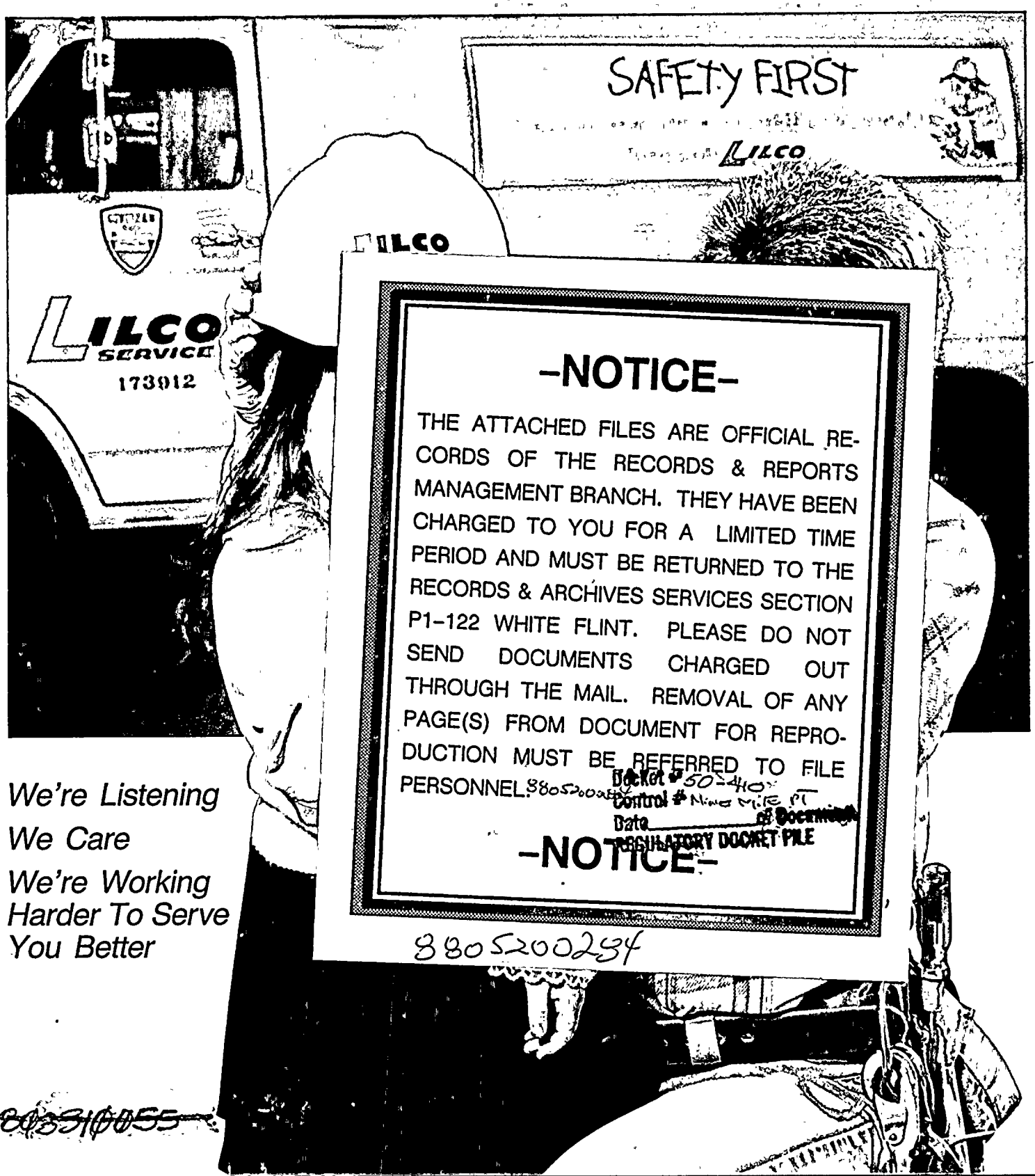
Long Island Lighting Company

1987 Annual Report



We're Listening
We Care
We're Working Harder To Serve You Better

Summary Highlights 1987

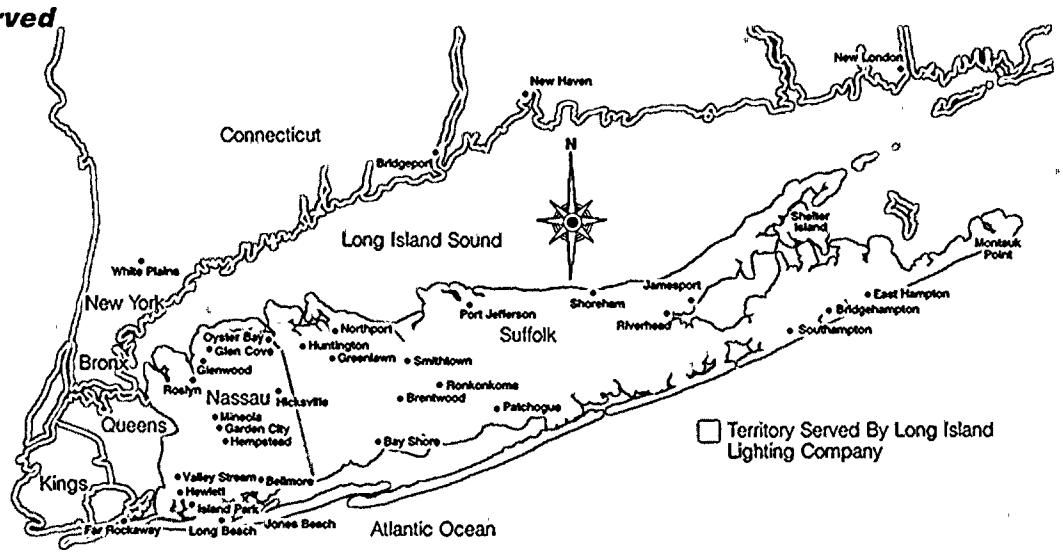
Summary of Operations (Millions*)	1987	1986
Total Revenues	$ 2,072	$1,977
Operating Income	$ 383	$ 387
Net Income**	$ 270	$ 317
Income for Common Stock	$ 192	$ 237
Average Common Shares Outstanding	111	111
Earned Per Average Common Share	$ 1.73	$ 2.13
Dividends Declared Per Common Share	—	—

* Except Earned Per Average Common Share and Dividends Declared Per Common Share.
**Non-cash allowance for funds used during construction represented 67% in 1987, and 85% in 1986 of Net Income.

Seven-year-old Erica Lefrak discovers that learning about electric safety can be fun as lineman Ron Noon lets her try a hard hat on for size.

The Electric safety program for children is part of LILCO's expanded consumer outreach programs that touch all customers — young and old alike.

Territory Served



LILCO supplies electric and gas service in Nassau and Suffolk Counties and the Rockaway Peninsula in Queens County, all on Long Island, New York. The 1,230 square mile service area contains a population of approximately 2.8 million persons, slightly over 100,000 of whom live in Queens County. Nassau and Suffolk Counties together constitute a federally-designated Metropolitan Statistical Area (MSA) which has the highest median disposable income per household of the more than 300 MSA's of the nation and ranks in the top ten of such areas, including metropolitan New York, Los Angeles and Chicago, in population, total income and retail sales. About 70% of all workers residing in Nassau-Suffolk Counties are employed within the two counties. In 1987, over 35,000 Nassau/Suffolk residents joined the ranks of the employed. This is an employment increase of 2.6% and represents 16% of the growth in total employment in New York State. The 1987 year-end unemployment rate in the bi-county area was 2.7%, substantially below the 4.2% rate for New York State and the more than 5% average for the United States. The area served is predominantly residential, but the Company receives approximately one-half of its electric revenues from commercial and industrial customers. Although electronics and aerospace are the largest manufacturing industries in the area, about 84% of total employment is non-manufacturing. Industrialization is gradually increasing in Suffolk County which has three times the land area and only one-third the population density of Nassau County. Reflecting the many natural attributes of the area, the Long Island Tourism and Convention Commission estimates that more than 24 million tourists visited the area in 1987.

William J. Catacosinos
Chairman and Chief Executive Officer

To The Shareowners

On behalf of the Board of Directors, I am pleased to present LILCO's 1987 Annual Report on your Company's operations during the past year and to comment on various related developments.

Long Island Power Authority

- On January 15, 1987, the New York State government formed the Long Island Power Authority (LIPA) pursuant to legislation signed into law in July 1986. The legislation empowers LIPA to attempt to acquire the assets or capital stock of LILCO if the Authority can demonstrate that electric rates following a takeover would be equal to or lower than LILCO's rates. To date, LIPA has not disclosed whether it believes it could provide Long Islanders with a sufficient and dependable supply of electricity at a lower cost than LILCO and LIPA has offered no proposal to acquire LILCO.

- LILCO's Board of Directors is prepared to review and evaluate a proposal if LIPA submits one. On March 4, 1988, the Company publicly requested that LIPA present its best offer to purchase LILCO. We believe the request demonstrates the Company's willingness to negotiate with the state either the sale of the Company or a mutually agreeable settlement.

Negotiating with New York State

- In December, the Company and state officials resumed negotiations to settle the controversy over Shoreham and to explore means to assure an adequate supply of electric power for Long Island. Since 1984, we have had numerous meetings with state officials in an attempt to bring the matters to an equitable resolution. We have remained flexible in our discussions with the state, but are unwilling to jeopardize the investment of our shareowners. The Company has suggested the presence of a mutually acceptable neutral moderator in the discussions as a demonstration of the Company's interest in a good faith negotiation. The State has refused to have a moderator present.

- These new discussions are in the initial stages and the ramifications of a negotiated settlement are extremely complex. We are methodically examining with the state the implications of a possible settlement in terms of Long Island's energy requirements, the future cost of electricity, and the financial viability of the Company. In these discussions with the state, LILCO is seeking a solution which would strengthen its financial condition so that the market price of its stock more closely reflects the Company's inherent value. We are also seeking a solution which would allow for future dividend payments to shareowners.

Financial

- On December 3, 1987, the New York State Public Service Commission (PSC) rejected LILCO's request, initiated in November 1986, for an $83 million rate increase. In denying the rate increase, the Commission did not accept either recommendations of the PSC administrative law judge who had presided over the rate case or the recommendations of its own staff. Both had recommended a $50 million rate increase. In its decision, the PSC maintained that it was seeking to end the Shoreham controversy which the Commission asserts has been prolonged by past rate increases providing LILCO with the cash necessary to pursue a license for Shoreham.

- The PSC will again consider, the Company's rate request in April 1988, to determine "if any rate revision upward or downward is then in order" trusting that the parties to the Shoreham dispute would by then resolve the deadlock. In its rate decision, the PSC further directed the Company to develop an alternative energy plan to Shoreham.

- While the PSC's order did not change the level of the Company's electric rates, it did alter the basis for those rates. The Commission reduced $113 million from rates principally by lowering the Company's rate of return, by taking into account changes in the federal tax laws, and by reflecting revenue growth from increased energy sales. At the same time, the Commission added back $113 million of cash flow rate relief, which is equivalent to rate recovery for most of the Company's 18% investment in the Nine Mile Point 2 plant which began commercial operation on March 11, 1988.

- The Company estimates that its operating and capital requirements in 1988 will exceed the total of the cash generated from operations during 1988 and the cash and short-term investments that were on hand at December 31, 1987. The Company's $200 million bank credit line will cover any shortfall in cash through the end of 1988; however, the credit line expires on December 31, 1988. Also on that day, the first of 16 quarterly payments of the $595 million owed the banks comes due. In December 1987, the Company commenced discussions with its banks to extend the credit line and to defer the repayment of its $595 million loan.

Shoreham

- On November 3, 1987, the Nuclear Regulatory Commission (NRC) unanimously approved a new regulation designed to prevent nuclear plants from being kept closed because of the refusal of state and local government officials to participate in emergency planning. The new regulation assumes that state and local officials will act responsibly to protect the public interest and safety by implementing the most effective available response plan. The non-cooperation of local and state governments in the Shoreham emergency plan remains the final obstacle to a full power operating license for Shoreham. This new rule provides a means to remove that obstacle, but we do not know how the NRC will apply it. In addition, the rule is being challenged by New York State and others in federal court.

- The Company must still demonstrate to the NRC that there is adequate emergency preparedness for Shoreham, although now it may rely on the new rule to do so. An NRC licensing board had previously ruled in August 1985, that emergency planning for Shoreham is feasible and that the Company's response plan satisfied federal requirements with minor exceptions. According to the NRC regulations, the Company must successfully exercise the plan before it can obtain a full power license.

- In this regard, the federal government conducted an exercise of the plan on February 13, 1986, and the plant's opponents litigated the results of the exercise before an NRC board. On December 7, 1987, the NRC licensing board ruled that the scope of the exercise was too limited in certain aspects, even though the federal officials in the NRC and the Federal Emergency Management Agency had approved the scope prior to the exercise. In a February 2, 1988 ruling, the same NRC licensing board noted certain deficiencies in the execution of the plan which now must be corrected before a full power license can be issued. The Company has appealed these decisions.

- In the meantime, the Company anticipates that the federal government will conduct another exercise of the plan this spring as part of its requirement to test emergency plans at nuclear plants every two years. Another full exercise and the litigation of the results are expected to delay the decision concerning the issuance of a full power license into 1989.

- Early in December, Shoreham received an excellent rating from the NRC in its annual review of the plant's operations. Shoreham was awarded the highest possible grades in most areas reviewed, placing it among the best managed plants in the northeast. In fact, Shoreham rated higher than 24 of the 27 operating plants in the northeast region.

- In April 1987, LILCO petitioned the NRC for permission to operate Shoreham at 25 percent of full power which would provide an additional 170 megawatts to help relieve the energy shortages on Long Island. Currently, the Company has a license to operate the plant at 5 percent of full power. In June, the NRC denied LILCO's request because the Commission could not complete its review before the summer of 1987. The NRC invited the Company to refile its petition if the Company still sought the 25 percent license to help meet the energy needs for

future summers. The Company refiled its petition last July. Subsequently, the NRC has assigned the petition to a licensing board, and the NRC staff has commenced its review of the Company's proposal.

Energy Growth

- In 1987, LILCO delivered more electricity than ever before as the demand for energy continues to grow at a substantial pace on Long Island. On August 17, LILCO reached a record peak demand of 3,576 megawatts, exceeding the 1986 record by 135 megawatts, a 3.9 percent increase. Total peak demand on Long Island has grown 18 percent over the past five years, an average of 3.6 percent each year. Electric system energy sales in kilowatt hours increased 4.5 percent in 1987 over 1986 and increased 4.4 percent in 1986 over 1985, reflecting the strength of the Long Island economy. On January 14, 1988, the Company reached a new winter peak demand.

- System sales of gas increased 4.4% in 1987 over 1986. The Company now has 415,600 gas customers which includes a net increase of 5,600 customers in 1987. The Company has an aggressive marketing program to encourage customers who heat with other fuels to convert to natural gas for space heating. In 1987, the Company increased its natural gas space heating customers by 8,200 reflecting its marketing program.

- LILCO was able to avert brownouts and blackouts last summer because plant operators managed to keep 95 percent of the Company's electric generating capacity available during critical days, far exceeding industry averages which range between 80 and 85 percent. It is unrealistic to expect that LILCO's aging power plants can sustain that level of performance and we continue to be faced with the need for additional generating capacity to meet the growing demand from our customers.

Service Improvements

- In 1987, the Company embarked on a major program to improve service to customers. As a result, LILCO now has one of the lowest complaint rates of the New York State utilities as measured by the PSC, a major improvement over previous measurements and earning for LILCO a reputation for service we intend to maintain.

Results of Operations

- Detailed information on the financial results of the past year and additional commentary on the major events of 1987 and the first part of the current year are contained in this 1987 Annual Report. The reported earnings for 1987 are lower than 1986 because they reflect the cessation of accruals of non-cash income (AFC) for the entire year on disallowed Shoreham costs and the Nine Mile Point 2 plant. While earnings would have dropped 79 cents per share as a result of the reduction of AFC, actual earnings dropped only 40 cents per share principally as a result of earnings from significant increases in energy sales which partially offset the reduction in AFC earnings. Effective January 1988, the Company recorded a write-down of $1.3 billion reflecting disallowed costs for Shoreham and certain costs for the Nine Mile Point 2 and Jamesport investments as required by Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 90.

We are saddened by the death of the Company's Executive Vice President, James W. Dye Jr., on December 24, 1987. Mr. Dye had served the Company with distinction in various positions for more than 38 years.

Effective January 1, 1988, Mr. Anthony F. Earley Jr., the Company's General Counsel, was elected Executive Vice President.

In 1987, despite the pressing urgency of the key issues concerning our Shoreham plant, your Company completed its 77th year of dependable service to the dynamic and growing Long Island community, a tribute to the performance of LILCO's 6,400 dedicated employees. Your Board of Directors and management remain committed to responsibly serving your best interests and will keep you promptly advised of future events concerning LILCO. Your continued interest and support is gratefully acknowledged.

Respectfully submitted,

W. J. Catacosinos

William J. Catacosinos
Chairman and Chief Executive Officer

March 11, 1988

Management's Discussion And Analysis Of Financial Condition And Results Of Operations

This analysis discusses matters of significance in the Company's Financial Statements, which follow, with regard to capital requirements and liquidity and with regard to results of operations for the last three years.

Capital Requirements and Liquidity

Financial Objectives: The utility industry, which is one of the most capital intensive in the world, has generally provided approximately 50% of the funds required for construction through cash generated from operations. The balance of the required funds have been obtained through the issuance of short-term debt, which would be repaid periodically with the proceeds from the sale of permanent securities.

