating to the business, earnings, cash flow, assets and prospects of APS and DQE furnished to Merrill Lynch by APS and DQE; (4) conducted discussions with members of senior management of APS and DQE concerning their respective businesses, regulatory environments, prospects and strategic objectives; (5) reviewed the market prices and valuation

multiples for APS Common Stock and DQE Common Stock and compared them with those of certain publicly traded companies which Merrill Lynch deemed to be reasonably similar to APS and DQE, respectively; (6) compared the results of operations of APS and DQE with those of certain companies which Merrill Lynch deemed to be reasonably similar to APS and DQE, respectively; (7) compared the proposed financial terms of the transaction contemplated by the Merger Agreement with the financial terms of certain other transactions which Merrill Lynch deemed to be relevant; (8) considered the pro forma effect of the Merger on APS' capitalization ratios and earnings, dividends and book value per share; (9) reviewed the Merger Agreement; (10) reviewed this Joint Proxy Statement/Prospectus (with respect to the Merrill Lynch Opinion, dated as of the date hereof); and (11) reviewed such other financial studies and analyses and performed such other investigations and took into account such other matters as Merrill Lynch deemed necessary, including its assessment of general economic, market, monetary and other conditions.

In preparing the Merrill Lynch Opinion, Merrill Lynch relied on the accuracy and the completeness of all information supplied or otherwise made available to it by APS and DQE, and Merrill Lynch did not independently verify such information or undertake an independent evaluation or appraisal of the assets or liabilities of APS or DQE. In addition, Merrill Lynch did not conduct any physical inspection of the properties or facilities of APS or DQE. With respect to the financial forecasts and the estimated synergies furnished by APS and DQE, Merrill Lynch assumed that they were reasonably prepared and reflected the best currently available estimates and judgments of APS' or DQE's management as to the expected future financial performances of APS or DQE, as the case may be, and as to the expected future projected outcomes of various legal, regulatory and other contingencies. Merrill Lynch assumed that the Merger will be accounted for as a pooling of interests and will be free of federal tax to APS, DQE and the holders of shares of APS Common Stock and the holders of shares of DQE Common Stock. The Merrill Lynch Opinion is necessarily based upon general economic, market, monetary and other conditions as they existed and could be evaluated, and the information made available to Merrill Lynch, as of the date of such opinion. The Merrill Lynch Opinion was prepared solely for the information and use of the APS Board.

In connection with the preparation of the Merrill Lynch Opinion, Merrill Lynch expressed no opinion as to what the value of APS Common Stock actually will be when issued upon consummation of the Merger or what the value of APS Common Stock or DQE Common Stock will be at any time after the date of the Merrill Lynch Opinion. No limitations were imposed by APS on Merrill Lynch with respect to the investigations made or procedures followed by Merrill Lynch in rendering its opinion.

The following is a summary of certain of the financial and comparative analyses performed by Merrill Lynch in arriving at the Merrill Lynch Opinion dated as of April 4, 1997.

Historical Market Value Analysis. Merrill Lynch reviewed the performance of the daily closing prices per share of DQE Common Stock and APS Common Stock in relation to each other for the period from February 1, 1994 to April 4, 1997. Merrill Lynch also reviewed the historical ratios of such daily closing prices per share of DQE Common Stock to those of APS Common Stock (the "Historical Trading Ratios") for the period from February 1, 1994 to April 4, 1997, and the mean of such Historical Trading Ratios for the one-year, two-year and three-year periods ended on April 4, 1997, and compared such Historical Trading Ratios to the Exchange Ratio. This analysis showed that, during the three-year period ended on April 4, 1997, the Historical Trading Ratio ranged from 1.079 to 0.861, and the mean of the Historical Trading Ratios for the one-year, two-year and three-year periods ended on April 4, 1997 were 0.937, 0.973 and 0.959, respectively.

Comparable Publicly Traded Company Analysis. Using publicly available information, Merrill Lynch compared certain financial and operating information and ratios (described below) for DQE with the corresponding financial and operating information and ratios for separate groups of publicly traded companies that Merrill Lynch deemed to be reasonably comparable to DQE. The companies included in the DQE analyses were: Baltimore Gas & Electric Company, Boston Edison Company, DTE Energy Company, Florida Progress Corporation, GPU, Inc., Illinova, New England Electric System and PP&L Resources, Inc. (collectively, the "DQE Comparables").

In deriving an estimated valuation range for DQE, Merrill Lynch compared: (i) current trading price to estimated 1997 earnings per share ("EPS") for the DQE Comparables, which estimates were obtained from Institutional Brokers Estimate System ("IBES") and ranged from 8.3x to 11.6x, with a mean of 10.0x.

compared to a multiple of 11.4x for DQE Common Stock based upon estimates from IBES; (ii) current trading price to estimated 1998 earnings per share for the DQE Comparables, which estimates were obtained from IBES and ranged from 7.9x to 11.3x, with a mean of 10.0x, compared to a multiple of 11.0x for DQE Common Stock based upon estimates from IBES; (iii) current trading price to book value for the DQE Comparables, which ranged from 1.01x to 1.53x, with a mean of 1.26x, compared to a multiple of 1.53x for DQE Common Stock; (iv) firm value to 1996 earnings before interest, taxes, depreciation and amortization ("EBITDA") for the DQE Comparables, which ranged from 5.2x to 7.3x, with a mean of 6.0x, compared to a multiple of 6.6x for DQE Common Stock; (v) firm value to 1996 earnings before interest and taxes ("EBIT") for the DQE Comparables, which ranged from 7.1x to 11.2x, with a mean of 9.2x, compared to a multiple of 11.4x for DQE Common Stock; (vi) the dividend yield ratio for the DQE Comparables, which ranged from 5.7% to 8.4%, with a mean of 6.8%, compared to the dividend yield ratio of 4.9% for DQE Common Stock; and (vii) the forward payout ratio for the DQE Comparables, which ranged from 46.8% to 80.7%, with a mean of 68.5%, compared to the dividend yield ratio of 56.4% for DQE Common Stock.

Based upon the estimated valuation ranges for DQE in such analyses and the APS current trading price as of April 1, 1997, Merrill Lynch calculated an implied exchange ratio of a share of DQE Common Stock to a share of APS Common Stock ranging from 0.82x to 1.00x, compared to the Exchange Ratio of 1.12.

No public company utilized as a comparison in the analyses described above is identical to DQE. Accordingly, an analysis of publicly traded comparable companies is not mathematical; rather it involves complex considerations and judgments concerning differences in financial and operating characteristics of the comparable companies and other factors that could affect the public trading value of the comparable companies or company to which they are being compared.

Comparable Transactions Analysis. Using publicly available information, Merrill Lynch reviewed eighteen transactions announced between May 1995 and December 1996, involving selected electric utility companies, eleven transactions of which were mergers of electric utility companies (the "Electric Merger Transactions") and seven transactions of which were so-called "convergence" transactions or mergers of utilities providing different types of power (the "Convergence Transactions"). The Electric Merger Transactions and the date each transaction was announced were as follows: Northern States Power Company/Wisconsin Energy Corporation (May 1995), CIPSCO Incorporated/Union Electric Company (August 1995), Southwestern Public Service Company/Public Service Company of Colorado (August 1995), Potomac Electric Power Company/Baltimore Gas and Electric Company (September 1995), UtiliCorp United Inc./Kansas City Power & Light Company (May 1996), Kansas City Power & Light Company/Western Resources, Inc. (June 1996), Atlantic Energy, Inc./Delmarva Power & Light Company (August 1996), IES Industries Inc./WPL Holdings, Inc. (August 1996), IES Industries Inc./Mid-American Energy Company (August 1996), Interstate Power/WPL Holdings, Inc. (August 1996) and Centerior Energy Corporation/Ohio Edison Company (September 1996). The Convergence Transactions and the date each transaction was announced were as follows: Washington Energy Company Inc./Puget Sound Power & Light Company (October 1995), ENSERCH Corporation/Texas Utilities Company (April 1996), Portland General Corporation/Enron Corp. (July 1996), NorAm Energy Corp./Houston Industries Incorporated (August 1996), Pacific Enterprises/Enova Corporation (October 1996), PanEnergy Corp./Duke Power Company (November 1996) and Long Island Lighting Company/The Brooklyn Union Gas Company (December 1996).

Merrill Lynch reviewed the transaction price in certain of the above transactions as a multiple of (i) last-twelve-months pre-announcement net income of the acquired company, which ranged from approximately 12.0x to 15.0x, (ii) pre-announcement book value of the acquired company, which ranged from approximately 1.55x to 1.90x, (iii) last-twelve-months pre-announcement EBIT of the acquired company, which ranged from approximately 9.0x to 11.0x and (iv) last-twelve-months pre-announcement EBITDA of the acquired company, which ranged from approximately 6.0x to 7.0x; and estimated transaction prices for DQE on the basis of such multiples.

Based upon the transaction prices estimated for DQE in such analyses using transaction price as a multiple of adjusted last-twelve-months pre-announcement net income and the APS current trading price as

of April 1, 1997, Merrill Lynch calculated an implied exchange ratio of a share of DQE Common Stock to a share of APS Common Stock ranging from 1.01 to 1.27, compared to the Exchange Ratio of 1.12.

None of the business combinations utilized as a comparison in the analyses described above is identical to the Merger. Accordingly, an analysis of comparable business combinations is not mathematical; rather it involves complex considerations and judgments concerning differences in financial and operating characteristics of the comparable companies and other factors that could affect the public trading value of the comparable companies or company to which they are being compared.

Discounted Cash Flow Analysis. Merrill Lynch derived estimated valuation ranges for APS and DQE by performing discounted cash flow ("DCF") analyses.

In the case of APS, the DCF was calculated assuming discount rates ranging from 7.5% to 11.5%, and was comprised of the sum of the present value of (i) the projected unlevered free cash flows for years 1997 to 2006 estimated by APS and (ii) the 2006 terminal value based upon a range of multiples from 6.5x to 7.0x of projected 2006 EBITDA. In the case of DQE, the DCF was calculated assuming discount rates ranging from 7.5% to 11.5%, and was comprised of the sum of the present value of (i) the projected unlevered free cash flows for years 1997 to 2006 estimated by DQE and (ii) the 2006 terminal value based upon a range of multiples from 6.25x to 6.75x of projected 2006 EBITDA.

Based upon the estimated valuation range of DQE set forth above and the APS current trading price as of April 1, 1997, Merrill Lynch calculated an implied exchange ratio of a share of DQE Common Stock to a share of APS Common Stock ranging from 0.91 to 1.22, compared to the Exchange Ratio of 1.12.

Contribution Analysis. Merrill Lynch calculated the contribution of each of APS and DQE to the *pro forma* combined company with respect to (i) earnings per share, (ii) common equity per share, (iii) dividends per share, (iv) book value per share, (v) EBITDA and (vi) EBIT, in each case for the historical fiscal years 1994 through 1996, and for the projected fiscal years 1997 through 2001 using the *projections of the respective companies' managements*.

Based upon the estimated implied ratios in such analyses calculated with respect to EBITDA, Merrill Lynch calculated *implied exchange ratios of a share of DQE Common Stock to a share of APS Common Stock* ranging from 1.17 to 1.51, compared to the Exchange Ratio of 1.12.

The summary set forth above does not purport to be a complete description of the analyses performed by Merrill Lynch. Arriving at a fairness opinion is a complex process not necessarily susceptible to partial analysis or summary description. Merrill Lynch believes that its analyses must be considered as a whole and that selecting portions of its analyses and of the factors considered by it, without considering all such factors and analyses, could create a misleading view of the processes underlying its opinion. Merrill Lynch did not assign relative weights to any of its analyses in preparing its opinion. The matters considered by Merrill Lynch in its analyses are based on numerous macroeconomic, operating and financial assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond APS' or DQE's control and involve the application of complex methodologies and educated judgment. Any estimates incorporated in the analyses performed by Merrill Lynch are not necessarily indicative of actual past or future results or values, which may be significantly more or less favorable than such estimates. Estimated values do not purport to be appraisals and do not necessarily reflect the prices at which businesses or companies may be sold in the future, and such estimates are inherently subject to uncertainty.

Merrill Lynch is an internationally recognized investment banking firm and is continually engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, corporate and other purposes. Merrill Lynch was selected to act as financial advisor to the APS Board because of its substantial expertise in transactions similar to the Merger and its reputation in investment banking and mergers and acquisitions.

In connection with APS' engagement of Merrill Lynch, APS and Merrill Lynch have entered into a letter agreement (the "Merrill Lynch Engagement Letter"). (1) pursuant to which Merrill Lynch was paid a fee of \$250,000 on the date of such letter agreement and (2) which provides that if, during the period Merrill Lynch is retained by APS or within 18 months thereafter, (a) a Merger Transaction (as defined in the Merrill Lynch

Engagement Letter) is consummated or (b) APS or its affiliate enters into an agreement with DQE which subsequently results in a Merger Transaction, an additional fee of \$8,650,000 will be payable. Any fee previously paid to Merrill Lynch in accordance with clause (1) of this paragraph will be deducted from the fee to which Merrill Lynch is entitled in accordance with clause (2). Pursuant to the Merrill Lynch Engagement Letter, if APS receives any bust-up fee, break-up fee, termination fee, expense reimbursement or any similar type of payment from DQE in connection with a proposed Merger Transaction, then APS has agreed to pay Merrill Lynch 10% of such payment received (excluding any payment to APS related to the reimbursement of actual out-of-pocket expenses incurred by APS, *provided, however*, that Merrill Lynch's fee pursuant to this sentence will not be considered as an out-of-pocket expense for purposes of this sentence), up to a maximum of \$6,250,000. In addition, pursuant to the Merrill Lynch Engagement Letter, APS has agreed to pay certain other expenses of, and has granted certain rights of indemnification to, Merrill Lynch.

In the ordinary course of Merrill Lynch's business, Merrill Lynch may actively trade the securities of APS or DQE for its own account and for the accounts of its customers and, accordingly, may at any time hold a long or short position in such securities.

DQE

CSFB has acted as financial advisor to DQE in connection with the Merger. CSFB was selected by DQE based on CSFB's experience, expertise and familiarity with DQE and its business. CSFB is an internationally recognized investment banking firm and is regularly engaged in the valuation of businesses and securities in connection with mergers and acquisitions, leveraged buyouts, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements and valuations for corporate and other purposes.

In connection with CSFB's engagement, DQE requested that CSFB evaluate the fairness of the Exchange Ratio from a financial point of view. On April 4, 1997, at a meeting of the DQE Board, CSFB rendered to the DQE Board an oral opinion, to the effect that, as of such date and based upon and subject to certain matters stated in such opinion, the Exchange Ratio was fair to the holders of DQE Common Stock from a financial point of view. CSFB has confirmed its earlier opinion by delivery of a written opinion dated the date of this Joint Proxy Statement/Prospectus. In connection with its opinion dated the date of this Joint Proxy Statement/Prospectus, CSFB updated certain of the analyses performed in connection with its earlier opinion and reviewed the assumptions on which such analyses were based and the factors considered in connection therewith.

The full text of CSFB's written opinion to the DQE Board, dated the date of this Joint Proxy Statement/Prospectus, which sets forth the procedures followed, assumptions made, matters considered and limitations on the review undertaken, is attached as Appendix C to this Joint Proxy Statement/Prospectus and is incorporated herein by reference. Stockholders of DQE are urged to, and should, read the opinion of CSFB carefully and in its entirety. CSFB's opinion is directed to the DQE Board and relates only to the fairness of the Exchange Ratio from a financial point of view and does not constitute a recommendation to any stockholder as to how such stockholder should vote at the DQE Meeting. The summary of the opinion of CSFB set forth in this Joint Proxy Statement/Prospectus is qualified in its entirety by reference to the full text of such opinion.

In arriving at its opinion, CSFB reviewed the Merger Agreement and certain publicly available business and financial information relating to DQE and APS and, in connection with its opinion dated the date of this Joint Proxy Statement/Prospectus, reviewed this Joint Proxy Statement/Prospectus. CSFB also reviewed certain other information relating to DQE and APS, including financial forecasts provided to CSFB by DQE and APS, and met with the managements of DQE and APS to discuss the businesses and prospects of DQE and APS. CSFB also considered certain financial and stock market data of DQE and APS and compared those data with similar data for other publicly held companies in businesses similar to those of DQE and APS, and considered, to the extent publicly available, the financial terms of certain other business combinations and other transactions recently effected. CSFB also considered such other information, financial studies, analyses and investigations and financial, economic and market criteria that CSFB deemed relevant.

In connection with its review, CSFB did not assume any responsibility for independent verification of any of the information provided to or otherwise reviewed by CSFB (including the information contained in this Joint Proxy Statement/Prospectus) and relied on such information being complete and accurate in all material respects. With respect to the financial forecasts, CSFB assumed that such forecasts were reasonably prepared on bases reflecting the best currently available estimates and judgments of the managements of DQE and APS as to the future financial performance of DQE and APS. CSFB also assumed, with the consent of the DQE Board and based upon the views of the management of, and regulatory counsel-for, DQE, that, in the course of obtaining the necessary regulatory and third-party consents for the Merger, no restriction will be imposed that will have a material adverse effect on the contemplated benefits of the Merger. CSFB was not requested to conduct, and did not conduct, an independent evaluation or appraisal of the assets or liabilities (contingent or otherwise) of DQE or APS, nor was CSFB furnished with any such evaluations or appraisals. CSFB's opinion was necessarily based upon information available to CSFB, and financial, economic, market and other conditions as they existed and could be evaluated, on the date of its opinion. CSFB did not express any opinion as to the actual value of the APS Common Stock when issued pursuant to the Merger or the prices at which the APS Common Stock will trade subsequent to the Merger. In connection with its engagement, CSFB was not requested to, and did not, solicit third-party indications of interest in acquiring all or any part of DQE. Although CSFB evaluated the Exchange Ratio from a financial point of view, CSFB was not requested to, and did not, recommend the specific consideration payable in the Merger, which consideration was determined through negotiation between DQE and APS. No other limitations were imposed by DQE on CSFB with respect to the investigations made or procedures followed by CSFB in rendering its opinion.

In preparing its opinion to the DQE Board, CSFB performed a variety of financial and comparative analyses, including those described below. The summary of CSFB's analyses set forth below does not purport to be a complete description of the analyses underlying CSFB's opinion. The preparation of a fairness opinion is a complex analytic process involving various determinations as to the most appropriate and relevant methods of financial analyses and the application of those methods to the particular circumstances and, therefore, such an opinion is not readily susceptible to summary description. In arriving at its opinion, CSFB made qualitative judgments as to the significance and relevance of each analysis and factor considered by it. Accordingly, CSFB believes that its analyses must be considered as a whole and that selecting portions of its analyses and factors, without considering all analyses and factors, could create a misleading or incomplete view of the processes underlying such analyses and its opinion. In its analyses, CSFB made numerous assumptions with respect to DQE, APS, industry performance, regulatory, general business, economic, market and financial conditions and other matters, many of which are beyond the control of DQE and APS. No company, transaction or business used in such analyses as a comparison is identical to DQE, APS or the Merger, nor is an evaluation of the results of such analyses entirely mathematical; rather, such analyses involve complex considerations and judgments concerning financial and operating characteristics and other factors that could affect the acquisition, public trading or other values of the companies, business segments or transactions being analyzed. The estimates contained in such analyses and the ranges of valuations resulting from any particular analysis are not necessarily indicative of actual values or predictive of future results or values, which may be significantly more or less favorable than those suggested by such analyses. In addition, analyses relating to the value of businesses or securities do not purport to be appraisals or to reflect the prices at which businesses or securities may actually be sold. Accordingly, such analyses and estimates are inherently subject to substantial uncertainty. CSFB's opinion and financial analyses were only one of many factors considered by the DQE Board in its evaluation of the proposed Merger and should not be viewed as determinative of the views of the DQE Board or management with respect to the Exchange Ratio or the Merger.

The following is a summary of the material financial analyses presented by CSFB to the DQE Board at the meeting of the DQE Board held on April 4, 1997:

Discounted Cash Flow Analysis. CSFB estimated the present value of the future streams of after-tax free cash flows that could be produced through fiscal 2006 by each of DQE's business segments (*i.e.*, Duquesne Light; Montauk; and Duquesne Enterprises, DQE Energy Partners and DQE Energy Services (the "Other Unregulated Businesses")), based upon internal estimates of DQE management, as adjusted after

consultation with DQE management. Ranges of estimated terminal values, when applied, were calculated using either terminal multiples of operating cash flow ("OCF") or perpetuity growth rates. The free cash flow streams and estimated terminal values were then discounted to present value using various discount rates depending upon the business segment analyzed. For Duquesne Light (excluding Duquesne Light's generation equipment investment), terminal OCF multiples of 6.5x to 7.0x and discount rates ranging from 7.75% to 8.25% were utilized. For Duquesne Light's generation equipment investment, discount rates ranging from 13.0% to 13.5% were utilized over the investment's remaining fixed life. For Montauk, perpetuity growth rates of (3.5%) to (3.0%) and discount rates ranging from 12.0% to 12.5% were utilized. CSFB also analyzed Montauk's current investment portfolio (assuming no additional investments), utilizing discount rates of 10.0% to 14.0%. The Other Unregulated Businesses were valued business by business, utilizing perpetuity growth rates of (0.5%) to 7.0% and discount rates ranging from 9.25% to 23.0%, depending upon the particular business. The Other Unregulated Businesses also were analyzed taking into account only current businesses and those planned by the end of fiscal 1997. This analysis indicated an enterprise reference range of approximately \$2.9 billion to \$3.2 billion for Duquesne Light and an overall enterprise reference range for DQE of approximately \$3.5 billion to \$3.9 billion.

CSFB also performed a discounted cash flow analysis of APS' electric utilities businesses (consisting of West Penn Power Company ("West Penn"), The Potomac Edison Company ("Potomac Edison") and Monongahela Power Company ("Monongahela")) (collectively, the "APS Electric Utility Businesses"), Allegheny Generating Company and AYP Capital, Inc. ("AYP Capital") based upon internal estimates of APS management, as adjusted after consultation with DQE management. Ranges of estimated terminal values were calculated by applying multiples of terminal year 2006 OCF of 6.5x to 7.0x to the APS Electric Utility Businesses, 8.0x to 8.5x to Allegheny Generating Company and 10.0x to 11.0x to AYP Capital. The after-tax free cash flow streams and estimated terminal values were then discounted to present value using discount rates ranging from 7.75% to 8.25%. This analysis indicated an enterprise reference range for APS of approximately \$6.1 billion to \$6.6 billion.

Selected Companies Analysis. CSFB compared certain financial and operating information of Duquesne Light to corresponding data of the following selected publicly traded companies in the electric utility industry: APS; Cinergy Corporation; DTE Energy Company; GPU, Inc.; New England Electric System; Ohio Edison Company; PECO Energy Company; and PP&L Resources, Inc. (the "Duquesne Comparables"). CSFB compared adjusted market values (equity market value plus net debt and other corporate adjustments) as a multiple of, among other things, estimated calendar 1997 OCF and operating income, and compared equity market values as a multiple of net income and book value. Estimates for the Duquesne Comparables were based on estimates of selected investment banking firms, and estimates for Duquesne Light were based on internal estimates of DQE management, as adjusted after consultation with DQE management. All multiples were based on closing stock prices on April 1, 1997. Applying a range of selected multiples for the Duquesne Comparables of estimated calendar 1997 OCF, operating income, net income and book value of 5.7x to 6.7x, 9.5x to 10.0x, 11.0x to 12.0x and 1.3x to 1.5x, respectively, to corresponding financial data of Duquesne Light resulted in an enterprise reference range for Duquesne Light of approximately \$2.8 billion to \$3.1 billion. CSFB did not derive an enterprise reference range for Montauk, the Other Unregulated Businesses or Duquesne Light's generation equipment investment based on this analysis since there were no publicly traded companies directly comparable to Montauk, the Other Unregulated Businesses or such investment.

CSFB also compared certain financial and operating information of the APS Electric Utility Businesses and Allegheny Generating Company to corresponding data of the following selected publicly traded companies in the electric utility industry: American Electric Power Company, Inc.; Carolina Power & Light Company; Dominion Resources Inc.; NIPSCO Industries Inc.; OGE Energy Corp.; and PP&L Resources, Inc. (the "APS Comparables"). CSFB compared adjusted market values as a multiple of, among other things, estimated calendar 1997 OCF and operating income, and compared equity market values as a multiple of net income and book value. Estimates for the APS Comparables were based on estimates of selected investment banking firms and estimates for APS were based on internal estimates of APS management, as adjusted after consultation with DQE management. All multiples were based on closing stock prices on April 1, 1997. Applying a range of selected multiples for the APS Comparables of estimated calendar 1997

OCF, operating income, net income and book value of 6.2x to 6.7x, 9.0x to 10.0x, 12.0x to 13.0x and 1.5x to 1.8x, respectively, to corresponding financial data of the APS Electric Utility Businesses and 7.5x to 8.5x, 9.5x to 10.5x, 12.0x to 13.0x and 1.5x to 1.8x, respectively, to corresponding financial data of Allegheny Generating Company, resulted in an overall enterprise reference range for the APS Electric Utility Businesses and Allegheny Generating Company of approximately \$6.0 billion to \$6.5 billion. CSFB did not derive an enterprise reference range for AYP Capital based on this analysis since there were no publicly traded companies directly comparable to AYP Capital.

Selected Transactions Analysis. Using publicly available information, CSFB analyzed the purchase prices and implied transaction multiples paid or proposed to be paid in the following selected transactions in the electric utility industry (acquiror/target): Western Resources, Inc./Kansas City Power & Light Company; The Brooklyn Union Gas Company/Long Island Lighting Company; Ohio Edison Company/Centenor Energy Corporation; Delmarva Power & Light Company/Atlantic Energy Inc.; MidAmerican Energy Company/IES Industries Inc.; Enron Corporation/Portland General Corporation; Kansas City Power & Light Company/UtiliCorp United Inc.; WPL Holdings, Inc./IES Industries Inc. and Interstate Power, Public Service Company of Colorado/Southwestern Public Service Company; Union Electric Company/CIPSCO Incorporated; PECO Energy Company/PP&L Resources, Inc.; and Wisconsin Energy Corporation/Northern States Power Company (the "Selected Transactions"). CSFB compared adjusted purchase prices as a multiple of latest 12 months OCF and operating income, and compared purchase prices as a multiple of net income and book value. All multiples were based on historical financial information available at the time of announcement of the transaction. Applying a range of selected multiples for the Selected Transactions of the latest 12 months OCF, operating income, net income and book value of 6.5x to 7.5x, 10.5x to 11.5x, 14.5x to 15.5x and 1.7x to 1.9x, respectively, to corresponding financial data of Duquesne Light resulted in an enterprise reference range for Duquesne Light (excluding Duquesne Light's generation equipment investment) of approximately \$3.3 billion to \$3.6 billion. CSFB did not derive an enterprise reference range for Montauk, the Other Unregulated Businesses or Duquesne Light's generation equipment investment based on this analysis since there were no transactions which involved companies directly comparable to Montauk, the Other Unregulated Businesses or such investment.

Aggregate Reference Ranges. On the basis of the valuation methodologies employed in the analyses described above, CSFB derived an aggregate enterprise and per share equity reference range for DQE of approximately \$3.7 billion to \$4.1 billion, or approximately \$30.32 to \$35.04 per fully diluted common share, and an aggregate enterprise and per share equity reference range for APS of approximately \$6.0 billion to \$6.6 billion, or approximately \$27.32 to \$31.91 per fully diluted common share.

Relative Contribution Analysis. CSFB analyzed the relative contributions of DQE and APS to the estimated revenues, OCF, operating income, net income, book value and total assets of the pro forma combined company for fiscal 1997. This analysis indicated that, in fiscal 1997, DQE would contribute approximately 33%, 37%, 26%, 40%, 39% and 41% of the revenues, OCF, operating income, net income, book value and total assets, respectively, of the pro forma combined company, and APS would contribute approximately 67%, 63%, 74%, 60%, 61% and 59% of the revenues, OCF, operating income, net income, book value and total assets, respectively, of the pro forma combined company. Based on the Exchange Ratio, current holders of DQE and APS would own approximately 42% and 58%, respectively, of the combined company upon consummation of the Merger.

Pro Forma Merger Analysis. CSFB analyzed the potential pro forma effect of the Merger on the EPS of APS during fiscal years 1997 through 1999. This analysis indicated that the Merger could be dilutive to APS' EPS in fiscal years 1997 and 1998 and accretive to APS' EPS in fiscal year 1999. The actual results achieved by the combined company may vary from projected results and the variations may be material.

Pursuant to the terms of CSFB's engagement, DQE has agreed to pay CSFB for its services in connection with the Merger an aggregate financial advisory fee of \$8.65 million. DQE also has agreed to reimburse CSFB for reasonable out-of-pocket expenses incurred by CSFB in performing its services, including the fees and expenses of legal counsel and any other advisor retained by CSFB, and to indemnify CSFB and certain related persons and entities against certain liabilities, including liabilities under the federal securities

laws, arising out of CSFB's engagement. CSFB has in the past provided financial services to DQE unrelated to the proposed Merger, for which services CSFB has received compensation.

In the ordinary course of its business, CSFB and its affiliates may actively trade the debt and equity securities of both DQE and APS for their own accounts and for the accounts of customers and, accordingly, may at any time hold a long or short position in such securities.

Management and Operations Following the Merger

The Merger Agreement provides that, from and after the Effective Time, the APS Board will be composed of 15 directors and that, immediately prior to the Effective Time, DQE will designate six of such directors, and APS will designate nine of such directors, and that all such designated directors will be the directors of APS from and after the Effective Time until their successors have been duly elected or appointed and qualified or until their earlier death, resignation or removal in accordance with the APS Charter and the APS Bylaws. Although as of the date hereof, neither DQE nor APS has determined whom it will designate to be directors of APS following the Effective Time, each of DQE and APS currently intends to nominate persons from among the members of its board of directors at the Effective Time. In addition, the Merger Agreement provides that following the Effective Time four of the six directors of APS designated by DQE pursuant to the Merger Agreement will be the chairmen of the following committees of the APS Board: Nuclear Review; New Business; Finance; and Employee and Community Relations, and that four of the nine directors of APS designated by APS pursuant to the Merger Agreement will be the chairmen of the following committees of the APS Board: Audit; Management Review; Nominating; and Benefits.

The Merger Agreement further provides that, from and after the Effective Time, Alan J. Noia will be the Chairman and Chief Executive Officer of APS and David D. Marshall will be the President and Chief Operating Officer of APS.

The Merger Agreement also provides that, from and after the Effective Time, APS' corporate headquarters will remain in Maryland and substantial operations of APS Subsidiaries, including the Surviving Corporation, will remain in the Pittsburgh, Pennsylvania area.

Cautionary Statement Concerning Forward-Looking Statements

Certain matters discussed in this Joint Proxy Statement/Prospectus contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The forward-looking statements relate to anticipated financial performance, management's plans and objectives for future operations, business prospects, market conditions and other matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of that safe harbor, APS and DQE note that a variety of factors could cause the actual results of the combined company to differ materially from the anticipated results expressed in such forward-looking statements. The following discussion is intended to identify certain factors that could cause future outcomes to differ materially from those set forth in the forward-looking statements contained in this Joint Proxy Statement/Prospectus.

Forward-looking statements include the information concerning possible or assumed future results of operations of APS and DQE set forth under "— Opinions of Financial Advisors," "— Reasons for the Merger: Recommendations of the Boards of Directors," and "— Synergies." Readers are cautioned that such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of APS and DQE to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors may affect APS', DQE's or the combined company's operations, markets, products, services and prices. Such factors include, among others, the following: general economic and business conditions; industry capacity; changes in technology; changes in political, social and economic conditions; regulatory matters; integration of the operations of APS and DQE; regulatory conditions to the combination; the loss of any significant customers; changes in business strategy or development plans; the speed and degree to which competition enters the electric utility industry; state and federal legislative and regulatory initiatives that increase competition, affect cost and investment recovery and have an impact on rate structures; industrial, commercial

and residential growth in the service territories of APS and DQE; the weather and other natural phenomena; the timing and extent of changes in commodity prices and interest rates; and growth in opportunities for Subsidiaries of APS and DQE.

THE MERGER AGREEMENT

This section describes certain aspects of the Merger Agreement. This section is not a complete description of the Merger Agreement and is qualified in its entirety by reference to the Merger Agreement, which is attached as Appendix A to this Joint Proxy Statement/Prospectus and is incorporated herein by reference. All holders of DQE Common Stock and APS Common Stock are urged to read the Merger Agreement in its entirety.

Representations and Warranties

The Merger Agreement contains various representations and warranties of DQE, APS and Merger Sub, certain of which are qualified by a Material Adverse Effect (as defined below) standard. Pursuant to the Merger Agreement, DQE represents and warrants to APS and APS represents and warrants to DQE regarding, among others, the following matters: (i) the corporate existence and capitalization of it and its respective Subsidiaries; (ii) corporate power and authority to execute, deliver and perform its obligations under the Merger Agreement and the Stock Option Agreement and to consummate the Merger; (iii) the execution, delivery and performance of the Merger Agreement and the Stock Option Agreement, and the consummation of the Merger and the other transactions contemplated by the Merger Agreement and the Stock Option Agreement, will not violate any law, rule, regulation, any governmental or non-governmental permit or license or the organizational documents of it or of its Subsidiaries and the making or provision of all required filings and notices with or to any governmental or regulatory authority, agency, commission, body or other governmental entity ("Governmental Entity"); (iv) consents, registrations, approvals, permits or authorizations required by any Governmental Entity, including filings with applicable utility commissions, the SEC, the FERC and the NRC; (v) its financial statements; (vi) the conduct of its and its Subsidiaries' businesses since December 31, 1996; (vii) pending or threatened civil, criminal or administrative actions, suits, claims, hearings, investigations or proceedings and obligations and liabilities of it or any of its Affiliates (as that term is defined under Rule 145 of the Securities Act of 1933, as amended (the "Securities Act"), and for the purposes of applicable interpretations regarding the "pooling-of-interests" method of accounting); (viii) its bonus, deferred compensation, pension, retirement, profit-sharing, thrift, savings, employee stock ownership, stock bonus, stock purchase, restricted stock, stock option, employment, termination, severance, compensation, medical, health or other plan, agreement, policy or arrangement that covers employees, directors, former employees or former directors of APS, DQE or their respective Subsidiaries ("Compensation and Benefit Plans"); (ix) compliance with all Laws; (x) with respect to DQE, the inapplicability of any "fair price," "moratorium," "control share acquisition" or other similar anti-takeover statute or regulation, including the Pennsylvania Control Transactions Statute (each, a "Takeover Statute"); (xi) environmental matters; (xii) the absence of any action that would prevent APS from accounting for the Merger as a "pooling of interests" or prevent the Merger and the other transactions contemplated by the Merger Agreement from qualifying as a "reorganization" within the meaning of Section 368(a) of the Code; (xiii) tax matters; (xiv) labor matters; (xv) the adequacy and maintenance of insurance coverage for all insurable risks; (xvi) intellectual property rights and infringements on intellectual property rights; (xvii) its and its "subsidiary companies" and "affiliates" (as such terms are defined in the PUHCA) status as a regulated utility; with respect to DQE, that it is an exempt holding company under Section 3(a)(1) of the PUHCA and, with respect to APS, that it is a registered holding company under the PUHCA; and (xviii) with respect to DQE, that its Nuclear Facilities have conducted their operations in compliance with all applicable laws and that insurance coverages consistent with industry practice are maintained.

"Material Adverse Effect" is defined in the Merger Agreement to mean, with respect to any person, a material adverse effect on the financial condition, properties, operations, business or results of operations of such person and its Subsidiaries taken as a whole; *provided, however*, that any such effect resulting from any change in law, rule, or regulation promulgated by (i) the United States Congress, (ii) the SEC with respect to the PUHCA, (iii) the Pennsylvania State Legislature or the PAPUC or (iv) the FERC, or any interpretation

of any such law, rule or regulation, or the application of the Pennsylvania Restructuring Legislation, that affects both DQE and its Subsidiaries, taken as a whole, and APS and its Subsidiaries, taken as a whole, is considered only when determining if a Material Adverse Effect has occurred to the extent that such effect on one such party exceeds such effect on the other party.

Conduct of Business Pending the Merger; Certain Covenants; Acquisition Proposals

Interim Operations

The Merger Agreement provides that during the period of time from the date of the Merger Agreement until the Effective Time, unless approved in writing by the other party or unless expressly contemplated by the Merger Agreement, the Stock Option Agreement, the respective budgets of DQE and APS (which have been submitted to the other party), or as required by applicable Law: (i) each of DQE and APS will conduct its and its Subsidiaries' businesses in the ordinary and usual course and, to the extent consistent therewith, each of DQE and APS will use its and its respective Subsidiaries' best efforts to preserve its business organization and maintain its existing relations and goodwill with customers, suppliers, creditors, regulators, lessors, employees and business associates; (ii) each of DQE and APS will not (A) issue, sell, pledge, dispose of or encumber any capital stock owned by it in any of its respective Subsidiaries; (B) amend its articles of incorporation, charter or bylaws; (C) split, combine or reclassify its outstanding shares of capital stock; (D) declare, set aside or pay any dividend payable in cash, stock or property in respect of any capital stock other than dividends from its direct or indirect wholly owned Subsidiaries, other than (x) in the case of DQE, regular quarterly cash dividends not in excess of \$0.34 per share of DQE Common Stock (which amount may, at the election of DQE, be increased by not more than 6.5% per year beginning in the 1997 fiscal year of DQE) and regular quarterly cash dividends on the preferred and preference stock of its Subsidiaries and (y) in the case of APS, regular quarterly cash dividends not in excess of \$0.43 per share of APS Common Stock (which amount may, at the election of APS, be increased by not more than 6.5% per year beginning in the 1997 fiscal year of APS) and regular quarterly cash dividends on the preferred shares of Subsidiaries of APS; or (E) repurchase, redeem or otherwise acquire (except for (x) mandatory sinking fund obligations existing on the date of the Merger Agreement and (y) redemptions, purchases, acquisitions or issuances required by the respective terms of any DQE Stock Plans, in the case of DQE, or APS Stock Plans, in the case of APS, or any dividend reinvestment plans in effect on the date of the Merger Agreement in the ordinary course of the operation of such plans) or permit any of its Subsidiaries to purchase or otherwise acquire, any shares of its capital stock or any securities convertible into or exchangeable or exercisable for any shares of its capital stock; (iii) each of DQE and APS will not and will not permit any of its Subsidiaries to (A) issue, sell, pledge, dispose of or encumber any shares of, or securities convertible into or exchangeable or exercisable for, or options, warrants, calls, commitments or rights of any kind to acquire, any shares of its capital stock of any class or any other property or assets (other than (x) in the case of DQE, shares of DQE Common Stock issuable pursuant to options outstanding on the date of the Merger Agreement under the DQE Stock Plans or upon conversion of the Preferred Stock of DQE (the "Preferred Shares") and additional options or rights to acquire shares of DQE Common Stock required by the terms of any DQE Stock Plan as in effect on the date of the Merger Agreement in the ordinary course of the operation of such DQE Stock Plan, (y) in the case of APS, shares of APS Common Stock issuable pursuant to options outstanding under the APS Stock Plans and additional options or rights to acquire shares of APS Common Stock required by the terms of any APS Stock Plan as in effect on the date of the Merger Agreement in the ordinary course of the operation of such APS Stock Plan, and (z) issuances of securities in connection with grants or awards of stock-based compensation made in accordance with the terms of the Merger Agreement); (B) other than in the ordinary and usual course of business, and except for long-term indebtedness incurred in connection with the refinancing of existing indebtedness either at its maturity or at a lower cost of funds, transfer, lease, license, guarantee, sell, mortgage, pledge, dispose of or encumber any other property or assets (including capital stock of any of its Subsidiaries) or incur or modify any material indebtedness or other liability; (C) make any commitments for, make or authorize any capital expenditures other than (x) capital expenditures not in excess of \$25,000,000 in the aggregate incurred in connection with the repair or replacement of facilities destroyed or damaged due to casualty or accident (whether or not covered by insurance), (y) as required by Law, or (z) in amounts less than \$5,000,000 individually and \$15,000,000 in the aggregate, or (D) make any acquisition of, or investment

in, assets or stock of any other person or entity in excess of \$15,000,000 in the aggregate; (iv) neither DQE nor APS or any of their respective Subsidiaries will terminate, establish, adopt, enter into, make any new grants or awards of stock-based compensation or other benefits under, amend or otherwise modify any Compensation and Benefit Plans or increase the salary, wage, bonus or other compensation of any directors, officers or employees except (A) for grants or awards to its or its respective Subsidiaries' directors, officers and employees under existing Compensation and Benefit Plans in such amounts and on such terms as are consistent with past practice, (B) in the normal and usual course of business (which shall include normal periodic performance reviews and related compensation and benefit increases, annual reestablishment of Compensation and Benefit Plans and the provision of individual Compensation and Benefit Plans consistent with past practice for newly hired or appointed officers and employees and the adoption of Compensation and Benefit Plans for employees of new Subsidiaries in amounts and on terms consistent with past practice) or (C) for actions necessary to satisfy existing contractual obligations under Compensation and Benefit Plans existing as of the date of the Merger Agreement; (v) each of DQE and APS will consult with the other prior to settling or compromising, or permitting any of their respective Subsidiaries to settle or compromise, any material claim or litigation, and neither DQE nor APS or any of their respective Subsidiaries will, except in the ordinary and usual course of business, modify, amend or terminate any of its material contracts or waive, release or assign any material rights or claims; (vi) neither DQE nor APS or any of their respective Subsidiaries will make any tax election or permit any insurance policy naming it as a beneficiary or loss-payable payee to be canceled or terminated except in the ordinary and usual course of business; and (vii) neither DQE nor APS or any of their respective Subsidiaries will take any action or omit to take any action that would prevent the Merger from qualifying for "pooling of interests" accounting treatment or as a "reorganization" within the meaning of Section 368(a) of the Code or that would cause any of their respective representations and warranties in the Merger Agreement to become untrue in any material respect.

Acquisition Proposals

The Merger Agreement provides that, except as contemplated by the budgets submitted by DQE to APS and by APS to DQE and except as expressly contemplated by the Merger Agreement, neither DQE nor APS or any of their respective Subsidiaries will, and DQE and APS will not authorize or permit their officers, directors, employees, agents or other representatives retained by them or any of their Subsidiaries, respectively, to (i) solicit, initiate or encourage, or take any other action designed to facilitate, directly or indirectly, any inquiries or the making of any Acquisition Proposal or (ii) participate in any discussions or negotiations relating to any Acquisition Proposal or Acquisition Transaction. The Merger Agreement does not prohibit either DQE or APS, at any time prior to the obtaining of the necessary vote of the DQE stockholders to effectuate the Merger, in the case of DQE, or the necessary vote of APS stockholders to effectuate the Merger, in the case of APS, from (i) furnishing information with respect to it and its Subsidiaries to any person pursuant to a customary confidentiality agreement (as determined by the party receiving such Acquisition Proposal after consultation with its outside counsel) and (ii) participating in negotiations regarding such Acquisition Proposal, if the DQE Board or the APS Board, as applicable, determines in good faith, based on the advice of outside counsel, that it is necessary to do so to avoid a breach of its duties under state corporate Law applicable to the conduct of directors of DQE or APS, as applicable, in response to an Acquisition Proposal which was not solicited by it or which did not otherwise result from a breach of these provisions of the Merger Agreement, subject to such party's compliance with the provisions of the Merger Agreement which relate to disclosure of Acquisition Proposals, which are discussed in the third succeeding paragraph below.

In addition, the Merger Agreement provides that, except as expressly permitted by the Merger Agreement, neither the DQE Board nor the APS Board, as applicable, or any committee thereof, will (i) withdraw or modify, or propose publicly to withdraw or modify, in a manner adverse to the other party to the Merger Agreement, the approval or recommendation by such board of directors or such committee of the Merger or the adoption and approval of the matters relating to the Merger to be considered at the DQE Meeting, in the case of DQE, and the APS Special Meeting, in the case of APS, (ii) approve or recommend, or propose publicly to approve or recommend, any Acquisition Proposal other than the Merger, or (iii) cause or permit DQE or APS, as applicable, to enter into any Acquisition Agreement, related to any Acquisition

Proposal. Notwithstanding the provisions of the Merger Agreement described in the previous sentence, in the event that prior to the obtaining of the necessary vote of the stockholders of DQE to effectuate the Merger, in the case of DQE, or the necessary vote of the stockholders of APS to effectuate the Merger, in the case of APS, there exists a Superior Proposal (as defined below) and the DQE Board or the APS Board, as applicable, determines that there is not a substantial probability that the necessary vote of the stockholders of DQE to effectuate the Merger or the necessary vote of the stockholders of APS to effectuate the Merger, as applicable, will be obtained due to the existence of such Superior Proposal, the DQE Board or the APS Board, as applicable, may, subject to the terms of the Merger Agreement described in this and the following sentences, withdraw or modify its approval or recommendation of the Merger or the approval of the matters to be considered at the DQE Meeting, in the case of DQE, and the APS Special Meeting, in the case of APS, and the DQE Board or the APS Board, as applicable, may (subject to the terms of the Merger Agreement described in this and the following sentences) approve or recommend such Superior Proposal or terminate the Merger Agreement, but only if (a) the party seeking to terminate is not in material breach of any of the terms of the Merger Agreement, (b) the board of directors of the party seeking to terminate authorizes DQE or APS, as applicable, to enter into a binding written Acquisition Agreement concerning an Acquisition Transaction that constitutes a Superior Proposal and the party seeking to terminate notifies the other party in writing that it intends to enter into such an Acquisition Agreement, attaching such Acquisition Agreement to such notice and specifying any material terms and conditions not included in the Acquisition Agreement and further identifying the party making the Superior Proposal, (c) the other party does not make, within fifteen business days of receipt of written notification from the party seeking to terminate of such party's intention to enter into a binding Acquisition Agreement for a Superior Proposal, an offer that the board of directors of such party believes, in good faith after consultation with its financial advisors, is at least as favorable, from a financial point of view, to its stockholders as the Superior Proposal, and (d) the party seeking to terminate prior to such termination pays to the other party in immediately available funds any fees required to be paid pursuant to the provisions of the Merger Agreement. Each of DQE and APS has agreed in the Merger Agreement (A) that it will not enter into a binding Acquisition Agreement until at least the sixteenth business day after it has provided the notice to DQE or APS, as applicable, required by the Merger Agreement and (B) to notify APS or DQE, as applicable, promptly, if its intention to enter into the written Acquisition Agreement referred to in its notification changes at any time after giving such notification.

A "Superior Proposal" is defined in the Merger Agreement to mean, in respect of DQE or APS, as applicable, any proposal made by a third party to acquire, directly or indirectly, for consideration consisting of cash and/or securities, more than 50% of the equity securities of DQE or APS, as the case may be, entitled to vote generally in the election of directors or all or substantially all the assets of DQE or APS, as the case may be, and otherwise on terms which the board of directors of such party determines in its good faith judgment (x) (based on the written opinion of a financial advisor of nationally recognized reputation (which opinion will be provided to the other party)) to be more favorable from a financial point of view to its stockholders after consideration of the Merger and the transactions contemplated by the Merger Agreement and for which financing, to the extent required, is then committed, (y) to be more favorable to such party after consideration of the Merger and the transactions contemplated by the Merger Agreement after taking into account any additional constituencies (including stockholders) and pertinent factors permitted under the laws of the Commonwealth of Pennsylvania or the laws of the State of Maryland, as applicable, and (z) to constitute a transaction that is reasonably likely to be consummated on the terms set forth, taking into account all legal, financial, regulatory and other aspects of the proposal.

The Merger Agreement also provides that if any party receives an Acquisition Proposal it will immediately advise the other party orally and in writing of such Acquisition Proposal, any request for information, the material terms and conditions of such request or Acquisition Proposal and the identity of the Person making such request or Acquisition Proposal. In addition, DQE and APS have agreed that if either has received an Acquisition Proposal it will keep the other party reasonably informed of the status and details of any such Acquisition Proposal.

The Merger Agreement further provides that nothing contained in the Merger Agreement will prohibit a party from taking and disclosing to its stockholders a position contemplated by Rule 14e-2(a) under the

Securities Exchange Act of 1934, as amended (the "Exchange Act") with respect to an Acquisition Proposal by means of a tender or exchange offer.

Conditions

The respective obligations of DQE, APS and Merger Sub to effect the Merger are subject to the satisfaction or waiver at or prior to the Effective Time of each of the following conditions: (i) the Merger Agreement having been duly approved by holders of shares of DQE Common Stock and by APS as the sole stockholder of Merger Sub and the issuance of APS Common Stock pursuant to the Merger having been duly approved by the holders of APS Common Stock; (ii) the shares of APS Common Stock issuable to holders of DQE Common Stock pursuant to the Merger Agreement having been authorized for listing on the NYSE upon official notice of issuance; (iii) the waiting period applicable to the consummation of the Merger under the HSR Act having expired or been terminated and, other than the filing of the Pennsylvania Articles of Merger, all filings required to be made prior to the Effective Time by DQE or APS or any of their respective Subsidiaries with, and all consents, approvals and authorizations required to be obtained prior to the Effective Time by DQE or APS, or any of their respective Subsidiaries, from any Governmental Entity (collectively, "Governmental Consents") in connection with the execution and delivery of the Merger Agreement and the consummation of the transactions contemplated by the Merger Agreement having been made or obtained (as the case may be) and having become Final Orders (as defined under "— Termination"), and such Final Orders not, individually or in the aggregate, containing terms that would have, or be reasonably likely to have, a Material Adverse Effect on DQE or a Material Adverse Effect on APS (excluding, after the Effective Time, DQE and its Subsidiaries); (iv) no court or Governmental Entity of competent jurisdiction having enacted, issued, promulgated, enforced or entered any Order, and no Governmental Entity having instituted any proceeding seeking any such Order; (v) the Registration Statement, of which this Joint Proxy Statement/ Prospectus is a part, having become effective under the Securities Act and no stop order suspending such effectiveness having been issued and no proceedings for that purpose having been initiated or been threatened by the SEC; (vi) APS having received all state securities and "blue sky" permits and other authorizations necessary to consummate the transactions contemplated by the Merger Agreement; and (vii) APS and DQE having received from APS' independent accounting firm a letter to the effect that the Merger will qualify for "pooling of interests" accounting treatment.

