BRAZOS ELECTRIC POWER COOPERATIVE, INC.

1986 ANNUAL REPORT

THE BRAZOS SYSTEM

Brazos Electric Power Cooperative, Inc. is a generation and transmission cooperative which provides electric power to its 20 member distribution cooperatives whose service areas cover 56,777 square miles of Texas. Brazos and its members comprise the Brazos System. Brazos also provides electric power to the municipal systems of the cities of Bartlett, Granbury, Hearne, Sanger, Seymour, Weatherford and Whitesboro and to Texas A&M University. Brazos is a member of the Texas Municipal Power Pool with the cities of Bryan, Denton, Garland and Greenville. The combined generation capacity of the Texas Municipal Power Pool is 2,063 megawatts.

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.
Dickens Electric Cooperative, Inc.
Erath County Electric Cooperative Assn.
Fort Belknap Electric Cooperative, Inc.
Gate City 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

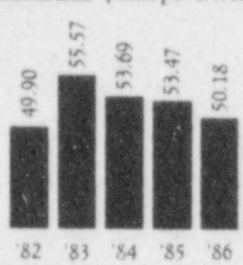
Other
Texas A & M University

On The Cover:
The river that gave Brazos Electric its name also provided the first power for the newly formed cooperative in 1941. Electricity generated at Morris Sheppard Dam on Possum Kingdom Lake continues to provide power for the Brazos System.

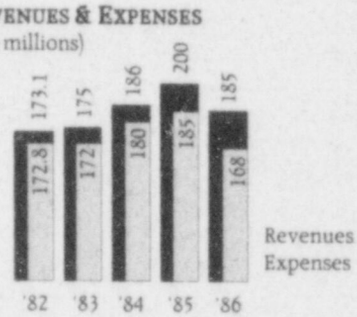
FINANCIAL AND OPERATING HIGHLIGHTS

	1986	1985
Total Operating Revenues (000's)	$185,293	$200,430
Total Operating Expenses (000's)	$167,950	$185,243
Operating Margins (Loss) (000's)	$ 17,343	$ 15,187
Total Assets (000's)	$474,308	$444,407
Total Equity (000's)	$ 68,321	$ 47,253
Times Interest Earned Ratio (TIER)	1.62	1.51
Debt Service Coverage (DSC)	1.64	1.54
Energy Sales (Megawatt hours)		
Member Cooperatives	3,217,290	3,033,643
Municipal Interchange Customers	352,870	386,707
Economy Sales	261,915	523,226
Total	3,832,075	3,943,576
Peak Demand (Megawatts)	764	721

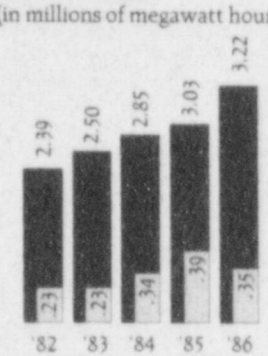
AVERAGE POWER COST TO MEMBERS (mills per KWH)



REVENUES & EXPENSES
(in $ millions)

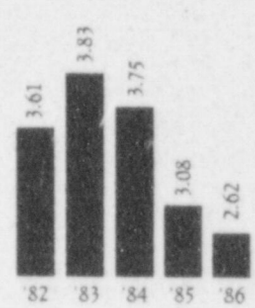


ENERGY SALES
(in millions of megawatt hours)

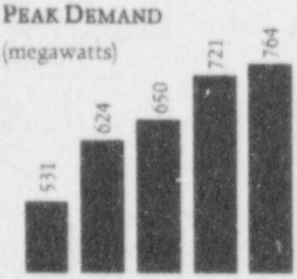


Member Cooperatives
Municipal Interchange Customers

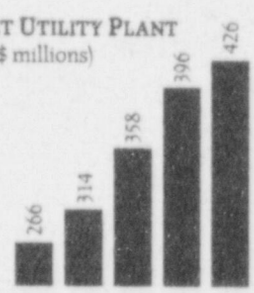
NATURAL GAS COST ($ per MCF)
(average, including transportation)



PEAK DEMAND
(megawatts)



NET UTILITY PLANT
(in $ millions)



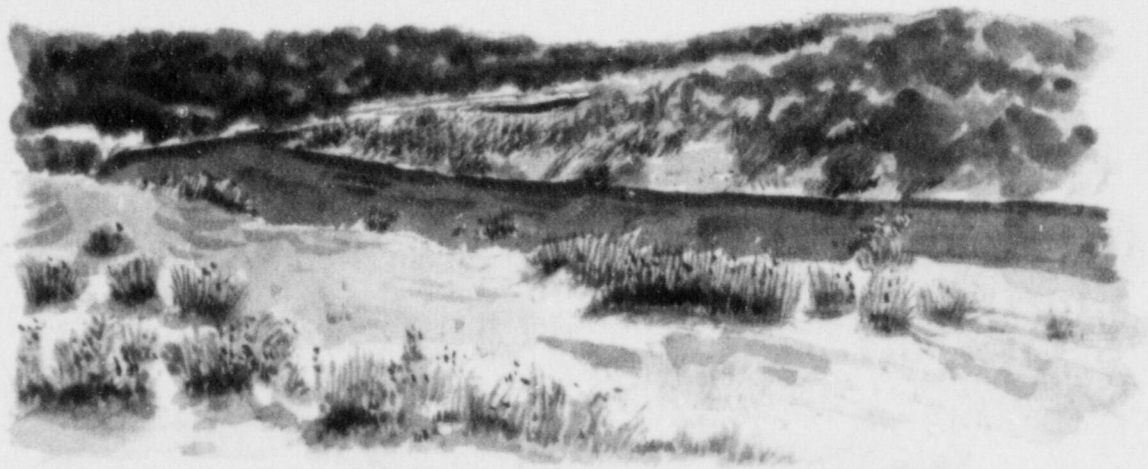
Executive Vice President and General Manager Richard E. McCaskill and President William G. Parker.

The Brazos River and her tributaries cut a broad path through Texas. Over thousands of years, this watershed encouraged man's existence in the area. More recently, the Brazos was instrumental to the development of Texas as a republic and, later, a state. Water, essential anywhere, is precious in the drier climate of the Southwest. After water and food, perhaps energy is our next most vital need.

Brazos Electric Power Cooperative took its name from this same river whose watershed cuts a broad path through our service area. When we were formed in 1941, there was the river, but little light in her rural sweep. The job of our predecessors was to bring economical and reliable power to our member cooperatives to allow them to effectively light the area. That dream and much more have been accomplished. As the river has supported development of the area, so has electrification.

We use the Brazos River as the theme of this year's annual report because her course and contribution are linked with ours and our consumers'.

We commend our superb employees for their enthusiastic and persistent efforts throughout 1986. They benefited our consumers with a third consecutive decrease in the annual average cost of wholesale power. In that period, we have lowered the cost a total of 10 percent. When today's dollars are adjusted for the mild inflation of the past three years, the decrease is effectively 15 percent.



Particularly satisfying this year have been our gas operations. Using our 24-mile natural gas pipeline, we have aggressively capitalized on opportunities provided by the gas spot market. Our efforts saved our members and municipal customers $12,182,000 in 1986 and $17,461,000 in the pipeline's 28 months of operation.

We sense a decline of over-supply conditions in the natural gas market. Prices have ceased to fall, stabilizing in the range of $1.40 - $1.60 per mmBtu. Last summer, some producers "shut in" their gas rather than sell it at lower prices. Gas prices may fall again before they rise, but forecasters are beginning to predict the end of the glut. Some foretell the end within two years. Other feel there will be subsequent shortages.

To take advantage of the favorable market conditions, we have been looking for additional long-term reserves. Additionally, we have been studying delivery systems to make more economical use of such reserves.

These activities seek economical fuel supplies for our gas-fired plants for the next decade. Arranging for sufficient generation plant capacity is another major effort. Presently, our power supply needs are greater than the capacity that we own and have under long-term contract. We have made up the difference by buying generation capacity at economical rates through our membership in the Texas Municipal Power Pool. However, by 1989 or 1990, the Pool will no longer have excess capacity. We will then need to increase our own plant capacity, purchase capacity such as cogeneration, limit the peak demand on our system, or a combination thereof.

To limit our peak demand, we have begun considering a demand-side management program for Brazos and its members. "Demand-side management" is influencing or controlling system load and marketing the methods to do so. The Board of Directors has appointed a Marketing and Load Management Committee to investigate what Brazos should do in these areas. We are enthusiastic about the interest of our members and about the possibilities that demand-side management holds for the entire Brazos System.

We are particularly pleased to welcome Dickens Electric Cooperative of Spur, Texas, and Gate City Electric Cooperative, of Childress, Texas, to Brazos. On April 1, these first additions since 1950 brought our membership to twenty. Ned Ward, a rancher and businessman from Aspermont, and James Driver, manager of

Gate City Electric, were elected directors to represent these new members.

One of our more serious challenges has been our involvement in the Comanche Peak Nuclear Plant Project. We began negotiations with Texas Utilities Electric Company (TUEC) in February 1985 to limit our investment in the project. In December 1985, we agreed on a proposed settlement, subject to approval of the Rural Electrification Administration.

On May 29 while REA was reviewing the agreement, TUEC sued the three minority owners—Brazos, Tex-La Electric Cooperative, and Texas Municipal Power Agency. This unexpected suit ended our consideration of the proposed settlement agreement and further negotiations.

The suit contends we have not met our obligation to pay our proportionate share of the remaining construction costs according to the Comanche Peak Joint Ownership Agreement. TUEC seeks a declaration that it has not failed to perform its obligations under the Agreement.

In June, we filed a responding countersuit. We contend that, among other things, the Comanche Peak project has not been completed in a timely fashion at a reasonable cost.

The cohesiveness and singleness of purpose of our directors and members on this issue has been superb. We have confidence in our case. We will do all in our power to prevent any unreasonable plant costs from being shouldered by our 229,000 consumers. Further discussion and review of this important issue is contained in our *Report on Operations*.

In our early years, we had a friend who helped us fight for the well-being of our consumers, W.R. (Bob) Poage, former Congressman from Central Texas. We were saddened by the loss of Chairman Poage on January 3, 1987 and we dedicate our annual report to the memory of this longtime friend of rural electrification.

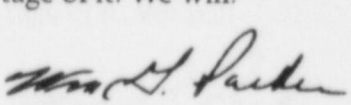
The passage of time brings changes of many natures. Our industry and its operating environment are becoming more competitive and dynamic. Two or three years ago, deregulation was an issue to be considered. Now, it has begun. The first signs were the efforts of industrial customers to find other sources of power supply, be they cogeneration, self-generation, or other utilities. A more recent development is the plan of a large utility to market excess power directly to customers outside its service areas.

Additional issues facing us stem from legislative and regulatory change. Of major concern is the changing nature of the Rural Electrification Administration. The present administration has repeatedly attempted to reduce Federal support to rural electrification with a stated goal of phasing out most functions of REA by 1992. For Brazos itself, the primary problem is to operate efficiently within the ever-changing rules. We remain confident that we could obtain different sources of financing and we are keeping ourselves prepared for that possibility. For our members, the severity of losing REA financing would vary with their financial strength, density of consumers, and related factors.

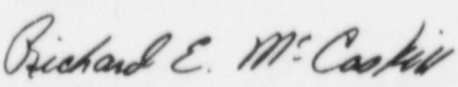
Another trend is consolidation of utilities. Investor-owned utilities with diminishing construction programs are generating large cash reserves. Looking for ways to earn a return on these assets, some are moving into non-utility fields. Others are trying to buy cooperatives and small utilities. We, ourselves, were approached with an expression of interest, though there was no specific offer. After review, the Board elected not to pursue it at that time.

