



*50
Years
of
Service*

1999 ANNUAL REPORT

Key Information

	1999	1998	% Change
Financial <i>(thousands of dollars)</i>			
Total operating revenues	\$4,084,186	\$3,992,420	2.3
Net loss	\$(35,088)	\$(157,380)	(77.7)
Earnings before interest, taxes, depreciation and amortization (EBITDA)	\$1,259,500	\$990,500	27.2
Total assets	\$12,670,435	\$13,861,187	(8.6)
Capital expenditures	\$298,081	\$392,200	(24.0)
Per Share			
Basic and diluted loss	\$(0.19)	\$(0.95)	(80.0)
Book value at year-end	\$16.78	\$16.92	(0.8)
Market price at year-end	\$13 15/16	\$16 1/8	(13.6)
Common shares at year-end	177,364,863	187,364,863	(5.3)
Regulated Electric Sales <i>(millions of KWh)</i>			
Public kilowatt-hour sales.....	33,756	32,855	2.7
Total kilowatt-hour sales.....	35,422	36,432	(2.8)
Electric customers at year-end	1,550,000	1,555,000	(0.3)
Regulated Gas Sales <i>(thousands of dekatherms)</i>			
Natural gas sales	68,582	65,025	5.5
Natural gas transported	137,240	127,850	7.3
Gas customers at year-end.....	542,000	536,000	1.1

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On the Cover

The background graphic is a small portion of a diagram depicting the convergence of more than 500 companies into Niagara Mohawk Power Corporation, formally chartered on January 5, 1950.

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To Our Shareholders

In 1999 we continued to make significant progress in fulfilling the conditions of our PowerChoice regulatory agreement and in improving our financial stability. During the year we completed the formation of the holding company, sold our hydroelectric and most of our fossil-fueled generating stations, reached agreements to sell our nuclear plants and the Albany steam station, considerably improved cash flow, successfully retired more than \$1 billion in debt, and bought back 10 million shares of our common stock. Additionally, by August 1999, all of our customers were eligible to choose their electricity supplier, and in September 1999, customers received a second consecutive annual electricity price decrease.

Consistent with our strategy to focus on the regulated energy delivery business, we completed an internal reorganization designed to enhance Niagara Mohawk's ability to provide low-cost, high-quality customer services. A new Customer Service System was introduced early in 1999. The new system was necessary so that we could unbundle our costs to enable customers to make informed decisions in the new competitive environment. Despite some significant start-up problems, we are confident of the value of the system and are confident it will help us compete in the years ahead.

Also in 1999, we continued to strengthen our senior leadership capabilities with John H. Dalton's election to our Board of Directors. Mr. Dalton served as the 70th Secretary of the Navy from July 1993 to November 1998. Previously, Mr. Dalton served as chairman of the Federal Home Loan Bank Board and President of the Government National Mortgage Association.

Generation Asset Sales

Furthering our transition to an energy delivery company, we made significant progress in our plan to divest our generating assets in 1999. We completed the sales of our hydroelectric facilities to Orion Power Holdings, and the sale of our Oswego steam station and the Huntley and Dunkirk coal plants to NRG Energy. The combined proceeds from these transactions were \$860 million.

We announced an agreement, expected to be completed in early 2000, to sell our Albany oil- and gas-fired electric generating station to PSEG

Power for \$47.5 million. We also reached an agreement with Central Hudson Gas & Electric to sell our share of the Roseton Station, an oil/gas generating facility. When these transactions are completed, we will have successfully divested all of our non-nuclear generating assets.

We also announced an agreement to sell our nuclear plants — Nine Mile Point Unit One and our 41 percent share of Nine Mile Point Unit Two — to AmerGen Energy Co. In December, Rochester Gas and Electric, a 14 percent co-owner of Unit Two, announced it was exercising its right of first refusal with respect to the nuclear sale, and that it would match the AmerGen offer. The staff of the New York State Public Service Commission has indicated that the terms of the proposed sale to AmerGen are not consistent with the public interest standard in Public Service Law. The PSC staff is continuing discussions with AmerGen, as well as exploring other options, including giving other interested parties the opportunity to put forth competing proposals. Although we are unable to determine the outcome of this matter at this time, we will continue to pursue the sale of our nuclear plants in a manner that serves the interests of both our customers and our shareholders.

Financial Restructuring

In 1999 we completed the first full year of PowerChoice, our five-year regulatory agreement, and the Master Restructuring Agreement, the agreement that substantially resolved our high-priced independent power producer contracts. As a result, we saw our cash flow improve significantly. Consistent with our plan to create shareholder value, the additional cash flow, combined with \$135 million in Federal income tax refunds and the proceeds from the sale of our generation assets, allowed us to retire more than \$1.1 billion in debt last year. This reduces our annual interest costs by about \$85 million.

To further strengthen our capital structure and rebuild shareholder value, the Board of Directors approved a program to repurchase 20 million shares of our common stock by the end of 2001. By the end of 1999, we had repurchased 10 million shares. In addition, 5 million shares were purchased by an intermediary on behalf of the company. We can repurchase the 5 million shares from the intermediary by September 2000. We plan to continue our common stock buyback program in 2000.

Financial Performance

Credit rating agencies reacted favorably to the year's accomplishments. Following our announcement that we had reached an agreement to sell our ownership interest in the Nine Mile Point nuclear station, Standard & Poor's and Moody's Investors Service raised their ratings on Niagara Mohawk's debt instruments. Standard & Poor's now rates the company's first mortgage bonds 'BBB+', and continues to carry a positive outlook on the company. Moody's raised their rating on the company's first mortgage bonds to 'Baa2'.

However, our common stock price fell to \$13-15/16 at year-end, as electric utility stocks were reported to post their worst performance since 1975. Our stock was down 13.6 percent for the year, compared to a 19.4 percent decrease in the Standard & Poor's Electric Companies Index, and a 17.7 percent decrease in the Philadelphia Stock Exchange Utility Index. Although obviously disappointed, I believe the achievements we made in 1999 helped our stock outperform most other electric utility stocks for the year.

Customer Choice, Rate Reductions

As provided in our PowerChoice agreement, all Niagara Mohawk electric-ity customers became eligible for retail choice in 1999. Residential customers were able to choose their electricity suppliers in April, groups of large commercial and industrial customers became eligible for choice in May, and small commercial customers received the option in August. To help customers compare their costs for electricity and related services among a variety of suppliers, our bills were "unbundled" or itemized. Beginning in November, gas customers also saw itemized bills.

1999 Results

In 1999, Niagara Mohawk Holdings continued to improve its financial stability. Last year marked the first full year of the Master Restructuring Agreement and PowerChoice. Although earnings were depressed as a result of the non-cash charges related to the MRA, the company's cash flow improved significantly in 1999. Earnings before interest, taxes, depreciation and amortization (EBITDA) for the year ended December 31, 1999, were \$1.26 billion, an increase of approximately \$270 million compared to the year ended December 31, 1998. The improvement in EBITDA is due primarily to a reduction in payments to IPPs.

The company reported a 1999 loss of \$35.1 million, or a loss of 19 cents per share, which includes a 13 cent per share extraordinary charge related to the early retirement of debt, compared to a 1998 loss of \$157.4 million, or a loss of 95 cents per share. Niagara Mohawk's lower purchased power costs, partially offset by increased interest charges, improved earnings by \$108.0 million, or 58 cents per share, for the year ended December 31, 1999. This improvement was offset by the incremental non-cash amortization of the MRA regulatory asset of \$167.5 million, or 90 cents per share.

Additionally, earnings in 1999 were reduced by \$23.8 million, or 13 cents per share, because of costs related to the implementation of a new customer service system, and by \$21.0 million, or 11 cents per share, because of higher bad debt expense. In 1998 the company recorded a one-time, non-cash charge to earnings of \$171.1 million, or \$1.03 per share related to the MRA and PowerChoice. Earnings in 1998 were also reduced by the incremental costs of two storms that together, lowered earnings by approximately \$50.6 million, or 30 cents per share.

Also as a part of the PowerChoice agreement, and part of our overall plan to increase our competitiveness, we reduced electricity prices for the second consecutive year in 1999. Combined with earlier price decreases, the new reductions, effective September 1, provided customers with more than \$370 million in cumulative savings. A third electricity price reduction is slated for September 2000. Natural gas customers began seeing bill reductions of 1 to 3 percent beginning November 1 as part of an interim agreement with the PSC. As a result, our electricity and natural gas prices now rank among the lowest of any major utility in the state.

Nuclear Operations

Although our Nine Mile Point nuclear plants completed another safe year of operation, performance fell somewhat below expectations in 1999. Nine Mile Point Unit One, in a refueling year, finished the year with a 67.0 percent capacity factor. Unit Two achieved a capacity factor of 86.8 percent.

While we have announced an agreement to sell the plants, subject to approval by the PSC, we must and we will strengthen our efforts to improve performance just as we would if we were planning to continue owning them. A comprehensive program to enhance performance is well under way in addressing effectiveness issues, and a number of major improvements have already been implemented.

On a commemorative note, we marked the 30th anniversary of Nine Mile Point Unit One early in 2000.

Economic and Community Development Efforts

Niagara Mohawk's economic development efforts in 1999 were instrumental in the creation of more than 2,700 new jobs and in attracting some \$313 million in new capital investment to our service territory.

We also increased our focus on community development efforts across the 24,000 square miles we serve. Among our successes was the launching of the daVinci of Upstate New York web site, which is helping to keep technical and engineering jobs in Central New York, and the Digital Towpath program, which is getting upstate New York wired and ready to participate in the e-commerce revolution. We also began promoting the positive impacts of community lighting, focusing on

City Hall and our art deco headquarters in Syracuse. We are working with local officials across our service territory in helping to revitalize communities in numerous other ways.

Unregulated Businesses

We have organized all of our unregulated businesses under our wholly owned subsidiary, Opinac NA. Niagara Mohawk Energy, which focuses primarily on energy marketing and energy services, finished the year 1999 with its first profit. We expect continued growth at Niagara Mohawk Energy as the company works to become one of the leading energy marketers in the Northeast. Niagara Mohawk Energy is also pursuing growth opportunities in the energy services business, and is exploring strategic opportunities in emerging distributed generation markets.

In 1999, Opinac NA increased its investment in Telergy, a regional facilities-based telecommunications company. Telergy's sales grew in 1999 as the company continued to expand its fiber-optic network. Opinac NA also owns 50 percent of Canadian Niagara Power, an investor-owned electric utility based in Ontario. Canadian Niagara Power provides us an opportunity to further expand our distribution and generation businesses in Canada.

50 Years of Customer Service

The year 2000 marks the 50th anniversary of Niagara Mohawk. As we celebrate this significant milestone, I am once again reminded that any organization is only as good as its people. We are indeed fortunate to have so many outstanding people who have given and continue to give so much of themselves for our company. We've seen many changes in the energy industry over the past 50 years, and we expect to see many more in the next few years as our company and this industry continue to respond to competitive challenges. You have our commitment that we will continue our efforts to grow the value of your investment. Thank you for your continued support.



William E. Davis
Chairman of the Board and
Chief Executive Officer
Niagara Mohawk Holdings, Inc.
Niagara Mohawk Power Corporation

Market Price of Common Stock and Related Stockholder Matters

Holding Company Formation. On March 18, 1999, Niagara Mohawk Power Corporation ("Niagara Mohawk") was reorganized into a holding company structure in accordance with its Agreement and Plan of Exchange between Niagara Mohawk and Niagara Mohawk Holdings, Inc. ("Holdings"). Niagara Mohawk's outstanding common stock was exchanged on a share-for-share basis for Holdings' common stock. Niagara Mohawk's preferred stock and debt were not exchanged as part of the share exchange and continue as shares and debt of Niagara Mohawk.

Holdings Common Stock. Holdings is authorized to issue 300 million shares of common stock. Holdings' common stock (par value \$0.01) and certain of Niagara Mohawk's preferred series are listed on the New York Stock Exchange ("NYSE"). Holdings' common stock is also traded on the Boston, Cincinnati, Midwest, Pacific and Philadelphia stock exchanges. Holdings' common stock options are traded on the American Stock Exchange. The ticker symbol is "NMK."

Holdings' common stock has been traded on the NYSE since March 19, 1999. Prior to that date, the market prices on the table below refer to Niagara Mohawk's common stock.

	1999		1998	
	High	Low	High	Low
1st Quarter	\$16 ⁷ / ₁₆	\$13 ¹ / ₁₆	\$13 ⁹ / ₁₆	\$10 ¹ / ₈
2nd Quarter	16 ¹ / ₁₆	13 ¹ / ₈	15 ¹ / ₄	11
3rd Quarter	16 ¹ / ₈	14 ⁵ / ₈	16 ³ / ₈	14 ³ / ₄
4th Quarter	16 ³ / ₁₆	13 ¹³ / ₁₆	16 ¹ / ₂	13 ¹⁵ / ₁₆

For a discussion regarding Holdings and Niagara Mohawk's common stock dividend, see Management's Discussion and Analysis of Financial Condition and Results of Operations - Financial Position, Liquidity and Capital Resources - Common Stock Dividend below.

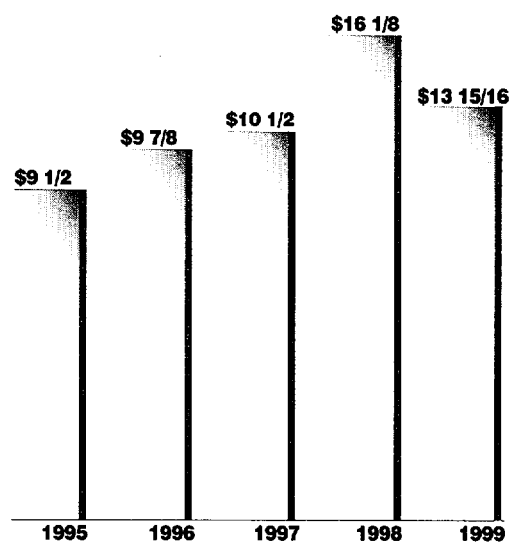
The holders of Holdings' common stock are entitled to one vote per share and may not cumulate their votes for the election of Directors. Upon any dissolution, liquidation or winding up of Holdings' business, the holders of common stock are entitled to receive a pro rata share of all of Holdings' assets remaining and available for distribution after the full amounts to which holders (if any) of Holdings' preferred stock are entitled have been satisfied.

After the closing of the MRA (see Management's Discussion and Analysis of Financial Condition and Results of Operations - PowerChoice and the Restructuring of the Regulated Electric Utility Business - The MRA Agreement), IPP Parties and their designees owned approximately 20.5 million shares of Niagara

Mohawk's common stock, representing approximately 11% of Niagara Mohawk's voting securities. These shares were also exchanged on March 18, 1999 on a share-for-share basis for Holdings' common stock. Pursuant to the MRA, any IPP Party that received 2% or more of the outstanding common stock and any designee of IPP Parties that received more than 4.9% of the outstanding common stock upon the consummation of the MRA, together with certain but not all affiliates (collectively, "2% Shareholders"), entered into certain shareholder agreements (the "Shareholders Agreements"). Pursuant to each Shareholder Agreement, the 2% Shareholders agree that for five years from the consummation of the MRA, they will not acquire more than an additional 5% of the outstanding common stock (resulting in ownership in all cases of no more than 9.9%) or take any actions to attempt to acquire control of Holdings, other than certain permitted actions in response to unsolicited actions by third parties. The 2% Shareholders generally vote their shares on a "pass-through" basis, in the same proportion as all shares held by other shareholders are voted, except that they may vote in their discretion (i) for extraordinary transactions and (ii) for directors when there is a pending proposal to acquire Holdings.

In 1999, the PSC approved Niagara Mohawk's petition to purchase up to \$800 million of Holdings' common stock. Holdings and Niagara Mohawk's Board of Directors have approved a program to repurchase 20

YEAR END PRICE OF COMMON STOCK



Note: Prior year values are Niagara Mohawk's

million shares through December 31, 2001. See Financial Statements and Supplementary Data, Note 5. – Capitalization, for a further discussion of the shares repurchased.

As of January 1, 2000, there were approximately 53,600 holders of record of common stock of Holdings and about 2,900 holders of record of Niagara Mohawk's preferred stock. The chart below summarizes common stockholder ownership by size of holding:

Size of Holding (Shares)	Total Stockholders	Total Shares Held
1 to 99	27,710	699,760
100 to 999	23,736	5,634,474
1,000 or more	2,157	171,030,629
	53,603	177,364,863

Holdings Preferred Stock. Holdings is authorized to issue 50 million shares of preferred stock with a par value of \$0.01. No preferred stock had been issued as of December 31, 1999.

Niagara Mohawk Common Stock. Niagara Mohawk is authorized to issue 250 million shares of common stock with a par value of \$1.00. As of December 31, 1999, Niagara Mohawk has 187,364,863 shares outstanding, which are all held by Holdings and are not traded.

The indenture securing Niagara Mohawk's mortgage debt provides that retained earnings shall be reserved and held unavailable for the payment of dividends on common stock to the extent that expenditures for maintenance and repairs plus provisions for depreciation do not exceed 2.25% of depreciable property as defined therein. Such provisions have never resulted in a restriction of Niagara Mohawk's retained earnings.

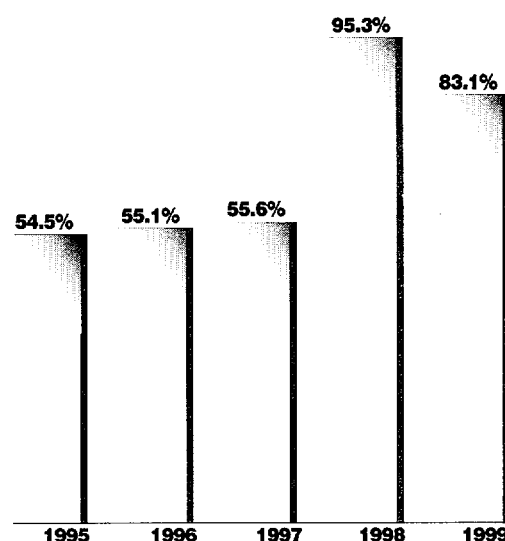
Niagara Mohawk Preferred Stock. The share exchange and the formation of the holding company structure did not change the rights of holders of the outstanding shares of Niagara Mohawk's preferred stock. Niagara Mohawk's preferred stock continues to rank senior to Niagara Mohawk's common stock (which are held by Holdings) as to dividends and as to distribution of Niagara Mohawk's assets upon any liquidation.

Whenever dividends on Niagara Mohawk's preferred stock are in default in an amount equivalent to four full quarterly dividends and thereafter until all dividends thereon are paid or declared and set aside for payment, the holders of such preferred stock can elect a majority of the Board of Directors of Niagara Mohawk. Whenever dividends on any preference stock are in default in an amount equivalent to six full quarterly dividends and thereafter until all dividends thereon are paid or declared and set aside for payment, the holders of such stock can elect two members to the Board of Directors of

Niagara Mohawk. No dividends on preferred stock are now in arrears and no preference stock is now outstanding.

Niagara Mohawk paid preferred dividends on March 31, June 30, September 30, and December 31. Niagara

MARKET TO BOOK RATIO



Note: Prior year ratios are Niagara Mohawk's

Mohawk estimates that none of the 1999 preferred stock dividends will constitute a return of capital, and therefore, all of such dividends are subject to federal tax as ordinary income.

Selected Consolidated Financial Data

The following table sets forth selected financial information of Holdings for 1999 and for Niagara Mohawk (Holdings' predecessor) for each of the five years during the period ended December 31, 1999, which has been derived from the audited financial statements of Holdings and Niagara Mohawk, and should be read in connection therewith. As discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations and Financial Statements and Supplementary Data – Notes to Consolidated Financial Statements, the following selected financial data is not likely to be indicative of Holdings' or Niagara Mohawk's future financial condition, results of operations or cash flows.

Selected Consolidated Financial Data

	Holdings 1999**		Niagara Mohawk			
		1999**	1998	1997	1996*	1995
Operations: (000's)						
Operating revenues	\$ 4,084,186	\$ 3,827,340	\$ 3,826,373	\$ 3,966,404	\$ 3,990,653	\$ 3,917,338
Net income (loss)	(35,088)	(2,061)	(120,825)	183,335	110,390	248,036
Common stock data:						
Book value per share at year end	\$ 16.78	***	\$ 16.92	\$ 18.89	\$ 17.91	\$ 17.42
Market price at year end	13 ¹⁵ / ₁₆	***	16 ¹ / ₈	10 ¹ / ₂	9 ¹ / ₈	9 ¹ / ₂
Ratio of market price to book value at year end	83.1%	***	95.3%	55.6%	55.1%	54.5%
Basic and diluted earnings (loss) per average common share	(\$0.19)	***	(\$0.95)	\$1.01	\$0.50	\$1.44
Rate of return on common equity	(1.1)%	***	(5.3)%	5.5%	2.8%	8.4%
Dividends paid per common share	—	***	—	—	—	\$1.12
Capitalization: (000's)						
Common equity	\$ 2,976,089	\$ 2,785,171	\$ 3,170,142	\$ 2,727,527	\$ 2,585,572	\$ 2,513,952
Non-redeemable preferred stock	440,000	440,000	440,000	440,000	440,000	440,000
Mandatorily redeemable preferred stock	61,370	61,370	68,990	76,610	86,730	96,850
Long-term debt	5,042,588	5,042,588	6,417,225	3,417,381	3,477,879	3,582,414
Total	8,520,047	8,329,129	10,096,357	6,661,518	6,590,181	6,633,216
Long-term debt maturing within one year	613,740	613,740	312,240	67,095	48,084	65,064
Total	\$ 9,133,787	\$ 8,942,869	\$10,408,597	\$ 6,728,613	\$ 6,638,265	\$ 6,698,280
Capitalization ratios: <i>(including long-term debt maturing within one year)</i>						
Common stock equity	32.6%	31.1%	30.5%	40.5%	39.0%	37.5%
Preferred stock	5.5	5.6	4.9	7.7	7.9	8.0
Long-term debt	61.9	63.3	64.6	51.8	53.1	54.5
Financial ratios:						
EBITDA, as defined (000's)	\$ 1,259,500	\$ 1,262,500	\$ 990,500	\$ 961,500	\$ 957,500	\$ 929,100
Net cash interest, as defined (000's)	\$ 397,100	\$ 404,700	\$ 345,500	\$ 226,900	\$ 244,500	\$ 260,500
Ratio of EBITDA to net cash interest	3.2	3.1	2.9	4.2	3.9	3.6
Ratio of earnings to fixed charges	0.95	1.01	0.57	2.02	1.57	2.29
Ratio of earnings to fixed charges and preferred stock dividends	N/A	0.94	0.52	1.67	1.31	1.90
Other ratios (% of operating revenues):						
Fuel, electricity purchased and gas purchased	36.7%	33.0%	39.6%	44.4%	43.5%	40.3%
Other operation and maintenance expenses	22.3	23.2	24.5	21.1	23.3	20.9
Depreciation and amortization	8.5	9.0	9.3	8.6	8.3	8.1
Amortization of the MRA regulatory asset	9.5	10.1	3.4	—	—	—
Federal and foreign income taxes, and other taxes	10.6	11.3	10.3	15.1	13.6	17.3
Operating income	12.9	13.9	4.4	14.1	13.1	17.5
Balance available for common stock	(0.9)	***	(4.1)	3.7	1.8	5.3
Miscellaneous: (000's)						
Gross additions to utility plant	\$ 298,081	\$ 298,081	\$ 392,200	\$ 290,757	\$ 352,049	\$ 345,804
Total utility plant	9,792,291	9,792,291	11,431,447	11,075,874	10,839,341	10,649,301
Accumulated depreciation						
and amortization	3,904,049	3,904,049	4,553,448	4,207,830	3,881,726	3,641,448
Total assets	12,670,435	12,445,608	13,861,187	9,584,141	9,427,635	9,477,869

* Amounts include extraordinary item for the discontinuance of regulatory accounting principles.

** Amounts include extraordinary item for the early extinguishment of debt, see Note 5. - Capitalization.

*** Holdings owns all of Niagara Mohawk's shares of common stock.

Glossary of Terms

<u>Term</u>	<u>Definition</u>	<u>Term</u>	<u>Definition</u>
AFC	Allowance for Funds Used During Construction	accrued on the Nuclear Waste Policy Act disposal liability less interest income	
CNG	CNG Transmission Corporation, an interstate natural gas pipeline regulated by FERC	NRC	U. S. Nuclear Regulatory Commission
CTC	Competitive transition charges: a mechanism established in Niagara Mohawk's PowerChoice agreement to recover stranded costs from customers	NYISO	New York Independent System Operator
DEC	New York State Department of Environmental Conservation	NYPA	New York Power Authority
DOE	U. S. Department of Energy	NYPP	New York Power Pool
Dth	Dekatherm: one thousand cubic feet of gas with a heat content of 1,000 British Thermal Units per cubic foot	NYSERDA	New York State Energy Research and Development Authority
EBITDA	A non-GAAP measure of cash flow which is calculated as: earnings before interest charges, interest income, income taxes, depreciation and amortization, amortization of nuclear fuel, allowance for funds used during construction, MRA regulatory asset amortization, and extraordinary items	PowerChoice	Niagara Mohawk's five-year electric rate agreement, which incorporates the MRA agreement approved by the PSC in an order dated March 20, 1998, and became effective September 1, 1998
FASB	Financial Accounting Standards Board	PPA	Power Purchase Agreement: long-term contracts under which a utility is obligated to purchase electricity from an IPP at specified rates
FERC	Federal Energy Regulatory Commission	Provider of last resort	The entity that will provide electric or gas commodity to its customers who are unable or unwilling to obtain an alternative supplier
GAAP	Generally Accepted Accounting Principles	PRP	Potentially Responsible Party
GRT	Gross Receipts Tax	PSC	New York State Public Service Commission
GWh	Gigawatt-hour: one gigawatt-hour equals one billion watt-hours	PURPA	Public Utility Regulatory Policies Act of 1978, as amended. One of five bills signed into law on November 8, 1978, as the National Energy Act. It sets forth procedures and requirements applicable to state utility commissions, electric and natural gas utilities and certain federal regulatory agencies. A major aspect of this law is the mandatory purchase obligation from qualifying facilities.
IPP	Independent Power Producer: any person that owns or operates, in whole or in part, one or more Independent Power Facilities, including the purchasers of Niagara Mohawk's generation assets	SFAS No. 71	Statement of Financial Accounting Standards No. 71 "Accounting for the Effects of Certain Types of Regulation"
IPP Party	Independent Power Producers that were a party to the MRA	SFAS No. 101	Statement of Financial Accounting Standards No. 101 "Regulated Enterprises - Accounting for the Discontinuance of Application of FASB Statement No. 71"
KW	Kilowatt: one thousand watts	SFAS No. 106	Statement of Financial Accounting Standards No. 106 "Employers' Accounting for Postretirement Benefits Other Than Pensions"
KWh	Kilowatt-hour: a unit of electrical energy equal to one kilowatt of power supplied or taken from an electric circuit steadily for one hour	SFAS No. 109	Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes"
MRA	Master Restructuring Agreement - a Niagara Mohawk agreement, including amendments thereto, which terminated, restated or amended certain IPP Party power purchase agreements effective June 30, 1998	SFAS No. 121	Statement of Financial Accounting Standards No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of"
MRA regulatory asset	Recoverable costs to terminate, restate or amend IPP Party contracts, which have been deferred and are being amortized and recovered under Niagara Mohawk's PowerChoice agreement	Stranded costs	Regulated utility costs that may become unrecoverable due to a change in the regulatory environment
MW	Megawatt: one million watts	Unit 1	Nine Mile Point Nuclear Station Unit No. 1
MWh	Megawatt-hour: one thousand kilowatt-hours	Unit 2	Nine Mile Point Nuclear Station Unit No. 2
Net Cash Interest	Reflects interest charges (net of allowance for funds used during construction) less the non-cash impact of the net amortization of discount on long-term debt and interest		

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

Certain statements included in this Annual Report are forward-looking statements as defined in Section 21E of the Securities Exchange Act of 1934 that involve risk and uncertainty, including the improvement in Holdings and Niagara Mohawk's cash flow upon the implementation of the MRA and PowerChoice, the timing and outcome of the proposed future sale of Niagara Mohawk's remaining fossil and nuclear generation assets, the planned repayment of debt, the effects of Niagara Mohawk's transition to a new customer service system, and the collection of accounts receivable and the corresponding bad debt expense. These forward-looking statements are based upon a number of assumptions, including assumptions regarding PowerChoice and regulatory actions to continue to support such an agreement. Actual future results and developments may differ materially depending on a number of factors, including regulatory changes either by the federal government or the PSC, uncertainties regarding the ultimate impact on Holdings and Niagara Mohawk as the regulated electric and gas industries are further deregulated and electricity and gas suppliers gain open access to Niagara Mohawk's retail customers, challenges to PowerChoice under New York laws, the timing and extent of changes in commodity prices and interest rates, the effects of weather, the length and frequency of outages at Niagara Mohawk's two nuclear plants, the results from Niagara Mohawk's proposed sale of its generation assets, the effects of transition to a new customer service system, including the efforts made by Niagara Mohawk to collect from customers, and the economic conditions of Niagara Mohawk's service territory.

The electric utility industry in the United States has experienced a deregulatory climate in recent years whereby federal and state regulatory initiatives have sought to provide separation of the vertically integrated energy generation, transmission and distribution functions and promote competition and lower prices. This unbundling of services has led to some restructuring throughout the industry. Niagara Mohawk's response to these developments was to formulate a restructuring strategy and a multi-year rate plan which enables it to exit the generation business, reduce the amount of its over-market purchase power obligations, recover its stranded costs and lower prices to customers. Implementation of this restructuring strategy commenced in 1998 with the regulatory approval of the rate plan and the consummation of the MRA, and 1999 was a year punctuated by the further execution of the restructuring strategy.

Key events were:

- On March 18, 1999, Niagara Mohawk was reorganized into a holding company structure providing Holdings and its subsidiaries with financial and regulatory flexibility to compete more effectively in an increasingly competitive energy industry.
- On June 11, 1999, Niagara Mohawk completed the sale transactions of its two coal-fired generation plants; on July 29, 1999, Niagara Mohawk completed the sale of its hydroelectric generation plants; and on October 22, 1999, Niagara Mohawk completed the sale of its oil and gas-fired plant at Oswego. In addition, on October 6, 1999, Niagara Mohawk announced an agreement to sell its oil and gas-fired generation plant at Albany.
- On June 24, 1999, Niagara Mohawk announced an agreement to sell its nuclear generation assets to AmerGen Energy Company, LLC ("AmerGen"). However, on December 21, 1999, Rochester Gas & Electric Corporation ("RG&E") notified Niagara Mohawk of its intent to exercise its rights to purchase the nuclear generation assets. The PSC Staff has informed Niagara Mohawk that they believed that the terms of the proposed sale are not consistent with the public interest standard in the Public Service Law, but that discussions with AmerGen and other interested parties would continue.
- Niagara Mohawk redeemed approximately \$1.1 billion in debt.
- In the fourth quarter, Niagara Mohawk commenced a multi-year program to repurchase shares of Holdings' common stock. The repurchases are aimed at managing Holdings' capital structure to competitive norms within the utility industry.
- The PSC established a formal proceeding on the methodology to determine exit fees.
- Niagara Mohawk implemented a new customer service system, which continues to experience transition issues in customer satisfaction, incremental costs and PSC scrutiny.

PowerChoice and the Restructuring of the Regulated Electric Utility Business

The PSC approved the PowerChoice agreement on March 20, 1998 and the rate plan was implemented beginning September 1, 1998. The PowerChoice

agreement outlined Niagara Mohawk's future structure in the regulated electric business. During 1999 and 1998, Niagara Mohawk has worked toward the implementation of all phases of PowerChoice and has implemented other federal and state orders that promote deregulation as described below:

PowerChoice Rate Reductions and Retail Choice of Electricity Supplier. The PowerChoice agreement established a five-year electric rate plan that reduces class average residential and commercial prices by an aggregate of 3.2% over the first three years, beginning September 1, 1998. On September 1, 1999, Niagara Mohawk implemented its second phase of rate reductions. The reduction in prices includes certain savings that result from approved reductions of the GRT. Industrial customers are currently receiving average reductions of 25% relative to 1995 tariffs; this decrease includes discounts previously offered to some industrial customers through optional and flexible rate programs. As part of PowerChoice, Niagara Mohawk has retained the flexibility to address specific competitive challenges for energy intensive customers through individual rate negotiations.

Effective August 1, 1999, all of Niagara Mohawk's customers were able to choose their electricity supplier. As of December 31, 1999, 6,658 (4.25%) of Niagara Mohawk's commercial and industrial customers or approximately 14.56% of eligible load, and 4,325 (0.31%) residential customers or approximately 0.36% of eligible load, have chosen an electricity supplier other than Niagara Mohawk. See "FERC Order 888 – Open Access" below for a discussion of open transmission access as a result of the formation of the NYISO. Niagara Mohawk will continue to distribute electricity through its transmission and distribution systems for all customers, regardless of supplier, and will be provider of last resort for those customers who do not exercise their right to choose a new electricity supplier. If a customer chooses an alternative supplier, Niagara Mohawk, as allowed under PowerChoice, will continue to charge the customer for delivery of the energy and for a non-bypassable CTC charge. Niagara Mohawk will also give a credit to the customer for any services provided by the alternative energy supplier that were provided by Niagara Mohawk in the past.

