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SUBJECT: Forwards "1987 Annual Rept" & 1988 projected cash flow for plant.

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1987 Annual Report

AEP
INDIANA MICHIGAN POWER

Indiana Michigan Power Company

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Contents

Background of the Company

INDIANA MICHIGAN POWER COMPANY (the Company), a subsidiary of American Electric Power Company, Inc. (AEP), is engaged in the generation, purchase, transmission and distribution of electric power. The Company was organized under the laws of Indiana on February 21, 1925, and is also authorized to transact business in Michigan and West Virginia. Its principal executive offices are in Fort Wayne, Indiana.

The Company has two wholly owned subsidiaries; they are Blackhawk Coal Company and Price River Coal Company, which were formerly engaged in coal-mining operations.

The Company serves approximately 464,000 customers in northern and eastern Indiana and a portion of southwestern Michigan. Among the principal industries served are transportation equipment, primary metals, fabricated metal products, electrical and electronic machinery, and rubber and plastic products. In addition, the Company supplies wholesale electric power to other electric utilities, municipalities and electric cooperatives.

The Company's generating plants and important load centers are interconnected by a high-voltage transmission network. This network in turn is interconnected either directly or indirectly with the following other AEP System companies to form a single integrated power system: AEP Generating Company, Appalachian Power Company, Columbus Southern Power Company, Kentucky Power Company, Kingsport Power Company, Michigan Power Company, Ohio Power Company and Wheeling Power Company. The Company is also interconnected with the following other utilities: Central Illinois Public Service Company, The Cincinnati Gas & Electric Company, Commonwealth Edison Company, Consumers Power Company, Illinois Power Company, Indiana-Kentucky Electric Corporation (a subsidiary of Ohio Valley Electric Corporation), Indianapolis Power & Light Company, Northern Indiana Public Service Company and Public Service Company of Indiana, Inc.

Directors

J. M. Allison
W. A. Black
Richard E. Disbrow
John E. Dolan (a)
William N. D'Onofrio
A. R. Glassburn (b)
M. R. Harrell (c)
Gerald P. Maloney
Richard C. Menge
C. W. Roahrig (d)
J. F. Stark (e)
Joseph H. Vipperman
W. S. White, Jr.
David H. Williams, Jr. (f)

Officers

W. S. White, Jr.
Chairman of the Board and Chief Executive Officer

W. A. Black
President and Chief Operating Officer

J. F. Stark (e)
Senior Vice President

Milton P. Alexich
Vice President

Richard E. Disbrow
Vice President

John E. Dolan (a)
Vice President

William N. D'Onofrio
Vice President

A. Joseph Dowd
Vice President

Richard F. Hering
Vice President

Gerald P. Maloney
Vice President

Richard C. Menge
Vice President

Joseph H. Vipperman
Vice President

David H. Williams, Jr. (f)
Vice President

Peter J. DeMaria
Treasurer

John R. Burton (g)
Secretary

John F. DiLorenzo, Jr. (h)
Secretary

Elio Bafile
Assistant Secretary and Assistant Treasurer

Jeffrey D. Cross (i)
Assistant Secretary

William C. Harvey (j)
Assistant Secretary

Carl J. Moos
Assistant Secretary

John B. Shinnock
Assistant Secretary

Joan St. James
Assistant Secretary

Leonard V. Assante
Assistant Treasurer

Bruce M. Barber
Assistant Treasurer

James D. Huebner
Assistant Treasurer

Gerald R. Knorr
Assistant Treasurer

The principal occupation of each of the above directors and officers of Indiana Michigan Power Company, with ten exceptions, is as an employee of American Electric Power Service Corporation. The exceptions are Messrs. Allison, Bafile, Black, D'Onofrio, Glassburn, Harrell, Menge, Moos, Roahrig and Stark whose principal occupations during 1987 were as officers or employees of Indiana Michigan Power Company.

(a) Resigned February 1, 1988
(b) Elected September 24, 1987
(c) Elected January 29, 1987
(d) Resigned September 24, 1987
(e) Resigned January 29, 1987
(f) Elected February 1, 1988
(g) Resigned May 1, 1987
(h) Elected May 1, 1987
(i) Elected October 1, 1987
(j) Resigned October 1, 1987

Selected Financial Data

	Year Ended December 31,				
	1987	1986	1985	1984	1983
			(in thousands)		
INCOME STATEMENTS DATA:					
Operating Revenues — Electric	$1,017,268	$1,091,295	$1,078,793	$979,551	$896,104
Total Operating Expenses	794,222	900,151	886,904	799,393	713,361
Operating Income	223,046	191,144	191,889	180,158	182,743
Total Other Income and Deductions	56,828	66,905	76,879	53,044	53,629
Income Before Interest Charges	279,874	258,049	268,768	233,202	236,372
Net Interest Charges	113,508	105,568	122,667	91,017	96,496
Consolidated Net Income — before preferred stock dividend requirements	166,366	152,481	146,101	142,185	139,876
Preferred Stock Dividend Requirements	20,955	26,256	27,056	27,705	28,384
Earnings Applicable to Common Stock	$ 145,411	$ 126,225	$ 119,045	$114,480	$111,492

	December 31,				
	1987	1986	1985	1984	1983
			(in thousands)		
BALANCE SHEETS DATA:					
Electric Utility Plant	$4,017,718	$3,832,796	$3,940,903	$3,790,123	$3,733,553
Accumulated Provisions for Depreciation and Amortization	1,118,254	1,018,455	962,670	868,192	782,614
Nuclear Fuel Under Capital Leases (net of amortization)	135,563	147,026	166,623	150,883	149,197
Net Electric Utility Plant	3,035,027	2,961,367	3,144,856	3,072,814	3,100,136
Total Assets	3,956,563	3,849,208	3,763,595	3,658,647	3,538,165
Common Stock, Premiums on Capital Stock and Other Paid-in Capital	828,347	828,347	828,347	828,344	807,925
Retained Earnings	145,302	113,123	100,130	94,317	95,616
Total Common Shareowner's Equity	973,649	941,470	928,477	922,661	903,541
Cumulative Preferred Stock:					
Not Subject to Mandatory Redemption	197,000	197,000	197,000	197,000	197,000
Subject to Mandatory Redemption (a)	32,030	79,030	86,030	93,197	99,497
Long-term Debt (a)	1,591,768	1,421,523	1,442,070	1,347,623	1,445,704

(a) Including portion due within one year.

NOTE: Certain prior-period amounts have been reclassified or restated as discussed in Note 1 of the Notes to Consolidated Financial Statements.

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

The following are the more significant factors bearing on the financial condition of Indiana Michigan Power Company and its subsidiaries as reflected in the consolidated results of operations. This discussion refers to the consolidated financial statements that follow.

