LILCO
LONG ISLAND LIGHTING

LONG ISLAND LIGHTING COMPANY
SHOREHAM NUCLEAR POWER STATION
P.O. BOX 618, NORTH COUNTRY ROAD • WADING RIVER, N.Y. 11792

WILLIAM E. STEIGER, JR.
ASSISTANT VICE PRESIDENT-NUCLEAR OPERATIONS

SNRC-1697

MAR 15 1990

U.S. Nuclear Regulatory Commission
ATTN: Document Control Desk
Washington, D.C. 20555

Annual Financial Report
Shoreham Nuclear Power Station - Unit 1
Docket No. 50-322

Gentlemen:

The purpose of this letter is to transmit the financial information required by 10 CFR 50.71(b). Attached please find a copy of the Long Island Lighting Company's 1989 Annual Financial Report.

If there are any questions concerning this information, please contact this office.

W. E. Steiger, Jr.
Assistant Vice President
Nuclear Operations

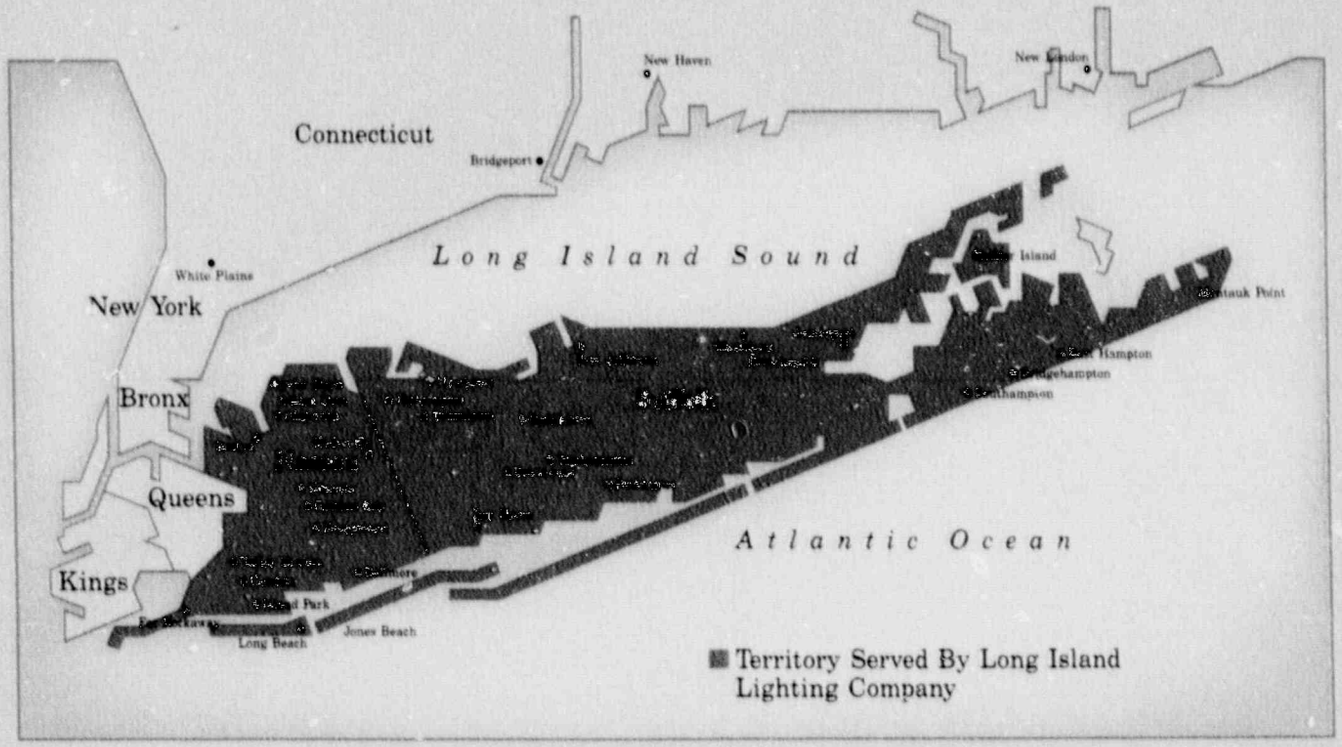
DRH/ck
Attachment

cc: S. Brown
T. T. Martin
L. Doerflein

M004
1/1

Long Island Lighting Company
1989 Annual Report

Long Island Lighting Company 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.



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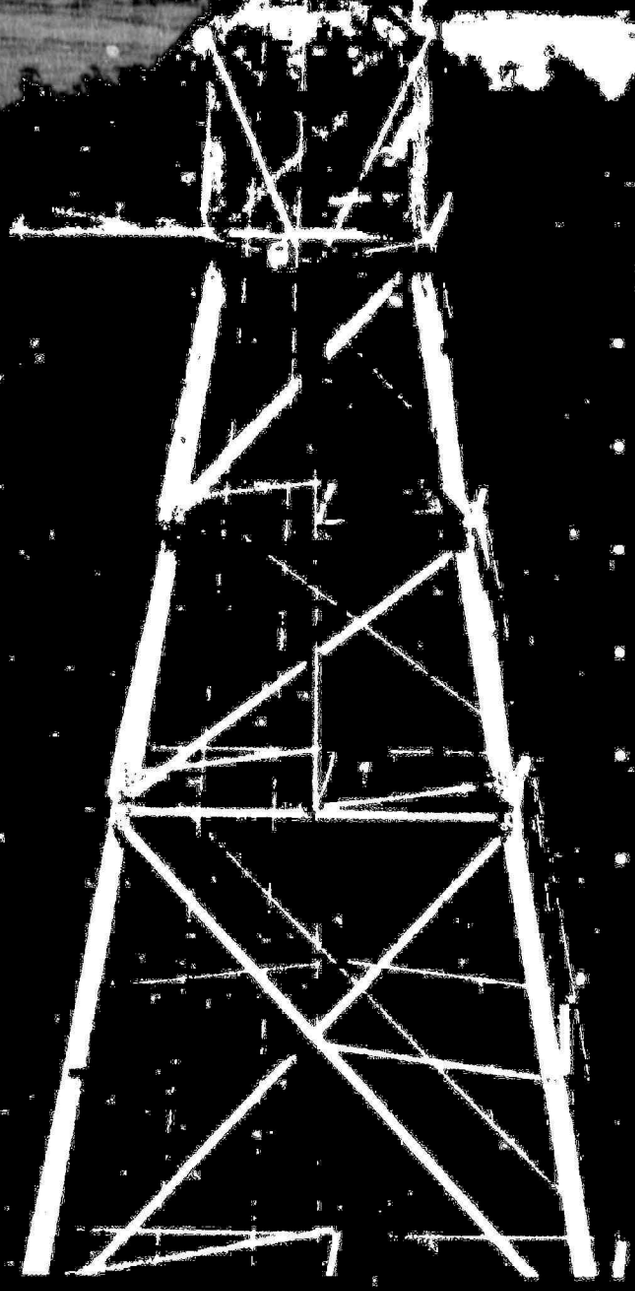
About the Cover
LILCO energy expert Mike Hughes (left) assists a commercial customer in planning for the energy needs of a new office complex.



1989 Highlights

- Shareowners approve Shoreham settlement with New York State.
- Common and preferred stock dividend payments resumed; preferred dividend arrearages paid.
- $1.1 billion of debentures sold — the largest single debt offering ever by an electric and gas utility.
- New 240-megawatt combustion turbine generators installed ahead of schedule and under budget.
- New records set for winter electric and gas consumption during December cold snap.
- Energy conservation programs reduced summer power demand by 132 megawatts.

William J. Catacosinos
Chairman and Chief Executive Officer

In 1989 we set the company on a course toward financial health — we received a rate increase for the first time in three years, resumed dividend payments and refinanced our high cost debt. Rating agencies demonstrated renewed confidence in our financial condition by significantly upgrading each of the company's securities.

Settlements Mark Turning Point

On June 28, 1989, LILCO shareowners approved an agreement negotiated with New York State that ended the controversy surrounding Shoreham. Shareowners also endorsed a class action settlement that resolved a civil lawsuit brought by Suffolk County against the company and certain of its former officers. These two agreements removed many of the financial uncertainties surrounding the company.

Under the terms of the agreement with the state, Shoreham will be transferred to the Long Island Power Authority (LIPA), an agency of New York State, for $1; LILCO will receive annual rate increases over a ten-year period; and the state will assist the company in meeting the energy needs of Long Island.

As part of the settlement concerning Shoreham, the Public Service Commission (PSC) made permanent a temporary 5.4 percent rate increase it had approved in February 1989, granted a 5 percent rate increase on December 1, 1989 and approved an additional 5 percent increase which is expected to become effective on December 1, 1990. The agreement also targets rate increases of between 4.5 percent to 5 percent for each subsequent year through 1998.

Renewed Financial Strength

The settlements opened the door to financial recovery — enhancing our shareowners' investment in the company. In 1989, LILCO's common stock price rose more than 50 percent during the year.

On June 30, 1989, LILCO sold $1.1 billion of debentures — the largest single debt offering ever by an electric and gas utility. The sale reflects the investment community's continued confidence in the company. In August, LILCO redeemed $495 million of the company's outstanding general and refunding bonds — a move that will save the company approximately $17 million each year in interest.

In addition, the company renegotiated a $446 million seven-year term bank loan, obtained a $300 million bank line of credit and sold $100 million of tax-exempt bonds.

In September, we paid our preferred stock dividend arrearages aggregating $390 million, resumed preferred dividend payments for the first time in five years and sold $320

million of preferred stock as part of a program to refinance our high cost debt and equity. On October 1, 1989, we resumed dividend payments to our common shareowners at the rate of $.25 per share per quarter.

Shoreham Update

Our settlement agreement with New York State prohibits the company from operating Shoreham. To protect the interests of its shareowners, the company pursued a full-power operating license for Shoreham pending final approval of the settlement. On April 20, 1989, the Nuclear Regulatory Commission (NRC) authorized a full-power license for Shoreham, but the company fulfilled its obligations under the settlement by not operating the plant.

In August, plant staff removed the fuel rods from the reactor vessel as stipulated by the settlement, prompting the NRC to allow us to reduce staffing at the plant and shut down various systems normally required for full-power operation. Since the settlement prohibits us from operating Shoreham, we have asked the NRC to issue a "zero power" license to reflect the current status of the plant. In addition, we are seeking an exemption from offsite emergency regulations and insurance requirements to reduce our costs at the plant. The NRC has yet to render a decision on these requests.

In 1990, we hope to make applications to the NRC to further reduce the costs at Shoreham in preparation for transferring the Shoreham plant to LIPA. The state authority has indicated it will decommission Shoreham and is expected to file a decommissioning plan with the NRC. LIPA is also studying the feasibility of converting the facility to a natural gas-fired generating plant.

Electric And Gas Outlook

Our planners project Long Island's demand for electricity to grow by approximately 1.5 percent each year over the next several years. We are meeting increased demand through an aggressive energy conservation program, the emergence of independent power producers and the construction of new combustion turbine generators. Cooler weather last summer held peak demand below 1988's record setting levels, but during a month-long deep freeze in December, we set new records for winter electric consumption.

We are expanding our natural gas system to keep pace with growing demand. In 1989, we installed new gas mains in eastern Long Island to bring this economic fuel to more neighborhoods. More than 7,400 Long Island homes and businesses became new gas heat customers.

LILCO's low-cost natural gas has triggered keen competition in the home heating market. A surge in home heating oil prices during December's bitter cold prompted calls from hundreds of homeowners inquiring how they could convert to natural gas heat. We have secured additional gas supplies to provide natural gas to more customers in the 1990s.

On January 11, 1990, the PSC approved a 1.28 percent increase in our natural gas rates, which will raise $5.5 million for the company each year. The gas rate increase, the first for LILCO in six years, will help us expand our gas facilities.

New Service Culture

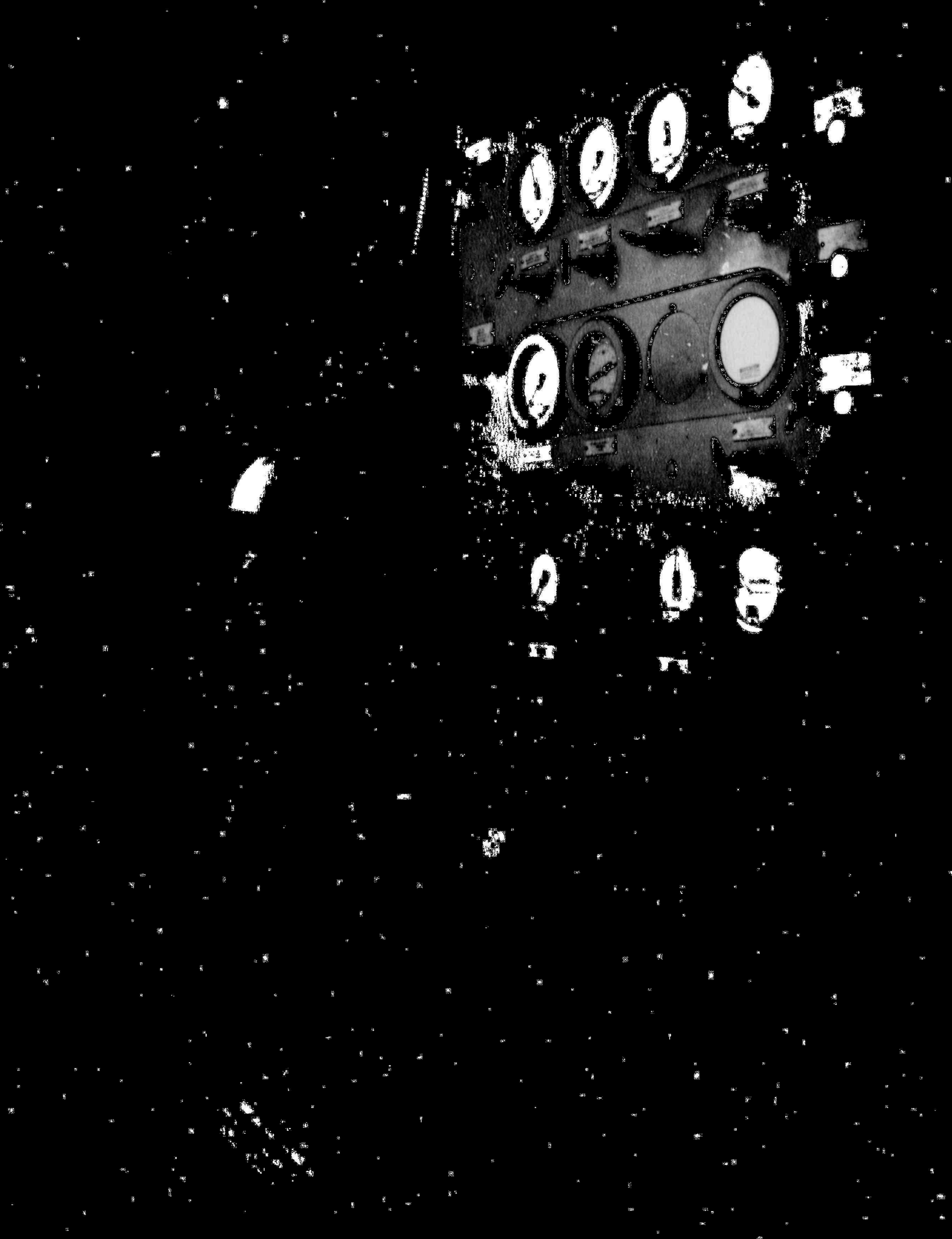
With the Shoreham controversy behind us, we are ushering in a new era marked by service improvements. Employees are working closely with management to explore new ways to improve service to our customers. It's an exciting, productive process that's making LILCO a stronger, more efficient company.

On behalf of the Board of Directors, I extend my sincere appreciation for your interest and support as we strive to return the company to financial health and provide our customers with unparalleled service.

Sincerely,

W. J. Catacosinos

William J. Catacosinos
Chairman and Chief Executive Officer



"Pinpointing possible failures and fine-tuning the units have provided our customers with a reliable source of electricity."

Electric use on Long Island continues to increase — up 17 percent in the last five years. The power supply situation remained tight, but cooler temperatures held last summer's peak demand short of the record set in 1988. During a month-long cold snap in December, new records for winter electric consumption were set on two different days.

LILCO was able to meet peak customer demand by installing new turbine generators, implementing a comprehensive energy conservation program and operating the company's aging generating plants efficiently.

During the fall and spring, skilled LILCO engineers and technicians perform periodic overhauls on generating units. An extensive $20-million preventive maintenance program in the power plants paid off — LILCO plant operators kept their units running even on the most demanding days.

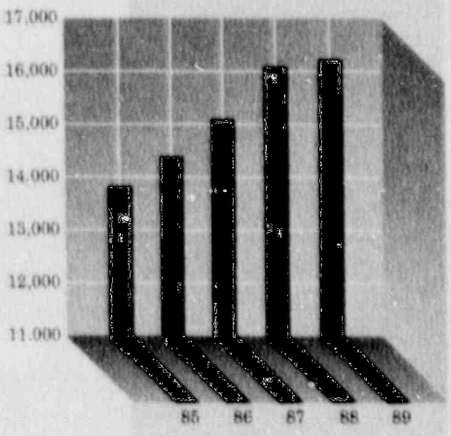
"Pinpointing possible failures and fine-tuning the units have provided our customers with a reliable source of electricity," said James Flynn, group vice president of Engineering and Operations.