Traditionally, the Company has sought to achieve this objective. However, in recent years, in order to adjust to the political and regulatory uncertainties confronting it, the Company has had to deviate from these financing patterns in order to maintain its financial viability.

Starting in 1983, with the additional adversities of the downrating of its securities to below investment grade and the withdrawal of its commercial paper ratings, the Company was forced to eliminate the use of all short-term debt and sought to maintain cash and short-term investments through borrowings on a longer-term basis under its then existing credit agreements.

In 1984, given the continuation of the various adverse factors affecting the Company, no assurance could be given regarding its ability to raise the necessary funds, either in the current year or in future years, to support its capital and operational needs. In view of this situation, and in order to avoid having to file for bankruptcy when $90 million of General and Refunding Bonds (G&R Bonds) matured in September 1984, the Company implemented a number of steps to conserve cash, including omitting common dividends, reducing operations and maintenance expenses, and suspending Nine Mile Point 2 (NMP2) construction payments. Additionally, the Company was granted a permanent electric rate increase, entered into a Revolving Credit Agreement (1984 RCA) which provided for borrowings up to $150 million through year-end 1985 but required cessation of preferred dividend payments, entered into an agreement with Niagara Mohawk under which they would finance up to $250 million of the Company's share of construction costs of NMP2, and sold $100 million of five year G&R Bonds. As a result of these and other actions, the Company was able to maintain its financial viability.

Entering 1985, the Company developed and implemented an interim financing plan designed to assure its financial viability at least through mid-1986. In line with this plan, the Company entered into an amendment to the 1984 RCA which extended its termination date through mid-1986. In addition, the Company, among other actions, sold $225 million of G&R Bonds, repaid $75 million of maturing bank debt, prepaid $145 million of its then outstanding bank debt, issued $150 million of tax-exempt bonds, and applied $145 million toward obligations resulting from its 1984 suspension of NMP2 payments.

At January 1, 1986, current maturities of long-term debt totaled $715 million. Accordingly, the Company's primary financial objective in 1986 was to develop and implement a plan to assure its financial viability at least through 1988. To this end, the Company implemented a Restructuring Credit Agreement (1986 RCA) with its 42 lending banks, sold $525 million of G&R Bonds, extended to year-end 1988 the 1984 RCA, and sold $700 million of debentures.

Pursuant to the 1986 RCA arrangements, (a) $400 million of proceeds from the sale of the G&R Bonds was applied to prepay a portion of the approximately $1.0 billion of the then outstanding bank debt, (b) payment for the remaining approximately $600 million was restructured to provide for 16 quarterly installments starting December 31, 1988 and ending September 30, 1992, (c) provision was also made for mandatory prepayments of bank debt up to $250 million under certain circumstances relating to the payment of preferred and common stock dividends, and (d) the Company's trust obligations were consolidated into the restructured bank notes.

In conjunction with extending the 1984 RCA, the Company was permitted to (a) increase the maximum amount available from $150 million to $200 million, subject to accounts receivable and fuel oil inventory amounts to be used as security (Borrowing Base), and (b) sell up to $200 million per year of G&R Bonds through 1992 in addition to any G&R Bonds sold to refund similar bonds having a higher effective cost. Furthermore, any G&R Bonds not sold in any one year could be carried forward to a subsequent year through 1992.

Of the total debentures sold in 1986, approximately $339 million was used to refund principal ($325 million) and finance call premiums ($14 million) for outstanding G&R Bonds which included $225 million issued to Niagara Mohawk. An additional $27 million was used to repay unsecured obligations to Niagara Mohawk.

Debentures were sold in 1986 to comply with restrictions contained in the 1986 RCA and as a consequence of the then G&R Bond Trustee, Sterling National Bank and Trust Company of New York (Sterling), questioning the Company's ability to issue new G&R Bonds based on Shoreham and NMP2 property additions. In January 1987, subsequent to Sterling resigning as Trustee, United States Trust Company of New York (U.S. Trust) became successor trustee with the understanding that the Company would not issue any new G&R Bonds on the basis of property additions until the uncertainties regarding Shoreham and NMP2 were resolved to the satisfaction of U.S. Trust. The Company may, however, issue new G&R Bonds on the basis of refunded bonds.

As a result of the actions taken during 1986, mandatory current maturities of long-term debt through 1988 had been significantly reduced, cash and short-term investments at December 31, 1986 totaled $366 million, and no loans were outstanding under the 1984 RCA.

During 1987, the Company's operations and maintenance expenses as well as its capital requirements were funded in part from cash generated from operations and the remainder from its cash and short-term investments. At December 31, 1987, cash and short-term investments totaled $211 million, no loans were outstanding under the 1984 RCA, and $145 million was available as a Borrowing Base under the 1984 RCA.

At December 31, 1987, 1986 and 1985, the Company's capitalization ratios were:

Capitalization Ratios at December 31	1987	1986	1985
Debt	46.4%	48.4%	47.3%(1)
Preferred Stock (No Preference Stock)	8.8	9.3	10.5
Common Stock and Retained Earnings	44.8	42.3	42.2
Total	100.0%	100.0%	100.0%

(1) Includes current maturities of debt restructured in 1986.

The Company is required to adopt in 1988 the provisions of Statement of Financial Accounting Standards No. 90 (SFAS 90) (See Note 1 of Notes to Financial Statements). However, had the provisions of SFAS 90 been adopted in 1987, the Company would have had to record a write-down of its net assets of approximately $1.3 billion, net of tax effects, principally relating to the Shoreham disallowed costs and the NMP2 most recent estimate of costs in excess of the amount provided in the settlement as discussed in Note 6 of Notes to Financial Statements. Accordingly, retained earnings would be reduced by approximately $1.3 billion on an after-tax basis and the effect, as measured by the adjusted capitalization ratios at December 31, 1987 would be (a) debt 55.5%, (b) preferred stock 10.5%, and (c) common stock and retained earnings 34.0%.

In 1986, the PSC adopted a Rate Moderation Plan (RMP) whereby the allowable cost of Shoreham and the Company's share of the allowable cost of NMP2 would be phased into rates over a 15 year period starting with the commencement of commercial operation. As discussed in Note 1 of Notes to Financial Statements, the RMP as ordered by the PSC does not meet the criteria set forth in Statement of Financial Accounting Standards No. 92 (SFAS 92) permitting the capitalization of certain costs. However, the PSC has indicated that it would be prepared to readjust the phase-in period if SFAS 92 is shown to affect the ratepayers materially. The Company intends to request that the PSC modify the RMP so as to meet the criteria established by SFAS 92, but the Company can give no assurance that the modifications will be ordered by the PSC.

Capital Requirements: For 1987, total capital requirements amounted to $441 million, of which total construction (excluding $181 million of AFC) was $400 million, and total refunding was $41 million.

For 1988, total capital requirements are estimated at $564 million, of which total construction (excluding $147 million of AFC) is $463 million, and total refunding is $101 million.

Capital requirements in 1987 and 1986 were as follows:

Capital Requirements (Dollars in Millions)	1987	1986
Construction Requirements (Including AFC)		
Electric		
Shoreham (1)	$383	$ 374
Nine Mile Point 2 (1)	47	192
Nuclear Fuel (1)	13	10
Other Production	24	38
Other	62	62
Total Electric	529	676
Gas	34	32
Common	18	5
Total Construction (Including AFC)	581	713
Less AFC	181	269
Total Construction (Excluding AFC)	400	444
Refunding Requirements		
Senior Securities	41	366
Bank Loans	—	463
1984 Niagara Mohawk Unsecured Note	—	7
Total Refunding Requirements	41	836
Total Capital Requirements	$441	$1,280

(1) See Note 6 of Notes to Financial Statements.

Capital Provided and Liquidity: Internal cash generation from operations was equal to 90% of total construction expenditures (excluding AFC) in 1987, and 77% in 1986.

The capital provided in 1987 and 1986 was as follows:

Capital Provided (Dollars in Millions)	1987	1986
Total External Financing - Long-term debt	$ —	$1,296
Cash and Short-term Investments	156	(351)
Internal Cash Generation from Operations	360	342
Other Internal Funds Used	(75)	(7)
Total Capital Provided	$441	$1,280

For 1988, the Company estimates that its operating and capital requirements will exceed the cash generated from operations and cash and short-term investments that were on hand at December 31, 1987. Although any shortfall in cash will be covered through the end of 1988 by the 1984 RCA, there is no present committed borrowing capacity which extends beyond December 31, 1988. The Company's ability to extend the 1984 RCA is presently under discussion with its banks; however, there is no assurance that an extension will be obtained, nor is there any assurance at this time that other financing will be available to meet its obligations as they mature.

The Company's continued financial viability is dependent upon various factors, including its (a) receipt of adequate and timely rate relief, including recovery in rates of its prudent investment in Shoreham, whether or not Shoreham operates, and the PSC-approved amount of its investment in NMP2, (b) continued access to capital markets, (c) ability to continue to conserve cash, and (d) ability to recover its investments in Jamesport and Bokum. The Company cannot at this time predict whether it will be able to obtain any or all of such rate relief or external financing or the effects of the other factors. See Note 6 of Notes to Financial Statements for further discussion.

Rates: The PSC granted the Company electric rate relief totaling $245 million annually in September 1984 and $69 million annually in January 1986. This rate relief, most of which has provided Financial Stability Adjustment (FSA) revenue (see Note 1 of Notes to Financial Statements), enabled the Company to obtain additional credit and made possible its re-entry into the capital markets in 1984 and has subsequently provided a significant portion of the cash requirements for the Company's operating and capital requirements.

In December 1987, the PSC concluded a rate proceeding, which had sought a 5% increase in electric rates, without granting the Company any additional rate relief citing, among other reasons, the continuing "deadlock" over Shoreham; and further stating that, while it was too soon to commit to specific ratemaking treatment, a harmonizing of the economic interest of the Company and the desires of its customers must be recognized if the deadlock is to be broken within the context of regulation of the Company "short of bankruptcy." Further, the PSC indicated that it would review in, April 1988, the Company's entitlement to its existing rates or to an increase in rates. The PSC could increase, decrease, or otherwise modify the Company's current rates. The Company believes that the rate relief it sought was appropriate and will refile in April for an increase in rates. However, it cannot predict what action the PSC will take in such proceeding. The PSC also directed the Company to submit a plan in April 1988 that addresses the energy requirements on Long Island without Shoreham.

The rates currently in effect are providing the Company with $488 million of cash-flow revenues, including $113 million relating to NMP2. The PSC has ordered that approximately $322 million of the Company's Shoreham-related revenues and, so long as NMP2 is not in commercial operation, $113 million of the Company's NMP2-related revenues, would be terminated in the event of bankruptcy. The failure of the PSC to act favorably on the Company's most recent request for rate relief, and an adverse order by the PSC following the Company's filing in April 1988, could adversely affect the Company's financial viability, particularly its ability to access the capital markets.

Equity Securities: As previously discussed, the payment of dividends on the Company's preferred and common securities was suspended in 1984.

Modifications to the 1984 RCA eliminated all restrictions on the payment of preferred dividends in arrears through December 31, 1987. With respect to future common and preferred dividends, payment would be limited by a formula tied to internal cash generation. See Note 2 of Notes to Financial Statements for further discussion. The Company believes that the suspension of dividends has adversely affected the Company's ability to sell any of its equity securities.

Common dividends would at all times be subject to the Company's Certificate of Incorporation which prohibits the payment of such dividends so long as preferred stock sinking fund requirements or dividends are in arrears. The Company's retained earnings at December 31, 1987 were approximately $2.1 billion. Had the provisions of SFAS 90 been adopted by the Company in 1987, retained earnings of approximately $0.8 billion would have been available for the payment of dividends, including $265 million of preferred stock dividends in arrears at December 31, 1987. Reflecting the omission of dividends, retained earnings grew by approximately $0.3 billion in 1987.

The Company's ability to pay preferred or common dividends is dependent upon, among other factors, (a) its ability to comply with the requirements of the 1986 RCA, (b) receipt of adequate and timely rate relief, including recovery in rates of its investments in Shoreham, whether or not Shoreham operates, and NMP2 which have been determined to be prudent and allowed, (c) the availability of cash, and (d) action by the Board of Directors.

For additional data on the Company's capitalization and other Balance Sheet items, see Table 10 of "Selected Financial Data." For quarterly data on the market prices of the Company's securities during the past two years, see Table 11 of "Selected Financial Data."

Results of Operations

Earnings: Summary results of recent earnings are:

Earnings	1987	1986	1985
Net Income (Millions)	$269.9	$316.7	$524.3
Income for Common Stock (Millions)	$192.3	$236.9	$440.6
Average Common Shares Outstanding (Millions)	111.1	111.1	110.8
Earned Per Average Common Share	$ 1.73	$ 2.13	$ 3.97
AFC (Millions)	$181.0	$269.0	$438.4
AFC % of Net Income	67%	85%	84%

Average common shares outstanding indicated in the above table reflect the issuance of a total of 45,000 shares in 1987, 46,000 shares in 1986 and 847,000 shares in 1985. In 1986 and 1987, net income, income for common stock and earned per average common share decreased, in large part, because (a) effective March 1, 1986, the Company stopped accruing non-cash AFC (see Note 1 of Notes to Financial Statements) on the $1.4 billion of the Company's investment in Shoreham determined by the PSC to be imprudent, and (b) effective October 3, 1986, the Company stopped accruing AFC on its investment in NMP2. In addition, in December 1986, the Company recorded a net provision for loss relating to its investment in Jamesport of $16 million.

The ratio of earnings to fixed charges was 2.02 in 1987, compared with 2.17 in 1986, and 2.75 in 1985. The ratio of earnings to fixed charges and preferred dividend requirements was 1.56 in 1987, compared with 1.68 in 1986, and 2.15 in 1985. Both ratios, in each instance including AFC, are computed in accordance with Securities and Exchange Commission rules. The ratio of earnings, excluding AFC, to fixed charges was 1.60 in 1987, compared with 1.53 in 1986 and 1.62 in 1985.

The trends of earnings, dividends, and coverage of interest and fixed charges over the past five years are provided in

Table 1 of "Selected Financial Data." Information with regard to the electric and gas segments of the Company's business for the most recent three years is provided in Note 7 of Notes to Financial Statements. Additional data for prior years for both electric and gas operations is contained in the various tables of "Selected Financial Data."

Revenues: Total revenues, including revenues from the recovery of fuel costs, increased $95.0 million, or 4.8%, to $2,072.1 million in 1987 from $1,977.1 million in 1986. The decrease in 1986 from 1985 was $73.2 million, or 3.6%. Revenues realized from sales of electricity and gas to the various classes of the Company's customers are shown in detail in Tables 2 and 3 of "Selected Financial Data." Electric and gas revenues reflect monthly adjustments in rates as a result of changes, up and down, in the cost of fuels for electric generation, purchased power costs and the cost of gas.

The principal factors causing these changes in revenues were:

Factors Causing Change In Revenues	**Increases (Decreases) from Prior Year**	
(Dollars in Millions)	**87/86**	86/85
(1) Fuels and Purchased Power	**$19.7**	$(164.9)
(2) Rate Increases	**9.9**	59.4
(3) Changes in Energy Sales and Other Changes	**65.4**	32.3
Total	**$95.0**	$ (73.2)

Additional information about these factors:
(1) Fuels and Purchased Power: Changes between periods in the cost of electric fuels, purchased power, and gas fuels were influenced primarily by the mix of fuels used and changes in the cost of fuels.

During 1987 and 1986, the Company displaced 32% and 42%, respectively, of the oil it would otherwise have used to generate electricity by burning natural gas and purchasing power from other utilities. Burning gas and purchasing power displaced 8.8 million barrels of oil in 1987 and 11.0 million barrels in 1986. The Company estimates that these and related interchanges of power with other utilities saved electric customers a total of $64.5 million in 1987 and $85.7 million in 1986, compared to the estimated cost of generating an equivalent amount of power on the Company's system with oil. In addition, electric customers saved $17.6 million during 1987 and $23.5 million during 1986, as a result of burning higher sulfur oil through the Company's Environmental Quality Control System. Starting January 1, 1988, the Company is no longer allowed to burn higher sulfur oil. As a result of sharing in the economies of burning gas to generate electricity, gas customers saved $7.0 million in 1987 and $2.5 million in 1986.

The mix of fuels and purchased power for providing the Company's electric system energy requirements during 1987, 1986, and 1985 was as follows:

Fuel Mix	**1987**	1986	1985
Oil	**68%**	58%	61%
Purchased Power	**17**	26	20
Natural Gas	**15**	16	19
Total	**100%**	100%	100%

The costs of electric and gas fuels in 1987, 1986, and 1985 were:

Fuels and Purchased Power* (Dollars in Millions)	**1987**	1986	1985
Electric Fuels	**$417.9**	$326.1	$515.5
Purchased Power	**93.2**	134.3	113.9
Natural Gas	**174.6**	205.6	201.5
Total	**$685.7**	$666.0	$830.9

* Includes fuel cost adjustment deferred.

The average unit prices of fuels in 1987, 1986, and 1985 were as follows:

Average Unit Price*	**1987**	1986	1985
For Electric Operations ¢/kWh			
Fuels consumed for net generation	**3.01¢**	2.74¢	4.19¢
Purchased Power	**3.23¢**	3.24¢	3.74¢
For Gas Sendout - $/dth	**$2.97**	$3.87	$3.80

* Includes fuel cost adjustment deferred.

Additional fuel data for prior years is contained in Tables 4 and 5 of "Selected Financial Data."