Results of Operations

Net Income

Consolidated net income before preferred stock dividend requirements increased by 9.1% in 1987 and 4.4% in 1986. The 1987 increase resulted primarily from a 16.7% increase in operating income which was partially offset by a 15.1% decrease in other income and deductions and a 3.5% increase in total interest charges. The 1986 increase resulted mostly from lower fixed charges for interest and increased miscellaneous nonoperating income less deductions due predominantly to a decrease in certain costs associated with a subsidiary's Utah mining properties.

Outlook

The Company has lost one major wholesale customer and received notice from another to terminate service. In the first instance the Company had a long-term contract that expired on December 31, 1987 to provide 400,000 kilowatts of energy (200,000 kilowatts after February 1, 1987) to an unaffiliated utility. This contract contributed approximately 7%, 12% and 12% of the Company's total operating revenues and 19%, 37% and 37% of the Company's earnings applicable to common stock before adjustment for AEP System intercompany transactions in 1987, 1986 and 1985, respectively.

In the second situation a wholesale customer has notified the Company that it plans to terminate purchasing energy from the Company and requested transmission wheeling arrangements with the Company effective August 1, 1988. Service by the Company to this customer was at an average level of 170,000 kilowatts in 1987 and contributed approximately 4%, 3% and 3% of the Company's total operating revenues and 12%, 11% and 11% of the Company's earnings applicable to common stock before adjustment for AEP System intercompany transactions in 1987, 1986 and 1985, respectively. The Company is developing proposals to provide transmission wheeling service with and without partial load requirements service to this wholesale customer. The Company cannot predict the amount of revenues which may be realized from any such arrangements.

If these contracts did not exist the Company would have been required to make payments in a lesser amount, or alternatively been entitled to more receipts, due to operation of the AEP System Pool. After pro forma adjustment for AEP System intercompany transactions, the aggregate contribution of these contracts was approximately 20%, 21% and 19% of the Company's earnings applicable to common stock in 1987, 1986 and 1985, respectively.

As discussed in Note 2 of the Notes to Consolidated Financial Statements the Company has a regulatory proceeding with the Federal Energy Regulatory Commission (FERC) regarding, among other things, modification to conform a rate phase-in plan for Rockport Plant Unit No. 1 (Rockport 1) to Statement of Financial Accounting Standards No. 92 (SFAS 92). Unless the FERC issues a final order approving a phase-in plan to comply with SFAS 92, the Company would be required to write-off retroactively all non-complying deferred costs, totaling approximately $43,900,000 net of income taxes at December 31, 1987.

The Company also has under construction a second unit at the Rockport Plant that is expected to be completed in 1989. The inclusion of Rockport 2 in rate base and the timing of such are dependent on the outcome of future regulatory proceedings.

Over the past several years, in response to economic conditions, the Company has developed and implemented marketing strategies for each of its main market segments, retail and wholesale. The "constructive marketing" program aimed at retail customers is designed both to increase sales and to encourage the efficient use of electricity. This program's primary focus is on the installation and use of high-efficiency electrical equipment. Another part of the program promotes economic development to maintain and encourage the economic prosperity of the service area. The marketing effort directed toward sales to other utilities — i.e., sales through the AEP System Pool — involves flexible pricing based on continual analysis of the competition with an emphasis on seeking the market share that promises the greatest profit margin.

Operating Revenues and Energy Sales

Consolidated operating revenues decreased 6.8% in 1987 from the previous year compared to a slight increase in 1986. The decrease in 1987 resulted primarily from an overall 14.1% decrease in sales of electric energy. The increase in 1986 revenues was mostly due to additional rate relief and a small increase in kilowatt-hour (kwh) sales partially offset by reduced fuel clause revenues.

Revenues from retail customers (residential, commercial and industrial) rose 5.1% in 1987 following a 1.2% increase in 1986. The increase in 1987 reflects a 6.9% increase in kwh sales including increases in residential, commercial and, for the fifth consecutive year, industrial customers, indicating continued economic growth in the Company's service territory. The increase in 1986 revenues was mainly because of additional rate relief coupled with a slight increase in energy sales partially offset by lower fuel clause revenues.

Revenues from wholesale customers dropped 26.8% during 1987 with a corresponding 35.2% decrease in kwh sales, whereas revenues remained virtually unchanged in 1986 despite a 5.2% rise in kwh sales. Although 1986 kwh sales exceeded 1985 sales, year-to-year revenues remained flat because of lower average realization per kwh sold due to competition and price cutting in the wholesale market. In 1987, however the kwh decrease was offset partially by an increase in the average wholesale realization as the Company pursued sales with higher profit margins. The 1987 decline in energy sales was caused mainly by the reduction of a long-term contract with an unaffiliated utility (discussed above) and by an increase in available energy supply from unaffiliated generating capacity that had been out of service for an extended time and the addition of new generating units by unaffiliated utilities.

Operating Expenses

Purchased and interchange power expense decreased by 43.2% in 1987 following a 20.6% decrease in 1986. The 1987 decrease was caused primarily by the assignment of certain rights to purchase power from AEP Generating Company, an affiliated company, to an unaffiliated company. This decrease was partially offset by increased interchange power transactions, primarily with affiliated companies, in order to replace internal generation lost because of outages. The decrease in 1986 was mostly caused by the return to service of the Cook Nuclear Plant Unit No. 1 (Cook 1) which had been unavailable during 1985 due to the 10-year anniversary service outage required by the Nuclear Regulatory Commission. When Cook 1 was returned to service, the purchased and interchange power transactions were no longer needed to meet the Company's load requirements.

Fuel expense, the single largest expense of the Company, decreased 10.4% in 1987 after an 8.7 % increase in 1986. The decrease in 1987 was due mainly to reduced levels of generation. In 1986 the consumption of fuel had increased as a result of a higher generation level mostly the result of Cook 1 being returned to service as explained above. Changes in fuel costs generally are recovered in revenues through fuel-clause adjustment mechanisms and therefore do not have a significant effect on net income.

Maintenance expense increased 14.5% in 1987 following a slight decrease in 1986. Factors contributing to the 1987 increase were additional maintenance activities for nuclear plant and other maintenance activities.

Depreciation expense increased 10.8% in 1987 and 9.2% in 1986. Both changes resulted largely from decreases in the net deferral of depreciation expense associated with the Rockport 1 phase-in plan.

Federal income tax expense decreased 21.4% in 1987 after a 31.4% increase in 1986. The decrease in 1987 was primarily due to the decrease in the statutory Federal income tax rate as a result of the Tax Reform Act of 1986. The 1986 increase was mostly due to an increase in pretax book operating income and changes in certain book/tax timing differences, the tax effects of which are accounted for on a flow-through basis.

Total interest charges increased in 1987 by 3.5% following an 8.9% decrease in 1986. The increase in 1987 was primarily the result of the issuance of additional long-term debt during 1987 while the decrease in 1986 resulted from the Company's refinancing of high-interest bonds with bonds having lower interest rates.

