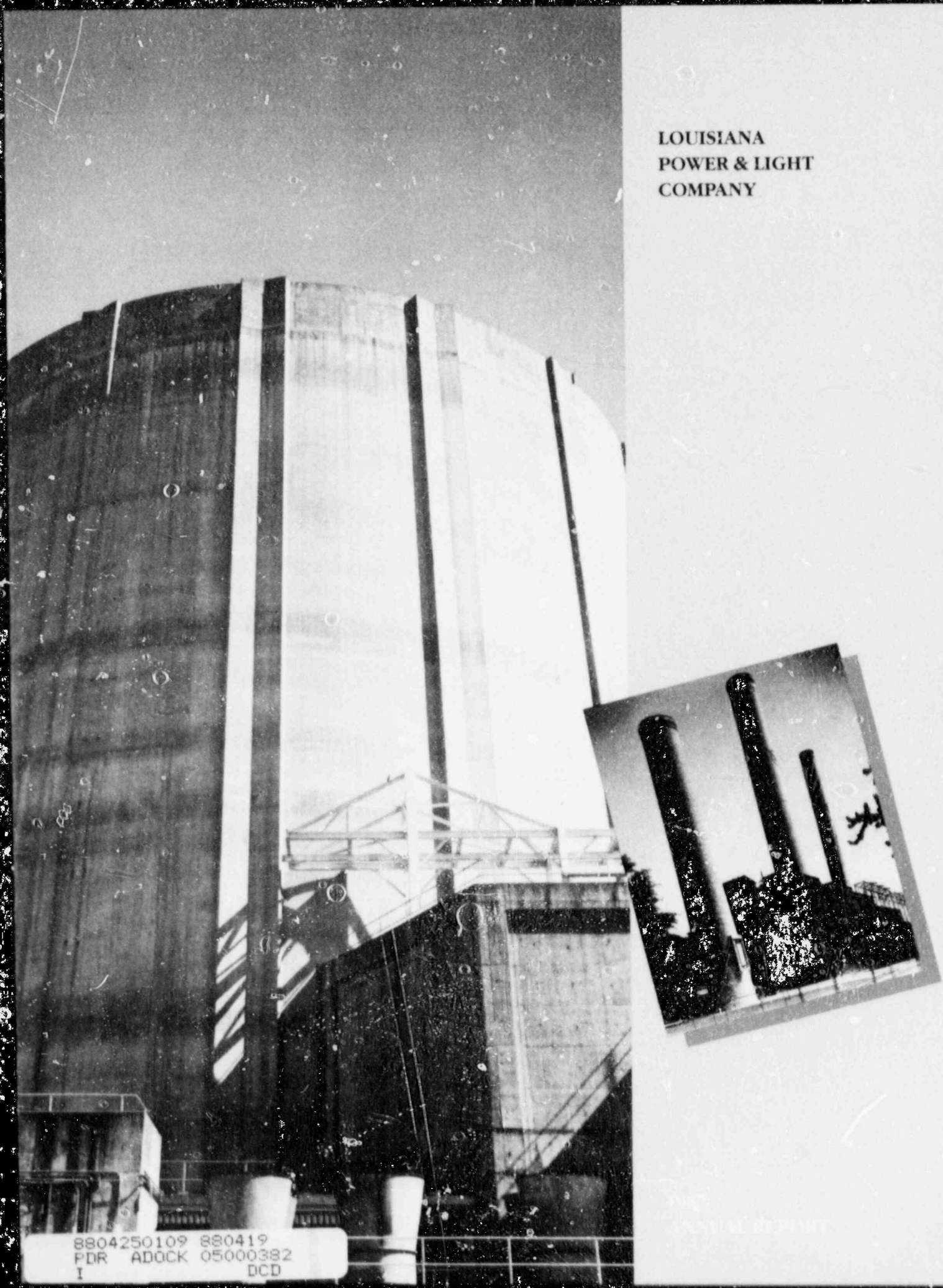
LOUISIANA
POWER & LIGHT
COMPANY



1987
ANNUAL REPORT


Monroe

Louisiana Power & Light Company is a member of one of the largest investor-owned public utility holding companies in the United States: Middle South Utilities, Inc. (MSU). Ranked fourth among the nation's electric and gas utilities in 1987, the MSU System is the leading electric energy supplier to the Middle South, a region comprised of Arkansas, Louisiana, Mississippi, and southeastern Missouri. Gas service is provided in New Orleans and portions of Arkansas and Missouri.

The MSU System utilizes a vast, interconnected transmission and distribution network and a balanced system of fossil fuel and nuclear generating plants to meet the electric needs of 1.68 million customers in the 91,000-square-mile Middle South area, encompassing 1,300 communities with an aggregate population of five million.

At the heart of the System are five operating companies working together: Arkansas Power & Light Company (AP&L), Louisiana Power & Light Company (LP&L), Mississippi Power & Light Company (MP&L), New Orleans Public Service Inc. (NOPSI), and System Energy Resources, Inc. (SERI), which is responsible for the management and operation of the Grand Gulf Nuclear Station.

Additional subsidiaries include: MSU System Services, Inc. (SSI), which provides various technical, administrative, and corporate services that benefit all of the MSU System companies in common; System Fuels, Inc. (SFI), a fuels subsidiary and Electec, Inc. (EI), a subsidiary that markets the commercial capabilities, expertise, and resources of the System companies.

The combined companies of the MSU System are committed to providing the Middle South region economical, dependable service that can be tailored to meet specific energy requirements, and to strengthening the regional economy through economic and educational development initiatives.

HIGHLIGHTS

	As of Dec. 31, 1987	As of Dec. 31, 1986
Plant Investment	**$4,395,545,000**	$4,269,519,000*
Revenue	**$1,340,902,000**	$1,339,211,000
Net Income	**$ 115,649,000**	$ 143,767,000*
Peak Load (occurred 8/21/87 and 7/30/86)	**4,552,000 KW**	4,603,000 KW
Generating Capability	**5,665,000 KW**	5,665,000 KW
Customers	**569,663**	569,229
Average annual kilowatt-hours used per residential customer	**13,477**	13,927
Average annual revenue per residential kilowatt-hour	**7.04¢**	6.79¢
Population in area served	**1,672,000**	1,670,000

*Restated to reflect the adoption of Statement of Financial Accounting Standards No. 90. (See Note 13 of Notes to Financial Statements.)

Cover Photos: From its earliest power station at Sterlington (inset) to the Waterford 3 nuclear plant at Taft, La., LP&L for 60 years has generated the energy to keep Louisiana growing.

Dear Fellow Stockholders and Employees:

1987 marked an important, yet perplexing, year for Louisiana Power & Light Company. It was, of course, our 60th anniversary of helping serve our state's electric needs. Yet it was much more than simply an anniversary. Even though 1987 turned out to be much like 1986, at least in the regulatory and financial arenas, it was also a time that saw our management and employees join together to implement programs and innovations that will not only improve service to our customers, but also save millions of dollars in costs both immediately and in the long run. A perplexing year? Yes. But one that proves "60 Years of Service & Pride" really means service to, and pride in, Louisiana!

Indications are that the state's economy may have bottomed out in 1987 and that our region will begin the climb back toward prosperity in 1988. In the regulatory arena, we are optimistic that some of the vexing issues faced by the Company may be acceptably resolved.

Net income for 1987 slipped to $115.6 million from $147.8 million in 1986. LP&L also resumed payment of modest common stock dividends in 1987 to its parent company, Middle South Utilities, Inc. Common stock dividends had been suspended since the second quarter of 1985.

On January 25, 1988, the Company's Board of Directors approved a reduction in previously reported net income for fiscal year 1985. The reduction totalled $185.4 million and came in response to changes in the rules of the Financial Accounting Standards Board (FASB) and a November 1985, agreement between the Company and the Louisiana Public Service Commission (LPSC) regarding the Waterford 3 rate settlement. (Further details on this matter may be found in the Notes to Financial Statements.)

LP&L's financing activities in 1987 included retirement of $20 million of 4¾% First Mortgage Bonds due January 1, 1987 and the remarketing of $220 million in St. Charles Parish Pollution Control Revenue Bonds. (Comprehensive information about the Company's financial condition may be found in the Financial Statements of this annual report.)

Various regulatory issues and challenges are of concern. One of the more important involves litigation in the U.S. Supreme Court between our sister company, Mississippi Power & Light Company, the Mississippi Attorney General's office, and the Mississippi Legal Services Coalition. A resolution of this case will remove much of the financial and regulatory uncertainty about Grand Gulf 1. We expect a decision by the end of June, 1988.

There were a number of other important events involving regulatory agencies and the courts during 1987:

The Federal Energy Regulatory Commission (FERC) on November 30, 1987 reaffirmed (in Order 292) its original percentage allocations to the System operating companies of System Energy Resources, Inc.'s 90% of the costs, capacity and energy of the Grand Gulf 1 nuclear generating plant (including LP&L's 14%.) On January 29, 1988, the FERC

James M. Cain
President & CEO

also denied the requests for rehearing that had been filed by the New Orleans City Council and other regulatory bodies and interested parties. Appeals from Order 292 have been filed with the U.S. Court of Appeals for the District of Columbia Circuit by most of the same parties that requested a rehearing by the FERC.

The New Orleans City Council ordered a prudence investigation of the need for and construction of Waterford 3 in the aftermath of a filing by LP&L for a rate increase for customers residing in the city's 15th Ward (Algiers). Council hearings on both the prudence investigation and the rate case are scheduled in the spring of 1988, with a decision set for late spring or early summer.

As part of the City Council's ongoing examination of the merits of municipalization of LP&L's sister company, New Orleans Public Service Inc. (NOPSI), the Council has indicated that it would also consider expropriating LP&L's assets in Algiers.

In another significant development, the Council, in November 1987, rejected an Offer of Settlement presented by LP&L and NOPSI (the Companies) in July in an attempt to settle the outstanding issues between the Companies and the Council. The proposed settlement offer contained a number of concessions to ratepayers and an economic development package for the City of New Orleans. In October 1987 the Council submitted a counter-offer of settlement that the Companies still have under study.

The settlement proposals were part of negotiations between the Companies and the Council to reach a compromise on several outstanding regulatory and legal issues, including municipalization and prudence.

With regard to the continuing litigation between the Company and United Gas Pipe Line Company, along with United's parent company Occidental Petroleum Co., the Louisiana Fourth Circuit Court of Appeals, in April 1987, increased the amount awarded to the Company in a District Court judgment to a total of nearly $50 million. When judicial interest is included, the total amount awarded to LP&L would be more than $180 million.

In May 1987, LP&L, United and Occidental agreed to a tentative settlement of litigation with these two provisions: (1) LP&L would receive $120 million (which would ultimately benefit the Company's ratepayers), and (2) another Occidental subsidiary, Occidental Chemical Company (LP&L's largest customer), would agree to remain on the LP&L system for at least five more years. But in November 1987, the LPSC in a 2-2 vote failed to approve the settlement.

A series of rate orders was adopted by the LPSC, certain of which impact LP&L's current and deferred collection of Waterford 3-related costs and the accounting for LP&L's "phase-in plan." A district court's resolution of a dispute over these orders was appealed both by the Company and the Commission to the Louisiana Supreme Court. And on January 29, 1988, the state Supreme Court refused to grant a stay requested by the LPSC, thereby allowing LP&L to place an additional $40 million in base rates in effect February 1, 1988 (subject to refund). Oral arguments on the increase were held March 2, 1988. (Further details on this matter may be found in the Notes to Financial Statements.)

"Never before has a program like Pride Through Teamwork had such a profound impact on a company so quickly."

Internally, LP&L worked vigorously and successfully to reduce costs, improve efficiency, and complete important construction service programs.

Some highlights:

The Company was under budget for the year on our operation and maintenance expenses as well as on construction expenditures, while completing many major projects. We finished 14 construction projects, increasing and updating our power transmission and distribution flexibility, while saving substantial money. Several of the projects used a design developed by our Engineering section which has already saved over a million dollars for the Company.

As a result of recommendations by consultants and an internal ad hoc task force, the Company has also begun the in-house repair of hydraulic equipment used by the Company. A facility to handle this type of repair work has been opened and staffed and began operating in 1988. The Company anticipates significant cost savings from this in-house service, as well as being able to prolong equipment life through improved maintenance.

The Company's fossil group performed infrared services on plant boilers, 150 substations and 1200 miles of transmission lines to identify potential trouble spots in the LP&L system. Significantly, the fossil group in 1987 completed its implementation of the Power Plant Productivity Improvement Program (PPPIP) which is projected to save the System's customers more than $500 million over the next decade through improved plant efficiency, availability, training and maintenance. So significant is the PPPIP effort that System president and chief executive officer Edwin Lupberger presented the coveted "Eagle Award" to those in the Company who played a vital role in the program's development. The "Eagle Award" is symbolic of the Systemwide Teamwork effort.

In 1987, the Company computerized its storerooms in an important move toward improving purchasing efficiency.

In marketing, the Company achieved good results. Some 52% of all new single family homes and a whopping 91% of multi-family dwellings chose all electric service. Of new commercial buildings, 76% chose all electric.

Many positive signs came from the industrial and commercial sections during the year. Among them was completion of the 33-story office complex in Lakeway Center and Phase I of the Galleria in Jefferson Parish. Four industrial customers also completed expansions during the year.

The Company's performance at its Waterford 3 plant was impressive. The capacity factor at the plant for the year was 78.85%, exceeding the goal of 75%. It achieved a number of difficult goals in the areas of unit capacity, budget performance, reducing employee turnover, plant performance and having its training programs fully accredited by the Institute of Nuclear Power Operations, making LP&L the 24th utility nationwide to become a member of the National Academy for Nuclear Training.

LP&L also accomplished important efficiencies regarding its General Office staff in New Orleans, by consolidating employees in three locations. Major improvements were made to district offices throughout the state, including renovations to nearly half the offices in the Northern Division. The largest renovation job, though, was the completion of a 28,000-square-foot addition to the Northern Division office which features a new Control Center operation.

1987 was another banner year for the employees' volunteer service organization, the Family of Community and Utility Supporters (FOCUS). FOCUS, with their employee members and families, helped their communities by participating in an extraordinary 7,500 hours of volunteer civic and charitable work on 26 major projects. Such contributions of time and talent no doubt played a role in a favorable image held by LP&L among its customers. In fact, an attitudinal survey of nuclear utilities indicates LP&L customers rate it among the best in the nation.

In the economic development and civic areas, LP&L continued to work diligently to provide leadership in needed areas. A key stumbling block to business relocations in Louisiana has been the educational and literacy levels of its workforce. The Company's General Educational Development (GED) on TV program improved the skills of thousands of citizens last year. In 1987, approximately 8000 persons signed up for GED in response to LP&L ads.

The Company's economic development efforts are paying off in tangible ways. A firm that responded to one of LP&L's industrial development efforts began operating in Bogalusa, La. in July and is already planning to expand. Five other businesses have also located in our operating area, bringing sorely needed jobs.

1987 also saw a recommitment to the pride that, through the years, made LP&L a pacesetter among utilities for innovations, customer service and cost control. The program, called Pride Through Teamwork, brought together hundreds of employees who combined their talents in mapping out a plan to push the Company into a future of better service to the customers. Numerous programs came from this effort, as well as new efforts to meet the challenges of the future through quick response to changes in the business environment; better service to customers at a competitive price; and improved budgetary controls to get the most out of dollars we spend so we can continue to be a tough cost competitor.

Let me emphasize that these objectives are more than simply a one-year effort. They are only the foundation upon which will come even more long-term efforts designed to keep LP&L the most efficient company in the MSU System.

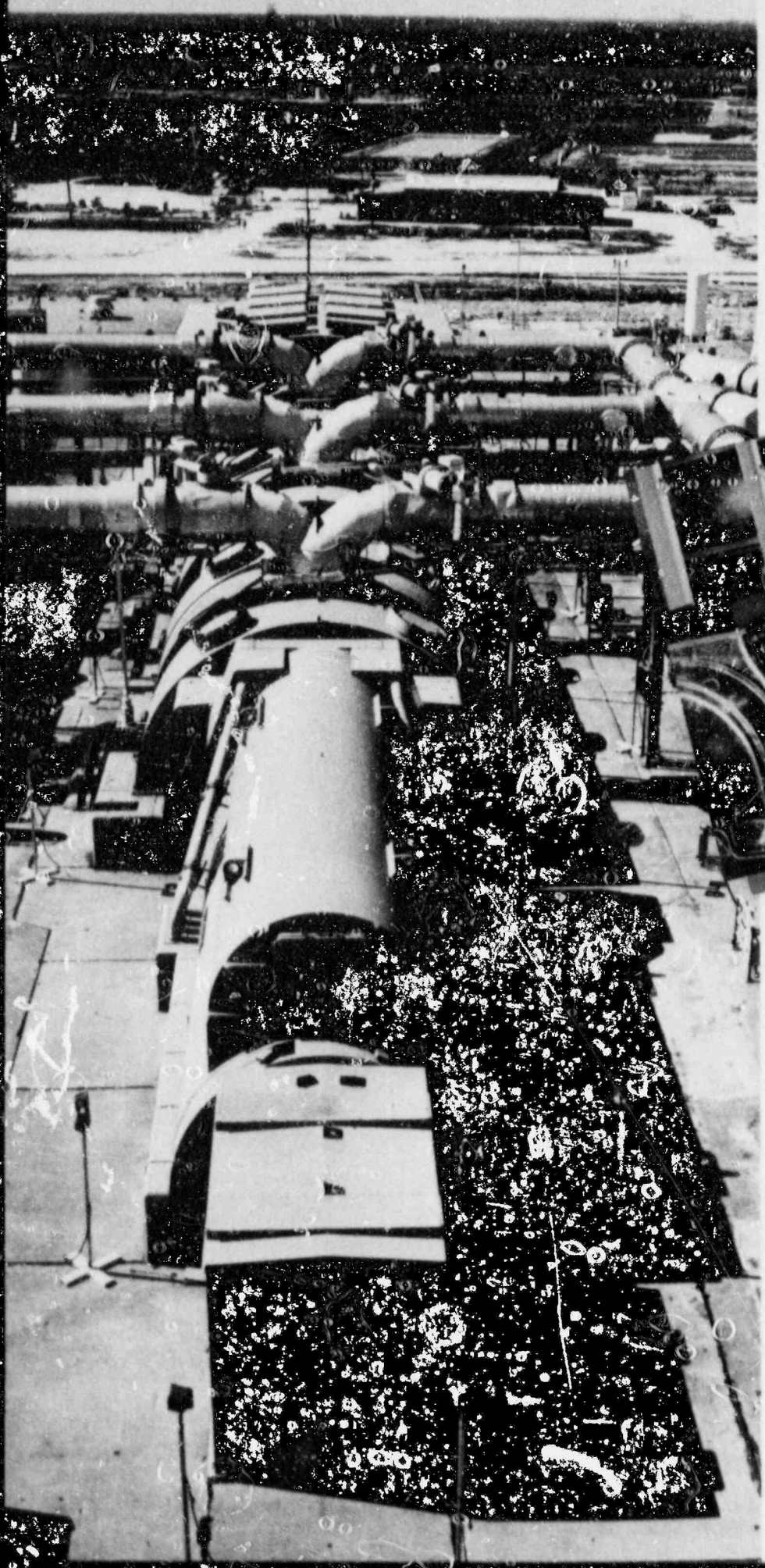
As I began this visit with you, I made it a point to refer to our "60 Years of Service & Pride" theme in this report. Never before has a program like Pride Through Teamwork had such a profound impact on a company so quickly. We are all part of the effort to become a great company. We're proud of the technical innovations, the construction programs and other moves made with our customers, stockholders and employees in mind. And with the foundation now firmly in place for more of the same in the future, lower costs and better service will be a hallmark of LP&L over the next 60 years.

