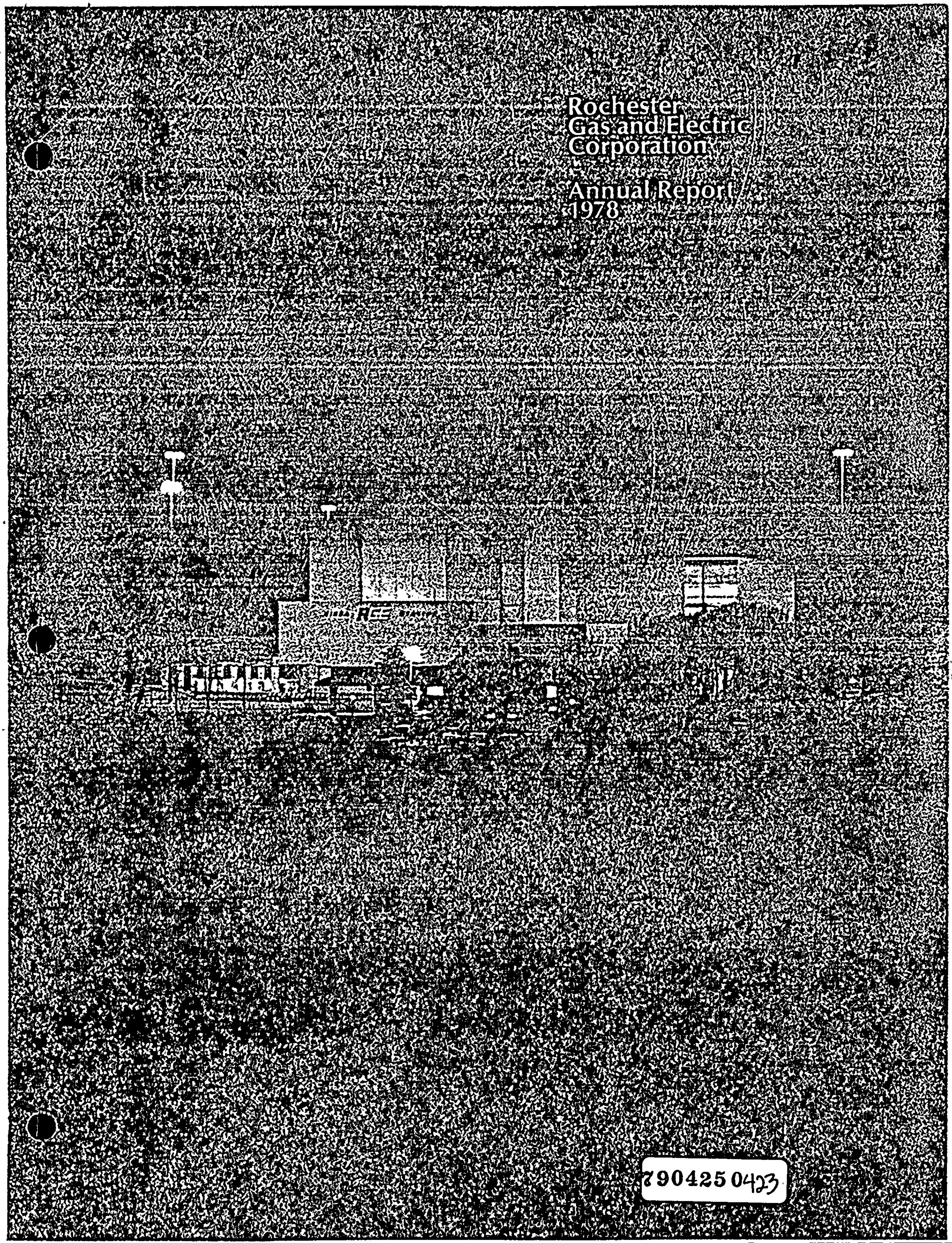
# Rochester Gas and Electric Corporation

# Annual Report 1978



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## RG&E Service Area/Business

The Company supplies electric, gas and steam service wholly within the State of New York, and is engaged in the production, transmission, distribution and sale of these services in a nine-county area centering around the City of Rochester.

The Company's territory, which has a population of approximately 880,000, is well diversified among residential, commercial and industrial consumers. In addition to the City of Rochester, which is the third largest city and a major industrial center in the State, it includes a large and prosperous farming area.


### Cover

RG&E's 470,000 kilowatt Ginna nuclear power plant stands out at night under the new security lighting system. The year 1979 marks the tenth year of the nuclear plant's highly successful operation.

# Annual Report for year ended December 31, 1978

## Contents



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Rochester, New York 14649
(716) 546-2700

**Financial Contact**
Paul W. Briggs
President

**Annual Meeting**
May 16, 1979
At Rochester, New York

**New York Stock Exchange Symbol**
Rochester Gas and Electric Corporation
Common Stock—RGS

**Transfer and Dividend Disbursing Agent**
Lincoln First Bank, N.A.
Stock Transfer Department
Post Office Box 1250
Rochester, New York 14603

**Registrar**
Security Trust Company of Rochester
One East Avenue
Rochester, New York 14638

**Co-transfer Agent**
Morgan Guaranty Trust Company of New York
30 West Broadway
New York, New York 10015

**Co-registrar**
The Chase Manhattan Bank, N.A.
One Chase Manhattan Plaza
New York, New York 10015

**Agent for Automatic Dividend Reinvestment Plan**
Lincoln First Bank, N.A.
Automatic Dividend Reinvestment Service
Post Office Box 1507
Rochester, New York 14603

**Bond Trustee and Paying Agent**
Bankers Trust Company
Post Office Box 318
Church Street Station
New York, New York 10015

## Shareholder Inquiries

Communications regarding stock transfer requirements, lost certificates or dividend payments may be directed to Lincoln First Bank, N.A.

Other inquiries should be directed to D. W. Caple, Secretary and Treasurer at the Company.

The Company will provide, without charge, a copy of the Annual Report on Form 10-K filed with the Securities and Exchange Commission with respect to fiscal year 1978, upon written request of any shareholder addressed to the Secretary.

## Highlights

| | 1978 | | 1977 | | % Change |
|---|---|---|---|---|---|
| **Common Stock** | | | | | |
| Earnings per weighted average share | | $2.46 | | $2.12 | 16 |
| Number of shares (000's) | | | | | |
| Weighted average | | 13,774 | | 12,474 | 10 |
| Pro forma weighted average after stock dividend paid in following year (See Note) | | 14,187 | | 12,848 | 10 |
| Actual number at December 31 | | 14,733 | | 12,890 | 14 |
| Number of shareholders | | 48,148 | | 44,135 | 9 |
| Price range (Sales on New York Stock Exchange) | *High* | *Low* | *High* | *Low* | |
| 1st quarter | 21½ | 17⅞ | 20⅛ | 17¾ | |
| 2nd quarter | 18⅞ | 17⅝ | 20⅝ | 18 | |
| 3rd quarter | 19⅜ | 18 | 21¼ | 19¼ | |
| 4th quarter | 18¼ | 16½ | 21⅜ | 19½ | |
| Cash dividends paid (100% taxable) | | | | | |
| 1st quarter | | $.35 | | $.32 | |
| 2nd quarter | | .35 | | .32 | |
| 3rd quarter | | .36 | | .35 | |
| 4th quarter | | .36 | | .35 | |
| Stock dividend paid (See Note) | | 3% | | 3% | |
| **Sales and Revenues** | | | | | |
| Electricity to customers | | | | | |
| Kilowatt-hours (000's) | | 5,102,923 | | 4,938,362 | 3 |
| Revenue (000's) | | $202,631 | | $179,940 | 13 |
| Electricity to other utilities | | | | | |
| Kilowatt-hours (000's) | | 1,445,391 | | 1,453,590 | (1) |
| Revenue (000's) | | $ 28,676 | | $ 26,403 | 9 |
| Gas | | | | | |
| Therms (000's) | | 433,324 | | 420,438 | 3 |
| Revenue (000's) | | $118,531 | | $105,797 | 12 |
| Steam | | | | | |
| Pounds (000's) | | 2,963,500 | | 2,950,287 | |
| Revenue (000's) | | $ 19,110 | | $ 19,004 | 1 |
| Total revenues | | $368,948 | | $331,144 | 11 |
| **Operating Expenses (000's)** | | | | | |
| Electric and steam fuels | | $ 58,140 | | $ 56,993 | 2 |
| Purchased electricity | | 19,337 | | 13,635 | 42 |
| Purchased natural gas | | 71,109 | | 62,086 | 15 |
| Wages and benefits | | 54,390 | | 50,318 | 8 |
| Depreciation | | 22,206 | | 21,053 | 5 |
| Taxes—local, state and other | | 45,935 | | 43,876 | 5 |
| Federal income taxes charged to operations | | 11,041 | | 3,858 | 186 |
| Other expenses | | 37,541 | | 34,548 | 9 |
| Total operating expenses | | $319,699 | | $286,367 | 12 |
| **Capital Expenditures, less allowance for funds used during construction (000's)** | | $112,552 | | $ 98,091 | 15 |
| **Net Utility Plant at December 31 (000's)** | | $810,016 | | $722,780 | 12 |
| **Number of Employees** | | 2,622 | | 2,624 | |

*Note: The 20th annual stock dividend was paid February 23, 1979 at the rate of three percent.*

## To Shareholders:

After a disappointing year in 1977, common stock earnings in 1978 rebounded to $2.46 per share. This represents an increase of 34 cents, or 16 percent more than the 1977 earnings of $2.12 per share; a substantial improvement, especially since there were 1.3 million additional shares outstanding during 1978.

Earnings continue to be affected by the weak economy of the State, by inadequate rate relief, and by increasing costs, including those due to inflation and government regulation. Although earnings have improved, they are not at the level we believe they should be. On the plus side, some encouragement can be taken from the State government's more serious efforts to retain and attract business and industry.

Dividends paid per common share for the year totaled $1.41, 12 cents more than the $1.29 paid the previous year. Additionally, a three percent common stock dividend was paid in February 1979. This is the 20th consecutive year in which a stock dividend has been paid.

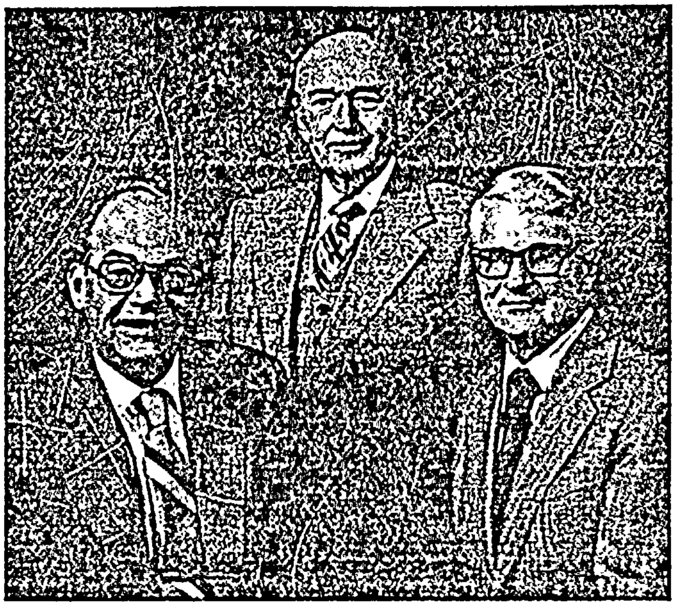
Total customer revenues for 1978 were $340.3 million, a 12 percent increase over 1977 customer revenues of $304.7 million. Revenue from electric sales to other utilities rose 8.6 percent in 1978 and totaled $28.7 million. The gain resulted from a sustained strong market for RG&E's coal-fired electricity through the New York Power Pool to utilities that would otherwise have to rely on the more expensive oil-fired electric generation. These sales brought total revenues for the year to $369.0 million, an 11 percent increase over 1977.

Kilowatt-hour sales of electricity to customers increased 3.3 percent for the year. Industrial kilowatt-hour sales led gains with a six percent increase over 1977, a relatively strong growth. Residential kilowatt-hour sales increased 2.5 percent.

Natural gas sales in therms were up 3.1 percent over 1977. The gain is attributed primarily to colder than normal weather and the addition of more than 2200 gas space heating customers following the 1977 lifting of a New York State Public Service Commission (PSC) prohibition on additional gas service.

The performance of the Ginna nuclear power plant was excellent. The plant was available 81 percent of the time during the year and had regained its maximum dependable capacity of 470,000 kilowatts following the May 1978 installation of a new turbine rotor. Thus the nuclear power plant economically provided 60 percent of the electricity on our own system and, when compared with an equivalent amount of energy generated by a coal-fired plant, saved our customers $32 million in fuel costs for the year.

Operating expenses rose 11.6 percent, going to $319.7 million in 1978 from $286.4 million in 1977. Fuel expense, including purchased electricity and



*Keith W. Amish* *Francis E. Drake, Jr.* *Paul W. Briggs*

gas, went up 12.0 percent, an increase of $15.9 million. Employee wages and benefits expense increased 8.1 percent, or $4.1 million over 1977. The total number of employees, 2622, was reduced by two over the year while the number of customers continued to increase, resulting in improved productivity. Employee overtime was kept to a minimum. Taxes, including Federal income tax, increased $9.2 million over 1977, or 19.4 percent.

Capital expenditures for 1978 were $112.6 million, excluding Allowance for Funds Used During Construction (AFDC). This was 15 percent more than the 1977 capital expenditure of $98.1 million.

A total of $38.7 million was required during 1978 for additional electric generating capacity. This included $3.6 million capital investment in our proposed Sterling nuclear power plant project, $12.2 million for a 24 percent share of Niagara Mohawk Power Corporation's Oswego #6 oil-fired plant, and $22.9 million for 14 percent of its Nine Mile Point #2 nuclear plant. The Niagara Mohawk plants have been rescheduled to be operational in 1980 and 1984 respectively. These later operational dates will not affect the Company's ability to meet projected increased customer electric demand unless we should experience an increase in the present growth rate of electric use.

Plans for a proposed 1,150,000 kilowatt nuclear power plant at Sterling, New York await reinstatement of a certification from the New York State Board on Electric Generation Siting and the Environment. In January 1978 this Board granted a construction certificate for the Sterling plant with an operational target for the year 1986. The Board suspended the certificate in May 1978 and requested further proof of "need" for the unit. Based on updated load growth projections that showed lower electric load growth in the State as a whole, the Siting Board felt there was a question as to the necessity for the unit in the time frame originally requested. The four partners in the Sterling project subsequently advised the Siting Board that the operational date for the plant could be extended to 1988 if the updated growth estimates proved to be accurate.

RG&E continues to pursue the authorization for timely construction of the Sterling plant based on state-wide needs as well as customer needs on the Rochester system. Although construction cost estimates in an inflationary economy have greatly appreciated due to the delays in completion date of the project, it is our opinion that this plant represents the best and most economic option for meeting electric energy demands in New York State and the Rochester system.

We petitioned the PSC in May 1978 for rate increases amounting to a total of $48.7 million in additional revenue, consisting of an 8.9 percent gas rate increase and a 17.8 percent increase in electric rates. The proceeding is in its final stages and the PSC decision is expected to be rendered in late April with the new rates to take effect in May.

The September 1978 sale of an additional 1,250,000 shares of common stock realized $23.4 million in new capital. In December 1978 RG&E completed the private placement with institutional investors of $40 million in first mortgage bonds at 9.5 percent interest.

More than 18 percent of holders of common stock are now participating in the Company's Automatic Dividend Reinvestment Plan as compared with 11 percent when the Plan was initiated in 1974. During 1978, they invested more than $3.7 million in 206,427 new shares of common stock.

We have consistently expressed support for the creation of Empire State Power Resources, Inc. (ESPRI). This plan would have allowed power companies in New York State to join in common power plant licensing, financing and plant operation, yet sustain the autonomy of the companies. The plan would have benefited customers through lower generating costs than would otherwise be possible. The projected savings to RG&E customers alone through the year 1998 would approach $1 billion. In February 1979, after five years of lengthy deliberations, the PSC took an informal poll that indicated that the proposal would be disapproved. We are still awaiting the formal decision. The verdict is very disappointing, and the higher costs it will produce for the long-suffering consumers cannot be justified, in our opinion.

Once again, the PSC reported that RG&E had the lowest number of customer complaints per capita of any power company in New York State. These figures are supported by our own consumer surveys that show customers give the Company very high marks for the quality and reliability of its service. The credit goes to our fine employees.

We anticipate modest increases in demand for both electricity and natural gas in 1979. Gas supplies are sufficient and we will continue to expand gas space heating service while balancing known supply with anticipated demand. Total kilowatt-hour sales of electricity to customers are projected to increase 3.1 percent. Our service area is expected to realize this growth despite the adverse economic factors that have significantly diminished load growth in other areas of the State.

Expenses will continue to increase, with taxes estimated to go up by 7.7 percent. Capital expenditures will go up to $115 million, excluding AFDC.

Although we retain a markedly positive view of the future in our service area, efforts to improve performance as a utility are regularly hampered by events and circumstances largely outside our control. The costs associated with virtually every segment of our business continue to rise, and inflationary pressures will undoubtedly necessitate further increases in our rates for natural gas and electricity.

The cost problems are compounded by a regulatory environment that frustrates our attempts to build the generating capacity that will be required if there is to be economic growth in New York State. Along with increased taxes, the burdens of excessive regulation and extraordinary regulatory delays are passed on to our customers as increased prices, and this further compounds the problems faced by businesses and consumers within our service area.

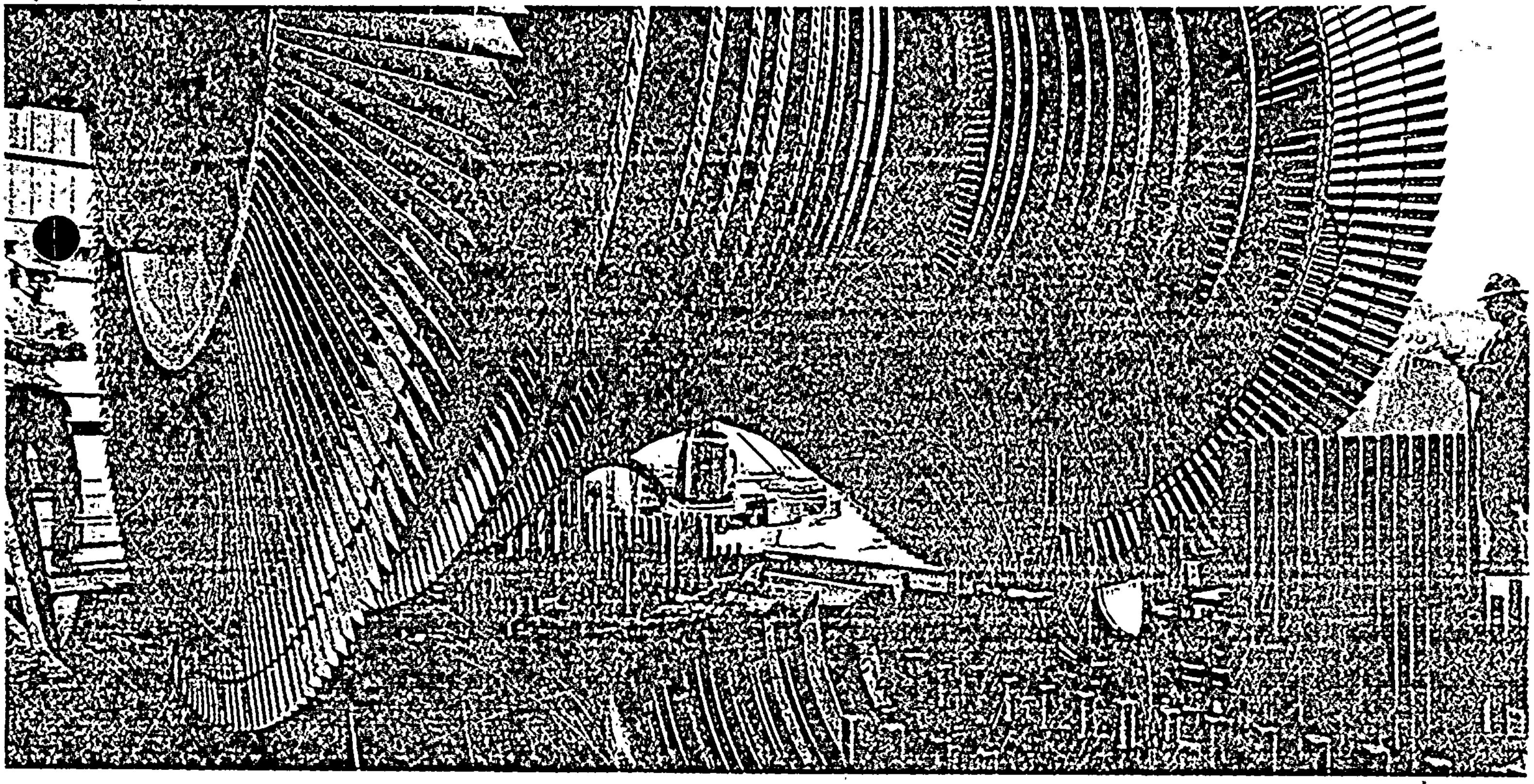
These problems are so important that we have taken the unusual step of preparing a special section to this report that can be found on page eight. We hope you will take the time to read it.

*Francis E. Drake, Jr.*
*Chairman of the Board and*
*Chief Executive Officer*

*Paul W. Briggs*
*President*

*Keith W. Amish*
*Executive Vice President*

March 15, 1979



*Following a major redesign of blade configuration, this new, 80-ton low pressure turbine rotor was installed at the Ginna nuclear power plant.*

## Electric Operations

**Generation** Over the past few years, three incidents of blade failures in one of the rows of a low pressure turbine rotor at the Ginna nuclear power plant had reduced plant availability—the percentage of time the plant is in service. In 1976, for example, the plant's availability was only 58 percent. A temporary modification to the turbine following the third blade failure allowed continued plant operation, but only at 86 percent of capacity.

RG&E worked with the manufacturer in redesigning blades for a new turbine rotor to solve the problem. The new rotor was installed in May 1978 and it has performed very well. The plant is once again operating economically and efficiently at full capacity, providing more than half of the electricity for the Company's system. During the seven-month period from the time the rotor was replaced to the end of the year, the Ginna nuclear power plant recorded a remarkable 98 percent availability. For the entire year, the plant's availability was a noteworthy 81 percent.

For further reliability, the original rotor has been rebuilt with the improved blades and was replaced in the second low pressure turbine unit during the 1979 annual refueling, maintenance and inspection shutdown. The displaced rotor will be rebuilt and kept at the nuclear power plant as a spare to significantly reduce shutdown time in the event of any future, unforeseen rotor problem.

**Distribution** In the Rochester vicinity, a substation was constructed to meet electric demand at the new manufacturing plant at Rochester Products, Fuel Systems Division of General Motors. An additional overhead transmission line was constructed to the Xerox Corporation facility in Webster providing greater capacity for Xerox and other area customers. As part of the 115 KV transmission construction project in the Rochester area, a major circuit was reconstructed in western Monroe County that increased capacity to suburban customers in the Town of Gates, including the expanding Apparatus Division of Eastman Kodak Company located there.

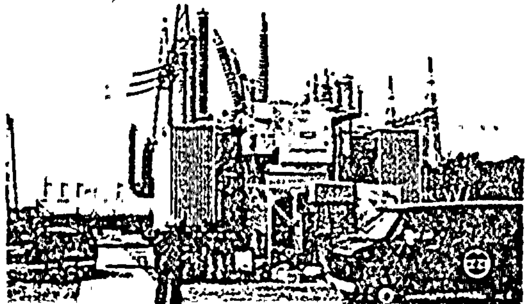
RG&E continued its construction program extending 34.5 KV distribution facilities in the Genesee District, south of Rochester. The Canandaigua-Finger Lakes District expanded 115 KV facilities in meeting sustained growth in its area. A new 12.5 KV service was installed at the recently completed Voplex plant in Canandaigua.

In the Lakeshore District to the east, plans call for the construction of a 115 KV transmission line along the recently acquired right-of-way section of the Hojack Line railroad to meet growth in that outlying district.

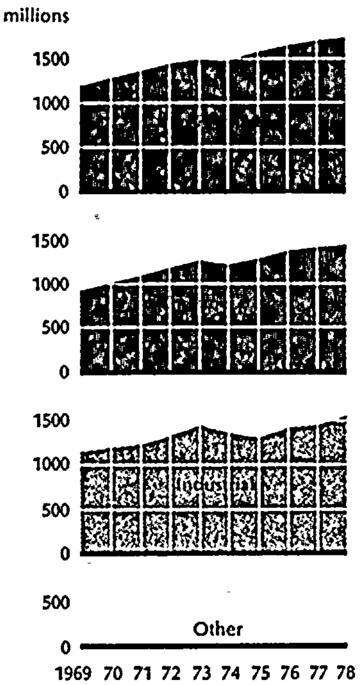
Streetlighting modernization programs in 1978 resulted in more than 2000 older incandescent lamps being replaced with high pressure sodium units in the northern part of the City of Rochester. This project, paid for by the City, increases lighting efficiency and enhances public safety. A streetlighting modernization program was completed in the Village of Mt. Morris, and another is underway in the Village of Webster.

Electric and gas facility relocation on public property became a larger-than-normal undertaking in 1978 due to the extensive activity in road construction and highway improvement. The $7 million expense for this work must ultimately be borne by the Company's customers since there is only occasional and very minor reimbursement from government agencies that order the relocations.

*This electric transformer replaced a unit that failed in service in 1978. It is one of two transformers at an interconnection that reduces 345,000 volts to 115,000 volts for transmission in the RG&E system.*



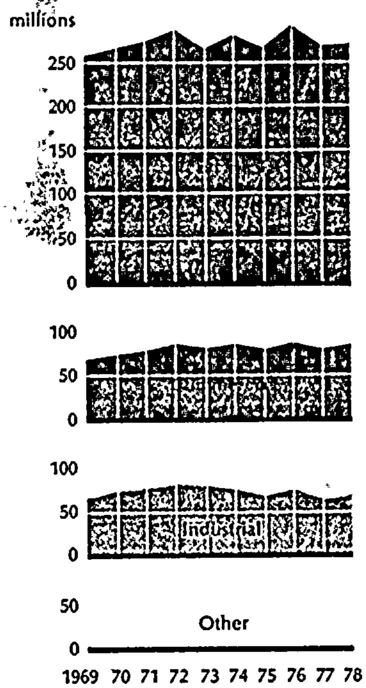
**Electric Kilowatt-Hour Sales to our Customers *by Classes***




**Total Electric KWH Sales**
*In Millions*

| Year | Total |
|---|---|
| 1978 | 5103 |
| 1977 | 4938 |
| 1976 | 4806 |
| 1975 | 4521 |
| 1974 | 4408 |
| 1973 | 4540 |
| 1972 | 4292 |
| 1971 | 3982 |
| 1970 | 3802 |
| 1969 | 3578 |

**Gas Therm Sales to our Customers *by Classes***




**Total Gas Therm Sales**
*In Millions*

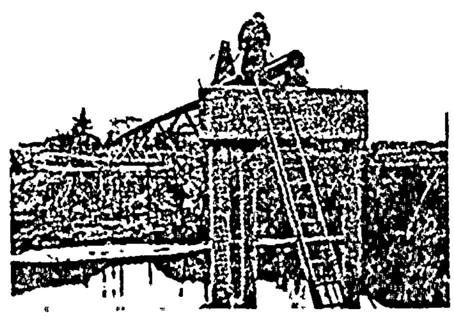
| Year | Total |
|---|---|
| 1978 | 433 |
| 1977 | 420 |
| 1976 | 468 |
| 1975 | 424 |
| 1974 | 454 |
| 1973 | 435 |
| 1972 | 469 |
| 1971 | 442 |
| 1970 | 425 |
| 1969 | 403 |

## Gas Operations

**Supply Adequate** RG&E's supply of natural gas, under contract with Consolidated Gas Supply Corporation, remains adequate. Deliveries of liquefied natural gas (LNG) from Algeria to our supplier continue on schedule, adding 15 percent to the supplier's capacity. This, combined with increasing yields from the supplier's Louisiana offshore wells, provides assurances for adequate gas volumes in meeting existing and projected demands.

**New Gas Service** RG&E installed more than 1300 gas service lines to new residential, commercial and industrial customers in 1978. Including heating system conversions, more than 2200 gas space heating customers were added during 1978. This expansion followed Public Service Commission approval in 1977 of the Company's petition to lift the prohibition on accepting new or additional gas service. The additional services have helped slow the decline in total gas deliveries seen over the last several years that resulted from customer attrition and conservation. RG&E estimates that more than 3400 space heating customers will be added in 1979 including new homes, commercial establishments and heating system conversions.

**Therm Billing** Liquefied natural gas (LNG) has a higher heat value (BTU's per cubic foot) than the domestic gas we have previously received. When LNG is mixed with domestic gas, as in the supplier's delivery to RG&E, the thermal value varies. For this reason, RG&E has changed its gas billing from hundreds of cubic feet to therms, one therm being one hundred thousand BTU's. Starting in May 1979, a gas customer's bill will be calculated according to the average heat value (therms) used during the billing month. While this new system should have no effect on the amount of the customer's bill, it ensures that the Company's gas revenues will more accurately reflect the heat value of the gas sold.



*RG&E engineers designed an uncommon type of gas pipeline support in this bridge that crosses the Barge Canal. The support cables are underneath the pipe instead of above.*

## Research and Development

In 1978 RG&E invested $2.8 million in research and development projects. Half of that amount was directed to nation-wide utility industry supported research organizations as well as the research arm of New York State utilities, known by the acronym ESEERCO. One such ESEERCO program helps support the nuclear fusion experiments at the University of Rochester. The New York State Energy, Research and Development Authority directly assessed RG&E $600,000 for state government sponsored research and development projects.

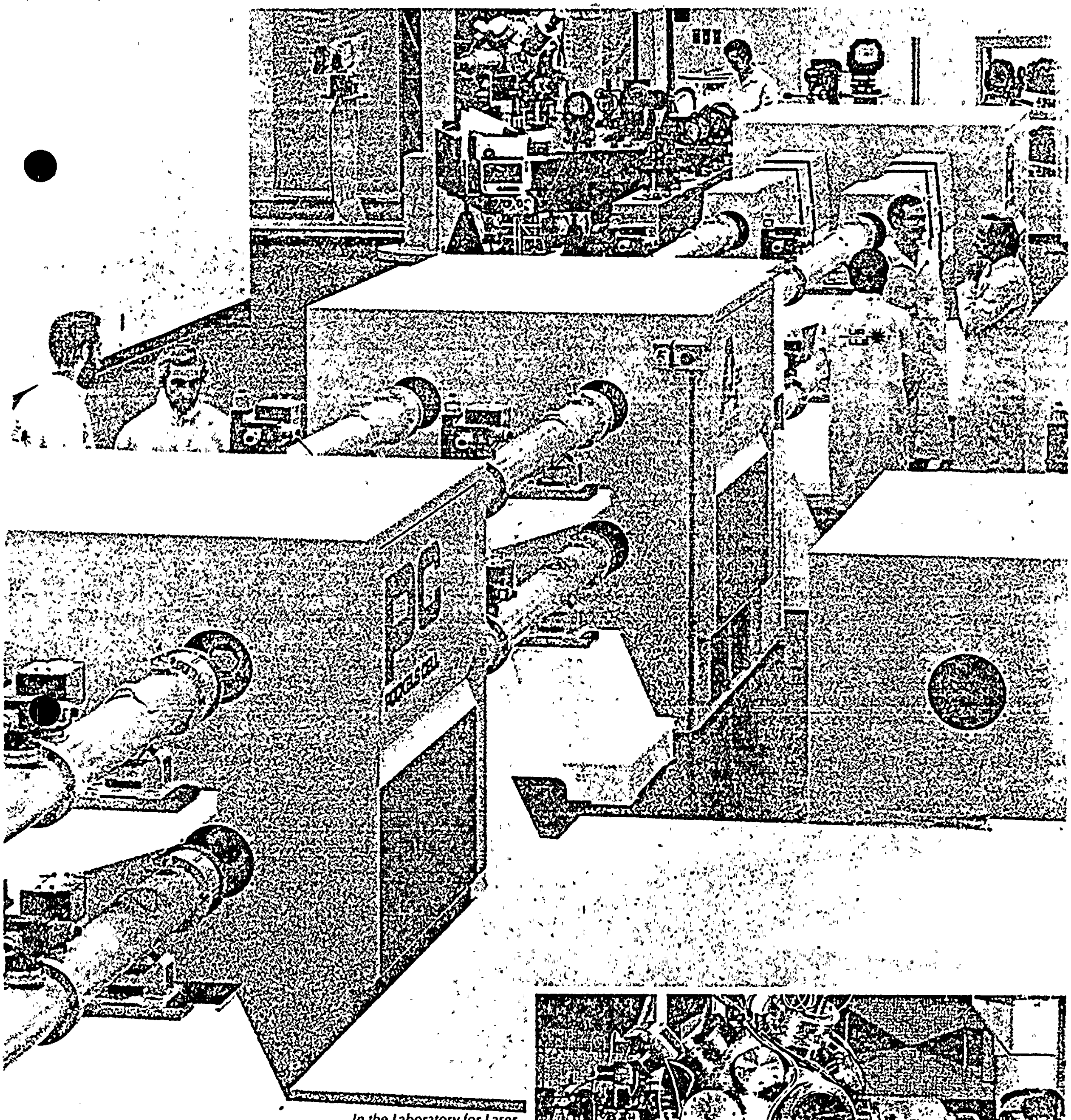
The other half of the research and development funds was allocated to Company-sponsored and -coordinated projects such as the gas furnace demonstration program in which a number of residential gas furnaces have been modified for test purposes in an attempt to improve efficiencies. So far, an average gas saving of 17 percent has been achieved in the test homes while maintaining comfortable heating levels.

