

*Brazos Electric
Power Cooperative, Inc.
1985 Annual Report*



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The Brazos System

The Brazos System is a public utility system serving the rural areas of Texas. It is a member of the Rural Electrification Administration (REA) and is committed to providing reliable and affordable electric service to its customers. The system is owned and operated by The Brazos Electric System, Inc., a public utility company. The system's service area covers a large portion of rural Texas, and it is dedicated to meeting the needs of its customers through continuous investment in infrastructure and customer service.

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Kilovolt-ampere - 1,000 volt-amperes
A measure of capability of electrical equipment to operate under load without heat damage. This figure is the mathematical product of voltage times current (ampere).

British Thermal Unit
A measure of heat.

MMBTU - One Million BTU's

Cignite - A low quality coal.

Mill - One-tenth of a cent.

1985 was the 50th anniversary of the Rural Electrification Administration: a year of celebration and a year of reflection.

It was a time to look back on those days, less than a generation ago, when life in rural Texas was hard. When each day meant a struggle with the elements and a race with the sun to finish the work before nightfall... a time before lights came on.

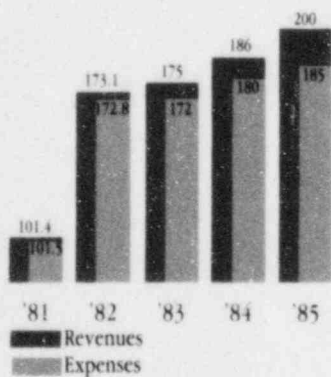
It was a year to pay tribute to the rural people who laid down their lanterns and plows to join together for the common goal of rural electrification.

This cooperative spirit—the drive for a better quality of life today and for the future—is “alive and well” among the people of our service area. So, in this year of recognition, we would like to pay tribute to them; their spirit, their achievements, and their dreams and dedicate our 1985 Annual Report to the people of The Brazos System.

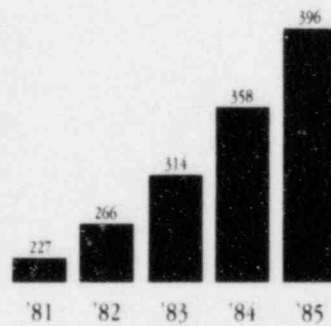
Financial and Operating Highlights

	1985	1984	1983
Total Operating Revenues (000's)	\$200,430	\$186,164	\$174,860
Total Operating Expenses (000's)	\$185,243	\$180,394	\$172,479
Operating Margins (Loss) (000's)	\$ 15,187	\$ 5,770	\$ 2,381
Total Assets (000's)	\$444,515	\$400,826	\$351,987
Total Equity (000's)	\$ 47,253	\$ 29,949	\$ 23,497
Times Interest Earned Ratio (TIER)	1.51	1.22	1.10
Debt Service Coverage (DSC)	1.54	1.27	1.15
Energy Sales (Megawatt hours)			
Member Cooperatives	3,033,643	2,846,999	2,498,886
Municipal Customers	386,707	341,058	303,299
Economy Sales	523,226	370,149	461,793
Total	<u>3,943,576</u>	<u>3,558,206</u>	<u>3,263,978</u>
Peak Demand (Megawatts)	721	650	624

Revenues & Expenses (in \$ millions)

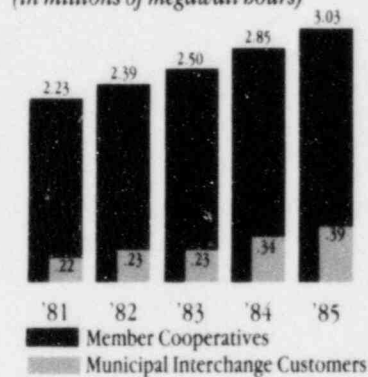


Net Utility Plant (in \$ millions)

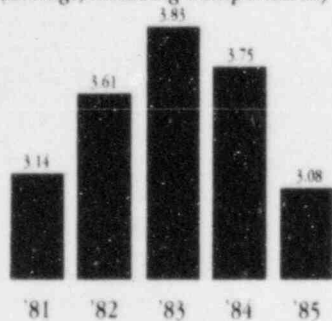


Energy Sales

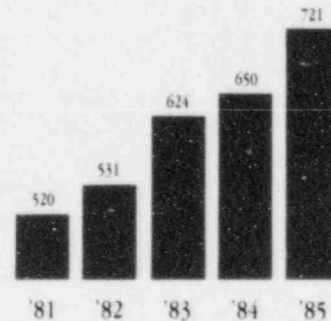
(in millions of megawatt hours)



Natural Gas Cost (\$ per MCF)
(average, including transportation)

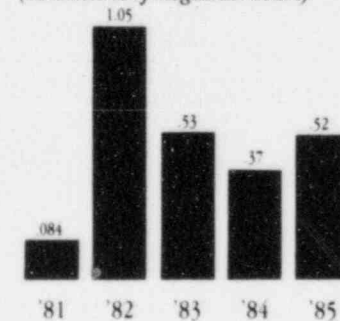


Peak Demand (megawatts)



Economy Energy Sales

(in millions of megawatt hours)





Report to Members

We are pleased to report that the average cost of wholesale power to our members decreased again this year. The change was small, but it was in the right direction. Several factors contributed to this accomplishment. The San Miguel Plant, which provides approximately 60 percent of our power, again operated at a high capacity factor for Brazos, 78 percent. Furthermore, the San Miguel Electric Cooperative was able to return to Brazos approximately \$3.1 million due to efficient operations and fuel cost savings in 1984.

Also contributing to the reduction in power cost was the decline in natural gas costs which we were able to realize. In our last report, we spoke enthusiastically about our new, natural gas pipeline. This year we are even more enthusiastic. Even by conservative estimates, the pipeline paid for itself in 13 months through fuel cost savings! At year end, our purchases on the spot market were at a unit cost which had declined 46 percent in 16 months.

We recognize that the gas glut, with its low prices, will not last forever. Consequently, we are looking for additional reserves for our long-term supply.

During 1985, we dealt with one of the more crucial challenges in the history of the Cooperative: ending our exposure to further price escalation of the Comanche Peak Nuclear Plant. Acquiring our 3.8 percent share in 1979 was a sound business decision. Since that time, the project has experienced delays and substantial cost increases. Now it is in the best interest of our consumers for us to limit our financial exposure to the project. Consequently, we have withheld construction payments and have been negotiating with Texas Utilities Electric Company to limit our investment in the project.

Another issue continues to challenge the entire rural electrification program. As rural electric consumers throughout the nation celebrated the fiftieth anniversary of rural electrification, people who do not understand this very successful program and its contribution to the nation and the national economy were trying to dissolve the Rural Electrification Administration and its loan programs. They are persistent. Every time our broad constituency defeats them, they try again. Removal of this financing

*Beneath the historic
Suspension Bridge in Waco flow
the waters of the Brazos River.
They are waters that originate
up in the Texas Panhandle as
three ordinary forks. These
forks combine to form the river
that has brought growth and
prosperity as it has coursed
through the heart of our state
and the heart of The Brazos
System. Ever since we took its
name back in 1941, this river
has been a binding thread in
the fabric that is Brazos Electric
Power Cooperative.*

*Our President, William
Parker (left), and General
Manager, Richard McCaskill
(right), today provide the
leadership that ensures Brazos'
future growth and prosperity.
Our headquarters are located
not far from the Brazos River,
which serves as an ongoing
reminder of change and
stability and of our continued
success in serving fellow
Texans who have chosen
Brazos' service area as
their home.*

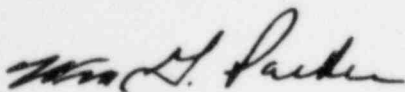
source could create considerable hardship for our members and their consumers. We do believe that Brazos could obtain other financing.

Last year we reported that we would need new generation plant capacity in 1992. For the past two years, the growth of our peak demand has been so strong that the date may have to be advanced to 1991. Our pooling of capacity through our membership in the Texas Municipal Power Pool will still allow us to delay this plant from 1986 to that time with a resulting savings of approximately \$40 million per year. The reduction in natural gas prices and the availability of cogeneration power give us considerable flexibility in choosing the most economical source for our next capacity addition.

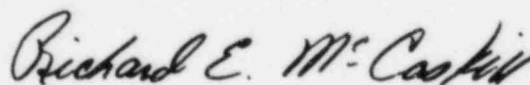
Our municipal customers have been managing their systems with increased professionalism and sophistication. Seymour recently consolidated the electric systems within its city limits by purchasing the facilities of another utility to end 50 years of dual service. Hearne has decided to purchase all of its power from Brazos. Previously, it used its own generation facilities to meet its peak load. Each of these cities is responding to its own specific needs and we support them in that effort.

A change in our membership resulted from the merger of Robertson Electric and Limestone County Electric this past spring. The unified cooperative is Navasota Valley Electric Cooperative with headquarters in Franklin, Texas.

Our report would be incomplete without special recognition of three friends and directors who retired from our board: F.C. Luedtke, Horace LeNoir, and Melvin Jordan. We thank them for their many years of service to Brazos, The Brazos System, and rural electrification. And, we wish them well in their retirement and future pursuits.



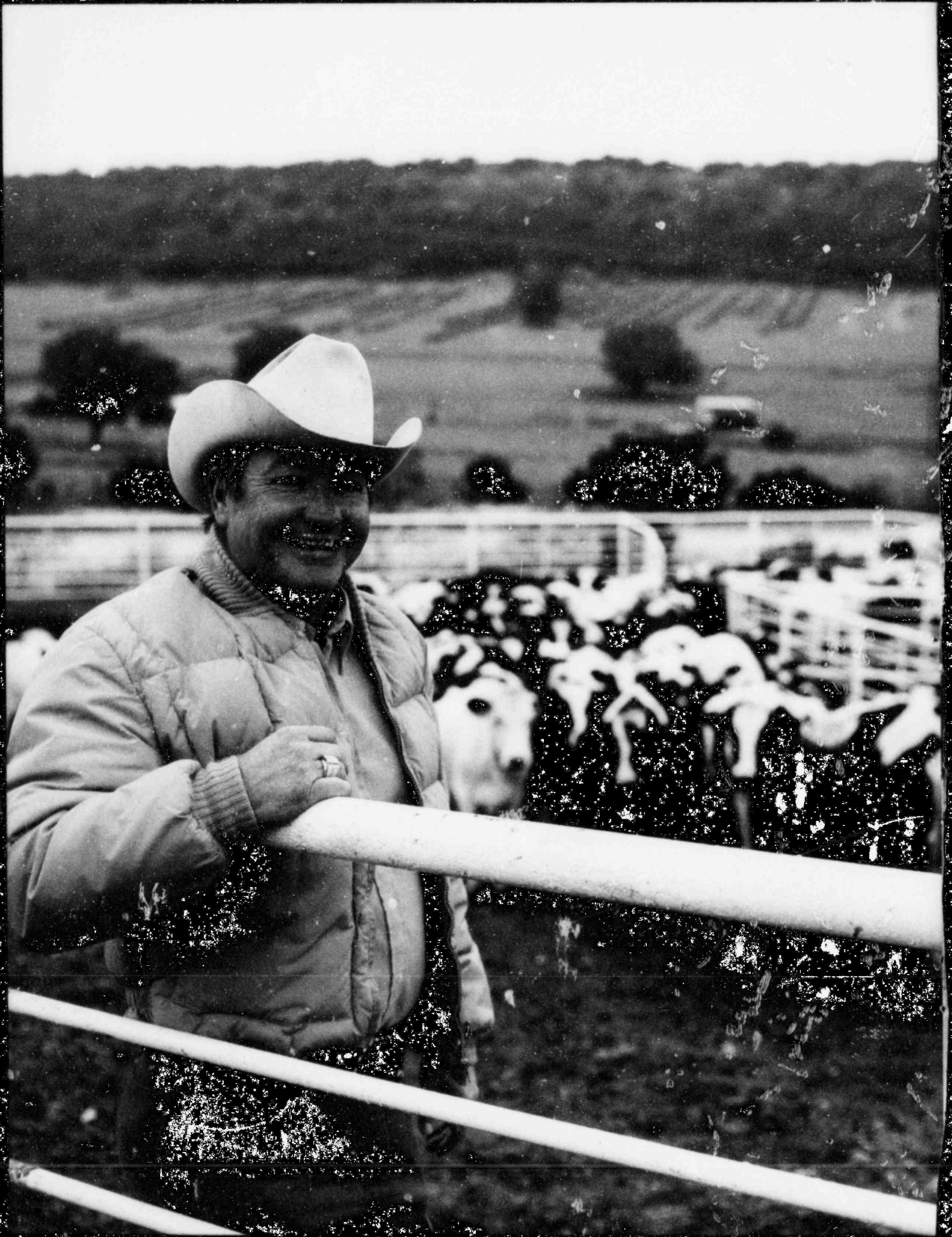
William G. Parker
President



Richard E. McCaskill
Executive Vice President
and General Manager

The community feeling still thrives in Falls County. That group spirit is evident in the folks that gather at Gene Jansing's grocery store and in his dedication to serving them. It's the same cooperative spirit that pulled rural people together in the 1930s to bring electricity to their farms, churches—and even to that little store in Westphalia.*





Year in Review

Sales and Growth

Growth in our peak demand has accelerated during the past two years. Our peak demand this summer was 721 megawatts, a 10.9 percent increase over 1984. Energy sales to our cooperative and municipal customers increased 7.3 percent to 3,420,350 megawatt hours. Much of this growth comes from the unabated, suburban development in the Dallas-Fort Worth area.