In addition, the obligations of APS and Merger Sub to effect the Merger are also subject to the satisfaction or waiver by APS, prior to the Effective Time, of the following conditions: (i) the representations and warranties of DQE set forth in the Merger Agreement being true and correct in all material respects as of the date of the Merger Agreement and as of the Closing Date, including the representation by DQE relating to the absence of any change in the financial condition, properties, business or results of operations of DQE that would be reasonably likely to have a Material Adverse Effect on DQE and its Subsidiaries (except to the extent any such representation or warranty expressly speaks as of an earlier date), and APS having received a certificate signed on behalf of DQE by an executive officer of DQE to such effect; (ii) DQE having performed in all material respects all obligations required to be performed by it under the Merger Agreement at or prior to the Closing Date, and APS having received a certificate signed on behalf of DQE by an executive officer of DQE to such effect; (iii) DQE having obtained the consent or approval of each person whose consent or approval is required to consummate the transactions contemplated by the Merger Agreement and the Stock Option Agreement under any contract to which DQE or any of its Subsidiaries is a party, except those for which the failure to obtain such consent or approval, individually or in the aggregate, is not reasonably likely to have a Material Adverse Effect on DQE or is not reasonably likely to materially adversely affect the ability of DQE to consummate the transactions contemplated by the Merger Agreement; (iv) APS having received the opinion of Sullivan & Cromwell to the effect that the Merger will be treated for Federal income tax purposes as a "reorganization" within the meaning of Section 368(a) of the Code, and that each of APS, Merger Sub and DQE will be a party to that reorganization within the meaning of Section 368(b) of the Code; (v) APS having received a letter from each of DQE's Affiliates, making certain representations and assurances in connection with the resale of APS Common Stock received pursuant to the Merger Agreement and the transactions contemplated thereby (each an "Affiliates Letter") from each person identified as an affiliate of DQE in accordance with the provisions of

the Merger Agreement; (vi) APS having received from its independent public accounting firm and DQE's independent public accounting firm customary "comfort" letters.

Further, the obligation of DQE to effect the Merger is also subject to the satisfaction or waiver by DQE, prior to the Effective Time, of the following conditions: (i) the representations and warranties of APS and Merger Sub set forth in the Merger Agreement being true and correct as of the date of the Merger Agreement and as of the Closing Date, including the representation by APS relating to the absence of any change in the financial condition, properties, business or results of operations of APS that would be reasonably likely to have a Material Adverse Effect on APS and its Subsidiaries (except to the extent any such representation and warranty expressly speaks as of an earlier date), and DQE having received a certificate signed on behalf of APS by an executive officer of APS and Merger Sub to such effect; (ii) each of APS and Merger Sub having performed in all material respects all obligations required to be performed by it under the Merger Agreement at or prior to the Closing Date, and DQE having received a certificate signed on behalf of APS and Merger Sub by an executive officer of APS to such effect; (iii) APS having obtained the consent or approval of each person whose consent or approval will be required in order to consummate the transactions contemplated by the Merger Agreement and the Stock Option Agreement under any contract to which APS or any of its Subsidiaries is a party, except those for which failure to obtain such consents and approvals, individually or in the aggregate, is not reasonably likely to have a Material Adverse Effect on APS or is not reasonably likely to materially adversely affect the ability of APS to consummate the transactions contemplated by the Merger Agreement; (iv) DQE having received the opinion of LeBoeuf, Lamb, Greene & MacRae, L.L.P. to the effect that the Merger will be treated for Federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Code, and that each of APS, Merger Sub and DQE will be a party to that reorganization within the meaning of Section 368(b) of the Code; and (v) DQE having received from its independent public accounting firm and APS' independent accounting firm customary "comfort" letters.

Each of the foregoing conditions to the Merger, including the receipt of opinions with respect to the federal income tax consequences of the Merger, may be waived solely at the discretion of the party waiving such condition. In the event that any such waiver occurs after the respective stockholders have approved the issuance of APS Common Stock, in the case of APS, or the Merger Agreement, in the case of DQE, at their respective Stockholders Meetings, APS or DQE, as the case may be, may seek to re-solicit the approval of its respective stockholders. If either party waives the condition relating to the receipt of an opinion with respect to the federal income tax consequences of the Merger it will recirculate a revised version of this Joint Proxy Statement/Prospectus to disclose the waiver of this condition, to disclose material risks to its stockholders as a result of the waiver of this condition, if any, and to disclose any related material disclosures. In addition, each party would re-solicit the approval of its respective stockholders in the event that it waived the condition relating to the receipt of an opinion with respect to the federal income tax consequences of the Merger and the tax consequences of the Merger are, at such time, materially different from the tax consequences described under "Certain Federal Income Tax Consequences of the Merger."

Modification or Amendment; Waiver of Conditions; Extension

The Merger Agreement provides that, subject to the provisions of applicable Law, the parties to the Merger Agreement may modify or amend the Merger Agreement, by written agreement executed and delivered by duly authorized officers of the respective parties. The Merger Agreement also provides that the conditions to each of the parties' obligations to consummate the Merger are for the sole benefit of such party and at any time prior to the Effective Time such party may waive such conditions in whole or in part or extend the time for the performance of any of the obligations or other acts of the other parties thereto to the extent permitted by applicable Law.

Termination

The Merger Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time (a) by mutual written consent of DQE, APS and Merger Sub by action of the DQE Board and the APS Board or (b) by action of the DQE Board or the APS Board if (i) the Merger has not been consummated by the Termination Date (*provided* that the Termination Date will automatically be extended for six months if, on the Termination Date: (A) any of the conditions relating to regulatory consents has not

been satisfied or waived, (B) each of the other conditions to the consummation of the Merger has been satisfied or waived or can readily be satisfied, and (C) any Governmental Consent that has not yet been obtained is being pursued diligently and in good faith), (ii) any Governmental Consent will have been made or obtained by action by the relevant Governmental Entity that has not been reversed, stayed, enjoined, set aside, annulled or suspended, with respect to which any waiting period prescribed by law before the transactions contemplated by the Merger Agreement may be consummated has expired, and as to which all conditions to the consummation of such transactions prescribed by law, regulation or order have been satisfied ("Final Orders") which contain terms or conditions that would cause any of the conditions relating to regulatory consents not to be satisfied, (iii) any Order permanently restraining, enjoining or otherwise prohibiting the Merger has become final and non-appealable, (iv) the necessary vote of DQE's stockholders to effectuate the Merger has not been obtained at the DQE Meeting, including any adjournments thereof, or (v) the necessary vote of APS' stockholders to effectuate the Merger has not been obtained at the APS Special Meeting, including any adjournments thereof. The Merger Agreement provides that the right to terminate the Merger Agreement pursuant to clause (i), (ii), (iv) or (v) above will not be available to any party that has breached in any material respect its obligations under the Merger Agreement in any manner that has contributed to the failure of the Merger to be consummated.

Further, the Merger Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time by action of the DQE Board: (a) subject to and in accordance with the termination provisions of the Merger Agreement relating to Acquisition Proposals (see "The Merger Agreement — Conduct of Business Pending the Merger; Certain Covenants; Acquisition Proposals — Acquisition Proposals"); or (b) if (i) the APS Board has withdrawn or adversely modified its approval or recommendation of the Merger Agreement or failed to reconfirm its recommendation of the Merger Agreement after a written request by DQE to do so, (ii) there has been a material breach by APS or Merger Sub of any representation, warranty, covenant or agreement contained in the Merger Agreement that is not curable or, if curable, is not cured within 30 days after written notice of such breach is given by DQE to the party committing such breach, or (iii) APS or any of its affiliates, representatives or agents takes any of the actions that would be proscribed by certain provisions of the Merger Agreement which restrict APS' conduct with respect to Acquisition Proposals (see "The Merger Agreement — Conduct of Business Pending the Merger; Certain Covenants; Acquisition Proposals — Acquisition Proposals").

In addition, the Merger Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time by action of the APS Board: (a) subject to and in accordance with the termination provisions of the Merger Agreement relating to Acquisition Proposals (see "The Merger Agreement — Conduct of Business Pending the Merger; Certain Covenants; Acquisition Proposals — Acquisition Proposals"); or (b) if (i) the DQE Board has withdrawn or adversely modified its approval or recommendation of the Merger Agreement or failed to reconfirm its recommendation of the Merger Agreement after a written request by APS to do so, (ii) there has been a material breach by DQE of any representation, warranty, covenant or agreement contained in the Merger Agreement that is not curable or, if curable, is not cured within 30 days after written notice of such breach is given by APS to the party committing such breach, or (iii) DQE or any of its affiliates, representatives or agents takes any of the actions that would be proscribed by certain provisions of the Merger Agreement which restrict DQE's conduct with respect to Acquisition Proposals (see "The Merger Agreement — Conduct of Business Pending the Merger; Certain Covenants; Acquisition Proposals — Acquisition Proposals").

In the event of termination of the Merger Agreement and the abandonment of the Merger, the Merger Agreement (other than certain provisions of the Merger Agreement relating to expenses and confidentiality and other than as described below under "The Merger Agreement — Certain Termination Fees") will become void and of no effect with no liability of any party thereto (or any of its directors, officers, employees, agents, legal and financial advisors or other representatives); *provided, however*, except as otherwise provided in the Merger Agreement, no such termination will relieve any party thereto of any liability or damages resulting from any breach of the Merger Agreement.

Certain Termination Fees

The Merger Agreement provides that in the event that it is terminated (a) by DQE pursuant to the provisions of the Merger Agreement permitting DQE to terminate the Merger Agreement under certain circumstances when a Superior Proposal exists, (b) by APS following (i) the DQE Board having withdrawn or adversely modified its approval or recommendation of the Merger Agreement or failing to reconfirm its recommendation of the Merger Agreement after a written request by APS to do so, or (ii) DQE or any of its affiliates, representatives or agents having taken any of the actions that would be proscribed by certain provisions of the Merger Agreement which restrict DQE's conduct with respect to Acquisition Proposals, or (c) by DQE or APS pursuant to the provisions of the Merger Agreement permitting them to terminate if the necessary vote of the stockholders of DQE to effectuate the Merger has not been obtained at the DQE Meeting, then DQE will promptly pay APS in addition to any amount, not to exceed \$20,000,000, paid and/or payable by DQE to APS pursuant to the Stock Option Agreement, a termination fee (the "DQE Initial Termination Fee") equal to the sum of (x) the charges and expenses incurred by APS or Merger Sub in connection with the Merger Agreement and the Stock Option Agreement and the transactions contemplated by the Merger Agreement and the Stock Option Agreement up to a maximum amount of \$10,000,000 and (y) an amount equal to \$50,000,000 less the sum of (I) the amount paid pursuant to clause (x) above and (II) the amount not to exceed \$20,000,000 paid and/or payable by DQE to APS pursuant to the Stock Option Agreement. The Merger Agreement provides that in no event will the amount payable pursuant to the previous sentence exceed \$50,000,000. In addition, if the Merger Agreement is terminated (A) at a time when the DQE Initial Termination Fee is payable to APS or (B) at a time when the approval of DQE stockholders has not been obtained at the DQE Meeting *and* at any time within two years after such termination DQE consummates a Material Acquisition Transaction (as defined below) with any person other than APS or a Subsidiary of APS, then DQE will pay APS an additional termination fee (the "Further Termination Fee") of \$50,000,000. For a discussion of the terms of the Stock Option Agreement, see "Certain Related Agreements — Stock Option Agreement."

A "Material Acquisition Transaction" is defined in the Merger Agreement to mean, with respect to APS or DQE, any Acquisition Transaction or series of related Acquisition Transactions involving a merger or consolidation of such party or forty percent or more of its voting power, equity interests or assets (in each case directly or indirectly).

The Merger Agreement also provides that in the event that it is terminated (a) by APS pursuant to the provisions of the Merger Agreement permitting APS to terminate the Merger Agreement under certain circumstances when a Superior Proposal exists, (b) by DQE following (i) the APS Board having withdrawn or adversely modified its approval or recommendation of the Merger Agreement or failing to reconfirm its recommendation of the Merger Agreement after a written request by DQE to do so, or (ii) APS, or any of its affiliates, representatives or agents having taken any of the actions that would be proscribed by certain provisions of the Merger Agreement, which restrict APS' conduct with respect to Acquisition Proposals, or (c) by DQE or APS pursuant to the provisions of the Merger Agreement permitting them to terminate if the necessary vote of the stockholders of APS has not been obtained at the APS Special Meeting, then APS will promptly pay DQE in addition to any amount, not to exceed \$20,000,000, paid and/or payable by APS to DQE pursuant to the Letter Agreement, a termination fee (the "APS Initial Termination Fee") equal to the sum of (x) the charges and expenses incurred by DQE in connection with the Merger Agreement and the Stock Option Agreement and the transactions contemplated by the Merger Agreement and the Stock Option Agreement up to a maximum amount of \$10,000,000 and (y) an amount equal to \$50,000,000 less the sum of (I) the amount paid pursuant to clause (x) and (II) the amount, not to exceed \$20,000,000, paid and/or payable by APS to DQE pursuant to the Letter Agreement. The Merger Agreement provides that in no event will the amount payable pursuant to the previous sentence exceed \$50,000,000. In addition, if the Merger Agreement is terminated (A) at a time when the APS Initial Termination Fee is payable to DQE or (B) at a time when the approval of APS' stockholders has not been obtained at the APS Special Meeting *and* at any time within two years after such termination APS consummates a Material Acquisition Transaction with any person other than DQE or a Subsidiary of DQE, then APS will pay DQE the Further Termination Fee. For a discussion of the terms of the Letter Agreement, see "Certain Related Agreements — Letter Agreement."

Expenses

The Merger Agreement provides that except as provided therein with respect to certain expenses described below and except as provided with respect to expenses in the event of termination of the Merger Agreement, the Surviving Corporation will pay all charges and expenses, including those of the Exchange Agent, in connection with the exchange of shares, and APS has agreed to reimburse the Surviving Corporation for such charges and expenses. The Merger Agreement also provides that, whether or not the Merger is consummated, all costs and expenses incurred in connection with the Merger Agreement and the Stock Option Agreement and the Merger and the other transactions contemplated by the Merger Agreement and the Stock Option Agreement will be paid by the party incurring such expense, except that expenses incurred in connection with the filing fee for the filings under the HSR Act, the Registration Statement of which this Joint Proxy Statement/Prospectus forms a part and printing and mailing this Joint Proxy Statement/Prospectus and such other expenses as the parties may agree will be shared equally by APS and DQE.

Stock Options

Pursuant to the Merger Agreement, at the Effective Time each outstanding DQE Option under the DQE Stock Plans, whether vested or unvested, will be deemed to constitute an option to acquire, on the same terms and conditions as were applicable under such DQE Option, the same number of shares of APS Common Stock as the holder of such DQE Option would have been entitled to receive pursuant to the Merger had such holder exercised such option in full immediately prior to the Effective Time (rounded down to the nearest whole number), at a price per share of APS Common Stock (rounded up to the nearest whole cent) equal to (y) the aggregate exercise price for the shares of DQE Common Stock otherwise purchasable pursuant to such DQE Option divided by (z) the number of full shares of APS Common Stock deemed purchasable pursuant to such DQE Option. In addition, pursuant to the Merger Agreement, APS has agreed to assume, effective as of the Effective Time, each DQE Option in accordance with the terms of the DQE Stock Plan under which it was issued and the stock option agreement by which it is evidenced.

Nuclear Matters

The Merger Agreement provides that, at least quarterly prior to the Effective Time, DQE, upon request by APS, will cause its President — Generation Group and its Chief Nuclear Officer to attend a meeting of the APS Board and provide APS' directors with such oral and written information concerning the Nuclear Facilities and DQE's nuclear generation program as such directors and/or the Chief Financial Officer of APS may reasonably request, including, but not limited to, information relating to safety matters, regulatory matters, refueling plans, outages, planned and pending capital expenditures and DQE's relations with co-owners of the Nuclear Facilities. In addition, prior to the Effective Time, APS will be entitled to designate one person who will be a director of APS or will be a person expert in nuclear matters reasonably acceptable to DQE, to attend and participate in each meeting of the Nuclear Review Committee of the DQE Board.

Certain Regulatory Provisions

Pursuant to the Merger Agreement, DQE and APS each have agreed to, and to cause their respective subsidiaries to, discuss with each other any changes in its or its respective subsidiaries' regulated rates or charges (other than pass-through fuel rates or charges), standards of service or accounting from those in effect on the date of the Merger Agreement, and to consult with the other prior to making any filing (or any amendment thereto), or effecting any agreement, commitment, arrangement or consent, whether written or oral, formal or informal, with respect thereto, other than in connection with rate filings pending as of the date of the Merger Agreement.

In addition, pursuant to the Merger Agreement, DQE and APS have agreed that neither DQE nor APS will, nor will DQE or APS permit any of their respective subsidiaries to, take any action that would impair the ability of APS to obtain the approvals under the PUHCA for the transactions contemplated by the Merger Agreement.

Further, pursuant to the Merger Agreement, DQE and APS have agreed that they will cause their respective Pennsylvania utility subsidiaries to file in a timely manner with the PAPUC a restructuring plan to

implement direct access to a competitive market for electric generation pursuant to the Pennsylvania Restructuring Legislation.

New York Stock Exchange Listing; De-Listing of DQE Common Stock

APS will file a listing application with the NYSE covering the shares of APS Common Stock to be issued in connection with the Merger. The obligations of APS and DQE to consummate the Merger are subject to the condition that the shares of APS Common Stock to be issued to the holders of DQE Common Stock in connection with the Merger be approved for listing on the NYSE, subject only to official notice of issuance. DQE Common Stock will be delisted from the NYSE, the CSE and the PHSE and deregistered under the Exchange Act as soon as practicable following the Effective Time.

CERTAIN REGULATORY MATTERS

HSR Act

Under the HSR Act and the rules promulgated thereunder, certain transactions, including the Merger, may not be consummated unless certain waiting period requirements have been satisfied. APS and DQE each will file a Notification and Report Form pursuant to the HSR Act with the DOJ and the FTC. At any time before or after the Effective Time, the FTC, the DOJ or others could take action under the antitrust laws with respect to the Merger, including seeking to enjoin the consummation of the Merger, to rescind the Merger or to require divestiture of substantial assets of APS or DQE. There can be no assurance that a challenge to the Merger on antitrust grounds will not be made or, if such a challenge is made, that it would not be successful.

Federal Power Act

Section 203 of the Power Act provides that no public utility shall sell or otherwise dispose of the whole of its facilities subject to the jurisdiction of the FERC or directly or indirectly merge or consolidate its facilities with those of any other person or purchase, acquire or take any security of any other public utility without first having obtained an order authorizing it from the FERC. The approval of the FERC is required to consummate the Merger. Under Section 203 of the Power Act, the FERC will approve a merger if it finds the merger to be "consistent with the public interest." The FERC may grant its order on such terms and conditions as it finds necessary or appropriate to secure the maintenance of adequate service and coordination in the public facilities subject to its jurisdiction. In December 1996, the FERC issued a policy statement which updated and clarified its procedures, criteria and policies concerning public utility mergers for the purpose of providing greater certainty and expedition in its analysis of mergers. The FERC announced that it would generally take into account three factors in analyzing proposed mergers: the effect on competition, the effect on rates and the effect on regulation. DQE and APS will file a joint application before the FERC seeking approval of the Merger.

PUHCA

APS is registered as a holding company under the PUHCA. Pursuant to Section 3(a)(1) of the PUHCA, DQE is a holding company exempt from all of the provisions of the PUHCA except for Section 9(a)(2) thereof. APS is required to obtain SEC approval under Section 9(a)(1) of the PUHCA in connection with the Merger. DQE is not required to obtain SEC approval. An application for approval of the Merger will be filed by APS.

Under the applicable standards of the PUHCA, the SEC is directed to approve the Merger unless it finds that (i) the Merger would tend towards interlocking relations or a concentration of control which is detrimental to the public interest or the interest of investors or consumers, (ii) the consideration to be paid in connection with the Merger is not reasonable or does not bear a fair relation to the sums invested in or the earning capacity of the utility assets underlying the securities to be acquired, (iii) the Merger would unduly complicate the capital structure of APS' holding company system or would be detrimental to the proper functioning of APS' holding company system or (iv) the Merger would be unlawful pursuant to an appropriate

state law. To approve the Merger, the SEC must also find that the Merger would tend towards the economical and efficient development of an integrated public utility system and would otherwise conform to the PUHCA's integration and corporate simplification standards.

Following the Merger, APS will continue to be a registered holding company under the PUHCA and therefore, following the Merger, stockholders of DQE will own stock in a regulated holding company pursuant to the PUHCA. The PUHCA imposes restrictions on the operations of registered holding company systems. Among these are requirements that certain securities issuances, as well as acquisitions of securities, sales and acquisitions of utility assets and acquisitions of interests in any other business, be approved by the SEC. The PUHCA also limits the ability of registered holding companies to engage in non-utility ventures and regulates holding company system service companies and the rendering of services by holding company affiliates to the system's utilities. The SEC has authority under the PUHCA to preclude the payment of dividends by APS and the payment of dividends by DQE to APS under certain circumstances. DQE and APS recognize that the divestiture of certain of the existing nonutility operations of DQE is a possibility, but APS will request in its PUHCA application that it be allowed to retain the nonutility operations of DQE, or, in the alternative, that the question of divestiture be deferred. If divestiture is ultimately required, the SEC historically has allowed companies sufficient time to accomplish divestiture in a manner that protects stockholder value. Following the Merger, DQE will no longer be exempt as a public utility holding company under the PUHCA.

In June 1995, the staff of the SEC published a report which recommended changes to the PUHCA, including a recommendation to Congress to repeal the entire act. Bills were introduced in the last Congress to repeal the PUHCA, but did not pass. Similar bills have been introduced in the 105th Congress. However, neither APS nor DQE can predict what changes, if any, will be made to the PUHCA as a result of these activities.

Nuclear Regulatory Commission

Duquesne Light owns a 13.74% interest in Perry Unit 1, a 47.50% interest in Beaver Valley 1 and a 13.74% interest in Beaver Valley 2. Pursuant to agreements with the co-owners, a subsidiary of Duquesne Light operates Beaver Valley 1 and Beaver Valley 2. Duquesne Light holds NRC licenses with respect to its ownership interests in and operating responsibilities for these nuclear units. The AEA currently provides that licenses may not be transferred or in any manner disposed of, either voluntarily or involuntarily, directly or indirectly, unless the NRC finds that such transfer or disposition is in accordance with the AEA and consents in writing. Pursuant to the AEA, Duquesne Light will seek approval from the NRC to the full extent required to reflect that, after the Merger, Duquesne Light, although continuing to own the identical pre-Merger shares of the Nuclear Facilities, will become an indirect operating subsidiary of APS.

Pennsylvania Public Utility Commission

DQE is a Pennsylvania corporation and is the parent corporation of Duquesne Light, a Pennsylvania public utility providing electric service to the public in Pennsylvania. APS' subsidiaries own significant generating units in Pennsylvania. APS' subsidiary West Penn is a Pennsylvania public utility providing electric service to the public in Pennsylvania. Pursuant to the laws of Pennsylvania, approval of the PAPUC is required for any public utility to be acquired by or to be transferred to any person or corporation, including a transfer by way of merger. The PAPUC will approve transfers if the PAPUC finds or determines that such transfer is necessary or proper for the service, accommodation, convenience or safety of the public. In addition, under the Pennsylvania Restructuring Legislation, the PAPUC may investigate the effect of mergers on the proper functions of a competitive retail electricity market. Duquesne Light and West Penn Power Company will file appropriate applications seeking any required or necessary approval of the PAPUC.

In connection with the Pennsylvania Restructuring Legislation, APS and DQE will each file restructuring plans with the PAPUC. Each such plan will set forth proposals for the transition to customer choice and recovery of stranded costs.

Maryland Public Service Commission

APS is a Maryland corporation. The MPSC is granted general authority to supervise and regulate public utility operations in the State of Maryland. The issuance of APS Common Stock may require the approval of the MPSC. The MPSC will authorize an issuance of stock if the issuance is reasonably required for the acquisition of property by the issuing company. If appropriate or necessary, APS will file an application for approval of the MPSC.

Other Regulatory Matters

In addition to Pennsylvania and Maryland, APS has public utilities subsidiary operations in Ohio, West Virginia and Virginia. Certain of these states may contend that they have jurisdiction over the Merger and that their consent to the Merger is required. Amendment of certain affiliate agreements which may occur in connection with the Merger will require the approval of the State Corporation Commission of Virginia and the Public Service Commission of West Virginia. Other than with respect to the amendment of these affiliate agreements, APS does not believe that any of these states has jurisdiction with respect to the Merger.

Power Supply Agreement

APS' subsidiaries currently intend to either amend the Power Supply Agreement, dated January 1, 1968, among Monongahela, Potomac Edison and West Penn, as amended, or eliminate such agreement and in lieu thereof may (a) organize a new subsidiary or subsidiaries of APS, (b) cause APS' utility subsidiaries to transfer or lease certain of their respective generation or transmission assets and liabilities to such subsidiary or Subsidiaries and (c) cause such new subsidiary or Subsidiaries to sell APS' utility subsidiaries' generation and generation services and/or transmission and transmission services as appropriate or as required. These transactions may require regulatory approvals. Any required approvals will be sought by APS and its subsidiaries as soon as practicable following the decision to engage in any of these transactions.

Effects of Certain Regulatory Trends

SFAS No. 71

In accordance with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," the regulated entities' financial statements reflect assets and liabilities issued on current cost-based ratemaking regulation. Once the transition to full retail competition is completed in Pennsylvania, APS' wholly owned subsidiary operating in Pennsylvania, West Penn, and Duquesne Light may not meet the criteria for applying SFAS No. 71 to their respective generation operations and assets. In that event, any remaining generation related regulatory assets and liabilities, if any, would be written off, and any generation related long-lived fixed and intangible assets would need to be evaluated for impairment under the provisions of SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." The result could be an extraordinary noncash charge to operations that could be material to the financial position and results of operations of APS or DQE, as the case may be. Because of the provisions in the Pennsylvania Restructuring Legislation related to stranded cost recovery, APS and DQE do not believe any significant write-offs or charges should be required.

Stranded Cost Recovery

Stranded costs can generally be described as mandated costs (such as regulatory assets and obligations under PURPA contracts) and costs of generation that could be recovered in a regulated environment but cannot be recovered in a competitive environment because they are in excess of market. The Pennsylvania Restructuring Legislation permits recovery of both types from customers through a competitive transition charge ("CTC"), subject to PAPUC approval, with the provision that utilities have an obligation to mitigate stranded costs to the extent practicable. Over the CTC recovery period, which can be up to nine years, all Pennsylvania utilities are permitted a CTC charge to recover costs in excess of market. Generally, because West Penn has a lower per unit cost of operation, its CTC charge for costs in excess of market may be less than other utilities. Duquesne Light by comparison has certain higher cost per unit operations which would

provide it with a higher charge for costs in excess of market. West Penn and Duquesne Light will each file its restructuring plan on August 1, 1997 in which it will address this issue.

Emerging Issues Task Force

Members of the *Emerging Issues Task Force* of the Financial Accounting Standards Board (the "Task Force") have discussed issues related to the impact of changes in the regulatory environment for electric utilities. These changes have resulted from initiatives which are intended to ultimately change the pricing of the generation of electricity (but not of its transmission or distribution) to competitive pricing. Although the arrangements vary from state to state, the regulators are expected to provide (or are providing, such as in the Pennsylvania Restructuring Legislation) for a transition period for the generation of electricity from a fully regulated to a competitive environment. During these transition periods, mechanisms are being provided for a utility to recover certain assets and other costs associated with its generation operations prior to (and, in some cases, subsequent to) the change, while at the same time the price of electricity generated after the change will be based on market rates. During this transition period and thereafter, for the foreseeable future, the transmission and distribution portions of a utility's operations are expected to continue to be cost of service based rate regulated.

The Task Force is considering how to identify the regulatory assets attributable to that portion of a business which under SFAS 101 would require write-off, assuming SFAS 71 is no longer applicable to the generation portion of a utility's operations. The Task Force is also considering a threshold question of whether application of SFAS 71 to the generation facilities of a utility is appropriate during the transition period, or whether SFAS 101 requires that regulatory accounting principles no longer be applied.

There can be no assurances as to how the Task Force will resolve these issues. As disclosed above under "— SFAS No. 71," a determination that SFAS No. 71 is inapplicable would have significant adverse consequences to West Penn and Duquesne Light.

INTERESTS OF CERTAIN PERSONS IN THE MERGER

Certain members of the management of DQE and the DQE Board who have interests in the Merger that are in addition to their interests as holders of DQE Common Stock have participated in the negotiation of the terms of the Merger Agreement and the transactions contemplated thereby.

Directors and Officers

The Merger Agreement provides that from and after the Effective Time, the APS Board will be composed of 15 directors and that immediately prior to the Effective Time, DQE will designate six of such directors, and APS will designate nine of such directors, and that all such designated directors will be the directors of APS from and after the Effective Time until their successors have been duly elected or appointed and qualified or until their earlier death, resignation or removal in accordance with the APS Charter and the APS Bylaws. Although as of the date hereof, neither DQE nor APS has determined who it will designate to be directors of APS following the Effective Time, each of DQE and APS currently intends to nominate persons from among the members of its respective boards of directors at the Effective Time. In addition, the Merger Agreement provides that four of the six directors of APS designated by DQE pursuant to the Merger Agreement will be the chairmen of the following committees of the APS Board: Nuclear Review; New Business; Finance; and Employee and Community Relations, and that four of the nine directors of APS designated by APS pursuant to the Merger Agreement will be the chairmen of the following committees of the APS Board: Audit; Management Review; Nominating; and Benefits.

Severance Agreements

DQE and its affiliates have entered into severance agreements (the "DQE Severance Agreements") with David D. Marshall, Victor A. Roque, Gary L. Schwass and James D. Mitchell, and with nine other officers of DQE or its affiliates, providing benefits upon a Change in Control (as defined below). The DQE Severance

Agreements provide for payments and certain other benefits to the officer if the officer's employment is terminated by the officer after a Constructive Discharge (as defined below), or is terminated by DQE for any reason other than death, disability or cause at any time during the period that begins on the date of a Change of Control and ends 36 months after the closing of the transactions giving rise to such Change in Control. The payment will be a lump sum amount equal to (i) three times the officer's current annual base pay and target bonus opportunity at the time of the termination, (ii) an amount intended to compensate the officer for the loss of long-term incentive benefits, and (iii) the amount of forfeitures, if any, and expected contributions for the 36 months following the termination under DQE's 401(k) Plan. In addition, the officer will receive a lump sum payment equal to the actuarial value of the excess of (x) the benefits payable to the officer under the Retirement Plan of DQE and the Supplemental Executive Retirement Plan of DQE (the "Retirement Plans"), assuming three additional years of participation by the officer in the Retirement Plans, over (y) the actual benefit payable to the officer under the Retirement Plans. Medical, disability and life insurance benefits also will continue for the same 36-month period. The officer also is entitled to such payments and benefits if the employee voluntarily terminates his or her employment in the thirteenth month following the closing of the transaction giving rise to the Change in Control, provided that the 36 month payment and benefit period would be reduced to 24 months and payments and benefits would be reduced, if necessary, to avoid the excise tax under Section 4999 of the Code.

The officer will also be entitled to a tax gross-up payment if (i) it is determined that any payment (and the value of any benefits) received or to be received under his or her DQE Severance Agreement would be subject to the excise tax imposed by Section 4999 of the Code and (ii) the payments (and the value of any benefits) to be received in excess of 300% of the base amount (as that term is defined in Section 280G of the Code) exceeds 10% of the total payments and benefits due pursuant to the DQE Severance Agreements. Otherwise, the payments and benefits received or to be received pursuant to the DQE Severance Agreements will be reduced to an amount which will not be subject to such excise tax.

"Change in Control" is defined in the DQE Severance Agreements as, among other things, the public announcement of a transaction approved by the DQE Board involving a merger of DQE other than a merger in which the outstanding voting securities of DQE immediately prior to the merger continue to represent at least 80% of the outstanding voting securities of DQE or the surviving entity immediately after the merger. The Merger constitutes such a merger and therefore the public announcement of the DQE Board's approval of the Merger constituted a Change in Control for purposes of the DQE Severance Agreements, unless and until the Merger is abandoned. "Constructive Discharge" is defined in the DQE Severance Agreements as, among other things, (i) a requirement that the officer be based at any office or location more than 50 miles from Pittsburgh, Pennsylvania, other than an office or location within 35 miles of DQE's or Duquesne Light's principal executive offices; (ii) the reduction of the officer's compensation or benefits, unless part of a reduction for all executive officers of DQE, Duquesne Light or any parent thereof; (iii) the material failure of DQE to comply with the terms of the officer's DQE Severance Agreement; or (iv) prior to the closing of the transaction giving rise to the Change in Control, a material decrease in the employee's positions, titles, authority or duties.

If the employment of all officers with DQE Severance Agreements had been terminated as of the date of this Joint Proxy Statement/Prospectus, the aggregate cost to DQE under the DQE Severance Agreements would not exceed \$20,000,000.

DQE, Inc. Long-Term Incentive Plan

The DQE, Inc. Long-Term Incentive Plan (the "Incentive Plan") provides long-term incentive compensation in the form of stock options (with or without stock appreciation rights and dividend equivalents). Several officers of DQE have been awarded options pursuant to the Incentive Plan, some of which are not currently exercisable and/or subject to forfeiture. Under the terms of the Incentive Plan, upon the occurrence of certain events, including the adoption of the Merger Agreement by the holders of DQE Common Stock, all stock options and stock appreciation rights become immediately exercisable. In addition, an option holder whose employment is terminated within one year of such stockholder approval, for any reason

other than disability, retirement or death, has a period of three months following such termination to exercise such option (but in no event later than the original expiration date of such option).

If all such stock options and stock appreciation rights become immediately exercisable after the DQE Meeting, the aggregate benefit to the holders of all such stock options and stock appreciation rights based on current values would not exceed \$500,000.

Director and Officer Indemnification and Insurance

Pursuant to the Merger Agreement, APS has agreed that, from and after the Effective Time, it will indemnify and hold harmless each present and former director and officer of DQE or any of its Subsidiaries (when acting in such capacity), against any costs or expenses (including reasonable attorneys' fees), judgments, fines, losses, claims, damages or liabilities incurred in connection with any claim, action, suit, proceeding or investigation, whether civil, criminal, administrative or investigative, arising out of matters existing or occurring at or prior to the Effective Time, whether asserted or claimed prior to, at or after the Effective Time, to the fullest extent that DQE or such Subsidiary is permitted to indemnify such person under the law of its jurisdiction of incorporation and the DQE Articles and DQE Bylaws in effect on the date of the Merger Agreement. In addition, the Merger Agreement provides that the Surviving Corporation will maintain DQE's existing D&O Insurance for a period of six years after the Effective Time so long as the annual premium therefor is not in excess of 200% of the Current Premium; *provided, however*, that if the existing D&O Insurance expires or is terminated or canceled during such six-year period, the Surviving Corporation will use its reasonable efforts to obtain as much D&O Insurance as can be obtained for the remainder of such period for a premium not in excess (on an annualized basis) of 200% of the Current Premium.

ACCOUNTING TREATMENT

Consummation of the Merger is conditioned upon the receipt by each of APS and DQE of a letter from APS' independent public accountant stating that the Merger, in its opinion, will qualify as a "pooling of interests" for accounting purposes, it being understood that APS' independent accounting firm may rely on a letter from DQE's independent accounting firm with respect to the eligibility of DQE and its subsidiaries for such accounting treatment. See "The Merger Agreement — Conditions" and "Unaudited Pro Forma Combined Financial Information of APS and DQE."

APS and DQE believe that the Merger will qualify as a "pooling of interests" for accounting and financial reporting purposes, and have been so advised by Price Waterhouse LLP and Deloitte & Touche, their respective independent public accountants, based on information through the date hereof. Under this method of accounting, APS will restate at the Effective Time its consolidated financial statements to include the assets, liabilities, stockholders' equity and results of operations of DQE. It is anticipated that upon consummation of the Merger, the fiscal year of the combined company will be the calendar year.

RESALE OF APS COMMON STOCK

The shares of APS Common Stock issuable to stockholders of DQE in connection with the Merger have been registered under the Securities Act. Such shares may be traded freely and without restriction by those stockholders not deemed to be "affiliates" of APS or DQE as that term is defined in the rules under the Securities Act. "Affiliates" are generally defined as persons who control, are controlled by or are under common control with DQE at the time of the DQE Meeting. Shares of APS Common Stock received by those stockholders of DQE who are deemed to be "affiliates" of DQE may be resold without registration as provided for by Rule 144 or 145, or as otherwise permitted, under the Securities Act. This Joint Proxy Statement/Prospectus does not cover any resales of APS Common Stock received by affiliates of DQE, or by certain of their family members or related interests.

Pursuant to the Merger Agreement, each of DQE and APS have agreed to deliver to the other a letter identifying all persons whom such party believes to be, as of the date of their respective Stockholders Meetings, "affiliates" of such party for purposes of Rule 145 under the Securities Act. Each of DQE and APS

has agreed to use its best efforts to cause each person who is identified as an "affiliate" in the letter referred to above to deliver to APS prior to the date of their respective Stockholders Meetings an Affiliates Letter providing that each such person will agree not to sell, pledge, transfer or otherwise dispose of the shares of APS Common Stock to be received by such person in the Merger except in compliance with the applicable provisions of the Securities Act and, if the Merger qualifies for "pooling of interests" accounting treatment, until such time as financial results covering at least 30 days of combined operations of APS and DQE shall have been published.

DIVIDENDS

It is presently anticipated that, following the Effective Time, the current \$1.72 annual dividend per share of APS Common Stock will be maintained or increased, subject to evaluation from time to time by the APS Board based on APS' results of operations, financial condition, capital requirements, future business prospects, regulatory environment and such other considerations as the APS Board deems relevant. However, no assurance can be given that such dividend will be maintained or increased.

DQE's current annual dividend is equal to \$1.36 per share of DQE Common Stock. It has been DQE's practice to limit its dividend payout such that dividends do not exceed 60% of earnings. Pursuant to the Merger Agreement, DQE has agreed to coordinate with APS the declaration, setting of record dates and payment dates of dividends on DQE Common Stock so that holders of DQE Common Stock do not receive dividends on both DQE Common Stock and APS Common Stock received in the Merger in respect of any calendar quarter, or fail to receive a dividend on either DQE Common Stock or APS Common Stock received in the Merger in respect of any calendar quarter.

CERTAIN FEDERAL INCOME TAX CONSEQUENCES OF THE MERGER

The following summary discusses the material federal income tax consequences of the Merger. The summary is based upon the Code, applicable Treasury Regulations thereunder and administrative rulings and judicial authority as of the date hereof. All of the foregoing are subject to change, possibly with retroactive effect, and any such change could affect the continuing validity of the discussion. The discussion assumes that holders of shares of DQE Common Stock hold such shares as a capital asset. Further, the discussion does not address the tax consequences that may be relevant to a particular stockholder subject to special treatment under certain federal income tax laws, such as dealers in securities, banks, insurance companies, tax-exempt organizations, non-United States persons, stockholders who acquired shares of DQE Common Stock through the exercise of options or otherwise as compensation or through a tax-qualified retirement plan, and holders of options and performance share units granted under DQE's benefit plans. This discussion does not address any consequences arising under the laws of any state, locality or foreign jurisdiction, nor does it address the effect of the Merger on DQE or APS in respect of any asset as to which unrealized gain is required to be recognized for U.S. federal income tax purposes at the end of each taxable year under a mark-to-market system.

Neither DQE nor APS has requested a ruling from the Internal Revenue Service ("IRS") with regard to any of the federal income tax consequences of the Merger, and the opinions of counsel as to such federal income tax consequences referred to below will not be binding on the IRS.

General

As of the date hereof, it is intended that the Merger will constitute a "reorganization" pursuant to Section 368(a) of the Code and that for federal income tax purposes no gain or loss will be recognized by APS, DQE or Merger Sub. The respective obligations of the parties to consummate the Merger are conditioned on (i) the receipt by APS of an opinion of Sullivan & Cromwell dated the Closing Date confirming that the Merger will qualify as a reorganization within the meaning of Section 368(a) of the Code and that each of APS, DQE and Merger Sub will be a party to the reorganization within the meaning of Section 368(b) of the Code, and (ii) the receipt by DQE of an opinion of LeBoeuf, Lamb, Greene & MacRae, L.L.P. dated the Closing Date confirming that the Merger will qualify as a reorganization within the meaning of Section 368(a) of the Code

and that each of APS, DQE and Merger Sub will be a party to the reorganization within the meaning of Section 368(b) of the Code. These conditions may be waived at the sole discretion of the party waiving the condition. Such opinions will be based upon, among other things, (i) representations of DQE, APS and certain stockholders of DQE customarily given in transactions of this type and (ii) the assumption that the Merger will be consummated in accordance with the terms of the Merger Agreement. DQE and APS expect to receive such opinions prior to closing, but have not yet received such opinions. If either party waives the condition relating to the receipt of an opinion with respect to the federal income tax consequences of the Merger it will re-circulate a revised version of this Joint Proxy Statement/Prospectus to disclose the waiver of this condition, to disclose material risks to its stockholders as a result of the waiver of this condition, if any, and to disclose any related material disclosures. In addition, each party would re-solicit the approval of its respective stockholders in the event that it waived the condition relating to the receipt of an opinion with respect to the federal income tax consequences of the Merger and the tax consequences of the Merger are, at such time, materially different from the tax consequences of the Merger described below.

The discussion below summarizes the respective opinions of Sullivan & Cromwell and LeBoeuf, Lamb, Greene & MacRae, L.L.P. with respect to the material federal income tax consequences of the Merger, and is subject to the significant assumptions contained in such opinions. Such assumptions are set forth in the respective opinions of Sullivan & Cromwell and LeBoeuf, Lamb, Greene & MacRae, L.L.P. which are set forth respectively as Exhibits 8-a and 8-b to the Registration Statement of which this Joint Proxy Statement/Prospectus forms a part. Stockholders are urged to read such opinions in their entirety.

Consequences to DQE Stockholders

Under the reorganization provisions of the Code, no gain or loss will be recognized by holders of DQE Common Stock with respect thereto as a result of the surrender of their shares of DQE Common Stock in exchange for shares of APS Common Stock pursuant to the Merger (except as discussed below with respect to cash received in lieu of fractional shares). The aggregate tax basis of the shares of APS Common Stock received in the Merger (including any fractional shares of APS Common Stock deemed received) will be the same as the aggregate tax basis of the shares of DQE Common Stock surrendered in exchange therefor in the Merger. The holding period of the shares of APS Common Stock received (including the holding period of fractional shares of APS Common Stock deemed received) will include the holding period of shares of DQE Common Stock surrendered in exchange therefor.

Fractional Shares

If a holder of shares of DQE Common Stock receives cash in lieu of a fractional share interest in APS Common Stock in the Merger, such fractional share interest will be treated as having been distributed to the holder, and such cash amount will be treated as received in redemption of the fractional share interest. Under Section 302 of the Code, if such redemption is "not essentially equivalent to a dividend" after giving effect to the constructive ownership rules of the Code, the holder will generally recognize capital gain or loss equal to the cash amount received for the fractional share of APS Common Stock reduced by the portion of the holder's tax basis in shares of DQE Common Stock surrendered that is allocable to the fractional share interest in APS Common Stock. Under these rules, a minority stockholder of DQE should recognize capital gain or loss on the receipt of cash in lieu of a fractional share interest in APS Common Stock. The capital gain or loss will be long term capital gain or loss if the holder's holding period in the fractional share interest is more than one year.

Consequences to DQE, APS, Merger Sub and Holders of APS Common Stock

None of DQE, APS or Merger Sub or the holders of APS Common Stock will recognize gain or loss as a result of the Merger.

THE PRECEDING DISCUSSION DOES NOT PURPORT TO BE A COMPLETE ANALYSIS OR DISCUSSION OF ALL POTENTIAL TAX EFFECTS RELEVANT TO THE MERGER. THUS, DQE STOCKHOLDERS ARE URGED TO CONSULT THEIR OWN TAX ADVISORS AS TO THE

SPECIFIC TAX CONSEQUENCES TO THEM OF THE MERGER, INCLUDING TAX RETURN REPORTING REQUIREMENTS, THE APPLICABILITY AND EFFECT OF FEDERAL, STATE, LOCAL, AND OTHER APPLICABLE TAX LAWS AND THE EFFECT OF ANY PROPOSED CHANGES IN THE TAX LAWS.

CERTAIN RELATED AGREEMENTS

Stock Option Agreement

In connection with the Merger Agreement and the Merger, APS and DQE entered into the Stock Option Agreement, pursuant to which DQE granted to APS the Option entitling APS to purchase up to 15,379,007 shares of DQE Common Stock (the "Option Shares") under the circumstances described below at an initial cash price per share of DQE Common Stock equal to \$27.850 (such price as adjusted as provided in the Stock Option Agreement, the "Option Price"). The Stock Option Agreement provides that in no event will the number of shares of DQE Common Stock for which the Option is exercisable exceed 19.9% of DQE Common Stock issued and outstanding at the time of exercise.

APS may exercise its Option, in whole or in part, if, but only if, a Triggering Event (as defined below) will have occurred prior to the occurrence of an Exercise Termination Event (as defined below); provided that APS sends DQE a written notice of such exercise within 180 days following the first such Triggering Event.

As defined in the Stock Option Agreement, a "Triggering Event" means the occurrence of any event which could cause the Merger Agreement to be terminable: (x) by DQE subject to and in accordance with the termination provisions of the Merger Agreement relating to Acquisition Proposals (See "The Merger Agreement — Conduct of Business Pending the Merger; Certain Covenants; Acquisition Proposals — Acquisition Proposals"); (y) by APS if the DQE Board has withdrawn or adversely modified its approval or recommendation of the Merger Agreement or failed to reconfirm its recommendation of the Merger Agreement after a written request by APS to do so or if DQE or any of its affiliates, representatives or agents takes any of the actions that would be proscribed by certain provisions of the Merger Agreement which restrict DQE's conduct with respect to Acquisition Proposals (See "The Merger Agreement — Conduct of Business Pending the Merger; Certain Covenants; Acquisition Proposals — Acquisition Proposals"); or (z) by APS or DQE if the necessary vote of DQE's stockholders to effectuate the Merger has not been obtained at the DQE Meeting, including any adjournments thereof.

As defined in the Stock Option Agreement, an "Exercise Termination Event" means (i) the Effective Time; (ii) the termination of the Merger Agreement in accordance with the provisions thereof if such termination precedes the occurrence of a Triggering Event; or (iii) the first anniversary of the date of termination of the Merger Agreement if such termination follows, or occurs at the same time as, the occurrence of a Triggering Event, or, if on such anniversary date the Option cannot be exercised by reason of any applicable judgment, decree, order, law or regulation, 30 business days after such impediment to exercise is removed or becomes final and not subject to appeal, but in no event under clause (iii) later than April 5, 1999.

The Stock Option Agreement provides that in the event that any additional shares of DQE Common Stock are issued or otherwise become outstanding after the date of the Stock Option Agreement, the aggregate number of shares of DQE Common Stock purchasable upon exercise of the Option (inclusive of shares, if any, previously purchased upon exercise of the Option) will automatically be increased so that, after such issuance, it equals 19.9%. Any such increase shall not affect the Option Price. Further, in the event of any change in the outstanding shares of DQE Common Stock by reason of stock dividends, split-ups, mergers, recapitalizations, combinations, subdivisions, conversions, exchanges of shares or the like, the type and number of shares of DQE Common Stock purchasable pursuant to the Option will be appropriately adjusted. Whenever the number of shares of DQE Common Stock purchasable upon exercise of the Option is adjusted as described in the preceding sentence, the Option Price will be adjusted by multiplying the Option Price by a fraction, the numerator of which is equal to the number of shares of DQE Common Stock purchasable prior to

the adjustment and the denominator of which is equal to the number of shares of DQE Common Stock purchasable after the adjustment.

The Stock Option Agreement also provides that APS may require that DQE repurchase the Option from APS. The Stock Option Agreement provides that upon the occurrence of a Triggering Event that occurs prior to an Exercise Termination Event, (i) at the request of APS, delivered in writing within 180 days of such occurrence (or such later period as provided in the Stock Option Agreement under certain circumstances in connection with the obtaining of regulatory approvals or avoidance of liability under Section 16(b) of the Exchange Act) DQE will repurchase the Option from APS, as a whole or in part, at a price (the "Option Repurchase Price") equal to the number of shares of DQE Common Stock then purchasable upon exercise of the Option multiplied by the amount by which the market/offer price (as defined below) exceeds the Option Price and (ii) at the request of APS, delivered in writing within 180 days of such occurrence (or such later period as provided in the Stock Option Agreement under certain circumstances in connection with the obtaining of regulatory approvals or avoidance of liability under Section 16(b) of the Exchange Act), DQE will repurchase such number of Option Shares from APS as APS shall designate at a price (the "Option Share Repurchase Price") equal to the number of shares designated multiplied by the market/offer price. The term "market/offer price" is defined in the Stock Option Agreement to mean the highest of (x) the price per share of DQE Common Stock at which a tender or exchange offer for DQE Common Stock has been made, (y) the price per share of DQE Common Stock to be paid by any third party pursuant to an agreement with DQE and (z) the average closing price for shares of DQE Common Stock on the 10 consecutive trading days on the NYSE immediately preceding the delivery of the written notice stating that APS elects to require DQE to repurchase the Option and/or any Option Shares in accordance with the Stock Option Agreement (each such notice, a "Repurchase Notice"). In the event that a tender or exchange offer is made for DQE Common Stock or an agreement is entered into for a merger or consolidation involving consideration other than cash, the value of the securities or other property issuable or deliverable in exchange for DQE Common Stock will be determined by a nationally recognized investment banking firm selected by DQE.

In the event that APS requests the repurchase of the Option in part, DQE will deliver with the Option Repurchase Price a new Stock Option Agreement evidencing APS' right to purchase that number of shares of DQE Common Stock purchasable pursuant to the Option at the time of delivery of the Repurchase Notice minus the number of shares of DQE Common Stock represented by that portion of the Option then being repurchased.

The Stock Option Agreement provides that the Total Profit of APS will not exceed \$20,000,000 and, if it otherwise would exceed such amount, APS, at its sole election, will either (a) reduce the number of shares of DQE Common Stock subject to the Option, (b) deliver to DQE for cancellation Option Shares previously purchased by APS, (c) pay cash to DQE, or (d) any combination thereof, so that APS' actually realized Total Profit does not exceed \$20,000,000 after taking into account the foregoing actions.

As defined in the Stock Option Agreement, the term "Total Profit" means the aggregate amount (before taxes) of the following: (i) (x) the amount received by APS pursuant to DQE's repurchase of the Option (or any portion thereof) or any Option Shares pursuant to the Stock Option Agreement, less, in the case of any repurchase of Option Shares, (y) APS' purchase price for such Option Shares, as the case may be, (ii) (x) the net cash amounts received by APS pursuant to the sale of Option Shares (or any other securities into which such Option Shares are converted or exchanged) to any unaffiliated party, less (y) APS' purchase price of such Option Shares, and (iii) any Notional Total Profit (as defined below).

The term "Notional Total Profit" with respect to any number of shares as to which APS may propose to exercise the Option shall be the Total Profit determined as of the date of such proposal assuming that the Option was exercised on such date for such number of shares and assuming that such shares, together with all other Option Shares held by APS and its affiliates as of such date, were sold for cash at the closing market price for the Common Stock as of the close of business on the preceding trading day (less customary brokerage commissions).