During the term of the PowerChoice agreement, Niagara Mohawk is permitted to defer certain incremental costs associated primarily with environmental remediation, nuclear decommissioning and related costs, and changes in laws, regulations, rules and orders. In the fourth and fifth years of the rate plan, Niagara Mohawk can request an annual increase in prices subject to a cap of 1% of the all-in price, excluding commodity costs (e.g., transmission, distribution, nuclear, and forecasted CTC). In addition to the price cap, the PowerChoice agreement provides for the

recovery of deferrals established in years one through four and the generation sale incentive. See Financial Statements and Supplementary Data – Note 2. Rate and Regulatory Issues and Contingencies – Deferred Loss on the Sale of Assets, for a discussion of the generation sale incentive. The aggregate of the price cap increase and recovery of deferrals is subject to an overall limitation of general inflation. Any remaining unamortized deferrals at the end of year five will be recovered over a period not to exceed five years beginning in year six.

Beginning in year four of PowerChoice, Niagara Mohawk can continue to recover the cost variations in the indexed swap contracts entered into as part of the MRA, resulting from the indexing provisions of these contracts. As these indexed swap contracts and other contracts expire, the fluctuations in market price of unhedged energy will be billed to customers through a commodity adjustment clause in the CTC. Niagara Mohawk may need to reassess its hedging strategy if the PSC renders a decision regarding provider of last resort.

The PowerChoice agreement further provides that Niagara Mohawk shall have a reasonable opportunity to recover its stranded costs, including those associated with the MRA and the contracts entered into as part of the MRA, through a CTC and, under certain circumstances, through exit fees or in rates for back up service. See "FERC Order 888 – Stranded Cost Recovery in the Case of Municipalization" for a further discussion of stranded costs and exit fees. Niagara Mohawk's rates under PowerChoice are designed to permit recovery of the MRA regulatory asset and to permit recovery of, and a return on, the remainder of its assets, as appropriate.

Generation Asset Sales. Niagara Mohawk has completed the sale of its coal-fired generation plants, its hydro generation plants, and its oil and gas-fired generation plant at Oswego. Niagara Mohawk has also announced an agreement to sell its Albany oil and gas-fired generation plant. Niagara Mohawk expects to complete the Albany sales transaction in the first quarter of 2000. In May 1999, Niagara Mohawk entered into an agreement with Central Hudson Gas & Electric Corporation ("Central Hudson"), subject to regulatory approval, to sell its interest in the Roseton plant to Central Hudson, at approximately net book value by no later than January 1, 2003. For a further discussion of these sales, see Financial Statements and Supplementary Data, Note 2. – Rate and Regulatory Issues and Contingencies. For a discussion on how Niagara Mohawk used the proceeds from the sale of its generation assets, see "Liquidity and Capital Resources."

Niagara Mohawk signed agreements with the buyers of the plants for energy and capacity at negotiated prices, which are above market, based on current energy price forecasts. While the PPAs with the buyers of the formerly owned fossil and hydro assets, which were entered into as

an integral part of the sales, are above market, they are designed to help Niagara Mohawk meet rate reduction and price cap commitments as well as expected demand as the provider of last resort. The PPAs that convert to either swap agreements or swaptions (swap agreement with a call option) act as hedges against a substantial rise in power costs. See Financial Statements and Supplementary Data – Note 2. – Rate and Regulatory Issues and Contingencies, Note 8. – Commitments and Contingencies, and Note 9. – Fair Value of Financial and Derivative Financial Instruments, for a further discussion of the terms of these agreements.

Niagara Mohawk expects to incur a net loss, mainly attributable to the Oswego oil and gas-fired plant, on the sale of the fossil and hydro generation assets of approximately \$150 million. The PowerChoice agreement provides for deferral and future recovery of the net losses resulting from the sale of the assets. For a further discussion of the loss incurred on these sales, the regulatory treatment of such loss, and the factors that may cause the amount of loss to change, see Financial Statements and Supplementary Data, Note 2. – Rate and Regulatory Issues and Contingencies.

After the fossil and hydro sales are completed, Niagara Mohawk has agreed not to own any non-nuclear generation assets in the state of New York, subject to certain exceptions provided in the PowerChoice agreement.

The PowerChoice agreement stipulated that absent a statewide solution, Niagara Mohawk would file a detailed plan for analyzing other proposals regarding its nuclear assets, including the feasibility of an auction, transfer and/or divestiture of such facilities, within 24 months of PowerChoice. On June 24, 1999, Niagara Mohawk announced an agreement to sell its nuclear generation assets to AmerGen. The sale to AmerGen was subject to a previously existing agreement among the five co-owners of Unit 2 that gives the co-owners the right to match a third-party purchase offer. On December 21, 1999, RG&E, a 14% co-owner of Unit 2, submitted a notice stating it would match the AmerGen offer. On January 26, 2000, the PSC Staff had informed the ALJ and all parties, including Niagara Mohawk, that they believed the terms of the proposed nuclear sale were not in the public interest. The PSC Staff is continuing its discussions with AmerGen, as well as exploring other options, including giving other interested parties the opportunity to put forth competing proposals. Niagara Mohawk cannot predict the outcome of this proceeding, but is committed to pursue the sale of Unit 1 and Unit 2. Notwithstanding this commitment, because of the regulatory hurdles that must be overcome, Niagara Mohawk does not believe that such a sale is any more likely to occur than other possible scenarios, including the possible continued operation of the plants by Niagara Mohawk for the remainder of their useful lives.

For a further discussion regarding the details of the sale agreement, the status of the sale, the proposed regulatory and accounting treatment of the announced sale, the PPAs signed as part of the agreement, and the treatment under PowerChoice in the event a sale does not occur, see Financial Statements and Supplementary Data, Note 2. – Rate and Regulatory Issues and Contingencies, Note 3. – Nuclear Operations and Note 8. – Commitments and Contingencies.

The MRA Agreement. As a result of various federal and state requirements, Niagara Mohawk was required to enter into contracts to purchase electricity from IPPs in quantities in excess of its own demand and at prices in excess of those available to it. In mid-1996, Niagara Mohawk began comprehensive negotiations to terminate, amend or restate a substantial portion of above-market PPAs in an effort to mitigate the escalating cost of these PPAs as well as to prepare Niagara Mohawk for a more competitive environment. These negotiations led to the MRA and the PowerChoice agreement.

The MRA was consummated on June 30, 1998 with 14 IPPs. The MRA allowed Niagara Mohawk to terminate, restate or amend 27 PPAs which represented approximately three-quarters of its over-market purchased power obligations. Niagara Mohawk terminated 18 PPAs for 1,092 MW of electric generating capacity, restated 8 PPAs representing 535 MW of capacity and amended 1 PPA representing 42 MW of capacity. Niagara Mohawk paid the IPP Parties an aggregate of \$3.934 billion in cash, of which \$3.212 billion was obtained through a public market offering of senior unsecured debt, \$303.7 million from the public sale of 22.4 million shares of common stock, and the remainder from cash on hand. In addition, Niagara Mohawk issued 20.5 million shares of common stock to the IPP Parties.

PowerChoice provided that the MRA and the contracts executed as part of the MRA were prudent and accordingly, PSC approval of PowerChoice allowed Niagara Mohawk to record a regulatory asset for the costs of the MRA, which is being amortized over a period generally not to exceed ten years. Niagara Mohawk's rates under PowerChoice were designed to permit recovery of the MRA regulatory asset. In approving PowerChoice, the PSC limited the estimated value of the MRA regulatory asset that could be recovered, which resulted in a charge to the second quarter of 1998 earnings of \$263.2 million upon the closing of the MRA. The PowerChoice agreement, while having the effect of substantially depressing earnings during its five-year term, substantially improves operating cash flow. The ability of Niagara Mohawk to improve earnings in the period subsequent to PowerChoice will depend on the outcome of the regulatory process to set prices at that time.

The MRA has the effect of reducing Niagara Mohawk's IPP payments by more than \$500 million annually as compared to leaving the pre-existing contracts in place, net of purchases of power at market price. The resulting improvement in cash flow and the proceeds from the sale of the generation assets have allowed Niagara Mohawk to repay debt and repurchase Holdings' common stock.

Under the terms of the MRA, Niagara Mohawk has no continuing obligation to purchase energy from the terminated IPP Parties. The restated contracts with eight PPAs reflect economic terms and conditions that are more favorable to Niagara Mohawk than the previous PPAs. See Quantitative and Qualitative Disclosures About Market Risk, and Financial Statements and Supplementary Data, Note 8 - Commitments and Contingencies and Note 9 - Fair Value of Financial and Derivative Financial Instruments, for a further discussion regarding the remaining payments to the IPP Parties for the purchase of electric power and the payments made under the swap agreements.

Niagara Mohawk is actively pursuing other opportunities to reduce its payments to IPPs that were not party to the MRA. Niagara Mohawk is permitted to defer and amortize the cost of any additional IPP contract buyouts. In 1999, there have been four IPP contracts for approximately 127 MW terminated for a total consideration (cash and/or notes) of \$229.2 million. Niagara Mohawk estimates that it will have reduced IPP payments by approximately \$60 million annually, net of purchases of power at market price as a result of these contract buyouts. Deferred costs associated with IPP buyouts must generally be amortized over five years, unless PSC approval is obtained for a different amortization period. Niagara Mohawk retains the annual net savings from the buyouts during the remaining term of PowerChoice to offset the amortization expense. Niagara Mohawk is negotiating buyouts and amendments of other IPP contracts, but is unable to determine the timing and outcome of these negotiations.

Formation of a Holding Company Structure. Niagara Mohawk was reorganized into a holding company structure in accordance with its Agreement and Plan of Exchange with Niagara Mohawk Holdings, Inc. on March 18, 1999. The outstanding shares of Niagara Mohawk's common stock, \$1.00 par value, were exchanged on a share-for-share basis for Holdings' common stock, par value of \$0.01. Niagara Mohawk then became a subsidiary of Holdings. Niagara Mohawk's preferred stock and debt were not exchanged and remained securities of Niagara Mohawk. The holding company structure was completed March 31, 1999 with the Niagara Mohawk dividend transfer of Opinac North America Inc. ("Opinac") to Holdings.

The holding company structure provides Holdings and its subsidiaries with the financial and regulatory flexibility to compete more effectively in an increasingly competitive energy industry by providing a structure that can accommodate both regulated and unregulated lines of businesses (energy related services and telecommunications). The holding company structure permits Holdings to participate in unregulated business opportunities as the industry evolves. The PowerChoice agreement provides for affiliate rules to be abided by Holdings and its affiliated companies, including the allocation of costs for providing goods and services.

FERC Order 888. In April 1996, FERC issued Order 888, which promotes competition by requiring that public utilities owning, operating, or controlling interstate transmission facilities file tariffs which offer others the same transmission services they provide for themselves, under comparable terms and conditions. FERC Order 888 required the NYPP to file reformed power pooling agreements that establish open, non-discriminatory membership provisions and modify any provisions that are unduly discriminatory or preferential. In addition, the FERC Order also provides for the recovery of prudent and verifiable stranded costs where the wholesale customer was able to obtain alternative power supplies as a result of Order 888's open access mandate.

As a result of Order 888, there have been several developments during the past few years as follows:

- **Open Access**

The NYISO commenced formal operations on December 1, 1999. Niagara Mohawk views this progress as an important step toward a more competitive market for wholesale electricity supply service in New York State, consistent with its PowerChoice restructuring agreement.

Twice annually, Niagara Mohawk will be required to sell to the NYISO all of its transmission capacity, except such transmission capacity grandfathered under pre-existing Transmission Service Agreements ("TSAs"), for a subsequent six month period. In turn, Niagara Mohawk will purchase any additional transmission capacity it needs through the competitive bid process of the NYISO.

Approximately \$70 - \$75 million, or three-quarters of Niagara Mohawk's annual transmission revenues, are derived from the grandfathered TSAs. These grandfathered TSAs have various expiration dates, with the more significant TSAs not expiring until 2013 and beyond. Niagara Mohawk expects that total transmission revenues will decline from \$100 million in 1999 to \$75 million in 2000, which is due to the transition from Niagara Mohawk's transmission tariffs to the NYISO tariffs. Niagara Mohawk cannot determine the long-term impact of

the NYISO on its transmission revenues due to lack of market experience in pricing and capacity needs.

- **Stranded Cost Recovery in the Case of Municipalization**

Order 888 stated that it would provide for the recovery of prudent and verifiable wholesale stranded costs where the wholesale customer was able to obtain alternative power supplies as a result of Order 888's open access mandate. Order 888 left to the states the issue of retail stranded cost recovery. Where newly created municipal electric utilities required transmission service from the displaced utility, the FERC stated that it would entertain requests for stranded cost recovery since such municipalization is made possible by open access. The FERC also reserved the right to consider stranded costs on a case-by-case basis if it appeared that open access was being used to circumvent stranded cost review by any regulatory agency.

In November 1997, FERC issued Order 888-B. This Order clarified that the FERC recognizes the existence of concurrent state jurisdiction over stranded costs arising from municipalization. The FERC acknowledged in Order 888-B that the states may be first to address the issue of retail-turned-wholesale stranded costs, and stated that it will give the states substantial deference where they have done so.

In approving PowerChoice, the PSC authorized changes to Niagara Mohawk's Retail Tariff providing for the recovery of stranded costs in the case of municipalization regardless of whether the new municipal utility requires transmission service from Niagara Mohawk. The calculation of stranded costs is governed by this Retail Tariff, which became effective on April 6, 1998. A number of communities served by Niagara Mohawk are considering municipalization and have requested an estimate of their stranded cost obligation.

The Village of Lakewood ("Lakewood") is considering municipalization. In August 1997, Niagara Mohawk provided Lakewood with an estimate of its stranded cost obligation in response to a formal request under FERC Order 888. In June 1998, Lakewood filed a petition with FERC seeking a determination that it would not be responsible for any of Niagara Mohawk's stranded costs if it created a new municipal electric system.

On December 11, 1998, the FERC issued an order granting Niagara Mohawk's request for clarification that Order 888 does not preempt the exit fee provision of the Retail Tariff and directing that the Lakewood case be held in abeyance pending the

resolution of Lakewood's stranded cost obligation under Niagara Mohawk's Retail Tariff.

During 1999, the PSC established a formal proceeding in this matter. Niagara Mohawk filed its direct case on September 3, 1999, which supported a revised estimate of exit fees of \$18.0 million. Lakewood filed its direct case on October 18, 1999, which supported an exit fee of approximately \$5 million. The PSC Staff filed their direct case on October 25, 1999, which supported an exit fee of \$15.6 to \$16.7 million. Rebuttal testimony was filed on November 10, 1999 and a hearing for the purpose of cross-examination of all testimony was held on December 1 and 2, 1999. Niagara Mohawk expects the PSC to render a decision by the second quarter of 2000. Niagara Mohawk is unable to predict the outcome of this matter.

While the municipalization of Lakewood would not have a material impact on Niagara Mohawk's results of operation and financial position, the outcome of this matter will likely define the methodology to determine exit fees. There have been other challenges to the determination and recovery of stranded costs through the application of CTCs and exit fees as follows:

In early October 1998, the Alliance for Municipal Power ("AMP"), a group of 21 towns and villages in St. Lawrence and Franklin Counties pursuing municipalization, and Alfred P. Coppola ("Coppola"), a Councilman from the city of Buffalo, commenced a proceeding in Albany County Supreme Court that challenged the PSC's decision to approve PowerChoice and the PSC's decision that denied the petitions of Alliance for Municipal Power and Coppola for rehearing before the Commission. The proceeding sought to vacate the decision of the PSC approving PowerChoice provisions relating to the determination and recovery of strandable costs through the application of a competitive transition charge and exit fees. The PSC has made a motion to dismiss the proceeding in this matter. On March 11, 1999, the Albany County Supreme Court dismissed in its entirety the petition of Coppola and also dismissed AMP's petition to the extent that it challenged the determination and recovery of stranded costs through the application of CTCs and exit fees. However, the Court did order the PSC to respond to AMP's claim that the PSC failed to act on discovery requests seeking information about exit fees. Niagara Mohawk has provided AMP with an updated exit fee estimate of \$150 million (PSC method) to \$272 million (FERC method). The range is dependent on whether the formula prescribed by the PSC in PowerChoice or the method defined by FERC is used. During the first

quarter of 1999, AMP filed a motion to re-argue with the Supreme Court and has also filed a notice of appeal from the decision of the lower court. On June 29, 1999, the Albany County Supreme Court denied AMP's motion to re-argue and renew the case. AMP failed to perfect on a timely basis, which failure may be excused by the court for good reason. Niagara Mohawk is unable to predict what future actions, if any AMP will take with respect to this matter. If these 21 communities withdrew from Niagara Mohawk's system, Niagara Mohawk would experience a potential revenue loss of approximately 2% per year. In addition, the impact on Niagara Mohawk's electric margin is considered to be immaterial. However, suspension of PowerChoice or renegotiation of its material terms could have a material adverse effect on Holdings and Niagara Mohawk's results of operations, financial condition, and future cash flows.

Niagara Mohawk has also prepared exit fee stranded cost estimates for several other municipalities and customers, including the city of Buffalo. Niagara Mohawk is unable to predict whether these other municipalities or customers will pursue a withdrawal from Niagara Mohawk's system or the amount of stranded costs it may receive as a result of any withdrawals.

FERC Order 2000. In December 1999, FERC issued Order 2000, which requires all public utilities that own, operate or control interstate electric transmission to file a proposal for a Regional Transmission Organization ("RTO") by October 15, 2000. Alternatively, FERC Order 2000 requires such utilities to provide a description of any efforts made by the utility to participate in an RTO, the reasons for not participating and any obstacles to participation, and any plans for further work toward participation. RTOs are required to be operational by December 15, 2001. Niagara Mohawk is currently evaluating FERC Order 2000 and believes that the current NYISO structure provides for much of the FERC mandate under Order 2000. However, at this time, it is difficult to determine how the NYISO may be impacted by an RTO and what financial consequences, if any, may result from the formation of an RTO.

Other Regulatory Restructuring Proceedings. The PSC continues to assess other functions in the regulated electric and gas business to lower consumer rates and increase customer choice. The PSC is considering opening competition to such functions as metering, billing, collections and customer service. On January 13, 1999, the PSC adopted a set of Uniform Business Practices for Retail Access designed to streamline and make more uniform the manner in which the local utilities interact with natural gas and electricity

marketers, energy services companies and customers who purchase energy in New York State's evolving competitive market.

During the latter part of 1999, the PSC required the New York State utilities to file tariffs providing a backout credit against utility prices to large electric customers (greater than 50KW) choosing to have their meter services performed by someone other than their local utility. The backout credit is an estimate of costs the utilities incur to provide meter services to these customers. The PSC has stated a preference for using long run avoided costs to establish backout credits, and in the absence of long run avoided cost estimates, the use of embedded, or fully allocable costs of the avoided activities. Embedded costs may exceed the costs the utility could actually avoid when not providing a service to customers that have chosen an alternative, creating stranded costs. The PSC has postponed the implementation of these rates until March 29, 2000. Due to the limited scope of the PSC's order on metering, the impact on Niagara Mohawk's results of operations should be minimal. The exposure could grow, however, if the scope of the metering proposal is expanded, or other services are required to be opened to competition using embedded cost as a backout credit.

Niagara Mohawk will continue to participate with the PSC and other parties as New York State moves forward with a competitive utility industry, but it cannot predict the outcome of the results and the impact on its PowerChoice agreement.

Other Federal and State Regulatory Initiatives

Gas Multi-Year Rate and Restructuring Proposal. Niagara Mohawk filed a three-year gas rate and restructuring proposal on March 11, 1999, in anticipation of the expiration of its 1996 three-year gas rate settlement agreement, which expired on November 1, 1999. Niagara Mohawk is currently negotiating with the PSC and other parties, but has not reached a final agreement. However, on October 15, 1999, and January 12, 2000, the PSC approved an interim arrangement that freezes delivery rates at current levels, subject to refund if the permanent rates are lower and allows the pass through to customers the benefits of lowered pipeline costs. In addition, the interim arrangement minimizes Niagara Mohawk's exposure to stranded costs. The interim agreement also included provisions for the implementation of both unbundled gas rates and a return to a full gas cost collection mechanism (gas adjustment clause "GAC") effective November 1, 1999. In addition, Niagara Mohawk is allowed to recover all commodity costs along with fixed capacity costs for capacity actually used to serve customers. It also provides

that, pending resolution of the issue in that case, costs for capacity upstream of CNG that are not actually required for sales customer demands or offset by assignment and secondary market release (stranded capacity costs) are not recoverable beginning November 1, 1999. However, the potential for stranded costs are not considered material to Niagara Mohawk's results of operations or financial condition. The exposure may increase in the future as additional customers select alternative suppliers. Niagara Mohawk is continuing to work with the PSC and other interested parties to reach a final settlement, but it cannot predict the timing or outcome of such a settlement.

Future of the Natural Gas Industry. In November 1998, the PSC issued its Policy Statement concerning the Future of the Natural Gas Industry in New York State and Order Terminating Capacity Assignment ("PSC Policy Statement"). The PSC envisions a transitional time frame of three to seven years for local gas distribution companies ("LDC") to exit the business of purchasing natural gas (the "merchant" function). The PSC established a process comprising three basic elements, to be pursued in parallel in the exiting of the merchant function:

- Addressing the issues involved in the exiting of the merchant function on a utility-by-utility basis as part of the LDCs individual rate plans;
- Collaboration among staff, LDCs, marketers, pipelines and other stakeholders of generic issues such as operational and reliability issues, protocols and information systems requiring a status report by April 1, 1999; and
- Coordination of issues faced by electric utilities, including provider of last resort issues and a plan to allow competition in other areas, such as metering, billing and information services.

In December 1998, Niagara Mohawk notified the PSC that its specific operational and reliability requirements continue to warrant certain mandatory capacity assignment and inclusion of capacity costs in transportation rates after April 1, 1999. Niagara Mohawk will continue to assign CNG capacity until a final determination is reached in the current rate and restructuring case. The PSC noted in its PSC Policy Statement that it will provide LDCs with a reasonable opportunity to recover these strandable costs if they can demonstrate compliance with the PSC's directives to minimize such costs.

As a result of the collaborative process established in the PSC Policy Statement, on August 19, 1999, the PSC issued an order requiring that marketers serving firm customers have firm, primary delivery point capacity for the five winter months of November through March, but allowed an alternative for marketers, only for the 1999 -

2000 heating season, to have firm secondary delivery point capacity and to pay the LDC a standby charge to provide backup service. LDCs that implemented this Order would be presumed to have met the PSC's directive to minimize their stranded costs.

Niagara Mohawk believes that it has taken numerous actions to reduce its capacity obligations and its potential stranded costs, but is unable to predict the outcome of this matter. Niagara Mohawk has addressed the issues from the PSC Policy Statement in its three-year gas rate and restructuring proposal filed on March 11, 1999 and as noted above, Niagara Mohawk is currently working with the PSC and other interested parties to reach a final settlement. For a discussion of Niagara Mohawk's long term supply, transportation and storage commitments, see Financial Statements and Supplementary Data, Note 8. - Commitments and Contingencies.

NRC and Nuclear Operating Matters. On September 24, 1999, Niagara Mohawk announced that it had begun a comprehensive program to enhance the operating performance of Unit 1 and Unit 2. Previous internal and external performance reviews, including a review by the NRC, outlined the need for operational improvements. Niagara Mohawk has implemented a phased improvement program designed to strengthen organizational capability to improve more rapidly and address challenges more effectively. Niagara Mohawk also established a contractual partnership with PECO Energy, a partner in AmerGen, to provide additional management and expertise. Niagara Mohawk incurred approximately \$1.0 million in expense during 1999 for this performance improvement program and has budgeted an additional \$5.9 million in expense and \$2.8 million for capital improvements for the 6 months ending June 30, 2000. Any delay in the timing or outcome of the nuclear asset sale will affect the cost of the improvement program.

Niagara Mohawk also experienced several outages with its two nuclear plants, including the scheduled refueling outage, during 1999. The following summarizes the two most significant of the outages:

- Unit 1: Unit 1 had a scheduled refueling and maintenance outage that began on April 11, 1999. During the core shroud reinspection, indications of crack growth on vertical welds were found. The growth rate identified was consistent with findings noted in earlier inspections at Unit 1. After careful examination and analysis, Niagara Mohawk decided to install a repair modification on two of the shroud's vertical welds. A damaged tie rod, previously installed to address horizontal shroud cracks, was also identified. As a result, all four tie rods were repaired to correct a design deficiency. The plant returned to service on June 16, 1999. The incremental costs associated with the refueling

and maintenance outage at Unit 1 was \$10.8 million, including \$6.3 million of replacement power costs.

- **Unit 2:** On June 24, 1999, Unit 2 automatically shut down due to a malfunction in a device that controls water flow level to the reactor vessel. Unit 2 returned to full power on July 26, 1999. The incremental costs associated with the outage at Unit 2 were \$11.4 million, including \$10.6 million of replacement power costs.

PSC Staff's Tentative Conclusions on the Future of Nuclear Generation. On August 27, 1997, the PSC requested comments on its staff's tentative conclusions that beyond the transition period (the period covered by the various New York utility restructuring agreements, including PowerChoice), nuclear generation should operate on a competitive basis.

In October 1997, the majority of utilities with interests in nuclear power plants, including Niagara Mohawk, requested that the PSC reconsider its staff's nuclear proposal, and the utilities recommended that a more formal process be developed to address issues relating to competition, sale of nuclear plants, responsibility for decommissioning, disposal of spent fuel, safety, and environmental benefits of fuel diversity.

On March 20, 1998, the PSC issued an opinion and order instituting a further inquiry into the matters addressed in the PSC Staff's tentative conclusions regarding the treatment of nuclear generation in the future. The Order concluded that the proposals contained in the Staff Report required more extensive examination, and directed that the examination begin with a collaborative process and move to litigation on particular issues if necessary. A collaborative proceeding commenced on January 20, 1999.

The matters addressed in the inquiry include:

- Market treatment for nuclear power
- The feasibility of mandated divestiture and its likely consequences
- Decommissioning issues
- Effects of PSC Staff's proposal on municipalities

The proceeding has been delayed due to the PSC Staff's attention devoted to the sale of Unit 1 and Unit 2.

As noted above, Niagara Mohawk has announced an agreement to sell its nuclear generation assets, but is unable to determine the outcome of such a sale. See Financial Statements and Supplementary Data, Note 2. - Rate and Regulatory Issues and Contingencies and Note 3. - Nuclear Operations, for a further discussion of the agreement.

At December 31, 1999, the net book value of Niagara Mohawk's nuclear generation assets (including materials,

supplies and nuclear fuel) was approximately \$1.6 billion, excluding the reserve for decommissioning. In addition, Niagara Mohawk has other nuclear-related assets of approximately \$0.5 billion. These assets include the decommissioning trusts and regulatory assets, primarily related to the flow-through to customers of prior income tax benefits.

Year 2000 Readiness Disclosure

Niagara Mohawk has not experienced any significant problems related to the year 2000-date rollover. In general, however, all problems related to the year 2000-date rollover may not yet have become apparent. There are other critical dates, such as leap year, that could cause similar computer problems. While Niagara Mohawk believes its efforts to date have successfully addressed the problems, there can be no assurance until the passage of time, that no further problems will occur, including with respect to Niagara Mohawk's third party business partners.

Niagara Mohawk incurred total year 2000 readiness project costs of \$26.0 million through December 31, 1999 of which \$16.3 million was expensed and \$9.7 million was capitalized. Niagara Mohawk estimates that program costs for 2000 will approximate \$4.5 million, of which approximately \$3.9 million will be expensed and \$0.6 million will be capitalized.

Results of Operations

This results of operations section includes the results of both Holdings and Niagara Mohawk. Holdings' prior period results are the same as Niagara Mohawk's results, except for the treatment of preferred stock dividends paid by Niagara Mohawk and the manner in which unregulated business activities are consolidated in the financial statements. See Financial Statements and Supplementary Data, Note 1. - Summary of Significant Accounting Policies, for a further discussion of the formation of the holding company structure during 1999.

Holdings. Holdings experienced a loss in 1999 of \$35.1 million or 19 cents per share, as compared to a loss of \$157.4 million or 95 cents per share in 1998 and earnings of \$145.9 million or \$1.01 per share in 1997.

Earnings for 1999 reflect the impact of Niagara Mohawk's lower purchased power costs, partially offset by increased interest charges, resulting in improved earnings by \$108.0 million or 58 cents per share. However, the amortization of the MRA regulatory asset had a non-cash adverse earnings impact of \$167.5 million or 90 cents per share. Earnings for 1999 were also negatively impacted by Niagara Mohawk's early redemption of First Mortgage Bonds, Senior Notes and Medium Term Notes, which required a charge to earnings of \$23.8 million or 13 cents per share and is

reflected as an extraordinary item. See Financial Statements and Supplementary Data, Note 5. – Capitalization, for a further discussion of the extraordinary item. As discussed in more detail below, Niagara Mohawk implemented a Customer Service System in February 1999. Additionally, earnings in 1999 were reduced by \$23.8 million, or 13 cents per share, because of costs related to the new Customer Service System, and by \$21.0 million, or 11 cents per share, because of higher bad debt expense. The repurchase of Holdings' common stock has not had a significant impact on earnings per share for the year ended December 31, 1999, since earnings per share is based upon the weighted average shares outstanding. However, the effect on earnings per share in the future should increase.

Results for 1998 were negatively impacted by a non-cash write-off of \$171.1 million or \$1.03 per share associated with the portion of the MRA regulatory asset disallowed in rates by the PSC and by the regulatory treatment of the MRA regulatory asset. The January 1998 ice storm and the September 1998 windstorm also negatively impacted 1998 earnings by \$50.6 million, or 30 cents per share, which reflected Niagara Mohawk's estimate of incremental, non-capitalized costs to restore power and rebuild its electric system. In addition, per share results for the year ended December 31, 1998, were diluted by the issuance of 42.9 million shares of common stock in connection with the MRA.

Niagara Mohawk. Niagara Mohawk had a net loss of \$2.1 million after the extraordinary item. The preferred dividend requirements reduced the balance available for common stock to a greater loss of \$38.9 million. This loss as compared to 1998 and 1997 is explained above in the discussion of Holdings' loss for the same period.

The following discussion and analysis highlights items that significantly affected Holdings and Niagara Mohawk's operations during the three-year period ended December 31, 1999. This discussion and analysis is not likely to be indicative of future operations or earnings, particularly in view of the consummation of the MRA and implementation of PowerChoice, including the sale of Niagara Mohawk's generation assets. It should also be read in conjunction with Financial Statements and Supplementary Data, and other financial and statistical information appearing elsewhere in this report.

Customer Service System. In mid-February 1999, Niagara Mohawk implemented a new Customer Service System ("CSS"). The CSS replaced existing order, billing, collection and other infrastructural systems and is designed to provide real-time information as well as a more flexible and streamlined billing system. The new CSS also provides retail access and unbundled bill functionality required under PowerChoice and addresses

Year 2000 compliance. These capabilities could not be developed in the previous systems.

Niagara Mohawk, like other companies that have implemented similar CSS projects, has experienced a transition period, characterized by significantly higher customer call volumes and complaints, billing and data accumulation issues, and other problems that impact productivity and costs. The transition was also complicated by changes in the information and choices provided to customers pursuant to PowerChoice. Niagara Mohawk has taken steps prior to and during the transition period to prioritize and respond to problems. Although the more significant billing and data accumulation issues concerning customers have been addressed, resolution of the remaining transition issues will continue into 2000.

The CSS transition period presents several financial exposures. Outstanding accounts receivables have increased and Niagara Mohawk's bad debt expense for 1999 was \$64.0 million as compared to \$31.7 million in 1998, with the increase in 1999 primarily attributable to the added exposure to collection risk. Niagara Mohawk is taking aggressive action to reduce its outstanding accounts receivable balance relating to this transition period, so that the reserve for bad debts can be returned to a level appropriate in the normal course of business. However, the actions available to Niagara Mohawk are more limited during the heating season (beginning November 1, 1999 through April 15, 2000), since under the law, it cannot disconnect service to residential customers unless a 72-hour notice is given to the residential customer.

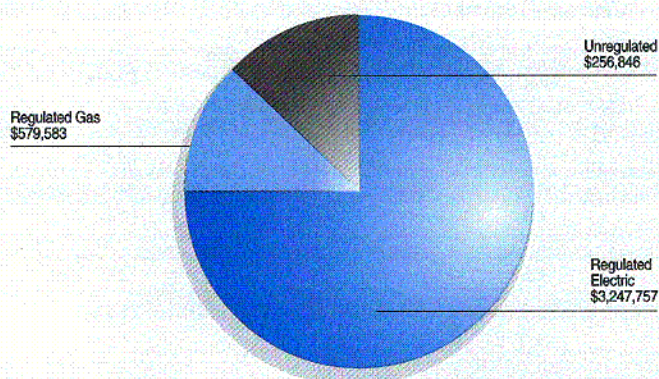
The PSC has been evaluating the development and implementation costs of the CSS project, as well as Niagara Mohawk's response to the transition problems incurred during implementation. The PSC issued an order in January 2000 directing that remaining billing related problems be corrected, with emphasis on estimated bills, by March 31, 2000. Niagara Mohawk cannot predict the outcome or financial consequences, if any, of the PSC's inquiry.