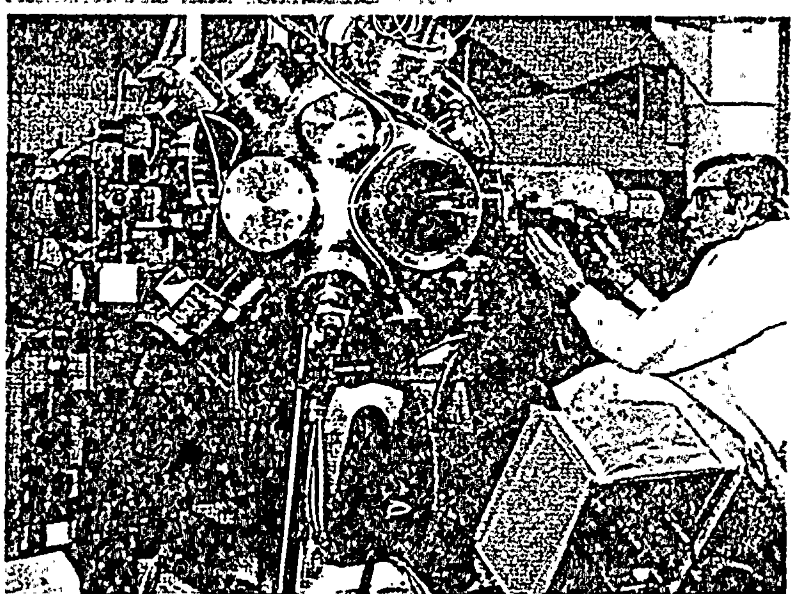
A broad, national program to encourage development of nuclear steam generation equipment and maintenance improvements was initiated in 1978 and is co-sponsored by RG&E. The research on a novel backhoe safety shutoff system that will prevent accidental damage to underground cable and pipeline has produced a prototype that will be field-tested this year. In another research area under RG&E coordination, data collected from several utilities were analyzed to determine spawning habits of fish along the southern shoreline of Lake Ontario. In all, RG&E directly supported more than 40 research and development projects in 1978.

### Management Appointment

Joseph J. Hartman was elected to the position of Vice President, Gas and Transportation by the board of directors effective December 1, 1978. He succeeded Elvin A. Skibinski who retired after 33 years of service.

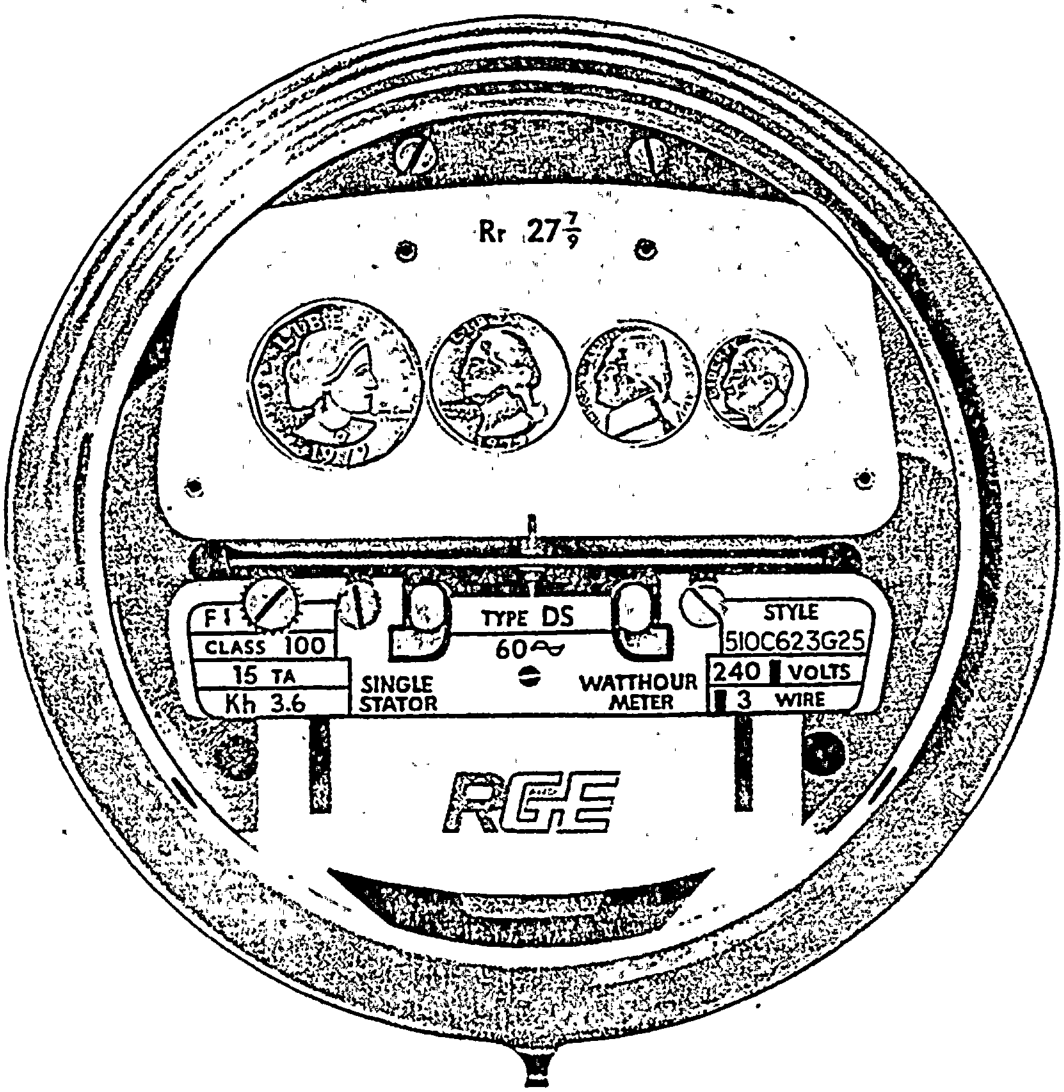
Mr. Hartman joined RG&E in 1946 as a co-op student in the Gas Department. He held a series of engineering positions in the Gas Department until 1974 when he was appointed Superintendent of General Maintenance.





*In the Laboratory for Laser Energetics of the College of Engineering and Applied Science at the University of Rochester, experiments are conducted in an attempt to harness thermal energy from nuclear fusion. Powerful laser beams are focused through mirrors and converge on a minute hydrogen pellet inside a target chamber (photo inset). The project is supported in part by RG&E, and the experiment may one day lead to a virtually inexhaustible source of thermal energy for the generation of electricity.*

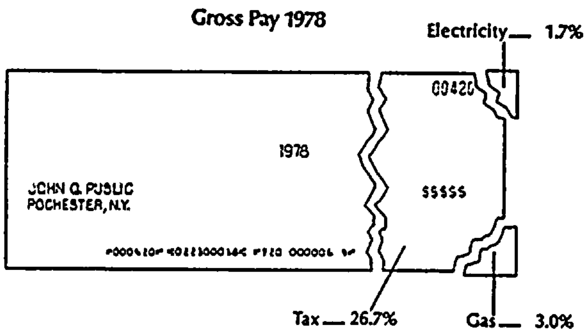
*Some Plain Talk*



The cost of living has gone up drastically over the years, and we know it will continue to rise until inflation, at least, is brought under control. But, it's not just the cost of living that's gone up, it's the cost of doing business, too. The inflationary economy has adversely affected business and industry as well as the individual. Despite efforts to minimize expenses, the rising cost of doing business has affected RG&E, particularly on costs over which the Company can exert little or no control.

This special section of the 1978 annual report is intended to portray, in plain talk, the rising costs and their effect on RG&E, its customers and shareholders.

Before getting into specifics on the cost increases, let's take a look at the overall impact on RG&E customers in general. From 1970 to 1978 the cost of electricity to RG&E customers had risen 84.5 percent, and the cost of gas went up 109 percent. How has the higher cost of electricity and gas affected most RG&E customers? Based on wage figures published by the New York State Department of Labor, our records show that in 1970 the typical Rochester production worker paid 1.6 percent of his or




her gross income for electricity. In 1978, despite more than a ten percent increase in electric use by the average residential customer, the same worker still paid just 1.7 percent of gross pay for electricity. If that worker was a gas space heating customer, he or she paid 3.1 percent of gross income for gas in 1970, and only 3.0 percent in 1978. In the meantime the tax bite (property, income, social security and sales) out of that same gross pay went from 23.9 to 26.7 percent.

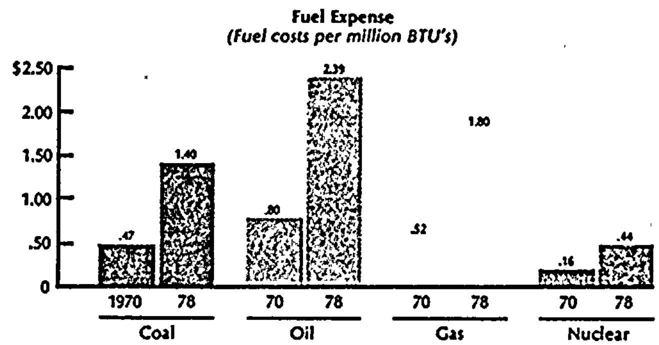
Most pay has kept pace with the inflationary impact on prices. Even though more actual dollars are needed to pay for electricity and gas, these forms of energy absorb about the same amount of gross income as they did nearly ten years ago. The problem is that government taxes are taking greater amounts of the devalued gross paycheck dollars.

We're certainly not saying that all of our customers have incomes that have kept pace with escalating inflation. The senior citizen, for example, on low, fixed income is having an extremely difficult time meeting the continually increasing costs of all essentials for living, including heat and electricity.

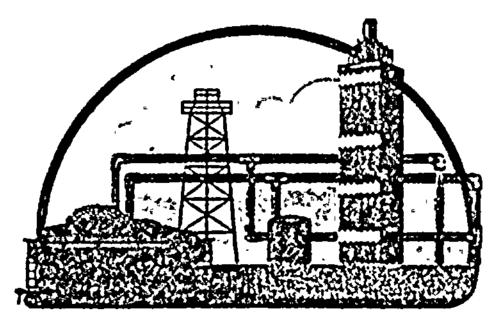
The plight of a senior citizen in the situation described above is a very complex social problem that stems from rampant inflation. And, as a social problem, it is one that should not be placed upon any one segment of the economy or any one industry, whether it be a regulated natural monopoly or not. Recognizing this social problem, we at RG&E have expressed our support for an energy stamp program and have even offered to help develop such a plan. But, so far, the authorities have not accepted the offer. Further, we have contended that residential heat and electricity are just as essential to our customers as food, and should be tax-exempt. In that regard, the State did reduce sales tax on electricity and gas by one percent in 1978.

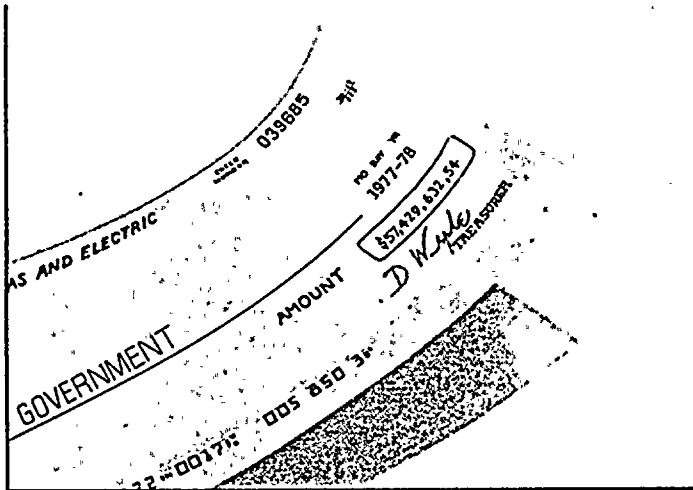
On the subject of rising costs, pressure groups and consumer activists often suggest that utilities, like RG&E, should hold the line on "their" rising costs and maintain existing rates or even lower them by reducing "profits." Well, the fact is, RG&E has no control over most of the costs that comprise the rates. And as for "profits," there really aren't any profits in a strict sense of the word as we'll point out later. Let's take a look at the costs in RG&E's business.

Fuel expense consumes the largest portion of the revenue dollar. Today 40 cents of each revenue dollar go to pay for the fuels used in the generation of electricity, steam, and for the cost of natural gas. Over a nine-year period through the end of 1978, the cost of coal per ton more than doubled while oil and natural gas had tripled in cost. Nuclear fuel, processed and ready for use in a power plant, had a fourfold cost increase, yet it still remains the most economical fuel for electric generation as seen in the accompanying chart that compares fuel cost on a BTU or heat value basis.



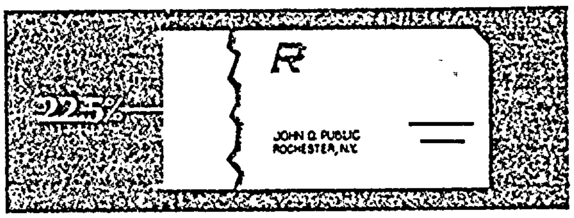

The market price of fuels is beyond the influence of RG&E's prudent and aggressive purchasing procedures. Rising inflation gradually boosted fuel prices. The single most devastating factor, though, was the 1973 Arab Oil Embargo that not only caused the price of oil to double in a year, but also illustrated that the United States had become dangerously dependent on foreign oil sources. This dependence, combined with the rapid cost increases, produced trade deficits that have seriously eroded the value of the American dollar and have helped promote uncontrolled inflation. It's a serious situation and one that is increasingly agitated by a glut of self-defeating laws, regulations and taxes enacted by the federal and state governments.






RG&E's tax expense has tripled since 1970 going from $19 million to $57 million in 1978. And, the 1978 figure doesn't even include the $15.5 million in sales tax RG&E had to collect from customers in their bills for the State and local governments. Aside from the visible sales tax, "hidden" taxes in the customer bills account for more than 15 cents of every dollar the customer pays to RG&E. When sales taxes are included, the typical residential customer's bill is more than 22 percent tax. And that's a cost of government, not of energy.

Tax Portion of 1978 Customer Bill — 22.5%




Tax is another example of expense where RG&E can exercise little or no control. Of course, it could be pointed out that property taxes do mount up as we expand facilities such as substations, transformers and power lines. But, even here there is no option. We are obligated to meet growth, and are required by PSC law to serve the instant energy demands of customers regardless of the amounts called for. And just like every other property owner, we pay high tax rates on inflated values. The effect is cumulative.

Expense for employee wages and benefits has increased 80 percent since 1970, a relatively small increase compared to other items mentioned. This is an area where RG&E may and does exercise control—reasonable control. And it has to be reasonable if the Company is to retain competent personnel and remain competitive in the labor and professional employment market. Let's face it, we're in a highly complex, technical business. Low or inadequate wages would produce nothing but a false economy.

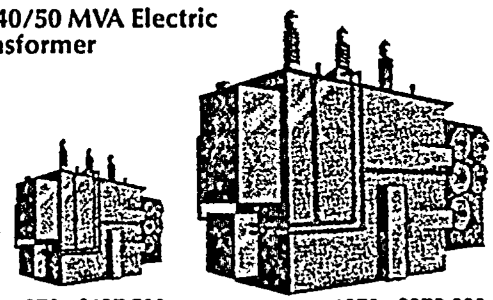
More importantly, RG&E employees are qualified, dedicated and productive people who are entitled to fair return for their efforts.

The ratio of RG&E customers to employees in 1970 was 168 to one. In 1978 there were 186 customers for each RG&E employee. This means that our employees have increased their productivity as their contribution in the struggle against inflation. Productive, competent employees provide for the best interest of the shareholder and the customer.

RG&E will continue to exercise control of wage and benefit expenses, and we are observing the current voluntary anti-inflationary guidelines.

In addition to the expenses just discussed, seven percent of the 1978 revenue dollar was used to pay for miscellaneous materials and services. Among other items this category includes fees assessed by regulatory agencies, expenses for regulatory compliance, legal counsel, and building and grounds maintenance. Here, too, there is really little choice. We do, however, request bids where we can and look for the best price in the marketplace.

30/40/50 MVA Electric Transformer

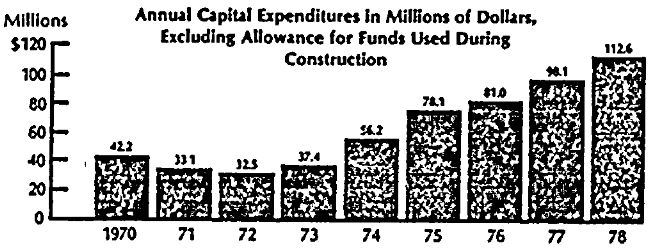


1970–$127,500 1978–$278,000

Percentage increase–118.0%

to serve customers. So, when it comes right down to it, RG&E's "profit," or the interest cost of money, is a cost of doing business, and it's certainly one over which we have little control.

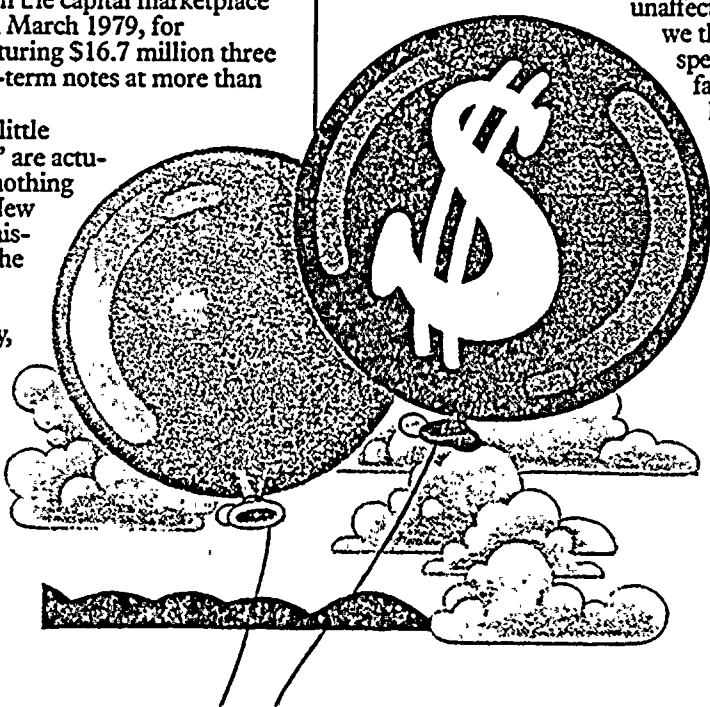
Gas and electric companies constitute the most capital-intensive industry in the entire economy. The average manufacturing concern, for example, invests 75 cents in plant for each dollar of gross income while RG&E has had to invest more than three dollars for each gross income dollar. Large amounts of money are required to pay for facility expansion, improvement and replacement. Prices for materials and labor have gone up, and so has the cost of borrowing the money to finance the new facilities. For the most part, these costs cannot be controlled by us. Just as inflation has driven up costs in the markets where people shop, it has also affected the markets where utilities purchase their hardware and money.




In 1978, $112 million were needed to cover the cost of new facilities required to serve customers. Although 40 percent of that capital was raised internally, the rest had to come from a highly competitive money market. There is no alternative. Regardless of market conditions we cannot and would not elect to ignore necessary additions to serve customer energy needs. To compromise on improvements and replacements that protect the energy systems is to gamble on efficient and reliable service to our customers, and we won't do that.

Cost of capital is a major area where we can exercise little or no control other than continuing to employ efficient methods for raising funds in the capital marketplace where costs are rising rapidly. In March 1979, for example, we had to replace a maturing $16.7 million three percent interest bond with short-term notes at more than 11 percent interest.

Although this may seem a little strange at first, RG&E's "profits" are actually an expense. Our "profit" is nothing more than the amount that the New York State Public Service Commission (PSC) allows us to pay for the money we have to borrow to build the facilities needed to serve customers. Put another way, we are allowed to earn a "rate of return" on the capital invested in plant used to serve the public. The rates of return are set by the PSC, but are in no way guaranteed. Without the ability to pay the cost of money in interest and shareholder dividends we would not be able to raise the capital necessary to continue



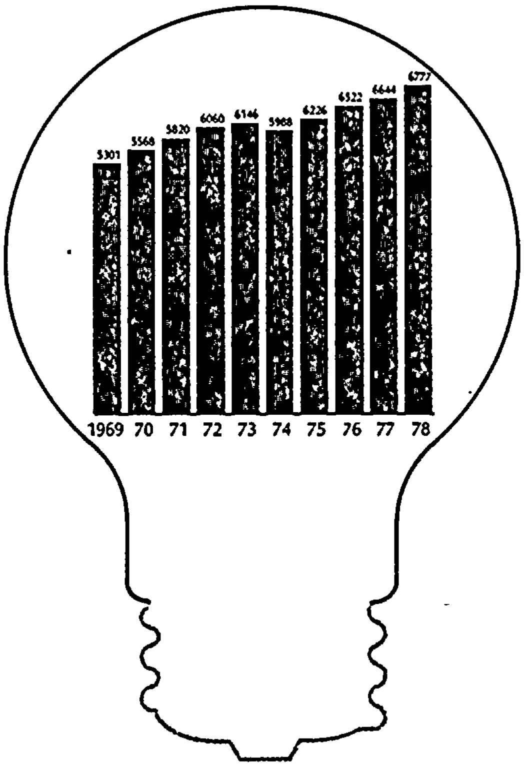
RG&E has a responsibility to supply electricity, gas and steam to its customers at the most economical prices. But, try as we may, we have little control over most of the expenses incurred in fulfilling this responsibility. We have consistently applied sound management policies and principles in attempting to minimize the amount of rate increases while maintaining the Company as a sound investment and reliable supplier. It's very discomforting to realize that uncontrollable costs have accounted for more than 80 percent of customer cost increase since 1970!

The cost of doing business, especially power company business, is high, and it continues to go higher, driven by unbalanced federal and state budgets. Most of the cost is in fuels, taxes, capital expenditures and the cost of money. And, part of the cost is a result of heavy regulation by all layers of government. We are not saying that regulation is unnecessary. Some of it is beneficial. But, like everything else, regulation has a price.

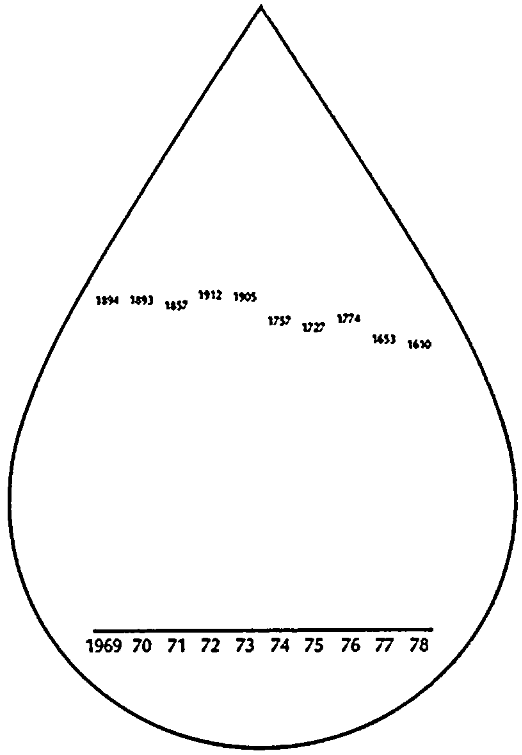
Since 1970, RG&E's spending for capital improvements just to comply with regulatory requirements and laws approaches $100 million. This expense amounts to almost a $20 million annual cost to customers. To this we can add at least another $10 million a year in operational expense to comply with various other federal and state regulatory requirements. Thus, a very conservative estimate of the annual cost of government regulation to our customers is $30 million, a very real part of the rising cost of energy.

We have taken this opportunity to present a story to you our shareholders, and hopefully to many of our customers. It is not a unique story because each of you is experiencing the same pressures, the same cost increases, the same inflation, over-regulation and taxes. But, because utilities are sometimes regarded by the uninformed as unaffected by such pressures, we thought it important to spell out how these same factors, over which we have little or no control, are driving up the absolute cost of energy.

**Average Annual Use Per Residential Electric Customer**
*Kilowatt – Hours*

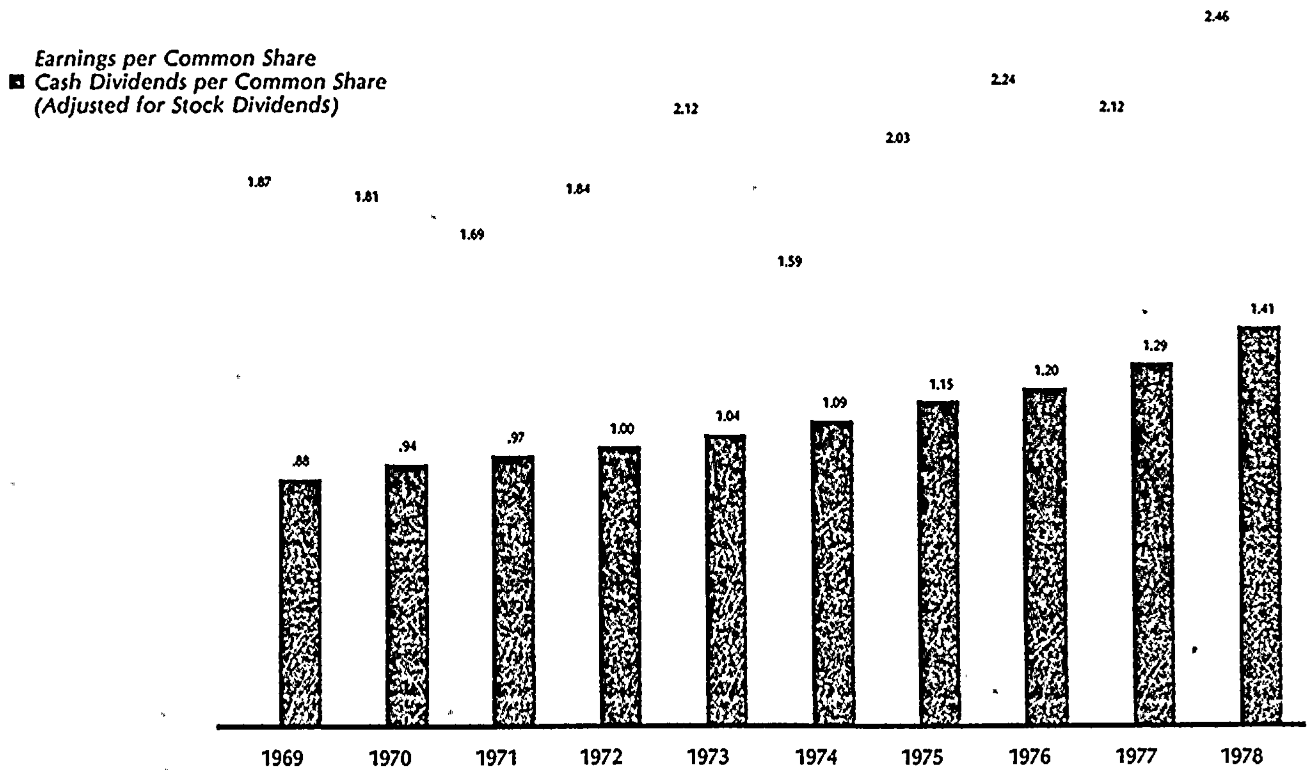



**Average Annual Use Per Residential Space Heating Gas Customer**
*Therms**

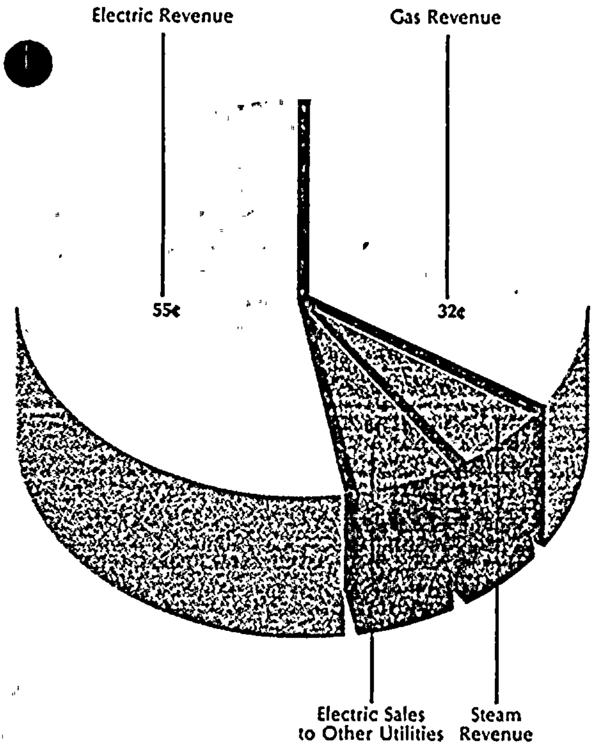



*Adjusted for normalized weather by degree days.