In closing, allow me to invite you to review 60 exciting years. These next few pages will not only [illegible] where we've been as a company, but will also give you an indication of where we hope to be in the future. And that is right here, giving service to, and sharing pride in, Louisiana!

Sincerely,

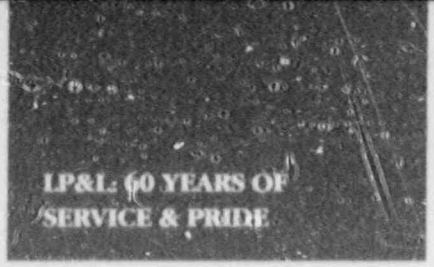
James M. Cain

James M. Cain
President & CEO



Early LP&L generators were relatively small in size and capacity.

Today, huge turbine generators like this one at Waterford 3 can generate more than 1100 megawatts of electricity, enough to power a city the size of New Orleans.



LP&L: 60 YEARS OF SERVICE & PRIDE

It is difficult to imagine today that Edison's invention of the first successful incandescent electric light bulb in 1879 gave rise to angry letters such as this to a Philadelphia newspaper:

"No resident west of Broad Street desires the electric light. Would any one of the editors or owners of the daily papers like one in front of his private dwelling? Would Mayor King or any member of Councils be delighted with one in front of his sleeping chambers? There is no city in the world where it would be tolerated in a street occupied almost entirely by private residences as West Chestnut Street is. Do you admire the six red poles in each square?"

The writer of the letter would no doubt be more than a little surprised to see how electricity in a little over a hundred years has transformed both Philadelphia and the entire world. Most Americans today would rank electricity close behind the essentials of food, clothing and shelter in its importance to modern life.

Though not everyone accepted or wanted electricity initially, we are fortunate that enough far-sighted people possessed the wisdom, imagination and entrepreneurial spirit to see the tremendous potential for humanity emanating from Edison's newly illumined Menlo Park laboratory.

In the Deep South, Louisiana Power & Light Company was among the earliest pioneers in bringing electrification to both the cities and the rural areas of Louisiana.

The story of the growth of the company over the past 60 years is in large measure the story of the development of Louisiana, for so many of the modern needs and conveniences taken for granted today have been made possible by the availability of safe, reliable electricity.

Initially Louisiana, like most other rural states of the South, lagged considerably behind the rest of the nation in the development of electric power. New Orleans, as the state's largest city, was the logical site for first efforts at bringing electricity to Louisiana.

In 1882, the Southwestern Brush Electric Light and Power Company installed 12 generators in the city. They served 480 of the brilliant electric arc lights invented by Charles F. Brush, nearly all of them for street lighting.

In 1884, the company illuminated world-famed Canal Street with additional arc lights.

The 20s: The Early Years

By 1920 most Americans had at least seen the electric light, but very little of rural America was electrified and this was certainly the case in Louisiana.

However, hundreds of small electric plants and systems had begun operating throughout the nation, and Louisiana had more than a smattering of them, although electricity was still unavailable to most Louisianians.

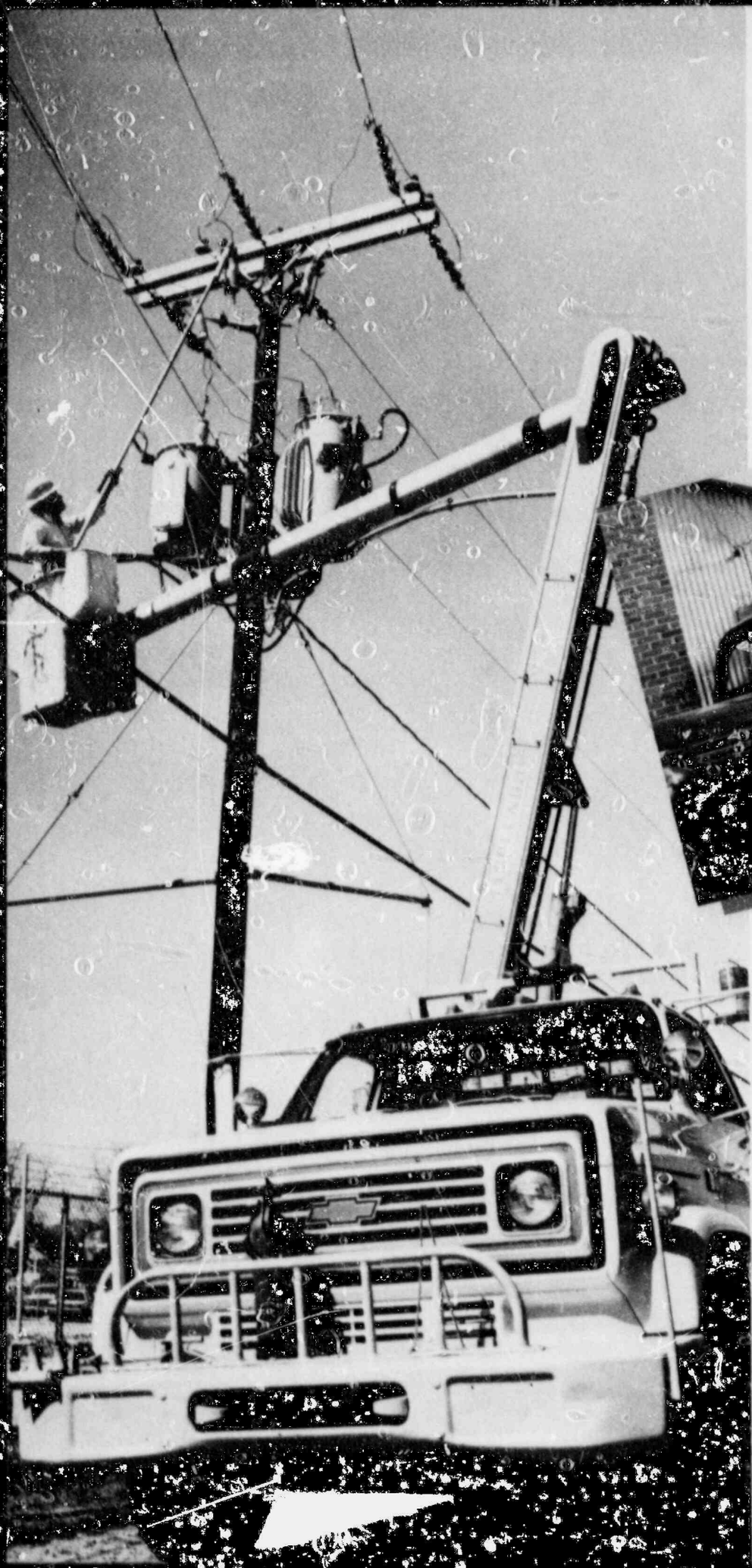
About a month after Charles Lindbergh flew the Atlantic alone and non-stop in May 1927, LP&L was incorporated. The formation of LP&L initiated an effort that was to spread rapidly the countless benefits of electrical service throughout large sections of Louisiana. How was this accomplished? Well, the Company was a merger, so to speak, of six relatively large and numerous other smaller companies. From this unique mix came the expression "Lucky 7 for Louisiana". The old saying literally described the seven services LP&L then offered its customers: electric, electric railway, manufactured and natural gas, telephone, water and ice services.

Key figures in the organization of the Company were Harvey Couch, a builder of electric systems in Louisiana, Mississippi and Arkansas who served as president of LP&L from 1927 to 1936, and Sidney Mitchell, president of Electric Bond and Share Company, then one of the largest utility holding companies in America.

Couch and Mitchell consolidated their interests into a single coordinated system owned by Electric Power & Light Corporation, from which Middle South Utilities was later formed.

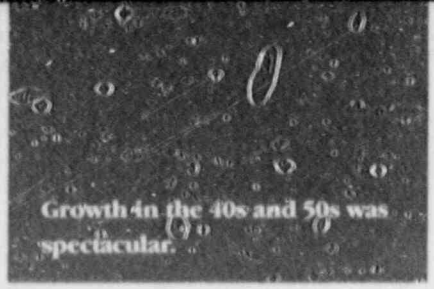
LP&L's first major generating station was located at Sterlington, La., near the center of a newly discovered natural gas field, at that time the world's largest.

Placed in service in 1927, the Sterlington station initially boasted two 12,500-kilowatt turbo-generators. By 1929, two additional turbo-generators had been added, making Sterlington one of the largest producers of electricity in the South.



Before the 50s, service trucks like the one pictured here in 1939 carried linemen with hooks and safety belts for pole-climbing.

In 1954, LP&L revolutionized the electric utility industry with the first "bucket" service trucks. Now, such trucks are the backbone of every utility's fleet.



Growth in the 40s and 50s was spectacular.

In 1927, LP&L served 15,250 electric customers in 65 communities in an area with an estimated population of 108,000.

The roaring 20s ended on a sour note for the United States as the stock market crash of October, 1929 plunged the nation into a wrenching depression that was to test the very fiber of the free enterprise system and America's democratic institutions.

The 30s: Depression Years Growth

LP&L fared far better than most utilities during the depression years as it continued expansion of its service to new communities, providing light amid the dreary darkness of the economic malaise.

LP&L's emphasis on building rural electric lines was not universally accepted by other utilities, but it was the Company's firm commitment to extend its service facilities into new territory "as rapidly as economically possible."

In 1936 McGregor Smith succeeded Harvey Couch as president of the Company and in 1939 W. O. Turner succeeded Smith. Turner had 10 years earlier launched a distinguished career at LP&L that was to lead him to a 28-year tenure as chief executive officer. More than any other person, Turner is credited with molding the development of LP&L through a combination of extraordinary leadership and personal integrity. He was to head the Company until his retirement in 1967.

Though LP&L's growth during the depression years was difficult, by 1939 the average residential customer was using 671 kilowatt-hours a year, more than twice the average in 1929. What's more, the 1939 customer paid slightly less than his 1929 counterpart because of reduced rates.

As America geared up for a possible war in 1940, the nation seemed to sense the end of the depression. By year-end, the Company served 50,212 electric customers.

The 40s: A Busy Decade

The onslaught of World War II involved much of the Company's resources during the early 40s. LP&L answered the call to serve three bustling Army camps in the state while more than 200 of its employees served actively in the Armed Forces.

The Company continued to grow modestly in the war years, limited by restrictions of resources needed for the hostilities. One accomplishment, major at that time, was to add a new generating unit of 44,000 kilowatts at Sterlington, chiefly to serve military needs.

The war's end in 1945 brought with it a need to replace military loads with peacetime uses. To fill this void, LP&L stepped up its emphasis on rural electrification.

While resuming construction of new transmission lines and substations, LP&L also reduced its electric rates for the eighth time since 1927.

Growth was rapid. A popular marketing program called "Be a Forty-Niner" added thousands of new customers in 1949. By the end of the year, LP&L had grown to 171,119 customers and average annual residential electric customer consumption climbed to 900 kilowatt-hours from 671 in 1939.

Other important events in 1949 included the beginning of construction on the new Ninemile Point generating station near New Orleans and the evolution of LP&L as an operating subsidiary of the newly formed Middle South Utilities, Inc.

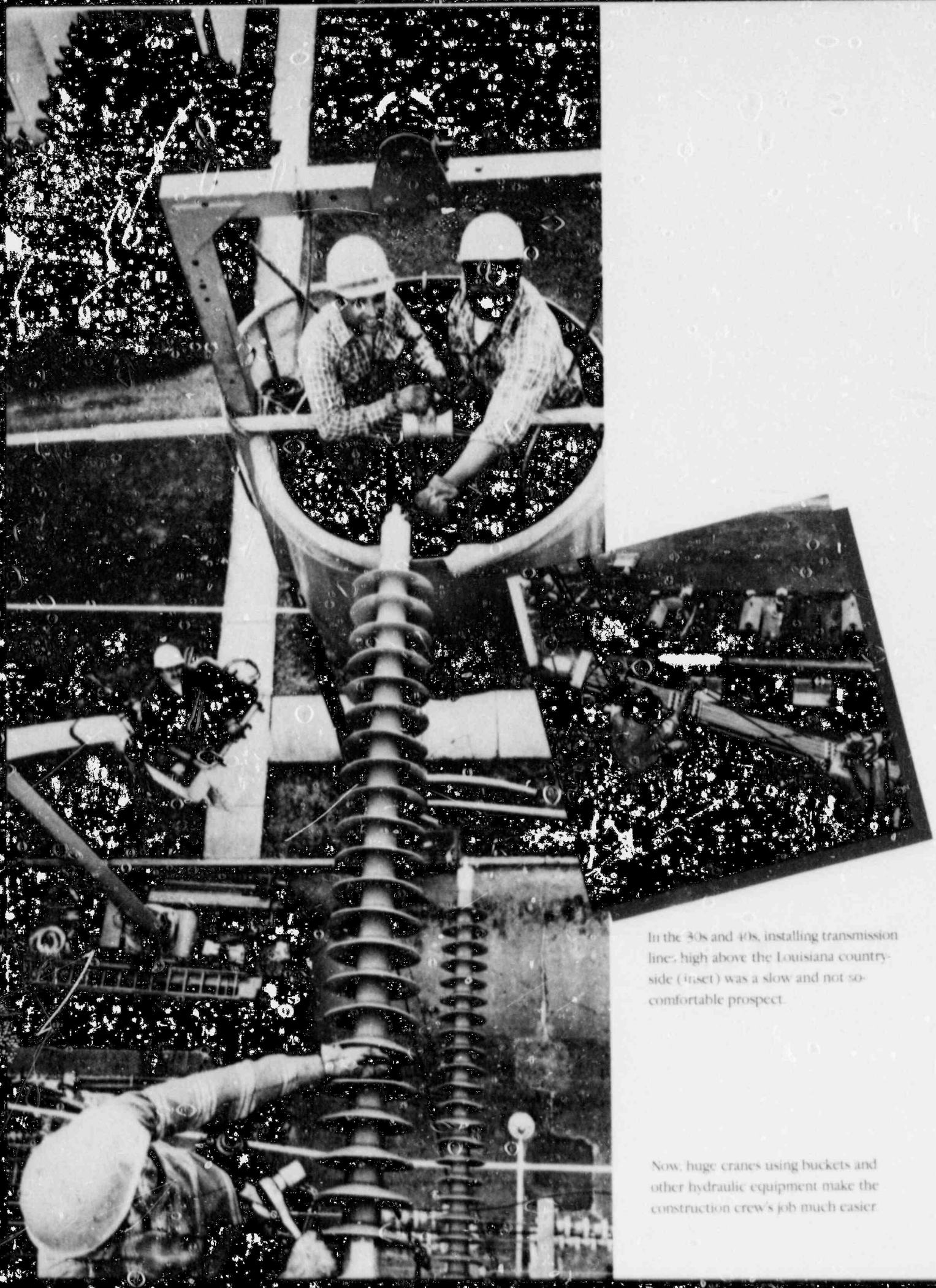
LP&L's growth in the 40s was spectacular, and it was difficult for most of those associated with the Company to foresee that an even more phenomenal decade lay immediately ahead.

The Flourishing Fifties

The start of the Korean War in 1950 again put the nation on an emergency status and set the stage for troubled times in America. But LP&L's strong emphasis on industrial development contributed greatly to surging industrial growth in the state in the 50s.

The first three units of Ninemile Point started up in the first half of the decade, adding 445,000 kilowatts of capability. Later, a 224,000 kilowatt unit went on line at Sterlington. The importance of this unit, though, was that it was semi-automated. It was a pioneer unit, paving the way for what would later become the world's first completely automated steam electric generating station: yet another engineering first for LP&L, which was rapidly gaining a reputation as a leader in advanced utility technology.

In 1954, LP&L began using aerial hydraulic equipment for service, construction and tree-trimming work, a move which gained recognition for the Company as a leader in such mechanization, as well. But the development of the industry's first "bucket truck" was not the last major innovation developed by LP&L. Huge transmission towers had to cross swampy South Louisiana. To get the job done, Company planners turned to helicopters. LP&L then became the first utility to put the "work-horse of the air" on the job in crossing the bayous with steel transmission towers.



In the 30s and 40s, installing transmission lines high above the Louisiana countryside (inset) was a slow and not so-comfortable prospect.

Now, huge cranes using buckets and other hydraulic equipment make the construction crew's job much easier.

Hurricane Betsy's devastation was unparalleled . . . the recovery remarkable.

By 1955, LP&L added its 200,000th electric customer. Later in the decade the Company was required by federal law to dispose of its gas operations. In 1958, LP&L organized Louisiana Gas Service Company. The Company transferred to Louisiana Gas its non-electric properties at net book cost.

W. O. Turner was elevated to chairman of the board and chief executive officer in 1959 and G. C. Rawls, vice president in charge of operations, was named president.

The Company's achievements in the fifties marked the most notable progress in its history with rapidly expanded consumption, enormous industrial growth, and an optimistic organization, well-positioned to take full advantage of the promising sixties.

The Stormy Sixties

Repair and maintenance crews probably remember the sixties most for the three devastating hurricanes that savaged the southern end of the service territory. Though Hilda was nasty and Camille was vicious, it was Betsy whose blustery path through Louisiana left an indelible impression as the worst natural disaster in LP&L's history.

Betsy disrupted service to all 200,000 LP&L customers in South Louisiana, inflicting $10 million damage to Company facilities. To this day, Betsy is blamed for the worst weather-caused damage ever visited on a utility company. At one point, the recovery effort engaged more than 2,000 workers from as far away as Pennsylvania. Some 90 percent of LP&L customers were back in service within 10 days, a remarkable feat especially in view of the severe flooding which made access to some areas virtually impossible.

Despite the hurricanes, the 60s were great years for the Company with record growth and important technological advances.

Little Gypsy No. 1 came on line in 1961 as the world's first generating unit capable of fully automated operation.

During the decade, Company revenues soared to $136.5 million from $46.8 million, a jump of 292 percent. The number of customers increased to 334,861 from 246,239 and average annual residential use of electricity more than doubled – from 3,411 to 8,579 kilowatt hours. A major acquisition of LP&L in 1966 was People Utilities, Inc., a utility based in Buras, La., serving most of rural, and coastal, Plaquemines Parish. The purchase of the smaller company not only increased LP&L's service area, but also served as an important testing ground for new technology. Having to cross the Mississippi River and its Delta region with transmission and distribution facilities, LP&L gained experience that made it an industry-leader in serving areas faced with problems unique to electric utilities.

W. O. Turner took well-earned retirement in 1967. He was succeeded as chief executive officer by G. C. Rawls, president of the Company since 1959.

LP&L looked to the seventies with confidence. Said the 1969 annual report: "The future of LP&L will take place within an environment that should be exciting, challenging and extremely productive." The statement was prophetic on all counts.

The 70s: New Challenges

LP&L entered the seventies with the news that it planned to build a giant nuclear generating unit to be known as Waterford 3. Also planned were two, 411,000-kilowatt, fossil-fueled units at the Waterford site.