Niagara Mohawk has incurred increased costs to complete the transition to CSS. Costs incurred prior to implementation of CSS in February 1999 were generally capitalized. Niagara Mohawk has capitalized \$56 million through December 31, 1999, for the entire CSS project. Niagara Mohawk expected to incur costs chargeable to expense in 1999 for maintenance of CSS. Incurred costs are also expected to be higher in the first several years subsequent to implementation as knowledge and experience is transferred from the vendor to Niagara Mohawk. While implementation requirements are diminishing, Niagara Mohawk may face additional costs if the PSC seeks other retail access-related initiatives that would require modifications to CSS. Niagara Mohawk

cannot predict the costs of these potential changes. Niagara Mohawk also experienced higher costs in 1999 as a result of implementing retail access for all customers. Niagara Mohawk incurred \$36.6 million in 1999 for total CSS-related charges to expense, exclusive of bad debts. Niagara Mohawk had expected to spend \$11.2 million during 1999 for maintenance and knowledge transfer activities. Niagara Mohawk expects to incur additional costs in 2000, as remaining issues are addressed and enhancements are made. These amounts are expected to be substantially less than 1999 spending.

Revenues and Sales

1999 TOTAL OPERATING REVENUES
(thousand of dollars)



Regulated electric revenues for 1999 were \$3,248 million, and were \$3,261 million and \$3,309 million in 1998 and 1997, respectively.

Regulated electric revenues for 1999 decreased \$13.4 million or 0.4% as compared to 1998. The new CSS system has converted all customers previously billed on a bi-monthly basis to a monthly basis, which has resulted in an increase in billed revenue and sales (GWh), with corresponding decreases in accrued unbilled revenues. In accordance with PowerChoice, Niagara Mohawk recognizes changes in accrued unbilled electric revenues in its results of operations, whereas, in the first eight months of 1998, the effects of the changes in accrued unbilled revenues were deferred. As a result, miscellaneous revenues, which include the unbilled revenues, have decreased by approximately \$13.3 million. Commercial revenues have decreased in 1999 due to lower rates under the PowerChoice agreement and due to commercial customers switching energy providers as a result of open access. When customers choose an alternative supplier of energy, Niagara Mohawk continues to collect delivery charges and the CTC, which are reflected as "Distribution of Energy." The GWh that are delivered to the customers who have chosen an alternative supplier are not included in

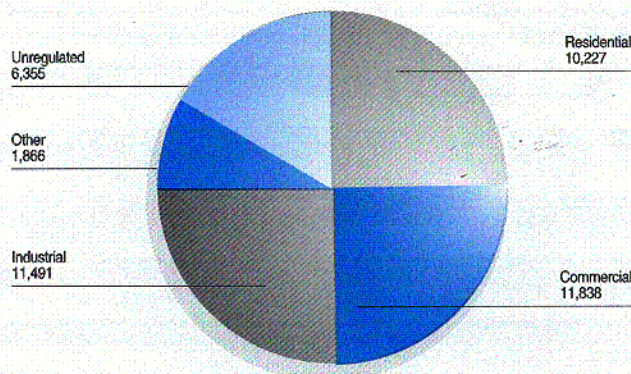
Niagara Mohawk's sales amounts. In circumstances where Niagara Mohawk sells energy to energy service companies for resale, those revenues are included in "Other Electric Systems." Overall electric revenues were not materially impacted by open access. Sales to other electric systems were also lower in 1999 primarily due to lower sales to one utility. Under PowerChoice, revenues may decline further as customers choose alternative suppliers and Niagara Mohawk no longer sells energy to energy service companies. However, Niagara Mohawk expects to incur less purchased power expense, and will be able to recover its stranded costs through the CTC. See Financial Statements and Supplementary Data – Electric Statistics, for a summary of electric revenue and sales data for the years 1997 through 1999.

The \$48.3 million or 1.5% decrease in 1998 regulated electric revenues was primarily due to a decrease in volume and mix of sales of \$72.3 million along with rate reductions under PowerChoice. The decrease was partially offset by increases in sales of energy to other electric systems and revenue from the distribution of energy.

	Increase (decrease) from prior year (In millions of dollars)		
Regulated Electric Revenues	1999	1998	Total
Fuel adjustment clause revenues....	\$ (33.5)	\$ (4.7)	\$ (38.2)
Changes in volume and mix of sales to ultimate consumers	101.6	(72.3)	29.3
Sales to other electric systems	(46.9)	11.0	(35.9)
Unbilled revenues.....	(43.3)	(2.3)	(45.6)
Distribution of energy.....	25.3	30.2	55.5
PowerChoice rates.....	(16.6)	(10.2)	(26.8)
	\$ (13.4)	\$ (48.3)	\$ (61.7)

Regulated electric kilowatt-hour sales were 35.4 billion in 1999, 36.4 billion in 1998 and 37.1 billion in 1997. While sales may continue to decline in 2000 and beyond as customers select alternative energy suppliers, Niagara Mohawk expects to remain stable.

1999 TOTAL ELECTRIC SALES
(millions of KWh)



Regulated electric sales for 1999 decreased 1.0 billion KWh or 2.8% as compared to 1998. The decrease is primarily due to a decrease in sales to other electric systems of 1.9 billion KWh or 53.4% as compared to 1998. Sales to other electric systems were lower in 1999 primarily due to reduced sales to one utility. Regulated electric sales were also affected by customers selecting alternative suppliers and billing customers that had been previously billed bi-monthly on a monthly basis.

The 1998 decrease of 0.7 billion KWh, or 1.9% as compared to 1997, is related primarily to a 4.5% decrease in sales to other electric systems. Sales to ultimate consumers also decreased in 1998 primarily due to warmer weather during the winter months.

Unregulated electric revenues for 1999 were \$217.1 million and were \$129.4 million and \$86.2 million in 1998 and 1997, respectively.

Unregulated electric sales for 1999 were 6.4 billion KWh and were 4.6 billion KWh and 3.3 billion KWh in 1998 and 1997, respectively.

The unregulated electric revenues and sales are generated entirely from Niagara Mohawk Energy, Inc. ("Niagara Mohawk Energy"). The revenue and sales include wholesale and retail transactions and reflect Niagara Mohawk Energy's increasing activity in the competitive energy market.

Detail of the changes in electric revenues and KWh sales by customer group are highlighted in the table below:

Class of service	1999 % of Holdings' Electric Revenues	% Increase (decrease) from prior year			
		Revenues	1999 Sales	Revenues	1998 Sales
Regulated:					
Residential	36.1%	4.0%	6.1%	(2.1)%	(2.6)%
Commercial	34.4	(2.3)	2.4	(1.1)	0.1
Industrial	14.0	0.8	2.1	(9.5)	(4.8)
Industrial – Special	1.9	2.0	(1.4)	3.3	1.4
Other	1.4	(8.8)	(17.0)	1.1	2.6
Total to ultimate consumers. . .	87.8	0.7	2.7	(2.8)	(1.6)
Other electric systems	1.4	(49.5)	(53.4)	13.1	(4.5)
Distribution of energy	1.6	82.3	—	5,565.0	—
Miscellaneous	2.9	(11.6)	—	(2.6)	—
Total regulated	93.7	(0.4)	(2.8)	(1.5)	(1.9)
Unregulated:					
Wholesale and retail	6.3	67.9	39.0	50.1	40.3
Total	100.0%	2.2%	1.9%	(0.2)%	1.5%

Regulated gas revenues increased \$14.4 million or 2.5% in 1999 primarily as a result of an increase in residential sales and revenue. The increase in residential revenues is partly the result of beginning to bill customers on a monthly basis rather than a bi-monthly basis. Most customers that were billed on a bi-monthly basis were residential customers. Pursuant to the gas settlement, changes in accrued unbilled revenue are deferred. The increase in regulated gas revenues is also due to revenue earned from revenue sharing mechanisms allowed in Niagara Mohawk's gas rates as a result of lowering the non-commodity cost of gas.

Regulated gas revenues decreased in 1998 by \$91.7 million or 14.0% primarily due to decreased sales to ultimate customers as a result of the migration of commercial sales customers to the transportation class and due to warmer weather in the winter months. Regulated gas revenues in 1998 were also negatively impacted by the regulated gas commodity cost adjustment clause ("CCAC").

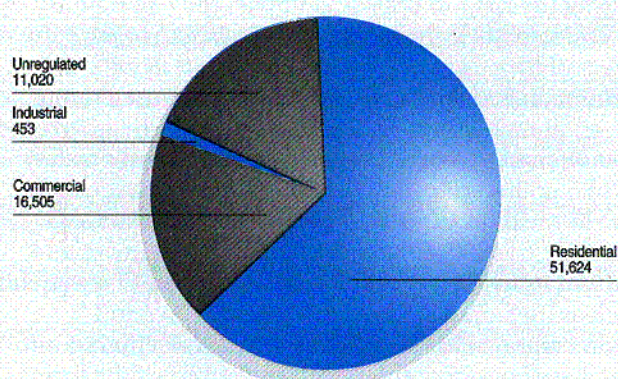
Rates for transported gas (excluding aggregation services) yield lower margins than gas sold directly by Niagara Mohawk. Therefore, sales of gas transportation services have not had a proportionate impact on earnings, particularly in instances where customers that took direct service from Niagara Mohawk move to a transportation-only class. In addition, changes in CCAC revenues are generally margin-neutral.

Regulated Gas Revenues	Increase (decrease) from prior year (in millions of dollars)		
	1999	1998	Total
Transportation of customer-owned gas	\$ 3.9	\$ (1.6)	\$ 2.3
CCAC revenues	(8.2)	(38.5)	(46.7)
Revenue sharing mechanisms	9.1	3.4	12.5
Spot market sales	(4.5)	2.4	(2.1)
Changes in volume and mix of sales to ultimate consumers	14.1	(57.4)	(43.3)
	\$ 14.4	\$ (91.7)	\$ (77.3)

Regulated gas sales in 1999, excluding transportation of customer-owned gas and spot market sales, were 68.6 million Dth, a 5.5% increase from 1998. The increase in the regulated gas sales is primarily attributable to colder weather in the first quarter of 1999, as well as the shift to monthly billing described above, which increased residential sales. Regulated revenues were also positively impacted by an increase in transportation volumes of 9.4 million Dth or 7.3% to customers purchasing gas directly from producers. The increases were partially offset by decreased spot market sales (sales for resale), which are generally from higher priced gas available to Niagara Mohawk and, therefore, yield margins that are substantially lower than traditional sales to ultimate customers.

Regulated gas sales in 1998, excluding transportation of customer-owned gas and spot market sales, were 65.0 million Dth and a 17.3% decrease from 1997. The decrease in 1998 was in all ultimate consumer classes, primarily due to the warmer weather. Regulated gas revenues were also negatively impacted by a decrease in transportation volumes of 24.9 million Dth or 16.3% to customers purchasing gas directly from producers mainly as a result of the termination and restatement of the PPAs as part of the MRA. The decreases were partially offset by increased spot market sales (sales for resale), which are generally from higher priced gas available to Niagara Mohawk and, therefore, yield margins that are substantially lower than traditional sales to ultimate customers.

1999 TOTAL GAS SALES
(thousands of Dth)



Unregulated gas revenues for 1999 were \$31.6 million and were \$36.0 million and \$24.3 million in 1998 and 1997, respectively.

Unregulated gas sales for 1999 were 11.0 million Dth and were 13.9 million Dth and 6.8 million Dth in 1998 and 1997, respectively.

The unregulated gas revenues and sales are generated entirely from Niagara Mohawk Energy. Unregulated gas revenues and sales declined in 1999 due to reduced opportunities in the wholesale market, which were only partially offset by increases in the retail market.

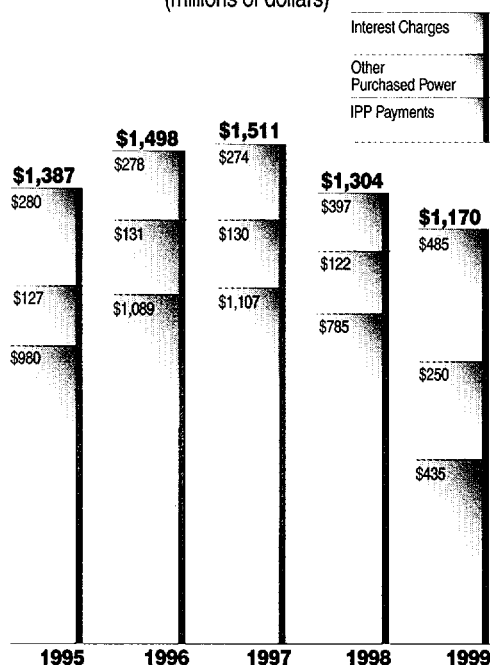
Changes in gas revenues and Dth sales by customer group are detailed in the following table:

Class of service	1999 % of Holdings' Gas Revenues	% Increase (decrease) from prior year			
		1999		1998	
		Revenues	Sales	Revenues	Sales
Regulated:					
Residential	63.8%	3.2%	9.3%	(13.3)%	(14.4)%
Commercial	17.6	(2.6)	(3.0)	(25.4)	(22.9)
Industrial	0.4	(35.3)	(39.8)	(44.8)	(45.5)
Total to ultimate consumers.....	81.8	1.6	5.5	(16.7)	(17.3)
Other gas systems.....	—	(17.4)	(41.2)	(46.9)	(39.3)
Transportation of customer-owned gas.....	9.5	7.3	7.3	(2.8)	(16.3)
Spot market sales	0.7	(51.1)	(59.3)	37.9	83.6
Miscellaneous	2.8	69.1	—	155.7	—
Total regulated	94.8	2.5	5.2	(14.0)	(15.6)
Unregulated:					
Wholesale and retail	5.2	(12.2)	(20.5)	48.5	105.0
Total	100.0%	1.7%	3.5%	(11.7)%	(12.2)%

Operating Expenses

Niagara Mohawk has taken two significant actions during the last two years that impact the components of its cost structure. In 1998, the MRA began to have the effect of lowering purchased power costs from IPPs by more than \$500 million annually, net of purchases of power at market prices, while creating a regulatory asset that increases amortization expense by approximately \$386.5 million per year and increasing interest expense due to the debt incurred to finance the MRA (\$3.45 billion). In 1999, Niagara Mohawk sold its hydro and most of its fossil assets, which reduced costs of ownership such as fuel, operating costs, property taxes and depreciation. However, Niagara Mohawk entered into purchase power contracts with the buyers of the formerly owned fossil and hydro assets, which were entered into as an integral part of the fossil/hydro sales, that increased its electricity purchased power costs by \$125.4 million through December 31, 1999. However, this increase was partially offset by lower fuel costs, which resulted in a net reduction in margin of approximately \$84 million. These purchase power contracts mainly expire in 2003. The proceeds from the sale of assets, combined with the improved cash flow resulting from the MRA, enabled Niagara Mohawk to reduce debt by over \$1.1 billion in 1999, which will reduce interest expense in the future.

NET REDUCTION IN CASH EXPENDITURES FROM THE MRA (millions of dollars)



Note: Values are for Niagara Mohawk only.

Niagara Mohawk's fuel for electric generation decreased \$50.3 million or 21% in 1999 primarily due to the sale of the two coal-fired generation plants in June 1999 and the sale of the oil and gas-fired generation plant

at Oswego in October 1999. Generation from Niagara Mohawk's two nuclear plants was reduced due to the two significant outages. See "NRC and Nuclear Operating Matters" above for a discussion of these outages. The decrease in fuel costs was partially offset by an increase in the generation at the remaining fossil generation plants. In accordance with PowerChoice, the electric fuel adjustment clause was discontinued. The fuel adjustment clause provided an adjustment to the customer's bill if the cost of fuel varied from a specified unit cost. In 1999, Niagara Mohawk recorded a \$3.0 million liability to customers resulting from PSC audit adjustments of prior years fuel costs. Niagara Mohawk's fuel for electric generation will continue to decrease in 2000 as the remaining generation assets are sold.

Niagara Mohawk's electricity purchased decreased \$195 million or 19.5% in 1999, as a result of reduced purchases and payments to IPPs. The decrease in IPP purchases is primarily the result of the MRA, which became effective June 30, 1998, and has had the impact of lowering Niagara Mohawk's average unit cost of purchased power. The decrease is partially offset by purchases under PPAs from Niagara Mohawk's previously owned fossil and hydro generation plants. Niagara Mohawk also increased its electricity purchases from other utilities and the NYISO in 1999 to meet its remaining load requirements. Niagara Mohawk anticipates that purchases from other utilities will decrease in the future and that these purchases will be made through the NYISO at market prices. Future IPP costs will be further reduced as Niagara Mohawk continues to negotiate settlements with other IPPs. However, purchased power costs will trend upward in the future as Niagara Mohawk's generation asset sales are completed and supply from owned generation is replaced by purchased power. See Financial Statements and Supplementary Data – Note 8. - Commitments and Contingencies, for a discussion of the PPAs that Niagara Mohawk is committed to at December 31, 1999.

Regulated electric fuel and purchased power costs decreased in 1998 by 12.3% or \$173.6 million. The decrease is mainly the result of decreased purchases from the IPPs of \$321.9 million. Of this amount, \$80 million relates to net reductions in purchases from IPP Parties for the period between the closing of the MRA to the PowerChoice implementation date, which were deferred for future rate making disposition because the time lag between these events was not contemplated in the PowerChoice agreement. The decrease in IPP purchases is primarily the result of the MRA agreement. (See "The MRA Agreement" above). Other purchased power costs decreased \$8.2 million. As a result, Niagara Mohawk's load requirements were met to a greater extent from internal sources, which resulted in an increase in fuel costs of \$58.9 million as compared to 1997.

Regulated Electric Fuel and Purchased Power Costs

(in millions of dollars)	% change from prior year									
	1999		1998		1997		1999 to 1998		1998 to 1997	
	GWh	Cost	GWh	Cost	GWh	Cost	GWh	Cost	GWh	Cost
Fuel for electric generation:										
Coal	2,989	\$ 44.9	7,988	\$ 118.7	7,459	\$ 106.4	(62.6)%	(62.2)%	7.1%	11.6%
Oil	2,282	74.3	1,669	57.1	701	32.2	36.7	30.1	138.1	77.3
Natural gas	946	30.6	843	23.3	394	8.6	12.2	31.3	114.0	170.9
Nuclear	7,166	36.9	7,842	40.0	6,339	33.0	(8.6)	(7.8)	23.7	21.2
Hydro	1,396	—	2,694	—	2,905	—	(48.2)	—	(7.3)	—
Sub-total electric generation	14,779	186.7	21,036	239.1	17,798	180.2	(29.7)	(21.9)	18.2	32.7
Deferral	—	3.0	—	0.9	—	(0.7)	—	233.3	—	(228.6)
Total electric generation	14,779	189.7	21,036	240.0	17,798	179.5	(29.7)	(21.0)	18.2	33.7
Electricity purchased:										
IPPs:										
Capacity	—	13.8	—	127.9	—	220.8	—	(89.2)	—	(42.1)
Energy and taxes	6,768	324.9	9,668	605.5	13,520	885.7	(30.0)	(46.3)	(28.5)	(31.6)
Swap payments	—	96.5	—	51.2	—	—	—	88.5	—	100.0
Total IPP purchases	6,768	435.2	9,668	784.6	13,520	1,106.5	(30.0)	(44.5)	(28.5)	(29.1)
Fossil/Hydro PPA's:										
Capacity	—	42.8	—	—	—	—	100.0	100.0	—	—
Energy and taxes	3,490	80.9	—	—	—	—	100.0	100.0	—	—
Swap payments	—	1.7	—	—	—	—	100.0	100.0	—	—
Total Fossil/Hydro purchases	3,490	125.4	—	—	—	—	100.0	100.0	—	—
Other purchases	12,306	250.0	8,638	122.0	9,421	130.2	42.5	104.9	(8.3)	(6.3)
Sub-total regulated purchases	22,564	810.6	18,306	906.6	22,941	1,236.7	23.3	(10.6)	(20.2)	(26.7)
Deferral	—	(3.6)	—	95.4	—	(0.6)	—	(103.8)	—	—
Total regulated purchases	22,564	807.0	18,306	1,002.0	22,941	1,236.1	23.3	(19.5)	(20.2)	(18.9)
Total generated and purchased	37,343	996.7	39,342	1,242.0	40,739	1,415.6	(5.1)	(19.8)	(3.4)	(12.3)
Losses/Niagara Mohawk use	1,921	—	2,910	—	3,603	—	(34.0)	—	(19.2)	—
	35,422	\$ 996.7	36,432	\$1,242.0	37,136	\$1,415.6	(2.8)%	(19.8)%	(1.9)%	(12.3)%
Average unit cost* (cents per KWh):										
Fuel for electric generation		1.26		1.14		1.01				
Electricity purchased		3.59		4.95		5.39				
Combined unit cost		2.67		2.91		3.48				

* The average unit cost does not include the deferred costs.

The above table presents the total costs for purchased electricity, while reflecting only fuel costs for Niagara Mohawk generation. Other costs of power production, such as property taxes, other operating expenses and depreciation are included within other income statement line items.

Holdings' fuel for electric generation and electricity purchased for 1999 is explained by Niagara Mohawk's activity, as well as an increase in unregulated supply costs of \$69.3 million or 50.8%, primarily due to increased sales requirements.

Niagara Mohawk's total cost of gas purchased decreased 2.0% in 1999 and decreased 21.3% in 1998. The cost fluctuations generally correspond to sales volume changes, as well as a decrease in gas prices. Niagara Mohawk sold 1.8, 4.5, and 2.5 million Dth on the

spot market in 1999, 1998, and 1997, respectively. The total cost of gas decreased \$5.4 million in 1999. This was the result of a 2.7% decrease in the average cost per Dth purchased (\$7.6 million), a \$4.5 million decrease in Dth purchased for spot market sales (sales for resale), which are generally from higher priced gas, and therefore, yield margins that are substantially lower than traditional sales to ultimate consumers, and a \$16.9 million decrease in purchased gas costs and certain other items recognized and recovered through the CCAC. These decreases were offset by a 6.4 million increase in Dth purchased and withdrawn from storage for ultimate consumer sales (\$23.6 million).

The total cost of gas decreased \$73.5 million in 1998. This was the result of a 19.3 million decrease in Dth purchased and withdrawn from storage for ultimate

consumer sales (\$71.7 million), a 1.3% decrease in the average cost per Dth purchased (\$3.5 million) and a \$1.0 million decrease in purchased gas costs and certain other items recognized and recovered through the CCAC. These decreases were partially offset by a \$2.7 million increase in Dth purchased for spot market sales.

Holdings' gas purchased expense reflects Niagara Mohawk's activity, as well as a decrease of \$4.8 million during 1999 primarily as a result of lower unregulated sales.

Other operation and maintenance expense for Holdings and Niagara Mohawk have decreased \$37.4 million and \$48.7, respectively in 1999. Expenses in 1999 have decreased in part as a result of the sale of the fossil and hydro generation assets. Partially offsetting these decreases are incremental costs associated with the implementation of CSS as discussed above, as well as an increase in bad debt expense of \$32.2 million. Operation and maintenance expense in 1998 reflect two major storms totaling approximately \$80.2 million in incremental costs.

Depreciation and amortization expense for both Holdings and Niagara Mohawk have decreased approximately \$10.4 million during 1999 primarily as a result of the sale of Niagara Mohawk's two coal-fired generation plants, its hydro generation plants and its oil and gas-fired generation plant at Oswego. However, this decrease is partially offset as a result of placing in service several computer system projects with depreciable lives that are significantly shorter than typical transmission and distribution assets.

Other taxes for both Holdings and Niagara Mohawk have decreased as compared to 1998 as a result of a reduction in the New York State GRT tax rate beginning in October 1998, as well as a reduction in property taxes of \$31.9 million in connection with the sale of Niagara Mohawk's two coal-fired generation plants, its hydro generation plants, and its oil and gas-fired plant at Oswego.

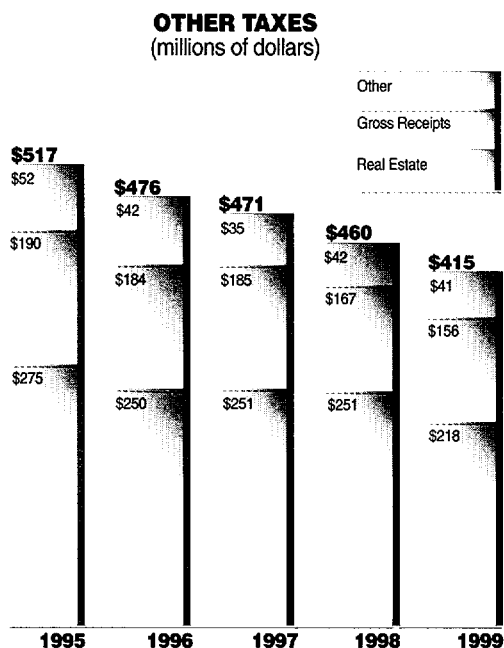
Other taxes decreased by \$11.5 million in 1998 primarily due to a reduction in GRT taxes of \$17.6 million as a result of the lower sales revenue.

In approving PowerChoice, the PSC ordered that any savings from any reduction in the interest associated with the debt issued in connection with the MRA financing as compared to assumptions underlying Niagara Mohawk's PowerChoice filing be deferred for future disposition. Holdings and Niagara Mohawk's other income decreased in part due to the recording of a regulatory liability relating to the MRA debt interest rate savings liability of \$17.3 million as compared to 1998. The decrease in other income is also due to the recording of approximately \$44.6 million in 1998 on the deferral of MRA financing costs as ordered by the PSC. These decreases were partially offset by the recording of the approximately \$9.0 million incentive earned under PowerChoice in 1999 on the sale of the fossil and hydro generation assets.

Although Holdings and Niagara Mohawk's interest charges increased in 1999 mainly due to the debt incurred to finance the MRA, the annualized level of charges has decreased since \$1.1 billion of debt was repaid during the year. Interest charges increased in 1998 by \$123.3 million after having remained fairly constant for the years 1996 and 1997. The increase in 1998 is mainly due to the interest charges incurred on the debt issued in mid-1998 in connection with the MRA.

Dividends on Niagara Mohawk's preferred stock did not significantly change from 1998 to 1999 and from 1997 to 1998. The changes are due to sinking fund redemptions and due to variations in dividend rates on the adjustable rate series of preferred stock. The weighted average long-term debt interest rate and preferred dividend rate paid, reflecting the actual cost of variable rate issues, were 7.74% and 7.00%, respectively in 1999 and were 7.46% and 7.00%, respectively in 1998.

The increase in Holdings and Niagara Mohawk's federal and foreign income taxes of approximately \$86 million, excluding the tax benefit associated with the extraordinary item, is primarily due to higher book taxable income in 1999 as compared to 1998. Included in the earnings for 1999 is approximately \$16.2 million of previously deferred investment tax credits associated with the two coal-fired generation plants, the hydro generation plants, and the oil and gas-fired plant in Oswego, which were sold. Niagara Mohawk believes this



Note: Prior year amounts are Niagara Mohawk's

accounting is consistent with applicable tax laws. After adjusting for Holdings' treatment of Niagara Mohawk's preferred dividends, Holdings' effective tax rate for 1999 is slightly higher than statutory rates. See Financial Statements and Supplementary Data – Note 6. Federal and Foreign Income Taxes for a reconciliation of the tax adjustments.

Niagara Mohawk recorded an extraordinary item during 1999 for the early extinguishment of debt of \$23.8 million, net of income taxes. With Niagara Mohawk's stronger operating cash flows and the proceeds from the sales of its coal, hydro and its oil and gas generation plants, Niagara Mohawk redeemed over \$820 million in debt prior to its scheduled maturity. The extraordinary item includes redemption premiums incurred, and the write-off of unamortized debt expense and debt issuance costs associated with each of the series that was redeemed.

Effects of Changing Prices

Niagara Mohawk is especially sensitive to inflation because of the amount of capital it typically needs and because its prices are regulated using a rate-base methodology that reflects the historical cost of utility plant.

Holdings and Niagara Mohawk's consolidated financial statements are based on historical events and transactions when the purchasing power of the dollar was substantially different than now. The effects of inflation on most utilities, including Niagara Mohawk, are most significant in the areas of depreciation and utility plant. Niagara Mohawk could not replace its utility assets for the historical cost value at which they are recorded on its books. In addition, Niagara Mohawk would not replace these with identical assets due to technological advances and competitive and regulatory changes that have occurred. In light of these considerations, the depreciation charges in operating expenses do not reflect the cost of providing service if new facilities were installed. See Construction and Other Capital Requirements below for a discussion of Niagara Mohawk's future capital requirements.

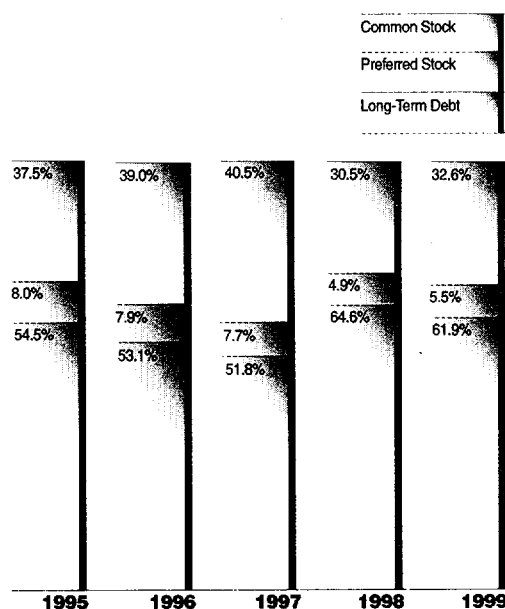
Financial Position, Liquidity and Capital Resources

Financial Position. Holdings and Niagara Mohawk's capital structure at December 31, 1999, and 1998 were as follows:

	Holdings	Niagara Mohawk	Holdings and Niagara Mohawk
%	1999	1999	1998
Long-term debt . .	61.9	63.3	64.6
Preferred stock of subsidiary . . .	5.5	—	—
Preferred stock . .	—	5.6	4.9
Common equity . .	32.6	31.1	30.5

The culmination of the MRA significantly increased the leverage of Niagara Mohawk and Holdings. However, the anticipated increased operating cash flow resulting from the MRA and PowerChoice agreement, including the proceeds from the sale of the fossil and hydro generation assets, and the planned rapid repayment of debt, should reduce the leverage in the capital structure of both entities.

CAPITALIZATION RATIO

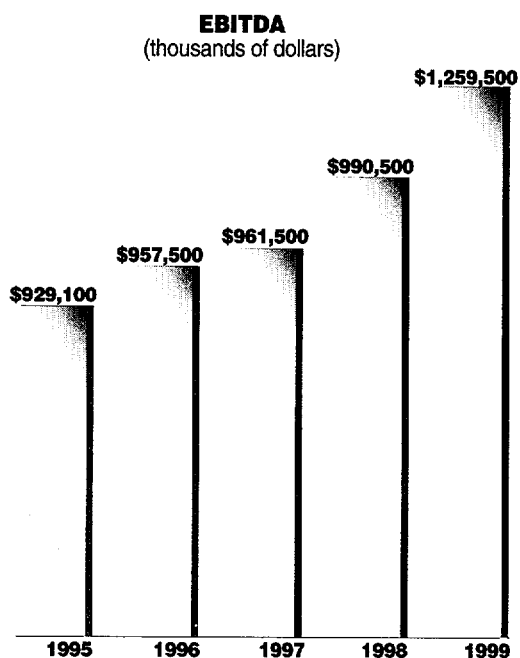


Note: Prior year ratio's are Niagara Mohawk's

Holdings' 1999 ratio of earnings to fixed charges was 0.95 times. Niagara Mohawk's ratios of earnings to fixed charges for 1998 and 1997 were 0.57 times and 2.02 times, respectively. The changes in the ratio are primarily due to the consummation of the MRA during 1998 and the redemption of over \$1 billion in debt during 1999. The MRA and PowerChoice agreement have the effect of substantially depressing earnings during its five-year term, while at the same time substantially improving operating cash flows. The primary result of the MRA was to convert a large and growing off-balance sheet payment obligation that threatened the financial viability of Niagara Mohawk into a fixed and more manageable capital obligation.

EBITDA for the 12 months ended December 31, 1999 was approximately \$1,260 million for Holdings, an increase of approximately \$0.3 billion compared to the 12 months ended December 31, 1998. This increase is generated almost entirely by Niagara Mohawk. The improvement in EBITDA is derived primarily from the impacts of the MRA and PowerChoice. EBITDA represents earnings before interest charges, interest income, income taxes, depreciation and amortization, amortization of nuclear fuel, allowance for funds used during construction, MRA regulatory asset amortization, and extraordinary items. The ratio of EBITDA to net cash interest for 1999 was 3.2 times as compared to 2.9 times in 1998. Net cash interest is defined as interest charges (net of allowance for funds used during construction) and less the non-cash impact of the net amortization of discount on long-term debt and interest accrued on the Nuclear Waste Policy Act liability and less interest income. The ratio of EBITDA to net cash interest also improved due to the impacts of the MRA and PowerChoice and Niagara Mohawk's debt reduction. EBITDA is a non-GAAP measure of cash flows and is presented to provide additional information about Holdings and Niagara Mohawk's ability to meet its future requirements for debt service. EBITDA should not be considered an alternative to net income as an indicator of operating performance or as an alternative to cash flows, as presented on the Consolidated Statement of Cash Flows, as a measure of liquidity.

The sales of the generation plants, especially nuclear, will tend to slightly lower future EBITDA primarily as a result of the PPAs that Niagara Mohawk entered into with the new owners of the generation assets.



