New York State Electric & Gas Corporation

1987 Annual Report

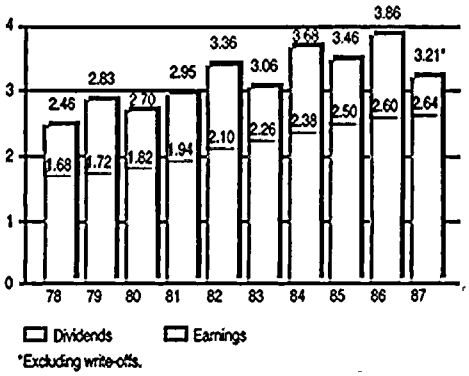
Contents

Highlights

	1987	1986	Percent Change
Sales			
Gross operating revenues (thousands)	$ 1,289,638	$ 1,277,284	1
Kilowatt-hour sales to ultimate customers (millions)	12,177	11,807	3
Dekatherms of gas delivered (thousands)	32,196	33,268	(3)
Common Stock Data			
Earnings (loss) for common stock (thousands)	$ (191,399)	$ 208,390	(192)
Dividends paid per share of common stock	$2.64	$2.60	2
Book value per share of common stock	$19.85	$25.86	(23)
Market value per share of common stock	$20.88	$31.38	(33)
Excluding write-offs:			
Earnings available for common stock (thousands)	$ 177,390	$ 208,390	(15)
Earnings per share of common stock	$3.21	$3.86	(17)
Return on average common stock equity	12.2%	15.3%	(20)
Customer Data			
Average number of customers			
Electric	726,000	712,000	2
Gas	135,000	133,000	2
Average annual use per residential customer			
Electric (kilowatt hours)	7,569	7,538	—
Gas (dekatherms)	120	125	(4)

Earnings and Dividends

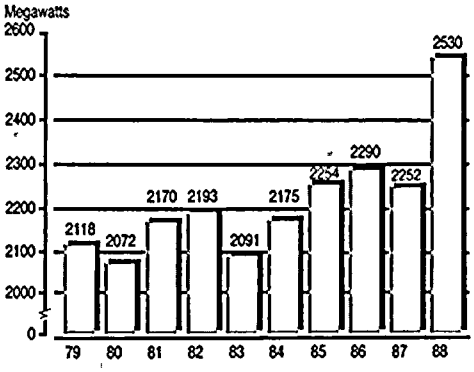
Dollars Per Share



*Excluding write-offs.

Electric Peak Loads

Winter



To the Stockholders

For NYSEG 1987 was a year we are happy to have behind us. Disallowed costs of nuclear plant projects, largely Nine Mile Point II, caused us to record a loss for the year of $191 million, or $3.46 a share. Other bad news during the year included a damaging snowstorm in October and the regulatory denial in late December of a 4% electric rate increase request.

The nuclear write-offs and income adjustments stemming from the rate decision were primarily responsible for a reduction in the Company's equity from 39% of invested capital to 33% at year-end. The average equity proportion for U.S. electric utilities is currently about 43%.

It was this loss of equity capital and its prospective adverse impact on earnings that caused the Board of Directors to reduce the quarterly dividend on the common stock in January 1988 from 66 to 50 cents a share. This is the first time since the Company became an independent utility in 1949 that we have sustained an annual loss and have had to reduce the dividend rate.

It was with great regret that the Board of Directors took the dividend action. Management has worked hard over the years to improve earnings, permitting increases in the dividend to the 66-cent level. Prior to 1987 we had raised the dividend rate each year for nine consecutive years.

But all this is history and we now look with optimism to the future. If Nine Mile II commences commercial service in the second quarter of 1988, as we expect it will, we believe the Company will begin its return to financial health. Our electric sales are trending upwards and we are in the process of adding several new areas to our gas service territory. Quality of earnings and cash flow will begin to improve. With the addition of the coal-fired Somerset Generating Station in 1984 and Nine Mile II generation, we should have adequate power-supply capacity to meet our electricity needs until the mid 1990s. Incidentally, Somerset's performance has been excellent to date, recording 93% availability since its 1984 start-up.

Other aspects of our operations also reflect good performance and high efficiency. The Company's 1987 system heat rate, that is, the amount of heat required to produce one kilowatt-hour, was our best since 1964. This places NYSEG's system efficiency near the top among 100 major utilities throughout the country.

Results of our efforts to increase employee productivity are reflected in the number of customers per employee. In 1987 NYSEG served 191 customers for each employee, an increase of 5% since 1982. This statistic also compares favorably with other utilities.

But statistics alone do not give the full story. The quality of our service has improved as well. We have a unique Consumer Representative Program in which human-service professionals, mostly former social workers, provide counseling and a variety of services to elderly, handicapped and needy customers. The value of this program has been widely recognized and was featured in a *Wall Street Journal* article on July 8, 1987.

Quality of our service is also demonstrated when natural disasters strike, such as the October 1987 snowstorm when heavy, wet snow fell while leaves were still on the trees. Our employees worked long hours under difficult circumstances to restore electric service to thousands of customers. They are as conscientious a group as you will find anywhere and we are especially proud of them and the good work they do.

Two members of the Board of Directors, Alexander Horwitz and Charles F. Kennedy, retired in 1987 under Company rules relating to retirement of directors. Mr. Kennedy, a director since 1955, was Chairman and Chief Executive Officer of the Company from 1977 to 1983. Mr. Horwitz was first elected a director in 1975. We take this opportunity to thank them both for their fine contributions and dedication to the Company over the years.

At last year's Annual Meeting we announced that James A. Carrigg will become Chairman and Chief Executive Officer of the Company on May 13, 1988 upon the planned retirement of Wells P. Allen, Jr. Later in 1987 Allen E. Kintigh, formerly Senior Vice President—Generation, was elected Executive Vice President and a director. He will become President and Chief Operating Officer on May 13. Other new officers were also elected which will provide for future management succession.

While 1987 and early 1988 was a turbulent financial period for the Company, we have been encouraged by the support we have received from many stockholders. It is gratifying to know we have long-time stockholders who closely follow Company affairs and understand our problems. We now look forward to building on our strengths and the Company's financial recovery.

For the Board of Directors,

Wells P. Allen Jr.

Chairman and Chief
Executive Officer

James A. Carrigg

President and Chief
Operating Officer

March 1, 1988

Wells Allen (center) and James Carrigg (right) discuss service restoration after October 1987 snowstorm with NYSEG operating superintendent Robert Kirn.

The Year at a Glance

- Financial Review: Company records earnings loss for the year largely because of nuclear-plant write-offs . . . Board reduces quarterly common stock dividend to 50 cents from 66 cents . . . Public Service Commission denies Company's 4% rate increase request, defers rate action on abandoned Jamesport nuclear plant . . . Refinancing reduces interest costs, annual savings total $2 million .

- Construction and Capital Projects: Nine Mile Point II main steam safety valves replaced, full operating license obtained, commercial operation of plant expected soon . . . Construction costs in 1987 total $270 million . . . Construction underway on $57 million Energy Control Center in Binghamton, scheduled for operation in 1991.

- Electric and Gas Operations: New electric peak load of 2,530,000 kilowatts eclipses old peak by 10% . . . Plant efficiency in 1987 places Company among top utilities in nation . . . Somerset Station availability continues far above average . . . Electric Power Research Institute's High Sulfur Test Center at Somerset Station begins operation . . . October snowstorm damage costs $6.5 million . . . Electric sales up, gas sales off.

- Consumer Relations, Stockholders and Management: Project SHARE contributions hit $1 million, over 5,000 customers have received grants . . . Consumer programs feature customer assistance . . . New officers elected, James A. Carrigg to become Chairman and Chief Executive Officer in May 1988 . . . Stockholder share purchases rise.

- Marketing: Long-range marketing plan aims at increasing off-peak electric sales, gas sales . . . Employees achieved 123% of marketing goal in 1987 . . . 27,000 home energy surveys also exceed goal . . . Industrial Development Department contributes to net gain of 4,500 jobs in service area.

Lower gas prices and gas main extensions were instrumental in the addition of 2,000 gas customers in 1987 including this Norwich Eaton Pharmaceutical, Inc. manufacturing facility in Norwich, N.Y.

Financial Review

Earnings Reflect Nuclear Write-offs

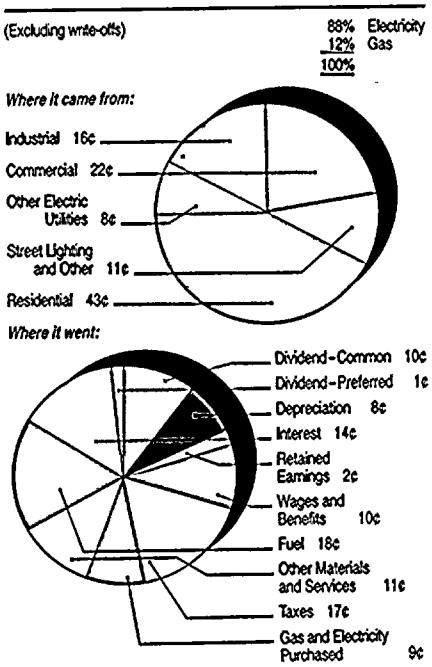
For the first time since NYSEG became an independent company in 1949, it recorded a loss for the year. Earnings in 1987 were a negative $191 million, or a loss of $3.46 a share. The loss stems from write-offs of nuclear plant expenditures disallowed in rates and other accounting adjustments. Excluding these non-recurring items, earnings were $177 million, or $3.21 a share, which compares with $208 million, or $3.86 a share, in 1986.

Write-offs related to the Nine Mile Point II nuclear plant totaled $322 million net of federal income taxes. This amount assumes commercial operation of the facility on May 1, 1988. Another $25 million net of federal income taxes was written off for the Company's share of the Jamesport nuclear project which was terminated in 1980. Adoption of a new income tax accounting standard resulted in a $22 million write-off of tax benefits related to Nine Mile II cost disallowances. A rate decision, discussed below, caused a reduction of $13 million for excess 1987 earnings.

These write-offs, totaling $382 million, were the principal reason the Company's common stock book value declined to $19.85 a share from $25.86 at the end of 1986. Since the Company's service rates are based on, among other things, an equity return on book value, future earnings will be adversely affected by this decline. This was an important consideration in the Board of Directors' action, on January 15, 1988, to reduce the quarterly dividend rate on the Company's common stock from 66 to 50 cents a share.

The decline in earnings excluding write-offs largely reflects lower Allowance for Funds Used During Construction (and associated tax benefits) stemming from Nine Mile II cost disallowances. Also, operating expenses increased, in part because of damages sustained in early October 1987 when heavy, wet snow fell in eastern sections of the service area.

The Revenue Dollar–1987



Rate Increased Denied

In January 1988 the Public Service Commission denied the Company's request, made in February 1987, for a 4% increase in electric rates. The increase was designed to begin recovery of allowed Nine Mile II costs and expenditures on the Jamesport nuclear project which was terminated in 1980.

The Commission deferred rate action on Jamesport and ruled that current electric rates are already adequate to recover Nine Mile II costs because of lower federal income tax rates, increased forecasted sales volumes and other factors. A 13.8% return on equity was granted which compares with 15.5% in the Company's previous electric rate decision rendered in April 1985.

In August 1987 the PSC moved to make the Company's electric rates temporary pending resolution of a PSC Staff contention that 1987 earnings would exceed allowed levels. In the January 1988 decision the Commission concluded that earnings had exceeded allowed levels and that $13 million should be set aside to be returned to ratepayers beginning in 1988.

Refinancings Reduce Interest Costs

Capital requirements in 1987 were $350 million, which includes $185 million of cash construction expenditures, $95 million for reduction of short-term debt, $35 million for early refunding of high-rate securities and $35 million to pay sinking funds and maturing debt. These needs were met with $208 million in sales of securities together with internally-generated funds.

Refinancing of high-rate securities continued into early 1988 with the refunding of $100 million of 13⅝% first mortgage bonds due 2012. These bonds were refinanced with $100 million of 10⅝% first mortgage bonds due 2018. Savings in interest costs will be about $2 million a year.

New-home construction and general economic activity in the service area continued to be strong in 1987. More than 14,000 new electric customers were connected, the largest addition in over ten years.

Construction and Capital Expansion

Nuclear Plant Nears Commercial Operation

After faulty main steam safety valves were replaced early in 1987, the Nine Mile II nuclear plant made good progress. The plant began its heat-up in May, received a full operating license in July and started generating electricity on a test basis in August. Since then it has continued test operations, reaching full electrical output in February 1988. It is expected to achieve commercial operation in the second quarter of 1988. NYSEG owns 18% of the 1,084,000-kilowatt (kw) facility which was built and will be operated by Niagara Mohawk Power Corporation.

Like most other nuclear plants under construction after the 1979 accident at Three Mile Island, Nine Mile II has experienced construction delays and a substantial increase in cost. The Public Service Commission in 1986 approved a settlement that allowed $4.2 billion of Nine Mile II costs to be ultimately reflected in electric rates of the five utilities owning the $6.5 billion plant. For NYSEG the allowed cost amounts to $736 million. Disallowed costs of $428 million ($322 million after tax effect) were written off in 1987. If commercial operation of the generating unit is delayed beyond May 1, 1988, the Company would sustain an additional write-off of about $9 million for each month of delay.

Commercial operation of Nine Mile II will add 195,000 kw, or about 7%, to the Company's power-supply capability. For the state as a whole it will displace oil-fired electric generation, at least initially, which will help the state reduce the amount of oil it imports from foreign countries.

Three-year Budget Totals $631 Million

Outlays for construction, including Allowance for Funds Used During Construction, were $270 million in 1987. The largest single item was $127 million for the Company's share of expenditures for Nine Mile II. Continued improvements at existing generating stations, including environmental protection work, required $37 million. About $13 million was spent on reinforcement and expansion of the gas system. The remaining $93 million was for general facilities and equipment, including electric and gas service lines to new customers.

Construction expenditures in the 1988–90 period are expected to total $631 million. About $80 million is budgeted for the Company's ongoing program to increase efficiency and extend service lives of existing coal-fired generating stations. This includes studies of new combustion technologies that may be appropriate for certain stations.

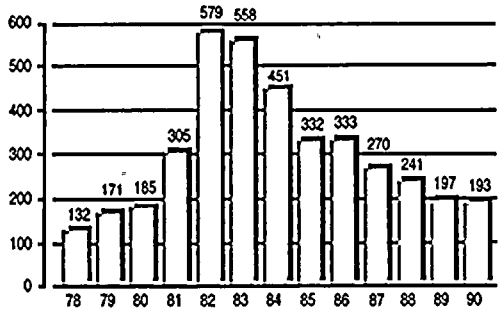
Another major item is $46 million toward construction of a $57 million Energy Control Center being built near the Company's general office in Binghamton. Scheduled for operation in 1991, it will continually monitor and control generation of electricity and distribution of electricity and gas across the service territory. It will utilize state-of-the-art computer and communications equipment, replacing facilities installed in the 1970s.

About $25 million has been allocated for collection and treatment of waste water at certain generating stations that is required by environmental regulations. This includes such things as placing liners under coal piles to prevent seepage into ground water.