Plans for Future Growth

Circumstances present us with an uncommon variety of opportunities for meeting our growth. From now through approximately 1991, we will take advantage of our membership in the Texas Municipal Power Pool and more economical alternatives, when available, to meet our load. In the meantime we will be taking measures to control demand.

Management of consumer demand has gained increased attention in the electric utility industry. With the ultimate objective of improving consumer relations, it has a more immediate goal of slowing the growth of rates. By using demand-side management techniques to delay plant construction and operate our existing facilities at a higher average usage, we should be able to achieve that goal, assuming fuel costs remain reasonable. Our board of directors has taken the initial step of appointing a Marketing and Load Management Committee. We are very enthusiastic about moving in this direction. We see only opportunities ahead. Aside from gaining more control of rates, we believe that the programs we develop with our member cooperatives will improve our understanding of their needs and will bring all of us closer to our consumers. Moreover, we feel that the effort will provide some of our employees with new leadership, management, and professional challenges which will allow them to grow.

When new capacity is required, we have several choices. If natural gas prices remain low, construction of gas turbines to meet our growing peak will be beneficial. Alternatives for meeting our base load include power from cogeneration or small power production sources, purchases from other utilities, and a second unit at the San Miguel plant site.

Joe and Howie and his wife Oleta used to work by lantern light to raise hogs and sheep on their farm across the road from here. This little section of Texas, like many others, didn't see electric light until the 1940s, when the then Brazos River Transmission Electric Cooperative was founded. Today, their son Willard (left) runs the farm that is now Howie's Mountain Road Dairy, an Erath County Dairy of Merit anticipating its third generation of dairymen in the 1980s. An American success story—right here in The Brazos System.

System Reliability

We are pleased with the reduction in outage time we have achieved this past year. We decreased the average outage time per substation to 48.0 minutes from 60.4 in 1984. The increase in reliability stems in part from our transmission pole inspection and treatment program begun in 1981 and from an infrared monitoring program begun last year. Viewing transmission and substation facilities through a device that makes infrared light visible has enabled us to detect overheated components that are candidates for failure. They then can be replaced or repaired before they cause an outage.

Our training also has had a positive effect on reliability. The increased awareness of operating personnel has led to early identification and elimination of various equipment problems.

Another long-term process that contributes to our system reliability is intensive planning to evaluate where and when new or upgraded transmission facilities will be needed. Our planning division determines where weaknesses will occur under selected conditions as our load increases. They then determine the most economical way to prevent failures by upgrading the system—adding new transmission lines, increasing the voltage and capacity of existing lines, and using other methods.

At the appropriate time, our engineers begin design and procurement to upgrade the facility. Right-of-way alternatives are selected and evaluated. Easements are obtained and construction follows. This year we built 37 miles of 138KV transmission line. We also added five new substations to support our members' growth.

We expanded our microcomputer communications to six stations primarily in the northwest area of our system. Substation remote control and monitoring was extended to eight additional locations. These improvements will increase our reliability, enabling us to shorten outage times in these areas.

Transmission Line Right-of-Way

One of the difficulties we have encountered in building new facilities is obtaining right-of-way. We need to strengthen our system primarily in

suburban areas where most of our growth is occurring.

"The average [consumer] of today is not as close to the cooperative (many are of a new generation) and they measure our success by the quality and price of service to themselves."

"... it was necessary to condemn fifty out of eighty-eight ... landowners in order to obtain the easements needed to serve the same [consumers] from whom we were attempting to obtain the easements."

The preceding quotations are from our 1955 annual report so one cannot say that our problems are new.

However, obtaining right-of-way has again become more difficult. Understandably, everyone would prefer to have electricity come from a plug instead of through transmission and distribution lines along rights-of-way on or near their property. Nevertheless, such lines are an integral part of our service obligation; and they must be timely built. Recently, the Public Utility Commission of Texas (PUC) has intensified its scrutiny of the location of proposed transmission lines in its certification process. We do not oppose those efforts of the PUC that are consistent with its own rules and the law. We pride ourselves on our care in selecting routes that minimize the impact on landowners and the environment, and we studiously adhere to federal and PUC regulations regarding transmission line route selection and construction. We accept the obligation and challenge of proving to our regulators and to the public that our actions, including our transmission line route selections, are in the public interest.

Natural Gas Supply

We are delighted with the results of our fuel operations this year. In our Report to Members, we related the savings resulting from our pipeline. We have been studying to what extent a pipeline to our North Texas Plant might improve the reliability of the plant's gas supply as well as making its gas purchases more competitive.

While we have been able to take advantage of the gas market for current savings, we recognize the need to develop long-term supplies that will reflect at least some of the current improvements in pricing. At present, "long-term" appears to be no better than one year with options for renewal with price redetermination. We will keep close to the market to benefit from opportunities when they occur.

Economic Dispatch Operations

During 1985, Brazos, as a member of the Texas Municipal Power Pool, saved approximately \$1.2 million for our members and municipal customers through economic dispatch of the Pool's generating facilities. Since 1982, these savings have been approximately \$9.5 million. The other Pool members, the cities of Bryan, Denton, Garland and Greenville, have achieved proportionate savings. Economic dispatch operations consist of choosing the best combination of generating units to meet the Pool's load and reserve requirements and then loading the units in relation to their fuel costs per KWH to minimize the cost of electricity.

Member Prepayment Plan

The Member Prepayment Plan, initiated in 1982, has proved extremely beneficial to Brazos and its membership. Through this plan, our members have an investment alternative that yields a return greater than might otherwise be available. At the same time, their prepayments provide a source of short-term financing for Brazos at a cost that is lower than what we might find elsewhere. For example, prepayments in December 1985 amounted to approximately \$14.2 million. Participating members earned a return based on an annual rate of 8 1/8 percent and Brazos was able to save one percentage point of interest cost.

Merit Compensation Plan

This year we developed and instituted a compensation plan that gives more opportunity to reward exceptional performance.

It provides supervisors with more flexibility to choose the level of compensation as well as the timing of increases. Implementation has been

*Just about the last thing
you would expect to find in the
farm-and-ranch-dominated
counties of the Brazos System
is a mecca for artists. In a mere
10 years, Hoka Hey has become
just that. Just as the rural
people of the 1930s sacrificed
those precious five dollars to
make the dream of a new life
with electricity come true,
Wade Cowan and his family
sacrificed to make Hoka Hey
the success it is today. Both, in
their own way, are a lasting
tribute to the value of
following your dreams.*





*Hidden away in a small
Bosque County town was a star
in his own right. Magdaleno
Trujillo was a remnant of a
breed of craftsmen that is no
longer easily found in our
mass-produced world.*

*Magdaleno passed away
February 19, 1986, three
months after we spent a
delightful morning
interviewing him in his boot
shop in Meridian. We deeply
regret his loss, but hope that
our story will be a fitting
tribute to his memory.*

*Although Magdaleno is gone,
his respect for hard work and
quality products is a tradition,
and always will remain a
common thread among his
neighbors and patrons—the
people of The Brazos System.*

accomplished smoothly. The increase in payroll will be nominal. Time will show the benefits of the increased incentive.

Coincidentally with the merit compensation program, we revised our employee evaluation system to make it more effective and a better communications tool. To date, we are very pleased with the results. We are also pleased that both of these changes were effected with little, outside consultation. The results reflect very favorably on the capabilities of our personnel.

Insurance

As many businessmen and public administrators well know, liability insurance has become scarce and its cost, exorbitant. We have also experienced unexpected changes in our fire and extended coverage insurance. Consequently, early in 1985 we retained an insurance consultant for one year to advise us on risk management. We feel that we will be able to achieve more effective and economical insurance coverage as a result of this review and support.

Management

Executive Vice President and General Manager

Richard E. McCaskill, age 49, joined Brazos in 1979. He is also the General Manager of San Miguel Electric Cooperative, Inc. in Jourdanton, Texas.

McCaskill is a graduate of Texas Tech University, where he earned a Bachelor of Science Degree in Electrical Engineering. He has worked in the electric utility industry for 20 years, including positions as Assistant Division Manager, Safety Engineer, Training Director and Division Manager for Central Power and Light Company in Corpus Christi. Upon coming to Brazos in 1979, McCaskill assumed the duties of Manager—Engineering, Power Supply and Construction. He was elected to his current position in January, 1981.

McCaskill is a registered Professional Engineer in the state of Texas and a member of the Texas Tech Electrical Engineering Industrial Advisory Committee. He is a director of InterFirst Bank in Waco.

Assistant General Manager

J.D. Copeland, Jr., age 41, joined Brazos in 1971 as an accountant, became Manager of the Accounting Department in 1977 and was promoted to his current position in 1984. He also is Assistant to the General Manager of San Miguel Electric Cooperative, Inc. in Jourdanton, Texas.

Copeland received a Bachelor of Business Administration Degree in 1970 and a Masters of Business Administration Degree in 1977, both from Baylor University. He became a Certified Public Accountant in 1972. He is also a member of the American Institute of Certified Public Accountants and the Texas Society of Certified Public Accountants.

Executive Assistant and Manager—Public Relations

Francis M. Bushnell Jr., age 42, joined Brazos in 1979 as Executive Assistant and was given the added responsibility of Manager—Public Relations in 1980.

Bushnell received his Bachelor of Science Degree in Engineering and Business Administration from Princeton University in 1965. He spent nine years as a submarine officer in the U.S. Navy Nuclear Power Program. He was employed by Stone & Webster Engineering Corporation for four years, where he administrated a nuclear power project and was a Marketing Engineer.

He is a certified instructor for the Dale Carnegie Course and is also President Elect of the Central Texas Chapter of the Public Relations Society of America.

Manager—Fuel Operations

Clifford L. Sartin, age 56, joined Brazos Fuel Company in 1974.

Sartin graduated from Texas Tech University in 1954 with a Bachelor of Science Degree in Petroleum Geology and minor in Chemistry. Before joining Brazos Fuel, he had extensive experience as an oil and gas exploration geologist and spent three years primarily exploring for lignite reserves. He worked for Cities Service Petroleum Company for seven and one-half years. He also served as Senior Geologist for National Soil Services, Inc. from 1966-1974.

Manager—Finance and Administration

Clarence W. Carpenter, age 53, joined Brazos in 1967 as Manager—Accounting Department. He was promoted to his current position in 1977.

Carpenter received a Bachelor of Business Administration Degree from Baylor University and became a Certified Public Accountant in 1963. Prior to coming to Brazos, Carpenter worked for the Internal Revenue Service for seven years.

Carpenter is Director of the Texas Society of Certified Public Accountants and Past President of the Central Texas Chapter of Certified Public Accountants. He is Past President of the National G&T Accountants Association.