(2) Rate Increases: Total revenues net of the above fuel costs increased $75.3 million, or 5.7%, in 1987 to $1,386.4 million and increased $91.7 million, or 7.5%, in 1986 to $1,311.1 million.

The $75.3 million increase in revenue net of fuel in 1987 was comprised of $9.9 million due to increased electric rates, $46.5 million due to increased electric sales, and $18.9 million from increased gas sales. Higher electric rates of $59.4 million provided a substantial portion of the total $91.7 million increase in revenue net of fuels in 1986. The balance of the increase was due to a $42.1 million increase in electric sales, partially offset by a $9.8 million decrease in gas sales.

(3) Changes in Energy Sales and Other Changes: Changes in energy sales to customers result from changes in (a) the number of customers and (b) the level of consumption by customers, which, in turn, may be influenced by differences in weather conditions.

Electric Sales: The changes in the above factors between current and prior comparable periods were as follows:

Customers and Average Use	**% Increase from Prior Year**	
	87/86	86/85
(a) Average Number of Customers		
Residential	**1.3%**	1.2%
Commercial & Industrial	**2.8**	3.0
(b) Average kWh Use Per Customer		
Residential	**4.3**	3.4
Commercial & Industrial	**0.9**	1.7

Consumption during 1987 by residential customers accounted for approximately 43.9% of the Company's annual system kWh sales of electricity. Following relatively stable levels of use in 1983, 1984, and 1985, the average kWh use per residential customer increased 3.4% in 1986 over 1985 and 4.3% in 1987 over 1986.

Electric Sales

(Millions of kWh)	1987	1986	1985
System Sales			
Residential	6,603	6,251	5,970
Commercial & Industrial	8,004	7,713	7,369
Other	439	429	451
Total System Sales	15,046	14,393	13,790
Power Pool Sales	239	244	226
Total Sales	15,285	14,637	14,016

Total kWh sales to residential, commercial and industrial customers increased 4.6% in 1987 over 1986 and increased 4.7% in 1986 over 1985, reflecting the strength of the Long Island economy. The Company expects this growth to continue in 1988.

Electric system peak demand in 1987 of 3,576,000 kWh was 3.9% higher than in 1986 and 17.4% higher than in 1982, a compounded annual growth rate of 3.3%.

Gas Sales

(dth in Millions)	1987	1986	1985
Firm System Sales			
Space Heating	39.3	38.2	35.4
Non-Space Heating	8.3	8.1	8.1
Total Firm	47.6	46.3	43.5
Interruptible	6.5	5.5	6.3
Total System Sales	54.1	51.8	49.8
Other Utilities	2.2	—	—
Total Sales	56.3	51.8	49.8
Degree Days Billed	4,802	4,795	4,444

Additional energy sales data for prior years is contained in Tables 6 and 7 of "Selected Financial Data."

Gas Sales: Approximately 72.6% of the Company's 1987 system dekatherm (dth) sales of gas resulted from consumption by space heating customers. Accordingly, total gas system revenues and sales can be heavily influenced by seasonal temperature variations between periods and the availability of gas for sale to interruptible customers.

The average number of space heating customers increased 3.7% in 1987 but the average dth usage of gas per customer declined 0.6%. These two factors, combined, resulted in an increase of 3.0% in gas sales to space heating customers. Sales of gas to firm non-space heating customers increased 2.2%, while sales to interruptible customers increased 17.2%. The number of degree days were comparable in both years.

The average number of gas space heating customers increased 2.8% in 1986 over 1985, while average dth usage increased 5.0%. These two factors combined to increase sales to firm space heating customers 7.9%. Sales of gas to firm non-space heating customers remained at the same level as the prior year, while sales to interruptible customers decreased 12.3% in 1986. A substantial increase in degree days was largely responsible for the increased average usage of space heating gas in 1986.

Operations and Maintenance Expense: Total operations and maintenance expense exclusive of fuels and purchased power increased $19.0 million, or 5.9%, in 1987 to $342.0 million, reflecting continuing efforts to improve customer service and reliability. These expenses increased $68.6 million, or 27.0%, in 1986 to $323.0 million, and $16.2 million or 6.8% in 1985 to $254.3 million. Nearly 58% in 1987, 56% in 1986, and 62% in 1985 of these total costs represented employee wages and benefits.

Other Items: Federal income taxes in 1987 were $1.5 million lower than in 1986, and in 1986 federal income taxes were $16.2 million higher than in 1985. Changes in federal income taxes are due principally to variations in net income before income taxes, recognition of investment tax credits, and items capitalized for financial statement purposes that are allowed as current deductions on the Company's tax returns. The income tax expense recorded in 1987 includes certain adjustments required by the PSC in reflecting the effects of the Tax Reform Act of 1986 (see Note 5 of Notes to Financial Statements).

Other items such as depreciation, operating taxes, interest expense and preferred stock dividend requirements, (including $77.6 million in 1987 and $79.8 million in 1986 reflected in the financial statements although unpaid) in aggregate increased $30.4 million or 3.6% in 1987 to $864.3 million, and $25.1 million, or 3.1%, to $833.9 million in 1986, from $808.8 million in 1985. In addition, in 1987 and 1986, there were $87.9 million and $169.4 million decreases, respectively, in AFC principally as a result of stopping (a) in March 1986, AFC accruals on the $1.4 billion investment in Shoreham determined by the PSC to be imprudent and (b) in October 1986, AFC accruals related to the Company's investment in NMP2. Increases in depreciation generally result from additions to plant in service. Increases in operating taxes are largely due to higher property taxes resulting from the addition of new plant and increased property tax rates. State and local gross income and franchise taxes vary with revenues. Changes in interest charges result primarily from increased borrowings and the effect of changing interest rates. Decreases in preferred stock dividend requirements result from decreases in preferred shares outstanding.

AFC is a non-cash credit to income that represents the cost of borrowed funds for construction purposes and a reasonable rate of return upon a utility's other funds when so used. The amount of AFC fluctuates from period to period resulting from changes in the cost of money, the level of construction activity, the amount of construction work in progress (CWIP) included in rate base, modifications in regulatory policy, and the effects of regulatory disallowances.

LILCO AFC totaled $181.0 million in 1987, $269.0 million in 1986, and $438.4 million in 1985, representing 67%, 85%, and 84%, respectively, of net income. CWIP included in rate base totaled approximately $400 million in each of the years 1987, 1986, and 1985, including approximately $355 million related to Shoreham.

Financial Statements

Statement of Income

For year ended December 31 (In thousands of dollars)	1987	1986	1985
Revenues			
Electric	$1,718,861	$1,611,789	$1,679,259
Gas	353,216	365,332	371,081
Total Revenues	2,072,077	1,977,121	2,050,340
Expenses			
Operations — fuel and purchased power	685,689	666,015	830,928
Operations — other	240,713	220,309	183,260
Maintenance	101,287	102,645	71,049
Depreciation, depletion, and amortization	73,905	70,139	66,742
Operating taxes	300,159	277,992	271,054
Federal income tax — current	83,577	41,347	514
Federal income tax — deferred and other	204,143	211,597	238,653
Total Expenses	1,689,473	1,590,044	1,662,200
Operating Income	382,604	387,077	388,140
Other Income and (Deductions)			
Allowance for other funds used during construction	127,958	139,639	261,876
Other income and (deductions)	14,885	6,697	(604)
Provision for net loss on Jamesport abandoned generating project	—	(16,000)	—
Federal income tax credit (provision) — current	80,597	41,347	(72)
Federal income tax credit — deferred and other	38,269	41,232	85,122
Total Other Income and (Deductions)	261,709	212,915	346,322
Income Before Interest Charges	644,313	599,992	734,462
Interest Charges and (Credits)			
Interest on long-term debt	410,097	397,318	371,115
Other interest	17,404	15,316	15,561
Allowance for borrowed funds used during construction	(53,076)	(129,317)	(176,502)
Total Interest Charges and (Credits)	374,425	283,317	210,174
Net Income	269,888	316,675	524,288
Preferred stock dividend requirements	77,576	79,811	83,725
Income for Common Stock	$ 192,312	$ 236,864	$ 440,563
Average Common Shares Outstanding — (000)	111,129	111,085	110,842
Earned per Common Share	$ 1.73	$ 2.13	$ 3.97
Dividends Declared per Common Share	$ —	$ —	$ —

See Notes to Financial Statements.

Balance Sheet

Assets

At December 31 (In thousands of dollars)		1987	1986
Utility Plant	Electric	**$2,018,324**	$1,943,555
	Gas	**446,607**	415,258
	Common	**125,032**	112,354
	Construction work in progress	**6,503,606**	6,068,375
	Nuclear fuel in process and in reactor	**183,740**	170,521
		9,277,309	8,710,063
	Less — Accumulated depreciation, depletion, and amortization	**983,272**	919,452
	Total Net Utility Plant	**8,294,037**	7,790,611
Other Property and Investments	Nonutility property, principally at cost	**1,031**	995
	Investment in subsidiary companies, at equity	**354**	444
	Other investments and deposits, principally Bokum Resources Corporation	**67,378**	66,944
	Total Other Property and Investments	**68,763**	68,383
Current Assets	Cash	**19,995**	14,405
	Temporary cash investments	**190,786**	351,881
	Special deposits	**18,858**	501
	Accounts receivable (less allowance for doubtful accounts of $4,048,000 and $3,891,000)	**168,508**	171,656
	Accrued revenue on accounts billed bimonthly	**22,801**	21,216
	Materials and supplies at average cost	**42,231**	36,714
	Fuel oil at average cost	**40,094**	26,002
	Gas in storage at average cost	**45,638**	38,991
	Prepayments and other current assets	**57,668**	41,459
	Total Current Assets	**606,579**	702,825
Deferred Charges	Unamortized cost of abandoned generating projects (less allowance for loss on Jamesport abandoned generating project of $19,000,000 in both periods)	**118,484**	127,590
	Deferred storm damage costs	**44,048**	44,034
	Other (including deferred taxes of $127,061,000 and $65,799,000)	**191,776**	124,712
	Total Deferred Charges	**354,308**	296,336
	Total Assets	**$9,323,687**	$8,858,155

See Notes to Financial Statements.

Capitalization and Liabilities

At December 31 (In thousands of dollars)		1987	1986
Capitalization	Long-term debt	**$3,724,601**	$3,805,796
	Unamortized premium and (discount) on debt	**(26,646)**	(28,281)
		3,697,955	3,777,515
	Preferred stock — redemption required	**520,788**	527,465
	Preferred stock — no redemption required	**221,051**	221,053
	Treasury stock, at cost	**(40,881)**	(25,701)
	Total Preferred Stock	**700,958**	722,817
	Common stock	**555,749**	555,525
	Premium on capital stock	**1,001,179**	1,000,958
	Capital stock expense	**(56,144)**	(56,138)
	Retained earnings	**2,067,207**	1,797,319
	Total Common Shareowners' Equity	**3,567,991**	3,297,664
	Total Capitalization	**7,966,904**	7,797,996
Current Liabilities	Current maturities of long-term debt	**81,195**	24,000
	Current redemption requirements of preferred stock	**13,025**	6,347
	Accounts payable and accrued expenses	**132,101**	128,852
	Accrued taxes (including federal income tax of $3,909,000 and $10,127,000)	**26,300**	32,645
	Accrued interest	**70,604**	69,967
	Customer deposits	**16,348**	15,362
	Total Current Liabilities	**339,573**	277,173
Deferred Credits	Accumulated deferred income tax reductions	**921,397**	692,758
	Other	**83,217**	75,195
	Total Deferred Credits	**1,004,614**	767,953
Reserves for Claims, Damages, Pensions, and Benefits		**12,596**	15,033
Commitments and Contingencies		**—**	—
	Total Capitalization and Liabilities	**$9,323,687**	$8,858,155

See Notes to Financial Statements.

Statement of Changes in Financial Position

For year ended December 31 (In thousands of dollars)	1987	1986	1985
Source of Funds			
Operations			
Net income	$ 269,888	$ 316,675	$ 524,288
Principal noncash charges and (credits) to income:			
Depreciation, depletion, and amortization	73,905	70,139	66,742
Deferred and other federal income taxes	165,874	170,365	153,531
Amortization of New Haven abandoned generating project	10,853	16,280	16,975
Allowance for funds used during construction	(181,034)	(268,956)	(438,378)
Provision for net loss on Jamesport abandoned generating project	—	16,000	—
Other	20,935	21,848	12,554
Funds provided from operations:	360,421	342,351	335,712
Long-term financing			
Restructured current maturities of long-term debt	—	358,579	—
Long-term debt	—	1,225,000	503,730
Common stock	439	457	4,969
Decrease (increase) in advance payment for construction costs	—	71,377	(71,377)
Increase in other deferred credits	8,022	33,996	22,426
Decrease (increase) in working capital	158,646	(1,032,899)	538,629
Other sources	15,785	16,828	431
Total Source of Funds	$ 543,313	$1,015,689	$1,334,520
Use of Funds			
Construction and nuclear fuel expenditures	$ 581,175	$ 713,144	$ 901,242
Less — Allowance for funds used during construction (AFC)	181,034	268,956	438,378
Construction and nuclear fuel expenditures, less AFC	400,141	444,188	462,864
Reduction of long-term debt	81,195	495,975	787,334
Discount and expenses on long-term debt	601	60,630	15,104
Preferred stock conversions and retirements	21,859	18,197	10,199
Deferred storm damage costs	14	1,486	42,548
(Decrease) increase in fuel cost adjustments	2,022	(28,172)	5,914
Other uses	37,481	23,385	10,557
Total Use of Funds	$ 543,313	$1,015,689	$1,334,520
Increase (Decrease) In Working Capital			
Cash	$ 5,590	$ 2,377	$ 1,923
Temporary cash investments	(161,095)	348,581	(18,300)
Special deposits	18,357	(2,985)	(58,414)
Accounts receivable	(3,148)	(6,112)	(5,936)
Accrued revenue	1,585	(1,406)	(1,286)
Materials, supplies, gas in storage, and fuel oil	26,256	(8,918)	(10,459)
Prepayment and other current assets	16,209	3,321	23,003
Current maturities of long-term debt	(57,195)	690,903	(585,857)
Sinking fund requirement of preferred stock	(6,678)	(147)	(3,050)
Accounts payable and accrued expenses	(3,249)	22,756	25,089
Accrued taxes	6,345	(3,774)	95,948
Accrued interest	(637)	(10,349)	(38)
Customer deposits	(986)	(1,348)	(1,252)
Net Increase (Decrease) In Working Capital	$ (158,646)	$1,032,899	$ (538,629)

See Notes to Financial Statements.

Shareowners' Equity

At December 31 (In thousands of dollars)	Call Price Per Share December 31, 1987	Call Price Per Share Final	1987	1986	1985
Statement of Retained Earnings					
Balance, January 1			$ 1,797,319	$ 1,480,644	$ 956,356
Add — Net income for the year			269,888	316,675	524,288
Balance, December 31			$ 2,067,207	$ 1,797,319	$ 1,480,644
Common Stock					
Par Value $5 per Share					
Shares authorized			150,000,000	150,000,000	150,000,000
Shares issued and outstanding			111,149,818	111,104,995	111,058,899
Increase in shares outstanding			44,823	46,096	846,743
Increase in $5 par value			$ 224	$ 230	$ 4,234
Increase in Premium on capital stock			221	227	735
Increase in Capital stock expense			6	22	13
Preferred Stock					
Par Value $100 per Share, Cumulative:					
Shares authorized			7,000,000	7,000,000	7,000,000
Shares issued and outstanding			2,793,227	2,863,525	2,949,930
Shares held in treasury**			205,404	135,130	48,750
5.00% Series B	$101.00	$101.00	$ 10,000	$ 10,000	$ 10,000
4.25% Series D	102.00	102.00	7,000	7,000	7,000
4.35% Series E	102.00	102.00	20,000	20,000	20,000
4.35% Series F	102.00	102.00	5,000	5,000	5,000
5 1/8 % Series H	102.00	102.00	20,000	20,000	20,000
5¾ % Series I Convertible	100.00	100.00	4,052	4,053	4,056
8.12% Series J	101.00	101.00	25,000	25,000	25,000
8.30% Series K	103.29	103.29	30,000	30,000	30,000
7.40% Series L*	104.32	100.00	27,650	27,650	27,650
8.40% Series M*	104.76	100.00	33,600	33,600	33,600
8.50% Series R*	103.50	100.00	45,000	45,000	45,000
9.80% Series S*	105.00	100.00	72,562	72,562	72,562
Total Par Value $100			$ 299,864	$ 299,865	$ 299,868
Par Value $25 per Share, Cumulative:					
Shares authorized			30,000,000	30,000,000	30,000,000
Shares issued and outstanding			17,348,600	17,595,900	17,920,000
Shares held in treasury**			851,400	604,100	280,000
$2.47 Series O*	$ 25.75	$ 25.25	$ 40,000	$ 40,000	$ 40,000
$2.43 Series P	28.50	27.75	35,000	35,000	35,000
$3.31 Series T*	26.25	25.00	75,000	75,000	75,000
$4.25 Series U*	26.67	25.00	65,000	65,000	65,000
$3.50 Series V*	26.50	25.00	75,000	75,000	75,000
$3.52 Series W	32.00	27.50	65,000	65,000	65,000
$3.50 Series X*	29.25	25.00	100,000	100,000	100,000
Total Par Value $25			$ 455,000	$ 455,000	$ 455,000
Less — Sinking fund requirements			13,025	6,347	6,200
Less — Treasury stock at cost**			40,881	25,701	7,654
Total Preferred Stock			$ 700,958	$ 722,817	$ 741,014

See Notes to Financial Statements.
*Redemption required, see Note 2.
**Held to meet annual sinking fund requirements.