In July, we completed the installation of three combustion turbine generators. On line ahead of schedule and under budget, the turbines provide an additional 240 megawatts of power on peak demand days.

LILCO customers played a critical role in averting power shortages in 1989. By participating in the company's energy conservation programs, businesses and households helped shave 132 megawatts from peak demand.

Electric System Sales

(Millions of Kilowatt Hours)



Mechanic John McCormick examines a pressure gauge on one of three new 80-megawatt combustion turbines that will help meet the energy needs of Long Island.

LILCO successfully managed the critical electricity shortage on Long Island during the 80s — providing reliable, responsive electric service. Customer satisfaction will continue to be a challenge in the 90s. LILCO has made significant strides in satisfying customers as demonstrated by the steady reduction in our customer complaint rate.

"Reducing the frequency and duration of outages depends on . . . a year-round devotion to system maintenance."

In September, LILCO's responsiveness was put to the test when the remnants of Hurricane Hugo hit Long Island with wind gusts approaching 100 miles per hour — knocking out power to more than 107,000 customers. LILCO emergency service crews, working 16-hour shifts, restored service to all customers within 48 hours.

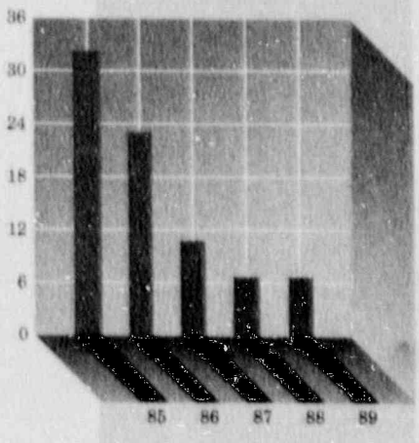
"Reducing the frequency and duration of outages depends on our ability to respond quickly when a customer calls to report a power interruption and a year-round devotion to system maintenance," said Bill Museler, vice president of Electric Operations.

As part of our reliability program, we began installing additional radio-controlled switches throughout the company's 45,000 miles of power lines. The switches isolate electric line problems remotely, enabling our operators to restore service to customers more quickly. To minimize the inconvenience power outages cause, we are developing a complex computer program to let individual customers know how long it will take to restore power to their homes following an outage.

In 1989 we installed 57 miles of weather-resistant plastic-covered wire and scanned 2,600 miles of power lines to detect potential trouble spots before they cause power outages. We also trimmed trees for 38,000 customers and pruned along 1,700 miles of power lines to keep branches from interfering with electric lines.

Reduction in Customer Complaints

(Per 100,000 Customers)



Electric linemen Arthur Van Gorden and Charles Tansey perform preventive maintenance on a 138-kv transmission pole to provide our customers with reliable electric service.

. . . we are expanding our natural gas system to make this premium fuel available to more customers.

More and more Long Islanders are enjoying the outstanding value of natural gas for heating — its cleanliness, convenience and economy. In 1989, 7,400 Long Island homes and businesses became new gas heat customers. The company expects to add about 130,000 new gas space-heating customers over the next decade.

To meet growing demand, we are expanding our natural gas system to make this premium fuel available to more customers. Canadian gas from the Iroquois Pipeline will play a major role in LILCO's gas expansion system. The pipeline, extending 369 miles from Canada to Long Island, is expected to be completed by 1991.

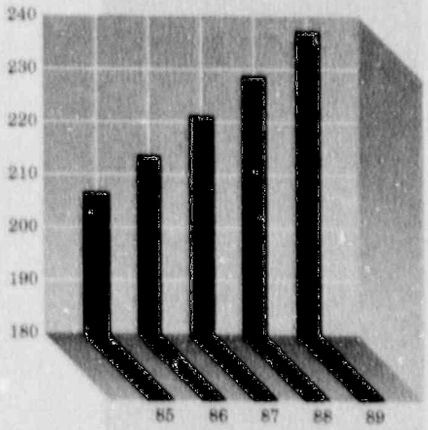
In 1989 LILCO installed 20,000 feet of new gas, or "venture," mains in eastern Long Island to bring natural gas to many neighborhoods. The three-mile-long Yaphank main in eastern Suffolk County will provide natural gas for up to 10,000 customers.

An intensified marketing program has encouraged more customers to "turn on the comfort" of gas heat and increased our share of the home heating market. Long considered the most dependable and efficient source of space-heating, Long Islanders realized the economy of gas heat this winter when home heating oil prices jumped 50 percent during December's record cold snap.

"Nearly 240,000 LILCO customers use natural gas for heating, representing 20 percent of the heating market on Long Island," said Jay Kessler, vice president of Gas Operations. "We have a tremendous opportunity to expand our gas business to provide more customers with gas heat."

Growth in Gas Heating Customers

(In Thousands)



Gas equipment operator Bill Kienle digs a trench for a gas main as part of LILCO's gas expansion program.

In 1989 we improved our consumer outreach programs and developed new services to respond to customer concerns.

"Our customer representatives are available 24 hours a day, seven days a week, to serve customers at their convenience," said Walter Wilm, vice president of Customer Relations. "We encourage customers to call us anytime, day or night."

"Our customer representatives are available 24 hours a day, seven days a week, to serve customers at their convenience."

We are committed to helping our customers control their energy costs. In 1989, LILCO energy specialists performed free home energy audits for over 22,000 Long Islanders. In a brand new program for the 90s, LILCO energy experts provide assistance in weatherizing the homes of low income families.

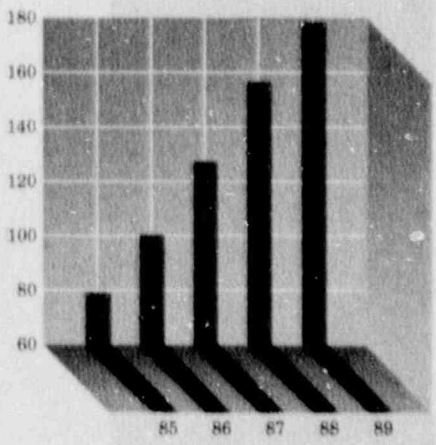
More than 36,000 senior citizens joined our "Golden Link" program this year — doubling the size of the program to 72,000 members. And we provided more than 30,000 school children with electric and gas safety demonstrations.

In one of the most innovative programs in the utility industry, LILCO consumer advocates are reaching out to hundreds of customers with financial hardships to work out payment agreements, arrange energy budgets and provide help when applying for various government assistance programs.

This year we introduced large print and braille bills for our visually impaired customers. We also have special equipment to receive typewritten messages by telephone for hearing and speech impaired customers who have compatible (TTY) devices at home.

Total Home Energy Audits Conducted

(In Thousands)



Customer representative Myra Riddick of our Port Jefferson office assists customers with billing inquiries and provides information about our many outreach programs.

More than two-thirds of our workforce receives detailed training annually . . .

We are engaged in an extensive employee training program as part of our commitment to provide customers with unparalleled service. More than two-thirds of our workforce receives detailed training annually to learn new skills, upgrade job performance and enhance professional development.

Many employees receive specialized instruction in their profession at the company's J.W. Dye, Jr. Training Center in Hauppauge. Over 95 different courses in topics ranging from forklift operations to digital electronics are taught by LILCO experts and outside consultants.

Our customer representatives received 10 weeks of intensive classroom and on-the-job training to prepare them to respond to the more than 1.4 million business inquiries from customers in 1989.

We focus much of our attention on storm restoration training. Under the company's Storm Restoration Plan, all 6,200 LILCO employees turn from their regular jobs to emergency storm duties. When storm-related outages occur, this specialized training enables workers to respond quickly and effectively to minimize inconvenience to our customers.

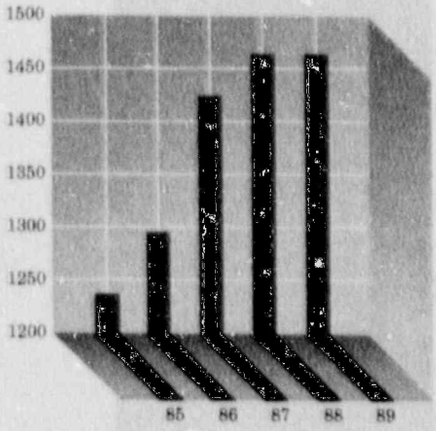
LILCO's training programs stress safety on the job at all times. Our electric and gas service crews learn to protect themselves, their fellow workers and our customers when installing or repairing service equipment.

In addition to being experts in their particular field, each LILCO employee — from corporate officer to field worker — has participated in customer sensitivity training to improve their understanding of our customers' concerns.

Instructor Tom Madden teaches a welding course at our Dye Training Center — home of the most modern welding lab in the country.

Customer Inquiries Handled

(In Thousands)



The 1980s marked a decade of tremendous growth in energy demand on Long Island. Our customer base swelled 26 percent to nearly one million, peak electric demand climbed 11.6 percent to an all-time high of 3,822 megawatts and peak gas demand reached a record of 463,000 decatherms. After years of political discord, we ended the controversy surrounding the Shoreham nuclear power plant, regained financial strength and embarked on a program to become a premier service company for the 90s.

Our people are leading this new service culture by providing prompt and efficient service to our customers.

Our people are leading this new service culture by providing prompt and efficient service to our customers. We are nurturing a customer-driven culture throughout the company by recognizing that many employees provide a service to "internal" customers — fellow workers who depend on them to service our customers.

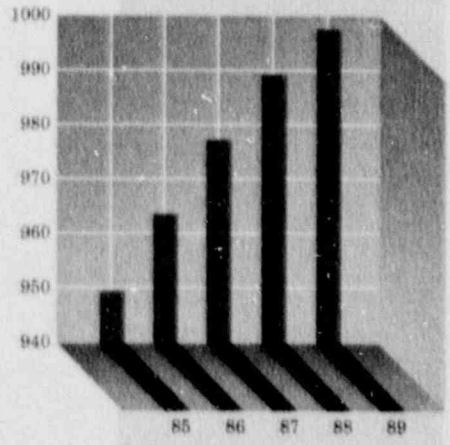
Better teamwork among employees is helping us transform our corporate culture to a customer-driven company. Our new management team and dedicated employees are reexamining the way we do business so we can become more responsive to the concerns of our customers.

Our employees are meeting in small "focus groups" to explore ways to improve the efficiency of our operations. In this way, employees participate in the decision-making process to help reorient our company to better serve our customers.

Backed by a talented work force, LILCO is poised to tackle new challenges and thrive in the competitive environment of the 90s. We are proud of our accomplishments this past year and look forward to adding "service-driven" to our list of achievements in the new decade.

Electric Customer Growth

(In Thousands)



Order representative Judy Gise turns on electric service at a farmstand on eastern Long Island.

Financial Review

Overview

The year 1989 marked a year of transition and accomplishment for the Company.

LILCO received rate relief in 1989, the first such additional cash revenues in more than three years and resumed preferred and common stock dividend payments for the first time in five years. The Company sold equity securities for the first time in six years and for the first time in four years was able to utilize tax-exempt securities. Also, in 1989, the rating agencies significantly upgraded their ratings on each of the Company's principal securities.

In 1989, among other accomplishments, the Company:

- Sold $1.1 billion of debentures;
- Restructured its $446 million of bank debt;
- Established a $300 million Revolving Credit Agreement (the 1989 RCA) with its banks;
- Redeemed $595 million of higher interest rate General and Refunding Bonds (G&R Bonds);
- Resumed the payment of preferred stock dividends, including the payment of $390 million of arrearages;
- Sold $320 million of preferred stock;
- Resumed the payment of common stock dividends at the annual rate of $1.00 per share, of which 25¢ per share, or approximately $28 million, was paid in 1989;
- Restructured $165 million of letters of credit;
- Redeemed approximately $300 million of higher dividend rate preferred stock;
- Utilized $100 million of tax-exempt securities.

These accomplishments followed a settlement with New York State (the State) concerning the Shoreham Nuclear Power Station (Shoreham) and a settlement of a class action suit with ratepayers. Both settlements became effective on June 28, 1989, when shareowners approved them.

The Shoreham settlement (the 1989 Settlement) with the State is designed to eliminate the controversy over Shoreham by providing for the transfer of Shoreham to an agency of the State.

The controversy had jeopardized LILCO's financial viability because the Company had not been permitted to recover a significant portion of its investment in Shoreham. The 1989 Settlement provides for fixed rate increases in 1989 and 1990 and annual targeted rate increases through 1998.

The class action settlement (the Class Settlement) resolves a civil lawsuit brought against the Company and certain of its former Officers by ratepayers acting as a class under the Federal Racketeer Influenced and Corrupt Organizations Act.

The Class Settlement, which is discussed further in Note 5 of Notes to Financial Statements, provides for rate reductions aggregating $390 million to be made to the Company's ratepayers' monthly electric bills over a ten-year period beginning in June of 1990. For information concerning contingencies relating to the Class Settlement, see Note 6 of Notes to Financial Statements.

The 1989 Settlement

As part of the 1989 Settlement, the Company and the State entered into an agreement (the 1989 Issues Agreement) which provides for the transfer of Shoreham and recites that the parties intend to return LILCO to investment grade financial condition.

On April 13, 1989, the Public Service Commission of the State of New York (the PSC) approved a Rate Moderation Agreement (the RMA). The RMA provides that the Company will receive rate increases of 5.0% on December 1, 1989 (which the Company is currently receiving), 5.0% on December 1, 1990 and targeted annual rate increases thereafter of 4.5% to 5.0% in each year for the following eight years through 1998. In addition, the temporary 5.4% rate increase granted by the PSC in February 1989 was made permanent when the 1989 Settlement became effective. The 5.4% rate increase granted in February and the 5.0% rate increase granted in December provide the Company with an annualized increase in cash revenues of approximately $165 million.

The rate increases contemplated by the RMA are designed to provide the Company with pre-tax interest coverage ratio targets of 1.3 to 1.4 times in 1990 and 1991 and an allowed return on common equity of 13% in 1990 and 12.75% in 1991.

The RMA does not reflect the impact that the Class Settlement will have upon future rates that are provided by the RMA. However, the Company estimates that such rate increases will only be approximately .2% to .3% lower than they would otherwise be under the rate structure embodied in the RMA.

Further, the PSC authorized the Company to record on its books the Financial Resource Asset (the FRA) which represents the present value of the future net-after-tax cash flows which the RMA provided the Company for its financial recovery. The FRA will be amortized over a forty-year period and a full return will be allowed on the unamortized balance. The Company recorded the asset on its books at the end of June 1989 at an amount of approximately $4 billion.

For the next several years, a substantial portion of the Company's earnings will be non-cash earnings reflecting the rate structure under the RMA. For 1989, these non-cash earnings were approximately $131 million. The Company estimates that its non-cash earnings could approximate between 80%-90% of earnings for the years 1990 and 1991 and decrease thereafter. The RMA provides for full recovery of these non-cash earnings by approximately 1999.

On April 17, 1989, the Company received a private letter ruling from the Internal Revenue Service confirming LILCO's entitlement on its federal income tax return to an abandonment loss deduction in connection with Shoreham as a result of the 1989 Settlement. The Company will claim this deduction for 1989 which will entitle the Company to an estimated tax refund of approximately $23 million.

At December 31, 1989, the Company's Net Operating Loss (NOL) carryforward is estimated to be $2.1 billion. The Company estimates that the NOL carryforward will be utilized to reduce federal income tax payments within the 15-year statutory carryforward period.

On April 21, 1989, the Nuclear Regulatory Commission (the NRC) issued a full-power operating license for Shoreham, but the 1989 Settlement prohibits the Company from operating Shoreham and calls for the Company to transfer Shoreham to an agency of the State following NRC approval. The Company expects to file an application in 1990 with the NRC to transfer Shoreham and expects the agency of the State to apply to the NRC for authority to decommission Shoreham.

For a further discussion of the 1989 Settlement, see Note 5 of Notes to Financial Statements. Contingencies relating to the 1989 Settlement are discussed in Note 6 of Notes to Financial Statements.

Financial Condition

Liquidity

At December 31, 1989, the Company's cash and short term investment balances were $340 million, compared to $93 million at December 31, 1988. In addition, the Company has $300 million of credit available to it through October 1, 1992, provided by the 1989 RCA. This line of credit is secured by the Company's accounts receivable and fuel oil inventories. The termination date of the 1989 RCA may be extended for one year periods upon the Company's request. At December 31, 1989, no amounts were outstanding under the 1989 RCA.

The 1989 Settlement is intended to provide the Company with adequate and timely rate relief which, together with continued access to the capital markets, is expected to enable the Company to meet its operating and capital requirements. The Company does not believe it will need to access the capital markets to meet its operating and capital requirements in 1990.

The 1989 Settlement assumes that the Company is to be allocated up to $500 million (at a minimum of $100 million per year through 1993) of the New York State private activity bond volume cap to permit the Company to utilize tax-exempt securities. In 1989, the Company utilized $100 million of such securities. In 1990, the Company intends to apply for permission to utilize at least an additional $100 million of these tax-exempt securities with the proceeds principally used to reimburse the Company for expenditures previously incurred for qualifying facilities. This will, in turn, permit the Company to retire higher cost G&R Bonds previously issued. If market conditions permit, the Company may issue debentures in 1990 to refinance certain other currently outstanding higher cost G&R Bonds.