The Company estimates that about 10% of capital expenditures is required for projects designed to protect the environment.

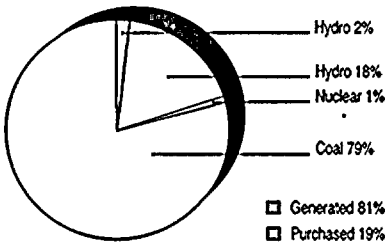
Construction Program

Millions of Dollars



Electricity Sources–1987

Kilowatt-hours



Food processing and other agriculture-related businesses are an important part of the service area economy. New small wineries in the scenic Finger Lakes Region also have had a favorable effect on tourism.

Electric and Natural Gas Operations

Peak Load Rises 10%

During very cold weather in mid-January 1988 a new peak electric load of 2,530,000 kw was established. This exceeds the previous peak, set in December 1985, by 10%.

The Company's power supply capability at the end of 1987 was 2,970,000 kw. This includes 509,000 kw of firm purchases, most of which is from hydroelectric facilities of the State Power Authority. In early 1988 agreement in principle was reached with the Authority to extend, for about 17 years, hydroelectricity purchase contracts expiring on January 1, 1990. The new contracts cover 220,000 kw of firm hydropower and 150,000 kw of hydro peaking capacity.

Heat rate, expressed in Btus per kilowatt-hour, is an industry measure of generating plant efficiency. For 1987 the Company's heat rate was 9,897 Btu/kwh, the best since 1964. It is expected to place the Company among the top 10 of the nation's 100 largest investor-owned utilities. Over 95% of the Company's electricity is produced by coal-fired generating facilities.

Somerset Station continues to be a major contributor to generating system efficiency. From its start-up in August 1984 through December 1987, availability has been 93% compared with 80% for units of similar size nationwide. Somerset's extensive scrubber system, which removes sulfur dioxide from chimney discharges, has been available 100% of the time since start-up.

High Sulfur Test Center Begins Operation

A High Sulfur Test Center at the Company's Somerset Station began operation in the spring of 1987. The purpose of the test center, which is owned and operated by the Electric Power Research Institute, is to find ways to reduce the cost and improve emission control technology for power plants that burn coal with a sulfur content of more than 2%. As the result of work at the $20 million center, costing $45 million over the next ten years, plants throughout the country may be able to use more local coal, significantly reduce scrubber costs, improve reliability and cut the amount of electricity required to operate scrubbers. The Company's contribution to the project amounts to $5 million in cash and services.

The Company's total research and development costs in 1987 were about $11 million. Half the money was used for internal research and half went to national and state research organizations such as the Electric Power Research Institute, Empire State Electric Energy Research Corporation and New York State Energy Research and Development Authority.

One feature of the Company's internal research is a program to monitor and evaluate various techniques for reducing customers' electricity demands during periods of peak load. If effective, such measures would be useful in helping to defer construction of new generating facilities.

Storm Damage Costs $6.5 Million

Kilowatt-hour sales of electricity to retail customers were up 3% and revenues rose 4% in 1987. Sales to other utilities jumped sharply, up 21%, after a 29% decline in 1986. Revenues from sales to other utilities climbed 14%. Total sales increased 7% while revenues increased 4%.

The average number of electric customers served was 726,000, a 14,000 increase over 1986. This is the largest increase in over ten years.

Operating expenses rose 5%. The largest single expense, fuel cost, increased 5% on a 14% rise in kilowatt-hours generated. Operating expenses excluding fuel were also up 5%. Fuel costs on a energy-unit basis were $1.56 a million Btu which compares with $1.67 in 1986. Operating expenses were increased by $6.5 million due to a severe October snowstorm in eastern New York which caused widespread power outages.

New Franchise Areas Established

The Company is expanding its gas market by adding customers in existing franchise areas and pursuing new franchises in about 40 towns across the state. If all franchises are received, the number of gas customers served would increase by about 15%.

Gas sales and revenues declined in 1987 primarily because of some customers purchasing gas directly from producers, switches of a few large users to oil fuels and customers' conservation efforts.

Dekatherm sales to residential customers were down 2% and revenues were off 6%. Sales to commercial customers decreased 7% and revenues dropped 12%.

Industrial gas sales declined materially, principally reflecting a shift of some industry to oil and customers' direct purchase of gas from producers. The gas is transported over NYSEG facilities and the Company is compensated for the service.

Gas operating expenses were down 12% largely because of lower purchases and a decline in purchased-gas cost from $3.75 to $3.43 a dekatherm. Operating expenses excluding purchased gas were up 13%, reflecting in part a pension expense accounting adjustment.

The average number of gas customers served was 135,000, a 2,000 increase over 1986.

Electricity adds to the quality of life in numerous ways. Here a youngster is outfitted with special breathing apparatus after undergoing throat surgery.

Consumer Relations

New Milestone Reached

Project SHARE, an emergency assistance program for elderly or disabled customers, topped the $1 million mark in 1987 for contributions since its inception. The program, administered by the American Red Cross, has helped over 5,000 customers since it was started in 1982. Contributions are made by customers, employees and the Company.

NYSEG also expanded its consumer representative program to all 13 operating districts in 1987. Consumer representatives are human-services professionals who help customers facing a crisis.

Other consumer affairs highlights include:

- Installation of facilities to communicate with customers who have a Telecommunications Device for the Deaf.
- Use of Sight Saver, or large-type bills for customers who are sight impaired.
- The start of Energylines, a one-page newsletter-style bill insert to replace many separate inserts in each bill.
- An increase of 10% in classroom presentations and 20% in film distribution to schools.

Stockholders

Share Purchases Increase

In 1987 stockholders purchased 977,000 shares of common stock with their dividends and optional cash payments. This compares with 911,000 shares in 1986. About a third of the Company's 70,000 holders of common stock currently reinvest dividends.

On January 1, 1988, the Dividend Reinvestment and Stock Purchase Plan was amended so that purchased shares no longer will be obtained on the open market but will be new shares issued by the Company. This provides additional equity capital to help strengthen the Company's capital structure.

Any stockholder of record is eligible to join the plan. If you would like further information, call the toll-free number listed in the back of this report.

Management

New Officers Elected

Officer retirements and reorganizations to increase operating efficiency and allow for future management succession caused a number of management changes in 1987.

Allen E. Kintigh, formerly Senior Vice President—Generation, was elected Executive Vice President. He will become President and Chief Operating Officer in May 1988 succeeding James A. Carrigg who moves up to Chairman and Chief Executive Officer. At that time Wells P. Allen, Jr., Chairman and Chief Executive Officer, will retire after 39 years of distinguished service to the Company. Richard A. Jacobson, formerly a Senior Vice President, was elected Executive Vice President and Chief Financial Officer.

Other officers elected include Richard P. Fagan, Senior Vice President and Comptroller; Bernard M. Rider, Senior Vice President—Electric Operations and Engineering; Jack H. Roskoz, Senior Vice President—Administration; Paul Komar, Vice President and Executive Assistant; William G. McCann, Vice President—Electric Operations; Daniel W. Farley, Secretary; and Sherwood J. Rafferty, Treasurer.

A NYSEG-sponsored 10-kilometer run, which included a wheelchair division, raised over $7,000 for Project SHARE, an emergency assistance program for elderly or disabled customers.

Marketing

Program Selectively Raises Sales

A long-range strategic marketing plan, developed in 1987, is designed to selectively increase electric sales during off-peak hours and raise gas sales within the existing service territory and in new franchise areas.

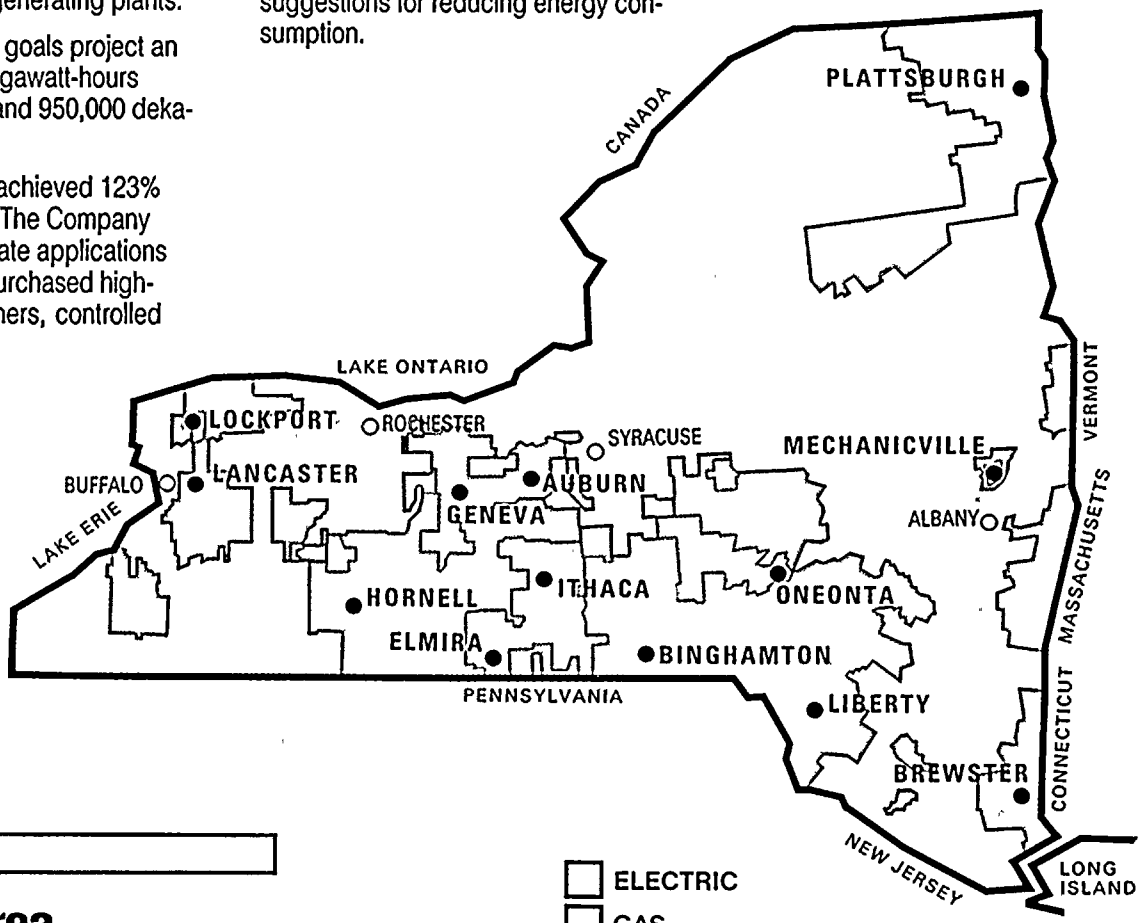
Marketing off-peak electricity will help customers reduce electric bills by taking advantage of the Company's half-price off-peak rate thereby increasing sales without adding generating plants.

The 1988 marketing goals project an increase of 50,000 megawatt-hours of off-peak electricity and 950,000 dekatherms of gas sales.

In 1987 employees achieved 123% of the marketing goal. The Company processed 11,000 rebate applications from customers who purchased high-efficiency air conditioners, controlled electric water heaters, electric thermal storage units, heat pumps and gas space or water heating equipment. An incentive program for employees and appliance dealers generated 32,000 sales prospects.

Employees involved in a home energy survey program completed 27,000 surveys in 1987, exceeding the goal of 18,000 set by the PSC. The Company offers free energy surveys to all customers which analyze energy use and provide suggestions for reducing energy consumption.

The Company's extensive industrial development efforts have again been a contributing factor to growth in the service area. The net gain in industrial jobs was 4,500 in 1987 compared with 3,500 the previous year.



Service Area

NYSEG serves 800,000 customers who live in small cities, suburbs and rural areas of Upstate New York. The economy of the 17,000 square mile service area is supported by light industry, agriculture, recreational facilities, colleges and universities. Most of the electricity supplied by the Company is generated at seven coal-fired plants.

Raising operating efficiency continues to have a high priority. In 1987 NYSEG's generating plant efficiency was the best in New York State and ranked high among utilities nationwide.

Consolidated Balance Sheet

Assets	December 31 1987 (Thousands of Dollars)	1986
Utility plant, at original cost (Note 1)		
Electric	$3,128,188	$3,004,799
Gas	169,993	160,762
Common	87,114	74,658
	3,385,295	3,240,219
Less accumulated depreciation	855,198	769,336
Net utility plant in service	2,530,097	2,470,883
Construction work in progress (Note 9)	776,965	1,132,826
	3,307,062	3,603,709
Other Property and Investments	65,561	68,903
Current Assets		
Cash	4,831	10,267
Special deposits	3,901	4,823
Accounts receivable	113,718	126,081
Accounts receivable—Unfunded future federal income taxes (Note 3)	18,884	—
Accounts receivable—Nine Mile Point Unit No. 2 Settlement Inducement (Note 9)	52,200	—
Fuel, at average cost	61,875	49,283
Materials and supplies, at average cost	45,639	44,272
Prepayments	22,769	27,546
Accumulated deferred federal income tax benefits (Note 3)	17,510	—
	341,327	262,272
Deferred Charges		
Abandoned project costs (Note 10)	74,087	108,926
Somerset Station phase in costs (Note 1)	71,077	74,348
Unamortized debt expense (Note 1)	63,700	64,762
Accumulated deferred federal income tax benefits (Note 3)	112,994	19,011
Unfunded future federal income taxes (Note 3)	429,625	—
Other	21,911	23,053
	773,394	290,100
	$4,487,344	$4,224,984
Capitalization and Liabilities		
Capitalization (Notes 4–7)		
Capital stock and retained earnings		
Preferred stock redeemable solely at the option of the Company	$ 160,500	$ 160,500
Preferred stock subject to mandatory redemption requirements	18,150	22,820
Common stock equity		
Common stock	371,557	360,408
Capital in excess of par value	542,063	503,364
Retained earnings	192,898	534,190
Total common stock equity	1,106,518	1,397,962
Long-term debt	2,055,224	1,928,407
Total	3,340,392	3,509,689
Current Liabilities		
Current portion of long-term debt and preferred stock	41,124	65,332
Commercial paper (Note 7)	16,000	110,600
Accounts payable	59,852	64,898
Dividends payable on preferred stock	3,477	4,516
Pensions accrued (Note 2)	11,353	14,044
Taxes accrued	3,233	14,619
Interest accrued	59,498	54,973
Unfunded future federal income taxes (Note 3)	18,884	—
Accumulated deferred federal income taxes (Note 3)	7,643	—
Other	29,327	28,555
	250,391	357,537
Deferred Credits		
Accumulated deferred investment tax credit (Note 3)	128,091	106,436
Excess deferred federal income taxes (Note 3)	88,986	—
Other	52,130	19,307
	269,207	125,743
Accumulated Deferred Federal Income Taxes (Note 3)		
Unfunded future federal income taxes	429,625	—
Other	197,729	232,015
	627,354	232,015
Commitments and Contingencies (Notes 8–11)	—	—
	$4,487,344	$4,224,984

The accompanying notes shown on pages 19 through 29 are an integral part of the financial statements.