In 1985, the state legislature appointed the Joint Special Committee on Cogeneration. Its mission was to examine cogeneration and small power production as components of the state's electric power supply, their importance to industry, and the consequences of current state policy. Throughout 1986, we participated in the forum provided by this committee. The committee made its report to the legislature early in 1987, and related bills are now being introduced. We see benefits to cogeneration, but we have also seen regulations to encourage its development that can increase costs to our consumers. So, we are working to ensure that legislation reflects the interests and needs of our consumers.

It's a challenging and exciting environment. With change comes the opportunity to take advantage of it. We will.



William G. Parker
President



Richard E. McCaskill
Executive Vice President and General Manager

The land along the Brazos River has many faces. From the dry red sands of the Texas Panhandle to the lush, fertile farmland in her southernmost reaches, the Brazos River valley has been a wellspring of prosperity.

Opposite Page
The Brazos River village of Old Washington, where Stephen F. Austin first settled in 1821, was the location of one of the first ferry crossings of the river. It was also the home of the Texas Declaration of Independence in 1836.

Sales And Growth

Our electric revenues totalled $184,746,114. The 7.6 percent reduction since last year was passed on to our consumers and was due to declining costs of both fuel and economy energy purchases. While firm kilowatt hour sales (to member cooperatives and municipal customers) increased 4.4 percent, total sales decreased 2.8 percent to 3,832,075 megawatt hours. This decrease was caused by a reduction in sales to other utilities, a reflection of economic conditions in the state. Sales to members increased 6.1 percent primarily from the additions of Dickens Electric and Gate City Electric to our membership. Our current study of power requirements indicates that our energy growth will average about 7.8 percent through the end of the decade.

The peak demand on our transmission system increased 6.0 percent to 764 megawatts from 721 in 1985. We had a productive year in construction to meet the growing demand. We added 113,814 KVA to our delivery substation capacity, an 8.5 percent increase. Additionally we constructed 20 miles of new 138 KV transmission line and converted 15 miles of other line to 138 KV. Much of this work was in the vicinity of the Dallas-Fort Worth metroplex where most of our growth continues to occur.

Comanche Peak Nuclear Plant Project

The Comanche Peak Nuclear Plant Project has been a major issue in 1986. In dealing with it, our sole objective has been and will be to ensure that our 229,000 consumers do not have to bear any unreasonable plant costs.

Last year we reported withholding construction payments and negotiating with Texas Utilities Electric Company (TUEC), which serves as the project manager and our agent under the Comanche Peak Joint Ownership Agreement.

By early 1985, the project cost estimate had increased six-fold. Construction was more than six years behind the schedule we had been given in 1979. When we ceased making construction payments in May 1985, it was because the project had not been brought into operation at a reasonable cost.

We continued our negotiations until December 1985 when a proposed agreement was reached. We then sought REA approval. REA reviewed the agreement and requested some changes which we made and TUEC accepted. In January 1986, we returned the proposed agreement to REA for approval. We exerted considerable effort attempting to facilitate the understanding of government officials and gain their approval. From our viewpoint, the agreement was in the best interest of both Brazos and the U.S. Government. It would have limited our investment in the project and made additional non-nuclear generation capacity available to us. For the government, it would have protected the federal mortgage to us.

On May 29, an unexpected event stopped further action on the proposed agreement. TUEC filed a suit in the State District Court in Dallas County, Texas, naming the three minority owners—Brazos, Tex-La Electric Cooperative, and Texas Municipal Power Agency—as co-defendants.

The suit contends that Brazos has breached the contract by "failing and refusing" to make required construction payments. It asks the court to find, among other things, that the project manager has operated prudently, that it has adhered to the requirements of the Joint Ownership Agreement, and that it has been timely in pursuing construction and obtaining a license.

We think that the project has not been completed in a timely fashion and at a reasonable cost. In June we responded with a suit in State District Court in Travis County, Texas, for breach of contract and numerous other grounds. Subsequently, we filed a like response to the Dallas suit. Presently, the litigation is being pursued only in the Dallas court.

We have confidence in our position. In our negotiations for ownership, we were told that the project's total cost would be $1.7 billion. It has grown to about $7.6 billion. Unit No. 1 was to begin commercial operation in 1981 and Unit No. 2, in 1983. Today, those dates are projected to be 1989 or later. We bought 3.8 percent share (87.4 megawatts) of the project when our cost was estimated to be $96 million, including borrowing costs. Based on the present project cost estimate and schedule, our cost would be more than $404 million. Brazos presently has about $232 million invested in the project's two units.

Gas Operations

We reported that our 24-mile natural gas pipeline has enabled us to save our members $12,182,000 this year. We now have spot market suppliers bid monthly to meet our gas needs above the usage met by our long-term contracts. We then buy gas from the suppliers in the most economical quantities.

The spot market has evolved to the state where the suppliers may offer "blocks" of gas at different prices depending on their arrangements with producers. To optimize costs and reliability, we have installed a computer at the Miller Plant to control the quantity of gas taken from each source according to price and contractual conditions.

We saw prices decrease to the point where, at times, producers in the area ceased to sell their gas. Such action indicates at least a temporary low in market prices. To prepare for the future while the market is favorable, we have been looking for additional long-term gas supplies. Initially, we found that "long-term" meant one year. Producers were willing to propose contracts of five-years' duration, but with the price open for negotiation each year and the contract cancellable by either party on short notice. Now, we are beginning to see more producer interest in longer-term arrangements.

We have also been studying the delivery systems that would allow best utilization of the long-term supplies we are investigating. One of our studies is evaluating construction of a gas pipeline to the North Texas Plant site from one of several intra-state pipelines.

A rocky stream bed near Mineral Wells, Texas. In some areas the Brazos River has a southern appearance; in others, a western look.

The gas pipeline presently serving the plant can no longer provide a flow of gas sufficient for the plant to operate at full capacity. We will increasingly need this capacity as our load grows for the rest of the decade. Moreover, the plant site is a candidate for gas combustion turbines should we choose them to provide peaking capacity. At this point in our evaluation, it appears that the economic justification of the new pipeline is not as strong as the operational need. So, we are reviewing other options, too.

Another matter under consideration is the practicality and feasibility of acquiring a gas reservoir. As we look for long-term sources of natural gas, one constraint on our negotiations is the large variation, both seasonal and daily, in our gas demand. Suppliers are looking for a steady income to justify their investment. The more variable our demand, the more unfavorable will be the terms they offer us. A reservoir would allow placing a more constant demand on suppliers. Gas would be stored in it during periods of low usage and withdrawn when our demand is high. Our investigations are still preliminary.

GENERATION CAPACITY PLANNING

We have continued to refine evaluations of how we will meet the demand on our system in the next few years. In 1986, we purchased generation capacity at economical rates from the Texas Municipal Power Pool, of which we are a member. We estimate that by 1989 or 1990, the Pool will no longer have excess capacity to sell. We will then need to add or purchase capacity or limit our peak.

We have studied cogeneration and gas turbines as choices for meeting the system's peak demand. To date, cogenerators have not been willing to consider an agreement for peaking power and consequently have not been able to make an economical offer. Gas turbines (somewhat like jet engines connected to a generator, but muffled to reduce noise) would give us the required capacity at low capital cost. They would be fueled by natural gas for their short periods of operation each year. Distillate (light) oil would be a back-up fuel.

To limit the increase in our peak demand, we began considering a demand-side management program as discussed in our *Report to Members*. There are techniques with potential for us to gain substantial control of our peak load growth and load factor. The results can improve rates, competitive position and relationships among Brazos, its members and their consumers.

New Members

On April 1, Dickens Electric Cooperative and Gate City Electric Cooperative joined Brazos. Dickens, with headquarters in Spur, Texas, serves about 4,700 consumers in Crosby, Dickens, Garza, Kent, King, Motley, and Stonewall counties. Dickens has 56 miles of 69 KV transmission line and seven substations. It has 2,697 miles of distribution line. The cooperative's peak demand is 17.5 megawatts with a very high load factor, 88 percent, due to oil field load.

Gate City is headquartered in Childress, Texas. It serves about 1,800 consumers through 1,375 miles of distribution line in Childress, Cottle, Dickens, Foard, King, Hardeman, Hall, and Motley counties. One consumer of particular note is the historic 6666 Ranch (read "four sixes"). At one time one of the largest ranches, it is now a highly innovative operation that has diversified into such areas as raising registered, quarter horses for racing. Gate City has three distribution substations. The cooperative's peak demand is 6.0 megawatts.

With the addition of these cooperatives, the Brazos System now serves approximately 229,000 consumers in 66 counties covering 56,777 square miles of Texas.

Three other West Texas cooperatives considered membership in Brazos, but elected not to request it at the time.

Production

During the year, we initiated a plant life extension and betterment study for our largest natural gas-fired plant, R.W. Miller. This study is investigating ways to upgrade the plants' three boilers and primarily their tubing (in which water is heated to steam). Our system's demand and capacity characteristics frequently require the electric generation units of our gas-fired plants to respond rapidly to large changes in demand. Such changes create thermal and mechanical stresses in the boilers and turbines, thereby shortening their lifespans.

Reliability

This year we completed our long-term program of pole groundline inspection and treatment. We think it has improved system reliability because there were substantially fewer outages related to pole failures. To improve our responsiveness and reliability, we acquired a fourth mobile substation, one having a capacity of 20 MVA. We also initiated the installation of an 800-megahertz radio system to improve and increase the area coverage of our communications. At year-end, we initiated a right-of-way clearing program that should also improve reliability.

Overall, we are not satisfied with our record of outages this year. We have 184 substations serving our customers. Our goal is to reduce average annual outage time to less than 30 minutes per substation. An unfortunate weather-related casualty to another utility's transmission line added 11 minutes to this year's average figure. The line fell, broken by a tornado, and created numerous outages at points where it crossed our transmission lines.

The recent history of outages is:

Year	Average Annual substation outage (minutes)
1981	87.00
1982	100.00
1983	61.45
1984	60.44
1985	47.96
1986	58.60*

*67.20 (including new, off-system load)

We are making steady progress but have much work left.

