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SHAREHOLDERS MEETING

The annual meeting of holders of common stock will be held on Tuesday, April 5, 1988, at 10:30 a.m., at the South Avenue office of the Company in Poughkeepsie, New York. Notice of this meeting, together with the proxy statement, proxy, and this Annual Report, was mailed to shareholders on February 26, 1988. The management welcomes the personal attendance of shareholders at the meeting.

ADDITIONAL INFORMATION

Shareholders may obtain, without charge, a copy of Central Hudson's annual report to the Securities and Exchange Commission, on Form 10-K, by writing to Gladys L. Cooper, Secretary, Central Hudson Gas & Electric Corporation, 284 South Avenue, Poughkeepsie, New York 12601-4879. A comprehensive statistical supplement to the Company's 1987 Annual Report, containing key financial and operating results for a ten-year period, will be available soon on request to Ms. Cooper.

Central Hudson
GAS & ELECTRIC CORPORATION

General Office
284 South Avenue,
Poughkeepsie, NY 12601-4879
Telephone (914) 452-2000

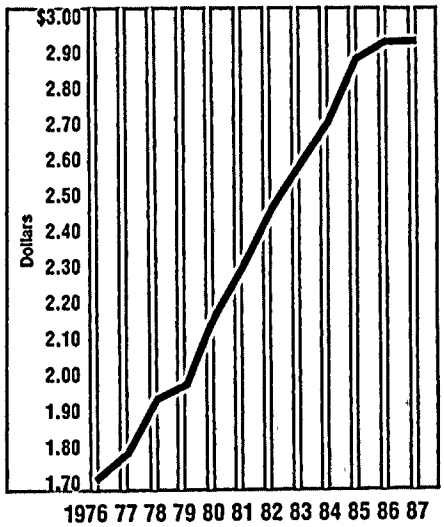
Central Hudson

Financial Highlights for 1987

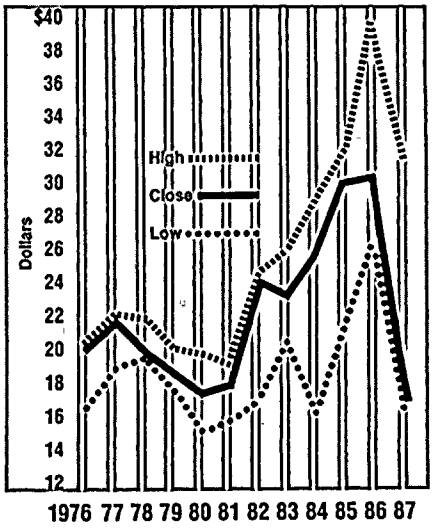
	1987	1986	Change
Operating revenues	**$429,077,000**	$438,551,000	(2%)
Net income (loss) *	**$(109,944,000)**	$64,884,000	(269%)
Earnings (loss) per share *	**$(8.12)**	$4.49	(281%)
Average shares outstanding	**14,230,000**	13,207,000	8%
Declared dividends per share	**$2.645**	$2.96	(11%)
Total assets	**$1,024,371,000**	$1,157,698,000	(12%)
Electric sales own territory (kwh.)	**4,354,902,000**	4,158,694,000	5%
Natural gas firm sales (thousands of cubic ft.)	**7,403,000**	7,207,000	3%
Electric customers (average)	**237,843**	231,938	3%
Gas customers (average)	**51,951**	50,166	4%

* See Note 1 of the Notes to Financial Statements.

DIVIDENDS PAID PER SHARE



COMMON STOCK PRICES



TO OUR SHAREHOLDERS:

February 26, 1988

The theme of our Annual Report for 1987 is the year of accomplishment. Perhaps you may wonder on what grounds we can use such a characterization when in December we were forced to reduce the quarterly dividend payable in February; you may even think that we are seeking to divert attention from the unfortunate necessity of the dividend reduction.

The fact is quite the contrary, because even with the dividend reduction and the loss we experienced as a result of writing off our disallowed investment in the Nine Mile 2 Plant, we look at 1987 as a turning point and note with pride the following accomplishments:

First, we completed, on time and on budget, the reconversion of Units 3 and 4 at our Danskammer Generating Plant to permit the burning of low-sulfur coal for fuel. In view of the volatile oil market, and the potential threats to oil supplies, this was a significant achievement. Furthermore, this enables us to stabilize the cost of electricity and makes the Company more competitive in the energy marketplace.

Second, the actual construction of the Nine Mile 2 Nuclear Plant was completed in 1987, after 12 years of construction. Our involvement in Nine Mile 2 admittedly has been a struggle, and the issues relating to it have been the cause of our dividend reduction. It is, nonetheless, an important part of our fuel diversification objective; and, as the future unfolds, we believe that the Nine Mile 2 Plant will be an important asset. It should also be recognized that this project has been a major construction project in New York State with a positive input into its economy. Although Atomic Energy as a national objective seemingly is forgotten, the plant fulfills the purposes of federal legislation which entrusted the development of nuclear power to the investor-owned electric utility industry.

Third, in 1987 we concluded an extended period of time when a major part of our earnings was represented by allowances for funds used during construction (AFDC), noncash income. As a result of completing our major construction program, the amount of AFDC will be substantially reduced in the future and there will be a corresponding increase in the quality of our earnings which will be substantially cash earnings. In this regard, you might wish to read Note 1 of the Notes to Financial Statements.

In addition to these factors, we are most fortunate in the nature of the territory we serve. It is one of the most beautiful, cultural and historic areas of the entire country, and now it is growing ebulliently. As a result, our sales are increasing. Unless there are substantial changes in the national economy, we believe the upward sales trend will continue.

We are expanding our natural gas markets with good results. We have entered into an agreement with Niagara Mohawk Power Corporation for the purchase and ownership of electric capacity which, if approved by the Commission, together with our existing capacity, will provide for our needs into the next century; thus we do not contemplate a major construction program for many years.

All of these matters are explained in more detail in this Report and they lead us to the conclusion that 1987, indeed, was a year of accomplishment.

Very truly yours,

Theodore J. Carlson
Chairman of the Board

John E. Mack III
President and Chief Executive Officer

A STRATEGY THAT WORKED

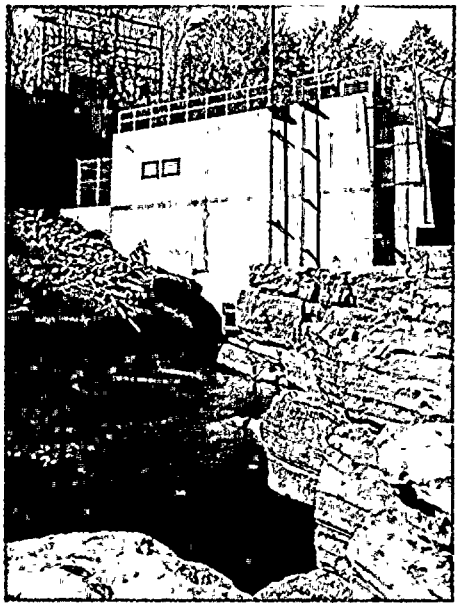
Central Hudson's strategy for the 80s has been to reduce our dependence on oil for electric generation. Responding to market conditions and economic forecasts in the mid to late 1970s and early 1980s, which were predicated on a dramatic increase in the cost of oil, we recognized the importance of stabilizing the price of electric energy for our growing region. To meet this challenge, we developed our "Energy Strategy for the 80s."

Our primary focus was to radically diversify our fuel mix – which at the beginning of the decade was 90 percent oil, 7 percent natural gas, and 3 percent hydro – by substituting domestic fuels such as coal, nuclear, additional hydro and natural gas in the generation of electricity.

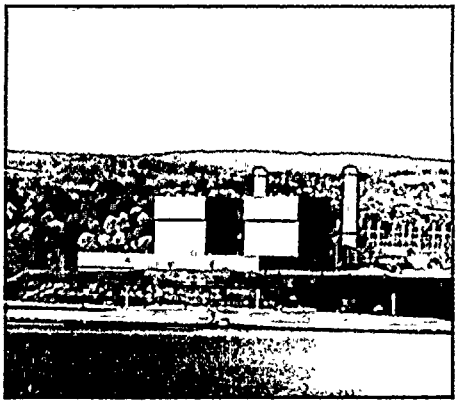
Previous reports have documented the steps taken through 1986 to achieve this goal. We are pleased to report that in 1987 we reduced our dependence on oil to 52 percent with the successful completion of the reconversion of our Danskammer Generating Plant to coal and natural gas and the rehabilitation of the High Falls Hydroelectric Plant. This dependence on oil will be reduced further by the commercial operation of the Nine Mile 2 Nuclear Plant in 1988 and, in the future, the proposed addition of a second fuel at our Roseton Generating Plant.

Through this energy strategy we are now able to take advantage of favorable supply and price options, enabling us to provide our customers with more competitively priced electric energy.

Our prices for electricity are now below the state average, and this will continue to encourage business and industry to locate and expand in the Mid-Hudson Valley, thus providing the region with a growing economy and lower-priced energy, both of which benefit our customers.

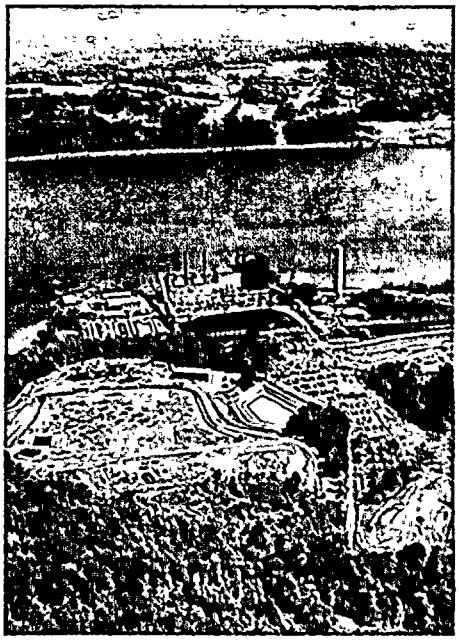


High Falls Hydroelectric Plant



Roseton Generating Plant

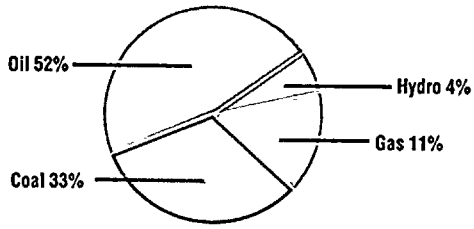
COAL: SOMETHING OLD AND NEW



Danskammer Generating Plant

The reconversion of our Danskammer Generating Plant's Units 3 and 4 from oil to coal as a primary fuel was the cornerstone of our fuel diversification program. The project, which was under the supervision of Company personnel, was completed in 1987, on time and on budget.

The two units are now capable of producing 360 megawatts of electricity by burning coal or natural gas, as well as oil. Prior to the reconversion, we were limited to burning only oil in these units. By burning coal, we were able to save our customers approximately $10.4 million in fuel costs during 1987.



Our commitment to protect the environment while providing our customers with lower-cost energy has been achieved by burning coal with a 0.7 percent sulfur content, which is equal to the sulfur content of the 1 percent oil previously burned at the plant. This, combined with a newly constructed 240-foot chimney and two electrostatic precipitators – designed to remove 99.7 percent of the particulate emissions from the coal-burning units – assures compliance with air quality standards. In addition, we also have reduced the sulfur content of the fuel burned at the neighboring Roseton plant to 1.3 percent – on average.

The completion of the Danskammer Coal Reconversion project was a significant step in providing our customers with a reliable supply of electricity at a competitive price and the realization of a major portion of our "Energy Strategy for the 80s."

HYDRO RENEWAL AT HIGH FALLS

Turbine setup at High Falls

The construction and rehabilitation of our High Falls Hydroelectric Plant was another important contribution to our energy strategy. The plant, which began generating electricity in December 1986, has a capacity of 3.25 megawatts and the ability to produce 10 million kilowatt-hours of hydroelectric power annually. We have no immediate plans to construct additional hydro facilities but intend to work closely with private entrepreneurs to continue to develop hydroelectric resources in the Hudson Valley region.

The dedication of High Falls in June as an historic site and recreational area is another statement of our commitment to preserve historic, scenic, and recreational areas in the Mid-Hudson Valley.

NINE MILE 2 NEARS COMMERCIAL OPERATION

With the commercial operation of the Nine Mile 2 Nuclear Plant, our dependence on oil will be further reduced to 43 percent. The Company owns nine percent of the plant, which is operated by the Niagara Mohawk Power Corporation (Niagara Mohawk).

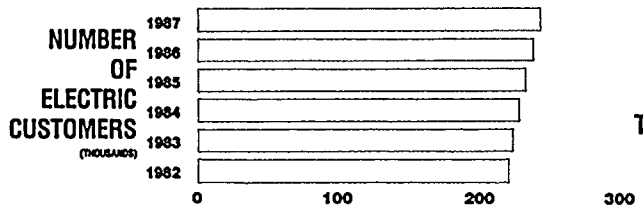
During 1987, the plant was tied into the New York State electric grid. The plant has operated at up to 65 percent capacity and is still undergoing further testing. During the power ascension program, the unit began to produce electricity at increasing levels and was subjected to extensive testing. This is part of the continuous review procedure required by the Nuclear Regulatory Commission (NRC) to ensure safe performance of the plant.

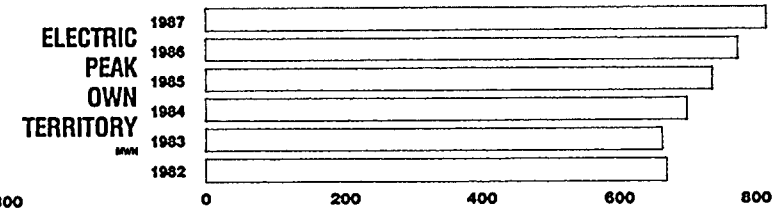
In March 1987, it was determined that the plant's original main steam isolation valves required replacement. In July, the NRC authorized full-rated power operation following the completion of the power ascension program, which was 73 percent complete at the end of 1987. In November, Niagara Mohawk announced that modifications on one of the plant's piping systems were required which will delay the plant's commercial operation date until 1988.

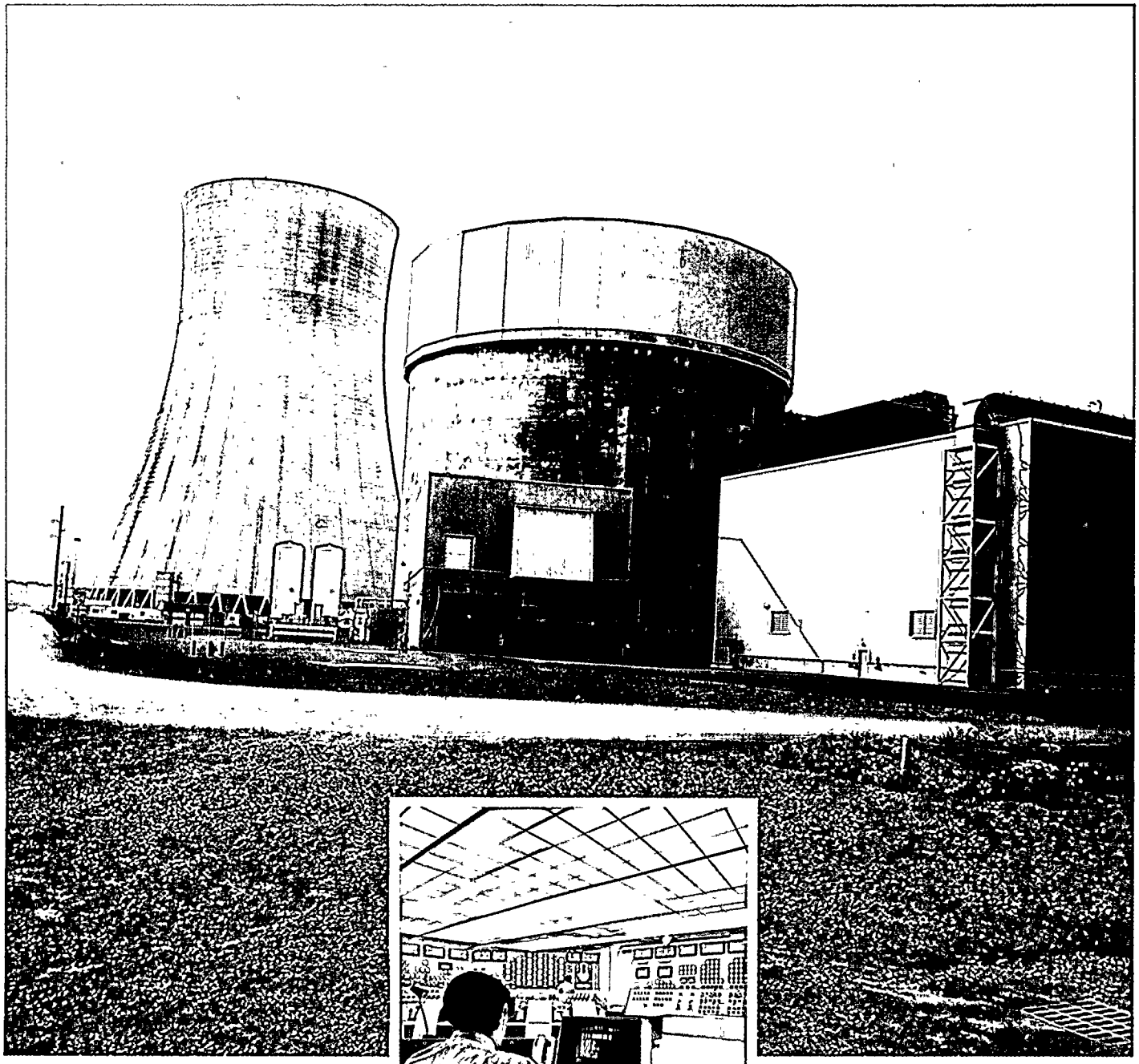
The delay in the plant's commercial in-service date has increased the Company's share for completion costs to $537.9 million. As a result of the cost increase, our share of the previously reported settlement disallowance has increased to $169.3 million.

In accordance with generally accepted accounting principles and in compliance with Statement No. 90 of the Financial Accounting Standards Board – which deals with disallowed charges for utility plants – the Company wrote off the disallowed investment during the last quarter of 1987. A detailed discussion of this subject is presented in Note 1 of the Notes to Financial Statements.

With the completion of Nine Mile 2 and the Danskammer coal reconversion and with no new major construction programs anticipated in the near future, we will be able to sharply reduce our external financing, and our cash flow will be greatly improved, placing the Company in a strong financial position for the decade of the 90s. For example, based on current projections we anticipate that all of the capital spending for the next five years will be financed internally.



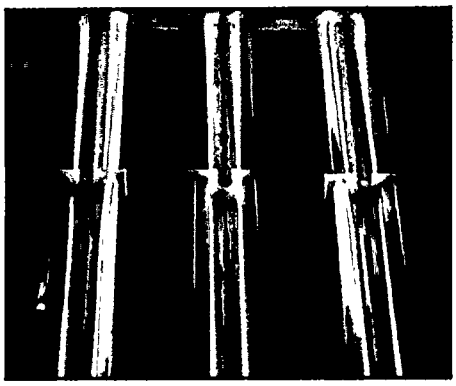




Nine Mile 2 Nuclear Plant and Control Room

ELECTRICITY FROM NATURAL GAS

PROVIDING ENERGY FOR THE FUTURE



Burner insert for natural gas appliances

The most promising means of further diversifying our fuel sources will be the conversion of the Roseton Generating Plant to burn natural gas during the non-heating season.