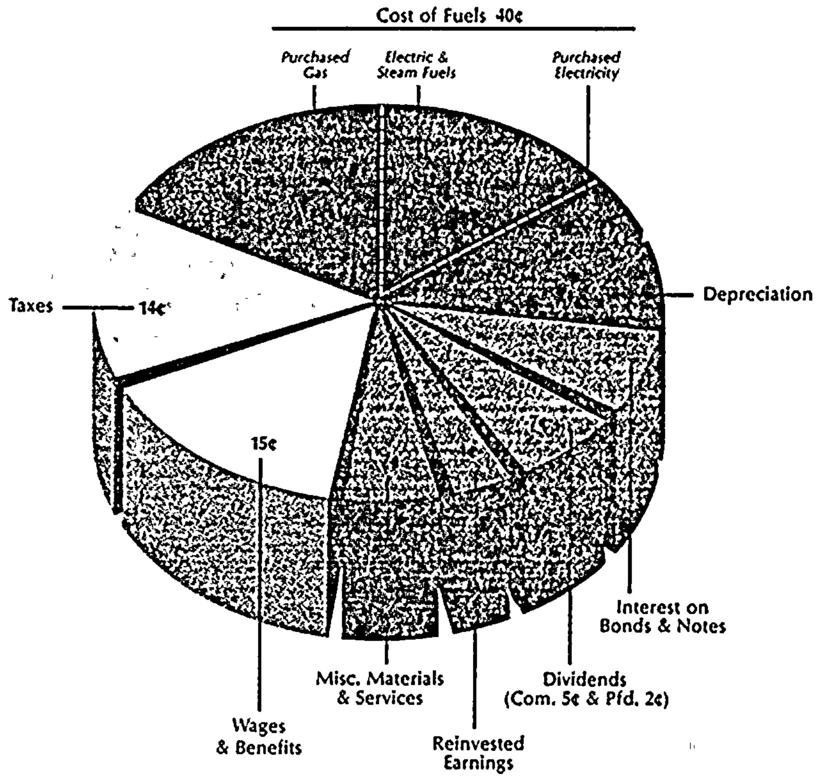
**Earnings and Dividends Per Common Share**
*in Dollars*



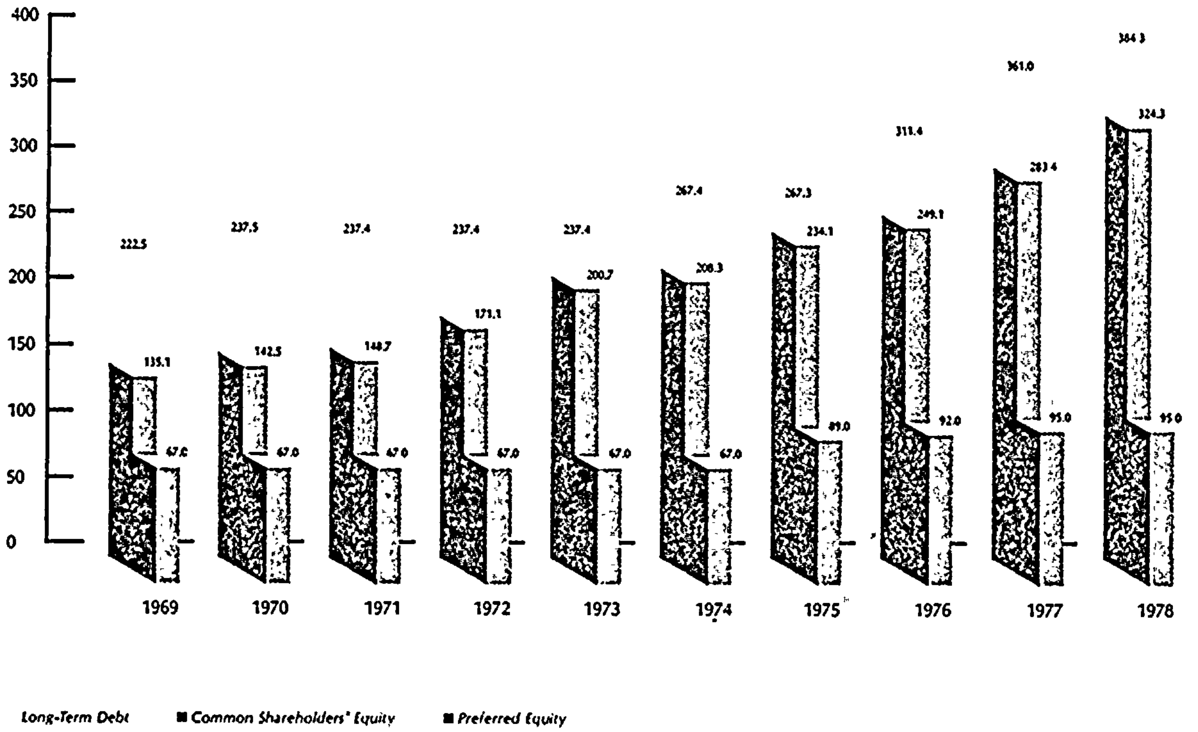
**Source of 1978 Revenue Dollar**
*in Cents*




**Use of 1978 Revenue Dollar**
*in Cents*




**Capitalization**
*in Millions of Dollars*



## Statement of Income (Thousands of Dollars)

| | Year Ended December 31 1978 | 1977 |
|---|---|---|
| **Operating Revenues (Note 1)** | | |
| Electric | $202,631 | $179,940 |
| Gas | 118,531 | 105,797 |
| Steam | 19,110 | 19,004 |
| | 340,272 | 304,741 |
| Electric sales to other utilities | 28,676 | 26,403 |
| Total Operating Revenues | 368,948 | 331,144 |
| **Operating Expenses (Note 1)** | | |
| Operation | | |
| Electric and steam fuels | 58,140 | 56,993 |
| Purchased electricity | 19,337 | 13,635 |
| Purchased natural gas | 71,109 | 62,086 |
| Other | 65,685 | 62,494 |
| Maintenance | 26,246 | 22,372 |
| Depreciation | 22,206 | 21,053 |
| Taxes—local, state and other | 45,935 | 43,876 |
| Federal income tax—current (Note 3) | 5,166 | 961 |
| —deferred (Note 3) | 5,875 | 2,897 |
| Total Operating Expenses | 319,699 | 286,367 |
| **Operating Income** | 49,249 | 44,777 |
| **Other Income and Deductions** | | |
| Allowance for other funds used during construction (Note 1) | 8,705 | 6,473 |
| Other—net | 4,418 | 1,310 |
| Total Other Income and Deductions | 13,123 | 7,783 |
| **Income before Interest Charges** | 62,372 | 52,560 |
| **Interest Charges** | | |
| Long-term debt | 25,594 | 22,542 |
| Short-term debt | 1,588 | 1,319 |
| Other—net | 416 | 494 |
| Allowance for borrowed funds used during construction (Note 1) | (4,812) | (4,84[illegible] |
| Total Interest Charges | 22,786 | 19,511 |
| **Net Income** | 39,586 | 33,049 |
| **Dividends on Preferred and Preference Stock, at required rates** | 5,678 | 6,512 |
| **Earnings Applicable to Common Stock** | $ 33,908 | $ 26,537 |
| **Weighted average number of shares outstanding in each period, adjusted for stock dividends (000's)** | 13,774 | 12,474 |
| **Earnings per Common Share (Note 1)** | $2.46 | $2.12 |
| **Cash Dividends per Common Share, adjusted for stock dividends (Note 1)** | $1.41 | $1.29 |

## Statement of Retained Earnings (Thousands of Dollars)

| | 1978 | 1977 |
|---|---|---|
| **Balance at beginning of period** | $ 70,819 | $ 67,812 |
| **Add** | | |
| Net income | 39,586 | 33,049 |
| Total | 110,405 | 100,861 |
| **Deduct** | | |
| Issuance costs of preferred stock (Note 4) | | 701 |
| Dividends on capital stock | | |
| Cumulative preferred stock, at required rates (Note 4) | 3,550 | 6,453 |
| Preference stock (Note 4) | 2,128 | 59 |
| Common stock | | |
| Cash (Note 1) | 19,269 | 16,009 |
| Stock (Note 4) | 8,120 | 6,820 |
| Total | 33,067 | 30,04[illegible] |
| **Balance at end of period** | $ 77,338 | $ 70,819 |

## Balance Sheet (Thousands of Dollars)

| | At December 31 1978 | 1977 |
|---|---|---|
| **ASSETS** | | |
| **Utility Plant, at original cost (Note 1)** | | |
| Electric | $669,104 | $609,387 |
| Gas | 171,120 | 162,946 |
| Steam | 17,735 | 17,442 |
| | 857,959 | 789,775 |
| Less—Accumulated depreciation and amortization | 261,477 | 229,122 |
| | 596,482 | 560,653 |
| Construction work in progress | 213,534 | 162,127 |
| Net Utility Plant | 810,016 | 722,780 |
| **Investment in subsidiary, at equity** | 1,996 | 1,947 |
| **Current Assets** | | |
| Cash (Note 5) | 11,777 | 6,617 |
| Accounts receivable | 31,700 | 30,332 |
| Materials and supplies, at average cost | | |
| Fossil fuel | 12,673 | 10,787 |
| Construction and other supplies | 9,643 | 9,724 |
| Prepayments | 1,160 | 927 |
| Total Current Assets | 66,953 | 58,387 |
| **Deferred Debits** | | |
| Unamortized debt expense | 3,620 | 3,348 |
| Deferred fuel cost (Note 1) | 5,362 | 6,338 |
| Other (Note 4) | 5,439 | 5,574 |
| Total Deferred Debits | 14,421 | 15,260 |
| Total Assets | $893,386 | $798,374 |
| **CAPITALIZATION AND LIABILITIES** | | |
| **Capitalization (Note 4)** | | |
| Long-term debt | $384,303 | $361,022 |
| Preferred stock | 67,000 | 67,000 |
| Preference stock | 28,000 | 28,000 |
| Common shareholders' equity | | |
| Common stock | 246,938 | 212,533 |
| Retained earnings | 77,338 | 70,819 |
| Total common shareholders' equity | 324,276 | 283,352 |
| Total Capitalization | 803,579 | 739,374 |
| **Current Liabilities** | | |
| Short-term debt (Note 5) | | 9,000 |
| Long-term debt due within one year | 16,677 | |
| Accounts payable | 29,021 | 18,635 |
| Taxes accrued, including income taxes | 11,335 | 4,610 |
| Interest accrued | 7,667 | 7,355 |
| Payroll accrued | 2,596 | 2,388 |
| Other | 1,066 | 825 |
| Total Current Liabilities | 68,362 | 42,813 |
| **Deferred Credits and Other Liabilities** | | |
| Accumulated deferred income taxes (Notes 1 and 3) | 18,394 | 15,233 |
| Other | 3,051 | 954 |
| Total Deferred Credits and Other Liabilities | 21,445 | 16,187 |
| **Commitments and Other Matters (Note 6)** | | |
| Total Capitalization and Liabilities | $893,386 | $798,374 |

## Statement of Changes in Financial Position (Thousands of Dollars)

| | Year Ended December 31 1978 | 1977 |
|---|---|---|
| **Sources of Funds** | | |
| Operations | | |
| Net income | $ 39,586 | $ 33,049 |
| Principal non-cash charges (credits) to income | | |
| Depreciation | 22,206 | 21,053 |
| Amortization of nuclear fuel | 15,746 | 14,386 |
| Deferred fuel costs | 976 | (2,886) |
| Deferred income taxes—net | 3,161 | 2,675 |
| Allowance for funds used during construction | (13,517) | (11,317) |
| Other—net | 1,204 | 757 |
| Total from Operations | 69,362 | 57,717 |
| Financing | | |
| Sale of long-term debt | 40,000 | 50,000 |
| Sale of common stock | 27,186 | 24,579 |
| Sale of preference stock | | 28,000 |
| Total from Financing | 67,186 | 102,579 |
| Total Sources of Funds | $136,548 | $160,296 |
| **Uses of Funds** | | |
| Utility plant | | |
| Plant additions | $105,191 | $ 94,958 |
| Nuclear fuel additions | 20,878 | 14,450 |
| Less: allowance for funds used during construction | 13,517 | 11,317 |
| Net Additions to Utility Plant | 112,552 | 98,091 |
| Dividends on preferred stock | 3,550 | 6,453 |
| Dividends on preference stock | 2,128 | 59 |
| Dividends on common stock | 19,269 | 16,009 |
| Reduction of short-term debt—net | 9,000 | 9,051 |
| Retirement of long-term debt | 16,677 | 333 |
| Redemption of preferred stock, including call premium | | 27,750 |
| Capital stock expense | 902 | 167 |
| Expense of issuing long-term debt | 490 | 892 |
| Other—net | (2,037) | 1,406 |
| Increase (decrease) in working capital (excluding short-term debt) | (25,983) | 85 |
| Total Uses of Funds | $136,548 | $160,296 |
| **Changes in Components of Working Capital** | | |
| Increase (decrease) in current assets | | |
| Cash | $ 5,160 | $ 188 |
| Accounts receivable | 1,368 | (3,474) |
| Materials and supplies | | |
| Fossil fuel | 1,886 | (49) |
| Construction and other supplies | (81) | 351 |
| Prepayments | 233 | 281 |
| Total | 8,566 | (2,703) |
| Increase (decrease) in current liabilities (excluding short-term debt) | | |
| Accounts payable | 10,386 | 482 |
| Taxes | 6,725 | 1,651 |
| Accrued interest and payroll | 520 | 1,234 |
| Long-term debt due within one year | 16,677 | (6,000) |
| Other—net | 241 | (155) |
| Total | 34,549 | (2,788) |
| Increase (decrease) in Working Capital excluding short-term debt | $(25,983) | $ 85 |

## Notes to Financial Statements

### Note 1. Summary of Accounting Policies

**General.** The Company is subject to regulation by the Public Service Commission of the State of New York (PSC) with respect to its rates for service and the maintenance of its accounting records. The Company's accounting policies conform to generally accepted accounting principles as applied to New York State public utilities giving effect to the rate-making and accounting practices and policies of the PSC.

A description of the Company's principal accounting policies follows.

**Utility Plant and Depreciation.** The cost of additions to utility plant and replacement of retirement units of property is capitalized. Cost includes labor, material, and similar items as well as indirect charges for engineering, supervision, etc. The Company capitalizes an allowance for funds used during construction approximately equivalent to the cost of capital devoted to plant under construction. Replacement of minor items of property is included in maintenance expenses. Costs of depreciable units of plant retired are eliminated from utility plant accounts, and such costs, plus removal expenses, less salvage, are charged to accumulated depreciation and amortization.

Depreciation in the financial statements is provided on a straight-line basis at rates based on the estimated useful lives of property, which have resulted in provisions of 3.0% and 3.1% per annum, of average depreciable property in 1977 and 1978, respectively.

**Jointly-Owned Facilities.** The following table sets forth the major electric generation projects currently planned which will add to the Company's present generating capability. Each participant must provide its own financing for these projects.

| | Oswego Fossil Unit #6[1] | Nine Mile Point Nuclear Unit #2[1] | Sterling Nuclear[2] |
|---|---|---|---|
| Estimated year of completion | 1980 | 1984 | 1988 |
| Net megawatt capability | 850 | 1084 | 1150 |
| RG&E's share—megawatts | 204 | 150 | 322 |
| —percent | 24 | 14 | 28 |
| | | (Millions of Dollars) | |
| Total estimated project costs[3] | $252.6[4] | $1,441.4[5] | $1,354.7[6] |
| RG&E's share | 60.6 | 201.8 | 379.3 |
| RG&E's actual construction costs[3]—1977 | 10.0 | 21.7 | 3.5 |
| —1978 | 12.2 | 22.9 | 3.5 |

[1] To be constructed and operated by Niagara Mohawk Power Corporation.

[2] To be constructed and operated by Rochester Gas and Electric Corporation.

[3] Construction costs exclude allowance for funds used during construction and certain overhead costs to be capitalized.

[4] Total project costs include $8.5 million for oil handling facilities, of which RG&E has not agreed upon the percentage participation, and excludes common facilities.

[5] Total project costs include $89.4 million for the initial nuclear fuel loading and excludes common facilities.

[6] Total project costs include $114.7 million for the initial nuclear fuel loading.

**Nuclear Fuel and Decommissioning Costs.** The cost of nuclear fuel and estimated permanent storage costs are charged to operating expense on the basis of the thermal output of the reactor. These costs are charged to customers through base rates and through the fuel cost adjustment clause.

Due to a Federal government policy adopted in 1977, the Company has changed its nuclear fuel cost computation to reflect the costs of permanent storage of spent nuclear fuel. Prior years' nuclear fuel cost computations anticipated spent nuclear fuel would be reprocessed. Cumulative prior years' fuel expenses would have been increased by approximately $8.0 million if they had been determined on the basis of current cost estimates for permanent storage of spent nuclear fuel, rather than on an estimated amount for reprocessing. If the government's permanent storage policy is continued, the Company believes that such amount will be fully allowable for rate-making purposes.

Decommissioning costs (costs to take the plant out of service in the future) for the Company's Ginna nuclear power plant cannot be estimated at this time. The Company believes that the costs of decommissioning will be fully allowable for rate-making purposes.

**Allowance for Funds Used During Construction.** The Company capitalizes an Allowance for Funds Used During Construction (AFDC) based upon the net cost of borrowed funds for construction purposes and a reasonable rate upon the Company's other funds when so used. The rate used for this purpose was 8¾%, which became effective in May 1976. In accordance with the order issued by the Federal Energy Regulatory Commission, AFDC is segregated into two component parts and classified in the Statement of Income to disclose an Allowance for Borrowed Funds Used During Construction as a credit to Interest Charges and an Allowance for Other Funds Used During Construction as a part of Other Income.

In December 1977, the Company began computing AFDC on its share of Nine Mile Point Nuclear Unit #2 and Oswego Fossil Unit #6 at an average reduced rate of 6.85%, which is net of the income tax effect of the interest portion of AFDC.

**Rates and Revenue.** Revenue is recorded on the basis of meters read during the calendar year.

Tariffs for electric and steam service include fuel cost adjustment clauses which serve to adjust electric and steam rates from time to time to reflect changes in the average costs of fuels used in electric and steam generation from the average cost of such fuels during the base period. Tariffs for gas service contain a comparable clause to adjust gas rates for changes in the price of purchased natural gas.

**Deferred Fuel Costs.** Fuel costs which are recoverable under the electric, gas and steam cost adjustment clauses included in the tariff schedules of the Company are deferred until they are billed to customers. A reconciliation of recoverable gas costs with billed gas revenues is done annually as of August 31, and the excess or deficiency is refunded to or recovered from the customers during a subsequent twelve month period.

**Federal Income Tax.** For income tax purposes, depreciation is computed using the most liberal methods permitted. In addition, certain costs capitalized for financial reporting purposes are deducted currently for income tax purposes. The resulting tax reductions are offset by provisions for deferred income taxes only to the extent ordered or permitted by regulatory authorities.

The 10% investment tax credit rate, which had been scheduled to return to 4% in 1981, has been made permanent by the Revenue Act of 1978. The prior rate of 4% is applied to reduce the current tax provision while, as recommended by the PSC, normalized tax accounting is followed in the application of the remaining 6%.

The Company uses the separate period approach in calculating the interim quarterly tax provision.

**Pension Plan.** The Company's retirement plan is noncontributory and covers all regular employees. Current service costs are funded annually. Past service costs are being amortized over a 40 year period.

Retirement plan expenditures for the years 1977 and 1978 were $9.2 million and $9.9 million, respectively. The actuarially computed value of vested benefits at December 31, 1978 exceeds the assets in the plan by approximately $15 million.

**Earnings and Dividends Per Share.** Earnings applicable to each share of common stock are based on the weighted average number of shares outstanding during the respective years, adjusted for stock dividends. Assuming the 1,250,000 shares of common stock issued on September 27, 1978 were outstanding at the beginning of 1978 and the proceeds were applied to reduce the short term debt, the earnings per share for 1978 would have been $2.36. Cash dividends per share are based on the shares outstanding at the time dividends are paid, adjusted for stock dividends. Cash dividends per share at the rates declared in each period amount to $1.34 for 1977 and $1.42 for 1978.

## Note 2. Departmental Financial Information (Thousands of Dollars)

The Company's records are maintained by operating departments, in accordance with PSC accounting policies, giving effect to the rate-making process. The following is the operating data for each of the Company's departments and no interdepartmental adjustments are required to arrive at the operating data included in the Statement of Income.

| | Electric | Gas | Steam | Total |
|---|---|---|---|---|
| **Operating information—1978** | | | | |
| Operating revenues | $231,307 | $118,531 | $ 19,110 | $368,948 |
| Operating expenses, excluding provision for income taxes | 181,428 | 107,873 | 19,357 | 308,658 |
| Pretax operating income | 49,879 | 10,658 | (247) | 60,290 |
| Provision for income taxes | 9,244 | 1,966 | (169) | 11,041 |
| Net operating income | $ 40,635 | $ 8,692 | $ (78) | 49,249 |
| Other income—net | | | | 13,123 |
| Interest charges | | | | 22,786 |
| Net income per statement of income | | | | $ 39,586 |
| **Other information** | | | | |
| Depreciation | $ 16,984 | $ 4,641 | $ 581 | $ 22,206 |
| Nuclear fuel amortization | 15,746 | | | 15,746 |
| Capital expenditures | 100,194 | 11,903 | 455 | 112,552 |
| **Investment information—December 31, 1978** | | | | |
| Identifiable assets | $711,917 | $146,299 | $ 15,716 | $873,932 |
| Assets utilized for overall Company operations (a) | | | | 19,454 |
| Total assets per balance sheet | | | | $893,386 |
| **Operating information—1977** | | | | |
| Operating revenues | $206,343 | $105,797 | $ 19,004 | $331,144 |
| Operating expenses, excluding provision for income taxes | 165,858 | 97,465 | 19,186 | 282,509 |
| Pretax operating income | 40,485 | 8,332 | (182) | 48,635 |
| Provision for income taxes | 4,041 | 147 | (330) | 3,858 |
| Net operating income | $ 36,444 | $ 8,185 | $ 148 | 44,777 |
| Other income—net | | | | 7,783 |
| Interest charges | | | | 19,511 |
| Net income per statement of income | | | | $ 33,049 |
| **Other information** | | | | |
| Depreciation | $ 15,333 | $ 5,140 | $ 580 | $ 21,053 |
| Nuclear fuel amortization | 14,386 | | | 14,386 |
| Capital expenditures | 90,722 | 6,943 | 426 | 98,091 |
| **Investment information—December 31, 1977** | | | | |
| Identifiable assets | $626,464 | $141,130 | $ 16,619 | $784,213 |
| Assets utilized for overall Company operations (a) | | | | 14,161 |
| Total assets per balance sheet | | | | $798,374 |

(a) Consists primarily of cash, prepayments and unamortized debt expense.

## Note 3. Federal Income Tax Provision (Thousands of Dollars)

The following is a reconciliation for the years 1977 and 1978 of the difference between the amount of Federal income tax expense reported in the Statement of Income and the amount computed by multiplying the income before tax by the statutory tax rate.

| | 1978 Amount | 1978 % of Pretax Income | 1977 Amount | 1977 % of Pretax Income |
|---|---|---|---|---|
| Net income | $39,586 | | $33,049 | |
| Federal income tax | | | | |
| Current | 5,166 | | 961 | |
| Deferred | 5,875 | | 2,897 | |
| Charged to operating expense | 11,041 | | 3,858 | |
| Amort. of deferred investment tax credit | (513) | | (222) | |
| AFDC net of tax rate difference | (2,201) | | | |
| Other | (2,501) | | (1,460) | |
| Included in Other Income | (5,215) | | (1,682) | |
| Actual Federal income tax expense | 5,826 | | 2,176 | |
| Income before Federal income tax | $45,412 | | $35,225 | |
| Computed tax expense | $21,797 | 48.0 | $16,908 | 48.0 |
| Increases (reductions) in tax resulting from: | | | | |
| Excess of tax depreciation less amount deferred | (3,525) | (7.8) | (3,580) | (10.2) |
| Expenses capitalized for financial statements including interest, payroll and use tax, etc. | (9,361) | (20.6) | (7,765) | (22.0) |
| Investment tax credit | (4,955) | (10.9) | (2,624) | (7.4) |
| Property taxes on basis of date of taxable status | 224 | .5 | (254) | (.7) |
| Cost of removal, less net amount deferred | (724) | (1.6) | (655) | (1.9) |
| Revenue taxes (deducted when paid) | 2,133 | 4.7 | | |
| Miscellaneous items, net | 237 | .5 | 146 | .4 |
| Actual Federal income tax expense | $ 5,826 | 12.8 | $ 2,176 | 6.2 |

A summary of the deferred amounts charged or (credited) to income is as follows:

| | 1978 | 1977 |
|---|---|---|
| Investment tax credit | $ 6,629 | $ 2,003 |
| Class life depreciation | 1,763 | 1,379 |
| Fuel costs | (469) | 1,386 |
| Nuclear fuel amortization | (142) | (362) |
| Nuclear fuel storage costs | (4,989) | (3,346) |
| Fossil plant abandonment costs | | 2,160 |
| 765 KV Transmission system abandonment costs | 850 | |
| Other | (481) | (545) |
| | $ 3,161 | $ 2,675 |

## Note 4. Capitalization

### Long-Term Debt

First Mortgage Bonds

| % | Series | Due | (Thousands) Principal Amount December 31, 1978 | 1977 |
|---|---|---|---|---|
| 3 | L | Mar. 1, 1979 | $ 16,677 | $ 16,677 |
| 2¾ | M | Aug. 15, 1980 | 12,000 | 12,000 |
| 3⅜ | N | June 1, 1982 | 6,000 | 6,000 |
| 3⅛ | O | Mar. 1, 1985 | 10,000 | 10,000 |
| 4⅞ | R | July 1, 1987 | 15,000 | 15,000 |
| 5 | S | Oct. 15, 1989 | 12,000 | 12,000 |
| 4½ | T | Nov. 15, 1991 | 15,000 | 15,000 |
| 4⅝ | U | Sept. 15, 1994 | 16,000 | 16,000 |
| 5.3 | V | May 1, 1996 | 18,000 | 18,000 |
| 6¼ | W | Sept. 15, 1997 | 20,000 | 20,000 |
| 6.7 | X | July 1, 1998 | 30,000 | 30,000 |
| 8 | Y | Aug. 15, 1999 | 30,000 | 30,000 |
| 9⅛ | Z | Sept. 1, 2000 | 30,000 | 30,000 |
| 10¾ | AA | Aug. 1, 1983 | 29,667 | 29,667 |
| 9¼ | BB | June 15, 2006 | 50,000 | 50,000 |
| 8⅜ | CC | Sept. 15, 2007 | 50,000 | 50,000 |
| 9½ | DD | Dec. 1, 2003 | 40,000 | |
| | | | 400,344 | 360,344 |
| Less: Series L due in 1979 | | | 16,677 | |
| Total Long-Term Debt | | | $383,667 | $360,344 |

Bond premium applicable to the years 1977 and 1978 is $677,702 and $635,667, respectively.

Sinking and improvement fund requirements aggregate $333,540 per annum. Such requirements may be met by certification of additional property or by depositing cash with the Trustee. The 1977 and 1978 requirements were met by certification of additional property.

### Capital Stock

Preferred Stock (cumulative)—Par value $100; 2,000,000 shares authorized:

| % | Series | Shares Outstanding | (Thousands) December 31, 1978 | 1977 | Redemption (per share) (a) | |
|---|---|---|---|---|---|---|
| 4 | F | 120,000 | $12,000 | $12,000 | 105 | At any time |
| 4.10 | H | 80,000 | 8,000 | 8,000 | 101 | At any time |
| 4¾ | I | 60,000 | 6,000 | 6,000 | 101 | At any time |
| 4.10 | J | 50,000 | 5,000 | 5,000 | 102.50 | At any time |
| 4.95 | K | 60,000 | 6,000 | 6,000 | 102 | At any time |
| 4.55 | M | 100,000 | 10,000 | 10,000 | 102 | Before 3/1/80 |
| 7.50 | N | 200,000 | 20,000 | 20,000 | 108 | Before 6/1/79 |
| 11 | O | | | | | (b) |
| | | 670,000 | $67,000 | $67,000 | | |

(a) Redeemable at the option of the Company on 30 days' minimum notice, plus accrued dividends in all cases.

(b) Called for redemption on December 20, 1977. The issuance costs related to Series O were charged to retained earnings, and the call premium of $2,750,000 related to this series was reported as other deferred debits and, beginning in January 1978, is being amortized in accordance with an order from the PSC.

The Company's Certificate of Incorporation was amended on June 1, 1977 to authorize 4,000,000 additional shares of cumulative preferred stock, having a par value of $25 per share. None of this preferred stock has been issued.

Preference Stock—Par value $1; 5,000,000 shares authorized:

| % | Series | Shares Outstanding | (Thousands) December 31, 1978 | 1977 | Issued |
|---|---|---|---|---|---|
| 7.6 | A | 280,000 | $28,000 | $28,000 | 12/20/77 |

During January 1985, the Company must offer to purchase on October 1, 1985 all of the outstanding 7.6% Series A preference stock at a price of $100 per share. The shares remaining outstanding after such offer are callable at $100 per share at the option of the Company at any time after December 20, 1987.

Preference stock is subordinate to preferred stock but is senior to common stock.

Common Stock—Par value $5; 25,000,000 shares authorized:

| | Per Share | Shares | (Thousands) Amount |
|---|---|---|---|
| Outstanding, December 31, 1976 | | 11,366,111 | $181,301 |
| 3% Stock Dividend ....... | 20.00 | 340,984 | 6,820 |
| Sale of Stock ........... | 21.00 | 1,000,000 | 21,000 |
| TRASOP* ............ | 20.91 | 24,300 | 508 |
| Automatic Dividend Reinvestment Plan ...... | 18.31-20.94 | 158,236 | 3,071 |
| Capital Stock Expense ..... | | | (167) |
| Outstanding, December 31, 1977 | | 12,889,631 | 212,533 |
| 3% Stock Dividend ....... | 21.00 | 386,689 | 8,120 |
| Sale of Stock ........... | 18.75 | 1,250,000 | 23,438 |
| Automatic Dividend Reinvestment Plan ...... | 17.19-19.25 | 206,427 | 3,749 |
| Capital Stock Expense ..... | | | (902) |
| Outstanding, December 31, 1978 | | 14,732,747 | $246,938 |

*Tax Reduction Act Stock Ownership Plan

The Company's Certificate of Incorporation was amended on June 1, 1977 to authorize an additional 10,000,000 shares of common stock, par value $5 per share.

At December 31, 1978 there were 415,797 shares of common stock reserved and unissued under the Automatic Dividend Reinvestment Plan. No other shares of common, preferred or preference stock are reserved for officers and employees or for options, warrants, conversions, and other rights.

## Note 5. Cash and Short-Term Debt

At December 31, 1978, the Company had $7 million in temporary cash investments.

Under informal agreements with certain banks, the Company is expected to maintain an average compensating balance of 10 percent of the lines of credit plus an additional 10 percent of the principal amount of each borrowing. Under the agreements, withdrawal of the compensating balances is not legally restricted, and at December 31, 1978 the balances amounted to $4.4 million. Bank lines of credit aggregated $64 million and borrowings are at current floating prime interest rates. The Company also issues commercial paper at various discount rates, usually maturing within 30-45 days.

Balances and average interest rates of short-term borrowings as of December 31 for the years indicated were as follows:

| | 1978 Rates | 1978 Amount (Thousands) | 1977 Rates | 1977 Amount (Thousands) |
|---|---|---|---|---|
| Outstanding short-term debt and average interest rate at end of period: | | | | |
| Notes Payable ... | | | 7.00% | $ 7,000 |
| Commercial Paper . | | | 6.63 | 2,000 |
| Maximum short-term debt outstanding during the period: | | | | |
| Notes Payable ... | | $15,500 | | 25,000 |
| Commercial Paper . | | 15,900 | | 26,500 |
| Weighted average short-term debt and interest rates during the period: | | | | |
| Notes Payable ... | 8.82% | 7,769 | 6.42 | 10,960 |
| Commercial Paper . | 7.84 | 9,450 | 5.35 | 11,148 |

The above averages were based upon the daily balances and interest rates in effect for the periods during which short-term borrowings were outstanding and before giving effect to the additional interest cost resulting from compensating balances.

## Note 6. Commitments and Other Matters

The Company's capital expenditures program involves an estimated expenditure of $115 million, not including allowance for funds used during construction, in 1979 and the Company has entered into certain commitments for purchase of materials and equipment in connection with such program.

Operations of the Company's generating stations are subject to various Federal, state and local environmental standards.

Under the Clean Water Act, the Company is required to obtain permits to discharge pollutants into the waters of the United States. The United States Environmental Protection Agency (EPA) issued National Pollutant Discharge Elimination System permits for all the Company's major generating facilities, but a number of conditions relating to thermal and chemical discharge limitations were contested by the Company in adjudicatory hearing requests submitted to EPA. The Company, the New York State Department of Environmental Conservation (which became a party to the adjudicatory hearings) and EPA have settled the hearing requests as described below.

The Company has reached agreement with the regulatory agencies on non-thermal effluent limitations and final permits containing these agreed limitations have been issued and are now in effect. Construction of treatment facilities is required to enable Company compliance with permit limitations for two of the Company's generating stations. Pending completion of these facilities, the regulatory agencies have agreed in an Enforcement Compliance Schedule Letter to exercise their prosecutorial discretion to refrain from prosecuting the Company for violation of certain effluent limitation deadlines contained in the Clean Water Act so long as the Company adheres to a specified construction schedule for the facilities. Construction of these treatment facilities is expected to require capital expenditures estimated at $10.5 million over the next two years.

The Company has pursued resolution of the contested thermal limitations by submitting demonstrations in an effort to justify less stringent limitations for three generating stations. The thermal conditions of the permits remain stayed pending resolution of the thermal issues either through regulatory agencies' approval of the demonstrations and less stringent thermal limitations or, in the absence of such approval, through the resumption of the adjudicatory hearing process. If the demonstrations and less stringent thermal limitations are not approved for any of the three facilities, the Company could be required to install cooling towers which would involve capital expenditures estimated at $53 million plus significant operating and maintenance expenses.

The Company believes that additional expenditures and costs made necessary by environmental regulations will be fully allowable for rate-making purposes.

Through December 31, 1978, the Company has expended approximately $28.4 million (excluding land) with respect to its interest in the Sterling nuclear plant. The Company estimates that if it were required to cancel all existing contracts relating to the construction of this project, it could incur up to $6 million in cancellation charges. The Company believes that, if it were required to cancel the project, the PSC would permit it to amortize all expenditures involved over a period of several years and to recover those expenditures through rate relief.

On December 1, 1978, the PSC ruled that the case involving the 765 KV transmission facility that the Company had planned to construct be dismissed. The Company has petitioned the PSC requesting the amortization of the $2.1 million in expenditures for the line over a 3 year period, and to allow the Company to recover the unamortized costs through rate relief.

### Note 7. Interim Financial Information (Unaudited)

In the opinion of the Company, the following quarterly information includes all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of the results of operations for such periods. The variations in operations reported on a quarterly basis are a result of the seasonal nature of the Company's business and the availability of the Company's Ginna nuclear plant. Earnings per common share have been adjusted for stock dividends.

| | Quarter Ended (Thousands) | | | |
|---|---|---|---|---|
| | Dec. 31, 1978 | Sept. 30, 1978 | June 30, 1978 | Mar. 31, 1978 |
| Operating revenues | $92,312 | $73,665 | $86,942 | $116,029 |
| Operating income | 8,466 | 9,527 | 12,009 | 19,247 |
| Net income | 7,088 | 6,596 | 9,909 | 15,993 |
| Earnings on common stock | 5,669 | 5,175 | 8,490 | 14,574 |
| Earnings per common share (in dollars) | .38 | .37 | .63 | 1.09 |
| | Dec. 31, 1977 | Sept. 30, 1977 | June 30, 1977 | Mar. 31, 1977 |
| Operating revenues | $84,458 | $67,199 | $74,138 | $105,349 |
| Operating income | 9,395 | 7,479 | 10,626 | 17,277 |
| Net income | 6,444 | 4,619 | 7,775 | 14,211 |
| Earnings on common stock | 4,657 | 3,044 | 6,200 | 12,636 |
| Earnings per common share (in dollars) | .35 | .24 | .51 | 1.04 |

### Note 8. Replacement Cost Information (Unaudited)

The impact of the rate of inflation experienced in recent years has resulted in replacement costs of productive capacity greater than the historical costs of such assets reported in the Company's financial statements. In compliance with reporting requirements, estimated replacement cost information is disclosed in the Company's annual report to the Securities and Exchange Commission on Form 10-K.

