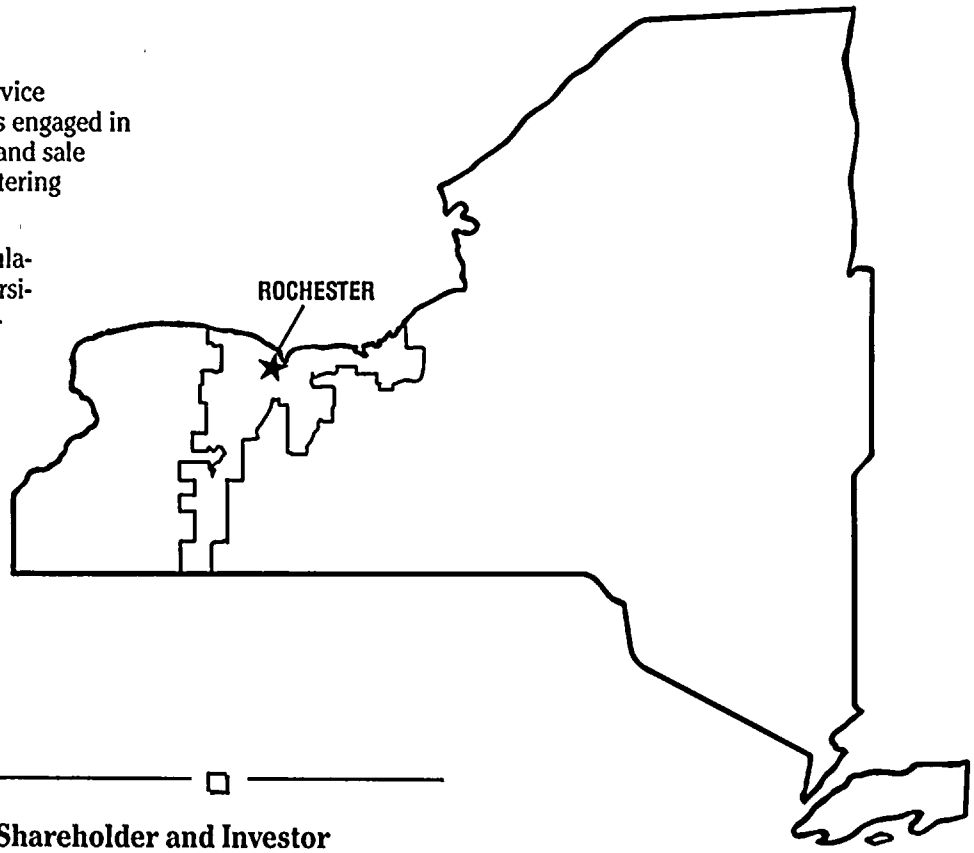
Rochester Gas and Electric Corporation

Report 1987

RG&E Service Area/Business

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

The Company's territory, which has a population of approximately 900,000, is well diversified among residential, commercial and industrial consumers. In addition to the City of Rochester, which is the third largest city and a major industrial center in the State, it includes a large and prosperous farming area.



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Shareholder and Investor Relations Information

Inquiries regarding the Company's operations should be directed to David C. Heiligman, Secretary and Treasurer of the Company.

Communications regarding changes of address, stock transfers, lost certificates or dividend payments should be directed to Chase Lincoln First Bank, N.A.

Corporate Office
89 East Avenue
Rochester, New York 14649
(716) 546-2700

Annual Meeting
May 18, 1988
At Rochester, New York

Listed
New York Stock Exchange
(Stock Symbol—RGS)

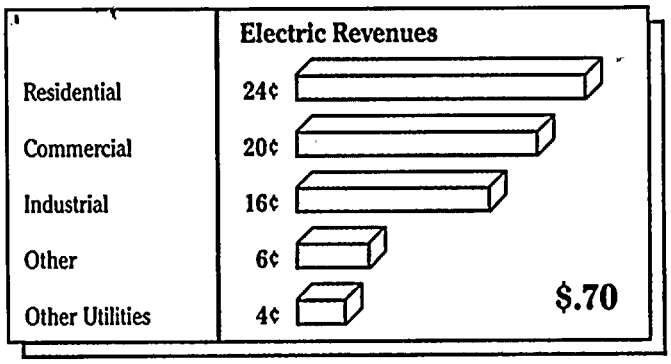
Transfer Agent and Registrar
Chase Lincoln First Bank, N.A.
Corporate Agency Department
Post Office Box 1250
Rochester, New York 14603
(716) 258-5874

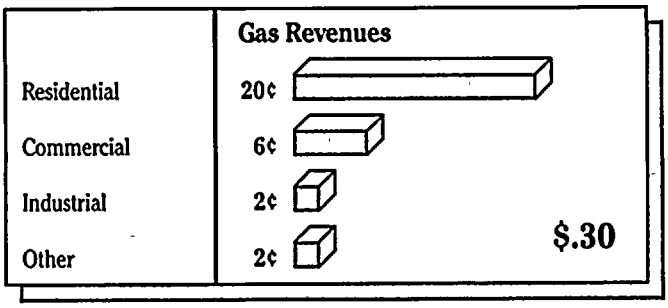
Agent for Automatic Dividend Reinvestment and Stock Purchase Plan
(See page 35 for description of plan)
Chase Lincoln First Bank, N.A.
Corporate Agency Department
Post Office Box 1507
Rochester, New York 14603
(716) 258-5854

First Mortgage Bond Trustee and Paying Agent
Bankers Trust Company
Corporate Trust and Agency Group
Attention: Security Holder Relations
Post Office Box 9005
Church Street Station
New York, New York 10249
(212) 250-6000

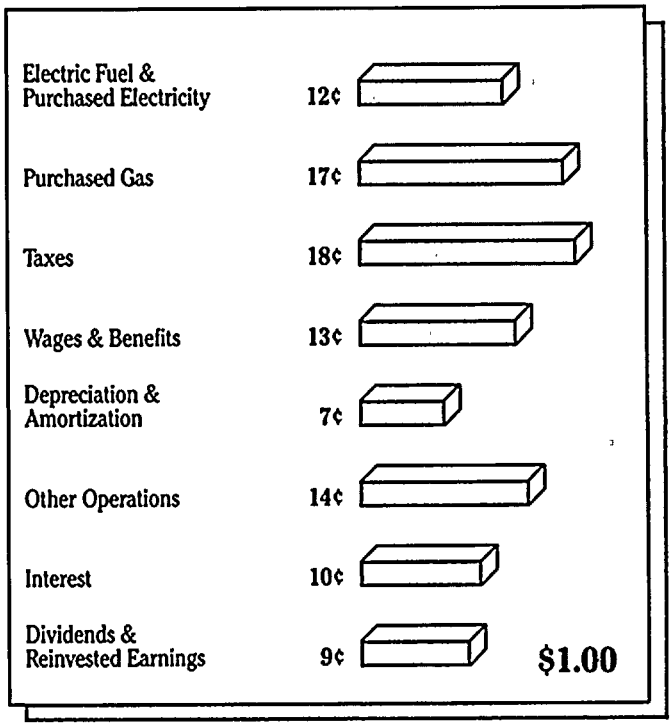
Form 10-K Annual Report
The Company will provide, without charge, a copy of the Annual Report on Form 10-K filed with the Securities and Exchange Commission with respect to fiscal year 1987, upon written request of any shareholder addressed to the Secretary.

Source of 1987 Revenue Dollar





Use of 1987 Revenue Dollar*



Financial Highlights

Sales, Revenues and Earnings (Thousands, Except Per Share Amounts)	1987	1986	% Change
Electricity to customers			
Kilowatt-hours	5,948,763	5,776,377	3
Revenue	$ 489,215	$ 466,496	5
Electricity to other utilities			
Kilowatt-hours	1,047,654	925,318	13
Revenue	$ 26,215	$ 20,465	28
Gas			
Therms sold and transported	445,591	461,962	(4)
Revenue	$ 216,058	$ 261,688	(17)
Total operating revenues	$ 731,488	$ 748,649	(2)
Total operating expenses	$ 609,113	$ 632,828	(4)
Operating income	$ 122,375	$ 115,821	6
Nine Mile Two write-off, net	$ 262,000	—	—
Net income (loss)	$ (168,711)	$ 104,519	(261)
Earnings (loss) applicable to common stock	$ (176,858)	$ 96,461	(283)
Weighted average number of common stock shares outstanding	29,728	28,927	3
Earnings (loss) per common share	$(5.95)	$3.33	(279)
Cash dividends paid per common share	$2.025	$2.20	(8)
Rate of return on average common equity*	12.45%	13.38%	(7)
Book value per common share—year end	$16.98	$24.93	(32)
Utility Plant (Thousands)			
Capital expenditures, less allowance for funds used during construction	$ 120,965	$ 164,402	(26)
Net utility plant at December 31	$1,474,746	$1,728,902	(15)
Number of Customers at December 31			
Electric	317,033	312,129	2
Gas	250,124	245,446	2
Number of Common Stock Shareholders at December 31	44,127	45,959	(4)
Number of Employees at December 31	2,558	2,576	(1)

**Excludes disallowed Nine Mile Two costs written off in 1987.*

Letter to Shareholders

Paul W. Briggs

The year 1987 was the first year since Rochester Gas and Electric Corporation was incorporated in 1904 that the Company had to report a loss. In 1987 we wrote off a total of $262 million against Common Stock earnings. This was a result of an October 1986 settlement agreement among the five co-tenants of the Nine Mile Two nuclear power plant project and the New York State Public Service Commission (PSC) wherein it was agreed to cap the cost of the plant at $4.16 billion for rate-making purposes. In return, the PSC agreed to discontinue its prudency investigation.

☐ More detailed information about the settlement agreement, plant costs, and pending litigation against certain Nine Mile Two contractors can be found in Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 10 on page 29 of this report.

Earnings and Dividends: In September 1987, the Company wrote off $243 million of the portion of its investment in Nine Mile Two which was disallowed as a result of the settlement. The September write-off was based on an assumed February 15, 1988 commercial operation date for Nine Mile Two. At the end of 1987, because of further delays, we assumed for accounting purposes a mid-May 1988 commercial operation date and wrote off an additional $19 million.

☐ Earnings for the twelve months ended December 31, 1987 were affected by the Nine Mile Two write-off in 1987 of $262 million ($8.81 per share), which includes $22 million of AFUDC accrued in 1987 on the disallowed project costs, resulting in a net loss of $176.9 million, or $5.95 per share for the year. Earnings per share for the twelve months ended December 31, 1987, excluding the write-off, were $2.12, compared to $2.32 for the twelve months ended December 31, 1986 (on a comparable basis.)

☐ The Company also announced last September a reduction in the quarterly dividend rate for Common Stock from $.55 per share to $.375 per share or $1.50 on an annual basis. The dividend reduction resulted when an analysis of the Company's most recent rate decision indicated that actual earnings were not expected to cover the dividends which would have been paid at the former annual rate of $2.20 per share. Although the Company believes that the new annual dividend rate of $1.50 is sustainable, its ability to maintain the Common Stock dividend and its Preferred Stock dividend is necessarily dependent on future earnings. The Company's Certificate of Incorporation provides for the payment of dividends on Common and Preferred Stocks out of retained earnings only. As of December 31, 1987 the Company's retained earnings (after giving effect to the write-offs described above) were approximately $18 million. In 1987, earnings per share, excluding the impact of the write-off, were sufficient to maintain the current dividend level. One of our objectives going forward is to rebuild retained earnings sufficient to permit the Board of Directors to consider future dividend increases. However, this process will take time.

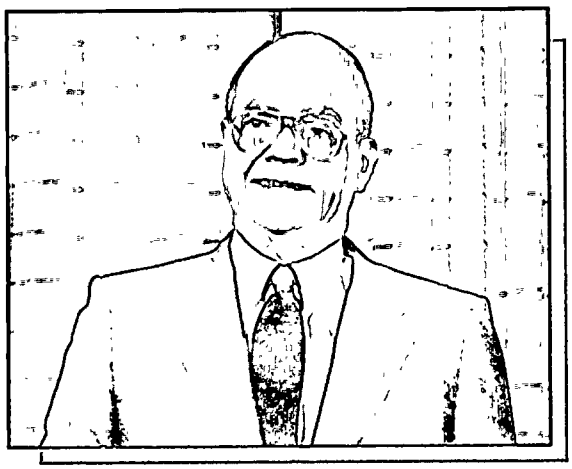
Nine Mile Two: At our 1987 annual meeting of shareholders we said that we expected the Nine Mile Two nuclear plant to be in commercial operation in the 1988 first quarter. The start-up testing phase of the plant had been going reasonably well, but a problem had developed with the main steam isolation valves. On May 23, 1987, following successful replacement and testing of the valves, Niagara Mohawk began low-power testing. On July 2, the Nuclear Regulatory Commission issued a full-power operating license for the plant. Then, during the

power ascension testing program in November some problems were discovered with the plant's main feed-water lines. Modifications were performed and the power ascension testing was resumed. While it is possible that the plant will achieve commercial operation in late March of this year, it is likely to slip into the second quarter. Any delay in commercial operation beyond mid-May 1988 increases the Company's investment in the plant and would require an additional write-off of approximately $6 million (net of tax) per month.

Rates: On June 25, 1987, the PSC ruled on the Company rate increase requests filed in August of 1986. Adjusting for projected fuel cost savings, the PSC allowed electric revenues to be increased by $13.5 million, or 2.8 percent. The PSC also ruled that there would be no increase for natural gas rates. The allowed rate of return on equity was set at 13.2 percent. While that is an increase over the former allowable rate of 12.6 percent, the higher rate applies to a lower equity component of total capitalization because of the Nine Mile Two write-off.

☐ The Company filed for gas and electric rate relief on August 21, 1987. These petitions, as updated, request $1.6 million in additional electric revenues, or a .3 percent increase, and $2.7 million in gas revenues, or a 1.2 percent increase. These increase requests are less than the inflation rate and are in keeping with one of our corporate strategic goals of containing price increases within the inflation rate. We are also seeking an allowable rate of return on equity of 14.0 percent in these cases that must be decided by July of this year. Included in the electric rate case is the balance of Nine Mile Two nuclear plant costs that have been allowed for recovery in customer rates.

Energy Sales: Kilowatt-hour sales of electricity to customers were up 3.0 percent over 1986 sales. The gain was partly attributable to warmer summer weather that boosted air conditioner sales and use, and partly to continued growth in customers in our service territory. We added 4,904 electric customers in 1987, the second largest increase in electric customers since 1972. Two new electric peak demand



Keith W. Amish

records have been set. On July 13, 1987, a new summer peak was set at 1,205,000 kilowatts, up from the previous summer peak record set on July 15, 1986 at 1,100,000 kilowatts. On January 5, 1988 a new winter peak record was set at 1,083,000 kilowatts. The former winter peak record was set on December 18, 1985 at 1,057,000 kilowatts. It is encouraging to note that the Nine Mile Two plant is beginning to contribute to the needs of our customers. On the day of the new record winter peak, up to 55,000 kilowatts of electricity were being provided through our share of the plant that was operating under test conditions.

☐ Therm sales of natural gas sold and transported declined 3.5% in 1987, reflecting mild weather throughout the heating season. Sales would have been lower had it not been for our aggressive program to encourage large commercial and industrial customers to purchase natural gas directly from producers and use the Company's facilities for transport. Such purchases amounted to 67 million therms in 1987. Although this causes a reduction in revenues there is little effect on earnings because of the offsetting reduction in fuel expense. The customer is billed for transportation at rates which approximate rates charged to the Company's other gas customers. Our own purchases in the spot gas market saved our customers $5.1 million in 1987.

Capital Requirements: Capital requirements continue to decrease. In 1988 we expect capital requirements to be $136 million, as opposed to the 1987 requirement of $154 million. Approximately $45 million will be spent at the Company's Ginna nuclear power plant. Of that amount, $25 million will be used to continue our plant modifications and upgrade program to maintain its excellent performance record and $20 million will be used for nuclear fuel. We expect to be able to finance our capital requirements this year entirely from internal sources along with funds from shareholders who are investing under our dividend reinvestment plan. We do not expect to increase debt in 1988 and we will take advantage of opportunities to reduce long-term debt as they become available.

Ginna: The Ginna nuclear power plant achieved a 92 percent capacity factor in 1987. That was one of the highest capacity factors achieved for the year by any American nuclear power plant. Over a three-year period from 1985 to 1987 the Ginna Plant had a capacity factor of 89 percent, also one of the best by any nuclear plant in the country.

☐ On February 5, 1988 the Ginna Plant shut down for scheduled maintenance, inspection and refueling. At the time it shut down, the plant established a record for itself by running for 332 consecutive days.

Hydropower Retained: In January the New York Power Authority and the Company concluded negotiations that will allow us to retain inexpensive hydroelectric power for our residential customers through the year 2007. The existing contract expires at the end of 1989.

☐ If the agreement is approved, as is expected, RG&E will be able to retain 130,000 kilowatts of hydropower and 35,000 kilowatts of peaking power. This is good news for residential electric customers, and it represents a plan that the Company strongly favors. If we had lost the Niagara hydropower in 1990, residential electric customer rates would have increased by as much as 20 percent.

Management Changes: Mario Silvestrone, Senior Vice President, General Services, and Dean W. Caple, Secretary, retired on January 1, 1988 after completing many years of dedicated service to the Company. As previously announced, John W. Oberlies has assumed Mr. Silvestrone's responsibilities as Senior Vice President, Customer and Administrative Services. Mr. Caple's responsibilities were assumed by David C. Heiligman, who was elected Secretary and Treasurer.

☐ At the request of the Board of Directors, both of us have agreed to stay on past our normal retirement dates until Nine Mile Two is in commercial operation and performing routinely. Nine Mile Two has tended to dominate our time in office. Even though we have had to take a significant write-off and reduce the Common Stock dividend, we believe that these actions, coupled with intensive cost control on the part of our employees over the last several years, have kept the Company in a reasonably good financial condition. Now, unless some unforeseen problem should arise, Nine Mile Two will go into commercial operation shortly, allowing management to devote more attention to the future.

☐ In mid-1987, the Board of Directors announced several changes in senior management by naming a new president and chief operating officer and four senior vice presidents to take office January 1, 1988. Immediately after the announcement, the new team began actively planning the course of the Company in the post-Nine Mile Two era. Its view of the future and identification of objectives which will dictate the path for the Company's future years are shown on the next three pages.

☐ We would be remiss if we didn't thank our employees for their tremendous support over these difficult years. They have done a superb job in providing safe, reliable service to our customers during a time in which the overall work force has been reduced. We look forward to their continued cooperation with the new management team.

