GULF STATES UTILITIES COMPANY

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August 28, 1989
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File No. G9.5

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

Gentlemen:

River Bend Station - Unit 1
Docket No. 50-458
Secondary Financial Protection

On behalf of Gulf States Utilities Company and Cajun Electric Power Cooperative, Inc., find enclosed a Certified Cash Flow Statement for each utility and Gulf States Utilities' Annual Report as required by 10CFR 140.21 for the guarantee of funds in the event of a retrospective call under the Secondary Financial Protection Program.

A copy of the Cajun Electric Power Cooperative, Inc. 1988 annual financial report will be provided once it becomes available.

Should you have any questions, please contact us.

Sincerely,

J. E. Booker

J. E. Booker
Manager-River Bend Oversight

LLD

JEB/LAE/LLD/lp

Enclosures

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

NRC Resident Inspector
P. O. Box 1051
St. Francisville, LA 70776

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CAJUN ELECTRIC POWER COOPERATIVE, INC.

1989 CASH FLOW OUTLOOK

($ 000'S)

	THRU 06/30/89	3RD QUARTER	4TH QUARTER	TOTAL 1989
APPLICATIONS OF CASH				
CAPITAL ADDITIONS	$5,906	$716	$24,461	$31,083
CONSTRUCTION WORK IN PROGRESS	5,256	3,420	5,998	14,674
LONG TERM DEBT RETIREMENT	110,041	10,363	8,485	128,889
OTHER OUTLAYS	0	0	3	3
TOTAL APPLICATIONS OF CASH	$121,203	$14,499	$38,947	$174,649

	THRU 06/30/89	3RD QUARTER	4TH QUARTER	TOTAL 1989
SOURCES OF CASH				
NET MARGIN	($88,511)	($34,329)	($41,941)	($164,781)
PLUS: NONCASH EXPENSES	40,162	22,458	22,457	85,077
LESS: NONCASH REVENUES	0	0	3,884	3,884
CASH FROM OPERATIONS	(48,349)	(11,871)	(23,368)	(83,588)
PLUS: NET TIMING DIFFERENCES	132,977	27,373	59,771	220,121
TOTAL SOURCES	$84,628	$15,502	$36,403	$136,533
DEFICIENCY TO BE FUNDED FROM LOANS AND OTHER SOURCES	$36,575	($1,003)	$2,544	$38,116

I HEREBY CERTIFY THAT, TO THE BEST OF MY KNOWLEDGE, THE ABOVE 1989 CASH FLOW OUTLOOK FOR CAJUN ELECTRIC POWER COOPERATIVE, INC. IS A REASONABLY ACCURATE PROJECTION BASED UPON JANUARY - JUNE ACTUALS AND JULY - DECEMBER PROJECTIONS.

DAVID LEE MOHRE

EXECUTIVE VICE PRESIDENT & GENERAL MANAGER

GULF STATES UTILITIES COMPANY
CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)
For the twelve months ended December 31
(in thousands)

	Actual 1988	Budgeted* 1989
PROVIDED FROM OPERATIONS		
Net income	$ 103,143	$ 47,889
Items not requiring cash:		
Deferred fuel and purchased power expense--net	(5,084)	(26,215)
Amortization of nuclear fuel	44,393	30,000
Depreciation and amortization	179,947	189,651
Deferred River Bend expenses, revenue requirement, and carrying charges	(280,145)	(97,462)
Amortization of accumulated deferred River Bend costs	38,575	33,313
Reduction of deferred River Bend costs	46,266	-
Deferred income taxes--net	71,594	34,516
Investment tax credits--net	(4,118)	(4,431)
Allowance for funds used during construction	(10,155)	(1,843)
Cumulative effect of the write-down of River Bend 2 (net of income taxes)	14,369	14,888
Disputed amount	3,624	(6)
Other	(9,257)	(1,842)
Changes in:		
Receivables--net of disputed amount	(756)	8,616
Fuel inventories	1,920	8,539
Materials and supplies	237	(671)
Prepayments and other current assets	(7,496)	(2,567)
Accounts payable--trade	4,197	(7,452)
Customer deposits	1,053	600
Taxes accrued	14,704	2,221
Interest accrued	(7,353)	(10,442)
Other current liabilities	3,556	1,081
Net cash flow provided by operating activities	203,314	218,383
FINANCING ACTIVITIES		
Increase in deferred River Bend construction and continuing services commitments	4,428	2,464
Payment of deferred River Bend construction and continuing services commitments	(8,400)	(31,512)
Payments of lease obligations	(38,188)	(27,468)
Retirement of long-term debt	(107,320)	(111,653)
Increase in other long-term debt	680	679
Net cash flow used by financing activities	(148,800)	(167,490)
INVESTING ACTIVITIES		
Construction expenditures	(38,654)	(55,376)
Nuclear fuel expenditures	(75,530)	(19,660)
Sale of nuclear fuel--River Bend fuel lease	-	98,893
Allowance for funds used during construction	10,155	1,843
Deposit to escrow account	(12,000)	-
Other property and investments	(4,157)	14
Net cash flow provided by (used by) investing activities	(120,186)	25,714
Net change in cash and cash equivalents	(65,672)	76,607
Cash and cash equivalents at January 1	168,065	102,393
Cash and cash equivalents at December 31	$ 102,393	$ 179,000
Average quarterly funds available	$ 25,598	$ 44,750
Percent ownership in all operating nuclear units:		
River Bend	70%	70%
Maximum total contingent liability		$ 7,000

*Based on six months actual and six months updated budget income statement. No assurances can be given that the budgeted results can be achieved.

Certified as correct:

B. J. Willis

B. J. Willis
Vice President and Controller
August 11, 1989

GULF STATES UTILITIES 1988 ANNUAL REPORT

DEPENDABLE PUBLIC SERVICE

GULF STATES UTILITIES CO.

~~8906130266~~ 48 pp.

Financial Highlights

Financial Highlights	1988	1987	% Change
Total Operating Revenue (000)	$1,520,477	$1,432,586	6.1
Operating Expenses and Taxes (000)	$1,087,621	$1,055,966	3.0
Net Income (000)	$ 103,143	$ 241,101	(57.2)
Income Applicable to Common Stock (000)	$ 40,079	$ 178,091	(77.5)
Earnings per Average Share of Common Stock Outstanding	$0.37	$1.65	(77.6)
Dividends per Share	—	—	—
Average Common Shares Outstanding (000)	108,055	107,995	.1
Number of Electric Customers (end of Year)	557,576	554,905	.5
Total Kilowatt-Hour Sales (000)	27,196,591	26,620,287	2.2
System Peak Load — Kilowatts	4,910,000	4,991,000	(1.6)

Description of Business

Gulf States Utilities was incorporated in 1925 and is primarily in the business of generating, transmitting and distributing electricity to almost 558,000 customers in Southeast Texas and South Louisiana. The service area extends 350 miles westward from Baton Rouge, La., to a point about 50 miles east of Austin, Texas. The service area encompasses the northern suburbs of Houston and major cities such as Conroe, Huntsville, Port Arthur, Orange and Beaumont Texas; Lake Charles and Baton Rouge, La.

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

As a member of the Southwest Power Pool, the company has the ability to interchange electricity with the 43 members (29 members and 14 associated members) serving eight states in the South and Southwest. The company had a peak load of 4,910 megawatts in 1988, while it had installed capacity and firm power purchase agreements totaling 6,805 megawatts at the time of that peak load.

About the Cover

"Dependable Public Service", the motto engraved on the Gulf States Utilities' logo at the company's founding, continues to serve as a guiding principle. GSU's emblems have changed over the years, but the company's commitment to providing service to its customers remains strong.

Report to Shareholders

Dear Fellow Shareholders:

A year ago, I told you that the test of a strong person is how he or she faces adversity — and adversity was certainly in abundance at the time. This year, I cannot report any magic cures or major breakthroughs, but there has been important progress made. Your company has taken the first steps down the long road to financial recovery and, barring some catastrophic event along the way, I believe we will be able to complete the journey. Our destination: a state of sustained financial health. It is a modest goal that recognizes the serious nature of our recent difficulties. I cannot give an estimated time of arrival, but it will not be a short trip.


E. Linn Draper Jr.

It now appears that the company will have sufficient revenues to cover day-to-day operations in 1989, but we have significant debt payments coming due this year and in succeeding years for which provisions must be made and we still have some serious contingencies. Regrettably, the rates we currently are allowed to charge do not provide the revenues needed to resume dividend payments. As you know, the preferred and preference dividends that have been omitted since the first quarter of 1987 must be satisfied before common stock dividend payments can be resumed. I know many of you have encountered hardships since we were forced to suspend dividends. The board of directors and the management of your company are committed to reinstating dividends as soon as our financial health permits. I cannot give a date, but I assure you it will not be one day longer than is necessary.

Earnings for 1988 were 37 cents per share of common stock, compared to $1.65 per share in 1987. Despite the negative implications of the year-to-year comparison, we believe we made some forward progress in 1988 as rate decisions in both states substantially reduced the level of non-cash accounting items related to River Bend reflected in net income. If all such non-cash accounting items were disregarded, we would have suffered a $25.3 million loss in 1988 compared to a $149 million loss for 1987. That obviously is an improvement, but it's still a long way from being positive.

The wearying struggle to reflect the River Bend nuclear power plant in our rates continues, although in some respects 1988 was not as arduous as the year before. The most positive development occurred in a Louisiana state district court, which in February of 1988 ordered a $92 million first-year rate increase to begin phasing in the $1.6 billion in River Bend costs that have been deemed prudent by the Louisiana Public Service Commission (LPSC). The court also adopted a phase-in plan that called for four additional revenue increases — $50 million each in years two, three and four and $38 million in year five — that would complete the phase-in of all River Bend costs allowed by the LPSC.

On Feb. 28, 1989, the LPSC granted the company a $38 million rate increase. It appears the net effect of the LPSC's action is consistent with the intent of the court-ordered phase-in plan with certain adjustments. The court-ordered plan calls for additional increases in future years subject to the LPSC review.

Still to be decided by a Louisiana state court, perhaps as soon as April, is the LPSC's disallowance of $1.4 billion in systemwide River Bend costs (about $677 million on a Louisiana jurisdictional basis). The company's appeal of that aspect of the case is pending in state district court, where Gulf States has proposed that this portion of the plant be placed in inventory and not included in rate base at the present time.

I believe a properly structured inventory plan is a reasonable way to protect the interests of our shareholders without putting excessive burdens on our customers who continue to struggle against poor economic conditions in our service area. Such a plan would keep our rates competitive and minimize the possibility that industrial customers who account for about 44 percent of sales would leave our system. This approach would give GSU shareholders an opportunity to earn a return on their investment, as opposed to a permanent disallowance which would eliminate such a possibility.

It is likely that all of the Louisiana rate issues will eventually be decided by the state Supreme Court. In addition to obtaining badly needed revenues, a major challenge facing the company is to emerge from the court proceedings without a major disallowance and with a rate phase-in plan that meets utility accounting requirements. If we can achieve those objectives, a potentially devastating write-off can be avoided.

In Texas, our goals are the same. The Public Utility Commission (PUCT) granted us a one-time rate increase of about $60 million in May of 1988 to cover the $1.6 billion in construction costs the PUCT said were prudently incurred. However, the commission held in abeyance about $1.4 billion of River Bend construction costs, saying the company did not provide enough evidence regarding cost increases beyond the 1979 construction estimate and disallowed $63 million as imprudent. The costs held in abeyance will be the subject of a rate filing planned for the first quarter of 1989.

While the rate struggles dragged on, River Bend continued to improve upon its already outstanding operating record. During the year, River Bend had a capacity factor of 88.2 percent, which ranked it fourth among boiling water reactors in the United States. It also set the world record for continuous days of operation for reactors of its class during a second fuel cycle; the unit already held the record for a first fuel cycle continuous run.

For the second time since the plant went into commercial operation in 1986, a Nuclear Regulatory Commission (NRC) team conducted a comprehensive review of how the company is managing the River Bend project. The resulting "report card" was, for the most part, outstanding. In the cover letter accompanying the report, the NRC's regional administrator wrote that the 15 staff members who conducted the review "noted a strong management commitment to improving plant operations" and that "the overall performance at (River Bend) has continued on an improving trend." In three key categories — emergency preparedness, engineering/technical support and safety assessment/quality verification — we received Category 1 ratings, the very highest, from the NRC team. A Category 1 means that "management attention and involvement are readily evident and place emphasis on superior performance of nuclear safety or safeguards . . . ."

While the safe operation of River Bend to protect the public is paramount, no less important is the safety of our employees. I am extremely pleased that our people at River Bend have worked almost 7.5 million man-hours without a lost-time injury, a record dating back to 1979 when actual construction began on River Bend.

River Bend's importance to the company and its customers is also evident when examining our 1988 fuel mix. River Bend accounted for 21 percent of the power generated by the company during the year, with natural gas providing 65 percent, coal 13 percent and oil 1 percent. I firmly believe that our fuel diversity — the ability to produce electricity with gas, uranium, coal and oil — will be an increasingly valuable asset in the years to come.

River Bend suffered one loss in 1988. Bill Cahill, the man most responsible for the successful construction of the plant, retired. He was senior vice president of the River Bend Nuclear Group throughout the construction phase and his leadership was often praised by the NRC. It is a tribute to the job he did for us that Texas Utilities Electric Co. has since lured him out of retirement to become executive vice president in charge of nuclear engineering and operations. Primary responsibility for River Bend is now in the very capable hands of Jim Deddens, who has been senior vice president of the nuclear group for two years.

In addition to the River Bend-related rate issues, another significant and lingering dispute facing Gulf States involves purchased power contracts with the Southern Co. It is our contention that the Southern Co. voided the contracts, among other things, by refusing to renegotiate them in good faith. The issue is before two different federal courts and will, in all likelihood, remain in litigation for some time.

Our business has suffered significantly from the economic downturn that affected our service territory so severely. Since the fortunes of Gulf States are tied closely to those of the region we serve, both the company and the communities in which we operate have been hit hard. During 1988, it began to seem that better times may be ahead.

Kilowatt-hour sales in 1988 increased by 2 percent over the previous year. That is significant because sales have declined annually since 1984 — one year by 8 percent. It was particularly encouraging to see that kilowatt-hour sales in the fourth quarter of 1988 were up more than 6 percent over the same period in 1987. Economists are predicting 1989 will be a better year for the region. Although the oil exploration, production and refining industries continue in a slump, our area is benefitting from the fact that the petrochemical and chemical industries are experiencing a mushrooming demand for their products.

It is clear to us that we can't depend solely on the chemical boom to revive the area economy and provide sustained growth for the future. Just as Gulf States diversified its fuel mix, so must our region diversify its industrial mix. That is one reason Gulf States is putting greatly-increased emphasis on our own economic development efforts. Working with local governments, economic development groups, the private sector and state agencies, we are actively recruiting all types of businesses and industries. We're teaching our communities to market themselves through our innovative Team City program. We have identified and can provide at almost a moment's notice information on buildings and sites throughout our service area through our Computer Analysis of Building and Sites (CABS) program.

Another area that is receiving intense attention is the retention of existing customers. We have had good success at keeping industrial users on the Gulf States system rather than seeing them leave to enter the risky business of generating their own power. To the extent that we can keep existing electric load — and add new load — all of our customers benefit because there is a broader customer base to share in the company's fixed costs.

With all of our legal and regulatory turmoil, it is sometimes easy to forget that we are in the business of making and selling electricity. I believe that our expanded efforts in the areas of marketing, customer retention and economic development will help boost sales and thereby prove beneficial to our shareholders and customers alike.

There has been one addition to the board of directors since I reported to you last. In January of this year, Eugene H. Owen of Baton Rouge was elected to the board. He is chief executive officer of the engineering firm Owen and White, Inc.; chairman and president of Utility Holdings, Inc.; and president of its two subsidiaries, Baton Rouge Water Co. and Louisiana Water Co. He brings to the board both a technical and a utility background that should prove extremely valuable.

It is traditional to use this space to recognize the hard work and dedication of our employees. But the job that Gulf States employees performed during 1988 was not traditional. Their cost-cutting and cash conservation efforts played a signal role in getting us through the year. Their work in the area of marketing and economic development holds the promise of better times ahead. Although our employees consistently get high marks for the service they provide our customers, they are striving to do even better. Our employees' dedication, their willingness to go the extra mile when necessary, is remarkable considering the efforts demanded of them in recent years. They also are sensitive to the needs of our shareholders because most of them also belong to that group.

Many difficult challenges remain. Yet, having seen the progress our employees helped us make in the face of great adversity, I am more confident than ever that Gulf States is headed in the right direction and that we will be able to complete our journey successfully.

Sincerely,

E. Linn Draper Jr.

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

March 1, 1989

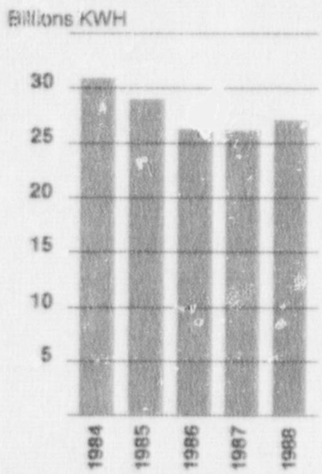
1988 In Review

Sales and Earnings

Electric sales for 1988 increased 2 percent over 1987 levels, the first time since 1984 that Gulf States has reported an improvement in sales activity. The residential, commercial and industrial class sales were up while the wholesale class remained flat.

Kilowatt-hour (kwh) sales for the year totaled 27.2 billion kwh, compared with 26.6 billion kwh for 1987.

Electric Sales



Total operating revenues for the year ended Dec. 31, 1988, were $1.5 billion, up 6.1 percent from the $1.4 billion in operating revenues reported in 1987. This can be attributed to rate increases in Texas and Louisiana during the year and to the increased sales of electricity.

Net income for 1988 was $103.1 million, which included $128.4 million attributable to accounting orders and amounts recorded in compliance with phase-in plans, net of related taxes. Excluding these effects, there would have been a $25.3 million loss recorded for the year. While net income for 1987 was $241.1 million, accounting orders and phase-in plan amounts accounted for $390.1 million. Excluding these effects, there would have been a $149 million net loss for 1987.

Earnings per share of common stock for 1988 were 37 cents, compared with $1.65 per share for the previous year.

The earnings and net income reported by Gulf States, because of pending court appeals, do not include any provisions for the write-off of the disallowance of $677 million of the investment in River Bend in the Louisiana retail jurisdiction or for the write-off of the exclusion of the $575 million investment in the Texas retail jurisdiction, or about $1.4 billion on a systemwide basis.