Another significant event in 1970 was the election of Floyd W. Lewis as chairman and chief executive officer and E. A. Rodrigue as president. Rodrigue in 1971 was named chief executive officer after Lewis had been elevated to the position of president of Middle South Utilities.

Thorough study indicated a definite need for the nuclear plant at Waterford but various government agencies delayed repeatedly the start of work, forcing costs to escalate dramatically, especially with the added effects of inflation.

Meanwhile, fuel supply problems worsened as supplies of natural gas for generation were curtailed, causing the Company's fuel costs to climb. Exacerbating an already difficult situation was the imposition of the Arab oil embargo in 1973.

By the mid-seventies, LP&L slipped into declining financial health, forcing the Company in 1976 to file for its first ever retail rate increase, after 29 rate decreases in its first 50 years! The Company ultimately was granted an increase of less than 25 percent of the amount sought, making necessary a second rate relief application in 1978.

The mantle of leadership was placed in 1976 on Jack M. Wyatt, who was elected president and chief executive officer of LP&L.

Though the decade had seen severe hardships for the Company, it managed to continue increasing service, connecting its 500,000th customer. The Company eventually also received rate relief amounting to $59.6 million from the Louisiana Public Service Commission. The amount was far less than the Company considered to be essential but it was nevertheless quite welcome.

The 80s: Nuclear Era

The Waterford 3 nuclear plant, then called "the largest single industrial project in Louisiana history," began commercial operation in 1985 with a 1104 megawatt-rated capacity.

A few months earlier, the 1250-megawatt Grand Gulf 1 nuclear plant went into operation in Port Gibson, Mississippi. LP&L's affiliate, System Energy Resources, Inc. (SERI), owns 90 percent of the plant and LP&L purchases 14 percent of SERI's portion of the power.

The Waterford 3 and Grand Gulf 1 projects signal major accomplishments in the fuel diversification program of the Company and SERI, assuring reliable electricity for decades.

However, delays in rate relief and a particularly harsh recession in Louisiana contributed to severe financial problems for the Company, causing LP&L to suspend payment of its quarterly common dividend from the third quarter of 1985 until the third quarter of 1987.

Other noteworthy events in the eighties included the election of James M. Cain as president in 1982 and chief executive officer in 1983 and the settlement with Texaco in 1982 of a dispute over disrupted natural gas supplies. The settlement brought payments totalling a $1.087 billion to LP&L, which has resulted in annual refunds to LP&L customers since that time.

Plans were announced in 1981 for LP&L and its sister company, New Orleans Public Service Inc., to consolidate operations. Public Service provides electricity to 16 of New Orleans' 17 wards and gas service to the entire city. Functional consolidation was virtually complete by 1985 but legal consolidation is pending before state, local and federal regulatory agencies.

The Future: Challenges and Opportunities

There is no question that LP&L's first 60 years were filled with expansion, excitement and engineering firsts. Our next 60 years will be equally challenging on many fronts, including both the legal and regulatory arenas. Even though these facets of the Company's future may require much attention, LP&L will continue to move forward as a pioneer of innovations to better serve its customers while holding costs down.

The term "pioneer" is often overused in describing a company's research efforts. But for LP&L, it is an accurate description of industry firsts like: using 500 kilovolt (kV) transmission; designing a new monitoring computer for plants like the Waterford 3 nuclear unit; converting 115 kV substations to 230 kV using existing structures; installing fiber optic pilot wire relays; developing the Jarraff tree-trimming machine; using 500 kV gas insulated substations; designing and developing a new substation battery alarm; using tap-less pole-top distribution transformers; and designing and developing the "rocket-ship" steel foundation for swamp construction.

Some engineers may consider a difficult situation as a problem. At LP&L, we consider it a challenge, another opportunity to improve service and reliability for our customers while saving money at the same time.

Pioneer? Yes, indeed. But with each day of innovation and new technology comes even more reasons for LP&L to use the word proudly: Louisiana Power & Light Company; 60 Years of Service to, and Pride in, Louisiana. And looking forward to 60 more years of the same type of effort and spirit.

REPORT OF MANAGEMENT

The management of Louisiana Power & Light Company has prepared and is responsible for the financial statements and related financial information included in this annual report. The financial statements are based on generally accepted accounting principles, applied on a consistent basis, after restatement for the change in the method of accounting for disallowed plant costs as described in Note 13 of Notes to Financial Statements. Financial information included elsewhere in this report is consistent with the financial statements.

To meet its responsibilities with respect to financial information, management maintains and enforces a system of internal accounting controls that is designed to provide reasonable assurance, on a cost effective basis, as to the integrity, objectivity, and reliability of the financial records and as to the protection of assets. This system includes communication through written policies and procedures as well as an organization structure that provides for appropriate division of responsibility and the training of personnel. This system is also tested by a comprehensive internal audit program.

The Board of Directors pursues its responsibility for reported financial information through its audit committee, composed of outside directors. The audit committee meets periodically with management, the internal auditors, and the independent public accountants to discuss auditing, internal control, and financial reporting matters. The independent public accountants and the internal auditors have free access to the audit committee at any time.

The independent public accountants provide an objective assessment of the degree to which management meets its responsibility for fairness of financial reporting. They regularly evaluate the system of internal accounting controls and perform such tests and other procedures as they deem necessary to reach and express an opinion on the fairness of the financial statements.

Management believes that these policies and procedures provide reasonable assurance that its operations are carried out with a high standard of business conduct.

AUDITORS' OPINION

Louisiana Power & Light Company:

We have examined the balance sheets of Louisiana Power & Light Company as of December 31, 1987 and 1986 and the related statements of income, retained earnings and cash flows for each of the three years in the period ended December 31, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the above-mentioned financial statements present fairly the financial position of the Company at December 31, 1987 and 1986 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1987 in conformity with generally accepted accounting principles applied on a consistent basis, after restatement for the change, with which we concur, in the method of accounting for disallowed plant costs as described in Note 13 to the financial statements.

Deloitte Haskins & Sells

New Orleans, Louisiana
February 29, 1988

BALANCE SHEETS
December 31, 1987 and 1986

	1987	1986
	(In Thousands)	
Assets		
UTILITY PLANT (Notes 11 and 13):		
Electric	$4,282,263	$4,148,772
Construction work in progress	113,282	120,747
Nuclear fuel	115,323	20,495
Total	4,510,868	4,290,014
Less accumulated depreciation	(824,465)	(721,543)
Utility plant – net	3,686,403	3,568,471
OTHER PROPERTY AND INVESTMENTS:		
Investment in subsidiary company – at equity (Note 8I)	49,524	49,524
Other	662	611
Total	50,186	50,135
CURRENT ASSETS:		
Cash and special deposits	11,803	16,756
Temporary investments – at cost, which approximates market:		
Associated companies (Note 4)	6,040	11,100
Other	56,650	82,900
Total cash and cash equivalents (Note 1I)	74,593	110,756
Notes receivable	310	336
Accounts receivable:		
Customer and other (less allowance for doubtful customer accounts of $1,900,000 in 1987 and $1,385,000 in 1986)	47,942	55,177
Associated companies	1,534	942
Accrued unbilled revenues (Note 1B)	50,936	54,973
Income taxes receivable (Note 3)	5,933	20,640
Materials and supplies – at average cost	10,320	14,404
Prepayments	6,658	7,093
Other	12,518	12,328
Total	210,654	276,649
DEFERRED DEBITS:		
Deferred Waterford 3 expenses (Notes 1G, 2 and 8G)	247,200	226,120
Unamortized debt expense (Note 6)	27,094	28,221
Other	12,812	790
Total	287,106	255,131
TOTAL	$4,234,349	$4,150,386

1986 has been restated to reflect the adoption of SFAS No. 90 (see Note 1F).
See Notes to Financial Statements.

Capitalization and Liabilities

	1987	1986
	(In Thousands)	
CAPITALIZATION:		
Common stock, no par value, authorized 150,000,000 shares; issued and outstanding 137,110,900 shares (Note 5)	$ 903,900	$ 903,900
Paid in capital	–	650
Retained earnings (deficit) (Notes 7 and 13)	16,076	(40,201)
Total common shareholder's equity	919,976	864,349
Preferred stock, without sinking fund (Note 5)	145,882	145,882
Preferred stock, with sinking fund (Note 5)	241,361	272,129
Long-term debt (Note 6)	1,772,264	1,783,032
Total	3,079,483	3,065,392
OTHER NONCURRENT LIABILITIES:		
Obligations under capital leases (Note 11)	56,363	–
Accumulated provision for property insurance	7,912	6,983
Accumulated provision for injuries and damages	5,326	3,398
Total	69,601	10,381
CURRENT LIABILITIES:		
Currently maturing long-term debt (Note 6)	2,832	22,774
Accounts payable:		
Associated companies	59,409	48,902
Other	67,592	60,418
Customer deposits	31,168	29,828
Taxes accrued	16,597	16,938
Accumulated deferred income taxes (Note 3)	3,936	14,782
Interest accrued	44,505	45,363
Dividends declared (Note 5)	12,095	13,141
Gas contract settlement – liability to customers (Notes 2 and 12)	56,403	56,450
Deferred fuel costs (Note 1B)	21,314	16,376
Obligations under capital leases (Note 11)	45,540	–
Other	4,002	20,200
Total	365,393	335,172
DEFERRED CREDITS:		
Accumulated deferred income taxes (Note 3)	251,426	211,030
Accumulated deferred investment tax credits (Note 3)	168,574	169,777
Gas contract settlement – liability to customers (Notes 2 and 12)	281,611	338,076
Other	18,261	20,558
Total	719,872	739,441
COMMITMENTS AND CONTINGENCIES (Notes 2, 8, 11, and 12)		
TOTAL	$4,234,349	$4,150,386

1986 has been restated to reflect the adoption of SFAS No. 90 (see Note 13).
See Notes to Financial Statements.

STATEMENTS OF INCOME (LOSS) AND RETAINED EARNINGS (DEFICIT)

For the years ended December 31,	1987	1986	1985
		(In Thousands)	
Statements of Income (Loss)			
OPERATING REVENUES (Note 1B)	$1,340,902	$1,339,211	$1,259,770
OPERATING EXPENSES:			
Fuel and purchased power (Notes 1B and 8D)	569,119	595,042	767,820
Other operation expenses	206,612	219,129	164,785
Maintenance	88,611	88,198	50,040
Depreciation	118,769	116,125	66,584
Taxes other than income taxes	46,106	42,393	37,442
Income taxes (Note 3)	26,707	41,432	(2,965)
Rate deferrals:			
Deferred Waterford 3 expenses (Notes 1G and 2)	(21,080)	(206,000)	(20,120)
Income taxes (Note 3)	9,434	103,659	10,124
Total	1,044,278	999,978	1,073,710
OPERATING INCOME	296,624	339,233	186,060
OTHER INCOME (DEDUCTIONS):			
Allowance for equity funds used during construction (Note 1F)	1,945	1,880	90,371
Miscellaneous income and deductions – net	7,192	8,717	13,997
Income taxes (Note 3)	(2,044)	(4,457)	(7,101)
Total	7,093	6,140	97,267
APPLICATION OF SFAS NO. 90 (Note 13):			
Disallowed plant costs	–	–	276,900
Income taxes (Note 3)	–	–	(90,259)
Total	–	–	186,641
INTEREST CHARGES:			
Interest on long-term debt	181,766	187,516	166,587
Other interest – net (Notes 4 and 12)	7,444	14,857	20,835
Allowance for borrowed funds used during construction (Note 1F)	(1,142)	(767)	(36,912)
Total	188,068	201,606	150,510
NET INCOME (LOSS)	$ 115,649	$ 143,767	$ (53,824)
Statements of Retained Earnings (Deficit)			
RETAINED EARNINGS (DEFICIT):			
January 1, as previously reported	$ 142,029	$ 54,500	$ 51,199
Cumulative effect of retroactively applying SFAS No. 90 (Note 13)	(182,230)	(185,393)	–
January 1, as adjusted	(40,201)	(130,893)	51,199
ADD: Net income (loss)	115,649	143,767	(53,824)
Total	75,448	12,874	(2,625)
DEDUCT:			
Dividends (Note 5):			
Preferred stock	50,724	53,068	26,918
Preferred stock arrearages	–	–	26,705
Common stock	8,315	–	74,645
Capital stock expenses	333	7	–
Total	59,372	53,075	128,268
RETAINED EARNINGS (DEFICIT), December 31 (Note 7)	$ 16,676	$ (40,201)	$(130,893)

1986 and 1985 have been restated to reflect the adoption of SFAS No. 90 (see Note 13).
See Notes to Financial Statements.

STATEMENTS OF CASH FLOWS.

For the years ended December 31.	1987	1986	1985
		(In Thousands)	
OPERATING ACTIVITIES:			
Net income (loss)	$ 115,649	$ 143,767	$ (53,824)
Adjustments to reconcile net income to net cash provided by operating activities:			
Disallowed plant costs (Note 13)	–	–	276,900
Depreciation	118,769	116,125	66,584
Deferred income taxes (Note 3)	29,550	156,827	(60,307)
Deferred Waterford 3 expenses (Notes 1G, 2, and 8G)	(21,080)	(206,000)	(20,120)
Allowance for funds used during construction (Note 1F)	(3,087)	(2,647)	(127,283)
Amortization of nuclear fuel assemblies	1,353	2,161	6,179
Investment tax credits – net (Note 3)	(1,203)	(1,254)	(451)
Changes in:			
Receivables	25,413	3,316	(35,077)
Accounts payable	17,681	(35,890)	49,124
Deferred fuel costs	4,938	(13,993)	13,513
Taxes and interest accrued	(1,199)	56	10,309
Other current assets and liabilities	(530)	(2,371)	3,418
Power purchase advance payments (Note 8D)	–	–	(37,776)
Power purchase advance repayments (Note 8D)	–	11,434	88,719
Refunds to customers – gas contract settlements (Notes 2 and 12)	(56,512)	(56,374)	(62,964)
Other	(16,434)	(18,076)	11,594
Net cash provided by operating activities	213,308	97,081	128,538
INVESTING ACTIVITIES:			
Investment in subsidiary (Note 8I)	–	–	(2,107)
Construction expenditures	(126,792)	(115,121)	(529,803)
Nuclear fuel expenditures	(28,663)	(56,424)	(12,716)
Proceeds from sale and leaseback of nuclear fuel	21,205	48,405	25
Allowance for funds used during construction (Note 1F)	3,087	2,647	127,283
Net cash used in investing activities	(131,163)	(120,493)	(214,403)
FINANCING ACTIVITIES:			
Proceeds from issuance of:			
First mortgage bonds	–	555,000	–
Other long-term debt	–	134,952	1,457
Common stock	–	–	100,000
Retirement of first mortgage bonds	(20,000)	(355,000)	–
Retirement of other long-term debt	(5,722)	(4,569)	(2,549)
Redemption of preferred stock	(32,591)	(6,744)	(6,510)
Changes in short-term borrowings	–	(133,859)	133,859
Dividends paid on common stock	(8,315)	–	(109,867)
Dividends paid on preferred stock	(51,770)	(66,632)	(40,473)
Net cash provided by (used in) financing activities	(118,398)	123,148	75,917
Net increase (decrease) in cash and cash equivalents	(36,253)	99,736	(9,948)
Cash and cash equivalents at beginning of year	110,756	11,020	20,968
Cash and cash equivalents at end of year	$ 74,503	$ 110,756	$ 11,020
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid (received) during the year for:			
Interest	$ 186,548	$ 197,040	$ 185,033
Income taxes	$ (4,630)	$ (4,704)	$ (3,961)
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:			
Capital lease obligations recorded (Note 11)	$ 143,278	–	–

1986 and 1985 have been restated to reflect the adoption of SFAS No. 90 (see Note 13).
See Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS
For the years ended December 31, 1987, 1986, and 1985.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. System of Accounts

The accounts of the Company are maintained in accordance with the system of accounts prescribed by the Louisiana Public Service Commission (LPSC), which conforms to the Uniform System of Accounts as prescribed by the Federal Energy Regulatory Commission (FERC).

B. Revenues and Deferred Fuel Costs

The Company recognizes revenues as billed to customers on a cycle billing basis in addition to an accrual for estimated unbilled revenues. Unbilled revenues result from energy delivered since the period covered by the latest billings to customers.

The rate schedules of the Company include fuel adjustment clauses under which fuel costs are billed to customers. The Company defers under/over recoveries of fuel costs that occur through operation of the fuel adjustment clauses until these costs/credits are reflected in billings to customers.

C. Utility Plant and Depreciation

Utility plant is recorded at original cost. Partial disallowances of plant costs ordered by the regulator have been recorded as an adjustment to utility plant. (See Note 13, "Statements of Financial Accounting Standards (SFAS) No. 90.") The cost of additions to utility plant includes contracted work, direct labor, materials, allocable overheads, and an allowance for the composite cost of funds used during construction (AFDC). The costs of units of property retired are removed from utility plant, and such costs plus removal costs less salvage are charged to accumulated depreciation. Maintenance and repairs of property and the replacement of items determined to be less than units of property are charged to operating expenses. Principally all of the utility plant is subject to the lien of the Company's first mortgage indenture. In addition, certain assets of the Company are subject to the liens of second mortgages.

Depreciation is computed on the straight-line basis at rates based on the estimated service lives of the various classes of property. Depreciation rates for Waterford 3 include a provision for nuclear plant decommissioning costs. Depreciation provisions on average depreciable property amounted to approximately 2.8% in 1987, 2.8% in 1986, and 3.0% in 1985.

D. Postretirement Benefits

The Company has postretirement plans covering substantially all employees. The Company's policy is to fund pension costs in accordance with guidelines established by the Employee Retirement Income Security Act of 1974. The costs of postretirement welfare benefit plans are funded as incurred.

E. Income Taxes

The Company joins its parent, Middle South Utilities, Inc. (MSU), in filing a consolidated federal income tax return. Income taxes are allocated to the Company in proportion to its contribution to the consolidated taxable income. Income taxes receivable include estimated amounts due under the tax allocation agreement.

Deferred income taxes are provided for differences between book and taxable income to the extent permitted by the regulatory bodies for ratemaking purposes. Investment tax credits allocated to the Company are deferred and amortized based on the average useful life of the related property in a manner consistent with ratemaking treatment.

F. Allowance for Funds Used During Construction

To the extent that the Company is not permitted by its regulatory bodies to recover in current rates the carrying costs of funds used for construction, it capitalizes as an appropriate cost of utility plant AFDC, which is calculated and recorded as provided by the regulatory system of accounts. Under this utility industry practice, construction work in progress on the balance sheet is charged and the income statement is credited for the approximate net composite interest cost of borrowed funds and for a reasonable return on the equity funds used for construction. This procedure is intended to remove from the income statement the effect of the cost of financing the construction program and results in treating the AFDC charges in the same manner as construction labor and material costs. As non-cash items, these credits to the income statement have no effect on current cash earnings. After the property is placed in service, the AFDC charged to construction costs is recoverable from customers through depreciation provisions included in rates charged for utility service. The composite AFDC rates for the Company were 8.73% and 9.79% for 1987 and 1986, respectively. For the year 1985, the effective AFDC composite rates were 9.79% and 4.68% for non-Waterford 3-related and Waterford 3 construction costs, respectively. The

Company ceased accruing AFDC on Waterford 3 as of its in-service date of September 24, 1985.