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

The Company's accounting policies conform to generally accepted accounting principles (GAAP) as they apply to a regulated enterprise. Its accounting records are maintained in accordance with the Uniform System of Accounts prescribed by the Public Service Commission of the State of New York (PSC) and the Federal Energy Regulatory Commission (FERC). Certain prior year amounts have been reclassified to be consistent with the current year's presentation.

Utility Plant

Additions to and replacements of utility plant are recorded at original cost, which includes material, labor, overhead, and an allowance for the cost of funds used during construction (AFC). The cost of renewals and betterments relating to units of property is added to utility plant. The cost of property replaced, retired, or otherwise disposed of is deducted from utility plant and, generally, together with dismantling costs less any salvage, is charged to accumulated depreciation. The cost of repairs and minor renewals is charged to maintenance expense. Mass properties (such as poles, wire, and meters) are accounted for on an average unit cost basis by year of installation.

The expected recoverable cost of any abandoned generating project is classified as construction work in progress (CWIP) until such time as an order is received from the PSC or FERC concerning its disposition.

Allowance for Funds Used During Construction

The Uniform System of Accounts defines AFC, which is not an item of current cash income, as the net cost of borrowed funds for construction purposes and a reasonable rate of return upon the utility's equity, when so used. AFC is computed monthly using a rate permitted by FERC on that portion of CWIP which is not included in the Company's rate base. For projects deemed to be associated with specific issues of debt, AFC is capitalized at a rate equal to the interest on the identifiable debt issues. It is the Company's policy not to record AFC or interest on costs upon receipt of an order from a regulator disallowing such costs for ratemaking purposes. The portion of AFC relating to borrowed funds is included in the Interest Charges and (Credits) section of the Statement of Income. The PSC requires that net of tax AFC rates be applied to the Shoreham Nuclear Generating Station (Shoreham) CWIP.

The average annual AFC rate, without giving effect to compounding or the reduced net of tax rate, was 13.53%, 13.56%, and 13.81% for the years 1987 through 1985, respectively. The average net of tax annual AFC rate, without giving effect to compounding, was 11.78%, 11.54%, and 11.61% for the years 1987 through 1985, respectively.

Depreciation

The provisions for depreciation result from the application of straight-line rates to the original cost, by groups, of depreciable properties in service. The rates are determined by age-life studies performed annually on depreciable properties. Depreciation was equivalent to approximately 3.5%, 3.4%, and 3.4% for electric and 2.7%, 2.5%, and 2.4% for gas of respective average depreciable plant costs for the years 1987 through 1985, respectively.

Revenues

Revenues are recorded when billed. Billings are rendered on a monthly or bimonthly cycle basis. The Company accrues estimated revenues for customers billed bimonthly in the month in which they are normally not billed.

Deferred Fuel Cost Adjustments

The Company's electric and gas tariffs include fuel cost adjustment clauses representing the difference between actual fuel costs and the fuel costs allowed in the Company's base tariff rates. The Company, to achieve a proper matching of costs and revenues, defers these adjustments, net of related income tax effects, to those future periods in which they will be billed or credited to customers.

Federal Income Taxes

The Company provides deferred federal income taxes with respect to certain differences between net income before income taxes and taxable income in certain instances when approved by the PSC, as disclosed in Note 5. The Company defers the benefit of 60% of pre-1982 gas and pre-1983 electric and 100% of all other investment tax credits when realized on its tax returns.

For ratemaking purposes, certain accumulated deferred federal income taxes are deducted from rate base and amortized or otherwise applied as a reduction (increase) in federal income tax expense in future years. Accumulated deferred investment tax credits are amortized ratably over the lives of the related properties.

The tax effects of other differences between income for financial statement purposes and for federal income tax purposes are accounted for as current adjustments in federal income tax provisions.

In December 1987, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 96, Accounting for Income Taxes, generally effective for fiscal years beginning after December 15, 1988. SFAS 96 will require, among other matters, (a) recognition of the amount of current and deferred taxes payable or refundable at the date of the financial statements as a result of all events that have been recognized in the financial statements, and (b) adjustment of deferred income taxes for an enacted change in tax laws. For regulated enterprises, SFAS 96 will (a) prohibit net of tax accounting and reporting and (b) require recognition of a deferred tax liability for (1) the tax benefits which are flowed through to its customers and (2) the equity component of AFC. A regulatory asset or liability should be recognized relating to such items if it is probable that the future increase or decrease in taxes payable thereon shall be recovered from or returned to customers through future rates. The Company is continuing to evaluate the provisions of SFAS 96 and its effect, if any, on the Company's financial statements

and, therefore, the accompanying financial statements do not give effect to SFAS 96.

Reserves for Claims, Damages, Pensions, and Benefits
Losses arising from claims against the Company are partially self-insured. Extraordinary storm losses are fully self-insured. Provisions credited to the reserves are based upon experience, risk of loss, actuarial estimates, and/or specific orders of the PSC.

Capitalization-Premiums, Discounts, and Expenses
Premiums or discounts and expenses related to the issuance of long-term debt are amortized over the lives of the issues. "Capital stock expense" related to that portion of Preferred Stock required to be redeemed is written-off as an adjustment to retained earnings or, if the Preferred Stock is redeemed below par value, any gain net of the related "Capital stock expense" is recorded as additional "Premium on capital stock." Through December 31, 1987, such gain was $3,637,000.

Regulatory Accounting
In accordance with present GAAP, disallowance of a portion of a plant's cost would not, in itself, require an immediate charge to income. Further, plant, financing, and other costs may be deferred in certain circumstances for recovery in the future and phased into rates over a period of time.

In December 1986, FASB issued SFAS 90, Regulated Enterprises — Accounting for Abandonments and Disallowances of Plant Costs, generally effective for fiscal years beginning after December 15, 1987. SFAS 90 requires, among other matters, that a loss be recognized when it becomes probable that (1) costs of a plant will be disallowed for ratemaking purposes or (2) the cost of an abandoned plant is in excess of the present value of the future revenues expected to be realized relative to the abandoned plant. The Company is required to adopt the provisions of SFAS 90 in 1988, and, therefore, the accompanying financial statements do not give effect to SFAS 90. However, had the provisions of SFAS 90 been adopted by the Company in 1987, the Company would have had to record a write-down of approximately $1.3 billion, net of tax effects, of its net assets, principally relating to the Shoreham disallowed costs ordered by the PSC in 1985 and the most recent estimate of Nine Mile Point 2 (NMP2) costs in excess of the amount provided in the PSC-approved NMP2 cost settlement in 1986, all of which are discussed in Note 6.

In August 1987, the FASB issued SFAS 92, Regulated Enterprises — Accounting for Phase-in Plans. The Rate Moderation Plan (RMP) ordered by the PSC on June 12, 1986, does not meet the criteria set forth in SFAS 92 which would provide for capitalization of costs which the regulator has permitted the utility to defer for future recovery. The Company intends to request that the PSC modify the RMP so as to meet the criteria established by SFAS 92 for capitalization of such costs. However, the Company can give no assurances that the required modifications will be ordered by the PSC.

Since 1984, the PSC has authorized the Company to collect additional revenues, designated as Financial Stability Adjustment (FSA) revenues, in excess of the amounts to which the Company would be entitled under conventional ratemaking. The effect of the FSA is to provide the Company with current cash and reduce the cost of construction through a decrease in non-cash AFC. The total amount of such cash, net of tax effects, was $185, $161, and $102 million during 1987, 1986, and 1985, respectively. The PSC has ordered that the FSA would be terminated in the event of bankruptcy. Additionally, effective May 1984, the PSC ordered the Company to provide for an equity earnings cap adjustment which is an accounting mechanism established to defer certain cost savings for possible distribution to its customers.

Note 2. Capital Stock

Preferred Stock Sinking Funds
Redemption of various series of Preferred Stock is effected through the operation of various sinking fund provisions. However, the Company's Certificate of Incorporation prohibits the retirement of Preferred Stock so long as dividends are in arrears; accordingly, the sinking fund requirements for 1987, 1986, and 1985 which totaled $16,888,000, $13,637,500, and $4,437,500, respectively, were not satisfied. The Company has purchased, but not yet retired, an aggregate number of shares of its Preferred Stock equivalent to the number of shares of such series scheduled to be redeemed by way of sinking funds through 1987. The aggregate amount of Preferred Stock required to be redeemed in each of the years 1988 through 1992 is $19,888,000 in 1988, and $23,888,000 each year thereafter.

Preferred Stock Dividends
Preferred Stock dividends are cumulative. Under the 1986 Restructuring Credit Agreement (1986 RCA), payment of Preferred Stock dividends accruing after December 31, 1987 is limited by a formula tied to internal cash generation. Of the maximum amount calculated according to that formula, 25% will be available for mandatory prepayments to the Company's 42 lending banks with 75% retained by the Company for dividend payments. However, mandatory bank prepayments would be required to the extent dividends are paid, limited to the lesser of (a) prepayments pursuant to the formula (which provides the maximum dividends and bank prepayments which can be paid) or (b) $.33⅓ for each $1.00 of actual dividends paid (which may be less than the formula allows). These mandatory prepayments to the banks will cease after they total $250 million in the aggregate under the formula. No preferred dividends can currently be declared pursuant to this formula except arrearages prior to January 1, 1988, which totaled $265 million at December 31, 1987, and whose payment is not limited by the aforementioned formula.

Preference Stock
None of the authorized shares of nonparticipating Preference Stock, par value $1 per share, which ranks junior to the Preferred Stock, are outstanding:

Common Stock
Of the 150,000,000 shares of authorized Common Stock at December 31, 1987, 2,000,000 shares were reserved for sale to employees, 6,802,247 shares were committed to the Automatic Dividend Reinvestment Plan, and 236,187 shares were reserved for conversion of the Series I Convertible Preferred Stock at a rate of $17.15 per share.

Common Stock Dividends
Under the 1986 RCA, the payment of Common Stock dividends, subject in any event to the Company's Certificate of Incorporation which prohibits the payment of Common Stock dividends so long as Preferred Stock dividends and sinking fund payments are in arrears, is limited by the same formula, described above, which is applicable to Preferred Stock dividends. At December 31, 1987, no Common Stock dividends could be declared pursuant to this formula. Dividend limitations contained in the mortgage securing the Company's First Mortgage Bonds are not material. The Company's General and Refunding Indenture does not restrict the payment of dividends.

Election of Board of Directors
The Company's Certificate of Incorporation states that Preferred Stockholders have the right to elect the smallest number of members of the Board of Directors so as to constitute a majority, should the Company be in arrears for a total of four quarterly dividend payments in any one series of Preferred Stock. Pursuant to this right to elect directors, the holders of Preferred Stock elected five of the Company's Directors and the holders of Common Stock elected four of the Company's Directors at the Annual Meeting of its Preferred Stock and Common Stock shareowners held on May 20, 1987. This right will continue so long as Preferred Stock dividends remain in arrears.

Note 3. Retirement Benefit Plans

The Company maintains a primary defined benefit pension plan (Primary Plan) which covers substantially all employees and a supplemental plan (Supplemental Plan) which covers key executives. All pension costs are borne by the Company. The Company's funding policy is to contribute annually to the Primary Plan, a minimum amount consistent with the requirements of the Employee Retirement Income Security Act plus such additional amounts as the Company may determine to be appropriate from time to time. Pension benefits are determined by crediting the employee with an amount determined using the base salary for each year the employee is a participant in the plan, plus an additional amount credited for each year the employee remains a participant beyond the age of 50.

The Supplemental Plan provides, without contribution from such employees, supplemental death and retirement benefits for officers and other key executives. Death benefits are currently provided by insurance. Retirement benefits totaling approximately $690,000 have been recognized as an expense in 1987 but are unfunded.

In 1987, the Company adopted SFAS No. 87, Employers' Accounting for Pensions. Pension expense and related information presented under pre-existing accounting standards for 1986 have not been restated.

The Primary Plan's funded status and amounts recognized in the balance sheet at December 31, 1987 for the Company's defined benefit plan are as follows:

	(Thousands)
Actuarial present value of benefit obligation -	
Vested benefits	$ 320,040
Nonvested benefits	11,608
Accumulated benefit obligation	$ 331,648
Plan assets at fair value	$ 379,166
Actuarial present value of projected benefit obligation	355,933
Projected benefit obligation less than plan assets	23,233
Unrecognized January 1, 1987 net obligations	15,376
Unrecognized net gain	(41,444)
Net accrued pension cost	$ (2,835)

Net periodic pension cost for 1987 included the following components:

	(Thousands)
Service cost - benefits earned during the period	$ 10,858
Interest cost on projected benefit obligation and service cost	26,759
Actual return on plan assets	(23,490)
Net amortization and deferral	(847)
Net periodic pension cost	$ 13,280

The projected benefit obligation has been determined assuming a discount rate of 8% and a 6% rate of future compensation increases. The expected long-term rate of return on assets was 7%.

As a result of adopting SFAS 87, and in connection with certain other actuarial assumption changes, 1987 pension cost was reduced by approximately $2.9 million. In addition, pursuant to an order issued by the PSC in September 1987, the Company deferred $4.6 million which represented the excess of pension expense collected from its ratepayers over that determined under SFAS 87.

The plan assets at fair value primarily include cash, cash equivalents, group annuities, bonds, and listed equity securities.

The actuarial present value of accumulated plan benefits at January 1, 1986 included $304,771,000 and $10,695,000, respectively for vested and nonvested benefits as compared with net assets available for benefits of $329,228,000. The weighted average assumed rates of return used in determining the actuarial present value of accumulated plan benefits for 1986 were 6% for the primary benefit retirement

plan and 10% for the supplemental death and retirement benefit plan. During 1986 and 1985 the costs of both plans, totaled $15,838,000, and $15,603,000, respectively. The cost of the Primary Plan was determined as the amount needed to meet the current service costs and the amount needed to amortize unfunded past service costs over a 30 year period.

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for retired employees. Substantially all of the Company's employees may become eligible for these benefits if they reach retirement age while working for the Company. These and similar benefits for active employees are provided through insurance companies whose premiums are based on the benefits paid during the year. The cost of providing these benefits was $20,638,000, $17,476,000, and $15,945,000, for 1987, 1986, and 1985, respectively. The cost of providing those benefits for 1,952, 1,899, and 1,875 retirees, is not separable from the cost of providing benefits for the 6,033, 5,866, and 5,231 active employees in 1987, 1986, and 1985, respectively.

Note 4. Debt at December 31

See Note 6 under the heading Financial Viability for a discussion of contingencies respecting the Company's continuing financial viability.

Each of the Company's three mortgages is a lien on substantially all of the Company's properties.

First Mortgage
All of the bonds issued under the First Mortgage, including those issued after June 1, 1975, and pledged with the Trustee of the General and Refunding Mortgage (G&R Mortgage) as additional security for General and Refunding Bonds (G&R Bonds), are secured by the first lien of the First Mortgage. The Pledged First Mortgage Bonds do not represent outstanding indebtedness of the Company. Amounts of such pledged bonds outstanding were $469 million at December 31, 1987 and 1986. The annual First Mortgage depreciation fund and sinking fund requirements for 1987, due not later than June 30, 1988, are estimated at $170 million and $16 million, respectively. The Company expects to meet all of these requirements with property additions.

G&R Mortgage
The second lien of the G&R Mortgage is subordinate to the lien of the First Mortgage. The annual G&R Mortgage sinking fund requirement for 1987 is estimated at $26 million.

Third Mortgage
The Third Mortgage, which is a lien on substantially all of the Company's properties, is subordinate to the liens of the First Mortgage and the G&R Mortgage and was created in 1984 to secure certain bank debt. The bank debt serviced by the Third Mortgage was restructured and combined in April 1986, and is described immediately below under the heading 1986 Restructuring Credit Agreement.

1986 Restructuring Credit Agreement (1986 RCA):
In April 1986, when the Company entered into the 1986 RCA with its lending banks whereby the Company restructured its bank debt (other than that pursuant to the 1984 RCA), including the former trust obligations outstanding under the Third Mortgage, the Company issued $525 million of G&R Bonds and, with a portion of the proceeds, permanently prepaid $400 million, on a pro-rata basis, of the $1.0 billion of debt outstanding under the Third Mortgage. The remaining $600 million of bank debt was restructured into several funding segments, each of which provides for a different interest rate. The average interest rate on the outstanding balance at December 31, 1987, was 9.33%. Mandatory payments on the remaining bank loan balances, which totaled $595 million at December 31, 1987, are to be made in sixteen quarterly installments beginning December 31, 1988, and ending September 30, 1992. The first such payment will be $37 million.

Under certain circumstances in connection with the payment of Preferred and Common Stock dividends, the Company would be required to make mandatory prepayments to reduce the bank loan balances by up to a total of $250 million as discussed in Note 2.

The following Funding Segments are outstanding:

Variable Rate Segment:
Pursuant to this segment, the Company has the option to commit to one of three interest rates including: (i) Adjusted Certificate of Deposit Rate which is a rate based on the certificate of deposit rates of certain of the lending banks, (ii) Base Rate which is generally a rate based on Citibank's prime rate, and (iii) Eurodollar Rate which is a rate based on LIBOR. At December 31, 1987, the Company had $490 million outstanding at the Base Rate which was 8.75% per annum at that date.

Eurodollar Segment:
The Company had $45 million outstanding at December 31, 1987, pursuant to the Eurodollar Rate which was 9.88% per annum at that date.