Capital Requirements and Capital Provided

In 1989, capital requirements amounted to $1.9 billion and consisted of construction requirements, refundings, dividends and Shoreham post settlement costs. Construction requirements were $201 million, refundings amounted to $1.2 billion and dividend payments on the Company's preferred stock and common stock amounted to $418 million and $28 million, respectively. Shoreham post settlement costs in 1989 amounted to $75 million, including $36 million of property taxes.

For 1990, total capital requirements (excluding Shoreham post settlement costs) are estimated at $324 million, of which construction requirements are estimated to be $235 million, refundings are $7 million, preferred stock sinking fund requirements are $14 million and preferred stock dividends are $68 million. Capital requirements and capital provided for 1989 and 1988 were as follows:

Capital Requirements:	1989	1988
	(millions of dollars)	
Construction		
Electric		
Nuclear		
Shoreham	$ 104	$ 369
Nine Mile Point 2 (NMP2)	6	19
Fuel	6	9
Non Nuclear	121	144
Total Electric	237	541
Gas	50	37
Common	10	9
Total Construction	297	587
Less: NMP2 Reimbursement	–	52
FSA Revenues	96	203
Total Construction	201	332
Refundings and Dividends		
Long-Term Debt	621	43
Short-Term Debt	112	–
Bank Loans	112	37
Preferred Stock	308	–
Preferred Stock Dividends	418	–
Common Stock Dividends	28	–
Treasury Stock	1	18
Total Refundings and Dividends	1,600	98
Subtotal	1,801	430
Shoreham Post Settlement Costs	75	–
Total Capital Requirements	$ 1,876	$ 430

Capital Provided:	1989	1988
	(millions of dollars)	
(Increase in) Use of Cash Balances	$ (247)	$ 118
Long-Term Debt	1,542	–
Short-Term Debt	112	–
Preferred Stock	309	–
Financing Costs	(81)	–
Internal Cash Generation from Operations	241	312
Total Capital Provided	$ 1,876	$ 430

For further information, see the Statement of Cash Flows and Note 1 of Notes to Financial Statements. For information with respect to Financial Stability Adjustment (FSA) revenues, see Note 5 of Notes to Financial Statements.

Investment Rating

The Company's securities are rated by Moody's Investor Service, Inc. (Moody's), Standard and Poor's Corporation (S&P), Fitch Investor Service, Inc. (Fitch) and Duff and Phelps (D&P).

During 1989, each of the rating agencies upgraded its ratings of the Company's principal securities. At December 31, 1989, LILCO's First Mortgage Bonds were rated minimum investment grade by D&P. At December 31, 1989, D&P rated the Company's G&R Bonds one "notch" below minimum investment grade. The Company's First Mortgage Bonds and G&R Bonds were rated one "notch" below minimum investment grade by each of the other three agencies at December 31, 1989.

The chart below indicates the ratings for each of the Company's principal securities at December 31, 1989 and the minimum investment grade rating used by each agency.

	Moody's	S&P	Fitch	D&P
First Mortgage Bonds	Ba1	BB+	BB+	BBB–
G&R Bonds	Ba1	BB+	BB+	BB+
Debentures	Ba2	BB–	BB–	BB–
Preferred Stock	ba3	BB–	BB–	B
Minimum Investment Grade	**Baa3**	**BBB–**	**BBB–**	**BBB–**

Capitalization

Capitalization (defined as the total of Long-Term Debt, Preferred Stock and Common Shareowners' Equity) was approximately $7.2 billion at December 31, 1989, an increase from $6.6 billion at December 31, 1988. The approximate $547 million increase in capitalization reflects the increase in debt associated with the 1989 financing activity, partially offset by the payment of dividends (including the payment of $390 million of preferred stock dividends in arrears), and a reduction in retained earnings caused by the Company's 1989 loss.

The 1989 loss results from recording non-cash charges to net income which resulted from the 1989 Settlement and the Class Settlement becoming effective and from the cessation of the allowance for funds used during construction (AFC) accruing on its Shoreham investment effective January 1, 1989, the aggregate effect of which is approximately $382 million, net of tax benefits, or $3.43 per share.

Under the 1989 Settlement, the Company recorded on its books the write-off of its remaining investment in Shoreham (and other related assets) and the establishment of the FRA. The net loss resulting therefrom, and the reduction of net income resulting from the cessation of AFC accruing on Shoreham, which mitigated such write-off, totaled approximately $269 million, net of tax benefits. Upon the effectiveness of the Class Settlement, the Company recorded a charge to income of approximately $113 million which represented the present value, at June 30, 1989, of the total amount of the Class Settlement, net of tax benefits.

Capitalization, at December 31, 1988, was approximately $1.4 billion lower than the December 31, 1987 balance of $8.0 billion. The decrease in 1988 was caused by the Company's 1988 loss which was attributable to a write-down of net assets amounting to approximately $1.3 billion, net of tax benefits, or $12.10 per common share resulting from the adoption of Statement of Financial Accounting Standards No. 90 (SFAS No. 90).

At December 31, 1989, 1988 and 1987, the components of the Company's capitalization ratios were as follows:

Capitalization Ratios	1989	1988	1987
Long-Term Debt	63.1%	51.7%	46.4%
Preferred Stock	9.7	15.4	12.1
Common Shareowners' Equity	27.2	32.9	41.5
	100.0%	100.0%	100.0%

Results of Operations

Earnings

In 1989, the Company incurred a loss for common stock of approximately $175 million, or $1.57 per common share resulting from recording non-cash charges to net income reflecting the 1989 Settlement and the Class Settlement becoming effective and the cessation of accruing AFC, the aggregate effect of which is approximately $382 million, net of tax benefits, or $3.43 per common share. Excluding these items, earnings for common stock in 1989 would have been approximately $207 million, or $1.86 per common share.

In 1988, the Company incurred a loss for common stock of approximately $1.1 billion, or $10.08 per common share resulting from a non-cash write-down attributable to adopting SFAS No. 90. The write-down amounted to approximately $1.3 billion, net of tax benefits, or $12.10 per common share and resulted principally from certain costs of Shoreham and NMP2 which the PSC determined the Company may not recover. Before this write-down, earnings for common stock in 1988 were approximately $224 million, or $2.02 per common share.

Net Income (Loss), Earnings (Loss) for Common Stock, and Earnings (Loss) per Common Share are shown below for the years 1989, 1988 and 1987.

	1989	1988	1987
	(in millions, except per share amounts)		
Net Income (Loss)	**$ (95.8)**	$ (1,046.6)	$ 269.9
Earnings (Loss) for Common Stock	**$ (175.0)**	$ (1,121.1)	$ 192.3
Earnings (Loss) per Common Share	**$ (1.57)**	$ (10.08)	$ 1.73

The loss in 1989 and the loss in 1988 were attributable to the items previously mentioned. Also contributing to the overall variance between 1989 when compared to 1988 were higher operating expenses and operating taxes as well as higher interest expenses in 1989 offset, in part, by higher revenues. The overall variance between 1988 when compared to 1987 includes higher revenues and lower federal income taxes, due to lower tax rates in 1988 offset, in part, by reductions in AFC and increases in expenses.

Revenues

Total revenues in 1989, including revenues from recovery of fuel costs, were $2.3 billion, which represents an increase of $210 million, or 9.8%, over 1988 revenues. Total revenues for the Company's electric and gas operations for 1989, 1988 and 1987 are shown below:

	1989	1988	1987
	(millions of dollars)		
Revenues			
Electric	**$ 1,983**	$ 1,787	$ 1,719
Gas	**365**	351	353
Total Revenues	**$ 2,348**	$ 2,138	$ 2,072

Electric Revenues: In 1989, electric revenues increased $196 million, or 11.0% over 1988. Revenues in 1988 had increased $68 million, or 4.0%, over 1987. The increases in electric revenues resulted primarily from the following factors:

	89/88	88/87
	(millions of dollars)	
Customer Consumption	**$ (45)**	$ 59
Customer Additions	**17**	23
Unbilled Revenue Accruals	**74**	30
Fuel Cost Adjustments	**75**	(44)
Rate Increases	**75**	—
Total	**$ 196**	$ 68

Average customer consumption decreased by .2%, or approximately 25 kilowatt-hours in 1989, with the decrease attributable, in part, to cooler summer weather in 1989 as compared to 1988. The successful implementation of the Company's energy conservation programs was also a contributing factor to the decrease in consumption. The average number of electric customers served in 1989 was approximately 995,000, up 9,500, or 1.0% over 1988.

Unbilled revenue accruals represent revenues which have been earned on electric service supplied to our customers, but not yet billed to them. See Note 1 of Notes to Financial Statements.

Revenues from fuel cost adjustments were higher in 1989, due primarily to an increase in oil prices. The average cost of oil burned in the Company's steam generating plants in 1989 was $17.83 per barrel, compared with $15.78 per barrel in 1988. The average cost of oil burned in 1987 was $18.16 per barrel.

In 1989, the Company was granted rate increases of 5.4% on February 15 and 5.0% on December 1. No rate increases were granted in 1988.

Gas Revenues: In 1989, gas revenues increased by $14 million, or 3.8%, compared to 1988. Revenues in 1988 had decreased $2 million, or .7%, compared to 1987. The increases (decreases) in gas revenues resulted primarily from the following factors:

	89/88	88/87
	(millions of dollars)	
Customer Consumption	**$ 6**	$ 6
Customer Additions	**4**	5
Fuel Cost Adjustments	**4**	(13)
Total	**$ 14**	$ (2)

The increase in average customer consumption in 1989 was 1.53 dekatherms (dth), or 1.2%, despite warmer winter weather.

The average number of gas customers served in 1989 was 424,000, up 5,100, or 1.2%, over 1988.

Revenues from fuel cost adjustments were higher in 1989, due primarily to an increase in gas prices. The average cost of gas sold in 1989 was $3.31 per dth, compared with $3.10 per dth in 1988. The average cost of gas sold in 1987 was $3.12 per dth.

In January 1990, the Company was granted a $5.5 million gas rate increase, or approximately 1.3%.

Operating and Maintenance Expenses

Excluding fuels and purchased power, operating and maintenance (O&M) expenses were $427 million in 1989, an increase of $69 million, or 19.4%, over 1988. In 1988, these O&M expenses increased $16 million, or 4.6%, over 1987. The increases in 1989 and 1988 were principally attributable to costs of maintaining production plant in an effort to further improve customer service. The success of this effort was evidenced by the extraordinary performance and reliability levels of the Company's electric generation facilities during the past three-year period. Higher costs for employee wages and medical insurance also contributed to the increases. In 1989, the Company embarked on aggressive energy conservation programs which, while reducing the use of energy by its customers, also contributed to the increase of O&M expenses in 1989 through the implementation of such programs. O&M expenses in 1989 also include costs associated with the first full year of operation of NMP2, whereas in 1988 NMP2 was placed in commercial operation in the second quarter.

Other Items

For a discussion of the accounting treatment of the 1989 Settlement and the Class Settlement, see Note 5 of Notes to Financial Statements.

Federal income taxes, excluding tax benefits attributable to the write-down of net assets in 1988, were $1.1 billion lower in 1989 than in 1988. In 1988, these taxes were $57 million lower than in 1987. The decrease in 1989 was principally due to the tax benefits resulting from the abandonment loss deduction in connection with Shoreham as a result of the 1989 Settlement and the Class Settlement. Changes in federal income taxes are also due 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.

Operating taxes, predominantly property taxes, were $364 million in 1989, compared to $311 million in 1988 and $300 million in 1987.

Depreciation expense increased by $10 million in 1989 and by $20 million in 1988, primarily attributable to the addition of NMP2 to plant in service in 1988. Interest expense increased by $54 million in 1989, principally due to the financing activities, and by $3 million in 1988. Changes in rates were also a contributing factor to changes in interest expense in both 1989 and 1988.

In addition to the charge to income recorded on June 30, 1989, resulting from the Class Settlement becoming effective, the Company recorded non-cash charges to income during the second half of 1989 of $16 million, or $11 million, net of tax benefits, for the ongoing carrying costs on the Company's obligation under the Class Settlement.

In January 1990, the Company, the other cotenants of NMP2, the PSC and other interested parties reached an agreement subject to final documentation resolving all NMP2 ratemaking issues with respect to the construction of NMP2 and its operation through January 19, 1990. Under the terms of the agreement, the Company's share of disallowed costs would aggregate approximately $11 million, or $7 million, net of tax benefits, and these costs were charged to income in 1989.

In December 1989, the Company recorded an additional charge to earnings of $7.2 million which reflects revisions to certain estimates relating to the 1989 Settlement.

In the past, AFC has represented a significant portion of the Company's earnings. AFC is a non-cash credit to income that represents the cost of borrowed funds for construction purposes and a reasonable rate upon a utility's other funds when so used. The amount of AFC fluctuates from period to period with changes in the cost of money, the level of construction activity, the amount of construction work in progress included in rate base, and modifications in regulatory policy and the effect of regulatory disallowances.

As a result of the cessation of accruing AFC on the Company's investment in Shoreham effective January 1, 1989, and the effectiveness of the 1989 Settlement in June 1989, AFC will no longer be a significant component of the Company's earnings, but other non-cash income will be substantial, generated principally by the accretion over the next several years of a component of the FRA. For a further discussion of AFC and the 1989 Settlement, see Note 5 of Notes to Financial Statements.

Selected Financial Data

Additional information respecting revenues, expenses, electric and gas operating income and operations data, capital expenditures and balance sheet information for the last five years is provided in Tables 1 through 10 of Selected Financial Data. Information with regard to the Company's business segments for the last three years is provided in Note 8 of Notes to Financial Statements.

Financial Statements

Statement of Income

For year ended December 31 *(In thousands of dollars except per share amounts)*	1989	1988	1987
Revenues			
Electric	**$ 1,983,288**	$ 1,786,933	$ 1,718,861
Gas	**364,326**	350,901	353,216
Total Revenues	**2,347,614**	2,137,834	2,072,077
Expenses			
Operations – fuel and purchased power	**772,452**	674,429	685,689
Operations – other	**297,518**	248,698	240,713
Maintenance	**129,788**	109,198	101,287
Depreciation, depletion and amortization	**103,430**	93,596	73,905
Base financial component amortization	**50,485**	–	–
Rate moderation component	**(131,167)**	–	–
Regulatory liability component	**750,554**	–	–
Jamesport amortization	**104,160**	–	–
Operating taxes	**364,391**	310,864	300,159
Federal income tax – current	**14,612**	18,395	83,577
Federal income tax (credit) – deferred and other	**(729,032)**	181,716	204,143
Total Expenses	**1,727,191**	1,636,896	1,689,473
Operating Income	**620,423**	500,938	382,604
Other Income and (Deductions)			
Allowance for other funds used during construction, net of financial stability adjustment revenues	**(54,918)**	75,491	127,958
Other income and (deductions)	**33,630**	(10,049)	14,885
1989 Settlement	**(303,947)**	–	–
Class Settlement	**(186,000)**	–	–
Federal income tax credit – current	**–**	–	80,597
Federal income tax credit – deferred and other	**322,991**	88,264	38,269
Total Other Income and (Deductions)	**(188,244)**	153,706	261,709
Income Before Interest Charges and Cumulative Effect of Accounting Change	**432,179**	654,644	644,313
Interest Charges and (Credits)			
Interest on long-term debt	**453,267**	410,966	410,097
Other interest	**31,366**	19,702	17,404
Allowance for borrowed funds used during construction, net of financial stability adjustment revenues	**43,349**	(74,514)	(53,076)
Total Interest Charges and (Credits)	**527,982**	356,154	374,425
Income (Loss) Before Cumulative Effect of Accounting Change	**(95,803)**	298,490	269,888
Cumulative Effect of Accounting Change for Disallowed Costs (net of applicable taxes of $448,978)	**–**	(1,345,110)	–
Net Income (Loss)	**(95,803)**	(1,046,620)	269,888
Preferred stock dividend requirements	**79,232**	74,508	77,576
Earnings (Loss) for Common Stock	**$ (175,035)**	$(1,121,128)	$ 192,312
Average Common Shares Outstanding (000)	**111,215**	111,177	111,129
Earnings (Loss) per Common Share			
Income (loss) before cumulative effect of accounting change for disallowed costs	**$ (1.57)**	$ 2.02	$ 1.73
Cumulative effect of accounting change	**–**	(12.10)	–
Earnings (Loss) per Common Share	**$ (1.57)**	$ (10.08)	$ 1.73
Dividends Declared per Common Share	**$ .50**	$ –	$ –
Pro Forma Earnings – with 1988 Accounting Change Applied Retroactively			
Earnings for common stock		$ 223,982	$ 176,712
Earnings per common share		$ 2.02	$ 1.59

See Notes to Financial Statements.