Letter Agreement

APS and DQE have also entered into the Letter Agreement in connection with the Merger Agreement. The Letter Agreement provides that in the event that the Merger Agreement is terminated (x) by APS pursuant to provisions of the Merger Agreement permitting APS to terminate the Merger Agreement under certain circumstances when a Superior Proposal exists, or (y) by DQE following (i) the APS Board having withdrawn or adversely modified its approval or recommendation of the Merger Agreement or failing to reconfirm its recommendation of the Merger Agreement after a written request by DQE to do so, or (ii) APS or any of its affiliates or representatives or agents having taken any of the actions that would be proscribed by certain provisions of the Merger Agreement which restrict APS' conduct with respect to Acquisition Proposals, or (z) by DQE or APS pursuant to the provisions of the Merger Agreement permitting them to terminate the Merger Agreement if the necessary vote of the stockholders of APS to effectuate the Merger has not been obtained at the APS Special Meeting, then APS will pay to DQE the amount, if any, by which (1) 0.199 multiplied by the number of shares of APS Common Stock outstanding at the close of business on the business day immediately prior to such termination (such date, the "Determination Date") multiplied by the average daily closing price of APS Common Stock on the NYSE on the ten NYSE trading days ending on the Determination Date, as reported in the New York City edition of *The Wall Street Journal*, exceeds (2) \$719,870,422; *provided* that the amount payable pursuant to the Letter Agreement will not exceed \$20,000,000.

**UNAUDITED PRO FORMA COMBINED FINANCIAL INFORMATION
OF APS AND DQE**

The following unaudited pro forma financial information combines the historical consolidated balance sheets and statements of income of APS and DQE, including their respective subsidiaries, after giving effect to the Merger. The unaudited pro forma combined balance sheet at March 31, 1997, set forth below, gives effect to the Merger as if it had occurred at March 31, 1997. The unaudited pro forma combined statements of income for the three months ended March 31, 1997, and each of the 3 years ended December 31, 1996, 1995 and 1994 give effect to the Merger as if it had occurred at January 1, 1996, 1995 and 1994, respectively, and the unaudited pro forma combined statement of income for the three months ended March 31, 1997, gives effect to the Merger as if it had occurred on January 1, 1997. These statements are prepared on the basis of accounting for the Merger as a "pooling of interests" and are based on the assumptions set forth in the notes thereto.

The following pro forma financial information has been prepared from, and should be read in conjunction with, the historical consolidated financial statements and related notes thereto of APS and DQE, incorporated by reference herein. The following information is not necessarily indicative of the financial position or operating results that would have occurred had the Merger been consummated on the dates, or at the beginning of the periods for which the Merger is being given effect, nor is it necessarily indicative of future financial position or operating results. See "Available Information" and "Incorporation of Certain Information by Reference."

APS and DQE

UNAUDITED PRO FORMA COMBINED BALANCE SHEET (e),(f)
At March 31, 1997
(in thousands of \$)

	APS Reclassified Balance(d)	DQE Reclassified Balance(d)	Pro Forma Adjustments	Total Adjusted Balance
ASSETS				
Current Assets:				
Cash and temporary cash investments	\$ 24,804	\$ 386,857	\$ —	\$ 411,661
Receivables:				
Electric customer accounts receivable, net	290,237	77,786	38,426(a)	406,449
Other receivables	14,692	50,999	—	65,691
Total Receivables — Net	304,929	128,785	38,426	472,140
Materials and supplies (at average cost):				
Coal/Fuel	73,289	19,114	—	92,403
Operating and construction	83,744	51,778	—	135,522
Total Materials and Supplies	157,033	70,892	—	227,925
Prepaid taxes	68,119	468	—	68,587
Deferred income taxes	52,129	—	—	52,129
Other current assets	14,840	6,630	—	21,470
Total Current Assets	\$ 621,854	\$ 593,632	\$38,426	\$ 1,253,912
Long-Term Investments:				
Benefit plans' investments	\$ 65,670	\$ 1,332	—	\$ 67,002
Affordable housing	—	155,662	—	155,662
Leveraged leases	—	193,654	—	193,654
Other leases	—	87,119	—	87,119
Gas reserves	—	77,855	—	77,855
Other investments	19,525	61,209	—	80,734
Total Long-Term Investments	\$ 85,195	\$ 576,831	—	\$ 662,026
Property, Plant and Equipment:				
At original cost property, plant and equipment	\$ 8,243,825	\$ 4,799,655	—	\$13,043,480
Less: Accumulated depreciation and amortization	(2,976,531)	(2,018,710)	—	(4,995,241)
Total Property, Plant and Equipment — Net	\$ 5,267,294	\$ 2,780,945	—	\$ 8,048,239
Other Non-Current Assets:				
Regulatory assets	\$ 551,674	\$ 541,359	\$(9,228) (b)	\$ 1,083,805
Unamortized loss on reacquired debt	52,440	83,867	—	136,307
Other	39,128	45,948	—	85,076
Total Other Non-Current Assets	\$ 643,242	\$ 671,174	\$(9,228)	\$ 1,305,188
Total Assets	<u>\$ 6,617,585</u>	<u>\$ 4,622,582</u>	<u>\$29,198</u>	<u>\$11,269,365</u>

See Notes to Unaudited Pro Forma Combined Financial Information

APS AND DQE
UNAUDITED PRO FORMA COMBINED BALANCE SHEET (e), (f)
At March 31, 1997
(in thousands of \$)

	<u>APS Reclassified Balance (d)</u>	<u>DQE Reclassified Balance (d)</u>	<u>Pro Forma Adjustments</u>	<u>Total Adjusted Balance</u>
LIABILITIES AND CAPITALIZATION				
Current Liabilities:				
Current maturities and sinking fund requirements	\$ 95,400	\$ 107,146	—	\$ 202,546
Short-term debt	133,746	930	—	134,676
Accounts payable	123,745	73,919	—	197,664
Accrued liabilities	—	27,689	13,213 (b)	40,902
Dividends declared	—	28,709	—	28,709
Taxes accrued:				
Federal and state income tax	46,182	(7,102)	—	39,080
Other	41,909	694	—	42,603
Interest accrued	43,441	26,550	—	69,991
Deferred power costs	23,937	1,903	—	25,840
Restructuring liability	39,296	—	—	39,296
Other	69,674	949	—	70,623
Total Current Liabilities	\$ 617,330	\$ 261,387	\$ 13,213	\$ 891,930
Non-Current Liabilities:				
Deferred income taxes — net	\$1,013,995	\$ 768,258	\$ (9,313) (b) 15,947 (c)	\$ 1,788,887
Deferred investment tax credits	139,468	104,096	—	243,564
Capital lease obligations	3,781	24,150	—	27,931
Regulatory liabilities	92,093	—	—	92,093
Deferred income	—	180,835	—	180,835
Other	71,395	248,687	—	320,082
Total Non-Current Liabilities	\$1,320,732	\$1,326,026	\$ 6,634	\$ 2,653,392
Commitments and Contingencies	—	—	—	—
Capitalization:				
Long-term Debt and QUIDS	\$2,307,107	\$1,402,286	—	\$ 3,709,393
Preferred and Preference Stock of Subsidiaries:				
Preferred and Preference Stock	170,086	242,605	—	412,691
Deferred ESOP benefit	—	(18,931)	—	(18,931)
Total Preferred and Preference Stock of Subsidiaries	170,086	223,674	—	393,760
Common Stockholders' Equity:				
Common stock	\$ 152,639	\$ —	\$ —	\$ 152,639
Other paid-in capital	1,035,825	987,413	—	2,023,238
Retained earnings	1,013,866	796,429	(13,128) (b) 22,479 (c)	1,819,646
Treasury stock (at cost)	—	(374,633)	—	(374,633)
Total Common Stockholders' Equity	\$2,202,330	\$1,409,209	\$ 9,351	\$ 3,620,890
Total Capitalization	\$4,679,523	\$3,035,169	\$ 9,351	\$ 7,724,043
Total Liabilities and Capitalization	\$6,617,585	\$4,622,582	\$ 29,198	\$11,269,365

See Notes to Unaudited Pro Forma Combined Financial Information

APS and DQE

UNAUDITED PRO FORMA COMBINED INCOME STATEMENT(e),(f)
For the three months ended March 31, 1997
(in thousands of \$)

	APS Reclassified Balance(d)	DQE Reclassified Balance(d)	Pro Forma Adjustments	Adjusted Total
Operating Revenues				
Sales of Electricity:				
Residential	\$ 257,913	\$ 104,322	\$(7,092)	\$ 355,143
Commercial	123,886	114,523	—	238,409
Industrial	182,270	47,597	—	229,867
Wholesale and other	19,940	202	—	20,142
Bulk power transactions, net	18,683	8,731	—	27,414
Total Sales of Electricity	602,692	275,375	(7,092)	870,975
Other	12,288	25,556	—	37,844
Total Operating Revenues	614,980	300,931	(7,092)	908,819
Operating Expenses				
Fuel and purchased power	\$ 191,048	\$ 51,654	\$ —	\$ 242,702
Other operating	72,825	80,603	—	153,428
Maintenance	61,480	17,749	(686) (b)	78,543
Deferred power costs, net	(2,083)	(124)	—	(2,207)
Depreciation and amortization	68,782	55,174	—	123,956
Taxes other than income	48,656	20,558	—	69,214
Total Operating Expenses	440,708	225,614	(686)	665,636
Operating Income	\$ 174,272	\$ 75,317	\$(6,406)	\$ 243,183
Other income, net	1,802	20,001	—	21,803
Interest and other charges	48,549	28,680	—	77,229
Income before income taxes	127,525	66,638	(6,406)	187,757
Income taxes	49,934	21,541	(2,943) (a) 285 (b)	68,817
Net Income	<u>\$ 77,591</u>	<u>\$ 45,097</u>	<u>\$(3,748)</u>	<u>\$ 118,940</u>
Average Number of Shares of Common Stock				
Outstanding (Thousands of Shares)	121,843	77,287	9,274	208,404
Earnings				
Earnings per share of common stock	\$ 0.64	\$ 0.58		\$ 0.57
Dividends				
Dividends declared per share of common stock	\$ 0.43	\$ 0.34		\$ 0.38 (h)

See Notes to Unaudited Pro Forma Combined Financial Information

APS and DQE
UNAUDITED PRO FORMA COMBINED INCOME STATEMENT (e), (f)
For the year ended December 31, 1996
(in thousands of \$)

	<u>APS Reclassified Balance (d)</u>	<u>DQE Reclassified Balance (d)</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Total</u>
Operating Revenues				
Sales of Electricity:				
Residential	\$ 932,235	\$ 404,183	\$ 3,905 (a)	\$1,340,323
Commercial	492,726	486,666	—	979,392
Industrial	752,905	189,527	—	942,432
Wholesale and other	74,260	857	—	75,117
Bulk power transactions, net	<u>74,790</u>	<u>58,046</u>	—	<u>132,836</u>
Total Sales of Electricity	2,326,916	1,139,279	3,905	3,470,100
Other	<u>2,068</u>	<u>73,994</u>	—	<u>76,062</u>
Total Operating Revenues	\$2,328,984	\$1,213,273	\$ 3,905	\$3,546,162
Operating Expenses				
Fuel and purchased power	\$ 698,902	\$ 236,678	—	\$ 935,580
Other operating	299,817	291,829	—	591,646
Maintenance	243,314	78,386	\$(4,566) (b)	318,657
			1,523 (c)	
Deferred power costs, net	15,621	(4,528)	—	11,093
Restructuring charges and asset write-off	103,865	—	—	103,865
Depreciation and amortization	263,246	222,928	—	486,174
Taxes other than income	<u>185,373</u>	<u>85,974</u>	—	<u>271,347</u>
Total Operating Expenses	\$1,810,138	\$ 911,267	\$(3,043)	\$2,718,362
Operating Income	\$ 518,846	\$ 302,006	\$ 6,948	\$ 827,800
Other income, net	9,882	74,790	—	84,672
Interest and other charges	<u>188,334</u>	<u>110,270</u>	—	<u>298,604</u>
Income before income taxes	340,394	266,526	6,948	613,868
Income taxes	130,347	87,388	1,621 (a)	220,645
			1,895 (b)	
			(606) (c)	
Net Income	<u>\$ 210,047</u>	<u>\$ 179,138</u>	<u>\$ 4,038</u>	<u>\$ 393,223</u>
Average Number of Shares of Common Stock				
Outstanding (Thousands of Shares)	121,141	77,349	9,282	207,772
Earnings				
Earnings per share of common stock	\$ 1.73	\$ 2.32		\$ 1.89
Dividends				
Dividends declared per share of common stock	\$ 1.69	\$ 1.30		\$ 1.47 (h)

See Notes to Unaudited Pro Forma Combined Financial Information

APS and DQE

UNAUDITED PRO FORMA COMBINED INCOME STATEMENT(e),(f)
For the year ended December 31, 1995
(in thousands of \$)

	APS Reclassified Balance(d)	DQE Reclassified Balance(d)	Pro Forma Adjustments	Adjusted Total
Operating Revenues				
Sales of Electricity:				
Residential	\$ 926,966	\$ 415,946	\$ 419 (a)	\$1,343,331
Commercial	493,696	493,780	—	987,476
Industrial	770,251	192,274	—	962,525
Wholesale and other	66,147	855	—	67,002
Bulk power transactions, net	58,151	51,117	—	109,268
Total Sales of Electricity	2,315,211	1,153,972	419	3,469,602
Other	—	65,157	—	65,157
Total Operating Revenues	\$2,315,211	\$1,219,129	\$ 419	\$3,534,759
Operating Expenses				
Fuel and purchased power	\$ 686,636	227,122	—	913,758
Other operating	290,501	290,724	—	581,225
Maintenance	249,477	81,516	(6,595) (b) 9,205 (c)	333,603
Deferred power costs, net	47,796	6,086	—	53,882
Restructuring charges and asset write-off	23,440	—	—	23,440
Depreciation and amortization	256,316	202,558	—	458,874
Taxes other than income	184,729	88,658	—	273,387
Total Operating Expenses	\$1,738,895	\$ 896,664	\$ 2,610	\$2,638,169
Operating Income	576,316	322,465	(2,191)	896,590
Other income, net	13,370	52,314	—	65,684
Interest and other charges	193,118	107,555	—	300,673
Income before income taxes	396,568	267,224	(2,191)	661,601
Income taxes	156,876	96,661	174 (a) 2,737 (b) (3,664) (c)	252,784
Net Income	\$ 239,692	\$ 170,563	\$(1,438)	\$ 408,817
Average Number of Shares of Common Stock				
Outstanding (Thousands of Shares)	119,854	77,674	9,321	206,859
Earnings				
Earnings per share of common stock	\$ 2.00	\$ 2.20		\$ 1.98
Dividends				
Dividends declared per share of common stock ...	\$ 1.65	\$ 1.21		\$ 1.41(h)

See Notes to Unaudited Pro Forma Combined Financial Information

APS and DQE
UNAUDITED PRO FORMA COMBINED INCOME STATEMENT(e),(f)
For the year ended December 31, 1994
(in thousands of \$)

	<u>APS Reclassified Balance(d)</u>	<u>DQE Reclassified Balance(d)</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Total</u>
Operating Revenues				
Sales of Electricity:				
Residential	\$ 863,725	\$ 397,976	\$ 842 (a)	\$1,262,543
Commercial	459,303	484,198	—	943,501
Industrial	728,009	193,098	—	921,107
Wholesale and other	65,795	845	—	66,640
Bulk power transactions, net	67,797	57,732	—	125,529
Total Sales of Electricity	<u>2,184,629</u>	<u>1,133,849</u>	842	<u>3,319,320</u>
Other	—	78,695	—	78,695
Total Operating Revenues	<u>\$2,184,629</u>	<u>\$1,212,544</u>	<u>\$ 842</u>	<u>\$3,398,015</u>
Operating Expenses				
Fuel and purchased power	\$ 721,066	\$ 243,572	—	\$ 964,638
Other operating	285,007	329,664	—	614,671
Maintenance	241,913	79,488	985 (b)	311,308
			(11,078)(c)	
Deferred power costs, net	11,805	(11,290)	—	515
Restructuring charges and asset write-off	9,178	—	—	9,178
Depreciation and amortization	223,883	165,912	—	389,795
Taxes other than income	183,060	88,331	—	271,391
Total Operating Expenses	<u>\$1,675,912</u>	<u>\$ 895,677</u>	<u>\$(10,093)</u>	<u>\$2,561,496</u>
Operating Income	<u>\$ 508,717</u>	<u>\$ 316,867</u>	<u>\$ 10,935</u>	<u>\$ 836,519</u>
Other income, net	43,142	42,924	—	86,066
Interest and other charges	176,528	110,002	—	286,530
Income before income taxes and cumulative effect of accounting change	375,331	249,789	10,935	636,055
Income taxes	155,580	92,973	349 (a)	252,902
			(409)(b)	
			4,409 (c)	
Income before cumulative effect of accounting change	219,751	156,816	6,586	383,153
Cumulative effect of accounting change, net	43,446	—	(43,446)(g)	—
Net Income	<u>\$ 263,197</u>	<u>\$ 156,816</u>	<u>\$(36,860)</u>	<u>\$ 383,153</u>
Average Number of shares of common stock outstanding (Thousands of Shares)	118,272	79,046	9,486	206,804
Earnings				
Earnings per share of common stock before cumulative effect of accounting change ..	\$1.86	\$1.98		\$1.85
Cumulative effect of accounting change	\$0.37	—		—
Earnings per share of common stock after cumulative effect of accounting change ..	\$2.23	\$1.98		\$1.85
Dividends				
Dividends declared per share of common stock	\$1.64	\$1.13		\$1.37(h)

See Notes to Unaudited Pro Forma Combined Financial Information

APS
RECLASSIFYING BALANCE SHEET (d)
At March 31, 1997
(in thousands of \$)

	APS <i>historical</i>	Reclassifications	Reclassified Balance
ASSETS			
Current Assets:			
Cash and temporary cash investments	\$ 24,804	\$ —	\$ 24,804
Receivables:			
Electric customer accounts receivable, net	290,237	—	290,237
Other receivables	14,692	—	14,692
Total Receivables — Net	304,929	—	304,929
Materials and supplies (at average cost):			
Coal/Fuel	73,289	—	73,289
Operating and construction	83,744	—	83,744
Total Materials and Supplies	157,033	—	157,033
Prepaid taxes	68,119	—	68,119
Deferred income taxes	52,129	—	52,129
Other current assets	14,840	—	14,840
Total Current Assets	\$ 621,854	—	\$ 621,854
Long-Term Investments:			
Subsidiaries consolidated — excess of cost over book equity at acquisition	\$ 15,077	\$(15,077)	\$ —
Benefit plans' investments	65,670	—	65,670
Other	4,448	15,077	19,525
Total Long-Term Investments	\$ 85,195	—	\$ 85,195
Property, Plant and Equipment:			
At original cost property, plant and equipment	\$ 8,243,825	—	\$ 8,243,825
Less: Accumulated depreciation and amortization	(2,976,531)	—	(2,976,531)
Total Property, Plant and Equipment — Net	\$ 5,267,294	—	\$ 5,267,294
Other Non-Current Assets:			
Regulatory assets	\$ 551,674	—	\$ 551,674
Unamortized loss on reacquired debt	52,440	—	52,440
Other	39,128	—	39,128
Total Other Non-Current Assets	\$ 643,242	—	\$ 643,242
Total Assets	\$ 6,617,585	—	\$ 6,617,585

APS
RECLASSIFYING BALANCE SHEET (d)
At March 31, 1997
(in thousands of \$)

	APS (historical)	Reclassifications	Reclassified Balance
LIABILITIES AND CAPITALIZATION			
Current Liabilities:			
Current maturities and sinking fund requirements	\$ —	\$ 95,400	\$ 95,400
Short-term debt	133,746	—	133,746
Long-term debt due within one year	95,400	(95,400)	—
Accounts payable	123,745	—	123,745
Taxes accrued:			
Federal and state income tax	46,182	—	46,182
Other	41,909	—	41,909
Interest accrued	43,441	—	43,441
Deferred power costs	23,937	—	23,937
Restructuring liability	39,296	—	39,296
Other	69,674	—	69,674
Total Current Liabilities	\$ 617,330	\$ —	\$ 617,330
Non-Current Liabilities:			
Deferred income taxes — net	\$1,013,995	\$ —	\$1,013,995
Deferred investment tax credit	—	139,468	139,468
Capital lease obligations	—	3,781	3,781
Unamortized investment credit	139,468	(139,468)	—
Regulatory liabilities	92,093	—	92,093
Other	75,176	(3,781)	71,395
Total Non-Current Liabilities	\$1,320,732	\$ —	\$1,320,732
Commitments and Contingencies	—	—	—
Capitalization:			
Long-term Debt and QUIDS	\$2,307,107	—	\$2,307,107
Preferred Stock	170,086	—	170,086
Common Stockholders' Equity:			
Common stock	152,639	—	152,639
Other paid-in capital	1,035,825	—	1,035,825
Retained earnings	1,013,866	—	1,013,866
Total Common Stockholders' Equity	\$2,202,330	—	\$2,202,330
Total Capitalization	\$4,679,523	—	\$4,679,523
Total Liabilities and Capitalization	\$6,617,585	\$ —	\$6,617,585

APS
RECLASSIFYING INCOME STATEMENT (d)
For the three months ended March 31, 1997
(in thousands of \$)

	<u>APS (historical)</u>	<u>Reclassifications</u>	<u>Reclassified Balance</u>
Operating Revenues			
Sales of Electricity:			
Residential	\$257,913	\$ —	\$257,913
Commercial	123,886	—	123,886
Industrial	182,270	—	182,270
Wholesale and other	20,235	(295)	19,940
Bulk power transactions, net	<u>30,676</u>	<u>(11,993)</u>	<u>18,683</u>
Total Sales of Electricity	614,980	(12,288)	602,692
Other	<u>—</u>	<u>12,288</u>	<u>12,288</u>
Total Operating Revenues	<u>\$614,980</u>	<u>\$ —</u>	<u>\$614,980</u>
Operating Expenses			
Fuel	\$140,465	\$(140,465)	\$ —
Purchased power	50,583	(50,583)	—
Fuel and purchased power		140,465	191,048
		50,583	
Other operating	72,825	—	72,825
Maintenance	61,480	—	61,480
Deferred power costs, net	(2,083)	—	(2,083)
Depreciation and amortization	68,782	—	68,782
Taxes other than income	48,656	—	48,656
Federal and state income taxes	<u>50,178</u>	<u>(50,178)</u>	<u>—</u>
Total Operating Expenses	\$490,886	\$ (50,178)	\$440,708
Operating Income	<u>\$124,094</u>	<u>\$ 50,178</u>	<u>\$174,272</u>
Other income, net	896	906	1,802
Allowance for other than borrowed funds used during construction	<u>1,150</u>	<u>(1,150)</u>	<u>—</u>
Total Other Income and Deductions	<u>2,046</u>	<u>(244)</u>	<u>1,802</u>
Interest and other charges	—	48,549	48,549
Interest on long term debt	43,380	(43,380)	—
Other interest	3,833	(3,833)	—
Allowance for borrowed funds used during construction	(965)	965	—
Dividends on preferred stock of subsidiaries	<u>2,301</u>	<u>(2,301)</u>	<u>—</u>
Total Interest Charges and Preferred Dividends	<u>48,549</u>	<u>—</u>	<u>48,549</u>
Income before income taxes	77,591	49,934	127,525
Income taxes	<u>—</u>	<u>49,934</u>	<u>49,934</u>
Net Income	<u>\$ 77,591</u>	<u>\$ —</u>	<u>\$ 77,591</u>

APS

RECLASSIFYING INCOME STATEMENT (d)
For the year ended December 31, 1996
(in thousands of \$)

	APS (historical)	Reclassifications	Reclassified Balance
Operating Revenues			
Sales of Electricity:			
Residential	\$ 932,235	—	\$ 932,235
Commercial	492,726	—	492,726
Industrial	752,905	—	752,905
Wholesale and other	74,260	—	74,260
Bulk power transactions, net	75,523	\$ (733)	74,790
Total Sales of Electricity	2,327,649	(733)	2,326,916
Other	—	2,068	2,068
Total Operating Revenues	\$2,327,649	\$ 1,335	\$2,328,984
Operating Expenses			
Fuel	\$ 513,210	\$(513,210)	\$ —
Purchased power	184,357	(184,357)	—
Fuel and purchased power	—	513,210	698,902
		184,357	
		1,335	
Other operating	299,817	—	299,817
Maintenance	243,314	—	243,314
Deferred power costs, net	15,621	—	15,621
Restructuring charges and asset write-off	103,865	—	103,865
Depreciation and amortization	263,246	—	263,246
Taxes other than income	185,373	—	185,373
Federal and state income taxes	127,992	(127,992)	—
Total Operating Expenses	\$1,936,795	\$(126,657)	\$1,810,138
Operating Income	\$ 390,854	\$ 127,992	\$ 518,846
Allowance for other than borrowed funds used during construction	3,157	(3,157)	—
Other income, net	4,370	5,512	9,882
Total Other Income and Deductions	7,527	2,355	9,882
Interest and other charges	—	188,334	188,334
Interest on long term debt	166,387	(166,387)	—
Other interest	15,398	(15,398)	—
Allowance for borrowed funds used during construction	(2,731)	2,731	—
Dividends on preferred stock of subsidiaries	9,280	(9,280)	—
Total Interest Charges and Preferred Dividends	188,334	—	188,334
Income before income taxes	210,047	130,347	340,394
Income taxes	—	130,347	130,347
Net Income	<u>\$ 210,047</u>	<u>\$ —</u>	<u>\$ 210,047</u>

APS
RECLASSIFYING INCOME STATEMENT (d)
For the year ended December 31, 1995
(in thousands of \$)

	<u>APS</u> <u>(historical)</u>	<u>Reclassifications</u>	<u>Reclassified</u> <u>Balance</u>
Operating Revenues			
Sales of Electricity:			
Residential	\$ 926,966	—	\$ 926,966
Commercial	493,696	—	493,696
Industrial	770,251	—	770,251
Wholesale and other	66,147	—	66,147
Bulk power transactions, net	58,151	—	58,151
Total Sales of Electricity	<u>2,315,211</u>	<u>—</u>	<u>2,315,211</u>
Other	—	—	—
Total Operating Revenues	<u>\$2,315,211</u>	<u>—</u>	<u>\$2,315,211</u>
Operating Expenses			
Fuel	\$ 508,533	(508,533)	\$ —
Purchased power	178,103	(178,103)	—
Fuel and purchased power	—	508,533	686,636
		178,103	
Other operating	290,501	—	290,501
Maintenance	249,477	—	249,477
Deferred power costs, net	47,796	—	47,796
Restructuring charges and asset write-off	23,440	—	23,440
Depreciation and amortization	256,316	—	256,316
Taxes other than income	184,729	—	184,729
Federal and state income taxes	154,203	\$(154,203)	—
Total Operating Expenses	<u>\$1,893,098</u>	<u>\$(154,203)</u>	<u>\$1,738,895</u>
Operating Income	<u>\$ 422,113</u>	<u>\$ 154,203</u>	<u>\$ 576,316</u>
Allowance for other than borrowed funds used during construction	4,473	(4,473)	—
Other income, net	6,224	7,146	13,370
Total Other Income and Deductions	<u>10,697</u>	<u>2,673</u>	<u>13,370</u>
Interest and other charges	—	193,118	193,118
Interest on long term debt	167,199	(167,199)	—
Other interest	14,417	(14,417)	—
Allowance for borrowed funds used during construction ..	(3,713)	3,713	—
Dividends on preferred stock of subsidiaries	15,215	(15,215)	—
Total Interest Charges and Preferred Dividends ...	<u>193,118</u>	<u>—</u>	<u>193,118</u>
Income before income taxes	239,692	156,876	396,568
Income taxes	—	156,876	156,876
Net Income	<u>\$ 239,692</u>	<u>\$ —</u>	<u>\$ 239,692</u>

APS
RECLASSIFYING INCOME STATEMENT (d)
For the year ended December 31, 1994
(in thousands of \$)

	APS (historical)	Reclassifications	Reclassified Balance
Operating Revenues			
Sales of Electricity:			
Residential	\$ 863,725	—	\$ 863,725
Commercial	459,303	—	459,303
Industrial	728,009	—	728,009
Wholesale and other	65,795	—	65,795
Bulk power transactions, net	67,797	—	67,797
Total Sales of Electricity	<u>2,184,629</u>	—	<u>2,184,629</u>
Other	—	—	—
Total Operating Revenues	<u>\$2,184,629</u>	—	<u>\$2,184,629</u>
Operating Expenses			
Fuel	\$ 547,241	(547,241)	\$ —
Purchased power	173,825	(173,825)	—
Fuel and purchased power	—	547,241	721,066
		173,825	
Other operating	285,007	—	285,007
Maintenance	241,913	—	241,913
Deferred power costs, net	11,805	—	11,805
Restructuring charges and asset write-off	9,178	—	9,178
Depreciation and amortization	223,883	—	223,883
Taxes other than income	183,060	—	183,060
Federal and state income taxes	125,913	\$(125,913)	—
Total Operating Expenses	<u>\$1,801,825</u>	<u>\$(125,913)</u>	<u>\$1,675,912</u>
Operating Income	<u>\$ 382,804</u>	<u>\$ 125,913</u>	<u>\$ 508,717</u>
Allowance for other than borrowed funds used during construction	11,966	(11,966)	—
Other income, net	1,509	41,633	43,142
Total Other Income and Deductions	<u>13,475</u>	<u>29,667</u>	<u>43,142</u>
Interest and other charges	—	176,528	176,528
Interest on long term debt	153,668	(153,668)	—
Other interest	10,394	(10,394)	—
Allowance for borrowed funds used during construction ...	(7,630)	7,630	—
Dividends on preferred stock of subsidiaries	20,096	(20,096)	—
Total Interest Charges and Preferred Dividends ...	<u>176,528</u>	—	<u>176,528</u>
Income before income taxes and cumulative effect of accounting change	219,751	155,580	375,331
Income taxes	—	155,580	155,580
Income before cumulative effect of accounting change ...	219,751	—	219,751
Cumulative effect of accounting change, net	43,446	—	43,446
Net Income	<u>\$ 263,197</u>	<u>\$ —</u>	<u>\$ 263,197</u>

DQE
RECLASSIFYING BALANCE SHEET (d)
At March 31, 1997
(in thousands of \$)

	DQE (historical)	Reclassifications	Reclassified Balance
ASSETS			
Current Assets:			
Cash and temporary cash investments	\$ 386,857	—	\$ 386,857
Receivables:			
Electric customer accounts receivable, net	97,655	(19,869)	77,786
Other utility receivables	16,534	(16,534)	—
Other receivables	34,465	16,534	50,999
Less: Allowance for uncollectible accounts	(19,869)	19,869	—
Total Receivables — Net	128,785	—	128,785
Materials and supplies (at average cost):			
Coal/Fuel	19,114	—	19,114
Operating and construction	51,778	—	51,778
Total Materials and Supplies	70,892	—	70,892
Prepaid taxes	—	468	468
Other current assets	8,430	(1,800)	6,630
Total Current Assets	\$ 594,964	\$ (1,332)	\$ 593,632
Long-Term Investments:			
Benefit plans' investments	\$ —	\$ 1,332	\$ 1,332
Affordable housing	155,662	—	155,662
Leveraged leases	193,654	—	193,654
Other leases	87,119	—	87,119
Gas reserves	77,855	—	77,855
Other investments	61,209	—	61,209
Total Long-Term Investments	\$ 575,499	\$ 1,332	\$ 576,831
Property, Plant and Equipment:			
At original cost Property, plant and equipment	\$ —	\$ 4,799,655	\$ 4,799,655
Electric plant in service	4,285,761	(4,285,761)	—
Construction work in progress	44,340	(44,340)	—
Property held under capital leases	100,036	(100,036)	—
Property held for future use	190,824	(190,824)	—
Other	178,694	(178,694)	—
Gross property, plant and equipment	\$ 4,799,655	\$ —	\$ 4,799,655
Less: Accumulated depreciation and amortization	(2,018,710)	—	(2,018,710)
Total Property, Plant and Equipment — Net	\$ 2,780,945	\$ —	\$ 2,780,945
Other Non-Current Assets:			
Regulatory assets	\$ 625,226	\$ (83,867)	\$ 541,359
Unamortized loss reacquired debt	—	83,867	83,867
Other	45,948	—	45,948
Total Other Non-Current Assets	\$ 671,174	\$ —	\$ 671,174
Total Assets	\$ 4,622,582	\$ —	\$ 4,622,582

DQE
RECLASSIFYING BALANCE SHEET (d)
At March 31, 1997
(in thousands of \$)

	<u>DQE</u> <u>(historical)</u>	<u>Reclassifications</u>	<u>Reclassified</u> <u>Balance</u>
LIABILITIES AND CAPITALIZATION			
Current Liabilities:			
Notes payable	\$ 930	\$ (930)	\$ —
Current maturities and sinking fund requirements	107,146	—	107,146
Short term debt	—	930	930
Accounts payable	80,626	(6,707)	73,919
Accrued liabilities	41,124	(13,435)	27,689
Dividends declared	28,709	—	28,709
Taxes accrued:			
Federal and state income tax	—	(7,102)	(7,102)
Other	—	694	694
Interest accrued	—	26,550	26,550
Deferred power costs	—	1,903	1,903
Other	2,852	(1,903)	949
Total Current Liabilities	<u>\$ 261,387</u>	<u>\$ —</u>	<u>\$ 261,387</u>
Non-Current Liabilities:			
Deferred income taxes — net	\$ 768,258	\$ —	\$ 768,258
Deferred investment tax credits	104,096	—	104,096
Capital lease obligations	24,150	—	24,150
Deferred income	180,835	—	180,835
Other	248,687	—	248,687
Total Non-Current Liabilities	<u>\$1,326,026</u>	<u>\$ —</u>	<u>\$1,326,026</u>
Commitments and Contingencies	—	—	—
Capitalization:			
Long-term Debt and QUIDS	\$1,402,286	\$ —	\$1,402,286
Preferred and Preference Stock of Subsidiaries:			
Preferred and preference stock	—	242,605	242,605
Non-redeemable preferred stock	213,608	(213,608)	—
Non-redeemable preference stock	28,997	(28,997)	—
Total preferred and preference stock before deferred employee stock ownership plan (ESOP) benefit	242,605	—	242,605
Deferred ESOP benefit	(18,931)	—	(18,931)
Total Preferred and Preference Stock of Subsidiaries	<u>\$ 223,674</u>	<u>\$ —</u>	<u>\$ 223,674</u>
Common Stockholders' Equity:			
Common stock	\$ 987,413	\$(987,413)	\$ —
Other paid-in capital	—	987,413	987,413
Retained earnings	796,429	—	796,429
Treasury stock (at cost) (32,318,774 shares)	(374,633)	—	(374,633)
Total Common Stockholders' Equity	<u>\$1,409,209</u>	<u>\$ —</u>	<u>\$1,409,209</u>
Total Capitalization	<u>\$3,035,169</u>	<u>\$ —</u>	<u>\$3,035,169</u>
Total Liabilities and Capitalization	<u>\$4,622,582</u>	<u>\$ —</u>	<u>\$4,622,582</u>

DQE
RECLASSIFYING INCOME STATEMENT(d)
For the three months ended March 31, 1997
(in thousands of \$)

	<u>DQE</u> <u>(historical)</u>	<u>Reclassifications</u>	<u>Reclassified</u> <u>Balance</u>
Operating Revenues			
Sales of Electricity:			
Residential	\$ 104,356	\$ (34)	\$ 104,322
Commercial	114,781	(258)	114,523
Industrial	47,631	(34)	47,597
Provision for doubtful accounts	(2,750)	2,750	—
Wholesale and other	—	202	202
Bulk power transactions, net	—	8,731	8,731
Customer Revenues	264,018	11,357	275,375
Electricity sales to other utilities	8,731	(8,731)	—
Total sales of electricity	272,749	2,626	275,375
Other	29,335	(3,779)	25,556
Total Operating Revenues	\$ 302,084	\$ (1,153)	\$ 300,931
Operating Expenses			
Fuel and purchased power	\$ 51,654	\$ —	\$ 51,654
Other operating	81,632	(1,029)	80,603
Maintenance	17,749	—	17,749
Deferred power costs, net	—	(124)	(124)
Depreciation and amortization	55,174	—	55,174
Taxes other than income	20,558	—	20,558
Total Operating Expenses	\$ 226,767	\$ (1,153)	\$ 225,614
Operating Income	\$ 75,317	\$ —	\$ 75,317
Other income, net	20,001	—	20,001
Interest and other charges	28,680	—	28,680
Income before income taxes	66,638	—	66,638
Income taxes	21,541	—	21,541
Net Income	<u>\$ 45,097</u>	<u>\$ —</u>	<u>\$ 45,097</u>

DQE
RECLASSIFYING INCOME STATEMENT(d)
For the year ended December 31, 1996
(in thousands of \$)

	<u>DQE</u> <u>(historical)</u>	<u>Reclassifications</u>	<u>Reclassified</u> <u>Balance</u>
Operating Revenues			
Sales of Electricity:			
Residential	\$ 405,392	\$ (1,209)	\$ 404,183
Commercial	489,646	(2,980)	486,666
Industrial	190,723	(1,196)	189,527
Provision for doubtful accounts	(10,582)	10,582	—
Wholesale and other	—	857	857
Bulk power transactions, net	<u>—</u>	<u>58,046</u>	<u>58,046</u>
Customer Revenues	1,075,179	64,100	1,139,279
Electricity sales to other utilities	<u>58,292</u>	<u>(58,292)</u>	<u>—</u>
Total sales of electricity	1,133,471	5,808	1,139,279
Other	<u>91,724</u>	<u>(17,730)</u>	<u>73,994</u>
Total Operating Revenues	\$1,225,195	\$(11,922)	\$1,213,273
Operating Expenses			
Fuel and purchased power	\$ 236,924	\$ (246)	\$ 236,678
Other operating	298,977	(7,148)	291,829
Maintenance	78,386	—	78,386
Deferred power costs, net	—	(4,528)	(4,528)
Depreciation and amortization	222,928	—	222,928
Taxes other than income	<u>85,974</u>	<u>—</u>	<u>85,974</u>
Total Operating Expenses	\$ 923,189	\$(11,922)	\$ 911,267
Operating Income	\$ 302,006	\$ —	\$ 302,006
Other income, net	74,790	—	74,790
Interest and other charges	<u>110,270</u>	<u>—</u>	<u>110,270</u>
Income before income taxes	266,526	—	266,526
Income taxes	<u>87,388</u>	<u>—</u>	<u>87,388</u>
Net Income	<u>\$ 179,138</u>	<u>\$ —</u>	<u>\$ 179,138</u>

DQE
RECLASSIFYING INCOME STATEMENT (d)
For the year ended December 31, 1995
(in thousands of \$)

	<u>DQE</u> <u>(historical)</u>	<u>Reclassifications</u>	<u>Reclassified</u> <u>Balance</u>
Operating Revenues			
Sales of Electricity:			
Residential	\$ 414,291	\$ 1,655	\$ 415,946
Commercial	491,789	1,991	493,780
Industrial	190,689	1,585	192,274
Provision for doubtful accounts	(13,430)	13,430	—
Wholesale and other	—	855	855
Bulk power transactions, net	—	<u>51,117</u>	<u>51,117</u>
Customer Revenues	1,083,339	70,633	1,153,972
Electricity sales to other utilities	<u>55,963</u>	<u>(55,963)</u>	<u>—</u>
Total Sales of Electricity	1,139,302	14,670	1,153,972
Other	<u>80,860</u>	<u>(15,703)</u>	<u>65,157</u>
Total Operating Revenues	<u>\$1,220,162</u>	<u>\$ (1,033)</u>	<u>\$1,219,129</u>
Operating Expenses			
Fuel and purchased power	\$ 231,968	\$ (4,846)	\$ 227,122
Other operating	292,997	(2,273)	290,724
Maintenance	81,516	—	81,516
Deferred power costs, net	—	6,086	6,086
Depreciation and amortization	202,558	—	202,558
Taxes other than income	<u>88,658</u>	<u>—</u>	<u>88,658</u>
Total Operating Expenses	<u>\$ 897,697</u>	<u>\$ (1,033)</u>	<u>\$ 896,664</u>
Operating Income	<u>\$ 322,465</u>	<u>\$ —</u>	<u>\$ 322,465</u>
Other income, net	52,314	—	52,314
Interest and other charges	<u>107,555</u>	<u>—</u>	<u>107,555</u>
Income before income taxes	267,224	—	267,224
Income taxes	<u>96,661</u>	<u>—</u>	<u>96,661</u>
Net Income	<u>\$ 170,563</u>	<u>\$ —</u>	<u>\$ 170,563</u>

DQE
RECLASSIFYING INCOME STATEMENT (d)
For the year ended December 31, 1994
(in thousands of \$)

	<u>DQE</u> <u>(historical)</u>	<u>Reclassifications</u>	<u>Reclassified</u> <u>Balance</u>
Operating Revenues			
Sales of Electricity:			
Residential	\$ 401,246	\$ (3,270)	\$ 397,976
Commercial	490,309	(6,111)	484,198
Industrial	195,852	(2,754)	193,098
Provision for doubtful accounts	(11,890)	11,890	—
Wholesale and other	—	845	845
Bulk power transactions, net	—	57,732	57,732
Customer Revenues	1,075,517	58,332	1,133,849
Electricity sales to other utilities	58,295	(58,295)	—
Total Sales of Electricity	1,133,812	37	1,133,849
Other	90,098	(11,403)	78,695
Total Operating Revenues	\$1,223,910	\$ (11,366)	\$1,212,544
Operating Expenses			
Fuel and purchased power	\$ 244,135	\$ (563)	\$ 243,572
Other operating	329,177	487	329,664
Maintenance	79,488	—	79,488
Deferred power costs, net	—	(11,290)	(11,290)
Depreciation and amortization	165,912	—	165,912
Taxes other than income	88,331	—	88,331
Total Operating Expenses	\$ 907,043	\$ (11,366)	\$ 895,677
Operating Income	\$ 316,867	\$ —	\$ 316,867
Other income, net	42,924	—	42,924
Interest and other charges	110,002	—	110,002
Income before income taxes	249,789	—	249,789
Income taxes	92,973	—	92,973
Net Income	<u>\$ 156,816</u>	<u>\$ —</u>	<u>\$ 156,816</u>

NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL INFORMATION

- (a) Represents the effect of recording unbilled revenue by DQE. APS changed its method of accounting for unbilled revenue in 1994.
- (b) Represents the effect of accruing for nuclear refueling outages by DQE during the periods leading up to the outage. DQE, historically, would defer the costs incurred and amortize them during the period(s) between outages.
- (c) Represents the effect of accruing for major turbine-generator inspection outages by APS during the periods leading up to the outage. APS, historically, has recorded such cost as incurred. APS believes accruing for such outages during the periods leading up to the outage is preferable to recording such cost as incurred and is consistent with DQE's method of accounting for such costs. The effect of the adjustment for the three months ended March 31, 1997, was not material and, accordingly, no pro forma adjustments were made to eliminate such transactions.
- (d) The revenues, expenses, assets, liabilities and equity of APS and DQE have been reclassified where appropriate to conform to the presentation expected to be used by the combined company in the future.
- (e) Intercompany transactions between APS and DQE during the periods presented were not material and, accordingly, no pro forma adjustments were made to eliminate such transactions.
- (f) The allocation between APS and DQE and their customers of the estimated cost savings resulting from the Merger, net of the costs incurred to achieve such savings, will be subject to regulatory review and approval. Transaction costs are estimated to be approximately \$24 million (including fees for financial advisors, attorneys, accountants, consultants, filings and printing). None of these estimated cost savings, the costs to achieve such savings or transaction costs have been reflected in the pro forma financial statements.
- (g) Represents the reversal of the cumulative effect of adopting unbilled revenues by APS in 1994. All periods presented include the impact of unbilled revenues.
- (h) APS expects, but cannot assure, that the dividend rate of \$1.72 per share will be maintained or increased following the Merger. See "Dividends."

DESCRIPTION OF APS CAPITAL STOCK

The following description of certain terms of the stock of APS does not purport to be complete and is qualified in its entirety by reference to the APS Charter incorporated herein by reference.

The authorized stock of APS currently consists of 260,000,000 authorized shares of APS Common Stock. As of June 1, 1997, there were outstanding 122,111,567 shares of APS Common Stock.

APS Common Stock

Except in connection with elections to the APS Board, the holders of APS Common Stock are entitled to one vote per share for each share held of record on matters voted on by stockholders and are entitled to participate equally in dividends when and as such dividends may be authorized by the APS Board out of assets legally available therefor. The APS Charter provides for cumulative voting in the election of directors, whereby each stockholder entitled to vote for the election of directors is entitled to the number of votes equal to the number of shares of such stock held by him multiplied by the number of directors to be elected, and such votes may be cast for a single director or may be distributed among any two or more of the directors standing for election. As a Maryland corporation, APS is subject to statutory limitations on the authorization and payment of dividends. In the event of a liquidation, dissolution or winding up of APS, holders of APS Common Stock have the right to a ratable portion of assets remaining after satisfaction in full of the prior rights of creditors, including holders of APS indebtedness, all liabilities and the aggregate liquidation preferences of any outstanding shares of APS Preferred Stock. The holders of APS Common Stock have no conversion or redemption rights. If the APS Board authorizes the issuances of new or additional shares of APS Common Stock, or any security convertible into APS Common Stock, for money and other than by a public offering of all such shares, or through underwriters or investment bankers who shall have agreed promptly to make a public offering of such shares, such new shares must first be offered pro rata to the then outstanding shares of APS Common Stock upon terms no less favorable to the purchaser than those offered to persons other than the holders of APS Common Stock. The period of time during which such pre-emptive rights may be exercised may be limited by the APS Board, but in no event for a period of time less than 10 days after the mailing of the notice announcing the availability of such rights. All outstanding shares of APS Common Stock are, and the shares of APS Common Stock to be issued in the Merger will be, validly issued, fully paid and non-assessable. As of June 1, 1997, there were 56,082 holders of record of APS Common Stock.

Transfer Agent

The transfer agent and registrar for APS Common Stock is ChaseMellon Shareholder Services, L.L.C.

COMPARISON OF CERTAIN RIGHTS OF THE HOLDERS OF APS COMMON STOCK AND DQE COMMON STOCK

General

As a result of the Merger, holders of DQE Common Stock will become holders of APS Common Stock and the rights of all such former holders of DQE Common Stock will thereafter be governed by the APS Charter, the APS Bylaws and the MGCL. The rights of the holders of DQE Common Stock are presently governed by the DQE Articles, the DQE Bylaws and the PBCL. The following summary, which does not purport to be a complete statement of the material differences in the rights of the stockholders of DQE and APS, sets forth certain differences between the MGCL and the PBCL, between the APS Charter and the DQE Articles and between the APS Bylaws and the DQE Bylaws. This summary is qualified in its entirety by reference to the full text of each of such documents, the MGCL and the PBCL. For information as to how such documents may be obtained, see "Available Information."

Size and Classification of the Board of Directors

APS

Except where a corporation has no outstanding stock or has fewer than three stockholders, Section 2-402 of the MGCL provides that every corporation shall have at least three directors, the precise number of directors to be specified in the corporation's charter until such number is changed by the corporation's bylaws. The APS Charter provides that the number of directors of APS may be changed from time to time in the manner provided by the APS Bylaws. The APS Bylaws provide that the number of directors of APS may be changed from time to time by the APS Board, but in no event will the APS Board be composed of more than 15 members or less than three members. As of the date of this Joint Proxy Statement/Prospectus, APS has nine directors. At the Effective Time, the APS Board will be composed of 15 members.

All of the directors of APS serve until the next annual meeting of stockholders and until their successors are duly elected and qualified.

DQE

The DQE Articles provide that the number of directors of DQE will be determined from time to time by the DQE Board by a resolution adopted by a majority vote of the Disinterested Directors (as defined below under "— Election and Removal of Directors; Filling of Vacancies on the Board of Directors — DQE").

The DQE Articles also provide that the DQE Board is divided into three classes, with each director serving for a term of three years. Each year, the term of one class of the DQE Board expires. As of the date of this Joint Proxy Statement/Prospectus, DQE has nine directors, of whom four had been elected for terms expiring in 1997, three had been elected for terms expiring in 1998, and two had been elected for terms expiring in 1999.

Election and Removal of Directors; Filling of Vacancies on the Board of Directors

APS

The APS Charter provides for cumulative voting in the election of directors, whereby each stockholder entitled to vote in the election of directors is entitled to the number of votes equal to the number of shares of such stock held by him multiplied by the number of directors to be elected, and such votes may be cast for a single director or may be distributed among any two or more of the directors standing for election.

Pursuant to Section 2-406 of the MGCL, subject to certain restrictions, stockholders may remove directors either with or without cause by the affirmative vote of a majority of all the votes entitled to be cast in the election of directors. However, if a corporation has cumulative voting for the election of directors, and less than the entire board of directors is removed, a director may not be removed without cause if the votes cast against his removal would be sufficient to elect him if then cumulatively voted at an election of the entire board of directors. Pursuant to Section 2-407 of the MGCL, stockholders of a corporation may elect a successor to fill a vacancy on a board resulting from the removal of a director. As provided in the APS Bylaws, vacancies, except for vacancies caused by an increase in the number of directors, may be filled by a majority of the remaining directors, whether or not sufficient to constitute a quorum; vacancies resulting from an increase in the number of directors may be filled by a majority of the APS Board. Under the MGCL, a director elected by a board of directors serves until the next annual meeting of stockholders and until a successor is elected and qualifies.

DQE

Section 1758(c) of the PBCL provides for cumulative voting in the election of directors.

Section 1726 of the PBCL provides that, unless otherwise provided in a bylaw adopted by a corporation's stockholders, any director or all of the directors of a corporation may be removed from office without cause by the vote of the stockholders entitled to elect directors, unless the board of directors is classified and such classification was effected by a bylaw adopted by the stockholders. The PBCL provides that, unless a

corporation's articles provide otherwise, if the board of directors is so classified — as is the DQE Board — any director or all of the directors may be removed from office only for cause by a vote of the stockholders entitled to vote thereon. Stockholders may also remove the entire board of directors by the unanimous consent or vote of stockholders entitled to vote in such matter.

Pursuant to the DQE Articles, so long as removal without cause is permitted under the PBCL, any director, any class of directors, or the entire DQE Board may be removed from office without cause only if stockholders entitled to cast at least 80% of the votes which all stockholders would be entitled to cast at an annual election of directors vote in favor of such removal. The DQE Articles also provide that, if the power to remove without cause is not mandated by statute, directors may be removed from office only for cause and only if such removal is approved by the affirmative vote of at least a majority of the voting power of the outstanding shares of capital stock of DQE entitled to vote generally in an annual election of the directors of DQE ("DQE Voting Stock") which are not beneficially owned by any person or entity (other than DQE or a subsidiary (as defined in the DQE Articles) or an employee benefit plan of DQE or a subsidiary) that is the beneficial owner, directly or indirectly, of 10% of the voting power of the outstanding DQE Voting Stock (a "DQE Interested Stockholder").

Pursuant to Section 1726 of the PBCL, unless otherwise provided in a bylaw adopted by the stockholders, a board of directors may remove any director who has been convicted of an offense punishable by imprisonment for a term of more than one year or been judicially declared of unsound mind, or for any other proper cause enumerated in a corporation's bylaws. The DQE Bylaws do not state any such cause. Section 1726 further allows any stockholder or director to petition a court to remove one or more directors for reasons of fraudulent or dishonest acts, for gross abuse of authority or discretion with respect to the corporation or for any other proper cause.