Note: Prior year values are Niagara Mohawk's

Niagara Mohawk has been reviewing its capital structure in light of its scheduled debt reduction program, its divestiture of its electric generation assets and the changing industry. As a result, Niagara Mohawk filed two petitions with the PSC on July 1, 1999, to refinance its preferred stock to take advantage of lower dividend rates, and to purchase Holdings' common stock. See Financial Statements and Supplementary Data, Note 5. – Capitalization, for a further discussion of the two petitions and the actions taken. The impact on earnings per share as a result of these stock purchases was not significant for the year ended December 31, 1999, since earnings per share is calculated using the weighted average of common stock outstanding. However, the impact on future earnings per share will be more significant.

Common Stock Dividend. Niagara Mohawk's Board of Directors omitted its common stock dividend beginning the first quarter of 1996. This action was taken to help stabilize Niagara Mohawk's financial condition and provide flexibility as Niagara Mohawk addressed growing pressure from mandated power purchases and weaker sales. In making future dividend decisions, the Board of Directors of Holdings and Niagara Mohawk will evaluate the relative value to shareholders of dividend payments or the repurchase of common stock, along with standard business considerations, their financial conditions, limitations on dividend payments under the PowerChoice agreement, limitations on common stock dividend payments in senior bank financing agreement if unsecured debt ratings fall below current levels, the degree of competitive pressure on its prices, the level of available cash flow and retained earnings and other investments to be made by unregulated subsidiaries. For the next several years, Niagara Mohawk expects to dedicate a substantial portion of its future expected positive cash flow to reduce debt and buy back Holdings' common stock. See Financial Statements and Supplementary Data, Note 5. – Capitalization, for a discussion of the Holdings' common stock repurchased through December 31, 1999. The PowerChoice agreement limits the amount of common stock dividends that can be paid by Niagara Mohawk to Holdings, but does not limit the dividends that Holdings may pay to its shareholders. The limit under PowerChoice is based upon the amount of net income each year of Niagara Mohawk, plus a specified amount ranging from \$75 million in 1999 to \$100 million in 2000, 2001 and 2002 and declining thereafter through 2007. The limitation excludes one-time dividends associated with the sale of Niagara Mohawk's generation assets. The dividend limitation is subject to review after the term of the PowerChoice agreement. Furthermore, Niagara Mohawk forecasts that earnings for the five-year term of the PowerChoice agreement will be substantially depressed, as non-cash amortization of the MRA

regulatory asset is occurring (which asset is being amortized generally over a 10-year period) and the interest costs on the IPP debt is the greatest. The ability to improve earnings in the period subsequent to PowerChoice will depend upon the outcome of the regulatory process to set prices at that time. Payment of Niagara Mohawk dividends to Holdings will be subject to the prior rights of holders of Niagara Mohawk preferred stock, First Mortgage Bonds and other long-term debt.

During 1999, Holdings did not declare or pay any common stock dividends. During 1999, Niagara Mohawk paid approximately \$64 million in cash dividends to Holdings, as well as the dividend of Opinac. During January 2000, Niagara Mohawk paid approximately \$36 million in cash dividends to Holdings.

Construction and Other Capital Requirements.

Niagara Mohawk's total capital requirements consist of amounts for its construction program, see Financial Statements and Supplementary Data – Note 8. – Commitments and Contingencies – Construction Program, working capital needs, maturing debt issues and sinking fund provisions on preferred stock. Niagara Mohawk's annual expenditures for the years 1997 to 1999 for construction and nuclear fuel, including related AFC and overheads capitalized, were \$290.8 million, \$392.2 million and \$298.1 million, respectively. These expenditures, excluding nuclear fuel and AFC, are budgeted to be approximately \$219 million for 2000 and \$229 million and \$230 million in years 2001 and 2002, respectively. If the nuclear sale does not occur, Niagara Mohawk estimates that it will incur expenditures for construction and nuclear fuel of \$69 million for 2000 and \$32 million and \$67 million for 2001 and 2002, respectively. Capital expenditures were lower in 1999 as compared to 1998 due in part to the sale of several of Niagara Mohawk's generation assets. In addition, there were higher capital expenditures in 1998 of approximately \$71 million due to the costs incurred to rebuild a portion of Niagara Mohawk's regulated transmission and distribution facilities as a result of several storms. The estimates for 2000 and beyond include amounts relating to Niagara Mohawk's Albany oil and gas-fired generation plant through March 2000, its nuclear assets through June 2000 and Niagara Mohawk's 25% interest in the Roseton plant through December 2000. The estimate of construction additions included in capital requirements for the period 2000 to 2002 will be reviewed by management to give effect to the overall objective of further reducing construction spending where possible. Any change in the timing or outcome of these remaining generation asset sales and nuclear sale will effect Niagara Mohawk's capital expenditure requirements.

Mandatory debt and preferred stock retirements are expected to add approximately another \$618.1 million to

the 2000 estimate of capital requirements and are expected to add approximately \$631.8, \$547.1, \$613.8, and \$235.5 million in the next subsequent four years. The 2000 estimate includes \$105 million related to the senior bank facility discussed below, which is classified as current pending renegotiation of the facility.

See discussion in "Liquidity and Capital Resources" section below, which describes how management intends to meet its future financing needs.

Liquidity and Capital Resources. External financing plans are subject to periodic revision as underlying assumptions are changed to reflect developments and market conditions. The ultimate level of financing during the period 2000 through 2004 will be affected by, among other things:

- Niagara Mohawk's competitive position and the extent to which competition penetrates its markets;
- changes in electric and gas prices as a result of regulatory proceedings;
- potential future actions with respect to IPPs not covered under the MRA;
- uncertain energy demand due to the weather and economic conditions and obligations to serve as provider of last resort;
- the cash tax benefits anticipated because the MRA generated a net tax operating loss carryforward in 1998;
- levels of common stock repurchases;
- levels of common dividend payments, if any, and preferred dividend payments; and
- the results of the remaining sales of Niagara Mohawk's generation assets.

The proceeds of the sales of the generation assets are subject to the terms of Niagara Mohawk's mortgage indenture and the note indenture that was entered into in connection with the MRA debt financing. Niagara Mohawk has petitioned the PSC to issue up to an aggregate of \$400 million in debt to address its financial needs arising from the recent and prospective termination or restructuring of additional IPP contracts. Niagara Mohawk plans to issue at least \$200 million of unsecured debt during the first half of 2000. In addition, Niagara Mohawk may refinance existing debt to take advantage of lower interest rates.

Niagara Mohawk is obligated to use 85% of the proceeds of the sale of its generation assets to reduce debt outstanding, as outlined in its Senior Note indenture. In June 1999, Niagara Mohawk announced an agreement to sell its nuclear assets to AmerGen for \$135 million, which is subject to price adjustments depending on the timing of the closing. Niagara Mohawk has also announced on October 6, 1999, an

agreement to sell its oil and gas-fired plant at Albany for \$47.5 million. In addition, Niagara Mohawk could also receive up to an additional \$11.5 million if the buyer chooses to pursue the redevelopment of the Albany plant. For a further discussion of the terms and adjustments to the generation assets sales agreements, see "Generation Assets Sales" above. With Niagara Mohawk's stronger operating cash flows and proceeds from sales of its coal, hydro, and its oil and gas facilities, approximately \$1.1 billion of debt was retired in 1999 consistent with debt reduction goals.

Niagara Mohawk has an \$804 million senior bank financing with a bank group, consisting of a \$255 million term loan facility, a \$125 million revolving credit facility and \$424 million for letters of credit. The letter of credit facility provides credit support for the adjustable rate pollution control revenue bonds issued through the NYSERDA. The interest rate applicable to the senior bank financing is variable based on certain rate options available under the agreement and currently approximates 6.625% (but is capped at 15%). As of December 31, 1999, the amount outstanding under the senior bank financing was \$529 million, consisting of \$105 million under the term loan facility and \$424 million of letters of credit, leaving Niagara Mohawk with \$275 million of borrowing capability under the financing. The senior bank facility term expires on June 1, 2000. As a result, the amount outstanding on this facility at December 31, 1999, \$105 million, is shown as a current liability on both Holdings and Niagara Mohawk's balance sheets. This facility is collateralized by first mortgage bonds. Niagara Mohawk is currently negotiating a new financing arrangement with a bank group and believes as a minimum it will be able to obtain \$424 million for letters of credit prior to the expiration of the senior bank facility on June 1, 2000. Opinac had an agreement with a bank providing for letters of credit totaling up to \$25 million which in January 2000 was replaced by a \$50 million bank facility secured by certain assets of Opinac. The facility provides for letters of credit and a \$10 million line of credit. The facility expires September 30, 2000 and as of January 31, 2000, supports approximately \$20 million in letters of credit. Opinac is working to extend the facility beyond September 30, 2000.

Niagara Mohawk has the ability to issue First Mortgage Bonds to the extent that there have been maturities since June 30, 1998. Through December 31, 1999, Niagara Mohawk had \$60 million in First Mortgage Bonds maturities.

Ordinarily, construction related short-term borrowings are refunded with long-term securities on a periodic basis. This approach generally results in a working capital deficit. Working capital deficits may also be a result of the seasonal nature of Niagara Mohawk's

operations as well as the timing of differences between the collection of customer receivables and the payments of fuel and purchased power costs. Niagara Mohawk's current working capital deficit is largely attributable to amounts due in 2000 for the Senior Notes incurred as part of the MRA and the current classification of \$105 million under the term loan facility. Niagara Mohawk believes it has sufficient cash flow and borrowing capacity to fund such deficits as necessary in the near term. In addition, as noted above, Niagara Mohawk is currently negotiating a new financing arrangement and expects to have it in place before the current arrangement expires.

Niagara Mohawk has established a single-purpose, financing subsidiary, NM Receivables LLC, ("NMR") whose business consists of the purchase and resale of an undivided interest in a designated pool of Niagara Mohawk customer receivables, including accrued unbilled revenues. See Financial Statements and Supplementary Data, Note 8. – Commitments and Contingencies for a further discussion of this customer receivables program.

At December 31, 1999, and 1998, \$215.1 million and \$150 million, respectively, of receivables had been sold by NMR to a third party. The total amount of receivables that can be sold is \$300 million. Niagara Mohawk has the discretion to increase or decrease the actual amount sold, subject to a cap. The undivided interest in the designated pool of receivables was sold with limited recourse. The agreement provides for a formula based loss reserve pursuant to which additional customer receivables are assigned to the purchaser to protect against bad debts. At December 31, 1999, the amount of additional receivables assigned to the purchaser, as a loss reserve, was approximately \$83.2 million.

In the fourth quarter of 1999, NMR was not in compliance with a certain statistical ratio relating to the pool of receivables sold. The purchaser has granted a waiver for this period. While NMR is working to return to compliance with this ratio, it is possible a non-compliance condition could continue to exist. NMR is unable to predict whether further waivers would be granted.

In December 1998, Niagara Mohawk received a ruling from the Internal Revenue Service ("IRS") to the effect that the amount of cash and the value of common stock that was paid to the terminated IPP Parties was deductible and generated a substantial net operating loss ("NOL") for federal income tax purposes, such that Niagara Mohawk did not pay federal income taxes for the 1998 tax year. Further, Niagara Mohawk has carried back unused NOL to the years ended 1996 and 1997, and also for the years 1988 through 1990, which resulted in a tax refund of \$135 million received in January 1999. As a result of the Agreement and Plan of Exchange between Niagara Mohawk and Holdings on March 18, 1999,

(Financial Statements and Supplementary Data, Note 1. - Summary of Significant Accounting Policies, Corporate Structure and Principles of Consolidation), Holdings will now be the tax filer to benefit from the remaining tax carryforward. Holdings anticipates that it will be able to utilize the remaining \$2.6 billion NOL carryforward, as of December 31, 1999, to offset income earned in the future, before the expiration date of the NOLs in 2019.

Holdings' ability to utilize the NOL generated, as a result of the MRA, could be limited under the rules of section 382 of the Internal Revenue Code if certain changes in Holdings' common stock ownership were to occur in the future. In general, the limitation is triggered by a more than 50% change in stock ownership during any three-year testing period by shareholders that own, directly or indirectly, 5% or more of the common stock. For purposes of making the change in ownership computation, the IPP Parties who were issued common stock pursuant to the MRA, are likely to be considered a separate 5% shareholder group, as will the purchasers of common stock in the public offering completed immediately prior to consummation of the MRA. Under the computational rules prescribed by applicable Treasury regulations, Niagara Mohawk has experienced an approximate 17 percentage point owner shift in its stock within the three-year period ending on June 30, 1998, as a result of the distribution of stock to the IPP Parties and the public offering. During the year 1999, Niagara Mohawk made several purchases of its parents' common stock. In total, Niagara Mohawk purchased 10 million shares of Holdings' common stock, which in aggregate would be treated under Code Section 382 as a redemption. Holdings has performed the testing required by Section 382 in connection with the purchases of Holdings' common stock by Niagara Mohawk. Holdings believes it has experienced an approximate 21 percentage point owner shift in its stock for the three year period ending December 31, 1999, which includes the shares issued as part of the MRA, as well as the stock repurchased by Niagara Mohawk. Thus, if the IPP Parties, the purchasers in the public offering and any other 5% shareholders collectively experience ownership increases totaling 29% or more during any three year testing period that includes the consummation dates of the public offering, the MRA and the stock purchases by Niagara Mohawk, the statutory limit could be breached. The rules for determining a change in stock ownership for purposes of Code Section 382 are extremely complicated and in many respects uncertain. A stock ownership change could occur as a result of circumstances that are not within the control of Holdings. If a more than 50% change in ownership were to occur, Holdings' remaining usable NOL carryforward would likely be significantly lower in the future than the NOL carryforward amount which otherwise would be usable absent the limitation. Consequently, Holdings'

net cash position could be significantly lower as a result of tax liabilities, which otherwise would be eliminated or reduced through unrestricted use of the NOL carryforward.

Net cash from operating activities increased \$4,035.4 million for Holdings and \$4,039.2 million for Niagara Mohawk in 1999 as compared to 1998, primarily because the 1998 operating cash included the payments to the settling IPPs to consummate the MRA. The operating cash flows for 1999 also improved due to Niagara Mohawk's receipt of federal income tax refunds in January 1999 totaling approximately \$135 million and as expected, operating cash flow improved due to the impacts of the MRA and PowerChoice.

Holdings and Niagara Mohawk's net cash from investing activities increased \$937.9 and \$1,043.6 million, respectively in 1999 as compared to 1998. These increases are primarily due to the cash received from the sales of the Huntley and Dunkirk coal-fired generation assets, the hydro generation assets and the oil and gas-fired plant at Oswego.

Holdings and Niagara Mohawk's net cash from financing activities decreased \$4,824.9 and \$4,978.5 million, respectively due to the early repayment of debt, and the dividend and related cash transfer of Opinac to Holdings on March 31, 1999. Financing activities during 1998 were positively impacted by the issuance of the Senior Notes to finance the MRA.

Quantitative and Qualitative Disclosures About Market Risk

Niagara Mohawk is exposed to various market risks in interest rates, commodity prices, equity prices and foreign currency valuation because of transactions conducted in the normal course of business. The financial instruments held or issued by Niagara Mohawk and Niagara Mohawk Energy, Opinac's energy marketing subsidiary are used for hedging or cost control and not for trading.

Quantitative and qualitative disclosures are discussed by market risk exposure category:

- Interest Rate Risk
- Commodity Price Risk
- Equity Price Risk
- Foreign Currency Exchange Risk

An Exposure Management Committee ("EMC") was set up to monitor and control efforts to manage these risks. The EMC issues and oversees the Financial Risk Management Policy (the "Policy") applicable to the regulated company that outlines the parameters within which corporate managers are to engage in, manage, and report on various areas of risk exposure. At the core

of the Policy is a condition that Niagara Mohawk will engage in activities at risk, only to the extent that those activities fall within commodities and financial markets to which it has a physical market exposure in terms and in volumes consistent with its core business. That core business is to supply energy, in the form of electricity and natural gas to customers within Niagara Mohawk's service territory. The policies of Niagara Mohawk may be revised as its primary markets continue to change, principally as increased competition is introduced and the role of Niagara Mohawk in these markets evolves.

Niagara Mohawk Energy maintains a separate Risk Management and Trading Policy Manual that allows for transactions such as marketing and trading in retail and wholesale, physically and financially settled, energy based instruments. These actions expose Niagara Mohawk Energy to a number of risks such as forward price, deliverability, market liquidity and credit risk. Like Niagara Mohawk's Policy, the energy trading policy seeks to assure that risks are identified, evaluated and actively managed.

Interest Rate Risk. Niagara Mohawk's exposure to changes in interest rates is due to its financing through a senior debt facility, several series of adjustable rate promissory notes and adjustable rate preferred stock. See Note 4. - Bank Credit Arrangements and Note 5. - Capitalization. Under the senior debt facility, Niagara Mohawk currently has an outstanding term loan of \$105 million. The adjustable rate promissory notes are currently valued at \$413.8 million, and Niagara Mohawk has \$121.3 million outstanding in adjustable rate preferred stock. Another issue of \$150 million of fixed-adjustable rate preferred stock is fixed at 6.9% for the first five years then adjusts and is not considered adjustable for this analysis. There is no interest rate cap on the promissory notes. The interest on the term loan is variable but capped at 15%.

Dividend rates for Niagara Mohawk's preferred stock are indexed to U.S. government interest bearing securities plus or minus an amount stipulated in each series and have floors of 6.5% to 7.5% and caps of between 13.5% and 16.5%. As of December 31, 1999, the rate calculated on the index for each series is below the floor, therefore, the current rate is equal to the floor. Future changes in the indexed rate will not result in an exposure to higher dividend rates until the floor is exceeded. However, for the purposes of the following sensitivity analysis, a hypothetical one percent increase from the floor dividend rate is assumed.

Niagara Mohawk also maintains long-term debt at fixed interest rates. A controlling factor on the exposure to interest rate variations is the mix of fixed to variable rate instruments maintained by Niagara Mohawk. For 1999 and 1998, adjustable rate instruments comprise 7.5% and 6.4% of total capitalization; term loan and

promissory notes are 9.2% and 7.7% of total long-term debt. The proportion of adjustable instruments to total capitalization and debt has increased because of Niagara Mohawk's efforts to pay down debt in 1999. However, they still remain small in relation to total capitalization and debt thus, limiting Niagara Mohawk's exposure to interest rate fluctuations.

If interest rates averaged one percent more in 2000 versus 1999, Niagara Mohawk's interest expense would increase and income before taxes decrease by approximately \$5.2 million. This figure was derived by applying the hypothetical one percent variance across the variable rate debt of \$518.8 million at December 31, 1999 (the sum of the term loan and promissory notes). The same one percent increase in Niagara Mohawk's preferred dividend rate applied against the outstanding balance of \$121.3 million would result in an increase to dividend payments of \$1.2 million, assuming that the indexed rate was between the floor and cap. Under the current rate agreement, prices to customers are fixed for three years, with limited increases available in years four and five, if justified by Niagara Mohawk. Changes in the actual cost of capital from levels assumed in the current rate agreement would create either exposure or opportunity for Niagara Mohawk until reflected in future prices.

Commodity Price Risk. Niagara Mohawk is exposed to market fluctuations in the prices for electricity, natural gas, and oil. Niagara Mohawk does not, generally, speculate on movements in the underlying prices for these commodities. Purchases are based on analyses performed in relation to fuel needs for power generation and customer delivery for electricity and natural gas. Niagara Mohawk's commodity price risk in regards to power generation will be eliminated after the sale of the remaining fossil generation plants. Where possible, Niagara Mohawk takes positions in order to mitigate expected price increases but only to the extent that quantities are based on expectations of delivery. Niagara Mohawk attempts to mitigate exposure through a program that hedges risks as appropriate.

Niagara Mohawk Energy has reduced its amount of trading activity since 1998. Any trading activities performed are accounted for on a marked-to-market basis with changes in fair value recognized as a gain or loss in the period of change. The fair value of open trading positions at December 31, 1999, as well as the effect of Niagara Mohawk Energy's trading activities were not material to Holdings' results of operations.

Activities for non-trading purposes generally consist of transactions entered into to hedge the market fluctuations of contractual and anticipated commitments. Gas futures and electric forward contracts are used for hedging purposes. Changes in market value of futures and forward contracts relating to hedged items

are deferred until the physical transaction occurs, at which time, income or loss is recognized. The fair value of open positions for non-trading purposes at December 31, 1999, as well as the effect of these activities on Holdings' results of operations for the same period ending, was not material.

The fair values of futures and forward contracts are determined using quoted market prices.

The commodity risk exposure of Niagara Mohawk Energy does not constitute a material risk of loss to Holdings.

With respect to electricity, as customers choose an alternative supplier, Niagara Mohawk sheds commodity risks. In addition, many large customers that continue to purchase electricity from Niagara Mohawk have agreed to take market price risk, further lowering commodity risk. For the remaining customers that have firm prices, Niagara Mohawk has hedged a significant portion of the commodity costs through various physical and financial contracts. Under the principles established in PowerChoice, as these contracts expire, customers who buy electricity from Niagara Mohawk will bear the commodity price risk for the amount of energy associated with the expiring contracts.

Niagara Mohawk, as part of the MRA, entered into restated indexed swap contracts with eight IPPs and financial swap agreements as part of the sale of the Huntley and Dunkirk coal-fired generation stations. See Note 9. - Fair Value of Financial and Derivative Financial Instruments, for a more detailed discussion of these swap contracts.

The fair value of the liability under the swap contracts, based upon the difference between projected future market prices and projected contract prices applied to the notional quantities and discounted at 8.5%, is approximately \$664 million and is recorded on Niagara Mohawk's balance sheet as a liability for swap contracts. The discount rate is based upon comparable debt instruments of Niagara Mohawk. Based upon the PSC's approval of the restated contracts, including the indexed swap contracts, as part of the MRA and being provided a reasonable opportunity to recover the estimated indexed swap liability from customers, Niagara Mohawk has recorded a corresponding regulatory asset. The amount of the recorded liability and regulatory asset is sensitive to changes in discount rate, anticipated future market prices and changes in the indices upon which the indexed swap contracts are based. However, changes in anticipated future market prices and discount rates will not impact the future cash flow of Niagara Mohawk when considering the all-in price of the notional quantities of energy. Specifically, as market prices rise or fall, payments under the indexed swap contracts move inversely. Similarly, changes in discount rates will not impact the all-in price. If the indexed contract price

were to increase or decrease by one percent, Niagara Mohawk would see a \$15.6 million increase or decrease in the present value of the projected over-market exposure. If the market prices were to increase or fall by one percent, Niagara Mohawk would see a \$9.7 million decrease or increase in the projected over-market exposure. If the discount rate were to increase or decrease to 9.0% or 8.0%, the net present value of the projected over market exposure would decrease or increase by approximately \$9.3 million.

The cost of natural gas sold to customers fluctuates during the year with prices most volatile in the winter months. Niagara Mohawk has a policy to reduce the variability in gas costs over the winter months. Through purchase agreements limiting or eliminating gas price volatility with three gas suppliers (approximately 3.2 billion cubic feet ("Bcf")) and by drawing on stored gas supplies (approximately 21.5 Bcf), Niagara Mohawk will be able to reduce price volatility on approximately 50% of the anticipated winter demand.

The rest of the gas needs are met through market-based purchases and are subject to price fluctuations. On November 1, 1999, the gas commodity cost adjustment clause ("CCAC") expired and, through an interim agreement with the PSC, was replaced by a Gas Adjustment Clause ("GAC") that allows for recovery in gas rates of actual commodity costs and pipeline demand charges. The GAC eliminates gas commodity and pipeline demand price risk from the earnings of Niagara Mohawk.

The PSC has mandated that Niagara Mohawk attempt to reduce the price volatility in the gas commodity portion of customers' bills. In response, Niagara Mohawk's board has authorized the use of futures, options and swaps to hedge against gas price fluctuations. The hedging program will be consistent with the Financial Risk Management Policy and will be monitored by the EMC. Niagara Mohawk intends to use futures contracts and options traded on the New York Mercantile Exchange to hedge approximately 10% of Niagara Mohawk's winter demand.

Equity Price Risk. The NRC requires nuclear plant owners to place funds in an external trust to provide for the cost of decommissioning of the contaminated portions of nuclear facilities. See Note 3. - Nuclear Operations. Niagara Mohawk has established qualified and non-qualified trust funds for Unit 1 and Unit 2. At December 31, 1998, these funds were invested in fixed income securities, domestic equity securities, and cash equivalents. The fixed income securities are subject to interest rate fluctuations and the equity securities to price change in the equity markets. The funds asset allocation was designed to maximize returns commensurate with Niagara Mohawk's risk tolerance. As of December 31, 1999, the funds were invested primarily

in high grade, short-term commercial paper. The current fund allocation is designed to guarantee stability and predictability in the fund balances.

During 1999, Niagara Mohawk announced an agreement to sell its nuclear assets. The agreement to sell the nuclear generation assets includes the transfer of the decommissioning trust funds, at an agreed amount, to the buyer. In anticipation of that sale, and to reduce the risk of a detrimental market shift affecting the funds, Niagara Mohawk converted all decommissioning assets to high grade, short-term commercial paper in October and November of 1999. The instruments purchased have specified coupon rates and maturity dates of generally one to four months. The fund managers can only purchase the commercial paper from a list of companies pre-approved based on an excellent credit

rating. Remaining cash is invested in an overnight, short-term investment fund. Due to the makeup of the funds at December 31, 1999, they no longer experience any substantial risk of loss due to market shifts or credit risk.

Foreign Currency Exchange Risk. Holdings has a foreign currency exchange risk as a result of its investments in Canada through its non-regulated subsidiary. Translation adjustments due to exchange rate movement across the value of the subsidiary is reported in Capitalization as a Foreign Currency Translation Adjustment (see Note 5. – Capitalization) and is a component of Comprehensive Income, see "Consolidated Statements of Comprehensive Income." In aggregate, the risk of loss does not pose a material threat to Holdings' consolidated results of operations or total capitalization.

Report of Management



The consolidated financial statements of Holdings and Niagara Mohawk and their subsidiaries were prepared by and are the responsibility of management. Financial information contained elsewhere in this Annual Report is consistent with that in the financial statements.

To meet its responsibilities with respect to financial information, management maintains and enforces a system of internal accounting controls, which is designed to provide reasonable assurance, on a cost effective basis, as to the integrity, objectivity and reliability of the financial records and protection of assets. This system includes communication through written policies and procedures, an organizational structure that provides for appropriate division of responsibility and the training of personnel. This system is also tested by a comprehensive internal audit program. In addition, a Corporate Policy Register and a Code of Business Conduct (the "Code") supply employees with a framework describing and defining Holdings' overall approach to business and require all employees to maintain the highest level of ethical standards as well as requiring all management employees to formally affirm their compliance with the Code.

The financial statements have been audited by PricewaterhouseCoopers LLP, Holdings and Niagara Mohawk's independent accountants, in accordance with generally accepted auditing procedures. In planning and performing its audit, PricewaterhouseCoopers LLP considered Holdings and Niagara Mohawk's internal control structures in order to determine auditing procedures for the purpose of expressing an opinion on the financial statements, and not to provide assurance on the internal control structures. The independent accountants' audit does not limit in any way management's responsibility for the fair presentation of the financial statements and all other information, whether audited or unaudited, in this Annual Report. The Audit Committee of Holdings' Board of Directors, consisting of five outside directors who are not employees, meets regularly with management, internal auditors and PricewaterhouseCoopers LLP to review and discuss internal accounting controls, audit examinations and financial reporting matters. PricewaterhouseCoopers LLP, and Holdings and Niagara Mohawk's internal auditors have free access to meet individually with the Audit Committee at any time, without management being present.

A handwritten signature in dark ink, appearing to read "William E. Davis".

William E. Davis
Chairman of the Board and
Chief Executive Officer
Niagara Mohawk Holdings, Inc. and
Niagara Mohawk Power Corporation

Report of Independent Accountants

PRICEWATERHOUSECOOPERS The PwC logo, consisting of the letters "PwC" in a stylized, bold font.

To the Stockholders and Board of Directors of
Niagara Mohawk Holdings, Inc. and
Niagara Mohawk Power Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and retained earnings, of comprehensive income and of cash flows present fairly, in all material respects, the financial position of Niagara Mohawk Holdings, Inc. and its subsidiaries ("Holdings") at December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999 and the accompanying consolidated balance sheets and the related consolidated statements of income and retained earnings, of comprehensive income and of cash flows present fairly, in all material respects, the financial position of Niagara Mohawk Power Corporation and its subsidiaries ("Niagara Mohawk") at December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of management of Holdings and Niagara Mohawk; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

A handwritten signature in dark ink, appearing to read "PricewaterhouseCoopers LLP".

