GULF STATES UTILITIES COMPANY
POST OFFICE BOX 2951 • BEAUMONT, TEXAS 77704
AREA CODE 713 838-6631

June 13, 1988
RBG- 28088
File No. G9.5

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

Gentlemen:

River Bend Station Unit 1
Docket No. 50-458
Annual Report

Enclosed are ten (10) copies of the Gulf States Utilities Company 1987 Annual Report. This report is being submitted in accordance with Section 50.71 of Title 10 of the Code of Federal Regulations and U. S. Nuclear Regulatory Commission Regulatory Guide 10.1. Copies of the Cajun Electric Power Cooperative, Inc. 1987 Annual Report will be provided once it becomes available.

Sincerely,

J. E. Booker

J. E. Booker
Manager-River Bend Oversight

DHW
JEB/DHW/do

Enclosures

cc: U. S. Nuclear Regulatory Commission
611 Ryan Plaza Drive, Suite 1000
Arlington, TX 76011

NRC Resident Inspector
P. O. Box 1051
St. Francisville, LA 70775

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GULF STATES UTILITIES 1987 ANNUAL REPORT

Financial Highlights	1987	1986	% Change
Total Operating Revenue (000)	$1,432,586	$1,478,388	(3.1)
Operating Expenses and Taxes (000)	$1,055,966	$1,164,582	(9.3)
Net Income (000)	$ 241,101	$ 244,981	(1.6)
Income Applicable to Common Stock (000)	$ 178,091	$ 181,854	(2.1)
Earnings per Average Share of Common Stock Outstanding	$1.65	$1.71	(3.5)
Dividends per Share	—	$ .67	(100)
Average Common Shares Outstanding (000)	107,995	106,132	1.8
Number of Electric Customers (end of Year)	554,905	555,075	—
Total Kilowatt-Hour Sales (000)	26,620,287	26,949,012	(1.2)
System Peak Load — Kilowatts	4,991,000	5,089,000	(1.9)

Description of Business

Gulf States Utilities was incorporated in 1925 and is primarily in the business of generating, transmitting and distributing electricity to 555,000 customers in southeast Texas and south Louisiana. The service area extends 350 miles westward from Baton Rouge, La., to a point about 50 miles east of Austin, Tx. The service area encompasses the northern suburbs of Houston and major cities such as Conroe, Huntsville, Port Arthur, Orange and Beaumont, Tx.; Lake Charles and Baton Rouge, La.

GSU also sells electricity to municipalities and rural electrical cooperatives in both Texas and Louisiana. In Baton Rouge, GSU supplies steam and electricity to a large industrial customer through a cogeneration facility and the company owns and operates a natural gas retail distribution system serving 83,000 customers.

As a member of the Southwest Power Pool, the company has the ability to interchange electricity with the 40 members (29 members and 11 associated members) serving eight states in the South and Southwest. The company had a peak load of 4,991 megawatts in 1987, while it had installed capacity and firm power purchase agreements totaling 6,871 megawatts at the time of that peak load.

Effective July 1, 1987, the company sold the oil and gas reserves of its wholly-owned subsidiary, Prudential Oil & Gas, Inc. to Moore McCormack Energy, Inc. GSU's officials and employees are in the process of discontinuing all Prudential affairs as Prudential's employees received a severance package and have been released. Although the ongoing operations of Prudential have been discontinued, the subsidiary will remain in existence for a few years to bring to a close all corporate matters.

Dividends

The resumption of dividends has a high priority for Gulf States' board of directors, but the picture remains rather bleak, given the uncertainty of regulatory proceedings.

The company has been unable to pay dividends on common stock since the second quarter of 1986 and the board reluctantly decided in the first quarter of 1987 that the preferred and preference stock dividends could no longer be paid.

Holders of common shares of stock need to be aware that the company cannot resume payment of their dividends until the cumulative preferred and preference stock dividends are repaid and preferred sinking fund obligations are satisfied.

Report to Shareholders

Dear Fellow Shareholders:

It is said that the test of a strong person is how he or she faces adversity. Your company and its people were put to the test time and time again during 1987 and, unfortunately, are continuing to wrestle with adversity as we move into 1988. As was the case in 1987, our principal focus continues to be rate cases in Louisiana and Texas. Although our River Bend nuclear power plant has generated more than 8 billion kilowatt-hours of electricity since December of 1985 and set operating records during 1987, we are still fighting to have the unit recognized in our rates.

I had believed that by the time this letter was written there would be conclusive news to report. Although we have achieved some court-ordered rate relief in Louisiana, we are still waiting for a positive decision in Texas that will enable the company to begin the long journey back to financial stability.

The Louisiana Public Service Commission (LPSC) rendered a totally unacceptable decision on Dec. 15. Rejecting its own consultants' and staff's recommendations, the commissioners granted $63 million — only $6 million more than the $57 million in interim relief already in effect. We immediately asked a state district court to overturn several elements of the LPSC order, including a finding that $1.4 billion in River Bend costs should be permanently disallowed on a system-wide basis. On Feb. 18, the court ordered immediate implementation of a $92 million first-year rate increase in Louisiana, which included the $63 million increase granted by the commission. The court also set a return on common equity of 14 percent, compared to the 12 percent figure approved by the commission. The preliminary injunction means that the $92 million rate increase will remain in effect while the disallowance and other issues are being decided on appeal.

E. Linn Draper, Jr.

In Texas, the Public Utility Commission (PUCT), which was to have made a decision in early January, issued a series of preliminary rulings on Feb. 23. The impact on Texas rates was not immediately clear. The commission held that $1.6 billion of GSU's share of River Bend costs could be placed in the rate base, but the remaining $1.5 billion would be set aside for the present time. The company will have the opportunity to present additional evidence justifying those costs at a later date. These decisions are not final until the PUCT issues a written order, and a final order is not expected to be approved before early March.

While the rate cases dragged on, River Bend hummed along. It operated 151 consecutive days during one stretch of 1987, which was the fourth best record among the 30 boiling water reactors in the United States. At times during 1987, River Bend provided one-third of all the power generated for our customers. A major accomplishment in 1987 was its successful first refueling which was completed faster than the average for similar plants.

The Nuclear Regulatory Commission also continued giving GSU high marks for River Bend, awarding the company the highest possible ratings in the critical areas of plant operations, quality programs and training.

As these rate cases have unfolded, it has been particularly unsettling to see the same basic set of facts produce such different conclusions about the prudency of the decision to build River Bend. In Louisiana, the commission's consultants concluded that Gulf States should have built a lignite-fueled plant instead of River Bend, which accounts for the $1.4 billion disallowance that remains an issue in our court appeal. In Texas, the three administrative law judges who listened to 118 days of testimony and reviewed thousands of pages of documents found that the decision to build River Bend was prudent. Obviously, we concur with the Texas findings.

The quality of the construction at River Bend has not been seriously disputed. Indirectly, even our rate case critics acknowledge that the project was a construction success story. Although different outside consultants reviewed many areas of the project on behalf of intervenor groups, they were unable to recommend any major construction cost disallowances. The administrative law judges in Texas made a disallowance recommendation of $253 million, 8 percent of the project's total cost, based on what they termed imprudence and inefficiency in the construction process. The hearing examiners' finding that GSU had justified 92 percent of River Bend costs makes the commission's preliminary decision particularly disheartening.

With only a minuscule portion of River Bend costs reflected in our rates, the company's financial condition continues to be precarious and the threat of bankruptcy lingers. Special accounting orders from the regulatory commissions make our financial

condition appear much better than it actually is. Earnings for 1987 were $1.65 per share of common stock, compared to $1.71 in 1986, but the quality of the earnings is poor because of the non-cash accounting orders. Although reported net income for 1987 was $241 million, 162 percent resulted from the non-cash accounting orders. In terms of real cash, we are taking in much less than we are paying out. This cannot continue indefinitely.

Early in 1987, we received emergency rate increases in both states. Those actions, coupled with continuing cost cutting and cash conservation measures taken by the company, got us through 1987. Even with the court-ordered Louisiana rate increase, GSU will still have to borrow money to meet its financial responsibilities.

The rate news at the wholesale level is more positive. We have reached agreement in our River Bend plant-in-service case with all but one of our wholesale customers. It is significant that these agreements include no findings of River Bend imprudence.

The Dec. 15 rate decision in Louisiana was the latest in a series of negative rulings from that commission. It reinforced the perception among our Texas customers that Louisiana is not willing to pay its share, although River Bend provided many economic benefits to that state. Recognizing the problems created by the regulatory imbalance between Texas and Louisiana, I asked your board of directors to take steps that could lead to a restructuring of the company aimed at ensuring that each state is receiving the level of service to which it is entitled, based upon the amount of revenues it provides.

Such a restructuring cannot be achieved overnight. In fact, there is no precedent to tell us that it can be accomplished at all. But the problem is serious enough to make us try.

As you know, our financial condition did not allow the board of directors to authorize any dividend payments during 1987. As was the case at the May 1987 shareholders meeting, I still cannot tell you when dividends might be resumed. We also were unable to pay dividends on preferred and preference stock during 1987 and all of those omitted payments must be made up before common stock dividends can be resumed. Even if we obtain reasonable treatment from the Texas PUC, the road to financial recovery still will be a long and arduous one.

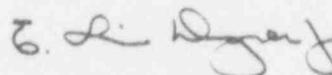
Aside from the rate cases, another key to regaining our financial health is the economy of our service area. The depressed state of the Gulf Coast oil and gas business, with high unemployment plaguing most of the area we serve, has been a major factor in the customer and political unrest swirling around the company. Provided we emerge from these rate cases with sufficient resources, GSU is going to place even more emphasis on trying to revitalize the area economy and bring in new jobs.

There are signs that the service area economy is stabilizing. The number of customers remained relatively stable in 1987 and kilowatt-hour sales declined only 1 percent from 1986 levels. This is much better than the 7 and 8 percent drop in sales for the previous two years and our corporate planning staff believes that the economy hit bottom in 1987 and that better times lie ahead.

For the first time in many years, Norman R. Lee's name will not be found in the list of GSU officers and directors. Mr. Lee, who retired as president and vice chairman of the board in November of 1986, stepped down as a director at the 1987 annual meeting. He is certainly missed. Also, Paul W. Murrill, who served as chairman of the board for five years, asked to be relieved of his duties as chairman in June and I was named his successor. Dr. Murrill continues to serve as my special advisor and remains on the board of directors. Sam F. Segnar, chairman of Houston-based Vista Chemical Co., joined our board of directors in February of 1988.

Finally, a few words are in order about the employees of your company. Like you, they are suffering. Although they have not had pay raises since 1986 and constantly work under tremendous pressure, they persevere. Times are tough for them and their families and we don't tell them often enough how much we appreciate them. But we do appreciate them, and it is their dedication, despite the adversity, that will see Gulf States through these difficult times.

Sincerely,



E. Linn Draper, Jr.
Chairman of the Board,
President and Chief
Executive Officer

March 1, 1988

Sales and Earnings

Overall electric sales declined by 1 percent during 1987. This was the slowest rate of decline since 1985, when Gulf States' kilowatt-hour sales recorded an 8 percent drop. This has been viewed by some economists as an indication that the economy in Southeast Texas and South Louisiana, hard-hit by the oil recession that began several years ago, has stabilized and that a slow recovery may be at hand.

During 1987, electric sales totaled 26.6 billion kilowatt-hours, compared with 26.9 billion kwh in 1986. Sales to industrial customers, who represent about 48 percent of GSU's annual electric sales, declined 3 percent from the previous year. This was primarily because two large customers displaced 84 megawatts with cogeneration. As a group, however, 40 of GSU's largest industrial customers increased their usage during the year. An experimental industrial rate aimed at combatting the loss of sales to cogeneration was credited with keeping 83 megawatts on the GSU system last year.

Residential sales increased slightly, commercial sales remained stable and wholesale sales dropped slightly.

Electric sales to other utilities were enhanced during the summer of 1987 through contracts with Florida Power & Light Co. and the Jacksonville Electric Authority in Florida. These off-system sales to other investor-owned utilities, rural cooperatives and municipal electric systems represent an area of business that the company will continue to pursue in 1988.

Operating revenues for the year were $1.4 billion, compared with $1.5 billion in 1986, down 3 percent. The decline can be attributed primarily to reduced fuel prices.

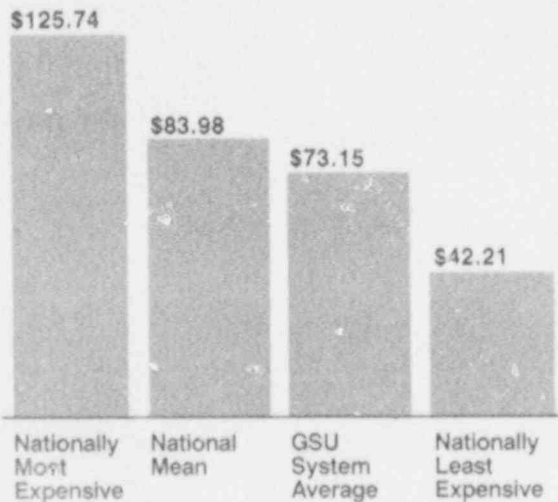
Earnings per share of common stock in 1987 were $1.65, contrasted with $1.71 for 1986. There were no common, preferred or preference stock dividends paid during the year because of Gulf States' financial condition.

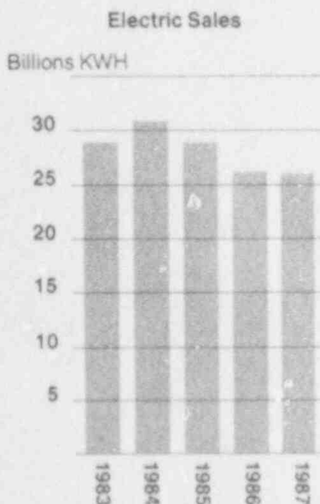
Although the company reported net income of $241 million for 1987, 162 percent, or $390 million, represents special non-cash accounting entries. Without the accounting entries GSU would show a net loss of $149 million for the year. The principal entries, in compliance with special accounting orders issued by the Texas and Louisiana regulatory commissions, include the deferral of River Bend nuclear power plant expenses and depreciation, the accrual of a carrying charge on the company's investment in the plant not yet included in the rate base and the cost of buying power from Cajun Electric Power Co-op's portion of the plant.

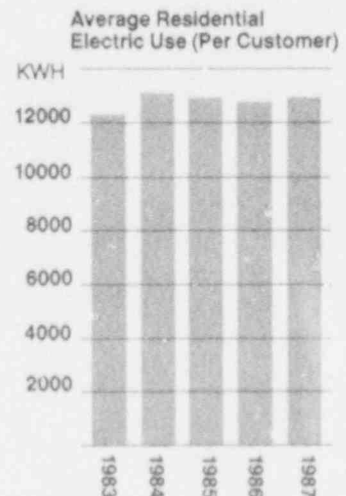
The earnings reported by the company, in accordance with generally accepted accounting principles and in view of the court appeal in Louisiana, do not include any provisions for Louisiana's share of the $1.4 billion disallowance of the company's investment in River Bend ordered by the Louisiana Public Service Commission (LPSC) in mid-December. The company is waiting for a decision from the Public Utility Commission of Texas (PUCT).

Financial Condition

Interim emergency rate increases granted by Texas and Louisiana regulators early last year, coupled with efforts on the part of management and employees to trim expenses and enhance cash flow, helped the company avert a financial crisis during 1987. However, the company's need for meaningful and permanent rate increases to improve cash flow continues, as GSU fights to avoid bankruptcy.







The company had projected a $211 million cash shortfall for 1988 if rates remained at Dec. 31, 1987, levels. Even with the rate increase ordered by the court in Louisiana, GSU will have to borrow money in order to meet its financial responsibilities.

Gulf States sold the oil and gas properties of its wholly-owned subsidiary, Houston-based Prudential Oil and Gas, Inc., to Moore McCormack Energy, Inc. of Dallas, effective July 1, for $22.5 million. After retiring production loans, net proceeds to the company were about $15.3 million, less any costs associated with phasing out Prudential's operations.

In February 1987, Moody's Investor Service, Standard & Poor's Corp. and other rating houses downgraded Gulf States' bonds and stocks further below investment grade. This action reflected the financial community's concern about the regulatory climate in the GSU service area.

Gulf States secured a $65 million line of credit through Irving Trust Co. in order to implement the interim rate increase in Texas. To secure the line of credit from Irving Trust, Gulf States had to agree to a number of conditions, including: high interest rates; no preferred or common stock dividend payments while the agreement is in force; a pledge of accounts receivable as collateral; and a lien to Irving on the Lewis Creek power plant in Texas. In June, the final steps were completed to provide Irving with a first mortgage on the power plant. A subsidiary of GSU, GSG&T Inc., was created to hold title to Lewis Creek. Through February 1988, no borrowing had been made under the Irving line of credit.

River Bend

The success experienced during River Bend's construction stage has continued with the efficient operation of the nuclear power plant. The plant has proven itself to be a "world class performer" during its commercial operation.

During 1987 alone, River Bend generated almost 5 billion kilowatt-hours of electricity. From Jan. 1 to shutdown in mid-September for refueling, the plant recorded a capacity factor of 85 percent, which is the actual generation as a percentage of its maximum capability. During the first three months of 1987, River Bend actually exceeded its rated capacity of 936 megawatts because of favorable weather and produced up to one-third of all the electricity generated by Gulf States. Even with the three-month refueling outage, the plant provided 15.2 percent of GSU's net generation for the year.

The successful first refueling itself was a major accomplishment for 1987 — completed in 103 days, compared with the national average of 106 days for domestic boiling water reactors (BWR). The next refueling is scheduled for the spring of 1989.