Consolidated Statement of Income

	Years Ended December 31		
	1987	1986	1985
	(Thousands of Dollars)		
Operating Revenues			
Electric	$1,136,799	$1,098,089	$1,051,579
Gas	152,839	179,195	190,201
Total	1,289,638	1,277,284	1,241,780
Operating Expenses			
Operation—fuel (Note 1)	249,520	238,371	280,397
—other	195,204	182,710	167,923
Electricity purchased	29,638	29,302	35,984
Gas purchased	90,974	111,147	129,809
Maintenance	93,274	88,486	81,591
Depreciation	110,679	100,796	98,085
Federal income tax recorded (Note 3)	110,355	122,987	96,651
Other taxes (Note 13)	128,776	122,400	113,587
Total	1,008,420	996,199	1,004,027
Operating Income	281,218	281,085	237,753
Other Income and Deductions			
Allowance for other funds used during construction (Note 1)	55,777	63,168	50,263
Non-cash return—utility plant in service (Note 1)	—	9,868	40,185
—abandoned projects (Notes 1 and 10)	5,039	5,906	6,682
Federal income tax credit recorded (Note 3)	4,699	4,648	2,544
Income tax benefits from AFDC and non-cash return (Note 3)	—	30,108	32,256
Disallowed project costs (Notes 9 and 10)	(151,648)	—	—
Tax effect of disallowed project costs recorded (Notes 3, 9 and 10)	12,929	—	—
Other—net	(672)	39	4,409
Income Before Interest Charges	207,342	394,822	374,092
Interest Charges			
Interest on long-term debt	195,264	187,238	178,985
Other interest	7,057	12,020	12,263
Allowance for borrowed funds used during construction (Note 1)	(47,312)	(32,930)	(25,589)
Interest charges—net	155,009	166,328	165,659
Income Before Cumulative Effect of Accounting Changes	52,333	228,494	208,433
Cumulative effect for years prior to 1987 of accounting change for disallowed project costs (less applicable taxes of $95,434) (Note 9)	(210,914)	—	—
Cumulative effect for years prior to 1987 of accounting change for income taxes (Note 3)	(19,156)	—	—
Net Income (Loss)	(177,737)	228,494	208,433
Preferred Stock Dividends	13,662	20,104	25,226
Earnings (Loss) for Common Stock	$ (191,399)	$ 208,390	$ 183,207
Earnings (Loss) Per Share			
Before cumulative effect of accounting changes	$ .70	$ 3.86	$ 3.46
Cumulative effect for years prior to 1987 of accounting change for:			
Disallowed costs	(3.81)	—	—
Income taxes	(.35)	—	—
Earnings (Loss) per share	$ (3.46)	$ 3.86	$ 3.46
Proforma Earnings—With 1987 Accounting Changes Applied Retroactively			
Earnings for common stock	$38,671	$96,604	$64,923
Earnings per share	$.70	$1.79	$1.22
Average Number of Shares Outstanding	55,317,858	54,013,868	53,013,086

Consolidated Statement of Retained Earnings

	Years Ended December 31		
	1987	1986	1985
	(Thousands of Dollars)		
Balance, beginning of year	$534,190	$469,661	$418,472
Add net income (loss)	(177,737)	228,494	208,433
	356,453	698,155	626,905
Deduct cash dividends			
Preferred stock (at serial rates)			
Redeemable solely at the option of the Company	11,355	11,338	12,559
Subject to mandatory redemption requirements	2,307	8,766	12,667
Common stock ($2.64, $2.60, and $2.50 per share in 1987, 1986 and 1985, respectively)	145,794	140,432	132,018
	159,456	160,536	157,244
Deduct premium paid on preferred stock redemption (Note 6)	4,099	3,429	—
Balance, end of year	$192,898	$534,190	$469,661

The accompanying notes shown on pages 19 through 29 are an integral part of the financial statements.

Consolidated Statement of Changes in Financial Position

Source of Funds	Years Ended December 31 1987	1986	1985
	(Thousands of Dollars)		
Operations			
Net income (loss)	$(177,737)	$228,494	$208,433
AFDC and other non-cash return	(108,128)	(111,872)	(122,719)
Depreciation	110,679	100,796	98,085
Amortization of deferred charges	13,847	25,188	23,773
Fuel and purchased gas costs deferred	2,359	1,332	2,820
Interchange profits deferred—net	(8)	(7,412)	(10,121)
Disallowed project costs (Notes 9 and 10)	457,996	—	—
Tax effect of disallowed project costs recorded (Notes 3, 9 and 10)	(89,207)	—	—
Nine Mile Point Unit No. 2 Settlement Inducement (Note 9)	52,200	—	—
Excess revenues	19,662	—	—
Federal income tax deferred—net (Note 3)	49,925	38,538	59,820
Investment tax credit deferred—net (Note 3)	21,655	30,998	1,727
Funds from operations	353,243	306,062	261,818
Financing Arrangements			
First mortgage bonds	100,000	275,000	175,000
Common stock	48,563	1,815	45,494
Long-term notes payable	59,500	(6,200)	228,350
Commercial paper	(94,600)	(7,700)	58,200
Obligations under capital leases	4,890	2,273	9,169
Funds from financing arrangements	118,353	265,188	516,213
Total funds available	$ 471,596	$571,250	$778,031
Application of Funds			
Construction expenditures	$ 184,917	$230,892	$256,149
Capitalization of equipment leases	4,890	2,273	9,169
Bonds and preferred stock reacquired	8,239	97,325	214,769
Securities to be redeemed or due within one year	34,770	64,204	58,010
Dividends on preferred stock	13,662	20,104	25,226
Dividends on common stock	145,794	140,432	132,018
Increase in working capital*	91,601	4,148	64,211
Other—net	(12,277)	11,872	18,479
Total funds applied	$ 471,596	$571,250	$778,031
Increase (Decrease) In Working Capital			
Current Assets			
Cash	$ (5,436)	$ 2,666	$ 3,273
Special deposits	(922)	(8,776)	(56,593)
Accounts receivable	(12,363)	9,544	(86)
Accounts receivable—Unfunded future federal income taxes (Note 3)	18,884	—	—
Accounts receivable—Nine Mile Point Unit No. 2 Settlement Inducement (Note 9)	52,200	—	—
Fuel	12,592	(8,812)	(10,843)
Materials and supplies	1,367	5,584	7,961
Prepayments	(4,777)	7,092	84
Accumulated deferred federal income tax benefits (Note 3)	17,510	—	—
Total increase (decrease) in current assets	79,055	7,298	(56,204)
Current Liabilities			
Current portion of long-term debt and preferred stock	(24,208)	5,819	(84,870)
Accounts payable	(5,046)	(12,262)	(30,548)
Dividends payable on preferred stock	(1,039)	(1,574)	(726)
Pensions accrued (Note 2)	(2,691)	1,433	(128)
Taxes accrued	(11,386)	9,574	(4,611)
Interest accrued	4,525	2,929	(1,469)
Unfunded future federal income taxes (Note 3)	18,884	—	—
Accumulated deferred federal income taxes (Note 3)	7,643	—	—
Other	772	(2,769)	1,937
Total increase (decrease) in current liabilities*	(12,546)	3,150	(120,415)
Increase in working capital*	$ 91,601	$ 4,148	$ 64,211

*Exclusive of changes in commercial paper

The accompanying notes shown on pages 19 through 29 are an integral part of the financial statements.

Notes to Consolidated Financial Statements

1. Significant Accounting Policies

a. Principles of consolidation

The consolidated financial statements include the Company's wholly-owned subsidiary, Somerset Railroad Corporation (SRC), which owns rail facilities for transport of coal and other supplies to the Somerset Generating Station (Somerset). All significant intercompany balances and transactions are eliminated in consolidation.

b. Accounting records

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

c. Utility plant

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

d. Allowance for funds used during construction (AFDC) and other non-cash return

AFDC is a non-cash return which is shown in the Consolidated Statement of Income as allowance for other funds used during construction and allowance for borrowed funds used during construction. AFDC rates are determined according to FERC regulations. The Company used a net-of-tax rate of 9.6% for 1985, except during the last eight months of 1985 when a before tax rate of 12.3% was used for projects other than Nine Mile Point nuclear generating unit No. 2 (NMP2). In 1986, the AFDC rate was 9.4% (net-of-tax) for NMP2 and 12.1% (before tax) for projects other than NMP2.

In 1987 as a result of the adoption of Statement of Financial Accounting Standards No. 96, Accounting for Income Taxes (SFAS 96) (See Note 3.), the Company used a before tax AFDC rate of 11.7% for all projects.

Non-cash return was accrued on certain unamortized abandoned project costs. (See Note 10.)

e. Revenue

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

f. Federal income taxes (See Note 3.)

The Company files a consolidated federal income tax return with its wholly-owned subsidiary, SRC.

Deferred income taxes are provided on all temporary differences between book and taxable income.

Investment tax credit, which reduces federal income tax currently payable, is deferred and amortized over the lives of the applicable property.

g. Deferred charges (See Notes 3 and 10.)

The Company defers certain fuel and purchased gas costs which are subsequently reflected in billings to customers through adjustment clauses in rates.

Debt expense is deferred and amortized ratably over the lives of the related issues. Unamortized debt expense also includes premiums paid on reacquisitions of first mortgage bonds totaling approximately $39 million which is being amortized ratably over periods ranging from five to thirty years.

h. Somerset Generating Station

Somerset plant costs of approximately $1 billion were phased into electric rates in three segments to moderate rate increases. The final segment was included in electric rates effective April 1986. When Somerset began operating in August 1984, a non-cash return similar to AFDC was recorded on the portion of costs not included in rate base. The Company recorded a total of $72 million of non-cash return during the phase-in period.

The Company had been amortizing these deferred charges over the remaining life of the plant. However, in 1987 Statement of Financial Accounting Standards No. 92, Regulated Enterprises—Accounting for Phase-in Plans (SFAS 92), was issued which required that costs deferred pursuant to a phase-in plan be amortized over a period not to exceed ten years. If an existing plan did not meet this criteria, SFAS 92 allowed companies to amortize the remaining deferred charges over the next ten years providing approval was obtained from their respective state regulatory commission. The PSC has allowed the Company to amortize the remaining deferred charges relating to Somerset over the next ten years beginning in 1988. As of December 31, 1987 the unamortized balance of non-cash return was approximately $67 million.

i. Depreciation

Depreciation expense is determined using straight-line rates, based on average service lives, applied to the original cost, by groups of depreciable property in service. Depreciation accruals were equivalent to 3.1% of average depreciable property for 1987, 1986 and 1985.

j. Amortization of nuclear fuel, fuel disposal and nuclear plant decommissioning costs

The cost of nuclear fuel associated with the Company's 18% share of NMP2 will be amortized on the basis of the quantity of heat produced for the generation of electricity. In computing the amortization, no salvage value will be assumed for spent nuclear fuel.

Niagara Mohawk Power Corporation (Niagara Mohawk), operator of NMP2, has contracted with the U.S. Department of Energy for the disposal of nuclear fuel. The Company is reimbursing Niagara Mohawk for its 18% share of the cost under the contract (currently $1.00 per megawatt hour of net generation).

The Company's 18% share of the cost to decommission NMP2 is currently estimated to be $248 million. This assumes that decommissioning of NMP2 will commence in 2027. Included in the Company's latest electric rate decision was an annualized allowance of $227,000 for decommissioning costs which was based on the PSC's estimate of $124 million for the Company's 18% share of decommissioning NMP2 in 2027. In the rate decision, the PSC also agreed to reconsider its allowance for decommissioning costs in the future should its estimate increase. The Company believes that the cost to decommission NMP2 will ultimately be recovered in rates.

2. Retirement Benefits

The Company has noncontributory retirement annuity plans which cover substantially all employees. Benefits are based principally on the employee's length of service and compensation for the five highest paid years out of the last ten years of service. It is the Company's policy to fund the pension costs accrued each year to the extent deductible for federal income tax purposes. Net periodic pension cost (benefit) for 1987, 1986 and 1985 totaled $(2.7) million, $8.4 million and $12.6 million, respectively.

In January 1987 the Company changed its method of accounting for pension costs to conform with Statement of Financial Accounting Standards No. 87, Employer's Accounting for Pensions (SFAS 87). The provisions of SFAS 87 were applied prospectively and therefore pension costs for prior years have not been restated.

Net periodic pension cost (benefit) for 1987 included the following components:

	(Thousands of Dollars)
Service cost: Benefits earned during the year	$ 11,656
Interest cost on projected benefit obligation	23,391
Expected return on plan assets	(23,939)
Net amortization and deferral	(13,799)
Net periodic pension cost (benefit)	$ (2,691)

The funded status of the plans at December 31, 1987 was:

	(Thousands of Dollars)
Actuarial present value of accumulated benefit obligation:	
Vested	$ 172,553
Nonvested	21,433
	$ 193,986
Fair value of plan assets	$ 426,817
Actuarial present value of projected benefit obligation	302,481
Plan assets in excess of projected benefit obligation	$ 124,336
Unrecognized net transition asset	(117,116)
Unrecognized net (gain) loss	(23,046)
Unrecognized prior service costs	4,473
Unpaid pension liability included in current liabilities	$ (11,353)

Plan assets consist primarily of equity securities, corporate bonds and U.S. Treasury bonds and notes.

At December 31, 1986 under the previous accounting standard, the Company had actuarial present value of accumulated plan benefits of $162.4 million which included vested benefits of $141.4 million. The fair value of plan assets was $363.5 million and the assumed investment rate of return was 7.5%.

For 1987 the assumed discount rate and long-term rate of increase in future compensation levels used in determining the net periodic pension cost and the funded status were 8.0% and 6.0%, respectively, while the expected long-term rate of return on plan assets was 7.5%.

The effect of adopting SFAS 87 was to decrease pension costs in 1987 by $11.9 million before the federal income tax effect. The PSC has directed the Company to defer for future disposition any change in pension expense resulting from the adoption of SFAS 87 which has not yet been reflected in the Company's electric and gas rates. The Company's electric rates currently reflect the adoption of SFAS 87. However, as of December 31, 1987 the Company recorded a deferred credit of approximately $2 million with respect to its gas operations.

In addition to providing pension benefits, the Company provides certain health care benefits for retired employees and their dependents. Substantially all of the Company's employees who retire under a Company pension plan may become eligible for those benefits at retirement. At December 31, 1987, 1,622 retirees were covered under the Company's comprehensive health insurance plan (CHIP) and prescription drug plan, which the Company self-insures. In 1987 the cost of providing these benefits to retirees was approximately $2.0 million. In prior years, the cost associated with providing these benefits to retirees was not separable from the cost of providing these benefits to active employees. At December 31, 1986, 4,423 active employees and 1,456 retirees and their dependents were covered under the Company's CHIP and prescription drug plan. The Company recognized as expense $8.0 million and $7.8 million for 1986 and 1985, respectively, for these benefits.