## Report of Independent Accountants

To the Shareholders and Board of Directors of Rochester Gas and Electric Corporation

In our opinion, the accompanying balance sheets and the related statements of income, retained earnings, and of changes in financial position appearing on pages 14 through 16 present fairly the financial position of Rochester Gas and Electric Corporation at December 31, 1978 and 1977, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Price Waterhouse & Co

1900 Lincoln First Tower
Rochester, New York 14604
January 26, 1979

## Management's Discussion and Analysis of the Summary of Operations

The following financial review explains significant changes in the amounts of revenues and expenses between 1978/1977 and between 1977/1976. The Notes to Financial Statements on page 17 of this report contain additional related information.

### Operating Revenues

Changes in Operating Revenues
Increase or (Decrease) from Prior Year
(Thousands of Dollars)

| | Electric Department 1978 | Electric Department 1977 | Gas Department 1978 | Gas Department 1977 | Steam Department 1978 | Steam Department 1977 |
|---|---|---|---|---|---|---|
| Customer Revenues (Estimated) from: | | | | | | |
| Rate Increases | $12,181 | $ 5,312 | $ 2,555 | $ 2,683 | $ — | $ — |
| Fuel Cost Adjustment | 6,446 | 410 | 5,582 | 12,475 | (23) | 1,824 |
| Weather Effects | 221 | (82) | 3,259 | (1,144) | 367 | (198) |
| Customer Sales | 3,485 | 3,605 | (289) | (7,631) | (314) | (997) |
| Other | 358 | 137 | 1,627* | (1,613)* | 76 | (8) |
| Total Change in Customer Revenues | 22,691 | 9,382 | 12,734 | 4,770 | 106 | 621 |
| Electric Sales to Other Utilities | 2,273 | 8,144 | — | — | — | — |
| Total Change in Operating Revenues | $24,964 | $17,526 | $12,734 | $4,770 | $106 | $ 621 |

*Reflects a one-time $10 gas heating bill credit in the aggregate amount of approximately $1.6 million that was applied to residential customers in February 1977. The credit was made by the Company on its own initiative in order to alleviate the economic burden to customers who were faced with record high gas heating bills caused by the severe weather conditions in January 1977 and, in some cases, with reduced income due to plant shutdowns forced by natural gas curtailments.

Revenues from electric sales to other utilities increased in both 1978 and 1977. Fluctuations in electric sales to other utilities and in purchased electricity discussed under Operating Expenses below generally are related to the output and availability of electric generation from the Ginna nuclear plant.

### Operating Expenses

Changes in Operation and Maintenance Expenses
Increase or (Decrease) from Prior Year
(Thousands of Dollars)

| | 1978 | 1977 |
|---|---|---|
| Electric and Steam Fuels | $ 1,147 | $10,632 |
| Purchased Electricity | 5,702 | (4,560) |
| Purchased Natural Gas | 9,023 | 5,894 |
| Other Operation | 3,191 | 4,817 |
| Maintenance | 3,874 | 2,166 |
| Total Change in Operation and Maintenance Expense | $22,937 | $18,949 |

The 1977 increase in electric and steam fuels expense was mainly due to an increase in electricity generated in 1977 and an increased fuel cost per kilowatt-hour generated by nuclear fuel. Purchased electricity expense increased in 1978 due to both higher costs and higher kilowatt-hour purchases while the decrease in 1977 reflected mainly decreased purchases netted against a relatively modest increase in the cost per kilowatt-hour.

Purchased natural gas expense increased in both 1978 and 1977 as a result of higher pipeline rates and increased consumption due to colder weather in 1978.

The increase in maintenance expense of $3.9 million in 1978 and $2.2 million in 1977 reflects increases in the cost of labor and material to repair and maintain existing facilities, and increased activity in the repair and upkeep of transmission and distribution facilities.

### Changes in Taxes

Taxes—local, state and other increased $2.1 million in 1978 principally due to higher gross income taxes based on increased revenues. The 1977 increase of $3.4 million was also due to higher gross income taxes as well as higher property taxes resulting from the addition of new plant and increased property tax rates.

Total Federal income taxes increased $3.7 million in 1978 after declining $1.8 million in 1977. See Note 3 to the Notes to Financial Statements for a detailed analysis.

### Other Statement of Income Items

The increase in allowance for funds used during construction of $2.2 million in 1978 and $3.8 million in 1977 was due to increases in utility plant expenditures in both periods. See Note 1 to the Notes to Financial Statements.

Other—other income and deductions increased $3.1 million during 1978 principally due to added non-operating Federal income tax credits.

Interest on long term debt increased $3.1 million in 1978 and $3.2 million in 1977 as a result of additional bonds issued in December 1978, September 1977 and June 1976.

Dividends on preferred and preference stock decreased $.8 million in 1978 due to the refunding in December 1977 of a series of preferred stock with the proceeds from the sale of a series of preference stock having a lower dividend rate.

ROCHESTER GAS AND ELECTRIC CORPORATION

## Summary of Operations (Thousands of Dollars)

| | Year Ended December 31 | | | | | |
|---|---|---|---|---|---|---|
| | 1978 | 1977 | 1976 | 1975 | 1974* | 1973 |
| **Operating Revenues** | | | | | | |
| Electric | $202,631 | $179,940 | $170,558 | $146,629 | $127,560 | $116,512 |
| Gas | 118,531 | 105,797 | 101,027 | 82,478 | 75,463 | 64,633 |
| Steam | 19,110 | 19,004 | 18,383 | 17,337 | 16,321 | 10,014 |
| | 340,272 | 304,741 | 289,968 | 246,444 | 219,344 | 191,159 |
| Electric sales to other utilities | 28,676 | 26,403 | 18,259 | 25,496 | 14,697 | 21,112 |
| Total Operating Revenues | 368,948 | 331,144 | 308,227 | 271,940 | 234,041 | 212,271 |
| **Operating Expenses** | | | | | | |
| Operation | | | | | | |
| Electric and steam fuels | 58,140 | 56,993 | 46,361 | 46,268 | 36,693 | 25,612 |
| Purchased electricity | 19,337 | 13,635 | 18,195 | 12,212 | 12,070 | 8,841 |
| Purchased natural gas | 71,109 | 62,086 | 56,192 | 42,247 | 37,342 | 29,923 |
| Other | 65,685 | 62,494 | 57,677 | 50,629 | 44,356 | 40,999 |
| Maintenance | 26,246 | 22,372 | 20,206 | 19,700 | 17,966 | 15,888 |
| Depreciation | 22,206 | 21,053 | 18,621 | 17,414 | 16,491 | 15,145 |
| Taxes—local, state and other | 45,935 | 43,876 | 40,502 | 36,157 | 32,410 | 29,993 |
| Federal income tax—current | 5,166 | 961 | (291) | 4,162 | (3,126) | 6,724 |
| —deferred | 5,875 | 2,897 | 5,656 | 1,133 | 4,277 | 915 |
| Total Operating Expenses | 319,699 | 286,367 | 263,119 | 229,922 | 198,479 | 174,040 |
| **Operating Income** | 49,249 | 44,777 | 45,108 | 42,018 | 35,562 | 38,231 |
| **Other Income and Deductions** | | | | | | |
| Allowance for other funds used during construction | 8,705 | 6,473 | 4,678 | 2,310 | 1,128 | 274 |
| Other—net | 4,418 | 1,310 | 1,128 | 537 | 670 | 715 |
| Total Other Income and Deductions | 13,123 | 7,783 | 5,806 | 2,847 | 1,798 | 989 |
| **Income before Interest Charges** | 62,372 | 52,560 | 50,914 | 44,865 | 37,360 | 39,220 |
| **Interest Charges** | | | | | | |
| Long-term debt | 25,594 | 22,542 | 19,378 | 16,963 | 14,965 | 13,738 |
| Short-term debt | 1,588 | 1,319 | 1,054 | 1,568 | 2,255 | 1,246 |
| Other—net | 416 | 494 | 246 | 1,227 | 210 | 103 |
| Allowance for borrowed funds used during construction | (4,812) | (4,844) | (2,853) | (1,264) | (613) | (173) |
| Total Interest Charges | 22,786 | 19,511 | 17,825 | 18,494 | 16,817 | 14,914 |
| **Net Income** | 39,586 | 33,049 | 33,089 | 26,371 | 20,543 | 24,306 |
| **Dividends on Preferred and Preference Stock, at required rates** | 5,678 | 6,512 | 6,245 | 4,054 | 3,550 | 3,550 |
| **Earnings Applicable to Common Stock** | $ 33,908 | $ 26,537 | $ 26,844 | $ 22,317 | $ 16,993 | $ 20,756 |
| **Weighted average number of shares outstanding in each period, adjusted for stock dividends (000's)** | 13,774 | 12,474 | 11,983 | 10,987 | 10,628 | 9,753 |
| **Earnings per Common Share** | $2.46 | $2.12 | $2.24 | $2.03 | $1.59 | $2.12 |
| **Cash Dividends per Common Share, adjusted for stock dividends** | $1.41 | $1.29 | $1.20 | $1.15 | $1.09 | $1.04 |

* In 1974, the Company began deferring a portion of increased fuel costs to the period in which the related revenues were recorded.

## Condensed Balance Sheet (Thousands of Dollars)

| | At December 31 1978 | 1977 | 1976 | 1975 | 1974 | 1973 |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Utility Plant, at original cost | $857,959 | $789,775 | $727,687 | $693,404 | $659,308 | $618,891 |
| Less—Accumulated depreciation and amortization | 261,477 | 229,122 | 198,778 | 185,455 | 167,645 | 150,600 |
| | 596,482 | 560,653 | 528,909 | 507,949 | 491,663 | 468,291 |
| Construction work in progress | 213,534 | 162,127 | 120,702 | 79,381 | 39,324 | 24,542 |
| Net utility plant | 810,016 | 722,780 | 649,611 | 587,330 | 530,987 | 492,833 |
| Investment in Subsidiary, at equity | 1,996 | 1,947 | 1,911 | 1,871 | 1,834 | |
| Current Assets | 66,953 | 58,387 | 61,090 | 53,796 | 52,678 | 38,982 |
| Deferred Debits | 14,421 | 15,260 | 8,151 | 7,450 | 8,213 | 4,874 |
| Total Assets | $893,386 | $798,374 | $720,763 | $650,447 | $593,712 | $536,689 |
| **CAPITALIZATION AND LIABILITIES** | | | | | | |
| Capitalization | | | | | | |
| Long-term debt | $384,303 | $361,022 | $311,395 | $267,314 | $267,348 | $237,382 |
| Preferred stock | 67,000 | 67,000 | 92,000 | 89,000 | 67,000 | 67,000 |
| Preference stock | 28,000 | 28,000 | | | | |
| Common shareholders' equity | | | | | | |
| Common stock | 246,938 | 212,533 | 181,301 | 173,586 | 154,758 | 148,566 |
| Retained earnings | 77,338 | 70,819 | 67,812 | 60,502 | 53,568 | 52,184 |
| Total common shareholders' equity | 324,276 | 283,352 | 249,113 | 234,088 | 208,326 | 200,750 |
| Total Capitalization | 803,579 | 739,374 | 652,508 | 590,402 | 542,674 | 505,132 |
| Current Liabilities | 68,362 | 42,813 | 54,652 | 51,712 | 43,952 | 29,091 |
| Deferred Credits and Other Liabilities | 21,445 | 16,187 | 13,603 | 8,333 | 7,086 | 2,466 |
| Total Capitalization and Liabilities | $893,386 | $798,374 | $720,763 | $650,447 | $593,712 | $536,689 |

## Financial Data

| | At December 31 1978 | 1977 | 1976 | 1975 | 1974 | 1973 |
|---|---|---|---|---|---|---|
| Capitalization Ratios (percent) | | | | | | |
| Long-term debt | 47.8 | 48.8 | 47.7 | 45.3 | 49.3 | 47.0 |
| Preferred and preference stock | 11.8 | 12.9 | 14.1 | 15.1 | 12.3 | 13.3 |
| Common shareholders' equity | 40.4 | 38.3 | 38.2 | 39.6 | 38.4 | 39.7 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Book Value per Common Share Adjusted for Stock Dividends—Year End | $22.01 | $21.34 | $20.89 | $19.69 | $19.55 | $18.91 |
| Internal Generation of Funds (percent) | 39.5 | 35.9 | 44.6 | 42.5 | 42.3 | 89.8 |
| Rate of Return On Average Common Equity—Year End (percent) | 11.22 | 10.02 | 11.16 | 10.18 | 8.44 | 11.35 |
| Effective Federal Income Tax Rate (percent) | 12.8 | 6.2 | 10.6 | 14.4 | 1.7 | 22.9 |
| Depreciation Rate—Electric | 3.09 | 3.00 | 2.90 | 2.79 | 2.79 | 2.71 |
| —Gas | 2.79 | 2.67 | 2.63 | 2.60 | 2.60 | 2.48 |
| Interest Coverages | | | | | | |
| Before federal income taxes (incld. AFDC) | 2.65 | 2.45 | 2.79 | 2.56 | 2.20 | 3.09 |
| (excld. AFDC) | 2.16 | 1.98 | 2.43 | 2.38 | 2.10 | 3.04 |
| After federal income taxes (incld. AFDC) | 2.43 | 2.36 | 2.60 | 2.33 | 2.18 | 2.61 |
| (excld. AFDC) | 1.94 | 1.89 | 2.24 | 2.15 | 2.08 | 2.58 |

## Electric Department

| | Year Ended December 31 1978 | 1977 | 1976 | 1975 | 1974 | 1973 |
|---|---|---|---|---|---|---|
| **Electric Revenue (000's)** | | | | | | |
| Residential | $ 72,854 | $ 64,986 | $ 61,498 | $ 53,904 | $ 45,354 | $ 42,125 |
| Commercial | 58,985 | 53,520 | 50,791 | 43,884 | 37,908 | 34,387 |
| Industrial | 48,792 | 41,783 | 39,402 | 33,244 | 30,858 | 27,597 |
| Other | 22,000 | 19,651 | 18,867 | 15,597 | 13,440 | 12,403 |
| Electric revenue from our customers | 202,631 | 179,940 | 170,558 | 146,629 | 127,560 | 116,512 |
| Other electric utilities | 28,676 | 26,403 | 18,259 | 25,496 | 14,697 | 21,112 |
| Total electric revenue | 231,307 | 206,343 | 188,817 | 172,125 | 142,257 | 137,624 |
| **Electric Expense (000's)** | | | | | | |
| Fuel used in electric generation | 45,093 | 44,010 | 34,247 | 33,442 | 25,739 | 19,461 |
| Purchased electricity | 19,337 | 13,635 | 18,195 | 12,212 | 12,070 | 8,841 |
| Other operation | 47,602 | 45,011 | 40,930 | 35,662 | 32,177 | 28,378 |
| Maintenance | 19,305 | 16,339 | 14,796 | 14,282 | 12,390 | 11,029 |
| Depreciation | 16,983 | 15,333 | 13,865 | 12,731 | 11,977 | 11,026 |
| Taxes—local, state and other | 33,108 | 31,530 | 28,543 | 25,369 | 22,784 | 21,281 |
| Electric revenue deductions | 181,428 | 165,858 | 150,576 | 133,698 | 117,137 | 100,016 |
| **Operating Income before Federal Income Tax** | 49,879 | 40,485 | 38,241 | 38,427 | 25,120 | 37,608 |
| Federal income tax | 9,244 | 4,041 | 3,102 | 5,069 | (433) | 7,235 |
| **Operating Income from Electric Operations (000's)** | $ 40,635 | $ 36,444 | $ 35,139 | $ 33,358 | $ 25,553 | $ 30,373 |
| **Electric Operating Ratio %** | 56.8 | 57.7 | 57.3 | 55.5 | 57.9 | 49.2 |
| **Electric Sales—KWH (000's)** | | | | | | |
| Residential | 1,701,938 | 1,660,425 | 1,618,314 | 1,530,421 | 1,456,335 | 1,468,376 |
| Commercial | 1,417,624 | 1,392,023 | 1,366,094 | 1,294,816 | 1,226,333 | 1,261,697 |
| Industrial | 1,517,988 | 1,431,855 | 1,384,235 | 1,284,940 | 1,346,116 | 1,424,639 |
| Other | 465,373 | 454,059 | 437,097 | 411,122 | 379,379 | 385,243 |
| Electric sales to our customers | 5,102,923 | 4,938,362 | 4,805,740 | 4,521,299 | 4,408,163 | 4,539,955 |
| Other electric utilities | 1,445,391 | 1,453,590 | 1,187,942 | 1,864,050 | 1,182,902 | 2,269,686 |
| Total electric sales | 6,548,314 | 6,391,952 | 5,993,682 | 6,385,349 | 5,591,065 | 6,809,641 |
| **Electric Customers at December 31** | | | | | | |
| Residential | 251,645 | 250,121 | 249,177 | 246,613 | 244,063 | 241,032 |
| Commercial | 24,137 | 24,023 | 23,983 | 23,874 | 23,827 | 23,436 |
| Industrial | 1,348 | 1,353 | 1,371 | 1,380 | 1,365 | 1,360 |
| Other | 2,423 | 2,328 | 2,271 | 2,305 | 2,316 | 1,995 |
| Total electric customers | 279,553 | 277,825 | 276,802 | 274,172 | 271,571 | 267,823 |
| **Electricity Generated and Purchased—KWH (000's)** | | | | | | |
| Fossil | 2,025,645 | 2,272,182 | 2,060,186 | 1,731,723 | 1,961,453 | 1,869,079 |
| Nuclear | 3,206,313 | 3,018,305 | 2,040,746 | 3,026,894 | 2,079,539 | 3,395,564 |
| Hydro | 192,278 | 222,391 | 277,010 | 265,401 | 234,568 | 243,582 |
| Pumped storage | 133,287 | 193,340 | 118,716 | 98,743 | 131,311 | 57,801 |
| Less energy for pumping | (189,453) | (283,573) | (180,317) | (148,180) | (192,311) | (86,362) |
| Other | 1,086 | 850 | 2,797 | 2,198 | 12,806 | 8,776 |
| Total generated—Net | 5,369,156 | 5,423,495 | 4,319,138 | 4,976,779 | 4,227,366 | 5,488,440 |
| Purchased | 1,579,863 | 1,400,505 | 2,106,904 | 1,888,091 | 1,836,911 | 1,709,420 |
| Total electric energy | 6,949,019 | 6,824,000 | 6,426,042 | 6,864,870 | 6,064,277 | 7,197,860 |
| **Electric Generation Costs (000's)** | | | | | | |
| Fossil | $38,995 | $40,557 | $36,901 | $33,120 | $30,361 | $18,099 |
| Nuclear | 25,561 | 22,330 | 13,485 | 14,191 | 7,980 | 10,368 |
| Hydro | 1,229 | 1,132 | 973 | 1,030 | 1,085 | 1,083 |
| Other | 57 | 44 | 118 | 63 | 321 | 123 |
| **Electric Department Fuel** | | | | | | |
| Fossil —Total BTU (million) | 21,139,146 | 23,862,599 | 21,822,976 | 18,388,874 | 20,911,993 | 20,331,338 |
| —Cents per million BTU | 144.27 | 136.92 | 137.42 | 142.18 | 117.05 | 62.12 |
| Nuclear—Total BTU (million) | 35,812,171 | 37,822,209 | 23,837,620 | 33,128,471 | 22,909,968 | 36,683,359 |
| —Cents per million BTU | 43.97 | 38.04 | 25.69 | 22.91 | 11.28 | 18.62 |
| **System Net Capability—KW at December 31** | | | | | | |
| Fossil | 443,000 | 443,000 | 452,000 | 452,000 | 452,000 | 457,000 |
| Nuclear | 470,000 | 470,000 | 470,000 | 470,000 | 470,000 | 420,000 |
| Hydro | 47,000 | 47,000 | 47,000 | 47,000 | 47,000 | 53,100 |
| Other | 29,000 | 29,000 | 29,000 | 29,000 | 29,000 | 42,500 |
| Purchased | 339,000 | 338,000 | 342,000 | 356,000 | 347,000 | 352,000 |
| Total system net capability | 1,328,000 | 1,327,000 | 1,340,000 | 1,354,000 | 1,345,000 | 1,324,600 |
| **Net Peak Load—KW** | 983,000 | 987,000 | 934,000 | 925,000 | 880,000 | 922,000 |
| **Annual Load Factor—Net %** | 63.9 | 62.0 | 63.8 | 61.7 | 63.3 | 61.0 |

## Gas Department

| | Year Ended December 31 1978 | 1977 | 1976 | 1975 | 1974 | 1973 |
|---|---|---|---|---|---|---|
| **Gas Revenue (000's)** | | | | | | |
| Residential | $ 5,096 | $ 4,828 | $ 4,426 | $ 3,964 | $ 3,809 | $ 3,627 |
| Residential spaceheating | 74,425 | 66,900 | 63,974 | 52,584 | 47,758 | 40,453 |
| Commercial | 20,535 | 18,057 | 16,848 | 13,593 | 12,533 | 10,433 |
| Industrial | 13,891 | 12,014 | 11,900 | 9,167 | 8,583 | 7,648 |
| Municipal and other | 4,584 | 3,998 | 3,879 | 3,170 | 2,780 | 2,472 |
| Total gas revenue | 118,531 | 105,797 | 101,027 | 82,478 | 75,463 | 64,633 |
| **Gas Expense (000's)** | | | | | | |
| Purchased natural gas | 71,109 | 62,086 | 56,192 | 42,247 | 37,342 | 29,923 |
| Other operation | 15,810 | 15,072 | 14,921 | 13,310 | 11,492 | 11,420 |
| Maintenance | 5,768 | 5,078 | 4,510 | 4,500 | 4,757 | 4,043 |
| Depreciation | 4,641 | 5,140 | 4,194 | 4,137 | 3,978 | 3,615 |
| Taxes—local, state and other | 10,545 | 10,089 | 9,729 | 8,715 | 7,937 | 7,281 |
| Gas revenue deductions | 107,873 | 97,465 | 89,546 | 72,909 | 65,506 | 56,282 |
| **Operating Income before Federal Income Tax** | 10,658 | 8,332 | 11,481 | 9,569 | 9,957 | 8,351 |
| Federal income tax | 1,966 | 147 | 2,212 | 914 | 1,221 | 840 |
| **Operating Income from Gas Operations (000's)** | $ 8,692 | $ 8,185 | $ 9,269 | $ 8,655 | $ 8,736 | $ 7,511 |
| **Gas Operating Ratio %** | 78.2 | 77.7 | 74.9 | 72.8 | 71.0 | 70.2 |
| **Gas Sales—Therms (000's)** | | | | | | |
| Residential | 13,465 | 13,833 | 14,404 | 14,328 | 14,903 | 15,141 |
| Residential spaceheating | 255,951 | 252,923 | 275,582 | 249,224 | 263,290 | 245,368 |
| Commercial | 82,451 | 77,751 | 86,400 | 78,217 | 84,872 | 79,039 |
| Industrial | 63,709 | 59,956 | 72,847 | 65,760 | 73,926 | 78,137 |
| Municipal | 17,748 | 15,975 | 18,598 | 16,705 | 16,696 | 17,148 |
| Total gas sales | 433,324 | 420,438 | 467,831 | 424,234 | 453,687 | 434,833 |
| **Gas Customers at December 31** | | | | | | |
| Residential | 38,013 | 39,977 | 40,892 | 41,437 | 42,884 | 45,958 |
| Residential spaceheating | 154,366 | 152,856 | 153,583 | 153,848 | 151,154 | 144,847 |
| Commercial | 12,092 | 11,268 | 11,475 | 11,390 | 11,478 | 11,303 |
| Industrial | 759 | 746 | 757 | 756 | 767 | 762 |
| Municipal | 1,084 | 989 | 936 | 957 | 1,024 | 865 |
| Total gas customers | 206,314 | 205,836 | 207,643 | 208,388 | 207,307 | 203,735 |
| **Gas—Therms (000's)** | | | | | | |
| Purchased for reforming and mixing | | | 9,830 | 23,160 | 31,518 | 30,834 |
| Purchased for resale | 449,904 | 428,811 | 478,935 | 421,252 | 438,494 | 422,718 |
| Other | 13,178 | 10,123 | 7,911 | 7,019 | 7,063 | 6,535 |
| Total gas available | 463,082 | 438,934 | 496,676 | 451,431 | 477,075 | 460,087 |
| Cost of gas per therm | 15.26¢ | 14.43¢ | 11.37¢ | 10.19¢ | 8.49¢ | 7.13¢ |
| **Total Daily Capacity—Therms at December 31** | | | | | | |
| Mixed gas | | | | 269,000 | 410,844 | 410,844 |
| Straight natural gas | 4,164,000 | 4,164,000 | 4,164,000 | 3,895,000 | 3,871,448 | 3,762,672 |
| Total daily capacity | 4,164,000 | 4,164,000 | 4,164,000 | 4,164,000 | 4,282,292 | 4,173,516 |
| Maximum daily sendout—Therms | 3,183,678 | 3,578,468 | 3,497,861 | 3,041,070 | 3,192,631 | 2,985,392 |
| **Degree Days (Customer Billing)** | | | | | | |
| For the period | 7,021 | 6,726 | 6,905 | 6,211 | 6,808 | 5,883 |
| Percent (warmer) colder than normal | 4.5 | (0.1) | 1.6 | (7.2) | 1.3 | (12.2) |

## Steam Department

| Year Ended December 31 | 1978 | 1977 | 1976 | 1975 | 1974 | 1973 |
|---|---|---|---|---|---|---|
| **Steam Revenue (000's)** | | | | | | |
| Commercial | $ 6,087 | $ 6,352 | $ 6,401 | $ 5,668 | $ 5,419 | $ 3,668 |
| Industrial | 10,732 | 10,455 | 9,799 | 9,862 | 9,396 | 5,470 |
| Municipal and other | 2,291 | 2,197 | 2,183 | 1,807 | 1,506 | 876 |
| Total steam revenue | 19,110 | 19,004 | 18,383 | 17,337 | 16,321 | 10,014 |
| **Steam Expense (000's)** | | | | | | |
| Fuel used in steam generation | 13,047 | 12,983 | 12,114 | 12,826 | 10,954 | 6,151 |
| Other operation | 2,273 | 2,411 | 1,826 | 1,657 | 687 | 1,201 |
| Maintenance | 1,173 | 955 | 900 | 918 | 819 | 816 |
| Depreciation | 581 | 580 | 562 | 546 | 536 | 504 |
| Taxes—local, state and other | 2,282 | 2,257 | 2,230 | 2,073 | 1,689 | 1,431 |
| Steam revenue deductions | 19,356 | 19,186 | 17,632 | 18,020 | 14,685 | 10,103 |
| **Operating Income before Federal Income Tax** | (246) | (182) | 751 | (683) | 1,636 | (89) |
| Federal income tax | (168) | (330) | 51 | (688) | 363 | (436) |
| **Operating Income from Steam Operations (000's)** | $ (78) | $ 148 | $ 700 | $ 5 | $ 1,273 | $ 347 |
| **Steam Operating Ratio %** | 86.3 | 86.0 | 80.7 | 88.8 | 76.3 | 81.6 |
| **Steam Sales—Lbs. (000's)** | | | | | | |
| Commercial | 898,904 | 933,609 | 1,041,415 | 980,324 | 1,160,122 | 1,268,917 |
| Industrial | 1,718,565 | 1,682,033 | 1,738,391 | 1,839,402 | 2,127,837 | 2,136,794 |
| Municipal | 346,031 | 334,645 | 367,553 | 325,727 | 334,463 | 318,323 |
| Total steam sales | 2,963,500 | 2,950,287 | 3,147,359 | 3,145,453 | 3,622,422 | 3,724,034 |
| **Steam Customers at December 31** | | | | | | |
| Commercial | 238 | 254 | 271 | 281 | 292 | 302 |
| Industrial | 70 | 74 | 77 | 77 | 78 | 78 |
| Municipal | 31 | 32 | 32 | 31 | 31 | 30 |
| Total steam customers | 339 | 360 | 380 | 389 | 401 | 410 |
| **Steam Produced—Lbs. (000's)** | | | | | | |
| Produced by steam department | 1,353,053 | 1,194,132 | 1,408,029 | 1,387,363 | 1,532,246 | 1,442,472 |
| By-product steam from electric department | 1,987,638 | 2,133,853 | 2,193,283 | 2,344,693 | 2,588,120 | 2,613,321 |
| Total steam produced | 3,340,691 | 3,327,985 | 3,601,312 | 3,732,056 | 4,120,366 | 4,055,793 |
| **Steam Department Fuel** | | | | | | |
| Total BTU (million) | 5,705,943 | 5,548,290 | 6,022,360 | 6,230,767 | 6,807,500 | 6,849,830 |
| Cents per million BTU | 226.21 | 232.60 | 203.35 | 203.08 | 196.31 | 89.80 |

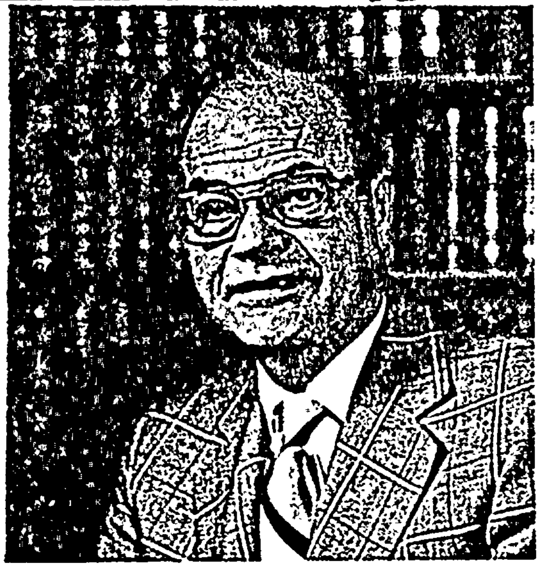
### Rate Increases

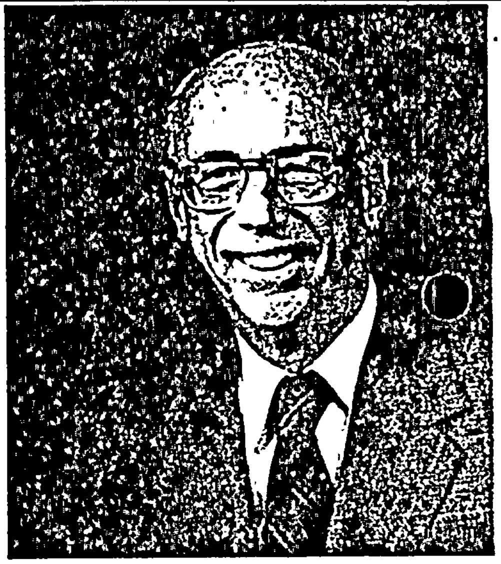
**Granted**

| Class of Service | Effective Date of Increase | Amount of Increase (Annual Basis) (000's) | Percent Increase | Rate of Return on Rate Base Authorized | Rate of Return on Equity Authorized |
|---|---|---|---|---|---|
| Electric | October 25, 1972 | $10,154 | 11.5% | 7.96% | 12.00% |
| | October 23, 1974 | 17,992 | 16.0 | 8.83 | 13.19 |
| | April 20, 1976 | 11,002 | 7.9 | 9.35 | 13.50 |
| | November 11, 1977 | 10,186 | 5.8 | 9.31 | 12.80 |
| | February 18, 1978 | 3,000 | 1.6 | 9.31 | 12.80 |
| Gas | April 28, 1972 | 3,676 | 6.8 | 7.77 | 12.00 |
| | October 23, 1974 | 4,854 | 7.6 | 8.42 | 12.09 |
| | April 20, 1976 | 4,983 | 6.3 | 9.35 | 13.50 |
| | November 11, 1977 | 2,536 | 2.4 | 9.31 | 12.80 |
| | February 2, 1978 | 678 | .6 | 9.31 | 12.80 |
| Steam | May 11, 1972 | 897 | 11.4 | 6.48 | |
| | November 12, 1973 | 500 | 5.1 | 7.25 | |
| | April 15, 1975 | 2,475 | 12.0 | 8.69 | |

**Pending Requests**

| Class of Service | Date of Filing | Amount (000's) | Percent |
|---|---|---|---|
| Electric | May 26, 1978 | $37,946 | 17.8% |
| Gas | May 26, 1978 | 10,789 | 8.9 |









## Directors

Keith W. Amish*
*Executive Vice President,*
*Rochester Gas and Electric Corporation*