While River Bend's 151 days of continuous operations during the first fuel cycle placed the unit fourth among the 30 boiling water reactors in the United States, it set the world record for BWR's with the Mark 6 containment design.

From the time River Bend began producing electricity in December 1985 to the end of 1987, more than 8 billion kilowatt-hours have been generated.

In its first comprehensive assessment of River Bend since the plant went into commercial operation in June 1986, the Nuclear Regulatory Commission (NRC) continued its praise of the facility. The "report card," prepared by the NRC's Systematic Assessment of Licensee Performance (SALP) team, gave GSU the highest ratings, Category 1, in three key areas — plant operations; quality programs and administrative controls affecting quality; and training and qualification effectiveness. The seven other areas reviewed by the SALP team received Category 2 ratings, the second highest.

Four more of the 10 training programs at the site were accredited during the year by the Institute of Nuclear Power Operations (INPO). The remaining three programs are expected to be accredited later this year which will make GSU a full member of the National Academy for Nuclear Training, established by INPO to recognize accomplishments in the nuclear industry and to ensure the safe operation of U.S. nuclear plants.

Rates and Regulation

The engineering and managerial accomplishments of successfully building and operating River Bend were largely overshadowed by the protracted regulatory challenges to having the plant's costs reflected in the rate bases. While both Texas and Louisiana regulatory commissions granted interim emergency relief earlier in the year, the effort to achieve permanent and adequate rate relief continues.

Although the area economy appears to have stabilized, it has done so at an unacceptably low level. The region's economic troubles have been a contributing factor in GSU's financial and political problems, as well as in customer opposition to rate increases. Economic growth is crucial both to Gulf States and the region it serves. One of the company's primary goals is to meet its revenue requirements to the greatest extent possible through additional sales rather than increased customer rates. This is a longer-term solution to GSU's economic problems, however. In the meantime, adequate rate relief remains at the cornerstone of the company's financial recovery. In both states, the company proposed rate moderation plans that took into account the difficult economic times facing the region.

The Louisiana Rate Case. Gulf States filed a $202 million rate moderation case in Louisiana in July 1986. (This amount was later reduced to $194.3 million to reflect the effect of changes in federal tax laws.) In this filing, the company sought to ease the financial burden of higher electric rates on customers and the local economy through a plan to phase in the costs of River Bend over an eight-year period. Under this proposal, rate increases would occur during the first three years, followed by five years of stable rates in which costs deferred from the first years would be recovered.

In September 1986, the company asked the Louisiana Public Service Commission to grant $100 million in emergency rates to cover Louisiana's portion of 1987 projected cash operation and

maintenance expenses, including interest. On Feb. 24, 1987, on remand from a state district court, the LPSC voted to grant GSU $57 million in emergency rate relief.

Hearings on the company's application for $194.3 million in permanent relief, which includes the $57 million in emergency rates, opened last March 30. Subsequent hearings and meetings were conducted on a sporadic basis until Dec. 15. Rejecting its own staff recommendation of a 10-year rate moderation plan with a $92 million first-year rate increase, the LPSC, on a 3-[illegible] vote, allowed only a $63 million permanent rate increase with no qualified phase-in plan to recover deferred costs, disallowed as imprudent $1.4 billion of GSU's 70 percent share of River Bend costs on a system-wide basis and set a 12 percent return on common equity. The disallowance proposal was based on the contention that a lignite-fueled plant should have been built instead of River Bend.

The company appealed all major aspects of the rate order to the state district court in Baton Rouge, saying that the proposed $1.4 billion disallowance — one of the largest rendered in any proceedings in the United States — would severely impair GSU's hopes for financial recovery and that the record and the facts clearly do not support a disallowance. On Feb. 18, the court ordered immediate implementation of a $92 million first-year rate increase in Louisiana, which includes the $63 million increase granted by the commission. The court also set a return on common equity of 14 percent, compared to the 12 percent figure approved by the commission. Other major aspects of the commission's decision — including the disallowance of $1.4 billion in River Bend costs on a system-wide basis — remain on appeal. However, the $92 million rate increase will remain in effect while the various issues on appeal are being decided.

Texas Rate Case. In Texas, the company remains mired in the longest rate proceedings in state history.

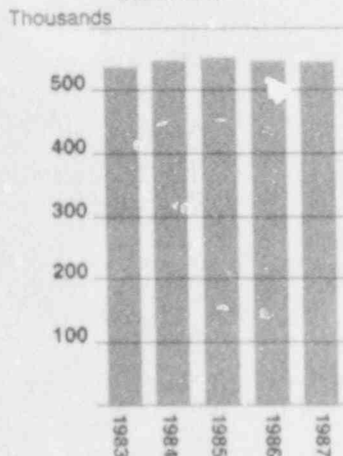
On Nov. 18, 1986, Gulf States filed a $144.1 million rate case with the Public Utility Commission of Texas and asked that $82 million be granted immediately on an emergency basis.

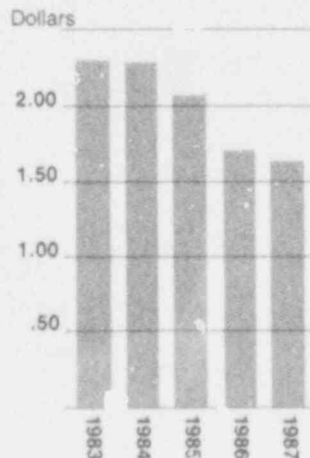
As with the Louisiana filing, the company's permanent case called for an eight-year rate moderation plan.

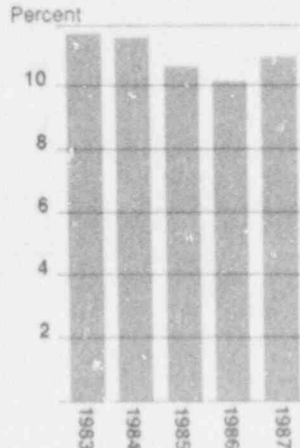
On Feb. 3, 1987, the commissioners granted $39.9 million in emergency relief, contingent upon the company securing a $250 million line of credit. This stipulation was later modified to allow the interim rates to be put into effect when GSU could demonstrate that it could provide assurance of obtaining $250 million from sources other than Texas ratepayers.

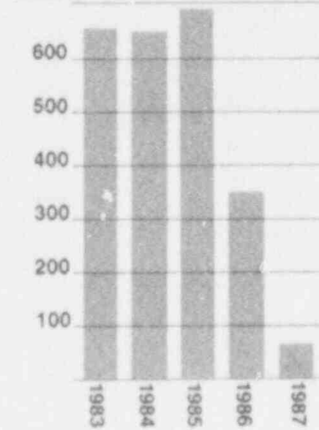
By the end of March, GSU submitted a $266 million financial plan to the PUCT which included a $65 million line of credit provided by Irving Trust Co., $57 million in interim rates in Louisiana, $47 million in reductions to the 1987 construction budget, $20 million from pollution control bond trust fund deposits, $13 million in new revenue from a rate case settlement with wholesale customers and $64 million in omission of preferred and preference dividends. The commissioners voted 2-1 to accept the company's proposal.

Hearings on the company's permanent rate case started on March 23 and lasted through Sept. 15. This was the lengthiest, and probably the most complex, case heard by the PUCT in its 12-year history. It was the first time the commission had dealt with inclusion of a major part of a nuclear power plant in the rate base of a Texas utility. The hearings stretched









through 118 days, plus 10 days devoted to the emergency rate case. In all, 88 witnesses, 44 representing Gulf States, testified.

In December, the administrative law judges who presided over the case presented their recommendations. They found that the decision to build River Bend was prudent and that the company was entitled to a first-year increase of $86.8 million, with $274 million of River Bend costs to be disallowed because this amount was imprudently or inefficiently incurred during construction of the plant. That disallowance was later recalculated to be $253 million.

The administrative law judges also proposed a 10-year rate moderation plan with three additional smaller rate increases and recovery of the deferred costs over the final six years of the plan.

The PUCT was scheduled to render a decision by Jan. 11, 1988, but the commissioners raised additional questions they believed might warrant more testimony and urged Gulf States and the intervening parties and staff to reach a negotiated settlement to avoid any court contests. Additional hearings were held in February, with more tentatively scheduled for early March. On Feb. 23, the commission issued a series of preliminary decisions regarding treatment of River Bend in the rates. The impact these decisions will have on Texas rates was not immediately clear, but preliminary indications were that they would not produce an adequate level of revenue. The commission held that $1.6 billion of GSU's share of River Bend costs can be placed in the rate base, along with $187 million of the Texas retail jurisdiction's deferred River Bend costs. The remaining $1.5 billion of plant costs and $151 million in deferrals are to be set aside and not allowed in the rate base now. However, the commission said it would reconsider the set-aside costs at some future time. Two of the three commmissioners contend that the company did not meet its burden of proof concerning the increase in the cost of River Bend.

Federal Regulation. Gulf States sells power wholesale to four rural cooperatives and seven municipalities in Texas and Louisiana. The company and 10 of its wholesale customers have settled a rate case filed with the Federal Energy Regulatory Commission (FERC) in 1986 that reflects River Bend costs in wholesale rates. Under the terms of the settlements, which have been approved for the majority of wholesale customers by the FERC, wholesale rates are increased by 24 percent from 1986 through 1989 and 14 percent, 10 percent and 7.4 percent respectively through 1992.

Economic Development — Key To Financial Recovery

Gulf States Utilities' involvement in area economic development is almost as old as the company itself. Within the last few years — in the face of the severe downturn in the oil, gas and petrochemical industries — the need for economic development has taken on even greater importance. Development of a diversified, expanded economic base is critical to rebuilding the region.

Since GSU is tied so closely to the area it serves, the company's financial problems and those of the area are almost inseparable. Rate increases, as discussed earlier, are at best a stopgap measure on the road to financial recovery. In the long run, increasing the number of customers we serve and selling them more of our commodity — electricity — is the answer. And a wider customer base and the permanent jobs it provides, lessens the need for future rate increases.

In short, GSU must sell its way into financial stability.

The area of Southeast Texas and South Louisiana Gulf States serves offers a new business or industry a wealth of natural resources, skilled labor, a nationally central location, reasonable energy costs, good transportation facilities and a stable business climate. The Gulf States Business Development Group works directly with communities and business prospects considering our area. The job of the 11 fully-trained economic development specialists is to match the right prospect with the right community.

Through national advertising and area promotion, special business data and information services, community marketing programs and incentive electric rates for new or expanding businesses in the region, GSU is attracting new industry and jobs.

The Economic Development Data Center contains the Southwest's most complete and up-to-date information on business development in the Gulf Coast region. This service assists cities and qualified private groups in creating proposals and presentations for business prospects, provides community profiles and data on buildings, sites, industrial parks and commercial buildings available for economic development use.

Our exclusive Computer Analysis of Buildings and Sites (CABS), available through the center, can quickly provide a

The settlement rates will produce lower revenues than those the FERC would have allowed the company to implement under bond in August 1986. However, it is significant that these rates reflect the wholesale customers' share of River Bend costs. With the River Bend question settled, the wholesale customers should have relatively stable rates for the foreseeable future. As part of the settlement, Gulf States has agreed to provide a portion of the wholesale customers' energy at a lower rate that keeps the company competitive with other wholesale power suppliers.

Also extended to wholesale customers was an incentive rate to encourage growth, similar to the economic development rate for GSU's qualifying retail customers. The incentive rate gives these municipalities and cooperatives another tool to use in attracting new business and industry.

Negotiations are continuing with the one wholesale customer that has not agreed to the settlement. This customer represents less than 1 percent of Gulf States' wholesale load.

The Southern Co. Suit. An administrative law judge for the FERC in May denied Gulf States' request to terminate or modify its 1982 contracts for power purchased from the Southern Co. The company has filed exceptions to the law judge's report and is awaiting a final decision [illegible] FERC. A negative decision would, in all likelihood, be appealed to the federal courts.

In other action regarding the Southern Co., the 5th U.S. Circuit Court of Appeals in late August ruled that the federal district court has jurisdiction over certain matters despite Southern's claim that all matters should be decided by FERC.

Gulf States filed the lawsuit and the petition with FERC in 1986, alleging the Southern Co. had failed and refused to negotiate in good faith changes in the purchased power agreements, as required by the terms of the contracts. GSU contends that its obligations under the contracts have been terminated by reason of breach of contract by the Southern Co. and for other reasons.

In another legal matter, an agreement in principle was reached on Feb. 8, 1988, to settle eight class-action lawsuits filed on behalf of shareholders against the company and a group of its officers, directors and several investment banking firms and to settle a derivative lawsuit filed against a group of officers and directors. In agreeing to settle the case, the company and other defendants continue to deny all charges. The settlement is designed to avoid addi-

business prospect with information on a particular type of facility. CABS can provide data and photos on available buildings, including sizes, locations, ages, condition of the buildings and lease or sale prices. If an appropriate site can't be found in one city, CABS can quickly locate another within the 28,000 square-mile GSU territory.

GSU also provides community profiles to help businesses determine a suitable location. The profile includes community population, labor analysis, tax structures, government, financial institutions, education, climate, major employers and medical facilities.

The "Team Cities" program brings members of the public and private sectors together to promote the development of individual cities. The program offers direction to a city's economic development goals by designating communities that are prepared to meet the needs of new business and industry. Team Cities provides community assessment, short and long range goals, selection and training of a community marketing team and, ultimately, designation as a Team City.

Innovative rates have been designed to promote economic development and to retain existing industrial load. Several new rates offer industries options by: giving qualified industrial customers electricity competitively priced with cogeneration; providing a discount to companies that increase their number of permanent, full-time employees; providing incentives for existing customers to increase electricity use over their present capacity; and providing a competitive rate to industrial customers that locate adjacent to a self-generating industry.

These economic development efforts paid off in new industries and jobs during 1987. Last year, 58 manufacturing industries either located or expanded within Gulf States' service area. These firms created approximately 3,700 permanent jobs for the region. New and expanding small businesses created about 2,200 permanent jobs.

Industries that located or expanded with GSU's help last year represent a diversification that will broaden the economic base of the area. These include a manufacturer of offshore equipment, two seafood processing plants, a gasket manufacturer, a kiln drying operation, a piping fabricator, a fruit and dairy products processing operation, a floor tile maker and a heating and air conditioning equipment manufacturer.

Additionally, construction of three state prisons in the GSU service area will create approximately 1,000 more jobs.

These are welcome, positive signs of a rebounding local economy and with it, a more financially secure Gulf States.

tional expense and inconvenience associated with protracted litigation of this kind. The agreement provides for the creation of a $6.5 million settlement fund, most of which will come from insurers over and above the applicable deductable amounts. Payments will be made to those who purchased GSU common stock during an agreed upon period in the past and who apply to participate in the settlement. Eligible shareholders will be notified after the final settlement is filed and approved by the federal court. This is expected to be in April.

General Operations

Although the company focused a great deal of attention on rate cases for virtually all of 1987, Gulf States has not lost sight of the fact that its primary business is making and selling electricity. A more detailed discussion is found elsewhere in this report of the company's renewed efforts to better market electricity, with the emphasis on economic development.

Unit 4-A gas turbine at Louisiana Station in Baton Rouge, formerly the No. 7 peaking unit at Nelson Station near Lake Charles, went into commercial operation on July 26. The unit was moved from one side of the state to the other to serve the large Exxon refinery and chemical complex with both steam and electricity. Gulf States employees managed the project from start to finish, providing the engineering and design work and supervising contractors.

Project CARE — Community Assistance Relating to Energy — the company's program to aid elderly customers in meeting energy bills during a financial emergency, is entering its fifth year. During 1987, funds donated by employees and customers to the project helped 5,688 elderly households in Texas and Louisiana pay their electric, gas, propane and butane bills. Contributions from all sources during the year totaled about $317,000.

A new customer assistance program — the Gatekeeper Program — was begun during 1987. Gulf States employees who have a great deal of public contact — meter readers, for example — are trained to identify what could be physical, emotional or economic problems of our older customers. Information gathered during employee contacts with customers is passed on to the state, county or regional agency primarily responsible for assisting the elderly. The professional staff at this agency then sees to it that the appropriate health or social service agency makes contact before a real crisis develops for one of our customers.

At the end of 1987, Gulf States had about 4,800 employees. This is compared to the 5,200 employed at the end of [illegible]5 following construction of River Bend. Th[illegible] freeze and early retirements offered in 1986, [illegible] attrition and the elimination of all but the n[illegible]cal unfilled positions helped reduce the work forc[illegible]

The company's employment practices are guided by the principles of equal opportunity for all. Affirmative action programs have enabled Gulf States to attract and retain skilled personnel from all community sectors. Fair employment practices and policies help the company develop its human resources to more effectively serve its customers.

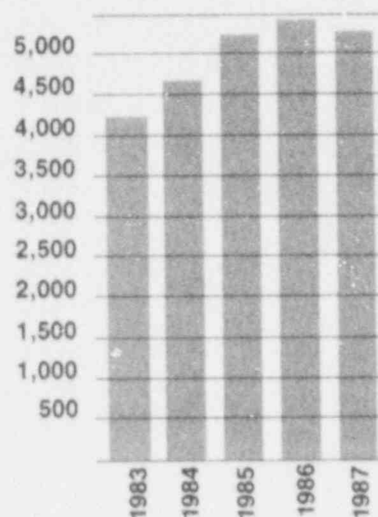
Management Changes

On June 4, the board of directors named E. Linn Draper, Jr. chairman of the board, in addition to his duties as chief executive officer and president. Paul W. Murrill requested to be allowed to step aside as board chairman after more than five years and recommended that Draper be named as his successor. Murrill remains as special advisor to the chairman and a member of the board.