There were no common, preferred or preference stock dividends paid during 1988 because of the continued poor financial condition of the company stemming from the lack of adequate rate relief.

Gulf States has not been able to pay common stock dividends since the second quarter of 1986 and suspended preferred and preference dividend payments beginning with the first quarter of 1987. No common stock dividends can be paid until all preferred and preference dividend arrearages and sinking fund obligations have been paid. At the end of 1988, the accumulated arrearages on preferred and preference stock totaled $125.4 million.

Financial Condition

Throughout 1988, Gulf States was able to meet its financial obligations, with the disappointing exception of dividend payments, primarily as a result of court-ordered rate relief in Louisiana in February and additional interim rate relief in Texas in March, made permanent in July. Slightly increased kilowatt-hour sales in the residential, commercial and industrial sectors and continued cost-cutting measures on the part of employees were factors that allowed the company to end the year with a positive cash balance.

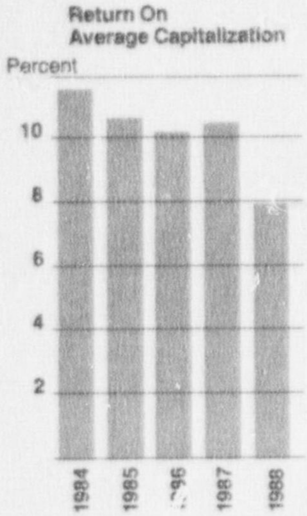
The company believes it will have cash needs of about $100 million more than current rates will generate during 1989. During the year, GSU has over $200 million in debt and other maturities and sinking fund obligations due. This means realistic regulatory treatment, increased sales and continued efforts by employees to keep costs down to enhance the cash flow are just as critical now as they have been for the past several years.

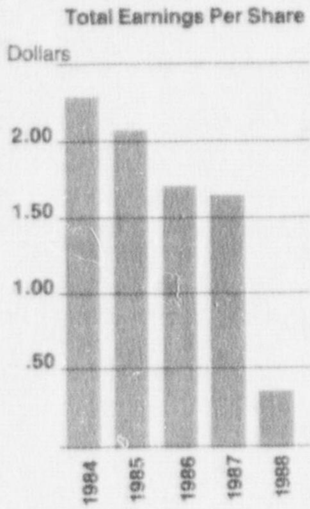
Gulf States will remain under great financial stress in 1989 because of the need to retire maturing obligations. On the positive side, once these obligations have been satisfied GSU will benefit from reduced interest obligations down the road.

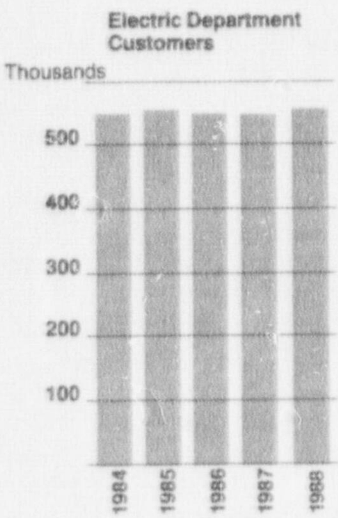
In February 1989, Gulf States concluded an agreement with a group of insurance companies and other private investors to refinance the company's nuclear fuel. The nuclear fuel that will be used at River Bend will be owned by a special-purpose corporation established by a trustee. GSU will then lease the fuel from that corporation.

The refinancing is enabling Gulf States to pay off the previous nuclear fuel lease of $58.3 million due in 1989 and to reimburse the company for $98.9 million of nuclear fuel costs which have been paid by the company. This money will be used to meet a portion of our cash requirements.

The $65 million secured line of credit Gulf States established in order to implement interim rates in Texas in early 1987 expires March 1, 1989, and the company must either renew it or obtain a similar credit line elsewhere. Negotiations with banking institutions are now underway.







River Bend

Gulf States' nuclear power plant continues its world class performance, with River Bend providing 21 percent of the electricity generated by the company in 1988. During the month of December, even though River Bend was in a coast-down mode to conserve fuel in preparation for the refueling outage scheduled to begin March 15, the plant accounted for 36 percent of the company's electric generation.

GSU owns 70 percent of the 936 megawatt plant and Cajun Electric Power Cooperative owns 30 percent.

The plant's statistics for 1988 are excellent. River Bend's capacity factor for the year was 88.2 percent, fourth among domestic boiling water reactors (BWR) of all classes. (The capacity factor is the actual generation as a percentage of maximum capability.) The most recently published average capacity factor for all domestic BWRs was 52.7 percent.

The unit was available for service 90.1 percent of the time, also an outstanding statistic when compared with a predicted industry equivalent availability factor of 63.6 percent for all domestic nuclear plants.

During the year, River Bend generated 7.2 billion kilowatt-hours (kwh) of electricity. Since the plant first put power into the grid in December 1985, it has generated 15.2 billion kwh.

River Bend set another world record for continuous operations for reactors of its class, with a continuous run of 184 days during its second fuel cycle. It was also the world pacesetter during the first fuel cycle.

The unit is scheduled to be off line for 60 days, beginning March 15, 1989, for its second refueling and maintenance. River Bend will be available for service by summer, GSU's peak season. During the refueling, more fuel bundles and higher enriched uranium will be added to the reactor core in order to enhance River Bend's capacity factor for the next 18-month cycle.

River Bend received the highest possible ratings in three key categories in the latest "report card" issued in December by the Nuclear Regulatory Commission (NRC). This is the second comprehensive assessment of River Bend, prepared by the NRC's Systematic Assessment of Licensee Performance (SALP) team, since the plant went into commercial operation in June 1986.

At a public meeting in mid-January 1989 between the NRC and River Bend's management, an NRC official said GSU will be used as "an example of good performance to other utilities" for the manner in which it operates River Bend.

In its report, the SALP team gave GSU Category 1 ratings, the highest, for emergency preparedness, engineering/technical support and safety assessment/quality verification. A Category 1 rating means GSU management "attention and involvement are readily evident and place emphasis on superior performance of nuclear safety" and that "a high level of performance . . . is being achieved."

The NRC praised improvement in the area of emergency preparedness and called the plant's emergency preparedness program "excellent and meets the requirements to protect the health and safety of the public." The federal agency also said Gulf States "has demonstrated an aggressive oversight of the engineering programs and described the training as 'effective'." In the safety assessment/quality verification area, the NRC board found that "corrective actions have been thorough and management involvement evident . . ."

In three of the remaining four areas — plant operations, radiological controls and maintenance/surveillance — the SALP team gave Category 2 ratings, meaning that "management attention to and involvement in the performance of nuclear safety or safeguards is good."

The only Category 3 rating, GSU's first since River Bend went into operation, was for security, but GSU had voluntarily undertaken a self assessment of security weaknesses before the report was issued. This rating means management attention to and involvement in this one area were insufficient.

River Bend became a full member of the National Academy for Nuclear Training in September when the final three of 10 training programs were accredited by the Institute of Nuclear Power Operations (INPO). The plant had been a branch of the academy since August 1986 when the first programs were certified. The program was created by INPO to recognize accomplishments in the nuclear industry and to ensure the safe operations of U.S. nuclear plants.

Rates and Regulations

Activity on Gulf States' rate cases in Texas and Louisiana moved from commission hearing rooms to state courtrooms during 1988, as the final rate decisions were appealed in both states.

In December 1987, Louisiana issued an order that allowed only slightly increased revenues over interim rates, disallowed a major portion of River Bend construction costs and did not include a qualified plan to phase-in even those costs of the plant the commission did allow.

The Texas commission did not issue its final order in the rate case until May 1988 — about 15 months after hearings on the permanent rate case began. Texas regulators also granted inadequate rate relief and held in abeyance a large portion of the nuclear plant's costs until GSU proves they were prudently incurred. This finding means Gulf States will be filing another River Bend rate case in Texas as it pursues the appeal of the May rate order.

The Louisiana Rate Case: The Louisiana Public Service Commission (LPSC) on Feb. 28, 1989, granted the company a $38 million rate increase. It appears the plan is consistent with the intent of a court-ordered phase-in plan with certain adjustments. The court-ordered plan calls for additional increases in future years subject to the LPSC review.

Hurricane Gilbert Finds GSU Ready

In mid-September 1988 as Hurricane Gilbert — the most powerful and potentially the most destructive storm of this century — prowled the Gulf of Mexico looking for landfall — somewhere between Mexico and Florida, Gulf States lost about 30 percent of its natural gas supply as production rigs in the gulf were evacuated. On-shore production facilities were also imperiled.

But the River Bend nuclear power plant continued GSU's tradition of "Dependable Public Service" to our customers.

Before natural gas from the gulf was curtailed, River Bend was operating at about 75 percent power, conserving fuel until the March 1989 reload. Once the gas supply dwindled, the nuclear unit was quickly brought up to 100 percent power, ensuring customers would have an adequate supply of electricity.

Hurricane Gilbert, which at times was predicted to slam into some part of the GSU service area with winds of 175 miles per hour, eventually swept into the upper Mexican coast, leaving our region safe, but ready.

The situation with Hurricane Gilbert was in sharp contrast to the last powerful storm that threatened — but missed — the Gulf States service area. Hurricane Allen in 1980, after considerable weakening, pummeled the Texas coastal bend area, a good distance west of GSU's territory, shutting off the company's gas supplies from fields in that area. That time, the company was forced to ask customers to curtail electricity use.

In 1988, some of the same fields had to shut down as Hurricane Gilbert neared but, this time, Gulf States was no longer completely gas-dependent.

This time, River Bend, as well as two coal-fired units, made the difference, providing dependable public service.

As background, on Dec. 15, 1987, the LPSC ordered only $63 million in permanent rate relief, which included a $57 million emergency increase approved in February 1987, with no qualified phase-in plan; disallowed as imprudent $1.4 billion of the company's total investment in River Bend; and set a 12 percent return on common equity. (The phase-in case to begin including River Bend costs in Louisiana's rate base was filed on July 25, 1986, and asked for a first-year increase of $194.3 million.)

The company appealed this decision on Dec. 30, 1987, and asked for immediate relief on rates and other issues. It also asked the court to overturn the disallowance on a less immediate basis because of its complexity.

On Feb. 18, 1988, State District Court Judge William H. Brown granted GSU a first-year $92 million rate increase; adopted a qualified 10-year phase-in plan that called for $50 million annual increases in years two, three and four and $38 million the final year; and set the return on common equity at 14 percent. The revenues not recovered during the earlier years would be deferred for recovery during the later years of the plan when rates, as they apply to River Bend, would remain stable.

Still on appeal awaiting a decision from another district judge are the $1.4 billion disallowance of River Bend costs on a systemwide basis (about $677 million on a Louisiana jurisdictional basis) and other issues. Retired District Judge Paul Landry heard 23 days of testimony during June and July 1988 and on Oct. 20 remanded the case to the LPSC for further consideration. The company had proposed that the generating capacity representing the $1.4 billion in River Bend costs be inventoried, rather than disallowed. This approach would give GSU shareholders an opportunity to earn a return on their investment, as opposed to a permanent disallowance which would eliminate such a possibility.

As proposed in the inventory plan, the electric output from the inventoried portion of River Bend would be sold to GSU customers at a rate of 4.6 cents per kilowatt-hour or to others at negotiated prices.

On Nov. 15, 1988, the commission reaffirmed its December 1987 decision to disallow the $1.4 billion, but offered a settlement proposal that covered many aspects of GSU's inventory plan. However, because of several financial, regulatory and accounting uncertainties associated with the settlement offer, the company on Nov. 28 told the LPSC that it could not accept all the terms and would have to continue the appeal. The decision will be made by the judge, who could rule as early as April 1989.

The implementation of the phase-in plan and the accompanying rates set by the court in February were appealed by the LPSC and the Louisiana attorney general to the Louisiana Supreme Court. It is likely the court's decision on the disallowance and other issues will also be appealed.

In another matter, the Louisiana commission ordered a management audit of GSU and hired Kennedy & Associates of Atlanta, the firm that had served as consultant to the LPSC during Gulf States' rate case. In early August the company asked a Baton Rouge district court to halt the audit on the grounds it would be duplicative of one completed in early 1986 at the order of the Texas commission. The earlier audit cost about $650,000 and the Kennedy estimate for the Louisiana audit is about $590,000. In the lawsuit, GSU asked that any costs associated with the audit either not be assessed against the company or that the company be allowed to recover them through customer rates.

The Baton Rouge district court on Jan. 23, 1989, ordered Gulf States and representatives of the commission to agree on the scope of the audit to prevent duplicating the Texas audit. Judge Robert Downing also ordered commission consultants to determine a means by which GSU would recover the cost of the audit.

The LPSC heard one day of testimony on Sept. 30, 1988, on GSU's application for a $3.3 million natural gas rate increase. The company does not expect a decision until March or April 1989.

Former State Rep. Kathleen Blanco of Lafayette was elected to the LPSC in November and took office in January 1989. She replaced Mrs. George Ackel who was appointed to the post on an interim basis after her husband, an LPSC commissioner, died in April 1988.

The Texas Rate Case: The Public Utility Commission of Texas (PUCT) issued its final order in the state's longest running rate case on May 16, 1988 granting GSU a one-time permanent rate increase of about $60 million with a return on common equity of 13 percent. The increase is based on including about $1.6 billion of the company's systemwide River Bend costs in rate base and about $182 million of related Texas deferred River Bend costs. The PUCT also ordered the company to refund overrecovered fuel costs of about $30 million during a 12-month period which began in late July 1988.

As background, Gulf States filed the first-year $144.1 million Texas rate case in November 1986 and asked for an immediate $82 million emergency rate increase because of its financial condition. On Feb. 3, 1987, the PUCT granted $39.9 million in interim relief, contingent upon the company demonstrating it had lines of credit or other means of obtaining $250 million from sources other than Texas ratepayers. In late March 1987 the commission accepted the company's financial package and interim rates were implemented in April 1987.

The three hearing examiners who listened to testimony in the permanent rate case from March 23, 1987, through Sept. 15, 1987, recommended in December 1987 a 10-year phase-in plan with a first year increase of $86.8 million to be followed by three smaller rate increases. Recovery of deferred costs would be over the remaining six years of the plan. The examiners found that the decision to build River Bend was prudent but that $253 million of the construction costs should be disallowed as imprudently or inefficiently incurred.

The commissioners, however, raised additional questions in early 1988, primarily concerning various tax treatments, and conducted more hearings until May. In connection with the delay in rendering a final decision, the commission granted an additional $22.5 million in interim relief effective April 1988. The commissioners voted on May 9 and issued the written order May 16, 1988.

The commission did reaffirm its preliminary ruling made in February 1988 to disallow as imprudent about $63 million of River Bend costs systemwide (about $25 million on a Texas jurisdictional basis) and to hold in abeyance, with no finding as to prudency, about $1.4 billion systemwide (about $550 million on a Texas jurisdictional basis) and $157 million in deferred costs associated with the portion held in abeyance.

The PUCT, very importantly, did find that Gulf States' decision to build River Bend was prudent.

The company, on May 31, 1988, filed a motion for rehearing, asking the commission to reconsider its decision to set aside a portion of the plant's costs and other issues. However, the PUCT failed to take action on the motion and it was effectively denied on June 29. The company appealed the final order to state district court in Austin. A briefing schedule has been established and oral arguments are currently set for this spring.

Gulf States plans to file a rate case justifying the prudency of the costs now held in abeyance during the first quarter of this year.

Almost three months after the conclusion of GSU's rate case a new member was appointed to the PUCT. Houston attorney William Cassin took office in August, replacing former PUCT Chairman Dennis Thomas who resigned.

Federal Regulation: Gulf States and its 11 wholesale customers have settled the rate case that reflects River Bend construction costs in rates. The case was filed in 1986 with the Federal Energy Regulatory Commission (FERC) which has jurisdiction over wholesale rates. During 1987 three rural cooperatives and all seven municipalities in Texas and Louisiana reached agreements. Gulf States and the remaining co-op negotiated a settlement in January 1989, subject to the approval of the FERC.

Although the settlement rates produce less revenue than those the FERC would have allowed the company to implement under bond in August 1986, they do encourage the cities and cooperatives to remain GSU wholesale customers. As part of the settlement, the wholesale customers are entitled to purchase a large portion of their load at rates lower than the standard rate. Also, incentive rates offered in the settlement give wholesale customers another tool to use in attracting new businesses and industries.

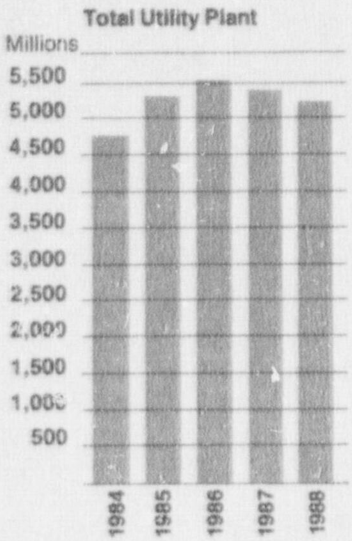
The Southern Co. Suit: Gulf States entered into contracts with the Southern Co. in 1982 and 1983 to purchase capacity and energy from coal-fired units owned by the Southern Co. GSU attempted unsuccessfully to renegotiate the terms of the contracts because of changed conditions and, on the advice of legal counsel, believes the contracts have been terminated.

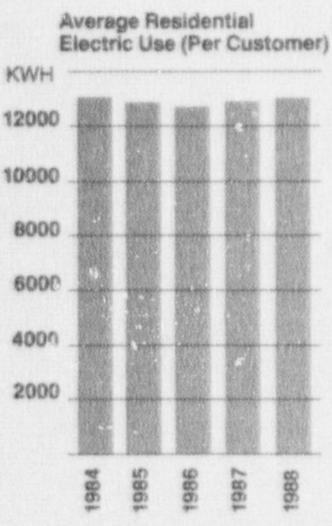
In a written order issued April 1, 1988, the FERC affirmed an administrative law judge's May 1987 determination that GSU's purchased power contracts with the Southern Co. were reasonable and valid. While the FERC found in favor of the Southern Co. in this case, it also said that certain state law contract issues remain open for the courts to resolve.