Fixed Rate Segment:
At December 31, 1987, the Company had two fixed rate notes outstanding totaling $60 million; $46 million at a fixed interest rate per annum of 14.07% until September 6, 1988, and $14 million at a fixed interest rate of 12.05% per annum until June 7, 1988. After such dates, the amounts then outstanding will be subject to the same rates as the Variable Rate Segment discussed above.

Other Long Term Debt

1984 Revolving Credit Agreement (1984 RCA):
As a result of the 1986 RCA, the amount of revolving credit available under the 1984 RCA was increased from $150 million to $200 million, subject to the amounts of accounts receivable and fuel oil inventory available as security for the loans ($145 million available at December 31, 1987). In addition, the termination date was extended from June 30, 1986, to December 31, 1988. At December 31, 1987, the

Company did not have any loans outstanding under this agreement. The loans made pursuant to the 1984 RCA are secured by a first lien on the Company's accounts receivable and substantially all of its fuel oil inventory. Such accounts receivable and fuel oil inventory are also the subject of a second lien for the benefit of the holders of the bank debt secured by the Third Mortgage. The cost of funds under the 1984 RCA includes (a) interest payable on borrowed funds at the Citibank Alternate Base Rate, 8.75% per annum at December 31, 1987, (b) a commitment fee of ½ of 1% per year on the unused funds, and (c) other miscellaneous fees and expenses. Future advances by the banks will be subject to certain terms and conditions; and the occurrence of an event of default will give the banks the right to accelerate payment of their loans and to take other remedial action.

Authority Financing Notes:
The Company issued $217 million of Authority Financing Notes (Notes) to the New York State Energy Research and Development Authority (NYSERDA). Of this amount, $150 million was issued in 1985 and $17 million was issued in 1982 to secure the Pollution Control Revenue Bonds (PCRBs) which are subject to periodic tender.

The $150 million of PCRBs issued by NYSERDA in 1985 are deemed to be tendered by the holders each March 1 thereafter and are remarketed at such tender date. The interest rate for these PCRBs is subject to redetermination at each tender date. These PCRBs were remarketed at an interest rate of 5.60% effective February 28, 1986, and were remarketed at an interest rate of 3.875% effective March 1, 1987, and are scheduled to be remarketed on March 1, 1988 at an interest rate of 5.125%. Letter of credit banks have agreed to pay the principal, interest and premium on the tendered PCRBs, in the aggregate, up to approximately $165 million in the event of default. Should the Company fail to reimburse the letter of credit banks, Niagara Mohawk is obligated under a guarantee to pay the letter of credit banks on the Company's behalf. The Company has agreed to repay Niagara Mohawk up to $165 million in consideration of Niagara Mohawk's guarantee to the letter of credit banks in connection with the Notes and certain amounts of interest and premium thereon. The Company's obligation under this guarantee is evidenced by a promissory note, under which there was no outstanding indebtedness at December 31, 1987, and is secured by an interest in the Third Mortgage in the amount of $85 million on the same basis (pari passu) as other debt secured by the Third Mortgage. The Company is not obligated to repay Niagara Mohawk prior to October 31, 1992. These letters of credit expire March 16, 1989 at which time the Company is required to obtain an extension of the letters of credit, substitute credit backup, or the PCRBs must be redeemed.

The $17 million of PCRBs issued by NYSERDA in 1982 may be tendered by the holders every three years. The next such tender will occur in October 1988. The interest rate on the 1982 PCRBs is fixed at 8¼%. The remaining $50 million of Notes were issued at varying fixed rates and are not subject to tender.

Debentures:
On November 25, 1986, the Company issued $700 million of debentures, of which $352 million was used to refinance higher interest debt, at an average offering yield of 11.99% per annum. The debentures rank on parity with all other unsecured indebtedness of the Company.

Long Term Debt at December 31 (In thousands of dollars)

	1987	1986
First Mortgage Bonds (excludes Pledged Bonds)		
4⅛% Series J Due 1988	$ 20,000	$ 20,000
5% Series L Due 1991	25,000	25,000
4.40% Series M Due 1993	40,000	40,000
4⅝% Series N Due 1994	25,000	25,000
4.55% Series O Due 1995	25,000	25,000
5¼% Series P Due 1996	40,000	40,000
5½% Series Q Due 1997	35,000	35,000
8.20% Series R Due 1999	35,000	35,000
9⅛% Series S Due 2000	25,000	25,000
7¼% Series U Due 2001	40,000	40,000
7½% Series V Due 2001	50,000	50,000
7⅝% Series W Due 2002	50,000	50,000
8⅛% Series X Due 2003	60,000	60,000
Total First Mortgage Bonds	470,000	470,000
Less Current Maturities	20,000	—
Total Less Current Maturities	450,000	470,000
General and Refunding Bonds		
17½% Series Due 1989	100,000	100,000
15.75% Series Due 1991	80,000	100,000
16.75% Series Due 1991	50,000	50,000
17% Series Due 1991	50,000	50,000
12⅝% Series Due 1992	75,000	75,000
13¼% Series Due 1995	225,000	225,000
11¼% Series Due 1996	250,000	250,000
9.75% Series Due 1999	84,000	88,000
9⅝% Series Due 2006	70,000	70,000
8⅝% Series Due 2006	50,000	50,000
8⅝% Series Due 2007	85,000	85,000
9.20% Series Due 2008	75,000	75,000
14¼% Series Due 2010	50,000	50,000
17⅛% Series Due 2012	100,000	100,000
15¼% Series Due 2012	100,000	100,000
13½% Series Due 2013	105,000	105,000
11⅞% Series Due 2015	275,000	275,000
Total General and Refunding Bonds	1,824,000	1,848,000
Less Current Maturities	24,000	24,000
Total Less Current Maturities	1,800,000	1,824,000
Third Mortgage		
1986 RCA	595,121	595,121
Less Current Maturities	37,195	—
Total Less Current Maturities	557,926	595,121
Other Long Term Debt		
Authority Financing Notes		
3⅞% to 8¼% Due 2006-2016	216,675	216,675
Debentures		
11½% to 11¾% Due 1993-2014	700,000	700,000
Total Other Long Term Debt	916,675	916,675
Less Current Maturities	—	—
Total Less Current Maturities	916,675	916,675
Total Long Term Debt Less Current Maturities	$3,724,601	$3,805,796

The aggregate of the Company's long-term debt due in the next five years is $81,195,000 (1988), $274,781,000 (1989), $175,781,000 (1990), $297,781,000 (1991), and $196,585,000 (1992).

Note 5. Federal Income Taxes

The federal income tax amounts included in the Statement of Income differ from the amounts which result from applying the statutory federal income tax rate to net income before income taxes. The reasons are as follows:

(In thousands of dollars)	1987		1986		1985	
	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income
Federal income tax, per Statement of Income — current	$ 83,577		$ 41,347		$ 514	
Included in other income and deductions—current	(80,597)		(41,347)		72	
Total Current	2,980		0		586	
Deferred and other (see Note 1)						
Accelerated tax depreciation	150,833		74,702		12,081	
Capitalized overheads	62,531		43,131		27,153	
TRA 86 benefits	27,756		0		0	
Interest capitalized	2,796		53,636		43,395	
Fuel cost adjustments	2,236		(12,959)		925	
Westinghouse settlement	(59)		(2,477)		(9,887)	
Call premiums	(538)		6,305		0	
Cancelled generating projects	(2,153)		(3,230)		17,105	
Accrued utility revenues	(13,585)		0		0	
Deferred tax credits	(67,642)		5,487		54,941	
Other items, net	3,699		5,770		7,818	
Total Deferred	165,874		170,365		153,531	
Total federal income tax expense	168,854		170,365		154,117	
Net income	269,888		316,675		524,288	
Income Before Income Taxes	$438,742		$487,040		$678,405	
Statutory federal income tax	$175,277	39.95%	$224,038	46.0%	$312,066	46.0%
Additions (reductions) in Federal income tax resulting from:						
TRA 86 benefits	27,756	6.3	0		0	
Tax credits	24,303	5.5	5,485	1.1	(1,721)	(0.3)
Interest capitalized	9,354	2.1	45,563	9.4	22,577	3.3
Excess of book depreciation over tax depreciation	6,304	1.4	7,646	1.5	5,365	0.8
Cancelled generating projects	2,466	0.6	11,618	2.4	3,698	0.6
Costs charged to plant but deducted currently	(1,384)	(0.3)	(7,039)	(1.4)	(7,204)	(1.1)
Lien date property taxes	(4,840)	(1.1)	(1,794)	(0.4)	(8,186)	(1.2)
Allowance for funds used during construction	(72,035)	(16.4)	(115,639)	(23.7)	(173,990)	(25.6)
Other items, net	1,653	0.4	487	0.1	1,512	0.2
Total Federal Income Tax Expense	$168,854	38.45%	$170,365	35.0%	$154,117	22.7%

The amount of investment tax credit (ITC) carryforward for financial statement purposes after 1987 is approximately $335 million. In 1986, the PSC directed the Company to recognize ITC for financial statement purposes when realized on its tax returns. These credits expire by the year 2002.

In accordance with the Tax Reform Act of 1986 (TRA 86), ITC allowable as credits to tax returns for years after 1987 must be reduced by 35%. The amount of the reduction will not be allowed as a credit for any other taxable year.

The Company has not provided deferred taxes on approximately $804 million of various other deductions and depreciation method differences for property placed in service prior to 1981 which, in conformity with the ratemaking practices of the PSC, have been flowed through. These various other flow-through tax deductions, which are deductible currently for tax purposes but capitalized for accounting and ratemaking purposes, include certain taxes, a portion of AFC, pensions and certain other employee benefits. See Note 1 with respect to SFAS 96 which the Company must adopt by no later than 1989.

The PSC required the Company to defer certain TRA 86 tax changes, including the lower corporate federal income tax rate, for future disposition. This resulted in recording an additional $27.8 million of income tax expense in 1987.

Note 6. Commitments and Contingencies

If some or all of the contingencies facing the Company discussed herein are resolved adversely, the impact on the Company's financial viability would be material, including the possibility of bankruptcy.

Financial Viability

The Company's continued financial viability is dependent upon various factors, including its (a) receipt of adequate and timely rate relief, including recovery in rates of its prudent investment in Shoreham, whether or not Shoreham operates, and the PSC-approved amount of its investment in NMP2, (b) continued access to capital markets, (c) ability to continue to conserve cash and (d) ability to recover its investments in Jamesport and Bokum. The Company cannot at this time predict whether it will be able to obtain any or all of such rate relief or external financing or the effects of the other factors.

The Company estimates that its operating and capital requirements in 1988 will exceed the total of the cash generated from operations during 1988 and the cash and short-term investments that were on hand at December 31, 1987. Although any shortfall in cash will be covered through the end of 1988 by the 1984 RCA, there is no present committed borrowing capacity beyond December 31, 1988, the date on which the 1984 RCA expires. In addition, the Company must obtain not later than in early 1989 extensions of the letters of credit issued in connection with $150 million of outstanding 1985 PCRBs, find satisfactory substitute credit backup, or redeem the PCRBs. The Company has begun discussions with its banks to extend the 1984 RCA and to defer, beyond 1989, commencement of the repayment, pursuant to the 1986 RCA, of $595 million now outstanding, $37 million of which is repayable in 1988 and $149 million of which is repayable in 1989. There can be no assurance at this time that an extension of the 1984 RCA will be obtained or that other financing will be available to meet the Company's obligations as they mature. The Company's financial viability will be materially adversely affected if the Company is unable to finance its operating and capital requirements.

The Company's long-term debt, including the 1984 RCA, the 1986 RCA, and its PCRBs, are discussed in Note 4.

Rates

The PSC granted the Company electric rate relief totaling $245 million annually in September 1984 and $69 million annually in January 1986. This rate relief, most of which has provided FSA revenue (see Note 1), enabled the Company to obtain additional credit and made possible its re-entry into the capital markets in 1984 and has subsequently provided a significant portion of the cash requirements for the Company's operating and capital requirements.

In 1986, the PSC adopted a RMP whereby the prudent cost of Shoreham and the Company's share of the allowed cost of NMP2 would be phased into rates over a 15 year period starting with the commencement of commercial operation. As discussed in Note 1, the RMP, as ordered by the PSC, does not meet the criteria set forth in SFAS 92 permitting the capitalization of certain costs. However, the PSC has indicated that it would be prepared to readjust the phase-in period if SFAS 92 is shown to affect the ratepayers materially. The Company intends to request the PSC to modify the RMP so as to meet the criteria established by SFAS 92, but the Company can give no assurance that the modifications will be ordered by the PSC.

In December 1987, the PSC concluded a rate proceeding, which had sought a 5% increase in electric rates, without granting the Company any additional rate relief citing, among other reasons, the continuing "deadlock" over Shoreham; and further stating that, while it was too soon to commit to specific ratemaking treatment, a harmonizing of the economic interest of the Company and the desires of its customers must be recognized if the deadlock is to be broken within the context of regulation of the Company "short of bankruptcy." Further, the PSC indicated that it would review in April 1988 the Company's entitlement to its existing rates or to an increase in rates. The PSC could increase, decrease or otherwise modify the Company's current rates. The Company believes that the rate relief it sought was appropriate and will refile in April for an increase in rates. However, it cannot predict what action the PSC will take in such proceeding. The PSC also directed the Company to submit a plan in April 1988 that addresses the energy requirements on Long Island without Shoreham.

In the December 1987 decision, for regulatory accounting and ratemaking purposes, the PSC gave effect to the amounts found imprudent for Shoreham and the disallowed amounts, discussed elsewhere, relating to the Company's investment in NMP2 and the Jamesport units. Without changing the Company's revenue levels, the PSC also reduced revenues based on conventional ratemaking principles by $113 million annually. This reduction was offset by the PSC granting the Company cash-flow revenues of $113 million annually, equivalent to the revenues it would receive if substantially all of the NMP2 costs provided for in a PSC approved settlement (the Settlement) were reflected in rates. The Company expects that the PSC will permit the Company to recover the balance of the NMP2 costs provided for in the Settlement in future rate cases.

The rates currently in effect are providing the Company with $488 million of cash-flow revenues, including the $113 million relating to NMP2. The PSC has ordered that approximately $322 million of the Company's Shoreham-related revenues and, so long as NMP2 is not in commercial operation, $113 million of the Company's NMP2-related revenues, would be terminated in the event of bankruptcy. The failure of the PSC to act favorably on the Company's most recent request for rate relief, and an adverse order by the PSC following the Company's filing in April 1988, could adversely affect the Company's financial viability, particularly its ability to access the capital markets.

In February 1988, the Company filed an application seeking to recover deferred storm damage costs and related carrying charges which totaled approximately $30 million, net of tax effects, at December 31, 1987. The Company can give no assurance as to the action which the PSC will take respecting this rate application.

Shoreham

General: Approximately $5.2 billion had been expended on Shoreham through December 31, 1987, including expenditures of $89 million for nuclear fuel for which the Company

has no other use. The Company expects that subsequent additions to the capitalized cost of Shoreham, including AFC on costs not found to be imprudent in the PSC order discussed below, will be approximately $25 to $35 million each month through the date of commercial operation. Almost all of these expenditures are for carrying charges, including financing charges, insurance, taxes, and other overhead expenses. The overhead expenses include maintenance expenses and plant personnel salaries and wages.

Shoreham has been successfully operated and tested at levels up to 5% of full power pursuant to a license issued in July 1985 by the Nuclear Regulatory Commission (NRC). Operation at levels above 5% is dependent upon further regulatory approval. Approval of the Company's offsite radiological emergency response plan and its successful exercise are the only obstacles remaining to issuance of a full power license.

The Company believes that the operation of Shoreham is in the public interest. Without Shoreham, the Company believes it will be difficult to meet the energy requirements of Long Island, and that alternatives to Shoreham which have been proposed, both by the Company and others, cannot be implemented in sufficient time to provide adequate energy in 1988 or in the next several years. The Company also believes that Shoreham will ultimately receive a license to operate at full power, unless the efforts of the Long Island Power Authority (LIPA) (discussed elsewhere) are successful, or the discussions between the State and the Company result in the non-operation of Shoreham, or the Company is unable to maintain its financial viability.

Licensing: New York State and local governments have opposed the approval of the offsite radiological emergency response plan in proceedings before the NRC and the courts. Nonetheless, in April 1985, an Atomic Safety and Licensing Board (ASLB) found that offsite emergency response planning is feasible for Shoreham and that the Company has established an organization that can effectively execute its responsibilities under the offsite emergency plan. In addition, the NRC, in a decision issued in 1986 in the Shoreham case and through the adoption of a rule in 1987, has determined that in evaluating a utility-only plan, the NRC will assume that state and local government officials will exercise their best efforts to protect the public in an actual emergency. The NRC will also assume that during an actual emergency state and local officials will generally follow the utility plan, although this presumption is rebuttable. The State and County, among others, have challenged the NRC rule in federal court.

In other litigation affecting Shoreham, the New York Court of Appeals, in a 7-0 decision, reversing two lower court decisions, directed that a complaint brought by the Governor of the State and others against the Company should be dismissed because it sought an advisory opinion. The lower courts had held that certain of the activities proposed by the Company to be performed by Company employees and others as part of the offsite emergency response plan were activities that only governmental entities may perform and therefore their performance as proposed by the Company violated state law. Although opposition to this plan is ongoing and the outcome and duration of any related litigation cannot be predicted, the Company is continuing its efforts to license Shoreham. These efforts include participation in an exercise of the Company's emergency response plan which the Company has requested the Federal Emergency Management Agency (FEMA) to schedule as soon as possible in the spring of 1988. The results of an earlier exercise, held in February 1986, were litigated before an ASLB which rendered its decision in two parts issued in December 1987 and February 1988. The December decision held that the scope of the exercise, which had been reviewed and approved by the staff of the NRC and the staff of FEMA prior to the exercise, was too narrow. The February decision, which reviewed the Company's performance, cited three areas — communications, mobilization and training — as involving shortcomings which prevented it from making a determination, required by the NRC's regulations, of reasonable assurance that appropriate measures can be taken to protect the health and safety of the public. The Company is appealing both ASLB decisions but cannot predict the outcome of these appeals.