Sam F. Segnar, chairman of Vista Chemicals Co. of Houston, was elected to the board of directors of Gulf States on Feb. 4, 1988. He also serves on the boards of First City Bancorporation of Texas, Hartmarx Corp. of Chicago, Textron Inc. of Providence, R.I., Seagull Energy Corp. of Houston and Becor Western Inc. of South Milwaukee, Wis.

Amery J. Champagne, formerly general manager of energy supply, was made vice president for energy resources in April. He assumed most of the responsibilities of George McCollough who retired as senior vice president for energy and planning.

In July, the board selected James E. Moss to become the company's vice president of marketing. James D. Watkins was appointed division vice president for Baton Rouge, replacing Moss.



The foregoing portion of this report is intended to present information the company believes may be of interest to shareholders. For purposes of making investment decisions, the more complete information contained in the company's Annual Report on Form 10-K and other current reports filed with the Securities and Exchange Commission should be consulted.

FINANCIAL SECTION

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Management Responsibility for Financial Statements

Management is responsible for the preparation, integrity, and objectivity of the financial statements of Gulf States Utilities Company. The statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and, in some cases, reflect amounts based on estimates and judgment of management, giving due consideration to materiality.

The Company maintains a system of internal controls designed to help give reasonable assurance that the books and records properly reflect the transactions of the Company and that established policies and procedures are followed. Internal control systems are subject to inherent limits in recognition of the need to balance their costs with the benefits they produce. The Company's management strives to maintain this balance.

Coopers & Lybrand, independent certified public accountants, are engaged to examine, in accordance with generally accepted auditing standards, the financial statements of the Company and issue a report thereon, which appears on page 40. Such auditing standards include a review of internal accounting controls, tests of transactions, and other procedures sufficient to provide reasonable assurance that the financial statements are neither materially misleading nor contain material errors.

The Board of Directors, through its Audit Committee, has general oversight of management's preparation of the financial statements and is responsible for engaging, subject to shareholder approval, the independent accountants. The Audit Committee, comprised entirely of outside directors, reviews with the independent accountants the scope of their audits and the accounting principles applied in financial reporting. The Audit Committee meets regularly, both separately and jointly, with the independent accountants, representatives of management, and the internal auditors, to review activities in connection with financial reporting. The independent accountants have full and free access to meet with the Audit Committee, without management representatives present, to discuss the results of their examination and their opinion on the adequacy of internal accounting controls and the quality of financial reporting.

Common Stock Prices and Cash Dividends Per Share

For the years ended December 31

1987	High	Low	Cash Dividends Paid Per Share	1986	High	Low	Cash Dividends Paid Per Share
First Quarter	$ 10	$ 7¼	$—	First Quarter	$ 15	$10⅝	$ .41
Second Quarter	8⅝	7⅛	—	Second Quarter	13	7⅝	.26
Third Quarter	8⅛	7	—	Third Quarter	9¾	7⅛	—
Fourth Quarter	7¾	4¾	—	Fourth Quarter	8⅝	7	—

The Common Stock of the Company is listed on the New York, Midwest and Pacific Stock Exchanges. The approximate number of common shareholders on December 31, 1987, was 78,387.

Financial Information

Selected Financial Data
(In thousands except per share amounts and ratios)

For the Years Ended December 31	1987	1986	1985	1984	1983
Operating Revenue	**$1,432,586**	$1,478,388	$1,858,436	$1,547,041	$1,436,188
Income from Continuing Operations	**242,605**	273,459	277,764	260,673	231,202
Income Applicable to Common Stock	**178,091**	181,854	205,362	202,511	180,747
Earnings Per Average Common Share Outstanding from Continuing Operations	**1.66**	1.98	2.22	2.33	2.33
Dividends Per Share of Common Stock	**—**	.67	1.64	1.64	1.62
Return on Average Common Equity	**9.29%**	10.49%	13.05%	14.42%	14.78%
Ratio of Earnings to Fixed Charges	**1.84**	1.92	2.18	2.38	2.46
As of December 31					
Total Assets*	**$6,677,057**	$6,338,939	$5,779,681	$5,084,437	$4,517,406
Long-Term Debt and Preferred Stock Subject to Mandatory Redemption	**3,090,977**	3,128,650	2,782,112	2,347,648	2,040,295
Capital Leases (Current and Non-current)	**187,640**	228,270	223,734	197,593	167,882
Book Value Per Share	**18.70**	16.79	16.02	15.79	15.73
Capitalization Ratios:					
Common Shareholders' Equity	**37.8%**	35.0%	35.4%	36.6%	36.6%
Preferred and Preference Stock	**11.1**	10.8	11.4	11.8	12.3
Long Term Debt	**51.1**	[illegible] 2	53.2	51.6	51.1
	100.0%	100.0%	100.0%	100.0%	100.0%

See Notes 1 and 3 to the Financial Statements regarding outstanding contingencies, current rate matters involving possible disallowances and write-offs and new accounting standards effective in 1988.
*Restated for accounting change — see Note 6 to the Financial Statements.

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

In reviewing this Management's Discussion and Analysis and the financial statements of the Company, special attention should be given to the disclosure that the Company may have to seek relief from its creditors under the Bankruptcy Code during 1988. Further, the results reported in 1987 and 1986, are not indicative of results expected to be reported in 1988, and subsequent periods. Special attention should be given to the fact that the results reported in 1987 and 1986, do not take into account the impacts of the rate order issued by the Louisiana Public Service Commission (LPSC) on December 15, 1987, now on appeal, and the rate order under consideration by the Public Utility Commission of Texas (PUCT). The Company presently believes that the LPSC order, unless substantially modified as a result of the appeal, and the application of new accounting standards, will result in very substantial write-offs and charges that will result in substantial net losses being reported in 1988, and subsequent periods, and substantial adverse adjustments to the capital accounts of the Company. For recent developments in the Louisiana rate proceedings, regarding the issuance of a preliminary injunction on February 18, 1988, see Note 14 to the Financial Statements. Additional substantial write-offs, losses, and adjustments would result from an adverse final PUCT order. For recent developments in the Texas rate proceedings, regarding prudency issues, see Note 14 to the Financial Statements. Reported results for 1987 and 1986, reflect the effects of accounting orders relating to River Bend Unit 1 (River Bend) which were issued by the respective commissions. All matters should be considered in light of these special accounting treatments and the transition from the prior accounting orders to the accounting to be required as a result of the permanent rate orders and requirements under new accounting standards. This Discussion and Analysis and the Notes to the Financial Statements are based upon information available as of the time they were released for printing. Retail rate proceedings were in a very active status at such time. Very significant developments may occur during the printing and distribution period as well as

thereafter. Readers are urged to investigate and consider such subsequent developments.

Financings and Capital Resources

The Company's financial condition continued to deteriorate during 1987. Inadequate permanent rate relief, operating costs of River Bend, buybacks of power from Cajun Electric Power Cooperative, Inc's. (CEPCO) share of River Bend, increased financing costs, payments for nuclear fuel, payments under deferred construction agreements, and debt maturities, as well as other pressures, have resulted in an ongoing need for cash which is expected to exceed the presently estimated cash resources of the Company. There can be no assurance that such needs can be met. In addition, significant contingencies exist which could not be met with current cash resources. The Company presently estimates that its cash resources could reach an insufficient operating level during the first half of 1988, without adequate permanent rate relief and financing, neither of which can be assured. Even if adequate rate relief is obtained, further external financing would be necessary.

The Company's ability to obtain financing through the issuance of debt securities and preferred and preference stock is materially affected by the credit ratings assigned by rating agencies. During 1986 and 1987, rating agencies downgraded the Company's long-term debt and preferred and preference stock to "speculative" grade. As a result, certain security markets are currently unavailable. Also, in January, 1988, the Public Service Company of New Hampshire, an investor-owned utility owning an interest in the nonoperating Seabrook nuclear generating plant, filed for relief under Chapter 11 of the Bankruptcy Code. Such development may adversely affect the marketability of any securities issued by the Company.

The failure to declare dividends on preferred and preference stock during 1987, and the omission of common dividends since the second quarter of 1986, make it highly unlikely that additional shares of such stock could currently be marketed. At December 31, 1987, based upon the results of operations for the year then ended, and existing circumstances, the Company is unsure whether it is able to meet coverage requirements necessary for the issuance of additional first mortgage bonds as specified in the Company's Mortgage Indenture or for the issuance of preferred stock as specified in its Restated Articles of Incorporation. It is also unsure whether such bonds or preferred stock could be marketed regardless of whether or not coverage requirements were met. External intermediate or long-term financing may only be available through issuance of unsecured or subordinated lien debt securities if, and to the extent, they can be marketed. As discussed in Note 11 to the Financial Statements, the Company's revolving credit agreement, with an unused balance of $450 million, is not available as an additional source of financing due to notification by the major banks involved in the agreement that a "material adverse change" has occurred and funds will no longer be advanced under the agreement. The Company has available unsecured short-term lines of bank credit of approximately $12 million at December 31, 1987. However, there can be no assurance that existing short-term lines of credit can be accessed or that they will remain available. See Note 12 to the Financial Statements for information regarding a $65 million credit facility available to the Company. The Company may have to seek relief from its creditors under the Bankruptcy Code during 1988, if it is unable to obtain adequate permanent rate relief, additional financing, or other sources of funds or deferrals of cash requirements.

Results Of Operations

The Company's 1987 and 1986 net income has been affected by the receipt of accounting orders issued in 1986 by regulators in Texas and Louisiana, pending completion of the Company's current retail rate cases. The accounting orders result in the Company deferring, for financial reporting purposes, the retail portion of those expenses incurred in connection with the operation of River Bend and the costs of buying back power from CEPCO and recording non-cash carrying charges on the Company's investment in the unit not already reflected in rate base. The rate (net of tax) used to compute the carrying charges was increased from 9.75 percent to 10 percent at the beginning of the second quarter of 1987, and was increased to 10.25 percent at the beginning of the fourth quarter of 1987, to reflect the increased cost of capital of the Company. The Company is also recording a reduction to the deferred River Bend costs, as discussed in Note 3 to the Financial Statements, and has started to amortize the accumulated deferred River Bend costs for the Louisiana jurisdiction over a ten year period. Additionally, in accordance with the

terms of a rate moderation plan approved for the majority of the Company's wholesale customers by the Federal Energy Regulatory Commission (FERC), the Company is recording in the Statement of Income a deferred revenue requirement representing those River Bend costs which are applicable to wholesale customers and which have been deferred for later recovery under the provisions of the rate moderation plan. These items (net of the related tax effects) have increased the Company's 1987 and 1986 net income and earnings per share as follows:

	For the Twelve Months Ended December 31, 1987		December 31, 1986	
	Effect on Net Income	Effect on EPS	Effect on Net Income	Effect on EPS
	(In thousands except per share amounts)			
Deferred River Bend expenses	$168,573	$1.56	$ 93,821	$ .88
Deferred revenue requirement	15,862	.15	7,264	.07
Amortization of accumulated deferred River Bend costs	(1,431)	(.01)	—	—
River Bend carrying charges	263,988	2.44	132,768	1.25
Reduction of deferred River Bend costs	(56,938)	(.53)	—	—
	$390,054	$3.61	$233,853	$2.20

Without the inclusion of the above items in the Company's Statement of Income, the Company would have reported a net loss in 1987 of $148,953,000 and net income of only $11,128,000 for 1986. The deferred items described above include substantial cash expenditures which were not recovered in 1987 and 1986, and there can be no assurances such expenditures will ultimately be recovered. The discussion below provides information on significant items which also affected the Company's results of operations during the period from 1985 through 1987.

Operating Revenue

Operating revenue declined by 3 percent during 1987, as compared to 1986. This decline followed a decrease of 20 percent during 1986, and an increase of 20 percent during 1985. The components of the changes in operating revenue are detailed below:

	Increase (Decrease) From Prior Year		
	1987	1986	1985
	(In thousands)		
Change in base rates	$ 68,433	$ (49,120)	$ 34,388
Fuel cost recovery	(99,592)	(307,255)	289,677
Sales volume and other	(14,643)	(23,673)	(12,670)
	$ (45,802)	$ (380,048)	$311,395

Rates. The changes in base rates shown above reflect rate orders and/or settlement agreements implemented during the period from 1985 through 1987.

During 1987, the Company implemented retail interim rate increases in both Texas and Louisiana. On April 7, 1987, the Company implemented an annualized interim rate increase of $39.9 million in Texas. On March 5, 1987, the Company implemented a $57 million annualized emergency rate increase in Louisiana, which remained in effect until December 15, 1987, when the LPSC granted the Company a $63 million permanent rate increase which the Company is appealing. For recent developments in the Louisiana rate proceedings, see Note 14 to the Financial Statements. For the year ended December 31, 1987, the Company billed $31,959,000 and $46,958,000 in interim rate relief in the Texas and Louisiana jurisdictions, respectively.

During 1986, the Company placed into effect an $80 million base rate decrease as part of a settlement agreement with its Texas retail customers. Additionally, in August, 1986, the FERC granted the Company a $26 million wholesale rate increase, subject to hearing and refund, in connection with the commercial operation of River Bend. However, as more fully detailed in Note 3 to the Financial Statements, the Company subsequently reached a settlement agreement with most of its wholesale customers, which has been approved for the majority of the Company's wholesale customers by the FERC, and placed into effect, rates which will result in revenues lower than those originally authorized by the FERC.

During March, 1985, the Company reached an agreement with its wholesale customers which resulted in an $18.55 million increase in wholesale rates. The Company had initially implemented a $29.3 million rate increase as authorized by the FERC in September, 1984, subject to hearing and refund. In July, 1985, the FERC authorized the Company to place into effect a $15.7 million rate increase applicable to transmission service customers. Additionally, during 1985, the Company placed into effect a $1.1 million retail rate reduction previously ordered by the LPSC in December, 1983.

Kilowatt-Hour Sales. The Company's 1987 kilowatt-hour sales declined by 1 percent compared with 1986. A decline in sales to industrial customers comprised virtually the entire 1987 decline, however, partially

offsetting the total decline was a 1 percent increase in sales to residential customers. The industrial sales decline reflects the depressed condition of the petroleum based economy in the Company's service area, which has continued for the past three years, as well as the loss of certain industrial customers who have converted to cogeneration. See the Statistical Summary on Page 41 for information on kilowatt-hour sales and related revenues by customer class.

The Company's 1986 kilowatt-hour sales declined by 7 percent as compared to the prior year. Kilowatt-hour sales to industrial and wholesale customers accounted for approximately 89 percent of the total sales decline. The decline in industrial sales originates from the reasons previously described. The decline in wholesale sales has resulted primarily because of the transfer of certain wholesale customers to a transmission service rate schedule during the second half of 1985.

During 1985, kilowatt-hour sales declined by 8 percent and the decline in sales to industrial and wholesale customers accounted for most of the overall sales decline. These declines again reflected the depressed economic conditions impacting the Company's industrial customers and the transfer of certain wholesale customers to a transmission service rate schedule. The sales declines in 1985, were offset in part by increased commercial sales caused primarily by customer growth.

Operating Expenses and Taxes

Fuel and Purchased Power. Fuel expense decreased 10 percent during 1987, when compared with 1986. The decline in fuel results from lower fuel prices, offset slightly by increased generation. The 10 percent decrease in the Company's average fuel cost highlights the continued decline in the price of natural gas as well as the low cost of nuclear fuel, which was utilized more extensively in 1987 than in 1986. Fuel expense declined by 21 percent during 1986, after increasing 36 percent during 1985. The decline in fuel expense was the result of lower fuel prices offset by increased generation. During 1986, the Company's overall system fuel cost declined by 34 percent, primarily as a result of the decline in the price of natural gas, the Company's primary fuel source. Kilowatt hour generation increased 19 percent during 1986, and reflected the increased utilization of River Bend and the decreased utilization of purchased power to meet load requirements. The increase in fuel expense during 1985, as compared to 1984, was caused by increased fuel prices resulting from the expiration of a low cost natural gas contract. The average cost per kilowatt-hour of natural gas increased from 1.50 cents during 1984, to 3.11 cents during 1985. The effect of the increased fuel prices was mitigated by reduced generation requirements caused by decreased sales, increased power purchases under long-term contracts, and the increased utilization of the Company's less expensive coal-fired generation.

Purchased power expense decreased 7 percent during 1987, primarily as a result of decreased kilowatt-hour purchases reflecting reduced load requirements, cessation of capacity payments to the Southern Company during 1986, and the increased utilization of River Bend to meet existing load requirements. This increase was offset in part by increased capacity costs associated with the CEPCO buyback. As discussed previously and in Note 3 to the Financial Statements, the CEPCO buyback cost has generally been deferred under accounting orders. Purchased power expense declined by 23 percent during 1986, primarily as a result of decreased kilowatt-hour purchases reflecting reduced load requirements, cessation of certain payments to the Southern Company during the last half of 1986, the availability of lower cost natural gas for use in Company-owned units, and the increased utilization of River Bend to meet load requirements. Purchased power expense increased by 67 percent during 1985, as a result of additional kilowatt-hour purchases made to displace the higher cost of fuel for Company-owned generation.

Other Operations and Maintenance Expense. Other operations and maintenance expense, excluding those associated with River Bend, decreased 6 percent during 1987. Other operations and maintenance expense, excluding those associated with River Bend, increased approximately 1 percent, during 1986 and 1985. The 1986 increase was primarily the result of an $8.9 million provision for pension benefits recorded in connection with the Company's early retirement plan offered during 1986, offset by a reduction in the amount and price of gas purchased for resale and the efforts of the Company to save cash.