Allowance For Funds Used During Construction and Deferred Return

The proportion of allowance for funds used during construction (AFUDC) included in net income before preferred stock dividend requirements was 29.7% (24.6% net of income taxes) in 1987 compared to 34.1% (27.2% net of income taxes) in 1986.

The Company continued to record a deferred return on its investment in Rockport 1 under an approved phase-in plan during most of 1987. The deferred return as a proportion of net income was 18.9% (15.1% net of income taxes) in 1987 and 28.5% (21.8% net of income taxes) in 1986. This decrease resulted largely from the cessation in the latter part of the year by the Company of deferrals in its Indiana jurisdiction as a result of a rate order that included the last component of plant investment in rate base.

Liquidity and Capital Resources

Construction Program

The Company's gross plant and property additions for 1987 amounted to $248 million, an 18.7% increase over 1986. Construction expenditures for the three-year period 1988-1990 are estimated at $638 million. This includes the completion of construction of the second 1.3 million-kilowatt generating unit at the Rockport Plant. In addition, the Company would be required to make substantial additional capital expenditures if acid rain legislation similar to that currently proposed is enacted into law.

Debt and Preferred Stock Financing

It is estimated that approximately 60% of the Company's projected construction expenditures for 1988-1990 will be financed with internally generated funds. The additional amounts needed in excess of other available funds will have to be raised externally, as in the past, through sales of securities, short-term borrowings and investments in the Company's common equity by AEP.

The Company generally issues short-term debt (commercial paper and bank loans) to provide interim financing of construction expenditures in excess of available internally generated and other funds. The Company then periodically reduces short-term debt with the proceeds from sales of long-term debt securities and preferred stock and with investments in its common equity by AEP. At December 31, 1987, the Company had outstanding unused short-term lines of credit of approximately $285 million which were shared with other System companies.

Cook Nuclear Plant

The Cook Nuclear units are exhibiting indications of intergranular corrosion (IGC) in the steam generator tubing, a condition which has developed in other pressurized water reactors. This has led to a decision to operate Unit No. 2 at 80% power and Unit No. 1 at 90% power as a steam-generator life conservation measure. It is presently planned to replace the Unit No. 2 steam generators in 1988, at an estimated cost of $160 million, to correct this condition. The IGC problem in the Unit No. 1 steam generators is occurring at a slower rate than in Unit No. 2, but it is possible that the Unit No. 1 steam generators may have to be replaced eventually. However, there are no present plans for such replacement. The Unit No. 2 replacement program will require an extended outage, estimated at 9 to 12 months. This is not expected to have a material adverse effect on the Company's operations or financial results.

Effect of Inflation

Inflation continues to affect the Company, even though the inflation rate has been relatively low in recent years. Since the rate-making process limits the Company to recovery of the historical cost of assets, economic losses are experienced when the inflated value of the assets is not recovered. However, such losses are offset partly by the economic gains that result from the repayment of long-term debt with inflated dollars.

Recently Issued Accounting Standards

Over the past year and a half, the Financial Accounting Standards Board has issued several new accounting standards that the Company will be required to adopt in the future. The potential impact, if any, of the new standards is discussed in the Notes to Consolidated Financial Statements.

Consolidated Statements of Income

	Year Ended December 31,		
	1987	1986	1985
		(in thousands)	
OPERATING REVENUES — ELECTRIC	$1,017,268	$1,091,295	$1,078,793
OPERATING EXPENSES:			
Operation:			
Fuel for Electric Generation	208,931	233,241	214,545
Purchased and Interchange Power (net)	102,644	180,620	227,391
Other	156,310	157,500	151,658
Maintenance	91,807	80,171	81,089
Depreciation and Amortization	112,427	101,456	92,895
Taxes Other Than Federal Income Taxes	46,730	51,291	46,339
Federal Income Taxes	75,373	95,872	72,987
Total Operating Expenses	794,222	900,151	886,904
OPERATING INCOME	223,046	191,144	191,889
OTHER INCOME AND DEDUCTIONS:			
Allowance for Other Funds Used During Construction	26,055	25,397	26,214
Deferred Return — Rockport Plant	31,442	43,438	60,378
Miscellaneous	(669)	(1,930)	(9,713)
Total Other Income and Deductions	56,828	66,905	76,879
INCOME BEFORE INTEREST CHARGES	279,874	258,049	268,768
INTEREST CHARGES:			
Long-term Debt	131,093	124,333	134,117
Short-term Debt	2,226	6,118	9,119
Miscellaneous	3,486	1,725	1,909
Total Interest Charges	136,805	132,176	145,145
Allowance for Borrowed Funds Used During Construction (credit)	(23,297)	(26,608)	(22,478)
Net Interest Charges	113,508	105,568	122,667
CONSOLIDATED NET INCOME — before preferred stock dividend requirements	166,366	152,481	146,101
PREFERRED STOCK DIVIDEND REQUIREMENTS	20,955	26,256	27,056
EARNINGS APPLICABLE TO COMMON STOCK	$ 145,411	$ 126,225	$ 119,045

See Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

	December 31, 1987	December 31, 1986
	(in thousands)	
ASSETS		
ELECTRIC UTILITY PLANT:		
Production	$2,269,325	$2,242,972
Transmission	725,047	713,398
Distribution	397,214	380,934
General and Miscellaneous	72,159	73,395
Construction Work in Progress	553,973	422,097
	4,017,718	3,832,796
Less Accumulated Provisions for Depreciation and Amortization	1,118,254	1,018,455
	2,899,464	2,814,341
Nuclear Fuel Under Capital Leases (net of amortization)	135,563	147,026
Electric Utility Plant Less Provisions	3,035,027	2,961,367
OTHER PROPERTY AND INVESTMENTS	283,313	262,800
CURRENT ASSETS:		
Cash	6,995	3,062
Special Deposits and Working Funds	24,394	41,891
Accounts Receivable:		
Customers	71,730	89,129
Associated Companies	7,058	5,360
Miscellaneous	15,475	10,701
Accumulated Provision for Uncollectible Accounts	(634)	(609)
Materials and Supplies (at average cost or less):		
Fuel	70,728	58,463
Construction and Operation Materials and Supplies	22,975	20,947
Accrued Utility Revenues	51,576	49,000
Prepayments and Other Current Assets	7,942	9,727
Total Current Assets	278,239	287,671
DEFERRED DEBITS:		
Deferred Nuclear Fuel Disposal Costs	56,434	64,546
Deferred Depreciation and Return — Rockport Plant	170,413	134,483
Other Deferred Debits	133,137	138,341
Total Deferred Debits	359,984	337,370
Total	$3,956,563	$3,849,208

See Notes to Consolidated Financial Statements.