The Company's policy is to continue to capitalize AFDC on projects during periods of interrupted construction when such interruption is temporary; the continuation can be justified as being reasonable under the circumstances, and it is probable such costs will be recoverable through rates.

G. Rate Deferrals

Pursuant to the November 1985, April 1987, and June 1987 LPSC rate orders, the Company has deferred, for future recovery, a portion of its costs associated with Waterford 3 ($247 million accumulated as of January 31, 1987). The deferred costs are to be phased-in on a schedule to be determined by the LPSC. Under this plan, those costs that are deferred in the early years of commercial operation would be collected in later years from customers. By deferring amounts to the future when they would be collected through increased rates billed to customers, the impact of the deferral aspect of the phase-in plan on the income statement has been removed. Because the actual collection of revenues to recover the deferred amount was not to occur until the future, the Company recorded a deferred asset representing the amount of the deferral and, at the same time, incurred additional capital requirements to finance this deferral. For further discussions of the above mentioned rate orders and related litigation, and the Company's phase-in plan, see Note 2, "Rate Matters", and Note 8, "Commitments and Contingencies – New Accounting Standards".

H. Other Noncurrent Liabilities

The Company provides for uninsured property risks and for claims for injuries and damages through charges to operating expenses on an accrual basis. Such expenses have been allowed for ratemaking purposes.

I. Statements of Cash Flows

During 1987, the Financial Accounting Standards Board (FASB) issued SFAS No. 95, "Statement of Cash Flows." The Company has adopted SFAS No. 95 and replaced the Statements of Changes in Financial Position with Statements of Cash Flows in the current and prior years' financial statements presented herein.

For purposes of the Statement of Cash Flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

In November 1985, the LPSC issued an order (November 1985 Order) granting the Company an emergency interim rate increase of $106.7 million (net of fuel savings), after application of certain conditions, and authorizing the Company to defer on an annual basis for future recovery approximately $206 million (accumulated to $247 million through January 31, 1987) of Waterford 3 costs. As part of the November 1985 Order, the Company agreed that it would permanently absorb, and not recover from its retail customers, $284 million of its investment in Waterford 3. In addition, the Company agreed that the LPSC may disallow on a prospective basis, subsequent to a prudence investigation and subject to appeal, any Waterford 3 expenditures found imprudent, but only to the extent that such imprudent expenditures exceed $284 million.

In connection with the November 1985 Order, the LPSC retained an independent consulting firm to conduct a prudence investigation of the Company's construction of Waterford 3 and participation in the purchase of capacity and energy from Unit No. 1 of the Grand Gulf Steam Electric Generating Station (nuclear) (Grand Gulf 1), of which 90% is owned by System Energy Resources, Inc. (SERI). The consultants concluded that $143 million in expenditures associated with the construction of Waterford 3 were imprudently incurred. It is the position of the Company that none of the costs were imprudently incurred. Moreover, since the consultants attributed an amount to imprudence of less than the $284 million previously agreed upon, the Company believes that no additional financial disallowance is justified. The report also concluded that the decisions to build Waterford 3 and

to enter into a contract for Grand Gulf 1 power were reasonable. As of December 31, 1987, the LPSC had not indicated its conclusions on the prudence issues. In December 1987, the Company implemented a new accounting standard that required recording, as a loss, the LPSC's jurisdictional portion (approximately $276.9 million) of the $284 million of disallowed investment in Waterford 3. The cumulative charge to December 31, 1986 retained earnings as a result of the loss was $182.2 million, net of tax. (See Note 7, "Retained Earnings", and Note 13, "Statement of Financial Accounting Standards No. 90.")

By order dated January 30, 1987 (January 1987 Order), the LPSC, among other things, (1) ruled that the overall fair rate of return on rate base appropriate for ratemaking purposes for the Company (utilizing a rate of return on common equity of 12%) is 10.75%; (2) ordered the Company to forego further refunds to its jurisdictional customers previously ordered in connection with the proceeds of a settlement with a gas supplier (see Note 12, "Settlement Agreement with Gas Supplier") and to use these funds, approximately $386 million as to LPSC jurisdictional customers, (a) to be applied against (used to recover) the accumulated Waterford 3 costs approximating $247 million as of January 31, 1987 that had been deferred pursuant to the November 1985 Order and (b) to reduce its rate base investment in Waterford 3 with the remaining $139 million; (3) granted the Company, in addition to the rate increase resulting from the November 1985 Order, an additional rate increase of $76.2 million annually; (4) ordered that there be no further or future phase-ins and no additional recoveries of Waterford 3 costs; and (5) stated that the prudence issue would not be resolved in this order. Motions for rehearing were filed by certain intervenors, and on March 24, 1987, the LPSC granted a rehearing but did not grant a suspension of or stay with respect to the January 1987 Order or the rates therein authorized.

Following hearings, the LPSC issued an order dated April 29, 1987 (April 1987 Order) that (1) determined that a 1983 order of the LPSC requiring annual refunds to customers of funds resulting from the abovementioned settlement agreement with a gas supplier (and the refund schedule therein adopted) should be reinstated and, accordingly, ordered that the 1987 refund of $55.2 million to LPSC jurisdictional customers be made within 30 days of the effective date of the April 1987 Order and (2) determined, on the basis of the phase-in of Waterford 3 costs recommended by its consultants, that the Company's rate increase should be $48 million annually rather than $76.2 million, and ordered that the Company reduce its rates accordingly by $28.2 million on the effective date of the order. The LPSC further stated that it expected the Company to seek further rate relief in the future pursuant to such phase-in, but that the LPSC did not by its order approve any future rate increases and will grant an increase to cover amounts the Company is required to defer only if the rate increases are shown to be just and reasonable after a hearing.

On May 6, 1987, the Company filed with the LPSC a Motion for Rehearing and Clarification of Order in order to obtain clarification of certain provisions of the April 1987 Order. Among other things, the April 1987 Order, as written, did not on its face provide adequate assurance of future recovery, through a phase-in plan, of previously deferred, but unrecovered Waterford 3 expenses.

In response to such motion, the LPSC, in its order dated June 26, 1987 (June 1987 Order), among other things, (1) found that, except as to the January 1987 Order, the April 1987 Order was not intended to change any of the LPSC's orders issued in the rate proceeding (which would include the November 1985 Order providing for the deferral and future recovery of approximately $247 million of Waterford 3 costs incurred through January 31, 1987), (2) denied the Company's Motion for Rehearing, and (3) as to the requested clarification, stated that, by the April 1987 Order, the LPSC (a) had abandoned the January 1987 Order, (b) had reduced the rate increase of $76.2 million, provided by the January 1987 Order, to $48 million, and (c) had reinstated the refunding program in favor of LPSC jurisdictional customers previously ordered in connection with the abovementioned settlement agreement with a gas supplier. The reduction in the Company's rate increase from $76.2 million to $48 million was placed into effect on July 6, 1987. Additionally, the Company made the required $55.2 million refund to the LPSC jurisdictional customers on that same date.

By its November 1985, April 1987, and June 1987 Orders, the LPSC has provided adequate assurance to the Company as to the future recovery of approximately $247 million of deferred Waterford 3 costs accumulated through January 31, 1987, but not with respect to certain additional Waterford 3 costs incurred but not recovered subsequent to July 6, 1987 (estimated by the LPSC's consultants to approximate $40 million on an annual basis). On July 8, 1987, the Company appealed to the Nineteenth Judicial District Court for the Parish of East Baton Rouge, Louisiana (District Court), among other things, those aspects of the LPSC orders that failed to provide adequate assurance of future recovery of Waterford 3 costs incurred but not recovered subsequent to July 6, 1987. On November 10, 1987, the District Court issued a judgment (November 1987 Judgment) that, among other things, would have allowed the Company to record approximately $19 million in additional deferrals associated with Waterford 3 costs incurred but not recovered from August 12, 1987 through January 31, 1988. In addition, the November 1987 Judgment authorized the Company to implement rates for services rendered on and after February 1, 1988 providing the Company a $40 million increase in annual base rate revenues, subject to refund. This amount is in addition to the $48 million annual rate increase provided by the April 1987 Order. The Company, on February 1, 1988, implemented rates to provide it with such $40 million in increased annual revenues. The Company and the LPSC have appealed the November 1987 judgment to the Louisiana Supreme Court. The matter is pending.

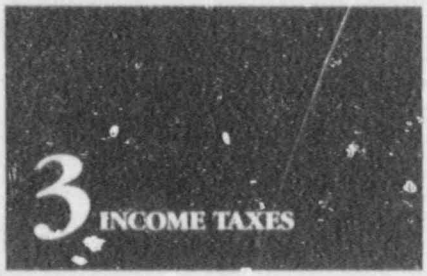
With respect to the accounting for deferred Waterford 3 costs, the previous orders of the LPSC in the above rate proceeding have provided adequate assurance with respect to the recovery of $247 million of such costs accumulated and deferred through January 31, 1987 and, under generally accepted accounting principles in effect prior to adoption of SFAS No. 92 (see Note 8, "Commitments and Contingencies – New Accounting Standards"), the Company has been permitted to record such deferred costs as an asset. However, the adoption of SFAS No. 92 will require, among other things, that the LPSC agree to a formal phase-in plan that specifies the timing (and meets the timing requirements) of recovery of costs previously deferred in order to permit the Company to continue to record such costs as an asset. Accordingly, the Company has made an application to the LPSC, in compliance with the transition provisions of SFAS No. 92, for approval of a formal plan for the future recovery of approximately $266 million ($247 million recorded as deferrals as of January 31, 1987 and $19 million of additional costs incurred, but not recovered, or deferred, from August 12, 1987 through January 31, 1988). Pending the outcome of that proceeding, the Company will be permitted, under applicable generally accepted accounting principles, to continue to record as an asset the $247 million of Waterford 3 costs incurred but not recovered through January 31, 1987 and will not, during this period, be required to write off (i.e., record as a loss) any such costs. On the other hand, although the November 1987 Judgment would have allowed the Company to record as an asset an additional $19 million of Waterford 3 costs incurred but not recovered from August 12, 1987 through January 31, 1988, the Company has not, in light of the pending appeal of the November 1987 Judgment, recorded on its books any additional deferrals associated with such costs, but rather has recorded such costs as current operating expenses. The recording of these additional costs as expenses has had an adverse effect upon the Company's earnings.

On February 19, 1988, the Company filed with the LPSC an application for retail rate relief (February 1988's Rate Filing) requesting a net increase in annual revenues of $38.2 million, subject to the final outcome of appeals of the November 1987 Judgment, so as to provide the Company with an 11.41% rate of return on rate base. Should the Louisiana Supreme Court overturn the District Court's November 1987 Judgment, the Company is requesting an alternate net increase in annual revenues of $78.2 million in order to achieve the 11.41% return on rate base. As part of the February 1988 Rate Filing, the Company has submitted a formal phase-in plan for the

LPSC's consideration that allows for the recovery of approximately $266 million in Waterford 3 costs, as described above, over a seven-year period beginning in 1990. Such plan, if approved and adopted by the LPSC, would comply with SFAS No. 92. (See Note 8, "Commitments and Contingencies – New Accounting Standards.")

On July 11, 1986, the Company filed with the Council of the City of New Orleans (Council), with respect to the 15th Ward of the City of New Orleans, a general retail rate increase application (1) to reflect costs associated with Grand Gulf 1, (2) to reflect the in-service status of Waterford 3, and (3) to produce a just and reasonable rate of return. On February 19, 1987, the Council by resolution initiated a prudence investigation with regard to the construction of Waterford 3. Hearings concerning the prudence of Waterford 3 are scheduled to commence on April 4, 1988, and hearings on the remaining issues not related to the Waterford 3 prudence phase are now scheduled to commence on April 27, 1988. The deadline for the Council's decision, in both the prudence and non-prudence phases, is now set for May 31, 1988.

The Company is a party to certain agreements and proceedings concerning SERI and the Grand Gulf Nuclear Station. (See Note 8, "Commitments and Contingencies.")



Income tax expense (benefit) consists of the following:

	1987	1986	1985
		(In Thousands)	
Current:			
Federal	$ 9,838	$ 4,658	$(13,140)
State	–	(10,683)	(2,101)
Total	9,838	(6,025)	(15,241)
Deferred – net:			
Liberalized depreciation	62,064	135,959	49,850
Deferred fuel costs	(1,299)	7,041	(7,120)
Unbilled revenue	(7,054)	1,112	11,131
Deferred Waterford 3 expenses	9,434	103,659	10,125
Adjustment of prior years' tax provisions	6,587	–	(14,113)
Provision for estimated losses	–	(8,113)	(8,929)
Reduction due to tax loss carryforward	(31,568)	(94,019)	(14,073)
Disallowed plant costs (Note 13)	–	3,760	(89,629)
Nuclear fuel	(4,630)	10,506	(703)
Alternative minimum tax	(3,248)	–	–
Other	(736)	(3,078)	3,154
Total	29,550	156,827	(60,307)
Investment tax credit adjustments – net	(1,203)	(1,254)	(451)
Recorded income tax expense	$38,185	$149,548	$(75,999)
Charged to operations	$ 36,141	$145,091	$ 7,159
Charged to other income	2,044	4,457	7,101
Charged to disallowed plant costs (Note 13)	–	–	(90,259)
Recorded income tax expense	38,185	149,548	(75,999)
Income taxes applied against the debt component of AFDC	925	777	33,225
Total income taxes	$ 39,110	$150,325	$(42,774)

Total income taxes differ from the amount computed by applying the statutory federal income tax rate to income before taxes. The reasons for the differences are as follows (dollars in thousands):

	1987		1986		1985	
	Amount	% of Pre-Tax Income	Amount	% of Pre-Tax Income	Amount	% of Pre-Tax Income
Computed at statutory rate	$ 61,534	40.0%	$134,924	46.0%	$(59,718)	46.0%
Increases (reductions) in tax resulting from:						
Allowance for funds used during construction	(777)	(0.5)	(865)	(0.3)	(57,850)	44.6
State income taxes net of federal income tax effect	(430)	(0.3)	13,539	4.6	7,362	(5.7)
Write-off of state deferred taxes related to depreciation timing differences*	(23,828)	(15.5)	–	–	–	–
Depreciation	6,951	4.5	7,530	2.6	4,076	(3.1)
Disallowed plant costs (Note 13)	–	–	–	–	36,881	(28.5)
Impact of change in tax rate	(3,127)	(2.0)	–	–	–	–
Other – net	(2,138)	(1.4)	(5,580)	(1.9)	(6,750)	5.2
Recorded income tax expense	38,185	24.8	149,548	51.0	(75,999)	58.5
Income taxes applied against debt component of AFDC	925	0.6	777	0.3	33,225	(25.6)
Total income taxes	$ 39,110	25.4%	$150,325	51.3%	$(42,774)	32.9%

*Results from an LPSC order to write off all previously provided deferred state income taxes related to depreciation timing differences.

The tax effect of the portion of the 1985, 1986, and 1987 federal tax losses that are carried forward has been recorded as a reduction of deferred income taxes. These losses totalling $303.7 million are available to offset taxable income in future years and, if not utilized, will expire in the years 2000 through 2002. Unused investment tax credits at December 31, 1987, amounted to $67.4 million after the 35% reduction required by the Tax Reform Act of 1986. These credits may be applied against federal income tax liabilities in future years. If not used, they will expire in years 1992 through 2002.

Cumulative income tax timing differences for which deferred income taxes have not been provided are $69.7 million, $73.2 million, and $103 million as of the end of 1987, 1986, and 1985, respectively. The alternative minimum tax (AMT) credit at December 31, 1987 is $3.2 million. This AMT credit can be carried forward indefinitely and will reduce the Company's income tax liability in the future.

In December 1987, the FASB issued SFAS No. 96, "Accounting for Income Taxes", which is effective for years beginning after December 15, 1988. Under the liability method adopted by SFAS No. 96, deferred tax balances will be based on enacted tax laws at tax rates that are expected to be in effect when the temporary differences reverse. SFAS No. 96 expands the requirement to record deferred income taxes for all temporary differences that are reported in one year for financial reporting purposes and a different year for tax purposes. This will require the recognition of deferred tax balances for certain items not previously reflected in the financial statements, such as a deferred tax liability relating to AFDC.

It is expected that reductions in deferred taxes resulting from the lower corporate federal tax rates will be reflected as liabilities to customers since the Company's regulators may require any such savings to be passed on to the ratepayers. The impact of SFAS No. 96 on the financial position or results of operations of the Company has not yet been determined.

4 LINES OF CREDIT AND RELATED BORROWINGS

At December 31, 1987, the Company had $50.3 million in lines of credit with Louisiana banks and $90 million in lines of credit with banks outside the Middle South System area of service. The lines of credit with Louisiana banks include $10 million that is shared with New Orleans Public Service Inc. (NOPSI). The lines of credit with Louisiana banks and $30 million with banks outside the Company's service area expire on June 30, 1988. As of February 29, 1988, $90 million in lines of credit with banks outside the Company's service area remained available for borrowing by the Company. Compensating balances (approximately 5% of the commitment amounts) or equivalent fees are required by certain of the non-service area lending banks. Additionally, the Company participates with certain other companies of the Middle South System in a money pool arrangement whereby those companies with available funds make short-term loans to other companies in the System having short-term borrowing requirements. The Company may borrow from the money pool and other available sources subject only to its maximum authorized level of short-term borrowings and the availability of funds. The Company has received authorization from the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935 to have outstanding at any one time short-term borrowings aggregating not more than 10% of the Company's capitalization as defined. At December 31, 1986, the Company had $38.4 million in lines of credit with Louisiana banks and $110 million in lines of credit with banks outside the Middle South System service area, all of which remained available at that date.