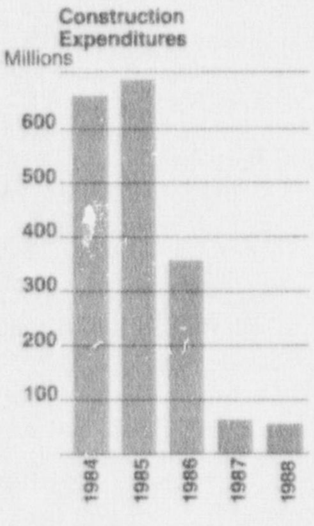
Both the Southern Co. and Gulf States had filed complaints with the FERC in July 1986, with the Atlanta-based holding company seeking a declaratory judgment upholding the agreements and GSU asking the contracts be voided on several grounds. Gulf States also filed a lawsuit in federal district court in Beaumont alleging, among other things, breach of contract.

After the FERC denied the company's motion for a rehearing, Gulf States on July 29, 1988, appealed to the U.S. District Court of Appeals, District of Columbia Circuit, where it is still pending.

Discovery is proceeding in the breach of contract lawsuit GSU filed against the Southern Co. in the U.S. District Court in Beaumont, but no trial date







has been set. The suit, also filed in July 1986, contends, among other things, that the Southern Co. voided the contracts by refusing to negotiate in good faith when Gulf States requested modifications because of changed conditions.

Both the Texas and Louisiana commissions in 1986 barred GSU from passing on to customers the costs of power purchased from the Southern Co.

On June 27, 1988, the Southern Co. requested FERC approval to suspend the contracts and on Aug. 26, 1988, the FERC granted the suspension.

On Dec. 5, 1988, the Southern Co. filed a counterclaim against GSU and an amended motion to dismiss Gulf States' lawsuit. The counterclaim seeks to enforce the purchased power contracts and to recover an unspecified amount of damages.

Other Litigation: In another legal matter, the Sam Rayburn G&T Electric Cooperative (SRG&T), a GSU wholesale customer, filed a four-count antitrust lawsuit against Gulf States in the U.S. District Court in Austin on June 17, 1988. SRG&T alleged the company refused to transmit power from companies other than Gulf States to the co-op's service area, although GSU had been negotiating the issue and had submitted a proposal on June 1, 1988. In September, Gulf States asked the FERC to decide certain issues involved in the dispute and petitioned the federal district court to dismiss the lawsuit or take no action until FERC acts.

General Operations

Although rate cases that began in Texas and Louisiana in 1986 continued as a major focus of company attention during 1988, there were other issues and matters that commanded attention. Gulf States has never lost sight of the fact it is in the business of generating and selling electricity.

Community Affairs: In August 1988 the Community Affairs Department was created to handle the special problems of certain utility customers. The department offers programs for customers who need assistance in various areas, including inability to pay bills, credit and collection policies and the efficient use of electricity; provides energy education to the public and to schools and educators; oversees administration of government-mandated energy audits; and coordinates community volunteer efforts of GSU employees, retirees and their families.

Vari Tech: The creation of a division of Varibus, GSU's non-utility subsidiary that operates pipelines and owns rights to lignite reserves, has the potential of being a plus for shareholders. Vari Tech, which was created in August 1988, is in the business of marketing computer-aided engineering and drafting technologies primarily to engineering, drafting and industrial concerns, as well as other utilities. Vari Tech, which has already negotiated several contracts, sells computer work stations, writes software programs and converts existing paper drawings into electronic data bases. The copyrighted package is considered a cost-effective approach to computer-aided drafting and engineering.

Power Plants: The equivalent availability of Gulf States' power plants — the percentage of time the power plants were available to generate power at 100 percent — has remained at or above the 80 percent level since 1984. During 1988, the equivalent availability of GSU's power plants was 84.3 percent, up from the 79.8 percent recorded during the previous year when River Bend was out of service for a period of time for maintenance and refueling.

Fuel: Despite the fact that natural gas and coal prices were higher in 1988, overall fuel costs were reduced slightly during the year because the nuclear plant provided almost 48 percent more generation than in the previous year.

During 1988, Gulf States entered into an eight-year gas supply agreement with Sabine Gas Transmission and a six-year agreement with Houston Pipe Line to provide part of the natural gas requirements at the Sabine power plant in Texas.

Early in 1989, Eastex Energy Inc. signed a long-term gas sales agreement with Gulf States and with Rotherwood Eastex Gas Storage Services. The agreement calls for Rotherwood Eastex to supply GSU with an average 50 million cubic feet of natural gas a day over the five-year primary term of the contract. The agreement also allows the company to store up to 750 million cubic feet of gas in the Rotherwood Gas Storage facility.

These contracts are part of a strategy to replace other long-term contracts that are expiring and to increase GSU's commitment to long-term contracts because of the changing gas market.

Reorganization: Under review by the GSU board of directors and management is the possible reorganization of the company. They have been weighing the advantages and disadvantages of restructuring GSU since the Louisiana commission entered a disappointing rate order in late 1987.

Legal counsel with expertise in reorganization was hired by directors in early 1988 and GSU is continuing to review primarily the possibility of establishing a parent holding company, with operating units in the two states.

In addition, the company, through its attorneys, is monitoring the restructuring efforts recently proposed by the Public Service Co. of New Hampshire, which filed for bankruptcy last year, and is studying other related legal developments during 1988. Company officials and board members have also visited with executives of other beleaguered utilities.

Joint Venture: Gulf States and three of its major industrial customers near Lake Charles, La., have entered into a joint venture, forming a company that will convert two of GSU's gas-fired units at the Nelson Station to burn low-cost petroleum coke. Gulf States' contribution to the Nelson Industrial Steam Co., NISCO, was the two units. The industrial partners, CITGO Petroleum Corp, Conoco Inc. and Vista Chemical Co., will pay the cost for replacing the gas-fired boilers with circulating fluidized-bed combustion boilers that will use locally produced petroleum coke. GSU personnel will continue operating the power plants, selling electricity and steam to the industries. By entering into the venture, GSU is retaining about 175 megawatts of load the three industrial partners represent.

Project CARE: Project CARE (Community Assistance Relating to Energy) is the company's program to assist those 60 and older with meeting their energy bills during emergencies. During 1988, money contributed by GSU customers and employees helped almost 4,900 elderly households in Texas and Louisiana pay their electric, natural gas, propane and butane bills, as well for minor repairs to heating and cooling equipment and for weatherization. Contributions from all sources during the year totaled more than $309,000.

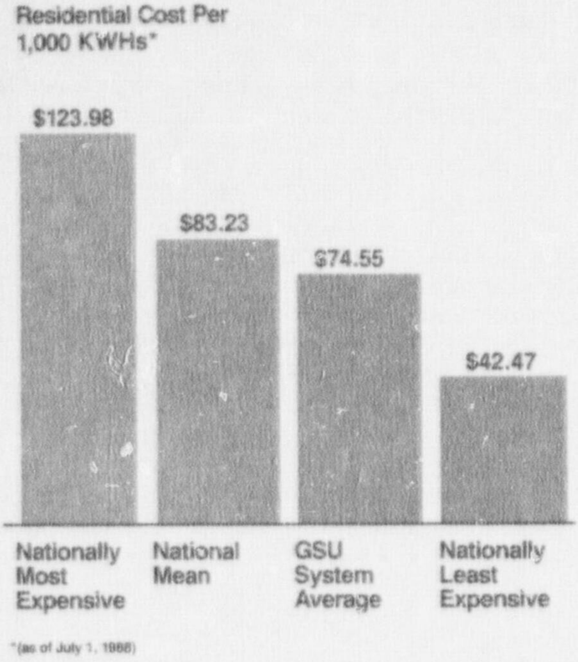
Employees: In June the company and the International Brotherhood of Electrical Workers, Local 2286, signed a new two-year labor contract that called for a 3 percent wage increase during the first year and a 20-cents-an-hour raise the second year. Employees covered by the labor agreement, as well as management employees, had not had a wage or salary increase in more than two years.

Employment practices for the 4,800 Gulf States employees are guided by the principles of equal opportunity for all. Affirmative action programs have helped the company obtain skilled personnel from all community sectors, and fair employment policies are one way GSU develops its human resources to serve customers more effectively.

Redfish Project: A pilot program by the Texas Agricultural Extension Service, with the assistance of Gulf States and others, could lead to commercial redfish farming in Southeast Texas. Once redfish dietary requirements, stocking rates and production rates are determined, the fisheries expert heading the program estimates this industry could eventually add as much as $300 million a year to the economy of the region. Gulf States' participation in the experimental program involves making available warm water tanks at the Sabine power plant near Bridge City, Texas, where the small fingerlings spend the winter before being transferred to "grow out" ponds.

Marketing Efforts

Additional increases in the level of customer rates are absolutely necessary to return Gulf States to financial health. At the same time, the company is very sensitive to the economic



conditions within the service area and for this reason, GSU has committed itself to playing a major role in the economic growth of the region in order to meet a portion of its revenue requirements with increased sales, rather than with higher customer rates alone.

Gulf States is providing leadership throughout the service area in mobilizing economic development and diversification efforts by the cities, towns and communities it serves. Through a program the company is calling "Team Cities," GSU is helping teach local communities how to market their areas to new businesses and industries. It also helps these communities develop an awareness of what they can do to help their existing firms expand.

The name of the game for the GSU communities is more jobs and an expanded tax base. For GSU, it's increasing sales through more large and small businesses using more kilowatt-hours.

Today, the competition for new businesses and new jobs is tougher than ever, with every region attempting to attract its share. When a company wants to know what a community in Southeast Texas or South Central Louisiana can offer, GSU's Team City program has prepared community leaders with the answers.

The poor economy in the Gulf States service area has been a significant contributor to the financial problems the company has been experiencing for the past several years. Most economists now see the Gulf Coast area emerging slowly from the recession that has taken jobs and people away from the region.

The brightest example is the petrochemical industry which is faced with the happy dilemma of not having enough capacity to meet demand. This has caused a trickle-down upswing in business for industry suppliers and, temporarily, for the construction industry as the chemical complexes add capacity. The regional chambers of commerce in Beaumont, Texas, and Lake Charles and Baton Rouge, La., report announced expansions by the refining and petrochemical industry in excess of $1.2 billion.

Foreign investors are increasingly interested in the U.S. petrochemical business, most of which is located along the Gulf Coast where the infrastructure — pipelines, feed stock sources, etc. — is already in place. Gulf States expects a good portion of the foreign investments in this energy-intensive industry will be made in its service area.

Gulf States' economic development efforts are concentrating on a diversified industrial base — everything from research facilities, to small manufacturers, to airplane maintenance companies. The strategy is to "sell" the entire area between Houston and New Orleans which comprises the GSU service territory.

To date, the Houston Area Research Center, a large facility involved in science and engineering research, has located in the Woodlands, north of Houston in GSU's service territory; the Pennington Research Center, which does biomedical research, is operating in Baton Rouge; the Ball Manufacturing Co. is making aluminum cans in Conroe; and, sometime in 1989, the Ramcor Airline Maintenance Corp. will begin providing maintenance service for commercial aircraft near Beaumont. The Boeing operation in the Lake Charles area continues to expand. Seafood processing businesses are becoming bigger businesses along the coastal section of the GSU service area. Every new job created, every additional kilowatt-hour sold benefits the company, its shareholders and its customers.

GSU's aggressive industrial marketing program which features rates that make it economical for the largest customers to remain on the Gulf States system has, for the time being, apparently staved off the switch to cogeneration or self generation. Only one customer installed cogeneration equipment during 1988, displacing about 35 megawatts of GSU electricity.

During 1988, a refinery that has always generated all its own power was connected to the GSU grid. The refinery in Beaumont has a large modernization project under construction and will require more electricity than it can self-generate. GSU is gaining about 7.5 megawatts of load, with the potential for additional load later.

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

Financial Information

FINANCIAL SECTION

Contents

Management Responsibility for Consolidated Financial Statements

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

The Company maintains an adequate system of internal controls to provide reasonable assurance that transactions are executed in accordance with management's authorization, that financial statements are prepared in accordance with generally accepted accounting principles and that the assets of the Company are properly safeguarded. The system of internal controls is documented, evaluated, and tested by the Company's internal auditors on a continuing basis. No internal control system can provide absolute assurance that errors and irregularities will not occur due to the inherent limitations of the effectiveness of internal controls; however, management strives to maintain a balance, recognizing that the cost of such a system should not exceed the benefits derived.

Coopers & Lybrand, independent certified public accountants, are engaged to audit, in accordance with generally accepted auditing standards, the financial statements of the Company and issue their report thereon, which appears on page 44. Their opinion, including explanatory paragraphs, is based on procedures believed by them to provide reasonable assurance about whether the consolidated financial statements are free of material misstatement.

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

Common Stock Prices and Cash Dividends Per Share

For the years ended December 31

1988	High	Low	Cash Dividends Paid Per Share	1987	High	Low	Cash Dividends Paid Per Share
First Quarter	$ 6⅞	$5	$—	First Quarter	$10	$7¼	$—
Second Quarter	6¾	4¾	—	Second Quarter	8⅝	7⅛	—
Third Quarter	7¾	5⅞	—	Third Quarter	8⅛	7	—
Fourth Quarter	9⅜	7	—	Fourth Quarter	7¾	4¾	—

The Common Stock of the Company is listed on the New York, Midwest and Pacific Stock Exchanges. The approximate number of common shareholders on December 31, 1988, was 69,235.

Financial Information

*Selected Consolidated Financial Data**
(in thousands except per share amounts and ratios)

For the Years Ended December 31	1988	1987	1986	1985	1984
Operating Revenue	**$1,520,477**	$1,432,586	$1,478,388	$1,858,436	$1,547,041
Income from Continuing Operations Before the Cumulative Effect of Accounting Change	**117,512**	240,804	271,872	276,484	259,393
Income Applicable to Common Stock	**40,079**	178,091	181,854	205,362	202,511
Earnings Per Average Share of Common Stock Outstanding from Continuing Operations Before the Cumulative Effect of Accounting Change	**.50**	1.65	1.97	2.21	2.31
Dividends Per Share of Common Stock	**—**	—	.67	1.64	1.64
Return on Average Common Equity	**1.95%**	9.29%	10.49%	13.05%	14.42%
Ratio of Earnings to Fixed Charges	**1.50**	1.84	1.92	2.18	2.38
As of December 31					
Total Assets	**$6,858,086**	$6,821,866	$6,492,582	$5,937,126	$5,234,551
Long-Term Debt and Preferred Stock Subject to Mandatory Redemption	**2,990,934**	3,090,977	3,134,950	2,794,112	2,361,648
Capital Lease Obligations (Current and Non-current)	**98,852**	187,640	228,270	223,734	197,593
Book Value Per Share	**19.32**	18.70	16.79	16.02	15.79
Capitalization Ratios:					
Common Shareholders' Equity	**39.3%**	37.8%	35.0%	35.4%	36.5%
Preferred and Preference Stock	**11.7**	11.1	10.8	11.3	11.7
Long-Term Debt	**49.0**	51.1	54.2	53.3	51.8
	100.0%	100.0%	100.0%	100.0%	100.0%

See Notes 1 and 3 to the Consolidated Financial Statements regarding contingencies, current rate matters involving possible disallowances and write-offs and accounting standards.

* Restated for accounting change — see Note 2 to the Consolidated Financial Statements.

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

In reviewing this Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements of the Company, special attention should be given to the disclosure that the Company may have to seek relief from its creditors under the Bankruptcy Code. This report was based upon information available at the time it was released for printing. Litigation and retail rate proceedings continued in an active status at such time. Significant developments may occur during the printing and distribution period as well as thereafter. Readers are urged to investigate and consider such subsequent developments.

Summary of Rate Matters

As of December 31, 1988, the Company's rate situation remained in an uncertain state. The Company has received varying rate treatments concerning River Bend Unit 1 (River Bend) in the different regulatory jurisdictions in which the Company operates. Detailed below is a summary of significant River Bend rate related events. See Note 3 and Note 15 to the Consolidated Financial Statements for a detailed description of rate matters.

Texas Retail Jurisdiction (Regulator — Public Utility Commission of Texas [PUCT])

— Effective June 16, 1986, the commercial in-service date of River Bend, the Company received an accounting order from the PUCT which allowed the Company to defer, for financial reporting purposes, those expenses incurred in connection with the operations of River Bend and the cost of buying back power from Cajun Electric Power Cooperative, Inc. (CEPCO) and to record a non-cash carrying charge on the Company's investment in River Bend not already reflected in rate base.

— In April, 1987, the Company received a $39,900,000 annualized interim rate increase from the PUCT.

— In April, 1988, the Company received a $22,500,000 annualized interim rate increase from the PUCT.

(The Company was required to reduce the deferred River Bend costs by $1.50 for each $1.00 of revenue received while the interim rate increases were in effect.)

- On May 16, 1988, the PUCT adjusted the two previous interim rate increases to a total level of $59,900,000, ordering a one-time permanent rate increase of that amount, set aside $1.4 billion (approximately $550,000,000 on a Texas retail jurisdiction basis) with no finding as to prudency, and disallowed as imprudent $63,468,000 (approximately $25,175,000 on a Texas retail jurisdiction basis).
- On July 23, 1988, the retail rates set in the May 1988 ruling became effective. The Company ceased accruing amounts under the accounting order received in 1986, and began amortizing the allowed portion of the deferred River Bend costs recorded pursuant to the accounting orders, over a 40-year period.
- On July 29, 1988, the Company filed an appeal of the May 1988 rate order in a state district court seeking to overturn key portions of the order.

Louisiana Retail Jurisdiction (Regulator — Louisiana Public Service Commission [LPSC])

- Effective June 16, 1986, the Company received an accounting order from the LPSC (similar to the one described above from the PUCT).
- In March 1987, the Company received $57,000,000 of emergency rate relief.

  (The Company was required to reduce the deferred River Bend costs by $1.00 for each $1.00 of revenue received while the emergency rate increase was in effect.)
- On December 15, 1987, the LPSC issued a permanent rate order granting a $63,000,000 rate increase (including the $57,000,000 of previously granted emergency rate relief), while also disallowing $1.4 billion of the Company's total River Bend plant investment (approximately $677,000,000 on a Louisiana retail jurisdictional basis) as having been imprudently incurred.
- On December 30, 1987, the Company appealed the LPSC's action in a state district court.
- On February 18, 1988, the Louisiana state district court judge issued a preliminary injunction ordering the immediate implementation of a $92,000,000 rate increase (which included the $63,000,000 granted by the LPSC on December 15, 1987) and adopted a phase-in plan which meets the guidelines set forth in Statement of Financial Accounting Standards (SFAS) No. 92 for a qualified phase in of the prudent costs of the Company's River Bend investment as determined by the LPSC. As a result, the Company recorded in 1988, for financial reporting purposes, the deferred revenue requirement associated with such plan.