CAPITALIZATION AND LIABILITIES

	December 31, 1987	December 31, 1986
	(in thousands)	
CAPITALIZATION:		
Common Stock — No Par Value:		
Authorized — 2,500,000 Shares		
Outstanding — 1,400,000 Shares	$ 56,584	$ 56,584
Premiums on Capital Stock	381	381
Other Paid-in Capital	771,382	771,382
Retained Earnings	145,302	113,123
Total Common Shareowner's Equity	973,649	941,470
Cumulative Preferred Stock:		
Not Subject to Mandatory Redemption	197,000	197,000
Subject to Mandatory Redemption	32,030	75,030
Long-term Debt	1,539,737	1,410,023
Total Capitalization	2,742,416	2,623,523
OTHER NONCURRENT LIABILITIES	193,692	179,057
CURRENT LIABILITIES:		
Cumulative Preferred Stock Due Within One Year	—	4,000
Long-term Debt Due Within One Year	52,031	11,500
Short-term Debt:		
Notes Payable	—	11,325
Commercial Paper	—	38,600
Accounts Payable:		
General	41,451	34,420
Associated Companies	17,576	25,009
Taxes Accrued	46,198	53,472
Interest Accrued	37,112	32,143
Obligations Under Capital Leases	43,856	61,630
Other Current Liabilities	48,928	56,771
Total Current Liabilities	287,152	328,870
COMMITMENTS AND CONTINGENCIES (Note 9)		
DEFERRED CREDITS:		
Deferred Income Taxes	542,298	525,044
Deferred Investment Tax Credits	171,559	180,306
Other Deferred Credits	19,446	12,408
Total Deferred Credits	733,303	717,758
Total	$3,956,563	$3,849,208

Consolidated Statements of Sources and Applications of Funds

	Year Ended December 31,		
	1987	1986	1985
		(in thousands)	
Sources of Funds:			
Funds from Operations:			
Consolidated Net Income	$166,366	$152,481	$ 146,101
Principal Non-fund Charges (Credits) to Income:			
Depreciation and Amortization	120,310	107,915	93,460
Provision for Deferred Income Taxes (net)	13,597	24,219	82,163
Deferred Investment Tax Credits (net)	(7,700)	25,328	46,571
Amortization of Deferred Nuclear Fuel Disposal Costs	12,207	13,247	9,206
Allowance for Other Funds Used During Construction	(26,055)	(25,397)	(26,214)
Deferred Return — Rockport Plant	(31,442)	(43,438)	(60,378)
Other (net)	2,900	4,585	3,789
Total Funds from Operations	250,183	258,940	294,698
Funds from Financings:			
Financings:			
Long-term Debt	376,811	197,681	144,660
Short-term Debt (net)	(49,925)	49,925	(110,000)
Total	326,886	247,606	34,660
Less Retirements of:			
Cumulative Preferred Stock	50,917	7,000	7,165
Long-term Debt	222,005	228,432	73,182
Net Funds from Financings	53,964	12,174	(45,687)
Funds from Nuclear Fuel Capital Lease Obligations	35,144	29,929	49,372
Other Changes (net)	44,745	6,147	(12,966)
Total Sources of Funds	$384,036	$307,190	$ 285,417
Applications of Funds:			
Plant and Property Additions:			
Gross Additions to Utility Plant	$247,987	$204,942	$ 222,625
Gross Other Additions	—	3,933	105
Total Gross Additions	247,987	208,875	222,730
Allowance for Other Funds Used During Construction	(26,055)	(25,397)	(26,214)
Net Plant and Property Additions	221,932	183,478	196,516
Dividends on Common Stock	113,232	113,232	113,232
Dividends on Cumulative Preferred Stock	20,955	26,256	27,056
Deferred Depreciation — Rockport Plant	9,025	12,765	16,652
Increase (Decrease) in Working Capital (a)	18,892	(28,541)	(68,039)
Total Applications of Funds	$384,036	$307,190	$ 285,417
(a) Excludes Cumulative Preferred Stock Due Within One Year, Long-term Debt Due Within One Year and Short-term Debt and is represented by increase (decrease) as follows:			
Cash and Cash Items	$(13,564)	$ (16,803)	$ (81,479)
Accounts Receivable	(10,952)	3,636	(5,497)
Materials and Supplies	14,293	9,361	(22,402)
Accrued Utility Revenues	2,576	(22,615)	26,236
Accounts Payable	402	10,571	1,687
Taxes Accrued	7,274	(20,554)	(6,096)
Revenue Refunds Accrued	—	18,625	1,052
Obligations Under Capital Leases	17,774	(605)	5,126
Other (net)	1,089	(10,157)	13,334
	$ 18,892	$ (28,541)	$ (68,039)

See Notes to Consolidated Financial Statements.

Consolidated Statements of Retained Earnings

	Year Ended December 31,		
	1987	1986	1985
		(in thousands)	
Balance at Beginning of Year	$113,123	$100,130	$ 94,317
Consolidated Net Income	166,366	152,481	146,101
Total	279,489	252,611	240,418
Cash Dividends Declared:			
Common Stock	113,232	113,232	113,232
Cumulative Preferred Stock:			
4⅛% Series	495	495	495
4.56% Series	273	273	273
4.12% Series	165	165	165
7.08% Series	2,124	2,124	2,124
7.76% Series	2,716	2,716	2,716
8.68% Series	2,604	2,604	2,604
12% Series	1,558	1,918	2,278
$2.15 Series	3,440	3,440	3,440
$2.25 Series	3,600	3,600	3,600
$2.75 Series	2,673	3,113	3,553
$3.63 Series	1,307	5,808	5,808
Total Dividends	134,187	139,488	140,288
Balance at End of Year	$145,302	$113,123	$100,130

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

1. Significant Accounting Policies:

Effective September 10, 1987, the Company changed its name from Indiana & Michigan Electric Company to Indiana Michigan Power Company.

The common stock of the Company is wholly owned by American Electric Power Company, Inc. (AEP).

The accounting and rates of the Company are subject in certain respects to the requirements of state regulatory bodies and in certain respects to the requirements of the Federal Energy Regulatory Commission (FERC).

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. Significant intercompany items have been eliminated in consolidation. The consolidated financial statements have been prepared on the basis of the accounts which are maintained for FERC purposes.

Electric Utility Plant; Depreciation and Amortization; Other Property and Investments

Electric utility plant is stated at original cost. Generally, the plant of the Company is subject to first mortgage liens.

The Company capitalizes, as a construction cost, an allowance for funds used during construction (AFUDC), an item not representing cash income, which is defined in the applicable regulatory systems of accounts as the net cost of borrowed funds used for construction purposes and a reasonable rate on other funds when so used. The composite rates used by the Company after compounding on a semi-annual basis were 11.5% in 1987 and 1986 and 12.55% in 1985.