3. Federal Income Taxes

Federal income tax expense on income before cumulative effect of accounting changes consists of:

	1987	1986	1985
		(Thousands of Dollars)	
Charged to operations:			
Current	$ 25,227	$ 13,966	$ 1,182
Deferred—net:			
Accelerated depreciation	50,605	42,896	46,206
Cost of reacquired debt	(733)	493	13,986
Income tax benefits from AFDC—Borrowed funds	18,883	30,108	32,256
Unbilled revenues	(9,044)	—	—
Miscellaneous	(562)	(3,744)	(289)
Investment tax credits deferred	25,979	39,268	3,310
	110,355	122,987	96,651
Included in other income:			
Deferred taxes—Disallowed project costs	(12,929)	—	—
Other	(4,699)	(4,648)	(2,544)
Total	$ 92,727	$118,339	$ 94,107

The effective tax rates on income before cumulative effect of accounting changes differ from the statutory rates (40% for 1987 and 46% for 1986 and 1985) due to the following:

	1987	1986	1985
		(Thousands of Dollars)	
Tax expense at the statutory rate	$ 57,951	$159,543	$139,168
AFDC	(24,314)	(35,030)	(39,028)
Disallowed project costs (Notes 9 and 10)	55,421	—	—
TRA 1986 deferrals	7,206		
Investment tax credit amortization	(4,497)	(3,374)	(2,438)
Other—net	960	(2,800)	(3,595)
Total	$ 92,727	$118,339	$ 94,107

The Tax Reform Act of 1986 (TRA 1986) was enacted on October 22, 1986. Among other things, TRA 1986 provided for a reduction in the statutory corporate income tax rates, the treatment of unbilled revenues as taxable income, elimination of the investment tax credit as of January 1, 1986, reduction of investment tax credit carry forwards and changes in depreciation rates and lives.

On July 7, 1987 the PSC issued a Statement of Policy on Accounting and Ratemaking Procedures to implement the requirements of TRA 1986. This statement required that the Company defer the impact of TRA 1986 until the benefits can be passed on to ratepayers. The Company has recorded a payable to ratepayers of $7.2 million which represents primarily 1987 excess federal income taxes resulting from the reduction of the statutory corporate income tax rate to 40%. In the Company's latest rate case decision, the PSC postponed acting on the TRA 1986 deferrals relating to 1987 until the Company's next rate request. The PSC incorporated the provisions of TRA 1986 into the Company's electric rates effective January 1988.

In December 1987 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96, Accounting for Income Taxes (SFAS 96). The Company adopted SFAS 96 in December 1987. This resulted in a $22 million write-off of tax benefits associated with the disallowed project costs of NMP2 to the statutory tax rate of 34% mandated by TRA 1986. This write-off is reflected on the Company's Consolidated Statement of Income for 1987 as the cumulative effect of an accounting change ($19 million) and as an adjustment to the tax effect of disallowed project costs recorded ($3 million).

In addition, SFAS 96 required that the Company record a payable to ratepayers as of December 1987 of approximately $89 million, primarily representing previously recorded excess deferred federal income tax credits resulting from the reduction of the statutory corporate federal income tax rate from 46% to 34%. Of this total, approximately $70 million will be refunded over the life of the related depreciable assets. The remaining balance will be refunded over a period to be determined by the PSC in a future rate decision.

The Company was also required to record approximately $449 million in deferred taxes representing the cumulative amount of federal income taxes on temporary differences which were previously flowed through to ratepayers. The Company recorded a corresponding receivable on the balance sheet for these items from ratepayers. These deferrals have been increased in accordance with SFAS 96 for the tax effect of the future revenue requirement and will be amortized over the life of the related depreciable assets concurrent with their recovery in rates.

Although the Company calculates its deferred tax assets and liabilities pursuant to SFAS 96, federal income tax expense recorded of $92.7 million reflects the federal income tax allowed in the Company's cost of service for ratemaking purposes. Had the provision for federal income tax expense been calculated under SFAS 96, the provision would have been approximately $5 million.

The Company has approximately $63 million of unused investment tax credits at December 31, 1987 which will expire beginning in 1999 and which reflect a $17 million reduction for 1988 as a result of TRA 1986.

4. Long-term Debt

At December 31, 1987 long-term debt was (Thousands of Dollars):

First mortgage bonds

Series	Due	Amount	Series	Due	Amount
3 7/8%	Feb. 1, 1988	$ 25,000	9.35%	July 1, 2003	$ 41,600
17 5/8%	Mar. 1, 1989	50,000	9 3/8%	Mar. 1, 2005	75,000
17 5/8%	Mar. 1, 1990	50,000	9 3/8%	Jan. 1, 2006	53,986
4 5/8%	May 1, 1991	25,000	7 1/4%	June 1, 2006	12,000
11 3/4%	Apr. 1, 1993	100,000	6 7/8%	Dec. 1, 2006	25,750
12 3/8%	Jan. 1, 1994	100,000	8 5/8%	Nov. 1, 2007	60,000
14 7/8%	July 1, 1994	50,000	13 5/8%	Dec. 1, 2012	100,000
8 3/8%**	Aug. 15, 1994	100,000	16 %	July 1, 2014	1,173
8 5/8%	June 1, 1996	50,000	12 %	July 1, 2015	100,000
5 5/8%	Jan. 1, 1997	25,000	12 1/8%	Oct. 1, 2015	75,000
6 1/4%	Sept. 1, 1997	25,000	10 5/8%**	Feb. 1, 2016	125,000
6 1/2%	Sept. 1, 1998	30,000	9 1/4%**	Apr. 1, 2016	50,000
7 5/8%	Nov. 1, 2001	50,000	9 %*	Mar. 1, 2017	100,000
Total first mortgage bonds					1,499,509

Pollution control notes

Interest Rate	Maturity Date	Interest Rate Adjustment Date	Letter of Credit Expiration Date	
12 %	May 1, 2014	—	—	60,000
12.30%	July 1, 2014	—	—	40,000
7 %	Dec. 1, 2014	Dec. 1, 1988	Dec. 15, 1989	74,000
7 %	Mar. 1, 2015	Mar. 1, 1988	Mar. 15, 1989	37,500
3 7/8%	Mar. 15, 2015	Mar. 15, 1988	Mar. 31, 1989	60,000
4 1/2%	July 15, 2015	July 15, 1988	July 31, 1989	63,500
6 %	Oct. 15, 2015	Oct. 15, 1988	Oct. 31, 1989	30,000
6 3/8%	Dec. 1, 2015	Dec. 1, 1988	Dec. 15, 1989	42,000
5 3/4%*	July 1, 2026	July 1, 1990	July 15, 1990	65,000
Total pollution control notes				472,000

7 3/4% notes payable due August 27, 1989	50,000
SRC commercial paper due December 31, 1990	34,400
Participations due April 5, 1990 in mining company notes	6,725
Obligations under capital leases	32,664
Unamortized premium and discount on debt—net	(3,620)
	2,091,678
Less debt due within one year—included in current liabilities	36,454
Total	$2,055,224

*Issued 1987 **Issued 1986

At December 31, 1987 long-term debt which will become due during the next five years is:

1988	1989	1990	1991	1992
		(Thousands of Dollars)		
$36,454	$111,613	$101,068	$34,373	$8,408

The Company's mortgage provides for a sinking and improvement fund. The provisions require the Company to make annual cash deposits with the Trustee equivalent to 1% of the principal amount of all bonds delivered and authenticated by the Trustee prior to January 1 of that year (excluding any bonds issued on the basis of the retirement of bonds). Pursuant to the terms of the mortgage, the Company has satisfied these requirements in 1987 by crediting "bondable value of property additions" against a portion of the amount of cash to be deposited and by depositing $5.3 million in cash which was used to redeem the 18% and 16⅜% Series First Mortgage Bonds.

Mandatory annual cash sinking fund requirements are $3,000,000 for the 9⅜% series due 2006, $2,100,000 for the 9.35% series, $600,000 beginning June 1, 2001 for the 7¼% series and $250,000 beginning December 1, 1992 for the 6⅞% series. The amount increases to $500,000 and $750,000 on December 1, 1997 and December 1, 2002, respectively, for the 6⅞% series.

The Company's first mortgage bond indenture constitutes a direct first mortgage lien on substantially all utility plant.

Adjustable rate pollution control notes were issued to secure like amounts of tax-exempt adjustable rate pollution control revenue bonds (Revenue Bonds) issued by a governmental authority. The Revenue Bonds bear interest at the rate indicated through the date preceding the interest rate adjustment date. The pollution control notes bear interest at the same rate as the Revenue Bonds. On the interest rate adjustment date and annually thereafter (every three years thereafter in the case of the Revenue Bonds due July 1, 2026), the interest rate will be adjusted, not to exceed a rate of 15%, or at the option of the Company, subject to certain conditions, a fixed rate of interest, not to exceed 18%, may become effective. In the case of the Revenue Bonds due July 1, 2026, at the option of the Company, subject to certain conditions, a fixed rate of interest may become effective prior to the interest rate adjustment date or each third year thereafter. Bondowners may elect, subject to certain conditions, to have their Revenue Bonds purchased by the Trustee.

The Company has irrevocable letters of credit which expire on the letter of credit expiration dates and which the Company anticipates being able to extend if the interest rate on the related Revenue Bonds is not converted to a fixed interest rate. These letters of credit support certain payments required to be made on the Revenue Bonds. If the Company is unable to extend the letter of credit that is related to a particular series of Revenue Bonds, that series will have to be redeemed unless a fixed rate of interest becomes effective. Payments made under the letters of credit in connection with purchases of Revenue Bonds by the Trustee are repaid with the proceeds from the remarketing of the Revenue Bonds. To the extent the proceeds are not sufficient, the Company is required to reimburse the bank that issued the letter of credit.

SRC has a letter of credit backed commercial paper program which provides for borrowing up to $40 million through December 31, 1990. The weighted average interest rate for 1987, including fees for the letter of credit, amounted to 6.9%. Substantially all of the property of SRC, other than rolling stock, is subject to a lien of a mortgage and security agreement.

5. Common Stock and Capital in Excess of Par Value

The following is a summary of changes in common stock and capital in excess of par value for 1987, 1986 and 1985:

		Common Stock $6.66 ⅔ Par Value		Capital In Excess of Par Value
		Shares	Amount	Amount
			(Thousands of Dollars)	
Balance at December 31, 1984		52,077,398	$347,183	$468,906
Public offering:	1986	32,100	214	850
	1987	1,467,900	9,786	33,258
Dividend reinvestment and stock-purchase plan:	1985	1,901,714	12,678	32,118
Employee stock ownership plans:	1985	27,862	186	499
	1986	22,123	147	574
	1987	204,389	1,363	4,156
Reacquired capital stock:	1986			417
	1987			1,285
Balance at December 31, 1987		55,733,486	$371,557	$542,063

70,000,000 Shares authorized at December 31, 1987

6. Preferred Stock

At December 31, 1987 serial cumulative preferred stock was:

Series	Par Value Per Share	Redeemable Prior to	Redeemable Per Share	Shares Authorized(1) and Outstanding	Amount (Thousands of Dollars)
Redeemable solely at the option of the Company:					
3.75%	$100		$104.00	150,000	$ 15,000
4 ½% (1949)	100		103.75	40,000	4,000
4.15%	100		101.00	40,000	4,000
4.40%	100		102.00	75,000	7,500
4.15% (1954)	100		102.00	50,000	5,000
6.48%	100		102.00	300,000	30,000
8.80%	100	3/1/91	103.94	250,000	25,000
		Thereafter	102.00		
8.48%	25	2/1/89	26.76		
		2/1/94	26.23	1,000,000	25,000
		Thereafter	25.70		
Adjustable Rate(2)	25	10/1/88	27.81		
		10/1/93	25.75	1,800,000	45,000
		Thereafter	25.00		
Total					$160,500
Subject to mandatory redemption requirements:(6) (7)					
4.50%	100	(3)	105.25	200	$ 20
9.00%	100	10/1/88(4)	103.50	168,000	16,800
9.10%	25	7/1/89(5)	25.00	240,000	6,000
					22,820
Less sinking fund requirements at par value—included in current liabilities					4,670
Total					$ 18,150

At December 31, 1987 redeemable preferred stock sinking fund requirements during the next five years are:

1988	1989	1990	1991	1992
(Thousands of Dollars)				
$4,670	$4,650	$1,650	$1,650	$1,650

(1) At December 31, 1987 there were 1,550,000 shares of $100 par value preferred stock, 8,000,000 shares of $25 par value preferred stock and 1,000,000 shares of $100 par value preference stock authorized but unissued.

(2) The Adjustable Rate Serial Preferred Stock, Series A was issued in September 1983. Dividends paid from the date of issuance through the January 1, 1988 payment varied from 7½% to 12.95% per annum. The payment for April 1, 1988 has been adjusted to a rate of 8.90% per annum and subsequent payments can vary from 7½% to 13½% per annum, based upon a formula included in the Certificate of Incorporation.

(3) By March 31, 1988 the Company must redeem at $103.25 per share the 200 outstanding shares of the 4.50% Series. The Company reacquired 300 shares in 1985 and canceled the shares in 1986.

(4) On October 1, in each year 1988 through 1995, the Company must redeem at par 16,500 shares of the 9.00% Series. For the years 1985 through 1987, 16,500 shares were reacquired and canceled annually. The 9.00% Series is redeemable at $103.50 per share prior to October 1, 1988. The $103.50 price per share will be reduced annually by $.50. As of October 1, 1994 and thereafter, the redemption price will be at par. By September 30, 1996, the Company must set aside the amount required to redeem at par all shares outstanding.

(5) By July 1 of 1988 and 1989, the Company must redeem at par 120,000 shares of the 9.10% Series. The Company reacquired and canceled 120,000 shares in 1987, 1986 and 1985.

(6) On January 1, 1987 the Company redeemed 1,104,000 shares of the 15% Series at a price of $27.50 per share and 96,000 shares at par. The premium paid on reacquisition is reported as a charge to retained earnings in 1987.

(7) The Company redeemed 300,000 shares of the 15⅜% Series in 1986 at a price of $110.00 per share plus accrued dividends. The premium paid on reacquisition was reported as a charge to retained earnings in 1986.

7. Bank Loans and Other Borrowings

The Company has a revolving credit agreement with banks which provides for borrowing up to $200 million to July 31, 1992. At the option of the Company, the interest rate on borrowings is related to the prime rate or the London Interbank Offered Rate or the interest rate applicable to certain certificates of deposit. The agreement also provides for the payment of a commitment fee on the unborrowed amount of one-quarter of a percent per annum.

The revolving credit agreement does not require compensating balances. The Company did not have any outstanding loans under this agreement at December 31, 1987 or 1986.

Interim financing in the form of short-term borrowings on commercial paper is utilized to finance construction expenditures.

Information relative to short-term borrowings is:

	Commercial Paper			Notes Payable
	1987	1986	1985	1985
		(Thousands of Dollars)		
Ending balance	$ 16,000	$110,600	$118,300	—
Maximum amount outstanding	$155,600	$141,400	$145,700	$70,000
Average amount outstanding(1)	$ 31,000	$ 93,300	$ 84,400	$13,600
Weighted average interest rate:				
On ending balance	7.5%	6.1%	8.0%	—
During the period(2)	6.3%	7.3%	8.5%	8.4%

(1) Calculated as the average of the sum of daily borrowings.