Balance Sheet

Assets

At December 31 *(In thousands of dollars)*	1989	1988
Utility Plant		
Electric	$ 3,119,085	$ 2,965,213
Gas	519,979	476,950
Common	131,989	128,866
Construction work in progress	128,820	4,249,845
Nuclear fuel in process and in reactor	42,743	199,379
	3,942,616	8,020,253
Less — Accumulated depreciation, depletion and amortization	1,161,459	1,075,129
Total Net Utility Plant	2,781,157	6,945,124
Regulatory Asset		
Base financial component (less accumulated amortization of $50,485)	3,988,344	—
Other Property and Investments		
Nonutility property, principally at cost	4,574	1,027
Investment in subsidiary companies, at equity	355	334
Bokum Resources Corporation	—	66,767
Other investments and deposits	1,121	1,143
Total Other Property and Investments	6,050	69,271
Current Assets		
Cash	15,963	13,647
Temporary cash investments	324,341	78,902
Special deposits	27,636	17,940
Accounts receivable (loss allowance for doubtful accounts of $5,072 and $4,239)	234,060	193,083
Accrued revenue	173,031	96,110
Materials and supplies at average cost	82,776	46,997
Fuel oil at average cost	36,232	36,581
Gas in storage at average cost	35,422	35,971
Prepayments and other current assets	52,571	52,703
Total Current Assets	982,032	571,934
Deferred Charges		
Accumulated deferred income taxes	262,298	525,029
Rate moderation component	102,971	—
1989 Settlement charges	106,248	—
Shoreham post settlement costs	75,044	—
Unamortized storm damage costs	40,902	44,048
Unamortized cost of issuing securities	150,610	52,689
Unamortized cost of Jamesport abandoned generating project	—	98,616
Other	24,382	19,626
Total Deferred Charges	762,455	740,008
Total Assets	$ 8,520,038	$ 8,326,337

See Notes to Financial Statements.

Capitalization and Liabilities

At December 31 *(In thousands of dollars)*	1989	1988
Capitalization		
Long-term debt	**$ 4,560,016**	$ 3,449,821
Unamortized premium and (discount) on debt	**(28,587)**	(25,011)
	4,531,429	3,424,810
Preferred stock — redemption required	**541,187**	513,924
Preferred stock — no redemption required	**155,592**	221,050
Treasury stock, at cost	**—**	(58,430)
Retained earnings restricted for preferred stock dividend requirements	**—**	341,008
Total Preferred Stock	**696,779**	1,017,552
Common stock	**556,247**	555,965
Premium on capital stock	**991,724**	1,001,328
Capital stock expense	**(42,916)**	(56,151)
Retained earnings	**436,690**	679,579
Total Common Shareowners' Equity	**1,941,745**	2,180,721
Total Capitalization	**7,169,953**	6,623,083
Current Liabilities		
Current maturities of long-term debt	**7,000**	274,780
Current redemption requirements of preferred stock	**13,638**	19,888
Accounts payable and accrued expenses	**229,755**	164,977
Accrued taxes (including federal income taxes of $25,631 and $12,570)	**98,435**	35,877
Accrued interest	**64,425**	70,207
Dividends payable	**39,173**	—
Customer deposits	**18,459**	17,288
Total Current Liabilities	**470,885**	583,017
Deferred Credits		
1989 Settlement credits	**191,933**	—
Class Settlement	**164,040**	—
Accumulated deferred income taxes	**430,933**	963,975
Other	**81,443**	144,015
Total Deferred Credits	**868,349**	1,107,990
Reserves for Claims, Damages, Pensions and Benefits	**10,851**	12,247
Commitments and Contingencies	**—**	—
Total Capitalization and Liabilities	**$ 8,520,038**	$ 8,326,337

See Notes to Financial Statements.

Shareowners' Equity

At December 31 *(In thousands of dollars)*			1989	1988	1987
Statement of Retained Earnings					
Balance, January 1			$ **679,579**	$ 1,801,919	$ 1,609,268
Add – Restricted for preferred stock dividend requirements at beginning of year			**341,008**	265,288	188,051
Add (deduct) – Net income (loss) for the year			**(95,803)**	(1,046,620)	269,888
Deduct – Cash dividends declared on preferred stock			**429,749**	–	–
Deduct – Cash dividends declared on common stock			**55,618**	–	–
Deduct – Capital stock expense			**2,727**	–	–
Deduct – Restricted for preferred stock dividend requirements at end of year			**–**	341,008	265,288
Balance, December 31			$ **436,690**	$ 679,579	$ 1,801,919
	Call Price Per Share 1989	Call Price Per Share Final			
Preferred Stock					
Par Value $100 per Share, Cumulative:					
Shares authorized			**7,000,000**	7,000,000	7,000,000
Shares issued and outstanding			**2,624,172**	2,715,116	2,793,227
Shares held in treasury*			**–**	283,500	205,404
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
5 3/4% Series I Convertible	100.00	100.00	**3,592**	4,050	4,052
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**	103.88	100.00	**23,450**	27,650	27,650
8.40% Series M**	104.20	100.00	**28,000**	33,600	33,600
8.50% Series R**	102.50	100.00	**30,000**	45,000	45,000
9.80% Series S**	103.00	100.00	**60,375**	72,562	72,562
Total Par Value $100			$ **262,417**	$ 299,862	$ 299,864
Par Value $25 per Share, Cumulative:					
Shares authorized			**30,000,000**	30,000,000	30,000,000
Shares issued and outstanding			**17,920,000**	17,140,000	17,348,600
Shares held in treasury*			**–**	1,060,000	851,400
$2.47 Series O**	$ 25.75	$ 25.25	$ **30,000**	$ 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	**63,000**	75,000	75,000
$4.25 Series U**	–	–	**–**	65,000	65,000
$3.50 Series V**	–	–	**–**	75,000	75,000
$3.52 Series W	–	–	**–**	65,000	65,000
$3.50 Series X**	–	–	**–**	100,000	100,000
$2.65 Series Y**	27.65	25.00	**320,000**	–	–
Total Par Value $25			$ **448,000**	$ 455,000	$ 455,000
Less – Sinking fund requirements			**13,638**	19,888	13,025
Less – Treasury stock at cost*			**–**	58,430	40,881
Add – Retained earnings restricted for preferred stock dividend requirements			**–**	341,008	265,288
Total Preferred Stock			$ **696,779**	$ 1,017,552	$ 966,246
Common Stock					
Par Value $5 per Share					
Shares authorized			**150,000,000**	150,000,000	150,000,000
Shares issued and outstanding			**111,249,468**	111,193,008	111,149,818
Increase in shares outstanding			**56,460**	43,190	44,823
Increase in $5 par value			$ **282**	$ 216	$ 224
Increase in premium on capital stock			**608**	149	221
Increase (decrease) in capital stock expense			**(13,235)**	7	6

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

Statement of Cash Flows

For year ended December 31 *(In thousands of dollars)*	1989	1988	1987
Operating Activities:			
Net Income (Loss)	$ (95,803)	$ (1,046,620)	$ 269,888
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Cumulative effect of accounting change for disallowed costs	—	1,345,110	—
Depreciation, depletion and amortization	103,430	93,596	73,905
Base financial component amortization	50,485	—	—
Rate moderation component	(131,167)	—	—
Regulatory liability component	750,554	—	—
Jamesport amortization	104,160	—	—
1989 Settlement	303,947	—	—
Class Settlement	186,000	—	—
Federal income taxes (credit) — deferred and other	(1,052,023)	93,452	165,874
Allowance for other funds used during construction	1,166	(177,656)	(258,623)
Other	40,481	19,873	32,462
Changes in operating assets and liabilities:			
Accounts receivable	(41,980)	(24,766)	2,991
Accrued revenue	(97,983)	(31,185)	(1,585)
Materials and supplies, fuel oil and gas in storage	(6,681)	8,414	(26,256)
Prepayments and other current assets	23,890	4,965	(16,209)
Accounts payable and accrued expenses	42,818	11,814	3,249
Accrued taxes	66,750	9,577	(6,345)
Other	(7,456)	5,695	(32,527)
Net Cash Provided by Operating Activities	240,588	312,269	206,824
Investing Activities:			
Construction and nuclear fuel expenditures	(297,396)	(586,514)	(507,414)
Financial stability adjustment revenues	96,180	203,013	184,862
Construction and nuclear fuel expenditures, net of financial stability adjustment revenues	(201,216)	(383,501)	(322,552)
Shoreham post settlement costs	(75,044)	—	—
Receivable — Nine Mile Point 2 settlement	—	52,200	—
Other	(393)	(532)	(434)
Net Cash Used in Investing Activities	(276,653)	(331,833)	(322,986)
Financing Activities:			
Proceeds from issuance of long-term debt	1,541,350	—	—
Proceeds from issuance of short-term debt	111,585	—	—
Redemption of long-term debt	(732,585)	(81,195)	(24,000)
Redemption of short-term debt	(111,585)	—	—
Proceeds from sale of preferred stock	309,120	—	—
Redemption of preferred stock	(307,738)	—	—
Preferred stock dividends paid	(418,387)	—	—
Common stock dividends paid	(27,807)	—	—
Acquisition of treasury stock	(1,400)	(17,549)	(15,179)
Cost of issuing long-term debt	(53,156)	(280)	(601)
Cost related to the sale of preferred stock	(24,827)	—	—
Other	(750)	356	437
Net Cash Provided by (Used in) Financing Activities	283,820	(98,668)	(39,343)
Net Increase (Decrease) in Cash and Cash Equivalents	$ 247,755	$ (118,232)	$ (155,505)
Cash and cash equivalents at beginning of year	$ 92,549	$ 210,781	$ 366,286
Net increase (decrease) in cash and cash equivalents	247,755	(118,232)	(155,505)
Cash and Cash Equivalents at End of Year	$ 340,304	$ 92,549	$ 210,781

See Notes to Financial Statements.

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).

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), net of Financial Stability Adjustment (FSA) revenues. 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.

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 construction work in progress (CWIP) which is not included in the Company's rate base. 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 or when it is probable that such costs will not be allowed 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 average annual AFC rate, without giving effect to compounding was 12.20%, 12.12% and 13.53% for the years 1989, 1988 and 1987, respectively. The average annual AFC rate, net of tax, which had been applied to the Shoreham Nuclear Power Station (Shoreham) CWIP, without giving effect to compounding, was 9.90%, 9.95% and 11.78% for the years 1989, 1988 and 1987, 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 3.2%, 3.6% and 3.5% for electric and 2.9%, 2.8% and 2.7% for gas of respective average depreciable plant costs for the years 1989, 1988 and 1987, respectively.

Nine Mile Point 2

The Company has an 18% undivided interest in Nine Mile Point 2 (NMP2), a nuclear power plant near Oswego, New York. The cotenants of NMP2, in addition to the Company, are Niagara Mohawk Power Corporation (NMPC), New York State Electric & Gas, Rochester Gas and Electric Corporation and Central Hudson Gas & Electric Corporation. At December 31, 1989, the Company's net utility plant investment in NMP2 was $836 million, net of accumulated depreciation of $38 million, which is included in the Company's rate base. The Company's share of expenses associated with NMP2 is included in the appropriate operating expenses in the Statement of Income. The Company is required to provide its respective share of financing for any capital additions to NMP2.

NMPC has contracted with the United States Department of Energy (DOE) for the disposal of nuclear fuel. The Company is reimbursing NMPC for its 18% share of the cost under the contract of $1.00 per megawatt hour of net generation.

The Company has been informed by NMPC that its 18% share of the cost to decommission NMP2 is currently estimated to be $37 million (in 1989 dollars). This estimate assumes that decommissioning of NMP2 will commence in 2027. The amount of accumulated decommissioning costs included in the Company's electric rates is $222,000, which is based on a prior estimate of $22 million (in 1984 dollars) for the Company's 18% share of decommissioning NMP2 in 2027. The Company will seek recovery in rates for these increased decommissioning costs.

In June 1988, the Nuclear Regulatory Commission (NRC) issued new regulations governing the funding of nuclear plant decommissioning costs. These regulations require the use of an external trust fund and accelerate previous funding requirements. A formal funding plan must be submitted to the NRC no later than July 27, 1990. To the extent that the NRC funding requirement is greater than the corresponding decommissioning costs allowed in rates by the PSC, the Company may be required to make deposits of the greater amount and will seek recovery in rates.

Revenues

Effective January 1, 1988, the Company recorded an asset for electric unbilled revenue, for all customers through December 31, 1987, and a corresponding liability amounting to $63.2 million to conform to an order of the PSC in its December 1987 rate decision. Pursuant to the same order, the Company is amortizing the liability and, therefore, increasing electric revenues by approximately $1.8 million per month, subject to any changes which the PSC may subsequently make to the level of amortization. The recognition of electric unbilled revenue, in conformity with the PSC order, including the liability amortization, increased 1988 electric revenues over 1987

electric revenues by approximately $29.5 million. Previously, unbilled revenue was recognized only for customers billed on a bi-monthly cycle basis for the month in which they are normally not billed.

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.

FERC has ruled that, subject to its regulations, interstate pipeline companies may pass on to their customers certain costs which resulted when demand for natural gas from interstate gas pipelines dropped off because of changing market conditions. In 1989, the PSC determined that 87.5% of these costs, known as take-or-pay costs, will be recovered from ratepayers, and, accordingly, the Company wrote-off the non-recoverable portion of such costs estimated to be approximately $4.7 million.

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 7. The Company defers the benefit of 60% of pre-1982 gas and pre-1983 electric and 100% of all other investment tax credits, with respect to regulated properties, 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, effective for fiscal years beginning after December 15, 1988. The FASB subsequently deferred the effective date of SFAS No. 96 to fiscal years beginning after December 15, 1991. SFAS No. 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 No. 96 will (a) prohibit net of tax accounting and reporting and (b) require recognition of a deferred tax liability for (i) the tax benefits which are flowed through to its customers and (ii) 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 does not expect to adopt SFAS No. 96 prior to January 1, 1992, which will provide additional time for the Company to complete its evaluation and analysis of SFAS No. 96. The impact of SFAS No. 96 on the Statement of Income is not expected to be material. However, the Company estimates that had it adopted SFAS No. 96 at December 31, 1989, the Company would have recorded an accumulated deferred tax liability and offsetting regulatory asset of approximately $1.5 billion.

Reserves for Claims, Damages, Pensions and Benefits

Losses arising from claims against the Company and extraordinary storm losses are partially 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. Upon redemption, 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 resulting gain, net of the related capital stock expense, is recorded as additional premium on capital stock. The capital stock expense and redemption costs associated with redeeming Preferred Stock Series U, V, W and X and the cost of issuance of Preferred Stock Series Y are being amortized over ten years.

Supplemental Information for Statement of Cash Flows

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The Company did not make any federal income tax payments during 1989. The Company made federal income tax payments of $17,090,000 and $13,044,000 during the years 1988 and 1987, respectively. Additionally, the Company received refunds of federal income taxes applicable to prior years of $2,660,000, $7,827,000 and $15,650,000 during the years 1989, 1988 and 1987, respectively. The Company made interest payments totaling $475,672,000, $422,780,000 and $418,065,000 during the years 1989, 1988 and 1987, respectively.

Abandonments and Disallowances of Plant Costs

In December 1986, the FASB issued SFAS No. 90, Regulated Enterprises — Accounting for Abandonments and Disallowances of Plant Costs. SFAS No. 90 requires, among other matters, that a loss be recognized when it becomes probable that (i) costs of a plant will be disallowed for ratemaking purposes or (ii) 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. As a result of adopting SFAS No. 90 effective January 1, 1988, the Company's 1988 financial statements reflect a write-down of net assets, amounting to approximately $1.3 billion, net of tax effects, or $12.10 per common share, which was accounted for as the cumulative effect of a change in accounting principle. This write-down related principally to certain costs of Shoreham determined to be imprudent by the PSC in 1985 and to the estimate as of January 1, 1988 of the Company's share of NMP2 costs in excess of the amount provided in the settlement among the cotenants of NMP2. Further, the Company had recorded in 1988 an adjustment reflecting revised estimated NMP2 disallowed project costs that are included within the settlement among the cotenants of NMP2. This adjustment reduced the write-down recorded effective January 1988 by $3.2 million, net of tax effects, and is reported in the Other Income and (Deductions) section of the Statement of Income. An additional NMP2 adjustment was recorded in December 1989, which is more fully discussed in Note 9. In June 1989 the Company recorded the effects of the 1989 Settlement and in December 1989 recorded an additional charge to earnings reflecting revisions to certain estimates relating to the 1989 Settlement, which are discussed in Notes 5 and 9.

Note 2. Capital Stock

Preferred Stock Dividends

Preferred stock dividends are cumulative. On September 1, 1989, the Company paid dividends amounting to approximately $390 million on all series of preferred stock, then in arrears. At December 31, 1989, there were no preferred stock dividends in arrears.

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. On July 25, 1989, simultaneous with the declaration of all preferred stock dividends in arrears, the Company satisfied sinking fund requirements totaling approximately $56 million then in arrears on all series of preferred stock by crediting previously acquired shares of preferred stock held in the Company's treasury. The aggregate par value of preferred stock required to be redeemed in each of the years 1990 through 1994 is $13,637,500.

Preferred Stock

In October 1989, the Company sold 12,800,000 shares of Preferred Stock, $2.65, Series Y, cumulative, par value $25 per share. The Company used the proceeds from the issuance of the Series Y Preferred Stock to call at applicable redemption prices its high cost Preferred Stock Series U, V, W and X.