The Company provides for depreciation on a straight-line basis over the estimated useful lives of the property. The current provisions are determined largely with the use of functional composite rates as follows:

Functional Class of Property	Composite Annual Rates
Production:	
Steam — Nuclear	4.0%
Steam — Fossil-fired	3.9%
Transmission	2.1%
Distribution	3.6%
General	3.0%

Operating expenses are charged with the costs of labor, materials, supervision and other costs incurred in maintaining the properties. Property accounts are charged with costs of betterments and major replacements of property, and the accumulated provisions for depreciation are charged with retirements, together with removal costs less salvage.

Other property and investments are generally stated at cost.

Income Taxes

Deferred Federal income taxes are provided to the extent that such amounts are reflected in revenue levels. The Company normalizes the effect of tax reductions resulting from investment tax credits utilized in connection with current Federal income tax accruals consistent with rate-making policies.

The Company's consolidated coal subsidiaries generally use the flow-through method of accounting for investment tax credits and practice deferred tax accounting for the effects of certain timing differences.

Pension Plans

The companies participate with other companies in the AEP System in a trusteed, noncontributory defined benefit plan to provide pensions, subject to certain eligibility requirements, for all their employees. Plan benefits are determined by a formula which considers each participant's highest average earnings, years of accredited service and social security benefits. The companies' funding policy is to make annual contributions to the plan equal to the amounts deductible for Federal income tax purposes.

The companies adopted Statement of Financial Accounting Standards No. 87 (SFAS 87), "Employers' Accounting for Pensions" as of January 1, 1987. Previously, pension cost included the cost of currently accruing benefits and amortization of, and interest on, unfunded prior-service costs over periods of up to 30 years. Pension cost determined under SFAS 87 is not significantly different. In accordance with the provisions of SFAS 87, pension cost has not been restated for prior periods. Net pension cost for the defined benefit plan for the year ended December 31, 1987 was approximately $161,000. In 1986 and 1985, the companies recorded no pension cost.

In addition to providing pension benefits, the companies provide certain health care benefits for retired employees. Substantially all of the companies' employees may become eligible for these benefits if they have completed 10 years

of continuous service at retirement. The cost of retiree health care benefits is recognized as expense when paid. In 1987, 1986 and 1985, these costs totaled $1,327,000, $1,061,000 and $780,000, respectively.

Operating Revenues

The Company accrues unbilled revenues for electric service rendered subsequent to the last billing cycle through month-end.

Operating revenues derived from a certain wholesale customer represent approximately 7% of total operating revenues for 1987 and 12% for 1986 and 1985. The contract with this customer expired on December 31, 1987.

Other

Certain prior-period amounts have been reclassified or restated to conform to current-period presentation including capital leases and certain interchange power transactions.

2. Rate Matters:

The Company has been engaged in rate proceedings for the inclusion in rate base of construction costs of Unit 1 of the Rockport Plant (Rockport 1). Rockport 1 is a 1,300,000-kilowatt generating unit jointly owned by the Company and AEP Generating Company (AEGCo), also an AEP subsidiary. The unit began commercial operation on December 10, 1984.

In August 1987 the Financial Accounting Standards Board (FASB) issued SFAS 92 "Regulated Enterprises-Accounting for Phase-in Plans" which amends SFAS 71 "Accounting for the Effects of Certain Types of Regulation" by specifying the accounting for phase-in plans. SFAS 92 requires, among other things, that costs may be deferred for future recovery under phase-in plans only if the phase-in plan meets certain criteria. Included in these criteria are the agreement to the plan by the regulator and the recovery of all costs deferred pursuant to the phase-in plan within 10 years of the date when the deferrals originally began. SFAS 92 further provides transition guidelines for phase-in plans in existence prior to the first fiscal year beginning after December 15, 1987. These guidelines permit the delayed commencement of the 10-year recovery period if certain conditions are met.

The Company has phase-in plans in both its Indiana and FERC jurisdictions for Rockport 1. The Company has recorded through December 31, 1987 and 1986 net deferred returns of $131,970,000 and $105,065,000, respectively, and net deferred depreciation of $38,443,000 and $29,418,000, respectively, on Rockport 1.

In September 1987 the Indiana Utility Regulatory Commission issued an order approving a Motion for Resolution which included compliance of the Company's Rockport 1 phase-in plan with the transition guidelines of SFAS 92, the effect of the Tax Reform Act of 1986 and other cost of service issues, resulting in a decrease in annual revenues of $5,000,000.

In December 1987 the FERC issued an interim order permitting the Company to increase its wholesale rates by approximately $3,100,000 annually, subject to refund. These rates reflect completion of the Company's Rockport 1 phase-in including compliance with the SFAS 92 guidelines, the effect of the Tax Reform Act of 1986 and other issues. Unless the FERC issues a final order approving a phase-in plan to comply with SFAS 92, the Company would be required to write-off retroactively all non-complying deferred costs, totaling approximately $43,900,000 net of income taxes at December 31, 1987. A final order is pending in this matter.

In October 1987 certain of the Company's wholesale customers filed a complaint with the FERC against the Company claiming that the rates charged by the Company to the complainants are excessive and that the Company should have ceased recording deferred return and deferred depreciation for its FERC jurisdiction as of December 31, 1986. The complaint has been consolidated with the Company's wholesale rate applications discussed above and a final order is pending.

The Company and AEGCo are constructing a second unit at the Rockport Plant (Rockport 2). Completion is expected in 1989 at an estimated cost of $1.25 to $1.35 billion. The Company and AEGCo have expended $896,300,000 on Rockport 2 through December 1987. The Company is committed to purchase 70% of AEGCo's share of Rockport 2 energy. The inclusion of Rockport 2 in rate base, the recovery of related purchased power and the timing of such are dependent on the outcome of future regulatory proceedings.

3. Federal Income Taxes:

The details of Federal income taxes as reported are as follows:

	Year Ended December 31, 1987	1986 (in thousands)	1985
Charged (Credited) to Operating Expenses:			
Current (net)	$63,543	$44,340	$(55,991)
Deferred (net)	19,533	26,208	82,407
Deferred Investment Tax Credits (net)	(7,703)	25,324	46,571
Total	75,373	95,872	72,987
Charged (Credited) to Other Income and Deductions:			
Current	2,760	(7,414)	(7,706)
Deferred (net)	(5,936)	(1,989)	(244)
Deferred Investment Tax Credits (net)	3	4	—
Total	(3,173)	(9,399)	(7,950)
Total Federal Income Taxes as Reported	$72,200	$86,473	$ 65,037

The following is a reconciliation of the difference between the amount of Federal income taxes computed by multiplying book income before Federal income taxes by the statutory tax rate, and the amount of Federal income taxes reported in the Consolidated Statements of Income.