Manager—Operations

Dan B. Swenke, age 47, joined Brazos in 1966 as a Junior Engineer. He has served in numerous positions including Design Engineer, Chief System Operator and Manager—Transmission Department.

Prior to coming to Brazos, Swenke had construction experience as an officer in the United States Army Corps of Engineers. He earned a Bachelor of Science Degree in Civil Engineering in 1963 from Texas Tech University, and is a registered Professional Engineer in Texas.

Manager—Project Construction and Engineering

Billy Dyess, age 55, joined Brazos in 1974 as Construction Supervisor and was promoted to his present position in 1981.

Prior to coming to Brazos, Dyess was employed by Hicks and Ragland Consulting Engineering Company. He advanced in the company to serve as Vice President—Director of Field Operations from 1968-1974. In this position, he was responsible for design and construction management, regulatory processes and public relations.

Dyess served two terms in the United States Army in 1947-1948 and 1950-1951, where he continued his education through various correspondence courses.

Manager—Corporate Planning

William B. Townsend Jr., age 46, joined Brazos in 1964 as a Junior Engineer. He was appointed Chief System Operator in 1967, Manager of Engineering (including construction) in 1970 and Administrative Assistant in 1980. He was appointed to his current position in 1981.

He received a Bachelor of Arts Degree in Math from Texas A&M University in 1963 and a Bachelor of Science Degree in Electrical Engineering in 1966.

Townsend is a registered Professional Engineer in Texas and the Brazos representative on the Electric Reliability Council of Texas (ERCOT)—Technical Advisory committee. He has held the positions of Secretary, Vice President and President of the Central Texas Chapter of the Texas Society of Professional Engineers.

Deep in the heart of the Brazos System is Texas A&M University, an institution known world-wide for its outstanding programs, faculty and students. Meet Becky and Beth Aldridge, two of those outstanding students, whose lives were permanently changed by the influence of 4-H and the caring sponsors that guided them. Their success story is but one example of the bright future in store for The Brazos System.



AMICUS
ROSS

Treasurer's Report

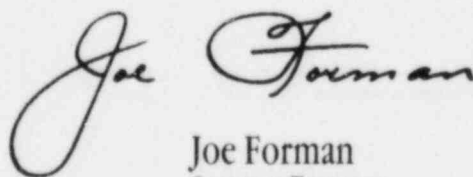
The Consolidated Statement of Revenue and Patronage Capital and Other Equities of the Cooperative and its wholly owned subsidiary, the Brazos Fuel Company, Inc., reflects that operations produced net margins of \$17,304,142 for the calendar year 1985. Margins improved significantly compared to the net margins of \$6,451,275 reported in 1984. The margins from 1985 resulted in a Times Interest Earned Ratio (TIER) of 1.51 and a Debt Service Coverage (DSC) of 1.54. The TIER and DSC ratios are key financial indicators used by the Rural Electrification Administration in assessing the ability of the Cooperative to meet its mortgage requirements.

Operating margins from the Cooperative's operations for 1985 were \$15,162,802. These margins and patronage capital allocations received have been allocated to customers on a patronage basis. Total patronage capital allocated was \$16,449,819.

This year, total assets exceeded \$440 million. Total revenues were \$200 million. The distribution of revenues indicates that purchased power continues to be the major cost item. We present at the right the distribution of both the 1984 and the 1985 revenue dollars.

The Cooperative received Rural Electrification Administration and Federal Financing Bank loan fund advances of \$27,709,000 during 1985. These funds were REA guaranteed. These advances were used to finance the construction of transmission facilities and to finance the cost of our 3.8% interest in the Comanche Peak Nuclear Plant. Long-term debt at year-end was just under \$372 million.

The Cooperative's total margins and equities of \$47.3 million represent 10.6% of the \$444.5 million total assets.



Joe Forman
Secretary-Treasurer



Distribution of 1985 Revenue Dollar

Purchased Power	47.8c
Wages & Other Costs	1.2c
<hr/>	
Fuel Cost	27.9c
Generated Power	29.1c
Operating Margins	7.6c
Interest	5.8c
Depreciation & Amortization	3.2c
Transmission	4.0c
Administrative & General	1.8c
Taxes	.7c
	<u>100.0c</u>

Distribution of 1984 Revenue Dollar

Purchased Power	52.2c
Wages & Other Costs	1.0c
<hr/>	
Fuel Cost	27.6c
Generated Power	28.6c
Operating Margins	3.1c
Interest	5.8c
Depreciation & Amortization	3.3c
Transmission	4.3c
Administrative & General	2.0c
Taxes	.7c
	<u>100.0c</u>

1985 Financial Statement

The financial strength and resilience of the Brazos System stems from its member cooperatives and customers. They serve consumers in rural, suburban, and urban areas totaling nearly 20% of Texas. This vast service area provides diversity for income sources of residential, agricultural and industrial loads. It also provides strong growth in energy sales.

Comparative Summary of Electrical Operations 1981-1985*

	1985	1984	1983	1982	1981
(Mills per KWH)					
Total Operating Revenue (1)	50.8	52.3	53.3	46.8	40.1
Operating Costs					
Production expenses (2)	39.1	42.3	43.4	39.5	34.1
Transmission expenses	2.0	2.3	2.5	2.2	1.6
Administrative and general expenses	.6	.6	.6	.8	1.0
Depreciation, taxes, insurance, interest	5.3	5.5	6.0	4.1	3.4
Total Operating Costs	47.0	50.7	52.5	46.6	40.1
Net Operating Margin (Loss)	3.8	1.6	.8	.2	(-)
(1) Average sales price by class					
Firm power sales					
Member Cooperatives	53.5	53.7	55.6	49.9	40.1
Cities	52.3	53.9	56.4	50.8	42.4
Surplus power sales					
Cities	33.3	39.3	38.0	37.9	33.9
(2) Further analyzed by source					
Generated power					
Cost of fuel	33.5	39.6	40.9	39.1	34.1
Wages and other costs	1.4	1.5	1.7	1.2	1.0
Purchased power					
For system	36.1	38.7	38.6	36.3	24.9
At isolated meter points	48.5	45.5	43.8	41.6	35.6

*Excludes operations of Brazos Fuel Company, Inc.

Comparative Summary of Electrical Operations 1981-1985*

	1985	1984	1983	1982	1981
Electricity Generated and purchased—In Megawatt Hours					
Generated at W.R. "Bob" Poage Plant	—	—	—	—	—
Generated at North Texas Plant	100,473	5,131	8,814	22,890	71,897
Generated at Randle W. Miller Plant	1,570,418	1,291,634	1,118,547	1,499,573	1,494,217
Purchased for system					
A. From San Miguel Electric Cooperative	1,558,827	1,707,432	1,668,411	1,654,877	366,664
B. From other utilities	355,562	206,859	229,462	170,161	295,685
Purchased at isolated meter points	548,418	509,537	460,553	458,434	412,529
	<u>4,133,698</u>	<u>3,720,593</u>	<u>3,485,787</u>	<u>3,805,935</u>	<u>2,640,992</u>
Electric Sales—In Megawatt Hours					
A. Firm					
Member Cooperatives	3,033,643	2,846,999	2,498,886	2,389,141	2,226,904
Municipal Customers	386,707	341,058	303,299	272,603	218,956
	<u>3,420,350</u>	<u>3,188,057</u>	<u>2,802,185</u>	<u>2,661,744</u>	<u>2,445,860</u>
B. Economy Sales					
	<u>523,226</u>	<u>370,149</u>	<u>461,793</u>	<u>1,003,469</u>	<u>83,595</u>
	<u>3,943,576</u>	<u>3,558,206</u>	<u>3,263,978</u>	<u>3,665,213</u>	<u>2,529,455</u>
Electric Sales to Member Cooperatives—In Megawatt Hours					
Bartlett Electric Cooperative, Inc.	57,341	53,251	47,297	47,221	43,646
Belfalls Electric Cooperative, Inc.	44,270	42,152	39,125	42,317	46,837
B-K Electric Cooperative, Inc.	65,057	68,565	61,230	61,530	62,194
Comanche County Electric Cooperative Assn.	152,581	150,106	141,177	136,675	123,059
Cooke County Electric Cooperative Assn.	266,709	257,327	244,152	234,604	220,337
Denton County Electric Cooperative, Inc.	336,826	292,555	242,089	218,286	195,937
Erath County Electric Cooperative Assn.	169,997	167,941	153,394	146,638	137,763
Fort Belknap Electric Cooperative, Inc.	117,100	113,499	105,013	94,726	84,994
Hamilton County Electric Cooperative Assn.	86,380	82,260	75,894	75,602	69,983
Hill County Electric Cooperative, Inc.	143,945	133,026	115,100	111,916	103,032
J-A-C Electric Cooperative, Inc.	98,332	97,748	87,038	82,017	73,085
Johnson County Electric Cooperative Assn.	382,877	345,719	299,957	286,371	259,155
McLennan County Electric Cooperative, Inc.	94,132	87,206	77,712	77,009	75,815
Mid-South Electric Cooperative Assn.	192,991	179,825	155,889	156,657	141,804
Navarro County Electric Cooperative, Inc.	130,092	139,314	91,528	86,241	95,233
Navasota Valley Electric Cooperative, Inc.**	137,990	122,104	108,079	109,827	100,309
Tri-County Electric Cooperative, Inc.	406,035	372,215	323,536	301,061	283,580
Wise Electric Cooperative, Inc.	150,988	142,186	130,676	120,443	110,141
	<u>3,033,643</u>	<u>2,846,999</u>	<u>2,498,886</u>	<u>2,389,141</u>	<u>2,226,904</u>

*Excludes operations of Brazos Fuel Company, Inc.

**Formed by the merger of Limestone County Electric Cooperative, Inc. and Robertson Electric Cooperative, Inc. in April 1985. Sales in preceding years have been restated.

	1985	1984	1983	1982	1981
Maximum Kilowatt Demand At Member Delivery Points	<u>759,495</u>	<u>683,450</u>	<u>612,297</u>	<u>568,681</u>	<u>556,837</u>
Annual Load Factor Percent Member Cooperatives	46	47	47	48	46
Electric Energy Sales					
Member Cooperatives	\$162,216,740	\$152,868,791	\$138,873,457	\$119,214,939	\$ 89,373,467
Municipal and Economy	<u>37,662,417</u>	<u>32,956,026</u>	<u>34,699,138</u>	<u>51,976,783</u>	<u>11,830,747</u>
	<u>\$199,879,157</u>	<u>\$185,824,817</u>	<u>\$173,572,595</u>	<u>\$171,191,722</u>	<u>\$101,204,214</u>
Other Electric Revenue	<u>584,387</u>	<u>371,785</u>	<u>233,616</u>	<u>184,241</u>	<u>245,027</u>
Total Operating Revenues	<u>\$200,463,544</u>	<u>\$186,196,602</u>	<u>\$173,806,211</u>	<u>\$171,375,963</u>	<u>\$101,449,241</u>
Operating Expenses					
Production Expense- Generated Power	\$ 58,382,299	\$ 53,333,538	\$ 48,018,505	\$ 59,530,029	\$ 54,979,207
Production Expense- Purchased Power	95,769,789	97,200,643	93,506,213	85,265,221	31,174,730
Transmission Expense	7,920,251	8,036,110	8,264,545	8,121,976	4,092,502
Insurance and Welfare Expense	1,304,137	1,459,113	1,344,556	1,200,410	954,435
Other Administrative & General Expenses	2,421,413	2,274,458	1,955,285	1,783,918	1,635,066
Depreciation and Amortization	6,434,379	6,048,486	5,631,674	5,126,312	3,826,420
Taxes	1,393,705	1,279,700	1,046,208	1,082,647	1,014,270
Interest on Long-Term Debt	33,798,340	29,081,630	26,620,960	22,403,479	15,530,709
Other Interest	280,301	487,041	972,492	1,047,359	583,981
Less Interest Charged to Construction	(22,403,872)	(18,820,116)	(17,466,851)	(14,735,721)	(12,438,836)
Other Operating Deductions	—	—	1,566,127	144,739	179,555
Total Cost of Electric Service	<u>\$185,300,742</u>	<u>\$180,380,603</u>	<u>\$171,459,714</u>	<u>\$170,970,369</u>	<u>\$101,532,039</u>
Gain (Loss) in Operating Margins	\$ 15,162,802	\$ 5,815,999	\$ 2,346,497	\$ 405,594	\$ (82,798)
Non-Operating Margins	2,121,009	701,313	366,651	337,760	92,624
Gain (Loss) in Total Margins	<u>\$ 17,283,811</u>	<u>\$ 6,517,312</u>	<u>\$ 2,713,148</u>	<u>\$ 743,354</u>	<u>\$ 9,826</u>