Paul W. Briggs

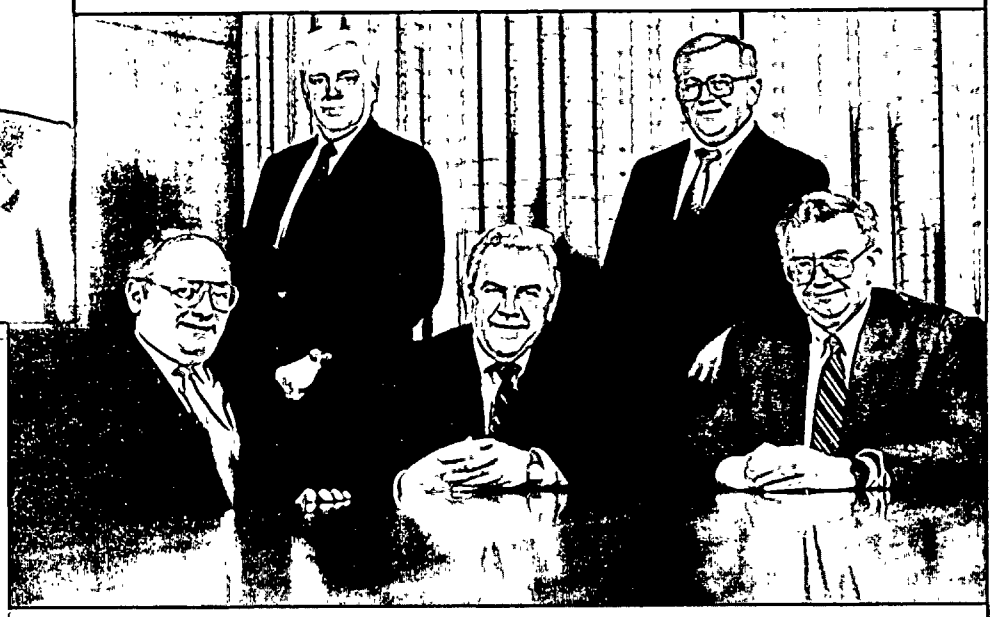
Paul W. Briggs
Chairman of the Board
and Chief Executive
Officer

Keith W. Amish

Keith W. Amish
Vice Chairman
of the Board
of Directors

February 8, 1988

Harry G. Saddock



Rochester Gas and Electric Corporation's new management team, left to right: John W. Oberlies; Roger W. Kober, (standing); David K. Laniak; Robert C. Henderson, (standing); and Harry G. Saddock.

Harry G. Saddock The year 1987 was a difficult one. A substantial write-off and related dividend reduction obscured our Company's operating results. However, in many ways we experienced favorable operating conditions. Our Ginna nuclear plant continued to perform at record levels of reliability. The number of gas and electric customers increased significantly. And the cost of gas and electricity remained stable with increases below the inflation rate. Pricing is most important in our present-day competitive society.

Your new president sees 1988 as a key year in which we are in a position to gain more control of our future. We will continue to carefully control our expenditures so that as much revenue as possible flows to earnings. The new management team you see on these pages is dedicated to earning a fair return for our investors, while providing our customers safe, reliable service at a reasonable cost. We will accomplish this by utilizing our most valuable asset—our dedicated employees.

As part of our leadership, we will adapt to the changing world around us by carefully monitoring, analyzing, then adopting measures that increase the value of our Company for its employees, customers and investors. We will never assume we are doing our best as a business, for we can always do better. While we have always given good service, we intend to provide even better service to our customers. Our independent customer attitude surveys show that customers generally hold our service in high regard. But we can, and will, improve. What is good for our customers is good for the Company and its investors. Service is the competitive edge of business today.

Each senior officer has a job plan that reflects our management strategy and has action plans to facilitate its implementation. I intend to provide the leadership needed to successfully respond to our changing world and increase the value of our Company. The challenges of 1988 will be answered with decisive actions.

Harry G. Saddock, President and
Chief Operating Officer

Robert C. Henderson

Robert C. Henderson

Senior Vice President/Controller and Chief Financial Officer Now that the Nine Mile Two construction is almost behind us and the resulting financial penalties have been incurred, we must look forward to a new era.

One of our primary goals will be to start rebuilding our retained earnings and our common equity capitalization and, at the same time, maximize the return to our common stockholders, who are the owners of the business. We will, of course, not forget your interest in dividends, both now and in the future. That will be an important factor in our financial planning process.

We are leaving behind a period in which it was necessary to raise significant amounts of new capital in the financial markets, and moving into a period in which we anticipate that all of our near-term capital requirements can be financed internally.

We will be increasing our investor relations activities in 1988 with the view toward enhancing the total return of your investment. While this program is still in the final planning stages, we will be increasing our personal contacts with analysts, investment managers, and present and prospective investors, both large and small.

From a customer perspective, we intend to continue our corporate goal of maintaining a real price decrease for our products, as we have over the last five years. With most of the Nine Mile Two capital and operational costs already reflected in our rates, customers will start to see the financial benefits of this generating unit's low fuel costs. With a continued emphasis on our ongoing cost control program, I expect that we will achieve this goal and, at the same time, improve the quality of service to our customers. ☐

Roger W. Kober

Senior Vice President/Production and Engineering In production and engineering, we remain dedicated to the safe and efficient operation of our facilities. We are continually striving to remain among the lowest-cost producers in New York State.

We have adopted a priority system for capital improvements consistent with safe operation, regulation and reliability goals. This has enabled us to minimize our capital outlays. In addition, we have established an aggressive station outage management program to help us maximize electric output. We are upgrading our hydro generating units to improve production from our lowest-cost producers.

In electric production, 1987 was a very good year. Our fossil units achieved an overall availability greater than 80 percent and our Ginna nuclear unit had an availability over 90 percent. In its 17th year of operation, the plant posted its best performance to date.

These performance levels kept our overall unit production costs trending downward during 1987 despite increased operating and maintenance expenses. Our sales to other utilities also increased in 1987, helping keep customer costs as low as possible.

As we look ahead, we are determined to maintain the excellent records we have come to expect from our generating units. We are expanding efforts to extend the lives of our fossil units and our Ginna nuclear unit. These efforts, coupled with the commercial operation of Nine Mile Two, will reduce our need for large capital investment in new generating facilities while meeting our system needs into the late 1990s. ☐

Roger W. Kober

David K. Laniak

Senior Vice President/Gas, Electric Distribution and Corporate Planning If a company is not valued by its customers, it will not be of value to its investors. Customer value comes from a combination of a product's cost and service. The people of the Gas and Electric Distribution Divisions work hard to add value to the energy they deliver to their customers.

They have done an excellent job. Record level electric loads were served last summer with no major problems, spot market natural gas purchases saved our customers $5.1 million in 1987, new customers were connected at the busiest rate in many years, and many facilities were moved to accommodate extensive road reconstruction projects.

These activities were accomplished within budget and with 162 fewer employees compared to five years ago. At the same time, service remained at an acceptable level.

What about the future? Our business is becoming more competitive. We intend to meet competition by continuing to offer a quality service at an affordable price. Emphasis on controlling our costs, careful allocation of our resources, work management initiatives, aggressively managing our existing energy supplies to achieve their maximum benefit, and focusing our resources on the services desired by our customers, will enable us to provide an energy service that our customers value and, as a result, enhance the value of our Corporation. ☐

David K. Laniak

John W. Oberlies

John W. Oberlies

Senior Vice President/Customer and Administrative Services As we chart the corporate course for 1988 and future years, we are very aware of the importance of customer satisfaction and the marketing effort of our Company.

The reaffirmation of customer awareness will be evidenced by a new program called *Customer Connection.* This program will reemphasize to our employees the importance of providing efficient, responsive and courteous service to all our customers whenever they visit or call us with a question, request or complaint. We want them to feel good about doing business with us.

The restoration of marketing to its proper role in the utility of tomorrow will enhance our ability to provide for the financial well-being of the Corporation while meeting the energy needs of our customers. This effort will promote the efficient use of our products, resulting in a positive cost-benefit relationship for our customers.

In order to accomplish all of these and our other goals and objectives as identified and monitored in the corporate Plan 88, we will supply all user departments with reliable and cost-effective services, and maximize the value received in our procurement of goods and services. We will also continue our efforts to maintain a positive public attitude toward the Corporation. We intend to take a pro-active role in speaking out on the issues that affect the Company.

We will continue our dedication to provide all Company employees a safe and pleasant work environment, compensating them in an equitable way, and providing a competitively designed benefits package. We are looking forward to the challenges of the future. ☐

The following is Management's assessment of significant factors which have affected the Company's financial condition and operating results. As indicated below, the Company's participation in the Nine Mile Two project has had a substantial impact on its financial condition and results of operations. The Company owns a 14 percent share of the Nine Mile Two facility, a 1,084,000 kilowatt nuclear generating unit that was constructed and will be operated by Niagara Mohawk Power Corporation (Niagara) near Oswego, New York. The plant is proceeding through its power ascension program leading to commercial operation, which the Company believes will commence in the second quarter of 1988.

Nine Mile Two

In October 1986 the New York State Public Service Commission (PSC) issued an order approving a settlement proposal (Nine Mile Two Settlement) which limits to $582 million the amount of the Nine Mile Two construction costs which may be included in the Company's rate base. This amount is currently comprised of $480 million of plant costs plus $102 million of customer prepaid financing costs. As a result of the Nine Mile Two Settlement, disallowed Nine Mile Two costs were recognized by the PSC in June 1987 when the Company's equity component of total capitalization, used to calculate the Company's cost of capital, was reduced effective August 1987 for rate-making purposes.

☐ Pursuant to accounting standards, as stated in Statement of Financial Accounting Standards No. 90 (SFAS-90) published by the Financial Accounting Standards Board (FASB) in December 1986, a loss resulting from disallowed costs of recently completed plants must be recognized when it becomes probable that some portion of the costs of the plant will be disallowed for rate-making purposes and a reasonable estimate of the amount of the disallowance can be made. Accordingly, the Company in September 1987 adopted the provisions of SFAS-90 and, for financial reporting purposes, recognized a $243 million after-tax write-off of the disallowed costs of its investment in Nine Mile Two based on an assumed commercial operation date of February 15, 1988. In adopting SFAS-90, the Company reflected the cumulative effect of the accounting change in its Statement of Income rather than restating previously issued financial statements. The write-off in September 1987 of $243 million includes the effect on retained earnings as of January 1, 1987 of $193 million, the reversal of $22 million in Allowance for Funds Used During Construction (AFUDC) recognized during the first nine months of 1987 and an additional $28 million to reflect other costs recognized during 1987 and certain items being disputed by the Nine Mile Two co-tenants with the PSC. An additional amount of $19 million was written off by the Company in December 1987 to reflect, for accounting purposes, an assumed commercial operation date of mid-May, 1988. Although the Company believes that no additional write-offs will be required, no such assurance can be given. Each month's delay in commercial operation of Nine Mile Two beyond mid-May 1988 is expected to require a further write-off of approximately $6 million per month. The Company does not anticipate that any costs incurred as a result of Nine Mile Two delays will be recovered through rates. Additional information regarding Nine Mile Two and the related write-off amounts is discussed in Note 10 of the Notes to Financial Statements.

Liquidity and Capital Resources

The combination of lower construction expenditures, refunding of higher cost securities and a rate increase has improved the Company's cash flow in 1987 compared to the prior two years.

Capital Requirements

The Company's capital requirements for the three-year period 1985–1987 and the current estimate of capital requirements through 1990 are summarized in the table to the right. The Company estimates total capital requirements of $136 million in 1988 of which costs related to the Nine Mile Two project constitute approximately 17 percent. Included in this table are the carrying charges, or financing costs, associated with major projects under construction. These carrying charges, which become a part of the capitalized cost of the related project, include AFUDC, discussed below and in Note 1 of the Notes to Financial Statements. In addition, such carrying charges include the recognition of certain customer prepaid Nine Mile Two financing costs as discussed below under Rate Base and Regulatory Policies.

☐ The Company begins to earn a cash return on its investment, including the carrying costs previously described, when the cost of a project is included in rate base, which generally is at the time such project is put into service. The Company's current rate base, however, includes all but approximately $50 million of allowable Nine Mile Two construction costs (see Rate Base and Regulatory Policies). This action, while reducing the amount of AFUDC, enhances the Company's current cash flow.

1987 Capital Requirements. Construction of Nine Mile Two is essentially completed and decreased construction activity at this project was responsible for over 80 percent of the approximately $40 million decline in cash expenditures for construction in 1987 compared to a year earlier.

☐ In addition to Nine Mile Two, construction requirements in 1987 for electric plant include $15 million of expenditures made at the Company's Ginna nuclear plant and $16 million for nuclear fuel. Expenditures for electric property also included $23 million invested in transmission and distribution facilities to provide service to new customers and to upgrade facilities necessary to maintain customer service standards.

Capital Requirements

Type of Facilities	Actual 1985	Actual 1986	Actual 1987	Projected 1988	Projected 1989	Projected 1990
	(Millions of Dollars)					
Electric Property:						
Nine Mile Two	$ 98	$ 69	$ 36	$ 13	$ —	$ —
Other*	57	59	48	68	61	56
Total Electric	155	128	84	81	61	56
Gas Property	12	13	14	15	15	13
Common Property	8	7	7	10	12	15
Total	175	148	105	106	88	84
Nuclear Fuel	13	12	16	22	22	26
Carrying Costs:						
Allowance for Funds Used During Construction (AFUDC)	53	45	8	4	3	3
Amortization of Deferred Financing Charges to Other Income	—	5	6	—	—	—
Total Construction Requirements	241	210	135	132	113	113
Securities Redemption, Maturities and Sinking Fund Obligations**	40	4	19	4	36	26
Total Capital Requirements	$281	$214	$154	$136	$149	$139

**Includes post in-service Nine Mile Two capital expenditures.*
***Excludes refinancings.*
Note: AFUDC prior to 1987 has not been restated to reflect the disallowance of certain Nine Mile Two plant costs recognized by the Company in 1987.

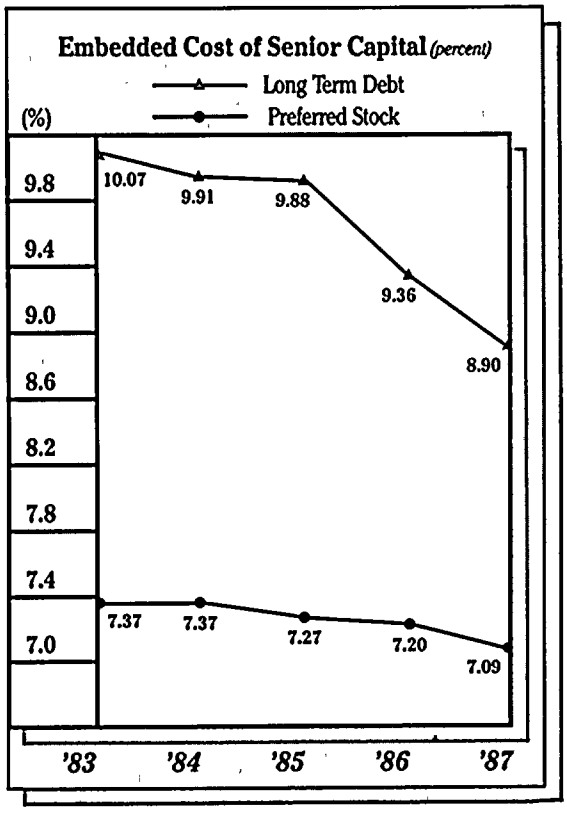
☐ Construction requirements in the Gas Department totaled $14 million in 1987, principally for the installation of gas services for new loads, the replacement of older gas services and mains, and the relocation of gas mains for highway improvement.

Projected Capital Requirements. Construction requirements, after declining in 1986 and 1987, are expected to continue to decline in 1988 as Nine Mile Two enters commercial operation. With no specific plans for major additions to generating capacity after Nine Mile Two is placed in service, the Company will carry out a program to extend the operating life of existing generating units. In addition, the Company's construction program will focus on the need to serve new customers, to provide for the replacement of utility property as such property becomes obsolete or inefficient, and to make modifications of facilities to satisfy the most recent environmental and safety requirements.

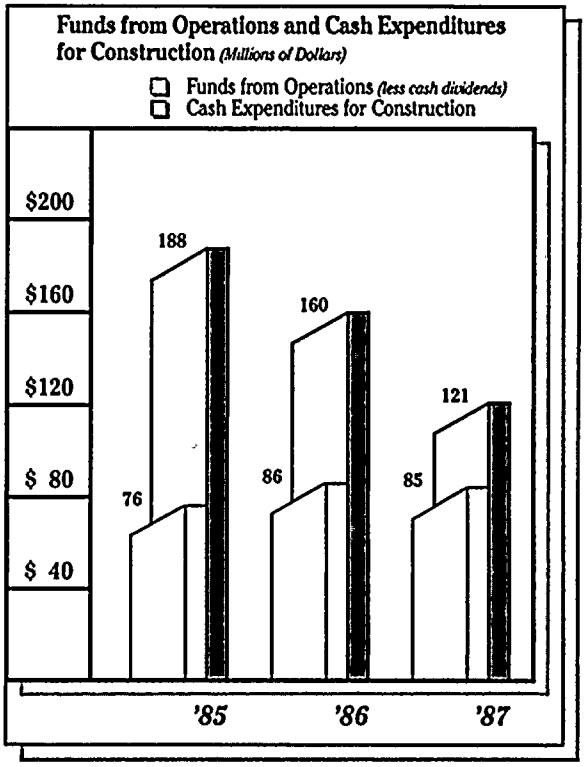
☐ The Company's capital expenditures program is under continuous review and will be revised depending upon the progress of major construction projects, capital availability, future economic conditions, customer demand for energy, rate relief, government mandates and other factors. In addition, the Company will consider, as conditions warrant, the refinancing of certain long-term securities to reduce its cost of money.

Financing and Capital Structure

The Company was active in the financial markets during 1987. In addition to obtaining funds to finance a portion of its construction requirements, the Company entered the financial markets to refinance certain senior capital obligations, as described below. Such refinancing activity, the result of favorable market rates and security provisions which allowed early redemption, contributed to a drop in the Company's embedded cost of senior capital, as illustrated by the graph below.



☐ With construction activity projected at lower levels than in past years and anticipated improvement in its cash flow, the Company believes it will not need to obtain outside financing to meet its construction requirements for the next several years. Below is a graph which compares funds from operations with the Company's cash expenditures for construction for the three-year period 1985–1987.



Financing. Subject to certain covenants relating to Nine Mile Two, interim financing is available through short-term borrowings with bank notes and commercial paper. The Company has a revolving credit agreement totaling $90 million with certain domestic banks which continues until October 1, 1988. The Company expects to negotiate a new revolving credit agreement upon the expiration of the existing agreement; however, the amount or terms of the new agreement cannot be predicted at this time. At December 31, 1987, the Company had no short-term debt outstanding.