Other operations and maintenance expense related to River Bend increased during 1987,

as compared to 1986, due to the full year of commercial operation and the fuel reloading outage which occurred in the last part of 1987. Other operations and maintenance expense related to River Bend increased during 1986, as compared to 1985, due to the commercial operation of River Bend in 1986. As discussed previously and in Note 3 to the Financial Statements, these expenses have been generally deferred under accounting orders.

Depreciation Expense. Depreciation expense, excluding depreciation and decommissioning expenses recorded on River Bend, increased 8 percent during 1987, as compared to 1986, due primarily to the reversal of Big Cajun 2 Unit 3 depreciation in 1986, as discussed below. Depreciation expense, excluding depreciation and decommissioning expenses recorded on River Bend, decreased by 3 percent during 1986, as compared to 1985, primarily as a result of the reversal of approximately $7 million of depreciation expense previously recorded on Big Cajun 2 Unit 3, offset by depreciation expense on routine plant additions. Pursuant to the settlement of the Company's Texas rate case in June, 1986, Big Cajun 2 Unit 3 was not considered as plant-in-service for ratemaking purposes in Texas and, consequently, depreciation expense on the unit was not being recovered. The Company interpreted the settlement agreement as allowing the reversal of previously recorded depreciation.

Depreciation expense related to River Bend increased during 1987, as compared to 1986, due to the full year of commercial operation. Depreciation expense related to River Bend increased during 1986, as compared to 1985, due to the commercial operation of River Bend in 1986. As discussed previously and in Note 3 to the Financial Statements, these expenses have generally been deferred under accounting orders.

Taxes. Income taxes increased dramatically during 1987, due to the tax effect of deferring certain River Bend-related operations and maintenance expenses and capacity buyback costs for the entire year of 1987, in accordance with regulatory accounting orders, versus capitalizing the operations and maintenance expenses in 1986, prior to commercial operation and deferring them subsequent to June 16, 1986. Capacity buyback costs were not incurred prior to commercial operation. Income taxes decreased by 105 percent during 1986, after a decline of 48 percent during 1985. The declines during 1986 and 1985, reflect lower amounts of taxable income. Other taxes have increased as a result of higher franchise and revenue-related taxes.

As discussed in Note 4 to the Financial Statements, the 1986 Tax Reform Act contains several provisions which impact the Company. Total federal income tax expense is expected to be less under the new law, as compared to the old law, as the effect of the tax rate reduction is likely to exceed the increased tax charges from other provisions of the new law. In 1987, this effect was not significant. While the Company's cash payments for federal income taxes were not affected in 1987, they may be higher under the new law in the near term, primarily due to the new alternative minimum tax. Additionally, internal cash generation is likely to decrease primarily as a result of reduced deferred tax charges due to the new law's lower tax rates.

Non-Operating Items

Allowance for Funds Used During Construction (AFUDC) and River Bend Carrying Charges. The total of AFUDC and carrying charges on the River Bend investment increased by 10 percent during 1987, as compared to 1986. This compares to increases of 16 percent during 1986, and 34 percent during 1985. These increases are primarily the result of increases in the amount of construction work in progress (CWIP) qualifying for AFUDC through the commercial operation date of River Bend and the subsequent recording of carrying charges on both the plant investment in River Bend not allowed in the Company's rate base by the PUCT and LPSC and the cash portion of deferred expenses recorded pursuant to accounting orders.

Reduction of Deferred River Bend Costs. As a result of the interim rate relief granted in both Texas and Louisiana retail jurisdictions in 1987, the Company has reduced the amount of deferred River Bend costs being recorded in accordance with accounting orders issued in 1986 by the regulatory commissions. This amount reflects a reduction of $1.50 (Texas) and $1.00 (Louisiana) for each $1.00 of revenue received as a result of the interim rate increases. Such adjustment is required since the Commissions, as a result of granting interim rate relief, have allowed some River Bend costs (on a non-specific basis) to be collected through rates rather than being deferred.

Other-Net. Other-net decreased during 1987, as compared to 1986, due to decreased interest income earned on temporary cash investments. During 1986, other-net increased when compared to 1985, due to increased interest income earned on temporary cash investments.

Interest Charges. During 1987, interest on long-term debt increased due to the interest requirement on increased debt and requirements on first mortgage bonds issued during 1986. Interest on short-term debt and other interest expense increased due to the required payment of interest on unused nuclear fuel. Prior to 1987, such interest was capitalized as part of the Company's nuclear fuel lease. For additional information regarding the Company's nuclear fuel lease, see Note 6 to the Financial Statements.

Increased interest on long-term debt during 1986 and 1985, resulted from interest requirements on new borrowings made to refund short and intermediate-term debt incurred in connection with the Company's construction program. These increases were offset in part by lower interest rates on short and intermediate-term debt.

Discontinued Nonutility Subsidiary Operations. The losses recorded in 1987, 1986, and 1985, were incurred by Prudential Oil and Gas, Inc. (Prudential), a wholly-owned subsidiary of the Company. These losses resulted from the write-off of costs recorded in the subsidiary's full cost pool. Such write-offs were necessitated by declines in the price of oil experienced during 1985 and 1986. For information regarding the sale of Prudential's oil and natural gas reserves in 1987, see Note 7 to the Financial Statements.

Effects of Inflation

The effects of inflation upon the Company have been less in the period 1985 through 1987, than in the preceding three-year period because the rate of inflation has declined. This decline is evidenced by the minimal growth in the Consumer Price Index over the period from 1985 to 1987. However, over the longer term, inflation has had serious effects on the Company's financial position. During periods of high inflation, provisions for depreciation become inadequate as construction costs increase. The rise in construction costs, in turn, results in the need for larger amounts of capital and increased external financing. The effects of inflation have been further exacerbated by slower sales growth.

New Accounting Standards

The Financial Accounting Standards Board has issued several Statements on Financial Accounting Standards (SFAS) which will affect the Company's results of operation and financial position. SFAS No. 90, Regulated Enterprises — Accounting for Abandonments and Disallowances of Plant Costs, will require the Company to write-off any portion of the River Bend investment that is permanently excluded from rate base and to write-down the investment in River Bend Unit 2 to an amount equal to the present value of probable future revenues. As discussed in Note 3 to the Financial Statements, the Company is appealing the LPSC's December 15, 1987 rate order which, among other things, permanently excluded $1.4 billion of the River Bend investment on a total Company basis from the rate base (approximately $677 million on a Louisiana retail jurisdictional basis). If SFAS No. 90 were applied as of December 31, 1987, the Company would be required to write-down approximately $22 million related to the wholesale and Texas retail portion of the unamortized River Bend Unit 2 cancellation cost (see Note 3 to the Financial Statements). Additionally, if the LPSC decision had not been appealed, at December 31, 1987 the Company would have been required to record a write-off of $514 million (net of tax impacts) related to the River Bend Unit 1 disallowance and an additional $41.8 million (net of tax) write-off related to River Bend Unit 2. For recent developments in the Louisiana and Texas rate proceedings, see Note 14 to the Financial Statements. SFAS No. 92, Regulated Enterprises — Accounting for Phase-In Plans, defines the accounting for phase-in plans.

SFAS No. 96, Accounting for Income Taxes, significantly changes accounting for income taxes and supersedes almost all existing authoritative accounting literature on accounting for income taxes. Adoption of SFAS No. 96 is expected to have an undetermined but significant impact on the Company's balance of deferred taxes. The impact on the Company's Statement of Income for future years cannot be determined at this time.

Financial Information

Statement of Income

For the years ended December 31
(in thousands except per share amounts)

	1987	1986	1985
Operating Revenue			
Electric	**$1,330,106**	$1,367,480	$1,714,405
Steam	**69,056**	77,783	102,576
Gas	**33,424**	33,125	41,455
	1,432,586	1,478,388	1,858,436
Operating Expenses and Taxes			
Fuel	**406,139**	449,213	569,182
Purchased power	**322,732**	347,075	449,554
Other operations	**240,788**	232,032	185,969
Maintenance	**108,797**	83,684	79,834
Depreciation and amortization	**187,459**	162,272	112,789
Deferred River Bend expenses	**(292,845)**	(175,236)	—
Deferred revenue requirement	**(26,436)**	(13,452)	—
Amortization of accumulated deferred River Bend costs	**1,793**	—	—
Income Taxes			
Federal	**24,291**	5,473	45,435
State	**(275)**	(7,496)	(5,633)
Other taxes	**83,523**	81,017	77,441
	1,055,966	1,164,582	1,514,571
Operating Income	**376,620**	313,806	343,865
Other Income and Deductions			
Allowance for equity funds used during construction	**259**	77,447	145,257
River Bend carrying charges	**263,988**	132,768	—
Reduction of deferred River Bend costs	**(94,896)**	—	—
Other — net	**5,744**	8,562	(6,012)
Income Before Interest Charges	**551,715**	532,583	483,110
Interest Charges			
Long-term debt	**299,931**	285,946	263,022
Short-term debt and other	**17,358**	9,741	10,679
Allowance for borrowed funds used during construction	**(8,179)**	(36,563)	(68,355)
	309,110	259,124	205,346
Income from Continuing Operations	**242,605**	273,459	277,764
Discontinued Nonutility Subsidiary Operations	**(1,504)**	(28,478)	(12,265)
Net Income	**241,101**	244,981	265,499
Dividends on Preferred and Preference Stock	**63,010**	63,127	60,137
Income Applicable to Common Stock	**$ 178,091**	$ 181,854	$ 205,362
Average Shares of Common Stock Outstanding	**107,995**	106,132	97,970
Earnings Per Average Share of Common Stock Outstanding from Continuing Operations	**$ 1.66**	$ 1.98	$ 2.22
Earnings Per Average Share of Common Stock Outstanding	**$ 1.65**	$ 1.71	$ 2.10
Dividends Per Share of Common Stock	**$ —**	$ .67	$ 1.64

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

Statement of Sources of Funds Invested In Utility and Other Plant

For the years ended December 31
(in thousands)

	1987	1986*	1985*
Provided From Operations			
Net income	**$ 241,101**	$ 244,981	$ 265,499
Principal income items not requiring current funds			
Depreciation and amortization	**187,459**	162,272	112,789
Deferred income taxes — net	**27,719**	2,587	108,889
Investment tax credits — net	**(3,703)**	(3,621)	(54,489)
Equity component of allowance for funds used during construction	**(259)**	(77,447)	(145,257)
Nonutility subsidiary operations	**167**	1,670	2,307
Early retirement pension benefits	**—**	8,938	—
Deferred River Bend expenses, revenue requirement, and carrying charges	**(583,269)**	(321,[illegible]56)	—
Reduction of deferred River Bend costs	**94,896**	—	—
Amortization of accumulated deferred River Bend costs	**1,793**	—	—
Discontinued nonutility subsidiary operations	**1,504**	28,478	12,265
Total provided from (used in) utility operations	**(32,592)**	46,402	302,003
Dividends			
Preferred and preference	**(34,160)**	(63,127)	(60,137)
Common	**—**	(70,319)	(161,605)
Reinvested funds provided from (used in) utility operations	**(66,752)**	(87,044)	80,261
Provided from Financing			
Sales of securities			
Common stock	**1,145**	47,070	122,180
Preferred stock subject to mandatory redemption	**—**	75,000	60,000
First mortgage bonds (principal amount)	**—**	200,000	100,000
Euro-debentures (principal amount)	**—**	—	75,000
Pollution control bonds (principal amount)	**—**	20,000	154,000
Change in pollution control funds held by trustee	**20,019**	12,001	36,253
Change in escrow deposit — guaranteed debentures	**—**	24,000	14,481
Net change in short-term borrowings	**—**	—	(52,000)
Retirement of long-term debt	**(25,570)**	(39,015)	(100,564)
Retirement of preferred stock subject to mandatory redemption	**—**	(48,148)	(5,306)
Net change in revolving credit agreement	**—**	80,000	120,000
Deferred River Bend construction and continuing services commitment	**13,779**	46,750	—
Net change in lease obligations	**(40,630)**	4,536	26,141
Dividends in arrears on preferred stock subject to mandatory redemption	**36,155**	—	—
Other long-term debt	**679**	—	—
Total provided from financing	**5,577**	422,194	550,185
Other Sources and Uses			
Investments (in) and advances (to) from subsidiary companies	**3,581**	(12,561)	(13,663)
Temporary cash investments	**(12,487)**	(76,765)	(60,596)
Change in other working capital — net	**55,082**	(27,931)	(17,467)
Amortization of leased nuclear fuel	**34,450**	23,232	298
Other — net	**46,166**	33,557	3,97[illegible]
Total other sources and uses	**126,792**	(60,468)	(87,500)
Expenditures for Utility and Other Plant	**65,617**	274,682	542,946
Equity component of allowance for funds used during construction	**259**	77,447	145,257
Invested in Utility and Other Plant	**$ 65,876**	$ 352,129	$ 688,203

* Restated for accounting change — see Note 6.

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

Balance Sheet
December 31
(in thousands)

	1987	1986*
Assets		
Utility and Other Plant, at original cost		
Plant in service	$ 6,434,702	$ 6,394,183
Less: Accumulated provision for depreciation	1,374,019	1,204,730
	5,060,683	5,189,453
Construction work in progress	7,393	18,704
Nuclear fuel	181,151	198,446
	5,249,227	5,406,603
Other Property and Investments		
Nonutility subsidiary companies	41,871	47,123
Other	3,112	3,641
	44,983	50,764
Current Assets		
Cash and temporary cash investments	155,321	143,880
Receivables		
Customers	123,860	119,381
Other	13,914	24,878
Fuel inventories	29,307	32,584
Materials and supplies	6,242	6,364
Prepayments and other	30,906	23,279
	359,550	350,366
Deferred Charges and Other Assets		
Unamortized debt expense	24,148	25,565
Unamortized project cancellation costs	118,755	125,126
Accumulated deferred income taxes	59,095	47,528
Deferred River Bend costs	808,036	321,456
Other	13,263	11,531
	1,023,297	531,206
	$ 6,677,057	$ 6,338,939
Capitalization and Liabilities		
Capitalization (See Statement of Capitalization)		
Common shareholders' equity	$ 2,020,308	$ 1,812,228
Preference stock	100,000	100,000
Preferred stock		
Not subject to mandatory redemption	136,444	136,444
Subject to mandatory redemption	356,522	323,313
Long-term debt	2,734,455	2,805,337
	5,347,729	5,177,322
Current Liabilities		
Long-term debt due within one year	80,000	17,000
Preferred stock and long-term debt sinking fund requirements	32,266	10,570
Deferred River Bend construction commitments	13,216	14,999
Accounts payable — trade	102,602	63,431
Customer deposits	15,593	15,149
Taxes accrued	20,286	20,912
Interest accrued	93,680	92,082
Capital leases — current	92,698	34,621
Other	37,531	26,339
	487,872	295,103
Deferred Credits and Other Liabilities		
Investment tax credits	114,025	117,728
Accumulated deferred income taxes	506,093	459,778
Capital leases — non current	94,942	193,649
Over-recovery of fuel costs	38,748	33,443
Disputed amounts	49,694	31,500
Other	37,954	30,416
	841,456	866,514
Commitments and Contingencies (Note 1)		
	$ 6,677,057	$ 6,338,939

* Restated for accounting change — see Note 6.

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

Statement of Changes in Capital Stock and Retained Earnings

For the years ended December 31
(in thousands)

	Preferred Stock Subject to Mandatory Redemption	Common Stock	Premium (Less Expense)	Other Paid-In Capital	Retained Earnings
Balance: January 1, 1985	$243,767	$1,024,753	$ (1,641)	$27,642	$ 441,044
Net income — 1985					265,499
Preferred stock sold (600,000 shares)	60,000				
Preferred stock sinking fund requirements	(4,045)				
Retirement of preferred stock	(5,306)			728	
Common stock sold:					
Public offerings (4,000,000 shares)		56,000			
Dividend reinvestment and stock purchase plan (4,352,640 shares)		58,237			
Employee benefit plans (551,501 shares)		7,388			
Conversion of debentures (42,550 shares)		555			
Dividends declared:					
Preferred and preference					(60,137)
Common					(161,605)
Capital stock expense			(1,871)		
Balance: December 31, 1985	294,416	1,146,933	(3,512)	28,370	484,801
Net income — 1986					244,981
Preferred stock sold (750,000 shares)	75,000				
Preferred stock sinking fund requirements	2,045				
Retirement of preferred stock	(48,148)			(2,240)	
Common stock sold:					
Dividend reinvestment and stock purchase plan (3,792,949 shares)		40,456			
Employee benefit plans (699,295 shares)		6,599			
Conversion of debentures (1,131 shares)		15			
Dividends declared:					
Preferred and preference					(63,127)
Common					(70,319)
Capital stock expense			(357)		(372)
Balance: December 31, 1986	323,313	1,194,003	(3,869)	26,130	595,964
Net income — 1987					241,101
Common stock sold:					
Employee benefit plans (149,365 shares)		1,145			
Reacquired capital stock				31	
Preferred stock sinking fund requirements	(2,946)				
Dividends in arrears on preferred stock subject to mandatory redemption	36,155				(34,160)
Capital stock expense			(37)		
Balance: December 31, 1987	$356,522	$1,195,148	$ (3,906)	$26,161	$ 802,905

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

Statement of Capitalization

December 31
(in thousands)

					1987	1986
Common Shareholders' Equity						
Common stock						
Authorized 200,000,000 shares without par value						
Outstanding 108,055,065 and 107,905,700 shares, respectively					**$1,195,148**	$1,194,003
Premium and expense on capital stock					**(3,906)**	(3,869)
Other paid in capital					**26,161**	26,130
Retained earnings					**802,905**	595,964
					2,020,308	1,812,228
Preference Stock						
Authorized 20,000,000 shares without par value, cumulative						
Outstanding 4,000,000 shares						
Dividend Series	Cumulative Per Share Dividends in Arrears	Shares Outstanding	Redemption Price as of December 31, 1987			
$4.40	$ 4.58	2,000,000	$ 30.45		**50,000**	50,000
3.85	4.01	2,000,000	30.15		**50,000**	50,000
					100,000	100,000
Preferred Stock						
Authorized 6,000,000 shares, $100 par value, cumulative						
Outstanding 4,617,568 shares						
Dividend Series	Cumulative Per Share Dividends in Arrears	Shares Outstanding at December 31, 1987	Redemption Price as of December 31, 1987			
Not subject to mandatory redemption						
$ 4.40	$ 4.58	51,173	$108.00		**5,117**	5,117
4.50	4.69	5,830	105.00		**583**	583
4.40-1949	4.58	1,655	103.00		**166**	166
4.20	4.38	9,745	102.818		**975**	975
4.44	4.63	14,804	103.75		**1,480**	1,480
5.00	5.21	10,993	104.25		**1,099**	1,099
5.08	5.29	26,845	104.63		**2,685**	2,685
4.52	4.71	10,564	103.57		**1,056**	1,056
6.08	6.33	32,829	103.34		**3,283**	3,283
7.56	7.88	350,000	101.80		**35,000**	35,000
8.52	8.88	500,000	104.43		**50,000**	50,000
9.96	10.38	350,000	106.64		**35,000**	35,000
					136,444	136,444
Subject to mandatory redemption						
8.80	9.17	301,029	105.00		**30,103**	30,103
9.75	10.16	29,636	105.00		**2,963**	2,963
8.64	9.00	302,465	105.00		**30,247**	30,247
11.48	11.96	480,000	105.00		**48,000**	48,000
13.64	14.21	40,000	105.00		**4,000**	4,000
12.92	13.46	600,000	112.92		**60,000**	60,000
11.50	11.98	750,000	111.50		**75,000**	75,000
Adjustable Rate	9.31	300,000	104.70		**30,000**	30,000
Adjustable Rate	9.36	450,000	106.80		**45,000**	45,000
Preferred dividends in arrears					**36,155**	—
					361,468	325,313
Preferred stock sinking fund requirements					**(4,946)**	(2,000)
					356,522	323,313

(Statement continued on following page.)