Consolidated Balance Sheet

<i>December 31, 1985 and 1984</i>	1985	1984
ASSETS (Note 2)		
Utility Plant (Notes 1, 3 and 12):		
Electric plant in service, at cost	\$212,365,725	\$201,032,449
Completed construction not classified	4,306,888	4,380,007
Construction work in progress	225,153,717	195,096,121
Nuclear fuel in process of refinement and enrichment	9,758,886	8,747,213
	<u>451,585,216</u>	<u>409,255,790</u>
Less accumulated provision for depreciation and amortization	55,998,607	50,893,788
Utility plant, net	<u>395,586,609</u>	<u>358,362,002</u>
Other property and investments:		
Investments in associated organizations:		
Capital term certificates (NRUCFC)	7,070,764	7,070,764
Patronage capital (Note 1)	2,137,204	1,114,644
Other	5,819	6,036
Restricted assets and other investments:		
Certificates of deposit	4,855	13,859
	<u>9,218,642</u>	<u>8,205,303</u>
Current assets:		
Cash—general	714,795	2,040,418
Cash—loan funds	115,954	47,156
Special deposits	72,675	64,675
Temporary cash investments	7,900,000	1,445,600
Accounts receivable	18,425,788	18,445,453
Fuel inventory, at average cost	3,242,111	3,344,797
Material and supplies, at average cost	6,477,767	5,953,419
Prepayments	14,159	84,320
Total current assets	<u>36,963,249</u>	<u>31,425,838</u>
Deferred charges: (Note 4):		
Unrecovered purchased fuel costs, less allowance for unrecoverable gas of \$225,034 and \$160,880 (Notes 1 and 12)	382,698	543,759
Fixed transmission costs, less amortization of \$1,699,592 and \$1,274,694	378,267	803,165
Other	1,985,693	1,486,017
	<u>2,746,658</u>	<u>2,832,941</u>
	<u>\$444,515,158</u>	<u>\$400,826,084</u>

	1985	1984
LIABILITIES		
Equity and margins:		
Memberships	\$ 90	\$ 95
Patronage capital and other equities (Note 5)	47,252,772	29,948,630
	<u>47,252,862</u>	<u>29,948,725</u>
Long-term debt: (Notes 5 and 6)		
REA mortgage notes	81,454,784	84,728,820
NRUCFC mortgage notes	15,626,848	10,545,339
FFB mortgage notes	274,616,000	252,629,000
	<u>371,697,632</u>	<u>347,903,159</u>
Current liabilities:		
Current maturities of long-term debt	3,817,800	3,520,000
Accounts payable	20,413,612	15,250,203
Notes payable—NRUCFC (Note 8)	—	2,900,000
Other accrued liabilities	1,222,104	1,142,027
Total current liabilities	<u>25,453,516</u>	<u>22,812,230</u>
Deferred credits (Note 7)	<u>111,148</u>	<u>161,970</u>
	<u>\$444,515,158</u>	<u>\$400,826,084</u>

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

Consolidated Statement of Revenue and Patronage Capital and Other Equities

Years Ended December 31, 1985 and 1984	1985	1984
Operating revenues:		
Sales of electric energy (Notes 1 and 10)	\$199,879,157	\$185,824,817
Other	550,637	338,823
	<u>200,429,794</u>	<u>186,163,640</u>
Operating costs and expenses:		
Operating expense:		
Operation expense:		
Production—fuel (Note 1)	55,712,307	51,129,695
Production—other	1,222,445	1,014,299
Purchased power	95,769,790	97,200,643
Transmission	5,891,140	5,883,761
Distribution	289,243	287,857
Administrative and general	3,808,866	3,801,710
Maintenance expense:		
Production	1,120,766	961,584
Transmission	1,142,007	1,098,378
Distribution	597,861	766,114
General plant	181,513	160,223
Depreciation and amortization (Note 1)	6,436,805	6,050,623
Taxes	1,404,227	1,290,384
Interest on long-term debt	33,798,340	29,081,630
Other interest	271,740	487,041
Interest charged to construction (Note 1)	(22,403,872)	(18,820,116)
Total operating costs and expenses	<u>185,243,178</u>	<u>180,393,826</u>
Operating margins	15,186,616	5,769,814
G & T Capital Credits	1,151,928	281,750
Other capital credits and patronage dividends	121,905	131,979
Non-operating margins:		
Interest income	842,565	261,443
Other	1,128	540
Margins before Federal income tax	17,304,142	6,445,526
Federal income tax (benefit) (Note 11)	—	(5,749)
Net margins	17,304,142	6,451,275
Patronage capital and other equities, beginning of year	29,948,630	23,497,355
Patronage capital and other equities, end of year	<u>\$ 47,252,772</u>	<u>\$ 29,948,630</u>

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

Consolidated Statement of Changes in Financial Position

Years Ended December 31, 1985 and 1984	1985	1984
Working capital provided from:		
Net margins	\$17,304,142	\$ 6,451,275
Depreciation and amortization	6,436,805	6,050,623
Patronage capital allocations	(1,273,833)	(413,729)
Working capital provided from operations	22,467,114	12,088,169
Advances from REA	—	3,603,000
Advances from FFB	22,061,000	49,142,000
Advances from CFC	5,648,000	1,264,400
Salvage value of retirements	1,003,864	786,055
Contributions for line removal and relocation	15,328	345,569
Decrease in unrecovered purchased fuel costs	161,061	161,135
Decrease in other property and investments— net of capital credits and patronage capital allocations	260,494	—
Total working capital provided	51,616,861	67,390,328
Working capital used for:		
Additions to utility plant	43,794,346	50,417,528
Reduction of long-term debt to REA	3,274,036	2,925,651
Reduction of long-term debt to CFC	566,491	524,504
Reduction of long-term debt to FFB	74,000	—
Plant removal costs	461,361	374,900
Decrease in deferred credits	50,821	58,050
Increase in other deferred debits	499,676	15,652
Increase in other property and investments—net of capital credits and patronage capital allocations	—	1,130,780
Decrease in memberships	5	—
Total working capital used	48,720,736	55,447,065
Increase in working capital	\$ 2,896,125	\$11,943,263
Changes in working capital:		
Increase (decrease) in current assets:		
Cash	\$(1,256,825)	\$ 326,462
Temporary cash investments	6,454,400	1,445,600
Special Deposits	8,000	(62,960)
Accounts receivable	(19,665)	223,444
Material and supplies	421,662	1,897,045
Prepayments	(70,161)	230
	5,537,411	3,829,821
Increase (decrease) in current liabilities:		
Current maturities of long-term debt	297,800	(178,000)
Accounts payable	5,163,409	(1,747,531)
Notes payable	(2,900,000)	(1,917,500)
Other accrued liabilities	80,077	(4,270,411)
	2,641,286	(8,113,442)
Increase in working capital	\$ 2,896,125	\$11,943,263

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

Notes to Consolidated Financial Statements

1—Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Cooperative and its wholly-owned subsidiary, Brazos Fuel Company. All intercompany items have been eliminated in consolidation.

System of Accounts

The accounting records of the Cooperative conform to the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission for Class A and B electric utilities modified for electric borrowers of the Rural Electrification Administration (REA).

Electric Revenues and Fuel Costs

Electric revenues are recorded monthly as of the date meters are read and accounts are billed.

Fuel costs are charged to production expense as fuel is consumed.

Plant Additions and Retirements

The cost of additions to electric plant in service represents the original cost of the contracted services, direct labor and material, interest on construction loans, and indirect charges for engineering, supervision and similar overhead items. Maintenance and repairs of property and replacements and renewals of items determined to be less than units of property are charged to operations. For property replaced or renewed, the original cost plus removal cost less salvage is charged to accumulated provision for depreciation. The cost of related replacements and renewals is added to electric plant. Contributions in aid of

construction are credited to the applicable plant accounts.

Interest Charged to Construction

The Cooperative has capitalized as a part of electric plant the cost of borrowed funds used for such purposes, net of interest earned on "idle" advances of the borrowings. This procedure is in accordance with that prescribed by REA.

Patronage Capital Certificates

Patronage capital from associated organizations is recorded at the stated amount of the certificates.

Unrecovered Purchased Fuel Costs

Natural gas purchased under the take or pay terms of contracts with various individual producers is recorded at contract cost, which includes production taxes and royalties. The amount of gas paid for in advance is classified as a deferred debit. Unpaid production taxes and royalties, related to the above contracts, are included in deferred credits until such time that the gas purchased and not taken will actually be recovered by the Cooperative.

An allowance for unrecoverable gas is provided for by charges to income. The allowance is based upon a determination by the Cooperative's consulting engineers as to the volume of gas losses in each well.

2—Assets Pledged

All assets are pledged as security for the long-term debt to REA, National Rural Utilities Cooperative Finance Corporation (CFC) and Federal Financing Bank (FFB).

3—Utility Plant

Listed below are the major classes of utility plant as of December 31, 1985 and 1984:

	December 31,	
	1985	1984
Intangible plant	\$ 2,170	\$ 2,170
Production plant	60,395,163	59,953,744
Transmission plant	108,876,114	103,028,281
Distribution plant	36,897,188	33,663,622
General Plant	6,195,090	4,384,632
Completed construction not classified	4,306,888	4,380,007
Electric plant in service	216,672,613	205,412,456
Construction work in progress	225,153,717	195,096,121
Nuclear fuel in process of refinement and enrichment	9,758,886	8,747,213
	<u>\$451,585,216</u>	<u>\$409,255,790</u>

Depreciation

Provision has been made for depreciation on a straight-line basis at annual composite rates as follows:

Production plant	3.10%
Transmission plant	2.75%
Distribution plant	2.88%
General plant:	
Structures and improvements	2.50%
Transportation	15.50%
Communications	6.50%
Other general plant	6.00%
EDP equipment	16.00%

Included in construction work in progress at December 31, 1985, are costs of \$201,625,464 for the purchase of 3.8% ownership of the Comanche Peak Nuclear Generating Station.

4—Deferred Charges

Following is a summary of amounts recorded as deferred charges at December 31, 1985 and 1984.

	1985	1984
Unrecovered purchase of fuel costs, less allowance for unrecoverable gas	<u>\$ 382,698</u>	<u>\$ 543,759</u>
Fixed transmission costs, less amortization	<u>\$ 378,267</u>	<u>\$ 803,165</u>

The Cooperative has constructed a 78 mile, 345KV transmission line from the San Miguel Electric Cooperative, Inc. generating plant (Plant) to a point of interconnection with another utility. Power is transmitted from the plant to the point of interconnection and is wheeled by other utilities into the Brazos transmission system. Certain fixed costs associated with the line, and charges from other utilities for wheeling services, were deferred pending commercial operation of the Plant which occurred in early 1982. The deferred costs are being amortized to expense on a straight-line basis over a period of 5 years.

Deferred charges—other:	1985	1984
Preliminary survey and investigation charges	\$1,754,946	\$1,304,174
Miscellaneous deferred charges	77,765	102,405
Work done for others	152,982	79,438
	<u>\$1,985,693</u>	<u>\$1,486,017</u>

Notes to Consolidated Financial Statements (continued)

5—Patronage Capital and Other Equities

Detail of patronage capital:

	December 31,	
	1985	1984
Assignable	\$16,449,819	\$ 6,242,912
Assigned	26,246,393	20,016,665
	<u>42,696,212</u>	<u>26,259,577</u>

Detail of other equities:

Capital gains and losses	9,383	9,383
Nonoperating margins	4,318,468	3,471,291
Retained earnings of subsidiary	228,709	208,379
	<u>4,556,560</u>	<u>3,689,053</u>
Total patronage capital and other equities	<u>\$47,252,772</u>	<u>\$29,948,630</u>

Under provisions of the long-term debt agreements, until the total of equities and margins equals or exceeds 40% of the total assets of the Cooperative, the return to patrons of capital contributed by them is limited generally to 25% of the patronage capital or margins received by the Cooperative in the next preceding year.