☐ The Company's Charter provides that unsecured debt may not exceed 15 percent of the Company's total capitalization (excluding unsecured debt). As of December 31, 1987, the Company would be able to incur approximately $11 million of additional unsecured debt under this provision. In order to be able to use its revolving credit agreement, the Company has created a subordinate mortgage which secures borrowings under its revolving credit agreement that might otherwise be restricted by this provision of the Company's Charter.

☐ During 1987 the Company refinanced its 10.84% Preferred Stock, Series Q, and its First Mortgage 15⅝% Bonds, Series II. The public sale in March 1987 of 300,000 shares of the Company's 8.25% Preferred Stock, Series R, provided net proceeds of $29,700,000 which were used to redeem all 225,550 outstanding shares of the Company's 10.84% Preferred Stock, Series Q, in April 1987 at the redemption price of $107 per share, with the remaining proceeds used to finance a portion of the Company's capital expenditures program. Likewise, the Company obtained funds for its capital expenditures program and funds to redeem $50 million principal amount of its First Mortgage 15⅝% Bonds, Series II, when in May 1987 it completed the public sale of $75 million principal amount of First Mortgage 8⅞% Bonds, Series MM.

☐ In July 1987 the Company issued a $50 million promissory note (the Note) due July 15, 2027 in connection with the sale of $50 million of New York State Energy Research and Development Authority Adjustable Rate Pollution Control Revenue Bonds (Rochester Gas and Electric Corporation Project), Series 1987. Proceeds from these tax-exempt bonds were used to reimburse the Company for prior expenditures associated with the Company's share of certain pollution control facilities at Nine Mile Two. The Note's initial annual interest rate of 5⅞% is subject to adjustment on July 15, 1990 and annually thereafter.

☐ The Company during 1987 issued approximately 761,000 shares of common stock through its Automatic Dividend Reinvestment and Stock Purchase Plan, providing $14.1 million to help finance the Company's construction program. The demands of the Company's construction program and the necessity to maintain a flexible capital structure have required the Company at times over the past three years to issue common stock at a market price below the book value per share. Such sales have had a dilutive effect on the book value per share of common stock at the time of issuance. Book value per share, however, increased from $23.79 at December 31, 1985 to $24.93 at December 31, 1986. The Company's book value per share was $16.98 at December 31, 1987, which reflects the total Nine Mile Two write-off in 1987 of $262 million ($8.81 per share).

☐ In January 1988 the Company completed the redemption and exchange of its Second Mortgage 11¾% Bonds, Series A, for a new series of First Mortgage 11¾% Bonds, Series NN. This exchange was required, pursuant to the terms of the Series A Bonds, and has no effect on the Company's cost of capital or the amount of its outstanding long-term debt.

Capital Structure. As previously discussed, the Company's retained earnings were reduced in 1987 by $262 million resulting from the adoption of SFAS-90 and the recognition of disallowed Nine Mile Two plant costs. After reflecting this write-off amount, approximately 34.7 percent of the Company's capitalization at December 31, 1987 was comprised of common equity, with the

balance being comprised of 8.0 percent preferred equity and 57.3 percent long-term debt. These percentages are based on the Company's capitalization exclusive of its long-term liability to the Federal Department of Energy (see Note 1 of the Notes to Financial Statements). The Company's retained earnings, which were $17.6 million at December 31, 1987, could be further reduced if the Company is required to recognize additional disallowed Nine Mile Two costs as discussed in Note 10 of the Notes to Financial Statements. It is the Company's intention to rebuild its retained earnings, thereby strengthening its common equity position and providing greater financing flexibility.

Projected Financings. The Company currently believes funds required for its 1988–1990 capital expenditures program will be provided primarily through internally generated funds. In addition, at December 31, 1987 the Company had temporary cash investments totaling $59.3 million, resulting in part from the proceeds of long-term financings in 1987 which were not immediately utilized for capital expenditures. Upon the commercial operation of Nine Mile Two, the Company will receive a cash payment of approximately $41 million from Niagara pursuant to the terms of the Nine Mile Two Settlement (see Note 10 of the Notes to Financial Statements).

☐ The Company's estimate of internally generated funds is under continuous review and may be revised depending on the level of construction, rate relief, customer demand, sales of energy to other utilities and other factors. The Company's Certificate of Incorporation and certain of its financial agreements contain covenants which may restrict the Company's ability to issue additional preferred stock or its ability to incur additional indebtedness should capital requirements exceed current estimates and create the need for external financing greater than that provided by the Company's revolving credit agreement.

Rate Base, Accounting Change and Regulatory Policies

Recent PSC rate decisions and the Company's pending rate requests are summarized in the table below.

Rate Increases

Granted

Class of Service	Effective Date of Increase	Amount of Increase (Decrease) (Annual Basis) (000's)	Percent Increase (Decrease)	Authorized Rate of Return on Rate Base	Authorized Rate of Return on Equity
Electric	February 17, 1984	$ 3,586*	0.8%	11.91%	15.10%
	July 16, 1984	16,270	3.7	12.52	16.00
	February 1, 1985	4,535*	0.9	12.52	16.00
	July 14, 1985	5,799	1.3	12.09	15.00
	January 2, 1986	2,845*	0.6	12.09	15.00
	July 20, 1986	20,895	4.4	10.75	12.60
	January 2, 1987	1,223*	0.2	10.75	12.60
	July 17, 1987	16,198	3.4	10.48	13.20
	January 4, 1988	2,413*	0.5	10.48	13.20
Gas	February 17, 1984	1,405*	0.4	11.91	15.10
	July 16, 1984	2,011	0.6	12.52	16.00
	July 14, 1985	157	0.1	12.09	15.00
	July 20, 1986	(3,185)	(1.1)	10.75	12.60
	January 2, 1987	458*	0.2	10.75	12.60
	July 17, 1987	—	—	10.48	13.20

**Second step increase allowed.*

Pending

Class of Service	Date of Filing	Amount of Increase* (Annual Basis) (000's)	Percent Increase*	Requested Rate of Return on Rate Base	Requested Rate of Return on Equity
Electric	August 21, 1987	$1,619	0.3%	10.64%	14.00%
Gas	August 21, 1987	2,711	1.2	10.64	14.00

**As amended.*

☐ The Company's accounting policies conform to generally accepted accounting principles as prescribed by the FASB and applied to New York State utilities giving effect to the rate-making and accounting policies of the PSC. In September 1987 the Company adopted the financial accounting principles recently prescribed by the FASB for disallowed plant costs and recognized an aggregate $262 million after-tax write-off of disallowed Nine Mile Two plant costs based on a 1986 settlement agreement with the PSC. In adopting these accounting principles, the Company has reflected an accounting change in its 1987 financial statements as previously discussed under the heading Nine Mile Two.

New York State Public Service Commission (PSC). In October 1986 the PSC issued an order approving the Nine Mile Two Settlement which limits to $582 million the amount of Nine Mile Two plant construction costs which may be included in the Company's rate base. The Nine Mile Two Settlement, which is under judicial challenge, resolved a proceeding established by the PSC in July 1985 to investigate the prudence of costs relating to the construction of Nine Mile Two.

☐ To implement the Nine Mile Two Settlement discussed above, the PSC in the Company's June 1987 rate decision established new rates calculated on a reduced equity component of total capitalization, as discussed under the heading Nine Mile Two. This action effectively reduces future revenues by reducing the base on which future rates will be calculated. Disallowed costs determined by the PSC were based on an estimated February 15, 1988 commercial operation date. Because commercial operation is now expected to be achieved at a later date, it appears likely the PSC will reduce the Company's capitalization for rate-making purposes accordingly when it issues its next rate decision in connection with the Company's pending rate requests.

☐ Currently, $430 million of Nine Mile Two expenditures are being reflected in electric rates. Accordingly, the Company's current cash flow has been enhanced, and the amount of AFUDC has been reduced because AFUDC is not accrued on those amounts included in rate base. Up to commercial operation, however, a comparable amount calculated similarly to AFUDC and representing customer prepaid financing costs is being recorded on the Balance Sheet as a liability, shown as a deferred credit. An equivalent amount is being recorded as an asset, shown as a deferred debit on the Company's Balance Sheet, since it represents deferred financing costs (or AFUDC) which are expected to be recovered over the life of the facility through amortization if the PSC chooses to utilize these amounts to moderate customer rates. The Company is currently seeking permission in its pending rate case to offset the unused portion of customer prepaid financing costs. Such amounts are anticipated to be $90.7 million. Pursuant to PSC authorization, the Company has amortized $10.9 million of such deferred credits to Other Income. Such amounts, which totaled $4.5 million in 1986 and $6.4 million in 1987, represent non-cash earnings.

☐ When Nine Mile Two begins commercial operation, the Company will accrue a return on the balance of allowable Nine Mile Two expenditures not yet included in rate base, as permitted by the PSC in the Company's July 1986 rate decision. This accrual will appear on the Company's Income Statement as a non-cash item subsequent to commercial operation. The Company will cease accruing this carrying charge once all allowable Nine Mile Two expenditures have been included in rate base.

☐ The Company's rate case filed with the PSC in August 1987 requests that the remaining increment of allowable Nine Mile Two expenditures (currently estimated at $50 million) be included in rate base commencing with the rate year beginning August 1, 1988. The table on page 11 summarizes the Company's pending rate requests. The staff of the PSC and intervenors have proposed lower rate increases than those sought by the Company. The Company is unable to predict what, if any, rate changes may be approved by the PSC. It is anticipated that any new rates resulting from the Company's pending rate requests will not take effect before July 1988.

Results of Operations

The following financial review identifies the causes of significant changes in the amounts of revenues and expenses, comparing 1987 to 1986 and 1986 to 1985. The Notes to Financial Statements on pages 20 to 34 of this report contain additional information. The Company's portion of operating and maintenance expenses of Nine Mile Two will be included in the appropriate expense categories when that project begins commercial operation.

Operating Revenues and Sales

Compared with a year earlier, operating revenues decreased two percent in 1987, reflecting lower purchased gas costs to be recovered. Operating revenues increased one percent in 1986. Details of the revenue changes are presented in the table to the upper right.

☐ Electric revenues derived from rate increases include approximately $13.7 million in 1987 and $4.2 million in 1986 which are applicable to Nine Mile Two operations and have been deferred through expense accruals. These revenues, therefore, did not affect earnings.

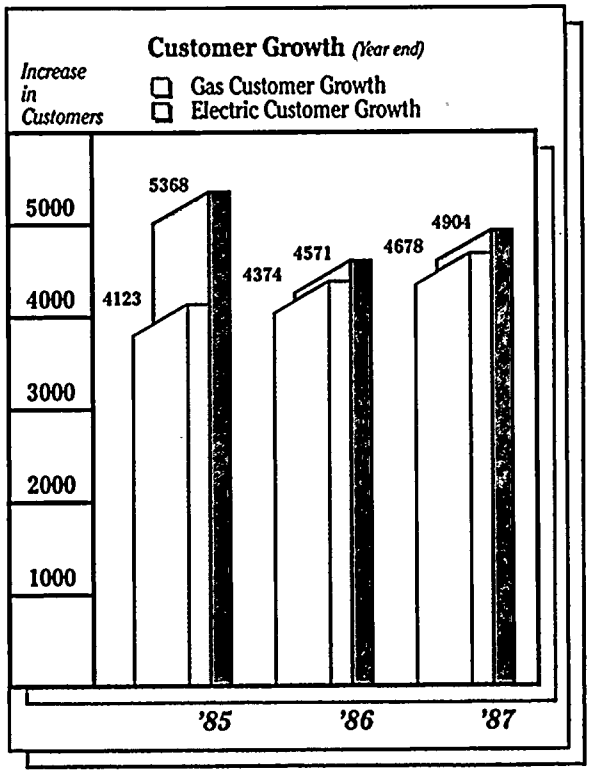
☐ A continuing decline in the average cost of fuel used for electric generation resulted in a lowering of the level of fuel costs in base tariffs. As a result, a transition adjustment was ordered by the PSC in 1987 which

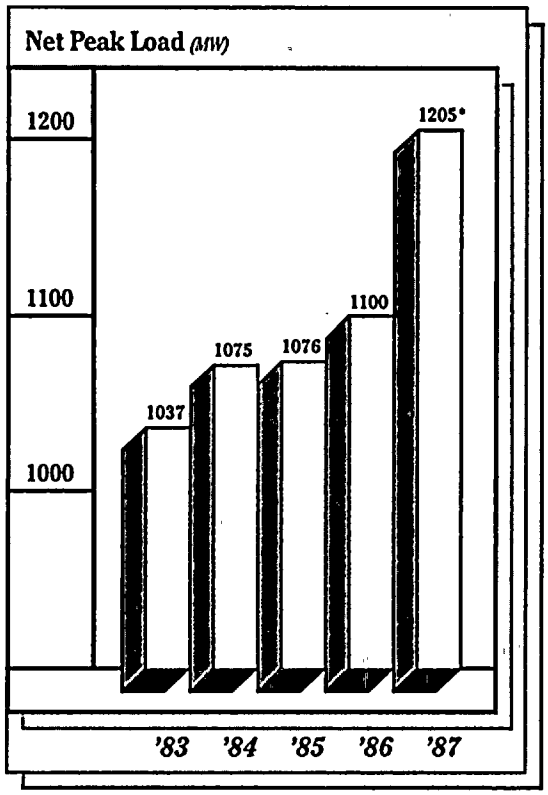
Operating Revenues

Increase or (Decrease) from Prior Year (Thousands of Dollars)	Electric Department 1987	Electric Department 1986	Gas Department 1987	Gas Department 1986
Customer Revenues (Estimated) from:				
Rate Increases	$ 19,924	$ 13,598	$ (1,499)	$ (717)
Fuel Clause Adjustments	(11,841)	16,716	(18,865)	(3,384)
Weather Effects	(559)	686	(8,551)	10,843
Customer Consumption	11,340	8,298	(2,654)	(2,099)
Other	3,855	(2,252)	(14,061)	(12,517)
Total Change in Customer Revenues	22,719	37,046	(45,630)	(7,874)
Electric Sales to Other Utilities	5,750	(23,638)	—	—
Total Change in Operating Revenues	$ 28,469	$ 13,408	$(45,630)	$ (7,874)

effectively transferred $9.4 million from tariff revenues to fuel clause adjustment revenues. The Company's fuel cost provisions provide that ratepayers and shareholders will share the risks or benefits derived depending on whether actual fuel costs are above or below forecasted amounts, as set by the PSC and discussed in Note 1 of the Notes to Financial Statements. In addition, fuel cost adjustment provisions include the sharing arrangement between ratepayers and shareholders for earnings derived from sales of electricity to other electric utilities in relation to targets for such sales. Any variation from a forecast of such targets as set by the PSC in the Company's electric rate schedule, will be shared 80 percent by ratepayers and 20 percent by shareholders. As a result of these sharing arrangements between ratepayers and shareholders, $9.7 million of pretax earnings are included in the Company's earnings for 1987. Likewise, earnings in 1986 include $12.7 million of pretax earnings related to these provisions.

- The effect of weather variations on operating revenues is most notable in the Gas Department, where revenues from space heating customers normally comprise 85 to 90 percent of total gas operating revenues. Temperatures for the first three months of the year, traditionally the period of heaviest demand for natural gas, were largely responsible for the variation in gas operating revenues due to weather fluctuations. Measured on a customer billing degree day basis, the weather as related to heating in 1987 was four and one-half percent warmer than 1986, with temperatures in the first quarter of 1987 being over four percent above the comparable period a year earlier. Conversely, billing degree days for the first three months of 1986 were approximately six percent lower than the first quarter of 1985, resulting in weather for all of 1986 being five percent colder than 1985.
- An increase in kilowatt-hour sales of electricity to all major customer classes in 1987 resulted in a 3.0 percent increase in customer sales over 1986. Stimulated by the unusually warm weather during the summer months, an increased use of air conditioning contributed to higher electric consumption by customers in 1987 compared with a year earlier. In addition, the sale of electric energy in 1987 reflects the continued strong growth in the number of customers, as reflected by the graph below. In July 1987, the Company experienced a new record demand of 1,205 megawatts on its electric system, or 9.5 percent above the 1986 peak demand, as illustrated by the graph on page 14. In 1986, increases in sales to residential and commercial customers, partially offset by a decline in sales to industrial customers, resulted in a 1.2 percent increase in kilowatt-hour sales of energy compared with 1985.





*New all-time peak demand on July 13, 1987

☐ Fluctuations in revenues from electric sales to other utilities are generally related to the Company's customer energy requirements, New York Power Pool energy market conditions and the availability of electric generation from the Company's nuclear-fueled plants, including in 1987 generation resulting from precommercial testing at Nine Mile Two. The availability of energy generated at Nine Mile Two will affect energy sales to other utilities to a greater extent as that plant enters commercial operation. Operation of the Ginna nuclear plant and Nine Mile Two allows the Company to sell more expensive fossil-fueled generation to other utilities while retaining lower cost nuclear-generated energy for the Company's own electric customers.

☐ Since October 1985 the Company has transported gas for certain large commercial and industrial customers who are able to purchase natural gas directly from producers and use the Company's facilities to transport it. Gas supplies transported in this manner, which amounted to 67.5 million therms in 1987 and 24.6 million therms in 1986, are not included in Company therm sales. These purchases cause decreases in customer revenues (included as "Other" changes in the table on page 13), with offsetting decreases in fuel expenses, but do not adversely affect earnings because these customers are billed at rates, which except for the cost of gas, approximate the rates charged the Company's other gas service customers.

☐ Total therms sold and transported decreased in 1987 by 3.5 percent after increasing 2.2 percent in 1986. These fluctuations reflect the effect of weather variations, as previously discussed, primarily on therm sales to residential customers with gas space heating. Boosting therm sales in 1987 and 1986 was the addition of new gas customers as illustrated by the graph on page 13. Several large dual-fuel industrial customers switched to using No. 6 fuel oil during 1987; however, many of these customers in recent months have resumed burning gas as the result of lower gas rates.

Operating Expenses

Compared with the prior year, operating expenses decreased 3.7 percent in 1987 following a modest one percent increase in 1986. A summary of these changes is presented in the table below.

Operating Expenses

Increase or (Decrease) from Prior Year (Thousands of Dollars)	1987	1986
Fuel for Electric Generation	$ 11,912	$(21,641)
Purchased Electricity	(3,677)	2,340
Deferred Fuel—Electric	(2,806)	9,051
Gas Purchased for Resale	(39,168)	(13,740)
Other Operation	10,830	19,067
Maintenance	1,357	2,249
Depreciation and Amortization	3,458	5,356
Taxes Charged to Operating Expenses	(5,621)	4,480
Total Change in Operating Expenses	$(23,715)	$ 7,162

Energy Costs—Electric. For the 1987 comparison period, increased generation from both the Company's fossil-fueled units and the Ginna nuclear plant was responsible for the increase in fuel expenses for electric generation. This higher generation reflects increased energy demand from customers and greater sales of energy to other utilities. For the 1986 comparison period, the decline in fuel expenses is a result of less generation from the Company's fossil-fueled units. Both comparison periods reflect declining costs for coal.