Wholesale Jurisdiction (Regulator — Federal Energy Regulatory Commission [FERC])

- On August 22, 1986, the FERC issued an order permitting the proposed first year rates to become effective on August 25, 1986, and the proposed second and third year rates to become effective on July 1, 1987 and July 1, 1988, respectively, under the Company's proposed phase-in plan.

  (At the time of the order, the Company had already commenced negotiations with its wholesale customers regarding alternative rates.)
- The Company filed a motion with the FERC for authorization to collect the settlement rates effective as of August 25, 1986, and was permitted to implement such rates effective as of that date. Under the settlement, the phase-in plan period is ten years, and the rate increases from 1986 through 1989 to the applicable customers for purchases on the standard wholesale rate will be 24 percent, 14 percent, 10 percent, and 7.4 percent, respectively.

Financings and Capital Resources

During 1988, the Company's cash position was under severe pressure due primarily to inadequate rate relief and the maturity of substantial debt obligations. While management presently believes that rate relief granted to date and the nuclear fuel refinancing, as discussed below, will improve its cash position in 1989, significant litigation, regulatory, and operational contingencies exist which, if adverse results occur, could necessitate financing from external sources.

During 1988, the Company had available $65,000,000 under a short-term credit facility described in Note 12 to the Consolidated Financial Statements. Such facility expires on March 1, 1989. The Company is currently negotiating the extension or replacement of this facility, but there can be no assurance of its ability to do so. The existing and proposed new credit facility contain restrictions upon additional borrowings, payment of dividends and other actions of the Company (See Note 12 to the Consolidated Financial Statements). On February 7, 1989, the Company entered into a new nuclear fuel financing arrangement which provided the Company with $98,893,000 of cash, in addition to $58,254,000 which was used to repay its previous nuclear fuel financing. The proceeds of this new financing are anticipated to satisfy the Company's external cash requirements for 1989, but there can be no assurance that operating results, regulatory actions, court decisions, or other developments will not necessitate additional external financing.

The Company's ability to arrange external financing has been and continues to be materially affected by its weak financial position. The credit ratings assigned by credit rating agencies to the Company's long-term debt and preferred and preference stock have been reduced to "speculative" grade. The failure to pay dividends on preferred and preference stock during 1987 and 1988, and the omission of the common stock dividend since the second quarter of 1986, make it highly unlikely that additional equity securities could currently be marketed. The Company's Mortgage Indenture contains an interest coverage covenant which limits the amount of first mortgage bonds which the Company may issue. Based upon the results of operations for the twelve months ended December 31, 1988, and existing circumstances, the Company believes it has sufficient coverage to issue additional first mortgage bonds, subject to the receipt of necessary legal opinions and any requisite consent of other lenders to the Company. However, the Company is unsure whether such bonds could be marketed regardless of whether or not coverage requirements are met. External intermediate or long-term financing may only be available through the issuance of unsecured or subordinated lien debt securities if, and to the extent, they can be marketed.

Due to the uncertainties about the Company's ability to obtain funds if and when needed, there can be no assurance that the Company would have available funds to meet its needs, in which event the Company may have to seek relief from its creditors under the Bankruptcy Code.

Results Of Operations

The Company's 1988, 1987, and 1986 net income has been affected by amounts recorded in accordance with phase-in plans and amounts recorded in accordance with accounting orders issued in 1986 by regulators pending completion of the Company's retail rate cases currently on appeal. These items (net of the related tax effects) have increased the Company's 1988, 1987, and 1986 net income and earnings per share as follows:

	1988		1987		1986	
	Effect on Net Income	Effect on EPS	Effect on Net Income	Effect on EPS	Effect on Net Income	Effect on EPS
	(in thousands except per share amounts)					
Deferred River Bend expenses	$ 31,503	$ .29	$168,573	$1.56	$ 93,821	$ .88
Deferred revenue requirement	130,516	1.21	15,862	.15	7,264	.07
Amortization of accumulated deferred River Bend costs	(27,754)	(.26)	(1,431)	(.01)	—	—
River Bend carrying charges	24,723	.23	263,988	2.44	132,768	1.25
Reduction of deferred River Bend costs	(30,576)	(.28)	(56,938)	(.53)	—	—
	$128,412	$1.19	$390,054	$3.61	$233,853	$2.20

Without the inclusion of the above items in the Company's Consolidated Statement of Income, the Company would have reported net losses in 1988 and 1987 of $25,269,000 and $148,953,000, respectively, and net income of $11,128,000 for 1986. The deferred items described above include substantial cash expenditures which were only partially recovered in 1988 and 1987, and there can be no assurance that all of such expenditures will ultimately be recovered. The Company is currently not recovering in rates the depreciation and return associated with the portion of River Bend disallowed in the Louisiana rate order and the portion of River Bend excluded in the Texas rate order and, as discussed in Note 3 to the Consolidated Financial Statements, and during

1988 has recorded a write-down of the wholesale and Texas retail portions of the unamortized River Bend Unit 2 cancellation cost and ceased accruing the equity component of River Bend carrying charges. The discussion below provides information on significant items which also affected the Company's results of operations during the period from 1986 through 1988.

Operating Revenue

Operating revenue increased by 6 percent during 1988, when compared to 1987. This increase followed declines of 3 percent and 20 percent for 1987 and 1986, respectively. The components of the changes in operating revenue are detailed below:

	Increase (Decrease) From Prior Year		
	1988	1987	1986
		(in thousands)	
Change in base rates	$ 87,150	$ 68,433	$ (49,120)
Fuel cost recovery	(25,710)	(99,592)	(307,255)
Sales volume and other	26,451	(14,643)	(23,673)
	$ 87,891	$ (45,802)	$ (380,048)

Rates. The changes in base rates shown above reflect rate orders, settlement agreements, and rate changes implemented during the period from 1986 through 1988.

As discussed above, the Company implemented interim/emergency and permanent rate increases in 1987 and 1988.

During 1986, the Company placed into effect an $80,000,000 base rate decrease as part of a settlement agreement with its Texas retail customers. Additionally, in August, 1986, the FERC granted the Company a $26,000,000 wholesale rate increase. However, as more fully detailed in Note 3 to the Consolidated Financial Statements, the Company subsequently reached a settlement agreement with its wholesale customers, and placed into effect rates which have resulted in revenues lower than those originally authorized by the FERC.

Kilowatt-Hour Sales. The Company's 1988 kilowatt-hour sales increased 2 percent when compared with 1987. The increased sales were in the residential, commercial, and industrial classes. This increase represents the first increase in sales after three years of consecutive declines. See Statistical Summary on Page 45 for information on kilowatt-hour sales and related revenues by customer class.

The Company's 1987 kilowatt-hour sales declined by 1 percent compared with 1986. A decline in sales to industrial customers accounted for virtually the entire 1987 decline, however, partially offsetting the total decline was a 1 percent increase in sales to residential customers. The industrial sales decline reflected the depressed condition of the petroleum-based economy in the Company's service area during 1987, as well as the loss of certain industrial customers which had converted to cogeneration.

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

Operating Expenses and Taxes

Fuel and Purchased Power. Fuel expense increased 3 percent during 1988, when compared with 1987. The increase in fuel resulted from the increased utilization of Company-owned generating units, primarily River Bend, to meet its energy requirements. A slight decrease in the Company's average fuel cost, due to increased utilization of low cost nuclear fuel, offset in part the increase described above. Fuel expense decreased 10 percent during 1987, when compared with 1986. The decline in fuel resulted from lower fuel prices, offset slightly by increased generation. The 10 percent decrease in the Company's average fuel cost in 1987 highlighted the decline in the price of natural gas as well as the low cost of nuclear fuel, which was utilized more extensively in 1987 than in 1986. Fuel expense declined by 21 percent during 1986. The decline in fuel expense was the result of lower fuel prices partially offset by increased generation. During 1986, the Company's overall system fuel cost declined by 34 percent, primarily as a result of the decline in the price of natural gas, the Company's primary fuel source. Kilowatt-hour generation increased 19 percent during 1986, and reflected the increased utilization of River Bend and the decreased utilization of purchased power to meet load requirements.

Purchased power expense decreased 29 percent during 1988, due primarily to reduced capacity payments to CEPCO under the buyback agreement as discussed in Note 13 to the Consolidated Financial Statements, as well as increased utilization of Company owned generating units. Purchased power expense decreased 7 percent during 1987, primarily as a result of decreased kilowatt-hour purchases reflecting reduced load requirements, cessation of capacity payments to the Southern Company during 1986, and the increased utilization of River Bend to meet existing load requirements. This decrease was offset in part by increased capacity costs associated with the CEPCO buyback. As discussed in Note 3 to the Consolidated Financial Statements, the CEPCO buyback costs were generally deferred under accounting orders prior to receipt of permanent rate orders. Purchased power expense declined by 23 percent during 1986, primarily as a result of decreased kilowatt-hour purchases reflecting reduced load requirements, cessation of certain payments to the Southern Company during the last half of 1986, as discussed in Note 1 to the Consolidated Financial Statements, the availability of lower cost natural gas for use in Company-owned units, and the increased utilization of River Bend to meet load requirements.

Other Operations and Maintenance Expense. Other operations and maintenance expense, including those associated with River Bend, decreased 4 percent during 1988, as a result of the Company's continued effort to reduce such expenses. During 1988, in accordance with the PUCT and LPSC rate orders, the Company recorded a deferred charge and reduction to operations and maintenance expense of $7,797,000 associated with the retail portion of the early retirement plan. Other operations and maintenance expense, excluding those associated with River Bend, decreased [illegible] percent during 1987. Other operations and maintenance expense, excluding those associated with River Bend, increased approximately 1 percent, during 1986. The 1986 increase was primarily the result of an $8.9 million provision for pension benefits recorded in connection with the Company's early retirement plan offered during 1986, offset by a reduction in the amount and price of gas purchased for resale and the efforts of the Company to save cash.

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

Depreciation and Amortization. The reduction in depreciation and amortization expense from 1987 to 1988, of $10,034,000 was attributable to a reduction in the depreciation rates in the Louisiana and Texas retail jurisdictions in accordance with the commissions orders, and an adjustment to decommissioning expense which resulted from revised assumptions and 38 year nuclear decommissioning funding approved by the PUCT and LPSC.

The increase in depreciation and amortization expense from 1986 to 1987, of $25,187,000 is primarily associated with a full year of depreciation expense recorded for River Bend in 1987, compared to the 1986 commercial in-service year of the unit. River Bend is being depreciated over a 40-year life at 2.50 percent annually.

Taxes. Deferred income taxes increased almost 150 percent during 1988, despite a decrease in the statutory rate from 40 percent to 34 percent. The increase resulted primarily from lower tax losses and permanent differences related to River Bend. Deferred income taxes increased dramatically during 1987, due to the tax effect of deferring certain River Bend-related operations and maintenance expenses and capacity buyback costs for the entire year of 1987, in accordance with regulatory accounting orders, versus capitalizing the operations and maintenance expenses in 1986, prior to commercial operation and deferring them subsequent to June 16, 1986. Capacity buyback costs were not incurred prior to commercial operation. Deferred income taxes decreased by 105 percent during 1986. The declines during 1986 reflect lower taxable income. Other taxes have increased as a result of higher franchise and revenue-related taxes.

Non-Operating Items

Allowance for Funds Used During Construction (AFUDC) and River Bend Carrying Charges. AFUDC increased slightly during 1988, due to the Company's increased ownership of nuclear fuel. River Bend carrying charges decreased due primarily to the termination of the accrued carrying charges upon receipt of permanent rate orders. The total of AFUDC and accrued carrying charges on the River Bend investment increased by 10 percent during 1987, as compared to 1986. This compares to increases of 16 percent during 1986. That increase was primarily the result of AFUDC on increases in the amount of River Bend's construction work in progress (CWIP) prior to its commercial operation date and the subsequent recording of carrying charges on both the plant investment not allowed in the Company's rate base by the PUCT and LPSC and the cash portion of deferred expenses recorded pursuant to accounting orders.

Reduction of Deferred River Bend Costs. As a result of the interim rate relief granted in both Texas and Louisiana retail jurisdictions in 1988 and 1987, the Company has reduced the amount of deferred River Bend costs being recorded in accordance with accounting orders issued in 1986 by the regulatory commissions. This amount reflects a reduction of $1.50 (Texas) and $1.00 (Louisiana) for each $1.00 of revenue received as a result of the interim/emergency rate increases.

Such adjustment is required since the commissions, as a result of granting interim/emergency rate relief, have allowed some River Bend costs (on a non-specific basis) to be collected through rates rather than being deferred.

Other — Net. Other — net increased during 1988, due to increased interest income and tax benefits related to the sale of Nelson Units 1 and 2 to a joint venture. See Note 14 to the Consolidated Financial Statements for additional information regarding the venture. Other — net decreased during 1987, as compared to 1986, due to decreased interest income earned on temporary cash investments. During 1986, other — net increased due to increased interest income earned on temporary cash investments.

Interest Charges. Interest charges decreased slightly during 1988, due primarily to the retirement of maturing debt. During 1987, interest on long-term debt increased due to the annual interest requirement on first mortgage bonds issued during 1986. Interest on short-term debt and other interest expense increased due to the required payment of interest on inventoried nuclear fuel. Prior to 1987, such interest was capitalized as part of the Company's nuclear fuel lease. For additional information regarding the Company's nuclear fuel lease, see Note 6 to the Consolidated Financial Statements.

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

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

Effects of Inflation

The effects of inflation upon the Company have been less in the period 1986 through 1988, than in the preceding three year period because the rate of inflation has declined. This decline is evidenced by the minimal growth in the Consumer Price Index over the period from 1986 to 1988. However, over the longer term, inflation has had serious effects on the Company's financial position. During periods of high inflation, provisions for depreciation become inadequate as construction costs increased. The rise in construction costs, in turn, results in the need for larger amounts of capital and increased external financing. The effects of inflation have been further exacerbated by slower sales growth.

New Accounting Standards

The Financial Accounting Standards Board (FASB) has issued several SFAS's which may affect the Company's results of operations and financial position when adopted.

SFAS No. 96. See Note 4 to the Consolidated Financial Statements.

SFAS No. 101. See Note 3 to the Consolidated Financial Statements.

Financial Information

Consolidated Statement of Income

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

	1988	1987	1986
Operating Revenue			
Electric	**$1,415,713**	$1,330,106	$1,367,480
Steam	**70,728**	69,056	77,783
Gas	**34,036**	33,424	33,125
	1,520,477	1,432,586	1,478,388
Operating Expenses and Taxes			
Fuel	**417,030**	406,139	449,213
Purchased power	**228,330**	322,732	347,075
Other operations	**234,320**	240,788	232,032
Maintenance	**100,270**	108,797	83,684
Depreciation and amortization	**177,425**	187,459	162,272
Deferred River Bend expenses	**(57,670)**	(292,845)	(175,236)
Deferred revenue requirement — River Bend phase-in plans	**(197,752)**	(26,436)	(13,452)
Amortization of accumulated deferred River Bend costs	**38,575**	1,793	—
Income Taxes			
Federal	**59,517**	24,291	5,473
State	**272**	(275)	(7,496)
Other taxes	**87,304**	83,523	81,017
	1,087,621	1,055,966	1,164,582
Operating Income	**432,856**	376,620	313,806
Other Income and Deductions			
Allowance for equity funds used during construction	**3,115**	259	77,447
River Bend carrying charges	**24,723**	263,988	132,768
Reduction of deferred River Bend costs	**(46,266)**	(94,896)	—
Other — net	**8,355**	3,943	6,975
Income Before Interest Charges	**422,783**	549,914	530,996
Interest Charges			
Long-term debt	**298,009**	299,931	285,946
Short-term debt and other	**14,302**	17,358	9,741
Allowance for borrowed funds used during construction	**(7,040)**	(8,179)	(36,563)
	305,271	309,110	259,124
Income from Continuing Operations Before the Cumulative Effect of Accounting Change	**117,512**	240,804	271,872
Discontinued Nonutility Subsidiary Operations	—	297	(26,891)
Income Before the Cumulative Effect of Accounting Change	**117,512**	241,101	244,981
Cumulative Effect on Prior Years of the Write-down of River Bend 2 (net of income taxes) (Note 3)	**(14,369)**	—	—
Net Income	**103,143**	241,101	244,981
Dividends on Preferred and Preference Stock (unpaid in 1988 and 1987)	**63,064**	63,010	63,127
Income Applicable to Common Stock	**$ 40,079**	$ 178,091	$ 181,854
Average Shares of Common Stock Outstanding	**108,055**	107,995	106,132
Earnings Per Average Share of Common Stock Outstanding from Continuing Operations Before the Cumulative Effect of Accounting Change	**$ .50**	$ 1.65	$ 1.97
Earnings Per Average Share of Common Stock Outstanding	**$ .37**	$ 1.65	$ 1.71
Dividends Per Share of Common Stock	$ —	$ —	$ .67

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

Consolidated Statement of Cash Flows
For the years ended December 31
(in thousands)