On February 26, 1986, the Board of Directors authorized payment of capital credits in 1986 for the years 1961 through 1966 in the amount of \$4,264,593, subject to REA approval and the availability of funds.

The by-laws of the Cooperative do not provide for the assignment of nonoperating margins or earnings of subsidiaries. The by-laws permit the offsetting of current year operating margins against operating deficits of prior years.

6—Long-Term Debt

Long-term debt consisted of the following at December 31, 1985 and 1984.

	1985	1984
REA—Installment mortgage notes:		
2%, various maturity dates to November 28, 2014	\$55,860,848	\$58,660,694
5%, various maturity dates to September 12, 2018	28,768,936	29,063,126
	<u>84,629,784</u>	<u>87,723,820</u>
Less: Current maturities	3,175,000	2,995,000
	<u>81,454,784</u>	<u>84,728,820</u>
CFC—Installment mortgage notes:		
7%, matures November 30, 2007	6,350,619	6,468,790
7%, matures May 31, 1989	1,649,178	2,051,348
14%, matures November 30, 2016	1,283,451	1,285,801
11%, matures August 31, 2018	6,912,400	1,264,400
	<u>16,195,648</u>	<u>11,070,339</u>
Less: Current maturities	568,800	525,000
	<u>15,626,848</u>	<u>10,545,339</u>
FFB—Mortgage notes:		
Various interest rates from 9.15% to 13.081% maturing at various dates from 1-27-86 to 12-31-2019	274,690,000	252,629,000
Less: Current maturities	74,000	—
	<u>274,616,000</u>	<u>252,629,000</u>
	<u>\$371,697,632</u>	<u>\$377,903,159</u>

Unadvanced loan funds of \$11,565,000 at 5% and \$1,775,600 at 11% are available to the Cooperative on commitments from REA and CFC, respectively.

Principal and interest instalments on the above REA and CFC notes are due quarterly in equal amounts of approximately \$1,952,000.

Long-term debt to FFB consists of 9.15% to 13.081%, 2 to 32 year notes payable with principal and interest payments of

approximately \$7,677,000 due quarterly. The Cooperative has an option to extend the due dates, of the 2 year notes, for a period not less than two years nor greater than seven years after the date of the advance; or to extend the maturity date to thirty-four years after the end of the calendar year in which the advance was made. At December 31, 1985, the Cooperative had \$134,561,647 of advances with short-term maturity dates which they intend to refinance under the above options. These advances have been classified as long-term debt for financial statement purposes. Unadvanced loan funds of \$28,371,000 are available to the Cooperative on loan commitments from FFB.

At December 31, 1985, estimated annual maturities of long-term debt outstanding for the next five years are as follows:

	REA	CFC	FFB	Total
1986	\$ 3,175,000	\$ 568,800	\$ 74,000	\$ 3,817,800
1987	3,367,000	633,900	524,000	4,524,900
1988	3,450,000	681,000	799,000	4,930,000
1989	3,537,000	461,800	1,125,000	5,123,800
1990	3,625,000	217,500	1,503,000	5,345,500
	<u>\$17,154,000</u>	<u>\$2,563,000</u>	<u>\$4,025,000</u>	<u>\$23,742,000</u>

7—Deferred Credits

Deferred credits consisted of the following at December 31, 1985 and 1984:

	1985	1984
Deferred production taxes	\$ 43,965	\$ 52,894
Deferred royalties	64,105	76,349
Deferred cost of fuel paid in advance	—	29,649
Miscellaneous	3,078	3,078
	<u>\$111,148</u>	<u>\$161,970</u>

Deferred production taxes and royalties are costs incurred in obtaining gas under the take or pay obligation of the Cooperative's contracts with various producers. These costs are deferred until such time that the gas will be taken by the Cooperative.

Deferred cost of fuel paid in advance represents the net obligation due to gas producers under the take or pay provisions of the fuel contracts, but of which a clear title of ownership has not been established by the producer. When clear title is established, the producer will be paid for the gas. If a clear title is not established, the producer is released from contract and the Cooperative has no obligation for the fuel.

8—Line of Credit Agreement

The Cooperative has established a line of credit, for short-term financing, with CFC for \$40,000,000. At December 31, 1985, no funds were owed under such agreement. In addition, the Cooperative has established a line of credit, for short-term financing, with a bank for \$20,000,000 at the prime interest rate. Prior approval from CFC is required if the combined borrowing under the lines of credit will exceed \$40,000,000. The Cooperative has not borrowed any funds under the agreement with the bank.

Notes to Consolidated Financial Statements (continued)

9—Retirement Plan

The Cooperative has a contributory retirement plan covering substantially all of its employees. Total retirement costs charged to operations for 1985 and 1984, were \$388,084 and \$333,251, respectively, and include charges for current and prior service costs. The Cooperative's policy is to fund retirement cost annually as it is accrued.

The actuarially computed value of vested benefits at December 31, 1984 (date of latest information available) was \$6,683,002. The book value of the retirement fund assets at December 31, 1984 was \$9,093,406.

10—Transactions with Member Cooperatives

The Cooperative has contracts with 17 of its 18 member distribution cooperatives, through June 30, 2020, for the sale of wholesale electric energy. The contract with the other member cooperative is through the period June 30, 2010. Sales of electric energy to the 18 members were \$162,216,740 and \$152,868,791 for 1985 and 1984, respectively.

11—Federal Income Taxes

Federal income taxes are paid on taxable income of the subsidiary only. No provision has been made for Federal income taxes for the Cooperative in reliance on a determination letter, dated March 12, 1969, issued by Internal Revenue Service, which states that in the opinion of the Service the Cooperative meets the requirements of Section 501(c)(12) of the

Internal Revenue Code and is entitled to exemption from Federal income tax.

The tax benefit of \$5,749 in the year ended December 31, 1984, represents a refund due from Internal Revenue Service resulting from a net operating loss of the subsidiary in 1984.

12 - Commitments and Contingencies

Joint Ownership Agreement

The Cooperative, pursuant to a Joint Ownership Agreement with Texas Utilities Electric Company (TUEC) and affiliates thereof, executed on June 1, 1979, has an undivided 3.8% ownership interest in the Comanche Peak Nuclear Generating Station (Project).


During 1985, the Cooperative and TUEC began negotiations intended to limit the Cooperative's financial obligation with regard to the Project. Also, during 1985, the Cooperative notified TUEC of the existence of a dispute regarding the Project and began withholding construction progress payments. A proposed settlement agreement has been prepared by the Cooperative and TUEC and forwarded to the Rural Electrification Administration (REA) for their approval.

As of December 31, 1985, the Cooperative has invested \$211,385,350 in the Project as construction payments, nuclear fuel, associated transmission facilities, and interest during construction and other indirect costs; exclusive of \$13,577,235 in withheld progress payments. Loans from the Federal Financing Bank, guaranteed by REA, totalling \$193 million were available for the Project.

When the Project begins commercial operation, a rate increase will be necessary to recover construction costs of the Project. As part of the anticipated rate proceeding, it is expected that the Public Utility Commission of Texas will inquire into the prudence of Brazos' investment in Comanche Peak. Brazos expects to justify fully before the Commission that the investment in Comanche Peak is in the public interest and will be used and useful in rendering utility service. Should the Commission find that some portion of the Project is to be disallowed for rate making purposes, the Cooperative may be required to write off that portion of the cost of the Project which is disallowed. The Cooperative is unable to determine whether or not some portion of the Project cost will be disallowed; additionally, the Cooperative is unable to determine the materiality of any disallowance should it occur and its effect on Brazos' rates and earnings, inasmuch as Brazos' return on invested capital has been treated historically by the Commission as a function of Brazos' cash requirements and not determined independently thereof.

Unrecovered Purchased Fuel Costs

The Cooperative has contracted to purchase gas from various individual producers, in addition to other suppliers. The remaining term of the majority of these contracts is approximately 8 years. Under the terms of the contract agreements, the Cooperative has agreed to purchase and receive, or pay for if available and not taken, a quantity of gas as set forth in the contracts. The contracts provide for the recovery of gas paid for, but not taken. It is the opinion of management, that with proper monitoring of reservoir performance and field surveillance of operating conditions, failure to recover gas paid for but not taken above the allowance for unrecoverable gas, will be minimal; and that such failures, should they occur, are a proper increment of the cost of actual gas delivered and therefore recoverable, under the Cooperative's rate structure, from its customers.



KMG Main Hurdman

Certified Public Accountants

Central Texas Tower
PO. Box 7616
Waco, TX 76714-7616

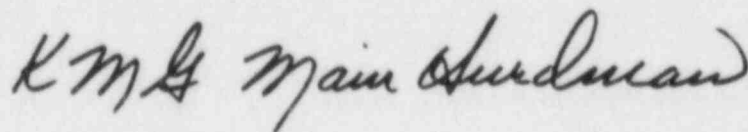
Telephone: (817) 776-4190

The Board of Directors
Brazos Electric Power Cooperative, Inc.

We have examined the consolidated balance sheet of Brazos Electric Power Cooperative, Inc. and subsidiary as of December 31, 1985 and 1984, and the related consolidated statements of revenue and patronage capital and other equities and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note 12, the recovery of certain construction costs associated with the 3.8% joint ownership of the Comanche Peak Nuclear Generating Station is dependent upon future events, the outcome of which cannot presently be determined.

In our opinion, subject to the effects on the financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, such financial statements present fairly the financial position of Brazos Electric Power Cooperative, Inc. and subsidiary at December 31, 1985 and 1984, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.



February 28, 1986 (except as to Note 12 - Commitments and Contingencies - Joint Ownership Agreement which is as of April 18, 1986)



Member of Klynveld Main Goerdeler

*The Spirit of
the Brazos System
as Seen in Six
Brazos Friends.*

*Eugene Jansing's Grocery,
Westphalia, Texas*

To the casual observer, it could seem like just another slow-paced community, with an unusual name, on one of Texas' back roads. The tall white steeples of the local church, which is the pride of the settlement, seem to be the only things worthy of notice. Other than the blinking yellow light in the middle of FM 320, there doesn't seem to be much to stop for in Westphalia.

Except for that old store. It really looks more like a barn than anything else. There's nothing outstanding about the weathered wooden building hosting a tin roof and faded Big Red sign. But that store is much more than just a pit stop about 20 miles southwest of Marlin. One step inside its crooked, screened door and the visitor feels the warmth of a community.

A group of locals lounge in the retired green and blue theater chairs clustered around the glowing heater; their murmuring is a continuous hum in the peaceful country store. A neighbor strolls in, helps himself to a soda from the cooler and deposits his change in the gold King Edwards cigar box behind the counter.

Further down, sitting on a low stool beneath a bare bulb, is Gene. Since 1943, Gene has been the manager and sole proprietor of Eugene Jansing's Grocery in Westphalia. He's also somewhat of a local celebrity in this German farming community of about 100 families. But the store that has been the hub of Westphalia since it opened in 1907 attracts "neighbors" from many miles away.

Gene's here every morning at about 7:30 or so, and sometimes doesn't go home until 10:30 or 11:00 at night. Rest assured that those long hours are appreciated. Just about 500 people gathered at the store last August for a barbeque

celebration of Gene's 59th birthday. Everyone pitched in to throw the gala event; and they plan to do it again next year.

On Friday nights, a smattering of country and western songs fight for time with the latest rock'n roll hit on the jukebox in the back room. Video games flash behind the domino tables—evidence that young and old alike still enjoy gathering at the store.

The rest of the week is sort of quiet, but there's always a steady stream of customers coming in to pick up that sack of feed or select a loaf of fresh bread from the sagging shelves. Or maybe they'll just sit and have a soda; the same way they've been doing since 1907. Either way, they'll be glad they stopped by.