Economic Dispatching Operations

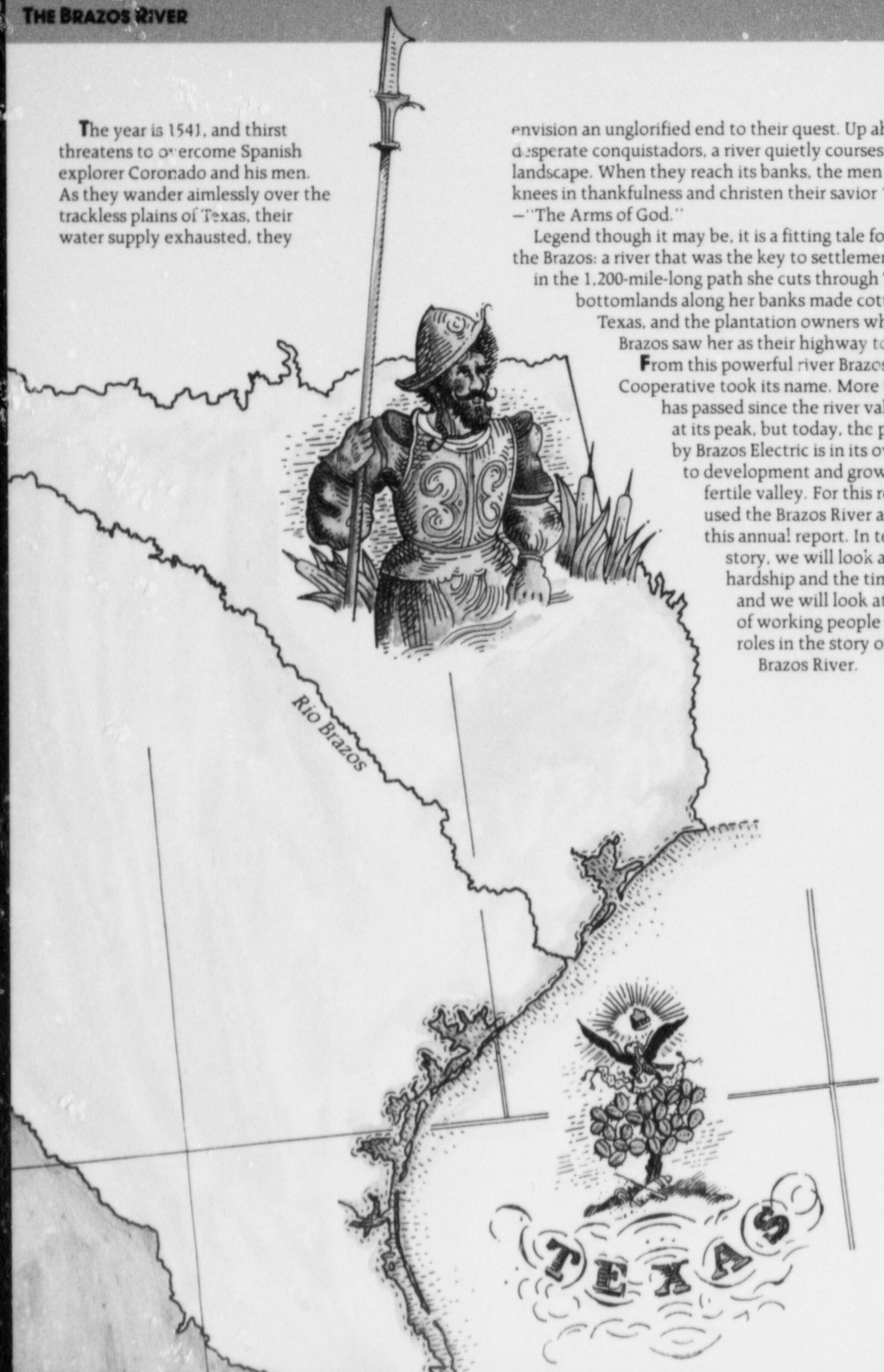
Since they began in 1982, economic dispatching operations within the Texas Municipal Power Pool have saved Brazos approximately $10 million. In 1986, the smaller differential between natural gas and lignite costs limited savings to approximately $500,000. The benefits of the program will continue at varying levels depending on economic conditions. Economic dispatching operations consist of choosing the best combinations of generating units to meet the load and reserve requirements of a system or pool and then loading the units in relation to their fuel costs per kilowatt hour to minimize the cost of electricity.

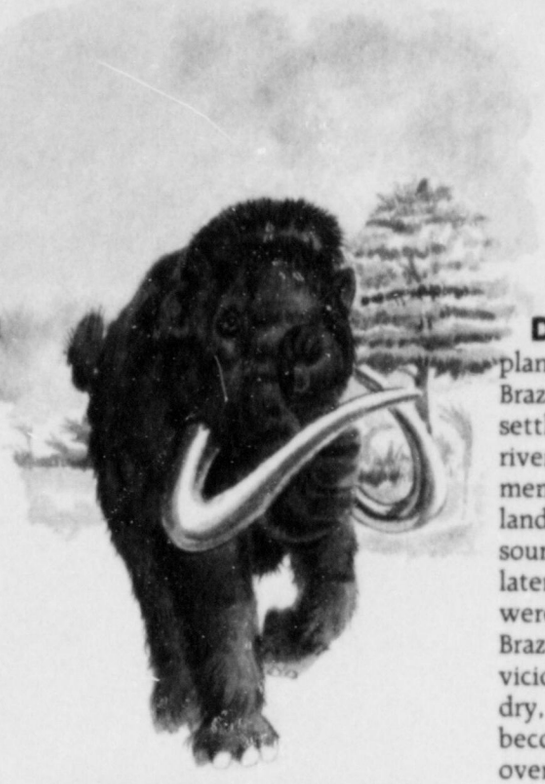
Another dispatching program that should help us minimize the cost of electricity is the Electric Reliability Council of Texas (ERCOT) Energy Broker System. It was reinstituted at year-end with revised operating procedures. It attempts to increase the savings of all utilities in the council through an hourly bidding process for available electric energy. Experience with earlier versions of this system should make our use of it more effective.

The year is 1541, and thirst threatens to overcome Spanish explorer Coronado and his men. As they wander aimlessly over the trackless plains of Texas, their water supply exhausted, they envision an unglorified end to their quest. Up ahead of the desperate conquistadors, a river quietly courses through the landscape. When they reach its banks, the men fall to their knees in thankfulness and christen their savior "Brazos de Dios" —"The Arms of God."

Legend though it may be, it is a fitting tale for the naming of the Brazos: a river that was the key to settlement and prosperity in the 1,200-mile-long path she cuts through Texas. The lush bottomlands along her banks made cotton "King" in Texas, and the plantation owners who lived along the Brazos saw her as their highway to riches.

From this powerful river Brazos Electric Power Cooperative took its name. More than a century has passed since the river valley's bounty was at its peak, but today, the power supplied by Brazos Electric is in its own way the key to development and growth in that same fertile valley. For this reason we have used the Brazos River as the theme of this annual report. In telling this brief story, we will look at the times of hardship and the times of prosperity, and we will look at the strong breed of working people who have played roles in the story of life along the Brazos River.





The Brazos River basin, with a total drainage area of 44,000 square miles, is the largest in the state. The present river is about 3,000 years old and is geologically known as an underfit river, or one that is too small for its valley. There is evidence that a trend of water drainage was established as early as 40 million years ago.

About one million years ago, the ancestral river increased its drainage area by capturing the headwaters of the Leon River in the Texas Panhandle. Today, in this area where the Brazos River first took in the Clear, Double Mountain and Salt Forks, the Brazos System, too, is expanding. Our addition of Gate City Electric Cooperative and Dickens Electric Cooperative in 1986 incorporated this same region of West Texas, increasing our service area by nine counties.

With all that the river has given to the life that has come to rely on her, she has not hesitated to take away. About 28,000 years ago, 15 woolly mammoths gathered at the ancestral Brazos, only to be trapped by the veiled quagmire at her shores, becoming victims of starvation.

But in her taking, the river also gives. In 1978, the bones of the mammoths were discovered near the present river. Scientists consider them to be the largest group of remains of the prehistoric creatures to have died from a single event. In the mammoths' graves also lies a unique learning opportunity. The find will be reconstructed for a walk-through display in the new $8 million Strecker Museum facility being built by Baylor University on the banks of the Brazos River in Waco.

Man, too, was attracted by the offerings of the Brazos. In 1983, the 10,000-year-old skeletons of an Indian man and child were discovered in a series of caves on the river. These skeletons are two of only five that have been found from this time period in either North or South America.

The intersection of the Brazos River and the Balcones Escarpment in McLennan County accounts for the abundance of archeological finds in the area. This intersection marks the meeting of two major climatic regions in Texas: the forests to the east and the plains to the west. It formed a natural gathering place for man and beast alike.

The recent history of the area began when Stephen F. Austin, in August of 1821, obtained permission from the Spanish Governor of Texas and Coahuila to explore the country along the Brazos River. This exploration convinced Austin of the great fertility of the land along the southern reaches of the river and he returned in December of the same year with his settlers.

At this site the settlers founded a ferry crossing of the Brazos, called LaBahia Road. The village of Old Washington now stands at the same location, where in 1836 the Texas Declaration of Independence was signed.

During the next few decades, vast plantations thrived in the lower Brazos Valley, and permanent settlements moved gradually up the river. In these years the determined men and women who wrestled the land from savagery developed three sources of wealth: cotton, cattle, and later, oil. Frequently, the settlers were at the river's mercy, for the Brazos was a moody, occasionally vicious stream. She was often nearly dry, but could and sometimes did become a raging torrent, spilling out over the land killing livestock and men, inundating cotton fields and burying oil wells under tons of mud. The extremes of her behavior were so great that men soon realized she must be tamed and controlled if they were to prosper. From the earliest days of settlement they dreamed of doing it.

In common with all Texas rivers, the Brazos was simply not designed by nature to accommodate steamboat travel. But, to the people who lived on her, or by her, the river was a symbol, representing far more than a means of access to the Gulf of Mexico. Continuing efforts to navigate her established a record for persistence. Those individuals who tried shared the conviction that the steamboat was the noblest form of transportation ever devised by civilized minds. From the 1850s to the turn of the century, almost 100 different steamboats attempted to force their way up the river, but with only partial success. The lower part of the river was heavily traveled in the years before the Civil War, but few vessels ventured farther north than Old Washington.

At one time there were as many as 70 towns along the Brazos expecting her to be developed as a trading thoroughfare. Around the turn of the

The Falls of the Brazos River, located near Marlin, formed a natural fording place for frontier travel.

century, though, it became apparent that she would not live up to their expectations. Frequent floods deposited submerged debris that hampered even the most powerful boats. Left with no means of commercial trade, many river towns died and most are now ghost towns.

Debris left by floods was not the only barrier to the successful navigation of the river. The Falls of the Brazos, located 5 miles southwest of Marlin, marked the limit of the river's traffic. But once again the river delivered disguised blessings. The falls formed a natural fording place for frontier travel, as the rocky stream bed was the only hardbottom crossing of the Brazos within 200 miles of the coast.

While steamboat travel up and down the river was difficult, crossing the river also proved a major challenge for early settlers and, later, for the lucrative cattle business. The Kimball Crossing of the famous Chisolm Trail in Bosque County was the location of the perilous ford by western wagon routes and cattle drives until a ferry was built in 1865.

But cattle trails and steamboats waned in importance as the snort of the Iron Horse began to awaken the solitude of the prairies. As the population of Texas grew, settlement gradually moved away from the familiar rivers, taking with it miles of newly laid track. Railroads were to become the key to economic development in the river valley that the river herself never was.