In the exercise which the Company has requested FEMA to schedule in the spring of 1988, the Company intends to demonstrate that the defects found have been remedied. Furthermore, because of the opposition to licensing Shoreham and unanticipated delays during power ascension if a full power license is issued, the prospect exists for further delays for Shoreham, for further increases in its costs, and for further uncertainties respecting the recoverability of those costs. Accordingly, the Company cannot give any assurances that the operating license will be granted or when.

LIPA and New York State: The Company may be forced to abandon Shoreham as a result of the efforts of the State of New York and of local governments, not only through their opposition in the licensing proceedings before the NRC, but also by other means, principally through LIPA, created by statute in 1986.

LIPA is authorized first to negotiate a purchase of the Company's securities or assets and, failing to arrive at such a negotiated purchase, is then authorized to commence a tender offer for the Company's securities or a condemnation proceeding for the securities or assets of the Company. In order to complete the acquisition of either the securities or assets of the Company, LIPA must comply with certain conditions set forth in the LIPA statute. The Company believes that the LIPA statute contains constitutional and other legal defects and has commenced litigation in federal and state courts challenging the legality of the LIPA statute. The Company has appealed to the U.S. Court of Appeals, Second Circuit, a decision in U.S. District Court which failed to find the LIPA statute unconstitutional. The Company cannot predict the outcome of this appeal or of related litigation in the state courts.

In December 1987, two shareowners of the Company initiated class action litigation in Supreme Court, Nassau County, alleging that the actions by the Company and certain of the Company's directors, in opposing the takeover of the Company by LIPA, have tortiously interfered with the shareowners' ability to sell their shares to LIPA and are depriving them of the best price obtainable for the Company's shares. The Company cannot predict the outcome of this litigation or the impact, if any, that its ultimate resolution will have on the financial viability of the Company.

Representatives of the State and the Company have met on a number of occasions to discuss, among other matters, energy alternatives for Long Island, the cost of electricity for its residents, the Company's financial health including the ability to finance its capital programs, the future of Shoreham, and changes in corporate structure such as the formation of a holding company with the possibility of both regulated and unregulated subsidiaries. The Company is continuing to seek a license for Shoreham as it pursues other alternatives to resolve the energy needs of Long Island. In this connection, the Company recently advised the State's representatives that the Company remains ready and willing to continue with negotiations. In a separate letter, the Company invited LIPA to present its best offer for the purchase of the Company. In the discussions with the State, the State has been insisting that Shoreham must not be permitted to operate. The PSC recently denied the Company an increase in its rates, indicating that rate relief previously given has not encouraged the Company to consider alternatives to Shoreham.

Prudence: In December 1985, the PSC issued an order finding that the Company had imprudently managed the construction of Shoreham. The PSC concluded that approximately $1.4 billion of Shoreham expenditures were incurred as a result of the Company's imprudence and could not be recovered in rates. Pursuant to this PSC order, the Company, as of March 1, 1986, ceased to accrue AFC on Shoreham expenditures disallowed by the PSC. The Company will continue to accrue AFC on the costs not found to be imprudent until, following authorization from the NRC, levels of operation of Shoreham have ascended substantially above 5% for a period sufficient to indicate that Shoreham will be a reliable source of base power. At that time, the Company may declare Shoreham to be in commercial operation (an event which may occur prior to operation at full power) and will cease to accrue AFC.

The Company expects to recover a carrying charge on any prudent costs not included in rate base until, over a period of years in future rate cases, all of such costs have been included in the rate base. The Company also expects, when Shoreham becomes operational, that it will be permitted to continue to receive in rates, through the partial inclusion in rate base of Shoreham's prudent costs, an amount equivalent to at least the amounts now generated by Shoreham CWIP in rates and the FSA. Such Shoreham-related revenues currently provide approximately $375 million annually. Because of the substantial uncertainties relating to Shoreham, the Company is unable at this time to determine when Shoreham will go into commercial operation, if ever, or, if Shoreham does not go into commercial operation, what rate treatment, if any, will be accorded the Company's investment. The Company believes that it is entitled to recover its prudent investment in Shoreham even if Shoreham does not operate.

In December 1987, the Appellate Division, Third Department, of the New York Supreme Court, affirmed approximately $640 million of the PSC's determination that $1.4 billion of Shoreham's expenditures had been imprudently incurred. With respect to the remaining $759 million, the court remanded the matter to the PSC in order that it might further consider and explain the basis upon which it determined that delay costs for the period from August 1, 1982 to March 1, 1986, totaling $1.518 billion, were to be shared equally between shareowners and ratepayers. Upon remand, the Company will seek to reduce the amount of costs determined to be imprudent while intervenors might seek to have such amount increased. The Company is unable to predict the outcome of the remanded proceeding before the PSC or the outcome of further judicial appeals, if any, that might be taken from the court's decision. The appellate decision is also subject to further appeal by the Company or by intervenors. The Company is considering taking such an appeal. There has been no determination of prudence respecting the costs of Shoreham subsequent to March 1, 1986. The Company believes all of such costs have been prudently incurred. The Company cannot predict whether the PSC will conduct further proceedings relating to prudence or, if held, whether such proceedings would result in further disallowances.

No write-down is required for the Company's investment in Shoreham under present GAAP based on the current cost estimates of Shoreham, the amount of Shoreham's disallowed cost determined by the PSC, and the RMP approved by the PSC. However, in 1988, pursuant to SFAS 90, as discussed in Note 1 under the heading "Regulatory Accounting," the Company is required to adopt in its financial statements the PSC's determination of imprudence respecting Shoreham with a write-down of the Company's net assets, amounting to approximately $1.1 billion, net of tax effects. Neither this write-down, nor the write-down with respect to the costs of NMP2 in excess of amounts provided in the NMP2 Settlement, separately or in the aggregate, are likely to prevent the Company from accessing capital markets. However, if the Company is not permitted by the NRC to operate Shoreham and if the Company is unable to recover its prudent costs of Shoreham, the total write-off of these costs would exceed the Company's net worth and could materially affect the financial viability of the Company.

Used and Useful: The New York Court of Appeals has determined that under New York law the PSC may lawfully allow a utility to recover prudent expenditures relating to a generating station project that has not begun commercial operation or has been cancelled prior to operation. A statute (the Used and Useful Act) adopted by New York State, which would have prevented rate recovery of any costs when a nuclear generating station owned by a single utility fails to commence commercial operation by January 1989 or, having commenced commercial operation after July 1986, failed to continue commercial operation at any time thereafter, has been declared unconstitutional by a United States District Court. This decision has been appealed. If the Used and Useful Act is ultimately held to be valid, and Shoreham also fails to operate within the time provided by the statute, the Company believes that it will probably not be able to continue to receive Shoreham-related revenues, which currently provide approximately $375 million annually, and that alternative rate relief to meet Shoreham-related financial obligations would be precluded. The Company believes that the loss of these Shoreham-related revenues would materially affect its financial viability.

Litigation: Separate class action and derivative lawsuits initiated in 1984 by holders of the Company's Common Stock and holders of certain classes of the Company's Preferred Stock, alleging violations of the Securities Act of 1933 and the Securities Exchange Act of 1934, have been consolidated into a single proceeding in the U.S. District Court for the Eastern

District of New York. In general, the plaintiffs allege that over a period of years one or more of the defendants, either individually or in concert, failed to make adequate disclosures or made false and misleading statements respecting, among other issues, the cost of Shoreham, the management of its construction, AFC, and the recoverability through rates of its investment in Shoreham. The Company, certain of its present and former officers and directors, its former independent accountants, and certain of the underwriters of certain of the Company's securities are named as defendants in the consolidated lawsuit. The plaintiffs seek damages to be proved at trial which is expected to begin April 1, 1988. The Company, which is contesting the litigation, is currently unable to measure the effect, if any, that the ultimate resolution of such litigation will have on its financial condition and results of operations.

In addition to the appeal, discussed above, of the PSC's determination of imprudence, the Company is seeking to ameliorate that decision through litigation initiated against Transamerica Delaval, Inc., now IMO Delaval, Inc. (IMO), in the U.S. District Court for the Southern District of New York for damages resulting from the failure of three diesel generators purchased by the Company as sources of on-site standby generating capacity for Shoreham, to be utilized in the unlikely event that all offsite power sources failed at a time when it was necessary to shut Shoreham down. The Company discovered cracks in the crankshafts of the IMO diesel generators during testing in August 1983 and subsequently identified other defects. Funded substantially by the Company, the IMO diesel generators were completely rebuilt. Subsequently, the generators were accepted by the NRC. The Company cannot predict what recovery, if any, will result from this lawsuit.

The Company is also seeking damages against General Electric (GE) alleging violations of the Federal Racketeer Influenced and Corrupt Organizations Act, as well as common law fraud, in misrepresenting and concealing certain information relating to a pressure suppression containment system for Shoreham intended to prevent the escape of radioactive steam into the atmosphere in the event of a certain type of nuclear reactor accident. The problems identified with the containment system were subsequently corrected by the Company and, as corrected, the containment system has been approved by the NRC. In its lawsuit against GE, initiated in the U.S. District Court for the Northern District of California, the Company alleges, among other causes of action, breaches of contract, warranties, duties of reasonable care and professional engineering standards. The Company cannot predict what recovery, if any, will result from this lawsuit.

Other: The costs of Shoreham include real property taxes capitalized during construction. The Company is seeking a judicial review of the assessments upon which those taxes were based in certain years. In 1984 and 1985, the Company withheld payment of the taxes, because it believed that, if the Company were to be successful in the pending tax litigation reflecting the claimed overassessments, it would be unable to enforce a judgment directing a refund of the taxes already paid. Subsequently, the Company paid the taxes. During the period of non-payment, charges for non-payment were assessed by Suffolk County against the Company and included by the Company in capitalized plant costs. FERC, as part of an audit by its staff of the Company's books and records for the period from January 1, 1979, through December 31, 1984, has directed the Company to take corrective action by charging to expense those Shoreham costs which were incurred as a result of withholding the taxes. The amount of such costs recorded on the Company's books and records at December 31, 1987 was $13 million. The Company requested FERC to conduct an administrative proceeding to review the directed accounting treatment. An Administrative Law Judge (ALJ) has rendered a decision on this issue which upholds FERC staff's position. However, a final disposition of the controversy will be made by FERC itself, which may accept, reject or modify the ALJ's decision. The Company cannot predict the outcome of this issue before FERC. In the event of an adverse decision by FERC, the Company will determine whether to pursue an appeal to the federal courts.

Nine Mile Point 2

As of December 31, 1987, approximately $1.04 billion, net of tax effects, including expenditures of $27 million for nuclear fuel for which the Company has no other use, had been expended on the Company's 18% undivided interest in NMP2, a nuclear power plant near Oswego, New York. The cotenants of NMP2, in addition to the Company, are Niagara Mohawk Power Corporation, New York State Electric & Gas Corporation (NYSEG), Rochester Gas and Electric Corporation, and Central Hudson Gas & Electric Corporation.

The PSC approved the NMP2 Settlement, tendered by the Company, the four other cotenants of NMP2 and the staff of the PSC, of an investigation of the prudence of the costs incurred in the construction of NMP2 which limits to $4.16 billion the amount of NMP2 expenditures which may be included in the rate bases of the cotenants. The Company's share of this maximum amount of NMP2 expenditures is $725 million. In addition, in order to induce settlement among the cotenants, Niagara Mohawk entered into an agreement with the other cotenants to pay to the cotenants, upon commercial operation of NMP2, an allocable share of the $290 million incremental disallowance between $4.45 billion, the original proposed allowed cost of NMP2, and $4.16 billion, the allowed cost of NMP2 as set forth in the Settlement. The Company's share of this payment would be $52.2 million and will not be increased as a result of any further delay in the commercial operation date of NMP2. The order of the PSC approving the Settlement has been appealed in the courts. The Company is unable to predict its outcome.

The NRC has issued a full power operating license for NMP2 pursuant to which the plant is now in power ascension. Although there can be no assurance as to when commercial operation will be achieved, the Company estimates that NMP2 will not commence commercial operation until the spring of 1988 at the earliest. Pursuant to the terms of the Settlement, none of the Company's share of the costs of NMP2 in excess of $725 million will be recoverable from ratepayers. Based upon an assumed commercial operation date in April 1988, and the Company's most recent estimate of the cost of NMP2, no write-down of the disallowed costs of NMP2 would be required under present GAAP. However, under SFAS 90, and based upon the same assumptions, the Company is required to write-down in 1988 approximately $200 million of the Company's share of the costs of NMP2, net of tax effects. Furthermore, the costs of each month of delay beyond April 1,

1988, none of which will be recoverable, are estimated at approximately $4 to $5 million, excluding interest costs on both the allowed and disallowed costs of NMP2. Because the Company does not know when NMP2 will begin commercial operation nor what the total cost of NMP2 will be, the Company is unable at this time to predict the amount of the Company's share of disallowed costs in excess of the $725 million recoverable from ratepayers.

In April 1987, the Company and the four other cotenants of NMP2 filed a lawsuit for more than $500 million in damages in Onondaga County Supreme Court against Gulf + Western, Inc., Wickes Manufacturing Company, Inc., and Crosby Valve & Gage Company resulting from design flaws in the plant's main steam isolation valves causing months of delay in attaining commercial operation of NMP2. The Company cannot predict what recovery, if any, will result from this lawsuit.

Investments

Jamesport: In the 1970's, the Company and NYSEG had sought regulatory approval for the construction of two nuclear generating units at Jamesport, New York. The Company and NYSEG each subsequently abandoned the plans to construct the Jamesport units. The Company's share of the Jamesport costs, net of estimated tax effects and a provision for loss, was approximately $101 million at December 31, 1987. Although the Company believes that virtually all of its costs, including AFC, were prudent and therefore recoverable in rates, it agreed in a settlement reached in 1987 with the staff of the PSC (but opposed by the New York Consumer Protection Board and others) to accept recovery of $77.5 million and certain future favorable ratemaking treatment covering the Jamesport property. Although the ALJ reviewing the settlement recommended that it be rejected by the PSC so that evidentiary hearings could be concluded, the PSC, on February 24, 1988, indicated that it would approve the settlement. The decision of the PSC is subject to judicial review. The Company recorded in 1986 a provision for loss, relating to Jamesport, of $16 million, after estimated tax effects of $3 million, based on the terms of the settlement and present GAAP. See also Note 1 for a discussion of SFAS 90.

Bokum: Beginning in 1976, the Company began making investments in Bokum Resources Corporation (BRC) which at December 31, 1987 totaled approximately $135 million. This amount includes $20 million of advance payments made for uranium concentrates and $49 million for financing costs on those advance payments. Both amounts are included in the Balance Sheet under "Nuclear fuel in process and in reactor." The remaining $66 million of the investment consists of $60 million of loans to BRC, including financing costs, for the completion of a uranium mine and ore-processing mill in New Mexico and $6 million expended since mid-1980 for preservation and maintenance of BRC's mine and mill. These amounts are included in the Balance Sheet under "Other investments and deposits, principally Bokum Resources Corporation." BRC is presently in reorganization under Chapter 11 of the Federal Bankruptcy Code. The Company ceased accruing interest on its loans to BRC after the filing of the bankruptcy petition. However, the Company is continuing to capitalize its financing costs on the advance payments for the uranium concentrates.

As part of the FERC staff audit discussed above under the heading "Shoreham" in connection with a capitalized real property tax penalty, FERC has advised the Company that the capitalization of carrying charges on the advance payments for uranium, subsequent to the declaration of BRC's bankruptcy in June 1981 is improper because its staff believes that performance by BRC under the terms of the contract had become doubtful. Accordingly, FERC has directed the Company to expense those carrying charges. The amount of such carrying charges recorded on the Company's books and records was $34 million at December 31, 1987. An administrative hearing to review the directed accounting treatment, ordered by FERC at the request of the Company, was held in 1987. An ALJ has rendered a decision on this issue which upholds FERC staff's position. However, a final disposition of the controversy will be made by FERC itself, which may accept, reject or modify the ALJ's decision. The Company cannot predict the outcome of this issue before FERC. In the event of an adverse decision by FERC, the Company will determine whether to pursue an appeal to the federal courts.

Virtually all litigation between the Company and BRC in the U.S. Bankruptcy Court for the District of New Mexico has been concluded. An appeal is pending with respect to previously litigated matters. The only pending adversary proceeding between BRC and the Company in the Bankruptcy Court is a mortgage foreclosure by the Company against BRC. In December 1987, the U.S. District Court for the District of New Mexico affirmed a determination of the Bankruptcy Court which granted the Company's motion for summary judgment respecting a BRC counterclaim in the mortgage foreclosure action and the time for appeal of this decision has expired. A jury trial of the breach of contract suit by BRC against the Company ended on February 11, 1988 with directed verdicts in favor of the Company on all issues raised in BRC's complaint. The Company's counterclaims in the breach of contract litigation, interest on advance payments on the 1976 and 1978 contracts and continuing validity of those contracts are being submitted to the District Court for decision.