Paul W. Briggs*
*President,*
*Rochester Gas and Electric Corporation*

John D. Cockcroft*
*Former Chairman of the Board,*
*The R. T. French Company*

Wilmot R. Craig‡
*Former Chairman of the Board,*
*Lincoln First Banks Inc.*

E. Kent Damon†‡
*Vice President and Secretary,*
*Xerox Corporation*

Francis E. Drake, Jr.*
*Chairman of the Board and Chief Executive Officer,*
*Rochester Gas and Electric Corporation*

J. Wallace Ely*†
*Chairman of the Board,*
*Security New York State Corporation*

Walter A. Fallon
*Chairman of the Board and Chief Executive Officer,*
*Eastman Kodak Company*

Ernest J. Howe*†‡
*Chairman of the Executive and Finance Committee,*
*Rochester Gas and Electric Corporation*

*Member of the Executive and Finance Committee of the Board of Directors

†Member of the Audit Committee of the Board of Directors






Daniel G. Kennedy*
*Partner,*
*Nixon, Hargrave, Devans & Doyle*

A.[illegible]cMullen
*Cha[illegible]n of the Executive Committee, Garlock Inc., and Director of the parent company, Colt Industries, Inc.*

Paul A. Miller
*Former President,*
*Rochester Institute of Technology*

Edward J. Nelson
*Former President,*
*Rochester Gas and Electric Corporation*

William S. Vaughn*†‡
*Former Chairman of the Board,*
*Eastman Kodak Company*

William G. vonBerg†
*Chairman of the Board and Chief Executive Officer,*
*Sybron Corporation*

‡Member of the Salary Review Committee of the Board of Directors

## Officers

**Francis E. Drake, Jr.**
*Chairman of the Board and Chief Executive Officer*
*Age 63, Years of Service, 41*

**Paul W. Briggs**
*President*
*Age 56, Years of Service, 33*

**Keith W. Amish**
*Executive Vice President*
*Age 55, Years of Service, 31*

**Joseph J. Hartman**
*Vice President, Gas and Transportation*
*Age 54, Years of Service, 32*

**John L. Kennedy**
*Vice President, Rates and Governmental Affairs*
*Age 60, Years of Service, 38*

**John E. Maier**
*Vice President, Employee Relations*
*Age 51, Years of Service, 31*

**Richard J. Rudman**
*Vice President, Electric Transmission and Distribution*
*Age 51, Years of Service, 33*

**Harry G. Saddock**
*Vice President, Electric System Planning and Operation*
*Age 49, Years of Service, 28*

**Mario Silvestrone**
*Vice President, Consumer Services, Corporate Communications and Purchasing*
*Age 55, Years of Service, 28*

**Leon D. White, Jr.**
*Vice President, Electric and Steam Production*
*Age 59, Years of Service, 41*

**Dean W. Caple**
*Secretary and Treasurer*
*Age 55, Years of Service, 30*

**Francis A. Sullivan, Jr.**
*Controller*
*Age 55, Years of Service, 28*

**Robert W. Ball**
*Assistant Treasurer*
*Age 62, Years of Service, 40*

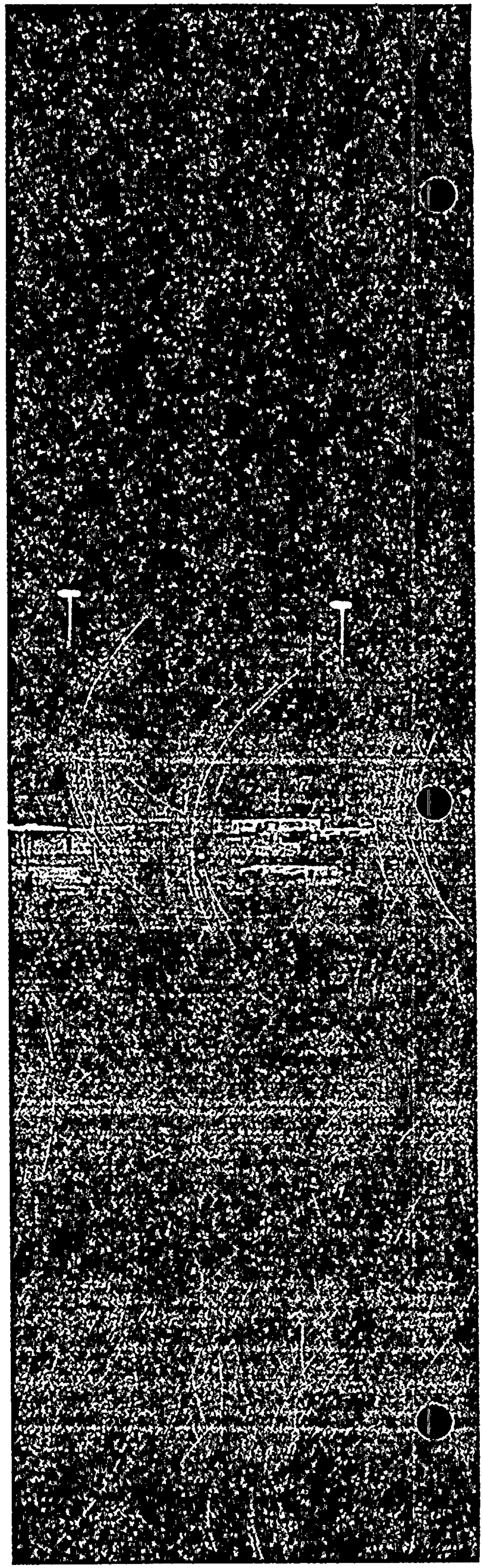
**David C. Heiligman**
*Assistant Secretary*
*Age 38, Years of Service, 15*

**Robert C. Henderson**
*Assistant Controller*
*Age 38, Years of Service, 15*

**Stephen Kowba**
*Assistant Controller*
*Age 59, Years of Service, 28*

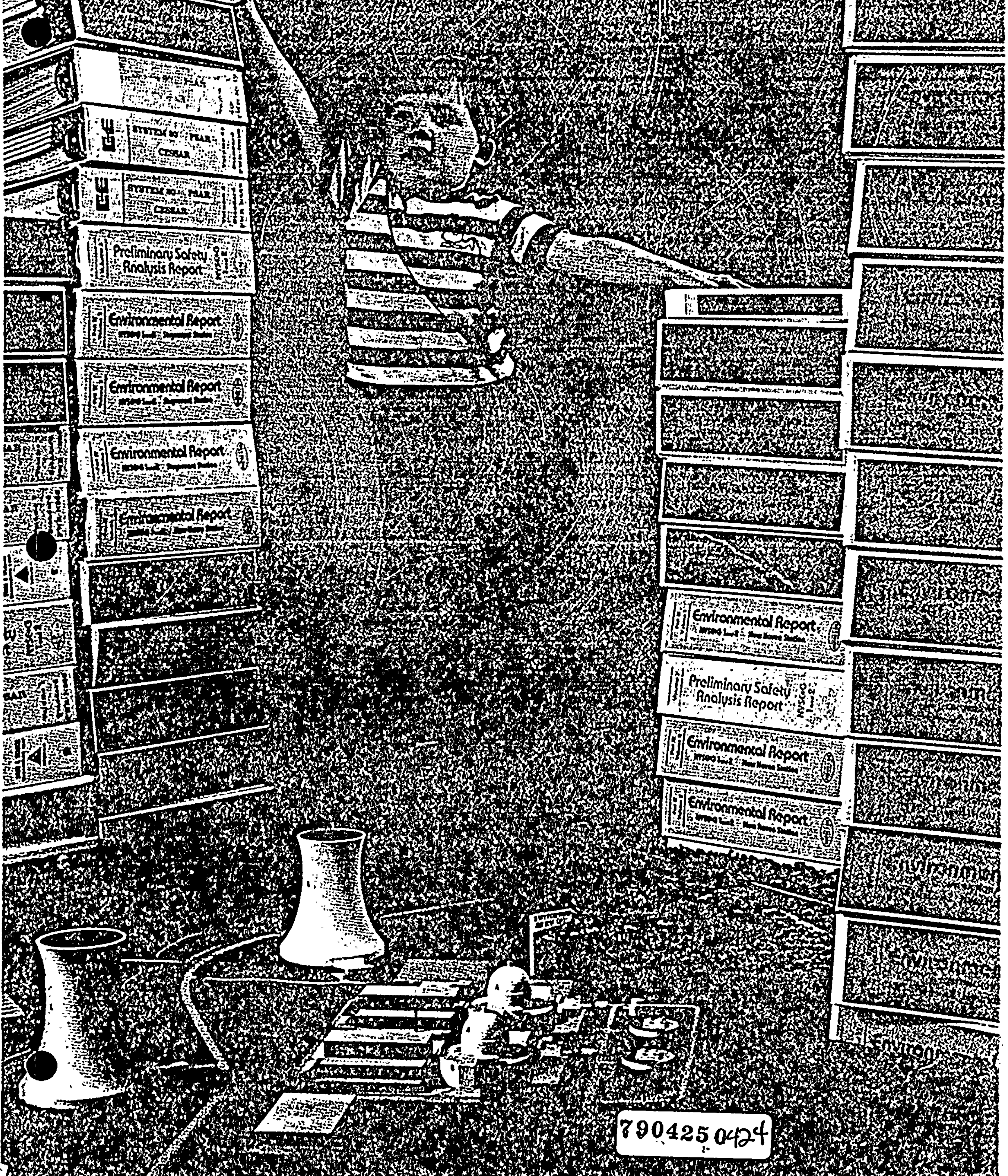
**John M. Kuebel**
*Auditor*
*Age 43, Years of Service, 14*

**Rochester Gas and Electric Corporation**
89 East Avenue
Rochester, New York 14649



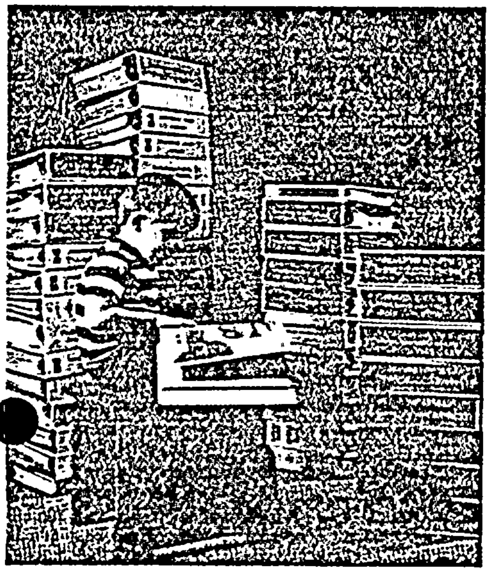
# New York State Electric & Gas Corporation

## 1978 Annual Report



New York State Electric & Gas Corporation

# 1978 Annual Report



**Cover:**

Various reports filed with regulatory agencies for the proposed New Haven nuclear generating station dwarf three-year-old Geoffrey Keltner, son of Company nuclear engineer Wallace G. Keltner. The project, a model of which is in the foreground of the cover photo, would be owned equally with Long Island Lighting Company. Many of the reports concern environmental studies which have cost the two companies over $30 million to date.

## Contents



THE ANNUAL MEETING of stockholders will be held at the Corporation's General Office Building on Route 13 (Dryden Road) in the Town of Dryden, N.Y., on May 11, 1979 at 11 a.m. Formal notice of the meeting, a proxy statement and form of proxy will be sent to stockholders in early April.

# Highlights of the Year

| | 1978 | 1977 | Increase | Percent |
|---|---|---|---|---|
| Gross operating revenues (thousands) | $ 532,171 | $ 459,452 | $ 72,719 | 16 |
| Income before interest charges (thousands) | $ 122,206 | $ 97,767 | $ 24,439 | 25 |
| Earnings available for common stock (thousands) | $ 57,473 | $ 46,851 | $ 10,622 | 23 |
| Earnings per share of common stock | $2.46 | $2.21 | $.25 | 11 |
| Allowance for funds used during construction per share of common stock | $.71 | $1.20 | $(.49) | (41) |
| Dividends paid per share of common stock | $1.68 | $1.60 | $.08 | 5 |
| Taxes per share of common stock | $2.78 | $2.34 | $.44 | 19 |
| Kwh sales to ultimate customers (millions) | 10,492 | 10,211 | 281 | 3 |
| Mcf sales (thousands) | 38,271 | 36,863 | 1,408 | 4 |
| Cost of fuel for electric generation (thousands) | $ 118,384 | $ 87,181 | $ 31,203 | 36 |
| Total utility plant (thousands) | $1,789,549 | $1,673,083 | $116,466 | 7 |
| Expenditures for construction (thousands) | $ 115,098 | $ 158,493 | $ (43,395) | (27) |

# To the Stockholders:

Wells P. Allen, Jr. (left) and Charles F. Kennedy

A milestone was reached in 1978 as total revenues exceeded $500 million for the first time. In addition, return on common stockholders' equity reached a new high for recent years of 11.8%. Despite the improvement, the return remains below levels allowed by the Public Service Commission.

While the quantity of earnings increased during the year, the quality improved as well. A non-cash item, allowance for funds used during construction (AFDC), which constituted over half of 1977 earnings, was less than 30% of 1978 earnings. This reflects to some extent the partial displacement of AFDC with federal income tax benefits related to the tax deduction for construction interest, which the PSC permitted in a fall 1977 rate decision.

Higher electric and gas rates granted in that 1977 decision were primarily responsible for the 1978 earnings improvement. Although the full effect of the rate increases was substantially realized during the year, return on equity did not reach the 13% which the Commission claimed the new rates would yield. This shortfall occurred despite colder-than-normal weather and unusually good sales of interchange electric energy. The latter is reflected as an offset to purchased power costs.

The shortfall in rate of return has become a common occurrence for the Company in recent years. It is in large measure typical of the regulatory lag that has adversely affected utilities nationwide. In some respects it is ironic because in rate proceedings expert witnesses and others devote extensive time and effort to developing a fair rate of return. After the regulatory process finally establishes that return, it becomes somewhat academic as few utilities receive the rates necessary to actually earn it.

In the Company's pending application for higher electric and gas rates, the administrative law judge has recommended rate increases aggregating only

$42 million annually, based on projected sales volumes. This is less than half the $94 million requested by the Company. Adding to the problem is the fact that the requested and recommended increases are based on projected sales levels which now appear to be high in light of energy conservation by customers that has become increasingly evident since the application was filed. Depending on the adequacy of revenue relief finally provided in the proceeding, it may be necessary to consider a new application for increased rates at an early date.

The Public Service Commission has informally rejected the New York utilities' generating company (ESPRI) proposal, which is reported on page 8. In our view, this proposal would have been of considerable help in keeping future rate increases to a minimum. While there is no practical alternative in sight, the Commission has indicated that it hopes to propose one.

There has been much controversy within the state as to future power needs. Some groups contend there should be no need for additional power plants. We believe that the state's growing economy and the desire of its residents to maintain and improve living standards will require the availability of additional sources of clean energy. Our peak demand has grown in the past five years by 437,000 kilowatts, or more than 25%. Although nobody knows of course what degree of growth will actually materialize, we are projecting growth in demand for electricity of between 4 and 5% per year as our best estimate at this time. Given the nation's general energy situation, the evermore indispensable uses of electricity, plus the present-day stretch out by years that is encountered in creating new generating plants, we believe that the public interest will have been better served if we were to find ourselves years hence on the high side rather than the low side of electricity demand.

Improved gas supply to the Company and other utilities is an encouraging development. In the near term, we anticipate some recovery in sales growth, particularly to industrial customers. Over the longer term, sales will depend on national gas supply developments.

Under legislation adopted in 1978, a new State Energy Office is charged with developing forecasts of the state's future electric and gas needs. Its findings will be binding on other state agencies concerned with need for and siting of major generation and transmission facilities. The Company and the state's other utilities are currently submitting comprehensive energy data to this agency. After public hearings, it is expected the State Energy Office will issue its conclusions sometime in 1980.

Since last October, the Company's operations have been undergoing close scrutiny by a management consulting firm selected by the Public Service Commission. This management audit is required every five years by state law. We are working with the consultants in an effort to determine any areas where improvements may be made to increase operating efficiencies.

Keeping cost increases to a minimum was a prime objective of management during the year and will continue to be in the future. Operating expenses in 1978, excluding electricity production and purchased gas costs, increased 7% despite general inflationary cost rises for all goods and services which averaged 8% nationally.

Looking ahead to 1979 operations, there are the usual number of imponderables, not the least of which is the outcome of the pending rate proceeding. We are hopeful that the PSC will recognize that the Company must have adequate earnings if it is to raise the large amounts of capital needed to finance the construction program. Some progress was made in the last rate case with the result that earnings quality and cash flow have improved. We look for a continuation of that progress.

No annual report is complete without recognizing the skill and diligence of our employees in accomplishing their assigned tasks. They are as conscientious a group as you will find anywhere.

May we take this opportunity to express appreciation to our stockholders for their support and continued confidence in the management.

FOR THE BOARD OF DIRECTORS,

Charles H Kennedy

*Chairman and*
*Chief Executive Officer*

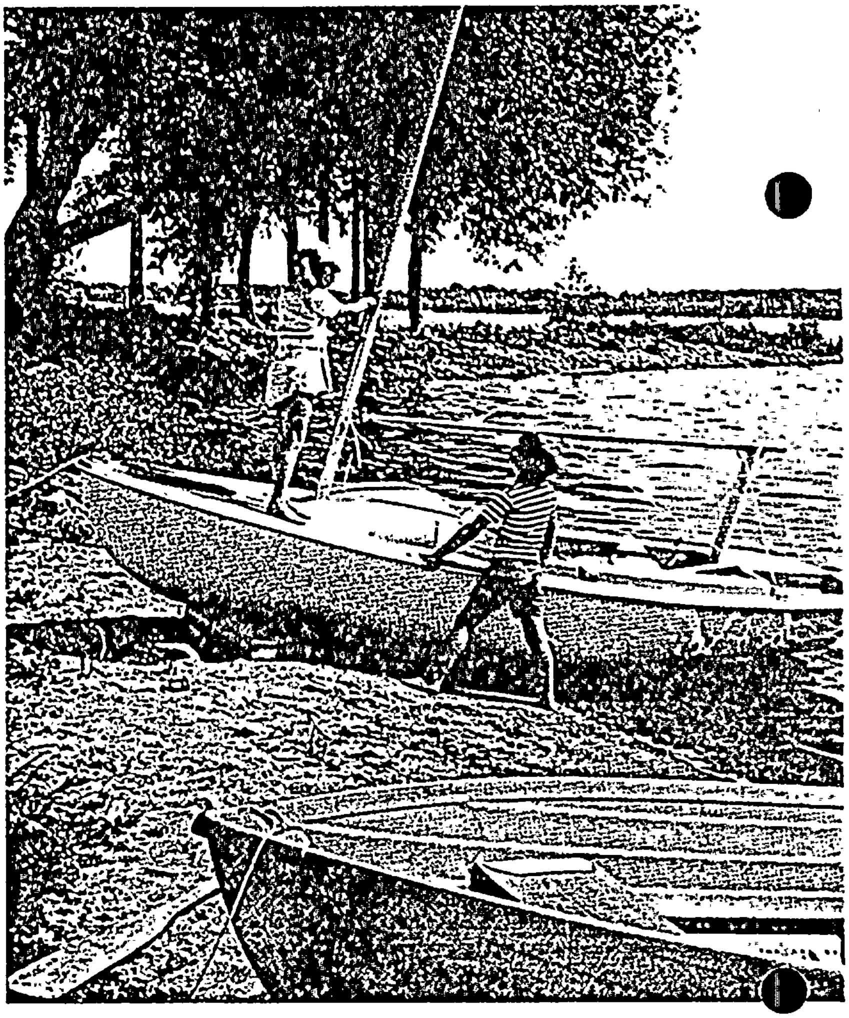
Wells P Allen Jr.

*President and*
*Chief Operating Officer*

March 1, 1979

# Condensed Statement of Income

| | 1978 | 1977 | Increase |
|---|---|---|---|
| | | *Thousands of Dollars* | |
| **REVENUES** | | | |
| Sales of electricity | $433,774 | $374,456 | $59,318 |
| Sales of gas and miscellaneous income | 98,599 | 84,836 | 13,763 |
| Total | 532,373 | 459,292 | 73,081 |
| **EXPENSES** | | | |
| Wages and salaries of employees and contributions to retirement and insurance plans (exclusive of $40,179,000 in 1978 and $37,518,000 in 1977 charged to construction, etc.) | 58,686 | 55,639 | 3,047 |
| Fuel used to produce electricity | 118,384 | 87,181 | 31,203 |
| Electricity purchased and interchanged | 19,059 | 46,599 | (27,540) |
| Gas purchased | 63,896 | 56,284 | 7,612 |
| Other materials, services and research | 54,309 | 45,615 | 8,694 |
| Federal taxes | 10,569 | 1,438 | 9,131 |
| State and local taxes | 54,461 | 48,281 | 6,180 |
| Depreciation | 41,462 | 34,544 | 6,918 |
| Total | 420,826 | 375,581 | 45,245 |
| Income available to investors | 111,547 | 83,711 | 27,836 |
| **ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION** | 16,655 | 25,363 | (8,708) |
| **INVESTORS' SHARE** | | | |
| Interest on bonds | 51,918 | 43,509 | 8,409 |
| Interest on notes payable and other | 5,721 | 5,620 | 101 |
| Dividends on preferred stock | 13,090 | 13,094 | (4) |
| Dividends on common stock | 38,732 | 33,564 | 5,168 |
| Total | 109,461 | 95,787 | 13,674 |
| RETAINED IN THE BUSINESS | $ 18,741 | $ 13,287 | $ 5,454 |



**Outstanding recreational facilities** and pleasant residential areas contribute to the quality of life in the service territory. The Finger Lakes, Catskill Mountains and Southern Tier regions offer a variety of leisure-time activities.

# General Review of the Year

*Earnings and Dividends*

## Per-Share Earnings Rise 11%

Operating income in 1978 was $103 million, an increase of $20.3 million or 25% over 1977. Most of the increase reflects higher electric and gas rates which added about $45 million to 1978 revenues.

Allowance for funds used during construction (AFDC) declined as the result of the start-up of a new generating unit and the use of a net-of-tax AFDC rate for major projects. The effect on income of the latter was offset by higher revenues permitted by the Public Service Commission to offset the federal income tax effect of the interest paid on construction funds, thereby improving interest coverage and cash flow. This offset is reflected in Other Income as a part of the federal income tax credit which also reflects improved availability of investment tax credits.

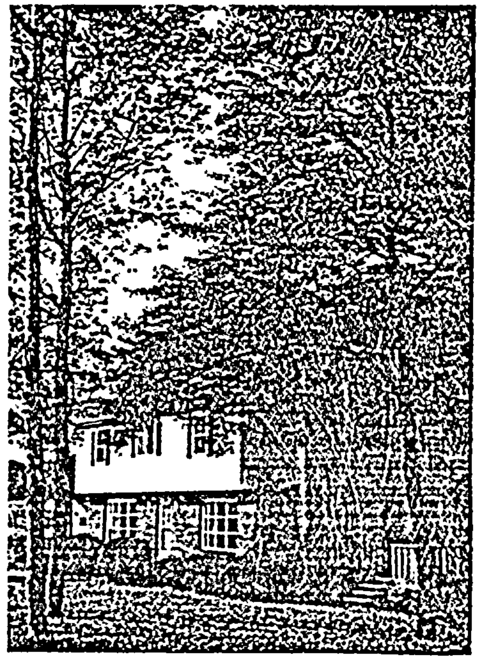
Interest charges of $57.6 million were 17% higher largely as a result of additional mortgage bonds outstanding and higher short-term interest rates.

Earnings available for common stock rose 23% to $57.5 million. On a per-share basis earnings were $2.46, based on a larger average number of shares outstanding. This is 11% higher than the $2.21 recorded in 1977.

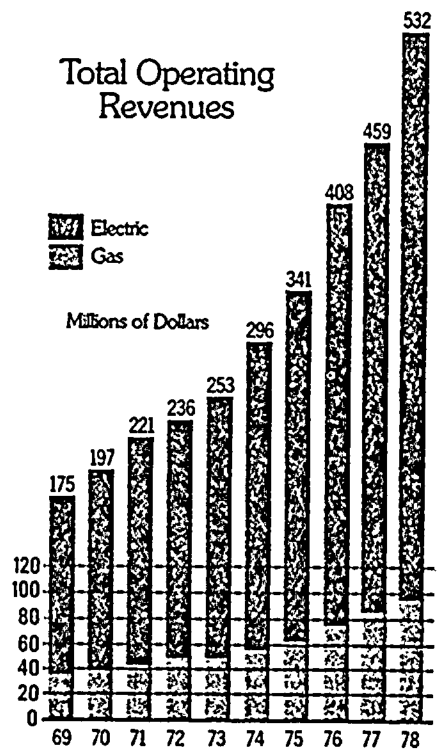
Dividends paid per share were $1.68 which compares with $1.60 in 1977. The quarterly dividend rate was increased to 42 cents a share effective with the February 15, 1978 payment.

After common stock dividends of $38.7 million, earnings retained in the business were $18.7 million.

An estimated 22% of 1978 common stock dividends is a return of capital for federal income tax purposes and may be excluded from dividend income.



Total Operating Revenues




*Dividend Reinvestment*

## Plan Now Includes Discount

With the February 15, 1979 dividend payment, the Company instituted a revised Dividend Reinvestment and Stock Purchase Plan which features a 5% discount on the purchase of additional shares with reinvested dividends. In addition, the lump-sum share purchase option was increased from $3,000 to $5,000 quarterly. The discount does not apply to lump-sum purchases. There are no commissions or service charges for the purchase of shares.

The new plan has been well received by stockholders. Stockholder participants have increased from about 9% of total stockholders in 1978 to 14% currently.

During 1978 stockholders purchased 99,600 shares with $1.8 million of reinvested dividends and 77,100 shares with $1.4 million in optional cash payments. Participants invested quarterly an average of $80 with dividends and $550 with cash payments.

If you are interested in enrolling in the plan, send for further information to New York State Electric & Gas Corporation, Shareholder Services, P.O. Box 200, Ithaca, New York 14850.

*Stockholders*

## Number of Stockholders Increases 25%

Largely as the result of the sale of new common stock, the number of stockholders increased from 51,600 to 64,600, or 25%, during the year. The number of shares outstanding at the end of 1978 was 19% higher than a year earlier.

A majority of the Company's shares, or 61%, is owned by individuals. About a third is owned by institutions such as bank trust accounts, pension funds and insurance companies. The remainder is primarily held by stockbrokers for individual accounts.

Of the individual stockholders, about 80% own 300 shares or less. This means that at current market prices most stockholders have less than $6,000 invested in the Company.

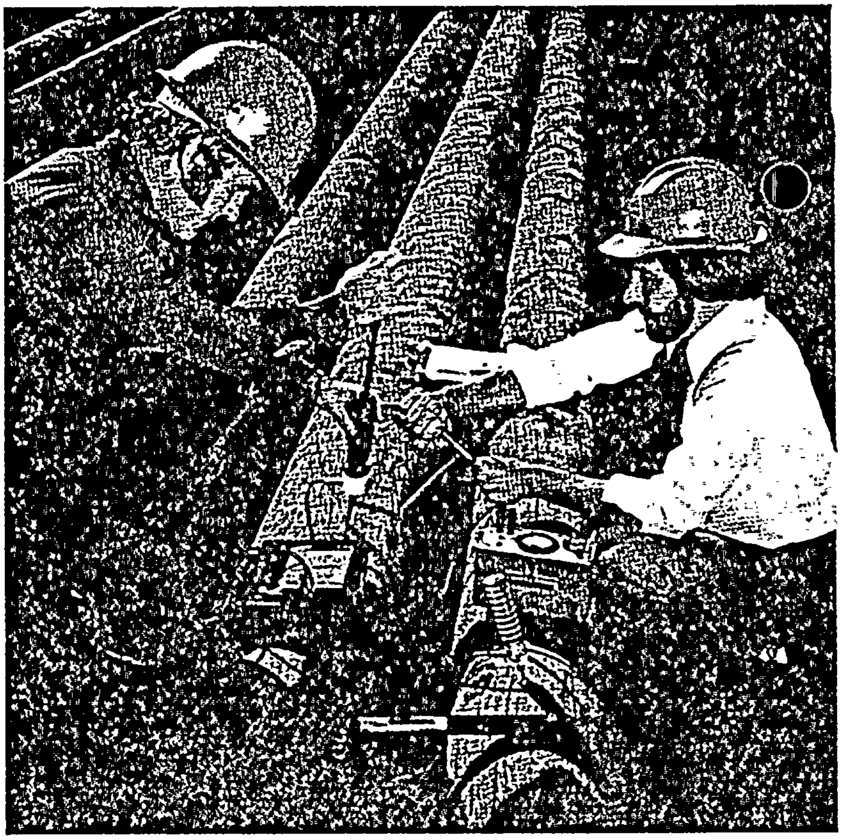
*Rate Matters*

## Higher Rates Pending

In May 1978 the Company applied to the Public Service Commission for higher electric and gas rates which are needed to offset inflationary increases in costs, improve interest coverage, and provide a fair return on stockholders' investment. The proposed rates would increase annual electric revenues by $87.4 million, or 18%, and gas revenues by $6.3 million, or 6%, based on sales projected for a test year ending April 30, 1980.

After a series of public hearings, the presiding administrative law judge recommended earlier this year that electric revenues be increased $40.5 million annually and gas revenues $1.8 million. The recommendation was based on including $100 million of construction work in progress in rate base, which is $205 million less than the Company has requested. It was also based on interest coverage of 2.7 times and a return on common stock equity of 13.65%. The Company has requested 3.0 times coverage and a 15% return on equity.

The Commission is expected to render a decision in the proceeding on or before April 20, 1979.



**Wooden utility poles** are tested for decay, moisture and condition as part of Company research into using fumigants to extend the life of poles and reduce replacement costs.

*Generating Company*

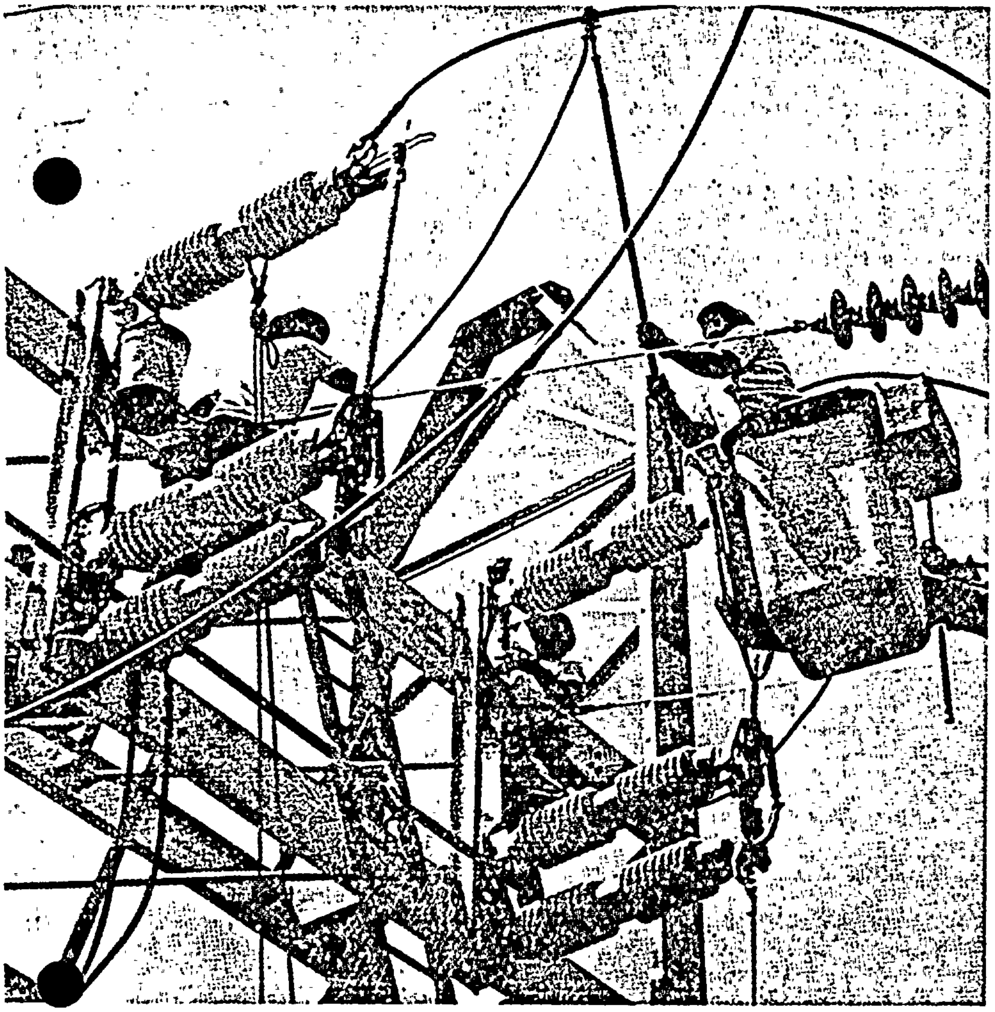
## PSC Informally Turns Down ESPRI

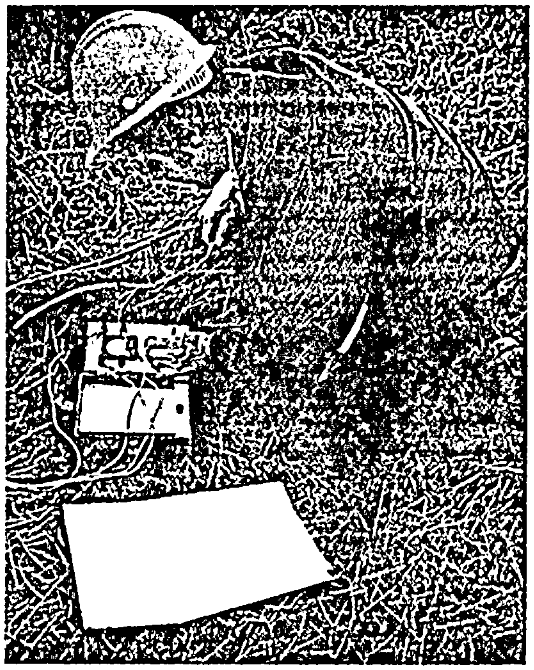
After four years of deliberations, including extended public hearings, members of the Public Service Commission indicated informally in February 1979 that they would reject New York utilities' proposal to finance and operate a generating company. The company, known as Empire State Power Resources, Inc. (ESPRI), would have built and operated new generating facilities on a statewide basis thereby permitting the sharing of risks, reduction of construction costs, and other means of keeping future rate increases at a minimum.