Under Section 1725 of the PBCL, except as otherwise provided in a corporation's bylaws, vacancies on a corporation's board of directors, including vacancies resulting from an increase in the number of directors, may be filled by a majority of the remaining directors, although less than a quorum, or by a sole remaining director, and any such person so selected will be a director and serve for the balance of the unexpired term, unless the corporation's bylaws provide otherwise.

The DQE Bylaws provide that vacancies in the DQE Board will be filled in the manner provided in the DQE Articles, which state that a vacancy may be filled only by a majority vote of the Disinterested Directors then in office, even if less than a quorum, and provide that all such directors elected to fill vacancies shall hold office for the remainder of the term for the class of directors to which they have been elected.

A "Disinterested Director" is defined in the DQE Articles to mean a director of DQE who is not a DQE Interested Stockholder or an affiliate, associate or representative of a DQE Interested Stockholder and either (i) was a director of DQE immediately prior to the time the DQE Interested Stockholder attained such status or (ii) is a successor to a Disinterested Director and is recommended or elected to succeed a Disinterested Director by a majority of the Disinterested Directors.

Duties of Directors

APS

Section 2-405.1 of the MGCL requires a director of a Maryland corporation to perform his duties in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person in a like position would use under similar circumstances. A director in performing his duties is entitled to rely on any information, opinion, report or statement prepared or presented by: (i) an officer or employee of the corporation whom the director reasonably believes to be competent in the matter presented, (ii) a lawyer, public accountant, or other person, as to matters the director reasonably believes to be within that person's professional competence, or (iii) a committee of the corporation's board on which the director does not serve as to a matter within its designated authority, if the director reasonably believes the committee to merit confidence.

DQE

In discharging their fiduciary duties, the directors of a corporation individually, committees of the board, and the board of directors as a whole may, pursuant to Section 1715 of the PBCL, in considering the best interests of the corporation, consider to the extent they deem appropriate: (i) the effects of any action on the corporation's shareholders, employees, suppliers, customers, creditors and the communities in which the corporation is located, (ii) the short-term and the long-term interests of the corporation and the possibility that such interests may be best served by the independence of the corporation, (iii) the resources, intent and conduct (past, stated and potential) of any person seeking to acquire control of the corporation, and (iv) all other pertinent factors. Section 1715 further relieves the board of directors from any duty to regard any interest (including any corporate interest) as dominating or controlling, and explicitly states that the board of directors need not render inapplicable or make a determination under the provisions of the PBCL relating to (i) control acquisitions, (ii) business combinations, (iii) control share acquisitions, or (iv) disorgement following attempts to acquire control of the corporation. With respect to an acquisition or potential or proposed acquisition for control of a corporation, Section 1715 explicitly states that actions by directors are subject to the same standard of conduct for directors that is applicable to all other conduct, and also establishes a presumption that actions with respect to an acquisition, or a potential or proposed acquisition of control, to which a majority of disinterested directors shall have assented, satisfy the directors' standards of care under the PBCL unless it is proved by clear and convincing evidence that the "disinterested directors" (as defined in the PBCL) did not assent to such action in good faith after reasonable investigation.

Meetings of Stockholders

APS

Pursuant to the APS Bylaws, special meetings of the stockholders may be called for any purpose by the Chairman of the APS Board, the President, the APS Board or the Executive Committee of the APS Board, and must be called by APS' Secretary, President or any director at the written request of stockholders holding a majority of the issued and outstanding stock of APS entitled to vote at the meeting. Any request by the stockholders must state the purpose or purposes of the meeting. On June 5, 1997, the APS Bylaws were amended to provide that unless the APS Board or the Executive Committee of the APS Board determine otherwise, the business of any special meeting will be limited to the purpose or purposes for which such special meeting is called, and no other proposals or matters will be considered. The APS Charter and the APS Bylaws both provide that a quorum consists of the presence, in person or by proxy, of a majority of the issued and outstanding shares entitled to vote at the meeting, except as otherwise provided by law or the APS Bylaws. The APS Charter provides that, notwithstanding any other provision of law requiring action to be taken or authorized by the affirmative vote of the holders of a majority or other designated proportion of the shares of APS, action taken by APS will be valid if taken or authorized by the affirmative vote of the holders of a majority of the total number of shares outstanding and entitled to vote thereon.

DQE

Section 1755 of the PBCL allows special meetings of shareholders to be called at any time by the board of directors, by shareholders entitled to cast at least 20% of the votes that all shareholders are entitled to cast at such special meeting (unless the corporation's articles of incorporation provide otherwise) or by such officers or other persons as may be authorized by the corporation's bylaws. The DQE Bylaws provide that special meetings of the stockholders may be called at any time by the Chairman of the DQE Board, the President or by the DQE Board, and (to the extent permitted by the PBCL) shall be called at the written request of stockholders owning at least 20% of the shares of DQE capital stock entitled to be voted at the meeting (which request shall state the purpose of the proposed meeting). Other than as provided in Section 1755 of the PBCL, under Section 2521 of the PBCL, the stockholders, with the exception of an "interested stockholder" (as that term is defined in Section 2553 of the PBCL with respect to meetings the purpose of which is to approve certain business combinations), of a Registered Corporation (defined in the PBCL generally as a domestic corporation that has a class or series of shares entitled to vote generally in the

election of directors of the corporation registered under the Exchange Act) do not have the right to call a special meeting.

Section 1756 of the PBCL provides that, unless otherwise stated in a bylaw adopted by the stockholders, a quorum consists of the presence of stockholders entitled to cast at least a majority of the votes that all stockholders are entitled to cast on a particular matter. However, pursuant to Section 2523 of the PBCL, the board of directors of a Registered Corporation may adopt or change a bylaw related to a quorum. The DQE Bylaws provide that the presence, either in person or by proxy, of a majority of outstanding shares of capital stock entitled to vote constitutes a quorum.

Action by Written Consent

APS

Under Section 2-505 of the MGCL, stockholders may take any action required or permitted to be taken at a meeting without a meeting only by unanimous written consent signed by each stockholder entitled to vote on such matter and a written waiver of any right to dissent signed by each stockholder entitled to notice of the meeting but not entitled to vote at it. The APS Charter provides that a change in the terms of any of the outstanding APS Common Stock may be made upon the consent in writing, or by vote at a meeting of stockholders called for that purpose, of the holders of a majority of the outstanding APS Common Stock.

DQE

Under Section 2524 of the PBCL, the stockholders of a Registered Corporation may act without a meeting by less than unanimous written consent if such action is permitted by such corporation's articles of incorporation. The DQE Articles provide that any action that could be taken at a meeting of stockholders may be taken without a meeting by the written consent of stockholders who would have been entitled to cast the minimum number of votes that would be necessary to authorize the action at a meeting at which all stockholders entitled to vote thereon were present and voting.

Stockholder Proposals and Stockholder Nominations of Directors

APS

The APS Bylaws provide that stockholder proposals and nominations for election of directors may be made at any annual or special meeting of stockholders only if advance notice of the proposal has been timely given in accordance with the APS Bylaws, and such proposals or nominations are otherwise proper for consideration under applicable Law, the APS Charter and the APS Bylaws. The APS Bylaws provide that a stockholder must deliver notice of any proposal or the name of any person to be nominated for election as a director of APS to APS' Corporate Secretary at APS' principal executive office not less than 60 nor more than 90 days prior to the date of the meeting. In the event that the date of the meeting is first publicly announced or disclosed less than 70 days prior to the date of the meeting, such notice must be given not more than ten days after the date of the announcement or disclosure. Public notice will be deemed to have been given more than 70 days in advance of the annual meeting of APS if APS has previously disclosed, in the APS Bylaws or otherwise, that the annual meeting in each year is to be held on a determinable date, unless and until the APS Board determines to hold the meeting on a different date. With respect to a proposal, the stockholder must deliver with the notice of the proposal the text of the proposal to be presented, a brief written statement of the reasons why such stockholder favors the proposal and must set forth such stockholder's name and address, the number and class of all shares of each class of stock of APS beneficially owned by such stockholder and any material interest of such stockholder in the proposal (other than as a stockholder). With respect to a nomination of a person for the APS Board, the stockholder must deliver with the notice a written statement setting forth the name of the person to be nominated, the number and class of all shares of each class of stock of APS beneficially owned by such person, the information regarding such person required by certain sections of Regulation S-K adopted by the SEC (or the corresponding provisions of any regulation subsequently adopted by the SEC applicable to APS), such person's signed consent to serve as a director of APS if elected, and such stockholder's name and address and the number and class of all shares of each class of stock of APS

beneficially owned by such stockholder. The Chairman of the meeting will have the right to determine whether such notice has been duly given and, if it has not, may direct that proposals and nominees not be considered. For information with respect to presenting matters at special meetings, see "— Meetings of Stockholders — APS."

DQE

Pursuant to the DQE Articles, any stockholder of record entitled to vote in an election of directors may nominate a candidate for election as a director of DQE upon written notice of the nomination to the DQE's Corporate Secretary not later than 120 days in advance of the meeting at which the election will be held, such notice setting forth: (a) the name and address of the stockholder who intends to make the nomination and of the person or persons to be nominated; (b) a representation that the stockholder is a holder of record of stock of DQE entitled to vote at such meeting and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice; (c) a description of all arrangements or understandings between the stockholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by the stockholder; (d) such other information regarding each nominee proposed by such stockholder as would be required to be included in a proxy statement filed pursuant to the proxy rules of the SEC, had the nominee been nominated by the DQE Board; and (e) the consent of each nominee to serve as a director of DQE if so elected.

Amendment of Charter and Bylaws

APS

Under Section 2-604 of the MGCL, an amendment of a corporate charter requires a resolution by the board of directors setting forth the proposed amendment and declaring it advisable, and approval by the stockholders of the corporation by the affirmative vote of two-thirds of all votes entitled to vote on the matter; unless the charter provides otherwise. The APS Charter provides that any action by the stockholders of APS requires approval by the holders of a majority of the outstanding shares of APS. See "— Meetings of Stockholders — APS."

Section 2-109 of the MGCL provides that the power to adopt, alter and repeal a corporation's bylaws shall be vested in the stockholders, except to the extent that a corporation's charter or bylaws confer this power on the corporation's board of directors. The APS Charter provides that a majority of the APS Board has the power to make, alter and repeal the APS Bylaws, except that the power to alter the APS Bylaws to divide the board into separate classes having different tenures is reserved to APS' stockholders.

DQE

Under Section 1912 of the PBCL, amendments to a corporation's articles of incorporation may be proposed for adoption either by a resolution of the board of directors setting forth the proposal or, unless otherwise provided by the corporation's articles of incorporation, by petition of the stockholders entitled to cast at least 10% of the votes that all stockholders are entitled to cast on the proposal. The right of the stockholders to propose an amendment to a corporation's articles of incorporation does not apply to a Registered Corporation. In either case, any proposal to amend the articles of incorporation must be approved by the affirmative vote of a majority of the votes cast by all stockholders entitled to vote on such proposal, unless the articles of incorporation or the PBCL requires approval by a greater proportion of votes. Further, if a proposed amendment would authorize a board of directors to determine the relative rights as between series of preferred or special classes of stock, adversely alter the preferences, limitations or special rights (other than preemptive rights or the right to vote cumulatively) of the shares of a class or series, authorize a new class or series of shares with a preference as to dividends or assets senior to an existing class of shares, or increase the number of authorized shares of any class or series having a preference as to dividends or assets which is senior to another class or series of shares, then the holders of the outstanding shares of the class or series shall have the right to vote as a class in respect of the amendment, the bylaws or articles of incorporation of the corporation notwithstanding, and the amendment must be approved by a majority of votes cast in each such class vote.

Under Section 1914 of the PBCL, stockholder approval is not required for certain specified amendments to the articles of incorporation that do not adversely affect the rights of stockholders.

The DQE Articles provide that, in addition to any other affirmative vote required by applicable law, the DQE Articles or otherwise, any amendment, alteration, change or repeal of Articles 7 and 8 of the DQE Articles (which provide for (i) supermajority stockholder approval of certain business combinations, and (ii) the definitions of terms used in the DQE Articles), requires (A) the approval of at least 80% of the voting power of all then outstanding shares of DQE Voting Stock, voting together as a single class, and (B) the holders of at least a majority of the voting power of the then outstanding shares of DQE Voting Stock, which are not beneficially owned by any DQE Interested Stockholder, voting together as a single class. However, the supermajority requirement to amend Articles 7 and 8 does not apply if a majority of the Disinterested Directors recommends the proposed action and the Disinterested Directors at the time of the recommendation constitute at least a majority of the full DQE Board, exclusive of any directors elected by the holders of any class of stock having preferences over the DQE Common Stock as to dividends or assets.

The DQE Articles also provide that the DQE Board, by vote including a majority of the DQE Disinterested Directors, may adopt, repeal and amend the DQE Bylaws, except with respect to such matters as are reserved by statute to the stockholders. Stockholders of DQE may repeal, amend and adopt the DQE Bylaws only if, in addition to any other affirmative vote required by law, the DQE Articles or otherwise, such action is approved by the affirmative vote of (i) the holders of at least 80% of the voting power of all then outstanding shares of DQE Voting Stock, voting together as a single class, and (ii) the holders of at least a majority of the voting power of the then outstanding shares of DQE Voting Stock which are not beneficially owned by any Interested Stockholder, voting together as a single class. However, the supermajority requirement does not apply if a majority of the Disinterested Directors recommends the proposed action and the Disinterested Directors at the time of the recommendation constitute at least a majority of the full DQE Board, exclusive of any directors elected by the holders of any class of stock having a preference over DQE Common Stock as to dividends or assets. The DQE Bylaws provide that, except as provided by the DQE Articles or by statute, the power to amend the DQE Bylaws is exclusively vested in the DQE Board.

Required Vote for Authorization of Certain Actions

APS

Under Section 3-105 of the MGCL, in order for a corporation to merge, consolidate, transfer all or substantially all of its assets or engage in a share exchange, the corporation's board of directors must adopt a resolution declaring that the proposed transaction is advisable on substantially the terms and conditions set forth or referred to in such resolution and direct that the proposed transaction be submitted for stockholder consideration at either an annual or a special meeting of stockholders. To be approved, the proposed transaction must receive the affirmative vote of two-thirds of all the votes entitled to be cast on the matter, unless the charter provides otherwise. In certain cases (e.g. merger of a 90%-owned subsidiary into its parent), no vote of the stockholders is required. The APS Charter requires that a merger, consolidation, transfer of assets and share exchange be approved by the holders of a majority of the total number of shares outstanding and entitled to vote thereon of APS. See "— Meetings of Stockholders — APS." No approval of the Merger by the stockholders of APS is required pursuant to the APS Charter or the MGCL. However, approval of the issuance of APS Common Stock in the Merger is required pursuant to the rules and regulations of the NYSE.

DQE

Under Section 1924 of the PBCL, for a plan of merger to be adopted, a corporation's board of directors must adopt a resolution approving such plan of merger and must direct that the plan of merger be submitted to a vote of the stockholders entitled to vote thereon at a regular or special meeting of the stockholders. The plan of merger must be approved by a majority of the votes cast by all stockholders entitled to vote thereon and, if any class or series of shares is entitled to vote thereon as a class, by a majority of the votes cast in each class vote. Unless otherwise required by a corporation's bylaws, a plan of merger does not require stockholder approval if: (i) (A) the surviving or new corporation is a domestic corporation whose articles of incorporation

are identical to the articles of incorporation of such constituent corporation, *provided that*, the articles of incorporation need not be identical to the extent that stockholder approval would not be required to amend the corporation's articles of incorporation generally; (B) each share of such constituent corporation outstanding immediately prior to the merger or consolidation will continue as, or be converted into (except as otherwise agreed to by the holder thereof), an identical share of the surviving or new corporation; and (C) such plan provides that the stockholders of such constituent corporation will hold in the aggregate shares of the surviving or new corporation having a majority of the votes entitled to be cast generally in an election of directors: (ii) prior to the adoption of such plan, another corporation that is a party to such plan owns 80% or more of the outstanding shares of each class of such constituent corporation so long as, in the case of a Registered Corporation, the adoption is consistent with the provisions of the PBCL relating to business combinations with interested stockholders, or (iii) no shares of the constituent corporation have been issued prior to the adoption of the plan of merger by the board of directors pursuant to Section 1922 of the PBCL (relating to a plan of merger). In certain circumstances, to approve a "business combination" (as defined in the DQE Articles), the DQE Articles require the affirmative vote of (i) the holders of at least 80% of the DQE Voting Stock and (ii) a majority of the voting power of DQE Voting Stock not beneficially owned by a DQE Interested Stockholder, voting together as a single class. See "— Fair Price and Anti-Greenmail Provisions in the Charter Documents — DQE."

Appraisal and Dissenters' Rights

APS

Under Section 3-202 of the MGCL, a stockholder of a Maryland corporation has, subject to certain limitations, the right to demand and receive the fair value of such stockholder's stock from the corporation if: (i) the corporation consolidates or merges with another corporation; (ii) the stockholder's stock is acquired in a share exchange; (iii) the corporation transfers all or substantially all of its assets in a manner that requires corporate action under Section 3-105 of the MGCL (relating to mergers, consolidations, transfers of assets and share exchanges); (iv) unless permitted to do so by its charter (which the APS Charter does), the corporation amends its charter so as to alter the contract rights, as expressly set forth in the charter, of outstanding stock and substantially adversely affects the stockholder's rights; or (v) the transaction involves a business combination between the corporation and an Interested Stockholder (defined generally in the MGCL as any person that is the beneficial owner, directly or indirectly, of ten percent or more of the voting power of the outstanding voting stock of the corporation). Unless the transaction involves a business combination between the corporation and an interested stockholder, the right to receive fair value does not exist (A) if the stockholder's stock is listed on a national securities exchange or is designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc., or (B) if the stock is that of a successor in a merger, unless, among other things, (x) the merger alters the contract rights of the stock as expressly set forth in the corporation's charter, without such charter reserving the right to do so, or (y) the stock is to be changed or converted into something other than either the stock in the successor or cash, scrip, or other rights or interests arising out of provisions for the treatment of fractional shares of stock in the successor.

DQE

Section 1571 of the PBCL provides that stockholders of a corporation have appraisal rights with respect to specified corporate actions, including: (i) a plan of merger, consolidation, division, share exchange or conversion; (ii) certain amendments to its articles of incorporation in which disparate treatment is accorded to the holders of shares of the same class or series; and (iii) a sale or transfer of all or substantially all of such corporation's assets. However, in no event are appraisal rights afforded to the holders of shares that are either listed on a national securities exchange or held of record by more than 2,000 stockholders unless (A) shares converted by a plan are not converted solely into shares of the acquiring, surviving, new or other corporation and cash in lieu of fractional shares; (B) the shares are a preferred or special class of stock, unless the articles of incorporation of such corporation, the plan, or the terms of the transaction entitle all holders of the shares of such class to vote thereon and require for the adoption thereof the affirmative vote of a majority of the votes

cast by all stockholders of such class; or (C) if such shares constitute a group of a class or series which are to receive special treatment in the corporate action under consideration, the holders of such group are not entitled to vote as a special class in respect of such corporate action.

State Anti-Takeover Statutes

APS

Under Sections 3-601 to 3-603, inclusive, of the MGCL, certain "business combinations" (including a merger, consolidation, share exchange or, in certain circumstances, an asset transfer or issuance or reclassification of equity securities) between a Maryland corporation and any person (other than the corporation or a subsidiary of the corporation) who beneficially owns 10 percent or more of the voting power of the corporation's shares or an affiliate or associate of the corporation who, at any time within the two-year period prior to the date in question, was the beneficial owner of ten percent or more of the voting power of the then-outstanding voting stock of the corporation (an "MGCL Interested Stockholder") or an affiliate of such an MGCL Interested Stockholder are prohibited for five years after the most recent date on which the MGCL Interested Stockholder becomes an MGCL Interested Stockholder. Thereafter, any such business combination must be recommended by the board of directors of such corporation and approved by the affirmative vote of at least (a) 80% of the votes entitled to be cast by holders of outstanding shares of voting stock of the corporation, voting together as a single voting group, and (b) two-thirds of the votes entitled to be cast by holders of voting stock of the corporation other than shares held by the MGCL Interested Stockholder who will (or whose affiliate will) be a party to the business combination or by an affiliate or associate of the MGCL Interested Stockholder, voting together as a single voting group, unless, among other conditions, the corporation's common stockholders receive a minimum price (as defined in the MGCL) for their shares and the consideration is received in cash or in the same form as previously paid by the MGCL Interested Stockholder for its shares. These provisions of the MGCL do not apply, however, to business combinations that are approved or exempted by the board of directors of the corporation prior to the time that the MGCL Interested Stockholder becomes an MGCL Interested Stockholder.

Under Sections 3-701 et seq. of the MGCL, "control shares" of a Maryland corporation acquired in a "control share acquisition" have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast on the matter, excluding shares of stock owned by the acquiror, by officers or by directors who are employees of the corporation. "Control Shares" are voting shares of stock which, if aggregated with all other such shares of stock previously acquired by the acquiror or in respect of which the acquiror is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquiror to exercise voting power in electing directors within one of the following ranges of voting power: (i) one-fifth or more but less than one-third, (ii) one-third or more but less than a majority, or (iii) a majority or more of all voting power. Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained stockholder approval. A "control share acquisition" means the acquisition of control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition, upon satisfaction of certain conditions (including an undertaking to pay expenses), may compel the board of directors of the corporation to call a special meeting of stockholders to be held within 50 days of demand to consider the voting rights of the shares. If no request for a meeting is made, the corporation may itself present the question at any stockholders meeting.

If voting rights are not approved at the meeting or if the acquiring person does not deliver an acquiring person statement as required by the MGCL, then, subject to certain conditions and limitations, the corporation may redeem any or all of the control shares (except those for which voting rights have previously been approved) for fair value determined, without regard to the absence of voting rights for the control shares, as of the date of the last control share acquisition by the acquiror or of any meeting of stockholders at which the voting rights of such shares are considered and not approved. If voting rights for control shares are approved at a stockholders meeting and the acquiror becomes entitled to vote a majority of the shares entitled to vote, all other stockholders may exercise appraisal rights. The fair value of the shares as determined for

purposes of such appraisal rights may not be less than the highest price per share paid by the acquiror in the control share acquisition.

The control share acquisition statute does not apply (a) to shares acquired in a merger, consolidation or share exchange if the corporation is a party to the transaction or (b) to acquisitions approved or exempted by the charter or bylaws of the corporation, *provided, however*, that the charter or bylaw provision was adopted before the acquisition of the shares.

Neither the APS Charter nor the APS Bylaws contains a provision exempting from the control share acquisition statute any acquisitions by any person of shares of stock of APS. There can be no assurance that such a provision will not be added at any time in the future.

DQE

Chapter 25 of the PBCL contains several anti-takeover provisions that apply to Registered Corporations.

Section 2538 of the PBCL provides that if (i) a stockholder of a Registered Corporation (together with others acting jointly or in concert therewith and affiliates thereof) is to be a party to a merger or consolidation, a share exchange or certain sales of assets involving such corporation or a subsidiary thereof; (ii) a stockholder is involved in a transaction in which such stockholder will receive a disproportionate amount of the securities resulting from a division of such corporation; (iii) a stockholder, other than certain dissenting stockholders, is to be treated differently from others holding shares of the same class in a voluntary dissolution or winding up of such corporation; or (iv) in a reclassification, a stockholder's percentage of voting or economic share interest is materially increased relative to substantially all other stockholders, then the transaction being proposed must be approved by the affirmative vote of stockholders representing at least a majority of the votes that all stockholders are entitled to cast with respect to such transaction, excluding all such shares which the stockholder who is interested in the transaction is entitled to cast. The approvals required by Section 2538 are in addition to any other approvals required by Subpart B of Part II of the PBCL, the corporation's articles of incorporation or bylaws or otherwise. Such special voting requirement does not apply to a transaction (A) that has been approved by a majority of such corporation's board of directors, excluding directors who are officers or directors of, or have a material equity interest in, the interested stockholder or who were nominated for election as a director by the interested stockholder and first elected as a director within 24 months of the vote on the proposed transaction; (B) in which the consideration to be received by the stockholders for shares of any class of which shares are owned by the interested stockholder is not less than the highest amount paid by the interested stockholder in acquiring shares of the same class; or (C) that has been approved by the directors of the corporation and involves an 80% or more stockholder.

Sections 2545 and 2546 of the PBCL, which are part of the Pennsylvania Control Transactions Statute, provide that, subject to certain limited exceptions, in the event of the acquisition by any person or group of persons acting together that has voting power over voting shares of a Registered Corporation that entitle the holders thereof to at least 20% of the voting power of the voting shares of such corporation (a "controlling person or group" for purposes of Sections 2545 and 2546 of the PBCL): (i) such controlling person or group must give prompt notice to all stockholders of record of such corporation that such acquisition has occurred; and (ii) any stockholder may make written demand on such controlling person or group for payment of the fair value, to be determined in the manner prescribed by the PBCL (the minimum of which must be the highest price paid per share by the controlling person during the prior 90 days), of the voting shares held by such stockholder, and upon receipt of any such demand, such controlling person or group must pay such fair value to such stockholder in accordance with the procedures set forth in the PBCL, which include proceedings that would require such stockholder to present such stockholder's shares to a court for a determination of the fair value thereof. If the Control Transactions Amendment is approved at the DQE meeting, DQE will have authorized opting out of the Pennsylvania Control Transactions Statute.

Section 2555 of the PBCL applies to transactions between a Registered Corporation and a 20% stockholder thereof (an "interested stockholder" for purposes of Section 2555 of the PBCL), notwithstanding that Section 2538 of the PBCL is also applicable. Section 2555 prohibits a Registered Corporation from engaging in a business combination with an interested stockholder unless: (i) such business combination or

the acquisition of shares causing such interested stockholder to become such was approved by the board of directors of such corporation prior to the interested stockholder's share acquisition, or where the purchase of shares made by the interested shareholder had been approved by the board of directors of such corporation prior to the interested shareholder's share acquisition date; (ii) such business combination is approved by the affirmative vote of the holders of shares representing at least a majority of the votes entitled to be cast in an election of directors, excluding voting shares beneficially owned by such interested stockholder or its affiliates or associates, and the meeting at which such business combination is approved is held at least three months after the time the interested stockholder became the beneficial owner of at least 80% of the shares entitled to vote in an election of directors and the consideration to be offered to stockholders in connection with such business combination meets specified fair price standards; (iii) such business combination is unanimously approved by the holders of all outstanding common shares of such corporation; (iv) such business combination is approved by the affirmative vote of the holders of shares entitling such holders to cast a majority of the votes that all stockholders would be entitled to cast in an election of directors of the corporation, excluding any voting shares beneficially owned by the interested stockholder or any affiliate or associate of the interested stockholder, at a meeting called for such a purpose no earlier than five years after the date of the interested shareholder's share acquisition; or (v) such business combination is approved at a stockholder's meeting called for such a purpose no earlier than five years after the date of the interested stockholder's share acquisition and that satisfies specified fair price standards.

Section 2564 of the PBCL provides that PBCL Control Shares (as defined below) of a corporation will have their voting rights taken away. Such voting rights may only be restored by the affirmative vote of (i) the holders of a majority of the disinterested shares (as defined in the PBCL) and (ii) a majority of the voting power of the outstanding voting shares of such corporation. In addition, under certain circumstances, a Registered Corporation is permitted to redeem PBCL Control Shares. "PBCL Control Shares" are defined as the number of voting shares which, upon acquisition by any person or group, results in a "PBCL Control-Share Acquisition," which is defined as an acquisition of such number of voting shares as, when added to the voting shares already held by such acquiring person or group, would entitle such person or group to exercise voting power for the first time within any of the following three ranges: (i) at least 20% but less than 33 $\frac{1}{3}$ %; (ii) at least 33 $\frac{1}{3}$ % but less than 50%; or (iii) 50% or more. PBCL Control Shares also include voting shares acquired within 180 days of the occurrence of a PBCL Control-Share Acquisition or acquired with the intention of making a PBCL Control-Share Acquisition. Under a provision of the DQE Bylaws, DQE has opted out of the provisions of Section 2564 of the PBCL.

Section 2575 of the PBCL provides that any profit realized by a "controlling person or group" (as defined above) from the disposition of any equity security of a Registered Corporation is recoverable by such corporation if (i) such profit is realized by such controlling person within 18 months after the controlling person became such and (ii) the equity security so disposed of was acquired by such controlling person within 24 months prior to or 18 months after such controlling person became such. Subject to certain exceptions, "controlling person or group" includes any person or group who (i) acquired, offered to acquire or, directly or indirectly, publicly disclosed or caused to be publicly disclosed its intention to acquire, power to vote at least 20% of the voting shares of such corporation or (ii) publicly disclosed or caused to be publicly disclosed that it may seek to acquire control of such corporation through any means. Under a provision of the DQE Bylaws, DQE has opted out of the provisions of Section 2575 of the PBCL.

Pursuant to Section 1713 of the PBCL, except in the case of obligations imposed by criminal statutes and a director's liability to pay federal, state and local taxes, if a corporation's bylaws so provide, its directors may not be held personally liable for monetary damages for any action taken, unless the director's actions constitute self-dealing, willful misconduct or recklessness or the director has failed to perform the duties of his office under the PBCL. Both the DQE Articles and the DQE Bylaws provide that, to the maximum extent provided by Pennsylvania law, no director of DQE will be personally liable for monetary damages for any act or omission taken as a director.

Indemnification of Officers and Directors

APS

Section 2-418 of the MGCL requires a corporation (unless its charter provides otherwise, which the APS Charter does not) to indemnify a director or officer who has been successful, on the merits or otherwise, in the defense of any proceeding to which he is made a party by a reason of his service in that capacity. Section 2-418 permits a corporation to indemnify its present and former directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses (including attorney's fees) actually incurred by them in connection with any proceeding to which they may be made a party by reason of their service in those or other capacities unless it is established that (a) the act or omission of the director or officer was material to the matter giving rise to the proceeding and (i) was committed in bad faith or (ii) was the result of active and deliberate dishonesty, (b) the director or officer actually received an improper personal benefit in money, property or services or (c) in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful. However, under the MGCL, a Maryland corporation may not indemnify for an adverse judgment in a suit by or in the right of the corporation or in which the director was found to have received an improper personal benefit, unless a court so orders and then only for expenses. In addition, the MGCL permits a corporation to advance reasonable expenses to a director or officer upon the corporation's receipt of (a) a written affirmation by the director or officer of his good faith belief that he has met the standard of conduct necessary for indemnification by the corporation as authorized by the MGCL and (b) a written statement by or on his behalf to repay the amount paid or reimbursed by the corporation if it shall ultimately be determined that the standard of conduct was not met.

The APS Bylaws provide that APS will indemnify any person who was or is a party or is threatened with being made a party to any action, suit, or proceeding, including appeals (other than an action, suit or proceeding by or in the right of APS), by reason of being a director, officer or employee of APS or serving at the request of APS in a similar capacity for another entity, against expenses (including attorneys' fees), judgments, decrees, fines, penalties and amounts paid in settlement actually and reasonably incurred by the person in connection with such proceeding if the person acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe that the conduct was unlawful. The APS Bylaws further provide that APS will indemnify any person who, by reason of being a director, officer or employee of APS or serving at the request of APS in a similar capacity for another corporation, is or was a party or is threatened with being made a party to any action, suit or proceeding, including appeals, by or in the right of APS to procure a judgment in its favor, against all expenses actually and reasonably incurred (including attorneys' fees) in connection with the defense or settlement of such action, suit or proceeding. APS will also indemnify such person for any amounts paid in settlement of such action, suit or proceeding, up to the amount that would have reasonably been expended in such person's defense, if such action had been prosecuted to conclusion. However, indemnification in the case of an action brought by or in the right of APS will be made only if the person acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of APS and no such indemnified party shall have been finally adjudged to be liable for negligence or misconduct in the performance of his duty to APS, except that a court may order indemnification despite an adjudication of liability if it deems such indemnification proper in view of all the circumstances. Other provisions of the APS Charter provide for indemnification as permitted by the MGCL.

Consistent with Section 2-405.2 of the MGCL and Section 5-349 of Courts and Judicial Proceedings Article, the APS Charter provides that directors and officers are not liable to APS or its stockholders for monetary damages for breach of their fiduciary duties, provided that director and officer liability is not eliminated (i) to the extent that it is proved that the person actually received an improper benefit or profit in money, property or services, to the extent of the improper money, property or services actually received, or (ii) to the extent that a judgment or final adjudication adverse to the person is entered in a proceeding based on a finding in the proceeding that the person's action, or failure to act, was the result of active and deliberate dishonesty and was material to the cause of action adjudicated in the proceeding.

DQE

Sections 1741 and 1742 of the PBCL permit a corporation, unless otherwise restricted by its bylaws, to indemnify a person who was or is a party or is threatened to be made a party to (i) any action or proceeding, whether civil, criminal, administrative or investigative, not on behalf of such corporation, against expenses (including attorneys' fees), judgments, penalties, fines and settlement amounts incurred by reason of such person's being or having been a representative of such corporation or having served at the request of the corporation as a representative of another entity, if such person acted in good faith and reasonably believed that his actions were in or not opposed to the best interests of such corporation and, with respect to any criminal proceeding, had no reasonable cause to believe that his conduct was unlawful, or (ii) any action by or in the right of the corporation to procure a judgment in its favor against expenses (including attorneys' fees) incurred by reason of such person's being or having been a representative of such corporation or having served at the request of the corporation as a representative of another entity, if such person acted in good faith and reasonably believed that his actions were in or not opposed to the best interests of such corporation and, with respect to any criminal proceeding, had no reasonable cause to believe that his conduct was unlawful. To the extent that a representative of a corporation has been successful on the merits or otherwise in the defense of a third party or derivative action, indemnification for expenses incurred (including attorneys' fees) is mandatory. Section 1746 of the PBCL provides that its provisions on indemnification will not be deemed exclusive of any other rights to which a person may be entitled under any bylaw, agreement or otherwise, *provided* that indemnification shall not be made in the case of willful misconduct or recklessness. Section 1745 of the PBCL provides that a corporation may pay expenses in advance, provided that the person undertakes to repay the amount if it is ultimately determined that he is not entitled to be indemnified by the corporation.

The DQE Bylaws provide that directors and officers will be entitled to indemnification for any reasonable expense (including attorneys fees) or liability paid or incurred in connection with any actual or threatened claim, action, suit or proceeding, civil, criminal, administrative, investigative or otherwise, whether by or in the right of DQE or otherwise, by reason of such person serving in such capacity or, at the request of DQE, in a similar capacity with another entity, and such indemnification includes the right to have expenses paid in advance, in compliance with applicable law. The right to receive indemnification does not apply in suits by directors or officers against DQE, other than suits to obtain indemnification.

Pursuant to Section 1713 of the PBCL, except in the case of obligations imposed by criminal statutes and a director's liability to pay federal, state and local taxes, if a corporation's bylaws so provide, its directors may not be held personally liable for monetary damages for any action taken, unless the director's actions constitute self-dealing, willful misconduct or recklessness or the director has failed to perform the duties of such director's office under the PBCL. Both the DQE Articles and the DQE Bylaws provide that, to the maximum extent provided by Pennsylvania law, no director of DQE will be personally liable for monetary damages for any act taken or omission made as a director.

Fair Price and Anti-Greenmail Provisions in the Charter Documents

APS

Neither the APS Charter nor the APS Bylaws contain any "Anti-Greenmail" or "Fair Price" provisions, which would, respectively, prevent APS from repurchasing shares of APS from a potential acquiror of APS, and paying a premium for those shares, in order to prevent an acquisition of APS by such potential acquiror, and require that transactions with specified stockholders meet certain price criteria.

DQE

Neither the DQE Articles nor the DQE Bylaws contain any "Anti-Greenmail" provision.

The DQE Articles provide, among other things, that (i) business combinations with; (ii) issuance of securities of DQE to; (iii) adoption of a plan for the liquidation or winding up of the DQE affairs proposed by or on behalf of; or (iv) any transaction, recapitalization or stock reclassification having the result of increasing the amount of outstanding shares of DQE owned by, a DQE Interested Stockholder or an affiliate or associate

of a DQE Interested Stockholder, requires the approval of 80% of DQE Voting Stock, voting together as a single class, and the approval of a majority of the shares of DQE Voting Stock, other than those beneficially owned by DQE Interested Stockholders, voting as a class. However, if (i) the transaction is approved by a majority of Disinterested Directors, or (ii) the per-share consideration received by holders of common stock satisfies the fair price criteria specified in the DQE Articles, the approval described above is not required, and such transaction will require only such affirmative vote, if any, as may be required by law, by any other provision of the DQE Articles or by any agreement with any national securities exchange.

Conflict-of-Interest Transactions

APS

Under Section 2-419 of the MGCL, a contract or transaction between (i) a corporation and any of its directors, or (ii) a corporation and any other entity in which any of its directors has a material financial interest, is not void or voidable solely because of a common directorship or interest, the presence of the director at the meeting of the board or a committee of the board that authorizes the contract or transaction or the counting of the vote of the director for the authorization, if (x) the fact of the common directorship or interest is known or disclosed and either (A) a majority of the disinterested directors on the board or committee approve the contract or transaction, or (B) the majority of the shares entitled to vote, other than those owned of record or beneficially owned by the interested director, approve the contract or transaction, or (y) the contract or transaction is fair and reasonable to the corporation.

The APS Charter provides that, in the absence of fraud, the fact that a director has an interest in a transaction or contract with APS or an interest in any entity that engages in a transaction or enters into a contract with APS, will not affect or invalidate the contract if authorized, ratified or approved by the APS Board or the stockholders of APS. The APS Charter further provides that a director will not be liable to account to APS for any profit made on any such contract or transaction if the contract or transaction has received the authorization, approval or ratification of the APS Board or the stockholders of APS.

DQE

Under Section 1728 of the PBCL, unless the bylaws of the corporation provide otherwise, transactions between a corporation and one or more of its directors or officers or between a corporation and any other entity in which one or more directors or officers has a financial interest are not void or voidable, solely due to the existence of such relationship, the presence at or participation in the meeting of the board of directors that authorizes that transaction or the counting of such persons' votes, if: (i) the material facts are disclosed as to the relationship or interest or are known to the board of directors and a majority of the disinterested directors approves the transaction; (ii) the material facts are disclosed as to the relationship or interest and the transaction is specifically approved in good faith by a vote of the stockholders; or (iii) the contract is fair to the corporation at the time authorized.

THE APS CHARTER AMENDMENT

The APS Board has determined that the Charter Amendment is advisable for APS whether or not the Merger is effectuated. The APS Board believes that the name "Allegheny Energy, Inc." more accurately describes the focus of the combined company and the path that APS will take whether or not the Merger is consummated. The APS Board believes that Allegheny Energy, Inc. is a more accurate description of a company that intends to provide its customers with a wide array of energy products and services. Stockholders of APS should not be affected in any way by this change of name. Assuming the Charter Amendment is approved at the APS Special Meeting, stockholders of APS will not be required to take any further action to effect the Charter Amendment; stock certificates representing shares of APS Common Stock will not need to be exchanged for new stock certificates. **The APS Board unanimously recommends that the holders of APS Common Stock vote FOR the Charter Amendment.**

AMENDMENT TO THE DQE ARTICLES

The DQE Board has determined that the Control Transactions Amendment, which would amend the DQE Articles to make the Pennsylvania Control Transactions Statute inapplicable to DQE, is advisable for DQE. DQE does not believe holders of DQE Common Stock would be entitled to any rights under the Pennsylvania Control Transactions Statute as a result of the Merger, but because there is no controlling precedent interpreting this portion of the Pennsylvania Control Transactions Statute, DQE is recommending the Control Transactions Amendment in order to remove any possible uncertainty or legal challenge. If the Pennsylvania Control Transactions Statute were applicable to the Merger, holders of DQE Common Stock would have the right following the Merger to demand payment for the fair value of their DQE Common Stock as determined in accordance with the Pennsylvania Control Transactions Statute. Such payments could adversely affect the ability of APS and DQE to account for the Merger as a "pooling-of-interests" for accounting purposes. Notwithstanding the approval of the Control Transactions Amendment by the stockholders of DQE, DQE will not file the Control Transactions Amendment until all of the conditions to the Merger have been satisfied or waived. Therefore, even if there is stockholder approval of the Control Transactions Amendment, if the Merger does not occur, the Control Transactions Amendment will not become effective, and DQE will remain subject to the Pennsylvania Control Transactions Statute. A copy of the form of the Control Transactions Amendment is attached as Appendix E to this Joint Proxy Statement/Prospectus. **The DQE Board unanimously recommends that the holders of DQE Common Stock vote FOR the Control Transactions Amendment.**

The operation of the Pennsylvania Control Transactions Statute is described under "The Merger — Appraisal Rights." The text of the Pennsylvania Control Transactions Statute is attached hereto as Appendix D.

OTHER INFORMATION FOR THE DQE MEETING

There were 77,408,557 shares of DQE Common Stock outstanding and entitled to vote at the close of business on June 16, 1997, the DQE Record Date. Each stockholder is entitled to one vote for each whole share held on all matters to be voted upon at the DQE Meeting and, in addition, has cumulative voting rights with respect to the election of directors.

Confidentiality: It is the policy of DQE that proxies, ballots, and voting tabulations that identify individual stockholders are kept confidential, except in a contested proxy solicitation or as may be necessary to meet applicable legal requirements. Proxies, ballots, and other voting documents are available for examination only by the judges of election and those associated with processing proxy cards and tabulating the vote, who must agree to comply with this policy of confidentiality.

Wesley W. von Schack resigned as Chairman, President, and Chief Executive Officer of DQE in August of 1996. In February of 1997, the DQE Board elected David D. Marshall, President and Chief Executive Officer. Mr. Marshall had been serving as interim President and Chief Executive Officer since August of 1996. In August of 1996, the DQE Board also elected Robert P. Bozzone and William H. Knoell to serve as Lead Directors. The Lead Directors alternately chair DQE Board meetings and perform other functions of a Chairman not delegated to the President and Chief Executive Officer of DQE.

DQE appreciates the outstanding leadership, wisdom, and dedication that Mr. von Schack provided during his twelve years of distinguished service to DQE and his significant contributions to the community.

DQE has a mandatory retirement age of 70 with an exception to allow directors who reach the age of 70 while serving as directors to complete their terms. In 1996 the DQE Bylaws were amended to provide for the position of "Lead Director" and to provide that directors serving as Lead Directors are not subject to the mandatory retirement age of 70. As a result, William H. Knoell will be eligible to be a nominee for reelection at this Annual Meeting and has been unanimously nominated by the DQE Board. Lead Directors chair meetings of the DQE Board or stockholders (under certain circumstances) and advise the Company on matters of DQE Board and corporate governance.

Election of Directors

Four directors are to be elected by the stockholders of DQE at the DQE Meeting. Unless the Merger is consummated, they will continue to serve until the Annual Meeting of DQE in the year 2000 and thereafter until their successors are chosen and qualified. It is intended that proxies solicited on behalf of the DQE Board will be voted for the nominees named below. If, because of events not presently known or anticipated, any nominee is unable to serve or for good cause will not serve, the proxies voted for the election of that director may be voted (in the discretion of the holders of the proxies) for other nominees not named below. Unless otherwise indicated, the business positions have been held for the past five years.

Nominees for Directors

Terms Expiring in the Year 2000:



Daniel Berg, Age 68, Director of DQE since 1989. Institute Professor and Acting Director, Services Research and Education Center, of Rensselaer Polytechnic Institute. A director of Duquesne Light, Hy-Tech Machine, Inc. (manufacturer of specialty parts and equipment), and Joachim Machinery Company, Inc. (distributor of machine tools), and Chairman of the Academic Advisory Board of the National Academy of Engineering.



Robert P. Bozzone, Age 63, Director of DQE since 1990. Elected to be a Lead Director in August of 1996. Vice Chairman of Allegheny Teledyne, Inc. (specialty metals production) since its formation through the merger of Allegheny Ludlum Corporation and Teledyne, Inc. in August 1996. Formerly Vice Chairman from 1994-1996 and President and Chief Executive Officer from 1990-1994 of Allegheny Ludlum. Also a director of Duquesne Light and Allegheny Teledyne, Inc., a trustee of Rensselaer Polytechnic Institute, a life member of ASM International (engineering technical society), and a board member of the Greater Pittsburgh Council — Boy Scouts of America, The Salvation Army, and Catholic Charities. Also former Chairman of the Pittsburgh Branch of the Federal Reserve Bank of Cleveland.



William H. Knoell, Age 72, Director of DQE since 1989. Elected to be a Lead Director in August of 1996. Retired Chairman of the Board and Chief Executive Officer of Cyclops Industries, Inc. (basic and specialty steels and fabricated steel products, industrial and commercial construction). Also a director of Duquesne Light, Cabot Oil & Gas Corporation and St. Clair Memorial Hospital and a life trustee of Carnegie Mellon University.



Thomas J. Murrin, Age 68, Director of DQE since 1991. Dean of the A. J. Palumbo School of Business Administration of Duquesne University since 1991. Prior to that, Deputy Secretary of the U.S. Department of Commerce and President of the Energy and Advanced Technology Group of Westinghouse Electric Corporation. Also a director of Duquesne Light and Motorola, Inc. (manufacturer of electronic equipment and components) and a member of the Executive Committee of the U.S. Council on Competitiveness and Chairman of the District Export Council.

The DQE Board unanimously recommends that DQE stockholders approve the election of the nominees for director.

Standing Directors

The other members of the DQE Board currently serving terms expiring as noted are as follows:

Terms Expiring in 1998:



Doreen E. Boyce, Age 63, Director of DQE since 1989. President of the Buhl Foundation (charitable institution for educational and public purposes). Also a director of Duquesne Light, Microbac Laboratories, Inc., Orbeco Analytical Systems, Inc. and Dollar Bank, Federal Savings Bank and a trustee of Franklin & Marshall College.



David D. Marshall, Age 45, Director of DQE since 1995. President and Chief Executive Officer of DQE and Duquesne Light since August of 1996. Previously Executive Vice President of DQE and President and Chief Operating Officer of Duquesne Light since 1995. Vice President of DQE from 1989 to 1995, and Executive Vice President of Duquesne Light from 1992 to 1995. Also a director of Duquesne Light, United Way of Allegheny County, and Southwestern Pennsylvania Industrial Resource Center (economic development), and Trustee, Vice President, and Secretary of Penn's Southwest Association (economic development).



Robert Mehrabian, Age 55, Director of DQE since 1991. President Emeritus and Professor of Material Science and Engineering at Carnegie Mellon University. Distinguished Visiting Professor at the University of California, Santa Barbara. Also a director of Duquesne Light, Allegheny Teledyne, Inc., PPG Industries Inc., Mellon Bank Corporation, Mellon Bank, N.A., and BEI Electronics, Inc. (develops systems and sensors for satellites, aircraft, medical devices and automobiles), an ex-officio trustee of Carnegie Mellon University and a member of the Alcoa Science & Technology Council.

Terms Expiring in 1999:



Sigo Falk, Age 62, Director of DQE since 1989. Management of personal investments. Chairman of The Maurice Falk Medical Fund and Leon Falk Family Trust and a director of Duquesne Light. Also Chair of the Chatham College Board of Trustees and a board member of the Historical Society of Western Pennsylvania and the Allegheny Land Trust.



Eric W. Springer, Age 68, Director of DQE since 1989. Partner of Horty, Springer & Mattern, P.C. (attorneys-at-law). Also a director of Duquesne Light, a trustee of the Maurice Falk Medical Fund, a Trustee Emeritus of Presbyterian University Hospital and the University of Pittsburgh Medical Center, and Past President of the Allegheny County Bar Association.

Directors' Fees and Plans

Directors of DQE who are not employees are compensated for their DQE Board service by a combination of DQE Common Stock and cash. They receive an annual retainer of \$15,000 in cash for service to DQE and its affiliates, payable in twelve monthly installments, and 250 shares of DQE Common Stock, payable in April of each year. Each director also receives a fee of \$1,000 for each DQE Board and committee meeting attended. For service as Lead Directors in 1996, Messrs. Bozzone and Knoell each received 263 shares of DQE Common Stock and \$5,021 in cash. Dr. Berg received a fee of \$1,000 per meeting for three meetings he attended as a director of Chester Engineers, Inc., which at the time was an affiliate of DQE. Directors who are employees of DQE or any of its affiliates do not receive fees for their services as directors.

In February of 1996, the DQE Board authorized a study of outside director pension programs. After a full review, the Duquesne Light Board voted to terminate the Duquesne Light Outside Directors' Retirement Plan (the "Directors' Retirement Plan") for individuals who become non-employee directors after August 27, 1996 and to freeze the plan for current non-employee directors of DQE as of December 1, 1996. Directors of DQE and Duquesne Light who retired prior to August 27, 1996 will continue to receive their monthly benefits under the Directors' Retirement Plan which are equal to the monthly retainer in effect at the time of retirement from the DQE Board for a period equal to the total months of service on the DQE Board and the board of directors of Duquesne Light but no longer than 120 months. As a result of the termination of the Directors' Retirement Plan, new non-employee directors will not be entitled to benefits under that plan, and current non-employee directors of DQE and Duquesne Light will accrue no additional retirement benefits for services after December 1, 1996. In full satisfaction of their accrued benefits under the Directors' Retirement Plan, current directors of DQE received, as of December 31, 1996, shares of DQE Common Stock and cash equal in value to the actuarial value of such accrued benefits. Such actuarial value was determined assuming a 5% per annum increase in the annual retainer, future annual increases in the value of DQE Common Stock of 6.5%, a dividend yield of 4.5%, and an after-tax discount rate of 4.5% per annum. In the case of current directors with less than ten years' service, all or a portion of the shares received are subject to a vesting schedule. The vesting schedule is the same as the vesting schedule to which benefits under the Directors' Retirement Plan were subject, *i.e.*, 50% vesting after five years of service plus an additional 10% vesting in years six through ten.

In order to increase directors' stock-based compensation and thus strengthen the link between directors' compensation and stockholder interests, the DQE Board adopted a new stock plan under which new non-employee directors of DQE will each receive up to 4,150 shares of restricted DQE Common Stock that will vest at the rate of 50% after five years of service as a director plus an additional 10% per year in years six through ten. Unvested shares are forfeited if the recipient ceases to be a director.

Each director of Duquesne Light under the age of 72 who is not an employee may elect under a directors' deferred compensation plan to defer receipt of a percentage of his or her director's remuneration until after termination of service as a director. Deferred compensation may be received in one to ten annual installments commencing, with certain exceptions, on the 15th day of January of the year designated by the director. Interest accrues quarterly on all deferred compensation at a rate equal to a specified bank's prime lending rate. Dr. Berg and Mr. Mehrabian elected to participate in the plan for 1996.

As part of its overall program to promote charitable giving, DQE and Duquesne Light have a Charitable Giving Program for all directors funded by life insurance policies on the directors owned by Duquesne Light. Directors of DQE are paired, and upon the death of the second of the two directors, DQE will donate up to five hundred thousand dollars each to one or more qualifying charitable organizations recommended by each of the two directors and reviewed and approved by the Employment and Community Relations Committee of the DQE Board. A director of DQE must have service of 60 months or more on the DQE Board in order to qualify for the full donation amount, with service of less than 60 months qualifying for an incremental donation. The program does not result in any material cost to DQE.