☐ Fluctuations in purchased electricity expense resulted primarily from changes in kilowatt-hours purchased, together with declining average rates for the 1986 comparison period.

☐ Fuel costs are expensed currently to the extent recovered in revenues in accordance with PSC policy. Deferred fuel provisions are being adjusted for profit margins from sales to other electric utilities and the reduction in deferred electric fuel expense in 1987 results mainly from the recognition of such profit margins. In 1986, declining fuel costs resulted in higher net deferred electric fuels compared to 1985.

Energy Costs—Gas. The gas procurement practices of the Company reflect a transition to a more open-market approach taking place in the gas utility industry. This approach allows the Company to take advantage of favorable spot market purchases. These purchases, together with contract purchases, provide more flexibility in responding to price variations while helping to assure an adequate supply of gas. The cost of gas purchased for both comparison periods reflects lower average rates, together with a decrease in the volume of gas purchased.

Operating Expenses, Excluding Fuel. Excluding accounting procedures in 1987 which affected certain operating accounts, other operation expenses were unchanged in 1987 compared with the prior year. Increasing other operation expenses in 1987 by $9.5 million was an accounting procedure in connection with the deferral of Nine Mile Two revenues (see Operating Revenues and Sales). Primarily as a result of this accounting procedure, together with the discontinuance of an accounting procedure to levelize the Company's portion of profits from sales of electric energy to other utilities, other operation expenses increased in 1986 compared with a year earlier.

Taxes. The fluctuation in local, state and other taxes in both comparison periods primarily reflects gross income and gross earnings taxes, which are based on revenues, together with the effect of higher property taxes resulting from the addition of new plant.

☐ In October 1986, the Tax Reform Act of 1986 (Tax Act) was enacted. The major components of the Tax Act affecting the Company are a reduction in the Company's marginal Federal income tax rate from 46 percent in 1986 to 40 percent in 1987, with provision for a further reduction to 34 percent for calendar years 1988 and thereafter, the elimination of investment tax credits and the inclusion of unbilled revenues in taxable income. The provisions of the Tax Act will result in higher currently payable Federal income taxes, but a lower Federal income tax provision for regulatory purposes. The PSC in its June 1987 rate order incorporated these tax changes through July 1988, and the Company has reflected the balance of them in its currently pending rate increase applications.

☐ In December 1987, the FASB issued a Statement of Financial Accounting Standards entitled "Accounting for Income Taxes" (SFAS-96). Among other things, the SFAS-96 requires the Company to adjust certain of its deferred tax assets and liabilities to reflect periodic changes in tax rates. In addition, the Company may also be required to provide deferred taxes for the effect of taxes previously flowed through to the Income Statement. The Company believes it would be permitted to defer such adjustments and include them as part of the cost of service in future rate proceedings. SFAS-96 is effective for fiscal years beginning after December 15, 1988 with earlier application encouraged.

Other Statement of Income Items

As discussed above, the Company's Statement of Income reflects the cumulative effect as of January 1, 1987 of an accounting change in connection with the write-off of disallowed Nine Mile Two plant costs in 1987. Disallowed costs for the period subsequent to January 1, 1987 are reported under the caption "Other Income and Deductions" on the Statement of Income.

☐ AFUDC variances are generally related to the amount of utility plant under construction not included in rate base. AFUDC is not being recognized on disallowed Nine Mile Two plant costs; and, for 1987, the amount of AFUDC reported reflects such disallowance for the entire year. AFUDC reported in prior years has not been restated as a result of the accounting change adopted by the Company and referenced above.

☐ Other Income includes $6.4 million in 1987 and $4.5 million in 1986 associated with the amortization of certain customer prepaid Nine Mile Two financing costs which had been deferred, as discussed above.

☐ The issuance of additional long-term debt in May and December 1985, August 1986, and May and July 1987 has increased long-term debt interest expense over the past three years. More than offsetting this additional expense in the 1987 comparison period, however, was the reduction in interest expense due to the redemption in June 1987 of the Company's 15⅝% First Mortgage Bonds, Series II, and the redemption of the Company's 16¾% First Mortgage Bonds, Series GG, in September 1986. The redemption of the Series GG Bonds partially offset the increase in long-term interest expense in the 1986 comparison period.

☐ Compared to 1985, decreased dividends on preferred and preference stock in 1986 largely reflect the Company's repurchase of shares of its preference stock in October 1985.

Earnings/Summary

The table below presents the Company's common earnings in total and on a per-share basis as reported and as modified in 1987 and 1986 to exclude the effect of the Nine Mile Two write-off and to exclude AFUDC on the disallowed Nine Mile Two costs.

☐ Analysis of the PSC's 1987 rate decision discussed above indicated that anticipated earnings were not expected to cover the Common Stock dividends which would have been paid at the former annual rate of $2.20 per share. Accordingly, in September 1987 the Company announced a reduction in its quarterly dividend rate for Common Stock from $.55 per share to $.375 per share, or $1.50 on an annual basis. Although the Company believes that this new dividend rate is sustainable, its ability to maintain the Common Stock dividend and its Preferred Stock dividend is necessarily dependent on future earnings. The Company's Certificate of Incorporation provides for the payment of dividends on Common and Preferred Stock out of retained earnings only. As of December 31, 1987 the Company's retained earnings (after giving effect to the write-offs described above) were approximately $18 million. In 1987, earnings per share, excluding the impact of the Nine Mile Two write-off, were sufficient to maintain the current dividend level. Although the Company believes that no additional write-offs will be required, no such assurance can be given and an additional write-off could adversely affect the ability of the Company to pay its Common or Preferred Stock dividend if the retained earnings were to be eliminated or become negative until sufficient positive retained earnings were established.

Earnings Summary

	Earnings (Thousands of Dollars)	Shares[1] (Thousands)	Earnings per Share
1987			
As Reported	$(176,858)	29,728	$(5.95)
Excluding Nine Mile Two Write-Off	$ 63,042[2]	29,728	$ 2.12
1986			
As Reported	$ 96,461	28,927	$ 3.33
Excluding Nine Mile Two Write-Off	$ 67,161[2]	28,927	$ 2.32
1985			
As Reported	$ 99,001	27,641	$ 3.58

[1]*Weighted average shares outstanding.*

[2]*Reported earnings modified to exclude disallowed Nine Mile Two costs written off in 1987 and to exclude AFUDC on these costs in 1987 and 1986. See Note 10 of the Notes to Financial Statements.*

Statement of Income

(Thousands of Dollars)	Year Ended December 31	1987	1986	1985
Operating Revenues	Electric	$ 489,215	$466,496	$429,450
	Gas	216,058	261,688	269,562
		705,273	728,184	699,012
	Electric sales to other utilities	26,215	20,465	44,103
	Total Operating Revenues	731,488	748,649	743,115
Operating Expenses	Fuel Expenses			
	Fuel for electric generation	61,443	49,531	71,172
	Purchased electricity	26,467	30,144	27,804
	Electric deferred fuel	(151)	2,655	(6,396)
	Gas purchased for resale	121,736	160,904	174,644
	Total Fuel Expenses	209,495	243,234	267,224
	Operating Revenues Less Fuel Expenses	521,993	505,415	475,891
	Other Operating Expenses			
	Operations excluding fuel expenses	159,170	148,340	129,273
	Maintenance	46,124	44,767	42,518
	Depreciation and amortization	55,530	52,072	46,716
	Taxes—local, state and other	82,869	84,590	81,983
	Federal income tax—current	32,781	22,521	12,974
	—deferred	23,144	37,304	44,978
	Total Other Operating Expenses	399,618	389,594	358,442
	Operating Income	122,375	115,821	117,449
Other Income and Deductions	Allowance for other funds used during construction	5,030	32,828	38,393
	Federal income tax	17,520	13,880	13,344
	Disallowed project costs	(55,860)	—	—
	Other, net	8,831	6,725	3,899
	Total Other Income and Deductions	(24,479)	53,433	55,636
	Income Before Interest Charges	97,896	169,254	173,085
Interest Charges	Long term debt	73,489	74,571	70,373
	Other, net	2,814	2,142	2,227
	Allowance for borrowed funds used during construction	(2,696)	(11,978)	(14,339)
	Total Interest Charges	73,607	64,735	58,261
	Income from Continuing Operations, Before Cumulative Effect of Accounting Change	24,289	104,519	114,824
	Discontinued Steam Operations	—	—	(6,356)
	Cumulative Effect for Years Prior to 1987 of Accounting Change for Disallowed Costs (less related Federal income tax benefits of $65,000)	(193,000)	—	—
	Net Income (Loss)	(168,711)	104,519	108,468
	Dividends on Preferred and Preference Stock	8,147	8,058	9,467
	Earnings (Loss) Applicable to Common Stock	$(176,858)	$ 96,461	$ 99,001
	Weighted Average Number of Shares for Period (000's)	29,728	28,927	27,641
	Earnings (Loss) per Common Share—Continuing Operations	$ .54	$3.33	$3.81
	—Discontinued Operations	—	—	(.23)
	—Cumulative Effect of Accounting Change	(6.49)	—	—
	—Total	$ (5.95)	$3.33	$3.58

Statement of Retained Earnings

(Thousands of Dollars)	Year Ended December 31	1987	1986	1985
	Balance at Beginning of Period	$ 249,505	$216,795	$179,676
	Add			
	Net Income (Loss)	(168,711)	104,519	108,468
	Total	80,794	321,314	288,144
	Deduct			
	Dividends declared on capital stock			
	Cumulative preferred stock	8,147	8,058	8,154
	Preference stock	—	—	1,313
	Common stock	55,030	63,751	61,882
	Total	63,177	71,809	71,349
	Balance at End of Period	$ 17,617	$249,505	$216,795

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

Balance Sheet

(Thousands of Dollars)	At December 31	1987	1986
Assets	**Utility Plant**		
	Electric	$1,031,334	$ 996,540
	Gas	258,828	244,909
	Common	81,637	77,818
	Nuclear fuel	188,049	211,752
		1,559,848	1,531,019
	Less: Accumulated depreciation	457,605	417,350
	Nuclear fuel amortization	129,235	153,672
		973,008	959,997
	Construction work in progress	501,738	768,905
	Net Utility Plant	1,474,746	1,728,902
	Current Assets		
	Cash and temporary cash investments	60,146	3,778
	Accounts receivable, net of allowance for doubtful accounts: 1987—$5,498; 1986—$5,708	53,709	54,455
	Receivable under Nine Mile cotenant agreement	40,600	40,600
	Materials and supplies, at average cost		
	Fossil fuel	9,707	13,151
	Construction and other supplies	10,544	11,071
	Prepayments	9,603	11,323
	Federal income taxes receivable	—	6,844
	Total Current Assets	184,309	141,222
	Deferred Debits		
	Sterling project property loss	19,052	42,577
	Unamortized debt expense	14,678	12,022
	Deferred finance charges—Nine Mile project	73,631	38,306
	Other	24,165	21,435
	Total Deferred Debits	131,526	114,340
	Total Assets	$1,790,581	$1,984,464
Capitalization and Liabilities	**Capitalization**		
	Long term debt—mortgage bonds	$ 703,426	$ 681,182
	—promissory notes	141,900	91,900
	Preferred stock redeemable at option of Company	67,000	67,000
	Preferred stock subject to mandatory redemption	50,797	43,485
	Common shareholders' equity		
	Common stock	494,018	479,704
	Retained earnings	17,617	249,505
	Total Common Shareholders' Equity	511,635	729,209
	Total Capitalization	1,474,758	1,612,776
	Long Term Liability—Department of Energy	47,773	44,950
	Current Liabilities		
	Long term debt due within one year	2,750	17,750
	Preferred stock redeemable within one year	812	1,625
	Short term debt	—	18,000
	Accounts payable	32,833	29,178
	Dividends payable	13,297	18,069
	Taxes accrued	3,423	3,162
	Interest accrued	15,922	14,236
	Pension costs accrued	1,359	—
	Other	20,108	16,328
	Total Current Liabilities	90,504	118,348
	Deferred Credits and Other Liabilities		
	Accumulated deferred income taxes	86,884	149,413
	Deferred finance charges—Nine Mile project	73,631	38,306
	Other	17,031	20,671
	Total Deferred Credits and Other Liabilities	177,546	208,390
	Commitments and Other Matters *(Notes 10 and 11)*		
	Total Capitalization and Liabilities	$1,790,581	$1,984,464

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

Statement of Changes in Financial Position

(Thousands of Dollars)	Year Ended December 31	1987	1986	1985
Sources of Funds	**Operations**			
	Income (loss) from Continuing Operations	$(168,711)	$104,519	$114,824
	Principal non-cash charges (credits) to income			
	Depreciation and amortization	55,530	52,072	46,716
	Amortization of nuclear fuel	20,678	18,598	17,356
	Deferred fuel—electric	(151)	2,655	(6,396)
	Deferred income taxes, net	4,984	22,810	29,856
	Allowance for funds used during construction	(7,726)	(44,806)	(52,732)
	Other, net	(4,839)	2,288	(2,855)
	Total from Continuing Operations	(100,235)	158,136	146,769
	Disallowed project costs—Nine Mile plant	248,860		
	Income (loss) from Discontinued Operations			(6,356)
	Principal non-cash charges (credits) to income			
	Loss on sale of steam plant			8,951
	Depreciation			532
	Deferred fuel—steam			152
	Deferred income taxes, net			(2,320)
	Total from Discontinued Operations			959
	Total from Operations	148,625	158,136	147,728
	Financing			
	Sale of long term debt, mortgage bonds	75,000	75,000	50,000
	Sale of long term debt, promissory notes	50,000		40,200
	Sale of common stock	16,268	18,827	56,907
	Sale of preferred stock	30,000		
	Proceeds from short term debt, net		18,000	
	Total from Financing	171,268	111,827	147,107
	Total Sources of Funds	$ 319,893	$269,963	$294,835
Uses of Funds	**Utility Plant**			
	Plant additions	$ 110,139	$194,315	$226,993
	Receivable under Nine Mile cotenant agreement		(40,600)	
	Nuclear fuel additions	18,552	14,893	15,847
	Less: Allowance for funds used during construction	7,726	44,806	52,732
	Additions to Utility Plant	120,965	123,802	190,108
	Dividends on preferred stock	8,147	8,058	8,154
	Dividends on preference stock			1,313
	Dividends on common stock	55,030	63,751	61,882
	Retirement of long term debt	52,750	67,750	2,750
	Retirement of preferred and preference stock, net	22,649	2,472	1,366
	Gas supplier refunds due customers	(1,816)	3,240	(1,200)
	Sterling project property loss	(17,023)		17,769
	Retirement of short term debt	18,000		
	Capital stock expense	1,993	166	1,303
	Discount and expense of issuing long term debt	4,476	3,729	1,839
	Other, net	1,791	2,068	(16,462)
	Increase (decrease) in working capital	52,931	(5,073)	26,013
	Total Uses of Funds	$ 319,893	$269,963	$294,835
Changes in Components of Working Capital	**Increase (decrease) in current assets**			
	Cash and temporary cash investments	$ 56,368	$ (42,262)	$ (2,386)
	Accounts receivable	(746)	(12,037)	(1,145)
	Receivable under Nine Mile cotenant agreement		40,600	
	Materials and supplies—fossil fuel	(3,444)	1,438	(4,998)
	—construction and other supplies	(527)	1,770	(868)
	Prepayments	(1,720)	1,137	2,087
	Federal income taxes receivable	(6,844)	6,359	485
	Total	43,087	(2,995)	(6,825)
	Increase (decrease) in current liabilities (excluding short term debt)			
	Accounts payable	5,014	(17,669)	1,066
	Dividends payable	(4,772)	350	870
	Taxes accrued	261	1,378	(5,525)
	Accrued interest	1,686	(349)	1,309
	Long term debt due within one year	(15,000)	15,000	(7,250)
	Preferred and preference stock redeemable within one year	(813)		(28,000)
	Other, net	3,780	3,368	4,692
	Total	(9,844)	2,078	(32,838)
	Increase (decrease) in working capital (excluding short term debt)	$ 52,931	$ (5,073)	$ 26,013

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

Note 1. Summary of Accounting Policies

General. The Company is subject to regulation by the Public Service Commission of the State of New York (PSC) under New York statutes and by the Federal Energy Regulatory Commission (FERC) as a licensee and public utility under the Federal Power Act. The Company's accounting policies conform to generally accepted accounting principles as applied to New York State public utilities giving effect to the rate-making and accounting practices and policies of the PSC.

☐ In December 1986, the Financial Accounting Standards Board (FASB) issued its Statement of Financial Accounting Standards No. 90 (SFAS-90) with respect to, among other things, the financial accounting for disallowed costs of recently completed plants. Under SFAS-90, a loss must be recognized when it becomes probable that some portion of the costs of the plant will be disallowed for rate-making purposes and a reasonable estimate of the amount of the disallowance can be made. SFAS-90 is generally effective beginning in 1988 with earlier application encouraged, but applies to plant costs disallowed prior thereto. The Company elected to adopt SFAS-90 in the third quarter of 1987 for its investment in Nine Mile Point Nuclear Plant. SFAS-90 does not apply to the Sterling project.

☐ In adopting SFAS-90, the Company presented the cumulative effect of the accounting change prior to January 1, 1987 in the Statement of Income rather than restate previously issued financial statements. Refer to Note 10 for additional information.

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

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

☐ Tariffs for electric and gas service include fuel cost adjustment clauses which adjust the rates monthly to reflect changes in the actual average cost of fuels. The electric fuel adjustment provides that ratepayers and the Company will share the effects of any variation from forecast monthly unit fuel costs on an 80%/20% basis up to a $3.3 million cumulative, after tax, annual gain or loss to the Company. Thereafter, 100 percent of additional fuel clause adjustment amounts are assigned to ratepayers. The electric fuel adjustment also provides for the sharing between the ratepayers and the Company, on an 80%/20% basis, any variances in gains or losses from PSC established forecast amounts related to electricity sales to other electric utilities.

☐ The gas department tariffs provide a separate rate to reflect charges for the transportation of privately owned gas through the Company's facilities.