*Willard Howle's Mountain Road Dairy,
Stephenville, Texas*

When John Howle rode into Texas from Alabama back in 1904, our great state was full of cactus, wide open spaces and cheap land—you could buy it for \$7 or \$8 an acre out in southwest Erath County. You probably wouldn't even recognize the area in those days; after all, the Comanche Indians had ruled there not too long ago and the deer probably still outnumbered the settlers. But it was a land full of promise; and when John grew up, he became a farmer.

Today, there are more Deere tractors to be seen than deer of the furry variety (although they say the hunting isn't bad,) and the only Comanche around is the Comanche Peak Nuclear Power Plant that dominates the horizon about 17 miles away. But at least one thing has not changed for the Howle family: a promising future in agriculture.

Willard Howle, John's son, stands at the edge of his dairy barn on the hill and looks contentedly at the green pastures and the lumbering black and white beasts climbing the hill toward him for their afternoon milking.

"You know, there's not much other place I'd rather be. It's a healthy kind of life out here," he says. Willard admits there are days when he considers selling the dairy and retiring at the ripe old age of 42, but they are few and far between.

But Willard wasn't always that fond of dairying. When he graduated from Texas A&M in 1964, a U.S. Soil Conservation service job in Abilene seemed much more appealing than dealing with dairy cows 365 days a year.

"He wouldn't have had the dairy if you gave it to him," 82-year-old John says with a shake of his head.

In 1973, Willard and his wife Helen returned to Erath County, built one of the most up-to-date dairy barns and set a goal to make a million dollars off those cows by the time he was 35. And they did.

The herd is trimmed down to a manageable 250 head now—one of the smaller ones here in "Dairy Country." The afternoon milking proceeds smoothly with the automatic machines chugging away. The machines that made dairying an industry seem coarse in comparison to the new technology his children, Randy and Ginger, will use. They both anticipate a career in dairying—but after college.

"They've grown up in agriculture, but I want them to know the business end of it. You handle a lot of money in this business, but you can be broke before you know it," Willard says knowingly.

Wade Cowan's Hoka Hey Fine Arts Foundry, Dublin, Texas

Not often do people have the courage to give up their careers and follow their dreams, to give up a steady paycheck to pursue a craft, to risk stability to reap fulfillment. When they do, not often is the story as successful as it is at Hoka Hey.

In 1976, while the rest of the country was immersed in its mammoth bicentennial celebration of history, Wade Cowan abandoned his past and looked to the future. Wade sat at a table with internationally-known Western artist Randy Steffen, a descendent of Sioux war chief Crazy Horse, and accepted his challenge to establish a fine arts bronze foundry dedicated to nothing less than the best. He gave up his job as a 15-mile-a-day postal carrier, retired his hay equipment and sold his registered Angus herd.

"I was very much in awe of Randy," Wade recalls. He said the artist provided the spark he needed to pursue preserving western art with bronze.

Almost 10 years later, nestled unobtrusively on Highway 377 between Stephenville and Dublin in Erath County, Hoka Hey Fine Arts Foundry remains true to the perfectionist ideas that conceived it. Today, it is the main bronze foundry for 54 professional Western sculptors.

Hoka Hey is an Oglala Sioux term meaning "have a good day." And every day is looked on as a good day at the foundry, where Wade and his wife Pat, son Richard and his wife Jalea and about 15 other employees manicure wax and silicon to create impeccable bronze reproductions.

Although Wade grew up around his father's machine shop and studied industrial arts in college, he and his wife are the first to admit they often learned things the hard way.

"There are a lot of tears on this ground," Pat says with a laugh. The 5,000 square foot foundry was designed and built solely by Wade and Richard.

But Hoka Hey is much more than wax, silicon molds and furnaces. The employees, many of whom have been there almost since the foundry's inception, are what make it unique. Pat emphasizes the family atmosphere among the group. The Cowans prefer that their employees have no formal artistic training, allowing them to start out with the Hoka Hey golden rule in mind: Thou shalt not change the work in any way.

"You've got to have good eyes, steady hands and the patience of Job to work here," Pat explains.

"We have a special group here," Wade says. "A lot of people can't take the perfectionist ideas we have, but when you have perfection to begin with, it cannot be changed. There is no grey area in this business . . . it's either right or it's wrong."

Becky and Beth Aldridge, Texas A&M University

The future for Texas looks bright. And it's reflected in Becky and Beth Aldridge: two of tomorrow's leaders. Raised on a healthy blend of caring parents and solid schooling, with a big dose of 4-H thrown in, the Aldridge sisters are a good example of what's very right about our youth today.

Becky is a senior at Texas A&M University, majoring in agricultural education. Roommate and younger sister Beth is a freshman anticipating a teaching career. As they stroll through the bustling College Station campus, pointing out facts about their school, their enthusiasm brightens the overcast day.

Caught up in their college life, they probably

are unaware that Texas A&M is one of Brazos' customers. But Becky and Beth became a part of the Brazos System long before they left their home outside of Waco to become loyal Aggies. In fact, Brazos was proud to have both girls represent us on the National Rural Electric Cooperative Association Government-In-Action Youth Tour to Washington, D.C.

The girls have fond, if not different, memories of the 10-day trip awarded yearly to high school students. When Beth went in 1984, she was one of two selected to place a wreath on the Tomb of the Unknown Soldier in Arlington National Cemetery. Becky recalls wearing borrowed clothes when she met her Congressman on the 1982 trip. Hers had been left behind in Tennessee!

It has been about 10 years since Vernon and Joyce Aldridge, Becky and Beth's parents, founded the Bellmead 4-H Club and started their girls and countless other lucky kids on the road to success. The Aldridge girls did it all in 4-H; all the way up to each receiving the 4-H Gold Star Award, one of the highest 4-H honors.

Now they are college students; and raising calves has taken a back seat to studies, part-time jobs and supporting the Aggies on to the Cotton Bowl. But they haven't abandoned their roots: both girls are members of Texas A&M's Collegiate Future Farmers of America. Becky's job at the State 4-H Office is a natural extension of her upbringing, and she also is a member of Alpha Zeta, an agriculture honor society.

For the Aldridge sisters, what, besides success, does the future hold? Each anticipates staying in Texas, preferably in a smaller town. They also say that neither would mind following in the footsteps of Wanda Hargrove, the 4-H Coordinator who gave them so much encouragement. But Becky is leaving her options open, recognizing that many forks lie in the road ahead.

Magdaleno Trujillo's Boot Shop, Meridian, Texas

Magdaleno Trujillo was an artist. Though his 79-year-old frame was weak and slightened by a recent bout with pneumonia, his remained the strong hands of an artist. Bolts of lifeless hide of all shapes and colors were piled around his cluttered shop on Morgan Street in Meridian. Ancient stitching machines and shoe forms sat silent, all waiting for "El Maestro" to transform the skins into a masterpiece.

Magdaleno was a bootmaker of the finest sort. He could make or repair just about any shoes you wished, but when he handmade boots—he was an artist.

For almost 71 years, he worked his magic with leather. Each pair—whether it be for a Central Texas farmer or the star of a Western movie—received the same dedication and attention as the last. Magdaleno said it was for that reason that he built a reputation for being the best bootmaker in Texas. They called him "El Maestro"—the master. His secret is simple.

"I do everything with my hands," he said, as he proudly displayed his two wrinkled tools. "Nobody could ever compete with me."

He was born into a family rich in the tradition of the handiwork. His father taught him the craft known by his grandfather and countless uncles when he was a child in Mexico. At the age of nine, he began his life's work. And at the age of 79, he showed few signs of slowing down.

As a youth, Magdaleno had dreams of being a tailor, but obedience and respect for his father's wishes drew him to leather instead.

"It was the least I could do for him," he explained. "This is hard work but a pretty good way to make a living . . . at least it's honest."

"Twenty five years ago I was a celebrity," he said with a chuckle. "But I never let it go to my head."

Magdaleno shod the famous feet of Roy Rogers, Gene Autry, Tex Ritter, John Wayne and a host of other stars who caught wind of this Texan's reputation. For five years, he traveled back and forth to Hollywood to fit his elaborate original designs on the stars. But the temperamental nature of the actors' agent did not suit this artist's gentle disposition.

Magdaleno said he told the agent he didn't need the business, and he abandoned his contract for a more personal lifestyle.

So for the last 46 years, Magdaleno worked out of the little shop in Meridian that is adjacent to his home. He allowed his loyal customers to come to him from all over the country, even though his quality did not come cheap.

Magdaleno said he had been trying to retire for years, but each time someone pleaded that he craft just one more pair for them.

"They just won't let me quit," he said resignedly. But he didn't seem to mind. His love for the craft was evident as he proudly displayed the intricate decorative stitching on the upper of a boot. "You see, I still do pretty good for 79 years old."



Only two months after this interview, Magdaleno Trujillo passed away. We are saddened by his death, but know that the dedication and craftsmanship that set "El Maestro" in a class by himself will be remembered by other Texans who looked to him for his high standards.

The Brazos System

Brazos Electric Power Corporation, Inc.
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Wichita, Kansas 67206
316/733-2101



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Brazos Electric Power Corporation

The Brazos System

Member Cooperatives

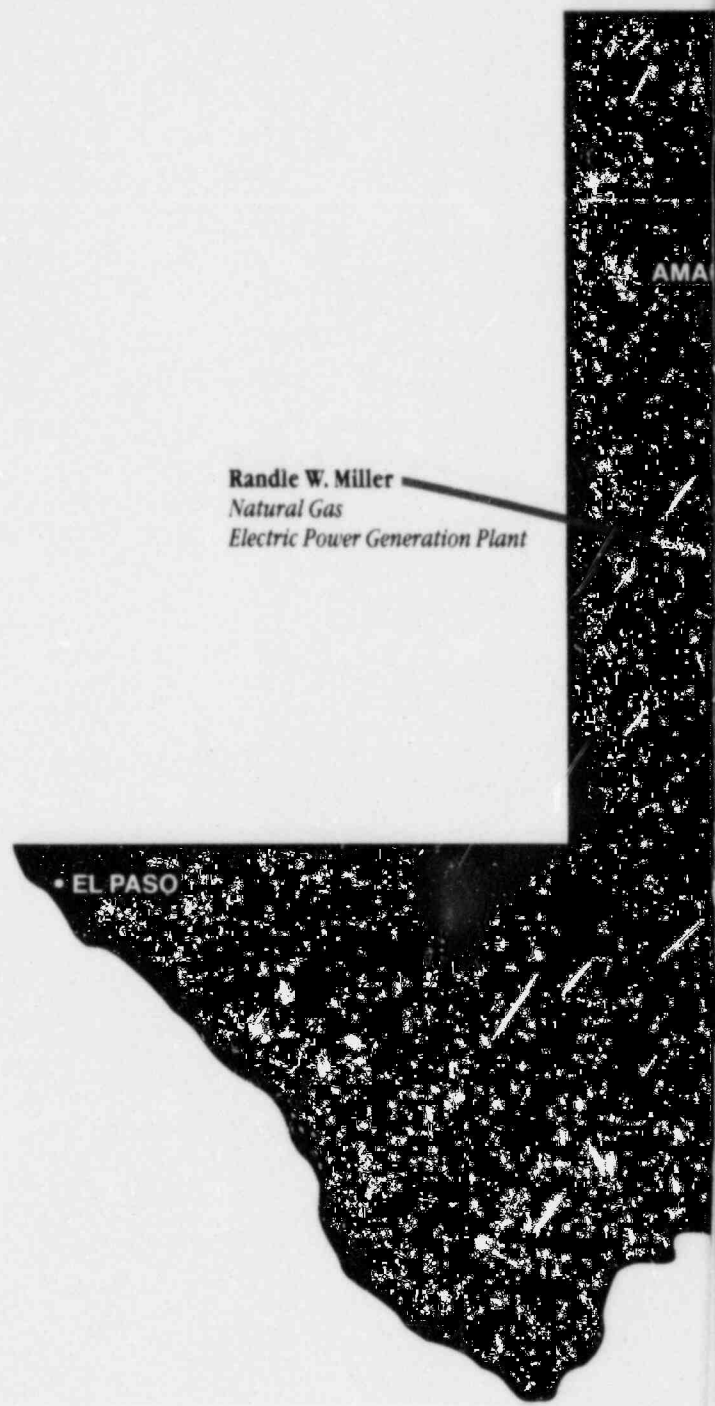
- Bartlett Electric Cooperative, Inc.
- B-K Electric Cooperative, Inc.
- Belfalls Electric Cooperative, Inc.
- Comanche County Electric Cooperative Assn.
- Cooke County Electric Cooperative Assn.
- Denton County Electric Cooperative, Inc.
- Erath County Electric Cooperative Assn.
- Fort Belknap Electric Cooperative, Inc.
- Hamilton County Electric Cooperative Assn.
- Hill County Electric Cooperative, Inc.
- J-A-C Electric Cooperative, Inc.
- Johnson County Electric Cooperative Assn.
- McLennan County Electric Cooperative, Inc.
- Mid-South Electric Cooperative Assn.
- Navarro County Electric Cooperative, Inc.
- Navasota Valley Electric Cooperative, Inc.
- Tri-County Electric Cooperative, Inc.
- Wise Electric Cooperative, Inc.