Based upon an analysis by consultants retained to assess the uranium market and the value of the mine and mill, the Company has concluded that the BRC project is no longer economically viable. The analysis also concludes that the BRC properties have a current value substantially below the amount of the Company's investment. Consequently, the Company has asked BRC to dispose of the BRC properties. Any such transaction would require the approval of the Bankruptcy Court.

The Company is planning to petition the PSC to recover its expenditures for BRC. The Company believes that its past expenditures for BRC have been prudently incurred and that it should be permitted to recover from its ratepayers such amounts, including related AFC. The Company believes that the PSC would reduce the prudently determined expenditures by amounts recovered from the Westinghouse Corporation in settlement of a lawsuit arising from a breach, in the late 1970s, of a contract providing for the delivery of uranium and amounts, if any, which the Company might receive as a distribution in the bankruptcy proceeding, including amounts, if any, received on the sale of the BRC properties. The Company cannot predict what action the PSC will take respecting the prudence of BRC expenditures and their recovery in rates.

Due to the many contingencies upon which the outcome of the BRC transactions, the related litigation, and the ratemaking treatment are dependent, the Company cannot accurately measure either the probability of its realizing a loss on the transactions involving BRC, or the amount of that loss if it should occur. While under the most adverse circumstances the loss could be material, the Company believes that the loss, if any, by itself will not have a material adverse effect on the financial condition and results of operations of the Company.

Litigation

Currently there are four actions pending in federal court, two actions in state court which seek in the aggregate approximately $59 million in damages, and several actions before administrative agencies, including the Federal Equal Employment Opportunity Commission and the New York State Division of Human Rights, alleging employment discrimination. The Company believes it has meritorious defenses to these matters, but cannot at this time predict their ultimate outcome.

The Company has been named as a third-party defendant in each of two environmental lawsuits which, in general, allege that the Company, along with others, disposed of chemical and industrial wastes and by-products, including hazardous wastes and substances, at the sites named in the complaints. In addition, the Company has been named along with several other utilities by the U.S. Environmental Protection Agency as a potentially responsible party for PCBs at a third site. The Company has initiated an investigation into the claims made by the EPA, but cannot, at this time, assess its ultimate outcome. The Company believes that it has meritorious defenses to these matters, but cannot at this time predict their ultimate outcome.

In 1987, a total of thirty-two lawsuits were brought against the Company in New York Supreme Court alleging death and bodily injuries to 607 individuals since 1940 as a result of exposure to asbestos in buildings. Each of the lawsuits named multiple defendants including one lawsuit in which 142 defendants were named. The damages sought in these suits amount to $6.5 billion plus an additional unspecified amount of punitive damages. The Company is presently unable to assess the validity of the complaints or measure the impact, if any, that the ultimate resolution of this litigation may have on its financial condition and results of operations.

In March 1987, Suffolk County and six of the Company's ratepayers initiated litigation against the Company in the U. S. District Court for the Eastern District of New York on behalf of substantially all of the Company's ratepayers. Certain former officers of the Company are also named as defendants. In general, the plaintiffs allege in the complaint that from approximately 1974 to the present the Company fraudulently failed to make adequate disclosures or alternatively made false and misleading statements with respect to Shoreham and Jamesport in connection with its rate applications before the PSC. The plaintiffs seek damages in an amount of not less than $2.9 billion and, alleging that the Company's activities and statements constitute violations of the Federal Racketeer Influenced and Corrupt Organizations Act, seek treble damages, or a total of not less than $8.7 billion. The court has ordered that the trial begin in September 1988. The Company believes the suit is without merit, but is unable to predict its outcome. The outcome, if adverse, could have a material effect on the financial condition and results of operations of the Company.

Other

Commitments: The Company has entered into substantial commitments for fossil fuel and gas supply. The costs of fuel and gas supply are normally recovered from ratepayers through provisions in the Company's rate schedules. The Company has also entered into a contract with the New York Power Authority (NYPA) pursuant to which the Company has obligated itself to pay NYPA for the construction and operation of a new interconnection between Westchester and Nassau Counties. The Company will seek to recover the costs of the interconnection from its ratepayers.

Nuclear Plant Insurance: The maximum amount of property damage insurance coverage currently available at Shoreham is approximately $1.4 billion. The insurable value of Shoreham at December 31, 1987, was approximately $2.2 billion. The maximum amount of property damage insurance currently available at Nine Mile Point, where there are two units, is also approximately $1.4 billion for each unit under certain circumstances. The insurable value of NMP2 at December 31, 1987, was $3.4 billion, of which the Company's share was $606 million. The Company has no interest in NMP1, which is owned and operated solely by Niagara Mohawk.

The NRC requires a minimum of approximately $1.1 billion of property damage coverage to be in effect at each nuclear generating site. For Shoreham, however, the Company has requested a waiver from the NRC permitting the Company to defer the effective date of, and the related premium for, $440 million of coverage so long as Shoreham does not operate above 5% of full power. Of the balance of the required coverage, the Company has purchased $620 million. Certain of these insurance programs provide for retroactive premium adjustments pursuant to which the Company would be liable for maximum assessments of approximately $36 million in any one policy year, in the event of a loss to any other insured utility company. This assessment would only be required if existing premiums and loss reserves were exhausted. For NMP2, the cotenants have approximately $1.4 billion of property damage coverage in effect but, under certain circumstances, only a portion of that amount would be available. The Company's share of the annual premium for the retroactive premium adjustment is currently approximately $1 million.

Third-party bodily injury and property damage coverage arising out of a nuclear occurrence at either Shoreham or NMP2 of up to $720 million at each unit is available. Pursuant to agreements established under the provisions of the Price Anderson Act, the Company may be assessed up to $6 million per nuclear incident, but not in excess of $12 million per year. The Price Anderson Act expired in August 1987 but the agreements covering existing licensees, including the Company, are not affected by its expiration. The Company cannot predict what action Congress will take with respect to its extension although amendments considered by Congress in 1987 would have increased the statutory limitations substantially. Unless the Act is extended with these or other modifications, the Company's liability for third-party bodily injury and property damage would be unlimited.

Note 7. Segments of Business

The Company is a public utility operating company engaged in the generation, distribution, and sale of electric energy and the purchase, distribution, and sale of natural gas.

	1987			1986			1985		
(In millions of dollars)	Electric	Gas	Total Company	Electric	Gas	Total Company	Electric	Gas	Total Company
Operating Information (Year ended December 31):									
Revenues	$1,719	$353	$2,072	$1,612	$365	$1,977	$1,679	$371	$2,050
Expenses (excluding income tax)	1,101	301	1,402	1,017	320	1,337	1,114	309	1,423
Operating income (before income tax)	$ 618	$ 52	$ 670	$ 595	$ 45	$ 640	$ 565	$ 62	$ 627
Allowance for other funds used during construction and other			(143)			(146)			(261)
Provision for net loss on Jamesport abandoned generating project			—			16			—
Interest charges, net			374			283			210
Income taxes—operating			288			253			239
Income taxes—nonoperating (credit)			(119)			(83)			(85)
Net income per accompanying Statement of Income			$ 270			$ 317			$ 524
Other Information (Year ended December 31):									
Depreciation, depletion and amortization	$ 64	$ 10	$ 74	$ 61	$ 9	$ 70	$ 59	$ 8	$ 67
Construction and nuclear fuel expenditures	547	34	581	681	32	713	883	18	901
Investment Information (At December 31):									
Assets (a)	$8,128	$370	$8,498	$7,633	$343	$7,976	$7,096	$334	$7,430
Nonutility plant			1			1			2
Other investments (b)	67	1	68	66	1	67	65	1	66
Assets utilized for overall Company operations			757			814			465
Total Assets			$9,324			$8,858			$7,963

(a) Includes net utility plant and deferred charges (excluding common), materials and supplies, accrued revenues, gas in storage and fuel.
(b) Principally consisting of the Company's investment in Bokum Resources Corporation.

Note 8. Quarterly Financial Information *(Unaudited)*

(In millions of dollars except Earned per Common Share)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1987				
Operating revenues	$569	$452	$578	$473
Operating income	116	72	124	71
Net income	70	39	108	53
Income for common stock	50	19	88	35
Earned per common share	.45	.17	.79	.32
1986				
Operating revenues	$592	$451	$491	$443
Operating income	113	105	132	37
Net income	129	75	115	(2) (a)
Income for common stock	108	54	95	(20) (a)
Earned per common share	.97	.49	.86	(.19) (a)

(a) During the fourth quarter of 1986, the Company determined that it would have a net operating loss for federal income tax purposes and, accordingly, the utilization of the investment tax credits recorded during the first three quarters of 1986 were reversed, reducing fourth quarter net income by approximately $23 million or $.21 per share. Also during the fourth quarter of 1986, as a result of the settlement agreement between the Company and the Staff of the PSC as discussed in Note 6, the Company recorded a provision for loss relating to Jamesport of $16 million after tax effects or $.14 per share.

Report of Independent Accountants

To the Shareowners and
Board of Directors of
Long Island Lighting Company

We have examined the balance sheet of Long Island Lighting Company as of December 31, 1987 and 1986, and the related statements of income, shareowners' equity and changes in financial position for each of the three years in the period ended December 31, 1987 appearing on pages 9 to 26. 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 December 1986, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 90 ("SFAS 90"), Regulated Enterprises — Accounting for Abandonments and Disallowances of Plant Costs, generally effective for fiscal years beginning no later than after December 15, 1987. The Company will adopt SFAS 90 in 1988. As more fully described in Note 1 of the Notes to Financial Statements, had the provisions of SFAS 90 been adopted by the Company in 1987, the Company would have had to record a writedown of its net assets of approximately $1.3 billion, net of tax effects.

As more fully discussed in Note 6 of the Notes to Financial Statements, if some or all of the following uncertainties are resolved adversely, the impact on the Company's financial viability would be material, including the possibility of bankruptcy:

(a) The Company estimates that its 1988 operating and capital requirements, including the repayment of approximately $81 million of current maturities of long term debt, will exceed its 1988 cash receipts from operations and cash and short term investments on hand at December 31, 1987. Further, the Company's 1984 Revolving Credit Agreement ("1984 RCA"), under which no amounts were outstanding at December 31, 1987, expires on December 31, 1988 and will not be available after that date as a means of financing the Company's operating and capital requirements. Providing the funds to meet the Company's operating and capital requirements beyond December 31, 1988 is dependent upon various factors, including (a) the Company's ability to continue to conserve cash, (b) receipt of adequate and timely rate relief, including recovery in rates of its prudent investment in the Shoreham Nuclear Power Station ("Shoreham"), whether or not Shoreham operates, and the Public Service Commission of the State of New York ("PSC") approved amount of its investment in the Nine Mile Point 2 nuclear power plant, and (c) continued access to the capital markets. The Company has commenced discussions with its banks to extend the maturity of the 1984 RCA and restructure the 1986 Restructuring Credit Agreement. However, there can be no assurance at this time that an extension of the 1984 RCA will be granted or that other financing will be available to meet the Company's obligations as they mature. The Company's financial viability will be materially adversely affected if the Company is unable to finance its operating and capital requirements. The accompanying financial statements do not include any adjustments relating to the recoverability of recorded asset amounts or to the amounts and classification of liabilities that might be necessary in the event that the Company is unable to finance its operating and capital requirements.

(b) At December 31, 1987, the Company's investment in Shoreham approximated $5.2 billion, including $89 million for nuclear fuel for which the Company has no other use, and the Company will expend additional amounts through the date of its commercial operation. There is substantial opposition to the licensing of Shoreham from New York State, local governments and others and, accordingly, the Company is unable to predict when, if ever, Shoreham will obtain its license to operate from the Nuclear Regulatory Commission. Further, there are uncertainties with respect to the effect of Shoreham, if any, on the Company's ability to obtain adequate rate relief and with respect to the ultimate rate treatment of Shoreham costs, including among other matters the effect, if any, of the final disposition of the order of the PSC disallowing approximately $1.4 billion of Shoreham costs from rate recovery and the New York State Used and Useful Act respecting rate recovery for a generating station owned by a single utility that never operates. As a result of the foregoing, the Company is unable to determine the recoverability of its Shoreham investment and the impact thereof upon the Company and its financial statements.

(c) At December 31, 1987, the Company's investment (an 18% undivided interest) in Nine Mile Point 2 is approximately $1.04 billion, including $27 million for nuclear fuel for which the Company has no other use. The Company is unable to determine its share of disallowed Nine Mile Point 2 costs and what impact, if any, the appeal of the PSC's approval of the Nine Mile Point 2 settlement will have on the recoverability of the Company's investment.

(d) At December 31, 1987, the Company has made advances and loans, including financing costs, of approximately $135 million to Bokum Resources Corporation ("BRC") and litigation exists between the Company and BRC. In addition, the Company has incurred costs of approximately $101 million through December 31, 1987 for its share of the abandoned nuclear project at Jamesport, New York net of the 1986 provision for loss of approximately $16 million. The Company is presently unable to determine the amount of additional loss, if any, that will result from the foregoing matters.

(e) The Company is presently unable to predict the outcome of the (i) 1987 class action and 1984 consolidated class action and shareholders' derivative action lawsuits, (ii) actions in federal court, state court and before administrative agencies alleging employment discrimination, (iii) environmental claims against the Company, (iv) asbestos related lawsuits, and (v) litigation initiated against the Company in 1987 by Suffolk County and six of the Company's ratepayers seeking total damages of not less than $8.7 billion, and the impact, if any, that the ultimate resolution of such litigation will have upon the Company and its financial statements.

In our opinion, subject to the effects on the financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainties referred to in items (a) through (e) of the preceding paragraph been known, the financial statements referred to above present fairly the financial position of Long Island Lighting Company at December 31, 1987 and 1986, and the results of its operations and the changes in its financial position for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

ERNST & WHINNEY

Melville, New York
February 24, 1988

Selected Financial Data †

	1987	1986	1985	1984	1983
Summary of Operations**					**Table 1**
Total revenues ($000)	$2,072,077	$1,977,121	$2,050,340	$1,955,230	$1,787,851
Total operating income ($000)					
Before federal income taxes	$ 670,324	$ 640,021	$ 627,307	$ 510,993	$ 366,078
After federal income taxes	$ 382,604	$ 387,077	$ 388,140	$ 308,421	$ 268,989
Income for Common Stock ($000)	$ 192,312	$ 236,864	$ 440,563	$ 340,264	$ 287,163
Average common shares outstanding (000)	111,129	111,085	110,842	110,120	102,484
Earned per common share	$ 1.73	$ 2.13	$ 3.97	$ 3.09	$ 2.80
Dividends paid per share	$ —	$ —	$ —	$ 0.505	$ 2.02
Book value per share at year end	$ 29.71*	$ 27.99*	$ 25.88*	$ 22.05*	$ 19.29
Common shareowners at year end	106,117	117,962	143,627	163,354	180,291
Ratio of earnings to fixed charges	2.02	2.17	2.75	2.49	2.46
Ratio of earnings to fixed charges and preferred dividends	1.56	1.68	2.15	1.91	1.88
Ratio of earnings to fixed charges excluding AFC	1.60	1.53	1.62	1.40	1.28

* After deducting Preferred Stock dividends in arrears.

** See Table 10 of Selected Financial Data for Assets and Capitalization. See also Note 6 to Notes to Financial Statements.

Electric Operating Income *(In thousands of dollars)*					**Table 2**
Revenues					
Residential	$ 800,952	$ 744,898	$ 772,861	$ 752,123	$ 674,190
Commercial and industrial	849,626	804,387	844,636	796,543	694,038
Street and highway lighting	16,840	16,517	18,675	19,004	17,320
Other public authorities	21,251	20,447	25,755	23,986	21,138
Other utilities	68	103	55	408	1,066
Other	18,235	14,380	4,306	(2,446)	3,276
System revenue	1,706,972	1,600,732	1,666,288	1,589,618	1,411,028
Power pools	11,889	11,057	12,971	23,779	24,919
Total Operating Revenue	1,718,861	1,611,789	1,679,259	1,613,397	1,435,947
Expenses					
Operations — fuel and purchased power	511,079	460,399	629,470	692,515	645,211
Operations — other	187,573	173,702	141,312	136,412	146,350
Maintenance	88,431	91,611	60,154	50,038	58,865
Depreciation	63,840	61,194	58,510	57,198	55,649
Operating taxes	250,047	230,508	224,376	213,691	201,842
Federal income tax — current	64,095	24,452	(6,921)	9,710	(16,774)
Federal income tax — deferred and other	208,954	218,256	225,442	177,566	104,765
Total Expenses	1,374,019	1,260,122	1,332,343	1,337,130	1,195,908
Electric Operating Income	$ 344,842	$ 351,667	$ 346,916	$ 276,267	$ 240,039

Gas Operating Income *(In thousands of dollars)*					**Table 3**
Revenues					
Residential — space heating*	$ 194,303	$ 207,937	$ 190,357	$ 195,035	$ 186,753
— other	32,877	35,393	35,638	35,916	36,144
Non-residential, firm — space heating*	63,267	68,380	62,268	63,442	61,927
— other	28,443	31,473	31,043	31,526	32,134
Total firm sales revenue	318,890	343,183	319,306	325,919	316,958
Interruptible	24,150	22,132	33,446	32,149	32,768
Total system sales revenue	343,040	365,315	352,752	358,068	349,726
Other utilities	4,970	—	—	—	—
Total sales revenue	348,010	365,315	352,752	358,068	349,726
Other revenue	5,206	17	18,329	(16,235)	2,178
Total Operating Revenue	353,216	365,332	371,081	341,833	351,904
Expenses					
Operations — fuel	174,610	205,616	201,458	192,581	209,626
Operations — other	53,140	46,607	41,948	41,097	46,085
Maintenance	12,856	11,034	10,895	10,530	11,022
Depreciation, depletion and amortization	10,065	8,945	8,232	8,011	7,761
Operating taxes	50,112	47,484	46,678	42,164	39,362
Federal income tax — current	19,482	16,895	7,435	4,386	12,646
Federal income tax — deferred and other	(4,811)	(6,659)	13,211	10,910	(3,548)
Total Expenses	315,454	329,922	329,857	309,679	322,954
Gas Operating Income	$ 37,762	$ 35,410	$ 41,224	$ 32,154	$ 28,950

*In the heating classifications, the revenues shown cover all gas used, including nonheating use.