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, 1989, 1,927,062 shares were reserved for sale to employees, 6,802,247 shares were committed to the Automatic Dividend Reinvestment Plan, and 209,469 shares were reserved for conversion of the Series I Convertible Preferred Stock at a rate of $17.15 per share.

Common Stock Dividends

On August 14, 1989 and November 15, 1989, the Company's Board of Directors declared common stock dividends of $.25 per share payable on October 1, 1989 and January 1, 1990, respectively. Dividend limitations contained in the mortgage securing the Company's First Mortgage Bonds are not material. There are no dividend limitations contained in the Company's other debt instruments.

Note 3. Debt at December 31

Each of the Company's four 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 G&R Mortgage (G&R Trustee) as additional security for General and Refunding Bonds (G&R Bonds), are secured by the lien of the First Mortgage. First Mortgage Bonds pledged with the G&R Trustee do not represent outstanding indebtedness of the Company. Amounts of such pledged bonds outstanding were $449 million and $469 million at December 31, 1989 and 1988, respectively. The annual First Mortgage depreciation fund and sinking fund requirements for 1989, due not later than June 30, 1990, are estimated at $175 million and $12 million, respectively. The Company expects to meet these requirements with property additions and retired First Mortgage Bonds.

G&R Mortgage

The lien of the G&R Mortgage is subordinate to the lien of the First Mortgage. The annual G&R Mortgage sinking fund requirement for 1989, due not later than June 30, 1990, 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 secured by the Third Mortgage was restructured on June 30, 1989, at which time, the Company entered into the 1989 Amended and Restated Restructuring Credit Agreement (1989 Term Loan Agreement) pursuant to which the Company is to pay to its lending banks approximately $446 million previously outstanding under the 1986 Restructuring Credit Agreement (1986 RCA) in sixteen substantially equal consecutive quarterly installments commencing on January 1, 1993 and ending on October 1, 1996. This payment schedule deferred, for three years, the repayment of the remaining balance outstanding under the 1986 RCA, the next installment of which would have been due on December 31, 1989. Pursuant to the 1989 Term Loan Agreement, the Company has the option to commit to one of three interest rates including: (i) Adjusted Certificate of Deposit Rate (CD 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, 1989, the Company had approximately $446 million outstanding under the 1989 Term Loan Agreement at the LIBOR Rate which was at 9.55% per annum.

Fourth Mortgage

The Fourth Mortgage was created in October 1989 to partially secure, in the amount of $85 million, letters of credit, described below under the heading Authority Financing Notes. The Fourth Mortgage ranks pari passu with the Third Mortgage.

Other Long-Term Debt

1989 Credit Agreement

In February 1989, the Company and certain of its lending banks entered into a credit agreement (the 1989 Credit Agreement) pursuant to which an amount up to $200 million of credit secured by a first lien upon the Company's accounts receivable and fuel oil inventory was made available to the Company. Under the terms of this agreement, which was due to expire in February 1990, the Company immediately borrowed and applied approximately $112 million to prepay the March, June and September 1989 payments of approximately $37 million each associated with the Company's 1986 RCA. On June 30, 1989, the Company repaid the $112 million outstanding under the 1989 Credit Agreement. The 1989 Credit Agreement was subsequently replaced by the 1989 Revolving Credit Agreement, described immediately below.

1989 Revolving Credit Agreement

On June 30, 1989, the Company and certain of its lending banks entered into the 1989 Revolving Credit Agreement (1989 RCA) which provides credit to the Company through October 1, 1992, secured by a first lien upon its accounts receivable and fuel oil inventory, of up to $300 million. The Company has the option to commit to one of three interest rates including: (i) the CD Rate, (ii) the Base Rate and (iii) the Eurodollar Rate. Currently, the 1989 RCA is unused and remains available to the Company. The Company has agreed to pay a fee of three tenths of one percent per annum on the unused portion. The termination date of the 1989 RCA may be extended for one year periods upon the Company's request delivered to the lending banks in June of each year beginning in 1991.

Debentures

On April 17, 1989, the Company issued $375 million of debentures, 11-3/8% Series Due 1993.

On July 11, 1989, the Company issued $1.1 billion of debentures ($400 million, 10.25% Series Due 1994; $350 million, 10.875% Series Due 1999 and $350 million, 11.375% Series Due 2019). The Company used $535 million of the proceeds from the issuance of the debentures to redeem, at applicable redemption prices, $495 million principal amount of high interest rate G&R Bonds in August 1989.

The Company's debentures rank on parity with all other unsecured indebtedness of the Company.

Authority Financing Notes

The Company issued $317 million of Authority Financing Notes (Notes) to the New York State Energy Research and Development Authority (NYSERDA) to secure certain tax-exempt bonds issued by NYSERDA. Of this amount $100 million was issued in 1989, $150 million was issued in 1985 and $17 million was issued in 1982, all of which are subject to periodic tender by the holders thereof. The remaining $50 million of Notes were issued at varying fixed rates and are not subject to tender.

The $100 million of Electric Facilities Revenue Bonds (1989 EFRBs) were issued in December 1989 by NYSERDA with an initial interest rate of 6 1/4% and were remarketed at an interest rate of 6% effective February 1, 1990. The 1989 EFRBs are scheduled to be tendered by the holders on September 4, 1990 and remarketed at such tender date. Thereafter, the 1989 EFRBs are subject to periodic tender by the holders. The 1989 EFRBs are supported by letters of credit pursuant to which the letter of credit bank has agreed to pay the principal, interest and premium on any tendered 1989 EFRBs, in the aggregate, up to approximately $108 million in the event of default. The obligation of the Company to reimburse the letter of credit bank is unsecured. These letters of credit expire on December 31, 1991, at which time the Company is required to obtain either an extension of the letters of credit or substitute credit backup. If neither can be obtained, the EFRBs must be redeemed unless the Company purchases the EFRBs in lieu of redemption and subsequently remarkets them.

The $150 million of Pollution Control Revenue Bonds (PCRBs) issued by NYSERDA in 1985 are deemed to be tendered by the holders each March 1 and are remarketed at such tender date. The interest rate for these PCRBs is subject to redetermination at each tender date and is currently 7%. The letter of credit bank, partially secured by the Fourth Mortgage in the amount of $85 million, has agreed, in the event of default to pay the principal, interest and premium on the tendered PCRBs, in the aggregate, up to approximately $165 million. These letters of credit expire on September 15, 1992, at which time the Company is required to obtain either an extension of the letters of credit or substitute credit backup. If neither can be obtained, the PCRBs must be redeemed unless the Company purchases the PCRBs in lieu of redemption and subsequently remarkets them.

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 1991. The interest rate on the 1982 PCRBs is currently 8 1/4%.

Long-Term Debt

At December 31 *(In thousands of dollars)*	**1989**	1988
First Mortgage Bonds *(excludes Pledged Bonds)*		
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	**450,000**	450,000
Less Current Maturities	**–**	–
Total Less Current Maturities	**450,000**	450,000
General and Refunding Bonds		
17½% Series Due 1989	**–**	100,000
15¾% Series Due 1991	**–**	60,000
16⅝% Series Due 1991	**–**	50,000
17% Series Due 1991	**–**	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	**74,000**	80,000
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
17⅛% Series Due 2012	**–**	100,000
15¼% Series Due 2012	**–**	100,000
13½% Series Due 2013	**–**	105,000
11⅞% Series Due 2015	**275,000**	275,000
Total General and Refunding Bonds	**1,179,000**	1,800,000
Less Current Maturities	**7,000**	126,000
Total Less Current Maturities	**1,172,000**	1,674,000
Third Mortgage		
1989 Term Loan Agreement/ 1986 RCA	**446,341**	557,926
Less Current Maturities	**–**	148,780
Total Less Current Maturities	**446,341**	409,146
Other Long-Term Debt		
Debentures		
10.25% to 11.75% Due 1993-2019	**2,175,000**	700,000
Authority Financing Notes		
5⅛% to 8¼% Due 2006-2019	**316,675**	216,675
Total Other Long-Term Debt	**2,491,675**	916,675
Less Current Maturities	**–**	–
Total Less Current Maturities	**2,491,675**	916,675
Total Long-Term Debt Less Current Maturities	**$ 4,560,016**	$ 3,449,821

The aggregate of the Company's long-term debt due in the next five years is $7,000 (1990), $29,000 (1991), $85,000 (1992), $705,585 (1993) and $715,585 (1994).

Note 4. 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 of 1974 (ERISA) plus such additional amounts, if any, 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. Effective January 1, 1989, employees become vested in the pension plan after five years of service with the Company.

The Supplemental Plan provides, without contribution from such employees, supplemental death and retirement benefits for officers and other key executives. The Supplemental Plan is a non-qualified plan under the Internal Revenue Code. Death benefits are currently provided by insurance. Retirement benefits totaling approximately $546,000, $688,000 and $690,000 have been recognized as expense in 1989, 1988 and 1987, respectively, but are unfunded.

The Primary Plan's funded status and amounts recognized in the Balance Sheet at December 31, 1989 and 1988 are as follows:

	1989	1988
	(thousands of dollars)	
Actuarial present value of benefit obligation		
Vested benefits	**$ 335,535**	$ 344,000
Nonvested benefits	**17,846**	11,000
Accumulated benefit obligation	**$ 353,381**	$ 355,000
Plan assets at fair value	**$ 454,159**	$ 406,400
Actuarial present value of projected benefit obligation	**423,769**	381,184
Projected benefit obligation less than plan assets	**30,390**	25,216
Unrecognized January 1, net obligations	**27,855**	14,351
Unrecognized net gain	**(56,535)**	(42,006)
Net prepaid (accrued) pension cost	**$ 1,710**	$ (2,439)

Net periodic pension cost for 1989, 1988 and 1987 for the Primary Plan included the following components:

	1989	1988	1987
		(thousands of dollars)	
Service cost — benefits earned during the period	**$ 10,797**	$ 9,800	$ 10,858
Interest cost on projected benefit obligation and service cost	**31,458**	29,004	26,759
Actual return on plan assets	**(49,316)**	(34,061)	(23,490)
Net amortization and deferral	**22,955**	8,773	(847)
Net periodic pension cost	**$ 15,894**	$ 13,516	$ 13,280

Assumptions used in accounting for the Primary Plan in 1989, 1988 and 1987 respectively, were:

	1989	1988	1987
Discount rate	**7.5%**	8.0%	8.0%
Rate of future compensation increases	**6.0%**	6.0%	6.0%
Long-term rate of return on assets	**7.0%**	7.0%	7.0%

Pursuant to an order issued by the PSC in September 1987, the Company has deferred $.7 million, $2.1 million and $4.6 million in 1989, 1988 and 1987, respectively, which represents the excess of pension expense collected from its ratepayers over that determined under SFAS No. 87, Employers' Accounting for Pensions.

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

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 $27,155,000, $23,298,000 and $20,638,000, for 1989, 1988 and 1987, respectively, and were recognized as an expense as premiums were paid. The cost of providing those benefits for 2,112, 2,020 and 1,952 retirees, is not separable from the cost of providing benefits for the 5,937, 5,931 and 6,033 active employees in 1989, 1988 and 1987, respectively.

Note 5. The 1989 Settlement and Class Settlement

The 1989 Settlement

On February 28, 1989, the Company and the State of New York (by its Governor) entered into the 1989 Issues Agreement. The principal matters to which the 1989 Issues Agreement relates are: (i) the operation, the transfer of ownership and decommissioning of Shoreham, (ii) the settlement of certain then pending litigation and administrative proceedings and (iii) the implementation of certain recommendations contained in two PSC-directed management audits. The 1989 Issues Agreement recites the intention of the parties that the Company shall be returned to investment grade financial condition and that the Company and the State of New York anticipate that the PSC shall ensure that the future impacts on rates are to be minimized to the maximum extent practicable and shall promptly determine just and reasonable rates for the Company. It is the Company's position that these objectives can be achieved, in part, through the continued receipt of adequate and timely rate relief.

On April 13, 1989, the PSC issued the Rate Order, embodying its approval of the 1989 Issues Agreement, the Rate Moderation Agreement (RMA) and the Amended and Restated Asset Transfer Agreement. The RMA provides that the Company receive rate increases of 5.4% effective February 18, 1989, 5.0% effective December 1, 1989 (each of which the Company is currently receiving) and 5.0% effective December 1, 1990 and targeted increases of approximately 4.5% to 5.0% in each year for the following eight years. The targeted rate increases will generally be subject to normal ratemaking procedures. The RMA provides for the full capital recovery of a regulatory asset known as the Financial Resource Asset (FRA). The FRA has two components, the Base Financial Component (BFC) and the Rate Moderation Component (RMC). The RMA recognized the establishment of the BFC which, as initially established, represents the present value of the future net-after-tax cash flows which the RMA provided the Company for its financial recovery. See the discussion below under the heading Accounting Treatment of the 1989 Settlement. The RMA does not reflect the impact that the Class Settlement, discussed below, will have upon future rates. The Company estimates, however, that the annual rate increases which the Company will receive under the RMA will be approximately .2% to .3% per year lower than they would otherwise have been during the Class Settlement period.

The 1989 Settlement, which consists of: (i) the 1989 Issues Agreement; (ii) the Rate Moderation Agreement; (iii) the Amended and Restated Asset Transfer Agreement and (iv) the Amended Power Supply Memorandum became effective on June 28, 1989, having been approved by the PSC, the New York Power Authority (NYPA), the Long Island Power Authority (LIPA), the Company's Board of Directors and the Company's shareowners. The 1989 Settlement has been challenged in the courts and is subject to further challenges and uncertainties, as discussed in Note 6.

As a result of the effectiveness of the 1989 Settlement, the Company simultaneously recorded on its Balance Sheet the retirement of its investment in Shoreham and Bokum Resources Corporation (Bokum) and the establishment of the BFC. Immediately prior to the effectiveness of the 1989 Settlement, the amount of the Company's investment in Shoreham and Bokum was approximately $4.2 billion. At June 30, 1989, the BFC was approximately $4.0 billion. The Company recognized a loss in June 1989, of approximately $62 million, net of tax effects, which primarily reflects the difference between the recorded costs of the Company's investment in Shoreham and Bokum and the BFC. As a result of the PSC's approval of the RMA in 1989, the Company believed that the remaining approvals necessary for the effectiveness of the 1989 Settlement would be obtained and that the 1989 Issues Agreement and RMA would become effective. Accordingly, the Company, effective January 1, 1989, ceased the accrual of AFC on Shoreham in its GAAP basis financial statements, the result of which was to reduce net income by approximately $200 million through June 1989. The discontinuance of accruing AFC on Shoreham had no effect on the Company's cash flow and mitigated the foregoing write-off resulting from the effectiveness of the 1989 Settlement.

The RMA provides for full recovery of the BFC over 40 years. Pursuant to the RMA, a substantial amount of the Company's earnings will, for several years, be non-cash, resulting from the ratemaking treatment of the FRA. At December 31, 1989, these non-cash earnings, recorded as the RMC of the FRA, were approximately $131 million. The RMA contemplates the full recovery of the RMC within approximately ten years from the effective date of the 1989 Settlement. The RMC initially increases as the difference between revenues resulting from the implementation of the rate moderation plan provided for in the RMA and revenue requirements under conventional ratemaking, together with a carrying charge based on the allowed rate of return on rate base, are deferred and will subsequently decrease and is expected to be fully amortized by approximately 1999 as these deferred revenue requirements are recovered.

The RMA targets allowed common equity returns of 14.2% for the period ending November 30, 1989, 13% for the period ending November 30, 1990 and 12.75% for the period ending November 30, 1991. The Company may retain an additional 50 basis points of the earned return on common equity in excess of the targeted allowed return, as a result of reducing preferred stock dividend requirements. In addition, the Company may also realize as much as 20 basis points above the targeted allowed return if it successfully implements an aggressive conservation and demand side management program. Earned returns on common equity in excess of the targeted allowed returns, adjusted for the foregoing, will be applied to reduce the RMC or mitigate rates, as determined by the PSC. The Company did not earn in excess of the targeted allowed returns, as adjusted, for the year ended December 31, 1989.

The PSC had authorized the Company, since 1984, to collect additional revenues, designated as FSA revenues, which were in excess of the amounts to which the Company was entitled under conventional ratemaking. The effect of the FSA revenues was 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 flow revenues, net of tax effects, was $96, $203 and $185 million during 1989, 1988 and 1987, respectively. As a result of the discontinuance of AFC on Shoreham, discussed above, the FSA revenue offset to AFC exceeded AFC recorded during the year ended December 31, 1989 through the date of the effectiveness of the 1989 Settlement, at which time the FSA revenues ceased.

Accounting Treatment of the 1989 Settlement

The accounting treatment of the 1989 Settlement is subject to review by the PSC and FERC, which may concur, reject or modify the accounting treatment for regulatory purposes. The Company believes that the accounting treatment afforded the FRA under the 1989 Settlement conforms to GAAP. For purposes of administering its Uniform System of Accounts, FERC has adopted the provisions of SFAS No. 90 which sets forth the criteria for recognition of regulatory created assets resulting from abandonments. Accordingly, the Company believes that the accounting treatment afforded the FRA conforms to FERC's standards for accounting and asset recognition of regulatory-created assets.