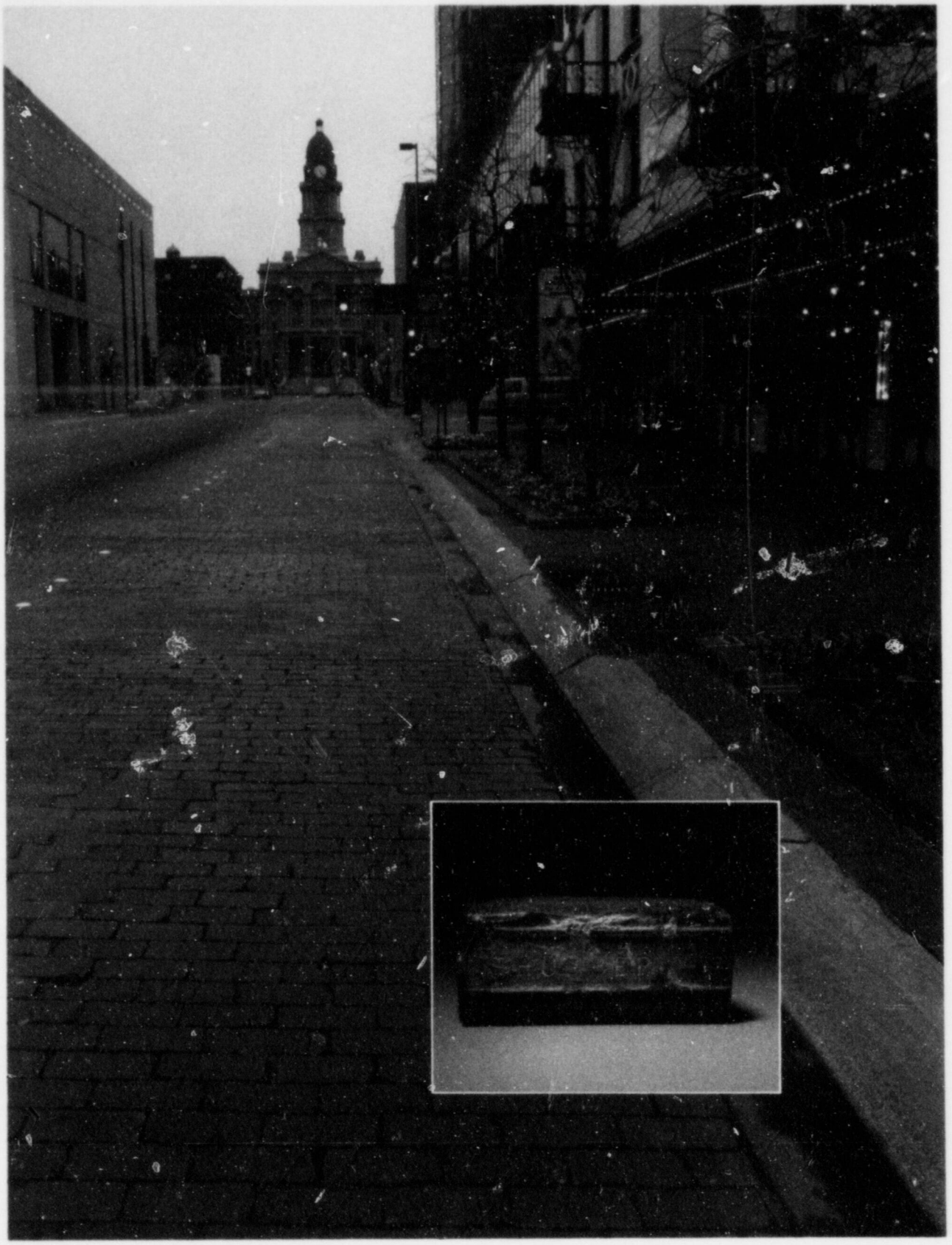
About 15 miles from the banks of the Brazos in Palo Pinto County lie the remnants of a town that once bore testimony to the power of a dependable transportation system. In 1886, coal was discovered here by W.W. Johnson. Two years later Johnson sold his rights to the Texas & Pacific Coal Company, which provided fuel for the Texas & Pacific Railroad.

For the next 30 years, the town named Thurber was the most important mine site in Texas and, with a population of more than 10,000, just about the biggest thing between Fort Worth and El Paso. Thurber was a company town that enjoyed the status of having its own ice plant. Its generating station made it one of the first towns in Texas to be fully electrified.

Thurber left a mark on the development of towns not only up and down the Brazos but all over the state. In 1897, enterprising Thurberites capitalized on the large deposits of shale in the nearby hills and pea coal that could be used to fire brick kilns. They erected a brick plant in the southeast part of town, and by fall, the new enterprise was producing dry-pressed bricks in the most modern facility west of the Mississippi River.

Profits soared as Thurber brick found ready markets in the Southwest for buildings, streets, highways, and heavy construction. The Galveston Sea Wall was built of Thurber brick, as were Congress Avenue in Austin and most of the streets in Fort Worth. But perhaps more importantly, Thurber brick was used to pave streets in innumerable small towns in the Brazos River valley. Such towns might have died were they not lifted from the suffocating mire of rain-soaked roads, infrequent though the occurrence.

The appearance of oil-burning locomotives on the Texas & Pacific tracks boldly announced a technological change that immediately reduced the need for Thurber coal. A strike followed a cut in pay and the coal mines were closed in 1921. The brick plant survived until 1930, when the depression curtailed construction and the need for brick. Thurber has now dwindled to a few delapidated buildings and a tall red brick smokestack: the tattered remnants of the prosperity the town once knew.



Not far from the Brazos River in Palo Pinto County is Thurber: a town that helped pave the way for settlement in the river valley with its sturdy, dry-pressed brick. Thurber brick can still be found in the streets of Fort Worth and many smaller Texas towns.

Without coal mining, the river valley inhabitants relied on an economy based primarily on farming and oil. During this period, rural Texans were waging a struggle for a comfortable life as fiercely as the settlers of the 1830s fought for their survival. When President Franklin D. Roosevelt established the Rural Electrification Administration in May of 1935, it was estimated that only about two percent of the rural areas of Texas were served with electric power. Residents of the other 98 percent lived much as Stephen F. Austin's settlers—without light, refrigeration or power.

By 1940, the efforts of small rural distribution cooperatives had brought electric power to nearly one quarter of the rural families. However, the distribution cooperatives were also concerned about the reliability and cost of wholesale power. So in 1941, eleven Central Texas rural electric distribution cooperatives formed a generation and transmission cooperative. This Brazos River Transmission Electric Cooperative, Inc. later changed its name to Brazos Electric Power Cooperative, Inc.

The river that provided Brazos Electric its name began providing the power that would nourish the fledgling cooperative. In 1941, the first Brazos transmission line was built to transport electricity generated at the Brazos River Authority's new dam at Possum Kingdom Lake on the Brazos River.

The far-reaching effects of the joint efforts of the Brazos River Authority and Brazos Electric Power Cooperative in providing power to rural Texans is exemplified in this typical editorial from the Marlin Democrat on March 26, 1941:

> *The completion of the Possum Kingdom Dam marked the first step in the realization of a dream of many years . . . The development of hydro-electric power is a by-product of the major aim of conservation and reclamation of the rich farm lands which have been denuded by unchecked floods. The sale of power is on a non-profit basis. The aim is to reach rural areas not served by the existing utilities thus giving the farms the advantage of electrical power and light and rendering rural life more attractive and comfortable.*

Finally, the river was being tamed.

Today, Brazos Electric Power sells wholesale power to its 20 member cooperatives which serve 229,000 consumers in 66 counties that surround the Brazos River. And that power has made a difference. No longer do those consumers rely only on the land for their sustinence. Agriculture and oil still play important roles in the economic life around the river. But today, modern, multi-million dollar companies such as the Westinghouse Electronic Assembly Plant in College Station and Hexcel Corporation in Graham thrive in towns along the Brazos River, providing jobs, prosperity, and most importantly, products to carry our world into the 21st century.

The Westinghouse Electric Assembly Plant in College Station is a $25 million facility that manufactures printed wiring assemblies for radar systems in our country's most advanced military aircraft: the B-1B bomber and F-16 fighter. The plant, which is a part of the Energy and Advanced Technology group of Westinghouse, employs about 500 people. It is one of only two such plants in the country that build the wiring boards: the heart of the protection systems for these planes and their pilots.

Perhaps what the plant produces is not even as important as how it produces. Westinghouse employs innovative management techniques, including employee task forces, self-managing work teams and flexible training. These techniques assure that all areas of the plant will have an adequate work force when time is essential. Videotapes and frequent workshops help management convey to the employees the importance of their work: a moment's distraction on the job could lead to the loss of protection for a fighter pilot. The quality of their work is unparalleled.

About 400 miles north of College Station, near the banks of the Brazos River and nestled among the hills surrounding Possum Kingdom Lake, is the quiet town of Graham. The hub of the area's oil- and gas-related industry, Graham has suffered from the bearish fuels market. Based in this unlikely locale is Hexcel, a $40 million plant that produces honeycomb: the structural material that is used in almost every commercial and military aircraft built today.

Honeycomb: lightweight, with an unusually high strength-to-weight ratio. Its practical uses are endless. In aircraft, it is used in engines, airfoil sections, stabilizers, rotors and even interior appointments. In construction, honeycomb can be sandwiched into exterior walls of skyscrapers to allow a tough marble finish without the excessive marble weight. Honeycomb, with its excellent capacity for energy absorption, was used as a shock absorber in the landing apparatus on the Apollo spaceship when it landed on the moon.

The Voyager, which recently completed its historic round-the-world flight on one tank of fuel, was made almost exclusively of Hexcel honeycomb.

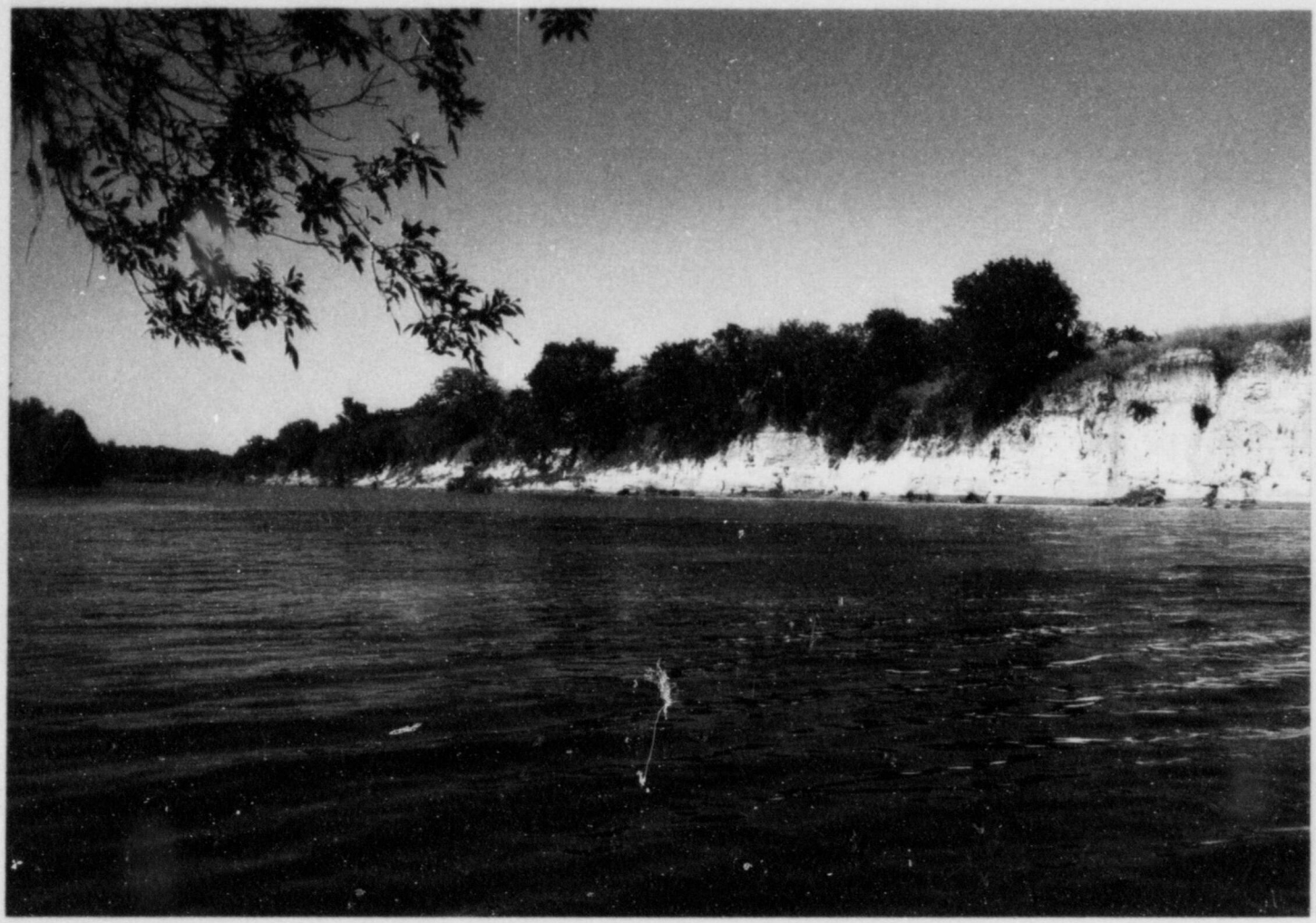
Hexcel has been producing honeycomb in Graham since 1964 when it opened with a 25,000 square-foot plant and 25 employees. Today, it employs 350-400 people in its 300,000 square-foot facility and is the largest producer of honeycomb in Hexcel's world-wide scope. Plant Manager Frank Jones said the source of his plant's success lies in the work ethic of the people in the area, which he said is superior to any he has seen in his 35 years with the company.