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

Utility Plant, Depreciation and Amortization. The cost of additions to utility plant and replacement of retirement units of property is capitalized. Cost includes labor, material, and similar items, as well as indirect charges such as engineering and supervision, and is recorded at original cost. See Note 10 for discussion of the Nine Mile Point Nuclear Plant. The Company capitalizes an allowance for funds used during construction approximately equivalent to the cost of capital devoted to plant under construction that is not included in its rate base. Replacement of minor items of property is included in maintenance expenses. Costs of depreciable units of plant retired are eliminated from utility plant accounts, and such costs, plus removal expenses, less salvage, are charged to accumulated depreciation and amortization.

☐ Depreciation in the financial statements is provided on a straight-line basis at rates based on the estimated useful lives of property, which have resulted in provisions of 3.6%, 3.6% and 3.5% per annum of average depreciable property in 1987, 1986 and 1985, respectively. Amortization includes $6.5 million in 1987, $5.5 million in 1986 and $4.1 million in 1985 related to the Sterling project property loss. See Note 11.

Nuclear Fuel Disposal Costs. The Nuclear Waste Policy Act (Act) of 1982, as amended, requires the United States Department of Energy (DOE) to establish a nuclear waste disposal site by 1998 and to take title to nuclear waste. The Act provides for a determination of the fees collectible by the DOE for the disposal of nuclear fuel irradiated prior to April 7, 1983 and for three payment options. The option of a single payment to be made at any time prior to the first delivery of fuel to the DOE was selected in June 1985. The Company estimates the fees owed, including accrued interest, to the DOE to be approximately $47.8 million at December 31, 1987. The Company has collected in rates and credited to the nuclear fuel amortization reserve an amount sufficient for the disposal of nuclear fuel irradiated prior to April 7, 1983. The estimated fees are classified as a long-term liability. The Act also provides for the disposal of nuclear fuel irradiated after April 6, 1983, in exchange for a charge of one mill ($.001) per KWH generated at nuclear plants. This charge is currently being collected from customers and paid to the DOE pursuant to PSC authorization.

(Note 1 continued on page 21)

(Continued from page 20)

Nuclear Decommissioning Costs. Decommissioning costs (costs to take the plant out of service in the future) for the Company's Ginna Nuclear Plant are estimated by the PSC to be approximately $179.1 million in the year 2006 when the permanent license expires. Through December 31, 1987, the Company has accrued $18.9 million for this purpose and is currently accruing additions to a reserve at a rate of $2.7 million per year based on a graduated revenue requirement methodology adopted by the PSC.

Allowance for Funds Used During Construction. The Company capitalizes an Allowance for Funds Used During Construction (AFUDC) based upon the net cost of borrowed funds for construction purposes, and a reasonable rate upon the Company's other funds when so used. In accordance with an order issued by the FERC, AFUDC is segregated into two components and classified in the Statement of Income as Allowance for Borrowed Funds Used During Construction, an offset to Interest Charges, and Allowance for Other Funds Used During Construction, a part of Other Income.

☐ Effective July 16, 1984, pursuant to PSC authorization, the Company discontinued accruing AFUDC on $50 million of construction work in progress related to its investment in the Nine Mile Point Nuclear Plant Unit No. 2 (Unit) for which a cash return is being allowed through its inclusion in rate base. An additional $150 million and $230 millon were included in rate base, effective July 9, 1985 and July 14, 1986, respectively, as authorized by the PSC. The PSC also ordered in 1984 that amounts be accumulated in deferred debit and credit accounts equal to the amount of AFUDC which is no longer accrued. As a consequence of such order, the balance in the deferred credit account would be available to reduce future revenue requirements over a period substantially shorter than the life of the Unit and the balance in the deferred debit account would then be collected from customers over a longer period of time. At December 31, 1987, the cumulative balance was $73.6 million. In accordance with PSC Opinion 86-17, issued July 14, 1986, $10.875 million of these accruals were amortized over the rate year commencing August 1, 1986. The deferred credit was discharged through the income statement in 1986 and 1987, while the deferred debit was reclassified into a separate deferred debit account. In September 1987, the Company wrote off $22.1 million in AFUDC that had been recorded in 1987, applicable to PSC disallowed expenditures in the Unit. See Note 10.

☐ The gross rates approved by the PSC for purposes of computing AFUDC were: 10.20% effective August 1, 1987; 10.60% effective August 1, 1986 through July 31, 1987; 12.00% effective August 1, 1985 through July 31, 1986 and 12.30% for the seven months ended July 31, 1985. AFUDC on certain major construction projects, however, including the Unit, has been applied at a reduced rate which is net of the income tax effect of the interest portion of AFUDC. The net-of-tax rates used on these projects for 1987, 1986 and 1985 were 8.47%, 9.32% and 9.94%, respectively.

Federal Income Tax. For income tax purposes, depreciation is computed using the most liberal methods permitted. In addition, certain costs capitalized for financial reporting purposes were deducted currently for income tax purposes in accordance with the Internal Revenue Code prior to the enactment of the Tax Reduction Act of 1986. The resulting tax reductions were offset by provisions for deferred income taxes only to the extent ordered or permitted by regulatory authorities. The cumulative balance of tax deductions not offset by provisions for deferred income taxes through 1987 is approximately $375 million.

☐ The Company provides for full normalization of depreciation and investment tax credits. The Tax Reform Act of 1986 provided for the repeal of investment tax credits; however, some credits continue to be available under the transitional rules contained in the Tax Act.

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

☐ SFAS-96, Accounting for Income Taxes, was issued in December of 1987 and has not yet been adopted. SFAS-96 requires that a deferred tax liability or asset be adjusted in the period of enactment for the effect of changes in tax laws or rates. Additionally, the Company may also be required to provide deferred taxes for the effect of taxes previously flowed through the Income Statement. SFAS-96 is effective for fiscal years beginning after December 15, 1988, with earlier application encouraged.

Retirement Health Care and Life Insurance Benefits. The Company provides certain health care and life insurance benefits for retired employees and health care coverage for surviving spouses of retirees. 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 upon the experience of benefits actually paid. The Company recognizes the costs of providing these benefits by a current charge to expense. The cost of providing these benefits was approximately $1.8 million in 1987, $1.6 million in 1986 and $1.8 million in 1985.

Earnings and Dividends Per Share. Earnings applicable to each share of common stock are based on the weighted average number of shares outstanding during the respective years. The pro forma earnings (loss) per share, assuming the accounting change described above and in Note 10 was applied retroactively, are $.54 in 1987 and $(3.33) in 1986.

Note 2. Federal Income Taxes *(Thousands of Dollars)*

The provision for Federal income taxes is distributed between operating expense and other income based upon the treatment of the various components of the provision in the rate-making process. The following is a summary of income tax expense for the three most recent years.

	1987	1986	1985
Charged to operating expense:			
Current	$ 32,781	$ 22,521	$ 12,974
Deferred	23,144	37,304	44,978
Total	55,925	59,825	57,952
Charged (Credited) to other income:			
Current	640	614	1,778
Deferred	(18,160)	(14,494)	(15,122)
Total	(17,520)	(13,880)	(13,344)
Total Federal income tax expense	$ 38,405	$ 45,945	$ 44,608

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

	1987		1986		1985	
	Amount	% of Pretax Income	Amount	% of Pretax Income	Amount	% of Pretax Income
Income from continuing operations, before cumulative effect of accounting change	$24,289		$104,519		$114,824	
Add: Federal income tax expense	38,405		45,945		44,608	
Income before Federal income tax	$62,694		$150,464		$159,432	
Computed tax expense	$25,078	40.0	$ 69,213	46.0	$ 73,339	46.0
Increases (decreases) in tax resulting from:						
Expenses capitalized for financial reporting purposes	(8,337)	(13.3)	(23,168)	(15.4)	(24,569)	(15.4)
Disallowed project costs	15,064	24.0				
Difference between tax depreciation and amount deferred	4,312	6.9	3,885	2.6	499	.3
Investment tax credit	(3,701)	(5.9)	(5,177)	(3.4)	(3,986)	(2.5)
Tax Reduction Act benefits deferred	4,561	7.3				
Miscellaneous items, net	1,428	2.3	1,192	.7	(675)	(.4)
Total Federal income tax expense	$38,405	61.3	$ 45,945	30.5	$ 44,608	28.0

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

	1987	1986	1985
Investment tax credit	$ (4,619)	$10,145	$ 9,955
Depreciation	26,956	12,855	9,181
Fuel costs	1,086	(5,035)	2,918
Sterling abandonment	(8,249)	(1,597)	51
Capitalized overheads	3,410	4,278	3,643
Accrued revenue	(4,740)	—	—
Disallowed project costs	(8,960)	—	—
Other items	100	2,164	4,108
Total	$ 4,984	$22,810	$29,856

Note 3. Pension Plan

The Company has a defined benefit pension plan covering substantially all of its employees. The benefits are based on years of service and the employee's compensation during the last three years of employment. The Company's funding policy is to contribute annually an amount consistent with the requirements of the Employee Retirement Income Security Act. These contributions are intended to provide for benefits attributed to service to date and for those expected to be earned in the future.

☐ The plan's funded status and amounts recognized on the Company's Balance Sheet are as follows:

	(Millions)	
	1987	1986
Accumulated benefit obligation, including vested benefits of $180.2 in 1987 and $171.0 in 1986	$193.3*	$183.8*
Projected benefit obligation for service rendered to date	$285.0*	$267.1*
Less—Plan assets at fair value, primarily listed stocks and bonds	276.9	264.9
	8.1	2.2
Unrecognized net gain or (loss) from past experience different from that assumed and effects of changes in assumptions	(1.5)	2.4
Less—Unrecognized net obligation at December 31	5.3	5.7
Prepaid pension cost (pension liability) recognized on the balance sheet	$ (1.3)	$ 1.1

Actuarial present value

☐ Net pension cost included the following components:

	(Millions)	
	1987	1986
Service cost—benefits earned during the period	$ 7.2	$ 6.6
Interest cost on projected benefit obligation	20.4	18.5
Actual return on plan assets	(18.2)	(34.9)
Net amortization and deferral	1.3	$ 19.8
Net periodic pension cost	$ 10.7	$ 10.0

☐ The projected benefit obligation at December 31, 1987 and 1986 assumed discount rates of 8 percent and 7½ percent, respectively, and a long-term rate of increase in future compensation levels of 7 percent. The assumed long-term rate of return on plan assets was 8 percent. The unrecognized net obligation is being amortized over 15 years beginning January 1, 1986.

☐ Pension cost for 1987, 1986 and 1985 was $10.7 million, $10.0 million and $12.3 million, respectively. The reduction in the 1986 pension cost was the result of adopting SFAS-87 and a decrease from 9 percent to 7 percent in the assumed long-term rate of increase in compensation levels. The PSC has directed the Company to defer for future disposition any difference resulting from the calculation of pension cost pursuant to SFAS-87.

Note 4. Departmental Financial Information

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

A. Continuing Operations

		(Thousands of Dollars)		
		1987	1986	1985
Electric	**Operating information**			
	Operating revenues	$ 515,430	$ 486,961	$ 473,553
	Operating expenses, excluding provision for income taxes	360,000	337,467	321,669
	Pretax operating income	155,430	149,494	151,884
	Provision for income taxes	48,788	52,051	52,068
	Net operating income	$ 106,642	$ 97,443	$ 99,816
	Other information			
	Depreciation and amortization	$ 46,776	$ 43,753	$ 39,015
	Nuclear fuel amortization	$ 20,678	$ 18,598	$ 17,356
	Capital expenditures	$ 104,295	$ 108,095	$ 174,963
	Investment information			
	Identifiable assets (a)	$1,483,860	$1,729,194	$1,568,361
Gas	**Operating information**			
	Operating revenues	$ 216,058	$ 261,688	$ 269,562
	Operating expenses, excluding provision for income taxes	193,188	235,536	246,045
	Pretax operating income	22,870	26,152	23,517
	Provision for income taxes	7,137	7,774	5,884
	Net operating income	$ 15,733	$ 18,378	$ 17,633
	Other information			
	Depreciation and amortization	$ 8,754	$ 8,319	$ 7,701
	Capital expenditures	$ 16,670	$ 15,707	$ 15,034
	Investment information			
	Identifiable assets (a)	$ 224,391	$ 219,716	$ 218,695

(a) Excludes cash, unamortized debt expense and other common items.

B. Steam Service Termination

On December 20, 1985, the Company sold certain of the assets of its Steam Department for $750,000 in cash. The remaining assets have been abandoned. As a result, in 1985 the Company recognized a loss on the disposal of the Steam Department of $8.2 million net of the related income tax effect of $3.5 million.

☐ Operating results of the Steam Department for 1985 (in thousands), which have been reported separately as discontinued operations in the accompanying financial statements, consist of the following: Steam revenues of $13,720 less expenses of $10,718 and income taxes of $1,197 resulting in operating income from discontinued operations of $1,805 offset by a loss on the disposal of the department of $(11,673), less tax savings amounting to $3,512 for a net loss on disposition of $(8,161) and a total discontinued Steam Operations of $(6,356).

Note 5. Jointly-Owned Facilities

The following table sets forth the jointly-owned electric generating projects in which the Company is participating. Each participant must provide its own financing for the Nine Mile Point Nuclear Plant Unit No. 2 and for any additions to the Oswego unit. The Company's share of direct expenses associated with the Oswego unit is included in the appropriate operating expenses in the Statement of Income.

	Oswego Fossil Unit #6 (1)(2)(5)	Nine Mile Point Nuclear Unit #2 (1)(2)(5)(6)
Net megawatt capacity	850	1,084
RG&E's share—megawatts	204	152
—percent	24	14
Year of completion	1980	(3) 1988
	(Millions of Dollars)	
Total estimated project costs		(3) $4,214.0
RG&E's share		(4) 591.0
RG&E's actual construction costs		
—1986	$ 1.4	$ 69.0
—1987	.7	35.6
Expended by RG&E in prior years	75.3	470.8
	$77.4	(4)(6) $575.4

(1) Construction and operation by Niagara Mohawk Power Corporation.

(2) Construction costs exclude allowance for funds used during construction.

(3) Current Niagara Mohawk estimate. Total project cost, including allowance for funds used during construction and prepaid financing costs, is currently estimated to be $6,533.0 million (See Note 10, Nine Mile Point Nuclear Plant).

(4) Does not include Company cost of approximately $13.0 million for the initial fuel loading, and $20.0 million for common facilities, operating spare parts, transmission facilities, and Company direct costs.

(5) Throughout the life of the plant, modifications will be made in order, among other reasons, to increase operating efficiency or reliability, and to satisfy changing environmental and safety regulations.

(6) Pursuant to Statement of Financial Accounting Standards No. 90, the Company, during 1987, completed a write-off in recognition of a regulatory disallowance of a portion of the Nine Mile Point #2 project for rate-making purposes. The disallowance is not included in this table. (See Note 10.)

Note 6. Long Term Debt

Mortgage Bonds

%	Series	Due	(Thousands) Principal Amount December 31 1987	1986
First Mortgage Bonds				
4⅞	R	July 1, 1987		$ 15,000
5	S	Oct. 15, 1989	$ 12,000	12,000
4½	T	Nov. 15, 1991	15,000	15,000
4⅝	U	Sept. 15, 1994	16,000	16,000
5.3	V	May 1, 1996	18,000	18,000
6¼	W	Sept. 15, 1997	20,000	20,000
6.7	X	July 1, 1998	30,000	30,000
8	Y	Aug. 15, 1999	30,000	30,000
9⅛	Z	Sept. 1, 2000	30,000	30,000
9¼	BB	June 15, 2006	50,000	50,000
8⅜	CC	Sept. 15, 2007	50,000	50,000
9½	DD	Dec. 1, 2003	40,000	40,000
6½	EE	Aug. 1, 2009	10,000	10,000
10.95	FF	Feb. 15, 2005	49,500	52,250
12¼	HH	May 15, 2012	10,500	10,500
15⅝	II	June 15, 1992		50,000
13⅞	JJ	June 15, 1999	25,000	25,000
11¼	KK	May 15, 1995	50,000	50,000
8.6	LL	Aug. 1, 1993	75,000	75,000
8⅞	MM	May 1, 1992	75,000	
Second Mortgage Bonds*				
11¾	A	June 15, 1993	100,000	100,000
			706,000	698,750
Net bond premium			176	182
Less: Due within one year			2,750	17,750
Total Long Term Debt			$703,426	$681,182

**In January 1988 the Company redeemed the Series A Second Mortgage Bonds and exchanged them for Series NN First Mortgage Bonds. All terms and conditions of the Series NN Bonds are substantially identical to the redeemed Series A Bonds.*

☐ The First Mortgage provides security for the bonds through a first lien on substantially all the property owned by the Company (except cash and accounts receivable).

☐ Sinking and improvement fund requirements aggregate $333,540 per annum under the First Mortgage, excluding mandatory sinking funds of individual series. Such requirements may be met by certification of additional property or by depositing cash with the Trustee. The 1987 and 1986 requirements were met by certification of additional property.

(Note 6 continued on page 26)

(Continued from page 25)

☐ The Series EE and Series HH First Mortgage Bonds equal the principal amount of and provide for all payments of principal, premium and interest corresponding to the Pollution Control Revenue Bonds, Series A and Series B, respectively (Rochester Gas and Electric Corporation Projects) issued by the New York State Energy Research and Development Authority through a participation agreement with the Company. The Series EE bonds are subject to a mandatory sinking fund beginning August 1, 2000 and each August 1 thereafter. Nine annual deposits aggregating $3.2 million will be made to the sinking fund, with the balance of $6.8 million principal amount of the bonds becoming due August 1, 2009.

☐ The Series FF First Mortgage Bonds are subject to a mandatory sinking fund of $2.75 million annually which began on February 15, 1986 and will continue each February 15, with the noncumulative option to double the payment in any year up to a maximum of 5 years.

☐ The Series II First Mortgage Bonds were refunded in June 1987 with proceeds from the issuance of the Series MM First Mortgage Bonds.

☐ The Series LL and MM First Mortgage Bonds are not redeemable prior to maturity.

☐ The Series NN First Mortgage Bonds issued and exchanged for the Series A Second Mortgage Bonds in January 1988 are subject to a mandatory sinking fund of $20.0 million annually beginning June 15, 1989 and each June 15 thereafter.

☐ The Series JJ First Mortgage Bonds are subject to a mandatory sinking fund of $2.5 million annually beginning June 15, 1990 and each June 15 thereafter.

☐ The bonds maturing in the next five years are $12 million in 1989 for Series S, $15 million in 1991 for Series T and $75 million in 1992 for Series MM.