In early 1978, the presiding administrative law judge issued a decision recommending approval of ESPRI with certain modifications. He found that the generating company proposal was in the public interest and that it would provide potential for reducing the need for future rate increases.

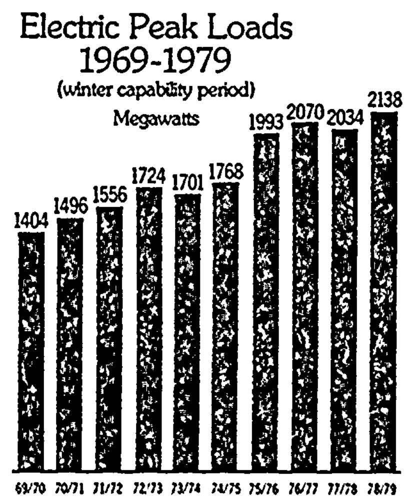
The PSC's objections to ESPRI apparently centered on two features of the proposal: the regulation of ESPRI's wholesale power rates by the Federal Energy Regulatory Commission and the automatic recovery of ESPRI's costs through an "automatic revenue assurance mechanism."

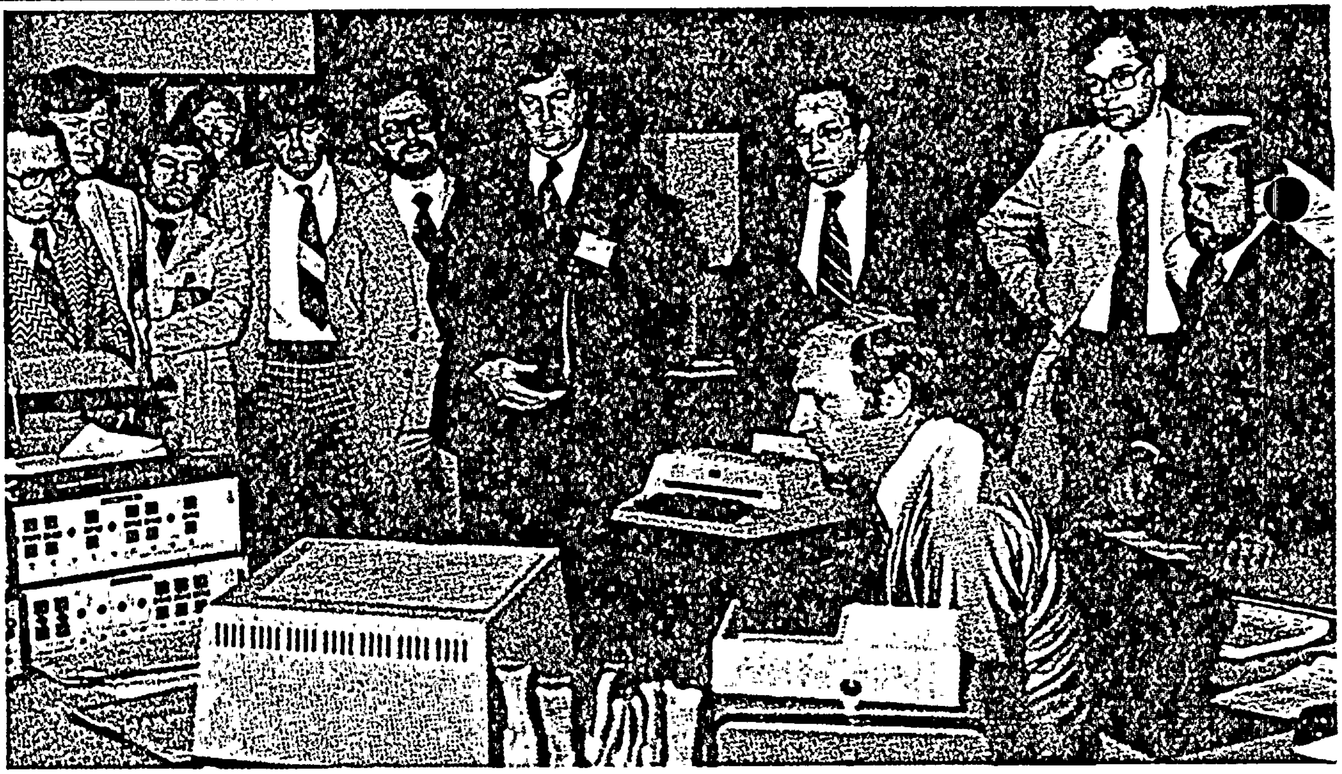
The sponsoring utilities believe that if the entire ESPRI proposal is denied as a result of the above objections, the people of New York State will lose the opportunity for significant savings in future electric bills. As a result, the utilities have formally requested the Commission to approve ESPRI without the revenue assurance mechanism and subject to passage of federal legislation that would permit exclusive PSC jurisdiction over ESPRI's rates or, in the alternative, to hold its decision in abeyance until such legislation could be pursued.





**Soil testing** is part of extensive engineering studies conducted at site of proposed Somerset generating station near Lake Ontario.
**New 115-kilovolt equipment** is installed (left) at Macedon Substation to meet growing electricity demand in Geneva area. More than $90 million was spent on such improvements during 1978.
**Ground-water samples** are collected (below left) from the ash disposal site serving Milliken generating station and then tested as part of efforts to safeguard the environment.





**Management consulting firm** and Public Service Commission representatives visit power supply center as part of a periodic review of Company operations.

*Independent Audit*

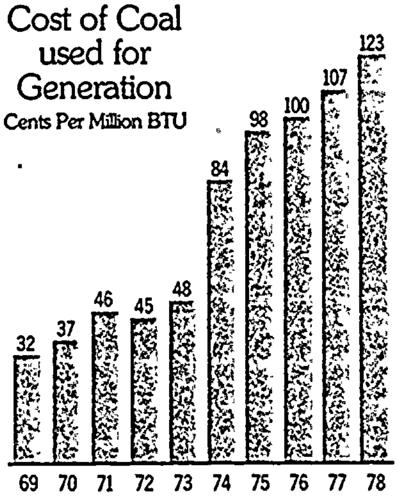
## Management Review Begins

Under a state law adopted in 1976, the state's major utilities are required to undergo an audit of operations every five years to evaluate the effectiveness of management in conducting efficient operations.

In October 1978 Theodore Barry & Associates, a nationwide management consulting firm, was selected by the Public Service Commission for a management audit of the Company. The first phase of the audit, expected to be completed by April 1979, involves a comprehensive overview of operations to determine areas where there is potential for cost savings and improved efficiency. A second phase, if required, would study in depth the areas designated in phase one and make recommendations for changes.

The first phase of the audit is estimated to cost $350,000. The Company is required to pay the full cost of the audit.

Cost of Coal used for Generation
Cents Per Million BTU




*Power Supply*

## New Peak Load Established

In mid-February 1979 a new peak electric load of 2,138,000 kilowatts (kw) was established. It exceeded the previous peak set in December 1976 by 3% and the 1977-78 winter peak by 5%. During the past five years, peak loads have increased at an average rate of about 4% a year.

The Company's power supply capability to meet peak loads is currently 2,567,000 kw. This comprises 1,782,000 kw of generating capacity (substantially all of which is coal-fired), 685,000 kw of purchases from the New York State Power Authority and 100,000 kw of purchases from a neighboring utility. Most of the purchases from the Power Authority are from the Niagara hydroelectric project and are made under a contract expiring January 1, 1990.

A third unit at Homer City Generating Station, a 652,000-kw coal-fired facility half-owned with Pennsylvania Electric Company, began operation in December 1977. It operated at an average of 70% of full rated capacity during 1978, which is unusually good for first-year service. A coal-cleaning plant at the station continues to undergo development and testing and is expected to be placed in full service in 1981.

**Schoolchildren learn** about energy from market services personnel who made 163 school presentations to more than 15,000 children in 1978.

*Future Power Supply*

## Load Growth Projected at 4 to 5% a Year

The Company is currently projecting peak-load growth of 4 to 5% annually over the next fifteen years. To meet this growth, it plans to begin construction this fall of an 850,000-kw coal-fired generating station, is participating in construction of a nuclear unit, and is planning, along with co-owner Long Island Lighting Company (LILCO), the construction of two nuclear generating plants.

The coal-fired facility would be located at Somerset near Lake Ontario in western New York. It was approved in late 1978 by a 5-0 vote of the state Siting Board and certain aspects of its design are currently awaiting approval by federal regulatory agencies. It is estimated to cost $980 million which includes major expenditures for flue gas desulphurization facilities. About $40 million has been spent to date for land, environmental studies and licensing. The projected in-service date was recently changed from 1983 to 1984 due to delay in receipt of regulatory approvals.

The Company is an 18% participant in a 1,090,000-kw nuclear unit being constructed by Niagara Mohawk Power Corporation as a second unit at its Nine Mile Point generating facility near Oswego, New York. The Company's share is estimated to cost $312 million of which $91 million has been spent to date. In late 1978 the initial operating date for the unit was rescheduled from 1983 to 1984 because of construction delays.

The other nuclear facilities would be one-half owned by the Company and are planned for service in the late 1980s and early to mid-1990s. One is a plant with two 1,150,000-kw units proposed to be built by LILCO at Jamesport, New York, in Suffolk County. The other would be built by the Company at New Haven, New York, near Oswego, and would have two 1,250,000-kw units. At the end of 1978, the Company had expended $58 million on the New Haven project, to be matched by LILCO, and $52 million on Jamesport, including outlays for nuclear fuel. These plants are currently subjects of Siting Board and other regulatory agency proceedings.

To meet anticipated load growth in the years prior to 1984, the Company plans to purchase generating capacity from neighboring utilities when required.

*1978 Construction*

## Outlays Down From Forecast Level

Construction outlays in 1978 aggregated $160 million which includes $16.7 million of allowance for funds used during construction. Expenditures were down about 20% from forecasted levels largely because of generating project delays and reduced needs for transmission and distribution system reinforcements.

Net additions to plant were $132 million because of a transfer of $28 million to investment other than plant. The transfer reflects LILCO's one-half interest in the New Haven project.

Major expenditures during the year included $32 million for the Company's share of Nine Mile Point 2, $20 million for the New Haven project, $10 million for the Company's share of the Jamesport project and $4 million for the Somerset project. Slightly over $2 million was expended on nuclear fuel.

The remaining $92 million was spent for general improvements in electric and gas systems, including capital spent to meet environmental requirements. Minor projects of $25,000 or less aggregated $39 million.

*Future Construction*

## Three-Year Program Record $858 Million

Construction expenditures for the three years 1979 through 1981, including AFDC, are projected to total $858 million, a record three-year program for the Company.

About 30% of the projected expenditures, or $257 million, is budgeted for construction of the Somerset project. The Company's 18% share of Nine Mile Point 2 will require $110 million. Other large outlays include $77 million for the Company's share of the Jamesport project and $33 million for its share of the New Haven generating station. The purchase and fabrication of nuclear fuel is estimated at $23 million during the period.

The remaining $358 million is required for general improvement of electric and gas systems, additional facilities to serve new customers, and modifications and installations required to meet environmental regulations.

*Financing*

## Third of Construction Needs Provided Internally

Cash requirements for construction in 1978 were $143 million, of which $51 million, or 35%, was provided through internally-generated funds. With repayment of $5.5 million in maturing 3% first mortgage bonds and a reduction of $45 million in short-term debt, total cash requirements were $194 million.

In addition to the internally-generated funds, cash requirements were met with proceeds of three security issues aggregating $119 million, about $21 million in reduced net working capital requirements, and $3 million from the dividend reinvestment plan.

The security issues included a sale of two million shares of common stock to underwriters in March at $18.095 a share. The stock was reoffered to the public at $18.625 a share. Another two-million-share issue of common stock was sold to underwriters in October at $16.275 a share and was reoffered to the public at $16.875 a share.

In July, $50 million principal amount of 9.35% first mortgage bonds due 2003 was sold through private placement with 19 institutional investors. The bonds have a mandatory sinking fund giving the issue an average life of 17 years, and an option with respect to the sinking fund which, if fully exercised

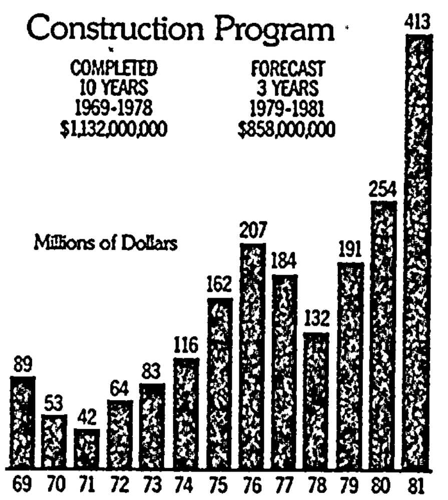
## Industrial Electric Revenues

| | 1978 (thousands) | Percent of total |
|---|---|---|
| Stone, clay and glass products | $ 10,824 | 13.3% |
| Machinery, except electrical | 8,930 | 11.0 |
| Transportation equipment | 7,885 | 9.7 |
| Fabricated metal products | 6,662 | 8.2 |
| Electrical machinery and supplies | 6,468 | 8.0 |
| Primary metal industries | 6,361 | 7.8 |
| Food and kindred products | 6,130 | 7.5 |
| Rubber and plastic products | 5,239 | 6.4 |
| Chemicals and allied products | 3,143 | 3.9 |
| Paper and allied products | 2,699 | 3.3 |
| Instruments and related products | 2,427 | 3.0 |
| Nonmetal mining, excluding fuels | 2,069 | 2.5 |
| Printing and publishing | 1,857 | 2.3 |
| Wood products, except furniture | 1,781 | 2.2 |
| Petroleum and refining | 1,186 | 1.5 |
| Leather and leather products | 1,032 | 1.3 |
| Textile mill products | 847 | 1.0 |
| Furniture and fixtures | 839 | 1.0 |
| Metal mining | 793 | 1.0 |
| Miscellaneous industries | 1,663 | 2.0 |
| Unclassified (under 50 kw demand) | 2,497 | 3.1 |
| Total | $ 81,332 | 100.0% |
| Total electric revenues | $433,774 | |

by the Company, would give the issue an average life of 11½ years.

Work is under way to seek regulatory approval for the establishment of trusts for financing nuclear fuel outlays which currently aggregate about $20 million.

It is estimated that $128 million will be required from external sources to finance 1979 construction requirements and to refund $10 million of 2.80% first mortgage bonds due December 1. It is presently anticipated that these funds will be provided through sales of additional debt and senior equity securities.




**Vineyards flourish** near Keuka Lake in the scenic Finger Lakes region. Agriculture is an important part of the service area's economy.

*Environmental Protection*

## Somerset Protection to Cost $240 Million

The proposed 850,000-kw coal-fired generating station to be built at Somerset, New York, provides striking evidence of the high cost of environmental controls. Environmental devices, notably flue gas desulphurization equipment, will account for $240 million, or about a quarter of the total estimated cost of the project.

The Company is continuing its efforts to meet stringent federal and state air and water quality standards at existing generating stations. These activities include improvements in water treatment, air pollution controls and ash disposal. Several studies concerning stack emissions have been completed and plans are under way to improve emissions by mid-1979. Air quality monitoring efforts for state agencies will be continued at Jennison and Hickling generating stations.

During 1978 the Company incurred an estimated $40 million in environmental capital, operating and maintenance expenses. For the next three years (1979-1981) those expenses are expected to total $160 million.

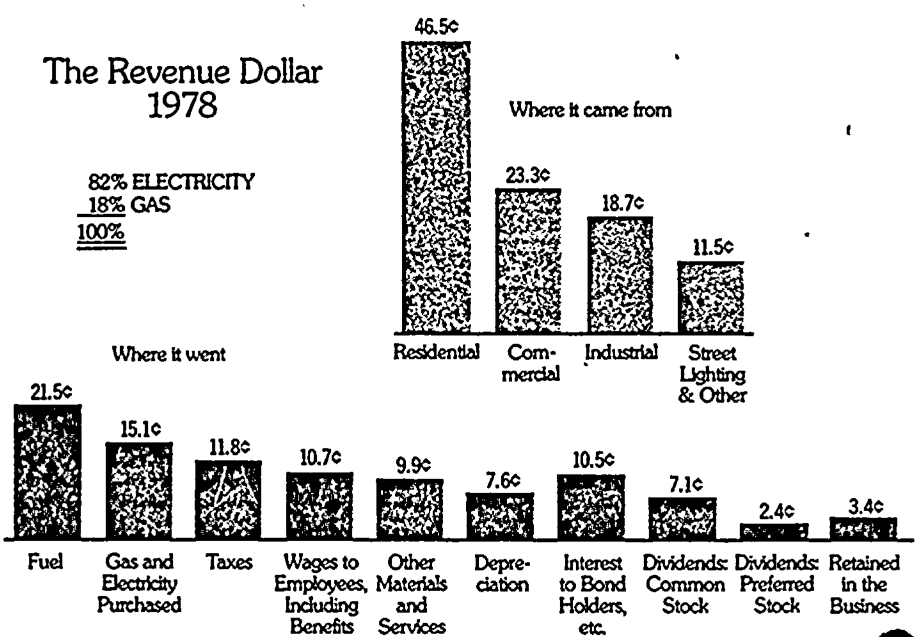
*Conservation*

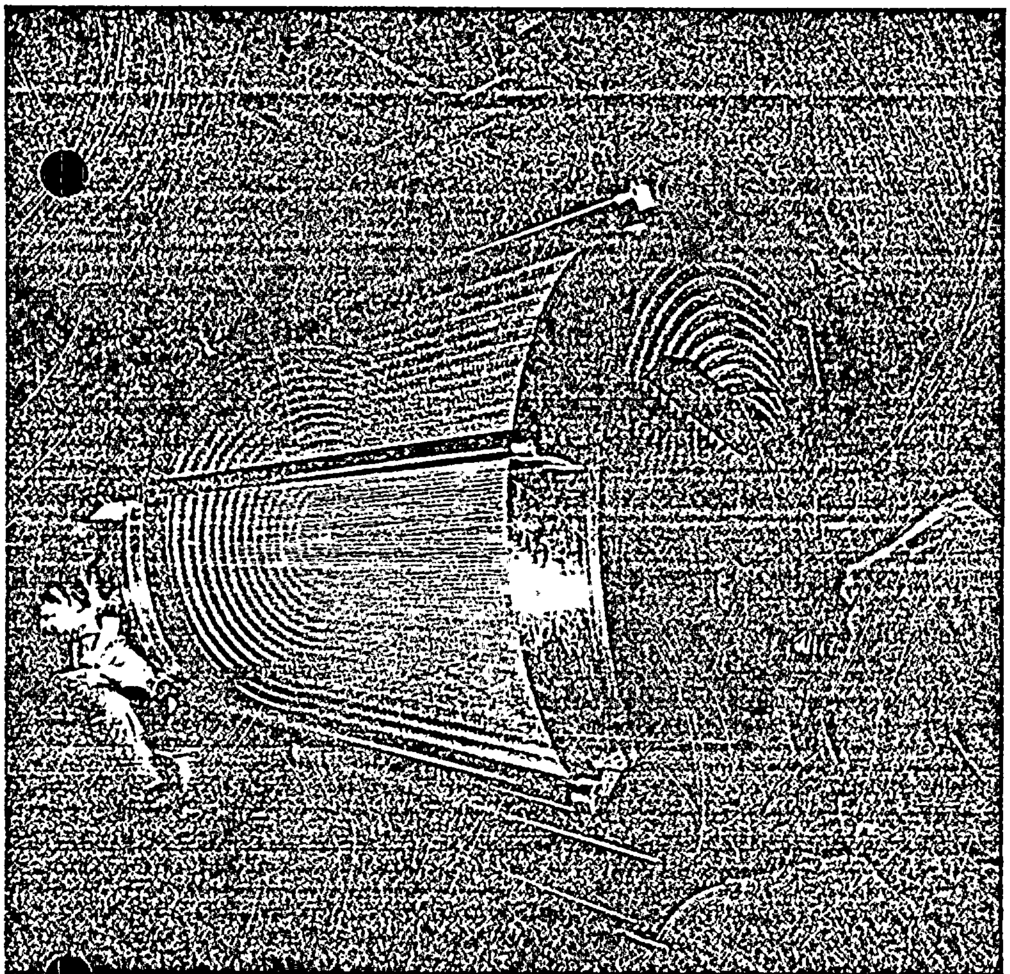
## Insulation-Financing Response Disappointing

Despite promotion through radio and newspaper advertising and bill enclosures, customer response to a conservation program mandated by law has been disappointing. The program, which was initiated in October 1977, provides for financing of home insulation and the conduct of energy surveys of residential premises for a $10 fee. To date only 40 insulation projects have been financed and 90 energy surveys completed.

Other conservation efforts where there are no fees or charges to customers have been more successful. Market services personnel address civic and other groups on conservation methods and the wise use of energy. They work closely with home builders, industries and commercial, municipal and farm customers to promote efficient utilization of energy. Free publications on various energy conservation topics are popular and are distributed widely.

**Attic insulation** is checked during an energy audit of a customer's home. Such insulation is particularly important in one-story homes where over half of heat lost escapes through ceilings.





**Large-particle detector** at the Wilson Synchrotron Laboratory at Cornell University in Ithaca contains this cylindrical chamber where collisions of high-energy particles are studied in basic research conducted at the University.

**New energy management** system is used to control air handling and other equipment at Hobart College in Geneva. Market services personnel help customers install such systems.

*Research and Development*

## Expenditures Rise 12%

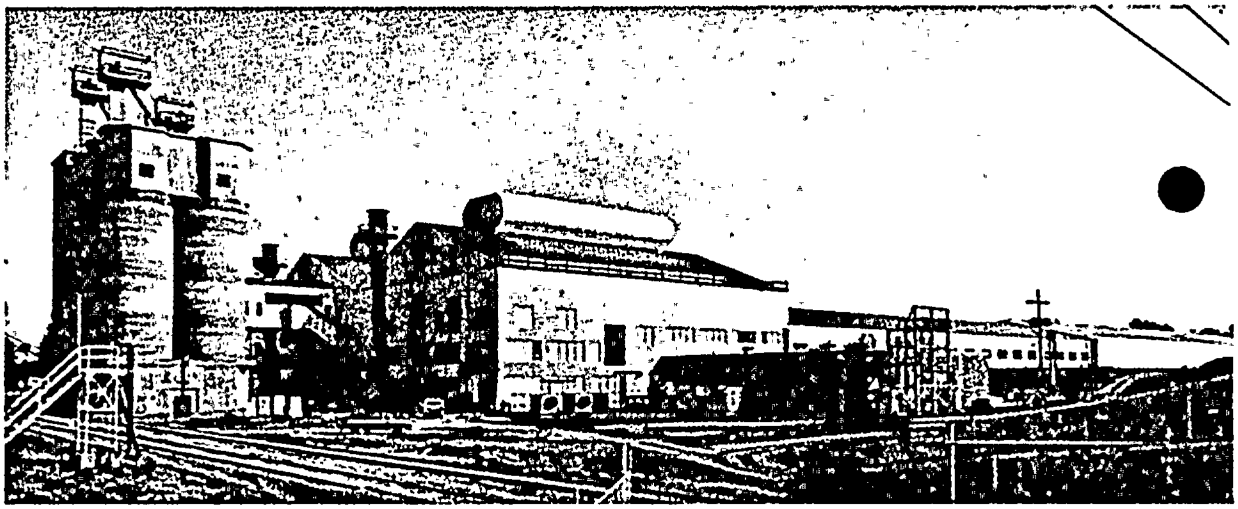
Expenditures on research and development in 1978 amounted to $3.8 million, a 12% increase over 1977.

About three-quarters of research outlays reflect the Company's participation in various research organizations. The largest amount, $1.3 million, is contributed to the research program of the Electric Power Research Institute which is financed by private and publicly-owned utilities nationwide. The Institute's research budget totals over $200 million and is devoted to such areas as nuclear safety, direct-current transmission and improved ways of generating electricity.

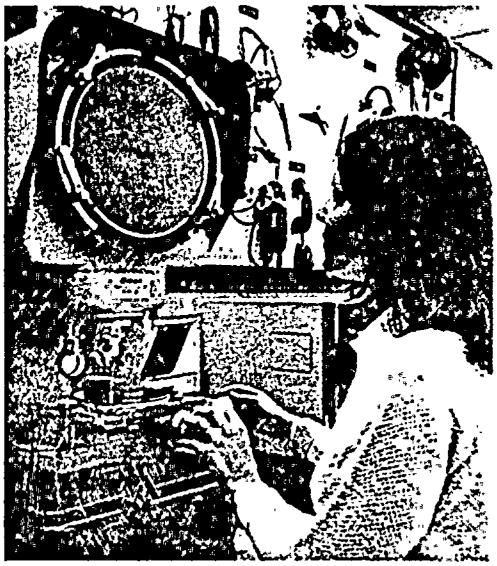
Participation by the Company in research of the Empire State Electric Energy Research Corporation (ESEERCO) amounted to $670,000. ESEERCO spent $4.5 million on research and development in 1978, including work on laser fusion development, use of fuel cells and new methods for insulating transformers.

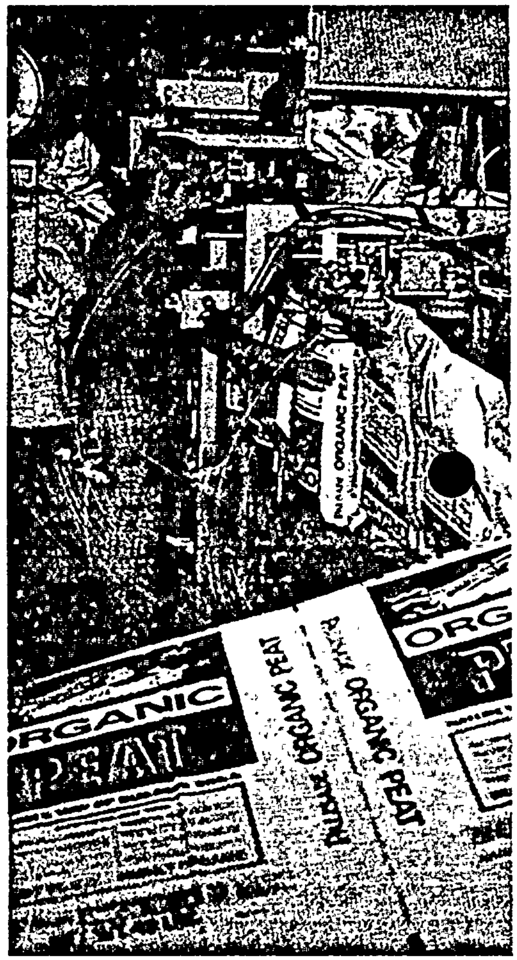
Under state law, the Company is required to finance, along with the state's other electric and gas utilities, the New York State Energy Research and Development Authority's research program. The Company contributed $820,000 in 1978. Its research projects range from the use of solar energy to the development of small hydro-electric plants.

The remaining quarter of research expenditures was devoted to internal research projects including improvement of coal-cleaning at the Homer City Generating Station, prevention of decay in wood poles and improving performance of electrostatic precipitators used to remove dust from stack discharges.



**Electric and gas sales growth** among industrial customers outpaced other customer categories in 1978. This new plant (above) near Auburn, which created 210 new jobs, is designed to produce up to two million bottles a day for a nearby brewery.






**Electronics firm** (right) near Oneonta makes depth finders and communications equipment, while another plant (far right) north of Brewster extracts and packages humus and topsoil for home gardeners. These facilities are typical of small industry in the service area.

*Electric Department*

## Kwh Sales Increase 3%

Kilowatt-hour sales in 1978 increased 3%. Revenues were up 16%, reflecting higher rates which became effective November 1, 1977 and fuel costs included in customer billings.

Percent increases by principal customer category were as follows:

| | Kwh Sales | Revenues |
|---|---|---|
| Residential | 2% | 17% |
| Commercial | 3 | 15 |
| Industrial | 5 | 16 |
| Other | – | 12 |
| Total | 3% | 16% |

During the past five years, growth in kilowatt-hour sales has averaged about 4% a year.

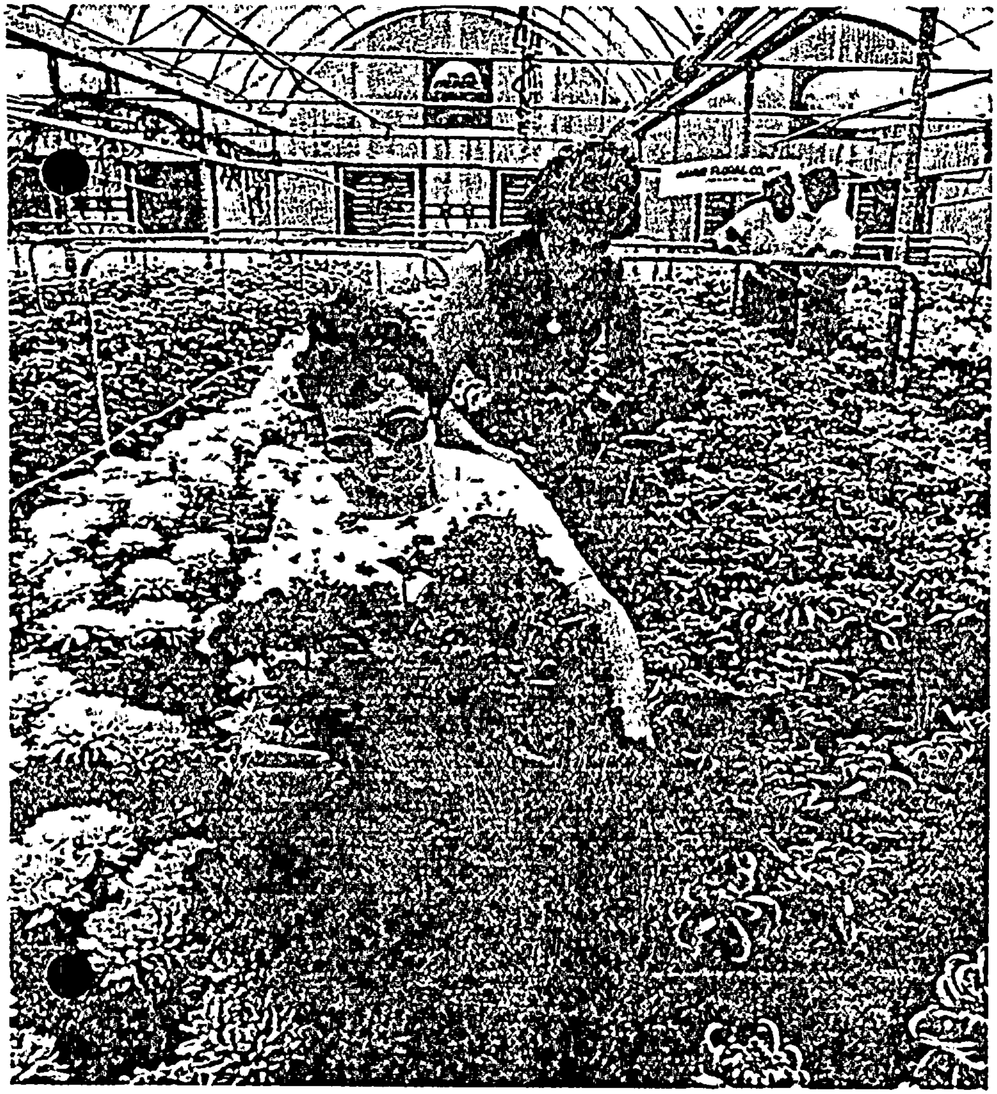
Operating and maintenance expense, excluding production costs, increased $4.4 million, or 7%. Production costs, which constitute 70% of operating and maintenance expense, also increased 7%, and reflect greater sales and reduced purchases of interchange energy. Initial operations of Homer City 3 made relatively low-cost energy available for interchange sales which offset higher fuel and other expense. Net sales of such energy are credited to production costs. Average unit fuel costs for generating facilities increased 15% to $1.23 per million Btu.