	1987	1986
Long-Term Debt		
First mortgage bonds		
Maturing 1988 through 1992 —		
4% due May 1, 1988	—	20,000
4¾% due January 1, 1989	**10,000**	10,000
5¼% due December 1, 1989	**16,000**	16,000
4⅞% due July 1, 1990	**17,000**	17,000
14¾% due May 28, 1991	**75,000**	75,000
17½% due January 13, 1992	**100,000**	100,000
4⅝% due May 1, 1992	**17,000**	17,000
Maturing 1993 through 1997 — 4⅝% through 16.8%	**206,430**	215,000
Maturing 1998 through 2002 — 6⅝% through 8½%	**210,000**	210,000
Maturing 2003 through 2007 — 8½% through 10.15%	**270,000**	70,000
Maturing 2008 through 2012 — 10⅛% through 15%	**325,000**	325,000
Maturing 2013 through 2016 — 11⅜% through 13½%	**500,000**	500,000
First mortgage bonds sinking fund requirements	**(27,320)**	(8,570)
	1,719,110	1,766,430
Pollution control and industrial development bonds		
7% due 2006	**25,000**	25,000
5.9% due 2007	**23,000**	23,000
10⅜% due 2012	**48,285**	48,285
9½% due 2013	**17,450**	17,450
10⅝% due 2014	**50,000**	50,000
12% due 2014	**52,000**	52,000
Variable rate due 2014	**94,000**	94,000
Variable rate due 2015	**154,000**	154,000
Variable rate due 2016	**20,000**	20,000
Pollution control funds held by trustee	—	(20,019)
Debentures		
Guaranteed debentures		
17½% due October 1, 1988	—	60,000
16% due April 15, 1990	**60,000**	60,000
Euro-debentures — 13% due 1992	**75,000**	75,000
Convertible debentures — 7¼% due 1992	**2,003**	2,003
Revolving credit agreement	**350,000**	350,000
Deferred River Bend construction and continuing services commitment (variable rate through 1991)	**47,313**	31,751
Other long-term debt	**679**	—
	2,737,840	2,808,900
Unamortized premium and discount on debt-net	**(3,385)**	(3,563)
	2,734,455	2,805,337
	$5,347,729	$5,177,322

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

Gulf States Utilities Company Notes to the Financial Statements

1. Commitments and Contingencies

Financial Condition. The Company's financial condition has continued to deteriorate, and the Company is in critical need of timely and adequate permanent rate relief in both Texas and Louisiana. The Company's cash resources are very limited and could reach an insufficient operating level during the first half of 1988. The Company continues to receive increasing pressures from its creditors and suppliers, including but not limited to the nuclear fuel lease facility and suppliers of fuel and purchased power. If adequate permanent rate relief is not granted in Texas and Louisiana sufficient for the Company to arrange additional credit or financings, the Company would probably have to file for relief from creditors under the Bankruptcy Code or attempt to negotiate such relief, and there can be no assurance that any such negotiations would be timely or successfully concluded. For recent developments in the Louisiana and Texas rate proceedings, see Note 14.

The Nuclear Regulatory Commission (NRC), which regulates the operation of River Bend Unit 1 (River Bend), has expressed to the Company its concern that the Company's financial condition could negatively impact activities associated with River Bend. The NRC requested that the Company evaluate its plans to assure that continued safe operation and fulfillment of commitments to the NRC will not be affected, report the results of the evaluation, and keep them informed of developments. If the Company's financial condition continues to deteriorate, what action the NRC may take and its financial impact upon the Company cannot be predicted, but such action could include suspension of operation of River Bend, which could have a very substantial adverse effect on the financial condition of the Company.

The Company has significant business relationships with Cajun Electric Power Cooperative, Inc. (CEPCO), including co-ownership of River Bend Unit 1. The Company has been informed that CEPCO is in arrears in payment of some of its debt service and has employed bankruptcy counsel. One of its member cooperatives has filed bankruptcy. Further, deterioration of CEPCO's financial condition and its bankruptcy could have significant adverse effects on the Company, including but not limited to possible NRC action as described above.

Southern Company Litigation. The Company and the Southern Company have entered into purchase power contracts providing for purchases by the Company of capacity and energy from coal-fired units owned by the Southern Company. In the Company's opinion, based on advice from legal counsel, such contracts have been terminated by reason of alleged breach of contract by the Southern Company and for other reasons and its obligations under the contracts have been discharged and excused. Accordingly, on July 2, 1986, the Company filed suit against the Southern Company in U.S. District Court requesting that the Company be excused and discharged from the contracts and for other relief. Additionally, the Company and the Southern Company each filed applications with the Federal Energy Regulatory Commission (FERC) seeking findings and actions, respectively, to void or reform the contracts and to support and continue such contracts. The FERC accepted jurisdiction over certain issues but refused hearing on state law contract issues. On May 12, 1987, the presiding administrative law judge rendered an initial decision ordering that the Company's complaint be dismissed and granting certain declarations favorable to the Southern Company and supporting the contracts. The Company has filed exceptions to such initial decision and is seeking a favorable decision from the FERC upon its review of the initial decision. No assurance can be given that the initial decision will be reversed or changed in favor of the Company by the FERC or upon subsequent appeal. Also, the Company's appeals to the appropriate state courts of the actions of the Public Utility Commission of Texas (PUCT) and the Louisiana Public Service Commission (LPSC) disallowing pass through of Southern Company capacity charges under the contracts are pending. The Company cannot predict the outcome of these proceedings.

As of December 31, 1987, the Company had not recorded as a liability and not paid approximately $144 million of charges billed to the Company by the Southern Company, as in the Company's opinion, based on advice from legal counsel, such contracts have been terminated and its obligations under the contracts have been discharged

and excused. If the Company had not been discharged and excused from the contracts, and had recorded the charges, net income for 1987 and 1986 would have been reduced by approximately $73 million and $12 million, respectively. The Company has also withheld payment of approximately $26 million which is recorded as an amount in dispute on the balance sheet resulting from differences in certain amounts billed by the Southern Company and amounts paid. The Company has estimated that minimum payments for capacity which would be due under such contracts from January 1, 1988, through their termination in 1992 would aggregate approximately $744 million and that payments for energy would be approximately $386 million. If the Company is ultimately unsuccessful in the pending litigation and were required to make such payments to the Southern Company and not permitted to pass these costs through to customers in its rates, the Company would probably be unable to make such payments and would probably have to seek protection from its creditors under the Bankruptcy Code.

Disposal of Spent Nuclear Fuel and Nuclear Decommissioning. As provided in the Nuclear Waste Policy Act of 1982, the Company has entered into contracts with the United States Department of Energy (DOE) for disposal of spent nuclear fuel from River Bend. Under the terms of the contract, the Company is required to pay a quarterly fee to the DOE of one mill per kilowatt hour generated by River Bend. The Company is currently recovering such costs from wholesale and Louisiana retail customers and expects regulatory authorization to recover these costs in the Texas retail jurisdiction.

A 1985 decommissioning study indicates that the total estimated cost to decommission River Bend is $202 million in 1985 dollars. Decommissioning studies are reviewed and updated periodically to reflect changes in decommissioning requirements, technology, and inflation. The Company has either received or expects to receive regulatory authorization to recover through rates amounts required to fund the decommissioning costs over a period of 35 to 40 years, but cannot be assured of such initial or continuing authorization.

Nuclear Insurance. Ownership and operation of a nuclear generating unit subjects a company to significant special risks. The Company is insured to an extent as to its interest in River Bend for property damage and decontamination, liability to employees and third parties, and incremental replacement power costs, as described below. However, some potential liabilities, including but not limited to liabilities relating to the release or escape of hazardous substances into the environment to which the Company may be subject, may not be insurable and the amount of insurance carried may not be sufficient to meet potential liabilities and losses. There is also no assurance that the Company will be able to maintain insurance coverages at their present levels. Under those circumstances, such losses or liabilities would have a material adverse effect on the financial condition of the Company.

Public liability in case of a nuclear incident at any licensed nuclear facility in the United States is currently limited to $715 million under provisions of the Price-Anderson Act (Act) still in effect. The Company insures River Bend for this exposure through a combination of private insurance and the industry-wide secondary financial program. Under this program the Company is subject to a retrospective assessment of $5 million per incident with a maximum amount of $10 million payable in any one year. Should more than two incidents occur in a single year, any liability in excess of the $10 million will be payable in the succeeding year(s).

The Price-Anderson Act legislation expired August 1, 1987. Bills to amend the Act, including proposals to substantially modify or eliminate the limitation on liability provisions, have been introduced in Congress, but no action has been approved. Under the provisions of the Act, all reactor facilities with operating licenses or construction permits issued before August 1, 1987, will continue to be covered under the expiring version of the Act until such time new legislation is enacted.

The Company maintains $500 million property damage insurance and $250 million of such excess insurance for River Bend from the private insurance market. Additionally, the Company has acquired $775 million of excess property insurance coverage on River Bend through participation in the Nuclear Electric Insurance Limited (NEIL) II program. Under NEIL II, the Company is subject to a maximum assessment of approximately $8.3 million in any one policy year. Although the Company has continued to increase the limits of such insurance as capacity becomes available, no assurance can be given about the adequacy of such insurance limits in the event of a major accident.

Financial Information

Some extra expense for River Bend replacement power is insured through the NEIL I program. Following an insured property loss which results in the unit being unavailable for generation and a 26 week waiting period, the NEIL I program will pay the Company a specified weekly indemnity for 52 weeks followed by one-half the specified weekly indemnity for an additional 52 week period. Under the NEIL I program the Company is subject to a maximum annual retrospective assessment of approximately $1.3 million.

Stockholder Litigation. The Company, and with variations as between suits, its officers and directors, and River Bend contractor, have been named in eight class action complaints filed in 1986 and 1987, in the U.S. District Court for the Eastern District of Texas. The suits allege violation of the securities laws and wrongful conduct involving various disclosures in connection with various offerings of common stock and reports filed with the Securities and Exchange Commission (SEC), allegedly resulting in damage, in unspecified amounts to the plaintiffs and other purchasers of the Company's common stock similarly situated. The Company denies, and is advised that the other defendants deny, any such violations or wrongdoing and will vigorously defend such actions. Under its Restated Articles of Incorporation (Articles), as amended, and Bylaws, the Company is obligated to indemnify its officers and directors under conditions presently believed to exist.

On February 8, 1988, an agreement in principle was executed providing for the settlement of such suits against all defendants except the contractor and for settlement of a derivative suit based upon similar allegations and upon allegations of mismanagement primarily relating to River Bend. Such settlements are subject, among other conditions, to negotiation of a stipulation of settlement and to approval by the court.

Dividend Suspension. In view of the continued deterioration of the Company's financial condition, the Board of Directors did not declare any dividends on the Company's common stock for the third quarter of 1986, and no dividend on common stock has been declared through December 31, 1987. The Board of Directors did not declare the dividends on the preferred and preference stock of the Company payable on March 15, 1987, and has continued not to declare them through December 31, 1987. Unless the financial condition of the Company improves, the Company expects to continue to be unable to pay dividends on such stock. Dividends on all series of the Company's preferred and preference stock are cumulative. If the Company fails to pay the dividends in arrears and all dividends which have, in the meantime, become due and payable on preferred stock on or before the fourth succeeding quarterly dividend date after a failure to pay a quarterly dividend, the holders of such stock would have the right to elect a majority of the Board of Directors. Such voting rights are presently expected to become effective on March 15, 1988. Similar voting rights to elect two directors are provided for holders of preference stock, if the Company fails to pay the dividends in arrears and all dividends which have, in the meantime, become due and payable on such stock on or before the sixth succeeding quarterly dividend date after a failure to pay a quarterly dividend. The Company may not pay any dividend or distribution on any of its common stock, or purchase or otherwise acquire common stock, unless all cumulative dividends and sinking fund obligations have been paid on preferred and preference stock. Under its Articles the Company may not pay any dividend or distribution on any of its preference stock, or otherwise acquire preference stock, unless all sinking fund obligations have been paid on preferred stock. On December 15, 1987, the Company failed to satisfy the $2,000,000 sinking fund requirement related to the $11.48 Series Preferred Stock. See Note 12 regarding dividend payment and other restrictions contained in the terms of a $65 million credit facility.

Pursuant to SEC Staff Accounting Bulletin No. 64, the Company has accrued dividends on and increased the balance of mandatory redeemable preferred stock with an offsetting decrease to retained earnings. However, since dividends on all series of the Company's preferred and preference stock are cumulative (the aggregate amount of cumulated and unpaid preferred and preference stock dividends as of December 15, 1987 being $62,378,000), income applicable to common stock and earnings per average common share outstanding have been computed assuming that all such dividends, through December 31, 1987, were accrued.

Cancelled Nuclear Unit. The Company previously reported the cancellation of River

Bend Unit 2. The Company has begun amortizing that portion of the cost of the unit applicable to its wholesale and Texas retail operations over 10 and 15 year periods, respectively. As discussed in Note 3, the LPSC, as part of its December 15, 1987 rate decision, disallowed all costs incurred in connection with the Company's investment in River Bend Unit 2 (approximately $41.8 million, net of tax, for the Louisiana jurisdictional basis). The Company has appealed the LPSC's decision in a state district court. The Company cannot predict the outcome of the state district court's decision with respect to this or any other issue. At December 31, 1987, the unamortized balance of the Company's investment in River Bend Unit 2 was $116,337,000. See Note 3 for additional write-downs required with respect to such Unit 2.

2. Summary of Significant Accounting Policies

System of Accounts. The accounting records of the Company are maintained in accordance with the Uniform System of Accounts as prescribed by the FERC and adopted by the LPSC and the PUCT.

Utility Plant and Depreciation. Utility and other plant is stated at original cost when first dedicated to public service. Costs of repairs and minor replacements are charged to expense as incurred. The original cost of depreciable utility plant retired and cost of removal, less salvage, are charged to accumulated provision for depreciation. The provision for depreciation is computed using the straight-line method at rates which will amortize the unrecovered cost of depreciable plant over the estimated remaining service life.

Composite depreciation rates were as follows:

	1987	1986	1985
Electric	2.94%	3.31%	3.43%
Steam	4.55	2.47	2.34
Gas	3.52	3.52	3.53
Total Company	2.96	3.30	3.41

Decommissioning. The Company is accruing the decommissioning costs of River Bend over the life of the plant.

Allowance for Funds Used During Construction (AFUDC) and Capitalization of Interest. The accrual of AFUDC is a utility accounting practice calculated under guidelines prescribed by the FERC and capitalized as part of the cost of utility plant representing the cost of servicing the capital invested in construction work in progress (CWIP). Such AFUDC has been segregated into two component parts — borrowed and equity funds. That portion allocated to borrowed funds is reflected as an adjustment to interest charges, while that portion applicable to equity funds is shown as a source of other income. Both the equity and the borrowed portions of AFUDC are non-cash items which have the effect of increasing the Company's reported net income. When the related utility plant is placed in service, a return on and recovery of these costs generally have been permitted by regulators in determining the rates charged for utility service. The Company computed AFUDC at the following net of tax rates compounded semiannually:

January 1, 1985-March 31, 1986	10.00%
April 1, 1986-June 30, 1986	9.75
July 1, 1986-December 31, 1986	9.50

In 1987, due to the construction interest capitalization provisions of the Tax Reform Act of 1986, the Company began accruing AFUDC at pre-tax rates. These rates were as follows:

January 1, 1987-March 31, 1987	12.00%
April 1, 1987-September 30, 1987	12.25
October 1, 1987-December 31, 1987	12.50

Revenue, Fuel, and Purchased Power. The Company records revenue as billed to its customers on a cycle billing basis. Revenue is not recorded for energy delivered and unbilled at the end of each fiscal period. The Company's wholesale and Louisiana retail rate schedules provide for adjustments to substantially all rates for increases or decreases in the costs of fuel for generation, purchased power, and gas distributed. The Company's Texas retail rate schedules include a fixed fuel factor approved by the PUCT. Such factor remains the same until the Company files for a general rate increase or until the PUCT orders a reconciliation for any over or under collections of fuel cost. Fuel and purchased power costs in excess of those included in base rates or recovered through fuel adjustment clauses are deferred (or accrued) until such costs are billed (or credited) to customers.