The short-term borrowings and the applicable interest rates (determined by dividing applicable interest expense by the average amount borrowed) for the Company were as follows:

	1987	1986	1985
		(In Thousands)	
Maximum borrowing	$20,000	$168,360	$229,710
Year-end borrowing:			
Bank loans	–	–	$ 99,160
Associated companies	–	–	$ 34,700
Average borrowing:			
Bank loans	$ 2,615	$ 77,656	$ 75,998
Associated companies	–	$ 15,787	$ 95,176
Average interest rate during the period:			
Bank loans	8.2%	8.6%	9.9%
Associated companies	–	7.6%	8.2%
Average interest rate at end of period:			
Bank loans	–	–	9.9%
Associated companies	–	–	8.5%

5 PREFERRED AND COMMON STOCK

Preferred stock at December 31, 1987 and 1986 consisted of the following:

Cumulative, $100 Par Value	Shares Authorized at December 31, 1987	Shares Outstanding at December 31, 1987	Shares Outstanding at December 31, 1986	Current Call Price Per Share
Without sinking fund:				
4.96% Series	60,000	60,000	60,000	$104.25
4.16% Series	70,000	70,000	70,000	104.21
4.44% Series	70,000	70,000	70,000	104.06
5.16% Series	75,000	75,000	75,000	104.18
5.40% Series	80,000	80,000	80,000	103.00
6.44% Series	80,000	80,000	80,000	102.92
9.52% Series	70,000	70,000	70,000	104.20
7.84% Series	100,000	100,000	100,000	103.78
7.36% Series	100,000	100,000	100,000	103.36
8.56% Series	100,000	100,000	100,000	105.28
9.44% Series	300,000	300,000	300,000	106.72
11.48% Series	350,000	350,000	350,000	111.11
Total	1,455,000	1,455,000	1,455,000	
Unissued	3,045,000	–	–	
Total	4,500,000	1,455,000	1,455,000	

Cumulative, $25 Par Value				
With sinking fund:				
10.72% Series	1,559,850	1,559,850	2,039,850	$ 27.01
13.12% Series	1,152,511	1,152,511	1,355,000	27.46
15.20% Series	955,040	955,040	1,075,000	27.85
14.72% Series	1,633,316	1,633,316	2,000,000	27.76
12.64% Series	2,865,500	2,865,500	3,000,000	28.16
19.20% Series	2,000,000	2,000,000	2,000,000	28.20
Total	10,166,217	10,166,217	11,469,850	
Unissued	9,800,000	–	–	
Total	19,966,217	10,166,217	11,469,850	

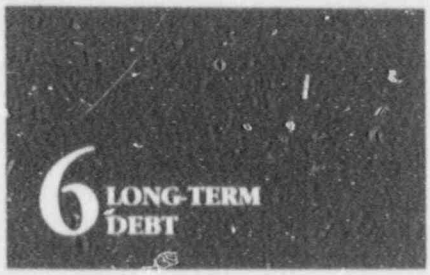
	1987	1986
	(In Thousands)	
Without sinking fund:		
Stated at $100 a share	$145,500	$145,500
Premium	382	382
Total preferred stock and premium without sinking fund	$145,882	$145,882
With sinking fund:		
Stated at $25 a share	$254,156	$286,746
Issuance expense	(12,795)	(14,617)
Total preferred stock and issuance expense, with sinking fund	$241,361	$272,129

Cash sinking fund requirements for preferred stock outstanding at December 31, 1987 for the years 1988 through 1992 are as follows (in thousands): 1988, $2,825; 1989, $12,750; 1990, $22,750; 1991, $22,750; and 1992, $22,750. The 1988 amount reflects earlier retirements of shares of preferred stock that will be applied against 1988 cash sinking fund requirements. In addition, each year the Company has the non-cumulative option to redeem additional amounts of preferred stock outstanding in accordance with its articles of incorporation.

The Company has continued to remain current with respect to payment of its quarterly preferred stock dividends since the elimination of arrearages in May 1986. In 1987, the Company paid $8.3 million in common stock dividends to MSU. Prior to these dividends, the Company had not paid quarterly dividends on its common stock since June 1985. In February 1988, the Company paid $4.6 million in common stock dividends to MSU.

The changes in the number of shares of common and preferred stock outstanding during the years 1987, 1986, and 1985 were as follows:

	Number of Shares		
	1987	1986	1985
Common stock shares sold	–	–	15,152,000
$25 Preferred stock shares retired	1,303,0[illegible]3	269,750	260,400



Long-term debt at December 31, 1987 and 1986 consisted of the following:

	1987	1986
	(In Thousands)	
First Mortgage Bonds:		
4¾% Series due 1987	–	$ 20,000
10⅞% Series due 1989	$ 45,000	45,000
5 % Series due 1990	20,000	20,000
14 % Series due 1992	60,000	60,000
10½% Series due 1993*	200,000	200,000
12 % Series due 1993	100,000	100,000
4⅝% Series due 1994	25,000	25,000
16 % Series due 1994	100,000	100,000
14¼% Series due 1995	15,000	15,000
5¾% Series due 1996	35,000	35,000
5⅝% Series due 1997	16,000	16,000
6½% Series due 1997	18,000	18,000
7⅛% Series due 1998	35,000	35,000
9⅝% Series due 1999	25,000	25,000
9⅜% Series due 2000	20,000	20,000
7⅞% Series due 2001	25,000	25,000
7½% Series due 2002	25,000	25,000
7½% Series due 2002	25,000	25,000
8 % Series due 2003	45,000	45,000
8¾% Series due 2004	45,000	45,000
8¾% Series due 2006	40,000	40,000
10 % Series due 2008	60,000	60,000
13¼% Series due 2013	100,000	100,000
13 % Series due 2013	50,000	50,000
14¾% Series due 2014	55,000	55,000
15¼% Series due 2014	35,000	35,000
10⅜% Series due 2016	280,000	280,000
Total First Mortgage Bonds	1,499,000	1,519,000

	1987	1986
	(In Thousands)	
Other:		
St. Charles Parish Pollution Control Revenue Bonds, Series 1984, 5.25% due 2014	115,000	115,000
St. Charles Parish Pollution Control Revenue Bonds, Second Series 1984, 7.625% due 2014	105,000	105,000
Other pollution control and industrial revenue bond obligations, 6.40%-8% due 1988-2009	16,300	16,300
Principal amount of municipal revenue bond obligations, 1¼%-8% due serially 1988-2004, and other future obligations under operating agreements	26,344	29,118
Purchase obligations under an inventory supply agreement	25,110	28,058
Total Other	287,754	293,476
Unamortized premium and discount on long-term debt – net	(11,658)	(6,670)
Total Long-Term Debt	1,775,096	1,805,806
Less: Amount due within one year	2,832	22,774
Long-Term Debt Excluding Amount Due Within One Year	$1,772,264	$1,783,032

* In April 1986, the Company sold $200 million principal amount of intermediate-term secured notes at an annual interest rate of 10½%. On August 28, 1986, the Company collateralized these outstanding intermediate-term secured notes by depositing first mortgage bonds in that amount with the trustee for such notes effectively making such notes of equal rank with the outstanding first mortgage bonds of the Company.

In August 1986, the Company obtained approximately $30 million under an inventory supply agreement with a non-affiliated entity with respect to spare parts for Waterford 3. Additionally, on November 6, 1986, the Company sold $280 million aggregate principal amount of First Mortgage Bonds, 10¾% Series due November 1, 2016. The Company used the net proceeds from the sale to redeem an aggregate of $280 million of several series of its outstanding First Mortgage Bonds bearing interest at rates ranging from 13½% to 16¼%. As a result of such refinancing, the Company realized an $18.7 million loss on the reacquired debt. The loss is being amortized over the life of the new issue as permitted for ratemaking purposes. This refinancing results in a net savings to the Company due to reduced interest costs.

The St. Charles Parish Pollution Control Revenue Bonds Series 1984 and the Second Series 1984, which are secured by letters of credit, currently bear interest at 5.25% and 7.625%, respectively, and are adjusted annually not to exceed an interest rate of 15% per annum. In December 1986, upon participation of several banks in the letter of credit, the Company received the Second Series 1984 bond proceeds of $105 million previously held in a cash collateral security account.

Sinking fund requirements on first mortgage bonds and maturities under long-term debt instruments in effect at December 31, 1987 for the years 1988 through 1992 are as follows:

Year	Sinking Fund**	Maturities
	(In Thousands)	
1988	$12,240	$ 2,832
1989	12,240	48,016
1990	11,790	23,202
1991	11,590	2,687
1992	11,590	62,333

** Sinking fund requirements may be satisfied by certification of property additions at the rate of 167% of such requirements.

The Company's Restated Articles of Incorporation, as amended, and certain of its indentures contain provisions restricting the payment of dividends or other distributions to common stockholders. At December 31, 1987, all retained earnings were free from such restrictions.

In accordance with the LPSC's November 1985 Order, the Company recorded as a loss its LPSC jurisdictional portion of the $284 million of the Waterford 3 disallowance (approximately $276.9 million) by recording an adjustment retroactive to 1985. (See Note 13, "Statement of Financial Accounting Standards No. 90.")

8 COMMITMENTS AND CONTINGENCIES

A. General

At December 31, 1987, the Company's most significant commitments and contingencies related to (1) the final resolution of certain other Middle South System operating companies' (System operating companies) rate orders and related matters (see "Potential Debt Acceleration, Bankruptcy, and Middle South System Viability"), (2) the effect on the Company of a new accounting standard relating to the accounting for phase-in plans (see "New Accounting Standards"), (3) the outcome of the pending appeal of the November 1987 Judgment and any resulting potential long term effect upon the Company's earnings, liquidity, and financial condition (see Note 2, "Rate Matters"), (4) the final resolution of the LPSC prudence investigation (see Note 2, "Rate Matters"), (5) the outcome of challenges to the FERC allocation of capacity and energy from Grand Gulf 1, which could have a significant impact on the Company (see "Unit Power Sales Agreement"), (6) the future status of Unit No. 2 of the Grand Gulf Steam Electric Generating Station (nuclear) (Grand Gulf 2), of which 90% is owned by SERI and the possible allocation to the Company of costs associated with that unit (see "Grand Gulf 2"), and (7) the ultimate outcome of disputes related to a certain System Fuels, Inc. (SFI) coal supply agreement (see "System Fuels, Inc.").

B. Capital Requirements and Financing

The Company's construction program contemplates expenditures (including AFDC but excluding nuclear fuel) of approximately $142.4 million in 1988, $149.6 million in 1989, and $156 million in 1990. The Company's obligation to SERI for Grand Gulf 1 capacity and energy is approximately $11 million per month.

The credit line associated with the Company's nuclear fuel lease has terminated, and the Company is in the process of attempting to arrange for a new line of credit. Without replacement of the credit line, no additional fuel may be leased. The Company will continue to make payments under the lease until the lease terminates on June 1, 1991. The Company will be required to repurchase any unburned nuclear fuel financed under the lease when the lease expires on June 1, 1991. As of December 31, 1987, the unrecovered cost base of the nuclear fuel lease was $88.7 million. It is assumed that the credit line will be replaced during the period 1988-1989.

C. Potential Debt Acceleration, Bankruptcy, and Middle South System Viability

Certain of the other System operating companies' retail rate orders with respect to their allocated costs for Grand Gulf 1 capacity and energy have either been challenged, reversed by judicial decisions, or have been, or currently are, subject to prudence investigations or disallowances. On February 25, 1987, Mississippi Power & Light Company's (MP&L) Grand Gulf 1 rate order was reversed on appeal by the Mississippi Supreme Court (February 1987 Decision) and remanded to the Mississippi Public Service Commission (MPSC) for reconsideration. Subsequently, MP&L filed an appeal of the February 1987 Decision with the U.S. Supreme Court and on October 5, 1987 the Court decided to hear full argument of MP&L's appeal. Oral argument was held on February 22, 1988. The case is expected to be decided by the end of June 1988. On February 4, 1988, the Council adopted a resolution (Resolution), as its formal findings of fact, conclusions, and order in its prudence investigation, under which NOPSI is to absorb, and not recover from its retail electric customers, $135 million of its FERC-allocated Grand Gulf 1 costs. This $135 million disallowance is in addition to the $51.2 million of such costs that NOPSI had agreed to absorb in a March 1986 rate settlement. NOPSI has applied to federal and state courts for reversal of the Council's Resolution and continues to press for a judicial stay of the Resolution. The matter is pending. Without adequate rates to recover Grand Gulf 1 charges, NOPSI and MP&L could suffer such liquidity constraints that they would, in a short period of time, be unable to meet their contractual obligations to SERI with respect to the Grand Gulf Station and could be rendered insolvent.

Certain of SFI's financing agreements and leases may require payments by the Company and the other System operating companies, MSU, or SERI in the event SFI's obligations under such agreements are accelerated as a result of the insolvency of a System operating company and SFI is unable to meet these obligations or otherwise to satisfy these obligations through the sale of the collateral securing such obligations. In addition, insolvency of a System company would affect the terms of financing by including an increase in the cost of financing, or could preclude financing for other Middle South System companies.

Failure of any System operating company to maintain its current rate structure or to meet its contractual obligations to SERI in respect of the Grand Gulf Station could cause acceleration

of SERI's indebtedness under certain agreements (but only upon further action by the requisite percentage of SERI's creditors) unless (1) waivers were obtained, (2) the debt was restructured, or (3) other arrangements could be negotiated. In addition, in the absence of such waivers, debt restructuring, or other negotiated arrangements, acceleration of such indebtedness could occur if a System operating company were rendered insolvent as a result of a reduction in rates. Given the substantial amount of its obligations, SERI, with its financial resources currently limited, would not be able to meet these obligations, if accelerated. Under SERI's financing agreements, the System operating companies would not be responsible to pay SERI's accelerated obligations if SERI could not meet them. MSU, with its financial resources currently limited, would not, at this time, be in a position to satisfy SERI's obligations if accelerated.

In the event of any of the foregoing adverse developments, the continuing viability of the Middle South System would be placed in jeopardy, and it could be difficult to avoid a bankruptcy filing by one or more of the affected Middle South System companies. In this connection, MSU, MP&L, and SERI have each retained independent special counsel experienced in bankruptcy matters and have been studying the relief and protection that might be available to them under Chapter 11 of the United States Bankruptcy Code. While no decisions with regard to bankruptcy filings have yet been made, it must be recognized, in light of the risks discussed herein, that future events, either singly or in combination, may result in such adverse changes in business circumstances or such a decrease in liquidity as to make it prudent for one or more of the affected Middle South System companies to file a petition for reorganization under Chapter 11. Many of these future events are beyond the control of the Middle South System.

The effects of a bankruptcy proceeding involving one or more Middle South System companies and the extent of jurisdiction of the SEC under the Public Utility Holding Company Act and of other federal and state regulatory bodies over the bankrupt entity or entities and over any other Middle South System companies not in bankruptcy cannot be predicted. In any event, security holders and creditors of the company or companies involved in bankruptcy proceedings could be significantly affected by such proceedings. The proceedings could last for years, and there are many uncertainties as to how provisions of the law would be applied. Rights and remedies of security holders and creditors may be altered, denied, or limited under such laws. The obligations of the System operating companies under the Availability Agreement and the assignments thereof could also be litigated and possibly reduced or eliminated. (See "Availability and Reallocation Agreements" below for a discussion of the System operating companies' respective obligations to make payments or otherwise support SERI under the Availability Agreement and the Reallocation Agreement.) There could be no assurance that any creditors would be able to recover the full amount of their claims, and securities and stock with inferior rights could be substituted for those with priorities. Further, holders of equity securities may not be able to recover any substantial amount on their investment. Moreover, it is uncertain whether the bankrupt entity or entities could be successfully reorganized in their present form, whether the current relationships between and among various Middle South System companies would be significantly altered or whether the Middle South System would continue to exist in its present form after bankruptcy of one or more Middle South System companies.

D. Unit Power Sales Agreement

The Unit Power Sales Agreement (UPSA), as approved by the FERC on June 13, 1985 (June 1985 Decision), obligates the System operating companies to purchase from SERI, at SERI's full cost of service, all of SERI's 90% share of the capacity and energy from Grand Gulf 1 in accordance with the following percentage allocations: the Company, 14%; Arkansas Power & Light Company (AP&L), 36%; MP&L, 33%; and NOPSI, 17%. On January 6, 1987, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) affirmed the FERC's June 1985 Decision. After subsequently granting rehearing of two issues raised in the January 6, 1987 decision, the D.C. Circuit, on June 26, 1987, reversed, in part, the June 1985 Decision and remanded the June 1985 Decision to the FERC (June 1987 Remand) for reconsideration of its decision to equalize the capacity costs of all Middle South System nuclear plants and for an explanation of the criteria used to determine what constitutes "undue discrimination" under the Federal Power Act and why the June 1985 Decision is not unduly discriminatory. In reversing, in part, the June 1985 Decision, the D.C. Circuit did not

change that part of its January 6, 1987 decision upholding the FERC's authority to review and modify the allocation of power from Grand Gulf 1. Various parties filed petitions for certiorari with the United States Supreme Court seeking review of the principle underlying that portion of the D.C. Circuit's January 6, 1987 decision that affirmed the FERC's jurisdiction to allocate Grand Gulf 1 costs. On December 14, 1987, the United States Supreme Court denied without comment these petitions, thereby leaving in place that part of the January 6, 1987 decision upholding the FERC's jurisdiction to allocate Grand Gulf 1 costs.

On November 30, 1987, the FERC issued an order (November 1987 Order) in response to the June 1987 Remand reaffirming and reinstating the June 1985 Decision, thus maintaining the previous allocation of Grand Gulf 1 capacity and energy among the System operating companies. In issuing the November 1987 Order, the FERC found that the allocation in the June 1985 Decision was not unduly discriminatory. Requests for rehearing of the FERC's November 1987 Order were filed by various parties (other than Middle South System companies) and by order dated January 29, 1988 (January 1988 Order), the FERC denied such requests. Petitions for review of the November 1987 and January 1988 Orders were filed with the D.C. Circuit by various parties.

It is not possible at this time to predict the ultimate outcome of this matter, including the possible reallocation, if any, of Grand Gulf 1-related costs or the effect thereof upon the Company or the other System operating companies, or SERI, including possible refunds, if any. Any modification of the allocation established by the June 1985 Decision, as affirmed by the FERC's November 1987 Order, could give rise to additional litigation, disputes, and challenges in the affected jurisdictions.

In addition, the System operating companies have initiated a study, currently scheduled to be completed in the near future, to determine whether a more equitable method of allocating costs, including those relating to Grand Gulf 1, would be appropriate in the future.

E. Availability and Reallocation Agreements

The System operating companies are severally obligated, monthly, to SERI under the Availability Agreement, as amended to date, to make payments or subordinated advances adequate to cover all the operating expenses, including depreciation and interest charges, of SERI. The Company's percentage share of these obligations is 26.9%. SERI has, with the consent of the System operating companies, assigned its rights to payments and advances from the System operating companies under the Availability Agreement to the holders of its long-term debt. Payments or advances under the Availability Agreement are only required to be made to the extent SERI's receipts from all sources, including the UPSA approved by the FERC (of which the Company's current share is 14%), are less than the amount required under the Availability Agreement. Since commercial operation of Grand Gulf 1, payments under the UPSA (which are based on Grand Gulf 1's full cost of service, including a return on equity) have been more than sufficient to cover the amounts owing under the Availability Agreement (which does not cover a return on equity); accordingly, no payments have ever been made under the Availability Agreement.

If, as a result of an adverse decision in the MP&L Supreme Court litigation discussed above or other developments, a System operating company other than the Company becomes unable in whole or in part to continue making payments to SERI under the UPSA, and SERI were unable to procure funds from other sources sufficient to cover any potential shortfall between the amount owing under the Availability Agreement and the amount of continuing payments under the UPSA plus other funds then available to SERI, the Company may become subject to claims or demands by SERI or its creditors for payments or advances under the Availability Agreement or the assignments thereof. The amount, if any, which the Company would become liable to pay or advance over and above amounts it currently pays under the UPSA for capacity and energy from Grand Gulf 1 would depend on a variety of factors (especially the degree of any such shortfall and SERI's access to other funds). The Company cannot predict whether any such claims or demands, if made, could be satisfied.

The System operating companies in November 1981 entered into a Reallocation Agreement that would have allocated the capacity and energy available to SERI from the Grand Gulf Station and the related costs to the Company, MP&L, and NOPSI. These companies had agreed to assume all the responsibilities and obligations of AP&L with respect to the Grand Gulf Station under the Availability Agreement with AP&L relinquishing its

rights with respect to capacity and energy from the Grand Gulf Station. Each of the System operating companies, including AP&L, individually would have remained primarily liable to SERI and its assignees for payments or advances under the Availability Agreement and assignments thereof. AP&L was obligated to make its share of the payments or advances only if the other System operating companies were unable to meet their contractual obligations. However, the FERC's June 1985 Decision supercedes the Reallocation Agreement insofar as it relates to Grand Gulf 1.