	Year Ended December 31, 1987	1986 (in thousands)	1985
Consolidated Net Income Before Preferred Stock Dividend Requirements	$166,366	$152,481	$146,101
Federal Income Taxes	72,200	86,473	65,037
Pre-tax Book Income	$238,566	$238,954	$211,138
Federal Income Taxes on Pre-Tax Book Income at Statutory Rate (40% in 1987 and 46% in 1986 and 1985)	$ 95,426	$109,919	$ 97,123
Increase (Decrease) in Federal Income Taxes Resulting From the Following Items on Which Deferred Taxes Are Not Provided:			
Excess of Book Over Tax Depreciation	5,104	6,242	4,930
Allowance for Funds Used During Construction and Miscellaneous Items Capitalized on the Books but Deducted for Tax Purposes	(13,965)	(15,529)	(15,633)
Deferred Return — Rockport Plant	(5,447)	(9,228)	(14,929)
Amortization of Deferred Investment Tax Credits	(7,334)	(4,530)	(4,786)
Other	(1,584)	(401)	(1,668)
Total Federal Income Taxes as Reported	$ 72,200	$ 86,473	$ 65,037
Effective Federal Income Tax Rate	30.3%	36.2%	30.8%

The following are the principal components of Federal income taxes as reported:

	Year Ended December 31,		
	1987	1986	1985
		(in thousands)	
Current:			
Federal Income Taxes	$65,918	$ 68,308	$(11,824)
Investment Tax Credits	385	(31,382)	(51,873)(a)
Total Current Federal Income Taxes (net)	66,303	36,926	(63,697)
Deferred:			
Depreciation (liberalized, ADR and ACRS)	15,328	26,272	33,099
Allowance for Borrowed Funds Used During Construction and Miscellaneous Items Capitalized	3,931	9,448	6,511
Unrecovered and Levelized Fuel	(9,327)	(2,466)	14,506
Adjustments for Revenue Refunds	—	—	9,052
Nuclear Fuel Lease Adjustments	1,074	(638)	9,530
Spent Nuclear Fuel Fee	251	(7,845)	(3,175)
Unbilled Revenue	(2,839)	(4,247)	6,804
Deferred Return — Rockport Plant	5,315	9,818	12,791
Other	(136)	(6,123)	(6,955)
Total Deferred Federal Income Taxes (net)	13,597	24,219	82,163
Total Deferred Investment Tax Credits (net)	(7,700)	25,328	46,571
Total Federal Income Taxes as Reported	$ 72,200	$ 86,473	$ 65,037

(a) The Company was able to utilize investment tax credits in excess of the statutory limitation as a result of the lack of available credits of other System companies with taxable income.

The companies join in the filing of a consolidated Federal income tax return with their affiliated companies in the AEP System. The allocation of the AEP System's consolidated Federal income tax to the System companies is in accordance with SEC rules under the Public Utility Holding Company Act of 1935. These rules permit the allocation of the benefit of current tax losses to the System companies giving rise to such losses in determining taxes currently payable. The tax loss of the System parent company, American Electric Power Company, Inc., is allocated to its subsidiaries with taxable income. With the exception of the loss of the parent company, the method of allocation approximates a separate return result for each company in the consolidated group. Consolidated investment tax credits utilized are allocated to the System companies giving rise to them.

At December 31, 1987, the companies' cumulative net amount of income tax timing differences on which deferred taxes have not been provided totaled $494,000,000.

The System reached a settlement with the Internal Revenue Service (IRS) for all issues from the audits of the consolidated Federal income tax returns for the years 1974-1980. Returns for the years 1981 and 1982 have been audited by the IRS, and additional taxes have been proposed, some of which the System companies have protested. In the opinion of management, the final resolution of open matters will not have a material effect on the earnings of the Company.

In December 1987 the FASB issued SFAS 96 "Accounting for Income Taxes" effective for fiscal years beginning after December 15, 1988, which, among other things, requires that the companies adopt the liability method of accounting for income taxes. The Company has not yet determined when it will adopt SFAS 96 and its effect on the Company's financial statements, including what additional deferred taxes will have to be provided on a restated basis.

4. Common Stock, Premiums on Capital Stock and Other Paid-in Capital:

In 1985 a credit to other paid-in capital of $3,000 represented the excess of par value over cost of cumulative preferred stock reacquired by the Company to meet sinking fund requirements. There were no other changes in any of the aforementioned accounts in 1987, 1986 or 1985.

5. Retained Earnings:

Various restrictions on the use of retained earnings for cash dividends on common stock and other purposes are contained in or result from covenants in mortgage indentures, debenture and bank loan agreements, charter provisions, and orders of regulatory authorities. Approximately $45,900,000 at December 31, 1987, was so restricted.

6. Cumulative Preferred Stock:

At December 31, 1987, authorized shares of cumulative preferred stock were as follows:

Par Value	Shares Authorized
$100	2,250,000
25	11,200,000

The cumulative preferred stock is callable at the option of the Company at the price indicated plus accrued dividends. The involuntary liquidation preference is par value. Unissued shares of the cumulative preferred stock may or may not possess mandatory redemption characteristics upon issuance.

A. Cumulative Preferred Stock Not Subject To Mandatory Redemption:

			Number of Shares Redeemed Year Ended December 31,				Amount December 31, (in thousands)	
Series	Year-end Call Price	Par Value	1987	1986	1985	Shares Outstanding	1987	1986
4⅛%	$106.125	$100	—	—	—	120,000	$ 12,000	$ 12,000
4.56%	102	100	—	—	—	60,000	6,000	6,000
4.12%	102.728	100	—	—	—	40,000	4,000	4,000
7.08%	102.91	100	—	—	—	300,000	30,000	30,000
7.76%	103.44	100	—	—	—	350,000	35,000	35,000
8.68%	105.27	100	—	—	—	300,000	30,000	30,000
$2.15	26.08	25	—	—	—	1,600,000	40,000	40,000
$2.25	26.69	25	—	—	—	1,600,000	40,000	40,000
							$197,000	$197,000

B. Cumulative Preferred Stock Subject to Mandatory Redemption:

			Number of Shares Redeemed Year Ended December 31,				Amount December 31, (in thousands)	
Series (a)	Year-end Call Price	Par Value	1987	1986	1985	Shares Outstanding	1987	1986
12% (b)	$106	$100	30,000	30,000	31,673	107,325	$10,733	$13,733
$2.75 (c)	27.07	25	160,000	160,000	160,000	851,900	21,297	25,297
$3.63	—	25	1,600,000	—	—	—	—	40,000
							32,030	79,030
Less Portion Due Within One Year							—	4,000
							$32,030	$75,030

(a) The sinking fund provisions of the series subject to mandatory redemption aggregate $232,500 in 1989, $2,797,500 in 1990, $3,500,000 in 1991 and 1992. Unless all sinking fund provisions have been met, no distribution may be made on the common stock.