*Gas Department*

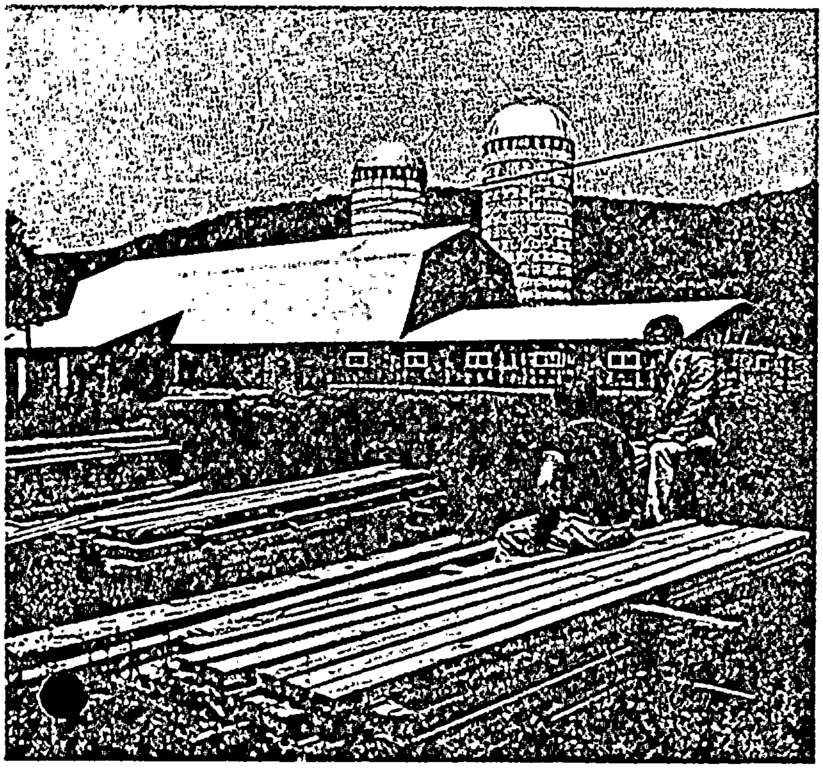
## Over 600 Install Heating

Unit gas sales in 1978 increased 4% over 1977. Use by space heating customers increased only 1% despite colder weather and the fact that over 600 customers installed space heating equipment during the year. It is evident that many customers have improved insulation or otherwise conserved energy.

Gas revenues rose 16% and now total $97.8 million. Revenues reflect



**A worker uses natural gas** to make a part for a gas-turbine engine at an expanding manufacturing facility near Norwich, which recently increased its work force from 500 to 700. Newark floral firm added an acre of new greenhouses (left) with sophisticated devices for controlling temperature and moisture levels. Central New York farmer (below) discusses insulation and electrical system for his new barn with Company representative.



higher rates instituted in November 1977 and increased purchased gas cost included in customer bills.

Sales and revenue increases by major customer category were as follows:

| | Mcf Sales | Revenues |
|---|---|---|
| Residential | — | 13% |
| Commercial | 3% | 15 |
| Industrial | 8 | 20 |
| Total | 4% | 16% |

With the increased availability of gas from pipeline suppliers, the Company has resumed limited promotional activity in most operating areas and is adding new customers where gas distribution facilities are available.

Operating expense, excluding the cost of purchased gas, rose 5%. Purchased gas expense increased 14% and on a per-unit basis was $1.66 per Mcf which compares with $1.54 per Mcf in 1977.

# Balance Sheet

| | December 31 1978 | December 31 1977 |
|---|---|---|
| | *Thousands of Dollars* | |
| **ASSETS** | | |
| UTILITY PLANT, at original cost (Note 1): | | |
| Electric | $1,325,609 | $1,265,796 |
| Gas | 115,577 | 112,764 |
| Common | 39,058 | 37,617 |
| | 1,480,244 | 1,416,177 |
| Less, Accumulated depreciation | 376,933 | 350,014 |
| Net utility plant in service | 1,103,311 | 1,066,163 |
| Construction work in progress | 309,305 | 256,906 |
| | 1,412,616 | 1,323,069 |
| OTHER INVESTMENTS (Note 5) | 48,453 | 19,668 |
| CURRENT ASSETS: | | |
| Cash | 4,550 | 7,178 |
| Special deposits | 10,915 | 9,702 |
| Accounts receivable | 53,606 | 47,142 |
| Fuel | 18,907 | 32,686 |
| Materials and supplies, at average cost | 16,272 | 14,153 |
| Prepayments | 8,802 | 8,613 |
| | 113,052 | 119,474 |
| DEFERRED DEBITS: | | |
| Fuel costs deferred | 14,059 | 12,144 |
| Unamortized debt expense | 6,654 | 6,292 |
| Other | 8,591 | 9,215 |
| | 29,304 | 27,651 |
| | $1,603,425 | $1,489,862 |
| **CAPITALIZATION AND LIABILITIES** | | |
| CAPITALIZATION: | | |
| Capital stock and retained earnings: | | |
| Preferred stock | $ 176,375 | $ 176,463 |
| Common stock equity: | | |
| Common stock | 171,166 | 143,322 |
| Capital in excess of par value | 181,375 | 137,293 |
| Capital stock expense | (4,614) | (4,403) |
| Retained earnings | 185,479 | 166,738 |
| Total common stock equity | 533,406 | 442,950 |
| Long-term debt | 711,347 | 672,461 |
| Total | 1,421,128 | 1,291,874 |
| CURRENT LIABILITIES: | | |
| Long-term debt, due within one year | 10,000 | 5,500 |
| Notes payable (Note 6) | 35,300 | 79,500 |
| Accounts payable | 34,751 | 41,431 |
| Dividends payable on preferred stock | 3,272 | 3,273 |
| Pensions accrued | 11,750 | 10,644 |
| Taxes accrued | 17,251 | 3,491 |
| Interest accrued | 16,862 | 14,388 |
| Other | 17,289 | 10,561 |
| | 146,475 | 168,788 |
| DEFERRED CREDITS: | | |
| Accumulated deferred investment tax credit (Note 3) | 10,762 | 4,570 |
| Other | 1,760 | 1,393 |
| | 12,522 | 5,963 |
| ACCUMULATED DEFERRED FEDERAL INCOME TAX (Note 3) | 23,300 | 23,237 |
| | $1,603,425 | $1,489,862 |

The accompanying notes shown on pages 22 through 25 are an integral part of the financial statements.

# Statement of Income

| | 1978 | 1977 |
|---|---|---|
| | *Thousands of Dollars* | |
| OPERATING REVENUES: | | |
| Electric | $433,774 | $374,456 |
| Gas | 98,397 | 84,996 |
| Total | 532,171 | 459,452 |
| OPERATING EXPENSES: | | |
| Operation—fuel (Note 1) | 118,384 | 87,181 |
| —other | 74,465 | 67,544 |
| Electricity purchased and interchanged | 19,059 | 46,599 |
| Gas purchased | 63,896 | 56,284 |
| Maintenance | 38,529 | 33,709 |
| Depreciation | 41,462 | 34,544 |
| Federal income tax (Note 3) | 16,350 | 330 |
| Other taxes (Note 7) | 57,064 | 50,645 |
| Total | 429,209 | 376,836 |
| OPERATING INCOME | 102,962 | 82,616 |
| OTHER INCOME AND DEDUCTIONS: | | |
| Allowance for other funds used during construction (Note 1) | 10,659 | 14,056 |
| Federal income tax credit (Note 3) | 8,383 | 1,255 |
| Other, net | 202 | (160) |
| Income before interest charges | 122,206 | 97,767 |
| INTEREST CHARGES: | | |
| Interest on long-term debt | 52,337 | 45,119 |
| Other interest | 5,302 | 4,010 |
| Allowance for borrowed funds used during construction (Note 1) | (5,996) | (11,307) |
| Interest charges — net | 51,643 | 37,822 |
| NET INCOME | 70,563 | 59,945 |
| PREFERRED STOCK DIVIDENDS | 13,090 | 13,094 |
| EARNINGS AVAILABLE FOR COMMON STOCK | $ 57,473 | $ 46,851 |
| EARNINGS PER SHARE | $2.46 | $2.21 |
| AVERAGE NUMBER OF SHARES OUTSTANDING | 23,392,883 | 21,208,145 |

# Statement of Retained Earnings

| | 1978 | 1977 |
|---|---|---|
| | *Thousands of Dollars* | |
| Balance, beginning of year | $166,738 | $153,451 |
| Add, Net income | 70,563 | 59,945 |
| | 237,301 | 213,396 |
| Deduct, Dividends on capital stock: | | |
| Preferred stock | 13,090 | 13,094 |
| Common stock ($1.68 a share in 1978 and $1.60 in 1977) | 38,732 | 33,564 |
| | 51,822 | 46,658 |
| Balance, end of year | $185,479 | $166,738 |

The accompanying notes shown on pages 22 through 25 are an integral part of the financial statements.

# Statement of Changes in Financial Position

| | 1978 | 1977 |
|---|---|---|
| | *Thousands of Dollars* | |
| **SOURCE OF FUNDS** | | |
| Net Income | $ 70,563 | $ 59,945 |
| Depreciation | 41,462 | 34,544 |
| Amortization of deferred charges | 2,792 | 3,045 |
| Federal income tax deferred—net | (1,337) | (1,069) |
| Investment tax credit deferred—net | 6,192 | 973 |
| Allowance for funds used during construction | (16,655) | (25,363) |
| Funds from operations | 103,017 | 72,075 |
| Proceeds from sale of first mortgage bonds | 50,000 | 110,000 |
| Proceeds from sale of common stock | 71,930 | 36,648 |
| Increase in notes payable | — | 39,000 |
| Total funds available | $224,947 | $257,723 |
| **APPLICATION OF FUNDS** | | |
| Additions to utility plant | $115,098 | $158,493 |
| Dividends on preferred stock | 13,090 | 13,094 |
| Dividends on common stock | 38,732 | 33,564 |
| First mortgage bonds becoming due within one year | 10,000 | 5,500 |
| Fuel costs deferred | 2,610 | 1,283 |
| Other investments | 28,756 | 2,350 |
| Decrease in notes payable | 44,200 | — |
| Other debt—net | 1,021 | 13,964 |
| Debt expense and other—net | (251) | 2,701 |
| Increase (decrease) in working capital (excluding changes in notes payable) | (28,309) | 26,774 |
| Total funds applied | $224,947 | $257,723 |

The accompanying notes shown on pages 22 through 25 are an integral part of the financial statements.

# Statement of Capital Stock and Long-Term Debt

December 31, 1978

## CAPITAL STOCK

| | Redemption Price | | | | |
|---|---|---|---|---|---|
| | Current | Through | Eventual Minimum | Shares Outstanding | Amount *(Thous.)* |
| Serial cumulative preferred stock, par value $100 a share, 1,963,750 shares authorized: | | | | | |
| 3.75% series | $104.00 | — | $104.00 | 150,000 | $ 15,000 |
| 4.50% sinking fund series | 105.25 | — | 105.25 | 8,750 | 875 |
| 4½ % series (1949) | 103.75 | — | 103.75 | 40,000 | 4,000 |
| 4.15% series | 101.00 | — | 101.00 | 40,000 | 4,000 |
| 4.40% series | 102.00 | — | 102.00 | 75,000 | 7,500 |
| 4.15% series (1954) | 102.00 | — | 102.00 | 50,000 | 5,000 |
| 6.48% series | 103.00 | 2-1-83 | 102.00 | 300,000 | 30,000 |
| 8.80% series | 108.34 | 3-1-81 | 102.00 | 250,000 | 25,000 |
| 9.00% sinking fund series | 108.00 | 9-30-79 | 100.00 | 300,000 | 30,000 |
| Serial cumulative preferred stock, par value $25 a share, 5,000,000 shares authorized: | | | | | |
| 8.48% series | 27.82 | 2-1-79 | 25.70 | 1,000,000 | 25,000 |
| 8.50% sinking fund series | 25.91 | 7-1-79 | 25.00 | 600,000 | 15,000 |
| 9.10% sinking fund series | 28.75 | 7-1-84 | 25.00 | 600,000 | 15,000 |
| Total preferred stock | | | | | $176,375 |
| Preference stock, par value $100 a share, 1,000,000 shares authorized | | | | None | |
| Common stock, par value $6.66⅔ a share, 40,000,000 shares authorized* | | | | 25,674,936 | $171,166 |

* In 1978 the Company sold 4,000,000 shares of common stock (1,800,000 shares in 1977) by public offering and issued 176,702 shares (112,254 shares in 1977) through its dividend reinvestment and stock purchase plan for net aggregate proceeds of $71,930,000 in 1978 and $36,648,000 in 1977 (See Note 4).

## LONG-TERM DEBT

| | Amount *(Thous.)* |
|---|---|
| First mortgage bonds: | |
| 2.80% series, due December 1, 1979 | $ 10,000 |
| 2.80% series, due December 1, 1980 | 12,500 |
| 7⅝ % series, due August 1, 1981 | 60,000 |
| 10.60% series, due October 1, 1982 | 50,000 |
| 3¼ % series, due May 1, 1984 | 20,000 |
| 3⅜ % series, due September 1, 1985 | 15,000 |
| 4⅝ % series, due May 1, 1987 | 25,000 |
| 3⅞ % series, due February 1, 1988 | 25,000 |
| 4⅝ % series, due May 1, 1991 | 25,000 |
| 8⅝ % series, due June 1, 1996 (issued 1977) | 50,000 |
| 5⅝ % series, due January 1, 1997 | 25,000 |
| 6¼ % series, due September 1, 1997 | 25,000 |
| 6½ % series, due September 1, 1998 | 30,000 |
| 7⅝ % series, due November 1, 2001 | 50,000 |
| 9.35% series, due July 1, 2003, (issued 1978) | 50,000 |
| 9⅜ % series, due March 1, 2005 | 75,000 |
| 9⅜ % series, due January 1, 2006 | 75,000 |
| 7¼ % series, due June 1, 2006 | 12,000 |
| 6⅞ % series, due December 1, 2006 | 25,750 |
| 8⅝ % series, due November 1, 2007 (issued 1977) | 60,000 |
| Total first mortgage bonds | 720,250 |
| Other - principally unamortized premium on debt | 1,097 |
| Total debt | 721,347 |
| Less, debt due within one year - included in current liabilities | 10,000 |
| Total long-term debt | $711,347 |

The mortgage indenture, as amended and supplemented, secures the first mortgage bonds which constitute a direct first mortgage lien on substantially all utility plant.

The accompanying notes shown on pages 22 through 25 are an integral part of the financial statements.

# Notes to Financial Statements

## 1. Significant Accounting Policies

**a. Accounting records**

The Company maintains its accounting records in conformity with the uniform system of accounts prescribed by the Federal Energy Regulatory Commission and the Public Service Commission of the State of New York (PSC).

**b. Utility plant**

The cost of current repairs and minor replacements is charged to appropriate operating expense and clearing accounts; the cost of renewals and betterments, including indirect costs, is capitalized. The original cost of utility plant retired or otherwise disposed of and the cost of removal less salvage are charged to accumulated depreciation.

**c. Allowance for funds used during construction (AFDC)**

AFDC was capitalized during 1978 on a compound basis at 6¾% (net of income taxes) on construction work in progress (CWIP) related to construction of electric facilities (in excess of $30 million CWIP allowed in rate base) limited to a base of $220 million. AFDC was also capitalized on a compound basis during 1978 at 8¾% (before income tax effect) on CWIP for electric facilities in excess of $250 million and on all other CWIP. AFDC was capitalized at 9% (before income tax effect) during 1977 on CWIP in excess of $45 million included in rate base, except for capitalization at 7% (net of income taxes) on $220 million in December, concurrent with a reduction to $30 million of CWIP included in rate base. AFDC is apportioned in the financial statements as other income and as a reduction of interest charges.

**d. Revenue**

Revenues from the sale of electricity and gas are recorded on the basis of meters read.

**e. Retirement plans**

The Company has noncontributory retirement annuity plans which cover all officers and substantially all employees. The cost of these annuity plans and supplemental payments made directly by the Company to retired employees was $12,069,000 and $10,854,000 for 1978 and 1977. The annuity plan costs are based on normal cost and amortization of the unfunded liability as provided for by the Pension Reform Act of 1974. The unfunded liability (excess of actuarial liability over actuarial value of the fund) as of December 31, 1977 was estimated to be $52,000,000. The Company's policy is to fund pension costs accrued.

**f. Deferred debits**

Debt expense is deferred and amortized ratably over the lives of the issues.

Pursuant to PSC policy, the Company defers certain fuel and purchased gas costs which are subsequently billed to customers through adjustment clauses in rates.

At December 31, 1978, other deferred debits include $2,800,000 of unamortized costs related to an abandoned nuclear power plant project. In a 1977 rate decision, the PSC granted electric revenues sufficient to amortize the deferred amount over a five-year period.

**g. Depreciation**

Depreciation of utility plant is provided for on a "straight-line group method basis" (equivalent to 3.2% of plant for 1978 and 1977).

## 2. Commitments and Proposed Sales of Securities

It is estimated that 1979 costs for the Company's construction program will approximate $190,000,000. The program is subject to periodic review and revision, and actual construction costs to be incurred may vary because of revised load estimates, the imposition of additional regulatory requirements and the availability and cost of capital. Proceeds from periodic security sales are used to repay notes payable to banks and commercial paper, the proceeds of which had been used for construction purposes.

## 3. Federal Income Taxes

For federal income tax purposes the Company uses the sum-of-the-years-digits depreciation method and the Asset Depreciation Range System (ADR). The PSC requires that federal income tax reductions resulting from the use of accelerated methods of depreciation be reflected currently in income whereas reductions arising from the use of ADR are deferred and, in general, are returned to income over the book life of the applicable property. Similarly, the reduction in federal income taxes arising from the accelerated amortization of certain pollution control facilities is deferred and is being returned to income over the tax life of the facilities.

In an October 1977 rate decision, the PSC allowed revenues equal to the federal income tax effect of the interest on debt portion of AFDC on $220 million of test year CWIP related to construction of electric facilities and directed the Company to use a net-after-tax method to calculate AFDC on that portion of CWIP. This net-after-tax (imputed income tax) benefit ($4,312,000 for 1978 and $367,000 for 1977) has been allocated to other income and deductions.

Investment tax credits (ITC) based on the Revenue Act of 1973 (4%) are reflected currently in income and are shared equally between stockholders and customers for rate making purposes. Increased ITC derived from the Tax Reduction Act of 1975 are deferred. The Company has estimated ITC carry-forward of $12,874,000 at December 31, 1978, which the Tax Reform Act of 1976 will allow the Company to utilize to reduce future federal income taxes before taxes are decreased by current year ITC. Federal income taxes for 1978 and 1977 are as follows:

| | 1978 | 1977 |
|---|---|---|
| | *(Thousands of Dollars)* | |
| Federal income tax: | | |
| Current | $ 3,040 | $ (829) |
| Deferred-net: | | |
| ADR and cost of removal | (211) | 24 |
| Pollution control facilities | (197) | 269 |
| Fuel costs | 74 | (391) |
| Other | (1,003) | (971) |
| | (1,337) | (1,069) |
| AFDC imputed income tax benefit | 4,312 | 367 |
| Investment tax credits: | | |
| Deferred (net of flow through, $7,584,000 and $1,426,000) | 6,543 | 1,148 |
| Shared | 3,792 | 713 |
| Charged to operations | 16,350 | 330 |
| Included in other income: | | |
| AFDC imputed income tax benefit | (4,312) | (367) |
| Investment tax credits — shared | (3,792) | (713) |
| Tax on other income | 72 | — |
| Amortization of ITC deferred in prior years | (351) | (175) |
| | (8,383) | (1,255) |
| Total | $ 7,967 | $ (925) |

Federal income tax provisions for 1978 and 1977 are substantially less than the amount obtained by using the 48% statutory rate, primarily due to the following:

| | 1978 | 1977 |
|---|---|---|
| Statutory rate | 48.0% | 48.0% |
| Decrease: | | |
| Excess of allowable tax depreciation and amortization over book amounts | (10.2) | (14.8) |
| Costs capitalized on books, expensed for income taxes: | | |
| AFDC | (10.2) | (20.6) |
| Taxes, pensions and insurance | (5.9) | (7.3) |
| Investment tax credits | (9.4) | (2.4) |
| Miscellaneous | (2.1) | (4.5) |
| Actual rate | 10.2% | (1.6)% |

## 4. Common Stock

On May 13, 1977 shareholders approved a 3-for-2 split of common stock which became effective May 17, 1977. Par value was reduced to $6.66⅔ from $10 and total shares authorized increased to 30,000,000 shares from 20,000,000. On May 12, 1978 shareholders approved an increase in total shares authorized to 40,000,000 from 30,000,000.

## 5. Other Investments

The Company has entered into long-term contracts for the supply of coal to the Homer City Generating Station and, in that connection, has agreed to make loans (maximum aggregate amount of $23,150,000 approved by the PSC) to the mining companies. These loans (amounting to $19,375,000 and $18,750,000 at December 31, 1978 and 1977) are being made on first mortgage notes maturing December 31, 1981 and bear interest at 1½% above the prime interest rate in effect from time to time.

The Company and the Long Island Lighting Company have each contributed $57,544,000 as of December 31, 1978 for a joint venture to construct a nuclear generating station in the town of New Haven near Lake Ontario. The Company has recorded $28,131,000 of its contribution in other investments and the balance is included in construction work in progress.

## 6. Bank Loans and Other Borrowings

In 1976 the Company entered into a loan agreement with eighteen New York banks which provides for borrowing up to $75,000,000 through January 31, 1979 at the prime commercial rate in effect from time to time at The Chase Manhattan Bank, N.A. and the payment of a commitment fee of one-half of one percent per annum on the unborrowed amount. This agreement has been renewed to provide for borrowings through January 31, 1982. The average balance outstanding during 1978 was $569,000 and for 1977 was $20,400,000 and there was no balance at December 31, 1978. The loan agreement does not require compensating balances; however, the Company maintains balances which generally average, over the life of the agreement, 15% to 20% of the borrowed amount from each of the participating banks.

Interim financing in the form of short-term borrowings on commercial paper ($35,300,000 at December 31, 1978) is also utilized to finance construction expenditures. The average daily aggregate commercial paper borrowing outstanding amounted to $47,500,000 during 1978 and $54,200,000 during 1977 (calculated as the average of the sum of daily borrowings) and the weighted average interest rate was 7.9% in 1978 and 5.7% in 1977 (calculated by dividing total interest expense by the average of the sum of the daily borrowings). The maximum borrowing on commercial paper at any time was $75,000,000 during 1978 and was $73,000,000 during 1977.

# Notes to Financial Statements (cont'd.)

## 7. Supplementary Income Statement Information

Charges for maintenance and repairs, and depreciation, other than those set forth in the statement of income, were not significant in amount. Neither advertising costs nor research and development costs exceed 1% of total revenues and there are no royalties.

Taxes, other than federal income taxes, and rental charges are classified as follows:

| | 1978 | 1977 |
|---|---|---|
| | (Thousands of Dollars) | |
| Real estate and personal property | $24,982 | $24,822 |
| Franchise and gross receipts | 28,057 | 22,38[illegible] |
| Social security | 4,747 | 4,169 |
| Miscellaneous | 3,133 | 2,715 |
| | $60,919 | $54,093 |
| Charged to: | | |
| Tax expense | $57,064 | $50,645 |
| Other accounts (principally utility plant and clearing accounts) | 3,855 | 3,448 |
| | $60,919 | $54,093 |
| Rentals, charged principally to operating expenses | $ 3,038 | $ 2,360 |

## 8. Industry Segment Information

Certain information pertaining to the electric and gas operations of the Company is as follows:

| | 1978 | 1977 | 1976 | 1975 (Unaudited) | 1974 |
|---|---|---|---|---|---|
| | Thousands of Dollars | | | | |
| **Operating Revenues:** | | | | | |
| Electric | $ 433,774 | $ 374,456 | $ 330,870 | $ 277,097 | $237,955 |
| Gas | 98,397 | 84,996 | 77,397 | 63,688 | 58,049 |
| Total | 532,171 | 459,452 | 408,267 | 340,785 | 296,004 |
| **Operating Expenses:** | | | | | |
| Electric | 339,451 | 296,775 | 257,884 | 214,295 | 182,559 |
| Gas | 89,758 | 80,061 | 70,885 | 57,750 | 51,998 |
| Total | 429,209 | 376,836 | 328,769 | 272,045 | 234,557 |
| **Operating Income:** | | | | | |
| Electric | 94,323 | 77,681 | 72,986 | 62,802 | 55,396 |
| Gas | 8,639 | 4,935 | 6,512 | 5,938 | 6,051 |
| Total | $ 102,962 | $ 82,616 | $ 79,498 | $ 68,740 | $ 61,447 |
| **Depreciation:**(A) | | | | | |
| Electric | $ 38,428 | $ 31,718 | $ 29,820 | $ 27,874 | $ 26,159 |
| Gas | 3,034 | 2,826 | 2,769 | 2,720 | 2,553 |
| Total | $ 41,462 | $ 34,544 | $ 32,589 | $ 30,594 | $ 28,712 |
| **Construction Expenditures:** | | | | | |
| Electric | $ 110,784 | $ 154,460 | $ 190,288 | $ 150,011 | $107,164 |
| Gas | 4,314 | 4,033 | 3,259 | 3,225 | 5,250 |
| Total | $ 115,098 | $ 158,493 | $ 193,547 | $ 153,236 | $112,414 |
| **Identifiable Assets:** | | | | | |
| Electric | $1,418,038 | $1,310,846 | $1,151,977 | $ 973,002 | $834,052 |
| Gas | 95,022 | 95,029 | 93,147 | 92,250 | 89,918 |
| Corporate | 90,365 | 83,987 | 78,858 | 62,359 | 52,132 |
| Total | $1,603,425 | $1,489,862 | $1,323,982 | $1,127,611 | $976,102 |

(A) Included in operating expenses.

## 9. Quarterly Financial Information (unaudited)

The following is a summary of quarterly results of Company operations as previously reported to stockholders:

| Quarter Ended | Operating Revenues | Operating Income | Net Income | Earnings Available for Common Stock | Average Shares Outstanding | Earnings Per Share |
|---|---|---|---|---|---|---|
| | (Thousands of Dollars) | | | | (Thousands) | |
| **1978** | | | | | | |
| March 31 | $162,784 | $32,448 | $24,470 | $21,197 | 21,598 | $.98 |
| June 30 | 128,429 | 25,835 | 17,810 | 14,538 | 23,547 | .62 |
| September 30 | 111,453 | 22,086 | 14,026 | 10,754 | 23,593 | .46 |
| December 31 | 129,504 | 22,593 | 14,257 | 10,985 | 24,796 | .44 |
| **1977** | | | | | | |
| March 31 | $137,660 | $24,103 | $18,285 | $15,011 | 20,457 | $.73 |
| June 30 | 105,730 | 19,785 | 14,112 | 10,839 | 21,426 | .51 |
| September 30 | 96,368 | 17,700 | 11,974 | 8,701 | 21,453 | .41 |
| December 31 | 119,693 | 21,027 | 15,574 | 12,301 | 21,481 | .57 |

## 10. Replacement Cost (unaudited)

Replacement cost information is disclosed in the Company's 10-K Report to the Securities and Exchange Commission. The cost of replacing the Company's utility plant in service at current prices would be significantly more than the amount actually spent. The Company's rates are determined by the PSC on an original cost basis and the Company believes that as existing plant is replaced with higher cost plant these costs will be reflected in rates through the regulatory process.

COOPERS & LYBRAND

IN PRINCIPAL AREAS
OF THE WORLD

1251 AVENUE OF THE AMERICAS
NEW YORK, N.Y. 10020

To the Stockholders and Board of Directors
New York State Electric & Gas Corporation
Ithaca, New York

We have examined the balance sheets of New York State Electric & Gas Corporation as of December 31, 1978 and 1977 and the related statements of income, retained earnings and changes in financial position for the years then ended and the statement of capital stock and long-term debt as of December 31, 1978. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of New York State Electric & Gas Corporation at December 31, 1978 and 1977, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

February 1, 1979

Coopers & Lybrand

## Discussion and Analysis of the Statement of Income

### Operating Revenues

Total operating revenues increased $72,700,000, $51,200,000 and $67,500,000 respectively for 1978, 1977 and 1976 as compared with each of the previous years. The increases are attributable principally to increased fuel and gas adjustment revenue ($16,200,000, $43,200,000 and $13,200,000) increased rates ($45,400,000, $5,000,000 and $36,500,000) and additional sales of electricity. Kilowatt-hour sales (excluding sales to other utilities) increased 3%, 3% and 5% for the years 1978, 1977 and 1976 over the corresponding prior period. Unit sales of gas increased 4% in 1978, decreased 11% in 1977 and increased 7% in 1976.

### Operating Expenses

During each of the past three calendar years, major items of operating expense increased over the corresponding prior period. Operation — fuel increased $31,200,000 (36%) in 1978, $14,600,000 (20%) in 1977 and $2,900,000 (4%) in 1976. The increase in 1978 is due primarily to a third generating unit at Homer City Station placed in service December 1977 and higher prices paid for coal. The increases in 1977 and 1976 are due chiefly to higher cost of coal. Operation — other increased between 10% and 17% in each period primarily due to increased labor and material costs. Electricity purchased and interchanged decreased in 1978 due to increased Company generation of power, increased in 1977 due to power purchased to replace reduced deliveries of low-cost hydro-electricity, and increased in 1976 due to increased purchases of power. Gas purchased reflects higher unit costs for each period. During 1977 such higher cost was partially offset by decreased units purchased.

Maintenance increased $4,800,000 (14%) in 1978, $4,000,000 (13%) in 1977 and $6,900,000 (30%) in 1976 largely due to periodic costs related to maintenance of generating facilities. Depreciation increased $6,900,000 (20%) in 1978 due primarily to the third generating unit at Homer City Station. Higher real property and state gross receipts taxes were largely responsible for increases in other taxes. Federal income taxes increased $16,000,000 in 1978, decreased $7,400,000 in 1977 and increased $2,600,000 in 1976. The changes in Federal income tax are due primarily to variances in taxable income.

### Other Income and Deductions

Allowance for other funds used during construction decreased $3,400,000 in 1978 and increased $6,300,000 in 1977 and $3,400,000 in 1976 due to corresponding changes in the levels of construction work in progress.

Federal income tax credit increased in 1978 by $7,100,000 due to an increase in the imputed income tax benefit of AFDC and a larger credit for ITC shared due to increased taxable income allowing for utilization of more ITC.

### Interest Charges and Preferred Stock Dividends

Interest charges before offset for AFDC — borrowed funds increased due to borrowings to finance the Company's construction program. The off-setting allowance for borrowed funds used during construction decreased in 1978 due to the use of a lower net of income tax rate and lower amounts of construction work in progress and increased in 1977 and 1976 due to higher amounts of construction work in progress. Preferred stock dividends increased in 1977 due to additional issuances of preferred stock at higher rates.