F. Grand Gulf 2

As of December 31, 1987, SERI had invested approximately $890 million in Grand Gulf 2 (including approximately $392 million of AFDC), which was approximately 34% complete based on the estimated man-hours needed to complete the unit. In September 1985, following an order of the MPSC, SERI suspended construction activities on Grand Gulf 2 and ceased accruing AFDC on the unit. Since that time, SERI has limited expenditures to only those activities that are absolutely necessary for demobilization and suspension. In December 1986, SERI's Board of Directors (with the MSU Board of Directors concurring) adopted the recommendation of a special group of Middle South System officials and outside consultants that suspension of construction be continued and that a further decision be made by 1990 on the future status of Grand Gulf 2 in light of alternatives available at that time. As a result of SERI's Board of Directors deciding to continue suspension of construction, SERI does not intend to make an application to the FERC during the period of suspension with respect to the recovery through rates of SERI's investment in Grand Gulf 2.

During the period of continued suspension, SERI's expenditures on Grand Gulf 2 will be limited and it will continue not to accrue AFDC on its investment in the unit. During the suspension period, SERI will continue to evaluate various alternatives for the future of Grand Gulf 2 and will also continue to assess whether certain equipment or facilities should continue to be carried at their full cost. Any determination that the value of SERI's investment should be reduced and the amount of any such reduction written off could adversely affect various companies in the Middle South System, including the Company. SERI believes, however, that it is justified in carrying Grand Gulf 2 at its full value because the property currently comprising Grand Gulf 2 is of the same design as that of Grand Gulf 1 and is being properly maintained and is therefore suitable for its intended purpose. Certain issues relating to the value of SERI's investment in Grand Gulf 2 also exist in connection with an audit by the FERC of SERI and the Grand Gulf Station.

While SERI believes that all of its investment to date in Grand Gulf 2 has been prudent, in connection with any subsequent decisions as to the value of Grand Gulf 2 or the ultimate decision regarding the future of Grand Gulf 2, SERI will, at an appropriate time, make a determination as to the appropriate recovery of its investment. Any action by SERI to seek recovery of Grand Gulf 2 costs would likely involve a filing with the FERC requesting such recovery over a period of years through charges to the System operating companies and related filings by the System operating companies before state or local regulatory authorities to recognize the FERC-allowed charges in retail rates. In view of the controversies over the Grand Gulf Station, including the adverse reaction of various rate regulatory bodies to allocation of costs, and regulatory uncertainties, including rate making, attendant to a delay in the decision as to the future of Grand Gulf 2, there can be no assurance that the full cost of Grand Gulf 2 will be recovered or as to the timing of any recovery. As was the case with Grand Gulf 1, such proceedings before the FERC and, with respect to recognition in retail rates of FERC-approved rates, before state or local regulatory authorities, could be protracted and strongly contested on various grounds, including imprudence. If costs associated with Grand Gulf 2 were allocated to the Company and it were unable to recover these costs from its customers, the Company's financial condition could be materially, adversely affected.

G. New Accounting Standards

The accounting standards relating specifically to public utilities and certain other regulated enterprises are set forth by the FASB in SFAS Nos. 71, 90, and 92. In December 1986, the FASB issued SFAS No. 90, as an amendment to SFAS No. 71. (See Note 13, "Statement of Financial Accounting Standards No. 90.")

In August 1987, the FASB issued SFAS No. 92, "Regulated Enterprises – Accounting for Phase-in Plans", an amendment of SFAS No. 71. SFAS No. 92

requires the following conditions for deferral of costs relating to a newly completed plant: (1) the costs are deferred pursuant to a formal plan that has been agreed to by the regulator, (2) the plan specifies when recovery of costs will occur, (3) the costs deferred are scheduled for recovery within ten years of the date when deferrals begin, and (4) the percentage increase in rates for each future year is no greater than the percentage increase in rates for each immediately preceding year. The new statement is effective for fiscal years beginning after December 15, 1987 and requires that amounts previously deferred under plans that do not meet the requirements of the statement be written off. SFAS No. 92 has transition rules designed to allow an affected company to delay application of the new statement and to continue deferral of costs under its existing phase-in plan provided that both of the following conditions are met: (1) the company has filed a rate application to have the plan amended to meet the requirements of the statement or it intends to do so as soon as practicable and (2) it is reasonably possible that the regulator will change the terms of the phase-in plan so that it will meet the requirements of the statement.

As part of its February 1988 Rate Filing with the LPSC, the Company submitted a formal phase-in plan to recover a total of approximately $266 million of Waterford 3 costs ($247 million recorded as deferrals as of January 31, 1987 and $19 million of additional costs incurred but not recovered, or deferred, from August 12, 1987 through January 31, 1988) in accordance with the provisions of SFAS No. 92 as discussed above. If the LPSC does not approve a phase-in plan that complies with SFAS No. 92, the Company will be required to write off the deferred Waterford 3 costs. (See Note 2, "Rate Matters", for further discussion of the Company's phase-in plan and related rate filing.)

H. MSU Shareholder Litigation

In 1985, MSU, certain other Middle South System companies, including the Company, and certain individuals and others became defendants in a purported class action suit. The initial complaint was filed in August 1985 by an MSU shareholder (purporting to represent a class that purchased MSU common stock) and was followed by four similar complaints filed by MSU shareholders in August and September 1985. The five actions were consolidated in the U.S. District Court for the Eastern District of Louisiana. The consolidated, amended, and supplemental complaint alleged violations of the disclosure requirements of the Securities Exchange Act of 1934 and the Securities Act of 1933, common law fraud, and common law misrepresentation in connection with the financial condition of MSU and prayed for compensatory and punitive damages, legal costs and fees, and other proper relief against MSU, various other System companies, including the Company, certain officers (and former officers) and directors of MSU, the Company's outside auditors, and certain underwriters of MSU common stock. In April 1986, MSU and the other defendants, including the Company, filed a motion to dismiss or, in the alternative, a motion for summary judgment. On January 12, 1987, the District Court entered a judgment granting defendants' motion for the summary judgment and dismissing the suit. On February 6, 1987, the plaintiffs in the consolidated action filed a Notice of Appeal in the U.S. Court of Appeals for the Fifth Circuit. Oral argument was held on November 5, 1987. The defendants intend to oppose vigorously the appeal of the District Court's decision. In the event the dismissal is reversed on appeal, the eventual outcome and impact on the Company's financial condition cannot be predicted.

I. System Fuels, Inc.

The Company has a 33% interest in SFI, a jointly owned subsidiary of the Company, AP&L, MP&L, and NOPSI. SFI operates on a non-profit basis for the purpose of planning and implementing programs for the procurement of fuel supplies for all of the System operating companies and SERI. Its costs are primarily recovered through charges for fuel delivered.

The parent companies of SFI had agreed to make loans to SFI to finance its fuel supply business under a loan agreement dated January 1, 1984, as amended January 1, 1987, which provided for SFI to borrow up to $51 million from its parent companies through December 31, 1987. This loan agreement was not amended in 1988 and, consequently, no future loans may be made to SFI from the parent companies at this time. As of

December 31, 1987, the Company had loaned SFI $49.5 million under the above and previous loan agreements. Notes mature in 1992, 2002, and 2008 under provisions of these loan agreements.

In connection with certain of SFI's borrowing arrangements, SFI's parent companies, including the Company, have covenanted and agreed, severally in accordance with their respective shares of ownership of SFI's common stock, that they will take any and all action necessary to keep SFI in a sound financial condition and to place SFI in a position to discharge and to cause SFI to discharge its obligations under these arrangements. At January 1, 1988, the total loan commitment under these arrangements amounted to $105 million, of which $97 million was outstanding at that date. Also, SFI's parent companies, including the Company, have made similar covenants and agreements in connection with long-term leases by SFI of oil storage and handling facilities and coal hopper cars. At December 31, 1987, the aggregate discounted value of these lease arrangements was $73.5 million. In connection with an SFI $50 million secured financing of nuclear fuel inventories, the Company, AP&L, and SERI have agreed to purchase such inventories in the event that SFI is unable to fulfill its obligations under the borrowing arrangement. At December 31, 1987, there were no borrowings outstanding under this arrangement.

In July 1980, SFI executed a coal supply agreement for the purchase of approximately 100 million tons of coal for use at the Company's proposed Wilton Station with an option to purchase an additional 50 million tons. By separate agreement, the Company guaranteed SFI's performance of the contract and agreed to purchase the coal from SFI. SFI, after having kept the coal supplier advised of possible delays, advised the supplier in August 1985 that, based on the System's latest appraisal for planning purposes, the System's requirement for additional coal capacity is now forecasted to be in a time frame that makes the existing contract in fact non-viable. Upon receipt of the August 1985 notification, the supplier filed a Demand For Arbitration under the coal supply agreement to establish that the agreement remains in full force and effect and that SFI is not excused from performing its obligations and, alternatively, that SFI's actions constitute anticipatory repudiation of the coal supply agreement. The parties agreed to a postponement of the arbitration on the basis that it can be restarted by either party on ten days notice. The Company filed with the LPSC an application for a certificate authorizing the construction of the first generating unit for the Wilton Station, with an in-service date of 1995 or earlier and hearings were held thereon on April 18, 1986 and November 12, 1987. In view of the reduction in projected load requirements within the Company's service area since the time the coal supply agreement was entered into and in view of other factors relating to the Company, the LPSC may not grant such a certificate. On October 30, 1987, consultants to the LPSC filed a report concluding that such certificate should be denied. It is SFI's counsel's opinion that a refusal by the LPSC to grant a certificate on a reasonable basis will constitute the existence of a force majeure which would relieve the Company and SFI of a substantial part, if not all, of their obligation under the coal supply agreement. In an effort to resolve the abovementioned dispute, the Company, SFI, and the coal supplier entered into settlement discussions; as a result thereof, the Company and the coal supplier have agreed in principle to a 25-year natural gas supply arrangement. The definitive agreement is expected to be completed in 1988. Unsatisfactory resolution of this matter could expose the Company and SFI to claims for significant damages in the event SFI is unable to negotiate a new arrangement with the coal supplier. SFI does not ultimately prevail in asserting that events of force majeure have excused performance, or other efforts to mitigate any possible significant damages are unsuccessful.

J. Nuclear Insurance

As of December 31, 1987, the Price-Anderson Act (Act) limited the public liability of a licensee of a nuclear power plant to $720 million for a single nuclear incident. The Act in its current form provides that this limit will increase by $5 million for each additional operating license issued by the Nuclear Regulatory Commission (NRC). Insurance for this exposure is provided by private insurance and an indemnity agreement with the NRC. Every licensee of a nuclear power

plant is obligated to pay retrospective assessments of up to $5 million per incident for each licensed reactor it operates or up to a maximum per reactor owned of $10 million in any calendar year in the event of a nuclear incident involving any commercial nuclear facility in the United States that results in damages in excess of the private insurance. The Company has one licensed reactor. Certain provisions of the Act expired on August 1, 1987 and Congress is considering several proposals to amend and extend these provisions of the Act. In this connection, the United States House of Representatives, on July 29, 1987, passed a bill which would, among other things, raise the public liability limit associated with any nuclear incident to $7 billion. The United States Senate has under consideration a similar bill relating to the extension of the Act. Until a bill is adopted by both the Senate and House of Representatives and signed into law by the President, the provisions of the Act which expired August 1, 1987 will continue to apply to all currently licensed reactors (including all Middle South System reactors). The Company is unable to predict what action Congress might ultimately take regarding the Act and what effect such action might have on the Company's potential liability.

The Company is a member-insured of Nuclear Electric Insurance Limited (NEIL), an industry mutual insurer that provides its members with insurance coverage for certain costs of replacement power incurred due to certain prolonged outages of nuclear units (NEIL I). In addition, the Company is a member-insured under NEIL II, an excess property insurance program, which provides $775 million of coverage for property damage sustained by the insured in excess of $500 million caused by radioactive contamination or other specified damage. The Company has an additional $120 million of excess property and decontamination insurance with American Nuclear Insurers (ANI) and Mutual Atomic Energy Liability Underwriters, a pool of private insurance carriers, thus giving the Company a total of $895 million of excess property and decontamination insurance above the $500 million primary amount. The Company's primary property and decontamination damage insurance is provided by ANI. As a member-insured with these industry mutual insurers, the Company is subject to assessments if losses exceed the accumulated funds available to the insurer. The Company's present maximum assessment for incidents occurring during a policy year is approximately $10 million.

Effective October 5, 1987, the NRC amended its regulations to require nuclear power plant licensees to obtain property insurance coverage in the minimum amount of $1.06 billion. The regulations further provide that the proceeds of this insurance shall be used first to ensure that the licensed reactor is in a safe and stable condition and can be maintained in that condition so as to prevent any significant risk to the public health and safety. Within 30 days of stabilization, the licensee is required to prepare and submit to the NRC a cleanup plan for approval. The plan is required to identify all cleanup operations necessary to decontaminate the reactor sufficiently to permit the resumption of operations or to commence decommissioning. Any property insurance proceeds not already expended to place the reactor in a safe and stable condition must be used first to complete those decontamination operations that are ordered by the NRC. Property insurance proceeds subject to the decontamination priority must be payable to a separate trust established for the sole purpose of paying for costs incurred in decontaminating the reactor and removing radioactive debris. The NRC further requires that the decontamination priority and trust requirements set forth in the regulation be incorporated in on-site property damage insurance policies not later than October 4, 1988 and apply uniformly to all required on-site property damage insurance policies for nuclear power plants.

The Company's insurance carriers have announced that, effective as of January 1, 1988, the aggregate amount of property and decontamination expense insurance available for nuclear generating plants will increase to $1.525 billion. With this increase, the coverage available above the amount required by the NRC to be set aside for reactor stabilization and cleanup would be $465 million. The Company is unable to predict what effect the NRC's amended regulations may have at the time when insurance proceeds would be made available to the Company or the trustee for the bondholders of the Company.

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K. Spent Nuclear Fuel and Decommissioning Costs

Under the terms of its nuclear fuel lease, the Company is responsible for the disposal of spent nuclear fuel. The Company considers all costs incurred or to be incurred in the use and disposal of nuclear fuel to be proper components of nuclear fuel expense and provisions to recover such costs have been accepted by the LPSC. The Company has executed a contract with the Department of Energy (DOE) whereby the DOE will furnish disposal service for the Company's spent nuclear fuel at a cost of one mill per kilowatt-hour of net generation.

In addition to the recovery of costs associated with the disposal of spent nuclear fuel, the Company is presently recovering a total of approximately $2.1 million annually for decommissioning costs for its nuclear unit. The Company currently projects total estimated nuclear plant decommissioning costs to be $140.6 million, exclusive of the effects of inflation.

L. Consolidation with NOPSI

In the interest of increased economic efficiency, the Company and NOPSI have developed a long-term plan to consolidate the two companies and their operations. Under the proposed arrangement, subject to receipt of necessary regulatory and other approvals, the two companies would be consolidated into a new company to be called Louisiana Power & Light Company. MSU, which currently owns all of the outstanding common stock of the Company and NOPSI, would own all of the common stock of the new company. While functional consolidation, in terms of Company management and personnel, has already been achieved in a number of areas, legal consummation of the consolidation is not expected to be achieved in the near future.

The companies of the Middle South System have various postretirement benefit plans covering substantially all of their employees. The pension plans are noncontributory and provide pension benefits that are based on the employees' credited service and average compensation, generally during the last five years before retirement. The policy of the Company is to fund pension costs in accordance with contribution guidelines established by the Employee Retirement Income Security Act of 1974.

Pension plans are administered by a trustee who is responsible for pension payments to retirees. Various investment managers have responsibility for management of the plans' assets. In addition, an independent actuary performs the necessary actuarial valuations for the individual company plans.

Total pension cost (credit) of the Company for 1987, 1986, and 1985 was $(1,949,000), $737,000, and $1,221,000, respectively. The Company adopted SFAS No. 87, "Employers' Accounting for Pensions", effective January 1, 1987. Adoption of SFAS No. 87 reduced 1987 pension costs by approximately $2,492,000. The decrease in 1986 expense compared to 1985 resulted primarily from inclusion of $1,510,000 in 1985 for a special early retirement program that was offered for a limited period and was not available in 1986. The Company's total 1987 pension cost (credit), including amounts capitalized, included the following components:

	(In Thousands)
Service cost – benefits earned during the period	$ 4,500
Interest cost on projected benefit obligation	9,289
Actual return on plan assets	(5,095)
Net amortization and deferral	(10,643)
Net pension credit	$ (1,949)

10 TRANSACTIONS WITH AFFILIATES

The assets of the plan consist primarily of common and preferred stocks, fixed income securities, and insurance contracts.

The funded status of the Company's pension plan at December 31, 1987 is as follows:

	(In Thousands)
Actuarial present value of accumulated pension plan benefits:	
Vested	$ 83,283
Nonvested	7,315
Accumulated benefit obligation	$ 90,598
Projected benefit obligation	$114,968
Plan assets at fair value	155,740
Plan assets in excess of projected benefit obligation	40,772
Unrecognized prior service cost	970
Unrecognized transition asset	(38,098)
Unrecognized net (gain) loss	(4,686)
Accrued pension asset (liability)	$ (1,042)

The weighted average discount rate and rate of increase in future compensation used in determining the actuarial present value of the projected benefit obligation were 9.0% and 5.6%, respectively. The expected long-term rate of return on plan assets was 8.5%. Transition assets are being amortized over 15 years. The actuarial present value of accumulated plan benefits at January 1, 1986 was $76,563,000 (of which $4,364,000 was nonvested), compared with net assets available for pension benefits of $139,458,000. The assumed rate of return used in determining the actuarial present value of accumulated plan benefits at that date was 9.0%.

The Company also provides certain health care and life insurance benefits for retired employees. Substantially all employees may become eligible for these benefits if they reach retirement age while still working for the Company. These benefits and similar benefits for active employees are provided through various means including payments of premiums to insurance companies and/or accruals for self-insurance policies managed by insurance companies. The cost of providing these benefits for retirees is not separable from the cost of providing benefits for active employees. The total cost of providing these benefits and the number of active employees and retirees for the last three fiscal years were as follows:

	1987	1986	1985
Total cost of health care and life insurance (in thousands)	$10,454	$7,995	$6,523
Number of active employees	3,300	3,054	2,985
Number of retirees	650	638	539

The Company buys electricity from and/or sells electricity to the other operating subsidiaries of MSU, including SERI, under rate schedules filed with the FERC. In addition, the Company purchases fuel from SFI and receives technical and advisory services from MSU System Services, Inc. During 1987 and 1986, the Company paid SFI approximately $23 million and $47 million, respectively, for nuclear fuel processing services.

Operating revenues include revenues from sales to affiliates amounting to $5.9 million in 1987, $18.5 million in 1986, and $13.6 million in 1985. Operating expenses include charges from affiliates for fuel cost, purchased power, and technical and advisory services totalling $381.5 million in 1987, $379.4 million in 1986, and $389.9 million in 1985.

11 LEASES

Prior to 1987, the Company accounted for leases on the same basis as that used by its regulatory authority in the rate-making process that determines the revenues utilized to recover the lease costs. In 1987, SFAS No. 71 required that the Company record on its books the assets and related obligations applicable to capital leases in accordance with SFAS No. 13, "Accounting for Leases." The recording of capital leases does not affect amounts reported as either expense or income. The assets and liabilities associated with these leases at December 31, 1987, are presented below.