DQE provides Business Travel Insurance to its non-employee directors as part of its Business Travel Insurance Plan for Management Employees. In the event of accidental death or dismemberment, benefits of up to \$400,000 per individual are provided. The program does not result in any material cost to DQE.

The DQE Board and Its Committees

There were twelve regular meetings and four special meetings of the DQE Board during 1996. Attendance by the directors at DQE Board meetings and committee meetings in 1996 averaged 98.9%. No director failed to attend at least 75% of the DQE Board meetings and committee meetings of the DQE Board.

The DQE Board has standing committees which meet periodically, including the Audit, Compensation, and Nominating Committees of the DQE Board which are described below and a Finance Committee.

Actions taken by any committee of the DQE Board are reported to the full DQE Board.

Audit Committee

The Audit Committee of the DQE Board is composed of four directors who are not employees of DQE. Members are Drs. Berg and Mehrabian and Messrs. Bozzone and Springer. The principal responsibilities of the Audit Committee of the DQE Board include recommending the independent public accountants and reviewing the DQE financial statements and the related report of the independent public accountants; the results of the annual audit performed by the accountants; the DQE system of internal accounting control; and the adequacy of the internal audit function. The Audit Committee of the DQE Board met four times during 1996.

Compensation Committee

The Compensation Committee of the DQE Board, composed of three non-employee directors, makes recommendations to the DQE Board regarding compensation and benefits provided to executive officers and members of the DQE Board and the establishment or amendment of various employee benefit plans. The members of the Compensation Committee in 1996 were Dr. Boyce and Messrs. Bozzone and Falk. The Compensation Committee of the DQE Board met three times during 1996.

Nominating Committee

The Nominating Committee of the DQE Board recommends to the DQE Board DQE candidates for election and reelection to, or to fill vacancies on, the DQE Board. The Nominating Committee of the DQE Board considers nominees recommended to it in writing by stockholders and sent to the Corporate Secretary of DQE. Members of the Nominating Committee of the DQE Board are Messrs. Falk, Knoell, and Springer. The Nominating Committee of the DQE Board met once during 1996.

Beneficial Ownership of Securities of DQE

The following table shows all equity securities of DQE beneficially owned, directly or indirectly, as of June 16, 1997, by each director and by each current executive officer named in the Summary Compensation Table:

	<u>Total Shares of DQE Common Stock</u>	<u>Shares of DQE Common Stock/ Nature of Ownership(1)</u>		<u>Percent of Class</u>
Daniel Berg	6,939	5,289	VP, IP	*
		1,650	Joint, SVP SIP	
Doreen E. Boyce	5,994	5,994	VP, IP	*
Robert P. Bozzone	18,945(2)	8,870	VP, IP	*
		7,000	VP, IP	*
		3,075	VP	
Sigo Falk	7,895(3)	6,395	VP, IP	*
		1,500	SVP, SIP	
William H. Knoell	7,537(4)	6,502	VP, IP	*
		1,035	SVP, SIP	
David D. Marshall	80,941(5)(6)	5,200	VP	*
		66	VP, IP	
		18,708	Joint, SVP SIP	
Robert Mehrabian	7,164(7)	2,282	VP, IP	*
		3,382	VP	
		1,500	SVP, SIP	
Thomas J. Murrin	6,079(8)	2,143	VP, IP	*
		3,186	VP	
		750	Joint, SVP SIP	
Eric W. Springer	8,071(9)	7,169	VP, IP	*
Gary L. Schwass	106,730(5)	20,829	VP, IP	*
Victor A. Roque	23,962(5)(6)	200	VP	*
		417	VP, IP	
		3,988	Joint, SVP, SIP	
James D. Mitchell	28,432(5)(6)	200	VP	*
		772	VP, IP	
		5,067	Joint, SVP, SIP	
Wesley W. von Schack	308,451(10)	21,744	VP, IP	*
Directors, Nominees and Executive Officers as a Group (16 persons)	633,161			*

* None of the individuals named in the table above owned beneficially more than 1% of the outstanding shares of DQE Common Stock. The directors and executive officers of DQE as a group beneficially owned 0.818% of the outstanding shares of DQE Common Stock as of June 16, 1997.

(1) The term "Joint" means owned jointly with the person's spouse. The initials "VP" and "IP" mean sole voting power and sole investment power, respectively, and the initials "SVP" and "SIP" mean shared voting power and shared investment power, respectively.

(2) 7,000 of these shares are held by a foundation established for charitable purposes, for which Mr. Bozzone is the trustee but not an income beneficiary. 3,075 shares were granted under the DQE 1996 Stock Plan for Non-Employee Directors to vest over four years.

- (3) 1,500 of these shares are held by a trust in which Mr. Falk is an income beneficiary but not a trustee.
- (4) 1,035 of these shares are held by a trust in which Mr. Knoell is a trustee and the income beneficiary.
- (5) The amounts shown as owned by Messrs. Marshall, Schwass, Roque, Mitchell and von Schack include shares of DQE Common Stock which they have the right to acquire within 60 days of June 16, 1997 through the exercise of stock options granted under the Long-Term Incentive Plan in the following amounts: 56,967; 85,901; 19,357; 22,393; and 285,608, respectively, and all executive officers as a group: 478,826 shares.
- (6) The amounts shown as being owned by Messrs. Marshall, Roque and Mitchell include 200 shares of restricted stock that each was awarded as part of consideration for the signing of Noncompetition and Confidentiality Agreements and are subject to forfeiture for a period of one year from the date of such agreement, and 5,000 shares of restricted stock granted to Mr. Marshall which are subject to performance vesting for a three-year period.
- (7) 1,500 of these shares are held in an IRA for which Mellon Bank, N.A. is the trustee; Dr. Mehrabian is the beneficiary. 3,382 shares were granted under the DQE 1996 Stock Plan for Non-Employee Directors to vest over five years.
- (8) 3,186 shares were granted under the DQE 1996 Stock Plan for Non-Employee Directors to vest over three years.
- (9) 902 of these shares are held by Mr. Springer's wife. Mr. Springer disclaims beneficial ownership of such shares.
- (10) 166 of these shares are held in an IRA for which The Dreyfus Corporation is the trustee, and Mr. von Schack is the beneficiary. 1,099 of these shares are held in an IRA by Mr. von Schack's wife. Mr. von Schack disclaims beneficial ownership of these shares.

Messrs. Marshall, Schwass, Roque and Mitchell also beneficially own 715, 717, 239 and 357 shares, respectively, of the Preference Stock, Plan Series A, of Duquesne Light. The preference shares are held by the Duquesne Light Employee Stock Option Plan trustee for Duquesne Light's 401(k) Plan on behalf of the Executive Officers of DQE, who have voting but not investment power. The preference shares are redeemable for DQE Common Stock or cash on retirement, termination of employment, death, or disability. Shares outstanding as of June 16, 1997 for the Preference Stock, Plan Series A, of Duquesne Light, are 811,807. Mr. Roque is not vested in these preference shares.

The directors and executive officers of DQE do not own any shares of Preferred Stock of Duquesne Light.

Compensation Committee Report on Executive Compensation

All components of compensation for senior management are approved by the Compensation Committee of the DQE Board and ratified by the DQE Board based on the recommendations of the Compensation Committee of the DQE Board, which is composed entirely of non-employee directors of DQE.

On December 20, 1995, the Internal Revenue Service issued final regulations under Code Section 162(m) limiting the deductibility of executive compensation for officers of public companies. DQE believes that all compensation paid by DQE and its Subsidiaries in 1996 was fully tax deductible. It is the present intention of the Compensation Committee of the DQE Board to seek to ensure that all compensation that is otherwise tax deductible will continue to be tax deductible. The amendments to the Incentive Plan, which were approved by the stockholders in 1996, were designed to allow the Compensation Committee of the DQE Board, in its discretion, to grant stock options that comply with the final regulations. However, the Compensation Committee of the DQE Board reserves the right to take whatever action with respect to senior management compensation that it deems appropriate and in the best interest of DQE and its stockholders.

The primary objective of the Compensation Committee of the DQE Board is to ensure that the DQE senior management compensation programs and strategies are designed and administered to attract, retain, and motivate persons required to achieve the DQE overall mission of creating and enhancing value for its stockholders, customers, and employees, as well as for the community in which it operates.

Throughout the development and administration of the DQE strategic compensation plans, the Compensation Committee of the DQE Board has adhered to a results-based approach by linking a significant percentage of total compensation to performance. The Compensation Committee of the DQE Board has purposely placed an emphasis on the at-risk elements of compensation for the DQE Chief Executive Officer and other senior officers. The DQE awards under these incentive programs are tied to corporate and individual performance. The accomplishment of goals and objectives is at the center of the Compensation Committee of the DQE Board's decision to make awards under these incentive programs and strengthens the relationship between stockholder interests and ultimate total compensation. The Compensation Committee of the DQE Board exercises a degree of discretion in administering these incentive plans which the Compensation Committee of the DQE Board believes encourages continual focus on building long-term stockholder value.

An independent outside consultant with industry expertise has determined that a greater percentage of the DQE senior management's total compensation is variable and placed at risk, when benchmarked against a comparative industry panel of energy service companies of similar operating revenue size. All stock options are performance-based and are granted under the Incentive Plan, which was approved by the stockholders of DQE.

Annually, the Compensation Committee of the DQE Board reviews and determines base salary levels, annual incentive compensation, and long-term performance-based stock option vesting, based on competitive pay levels, individual performance and potential, and changes in duties and responsibilities. Base salaries are competitively benchmarked with the averages of comparative utility and general industry panels of companies of similar revenue and operating characteristics, reflecting the diversification of DQE's business operations. Some of the utility companies in the utility industry panel are also included in the Standard & Poor's Electric Companies Index used in the performance graph. See "— Performance Graph." DQE entered into employment agreements with Messrs. Schwass and Marshall and Ms. Green pursuant to which the minimum annual base salary is specified. See "Interests of Certain Persons in the Merger" and "— Employment and Change of Control."

In addition to the industry panel comparison, the Compensation Committee of the DQE Board considered results in the areas of customer service levels, cost-effective management, and operational performance (including, for example, generating plant performance and system reliability) in determining whether a base salary increase, as well as annual or long-term awards, were granted in 1996. Messrs. Marshall, Schwass, and von Schack received increases in base salary in 1996.

If a predetermined corporate financial performance threshold is met, there is an opportunity to earn annual cash and stock option performance awards by meeting short-term operating and financial goals. The threshold recommended by the Compensation Committee of the DQE Board and approved by the DQE Board for 1996 related to DQE Board earnings per share. DQE met this goal in 1996. At the beginning of each year, individual objectives also are established for each officer and approved by the Compensation Committee of the DQE Board. The DQE Chief Executive Officer's performance is evaluated for annual and long-term awards on the basis of the overall performance of DQE, the performance of the other members of his management team and, as discussed in more detail below, his leadership in developing and implementing operating and strategic plans to further the DQE long-term corporate objectives. The Compensation Committee of the DQE Board reviews individual results and the corporate performance with the full DQE Board. The DQE Board, upon the recommendation of the Compensation Committee of DQE, approves the amount of annual performance awards granted to each officer based on the achievement of corporate and individual objectives.

Specific individual annual objectives considered by the Compensation Committee of the DQE Board in determining the annual performance compensation awards support one or more of five major corporate objectives of DQE, including maximizing long-term stockholder value; providing quality service and superior customer satisfaction; managing assets cost effectively; maintaining excellent operational performance; and providing leadership in the community.

In the aggregate, annual incentives ranged from fifteen to thirty-five percent of base salary in 1996. The actual percentage of annual cash incentive awards varies, depending upon the degree to which performance objectives are met. See "Summary Compensation Table" for the annual cash incentive compensation awards earned. As former Chief Executive Officer of DQE, Mr. von Schack received a pro-rated annual cash award for his performance.

The number of performance stock options awarded annually from the prior year's annual grants is determined by use of a cash incentive performance multiplier. The size of the multiplier is based on the amount of increase in earnings per share of DQE Common Stock. The Compensation Committee of the DQE Board awarded annual performance options for 1996 in the amount of 33,861 to Mr. Marshall; 28,985 to Mr. Schwass; 17,391 to Mr. Roque; 12,919 to Mr. Mitchell; and 15,503 to Ms. Green. Additional options were not earned because not all of the established annual performance objectives were achieved (see footnote 4 to the "Summary Compensation Table"). Fifty percent of the annual stock options awarded in 1996 vested upon award, and there is a one-year wait before the officer is able to exercise the remaining fifty percent. In recognition of his performance over the past twelve years and his overall contributions to DQE, 65,590 annual performance options were awarded to Mr. von Schack to vest upon award.

Performance-based stock options awarded in 1996 pursuant to the Incentive Plan were granted under the provisions of a three-year plan approved and recommended by the Compensation Committee of the DQE Board and approved by the DQE Board. Three-year strategies were developed by each individual, and annual milestones designed to enhance the general well-being of DQE were established by the Chief Executive Officer of DQE and approved by the Compensation Committee of the DQE Board. The long-term strategies were designed to support the long-term corporate objectives of maximizing stockholder value; providing quality service and superior customer satisfaction; managing assets cost effectively; maintaining excellent operational performance; and providing leadership in the community. Through a performance-based award schedule, there is an opportunity to earn a percentage of the three-year grant annually. The award opportunity is up to thirty percent in the first year, up to sixty percent in the second year, and up to one hundred percent in the third year. In recognition of his performance over the past twelve years and his contributions to DQE, all of the options previously granted to Mr. von Schack were awarded.

Under the leadership of Mr. Marshall, DQE's management team continued to achieve excellent results with respect to DQE's long-term corporate objectives. In 1996, DQE continued to demonstrate a solid track record of financial and operational performance. Earnings per share increased over 5%. In November, an increase of eight cents (6.25%) in the annual dividend was declared beginning in January 1997. As shown under "— Performance Graph," DQE's common stock has had a total return which exceeded the S&P Electric Companies over the same period. A full report on DQE's financial performance can be found in its 1996 Annual Report to Stockholders. These results are consistent with the objective to achieve measurable and meaningful increases in the value of DQE's stockholders' investment.

Customers continue to rate the quality of service provided by Duquesne Light's representatives higher than the national utility average, according to independent surveys. Duquesne Light's customers also experience service restoration among the top U.S. utilities. Duquesne Light's current reliability performance provides service that is available approximately 99.9% of the time. Duquesne Light was one of the first electric utilities in the United States to offer comprehensive service guarantees. Since service guarantees were inaugurated in early 1995, Duquesne Light's error rate has been only 0.007% out of more than 37 million guaranteed performance transactions with customers.

Customers have seen the average price of electricity drop 13.4% since August of 1991 as a result of rate reductions in 1993 and 1994 while inflation raised the price of other goods and services by 18%. In 1996, the PAPUC approved a Duquesne Light proposal which included a commitment that rates would not increase through the year 2000. With inflation expected to increase 13.6% through the year 2000, the average cost of other products and services will have increased 50% relative to the price of electricity by the end of the decade.

Duquesne Light continues to be widely recognized as an environmental leader. Some examples of recent environmental accomplishments include successfully meeting all of the objectives and goals of Duquesne Light's Environmental Strategic Plan; complying throughout 1996 with all federal, state, and local environmental laws and regulations; developing a comprehensive compliance plan through the year 2000 for effective control of SO₂ and NO_x; installing reasonably available control technology for NO_x emissions on all operated coal-fired generating units; and implementing a DQE-wide pollution prevention program to plan, document, and verify DQE's continuing efforts to effectively control pollution. Duquesne Light is an environmentally clean utility and innovative and forward-thinking in environmental matters.

In terms of awards and recognition, three of Duquesne Light's environmental projects were selected for national recognition by the National Awards Council for Environmental Sustainability, a coalition of 60 environmental, community, government, and business organizations, by inclusion in Renew America's 1996 Environmental Success Index. The 1996 Index includes Duquesne Light's environmental awareness and educational programs for youth; the Brunot Island Wildlife Habitat Enhancement Project; and Duquesne Light's innovative disposal of fly ash in abandoned mines. Duquesne Light was also awarded the 1996 Governor's Award for Environmental Excellence for "Outstanding Achievement in Technology Innovation" related to Duquesne Light's research and development of cost-effective low NO_x burner technology. This patented technology, developed for the Etrama Power Station, is readily transferable to numerous other coal-fired boilers around the country. Duquesne Light's marketing activities also received national recognition during 1996, including, for the fourth consecutive year, the National Association of Town Watch's National Electric Utility Award for outstanding participation in the National Night Out and the Edison Electric Institute Marketing Achievement Award for managing an electric vehicle transportation project utilizing an electric shuttle bus at the Pittsburgh International Airport. In addition, Duquesne Light received the 1996 Edison Electric Institute Minority Business Development Corporation of the Year Award.

Duquesne Light's lunchtime seminar program, "Work and Family Issues," earned it membership in the first class of the U.S. Department of Labor's "Working Women Count!" Honor Roll. The honor roll singles out policies and programs that respond to improving pay and benefits; building a family-friendly work place; and valuing women's work through training and advancement.

Robert P. Bozzone, *Chairman*
Doreen E. Boyce
Sigo Falk

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires directors and executive officers of DQE, and any persons who beneficially own more than ten percent of DQE Common Stock, to file with the SEC initial reports of ownership and reports of changes in ownership of DQE Common Stock. Such persons are required by SEC regulations to furnish DQE with copies of all Section 16(a) forms they file.

To DQE's knowledge, during the year ended December 31, 1996, based solely on review of the copies of such reports furnished to DQE and written representations that no other reports were required, all such Section 16(a) filing requirements were met except that a grant of restricted stock that was unissued was inadvertently excluded from the initial Form 3 Report of Jack E. Saxer, Jr., Vice President. The Form 3 was later amended.

Compensation Committee Interlocks and Insider Participation

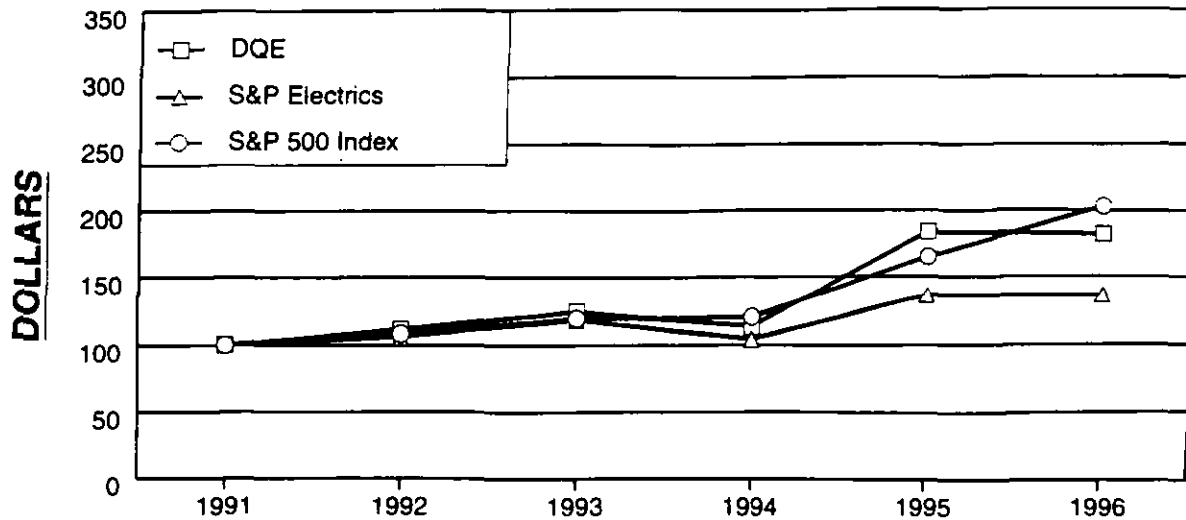
The members of the Compensation Committee of the DQE Board are Dr. Boyce and Messrs. Bozzone and Falk. No member of the Compensation Committee of the DQE Board was at any time during 1996 or at any other time an officer or employee of the DQE Board.

No executive officer of DQE served on the board of directors or compensation committee of any entity which has one or more executive officers serving as a member of the DQE Board or the Compensation Committee of the DQE Board.

Performance Graph

The following graph represents a performance comparison of cumulative total return on DQE Common Stock as compared to the S&P Electric Companies and the S&P 500 Index for the period of five fiscal years commencing December 31, 1991 and ending on December 31, 1996.

**COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURN
DQE, S&P ELECTRICS AND S&P 500 INDEX**



	1991	1992	1993	1994	1995	1996
DQE	100	111	124	113	184	182
S&P Electrics	100	106	118	104	136	136
S&P 500 Index	100	108	119	120	165	203

Assumes \$100 invested on December 31, 1991.

* Total return assumes reinvestment of dividends.

Compensation

The following Summary Compensation Table sets forth certain information as to cash and noncash compensation earned and either paid to, or accrued for the benefit of, the current President and Chief Executive Officer of DQE, the four other highest-paid executive officers of DQE, and the former Chairman of the Board, President and Chief Executive Officer of DQE, who resigned effective August 9, 1996, for services rendered in all capacities to DQE and its Subsidiaries during the years indicated.

SUMMARY COMPENSATION TABLE

(a) Name and Principal Position	Annual Compensation				Long-Term Compensation			
	(b) Year	(c) Salary (\$)	(d) Bonus (\$)(1)	(e) Other Annual Compensation (\$)(2)	Awards		Payouts	
					(f) Other Restricted Stock Award(s) (\$)(3)	(g) Securities Underlying Performance Options/SARs (#)(4)	(h) LTIP Payouts (\$)(5)	(i) All Other Compensation (\$)(2)(7)
D. D. Marshall President and Chief Executive Officer (Effective 8/9/96)	1996	289,486	101,367	68,284	141,250(5) 5,725(6)	56,645	0	7,375
	1995	233,333	86,750	27,918	0	63,555	0	4,291
	1994	191,667	48,450	7,814	0	52,813	0	4,504
G. L. Schwass Exec. Vice Pres. and Chief Financial Officer	1996	250,000	87,500	124,191	0	68,964	0	4,458
	1995	216,667	78,750	60,638	0	61,539	0	4,448
	1994	191,667	57,000	21,299	0	52,813	0	4,430
D. L. Green Senior Vice President(9)	1996	195,000	46,800	13,860	5,650(6)	54,768	0	7,622
	1995	184,000	51,900	44,268	0	28,954	0	4,460
	1994	166,333	49,500	16,319	0	35,469	0	4,482
V. A. Roque Vice President and General Counsel	1996	175,000	52,500	0	5,540(6)	17,391	0	7,388
	1995	175,000	52,500	215,097	0	31,731	0	4,490
J. D. Mitchell Vice President	1996	130,000	39,000	0	5,650(6)	17,883	0	6,002
	1995	130,000	39,000	0	0	25,500	0	2,508
	1994	128,847	25,391	0	0	10,000	0	1,923
W. W. von Schack Former Chairman, President and CEO (1/1/96 — 8/9/96)	1996	276,975	120,428	572,603	0	91,459	0	1,828(8)
	1995	440,000	194,700	174,853	0	166,385	0	4,448
	1994	440,000	163,240	173,682	0	155,000	0	4,490

- (1) The amount of any bonus compensation is determined annually based upon the prior year's performance and either paid or deferred (via an eligible participant's prior election) in the following year. The amounts shown for each year are the awards earned in those years but established and paid or deferred in the subsequent years. Mr. von Schack's bonus was prorated for his months of service before his resignation.
- (2) Amounts of Other Annual Compensation are connected to the funding of non-qualified pension benefit accruals for Messrs. Marshall, Schwass, and von Schack and Ms. Green (recently deceased). Amounts of Other Annual Compensation for Mr. Roque represent reimbursement for moving expenses, including sale of residence and income taxes. Amounts of All Other Compensation shown are DQE matching contributions during 1994, 1995, and 1996 under the Duquesne Light 401(k) Retirement Savings Plan for Management Employees and compensatory tax payments on restricted stock.
- (3) The awards listed are the only restricted stock holdings of the named officers.
- (4) Includes total number of stock options granted during the fiscal year, with or without tandem SARs and stock-for-stock (reload) options on option exercises, as applicable, whether vested or not. See table "Option/SAR Grants in Last Fiscal Year." The stock options are subject to vesting (exercisability) based on DQE and individual performance and achievement of specified goals and objectives. Of the amount of 1994 stock options granted, Messrs. Marshall and von Schack have lost 2,673 and 3,988 stock options, respectively. Of the amount of 1995 stock options granted, Messrs. Marshall and von Schack have lost 347 and 1,524 stock options, respectively. Of the amount of 1996 stock options granted, Ms. Green lost 3,876 stock options.
- (5) Vesting of this award is based on the achievement of performance goals for a three-year period. Dividends will be accrued and paid after the end of the three-year period on the shares earned.
- (6) Represents the value of 200 shares of DQE Common Stock awarded as part of the consideration for the signing of a Non-Competition and Confidentiality Agreement. Dividends are paid quarterly.

- (7) In 1996, premiums in the amount of \$95,980 were paid by DQE for split-dollar life insurance for Mr. von Schack. This amount was refunded to DQE in full in 1996 in connection with his resignation.
- (8) Includes a payment of \$401 to cover one month's health care premium pursuant to Mr. von Schack's resignation.
- (9) Deceased April 1997.

Supplemental Tables

The following tables provide information with respect to options to purchase DQE Common Stock and tandem stock appreciation rights in 1996 under the Incentive Plan.

Option grants are structured to align compensation with the creation of value for common stockholders. For example, should DQE stock rise 50% in value over the ten-year option term (from \$29.00 per share to \$43.50 per share), stockholder value would increase an estimated \$1,120,458,775, while the value of the grants to the individuals listed below would increase an estimated three-tenths of one percent (\$3,460,403) of the total gain realized by all stockholders.

OPTION/SAR GRANTS IN LAST FISCAL YEAR

Individual Grants					
(a)	(b)	(c)	(d)	(e)	(f)
Name	Number of Securities Underlying Options/SARs Granted (#)	% of Total Options/SARs Granted to Employees in Fiscal Year	Exercise or Base Price (\$/Sh) (3)	Expiration Date	Grant Date Present Value(\$)(4)
D. D. Marshall.....	28,986(1)	6.7%	30.1875	02/26/06	127,538*
	13,139(2)	3.0%	26.4375	02/18/02	37,709*
	619(2)	0.1%	30.0000	02/18/02	2,037*
	13,901(2)	3.2%	30.0000	08/29/04	49,210*
G. L. Schwass	28,986(1)	6.7%	30.1875	02/26/06	127,538*
	18,229(2)	4.2%	27.5625	07/22/01	54,140*
	748(2)	0.2%	27.5625	08/29/04	2,438*
	21,001(2)	4.8%	29.7500	08/29/04	70,143*
D. L. Green(6)	19,379(1)	4.5%	30.1875	02/26/06	85,268*
	15,133(2)	3.5%	30.3125	07/31/98	41,313*
	1,535(2)	0.4%	28.8125	07/31/98	3,653*
	18,721(2)	4.3%	28.8125	07/22/01	54,104*
V. A. Roque.....	17,391(1)	4.0%	30.1875	02/26/06	76,520*
J. D. Mitchell.....	12,919(1)	3.0%	30.1875	02/26/06	56,844*
	751(2)	0.2%	30.8750	08/29/04	2,839*
	1,435(2)	0.3%	27.0625	08/29/04	4,563*
	2,778(2)	0.6%	29.9375	08/29/04	9,751*
W. W. von Schack	20,297(2)	4.7%	30.7500	08/08/97	47,292*
	5,572(2)	1.3%	30.7500	08/08/97	12,983*
	65,590(1)(5)	15.1%	30.1875	08/08/97	150,201*

* The actual value, if any, an executive may realize will depend on the difference between the actual stock price and the exercise price on the date the option is exercised. There is no assurance that the value ultimately realized by an executive, if any, will be at or near the value estimated.

- (1) These grants represent performance stock options with tandem stock appreciation rights and stock-for-stock (reload) options. If the performance conditions are met and the granted option is awarded, 50% of the award vests immediately, and the remaining 50% vests one year later.
- (2) These grants represent stock-for-stock (reload) options received upon exercise of stock options by the applicable officer electing to use previously owned DQE stock to exercise the options and/or pay

withholding taxes under the terms of the Incentive Plan. These options include tandem stock appreciation rights, dividend equivalent accounts, and stock-for-stock options.

- (3) The exercise price of the options is the fair market value of DQE Common Stock on the date such options were granted. The exercise price may be payable in cash or previously owned shares of DQE Common Stock held for at least six months.
- (4) The grant date present value shown in column (f) gives the theoretical value of the options listed in column (b) on the grant dates using the Black-Scholes option pricing model, modified to account for the payment of dividends. The theoretical value of the option was calculated assuming an option life equal to the time period between the grant date and expiration date (i.e., from 1.45 to 10.00 years); a periodic risk-free rate of return equal to the yield of the U.S. Treasury note having a similar maturity date as the option expiration date, as reported by Bloomberg Financial Markets on the grant date (i.e., from 4.86% to 6.65%); the most recent initial quarterly dividend as of the option grant date (i.e., from \$0.32 to \$0.34), with an expected growth rate of 5.5% per year as estimated by "Value Line Ratings and Reports", dated December 13, 1996; and an expected stock price volatility as reported by Bloomberg Financial Markets over the same length of time as the option life as of the month of the grant (i.e., from 12.96% to 17.94%). No adjustments to the grant date present values have been made with respect to exercise restrictions, forfeiture, or early exercise.
- (5) Vested upon award.
- (6) Deceased April 1997.

AGGREGATED OPTION/SAR EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION/SAR VALUES

(a) Name	(b) Number of Securities Underlying Options/SARs Exercised (#)	(c) Value Realized (\$)(5)	(d) Number of Securities Underlying Unexercised Options/SARs at Fiscal Year-End (#) (6) Exercisable/Unexercisable	(e) Value of Unexercised in-the-Money Options/SARs at Year-End (\$) (6) (7) Exercisable/Unexercisable
D. D. Marshall	38,012(1) 31,177(2) 18,511(3) 23,422(4)	271,938 271,720 159,715 302,532	40,839/84,525	190,809/328,803
G. L. Schwass	108,089(1) 45,884(2)	950,779 441,865	38,549/89,161	103,558/315,273
D. L. Green(8)	20,897(1) 43,989(2)	151,937 690,645	73,921/65,612	511,022/194,314
V. A. Roque	12,115(1) 2,000(4)	83,542 15,625	11,500/38,507	103,500/157,349
J. D. Mitchell	5,975(2) 9,000(3) 5,000(4)	53,419 62,062 48,229	9,711/33,697	67,996/133,998
W. W. von Schack	233,709(1) 34,369(2)	2,105,058 656,493	549,608/0	3,974,516/0

- (1) Stock appreciation rights exercised for stock and cash.
- (2) Stock options exercised for stock by tendering shares of previously-owned DQE Common Stock.
- (3) Stock appreciation rights exercised for cash.
- (4) Stock options exercised for stock by tendering cash.

- (5) Represents the difference between the exercise price of the options or SARs and the fair market value of DQE Common Stock on the NYSE on the date of exercise.
- (6) The numbers set forth include options/SARs previously granted (including those granted in 1996) but not yet earned. The number to be earned will be based on individual performance and could range from zero to the following numbers for the named officers, respectively: 49,986 (\$181,998); 49,986 (\$181,998); 33,379 (\$102,686); 26,391 (\$68,499); 21,919 (\$67,999); and 0 (\$0). These options may be earned by the officer over future periods from one to three years as established with each option grant.
- (7) Represents the difference between the exercise price of the options or SARs and the fair market value of DQE Common Stock on the NYSE on December 31, 1996.
- (8) Deceased April 1997.

Retirement Plan

DQE and its Subsidiaries maintain tax-qualified and non-qualified defined benefit pension plans and arrangements that cover the named executive officers, among others. The following table illustrates the estimated annual straightlife annuity benefits payable at the normal retirement age of 65 to management employees in the specified earnings classifications and years of service shown:

PENSION PLAN TABLE

Highest Consecutive Five-Year Average Compensation	5	10	15	20	25	30	35
\$125,000	\$10,000	\$ 20,000	\$ 31,000	\$ 41,000	\$ 51,000	\$ 59,000	\$ 65,000
\$150,000	\$12,000	\$ 25,000	\$ 37,000	\$ 50,000	\$ 62,000	\$ 72,000	\$ 79,000
\$175,000	\$15,000	\$ 29,000	\$ 44,000	\$ 59,000	\$ 74,000	\$ 85,000	\$ 93,000
\$200,000	\$17,000	\$ 34,000	\$ 51,000	\$ 68,000	\$ 85,000	\$ 98,000	\$108,000
\$300,000	\$26,000	\$ 52,000	\$ 78,000	\$104,000	\$130,000	\$149,000	\$165,000
\$400,000	\$35,000	\$ 70,000	\$105,000	\$140,000	\$175,000	\$201,000	\$221,000
\$500,000	\$44,000	\$ 88,000	\$132,000	\$176,000	\$220,000	\$252,000	\$277,000
\$600,000	\$53,000	\$106,000	\$159,000	\$212,000	\$265,000	\$304,000	\$334,000
\$700,000	\$62,000	\$124,000	\$186,000	\$248,000	\$310,000	\$356,000	\$391,000
\$800,000	\$71,000	\$142,000	\$213,000	\$284,000	\$355,000	\$407,000	\$447,000
\$900,000	\$80,000	\$160,000	\$240,000	\$320,000	\$400,000	\$459,000	\$504,000
\$950,000	\$85,000	\$169,000	\$253,000	\$338,000	\$422,000	\$485,000	\$532,000

Compensation utilized for pension formula purposes includes salary and bonus reported in columns (c) and (d) of the Summary Compensation Table and stock option compensation prior to March 1, 1994. An employee who has at least five years of service has a vested interest in the retirement plan. Benefits are received by an employee upon retirement, which may be as early as age 55. Benefits are reduced by reason of retirement if commenced prior to age 60 or upon election of certain options under which benefits are payable to survivors upon the death of the employee. Pension amounts set forth in the above table reflect the integration with social security of the tax-qualified retirement plans. Retirement benefits are also subject to offset by other retirement plans under certain conditions.

The credited years of service for Messrs. Marshall and Schwass, and Ms. Green (recently deceased), are 19, 22 and 17, respectively. The current five-year covered compensation and current years of credited service of Messrs. Roque, Mitchell, and von Schack, respectively, are \$199,231 and 4; \$138,241 and 16; and \$853,396 and 32.

Employment and Change of Control

DQE has three-year employment agreements with Messrs. Marshall and Schwass. Each agreement is subject to automatic one-year renewals unless prior written notice of termination is given by the officer or DQE.

The agreements provide, among other things, that each serve in his present position at an annual base salary of at least \$190,000 for each of Messrs. Marshall and Schwass, subject to periodic review, and for the participation of each in executive compensation and other employee benefit plans of the companies.

If any of the officers is discharged other than for cause or resigns for good reason, then, in addition to any amounts earned but not paid as of the date of termination, he would receive in a cash lump sum the balance of his base salary for the remaining term of the agreement, a bonus amount with respect to the remaining term of the agreement calculated at a rate equivalent to his prior year's bonus and the actuarial equivalent of the additional pension he would have accrued had his service for pension purposes continued until the expiration of the agreement. In addition, the officer would be entitled to immediate vesting (or the redemption in cash) of all of his stock-based awards. Pursuant to the Severance Agreements with Messrs. Marshall and Schwass, these three-year employment agreements have been terminated subject to reinstatement if the Merger is abandoned.

During 1996, the DQE Board authorized and DQE entered into non-competition and confidentiality agreements with Messrs. Marshall, Roque and Mitchell. The agreements provide that these individuals will not disclose confidential information about DQE or its affiliates; compete directly or indirectly with DQE or any of its affiliates in a specified geographic area; solicit the business of certain customers and suppliers of DQE; or induce any employee of DQE or its affiliates to leave his current employment, each for specified periods of time following the termination of his or her employment with DQE. Consideration for these agreements was 200 shares of DQE Common Stock subject to a one-year transfer restriction plus sufficient cash to pay federal, state, and local taxes on the shares and an increase in the severance benefits payable to the executive to one and one-half times the severance benefits, if any, to which the individual is otherwise entitled with a minimum of six months and a maximum of one year of severance pay. If, however, an executive is a party to an employment agreement which provides greater severance benefits than are provided under the non-competition and confidentiality agreements, the employment agreement shall control.

In connection with the August 1996 resignation of Mr. von Schack as Chairman, President, and Chief Executive Officer of DQE, DQE, Duquesne Light, and Mr. von Schack entered into a letter agreement pursuant to which Mr. von Schack was paid a prorated bonus in the amount of \$120,428 and his coverage under the medical benefits program was continued for a period of one month. All of the stock options granted to and currently held by Mr. von Schack were fully awarded, vested, and made exercisable. Mr. von Schack agreed, among other things, not to disclose confidential information about DQE and its affiliates; compete directly or indirectly with DQE or any of its affiliates in a specified geographic area; solicit the business of customers and suppliers of DQE; or induce any employee of DQE or its affiliates to leave his or her current employment, each for specified periods of time. Mr. von Schack also released DQE from liability for claims arising from and during his employment and his Employment Agreement with DQE was terminated. All of Mr. von Schack's retirement benefits were fully vested and nonforfeitable and will be distributed in accord with the terms of the retirement plans.

Options and alternative stock appreciation rights granted under the DQE, Inc. Long-Term Incentive Plan become immediately and fully exercisable upon occurrence of certain change-in-control events. See "Interests of Certain Persons in the Merger."

Approval of Appointment of Independent Public Accountants

Action is to be taken at the DQE Meeting to approve the appointment, by the DQE Board, of independent certified public accountants to audit the books of DQE and its Subsidiaries for the year ending

December 31, 1997. The DQE Board recommends the approval of the appointment of Deloitte & Touche as independent certified public accountants for 1997.

Deloitte & Touche provided a variety of professional services for DQE and its Subsidiaries during 1996. Included were the audit of the annual financial statements of DQE; reviews of quarterly financial statements; services related to filings with the SEC and the FERC; audits of certain employee benefit plans; and consultations on matters related to accounting and financial reporting. Non-audit services also were provided during 1996, including advice and technical assistance relating to corporate tax matters.

Representatives of Deloitte & Touche will be present at the DQE Meeting and have the opportunity to make a statement if they desire and will also be available to respond to appropriate questions from stockholders in attendance.

DQE is submitting the appointment of independent public accountants for approval by the stockholders, although approval is not required. If approval is not obtained, the DQE Board will reconsider its appointment of Deloitte & Touche.

**The DQE Board unanimously recommends that stockholders
approve the appointment of Deloitte & Touche as independent accountants.**

Proposal of a DQE Stockholder

Annual Election of All Directors

Approval of the Stockholder Proposal requires the affirmative vote of a majority of the votes cast by all stockholders entitled to vote. If a stockholder abstains from voting certain shares or a broker indicates on a proxy that it does not have discretionary authority to vote certain shares, those shares will not be considered as votes cast with respect to this proposal and will not have the same legal effect as a vote "Against" the proposal.

Approval of the Stockholder Proposal would be advisory only and would not effect a change in the length of terms of the directors. Actual replacement of the three-year terms with a one-year term would require an amendment to the DQE Articles. If the proposal receives the affirmative vote of over 50% of the votes cast by all stockholders entitled to vote in 1997, the DQE Board will consider an amendment to the Articles to be submitted to stockholders for approval at the 1998 Annual Meeting. Under the DQE Articles, if the DQE Board agreed with the amendment, it would require the affirmative vote of over 50% of the votes cast by all stockholders entitled to vote. If the DQE Board did not agree with the amendment, it would require the affirmative vote of the holders of at least 80% of the then-outstanding shares for approval.

An individual stockholder has informed DQE that he intends to present the following proposal at the DQE Meeting. The name and address of the proponent and the number of shares he holds will be furnished by DQE to any person, orally or in writing as requested, promptly upon the receipt of any oral or written request to Stockholder Relations, DQE, P. O. Box 68, Pittsburgh, PA 15230-0068 (telephone number: 412-393-6167).

"Resolved that stockholders Board action to eliminate (after current director terms expire) three year director terms and set one year as the term for each director.

"Reasons:

- (1) Corporate experience has shown that staggered three year terms are almost a totally ineffective defense against takeovers.
- (2) DQE's director vacancies (recently 3) are abnormally low in relation to other NYSE-listed firms.

- (3) Recently several corporations (locally and nationally) have adopted (or readopted) single-year terms.
- (4) Institutional investors, financial and union pension fund administrators, many analysts, and specialist in corporate governance now prefer single year terms.
- (5) Opposition to annual election now generally gives a perception of non-responsive management.
- (6) DQE's stockholder and public images would improve if management ceased opposing one-year terms.

"Discussion:

"Sources within the College Equities Retirement Fund have advised the proposer is the least effective of any anti-takeover provisions adopted during the '80s and '90s. The respected UAW (United Auto Workers) investment strategist has publicly reiterated that staggered terms are useless as anti-takeover defense. Classical opponents of staggered boards agree. And managements under investor pressure for poor performance (Westinghouse, etc.) have not opposed a switch to single-year terms. Institutional investors and pension fund managers have increasingly used the stockholder resolution mechanism to promote single-year terms. Examples — UAW at Tenneco (1996) CREF, CALPERS (California Public Employees Retirement System) with several corporations, and the vote totals in favor have steadily increased from the mid-20% range to the mid-40% level recently. (In the Ichan motivated turmoil just prior to the split of U.S. Steel into USX-Marathon and USX-U.S. Steel, a single-term resolution received 51% of the vote recorded on a very low number of total shares voted because of an excessively delayed proxy statement). In previous votes at DQE, the last (1993) was slightly over 30.9%.

"At the time of submission of this proposal (November, 1996), the proponent does not know what management's action may be. There are three choices open:

- (a) recommendation against
- (b) no recommendation
- (c) recommendation of support

"About 1970, a supporting recommendation actually occurred at ATT. Mr. John De Butts, then chairman, asked his staff to try and find one stockholder resolution that was meritorious and that management could support. One was found, and the vote in favor was a landslide. De Butts' action spiked the "Always-Agin-It" unless it was management's origination.

"Please vote your shares by marking the "FOR" box on DQE's ballot card or on the instruction form to your broker or pension plan. Remember, failure to mark a box is a vote "against" if management exercises its established right to count blank boxes as it wishes. Otherwise, still vote — good management is promoted by a large share turnout.

"Thank you."

Management's Statement in Opposition

The DQE Board of recommends that stockholders vote AGAINST the adoption of the stockholder's proposal.

The main advantage of a staggered board is time — time to negotiate prior to a hostile takeover.

The DQE Board believes that stockholders are not the victims, but are, in fact, the main beneficiaries of the use of a staggered board since a corporate raider could not takeover DQE immediately. Keeping a staggered board forces a raider to negotiate with DQE, which means all stockholders of DQE should have an opportunity to receive the best stock price in a takeover. Use of a staggered board also provides the DQE Board with time to negotiate the effect of a business combination on the DQE employees, customers, region,

and other affected constituencies. Even in light of the Merger Agreement, the staggered board remains necessary. The consummation of the Merger is not guaranteed, and the initiation of a hostile bid could deprive stockholders of the value of the Merger by creating undue confusion if the DQE Board is replaced.

A staggered board also protects stockholder value since it provides director continuity and stability by ensuring that at least some experienced directors are on the DQE Board and preventing the sharp changes in policies, strategies, and operations which could occur in a hostile takeover.

See the chart under "— Performance Graph" for a comparison of DQE's five-year cumulative total return. DQE has continued to outperform the industry as represented by the S&P Electrics Index and has achieved a very respectable performance as measured against the outstanding performance of the S&P 500 Index.

Because of their value, staggered boards are still in common use in utilities and other companies in Pennsylvania and other states.

A staggered board has worked well for DQE over the years. It was first approved by Duquesne Light stockholders in 1987, ten years ago. It was originally passed by DQE stockholders in 1989 and was reaffirmed in 1992 and 1993 when this same stockholder proposal was defeated on two separate occasions.

The DQE Board has considered the merits of the stockholder proposal and, on balance, believes stockholders are better served by keeping a staggered board.

The DQE Board asks for your support to keep this protection for your stock value in place.

Other Matters

Any person who is a holder or beneficial holder of DQE Common Stock on the Record Date will receive, free upon request, a copy of DQE's Annual Report on Form 10-K for the year ended December 31, 1996 (the "DQE 10-K") as filed with the SEC. Requests must be made in writing to the Corporate Secretary of DQE, Box 68, Pittsburgh, PA 15230-0068.

Note that the Audited Financial Statements and the Notes to the Audited Financial Statements from the DQE 10-K are embodied in DQE's 1996 Annual Report to Shareholders, which was previously mailed to all holders of DQE Common Stock.

EXPERTS

The consolidated financial statements of APS at December 31, 1996 and 1995 and for each of the three years in the period ended December 31, 1996, incorporated by reference in this Joint Proxy Statement/Prospectus and the financial statement schedules incorporated by reference in the Registration Statement have been so incorporated in reliance on the report of Price Waterhouse LLP, independent public accountants, given on the authority of said firm as experts in auditing and accounting.

The consolidated financial statements and schedules of DQE as of December 31, 1996 and 1995 and for the years ended December 31, 1996, 1995 and 1994, incorporated by reference in this Joint Proxy Statement/Prospectus have been audited by Deloitte & Touche LLP, independent auditors. Such financial statements are incorporated herein by reference in reliance upon such reports given upon their authority as experts in accounting and auditing.

VALIDITY OF SHARES

The validity of the APS Common Stock to be issued pursuant to the Merger will be passed upon for APS by Sullivan & Cromwell.

STOCKHOLDER PROPOSALS

The date by which stockholder proposals must be received by APS for inclusion in the proxy materials relating to the 1998 annual meeting of stockholders of APS is December 5, 1997. The date by which stockholder proposals must be received by DQE for inclusion in the proxy materials relating to the 1998 annual meeting of stockholders of DQE, which is currently expected to be held on April 28, 1998, is November 17, 1997.

AGREEMENT AND PLAN OF MERGER

Among

DQE, Inc.,

Allegheny Power System, Inc.

and

AYP Sub, Inc.

Dated as of April 5, 1997

TABLE OF CONTENTS

	<u>Page</u>
RECITALS	A-1
ARTICLE I The Merger; Closing; Effective Time	A-1
1.1. Merger Sub; The Merger	A-1
1.2. Closing	A-2
1.3. Effective Time	A-2
ARTICLE II Certificate of Incorporation and By-Laws of the Surviving Corporation	A-2
2.1. The Certificate of Incorporation	A-2
2.2. The Bylaws	A-2
ARTICLE III Officers and Directors of the Surviving Corporation	A-2
3.1. Directors	A-2
3.2. Officers	A-2
ARTICLE IV Effect of the Merger on Capital Stock; Exchange of Certificates	A-2
4.1. Effect on Capital Stock	A-2
(a) Merger Consideration	A-2
(b) Cancellation of Shares	A-3
(c) Merger Sub	A-3
4.2. Exchange of Certificates for Shares	A-3
(a) Exchange Agent	A-3
(b) Exchange Procedures	A-3
(c) Distributions with Respect to Unexchanged Shares; Voting	A-4
(d) Transfers	A-4
(e) Fractional Shares	A-4
(f) Termination of Exchange Fund	A-4
(g) Lost, Stolen or Destroyed Certificates	A-4
(h) Affiliates	A-5
4.3. Dissenters' Rights	A-5
4.4. Adjustments to Prevent Dilution	A-5
ARTICLE V Representations and Warranties	A-5
5.1. Representations and Warranties of the Company and Parent	A-5
(a) Organization, Good Standing and Qualification	A-5
(b) Capital Structure	A-6
(c) Corporate Authority; Approval and Fairness	A-7
(d) Governmental Filings; No Violations	A-8
(e) Reports; Financial Statements	A-8
(f) Absence of Certain Changes	A-9
(g) Litigation and Liabilities	A-9
(h) Employee Benefits	A-9
(i) Compliance with Laws; Permits	A-11
(j) Takeover Statutes	A-11
(k) Environmental Matters	A-11
(l) Accounting and Tax Matters	A-12
(m) Taxes	A-12
(n) Labor Matters	A-13

	<u>Page</u>
	(o) Insurance A-13
	(p) Intellectual Property A-13
	(q) Brokers and Finders A-15
	(r) Regulation as a Utility A-15
	(s) Operations of Nuclear Power Plants A-15
	(t) Affiliates of the Company A-16
	(u) Ownership of Other Party's Common Stock A-16
ARTICLE VI	Covenants A-16
6.1.	Interim Operations A-16
6.2.	Acquisition Proposals A-18
6.3.	Information Supplied A-19
6.4.	Stockholders Meetings A-19
6.5.	Filings; Other Actions; Notification A-20
6.6.	Taxation and Accounting A-21
6.7.	Access A-21
6.8.	Affiliates A-21
6.9.	Stock Exchange Listing and De-listing A-22
6.10.	Publicity A-22
6.11.	Benefits. A-22
	(a) Stock Options A-22
	(b) Directors of Parent A-23
	(c) Officers of Parent A-23
	(d) Parent Board Committees A-23
	(e) Corporate Headquarters A-23
6.12.	Expenses A-23
6.13.	Indemnification; Directors' and Officers' Insurance A-24
6.14.	Other Actions by the Company and Parent A-24
	(a) Takeover Statute A-24
	(b) Dividends A-25
6.15.	Parent Vote A-25
6.16.	Rate Matters A-25
6.17.	PUHCA A-25
6.18.	Pennsylvania Restructuring Legislation A-25
6.19.	Nuclear Matters A-25
ARTICLE VII	Conditions A-26
7.1.	Conditions to Each Party's Obligation to Effect the Merger A-26
	(a) Stockholder Approval A-26
	(b) NYSE Listing A-26
	(c) Regulatory Consents A-26
	(d) Litigation A-26
	(e) S-4 A-26
	(f) Blue Sky Approvals A-26
	(g) Pooling Letter A-26
7.2.	Conditions to Obligations of Parent and Merger Sub A-26
	(a) Representations and Warranties A-26
	(b) Performance of Obligations of the Company A-27
	(c) Consents A-27
	(d) Tax Opinion A-27

	<u>Page</u>
	(e) Affiliates Letters A-27
	(f) Comfort Letters A-27
7.3.	Conditions to Obligation of the Company A-27
	(a) Representations and Warranties A-27
	(b) Performance of Obligations of Parent and Merger Sub A-27
	(c) Consents A-27
	(d) Tax Opinion A-28
	(e) Comfort Letters A-28
ARTICLE VIII	Termination A-28
8.1.	Termination by Mutual Consent A-28
8.2.	Termination by Either Parent or the Company A-28
8.3.	Termination by the Company A-28
8.4.	Termination by Parent A-29
8.5.	Effect of Termination and Abandonment A-29
ARTICLE IX	Miscellaneous and General A-30
9.1.	Survival A-30
9.2.	Modification or Amendment A-30
9.3.	Waiver of Conditions; Extension A-30
9.4.	Counterparts A-31
9.5.	GOVERNING LAW AND VENUE; WAIVER OF JURY TRIAL A-31
9.6.	Notices A-32
9.7.	Entire Agreement A-32
9.8.	No Third Party Beneficiaries A-32
9.9.	Obligations of Parent and of the Company A-33
9.10.	Severability A-33
9.11.	Interpretation A-33
9.12.	Assignment A-33

SCHEDULE OF DEFINED TERMS

<u>Defined Term</u>	<u>Page</u>
Acquisition Agreement	A-18
Acquisition Proposal	A-18
Acquisition Transaction	A-18
AEA	A-8
Affiliates Letter	A-21
Agreement	A-1
Audit Date	A-8
Bankruptcy and Equity Exception	A-7
Budgets	A-9
Bylaws	A-2
Certificate	A-3
Charter	A-2
Closing	A-2
Closing Date	A-2
Code	A-1
Company	A-1
Company Budget	A-9
Company Disclosure Letter	A-5
Company Option	A-6
Company Requisite Vote	A-7
Compensation and Benefit Plans	A-9
Confidentiality Agreement	A-32
Constituent Corporations	A-1
Contracts	A-8
Conversion Ratio	A-3
Costs	A-24
Current Premium	A-24
D&O Insurance	A-24
Disclosure Letter	A-5
Effective Time	A-2
Environmental Law	A-12
ERISA	A-10
ERISA Affiliate	A-11
ERISA Affiliate Plan	A-11
Exchange Act	A-8
Exchange Agent	A-3
Exchange Fund	A-3
Excluded Shares	A-2
FERC	A-6
Final Order	A-26
GAAP	A-9
Governmental Consents	A-26
Governmental Entity	A-8
Hazardous Material	A-12
HSR Act	A-8
Indemnified Parties	A-24
Intellectual Property Rights	A-15
IRS	A-10
Law/Laws	A-11
Material Acquisition Transaction	A-29

<u>Defined Term</u>	<u>Page</u>
Material Adverse Effect	A-5
Merger	A-1
Merger Consideration	A-3
Merger Sub	A-1
Nuclear Facility/Nuclear Facilities	A-15
Nuclear Review Committee	A-25
NYSE	A-22
Order	A-26
Parent	A-1
Parent Budget	A-9
Parent Common Stock	A-3
Parent Companies	A-2
Parent Disclosure Letter	A-5
Parent Requisite Vote	A-7
Parent Stock Plans	A-6
Parent Stockholders Meeting	A-19
Parent Voting Debt	A-7
PBCL	A-1
Pennsylvania Articles of Merger	A-2
Pennsylvania Restructuring Legislation	A-25
Pension Plan	A-11
Permits	A-11
Person	A-4
Pooling Affiliates Letter	A-22
Power Act	A-8
Preferred Shares	A-6
Prospectus/Proxy Statement	A-19
PUHCA	A-6
Reports	A-8
Representatives	A-21
S-4 Registration Statement	A-19
SEC	A-6
Securities Act	A-8
Shares	A-2
Stock Option Agreement	A-1
Stock Plans	A-6
Stockholders Meeting	A-19
Subsidiary	A-5
Superior Proposal	A-19
Surviving Corporation	A-1
Takeover Statute	A-11
Tax/Taxes/Taxable	A-14
Tax Return	A-14
Termination Date	A-28
Third-Party Intellectual Property Rights	A-15
Voting Debt	A-6

AGREEMENT AND PLAN OF MERGER

AGREEMENT AND PLAN OF MERGER (hereinafter called this "*Agreement*"), dated as of April 5, 1997, among DQE, Inc., a Pennsylvania corporation (the "*Company*"), Allegheny Power System, Inc., a Maryland corporation ("*Parent*"), and AYP Sub, Inc., a Pennsylvania corporation to be organized as a wholly owned subsidiary of Parent ("*Merger Sub.*" the Company and Merger Sub sometimes being hereinafter collectively referred to as the "*Constituent Corporations.*")

RECITALS

WHEREAS, Parent and the Company have determined to engage in a strategic business combination;

WHEREAS, in furtherance thereof, the respective boards of directors of each of Parent and the Company have approved this Agreement, which contemplates the merger of Merger Sub with and into the Company (the "*Merger*") whereby the Company will become a wholly owned subsidiary of Parent, and have approved the Merger upon the terms and subject to the conditions set forth in this Agreement;

WHEREAS, it is intended that, for federal income tax purposes, the Merger shall qualify as a reorganization under the provisions of Section 368(a) of the Internal Revenue Code of 1986, as amended, and the rules and regulations promulgated thereunder (the "*Code*");

WHEREAS, for financial accounting purposes, it is intended that the Merger shall be accounted for as a "pooling-of-interests;"

WHEREAS, contemporaneously with the execution and delivery of this Agreement, as a condition and inducement to Parent's willingness to enter into this Agreement, the Company is entering into a stock option agreement with Parent (the "*Stock Option Agreement*"), pursuant to which the Company has granted to Parent an option to purchase Shares (as defined in Section 4.1(a)) under the terms and conditions set forth in the Stock Option Agreement; and

WHEREAS, the Company and Parent desire to make certain representations, warranties, covenants and agreements in connection with this Agreement.