The accounting treatment of the 1989 Settlement is reflected in the Company's financial statements as follows:

Statement of Income

- Base financial component amortization — The BFC, which is afforded rate base treatment under the terms of the RMA, is included in the Company's revenue requirements through an amortization included in rates over 40 years on a straight-line basis. The BFC amortization for the year ended December 31, 1989 was approximately $50 million.
- Rate moderation component — The RMC reflects the difference between the Company's revenue requirements under conventional ratemaking and the revenues resulting from the implementation of the rate moderation plan provided for in the RMA. This rate moderation plan is designed to hold electric rate increases to the levels provided for in the RMA, subject to the adjustments provided for therein. The RMC is recorded based on forecast data filed in connection with the RMA, adjusted to reflect actual property taxes, cost of asbestos removal, interest expense, energy conservation and load management program costs and inflation. For the year ended December 31, 1989 the RMC deferral was approximately $131 million. A return on the RMC of approximately $1 million for the year ended December 31, 1989, is included in Other Income and Deductions.
- Regulatory liability component — A regulatory liability of approximately $794 million was recorded in June 1989, to preserve an amount equivalent to the ratepayer tax benefits attributable to the Shoreham abandonment. Under the 1989 Settlement, certain tax benefits of the transactions are to be shared between ratepayers and shareowners. Based on discussions with the PSC staff, the Company has allocated the abandonment loss tax deduction to ratepayers and recognized a corresponding regulatory liability recorded as an expense to be amortized over ten years on a straight-line basis from the effective date of the 1989 Settlement. Other tax benefits relating to Shoreham have been allocated to shareowners. The tax benefit arising from the abandonment loss deduction has been offset against the corresponding regulatory liability in the Company's Balance Sheet as it could not have been fully recognized under GAAP were it not for the fact that its recovery is assured under the 1989 Settlement through the regulatory liability offset. The amortization of the regulatory liability for the year ended December 31, 1989 was approximately $43 million.
- Jamesport amortization — The Jamesport amortization of approximately $104 million was offset by deferred federal income tax credits of an equivalent amount.
- 1989 Settlement — The 1989 Settlement amount of approximately $304 million principally reflects the net difference between the write-off of Shoreham and Bokum, the establishment of the BFC, and the adjustment required to correspond with the negotiated settlement amount.

Balance Sheet — Assets

- Construction work in progress — CWIP was reduced at June 30, 1989 by approximately $4 billion to reflect the write-off of the Company's investment in Shoreham.
- Nuclear fuel in process and in reactor — Nuclear fuel in process and in reactor was reduced at June 30, 1989 by approximately $100 million to reflect the reclassification of Shoreham-related nuclear fuel as Deferred 1989 Settlement charges and is being amortized and recovered over 40 years on a straight-line remaining life basis. Nuclear fuel also was reduced at June 30, 1989 by approximately $65 million to reflect the write-off of the Company's nuclear fuel investment in Bokum.
- Base financial component — The BFC of the FRA was established in June 1989 in the amount of approximately $4 billion. At December 31, 1989, the BFC, less accumulated amortization, was approximately $3.988 billion.
- Materials and supplies at average cost — Materials and supplies at average cost was increased at June 30, 1989 by approximately $28 million to reflect Shoreham materials and supplies reclassified from CWIP.
- 1989 Settlement charges — The 1989 Settlement charges principally reflects the unamortized balance of the reclassification of Shoreham nuclear fuel.
- Rate moderation component — The current RMC balance represents the RMC, discussed above under the heading Statement of Income, offset under the terms of the RMA by certain prior deferred credits.
- Shoreham post settlement costs—Shoreham post settlement costs represents all costs associated with Shoreham incurred subsequent to the effectiveness of the 1989 Settlement. The Company believes that the RMA will enable the Company to capitalize all prudent costs relating to Shoreham, incurred after the effectiveness of the 1989 Settlement, and to recover them from its customers through electric rates.

Balance Sheet — Liabilities

- 1989 Settlement credits—1989 Settlement credits of approximately $192 million, net of amortization, reflects an adjustment of the book write-off to the negotiated 1989 Settlement amount, and is being amortized over a ten-year period.

The Class Settlement

On February 14, 1989, the Company and certain of its former Officers entered into an agreement (the Class Settlement) settling a civil lawsuit against the Company brought under the Federal Racketeer Influenced and Corrupt Organizations Act (the RICO Act), alleging that the Company made inadequate disclosures before the PSC concerning the construction and completion of nuclear generating facilities and seeking damages on behalf of the class of all present and former ratepayers. The Class Settlement was entered into after the dismissal by the trial court of Suffolk County's RICO Act claims as to which a jury had earlier found the Company liable.

With the approval by the shareowners on June 28, 1989, all of the conditions for the effectiveness of the Class Settlement have been met. The Class Settlement provides for rate reductions aggregating $390 million to be made to the ratepayers monthly electric bills over a ten-year period beginning June 1, 1990. Fairness hearings were held to hear comments by class members, including intervenors and the public, concerning the adequacy and reasonableness of the Class Settlement. Upon the effectiveness of the Class Settlement, the Company recorded the effects of the Class Settlement as a charge to income of approximately $113 million (net of tax effects of $57 million) which was the present value at June 30, 1989 of the Class Settlement amount including $10 million for attorneys' fees and expenses and certain other costs associated with the Class Settlement. The Class Settlement amount of $186 million included in the Company's Statement of Income for the year ended December 31, 1989 represents the Class Settlement amount recorded in June 1989, before tax effects, plus carrying charges through December 31, 1989. The Class Settlement amount of $164 million on the Company's Balance Sheet at December 31, 1989 and the current portion of $22 million, included in accounts payable and accrued expenses, represents the present value at December 31, 1989 of the Class Settlement, before tax effects. See Note 6 for additional information respecting the uncertainties related to the Class Settlement and the RICO Act litigation.

Note 6. Commitments and Contingencies

During 1989, the 1989 Settlement and the Class Settlement discussed in Note 5 were approved by the Company's shareowners and thereafter certain of the financings discussed in Notes 2 and 3 were completed. These events brought to a resolution some of the material uncertainties which had arisen from the circumstances surrounding the Company's investment in Shoreham and brought other uncertainties closer to resolution. Thus, some uncertainties still exist respecting the settlements and certain other matters.

RICO Act Litigation and Related Matters

The Class Settlement, discussed in Note 5, settles a civil lawsuit against the Company brought under the RICO Act. The Company has made no provision for any liability beyond the amount referred to in Note 5. Suffolk County has opted out of the Class Settlement. A jury had found the Company liable to Suffolk County for approximately $7.6 million which, under the RICO Act, would have been trebled to approximately $23 million. The trial court dismissed the claims asserted by Suffolk County. Suffolk County has appealed the dismissal of its claims. In addition, certain members of the class have appealed the trial court's approval of the Class Settlement. The Company has also appealed certain portions of the Class Settlement, as approved by the trial court. Plaintiffs in a second lawsuit brought under the Federal False Claims Act did not sign the definitive agreement embodying the Class Settlement. In this second lawsuit, plaintiffs' counsel stated that their total recovery would be approximately $500 million. The court has dismissed this lawsuit and plaintiffs have appealed. If, on appeal, all determinations in the RICO Act and Federal False Claims Act lawsuits were adverse to the Company, the Company's potential ultimate liability could be approximately $9 billion. The Company cannot predict the outcome of these appeals.

The 1989 Settlement

Pursuant to the 1989 Settlement, the Company has recorded the FRA and received two permanent electric rate increases in 1989. Certain litigation and other matters discussed below, relating to the 1989 Settlement, remain unresolved. The Company can give no assurance that it will realize all of the benefits contemplated by the 1989 Settlement. Nevertheless, the Company has no reason to believe that the PSC will not honor its commitments respecting the recovery of the FRA and other assets provided by the RMA. Accordingly and based upon the PSC's actions which have been consistent with establishment and recovery from ratepayers of the FRA and the other assets, the Company believes that recovery of such assets is likely to be provided by the PSC.

Enforceability of the Rate Moderation Agreement: Because the parties to the 1989 Settlement, other than the Company, are governmental entities, a question arises as to whether the terms of the 1989 Settlement and the obligations of such parties, as embodied therein, will be enforceable against them. Because of their nature, governmental entities may have legal obligations or limitations that circumscribe their ability to be irrevocably bound by contract. Consequently, the PSC could take the position in the future that it is not legally bound by the rate increases contemplated by the 1989 Settlement and may, pursuant to its statutory authority, seek to modify or avoid the provisions of the 1989 Settlement. The power of the PSC to claim that it is not bound by the 1989 Settlement may be limited, however, as a result of, among other things, the provisions in the 1989 Settlement that permit the 1989 Settlement and the PSC's decision to be submitted to the appropriate courts for approval and enforcement. In this connection, the RMA is one of a significant number of rate settlement agreements between the PSC, its jurisdictional utilities, including the Company, and other parties. The Company is unaware of any instance in which the PSC has taken any action to attempt to withdraw its support of a settlement to which it is a party. Consequently, the Company has no reason to believe that the PSC, which has authorized the first two of the three rate increases provided by the RMA, will not permit the third increase to go into effect on December 1, 1990 or will fail to honor its commitments, contained in the RMA, respecting the rate increases for the years beginning December 1, 1991 through November 30, 1998 or recovery of (i) both components of the FRA and (ii) other 1989 Settlement-related deferred charges, described above in Note 5. Furthermore, the State of New York could enact subsequent legislation and any other party to the 1989 Settlement could take or refrain from taking some action which would in some way impair or alter the rights of the Company pursuant to the 1989 Settlement. In the event any party fails to perform in accordance with its obligations under the 1989 Settlement, the Company may be able to contend, in a judicial proceeding or otherwise, that such failure impairs the Company's contract rights as set forth in the 1989 Settlement and that it violates the terms of certain proposed judicial settlements which incorporate the 1989 Settlement. However, there can be no assurance that the Company would prevail in such judicial or other proceeding.

Challenges to the 1989 Settlement: Currently there are three actions pending in the Appellate Division of the New York Supreme Court against the Company challenging the 1989 Settlement. The first lawsuit seeks a judgment declaring the 1989 Issues Agreement null and void and enjoining the proposed transfer of Shoreham to LIPA as contemplated in that agreement. In a second lawsuit, other plaintiffs seek to have the 1989 Settlement declared invalid and to require that

environmental guidelines be followed. The United States, on behalf of the DOE, has been permitted to intervene as a party in this case. In a third lawsuit, petitioners seek to annul the determination of the PSC which granted the Company rate relief in connection with the 1989 Settlement. Petitioners also request such other relief as may be deemed just and proper. The Company cannot predict the outcome of these challenges to the 1989 Settlement.

Effect of the 1989 Settlement on Holders of the Company's Securities: It is the Company's position that the transactions contemplated by the 1989 Settlement do not require the consideration or consent of the holders of bonds issued under the Company's First Mortgage or the Company's G&R Mortgage and that those transactions, including the transfer of Shoreham, do not constitute a breach of, or default under, and are not prohibited by, and do not require a deposit or retirement of bonds under, either mortgage. The trustee of the First Mortgage has questioned the Company's position. The Company cannot predict whether the trustee under either mortgage or a bondholder will take any action to assert a position contrary to the Company's position. Notwithstanding the Company's position in this matter, in the event that there is a final judicial determination that a default has occurred, such default, if not cured or waived, could, under certain circumstances, result in an acceleration of all amounts due under the Company's mortgages and credit facilities. Under such circumstances, the Company might seek the protection of the federal bankruptcy laws while it continues its operations. Alternatively, the Company might consider the possibility of seeking to refinance and redeem all outstanding G&R Bonds and First Mortgage Bonds unless the indebtedness is first accelerated and payment of principal and interest is then due as at maturity. Any such refinancing would be subject to market conditions at the time. Consequently, the Company can give no assurance that such refinancing could be completed or as to the interest rates which would be established for the new securities if such refinancing takes place.

Shoreham: Although on April 21, 1989, the NRC issued a full-power operating license for Shoreham, the 1989 Settlement prohibits the Company from operating Shoreham at any level of power. The NRC's grant to the Company of a license to operate Shoreham at full-power has been appealed. The Company has petitioned the NRC to amend the full-power operating license to allow the Company to curtail its operations at Shoreham which, if granted, will remove the Company's authority to operate Shoreham at any power level for so long as the amended license is in effect. The 1989 Settlement provides that the Company will transfer Shoreham to LIPA upon approval by the NRC of the joint request of the Company and LIPA for the transfer of the Shoreham license to LIPA or an entity designated by LIPA. Before approving the transfer of the Shoreham license, the NRC must be satisfied that a licensee has the necessary technical and financial qualifications. The 1989 Settlement also contemplates that LIPA will apply to the NRC for authority to decommission Shoreham. No application for a transfer of the Shoreham licenses is presently pending before the NRC. The Secretary of Energy has stated that the DOE intends to oppose the transfer of Shoreham's operating license in its transfer proceeding before the NRC. In addition, the Shoreham-Wading River Central School District (the School District), Scientists and Engineers for Secure Energy, Inc. (the Scientists and Engineers) and the Long Island Association, Inc. have each petitioned the NRC, setting forth their opposition to the transfer of Shoreham and its decommissioning and requesting various relief which, if granted, would delay and perhaps prevent the transfer and decommissioning of Shoreham. The NRC, which is reviewing these petitions, has not granted them to date. On October 13, 1989, the School District and the Scientists and Engineers petitioned the United States Circuit Court of Appeals for the District of Columbia to review the alleged failure of the NRC to grant the relief which the petitioners had requested. On January 22, 1990, the court denied this petition. The Company believes that any efforts in opposition to the transfer and decommissioning of Shoreham could increase the time and cost associated with such transfer and decommissioning.

In 1989, a proposed amendment to the Nuclear Regulatory Commission Authorization Act was passed by the Energy & Commerce Committee of the United States House of Representatives. The proposed amendment, if enacted into law, would prohibit the NRC from using any funds, and thereby prohibit any action by it, with respect to the proposed transfer to LIPA, or the termination, of the Shoreham operating license. The proposed amendment contains a provision that except if there is a transfer of the operating license to a third party other than LIPA, no amount appropriated to the NRC under that Act may be used by the NRC for any purpose related to the decommissioning of Shoreham unless the NRC determines that the operation of Shoreham is unsafe. If the amendment were to be approved by the full House of Representatives, the appropriate Senate Committee and the full Senate, and subsequently became a law and withstood legal challenge, the effect could be to prohibit the transfer of Shoreham and the Shoreham operating license to LIPA and to inhibit the reduction of the staffing, maintenance and other costs relating to Shoreham. If the amendment is enacted into law in its present form, the Company intends to pursue its legal remedies. The Company cannot predict when further consideration of this legislation, if any, is likely to occur. While the Company believes that enactment of the proposed amendment is unlikely, it can give no assurance that this or similar legislation will not become law before the actions contemplated by the Amended and Restated Asset Transfer Agreement are consummated.

The Company believes that the RMA will remain in force regardless of any inability to transfer Shoreham. The Company also believes that the RMA will enable the Company to capitalize all prudent costs relating to Shoreham, incurred after the effectiveness of the 1989 Settlement, and to recover them from its customers through electric rates over the balance of a forty-year period ending 2029. However, the Company cannot predict what the costs resulting from an inability to transfer Shoreham would be, the effects such costs would have upon the rates contemplated by the 1989 Settlement, or the position that parties other than the Company might take respecting the recovery of such costs under the 1989 Settlement. Since the Company is contractually prohibited from operating Shoreham, the Company also believes that any inability to transfer Shoreham or the Shoreham operating license or to decommission Shoreham would not affect the conclusion reached by the Internal Revenue Service (IRS) in the private letter ruling described in Note 7.

Nine Mile Point 2

Under a settlement approved in 1986 (the 1986 NMP2 Settlement), the PSC has limited the Company's recovery from its ratepayers of the costs incurred in the construction of NMP2 to $725 million. All of the costs allowed pursuant to the 1986 NMP2 Settlement are currently reflected in the Company's rates. The NMP2 cotenants and other parties, including the New York State Consumer Protection Board (the CPB), separately challenged the decision of the PSC implementing the 1986 NMP2 Settlement in the courts. The parties to these appeals have agreed to a settlement of this litigation as part of the agreement discussed below.

In January of 1990, the Company and the other cotenants of NMP2 reached an agreement subject to final documentation with the Attorney General, the CPB and the staff of the PSC resolving certain ratemaking issues regarding the construction of NMP2 and its operation through January 19, 1990. The agreement, which will require PSC approval, also disposes of the appeals of the 1986 NMP2 Settlement and the proceeding brought by the Attorney General with respect to an outage in 1988-1989. The agreement contemplates a net disallowance of the Company's costs (which have been charged to income in 1989) amounting to approximately $7 million. NMP2 was shut down on December 26, 1989 for repairs and resumed operation on February 6, 1990.