Inventories. The Company's fuel inventories are comprised of fuel oil, valued at weighted average cost, and coal, valued at last-in, first-out (LIFO) cost. Materials and supplies are valued at weighted average cost.

Income Taxes. The Company and its subsidiaries file a consolidated federal income tax return. Income taxes are allocated

to the individual companies based on their respective taxable income or loss and investment tax credits.

The Company follows a policy of comprehensive interperiod income tax allocation where such treatment is permitted for ratemaking purposes by regulatory bodies. Deferred income taxes result from timing differences in the recognition of revenue and expenses for tax and accounting purposes.

Investment tax credits have been deferred and are being amortized ratably over the useful lives of the related property.

Subsidiary Companies. The Company accounts for its investments in its wholly-owned nonutility subsidiary companies, Prudential Oil & Gas, Inc. (Prudential) and Varibus Corporation (Varibus), on the equity basis. Prudential was engaged primarily in the exploration for, development, production, and marketing of oil and gas properties. See Note 7 for information regarding the sale of Prudential's natural gas and oil reserves. Varibus operates pipelines and owns rights to lignite reserves.

In October, 1987, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 94, Consolidation of all Majority-Owned Subsidiaries. SFAS No. 94 will require consolidation of Varibus and Prudential effective for financial statements presented at December 31, 1988. Two additional subsidiaries, GSG&T, Inc., discussed further in Notes 6 and 12 and Gulf States Overseas Finance N.V. are presently being accounted for on a consolidated basis.

Retirement Plan and Other Post Employment Benefits. The Company has a noncontributory pension plan, which covers all employees meeting certain age and service requirements. The Company's policy is to fund the actuarially computed pension contribution annually. Past and prior service costs are being funded by the Company over periods of up to forty years.

In addition to the pension plan, the Company provides retired employees with life and health care insurance benefits. All of the Company's employees may become eligible for benefits upon reaching normal retirement age. The annual cost of such benefits, which is currently not material, is recognized as claims are actually paid.

Reclassification of Prior Years Financial Statements. Prior year financial statements have been reclassified in order to be consistent with current year presentation with no affect on net income or common shareholders' equity.

3. Rates and Accounting

Rate Matters

Louisiana. On July 25, 1986, the Company filed a rate moderation plan with the LPSC providing for the costs of River Bend to be phased in over eight years with deferrals of costs in the first three years and recovery of deferred costs over the remaining five years while the rates related to River Bend would remain level during such five-year recovery period. On September 8, 1986, the Company filed with the LPSC an emergency request for interim rate relief in the amount of $100 million and asked that such relief become effective in November, 1986. On December 2, 1986, the LPSC denied the Company's request for interim rate relief. The Company filed an appeal of the LPSC's decision in a state district court. Pending a ruling by such court, on February 6, 1987, the Company filed with the Louisiana Supreme Court requesting that the Supreme Court direct the state district court to remand the case back to the LPSC. Also on that date, the Company filed a new emergency interim request for $100 million with the LPSC. The new request was updated with respect to Texas rate relief, suspension of preferred and preference stock dividends, downratings of the Company's securities, and other developments. On February 13, 1987, the state district court remanded the case back to the LPSC. On March 2, 1987, the LPSC issued an order granting the Company $57 million in annualized emergency rate relief which was subsequently extended to December 15, 1987, the date of the permanent rate order.

On December 15, 1987, the LPSC issued an order granting the Company $63 million in rate relief (including the $57 million of previously granted emergency rate relief) and a 12 percent return on common equity, while also disallowing $1.4 billion of the Company's total River Bend plant investment (approximately $677 million on a Louisiana retail jurisdictional basis) as having been imprudently incurred. The order also disallowed any recovery of costs incurred in connection with the Company's investment in its cancelled River Bend Unit 2 of approximately $61.8 million. The LPSC order also approved the form of a rate moderation plan but required evidentiary hearings and subsequent approval by the LPSC of any

future increases to be granted under the rate moderation plan. The LPSC order failed to specify the level of revenue requirements deferred under the plan as well as the timing of recovery of the deferred amounts.

On December 30, 1987, the Company appealed the LPSC's action in a state district court. The Company's appeal requested, among other things, injunctive relief concerning the failure of the Commission's rate moderation plan to meet the criteria set forth in generally accepted accounting principles for such plans and the decrease in return on common equity from the 14 percent recommended by the Commission consultants to the 12 percent granted in the rate order and the resulting impact from this decrease on the amount of rate relief granted by the LPSC. The Company's appeal also covers the LPSC's ordered imprudency disallowance related to River Bend and the disallowance of any recovery of the cancelled River Bend Unit 2.

Pending the outcome of the appeal, the Company placed the increased rates into effect, discontinued accounting treatment of River Bend costs pursuant to the accounting order received from the LPSC in December, 1986, began amortizing the deferrals and accruals accumulated under the accounting order, and did not recognize the alleged imprudency disallowance of River Bend and the disallowance of recovery of the cancelled River Bend Unit 2. Hearings were held on January 28 through February 1 and on February 18 in state district court on the Company's petition for injunctive relief. Injunctive relief was granted on February 18, 1988. For this and other recent developments in these proceedings, if any, after February 18, 1988, see Note 14. The Company cannot predict the ultimate outcome of these proceedings or when they will be finally concluded.

Texas. On November 18, 1986, the Company filed a $144 million (26 percent) rate increase request with the PUCT and applicable cities. The request was based on a test year ended June 30, 1986, which included River Bend in rate base and asked for a 15.25 percent return on equity. The request proposed a rate moderation plan providing for the costs of River Bend to be phased in over eight years with deferrals of costs in the first three years and recovery of deferred costs over the remaining five years while the rates related to River Bend would remain level during such five-year recovery period. As a part of the request, the Company requested interim rate relief of $82 million to become effective in December, 1986. Hearings on the interim request commenced on January 12, 1987, and concluded on January 27, 1987. On February 3, 1987, the PUCT granted the Company an annualized interim increase of $39.9 million, subject to refund, contingent upon the Company obtaining a new $250 million line of credit, or equivalent, to pay necessary operating expenses. On March 31, 1987, the Company submitted, and the PUCT approved, a $266 million finance plan. Such approval allowed the interim rate increase to be implemented on April 7, 1987. The PUCT stated that if bankruptcy proceedings should be filed, the rate increase would no longer be effective. Hearings on the permanent portion of this request began on March 23, 1987, and concluded on September 15, 1987.

Briefs and reply briefs in this proceeding were filed in the fourth quarter of 1987, with the PUCT Examiner's Report subsequently also filed in December, 1987. The PUCT has held additional meetings and hearings in this proceeding in January and early February, 1988, with additional hearings on the subject of rate case expenses held beginning February 16.

For recent developments regarding rulings on the prudency of River Bend by the PUCT on February 23, 1988, see Note 14. The Company cannot predict the ultimate outcome of the proceedings and appeals or when they will be finally concluded.

Wholesale. On June 24, 1986, the Company filed a wholesale electric rate increase request with the FERC in the form of a rate moderation plan to phase in the River Bend in-service costs over an eight year period. The request asked for increases of approximately $24.9 million (39.8 percent), $18.5 million (21.2 percent), and $13.5 million (12.8 percent), respectively, in each of the first three years, with the portion of rates relating to River Bend remaining constant during the final five years of the plan as the Company recovers its deferred investment costs from the first three years of approximately $61.6 million. The requested amounts were based on a 15.25 percent return on common equity.

On August 22, 1986, the FERC issued an order permitting the proposed first year rates to become effective on August 25, 1986, and the proposed second and third year rates to become effective on July 1, 1987 and July 1,

1988, respectively, under the Company's proposed rate moderation plan. The order did not permit the Company to include in its rates, or defer for financial accounting purposes, costs associated with River Bend for the period June 16, 1986, the date the unit became commercially operable, to August 24, 1986, amounting to approximately $6 million.

At the time of the order, the Company had already commenced negotiations with its wholesale customers regarding alternative rates. A settlement regarding alternative rates has been reached with all but one wholesale customer, and the Company is seeking such settlement with its remaining wholesale customer. The Company filed a motion with the FERC for authorization to collect the proposed settlement rates effective as of August 25, 1986, and was permitted to implement such rates effective as of that date. Under the proposed settlement, the rate moderation plan period is ten years, and the rate increases from 1986 through 1989, to the applicable customers for purchases on the standard wholesale rate will be 24 percent, 14 percent, 10 percent, and 7.4 percent, respectively. However, the settlement provides that for several years substantial portions of such customers' loads may be served from power purchased from others for which the Company receives transmission charges or, depending on relative costs of such other power, from the Company at a rate lower than the standard rate. The Company believes that currently no write-off of the wholesale portion of the River Bend investment is required to reflect the reduction in revenues as described above. Accounting standards, as discussed below, which are effective for 1988, could possibly result in a write-off of some portion of the wholesale portion of the River Bend investment in an amount which has not yet been determined. Additionally, there can be no assurances that, as a result of the loss of wholesale customers, a write-off of some portion or all of the remaining unrecovered River Bend investment allocable to the wholesale jurisdiction will not be required at a future date.

Accounting Developments

Statement of Financial Accounting Standards No. 90. During December, 1986, the FASB issued SFAS No. 90, Regulated Enterprises — Accounting for Abandonments and Disallowances of Plant Costs, which amends certain accounting standards for rate regulated enterprises. SFAS No. 90 specifies the accounting for the financial effect of disallowances of costs of newly completed plants and plant abandonments and requires an immediate charge to operations for any portion of the cost of River Bend permanently excluded from rate base. Additionally, it requires the Company to reduce its investment in the abandoned River Bend Unit 2 to an amount equal to the present value of the probable future revenues expected to be provided over the amortization period authorized by regulators. In subsequent years, the Company will recognize interest income to the extent of the difference between amortization allowed for regulatory purposes and reduced amortization recorded for financial reporting purposes. SFAS No. 90 is generally effective beginning in fiscal year 1988.

If SFAS No. 90 were applied as of December 31, 1987, the Company would be required to write-down approximately $22 million related to the wholesale and Texas retail portion of the unamortized River Bend Unit 2 cancellation loss (see Note 1). Additionally, if the LPSC decision had not been appealed, at December 31, 1987 the Company would have been required to record a write-off of $514 million (net of tax impacts) related to the River Bend Unit 1 disallowance and an additional $41.8 million (net of tax) write-off related to River Bend Unit 2. For recent developments in the Texas and Louisiana rate proceedings, see Note 14.

Statement of Financial Accounting Standards No. 92. In August, 1987, the FASB issued SFAS No. 92, Regulated Enterprises — Accounting for Phase-In Plans. This statement prescribes the criteria which must be met by a phase-in plan ordered by a regulator in order for the regulated utility receiving such order to be able to record, for financial reporting purposes, the deferrals of expense or revenue requirements included in the phase-in plan. As discussed previously, the LPSC order of December 15, 1987 failed to specify both the level of revenue requirements deferred under the phase-in plan adopted by that regulator and the timing of recovery of the deferred amounts. It is the Company's opinion that the LPSC plan therefore fails to meet the criteria set forth in SFAS No. 92. For recent developments in the Louisiana rate proceedings, see Note 14.

An additional provision of SFAS No. 92 is the prohibition, effective January 1, 1988, of the recognition of the equity portion of

carrying charges, accrued in accordance with an accounting order granted by a regulator, on recently completed generating plant that is in commercial service but not yet reflected in rates. This provision does not require the reversal of such equity charges accrued prior to January 1, 1988.

The Company is continuing in 1988, pending the receipt of a rate order from the PUCT to defer expenses and accrue the debt portion of carrying costs related to River Bend. While the Company will be prohibited from the financial statement recognition of the equity portion of carrying costs in accordance with the provisions of SFAS No. 92 described above, nothing in SFAS No. 92 prohibits such carrying costs from being allowable for future ratemaking consideration. However, there can be no assurance as to the extent of the future recoverability, if any, of the deferrals and accruals of River Bend costs recorded pursuant to the PUCT accounting order subsequent to January 1, 1988. The equity portion of the Texas retail amount of River Bend carrying costs was approximately $74 million for the twelve months ended December 31, 1987.

Deferred Revenue Requirements. In accordance with the terms of the rate moderation plan approved by the FERC, as described above, the Company is recording a deferred revenue requirement representing those River Bend costs applicable to wholesale customers which have been deferred for future recovery from such customers. The Company had recorded deferred revenue requirements of $26.4 and $13.5 million for 1987 and 1986, respectively.

River Bend Cost Deferrals. Pursuant to accounting orders received from the LPSC and the PUCT, the Company, prior to receipt of permanent rate orders, deferred recognition, for financial reporting purposes, of the retail portion of the operating costs associated with River Bend and costs of purchasing capacity from CEPCO's portion of the unit incurred subsequent to the unit's commercial in-service date and accrued carrying charges upon the retail portion of both the cash portion of the deferrals and the investment in the unit not included in the Company's rate base. The rate used in computing the carrying charges was 9.75 percent during the period from January 1 to March 31, 1987, 10 percent from April 1 to September 30, 1987, and 10.25 percent from October 1 to December 31, 1987. The deferral of costs and accrual of carrying charges associated with River Bend was terminated in the Louisiana jurisdiction on December 15, 1987, upon receipt of the permanent rate decision.

Reduction of Deferred River Bend Costs. As a result of the interim rate relief granted in both the Texas and Louisiana retail jurisdictions, the Company has reduced by $94,896,000 (pre-tax), for the year ended December 31, 1987, the amount of deferred River Bend costs being recorded in accordance with accounting orders issued in 1986, by the regulatory commissions. This amount reflects a reduction of $1.50 (Texas) and $1.00 (Louisiana) for each $1.00 of revenue received as a result of the interim rate increases. Such adjustment is required since the Commissions, as a result of granting interim rate relief, have allowed some River Bend costs (on a non-specific basis) to be collected through rates rather than being deferred. The reduction of deferred River Bend costs was terminated in the Louisiana jurisdiction upon receipt of the permanent rate decision.

Recovery of Costs. The Company was ordered by the LPSC, by virtue of the December 15, 1987 rate order, to amortize the deferred costs and accrued carrying charges related to the accounting orders over a ten year period.

Deferred River Bend Costs. For the effect of the deferred River Bend costs on the results of operations, see Management's Discussion and Analysis of Financial Condition and Results of Operations.

Statement of Financial Accounting Standards No. 95. In November, 1987, the FASB issued SFAS No. 95, Statement of Cash Flows. The Statement provides for the replacement of the Company's current Statement of Sources of Funds Invested in Utility and Other Plant effective in 1988.

4. Federal Income Taxes

The provisions for federal income taxes were less than the amounts computed by applying the statutory federal income tax rate to net income before federal income taxes.

The reasons for these differences are as follows:

	1987	1986	1985
	(in thousands except percents)		
Net income before federal income taxes	$ 273,232	$ 257,262	$321,066
Statutory tax rate	40%	46%	46%
Federal income taxes at statutory tax rate	109,293	118,341	147,690
Additions (reductions) in federal income taxes resulting from:			
Exclusion of AFUDC and River Bend carrying costs from taxable income	(105,325)	(113,863)	(98,262)
Items capitalized for book purposes but expensed for tax purposes	542	(14,523)	(9,681)
Non-deferred depreciation differences	3,249	6,066	5,413
Adjustment for prior years taxes and other regulatory adjustments	693	(3,732)	492
Equity in earnings of nonutility subsidiaries	668	13,868	6,733
Deferral of nuclear fuel savings	22,197	10,967	—
Amortization of investment tax credit	(3,712)	(3,530)	(3,872)
Foreign tax credit reversal	—	—	3,976
Other items	4,526	(1,313)	3,108
Total federal income taxes	$ 32,131	$ 12,281	$ 55,567
Effective federal income tax rate	11.8%	4.8%	17.3%

The components of federal income taxes are as follows:

	1987	1986	1985
	(in thousands)		
Charged to operating expenses:			
Current federal income tax provision	$ —	$ (1,120)	$ (8,229)
Deferred federal income taxes — net			
Tax depreciation	105,714	159,111	103,067
Capitalized construction costs	1,333	4,634	8,819
Amortized nuclear unit cancellation costs	(1,827)	(1,668)	(1,497)
Nuclear unit cancellation costs	200	100	5,139
Fuel and purchased power costs accrued	(1,662)	(6,106)	(8,412)
Book expenses deferred for tax purposes	(5,447)	(1,257)	850
Net operating tax loss carryforward benefit recognized currently	(140,955)	(212,680)	—
River Bend operating expenses deferred for books, expensed for tax purposes	74,040	68,777	—
Unbilled revenues	(2,343)	—	—
Other	(1,059)	(697)	187
Total deferred federal income taxes — net	27,994	10,214	108,153
Investment tax credits — net	(3,703)	(3,621)	(54,489)
Total federal income taxes charged to operating expenses	24,291	5,473	45,435
Charged to other income — net	7,840	6,808	10,132
Total federal income taxes	$ 32,131	$ 12,281	$ 55,567

Timing differences exist for which deferred taxes have not been provided and, therefore, have not been recovered through rates. The cumulative amount of timing differences for which no deferred taxes have been provided was approximately $131 million at December 31, 1987. The tax effect of the Company's 1987 federal tax loss has been recorded as a reduction of deferred income taxes. At December 31, 1987, for tax purposes, the Company had tax loss carryforwards of $797 million and investment tax credit carryforwards for book and tax purposes of approximately $180 million. These will be used to reduce income taxes in future years and, if not used, will expire through the year 2002. An additional $80 million of investment tax credit carryforwards may be available to the Company if credits generated prior to 1986 are determined not to be subject to the 35 percent reduction of tax credit carryforwards required by the 1986 Tax Reform Act.