	1988	1987	1986
Provided From Operations			
Net income	**$ 103,143**	$ 241,101	$ 244,981
Items not requiring cash:			
Deferred fuel and purchased power expense — net	**(5,084)**	5,305	13,370
Amortization of nuclear fuel	**44,393**	34,450	23,232
Depreciation and amortization	**179,947**	191,859	165,863
Deferred River Bend expenses, revenue requirement, and carrying charges	**(280,145)**	(583,269)	(321,456)
Amortization of accumulated deferred River Bend costs	**38,575**	1,793	—
Reduction of deferred River Bend costs	**46,266**	94,896	—
Deferred income taxes — net	**71,594**	35,418	40
Investment tax credits — net	**(4,118)**	(3,703)	(3,611)
Allowance for funds used during construction	**(10,155)**	(8,438)	(114,010)
Cumulative effect of the write-down of River Bend 2 (net of income taxes)	**14 369**	—	—
Early retirement pension benefits	**—**	—	8,938
Disputed amount	**3,624**	25,570	—
Other	**(9,257)**	10,876	9,432
Changes in:			
Receivables — net of disputed amount	**(756)**	6,076	27,302
Fuel inventories	**1,920**	3,277	8,094
Materials and supplies	**237**	130	2,755
Prepayments and other current assets	**(7,496)**	(7,890)	(15,711)
Accounts payable — trade	**4,197**	37,596	(34,123)
Customer deposits	**1,053**	444	(701)
Taxes accrued	**14,704**	(623)	(1,002)
Interest accrued	**(7,353)**	1,478	11,434
Other current liabilities	**3,656**	11,191	(8,664)
Net cash flow provided by operating activities	**203,314**	97,537	16,083
Financing Activities			
Sale of common stock	**—**	1,145	47,070
Sale of preferred stock subject to mandatory redemption	**—**	—	75,000
Sale of first mortgage bonds (principal amount)	**—**	—	200,000
Sale of pollution control bonds (principal amount)	**—**	—	20,000
Pollution control funds held by trustees	**—**	20,019	12,001
Net change in revolving credit agreement	**—**	—	80,000
Change in escrow deposit — guaranteed debentures	**—**	—	24,000
Increase in deferred River Bend construction and continuing services commitments	**4,428**	13,779	46,750
Increase in other long-term debt	**680**	679	—
Payment of deferred River Bend construction commitments	**(8,400)**	—	—
Payments of lease obligations	**(38,188)**	(37,454)	(20,085)
Retirement of long-term debt	**(107,320)**	(32,570)	(46,015)
Retirement of preferred stock subject to mandatory redemption	**—**	—	(48,148)
Payment of preferred and preference dividends	**—**	—	(63,127)
Payment of common dividends	**—**	—	(70,319)
Net cash flow provided by (used by) financing activities	**(148,800)**	(34,402)	257,127
Investing Activities			
Construction expenditures	**(38,654)**	(48,721)	(339,578)
Nuclear fuel expenditures	**(75,530)**	(20,331)	—
Allowance for funds used during construction	**10,155**	8,438	114,010
Deposit to escrow account	**(12,000)**	—	—
Other property and investments	**(4,157)**	21,562	28,029
Net cash flow used by investing activities	**(120,186)**	(39,052)	(197,539)
Net change in cash and cash equivalents	**(65,672)**	24,083	75,671
Cash and cash equivalents at January 1	**168,065**	143,982	68,311
Cash and cash equivalents at December 31	**$ 102,393**	$ 168,065	$ 143,982
Supplemental Cash Flow Disclosure			
Cash paid during the period for:			
Interest	**$ 299,665**	$ 293,084	$ 275,100
Income Taxes	**2,406**	1,291	6,732
Increase in nuclear fuel lease obligations	**—**	8,824	24,621

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

Consolidated Balance Sheet

December 31
(in thousands)

	1988	1987
Assets		
Utility and Other Plant, at original cost		
Plant in service	$ 6,579,622	$ 6,589,893
Less: Accumulated provision for depreciation	1,523,229	1,387,185
	5,056,393	5,202,708
Construction work in progress	7,690	7,393
Nuclear fuel, net of accumulated amortization	161,688	181,151
	5,225,771	5,391,252
Other Property and Investments	50,988	30,038
Current Assets		
Cash and cash equivalents	102,393	168,065
Receivables		
Customers	147,913	123,860
Other	11,289	15,110
Fuel inventories	27,387	29,307
Materials and supplies	6,005	6,242
Prepayments and other	39,703	32,207
	334,690	374,791
Deferred Charges and Other Assets		
Unamortized debt expense	22,506	24,148
Unamortized project cancellation costs	94,848	118,755
Accumulated deferred income taxes	61,899	59,095
Deferred River Bend costs	997,079	808,036
Long-term receivable	47,220	—
Other	23,085	15,751
	1,246,637	1,025,785
	$ 6,858,086	$ 6,821,866
Capitalization and Liabilities		
Capitalization (See Statement of Capitalization)		
Common shareholders' equity	$ 2,088,055	$ 2,020,308
Preference stock	100,000	100,000
Preferred stock		
Not subject to mandatory redemption	136,444	136,444
Subject to mandatory redemption	387,189	356,522
Long-term debt	2,603,745	2,734,455
	5,315,433	5,347,729
Current Liabilities		
Long-term debt due within one year	84,333	80,000
Preferred stock and long-term debt sinking fund requirements	36,967	32,266
Deferred River Bend construction and continuing services commitments	29,170	13,216
Accounts payable — trade	107,465	103,268
Customer deposits	16,646	15,593
Taxes accrued	34,993	20,289
Interest accrued	86,327	93,680
Capital leases — current	79,074	92,698
Over-recovery of fuel costs	14,602	—
Other	41,187	37,531
	530,764	488,541
Deferred Credits and Other Liabilities		
Investment tax credits	109,907	114,025
Accumulated deferred income taxes	576,312	508,209
Capital leases — non-current	19,778	94,942
Deferred River Bend financing costs	135,764	142,024
Over-recovery of fuel costs	19,062	38,748
Disputed amounts	72,793	49,694
Deferred income from sale of utility plant	46,283	—
Other	31,990	37,954
	1,011,889	985,596
Commitments and Contingencies (Note 1)		
	$ 6,858,086	$ 6,821,866

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

Consolidated Statement of Changes in Capital Stock and Retained Earnings

For the years ended December 31
(in thousands)

	Preferred Stock Subject to Mandatory Redemption	Common Stock	Premium (Less Expense)	Other Paid-in Capital	Retained Earnings
Balance: January 1, 1986	$294,416	$1,146,933	$ (3,512)	$28,370	$ 484,801
Net income — 1986					244,981
Preferred stock sold (750,000 shares)	75,000				
Preferred stock sinking fund requirements	2,045				
Retirement of preferred stock	(48,148)			(2,240)	
Common stock sold:					
Dividend reinvestment and stock purchase plan (3,792,949 shares)		40,456			
Employee benefit plans (699,295 shares)		6,599			
Conversion of debentures (1,131 shares)		15			
Dividends declared:					
Preferred and preference					(63,127)
Common					(70,319)
Capital stock expense			(357)		(372)
Balance: December 31, 1986	323,313	1,194,003	(3,869)	26,130	595,964
Net income — 1987					241,101
Common stock sold:					
Employee benefit plans (149,365 shares)		1,145			
Reacquired capital stock				31	
Preferred stock sinking fund requirements	(2,946)				
Dividends in arrears on preferred stock subject to mandatory redemption	36,155				(34,160)
Capital stock expense			(37)		
Balance: December 31, 1987	356,522	1,195,148	(3,906)	26,161	802,905
Net income — 1988					103,143
Reacquired capital stock				2	
Preferred stock sinking fund requirements	(4,701)				
Dividends in arrears on preferred stock subject to mandatory redemption	35,368				(35,368)
Capital stock expense			(30)		
Balance: December 31, 1988	$387,189	$1,195,148	$ (3,936)	$26,163	$ 870,680

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

Consolidated Statement of Capitalization

December 31
(in thousands)

	1988	1987
Common Shareholders' Equity		
Common stock		
Authorized 200,000,000 shares without par value		
Outstanding 108,055,065 shares	**$1,195,148**	$1,195,148
Premium and expense on capital stock	**(3,936)**	(3,906)
Other paid in capital	**26,163**	26,161
Retained earnings	**870,680**	802,905
	2,088,055	2,020,508

Preference Stock
Authorized 20,000,000 shares without par value, cumulative
Outstanding 4,000,000 shares

Dividend Series	Cumulative Per Share Dividends in Arrears	Shares Outstanding	Redemption Price as of December 31, 1988	1988	1987
$4.40	$ 8.98	2,000,000	$ 30.45	**50,000**	50,000
3.85	7.86	2,000,000	30.15	**50,000**	50,000
				100,000	100,000

Preferred Stock
Authorized 6,000,000 shares, $100 par value, cumulative
Outstanding 4,617,568 shares

Dividend Series	Cumulative Per Share Dividends in Arrears	Shares Outstanding at December 31, 1988	Redemption Price as of December 31, 1988	1988	1987
Not subject to mandatory redemption					
$ 4.40	$ 8.98	51,173	$108.00	**5,117**	5,117
4.50	9.19	5,830	105.00	**583**	583
4.40-1949	8.98	1,655	103.00	**166**	166
4.20	8.58	9,745	102.818	**975**	975
4.44	9.07	14,804	103.75	**1,480**	1,480
5.00	10.21	10,993	104.25	**1,099**	1,099
5.08	10.37	26,845	104.63	**2,685**	2,685
4.52	9.23	10,564	103.57	**1,056**	1,056
6.08	12.41	32,829	103.34	**3,283**	3,283
7.56	15.44	350,000	101.80	**35,000**	35,000
8.52	17.40	500,000	104.43	**50,000**	50,000
9.96	20.34	350,000	106.64	**35,000**	35,000
				136,444	136,444
Subject to mandatory redemption					
8.80	17.97	301,029	103.00	**30,103**	30,103
9.75	19.91	29,636	103.00	**2,963**	2,963
8.64	17.64	302,465	105.00	**30,247**	30,247
11.48	23.44	480,000	105.00	**48,000**	48,000
13.64	27.85	40,000	105.00	**4,000**	4,000
12.92	26.38	600,000	112.92	**60,000**	60,000
11.50	23.48	750,000	111.50	**75,000**	75,000
Adjustable Rate	19.12	300,000	103.00	**30,000**	30,000
Adjustable Rate	19.23	450,000	104.90	**45,000**	45,000
Preferred dividends in arrears				**71,523**	36,155
				396,836	361,468
Preferred stock sinking fund requirements				**(9,647)**	(4,946)
				387,189	356,522

(Statement continued on following page.)

	1988	1987
Long-Term Debt		
First mortgage bonds		
Maturing 1989 through 1993 —		
4¾% due January 1, 1989	—	10,000
5¼% due December 1, 1989	—	16,000
4⅞% due July 1, 1990	17,000	17,000
14¾% due May 28, 1991	56,250	75,000
17½% due January 13, 1992	100,000	100,000
4⅜% due May 1, 1992	17,000	17,000
16.8% due September 23, 1993	42,860	51,430
Maturing 1994 through 1998 — 5% through 13¾%	220,000	220,000
Maturing 1999 through 2003 — 7¼% through 8½%	195,000	195,000
Maturing 2004 through 2008 — 8⅜% through 10.15%	220,000	220,000
Maturing 2009 through 2013 — 10⅛% through 15%	525,000	525,000
Maturing 2014 through 2016 — 11⅜% through 12⅝%	300,000	300,000
First mortgage bond sinking fund requirements	(27,320)	(27,320)
	1,665,790	1,719,110
Pollution control and industrial development bonds		
7% due 2006	25,000	25,000
5.9% due 2007	23,000	23,000
10⅜% due 2012	48,285	48,285
9½% due 2013	17,450	17,450
10⅝% due 2014	50,000	50,000
12% due 2014	52,000	52,000
Variable rate due 2014	94,000	94,000
Variable rate due 2015	154,000	154,000
Variable rate due 2016	20,000	20,000
Debentures		
Guaranteed debentures — 16% due April 15, 1990	60,000	60,000
Euro-debentures — 13% due 1992	75,000	75,000
Convertible debentures — 7¼% due 1992	2,003	2,003
Revolving credit agreement	291,667	350,000
Deferred River Bend construction and continuing services commitments (variable rate through 1991)	27,387	47,313
Other long-term debt	1,359	679
	2,606,941	2,737,840
Unamortized premium and discount on debt — net	(3,196)	(3,385)
	2,603,745	2,734,455
	$5,315,433	$5,347,729

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

Gulf States Utilities Company Notes to the Consolidated Financial Statements

1. Commitments and Contingencies

Financial Condition. The Company's financial condition has been strained by the large financing requirements of its construction program, resulting primarily from the construction of the River Bend Unit 1 (River Bend) nuclear unit which was completed in 1986. Although the Company has received some rate relief during 1987 and 1988, it has been unable to obtain permanent rate relief adequate to meet its needs, it is still experiencing strong regulatory, political, and consumer resistance to rate increases, and it faces the prospect of continued inadequate rate relief. Issues to be finally resolved in the Louisiana Public Service Commission (LPSC) and the Public Utility Commission of Texas (PUCT) rate proceedings and appeals thereof, combined with the application of accounting standards, may result in substantial write-offs and charges that could result in substantial net losses being reported in 1989 and subsequent periods with resulting substantial adverse adjustments to common shareholders' equity and to the Company's ability to purchase its stock to satisfy sinking fund requirements and reinstate dividends in the future. While management presently believes that the rate relief granted to date and the nuclear fuel refinancing concluded in February 1989 have improved the Company's financial position, significant litigation, regulatory, and operational contingencies exist which, if adverse results occur, could force the Company to seek relief from its creditors under the Bankruptcy Code or to attempt to negotiate such relief, and there can be no assurance that any such negotiations could be timely or successfully concluded.

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

Southern Company Litigation. The Company and the Southern Company entered into purchase power contracts providing for purchases by the Company of capacity and energy from the Southern Company. In management's opinion, based on advice from legal counsel, such contracts have been terminated by reason of breach of contract by the Southern Company and for other reasons and its obligations under the contracts have been discharged and excused.

As of December 31, 1988, the Company had not recorded as a liability and had not paid an estimated $313,000,000 of charges related to the Southern Company contracts. If the Company had not been discharged and had recorded the charges as if they had not been discharged and excused, net income for the twelve months ended December 31, 1988, 1987, and 1986 would have decreased by approximately $112,000,000, $73,000,000, and $12,000,000, respectively. The Company has also withheld payment of $29,193,000 which is recorded as an amount in dispute on the balance sheet resulting from differences in certain amounts billed by the Southern Company and amounts paid. The Company has estimated that minimum payments for capacity which would be due under such contracts from January 1, 1989, through their termination in 1992, would aggregate approximately $609,000,000 and that payments for energy would be approximately $301,000,000.

On July 2, 1986, the Company filed suit against the Southern Company in U.S. District Court requesting that the Company be excused and discharged from the contracts and for other relief. Additionally, the Company and the Southern Company each filed applications with the Federal Energy Regulatory Commission (FERC) seeking findings and actions, respectively, to void or reform the contracts and to support and continue such contracts. The FERC accepted jurisdiction over certain issues but refused hearing on state law contract issues.

On March 30, 1988, the FERC held "the presiding law judge's determination that grounds for modification of the purchase power contract pursuant to Section 206(a) of the Federal Power Act have not been established." The FERC also ordered the Company's "complaint for relief under Section 206(a) of the Federal Power Act" be dismissed, that the Southern Company's petition for declaratory order be granted as to certain issues, and that the dockets involved are terminated. The FERC found no basis within its jurisdiction to relieve the Company of its obligations under the contracts, but reconfirmed that certain state law contract issues remain open for the court to resolve. The Company's application for rehearing has been denied, and the Company has appealed the FERC order.

On June 27, 1988, the Southern Company requested FERC approval of a suspension of performance by the Southern Company effective July 1, 1988, under its Unit Power Sales Agreement and certain other service schedules with the Company. On August 26, 1988, the FERC granted such suspension, denied an intervenor's request to cancel the rate schedules, and noted that the Southern Company had not waived any of their legal rights, remedies, and claims for damages available against the Company. The effect of such a suspension upon the ultimate outcome of the ongoing litigation cannot yet be predicted.

On December 5, 1988, the Southern Company filed with the district court an amended motion to dismiss and counterclaim. The counterclaim seeks to enforce the power sales contract and recover an unspecified amount of compensatory and punitive damages, including the amounts equal to the contractual payments due to date and the present value of the remaining payments alleged to be due under the contracts, interest, and attorneys' fees. The counterclaim alleges, among other things, that the Company has been in breach of the contract since July 1986, and has been guilty of fraudulent conduct in relation to service taken since July 1986, but not paid in full. On January 24, 1989, the district court over-ruled the Southern Company's amended motion to dismiss.

Also, the Company's appeals to the appropriate state courts of the actions of the PUCT and the LPSC in 1986, disallowing pass through of Southern Company capacity charges under the contracts, are pending.

The Company cannot predict the outcome of the various proceedings; however, if the Company were ultimately unsuccessful in the pending litigation and were required to make substantial payments to the Southern Company and not permitted to pass these costs through to customers in its rates, the Company would probably be unable to make such payments and would probably have to seek protection from its creditors under the Bankruptcy Code.

Cajun Electric Power Cooperative, Inc. (CEPCO). The Company has significant business relationships with CEPCO, including co-ownership of River Bend Unit 1 and Big Cajun 2 Unit 3. The Company and CEPCO own 70 percent and 30 percent of River Bend, respectively, while Big Cajun 2 Unit 3 is owned 42 percent and 58 percent by the Company and CEPCO, respectively. The Company has been informed that CEPCO is in arrears in payment of some of its debt service, has employed bankruptcy counsel and has been sued by one of its major creditors. Additionally, one of its member cooperatives has filed bankruptcy. Further, deterioration of CEPCO's financial condition and its bankruptcy could have significant adverse effects on the Company, including but not limited to possible NRC action as described above and a need to bear additional costs associated with the co-owned facilities. CEPCO has also threatened to sue the Company for alleged mismanagement of the construction of River Bend and for fraud in the inducement to enter into the River Bend agreements.

The Company and CEPCO are parties to FERC proceedings regarding certain long-standing disputes relating to transmission service charges. Hearings before the FERC were completed in December 1988. At December 31, 1988, the Company claimed CEPCO had underpaid transmission charges in the amount of $43,600,000. Such amount was recorded on the balance sheet as an account receivable and offsetting amount in dispute, with no effect on net income. The Company and CEPCO are also in dispute over certain billings related to the jointly-owned facilities, River Bend and Big Cajun 2 Unit 3. The Company and CEPCO have reached a preliminary agreement regarding disputes under the River Bend buyback arrangement, which must be ratified by the Rural Electrification Administration. The Company has previously advised CEPCO that it may need to renegotiate the River Bend buyback agreement if adequate and timely permanent rate relief is not received.

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

Public liability in case of a nuclear incident at any licensed nuclear facility in the United States is currently limited to $7.7 billion under provisions of the Price-Anderson Act (Act) which was renewed and revised in 1988 and extends through August 1, 2002. The Company insures River Bend for this exposure through a combination of private insurance and the industry-wide secondary financial program. The changes to the Act will necessitate modifications to the secondary financial protection, such that the Company will be subjected to a potential retrospective assessment of approximately $66,150,000 per incident with a maximum amount of $10,000,000 per incident payable in any one year for losses in the event of a nuclear incident at its facility or any other licensed nuclear reactor facility. Any retrospective assessments pertaining to this liability are subject to the 70/30 percent ownership interest in River Bend between the Company and CEPCO.