NMPC, the manager and a cotenant in NMP2, and the sole owner of Nine Mile Point 1, another nuclear generating unit located at the same site, has been notified by the NRC that NMP2, along with Nine Mile Point 1, had been categorized "as requiring close monitoring." The requirement for close monitoring was based on a current assessment by the NRC of the overall performance of NMP2 during the first year of its operation. The NRC was advised of the steps which NMPC has taken, including a strengthening of its nuclear management organization, to improve operations. However, a report issued subsequently by the staff of the NRC relating to the problems at Nine Mile Point 1 and NMP2 stated that there had been no significant improvement. NMPC has signed an agreement with the PSC which is intended to stabilize NMPC's declining financial condition by, among other things, omitting dividends on its common stock and providing for the implementation of a management assessment program.

A new interim agreement for the operation of NMP2 has been signed by each of the five cotenants permitting the cotenants greater oversight of the plant's operations. In addition, the cotenants have agreed to conduct an 18-month study on the formation of a separate company to operate the plant.

Litigation

Asbestos: The Company is a co-defendant with manufacturers, distributors and other utilities in personal injury and wrongful death actions brought by approximately 700 plaintiffs in New York County Supreme Court alleging exposure since the 1930s to asbestos in buildings. The damages demanded in each of these complaints range up to $55 million including punitive damages. To date, the cases of 36 plaintiffs have proceeded to pre-trial discovery of which 11 cases have been disposed of. Of these cases, the Company has been dismissed in 10 cases and has settled one case for a *de minimus* amount. Discovery is continuing with respect to the remaining claims.

Environmental Litigation: The Company has been named as a potentially responsible party by the United States Environmental Protection Agency (the EPA) which has requested the Company to assist in the funding of remedial actions and reimbursement of costs which the EPA has incurred to date at a landfill located in Port Washington, New York. In addition, the Company has been named, along with several other utilities, by the EPA as a potentially responsible party for certain pollutants, in particular, polychlorinated biphenyls at a second site. While the outcome of these matters is not certain, based upon the Company's past experience in similar matters and the respective financial condition of the other parties involved, the Company does not believe these matters will have a material impact on its financial condition.

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 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 Company has both property damage insurance and third-party bodily injury and property liability insurance for its 18% share in NMP2 and for Shoreham. The NRC requires a minimum of $1.06 billion of property damage coverage to be in effect at each nuclear generating site. The Price Anderson Act limits liability for third-party bodily injury and third-party property damage arising out of a nuclear occurrence at each unit to $7.8 billion.

The insurable value of NMP2 at December 31, 1989 was $3.4 billion, of which the Company's share was $612 million. The maximum amount of property damage insurance currently available at Nine Mile Point, where there are two units, is approximately $2.035 billion for each unit under certain circumstances. The NMP2 cotenants have approximately $1.875 billion of property damage coverage in effect but, under certain circumstances, only a portion of that amount would be available. The NMP2 cotenants have $200 million in third-party bodily injury liability coverage.

The insurable value of Shoreham at December 31, 1989 was $2.2 billion. The maximum amount of property damage insurance coverage currently available at Shoreham is approximately $2.035 billion. For Shoreham, the Company currently carries $1.06 billion in coverage. The Company currently carries third-party bodily injury liability coverage for Shoreham in the amount of $200 million. Pursuant to the 1989 Settlement, the Company will maintain insurance on Shoreham until the transfer of Shoreham to LIPA and thereafter will reimburse LIPA (and recover from ratepayers) for any insurance which the NRC requires LIPA to maintain.

Certain of the property damage insurance programs provide for retroactive premium adjustments pursuant to which the Company would be liable for maximum assessments of approximately $30.5 million in any one policy year in the event of property loss to any other insured utility company, of which $1.7 million is for its share of NMP2 and $28.8 million is for Shoreham. This assessment would only be required if existing premiums and loss reserves were exhausted.

Under agreements established pursuant to the Price Anderson Act, the Company may be assessed up to $63 million per nuclear incident in any one year at other nuclear units, but not in excess of $10 million in payments per year for each incident.

Note 7. Federal Income Taxes

On April 17, 1989, the Company received a private letter ruling from the IRS which stated that the Company would be entitled, for federal income tax purposes, to an abandonment loss deduction in connection with Shoreham, upon effectiveness of the 1989 Settlement. The Company will claim this deduction on its 1989 federal income tax return. The Company estimates that this deduction will be approximately $1.8 billion. The Company's net operating loss carryforward is estimated to be approximately $2.1 billion at December 31, 1989.

On January 8, 1990, the Company received a Revenue Agent's Report disallowing certain deductions claimed by the Company on its tax returns for the years under audit. The Revenue Agent's Report reflects proposed adjustments to the Company's federal income tax returns for 1984 through 1987 which, if sustained, would give rise to tax deficiencies totalling approximately $87 million. The Company intends to protest some of the adjustments and seek an administrative and, if necessary, a judicial review of the conclusions reached in the Revenue Agent's Report. The Company cannot predict either the timing or the manner in which this matter will be resolved. If, however, the ultimate disposition of any or all matters raised in the Revenue Agent's Report is adverse to the Company, the Company expects that any deficiencies that may arise will be substantially offset by the net operating loss carrybacks associated with the Shoreham abandonment loss deduction and thus any impact would not have a material effect on the Company's financial condition or cash flows.

The amount of investment tax credit (ITC) carryforward for financial statement purposes after 1989 is approximately $192 million. 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 $500 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 No. 96 which the Company must adopt by no later than 1992.

The PSC required the Company to defer the effect of certain TRA 86 tax changes, including the lower corporate federal income tax rate, for future disposition. This resulted in recording an additional $1.3 million, $1.7 million and $27.8 million of income tax expense in 1989, 1988 and 1987, respectively.

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 table below sets forth the reasons for such differences. In 1989, the difference results principally because the tax basis attributable to Shoreham was less than its recorded basis for financial statement purposes and the FRA and certain other 1989 Settlement items recorded by the Company pursuant to the 1989 Settlement have no tax basis.

(In thousands of dollars)	**1989**		1988		1987	
	Amount	**% of Pre-tax Income**	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income
Federal income tax, per Statement of Income — current	**$ 14,612**		$ 18,395		$ 83,577	
Included in other income and deductions — current	**—**		—		(80,597)	
Total Current	**14,612**		18,395		2,980	
Deferred and other (see Note 1):						
1989 Settlement						
Shoreham abandonment	**(907,467)**		—		—	
Jamesport recovery	**(104,159)**		—		—	
Bokum Resources Corporation	**(35,977)**		—		—	
Rate moderation component	**27,879**		—		—	
Other 1989 Settlement items	**(20,782)**		—		—	
Class Settlement	**(63,240)**		—		—	
Interest capitalized	**(3,752)**		185		2,796	
Accrued utility revenues	**(2,803)**		8,131		(13,585)	
Deferred tax credits	**(580)**		(13,611)		(67,642)	
Accelerated tax depreciation	**36,242**		47,926		150,833	
Call premiums	**12,452**		(221)		(538)	
Fuel cost adjustments	**4,451**		1,448		2,236	
Nine Mile Point 2 deferred revenues	**4,151**		(4,151)		—	
Capitalized overheads	**1,272**		55,504		62,531	
TRA 86 benefits	**1,283**		1,659		27,756	
Other items, net	**(993)**		(3,418)		1,487	
Total Deferred	**(1,052,023)**		93,452		165,874	
Total federal income tax expense (credit)	**(1,037,411)**		111,847		168,854	
Income (loss) before cumulative effect of accounting change	**(95,803)**		298,490		269,888	
Income (Loss) Before Cumulative Effect of Accounting Change and Income Taxes	**$ (1,133,214)**		$ 410,337		$ 438,742	
Statutory federal income tax (credit)	**$ (385,293)**	**34.0%**	$ 139,515	34.0%	$ 175,277	39.95%
Additions (reductions) in federal income tax resulting from:						
1989 Settlement						
Shoreham abandonment	**(691,242)**	**61.0**	—	—	—	—
Jamesport recovery	**20,101**	**(1.8)**	—	—	—	—
Bokum Resources Corporation	**(34,015)**	**3.0**	—	—	—	—
Rate moderation component	**(7,360)**	**0.7**	—	—	—	—
Other 1989 Settlement items	**(19,821)**	**1.8**	—	—	—	—
Allowance for funds used during construction	**31,527**	**(2.8)**	(54,899)	(13.4)	(72,035)	(16.4)
Lien date property taxes	**20,034**	**(1.8)**	(2,673)	(0.6)	(4,840)	(1.1)
Tax credits	**13,534**	**(1.2)**	4,153	1.0	24,303	5.5
Excess of book depreciation over tax depreciation	**10,842**	**(1.0)**	10,014	2.4	6,304	1.4
TRA 86 benefits	**1,283**	**(0.1)**	1,659	0.4	27,756	6.3
Interest capitalized	**3,251**	**(0.3)**	8,066	2.0	9,354	2.1
Other items, net	**(252)**	**0.0**	6,012	1.5	2,735	0.7
Total Federal Income Tax Expense (Credit)	**$ (1,037,411)**	**91.5%**	$ 111,847	27.3%	$ 168,854	38.45%

Note 8. 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. Identifiable assets by segment include net utility plant, financial resource asset, materials and supplies (excluding common), accrued revenues, gas in storage, fuel and deferred charges (excluding common). Assets utilized for overall Company operations consist of other property and investments, cash, temporary cash investments, special deposits, accounts receivable, prepayments and other current assets, unamortized debt expense and other deferred charges.

(In millions of dollars)

For year ended December 31	**1989**	1988	1987
Operating revenues:			
Electric	**$ 1,983**	$ 1,787	$ 1,719
Gas	**365**	351	353
Total	**$ 2,348**	$ 2,138	$ 2,072
Operating expenses: *(excluding income tax)*			
Electric	**$ 2,116**	$ 1,140	$ 1,101
Gas	**326**	297	301
Total	**$ 2,442**	$ 1,437	$ 1,402
Operating income (loss): *(before income tax)*			
Electric	**$ (133)**	$ 647	$ 618
Gas	**39**	54	52
Total	**(94)**	701	670
AFC, net of FSA revenues	**98**	(150)	(181)
Other income and deductions	**456**	10	(15)
Interest charges	**485**	431	427
Income taxes—operating	**(714)**	200	288
Income taxes—non operating	**(323)**	(88)	(119)
Income (loss) before cumulative effect of accounting change	**(96)**	298	270
Cumulative effect of accounting change (net of tax)	**—**	(1,345)	—
Net income (loss)	**$ (96)**	$(1,047)	$ 270
Depreciation, depletion and amortization:			
Electric	**$ 92**	$ 83	$ 64
Gas	**11**	11	10
Total	**$ 103**	$ 94	$ 74
Construction and nuclear fuel expenditures:*			
Electric	**$ 150**	$ 523	$ 547
Gas	**50**	38	34
Total	**$ 200**	$ 561	$ 581
Identifiable assets: (at December 31)			
Electric	**$ 7,133**	$ 7,220	$ 8,195
Gas	**451**	411	371
Total	**7,584**	7,631	8,566
Assets utilized for overall Company operations	**936**	695	758
Total Assets	**$ 8,520**	$ 8,326	$ 9,324

**Includes non-cash allowance for other funds used during construction.*

Note 9. Quarterly Financial Information

(Unaudited)

(In millions of dollars except earnings per common share)

		1989	1988
Operating revenues:			
For quarter ended	March 31	**$ 607**	$ 593
	June 30	**510**	454
	September 30	**664**	611
	December 31	**567**	480
Operating income:			
For quarter ended	March 31	**$ 137**	$ 146
	June 30	**110**	100
	September 30	**261**	191
	December 31	**112**	64
Net income (loss):			
For quarter ended	March 31	**$ 6** (a)	$ (1,271)(c)
	June 30	**(215)** (a)	64
	September 30	**139**	143
	December 31	**(26)** (b)	17 (d)
Earnings (loss) for common stock:			
For quarter ended	March 31	**$ (14)** (a)	$ (1,290)(c)
	June 30	**(235)** (a)	44
	September 30	**119**	125
	December 31	**(45)** (b)	0 (d)
Earnings (loss) per common share:			
For quarter ended	March 31	**$ (.13)** (a)	$ (11.61)(c)
	June 30	**(2.11)** (a)	.40
	September 30	**1.07**	1.13
	December 31	**(.40)** (b)	.00 (d)

(a) Effective January 1, 1989, the Company ceased accruing AFC on Shoreham which reduced net income by approximately $100 million, or $.90 per common share, in each of the first and second quarters. Additionally, in June 1989, the Company recognized losses in connection with the 1989 Settlement and the Class Settlement of approximately $62 million, net of tax effects, and $113 million, net of tax effects, respectively, or $.55 and $1.02 per common share.

(b) In December 1989, the Company recorded an additional charge to earnings of $7.2 million, net of tax effects, or $.06 per common share, to reflect revisions to certain estimates relating to the 1989 Settlement. In addition, as a result of an agreement subject to final documentation resolving certain ratemaking issues regarding the construction and operation of NMP2, in December 1989, the Company recorded a charge to earnings of $7.3 million, net of tax effects, or $.07 per common share. Further, as a result of a PSC order relating to gas take-or-pay costs, the Company recorded, during the fourth quarter of 1989, a charge to earnings of $3.1 million, net of tax effects, or $.03 per common share.

(c) As a result of adopting SFAS No. 90 in January 1988, these amounts include the cumulative effect of an accounting change for disallowed costs amounting to approximately $1.345 billion, net of tax effects, or $12.10 per common share.

(d) As a result of the settlement of the 1984 consolidated class action and shareowners' derivative action securities litigation, which became effective in December 1988, the Company had recorded, during the fourth quarter of 1988, a charge to earnings amounting to approximately $21 million or $.19 per common share.

Report of Ernst & Young, Independent Auditors

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

We have audited the accompanying balance sheet of Long Island Lighting Company as of December 31, 1989 and 1988 and the related statements of income, shareowners' equity and cash flows for each of the three years in the period ended December 31, 1989. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Long Island Lighting Company at December 31, 1989 and 1988, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1989 in conformity with generally accepted accounting principles.

As more fully discussed in Note 6 of the Notes to Financial Statements, the Company is presently unable to predict the outcome of the appeals taken with respect to the RICO Act litigation and related matters.

Ernst & Young

Ernst & Young

Melville, New York
February 6, 1990

Selected Financial Data

	1989	1988	1987	1986	1985
Summary of Operations *(See Notes 1, 2, 5 and 6 of Notes to Financial Statements)*					**Table 1**
Total revenues (000)	**$ 2,347,614**	$ 2,137,834	$ 2,072,077	$ 1,977,121	$ 2,050,340
Total operating income (loss) (000)					
Before federal income taxes	**$ (93,997)**	$ 701,049	$ 670,324	$ 640,021	$ 627,307
After federal income taxes	**$ 620,423**	$ 500,938	$ 382,604	$ 387,077	$ 388,140
Income (loss) before cumulative effect of accounting change (000)	**$ (95,803)**	$ 298,490	$ 269,888	$ 316,675	$ 524,288
Cumulative effect of accounting change for disallowed costs (net of taxes) (000)	**—**	$(1,345,110)	—	—	—
Earnings (loss) for common stock (000)	**$ (175,035)**	$(1,121,128)	$ 192,312	$ 236,864	$ 440,563
Average common shares outstanding (000)	**111,215**	111,177	111,129	111,085	110,842
Earnings (loss) per common share before cumulative effect of accounting change	**$ (1.57)**	$ 2.02	$ 1.73	$ 2.13	$ 3.97
Earnings (loss) per common share	**$ (1.57)**	$ (10.08)	$ 1.73	$ 2.13	$ 3.97
Common stock dividends declared per share	**$ .50**	—	—	—	—
Book value per common share at year end	**$ 17.45**	$ 19.61	$ 29.71	$ 27.99	$ 25.88
Common shareowners at year end	**85,142**	93,267	106,117	117,962	143,627
Ratio of earnings to fixed charges	*****	1.95	2.02	2.17	2.75
Ratio of earnings to combined fixed charges and preferred stock dividends	*****	1.58	1.56	1.68	2.15
Ratio of earnings to fixed charges (excluding AFC and RMC)	*****	1.60	1.60	1.53	1.62
Ratio of earnings to combined fixed charges and preferred stock dividends (excluding AFC and RMC)	*****	1.30	1.24	1.18	1.27
Pro forma earnings — with 1988 accounting change applied retroactively:					
Earnings (loss) for common stock (000)		$ 223,982	$ 176,712	$ 30,864	$ (682,947)
Earnings (loss) per common share		$ 2.02	$ 1.59	$ .28	$ (6.16)

**The Company had no earnings to cover fixed charges.*

Operations and Maintenance Expense Details *(In thousands of dollars)*					**Table 2**
Total payroll and employee benefits	**$ 349,242**	$ 333,359	$ 315,114	$ 283,427	$ 257,509
Less — Charged to construction and other	**117,761**	129,990	115,315	102,987	99,415
Payroll and Employee Benefits Charged to Operations	**231,481**	203,369	199,799	180,440	158,094
Fuels — electric operations	**461,576**	410,174	422,997	311,872	511,193
Fuels — gas operations	**188,139**	172,431	174,610	205,616	201,458
Purchased power costs	**128,368**	88,465	93,186	134,347	113,867
Fuel cost adjustments deferred	**(5,631)**	3,359	(5,104)	14,180	4,410
Total Fuel and Purchased Power	**772,452**	674,429	685,689	666,015	830,928
All other	**195,825**	154,527	142,201	142,514	96,215
Total Operations and Maintenance Expense	**$ 1,199,758**	$ 1,032,325	$ 1,027,689	$ 988,969	$ 1,085,237
Employees at December 31	**6,239**	6,281	6,378	6,219	5,676