We are currently negotiating to purchase up to 100,000 mcf. of natural gas per day during the non-heating season for this purpose. If the contract is approved, the gas would be delivered by the proposed Iroquois Gas Pipeline, which is scheduled for completion in late 1989.

Federal deregulation has had a positive impact on natural gas prices. Natural gas is not only a more environmentally acceptable fuel but also costs less during the non-heating season than the 1.3 percent sulfur oil currently being burned at the plant.

Generating electricity by burning natural gas is another important step in stabilizing the cost of electricity and diversifying our fuel mix, thereby further implementing our "Energy Strategy for the 80s."

Our customers established a new peak for electric use. The new hourly peak of 824,000 kilowatts surpassed two previous peaks set earlier in the summer of 1987. The 1987 peak is 60,000 kilowatts, or 7.8 percent, higher than the record established in 1986.

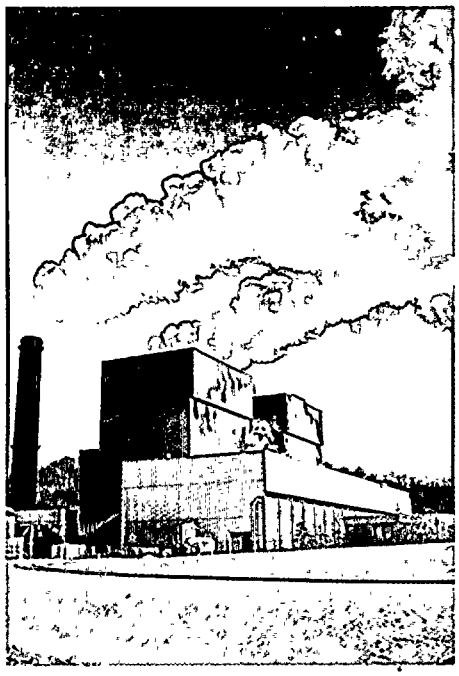
During 1987, we added 5,904 new electric customers to our system, an increase of 3 percent. Electric sales within our service territory increased by 5 percent during 1987.

The number of new electric customers has increased 10 percent since 1982, an average annual increase of 2 percent. During the same period, our electric sales have increased 28 percent, an average annual increase of 6 percent.

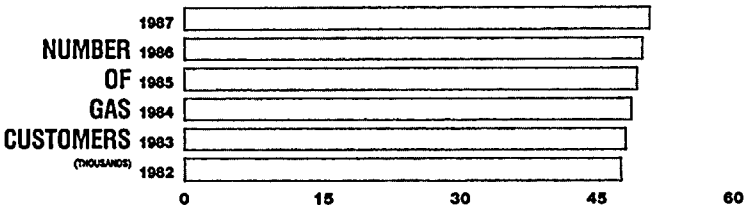
To meet the challenge of the growing demand for electricity, we have entered into an agreement with Niagara Mohawk to purchase additional ownership interest in the Roseton Generating Plant.

Under the terms of the original ownership agreement, the Company, which currently owns 35 percent – or 420 megawatts – of Roseton, has the option (subject to Public Service Commission approval) to purchase all of the remaining interests of Niagara Mohawk and Consolidated Edison Company of New York, Inc., the two other cotenants in the plant, in December 2004. However, because the Company needs capacity prior to 2005, we have entered into an agreement with Niagara Mohawk modifying the original arrangement. Under the new agreement, the Company will purchase ten equal installments of 30 megawatts each on December 31 of each year from 1994 through 2003. In exchange, Niagara Mohawk has the option to purchase up to 300 megawatts in December 2004.

The purchase of this additional capacity – which is subject to the approval of the New York State Public Service Commission (PSC) – will cost approximately $36 million and, based on present forecasts, will eliminate the need for the Company to build any new large base-load generating plants during the remainder of this century. It most efficiently matches our increased demand for electricity with additional generating capacity.



OUR APPROACH TO THE GAS BUSINESS: AGGRESSIVE



"Aggressive" is the word that best describes our approach to the natural gas business.

We successfully exercised our natural gas franchise in the Town of Carmel in Putnam County where we do not have an electric franchise. In July 1987, we opened a new office in Mahopac in the Town of Carmel to serve our new customers in this area, becoming the first utility to exercise a gas franchise in Putnam County.

We also exercised our gas franchise in the Town of Pleasant Valley and have expanded gas service in the Town of East Fishkill in Dutchess County. We have also petitioned the PSC to exercise our gas franchise in the Village of Ravena in Albany County. Plans for expansion in other areas are also well under way.

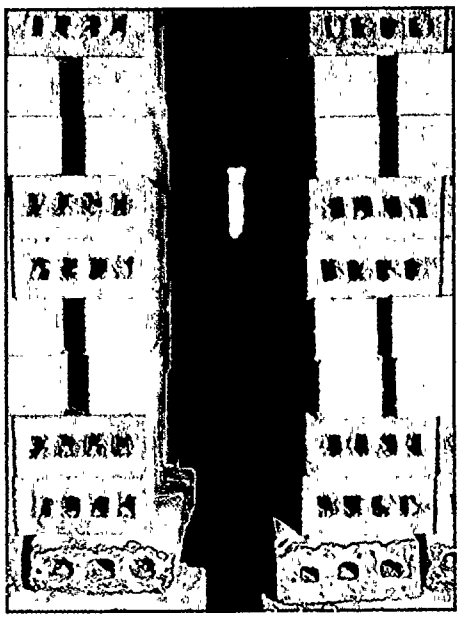
Plastic pipe speeds construction

Firm sales of natural gas reached an all-time record in 1987. Our customers used a record 7,403,000 mcf. of natural gas, a 9 percent increase since 1982. More than 5,701 new natural gas customers were added to our system during this same period.

The significant increase in natural gas sales was one reason that the Company agreed to a reduction of 7 percent, or $3 million, in the price our customers pay for natural gas. This price reduction was approved by the PSC in November and will remain in effect through December 31, 1990.

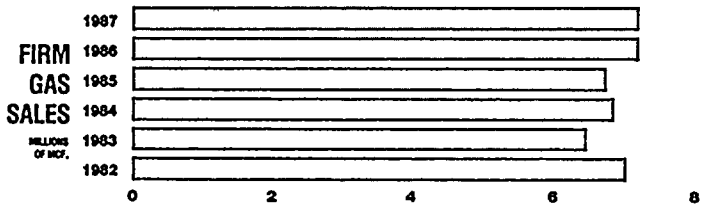
To ensure continued competitive pricing and to provide for the needs of our current and future customers, we signed a contract with a fourth supplier of natural gas, Alberta Northeast Gas Ltd. Ten million cubic feet of natural gas will be delivered daily to the Mid-Hudson region via the proposed Iroquois Gas Pipeline.

To enhance our long-term potential for natural gas sales, we are continuing our Compressed Natural Gas (CNG) vehicle project. Currently, we are performing on-the-road testing of our natural gas fleet. With new, more stringent regulations for vehicle emissions being proposed throughout the early 1990s, CNG vehicles are being given increased consideration as a possible answer to solving these problems. Cost savings in operation and maintenance also make the CNG vehicle attractive to automotive fleets and provide the potential for our successful expansion into the transportation market.



A brick kiln, a major consumer of natural gas

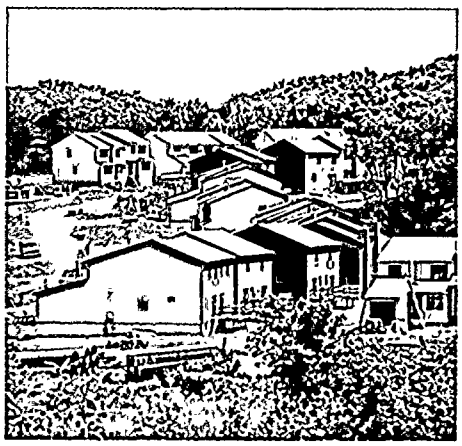
MAINTAINING A DELICATE BALANCE

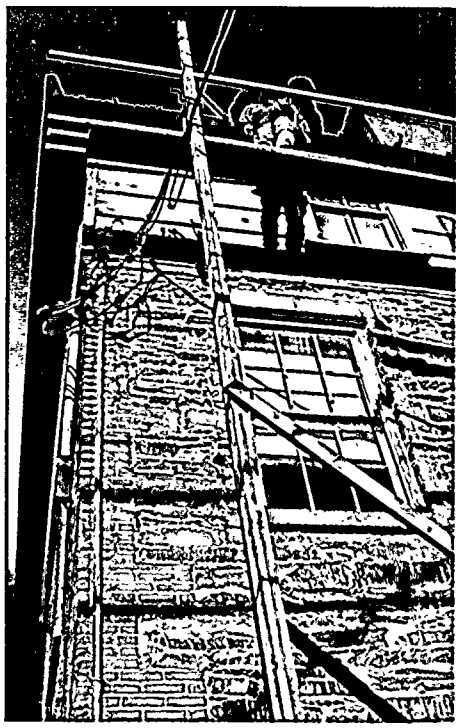


The Mid-Hudson Valley is an area rich in history and natural beauty, balanced with an excellent quality of life and rapid economic growth. We have long recognized the need to maintain and enhance these characteristics and have been a leader in this effort on a regional basis.

Our Chairman, Theodore J. Carlson, has been a prominent spokesman in promoting the themes of the quality of life and economic development in the Mid-Hudson Valley. Under Mr. Carlson's leadership, the Mid-Hudson Regional Economic Development Council has been actively advancing the strategy that through developing, maintaining, preserving and promoting the quality of life in our area, balanced economic development will follow.

Inherent in this approach is revitalization of the cities in our region. A resurgence in the use of the Hudson River and an increased emphasis on tourism make the redevelopment of the cities along the river even more important. Cities have an infrastructure already in place. They are once again becoming centers of commerce, finance, government and culture and offer the greatest potential for providing affordable housing.





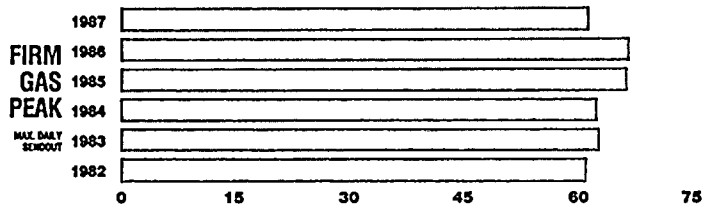
Renovation of the historic Hoffman House, Poughkeepsie

Natural gas research vehicle

President and Chief Executive Officer John E. Mack III served as the Chairman of the City of Poughkeepsie Tricentennial Celebration, a year-long event designed not only to celebrate the founding of Poughkeepsie in 1687 but also to rekindle a sense of pride and a heightened awareness of the City's inherent attractiveness as a community in which to live and work.

Through continuing partnerships with the public and private sectors, we have brought a regional perspective to balancing prosperity and preserving the area's natural resources. By working with organizations such as Mid-Hudson Pattern, Inc., the Hudson River Valley Association, the Orange County Partnership, other economic development organizations and Chambers of Commerce in the counties we serve, industries that are compatible with the quality of life in the Hudson Valley are encouraged to relocate to the region.

The success of the Stewart Industrial Park and 11 other full-service industrial parks in our service territory reveal how our efforts, combined with those of public officials and developers, can benefit the entire area. The Company's responsiveness



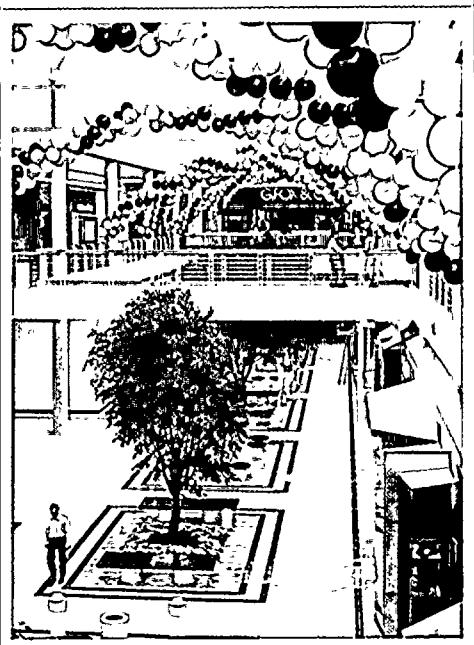
to our industrial customers' energy needs has resulted in the introduction of innovative pricing policies, which are additional incentives for industries to expand or relocate in the Hudson Valley.

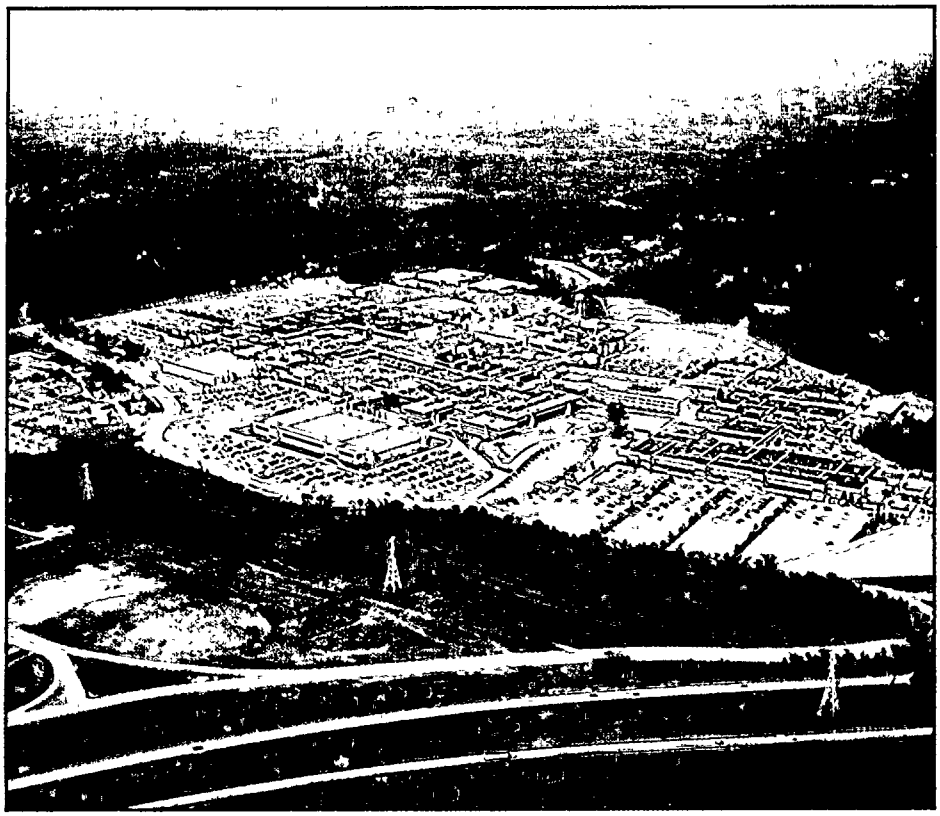
This, in turn, increases our customer base, helps reduce the unit cost of electric and gas service and lessens the need for large price increases to raise additional revenues for operating our business. Balanced growth promotes the economic well-being of the entire Mid-Hudson Valley region.

Left and above: Poughkeepsie Tricentennial Celebration

Right: Poughkeepsie Galleria grand opening.

Below: IBM East Fishkill





REACHING OUT TO TODAY'S CUSTOMERS

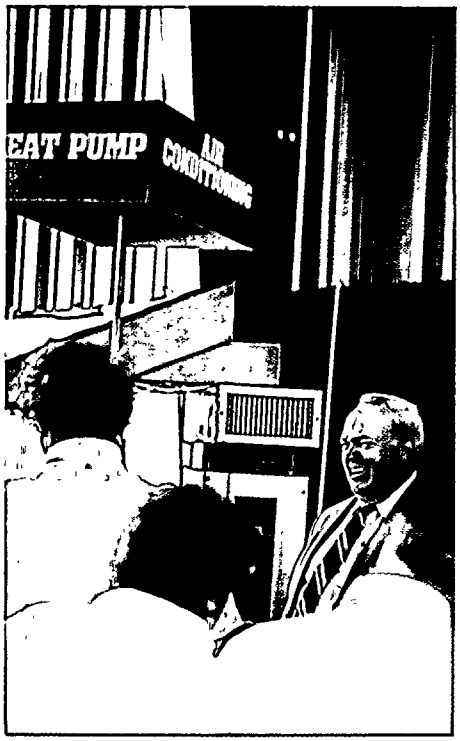
The use of advanced technology, improved work methods, and continued emphasis on operating efficiency have helped us keep the price for our electric service below the state average. In an audit of the management of the Company's operation, completed during 1987, the PSC consultant documented a tightly managed organization which places a high value on customer service.

A computerized customer information system, electronic meter reading devices and a sophisticated telephone system have improved the effectiveness with which we handle customer inquiries and billing. We are, however, aware that customer service goes beyond these technical advances – it is responding to the needs of our customers through programs designed and developed with their input.

A newly established Customer Outreach Section was formed in 1987 to integrate and expand existing programs for our customers with special needs. Our representatives are responsible for balancing these special customers' energy requirements with the best interests of the Company, to make them fully aware of many existing Company programs that will help meet their energy needs and to work with outside agencies which may be able to provide further assistance.

To accurately determine how this specialized group of customers assess and rank their energy and non-energy needs, a comprehensive survey is being conducted. The survey, scheduled for completion in 1988, will provide us with customer input to continue to develop effective and meaningful outreach programs.

Jackie Chatfield, Senior Consumer Outreach Representative and Katie Kane, HEAP Coordinator, Dutchess County Department of Social Services and a member of Central Hudson's Consumer Advisory Panel



A successful pilot program conducted in conjunction with the Greene County Office for the Aging in cooperation with the Senior Community Action Program will be extended during 1988. "Seal-Up," a program designed to increase home energy conservation through weatherization improvements, will be extended to all qualified low-income customers as the result of a cooperative effort between

the Company and the Departments of Social Services in our eight-county service territory.

To encourage our senior customers to reduce their energy costs, we will be expanding our "Senior-to-Senior" program in 1988. This innovative program, which uses a one-on-one approach, offers the opportunity for our senior customers to have a SAVINGPOWER survey and provides all the follow-up assistance – completing the paperwork, securing a contractor or obtaining grants or low-interest loans – for weatherization or other conservation improvements.

The Consumer Advisory Panel, a group of volunteers who act as advocates for our customers by providing suggestions for improved services and programs, completed its seventh year in 1987.

With the Panel's input, we developed and introduced our new two-page gas and electric bill during 1987. Definitions, unit pricing and cost comparisons are some of its features. The new format uses larger type for easier reading and also includes a message center which relates specific information about billing and our programs or services which may be helpful to our customers.

Senior Times received the New York Chapter of the International Association of Business Communicators' Modern Masterpieces Award for Excellence in Feature Writing in 1987. This Company-sponsored quarterly publication is received by more than 20,000 of our senior customers.

More than 7,200 SAVINGPOWER surveys were conducted during 1987, bringing the total number of energy audits performed since the program's inception in 1978 to more than 39,000. We have provided $1.7 million in low-interest loans to qualified customers to finance energy conservation measures.