The Company maintains $500,000,000 property damage insurance and $400,000,000 of such excess insurance for River Bend is from the private insurance market. Additionally, the Company has acquired $825,000,000 of excess property insurance coverage on River Bend through participation in the Nuclear Electric Insurance Limited (NEIL) II program. Under NEIL II, the Company is subject to a maximum assessment of approximately $7,750,000 in any one policy year. Although the Company has continued to increase the limits of such insurance as capacity becomes available, no assurance can be given about the adequacy of such insurance limits in the event of a major accident. The property damage insurance policy limits are substantially less than the replacement cost of the River Bend facilities.

The Company maintains a Nuclear Workers' Liability policy which covers liability for tort claims by on-site workers first employed at a nuclear facility after January 1, 1988, for non-catastrophic nuclear related injury such as the exposure to long-term, low-level radiation. Nuclear related claims by workers employed in a nuclear facility prior to January 1, 1988, will continue to be covered under the Nuclear Energy Liability policy provided the claim is made by December 31, 1997. Under the Nuclear Workers' Liability policy, the Company is subject to a maximum retrospective premium assessment of $3,200,000.

Some extra expense for River Bend replacement power is insured through the NEIL I program. Following an insured property loss which results in the unit being unavailable for generation and a 21 week waiting period, the NEIL I program will pay the Company a specified weekly indemnity for 52 weeks followed by one-half the specified weekly indemnity for an additional 52 week period. Under the NEIL I program the Company is subject to a maximum annual retrospective assessment of approximately $1,100,000.

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

The Company has received approval from the PUCT, LPSC, and FERC to collect in rates amounts necessary to decommission River Bend when it reaches the end of its service life. Decommissioning costs are subject to the 70/30 percent ownership interest in River Bend between the Company and CEPCO. In 1988 dollars the Company's share of decommissioning costs is approximately $158,600,000, which at the end of the life of the unit, may be well over $700,000,000. To provide for these future decommissioning costs, the amounts collected through rates from customers will be placed in a master trust fund where the contributions plus interest will provide amounts needed in the future. The Company has elected the provisions of section 468A of the Internal Revenue Code to qualify for an annual tax deduction for payments made to the nuclear decommissioning fund.

Dividend Suspension. The Board of Directors did not declare any dividends on the Company's common stock for the third quarter of 1986, and no dividend on common stock has been declared through December 31, 1988. The Board of Directors did not declare the dividends on the preferred and preference stock of the Company payable on March 15, 1987, and has continued not to declare them through December 31, 1988. Unless the financial condition of the Company improves, the Company expects to continue to be unable to pay dividends on such stock. Dividends on all series of the Company's preferred and preference stock are cumulative. Since the Company has failed to pay such dividends, the holders of preferred stock became eligible, as of March 15, 1988, to elect a majority of the Board of Directors and did so at the annual meeting on May 5, 1988. The holders of preference stock became eligible as of September 15, 1988, to elect two directors at the 1989 annual meeting. The Company may not pay any dividend or distribution on any of its common stock, or purchase or otherwise acquire common stock, unless all cumulative dividends and sinking fund obligations have been paid on preferred and preference stock. Under its Restated Articles of Incorporation (Articles), as amended, the Company may not pay any dividend or distribution on any of its preference stock, or otherwise acquire preference stock, unless all sinking fund obligations have been paid on preferred stock. As of December 31, 1988, the Company has not met four sinking fund obligations totaling $4,945,900. Under the terms of its credit agreement with Irving Trust Company, as discussed in Note 12, the Company is also restricted from paying dividends on any of its classes of stock while such credit agreement remains outstanding. The Company's ability to pay dividends and redeem and purchase outstanding stock (as is necessary to meet its preferred stock sinking fund obligations) will be adversely affected, and possibly foreclosed for an indeterminate period of time if significant write-offs result from regulatory actions, judicial actions, or requirements of accounting standards.

The Company has accrued dividends on and increased the balance of mandatory redeemable preferred stock with an offsetting decrease to retained earnings. However, since dividends on all series of the Company's preferred and preference stock are cumulative (the aggregate amount of accumulated and unpaid preferred and preference stock dividends as of December 15, 1988 is $125,440,000) income applicable to common stock and earnings per average common share outstanding have been computed assuming that all such dividends through December 31, 1988, were accrued.

Other Litigation. The Company is involved in litigation arising in the normal course of business. While the results of such litigation cannot be predicted with certainty, management believes that the final outcome will not have a material adverse effect on its consolidated financial position.

2. Summary of Significant Accounting Policies

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

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

Composite depreciation rates were as follows:

	1988	1987	1986
Electric	2.72%	2.94%	3.31%
Steam	4.05	4.55	2.47
Gas	3.52	3.52	3.52
Total Company	2.74	2.96	3.30

Decommissioning. The Company is accruing the decommissioning costs of River Bend in accordance with the Commissions orders over a 38-year to 40-year period.

Allowance for Funds Used During Construction (AFUDC) and Capitalization of Interest. The accrual of AFUDC is a utility accounting practice calculated under guidelines prescribed by the FERC and capitalized as part of the cost of utility plant representing the cost of servicing the capital invested in construction work in progress (CWIP). Such AFUDC has been segregated into two component parts — borrowed and equity funds. That portion allocated to borrowed funds is reflected as an adjustment to interest charges, while that portion applicable to equity funds is shown as a source of other income. Both the equity and the borrowed portions of AFUDC are non-cash items which have the effect of increasing the Company's reported net income. When the related utility plant is placed in service, a return on and recovery of these costs generally have been permitted by regulators in determining the rates charged for utility service (see Notes 3 and 15 for information regarding recent and current rate actions). The Company computed AFUDC at the following net of tax rates compounded semiannually:

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

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

January 1, 1987-March 31, 1987	12.00%
April 1, 1987-September 30, 1987	12.25
October 1, 1987-March 31, 1988	12.50
April 1, 1988-December 31, 1988	12.25

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

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

Income Taxes. The Company and its subsidiaries file a consolidated federal income tax return. Income taxes are allocated to the individual companies based on their respective taxable income or loss and investment tax credits.

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

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

Subsidiary Companies. For financial statements prior to December 31, 1988, the Company accounted for its investments in its wholly-owned nonutility subsidiary companies, Prudential Oil and Gas, Inc. (Prudential) and Varibus Corporation (Varibus), on the equity basis. In October, 1987, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 94, Consolidation of all Majority-Owned Subsidiaries, which required consolidation of Varibus and Prudential for financial statements presented at December 31, 1988, and restatement of prior years financial statements, which effect was immaterial. Two additional subsidiaries, GSG&T, Inc. (GSG&T), discussed further in Notes 6 and 12, and Gulf States Overseas Finance N.V. have been previously presented on a consolidated basis. See Note 7 for information regarding the sale of Prudential's natural gas and oil reserves. Varibus operates pipelines and owns rights to lignite reserves.

Retirement Plan and Other Post Employment Benefits. The Company has a noncontributory pension plan which covers all employees meeting certain age and service requirements. Benefits are based on years of service and employees' compensation during the last 10 years of service. The Company's policy is to fund the actuarially computed pension contribution annually. Past and prior service costs are being funded by the Company over periods of up to forty years.

In addition to the pension plan, the Company provides retired employees with life and health care insurance benefits. All of the Company's employees may become eligible for benefits upon reaching normal retirement age. The annual cost of such benefits of approximately $3,736,000 is recognized as claims are actually paid.

Consolidated Statement of Cash Flows. The Company adopted the provisions of SFAS No. 95, Statement of Cash Flows, in its financial statements during 1988, and replaced the previously reported Statement of Sources of Funds invested in Utility and Other Plant for 1987 and 1986. For the purposes of the Statement of Cash Flows, the Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

Reclassification of Financial Statements. In September, 1988, the Company reclassified $142,024,000 from "UTILITY AND OTHER PLANT, at original cost" to "DEFERRED CREDITS AND OTHER LIABILITIES — Deferred River Bend Financing Costs." This reclassification was in accordance with the Company's interpretation of the May 16, 1988 PUCT rate order (see Note 3) of Texas retail jurisdictional amounts (which had been recorded as a reduction in net plant in service) related to the previous inclusion of portions of River Bend in rate base during the construction period of the unit. The Company is amortizing the reclassified amount over a 10 year period.

Prior year financial statements have been reclassified in order to be consistent with current year presentation with no effect on net income or common shareholders' equity.

3. Rates and Accounting

Rate Matters

Texas. On November 18, 1986, the Company filed a rate increase request with the PUCT and applicable cities. The request proposed a phase-in plan for River Bend costs.

On May 16, 1988, the PUCT granted the Company a one-time permanent rate increase of $59,900,000. The increase is based on including in rate base approximately $1.6 billion of the Company's system-wide River Bend plant investment and approximately $182,000,000 of related Texas retail jurisdiction deferred River Bend costs ruled prudent. The PUCT also ordered the Company to refund $27,462,000 of fuel overrecoveries plus accrued interest to its customers over a twelve month period beginning in July 1988. Additionally, the PUCT affirmed its preliminary rulings made in February 1988 to disallow as imprudent $63,468,000 of the Company's system-wide River Bend plant costs (approximately $25,175,000 on a Texas retail jurisdiction basis) and set aside in abeyance approximately $1.4 billion of the Company's system-wide River Bend plant investment (approximately $550,000,000 on a Texas retail jurisdictional basis) and approximately $157,000,000 of Texas retail jurisdiction deferred River Bend costs with no finding as to prudency. The PUCT affirmed that the ultimate rate treatment of such amounts will be subject to future demonstration by the Company of the prudency of such costs. River Bend costs deferred subsequent to December 31, 1987 were not specifically addressed by the PUCT.

On May 31, 1988, the Company filed a motion for rehearing of the PUCT's order of May 16, 1988. On June 29, 1988, the PUCT failed to take action on the Company's request for rehearing and it was denied as a matter of law on June 30, 1988. On July 29, 1988, the Company filed an appeal of the May 16, 1988 order in a state district court which is currently set for hearings in early May 1989. The appeal included, among other things, a request that the $1.4 billion of River Bend plant investment which was set aside with no finding as to prudency be included in rate base, as well as a request that approximately $27,000,000 in additional rate relief be granted. The Company's appeal also covers the imprudency disallowance related to River Bend. Pending resolution of this case, the Company has not recognized the alleged imprudency disallowance of $63,468,000. The Company believes the denial of its request for rehearing of the rate case will, under the terms of the PUCT's final order, allow it to submit additional River Bend cost information in a future rate proceeding, which the Company plans to file in March 1989. No assurance can be given as to the timing or outcome of the court appeal.

Louisiana. On July 25, 1986, the Company filed an electric rate increase application including a phase-in plan with the LPSC for River Bend costs.

On December 15, 1987, the LPSC issued a permanent rate order granting the Company $63,000,000 in rate relief (including $57,000,000 of previously granted emergency rate relief) and a 12 percent return on common equity and disallowed $1.4 billion of the Company's total River Bend plant investment (approximately $677,000,000 on a Louisiana retail jurisdictional basis) as having been imprudently incurred. The order also disallowed any recovery of costs incurred in connection with the Company's investment in its cancelled River Bend Unit 2 which amounts to $61,979,000 as of December 31, 1988. The LPSC order also approved the form of a phase-in plan but required evidentiary hearings and subsequent approval by the LPSC of any future increases to be granted under the phase-in plan. The LPSC order failed to specify the level of revenue requirements deferred under the plan as well as the timing of recovery of the deferred amounts.

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

On February 18, 1988, the Louisiana state district court judge issued a preliminary injunction ordering the immediate implementation of a $92,000,000 rate increase (which included the $63,000,000 granted by the LPSC on December 15, 1987) and setting the return on common equity at 14 percent. The judge also adopted a phase-in plan which meets the guidelines set forth in SFAS No. 92 for a qualified phase-in of the prudent costs of the Company's River Bend investment as determined by the LPSC. As a result, the Company began recording in 1988, for financial reporting purposes, the deferred revenue requirements associated with such plan subject to the outcome of the appeal. The Company believes that the first-year $92,000,000 increase will remain in effect until the appeal of the LPSC's December 15, 1987 order on the merits is decided. The court's plan provides for 4 additional increases and level rates for 5 years thereafter. The increases are subject to LPSC review.

On July 27, 1988, the Supreme Court of Louisiana agreed to hear the LPSC's and the attorney general of Louisiana's appeal of the injunctive relief granted the Company. As of December 31, 1988, no hearings have been scheduled.

On October 20, 1988, the Louisiana state district court judge presiding over the Company's appeal of the December 15, 1987 rate order issued an order remanding the case back to the LPSC for further consideration. On November 15, 1988, the LPSC issued an order on the case remanded to it by the Louisiana district court. The LPSC reaffirmed its finding that the Company was imprudent in deciding to restart construction of River Bend in 1979, instead of constructing a lignite-fueled generating unit and that $1.4 billion of the Company's $3 billion investment should be excluded from rate base as imprudent. However, the LPSC offered an alternative rate treatment for the $1.4 billion of River Bend investment in settlement of the pending rate case and appeal.

After studying the alternative rate treatment and implications thereof, the Company informed the Commission and the district court on November 28, 1988, that it could not accept the settlement offer and would, therefore, continue its court appeal of the LPSC's December 15, 1987 rate decisions because of several financial, regulatory, and accounting uncertainties associated with the LPSC's settlement proposal. The case now reverts to the court for its decision. The Company cannot predict the ultimate outcome of these proceedings or when they will finally be concluded. Pending resolution of this case, the Company has not recognized the alleged imprudency disallowance of River Bend and the disallowance of recovery of the cancelled River Bend Unit 2.

On December 27, 1988, the Company filed a request with the LPSC for the second step, a $50,000,000 rate increase, of the phase-in plan adopted as part of the preliminary injunction issued by the Louisiana state district court on February 18, 1988. For recent developments in the Louisiana rate proceedings, see Note 15.

Wholesale. On June 24, 1986, the Company filed a wholesale electric rate increase request with the FERC to phase in the River Bend costs.

On August 22, 1986, the FERC issued an order permitting the proposed first year rates to become effective on August 25, 1986, and the proposed second and third year rates to become effective on July 1, 1987 and July 1, 1988, respectively, under the Company's proposed phase-in plan.

At the time of the order, the Company had already commenced negotiations with its wholesale customers regarding alternative rates. A settlement regarding alternative rates has been finalized with all but CEPCO. The Company and CEPCO have reached a settlement on this matter contingent on the ultimate resolution of the dispute over the River Bend buyback, as discussed in Note 1. The settlement of this wholesale rate will require FERC approval. The Company filed a motion with the FERC for authorization to collect the settlement rates effective as of August 25, 1986, and was permitted to implement such rates effective as of that date. Under the settlement, the phase-in plan period is ten years, and the rate increases from 1986 through 1989, to the applicable customers for purchases on the standard wholesale rate will be 24 percent, 14 percent, 10 percent, and 7.4 percent, respectively. However, the settlement provides that for several years substantial portions of such customers' loads may be served from power purchased from others for which the Company receives transmission charges or, depending on relative costs of such other power, from the Company at a rate lower than the standard rate. The Company believes that currently no write-off of the wholesale portion of the River Bend investment is required. However, there can be no assurances that, as a result of the future loss of wholesale customers or rate reductions to meet competition or accounting standards as discussed below, a write-off of some portion or all of the remaining unrecovered River Bend investment allocable to the wholesale jurisdiction, or an adjustment to the deferred revenue requirement recorded by the Company with respect to the phase-in plan for such customers, will not be required at a future date.

Accounting Developments

SFAS No. 90. In December, 1986, the FASB issued SFAS No. 90, Regulated Enterprises — Accounting for Abandonments and Disallowances of Plant Costs, which amends certain accounting standards for rate regulated enterprises, and was adopted by the Company during the first quarter of 1988. SFAS No. 90 specifies the accounting for the effect of disallowances of costs of newly completed plants and plant abandonments and requires an immediate charge to operations for any portion of the cost of River Bend permanently excluded from rate base. Additionally, it requires the Company to reduce its investment in the abandoned River Bend Unit 2 to an amount equal to the present value of the probable future revenues expected to be provided over the amortization period authorized by regulators. In subsequent periods, the Company is recognizing interest income to the extent of the difference between amortization allowed for regulatory purposes and the reduced amortization recorded for financial reporting purposes. The effect of the accounting change on 1988, 1987 and 1986 of $2,147,000, $2,027,000 and $1,900,000, respectively, is included in net income for 1988.

The following table illustrates SFAS No. 90's cumulative effect of the River Bend Unit 2 plant write-down:

	1988 (in thousands except per share amounts)
Property Abandonment — River Bend Unit 2	
Texas retail jurisdiction	
Return disallowance — discounted	$19,277
Related income taxes	(6,554)
Wholesale jurisdiction	
Return disallowance — discounted	2,494
Related income taxes	(848)
Effect of SFAS No. 90	$14,369
Earnings per average share of common stock outstanding from continuing operations before the effects of SFAS No. 90	$ .50
Earnings per average share of common stock effect of SFAS No. 90	(.13)
Earnings per average share of common stock outstanding	$ .37

During 1984, the Company began amortizing the cost of the River Bend Unit 2 cancellation applicable to its wholesale and Texas retail operations over 10 and 15 year periods, respectively.

If the LPSC rate order of December 15, 1987 had not been appealed at December 31, 1988, the Company would have been required to record a write-off of approximately $524,000,000 (net of tax) related to the River Bend Unit 1 disallowance and an additional $42,111,000 (net of tax) write-off related to River Bend Unit 2.

Additionally, if the PUCT rate order of May 16, 1988 had not been appealed, at December 31, 1988, the Company would have been required to record a write-off of approximately $19,765,000 (net of tax) related to the River Bend disallowance.

SFAS No. 92. In August, 1987, the FASB issued SFAS No. 92, Regulated Enterprises — Accounting for Phase-in Plans. This statement prescribes the criteria which must be met by a phase-in plan ordered by a regulator in order for the regulated utility receiving such order to be able to record, for financial reporting purposes, the deferrals of expense or revenue requirements included in the phase-in plan.

An additional provision of SFAS No. 92 is the prohibition, effective January 1, 1988, of the recognition of the equity portion of carrying charges, accrued in accordance with an accounting order granted by a regulator, on a recently completed generating plant that is in commercial service but not yet reflected in rates. This provision does not require the reversal of such equity charges accrued prior to January 1, 1988.

SFAS No. 101. In December 1988, the FASB issued SFAS No. 101, Regulated Enterprises — Accounting for the Discontinuation of Application of SFAS No. 71.

SFAS No. 101 specifies how an enterprise that ceases to meet the criteria for application of SFAS No. 71, Accounting for the Effects of Certain Types of Regulation, to all or part of its operations should report that event in its general-purpose external financial statements.