NOW, THEREFORE, in consideration of the premises, and of the representations, warranties, covenants and agreements contained herein, the parties hereto agree as follows:

ARTICLE I

The Merger; Closing; Effective Time

1.1. *Merger Sub; The Merger.* (a) As promptly as practicable following the execution of this Agreement and receipt of any required regulatory approvals, Parent shall cause Merger Sub to be incorporated under the laws of the Commonwealth of Pennsylvania. The Articles of Incorporation and Bylaws of Merger Sub shall be in a customary form. The authorized capital stock of Merger Sub shall consist of 1,000 shares of common stock, \$0.01 par value per share, all of which shall be issued to Parent at a price of \$1.00 per share following the receipt of any required regulatory approvals. As promptly as practicable following the issuance of such shares, Parent shall cause Merger Sub to authorize, execute and deliver this Agreement and to assume its obligations as a party hereto.

(b) Upon the terms and subject to the conditions set forth in this Agreement, at the Effective Time (as defined in Section 1.3), Merger Sub shall be merged with and into the Company and the separate corporate existence of Merger Sub shall thereupon cease. The Company shall be the surviving corporation in the Merger (sometimes hereinafter referred to as the "*Surviving Corporation*"), and the separate corporate existence of the Company with all its rights, privileges, immunities, powers and franchises shall continue unaffected by the Merger, except as set forth in Article III. The Merger shall have the effects specified in the Pennsylvania Business Corporation Law, as amended ("*PBCL*").

1.2. *Closing.* The closing of the Merger (the "*Closing*") shall take place (i) at the offices of Sullivan & Cromwell, 125 Broad Street, New York, New York at 9:00 A.M. on the fifth business day after the day on which the last to be fulfilled or waived of the conditions set forth in Article VII (other than those conditions that by their nature are to be satisfied at the Closing, but subject to the fulfillment or waiver of those conditions) shall be satisfied or waived in accordance with this Agreement or (ii) at such other place and time and/or on such other date as the Company and Parent may agree in writing (the "*Closing Date*").

1.3. *Effective Time.* As soon as practicable following the Closing, the Company and Parent will cause an Articles of Merger (the "*Pennsylvania Articles of Merger*") to be executed and filed with the Department of State of the Commonwealth of Pennsylvania as provided in Section 1927 of the PBCL. The Merger shall become effective at the time when the Pennsylvania Articles of Merger has been duly filed with the Department of State of the Commonwealth of Pennsylvania (the "*Effective Time*").

ARTICLE II

Certificate of Incorporation and By-Laws of the Surviving Corporation

2.1. *The Certificate of Incorporation.* The articles of incorporation of the Company as in effect immediately prior to the Effective Time shall be the articles of incorporation of the Surviving Corporation (the "*Charter*"), until duly amended as provided therein or by applicable law, except that Article V of the Charter shall be amended to read in its entirety as follows: "The aggregate number of shares that the Corporation shall have the authority to issue is 1,000 shares of Common Stock, par value \$0.01 per share".

2.2. *The Bylaws.* The by-laws of Merger Sub in effect at the Effective Time shall be the by-laws of the Surviving Corporation (the "*Bylaws*"), until thereafter amended as provided therein or by applicable law.

ARTICLE III

Officers and Directors of the Surviving Corporation

3.1. *Directors.* The directors of Merger Sub at the Effective Time shall, from and after the Effective Time, be the directors of the Surviving Corporation until their successors have been duly elected or appointed and qualified or until their earlier death, resignation or removal in accordance with the Charter and Bylaws.

3.2. *Officers.* The officers of the Company at the Effective Time shall, from and after the Effective Time, be the officers of the Surviving Corporation until their successors have been duly elected or appointed and qualified or until their earlier death, resignation or removal in accordance with the Charter and Bylaws.

ARTICLE IV

Effect of the Merger on Capital Stock; Exchange of Certificates

4.1. *Effect on Capital Stock.* At the Effective Time, as a result of the Merger and without any action on the part of the holder of any capital stock of the Company:

(a) *Merger Consideration.* Each share of the Common Stock, without par value, of the Company (the "*Shares*") issued and outstanding immediately prior to the Effective Time (other than Shares owned by Parent, Merger Sub or any other direct or indirect subsidiary of Parent (collectively, the "*Parent Companies*") and Shares that are owned by the Company or any direct or indirect Subsidiary of the Company, in each case not held on behalf of third parties, and which are not Shares held by the Company's utility Subsidiary to provide for redemption of such Subsidiary's preference shares pursuant to the terms of such Subsidiary's 401(k) plan or to provide benefits under another employee benefit plan of such Subsidiary (collectively, "*Excluded Shares*") shall, subject to Section 4.2(e) of this Agreement,

be converted into, and become exchangeable for 1.12 (the "*Conversion Ratio*") shares of Common Stock, par value \$1.25 per share, of Parent ("*Parent Common Stock*"), except as such merger consideration may be adjusted pursuant to Section 4.4 (as so adjusted, the "*Merger Consideration*"). At the Effective Time, all Shares shall no longer be outstanding and shall be cancelled and retired and shall cease to exist, and each certificate (a "*Certificate*") formerly representing any of such Shares (other than Excluded Shares) shall thereafter represent only the right to receive the Merger Consideration and the right, if any, to receive pursuant to Section 4.2(e) cash in lieu of fractional shares into which such Shares have been converted pursuant to this Section 4.1(a) and any distribution or dividend pursuant to Section 4.2(c).

(b) *Cancellation of Shares.* Each Excluded Share shall, by virtue of the Merger and without any action on the part of the holder thereof, cease to be outstanding, shall be cancelled and retired without payment of any consideration therefor and shall cease to exist.

(c) *Merger Sub.* At the Effective Time, each share of Common Stock, par value \$0.01 per share, of Merger Sub issued and outstanding immediately prior to the Effective Time shall be converted into one share of common stock of the Surviving Corporation.

4.2. *Exchange of Certificates for Shares.*

(a) *Exchange Agent.* As of the Effective Time, Parent shall deposit, or shall cause to be deposited, with an exchange agent selected by Parent with the consent of the Company (the "*Exchange Agent*"), which consent shall not be unreasonably withheld, for the benefit of the holders of Shares, certificates representing the shares of Parent Common Stock and, after the Effective Time, if applicable, any cash, dividends or other distributions with respect to the Parent Common Stock to be issued or paid pursuant to the last sentence of Section 4.1(a) in exchange for outstanding Shares upon due surrender of the Certificates (or affidavits of loss in lieu thereof) pursuant to the provisions of this Article IV (such certificates for shares of Parent Common Stock, together with the amount of any dividends or other distributions payable with respect thereto, being hereinafter referred to as the "*Exchange Fund*").

(b) *Exchange Procedures.* Promptly after the Effective Time, the Surviving Corporation shall cause the Exchange Agent to mail to each holder of record of Shares (other than holders of Excluded Shares) (i) a letter of transmittal specifying that delivery shall be effected, and risk of loss and title to the Certificates shall pass, only upon delivery of the Certificates (or affidavits of loss in lieu thereof) to the Exchange Agent, such letter of transmittal to be in such form and have such other provisions as Parent and the Company may reasonably agree, and (ii) instructions for use in effecting the surrender of the Certificates in exchange for (A) certificates representing shares of Parent Common Stock and (B) any unpaid dividends and other distributions and cash in lieu of fractional shares. Subject to Section 4.2(h), upon surrender of a Certificate for cancellation to the Exchange Agent together with such letter of transmittal, duly executed, the holder of such Certificate shall be entitled to receive in exchange therefor (x) a certificate representing that number of whole shares of Parent Common Stock that such holder is entitled to receive pursuant to this Article IV, (y) a check in the amount (after giving effect to any required tax withholdings) of (A) any cash in lieu of fractional shares plus (B) any unpaid non-stock dividends and any other dividends or other distributions that such holder has the right to receive pursuant to the provisions of this Article IV, and the Certificate so surrendered shall forthwith be cancelled. No interest will be paid or accrued on any amount payable upon due surrender of the Certificates. In the event of a transfer of ownership of Shares that is not registered in the transfer records of the Company, a certificate representing the proper number of shares of Parent Common Stock, together with a check for any cash to be paid upon due surrender of the Certificate and any other dividends or distributions in respect thereof, may be issued and/or paid to such a transferee if the Certificate formerly representing such Shares is presented to the Exchange Agent, accompanied by all documents required to evidence and effect such transfer and to evidence that any applicable stock transfer taxes have been paid. If any certificate for shares of Parent Common Stock is to be issued in a name other than that in which the Certificate surrendered in exchange therefor is registered, it shall be a condition of such exchange that the Person (as defined below) requesting such exchange shall pay any transfer or other taxes required by

reason of the issuance of certificates of shares of Parent Common Stock in a name other than that of the registered holder of the Certificate surrendered, or shall establish to the satisfaction of Parent or the Exchange Agent that such tax has been paid or is not applicable.

For the purposes of this Agreement, the term "*Person*" shall mean any individual, corporation (including not-for-profit), general or limited partnership, limited liability company, joint venture, estate, trust, association, organization, Governmental Entity (as defined in Section 5.1(d)) or other entity of any kind or nature.

(c) *Distributions with Respect to Unexchanged Shares; Voting.* (i) All shares of Parent Common Stock to be issued pursuant to the Merger shall be deemed issued and outstanding as of the Effective Time and whenever a dividend or other distribution is declared by Parent in respect of the Parent Common Stock, the record date for which is at or after the Effective Time, that declaration shall include dividends or other distributions in respect of all shares issuable pursuant to this Agreement. No dividends or other distributions in respect of the Parent Common Stock shall be paid to any holder of any unsurrendered Certificate until such Certificate is surrendered for exchange in accordance with this Article IV. Subject to the effect of applicable laws, following surrender of any such Certificate, there shall be issued and/or paid to the holder of the certificates representing whole shares of Parent Common Stock issued in exchange therefor, without interest, (A) at the time of such surrender, the dividends or other distributions with a record date after the Effective Time theretofore payable with respect to such whole shares of Parent Common Stock and not paid and (B) at the appropriate payment date, the dividends or other distributions payable with respect to such whole shares of Parent Common Stock with a record date after the Effective Time but with a payment date subsequent to surrender.

(ii) Holders of unsurrendered Certificates shall be entitled to vote after the Effective Time at any meeting of Parent stockholders the number of whole shares of Parent Common Stock represented by such Certificates, regardless of whether such holders have exchanged their Certificates.

(d) *Transfers.* After the Effective Time, there shall be no transfers on the stock transfer books of the Company of the Shares that were outstanding immediately prior to the Effective Time.

(e) *Fractional Shares.* Notwithstanding any other provision of this Agreement, no fractional shares of Parent Common Stock will be issued and any holder of Shares entitled to receive a fractional share of Parent Common Stock but for this Section 4.2(e) shall be entitled to receive a cash payment in lieu thereof, which payment shall represent such holder's proportionate interest in a share of Parent Common Stock based on the closing price of a share of the Parent Common Stock, as reported in The Wall Street Journal, New York City edition, on the trading day immediately prior to the Effective Time.

(f) *Termination of Exchange Fund.* Any portion of the Exchange Fund (including the proceeds of any investments thereof and any Parent Common Stock) that remains unclaimed by the stockholders of the Company for 180 days after the Effective Time shall be paid to Parent. Any stockholders of the Company who have not theretofore complied with this Article IV shall thereafter look only to Parent for payment of their shares of Parent Common Stock and any cash, dividends and other distributions in respect of the Parent Common Stock payable and/or issuable pursuant to Section 4.1 and Section 4.2(c) upon due surrender of their Certificates (or affidavits of loss in lieu thereof), in each case, without any interest thereon. Notwithstanding the foregoing, none of Parent, the Surviving Corporation, the Exchange Agent or any other Person shall be liable to any former holder of Shares for any amount properly delivered to a public official pursuant to applicable abandoned property, escheat or similar laws.

(g) *Lost, Stolen or Destroyed Certificates.* In the event any Certificate shall have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the Person claiming such Certificate to be lost, stolen or destroyed and, if required by Parent, the posting by such Person of a bond in customary amount as indemnity against any claim that may be made against it with respect to such Certificate, the Exchange Agent will issue in exchange for such lost, stolen or destroyed Certificate the shares of Parent Common Stock and any cash payable and any unpaid dividends or other distributions in respect of Parent

Common Stock pursuant to Section 4.2(c) upon due surrender of and deliverable pursuant to this Agreement in respect of the Shares to which such Certificate relates.

(h) *Affiliates*. Notwithstanding anything herein to the contrary, Certificates surrendered for exchange by any "affiliate" (as determined pursuant to Section 6.8) of the Company shall not be exchanged until Parent has received a written agreement from such Person as provided in Section 6.8 hereof.

4.3. *Dissenters' Rights*. In accordance with Section 1571 of the PBCL, no appraisal rights shall be available to holders of Shares in connection with the Merger.

4.4. *Adjustments to Prevent Dilution*. In the event that Parent changes the number of Shares or shares of Parent Common Stock or securities convertible or exchangeable into or exercisable for Shares or shares of Parent Common Stock issued and outstanding prior to the Effective Time as a result of a reclassification, stock split (including a reverse split), stock dividend or distribution, recapitalization, merger, subdivision, issuer tender or exchange offer, or other similar transaction, the Merger Consideration shall be equitably adjusted.

ARTICLE V

Representations and Warranties

5.1. *Representations and Warranties of the Company and Parent*. Except as set forth in the corresponding sections or subsections of the disclosure letter, dated the date hereof, delivered by the Company to Parent or by Parent to the Company (each a "Disclosure Letter", and the "Company Disclosure Letter" and the "Parent Disclosure Letter", respectively), as the case may be, the Company (except for subparagraphs (b) (ii), (b) (iii), (c) (ii), (c) (iii), (q) (ii), (r) (iii) and (u) (ii) below and references in subparagraphs (a) and (h) (i) below to documents made available by Parent to the Company) hereby represents and warrants to Parent, and Parent (except for subparagraphs (b) (i), (c) (i), (j), (q) (i), (r) (ii), (s), (t) and (u) (i) below and references in subparagraphs (a) and (h) (i) below to documents made available by the Company to Parent and the reference in subparagraph (h) (i) below to items to be included in the Company Disclosure Letter), hereby represents and warrants to the Company, that:

(a) *Organization, Good Standing and Qualification*. Each of it and its Subsidiaries is a corporation duly organized, validly existing and in good standing under the laws of its respective jurisdiction of organization and has all requisite corporate or similar power and authority to own and operate its properties and assets and to carry on its business as presently conducted and is qualified to do business and is in good standing as a foreign corporation in each jurisdiction where the ownership or operation of its properties or conduct of its business requires such qualification, except where the failure to be so qualified or in good standing, when taken together with all other such failures, is not reasonably likely to have a Material Adverse Effect (as defined below) on it. It has made available to Parent, in the case of the Company, and to the Company, in the case of Parent, a complete and correct copy of its and its Subsidiaries' certificates or articles of incorporation, as the case may be, and by-laws, each as amended to date. Such certificates or articles of incorporation, as the case may be, and by-laws as so made available are in full force and effect. Section 5.1 (a) of the Disclosure Letters contains a correct and complete list of each jurisdiction where the Company, in the case of the Company Disclosure Letter, and Parent, in the case of the Parent Disclosure Letter, and in each case, each of its Subsidiaries is organized and qualified to do business.

As used in this Agreement, the term (i) "Subsidiary" means, with respect to the Company, Parent or Merger Sub, as the case may be, any entity whether incorporated or unincorporated, in which the Company, Parent or Merger Sub, as the case may be, owns, directly or indirectly, at least a majority of the outstanding voting securities or other equity interests having the power to elect a majority of the directors, or otherwise direct the management and policies, of such entity and (ii) "Material Adverse Effect" means, with respect to any Person, a material adverse effect on the financial condition, properties, operations, business or results of operations of such Person and its Subsidiaries taken as a whole; provided, however, that any such effect resulting from any change in law, rule, or regulation promulgated

by (i) the United States Congress, (ii) the Securities and Exchange Commission (the "SEC") with respect to the Public Utility Holding Company Act of 1935, as amended (the "PUHCA"), (iii) the Pennsylvania State Legislature or the Pennsylvania Public Utilities Commission or (iv) the Federal Energy Regulatory Commission (the "FERC"), or any interpretation of any such law, rule or regulation, or the application of the Pennsylvania Restructuring Legislation (as defined in Section 6.18), which affects both the Company and its Subsidiaries, taken as a whole, and Parent and its Subsidiaries, taken as a whole, shall only be considered when determining if a Material Adverse Effect has occurred to the extent that such effect on one such party exceeds such effect on the other party.

(b) *Capital Structure.* (i) The authorized capital stock of the Company consists of 187,500,000 Shares, of which 79,318,011 Shares were outstanding as of the close of business on April 3, 1997, and 4,000,000 shares of Preferred Stock, without par value, of which no shares were outstanding as of the close of business on April 3, 1997 (the "Preferred Shares"). All of the outstanding Shares have been duly authorized and validly issued and are fully paid and nonassessable. The Company has no Shares or Preferred Shares reserved for issuance, except that, as of April 3, 1997, there were 1,584,285 Shares reserved for issuance pursuant to the Company's Long-Term Incentive Savings Plan, the Dividend Reinvestment and Stock Purchase Plan, the 1996 Stock Plan for Non-Employee Directors and the Performance Incentive Program for the Company and its Subsidiaries (the "Stock Plans"). The Company Disclosure Letter contains a correct and complete list of each outstanding option to purchase Shares under the Stock Plans (each a "Company Option"), including the holder, date of grant, exercise price and number of Shares subject thereto.

Each of the outstanding shares of capital stock or other securities of each of the Company's Subsidiaries is duly authorized, validly issued and is fully paid and nonassessable and owned by a direct or indirect wholly owned subsidiary of the Company, free and clear of any lien, pledge, security interest, claim or other encumbrance. Except as set forth above, there are no preemptive or other outstanding rights, options, warrants, conversion rights, stock appreciation rights, redemption rights, repurchase rights, agreements, arrangements or commitments which obligate the Company or any of its Subsidiaries to issue or sell any shares of capital stock or other securities of the Company or any of its Subsidiaries or any securities or obligations convertible or exchangeable into or exercisable for, or giving any Person a right to subscribe for or acquire from the Company or any of its Subsidiaries, any securities of the Company or any of its Subsidiaries, and no securities or obligations evidencing such rights are authorized, issued or outstanding. The Company does not have outstanding any bonds, debentures, notes or other obligations the holders of which have the right to vote (or are convertible into or exercisable for securities having the right to vote) with the stockholders of the Company on any matter ("Voting Debt").

(ii) The authorized stock of Parent consists of 260,000,000 shares of Parent Common Stock, of which 122,111,567 shares were outstanding as of the close of business on April 3, 1997. All of the outstanding shares of Parent Common Stock have been duly authorized and validly issued and are fully paid and nonassessable. Parent has no Parent Common Stock reserved for issuance, except that, as of April 3, 1997, there were 1,692,310 shares of Parent Common Stock reserved for issuance pursuant to the Allegheny Power Employee Stock Ownership and Savings Plan and the Allegheny Power System Performance Share Plan (the "Parent Stock Plans"). Each of the outstanding shares of capital stock of each of Parent's Subsidiaries is duly authorized and validly issued and is fully paid and nonassessable and owned by a direct or indirect wholly owned subsidiary of Parent, free and clear of any lien, pledge, security interest, claim or other encumbrance. Except as set forth above, there are no preemptive or other outstanding rights, options, warrants, conversion rights, stock appreciation rights, redemption rights, repurchase rights, agreements, arrangements or commitments which obligate Parent or any of its Subsidiaries to issue or to sell any shares of capital stock or other securities of Parent or any of its Subsidiaries or any securities or obligations convertible or exchangeable into or exercisable for, or giving any Person a right to subscribe for or acquire from Parent or any of its Subsidiaries, any securities of Parent or any of its Subsidiaries, and no securities or obligations evidencing such rights are authorized, issued or outstanding. Parent does not have outstanding any bonds, debentures, notes or other obligations

the holders of which have the right to vote (or are convertible into or exercisable for securities having the right to vote) with the stockholders of Parent on any matter ("*Parent Voting Debt*").

(iii) The authorized capital stock of Merger Sub shall consist of 1,000 shares of Common Stock, par value \$0.01 per share, all of which shall be validly issued and outstanding at the Effective Time. At the Effective Time, all of the issued and outstanding capital stock of Merger Sub will be owned by Parent and there shall be (i) no other voting securities of Merger Sub, (ii) no securities of Merger Sub convertible into or exchangeable for shares of capital stock or voting securities of Merger Sub and (iii) no options or other rights to acquire from Merger Sub, and no obligations of Merger Sub to issue, any capital stock, voting securities or securities convertible into or exchangeable for capital stock or voting securities of Merger Sub. At the Effective Time, Merger Sub shall not have conducted any business, and shall have no, assets, liabilities or obligations of any nature, other than those incident to its formation and pursuant to this Agreement and the Merger and the other transactions contemplated by this Agreement.

(c) *Corporate Authority; Approval and Fairness.* (i) The Company has all requisite corporate power and authority and has taken all corporate action necessary in order to execute, deliver and perform its obligations under this Agreement and the Stock Option Agreement and to consummate, subject only to approval of this Agreement by the holders of a majority of the votes cast by Shares entitled to a vote on approval of this Agreement (the "*Company Requisite Vote*"), the Merger. This Agreement and the Stock Option Agreement have been duly executed and delivered by the Company and, assuming the due authorization, execution and delivery hereof and thereof by the other signatories hereto and thereto, constitute valid and binding agreements of the Company enforceable against the Company in accordance with their terms, subject to bankruptcy, insolvency, fraudulent transfer, reorganization, moratorium and similar laws of general applicability relating to or affecting creditors' rights and to general equity principles (the "*Bankruptcy and Equity Exception*"). The board of directors of the Company (A) has approved this Agreement and the Stock Option Agreement and the Merger and the other transactions contemplated hereby and thereby and (B) has received the opinion of its financial advisor Credit Suisse First Boston Corporation to the effect that, as of the date of this Agreement, the Conversion Ratio is fair to the holders of Shares from a financial point of view.

(ii) Parent has all requisite corporate power and authority and each has taken all corporate action necessary in order to execute, deliver and perform its obligations under this Agreement and to consummate, subject only to any stockholder approval necessary to permit the issuance of Parent Common Stock required to be issued pursuant to Article IV (the "*Parent Requisite Vote*"), the Merger. This Agreement has been duly executed and delivered by Parent and, assuming the due authorization, execution and delivery hereof by the Company, constitutes a valid and binding agreement of Parent, enforceable against Parent in accordance with its terms, subject to the Bankruptcy and Equity Exception. At the Effective Time, Merger Sub shall have all requisite corporate authority and shall have taken all corporate action necessary in order to execute, deliver and perform its obligations under this Agreement and to consummate the Merger. At the Effective Time, this Agreement shall have been duly executed and delivered by Merger Sub and, assuming the due authorization, execution and delivery hereof by the Company, shall constitute a valid and binding agreement of Merger Sub, enforceable against Merger Sub in accordance with its terms, subject to the Bankruptcy and Equity Exception. The Parent Common Stock, when issued, will be validly issued, fully paid and nonassessable, and no stockholder of Parent will have any preemptive right of subscription or purchase in respect thereof. The Board of Directors of Parent (A) has approved this Agreement, the Merger and the transactions contemplated hereby and (B) has received the opinion of its financial advisors Merrill Lynch & Co. to the effect that the consideration to be paid by Parent to the holders of the Shares in the Merger is fair to Parent from a financial point of view.

(iii) Parent has all requisite corporate power and authority and has taken all corporate action necessary in order to execute, deliver and perform its obligations under the Stock Option Agreement. The Stock Option Agreement has been duly executed and delivered by Parent, and, assuming the due authorization, execution and delivery thereof by the Company, constitutes a valid and binding agreement of Parent, enforceable against Parent in accordance with its terms, subject to the Bankruptcy and Equity Exception.

(d) *Governmental Filings; No Violations.* (i) Other than the filings, notices and/or approvals (A) pursuant to Section 1.3, (B) under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "*HSR Act*"), the Securities Exchange Act of 1934, as amended (the "*Exchange Act*") and the Securities Act of 1933, as amended (the "*Securities Act*"), (C) to comply with state securities or "blue-sky" laws, (D) of the SEC pursuant to the PUHCA, the FERC pursuant to the Federal Power Act, as amended (the "*Power Act*") and the NRC pursuant to the Atomic Energy Act, as amended (the "*AEA*"), (E) of federal or state regulatory bodies pursuant to Environmental Laws (as defined in Section 5.1(k)), and (F) of the state public utility commissions or similar state regulatory bodies identified in the respective Disclosure Letter pursuant to applicable state laws regulating the electric utility business, no notices, reports or other filings are required to be made by it with, nor are any consents, registrations, approvals, permits or authorizations required to be obtained by it from, any governmental or regulatory authority, agency, commission, body or other governmental entity ("*Governmental Entity*"), in connection with the execution and delivery of this Agreement and the Stock Option Agreement by it and the consummation by it of the Merger and the other transactions contemplated hereby and thereby, except those that the failure to make or obtain are not, individually or in the aggregate, reasonably likely to have a Material Adverse Effect on it or prevent, materially delay or materially impair the ability of it to consummate the transactions contemplated by this Agreement and the Stock Option Agreement.

(ii) The execution, delivery and performance of this Agreement and the Stock Option Agreement by it does not, and the consummation by it of the Merger and the other transactions contemplated hereby and thereby will not, constitute or result in (A) a breach or violation of, or a default under, its certificate or articles of incorporation or by-laws or the comparable governing instruments of any of its Subsidiaries, (B) subject to the receipt of all required waivers and consents as described in Section 5.1(d)(i) or the last sentence of this subsection, a breach or violation of, or a default under, the acceleration of any obligations or the creation of a lien, pledge, security interest or other encumbrance on the assets of it or any of its Subsidiaries (with or without notice, lapse of time or both) pursuant to any agreement, lease, contract, note, mortgage, indenture, arrangement or other obligation ("*Contracts*") binding upon it or any of its Subsidiaries or any Law (as defined in Section 5.1(i)) or governmental or non-governmental permit or license to which it or any of its Subsidiaries is subject or (C) any change in the rights or obligations of any party under any of the Contracts, except, in the case of clause (B) or (C) above, for any breach, violation, default, acceleration, creation or change that, individually or in the aggregate, is not reasonably likely to have a Material Adverse Effect on it or prevent, materially delay or materially impair its ability to consummate the transactions contemplated by this Agreement and the Stock Option Agreement. The Company Disclosure Letter, with respect to the Company, and the Parent Disclosure Letter, with respect to the Parent, contains a correct and complete list of Contracts of the Company, in the case of the Company Disclosure Letter, and of Parent, in the case of the Parent Disclosure Letter, and its respective Subsidiaries pursuant to which consents or waivers are or may be required prior to consummation of the transactions contemplated by this Agreement and the Stock Option Agreement (whether or not subject to the exception set forth with respect to clauses (B) and (C) above).

(e) *Reports; Financial Statements.* The filings required to be made by it and its Subsidiaries since December 31, 1993 under the PUHCA, the Power Act, the AEA and state law, and under regulations applicable to public utilities, have been made with the relevant Governmental Entities, and each of it and its Subsidiaries has complied in all material respects with such laws and regulations, except for such failures as are not reasonably likely to have a Material Adverse Effect on it. It has delivered to the other party each registration statement, report, proxy statement or information statement prepared by it or its Subsidiaries and filed with the SEC since December 31, 1996 (the "*Audit Date*"), including its Annual Report on Form 10-K for the year ended December 31, 1996 in the form (including exhibits, annexes and any amendments thereto) filed with the SEC (collectively, including any such registration statement, report, proxy statement or information statement filed subsequent to the date hereof, the "*Reports*"). As of their respective dates, the Reports did not, and any Reports filed with the SEC subsequent to the date hereof will not, contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements made therein, in the light of the circumstances under which they were made, not misleading. Each of the consolidated balance sheets included in or

incorporated by reference into the Reports (including the related notes and schedules) fairly presents, or will fairly present, the consolidated financial position of it and its Subsidiaries as of its date and each of the consolidated statements of income and of changes in financial position included in or incorporated by reference into the Reports (including any related notes and schedules) fairly presents, or will fairly present, the results of operations, retained earnings and changes in financial position, as the case may be, of it and its Subsidiaries for the periods set forth therein (subject, in the case of unaudited statements, to notes and normal year-end audit adjustments that will not be material in amount or effect), in each case in accordance with generally accepted accounting principles ("GAAP") consistently applied during the periods involved, except as may be noted therein.

(f) *Absence of Certain Changes.* Except as disclosed in the Reports filed prior to the date hereof, or as expressly contemplated by this Agreement or as expressly contemplated by the DQE, Inc. 1997 Five Year Plan, a copy of which has been provided to, and accepted by, Parent (the "Company Budget") or the Allegheny Power Final Operating, Cash and Capital Budget for Year 1997 and Forecast Years 1998 through 2001, a copy of which has been provided to, and accepted by, the Company (the "Parent Budget" and, collectively with the Company Budget, the "Budgets"), since the Audit Date it and its Subsidiaries have conducted their respective businesses only in, and have not engaged in any material transaction other than according to, the ordinary and usual course of such businesses and there has not been (i) any change in the financial condition, properties, business or results of operations of it and its Subsidiaries or any development or combination of developments affecting it of which its management has knowledge that, individually or in the aggregate, is reasonably likely to have a Material Adverse Effect on it; (ii) any material damage, destruction or other casualty loss with respect to any material asset or property owned, leased or otherwise used by it or any of its Subsidiaries, whether or not covered by insurance; (iii) any declaration, setting aside or payment of any dividend or other distribution in respect of its capital stock, except for dividends or other distributions on its capital stock publicly announced prior to the date hereof and except as expressly provided for herein; or (iv) any change by it in accounting principles or material accounting practices or methods. Since the Audit Date, except as provided for herein or as disclosed in the Reports filed prior to the date hereof, there has not been any increase in the compensation payable or that could become payable by it or any of its Subsidiaries to officers or key employees or any amendment of any of the Compensation and Benefit Plans (as defined in Section 5.1(h)) other than increases or amendments in the ordinary course.

(g) *Litigation and Liabilities.* Except as disclosed in the Reports filed prior to the date hereof, there are no (i) civil, criminal or administrative actions, suits, claims, hearings, investigations or proceedings pending or, to the knowledge of its executive officers, threatened against it or any of its Affiliates or (ii) obligations or liabilities, whether or not accrued, contingent or otherwise and whether or not required to be disclosed, including those relating to matters involving any Environmental Law (as defined in Section 5.1(k)) or any other facts or circumstances of which its executive officers have knowledge that could result in any claims against, or obligations or liabilities of, it or any of its Affiliates, that, individually or in the aggregate, are reasonably likely to have a Material Adverse Effect on it or prevent or materially burden or materially impair the ability of it to consummate the transactions contemplated by this Agreement and the Stock Option Agreement.

(h) *Employee Benefits.*

(i) With the exception of documents as to which Parent is bound by a confidentiality agreement (which pertain to arrangements which are not, individually or in the aggregate, material), a copy of each bonus, deferred compensation, pension, retirement, profit-sharing, thrift, savings, employee stock ownership, stock bonus, stock purchase, restricted stock, stock option, employment, termination, severance, compensation, medical, health or other plan, agreement, policy or arrangement that covers employees, directors, former employees or former directors of Parent, the Company or their respective Subsidiaries (its "Compensation and Benefit Plans") and any trust agreement or insurance contract forming a part of such Compensation and Benefit Plans has been made available to the other party prior to the date hereof and each such Compensation and Benefit Plan is listed in Section 5.1(h) of the applicable Disclosure Letter. Any "change of control" or similar provisions in

the Compensation and Benefit Plans are specifically identified in Section 5.1(h) of the applicable Disclosure Letter.

(ii) All Compensation and Benefit Plans are in substantial compliance with all applicable law, including the Code and the Employee Retirement Income Security Act of 1974, as amended ("*ERISA*"). Each Compensation and Benefit Plan that is an "employee pension benefit plan", within the meaning of Section 3(2) of ERISA (a "*Pension Plan*") and that is intended to be qualified under Section 401(a) of the Code has received a favorable determination letter from the Internal Revenue Service (the "*IRS*") for "*TRA*" (as defined in Rev. Proc. 93-39), or the remedial amendment period for such Pension Plan has not yet expired, and it is not aware of any circumstances likely to result in revocation of any such favorable determination letter. There is no pending or, to the knowledge of its executive officers, threatened material litigation relating to the Compensation and Benefit Plans. Neither it nor any of its Subsidiaries has engaged in a transaction with respect to any Compensation and Benefit Plan that, assuming the taxable period of such transaction expired as of the date hereof, would be reasonably expected to subject it or any of its Subsidiaries to a material tax or penalty imposed by either Section 4975 of the Code or Section 502(i) of ERISA.

(iii) As of the date hereof, no liability under Subtitle C or D of Title IV of ERISA has been or is expected to be incurred by it or any of its Subsidiaries with respect to any ongoing, frozen or terminated "single-employer plan", within the meaning of Section 4001(a)(15) of ERISA, currently or formerly maintained by it or any of its Subsidiaries, or the single-employer plan (an "*ERISA Affiliate Plan*") of any entity which is treated as a single employer with it or any of its Subsidiaries under Section 414 of the Code (an "*ERISA Affiliate*"). It and its Subsidiaries have not incurred and do not expect to incur any withdrawal liability with respect to any "multiemployer plan", within the meaning of Section 4001(a)(3) of ERISA, under Subtitle E of Title IV of ERISA (including withdrawal liability as a result of actions of ERISA Affiliates). No notice of a "reportable event", within the meaning of Section 4043 of ERISA, for which the 30-day reporting requirement has not been waived, has been required to be filed for any Pension Plan or ERISA Affiliate Plan within the 12-month period ending on the date hereof or will be required to be filed in connection with the transaction contemplated by this Agreement and the Stock Option Agreement.

(iv) All contributions required to be made under the terms of any Compensation and Benefit Plan as of the date hereof have been timely made. Neither any Pension Plan nor any ERISA Affiliate Plan has an "accumulated funding deficiency" (whether or not waived) within the meaning of Section 412 of the Code or Section 302 of ERISA. Neither it nor its Subsidiaries has provided, or is required to provide, security to any Pension Plan or to any ERISA Affiliate Plan pursuant to Section 401(a)(29) of the Code.

(v) Under each Pension Plan which is a single-employer plan and ERISA Affiliate Plan, as of the last day of the most recent plan year ended prior to the date hereof for which an actuarial valuation has been completed, the actuarially determined present value of all "benefit liabilities", within the meaning of Section 4001(a)(16) of ERISA (as determined on the basis of the actuarial assumptions contained in the Pension Plan's or ERISA Affiliate Plan's most recent actuarial valuation), did not exceed the then current value of the assets of such Pension Plan or ERISA Affiliate Plan, and there has been no material change in the financial condition of such Pension Plan since the last day of such most recent plan year. The potential withdrawal liability of it and its Subsidiaries and ERISA Affiliates under each multiemployer plan to which each such entity contributes or had an obligation to contribute, determined as if a "complete withdrawal" (within the meaning of Section 4203 of ERISA) has occurred as of the date hereof, would not reasonably be expected to have a Material Adverse Effect on it.

(vi) Neither it nor its Subsidiaries have any obligations for retiree health and life benefits under any Compensation and Benefit Plan. It or its Subsidiaries may amend or terminate any such plan under the terms of such plan at any time without incurring any material liability thereunder.

(vii) The consummation of the Merger and the other transactions contemplated by this Agreement or the Stock Option Agreement would not, directly or indirectly (including as a result of any Compensation and Benefit Plans providing for severance as a result of termination of employment within a specified time period following a change in control of the Company) (x) entitle any employees of it or its Subsidiaries to severance pay, (y) accelerate the time of payment or vesting or trigger any payment of compensation or benefits under, increase the amount payable or trigger any other material obligation pursuant to, any of the Compensation or Benefit Plans or (z) result in any breach or violation of, or a default under, any of the Compensation and Benefit Plans.

(viii) All Compensation and Benefit Plans covering current or former non-U.S. employees or former employees of it and its Subsidiaries comply in all material respects with applicable local law. It and its Subsidiaries have no material unfunded liabilities, as determined under local funding requirements, with respect to any Pension Plan that covers such non-U.S. employees.

(i) *Compliance with Laws; Permits.* Except as set forth in the Reports filed prior to the date hereof, the businesses of each of it and its Subsidiaries have not been, and are not being, conducted in violation of any law, ordinance, regulation, judgment, order, decree, arbitration award, license or permit of any Governmental Entity (each a "Law" and collectively, "Laws"), except for violations or possible violations that, individually or in the aggregate, are not reasonably likely to have a Material Adverse Effect on it or prevent or materially burden or materially impair its ability to consummate the transactions contemplated by this Agreement and the Stock Option Agreement. Except as set forth in the Reports filed prior to the date hereof, no investigation or review by any Governmental Entity with respect to it or any of its Subsidiaries is pending or, to the knowledge of its executive officers, threatened, nor has any Governmental Entity indicated an intention to conduct the same, except for those the outcome of which are not, individually or in the aggregate, reasonably likely to have a Material Adverse Effect on it or prevent or materially burden or materially impair the ability of it to consummate the transactions contemplated by this Agreement and the Stock Option Agreement. To the knowledge of its executive officers, no material change is required in its or any of its Subsidiaries' processes, properties or procedures in connection with any such Laws, and it has not received any notice or communication of any material noncompliance with any such Laws that has not been cured as of the date hereof. Each of it and its Subsidiaries has all permits, licenses, trademarks, service marks, franchises, variances, exemptions, orders and other governmental authorizations, consents and approvals (collectively, "Permits") necessary to conduct its business as presently conducted except those the absence of which are not, individually or in the aggregate, reasonably likely to have a Material Adverse Effect on it or prevent or materially burden or materially impair its ability to consummate the Merger and the other transactions contemplated by this Agreement and the Stock Option Agreement.

(j) *Takeover Statutes.* The Board of Directors of the Company has taken or will take all appropriate and necessary action such that each of PBCL § 2551 et seq. and Article VII of the Company's charter will not have any effect on the Merger or the transactions contemplated by this Agreement or the Stock Option Agreement. No other "fair price," "moratorium," "control share acquisition" or other similar anti-takeover statute or regulation, including, without limitation, PBCL § 2541 et seq. (each, a "Takeover Statute") or any applicable anti-takeover provision in the Company's articles of incorporation and by-laws is, or at the Effective Time will be, applicable to the Company, the Shares, the Merger or the other transactions contemplated by this Agreement or the Stock Option Agreement.

(k) *Environmental Matters.* Except as disclosed in the Reports filed prior to the date hereof, and except for such matters that, individually or in the aggregate, are not reasonably likely to have a Material Adverse Effect on it: (i) it and its Subsidiaries have complied with all applicable Environmental Laws; (ii) the properties currently owned or operated by it (including soils, groundwater, surface water, buildings or other structures) are not contaminated with any Hazardous Material; (iii) the properties formerly owned or operated by it or any of its Subsidiaries were not contaminated with any Hazardous Material during the period of ownership or operation by it or any of its Subsidiaries; (iv) neither it nor its

Subsidiaries are subject to liability for any Hazardous Material disposal or contamination on any third party property: (v) neither it nor any Subsidiary has been associated with any release or threat of release of any Hazardous Material; (vi) neither it nor any Subsidiary has received any notice, demand, letter, claim or request for information alleging that it or any of its Subsidiaries may be in violation of or liable under any Environmental Law; (vii) neither it nor any of its Subsidiaries is subject to any orders, decrees, injunctions or other arrangements with any Governmental Entity or is subject to any indemnity or other agreement with any third party relating to liability under any Environmental Law or relating to any Hazardous Material; and (viii) there are no circumstances or conditions involving it or any of its Subsidiaries that could reasonably be expected to result in any claims, liability, investigations, costs or restrictions on the ownership, use, or transfer of any property of it pursuant to any Environmental Law.

As used herein, the term "*Environmental Law*" shall mean any local, state or federal statute, rule, regulation, order, consent decree, agreement with any Governmental Entity, common law standard of conduct, directive or ordinance pertaining to: (A) the protection of health, safety or the indoor or outdoor environment; (B) the use, development and control of land; (C) the conservation, management or use of natural resources and wildlife; (D) the protection or use of surface water and ground water; (E) the management, manufacture, possession, presence, use, generation, transportation, treatment, storage, disposal, release, threatened release, abatement, removal, remediation, or handling of, or exposure to, any Hazardous Material or waste (including, without limitation, ash, coal residues and radioactive wastes and contaminated materials); or (F) pollution (including any release or threat of release to air, land, surface water and ground water); and includes without limitation, the following federal statutes (and their implementing regulations and the analogous state statutes and regulations): the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended by the Superfund Amendments and Reauthorization Act of 1986, 42 U.S.C. § 9601 *et seq.*; the Solid Waste Disposal Act, as amended by the Resource Conservation and Recovery Act of 1976, as amended by the Hazardous and Solid Waste Amendments of 1984, 42 U.S.C. § 6901 *et seq.*; the Federal Water Pollution Control Act of 1972, as amended by the Clean Water Act of 1977, as amended, 33 U.S.C. § 1251 *et seq.*; the Toxic Substances Control Act of 1976, as amended, 15 U.S.C. § 2601 *et seq.*; the Emergency Planning and Community Right-to-Know Act of 1986, 42 U.S.C. § 11001 *et seq.*; the Clean Air Act of 1966, as amended by the Clean Air Act Amendments of 1990, 42 U.S.C. § 7401 *et seq.*; the Occupational Safety and Health Act of 1970, as amended, 29 U.S.C. § 651 *et seq.*; the Rivers and Harbors Act of 1899, as amended, 33 U.S.C. § 401 *et seq.*; the Endangered Species Act of 1973, as amended, 16 U.S.C. § 1531 *et seq.*; the Atomic Energy Act, as amended, 42 U.S.C. § 2014 *et seq.*; the Occupational Safety and Health Act of 1970, as amended, 29 U.S.C. § 651 *et seq.*; and the Safe Drinking Water Act of 1974, as amended, 42 U.S.C. § 300(f) *et seq.*

As used herein, the term "*Hazardous Material*" shall mean any substance, chemical, compound, product, solid, gas, liquid, waste, by-product, pollutant, contaminant, or material which is hazardous or toxic, and includes without limitation, asbestos or any substance containing asbestos, polychlorinated biphenyls, radioactive materials, petroleum (including crude oil or any fraction thereof), and any hazardous or toxic waste, material, or substance regulated under any Environmental Law.

(l) *Accounting and Tax Matters.* As of the date hereof, neither it nor any of its Affiliates has taken or agreed to take any action, nor do its executive officers have any knowledge of any fact or circumstance, that would prevent Parent from accounting for the business combination to be effected by the Merger as a "pooling-of-interests" or prevent the Merger and the other transactions contemplated by this Agreement from qualifying as a "reorganization" within the meaning of Section 368(a) of the Code.

(m) *Taxes.* Except for such matters that, individually or in the aggregate, will not have a Material Adverse Effect on it: (i) it and each of its Subsidiaries (as appropriate) (x) have prepared in good faith and duly and timely filed (taking into account any applicable extensions) all Tax Returns (as defined below) that they were required to file (whether separately or on a combined or consolidated basis) and all such Tax Returns are complete and accurate in all material respects; (y) have timely paid in full all Taxes (as defined below) they were or are required to pay and duly and timely withheld and paid over to the appropriate recipient all Taxes that they were or are obligated to withhold from amounts paid or

owing to any employee, creditor or third party; and (z) have not waived or agreed to waive any statute of limitations with respect to Taxes or agreed to any extension of time with respect to the assessment or collection of any Tax (unless such waiver or extension is not currently effective); (ii) no audits, examinations, investigations, assessments or proposed assessments of deficiencies, refund claims or other proceedings relating to the Taxes of it or any of its Subsidiaries are pending or, to the knowledge of any of its executive officers, threatened; (iii) there are not, to the knowledge of its executive officers, unresolved actual claims concerning its or any of its Subsidiaries' Tax liability; (iv) all Taxes due with respect to completed and settled examinations or concluded litigation relating to it or any of its Subsidiaries have been timely paid in full; (v) it has made available to the other party true, correct and complete copies of all United States federal income Tax Returns (including all consolidated Tax Returns) filed by it or any of its Subsidiaries with respect to the taxable periods ending on or after December 31, 1992, together with true, correct and complete copies of any audit or other examination reports and any notices or proposed notices of deficiency relating to such Tax Returns; (vi) neither it nor any of its Subsidiaries has any liability with respect to accrued but unpaid Taxes (whether or not assessed or shown as due on any Tax Return) in excess of the reserves therefor reflected in the financial statements included in the most recently filed Reports (as adjusted for any time elapsed since the date of such Reports in accordance with the past customary practice of it and its Subsidiaries); (vii) no liens or other security interests have been imposed on any of its assets or any assets of any of its Subsidiaries in connection with any failure (or alleged failure) to pay any Tax; (viii) neither it nor any of its Subsidiaries is a party to any Tax allocation or sharing agreement, is or has been a member of an affiliated group filing a consolidated or combined Tax Return (other than a group of which it or one of its Subsidiaries is or was the common parent) or otherwise has any liability for Taxes other than its Taxes or Taxes of one of its Subsidiaries; (ix) neither it nor any of its Subsidiaries has filed a consent under Section 341 (f) of the Code; or has made or is a party to any agreement under which it is or may become obligated to make any payments that will be nondeductible under Section 280G of the Code (assuming it cannot be established that any such payments are "reasonable compensation" within the meaning of Section 280G(B)(4) of the Code); (x) it and each of its Subsidiaries has complied (and until the Effective Time will comply) in all material respects with the provisions of the Code relating to the payment and withholding of Taxes, including without limitation the withholding and reporting requirements under Sections 1441 through 1464, 3401 through 3406, and 6041 and 6049 of the Code, as well as similar provisions under any other laws; (xi) the statute of limitations for the assessment of all Taxes has expired for all applicable Tax Returns of it and each of its Subsidiaries for taxable years ending on or before the date three years before the date of this Agreement; (xii) no power of attorney currently in force has been granted by it or any of its Subsidiaries concerning any Tax matter; (xiii) no property of it or any of its Subsidiaries is property that it or any such Subsidiary or any party to this transaction is or will be required to treat as being owned by another person pursuant to the provisions of Section 168(f)(8) of the Code (as in effect prior to its amendment by the Tax Reform Act of 1986) or is tax-exempt use property within the meaning of Section 168 of the Code; (xiv) neither it nor any of its Subsidiaries is required to include in income any adjustment pursuant to Section 481 (a) of the Code by reason of a voluntary change in accounting method initiated by it or any of its Subsidiaries, and to the best of the knowledge of its executive officers, the IRS has not proposed any such adjustment or change in accounting method; (xv) it and its Subsidiaries have or had substantial authority (within the meaning of Section 6661 of the Code for Tax Returns filed on or before December 31, 1990, and within the meaning of Section 6662 of the Code for Tax Returns filed after December 31, 1990) for all transactions that could give rise to an understatement of federal income tax (within the meaning of Section 6661 of the Code, for Tax Returns filed on or before December 31, 1990, and within the meaning of Section 6662 of the Code, for Tax Returns filed after December 31, 1990); (xvi) as of December 31, 1995, it and its Subsidiaries had net operating loss carryovers available to offset future income as disclosed in the relevant Disclosure Letter; (xvii) such Disclosure Letter discloses the amount of and year of expiration of each company's net operating loss carryovers; (xviii) it and each of its Subsidiaries had tax credit carryovers available to offset future tax liability as disclosed in the relevant Disclosure Letter; (xix) such Disclosure Letter discloses the amount and year of expiration of each company's tax credit carryovers; (xx) no election under Section 338 of the Code (or any predecessor provision) has been made by or with respect to it or any of its Subsidiaries or any of their respective assets

or properties; (xxi) no indebtedness of it or any of its Subsidiaries is "corporate acquisition indebtedness" within the meaning of Section 279(b) of the Code; and (xxii) neither it nor any of its Subsidiaries has engaged in any intercompany transactions within the meaning of Treasury Regulations § 1.1502-13 for which any income or gain will remain unrecognized as of the close of the last taxable year prior to the Effective Time.