Of course, we already knew that.

And so, within the last few pages, we have explored but a fragment of the geological, anthropological, sociological and economic history of the Brazos River and her surrounding floodplain. The brevity enforced by these pages does not do justice to the history of the river around which Brazos Electric Power Cooperative was founded, has prospered and will continue to grow.

It is to those settlers who followed Stephen F. Austin into the wilds along the shores of the Brazos, to the river captains who spent a lifetime trying to tame her, to the farsighted men who recognized the need for power in her rural sweep and to the men and women who have worked and lived in towns in her valley that we may give our recognition and thanks. For the story of their lives and works is the source of today's prosperity and our unlimited potential.

Hexcel honeycomb, produced in Graham near the Brazos River, is the structural material used in almost every commercial and military aircraft built today.



WITH SPECIAL THANKS

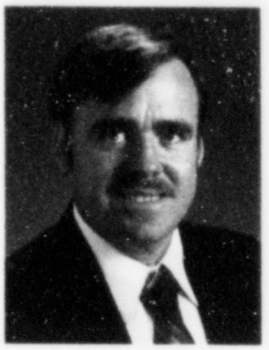
To Frank Jones, Jamie James and Mark Tooley of Hexcel; Jeannie Plass of Westinghouse; Kay Yount of the Fort Worth Street Department; Calvin Smith, David Lintz and Ted Hollingsworth of Strecker Museum; Dr. John Fox of the Baylor anthropology department and to Brazos employees Ernie Pars: ns, Bobby Jenkins and Woody Baldwin. They shared their knowledge, they shared their time and they shared their interest. Without them, this tribute to the Brazos River would not have been possible. Our thanks also to Patrick Pollei for the Bob Poage illustration.

William G. Parker
President
Comanche County Electric Cooperative Assn.

Luther L. Parks
Vice President
Belfalls Electric Cooperative, Inc.

Joe Forman
Secretary
Wise Electric Cooperative, Inc.

Don Gregg
B-K Electric Cooperative, Inc.



Lawrence Karl
Bartlett Electric Cooperative, Inc.

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

M.E. Holley
Denton County Electric Cooperative Assn.

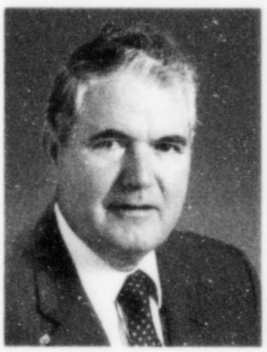
Ned Ward
Dickens Electric Cooperative, Inc.

Fred Parker
Erath County Electrtic Cooperative Assn.

Philip E. Slater
Fort Belknap Electric Cooperative, Inc.

James Driver
Gate City Electric Cooperative, Inc.

Jack Elam
Hamilton County Electric Cooperative Assn.



Sam Houston
Hill County Electric Cooperative, Inc.

Bernard Hilbers
J-A-C Electric Cooperative, Inc.

Billy J. Poland
Johnson County Electric Cooperative Assn.

Ron Golden
McLennan County Electric Cooperative, Inc.

Woodrow Hensarling
Mid-South Electric Cooperative Assn.

Aubrey Berry
Navarro County Electric Cooperative, Inc.

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

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

Executive Vice President and General Manager

Richard E. McCaskill, age 50, 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 26 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 director of InterFirst Bank in Waco. He is also First Vice President of the National G&T Manager's Association and Vice Chairman of the Executive Board of the Electric Reliability Council of Texas.

Assistant General Manager

J.D. Copeland, age 42, 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 43, 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 was responsible for administration on a nuclear power plant project and was a Marketing Engineer.

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

Manager—Fuel Operations

Clifford L. Sartin, age 57, 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 54, 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 48, 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. He is presently Chairman of the ERCOT Operating Subcommittee.

Manager—Project Construction and Engineering

Billy Dyess, age 56, 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 47, joined Brazos in 1964 as a Junior Engineer. He was appointed to 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.

The Consolidated Statement of Revenue and Patronage Capital and Other Equities of the Cooperative and its wholly owned subsidiary, Brazos Fuel Company, Inc., reflect net margins of $21,068,620 for the calendar year 1986. Because of these margins, we increased our equity to 14.4 percent of assets from 10.6 percent.

As previously reported, we discontinued construction payments on the Cooperative's interest in the Comanche Peak Nuclear Plant Project in mid-1985. We continued to make project interest payments using $20.5 million of General Funds in 1986 since Federal Financing Bank loan funds for the project had been exhausted. Consequently, on a cash basis, we did little more than break even. The loan payments from General Funds were accounted for as capitalized-interest-during-construction.

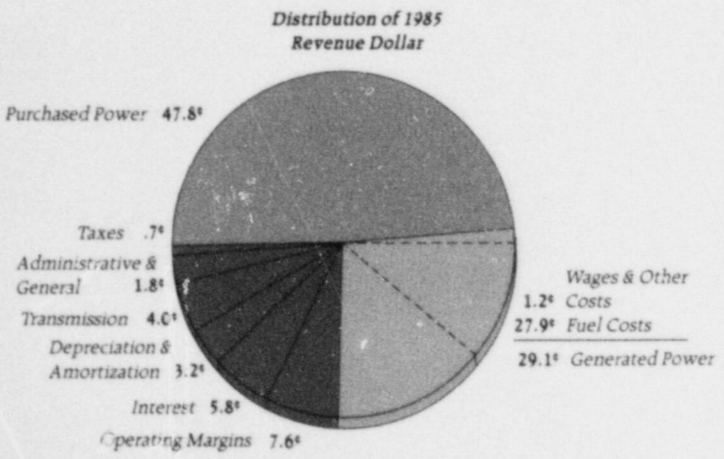
We filed two transmission loan applications in 1986. In the last quarter, we received approval of a $31.4 million concurrent Rural Electrification Administration/National Rural Utilities Cooperative Finance Corporation loan. A Federal Financing Bank loan application is still pending. Our total long-term debt grew from $375.5 million to $380.5 million.

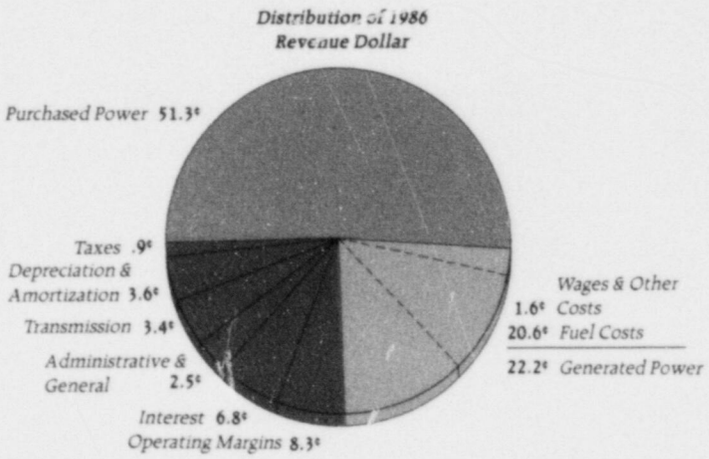
Reductions in Federal Financing Bank interest rates continued. The Cooperative's average interest rate on long-term debt decreased from 9.187 percent to 8.876 percent. The effect of this change is an annual reduction of approximately $1.2 million in our interest payments for long-term debt based on the long-term debt outstanding on January 1, 1986.

Despite the overwhelmingly positive nature of our financial report for this year, we must note that interest payments on debt associated with the Comanche Peak Nuclear Project periodically strained our cash flow during 1986. A call was made to members for advanced power bill payments under the Member Prepayment Plan. Their superb response provided working capital throughout the year.

Joe Forman

Joe Forman
Secretary-Treasurer





1986 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 more than 20 percent 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 1982-1986*

	1986	1985	1984	1983	1982
(Mills per KWH)					
Total Operating Revenue (1)	**48.4**	50.8	52.3	53.3	46.8
Operating Costs					
Production expenses (2)	**35.6**	39.1	42.3	43.4	39.5
Transmission expenses	**1.7**	2.0	2.3	2.5	2.2
Administrative and general expenses	**.8**	.6	.6	.6	.8
Depreciation, taxes, insurance, interest	**5.8**	5.3	5.5	6.0	4.1
Total Operating Costs	**43.9**	47.0	50.7	52.5	46.6
Net Operating Margin (Loss)	**4.5**	3.8	1.6	.8	.2
(1) Average sales price by class					
Firm power sales					
Member Cooperatives	**50.2**	53.5	53.7	55.6	49.9
Cities	**50.8**	52.3	53.9	56.4	50.8
Surplus power sales					
Cities	**20.6**	33.3	39.3	38.0	37.9
(2) Further analyzed by source					
Generated power					
Cost of fuel	**28.4**	33.5	39.6	40.9	39.1
Wages and other costs	**1.5**	1.4	1.5	1.7	1.2
Purchased power					
For system	**34.0**	36.1	38.7	38.6	36.3
At isolated meter points	**41.8**	48.5	45.5	43.8	41.6

**Excludes operations of Brazos Fuel Company, Inc.*

COMPARATIVE SUMMARY OF ELECTRICAL OPERATIONS 1982-1986*

	1986	1985	1984	1983	1982
Electricity Generated and Purchased—*In Megawatt Hours*					
Generated at North Texas Plant	**5,404**	100,473	5,131	8,814	22,890
Generated at Randle W. Miller Plant	**1,339,210**	1,570,418	1,291,634	1,118,547	1,499,573
Purchased for system					
A. From San Miguel Electric Cooperative	**1,469,983**	1,558,827	1,707,432	1,668,411	1,654,877
B. From other utilities	**517,800**	355,562	206,859	229,462	170,161
Purchased at isolated meter points	**660,448**	548,418	509,537	460,553	458,434
	3,922,845	4,133,698	3,720,593	3,485,787	3,805,935
Electric Sales—*In Megawatt Hours*					
A. Firm					
Member Cooperatives	**3,217,290**	3,033,643	2,846,999	2,498,886	2,389,141
Municipal Customers	**352,870**	386,707	341,058	303,299	272,603
	3,570,160	3,420,350	3,188,057	2,802,185	2,661,744
B. Economy Sales	**261,915**	523,226	370,149	461,793	1,003,469
	3,832,075	3,943,576	3,558,206	3,263,978	3,665,213
Electric Sales to Member Cooperatives—*In Megawatt Hours*					
Bartlett Electric Cooperative, Inc.	**57,975**	57,341	53,251	47,297	47,221
Belfalls Electric Cooperative, Inc.	**46,427**	44,270	42,152	39,125	42,317
B-K Electric Cooperative, Inc.	**61,298**	65,057	68,565	61,230	61,530
Comanche County Electric Cooperative Assn.	**142,531**	152,581	150,106	141,177	136,675
Cooke County Electric Cooperative Assn.	**250,198**	266,709	257,327	244,152	234,604
Denton County Electric Cooperative, Inc.	**331,363**	336,826	292,555	242,089	218,286
Dickens Electric Cooperative, Inc.	**133,204**	–	–	–	–
Erath County Electric Cooperative Assn.	**166,697**	169,997	167,941	153,394	146,638
Fort Belknap Electric Cooperative, Inc.	**107,821**	117,100	113,499	105,013	94,726
Gate City Electric Cooperative, Inc.	**21,473**	–	–	–	–
Hamilton County Electric Cooperative Assn.	**86,479**	86,380	82,260	75,894	75,602
Hill County Electric Cooperative, Inc.	**146,546**	143,945	133,026	115,100	111,916
J-A-C Electric Cooperative, Inc.	**84,142**	98,332	97,748	87,038	82,017
Johnson County Electric Cooperative Assn.	**391,618**	382,877	345,719	299,957	286,371
McLennan County Electric Cooperative, Inc.	**93,987**	94,132	87,206	77,712	77,009
Mid-South Electric Cooperative Assn.	**184,931**	192,881	179,825	155,889	156,657
Navarro County Electric Cooperative, Inc.	**148,616**	130,092	139,314	91,528	86,241
Navasota Valley Electric Cooperative, Inc.**	**169,364**	137,990	122,104	101,079	109,827
Tri-County Electric Cooperative, Inc.	**413,127**	406,035	372,215	323,536	301,061
Wise Electric Cooperative, Inc.	**149,493**	150,988	142,186	130,676	120,443
	3,217,290	3,033,643	2,846,999	2,498,886	2,389,141

*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.