SAVINGPOWER energy survey

Our "GET HELP" program is an emergency assistance fund designed to ease the burden of low-income and elderly customers who have exhausted their Home Energy Assistance Program benefits. Since the program's inception in 1985, approximately $128,500 has been distributed by the Salvation Army, which is responsible for administering the grants.

REACHING TOMORROW'S CUSTOMERS

Recognizing the value of reaching out to today's youth and tomorrow's customers, we have a number of programs designed to help educators improve their students' knowledge of energy. To assist us in these efforts, a Teacher Advisory Panel, consisting of four teachers from our service territory, previews materials and makes suggestions for their use in meeting instructional objectives.

During 1987, more than 200 teachers in our service territory availed themselves of films and other educational materials which we make available for their energy education programs.

On the state level, we participate in the New York Energy Education Project, provide teaching materials and workshops for educators and elicit local industry support for energy education. We were the first industry representative to the Mid-Hudson Teacher Center, which provides in-service energy education training for teachers in the area.

In partnership with IBM, Rotron, and the U.S. Navy, we formed the Ulster County School/Industry Council which provides seminars for gifted science and math students, as well as educational resources for teachers and students.

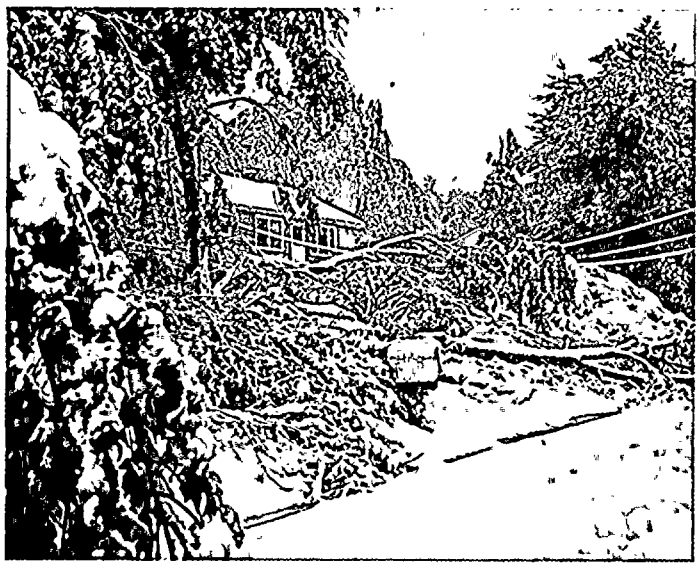
In conjunction with the Beacon Blue Ribbon Panel, we participated with students and teachers in the Beacon City Schools (Dutchess County) in the National Energy Education Day project. Students encouraged local merchants to conserve energy on "Save A Watt Day" and arranged for 120 customers in the Beacon area to have SAVINGPOWER surveys. In recognition of their efforts to promote energy conservation, four elementary school students and their teachers were sponsored by the Company to represent New York State at a national energy conference in Washington, D.C.

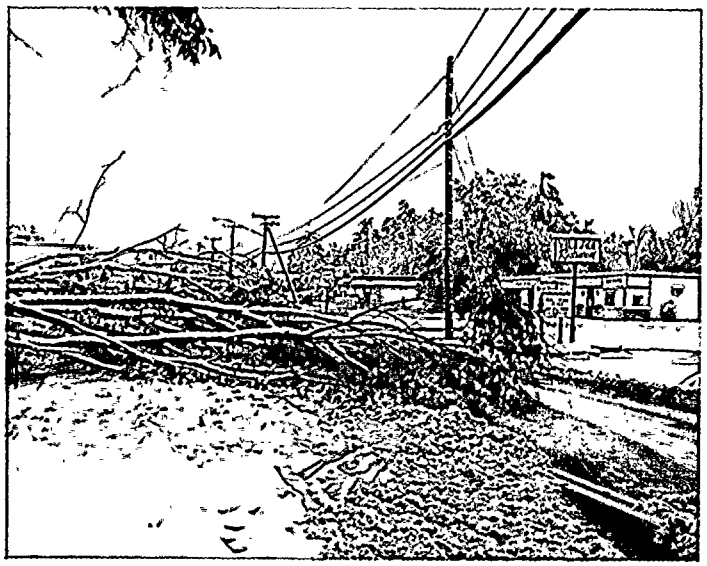
To complement our educational programs and provide basic information about the production and distribution of electricity, we conduct tours of the Roseton Generating Plant. During 1987, more than 2,500 students, ranging from fifth graders to college students, participated in this program.

Education is not limited to just students. Our Speakers Bureau provides free slide shows and informational presentations on a variety of energy-related topics. Since the Bureau's inception in 1981, our members have made presentations to 600 groups and organizations in the Mid-Hudson Valley region.

Power plant tour

WE ARE CENTRAL HUDSON





Our service territory experienced the most severe snowstorm in the Company's history on October 4, 1987. Approximately 80,000 of our 237,800 customers were without electric service at the height of the storm. Although 75 percent of these customers had their service restored within two days, the restoration effort required the assistance of other utilities because of the extensive damage to our system. Our own employees from all parts of the Company worked long and arduous hours to restore service and handle customer relations activities.

Our employees received numerous letters of praise and statements of appreciation following the storm, echoing the words of a commendation presented to the Company by the Dutchess County Legislature and signed by Lucille P. Pattison, the County Executive:

RESOLVED, that the Dutchess County Legislature, on behalf of all of the people of Dutchess County, does hereby extend its deep appreciation and gratitude to . . . CENTRAL HUDSON GAS & ELECTRIC CORPORATION . . . for and on account of their prompt and effective response to the emergency which was created by the sudden and unexpected snowstorm of October 4, 1987 . . . .

Following the storm, a survey was conducted by an independent research and public opinion firm to see how our customers rated our service. More than 80 percent of our customers rated the Company's overall performance as excellent or good.

Our dedicated employees were the basis for our 1987 advertising campaign. Following the theme of "Good Neighbors," each ad in the series highlighted an employee, showing how his or her occupation serves the community. The campaign also featured each employee's community activities, which we believe are an integral part of our commitment to enriching the quality of life in the Mid-Hudson Valley.

INTRODUCTION TO FINANCIAL SECTION

Earnings Per Share (Note 1):

The Company experienced a loss of $8.12 per share of common stock in 1987. Earnings for 1987 include the effect of adopting SFAS 90 and recording the write-off of the NMP-2 disallowance for financial reporting purposes. These actions reduced earnings for 1987 by $11.90 per share and accounted for the loss.

The after-tax amount of the NMP-2 investment written off against income in 1987 was $169.3 million, of which $15.9 million represented the reversal of AFDC accrued on the disallowed NMP-2 investment in calendar year 1987. The reversal of the AFDC reduced earnings by $1.12 per share and the balance of the NMP-2 disallowance reduced earnings by $10.78 per share.

Earnings per share for 1987, excluding the effect of the $10.78 reduction due to the write-off of the NMP-2 disallowance, would have been $2.66 ($10.78 - $8.12).

Dividend Reduction (Page 26):

On December 18, 1987, the Company reduced its quarterly dividend payable February 1, 1988 to $.425 per share from the previous quarterly dividend of $.74 per share, a reduction of 43%.

The lower earnings resulting from the rate-making treatment of the NMP-2 disallowance, which was implemented by the PSC in its July 1987 electric rate order, was the primary factor contributing to the dividend reduction.

The Company's earnings have been, and will be, significantly reduced as a result of this cost disallowance because the Company is not allowed to earn a return on the after-tax amount of such disallowed investment.

Dividends Paid:

Dividends paid on common stock in 1987 were $2.96 per share, the same amount as paid in 1986. No portion of the 1987 dividend represents a return of capital.

Electric Sales (Page 41):

Electric sales within the service area increased 5% in 1987. Sales to residential and commercial customers each increased 6%, while sales to industrial customers increased 2%.

Gas Sales (Page 41):

Firm sales of natural gas, excluding sales to the electric department, increased 3% in 1987. Sales to residential and commercial customers increased 3% and 2%, respectively. Firm sales to industrial customers increased 5%.

Construction Program (Page 37):

During 1987, the Company completed its major construction program. The reconversion of both Danskammer Units 3 and 4 from oil- to coal-burning was completed during the year. The actual construction of NMP-2 was also completed in 1987. NMP-2 is currently undergoing its power ascension program and is presently scheduled to commence commercial operation in March 1988.

Effective July 25, 1987, all of the Company's allowable investment in NMP-2 was included in rate base, as was its full investment in the Danskammer coal reconversion.

Financing Program:

In July, the Company issued $43.6 million of its variable rate promissory notes to secure an equal amount of NYSERDA tax-exempt Pollution Control Revenue Bonds. Proceeds were used to finance pollution control facilities at NMP-2 and refinance $9.9 million of 11 1/4% pollution control debt.

In November, the Company redeemed $25 million of its 14 1/2% first mortgage bonds.

Participation in the Company's Dividend Reinvestment Plan remained constant in 1987 and the proceeds realized were $6.1 million. There were no public offerings of common stock in 1987.

At December 31, the Company had $4 million of short-term debt outstanding and it had $68 million of short-term credit available.

Five-Year Summary of Operations and Selected Financial Data*

(Thousands of Dollars)

	1987	1986	1985	1984	1983
Operating Revenues:					
Electric	$ 374,951	$377,103	$436,652	$454,860	$411,770
Gas	54,126	61,448	68,150	68,329	61,968
Total	429,077	438,551	504,802	523,189	473,738
Operating Expenses:					
Operations	223,916	240,196	316,553	352,642	325,158
Maintenance	20,632	19,733	14,884	13,814	14,456
Depreciation and amortization	28,163	24,894	24,249	22,531	20,524
Operating taxes	44,379	42,551	41,675	39,681	35,693
Federal income tax	31,476	39,454	38,082	34,208	25,280
Total	348,566	366,828	435,443	462,876	421,111
Operating Income	80,511	71,723	69,359	60,313	52,627
Other Income and Deductions:					
Equity component of AFDC	3,371	21,594	18,644	15,709	11,105
Federal income tax—credit	(71)	6,690	6,570	4,965	4,605
Current year effect of adoption of SFAS 90	(51,919)	—	—	—	—
Other—net	2,198	371	(604)	621	(389)
Total	(46,421)	28,655	24,610	21,295	15,321
Income before Interest Charges and Cumulative Effect of a Change in Accounting Principle	34,090	100,378	93,969	81,608	67,948
Interest Charges	42,559	35,494	34,297	30,471	27,712
Income (loss) before cumulative effect of a change in accounting principle	(8,469)	64,884	59,672	51,137	40,236
Cumulative effect on prior years of adoption of SFAS 90	(101,475)	—	—	—	—
Net Income (Loss)	(109,944)	64,884	59,672	51,137	40,236
Dividends on Preferred Stock	5,593	5,614	6,184	6,459	5,783
Income (Loss) Available for Common Stock	(115,537)	59,270	53,488	44,678	34,453
Dividends Declared on Common Stock	37,666	40,393	33,945	28,860	23,480
Amount Retained in the Business	(153,203)	18,877	19,543	15,818	10,973
Retained Earnings—beginning of year	164,733	145,856	126,313	110,495	99,522
Retained Earnings—end of year	$ 11,530	$164,733	$145,856	$126,313	$110,495
Common Stock:					
Average Shares Outstanding (000's)	14,230	13,207	11,458	10,087	8,745
Income (Loss) Available Per Average Share	$(8.12)	$4.49	$4.67	$4.43	$3.94
Dividends Declared Per Share	$2.645	$2.96	$2.93	$2.78	$2.63
Book Value Per Share (at year end)	$20.35	$31.18	$29.49	$27.91	$27.40
Total Assets	$1,024,371	$1,157,698	$1,038,524	$878,240	$764,205
Long-Term Debt	430,250	439,725	444,900	352,825	274,600
Cumulative Preferred Stock	81,030	81,030	81,030	81,030	81,030
Common Equity	292,240	439,860	356,084	307,156	263,649
PRO FORMA EFFECT OF SFAS 90 BEING APPLIED RETROACTIVELY FOR NMP-2 DISALLOWANCE (NOTE 1):					
Income (Loss) Available for Common Stock	$ (14,062)	$ 13,270	$ (1,512)	—	—
Income (Loss) Available Per Average Share of Common Stock	$ (.99)	$ 1.01	$ (.13)	—	—

* This summary should be read in conjunction with the financial statements and notes thereto included in the "Financial Section" of this Annual Report.

Report of Independent Accountants

To the Board of Directors and Shareholders of Central Hudson Gas & Electric Corporation

We have examined the accompanying balance sheet of Central Hudson Gas & Electric Corporation as of December 31, 1987 and 1986, and the related statements of income, of retained earnings and of changes in financial position for each of the three years in the period ended December 31, 1987. 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.

As described in Note 1 to the financial statements, the Company adopted Statement of Financial Accounting Standards No. 90 "Regulated Enterprises – Accounting for Abandonments and Disallowances of Plant Costs." The adoption of this Statement resulted in the disallowed portion of the Company's investment in Unit No. 2 of the Nine Mile Point Nuclear Station (NMP-2) being recognized as a loss in the 1987 financial statements.

As a result of continuing uncertainties with respect to NMP-2 discussed in Note 2, management is unable to predict whether additional write-offs will occur and/or whether further regulatory actions by the New York State Public Service Commission with respect to the Company's investment in NMP-2 will have, in the aggregate, a material effect on the Company's financial position and results of operations.

In our opinion, subject to the effects on the 1987, 1986 and 1985 financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainties referred to in the preceding paragraph been known, the financial statements examined by us present fairly the financial position of Central Hudson Gas & Electric Corporation at December 31, 1987 and 1986, and the results of its operations and the changes in its financial position for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles consistently applied during the period except for the change, with which we concur, referred to in the second paragraph of this report.

PRICE WATERHOUSE

New York, New York
January 29, 1988

Statement of Retained Earnings
(Thousands of Dollars)

	Year ended December 31, 1987	1986	1985
Balance at beginning of year	$164,733	$145,856	$126,313
Net Income (Loss) (Note 1)	(109,944)	64,884	59,672
	54,789	210,740	185,985
Dividends declared:			
On cumulative preferred stock	5,593	5,614	6,184
On common stock ($2.645 per share 1987; $2.96 per share 1986; $2.93 per share 1985)	37,666	40,393	33,945
	43,259	46,007	40,129
Balance at end of year	$ 11,530*	$164,733	$145,856

* Pursuant to the terms of the 4.85% promissory notes, due 1995, $3,116 is available for payment of dividends on common stock.

The Notes to Financial Statements are an integral part hereof.

Statement of Income

(Thousands of Dollars)

	Year ended December 31, 1987	1986	1985
Operating Revenues			
Electric	$ 357,726	$347,593	$384,631
Gas	54,126	61,448	68,150
Total—own territory	411,852	409,041	452,781
Revenues from electric sales to other utilities	17,225	29,510	52,021
	429,077	438,551	504,802
Operating Expenses			
Operation:			
Fuel used in electric generation	104,041	110,258	168,188
Purchased electricity	30,031	34,362	50,943
Purchased natural gas	27,131	33,413	40,343
Other expenses of operation	62,713	62,163	57,079
Maintenance	20,632	19,733	14,884
Depreciation and amortization (Note 3)	28,163	24,894	24,249
Taxes, other than income tax	44,379	42,551	41,675
Federal income tax (Note 4)	13,032	38,162	26,768
Deferred income tax (Note 4)	18,444	1,292	11,314
	348,566	366,828	435,443
Operating Income	80,511	71,723	69,359
Other Income and Deductions			
Allowance for equity funds used during construction (Note 3)	3,371	21,594	18,644
Federal income tax (Note 4)	3,330	5,908	5,969
Deferred income tax—credit (Note 4)	(3,401)	782	601
Current year effect of adoption of SFAS 90 (Note 1):			
Disallowed plant costs	(64,874)	—	—
Related income tax	12,955	—	—
Other—net	2,198	371	(604)
	(46,421)	28,655	24,610
Income before Interest Charges and Cumulative Effect of a Change in Accounting Principle	34,090	100,378	93,969
Interest Charges			
Interest on mortgage bonds	33,313	37,226	37,200
Interest on other long-term debt	7,318	6,105	3,220
Interest on short-term debt	726	—	325
Other interest	1,751	1,637	931
Allowance for borrowed funds used during construction (Note 3)	(1,605)	(10,131)	(7,788)
Amortization of premium and expense on debt	1,056	657	409
	42,559	35,494	34,297
Income (loss) before cumulative effect of a change in accounting principle	(8,469)	64,884	59,672
Cumulative effect on prior years of adoption of SFAS 90 (less applicable income tax of $45,431) (Note 1)	(101,475)	—	—
Net Income (Loss)	(109,944)	64,884	59,672
Dividends on Preferred Stock	5,593	5,614	6,184
Income (loss) Available for Common Stock	$(115,537)	$ 59,270	$ 53,488
Average Shares of Common Stock Outstanding (000's)	14,230	13,207	11,458
Earnings (Loss) Per Common Share—On Average Shares Outstanding:			
Income (loss) before cumulative effect of a change in accounting principle	$ (.99)	$4.49	$4.67
Cumulative effect on prior years of adoption of SFAS 90	(7.13)	—	—
Earnings (loss) per share	$(8.12)	$4.49	$4.67

The Notes to Financial Statements are an integral part hereof.

Balance Sheet
(Thousands of Dollars)

Assets

	1987	1986
Utility Plant, at original cost		
Electric	$ 652,170	$ 522,866
Gas	73,335	70,098
Common	47,011	43,797
	772,516	636,761
Less accumulated depreciation	263,396	253,168
	509,120	383,593
Construction work in progress	320,995	555,735
	830,115	939,328
Other Property and Investments (Note 3)	6,092	6,290
Current Assets		
Cash	1,786	1,690
Temporary cash investments	420	6,413
Special deposits:		
Pollution control funds held by trustee	3,106	17,594
Other	1,494	2,133
Accounts receivable from customers—net (Note 10)	9,249	32,344
Receivable—Nine Mile 2 Settlement (Note 2)	26,100	26,100
Accrued unbilled utility revenues (Notes 3 and 10)	—	8,475
Other receivables	9,775	3,235
Materials and supplies, at average cost:		
Fuel	11,019	13,112
Construction and operating	11,344	9,912
Prepayments	7,690	8,119
	81,983	129,127
Deferred Charges		
Deferred finance charges—Nine Mile 2 Project (Note 3)	68,326	41,971
Unamortized investment in Sterling Project (Note 9)	761	9,063
Deferred Sterling cancellation charges (Note 9)	—	1,012
Deferred Roseton litigation settlement (Note 3)	5,528	6,449
Unamortized debt expense	9,697	9,973
Unamortized rehabilitation costs	7,147	2,731
Other	14,722	11,754
	106,181	82,953
	$1,024,371	$1,157,698

The Notes to Financial Statements are an integral part hereof.