	(In Thousands)
Assets:	
Utility plant	$26,578
Accumulated amortization	13,398
Net properties under capital lease	$13,180
Liabilities:	
Noncurrent obligations under capital leases	$10,005
Current obligations under capital leases	3,175
Total obligations under capital leases	$13,180

Excluded from the above amounts at December 31, 1987 is approximately $88.7 million which has been recorded in connection with nuclear fuel leases.

Future minimum lease payments, by period and in the aggregate, of the Company's capital leases (excluding nuclear fuel leases) and noncancellable operating leases consisted of the following at December 31, 1987:

Year	Capital Leases	Operating Leases
	(In Thousands)	
1988	$ 4,448	$ 4,511
1989	3,996	4,641
1990	3,651	4,641
1991	3,651	3,307
1992	2,363	3,307
For years thereafter	768	25,907
Minimum rental commitments	18,877	$46,314
Less: Amount representing interest	5,697	
Present value of future minimum lease payments	$13,180	

The Company has a nuclear fuel lease pursuant to which $88.7 million of nuclear fuel may be leased as of December 31, 1987. The credit line associated with the nuclear fuel lease has terminated, and the Company is in the process of attempting to obtain a new line of credit. If a new line of credit is not obtained, fuel presently under lease may continue to be leased until June 1, 1991, but no new fuel may be leased under this arrangement. When the lease terminates the Company will be required to repurchase any unburned nuclear fuel financed under the lease. Lease payments, which are not included in the tabulations above, are based on nuclear fuel use. Nuclear fuel lease expense consists of amortization of the nuclear fuel lease and interest on the lease obligation. Amortization recorded in connection with the nuclear fuel lease for 1987, 1986, and 1985 was $50 million, $56.6 million, and $13.1 million, respectively. Interest expense related to the nuclear fuel lease for 1987, 1986, and 1985 was $7.9 million, $6.4 million, and $0.8 million respectively. The unrecovered cost base of the lease was $88.7 million, $116.3 million, and $120 million at December 31, 1987, 1986, and 1985, respectively.

In 1980, the Company entered into a sale and leaseback of certain office buildings and related real properties. A gain of $13.4 million has been deferred and is now being amortized over the life of the lease. The lease is for a primary term of 20 years.

Rental expense for capital and operating leases (excluding nuclear fuel leases) amounted to approximately $8.3 million, $6.7 million, and $6.3 million in 1987, 1986, and 1985, respectively.

12 SETTLEMENT AGREEMENT WITH GAS SUPPLIER

A dispute between a gas supplier and the Company arising from the gas supplier's claimed inability to deliver the full quantities of fuel gas due the Company under several natural gas contracts was settled by the execution of a settlement agreement on June 4, 1982. The settlement agreement provides for the payment of $1.087 billion in cash (of which $587 million, $250 million, and $250 million were received by the Company in June 1982, January 1983, and January 1984, respectively) plus a guaranty of savings of at least $585 million in certain gas acquisition costs between 1982 and 1996. In March 1983, the LPSC ordered, in general, that refunds of the settlement proceeds be made to customers as follows: the $587 million received on June 4, 1982 plus interest or a total of $637 million to be refunded in 1983; the $250 million received in January 1983 to be refunded in ten equal annual installments beginning in 1984; and the $250 million received in January 1984 to be refunded in nine equal annual installments beginning in 1985. In addition, in February 1984, the LPSC ordered the Company to refund $32.6 million, representing interest not already covered in its March 1983 refund order, to customers in equal installments over a nine year period beginning with the 1985 refund. As a result of the LPSC orders, the Company accrued in 1985 net interest expense in the amount of $0.2 million. No accruals were required for 1987 and 1986. Through December 31, 1987, the Company had refunded a total of approximately $826 million to its customers.

With respect to certain rate orders issued by the LPSC in 1987 affecting the above mentioned settlement, see Note 2, "Rate Matters," for further discussion.

13 STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 90

SFAS No. 90 requires that any partial disallowances (for ratemaking purposes) of recently completed generating plants be recognized as a loss. SFAS No. 90 is effective for fiscal years beginning after December 15, 1987 with earlier application encouraged. The Company has chosen to adopt the provisions of SFAS No. 90 in 1987. Prior years' financial statements have been restated to reflect the application of the new statement.

On November 14, 1985, the LPSC issued an order on the Company's Waterford 3 rate application granting an emergency interim rate increase subject to the Company's agreement to certain conditions. The order provided, among other things, for the Company to permanently absorb and not recover from its retail customers $284 million (of which the LPSC's jurisdictional portion is approximately $276.9 million) of the $2.84 billion estimated cost of Waterford 3 regardless of the outcome of a prudence review of the construction of Waterford 3.

The following table illustrates the effects of adoption of SFAS No. 90 for the years ended December 31, 1986 and 1985:

	(In Thousands) 1986	1985
Net income, as previously reported	$140,604	$ 131,569
Adjustments to operating income:		
Depreciation previously taken	6,923	1,878
Related income taxes	(3,771)	(635)
Total	3,152	1,243
Adjustments to other income:		
Related income taxes	11	5
Disallowed costs:		
Direct disallowance	–	(276,900)
Related income taxes	–	90,259
Total	–	(186,641)
Change in net income*	3,163	(185,393)
Net income (loss), as restated	$143,767	$ (53,824)

*Restatement of 1985 and 1986 net income resulted in a cumulative reduction in December 31, 1986 retained earnings of $182.[illegible] million.

Deferred taxes related to the Waterford 3 disallowance have been provided at rates that, under current tax law, are effective when the tax basis of the plant is depreciated (46% in 1985 and 1986, 40% in 1987, and 34% thereafter) to determine the net realizable value of the tax benefit.

14 QUARTERLY RESULTS (Unaudited)

Unaudited operating results for the four quarters of 1987 and 1986 follow:

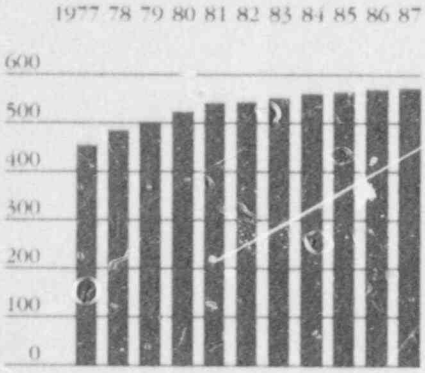
Quarter Ended	Operating Revenues	Operating Income	Net Income (Loss)
		(In Thousands)	
1987:			
March (1)	$296,806	$ 74,716	$28,761
June (1)	333,318	71,633	26,232
September (1)	415,783	108,625	64,042
December (2)	294,995	41,650	(3,386)
1986: (1)			
March	$297,517	$ 75,663	$28,159
June	332,296	88,998	40,379
September	409,757	113,091	63,640
December (3)	299,641	61,481	11,589

(1) Restated to reflect the adoption of SFAS No. 90.
(2) The quarter ended December 31, 1987 includes a $24.4 million, net of tax, decrease attributable to the effects of the discontinuance of Waterford 3 rate deferrals offset by a $6.5 million decrease in taxes due to the amortization of previously provided accumulated deferred state income taxes related to depreciation timing differences.
(3) The quarter ended December 31, 1986 includes the effect of an $8.4 million reduction, net of tax, in operating income and net income due to the provisions for estimated losses of the Company's share of certain costs associated with indefinitely delayed future fossil-fuel generating facilities.

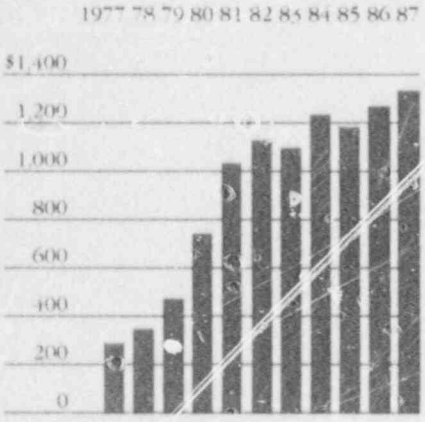
The business of the Company is subject to seasonal fluctuations, with the peak period occurring during the summer months. Accordingly, earnings information for the interim period should not be considered as a basis for estimating the results of operations for a full year.

MANAGEMENT'S FINANCIAL & DISCUSSION AND ANALYSIS

CUSTOMERS
(Thousands)
1987 = 569.7



OPERATING REVENUES
From Retail Customers
(Millions of Dollars)
1987 = $1,313.4



FINANCIAL CONDITION

The following analysis reflects the effects of implementation of Statement of Financial Accounting Standards (SFAS) No. 90, "Regulated Enterprises – Accounting for Abandonments and Disallowances of Plant Costs", which resulted in the restatement of the 1985 and 1986 financial statements. The Company's financial condition declined in 1987 despite rate relief granted by the Louisiana Public Service Commission (LPSC) in January 1987, which was subsequently reduced in April 1987. Net income decreased $28.1 million or 20% due to the reduction in the allowed return on common equity to 12% as required by the January 30, 1987 rate order and the discontinuance on February 1, 1987 of additional Waterford 3 deferrals. The Company has remained current with respect to its preferred stock sinking fund payments and the declaration and payment of preferred stock dividends. The payment of common stock dividends resumed in the third quarter of 1987 for the first time since the second quarter of 1985. Common stock dividends totalling $8.3 million were paid to Middle South Utilities, Inc. (MSU) in 1987 and common dividends of $4.6 million were paid in February 1988.

During 1987, the Company faced continued uncertainties and challenges. These included the final resolution of certain other Middle South System operating companies' rate orders; the resolution of a permanent rate relief request pending before the LPSC; the effect of a new accounting standard relating to the accounting for phase-in plans; the final resolution of a prudence investigation of the Company's decision to construct Waterford 3, the plant's construction costs, and the Company's decision to buy power from Unit No. 1 of the Grand Gulf Steam Electric Generating Station (nuclear) (Grand Gulf 1) of which 90% is owned by System Energy Resources, Inc. (SERI); recording of the LPSC jurisdictional portion of the $284 million disallowance of Waterford 3 investment in accordance with SFAS No. 90; the outcome of a challenge to the allocation of capacity and energy from Grand Gulf 1; the uncertain status of Unit No. 2 of the Grand Gulf Steam Electric Generating Station (nuclear) (Grand Gulf 2) and the accounting treatment and possible cost allocation in the event of cancellation (see Note 8, "Commitments and Contingencies – Grand Gulf 2"); and the ultimate outcome of disputes related to System Fuels, Inc.'s (SFI) coal supply agreement (see Note 8, "Commitments and Contingencies – System Fuels, Inc"). Although some of these issues have been resolved, certain of them are still pending and could have a material adverse effect on the Company's future financial condition, liquidity and capital resources.

Rate Relief

On January 30, 1987, the LPSC issued a permanent order for rate relief (January 1987 Order) that would allow the Company a base rate increase of $76.2 million annually. Additionally, the January 1987 Order required the Company to retain approximately $386 million of the balance of proceeds of a gas contract settlement and to use these funds, among other things, to recover Waterford 3 deferred expenses accumulated through January 31, 1987 (approximately $247 million). However, on April 28, 1987 (April 1987 Order) the LPSC modified its January 1987 Order by reducing the Company's rate increase from $76.2 million to $48 million on the basis of the phase-in of Waterford 3 costs recommended by its consultants. The April 1987 Order also reinstated the provisions of a 1983 order requiring the gas contract settlement proceeds to be refunded to LPSC jurisdictional customers in annual payments.

On May 6, 1987 the Company filed with the LPSC a Motion for Rehearing and Clarification of Order to obtain clarification of certain provisions of the April 1987 Order. In response to such motion, the LPSC, by order of June 26, 1987 (June 1987 Order), found, among other things, that except as to the January 1987 Order, the April 1987 Order was not intended to change any of the LPSC's orders issued previously, in the rate case, and stated that by the April 1987 Order, the LPSC had abandoned the January 1987 Order, had reduced the rate increase of $76.2 million to $48 million, and had reinstated the multi-year refunding program in connection with the gas contract settlement. The reduction in the Company's rate increase was placed into effect on July 6, 1987. The 1987 gas contract settlement refund of approximately $55.2 million was made on that same date. On July 8, 1987, the Company appealed, among other things, those aspects of the January 1987, April 1987, and June 1987 Orders that failed to provide adequate assurance of future recovery, through a phase-in plan, of Waterford 3 costs incurred but not recovered subsequent to July 6, 1987, and not permitting the Company to earn an adequate rate of return on its investment. On November 10, 1987, the Nineteenth Judicial District Court for the Parish of East Baton Rouge, Louisiana issued a judgment (November 1987 Judgment) providing, among other things, the authority to implement an additional rate increase of $40 million annually for services rendered on and after February 1, 1988. The Company has implemented such rate increase effective February 1, 1988, subject to refund. The LPSC and the Company have appealed the November 1987 Judgment to the Louisiana Supreme Court. The matter is pending.

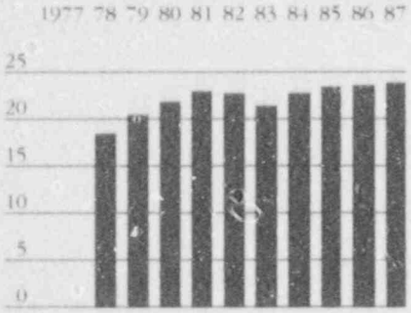
On February 19, 1988, the Company filed with the LPSC, an application for retail rate relief requesting a net increase of $38.2 million in annual revenues (February 1988 rate filing). Such request provides for adjustment subject to the final outcome of appeals of the November 1987 Judgment. Specifically, should the Louisiana Supreme Court overturn the District Court's November 1987 Judgment, the Company is requesting an alternate net increase in annual revenues of $78.2 million. (See Note 2, "Rate Matters.")

Rate Deferrals

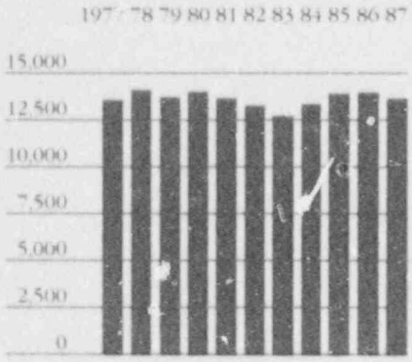
By its orders of November 14, 1985, April 1987, and June 1987, the LPSC has provided adequate assurance to the Company as to the future recovery of the approximately $247 million of deferred Waterford 3 costs accumulated as of January 31, 1987. On the other hand, the LPSC's actions did not appear to have provided adequate assurance as to the future recovery of those additional Waterford 3 costs incurred subsequent to August 12, 1987, that, in the Company's opinion, should be deferred for future recovery. Although, the November 1987 Judgment stated, among other things, that the Company could record as an asset Waterford 3 amounts deferred from August 12, 1987 through January 31, 1988 totalling approximately $19 million (approximately $15 million in 1987), the Company has not done so pending the outcome of appeals to the Supreme Court of Louisiana. Therefore such additional Waterford 3 costs have not been deferred but have been recorded as current operating expense, adversely affecting earnings.

It is the Company's opinion that a total of approximately $266 million of Waterford 3 costs should have been deferred as of January 31, 1988. As part of the February 1988 rate filing, the Company submitted to the LPSC for approval a formal phase-in plan that will allow for the recovery of the $247 million of Waterford 3 costs deferred through January 31, 1987 as well as the $19 million of Waterford 3 costs subject to deferral

ENERGY SALES
To Retail Customers
(Billions of Kilowatt-Hours)
1987 = 24.25



AVERAGE KWH USE
Per Residential Customer
1987 = 13,477



for the period August 12, 1987 through January 31, 1988. The phase-in plan submitted, if adopted by the LPSC, will comply with the provisions of SFAS No. 92, "Regulated Enterprises – Accounting for Phase-in Plans" (SFAS No. 92), and allow the Company to recover the approximately $266 million of Waterford 3 costs over a seven year period beginning in 1990. If the LPSC does not approve a phase-in plan that complies with SFAS No. 92, the Company will be required to write off the deferred Waterford 3 costs. (See Note 8, "Commitments and Contingencies – New Accounting Standards", for the specific requirements of SFAS No. 92.)

Prudence

The LPSC ordered an investigation in connection with its November 1985 Order which in effect required the Company to permanently absorb, and not recover from retail customers, the LPSC jurisdictional portion (approximately 97.5%) of the $284 million disallowance. The LPSC's consultants concluded that the Company's decisions to build Waterford 3 and to enter into a contract to purchase capacity and energy from Grand Gulf 1 were reasonable. They also concluded that $143 million of the total Waterford 3 construction costs were imprudently incurred. It is the position of the Company that none of the Waterford 3 construction costs were imprudently incurred. Moreover, since the findings are less than the $284 million disallowance that the Company previously agreed to absorb, the Company feels that no additional disallowance is justified.

As of December 31, 1987, the LPSC had not indicated its conclusions on the prudence issues.

Plant Disallowance

Earnings have been and will continue to be adversely affected by the Company's agreement to permanently absorb the aforementioned $284 million of its investment in Waterford 3. In this connection, the Company implemented SFAS No. 90 in 1987, thereby recording the loss in respect of such partial disallowance of Waterford 3 investment by way of a write-off. Accordingly, 1985 and 1986 financial statements have been restated to reflect the write-off. Such restatement resulted in a net loss of $53.8 million in 1985, the first loss recorded in the Company's history. (See Note 13, "Statement of Financial Accounting Standards No. 90.")

Grand Gulf 1

The Company's agreement, as part of the November 1985 Order, to permanently retain 18% of its share of Grand Gulf 1 costs continues to adversely affect the Company's earnings. However, the capacity and energy relating to the Company's retained percentage of Grand Gulf 1 costs could be available for sale to non-affiliated parties, subject to LPSC approval.

Federal Energy Regulatory Commission (FERC) Allocation of Grand Gulf 1

During 1987, the FERC reaffirmed its June 13, 1985 allocation of Grand Gulf 1 costs, capacity and energy to the Company. Further challenges to the FERC's jurisdictional authority to allocate Grand Gulf 1 capacity and energy have thus far been unsuccessful. Should currently unresolved or future challenges force changes in the FERC's allocation, the Company's earnings, liquidity, and financial condition could be materially adversely affected. (See Note 8, "Commitments and Contingencies – Unit Power Sales Agreement.")

LIQUIDITY AND CAPITAL RESOURCES

During 1987, the Company's primary capital requirements included construction expenditures, including an allowance for the composite cost of funds used during construction (AFDC), of $127 million, payment of preferred and common stock dividends of $50.7 million and $8.3 million, respectively, the refunding of $55.2 million to customers in connection with a gas contract settlement, the redemption of $32.6 million of preferred stock, the financing of deferred Waterford 3 expenses of approximately $21.1 million, and the retirement of $20 million of first mortgage bonds. The Company's cash needs for 1987 were primarily satisfied through internally generated funds.