PricewaterhouseCoopers LLP
Syracuse, New York

January 27, 2000

Niagara Mohawk Holdings, Inc. and Subsidiary Companies

Consolidated Balance Sheets

At December 31,	In thousands of dollars	
	1999	1998
ASSETS		
Utility plant (Note 1):		
Electric plant	\$ 7,221,762	\$ 8,826,650
Nuclear fuel	630,321	604,213
Gas plant	1,263,168	1,179,716
Common plant	364,718	349,066
Construction work in progress	312,322	471,802
Total utility plant	9,792,291	11,431,447
Less-Accumulated depreciation and amortization	3,904,049	4,553,488
Net utility plant	5,888,242	6,877,959
Other property and investments	484,735	411,106
Current assets:		
Cash, including temporary cash investments of \$90,029 and \$122,837, respectively	116,164	172,998
Accounts receivable (less allowance for doubtful accounts of \$61,400 and \$47,900, respectively) (Notes 1 and 8)	373,510	427,588
Materials and supplies, at average cost:		
Coal and oil for production of electricity	9,263	42,299
Gas storage	39,166	38,803
Other	90,605	118,855
Refundable federal income taxes	—	130,411
Prepaid taxes	21,489	17,282
Other	24,042	22,208
	674,239	970,444
Regulatory assets (Note 2):		
MRA regulatory asset	3,686,019	4,045,647
Swap contracts regulatory asset	505,723	535,000
Regulatory tax asset	483,546	425,898
IPP buyout costs	260,873	41,971
Deferred environmental restoration costs (Note 8)	240,000	220,000
Deferred loss on sale of assets	135,229	—
Postretirement benefits other than pensions	48,937	52,701
Unamortized debt expense	44,903	51,922
Other	112,556	95,090
	5,517,786	5,468,229
Other assets	105,433	133,449
	\$ 12,670,435	\$ 13,861,187

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

Niagara Mohawk Holdings, Inc. and Subsidiary Companies

Consolidated Balance Sheets

At December 31,	In thousands of dollars	
	1999	1998
CAPITALIZATION AND LIABILITIES		
Capitalization (Note 5):		
Common stockholders' equity:		
Common stock, outstanding 177,364,863 shares	\$ 1,874	\$ —
Common stock of Niagara Mohawk, issued and outstanding 187,364,863 shares	—	187,365
Treasury stock, at cost -10,000,000 shares	(157,167)	—
Capital stock premium and expense	2,546,630	2,362,531
Accumulated other comprehensive income	(26,200)	(25,794)
Retained earnings	610,952	646,040
	2,976,089	3,170,142
Preferred stock of subsidiary:		
Not subject to mandatory redemption	440,000	440,000
Subject to mandatory redemption	61,370	68,990
Long term debt	5,042,588	6,417,225
Total capitalization	8,520,047	10,096,357
Current liabilities:		
Long-term debt due within one year (Note 5)	613,740	312,240
Sinking fund requirements on redeemable preferred stock of subsidiary (Note 5)	7,620	7,620
Accounts payable	288,223	197,124
Payable on outstanding bank checks	22,067	39,306
Customers' deposits	15,255	17,148
Accrued taxes	1,408	6,254
Accrued interest	67,593	132,236
Accrued vacation pay	35,334	38,727
Other	67,068	91,877
	1,118,308	842,532
Regulatory and other liabilities:		
Accumulated deferred income taxes (Notes 1 and 6)	1,568,957	1,511,417
Liability for swap contracts (Note 9)	663,718	693,363
Employee pension and other benefits (Note 7)	226,223	235,376
Unbilled gas revenues (Note 1)	14,552	30,652
Other	318,630	231,490
	2,792,080	2,702,298
Commitments and contingencies (Notes 2 and 8):		
Liability for environmental restoration	240,000	220,000
	\$ 12,670,435	\$ 13,861,187

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

Niagara Mohawk Holdings, Inc. and Subsidiary Companies
Consolidated Statements of Income and Retained Earnings

For the year ended December 31,	In thousands of dollars		
	1999	1998	1997
Operating revenues:			
Electric	\$ 3,464,901	\$ 3,390,501	\$ 3,395,611
Gas	611,226	601,276	681,230
Other	8,059	643	1,654
	4,084,186	3,992,420	4,078,495
Operating expenses:			
Electricity purchased	1,012,811	1,138,453	1,322,537
Fuel for electric generation	189,657	239,982	179,455
Gas purchased	297,641	307,841	371,615
Other operation and maintenance	910,871	948,297	845,758
PowerChoice charge	—	263,227	—
Amortization of the MRA regulatory asset	386,499	128,833	—
Depreciation and amortization	345,473	355,919	340,239
Other taxes	415,082	460,940	472,212
	3,558,034	3,843,492	3,531,816
Operating income	526,152	148,928	546,679
Other income	3,795	60,697	37,157
Income before interest charges	529,947	209,625	583,836
Interest charges	485,240	397,178	273,906
Preferred dividend requirement of subsidiary	36,808	36,555	37,397
Income (loss) before federal and foreign income taxes	7,899	(224,108)	272,533
Federal and foreign income taxes	19,180	(66,728)	126,595
Income (loss) before extraordinary item	(11,281)	(157,380)	145,938
Extraordinary item - Loss from the extinguishment of debt, net of income taxes of \$12,819 (Note 5)	(23,807)	—	—
Net income (loss)	(35,088)	(157,380)	145,938
Retained earnings at beginning of year	646,040	803,420	657,482
Retained earnings at end of year	\$ 610,952	\$ 646,040	\$ 803,420
Average number of shares of common stock outstanding (in thousands)	186,689	166,186	144,404
Basic and diluted earnings (loss) per average share of common stock before extraordinary item	\$ (0.06)	\$ (0.95)	\$ 1.01
Extraordinary item per average share of common stock	(0.13)	—	—
Basic and diluted earnings (loss) per average share of common stock	\$ (0.19)	\$ (0.95)	\$ 1.01

Consolidated Statements of Comprehensive Income

For the year ended December 31,	In thousands of dollars		
	1999	1998	1997
Net income (loss)	\$ (35,088)	\$ (157,380)	\$ 145,938
Other comprehensive income (loss):			
Unrealized gains on securities, net of tax	113	304	6
Foreign currency translation adjustment	5,448	(6,896)	(4,567)
Additional minimum pension liability	(5,967)	—	—
Other comprehensive loss	(406)	(6,592)	(4,561)
Comprehensive income (loss)	\$ (35,494)	\$ (163,972)	\$ 141,377

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

Niagara Mohawk Holdings, Inc. and Subsidiary Companies

Consolidated Statements of Cash Flows

Increase (Decrease) in Cash

For the year ended December 31,

In thousands of dollars

	1999	1998	1997
Cash flows from operating activities:			
Net income (loss)	\$ (35,088)	\$ (157,380)	\$ 145,938
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
PowerChoice charge	—	263,227	—
Amortization of the MRA regulatory asset	386,499	128,833	—
Depreciation and amortization	345,473	355,919	340,239
Amortization of nuclear fuel	28,285	30,798	25,241
Extraordinary loss on extinguishment of debt, net of taxes	9,627	—	—
Provision for deferred income taxes	(8,325)	97,606	46,994
Unbilled revenues	(16,100)	(12,629)	(6,600)
Net accounts receivable (net of changes in accounts receivable sold)	54,078	64,656	(118,939)
Materials and supplies	21,800	(14,341)	(1,306)
Accounts payable and accrued expenses	50,358	(38,712)	(11,175)
Accrued interest and taxes	(53,361)	66,842	4,180
MRA regulatory asset	2,605	(3,959,508)	(7,516)
Deferral of MRA interest rate savings	28,006	10,741	—
Refundable federal income taxes	130,411	(130,411)	—
Change in IPP buyout costs regulatory asset	(218,902)	(41,971)	—
Changes in other assets and liabilities	33,065	59,320	83,122
Net cash provided by (used in) operating activities	758,431	(3,277,010)	500,178
Cash flows from investing activities:			
Construction additions	(271,973)	(365,396)	(286,389)
Nuclear fuel	(26,108)	(26,804)	(4,368)
Less: Allowance for other funds used during construction	5,366	8,626	5,310
Acquisition of utility plant	(292,715)	(383,574)	(285,447)
Material and supplies related to construction	1,586	(219)	1,042
Accounts payable and accrued expenses related to construction	12,589	(9,678)	(2,794)
Proceeds from the sale of generation assets	860,080	—	—
Other investments	(73,482)	(35,069)	(115,533)
Other	(17,272)	(18,551)	8,761
Net cash provided by (used in) investing activities	490,786	(447,091)	(393,971)
Cash flows from financing activities:			
Issuance of Niagara Mohawk common stock	—	316,389	—
Proceeds from long-term debt	—	3,361,178	—
Proceeds from preferred stock of subsidiary	150,000	—	—
Reduction in preferred stock of subsidiary	(157,620)	(10,120)	(8,870)
Reductions in long-term debt	(1,134,020)	(135,000)	(44,600)
Purchase of treasury stock	(157,167)	—	—
Other	(7,244)	(13,580)	97
Net cash provided by (used in) financing activities	(1,306,051)	3,518,867	(53,373)
Net increase (decrease) in cash	(56,834)	(205,234)	52,834
Cash at beginning of year	172,998	378,232	325,398
Cash at end of year	\$ 116,164	\$ 172,998	\$ 378,232
Supplemental disclosures of cash flow information:			
Interest paid	\$ 512,735	\$ 315,541	\$ 279,957
Income taxes paid (refunded)	\$ (118,052)	\$ (12,127)	\$ 82,331

Supplemental schedule of noncash financing activities:

On March 18, 1999, Holdings issued 187,364,863 shares of common stock in a share-for-share exchange for Niagara Mohawk's outstanding common stock.

Niagara Mohawk issued 20,546,264 shares of common stock, valued at \$14.75 per share (\$303.1 million) to the IPP Parties on June 30, 1998.

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

Niagara Mohawk Power Corporation and Subsidiary Companies

Consolidated Balance Sheets

At December 31,	In thousands of dollars	
	1999	1998
ASSETS		
Utility plant (Note 1):		
Electric plant	\$ 7,221,762	\$ 8,826,650
Nuclear fuel	630,321	604,213
Gas plant	1,263,168	1,179,716
Common plant	364,718	349,066
Construction work in progress	312,322	471,802
Total utility plant	9,792,291	11,431,447
Less: Accumulated depreciation and amortization	3,904,049	4,553,488
Net utility plant	5,888,242	6,877,959
Other property and investments	349,718	411,106
Current assets:		
Cash, including temporary cash investments of \$58,276 and \$122,837, respectively	72,479	172,998
Accounts receivable (less allowance for doubtful accounts of \$59,400 and \$47,900, respectively) (Notes 1 and 8)	331,222	427,588
Materials and supplies, at average cost:		
Coal and oil for production of electricity	9,263	42,299
Gas storage	38,252	38,803
Other	90,605	118,855
Refundable federal income taxes	—	130,411
Prepaid taxes	21,489	17,282
Other	22,668	22,208
	585,978	970,444
Regulatory assets (Note 2):		
MRA regulatory asset	3,686,019	4,045,647
Swap contracts regulatory asset	505,723	535,000
Regulatory tax asset	483,546	425,898
IPP buyout costs	260,873	41,971
Deferred environmental restoration costs (Note 8)	240,000	220,000
Deferred loss on sale of assets	135,229	—
Postretirement benefits other than pensions	48,937	52,701
Unamortized debt expense	44,903	51,922
Other	112,556	95,090
	5,517,786	5,468,229
Other assets	103,884	133,449
	\$ 12,445,608	\$ 13,861,187

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

Niagara Mohawk Power Corporation and Subsidiary Companies

Consolidated Balance Sheets

At December 31,	In thousands of dollars	
	1999	1998
CAPITALIZATION AND LIABILITIES		
Capitalization (Note 5):		
Common stockholders' equity:		
Common stock, issued and outstanding 187,364,863 shares	\$ 187,365	\$ 187,365
Repurchase of Holdings' common stock, at cost	(157,167)	—
Capital stock premium and expense	2,361,139	2,362,531
Accumulated other comprehensive income	(5,153)	(25,794)
Retained earnings	398,987	646,040
	2,785,171	3,170,142
Non-redeemable preferred stock	440,000	440,000
Mandatorily redeemable preferred stock	61,370	68,990
Long-term debt	5,042,588	6,417,225
Total capitalization	8,329,129	10,096,357
Current liabilities:		
Long-term debt due within one year (Note 5)	613,740	312,240
Sinking fund requirements on redeemable preferred stock (Note 5)	7,620	7,620
Accounts payable	244,031	197,124
Payable on outstanding bank checks	22,067	39,306
Customers' deposits	15,255	17,148
Accrued taxes	6,246	6,254
Accrued interest	67,593	132,236
Accrued vacation pay	35,334	38,727
Other	66,160	91,877
	1,078,046	842,532
Regulatory and other liabilities:		
Accumulated deferred income taxes (Notes 1 and 6)	1,575,335	1,511,417
Liability for swap contracts (Note 9)	663,718	693,363
Employee pension and other benefits (Note 7)	226,223	235,376
Unbilled gas revenues (Note 1)	14,552	30,652
Other	318,605	231,490
	2,798,433	2,702,298
Commitments and contingencies (Notes 2 and 8):		
Liability for environmental restoration	240,000	220,000
	\$ 12,445,608	\$ 13,861,187

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

Niagara Mohawk Power Corporation and Subsidiary Companies

Consolidated Statements of Income and Retained Earnings

For the year ended December 31,	In thousands of dollars		
	1999	1998	1997
Operating revenues:			
Electric	\$ 3,247,757	\$ 3,261,144	\$ 3,309,441
Gas	579,583	565,229	656,963
	3,827,340	3,826,373	3,966,404
Operating expenses:			
Electricity purchased	807,038	1,001,991	1,236,108
Fuel for electric generation	189,657	239,982	179,455
Gas purchased	266,723	272,141	345,610
Other operation and maintenance	889,100	937,798	835,282
PowerChoice charge	—	263,227	—
Amortization of the MRA regulatory asset	386,499	128,833	—
Depreciation and amortization	344,930	355,417	339,641
Other taxes	411,842	459,961	471,469
	3,295,789	3,659,350	3,407,565
Operating income	531,551	167,023	558,839
Other income (deductions)	(5,682)	42,602	24,997
Income before interest charges	525,869	209,625	583,836
Interest charges	485,240	397,178	273,906
Income (loss) before federal and foreign income taxes	40,629	(187,553)	309,930
Federal and foreign income taxes	18,883	(66,728)	126,595
Income (loss) before extraordinary item	21,746	(120,825)	183,335
Extraordinary item - Loss from the extinguishment of debt, net of income taxes of \$12,819 (Note 5)	(23,807)	—	—
Net income (loss)	(2,061)	(120,825)	183,335
Dividends on preferred stock	36,808	36,555	37,397
Balance available for common stock	(38,869)	(157,380)	145,938
Retained earnings at beginning of year	646,040	803,420	657,482
Dividend of Opinac to Holdings (Note 1)	144,465	—	—
Dividend to Holdings	63,719	—	—
Retained earnings at end of year	\$ 398,987	\$ 646,040	\$ 803,420

Consolidated Statements of Comprehensive Income

For the year ended December 31,	In thousands of dollars		
	1999	1998	1997
Net income (loss)	\$ (2,061)	\$ (120,825)	\$ 183,335
Other comprehensive income (loss):			
Unrealized gains on securities, net of tax	113	304	6
Foreign currency translation adjustment	1,309	(6,896)	(4,567)
Additional minimum pension liability	(5,967)	—	—
Other comprehensive loss	(4,545)	(6,592)	(4,561)
Comprehensive income (loss)	\$ (6,606)	\$ (127,417)	\$ 178,774

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

Niagara Mohawk Power Corporation and Subsidiary Companies

Consolidated Statements of Cash Flows

Increase (Decrease) in Cash

In thousands of dollars

For the year ended December 31,

	1999	1998	1997
Cash flows from operating activities:			
Net income (loss)	\$ (2,061)	\$ (120,825)	\$ 183,335
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
PowerChoice charge	—	263,227	—
Amortization of MRA regulatory asset	386,499	128,833	—
Depreciation and amortization	344,930	355,417	339,641
Amortization of nuclear fuel	28,285	30,798	25,241
Extraordinary loss on extinguishment of debt, net of taxes	9,627	—	—
Provision for deferred income taxes	(7,543)	97,606	46,994
Unbilled revenues	(16,100)	(12,629)	(6,600)
Net accounts receivable (net of changes in accounts receivable sold)	84,683	64,656	(118,939)
Materials and supplies	22,355	(14,341)	(1,306)
Accounts payable and accrued expenses	21,751	(38,712)	(11,175)
Accrued interest and taxes	(48,666)	66,842	4,180
MRA regulatory asset	2,605	(3,959,508)	(7,516)
Deferral of MRA interest rate savings	28,006	10,741	—
Refundable federal income taxes	130,411	(130,411)	—
Change in IPP buyout costs regulatory asset	(218,902)	(41,971)	—
Changes in other assets and liabilities	32,850	59,822	83,720
Net cash provided by (used in) operating activities	798,730	(3,240,455)	537,575
Cash flows from investing activities:			
Construction additions	(271,973)	(365,396)	(286,389)
Nuclear fuel	(26,108)	(26,804)	(4,368)
Less: Allowance for other funds used during construction	5,366	8,626	5,310
Acquisition of utility plant	(292,715)	(383,574)	(285,447)
Materials and supplies related to construction	1,586	(219)	1,042
Accounts payable and accrued expenses related to construction	5,436	(9,678)	(2,794)
Proceeds from sale of generation assets	860,080	—	—
Other investments	43,426	(35,069)	(115,533)
Other	(20,866)	(18,551)	8,761
Net cash provided by (used in) investing activities	596,947	(447,091)	(393,971)
Cash flows from financing activities:			
Issuance of common stock	—	316,389	—
Proceeds from long-term debt	—	3,361,178	—
Proceeds from preferred stock	150,000	—	—
Reductions of preferred stock	(157,620)	(10,120)	(8,870)
Reductions of long-term debt	(1,134,020)	(135,000)	(44,600)
Corporate restructuring to establish holding company	(89,618)	—	—
Preferred dividends paid	(36,808)	(36,555)	(37,397)
Common stock dividend paid to Holdings	(63,719)	—	—
Repurchase of Holdings' common stock	(157,167)	—	—
Other	(7,244)	(13,580)	97
Net cash provided by (used in) financing activities	(1,496,196)	3,482,312	(90,770)
Net increase (decrease) in cash	(100,519)	(205,234)	52,834
Cash at beginning of year	172,998	378,232	325,398
Cash at end of year	\$ 72,479	\$ 172,998	\$ 378,232
Supplemental disclosures of cash flow information:			
Interest paid	\$ 512,735	\$ 315,541	\$ 279,957
Income taxes paid (refunded)	\$ (119,999)	\$ (12,127)	\$ 82,331

Supplemental schedule of noncash financing activities:

On March 18, 1999, Niagara Mohawk's outstanding common stock was exchanged on a share-for-share basis for Holdings' common stock.

On March 31, 1999, Niagara Mohawk distributed the stock of Opinac as a dividend to Holdings, which included cash of \$89.6 million.

Niagara Mohawk issued 20,546,264 shares of common stock, valued at \$14.75 per share (\$303.1 million) to the IPP Parties on June 30, 1998.

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

NOTE 1. Summary of Significant Accounting Policies

Corporate Structure and Principles of Consolidation: Niagara Mohawk Holdings, Inc. ("Holdings") is a New York corporation. On March 18, 1999, Niagara Mohawk Power Corporation ("Niagara Mohawk") was reorganized into a holding company structure in accordance with an Agreement and Plan of Exchange between Niagara Mohawk and Holdings. Niagara Mohawk's outstanding common stock was exchanged on a share-for-share basis for Holdings' common stock. Niagara Mohawk's preferred stock and debt was not exchanged as part of the share exchange and continue as obligations of Niagara Mohawk.

On March 31, 1999, Niagara Mohawk distributed its ownership in the stock of Opinac North America, Inc. ("Opinac") as a dividend to Holdings. As a result, the net assets and accumulated other comprehensive income of Opinac are no longer included in Niagara Mohawk's consolidated balance sheet as of December 31, 1999. The dividend completed the holding company structure, with Holdings owning 100% of the common stock of its two subsidiaries, Niagara Mohawk and Opinac. Niagara Mohawk and its subsidiaries manage all regulated activities and comprise approximately 98 percent of the assets and approximately 94 percent of the revenues of Holdings. Opinac and its subsidiaries manage all other activities including an energy marketing company and investments in energy related services businesses and a development stage telecommunications company.

Niagara Mohawk is subject to regulation by the PSC and FERC with respect to its rates for service under a methodology, which establishes prices, based on Niagara Mohawk's cost. Niagara Mohawk's accounting policies conform to GAAP, including the accounting principles for rate-regulated entities with respect to Niagara Mohawk's nuclear, transmission, distribution and gas operations (regulated business), and are in accordance with the accounting requirements and ratemaking practices of the regulatory authorities. In 1996, Niagara Mohawk discontinued the application of regulatory accounting principles to its fossil and hydro generation operations.

Holdings' consolidated financial statements include the accounts of Holdings' and its wholly owned subsidiaries. Niagara Mohawk's consolidated financial statements include its accounts as well as those of its

wholly owned subsidiaries. Inter-company balances and transactions have been eliminated. The notes to the Consolidated Financial Statements apply to both Holdings and Niagara Mohawk unless otherwise stated.

The closing of the MRA, which occurred on June 30, 1998, and the implementation of PowerChoice on September 1, 1998 have depressed and will continue to substantially depress earnings during the five-year term of PowerChoice. The ability of Niagara Mohawk to improve earnings in the period subsequent to PowerChoice will depend on the outcome of the regulatory process to set prices at that time. However, operating cash flows have substantially improved. The closing on the sale of the fossil and hydro generation assets at various times during the year has also affected the comparability of the financial statements. See Note 2. for a further discussion of the sales.

Estimates: In order to be in conformity with GAAP, management is required to use estimates in the preparation of Holdings and Niagara Mohawk's financial statements.

Utility Plant: The cost of additions to utility plant and replacements of retirement units of property are capitalized. Costs include direct material, labor, overhead and AFC. Replacement of minor items of utility plant and the cost of current repairs and maintenance are charged to expense. Whenever utility plant is retired, its original cost, together with the cost of removal, less salvage, is charged to accumulated depreciation.

The output of the co-owned generation units, Roseton Units No. 1 and 2 (which has a capability of 1,200 MW) and Nine Mile Point Nuclear Station Unit No. 2, and related expenses are shared in the same proportions as the co-tenants' respective ownership interests. Niagara Mohawk's share of expenses associated with these plants are included in the appropriate operating expenses in Niagara Mohawk's Consolidated Statements of Income.

Allowance for Funds Used During Construction: Niagara Mohawk capitalizes AFC in amounts equivalent to the cost of funds devoted to plant under construction for its regulated business. AFC rates are determined in accordance with FERC and PSC regulations. The AFC

rate in effect at December 31, 1999 was 8.86%. AFC is segregated into its two components, borrowed funds and other funds, and is reflected in the "Interest charges" and "Other income" sections, respectively, in both Holdings and Niagara Mohawk's Consolidated Statements of Income. The amount of AFC credits recorded in each of the three years ended December 31, in thousands of dollars, was as follows:

	1999	1998	1997
Other income	\$ 5,366	\$ 8,626	\$ 5,310
Interest charges	7,252	10,228	4,396

The amount of AFC credits in 1999 for fossil and hydro generation, included in the total above, is \$518,000 as compared to \$1,034,000 in 1998 and \$1,179,000 in 1997.

Depreciation, Amortization and Nuclear Generation Plant Decommissioning Costs: For accounting and regulatory purposes, Niagara Mohawk's depreciation is computed on the straight-line basis using the license lives for its nuclear class of depreciable property and the average service lives for all other classes. The percentage relationship between the total provision for depreciation and average depreciable property was approximately 3.4% to 3.6% for the years 1997 through 1999. Niagara Mohawk performs depreciation studies to determine service lives of classes of property and adjusts the depreciation rates when necessary.

Estimated decommissioning costs (costs to remove a nuclear plant from service in the future) for Niagara Mohawk's Unit 1 and its share of Unit 2 are being accrued over the service lives of the units, recovered in rates through an annual allowance and currently charged to operations through depreciation. Niagara Mohawk currently recognizes the liability for nuclear decommissioning over the service life of the plants as an increase to accumulated depreciation. As discussed in Notes 2 and 3, Niagara Mohawk announced an agreement to sell its nuclear assets. As part of the agreement, Niagara Mohawk will transfer its decommissioning liability, as well as the decommissioning funds, which will be increased by Niagara Mohawk to a specified amount at the time of the transfer. See Note 3. Nuclear Operations - Nuclear Plant Decommissioning, for more information on the decommissioning fund. Absent such a nuclear sale, Niagara Mohawk plans to commence decommissioning of both units using a method which removes or decontaminates the Units' components properly at that time.

Amortization of the cost of nuclear fuel is determined on the basis of the quantity of heat produced for the generation of electric energy. The cost of disposal of nuclear fuel, which presently is \$.001 per KWh of net generation available for sale, is based upon a contract

with the DOE. These costs are charged to operating expense as part of fuel for electric generation.

Regulated Revenues: Niagara Mohawk bills its customers on a monthly cycle basis at approved tariffs based on energy delivered and a minimum customer service charge. Revenues are determined based on these bills plus an estimate for unbilled energy delivered between the cycle billing date and the end of the accounting period. In February 1999, a new customer service billing system was implemented which converted all customers previously billed on a bi-monthly cycle to a monthly basis. (See Note 8 "Customer Service System" for a further discussion of this new system). The unbilled revenues included in accounts receivable at December 31, 1999 and 1998 were \$143.9 million and \$205.6 million, respectively.

In accordance with PowerChoice, Niagara Mohawk recognizes changes in accrued unbilled electric revenues in its results of operations. Previously, Niagara Mohawk did not recognize accrued unbilled electric revenues in its results of operations until authorized and used them to reduce future revenue requirements. Such amounts were included in "Other Liabilities" pending regulatory disposition. Under the PowerChoice agreement, \$8.6 million of unrecognized unbilled electric revenues as of September 1, 1998, the implementation date of PowerChoice, were netted with certain other regulatory assets and liabilities and any subsequent changes in the estimated unbilled electric revenues are recognized currently in results of operations.

Pursuant to Niagara Mohawk's 1996 three-year gas settlement, changes in accrued unbilled gas revenues are deferred. At December 31, 1999 and 1998, \$14.6 million and \$30.7 million, respectively, of unbilled gas revenues remain unrecognized in results of operations.

Prior to September 1, 1998, Niagara Mohawk's tariffs included an electric fuel adjustment clause, such that electricity costs above or below the levels allowed in approved rate schedules, were billed or credited to customers. Niagara Mohawk, as authorized by the PSC, charged operations for electricity cost variances in the period of recovery. Under the PowerChoice agreement, the electric fuel adjustment clause was discontinued as of September 1, 1998.

The 1996 three-year gas settlement agreement established a gas commodity cost adjustment clause ("CCAC"). Niagara Mohawk's gas CCAC provides for the collection or pass back of certain increases or decreases from the base commodity cost of gas as established in the gas settlement agreement. The maximum annual risk or benefit to Niagara Mohawk is \$2.25 million. All savings or excess costs beyond that amount flow to ratepayers. The PSC approved an interim gas rate agreement on October 15, 1999 and January 12, 2000 that included a

provision for the implementation of a return to a full gas cost collection mechanism and termination of the cost sharing mechanism, effective November 1, 1999.

Unregulated Revenues: Unregulated revenues and the related costs of gas and electricity are accrued and recorded in the month of delivery, based on contract price and nominated natural gas and electricity transmission reservation volumes sold to customers and purchased from suppliers. Adjustments are made to reflect actual volumes delivered or purchased when the actual volumetric information becomes available from the transporters.

Federal Income Taxes: As directed by the PSC, Niagara Mohawk defers any amounts payable pursuant to the alternative minimum tax rules. Deferred investment tax credits are amortized over the useful life of the underlying property. Deferred investment tax credits related to the assets that have been sold are taken into income in accordance with IRS rules. Holdings and its United States' subsidiaries file a consolidated federal income tax return. Income taxes are allocated to each company based on its taxable income.

Statements of Cash Flows: Holdings and Niagara Mohawk consider all highly liquid investments, purchased with a remaining maturity of three months or less, to be cash equivalents. The consolidated cash flow statements for Holdings and Niagara Mohawk have been presented to reflect the closing on the sale of the fossil and hydro generation assets, such that certain individual line items are net of the effects of the sale. (For example, the change in materials and supplies was reduced by the sale of inventory to the buyers of the fossil and hydro generation assets).

Treasury Stock: The PSC approved Niagara Mohawk's petition to purchase up to \$800 million of Holdings' common stock. Holdings' Board of Directors has approved a program to repurchase twenty million shares through December 31, 2001. The cost to acquire Holdings' common stock by Niagara Mohawk is presented as "Treasury stock" in Holdings' financial statements and as "Repurchase of Holdings' common stock" on Niagara Mohawk's financial statements. See Note 5 for a discussion of the stock repurchased during 1999.

Earnings Per Share: Basic earnings per share ("EPS") is computed based on the weighted average number of common shares outstanding for the period. Treasury stock is not considered outstanding and thus, reduces the weighted average shares outstanding. The number of options outstanding at December 31, 1999, 1998 and 1997 that could potentially dilute basic EPS, (but are considered antidilutive for each period because the options exercise price was greater than the average

market price of common shares), is immaterial. Therefore, the calculation of both basic and dilutive EPS is the same for each period.

Derivatives: In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." The new standard requires companies to record derivatives on the balance sheet as assets or liabilities, measured at fair value. Gains or losses resulting from the changes in the values of the derivatives will be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. Holdings and Niagara Mohawk will be required to adopt this standard in 2001. Niagara Mohawk has identified swap contracts, entered into as part of the MRA and generation asset sales agreements, (see Note 9) as derivative instruments and has recorded a liability at fair value under SFAS No. 80, "Accounting for Futures Contracts." These swap contracts qualify as hedges of future purchase commitments and will continue to qualify as hedges under SFAS No. 133. The financial sharing agreement entered into as part of the agreement to sell Niagara Mohawk's nuclear generation assets will be a derivative instrument as defined by SFAS No. 133 and will be recorded upon the closing of such sale. See Note 8 – "Long-term Contracts for the Purchase of Electric Power – Nuclear Contracts" for a further discussion of the financial sharing agreement. Holdings and Niagara Mohawk continue to assess the applicability of this new standard to other contractual obligations.

Energy Trading: The Emerging Issues Task Force ("EITF") of the FASB reached a conclusion on Issue No. 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities" to be applied for fiscal years beginning after December 15, 1998. This EITF states that energy trading contracts should be marked-to-market with the gains and losses included in earnings. Contracts that are designed as hedges of non-trading activities are outside the scope of this EITF. Niagara Mohawk's energy contracts and the majority of the marketing activities of NM Energy are not energy trading as defined by this EITF, and therefore, Holdings and its subsidiaries do not account for its energy contracts on a marked-to-market basis.

Comprehensive Income: Comprehensive income is the change in the equity of a company, not including those changes that result from shareholder transactions. While the primary component of comprehensive income is reported net income or loss, the other components of comprehensive income relate to foreign currency translation adjustments, additional minimum pension liability recognition and unrealized gains and losses associated with certain investments held as available for sale. The primary difference in comprehensive income

between Holdings and Niagara Mohawk is the treatment of Niagara Mohawk's preferred dividends and reported net income or loss.

Reclassifications: Certain amounts from prior years have been reclassified on the accompanying Consolidated Financial Statements to conform with the 1999 presentation.

Holdings' prior years consolidated financial statements have been prepared from Niagara Mohawk's prior year consolidated financial statements, except that accounts have been reclassified to reflect Holdings' structure.

NOTE 2. Rate and Regulatory Issues and Contingencies

Holdings and Niagara Mohawk's financial statements conform to GAAP, including the accounting principles for rate-regulated entities with respect to its regulated operations. Substantively, SFAS No. 71 permits a public utility, regulated on a cost-of-service basis, to defer certain costs, which would otherwise be charged to expense, when authorized to do so by the regulator. These deferred costs are known as regulatory assets, which in the case of Niagara Mohawk are approximately \$5.5 billion at December 31, 1999. These regulatory assets are probable of recovery.

Niagara Mohawk has recorded the following regulatory assets on its Consolidated Balance Sheets reflecting the rate actions of its regulators:

MRA Regulatory Asset: Under PowerChoice, a regulatory asset was established for the costs of the MRA and represents the costs to terminate, restate, or amend IPP Party contracts. This regulatory asset is being amortized generally over ten years, beginning September 1, 1999. Niagara Mohawk's rates under PowerChoice have been designed to permit recovery of the MRA regulatory asset.

Swap Contract Regulatory Asset: The swap contract regulatory asset represents the expected future recovery of the swap contract liability. The swap contract liability is the difference between estimated future market prices and the contract prices for the notional quantities of power in the restated IPP PPA contracts and in the financial swaps associated with the PPAs from the sale of the Huntley and Dunkirk coal-fired generation plants. The portion of this regulatory asset associated with the restated IPP PPA contracts will be amortized over ten years ending in June 2008, in accordance with the MRA, as notional quantities are settled. The portion of this regulatory asset associated with the Huntley and Dunkirk PPAs will be amortized over the remaining term of the swaps through June 2003. The amount of this regulatory

asset will fluctuate as estimates of future market and contract prices change over the terms of the contracts. For a further discussion of the several PPAs and other financial agreements that Niagara Mohawk has entered into as part of the MRA and the sale of its generation assets, see Note 8 - "Long-term contracts for the purchase of electric power and Note 9."

Regulatory Tax Asset: The regulatory tax asset represents the expected future recovery from ratepayers of the tax consequences of temporary differences between the recorded book bases and the tax bases of assets and liabilities. This amount is primarily timing differences related to depreciation. These amounts are recovered and amortized as the related temporary differences reverse. In January 1993, the PSC issued a Statement of Interim Policy on Accounting and Ratemaking Procedures that required adoption of SFAS No. 109 on a revenue-neutral basis.

IPP Buyout Costs: Niagara Mohawk is also permitted to defer and amortize the cost of any additional IPP contract buyouts. In 1999, there have been four IPP contracts for approximately 127 MW terminated for a total consideration (cash and/or notes) of \$229.2 million. Niagara Mohawk estimates that it will have reduced IPP payments of approximately \$60 million annually, net of purchases of power at market price as a result of the contract buyouts. Deferred costs associated with IPP buyouts will generally be amortized over five years in accordance with PowerChoice, unless PSC approval is obtained for a different amortization period. Niagara Mohawk retains the annual net savings of the buyouts during the remaining term of PowerChoice to offset the amortization expense. Niagara Mohawk is negotiating buyouts and amendments of other IPP contracts. Niagara Mohawk is unable to determine the timing and outcome of these negotiations.

Deferred Environmental Restoration Costs: The deferred environmental restoration costs regulatory asset represents Niagara Mohawk's share of the estimated costs to investigate and perform certain remediation activities at both Niagara Mohawk-owned sites and non-owned sites with which it may be associated. Niagara Mohawk has recorded a regulatory asset representing the remediation obligations to be recovered from ratepayers. PowerChoice and Niagara Mohawk's gas rates decisions provide for the recovery of these costs over the settlement periods. Niagara Mohawk believes future costs, beyond the settlement periods, will continue to be recovered in rates. See Note 8. - Environmental Contingencies.

Deferred Loss on the Sale of Assets: PowerChoice requires Niagara Mohawk to divest its portfolio of fossil and hydro generation assets. During 1999, Niagara Mohawk completed the sale its hydroelectric generation

plants, its two coal-fired generation plants and its Oswego oil and gas-fired plant for \$860 million. These assets had a combined net book value of \$956.8 million (including materials and supplies and fuel) at the time of their sale. In addition, there were purchase price adjustments of \$26.7 million, primarily due to a lower amount of fuel being delivered to the new owners of the Oswego generation assets than originally anticipated and provided for in the sales agreement.

On October 6, 1999, Niagara Mohawk announced an agreement to sell its Albany oil and gas-fired plant to PSEG Power LLC ("PSEG") for \$47.5 million. The 400 MW Albany plant has a net book value of approximately \$32.0 million (including materials and supplies and fuel) as of December 31, 1999. Niagara Mohawk could also receive up to an additional \$11.5 million if PSEG chooses to pursue the redevelopment of the Albany plant and the redevelopment is in service by July 1, 2003. The agreement with PSEG includes a "Post Closing Property Tax Adjustment" to be settled on the first ten anniversaries of the closing date. If actual annual property taxes exceed a predetermined amount, Niagara Mohawk will pay PSEG. If the property taxes are lower, then PSEG will pay Niagara Mohawk. The predetermined amount is based upon the taxes paid by Niagara Mohawk at the time of the sale, which should approximate \$6.7 million. During the ten years, the predetermined amount will be lowered by \$0.5 million each year. Niagara Mohawk is pursuing a reduction in the taxes paid on the facility. No amount has been reflected in the anticipated proceeds from the sale of Albany for the redevelopment fee or the post closing property tax adjustment. Niagara Mohawk expects to complete the Albany sale transaction in the first quarter of 2000.

The sale of the Roseton Steam Station, of which Niagara Mohawk owns 25%, is being pursued by Central Hudson. The remaining ownership interests are Central Hudson, the operator of the plant (35%), and Consolidated Edison Company of New York, Inc. (40%). Although Central Hudson stated that it expects to sell this plant by early 2001, to assure divestiture of this asset, Niagara Mohawk entered into an agreement with Central Hudson, subject to regulatory approval, to sell its interest in the plant to Central Hudson at approximately net book value by no later than January 1, 2003. Niagara Mohawk's share of the plant has a net book value of approximately \$40.8 million (which includes materials and supplies and fuel) as of December 31, 1999.