	1986	1985	1984	1983	1982
Maximum Kilowatt Demand At Member Delivery Points	836,721	759,495	683,450	612,297	568,681
Annual Load Factor Percent Member Cooperatives	44	46	47	47	48
Electric Energy Sales					
Member Cooperatives	$161,435,659	$162,216,739	$152,868,791	$138,873,457	$119,214,939
Municipal and Economy	23,310,455	37,662,418	32,956,026	34,699,138	51,976,783
	$184,746,114	$199,879,157	$185,824,817	$173,572,595	$171,191,722
Other Electric Revenue	581,285	584,387	371,785	233,616	184,241
Total Operating Revenues	$185,327,399	$200,463,544	$186,196,602	$173,806,211	$171,375,963
Operating Expenses					
Production Expense-Generated Power	$ 41,095,852	$ 58,382,299	$ 53,333,538	$ 48,018,505	$ 59,530,029
Production Expense-Purchased Power	95,136,544	95,769,789	97,200,643	93,506,213	85,265,221
Transmission Expense	6,390,050	7,920,251	8,036,110	8,264,545	8,121,976
Insurance and Welfare Expense	1,543,894	1,304,137	1,459,113	1,344,556	1,200,410
Other Administrative & General Expenses	3,083,501	2,421,413	2,274,458	1,955,285	1,783,918
Depreciation and Amortization	6,701,675	6,434,379	6,048,486	5,631,674	5,126,312
Taxes	1,607,255	1,393,705	1,279,700	1,046,208	1,082,647
Interest on Long-Term Debt	33,539,856	33,798,340	29,081,630	26,620,960	22,403,479
Other Interest	718,311	280,301	487,041	972,492	1,047,359
Less Interest Charged to Construction	(21,750,773)	(22,403,872)	(18,820,116)	(17,466,851)	(14,735,721)
Other Operating Deductions	–	–	–	1,566,127	144,739
Total Cost of Electric Service	$168,066,165	$185,300,742	$180,380,603	$171,459,714	$170,970,369
Gain (Loss) in Operating Margins	$ 17,261,234	$ 15,162,802	$ 5,815,999	$ 2,346,497	$ 405,594
Non-Operating Margins	3,739,291	2,121,009	701,313	366,651	337,760
Gain (Loss) in Total Margins	$ 21,000,525	$ 17,283,811	$ 6,517,312	$ 2,713,148	$ 743,354

CONSOLIDATED BALANCE SHEET

December 31, 1986 and 1985

	1986	1985
ASSETS (Note 2)		
Utility Plant (Notes 1, 3 and 11):		
Electric plant in service, at cost	$229,368,663	$212,365,725
Completed construction not classified	730,178	4,306,888
Construction work in progress	247,990,498	225,153,717
Nuclear fuel in process of refinement and enrichment	9,758,886	9,758,886
	487,848,225	451,585,216
Less accumulated provision for depreciation and amortization	61,930,375	55,998,607
Utility plant, net	425,917,850	395,586,609
Other property and investments:		
Investments in associated organizations:		
Capital term certificates (CFC)	7,070,764	7,070,764
Patronage capital (Notes 1 and 9)	4,768,239	2,137,204
Other	5,585	5,819
Restricted assets and other investments:		
Certificates of deposit	5,215	4,855
	11,849,803	9,218,642
Current assets:		
Cash—general	454,044	714,795
Cash—loan funds	50,723	115,954
Special deposits	66,715	72,675
Temporary cash investments	6,480,000	7,900,000
Accounts receivable	17,459,335	18,425,788
Fuel inventory, at average cost	3,236,595	3,242,111
Material and supplies, at average cost	6,758,313	6,477,767
Prepayments	30,372	14,159
Total current assets	34,536,097	36,963,249
Deferred charges (Note 4):	2,003,788	2,638,587
	$474,307,538	$444,407,087

	1986	1985
LIABILITIES		
Equity and margins:		
Memberships	$ 100	$ 90
Patronage capital and other equities (Note 5)	68,321,392	47,252,772
	68,321,492	47,252,862
Long-term debt: (Notes 5 and 6)		
REA mortgage notes	80,326,360	81,454,784
CFC mortgage notes	16,713,165	15,626,848
FFB mortgage notes	277,216,698	274,616,000
	374,256,223	371,697,632
Current liabilities:		
Current maturities of long-term debt	6,232,000	3,817,800
Accounts payable	24,471,498	20,413,612
Other accrued liabilities	1,026,325	1,225,181
Total current liabilities	31,729,823	25,456,593
Commitments and contingencies (Note 11)	—	—
	$474,307,538	$444,407,087

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, 1986 and 1985	1986	1985
Operating revenues:		
Sales of electric energy (Notes 1 and 9)	$184,746,114	$199,879,157
Other	546,891	550,637
	185,293,005	200,429,794
Operating costs and expenses:		
Operating expenses:		
Operation expense:		
Production—fuel (Note 1)	37,822,058	55,712,307
Production—other	1,234,838	1,222,445
Purchased power (Note 9)	95,136,544	95,769,790
Transmission	4,414,965	5,891,140
Distribution	335,446	289,243
Administrative and general	4,712,819	3,808,866
Maintenance expense:		
Production	1,660,686	1,120,766
Transmission	1,001,643	1,142,007
Distribution	637,996	597,861
General plant	179,316	181,513
Depreciation and amortization (Note 1)	6,715,920	6,436,805
Taxes	1,617,624	1,404,227
Interest on long-term debt	33,539,856	33,798,340
Other interest	699,650	271,740
Interest charged to construction (Note 1)	(21,750,773)	(22,403,872)
Other	(8,201)	—
Total operating costs and expenses	167,950,387	185,243,178
Operating margins	17,342,618	15,186,616
G & T capital credits (Note 9)	2,688,993	1,151,928
Other capital credits and patronage dividends	126,471	121,905
Nonoperating margins:		
Interest income	921,140	842,565
Other	2,475	1,128
Margins before Federal income tax	21,081,697	17,304,142
Federal income tax (Note 10)	13,077	—
Net margins	21,068,620	17,304,142
Patronage capital and other equities, beginning of year	47,252,772	29,948,630
Patronage capital and other equities, end of year	$ 68,321,392	$ 47,252,772

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

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Years Ended December 31, 1986 and 1985	1986	1985
Working capital provided from:		
Net margins	$21,068,620	$17,304,142
Depreciation and amortization	6,715,920	6,436,805
Patronage capital allocations	(2,815,464)	(1,273,833)
Working capital provided from operations	24,969,076	22,467,114
Advances from REA	2,149,000	–
Advances from CFC	1,775,600	5,648,000
Advances from FFB	4,909,000	22,061,000
Salvage value of retirements	1,573,580	1,003,864
Contributions for line removal and relocation	57,000	15,328
Decrease in other property and investments–net of capital credits and patronage capital allocations	184,303	260,494
Decrease in deferred charges	256,532	–
Increase in memberships	10	–
Total working capital provided	35,874,101	51,455,800
Working capital used for:		
Additions to utility plant	38,000,307	43,794,346
Reduction of long-term debt to REA	3,277,424	3,274,036
Reduction of long-term debt to CFC	689,283	566,491
Reduction of long-term debt to FFB	2,308,302	74,000
Plant removal costs	299,167	461,361
Increase in deferred charges	–	389,436
Decrease in memberships	–	5
Total working capital provided	44,574,483	48,559,675
Increase (decrease) in working capital	$(8,700,382)	$ 2,896,125
Changes in working capital:		
Increase (decrease) in current assets:		
Cash	$ (325,982)	$(1,256,325)
Temporary cash investments	(1,420,000)	6,454,400
Special deposits	(5,960)	8,000
Accounts receivable	(966,453)	(19,665)
Material and supplies	275,030	421,662
Prepayments	16,213	(70,161)
	(2,427,152)	5,537,411
Increase (decrease) in current liabilities:		
Current maturities of long-term debt	2,414,200	297,800
Accounts payable	4,057,886	5,163,409
Notes payable	–	(2,900,000)
Other accrued liabilities	(198,856)	80,077
	6,273,230	2,641,286
Increase (decrease) in working capital	$(8,700,382)	$ 2,896,125

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, the result of which is not materially different from that prescribed by Statement on Financial Accounting Standards No. 34.

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 less unpaid production taxes and royalties.

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 the Rural Electrification Administration (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, 1986 and 1985:

	December 31,	
	1986	1985
Intangible plant	$ 2,170	$ 2,170
Production plant	64,373,169	60,395,163
Transmission plant	117,619,897	108,876,114
Distribution plant	40,969,377	36,897,188
General plant	6,404,050	6,195,090
Completed construction not classified	730,178	4,306,888
Electric plant in service	230,098,841	216,672,613
Construction work in progress	247,990,498	225,153,717
Nuclear fuel in process of refinement and enrichment	9,758,886	9,758,886
	$487,848,225	$451,585,216

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	2.83%
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, 1986 and 1985, are costs of $222,158,837 and $201,625,464 including interest charged to construction of $113,656,386 and $93,144,648, respectively, for the purchase of 3.8% ownership of the Comanche Peak Nuclear Generating Station.

4—Deferred Charges

Following is a summary of deferred charges at December 31, 1986 and 1985.

	1986	1985
Unrecovered purchased fuel costs, less allowance for unrecoverable gas of $247,455 and $255,034; deferred production taxes of $34,959 and $43,965; and deferred royalties of $50,959 and $64,106	$ 132,118	$ 274,627
Fixed transmission costs, less amortization of $2,077,859 and $1,699,592	–	378,267
Preliminary survey and investigation charges	1,756,971	1,754,946
Other	114,699	230,747
	$2,003,788	$2,638,587

5—Patronage Capital and Other Equities

Detail of patronage capital:

	December 31,	
	1986	1985
Assignable	$20,076,698	$16,449,819
Assigned	42,696,212	26,246,393
	62,772,910	42,696,212

Detail of other equities:

Capital gains and losses	9,383	9,383
Nonoperating margins	5,242,295	4,318,468
Retained earnings of subsidiary	296,804	228,709
	5,548,482	4,556,560
Total patronage capital and other equities	$68,321,392	$47,252,772

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.

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, 1986 and 1985.

	1986	1985
REA–Installment mortgage notes:		
2%, various maturity dates to November 28, 2014	$52,986,611	$55,860,848
5%, various maturity dates to September 12, 2018	30,527,749	28,768,936
	83,514,360	84,629,784
Less: Current maturities	3,188,000	3,175,000
	80,326,360	81,454,784
CFC–Installment mortgage notes:		
7%, matures November 30, 2007	6,223,956	6,350,619
7%, matures May 31, 1989	1,218,108	1,649,178
14%, matures November 30, 2016	1,280,755	1,283,451
11%, matures August 31, 2018	8,680,346	6,912,400
	17,403,165	16,195,648
Less: Current maturities	690,000	568,800
	16,713,165	15,626,848
FFB–Mortgage notes:		
Various interest rates from 7.2% to 12.984% maturing at various dates from 1-26-87 to 12-31-2020	279,570,698	274,690,000
Less: Current maturities	2,354,000	74,000
	277,216,698	274,616,000
	$374,256,223	$371,697,632

Unadvanced loan funds of $9,416,000 at 5% interest rate are available to the Cooperative at December 31, 1986 from commitments from REA.