(b) A sinking fund for the 12% series requires the Company to provide, on or before October 1 of each year, for the redemption of 15,000 shares of such series. This provision may be satisfied through shares previously purchased or by redemption at $100 a share. The Company has the right, on each sinking fund date, to redeem an additional 15,000 shares. At December 31, 1987, the Company had reacquired 27,675 shares in anticipation of future sinking fund requirements.

(c) A cumulative sinking fund for the $2.75 series requires the Company to redeem 80,000 shares on or before October 1, of each year. The Company has the option to credit shares purchased or otherwise acquired in lieu of redeeming shares for the sinking fund and has the noncumulative option to double the number of shares to be redeemed in any year. At December 31, 1987, the Company had acquired 188,100 shares in anticipation of future sinking fund requirements.

7. Long-term Debt, Lines of Credit, and Compensating Balances:

Long-term debt by major category was outstanding as follows:

	December 31, 1987	December 31, 1986
	(in thousands)	
First Mortgage Bonds	$1,092,684	$1,008,248
Sinking Fund Debentures	7,813	8,357
Notes Payable to Banks	80,000	—
Installment Purchase Contracts	307,511	307,289
Other Long-term Debt (a)	103,760	97,629
	1,591,768	1,421,523
Less Portion Due Within One Year	52,031	11,500
Total	$1,539,737	$1,410,023

(a) Nuclear Fuel Disposal Costs. See Note 9.

First mortgage bonds outstanding were as follows:

% Rate	Due	December 31, 1987	December 31, 1986
		(in thousands)	
3⅞	1988 — February 1	$ 22,974	$ 22,974
4¾	1988 — November 1	17,557	17,557
11⅜	1990 — June 1	16,000	80,000
15⅝	1991 — November 1	—	38,800
16½	1992 — April 1	—	97,000
4⅜	1993 — August 1	42,902	42,902
7⅞	1997 — February 1	50,000	—
9⅛	1997 — July 1	75,000	—
7	1998 — May 1	35,000	35,000
8⅞	2000 — April 1	50,000	50,000
9½	2003 — June 1 (a)	208,000	219,500
8⅜	2003 — December 1	40,000	40,000
9½	2008 — March 1	100,000	100,000
13¾	2013 — August 1	64,578	67,200
9⅝	2015 — October 1	100,000	100,000
9¾	2016 — July 1	100,000	100,000
8¾	2017 — February 1	100,000	—
10⅛	2017 — May 1	75,000	—
Unamortized Discount (net)		(4,327)	(2,685)
		1,092,684	1,008,248
Less Portion Due Within One Year		52,031	11,500
Total		$1,040,653	$ 996,748

(a) The 9½% series due 2003 requires sinking fund payments of $11,500,000 annually on June 1, through 1991 and $13,500,000 annually on June 1, 1992 through 2002 with the noncumulative option to redeem an additional amount in each of the specified years from a minimum of $100,000 to a maximum equal to the scheduled requirement for each year, but with a maximum optional redemption, as to all years in the aggregate, of $75,000,000.

The indentures relating to the first mortgage bonds contain improvement, maintenance and replacement provisions requiring the deposit of cash or bonds with the trustee, or in lieu thereof, certification of unfunded property additions.

The sinking fund debentures are due May 1, 1998 at an interest rate of 7¼%. At December 31, 1987 and 1986, the principal amounts of debentures reacquired in anticipation of sinking fund requirements were $2,687,000 and $2,443,000, respectively. In addition to the sinking fund requirements the Company may call additional debentures of up to $300,000 annually.

In November 1987 the Company entered into term loan agreements with several banks. The unsecured promissory notes payable at year-end under these agreements were as follows:

	(in thousands)
9.18% due 1990	$20,000
9.12% due 1990	20,000
9.28% due 1991	40,000
Total	$80,000

Installment purchase contracts have been entered into by the Company in connection with the issuance of pollution control revenue bonds by governmental authorities as follows:

% Rate	Due	December 31, 1987	December 31, 1986
		(in thousands)	
City of Lawrenceburg, Indiana:			
8½	2006 — July 1	$ 25,000	$ 25,000
7	2006 — May 1	40,000	40,000
6⅞	2006 — May 1	12,000	12,000
City of Rockport, Indiana:			
9⅛	2005 — June 1	6,500	6,500
9¼	2010 — June 1	33,500	33,500
9¼	2014 — August 1	50,000	50,000
7½ (a)	2014 — August 1	50,000	50,000
(b)	2014 — August 1	50,000	50,000
City of Sullivan, Indiana:			
7⅜	2004 — May 1	7,000	7,000
6⅞	2006 — May 1	25,000	25,000
7½	2009 — May 1	13,000	13,000
Unamortized Discount		(4,489)	(4,711)
Total		$307,511	$307,289

(a) Adjustable interest rate will change August 1, 1990 and every five years thereafter.

(b) Variable interest rate is determined weekly. The average weighted interest was 5.5% for 1987 and 5.3% for 1986.

Under the terms of certain installment purchase contracts, the Company is required to pay purchase price installments in amounts sufficient to enable the cities to pay interest on and the principal (at stated maturities and upon mandatory redemption) of related pollution control revenue bonds issued to finance the construction of pollution control facilities at certain generating plants of the Company. On certain series the principal will be payable at stated maturities or on the demand of the bondholders at periodic interest adjustment dates.

Certain series are supported by letters of credit from a bank which expire in 1990 and 1992.

Portions of the proceeds of the installment purchase contracts are deposited with trustees and may be used only for specified construction expenditures. Approximately $17,928,000 and $35,743,000 of funds so deposited is included in special deposits and working funds at December 31, 1987 and 1986, respectively.

Long-term debt, excluding premium or discount, outstanding at December 31, 1987 is due as follows:

	Principal Amount
	(in thousands)
1988	$ 52,031
1989	11,500
1990	67,500
1991	51,500
1992	13,500
Later Years	1,404,553
Total	$1,600,584

The Company had unused short-term bank lines of credit of approximately $285,000,000 and $269,000,000 at December 31, 1987 and 1986, respectively, under which notes could be issued with no maturity more than 270 days. Available lines of credit are subject to withdrawal at the banks' option, and such lines are shared with other AEP System companies. In accordance with informal agreements with the banks, compensating balance deposits of up to 10% or equivalent fees are required to maintain the lines of credit. Substantially all bank balances are maintained by the Company to compensate the banks for services and for the Company's share of both used and available lines of credit.

8. Supplementary Income Statement Information and Related-party Transactions:

Electric operating revenues shown in the Consolidated Statements of Income include sales of energy to AEP System companies of approximately $35,000,000, $33,000,000 and $32,000,000 for the years ended December 31, 1987, 1986 and 1985, respectively.