As used in this Agreement, (i) the term "Tax" (including, with correlative meaning, the terms "Taxes" and "Taxable") includes all federal, state, local and foreign income, profits, franchise, gross receipts, environmental, customs duty, capital stock, severances, stamp, payroll, sales, employment, unemployment, disability, use, property, withholding, excise, production, value added, occupancy and other taxes, duties or assessments of any nature whatsoever, together with all interest, penalties and additions imposed with respect to such amounts and any interest in respect of such penalties and additions, and (ii) the term "Tax Return" includes all returns and reports (including elections, declarations, disclosures, schedules, estimates and information returns) required to be supplied to a Tax authority relating to Taxes.

(n) *Labor Matters.* Neither it nor any of its Subsidiaries is a party to or otherwise bound by any collective bargaining agreement, contract or other agreement or understanding with a labor union or labor organization, nor, as of the date hereof, is it or any of its Subsidiaries the subject of any material proceeding asserting that it or any of its Subsidiaries has committed an unfair labor practice or is seeking to compel it to bargain with any labor union or labor organization nor is there pending or, to the knowledge of its executive officers, threatened, nor has there been for the past five years, any labor strike, dispute, walkout, work stoppage, slow-down or lockout involving it or any of its Subsidiaries. It has previously made available to the other party correct and complete copies of all labor and collective bargaining agreements to which it or any of its Subsidiaries is party or by which any of them are otherwise bound.

(o) *Insurance.* All material fire and casualty, general liability, business interruption, product liability, and sprinkler and water damage insurance policies maintained by it or any of its Subsidiaries are with reputable insurance carriers, provide full and adequate coverage for all insurable risks incident to the business of it and its Subsidiaries and their respective properties and assets, and are in character and amount at least equivalent to that carried by persons engaged in similar businesses and subject to the same or similar perils or hazards, except for any such failures to maintain insurance policies that, individually or in the aggregate, are not reasonably likely to have a Material Adverse Effect on it. Neither it nor any of its Subsidiaries has received any notice of cancellation or termination with respect to any material insurance policy thereof. All material insurance policies of it and its Subsidiaries are valid and enforceable policies.

(p) *Intellectual Property.*

(i) It and/or each of its Subsidiaries owns, or is licensed or otherwise possesses sufficient legally enforceable rights to use, all patents, trademarks, trade names, service marks, copyrights, and any applications therefor, technology, know-how, computer software programs or applications, and tangible or intangible proprietary information or materials that are currently used (or, with respect to trademarks, tradenames and service marks, have been used within the last five years) in its and its Subsidiaries' business, except for any such failures to own, be licensed or possess that, individually or in the aggregate, are not reasonably likely to have a Material Adverse Effect on it.

(ii) Except as disclosed in the Reports filed prior to the date hereof or as is not reasonably likely to have a Material Adverse Effect on it:

(A) It is not, nor will it be as a result of the execution and delivery of this Agreement or the performance of its obligations hereunder, in violation of any licenses, sublicenses and other agreements as to which it is a party and pursuant to which it is authorized to use any third-party patents, trademarks, service marks, copyrights, trade names, technology, know-how, proprietary

information and computer software programs and applications ("*Third-Party Intellectual Property Rights*");

(B) no claims with respect to the patents, registered and material unregistered trademarks and service marks, registered copyrights, trade names and any applications therefor, technology, know-how, proprietary information and computer software programs and applications owned or used by it or any its Subsidiaries (the "*Intellectual Property Rights*"), any trade secret material to it or its Subsidiaries, or Third Party Intellectual Property Rights to the extent arising out of any use, reproduction or distribution of such Third Party Intellectual Property Rights by or through it or any of its Subsidiaries, are currently pending or, to the knowledge of its executive officers, are threatened by any Person;

(C) it does not know of any valid grounds for any bona fide claims (i) to the effect that the manufacture, sale, licensing or use of any product or service as now used, sold or licensed or proposed for use, sale or license by it or any of its Subsidiaries infringes on any copyright, patent, trademark, service mark, or trade secret; (ii) against the use or license for use by it or any of its Subsidiaries, of any trademarks, trade names, trade secrets, copyrights, patents, technology, know-how, proprietary information or computer software programs and applications used in the business of it or any of its Subsidiaries as currently conducted or as proposed to be conducted; (iii) challenging the ownership, validity or effectiveness of any of its Intellectual Property Rights or other trade secret material to it; or (iv) challenging the license or legally enforceable right to the use of the Third Party Intellectual Rights by it or any of its Subsidiaries;

(D) to the knowledge of its executive officers, none of the Intellectual Property Rights has been legally declared invalid and all patents, registered trademarks and service marks, and copyrights held by it are valid, enforceable and subsisting; and

(E) to the knowledge of its executive officers, there is no material unauthorized use, infringement or misappropriation of any of its Intellectual Property Rights by any third party, including any employee or former employee of it or any of its Subsidiaries, and no third party has applied to register any intellectual property which may infringe upon its Intellectual Property Rights.

(q) *Brokers and Finders.* Neither it nor any of its officers, directors or employees has employed any broker or finder or incurred any liability for any brokerage fees, commissions or finders' fees in connection with the Merger or the other transactions contemplated in this Agreement or the Stock Option Agreement except that (i) the Company has retained Credit Suisse First Boston Corporation as its financial advisor, the arrangements with which have been disclosed in writing to Parent prior to the date hereof and (ii) Parent has employed Merrill Lynch & Co. as its financial advisory, the arrangements with which have been disclosed in writing to the Company prior to the date hereof.

(r) *Regulation as a Utility.*

(i) Neither it nor any "subsidiary company" or "affiliate" of it (such terms having the meaning ascribed to such terms in the PUHCA) is subject to regulation as a public utility or public service company (or similar designation) by any state in the United States or any foreign country. Section 5.1(r) of its Disclosure Letter sets forth each "affiliate" and each "subsidiary company" of it which may be deemed to be a "public utility company" or a "holding company" within the meaning of the PUHCA.

(ii) The Company is an exempt holding company under Section 3(a)(1) of the PUHCA.

(iii) Parent is a registered holding company under the PUHCA.

(s) *Operations of Nuclear Power Plants.* The operations of Beaver Valley Power Station Unit 1, Beaver Valley Power Station Unit 2, and Perry Nuclear Power Plant Unit 1 (each, a "*Nuclear Facility*" and, collectively, the "*Nuclear Facilities*") owned by Duquesne Light Company (together with The Cleveland Electric Illuminating Company, Ohio Edison Company, Pennsylvania Power Company and

The Toledo Edison Company) are and have at all times been conducted in compliance with applicable health, safety, regulatory and other legal requirements, except for such failures to comply as are not, individually or in the aggregate, reasonably likely to have a Material Adverse Effect on the Company. To the knowledge of the Company, the Nuclear Facilities each maintain (i) emergency plans designed to respond to an unplanned release therefrom of radioactive materials into the environment and (ii) insurance coverages consistent with industry practice, all of which coverages are listed in Section 5.1(s) of the Company Disclosure Letter. To the knowledge of the Company, plans for the decommissioning of each of the Nuclear Facilities and for the short-term storage of spent nuclear fuel conform with the requirements of applicable law, and such plans have at all times been funded consistently with reasonable projections for such plans.

(t) *Affiliates of the Company.* Section 5.1(t) of the Company Disclosure Letter sets forth the name and every line of business conducted by each "affiliate" of the Company as that term is defined in Section 2(a)(11) of the PUHCA.

(u) *Ownership of Other Party's Common Stock.* (i) The Company does not "beneficially own" (as such term is defined in Rule 13d-3 under the Exchange Act) any shares of Parent Common Stock.

(ii) Parent does not "beneficially own" (as such term is defined in Rule 13d-3 under the Exchange Act) any Shares.

ARTICLE VI

Covenants

6.1. *Interim Operations.* The Company and Parent each covenants and agrees as to itself and its Subsidiaries that, after the date hereof and until the Effective Time (unless Parent or the Company, as the case may be, shall otherwise approve in writing and except as otherwise expressly contemplated by this Agreement, the respective Disclosure Letter, the Stock Option Agreement, the Company Budget or the Parent Budget, or as required by applicable Law):

(a) the business of it and its Subsidiaries shall be conducted in the ordinary and usual course and, to the extent consistent therewith, it and each of its Subsidiaries shall use its best efforts to preserve its business organization intact and maintain its existing relations and goodwill with customers, suppliers, creditors, regulators, lessors, employees and business associates;

(b) it shall not (i) issue, sell, pledge, dispose of or encumber any capital stock owned by it in any of its Subsidiaries; (ii) amend its articles of incorporation, charter or by-laws; (iii) split, combine or reclassify its outstanding shares of capital stock; (iv) declare, set aside or pay any dividend payable in cash, stock or property in respect of any capital stock other than dividends from its direct or indirect wholly owned Subsidiaries and other than (A) in the case of the Company, regular quarterly cash dividends not in excess of \$0.34 per Share (which amount may, at the election of the Company, be increased by not more than 6.5% per year, beginning in the 1997 fiscal year of the Company) and regular quarterly cash dividends on the preferred and preference stock of its Subsidiaries and (B) in the case of Parent, regular quarterly cash dividends not in excess of \$0.43 per share of Parent Common Stock (which amount may, at the election of Parent, be increased by not more than 6.5% per year, beginning in the 1997 fiscal year of Parent) and regular quarterly cash dividends on the preferred shares of subsidiaries of Parent; or (v) repurchase, redeem or otherwise acquire (except for (A) mandatory sinking fund obligations existing on the date hereof and (B) redemptions, purchases, acquisitions or issuances required by the respective terms of any Stock Plans, in the case of the Company, or Parent Stock Plans, in the case of Parent, or any dividend reinvestment plans as in effect on the date hereof in the ordinary course of the operation of such plans) or permit any of its Subsidiaries to purchase or otherwise acquire, any shares of its capital stock or any securities convertible into or exchangeable or exercisable for any shares of its capital stock;

(c) neither it nor any of its Subsidiaries shall (i) issue, sell, pledge, dispose of or encumber any shares of, or securities convertible into or exchangeable or exercisable for, or options, warrants, calls, commitments or rights of any kind to acquire, any shares of its capital stock of any class or any other property or assets (other than (x) in the case of the Company, Shares issuable pursuant to options outstanding on the date hereof under the Stock Plans or upon conversion of the Preferred Shares and additional options or rights to acquire Shares required by the terms of any Stock Plan as in effect on the date hereof in the ordinary course of the operation of such Stock Plan, (y) in the case of the Parent, shares of Parent Common Stock issuable pursuant to options outstanding under the Parent Stock Plans and additional options or rights to acquire Parent Shares required by the terms of any Parent Stock Plan as in effect on the date hereof in the ordinary course of the operation of such Parent Stock Plan, and (z) issuances of securities in connection with grants or awards of stock-based compensation made in accordance with Section 6.1(d) hereof); (ii) other than in the ordinary and usual course of business, and except for long-term indebtedness incurred in connection with the refinancing of existing indebtedness either at its maturity or at a lower cost of funds, transfer, lease, license, guarantee, sell, mortgage, pledge, dispose of or encumber any other property or assets (including capital stock of any of its Subsidiaries) or incur or modify any material indebtedness or other liability; (iii) make any commitments for, make or authorize any capital expenditures other than (x) capital expenditures not in excess of \$25,000,000 in the aggregate incurred in connection with the repair or replacement of facilities destroyed or damaged due to casualty or accident (whether or not covered by insurance), (y) as required by Law, or (z) in amounts less than \$5,000,000 individually and \$15,000,000 in the aggregate; *provided, however*, that if either party proposes to make any capital expenditure which requires the written consent of the other party pursuant to this Section 6.1, such other party shall not unreasonably withhold such consent; or (iv) make any acquisition of, or investment in, assets or stock of any other Person or entity in excess of \$15,000,000 in the aggregate;

(d) neither it nor any of its Subsidiaries shall terminate, establish, adopt, enter into, make any new grants or awards of stock-based compensation or other benefits under, amend or otherwise modify any Compensation and Benefit Plans or increase the salary, wage, bonus or other compensation of any directors, officers or employees except (i) for grants or awards to directors, officers and employees of it or its Subsidiaries under existing Compensation and Benefit Plans in such amounts and on such terms as are consistent with past practice, (ii) in the normal and usual course of business (which shall include normal periodic performance reviews and related compensation and benefit increases, annual reestablishment of Compensation and Benefit Plans and the provision of individual Compensation and Benefit Plans consistent with past practice for newly hired or appointed officers and employees and the adoption of Compensation and Benefit Plans for employees of new Subsidiaries in amounts and on terms consistent with past practice) or (iii) for actions necessary to satisfy existing contractual obligations under Compensation and Benefit Plans existing as of the date hereof;

(e) each of the Company and Parent shall consult with the other prior to settling or compromising, or permitting any of its Subsidiaries to settle or compromise, any material claim or litigation, and neither it nor any of its Subsidiaries shall, except in the ordinary and usual course of business, modify, amend or terminate any of its material Contracts or waive, release or assign any material rights or claims;

(f) neither it nor any of its Subsidiaries shall make any Tax election or permit any insurance policy naming it as a beneficiary or loss-payable payee to be cancelled or terminated except in the ordinary and usual course of business;

(g) neither it nor any of its Subsidiaries shall take any action or omit to take any action that would prevent the Merger from qualifying for "pooling of interests" accounting treatment or as a "reorganization" within the meaning of Section 368(a) of the Code or that would cause any of its representations and warranties herein to become untrue in any material respect; and

(h) neither it nor any of its Subsidiaries will authorize or enter into an agreement to do any of the foregoing.

6.2. *Acquisition Proposals.* (a) Except as contemplated by the Company Budget or the Parent Budget and except as expressly contemplated by this Agreement, neither the Company nor Parent shall, nor shall it permit any of its Subsidiaries to, nor shall it authorize or permit any of its officers, directors or employees or any investment banker, financial advisor, attorney, accountant, agent or other representative retained by it or any of its Subsidiaries to, directly or indirectly through another person, (i) solicit, initiate or encourage (including by way of furnishing information), or take any other action designed to facilitate, directly or indirectly, any inquiries or the making of any proposal with respect to a merger, reorganization, share exchange, consolidation or similar transaction involving, or, other than in the ordinary course of business, any purchase of all or any significant portion of assets or any equity securities, of the Company or Parent, as applicable, or any of its Subsidiaries (any such proposal or offer being hereinafter referred to as an "Acquisition Proposal" and any such transaction or purchase being hereinafter referred to as an "Acquisition Transaction") or (ii) participate in any discussions or negotiations relating to any Acquisition Proposal or Acquisition Transaction; *provided, however*, that if, at any time prior to the obtaining of the Parent Requisite Vote, in the case of Parent, or the Company Requisite Vote, in the case of the Company, the board of directors of the Company or Parent, as applicable, determines in good faith, based on the advice of outside counsel, that it is necessary to do so to avoid a breach of its duties under state corporate Law applicable to the conduct of directors, the Company or Parent, as applicable, may, in response to an Acquisition Proposal which was not solicited by it or which did not otherwise result from a breach of this Section 6.2(a), and subject to such party's compliance with Section 6.2(c), (A) furnish information with respect to it and its Subsidiaries to any person pursuant to a customary confidentiality agreement (as determined by the party receiving such Acquisition Proposal after consultation with its outside counsel), the benefits of the terms of which, if more favorable to the other party to such confidentiality agreement than those in place with the other party hereto, shall be extended to the other party hereto, and (B) participate in negotiations regarding such Acquisition Proposal.

(b) Except as expressly permitted by this Section 6.2, neither the board of directors of the Company or Parent, as applicable, nor any committee thereof shall (i) withdraw or modify, or propose publicly to withdraw or modify, in a manner adverse to the other party hereto, the approval or recommendation by such board of directors or such committee of the Merger or the adoption and approval of the matters to be considered at the Stockholders Meeting (as defined in Section 6.4), in the case of the Company, and the Parent Stockholders Meeting (as defined in Section 6.4), in the case of Parent, (ii) approve or recommend, or propose publicly to approve or recommend, any Acquisition Proposal other than the Merger, or (iii) cause or permit the Company or Parent, as applicable, to enter into any letter of intent, agreement in principle, acquisition agreement or other similar agreement or understanding (each, an "Acquisition Agreement") related to any Acquisition Proposal. Notwithstanding the foregoing, in the event that prior to the obtaining of the Company Requisite Vote, in the case of the Company, or the Parent Requisite Vote, in the case of Parent, there exists a Superior Proposal (as defined below) and the board of directors of the Company or Parent, as applicable, determines that there is not a substantial probability that the Company Requisite Vote or the Parent Requisite Vote, as applicable, will be obtained due to the existence of such Superior Proposal, the board of directors of the Company or Parent, as applicable, may, subject to this and the following sentences, withdraw or modify its approval or recommendation of the Merger or the approval of the matters to be considered at the Stockholders Meeting, in the case of the Company, and the Parent Stockholders Meeting, in the case of Parent, the board of directors of the Company or Parent, as applicable, may (subject to this and the following sentences of this Section 6.2(b)) approve or recommend such Superior Proposal or terminate this Agreement (and, subject to Article VIII hereof, concurrently with such termination, if it so chooses, cause the Company or Parent, as applicable, to enter into an Acquisition Agreement with respect to such Superior Proposal), but only if (i) the party seeking to terminate is not in material breach of any of the terms of this Agreement, (ii) the board of directors of the party seeking to terminate authorizes the Company or Parent, as applicable, to enter into a binding written Acquisition Agreement concerning an Acquisition Transaction that constitutes a Superior Proposal and the party seeking to terminate notifies the other party in writing that it intends to enter into such an Acquisition Agreement, attaching such Acquisition Agreement to such notice and specifying any material terms and conditions not included in the Acquisition Agreement and further identifying the party making the Superior Proposal, (iii) the other party does not make, within fifteen business days of receipt of written

notification from the party seeking to terminate of such party's intention to enter into a binding Acquisition Agreement for a Superior Proposal, an offer that the board of directors of such party believes, in good faith after consultation with its financial advisors, is at least as favorable, from a financial point of view, to its stockholders as the Superior Proposal, and (iv) the party seeking to terminate prior to such termination pays to the other party in immediately available funds any fees required to be paid pursuant to Section 8.5. The Company and Parent each agrees (i) that it will not enter into a binding Acquisition Agreement referred to in clause (ii) above until at least the sixteenth business day after it has provided the notice to Parent or the Company, as applicable, required thereby and (ii) to notify Parent or the Company, promptly, if its intention to enter into the written Acquisition Agreement referred to in its notification shall change at any time after giving such notification. For purposes of this Agreement, a "Superior Proposal" means in respect of the Company or Parent, as applicable, any proposal made by a third party to acquire, directly or indirectly, for consideration consisting of cash and/or securities, more than 50% of the equity securities of the Company or Parent, as the case may be, entitled to vote generally in the election of directors or all or substantially all the assets of the Company or Parent, as the case may be, and otherwise on terms which the board of directors of such party determines in its good faith judgment (x) (based on the written opinion of a financial advisor of nationally recognized reputation (which opinion shall be provided to the other party hereto)) to be more favorable from a financial point of view to its stockholders after consideration of the Merger and the transactions contemplated hereby and for which financing, to the extent required, is then committed, (y) to be more favorable to such party after consideration of the Merger and the transactions contemplated hereby after taking into account any additional constituencies (including stockholders) and other pertinent factors permitted under the laws of the Commonwealth of Pennsylvania or the laws of the State of Maryland, as applicable, and (z) to constitute a transaction that is reasonably likely to be consummated on the terms set forth, taking into account all legal, financial, regulatory and other aspects of the proposal.

(c) In addition to the obligations of the parties set forth in paragraphs (a) and (b) of this Section 6.2, any party that has received an Acquisition Proposal shall immediately advise the other party hereto orally and in writing of such Acquisition Proposal, any request for information, the material terms and conditions of such request or Acquisition Proposal and the identity of the Person making such request or Acquisition Proposal. Any party that has received an Acquisition Proposal will keep the other party hereto reasonably informed of the status and details (including amendments or proposed amendments) of any such Acquisition Proposal.

(d) Nothing contained herein shall prohibit a party from taking and disclosing to its stockholders a position contemplated by Rule 14e-2(a) under the Exchange Act with respect to an Acquisition Proposal by means of a tender or exchange offer.

6.3. *Information Supplied.* The Company and Parent each agrees, as to itself and its Subsidiaries, that none of the information supplied or to be supplied by it or its Subsidiaries for inclusion or incorporation by reference in (i) the Registration Statement on Form S-4 to be filed with the SEC by Parent in connection with the issuance of shares of Parent Common Stock in the Merger (including the joint proxy statement and prospectus (the "Prospectus/Proxy Statement") constituting a part thereof) (the "S-4 Registration Statement") will, at the time the S-4 Registration Statement becomes effective under the Securities Act, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading, and (ii) the Prospectus/Proxy Statement and any amendment or supplement thereto will, at the date of mailing to stockholders and at the times of the Stockholders Meeting and the Parent Stockholders Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading.

6.4. *Stockholders Meetings.* The Company will take, in accordance with applicable law and its articles of incorporation and by-laws, all action necessary to convene a meeting of holders of Shares (the "Stockholders Meeting") as promptly as practicable after the S-4 Registration Statement is declared effective to consider and vote upon the approval of this Agreement. Parent will take, in accordance with applicable law and its charter and by-laws, all action necessary to convene a meeting of holders of Parent Common Stock (the "Parent Stockholders Meeting") as promptly as practicable after the S-4 Registration Statement is

declared effective to consider and vote upon the approval of the issuance of Parent Common Stock in the Merger. Subject to obligations under applicable Law, each of the Company's and Parent's board of directors shall recommend such approval and shall take all lawful action to solicit such approval. Notwithstanding the foregoing, Parent may delay the Parent Stockholders Meeting and the Company may delay the Stockholders Meeting by action of its respective Board of Directors after written notice of such delay to the other party if such Board of Directors shall determine that a Person has made a Superior Proposal and there is not a reasonable probability that the Company Requisite Vote, in the case of the Company, or the Parent Requisite Vote, in the case of Parent, will be obtained without such delay; *provided*, that such Stockholders Meeting or Parent Stockholders Meeting, as the case may be, shall be held at the earliest time at which there is a reasonable probability of obtaining the Company Requisite Vote or Parent Requisite Vote, as the case may be. If a party determines to delay its stockholders meeting pursuant to the prior sentence the other party may (but need not) delay its stockholders meeting.

6.5. *Filings; Other Actions; Notification.* (a) The Company and Parent shall promptly prepare and file with the SEC the Prospectus/Proxy Statement, and Parent shall prepare and file with the SEC the S-4 Registration Statement as promptly as practicable. The Company and Parent each shall use its reasonable efforts to have the S-4 Registration Statement declared effective under the Securities Act as promptly as practicable after such filing, and, unless the Parent Stockholders Meeting or Stockholders Meeting has been delayed pursuant to Section 6.4, promptly thereafter mail the Prospectus/Proxy Statement to the respective stockholders of each of the Company and Parent. If the mailing is delayed it shall be completed as promptly as is practicable after the parties have determined to hold their respective stockholders meetings. Parent shall also use its best efforts to obtain prior to the effective date of the S-4 Registration Statement all necessary state securities law or "blue sky" permits and approvals required in connection with the Merger and to consummate the other transactions contemplated by this Agreement and the Stock Option Agreement.

(b) The Company and Parent each shall use its best reasonable efforts to cause to be delivered to the other party and its directors a letter of its independent auditors, dated (i) the date on which the S-4 Registration Statement shall become effective and (ii) the Closing Date, and addressed to the other party and its directors, in form and substance customary for "comfort" letters delivered by independent public accountants in connection with registration statements similar to the S-4 Registration Statement.

(c) The Company and Parent shall cooperate with each other and use (and shall cause their respective Subsidiaries to use) all commercially reasonable efforts (i) to take or cause to be taken all actions, and do or cause to be done all things, necessary, proper or advisable under this Agreement, the Stock Option Agreement and applicable Laws to consummate and make effective the Merger and the other transactions contemplated by this Agreement and the Stock Option Agreement as soon as practicable (including using their respective best efforts to prepare and file as promptly as practicable all documentation to effect all necessary applications, notices, petitions, filings and other documents) and (ii) to obtain as promptly as practicable all permits, consents, approvals and authorizations (including, without limitation, the expiration or earlier termination of any applicable waiting period under the HSR Act) necessary or advisable to be obtained from any third party and/or any Governmental Entity in order to consummate the Merger or any of the other transactions contemplated by this Agreement and the Stock Option Agreement. Subject to applicable Laws relating to the exchange of information, Parent shall have the right to review and approve in advance all characterizations of the information relating to Parent and its Subsidiaries, and the Company shall have the right to review and approve in advance all characterizations of the information relating to the Company and its Subsidiaries, and each will consult with the other to the extent practicable with respect to all such information, in each case that appears in any filing made with, or written materials submitted to, any third party and/or any Governmental Entity in connection with the Merger and the other transactions contemplated by this Agreement and the Stock Option Agreement. In exercising the foregoing right, each of the Company and Parent shall act reasonably and as promptly as practicable.

(d) The Company and Parent each shall, upon request by the other, furnish the other with all information concerning itself, its Subsidiaries, directors, officers and stockholders and such other matters as may be reasonably necessary or advisable in connection with the Prospectus/Proxy Statement, the S-4 Registration Statement or any other statement, filing, notice or application made by or on behalf of Parent, the

Company or any of their respective Subsidiaries to any third party and/or any Governmental Entity in connection with the Merger and the transactions contemplated by this Agreement and the Stock Option Agreement.

(e) The Company and Parent each shall keep the other apprised of the status of matters relating to completion of the transactions contemplated hereby, including promptly furnishing the other with copies of notice or other communications received by Parent or the Company, as the case may be, or any of its Subsidiaries, from any third party and/or any Governmental Entity with respect to the Merger and the other transactions contemplated by this Agreement and the Stock Option Agreement. The Company and Parent each shall give prompt notice to the other of any change that is reasonably likely to result in a Material Adverse Effect on it.

6.6. *Taxation and Accounting.* Subject to Section 6.2, neither Parent nor the Company shall take or cause to be taken any action, whether before or after the Effective Time, that would disqualify the Merger as a "pooling of interests" for accounting purposes or as a "reorganization" within the meaning of Section 368(a) of the Code.

6.7. *Access.* Upon reasonable notice, and except as may otherwise be required by applicable Law, the Company and Parent each shall (and shall cause its Subsidiaries to) afford the other's officers, employees, counsel, accountants and other authorized representatives ("*Representatives*") access, during normal business hours throughout the period prior to the Effective Time, to its properties, books, contracts and records and, during such period, each shall (and shall cause its Subsidiaries to) furnish promptly to the other all information concerning its business, properties and personnel as may reasonably be requested, *provided* that no investigation pursuant to this Section shall affect or be deemed to modify any representation or warranty made by the Company, Parent or Merger Sub, and *provided, further*, that the foregoing shall not require the Company or Parent to permit any inspection, or to disclose any information, that in the reasonable judgment of the Company or Parent, as the case may be, would result in the disclosure of any trade secrets of third parties or violate any of its obligations with respect to confidentiality to third parties if the Company or Parent, as the case may be, shall have used reasonable efforts to obtain the consent of such third party to such inspection or disclosure. All requests for information made pursuant to this Section shall be directed to an executive officer of the Company or Parent, as the case may be, or such Person as may be designated by it. All such information shall be governed by the terms of the Confidentiality Agreement, including without limitation all such information disclosed in the Disclosure Letters, and the Company and Parent, and each of their respective Subsidiaries, shall use their respective best reasonable efforts to maintain the confidentiality of all such information disclosed in the Disclosure Letters.

6.8. *Affiliates.* (a) Parent shall deliver to the Company a list of names and addresses of those Persons who are, in the opinion of the Parent, as of the time of the Stockholders Meeting, "affiliates" of the Company within the meaning of Rule 145 under the Securities Act and for the purposes of applicable interpretations regarding the pooling-of-interests method of accounting. The Company shall provide to Parent such information and documents as Parent shall reasonably request for purposes of preparing such list. There shall be added to such list the names and addresses of any other Person subsequently identified as a Person who may be deemed to be such an affiliate of the Company; *provided, however*, that no such Person identified by Parent shall be added to the list of affiliates of the Company if Parent shall receive from the Company, on or before the date of the Stockholders Meeting, an opinion of counsel reasonably satisfactory to Parent to the effect that such Person is not an affiliate. The Company shall exercise its best efforts to deliver or cause to be delivered to Parent, prior to the date of the Stockholders Meeting, from each affiliate of the Company identified in the foregoing list (as the same may be supplemented as aforesaid), a letter dated as of the Closing Date substantially in the form attached as Exhibit A-1 (the "*Affiliates Letter*"). Parent shall not be required to maintain the effectiveness of the S-4 Registration Statement or any other registration statement under the Securities Act for the purposes of resale of Parent Common Stock by such affiliates received in the Merger and the certificates representing Parent Common Stock received by such affiliates shall bear a customary legend regarding applicable Securities Act restrictions and the provisions of this Section.

(b) Prior to the date of the Stockholders Meeting, Parent shall deliver to the Company a list of names and addresses of those Persons who were, in the opinion of the Parent, at the time of the Stockholders Meeting, "affiliates" of Parent for the purposes of applicable interpretations regarding the "pooling-of-interests" method of accounting. Parent shall provide to the Company such information and documents as the Company shall reasonably request for purposes of reviewing such list. There shall be added to such list the names and addresses of any other Person the Company reasonably identifies (by written notice to Parent within ten business days after the Company's receipt of such list) as being a Person who may be deemed to be such an affiliate of Parent; *provided, however*, that no such Person identified by the Company shall be added to the list of affiliates of Parent if the Company shall receive from Parent, on or before the date of the Stockholders Meeting, an opinion of counsel reasonably satisfactory to the Company to the effect that such Person is not an affiliate. Parent shall exercise its best efforts to deliver or cause to be delivered to the Company, prior to the date of the Stockholders Meeting, from each of such affiliates of Parent identified in the foregoing list (as the same may be supplemented as aforesaid), a letter dated as of the Closing Date substantially in the form attached as Exhibit A-2 (the "*Pooling Affiliates Letter*").

(c) If the Merger would otherwise qualify for "pooling-of-interests" accounting treatment, shares of Parent Common Stock issued to affiliates of the Company in exchange for Shares shall not be transferable until such time as financial results covering at least 30 days of combined operations of Parent and the Company have been published within the meaning of Section 201.01 of the SEC's Codification of Financial Reporting Policies, regardless of whether each such affiliate has provided the written agreement referred to in this Section 6.8, except to the extent permitted by, and in accordance with, SEC Accounting Series Release 135 and SEC Staff Accounting Bulletins 65 and 76. Any shares held by any such affiliate shall not be transferable, regardless of whether such affiliate has provided the applicable written agreement referred to in this Section 6.8, if such transfer, either individually or in the aggregate with other transfers by affiliates, would preclude Parent's ability to account for the business combination to be effected by the Merger as a "pooling of interests". The Company shall not register the transfer of any Certificate, unless such transfer is made in compliance with the foregoing.

6.9. *Stock Exchange Listing and De-listing.* Parent shall use its best efforts to cause the shares of Parent Common Stock to be issued in the Merger to be approved for listing on the New York Stock Exchange, Inc. (the "*NYSE*") subject to official notice of issuance, prior to the Closing Date. The Company shall use its best efforts to cause the Shares to be (i) de-listed from the NYSE, the Philadelphia Stock Exchange and the Chicago Stock Exchange and (ii) de-registered under the Exchange Act as soon as practicable following the Effective Time.

6.10. *Publicity.* The initial press release concerning this Agreement and the transactions contemplated by this Agreement shall be a joint press release and thereafter the Company and Parent shall consult with each other prior to issuing any press releases or otherwise making public announcements with respect to the Merger and the other transactions contemplated by this Agreement and the Stock Option Agreement and prior to making any filings with any third party and/or any Governmental Entity (including any national securities exchange with respect thereto, except as may be required by law or by obligations pursuant to any listing agreement with or rules of any national securities exchange).

6.11. *Benefits.*

(a) *Stock Options.*

(i) At the Effective Time, each Company Option, whether vested or unvested, shall be deemed to constitute an option to acquire, on the same terms and conditions as were applicable under such Company Option, the same number of shares of Parent Common Stock as the holder of such Company Option would have been entitled to receive pursuant to the Merger had such holder exercised such option in full immediately prior to the Effective Time (rounded down to the nearest whole number), at a price per share (rounded up to the nearest whole cent) equal to (y) the aggregate exercise price for the Shares otherwise purchasable pursuant to such Company Option divided by (z) the number of full shares of Parent Common Stock deemed purchasable pursuant to such Company Option in accordance with the foregoing; *provided, however*, that in the case of any

Company Option to which Section 422 of the Code applies, the option price, the number of shares purchasable pursuant to such option and the terms and conditions of exercise of such option shall be determined in accordance with the foregoing, subject to such adjustments as are necessary in order to satisfy the requirements of Section 424(a) of the Code. At or prior to the Effective Time, the Company shall make all necessary arrangements with respect to the Stock Plans to permit the assumption of the unexercised Company Options by Parent pursuant to this Section.

(ii) Effective at the Effective Time, Parent shall assume each Company Option in accordance with the terms of the Stock Plan under which it was issued and the stock option agreement by which it is evidenced. At or prior to the Effective Time, Parent shall take all corporate action necessary to reserve for issuance a sufficient number of shares of Parent Common Stock for delivery upon exercise of Company Options assumed by it in accordance with this Section and, to the extent required under applicable SEC rules, take all corporate actions necessary or appropriate to obtain shareholder approval at a stockholders' meeting selected by Parent with respect to such Stock Plan to the extent such approval is required to enable such Stock Plan to comply with Rule 16b-3 under the Exchange Act. As soon as practicable after the Effective Time, Parent shall file a registration statement on Form S-3 or Form S-8, as the case may be (or any successor form), or on another appropriate form (or shall cause such Company Option to be deemed an option issued pursuant to a Parent Stock Plan for which shares of Parent Common Stock have previously been registered pursuant to an appropriate registration form), with respect to the Parent Common Stock subject to such Company Options, and shall use its best efforts to maintain the effectiveness of such registration statements (and maintain the current status of the prospectus or prospectuses contained therein) for so long as such Company Options remain outstanding.

(b) *Directors of Parent.* From and after the Effective Time, the board of directors of Parent shall consist of 15 directors. Immediately prior to the Effective Time, the Company shall designate six of such directors, and Parent shall designate nine of such directors, and such designated directors shall be the directors of Parent from and after the Effective Time until their successors have been duly elected or appointed and qualified or until their earlier death, resignation or removal in accordance with Parent's charter and bylaws.

(c) *Officers of Parent.* From and after the Effective Time, the Chairman and Chief Executive Officer of Parent shall be Alan J. Noia and the President and Chief Operating Officer of Parent shall be David D. Marshall. If either such officer is unable or unwilling to serve in such office immediately after the Effective Time, his successor shall be elected as soon as practicable after the Effective Time by the directors of Parent designated pursuant to Section 6.11(b). From and after the Effective Time, the individuals appointed by such designated directors shall be the other officers of Parent, and all such officers of Parent shall serve from and after the Effective Time until their successors have been duly elected or appointed and qualified or until their earlier death, resignation or removal in accordance with Parent's charter and by-laws.

(d) *Parent Board Committees.* From and after the Effective Time, four of the six directors of Parent designated by the Company pursuant to Section 6.11(b) shall be the chairman of the following committees of the board of directors of Parent: Nuclear Review; New Business; Finance; and Employee and Community Relations. From and after the Effective Time, four of the nine directors of Parent designated by Parent pursuant to Section 6.11(b) shall be the chairman of the following committees of the board of directors of Parent: Audit; Management Review; Nominating; and Benefits.

(e) *Corporate Headquarters.* From and after the Effective Time, Parent's corporate headquarters shall remain in Maryland and substantial operations of Parent's Subsidiaries, including the Surviving Corporation, shall remain in the Pittsburgh, Pennsylvania area.

6.12. *Expenses.* Except as provided in this Section 6.12, the Surviving Corporation shall pay all charges and expenses, including those of the Exchange Agent, in connection with the transactions contemplated in Article IV, and Parent shall reimburse the Surviving Corporation for such charges and expenses. Except as otherwise provided in Section 8.5(b), whether or not the Merger is consummated, all costs and

expenses incurred in connection with this Agreement and the Stock Option Agreement and the Merger and the other transactions contemplated by this Agreement and the Stock Option Agreement shall be paid by the party incurring such expense, except that expenses incurred in connection with the filing fee for the filings under the HSR Act, the S-4 Registration Statement and printing and mailing the Prospectus/Proxy Statement, the S-4 Registration Statement, and such other expenses as may be set forth in Section 6.12 of the Parent Disclosure Letter shall be shared equally by Parent and the Company.

6.13. *Indemnification; Directors' and Officers' Insurance.* (a) From and after the Effective Time, Parent agrees that it will indemnify and hold harmless each present and former director and officer of the Company or any of its Subsidiaries (when acting in such capacity), determined as of the Effective Time (the "*Indemnified Parties*"), against any costs or expenses (including reasonable attorneys' fees), judgments, fines, losses, claims, damages or liabilities (collectively, "*Costs*"), incurred in connection with any claim, action, suit, proceeding or investigation, whether civil, criminal, administrative or investigative, arising out of matters existing or occurring at or prior to the Effective Time, whether asserted or claimed prior to, at or after the Effective Time, to the fullest extent that the Company or such Subsidiary is permitted under the law of its jurisdiction of incorporation and its articles of incorporation and bylaws in effect on the date hereof to indemnify such Person (and Parent shall also advance expenses as incurred to the fullest extent permitted under applicable Law, *provided* that the Person to whom expenses are advanced provides an undertaking to repay such advances if it is ultimately determined that such Person is not entitled to indemnification).

(b) Any Indemnified Party wishing to claim indemnification under paragraph (a) of this Section 6.13, upon learning of any such claim, action, suit, proceeding or investigation, shall promptly notify Parent thereof. In the event of any such claim, action, suit, proceeding or investigation (whether arising before or after the Effective Time), (i) Parent or the Surviving Corporation shall have the right to assume the defense thereof and Parent shall not be liable to such Indemnified Parties for any legal expenses of other counsel or any other expenses subsequently incurred by such Indemnified Parties in connection with the defense thereof, (ii) the Indemnified Parties will cooperate in the defense of any such matter and (iii) Parent shall not be liable for any settlement effected without its prior written consent; *provided, however*, that Parent shall not have any obligation hereunder to any Indemnified Party if and when a court of competent jurisdiction shall ultimately determine, and such determination shall have become final, that the indemnification of such Indemnified Party in the manner contemplated hereby is prohibited by applicable Law.

(c) The Surviving Corporation shall maintain the Company's existing officers' and directors' liability insurance ("*D&O Insurance*") for a period of six years after the Effective Time so long as the annual premium therefor is not in excess of 200% of the last annual premium paid prior to the date hereof (the "*Current Premium*"); *provided, however*, that if the existing D&O Insurance expires, is terminated or cancelled during such six-year period, the Surviving Corporation will use reasonable efforts to obtain as much D&O Insurance as can be obtained for the remainder of such period for a premium not in excess (on an annualized basis) of 200% of the Current Premium.

(d) If the Surviving Corporation or any of its successors or assigns (i) shall consolidate with or merge into any other corporation or entity and shall not be the continuing or surviving corporation or entity of such consolidation or merger or (ii) shall transfer all or substantially all of its properties and assets to any individual, corporation or other entity, then and in each such case, proper provisions shall be made so that the successors and assigns of the Surviving Corporation shall assume all of the obligations set forth in this Section 6.13.

(e) The provisions of this Section 6.13 are intended to be for the benefit of, and shall be enforceable by, each of the Indemnified Parties, their heirs and their representatives.

6.14. *Other Actions by the Company and Parent.*

(a) *Takeover Statute.* If any Takeover Statute is or may become applicable to the Merger or the other transactions contemplated by this Agreement or the Stock Option Agreement, each of Parent and the Company and its board of directors shall grant such approvals and take such actions as are necessary so that such transactions may be consummated as promptly as practicable on the terms contemplated by

this Agreement or by the Stock Option Agreement, as the case may be, and otherwise act to eliminate or minimize the effects of such Takeover Statute on such transactions.

(b) *Dividends.* The Company shall coordinate with Parent the declaration, setting of record dates and payment dates of dividends on Shares so that holders of Shares do not receive dividends on both Shares and Parent Common Stock received in the Merger in respect of any calendar quarter or fail to receive a dividend on either Shares or Parent Common Stock received in the Merger in respect of any calendar quarter.

6.15. *Parent Vote.* Parent shall vote (or consent with respect to) or cause to be voted (or a consent to be given with respect to) any Shares and any shares of common stock of Merger Sub beneficially owned by it or any of its Affiliates or with respect to which it or any of its Affiliates has the power (by agreement, proxy or otherwise) to cause to be voted (or to provide a consent), in favor of the adoption and approval of this Agreement at any meeting of stockholders of the Company or Merger Sub, respectively, at which this Agreement and the Stock Option Agreement shall be submitted for adoption and approval and at all adjournments or postponements thereof (or, if applicable, by any action of stockholders of either the Company or Merger Sub by consent in lieu of a meeting).

6.16. *Rate Matters.* Other than currently pending rate filings, each of the Company and Parent shall, and shall cause its Subsidiaries to, discuss with each other any changes in its or its Subsidiaries regulated rates or charges (other than pass-through fuel rates or charges), standards of service or accounting from those in effect on the date hereof and consult with the other prior to making any filing (or any amendment thereto), or effecting any agreement, commitment arrangement or consent, whether written or oral, formal or informal, with respect thereto.

6.17. *PUHCA.* Neither the Company nor Parent shall, nor shall the Company or Parent permit any of its Subsidiaries to, take any action that would impair the ability of Parent to obtain the approvals under the PUHCA for the transactions contemplated by this Agreement.

6.18. *Pennsylvania Restructuring Legislation.* The Company and Parent each agrees that it will cause its Pennsylvania utility Subsidiary to file in a timely manner with the Pennsylvania Public Utility Commission a restructuring plan to implement direct access to a competitive market for electric generation pursuant to the Electricity Generation Customer Choice and Competition Act, 66 Pa. Comm. Stat. § 2801 *et seq.* (the "*Pennsylvania Restructuring Legislation*").

6.19. *Nuclear Matters.* (a) At least quarterly prior to the Effective Time, the Company shall, upon request by Parent, cause its President — Generation Group and its Chief Nuclear Officer to attend a meeting of the Board of Directors of Parent and provide Parent's directors with such oral and written information concerning the Nuclear Facilities and the Company's nuclear generation program as such directors and/or the chief financial officer of Parent may reasonably request, including but not limited to information relating to safety matters, regulatory matters, refueling plans, outages, planned and pending capital expenditures and the Company's relations with co-owners of the Nuclear Facilities.

(b) Prior to the Effective Time, Parent shall be entitled to designate one person who shall be a director of Parent or shall be a person expert in nuclear matters reasonably acceptable to the Company, to attend and participate (without having any voting rights) in each meeting of the Nuclear Review Committee of the Board of Directors of the Company (the "*Nuclear Review Committee*"), and such Parent designee shall be given the same notice of meetings and other information as is given each member of the Nuclear Review Committee.

ARTICLE VII

Conditions

7.1. *Conditions to Each Party's Obligation to Effect the Merger.* The respective obligation of each party to effect the Merger is subject to the satisfaction or waiver at or prior to the Effective Time of each of the following conditions:

(a) *Stockholder Approval.* This Agreement shall have been duly approved by holders of Shares constituting the Company Requisite Vote and by the sole stockholder of Merger Sub in accordance with applicable law and the certificate and by-laws of each such corporation, and the issuance of Parent Common Stock pursuant to the Merger shall have been duly approved by the holders of Parent Common Stock constituting the Parent Requisite Vote.

(b) *NYSE Listing.* The shares of Parent Common Stock issuable to holders of Shares pursuant to this Agreement shall have been authorized for listing on the NYSE upon official notice of issuance.

(c) *Regulatory Consents.* The waiting period applicable to the consummation of the Merger under the HSR Act shall have expired or been terminated and, other than the filing provided for in Section 1.3, all filings required to be made prior to the Effective Time by the Company or Parent or any of their respective Subsidiaries with, and all consents, approvals and authorizations required to be obtained prior to the Effective Time by the Company or Parent or any of their respective Subsidiaries from, any Governmental Entity (collectively, "*Governmental Consents*") in connection with the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby shall have been made or obtained (as the case may be) and become Final Orders (as hereinafter defined), and such Final Orders shall not, individually or in the aggregate, contain terms or conditions that would have, or be reasonably likely to have, a Material Adverse Effect on the Company or a Material Adverse Effect on Parent (excluding, after the Effective Time, the Company and its Subsidiaries). The term "*Final Order*" shall mean action by the relevant Governmental Entity that has not been reversed, stayed, enjoined, set aside, annulled or suspended, with respect to which any waiting period prescribed by law before the transactions contemplated hereby may be consummated has expired, and as to which all conditions to the consummation of such transactions prescribed by law, regulation or order have been satisfied.

(d) *Litigation.* No court or Governmental Entity of competent jurisdiction shall have enacted, issued, promulgated, enforced or entered any statute, rule, regulation, judgment, decree, injunction or other order (whether temporary, preliminary or permanent) that is in effect and restrains, enjoins or otherwise prohibits consummation of the transactions contemplated by this Agreement (collectively, an "*Order*"), and no Governmental Entity shall have instituted any proceeding seeking any such Order.

(e) *S-4.* The S-4 Registration Statement shall have become effective under the Securities Act and no stop order suspending the effectiveness of the S-4 Registration Statement shall have been issued and no proceedings for that purpose shall have been initiated or be threatened by the SEC.

(f) *Blue Sky Approvals.* Parent shall have received all state securities and "blue sky" permits and other authorizations necessary to consummate the transactions contemplated hereby.

(g) *Pooling Letter.* Parent and the Company shall have received from Parent's independent accounting firm a letter, dated as of the Closing Date, to the effect that the Merger will qualify for "pooling of interests" accounting treatment, it being understood Parent's independent accounting firm may rely upon a letter of the Company's independent accounting firm with respect to the eligibility of the Company and its Subsidiaries for such accounting treatment.

7.2. *Conditions to Obligations of Parent and Merger Sub.* The obligations of Parent and Merger Sub to effect the Merger are also subject to the satisfaction or waiver by Parent prior to the Effective Time of the following conditions:

(a) *Representations and Warranties.* The representations and warranties of the Company set forth in this Agreement shall be true and correct in all material respects as of the date of this Agreement and as

of the Closing Date as though made on and as of the Closing Date (except to the extent any such representation or warranty expressly speaks as of an earlier date), and Parent shall have received a certificate signed on behalf of the Company by an executive officer of the Company to such effect.

(b) *Performance of Obligations of the Company.* The Company shall have performed in all material respects all obligations required to be performed by it under this Agreement at or prior to the Closing Date, and Parent shall have received a certificate signed on behalf of the Company by an executive officer of the Company to such effect.

(c) *Consents.* The Company shall have obtained the consent or approval of each Person whose consent or approval shall be required in order to consummate the transactions contemplated by this Agreement and the Stock Option Agreement under any Contract to which the Company or any of its Subsidiaries is a party, except those for which the failure to obtain such consent or approval, individually or in the aggregate, is not reasonably likely to have a Material Adverse Effect on the Company or is not reasonably likely to materially adversely affect the ability of the Company to consummate the transactions contemplated by this Agreement.

(d) *Tax Opinion.* Parent shall have received the opinion of Sullivan & Cromwell, counsel to Parent, dated the Closing Date, to the effect that the Merger will be treated for Federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Code, and that each of Parent, Merger Sub and the Company will be a party to that reorganization within the meaning of Section 368(b) of the Code. Such opinion may be based on, in addition to the review of such matters of law and fact as Sullivan & Cromwell considers appropriate, (i) representations made at the request of Sullivan & Cromwell by Parent, the Company, stockholders of Parent or the Company, or any combination of such persons, (ii) certificates provided at the request of Sullivan & Cromwell by officers of Parent or the Company and other appropriate persons and (iii) assumptions set forth in the opinion with the consent of Parent, which consent shall not be unreasonably withheld.

(e) *Affiliates Letters.* Parent shall have received an Affiliates Letter from each Person identified as an affiliate of the Company pursuant to Section 6.8.

(f) *Comfort Letters.* Parent shall have received, in form and substance reasonably satisfactory to Parent, from its independent public accounting firm and the Company's independent public accounting firm the "comfort" letters described in Section 6.5(b).

7.3. *Conditions to Obligation of the Company.* The obligation of the Company to effect the Merger is also subject to the satisfaction or waiver by the Company prior to the Effective Time of the following conditions:

(a) *Representations and Warranties.* The representations and warranties of Parent and Merger Sub set forth in this Agreement shall be true and correct as of the date of this Agreement and as of the Closing Date as though made on and as of the Closing Date (except to the extent any such representation and warranty expressly speaks as of an earlier date), and the Company shall have received a certificate signed on behalf of Parent by an executive officer of Parent and Merger Sub to such effect.

(b) *Performance of Obligations of Parent and Merger Sub.* Each of Parent and Merger Sub shall have performed in all material respects all obligations required to be performed by it under this Agreement at or prior to the Closing Date, and the Company shall have received a certificate signed on behalf of Parent and Merger Sub by an executive officer of Parent to such effect.