Principal and interest installments of approximately $1,977,000 are due quarterly on the above REA and CFC notes.

Long-term debt to FFB consists of 2 to 32 year notes payable with principal and interest payments of approximately $6,896,000 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, 1986, the Cooperative had $39,340,353 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 $23,462,000 are available to the Cooperative on loan commitments from FFB.

At December 31, 1986, estimated annual maturities of principal of long-term debt outstanding for the next five years are as follows:

	REA	CFC	FFB	Total
1987	$ 3,188,000	$ 690,000	$ 2,354,000	$ 6,232,000
1988	3,385,000	737,000	2,765,000	6,887,000
1989	3,417,000	524,000	3,277,000	7,218,000
1990	3,459,000	287,000	4,216,000	7,962,000
1991	3,489,000	313,000	4,905,000	8,707,000
	$16,938,000	$2,551,000	$17,517,000	$37,006,000

7—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, 1986, 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 $3,000,000 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.

8—Retirement Plan

The Cooperative has a contributory retirement plan covering substantially all of its employees. Total retirement costs charged to operations for 1986 and 1985, were $406,772 and $388,084, 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, 1985 (date of latest information available) was $7,635,000. The book value of the retirement fund assets at December 31, 1985 was $10,495,982.

9—Transactions with Member Cooperatives and Affiliates

The Cooperative has contracts with 19 of its 20 member distribution cooperatives, through June 30, 2020, for the sale of wholesale electric energy. The contract with the other member cooperative is through June 30, 2010. Sales of electric energy to the member cooperatives were $161,435,659 and $162,216,740 for 1986 and 1985, respectively.

The Cooperative and South Texas Electric Cooperative, Inc. (STEC), another generation and transmission cooperative (G&T) are members of San Miguel Electric Cooperative, Inc., (San Miguel.) San Miguel owns and operates a 400 MW lignite-fired generating plant and associated mining facilities, which was constructed for the purpose of furnishing power and energy to the Cooperative and STEC.

The Cooperative and STEC have entered into wholesale power contracts with San Miguel through June 30, 2020, to purchase the entire output of San Miguel. The contracts provide that the Cooperative and STEC are collectively responsible for San Miguel's total cost of owning and operating the plant, including San Miguel's debt service obligations. Such responsibility is allocated between the Cooperative and STEC by reference to their respective power purchase obligations for any given year.

The Cooperative purchased $56,433,065 and $60,208,491 of electric energy from San Miguel in 1986 and 1985, respectively. Patronage capital credits were assigned to the Cooperative by San Miguel of $2,688,993 in 1986 and $1,151,928 in 1985 with cumulative totals of $4,122,671 at December 31, 1986 and $1,433,678 at December 31, 1985. Accounts payable due San Miguel from the Cooperative were $4,930,451 and $6,550,457 at December 31, 1986 and 1985, respectively.

In 1984 the Board of Directors approved a management plan under which San Miguel would pay the Cooperative for its general manager to serve as San Miguel's general manager. Further, San Miguel would pay STEC for its general manager to serve as San Miguel's Manager of Fuel Operations. Payments were made monthly in 1986 and 1985 in compliance with this management plan.

10—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.

11—Commitments and Contingencies Joint Ownership Agreement

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

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.

On May 29, 1986, TUEC filed suit in the 14th Judicial District Court of Dallas County, Texas, against Brazos and the two other minority interest owners of the Project. The suit requests a declaratory judgment on TUEC's allegation that it has performed all its obligations under the Joint Ownership Agreement in accordance with that agreement's standard of "prudent utility practice" and it alleges, among other things, breach of contract by Brazos in withholding construction progress payments. On June 20, 1986, Brazos filed counter claims against TUEC alleging, among other things, that TUEC has not met the agreement's standards and is in violation of the Texas Deceptive Trade Practices Act. The countersuit asks that the Joint Ownership Agreement be rescinded and Brazos' investment be returned, plus damages. Factual discovery is in progress. While the outcome of the litigation cannot be predicted with certainty, the Cooperative views its claims against TUEC as fully justifying the relief sought.

As of December 31, 1986, the Cooperative had invested $231,917,723 in the Project as construction payments, nuclear fuel, associated transmission facilities, interest during construction and other indirect costs, exclusive of $42,338,524 in withheld progress payments. Loans from FFB, guaranteed by REA, totalling $193 million have been used for the Project.

Should Brazos file an application for a rate increase, which includes costs of Comanche Peak in its cost of service, an inquiry by the Public Utility Commission of Texas into the prudence of Brazos' investment in the Project may result. 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 requirement and not determined independently thereof.

KMG Main Hurdman

Certified Public Accountants

Central Texas Tower
P.O. 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, 1986 and 1985, 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 11, 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.

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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, 1986 and 1985, 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.

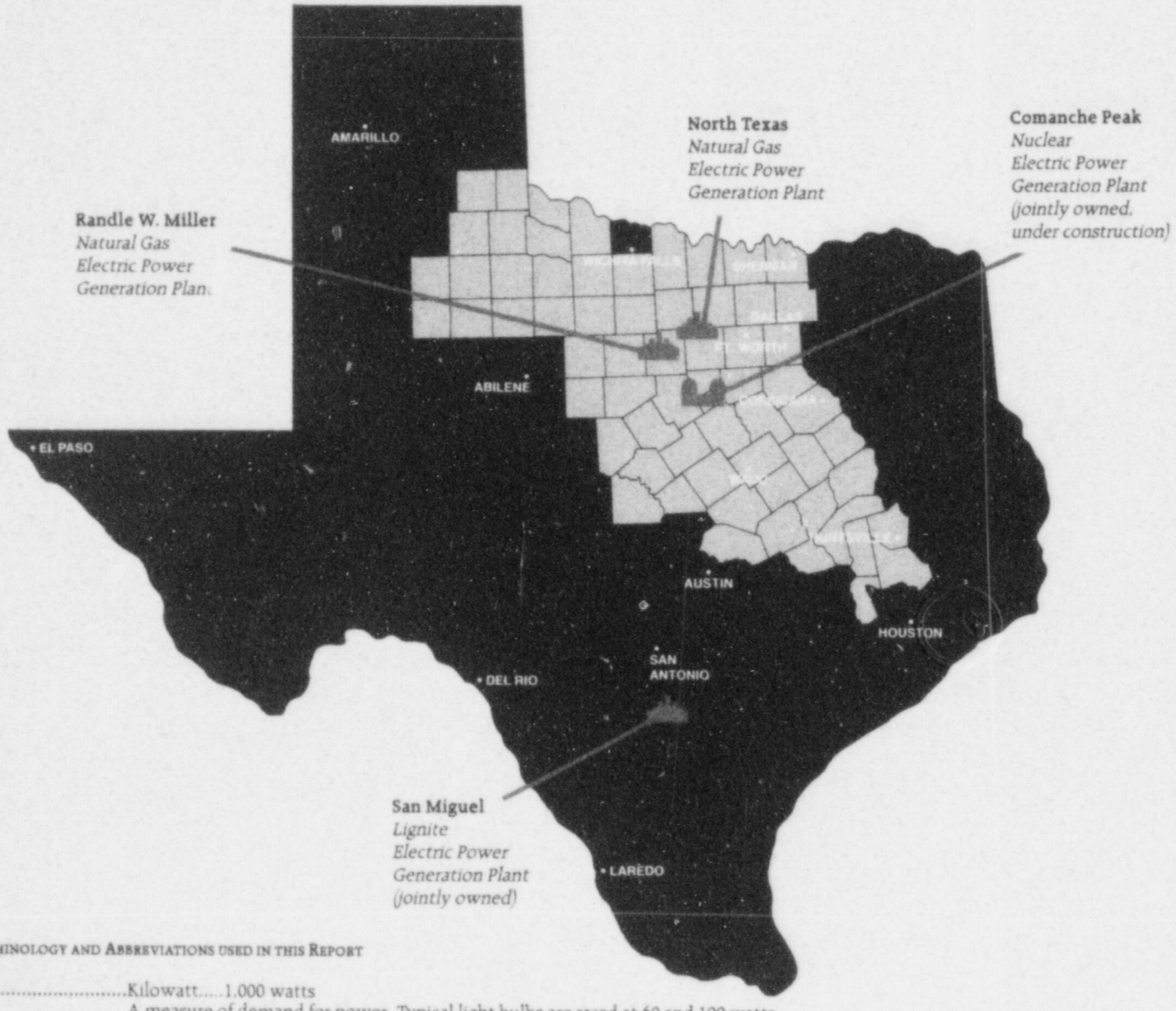
KMG Main Hurdman

February 28, 1987

System Statistics

	Fuel	Nameplate	Operating
Generation Capacity:			
San Miguel Plant	Lignite	195.5 MW	195.5 MW*
R.W. Miller Plant	N. Gas	366 MW	391 MW
North Texas Plant	N. Gas	66 MW	75.5 MW
Hydro (by contract)		50 MW	54 MW
** Capacity allocation as a joint owner.*		677.5 MW	716.0 MW

Transmission Lines:	
345 KV	96 miles
138 KV	627 miles
69 KV	1,510 miles
	2,233 miles
Member Cooperatives	20
Municipal Interchange Customers	7
Ultimate Consumers *(meters)*	229,000
Counties Served	66



Terminology and Abbreviations used in this Report

KW.....Kilowatt.....1,000 watts
A measure of demand for power. Typical light bulbs are rated at 60 and 100 watts.
MW.....Megawatt.....1 million watts. A measure of demand for power.
KWH.....Kilowatt hour.....1,000 watts used for 1 hour
A measure of energy. Energy used by a 100-watt light bulb during ten hours.
MWH.....Megawatt hour....1,000 kilowatt hours. A measure of energy.
KV.....Kilovolt.....1,000 volts
A measure of electrical potential. Household voltage is typically 115 volts.
KVA.....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).
BTU.....British Thermal Unit. A measure of heat.
MMBTU.....One Million BTU's
Lignite.....A low quality coal.
Mill.....One-tenth of a cent. A measure of cost of electricity.
MCF.....1,000 cubic feet. Volumetric measurement used for natural gas.

IN MEMORIAM...

When W.R. (Bob) Poage died on Jan. 3, 1987, Brazos Electric Power, our state and our nation lost a great friend. Poage served 42 years as the Congressman from Central Texas. For each of those 42 years, he was singularly dedicated to one goal: the betterment of Texas.

Bob Poage was instrumental in building the fledgling rural electrification program and became known as one of the foremost advocates of public power. Poage's impassioned efforts assured the month-old Brazos River Transmission Electric Cooperative its first power supply, a contract for the power generated at the new Possum Kingdom hydroelectric project.

Poage was recognized as one of the most knowledgeable men in the country on farm programs and agriculture. His love of the land led him to become a leading advocate of water conservation and flood control projects: his work helped pass the bills authorizing construction of Lakes Whitney, Belton, Stillhouse Hollow, Proctor, Somervell and Waco in Central Texas.

"Bob Poage had the most incredible foresight of anyone I have ever known. Fifty years ago he could see that the country was going to need water. The nice, comfortable life we enjoy now in Central Texas is a result of the foresight of Bob Poage," said his successor, U.S. Representative Marvin Leath.

Bob Poage, unlike many politicians, will be remembered not only in the history books or on plaques. The real monuments to "the man with the built-in smile" will endure forever in the lives of rural Texans. The daily tasks of filling a glass of water or flipping on a light switch are shining tributes to Bob Poage and his great work. He will be missed.

THE BRAZOS SYSTEM

Brazos Electric Power Cooperative, Inc.
2404 LaSalle
P.O. Box 2585
Waco, Texas 76702-2585
817/750-6500

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.