The sinking fund requirements for the next five years are:

	(Thousands)				
	1988	1989	1990	1991	1992
Series NN		$20,000	$20,000	$20,000	$20,000
Series FF	$2,750	2,750	2,750	2,750	2,750
Series JJ			2,500	2,500	2,500
	$2,750	$22,750	$25,250	$25,250	$25,250

Promissory Notes

		(Thousands)	
		December 31	
Issued	Due	1987	1986
November 15, 1984	October 1, 2014	$ 51,700	$51,700
December 5, 1985	November 15, 2015	40,200	40,200
July 22, 1987	July 15, 2027	50,000	
Total		$141,900	$91,900

☐ The Company is obligated to make payments of principal, premium and interest on each Promissory Note which correspond to the payments of principal, premium, if any, and interest on certain Pollution Control Revenue Bonds issued by the New York State Energy Research and Development Authority (NYSERDA) as described below. These obligations under each note shall be deemed satisfied to the extent of funds drawn under separate Letters of Credit which are discussed below. Any amounts advanced under such Letters of Credit must be repaid, with interest, by the Company.

☐ The $51.7 million Promissory Note was issued in connection with NYSERDA's Floating Rate Monthly Demand Pollution Control Revenue Bonds (Rochester Gas and Electric Corporation Project), Series 1984. This obligation shall be deemed satisfied to the extent of funds, if any, drawn on or before October 15, 1994 under an irrevocable Letter of Credit issued by Irving Trust Company. The interest rate on this note for each monthly interest payment period will be based on the evaluation of the yields of short term tax-exempt securities at par having the same credit rating as said Series 1984 Bonds. The average interest rate was 5.04% for 1987, 5.08% for 1986 and 5.37% for 1985.

☐ The $40.2 million Promissory Note was issued in connection with NYSERDA's Adjustable Rate Pollution Control Revenue Bonds (Rochester Gas and Electric Corporation Project), Series 1985. This obligation shall be deemed satisfied to the extent of funds, if any, drawn on or before November 30, 1990 under an irrevocable Letter of Credit issued by Westpac Banking Corporation. This Promissory Note will bear interest at 6½% per annum through November 14, 1988. Thereafter, the interest rate will be adjusted annually.

☐ The $50.0 million Promissory Note was issued in connection with NYSERDA's Adjustable Rate Pollution Control Revenue Bonds (Rochester Gas and Electric Corporation Project), Series 1987. This obligation shall be deemed satisfied to the extent of funds, if any, drawn on or before July 31, 1992 under an irrevocable Letter of Credit issued by Citibank, N.A. This Promissory Note will bear interest at 5⅞% per annum through July 14, 1990. Thereafter, the interest rate will be adjusted annually.

Note 7. Preferred and Preference Stock

Type, by Order of Seniority	Par Value	Shares Authorized	Shares Outstanding
Preferred Stock (cumulative)	$100	2,000,000	1,186,090*
Preferred Stock (cumulative)	25	4,000,000	
Preference Stock	1	5,000,000	

**See below for mandatory redemption requirements*

☐ No shares of preferred or preference stock are reserved for employees, or for options, warrants, conversions, or other rights.

A. Preferred Stock, not subject to mandatory redemption:

%	Series	Shares Outstanding	(Thousands) December 31 1987	1986	Redemption (per share)#
4	F	120,000	$12,000	$12,000	$105
4.10	H	80,000	8,000	8,000	101
4¾	I	60,000	6,000	6,000	101
4.10	J	50,000	5,000	5,000	102.5
4.95	K	60,000	6,000	6,000	102
4.55	M	100,000	10,000	10,000	101
7.50	N	200,000	20,000	20,000	102
		670,000	$67,000	$67,000	

#May be redeemed at any time at the option of the Company on 30 days' minimum notice, plus accrued dividends in all cases

B. Preferred Stock, subject to mandatory redemption:

	%	Series	Shares Outstanding December 31, 1987	(Thousands) December 31 1987	1986	Optional Redemption (per share)†
Preferred Stock	8.60	P	216,090	$21,609	$22,555	$105.00 Before 9/1/89
	10.84	Q			22,555	107.00 Before 9/1/90
	8.25	R	300,000	30,000		108.25 Before 3/1/92
			516,090	51,609	45,110	
Less: Redeemable within 1 year			8,125	812	1,625	
Total Preferred Stock			507,965	$50,797	$43,485	

†Thereafter at lesser rates

☐ Mandatory redemption for the Preferred Stock commenced on September 1, 1984 for Series P and on September 1, 1985 for Series Q. The Company must redeem 8,125 shares of each series per year, at $100 per share, by means of a sinking fund provision, with the noncumulative option to redeem not more than 8,125 additional shares of each series per year on the same terms. Mandatory redemption of 60,000 shares per year commences on March 1, 1993 for Series R. In the event the Company should be in arrears in the sinking fund requirement, the Company may not redeem or pay dividends on any stock subordinate to the Preferred Stock. On June 12, 1987, the Company called for redemption 9,460 shares of Series P Preferred Stock, which satisfied the sinking fund requirement due September 1, 1987, and exercised its option to redeem additional shares. On April 22, 1987 all outstanding shares of Series Q were called for redemption and subsequently cancelled.

☐ The redemption requirement for Series P is $812,500 per year.

Note 8. Common Stock

At December 31, 1987, there were 35,000,000 shares of $5 par value Common Stock authorized, of which 30,121,375 were outstanding. There were 1,091,329 shares of Common Stock reserved and unissued under the Automatic Dividend Reinvestment and Stock Purchase Plan and 45,264 shares reserved and unissued for employees under the Savings Plus Plan. No shares of Common Stock are reserved for options, warrants, conversions, or other rights. Net gains or losses resulting from the reacquisition of certain issues of preferred stock to satisfy sinking fund requirements (see Note 7) are shown as Reacquired Capital Stock.

Common Stock:

	Per Share	Shares Outstanding	(Thousands) Amount
Balance, January 1, 1985		25,676,487	$405,200
Sale of Stock	19.625	1,725,000	33,853
Automatic Dividend Reinvestment and Stock Purchase Plan	19.125–24.450	890,454	18,758
ESOP*	19.810–22.580	130,530	2,676
Savings Plus Plan	19.436–24.247	74,338	1,620
Capital Stock Expense			(1,303)
Reacquired Capital Stock			274
Balance, December 31, 1985		28,496,809	461,078
Automatic Dividend Reinvestment and Stock Purchase Plan	22.713–28.238	669,057	16,747
ESOP*	26.200	15,267	400
Savings Plus Plan	22.499–28.810	65,954	1,680
Capital Stock Expense			(166)
Reacquired Capital Stock			(35)
Balance, December 31, 1986		29,247,087	479,704
Automatic Dividend Reinvestment and Stock Purchase Plan	15.175–24.750	760,986	14,132
ESOP*	23.970	17,939	430
Savings Plus Plan	14.499–24.874	95,363	1,706
Capital Stock Expense			(1,993)
Reacquired Capital Stock			39
Balance, December 31, 1987		30,121,375	$494,018

**Employee Stock Ownership Plan*

Note 9. Short Term Debt

The Company had no outstanding short term debt at December 31, 1987. At December 31, 1986, the Company had short term debt outstanding of $18 million. The weighted average interest rates for borrowings in 1987 were 6.58% for short term notes and 6.25% for commercial paper, and for 1986 was 6.68% for short term notes.

☐ Effective May 1, 1985, the Company consolidated its two revolving credit facilities into one facility and increased the amount of the facility to $120 million. This facility was reduced to $90 million effective January 15, 1987. Commitment fees related to this facility amounted to $341,000 in 1987 and $450,000 in 1986.

☐ The Company's Charter provides that unsecured debt may not exceed 15 percent of the Company's total capitalization (excluding unsecured debt). As of December 31, 1987, the Company would be able to incur $11 million of additional unsecured debt under this provision. In order to be able to use its revolving credit agreement, the Company has created a subordinate mortgage which secures borrowings under its revolving credit agreement that might otherwise be restricted by this provision of the Company's Charter.

Note 10. Nine Mile Point Nuclear Plant

Nine Mile Point Nuclear Plant Unit No. 2 (Unit), a nuclear generating unit in Oswego County, New York, with a projected capability of 1,084 megawatts, is undergoing testing and being gradually brought to full power preparatory to entering commercial operation. Niagara Mohawk Power Corporation (Niagara) is directing the Unit's power ascension phase and will operate it for the owner co-tenants. Under the Basic Agreement entered into in September 1975, ownership, output, and cost of the project are shared by five co-tenants: the Company (14%), Niagara (41%), Long Island Lighting Company (LILCO) (18%), New York State Electric & Gas Corporation (18%) and Central Hudson Gas & Electric Corporation (9%).

☐ On July 2, 1987, the Nuclear Regulatory Commission (NRC) issued a full power operating license under which the Unit is licensed to operate for 40 years from October 31, 1986. That authorization enabled the Unit to be brought to power levels which allowed synchronization of the Unit's generator with the electric grid on August 8, 1987. Although the testing of equipment and systems and other steps involved in the power ascension program are progressing, delays typical of major generating units undergoing start-up testing have been experienced.

☐ In December 1987, the Company announced that the Unit was out of operation to perform modifications on the main feedwater lines in order to allow the power ascension testing program to continue. Those modifications were completed and the power ascension program is progressing. Niagara's current power ascension schedule projects commercial operation to be in the latter part of March 1988, but the Company believes it likely to be in the second quarter of 1988.

☐ In an action stemming from an earlier delay in the Unit's testing and power ascension schedule occasioned by defects in the reactor's main steam isolation valves, the co-tenants in April 1987 commenced a lawsuit against three companies involved in the furnishing of that equipment. The Company cannot predict whether this suit will be successful or the amount of damages, if any, which may be recovered.

☐ Niagara's January 1988 cost estimate for the Unit (excluding nuclear fuel) is $6.120 billion. Adding approximately $413 million of prepaid financing charges arising from the inclusion of construction work in progress in the rate bases of certain co-tenants, that sum is equivalent to a total Unit cost of $6.533 billion. The Company's estimated share of that $6.533 billion total Unit cost, including its applicable share of prepaid financing costs, would be approximately $951 million [$591 million of construction costs, $258 million of Allowance for Funds Used During Construction (AFUDC) and $102 million of prepaid financing costs]. At December 31, 1987, excluding the adoption of Statement of Financial Accounting Standards No. 90 (SFAS-90) (discussed below), the Company had incurred costs of $905 million ($576 million of construction costs, $244 million of AFUDC and $85 million of prepaid financing costs).

☐ In an order issued October 3, 1986, the PSC approved a settlement with the co-tenants of its proceeding to inquire into the prudence of costs incurred for the construction of the Unit. The settlement provides, independent of the actual ultimate cost, for an allowance for the Unit in the co-tenant rate bases of $4.16 billion reduced by any prepaid financing costs. Thus, any cost of the Unit in excess of that amount is disallowed unless the co-tenants can establish before the PSC their entitlement to an upward adjustment of the $4.16 billion allowance based on the occurrence of an "extraordinary event."

☐ In connection with the settlement, Niagara agreed to reimburse the other co-tenants, including the Company, for their respective shares of $290 million of the disallowance without varying any co-tenant's ownership and operational share in the Unit. The amount of the Company's reimbursement is approximately $41 million. That agreement was made part of the PSC's October 3, 1986 order.

☐ The settlement effectively supersedes certain prior orders of the PSC issued in 1982, adopting an incentive rate of return for the project, and in 1984, adopting a cost cap for the project, as discussed below. It also bars suits among the co-tenants based on design, engineering and construction of the Unit.

☐ Certain parties to the prudence proceeding petitioned the PSC for reconsideration of its October 3, 1986 order and, by order issued December 17, 1986, the PSC denied those petitions. On April 16, 1987 the petitioning parties brought an action in State Supreme Court, Albany County, seeking to annul the PSC's October 3, 1986 order approving the settlement. In June 1987, the action was transferred to the Appellate Division, Third Department, of State Supreme Court and is pending. Any failure of the PSC order to survive judicial challenge could result in resumption of the inquiry into the prudence of costs as well as an expectation that the PSC would impose its earlier incentive and cost cap programs. The Company cannot predict to what extent its investment in the project could be affected by an order which might result from a resumed prudence proceeding in conjunction with an imposition of the PSC orders on the incentive plan and project cost cap.

☐ In a proceeding stemming from a Niagara rate case, the Staff of the PSC disputed the co-tenants' understanding of the proposed settlement implementation measures, and the PSC upheld its Staff's position. The PSC decided to disallow costs for certain common facilities and certain other costs which were considered by the co-tenants to be outside the scope of the settlement. The Company's investment in these items at project completion is estimated to be $20 million. The PSC also decided that the tax benefits

(Note 10 continued on page 30)

(Continued from page 29)

associated with the disallowance should be calculated on a discounted present value basis, utilizing a 34% tax rate rather than a 46% tax rate proposed by the co-tenants. The Company, in its 1987 write-offs (discussed below), did not recognize the effect of discounting in its determination of the Federal income tax benefits applicable to the disallowance since the nominal tax benefits at the 34% rate will be ultimately recovered for the benefit of the shareholder. However, the PSC did discount these tax benefits in determining the regulatory disallowance in its June 1987 decision. Thus, the regulatory disallowance was approximately $19 million greater than the Company has recognized for financial reporting purposes. This difference in regulatory treatment will, all other things being equal, initially result in a reported return on equity which will be approximately 50 basis points less than the PSC authorized return on equity. The PSC also determined that the entire amount of disallowed costs will be recognized as a write-off to common equity for rate-making purposes. On July 10, 1987, the co-tenants commenced an action in State Supreme Court, Albany County, seeking review of the PSC decision on the settlement implementation issues. In August, the case was transferred to the Appellate Division, Third Department, and is pending.

☐ In subsequent rate cases of some of the co-tenants, the Staff of the PSC has argued that certain post in-service capital additions for the Unit should be considered as falling under the scope of the settlement cap and should not be afforded rate base treatment. The co-tenants disagree with the Staff's interpretation and will vigorously oppose it. The Company is unable to predict what position the PSC will ultimately adopt.

☐ Under the settlement approved by the PSC, that portion of the Company's investment in the Unit which the PSC allowed in rate base was to be phased in over a multi-year period. In its July 1986 rate decision, the PSC adopted a plan to phase allowable Unit construction expenditures into rates over a seven-year period beginning August 1, 1986, with an allowance for recovery of carrying charges on all costs that are deferred. Since then, PSC orders approving and implementing the settlement, the order in the Company's most recently decided rate case and an adjustment to reflect commercial operation of the Unit in the second quarter of 1988 have resulted in all but approximately $50 million of the Company's anticipated recoverable investment in the Unit being currently reflected in rates. In its current rate filing, the Company has requested that this remaining increment of its recoverable investment in the Unit be included in rate base, obviating the need for a phase-in period. Under the settlement, the Company's allowable investment in rate base is $582 million less prepaid financing charges currently estimated to be $102 million, or $480 million.

☐ The inclusion of $430 million of this investment in electric rates enhances the Company's cash flow and reduces the amount of AFUDC reported as income because AFUDC is not accrued on those amounts included in rate base. A comparable amount, however, calculated similarly to AFUDC and representing prepaid financing costs, is recorded on the balance sheet as a liability, shown as a deferred credit. An equivalent amount is recorded as an asset, shown as a deferred debit on the Company's balance sheet, since it represents deferred financing costs (or AFUDC) which are expected to be recovered over the life of the Unit through amortization. Pursuant to a July 1986 rate decision, the Company has amortized $10.9 million of such deferred credits to Other Income. Such amounts represent non-cash earnings.

☐ The Company has proposed as a part of its current rate filing that these prepaid financing charges be eliminated by offset (that is, both the deferred debit and deferred credit be eliminated from the balance sheet). This would allow the customers to recover such prepaid financing costs over the life of the plant, rather than such costs being used to moderate the rate effect of the Unit going into service. Certain parties to the Company's current rate proceeding are advocating that these prepaid financing costs should be retained and utilized to reduce the Company's current rates. The Company is unable to predict what position the PSC will ultimately adopt.

☐ In December 1986, the Financial Accounting Standards Board issued its Statement SFAS-90 amending its earlier position in SFAS-71 with respect to, among other things, the financial accounting for disallowed costs of recently completed plants. Under SFAS-90, a loss must be recognized when it becomes probable that some portion of the costs of the plant will be disallowed for rate-making purposes and a reasonable estimate of the amount of the disallowance can be made. SFAS-90 is generally effective beginning in 1988, but applies to plant costs disallowed prior thereto. Earlier application of the revised standard is encouraged.

☐ On September 16, 1987, the Company announced that it would adopt SFAS-90 in the third quarter of 1987, and would recognize a loss from the disallowance arising from the settlement. In adopting SFAS-90, the Company presented the cumulative effect of the accounting change prior to January 1, 1987 in the Statement of Income and did not restate previously issued annual financial statements. Accordingly, the net disallowance was presented separately for the effect prior to January 1, 1987, and for the portion of the disallowance which became known during 1987. The September write-off assumed a February 15, 1988 commercial operation date for the Unit. In December 1987, the Company subsequently adjusted its original estimate of the disallowance to reflect an assumed mid-May 1988 commercial operation date. The disallowance is now comprised of:

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	(Dollars in Millions)
Cumulative Effect of Accounting Change	$258
Less—Related Federal Income Tax Benefits	(65)
Net Effect Prior to January 1, 1987	193
Restatement of AFUDC Previously Accrued in 1987 on Disallowed Project Costs	22
Current Year Portion of Disallowed Plant Costs $ 56	
Less—Related Federal Income Tax Benefits (9)	
	47
Net Effect in 1987	69
Net Disallowance	$262

☐ The computation of the net disallowance as shown above is as follows:

		(Dollars in Millions)
Company Share of Total Plant Costs Based Upon Niagara's January 1988 Cost Estimate of $6.533 Billion Including Prepaid Financing Charges and Adjusted for the Company's Assumed Commercial Operation Date of Mid-May 1988:		
Plant Costs	$591	
AFUDC	258	
Prepaid Financing Costs	102	
		$951
Common Facilities and Unshared Costs which the Company Considers Outside the Scope of the Settlement and Which Are Being Litigated		20
Total Investment		971
Settlement Allowance Comprised of:		
Plant Costs	480	
Prepaid Financing Costs	102	
		582
Amount Disallowed		389
Less—Payment from Niagara Mohawk		(41)
—Federal Income Tax Benefits		(74)
—AFUDC for the period from December 31, 1987 to Commercial Operation included in Total Investment Above		(12)
Net Disallowance		$262

☐ Any delay in commercial operation from the Company's assumed mid-May commercial operation date increases the Company's investment in the Unit and would require an additional write-off of approximately $6 million (net of tax) each month.

☐ Concurrent with the announcement of the September write-off, the Company announced a reduction of 32% in the quarterly common stock dividend rate from $.55 per quarter per share to $.375 per quarter per share. This reduced rate was paid by the Company to its common shareholders on October 24, 1987 and January 25, 1988.