(c) *Consents.* Parent shall have obtained the consent or approval of each Person whose consent or approval shall be required in order to consummate the transactions contemplated by this Agreement and the Stock Option Agreement under any Contract to which Parent or any of its Subsidiaries is a party, except those for which failure to obtain such consents and approvals, individually or in the aggregate, is not reasonably likely to have a Material Adverse Effect on Parent or is not reasonably likely to materially adversely affect the ability of Parent to consummate the transactions contemplated by this Agreement.

(d) *Tax Opinion.* The Company shall have received the opinion of LeBoeuf, Lamb, Greene & MacRae, L.L.P., counsel to the Company, dated the Closing Date, to the effect that the Merger will be treated for federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Code, and that each of Parent, Merger Sub and the Company will be a party to that reorganization within the meaning of Section 368(b) of the Code. Such opinion may be based on, in addition to the review of such matters of law and fact as such counsel considers appropriate, (i) representations made at the request of such counsel by Parent, the Company, Merger Sub, stockholders of Parent or the Company, or any combination of such persons, (ii) certificates provided at the request of such counsel by officers of Parent, the Company and Merger Sub, or any combination of such officers and (iii) assumptions set forth in the opinion with the consent of the Company, which consent shall not be unreasonably withheld.

(e) *Comfort Letters.* The Company shall have received from its independent public accounting firm and Parent's independent public accounting firm the "comfort" letters described in Section 6.5(b).

ARTICLE VIII

Termination

8.1. *Termination by Mutual Consent.* This Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time, whether before or after the approval by stockholders of the Company and Parent referred to in Section 7.1(a), by mutual written consent of the Company, Parent and Merger Sub, by action of their respective boards of directors.

8.2. *Termination by Either Parent or the Company.* This Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time by action of the board of directors of either Parent or the Company if (a) the Merger shall not have been consummated by October 5, 1998, whether such date is before or after the date of approval by the stockholders of the Company or Parent (the "*Termination Date*"); *provided* that the Termination Date shall automatically be extended for six months if, on October 5, 1998: (i) any of the conditions set forth in Section 7.1(c) has not been satisfied or waived, (ii) each of the other conditions to the consummation of the Merger set forth in Article VII has been satisfied or waived or can readily be satisfied, and (iii) any Governmental Consent that has not yet been obtained is being pursued diligently and in good faith, (b) any Governmental Consents shall have been made or obtained by Final Orders which contain terms or conditions that would cause the condition set forth in Section 7.1(c) not to be satisfied, (c) any Order permanently restraining, enjoining or otherwise prohibiting the Merger shall have become final and non-appealable, whether before or after the approval by the stockholders of the Company or Parent, (d) the Company Requisite Vote shall not have been obtained at the duly held Stockholders Meeting, including any adjournments thereof, or (e) the Parent Requisite Vote shall not have been obtained at the duly held Parent Stockholders Meeting, including any adjournments thereof; *provided* that the right to terminate this Agreement pursuant to clause (a), (b), (d) or (e) above shall not be available to any party that has breached in any material respect its obligations under this Agreement in any manner that shall have proximately contributed to the occurrence of the failure of the Merger to be consummated.

8.3. *Termination by the Company.* This Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time, whether before or after the approval by stockholders of the Company referred to in Section 7.1(a), by action of the board of directors of the Company:

(a) subject to and in accordance with the provisions of Section 6.2; or

(b) if (i) the Board of Directors of Parent shall have withdrawn or adversely modified its approval or recommendation of this Agreement or failed to reconfirm its recommendation of this Agreement within five business days after a written request by the Company to do so, (ii) there has been a material breach by Parent or Merger Sub of any representation, warranty, covenant or agreement contained in this Agreement that is not curable or, if curable, is not cured within 30 days after written notice of such breach is given by the Company to the party committing such breach, or (iii) Parent or any of the other Persons described in Section 6.2(a) as affiliates, representatives or agents of Parent shall take any of the

actions that would be proscribed by Section 6.2 but for the exceptions therein allowing certain actions to be taken pursuant to the proviso in Section 6.2(a) or in the second sentence of Section 6.2(b).

8.4. *Termination by Parent.* This Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time, before or after the approval by the stockholders of Parent referred to in Section 7.1(a), by action of the board of directors of Parent:

(a) subject to and in accordance with the provisions of Section 6.2; or

(b) if (i) the Board of Directors of the Company shall have withdrawn or adversely modified its approval or recommendation of this Agreement or failed to reconfirm its recommendation of this Agreement within five business days after a written request by Parent to do so, (ii) there has been a material breach by the Company of any representation, warranty, covenant or agreement contained in this Agreement that is not curable or, if curable, is not cured within 30 days after written notice of such breach is given by Parent to the party committing such breach, or (iii) if the Company or any of the other Persons described in Section 6.2(a) as affiliates, representatives or agents of the Company shall take any of the actions that would be proscribed by Section 6.2 but for the exceptions therein allowing certain actions to be taken pursuant to the proviso in Section 6.2(a) or in the second sentence of Section 6.2(b).

8.5. *Effect of Termination and Abandonment.* (a) In the event of termination of this Agreement and the abandonment of the Merger pursuant to this Article VIII, this Agreement (other than as set forth in Section 9.1) shall become void and of no effect with no liability of any party hereto (or any of its directors, officers, employees, agents, legal and financial advisors or other representatives); *provided, however*, except as otherwise provided herein, no such termination shall relieve any party hereto of any liability or damages resulting from any breach of this Agreement.

(b) In the event that this Agreement is terminated (x) by the Company pursuant to Section 8.3(a) (or 6.2), or (y) by Parent pursuant to Section 8.4(b)(i) or (iii), or (z) by the Company or Parent pursuant to Section 8.2(d), then the Company: (1) shall promptly, but in no event later than two days after the date of such termination (except in the case of a termination pursuant to Section 8.3(a) which requires payment prior to termination), pay Parent, in addition to any amount, not to exceed \$20,000,000, paid and/or payable by the Company to Parent pursuant to the Stock Option Agreement, a termination fee equal to the sum of (I) the charges and expenses repaid to Parent or Merger Sub pursuant to clause (2) of this Section 8.5(b) and (II) an amount equal to \$50,000,000 less the sum of (x) the amounts paid pursuant to clause (I) of this Section 8.5(b)(1), and (y) the amount, not to exceed \$20,000,000, paid and/or payable by the Company to Parent pursuant to the Stock Option Agreement; and (2) shall promptly, but in no event later than two days after being notified of such by Parent, pay all of the charges and expenses, including those of the Exchange Agent, incurred by Parent or Merger Sub in connection with this Agreement and the Stock Option Agreement and the transactions contemplated by this Agreement and the Stock Option Agreement up to a maximum amount of \$10,000,000, in each case payable by wire transfer of same day funds. In no event shall the Company be required to pay more than \$50,000,000 pursuant to the preceding sentence. In addition, if this Agreement is terminated (x) at a time when a termination fee is payable pursuant to the terms of the preceding sentence or (y) at a time when the approval of the Company's stockholders required by Section 7.1(a) shall not have been obtained at a meeting duly convened therefor or at any adjournment or postponement thereof *and* at any time within two years after such termination the Company shall consummate a Material Acquisition Transaction (as defined below) with any Person other than Parent or a Subsidiary of Parent, then the Company shall simultaneously with the consummation of such Material Acquisition Transaction pay Parent an additional termination fee of \$50,000,000 payable by wire transfer of same day funds. A "*Material Acquisition Transaction*" shall mean, with respect to Parent or the Company, any Acquisition Transaction or series of related Acquisition Transactions involving a merger or consolidation of such party or involving forty percent or more of its voting power, equity interests or assets (in each case directly or indirectly). The Company acknowledges that the agreements contained in this Section 8.5(b) are an integral part of the transactions contemplated by this Agreement and that, without these agreements, Parent and Merger Sub would not enter into this Agreement; accordingly, if the Company fails to promptly pay the amount due pursuant to this Section 8.5(b) and, in order to obtain such payment, Parent or Merger Sub commences a suit which results in

a judgment against the Company for any of the fees set forth in this Section 8.5(b), the Company shall pay to Parent or Merger Sub its costs and expenses (including attorneys' fees) in connection with such suit, together with interest on the amount of such payment at the prime rate of Citibank, N.A. in effect on the date such payment was required to be made.

(c) In the event that this Agreement is terminated (x) by Parent pursuant to Section 8.4(a) (or 6.2) or (y) by the Company pursuant to Section 8.3(b)(i) or (iii), or (z) by the Company or Parent pursuant to Section 8.2(e), then Parent: (1) shall promptly, but in no event later than two days after the date of such termination (except in the case of a termination pursuant to Section 8.4(a) which requires payment prior to termination), pay the Company, in addition to any amount, not to exceed \$20,000,000, paid and/or payable by Parent to the Company pursuant to the letter agreement, dated the date hereof, between Parent and the Company, a termination fee equal to the sum of (I) the charges and expenses repaid to the Company pursuant to clause (2) of this Section 8.5(c) and (II) an amount equal to \$50,000,000 less the sum of (x) the amounts paid pursuant to clause (I) of this Section 8.5(c)(1), and (y) the amount, not to exceed \$20,000,000, paid and/or payable by Parent to the Company pursuant to the letter agreement, dated the date hereof, between Parent and the Company; and (2) shall promptly, but in no event later than two days after being notified of such by the Company, pay all of the charges and expenses incurred by the Company in connection with this Agreement and the Stock Option Agreement and the transactions contemplated by this Agreement and the Stock Option Agreement up to a maximum amount of \$10,000,000, in each case payable by wire transfer of same day funds. In no event shall Parent be required to pay more than \$50,000,000 pursuant to the preceding sentence. In addition, if this Agreement is terminated (x) at a time when a termination fee is payable pursuant to the terms of the preceding sentence or (y) at a time when the approval of Parent's stockholders required by Section 7.1(a) shall not have been obtained at a meeting duly convened therefor or at any adjournment or postponement thereof *and* at any time within two years after such termination Parent shall consummate a Material Acquisition Transaction with any Person other than the Company or a Subsidiary of the Company, then Parent shall simultaneously with the consummation of such Material Acquisition Transaction pay the Company an additional termination fee, payable by wire transfer of same day funds, of \$50,000,000. Parent acknowledges that the agreements contained in this Section 8.5(c) are an integral part of the transactions contemplated by this Agreement and that, without these agreements, the Company would not enter into this Agreement; accordingly, if Parent fails to promptly pay the amount due pursuant to this Section 8.5(c) and, in order to obtain such payment, the Company commences a suit which results in a judgment against Parent for any of the fees set forth in this Section 8.5(c), Parent shall pay to the Company its costs and expenses (including attorneys' fees) in connection with such suit, together with interest on the amount of such payment at the prime rate of Citibank, N.A. in effect on the date such payment was required to be made.

ARTICLE IX

Miscellaneous and General

9.1. *Survival.* This Article IX and the agreements of the Company, Parent and Merger Sub contained in Sections 6.6 (Taxation and Accounting), 6.11 (Benefits), 6.12 (Expenses) and 6.13 (Indemnification; Directors' and Officers' Insurance) shall survive the consummation of the Merger. This Article IX, the representations contained in Section 5.1(c), the agreements of the Company, Parent and Merger Sub contained in Section 6.12 (Expenses), Section 8.5 (Effect of Termination and Abandonment) and the Confidentiality Agreement shall survive the termination of this Agreement. All other representations, warranties, agreements and covenants in this Agreement shall not survive the consummation of the Merger or the termination of this Agreement.

9.2. *Modification or Amendment.* Subject to the provisions of applicable Law, the parties hereto may modify or amend this Agreement, by written agreement executed and delivered by duly authorized officers of the respective parties.

9.3. *Waiver of Conditions; Extension.* The conditions to each of the parties' obligations to consummate the Merger are for the sole benefit of such party and at any time prior to the Effective Time such party

may waive such conditions in whole or in part or extend the time for the performance of any of the obligations or other acts of the other parties hereto to the extent permitted by applicable Law.

9.4. *Counterparts.* This Agreement may be executed in any number of counterparts, each such counterpart being deemed to be an original instrument, and all such counterparts shall together constitute the same agreement. This Agreement shall become a binding obligation of Merger Sub upon Merger Sub's execution of this Agreement in accordance with Section 1.1(a).

9.5. **GOVERNING LAW AND VENUE; WAIVER OF JURY TRIAL.** (a) THIS AGREEMENT SHALL BE DEEMED TO BE MADE IN, AND IN ALL RESPECTS SHALL BE INTERPRETED, CONSTRUED AND GOVERNED BY AND IN ACCORDANCE WITH THE LAW OF, THE COMMONWEALTH OF PENNSYLVANIA WITHOUT REGARD TO THE CONFLICT OF LAW PRINCIPLES THEREOF. The parties hereby irrevocably submit to the jurisdiction of the courts of the Commonwealth of Pennsylvania and the Federal courts of the United States of America located in the Commonwealth of Pennsylvania solely in respect of the interpretation and enforcement of the provisions of this Agreement and the Stock Option Agreement and of the documents referred to in this Agreement and the Stock Option Agreement, and in respect of the transactions contemplated hereby and thereby, and hereby waive, and agree not to assert, as a defense in any action, suit or proceeding for the interpretation or enforcement hereof or of any such document, that it is not subject thereto or that such action, suit or proceeding may not be brought or is not maintainable in said courts or that the venue thereof may not be appropriate or that this Agreement and the Stock Option Agreement or any such document may not be enforced in or by such courts, and the parties hereto irrevocably agree that all claims with respect to such action or proceeding shall be heard and determined in such a Commonwealth of Pennsylvania or Federal court. The parties hereby consent to and grant any such court jurisdiction over the person of such parties and over the subject matter of such dispute and agree that mailing of process or other papers in connection with any such action or proceeding in the manner provided in Section 9.6, or in such other manner as may be permitted by Law, shall be valid and sufficient service thereof. No provision of this Agreement shall be construed to require any party to violate or contravene any applicable Law.

(b) EACH PARTY ACKNOWLEDGES AND AGREES THAT ANY CONTROVERSY WHICH MAY ARISE UNDER THIS AGREEMENT OR THE STOCK OPTION AGREEMENT IS LIKELY TO INVOLVE COMPLICATED AND DIFFICULT ISSUES, AND THEREFORE EACH SUCH PARTY HEREBY IRREVOCABLY AND UNCONDITIONALLY WAIVES ANY RIGHT SUCH PARTY MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY LITIGATION DIRECTLY OR INDIRECTLY ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE STOCK OPTION AGREEMENT, OR THE TRANSACTIONS CONTEMPLATED BY THIS AGREEMENT OR THE STOCK OPTION AGREEMENT. EACH PARTY CERTIFIES AND ACKNOWLEDGES THAT (i) NO REPRESENTATIVE, AGENT OR ATTORNEY OF ANY OTHER PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT SUCH OTHER PARTY WOULD NOT, IN THE EVENT OF LITIGATION, SEEK TO ENFORCE THE FOREGOING WAIVER, (ii) EACH SUCH PARTY UNDERSTANDS AND HAS CONSIDERED THE IMPLICATIONS OF THIS WAIVER, (iii) EACH SUCH PARTY MAKES THIS WAIVER VOLUNTARILY, AND (iv) EACH SUCH PARTY HAS BEEN INDUCED TO ENTER INTO THIS AGREEMENT OR THE STOCK OPTION AGREEMENT BY, AMONG OTHER THINGS, THE MUTUAL WAIVERS AND CERTIFICATIONS IN THIS SECTION 9.5.

9.6. *Notices.* Any notice, request, instruction or other document to be given hereunder by any party to the others shall be in writing and delivered personally or sent by registered or certified mail, postage prepaid, or by facsimile:

if to Parent or Merger Sub

Allegheny Power System, Inc.
10435 Downsville Pike
Hagerstown, Maryland 21740-1766
Attention: Thomas K. Henderson
telecopier: (301) 665-9006

(with a copy to Joseph B. Frumkin
Sullivan & Cromwell
125 Broad Street
New York, New York 10004
telecopier: (212) 558-3588)

if to the Company

DQE, Inc.
411 Seventh Avenue
Pittsburgh, Pennsylvania 15230-1930
Attention: Victor A. Roque
telecopier: (412) 393-6266

(with copies to Douglas W. Hawes
and Steven H. Davis
LeBoeuf, Lamb, Greene & MacRae, L.L.P.
125 West 55th Street
New York, New York 10019
telecopier: (212) 424-8500)

or to such other persons or addresses as may be designated in writing by the party to receive such notice as provided above.

9.7. *Entire Agreement.* This Agreement (including any exhibits hereto), the Company Disclosure Letter, the Parent Disclosure Letter, the Stock Option Agreement and the Confidentiality Agreement, dated November 18, 1996, between Parent and the Company (the "*Confidentiality Agreement*") constitute the entire agreement, and supersede all other prior agreements, understandings, representations and warranties both written and oral, among the parties with respect to the subject matter hereof. References herein to this Agreement shall for all purposes be deemed to include references to the Company Disclosure Letter and Parent Disclosure Letter. EACH PARTY HERETO AGREES THAT, EXCEPT FOR THE REPRESENTATIONS AND WARRANTIES CONTAINED IN THIS AGREEMENT, NEITHER PARENT AND MERGER SUB NOR THE COMPANY MAKES ANY OTHER REPRESENTATIONS OR WARRANTIES, AND EACH HEREBY DISCLAIMS ANY OTHER REPRESENTATIONS OR WARRANTIES MADE BY ITSELF OR ANY OF ITS OFFICERS, DIRECTORS, EMPLOYEES, AGENTS, FINANCIAL AND LEGAL ADVISORS OR OTHER REPRESENTATIVES WITH RESPECT TO THE EXECUTION AND DELIVERY OF THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY. NOTWITHSTANDING THE DELIVERY OR DISCLOSURE TO THE OTHER OR THE OTHER'S REPRESENTATIVES OF ANY DOCUMENTATION OR OTHER INFORMATION WITH RESPECT TO ANY ONE OR MORE OF THE FOREGOING.

9.8. *No Third Party Beneficiaries.* Except as provided in Section 6.13 (Indemnification; Directors' and Officers' Insurance), this Agreement is not intended to confer upon any Person other than the parties hereto any rights or remedies hereunder.

9.9. *Obligations of Parent and of the Company.* Whenever this Agreement requires a Subsidiary of Parent to take any action, such requirement shall be deemed to include an undertaking on the part of Parent to cause such Subsidiary to take such action. Whenever this Agreement requires a Subsidiary of the Company to take any action, such requirement shall be deemed to include an undertaking on the part of the Company to cause such Subsidiary to take such action and, after the Effective Time, on the part of the Surviving Corporation to cause such Subsidiary to take such action.

9.10. *Severability.* The provisions of this Agreement shall be deemed severable and the invalidity or unenforceability of any provision shall not affect the validity or enforceability of the other provisions hereof. If any provision of this Agreement, or the application thereof to any Person or any circumstance, is invalid or unenforceable, (a) a suitable and equitable provision shall be substituted therefor in order to carry out, so far as may be valid and enforceable, the intent and purpose of such invalid or unenforceable provision and (b) the remainder of this Agreement and the application of such provision to other Persons or circumstances shall not be affected by such invalidity or unenforceability, nor shall such invalidity or unenforceability affect the validity or enforceability of such provision, or the application thereof, in any other jurisdiction.

9.11. *Interpretation.* The table of contents and headings herein are for convenience of reference only, do not constitute part of this Agreement and shall not be deemed to limit or otherwise affect any of the provisions hereof. Where a reference in this Agreement is made to a Section or Exhibit, such reference shall be to a Section of or Exhibit to this Agreement unless otherwise indicated. Whenever the words "include," "includes" or "including" are used in this Agreement, they shall be deemed to be followed by the words "without limitation."

9.12. *Assignment.* This Agreement shall not be assignable by operation of law or otherwise; *provided, however,* that Parent may designate, by written notice to the Company, another wholly-owned direct or indirect subsidiary to be a Constituent Corporation in lieu of Merger Sub, in the event of which all references herein to Merger Sub shall be deemed references to such other subsidiary, except that all representations and warranties made herein with respect to Merger Sub as of the date of this Agreement shall be deemed representations and warranties made with respect to such other subsidiary as of the date of such designation.

IN WITNESS WHEREOF, this Agreement has been duly executed and delivered by the duly authorized officers of the Company and Parent as of the date hereof.

DQE, INC.

By: /s/ DAVID D. MARSHALL

David D. Marshall
President and Chief Executive Officer

ALLEGHENY POWER SYSTEM, INC.

By: /s/ ALAN J. NOIA

Alan J. Noia
President and Chief Executive Officer

Accepted and Agreed as of:

_____, 199__

AYP SUB, INC.

By: _____

Name:
Title:

Investment Banking

Item No: H-13
Page 410 of 422

Corporate and Institutional
Client Group

World Financial Center
North Tower
New York, New York 10281-1327
212 449 1000
FAX 212 449 7148
FAX 212 449 8636



June 25, 1997

Board of Directors
Allegheny Power System, Inc.
10435 Downsville Pike
Hagerstown, Maryland 21740-1766

Ladies and Gentlemen:

Allegheny Power System, Inc. ("Parent" or "Allegheny"), a Maryland corporation, and DQE, Inc. (the "Company" or "DQE"), a Pennsylvania corporation, have entered into an Agreement and Plan of Merger as of April 5, 1997 (the "Agreement") pursuant to which AYP Sub, Inc., a Pennsylvania corporation to be formed as a wholly owned subsidiary of Parent ("Sub"), shall be merged with and into the Company and the separate corporate existence of Sub shall thereupon cease (the "Merger"). Pursuant to the Agreement, each issued and outstanding share of the Company's common stock, without par value ("Company Common Stock"), shall be converted into, and become exchangeable for, 1.12 shares (the "Conversion Ratio") of Parent's common stock, par value \$1.25 per share ("Parent Common Stock").

You have asked us whether, in our opinion, the Conversion Ratio is fair to the holders of Parent Common Stock from a financial point of view.

In arriving at the opinion set forth below, we have, among other things:

- (1) Reviewed Allegheny's Annual Reports, Form 10-K's and related financial information for the three fiscal year period ended December 31, 1996 and certain other filings made with the Securities and Exchange Commission, including proxy statements, Form 8-K's and registration statements, during the last three years;
- (2) Reviewed DQE's Annual Reports, Form 10-K's and related financial information for the three fiscal year period ended December 31, 1996 and certain other filings made with the Securities and Exchange Commission, including proxy statements, Form 8-K's and registration statements, during the last three years;
- (3) Reviewed certain information, including financial forecasts, relating to the business, earnings, cash flow, assets and prospects of Allegheny and DQE furnished to us by Allegheny and DQE;
- (4) Conducted discussions with members of senior management of Allegheny and DQE concerning their respective businesses, regulatory environments, prospects and strategic objectives;
- (5) Reviewed the market prices and valuation multiples for the Parent Common Stock and the Company Common Stock and compared them with those of certain publicly traded companies which we deemed to be reasonably similar to Allegheny and DQE, respectively;
- (6) Compared the results of operations of Allegheny and DQE with those of certain companies which we deemed to be reasonably similar to Allegheny and DQE, respectively;

- (7) Compared the financial terms of the transaction contemplated by the Agreement with the financial terms of certain other transactions which we deemed to be relevant;
- (8) Considered the pro forma effect of the Merger on Allegheny's capitalization ratios and earnings, dividends and book value per share;
- (9) Reviewed the Agreement;
- (10) Reviewed the Joint Proxy Statement/Prospectus; and
- (11) Reviewed such other financial studies and analyses and performed such other investigations and took into account such other matters as we deemed necessary, including our assessment of general economic, market, monetary and other conditions.

In preparing our opinion, we have relied on the accuracy and completeness of all information supplied or otherwise made available to us by Allegheny and DQE, and we have not assumed any responsibility for independently verifying such information or undertaken an independent evaluation or appraisal of the assets or liabilities of Allegheny or DQE. In addition, we have not conducted any physical inspection of the properties or facilities of Allegheny or DQE. With respect to the financial forecasts and projected synergies furnished by Allegheny and DQE, we have assumed that they have been reasonably prepared and reflect the best currently available estimates and judgment of Allegheny's or DQE's management as to the expected future financial performance of Allegheny or DQE, as the case may be, and as to the expected future projected outcomes of various legal, regulatory and other contingencies. We have assumed that the Merger will be accounted for as a pooling of interests and will be free of Federal tax to Allegheny and DQE and the respective holders of Parent Common Stock and Company Common Stock.

Our opinion is necessarily based upon general economic, market, monetary and other conditions as they exist and can be evaluated, and the information made available to us, as of the date hereof.

This opinion has been prepared solely for the information and use of the Board of Directors of Parent and does not constitute a recommendation to any shareholder of Parent as to how such shareholder should vote on the Merger. This opinion may not be reproduced, summarized, described or referred to without Merrill Lynch's prior written consent, which is not to be unreasonably withheld.

We have acted as financial advisor to Allegheny in connection with the Merger and will receive a fee for our services, a significant portion of which is contingent upon consummation of the Merger. We have, in the past, provided financing services to Allegheny and DQE and have received fees for the rendering of such services. In the ordinary course of our business, we may actively trade the securities of Allegheny and DQE for our own account and for the accounts of customers and, accordingly, may at any time hold a long or short position in such securities.

On the basis of and subject to the foregoing and other matters which we deem relevant, we are of the opinion that, as of the date hereof, the Conversion Ratio is fair to the holders of Parent Common Stock from a financial point of view.

Very truly yours,

MERRILL LYNCH, PIERCE, FENNER & SMITH
INCORPORATED

By 
Managing Director
Investment Banking Group

**CREDIT
SUISSE****FIRST
BOSTON**

CREDIT SUISSE FIRST BOSTON CORPORATION

Eleven Madison Avenue
New York, NY 10010-3629

Telephone 212 325 2000

Item No: H-13
Page 412 of 422

June 25, 1997

Board of Directors
DQE, Inc.
411 7th Avenue
Pittsburgh, Pennsylvania 77054

Members of the Board:

You have asked us to advise you with respect to the fairness to the holders of the common stock of DQE, Inc. ("DQE") from a financial point of view of the consideration to be received by such holders pursuant to the terms of the Agreement and Plan of Merger, dated as of April 5, 1997 (the "Merger Agreement"), among DQE, Allegheny Power System, Inc. ("AYP") and AYP Sub, Inc. ("Merger Sub"). The Merger Agreement provides for, among other things, the merger of Merger Sub with and into DQE (the "Merger") pursuant to which DQE will become a wholly owned subsidiary of AYP and each outstanding share of the common stock, without par value, of DQE (the "DQE Common Stock") will be converted into the right to receive 1.12 shares (the "Conversion Ratio") of the common stock, par value \$1.25 per share, of AYP (the "AYP Common Stock").

In arriving at our opinion, we have reviewed the Merger Agreement, the Joint Proxy Statement/Prospectus of DQE and AYP relating to the proposed Merger (the "Joint Proxy Statement/Prospectus") and certain publicly available business and financial information relating to DQE and AYP. We have also reviewed certain other information relating to DQE and AYP, including financial forecasts, provided to us by DQE and AYP, and have met with the managements of DQE and AYP to discuss the businesses and prospects of DQE and AYP.

We have also considered certain financial and stock market data of DQE and AYP, and we have compared those data with similar data for other publicly held companies in businesses similar to DQE and AYP, and we have considered, to the extent publicly available, the financial terms of certain other business combinations and other transactions which have recently been effected. We also considered such other information, financial studies, analyses and investigations and financial, economic and market criteria which we deemed relevant.

In connection with our review, we have not assumed any responsibility for independent verification of any of the foregoing information (including the information in the Joint Proxy Statement/Prospectus) and have relied on its being complete and accurate in all material respects. With respect to the financial forecasts, we have assumed that such forecasts have been reasonably prepared on bases reflecting the best currently available estimates and judgments of the managements of DQE and AYP as to the future financial performance of DQE and AYP. We also have assumed, with your consent and based upon the views of the management of, and regulatory counsel for, DQE, that in the course of obtaining the necessary regulatory and third party consents for the proposed Merger, no restriction will be imposed that will have a material adverse effect on the contemplated benefits of the Merger. In addition, we have not been requested to make, and have not made, an independent evaluation or appraisal of the assets or liabilities (contingent or otherwise) of DQE or AYP, nor have we been furnished with any such evaluations or appraisals. Our opinion is necessarily based upon information available to us, and financial, economic, market and other conditions as they exist and can be

Board of Directors
DQE, Inc.
June 25, 1997
Page 2

evaluated, on the date hereof. We are not expressing any opinion as to the actual value of the AYP Common Stock when issued pursuant to the Merger or the prices at which the AYP Common Stock will trade subsequent to the Merger. In connection with our engagement, we were not requested to, and did not, solicit third party indications of interest in acquiring all or any part of DQE.

We have acted as financial advisor to DQE in connection with the Merger and will receive a fee for our services, a significant portion of which is contingent upon the consummation of the Merger. In the past, we have provided financial services to DQE unrelated to the proposed Merger, for which services we have received compensation. In the ordinary course of its business, Credit Suisse First Boston and its affiliates may actively trade the debt and equity securities of both DQE and AYP for their own accounts and for the accounts of customers and, accordingly, may at any time hold a long or short position in such securities.

It is understood that this letter is for the information of the Board of Directors of DQE in connection with its evaluation of the Merger, does not constitute a recommendation to any stockholder as to how such stockholder should vote with respect to the Merger, and is not to be quoted or referred to, in whole or in part, in any registration statement, prospectus or proxy statement, or in any other document used in connection with the offering or sale of securities, nor shall this letter be used for any other purposes, without our prior written consent.

Based upon and subject to the foregoing, it is our opinion that, as of the date hereof, the Conversion Ratio is fair to the holders of DQE Common Stock from a financial point of view.

Very truly yours,

CREDIT SUISSE FIRST BOSTON CORPORATION

SECTIONS 2541-2548 OF THE PENNSYLVANIA BUSINESS CORPORATION LAW

SECTION 2541

APPLICATION AND EFFECT OF SUBCHAPTER

(a) **GENERAL RULE** — Except as otherwise provided in this section, this subchapter shall apply to a registered corporation unless:

(1) the registered corporation is one described in section 2502(1)(ii) or (2) (relating to registered corporation status):

(2) the bylaws, by amendment adopted either:

(i) by March 23, 1984; or

(ii) on or after March 23, 1988, and on or before June 21, 1988;

and, in either event, not subsequently rescinded by an article amendment, explicitly provide that this subchapter shall not be applicable to the corporation in the case of a corporation which on June 21, 1988, did not have outstanding one or more classes or series of preference shares entitled, upon the occurrence of a default in the payment of dividends or another similar contingency, to elect a majority of the members of the board of directors (a bylaw adopted on or before June 21, 1988, by a corporation excluded from the scope of this paragraph by the restriction of this paragraph relating to certain outstanding preference shares shall be ineffective unless ratified under paragraph (3));

(3) the bylaws of which explicitly provide that this subchapter shall not be applicable to the corporation by amendment ratified by the board of directors on or after December 19, 1990, and on or before March 19, 1991, in the case of a corporation:

(i) which on June 21, 1988, had outstanding one or more classes or series of preference shares entitled, upon the occurrence of a default in the payment of dividends or another similar contingency, to elect a majority of the members of the board of directors; and

(ii) the bylaws of which on that date contained a provision described in paragraph (2); or

(4) the articles explicitly provide that this subchapter shall not be applicable to the corporation by a provision included in the original articles, by an article amendment adopted prior to the date of the control transaction and prior to or on March 23, 1988, pursuant to the procedures then applicable to the corporation, or by an article amendment adopted prior to the date of the control transaction and subsequent to March 23, 1988, pursuant to both:

(i) the procedures then applicable to the corporation; and

(ii) unless such proposed amendment has been approved by the board of directors of the corporation, in which event this subparagraph shall not be applicable, the affirmative vote of the shareholders entitled to cast at least 80% of the votes which all shareholders are entitled to cast thereon.

A reference in the articles or bylaws to former section 910 (relating to right of shareholders to receive payment for shares following a control transaction) of the act of May 5, 1933 (P.L. 364, No. 106), known as the Business Corporation Law of 1933, shall be a reference to this subchapter for the purposes of this section. See section 101(c) (relating to references to prior statutes).

(b) **INADVERTENT TRANSACTIONS** — This subchapter shall not apply to any person or group that inadvertently becomes a controlling person or group if that controlling person or group, as soon as practicable, divests itself of a sufficient amount of its voting shares so that it is no longer a controlling person or group.

(c) **CERTAIN SUBSIDIARIES** — This subchapter shall not apply to any corporation that on December 23, 1983, was a subsidiary of any other corporation.

SECTION 2542

DEFINITIONS

The following words and phrases when used in this subchapter shall have the meanings given to them in this section unless the context clearly indicates otherwise:

"CONTROL TRANSACTION." The acquisition by a person or group of the status of a controlling person or group.

"CONTROLLING PERSON OR GROUP." A controlling person or group as defined in section 2543 (relating to controlling person or group).

"FAIR VALUE." A value not less than the highest price paid per share by the controlling person or group at any time during the 90-day period ending on and including the date of the control transaction plus an increment representing any value, including, without limitation, any proportion of any value payable for acquisition of control of the corporation, that may not be reflected in such price.

"PARTIAL PAYMENT AMOUNT." The amount per share specified in section 2545(c)(2) (relating to contents of notice).

"SUBSIDIARY." Any corporation as to which any other corporation has or has the right to acquire, directly or indirectly, through the exercise of all warrants, options and rights and the conversion of all convertible securities, whether issued or granted by the subsidiary or otherwise, voting power over voting shares of the subsidiary that would entitle the holders thereof to cast in excess of 50% of the votes that all shareholders would be entitled to cast in the election of directors of such subsidiary, except that a subsidiary will not be deemed to cease being a subsidiary as long as such corporation remains a controlling person or group within the meaning of this subchapter.

"VOTING SHARES." The term shall have the meaning specified in section 2552 (relating to definitions).

SECTION 2543

CONTROLLING PERSON OR GROUP

(a) **GENERAL RULE** — For the purpose of this subchapter, a "controlling person or group" means a person who has, or a group of persons acting in concert that has, voting power over voting shares of the registered corporation that would entitle the holders thereof to cast at least 20% of the votes that all shareholders would be entitled to cast in an election of directors of the corporation.

(b) **EXCEPTIONS GENERALLY** — Notwithstanding subsection (a):

(1) A person or group which would otherwise be a controlling person or group within the meaning of this section shall not be deemed a controlling person or group unless subsequent to the later of March 23, 1988, or the date this subchapter becomes applicable to a corporation by bylaw or article amendment or otherwise, that person or group increases the percentage of outstanding voting shares of the corporation over which it has voting power to in excess of the percentage of outstanding voting shares of the corporation over which that person or group had voting power on such later date, and to at least the amount specified in subsection (a), as the result of forming or enlarging a group or acquiring, by purchase, voting power over voting shares of the corporation.

(2) No person or group shall be deemed to be a controlling person or group at any particular time if voting power over any of the following voting shares is required to be counted at such time in order to meet the 20% minimum:

(i) Shares which have been held continuously by a natural person since January 1, 1983, and which are held by such natural person at such time.

(ii) Shares which are held at such time by any natural person or trust, estate, foundation or other similar entity to the extent the shares were acquired solely by gift, inheritance, bequest, devise or other testamentary distribution or series of these transactions, directly or indirectly, from a natural person who had acquired the shares prior to January 1, 1983.

(iii) Shares which were acquired pursuant to a stock split, stock dividend, reclassification or similar recapitalization with respect to shares described under this paragraph that have been held continuously since their issuance by the corporation by the natural person or entity that acquired them from the corporation or that were acquired, directly or indirectly, from such natural person or entity, solely pursuant to a transaction or series of transactions described in subparagraph (ii), and that are held at such time by a natural person or entity described in subparagraph (ii).

(iv) Control shares as defined in section 2562 (relating to definitions) which have not yet been accorded voting rights pursuant to section 2564(a) (relating to voting rights of shares acquired in a control-share acquisition).

(v) Shares, the voting rights of which are attributable to a person under subsection (d) if:

(A) the person acquired the option or conversion right directly from or made the contract, arrangement or understanding or has the relationship directly with the corporation; and

(B) the person does not at the particular time own or otherwise effectively possess the voting rights of the shares.

(vi) Shares acquired directly from the corporation or an affiliate or associate, as defined in section 2552 (relating to definitions), of the corporation by a person engaged in business as an underwriter of securities who acquires the shares through his participation in good faith in a firm commitment underwriting registered under the Securities Act of 1933.

(3) In determining whether a person or group is or would be a controlling person or group at any particular time, there shall be disregarded voting power arising from a contingent right of the holders of one or more classes or series of preference shares to elect one or more members of the board of directors upon or during the continuation of a default in the payment of dividends on such shares or another similar contingency.

(c) **CERTAIN RECORD HOLDERS** — A person shall not be a controlling person under subsection (a) if the person holds voting power, in good faith and not for the purpose of circumventing this subchapter, as an agent, bank, broker, nominee or trustee for one or more beneficial owners who do not individually or, if they are a group acting in concert, as a group have the voting power specified in subsection (a), or who are not deemed a controlling person or group under subsection (b).

(d) **EXISTENCE OF VOTING POWER** — For the purposes of this subchapter, a person has voting power over a voting share if the person has or shares, directly or indirectly, through any option, contract, arrangement, understanding, conversion right or relationship, or by acting jointly or in concert or otherwise, the power to vote, or to direct the voting of, the voting share.

SECTION 2544

RIGHT OF SHAREHOLDERS TO RECEIVE PAYMENT FOR SHARES

Any holder of voting shares of a registered corporation that becomes the subject of a control transaction who shall object to the transaction shall be entitled to the rights and remedies provided in this subchapter.

SECTION 2545

NOTICE TO SHAREHOLDERS

(a) **GENERAL RULE** — Prompt notice that a control transaction has occurred shall be given by the controlling person or group to:

(1) Each shareholder of record of the registered corporation holding voting shares.

(2) To the court, accompanied by a petition to the court praying that the fair value of the voting shares of the corporation be determined pursuant to section 2547 (relating to valuation procedures) if the court should receive pursuant to section 2547 certificates from shareholders of the corporation or an equivalent request for transfer of uncertificated securities.

(b) **OBLIGATIONS OF THE CORPORATION** — If the controlling person or group so requests, the corporation shall, at the option of the corporation and at the expense of the person or group, either furnish a list of all such shareholders to the person or group or mail the notice to all such shareholders.

(c) **CONTENTS OF NOTICE** — The notice shall state that:

(1) All shareholders are entitled to demand that they be paid the fair value of their shares.

(2) The minimum value the shareholder can receive under this subchapter is the highest price paid per share by the controlling person or group within the 90-day period ending on and including the date of the control transaction, and stating that value.

(3) If the shareholder believes the fair value of his shares is higher, that this subchapter provides an appraisal procedure for determining the fair value of such shares, specifying the name of the court and its address and the caption of the petition referenced in subsection (a) (2), and stating that the information is provided for the possible use by the shareholder in electing to proceed with a court-appointed appraiser under section 2547.

There shall be included in, or enclosed with, the notice a copy of this subchapter.

(d) **OPTIONAL PROCEDURE** — The controlling person or group may, at its option, supply with the notice referenced in subsection (c) a form for the shareholder to demand payment of the partial payment amount directly from the controlling person or group without utilizing the court-appointed appraiser procedure of section 2547, requiring the shareholder to state the number and class or series, if any, of the shares owned by him, and stating where the payment demand must be sent and the procedures to be followed.

SECTION 2546

SHAREHOLDER DEMAND FOR FAIR VALUE

(a) **GENERAL RULE** — After the occurrence of the control transaction, any holder of voting shares of the registered corporation may, prior to or within a reasonable time after the notice required by section 2545 (relating to notice to shareholders) is given, which time period may be specified in the notice, make written demand on the controlling person or group for payment of the amount provided in subsection (c) with respect to the voting shares of the corporation held by the shareholder, and the controlling person or group shall be

required to pay that amount to the shareholder pursuant to the procedures specified in section 2547 (relating to valuation procedures).

(b) **CONTENTS OF DEMAND** — The demand of the shareholder shall state the number and class or series, if any, of the shares owned by him with respect to which the demand is made.

(c) **MEASURE OF VALUE** — A shareholder making written demand under this section shall be entitled to receive cash for each of his shares in an amount equal to the fair value of each voting share as of the date on which the control transaction occurs, taking into account all relevant factors, including an increment representing a proportion of any value payable for acquisition of control of the corporation.

(d) **PURCHASES INDEPENDENT OF SUBCHAPTER** — The provisions of this subchapter shall not preclude a controlling person or group subject to this subchapter from offering, whether in the notice required by section 2545 or otherwise, to purchase voting shares of the corporation at a price other than that provided in subsection (c), and the provisions of this subchapter shall not preclude any shareholder from agreeing to sell his voting shares at that or any other price to any person.

SECTION 2547

VALUATION PROCEDURES

(a) **GENERAL RULE** — If, within 45 days (or such other time period, if any, as required by applicable law) after the date of the notice required by section 2545 (relating to notice to shareholders), or, if such notice was not provided prior to the date of the written demand by the shareholder under section 2546 (relating to shareholder demand for fair value), then within 45 days (or such other time period, if any, required by applicable law) of the date of such written demand, the controlling person or group and the shareholder are unable to agree on the fair value of the shares or on a binding procedure to determine the fair value of the shares, then each shareholder who is unable to agree on both the fair value and on such a procedure with the controlling person or group and who so desires to obtain the rights and remedies provided in this subchapter shall, no later than 30 days after the expiration of the applicable 45-day or other period, surrender to the court certificates representing any of the shares that are certificated shares, duly endorsed for transfer to the controlling person or group, or cause any uncertificated shares to be transferred to the court as escrow agent under subsection (c) with a notice stating that the certificates or uncertificated shares are being surrendered or transferred, as the case may be, in connection with the petition referenced in section 2545 or, if no petition has theretofore been filed, the shareholder may file a petition within the 30-day period in the court praying that the fair value (as defined in this subchapter) of the shares be determined.

(b) **EFFECT OF FAILURE TO GIVE NOTICE AND SURRENDER CERTIFICATES** — Any shareholder who does not so give notice and surrender any certificates or cause uncertificated shares to be transferred within such time period shall have no further right to receive, with respect to shares the certificates of which were not so surrendered or the uncertificated shares which were not so transferred under this section, payment under this subchapter from the controlling person or group with respect to the control transaction giving rise to the rights of the shareholder under this subchapter.

(c) **ESCROW AND NOTICE** — The court shall hold the certificates surrendered and the uncertificated shares transferred to it in escrow for, and shall promptly, following the expiration of the time period during which the certificates may be surrendered and the uncertificated shares transferred, provide a notice to the controlling person or group of the number of shares so surrendered or transferred.

(d) **PARTIAL PAYMENT FOR SHARES** — The controlling person or group shall then make a partial payment for the shares so surrendered or transferred to the court, within ten business days of receipt of the notice from the court, at a per-share price equal to the partial payment amount. The court shall then make payment as soon as practicable, but in any event within ten business days, to the shareholders who so surrender or transfer their shares to the court of the appropriate per-share amount received from the controlling person or group.

(e) **APPOINTMENT OF APPRAISER** — Upon receipt of any share certificate surrendered or uncertificated share transferred under this section, the court shall, as soon as practicable but in any event within 30 days, appoint an appraiser with experience in appraising share values of companies of like nature to the registered corporation to determine the fair value of the shares.

(f) **APPRAISAL PROCEDURE** — The appraiser so appointed by the court shall, as soon as reasonably practicable, determine the fair value of the shares subject to its appraisal and the appropriate market rate of interest on the amount then owed by the controlling person or group to the holders of the shares. The determination of any appraiser so appointed by the court shall be final and binding on both the controlling person or group and all shareholders who so surrendered their share certificates or transferred their shares to the court, except that the determination of the appraiser shall be subject to review to the extent and within the time provided or prescribed by law in the case of other appointed judicial officers. See 42 Pa.C.S. §§ 5105(a)(3) (relating to right to appellate review) and 5571(b) (relating to appeals generally).

(g) **SUPPLEMENTAL PAYMENT** — Any amount owed, together with interest, as determined pursuant to the appraisal procedures of this section shall be payable by the controlling person or group after it is so determined and upon and concurrently with the delivery or transfer to the controlling person or group by the court (which shall make delivery of the certificate or certificates surrendered or the uncertificated shares transferred to it to the controlling person or group as soon as practicable but in any event within ten business days after the final determination of the amount owed) of the certificate or certificates representing shares surrendered or the uncertificated shares transferred to the court, and the court shall then make payment, as soon as practicable but in any event within ten business days after receipt of payment from the controlling person or group, to the shareholders who so surrendered or transferred their shares to the court of the appropriate per-share amount received from the controlling person or group.

(h) **VOTING AND DIVIDEND RIGHTS DURING APPRAISAL PROCEEDINGS** — Shareholders who surrender their shares to the court pursuant to this section shall retain the right to vote their shares and receive dividends or other distributions thereon until the court receives payment in full for each of the shares so surrendered or transferred of the partial payment amount (and, thereafter, the controlling person or group shall be entitled to vote such shares and receive dividends or other distributions thereon). The fair value (as determined by the appraiser) of any dividends or other distributions so received by the shareholders shall be subtracted from any amount owing to such shareholders under this section.

(i) **POWERS OF THE COURT** — The court may appoint such agents, including the transfer agent of the corporation, or any other institution, to hold the share certificates so surrendered and the shares surrendered or transferred under this section, to effect any necessary change in record ownership of the shares after the payment by the controlling person or group to the court of the amount specified in subsection (h), to receive and disburse dividends or other distributions, to provide notices to shareholders and to take such other actions as the court determines are appropriate to effect the purposes of this subchapter.

(j) **COSTS AND EXPENSES** — The costs and expenses of any appraiser or other agents appointed by the court shall be assessed against the controlling person or group. The costs and expenses of any other procedure to determine fair value shall be paid as agreed to by the parties agreeing to the procedure.

(k) **JURISDICTION EXCLUSIVE** — The jurisdiction of the court under this subchapter is plenary and exclusive and the controlling person or group, and all shareholders who so surrendered or transferred their shares to the court shall be made a party to the proceeding as in an action against their shares.

(l) **DUTY OF CORPORATION** — The corporation shall comply with requests for information, which may be submitted pursuant to procedures maintaining the confidentiality of the information, made by the court or the appraiser selected by the court. If any of the shares of the corporation are not represented by certificates, the transfer, escrow or retransfer of those shares contemplated by this section shall be registered by the corporation, which shall give the written notice required by section 1528(f) (relating to uncertificated shares) to the transferring shareholder, the court and the controlling shareholder or group, as appropriate in the circumstances.

(m) **PAYMENT UNDER OPTIONAL PROCEDURE** — Any amount agreed upon between the parties or determined pursuant to the procedure agreed upon between the parties shall be payable by the controlling person or group after it is agreed upon or determined and upon and concurrently with the delivery of any certificate or certificates representing such shares or the transfer of any uncertificated shares to the controlling person or group by the shareholder.

(n) **TITLE TO SHARES** — Upon full payment by the controlling person or group of the amount owed to the shareholder or to the court, as appropriate, the shareholder shall cease to have any interest in the shares.

SECTION 2548

COORDINATION WITH CONTROL TRANSACTION

(a) **GENERAL RULE** — A person or group that proposes to engage in a control transaction may comply with the requirements of this subchapter in connection with the control transaction, and the effectiveness of the rights afforded in this subchapter to shareholders may be conditioned upon the consummation of the control transaction.

(b) **NOTICE** — The person or group shall give prompt written notice of the satisfaction of any such condition to each shareholder who has made demand as provided in this subchapter.

APPENDIX E

FORM OF AMENDMENT TO THE DQE ARTICLES

To: Corporation Bureau
Department of State
Commonwealth of Pennsylvania

In compliance with the requirements of the Pennsylvania Business Corporation Law of 1988, as amended, the undersigned corporation, DQE, Inc., desiring to amend its Articles, certifies under its corporate seal that:

1. DQE, Inc. (the "Corporation") was incorporated on January 5, 1989 pursuant to Article II of the Pennsylvania Business Corporation Law approved the 5th day of May, 1933, P.L. 364, as amended. The location of its registered office in the Commonwealth of Pennsylvania is 500 Cherrington Parkway, Coraopolis, Pennsylvania 15108.

2. The amendment was adopted at a meeting of the Board of Directors of the Corporation duly called and held on June 24, 1997, at which a quorum was present and acting throughout. The amendment was approved by the shareholders of the Corporation at its Annual Meeting on August 7, 1997.

3. The amendment set forth in full is as follows: A new Section 10.3 is added to the Corporation's Articles of Incorporation to read in its entirety as follows:

10.3. Election to "Opt Out" of the Control Transaction Provisions. The provisions of Sections 2541-2548 of the Pennsylvania Business Corporation Law of 1988, as amended, shall not be applicable to the Corporation.

IN TESTIMONY WHEREOF, the undersigned Corporation has caused these Articles of Amendment to be signed by its _____ and its corporate seal to be affixed to this document this _____ day of _____, 199 .

[Corporate Seal]

DQE, Inc.

Attest: _____

By: _____

Name:

Name:

Title:

Title:

Filed in the Department of State on

Secretary of the Commonwealth

**DO NOT RETURN THIS FORM UNLESS YOU PLAN TO
ATTEND THE ANNUAL MEETING**

TICKET REQUEST

I (We) will attend the Annual Meeting of Stockholders on August 7, 1997 at 11:00 a.m. at the Manchester Craftsmen's Guild Auditorium, 1815 Metropolitan Street, Pittsburgh, PA 15233.

NOTE: If you are not a stockholder of record or 401 (k) participant, please send proof of ownership if requesting a ticket.

PLEASE PRINT

ACCOUNT NO.: _____

NAME: _____

ADDRESS: _____

PHONE: () _____

An admittance ticket will be sent to a stockholder whose request is received by July 28, 1997. Stockholders without tickets will need to register at the meeting. **RETURN WITH FORM OF PROXY OR MAIL TO:**

Diane S. Eismont, Corporate Secretary
DQE
Box 68
Pittsburgh, PA 15230-0088

DUQUESNE LIGHT COMPANY

H. Rate of Return

14. Supply projected capital requirements and sources of the filing utility, its parent and system—consolidated—for the base year and the subsequent ten calendar years.

Response:

The Company's projected capital budgets for the base year and subsequent ten calendar years are provided on page 2 of this Item. It is anticipated that all of the utility's capital requirements will be funded solely from internal sources. The parent company's projected investment for the next ten years is also shown on page 2 of this item. It is expected that the parent company investments will be funded by a combination of internal and external sources.

**DUQUESNE LIGHT COMPANY
CAPITAL BUDGETS
(\$ IN THOUSANDS)**

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Duquesne Light	\$92,771	\$108,933	\$110,982	\$95,195	\$99,728	\$94,956	\$92,521	\$99,164	\$132,491	\$90,766	\$95,139
DQE Parent & Other Subsidiaries	104,032	268,517	278,475	303,334	278,719	286,214	275,629	293,917	302,599	322,923	304,968
Total Capital Budget	<u>\$196,803</u>	<u>\$377,450</u>	<u>\$389,457</u>	<u>\$398,529</u>	<u>\$378,447</u>	<u>\$381,170</u>	<u>\$368,150</u>	<u>\$393,081</u>	<u>\$435,090</u>	<u>\$413,689</u>	<u>\$400,107</u>

FILE

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