† Certain prior year amounts have been reclassified to be consistent with the current year's presentation.

	1987	1986	1985	1984	1983
Electric Operations					**Table 4**
Energy — millions of kWh					
Net generation	**14,004**	11,707	12,292	12,159	11,703
Power purchased and (sold) — net	**2,516**	3,952	2,844	2,689	2,754
Total system requirements	**16,520**	15,659	15,136	14,848	14,457
Company use and unaccounted for	**(1,474)**	(1,266)	(1,346)	(1,271)	(1,308)
System sales	**15,046**	14,393	13,790	13,577	13,149
Power pool sales	**239**	244	226	418	494
Total Sales	**15,285**	14,637	14,016	13,995	13,643
Peak Demand — mW					
Station coincident demand	**3,333**	2,969	2,773	2,528	2,553
Purchased or (sold) — net	**243**	472	607	568	555
System Peak Demand	**3,576**	3,441	3,380	3,096	3,108
System Capability — mW					
LILCO stations	**3,799**	3,743	3,743	3,721	3,721
Firm purchase or (sale) — net	**550**	454	171	57	47
Total Capability	**4,349**	4,197	3,914	3,778	3,768
Fuel Consumed for Electric Operations					
Oil—thousands of barrels	**18,624**	15,625	15,790	15,531	15,707
Gas—thousands of dth	**29,762**	26,103	29,154	29,149	22,747
Total—billions of Btu	**146,536**	124,098	128,629	127,468	122,019
Dollars per million Btu	**$ 2.86**	$ 2.51	$ 3.97	$ 4.47	$ 4.23
Cents per kWh of net generation	**3.01¢**	2.66¢	4.16¢	4.68¢	4.41¢
Heat rate—Btu per net kWh	**10,509**	10,600	10,465	10,483	10,425

Gas Operations					**Table 5**
Energy—thousands of dth					
Natural gas	**58,832**	53,035	53,030	52,558	50,706
Manufactured gas and change in storage	**(63)**	65	(30)	(15)	100
Total Natural and Manufactured Gas	**58,769**	53,100	53,000	52,543	50,806
Total system requirements	**56,551**	53,100	53,000	52,543	50,806
Company use and unaccounted for	**(2,460)**	(1,282)	(3,219)	(1,632)	(3,240)
System sales	**54,091**	51,818	49,781	50,911	47,566
Other utilities	**2,218**	—	—	—	—
Total Sales	**56,309**	51,818	49,781	50,911	47,566
Maximum Day Sendout—dth	**404,679**	365,991	441,122	359,527	381,624
System Capability—dth per day					
Natural gas	**388,400**	345,200	335,700	315,400	315,400
LNG manufactured, or LP gas	**145,600**	145,600	145,600	145,600	146,900
Total Capability	**534,000**	490,800	481,300	461,000	462,300
Calendar Degree Days (61-year average 5,052)	**4,805**	4,715	4,638	4,739	4,781

	1987	1986	1985	1984	1983
Electric Sales and Customers					**Table 6**
Sales — millions of kWh					
Residential	**6,603**	6,251	5,970	6,000	5,900
Commercial and industrial	**8,004**	7,713	7,369	7,129	6,797
Street and highway lighting	**182**	180	178	182	181
Other public authorities	**255**	245	272	259	252
Other utilities	**2**	4	1	7	19
System sales	**15,046**	14,393	13,790	13,577	13,149
Power pool sales	**239**	244	226	418	494
Total Sales	**15,285**	14,637	14,016	13,995	13,643
Customers — Monthly average					
Residential	**872,419**	861,011	850,683	840,843	833,163
Commercial and industrial	**95,871**	93,228	90,548	88,459	86,687
Others	**4,389**	4,362	4,391	4,339	4,269
Customers — total monthly average	**972,679**	958,601	945,622	933,641	924,119
Customers — total at year end	**976,928**	963,197	948,797	935,964	926,335
Residential					
kWh per customer	**7,569**	7,260	7,018	7,136	7,081
Revenue cents per kWh	**12.13¢**	11.92¢	12.95¢	12.53¢	11.43¢
Commercial and Industrial					
kWh per customer	**83,487**	82,732	81,382	80,591	78,409
Revenue per kWh	**10.62¢**	10.43¢	11.46¢	11.17¢	10.21¢
System — Total revenue per kWh sold	**11.35¢**	11.12¢	12.08¢	11.71¢	10.73¢

Gas Sales and Customers					**Table 7**
Sales — thousands of dth					
Residential — space heating*	**29,239**	28,438	26,387	27,528	25,387
— other	**3,952**	3,629	3,642	3,702	3,601
Non-residential — space heating*	**10,055**	9,711	8,967	9,357	8,760
— other	**4,389**	4,533	4,510	4,638	4,518
Total firm sales	**47,635**	46,311	43,506	45,225	42,266
Interruptible	**6,456**	5,507	6,275	5,686	5,300
Total system sales	**54,091**	51,818	49,781	50,911	47,566
Other utilities	**2,218**	—	—	—	—
Total Sales	**56,309**	51,818	49,781	50,911	47,566
Customers — monthly average					
Residential — space heating*	**192,550**	186,625	182,593	179,030	176,250
— other	**184,411**	186,600	188,594	190,507	191,967
Non-residential — space heating*	**24,234**	22,514	20,935	20,173	19,959
— other	**11,778**	11,889	11,930	11,973	11,959
Total firm customers	**412,973**	407,628	404,052	401,683	400,135
Interruptible	**301**	289	297	306	308
Customers — total monthly average	**413,274**	407,917	404,349	401,989	400,443
Customers — total at year end	**415,629**	410,064	405,330	402,430	400,815
Degree days — billed	**4,802**	4,795	4,444	4,921	4,596
Residential					
dth per customer	**88.0**	85.9	80.9	84.5	79.3
Revenue per dth	**$ 6.84**	$ 7.59	$ 7.53	$ 7.40	$ 7.63
Non-residential, firm					
dth per customer	**401.1**	414.0	410.1	435.4	418.6
Revenue per dth	**$ 6.35**	$ 7.01	$ 6.92	$ 6.79	$ 7.04
System — total revenue per firm dth sold	**$ 6.69**	$ 7.41	$ 7.34	$ 7.21	$ 7.50

*In the heating classifications, the sales shown cover all gas used, including nonheating use.

	1987	1986	1985	1984	1983

Operations and Maintenance Expense Details *(In thousands of dollars)** — Table 8

	1987	1986	1985	1984	1983
Total payroll and employee benefits	$ 315,114	$ 283,427	$ 257,509	$ 215,373	$ 227,014
Less — Charged to construction and other	115,315	102,987	99,415	66,331	75,962
Charged to Operations	199,799	180,440	158,094	149,042	151,052
Fuels — electric operations	422,997	311,872	511,193	569,528	516,097
Fuels — gas operations	174,610	205,616	201,458	192,581	209,626
Purchased power costs	93,186	134,347	113,867	123,963	128,217
Fuel cost adjustments deferred	(5,104)	14,180	4,410	(976)	897
Total Fuel and Purchased Power	685,689	666,015	830,928	885,096	854,837
All other	142,201	142,514	96,215	89,035	111,270
Total Operations and Maintenance	$1,027,689	$ 988,969	$1,085,237	$1,123,173	$1,117,159
Employees at December 31	6,378	6,219	5,676	5,202	5,947

Construction Expenditures *(In thousands of dollars)* — Table 9

	1987	1986	1985	1984	1983
Electric					
Production	$ 453,544	$ 603,916	$ 807,067	$ 852,774	$ 804,538
Transmission	23,668	6,451	4,971	3,541	9,920
Distribution	32,209	50,847	38,333	31,778	40,617
General	6,470	4,165	(4,132)	1,294	1,190
Electric Total	515,891	665,379	846,239	889,387	856,265
Gas Total	34,270	31,978	19,564	12,354	17,458
Common Total	17,795	5,434	13,198	4,622	9,432
Total Construction Expenditures	$ 567,956	$ 702,791	$ 879,001	$ 906,363	$ 883,155
Nuclear Fuel	$ 13,219	$ 10,353	$ 22,241	$ 14,771	$ 16,636

Balance Sheet *(In thousands of dollars)** — Table 10

	1987	1986	1985	1984	1983
Assets					
Utility plant	$9,277,309	$8,710,063	$8,167,239	$7,272,544	$6,422,520
Less—accumulated depreciation, depletion, and amortization	983,272	919,452	853,071	788,565	727,298
Total Net Utility Plant	8,294,037	7,790,611	7,314,168	6,483,979	5,695,222
Other property and investments	68,763	68,383	139,783	68,639	67,693
Current assets	606,579	702,825	367,967	437,436	587,002
Unamortized cost of abandoned generating projects	118,484	127,590	27,133	44,108	—
Other	235,824	168,746	114,215	66,699	39,666
Total Assets	$9,323,687	$8,858,155	$7,963,266	$7,100,861	$6,389,583
Capitalization and Liabilities					
Capitalization:					
Long-term debt**	$3,724,601	$3,805,796	$2,718,192	$3,001,796	$2,894,205
Unamortized premium and (discount) on debt	(26,646)	(28,281)	(9,414)	(9,658)	(8,198)
Preferred stock—redemption required	520,788	527,465	527,612	530,662	542,450
Preferred stock—no redemption required	221,051	221,053	221,056	221,056	221,119
Treasury stock, at cost	(40,881)	(25,701)	(7,654)	(505)	(1,772)
Common stock and premium	1,556,928	1,556,483	1,556,026	1,551,057	1,485,162
Capital stock expense	(56,144)	(56,138)	(56,116)	(56,103)	(56,278)
Retained earnings	2,067,207	1,797,319	1,480,644	956,356	580,115
Total Capitalization**	7,966,904	7,797,996	6,430,346	6,194,661	5,656,803
Current Liabilities	339,573	277,173	975,214	506,054	478,637
Deferred Credits:					
Accumulated deferred income tax reductions	921,397	692,758	486,333	338,607	222,502
Other	83,217	75,195	62,039	54,649	25,055
Total Deferred Credits	1,004,614	767,953	548,372	393,256	247,557
Reserves for Claims, Damages, Pensions, and Benefits	12,596	15,033	9,334	6,890	6,586
Total Capitalization and Liabilities	$9,323,687	$8,858,155	$7,963,266	$7,100,861	$6,389,583

*Certain prior year amounts have been reclassified to be consistent with the current year's presentation.

**Includes $685,621,000 and $713,484,000 of Trust Obligations for the years 1984 and 1983, respectively.

Common and Preferred Stock Prices

Table 11

The Common Stock of the Company is traded on the New York Stock Exchange and the Pacific Stock Exchange. The Preferred Stock $100 par value Series B, E,I,J,K, and S and the Preferred Stock $25 par value, Series O,P,T,U,V,W, and X of the Company, are traded on the New York Stock Exchange. The table below indicates the high and low prices on the New York Stock Exchange listing of composite transactions for the years 1986 and 1987.

Common Stock			Preferred Stock																																											
			Series B 5%		Series E 4.35%		Series I 5¾%		Series J 8.12%		Series K 8.30%		Series O $2.47		Series P $2.43		Series S 9.80%		Series T $3.31		Series U $4.25		Series V $3.50		Series W $3.52		Series X $3.50	
Quarter	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low
1986																														
First	12⅝	8	41	30½	36½	27	85	64	65	47½	67	47½	21¾	18	21⅝	14⅞	76½	64½	25¾	20⅛	31½	25⅛	27¾	21¾	27⅝	22	27⅝	21½
Second	14⅝	10¼	45	37½	43	30¼	97½	86	72	60	75	59¾	22⅞	19⅛	23⅜	17½	87½	76¾	27⅝	21½	33⅝	25⅞	30⅛	21⅜	30	22¼	29¾	22
Third	13⅜	10	44½	41	41¾	37½	89½	82	72¼	66⅛	73	66¼	23⅞	20	23	20	84	79½	26¾	24	30⅞	26½	29	24¼	28¾	24⅛	28½	24⅜
Fourth	12½	10	43	41	38	35	83¾	71	67½	63	71	65	23½	20¾	22	19¾	87	81	28⅛	24⅞	31⅜	26⅜	28½	24½	29	25	28½	24⅜
1987																														
First	11⅞	10	45	40	41¼	35¼	80½	74¾	72½	63¼	74	65	23¾	21	23	20⅜	89	84	29¼	25	32⅜	28⅜	31⅛	26¼	31½	27⅜	30¾	26
Second	10¾	8¾	47	42	44	38	80	74½	75½	68	78	69	23	19	23	19½	89½	84⅛	28⅛	24⅝	31¾	28½	30⅛	27	29⅝	26⅞	29½	27
Third	12⅜	9	52	45	48	41½	88	75¼	81½	74¾	82	75	26½	22½	26¼	22⅛	93½	88	32⅞	27½	37¾	30½	33½	27⅞	34¼	28⅛	32⅞	27⅝
Fourth	11¾	6½	52	48½	46½	36¼	88	81¼	81	67	80½	65½	26	18¾	24	16¼	95	80	31¼	19⅞	35¼	23¾	32	22½	32⅞	21	30⅞	21⅛

The Series D-4.25% Stock is traded in the over-the-counter market. The Company has been advised of scattered trading at prices ranging between $24 and $39 per share during 1986. No price data is available for 1987. The Series F, H, L, M, and R Preferred Stock are held privately.

Corporate Information

Executive Offices
175 East Old Country Road
Hicksville, N.Y. 11801

Common Stock Listed
New York Stock Exchange
Pacific Stock Exchange

Ticker Symbol: LIL

Transfer Agents
Common Stock
Manufacturers Hanover
Trust Company
450 West 33rd Street
New York, N.Y. 10001
212-613-7147

Preferred Stock
The First National Bank
of Boston
50 Morrissey Boulevard
Dorchester, MA. 02102
800-442-2001

Registrar
Common and Preferred Stock
Mellon Securities Trust
Company
120 Broadway
New York, N.Y. 10271

Shareowners' Agent for Automatic Dividend Reinvestment Plan
Manufacturers Hanover
Trust Company
Dividend Reinvestment
Department
P.O. Box 24850
Church Street Station
New York, N.Y. 10242
212-613-7147

Annual Meeting
The Annual Meeting of Shareowners will be held on May 17, 1988 at 2:00 p.m. In connection with this meeting, proxies will be solicited by the Company. A notice of the meeting, a proxy statement, and a proxy will be mailed to shareowners in April.

Form 10-K Annual Report
The Company will furnish, without charge, a copy of the Company's Annual Report, Form 10-K, as filed with the Securities and Exchange Commission, upon written request to: Investor Relations, Long Island Lighting Company, 175 East Old Country Road, Hicksville, N.Y. 11801

Directors

William J. Catacosinos
Chairman of the Board and
Chief Executive Officer
Long Island Lighting Company

Winfield E. Fromm
Retired Vice President
Eaton Corporation
Electronics

Lionel M. Goldberg
Senior Vice President
Alexander & Alexander
of New York, Inc.
Insurance

Basil A. Paterson
Partner
Meyer, Suozzi, English
& Klein, PC
Law

James C. Peery
Senior Vice President
United Capital Investment
Investment Management

Eben W. Pyne
Corporate Director
and Consultant
Retired Senior Vice President
Citibank, N.A.

John H. Talmage
Farm Manager
H.R. Talmage & Son

Phyllis S. Vineyard
Health Planning Consultant
Director
N.Y. Statewide
Health Coordinating
Council

Russell C. Youngdahl
President and
Chief Operating Officer
Long Island Lighting Company

Officers

William J. Catacosinos
Chairman of the Board and
Chief Executive Officer

Russell C. Youngdahl
President and
Chief Operating Officer

Anthony F. Earley, Jr.
Executive Vice President
and General Counsel

George J. Sideris
Senior Vice President
Finance

Ralph T. Brandifino
Vice President
Finance

James T. Flynn
Vice President
Fossil Production

Ira L. Freilicher
Vice President
Law and Corporate Affairs

Robert X. Kelleher
Vice President
Human Resources

Jay R. Kessler
Vice President
Gas Operations

John D. Leonard, Jr.
Vice President
Nuclear Operations

Adam M. Madsen
Vice President
Corporate Planning

Brian R. McCaffrey
Vice President
Administration

Joseph W. McDonnell
Vice President
Communications

William J. Museler
Vice President
Electric Operations

John J. Russell
Vice President
Community Affairs

William G. Schiffmacher
Vice President
Engineering

John A. Weismantle
Vice President
Research, Development &
Corporate Studies

Walter F. Wilm, Jr.
Vice President
Customer Relations

Michael Czumak
Controller

Edward W. Eacker
Treasurer

John J. Kearney, Jr.
Secretary

Herbert M. Leiman
Assistant Secretary and
Assistant General Counsel

Francis M. Walsh
General Claims Attorney

Long Island Lighting Company
175 East Old Country Road
Hicksville, NY 11801

BULK RATE
U.S. POSTAGE
PAID
Hicksville, NY
Permit No. 254