	1989	1988	1987	1986	1985
Electric Operating Income *(In thousands of dollars)*					**Table 3**
Revenues					
Residential	**$ 915,644**	$ 835,584	$ 800,952	$ 744,898	$ 772,861
Commercial and industrial	**981,740**	883,267	849,626	804,387	844,636
Other	**43,024**	43,930	56,394	51,447	48,791
System revenue	**1,940,408**	1,762,781	1,706,972	1,600,732	1,666,288
Sales to other utilities	**42,880**	24,152	11,889	11,057	12,971
Total Revenues	**1,983,288**	1,786,933	1,718,861	1,611,789	1,679,259
Expenses					
Operations — fuel and purchased power	**584,313**	501,998	511,079	460,399	629,470
Operations — other	**237,931**	195,283	187,573	173,702	141,312
Maintenance	**115,502**	96,599	88,431	91,611	60,154
Depreciation	**91,759**	82,811	63,840	61,194	58,510
Base financial component amortization	**50,485**	—	—	—	—
Rate moderation component	**(131,167)**	—	—	—	—
Regulatory liability component	**750,554**	—	—	—	—
Jamesport amortization	**104,160**	—	—	—	—
Operating taxes	**312,456**	262,644	250,047	230,508	224,376
Federal income tax — current	**14,612**	18,394	64,095	24,452	(6,921)
Federal income tax — deferred and other	**(738,500)**	166,557	208,954	218,256	225,442
Total Expenses	**1,392,105**	1,324,286	1,374,019	1,260,122	1,332,343
Electric Operating Income	**$ 591,183**	$ 462,647	$ 344,842	$ 351,667	$ 346,916

Gas Operating Income *(In thousands of dollars)*					**Table 4**
Revenues					
Residential — space heating*	**$ 209,192**	$ 201,312	$ 194,303	$ 207,937	$ 190,357
— other	**31,692**	31,803	32,877	35,393	35,638
Non-residential, firm — space heating*	**72,351**	68,114	63,267	68,330	62,268
— other	**28,674**	28,078	28,443	31,473	31,043
Total firm sales revenue	**341,909**	329,307	318,890	343,183	319,306
Interruptible sales	**19,226**	18,821	24,150	22,132	33,446
Total system sales revenue	**361,135**	348,128	343,040	365,315	352,752
Sales to other utilities	**—**	—	4,970	—	—
Total sales revenue	**361,135**	348,128	348,010	365,315	352,752
Other revenue	**3,191**	2,773	5,206	17	18,329
Total Revenues	**364,326**	350,901	353,216	365,332	371,081
Expenses					
Operations — fuel	**188,139**	172,431	174,610	205,616	201,458
Operations — other	**59,587**	53,415	53,140	46,607	41,948
Maintenance	**14,286**	12,599	12,856	11,034	10,895
Depreciation, depletion and amortization	**11,671**	10,785	10,065	8,945	8,232
Operating taxes	**51,935**	48,220	50,112	47,484	46,678
Federal income tax — current	**—**	—	19,482	16,895	7,435
Federal income tax — deferred and other	**9,468**	15,160	(4,811)	(6,659)	13,211
Total Expenses	**335,086**	312,610	315,454	329,922	329,857
Gas Operating Income	**$ 29,240**	$ 38,291	$ 37,762	$ 35,410	$ 41,224

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

	1989	1988	1987	1986	1985
Electric Sales and Customers					**Table 5**
Sales – millions of kWh					
Residential	**7,063**	6,979	6,603	6,251	5,970
Commercial and industrial	**8,636**	8,566	8,004	7,713	7,369
Other	**470**	495	439	429	451
System sales	**16,169**	16,040	15,046	14,393	13,790
Sales to other utilities	**633**	433	239	244	226
Total Sales	**16,802**	16,473	15,285	14,637	14,016
Customers – monthly average					
Residential	**890,406**	882,962	872,419	861,011	850,683
Commercial and industrial	**100,481**	98,450	95,871	93,228	90,548
Others	**4,452**	4,436	4,389	4,362	4,391
Customers – total monthly average	**995,339**	985,848	972,679	958,601	945,622
Customers – total at year end	**996,488**	989,097	976,928	963,197	948,797
Residential					
kWh per customer	**7,932**	7,905	7,569	7,260	7,018
Revenue per kWh	**12.96¢**	11.97¢	12.13¢	11.92¢	12.95¢
Commercial and Industrial					
kWh per customer	**85,943**	87,005	83,487	82,732	81,382
Revenue per kWh	**11.37¢**	10.31¢	10.62¢	10.43¢	11.46¢
System – total revenue per kWh sold	**12.00¢**	10.97¢	11.35¢	11.12¢	12.08¢

Gas Sales and Customers					**Table 6**
Sales – thousands of dth					
Residential – space heating*	**32,024**	31,276	29,239	28,438	26,387
– other	**3,491**	3,589	3,952	3,629	3,642
Non-residential – space heating*	**11,548**	11,054	10,055	9,711	8,967
– other	**4,539**	4,580	4,389	4,533	4,510
Total firm sales	**51,602**	50,499	47,635	46,311	43,506
Interruptible sales	**5,300**	5,078	6,456	5,507	6,275
Total system sales	**56,902**	55,577	54,091	51,818	49,781
Sales to other utilities	**–**	–	2,218	–	–
Total Sales	**56,902**	55,577	56,309	51,818	49,781
Customers – monthly average					
Residential – space heating*	**204,982**	198,949	192,550	186,625	182,593
– other	**179,415**	181,926	184,411	186,600	188,594
Non-residential – space heating*	**27,733**	25,979	24,234	22,514	20,935
– other	**11,517**	11,725	11,778	11,889	11,930
Total firm customers	**423,647**	418,579	412,973	407,628	404,052
Interruptible customers	**359**	325	301	289	297
Customers – total monthly average	**424,006**	418,904	413,274	407,917	404,349
Customers – total at year end	**426,060**	421,429	415,629	410,064	405,330
Degree days – billed	**4,987**	5,074	4,802	4,795	4,444
Residential					
dth per customer	**92.4**	91.5	88.0	85.9	80.9
Revenue per dth	**$ 6.78**	$ 6.69	$ 6.84	$ 7.59	$ 7.53
Non-residential, firm					
dth per customer	**409.9**	414.6	401.1	414.0	410.1
Revenue per dth	**$ 6.28**	$ 6.15	$ 6.35	$ 7.01	$ 6.92
System – total revenue per firm dth sold	**$ 6.63**	$ 6.52	$ 6.69	$ 7.41	$ 7.34

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

Electric Operations	1989	1988	1987	1986	1985
					Table 7
Energy – millions of kWh					
Net generation	**15,220**	15,228	14,004	11,707	12,292
Power purchased and (sold) – net	**2,087**	1,940	2,516	3,952	2,844
Total system requirements	**17,307**	17,168	16,520	15,659	15,136
Company use and unaccounted for	**(1,138)**	(1,128)	(1,474)	(1,266)	(1,346)
System sales	**16,169**	16,040	15,046	14,393	13,790
Sales to other utilities	**633**	433	239	244	226
Total Sales	**16,802**	16,473	15,285	14,637	14,016
Peak Demand – mW					
Station coincident demand	**3,178**	3,347	3,333	2,969	2,773
Purchased or (sold) – net	**510**	475	243	472	607
System Peak Demand	**3,688**	3,822	3,576	3,441	3,380
System Capability – mW					
LILCO stations	**4,066**	3,834	3,799	3,743	3,743
Firm purchase or (sale) – net	**400**	482	550	454	171
Total Capability	**4,466**	4,316	4,349	4,197	3,914
Fuel Consumed for Electric Operations					
Oil – thousands of barrels	**20,480**	19,927	18,624	15,625	15,790
Gas – thousands of dth	**26,490**	29,126	29,762	26,103	29,154
Nuclear – thousands of mW days	**105**	87	–	–	–
Total – billions of Btu	**154,669**	153,828	146,536	124,098	128,629
Dollars per million Btu	**$ 2.86**	$ 2.53	$ 2.86	$ 2.51	$ 3.97
Cents per kWh of net generation	**3.06¢**	2.67¢	3.01¢	2.66¢	4.16¢
Heat rate – Btu per net kWh	**10,704**	10,545	10,509	10,600	10,465

Gas Operations					
					Table 8
Energy – thousands of dth					
Natural gas	**60,359**	58,743	58,832	53,035	53,030
Manufactured gas and change in storage	**53**	(18)	(63)	65	(30)
Total Natural and Manufactured Gas	**60,412**	58,725	58,769	53,100	53,000
Total system requirements	**60,412**	58,725	56,551	53,100	53,000
Company use and unaccounted for	**(3,510)**	(3,148)	(2,460)	(1,282)	(3,219)
System sales	**56,902**	55,577	54,091	51,818	49,781
Sales to other utilities	**–**	–	2,218	–	–
Total Sales	**56,902**	55,577	56,309	51,818	49,781
Maximum Day Sendout – dth	**462,610**	431,940	404,679	365,991	441,122
System Capability – dth per day					
Natural gas	**411,596**	411,596	388,400	345,200	335,700
LNG manufactured or LP gas	**145,600**	145,600	145,600	145,600	145,600
Total Capability	**557,196**	557,196	534,000	490,800	481,300
Calendar Degree Days					
(63-year average 5,048)	**5,169**	5,162	4,805	4,715	4,638

	1989	1988	1987	1986	1985
Construction Expenditures* *(In thousands of dollars)*					**Table 9**
Electric					
Production	**$ 59,880**	$ 419,028	$ 453,544	$ 603,916	$ 807,067
Transmission	**9,022**	13,379	23,668	6,451	4,971
Distribution	**66,679**	64,653	32,209	50,847	38,333
General	**(4,677)**	1,588	6,470	4,165	(4,132)
Electric Total	**130,904**	498,648	515,891	665,379	846,239
Gas Total	**49,847**	37,518	34,270	31,978	19,564
Common Total	**11,007**	9,352	17,795	5,434	13,198
Total Construction Expenditures	**$ 191,758**	$ 545,518	$ 567,956	$ 702,791	$ 879,001
Nuclear Fuel	**$ 8,292**	$ 15,639	$ 13,219	$ 10,353	$ 22,241

**Includes non-cash allowance for other funds used during construction.*

Balance Sheet *(In thousands of dollars)*					**Table 10**
Assets					
Utility plant	**$ 3,942,616**	$ 8,020,253	$ 9,277,309	$ 8,710,063	$ 8,167,239
Less — Accumulated depreciation, depletion and amortization	**1,161,459**	1,075,129	983,272	919,452	853,071
Total Net Utility Plant	**2,781,157**	6,945,124	8,294,037	7,790,611	7,314,168
Regulatory asset	**3,988,344**	—	—	—	—
Other property and investments	**6,050**	69,271	68,763	68,383	139,783
Current assets	**982,032**	571,934	606,579	702,825	367,967
Deferred charges:					
Accumulated deferred income taxes	**262,298**	525,029	127,061	65,799	26,286
Other	**500,157**	214,979	227,247	230,537	115,062
Total Deferred Charges	**762,455**	740,008	354,308	296,336	141,348
Total Assets	**$ 8,520,038**	$ 8,326,337	$ 9,323,687	$ 8,858,155	$ 7,963,266
Capitalization and Liabilities					
Capitalization:					
Long-term debt	**$ 4,560,016**	$ 3,449,821	$ 3,724,601	$ 3,805,796	$ 2,718,192
Unamortized premium and (discount) on debt	**(28,587)**	(25,011)	(26,646)	(28,281)	(9,414)
Preferred stock — redemption required	**541,187**	513,924	520,788	527,465	527,612
Preferred stock — no redemption required	**155,592**	221,050	221,051	221,053	221,056
Treasury stock, at cost	**—**	(58,430)	(40,881)	(25,701)	(7,654)
Retained earnings restricted for preferred stock dividend requirements	**—**	341,008	265,288	188,051	—
Common stock and premium	**1,547,971**	1,557,293	1,556,928	1,556,483	1,556,026
Capital stock expense	**(42,916)**	(56,151)	(56,144)	(56,138)	(56,116)
Retained earnings	**436,690**	679,579	1,801,919	1,609,268	1,480,644
Total Capitalization	**7,169,953**	6,623,083	7,966,904	7,797,996	6,430,346
Current Liabilities	**470,885**	583,017	339,573	277,173	975,214
Deferred Credits:					
Accumulated deferred income taxes	**430,933**	963,975	921,397	692,758	486,333
Other	**437,416**	144,015	83,217	75,195	62,039
Total Deferred Credits	**868,349**	1,107,990	1,004,614	767,953	548,372
Reserves for Claims, Damages, Pensions and Benefits	**10,851**	12,247	12,596	15,033	9,334
Total Capitalization and Liabilities	**$ 8,520,038**	$ 8,326,337	$ 9,323,687	$ 8,858,155	$ 7,963,266

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 and Y of the Company are, and Series U, V, W and X were, 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 1988 and 1989.

		1988 Quarter				1989 Quarter			
		First	Second	Third	Fourth	First	Second	Third	Fourth
Common Stock	High	10¼	14	15⅜	17⅛	15⅛	17⅜	19	20¼
	Low	7⅛	8	12⅜	11½	12⅝	14⅞	16¼	17⅛
Preferred Stock									
Series B 5.00%	High	50	66½	61⅛	64	60½	68	74½	51½
	Low	44	49	53½	51½	51½	60½	46½	46½
Series E 4.35%	High	49½	63½	52½	56	54¾	58½	64	44½
	Low	40½	49	49½	41¼	44	52	41	41
Series I 5¾%	High	80½	100	106	114	106	122	134⅞	117
	Low	78½	79½	97	99	100	107	106½	104½
Series J 8.12%	High	81	98	98	102	97¾	106¾	112½	82
	Low	67½	82	89½	78¼	80½	96⅝	75¼	76¼
Series K 8.30%	High	83	101¼	99½	105	100¼	109	118½	84
	Low	67½	82	90	80⅛	83¾	97½	76¼	76
Series O $2.47	High	27	30⅝	31⅛	32¼	31⅜	34	36⅛	25⅛
	Low	21	24½	28½	23¾	26⅜	31⅛	23⅜	23½
Series P $2.43	High	27	30½	30	31¼	30⅛	33	35	25¼
	Low	18¾	24¾	26¾	21¼	25¾	29	22⅝	22½
Series S 9.80%	High	102	122½	122½	125	122	131	142	96
	Low	81	99⅝	116	106½	106	123	92½	94
Series T $3.31	High	30	37½	37⅜	38⅝	38½	40¾	42¼	26¾
	Low	23¾	29¼	34⅞	27½	32	38¼	25¾	25⅝
Series U $4.25	High	34	42⅛	42¾	44½	43⅞	46¼	48¼	27¼
	Low	27½	32½	40	34	36½	43¼	26⅛	26⅝
Series V $3.50	High	31½	38	39	40¼	40½	42¾	44¼	26¾
	Low	25	30¼	35⅝	30⅜	33¼	39⅞	26	26½
Series W $3.52	High	33	40⅝	41¼	43¼	42⅜	44¾	46⅞	29¼
	Low	25½	31	37⅜	32	35	42¼	28½	29
Series X $3.50	High	32	38	38⅝	40¼	40¼	42½	44	27⅜
	Low	24½	30	35½	30¼	33⅛	39½	26	26¼
Series Y $2.65	High	—	—	—	—	—	—	—	26½
	Low	—	—	—	—	—	—	—	25

The Series D 4.25% Stock is traded in the over-the-counter market and no price data is available. 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 April 24, 1990 at 3:00 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 March.

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

Anthony F. Earley, Jr.
President and
Chief Operating Officer
Long Island Lighting
Company

Leon J. Campo
Assistant Superintendent for
Finance, East Meadow School
District; Chairman, Suffolk
County Water Authority

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

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

John H. Talmage
Partner
H.R. Talmage & Son

Phyllis S. Vineyard
Director
Long Island Community
Foundation
Regional and
Community Planning

Officers

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

Anthony F. Earley, Jr.
President and
Chief Operating Officer

George J. Sideris
Senior Vice President Finance
and Chief Financial Officer

James T. Flynn
Group Vice President
Engineering and Operations

P. Alan Gambill
Group Vice President
Commercial Operations

Ralph T. Brandifino
Vice President
Finance

Robert X. Kelleher
Vice President
Human Resources

Jay R. Kessler
Vice President
Gas Operations

John D. Leonard, Jr.
Vice President
Corporate Services

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

William G. Schiffmacher
Vice President
Engineering and Construction

Robert B. Steger
Vice President
Fossil Production

Walter F. Wilm, Jr.
Vice President
Customer Relations

Edward J. Youngling
Vice President
Conservation and
Load Management

Victor A. Staffieri
General Counsel and
Corporate Secretary

Michael Czumak
Controller and
Chief Accounting Officer

Andrew R. Ragogna
Treasurer

Herbert M. Leiman
Assistant General Counsel
and Assistant Corporate
Secretary

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