(2) Calculated by dividing total interest expense by the average of the sum of daily borrowings.

8. Jointly Owned Generating Stations

The Company has an undivided 50% interest in the output and costs of three generating units comprising the Homer City Generating Station. The station is owned with Pennsylvania Electric Company (Penelec) which operates the facility. The Company's share of the rated capability is 946,000 kw and its net utility plant investment is $261 million, which includes $7 million of construction work in progress. The accumulated provision for depreciation as of December 31, 1987 was $112 million. The Company's share of operation and maintenance expense of the station is reflected in the Consolidated Statement of Income.

The Company entered into a contract for the supply of coal to the Homer City Generating Station. By the terms of the contract dated January 2, 1985, the Company and Penelec are obligated to pay termination costs under certain conditions for a period of 17 years. The Company's share of the obligation at January 2, 1988 of $11.3 million would be reduced periodically through 2001.

On January 15, 1988 the Company and Penelec gave notice that the contract would be terminated effective June 30, 1988, providing efforts to renegotiate the contract were unsuccessful, pursuant to a provision that does not require a termination payment.

9. Nine Mile Point Unit No. 2

The Company has an undivided 18% interest in the 1,084,000 kw Nine Mile Point nuclear generating unit No. 2 (NMP2), which is currently undergoing its power ascension program. NMP2 was constructed by Niagara Mohawk Power Corporation (Niagara Mohawk) near Oswego, New York. Ownership of NMP2 is shared with Niagara Mohawk 41%, Long Island Lighting Company (LILCO) 18%, Rochester Gas and Electric Corporation 14% and Central Hudson Gas & Electric Corporation 9%.

Although no assurance can be provided as to the precise date on which commercial operation will be achieved, the Company believes that NMP2 will achieve commercial operation in the second quarter of 1988.

In March 1987 the Company adopted the provisions of Statement of Financial Accounting Standards No. 90, Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs, and recorded a disallowance on NMP2 as a charge to expense of approximately $377 million, reduced to $269 million after recognition of federal income tax benefits. The disallowance was based upon Niagara Mohawk's March 1987 cost estimate of $5.963 billion, a January 1988 commercial operation date, the $4.16 billion Offer and Cotenant Agreement (as defined below) and the determinations made by the PSC in the Niagara Mohawk rate case decision of March 13, 1987 pertaining to the implementation of the Offer. The cotenants of NMP2 have appealed to the Supreme Court of the State of New York (Albany County) the determinations made by the PSC in the March 13, 1987 decision pertaining to the implementation of the Offer. The proceeding was transferred to the Appellate Division (Third Department). The Company is unable to predict the results of this proceeding.

In December 1987 the Company wrote off an additional $51 million, reduced to $39 million after recognition of the federal income tax benefits, of disallowed costs with respect to NMP2. The largest portion of this additional write-off related to the delay in NMP2's estimated commercial operation date, assumed to be May 1, 1988 for purposes of calculating the write-off. The Company also reversed $14 million of previously recognized investment tax credit benefits relating to NMP2 as a result of a determination made in the Company's latest rate case. The additional write-off brings the total NMP2 costs written off in 1987 to approximately $428 million, reduced to $322 million after recognition of federal income tax benefits.

As a condition of the Offer the tax benefits associated with the disallowed costs of NMP2 have been reserved for the stockholders. These benefits (approximately $71 million at December 31, 1987) have also been excluded from rate base recognition. This exclusion will reduce 1988 earnings by approximately $6 million and will continue to adversely affect earnings by a declining amount until 1996 when the tax benefits are expected to be fully realized.

As a result of the adoption of Statement of Financial Accounting Standard No. 96, Accounting for Income Taxes, in December 1987, the Company wrote down certain tax benefits associated with the disallowed project costs of NMP2 to the statutory tax rate of 34% (See Note 3.).

In July 1987 the Nuclear Regulatory Commission issued a full power operating license for NMP2. NMP2 is now in the final test condition of its power ascension program and in February 1988 achieved 100% of its generating capability. The testing and start-up of all new nuclear plants, however, is subject to the risk of encountering unforeseen problems and, therefore, it must be recognized that commercial operation of NMP2 may be later than currently projected. The Company estimates that any delay in achieving commercial operation beyond May 1, 1988 would add approximately $9 million each month to its share of the construction costs of NMP2, the major portion of which is financing costs. Any additional costs would not be recoverable through rates unless it was determined that the delays were caused by the occurrence of an extraordinary event, as described below.

On April 17, 1987 the cotenants commenced an action in the Supreme Court of the State of New York (Onondaga County), seeking damages of approximately $500 million from Gulf & Western, Inc., Crosby Valve & Gage Company and Wickes Manufacturing Company. Those companies designed and fabricated NMP2's eight main steam isolation valves which were subsequently replaced after problems were experienced in establishing their leak integrity. The Company cannot predict whether this suit will be successful or the amount of damages, if any, which may be recovered.

In connection with a 1982 PSC proceeding discussed further below, which concluded that completion of NMP2 was warranted, the PSC stated that it would apply a strict standard of prudence for all costs incurred in completing NMP2. On July 3, 1985 the PSC issued an order establishing a proceeding to investigate the prudence of costs relating to the construction of NMP2 (Prudence Proceeding). On September 18, 1985 the cotenants and the PSC Staff submitted to the PSC an Offer of Settlement (Offer) to settle the Prudence Proceeding.

The Offer provided that a maximum of $4.45 billion of costs relating to construction of NMP2 were to be included in rate base and disallowed costs would not be less than $900 million. The cotenants may petition the PSC to increase the maximum in response to an extraordinary event and the cotenants represented in the Offer that, at the time of the Offer, they were not aware of any facts that would warrant a claim. The Offer also provides, among other things, that (1) the allowed costs for NMP2 would be phased into rate base over a reasonable period together with accumulated deferred carrying costs on the portion of NMP2's cost that has not yet been included in rate base, and that the phase-in of each cotenant's allocable share of allowed NMP2 costs will be resolved in the context of its rate proceeding; (2) certain tax benefits, based upon the accounting requirements arising out of the Offer, are to be reserved for the benefit of the stockholders; (3) the level of expenditures for NMP2 that are disallowed under the Offer shall be allocated among the cotenants in proportion to their respective ownership interests in NMP2 and each cotenant waives any and all claims arising out of the design, engineering or construction of NMP2 that it may have against any other cotenant or cotenants; (4) the cotenants agree that they will not challenge the legal validity of the Incentive Plan or the July 1984 Order which are discussed below; and (5) the provisions in the Offer shall be in full satisfaction of any monetary penalty or incentive provided for under the Incentive Plan or the July 1984 Order.

On July 15, 1986 the cotenants, in response to a request by the PSC, notified the PSC that they would agree to modify the Offer to provide for a change in the allowable cost to $4.16 billion. In addition, in order to induce settlement among the cotenants, Niagara Mohawk entered into an agreement with the other cotenants (Cotenant Agreement) whereby it would make a payment to the cotenants, upon commercial operation of NMP2, for their shares of the $290 million incremental disallowance between the original proposed allowed cost of $4.45 billion and the revised proposed allowed cost of $4.16 billion. The Company's share of this payment will be $52 million. This payment will not cause a reallocation of ownership interests in NMP2.

On October 3, 1986 the PSC issued Opinion No. 86-24 approving the Offer, as modified by the $4.16 billion cost allowance proposal, and terminating the Prudence Proceeding. On October 22, 1986 the Attorney General of the State of New York and the Consumer Protection Board of the State of New York (CPB) filed petitions with the PSC, requesting that the PSC reconsider the conclusions reached in Opinion No. 86-24 and resume the Prudence Proceeding. On December 17, 1986 the PSC issued an order which denied the petitions for rehearing. On April 16, 1987 the CPB, the Attorney General of the State of New York and a member of the New York State Assembly filed a petition in the Supreme Court of the State of New York (Albany County) asking that the PSC's Opinion No. 86-24 be annulled and that the PSC be directed to conduct a full prudence investigation with respect to NMP2. The proceeding was transferred to the Appellate Division (Third Department). The Company cannot predict the outcome of this proceeding.

In April 1982 the PSC established an incentive rate of return plan (Incentive Plan) for the ratemaking treatment of the remaining construction costs of NMP2. In July 1984 the PSC issued an Order (July 1984 Order) that amended the Incentive Plan by imposing a $5.4 billion ceiling on NMP2's final allowable cost. Under the amended Incentive Plan, the cotenant's common stockholders would, with a certain limitation, be penalized by a 20% reduction in the rate of return on common equity associated with the capital costs for NMP2 in excess of $4.6 billion, but less than $5.4 billion. Capital costs for NMP2 in excess of $5.4 billion would be borne in total by the cotenants' common stockholders. Since the PSC's approval of the Offer was in full satisfaction of any monetary penalty provided for under the Incentive Plan, as amended by the July 1984 Order, the Incentive Plan and the ceiling imposed by the July 1984 Order are not expected to be implemented.

The Company is unable to predict what further actions or proceedings, if any, may be instituted with respect to NMP2.

In light of the foregoing and the substantial cost increases, construction delays and licensing problems that have arisen with respect to other nuclear generating stations, the Company can predict neither the final cost of its share of NMP2 nor the completion of NMP2 consistent with the present schedule. If NMP2 were to be abandoned, it is anticipated that, to the extent the Company's remaining investment in the project ($680 million at December 31, 1987 including AFDC but excluding nuclear fuel costs and after recording the disallowance on NMP2) is not recovered through rates and alternative regulatory relief is not granted, the Company would have to charge expense with the project costs, net of the federal income tax effect.

10. Abandoned Projects—New Haven and Jamesport

The Company filed petitions with the PSC relative to the New Haven and Jamesport Projects, two abandoned nuclear generating projects, requesting authorization to (1) continue to accrue AFDC on its share of costs until amortization of such costs commences to be recovered in rates, (2) amortize the investments through rates and (3) include in rates appropriate carrying charges on the unamortized balances. The projects were originally planned for completion on a joint venture basis with LILCO.

On September 19, 1984 the PSC issued Opinion and Order No. 84-25 which effectively authorized recovery of 70% of the Company's investment in the New Haven Project. The recoverable portion of the investment is included in Deferred charges—Abandoned project costs in the Consolidated Balance Sheet. Amortization of the deferred charge is being recorded over five years beginning May 1985 coincident with recovery in rates. As of December 31, 1987 the unamortized balance was $20.4 million.

In March 1982 the PSC authorized the Company to continue accruing AFDC on its Jamesport investment until the PSC rendered its decision with respect to the prudence and disposition of the project costs. On March 23, 1987 the Company and the PSC Staff agreed (Agreement) to a recovery of 62.3% of the Company's Jamesport investment as of December 31, 1986 which resulted in a charge to expense in March 1987 of approximately $30 million reduced to $25 million after recognition of the federal income tax benefits. The Agreement also provides for carrying charges on the recoverable portion of the investment. In October 1987 the Administrative Law Judge reviewing the Agreement recommended to the PSC that the Agreement be rejected and a full prudence proceeding be reinstated. At its February 24, 1988 meeting the PSC approved the Agreement.

In August 1987 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 92, Regulated Enterprises—Accounting for Phase-in Plans (SFAS 92). Among other things, SFAS 92 limits the capitalization of an allowance for equity return to 1) projects under construction and 2) qualified phase-in plans. Since the Company's investment in Jamesport does not meet either of these criteria and the PSC has authorized the Company to accrue a non-cash return on Jamesport until its inclusion in rates, beginning in 1988 the Company will be prohibited from accruing an equity return on its Jamesport investment for financial reporting purposes. This will reduce the Company's non-cash earnings by approximately $200,000 a month for financial reporting purposes until the Jamesport investment is incorporated into rates but will not affect the Company's earnings for ratemaking purposes.

11. Commitments and Contingencies

The Company estimates that 1988 costs for its construction program will approximate $241 million. The program is subject to periodic review and revision, and actual construction costs to be incurred may vary because of revised load estimates, imposition of additional regulatory requirements and the availability and cost of capital.

In 1986 the Company entered into two agreements for the construction of two service center buildings in one of its districts. The Company has agreed to lease each premises, upon completion, for a period of seven years. The Company is making payments equivalent to the interest costs on the debt incurred to purchase the land and construct one of the buildings and will do the same for the second building when it is completed. The Company has the option to purchase either premises at the end of the third, fourth, fifth, sixth and seventh years of the respective lease and the lessors have the right to require that the Company purchase the premises at the end of the lease term.

In connection with the lease agreements, the Company has guaranteed the debt incurred by the lessors in constructing the service center buildings. Should the lessors default on the loans, the Company has several options, one of which is to pay off the loans. The Company would then acquire ownership of the affected premises. At December 31, 1987 the total debt guaranteed by the Company is approximately $12 million.

Niagara Mohawk maintains public liability and property insurance for NMP2. The Company reimburses Niagara Mohawk for its 18% share of these costs.

The Price-Anderson Act limits the Company's public liability for claims resulting from a nuclear incident at NMP2 to its 18% share of $715 million. Niagara Mohawk maintains $160 million of public liability insurance. The remaining potential liability of $555 million is covered by a mandatory program in which operators of nuclear generating facilities are liable for up to $5 million per incident or a maximum of $10 million per year. The Company's maximum assessment would be approximately $1 million per incident or $2 million per year for its 18% share of NMP2.

The Price-Anderson Act expired August 1, 1987, however, its provisions continue to apply to existing licensed facilities. Several bills have been introduced in Congress which would significantly increase the $5 million assessment per incident. The Company is unable to predict what legislation, if any, will be passed to amend the Price-Anderson Act.

Niagara Mohawk also maintains nuclear property insurance for NMP2. Through the Nuclear Insurance Pool and the Nuclear Electric Insurance Limited (NEIL), Niagara Mohawk has procured property insurance aggregating $1.4 billion. Under NEIL, should losses resulting from an incident at a member nuclear facility exceed the accumulated reserves of NEIL, each member, including the Company, would be liable for its share of the deficiency up to a maximum of 7.5 times its annual property insurance premium. The Company's maximum liability for its 18% share of NMP2 is approximately $2 million.

12. Industry Segment Information

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

	1987		1986		1985	
	Electric	Gas	Electric	Gas	Electric	Gas
			(Thousands of Dollars)			
Operating:						
Revenues	**$1,136,799**	**$152,839**	$1,098,089	$179,195	$1,051,579	$190,201
Expenses	**868,545**	**139,875**	836,471	159,728	825,719	178,308
Income	**268,254**	**12,964**	261,618	19,467	225,860	11,893
Depreciation*	**106,401**	**4,278**	96,804	3,992	94,163	3,922
Construction expenditures	**170,943**	**13,974**	220,275	10,617	247,759	8,390
Identifiable assets**	**3,583,584**	**124,838**	3,844,469	119,565	3,623,481	113,035

*Included in operating expenses.

**Assets used in both electric and gas operations ($778,922, $260,950 and $240,103 at December 31, 1987, 1986 and 1985, respectively) consist primarily of cash, special deposits, accounts receivable, prepayments, unamortized debt expense, unfunded future federal income taxes and accumulated deferred income tax benefits.