Municipal Customers

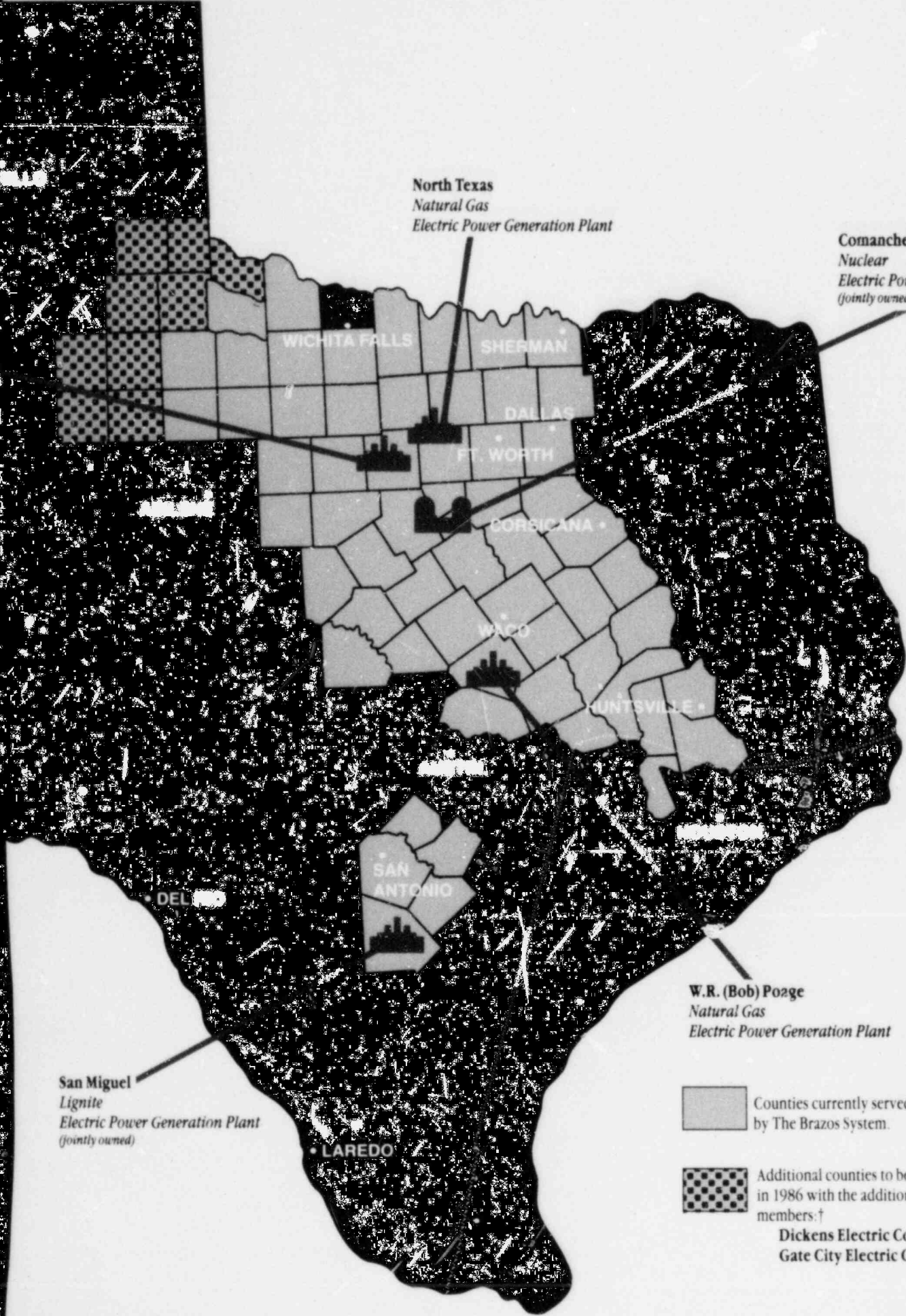
- Bartlett
- Granbury
- Hearne
- Sanger
- Seymour
- Weatherford
- Whitesboro

Other

- Texas A & M University



System Statistics				
	Fuel	Nameplate	Operating	
Generation Capacity:				Transmission Lines:
San Miguel Plant	Lignite	195.5 MW	195.5 MW*	345 KV 174 miles
R. W. Miller Plant	N. Gas	366 MW	391 MW	138 KV 644 miles
North Texas Plant	N. Gas	66 MW	75.5 MW	69 KV 1,459 miles
W.R. (Bob) Poage Plant	N. Gas	23 MW	24 MW 2,277 miles
Hydro (by contract)		50 MW	54 MW	Member Cooperatives 70†
* Capacity allocation as a joint owner.		700.5 MW	740.0 MW	Municipal Interchange Customers 7†
				Ultimate Consumers (meters) 227,000†
				Counties Served 66†
				† As of April 1, 1986



North Texas
Natural Gas
Electric Power Generation Plant

Comanche Peak
Nuclear
Electric Power Generation Plant
(jointly owned, under construction)

WICHITA FALLS SHERMAN

DALLAS

FT. WORTH

CORSICANA

WACO

HUNTSVILLE

SAN ANTONIO

DEL RIO

LAREDO

W.R. (Bob) Poage
Natural Gas
Electric Power Generation Plant

San Miguel
Lignite
Electric Power Generation Plant
(jointly owned)

Counties currently served
by The Brazos System.

Additional counties to be served
in 1986 with the addition of new
members: †

Dickens Electric Cooperative, Inc.
Gate City Electric Cooperative, Inc.

Board of Directors



William G. Parker
President
Comanche County Electric
Cooperative Association



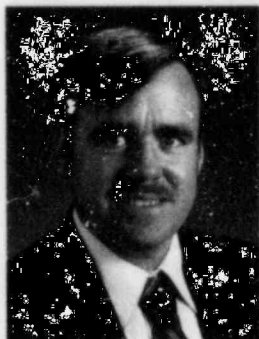
Luther L. Parks
Vice President
Belfalls Electric
Cooperative, Incorporated



Joe Forman
Secretary
Wise Electric
Cooperative, Incorporated



Don Gregg
B-K Electric
Cooperative, Incorporated



Lawrence Karl
Bartlett Electric
Cooperative, Incorporated



Robert T. Lewis, Jr.
Cooke County Electric
Cooperative Association



M. E. Holley
Denton County Electric
Cooperative Association



Fred Parker
Erath County Electric
Cooperative Association



Phillip E. Slater
Fort Belknap Electric
Cooperative, Incorporated



Jack Elam
Hamilton County Electric
Cooperative Association



Sam Houston
Hill County Electric
Cooperative, Incorporated



Bernard Hilbers
J-A-C Electric
Cooperative, Incorporated



Billy J. Poland
Johnson County Electric
Cooperative Association



Ron Golden
McLennan County Electric
Cooperative, Incorporated



Woodrow Hensarling
Mid-South Electric
Cooperative Association



Aubrey Berry
Navarro County Electric
Cooperative, Incorporated



J. W. Richards, Jr.
Navasota Valley Electric
Cooperative, Incorporated



J. F. Herring, Jr.
Tri-County Electric
Cooperative, Incorporated

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.

FINANCIAL STATEMENTS

December 31, 1985 and 1984

and

ACCOUNTANTS' REPORT

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.

FINANCIAL STATEMENTS

December 31, 1985 and 1984

and

ACCOUNTANTS' REPORT

AXLEY & RODE

CERTIFIED PUBLIC ACCOUNTANTS

C O N T E N T S

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Statements of Revenue and Expenses -----	3
Statements of Patronage Capital and Other Equities -----	4
Statements of Changes in Financial Position -----	5
Notes to Financial Statements -----	6

AXLEY & RODE
CERTIFIED PUBLIC ACCOUNTANTS
LUFKIN - NACOGDOCHES - CROCKETT - LIVINGSTON
TEXAS

March 25, 1986

The Board of Directors
Tex-La Electric Cooperative
of Texas, Inc.

We have examined the balance sheets of Tex-La Electric Cooperative of Texas, Inc. as of December 31, 1985 and 1984, and the related statements of revenue and expenses, patronage capital, and other equities, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Tex-La Electric Cooperative of Texas, Inc. as of December 31, 1985 and 1984, and the results of its operations and changes in its financial position for the years then ended in conformity with generally accepted accounting principles applied on a consistent basis.

Axley & Rode
CERTIFIED PUBLIC ACCOUNTANTS

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.
BALANCE SHEETS
December 31, 1985 and 1984

	1985	1984
<u>ASSETS</u>		
Electric Plant, At Cost:		
Furniture and fixtures	\$ 16 251	\$ 15 844
Less accumulated depreciation	<u>3 912</u>	<u>2 781</u>
	12 339	13 063
Construction work in progress (Notes 2 and 6)	<u>147 431 383</u>	<u>120 788 035</u>
	<u>147 443 722</u>	<u>120 801 098</u>
Other Assets and Investments:		
Nonutility property	-	12 887
Investments in associated organizations (Note 3)	<u>2 838 157</u>	<u>2 838 157</u>
	<u>2 838 157</u>	<u>2 851 044</u>
Current Assets:		
Cash, including temporary cash investments of \$610,546 in 1985 and \$271,174 in 1984-General funds	635 283	309 186
Cash, including temporary cash investments of \$1,571,540 in 1985 and \$206,605 in 1984-Construction funds	1 573 186	207 766
Accounts receivable (includes receivables from member cooperatives of \$2,372,807 in 1985 and \$2,437,991 in 1984)	2 459 005	2 723 669
Prepaid expenses	7 136	441
Accrued interest	-	789
	<u>4 674 610</u>	<u>3 241 851</u>
	<u>\$154 956 489</u>	<u>\$126 893 993</u>
<u>EQUITIES AND LIABILITIES</u>		
Patronage Capital and Other Equities (Note 10):		
Memberships	\$ 700	\$ 700
Patronage capital (Note 4)	258 101	76 348
Other equities (Note 5)	<u>97 075</u>	<u>68 015</u>
	<u>355 876</u>	<u>145 063</u>
Long-term debt (Note 6)	<u>151 778 000</u>	<u>121 027 000</u>
Current Liabilities:		
Accounts payable	2 817 652	2 599 995
Accrued interest	<u>4 961</u>	<u>3 121 935</u>
	<u>2 822 613</u>	<u>5 721 930</u>
	<u>\$154 956 489</u>	<u>\$126 893 993</u>

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

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.
 STATEMENTS OF REVENUE AND EXPENSES
 For The Years Ended December 31, 1985 and 1984

	1985	1984
Operating Revenue:		
Power sales (Note 7)	\$30 537 181	\$29 573 607
Operating Expenses:		
Cost of purchased power	29 638 267	28 710 170
Administrative and general (Notes 8 and 9)	741 996	1 033 343
Depreciation	1 131	992
	30 381 394	29 744 505
Operating margin (deficit) before interest expense	155 787	(170 898)
Interest Expense:		
Interest on long-term debt	14 522 125	11 806 897
Allowance for borrowed funds used during construction	(14 522 125)	(11 806 897)
	-	-
Operating margin (deficit)	155 787	(170 898)
Nonoperating Margin:		
Interest income	55 026	29 060
Net margin (deficit)	\$ 210 813	\$ (141 838)