An enterprise's operations can cease to meet those criteria for various reasons, including deregulation, a change in the method of regulation, or a change in the competitive environment for the enterprise's regulated services or products. Regardless of the reason, an enterprise whose operations cease to meet those criteria should discontinue application of SFAS No. 71 and report that discontinuation by eliminating from its balance sheet the effects of any actions of regulators that had been recognized as assets and liabilities pursuant to SFAS No. 71 but would not have been recognized as assets and liabilities by enterprises in general.

While no application of SFAS No. 101 is currently required, there can be no assurances that, as a result of the loss of wholesale customers or rate reductions to meet competition, a write-off of some portion or all of the remaining unrecovered plant investment allocable to the wholesale jurisdiction, or an adjustment to the deferred revenue requirement recorded by the Company with respect to the phase-in plan for such customers, or other adjustments required by SFAS No. 101, will not be required at a future date.

Additionally, there can be no assurances that, as a result of new rate orders or settlements, a write-off of some portion or all of the remaining unrecovered River Bend investment and other adjustments required by SFAS No. 101 will not be required at a future date for other jurisdictions in which the Company operates.

SFAS No. 101 is effective for discontinuations of application of SFAS No. 71 occurring in fiscal years ending after December 15, 1988, but its adoption may be delayed until the issuance of annual financial statements for the fiscal year that includes December 15, 1989.

Deferred Revenue Requirements — River Bend Phase-in Plans. In accordance with the terms of the phase-in plan approved by the FERC and the phase-in plan authorized by the court in Louisiana, as described above, the Company is recording a deferred revenue requirement representing those River Bend costs which have been deferred for future recovery.

River Bend Cost Deferrals. Pursuant to accounting orders received in 1986 from the LPSC and the PUCT, the Company deferred recognition, for financial reporting purposes, of the retail portion of the operating costs associated with River Bend and costs of purchasing capacity from CEPCO's portion of the unit incurred subsequent to the unit's commercial in-service date and accrued carrying charges upon the retail portion of both the cash portion of the deferrals and the investment in the unit not included in the Company's rate base. The rate used in computing the carrying charges was 9.75 percent during the period from January 1 to March 31, 1987, 10 percent from April 1 to December 31, 1987, and 10.25 percent from October 1, 1987 to July 22, 1988. The deferral of costs and accrual of carrying charges associated with River Bend was terminated in the Louisiana retail jurisdiction on December 15, 1987, upon receipt of the permanent rate decision and terminated in the Texas retail jurisdiction on July 22, 1988, the effective date of rates authorized by the PUCT rate order on May 16, 1988.

The Company has capitalized $43,764,000 of River Bend equity carrying charges in 1988 for ratemaking purposes that have not been recorded in the Consolidated Statement of Income.

The following table details balances of amounts deferred and accrued under accounting orders issued by regulators, net of amortization of such amounts, and deferred revenue requirements related to phase-in plans recorded for financial reporting purposes, net of deferred River Bend financing costs (discussed in Note 2).

	Balance at December 31, 1988	Balance at December 31, 1987
	(in thousands)	
DEFERRED REVENUE REQUIREMENTS — RIVER BEND PHASE-IN PLANS		
Louisiana retail jurisdiction	$173,461	$ —
Wholesale jurisdiction	55,506	39,888
Steam jurisdiction	8,673	—
	237,640	39,888
ACCOUNTING ORDER DEFERRALS		
Texas retail jurisdiction		
Deferred River Bend expenses and carrying charges	377,329	339,456
Amortization of accumulated deferred River Bend costs	(2,010)	—
Louisiana retail jurisdiction		
Deferred River Bend expenses and carrying charges	408,854	410,532
Amortization of accumulated deferred River Bend costs	(42,549)	(1,710)
Steam jurisdiction		
Deferred River Bend expenses and carrying charges	19,884	19,953
Amortization of accumulated deferred River Bend costs	(2,069)	(83)
	759,439	768,148
DEFERRED RIVER BEND COSTS	997,079	808,036
DEFERRED RIVER BEND FINANCING COSTS, NET OF AMORTIZATION	135,764	142,024
	$861,315	$666,012

The deferred income taxes related to the amounts detailed above at December 31, 1988 and 1987 of $251,366,000 and $184,475,000, respectively, are included in "DEFERRED CREDITS AND OTHER LIABILITIES — Accumulated Deferred Income Taxes" on the Consolidated Balance Sheet.

Reduction of Deferred River Bend Costs. As a result of the interim rate relief granted during 1987 and 1988 in the Texas and Louisiana retail jurisdictions, the Company has reduced by $46,266,000 and $94,896,000 for the twelve months ended December 31, 1988 and 1987, respectively, the amount of deferred River Bend costs being recorded in accordance with accounting orders issued in 1986, by the regulatory commissions. This amount reflects a reduction of $1.50 (Texas) and $1.00 (Louisiana) for each $1.00 of revenue received as a result of the interim rate increases. Such adjustment was required since the commissions, as a result of granting interim rate relief, have allowed some River Bend costs (on a non-specific basis) to be collected through rates rather than being deferred. The reduction of deferred River Bend costs was terminated in both jurisdictions upon receipt of the permanent rate orders.

Recovery of Costs — Amortization of Accumulated Deferred River Bend Costs. The Company was ordered by the LPSC, as part of the December 15, 1987 rate order, to amortize the deferred costs and accrued carrying charges related to the accounting order over a ten-year period. In July 1988, the Company began amortizing over a 40-year period approximately $182,000,000 of deferred costs and accrued carrying costs associated with the portion of River Bend ruled prudent by the PUCT in accordance with the May 16, 1988 rate order.

4. Federal Income Taxes

The provisions for federal income taxes were different from the amounts computed by applying the statutory federal income tax rate to net income before federal income taxes. The reasons for these differences are as follows:

	1988	1987	1986
	(in thousands except percents)		
Net income before federal income taxes	$164,052	$273,091	$247,289
Statutory tax rate	34%	40%	46%
Federal income taxes at statutory tax rate	55,778	109,236	113,752
Additions (reductions) in federal income taxes resulting from:			
Exclusion of AFUDC and River Bend carrying charges from taxable income	(505)	(105,325)	(113,863)
Items capitalized for book purposes but expensed for tax purposes	(5,779)	542	(14,523)
Non-deferred depreciation differences	6,040	3,249	6,066
Adjustment for prior years taxes and other regulatory adjustments	(91)	693	(3,732)
Non-deferred differences of nonutility subsidiaries	(53)	584	8,484
Deferral of nuclear fuel savings	7,626	22,197	10,967
Amortization of investment tax credit	(4,118)	(3,712)	(3,530)
Other items	1,811	4,526	(1,313)
Total federal income taxes	$ 60,909	$ 31,990	$ 2,308
Effective federal income tax rate	37.1%	11.7%	.9%

The components of federal income taxes are as follows:

	1988	1987	1986
	(in thousands)		
Charged to operating expenses:			
Current federal income tax provision	$ —	$ —	$ (1,120)
Deferred federal income taxes — net			
Tax depreciation	56,692	105,714	159,111
Capitalized construction costs	(472)	1,333	4,634
Amortized nuclear unit cancellation costs	(2,104)	(1,827)	(1,668)
Nuclear unit cancellation costs	—	200	100
Fuel and purchased power costs accrued	4,704	(1,662)	(6,106)
Expenses deferred for tax purposes	(1,094)	(5,447)	(1,257)
Net operating tax loss carryforward benefit recognized currently	(56,581)	(140,955)	(212,680)
River Bend operating expenses deferred for financial reporting, expensed for tax purposes	64,517	74,040	68,777
Unbilled revenues	(3,665)	(2,343)	—
Other	1,638	(1,059)	(697)
Total deferred federal income taxes — net	63,635	27,994	10,214
Investment tax credits — net	(4,118)	(3,703)	(3,621)
Total federal income taxes charged to operating expenses	59,517	24,291	5,473
Charged to other income — net	1,392	7,699	(3,165)
Total federal income taxes	$ 60,909	$ 31,990	$ 2,308

Timing differences exist for which deferred taxes have not been provided and, therefore, have not been recovered through rates. The cumulative amount of timing differences for which no deferred taxes have been provided was approximately $128,000,000 at December 31, 1988. The tax effect of the Company's 1988 federal tax loss has been recorded as a reduction of deferred income taxes. At December 31, 1988, for tax purposes, the Company had tax loss carryforwards of approximately $928,000,000 and investment tax credit carryforwards for book and tax purposes of approximately $180,000,000. These will be used to reduce income taxes in future years and, if not used, will expire through the year 2003.

In December 1987, the FASB issued SFAS No. 96, Accounting for Income Taxes, which must be adopted by the Company beginning in 1990. SFAS No. 96 significantly changes accounting for income taxes and supersedes almost all existing authoritative accounting literature on accounting for income taxes. While the Statement retains (with the exception described below) the existing requirement to record deferred taxes for transactions that are reported in different years for financial reporting and tax purposes, it revises the computation of deferred income taxes so that the amount of deferred income taxes on the balance sheet is adjusted whenever tax rates or other provisions of the income tax law are changed. Adoption of SFAS No. 96 is expected to have a significant impact on the Company's balance of deferred income taxes through reclassifications. The impact on the Company's Consolidated Statement of Income for future years cannot be determined at this time.

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

5. Retirement Plan

The Company's pension provision for the twelve months ended December 31, 1988, 1987, and 1986 was $691,000, $798,000, and $(614,000), respectively. Of such amounts, $608,000, $703,000, and $(446,000), respectively, were charged/(credited) to income with the balance of such costs for each period charged/(credited) to construction and other accounts.

The components of the pension provision for 1988, 1987, and 1986, are summarized as follows:

	1988	1987	1986
	(in thousands)		
Service cost	$ 6,742	$ 6,690	$ 7,114
Interest cost on projected benefit obligation	11,933	11,330	10,589
Actual return on plan assets	(26,869)	(8,356)	(30,423)
Unrecognized net gain (loss)	11,812	(6,853)	14,494
Amortization of net gain	(1,270)	(356)	—
Amortization of prior service cost	730	730	—
Amortization of net transition asset	(2,387)	(2,387)	(2,388)
Net pension cost	$ 691	$ 798	$ (614)

The obligations for plan benefits and the amount recognized in the Company's Consolidated Balance Sheet at December 31, 1988, 1987, and 1986, are reconciled as follows:

	1988	1987	1986
	(in thousands)		
Actuarial Present Value of Benefit Obligations:			
Accumulated benefit obligation, including vested benefits of $123,125, $127,384, and $129,655	$ 135,279	$ 139,308	$ 140,869
Projected benefit obligation	$ (167,509)	$ (173,687)	$ (178,212)
Plan assets, at fair market value	217,559	200,762	202,786
Plan assets in excess of projected benefit obligation	50,050	27,075	24,574
Unrecognized net gain	(39,253)	(15,659)	(14,494)
Unrecognized net assets, being amortized over 15 years	(28,649)	(31,036)	(33,423)
Unrecognized prior service cost	19,003	21,462	22,869
Other — primarily benefit payments higher than those contained in computing the projected benefit obligation	—	—	3,114
Balance of accrued pension costs included in deferred assets	$ 1,151	$ 1,842	$ 2,640

The accumulated benefit obligation is the present value of future pension benefit payments and is based on the plan's benefit formulas without considering expected future salary increases. The projected benefit obligation considers future salary increases. The assumed discount rate and long-term return on pension assets was 8¼ percent and 7½ percent, respectively. The expected rate of increase in future salary levels averaged approximately 6.1 percent.

At December 31, 1988, 62.3 percent of plan assets were invested in equity securities, 25.3 percent in bonds, and 12.4 percent in cash or cash equivalents.

Early Retirement Plan. During 1986, the Company initiated an early retirement plan for employees meeting certain qualifications. The cost of the early retirement plan was $14,417,000, of which $8,938,000 was charged to operating expense, with the balance charged to construction.

During 1988, in accordance with the PUCT and LPSC rate orders, the Company recorded a deferred charge of $7,797,000 associated with the retail portion of the early retirement plan and began amortizing the Texas retail portion of

$3,778,000 over 23 years and the Louisiana retail portion of $3,969,000 over five years.

6. Leases

The Company has existing agreements for the leasing of certain vehicles, coal rail cars and other equipment, buildings, and nuclear fuel. Lease charges were $75,398,000, $67,367,000, and $20,119,000 for the twelve months ended December 31, 1988, 1987, and 1986, respectively. Of such amounts, $74,431,000, $65,925,000, and $17,466,000, respectively, were charged to income.

Future minimum lease payments under noncancellable capital and operating leases (including amounts due under a new nuclear fuel lease as discussed below) for each of the next five years and in the aggregate at December 31, 1988, are estimated to be (in thousands):

1989	$ 60,237
1990	67,899
1991	59,743
1992	56,247
1993	39,589
Remaining years	176,812
	$460,527

At December 31, 1988, the Company had a nuclear fuel lease with a non-affiliated third party fuel corporation (the Lessor), which provides for the Lessor to finance nuclear fuel for future use at River Bend. During 1987, the Company and participating banks agreed to an amendment that reduced the banks commitment to the outstanding lease balance each time the Company makes a quarterly payment for nuclear fuel used and an amendment that the Company would pay $4,600,000 per month, in addition to the quarterly fuel use payments, to reduce the unpaid lease balance.

On February 7, 1989, the Company completed a new nuclear fuel financing agreement. The proceeds of $160,000,000 was used to retire the outstanding balance of the previous nuclear fuel lease and to reimburse the Company for nuclear fuel costs incurred during 1987 and 1988. The balance will be used to pay future nuclear fuel costs. The agreement calls for the Company to make quarterly payments for the cost of fuel consumed during the previous quarter, including capitalized interest, and additional payments, if necessary to pay costs related to the fuel or reduce related debt.

The Company is leasing the Lewis Creek generating station from its wholly-owned consolidated subsidiary, GSG&T.

7. Discontinued Nonutility Subsidiary Operations

Effective July 1, 1987, the Company sold the natural gas and oil reserves belonging to Prudential, a wholly-owned subsidiary, for approximately $23,000,000. Operating results related to the discontinued operations of Prudential, as shown below, are included in nonutility subsidiary operations in the Consolidated Financial Statements. Included in the loss on disposition is a pre-tax provision of $757,000 related to the costs of disposal of the oil and gas operations.

	1987	1986
	(in thousands except per share amounts)	
Operating income (loss) from discontinued operations before tax effect	$ 1,570	$ (35,844)
Income tax provision	—	8,953
Operating income (loss) from discontinued operations	1,570	(26,891)
Loss on disposition of oil and gas properties	(1,273)	—
Income tax provision	—	—
Net loss on disposition	(1,273)	—
Income (loss) from discontinued operations	$ 297	$ (26,891)
Loss per average common share outstanding from discontinued operations	$ —	$ (.26)

8. Jointly-Owned Facilities

As of December 31, 1988, the Company owned undivided interests in three jointly-owned electric generating facilities as detailed below (dollars in thousands):

	River Bend Unit 1	Roy S. Nelson Unit 6	Big Cajun #2 Unit 3
Company Share of Investments:			
Plant in service	$3,056,659	$404,831	$219,193
Accumulated depreciation	192,654	84,011	29,788
Total plant capability	936 MW	550 MW	540 MW
Fuel source	Nuclear	Coal	Coal
Ownership share	70%	70%	42%

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

9. Capital Stock and Retained Earnings

The Company offers its common, preference, and preferred shareholders the opportunity to reinvest their dividends and to make additional cash payments to acquire shares of the Company's common stock through its Dividend Reinvestment and Stock Purchase Plan (DRIP). (However, see Note 1 for information on the omission of common, preferred, and preference stock dividends during 1986, 1987, and 1988.) The Company also offers all employees meeting designated service requirements the option to participate in benefit plans which provide an opportunity to obtain common shares of the Company. At December 31, 1988, the Company had reserved 5,562,503 shares of common stock to be issued in connection with its DRIP and employee benefit plans. The Company currently intends that the DRIP and employee benefit plans purchase shares of common stock in the open market rather than offering unissued shares which would have a dilutive effect on earnings per share and book value.

At the Company's option, the Articles provide that all or part of its preferred and preference stock may be redeemed at stated prices. Certain issues are subject to restrictions in the Articles which prohibit redemption for a period of time, directly or indirectly out of the proceeds of or in anticipation of borrowings or issuance of additional stock of equal or prior rank having a lower interest cost or dividend rate. See additional restrictions under the $65,000,000 credit facility in Note 12.

At December 31, 1988, the Company had authorized 10,000,000 shares of preferred stock without par value (none issued) and authorized 6,000,000 shares of preferred stock $100 par value (4,617,568 issued). Limitations based on the ratio of after-tax earnings to fixed charges and preferred dividends are imposed by the Articles upon the issuance of additional preferred stock. Based upon the results of operations for the year ended December 31, 1988, and existing circumstances, the Company is unsure whether it is able to issue any additional preferred stock.

Certain limitations on the payment of cash dividends on common stock are contained in the Articles, indentures, and loan agreements. Under existing limitations, as discussed in Notes 1 and 12, the Company may not pay dividends on such stock. If such restrictions did not exist, the most restrictive limitation at December 31, 1988, as to the amount of such dividends which might be paid, was contained in the Trust Indenture. Based on such limitation, the retained earnings available for payment of dividends as of December 31, 1988, amounted to $714,523,000. Preferred and preference dividend requirements, as well as preferred stock sinking fund requirements, have priority over the payment of cash dividends on common stock.

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

10. Preferred Stock Subject to Mandatory Redemption

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

As discussed in Note 1, as of December 31, 1988, the Company has failed to satisfy $4,945,900 of preferred stock sinking fund requirements. See Note 1 for the consequences of such failure.

During 1986, the Company purchased in the open market, shares of the applicable series of preferred stock in excess of the amount needed to satisfy the 1986 sinking fund requirement. At December 31, 1988, assuming that the additional shares purchased during 1986 are used to satisfy future sinking fund requirements, minimum redemption requirements amount to $4,701,100, $7,679,700, $11,066,700, $14,816,700, and $14,816,700 during the years 1989 through 1993, respectively, exclusive of the $4,945,900 unsatisfied provision discussed above.

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

11. Long-Term Debt

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

	Sinking Fund Requirements Satisfied by		Long-Term Debt Maturities
	Cash	Property Additions	
1989	$27,320	$17,928	$113,503
1990	67,320	17,724	150,856
1991	48,570	17,724	263,949
1992	8,995	17,520	114,003
1993	425	17,520	8,580

The Company's Mortgage Indenture contains an interest coverage covenant which limits the amount of first mortgage bonds which the Company may issue. Based upon the results of operations for the twelve months ended December 31, 1988, and existing circumstances, the Company believes it has sufficient coverage to issue additional first mortgage bonds subject to the receipt of necessary legal opinions and consent of Irving Trust Company under the credit agreement described below.