December 31, 1987 and 1986

Liabilities

	1987	1986
Capitalization		
Common Stock Equity		
Common stock (Note 6)	$ 236,079	$ 279,685
Paid-in capital (Note 6)	50,067	67
Retained earnings (Note 1)	11,530	164,733
Capital stock expense	(5,436)	(4,625)
	292,240	439,860
Cumulative Preferred Stock (Note 6)		
Without sinking fund	61,030	61,030
With sinking fund	20,000	20,000
	81,030	81,030
Long-term Debt (Note 7)	430,250	439,725
Unamortized Premium and Discount on Debt—Net	(292)	(400)
	803,228	960,215
Current Liabilities		
Long-term debt maturing within one year	18,000	—
Notes payable	4,000	—
Accounts payable	22,437	27,234
Accrued taxes	11,818	4,966
Accrued interest	7,526	8,055
Accrued vacation (Note 11)	2,973	2,806
Customer deposits	2,890	2,809
Dividends declared	7,570	11,794
Accrued Nine Mile 2 Project completion costs	10,132	—
Other	12,785	10,676
	100,131	68,340
Deferred Credits and Other Liabilities		
Deferred finance charges — Nine Mile 2 Project (Note 3)	66,726	41,304
Roseton subrogated claims (Note 3)	840	980
Miscellaneous reserves	1,942	1,962
Deferred gas refunds	305	745
Deferred electric fuel costs (Note 3)	—	5,030
Deferred electric revenues (Note 3)	—	5,394
Other	6,432	3,722
	76,245	59,137
Accumulated Deferred Income Tax (Note 4)	44,767	70,006
Commitments and Contingencies (Notes 2 and 11)	—	—
	$1,024,371	$1,157,698

The Notes to Financial Statements are an integral part hereof.

Statement of Changes in Financial Position
(Thousands of Dollars)

	Year ended December 31, 1987	1986	1985
Source of Funds			
Funds from operations:			
Net income (loss)	$(109,944)	$ 64,884	$ 59,672
Income items not requiring current outlays:			
Cumulative effect on prior years of adoption of SFAS 90	101,475	—	—
Current year effect of adoption of SFAS 90	51,919	—	—
Depreciation:			
Charged to depreciation expense	22,499	18,873	19,182
Charged to other income accounts	770	781	765
Amortization of investment in Sterling Project (Note 9)	5,664	6,021	5,067
Deferred income tax—net (Note 4)	21,845	510	10,713
Allowance for funds used during construction (Note 3)	(4,976)	(31,725)	(26,432)
Deferred electric revenues (Note 3)	(2,236)	5,394	—
Other—net	7,003	4,965	3,054
Net funds from operations	94,019	69,703	72,021
Available from outside sources:			
Mortgage bonds	—	50,000	20,000
Pollution control debt:			
Amount issued	43,600	—	72,250
Funds deposited with trustee	(43,600)	—	(72,250)
Funds withdrawn from trustee	58,088	35,668	26,245
Common stock	6,394	65,221	29,648
Short-term debt	4,000	—	—
Total funds from outside sources	68,482	150,889	75,893
Total sources of funds	$ 162,501	$220,592	$147,914
Application of Funds			
Construction and plant expenditures:			
Gross charges for construction and plant	$ 100,692	$171,182	$129,918
Less allowance for funds used during construction (Note 3)	4,976	31,725	26,432
Cash expenditures	95,716	139,457	103,486
Nine Mile 2 settlement receivable (Note 2)	—	(26,100)	—
Nine Mile 2 project completion costs	10,132	—	—
Net expenditures	105,848	113,357	103,486
Dividends:			
Preferred stock	5,593	5,614	6,184
Common stock	37,666	40,393	33,945
	43,259	46,007	40,129
Retirement of long-term debt:			
Mortgage bonds	34,900	55,000	—
Long-term promissory notes	175	175	175
	35,075	55,175	175
Net increase (decrease) in working capital *	(42,447)	(2,696)	3,555
Changes in deferred and other accounts—net	20,766	8,749	569
Total application of funds	$ 162,501	$220,592	$147,914

*Excludes short-term debt, current maturities of long-term debt and pollution control funds held by trustee.

The Notes to Financial Statements are an integral part hereof.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — WRITE-OFF OF THE DISALLOWED INVESTMENT IN THE NINE MILE 2 PLANT

As more fully discussed in Note 2, in September 1986 the New York State Public Service Commission (PSC) approved a settlement proposal (Settlement) which, among other things, limits the maximum amount of the investment in Unit No. 2 of the Nine Mile Point Nuclear Station (NMP-2) which can be included in the cotenants' rate bases to $4.16 billion. Based on the latest cost estimate for NMP-2 and the accounting and rate-making treatment ordered by the PSC in 1987 for the disallowed investment that is excluded from rate base, the Settlement has resulted in a disallowance of approximately $2.4 billion. The Company's share of the disallowance, after reflecting the applicable federal income tax benefits and a $26.1 million payment to be received from Niagara Mohawk, is currently estimated to be $169.3 million. Because NMP-2 has not yet been declared to be in commercial operation, the final amount of the NMP-2 disallowance is subject to change. The Company's earnings have been, and will be, significantly reduced as a result of the NMP-2 cost disallowance because the Company cannot earn a return on the disallowed investment.

In December 1986, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 90 "Regulated Enterprises–Accounting for Abandonments and Disallowances of Plant Costs, an amendment of FASB Statement No. 71" (SFAS 90). Among other things, the provisions of SFAS 90 require that when it becomes probable that part of the cost of a generating plant will be disallowed for rate-making purposes and a reasonable estimate of the disallowance can be made, the estimated amount of the probable disallowance shall be deducted from the reported cost of the Plant and recognized as a loss for financial reporting purposes. Also, SFAS 90 allows the capitalization of an allowance for funds used during construction (AFDC) only if it is probable that such AFDC will be included as an allowable cost for rate-making purposes. Application of SFAS 90 is required not later than the end of the first quarter of 1988.

On December 18, 1987, the Company reduced its quarterly dividend payable February 1, 1988 to $.425 per share from the previous quarterly dividend of $.74 per share, a reduction of 43%. The lower earnings resulting from the rate-making treatment of the NMP-2 disallowance, which was implemented by the PSC in its July 1987 rate order, was the primary factor contributing to the dividend reduction.

Concurrent with the dividend reduction, the Company also elected to adopt SFAS 90 during the fourth quarter of 1987 and recognize the NMP-2 disallowance for financial reporting purposes. Accordingly, the effect of the NMP-2 disallowance has been recorded in the Company's financial statements for 1987. The amount of the after-tax write-off in 1987 was $169.3 million, which amount, as stated above, is based on the current estimate of the Company's share of the disallowance. Any variance between the final amount of the disallowance and the amount recorded in 1987 will be recorded in subsequent years. This write-off has resulted in a significant loss for calendar year 1987 and has reduced the book value per share of the Company's common stock from $32.14 to $20.35, a reduction of 36.7%. In addition, the write-off reduced the amount of accumulated retained earnings from $180.8 million to $11.5 million and the common equity component of the Company's capital structure from 46.4% to 35.4%.

In accordance with the reporting requirements of SFAS 90 and generally accepted accounting principles, the total amount of the write-off is not recorded as a single item in the Statement of Income for 1987. The write-off has been recorded in the Statement of Income as follows:

	NMP-2 Write-off (Thousands of Dollars)	
Allowance for Funds used during Construction (a)		$ (15,878)
Current Year's Effect of Adoption of SFAS 90 (b):		
Disallowed Plant Costs	$(64,874)	
Related Income Tax	12,955	(51,919)
Cumulative Effect on Prior Years of Adoption of SFAS 90 (after tax) (c)		(101,475)
Total		$(169,272)

(a) Prior to the adoption of SFAS 90, generally accepted accounting principles required the Company to continue to accrue AFDC on the disallowed NMP-2 investment. As a result of adopting SFAS 90 in December 1987, the Company, in accordance with the provisions of such standard, reversed the AFDC previously accrued on the disallowed portion of the NMP-2 investment during calendar year 1987. The $15.9 million adjustment represents twelve months of such AFDC.

(b) The current year's effect of the adoption of SFAS 90 represents the difference between (i) the latest estimate of the disallowance, as adjusted for the current year's accrual of AFDC, and (ii) the net amount of the disallowance that would have been written off at December 31, 1986 if SFAS 90 had been adopted in prior years.

(c) The cumulative effect on prior years of adoption of SFAS 90 represents the estimated after-tax disallowance that would have been written off in calendar years 1985 and 1986 if SFAS 90 had been adopted in those years.

As stated above, 1987 earnings include the effect of adopting SFAS 90 and recording the write-off of the NMP-2 disallowance. These actions reduced earnings for 1987 by $11.90 per share. The write-off of the NMP-2 disallowance reduced earnings by $10.78 per share and the reversal of $15.9 million of AFDC accrued on the disallowed NMP-2 investment in calendar year 1987 reduced earnings by $1.12 per share. Earnings per share for 1987, excluding the effect of the $10.78 reduction due to the write-off of the NMP-2 disallowance, would have been $2.66 ($10.78 — $8.12).

Because the Company is reporting the effects of the NMP-2 disallowance as the cumulative effect of a change in accounting principle, it must report the pro forma effects of retroactive application. Accordingly, the pro forma amounts are presented in the following table and are based on the assumption that SFAS 90 had been in effect in 1985 and 1986:

	1987	1986	1985
Income (Loss) Available for Common Stock ($000)	$(14,062)	$13,270	$(1,512)
Income (Loss) Available per Average Share of Common Stock	$(.99)	$1.01	$(.13)

NOTE 2 — NINE MILE 2 PLANT

General: NMP-2 is located in Oswego County, New York, and is currently undergoing the pre-commercial operational power ascension testing program by the operator, Niagara Mohawk Power Corporation (Niagara Mohawk). NMP-2 is owned as tenants in common by the Company (9% interest), Niagara Mohawk (41% interest), New York State Electric & Gas Corporation (18% interest), Long Island Lighting Company (18% interest) and Rochester Gas and Electric Corporation (14% interest). The output of NMP-2, which will have a projected capability of 1,084 mw., will be shared in the same proportions as the cotenants' respective ownership interests.

Schedule: NMP-2 has been subject to schedule delays and cost estimate increases. In October 1986, the Nuclear Regulatory Commission (NRC) issued an operating license for NMP-2 which restricted operation to power levels up to five percent of rated output. Following the issuance of such license, fuel loading was accomplished and pre-operational testing leading to the power ascension program commenced at the Plant. However, as a result of leakage problems experienced in late 1986 and early 1987 with the main steam isolation valves at NMP-2, the decision was made in March 1987 to replace such valves with valves of a different design, which replacement delayed the scheduled commercial operation date from September 1987 to the beginning of 1988 (see subcaption "Main Steam Isolation Valves" below for a discussion of the problems experienced with these valves). NMP-2 began producing power during the spring of 1987. On July 2, 1987, the NRC issued a full-power license for NMP-2 which will permit operation at full-rated power upon completion of the power ascension program. On August 8, 1987, the main turbine generator was synchronized to the electric power grid. In November 1987, Niagara Mohawk informed the Company that an unplanned modification to one of the piping systems at the Plant would be required which it estimated will extend the power ascension testing program into February 1988 and delay until at least March 1988 the scheduled commercial operation date of NMP-2. As the testing and start-up of any new nuclear electric generating plant is subject to the risk of encountering unforeseen problems, no assurances can be given that further delays will not be experienced in completing the power ascension testing program and achieving commercial operation of NMP-2.

Cost: For the purpose of estimating the completion cost of NMP-2 and determining the amount of the NMP-2 disallowance to be written off against income in 1987, and in recognition that there could be a further delay in the scheduled in-service date of the Plant, the Company has assumed a commercial operation date of April 30, 1988.

Based on the assumed commercial operation date of April 30, 1988, the total cost of the Company's interest in NMP-2, including certain other plant-related costs, is estimated to be $537.9 million ($390.1 million for cash construction expenditures and $147.8 million for AFDC). As of December 31, 1987, the Company's investment in NMP-2 totaled $527.7 million ($379.9 million of cash expenditures and $147.8 million of AFDC). For a discussion of the rate-making treatment of the Company's investment in NMP-2, see the discussion under the subcaption "Rate Phase-In" below.

Cost Settlement: In July 1985, the PSC established a proceeding to determine the amount of expenditures incurred in the construction of NMP-2 which should not be allowed to be recovered through rates.

On September 10, 1986, the PSC approved a settlement proposal (Settlement) which constitutes a complete disposition of such proceeding; however, the Settlement is subject to judicial challenge. In agreeing to the Settlement, the cotenants stated that the Settlement does not in any way represent an admission of mismanagement or imprudence by any of the cotenants with respect to their actions related to the design, engineering or construction of NMP-2. The PSC's order approving the Settlement was issued on October 3, 1986 and includes the following key terms and conditions:

The maximum amount of NMP-2 expenditures to be included in the cotenants' rate bases would be $4.16 billion. The allowable expenditures of $4.16 billion would be reduced to reflect reduced

AFDC accruals resulting from the inclusion of NMP-2 construction work in progress (CWIP) in rate base. Expenditures that are disallowed would be allocated among the cotenants in proportion to their respective ownership interests.

The cotenants could request from the PSC an upward adjustment of the $4.16 billion limitation based only on the occurrence of an "extraordinary event." The cotenants stipulated at the time of their approval of the Settlement that they were not aware of any basis for such a claim.

Income tax deductions and credits applicable to NMP-2's total estimated completion cost would be allocated apportionately to the disallowed costs and reserved for shareholders.

Each cotenant would waive any and all claims it may have against any other cotenant concerning the design, engineering or construction of NMP-2.

In order to induce the other cotenants to accept the Settlement, Niagara Mohawk entered into an agreement, dated July 15, 1986, with the other cotenants whereby it would reimburse the other cotenants, upon commercial operation of NMP-2, for a portion of the cost disallowance in excess of $4.16 billion; the Company's share of which will be $26.1 million. This payment will not cause a reallocation of ownership interests in NMP-2. The PSC's October 3, 1986 order referred to above reflects such agreement.

Furthermore, as part of a Niagara Mohawk rate proceeding in 1987, the PSC reached the following determinations regarding the implementation of the Settlement: (i) the costs of certain common facilities and other items not considered by the NMP-2 cotenants to be subject to the Settlement will be disallowed, (ii) the after-tax disallowance will be determined at a 34% federal corporate tax rate and not at the 46% rate construed by the cotenants, (iii) the tax benefits will be valued at present value in determining the after-tax disallowance and not at nominal value as provided for under generally accepted accounting principles, (iv) the tax benefits reserved to the NMP-2 cotenants will not be included in rate base and (v) the disallowance will be taken wholly against the common equity account for rate-making purposes. This implementation of the Settlement has the effect of increasing the amount of the after-tax disallowance beyond that previously determined by the Company and of reducing the common equity account and rate base upon which rates are established.

The Company believes that the implementation requirements ordered by the PSC are contrary to the terms and intent of the Settlement. On July 10, 1987, the Company, together with the other NMP-2 cotenants, commenced a judicial proceeding in the Supreme Court of the State of New York, Albany County, pursuant to Article 78 of the Civil Practice Law and Rules (CPLR) challenging the Commission's accounting and rate-making implementation of the Settlement and seeking an order of the court directing the PSC: (i) to allow the cotenants to recover through rates certain costs improperly included by the PSC in the amounts not recoverable under the Settlement, (ii) to deduct the cost disallowance under the Settlement ratably against capitalization for rate-making purposes and not exclusively against common equity, (iii) to calculate the after-tax disallowance at a 46% tax rate, (iv) to value nominally the tax benefits reserved for the cotenants' shareholders, and (v) to include such tax benefits in rate base. The Company is unable to predict the results of such action.

Based on the total cost of the Company's interest in NMP-2 set forth under the subcaption "Cost" above, which assumes a commercial operation date of April 30, 1988, the Company's share of the Settlement disallowance, after adjusting for the $26.1 million payment from Niagara Mohawk, will be approximately $206.6 million, the after-tax effect of which is estimated to be approximately $171.2 million under the PSC's implementation of the Settlement at a 34% tax rate. In its order of July 2, 1987 with respect to the Company's rate proceeding (discussed under the subcaption "Rate Phase-In" below), the PSC determined that the Company's disallowance under the Settlement should be increased by approximately $9.2 million representing reduced AFDC accruals on NMP-2 CWIP included in the Company's rate base prior to January 1, 1985. As a consequence of this determination, the Company's net disallowance, after taxes, for rate-making purposes is estimated to be approximately $180.4 million.

The Company's share of the disallowance would be increased by any event (other than an "extraordinary event" under the Settlement) which caused its share of the cost of NMP-2 to exceed the amount set forth under the subcaption "Cost" above, or by any additional costs the PSC might allocate to the disallowance. While the Company believes that the estimate of its share of the cost of NMP-2 and estimate of the disallowance are reasonable based on current knowledge, given the uncertainties to which a nuclear electric generating plant in the start-up testing mode is subject and given the inability to predict what actions, if any, the PSC might take with respect to allocating additional costs to the disallowance, no assurances can be provided that events will not occur subsequently which could result in increases in the Company's share of the cost of NMP-2 or in the Company's share of the disallowance.

Any delay in achieving the commercial operation of NMP-2 beyond the April 30, 1988 date, assumed in estimating the Company's share of the disallowance, would increase the Company's after-tax share of the disallowance by approximately $3 million a month.

Several intervening parties petitioned the PSC for rehearing of the Settlement and such petitions were denied. By Petition dated April 15, 1987, the State Consumer Protection Board (CPB), the Attorney General and an Assemblyman from a district served by the Company commenced a proceeding in the Supreme Court of the State of New York, Albany County, under Article 78 of the CPLR alleging that the $4.16 billion of

expenditures in NMP-2 which the Settlement allows to be recovered through rates greatly exceeds the prudently incurred costs which should be accorded rate recovery, and that the PSC's approval of the Settlement is affected by an error of law, is arbitrary and capricious, is an abuse of discretion, and is not based on substantial evidence. Such parties request the court to direct the PSC to conduct full evidentiary proceedings into the amount of costs in NMP-2 which were prudently incurred.

The Company considers these parties' Petition to be without merit and will oppose the relief sought by such parties. However, should the relief sought be granted, the Company can make no prediction as to whether the PSC, as a result of such remanded proceeding, might find that the prudently incurred costs of NMP-2 should be less than $4.16 billion.

Certain Financial Effects:

Earnings: The Company's earnings have been, and will be, significantly reduced as a result of the cost disallowance under the Settlement because the Company is not allowed to earn a return on the after-tax amount of such disallowed investment. The specific effect of the disallowance on future earnings for a given period will be a function of the final amount of the disallowance, the final rate-making treatment for the disallowance and the authorized rate of return on common equity at that time. As reported under the subcaption "Rate Phase-In" below, the effect of the disallowance for rate-making purposes was reflected in the PSC's rate order issued in July 1987. Consequently, the adverse effect on earnings started on July 25, 1987, when the new rates became effective.

Dividends: On December 18, 1987, the Company declared a quarterly dividend on its common stock of $.425 per share payable on February 1, 1988. The quarterly dividend is a decrease of $.315, or 43%, from the previous quarterly dividend of $.74 per share. The indicated annual dividend rate is now $1.70 per share, compared to the previous annual dividend rate of $2.96 per share.

The dividend reduction was made necessary principally by the disallowance for rate-making purposes of a portion of the Company's investment in NMP-2. Based on the latest estimate of the disallowance, the rate-making treatment ordered by the PSC for such disallowance and the overall rate of return authorized in the Company's July 1987 rate order, projected earnings were not adequate to support the continuation of the $.74 dividend rate. In addition, the recording of the NMP-2 disallowance for financial reporting purposes reduced the amount of accumulated retained earnings available for the payment of dividends.