The following table summarizes Niagara Mohawk's electric plant assets as of December 31, 1999 and 1998, showing the impact on Niagara Mohawk's electric plant from the completed sales through December 31, 1999:

(in thousands)	December 31, 1999		December 31, 1998	
Plant Type	Original Cost	Net Book Value	Original Cost	Net Book Value
Unit 1 ¹	\$1,504,718	\$957,884	\$1,503,833	\$985,141
Unit 2 ¹	749,204	476,934	748,763	490,504
Albany	126,147	27,202	130,476	29,319
Roseton	92,544	34,448	91,871	36,842
Dunkirk	—	—	274,737	140,878
Huntley	—	—	399,660	204,868
Oswego	—	—	622,953	299,743
Hydro	—	—	448,212	214,351
Total generation	2,472,613	1,496,468	4,220,505	2,401,646
Transmission and distribution	4,277,210	2,862,408	4,142,255	2,795,782
Other/General	471,939	313,115	463,890	331,878
Total Electric Plant	\$7,221,762	\$4,671,991	\$8,826,650	\$5,529,306

1. Excludes nuclear fuel

The PowerChoice agreement provides for deferral and future recovery of net losses, if any, resulting from the sale of the fossil and hydro generation asset portfolio. As of December 31, 1999, Niagara Mohawk has recorded a regulatory asset of \$135.2 million for the net loss on the sale of its two coal-fired generation plants, its hydro generation assets, and its oil and gas fired plant at Oswego, which includes \$3.0 million in employee-related severance costs. The net loss is included in Niagara Mohawk's balance sheet as "Deferred Loss on the Sale of Assets." In accordance with PowerChoice, Niagara Mohawk will not earn a return on the deferred loss during the PowerChoice period. The amount of this regulatory asset is subject to change as a result of post closing adjustments on the sales, transaction costs, the accounting treatment relating to the hydro PPAs, the amount of severance and other costs and the outcome of the sale of the remaining fossil assets. Niagara Mohawk has petitioned the PSC to defer, as part of the regulatory asset associated with the sale of the fossil and hydro generation assets, the amount by which the actual amount incurred on the hydro PPAs exceeds the forecasted amount reflected in PowerChoice. After all the fossil and hydro sales transactions have been completed, Niagara Mohawk estimates that it will have a net loss (stranded costs) of approximately \$150 million, including an estimate of the future deferrable hydro payments. Niagara Mohawk is required to submit to the PSC a final accounting of the costs and proceeds from the sale of its assets upon completion of the final sale. Niagara Mohawk will begin recovery of the loss in 2003, over a period not to exceed the average remaining life of the assets sold, estimated at 20 years. Niagara Mohawk has earned an incentive as provided for in PowerChoice of \$9.0 million based on the asset sales concluded in 1999, which is reflected in income in 1999 and is recorded as an other regulatory asset in the Consolidated Balance Sheets. An additional incentive is expected to be earned upon the completion of the remaining assets sales of approximately \$6.0 million. Niagara Mohawk

will begin recovery of this amount in 2001, over a period not to exceed 5 years.

Niagara Mohawk has also announced an agreement to sell its nuclear generation assets. Niagara Mohawk estimates its net loss from the nuclear sale to be in the range of \$1,800 to \$1,850 million. Niagara Mohawk has petitioned the PSC for approval to defer this net loss for future recovery, which approval is a condition of the closing of the sale of the nuclear assets. See Note 3. - Nuclear Operations, for a complete discussion regarding this announced sale of Niagara Mohawk's nuclear generation assets and its regulatory treatment.

Postretirement Benefits other than Pensions: The postretirement benefits other than pensions regulatory asset represent the excess of such costs recognized in accordance with SFAS No. 106 over the amount received in rates. In accordance with a PSC policy statement, postretirement benefit costs other than pensions were phased into rates generally over a five-year period and amounts deferred are being amortized and recovered over a period of approximately 15 years.

Unamortized Debt Expense: The unamortized debt expense regulatory asset represents the costs to issue and redeem certain long-term debt securities, which were retired prior to maturity. These amounts are amortized as interest expense ratably over the lives of the related issues in accordance with PSC directives.

Other: Included in the other regulatory asset is the accumulation of numerous miscellaneous regulatory deferrals, including the deferral of nuclear outage costs, uncollectible accounts receivable, nuclear decontamination and decommissioning fund costs, and income earned on gas rate sharing mechanisms.

The EITF of the FASB reached a consensus on Issue No. 97-4 "Deregulation of the Pricing of Electricity - Issues Related to the Application of SFAS No. 71 and SFAS No. 101" in July 1997. EITF 97-4 does not require a company to earn a return on regulatory assets that arise from a deregulating transition plan in assessing the applicability of SFAS No. 71. Niagara Mohawk believes that the regulated cash flows to be derived from prices it will charge for electric service over the next ten years, including the Competitive Transition Charge ("CTC") assuming no unforeseen reduction in demand or bypass of the CTC or exit fees, will be sufficient to recover the MRA regulatory asset and to provide recovery of and a return on the remainder of its assets, as appropriate. In the event Niagara Mohawk determines, as a result of lower than expected revenues and/or higher than expected costs, that its net regulatory assets are not probable of recovery, it can no longer apply the principles of SFAS No. 71 and would be required to record an after-tax non-cash charge against income for any remaining unamortized regulatory assets and liabilities. If Niagara Mohawk could no longer apply

SFAS No. 71, the resulting charge would be material to Holdings and Niagara Mohawk's reported financial condition and results of operations and adversely effect Niagara Mohawk's, and therefore Holdings' ability to pay dividends.

Under PowerChoice, Niagara Mohawk's remaining electric business (electric transmission, distribution and nuclear business) will continue to be rate-regulated on a cost-of-service basis and, accordingly, Niagara Mohawk continues to apply SFAS No. 71 to these businesses. Also, Niagara Mohawk's IPP contracts, including those restructured under the MRA, as well as the PPAs entered into in connection with the generation divestiture, will continue to be the obligations of the regulated business.

NOTE 3. Nuclear Operations

Niagara Mohawk is the owner and operator of the 613 MW Unit 1 and the operator and a 41% co-owner of the 1,143 MW Unit 2. The remaining ownership interests are Long Island Power Authority (LIPA) - 18%; NYSEG - 18%; Rochester Gas and Electric Corporation (RG&E) - 14%; and Central Hudson - 9%. Unit 1 was placed in commercial operation in 1969 and Unit 2 in 1988.

Announced Sale: On June 24, 1999, Niagara Mohawk announced an agreement to sell its nuclear assets to AmerGen Energy Company, LLC ("AmerGen"), a joint venture of PECO Energy Company and British Energy, for approximately \$135 million, which is subject to price adjustments depending on the time of closing. Along with the asset purchase agreement, Niagara Mohawk also signed PPAs with AmerGen to purchase energy and capacity at negotiated prices. See Note 8 for a further discussion of these PPAs under "Long term contracts for the purchase of electric power."

New York State Electric and Gas Corporation is also a party to the agreement and has agreed to sell its 18% share of Unit 2 to AmerGen. The sale to AmerGen is subject to a previously existing agreement among the five co-owners of Unit 2 that gives the co-owners the right to match a third-party purchase offer made for any share of the plant. On December 21, 1999, RG&E, a 14% co-owner, submitted a notice stating it would match the AmerGen agreement.

As a condition of the sale transaction, Niagara Mohawk will pre-fund its nuclear decommissioning trust funds (discussed below) at the closing to a predetermined amount (which amount is contingent upon tax rulings and the closing date). The trust funds will be transferred to the buyer at the closing, and the buyer will assume full responsibility for the decommissioning of Unit 1 and its ownership share of Unit 2. If the sale occurs on July 1, 2000, Niagara Mohawk estimates that it will be required to make additional contributions to the

decommissioning trust funds of approximately \$90 million.

At December 31, 1999, the net book value of Niagara Mohawk's nuclear generation assets (including materials, supplies and nuclear fuel) was approximately \$1.6 billion, excluding the reserve for decommissioning. In addition, Niagara Mohawk has other nuclear-related assets of approximately \$0.5 billion. These assets include the decommissioning trusts and regulatory assets, primarily related to the flow-through to customers of prior income tax benefits.

Because of the uncertainty as to whether the PSC will approve the sale of the nuclear generating plants on terms acceptable to Niagara Mohawk, and the outcome of other regulatory approvals, Niagara Mohawk has continued to utilize its best estimate of cash flows based on a held-and-used (regulated) model for purposes of assessing whether an asset impairment existed as of December 31, 1999. Under this assumption the nuclear generating plants are not impaired.

If, and when, Niagara Mohawk concludes that its best estimate of future cash flows is from the sale of the power plants, the impairment test will be performed taking into consideration the expected cash flows from operations until sale, expected cash proceeds from the sale of the assets, less amounts required to pre-fund the nuclear decommissioning trust funds. In that event, Niagara Mohawk estimates its net loss (stranded costs) from the nuclear sale would be in the range of \$1,800 to \$1,850 million.

Niagara Mohawk has petitioned the PSC for approval to defer the net loss that would be recognized on the sale for future recovery, which approval is a condition of the closing of the sale of the nuclear assets. Accordingly, Niagara Mohawk plans to record a regulatory asset for the amount of the estimated net loss, as calculated pursuant to the assumptions and circumstances described in the preceding paragraph. However, the ability to record the regulatory asset is ultimately conditioned on an assessment by Niagara Mohawk that the amounts are probable of future recovery in rates and that the rates ultimately approved by the PSC can be charged to and collected from customers without unanticipated reduction in demand.

The amount of the estimated net loss on the sale of the nuclear assets is subject to change as a result of closing price adjustments, transaction costs and the final amount needed to pre-fund the decommissioning trust funds. The estimated range of loss excludes any accounting requirements relating to the nuclear PPAs. Niagara Mohawk has proposed to recover the regulatory asset, plus a return on the unamortized balance over a period not to exceed 15 years beginning in 2000, with a significant portion of the recovery likely to occur in years subsequent to the MRA regulatory asset amortization.

Niagara Mohawk's current rate structure includes recovery and a return on the nuclear assets. Niagara Mohawk proposes to recover a return on and a return of stranded nuclear costs within the rate structures contained in its PowerChoice agreement. This sale is also contingent upon approval by, among others, the PSC, NRC, IRS, and the SEC.

Niagara Mohawk originally requested PSC approval by December 1999 and has filed an application with the NRC to transfer the licenses to AmerGen. It is unlikely that any sale will close prior to the planned Unit 2 refueling and maintenance outage scheduled to begin in March 2000. A delay in the sale through the planned outage would result in an increase in the purchase price of Unit 2 as specified in the agreement to reflect the estimated costs of the refueling and maintenance outage. The sale price of Unit 1 decreases if the sale occurs after the Unit 2 refueling and maintenance outage. Until the sale is closed, Niagara Mohawk generally bears the risks associated with unexpected costs of the refueling outage at Unit 2 and any unscheduled outages at both units, including investigations and unexpected maintenance and capital costs. The purchase agreement terminates if the sale has not occurred before September 1, 2000. In the event that the sale of the nuclear assets does not occur, Niagara Mohawk will continue to recover the costs to run the nuclear generation plants in its PowerChoice rates. In addition, Niagara Mohawk would continue to participate in the PSC regulatory proceeding regarding the future of nuclear assets in New York State. On October 27, 1999, the FERC approved the sale of the transmission assets connected to the nuclear plants to AmerGen. On January 26, 2000, the PSC Staff had informed the ALJ and all parties, including Niagara Mohawk, that they believed the terms of the proposed nuclear sale were not in the public interest. The PSC Staff is continuing its discussions with AmerGen, as well as exploring other options, including giving other interested parties the opportunity to put forth competing proposals. Niagara Mohawk cannot predict the outcome of this proceeding, but is committed to pursue the sale of Unit 1 and Unit 2. Notwithstanding this commitment, because of the regulatory hurdles that must be overcome, Niagara Mohawk does not believe that such a sale is any more likely to occur than other possible scenarios, including the possible continued operation of the plants by Niagara Mohawk for the remainder of their useful lives.

Upon closing of the sale of the nuclear assets, Niagara Mohawk will continue to be liable for all spent nuclear fuel fees associated with electricity generated and sold and Unit 1 and Unit 2, prior to the closing. See "Nuclear Fuel Disposal Cost" for a discussion of the Nuclear Waste Policy Act of 1982 and Niagara Mohawk's determination of liability. This liability will remain with Niagara Mohawk until the DOE provides disposal facilities.

Niagara Mohawk also retains liability for changes enacted prior to closing, if any, in the disposal fees already paid to the DOE for fuel burned from 1983 through closing of the sale or in the pre-1983 liability. Niagara Mohawk has recovered these costs in rates in the past and believes that any increases in these costs would ultimately be included in the rate process.

Nuclear Plant Decommissioning: If the sale does not occur, Niagara Mohawk estimates its site specific costs for decommissioning Unit 1 and its ownership interest in Unit 2 at December 31, 1999 are as follows:

	Unit 1	Unit 2
Site Study (year)	1995	1995
End of Plant Life (year)	2009	2026
Radioactive Dismantlement		
to Begin (year)	*	2028
Method of Decommissioning	*	Immediate Dismantlement
Cost of Decommissioning (in January 2000 dollars)		
	<i>In millions of dollars</i>	
Radioactive Components	*	\$ 214
Non-radioactive Components	*	52
Fuel Dry Storage/Continuing Care	*	46
		\$ 312

* Niagara Mohawk has not made a final decision on the timing of decommissioning for Unit 1. Decommissioning could occur immediately after end of license shutdown in 2009 or coincident with Unit 2 decommissioning which would commence in 2026. The cost of decommissioning Unit 1 in January 2000 dollars is estimated to be \$594 million for immediate dismantlement or \$724 million for delayed dismantlement. Projected earnings from the decommissioning fund are expected to approximate the cost impact of inflation and continuing care under a delayed scenario. The final decision to decommission Unit 1 immediately after shutdown or to delay will occur much closer to the end of license shutdown date of 2009 so that Niagara Mohawk can adequately evaluate the variables that could impact total costs. These variables include but are not limited to the inflation projections, actual earnings rate on the decommissioning fund, the uncertainty of the availability of a low level waste disposal site and the DOE acceptance date and rate of spent fuel disposal.

Niagara Mohawk estimates that by the time decommissioning is completed, the above costs will ultimately amount to \$1.0 billion (immediate dismantlement) or \$1.7 billion (delayed dismantlement) for Unit 1 and \$0.9 billion for Niagara Mohawk's share of Unit 2, using approximately 3.5% as an annual inflation factor.

In addition to the costs mentioned above, Niagara Mohawk would expect to incur post-shutdown costs for plant ramp down, insurance and property taxes. In 2000 dollars, these costs are expected to amount to \$117 million (immediate dismantlement) or \$127 million (delayed dismantlement) for Unit 1 and \$65 million for Niagara Mohawk's share of Unit 2. The amounts will escalate to \$193 million (immediate dismantlement) or \$210 million (delayed dismantlement) and \$190 million for Unit 1 and Niagara Mohawk's share of Unit 2, respectively, by the time decommissioning is expected to be completed.

NRC regulations require owners of nuclear power plants to place funds into an external trust to provide for the cost of decommissioning radioactive portions of nuclear facilities and establish minimum amounts that must be available in such a trust at the time of decommissioning. The allowance for Unit 1 and Niagara Mohawk's share of Unit 2 was approximately \$28 million for the year ended December 31, 1999. PowerChoice permits rate recovery for all radioactive and non-radioactive cost components for both units, including post-shutdown costs, based upon the amounts estimated in the 1995 site specific studies described above, which are higher than the NRC minimum. The annual decommissioning allowance (which includes funds to be placed into the external trust plus internal reserves) for 2000 will increase to \$43.3 million of which \$28 million is for radioactive components and \$15.3 million is for non-radioactive components. There is no assurance that the decommissioning allowance recovered in rates will ultimately aggregate a sufficient amount to decommission the units. Niagara Mohawk believes that if decommissioning costs are higher than currently estimated, the costs would ultimately be included in the rate process.

Decommissioning costs recovered in rates are reflected in "Accumulated depreciation and amortization" on the balance sheet and amount to \$353.1 million and \$315.5 million at December 31, 1999 and 1998, respectively for both units. Additionally at December 31, 1999, the fair value of funds accumulated in Niagara Mohawk's external trusts were \$210.2 million for Unit 1 and \$70.9 million for its share of Unit 2. The trusts are included in "Other Property and Investments." Earnings on the external trust aggregated \$45.3 million through December 31, 1999, and because the earnings are available to fund decommissioning, have also been included in "Accumulated depreciation and amortization." For a further discussion on the earnings on the external trust, see Note 9. Amounts recovered for non-radioactive dismantlement are accumulated in an internal reserve fund, which has an accumulated balance of \$65 million at December 31, 1999.

Nuclear Liability Insurance: The Atomic Energy Act of 1954, as amended, requires the purchase of nuclear liability insurance from the Nuclear Insurance Pools in amounts as determined by the NRC. At the present time, Niagara Mohawk maintains the required \$200 million of nuclear liability insurance.

With respect to a nuclear incident at a licensed reactor, the statutory limit for the protection of the public under the Price-Anderson Amendments Act of 1988, which is in excess of the \$200 million of nuclear liability insurance, is currently \$8.89 billion without the 5% surcharge discussed below. This limit would be funded by assessments of up to \$83.9 million for each of

the 106 presently licensed nuclear reactors in the United States, payable at a rate not to exceed \$10 million per reactor, per year, per incident. Such assessments are subject to periodic inflation indexing and to a 5% surcharge if funds prove insufficient to pay claims. With the 5% surcharge included, the statutory limit is \$9.34 billion.

Niagara Mohawk's interest in Units 1 and 2 could expose it to a maximum potential loss, for each accident, of \$124.2 million (with 5% assessment) through assessments of \$14.1 million per year in the event of a serious nuclear accident at its own or another licensed U.S. commercial nuclear reactor. The amendments also provide, among other things, that insurance and indemnity will cover precautionary evacuations, whether or not a nuclear incident actually occurs.

This liability would transfer to the purchaser of the nuclear generation assets, if the assets are sold.

Nuclear Property Insurance: The Nine Mile Point Nuclear Site has \$500 million primary nuclear property insurance with the American Nuclear Insurers (ANI). In addition, there is \$2.25 billion in excess of the \$500 million primary nuclear insurance with Nuclear Electric Insurance Limited ("NEIL"). The total nuclear property insurance is \$2.75 billion. NEIL also provides insurance coverage against the extra expense incurred in purchasing replacement power during prolonged accidental outages. The insurance provides coverage for outages for 162 weeks, after a 12-week waiting period. NEIL insurance is subject to retrospective premium adjustment under which Niagara Mohawk could be assessed up to approximately \$8.8 million per loss.

If the sale of the nuclear generation assets occurs, Niagara Mohawk will still be liable for retrospective premium adjustments that are associated with NEIL losses that occurred prior to the date of the sale for up to a period of 6 years following the sale. As of December 31, 1999, Niagara Mohawk has not been made aware of any material retrospective premium adjustments.

Low Level Radioactive Waste: Niagara Mohawk currently uses the Barnwell, South Carolina waste disposal facility for low level radioactive waste. However, continued access to Barnwell is not assured, and Niagara Mohawk has implemented a low level radioactive waste management program so that Unit 1 and Unit 2 are prepared to properly handle interim on-site storage of low level radioactive waste for at least a ten-year period.

Under the Federal Low Level Waste Policy Amendment Act of 1985, New York State was required by January 1, 1993 to have arranged for the disposal of all low level radioactive waste within the state or in the alternative, contracted for the disposal at a facility outside the state. To date, New York State has made no

funding available to support siting for a disposal facility.

Nuclear Fuel Disposal Cost: In January 1983, the Nuclear Waste Policy Act of 1982 (the "Nuclear Waste Act") established a cost of \$.001 per KWh of net generation for current disposal of nuclear fuel and provides for a determination of Niagara Mohawk's liability to the DOE for the disposal of nuclear fuel irradiated prior to 1983. The Nuclear Waste Act also provides three payment options for liquidating such liability and Niagara Mohawk has elected to delay payment, with interest, until the year in which Niagara Mohawk initially plans to ship irradiated fuel to an approved DOE disposal facility. Progress in developing the DOE facility has been slow and it is anticipated that the DOE facility will not be ready to accept deliveries until at least 2010. In July 1996, the United States Circuit Court of Appeals for the District of Columbia ruled that the DOE had an obligation to accept spent fuel from the nuclear industry by January 31, 1998 even though a permanent storage site would not be ready by then. The DOE did not appeal this decision. On January 31, 1997, Niagara Mohawk joined a number of other utilities, states, state agencies and regulatory commissions in filing a suit in the U.S. Court of Appeals for the District of Columbia against the DOE. The suit requested the court to suspend the utilities payments into the Nuclear Waste Fund and to place future payments into an escrow account until the DOE fulfills its obligation to accept spent fuel. The DOE did not meet its January 31, 1998 deadline and indicated it was not obligated to provide a financial remedy for delay. On November 14, 1997 the United States Court of Appeals for the District of Columbia Circuit issued a writ of mandamus precluding DOE from excusing its own delay on the grounds that it has not yet prepared a permanent repository or interim storage facility. On December 11, 1997, 27 utilities, including Niagara Mohawk, petitioned the DOE to suspend their future payments to the Nuclear Waste Fund until the DOE begins moving fuel from their plant sites. The petition further sought permission to escrow payments to the waste fund beginning in February 1998. On January 12, 1998, the DOE denied the petition. In 1998, both the House and the U.S. Senate passed legislation to reform the federal government's spent nuclear fuel disposal policy. This legislation authorized DOE to construct an interim spent fuel storage facility to accommodate acceptance of spent fuel beginning no later than June 2003. Additionally, this legislation required the payment of one-time fees by electric utilities for the disposal of fuel irradiated prior to 1983 to be paid to the Nuclear Waste Fund no later than September 30, 2001. However, this legislation was never sent to the President for approval. As of December 31, 1999, Niagara Mohawk has recorded a liability of \$126.0 million in other long-term debt for the disposal of nuclear fuel irradiated prior to 1983.

Niagara Mohawk has several alternatives under consideration to provide additional spent fuel storage facilities, as necessary. Each alternative will likely require NRC approval, may require other regulatory approvals and would likely require incurring additional costs, which Niagara Mohawk has included in its decommissioning estimates for both Unit 1 and its share of Unit 2. Niagara Mohawk does not believe that the possible unavailability of the DOE disposal facility until 2010 will inhibit operation of either Unit.

NOTE 4. Bank Credit Arrangements

Niagara Mohawk has an \$804 million senior bank financing with a bank group consisting of a \$255 million term loan facility, a \$125 million revolving credit facility and \$424 million for letters of credit. The letter of credit facility provides credit support for the adjustable rate pollution control revenue bonds issued through the NYSEDA, discussed in Note 5. As of December 31, 1999, the amount outstanding under the senior bank financing was \$529 million, consisting of \$105 million under the term loan facility and \$424 million of letters of credit, leaving Niagara Mohawk with \$275 million of borrowing capability under the financing. The senior bank facility term expires on June 1, 2000. As a result, the amount outstanding on this facility at December 31, 1999, \$105 million, is shown as a current liability on both Holdings and Niagara Mohawk's balance sheets. Niagara Mohawk is currently negotiating a new financing arrangement with a bank group, and believes as a minimum it will be able to obtain \$424 million for letters of credit prior to the expiration of the senior bank facility on June 1, 2000. The interest rate applicable to the facility is variable based on certain rate options available under the agreement and currently approximates 6.625% (but capped at 15%).

Opinac had an agreement with a bank providing for letters of credit totaling up to \$25 million, which in January 2000 was replaced by a \$50 million bank facility secured by certain assets of Opinac. The facility provides for letters of credit and a \$10 million line of credit. The facility expires September 30, 2000 and as of January 31, 2000, supports approximately \$20 million in letters of credit. Opinac is working to extend the facility beyond September 30, 2000.

Holdings and Niagara Mohawk did not have any short-term debt outstanding at December 31, 1999 and 1998.

NOTE 5. Capitalization

Niagara Mohawk has been reviewing its capital structure in light of its scheduled debt reduction program, its divestiture of its electric generation and the changing industry. As a result, Niagara Mohawk filed two petitions with the PSC on July 1, 1999. The PSC approved the petitions on September 22, 1999 as follows:

- **Refinance Niagara Mohawk Preferred Stock** — The PSC approved Niagara Mohawk's petition to issue up to \$350 million in preferred stock to refinance existing preferred stock outstanding through December 31, 2000. During November 1999, Niagara Mohawk completed the sale of \$150 million of fixed-adjustable rate preferred stock (Series D) at a fixed rate of 6.9% for the first five years. The 3 million shares of fixed-adjustable rate preferred stock has a \$25 par value with a \$50 liquidation preference. Niagara Mohawk used the proceeds from the sale to redeem its 9.5% series of \$25 par value optionally-redeemable preferred stock on December 31, 1999.
- **Purchase of Holdings' Common Stock** — The PSC approved Niagara Mohawk's petition to purchase up to \$800 million of Holdings' common stock. Holdings' Board of Directors has approved a program to repurchase 20 million shares through December 31, 2001.

During the third quarter of 1999, Niagara Mohawk entered into two agreements, which expire in less than one year, whereby two agents would purchase up to 9 million shares of Holdings' common stock on Niagara Mohawk's behalf. At any time prior to the expiration of these agreements, Niagara Mohawk can repurchase the common stock from the agents and is required to reimburse these agents (in stock and/or cash) for the costs they incurred to buy the stock plus a carrying charge. The two agents have incurred a total of approximately \$140.3 million to purchase the 9 million shares. During December 1999, Niagara Mohawk purchased 4 million shares from one of the agents for approximately \$64.3 million, including fees paid to the agent. The remaining 5 million shares repurchased by the other agent, but not yet paid for by Niagara Mohawk (with the exception of \$1.4 million in carrying charges) remain in the number of shares outstanding in computing Holdings' earnings per share.

During the fourth quarter of 1999, Niagara Mohawk repurchased an additional 6 million shares of Holdings' common stock on the open market for approximately \$91.5 million, including fees.

Holdings Capital Stock

Holdings is authorized to issue 300,000,000 shares of common stock, \$0.01 par value. In addition, Holdings is authorized to issue 50,000,000 shares of preferred stock,

\$0.01 par value. The table below summarizes changes in the capital stock issued and outstanding and the related capital account for 1999:

	Common Stock \$0.01 Par Value		Treasury Stock (at cost)*	Capital Stock Premium and Expense (Net)*	Accumulated Other Comprehensive Income*
	Shares	Amount*			
December 31, 1998 ^(a) :	—	\$ —	\$ —	\$ —	\$ —
Exchange ^(a)	187,364,863	1,874		2,548,022	(29,722)
Issued by subsidiary				(1,479)	
Redemptions by subsidiary				87	
Treasury stock, at cost	(10,000,000)		(157,167)		
Other comprehensive income adjustments					3,521
December 31, 1999:	177,364,863	\$ 1,874	\$ (157,167)	\$ 2,546,630	\$ (26,201)

* In thousands of dollars

(a) On March 18, 1999, the common stock of Niagara Mohawk was exchanged on a share for share basis with Holdings. (See Note 1)

The cumulative amount of foreign currency translation adjustment was \$(21,048), the unrealized gain on securities was \$814 and the additional minimum pension liability was \$5,967 at December 31, 1999.

Niagara Mohawk Capital Stock

Niagara Mohawk is authorized to issue 250,000,000 shares of common stock, \$1 par value; 3,400,000 shares of preferred stock, \$100 par value; 19,600,000 shares of preferred stock, \$25 par value; and 8,000,000 shares of

preference stock, \$25 par value. The table below summarizes changes in the capital stock issued and outstanding and the related capital accounts for 1997, 1998, and 1999:

	Common Stock \$1 Par Value		Preferred Stock						Capital Stock Premium and Expense (Net)*	Accumulated Other Comprehensive Income*	Repurchased Holdings' Common Stock*
			\$100 Par Value			\$25 Par Value					
	Shares	Amount*	Shares	Non- Redeemable*	Redeemable*	Shares	Non- Redeemable*	Redeemable*			
December 31, 1996:	144,365,214	\$144,365	2,340,000	\$210,000	\$24,000 ^(a)	12,064,005	\$230,000	\$71,600 ^(a)	\$1,798,366	(\$14,641)	—
Issued	54,137	54	—	—	—	—	—	—	426		
Redemptions			(18,000)	—	(1,800)	(282,801)	—	(7,070)	98		
Other comprehensive income adjustments										(4,561)	
December 31, 1997:	144,419,351	\$144,419	2,322,000	\$210,000	\$22,200 ^(a)	11,781,204	\$230,000	\$64,530 ^(a)	\$1,798,890	(\$19,202)	—
Issued	42,945,512	42,946	—	—	—	—	—	—	563,540		
Redemptions			(18,000)	—	(1,800)	(332,801)	—	(8,320)	101		
Other comprehensive income adjustments										(6,592)	
December 31, 1998:	187,364,863	\$187,365	2,304,000	\$210,000	\$20,400 ^(a)	11,448,403	\$230,000	\$56,210 ^(a)	\$2,362,531	(\$25,794)	—
Issued			—	—	—	3,000,000 ^(c)	150,000	—	(1,479)		
Redemptions			(18,000)	—	(1,800)	(6,232,801) ^(c)	(150,000)	(5,820)	87		
Repurchase Holdings' common stock											(157,167)
Dividend of Opinac										25,186 ^(b)	
Other comprehensive income adjustments										(4,545)	
December 31, 1999:	187,364,863	\$187,365	2,286,000	\$210,000	\$18,600 ^(a)	8,215,602	\$230,000	\$50,390 ^(a)	\$2,361,139	(\$5,153)	(\$157,167)

* In thousands of dollars

(a) Includes sinking fund requirements due within one year.

(b) On March 31, 1999, Niagara Mohawk distributed its ownership interest in the stock of Opinac as a dividend to Holdings. As a result, the accumulated other comprehensive income of Opinac of \$25,186 million, which is entirely made up of foreign currency translation adjustment, is no longer included in Niagara Mohawk's "Accumulated Other Comprehensive Income." (See Note 1)

(c) The fixed-adjustable rate preferred stock issued during 1999 has a \$25 par value with a \$50 liquidation preference.

The cumulative amount of unrealized gain on securities was \$814 and the additional minimum pension liability was \$5,967 at December 31, 1999.

Niagara Mohawk Non-Redeemable Preferred Stock (Optionally Redeemable)

Niagara Mohawk had certain issues of preferred stock, which provide for optional redemption at December 31, as follows:

Series	Shares	In thousands of dollars		Redemption price per share (Before adding accumulated dividends)
		1999	1998	
Preferred \$100 par value:				
3.40%	200,000	\$20,000	\$ 20,000	\$103.50
3.60%	350,000	35,000	35,000	104.85
3.90%	240,000	24,000	24,000	106.00
4.10%	210,000	21,000	21,000	102.00
4.85%	250,000	25,000	25,000	102.00
5.25%	200,000	20,000	20,000	102.00
6.10%	250,000	25,000	25,000	101.00
7.72%	400,000	40,000	40,000	102.36
Preferred \$25 par value:				
9.50%	6,000,000	—	150,000	
Adjustable Rate —				
Series A	1,200,000	30,000	30,000	25.00
Series C	2,000,000	50,000	50,000	25.00
Series D	3,000,000	150,000	—	50.00
		\$440,000	\$440,000	

Niagara Mohawk Mandatorily Redeemable Preferred Stock

At December 31, Niagara Mohawk had certain issues of preferred stock, as detailed below, which provide for mandatory and optional redemption. These series require mandatory sinking funds for annual redemption and provide

optional sinking funds through which Niagara Mohawk may redeem, at par, a like amount of additional shares (limited to 120,000 shares of the 7.45% series). The option to redeem additional amounts is not cumulative.