Revolving Credit Agreement. At December 31, 1988, the amount outstanding under the Company's revolving credit agreement consisted of $200,000,000 bearing an interest rate of 10½ percent and $150,000,000 at 10⅛ percent. Amounts outstanding under the agreement are repayable over a three-year period with payments of $29,166,000 due on March 12, 1989 and September 12, 1989.

Deferred River Bend Construction and Continuing Services Commitments. Certain post-completion costs relating to the construction of River Bend remain unpaid to Stone & Webster Engineering Corporation, the general contractor for River Bend. As of December 31, 1988, the Company's share of such costs amounted to $41,724,000. The Company and CEPCO began making monthly installments of $2,000,000 on July 1, 1988, and will continue until the principal amount due and related accrued interest is paid. At current interest rates, these monthly payments would continue for approximately 31 months, through July, 1991. The Company and CEPCO own 70 percent and 30 percent of the unit, respectively.

An agreement was reached regarding the payment of costs relating to a continuing services agreement with Stone & Webster. Under the agreement, the Company's portion of the accumulated charges accrued at December 31, 1988, of $14,833,000, was paid in full on January 1, 1989.

American Municipal Bond Assurance Corporation (AMBAC). The Company has agreements with AMBAC which guarantee the payment of principal and interest on $65,735,000 of pollution control revenue bonds. Such agreements require the Company to make cash reserve deposits (or, alternatively, sign a promissory note for 200 percent of the cash reserve deposit then payable) upon the occurrence of a material development as defined in the agreements.

During January, 1988, the Company and AMBAC amended the original agreement. As part of the settlement, the Company agreed to deposit $12,000,000 in an escrow account which may be returned to the Company, based on the fixed charge coverage ratio at and subsequent to April, 1990, while AMBAC agreed to cancel notes totaling $110,000,000 and agreed that no further cash deposits would be required through April, 1990. During 1988 the Company executed an additional $49,934,000 of notes which are due in April 1990.

12. Notes Payable

As of December 31, 1988, the Company had agreements with banks and banking institutions which provided for short-term lines of credit totaling approximately $67,400,000 of which

$65,000,000 is collateralized as described below. There can be no assurance that the remaining unsecured sources of short-term funds may be accessed at this time, or will remain available, or that new sources can be arranged. Interest rates associated with these lines are based on the prime rate. Commitment fees on the collateralized line of credit range from ½ of 1 percent to ⅝ of 1 percent of the amount of available credit. In lieu of commitment fees on the uncollateralized lines, certain banks require a nonrestricted cash balance be maintained equal to 5 percent to 10 percent of the commitment.

Information regarding short-term debt outstanding is detailed below:

	1988	1987	1986
	(in thousands except percents)		
Maximum amount outstanding during period Bank notes	$ —	$ —	$9,000
Average daily amount outstanding Bank notes	—	—	37
Weighted average interest rate for amount outstanding at end of period Bank notes	—	—	—
Weighted average annual interest rate(a) Bank notes	—	—	7.87%

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

Included in the total short-term lines of credit is a $65,000,000 credit facility to be terminated and paid on or before March 1, 1989. The facility is fully underwritten by Irving Trust Company and is collateralized by a pledge of the Company's accounts receivable and the Lewis Creek Generating Station (the Station), a 530 megawatt gas-fired generating facility. The Station is owned by GSG&T, a wholly-owned subsidiary. The Company is leasing the Station from the subsidiary and will continue to operate the Station. The credit agreement contains negative covenants which, among other restrictions, restrict the incurrence of additional debt, creation of liens, payment of dividends, purchase of stock to satisfy sinking fund requirements, sale of assets, and acquisition of assets. The Company is presently negotiating the extension or replacement of this facility which will result in continuation of such covenants or similar ones.

13. Purchase Power Agreements

The Company has agreements with the participants in Nelson Unit 6 and River Bend (see Note 8) to buy back declining amounts of their share of the capacity of these units for periods ranging from seven to fourteen years in the case of Nelson Unit 6 and five years in the case of River Bend. The variable costs associated with such buybacks are composed of fuel costs and operations and maintenance expenses, while the fixed costs are based upon gross plant investment and other factors.

Nelson Unit 6. For the twelve months ended December 31, 1988, 1987, and 1986, variable costs applicable to the Nelson Unit 6 buybacks were $13,285,000, $12,829,000, and $16,441,000, respectively, while the fixed costs associated with such buybacks were $16,542,000, $17,945,000, and $20,892,000, respectively. Based upon current information, the Company estimates that the annual fixed costs incurred in connection with the Nelson Unit 6 buybacks will range in declining amounts from $11,860,000 in 1989 to $5,208,000 in 1993. From 1994 through 1996, aggregate fixed cost payments for the buybacks of power of such unit are estimated to be approximately $9,061,000.

River Bend. The Company and CEPCO have a five year agreement which began on June 16, 1986, whereby the Company will buyback power from CEPCO for declining amounts of CEPCO's share of River Bend. The fixed costs incurred in connection with the buybacks were $100,688,000, $150,382,000, and $92,494,000 for the twelve months ended December 31, 1988, 1987, and 1986, respectively, and will amount to $70,155,000 in 1989, $46,117,000 in 1990, and $17,145,000 in 1991. For the twelve months ended December 31, 1988, 1987, and 1986, variable costs applicable to the River Bend buyback were $34,233,000, $49,658,000, and $14,892,000, respectively.

Southern Company. As discussed in Note 1, the Company entered into contracts, some of which it asserts are terminated and on which it is currently withholding payment, with the Southern Company providing for power purchases by the Company. The fixed costs applicable to the power purchases from the Southern Company are based on costs of existing and future generating units and other factors. For the twelve months ended December 31, 1988, 1987, and 1986, the fixed costs associated with the power purchases totaled $11,996,000, $19,442,000, and $112,593,000, respectively. Under the terms of the contract, if determined to still be effective, the Company would be required to make, on a take-or-pay basis, annual payments for fixed costs currently estimated to range in amounts from approximately $167,000,000 to approximately $82,000,000 during the period from 1989 through 1992. The variable costs associated with such purchases are composed of fuel costs and operations and maintenance expenses. For the twelve months ended December 31, 1988, 1987, and 1986, such variable costs totaled $17,594,000, $60,337,000, and $58,597,000, respectively.

14. Joint Venture

The Company entered into a joint venture with Conoco, Inc., Citgo Petroleum Corporation, and Vista Chemical Company (the participants) whereby the Company's Nelson Units 1 and 2 (100 MW each) were sold to a partnership consisting of the participants and the Company.

On September 1, 1988, the Company recorded the sale of the units by recording a $48,490,000 receivable, the present value of 240 monthly payments of $529,000 to be made by the participants in payment for the units. The gain of $47,020,000 on the sale is being amortized over 20 years, the primary term of the joint venture.

The participants will supply the fuel for the units, while the Company will operate the units and purchase the electricity produced by the units. The Company will continue to sell electricity to the participants.

15. Subsequent Events

On February 28, 1989, the LPSC authorized an immediate $38,000,000 rate increase as the second step in the Company's court-ordered phase-in plan. The LPSC order, among other things, modified certain aspects of earlier decisions by reversing the prior denial of recovery of the Company's investment in the canceled River Bend Unit 2, reduced the appropriate level of return on common equity from the 14 percent ordered by the court to 13 percent, and made other adjustments. The Company is in the process of evaluating the LPSC order which may result in the appeal of certain aspects of the order. As discussed in Note 3, the court-ordered phase-in plan provides for additional increases in future years, which are subject to LPSC review.

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

1988	Operating Revenue	Operating Income	Income from Continuing Operations Before the Cumulative Effect of Accounting Change	Net Income	Earnings Per Average Share of Common Stock Outstanding from Continuing Operations Before the Cumulative Effect of Accounting Change	Earnings Per Average Share of Common Stock Outstanding
First Quarter	**$353,857**	**$102,081**	**$22,819**	**$ 8,450**	**$ .06**	**$ (.07)**
Second Quarter	**362,610**	**116,265**	**30,082**	**30,082**	**.14**	**.14**
Third Quarter	**437,183**	**138,649**	**57,005**	**57,005**	**.38**	**.38**
Fourth Quarter	**366,827**	**75,861**	**7,606**	**7,606**	**(.08)**	**(.08)**
1987						
First Quarter	$302,835	$ 53,607	$40,787	$41,110	$ .23	$ .23
Second Quarter	364,114	100,633	62,630	61,524	.43	.43
Third Quarter	429,387	134,119	89,961	90,260	.69	.69
Fourth Quarter	336,250	88,261	47,426	48,207	.30	.30

Financial Information

Report of Independent Accountants

To the Shareholders of Gulf States Utilities Company:

We have audited the accompanying consolidated balance sheets of Gulf States Utilities Company and subsidiaries as of December 31, 1988 and 1987, and the related consolidated statements of income, cash flows and changes in capital stock and retained earnings for each of the three years in the period ended December 31, 1988. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Gulf States Utilities Company and subsidiaries as of December 31, 1988 and 1987, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1988, in conformity with generally accepted accounting principles.

As of December 31, 1988 and 1987, the Company has capitalized approximately $3 billion of construction costs related to its River Bend Nuclear Generating Plant and has capitalized, in accordance with regulatory orders, $997 million and $808 million respectively, of deferred charges representing plant operating and carrying costs incurred subsequent to commercial operation. Without regulatory orders prescribing the deferral and capitalization of such charges, net income for 1988, 1987 and 1986 would have been reduced by $128 million ($1.19 per share), $390 million ($3.61 per share) and $234 million ($2.20 per share), respectively. During 1986, the Company filed requests with regulatory commissions in Texas and Louisiana requesting rate increases for recovery of River Bend construction costs and deferred charges and subsequently was granted increases covering a portion of such costs. As discussed in Note 3, if current regulatory orders are not modified a significant write-off of capitalized costs associated with River Bend may be required, however the extent of such write-offs, if any, will not be determinable until appropriate rate proceedings, including court appeals, have been concluded. Management can provide no assurance that the Company will ultimately earn a return on or fully recover its investment in River Bend.

As discussed in Notes 1 and 3, the Company is involved in legal proceedings relating to contractual disputes and rate issues. The ultimate outcome of the proceedings cannot presently be determined. Accordingly, no provision for any liability that may result from the resolution of the proceedings has been made in the accompanying consolidated financial statements.

As discussed in Notes 1 and 3, significant legal proceedings, rate issues and operational contingencies exist which raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements have been prepared assuming that the Company will continue as a going concern and do not include any adjustments that might result from the outcome of these uncertainties.

As discussed in Note 3, in accordance with recently issued statements of the Financial Accounting Standards Board, during 1988 the Company changed its method of accounting for plant abandonments and equity carrying charges.

Coopers & Lybrand

Houston, Texas
February 28, 1989

Statistical Summary
For the years ended December 31

	1988	1987	1986	1985	1984
ELECTRIC DEPARTMENT					
Number of customers at year end:					
Residential	**486,993**	484,838	484,608	485,825	485,711
Commercial	**61,958**	61,861	62,059	61,712	60,372
Industrial	**4,563**	4,319	4,322	4,398	4,302
Temporary construction	**1,477**	1,442	1,656	2,188	2,924
Other	**2,585**	2,445	2,430	2,333	2,182
Total Customers	**557,576**	554,905	555,075	556,456	555,491
Sales — Kilowatt-hours (thousands):					
Residential	**6,326,089**	6,208,961	6,174,567	6,224,555	6,209,347
Commercial	**5,023,755**	4,911,378	4,920,882	4,964,416	4,745,055
Industrial	**12,072,078**	11,811,676	12,158,762*	13,590,004	15,924,402
Temporary construction	**13,133**	16,241	42,498	47,475	57,354
Other	**1,482,652**	1,485,242	1,508,245	1,890,700	2,152,052
Total Sales	**24,917,707**	24,433,498	24,804,954	26,717,150	29,088,210
Revenue — (thousands):					
Residential	**$ 452,538**	$ 430,392	$ 425,206	$ 528,593	$ 434,946
Commercial	**331,178**	312,544	309,440	358,882	278,155
Industrial	**510,354**	476,871	500,026*	680,755	573,839
Temporary construction	**1,130**	1,364	3,066	3,666	3,702
Other	**120,513**	108,935	120,690	142,509	120,059
Total Revenue	**$1,415,713**	$1,330,106	$1,358,428	$1,714,405	$1,410,701
Average Annual KWH Use Per Customer:					
Residential	**13,029**	12,818	12,731	12,806	12,901
Commercial	**81,339**	79,180	79,416	80,951	80,264
Industrial	**2,717,101**	2,744,986	2,781,053	3,110,553	3,725,006
Revenue Per KWH — (cents):					
Residential	**7.15**	6.93	6.89	8.49	7.01
Commercial	**6.59**	6.36	6.29	7.23	5.86
Industrial	**4.23**	4.04	4.11	5.01	3.60
Electric Energy Output — Thousands of KWH:					
Net Generated	**25,146,780**	23,421,700	23,009,283	19,286,014	26,218,067
Net Purchased and Interchanged	**3,570,812**	4,593,232	5,281,404	11,340,923	6,953,777
	28,717,592	28,014,932	28,290,687	30,626,937	33,171,844
System Peak Load — Including Interruptible Load — Megawatts	**4,910**	4,991	5,089	5,139	5,475
Total Capability, Including Contract Purchases at Time of System Peak Load (MW)	**6,805**	6,871	7,548	6,610	6,780
Load Factor	**66.6%**	64.1%	63.5%	68.0%	69.0%
STEAM PRODUCTS DEPARTMENT					
Steam Revenue (thousands)	**$ 70,728**	$ 69,056	$ 77,783	$ 102,576	$ 83,165
Steam Sales — KWH (millions)	**2,279**	2,187	2,144	2,288	2,606
Steam Sales — millions of pounds	**10,494**	8,593	7,516	7,695	8,466
GAS DEPARTMENT					
Gas Revenue (thousands)	**$ 34,056**	$ 33,424	$ 33,125	$ 41,455	$ 53,175
Number of Customers at year end	**82,510**	83,003	83,994	85,039	85,665
Output — MM cu. ft. of natural gas purchased	**7,320**	7,305	7,086	8,454	8,252
Sales — MM cu. ft.	**7,134**	7,489	7,065	7,946	9,140
WEATHER DATA					
Cooling degree days (Normal 2,696)	**2,716****	2,660	2,935	2,877	2,654
Percentage change from normal	**.7**	(1.3)	8.9	6.7	(1.6)
Heating degree days (Normal 1,830)	**1,771****	1,892	1,636	1,565	2,062
Percentage change from normal	**(3.2)**	3.4	(10.6)	(14.5)	12.7

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

** Estimated.

Officers

Chairman, President and CEO

E. Linn Draper Jr. (9) 46
Chairman of the Board, President and Chief Executive Officer

Special Advisor to the Chairman

Paul W. Murrill (6) 54
Special Advisor to the Chairman

Senior Executive Vice Presidents

Joseph L. Donnelly (9) 59
Senior Executive Vice President and Chief Financial Officer

Edward M. Loggins (30) 58
Senior Executive Vice President

Senior Vice Presidents

James C. Deddens (5) 60
Senior Vice President-River Bend Nuclear Group

Calvin J. Hebert (26) 54
Senior Vice President-External Affairs

Vice Presidents

Janes R. Aldridge (8) 58
Vice President-Human Resources

William E. Barksdale (31) 57
Vice President-Engineering and Technical Services

Amery J. Champagne (15) 45
Vice President-Energy Resources

Anthony F. Gabrielle (8) 61
Vice President-Computer Applications

Charles D. Glass (39) 60
Vice President-Operations

William J. Jefferson (8) 59
Vice President-Rates and Regulatory Affairs

Cecil L. Johnson (12) 46
Vice President-Legal Services

James E. Moss (30) 52
Vice President-Marketing

Jack L. Schenck (7) 50
Vice President & Treasurer

Bobby J. Willis (26) 52
Vice President & Controller

Jasper F. Worthy (32) 59
Vice President-General Services

Division Vice Presidents

John W. Conley (30) 57
Division Vice President-Western

Arden D. Loughmiller (27) 50
Division Vice President-Beaumont

Ronald M. McKenzie (22) 48
Division Vice President-Port Arthur

J. Ted Meinscher (38) 56
Division Vice President-Lake Charles

James D. Watkins (30) 57
Division Vice President-Baton Rouge

Other Officers

Leslie D. Cobb (33) 53
Secretary

Clyde W. McBride (11) 36
Assistant Treasurer

Timothy L. Morris (9) 37
Assistant Secretary

( ) Years of service
Ages and years of service as of December 31, 1988

Directors

Directors

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

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

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

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

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

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

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

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

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

Eugene H. Owen
Chief Executive Officer
Owen & White, Inc.
Baton Rouge, LA (1989)

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

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

Sam F. Segnar
Chairman of the Board
Collecting Bank, N.A.
Houston, TX (1988)

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

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

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

Principal Offices

350 Pine Street
Beaumont, Texas
77701

Divisions

285 Liberty Avenue
Beaumont, Texas
77701

1540 Ninth Avenue
Port Arthur, Texas
77640

Highway 75 North
Conroe, Texas
77301

446 North Boulevard
Baton Rouge, Louisiana
70802

314 Broad Street
Lake Charles, Louisana
70601

Stockholder Information

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

Stock Transfer Agents
Gulf States Utilities Company
Beaumont, Texas

Morgan Shareholder Services
Trust Company
New York, New York

Registrars
First City National Bank of
Beaumont
Beaumont, Texas

Morgan Shareholder Services
Trust Company
New York, New York

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

Form 10-K

The Form 10-K Annual Report to the Securities and Exchange Commission and GSU's 1988 Financial and Statistical Report can be obtained without charge from Leslie D. Cobb, Secretary P.O. Box 2951, Beaumont, Texas 77704.

Notice of Annual Meeting

The 1989 Annual Meeting of shareholders will be held at 2 p.m., Thursday, May 4, 1989, in the company's headquarters, 350 Pine Street, Beaumont, Texas. Formal notices of the meeting, proxy statements and proxies will be mailed to the common shareholders on or about March 14, 1989. Shareholders are invited to attend, but if they cannot, they are urged to fill out and return their proxies.

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

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