### COMMON STOCK — MARKET PRICE RANGE AND DIVIDENDS 1978 AND 1977

| | Price of Common Stock New York Stock Exchange Composite | | | | Dividends Paid Per Share | |
|---|---|---|---|---|---|---|
| | 1978 | | 1977 | | | |
| | High | Low | High | Low | 1978 | 1977 |
| First Quarter | $19½ | $18⅛ | $21 | $18⅝ | $.42 | $.40 |
| Second Quarter | 19⅜ | 17¾ | 20½ | 18⅞ | .42 | .40 |
| Third Quarter | 19⅛ | 18⅛ | 21¾ | 18⅜ | .42 | .40 |
| Fourth Quarter | 19 | 16⅜ | 20 | 17¾ | .42 | .40 |

# Financial and Operating Statistics

| SUMMARY OF EARNINGS | 1978 | 1977 | 1976 | 1975 | 1974 | 1973 | 1968 |
|---|---|---|---|---|---|---|---|
| | | | | *Dollars In Thousands* | | | |
| OPERATING REVENUES: | | | | | | | |
| Electric | $433,774 | $374,456 | $330,870 | $277,097 | $237,955 | $203,485 | $124,805 |
| Gas | 98,397 | 84,996 | 77,397 | 63,688 | 58,049 | 49,687 | 36,115 |
| Total | 532,171 | 459,452 | 408,267 | 340,785 | 296,004 | 253,172 | 160,920 |
| OPERATING EXPENSES: | | | | | | | |
| Operation—fuel | 118,384 | 87,181 | 72,621 | 69,741 | 58,059 | 35,789 | 12,864 |
| —other | 74,465 | 67,544 | 60,132 | 51,346 | 46,052 | 40,456 | 25,321 |
| Electricity purchased and interchanged | 19,059 | 46,599 | 33,679 | 15,884 | 4,108 | 9,336 | 12,500 |
| Gas purchased | 63,896 | 56,284 | 47,944 | 37,904 | 33,866 | 27,660 | 20,278 |
| Maintenance | 38,529 | 33,709 | 29,757 | 22,887 | 22,047 | 20,337 | 8,835 |
| Depreciation | 41,462 | 34,544 | 32,589 | 30,594 | 28,712 | 26,870 | 17,648 |
| Federal income tax | 16,350 | 330 | 7,751 | 5,127 | 6,674 | 6,133 | 10,584 |
| Other taxes | 57,064 | 50,645 | 44,296 | 38,562 | 35,039 | 31,732 | 19,278 |
| Total | 429,209 | 376,836 | 328,769 | 272,045 | 234,557 | 198,313 | 127,308 |
| OPERATING INCOME | 102,962 | 82,616 | 79,498 | 68,740 | 61,447 | 54,859 | 33,612 |
| OTHER INCOME AND DEDUCTIONS: | | | | | | | |
| Allowance for other funds used during construction | 10,659 | 14,056 | 7,803 | 4,370 | 2,266 | 1,242 | 2,492 |
| Federal income tax credit | 8,383 | 1,255 | 1,166 | 987 | (51) | 326 | — |
| Other, net | 202 | (160) | (158) | 185 | 3,836 | 552 | 65 |
| INCOME BEFORE INTEREST CHARGES | 122,206 | 97,767 | 88,309 | 74,282 | 67,498 | 56,979 | 36,169 |
| INTEREST CHARGES: | | | | | | | |
| Interest on long-term debt | 52,337 | 45,119 | 39,712 | 33,516 | 29,711 | 24,755 | 12,228 |
| Other interest | 5,302 | 4,010 | 2,673 | 1,623 | 675 | 591 | 167 |
| Allowance for borrowed funds used during construction | (5,996) | (11,307) | (5,961) | (4,536) | (1,643) | (804) | (1,227) |
| Interest charges—net | 51,643 | 37,822 | 36,424 | 30,603 | 28,743 | 24,542 | 11,168 |
| NET INCOME | 70,563 | 59,945 | 51,885 | 43,679 | 38,755 | 32,437 | 25,001 |
| PREFERRED STOCK DIVIDENDS | 13,090 | 13,094 | 10,465 | 10,402 | 8,610 | 5,643 | 3,196 |
| EARNINGS AVAILABLE FOR COMMON STOCK | 57,473 | 46,851 | 41,420 | 33,277 | 30,145 | 26,794 | 21,805 |
| COMMON STOCK DIVIDENDS | 38,732 | 33,564 | 28,375 | 21,780 | 19,800 | 19,121 | 15,137 |
| RETAINED EARNINGS | $18,741 | $ 13,287 | $ 13,045 | $ 11,497 | $ 10,345 | $ 7,673 | $ 6,668 |
| Average number of shares of common stock outstanding (thousands) | 23,393 | 21,208 | 18,181 | 15,450 | 13,500 | 13,500 | 11,241 |
| Earnings per average share | $2.46 | $2.21 | $2.28 | $2.15 | $2.23 | $1.98 | $1.94 |
| Dividends paid per share | $1.68 | $1.60 | $1.60 | $1.47 | $1.47 | $1.45 | $1.35 |
| **INCOME STATISTICS** | | | | | | | |
| Income before interest charges—percent of operating revenues | 24.1 | 23.7 | 23.1 | 23.1 | 23.4 | 22.8 | 23.2 |
| Average common stock equity per share | $20.82 | $20.17 | $19.96 | $19.76 | $19.98 | $19.24 | $16.51 |
| Return on average common stock equity—percent | 11.8 | 10.9 | 11.4 | 10.9 | 11.2 | 10.3 | 11.8 |
| Mortgage bond interest—times earned | 2.5 | 2.5 | 2.6 | 2.6 | 3.0 | 2.9 | 4.7 |
| Interest charges and preferred dividends—times earned | 1.8 | 1.8 | 1.8 | 1.7 | 1.8 | 1.9 | 2.4 |
| Operating income before income taxes: | | | | | | | |
| Electric | $110,625 | $ 78,608 | $ 79,706 | $ 67,153 | $ 61,375 | $ 55,183 | $ 39,146 |
| Gas | 8,687 | 4,338 | 7,544 | 6,714 | 6,746 | 5,809 | 5,050 |

# Financial Statistics

| | 1978 | 1977 | 1976 | 1975 | 1974 | 1973 | 1968 |
|---|---|---|---|---|---|---|---|
| PROPERTY, PLANT AND EQUIPMENT: | | | | *Dollars in Thousands* | | | |
| Additions: | | | | | | | |
| Electric | $ 124,746 | $ 177,872 | $ 202,685 | $ 156,406 | $ 106,210 | $ 73,605 | $ 92,845 |
| Gas | 3,759 | 3,623 | 2,961 | 2,659 | 4,142 | 6,041 | 5,014 |
| Other | 3,248 | 2,361 | 1,665 | 3,077 | 5,971 | 3,636 | 2,547 |
| Total | 131,753 | 183,856 | 207,311 | 162,142 | 116,323 | 83,282 | 100,406 |
| Retirements and adjustments: | | | | | | | |
| Electric | 13,359 | 11,065 | 7,791 | 7,757 | 7,372 | 8,166 | 4,916 |
| Gas | 667 | 609 | 644 | 582 | 563 | 500 | 571 |
| Other | 1,261 | 508 | 840 | 314 | 640 | (1,096) | 381 |
| Total | 15,287 | 12,182 | 9,275 | 8,653 | 8,575 | 7,570 | 5,868 |
| Balance end of year: | | | | | | | |
| Electric | 1,631,797 | 1,520,410 | 1,353,604 | 1,158,710 | 1,010,061 | 911,224 | 637,518 |
| Gas | 117,168 | 114,076 | 111,062 | 108,745 | 106,668 | 103,089 | 83,696 |
| Other | 40,584 | 38,597 | 36,743 | 35,918 | 33,155 | 27,823 | 25,368 |
| Total | $1,789,549 | $1,673,083 | $1,501,409 | $1,303,373 | $1,149,884 | $1,042,136 | $746,582 |
| ACCUMULATED DEPRECIATION | $ 376,933 | $ 350,014 | $ 324,852 | $ 300,862 | $ 278,913 | $ 254,926 | $168,728 |
| CAPITALIZATION: | | | | | | | |
| Debt: | | | | | | | |
| First mortgage bonds | $ 720,250 | $ 675,750 | $ 578,750 | $ 475,700 | $ 450,700 | $ 370,000 | $266,393 |
| Debentures | — | — | — | — | — | 18,637 | 21,796 |
| Notes payable | 35,300 | 80,500 | 55,500 | 74,500 | 32,000 | 60,000 | 35,000 |
| Other | 1,097 | 1,211 | 1,276 | 1,380 | 1,709 | 2,180 | 142 |
| Total debt | 756,647 | 757,461 | 635,526 | 551,580 | 484,409 | 450,817 | 323,331 |
| Preferred stock | 176,375 | 176,463 | 176,543 | 146,638 | 146,661 | 91,666 | 67,036 |
| Common stock equity: | | | | | | | |
| Common stock | 352,541 | 280,615 | 243,971 | 200,460 | 150,889 | 150,718 | 104,473 |
| Capital stock expense | (4,614) | (4,403) | (4,238) | (3,969) | (3,715) | (3,437) | (2,305) |
| Retained earnings | 185,479 | 166,738 | 153,451 | 140,406 | 128,909 | 118,564 | 86,372 |
| Total common stock equity | 533,406 | 442,950 | 393,184 | 336,897 | 276,083 | 265,845 | 188,540 |
| Total capitalization | $1,466,428 | $1,376,874 | $1,205,253 | $1,035,115 | $ 907,153 | $ 808,328 | $578,907 |
| CAPITALIZATION RATIOS (percent): | | | | | | | |
| Mortgage bonds | 49.1 | 49.1 | 48.0 | 46.0 | 49.7 | 45.8 | 46.0 |
| Debentures | — | — | — | — | — | 2.3 | 3.8 |
| Notes payable and other debt | 2.5 | 5.9 | 4.7 | 7.3 | 3.7 | 7.7 | 6.0 |
| Preferred stock | 12.0 | 12.8 | 14.7 | 14.2 | 16.2 | 11.3 | 11.6 |
| Common stock equity | 36.4 | 32.2 | 32.6 | 32.5 | 30.4 | 32.9 | 32.6 |
| RATIO OF MORTGAGE BONDS TO NET UTILITY PLANT (percent) | 51.0 | 51.1 | 49.2 | 47.5 | 51.7 | 47.0 | 46.1 |
| STOCKHOLDERS: | | | | | | | |
| Common stock | 64,579 | 51,580 | 45,146 | 40,033 | 32,216 | 30,061 | 18,328 |
| Preferred stock | 6,503 | 6,544 | 6,591 | 6,454 | 6,257 | 3,881 | 1,421 |
| PAYROLL (including pensions, etc.): | | | | | | | |
| Charged to operations | $ 58,686 | $ 55,639 | $ 51,175 | $ 44,163 | $39,271 | $35,195 | $21,592 |
| Charged to construction and other accounts | 40,179 | 37,518 | 34,419 | 30,592 | 29,332 | 26,009 | 14,905 |
| Total | $ 98,865 | $ 93,157 | $ 85,594 | $ 74,755 | $68,603 | $61,204 | $36,497 |
| Number of employees—end of year | 4,215 | 4,202 | 4,170 | 4,131 | 4,179 | 4,154 | 3,722 |

# Electric Sales Statistics

| | 1978 | 1977 | 1976 | 1975 | 1974 | 1973 | 1968 |
|---|---|---|---|---|---|---|---|
| **Kwh Sales (millions):** | | | | | | | |
| Residential | 4,297 | 4,203 | 4,093 | 3,864 | 3,647 | 3,560 | 2,454 |
| Commercial | 2,438 | 2,370 | 2,322 | 2,215 | 2,090 | 2,070 | 1,351 |
| Industrial | 2,632 | 2,515 | 2,369 | 2,221 | 2,240 | 2,351 | 1,867 |
| Street lighting | 109 | 111 | 111 | 110 | 108 | 102 | 88 |
| Public authorities and other | 1,016 | 1,012 | 1,001 | 972 | 936 | 957 | 589 |
| Other electric utilities | 23 | 27 | 26 | 25 | 224 | 174 | 21 |
| Total | 10,515 | 10,238 | 9,922 | 9,407 | 9,245 | 9,214 | 6,370 |
| **Operating Revenues (thousands):** | | | | | | | |
| Residential | $197,024 | $168,041 | $151,790 | $125,928 | $109,841 | $ 99,727 | $ 62,600 |
| Commercial | 103,192 | 89,899 | 79,857 | 67,554 | 55,670 | 45,818 | 26,831 |
| Industrial | 81,332 | 70,009 | 58,095 | 48,033 | 39,523 | 30,904 | 20,346 |
| Street lighting | 6,967 | 6,742 | 5,971 | 5,516 | 5,269 | 5,086 | 3,774 |
| Public authorities and other | 38,712 | 34,034 | 29,837 | 25,285 | 20,246 | 16,598 | 8,726 |
| Other operating revenues | 6,109 | 5,284 | 4,906 | 4,394 | 3,929 | 3,393 | 2,259 |
| Other electric utilities | 438 | 447 | 414 | 387 | 3,477 | 1,959 | 269 |
| Total operating revenues | $433,774 | $374,456 | $330,870 | $277,097 | $237,955 | $203,485 | $124,805 |
| **Sales Revenues per kwh (cents):** | | | | | | | |
| Residential | 4.59 | 4.00 | 3.71 | 3.26 | 3.01 | 2.80 | 2.72 |
| Commercial | 4.23 | 3.79 | 3.44 | 3.05 | 2.66 | 2.21 | 2.16 |
| Industrial | 3.09 | 2.78 | 2.45 | 2.16 | 1.76 | 1.31 | 1.26 |
| Street lighting | 6.39 | 6.07 | 5.38 | 5.01 | 4.88 | 4.99 | 4.86 |
| Public authorities and other | 3.81 | 3.36 | 2.98 | 2.60 | 2.16 | 1.73 | 1.68 |
| Other electric utilities | 1.90 | 1.66 | 1.59 | 1.55 | 1.55 | 1.13 | 1.21 |
| Average revenue per kwh | 4.07 | 3.61 | 3.28 | 2.90 | 2.53 | 2.17 | 2.12 |
| **Total Customers (end of year)** | 648,638 | 640,361 | 632,148 | 624,087 | 615,617 | 605,957 | 594,096 |
| **Number of Customers (average for year):** | | | | | | | |
| Residential | 578,982 | 571,701 | 564,502 | 556,622 | 548,635 | 538,521 | 525,615 |
| Commercial | 55,725 | 55,113 | 54,808 | 54,413 | 53,990 | 53,215 | 52,194 |
| Industrial | 1,298 | 1,284 | 1,279 | 1,235 | 1,192 | 1,198 | 1,205 |
| Other | 9,226 | 9,042 | 8,633 | 8,292 | 7,906 | 7,844 | 7,694 |
| Total | 645,231 | 637,140 | 629,222 | 620,562 | 611,723 | 600,778 | 586,708 |
| **Annual Average Use (kwh):** | | | | | | | |
| Residential | 7,422 | 7,352 | 7,252 | 6,942 | 6,647 | 6,610 | 6,432 |
| Commercial | 43,751 | 43,003 | 42,366 | 40,707 | 38,710 | 38,899 | 36,155 |
| Industrial (thousands) | 2,028 | 1,959 | 1,852 | 1,798 | 1,879 | 1,962 | 1,819 |
| **Annual Average Bill:** | | | | | | | |
| Residential | $ 340 | $ 294 | $ 269 | $ 226 | $ 200 | $ 185 | $ 175 |
| Commercial | 1,852 | 1,631 | 1,457 | 1,242 | 1,031 | 861 | 783 |
| Industrial | 62,659 | 54,524 | 45,422 | 38,893 | 33,157 | 25,796 | 22,959 |

# Electric Operating Statistics

| | 1978 | 1977 | 1976 | 1975 | 1974 | 1973 | 1968 |
|---|---|---|---|---|---|---|---|
| PRODUCTION DATA: | | | | | | | |
| System Capability (megawatts): | | | | | | | |
| Net generating capability: | | | | | | | |
| Steam | 1,728 | 1,527 | 1,377 | 1,375 | 1,367 | 1,367 | 804 |
| Hydro | 38 | 38 | 38 | 38 | 38 | 38 | 40 |
| Internal combustion | 14 | 14 | 14 | 14 | 14 | 14 | 10 |
| Total | 1,780 | 1,579 | 1,429 | 1,427 | 1,419 | 1,419 | 854 |
| Purchased—firm contracts | 812 | 924 | 1,048 | 839 | 706 | 527 | 545 |
| Total system capability | 2,592 | 2,503 | 2,477 | 2,266 | 2,125 | 1,946 | 1,399 |
| Annual Load Factor (percent) | 63.6 | 62.9 | 61.0 | 62.2 | 66.2 | 66.0 | 62.1 |
| Coal Used (thousands of net tons) | 4,430 | 3,720 | 3,395 | 3,288 | 3,564 | 3,397 | 1,842 |
| Coal Quality (Btu per lb.) | 11,141 | 11,056 | 11.123 | 11,082 | 10,927 | 11,418 | 12,018 |
| Btu per Kwh Generated (net) | 10,744 | 11,145 | 11,112 | 10,932 | 10,926 | 10,672 | 10,478 |
| Kwh Production—net (millions): | | | | | | | |
| Generated | 9,350 | 7,606 | 7,046 | 6,870 | 7,344 | 7,493 | 4,414 |
| Purchased | 3,282 | 3,509 | 4,383 | 3,898 | 3,681 | 3,901 | 3,140 |
| Interchanged | (909) | 201 | (298) | (420) | (890) | (1,281) | (418) |
| Total | 11,723 | 11,316 | 11,131 | 10,348 | 10,135 | 10,113 | 7,136 |
| Production Expenses (thousands): | | | | | | | |
| Generated | $148,285 | $110,448 | $ 91,724 | $ 85,655 | $ 73,388 | $49,353 | $16,796 |
| Purchased | 37,297 | 39,670 | 34,926 | 22,188 | 20,776 | 19,206 | 15,143 |
| Interchanged (net) | (18,238) | 6,929 | (1,247) | (6,304) | (16,668) | (9,870) | (2,643) |
| Total | $167,344 | $157,047 | $125,403 | $101,539 | $ 77,496 | $58,689 | $29,296 |
| Production Costs per Kwh (mills): | | | | | | | |
| Generated | 15.86 | 14.52 | 13.02 | 12.47 | 9.99 | 6.57 | 3.81 |
| Purchased | 11.36 | 11.30 | 7.97 | 5.69 | 5.64 | 4.92 | 4.82 |
| Average cost per kwh | 14.27 | 13.88 | 11.27 | 9.81 | 7.65 | 5.80 | 4.11 |
| ELECTRIC OPERATION AND MAINTENANCE EXPENSES (thousands): | | | | | | | |
| Production | $167,344 | $157,047 | $125,403 | $101,539 | $ 77,496 | $58,689 | $29,296 |
| Transmission | 8,171 | 7,612 | 7,058 | 5,482 | 5,186 | 4,928 | 3,322 |
| Distribution | 22,644 | 22,544 | 21,569 | 16,928 | 16,307 | 14,992 | 9,813 |
| Customer accounting | 9,467 | 8,527 | 7,672 | 6,633 | 5,730 | 5,074 | 3,552 |
| Customer service | 2,887 | 2,605 | 2,507 | 2,288 | 2,487 | 1,578 | 1,963 |
| Administrative and general | 25,537 | 22,972 | 20,068 | 16,900 | 13,901 | 12,112 | 6,217 |
| Total | $236,050 | $221,307 | $184,277 | $149,770 | $121,107 | $97,373 | $54,163 |
| ELECTRIC OPERATION AND MAINTENANCE EXPENSES—as a percent of electric operating revenues: | | | | | | | |
| Production | 38.6 | 42.0 | 37.9 | 36.6 | 32.6 | 28.8 | 23.5 |
| Transmission | 1.9 | 2.0 | 2.1 | 2.0 | 2.2 | 2.4 | 2.7 |
| Distribution | 5.2 | 6.0 | 6.5 | 6.1 | 6.9 | 7.4 | 7.8 |
| Customer accounting | 2.2 | 2.3 | 2.3 | 2.4 | 2.4 | 2.5 | 2.8 |
| Customer service | .6 | .7 | .8 | .8 | 1.0 | .8 | 1.6 |
| Administrative and general | 5.9 | 6.1 | 6.1 | 6.1 | 5.8 | 5.9 | 5.0 |
| Total | 54.4 | 59.1 | 55.7 | 54.0 | 50.9 | 47.8 | 43.4 |

# Gas Department Statistics

| | 1978 | 1977 | 1976 | 1975 | 1974 | 1973 | 1968 |
|---|---|---|---|---|---|---|---|
| Mcf Sales (thousands): | | | | | | | |
| Residential | 17,892 | 17,876 | 19,424 | 18,023 | 19,172 | 18,736 | 18,786 |
| Commercial | 8,421 | 8,177 | 9,229 | 8,800 | 9,346 | 9,140 | 8,273 |
| Industrial | 8,418 | 7,764 | 8,998 | 8,635 | 10,105 | 11,041 | 9,167 |
| Public authorities and other | 3,540 | 3,046 | 3,705 | 3,170 | 3,363 | 3,499 | 2,928 |
| Total | 38,271 | 36,863 | 41,356 | 38,628 | 41,986 | 42,416 | 39,154 |
| Operating Revenues (thousands): | | | | | | | |
| Residential | $50,642 | $ 44,895 | $40,387 | $ 33,745 | $30,627 | $26,152 | $20,075 |
| Commercial | 20,908 | 18,236 | 16,850 | 13,996 | 12,602 | 10,637 | 7,484 |
| Industrial | 18,252 | 15,205 | 13,668 | 11,101 | 10,531 | 9,122 | 5,887 |
| Public authorities and other | 8,047 | 6,289 | 6,131 | 4,531 | 4,007 | 3,500 | 2,132 |
| Total sales revenues | 97,849 | 84,625 | 77,036 | 63,373 | 57,767 | 49,411 | 35,578 |
| Other operating revenues | 548 | 371 | 361 | 315 | 282 | 276 | 248 |
| Total operating revenues | $98,397 | $ 84,996 | $77,397 | $ 63,688 | $58,049 | $49,687 | $35,826 |
| Sales Revenues per Mcf: | | | | | | | |
| Residential | $ 2.83 | $ 2.51 | $ 2.08 | $ 1.87 | $ 1.60 | $ 1.40 | $ 1.07 |
| Commercial | 2.48 | 2.23 | 1.83 | 1.59 | 1.35 | 1.16 | .91 |
| Industrial | 2.17 | 1.96 | 1.52 | 1.29 | 1.04 | .83 | .64 |
| Public authorities and other | 2.27 | 2.07 | 1.66 | 1.43 | 1.19 | 1.00 | .73 |
| Average revenue per Mcf | $ 2.56 | $ 2.30 | $ 1.86 | $ 1.64 | $ 1.38 | $ 1.17 | $ .91 |
| Total customers (end of year) | 125,492 | 125,450 | 126,027 | 126,507 | 126,563 | 125,937 | 118,886 |
| Number of Customers (average for year): | | | | | | | |
| Residential with house heating | 97,469 | 97,082 | 97,496 | 97,091 | 95,532 | 94,357 | 85,327 |
| Residential without house heating | 12,124 | 12,630 | 12,812 | 13,329 | 14,442 | 15,003 | 16,639 |
| Commercial with space heating | 12,752 | 12,809 | 12,985 | 13,109 | 13,220 | 13,187 | 12,626 |
| Commercial without space heating | 1,233 | 1,234 | 1,266 | 1,282 | 1,302 | 1,318 | 1,487 |
| Industrial | 371 | 380 | 384 | 389 | 397 | 404 | 393 |
| Other | 1,185 | 1,241 | 1,142 | 1,157 | 1,136 | 1,146 | 1,049 |
| Total | 125,134 | 125,376 | 126,085 | 126,357 | 126,029 | 125,415 | 117,521 |
| Annual Average Use (Mcf): | | | | | | | |
| Residential | 163 | 163 | 176 | 163 | 174 | 171 | 184 |
| Commercial | 602 | 582 | 648 | 611 | 644 | 630 | 586 |
| Industrial | 22,690 | 20,432 | 23,432 | 22,198 | 25,453 | 27,329 | 23,327 |
| Annual Average Bill: | | | | | | | |
| Residential | $ 462 | $ 409 | $ 366 | $ 306 | $ 279 | $ 239 | $ 197 |
| Commercial | 1,495 | 1,300 | 1,182 | 973 | 868 | 733 | 530 |
| Industrial | 49,197 | 40,013 | 35,594 | 28,537 | 26,526 | 22,579 | 14,980 |
| Cost of Natural Gas Purchased: | | | | | | | |
| Amount (thousands) | $63,896 | $ 56,284 | $47,944 | $ 37,904 | $33,866 | $27,660 | $20,278 |
| Per Mcf | 1.66 | 1.54 | 1.14 | .97 | .80 | .65 | .51 |
| Gas Operation and Maintenance Expenses (thousands): | | | | | | | |
| Production | $64,089 | $ 56,923 | $48,210 | $ 38,089 | $33,956 | $27,710 | $20,328 |
| Transmission and distribution | 6,775 | 6,469 | 5,939 | 4,936 | 4,678 | 4,489 | 2,478 |
| Customer accounting | 1,988 | 1,812 | 1,705 | 1,493 | 1,367 | 1,233 | 826 |
| Customer service | 479 | 480 | 321 | 308 | 306 | 167 | 249 |
| Administrative and general | 4,952 | 4,326 | 3,681 | 3,166 | 2,717 | 2,605 | 1,496 |
| Total | $78,283 | $ 70,010 | $59,856 | $ 47,992 | $43,024 | $36,204 | $25,377 |
| Gas Operation and Maintenance Expenses—as a percent of gas operating revenues: | | | | | | | |
| Production | 65.1 | 67.0 | 62.3 | 59.8 | 58.5 | 55.8 | 56.7 |
| Transmission and distribution | 6.9 | 7.6 | 7.7 | 7.8 | 8.1 | 9.0 | 6.9 |
| Customer accounting | 2.0 | 2.1 | 2.2 | 2.3 | 2.4 | 2.5 | 2.3 |
| Customer service | .5 | .6 | .4 | .5 | .5 | .3 | .7 |
| Administrative and general | 5.0 | 5.1 | 4.7 | 5.0 | 4.6 | 5.2 | 4.2 |
| Total | 79.5 | 82.4 | 77.3 | 75.4 | 74.1 | 72.8 | 70.8 |

# Directors

**Charles F. Kennedy**
Chairman and Chief Executive Officer of the Company

**Robert B. Adam**
President, Adam, Meldrum & Anderson Co., Inc., Buffalo, N.Y.

**Wells P. Allen, Jr.**
President and Chief Operating Officer of the Company

**Roy S. Arrandale**
Technical Consultant to Thatcher Glass Manufacturing Co., Elmira, N.Y.

**Alison P. Casarett***
Dean-elect, The Graduate School Cornell University, Ithaca, N.Y.

**Howard W. Gunlocke**
Former President, Gunlocke Chair Company, Wayland, N.Y.

**Legare R. Hole**
Chairman and President, Columbian Rope Company, Auburn, N.Y.

**Alexander Horwitz**
Financial Consultant, Binghamton, N.Y.

**William A. Lyons**
Chairman of the Executive and Finance Committee of the Company

**Alton G. Marshall**
President, Rockefeller Center, Inc., New York, N.Y.

**C. William Stuart**
Chairman of the Board and Chief Executive Officer, C. H. Stuart & Co., Inc., Newark, N.Y.

**Charles A. Winding**
Director of various corporations, Elmira, N.Y.

DIRECTORS EMERITUS

**Sheldon H. Close**
Attorney, Oneonta, N.Y.

**Edgar W. Couper**
Former Chancellor, New York State Board of Regents, Binghamton, N.Y.

*Elected March 9, 1979

# Officers

**Binghamton Executive Offices**
4500 Vestal Parkway East, Binghamton, N.Y. 13902 Tel. 607/729-2551

**Charles F. Kennedy**
Chairman and Chief Executive Officer

**Wells P. Allen, Jr.**
President and Chief Operating Officer

**Dolores R. Hix***
**Richard Kroboth**
Assistants to the Chairman

**E. Eugene Forrest**
Senior Vice President

**Robert B. MacKenzie**
Senior Vice President

**James A. Ackerman**
Vice President

**Orlin W. Darrach**
Vice President

**Allen E. Kintigh**
Vice President

**Jack H. Roskoz**
Vice President

**Michael J. Turkovic**
Vice President

**Albert D. Tuttle**
Vice President

**William P. Walker**
Vice President

**Francis X. Carney**
Assistant Vice President

**Raymond A. Perine**
Assistant Vice President

*Also Assistant Secretary

**Ithaca Executive Offices**
Route 13, Dryden Road, P.O. Box 287, Ithaca, N.Y. 14850 Tel. 607/347-4131

**L. Theodore Everett**
Senior Vice President

**Eugene P. Waters**
Senior Vice President and Treasurer

**Jaime S. Hecht**
Secretary

**Richard A. Jacobson**
Comptroller

**John D. Scott**
Assistant Vice President

**Richard P. Fagan**
Assistant Comptroller

**Matthew F. Felo, Jr.**
Assistant Treasurer

**James M. Niefer**
Assistant Secretary

**General Counsel:**
Huber Magill Lawrence & Farrell,
99 Park Avenue, New York, N.Y. 10016

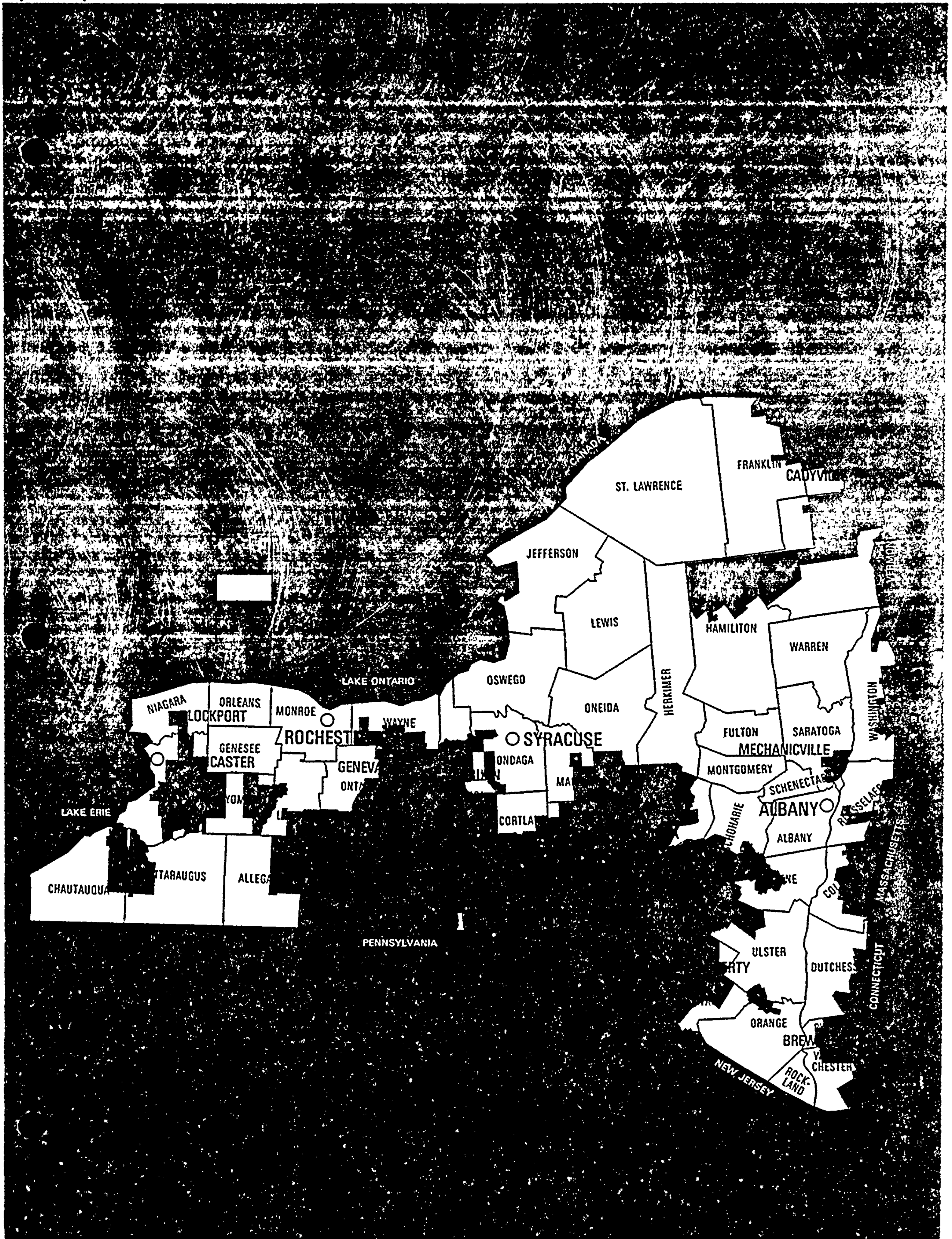
**Transfer Agent for Preferred Stock:**
Chemical Bank
55 Water Street, New York, N.Y. 10041

**Transfer Agent for Common Stock:**
Manufacturers Hanover Trust Company
4 New York Plaza, New York, N.Y. 10015

**Stockholder Records:** Communications regarding stock transfer requirements or lost certificates should be directed to the transfer agent. Changes of address may be sent to the Secretary. Inquiries on dividends and dividend reinvestment should be directed to Shareholder Services.

**The Company files an annual report on Form 10-K with the Securities and Exchange Commission. Stockholders may obtain a free copy of this report from the Secretary upon request.**

**Securities Listed on the New York Stock Exchange:**
Common Stock
3.75% Preferred Stock
8.80% Preferred Stock
8.48% Preferred Stock ($25 Par Value)
7⅝% First Mortgage Bonds due 1981
10.60% First Mortgage Bonds due 1982
7⅝% First Mortgage Bonds due 2001
9⅜% First Mortgage Bonds due 2005
9⅜% First Mortgage Bonds due 2006
8⅝% First Mortgage Bonds due 2007



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