☐ Earnings information for the twelve months ended December 31, 1987, excluding the write-off described above and for 1986 excluding AFUDC on the disallowed project costs of approximately $29 million is as follows:

	December 31, 1987	1986
Earnings Applicable to Common Stock (000's)	$63,042	$67,161
Weighted average number of shares (000's)	29,728	28,927
Earnings per Common Share	$2.12	$2.32

☐ Although the Company believes that its new annual common stock dividend rate of $1.50 per share is sustainable, its ability to maintain the common stock dividend and its preferred stock dividend is necessarily dependent on future earnings. The Company's Certificate of Incorporation provides for the payment of dividends on common and preferred stock out of retained earnings only. As of December 31, 1987, including the impact of the write-off, the Company's retained earnings were $18 million. Earnings per share, excluding the write-off, were sufficient in 1987 to maintain the current dividend level. Although the Company believes that no additional write-offs will be required, no such assurance can be given and an additional write-off could adversely affect the ability of the Company to pay its common or preferred stock dividend until sufficient positive retained earnings were re-established.

☐ In 1982, the PSC determined that ratepayer exposure to further project cost escalations should be reduced. It adopted an incentive plan under which the co-tenants would, with certain limitations, only recover from ratepayers 80% of revenue requirements necessary to support any capital costs for the Unit exceeding $4.6 billion. Implementation of this sharing was to have commenced at the time the Unit entered service. As the cost of the Unit has now exceeded the target figure, the sharing plan would have been expected to be implemented absent PSC approval of the settlement.

☐ In July 1984, the PSC placed a $5.4 billion cap on the amount of those prudently incurred costs which the co-tenants could recover in electric rates. As it had with respect to the incentive plan, the PSC left open the possibility of increasing the dollar figure if extraordinary circumstances could be demonstrated. It also provided (a) that the cap applied only to prudent costs, such that it would be imposed only if any disallowance of imprudent costs left the remaining allowable Unit costs in excess of the cap figure, and (b) that the cap would be allocated among the co-tenants when imposed. As is noted above, this 1984 cap order and the 1982 order adopting the 80%/20% incentive plan are superseded by the settlement; they would only become operative if the settlement were overturned in court proceedings.

(Note 10 continued on page 32)

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☐ In July 1986, the Governor signed into law legislation effective January 15, 1987 establishing the Long Island Power Authority (LIPA) for the possible take-over of LILCO. The legislation directs LIPA to make every effort to convey LILCO's interest in the Unit to the New York Power Authority or one or more of the remaining co-tenants, although LIPA would remain responsible for the purchase of LILCO's share of the electricity generated by the Unit. The LIPA take-over prospect stems from continued State and local government resistance to the efforts of LILCO to obtain a full-power NRC license for its Shoreham Nuclear Plant. If LILCO is unable to obtain such a license, adverse effects on that company's financial condition could result. The uncertainty of developments regarding Shoreham, LIPA and the possible sale of the LILCO interest in the Unit prevents the Company from offering any assessment of the potential impact of these events on the completion and operation of the Unit and, hence, on the Company's financial condition and results of operations.

☐ If for some unforeseen reason it became necessary to abandon the Unit, the Company's investment in the Unit would have to be written off. Although the Company would vigorously pursue authority to recover costs associated with the Unit in electric rates over a period of time, no assurance of such recovery can be given.

Note 11. Commitments and Other Matters

Capital Expenditures. The Company's construction expenditures program involves an estimated expenditure of $132 million in 1988, including $4 million of AFUDC. The Company has entered into certain commitments for purchase of materials and equipment in connection with that program.

Nine Mile Point Nuclear Plant. See Note 10.

Sterling Project. In the mid-1970's, the Company and three other utilities agreed to share in the cost of a proposed nuclear-powered electric generating plant to be built at Sterling, Cayuga County, New York. State and federal authorizations for construction were obtained, but the State siting agency ultimately revoked its authorization and the utilities elected to terminate the project. In 1982 the PSC authorized amortization of the Company's investment in the project over a period of years and allowed a return on the unamortized balance equal in rate to the Company's overall rate of return. From time to time, the PSC has increased the amount authorized for recovery, as contract termination charges and related expenses have been audited, and has modified the recovery schedule; most recently, it approved a final increment of $1.4 million, bringing the total approved to approximately $60 million. As of December 31, 1987, the amount remaining to be amortized is approximately $19.1 million, all of which is expected to be recovered by July 1992.

Ginna Nuclear Plant. In August 1984, the PSC concluded that the Company's actions in connection with a 1982 steam generator tube rupture and subsequent outage at the Company's Ginna Nuclear Plant were prudent, but also concluded that an employee had acted without reasonable care in failing to remove a piece of metal from the steam generator. It disallowed rate recovery of $3.5 million, consisting of $2.5 million in repair-related expenditures and $1.0 million of insurance deductibles, but allowed the Company to retain the incremental cost of replacement power it purchased as a result of the outage (estimated at $10.2 to $14.1 million). The New York State Attorney General appealed the PSC decision and, in a decision dated December 8, 1986, the State Supreme Court, Albany County upheld the PSC's determination to allow the Company to retain the additional cost of replacement power. The Attorney General filed an appeal from this decision with the Appellate Division, Supreme Court, Third Department. The Company is opposing that appeal. Oral argument is scheduled for February 1988, and a decision is expected shortly.

Insurance. The Company is a member of Nuclear Electric Insurance Limited, which provides insurance coverage for the cost of replacement power during certain prolonged accidental outages of nuclear generating units and coverage for property losses in excess of $500 million at nuclear generating units. If an insuring program's losses exceeded its other resources available to pay claims, the Company could be subject to maximum assessments in any one policy year of approximately $2.3 million and $6.9 million in the event of losses under the replacement power and property damage coverages, respectively.

☐ The Price-Anderson Act, at December 31, 1987, limits the public liability of a licensee to $720 million for a single nuclear incident. The Company's insurance for this exposure is first met by $160 million of private insurance, with the excess of $560 million covered by a mandatory program under which owners of nuclear generating facilities could be assessed $5 million per incident subject to a maximum assessment of $10 million per nuclear unit in any calendar year. Based on the

(Note 11 continued on page 33)

(Continued from page 32)

Company's Ginna Nuclear Plant and its 14% ownership interest in Nine Mile Two, the maximum assessment per incident would be $5.7 million, limited to a maximum of $11.4 million in any year.

☐ The Price-Anderson legislation expired on August 1, 1987. A bill extending and modifying the Price-Anderson legislation has been approved by the House of Representatives and similar legislation is now under study in the Senate. As passed by the House, the limit of liability would be increased to approximately $7 billion. The Company is unable to predict what modifications, if any, may be made in Price-Anderson coverage applicable to its nuclear-related activities or what commercial insurance may be available to complement any modified Price-Anderson coverage. Until renewal legislation is enacted, present coverage is continued for currently licensed facilities like Ginna and Nine Mile Two.

☐ Effective January 1, 1988, coverage for claims alleging radiation-induced injuries to some workers at nuclear reactor sites has been removed from the nuclear liability insurance policies purchased by the Company. Coverage for workers first engaged in nuclear-related employment at a nuclear site prior to January 1, 1988 will continue to be provided under the existing nuclear liability insurance policies. Those workers first employed at a nuclear facility after January 1, 1988 will be covered under a new, industry-wide insurance program. This new program contains a retrospective premium assessment feature whereby the participants in the program could be assessed to pay incurred losses that exceed the program's reserves. Under the plan as currently established, the Company could be assessed a maximum of $2.6 million over the life of the insurance coverage.

☐ The Company purchases Directors and Officers Liability Insurance from Directors and Officers Liability Insurance, Ltd. This insurance provides reimbursement to the Company for any obligation which it incurs as a result of indemnification of directors and officers, as permitted under the New York State Business Corporation Law. The insurance also insures such directors and officers for certain liabilities for which they may not be indemnified by the Company. If the insurer's losses exceeded the resources available to pay such losses, the Company could be subject to a maximum assessment for the current policy year of $5.2 million.

☐ The Company also purchases Excess Liability Insurance from Associated Electric & Gas Insurance Services Limited, which provides insurance coverage against liability imposed upon the Company by law or liability assumed by the Company under contract, which results from bodily injury or property damage. This insurance policy has an assessment feature whereby, under certain loss situations faced by the insurer, the Company could be assessed up to the amount of $1.0 million for the current policy year.

Environmental Matters. Operations of the Company's facilities are subject to various Federal, state and local environmental standards.

☐ In 1985, the New York State Department of Environmental Conservation (NYSDEC) identified, as an inactive hazardous waste disposal site, property in the vicinity of the Lower Falls of the Genesee River in Rochester, a portion of which is owned by the Company. NYSDEC is currently finalizing and is expected to release during 1988 a preliminary Phase I investigation of the site, which will probably include an assessment of the adequacy of available data and make recommendations for additional investigations. The site has been assigned Classification 2, "significant threat to the public health or environment—action required," in the NYSDEC's registry of inactive waste sites. Cleanup of certain areas of the site may eventually be ordered by NYSDEC. By virtue of ownership and/or past disposal activities at the site, the Company and others may be responsible for all or a portion of the costs of investigation and remediation at the site. The Company is cooperating with the NYSDEC and has itself conducted a study (already submitted to the NYSDEC) which concluded that, because of uncertainties regarding pathways of ground water movement, observed contaminants could not be connected with specific sources.

Other Matters. In September 1984, the Company negotiated a contract with the federal Department of Energy (DOE) for future nuclear fuel enrichment services for the Ginna Nuclear Plant. The contract provides for a minimum of 70 percent of that facility's enrichment services requirement for the life of the Plant or 30 years, whichever is less. Subsequent contracts have been signed with DOE to provide the remaining 30 percent of the Plant's requirements for the years 1987 and 1988 and for the years 1991–1995. The Company is currently reviewing its options to meet the remaining 30 percent of the Plant's requirements for the years 1989–1990. Services utilized by the Company under the DOE contract in 1987 amounted to $4.7 million, such services in 1986 amounted to $5.4 million and there were no services utilized in 1985. Future minimum annual payments are estimated as follows:

	(Thousands) (a)
1988	$6,200
1989–1990	4,600
1991–1995	5,500

(a) Priced at most current rate.

(Note 11 continued on page 34)

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In 1979 and early 1980, several legal actions were instituted against the Company seeking an aggregate of $34.5 million in compensatory and $64 million in punitive damages for alleged personal injuries as a result of exposure to radiation at the Company's Ginna Nuclear Plant in 1974. These actions were brought on behalf of Donald Gray, and others. Three actions were brought in Supreme Court, Monroe County, two actions were commenced in the United States District Court for the Western District of New York and the other actions were brought in Supreme Court, Erie County. Based on its investigation to date, the Company does not believe the plaintiffs will prevail on the merits, and is contesting these claims.

The Company is fully insured for the total compensatory damages that are sought in these actions, and its insurer has advised the Company that it will fully defend all claims. However, the insurer has disclaimed any obligation for the payment of any punitive damages which may be assessed against the Company. There is precedent in New York State that it is contrary to public policy for an insurance carrier to pay punitive damages assessed against its insured, but it is unclear whether that precedent would apply to the nuclear liability insurance involved in these actions. The Company intends to contest the disclaimer of coverage for punitive damages.

An additional legal action arising out of a Company interoffice memorandum advising its facility supervisors that none of the plaintiffs should be permitted on the Company's property was brought by some of the same plaintiffs in those actions. As a result of the dismissal of certain of plaintiffs' causes of action and the service of an amended complaint in January 1983, this action seeks to recover $7 million in compensatory damages and $7 million in punitive damages for alleged interference with plaintiffs' contracts of employment. The Company has insurance for compensatory damages sought in this claim, but not for punitive damages. The Company is contesting these claims.

Report of Independent Accountants

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1900 Lincoln First Tower
Rochester, New York 14604
January 26, 1988

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

We have examined the accompanying balance sheet of Rochester Gas and Electric Corporation as of December 31, 1987 and 1986, and the related statements of income, retained earnings, and 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 10, 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 Nine Mile Point Nuclear Plant Unit No. 2 (Unit) being recognized as a loss in the 1987 financial statements.

As a result of continuing uncertainties with respect to the Unit discussed in Note 10, the Company 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 its investment in the Unit will have, in the aggregate, a material effect on its financial position or results of operations.

In our opinion, subject to the effects on the 1987, 1986 and 1985 financial statements of such adjustments, if any, that might have been required had the outcome of the uncertainties discussed in the preceding paragraph been known, the financial statements examined by us present fairly the financial position of Rochester Gas and 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

Common Stock and Dividends

Dividend Policy

The Company has paid cash dividends quarterly on its Common Stock without interruption since it became publicly held in 1949. Dividends paid per share on Common Stock were $2.025 in 1987, a decrease of $.175 from 1986. The reduced dividend reflects a decrease in the quarterly dividend rate per share from $.55 to $.375 which took place in the fourth quarter of 1987. This reduction resulted from the Company's analysis of its 1987 rate decision, wherein the PSC recognized the disallowance of certain Nine Mile Two plant costs for rate-making purposes. The Company's analysis indicated that the rate increase granted was not adequate to maintain the quarterly Common Stock dividend at the prior level of $.55 per share. In January 1988, the Company paid a quarterly cash dividend on its Common Stock of $.375 per share. The level of future dividend payments is necessarily dependent on the Company's future earnings, its cash flow and additional factors discussed under the heading Earnings/Summary presented in Management's Discussion and Analysis of Financial Condition and Results of Operations. The Company's Certificate of Incorporation provides for the payment of dividends on Preferred Stock and Common Stock out of the surplus net profits (retained earnings) of the Company.

Automatic Dividend Reinvestment and Stock Purchase Plan

Common Stock shareholders may automatically reinvest cash dividends on all, or any designated number, of their registered shares by participating in the Company's Automatic Dividend Reinvestment and Stock Purchase Plan. They may also make optional cash payments of up to $5,000 each month to purchase additional shares of Common Stock, whether or not they elect to reinvest their cash dividends. Optional cash payments need not be made on a monthly or other recurring basis. There are no brokerage fees or other costs incurred by participants and shares are acquired at market price, based on a five-day average. Participants may change their method of participation, withdraw from the Plan or re-enroll as often as they wish. Currently, 29.5% of the Company's Common Stock shareholders, representing 20.2% of the outstanding shares, are participants in the Plan. Since its inception in October 1974, the Plan has provided $120 million in funds that were used for new or replacement utility plant and equipment. More information on the automatic reinvestment of dividends may be obtained by writing to the Agent, Chase Lincoln First Bank, N.A., Corporate Agency Department, Post Office Box 1507, Rochester, New York 14603 or by calling the Agent at (716) 258-5854.

Tax Status of Cash Dividends

Cash dividends paid in 1987, 1986 and 1985 were 100 percent taxable for Federal income tax purposes.

Earnings and Dividends

	1987	1986	1985
Earnings per weighted average share			
Total	$(5.95)	$3.33	$3.58
Continuing Operations	$ .54	$3.33	$3.81
Number of shares (000's)			
Weighted average	29,728	28,927	27,641
Actual number at December 31	30,121	29,247	28,497
Number of shareholders at December 31	44,127	45,959	50,115
Cash dividends paid			
1st quarter	$ .55	$.55	$.55
2nd quarter	.55	.55	.55
3rd quarter	.55	.55	.55
4th quarter	.375	.55	.55

Common Stock Trading

Shares of the Company's Common Stock are traded on the New York Stock Exchange under the symbol "RGS".

	1987	1986	1985
Common Stock—Price Range			
High			
1st quarter	25⅞	28	20½
2nd quarter	19⅞	28¼	24⅜
3rd quarter	18⅜	29⅞	24⅞
4th quarter	17¼	25⅜	24⅝
Low			
1st quarter	19⅞	22⅜	18⅝
2nd quarter	15⅝	24⅛	20¼
3rd quarter	16¾	24¾	19¾
4th quarter	14¼	21¼	19⅛

Selected Financial Data

Summary of Operations

(Thousands of Dollars) Year Ended December 31	1987	1986	1985	1984	1983	1982
Operating Revenues						
Electric	$ 489,215	$466,496	$429,450	$416,856	$407,948	$367,217
Gas	216,058	261,688	269,562	291,628	276,357	253,233
	705,273	728,184	699,012	708,484	684,305	620,450
Electric sales to other utilities	26,215	20,465	44,103	60,103	55,644	38,481
Total Operating Revenues	731,488	748,649	743,115	768,587	739,949	658,931
Operating Expenses						
Fuel Expenses						
Electric fuels	61,292	52,186	64,776	82,106	88,745	71,904
Purchased electricity	26,467	30,144	27,804	35,497	33,820	47,331
Gas purchased for resale	121,736	160,904	174,644	187,453	189,526	164,940
Total Fuel Expenses	209,495	243,234	267,224	305,056	312,091	284,175
Operating Revenues Less Fuel Expenses	521,993	505,415	475,891	463,531	427,858	374,756
Other Operating Expenses						
Operations excluding fuel expenses	159,170	148,340	129,273	131,670	132,032	114,195
Maintenance	46,124	44,767	42,518	41,013	39,418	42,254
Depreciation and Amortization	55,530	52,072	46,716	42,199	39,279	35,716
Taxes—local, state and other	82,869	84,590	81,983	83,013	80,118	73,284
Federal income tax—current	32,781	22,521	12,974	15,724	5,390	2,967
—deferred	23,144	37,304	44,978	41,885	32,794	21,991
Total Other Operating Expenses	399,618	389,594	358,442	355,504	329,031	290,407
Operating Income	122,375	115,821	117,449	108,027	98,827	84,349
Other Income and Deductions						
Allowance for other funds used during construction	5,030	32,828	38,393	33,782	25,697	19,720
Federal income tax	17,520	13,880	13,344	13,356	9,724	8,487
Disallowed project costs	(55,860)	—	—	—	—	—
Other, net	8,831	6,725	3,899	261	1,579	556
Total Other Income and Deductions	(24,479)	53,433	55,636	47,399	37,000	28,763
Income before Interest Charges	97,896	169,254	173,085	155,426	135,827	113,112
Interest Charges						
Long term debt	73,489	74,571	70,373	63,103	56,761	48,327
Short term debt	129	68	—	19	936	2,390
Other, net	2,685	2,074	2,227	2,464	2,048	2,070
Allowance for borrowed funds used during construction	(2,696)	(11,978)	(14,339)	(12,741)	(10,168)	(8,995)
Total Interest Charges	73,607	64,735	58,261	52,845	49,577	43,792
Income from Continuing Operations, Before Cumulative Effect of Accounting Change	24,289	104,519	114,824	102,581	86,250	69,320
Discontinued Steam Operations	—	—	(6,356)	1,037	(2)	720
Cumulative Effect for Years Prior to 1987 of Accounting Change for Disallowed Costs	(193,000)	—	—	—	—	—
Net Income (Loss)	(168,711)	104,519	108,468	103,618	86,248	70,040
Dividends on Preferred and Preference Stock, at required rates	8,147	8,058	9,467	12,213	10,515	10,538
Earnings (Loss) Applicable to Common Stock	$(176,858)	$ 96,461	$ 99,001	$ 91,405	$ 75,733	$ 59,502
Weighted Average Number of Shares Outstanding in Each Period, Adjusted for Stock Dividends (000's)	29,728	28,927	27,641	25,101	23,389	21,119
Earnings (Loss) per Common Share—Total	$ (5.95)	$3.33	$3.58	$3.64	$3.23	$2.81
Earnings (Loss) per Common Share—Continuing Operations	$ .54	$3.33	$3.81	$3.60	$3.23	$2.78
Cash Dividends Paid per Common Share, Adjusted for Stock Dividends	$2.025	$2.20	$2.20	$2.04	$1.84	$1.75