The 1986 Tax Reform Act contains many provisions that are affecting and will continue to affect the Company. These provisions include reductions in the corporate tax rate, a reduction of investment tax credit carryforwards, repeal of the investment tax credit effective January 1, 1986, inclusion of unbilled revenues and contributions in aid of construction in taxable income, required interest and overhead capitalization for construction, lengthened tax depreciation lives, and a new alternative minimum tax. The precise impact on the Company's future tax liability cannot presently be determined but will be dependent in large part upon the final amount of permanent rate relief realized from the Company's retail rate cases or upon appeal, as discussed in Note 3. For recent developments in the Louisiana and Texas rate proceedings, see Note 14.

In December, 1987, the FASB issued SFAS No. 96, Accounting for Income Taxes, which must be adopted by the Company beginning in 1989. SFAS No. 96 significantly changes accounting for income taxes and supersedes almost all existing authoritative accounting literature on accounting for income taxes. While the Statement retains (with the exception described below) the existing requirement to record deferred taxes for transactions that are reported in different years for financial reporting and tax purposes, it revises the computation of deferred taxes so that the amount of deferred taxes on the balance sheet is adjusted whenever tax rates or other provisions of the income tax law are changed. Adoption of SFAS No. 96 is expected to have an undetermined but significant impact on the Company's balance of deferred taxes through reclassifications. The impact on the Company's Statement of Income

for future years cannot be determined at this time.

The statement also changes current practice by significantly limiting the ability to recognize net deferred tax assets, i.e., the deferred tax effects of expenses or losses reported later for tax purposes than for financial reporting purposes.

5. Retirement Plan

The Company's pension provision for the years ended December 31, 1987, 1986, and 1985, was $798,000, $(614,000), and $7,994,000, respectively. Of such amounts, $703,000, $(446,000), and $4,912,000, respectively, were charged/(credited) to income with the balance of such costs for each period charged/(credited) to construction and other accounts.

During the third quarter of 1986, the Company adopted the provisions of SFAS No. 87, Employers' Accounting for Pensions. The adoption of the new standard resulted in an increase in net income of $922,000. The components of the pension provision for 1987 and 1986, are summarized as follows:

	1987	1986
	(In thousands)	
Service cost	$ 6,690	$ 7,114
Interest cost on projected benefit obligation	11,330	10,589
Actual return on plan assets	(8,356)	(30,423)
Unrecognized net gain (loss)	(6,853)	14,494
Amortization of net gain	(356)	—
Amortization of prior service cost	730	—
Amortization of net transition asset	(2,387)	(2,388)
Pension provision	$ 798	$ (614)

The obligations for plan benefits and the amount recognized in the Company's balance sheet at December 31, 1987 and 1986, are reconciled as follows:

	1987	1986
	(In thousands)	
Actuarial Present Value of Benefit Obligations:		
Accumulated benefit obligation, including vested benefits of $127,384 and $129,655	$139,308	$140,869
Projected benefit obligation	$173,687	$178,212
Plan assets, at fair market value	200,762	202,786
Plan assets in excess of projected benefit obligation	(27,075)	(24,574)
Unrecognized net gain	15,659	14,494
Unrecognized net assets, being amortized over 15 years	31,036	33,423
Unrecognized prior service cost	(21,462)	(22,869)
Other — primarily benefit payments higher than those contained in computing the projected benefit obligation	—	(3,114)
	$ (1,842)	$ (2,640)

The accumulated benefit obligation is the present value of future pension benefit payments and is based on the plan's benefit formulas without considering expected future salary increases. The projected benefit obligation considers future salary increases. The assumed discount rate and long term return on pension assets was 7½ percent and 7½ percent, respectively. The expected rate of increase in future salary levels averaged approximately 6.1 percent.

At December 31, 1987, 62.5 percent of plan assets were invested in equity securities, 30.8 percent in bonds, and 6.7 percent in cash or cash equivalents.

During the first quarter of 1986, the Company initiated an early retirement plan available to employees meeting certain qualifications and making application therefor prior to April 15, 1986. A total of 317 of 488 eligible employees elected to take early retirement. The cost of the early retirement plan approximated $14.4 million, of which $8.9 million (exclusive of related tax effects) was charged to operating expense during the second quarter of 1986, with the balance charged to construction.

6. Leases

The Company has existing agreements for the leasing of certain vehicles, coal rail cars and other equipment, buildings, and nuclear fuel. Lease charges were $67,367,000, $20,119,000, and $16,632,000 during 1987, 1986, and 1985, respectively. Of such amounts, $65,925,000, $17,466,000, and $14,041,000, respectively, were charged to income.

Future minimum lease payments under noncancellable capital and operating leases (including amounts due under a nuclear fuel lease as discussed below) for each of the next five years and in the aggregate at December 31, 1987, are estimated to be (in thousands):

Year	Amount
1988	$115,153
1989	100,996
1990	12,903
1991	10,521
1992	10,653
Remaining years	187,597
	$437,823

The Company has a nuclear fuel financing agreement with a non-affiliated third party fuel corporation (the Lessor), which provides for the Lessor to finance nuclear fuel for future use at River Bend. On July 30, 1987, the Company and participating banks agreed to an amendment that reduced the banks commitment to the outstanding lease balance each time the Company makes a quarterly payment for nuclear fuel used. As a result, the cost of new fuel (including acquisition, conversion, enrichment, and fabrication), interest on the unused fuel, and other expenses may no longer be capitalized in the lease, but rather will be paid for by the Company directly. This will result in the Company having to obtain funds from other sources to pay fuel costs previously expected to be financed through the lease. On October 31, 1987, the Company and the participating banks, which are providing credit for the nuclear fuel lease, amended the credit agreement whereby the Company paid $12 million on October 31, 1987 and will pay $4.6 million per month, in addition to the quarterly fuel use payments, beginning February 1, 1988, to reduce the unpaid lease balance.

Under the provisions of SFAS No. 71 and No. 13, the Company has recorded its capital leases on the financial statements for 1987, and restated the applicable financial statements for prior periods to provide comparative information. Since SFAS No. 71 also requires the Company to record lease expense in a manner consistent with ratemaking treatment, the change in accounting has no affect on net income.

The Company is leasing the Lewis Creek generating station from its wholly owned subsidiary, GSG&T, Inc. Such lease is not separately reflected as a result of the consolidated reporting of the Company and such subsidiary.

7. Discontinued Nonutility Subsidiary Operations

Effective July 1, 1987, the Company sold the natural gas and oil reserves belonging to Prudential, a wholly-owned subsidiary, for approximately $23 million.

Operating results of Prudential, as shown below, are reported separately as discontinued nonutility subsidiary operations in the accompanying financial statements. Included in the loss on disposition is a pre-tax provision of $757,000 related to the costs of disposal of the oil and gas operations.

	1987	1986	1985
	(In thousands except per share amounts)		
Operating loss from discontinued operations before tax effect	$ (231)	$ (37,431)	$ (23,876)
Income tax provision	—	8,953	11,611
Operating loss from discontinued operations	(231)	(28,478)	(12,265)
Loss on disposition of oil and gas properties	(1,273)	—	—
Income tax provision	—	—	—
Net loss on disposition	(1,273)	—	—
Loss from discontinued operations	$ (1,504)	$ (28,478)	$ (12,265)
Loss per average common share outstanding from discontinued operations	$ (.01)	$ (.27)	$ (.12)

8. Jointly-Owned Facilities

As of December 31, 1987, the Company owned undivided interests in three jointly-owned electric generating facilities as detailed below (dollars in thousands):

	River Bend Unit 1	**Roy S. Nelson Unit 6**	**Big Cajun #2 Unit 3**
Company Share of Investments:			
Plant in service	$3,055,913	$404,387	$219,586
Accumulated depreciation	116,880	72,194	23,298
Total plant capability	936 MW	550 MW	540 MW
Fuel source	Nuclear	Coal	Coal
Ownership share	70%	70%	42%

The Company's share of operations and maintenance expense related to the jointly-owned units in-service is included in operating expenses. See Note 13 for information relating to buyback agreements between the Company and the participants in River Bend and Nelson Unit 6. The amounts above do not reflect costs previously recovered through CWIP included in rate base.

9. Capital Stock and Retained Earnings

The Company offers its common, preference, and preferred shareholders the opportunity to reinvest their dividends and to make additional cash payments to acquire shares of the Company's common stock through its Dividend Reinvestment and Stock Purchase Plan (DRIP). (However, see Note 1 for information on the omission of common, preferred, and preference stock dividends during 1986 and 1987.) The Company also offers all employees meeting designated service requirements the option to participate in benefit plans which provide an opportunity to obtain common shares of the Company. At December 31, 1987, the Company had reserved 5,562,503 shares of common stock to be issued in connection with its DRIP and employee benefit plans. However, the Company currently intends that the DRIP and employee benefit plans purchase shares of common stock in the open market in order to meet the requirements of its DRIP and employee benefit plans, rather than offering unissued shares which would have a dilutive effect on earnings per share and book value.

At the Company's option, the Articles provide that all or part of its preferred and preference stock may be redeemed at stated prices. Certain issues are subject to restrictions in the Articles which prohibit redemption for a period of time, directly or indirectly out of the proceeds of or in anticipation of borrowings or issuance of additional stock of equal or prior rank having a lower interest cost or dividend rate.

At December 31, 1987, the Company had authorized 10,000,000 shares of preferred stock without par value (none issued) and 6,000,000 shares of preferred stock $100 par value authorized (4,617,568 issued). Limitations based on the ratio of after-tax earnings to fixed charges and preferred dividends are imposed by the Articles upon the issuance of additional preferred stock. Based upon the results of operations for the year ended December 31, 1987, and existing circumstances, the Company is unsure whether it is able to issue any additional preferred stock.

Certain limitations on the payment of cash dividends on common stock are contained in the Articles, indentures, and loan agreements. Under existing limitations discussed in Notes 1 and 12, the Company may not pay dividends on such stock. If such restrictions did not exist, the most restrictive limitation at December 31, 1987, as to the amount of such dividends which might be paid, was contained in the Articles. Based on such limitation, the retained earnings available for payment of dividends as of December 31, 1987, amounted to approximately $659 million. Preferred and preference dividend requirements, as well as preferred stock sinking fund requirements, have priority over the payment of cash dividends on common stock.

Payment of dividends on preference stock is subordinate to payment of dividends on preferred stock and preferred stock sinking fund obligations. There are no limitations in the Articles on the issuance of preference stock.

10. Preferred Stock Subject to Mandatory Redemption

The series of preferred stock subject to mandatory redemption are entitled to sinking funds which provide for the annual redemption of shares (varying in amount from 3 percent to 5 percent of the number of shares originally issued) at $100 per share, plus any dividends in arrears on such stock (see Note 1).

On December 15, 1987, the Company failed to satisfy the $2,000,000 sinking fund requirement related to the $11.48 Series Preferred Stock. See Note 1 for the consequences of such failure.

During 1986, the Company purchased in the open market, shares of the applicable series of preferred stock in excess of the amount needed to satisfy the 1986 sinking fund requirement. At December 31, 1987, assuming that the additional shares purchased during 1986 are used to satisfy future sinking fund requirements, minimum redemption requirements amount to $2,945,900, $4,701,100, $7,679,700, $11,056,700, and $14,816,700 during the years 1988 through 1992, respectively, exclusive of the $2,000,000 unsatisfied provision from 1987, discussed above.

See Notes 1 and 12 for limitations on payment of dividends on and purchases of preferred stock.

11. Long Term Debt

The Company's Mortgage Indenture contains sinking fund provisions which require, generally, that the Company make annual cash deposits equal to 1.2 percent of the greatest aggregate principal amount of first mortgage bonds outstanding or, in lieu thereof, to apply property additions or reacquired first mortgage bonds for that purpose. The Company has satisfied the mortgage requirements in past years and plans to meet current and future requirements by certifying "available net additions" to the trustee. Those series of the Company's first mortgage bonds which were privately placed require cash sinking funds. First mortgage bond sinking fund requirements, along with long-term debt maturities (excluding those amounts to be due under the revolving credit agreement as discussed below), for each of the next five years are detailed below (in thousands):

	Sinking Fund Requirements Satisfied by		Long-Term Debt Maturities
	Cash	Property Additions	
1988	$27,320	$16,240	$ 93,118
1989	27,320	17,928	55,141
1990	67,320	17,724	92,929
1991	48,570	17,724	21,092
1992	8,570	17,520	114,003

The Company's Mortgage Indenture contains an interest coverage covenant which limits the amount of first mortgage bonds which the Company may issue. Based upon the results of operations for the year ended December 31, 1987, and existing circumstances, the Company is unsure whether it is able to issue any additional first mortgage bonds.

At December 31, 1987, the amount outstanding under the Company's $800 million revolving credit agreement consisted of $150 million bearing an interest rate of 9⅝ percent, $130 million at 9⅞ percent, and $70 million at 9 1/16 percent. During January, 1987, seven of the participating banks (representing over 24 percent of the aggregate commitments under the credit agreement) notified the Company that in view of the Company's present financial condition, projected liquidity crisis, and failure to obtain adequate rate relief, a material adverse change of the type specified in the credit agreement exists. Whatever the rights of the parties may be under the agreement, the Company has been notified by the banks that they will not make additional loans under the agreement at this time. Amounts outstanding under the agreement at September 12, 1988, are repayable over a three-year period with the first payment due on March 12, 1989.

American Municipal Bond Assurance Corporation (AMBAC). The Company has agreements with AMBAC which guarantee the payment of principal and interest on $65,735,000 of pollution control revenue bonds. Such agreements require the Company to make cash reserve deposits (or, alternatively, sign a promissory note for 20% percent of the cash reserve deposit then payable) upon the occurrence of a material development as defined in the agreements. A material development was deemed by AMBAC to have occurred as of September 30, 1986, as a result of the Company's fixed charge coverage ratio (calculated in accordance with the agreements) being below the required level specified in the agreement. The cash reserve deposit required was approximately $55 million. The Company executed one year

notes totaling approximately $110 million in lieu of making a cash deposit. In November, 1987, AMBAC disputed the fixed charge coverage ratio submitted by the Company based on the results of operations as of September 30, 1987. The Company contended that the material development asserted by AMBAC no longer existed and requested cancellation of the notes by AMBAC.

During January, 1988, the Company and AMBAC amended the original agreement. As part of the settlement, the Company agreed to deposit $12 million in an escrow account which may be returned to the Company, based on the fixed charge coverage ratio at and subsequent to April, 1990, while AMBAC agreed to cancel the notes totaling $110 million and agreed that no further cash deposits would be required through April, 1990. The Company and AMBAC also agreed to amend the calculation of the fixed charge coverage ratio.

Deferred River Bend Construction and Continuing Services Commitment. The Company has previously reported that certain post completion costs relating to the construction of River Bend remain unpaid to Stone & Webster Engineering Corporation, the general contractor on the project. As of December 31, 1987, the Company's share of such costs amounted to $46,848,000. The Company and Stone & Webster reached an agreement whereby such costs would be paid by the Company and CEPCO in total monthly installments of $2 million beginning February 1, 1988, and continuing until the principal amount due and related accrued interest is paid. At current interest rates, these monthly payments would continue for approximately 37 months. The Company and CEPCO own 70 percent and 30 percent of the unit, respectively. The Company is negotiating for a further deferral and has not commenced making such payments.

In addition, an agreement has also been reached regarding the payment of costs relating to a continuing services agreement with Stone & Webster. Under the agreement, the Company's portion of the accumulated charges accrued at December 31, 1987, of $13,681,000, will be payable in full on January 1, 1989, and will include accrued interest on the amount due. Costs for services rendered under the agreement subsequent to March 31, 1987, are being paid monthly as incurred.

12. Notes Payable

As of December 31, 1987, the Company had agreements with banks and banking institutions which provided for short-term lines of credit totaling approximately $77 million of which $65 million is collateralized as described below. There can be no assurance that the remaining unsecured sources of short-term funds may be accessed at this time, or will remain available, or that new sources can be arranged. Interest rates associated with these lines are based on the prime rate. Commitment fees range from 3/8 of 1 percent to 3/4 of 1 percent of the amount of available credit. In lieu of commitment fees, certain banks require a nonrestricted cash balance be maintained equal to 5 percent to 10 percent of the commitment.

Information regarding short-term debt outstanding is detailed below:

	1987	1986	1985
	(In thousands except percents)		
Maximum amount outstanding during period			
Bank notes	$ —	$9,000	$157,000
Commercial paper	—	—	5,000
Average daily amount outstanding			
Bank notes	—	37	40,619
Commercial paper	—	—	14
Weighted average interest rate for amount outstanding at end of period			
Bank notes	—	—	—
Commercial paper	—	—	—
Weighted average annual interest rate(a)			
Bank notes	—	7.87%	8.81%
Commercial paper	—	—	8.75

(a) Calculated by dividing the sum of the effective interest for the year by the average daily short-term debt outstanding.