13. Supplementary Income Statement Information

Charges for maintenance, repairs and depreciation, other than those set forth in the Consolidated Statement of Income, were not significant in amount. Taxes, other than federal income taxes, are:

	1987	1986	1985
		(Thousands of Dollars)	
Property	**$ 66,802**	$ 62,245	$ 55,987
Franchise and gross receipts	**55,442**	53,960	49,247
Payroll	**12,283**	11,583	10,787
Miscellaneous	**6,080**	5,840	6,011
	140,607	133,628	122,032
Amounts charged to accounts other than taxes	**(11,831)**	(11,228)	(8,445)
Total other taxes	**$128,776**	$122,400	$113,587

14. Quarterly Financial Information (Unaudited)

	Quarter Ended			
	March 31	June 30	Sept. 30	Dec. 31
	(Thousands except for per share amounts)			
1987				
Operating revenues	$ 387,971	$311,416	$293,988	$296,263
Operating income	$ 92,240	$ 74,655	$ 67,181	$ 47,142
Income (loss) before cumulative effect of accounting changes (1) (2)	$ (6,813)	$ 50,421	$ 42,910	$ (34,185)
Net income (loss) (1) (2)	$(236,883)	$ 50,421	$ 42,910	$ (34,185)
Earnings (loss) for common stock (1) (2)	$(240,274)	$ 47,029	$ 39,508	$ (37,662)
Earnings (loss) per share (1) (2)	$(4.41)	$.85	$.71	$(.68)
Earnings (loss) per share before cumulative effect of accounting changes (1) (2)	$(.19)	$.85	$.71	$(.68)
Proforma Earnings (loss) per share (3)	$(.21)	$.85	$.71	$(.65)
Dividend per share	$.66	$.66	$.66	$.66
Average shares outstanding	54,482	55,529	55,529	55,716
Common stock price:*				
High	$33¼	$28½	$28⅞	$28⅛
Low	$27¾	$24½	$25⅛	$20⅛
1986				
Operating revenues	$ 381,321	$305,177	$274,945	$315,841
Operating income	$ 87,150	$ 70,230	$ 62,475	$ 61,230
Net income	$ 79,593	$ 55,269	$ 46,596	$ 47,036
Earnings for common stock	$ 73,599	$ 50,240	$ 42,031	$ 42,520
Earnings per share	$1.36	$.93	$.78	$.79
Proforma earnings (loss) per share (3)	$1.27	$.85	$(.05)	$(.31)
Dividends per share	$.64	$.64	$.66	$.66
Average shares outstanding	54,007	54,007	54,007	54,040
Common stock price:*				
High	$32	$33⅛	$38½	$34¼
Low	$27¼	$28⅜	$30	$30¼

(1) First quarter 1987 earnings have been restated to reflect the change in accounting for income taxes adopted by the Company in December 1987. The effect of the accounting change was to reduce net income (loss) and earnings (loss) for common stock by $19.2 million or $.35 a share for the period ended March 31, 1987. In addition, fourth quarter income (loss) before cumulative effect of accounting changes, net income (loss) and earnings (loss) for common stock were $2.8 million or $.05 a share lower as a result of the accounting change for income taxes (See Note 3.).

(2) First quarter 1987 earnings reflect a change in accounting for disallowed project costs and the write-off of certain disallowed costs with respect to the Company's investment in NMP2 and the abandoned Jamesport nuclear project. These items reduced income (loss) before cumulative effect of accounting changes by $82.6 million and net income (loss) and earnings (loss) for common stock by $293.6 million or $5.39 a share. (See Notes 9 and 10.).

Fourth quarter 1987 earnings reflect the write-off of additional disallowed costs with respect to NMP2 (See Note 9.) and a write-off of $13 million (net of tax) of excess earnings based on a decision by the PSC in the Company's recent electric rate case. These items reduced income (loss) before cumulative effect of accounting changes, net income (loss) and earnings (loss) for common stock by $66.2 million or $1.19 a share in the fourth quarter of 1987.

(3) Assuming the 1987 accounting changes were applied retroactively.

*The Company's common stock is listed on the New York Stock Exchange. The number of stockholders of record at January 26, 1988 was 70,441.

Dividend Limitations: After dividends on all outstanding preferred stock have been paid, or declared and funds set apart for their payment, the common stock is entitled to cash dividends as may be declared by the Board of Directors out of retained earnings accumulated since December 31, 1946. Such dividends are limited if Common Stock Equity (33% at December 31, 1987) falls below 25% of total capitalization. Dividends on common stock cannot be paid unless sinking fund requirements of the preferred stock are met. The Company has not been restricted in the payment of dividends on common stock by these provisions. In January 1988 the Company's Board of Directors reduced the quarterly common stock dividend to $.50 per share (See Management's Discussion and Analysis of Financial Condition and Results of Operations).

Selected Financial Data

	1987	1986	1985	1984	1983
		(Thousands—except per share data)			
Operating revenues	**$1,289,638**	$1,277,284	$1,241,780	$1,129,066	$ 993,589
Net income (loss)	**$ (177,737)***	$ 228,494	$ 208,433	$ 211,376	$ 156,680
Earnings (loss) per share	**$(3.46)***	$3.86	$3.46	$3.68	$3.06
Dividends paid per share	**$2.64 ****	$2.60	$2.50	$2.38	$2.26
Average shares outstanding	**55,318**	54,014	53,013	49,955	43,530
Book value per share of common stock (year-end)	**$19.85**	$25.86	$24.65	$23.71	$22.75
Interest charges	**$ 202,321**	$ 199,258	$ 191,248	$ 176,085	$ 137,372
AFDC and other non-cash return	**$ 108,128**	$ 111,872	$ 122,719	$ 126,265	$ 91,641
Depreciation	**$ 110,679**	$ 100,796	$ 98,085	$ 65,198	$ 56,799
Other taxes	**$ 128,776**	$ 122,400	$ 113,587	$ 102,152	$ 90,604
Construction expenditures	**$ 184,917**	$ 230,892	$ 256,149	$ 349,718	$ 466,642
Total assets	**$4,487,344**	$4,224,984	$3,976,619	$3,733,146	$3,200,466
Long-term obligations and redeemable preferred stock	**$2,073,374**	$1,951,227	$1,836,076	$1,663,784	$1,426,681

*Net income and earnings per share for 1987 would have been $191,052 and $3.21, respectively, excluding the effects of the write-off of Nine Mile Point nuclear generating unit No. 2 and Jamesport disallowed costs and the accounting change for income taxes, as discussed in Notes 3, 9 and 10 to the consolidated financial statements.

**See Management's Discussion and Analysis of Financial Condition and Results of Operations.

Coopers & Lybrand

certified public accountants

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

We have examined the consolidated balance sheets of New York State Electric & Gas Corporation and Subsidiary as of December 31, 1987 and 1986, and the related consolidated 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.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of New York State Electric & Gas Corporation and Subsidiary at December 31, 1987 and 1986, and the consolidated results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis, except for the changes in 1987, with which we concur, in the methods of accounting for income taxes and disallowed project costs as described in Notes 3 and 9, respectively, to the consolidated financial statements.

New York, New York
January 29, 1988

Coopers & Lybrand

Management's Discussion and Analysis of Financial Condition and Results of Operations

Liquidity and Capital Resources

The Company has an undivided 18% interest in the 1,084,000 kw Nine Mile Point nuclear generating unit No. 2 (NMP2), which is currently undergoing its power ascension program. NMP2 was constructed by Niagara Mohawk Power Corporation (Niagara Mohawk) near Oswego, New York. Ownership of NMP2 is shared with Niagara Mohawk 41%, Long Island Lighting Company 18%, Rochester Gas and Electric Corporation 14% and Central Hudson Gas & Electric Corporation 9%. At December 31, 1987 the Company had expended $1.160 billion for its share of NMP2 before the effects of the write-offs noted below.

In 1987 the Company adopted Statement of Financial Accounting Standards No. 90, Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs. This resulted in a write-off of $428 million, reduced to $322 million after recognition of federal income tax benefits, of disallowed project costs associated with NMP2 (See Note 9.). After reflecting these cost disallowances and the $52 million settlement agreement entered into with Niagara Mohawk, the Company's remaining investment in NMP2 was $680 million including allowance for funds used during construction (AFDC) but excluding nuclear fuel costs, at December 31, 1987.

In addition to the write-off of disallowed costs associated with NMP2, the Company also wrote off $30 million, reduced to $25 million after recognition of federal income tax benefits, of its investment in the abandoned Jamesport nuclear project in 1987. This write-off was based on an agreement (Agreement) reached with the staff of the Public Service Commission of the State of New York (PSC) in March 1987 which allowed the Company to recover 62.3% of its December 31, 1986 investment in Jamesport. The Agreement also provides for carrying charges on the recoverable portion of the investment. At its February 24, 1988 meeting the PSC approved the Agreement. (See Note 10.)

Due to the issuance of Statement of Financial Accounting Standards No. 92, Regulated Enterprises—Accounting for Phase-in Plans, the Company will be prohibited from accruing an equity return on its Jamesport investment for financial reporting purposes beginning in January 1988. This will reduce non-cash earnings approximately $200,000 a month for financial reporting purposes until Jamesport is incorporated into rates but will not affect the Company's earnings for ratemaking purposes. (See Note 10.)

The Company adopted Statement of Financial Accounting Standards No. 96, Accounting for Income Taxes (SFAS 96), in December 1987. This resulted in a $22 million write-off of tax benefits associated with the disallowed project cost of NMP2 to the statutory tax rate of 34% mandated by the Tax Reform Act of 1986 (TRA 1986) (See Note 3.).

Construction expenditures, including AFDC, during the period from 1985–1987 totaled approximately $935 million. NMP2 was the largest construction project during those three years, requiring approximately $500 million. Construction expenditures other than for NMP2 were primarily for the extension of service and efficiency improvements for existing facilities.

Estimated construction expenditures for 1988 through 1990 are included in the table below. The 1988 estimate has increased over the estimate made previously largely because of increased costs related to the change in the estimated commercial operation date of NMP2 to the second quarter of 1988. (See Note 9.) The Company's construction program is under continuing review and is revised from time to time.

In 1987 75% of total cash generation was from internal sources. This compares with 54% and 34% in 1986 and 1985, respectively. This increase reflects reduced construction expeditures as NMP2 nears completion and the phase-in of the Company's Somerset Generating Station (Somerset) into electric rates over a three year period beginning in 1984.

Cash requirements in excess of internally generated sources resulted primarily from the Company's construction program and its continuing effort to refinance high-cost securities. External financings in 1987 included:

- The issuance of $100 million principal amount of First Mortgage Bonds, 9% Series.
- The issuance of a $65 million adjustable rate pollution control note with an initial three year interest rate of 5¾%.
- The issuance of 1,467,900 shares of common stock under a continuous offering program which concluded in March 1987. This program provided $43 million.

Cash provided from the issuance of the 9% Series First Mortgage Bonds and the continuous offering program was used to retire short-term unsecured notes which were issued for construction purposes and which were issued for the redemption on January 1, 1987 of 1,200,000 shares of the 15% Serial Preferred Stock (Cumulative, $25 Par Value). Premiums paid to reacquire the preferred stock totaled $2.8 million.

Proceeds from the pollution control financing were used to reimburse the Company for pollution control expenditures relating to NMP2.

The Company also retired at par the following issues in 1987:

- $25 million principal amount of First Mortgage Bonds, 4⅝% Series.
- $3.5 million principal amount of First Mortgage Bonds, 18% Series.
- $1.8 million principal amount of First Mortgage Bonds, 16⅜% Series.

The funds used to retire these bonds were provided primarily from internal sources.

In an effort to reduce its cost of debt, the Company redeemed $100 million of First Mortgage Bonds, 13⅝% Series, due 2012 in February 1988 and $50 million of First Mortgage Bonds, 17⅝% Series, due 1989 in March 1988. Premiums paid to redeem these series totaled

$10.4 and $2 million, respectively. The funds used to retire these bonds were provided through the issuance of $100 million principal amount of First Mortgage Bonds, 10⅝% Series, due 2018 in February 1988 and commercial paper.

The Company uses interim financing in the form of short-term unsecured notes, usually commercial paper, to finance construction expenditures, thereby providing flexibility in the timing and amounts of long-term financings. The Company had $16 million of commercial paper outstanding at December 31, 1987.

The Company has a revolving credit agreement with certain banks which provides for borrowings up to $200 million to July 31, 1992. At the option of the Company, the interest rate on borrowings is related to the prime rate or the London Interbank Offered Rate or the interest rate applicable to certain certificates of deposit. The agreement also provides for the payment of a commitment fee on the unborrowed amount of one-quarter of a percent per annum.

The revolving credit agreement does not require compensating balances. The Company did not have any outstanding loans under this agreement at December 31, 1987.

In order for the Company to be able to issue first mortgage bonds or preferred stock, certain earnings requirements (subject to certain exceptions in the case of first mortgage bonds) under its Mortgage or Certificate of Incorporation have to be met for a twelve-month period. The impact of NMP2's disallowed cost, as discussed above, will preclude the Company from issuing preferred stock until April 1988 because it will be unable to meet the earnings requirement in its Certificate of Incorporation. The Company may also be precluded from issuing preferred stock until January 1989 should 1988 earnings not meet required levels. If the Company is unable to issue preferred stock during 1988, such inability will not have a material impact on the Company's liquidity.

The Company was able to meet the earnings requirement under its Mortgage in February 1988 and expects to be able to continue to do so in the future. Even if the Company was unable to meet the earnings requirement under its Mortgage, a provision in the Mortgage allows the Company to issue first mortgage bonds on the basis of retired bonds. As of March 1, 1988 approximately $160 million of first mortgage bonds could be issued on such basis.

In February 1987 the Company filed with the PSC for an electric rate increase of approximately 4% to become effective in January 1988.

In January 1988 the PSC issued its rate decision. In its decision the PSC allowed a 13.8% return on common equity and included the entire allowed costs ($736 million) of NMP2 in rates. This inclusion did not, however, result in an increase in the Company's electric rates due to various offsetting factors including increased sales forecasts, the exclusion of the Company's recoverable portion of its investment in the abandoned Jamesport nuclear project from rates until a final determination as to the allowable costs of the project was made (See Note 10.) and the determination made by the PSC that the Company's earnings for 1987 were excessive by approximately $13 million, net of the federal income tax effect. The Company reduced its 1987 earnings by $13 million and has recorded a liability to its ratepayers for these excess earnings. The Company will be refunding the majority of the excess earnings in 1988.

In January 1988 the Company's Board of Directors declared a quarterly dividend of 50 cents per share on the common stock of the Company payable Feburary 15, 1988 to holders of record on January 26, 1988. This represented a 24 percent reduction from the previous quarterly rate of 66 cents per share. On an annual basis, the new quarterly rate amounts to $2.00 per share compared with the previous annual amount of $2.64 per share.