Although the final amount of the NMP-2 disallowance is still unknown, the Company believes the new quarterly dividend rate of $.425 is sustainable, barring unforeseen problems. In all events, the Board of Directors will continue to consider the declaration of dividends based on all the facts and circumstances at the time of consideration.

Pursuant to applicable statutes and its Certificate of Incorporation, the Company may pay dividends on shares of preferred and common stock only out of surplus. The Company's surplus consists of (i) retained earnings of $11.5 million as of December 31, 1987, of which amount $8.4 million is restricted under the Company's 4.85% Promissory Notes with regard to payment of dividends on common stock (See "Common Stock Dividends and Price Ranges" below), and (ii) capital surplus of $50 million, representing stated capital which was transferred by the Company's Board of Directors to capital surplus pursuant to Section 516 of the Business Corporation Law as at September 30, 1987. While it is not the Company's present intention to pay dividends out of sources other than retained earnings, the aforementioned transfer of stated capital to capital surplus will provide the Company with additional flexibility with respect to future dividend payments, subject to compliance with applicable regulatory requirements. If the Company were unable to pay preferred stock dividends for a period of one year, the holders of all such stock would have the right to elect a majority of the Board of Directors of the Company so long as any such dividends remain unpaid.

Financial Reporting: Pursuant to generally accepted accounting principles, the amount of the disallowance to be recorded for financial reporting purposes does not include the effect of valuing the tax benefits on a present value basis. Accordingly, the after-tax effect of the disallowance which is currently estimated to be $180.4 million for rate-making purposes is $169.3 million for financial reporting purposes.

See Note 1 for a discussion of the write-off for financial reporting purposes in 1987 of the Company's disallowed investment in NMP-2.

Rate Phase-In: On July 17, 1986, the PSC issued an order (1986 Order) approving new electric rates for the Company. In such Order, the PSC approved the rate-making principles for the phased inclusion in rates of the prudently incurred investment and operating expenses associated with the Company's interest in NMP-2. Pursuant to the 1986 Order, the PSC authorized the inclusion in the Company's rate base of $222.4 million of the Company's investment in NMP-2 and $3.6 million of investment in related facilities. The 1986 Order did not reflect either the Settlement or the delays in the commercial operation date of NMP-2 described above under the subcaptions "Cost Settlement" and "Schedule."

On July 2, 1987, the PSC issued another order (1987 Order) regarding the electric rates of the Company. The 1987 Order implements the Settlement with respect to establishing the Company's electric rates. For rate-making purposes in the 1987 Order, the PSC assumed a commercial operation date for NMP-2 of

February 15, 1988; should the commercial operation date vary from that date, the 1987 Order authorizes deferral accounting for any difference resulting from such variation. In addition to the $226 million of the Company's investment in NMP-2 and associated facilities included in rate base by the 1986 Order, the 1987 Order includes an additional $74.6 million of such investment in rate base. The total investment of $300.6 million included in rate base constituted all of the Company's allowable investment in NMP-2 after reflecting implementation of the Settlement, based on the February 15, 1988 commercial operation date assumed by the PSC. Based on the commercial operation date of April 30, 1988, assumed for purposes of estimating the Company's share of the NMP-2 disallowance above, the Company's allowable investment in NMP-2 for rate-making purposes would be $296.0 million.

The 1987 Order authorizes a 13.4% return on common equity for the Company and a 10.36% overall return on invested capital. However, as a result of the PSC determination to deny rate base recognition for the tax benefits associated with the disallowance under the Settlement, the Company is afforded the opportunity under the 1987 Order to earn only a 12.5% return on common equity and a 10.03% overall return on invested capital.

By petition dated February 23, 1987, an Assemblyman from a district served by the Company commenced a proceeding in the Supreme Court of the State of New York, Albany County, under Article 78 of the CPLR challenging the PSC's determination in the 1986 Order that the Company is entitled to recover its prudently incurred investment in NMP-2 through rates. The Assemblyman argues that NMP-2 constitutes uneconomical capacity because the cost of electricity from such Plant exceeds the cost of electricity from alternative sources of generation and alleges that, by allowing the Company to recover its prudently incurred investment in NMP-2 through rates and by not adopting rate-making based on the value of power from alternative sources of generation, the PSC acted in derogation of its statutory and constitutional obligations to establish just and reasonable rates which appropriately balance the interests of the ratepayers and investors. The Assemblyman asks that the PSC's 1986 Order be annulled. The Company considers the Assemblyman's petition to lack merit and will oppose it.

By motion dated December 31, 1987, the Assemblyman requested the Appellate Division, Third Department, to permit him to file his brief and appendix past the period established by such Court's rules. No prediction can be made as to whether said Appellate Division will grant the Assemblyman permission to file his brief and appendix past the period established by its rules, or, if such permission is granted, what action the Court may ultimately take with respect to this matter. However, should the relief sought by the Assemblyman be ultimately granted, the Company's earnings could be materially adversely affected.

By petition dated November 12, 1986, the CPB commenced a CPLR Article 78 proceeding challenging the 1986 Order on grounds similar to those of the Assemblyman discussed above. The CPB has allowed the time in which to file its brief and appendix to pass without seeking permission from the Appellate Division, Third Department, to file such documents beyond the period in the Court's rules.

Main Steam Isolation Valves: The design for NMP-2 provides for eight main steam isolation valves (MSIVs). The MSIVs originally installed at NMP-2 were designed and fabricated by Gulf + Western, Inc., Crosby Valve & Gage Company and Wickes Manufacturing Company. Leakage problems experienced with such MSIVs during the summer of 1986 caused a delay in the commencement of the fuel loading of NMP-2 from July to November 1986. In December 1986, problems were again experienced with such MSIVs. Following assessment and attempted repairs to such MSIVs and testing of a proto-type valve in early 1987, Niagara Mohawk decided that it was unable to demonstrate the ability of such MSIVs to meet the specifications and regulations of the NRC and the decision was made in March 1987 to replace such MSIVs with valves of a different design. Such replacement was subsequently completed and Niagara Mohawk has advised the Company that the replacement valves have successfully completed preoperational tests. The replacement of the MSIVs resulted in delaying the scheduled commercial operation date of NMP-2 from September 1987 to the beginning of 1988.

On April 17, 1987, the Company and the other cotenants filed a complaint commencing an action in the Supreme Court of the State of New York, Onondaga County, against Gulf + Western, Inc., Crosby Valve & Gage Company and Wickes Manufacturing Company with respect to the problems encountered with the MSIVs designed and fabricated by them. In their complaint, the cotenants allege, among other things, that the MSIVs failed to perform in accordance with the terms of the contract entered into for their design, fabrication and delivery and seek damages of approximately $500 million from the defendants. The Company cannot predict whether the action will be successful or the amount of damages, if any, which may be recovered.

Nuclear Regulatory Commission and Licensing: As discussed under the subcaption "Schedule" above, on July 2, 1987, the NRC issued a full-power license which will permit NMP-2 to operate at full-rated power upon completion of the power ascension program.

The Federal Emergency Management Agency approved an Emergency Response Plan on February 1, 1985, for the Nine Mile Point complex which includes two other nuclear plants which are currently operating. Such plan encompasses all emergency preparedness activities, including the Emergency Notification

System, for the complex. Subject to certain testing, NMP-2 will come under such plan when it begins operation. Niagara Mohawk has informed the Company that it has received substantial cooperation from local authorities in connection with the continuing development of such plan.

Credit Ratings: As a result of the problems with the MSIVs, concerns over delays caused by these problems, the adverse consequences of such delays on the amount of the disallowance and the perception of a deteriorating regulatory climate in New York State, on February 9, 1987, Moody's Investors Service, Inc. reduced its rating of the Company's first mortgage bonds from A3 to Baa1 and of its preferred stock from baa1 to baa2; on March 9, 1987, Duff & Phelps Inc. reduced its rating of the Company's first mortgage bonds from #7 (Low A) to #8 (High BBB) and of its preferred stock from #8 (High BBB) to #10 (Low BBB); and on March 10, 1987, Standard & Poor's Corporation reduced its rating of the Company's first mortgage bonds from A- to BBB+ and of its preferred stock from A- to BBB.

Other: It is possible that commencement of commercial operation of NMP-2, consistent with its present schedule and cost estimate, could be adversely affected by a wide variety of factors, including current national controversy over nuclear power. If governmental restrictions or prohibitions as to the use of nuclear power develop which affect NMP-2, the remainder of the Company's 9% investment in such Plant may have to be written off, net of the effect of federal income taxes. Based on prior PSC determinations and policies, the Company believes that it would be authorized to amortize its prudently incurred investment in such Plant against income and to recover such investment and related carrying costs through rates over a period of years. However, the Company can give no assurances that it would be authorized to recover such investment through rates and, to the extent not recovered through rates, earnings available for the Company's Common Stock would be adversely affected and the Company's ability to pay dividends could be adversely affected.

If NMP-2 were to be abandoned, the Company would need to replace the lost capacity from such Plant in the 1991-1994 time period, based on current projections of the electric needs of its customers.

If NMP-2, once operational, were to experience any extensive periods in which it were out of service, any such outage could have a material adverse effect on the financial condition of the Company.

NOTE 3 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General: The Company is subject to regulation by the PSC and the Federal Energy Regulatory Commission (FERC) 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 in the case of regulated public utilities and are in accordance with the accounting requirements and rate-making practices of the regulatory authorities having jurisdiction.

Utility Plant: The costs of additions to utility plant and replacements of retirement units of property are capitalized at original cost. Costs include labor, materials and supplies, indirect charges for such items as transportation, certain taxes, pension and other employee benefits, and an allowance for the cost of funds used during construction. Replacement of minor items of property is included in maintenance expenses.

The original cost of property, together with removal cost, less salvage, is charged to accumulated depreciation at such time as the property is retired and removed from service.

Allowance for Funds used During Construction: The Company includes in plant costs AFDC approximately equivalent to the cost of funds used to finance construction expenditures. The concurrent credit for the amount so capitalized is reported in the Statement of Income as follows: the portion applicable to borrowed funds is reported as a reduction of interest charges while the portion applicable to other funds (the equity component) is reported as other income. AFDC is not considered a current source of funds and therefore is not included as such in the Statement of Changes in Financial Position.

Effective July 18, 1981, pursuant to PSC authorization, the Company began accruing AFDC on its investment in NMP-2 on a net-of-tax basis. This change in method results in a lower AFDC rate and a reduction in the amount of AFDC accrued. This reduction in AFDC, however, is offset by increased cash income generated by the deferral of the tax effect of the interest component of AFDC, and reduces NMP-2 plant costs for future rate base and depreciation cost of service purposes.

Since October 1982, the PSC has authorized the inclusion in rate base of increasing amounts of the Company's investment in NMP-2. The Company does not accrue AFDC on any NMP-2 CWIP which has been included in rate base and for which a cash return is being allowed; however, the PSC ordered, effective January 1, 1983, that amounts be accumulated in deferred debit and credit accounts equal to the amount of AFDC which is no longer being accrued on the CWIP included in rate base. The balance in the deferred credit account will be available to reduce future revenue requirements over a period substantially shorter than the life of NMP-2, while the balance in the deferred debit account will be recovered through amortization over the life of the Plant. The net effect of this procedure is that at the end of the amortization period for

the deferred credit, the accounting and rate-making treatment will be the same as if NMP-2 CWIP had not been included in rate base during the construction period.

Depreciation and Amortization: For financial statement purposes, the Company's depreciation provisions are computed on the straight-line method using rates based on studies of the estimated useful lives and estimated net salvage of properties. The provision for depreciation of transportation equipment is charged indirectly to various asset and expense accounts, while the depreciation provision for certain properties included in the account "Plant Held for Future Use" is charged to "Other Income Deductions" for accounting purposes.

For federal income tax purposes, the Company uses an accelerated method of depreciation and generally uses the shortest life permitted for each class of assets.

Effective October 22, 1982, the Company began recovering its investment in the cancelled Sterling Project through rates. The amortization and recovery of this investment will be complete in July 1988, and is reported on the Statement of Income as "Depreciation and Amortization." For additional information see Note 9.

Rates and Revenues: Electric and gas retail rates applicable to intrastate service (other than contractually established rates for service to municipalities and governmental bodies) are regulated by the PSC. Transmission rates and rates for electricity sold for resale in interstate commerce are regulated by the FERC.

Revenues are recognized on the basis of cycle billings rendered monthly or bimonthly. Estimated revenues are accrued for those bimonthly customers whose meters are not read in the current month.

The Company's tariff for retail electric service includes a fuel cost adjustment clause pursuant to which electric rates are adjusted to reflect changes in the average cost of fuels used for electric generation and in certain purchased power costs from the average of such costs included in base rates. The Company's tariff for gas service contains a comparable clause to adjust gas rates for changes in the price of purchased natural gas and in certain costs of manufactured gas.

Deferred Electric Revenues: On occasion, revenues which are billed over a twelve-month rate year are designed to cover specific expenses which are projected to be incurred during the latter part of the rate year. Although there will be a matching of revenues and costs in the rate year there can be a mismatching of revenues and costs within calendar years. When the amount of the projected mismatch is material, the Company will petition the PSC to defer any revenues collected prior to the time the associated expenses are incurred and to restore such deferred revenues at the time the expenses are incurred. Such deferred accounting provides a better matching of revenues and costs during calendar years.

Deferred Electric Fuel Costs: The provisions of the electric fuel cost adjustment clause are such that changes in fuel costs incurred in the current month are not billed or credited to customers until subsequent months. Therefore, in order to match costs and revenues, the Company defers that portion of such costs incurred in the current month which will result in a cost adjustment in subsequent months.

Effective with the May 1985 customer billings, the PSC adopted a revision to the Company's electric fuel adjustment clause which provides for a partial sharing of variations in fuel costs from the levels of fuel costs projected in the rate proceeding. The Company bears 20% of the first $10 million of variation and 10% of the second $10 million of variation. The partial sharing applies to variations in actual fuel cost either above or below the projected levels; accordingly, the Company's maximum annual exposure, or benefit, is $3 million, before taxes.

As a result of the adoption of the partial sharing electric fuel adjustment clause, the PSC adopted a symmetrical sharing arrangement for net revenues from sales to other utilities. Shortfalls below the imputed amount, as well as amounts above the imputed amount, will be shared 80% by the customers and 20% by the Company.

Deferred Gas Costs: In accordance with requirements applicable to regulated gas utilities in the State, the Company defers each month any difference between the amount of gas costs incurred which is recoverable through the gas adjustment clause (GAC) and GAC revenues. The net deferral remaining at August 31 of each year is amortized over a subsequent twelve-month period for both billing and accounting purposes.

Investments in Subsidiaries: The subsidiaries are wholly owned landholding, gas exploration, cogeneration and energy management companies, and are not consolidated for financial reporting purposes since their assets, liabilities and operations are not significant in relation to those of the Company. The Company uses the equity method of accounting for its investment in these subsidiaries.

Roseton Plant Litigation Settlement: During 1983, the Company and the other two co-owners of the Roseton Generating Plant reached a settlement to recover damages for alleged negligence in the design and construction of the Plant by certain contractors. The $5.5 million amount recorded at December 31, 1987 in Deferred Charges represents the Company's 35% interest in the remaining balance of the $26.3 million settlement to be received over a ten-year period that commenced in 1984. The Company is also obligated to pay $1.3 million as its share of the claims

of the subrogated insurers who reimbursed the Roseton cotenants for costs incurred to repair the steam generator. Such amounts are being paid over a nine-year period that commenced in 1985 and are recorded as a deferred liability. The Company's interest in the net amount of the cash settlement was credited to the electric utility plant accounts as an offset to the additional costs which were incurred as a result of the boiler implosion.

NOTE 4 — FEDERAL INCOME TAX

General: The Company's general policy with respect to accounting for the federal income tax is to reflect in income the estimated amount of income tax currently payable and to provide for deferred taxes on timing differences between book and taxable income to the extent permitted for rate-making purposes.

Depreciation: In computing depreciation for federal income tax purposes for years subsequent to 1980, the Company used the Accelerated Cost Recovery System (ACRS) as prescribed in the Economic Recovery Tax Act of 1981 (ERTA); however, commencing in 1987 the Company has complied with the changes to ACRS required by the Tax Reform Act of 1986 (TRA-86).

Investment Tax Credit: TRA-86 repealed the investment tax credit for property additions placed in service after December 31, 1985, except for property additions covered by the transitional rules. The Company's investment in NMP-2, as well as certain other property additions, meets these transitional rules and therefore the related investment tax credit for these projects continued to reduce federal income taxes in 1987.

With respect to periods preceding TRA-86, the additional investment tax credit which resulted from increasing the rate of such credit from 4% to 10%, as provided by the Tax Reduction Act of 1976, was deferred and is being amortized over the life of the related property in accordance with a Statement of Policy of the PSC. Effective July 18, 1981, the Company was authorized by the PSC to defer the full 10% investment tax credit associated with the Company's participation in NMP-2 to be subsequently amortized over a period yet to be determined. The Company commenced full deferral of its investment tax credit on October 22, 1982, pursuant to PSC authorization and in accordance with ERTA.

Deferred Income Tax: A summary of the amounts deferred or credited to income is as follows:

	Amounts Deferred			Amounts Credited		
	1987	1986	1985	1987	1986	1985
	(Thousands of Dollars)					
Operating Income:						
Tax effect of Danskammer coal reconversion	$ 7,619	$ —	$ —	$ 151	$ —	$ —
NMP-2 tax depreciation	5,807	—	—	64	—	—
Accelerated cost recovery system	2,463	2,636	2,010	235	140	68
Redemption of mortgage bonds	79	1,756	—	234	78	—
NMP-2 property tax	1,294	1,483	1,007	—	—	—
Class life depreciation	1,176	1,363	1,363	49	107	128
Deferred electric construction overheads	—	1,304	1,459	150	109	74
Investment tax credit	5,418	(913)	8,123	—	—	—
MTA tax surcharge	723	865	909	953	842	693
Cost of removal	480	558	477	450	443	478
Sterling cancellation charges	42	29	354	1,701	1,767	1,437
Deferred fuel and gas costs	(2,788)	4	727	(1,749)	2,072	2,235
Deferred revenues—Danskammer coal reconversion	1,869	—	—	497	1,372	—
Deferred revenues—NMP-2	—	—	—	2,296	1,109	—
Other	2,688	1,096	895	3,395	850	897
	26,870	10,181	17,324	8,426	8,889	6,010
Other Income:						
Current year tax depreciation benefit—NMP-2	3,298	—	—	—	—	—
Investment tax credit	—	—	—	424	396	332
Preferred stock dividend	352	162	56	80	487	325
Variable rate pollution control notes	298	—	—	43	61	—
	3,948	162	56	547	944	657
NMP-2 Disallowance:						
Current year effect of adoption of SFAS 90	11,873	—	—	12,955	—	—
Cumulative effect on prior years of adoption of SFAS 90	—	—	—	45,431	—	—
	11,873	—	—	58,386	—	—
Total	$42,691	$10,343	$17,380	$67,359	$9,833	$6,667

Reconciliation: The following is a reconciliation of the difference between the amount of federal income tax as reported in the Statement of Income and the amount computed by multiplying the income before tax by the statutory tax rate.