Included in the $77 million short-term lines of credit is a $65 million credit facility to be terminated and paid on or before May 28, 1988. The facility is fully underwritten by Irving Trust Company and is collateralized by a pledge of the Company's accounts receivable and the Lewis Creek Generating Station (the Station), a 530 megawatt gas-fired generating facility. The Station has been transferred to a new wholly-owned subsidiary, GSG&T, Inc. The Company is leasing the Station from the subsidiary and will continue to operate the Station. The credit agreement contains negative covenants which, among other restrictions, restrict the incurrence of additional debt, creation of liens, payment of dividends, sale of assets, and acquisition of assets.

13. Purchase Power Agreements

The Company has agreements with the participants in Nelson Unit 6 and River Bend (see Note 8) to buy back declining amounts of their share of the capacity of these units for periods ranging from seven to fourteen years in the case of Nelson Unit 6 and five years in the case of River Bend. The variable costs associated with such buybacks are composed of fuel costs and operations and maintenance expenses, while the fixed costs are based upon gross plant investment and other factors. For the years ended December 31, 1987, 1986, and 1985, variable costs applicable to the Nelson Unit 6 buybacks were $12.8 million, $16.4 million, and $25.2 million, respectively, while the fixed costs associated with such buybacks were $17.9 million, $20.9 million, and $26.9 million, respectively. Based upon current information, the Company estimates that the fixed costs incurred in connection with the Nelson Unit 6 buybacks will range in declining amounts from $18 million in 1988 to $5 million in 1992. From 1993 through 1996, aggregate payments for the buybacks of power of such unit are estimated to be approximately $14 million.

River Bend is jointly owned by the Company and CEPCO. Previously, the Company was obligated to purchase 100 percent of CEPCO's share of the unit's capacity for one year and thereafter declining amounts for two years. However, on September 2, 1986, the letter of agreement between the Company and CEPCO was amended to change the original three-year schedule to a five-year schedule beginning on June 16, 1986, the commercial operation date of River Bend. The fixed costs incurred in connection with the buybacks of power under the new agreement were $150.4 million and $92.5 million for the years ended December 31, 1987 and 1986, respectively, and will range in declining amounts from $99 million in 1988, to $17 million in 1991. For the years ended December 31, 1987 and 1986 variable costs applicable to the River Bend buyback were $49.7 million and $14.9 million, respectively.

The Company and CEPCO are parties to FERC proceedings regarding certain long standing disputes relating to transmission charges, and the Company has offset January, 1987 buy-back payments against claims asserted by the Company. At December 31, 1987, the Company claimed CEPCO had underpaid transmission charges in the amount of $24.1 million. Such amount was recorded on the balance sheet as an account receivable and offsetting amount in dispute. CEPCO disputes the offset and certain other payment adjustments made by the Company and claims the Company is approximately $19 million in arrears under the buyback arrangement. The Company also claims that CEPCO owes it approximately $21.1 million of overpayments relating to the River Bend buyback which are not reflected in the financial statements. The Company has advised CEPCO that it may need to renegotiate the River Bend buyback agreement if adequate and timely permanent rate relief is not received.

As discussed in Note 1, the Company entered into contracts, which it asserts are terminated and on which it is currently withholding payment, with the Southern Company providing for power purchases by the Company. The fixed costs applicable to the power purchases from the Southern Company are based on costs of existing and future generating units and other factors. For the years ended December 31, 1987, 1986, and 1985, the fixed costs associated with the power purchases totaled approximately $15.4 million, (excluding withheld payments), $112.6 million, and $132.3 million, respectively. Under the terms of the contract, if determined to still be effective, the Company would be required to make, on a take-or-pay basis, payments for fixed costs currently estimated to range in amounts from $135 million to $82 million during the period from 1988 through 1992. The variable costs associated with such purchases are composed of fuel costs and operation and maintenance expense. For the years ended December 31, 1987, 1986, and 1985, such variable costs totaled $60.3 million, $58.6 million, and $125.1 million, respectively.

14. Subsequent Events

On February 18, 1988, the Louisiana state district court judge issued a preliminary injunction ordering the immediate implementation of a $92 million rate increase (which included the $63 million granted by the LPSC on December 15, 1987) and setting the return on common equity at 14 percent. The judge also adopted a phase-in plan which meets the guidelines set forth in SFAS No. 92 for a qualified phase-in of the prudent costs of the Company's River Bend investment as determined by the LPSC. As a result, the Company will record in 1988, for financial

reporting purposes, the deferred revenue requirements associated with such plan subject to the outcome of the appeal discussed in Note 3.

The first-year $92 million increase will remain in effect until the appeal of the LPSC's December 15, 1987 order on the merits, is decided. No assurance can be given as to the timing or outcome of such appeal.

On February 23, 1988, the PUCT preliminarily ruled on the prudency of River Bend. The PUCT found $1.6 billion of the Company's total River Bend plant investment and $187 million of the related Texas retail jurisdiction deferred River Bend costs were prudent. The remaining $1.5 billion of the River Bend plant investment and $151 million of the Texas retail jurisdiction deferred River Bend costs were placed into abeyance with no finding as to prudency. The PUCT stated that the ultimate rate treatment of the amounts placed in abeyance will be subject to a future demonstration by the Company of the prudency of such costs. The PUCT has requested additional information from the Company regarding revenue requirements resulting from the above ruling. The Company cannot predict the ultimate outcome of the Texas rate proceedings, or any possible appeals, or when they will finally be concluded. The preliminary review of such proposals indicate that if relief is finally so limited, it may be insufficient to prevent the Company from having to seek relief from its creditors under the Bankruptcy Code.

In late February, 1988, the Company and Stone & Webster reached an agreement to defer the $2 million monthly payments to Stone & Webster, which were to begin in February 1988, until July 1, 1988.

15. Quarterly Financial Information (Unaudited) (in thousands except per share amounts)

	Operating Revenue	Operating Income	Net Income	Earnings Per Average Common Share Outstanding
1987				
First Quarter	**$302,835**	**$ 53,607**	**$41,110**	**$.23**
Second Quarter	**364,114**	**100,633**	**61,524**	**.43**
Third Quarter	**429,387**	**134,119**	**90,260**	**.69**
Fourth Quarter	**336,250**	**88,261**	**48,207**	**.30**
1986				
First Quarter	$ 375,171	$ 78,170	$ 66,117	$.48
Second Quarter	358,848	77,511	64,648	.46
Third Quarter	405,915	99,909	90,081	.69
Fourth Quarter	338,454	58,216	24,135	.08

Auditors' Report

To the Shareholders of Gulf States Utilities Company:

We have examined the balance sheet and the statement of capitalization of GULF STATES UTILITIES COMPANY as of December 31, 1987 and 1986, and the related statements of income, sources of funds invested in utility and other plant, and changes in capital stock and retained earnings 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 accounting records and such other auditing procedures as we considered necessary in the circumstances.

As of December 31, 1987 and 1986, the Company has capitalized approximately $3 billion of construction costs related to its River Bend Nuclear Generating Plant and has capitalized, in accordance with regulatory orders, $808 million and $321 million, respectively of deferred charges representing plant operating and carrying costs incurred subsequent to commercial operation. Without regulatory orders prescribing the deferral and capitalization of such operating and carrying costs, net income for 1987 and 1986 would have been reduced by $390 million ($3.61 per share) and $234 million ($2.20 per share), respectively. During 1986, the Company filed requests with regulatory commissions in Texas and Louisiana requesting rate increases for recovery of River Bend construction costs and deferred charges. As discussed in Notes 3 and 14, if existing regulatory orders are not modified, a significant write-off of capitalized costs associated with River Bend may be required. The extent of recovery of capitalized River Bend costs will not be determinable until appropriate proceedings, including court appeals, have been concluded. In the opinion of management, no assurance can be given that the Company will ultimately earn an adequate return on or fully recover its investment in River Bend.

As discussed in Notes 1 and 3, the Company is involved in legal proceedings relating to contractual disputes, shareholder litigation and rate issues. Management cannot predict what effect the ultimate resolution of these proceedings will have upon the Company's financial position or results of operations.

As discussed in Note 1, insufficient rate increases, among other things, will also result in a need for funds in excess of the currently estimated resources of the Company. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

In our opinion, subject to the effects on the 1987 and 1986 financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainties and the recoverability and classification of recorded asset amounts and the amount and classification of liabilities discussed in the preceding paragraphs been known, the financial statements referred to above present fairly the financial position of GULF STATES UTILITIES COMPANY at December 31, 1987 and 1986, and the results of its operations and the changes in its financial position for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

Houston, Texas
February 23, 1988

Coopers & Lybrand

Statistical Summary

For the years ended December 31

	1987	1986	1985	1984	1983
ELECTRIC DEPARTMENT					
Number of customers at year end:					
Residential	**484,838**	484,608	485,825	485,711	475,782
Commercial	**61,861**	62,059	61,712	60,372	57,446
Industrial	**4,319**	4,322	4,398	4,302	4,146
Temporary construction	**1,442**	1,656	2,188	2,924	3,624
Other	**2,445**	2,430	2,333	2,182	2,101
Total Customers	**554,905**	555,075	556,456	555,491	543,099
Sales — Kilowatt hours (thousands):					
Residential	**6,208,961**	6,174,567	6,224,555	6,209,347	5,686,436
Commercial	**4,911,378**	4,920,882	4,964,416	4,745,055	4,341,093
Industrial	**11,811,676**	12,158,762*	13,590,004	15,924,402	14,257,141
Temporary construction	**16,241**	42,498	47,475	57,354	55,927
Other	**1,485,242**	1,508,245	1,890,700	2,152,052	2,109,974
Total Sales	**24,433,498**	24,804,954	26,717,150	29,088,210	26,450,571
Revenue — (thousands):					
Residential	**$ 430,392**	$ 425,206	$ 528,593	$ 434,946	$ 396,026
Commercial	**312,544**	309,440	358,882	278,155	255,147
Industrial	**476,871**	500,026*	680,755	573,839	534,066
Temporary construction	**1,364**	3,066	3,666	3,702	3,699
Other	**108,935**	120,690	142,509	120,059	116,511
Total Revenue	**$1,330,106**	$1,358,428	$1,714,405	$1,410,701	$1,305,449
Average Annual KWH Use Per Customer:					
Residential	**12,818**	12,731	12,806	12,901	12,097
Commercial	**79,180**	79,416	80,951	80,264	77,138
Industrial	**2,744,986**	2,781,053	3,110,553	3,725,006	3,431,322
Revenue Per KWH — (cents):					
Residential	**7.17**	6.89	8.49	7.01	6.96
Commercial	**6.73**	6.29	7.23	5.86	5.88
Industrial	**4.14**	4.11	5.01	3.60	3.75
Electric Energy Output — Thousands of KWH:					
Net Generated	**23,421,700**	23,009,283	19,286,014	26,218,067	25,846,238
Net Purchased and Interchanged	**4,593,232**	5,281,404	11,340,923	6,953,777	4,987,292
	28,014,932	28,290,687	30,626,937	33,171,844	30,833,530
System Peak Load — Including Interruptible Load — Megawatts	**4,991**	5,089	5,139	5,475	5,348
Total Capability, Including Contract Purchases at Time of System Peak Load (MW)	**6,871**	7,548	6,610	6,780	7,152
Load Factor	**64.1%**	63.5%	68.0%	69.0%	65.8%
STEAM PRODUCTS DEPARTMENT					
Steam Revenue (thousands)	**$ 69,056**	$ 77,783	$ 102,576	$ 83,165	$ 83,646
Steam Sales — KWH (millions)	**2,187**	2,144	2,288	2,606	2,555
Steam Sales — millions of pounds	**8,593**	7,516	7,695	8,466	8,559
GAS DEPARTMENT					
Gas Revenue (thousands)	**$ 33,424**	$ 33,125	$ 41,455	$ 53,175	$ 47,093
Number of Customers	**83,003**	83,994	85,039	85,665	85,737
Output — MM cu. ft. of natural gas purchased	**7,305**	7,086	8,454	8,252	9,149
Sales — MM cu. ft.	**7,489**	7,065	7,946	9,140	8,498
WEATHER DATA					
Cooling degree days (Normal 2,696)	**2,650****	2,935	2,877	2,654	2,473
Percentage change from normal	**(1.7)**	8.9	6.7	(1.6)	(8.2)
Heating degree days (Normal 1,830)	**1,882****	1,636	1,565	2,062	1,829
Percentage change from normal	**2.8**	(10.6)	(14.5)	12.7	(.1)

* Excludes 182,580 MWH and $9,052 applicable to prior periods, related to capitalized River Bend construction energy.

** Estimated

Officers

Chairman, President and CEO

E. Linn Draper, Jr. (8) 45
Chairman of the Board, President and Chief Executive Officer

Special Advisor to the Chairman

Paul W. Murrill (5) 53
Special Advisor to the Chairman

Senior Executive Vice Presidents

Joseph L. Donnelly (8) 58
Senior Executive Vice President and Chief Financial Officer

Edward M. Loggins (29) 57
Senior Executive Vice President

Senior Vice Presidents

William J. Cahill, Jr. (7) 64
Senior Vice President-Special Projects

James C. Deddens (4) 59
Senior Vice President-River Bend Nuclear Group

Calvin J. Hebert (25) 53
Senior Vice President-External Affairs

Vice Presidents

James R. Aldridge (7) 57
Vice President-Human Resources

William E. Barksdale (30) 56
Vice President-Engineering and Technical Services

Amery J. Champagne (14) 44
Vice President-Energy Resources

Anthony F. Gabrielle (7) 60
Vice President-Computer Applications

Charles D. Glass (38) 59
Vice President-Operations

William J. Jefferson (7) 58
Vice President-Rates and Regulatory Affairs

Cecil L. Johnson (11) 45
Vice President-Legal Services

James E. Moss (29) 51
Vice President-Marketing

Jack L. Schenck (6) 49
Vice President & Treasurer

Bobby J. Willis (25) 51
Vice President & Controller

Jasper F. Worthy (31) 59
Vice President-General Services

Division Vice Presidents

John W. Conley (29) 56
Division Vice President-Western

Arden D. Loughmiller (26) 49
Division Vice President-Beaumont

Ronald M. McKenzie (21) 47
Division Vice President-Port Arthur

J. Ted Meinscher (37) 55
Division Vice President-Lake Charles

James D. Watkins (29) 56
Division Vice President-Baton Rouge

Other Officers

Leslie D. Cobb (32) 52
Secretary

Clyde W. McBride (10) 35
Assistant Treasurer

Timothy L. Morris (8) 36
Assistant Secretary

( ) Years of service
Ages and years of service as of December 31, 1987

Directors

Directors

*Robert H. Barrow
General, Retired Commandant
United States Marine Corps
St. Francisville, LA (1984)

**John W. Barton
Vice President-Louisiana
Aircraft, Inc.
Baton Rouge, LA (1970)

Joseph L. Donnelly
Senior Executive Vice President
and Chief Financial Officer
Beaumont, TX (1986)

*E. Linn Draper, Jr.
Chairman of the Board,
President and Chief Executive Officer
Beaumont, TX (1985)

Martin Goland
President-Southwest
Research Institute
San Antonio, TX (1983)

Edwin W. Hiam
Investment Consultant
Boston, MA (1959)

William H. LeBlanc, Jr.
Chairman of the Board
of Baton Rouge Supply Co., Inc.
Baton Rouge, LA (1974)

Charles W. McCoy
Chairman of the Board
Premier Bancorp Inc.
Baton Rouge, LA (1985)

*Paul W. Murrill
Special Advisor to the Chairman
Beaumont, TX (1978)

Monroe J. Rathbone, Jr.
Medical doctor and partner-
The Surgical Clinic
Baton Rouge, LA (1975)

*Nat S. Rogers
Consultant-First City
Bancorporation of Texas, Inc.
Houston, TX (1978)

Sam F. Segnar
Chairman of the Board
Vista Chemical Co.
Houston, TX (1988)

*Bismark A. Steinhagen
Chairman of the Board-
Steinhagen Oil Company, Inc.
Beaumont, TX (1974)

James E. Taussig II
President-Taussig Corporation
Lake Charles, LA (1975)

*Executive Committee
**Chairman, Executive Committee
( )Year Elected

Principal Offices

350 Pine Street
Beaumont, Texas
77701

Divisions

285 Liberty Avenue
Beaumont, Texas
77701

1540 Ninth Avenue
Port Arthur, Texas
77640

Highway 75 North
Conroe, Texas
77301

446 North Boulevard
Baton Rouge, Louisiana
70802

314 Broad Street
Lake Charles, Louisiana
70601

Stockholder Information

Stock Listing
Gulf States Utilities Company's common stock is traded under the symbol GSU on the New York, Midwest and Pacific Stock Exchanges.

Stock Transfer Agents
Gulf States Utilities Company
Beaumont, Texas

Morgan Shareholder Services
Trust Company
New York, New York

Registrars
First City National Bank of Beaumont
Beaumont, Texas

Morgan Shareholder Services
Trust Company
New York, New York

Dividend Reinvestment Plan Agent
Gulf States Utilities Company
P. O. Box 1671
Beaumont, Texas
77704

Form 10-K

The Form 10-K Annual Report to the Securities and Exchange Commission and GSU's 1987 Financial and Statistical Report can be obtained without charge from Leslie D. Cobb, Secretary, P. O. Box 2951, Beaumont, Texas 77704.

Notice of Annual Meeting

The 1988 Annual Meeting of shareholders will be held at 2 p.m., Thursday, May 5, 1988, in the company's headquarters, 350 Pine Street, Beaumont, Texas. Formal notices of the meeting, proxy statements and proxies will be mailed to the common shareholders on or about March 18, 1988. Shareholders are invited to attend, but if they cannot, they are urged to fill out and return their proxies.

Gulf States Utilities Co.
P. O. Box 2951
Beaumont, Texas 77704

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