FINANCIAL STATEMENTS

December 31, 1986 and 1985

and

ACCOUNTANTS' REPORT

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

TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC.

FINANCIAL STATEMENTS

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CERTIFIED PUBLIC ACCOUNTANTS

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

March 5, 1987

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. (the Cooperative) as of December 31, 1986 and 1985, 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.

As discussed in Note 11, in June 1986, litigation was instituted by the Cooperative and the other minority owners of a two-unit nuclear fueled power generation plant (Comanche Peak). The suit claims various breaches of a 1980 Joint Ownership Agreement for the Comanche Peak project. At this time the Cooperative cannot predict the ultimate outcome of this litigation or the impact thereof on its financial statements.

As more fully discussed in Notes 11 and 12, on May 20, 1986, the Cooperative ceased making payments for construction expenditures related to Comanche Peak. The Cooperative and the other minority owners have been sued by the majority owner of Comanche Peak for their failure to continue making payments. The Cooperative has submitted a deficiency loan application to the Rural Electrification Administration (REA). At this time, the Cooperative cannot predict the ultimate outcome of such litigation or the final determination by REA of the deficiency loan application.

In our report dated March 25, 1986, our opinion on the 1985 financial statements was not qualified with respect to the matters described in the preceding paragraphs; however, in view of the recent uncertainties referred to above, our present opinion on the 1985 financial statements, as presented herein, is different from that expressed in our previous report.

In our opinion, subject to the effect of the outcome of the uncertainties discussed above, the financial statements referred to above present fairly the financial position of Tex-La Electric Cooperative of Texas, Inc. as of December 31, 1986 and 1985, and the results of its operations and the 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, 1986 and 1985

	1986	1985
ASSETS		
Electric Plant, At Cost:		
Furniture and fixtures	$ 24 753	$ 16 251
Office building	91 102	-
	115 855	16 251
Less accumulated depreciation	8 651	3 912
	107 204	12 339
Construction work in progress (Notes 2 and 6)	170 128 561	147 431 383
	170 235 765	147 443 722
Other Assets and Investments:		
Investment in associated organizations (Note 3)	2 838 157	2 838 157
Other assets	3 731	-
	2 841 888	2 838 157
Current Assets:		
Cash, including temporary cash investments of $987,839 and $610,546 in 1986 and 1985 - General funds	1 011 071	635 283
Cash, including temporary cash investments of $152,632 and $1,571,540 in 1986 and 1985 - Construction funds	259 763	1 573 186
Accounts receivable (includes receivables from member cooperatives of $1,654,900 in 1986 and $2,372,807 in 1985)	1 723 594	2 459 005
Prepaid expenses	50 625	7 136
	3 045 053	4 674 610
	$176 122 706	$154 956 489
EQUITIES AND LIABILITIES		
Patronage Capital and Other Equities (Notes 10, 11 and 12):		
Memberships	$ 700	$ 700
Patronage capital (Note 4)	359 819	258 101
Other equities (Note 5)	152 100	97 075
	512 619	355 876
Long-term debt (Note 6)	173 035 986	151 778 000
Current Liabilities:		
Accounts payable	2 574 101	2 817 652
Accrued interest	-	4 961
	2 574 101	2 822 613
	$176 122 706	$154 956 489

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, 1986 and 1985

	1986	1985
Operating Revenue:		
Power sales (Note 7)	$27 412 058	$30 537 181
Operating Expenses:		
Cost of purchased power	26 526 304	29 638 267
Administrative and general (Notes 8 and 9)	766 547	741 995
Depreciation	4 739	1 131
	27 297 590	30 381 393
Operating margins before interest expense	114 468	155 788
Interest Expense:		
Interest on long-term debt	16 577 621	14 522 125
Allowance for borrowed funds used during construction	16 577 621	14 522 125
	-	-
Operating margin	114 468	155 788
Nonoperating Margin:		
Interest income	42 275	55 025
Net margin	$ 156 743	$ 210 813

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, 1986 and 1985

	MEMBERSHIPS	PATRONAGE CAPITAL	OTHER EQUITIES	TOTAL
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	700	258 101	97 075	355 876
Net margin	-	156 743	-	156 743
Transfer to appropriated margins	-	(55 025)	55 025	-
Balance, December 31, 1986	$700	$359 819	$152 100	$512 619

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, 1986 and 1985

	1986	1985
Funds Were Provided By:		
Net margin	$ 156 743	$ 210 813
Add Items Not Requiring Funds:		
Depreciation	4 739	1 131
TOTAL FROM OPERATIONS	161 482	211 944
Advances from REA	21 257 986	30 751 000
Decrease in nonutility property	-	12 887
Decrease in working capital	1 381 045	-
	$22 800 513	$30 975 831
Funds Were Used For:		
Additions to construction work in progress	$22 697 178	$26 643 348
Additions to furniture and fixtures	8 502	407
Additions to building	91 102	-
Additions to other assets	3 731	-
Increase in working capital	-	4 332 076
	$22 800 513	$30 975 831
Increase (Decrease) in Working Capital By Components:		
Cash - General	$ 375 788	$ 326 097
Cash - Construction	(1 313 423)	1 365 420
Accounts receivable	(735 411)	(264 664)
Prepaid expenses	43 489	6 595
Accrued interest	-	(789)
Accounts payable	243 551	(217 657)
Accrued interest	4 961	3 116 974
	$(1 381 045)	$ 4 332 076

The accompanying notes are an integral part of these 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:

Office building and furniture and fixtures are stated at historical cost. Depreciation of these assets is computed at a straight-line composite rate of 4% and 7%, respectively.

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.

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 agreed to reduce its interest in the project to 2 1/6%. In 1982 the Cooperative, based on Texas Utilities Electric Company's (Texas Utilities) 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 Texas Utilities 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 Texas Utilities' present estimate, the Cooperative does not expect commercial operation of the project to commence prior to 1989. As of December 31, 1986, the Cooperative's total expenditures for its 2-1/6 percent share of the project is approximately $170 million. Based on the Cooperative's current estimates for the completion and licensing of the project, the Cooperative's share of Comanche Peak is expected ultimately to cost approximately $279 million. This figure could increase further in the event of added delays or other difficulties with the project beyond those currently anticipated. 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.

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. The Cooperative has filed an application with the REA for a deficiency loan and has requested authorization from the Public Utility Commission of Texas for an increase in the Cooperative's electric rates.

NOTE 3 - INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations at December 31, 1986 and 1985 consisted of the following:

	1986	1985
Patronage capital from the National Rural Utilities Cooperative Finance Corporation (CFC)	$2 837 157	$2 837 157
Memberships	1 000	1 000
	$2 838 157	$2 838 157

The investment in 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, 1986 and 1985 are as follows:

	1986	1985
Assignable	$359 819	$258 101
Assigned	-	-
	359 819	258 101
Less: Retired	-	-
	$359 819	$258 101

NOTE 5 - OTHER EQUITIES

The details of other equities at December 31, 1986 and 1985 are as follows:

	1986	1985
Appropriated margins	$152 100	$97 075

The by-laws of the Cooperative provide that non-operating 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 non-operating margins and funded each year, if necessary, to maintain the $400,000 balance.

NOTE 6 - LONG-TERM DEBT

Long-term debt at December 31, 1986 and 1985 consisted of the following:

	1986	1985
Mortgage notes payable to the Federal Financing Bank at interest rates from 7.294% to 11.911% with the Rural Electrification Administration (REA) as administrator	$173 035 986	$151 778 000

NOTE 6 - LONG-TERM DEBT - CONTINUED

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.

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 1987 with the CFC under which there were no borrowings outstanding at December 31, 1986.

NOTE 7 - POWER CONTRACTS

The Cooperative has wholesale power contracts with each of its members which require the members to buy and receive from the Cooperative all their power and energy requirements and require the Cooperative to sell and deliver power and energy in satisfaction of such requirements. 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, the Southwestern Power Administration (SWPA), an agency of the Department of Energy, and Southwestern Electric Power Company (SWEPCO).

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, 1986 and 1985 was $14,333 and $11,020, 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 and equipment purchases. The total reimbursement for the years ended December 31, 1986 and 1985 was $131,582 and $116,274, respectively. Certain members of the Cooperative are members of SRG&T.

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 (Texas Utilities), the Cooperative has agreed to hold harmless Texas Utilities from any monetary damages and attorney fees that might result from any claim brought by Brazos against Texas Utilities as a result of the Scheduling Agent Agreement.

In a letter agreement signed by the Cooperative, it was agreed that if Texas Utilities intervenes in this action, the Cooperative will not be obligated to indemnify Texas Utilities for any attorney fees it incurs as a result of Texas Utilities intervening in this action. On January 23, 1985 Texas Utilities 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.

NOTE 11 - COMANCHE PEAK LITIGATION

In May, 1986, the Cooperative and the other minority owners of the Comanche Peak Steam Electric Station (Comanche Peak), a two-unit nuclear fueled power generation plant, were sued by the majority owner, Texas Utilities Electric Company (Texas Utilities). The suit seeks a declaration that Texas Utilities has properly performed all its obligations under the Joint Ownership Agreement relating to Comanche Peak and seeks to force those minority owners who have discontinued making payments to Texas Utilities to resume making payments. Texas Utilities' lawsuit was filed after months of settlement negotiations with the Cooperative had reached an impasse and after the Cooperative, in a letter dated May 20, 1986 to Texas Utilities, formally notified Texas Utilities that future payments would not be made

NOTE 11 - COMANCHE PEAK LITIGATION - CONTINUED

because the Cooperative believes that Texas Utilities has mismanaged the construction of Comanche Peak and has failed to provide a cost estimate and a schedule of completion to the to the Cooperative as required by a Joint Ownership Agreement. At this time, the Cooperative is not making any payments.

In June, 1986, the Cooperative and two minority owners (Texas Municipal Power Agency and Brazos Electric Power Cooperative, Inc.) of the Comanche Peak project instituted litigation against Texas Utilities claiming various breaches of the Joint Ownership Agreement by Texas Utilities. The estimated cost of the Comanche Peak project increased from $764 million in 1974 to $7.5 billion as currently estimated. Completion dates of these two units were estimated in 1972 to be 1980 and 1982 for units one and two. On November 18, 1985, Texas Utilities announced that, assuming no further unforeseen difficulties, commercial operations of unit one could not commence until mid-1987, with unit two commencing commercial operations 6 months later. On April 18, 1986, Texas Utilities announced that, because of new problems that had been uncovered through its reinspection program, the estimate for commercial operation made in November, 1986 was no longer valid. At present, Texas Utilities has indicated that Comanche Peak will not begin operating before early 1989.

In the litigation, all three minority owners assert their rights under the Texas Deceptive Trade Practices Act (DTPA). They seek to be compensated for their damages, including, but not limited to, damages related to increased costs of completion, delay damages and attorney's fees and expenses. Furthermore, under the DTPA, the minority owners may recover up to three times the amount of actual damages, plus court costs and reasonable attorney's fees.

Previous settlement discussions have been unproductive and, at present, there are no settlement discussions underway. The lawsuit currently is in the early phases of discovery. When the trial will take place is still uncertain.

NOTE 12 - REA DEFICIENCY LOAN

The Cooperative has financed its share of the Comanche Peak project with debt. On August 3, 1981 the Cooperative received a $180 million loan commitment from the Rural Electrification Administration to finance the Cooperative's share of the Comanche Peak project. Through December 31, 1986 the Cooperative has utilized approximately $173 million of the loan commitment. Based on the Cooperative's projections and expectation for commercial operation dates, the Cooperative estimates its 2 1/6% share of the project will cost in excess of $279 million. As a result, the Cooperative has submitted a deficiency loan application to the Rural Electrification Administration in regard to the Comanche Peak project. At this time, the Cooperative cannot predict the outcome of such application.