The dividend was reduced primarily as a result of ratemaking policy determinations of the PSC with respect to the disallowed costs of NMP2, as recently reflected in its January 1988 electric rate decision and the additional $53 million net of tax write-offs recorded in December 1987. These additional write-offs resulted from the anticipated delay in the commercial operation of NMP2 from January 1, 1988 to May 1, 1988 ($39 million) and the reversal of previously recognized investment tax credit benefits related to NMP2 ($14 million) (See Note 9.).

Although the Company believes that it can maintain a 50 cent quarterly dividend, its ability to do so will depend upon future sales, cash flow, regulatory treatment, legal requirements and the date NMP2 achieves commercial operation.

The following table sets forth certain data concerning the Company's estimated uses and sources of funds for the years 1988 through 1990.

	1988	1989	1990	Total
	(Millions of Dollars)			
Uses of Funds:				
Construction				
NMP2	$ 29	$ 9	$ 6	$ 44
Other Projects	183	180	179	542
AFDC	29	8	8	45
Total Construction	241	197	193	631
Working Capital	30	21	12	63
Retirement of Securities and Sinking Fund Obligations	247	60	41	348
Total	$518	$278	$246	$1,042
Sources of Funds:				
Internal Sources	$228	$199	$190	$ 617
Long-Term Financing	172	23	56	251
Increase in Short-Term Debt	66	56	—	122
Niagara Mohawk payment (See Note 9.)	52	—	—	52
Total	$518	$278	$246	$1,042

Results of Operations

Earnings

The Company recorded a loss for common stock of $191 million or $3.46 a share in 1987 as compared with earnings of $208 million or $3.86 a share in 1986. The loss in 1987 resulted primarily from the write-off of $322 million, net of tax, of disallowed costs associated with NMP2. In addition, the Company wrote off $25 million, net of tax, of its investment in the abandoned Jamesport nuclear project and $22 million of certain tax benefits associated with the disallowed project costs of NMP2 as a result of the adoption of SFAS 96. (See Notes 9, 10 and 3, respectively.)

Exclusive of these items, earnings were $177 million or $3.21 a share down 15% and 17% from the prior year, respectively. This decline in earnings was due primarily to lower AFDC on NMP2 as a result of the write-offs. Additionally, higher operating and maintenance expenses were incurred. These items were partially offset by lower preferred stock dividends as a result of the redemption of the 15% Series Preferred Stock. The number of average shares outstanding increased slightly as a result of the 1987 continuous offering program.

Earnings available for common stock and earnings per share for 1986 increased 14% and 12%, respectively, as compared with 1985, primarily as a result of higher retail electric sales and greater amounts of AFDC capitalized. In addition, earnings were higher due to the redemption of the 15⅝% Series Preferred Stock. These increases were partially offset by higher maintenance and operation—other expenses. The number of average shares outstanding increased slightly during this period.

Operating Revenues

Operating revenues increased 1% in 1987 compared with the prior year after increasing 3% in 1986. The increases were composed primarily of the following factors:

	Increase (Decrease) from Prior Year			
	1987 over 1986		1986 over 1985	
	(Thousands of Dollars)			
	Electric	Gas	Electric	Gas
Rate increase	$22,170	$ —	$ 69,630	$ 1,586
Fuel cost adjustment	(4,202)	(7,431)	(21,917)	(2,212)
Electricity sales to other utilities	13,746	—	(75,366)	—
Surcharge for (passback of) interchange profits	(4,053)	—	48,598	—
Sales volume and other	11,049	(18,925)	25,565	(10,380)
Total	$38,710	$(26,356)	$ 46,510	$(11,006)

The PSC granted the following rate increases which became effective on the indicated dates:

	Electric	% Increase	Gas	% Increase
	(Thousands of Dollars)			
April 15, 1986	$64,590	7.0%	—	—
August 29, 1985	$ 3,120	.3%	$ 509	.2%
April 15, 1985	$78,458	9.1%	$2.172	1.0%

The rate increases in April 1986 and 1985 reflect the final two increases associated with the three year phase-in of Somerset costs of approximately $1 billion. In connection with the 1986 rate increase, the Company agreed with the PSC to not file for further increases in electric or gas rates to become effective before January 1, 1988.

Prior to the April 1985 PSC rate decision, fuel cost adjustment revenues received by the Company completely recovered fuel costs not included in the base rates charged to customers, and therefore, did not affect earnings. The April 1985 rate decision provided that ratepayers and stockholders share the effects of a variation in fuel costs from forecasted levels up to a $6.6 million, after tax, maximum gain or loss to stockholders. In 1987 and 1986, the effect was to increase earnings before the federal income tax effect by approximately $4.0 million and $1.2 million, respectively. This provision in the April 1985 rate decision was extended by the PSC's January 1988 rate decision to January 1989.

In addition, the April 1985 rate decision contained provisions for ratepayers to share in the benefit or shortfall of profits from sales of electricity to other utilities. The April 1985 rate decision allowed ratepayers and stockholders to share on an 80%/20% basis in the benefit or shortfall of all profits from sales of electricity to other utilities above or below a monthly forecasted amount. As a result of these provisions, $31.9 million was passed back to ratepayers in 1985. However, in 1987 and 1986, the Company charged ratepayers $14.2 million and $18.2 million, respectively, primarily as a result of decreases in electricity sales to other utilities. As a result of this sharing provision, 1985 earnings increased by approximately $4 million while 1987 and 1986 earnings decreased approximately $3 million each year before the federal income tax effect. This provision in the April 1985 rate decision was extended by the PSC's January 1988 rate decision to January 1989.

Electric sales and revenue changes by major customer category are as follows:

	Increase/Decrease from Prior Year			
	1987		1986	
	Sales	Revenues	Sales	Revenues
Residential	2%	6%	4%	14%
Commercial	4	4	4	17
Industrial	4	2	3	17
Total Retail	3%	4%	4%	15%
Other Utilities	21%	14%	−29%	−44%
Total	7%	4%	−7%	4%

Oil prices have had a significant effect on Company sales to other utilities. In 1986 the Company had a 29% decrease in sales to other utilities primarily as a result of lower oil prices enabling oil-fired plants of other utilities to become more competitive with the Company's coal-fired plants. In 1987 higher generation and rising oil prices resulted in a 21% increase in sales to other utilities.

Gas sales and revenue changes by major customer category are as follows:

	Increase/Decrease from Prior Year			
	1987		1986	
	Sales	Revenues	Sales	Revenues
Residential	−2%	−6%	4%	3%
Commercial	−7	−12	−1	−1
Industrial	−41	−43	−34	−35
Total	−3%	−15%	−7%	−6%

The decrease in commercial gas sales in 1987 and the significant decreases in industrial sales in both 1987 and 1986 resulted primarily from certain customers purchasing gas directly from producers. Additionally, gas sales have declined in both 1987 and 1986 as a result of some customers converting to oil.

Operating Expenses

In total, operating expenses increased 1% in 1987 after declining a like amount in 1986. The increase in 1987 reflects higher fuel, depreciation and operating expenses partially offset by lower gas purchases and federal income taxes.

Fuel expense increased 5% in 1987 primarily as a result of a 14% increase in electric generation offset by increased generating efficiencies and a 7% decrease in fuel cost. In 1986, fuel expense had decreased 15% as a result of a 10% decrease in electric generation, increased efficiencies and a 3% decrease in fuel cost.

The Company reclassified amortization expense relating to its investment in the abandoned New Haven project from operation—other to depreciation in January 1987. Primarily as a result of this, depreciation increased 10% in 1987. Operating expenses—other increased 7% despite the reclassification of New Haven amortization due in part to increases in customer service and insurance costs offset by lower pension costs due to the adoption of Statement of Financial Accounting Standards No. 87, Employer's Accounting for Pensions (See Note 2.). In 1986, depreciation was comparable with the prior year while operation—other increased 9% due in part to increases in administrative and general costs.

Purchased gas costs continue to decline due to lower gas sales. Purchased gas costs declined 18% in 1987 after declining 14% in 1986 while during the same period of time gas sales to retail customers (excluding the transportation of gas) decreased 12% and 7%, respectively. In addition, the unit cost for gas declined in 1987 and 1986 by 9% and 3%, respectively.

Federal income tax expense decreased 10% in 1987 after increasing 27% in 1986. The decrease in 1987 can be attributed largely to lower taxable income and lower AFDC imputed tax benefits (see below) while the increase in 1986 primarily reflected higher taxable income over the previous year. During 1987, the Company deferred the 1987 impact of TRA 1986. The Company anticipates that this deferral ($7.2 million at December 31, 1987) will be refunded to ratepayers in a future rate decision. (See Note 3.).

Non-operating Income

Disallowed project costs reflect the portion of NMP2's disallowance which relates to 1987 events, $121.6 million, and $30 million for the abandoned Jamesport project. The related tax benefits are included in the tax effect of disallowed project costs recorded.

AFDC (including the associated income tax benefits) decreased 17% in 1987 after increasing 25% in 1986. Greater levels of construction work in progress relating to NMP2 were responsible for the 1986 increase while the decrease in 1987 reflects the write-off of the disallowed project costs associated with NMP2. Non-cash return decreased 68% in 1987 as all Somerset costs were included in rate base effective April 15, 1986 and non-cash return was accrued on a reduced Jamesport investment. The tax benefits associated with AFDC and non-cash return were reclassified in 1987 as a result of the Company using a before tax AFDC rate as required by SFAS 96. In total, AFDC and non-cash return (including the associated income tax benefits) amounted to 61%, 68% and 85% of earnings before the effects of the write-offs in 1987, 1986 and 1985, respectively.

Interest Expense

Interest expense before the reduction for AFDC borrowed funds increased 2% and 4% over the prior year for 1987 and 1986, respectively. These increases resulted from additional borrowings for construction and refinancing purposes offset by the redemption of certain high interest bonds. Additionally, 1987 interest expense was further offset by much lower short term debt outstanding when compared with the prior year.

The impact of inflation and changing prices on revenues and earnings (loss) for common stock was not material during the period from 1985 through 1987.

Financial and Operating Statistics

Summary of Earnings	1987	1986	1985	1984	1983	1982	1977
Operating Revenues			*(Dollars in Thousands)*				
Electric	$1,136,799	$1,098,089	$1,051,579	$ 921,248	$785,723	$768,717	$388,483
Gas	152,839	179,195	190,201	207,818	207,866	184,997	84,996
Total	1,289,638	1,277,284	1,241,780	1,129,066	993,589	953,714	473,479
Operating Expenses							
Operation—fuel	249,520	238,371	280,397	227,998	187,148	200,895	87,181
—other	195,204	182,710	167,923	141,056	128,986	125,044	67,544
Electricity purchased	29,638	29,302	35,984	69,206	66,575	68,781	60,626
Gas purchased	90,974	111,147	129,809	146,040	160,415	132,300	56,284
Maintenance	93,274	88,486	81,591	68,606	61,234	60,541	33,709
Depreciation	110,679	100,796	98,085	65,198	56,799	53,174	34,544
Federal income tax recorded	110,355	122,987	96,651	78,144	67,891	53,606	330
Other taxes	128,776	122,400	113,587	102,152	90,604	82,877	50,645
Total	1,008,420	996,199	1,004,027	898,400	819,652	777,218	390,863
Operating Income	281,218	281,085	237,753	230,666	173,937	176,496	82,616
Other Income and Deductions							
Allowance for other funds used during construction	55,777	63,168	50,263	68,145	57,895	33,691	14,056
Non-cash return							
—utility plant in service	—	9,868	40,185	22,002	—	—	—
—abandoned projects	5,039	5,906	6,682	9,283	8,927	9,256	—
Abandoned project costs	—	—	570	(11,026)	—	—	—
Federal income tax credit recorded	4,699	4,648	2,544	3,435	3,417	(328)	1,255
Income tax benefits from AFDC and non-cash return	—	30,108	32,256	29,814	23,449	11,774	—
Disallowed project costs	(151,648)	—	—	—	—	—	—
Tax effect of disallowed project costs recorded	12,929	—	—	—	—	—	—
Other—net	(672)	39	3,839	8,307	1,608	11,953	(160)
Income Before Interest Charges	207,342	394,822	374,092	360,626	269,233	242,842	97,767
Interest Charges							
Interest on long-term debt	195,264	187,238	178,985	164,435	130,488	104,080	45,119
Other interest	7,057	12,020	12,263	11,650	6,884	5,186	4,010
Allowance for borrowed funds used during construction	(47,312)	(32,930)	(25,589)	(26,835)	(24,819)	(11,519)	(11,307)
Interest charges—net	155,009	166,328	165,659	149,250	112,553	97,747	37,822
Income Before Cumulative Effect of Accounting Changes	52,333	228,494	208,433	211,376	156,680	145,095	59,945
Cumulative effect for years prior to 1987 of accounting change for disallowed project costs (less applicable taxes of $95,434)	(210,914)	—	—	—	—	—	—
Cumulative effect for years prior to 1987 of accounting change for income taxes	(19,156)	—	—	—	—	—	—
Net Income (Loss)	(177,737)	228,494	208,433	211,376	156,680	145,095	59,945
Preferred Stock Dividends	13,662	20,104	25,226	27,370	23,466	22,610	13,094
Earnings (Loss) Available for Common Stock	(191,399)	208,390	183,207	184,006	133,214	122,485	46,851
Common Stock Dividends	145,794	140,432	132,018	118,058	98,155	75,484	33,564
Retained Earnings Increase (Decrease)	$ (337,193)	$ 67,958	$ 51,189	$ 65,948	$ 35,059	$ 47,001	$ 13,287
Average number of shares of common stock outstanding (thousands)	55,318	54,014	53,013	49,955	43,530	36,414	21,208
Earnings (Loss) per average share	$(3.46)	$3.86	$3.46	$3.68	$3.06	$3.36	$2.21
Dividends paid per share	$ 2.64	$2.60	$2.50	$2.38	$2.26	$2.10	$1.60

Financial Statistics

	1987	1986	1985	1984	1983	1982	1977
Income Statistics:				*(Dollars in Thousands)*			
Return on average common stock equity —percent*	NM*	15.3	14.3	15.9	13.5	15.2	10.9
Mortgage bond interest—times earned	1.6	2.9	2.9	3.0	2.7	2.7	2.5
Interest charges and preferred dividends —times earned	1.2	1.9	1.8	1.9	1.8	1.9	1.8
Average common stock equity per share	$22.13	$25.24	$24.17	$23.21	$22.62	$22.14	$20.17
Property, Plant and Equipment:							
Electric	$3,885,989	$4,129,838	$3,828,220	$3,526,364	$3,109,469	$2,616,720	$1,520,410
Gas	176,019	164,426	154,675	147,120	142,072	137,788	114,076
Common	100,252	78,781	72,494	60,775	49,115	50,432	38,597
Total	$4,162,260	$4,373,045	$4,055,389	$3,734,259	$3,300,656	$2,804,940	$1,673,083
Accumulated Depreciation	$ 855,198	$ 769,336	$ 687,472	$ 617,687	$ 563,118	$ 526,471	$ 350,014
Capitalization:							
Long-term debt	$2,091,678	$1,959,089	$1,803,469	$1,691,367	$1,331,981	$1,123,789	$ 677,961
Preferred stock	183,320	217,970	252,620	277,300	278,950	236,075	176,463
Common stock equity	1,106,518	1,397,962	1,331,231	1,234,561	1,103,655	888,594	442,950
Total capitalization	$3,381,516	$3,575,021	$3,387,320	$3,203,228	$2,714,586	$2,248,458	$1,297,374
Capitalization Ratios (percent):							
Long-term debt	61.9	54.8	53.2	52.8	49.1	50.0	52.3
Preferred stock	5.4	6.1	7.5	8.7	10.3	10.5	13.6
Common stock equity	32.7	39.1	39.3	38.5	40.6	39.5	34.1
Number of Stockholders:							
Common stock	70,441	71,935	79,013	81,258	82,982	76,073	51,580
Preferred stock	4,583	6,060	6,364	6,380	6,607	6,669	6,544
Payroll (including pensions, etc):							
Charged to operations	$ 134,484	$ 126,307	$ 118,711	$ 108,707	$ 101,235	$ 94,219	$ 55,639
Charged to construction and other accounts	54,276	55,936	57,075	56,573	53,422	51,015	37,518
Total	$ 188,760	$ 182,243	$ 175,786	$ 165,280	$ 154,657	$ 145,234	$ 93,157
Number of employees end of year	4,498	4,423	4,360	4,347	4,378	4,426	4,202

*Not meaningful. Return on average common stock equity for 1987 would have been 12.2% excluding the effects of the write off of Nine Mile Point nuclear generating unit no. 2 and Jamesport disallowed costs and the accounting change for income taxes, as discussed in Notes 3, 9 and 10 to the consolidated financial statements.