Series	Shares		In thousands of dollars		Redemption price per share (Before adding accumulated dividends)	
	1999	1998	1999	1998	1999	Eventual minimum
Preferred \$100 par value:						
7.45%	186,000	204,000	\$18,600	\$ 20,400	\$101.21	\$100.00
Preferred \$25 par value:						
7.85%	365,602	548,403	9,140	13,710	25.00	25.00
Adjustable Rate —						
Series B	1,650,000	1,700,000	41,250	42,500	25.00	25.00
			68,990	76,610		
Less sinking fund requirements			7,620	7,620		
			\$ 61,370	\$ 68,990		

Niagara Mohawk's five-year mandatory sinking fund redemption requirements for preferred stock are as follows:

Year	Redemption Requirements (in thousands)
2000	\$ 7,620
2001	7,620
2002	3,050
2003	3,050
2004	3,050

Niagara Mohawk Long-Term Debt

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

		In thousands of dollars	
Series	Due	1999	1998
First mortgage bonds:			
9 1/2%	2000	\$ 150,000	\$ 150,000
6 7/8%	2001	210,000	210,000
9 1/4%	2001	100,000	100,000
5 7/8%	2002	230,000	230,000
6 7/8%	2003	85,000	85,000
7 3/8%	2003	220,000	220,000
8 %	2004	232,425	300,000
6 5/8%	2005	110,000	110,000
9 3/4%	2005	137,981	150,000
7 3/4%	2006	275,000	275,000
*6 5/8%	2013	45,600	45,600
9 1/2%	2021	—	150,000
8 3/4%	2022	136,597	150,000
8 1/2%	2023	146,020	165,000
7 7/8%	2024	170,257	210,000
*5.15%	2025	75,000	75,000
*7.2%	2029	115,705	115,705
Total First Mortgage Bonds		2,439,585	2,741,305
Senior Notes:			
6 1/2%	1999	—	300,000
7 %	2000	340,244	450,000
7 1/8%	2001	302,439	400,000
7 1/4%	2002	302,439	400,000
7 3/8%	2003	302,439	400,000
7 5/8%	2005	302,439	400,000
7 3/4%	2008	600,000	600,000
8 1/2%	2010	500,000	500,000
Unamortized discount on 8 1/2% Senior Note		(126,374)	(156,216)
Total Senior Notes		2,523,626	3,293,784
Promissory notes:			
*Adjustable Rate Series due			
2015		100,000	100,000
2023		69,800	69,800
2025		75,000	75,000
2026		50,000	50,000
2027		25,760	25,760
2027		93,200	93,200
Term Loan Agreement		105,000	105,000
Unsecured Medium Term Notes:			
Various rates, due 2000-2004		—	20,000
Other		186,902	174,462
Unamortized premium (discount)		(12,545)	(18,846)
TOTAL LONG-TERM DEBT		5,656,328	6,729,465
Less long-term debt due within one year		613,740	312,240
		\$ 5,042,588	\$ 6,417,225

* Tax-exempt pollution control related issues

Niagara Mohawk's long-term debt increased significantly upon the closing of the MRA on June 30, 1998. The MRA was largely financed through the Senior Notes. The Senior Notes are unsecured obligations of Niagara Mohawk and rank pari passu in right of payment to its First Mortgage Bonds, the senior bank financing and unsecured medium term notes.

Niagara Mohawk is obligated to use 85% of the net proceeds of the sales of the generation assets to reduce its senior debt outstanding within 180 days after the receipt of such proceeds. To date, Niagara Mohawk has received \$860 million on the sale of its two coal-fired generation plants, its hydro electric generation plants, and its oil and gas-fired plant in Oswego. During 1999 Niagara Mohawk redeemed approximately \$1.1 billion in debt using the proceeds from the assets sales and from improved cash flow. See Notes 2 and 3 for a discussion of the status of the remaining generation asset sales.

Several series of First Mortgage Bonds and Promissory Notes were issued to secure a like amount of tax-exempt revenue bonds issued by NYSERDA. Approximately \$414 million of such securities bear interest at a daily adjustable interest rate (with an option to convert to other rates, including a fixed interest rate which would require Niagara Mohawk to issue First Mortgage Bonds to secure the debt) which averaged 3.23% for 1999 and 3.39% for 1998 and are supported by bank direct pay letters of credit. Pursuant to agreements between NYSERDA and Niagara Mohawk, proceeds from such issues were used for the purpose of financing the construction of certain pollution control facilities at Niagara Mohawk's generation facilities or to refund outstanding tax-exempt bonds and notes (see Note 4).

Other long-term debt in 1999 consists of obligations under capital leases of approximately \$22.1 million, a liability to the DOE for nuclear fuel disposal of approximately \$126.0 million and a liability for IPP contract terminations not related to the MRA of approximately \$38.8 million. The aggregate maturities of long-term debt for the five years subsequent to December 31, 1999, excluding capital leases, in millions, are approximately \$610.5, \$624.2, \$544.0, \$610.7 and \$232.4, respectively. A reduction in debt that will occur from applying proceeds from additional generation asset sales may impact the schedule of maturities of long-term debt.

Early Extinguishment of Debt: During 1999, Niagara Mohawk redeemed approximately \$822 million in long-term debt prior to its scheduled maturity. Holdings and Niagara Mohawk charged to earnings, as an extraordinary item approximately \$23.8 million, after tax, for redemption premiums incurred, and unamortized debt expense and issuance costs. This extraordinary item had a 13 cents per share, after tax effect on Holdings' 1999 earnings per share.

NOTE 6. Federal and Foreign Income Taxes

The federal income tax amounts included in this note are for Holdings. The amounts for Niagara Mohawk are not materially different.

Components of United States and foreign income before income taxes:

	<i>In thousands of dollars</i>		
	1999	1998	1997
United States	\$ 25,276	\$ (206,372)	\$ 315,027
Foreign	6,124	8,227	(1,621)
Consolidating eliminations	13,307	10,592	(3,476)
Income before income taxes and preferred dividend requirement of subsidiary	\$ 44,707	\$ (187,553)	\$ 309,930

Following is a summary of the components of Federal and foreign income tax and a reconciliation between the amount of Federal income tax expense reported in the

Consolidated Statements of Income and the computed amount at the statutory tax rate:

	<i>In thousands of dollars</i>		
	1999**	1998	1997
Components of Federal and foreign income taxes:			
Current Federal tax expense:	\$ 24,637	\$ (155,320)	\$ 77,565
Deferred tax expense:			
Federal	(6,931)	84,466	47,836
Foreign	1,474	4,126	1,194
	(5,457)	88,592	49,030
Total	\$ 19,180	\$ (66,728)	\$ 126,595
Reconciliation between Federal and foreign income taxes and the tax computed at prevailing U.S. statutory rate on income before income taxes:			
Computed tax	\$ 15,648	\$ (65,644)	\$ 108,475
Increase (reduction) including those attributable to flow-through of certain tax adjustments:			
Depreciation	21,380	20,808	34,926
Cost of removal	(6,809)	(7,859)	(8,168)
Allowance for funds used during construction	(2,442)	(4,207)	(2,952)
Expiring foreign tax credits	692	10,053	—
Pension settlement amortization	(278)	(3,317)	(2,391)
Debt premium & mortgage recording tax	14,402	(9,408)	23
Real estate taxes	3,540	1,968	2,408
Provided at other than statutory rate	1,185	—	—
Subsidiaries	(2,294)	3,853	(1,820)
Reserve for Hydra-Co sale expenses	(1,181)	(15)	(276)
Deferred investment tax credit reversal*	(23,539)	(7,454)	(7,454)
Other	(1,124)	(5,506)	3,824
	3,532	(1,084)	18,120
Federal and foreign income taxes**	\$ 19,180	\$ (66,728)	\$ 126,595
Effective Tax Rate	43.0%	35.6%	40.8%

* Deferred investment tax credits of \$16.2 million related to the fossil and hydro generation assets that have been sold have been taken into income in 1999 in accordance with IRS rules.

** Does not include the tax benefit of \$12.819 million associated with the extraordinary item for the loss on the extinguishment of debt in 1999.

At December 31, the deferred tax liabilities (assets) were comprised of the following:

	<i>In thousands of dollars</i>	
	1999	1998
Alternative minimum tax	\$ (97,652)	\$ (82,621)
Unbilled revenue	(12,771)	(81,685)
Non-utilized NOL carryforward	(930,117)	(1,161,898)
Other	(336,478)	(290,035)
Total deferred tax assets	(1,377,018)	(1,616,239)
Depreciation related	1,275,804	1,292,582
Investment tax credit related	65,554	76,418
MRA terminated IPP contracts	1,172,380	1,415,977
Other	432,237	342,679
Total deferred tax liabilities	2,945,975	3,127,656
Accumulated deferred income taxes	\$ 1,568,957	\$ 1,511,417

In December 1998, Niagara Mohawk received a ruling from the IRS to the effect that the amount of cash and the value of common stock that was paid to the terminated IPP Parties was deductible in 1998 and generated a substantial net operating loss for federal income tax purposes, such that Niagara Mohawk did not pay federal income taxes for 1998. Further, Niagara Mohawk has carried back unused NOL carryforward to the years 1996 and 1997, and also for the years 1988 through 1990, which resulted in a tax refund of \$135

million that were received in January 1999. Holdings anticipates that it will be able to utilize the remaining \$3.3 billion NOL carryforward prior to its expiration date in 2019. The amount of the NOL carryforward as of December 31, 1999 is \$2.6 billion. Holdings' ability to utilize the NOL carryforward generated, as a result of the MRA could be limited under the rules of section 382 of the Internal Revenue Code if certain changes in Holdings' common stock ownership were to occur in the future.

NOTE 7. Pension and Other Retirement Plans

Niagara Mohawk and its affiliates have a non-contributory defined benefit pension plan covering substantially all employees, which was amended during 1998 to include a cash balance benefit in which the participant has an account to which amounts are credited based on qualifying compensation and with interest determined annually based on average annual 30-year Treasury bond yield. The majority of the costs and benefits associated with this plan are attributable to Niagara Mohawk employees. Supplemental non-

qualified, non-contributory executive retirement programs provide additional defined pension benefits for certain officers. In addition, Niagara Mohawk and its affiliates provide certain contributory health care and life insurance benefits for active and retired employees and dependents.

The changes in benefit obligations, plan assets and plan funded status for these pension and other retirement plans as of, and for the year ended December 31, are summarized as follows:

	<i>In thousands of dollars</i>			
	Pension Benefits		Other Retirement Benefits	
	1999	1998	1999	1998
Change in benefit obligation:				
Benefit obligation at January 1	\$ 1,302,197	\$ 1,172,428	\$ 547,620	\$ 519,851
Service cost	34,743	30,430	15,367	14,338
Interest cost	85,821	79,748	35,555	35,338
Benefits paid to participants	(234,683)	(75,650)	(35,568)	(32,917)
Plan amendments	19,300	33,694	—	(6,579)
Curtailments	(4,818)	—	7,287	—
Settlements	(32,058)	—	—	—
Actuarial (gain) loss	(58,669)	61,547	(51,203)	17,589
Benefit obligation at December 31	1,111,833	1,302,197	519,058	547,620
Change in plan assets:				
Fair value of plan assets at January 1	1,446,512	1,304,338	210,046	181,101
Contributions	11,878	12,446	9,435	9,466
Net return on plan assets	157,627	198,943	25,609	19,479
Benefits paid to participants	(234,152)	(69,215)	—	—
Settlements	(37,218)	—	—	—
Fair value of plan assets at December 31	1,344,647	1,446,512	245,090	210,046
Funded status	232,814	144,315	(273,968)	(337,574)
Unrecognized initial obligation	12,788	16,887	141,570	152,460
Unrecognized net gain from actual return on plan assets	(366,232)	(360,450)	—	—
Unrecognized net loss (gain) from past experience different from that assumed	(17,612)	41,914	(14,507)	55,335
Unrecognized prior service cost	81,178	79,269	(15,508)	(27,532)
Accumulated other comprehensive income	(6,746)	—	—	—
Benefits liability on Holdings' consolidated balance sheet	\$ (63,810)	\$ (78,065)	\$ (162,413)	\$ (157,311)

In 1999, Niagara Mohawk experienced a net curtailment/settlement gain of \$35.3 million due to the employee transfers associated with the sale of the hydro and fossil generating plants and normal terminations electing lump sum pension benefits distributions under the cash balance option and receiving postemployment medical and life insurance benefits. After a portion of the gain was allocated to the co-tenants, \$9.4 million of the

net gain was included in the deferred loss on the sale of the assets; the remaining \$23.6 was deferred as an Other Regulatory Liability as required by PSC regulations.

The non-qualified executive pension plan has no plan assets due to the nature of the plan, and therefore, has an accumulated benefit obligation in excess of plan assets of \$12.4 million and \$8.8 million at December 31, 1999 and 1998, respectively.

The following table summarizes the components of the net annual benefit costs.

	<i>In thousands of dollars</i>					
	Pension Benefits			Other Retirement Benefits		
	1999	1998	1997	1999	1998	1997
Service cost	\$ 34,743	\$ 30,430	\$ 27,106	\$ 15,367	\$ 14,338	\$ 12,255
Interest cost	85,821	79,748	74,984	35,555	35,338	34,829
Expected return on plan assets	(97,151)	(95,472)	(84,859)	(17,501)	(16,752)	(13,234)
Amortization of the initial obligation	2,526	2,559	2,559	10,890	10,890	10,890
Amortization of gains and losses	(1,574)	(8,408)	(9,226)	10,695	8,367	6,967
Amortization of prior service costs	7,675	4,899	3,892	(10,271)	(9,508)	(8,745)
Net benefit cost before curtailment and settlements	32,040	13,756	14,456	44,735	42,673	42,962
Curtailment loss	6,470	—	—	5,370	—	—
Settlement gain	(47,102)	—	—	—	—	—
Net benefit cost (1)	\$ (8,592)	\$ 13,756	\$ 14,456	\$ 50,105	\$ 42,673	\$ 42,962

(1) A portion of the benefit costs relates to construction labor, and accordingly, is allocated to construction projects.

Weighted-average assumptions as of December 31:	Pension Benefits		Other Retirement Benefits	
	1999	1998	1999	1998
Discount rate	7.75%	6.75%	7.75%	6.75%
Expected return on plan assets	9.25	9.25	9.25	9.25
Rate of compensation increase (plus merit increases)	2.50	2.50	N/A	N/A
Health care cost trend rate:				
Under age 65	N/A	N/A	6.00	7.00
Over age 65	N/A	N/A	5.50	6.00

The assumed health cost trend rates decline to 5% in 2000 and remain at that level thereafter. The assumed health cost trend rates can have a significant effect on the amounts reported for the health care plans.

A one-percentage-point change in assumed health care cost trend rates would have the following effects:

Holdings recognizes the obligation to provide postemployment benefits if the obligation is attributable to employees' past services, rights to those benefits are vested, payment is probable and the amount of the benefits can be reasonably estimated. At December 31, 1999 and 1998, Holdings' postemployment benefit obligation is approximately \$15.7 million and \$15.3 million, respectively.

	1% Increase	1% Decrease
<i>In thousands of dollars</i>		
Effect on total of service and interest cost components of net periodic postretirement health care benefit cost	\$ 4,920	\$ (4,130)
Effect on health care component of the accumulated postretirement benefit obligation	40,839	(35,091)

NOTE 8. Commitments and Contingencies

Long-term Contracts for the Purchase of Electric Power: Niagara Mohawk has several types of long-term contracts for the purchase of electric power. Niagara Mohawk's commitments under these long-term contracts, as of January 1, 2000, excluding its commitments with NYPA, which are shown separately, are summarized in the table below. Following the table are descriptions of the different types of these long-term

contracts. For a detailed discussion of the financial swap agreements that Niagara Mohawk has entered into as part of the MRA and the sale of its generation assets (the sale of the Huntley and Dunkirk coal-fired generation plants and the announced sale of the Albany oil and gas-fired generation plant) which are not included in the table below, see Note 9.

Year	<i>In thousands of dollars</i>			Estimated Purchased Capacity (in MW)	Estimated Purchased Energy (in MWh)
	Estimated Fixed Costs*	Estimated Variable Costs* Capacity Energy and Taxes***	Total*		
2000	\$ 128,995	\$ 221,032	\$ 350,027	1,945	5,776,572
2001	102,157	198,441	300,598	1,936	5,119,974
2002	40,288	182,337	222,625	1,303	3,476,141
2003	30,226	182,216	212,443	1,300	3,465,277
2004	15,218	175,067	190,285	430	3,249,885
2005-2015	94,852	1,829,292	1,924,144	422**	34,592,593

* Nominal value

** MW value represents the average annual quantity of purchased capacity

*** Does not include puts (see below)

PURPA Contracts: Under the requirements of PURPA, Niagara Mohawk is required to purchase power generated by IPPs, as defined therein. Niagara Mohawk has 112 PPAs with 120 IPP facilities, amounting to approximately 1,000 MW of capacity at December 31, 1999. All of this capacity amount is considered firm and excludes PPAs that provide energy only. The table above includes the estimated payments for fixed costs (capacity) and variable costs (capacity, energy and related taxes) that Niagara Mohawk estimates it will be obligated to make under these 112 IPP contracts, excluding the financial obligation under the swap contracts. The payments to the IPPs are subject to the tested capacity and availability of the facilities, scheduling and price escalation. These payments have been significantly reduced by the consummation of the MRA and additional IPP buyouts made in 1999. See Note 2 "IPP Buyout Costs" for a further discussion of the additional IPP buyouts made in 1999.

Fixed capacity costs (in the table above) relate to three contracts as follows: 1) a contract with an IPP that was a party to the MRA, 2) a contract for the sale of the Oswego generation assets as discussed further below, and 3) the contract for the sale of the hydroelectric generation assets as discussed further below. With respect to the IPP contract, Niagara Mohawk is required to make capacity

payments, including payments when the facility is not operating but available for service. The terms of this contract allows Niagara Mohawk to schedule energy deliveries and then pay for the energy delivered. Contracts relating to the remaining IPP facilities in service at December 31, 1999, require Niagara Mohawk to pay only when energy is delivered, except when Niagara Mohawk decides that it would be better to pay a particular project a reduced payment to have the project reduce its high priced energy deliveries. Niagara Mohawk paid approximately \$435 million, \$785 million and \$1,106 million in 1999, 1998 and 1997 for 6,765,000 MWh, 9,700,000 MWh and 13,500,000 MWh, respectively, of electric power under all IPP contracts.

Fossil/Hydro Contracts: As part of the sale of Niagara Mohawk's fossil and hydro generation assets, Niagara Mohawk entered into PPAs with the buyers of these assets for the purchase of capacity and energy as discussed in more detail below. The table above includes the estimated payments for variable costs and quantities (capacity and energy) associated with the PPAs that Niagara Mohawk estimates it will make under these contracts. Niagara Mohawk paid approximately \$123.7 million in 1999 for 2,409 MW of capacity and 3,490,000 MWh of electric power under these PPAs. The table above does not include the estimated payments for the

PPAs entered into with the buyers of the Albany Steam Station and the nuclear generation assets, since Niagara Mohawk has not closed on these asset sales.

The hydro PPA calls for the purchase of all energy and capacity through September 2001 at prices that approximate forecasted future market prices. Niagara Mohawk anticipates that the energy and capacity to be purchased under the hydro PPA to be at quantities approximating historical generation levels, subject to the effects of water flow availability. The Oswego PPA is primarily a contract for capacity with a nominal amount of energy at prices above forecasted future market prices.

Nuclear Contracts: As part of the agreement with AmerGen to sell its nuclear generation assets, Niagara Mohawk would enter into PPAs to purchase energy and capacity at negotiated prices. The negotiated prices are expected to be, on average, above projected market prices during the term of the PPAs. Niagara Mohawk would pay only for delivered output from the units. The terms of the PPAs would be for five years from Unit 1 and three years from Unit 2. Upon the expiration of the PPA for Unit 2, there would be a financial sharing agreement whereby Niagara Mohawk would be entitled to future payments from the purchaser over a ten-year period if electric energy market prices exceed certain amounts during the ten-year sharing period. Niagara Mohawk has proposed to the PSC that any future payments received under the financial sharing agreement will serve to reduce the unamortized regulatory asset recorded as a result of the sale of the nuclear assets. See Note 3. - Nuclear Operations, for a complete discussion of the proposed sale of the nuclear generation assets.

Put Contracts: As a part of the MRA, Niagara Mohawk signed put agreements with approximately one-third of the IPP Parties whereby the IPP Parties have an option to put the physical delivery of energy to Niagara Mohawk at market prices. These put agreements will be in effect until the NYISO meets certain volume and capacity conditions for a consecutive six-month period. If the NYISO does not meet the defined volume and capacity transactions that are outlined in the put agreements, then the put agreements are in effect until June 2008. Since Niagara Mohawk cannot predict if and when the NYISO will meet the volume and capacity conditions, the cost and quantity of energy associated with the put agreements have not been included in the table above. During 1999, Niagara Mohawk paid \$75.9 million to the IPP Parties for 2,782,678 MWh of electric power received as part of these put agreements. If the put agreements remain in effect, Niagara Mohawk expects to pay approximately \$77.1 million to \$91.3 million for

4,031,000 MWh to 4,093,000 MWh of electric power in each of the years 2000 to 2004.

While the PPAs for the generation asset sales, which were entered into as an integral part of the generation sales, are above market, they are designed to help Niagara Mohawk meet the objectives of rate reduction and price cap commitments as well as meet expected demand as the "provider of last resort" as outlined in the PowerChoice agreement.

At January 1, 2000, Niagara Mohawk had long-term contracts to purchase electric power from the following generation facilities owned by NYPA:

Facility	Expiration Date of Contract	Purchased Capacity in MW	Estimated Annual Capacity Cost
Niagara hydroelectric project	2007	951	\$ 28,392,000
St. Lawrence hydroelectric project	2007	104	1,248,000
Blenheim-Gilboa pumped storage generating station	2002	270	7,452,000
		1,325	\$ 37,092,000

The purchase capacities shown above are based on the contracts currently in effect. The estimated annual capacity costs are subject to price escalation and are exclusive of applicable energy charges. The total cost of purchases under these contracts, plus other miscellaneous NYPA purchases, was approximately, in millions, \$112.4, \$93.1 and \$91.0 for the years 1999, 1998 and 1997, respectively. Niagara Mohawk continues to have a contract with NYPA's Fitzpatrick nuclear facility to purchase for resale up to 46 MW of power for NYPA's economic development customers.

In addition to the contractual commitments described above, Niagara Mohawk entered into a four-year contract, expiring in June 2003, that gives it the option to buy additional power at market prices from the Huntley coal-fired generation plant, now owned by NRG. If Niagara Mohawk needs any additional energy to meet its load it can purchase the electricity from other IPPs, other utilities, other energy merchants or through the NYISO at market prices.

Gas Supply, Storage and Pipeline Commitments: In connection with its regulated gas business, Niagara Mohawk has long-term commitments with a variety of suppliers and pipelines to purchase gas commodity, provide gas storage capability and transport gas commodity on interstate gas pipelines.

The table below sets forth Niagara Mohawk's estimated commitments at December 31, 1999, for the next five years, and thereafter.

<i>(In thousands of dollars)</i>		
Year	Gas Supply	Gas Storage/Pipeline
2000	\$ 55,175	\$ 73,039
2001	52,538	66,203
2002	39,445	33,067
2003	39,445	11,535
2004	39,445	11,535
Thereafter	72,305	45,237

With respect to firm gas supply commitments, the amounts are based upon volumes specified in the contracts giving consideration for the minimum take provisions. Commodity prices are based on New York Mercantile Exchange quotes and reservation charges, when applicable. Storage and pipeline capacity commitments amounts are based upon volumes specified in the contracts, and represent demand charges priced at current filed tariffs. At December 31, 1999, Niagara Mohawk's firm gas supply commitments extend through October 2006, while the gas storage and transportation commitments extend through October 2012.

Gas Multi-Year Rate and Restructuring Proposal: Niagara Mohawk filed a three-year gas rate and restructuring proposal on March 11, 1999 in anticipation of the expiration of its 1996 three-year gas rate settlement agreement, which expired on November 1, 1999. Niagara Mohawk is currently negotiating with the PSC and other parties, but has not reached a final agreement. However, on October 15, 1999 and January 12, 2000, the PSC approved an interim arrangement that freezes delivery rates at current levels, subject to refund if the permanent rates are lower and allows the pass through to customers the benefits of lowered pipeline costs. In addition, the interim arrangement minimizes Niagara Mohawk's exposure to stranded costs. The interim agreement also included provisions for the implementation of both unbundled gas rates and a return to a full gas cost collection mechanism (gas adjustment clause "GAC") effective November 1, 1999. In addition, Niagara Mohawk is allowed to recover all commodity costs along with fixed capacity costs for capacity actually used to serve customers. It also provides that, pending resolution of the issue in that case, costs for capacity upstream of CNG that are not actually required for sales customer demands or offset by assignment and secondary market release (stranded capacity costs) are not recoverable beginning November 1, 1999. However, the potential for stranded costs are not considered material to Niagara Mohawk's results of operations or financial condition. The exposure may increase in the future as additional customers select

alternative suppliers. Niagara Mohawk is continuing to work with the PSC and other interested parties to reach a final settlement, but it cannot predict the timing or outcome of such a settlement.

Future of the Natural Gas Industry: In November 1998, the PSC issued its Policy Statement concerning the Future of the Natural Gas Industry in New York State and Order Terminating Capacity Assignment ("PSC Policy Statement"). The PSC envisions a transitional time frame of three to seven years for local gas distribution companies ("LDC") to exit the business of purchasing natural gas (the "merchant" function). The PSC established a process comprising three basic elements, to be pursued in parallel in the exiting of the merchant function:

- Addressing the issues involved in the exiting of the merchant function on a utility-by-utility basis as part of the LDCs individual rate plans;
- Collaboration among staff, LDCs, marketers, pipelines and other stakeholders of generic issues such as operational and reliability issues, protocols and information systems requiring a status report by April 1, 1999; and
- Coordination of issues faced by electric utilities, including provider of last resort issues and a plan to allow competition in other areas, such as metering, billing and information services.

In December 1998, Niagara Mohawk notified the PSC that its specific operational and reliability requirements continue to warrant certain mandatory capacity assignment and inclusion of capacity costs in transportation rates after April 1, 1999. Niagara Mohawk will continue to assign CNG capacity until a final determination is reached in the current rate and restructuring case. The PSC noted in its PSC Policy Statement that it will provide LDCs with a reasonable opportunity to recover these strandable costs if they can demonstrate compliance with the PSC's directives to minimize such costs.

As a result of the collaborative process established in the PSC Policy Statement, on August 19, 1999, the PSC issued an order requiring that marketers serving firm customers have firm, primary delivery point capacity for the five winter months of November through March, but allowed an alternative for marketers, only for the 1999 — 2000 heating season, to have firm secondary delivery point capacity and to pay the LDC a standby charge to provide backup service. LDCs that implemented this Order would be presumed to have met the PSC's directive to minimize their stranded costs.

Niagara Mohawk believes that it has taken numerous actions to reduce its capacity obligations and its potential

stranded costs, but is unable to predict the outcome of this matter. Niagara Mohawk has addressed the issues from the PSC Policy Statement in its three-year gas rate and restructuring proposal filed on March 11, 1999 and as noted above, Niagara Mohawk is currently working with the PSC and other interested parties to reach a final settlement.

Sale of Customer Receivables: Niagara Mohawk has established a single-purpose, financing subsidiary, NMR Receivables LLC ("NMR"), whose business consists of the purchase and resale of an undivided interest in a designated pool of Niagara Mohawk customer receivables, including accrued unbilled revenues. For receivables sold, Niagara Mohawk has retained collection and administrative responsibilities as agent for the purchaser. As collections reduce previously sold undivided interests, new receivables are customarily sold. NMR has its own separate creditors which, upon liquidation of NMR, will be entitled to be satisfied out of its assets prior to any value becoming available to Niagara Mohawk. The sale of receivables are in fee simple for a reasonably equivalent value and are not secured loans. Some receivables have been contributed in the form of a capital contribution to NMR in fee simple for reasonably equivalent value, and all receivables transferred to NMR are assets owned by NMR in fee simple and are not available to pay Niagara Mohawk's creditors.

At December 31, 1999 and 1998, \$215.1 million and \$150 million, respectively, of receivables had been sold by NMR to a third party. The undivided interest in the designated pool of receivables was sold with limited recourse. The agreement provides for a formula based loss reserve pursuant to which additional customer receivables are assigned to the purchaser to protect against bad debts. At December 31, 1999, the amount of additional receivables assigned to the purchaser, as a loss reserve, was approximately \$83.2 million.

To the extent actual loss experience of the pool receivables exceeds the loss reserve, the purchaser absorbs the excess. Concentrations of credit risk to the purchaser with respect to accounts receivable are limited due to Niagara Mohawk's large, diverse customer base within its service territory. Niagara Mohawk generally does not require collateral, i.e., customer deposits.

In the fourth quarter of 1999, NMR was not in compliance with a certain statistical ratio relating to the pool of receivables sold. The purchaser has granted a waiver for this period. While NMR is working to return to compliance with this ratio, it is possible a non-compliance condition could continue to exist. NMR is unable to predict whether further waivers would be granted.

Customer Service System: Niagara Mohawk implemented a new customer service system in mid-February 1999, which experienced transition issues in customer satisfaction, incremental costs and PSC scrutiny. The PSC has begun an inquiry into the development and implementation costs of CSS, as well as Niagara Mohawk's exposure to operational issues during transition. Niagara Mohawk is unable to predict the outcome or financial consequences, if any, of the PSC inquiry.

Environmental Contingencies: The public utility industry typically utilizes and/or generates in its operations a broad range of hazardous and potentially hazardous wastes and by-products. Niagara Mohawk believes it is handling identified wastes and by-products in a manner consistent with federal, state and local requirements and has implemented an environmental audit program to identify any potential areas of concern and aid in compliance with such requirements. Niagara Mohawk is also currently conducting a program to investigate and remediate, as necessary to meet current environmental standards, certain properties associated with former gas manufacturing and other properties which Niagara Mohawk has learned may be contaminated with industrial waste, as well as investigating identified industrial waste sites as to which it may be determined that Niagara Mohawk has contributed. Niagara Mohawk has also been advised that various federal, state or local agencies believe certain properties require investigation and has prioritized the sites based on available information in order to enhance the management of investigation and remediation, if necessary.

Niagara Mohawk is currently aware of 163 sites with which it may be associated, including 86 which are Niagara Mohawk-owned. With respect to non-owned sites, Niagara Mohawk may be required to contribute some proportionate share of remedial costs. Although one party can, as a matter of law, be held liable for all of the remedial costs at a site, regardless of fault, in practice costs are usually allocated among PRPs. Niagara Mohawk has denied any responsibility at certain of these PRP sites and is contesting liability accordingly.

Investigations at each of the Niagara Mohawk-owned sites are designed to (1) determine if environmental contamination problems exist, (2) if necessary, determine the appropriate remedial actions and (3) where appropriate, identify other parties who should bear some or all of the cost of remediation. Legal action against such other parties will be initiated where appropriate. After site investigations are completed, Niagara Mohawk expects to determine site-specific remedial actions and to estimate the attendant costs for restoration. However, since investigations are ongoing

for most sites, the estimated cost of remedial action is subject to change.

Estimates of the cost of remediation and post-remedial monitoring are based upon a variety of factors, including identified or potential contaminants; location, size and use of the site; proximity to sensitive resources; status of regulatory investigation and knowledge of activities at similarly situated sites. Additionally, Niagara Mohawk's estimating process includes an initiative where these factors are developed and reviewed using direct input and support obtained from the DEC. Actual Niagara Mohawk expenditures are dependent upon the total cost of investigation and remediation and the ultimate determination of Niagara Mohawk's share of responsibility for such costs, as well as the financial viability of other identified responsible parties since clean-up obligations are joint and several. Niagara Mohawk has denied any responsibility at certain of these PRP sites and is contesting liability accordingly.

As a consequence of site characterizations and assessments completed to date and negotiations with PRPs, Niagara Mohawk has accrued a liability in the amount of \$240 million and \$220 million, which is reflected in both Niagara Mohawk's and Holdings' Consolidated Balance Sheets at December 31, 1999 and 1998, respectively. The potential high end of the range is presently estimated at approximately \$480 million, including approximately \$245 million in the unlikely event Niagara Mohawk is required to assume 100% responsibility at non-owned sites. Niagara Mohawk increased its environmental liability \$20 million in 1999 as compared to 1998 primarily as a result of the availability of information on certain sites resulting from progress made on feasibility studies. The probabilistic method was used to determine the amount to be accrued for 24 of Niagara Mohawk's largest sites. The amount accrued for Niagara Mohawk's remaining sites is determined through feasibility studies or engineering estimates, Niagara Mohawk's estimated share of a PRP allocation or where no better estimate is available, the low end of a range of possible outcomes is used. In addition, Niagara Mohawk has recorded a regulatory asset representing the remediation obligations to be recovered from ratepayers. PowerChoice and the gas settlements provide for the continued application of deferral accounting for expense recognition resulting from this effort.

Niagara Mohawk recently informed the DEC in response to an October 1999 request for information, of 24 additional former manufactured gas plant sites that it may be associated with, including 2 sites that are currently owned by Niagara Mohawk. Niagara Mohawk is unable to predict what further action the DEC may take with respect to these sites.

In November 1999, Niagara Mohawk submitted a revised feasibility study to the DEC, which included the

land-based portions of Niagara Mohawk's Harbor Point site and five surrounding non-owned sites. The study indicates a range of viable remedial approaches and associated cost estimates and recommends a selected remedial alternative. This range consists of a high end of \$70 million, with an expected value calculation of \$49 million, which is included in the amounts accrued at December 31, 1999. The surface water-based portions of Niagara Mohawk's Harbor Point site are subject to continuing feasibility study evaluations and review by the DEC. Niagara Mohawk currently estimates the range of costs for remediation of the surface water bodies to consist of a high end of \$18 million, with an expected value of \$11 million. The ranges for the land-based and the surface water bodies portions represent the total estimated costs to remediate the properties and does not consider contributions from other PRPs, the amount of which Niagara Mohawk is unable to estimate.

In May 1995, Niagara Mohawk filed a complaint pursuant to applicable Federal and New York State law, in the U.S. District Court for the Northern District of New York against several defendants seeking recovery of past and future costs associated with the investigation and remediation of the Harbor Point and surrounding sites. The New York State Attorney General moved to dismiss Niagara Mohawk's claims against the state of New York, the New York State Department of Transportation and the Thruway Authority and Canal Corporation under the Comprehensive Environmental Response, Compensation and Liability Act. Niagara Mohawk opposed this motion. On April 3, 1998, the Court denied the New York State Attorney General's motion as it pertains to the Thruway Authority and Canal Corporation, and granted the motion relative to the state of New York and the Department of Transportation. The case management order, as amended by the Court, establishes February 29, 2000 as the trial ready date. As a result, Niagara Mohawk cannot predict the outcome of the pending litigation against the defendants or the allocation of Niagara Mohawk's share of the costs to remediate the Harbor Point and surrounding sites.