	1987		1986		1985	
	Amount ($000)	% of Pretax Income	Amount ($000)	% of Pretax Income	Amount ($000)	% of Pretax Income
Net income (loss)	$(109,944)		$ 64,884		$ 59,672	
Federal income tax	9,702		32,254		20,799	
Deferred income tax—net	(24,668)		510		10,713	
Income (loss) before tax	$(124,910)		$ 97,648		$ 91,184	
Computed tax expense	$ (49,964)	(40.0)%	$ 44,918	46.0%	$ 41,945	46.0%
Increases (reductions) in computed taxes resulting from:						
NMP-2 disallowance	79,963	64.0	—	—	—	—
AFDC	(1,998)	(1.6)	(14,604)	(15.0)	(12,159)	(13.3)
Sterling cancellation charges	2,250	1.8	2,745	2.8	1,979	2.2
Deferred fuel and gas costs—net	(838)	(0.6)	2,068	2.1	1,507	1.7
Excess tax depreciation	(11,963)	(9.6)	(1,584)	(1.6)	(738)	(0.8)
Taxes, pension and insurance costs expensed on tax return and capitalized on books	—	—	(1,546)	(1.5)	(1,437)	(1.6)
Investment tax credit	(3,692)	(3.0)	913	0.9	(8,350)	(9.2)
Cost of removal	(599)	(0.5)	(656)	(0.7)	(627)	(0.7)
Other deferred costs	(1,624)	(1.3)	(341)	(0.3)	(682)	(0.8)
MTA tax surcharge	101	0.1	(14)	—	(206)	(0.2)
Miscellaneous items—net	(1,934)	(1.5)	355	0.4	(433)	(0.5)
Federal income tax	9,702	7.8	32,254	33.1	20,799	22.8
Deferred income tax—net	(24,668)	(19.8)	510	.5	10,713	11.8
Total	$ (14,966)	(12.0)%	$ 32,764	33.6%	$ 31,512	34.6%

Tax Difference Not Deferred: Based primarily on a comparison of the net utility plant investment and the remaining tax basis of such properties, it is estimated that the cumulative net amount of income tax timing differences for which deferred income taxes have not been provided is approximately $290 million at December 31, 1987. Inasmuch as the total consists mainly of depreciation and other plant-related differences, it is expected that the net reversals of such tax-timing items would occur over an extended period of years and would result in cost of service increases to reflect any additional annual income taxes then payable.

Statement of Financial Accounting Standards No. 96: In December 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96 (SFAS 96) entitled "Accounting for Income Taxes." This Statement, among other things, requires a company to adjust its deferred tax assets and liabilities to reflect the effect of changes in tax laws and rates. The required implementation period is calendar year 1989, although earlier application is encouraged.

To date, the Company has not completely analyzed the effect that SFAS 96 will have on its results of operations or when it will implement the requirements thereof. It believes, however, that the adjustment required for a majority of its deferred tax assets and liabilities would have no immediate effect on the Company's results of operations,but instead would

require a refund to customers over a period of time to be determined by the PSC. Such refund would represent the excess deferred federal income tax credits that result from the reduction of the statutory corporate income tax rate from 46% to 34%.

NOTE 5 — SHORT-TERM BORROWING ARRANGEMENTS AND COMPENSATING BALANCES

Effective December 14, 1983, the Company entered into a revolving credit/term loan facility with five commercial banks. The revolving credit agreement is for a period of seven years, at the end of which the Company has the option to convert the revolving credit agreement to a three-year term loan. The revolving credit agreement provides for borrowing up to $70 million and gives the Company the option of borrowing at either the prime rate, or two other money market rates if such rates are lower. Such agreement also provides for the payment of annual commitment fees on the unborrowed amount. Compensating balances are not required under the revolving credit agreement. In addition, the Company continues to maintain confirmed lines of credit totaling $2 million with three local banks.

The amount of outstanding short-term debt at December 31, 1987 was $4 million, consisting of commercial paper. There was no short-term debt outstanding at December 31, 1986. All commercial paper obligations are supported by the credit agreements maintained with the banks.

NOTE 6 — CAPITALIZATION — CAPITAL STOCK

Common Stock without par value; 30,000,000 shares authorized:

	Shares Outstanding	Amount ($000)
December 31, 1984	11,007,135	$184,816
Issued through public offering	750,000	21,210
Issued under dividend reinvestment program	268,107	7,104
Issued under customer stock purchase plan	41,258	1,121
Issued under PAYSOP	8,265	213
December 31, 1985	12,074,765	214,464
Issued through public offering	1,800,000	57,686
Issued under dividend reinvestment program	194,109	6,273
Issued under customer stock purchase plan	30,723	1,034
Issued under PAYSOP	6,253	228
December 31, 1986	14,105,850	279,685
Issued under dividend reinvestment program	243,375	6,149
Issued under PAYSOP	10,330	245
Transferred to paid-in capital	—	(50,000)
December 31, 1987	14,359,555	$236,079

Cumulative Preferred Stock, $100 par value; 1,200,000 shares authorized:

	Series	Redemption Price Current	Redemption Price Through	Redemption Price Eventual Minimum	Shares Outstanding December 31, 1987 and 1986
Without Sinking Fund:					
	4½%	$107.00	—	$107.00	70,300
	4.75%	106.75	—	106.75	20,000
	4.35%	102.00	—	102.00	60,000
	4.96%	101.00	—	101.00	60,000
	7.72%	101.00	—	101.00	130,000
	7.44%	104.94	1/31/88	101.22	120,000
	8.40%	102.80	5/31/92	101.00	150,000
					610,300
With Sinking Fund:					
	A	—	—	100.00	200,000
Total					810,300

The cumulative preferred stock, without sinking fund, is redeemable only at the option of the Company and the sum payable per share is the then current redemption price plus accrued dividends thereon. In the event of involuntary liquidation, the redemption price is $100 per share plus accrued dividends.

The cumulative preferred stock with sinking fund is not redeemable at the option of the Company prior to April 1, 1988. A sinking fund provides for the annual retirement of 8,000 shares, at $100 per share plus accrued dividends, on each March 30, commencing March 30, 1993. The dividend to be paid will be adjusted each quarter and will be declared at a rate which is 1% per annum below the highest of three specific Treasury rates. The rate will never be less than 6% or greater than 12.5% per annum. The adjusted rates applied for each quarter of 1987 ranged between 6.28% and 8.72%, compared with the range of 6.48% to 8.96% experienced during 1986 and 9.52% to 11.12% during 1985.

Expenses incurred on issuance of capital stock are accumulated and reported as a reduction in total capital stock and are not being amortized.

Paid-In Capital: On September 25, 1987, the Board of Directors approved, pursuant to Section 516 of the New York Business Corporation Law, the transfer of $50 million from stated capital to capital surplus (paid-in capital) as of September 30, 1987. The amount so transferred from stated capital to capital surplus will be subsequently available for the payment of dividends on common and preferred stock, subject to compliance with applicable regulatory requirements. It is not the present intention of the Company to use such capital surplus for the payment of dividends; however, the transfer so approved by the Board of Directors will provide the Company with additional flexibility with respect to dividend payments in the future.

NOTE 7 — CAPITALIZATION — LONG-TERM DEBT

Details of long-term debt are shown below:

Series	Maturity Date	December 31, 1987	December 31, 1986
		(Thousands of Dollars)	
First Mortgage Bonds:			
4⅛%	May 15, 1988	$ —	$ 18,000
14½%	November 15, 1990	—	25,000
13 %	December 4, 1992	35,000	35,000
14⅝%	June 12, 1994	45,000	45,000
8⅛%	September 1, 1994	50,000	50,000
11 %	July 2, 1995	20,000	20,000
7⅛%	January 15, 1999	20,000	20,000
9⅜%	June 1, 2000	25,000	25,000
7¾%	February 1, 2002	20,000	20,000
9¼%	April 15, 2004	15,000	15,000
10⅝%	November 1, 2005	20,000	20,000
6¼%	June 1, 2007	4,500	4,500
10¾%	September 15, 2009	20,000	20,000
11¼%	September 1, 2012	—	9,900
		274,500	327,400
Promissory Notes issued in connection with the sale by New York State Energy Research and Development Authority of tax-exempt pollution control revenue bonds:			
1984 Series A	October 1, 2014	16,700	16,700
1984 Series B	October 1, 2014	16,700	16,700
1985 Series A	November 1, 2020	36,250	36,250
1985 Series B	November 1, 2020	36,000	36,000
1987 Series A	June 1, 2027	33,700	—
1987 Series B	June 1, 2027	9,900	—
		149,250	105,650
Promissory Notes (net of sinking fund requirements):			
4.85%	December 1, 1995	6,500	6,675
	Total long-term debt	$430,250	$439,725

On September 1, 1987, the 11 1/4% Series First Mortgage Bonds, due September 1, 2012, were called for redemption and on November 15, 1987, the 14 1/2% Series First Mortgage Bonds, due November 15, 1990, were called for redemption.

The pollution control bonds, Series A and B, issued in 1984, bear interest at 7 1/2% per annum through September 30, 1989. Thereafter, the bonds will be subject to repricing and investor tender on each October 1, commencing October 1, 1989. The Company has a one-time option for each series to convert to a long-term fixed rate at any annual tender date.

The pollution control bonds, Series A and B, issued in 1985 are variable rate obligations subject to weekly repricing and investor tender. The Company has a one-time option for each series to convert to a long-term fixed rate. The pollution control bonds, Series A and B, issued in 1987 are also variable rate obligations subject to weekly repricing and investor tender. The Company has a one-time option for each series to convert to a long-term fixed rate.

In its 1987 rate orders, the PSC allowed recovery of interest cost on the 1985 and 1987 Series variable rate obligations at the rate of 3.7% for the electric department and 4.0% for the gas department and deferral of any variation above or below these rates for future rate treatment. During 1987, such rates ranged from 3.875% to 6.25% for the 1985 Series, from 4.025% to 6.15% for the 1987 Series A and from 3.75% to 5.75% for the 1987 Series B.

Expenses incurred on debt issues and any discount or premium on debt are deferred and amortized over the lives of the related issues.

NOTE 8 — POST EMPLOYMENT BENEFITS

Retirement Income Plan: The Company has a non-contributory retirement income plan (Plan) covering substantially all of its employees. The Plan provides pension benefits that are based on the employee's compensation and years of service. It has been the Company's practice to provide periodic updates to the benefit formula stated in the Plan.

Effective January 1, 1987, the Company implemented Statement of Financial Accounting Standards No. 87 "Employers' Accounting for Pensions" (SFAS 87). The Company's funding policy, since such implementation, is to make annual contributions equal to the amount of net periodic pension cost, but not less than the minimum requirement under ERISA. The 1987 pension cost, calculated in accordance with SFAS 87, is $3,017,000. The effect of this change was a reduction of pension cost in 1987 of approximately $780,000. The 1987 cost represents a decrease of 25.5% from the 1986 pension cost of $4,048,000 and 26.4% from the 1985 pension cost of $4,100,000. Approximately 71% of the cost for the year 1985, 70% for the year 1986 and 70% for the year 1987 were charged to expense. Pension costs for 1986 and 1985 have not been restated and, accordingly, are not directly comparable with expenses for 1987.

Net periodic pension cost for 1987 includes the following components (in thousands):

Service cost—benefits earned during the period	$ 3,336
Interest cost on projected benefit obligation	8,204
Actual return on plan assets	(28,369)
Net amortization and deferral	19,846
Net periodic pension cost	$ 3,017

The following table sets forth the Plan's funded status at September 30, 1987 (in thousands):

Actuarial present value of benefit obligations:	
Accumulated benefit obligation, including vested benefits of $91,063	$ 92,144
Projected benefit obligation for service rendered to date	$119,574
Plan assets at market value (a)	148,589
Excess of plan assets over projected benefit obligation	29,015
Unrecognized net (gain) loss	(20,715)
Prior service cost not yet recognized in net periodic pension cost	—
Unrecognized net asset being amortized over 15.25 years	(9,054)
Amount contributed to Plan during fourth quarter of 1987	754
Prepaid pension cost (pension liability) recognized in the Balance Sheet	$ —

(a) At the valuation date, approximately 95% of the Plan's assets were invested in listed stocks and bonds. The remainder was invested primarily in cash equivalents.
At December 31, 1987, the market value of the Plan assets was $131.8 million.

The weighted average discount rate and rate of future compensation levels used in determining the actuarial present value of the projected benefit obligation were 7 1/4 percent and 6 percent, respectively. The expected long-term rate of return on plan assets was 8 percent.

Other Post Employment Benefits: In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for retired employees. Substantially all of the Company's employees may become eligible for these benefits if they reach retirement age while working for the Company. These and similar benefits for active employees are provided through insurance companies whose premiums are

based on the benefits paid during the year. The annual insurance premiums recorded by the Company for providing those benefits were $4,639,000 for 1987, $4,109,000 for 1986 and $3,951,000 for 1985. The cost of providing retirees with those benefits is not separable from the cost of providing those benefits for the active employees.

NOTE 9 — STERLING PROJECT

In January 1982, the PSC determined that all the expenditures on the Sterling Project were prudent. The PSC also approved amortization and recovery of the Company's investment in the Sterling Project on a levelized basis over a five-year period and permitted a return on the unamortized balance equal to the Company's authorized overall rate of return. Such recovery commenced on October 22, 1982.

Subsequently in August 1984, the PSC issued an order which authorized the owners of the Sterling Project to amortize and recover in rates the cancellation charges incurred during the period July 1, 1981 through December 31, 1983. In addition, the PSC also authorized the Company to include in the amounts to be amortized and recovered its 17% share of progress payments made between January 1, 1984 and April 30, 1986 in connection with the settlement of claims with respect to the steam supply system.

Pursuant to the provisions of the Company's 1987 rate order, the full recovery of its investment in the Sterling Project and related cancellation charges will be completed by July 31, 1988.

NOTE 10 — SALE OF RECEIVABLES

In November 1987, the Company entered into a program to sell on a daily basis, without recourse, its accounts receivables from retail customers. Such program provides the Company with cash immediately and, therefore, reduces its working capital requirements. The amount of the outstanding receivables sold on December 31, 1987 was $35.5 million, of which $27.7 million was accounts receivable from customers and $7.8 million was accrued unbilled utility revenues. The average amount of accounts receivable sold in 1987 was $32.7 million and the weighted average discount rate was 9.786%. The program also serves to improve the Company's common equity ratio.

NOTE 11 — COMMITMENTS AND CONTINGENCIES

Roseton Plant: The Company currently has a 35% undivided interest in the ownership and output of the 1,200 mw. Roseton Plant. The Company is acting as agent for the owners with respect to operation of the Roseton Plant. Generally, the owners share the costs and expenses of the operation of the Plant in accordance with their respective ownership interests. The Company's share of direct operating expense for the Roseton Plant is included in the appropriate expense classification in the accompanying Statement of Income.

The Company has the option to purchase the interests of Niagara Mohawk (25%) and of Consolidated Edison Company of New York, Inc. (40%) in the Roseton Plant in December 2004. Exercise of such option is subject to the approval of the PSC.

In order to make provision for anticipated requirements for additional generating capacity starting in the mid-1990's, the Company and Niagara Mohawk have entered into an agreement revising the option the Company has to buy Niagara Mohawk's interest in the Roseton Pant. Under this revision, Niagara Mohawk will sell to the Company a 2.5% interest in the Roseton Plant on December 31, 1994 and on each succeeding December 31, through and including December 31, 2003, which will be all of Niagara Mohawk's interest in the Roseton Plant. In exchange, Niagara Mohawk will have the option to repurchase from the Company up to a 25% interest in the Roseton Plant in December 2004. The prices for the puchases will be based on the depreciated book cost of the Roseton Plant assuming straight-line amortization to provide for a fully amortized facility as of December 31, 2009. This agreement is subject to the approval of the PSC.

Construction Program: Reference is made to "Management's Discussion and Analysis of Financial Condition and Results of Operations" for information regarding the Company's construction program for the five-year period 1988-1992.

Natural Gas Supply: The Company has long-term contracts for the supply of natural gas with three pipeline suppliers. The earliest expiration date of any of these contracts is in 1988, which provides that the contract shall continue thereafter until terminated by either party upon 12 months' prior written notice. The Company also has a contract for the storage of gas. All such contracts are under tariffs on file with and approved by the FERC.

Accrued Employees' Vacation Pay: The Company's employees begin accruing vacation in July of each year for use in the following year; the monthly accrual of days is based on the number of years of service for each employee. However, for rate-making purposes, vacation pay is recognized as an allowable expense only when paid. Consistent with this rate-making treatment, the Company accrued $3.0 million and $2.8 million as of December 31, 1987 and 1986, respectively, as a current liability for an estimate of earned vacation pay and recorded a current asset representing the future recoverability of this cost.

Rental Expenses and Lease Commitments: The Company has lease commitments expiring at various dates, principally for real property and data processing equipment. None of these leases involves any major facilities or any material noncancelable rental commitments. Although certain items meet the criteria for recording as capital leases, such recognition would have no significant effect on the financial statements. Therefore, all items are treated as operating leases for rate-making and accounting purposes.

NOTE 12 — DEPARTMENTAL INFORMATION

The following presents certain information pertaining to the Company's operations for its electric and gas departments for calendar years 1985, 1986, and 1987:

	Electric			Gas		
	1987	1986	1985	1987	1986	1985
	(Thousands of Dollars)					
Operating Revenues	$374,951	$377,103	$436,652	$54,126	$61,448	$68,150
Operating Expenses:						
Fuel and Purchased Electricity	134,072	144,620	219,131	—	—	—
Purchased Natural Gas	—	—	—	27,131	33,413	40,343
Depreciation and Amortization	26,017	22,875	21,255	2,146	2,019	2,994
Other, excluding income tax	110,474	108,346	98,906	17,250	16,101	14,732
Total	270,563	275,841	339,292	46,527	51,533	58,069
Operating Income before Income Tax	104,388	101,262	97,360	7,599	9,915	10,081
Federal Income Tax, including deferred income tax—net	28,862	36,265	34,409	2,614	3,189	3,673
Operating Income	$ 75,526	$ 64,997	$ 62,951	$ 4,985	$ 6,726	$ 6,408
Construction Expenditures*	$ 94,286	$165,894	$125,011	$ 6,406	$ 5,288	$ 4,908
Identifiable Assets at December 31*						
Net Utility Plant	$460,080	$336,397	$327,249	$49,040	$47,196	$43,778
Construction Work in Progress	315,864	553,110	439,187	5,131	2,625	2,676
Total Utility Plant	775,944	889,507	766,436	54,171	49,821	46,454
Materials and Supplies	18,795	19,666	22,426	3,568	3,358	3,549
Total	$794,739	$909,173	$788,862	$57,739	$53,179	$50,003

*Includes the allocation of Common Utility Property.

NOTE 13 — SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

Selected financial data for each quarterly period within 1986 and 1987 are presented below:

	As Previously Reported				Restated*	
	Operating Revenues	Operating Income	Income Available for Common Stock	Earnings Per Average Share of Common Stock Outstanding	Income Available for Common Stock	Earnings Per Average Share of Common Stock Outstanding
	(Thousands of Dollars)			(Dollars)		(Dollars)
Quarter Ended:						
March 31, 1986	$146,719	$24,095	$20,637	$1.70		
June 30, 1986	103,948	16,151	13,991	1.04		
September 30, 1986	93,218	17,029	13,765	1.02		
December 31, 1986	94,665	14,448	10,877	.79		
March 31, 1987	$120,039	$22,678	$17,954	$1.27	$(115,268)	$(8.11)
June 30, 1987	102,191	17,924	12,597	.89	8,667	.61
September 30, 1987	104,702	20,291	13,437	.94	424	.03
December 31, 1987	102,145	19,617	—	—	(9,360)	(.65)

*Restated for the effect of the adoption of SFAS 90. (See Note 1).