Condensed Balance Sheet

(Thousands of Dollars) At December 31	1987	1986	1985	1984	1983	1982
ASSETS						
Utility Plant	$1,559,848	$1,531,019	$1,446,916	$1,394,375	$1,310,459	$1,223,301
Less—Accumulated depreciation and amortization	586,840	571,022	532,947	489,938	449,807	437,117
	973,008	959,997	913,969	904,437	860,652	786,184
Construction work in progress	501,738	768,905	710,194	554,331	424,875	322,261
Net utility plant	1,474,746	1,728,902	1,624,163	1,458,768	1,285,527	1,108,445
Current Assets	184,309	141,222	144,217	151,042	135,403	124,677
Deferred Debits	131,526	114,340	82,092	64,269	75,927	70,381
Total Assets	$1,790,581	$1,984,464	$1,850,472	$1,674,079	$1,496,857	$1,303,503
CAPITALIZATION AND LIABILITIES						
Capitalization						
Long term debt	$ 845,326	$ 773,082	$ 765,511	$ 678,018	$ 611,282	$ 511,246
Preferred stock redeemable at option of Company	67,000	67,000	67,000	67,000	67,000	67,000
Preferred stock subject to mandatory redemption	50,797	43,485	45,922	47,562	49,187	50,000
Preference stock subject to repurchase					28,000	28,000
Common shareholders' equity						
Common stock	494,018	479,704	461,078	405,200	385,921	343,942
Retained earnings	17,617	249,505	216,795	179,676	153,142	119,799
Total common shareholders' equity	511,635	729,209	677,873	584,876	539,063	463,741
Total Capitalization	1,474,758	1,612,776	1,556,306	1,377,456	1,294,532	1,119,987
Long Term Liability—Department of Energy	47,773	44,950	42,214	39,084	35,363	
Current Liabilities	90,504	118,348	98,270	131,108	81,602	138,949
Deferred Credits and Other Liabilities	177,546	208,390	153,682	126,431	85,360	44,567
Total Capitalization and Liabilities	$1,790,581	$1,984,464	$1,850,472	$1,674,079	$1,496,857	$1,303,503

Financial Data

At December 31	1987	1986	1985	1984	1983	1982
Capitalization Ratios* (percent)						
Long term debt	58.7	49.3	50.5	50.6	48.6	45.7
Preferred and preference stock	7.7	6.7	7.1	8.1	10.9	12.9
Common shareholders' equity	33.6	44.0	42.4	41.3	40.5	41.4
Total	100.0	100.0	100.0	100.0	100.0	100.0
Book Value per Common Share—Year End	$16.98	$24.93	$23.79	$22.78	$22.09	$21.09
Rate of Return on Average Common Equity (percent)	12.45**	13.38	14.93	16.01	14.97	13.38
Effective Federal Income Tax Rate (percent)	61.3	30.5	28.0	30.1	24.8	19.2
Depreciation Rate (percent)—Electric	3.50	3.50	3.40	3.30	3.23	3.17
—Gas	2.98	2.99	2.98	3.12	2.96	2.96
Interest Coverages* **						
Before federal income taxes (incld. AFUDC)	2.55	2.96	3.08	3.26	2.91	2.64
(excld. AFUDC)	2.45	2.38	2.35	2.55	2.31	2.10
After federal income taxes (incld. AFUDC)	1.93	2.36	2.49	2.58	2.44	2.33
(excld. AFUDC)	1.83	1.78	1.77	1.87	1.84	1.78

**Includes Company's long term liability to the Department of Energy.*
***Excludes disallowed Nine Mile Two plant costs written off in 1987.*
****AFUDC included in interest coverages prior to 1987 has not been restated to reflect the disallowance of certain Nine Mile Two plant costs recognized by the Company in 1987.*

Electric Department Statistics

Year Ended December 31	1987	1986	1985	1984	1983	1982
Electric Revenue (000's)						
Residential	$178,933	$166,664	$155,193	$147,500	$143,455	$129,202
Commercial	146,138	137,077	122,292	118,628	118,610	106,630
Industrial	118,479	116,321	110,135	109,052	103,598	94,027
Other	45,665	46,434	41,830	41,676	42,285	37,358
Electric revenue from our customers	489,215	466,496	429,450	416,856	407,948	367,217
Other electric utilities	26,215	20,465	44,103	60,103	55,644	38,481
Total electric revenue	515,430	486,961	473,553	476,959	463,592	405,698
Electric Expense (000's)						
Fuel used in electric generation	61,292	52,186	64,776	82,106	88,745	71,904
Purchased electricity	26,467	30,144	27,804	35,497	33,820	47,331
Other operation	126,320	113,497	96,194	97,612	100,412	83,807
Maintenance	37,641	36,573	35,013	33,535	32,444	34,636
Depreciation and Amortization	46,776	43,753	39,015	34,822	32,648	29,428
Taxes—local, state and other	61,504	61,314	58,867	59,215	57,931	52,956
Electric revenue deductions	360,000	337,467	321,669	342,787	346,000	320,062
Operating Income before Federal Income Tax	155,430	149,494	151,884	134,172	117,592	85,636
Federal income tax	48,788	52,051	52,068	47,410	34,339	18,010
Operating Income from Electric Operations (000's)	$106,642	$ 97,443	$ 99,816	$ 86,762	$ 83,253	$ 67,626
Electric Operating Ratio %	48.8	47.7	47.3	52.2	55.1	58.6
Electric Sales—KWH (000's)						
Residential	1,970,345	1,890,293	1,846,993	1,834,564	1,788,785	1,757,252
Commercial	1,732,939	1,657,606	1,591,670	1,539,662	1,491,736	1,457,035
Industrial	1,782,223	1,775,722	1,814,460	1,783,415	1,609,787	1,578,201
Other	463,256	452,756	452,142	452,189	462,089	445,504
Electric sales to our customers	5,948,763	5,776,377	5,705,265	5,609,830	5,352,397	5,237,992
Other electric utilities	1,047,654	925,318	1,404,504	1,554,392	1,370,239	1,131,143
Total electric sales	6,996,417	6,701,695	7,109,769	7,164,222	6,722,636	6,369,135
Electric Customers at December 31						
Residential	285,988	281,630	277,758	273,050	268,764	265,119
Commercial	27,383	26,865	26,184	25,432	24,998	24,650
Industrial	1,381	1,368	1,362	1,459	1,425	1,418
Other	2,281	2,266	2,254	2,249	2,151	2,190
Total electric customers	317,033	312,129	307,558	302,190	297,338	293,377
Electricity Generated and Purchased—KWH (000's)						
Fossil	1,877,922	1,491,167	2,211,246	2,285,761	2,431,144	2,296,677
Nuclear	3,793,021	3,603,116	3,613,104	3,143,923	3,027,160	2,387,918
Hydro	223,958	235,175	153,636	218,228	200,325	210,031
Pumped storage	246,925	237,663	240,375	205,760	226,612	190,121
Less energy for pumping	(387,546)	(353,735)	(373,537)	(311,710)	(342,853)	(300,663)
Other	4,554	1,850	4,354	3,846	3,111	42,285
Total generated—Net	5,758,834	5,215,236	5,849,178	5,545,808	5,545,499	4,826,369
Purchased	1,703,408	1,945,586	1,713,481	2,037,936	1,609,553	1,955,110
Total electric energy	7,462,242	7,160,822	7,562,659	7,583,744	7,155,052	6,781,479
Electric Generation Costs (000's)						
Fossil	$ 59,695	$ 51,056	$ 71,898	$ 72,706	$ 80,909	$ 80,756
Nuclear	58,965	56,136	49,772	50,020	45,904	46,994
Hydro	1,695	2,134	1,616	1,504	1,180	1,113
Other	465	274	776	362	431	2,509
Electric Department Fuel						
Fossil —Total BTU (million)	20,083,347	15,896,376	23,140,883	23,627,034	25,670,771	25,250,646
—Cents per million BTU	209.55	216.69	237.09	232.64	252.67	256.93
Nuclear—Total BTU (million)	40,538,534	38,660,500	39,034,016	34,225,538	33,020,145	26,201,602
—Cents per million BTU	52.30	48.49	46.85	50.67	57.38	66.50
System Net Capability—KW at December 31						
Fossil	541,000	510,000	587,000	587,000	605,000	601,000
Nuclear	470,000	470,000	470,000	470,000	470,000	470,000
Hydro	47,000	47,000	47,000	47,000	47,000	47,000
Other	29,000	29,000	29,000	29,000	29,000	29,000
Purchased	363,000	356,000	352,000	355,000	353,000	352,000
Total system net capability	1,450,000	1,412,000	1,485,000	1,488,000	1,504,000	1,499,000
Net Peak Load—KW	1,205,000	1,100,000	1,076,000	1,075,000	1,037,000	996,000
Annual Load Factor—Net %	60.8	64.7	65.4	63.9	63.9	65.1

Gas Department Statistics

Year Ended December 31	1987	1986	1985	1984	1983	1982
Gas Revenue (000's)						
Residential	$ 6,436	$ 7,694	$ 8,403	$ 8,924	$ 8,910	$ 8,426
Residential spaceheating	138,552	156,120	153,279	162,727	153,167	139,264
Commercial	43,311	52,653	53,568	56,518	53,636	47,455
Industrial	10,842	28,800	38,837	46,518	44,552	43,701
Municipal and other	16,917	16,421	15,475	16,941	16,092	14,387
Total gas revenue	216,058	261,688	269,562	291,628	276,357	253,233
Gas Expense (000's)						
Gas purchased for resale	121,736	160,904	174,644	187,453	189,526	164,940
Other operation	32,850	34,843	33,079	34,058	31,620	30,388
Maintenance	8,483	8,194	7,505	7,478	6,974	7,618
Depreciation	8,754	8,319	7,701	7,377	6,631	6,288
Taxes—local, state and other	21,365	23,276	23,116	23,798	22,187	20,328
Gas revenue deductions	193,188	235,536	246,045	260,164	256,938	229,562
Operating Income before Federal Income Tax	22,870	26,152	23,517	31,464	19,419	23,671
Federal income tax	7,137	7,774	5,884	10,199	3,845	6,948
Operating Income from Gas Operations (000's)	$ 15,733	$ 18,378	$ 17,633	$ 21,265	$ 15,574	$ 16,723
Gas Operating Ratio %	75.5	77.9	79.8	78.5	82.5	80.1
Gas Sales—Therms (000's)						
Residential	10,255	11,382	12,296	12,746	12,323	13,931
Residential spaceheating	244,655	253,101	244,593	252,518	232,380	253,828
Commercial	83,167	92,864	93,283	95,427	88,501	93,156
Industrial	22,033	56,621	76,263	90,266	82,895	92,706
Municipal	17,985	23,405	24,848	26,937	24,661	26,574
Total gas sales to our customers	378,095	437,373	451,283	477,894	440,760	480,195
Transportation of customer-owned gas	67,496	24,589	618	—	—	—
Total gas sold and transported	445,591	461,962	451,901	477,894	440,760	480,195
Gas Customers at December 31						
Residential	24,834	25,865	27,202	28,438	29,246	30,237
Residential spaceheating	206,458	201,227	196,035	191,192	187,071	183,527
Commercial	16,771	16,330	15,816	15,323	15,020	14,698
Industrial	1,035	1,015	1,029	1,019	977	959
Municipal	1,026	1,009	990	977	970	977
Total gas customers	250,124	245,446	241,072	236,949	233,284	230,398
Gas—Therms (000's)						
Purchased for resale	381,632	439,381	469,386	475,976	462,357	487,550
Other	2,317	5,996	14,943	18,039	16,479	36,036
Total gas available	383,949	445,377	484,329	494,015	478,836	523,586
Cost of gas per therm	32.51¢	35.82¢	37.53¢	38.52¢	40.51¢	35.18¢
Total Daily Capacity—Therms at December 31*	4,485,000	4,485,000	4,485,000	4,485,000	4,150,000	3,880,000
Maximum daily sendout—Therms	3,155,170	3,496,040	3,746,980	3,711,490	3,456,050	4,087,480
Degree Days (Customer Billing)						
For the period	6,439	6,742	6,412	6,784	6,305	6,728
Percent colder (warmer) than normal	(4.5)	1.3	(5.0)	1.1	(6.3)	(0.1)

**Method for determining daily capacity, based on current network analysis, reflects the maximum demand which the transmission system can accept without a deficiency.*

Interim Financial Data

In the opinion of the Company, the following quarterly information includes all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of the results of operations for such periods. The variations in operations reported on a quarterly basis are a result of the seasonal nature of the Company's business and the availability of the Company's Ginna Nuclear Plant. Discontinued Steam Operations (1985) are detailed in Note 4 of the Notes to the Financial Statements. The cumulative effect of the accounting change related to the Nine Mile disallowed project costs and related write-offs during the year 1987 are discussed in Note 10 of the Notes to the Financial Statements.

	(Thousands)				
Quarter Ended	Operating Revenues	Operating Income	Net Income (Loss)	Earnings (Loss) on Common Stock	Earnings (Loss) Per Common Share (in dollars)
December 31, 1987	**$177,764**	**$25,256**	**$ (9,771)**	**$ (11,742)**	**$ (.39)**
September 30, 1987	**165,281**	**32,272**	**20,268**	**18,297**	**.61**
June 30, 1987	**157,193**	**24,271**	**12,686**	**10,715**	**.36***
March 31, 1987	**231,250**	**40,576**	**(191,894)**	**(194,128)**	**(6.60)***
December 31, 1986	180,634	23,433	18,910	16,926	.57
September 30, 1986	150,835	26,664	22,620	20,636	.71
June 30, 1986	162,991	24,539	23,130	21,085	.73
March 31, 1986	254,189	41,185	39,859	37,814	1.32
December 31, 1985	186,554	25,911	23,709	21,592	.75
September 30, 1985	142,246	25,889	24,418	22,195	.78
June 30, 1985	164,678	26,312	27,186	24,609	.88
March 31, 1985	249,637	39,337	39,511	36,961	1.40

**Restated from published quarterly data. The cumulative effect of the accounting change ($193 million, net of Federal income tax benefits) has been reflected in the first quarter restatement. The first and second quarters reflect the discontinuance of AFUDC on the disallowed project costs. (See Note 10 of the Notes to Financial Statements.)*

Directors and Officers

(As of January 1, 1988)

Board of Directors

Theodore J. Altier	Former Chairman of the Board and Chief Executive Officer, Altier & Sons Shoes, Inc.
Keith W. Amish	Vice Chairman of the Board, Rochester Gas and Electric Corporation
William Balderston III	Chairman of the Board, Chief Executive Officer and President, Chase Lincoln First Bank, N.A.
Paul W. Briggs	Chairman of the Board and Chief Executive Officer, Rochester Gas and Electric Corporation
E. Kent Damon	Former Vice President and Secretary, Xerox Corporation
Francis E. Drake, Jr.	Chairman of the Executive and Finance Committee, Rochester Gas and Electric Corporation
Natacha P. Dykman	Chairman of the Board of Trustees, Center for Governmental Research, Inc.
Walter A. Fallon	Former Chairman of the Board and Chief Executive Officer, Eastman Kodak Company
Theodore L. Levinson	Former President and Chief Executive Officer, Star Supermarkets, Inc.
Paul A. Miller	President Emeritus and Professor, Rochester Institute of Technology
Constance M. Mitchell	Program Director, Industrial Management Council of Rochester, New York, Inc.
Cornelius J. Murphy	Senior Vice President and General Manager, Eastman Kodak Company
Arthur M. Richardson	President, Richardson Capital Corporation
Harry G. Saddock	President and Chief Operating Officer, Rochester Gas and Electric Corporation
William G. vonBerg	Executive Director, Executive Service Corps of Rochester, Inc.

Committees of the Board of Directors

Executive and Finance	Audit	Compensation	Nominating
Keith W. Amish	William Balderston III	Theodore J. Altier	Theodore J. Altier
William Balderston III	Francis E. Drake, Jr.	E. Kent Damon	Paul W. Briggs
Paul W. Briggs	Natacha P. Dykman	Francis E. Drake, Jr.*	E. Kent Damon*
E. Kent Damon	Theodore L. Levinson	Walter A. Fallon	Constance M. Mitchell
Francis E. Drake, Jr.*	Cornelius J. Murphy	Arthur M. Richardson	Arthur M. Richardson
Walter A. Fallon	William G. vonBerg*	William G. vonBerg	
Paul A. Miller			
Harry G. Saddock			
William G. vonBerg			

*Chairman

Officers

Paul W. Briggs	Chairman of the Board and Chief Executive Officer Age 65, Years of Service, 42
Keith W. Amish	Vice Chairman of the Board Age 64, Years of Service, 40
Harry G. Saddock	President and Chief Operating Officer Age 58, Years of Service, 37
Robert C. Henderson	Senior Vice President, Controller and Chief Financial Officer Age 47, Years of Service, 24
Roger W. Kober	Senior Vice President, Production and Engineering Age 54, Years of Service, 22
David K. Laniak	Senior Vice President, Gas, Electric Distribution and Corporate Planning Age 52, Years of Service, 33
John W. Oberlies	Senior Vice President, Customer and Administrative Services Age 48, Years of Service, 26
John E. Arthur	Vice President, Engineering and Construction Age 58, Years of Service, 32
Joseph J. Hartman	Vice President, Gas and Transportation Age 63, Years of Service, 41
Richard J. Rudman	Vice President, Electric Transmission and Distribution Age 60, Years of Service, 42
David C. Heiligman	Secretary and Treasurer Age 47, Years of Service, 24
Daniel J. Baier	Assistant Controller Age 41, Years of Service, 4
John M. Kuebel	Auditor Age 52, Years of Service, 23
Alan A. Lohrmann	Assistant Treasurer Age 48, Years of Service, 26

Rochester Gas and Electric Corporation
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Equal Opportunity Employer