Electric Sales Statistics

	1987	1986	1985	1984	1983	1982	1977
Kwh Sales (millions):							
Residential	4,905	4,791	4,615	4,575	4,398	4,412	4,203
Commercial	2,882	2,772	2,678	2,611	2,536	2,492	2,370
Industrial	3,018	2,899	2,811	2,832	2,691	2,621	2,515
Public authorities	1,372	1,345	1,301	1,269	1,231	1,201	1,123
Subtotal	12,177	11,807	11,405	11,287	10,856	10,726	10,211
Other electric utilities	4,295	3,545	5,021	3,158	1,429	1,827	671
Total	16,472	15,352	16,426	14,445	12,285	12,553	10,882
Operating Revenues (thousands):							
Residential	$ 483,531	$ 457,132	$ 401,345	$365,331	$335,284	$325,124	$168,041
Commercial	244,416	235,246	201,654	190,891	169,537	163,755	89,899
Industrial	190,806	187,372	160,089	156,680	133,007	128,633	70,009
Public authorities	110,846	109,181	93,180	86,400	75,490	72,357	40,776
Subtotal	1,029,599	988,931	856,268	799,302	713,318	689,869	368,725
Other electric utilities	109,453	95,707	171,073	107,209	58,239	64,780	14,474
Other operating revenues	(2,253)	13,451	24,238	14,737	14,166	14,068	5,284
Total operating revenues	$1,136,799	$1,098,089	$1,051,579	$921,248	$785,723	$768,717	$388,483
Operating Revenues per kwh (cents):							
Residential	9.86	9.54	8.70	7.99	7.62	7.37	4.00
Commercial	8.48	8.49	7.53	7.31	6.69	6.57	3.79
Industrial	6.32	6.46	5.70	5.53	4.94	4.91	2.78
Public authorities	8.08	8.12	7.16	6.81	6.13	6.02	3.63
Subtotal	8.46	8.38	7.51	7.08	6.57	6.43	3.61
Other electric utilities	2.55	2.70	3.41	3.39	4.08	3.55	2.16
Average revenue per kwh	6.90	7.15	6.40	6.38	6.40	6.12	3.57
Number of Customers (average for year):							
Residential	648,024	635,536	624,751	616,051	608,886	603,904	571,701
Commercial	65,819	64,563	63,368	62,115	60,710	59,482	55,113
Industrial	1,414	1,393	1,389	1,362	1,333	1,340	1,284
Other	10,532	10,503	10,388	10,138	9,978	9,916	9,042
Total	725,789	711,995	699,896	689,666	680,907	674,642	637,140
Annual Average Use (kwh):							
Residential	7,569	7,538	7,387	7,426	7,223	7,306	7,352
Commercial	43,787	42,935	42,261	42,035	41,772	41,895	43,003
Industrial (thousands)	2,134	2,081	2,024	2,079	2,019	1,956	1,959
Annual Average Bill:							
Residential	$ 746	$ 719	$ 642	$ 593	$ 551	$ 538	$ 294
Commercial	3,713	3,644	3,182	3,073	2,793	2,753	1,631
Industrial	134,941	134,510	115,255	115,037	99,780	95,995	54,524

Electric Operating Statistics

	1987	1986	1985	1984	1983	1982	1977
Production Data:							
System Capability (megawatts):							
Net generating capability:							
Coal fired	2,386	2,366	2,366	2,376	1,733	1,731	1,527
Hydro	68	68	64	60	56	38	38
Diesel	7	7	7	7	10	11	14
Total	2,461	2,441	2,437	2,443	1,799	1,780	1,579
Purchased—Power Authority	509	563	621	683	680	768	824
—Other	—	—	—	—	300	350	100
Total system capability	2,970	3,004	3,058	3,126	2,779	2,898	2,503
Annual Load Factor (percent)	65.5	66.3	64.4	67.3	64.4	65.1	62.9
Coal Burned (thousands of net tons)	5,956	5,334	6,051	5,126	4,666	4,803	3,720
Coal Heat Value (Btu per lb.)	12,487	12,335	12,309	12,202	12,033	11,937	11,056
Btu per Kwh Generated (net)	9,897	9,959	10,093	10,562	10,552	10,670	11,145
Kwh Production—net (millions):							
Generated:							
Coal fired	15,025	13,196	14,769	11,850	10,641	10,748	7,380
Nuclear	60	—	—	—	—	—	—
Hydro	280	338	242	246	213	197	226
Total generated	15,365	13,534	15,011	12,096	10,854	10,945	7,606
Purchased—Power Authority	1,911	2,590	2,315	2,980	2,023	2,104	2,835
—Other	583	464	491	650	714	663	1,519
Total	17,859	16,588	17,817	15,726	13,591	13,712	11,960
Production Expenses (thousands):							
Generated	$332,250	$318,885	$353,265	$287,299	$237,309	$248,278	$110,448
Purchased	29,638	29,302	35,984	69,206	66,575	68,781	60,626
Total	$361,888	$348,187	$389,249	$356,505	$303,884	$317,059	$171,074
Costs per Kwh (mills):							
Generated	21.62	23.56	23.53	23.75	21.86	22.68	14.52
Purchased	11.88	9.59	12.82	19.07	24.32	24.86	13.92
Operating expense (excl. production)	9.79	9.85	8.46	7.97	8.60	8.39	5.37
Total	30.05	30.05	30.31	30.64	30.95	31.51	19.68
Electric Operation and Maintenance Expenses (thousands):							
Production	$361,888	$348,187	$389,249	$356,505	$303,884	$317,059	$171,074
Transmission	24,314	22,438	23,450	16,093	13,382	13,023	7,612
Distribution	55,673	49,522	46,120	42,494	39,111	36,495	22,544
Customer accounting	20,158	19,220	18,255	17,824	16,603	16,568	8,527
Customer service	12,047	8,867	7,005	6,149	5,221	4,457	2,605
Administrative and general	62,660	63,328	55,868	42,783	42,508	44,476	22,972
Total	$536,740	$511,562	$539,947	$481,848	$420,709	$432,078	$235,334

Gas Department Statistics

	1987	1986	1985	1984	1983	1982	1977
Dekatherm (dth) Sales (thousands):							
Residential	13,897	14,139	13,652	14,120	13,857	15,688	18,373
Commercial	6,803	7,343	7,392	7,761	7,514	8,123	8,408
Industrial	3,038	5,126	7,790	9,817	9,296	9,804	7,968
Other	2,499	3,373	3,547	3,691	3,718	4,314	3,132
Subtotal	26,237	29,981	32,381	35,389	34,385	37,929	37,881
Transportation of customer-owned gas	5,959	3,287	1,926	—	—	—	—
Total	32,196	33,268	34,307	35,389	34,385	37,929	37,881
Operating Revenues (thousands):							
Residential	$ 85,242	$ 91,068	$ 88,677	$ 92,288	$ 92,974	$ 83,167	$ 44,895
Commercial	37,620	42,711	42,952	45,403	44,980	38,192	18,236
Industrial	13,909	24,429	37,734	49,087	49,217	43,383	15,205
Other	13,137	18,819	19,917	21,040	20,695	20,255	6,660
Subtotal	149,908	177,027	189,280	207,818	207,866	184,997	84,996
Transportation of customer-owned gas	2,931	2,168	921	—	—	—	—
Total operating revenues	$152,839	$179,195	$190,201	$207,818	$207,866	$184,997	$ 84,996
Operating Revenues per dth:							
Residential	$ 6.13	$ 6.44	$ 6.50	$ 6.54	$ 6.71	$ 5.30	$ 2.44
Commercial	5.53	5.82	5.81	5.85	5.99	4.70	2.17
Industrial	4.58	4.77	4.84	5.00	5.29	4.43	1.91
Other	5.26	5.58	5.62	5.70	5.57	4.70	2.13
Average revenue per dth	$ 5.71	$ 5.90	$ 5.85	$ 5.87	$ 6.05	$ 4.88	$ 2.24
Number of Customers (average for year):							
Residential with house heating	107,237	105,094	103,822	103,132	102,728	103,031	97,082
Residential without house heating	8,212	8,300	8,440	8,630	8,830	9,106	12,630
Commercial with space heating	16,177	16,121	15,953	15,788	15,316	14,513	12,809
Commercial without space heating	1,414	1,406	1,396	1,415	1,410	1,286	1,234
Industrial	399	405	409	398	383	384	380
Other	1,185	1,173	1,159	1,137	1,139	1,135	1,241
Total	134,624	132,499	131,179	130,500	129,806	129,455	125,376
Annual Average Use (dth):							
Residential	120	125	122	126	124	140	167
Commercial	387	419	426	451	449	514	599
Industrial	7,614	12,657	19,046	24,666	24,272	25,531	20,968
Annual Average Bill:							
Residential	$ 738	$ 803	$ 790	$ 826	$ 833	$ 742	$ 409
Commercial	2,139	2,437	2,476	2,639	2,689	2,417	1,299
Industrial	34,860	60,319	92,259	123,334	128,504	112,977	40,013
Cost of Natural Gas Purchased:							
Amount (thousands)	$ 90,974	$111,147	$129,809	$146,040	$160,415	$132,300	$ 56,284
Per dth	3.43	3.75	3.87	4.09	4.52	3.49	1.50
Gas Operation and Maintenance Expenses (thousands):							
Production	$ 91,369	$111,538	$130,269	$146,401	$160,928	$132,724	$ 56,923
Transmission and distribution	11,570	11,013	10,224	9,651	8,908	9,010	6,469
Customer accounting	4,656	4,085	3,977	4,043	3,783	3,947	1,812
Customer service	2,374	2,227	1,779	1,580	1,328	1,141	480
Administrative and general	11,901	9,589	9,508	9,383	8,703	8,661	4,326
Total	$121,870	$138,452	$155,757	$171,058	$183,650	$155,483	$ 70,010

Directors

Wells P. Allen, Jr.
Chairman & Chief Executive Officer of the Company
Binghamton, N.Y.

James A. Carrigg
President & Chief Operating Officer of the Company
Binghamton, N.Y.

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

Eileen D. Dickinson
Vice President and Director
Arbor House
Albany, N.Y.

Everett A. Gilmour
Chairman of the Board
The National Bank and Trust Company of Norwich
Norwich, N.Y.

Allen E. Kintigh
Executive Vice President of the Company
Binghamton, N.Y.

Ben E. Lynch
President
Winchester Optical Company
Elmira, N.Y.

Alton G. Marshall
Chairman & Chief Executive Officer
Lincoln Savings Bank
New York, N.Y.

David R. Newcomb
Former President
Buffalo Forge Company
Buffalo, N.Y.

Robert A. Plane
Director
New York State Agricultural Experiment Station
Geneva, N.Y.

C. William Stuart
Chairman & Chief Executive Officer
C. W. Stuart & Co., Inc.
Newark, N.Y.

William D. Turner
Group Vice President
Training Systems Group
The Singer Company
Stamford, Conn.

Officers

Binghamton Executive Offices

4500 Vestal Parkway East, Binghamton, N.Y. 13903 Tel. 607/729-2551

Wells P. Allen, Jr.
Chairman & Chief Executive Officer

James A. Carrigg
President & Chief Operating Officer

Dolores R. Hix*
Richard Kroboth
Assistants to the Chairman

Allen E. Kintigh
Executive Vice President

Bernard M. Rider
Senior Vice President
Electric Operations & Engineering

Jack H. Roskoz
Senior Vice President
Administration

James A. Ackerman
Vice President
Area Administration

Orlin W. Darrach
Vice President
Customer Services

Paul Komar
Vice President & Executive Assistant

William G. McCann
Vice President
Electric Operations

Richard W. Page
Vice President
Human Resources

Raymond A. Perine
Vice President
Gas Operations

Vincent W. Rider
Vice President
Generation

Michael J. Turkovic
Vice President
Purchasing

John I. Fiala
Assistant Vice President
Plant Operations

John V. Kutz
Assistant Vice President
Transmission & Distribution

Irene M. Stillings
Assistant Vice President
Consumer Affairs

*Also Assistant Secretary

Ithaca Executive Offices

Route 13, Dryden Road, Ithaca, N.Y. 14851 Tel. 607/347-4131

Richard A. Jacobson
Executive Vice President & Chief Financial Officer

Richard P. Fagan
Senior Vice President & Comptroller

John D. Scott
Vice President
Economics

Sherwood J. Rafferty
Treasurer

Daniel W. Farley
Secretary

James M. Niefer
Assistant Secretary

Robert T. Pochily
Assistant Treasurer

Everett A. Robinson
Assistant Comptroller

Board of Directors
Standing, left to right: W. P. Allen, Jr., R. A. Plane, C. W. Stuart, A. G. Marshall, B. E. Lynch, W. D. Turner, E. A. Gilmour and A. E. Kintigh Seated: J. A. Carrigg, A. P. Casarett and E. D. Dickinson Not present: D. R. Newcomb

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

Transfer Agent for Common Stock and Preferred Stock:
Manufacturers Hanover Trust Company
450 West 33rd Street
New York, N.Y. 10001

Stockholder Inquiries:
Communications regarding stock transfer requests or lost certificates should be directed to the Transfer Agent. Stockholders with changes of address, dividend, dividend reinvestment and other inquiries may call toll-free between 8:00 a.m. and 4:30 p.m. Eastern Time:
1-800-225-5643

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

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

THE ANNUAL MEETING of stockholders will be held at the Corporation's General Office Building on Route 13 (Dryden Road) in the Town of Dryden, N.Y. on May 13, 1988 at 11 a.m. Formal notice of the meeting, a proxy statement and form of proxy will be sent to stockholders in early April.

NYSEG

New York State Electric & Gas Corporation
Box 287, Ithaca, New York 14851