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

CAPITAL RESOURCES AND LIQUIDITY

During 1987, the Company completed its major construction program. The reconversion of Danskammer Unit 4 (239 mw.) from oil- to coal-burning was completed in March and the reconversion of Danskammer Unit 3 (147 mw.) was completed in September. Also, the actual construction of Unit No. 2 of the Nine Mile Point Nuclear Station (NMP-2) was completed in 1987 and, as more fully discussed in Note 2, the plant is currently undergoing its power ascension program and is presently scheduled to commence commercial operation in March 1988.

The following table sets forth by year for the five-year period 1988-1992 estimates of construction expenditures, internal funds, mandatory redemption of long-term debt and working capital requirements:

	1988	1989	1990	1991	1992	Total 1988-1992
			(Thousands of Dollars)			
Construction Expenditures*:						
Electric	$ 38,900	$30,200	$28,100	$29,900	$29,300	$156,400
Gas	7,900	7,400	9,800	9,700	8,400	43,200
Common	9,500	8,900	18,000	10,900	9,600	56,900
Nuclear Fuel	1,700	4,500	2,300	5,100	2,800	16,400
Total	58,000	51,000	58,200	55,600	50,100	272,900
Internal Funds Available:						
Depreciation Accruals	32,100	36,600	38,200	39,900	41,600	188,400
Deferred Income Tax—Net	11,800	9,700	10,100	10,400	10,600	52,600
Other	9,600	5,800	5,800	6,700	7,200	35,100
Total	53,500	52,100	54,100	57,000	59,400	276,100
Excess of Construction Expenditures over Internal Funds	4,500	(1,100)	4,100	(1,400)	(9,300)	(3,200)
Mandatory Redemption of Long-term Debt	18,100	100	100	14,100	34,100	66,500
Working Capital Requirements	6,500	7,000	7,800	7,300	7,200	35,800
Payment from Niagara Mohawk (Note 2)	(26,100)	—	—	—	—	(26,100)
Total Cash Requirements	$ 3,000	$ 6,000	$12,000	$20,000	$32,000	$ 73,000

*Excluding allowance for funds used during construction (AFDC), a noncash item.

Estimates of construction expenditures are subject to continuous review and adjustment, and actual construction expenditures may vary from such estimates. The depreciation accrual for NMP-2 assumes a commercial operation date in March 1988 and a 2.5% annual rate applied to the allowed investment included in rate base. The deferred income tax projections are based on federal income tax law under the Tax Reform Act of 1986 (TRA-86).

As shown in the table above, it is presently estimated that funds available from internal sources will exceed cash construction expenditures for the five-year period 1988-1992 by $3.2 million. This amount, together with the payment by Niagara Mohawk Power Corporation of $26.1 million related to the NMP-2 Settlement, will be available to fund a portion of the mandatory redemptions of long-term debt and working capital requirements occurring during the period. It is currently estimated that the external financing requirements for the five-year period will amount to

$73 million, of which $66.5 million is related to the redemption of long-term debt.

At December 31, 1987, the Company had $4 million of short-term debt outstanding and had $68 million of short-term credit available, see Note 5.

The Company's year-end capital structure for the last three years is as follows:

	1985	1986	1987
Long-term Debt	50.4%	45.8%	54.3%
Short-term Debt	—	—	.5
Preferred Stock	9.2	8.4	9.8
Common Equity	40.4	45.8	35.4
	100.0%	100.0%	100.0%

The reduction in the common equity ratio at December 31, 1987 results from the write-off of the Company's disallowed investment in NMP-2 during the fourth quarter of 1987. For additional information regarding the write-off, see Note 1.

RATE PROCEEDINGS

Electric

On August 28, 1986, the Company filed an application with the PSC to increase its base rates for electric service to produce additional annual electric revenues of $27.1 million, or 7.9%, for the twelve months ending July 31, 1988 (Rate Year). During the course of the proceedings, the Company revised its rate request to reflect a higher sales forecast, the effects of TRA-86, the effects of the NMP-2 Settlement (excluding the accounting and rate-making issues related thereto), lower interest costs resulting from its revised financing program and a revision in the cash coverage target to reflect the downgrading of its securities. These revisions resulted in a revised requested increase in base rates of $5.9 million.

On July 2, 1987, the PSC issued its opinion and order (Order) with respect to such rate application which directed the Company to file revised electric rates designed to decrease electric revenues by approximately $8.7 million (2.6%) during the Rate Year. Such amount is based on a reduction in base rates of $6.3 million and estimated fuel savings from NMP-2 of $2.4 million. When combined with the $11.7 million of additional fuel savings anticipated from the operation on coal of Danskammer Units 3 and 4, the revised rates will produce a total reduction in electric revenues from retail customers of $20.4 million during the Rate Year. The new rates became effective on July 25, 1987 and are applicable to electric usage thereafter. The primary factor contributing to the $6.3 million reduction in base rate revenues was the reduction in the Company's common equity ratio which resulted from the PSC's decision that for rate-making purposes the NMP-2 disallowance should be written off entirely against the common equity account rather than proportionately across the entire capital structure at imbedded cost rates (see Note 2 for additional information).

The PSC's order authorized a return on common equity of 13.4% as compared to the 13.75% return requested by the Company and the 12.4% return authorized in the Company's last rate order (July 1986). The overall rate of return authorized by the PSC is 10.36%. However, because of the PSC's decision to deny rate base recognition for tax benefits reserved to shareholders under the Settlement, the Company is afforded the opportunity to earn only a 12.5% return on common equity and a 10.03% overall return on invested capital. The electric revenues authorized by the Order are projected to produce coverage of total interest charges in the range of 2.75 to 2.80 times when excluding AFDC.

The Order assumed a commercial operation date for NMP-2 of February 15, 1988 and included in rate base an additional $74.6 million of the Company's investment in NMP-2. Based on the February 15, 1988 commercial operation date and after reflecting the implementation of the Settlement all of the Company's allowable investment ($300.6 million) in NMP-2 is now included in rate base. In addition, five and one-half months of operating and maintenance expense plus depreciation are also included in electric rates. Should commercial operation of NMP-2 vary from the February 15, 1988 date assumed in the Order, the PSC has authorized deferral accounting for any difference resulting from such variation during the Rate Year.

In addition, the Order also provided for the inclusion in rate base of the remainder of the Company's investment in the Danskammer coal reconversion and includes all of the remaining operating and maintenance expenses plus depreciation associated with that project with the exception of one month for Unit 3. Moreover, the Order applied an aggregate of $9.0 million of deferred revenues (related to revenues previously collected toward the operation of NMP-2, deferred tax savings resulting from the implementation of TRA-86 and a reduction in base fuel costs) to reduce the Company's investment in the Danskammer coal reconversion and to complete the amortization of the Company's investment in the abandoned Sterling Nuclear Unit No. 1 Project.

Gas

In June 1987, the Company filed with the PSC a proposal to reduce its firm gas rates by approximately $2.3 million annually and freeze such rates at such level through December 31, 1990. The proposed gas rate reduction primarily reflected the effects of the implementation of the provisions of TRA-86 and reduced costs of capital. Settlement negotiations on the rate reduction proposal were held, and in August the Company, the Staff of the Department of Public Service and the representative of an industrial group entered

into a stipulation and agreement (Agreement) on a firm gas rate reduction proposal which would reduce such rates by approximately $3.0 million annually and freeze firm rates at such level through December 31, 1990. The Agreement was predicated on a targeted return on common equity of 12.9% with the Company retaining earnings, if any, in excess of such targeted return on common equity up to 13.4% and 50%/50% sharing between the Company and its firm customers of earnings in excess of a return on common equity of 13.4%. The Agreement provides that 100% of any net earnings from sales of gas – to interruptible customers and for electric generation – in excess of the $1.2 million of such net earnings imputed in establishing firm rates be passed through to firm customers up to $1.8 million and that any net earnings in excess of $1.8 million be shared 80%/20% between the firm customers and the Company. The Agreement was approved by the PSC and the lower rates became effective on September 1, 1987.

RESULTS OF OPERATIONS

The following discussion and analysis includes an explanation of significant changes in revenues and expenses during the years 1985, 1986 and 1987. Additional information relating to changes between these years is provided in the Notes to Financial Statements (Notes) on pages 23 through 36 of this Report.

EARNINGS

Earnings per share of common stock are shown after provision for dividends on preferred stock and are computed on the basis of the average number of common shares outstanding during the year. The number of common shares, the earnings per share, the percentage change and the rate of return earned on average common equity are as follows:

	1985	1986	1987
Average Shares Outstanding (000's)	11,458	13,207	14,230
Earnings (Loss) Per Share	$4.67	$4.49	$(8.12)
% Increase (Decrease) over Prior Year.....	5%	(4%)	(281%)
Return Earned on Common Equity for Regulatory Purposes...	15.6%	14.7%	12.4%

The 5% increase in earnings per share for 1985 can be attributed to two primary factors, a 6% growth in own territory electric sales and a 3% increase in earnings resulting from a partial sharing of lower fuel costs pursuant to an incentive/penalty fuel adjustment mechanism established by the PSC.

The 4% decrease in 1986 resulted primarily from a reduction in the rate of return on common equity authorized by the PSC in its July 1986 rate order from 15.7% to 12.4%. The lower authorized return primarily reflected the improved capital markets prevailing in mid-1986 as compared to early 1985.

As more fully discussed in Note 1, 1987 earnings reflect the effect of adopting SFAS 90 and recording the write-off of the NMP-2 disallowance. These actions reduced earnings for 1987 by $11.90 per share. The write-off of the NMP-2 disallowance reduced earnings by $10.78 per share and the reversal of $15.9 million of AFDC accrued on the disallowed NMP-2 investment in calendar year 1987 reduced earnings by $1.12 per share. Earnings for 1987, excluding the effect of the $10.78 reduction due to the write-off of the NMP-2 disallowance, would have been $2.66 per share ($10.78-$8.12).

Besides the effect on earnings of the write-off for financial reporting purposes, 1987 earnings were also adversely affected by the rate order issued by the PSC in July 1987 which implemented the rate-making treatment for the disallowed portion of the Company's 9% interest in NMP-2. See Note 2, subcaptions "Cost Settlement" and "Rate Phase-In" in the Notes to Financial Statements of this Report.

OPERATING REVENUES

Total operating revenues decreased $18.4 million (4%) in 1985, $66.3 million (13%) in 1986 and $9.5 million (2%) in 1987. The decline in revenues in the past three years was caused primarily by lower fuel costs which resulted from lower fuel prices in 1985 and 1986 and the burning of coal as a fuel in 1987. The lower fuel costs reduced the amount of revenues collected through the electric fuel cost adjustment clause and also the amount of revenues received from sales of electricity to other utilities. Details of the revenue changes are as follows:

	Increase or (Decrease) from Prior Year					
	1985		1986		1987	
	Electric	Gas	Electric	Gas	Electric	Gas
			(Thousands of Dollars)			
Customer sales	$ 15,690	$(3,674)	$ 16,402	$(3,003)	$ 16,693	$(2,186)
Sales to other utilities	(37,625)	—	(22,511)	—	(12,285)	—
Increase (decrease) in base rates	12,087	637	12,611	71	9,098	(599)
Fuel cost changes reflected in base rates	255	—	(11,427)	—	(39,596)	—
Fuel cost adjustment	(7,448)	1,783	(48,492)	(1,724)	21,330	(4,043)
Miscellaneous	(1,167)	1,075	(6,132)	(2,046)	2,608	(494)
Total	$(18,208)	$ (179)	$(59,549)	$ (6,702)	$ (2,152)	$(7,322)

Effective April 1985, the PSC revised the electric fuel cost adjustment clause to provide for a partial sharing of fuel cost variations, pursuant to an incentive/penalty formula. The change adopted by the PSC requires an 85%/15% sharing, on average, between the customers and the Company for the first $20 million of variations in fuel costs from those levels projected in the proceeding. Any variations in excess of $20 million are credited or charged in total to the customers. See Note 3, "Deferred Electric Fuel Costs."

Gross revenues from sales of electricity to other utilities decreased 42% in 1985, 43% in 1986 and 42% in 1987. Under its April 1985 rate order, the PSC imputed $11 million of net revenues in base rates. However, as a result of adopting an incentive/penalty formula for the electric fuel adjustment clause, the PSC adopted a symmetrical sharing arrangement for net revenues from sales to other utilities: shortfalls below the imputed amount as well as excesses above the imputed amount will be shared between customers and the Company on an 80%/20% basis. In its July 1986 Order, the PSC reduced the imputed amount to $6.2 million and in its July 1987 electric rate order the imputed amount was increased to $6.6 million. In addition, the effect of such imputation is now included in fuel adjustment revenues rather than base rates. The Company reflects any credits or charges to its customers resulting from these provisions through the electric fuel cost adjustment clause.

The following table shows the total amount of net revenues received from electric sales to other utilities, the amount credited, or charged, to retail customers through the electric fuel cost adjustment clause, and the amount of such net revenues retained by the Company and recognized in income:

	1985	1986	1987
		(Thousands of Dollars)	
Net Revenue	$7,020	$6,136	$2,433
Credited to Customers*	(347)	—	—
Customer Charge (Refund)	1,199	2,563	790
Retained by the Company	7,872	8,699	3,223
Restored (Deferred)*	344	—	—
Net Revenue Recognized	$8,216	$8,699	$3,223

* Prior to rate order of April 16, 1985.

The Company's largest customer is International Business Machines Corporation. For the year 1987, sales to IBM accounted for 19% of the Company's total electric revenues and 2% of its total gas revenues.

SALES

Total kwh. sales of electricity within the Company's service territory increased 6% in 1985, 7% in 1986 and 5% in 1987. Firm sales of natural gas, excluding sales to the electric department, decreased 4% in 1985, increased 8% in 1986 and increased 3% in 1987. Changes in sales by major customer classification are set forth below (parentheses denote decrease):

	Electric		
	1985	1986	1987
Residential	0%	6%	6%
Commercial	6	0	6
Industrial	12	13	2

	Gas		
	1985	1986	1987
Residential	(5)%	8%	3%
Commercial	(2)	8	2
Industrial	(3)	12	5

Residential electric sales: Residential electric sales are primarily affected by the growth in customers and the change in kwh. usage per customer. Customer usage is also sensitive to weather. Changes in these components are set forth in the table below (parentheses denote decrease):

	Residential Sales—Electric		
	1985	1986	1987
Growth in number of customers	2%	2%	2%
Change in average usage per customer	(2)	4	4
Change in billing cycle heating degree days	(7)	5	2

The 2% reduction in average usage per customer experienced in 1985 not only reflects the effects of a warmer winter but also the effects of a cooler summer; the coolest summer since 1967.

Commercial electric sales: During 1985 increased usage by existing customers was the primary reason for the higher sales. Additionally, in 1985 the New York Board of Water Supply activated its pumping station for part of the year causing sales to other public authorities, a portion of the commercial sector, to increase 16%. After adjusting for the abnormal sales to the pumping station in 1985, commercial sales increased 3% in 1986. Commercial sales increased 6% in 1987 due to a combination of a 3% increase in the number of customers and a 3% increase in the usage per customer.

Industrial electric sales: The large increases experienced during 1985 and 1986 resulted primarily from expansion by existing customers.

Gas sales—firm: The following table sets forth customer growth, changes in customer usage and heating degree days for the residential and commercial classifications. The changes in residential gas sales are primarily weather-related although the growth in customers has been 2% per year in both 1985 and 1986 and 3% in 1987. Commercial sales are also weather sensitive.

	Residential Sales (%)		
	1985	1986	1987
Growth in number of customers	2	2	3
Change in average usage per customer	(7)	6	0
Change in heating degree days	(7)	5	2

	Commercial Sales (%)		
	1985	1986	1987
Growth in number of customers	4	7	7
Change in average usage per customer	(5)	0	(5)
Change in heating degree days	(7)	5	2

Sales to industrial customers during 1985 were 3% lower than 1984 due primarily to reduced usage of the area's textile industry. In 1986 and 1987, sales to industrial customers increased primarily due to customer growth.

Gas sales—interruptible: Interruptible gas sales decreased 12% in 1985, 41% in 1986, and 4% in 1987. The decline experienced in these years was attributed to the change in the competitive position of natural gas with alternative fuel sources for boiler fuel usage. See caption "Rate Proceedings–Gas" for a discussion of the rate-making treatment of net revenues from interruptible gas sales.

OPERATING EXPENSES

Changes in operating expenses from the prior year are set forth below:

	Increase or (Decrease) from Prior Year					
	1985		1986		1987	
	Amount	%	Amount	%	Amount	%
	(Thousands of Dollars)					
Operating Expenses:						
Fuel and purchased electricity	$(38,570)	(15.0)	$(74,511)	(34.0)	$(10,548)	(7.3)
Purchased natural gas	249	.6	(6,930)	(17.2)	(6,282)	(18.8)
Other expenses of operation	2,232	4.1	5,084	8.9	550	.9
Maintenance	1,070	7.7	4,849	32.6	899	4.6
Depreciation and amortization	1,718	7.6	645	2.7	3,269	13.1
Taxes, other than income tax	1,994	5.0	876	2.1	1,828	4.3
Federal income tax	3,874	11.3	1,372	3.6	(7,978)	(20.2)
Total	$(27,433)	(5.9)	$(68,615)	(15.8)	$(18,262)	(5.0)

The most significant elements of cost are fuel and purchased electricity in the Electric Department and purchased natural gas in the Gas Department. Approximately 50% in 1985, 38% in 1986 and 36% in 1987 of every revenue dollar billed in the Electric Department were expended for the combined cost of fuel used in electric generation and purchased electricity. The corresponding figures in the Gas Department for the cost of purchased gas are 59%, 54% and 50%, respectively.

In 1985 the cost of fuel used in electric generation and the cost of purchased electricity decreased $36.5 million (18%) and $2.0 million (4%), respectively, which directly reflects the lower average price of fuel (10%) and the lower system output (7%) caused by decreased sales to other utilities. In 1986, a combination of a 37% decrease in the average price of fuel, a 14% decrease in purchases and a 2% increase in generation resulted in a decrease in both the cost of fuel used in electric generation of $57.9 million (34%) and purchased electricity of $16.6 million (33%). In 1987 the cost of fuel used in electric generation and the cost of purchased electricity decreased $6.2 million (6%) and $4.3 million (13%), respectively, which reflects the effect of lower fuel costs due to the reconversion to coal firing of Danskammer Units 3 and 4, a 1% decrease in system output and a 13% decrease in purchases.

The following table shows the average cost per million Btu for the Company's two major generating plants during the last five years:

	Average Cost ($/Million Btu)	
	Danskammer Plant	Roseton Plant (Company's Share)
1983	4.48	4.29
1984	4.76	4.67
1985	4.32	4.18
1986	2.93	2.56
1987	2.26	2.95

In an effort to keep the cost of electricity as low as possible, the Company purchases energy from member companies of the New York Power Pool whenever such energy can be purchased at a unit cost lower than the incremental cost of generating the energy in the Company's plants.