Construction Program: Niagara Mohawk is committed to an ongoing construction program to assure transmission and delivery of its electric and gas services. Niagara Mohawk presently estimates that the construction program for the years 2000 through 2002 will require approximately \$678 million, excluding AFC and nuclear fuel. For the years 2000 through 2002, the estimates, in millions, are \$219, \$229, and \$230, respectively, which includes amounts relating to Niagara Mohawk's nuclear assets through June 2000, its Albany plant through March 2000, and Niagara Mohawk's 25 percent ownership share in the Roseton plant through December 2000. If the nuclear sale does not occur, Niagara Mohawk estimates it will incur expenditures for construction and nuclear fuel of \$69 million for 2000

and \$32 million and \$67 million for 2001 and 2002, respectively. Any delay in the timing or outcome of these remaining generation asset sales will effect Niagara Mohawk's capital expenditure requirements.

NOTE 9. Fair Value of Financial and Derivative Financial Instruments

The discussion that follows covers Holdings and Niagara Mohawk and its subsidiaries. When necessary, specific reference is made to the subsidiary company. The figures for Holdings and Niagara Mohawk differ only in the Cash and temporary cash investments. All other figures shown for Holdings are the same for Niagara Mohawk.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and Temporary Cash Investments: The carrying amount approximates fair value because of the short maturity of the financial instruments.

Long-Term Debt and Mandatory Redeemable Preferred Stock: The fair value of fixed rate long-term debt and redeemable preferred stock is estimated using quoted market prices where available or discounting remaining cash flows at Niagara Mohawk's incremental borrowing rate. The carrying value of NYSERDA bonds and other long-term debt are considered to approximate fair value.

Derivative Financial Instruments: The fair value of futures and forward contracts are determined using quoted market prices and broker quotes. (See Note 8 for a discussion of the financial sharing agreement that Niagara Mohawk has entered into in connection with the announced sale of the nuclear generation assets.)

Swap Contracts: Niagara Mohawk has two different types of swap contracts; the IPP indexed swap contracts and the swap contracts resulting from the sale of Niagara Mohawk's Huntley and Dunkirk coal-fired generation plants. The terms of the two types of contracts are as follows:

- **IPP indexed swap contracts -** Niagara Mohawk, as part of the MRA, entered into restated contracts with eight IPPs. The contracts have a term of ten years and are structured as indexed swap contracts where Niagara Mohawk receives or makes payments to the eight IPPs based upon the differential between the contract price and a market reference price for electricity. Niagara Mohawk has recorded

the liability for these contractual obligations and recorded a corresponding regulatory asset since payments under these restated contracts are authorized and are currently being recovered under PowerChoice. The amount of this liability and regulatory asset will fluctuate as estimates of future market and contract prices change over the term of the contracts, and will decrease over the life of the contracts as notional quantities are settled.

The contract prices are fixed for the first two years changing to an indexed pricing formula primarily related to gas prices, thereafter. Contract quantities are fixed for each year of the full ten-year term of the contracts and average 4.1 million MWh. The indexed pricing structure ensures that the price paid for energy and capacity will fluctuate relative to the underlying market cost of gas and general indices of inflation.

- **Huntley and Dunkirk generating station swap contracts -** As part of the transaction to sell the Huntley and Dunkirk coal-fired generation plants, Niagara Mohawk entered into PPAs to purchase energy and capacity from the buyer, NRG Energy, Inc. ("NRG"). Niagara Mohawk was required to purchase a portion of the energy generated by the two coal-fired plants; however, it had call options to purchase additional energy if needed. The aggregate energy and capacity costs in the PPAs were above forecasted future market prices. The PPAs converted to financial swaps ("swaps") on December 1, 1999 and have the same economic terms as the energy contracts, with no physical delivery of energy.

The agreements expire in June of 2003. As of December 31, 1999, Niagara Mohawk has recorded a \$56.4 million swap contract liability for the present value of the difference between the contract energy prices and projected market prices and has recorded a corresponding swap contract regulatory asset. The asset and liability will be amortized over the remaining term of the swaps as nominal energy quantities are settled and may be adjusted as periodic reassessments are made of future energy prices. These amounts are included with the swap contract asset and liability.

The agreements to purchase capacity and energy began at the sale date of the assets (June 1999). Base quantities were set by the contract with a call option on additional amounts. The contracts converted to financial swaps at December 1, 1999 triggered by the ISO implementation. Contract quantities average 2.9 million MWh annually. These agreements expire in June 2003.

In connection with the pending sale of the Albany plant, Niagara Mohawk has entered into a contract with

the new owner that is intended to compensate PSEG in the near term for the costs of running the plant. This contract will be recorded as a financial agreement at the time of the closing on the sale. The contract is a financial agreement with an exchange of payments that are based on the market price of energy and expires on September 30, 2003. No actual energy will be delivered to Niagara Mohawk, but a quantity of energy, referred to as the call amount, is used to calculate the payment. The call amount is capped each year and totals 1,300 GWh for the life of the contract. The contract is a derivative instrument. Each month Niagara Mohawk will pay PSEG a fixed monthly charge plus the call amount times a contract price. The contract price approximates the cost of fuel for the plant and will fluctuate as fuel prices change. PSEG will pay Niagara Mohawk the same call amount times the current market price for energy. This market price will be determined by the NYISO. Niagara Mohawk has the sole option, within certain limits stated in the contract, to decide what the call amount will be. This combination of a swap with one party having an option is called a swaption. If the market price is expected to be higher than the contract price, Niagara Mohawk would likely exercise the option, elect a call amount, and PSEG will make a swap payment to Niagara Mohawk. If the market price is expected to be below the contract price, Niagara Mohawk would not likely choose

to name a call amount, in which case Niagara Mohawk would only be required to make the fixed monthly payment. For Niagara Mohawk, this contract will serve as a hedge against rising energy prices. Niagara Mohawk expects to account for this contract as a hedge of future purchase commitments upon the closing of the sale, expected to occur in the first quarter of 2000. The costs associated with the Albany contract are recoverable under Niagara Mohawk's PowerChoice rates.

At December 31, 1999, Niagara Mohawk projects that it will make the following payments in connection with the IPP and Huntley and Dunkirk swap contracts for the years 2000 to 2004, and thereafter:

Year	<i>In thousands of dollars</i>
	Projected Payment
2000	\$ 106,866
2001	120,253
2002	124,109
2003	114,166
2004	100,907
Thereafter	367,816

The financial instruments held or issued by Holdings and Niagara Mohawk are for purposes other than trading. The estimated fair values of their financial instruments are as follows:

	<i>In thousands of dollars</i>			
	1999		1998	
At December 31,	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Niagara Mohawk				
Cash and temporary cash investments	\$ 72,479	\$ 72,479	\$ 172,998	\$ 172,998
Holdings				
Cash and temporary cash investments	\$ 116,164	\$ 116,164	\$ 172,998	\$ 172,998
Mandatorily redeemable preferred stock	68,990	66,564	76,610	86,444
Long-term debt:				
First Mortgage bonds	2,439,585	2,380,992	2,741,305	2,905,141
Senior notes	2,523,626	2,423,611	3,293,784	3,324,777
Medium-term notes	—	—	20,000	23,290
Promissory notes	413,760	413,760	413,760	413,760
Other	269,827	269,827	253,195	253,195
Swap contract regulatory asset*	663,718	663,718	693,362	693,362

* Includes a portion reported in MRA regulatory asset.

Niagara Mohawk Energy's marketing activities generally consist of transactions entered into to hedge the market fluctuations of contractual and anticipated commitments. Gas futures and electric forward contracts are used for hedging purposes. Changes in market value of futures and forward contracts relating to hedged items are

deferred until the physical transaction occurs, at which time, income or loss is recognized.

At December 31, 1999, Niagara Mohawk Energy's open positions consisted of long and short gas futures and long electric forward contracts with approximate fair values as follows:

	1999		1998	
	Fair Value (in thousands)	Units (in thousands)	Fair Value (in thousands)	Units (in thousands)
Gas - Long	\$ 9,596	3,920 Dth	\$ 4,794	2,470 Dth
Gas - Short	\$ 4,725	2,020 Dth	\$ 1,170	650 Dth
Electric - Long	\$ 125,026	4,493 MWh	\$ 13,141	428 MWh
Electric - Short	—	—	—	—

The fair value of both the open gas and electric positions for non-trading purposes at December 31, 1999 and 1998, as well as the effect of these activities on Holdings' results of operations for the same period endings were not material.

The fair value of futures and forward contracts are determined using quoted market prices.

Niagara Mohawk's investments in debt and equity securities consist of trust funds for the purpose of funding the nuclear decommissioning of Unit 1 and its share of Unit 2 (see Note 3 - Nuclear Plant Decommissioning), investments held by Opinac and a trust fund for certain pension benefits. Holdings and Niagara Mohawk have classified all investments in debt and equity securities as available for sale and have recorded all such investments at their fair market value at December 31, 1999.

The nuclear decommissioning trust funds comprise over 73% of the investments in debt and equity securities. The agreement to sell the nuclear generation assets includes the transfer of the decommissioning trust funds, at an agreed amount, to the buyer. In anticipation of that sale, and to reduce the risk of a detrimental market shift affecting the funds, Niagara Mohawk converted all decommissioning assets to high grade, short-term commercial paper in October and November of 1999.

The instruments purchased have specified coupon rates and maturity dates of generally 1 to 4 months. Remaining cash is invested in an overnight, short-term investment fund. Due to the current makeup of the funds the book and market values are approximately equal therefore the decommissioning funds no longer experience any substantial unrealized gains or losses. These Actions also increased the sales activity for 1999 affecting both the proceeds reported and the realized gains and losses.

The proceeds from the sale of investments were \$463.9 million, \$202.1 million, and \$159.7 million in 1999, 1998, and 1997, respectively. Net realized and unrealized gains and losses related to the nuclear decommissioning trust are reflected in "Accumulated depreciation and amortization" on the Consolidated Balance Sheets, which is consistent with the method used by Niagara Mohawk to account for the decommissioning costs recovered in rates. The unrealized gains and losses related to the investments held by the pension trust and Opinac for the period ending December 31, 1999 are not material to Holdings' results of operations.

The recorded fair values and cost basis of Holdings and Niagara Mohawk's investments in debt and equity securities is as follows:

<i>In thousands of dollars</i>								
At December 31,	1999				1998			
Security Type	Cost	Gross Unrealized Gain	(Loss)	Fair Value	Cost	Gross Unrealized Gain	(Loss)	Fair Value
U.S. Government Obligations	\$ —	\$ —	\$ —	\$ —	\$ 19,291	\$ 2,621	\$ (117)	\$ 21,795
Commercial Paper	346,181	1,812	—	347,993	82,930	1,269	—	84,199
Tax Exempt Obligations	8,143	33	(311)	7,865	104,538	6,786	(164)	111,160
Corporate Obligations	8,057	1,532	(1)	9,588	100,736	22,684	(2,856)	120,564
Other	18,542	—	—	18,542	6,666	—	—	6,666
	\$ 380,923	\$ 3,377	\$ (312)	\$ 383,988	\$ 314,161	\$ 33,360	\$ (3,137)	\$ 344,384

Using the specific identification method to determine cost, the gross realized gains and gross realized losses were:

<i>In thousands of dollars</i>			
Year ended December 31,	1999	1998	1997
Realized gains	\$ 26,609	\$ 5,350	\$ 3,487
Realized losses	15,140	2,221	686

The contractual maturities of Holdings and Niagara Mohawk's investments in debt securities is as follows:

At December 31, 1999	Fair Value	Cost
Less than 1 year	\$ 335,155	\$ 333,343
1 year to 5 years	1,404	1,420
5 years to 10 years	2,061	2,098
Due after 10 years	4,399	4,625

NOTE 10. Stock Based Compensation

Under Holdings' stock compensation plans, stock units and stock appreciation rights ("SARs") may be granted to officers, key employees and directors. In addition, Holdings' plans allow for the grant of stock options to officers. The table below sets forth the activity under Holdings' stock compensation plans for the years 1997 through 1999. On March 18, 1999, Niagara Mohawk's common stock was exchanged for Holdings' common stock and the SARs, the stock units and the options were likewise exchanged. (See Note 1.)

Stock units are payable in cash at the end of a defined vesting period, determined at the date of the grant, based upon Holdings' stock price for a defined period. SARs become exercisable, as determined at the grant date, and are payable in cash based upon the increase in Holdings' stock price from a specified level. As such, for these awards, compensation expense is recognized over the vesting period of the award based upon changes in Holdings' stock price for that period. Options granted over the period 1992 to 1995 are currently exercisable with expirations ten years from the grant date. These

options are all considered to be antidilutive for EPS calculations. Included in Holdings and Niagara Mohawk's results of operations for the years ending 1999, 1998 and 1997, is approximately \$(1.9) million, \$9.8 million and \$3.2 million, respectively, related to these plans.

As permitted by SFAS No. 123 - "Accounting for Stock-Based Compensation" ("SFAS No. 123") Holdings' has elected to follow Accounting Principles Board Opinion No. 25 - "Accounting for Stock Issued to Employees" ("APB No. 25") and related interpretations in accounting for its employee stock options. Since stock units and SARs are payable in cash, the accounting under APB No. 25 and SFAS No. 123 is the same. Therefore, the pro forma disclosure of information regarding net income, as required by SFAS No. 123, relates only to Holdings' outstanding stock options, the effect of which is immaterial to the financial statements for the years ended 1999, 1998 and 1997. There is no effect on earnings per share for these years resulting from the pro forma adjustments to net income.

	SARs	Units	Options
Outstanding at December 31, 1996.....	790,600	460,728	298,583
Granted.....	296,300	208,750	—
Exercised.....	—	(2,514)	—
Forfeited.....	—	—	—
Outstanding at December 31, 1997.....	1,086,900	666,964	298,583
Granted.....	1,723,500	488,428	—
Exercised.....	(42,700)	(211,403)	—
Forfeited.....	(28,000)	(10,550)	(12,000)
Outstanding at December 31, 1998.....	2,739,700	933,439	286,583
Granted.....	253,200	148,531	—
Exercised.....	(5,500)	(173,991)	—
Forfeited.....	(134,838)	(42,985)	(39,208)
Outstanding at December 31, 1999.....	2,852,562	864,994	247,375

NOTE 11. Segment Information

Holdings is organized between regulated and unregulated activities. Within the regulated business, Niagara Mohawk, which has 98% of total assets and 94% of total revenues, there are two principal business units: Energy Delivery and Nuclear. As discussed in Note 2, Niagara Mohawk is in the process of selling its remaining fossil and nuclear generation assets. Although there are two identified business units, financial performance and resource allocation are measured and managed at the regulated business level.

Holdings and Niagara Mohawk use a shareholder value based management system. The measure of shareholder value creation is Economic Value Added ("EVA®"). EVA® is the financial measure used to evaluate projects, allocate resources and report and provide performance incentives.

Holdings' unregulated activities do not meet the reporting thresholds of SFAS No. 131, but comprise a substantial portion of "other" in the accompanying table.

<i>In thousands of dollars</i>	Total Revenues	Depreciation & Amortization*	Federal & Foreign Income Taxes**	Economic Value Added	Construction Expenditures	Identifiable Assets
1999						
Regulated company	\$ 3,827,340	\$ 731,429	\$ 18,883	\$ (732,041)	\$ 298,081	\$ 12,445,608
Other	257,645	543	10	(27,374)	—	224,827
Eliminations	(799)	—	287	—	—	—
Total Consolidated	\$ 4,084,186	\$ 731,972	\$ 19,180	\$ (759,415)	\$ 298,081	\$ 12,670,435
1998						
Regulated company	\$ 3,826,373	\$ 484,250	\$ (63,131)	\$ (697,948)	\$ 392,200	\$ 13,733,055
Other	169,086	502	(3,597)	(31,471)	—	128,132
Eliminations	(3,009)	—	—	—	—	—
Total Consolidated	\$ 3,992,450	\$ 484,752	\$ (66,728)	\$ (729,419)	\$ 392,200	\$ 13,861,187
1997						
Regulated company	\$ 3,966,404	\$ 339,641	\$ 125,401	\$ (650,188)	\$ 290,757	\$ 9,431,763
Other	114,444	598	1,194	(32,009)	—	152,378
Eliminations	(2,353)	—	—	—	—	—
Total Consolidated	\$ 4,078,495	\$ 340,239	\$ 126,595	\$ (682,197)	\$ 290,757	\$ 9,584,141

* Includes amortization of the MRA regulatory asset in 1998 and 1999.

** Excludes the tax benefit of \$12.189 million associated with the extraordinary item for the loss on extinguishment of debt recorded in 1999.

EVA® is calculated as Net Operating Profit after Taxes less a charge for the use of capital employed. The capital charge is determined by applying a rate representing an estimate of investors' expected return given the risk of the business and a targeted capital structure. The rate is not the same as the embedded cost of capital, and in particular does not reflect the return on equity that may be established in a rate proceeding. Certain adjustments to accounting data are made to more closely reflect operating or economic results. In each of the three years, an adjustment was made to include the recognition of the liability for remaining future over-market contracts with IPPs and the corresponding recognition of imputed interest on that liability. In addition, there was a significant adjustment in 1998 to reflect the re-

capitalization for EVA® purposes of the PowerChoice charge and the incremental operating expenses associated with the January 1998 ice storm.

EVA® is further segmented between EVA® from Operations and EVA® related to the IPPs. This distinction is used to allow management to focus on operating performance separate from the consequences of the IPP contracts, the MRA regulatory asset and finance decisions related to managing the capitalization of Holdings.

A reconciliation of total segment Economic Value Added to total consolidated net income for the years ended December 31, 1999, 1998 and 1997 is as follows:

	1999	1998	1997
Economic Value Added:			
Operations	\$ (261,697)	\$ (248,624)	\$ (266,459)
IPP-Related	(497,718)	(480,795)	(415,738)
Total Economic Value Added	(759,415)	(729,419)	(682,197)
Charge for Use of Investor's Capital	1,163,596	1,225,437	1,237,499
Adjustments for Significant Items	(58,536)	(351,388)	(189,938)
Interest Charges (net of taxes)	(320,119)	(265,455)	(182,029)
Extraordinary Item (net of taxes)	(23,806)	—	—
Niagara Mohawk Preferred Dividends	(36,808)	(36,555)	(37,397)
Consolidated Net Income (loss)	\$ (35,088)	\$ (157,380)	\$ 145,938

EVA® is a registered trademark of Stern Stewart & Co.

NOTE 12. Quarterly Financial Data (Unaudited)

Operating revenues, operating income, net income (loss) and earnings (loss) per common share by quarters from 1999, 1998 and 1997, respectively, are shown in the following tables. Quarterly information for Holdings prior to 1999 is Niagara Mohawk's, but has been reclassified to reflect Holdings' structure. Holdings and Niagara Mohawk, in their opinion, have included all adjustments necessary for a fair presentation of the

results of operations for the quarters. Due to the seasonal nature of the regulated utility business, the annual amounts are not generated evenly by quarter during the year. Niagara Mohawk's quarterly results of operations reflect the seasonal nature of its business, with peak electric loads in summer and winter periods. Gas sales peak in the winter.

Niagara Mohawk Holdings, Inc.

Quarter Ended	In thousands of dollars			
	Operating revenues	Operating income (loss)	Net income (loss)	Basic and Diluted Earnings (loss) per common share
December 31, 1999	\$ 1,016,504	\$ 94,830	\$ (18,166)	(\$0.10)
1998	904,066	99,666	(26,457)	(0.14)
1997	1,011,589	81,137	(1,355)	(0.01)
September 30, 1999	\$ 1,034,227	\$ 98,321	\$ (31,707)	(\$0.17)
1998	979,774	111,231	8,516	0.05
1997	942,636	108,049	22,330	0.15
June 30, 1999	\$ 914,321	\$ 81,153	\$ (36,047)	(\$0.19)
1998	944,684	(193,538)	(150,579)	(1.04)
1997	957,091	129,000	31,340	0.22
March 31, 1999	\$ 1,119,134	\$ 251,848	\$ 50,832	\$0.27
1998	1,163,897	131,569	11,140	0.08
1997	1,167,179	228,493	93,623	0.65

Niagara Mohawk Power Corporation

Quarter Ended	In thousands of dollars		
	Operating revenues	Operating income (loss)	Net income (loss)
December 31, 1999	\$ 933,562	\$ 95,797	\$ (10,811)
1998	886,432	103,263	(17,433)
1997	960,304	86,024	7,881
September 30, 1999	\$ 927,296	\$ 99,006	\$ (23,443)
1998	930,631	110,287	17,653
1997	896,570	110,174	31,683
June 30, 1999	\$ 870,461	\$ 82,464	\$ (27,663)
1998	910,906	(180,824)	(141,408)
1997	945,698	130,704	40,749
March 31, 1999	\$ 1,096,021	\$ 254,284	\$ 59,856
1998	1,098,404	134,297	20,363
1997	1,163,832	231,937	103,022

During the second and third quarters of 1999, Holdings and Niagara Mohawk recorded an extraordinary item for the early extinguishment of debt of \$10.8 million or 6 cents per share and \$13.0 million or 7 cents per share, respectively. In the first quarter of 1998, Holdings and Niagara Mohawk expensed \$70.2 million associated with the January 1998 ice storm (of

which \$62.9 million was considered incremental) or 28 cents per common share. In the second quarter of 1998, Holdings and Niagara Mohawk recorded a non-cash write-off of \$263.2 million (\$1.18 per common share) associated with the portion of the MRA disallowed in rates by the PSC.

Boards of Directors

Niagara Mohawk Holdings, Inc.

Salvatore H. Alfiero (B, D, E)
Chairman and Chief Executive Officer
Mark IV Industries, Inc.
Amherst, NY

William F. Allyn (A, C, F)
President and Chief Executive Officer
Welch Allyn Ventures LLC
Skaneateles Falls, NY

Albert J. Budney, Jr.
President

Lawrence Burkhardt, III (F)
Former Executive Vice President
Nuclear Operations
San Diego, CA

Douglas M. Costle (A, B, D, F)
Distinguished Senior Fellow and
Chairman of the Board, Institute for
Sustainable Communities
Montpelier, VT

John H. Dalton (B, F)
Chairman and Chief Executive Officer
Metal Technology, Inc.
Washington, DC

William E. Davis (D)
Chairman of the Board and
Chief Executive Officer

William J. Donlon
Former Chairman of the Board and
Chief Executive Officer
Syracuse, NY

Anthony H. Gioia (C, F)
Chairman and Chief Executive Officer
Gioia Management, Inc.
Buffalo, NY

Dr. Bonnie G. Hill (A, B, E)
President and Chief Executive Officer
The Times Mirror Foundation
Los Angeles, CA

Clark A. Johnson (C, D, E)
Former Chairman
Pier 1 Imports, Inc.
North Palm Beach, FL

Henry A. Panasci, Jr. (B, C, E)
Chairman
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Syracuse, NY

Dr. Patti McGill Peterson (A, B, D)
Executive Director
Council for International
Exchange of Scholars
Washington, DC

Donald B. Riefler (A, D, E, F)
Financial Market Consultant
Vero Beach, FL

Stephen B. Schwartz (C, D, E)
Former IBM Senior Vice President
Palm Beach Gardens, FL

*(Directors **Douglas M. Costle** and **Donald B. Riefler** will retire effective the date of the 2000 Annual Meeting of Shareholders.)*

- A. Audit Committee
- B. Committee on Corporate Public Policy and Environmental Affairs
- C. Compensation and Succession Committee
- D. Executive Committee
- E. Finance Committee
- F. Nuclear Oversight Committee

Niagara Mohawk Power Corporation

William E. Davis
Chairman of the Board and
Chief Executive Officer

Darlene D. Kerr
Executive Vice President and
Chief Operating Officer

John H. Mueller
Senior Vice President and
Chief Nuclear Officer

Officers

Niagara Mohawk Holdings, Inc.

William E. Davis
Chairman of the Board and
Chief Executive Officer

Albert J. Budney, Jr.
President

David J. Arrington
Senior Vice President and
Chief Administrative Officer

William F. Edwards
Senior Vice President and
Chief Financial Officer

Gary J. Lavine
Senior Vice President and
Chief Legal Officer

Theresa A. Flaim
Vice President
Strategic Planning

Michael J. Kelleher
Vice President
Financial Planning
(Effective December 9, 1999)

Kapua A. Rice
Corporate Secretary

Arthur W. Roos
Vice President-Treasurer

Steven W. Tasker
Vice President-Controller

David J. Walsh
Vice President
Ethics

Niagara Mohawk Power Corporation

William E. Davis
Chairman of the Board and
Chief Executive Officer

Darlene D. Kerr
Executive Vice President and
Chief Operating Officer

David J. Arrington
Senior Vice President
Human Resources and
Chief Administrative Officer

Thomas H. Baron
Senior Vice President
Field Operations

Edward J. Dienst
Senior Vice President
Asset Management and
Energy Delivery

William F. Edwards
Senior Vice President and
Chief Financial Officer

John H. Mueller
Senior Vice President and
Chief Nuclear Officer

Richard B. Abbott
Vice President
Nuclear Engineering

Joseph T. Ash
Vice President
Gas Delivery

Richard R. Borsellino
Vice President
Operations, Construction
and Maintenance

John T. Conway
Vice President
Nuclear Generation

Theresa A. Flaim
Vice President
Strategic Planning

Peter H. Lebro
Vice President
Logistics and Field Services

Leslie E. LoBaugh, Jr.
Vice President and General Counsel
(Effective February 8, 1999)

Samuel F. Manno
Vice President
Special Projects (Year 2000)

Clement E. Nadeau
Vice President
Electric Delivery

Kapua A. Rice
Corporate Secretary

Arthur W. Roos
Vice President-Treasurer

Richard H. Ryczek
Vice President
Environmental Affairs and
Property Management

William J. Synwoldt
Vice President
Information Technology and
Chief Information Officer

Steven W. Tasker
Vice President-Controller

Carl D. Terry
Vice President
Quality Assurance, Nuclear

David J. Walsh
Vice President
Employee Relations

Stanley W. Wilczek, Jr.
Vice President
Customer Service

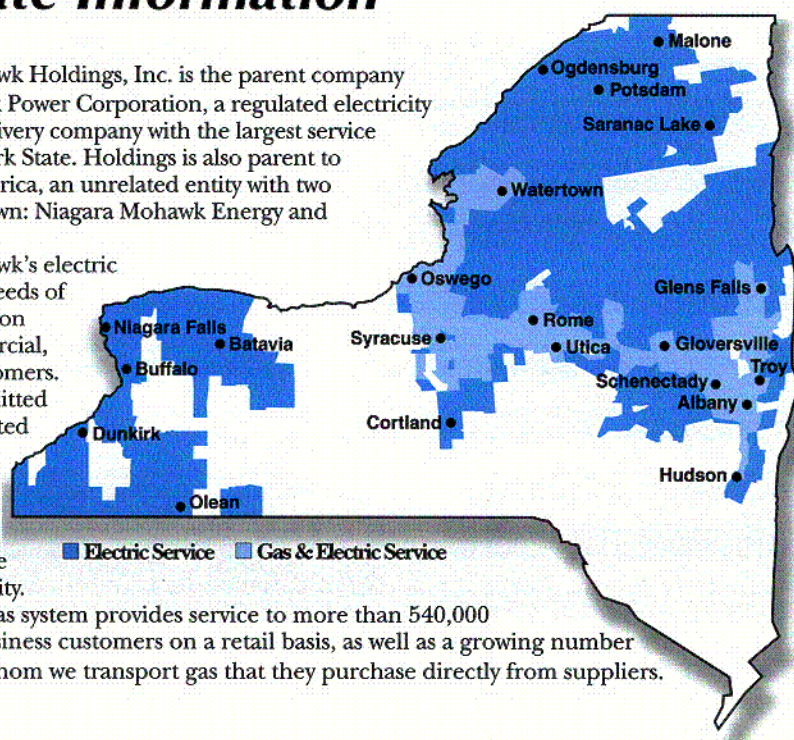
*(Douglas R. McCuen retired as an officer,
effective March 31, 1999; Michael J.
Kelleher, Kim A. Dahlberg and Nicholas J.
Ashooh resigned as officers, effective December
15, 1999, December 31, 1999 and January
14, 2000, respectively.)*

Corporate Information

Niagara Mohawk Holdings, Inc. is the parent company of Niagara Mohawk Power Corporation, a regulated electricity and natural gas delivery company with the largest service territory in New York State. Holdings is also parent to Opinac North America, an unrelated entity with two subsidiaries of its own: Niagara Mohawk Energy and Opinac Energy.

Niagara Mohawk's electric system meets the needs of more than 1.5 million residential, commercial, and industrial customers. Electricity is transmitted through an integrated operating network that is linked to other systems in the Northeast for economic exchange and mutual reliability.

Our natural gas system provides service to more than 540,000 residential and business customers on a retail basis, as well as a growing number of customers for whom we transport gas that they purchase directly from suppliers.



50
Years
of
Service

Annual Meeting

The Annual Meeting of Shareholders will be held at the OnCenter, 800 S. State Street, Syracuse, NY at 10:30 a.m., Tuesday, May 16, 2000. A notice of the meeting, proxy statement and form of proxy will be sent on or about March 31, 2000 to holders of common stock.

SEC Form 10-K Report

A copy of the company's Form 10-K report, filed annually with the Securities and Exchange Commission, is available without charge by writing the Investor Relations Department at 300 Erie Boulevard West, Syracuse, NY 13202.

Shareholder Inquiries

Questions regarding shareholder accounts may be directed to the company's Shareholder Services Department: 315-428-6750 (Syracuse) 800-448-5450 (elsewhere in the continental U.S.)

Analyst Inquiries

Analyst inquiries should be directed to:
Leon T. Mazur, Director-Investor Relations,
Phone: 315-428-5876 e-mail: mazurl@NiagaraMohawk.com

Ticker Symbol: NMK

Stock Exchange Listings

Common stock and most preferred series are listed and traded on the New York Stock Exchange. Bonds are traded on the New York Stock Exchange.

Disbursing Agents

Common and preferred stocks:
Niagara Mohawk Power Corp.
300 Erie Boulevard West
Syracuse, NY 13202

Bonds:
HSBC Bank USA
140 Broadway
New York, NY 10015

Transfer Agents and Registrars

Common and preferred stocks:
The Bank of New York
P.O. Box 11002
Church Street Station
New York, NY 10286
800-524-4458

Bonds:
HSBC Bank USA
140 Broadway
New York, NY 10015

The 1999 Annual Report is submitted for shareholders' information. It is not intended for use in connection with any sale or offer to sell or buy any securities.

This report was produced by Niagara Mohawk employees.



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Electric Statistics

	1999	1998	1997
Regulated Electric sales (Millions of KWh):			
Residential	10,227	9,643	9,905
Commercial	11,838	11,560	11,552
Industrial	6,985	6,843	7,191
Industrial – Special	4,506	4,568	4,507
Other	200	241	235
Other electric systems	1,666	3,577	3,746
Total regulated electric sales	35,422	36,432	37,136
Unregulated electric sales:	6,355	4,571	3,257
Total electric sales:	41,777	41,003	40,393
Regulated Electric revenues (Thousands of dollars):			
Residential	\$ 1,250,295	\$ 1,201,697	\$ 1,227,245
Commercial	1,192,390	1,220,067	1,233,417
Industrial	485,009	480,942	531,164
Industrial – Special	65,178	63,870	61,820
Other	50,294	55,119	54,545
Other electric systems	47,851	94,756	83,794
Distribution of Energy	56,068	30,761	543
Transmission of Energy	100,455	94,545	100,716
Miscellaneous	217	19,387	16,197
Total regulated electric revenue	3,247,757	3,261,144	3,309,441
Unregulated electric revenue:	217,144	129,357	86,170
Total electric revenue:	\$ 3,464,901	\$ 3,390,501	\$ 3,395,611
Regulated Electric customers (Average):	1,550,225	1,550,770	1,553,958

Gas Statistics

	1999	1998	1997
Regulated Gas sales (Thousands of Dth):			
Residential	51,624	47,250	55,203
Commercial	16,505	17,023	22,069
Industrial	453	752	1,381
Total regulated sales	68,582	65,025	78,653
Other gas systems	10	17	28
Spot market	1,834	4,501	2,451
Transportation of customer - owned gas	137,240	127,850	152,813
Total regulated gas delivered	207,666	197,393	233,945
Unregulated gas sales:	11,020	13,863	6,762
Total gas sales:	218,686	211,256	240,707
Regulated Gas revenues (Thousands of dollars):			
Residential	\$ 390,208	\$ 378,150	\$ 436,136
Commercial	107,669	110,499	148,213
Industrial	2,340	3,618	6,549
Other gas systems	57	69	130
Spot market	4,277	8,749	6,346
Transportation of customer - owned gas	58,032	54,091	55,657
Miscellaneous	17,000	10,053	3,932
Total regulated gas revenues	579,583	565,229	656,963
Unregulated gas revenues:	31,643	36,047	24,267
Total gas revenues:	\$ 611,226	\$ 601,276	\$ 681,230
Regulated Gas customers (Average):	541,956	530,633	528,566



Niagara Mohawk Holdings, Inc.
Niagara Mohawk Power Corporation
300 Erie Boulevard West
Syracuse, New York 13202

www.NiagaraMohawk.com