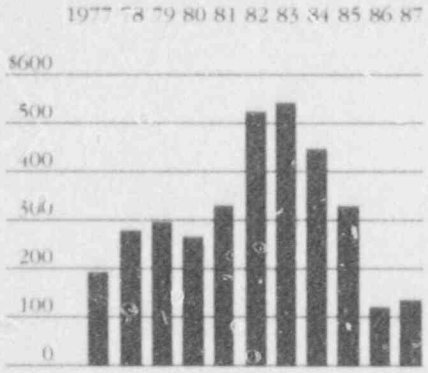
Over the next three years, the Company projects that capital will be required for construction expenditures (inclusive of AFDC but excluding nuclear fuel) of $142.4 million in 1988, $149.6 million in 1989, and $156 million in 1990. The Company projects that other primary capital requirements for the next three years are as follows: the funding of $45 million and $20 million principal amount of maturing first mortgage bonds in 1989 and 1990, respectively, and the funding of other maturing long-term debt and preferred stock retirements (including anticipated early retirements of preferred stock) aggregating $95.7 million in 1988, $17.9 million in 1989, and $18.8 million in 1990. In 1988 and 1990, the Company intends to finance substantially all of the above capital requirements with internally generated funds. The Company anticipates that its capital needs for 1989 will be satisfied through internally generated funds and the issuance of, among other things, first mortgage bonds. Additionally, the Company may enter into arrangements for the sale and leaseback of property in which the proceeds from such transactions could be used to retire debt at par.

In order to provide interim financing, the Company is currently authorized to effect short-term borrowings of up to 10% (approximately $301 million at year-end) of capitalization as defined, subject to the availability of short-term credit resources. The Company has unsecured bank lines of credit of approximately $140.3 million at December 31, 1987, none of which was utilized at that date. Such unsecured bank lines of credit include $90 million with non-territorial banks, of which $30 million expires on June 30, 1988 and $50.3 million with Louisiana banks, all of which expires on June 30, 1988. The lines of credit with Louisiana banks include $10 million that is shared with New Orleans Public Service Inc. As of February 29, 1988, $90 million in lines of credit with banks outside the Company's service area remained available for borrowing by the Company. Borrowings can also be effected through the Middle South System Money Pool, subject to the availability of funds, which at any particular time may be limited.

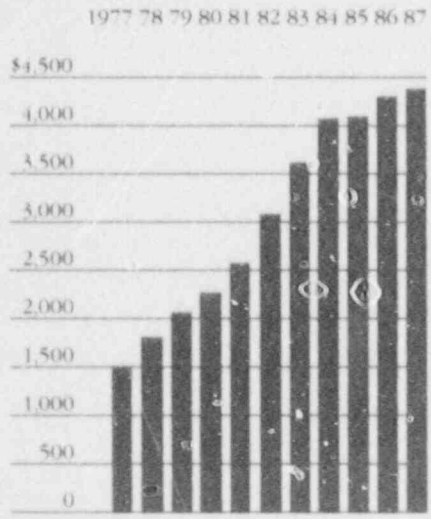
The Company has a nuclear fuel lease pursuant to which $88.7 million of nuclear fuel may be leased as of December 31, 1987. The credit line associated with the Company's nuclear fuel lease has terminated, and the Company is in the process of attempting to obtain a new line of credit. If a new line of credit is not obtained, fuel presently under lease may continue to be leased until June 1, 1991, but no new fuel may be leased under this arrangement. Upon termination of the lease, the Company will be required to repurchase any unburned nuclear fuel financed under the lease. It is currently assumed that a new line of credit will be secured.

The Company's earnings coverages for its first mortgage bonds decreased to 2.11 times the annual mortgage bond interest requirements for 1987 from 2.99 times for 1986. For 1985, the earnings coverage for first mortgage bonds was 1.37 times the annual mortgage bond interest requirements. Earnings coverages for preferred stock decreased to 1.28 times the annual interest charges and preferred stock dividend requirements for 1987 from 1.37 times in 1986. The preferred stock

CONSTRUCTION EXPENDITURES
(Millions of Dollars)
1987 = $126.8



TOTAL UTILITY PLANT
(excluding nuclear fuel)
(Millions of Dollars)
1987 = $4,395.5



earnings coverage for 1985 was 1.32 times. The earnings coverages for 1985 and 1986 do not reflect the effects of the restatement of such years' financial statements for implementation of SFAS No. 90. (See Note 13, "Statement of Financial Accounting Standards No. 90.")

The minimum earnings coverage requirements for issuing first mortgage bonds (other than for refunding purposes) and preferred stock are 2.0 times and 1.5 times, respectively, on a pro forma basis. Based upon 1987 earnings, the Company is precluded from raising capital through the sale of preferred stock. The amount of additional first mortgage bonds that could have been issued based upon available property additions at year-end was approximately $593.8 million. However, based upon mortgage earnings coverages and an assumed interest rate of 13%, the Company could have issued only up to $70 million of additional first mortgage bonds at year-end.

In the third quarter of 1987, the Company resumed payment of modest common stock dividends to MSU. The Company remains current with respect to preferred stock dividends and preferred stock sinking fund payments.

RESULTS OF OPERATIONS

Net income amounted to $115.6 million in 1987, a decrease of $28.1 million or 20% from 1986, and net income increased $197.6 million in 1986 when compared to 1985. The decrease in 1987 net income was principally due to, as required by the January 30, 1987 rate order, the reduction in the allowed rate of return on common equity to 12% and the discontinuance on February 1, 1987 of additional Waterford 3 deferrals. The 1986 increase was due primarily to the write-off in 1985 of $185.4 million, net of tax, of disallowed Waterford 3 costs.

Total operating revenues increased $1.7 million in 1987 and $79.4 million or 6% in 1986 when compared to 1986 and 1985, respectively. The increase in 1987 was principally due to an increase in base rates as a result of the LPSC's January 30, 1987 rate order (subsequently reduced by the April 28, 1987 rate order) mainly offset by rate concessions granted to industrial customers and a decrease in fuel adjustment revenues due to lower fuel costs. Sales volume remained relatively level in 1987 as compared to 1986 sales. The 1986 increase was primarily the result of rate increases implemented in late 1985 partially offset by a decrease in fuel adjustment revenues caused by lower fuel costs.

Fuel and purchased power costs decreased $25.9 million or 4% in 1987 and $172.7 million or 22% in 1986 as compared to the preceding year in each case. These decreases were the result of lower per-unit fuel costs and the increased use of nuclear generation at lower average unit costs.

Maintenance expenses remained level in 1987 compared to 1986 and increased $38.2 million or 76% in 1986 compared to 1985. Approximately $34 million of the 1986 increase reflected the impact of a full year of maintenance expenses associated with Waterford 3 which was placed into commercial operation in September 1985.

Depreciation expense increased slightly in 1987 and increased $49.5 million or 74% in 1986 as compared to 1986 and 1985, respectively. The 1986 increase was due principally to an increase in Waterford 3 depreciation reflecting the first full year of commercial operation of Waterford 3.

Deferred Waterford 3 expenses decreased $184.9 million or 90% in 1987 and increased $185.9 million in 1986 as compared to 1986 and 1985, respectively. The decrease in 1987 deferrals was due to the discontinuance, pursuant to the orders of the LPSC, of additional Waterford 3 deferrals on February 1, 1987. The 1986 increase was the result of rate deferrals implemented in late 1985.

Income taxes included in operating expenses (exclusive of those taxes related to deferred Waterford 3 expenses) for 1987 decreased $14.7 million or 36% and for 1986 increased $44.4 million as compared to the preceding year in each case. The 1987 decrease was primarily attributable to the discontinuance on January 31, 1987 of normalizing state income taxes related to depreciation timing differences, the write-off of all such previously deferred amounts, and a reduction in the federal corporate tax rate for 1987. Partially offsetting these decreases in 1987 was an increase in pre-tax book income. The 1986 increase was due to increased pre-tax book income.

AFDC increased slightly in 1987 and decreased in 1986 by $124.6 million or 98% when compared to 1986 and 1985, respectively. Since September 1985, the Company has ceased to accrue AFDC in association with Waterford 3 thereby greatly reducing AFDC for 1987 and 1986.

Interest on long-term debt decreased by $5.8 million or 3% in 1987 and increased $20.9 million or 13% in 1986 compared to 1986 and 1985, respectively. The 1987 decrease was due to the refunding in late 1986 of certain series of high interest-bearing debt. The increase in 1986 interest expenses was mainly attributable to the Company's issuance of additional debt.

Other interest-net decreased $7.4 million or 50% in 1987 and $6 million or 29% in 1986 as compared to 1986 and 1985, respectively. These decreases were primarily the result of lower levels of short-term borrowings.

SUMMARY

In 1987, the Company experienced decreases in net income and indenture and charter earnings coverage ratios. However, the Company has continued to remain current with respect to the payment of preferred stock dividends and has resumed the payment of common stock dividends. The Company's future financial condition will be affected by the final resolution of certain other Middle South System operating companies' rate orders and related matters, the effect on the Company of a new accounting standard relating to the accounting for phase-in plans, the outcome of the pending appeal of the November 1987 Judgment, the final resolution of the LPSC prudence investigation, the ultimate outcome of the appeal of the FERC's reconsideration of the allocation of capacity and energy from Grand Gulf 1, the future status of Grand Gulf 2 and the possible allocation to the Company of costs associated with that unit, and the ultimate outcome of disputes related to System Fuels, Inc.'s coal supply agreement (see Note 2, "Rate Matters", and Note 8, "Commitments and Contingencies").

RECORD OF PROGRESS 1977-1987

SELECTED FINANCIAL DATA

(Dollars in Millions)	1987	1986	1985	1984
Total Utility Plant (Excluding Nuclear Fuel) (1)	$4,395.5	$4,269.5	$4,162.6	$4,116.8
Total Assets (1)	$4,234.4	$4,150.4	$3,819.3	$3,849.1
Capitalization:				
Long-Term Debt (Excluding Current Maturities)	$1,772.3	$1,783.0	$1,470.1	$1,471.8
Preferred Stock with Sinking Fund	241.3	272.1	278.4	284.5
Preferred Stock without Sinking Fund	145.9	145.9	145.9	145.9
Common Equity (1)	920.0	864.4	774.1	855.9
Total (1)	$3,079.5	$3,065.4	$2,668.5	$2,758.1
Total Operating Revenues	$1,340.9	$1,339.2	$1,259.8	$1,245.7
Operating Income (1)	$ 296.6	$ 339.2	$ 186.1	$ 296.7
Net Income (Loss) (1 and 2)	$ 115.6	$ 143.8	$ (53.8)	$ 201.0
Employees – Year End	3,373	3,092	2,998	2,973
ELECTRIC OPERATIONS				
Operating Revenues (Dollars in Millions):				
Residential	$ 476.0	$ 473.3	$ 411.7	$ 404.8
Commercial	274.1	265.5	226.9	215.4
Industrial	525.8	512.9	528.4	562.1
Government and Municipal	37.5	34.6	30.7	30.2
Other	27.5	52.9	62.1	33.2
Total	$1,340.9	$1,339.2	$1,259.8	$1,245.7
Sales (Millions of KWH):				
Residential	6,757	6,975	6,981	6,630
Commercial	3,770	3,773	3,708	3,410
Industrial	13,102	12,341	12,468	12,168
Government and Municipal	620	593	583	553
Other	582	1,459	746	529
Total	24,831	25,141	24,486	23,290
Customers – Year End (Thousands):				
Residential	502.3	501.6	499.8	495.4
Commercial	57.3	57.3	57.1	55.8
Industrial	6.1	6.4	7.1	7.4
Government and Municipal	4.0	3.9	3.8	3.7
Total	569.7	569.2	567.8	562.3
Residential Customer Data:				
Average Annual Use (Kilowatt-Hours)	13,477	13,927	14,013	13,479
Average Annual Revenue per Kilowatt-Hour	7.04¢	6.79¢	5.90¢	6.10¢
LP&L System Input (Millions of KWH):				
Net Generation	17,658	20,286	16,478	14,100
Purchased Power and Interchange-in	8,941	6,725	9,905	10,931
Total	26,599	27,011	26,383	25,031
Peak Demand (MW)	4,552	4,603	4,355	4,200
Generating Capability (MW)	5,665	5,665	5,665	4,605

(1) 1986 and 1985 have been restated to reflect the adoption of Statement of Financial Accounting Standards No. 90. (See Note 13 of Notes to Financial Statements.)

(2) Net income for 1984 includes the cumulative effect to January 1, 1984 of accruing unbilled revenues in the amount of $17.6 million after income taxes.

1983	1982	1981	1980	1979	1978	1977
$3,608.1	$3,131.5	$2,634.0	$2,319.2	$2,069.1	$1,793.0	$1,509.8
$3,565.3	$3,602.1	$2,330.2	$2,078.4	$1,842.4	$1,557.2	$1,298.8
$1,173.5	$ 947.6	$1,001.2	$ 829.0	$ 827.4	$ 728.7	$ 566.3
240.9	169.1	121.4	121.4	93.0	–	–
145.9	145.9	145.9	145.9	145.9	110.8	110.8
778.8	649.9	615.9	564.1	487.4	417.2	362.8
$2,339.1	$1,912.5	$1,884.4	$1,660.4	$1,553.7	$1,256.7	$1,040.9
$1,144.7	$1,195.6	$1,117.8	$ 853.5	$ 557.5	$ 456.4	$ 379.0
$ 172.5	$ 187.3	$ 167.2	$ 133.0	$ 86.1	$ 79.7	$ 69.0
$ 131.5	$ 117.5	$ 124.5	$ 109.7	$ 65.1	$ 53.7	$ 44.4
2,756	2,721	2,499	2,342	2,329	2,216	2,129
$ 358.8	$ 364.0	$ 341.6	$ 265.1	$ 180.4	$ 146.3	$ 124.5
186.8	183.0	164.7	123.6	86.0	68.3	55.4
529.6	574.1	525.3	358.2	212.8	141.6	114.9
27.2	26.2	22.8	17.2	11.7	8.5	7.1
42.3	48.3	63.4	89.4	66.6	91.5	77.1
$1,144.7	$1,195.6	$1,117.8	$ 853.5	$ 557.5	$ 456.4	$ 379.0
6,274	6,429	6,405	6,398	5,996	5,862	5,334
3,168	3,130	3,016	2,876	2,721	2,624	2,268
11,491	12,997	13,067	11,963	11,388	9,635	9,028
525	518	479	462	445	394	359
780	867	1,185	2,245	2,702	4,147	3,963
22,238	23,941	24,152	23,945	23,252	22,712	20,952
487.1	478.4	470.0	457.2	445.5	427.9	395.5
53.8	52.0	50.6	48.6	46.8	44.9	40.1
7.5	6.6	6.7	6.8	7.2	7.5	7.6
3.6	3.4	3.3	3.3	3.2	3.1	2.8
552.0	540.4	530.6	515.9	500.7	483.4	446.0
[illegible]96	13,545	13,791	14,377	13,758	14,063	13,680
[illegible]72	5.66	5.33	4.14	3.01	2.50	2.35
[illegible]22	14,540	15,471	16,440	18,429	21,251	20,204
[illegible]84	11,138	10,369	9,424	6,837	3,813	2,931
[illegible]406	25,678	25,840	25,863	25,266	25,064	23,135
4,207	4,259	4,256	4,078	4,091	3,852	3,515
4,618	4,625	4,627	4,625	4,612	4,603	4,447

DIRECTORS

JAMES M. CAIN
President of the Company
President
New Orleans Public Service Inc.

TEX R. KILPATRICK [A]
President
Central American
Life Insurance Company

JOSEPH J. KREBS, JR. [A]
Chairman of the Board
J. J. Krebs & Sons, Inc.

EDWIN LUPBERGER
Chairman and President
Middle South Utilities, Inc.

H. DUKE SHACKELFORD [A]
Agricultural Interests

WM. CLIFFORD SMITH [A]
President
T. Baker Smith & Son

JACK M. WYATT
Former Chairman of the Board and
Chief Executive Officer of the Company
(Retired August 1, 1983)

[A] Members of Audit Committee

OFFICERS

JAMES M. CAIN
President & CEO

DONALD HUNTER
Executive Vice President

R. DRAKE KEITH
Executive Vice President

D. L. ASWELL
Senior Vice President –
Energy Supply-Fossil

JOHN J. CORDARO
Senior Vice President –
External Affairs

S. G. CUNNINGHAM, JR.
Senior Vice President –
Marketing & Rates

JERROLD G. DEWEASE
Senior Vice President –
Nuclear Operations

MALCOLM L. HURSTELL
Senior Vice President –
Energy Delivery

M. H. McLETCHIE
Senior Vice President –
Accounting & Finance, and Treasurer

RICHARD L. MURLOWSKI
Senior Vice President –
Administration & Planning

THOMAS J. WRIGHT [1]
Group Vice President

ROSS P. BARKHURST
Vice President –
Nuclear

JOSEPH Q. CIPRIANO
Vice President –
Division Manager

G. F. DELERY
Vice President –
Marketing

ROBERT J. DUNN
Vice President –
Administrative Services

RICHARD C. GUTHRIE
Vice President –
Public Affairs

W. J. LANNES III
Vice President –
System Engineering

THOMAS O. LIND [2]
Vice President –
Regulatory Counsel, and Secretary

LEE V. MAURIN [3]
Vice President –
Fossil Operations

JAMES J. McCLOSKEY, JR.
Vice President –
Division Manager

LEE W. RANDALL [4]
Vice President –
Accounting & Treasury,
and Assistant Treasurer

CARL C. SMITH
Vice President –
Division Manager

ROBERT J. ABADIE
Controller

JAMES C. ALACK
Assistant Controller

T. W. BOATRIGHT [5]
Assistant Controller

JOSEPH CAPAROTTA, JR. [6]
Assistant Controller

R. N. GARRETT, JR.
Assistant Controller

S. F. OHLMEYER
Assistant Treasurer

N. J. BRILEY
Assistant Secretary

CARY J. DUDENHEFER
Assistant Secretary

NOTES:
[1] Elected effective 10/12/87
[2] Elected Secretary effective 4/20/87
[3] Retired effective 10/1/87
[4] Resigned effective 3/2/88
[5] Resigned as Assistant Controller effective 10/1/87
[6] Elected effective 10/1/87

AREA SERVED BY LP&L

Louisiana Power & Light Company operates in 46 of the 64 parishes of Louisiana – a 19,500-square-mile area which, as of December 31, 1987, had an estimated population of 1,672,000. At year-end 1987, LP&L was serving approximately 37% of Louisiana's population.

The area served by LP&L includes most of North Louisiana, a small portion of East Central Louisiana, and most of Southeastern Louisiana, including the metropolitan area around the City of New Orleans and the 15th Ward in the City of New Orleans.

LP&L's system is part of, and is interconnected with, the other operating companies of the Middle South Utilities System. This arrangement provides more dependable electric service for customers, and also results in the greatest economy in the generation of electric power, with resultant savings to customers.

GENERAL OFFICE
142 Delaronde Street
P.O. Box 6008
New Orleans, Louisiana 70174
(504) 366-2345

REGISTRAR AND TRANSFER AGENT
FOR PREFERRED STOCK
Bank of Montreal Trust Company
Two Wall Street
New York, New York 10005

TRUSTEE FOR
FIRST MORTGAGE BONDS
Bank of Montreal Trust Company
Two Wall Street
New York, New York 10005

This 1987 Annual Report is prepared for the information of stockholders, employees, and other interested persons.

The Company's 1987 Annual Report to the Securities and Exchange Commission on Form 10-K (including financial statement schedules) is available to any stockholder without charge. Stockholders can obtain a copy by writing to:

Investor Relations Department
Louisiana Power & Light Company
Post Office Box 6008
L-360
New Orleans, Louisiana 70174
Telephone: (504) 363-8526

MIDDLE SOUTH UTILITIES SYSTEM

Louisiana Power & Light Company
P. O. Box 6008
New Orleans, Louisiana 70174
Address Correction Requested