The amount of natural gas purchased, excluding gas burned as boiler fuel, and the cost per mcf. during the last five years are set forth in the following table:

Year	Amount of Gas Purchased—Mcf.	$/Mcf.
1983	9,214,386	4.52
1984	10,547,504	4.15
1985	10,021,420	4.14
1986	9,387,520	3.64
1987	9,420,874	3.04

The reduction in the volumes of gas purchased during 1985 and 1986 resulted from lower sales of interruptible gas.

The effects of higher employee wages and benefits and increased research and development costs were the two major components of the $2.2 million, or 4%, increase for 1985 in other expenses of operation. The $5.1 million, or 9%, increase in 1986 was primarily caused by increased liability insurance premiums, increased wages and related fringe benefits, increased environmental expenses and increased research and development expenses. In 1987, the $600,000, or 1%, increase is primarily due to the net effect of higher employee wages, increased cost of the Company's end use efficiency program and lower research and development expenses.

Maintenance expenses rose 8% during 1985 primarily due to increased maintenance on the Company's generating units, higher transmission and distribution line trimming costs and higher storm-related maintenance from hurricane Gloria and an ice storm experienced in the fourth quarter. Maintenance expenses increased $4.8 million, or 33%, for 1986 primarily due to a major overhaul of Units 2 and 4 at the Danskammer Plant and Unit 2 at the Roseton Plant, and increased transmission and distribution maintenance, primarily repairs of substation equipment. Increased maintenance expenses from a devastating snowstorm in October 1987, offset by a decrease in maintenance on the Company's generating units and a decrease in the maintenance of electric transmission substation equipment, resulted in an overall increase of $900,000, or 5%, for 1987. The incremental costs of the October snowstorm amounted to approximately $5 million, an amount which is 14 times greater than the $352,000 which is reflected in current electric rates. Accordingly, the Company has requested permission from the PSC to defer 75% of the cost ($3.73 million) over a three-year period commencing August 1, 1988 and it wrote off to income in 1987 the 25% ($1.24 million) related to the current rate year which commenced August 1, 1987.

The Company's total provision for depreciation amounted to 3.47% in 1985, 3.31% in 1986 and 3.45% in 1987 of the original cost of average depreciable property. The 1987 provision reflects the commencement of depreciation on the Danskammer Coal Reconversion investment. Depreciation and amortization expenses in all three periods also include the amortization of the Company's investment in the Sterling Project ($5.1 million, $6.0 million and $5.7 million, respectively). The ratio of the amount of accumulated depreciation to the cost of depreciable property at December 31 was 40.3% in 1985, 40.8% in 1986 and 34.9% in 1987.

State and local taxes levied on gross revenues increased $700,000 in 1985, decreased $1.3 million in 1986 and remained stable in 1987. Property taxes, including school taxes, increased $1.3 million, $1.4 million and $1.2 million in 1985, 1986 and 1987, respectively. The Temporary Metropolitan Business Tax Surcharge decreased $328,000 in 1985, increased $316,000 in 1986 and increased $249,000 in 1987. These three categories of taxes accounted for the substantial portion of the total increases in operating taxes.

See Note 4 for a detailed analysis and reconciliation of the federal income tax.

OTHER INCOME AND INTEREST CHARGES

Details of the Allowance for Funds used During Construction are set forth below:

	1985	1986	1987
	(Thousands of Dollars)		
Nine Mile 2 Plant	$24,637	$25,013	$4,352
Danskammer Coal Reconversion	1,222	5,753	(161)
Other	573	959	785
Total	$26,432	$31,725	$4,976
Weighted Average Rate	10.34%	10.23%	8.90%

See Notes 1, 2, 3, and 9 for additional information on this subject.

Total interest charges (excluding AFDC), increased $5.4 million, or 15%, in 1985, increased $3.5 million, or 8%, in 1986 and decreased $1.5 million, or 3%, in 1987.

The following table sets forth some of the pertinent data pertaining to the Company's outstanding debt:

	1985	1986	1987
	(Thousands of Dollars)		
Long-Term Debt:			
New Debt Issued	$ 92,250	$ 50,000	$ 43,600
Debt Retired	175	55,175	35,075
Outstanding at Year-end:			
Amount	444,900	439,725	448,250
Effective Cost	10.73%	9.58%	8.95%
Short-Term Debt:			
Average Daily Amount Outstanding	$ 3,877	$ —	$ 10,400
Weighted Average Interest Rate	8.4%	—	7.0%

See Notes 5 and 7 for additional information on this subject.

FINANCIAL INDICES

Selected financial indices for the last five years are set forth in the following table:

	1983	1984	1985	1986	1987*
Pretax Coverage of Total Interest Charges:					
Including AFDC	2.84x	3.19x	3.17x	3.14x	2.70x
Excluding AFDC	2.35x	2.59x	2.54x	2.43x	2.56x
Pretax Coverage of Total Interest Charges and Preferred Stock Dividends	2.22x	2.51x	2.60x	2.66x	2.23x
Percent of Construction Expenditures Financed from Internal Funds	41%	35%	31%	17%	53%
AFDC as a Percentage of Income Available for Common Stock	48%	49%	50%	55%	16%
Effective Tax Rate	34%	36%	35%	34%	42%

*For comparative purposes, the effect of NMP-2 disallowance under SFAS 90 has been excluded.

The earnings tests contained in certain of the Company's long-term debt instruments will not be affected by the NMP-2 disallowance. The earnings for such tests will be calculated exclusive of the effect of the NMP-2 write-off.

COMMON STOCK DIVIDENDS AND PRICE RANGES

Dividends have been paid by the Company and its principal predecessors for 84 years, and the common stock of the Company has been listed on the New York Stock Exchange since 1945. The price ranges and the dividends paid for each quarterly period during the Company's last two fiscal years were as follows:

	1986			1987		
	High	Low	Dividend	High	Low	Dividend
First Quarter	$35⅛	$28	$.74	$31⅞	$24¾	$.74
Second Quarter	35⅛	30⅞	.74	28½	24⅛	.74
Third Quarter	39⅞	32¾	.74	27⅝	23	.74
Fourth Quarter	36½	26⅝	.74	24½	16½	.74

On December 18, 1987, the Company reduced its quarterly dividend payable February 1, 1988 to $.425 per share from the previous quarterly dividend of $.74 per share, a reduction of 43%. See page 26 for additional information.

The number of registered holders of common stock as of December 31, 1987 was 31,921. Of these, 31,326 were accounts in the names of individuals with total holdings of 7,362,222 shares, or an average of 235 shares per account. The 595 other accounts, in the names of institutional or other non-individual holders, for the most part hold shares for the benefit of individuals.

The Company's 4.85% Promissory Notes due December 1, 1995 contain limitations upon the right of the Company to declare or pay any dividend or make any other distribution on (other than dividends or distributions payable in Common Stock), or acquire for a consideration, any shares of its Common Stock unless the aggregate of all such dividends, distributions and considerations since December 31, 1964 does not exceed an amount determined by a formula. At December 31, 1987, the amount of retained earnings available for dividends on the Company's Common Stock under the provisions of said 4.85% Promissory Notes was $3,116,000.

Seated from left: Marjorie S. Brown; Richard H. Eyman; Theodore J. Carlson; Lee C. White; John M. Kingsland. Standing from left: Howard C. St. John; John E. Mack III; Edward F.X. Gallagher; Jack Effron; Charles LaForge.

YOUR BOARD OF DIRECTORS

Three new members have been appointed to the Company's Board of Directors to replace three members who did not stand for reelection at the 1987 Annual Meeting of Shareholders. The new members were selected for their expertise in economic development, finance, and industrial affairs.

The new Directors are:

Jack Effron, President of EFCO Products, Inc. in Poughkeepsie. He is a member of the St. Francis Hospital Board of Trustees and serves as Chairman of its Human Resources Committee, Vice President of the Council of Industry of Southeastern New York and a member of the American Society of Bakery Engineers and the National Association of Bakery Suppliers.

John M. Kingsland, Executive Vice President, Jiffy Packaging Corp. in Beverly, Massachusetts. Mr. Kingsland holds this position until the acquisition of Jiffy by Sealed Air Corporation is completed. He is a member of the New York Society of Security Analysts and past Chairman of the Regulated Industries Committee of the Securities Industry Association. Mr. Kingsland was formerly Vice President in the Utility Corporate Finance Division of Kidder, Peabody & Co. Incorporated. He has had a long association with the Company as a financial advisor and as an expert witness in rate cases.

Charles LaForge, President of Wayfarer Inns and Owner of Beekman Arms in Rhinebeck. He is a Trustee Emeritus of the Culinary Institute of America, a Trustee of the Rondout Savings Bank, and a Director of the New York State Restaurant Association and the International Hotel & Restaurant Show.

We extend our deepest appreciation to the following Directors who have concluded their service as members of the Board. Each is an outstanding member of the community and has rendered distinguished service to the Company. We extend to them our warmest and best wishes:

John Wilkie was a member of the management of Central Hudson for 61 years. He became a member of the Board in 1925 and was elected its Vice Chairman and Chief Financial Officer of the Corporation in 1960. He was elected Chairman of the Board in 1964 and served in that position until April 1974. Mr. Wilkie also served as Chairman of the Committees on Finance and on Audit and was Vice Chairman of the Executive Committee and a member of the Retirement Committee.

Roy C. Ketcham, Chairman of the Board and Chief Executive Officer of Ketcham Motors, Inc. and Chairman of the Board of The Fishkill National Bank, was a member of our Board since 1957 and served as Chairman of the Committee on Compensation and Succession and a member of the Executive Committee.

Dr. James R. Breed, a surgeon at and past President of the Medical Staff of Vassar Brothers Hospital and past Director of the Surgical departments of Vassar Hospital and the Northern Dutchess Health Center, was a member of our Board for 14 years. He served as a member of the Committees on Audit and on Compensation and Succession.

DIRECTORS

JAMES R. BREED, M.D.*
Poughkeepsie, NY
Surgeon;
Member of the Committees on Audit and on Compensation and Succession

MARJORIE S. BROWN
Millbrook, NY
Homemaker, active in civic and philanthropic work, former executive in retailing and promotional organizations;
Chairman of the Committee on Compensation and Succession; Member of the Executive and Retirement Committees

THEODORE J. CARLSON
Poughkeepsie, NY
Chairman of the Board;
Chairman of the Executive and Retirement Committees;
Member of the Committees on Finance, on Audit and on Compensation and Succession

JACK EFFRON
Poughkeepsie, NY
President, EFCO Products;
Member of the Committee on Compensation and Succession and the Retirement Committee

RICHARD H. EYMAN
Norwalk, CT
Senior Vice President, Brouillard Communications, Division of J. Walter Thompson Company;
Chairman of the Committee on Audit; Member of the Executive Committee and the Committee on Compensation and Succession

EDWARD F. X. GALLAGHER
Newburgh, NY
President and Owner, Gallagher Transportation Services;
Member of the Retirement Committee

ROY C. KETCHAM*
Fishkill, NY
Chairman of the Board and Chief Executive Officer, Ketcham Motors, Inc.; Chairman of the Board of The Fishkill National Bank;
Chairman of the Committee on Compensation and Succession; Member of the Executive Committee

JOHN M. KINGSLAND
Boston, MA
Executive Vice President, Jiffy Packaging Corp.;
Member of the Committees on Finance and on Audit

CHARLES LaFORGE
Rhinebeck, NY
President of Wayfarer Inns and Owner of Beekman Arms; Member of the Committee on Finance

JOHN E. MACK III
Poughkeepsie, NY
President and Chief Executive Officer; Member of the Executive and Retirement Committees, and the Committees on Finance and on Compensation and Succession

HOWARD C. ST. JOHN
Glenford, NY
Chairman of the Board and Chief Executive Officer, Ulster Savings Bank; Lawyer, Howard C. St. John & Associates; Vice Chairman of the Board; Chairman of the Committee on Finance;
Member of the Executive Committee and the Committee on Audit

LEE C. WHITE
Washington, D. C.
Lawyer, White, Fine & Verville;
Member of the Committee on Audit

JOHN WILKIE*
Katonah, NY
Vice Chairman of the Executive Committee;
Member of the Retirement Committee and the Committees on Finance and on Audit

* Retired 4/7/87

OFFICERS OF THE BOARD

THEODORE J. CARLSON
Chairman of the Board; Chairman of the Executive and Retirement Committees

HOWARD C. ST. JOHN
Vice Chairman of the Board and Chairman of the Committee on Finance

MARJORIE S. BROWN
Chairman of the Committee on Compensation and Succession

RICHARD H. EYMAN
Chairman of the Committee on Audit

OFFICERS

JOHN E. MACK III
President and Chief Executive Officer

L. WALLACE CROSS
Senior Vice President-Finance and Accounting

PAUL J. GANCI
Senior Vice President-Operations

WILLIAM E. VanWAGENEN
Vice President-Corporate Communications and Governmental Affairs

GLADYS L. COOPER
Secretary

ERIC M. MARKELL
Treasurer

JOHN F. DRAIN
Controller

HERBERT M. ROUND
Assistant Vice President-Corporate Planning and Energy Control

ALLAN R. PAGE
Assistant Vice President-Engineering

CARL E. MEYER
Assistant Vice President-Production

JOSEPH J. DeVIRGILIO, JR.
Assistant Vice President-Customer Services

JAMES E. SMITH
Assistant Vice President

WALTER A. BOSSERT, JR.
Assistant Secretary and Assistant Treasurer

CHARLES H. DENNY, JR.
Assistant Treasurer and Assistant Secretary

TRANSFER AGENT & REGISTRAR

COMMON & PREFERRED STOCK
Morgan Shareholder Services Trust Company
30 West Broadway
New York, NY 10015

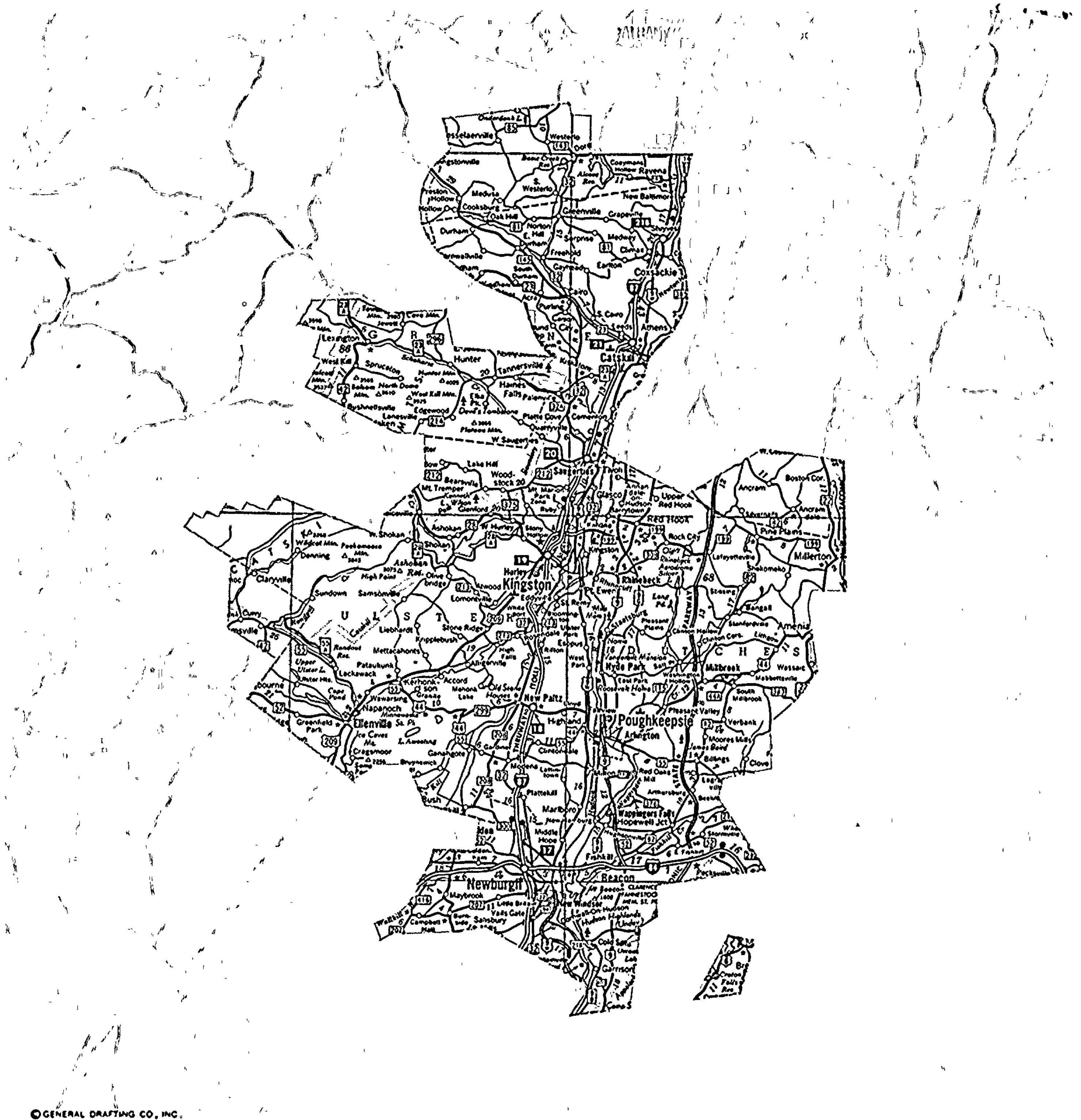
GENERAL COUNSEL
Gould & Wilkie
One Wall Street
New York, NY 10005

INDEPENDENT ACCOUNTANTS
Price Waterhouse
153 East 53rd Street
New York, NY 10022

AFFIRMATIVE ACTION POLICY

Central Hudson Gas & Electric Corporation affirms that equal opportunity shall be provided for all persons. This means that all personnel policies and practices, including those related to compensation, benefits, transfers, promotions, training, tuition assistance and social and recreational programs, shall be administered without regard to race, color, age, sex or national origin. Recruiting and hiring practices shall be administered to assure fulfillment of the Company's equal employment opportunity objective.

Central Hudson Gas & Electric Corporation affirms that it will not discriminate against any employee or applicant for employment because of physical or mental handicap in regard to any position for which the individual is qualified. This means that all personnel policies and practices, including those related to employment, promotion, demotion or transfer, training, compensation, benefits and termination, shall be administered without discrimination based upon physical or mental handicap against qualified handicapped individuals.



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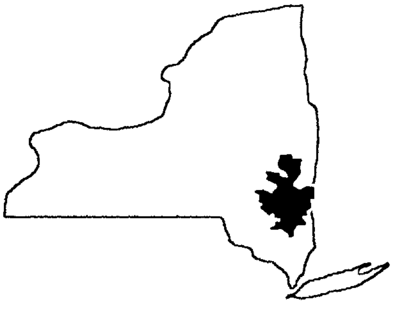

THE REGION WE SERVE

Central Hudson is an investor-owned utility serving more than 237,000 electric customers and 51,000 natural gas customers in the Mid-Hudson Valley and the eastern Catskill Mountains. Its 2,600 square-mile service territory reaches from 25 miles north of New York City to 10 miles south of Albany and includes portions of eight counties.