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

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.
 STATEMENTS OF PATRONAGE CAPITAL AND OTHER EQUITIES
 For The Years Ended December 31, 1985 and 1984

	<u>MEMBERSHIPS</u>	<u>PATRONAGE CAPITAL</u>	<u>OTHER EQUITIES</u>	<u>TOTAL</u>
Balance, December 31, 1983	\$700	\$218 186	\$68 015	\$286 901
Net deficit	-	(141 838)	-	(141 838)
Balance, December 31, 1984	700	76 348	68 015	145 063
Net margin	-	210 813	-	210 813
Transfer to appropriated margins	-	(29 060)	29 060	-
Balance, December 31, 1985	<u>\$700</u>	<u>\$258 101</u>	<u>\$97 075</u>	<u>\$355 876</u>

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

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.
 STATEMENTS OF CHANGES IN FINANCIAL POSITION
 For The Years Ended December 31, 1985 and 1984

	<u>1985</u>	<u>1984</u>
Funds Were Provided By:		
Net margin (deficit)	\$ 210 813	\$ (141 838)
Add Items Not Requiring Funds:		
Depreciation	<u>1 131</u>	<u>992</u>
TOTAL FUNDS PROVIDED (USED) FROM OPERATIONS	211 944	(140 846)
Advances from CFC	-	2 800 000
Advances from REA	30 751 000	17 079 000
Sale of furniture and fixtures	-	15 844
Decrease in nonutility property	12 887	-
Decrease in working capital	-	3 549 701
	<u>\$30 975 831</u>	<u>\$23 303 699</u>
Funds Were Used For:		
Additions to construction work in progress	\$26 643 348	\$20 490 926
Additions to furniture and fixtures	407	12 535
Additions to nonutility property	-	238
Payments on debt to CFC	-	2 800 000
Increase in working capital	<u>4 332 076</u>	<u>-</u>
	<u>\$30 975 831</u>	<u>\$23 303 699</u>
Increase (Decrease) In Working Capital By Components:		
Cash - General	\$ 326 097	\$ 12 477
Cash - Construction	1 365 420	(3 370 519)
Accounts receivable	(264 664)	959 868
Prepaid expenses	6 695	441
Accrued interest	(789)	(461)
Accounts payable	(217 657)	(767 846)
Accrued interest	3 116 974	(383 661)
	<u>\$ 4 332 076</u>	<u>\$(3 549 701)</u>

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

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Operation:

Tex-La Electric Cooperative of Texas, Inc. (the Cooperative) is an electric generating and transmission cooperative formed pursuant to the Texas Electric Cooperative Corporation Act. The Cooperative provides wholesale electric service to the distribution cooperatives of Cherokee County Electric Cooperative Association, Deep East Texas Electric Cooperative, Inc., Jasper-Newton Electric Cooperative, Inc., Houston County Electric Cooperative, Inc., Rusk County Electric Cooperative, Inc., Sam Houston Electric Cooperative, Inc. and Wood County Electric Cooperative, Inc. (Members).

The Cooperative was formed principally to provide dependable power and energy to its members at the lowest cost possible. In doing so, the Cooperative works closely with its members in determining their power requirements and in contracting with its respective bulk power suppliers to satisfy such requirements.

Chart of Accounts:

The Cooperative maintains its accounting records in accordance with the Federal Energy Regulatory Commission's Uniform System of Accounts as adopted by the Rural Electrification Administration. The more significant accounting policies are described below.

Electric Plant:

Furniture and fixtures are stated at the historical cost. Depreciation of these assets is computed at a straight-line composite rate of 7%.

Construction work in progress represents the Cooperative's share of the project costs for the construction of the Comanche Peak Steam Electric Station not yet in production.

Allowance for Borrowed Funds Used During Construction:

The Cooperative has capitalized to electric plant the cost of borrowed funds used for the construction of the Comanche Peak Steam Electric Station net of the related interest income from invested construction funds.

Income Taxes:

The Cooperative is exempt from Federal income tax under the provisions of Section 501(c)(12) of the Internal Revenue Code.

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.
NOTES TO FINANCIAL STATEMENTS - CONTINUED

NOTE 2 - JOINTLY-OWNED FACILITIES

On December 9, 1980, the Cooperative executed a Joint Ownership Agreement with Texas Power & Light Company to acquire a 4 1/3% undivided ownership interest in the Comanche Peak Steam Electric Station, a two unit 1150 megawatts each nuclear fueled electric generating station, located near Glen Rose, Texas in Hood and Somervell Counties, Texas, being constructed by Texas Utilities Generating Company.

On February 12, 1982, following the announcement of a substantial increase in the cost of the project and delay in the projected commercial operation date, the Cooperative sold 2 1/6% of its interest in the project back to Texas Power & Light Company. The proceeds from the sale represented the Cooperative's cost of construction and capitalized interest. In 1982 the Cooperative, based on Texas Utilities Electric Company's (TUEC) estimates, expected that Comanche Peak Units 1 and 2 would be licensed by the Nuclear Regulatory Commission (NRC) and commence commercial operation in 1984 and 1985, respectively, and that the Cooperative's share of the project would cost a total of \$120 million. The Cooperative planned to fund its participation in the project by means of a loan from the Federal Financing Bank of up to \$180 million, guaranteed by the Rural Electrification Administration (REA).

As a result of difficulties which TUEC has encountered in the NRC licensing process, primarily in convincing the NRC that Comanche Peak has been properly constructed, the NRC to date has not issued an operating license for either Unit 1 or 2. Based on TUEC's present estimate, the Cooperative does not expect commercial operation of the project to commence prior to 1988. As of February 28, 1986, the Cooperative's total expenditure for its 2-1/6 percent share of the project is approximately \$153 million. Based on current estimates for the completion and licensing of the project, the Cooperative's share of Comanche Peak is expected ultimately to cost approximately \$218 million. This figure could increase further in the event of added delays or other difficulties with the project beyond those currently anticipated.

The Cooperative has not yet determined how it will fund the portion of the project cost which is in excess of the current REA loan guarantee limit of \$180 million. Among the options it is considering is to apply to the REA for a deficiency loan and/or to seek authorization from the Public Utility Commission of Texas for an increase in the Cooperative's electric rates.

Construction of Unit 1 of Comanche Peak is virtually complete, but because of numerous uncertainties in the licensing process no assurance can be given that the estimated commercial operation dates of these units can be met or that the current estimated completion costs thereof will not be exceeded. Failure to secure timely and favorable regulatory approvals or any further delay occasioned by reinspections or possible rework resulting therefrom will increase the cost of the plant.

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.
NOTES TO FINANCIAL STATEMENTS - CONTINUED

NOTE 3 - INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations at December 31, 1985 and 1984 consisted of the following:

	1985	1984
Patronage capital from the National Rural Utilities Cooperative Finance Corporation (CFC) Memberships	\$2 837 157	\$2 837 157
	1 000	1 000
	\$2 838 157	\$2 838 157

The investment in the CFC represents patronage capital credits allocated to the Cooperative. Realization of cash from this investment is within the control of CFC.

NOTE 4 - PATRONAGE CAPITAL

The details of patronage capital at December 31, 1985 and 1984 are as follows:

	1985	1984
Assignable	\$258 101	\$76 348
Assigned	-	-
	258 101	76 348
Less: Retired	-	-
	\$258 101	\$76 348

NOTE 5 - OTHER EQUITIES

The details of other equities at December 31, 1985 and 1984 are as follows:

	1985	1984
Appropriated margins	\$97 075	\$68 015

The by-laws of the Cooperative provide that nonoperating margins be used initially to offset any losses incurred during the current or any prior fiscal year. Upon recovery of any losses, a fund in the amount of \$400,000 shall be accumulated from these remaining nonoperating margins and funded each year, if necessary, to maintain the \$400,000 balance.

NOTE 6 - LONG-TERM DEBT

Long-term debt at December 31, 1985 and 1984 consisted of the following:

	1985	1984
Mortgage notes payable to the Federal Financing Bank at interest rates from 9.072% to 13.091% with the Rural Electrification Administration (REA) as administrator	\$151 778 000	\$121 027 000

In July, 1981, the Cooperative entered into a loan agreement not to exceed \$180,000,000 to finance the construction and operation of generating facilities, electric transmission, distribution and service lines by the Cooperative payable to the Federal Financing Bank (FFB) pursuant to an agreement between the FFB and the REA.

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.
NOTES TO FINANCIAL STATEMENTS - CONTINUED

NOTE 6 - LONG-TERM DEBT - CONTINUED

The maturity date of each amount advanced under the loan agreement shall not be less than two years nor more than seven years after the date of the advance and shall be designated in writing at the time of request by the borrower subject to REA approval. Under the terms of the agreement the Cooperative may designate a maturity date of thirty-four years after the end of the calendar year in which such advance was made. The interest rate applicable to each advance is the respective rate established by the FFB at the time of the advance. The Cooperative has designated a long-term maturity of thirty-four years for a portion of the FFB advances. It is anticipated that the amounts due in 1986 and 1987, together with future additional borrowings from FFB, will be extended.

Substantially all of the Cooperative's assets are pledged as security for the long-term debt owed FFB.

The Cooperative has available a \$12,000,000 line of credit which expires in 1986 with the CFC under which there were no borrowings outstanding at December 31, 1985.

NOTE 7 - POWER CONTRACTS

The Cooperative is obligated to supply power to its Members under the power sales contracts which exist with the Cooperative's Members for the sale of all electric power which the Members will require for the operations of their respective systems. The contracts extend to December 30, 2026 and thereafter, as permitted by law until the expiration of six months after notice of cancellation by either the Cooperative or the Members.

The Cooperative purchased all of its power at wholesale from Texas Utilities Electric Company and from the Southwestern Power Administration (SWPA), an agency of the Department of Energy.

NOTE 8 - PENSION PLAN

The employees of the Cooperative participate in the National Rural Electric Cooperative Association (NRECA) Retirement and Security Program. The Cooperative makes annual contributions to the plan equal to the amounts accrued for pension expense. In this master multiple-employer plan, which is available to all member cooperatives of NRECA, the accumulated benefits and plan assets are not determined or allocated separately by individual employer. Pension expense for this plan for the years ended December 31, 1985 and 1984 was \$11,020 and \$11,843, respectively.

NOTE 9 - RELATED PARTY TRANSACTIONS

The Cooperative and Sam Rayburn G & T, Inc. (SRG&T), an electric generating and transmission cooperative, share facilities and personnel. SRG&T reimburses the Cooperative for its proportionate share of the related expenses. The total reimbursement for the years ended December 31, 1985 and 1984 was \$116,274 and \$97,688, respectively. Certain members of the Cooperative are members of SRG&T.

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.
NOTES TO FINANCIAL STATEMENTS - CONTINUED

NOTE 10 - LITIGATION

The Cooperative has been advised by legal counsel that litigation has been brought against the Southwestern Power Administration (SWPA) by Brazos Electric Power Cooperative, Inc. (Brazos), concerning a power contract between the Cooperative and the SWPA. Brazos has challenged the power contract as well as SWPA's power allocations as to the power the Cooperative receives from the Denison Dam. Furthermore, by the terms of the Scheduling Agent Agreement dated October 30, 1984 between the Cooperative and Texas Utilities Electric Company (TUEC), the Cooperative has agreed to hold harmless TUEC from any monetary damages and attorney fees that might result from any claim brought by Brazos against TUEC as a result of the Scheduling Agent Agreement.

In a letter agreement signed by the Cooperative, it was agreed that if TUEC intervenes in this action, the Cooperative will not be obligated to indemnify TUEC for any attorney fees it incurs as a result of TUEC intervening in this action. On January 23, 1985 TUEC filed a motion to intervene in the case of Brazos v. SWPA.

On December 30, 1985, the District Court granted the defendants' and intervenors' motions for summary judgment against Brazos, and dismissed the entire action. Brazos has appealed the District Court's ruling. If necessary, the Cooperative intends to vigorously pursue the litigation. However, it is not possible at present for the Cooperative and its counsel to predict the outcome which might result from the actions of Brazos. Accordingly, no provision for any liability that might result therefrom has been recorded in the accompanying financial statements.