Operating expenses shown in the Consolidated Statements of Income include certain items not shown separately, as follows:

	Year Ended December 31,		
	1987	1986	1985
		(in thousands)	
Purchased and Interchange Power (net):			
Purchased Power (a)	$ 42,139	$170,047	$149,198
Interchange Power (net):			
AEP System Electric Utilities	62,991	10,720	78,718
Other Companies	(2,486)	(147)	(525)
Total	$102,644	$180,620	$227,391
Taxes Other Than Federal Income Taxes:			
Real and Personal Property Taxes	$28,002	$27,795	$27,141
State Gross Receipts, Excise and Franchise Taxes and Miscellaneous State and Local Taxes	9,383	13,832	13,305
State Income Taxes	3,306	4,121	632
Social Security Taxes	6,039	5,543	5,261
Total	$46,730	$51,291	$46,339

(a) Includes power purchased from Ohio Valley Electric Corporation of approximately $31,076,000 in 1987, $39,378,000 in 1986 and $6,733,000 in 1985. Also includes power purchased from AEGCo of approximately $2,797,000 in 1987, $122,023,000 in 1986 and $119,952,000 in 1985.

Charges to operating expenses for royalties and for advertising are less than 1% of gross revenues in each year.

American Electric Power Service Corporation (AEPSC) provides certain services to the Company and the affiliated companies in the AEP System. The costs of the services

are determined by the service company on a direct charge basis to the extent practicable and on reasonable bases of proration for indirect costs. The charges for services are made on a cost basis and include no compensation for the use of equity capital, all of which is furnished to the service company by AEP. The service company is subject to the regulation of the SEC under the Public Utility Holding Company Act of 1935.

9. Commitments and Contingencies:

Construction

The construction budget of the companies for the years 1988-1990 is estimated at $638,000,000 and, in connection therewith, commitments have been made.

Ohio Valley Electric Corporation

AEP and Columbus Southern Power Company own 42.1% of Ohio Valley Electric Corporation (OVEC), which supplies the U.S. Department of Energy (DOE) with the power requirements of its uranium enrichment project near Portsmouth, Ohio. Proceeds from the sales of power by OVEC, aggregating $283,000,000 in 1987, are designed to be sufficient for OVEC to meet its operating expenses and fixed costs, and to provide for a return on its equity capital. The Company, as a sponsoring company, is entitled to receive from OVEC, and is obligated to pay for, the power not required by DOE in proportion to its power participation ratio, which averaged 15.4% in 1987. The DOE power agreement terminates in 1992.

Litigation

The Company and AEPSC have been involved in litigation with Terre Haute Industries, Inc. (THI) over a contract for construction of an electrostatic precipitator at the Breed Plant. In January 1984, the court awarded compensatory and punitive damages to THI in the amounts of $4,934,000 and $12,000,000, respectively, exclusive of interest. As a result of that judgment, the Company recorded a liability in 1983, including interest, on its Consolidated Balance Sheet for the compensatory damages. In April 1987, the Court of Appeals of Indiana reversed part of the decision, reduced the award for compensatory damages and dropped the award for punitive damages. In July 1987, both the Company and THI filed petitions with the Supreme Court of Indiana seeking to transfer the case to this court for review of portions of the April 1987 decision.

Environmental Matters

The companies are subject to regulation by Federal, state and local authorities with respect to air- and water-quality control and other environmental matters, and are subject to zoning and other regulation by local authorities. Although the cumulative, long-term effect of changing environmental requirements upon the companies cannot be estimated at present, compliance with such requirements may make it necessary, at costs which may be substantial, to retrofit existing facilities with additional air-pollution-control equipment; to change fuel supplies to lower sulfur content coal; to construct cooling towers or some other closed-cycle cooling systems; to undertake new measures in connection with the storage, transportation and disposal of by-products and wastes; to curtail or cease operations at existing facilities, and to delay the commercial operation of, or make design changes with respect to, facilities under construction.

Legislative proposals are pending before the United States Congress that expressly seek to control acid deposition in the eastern portion of the United States. If any of these bills become law, significant reductions in the emission of sulfur dioxide from various existing Company generating plants would be required. These reductions would entail very substantial capital and operating costs that, in turn, could necessitate substantial rate increases by the Company. In addition, a number of states and environmental organizations have commenced proceedings under the Clean Air Act seeking substantial reductions in the emission of sulfur dioxide in certain midwestern states.

Further, the U.S. Environmental Protection Agency is contemplating a number of significant policy changes in its rules governing sulfur dioxide emissions. Adoption of any of the contemplated policy changes could require substantial reductions in sulfur dioxide emissions from the Company's coal-fired generating plants.

Transmission Agreement

The Company participates with other AEP System companies in a Transmission Agreement. This agreement pools certain AEP System companies' investments in extra-high-voltage lines and shares among the parties the costs of ownership in proportion to the parties' respective demand ratios. The equalization of costs among the parties is being phased-in over the period 1985-1989. The agreement was permitted by the FERC to be implemented, effective January 22, 1985, subject to refund.

Pursuant to the terms of the agreement, the Company recorded credits of $26,025,000, $10,672,000 and $5,338,000 for transmission services in other operation expense for the years ended December 31, 1987, 1986 and 1985, respectively.

Nuclear Insurance

The Price-Anderson Act limits the public liability of a licensee of a nuclear plant for a single nuclear incident. The current level is $720,000,000. The Company has insurance covering its two-unit Donald C. Cook Nuclear Plant (Cook Plant) in the maximum available amount of $160,000,000, and the balance of $560,000,000 is covered by a mandatory program of deferred premiums that would be assessed, after a nuclear incident, against all owners of nuclear reactors. In the event of a nuclear incident, the Company could be assessed $5,000,000 per incident for each of its two nuclear generating units (subject to a maximum of $10,000,000 per reactor in any year in the event of more than one incident). The Price-Anderson Act expired in 1987, and Congress is considering its renewal. Since the Cook Plant received its licenses before the expiration, it continues to be subject to the Act. If the Act is renewed, it is likely that the limits of public liability will be increased.

The Company also has property insurance for damage to the Cook Plant facilities in the amount of $1.53 billion. The primary layer of $500,000,000 is provided through nuclear insurance pools. The excess coverage above $500,000,000 is provided through insurance pools ($250,000,000) and Nuclear Electric Insurance Limited (NEIL). NEIL's excess property insurance program provides $775,000,000 in coverage. The maximum assessment under this program could be $9,100,000 (seven and one-half times the annual premium on a 100% coverage basis).

NEIL's extra-expense program provides insurance to cover extra costs of replacement power resulting from a prolonged accidental outage of a nuclear unit. The Company's policy insures against such increased costs up to approximately $2,350,000 per week (starting 26 weeks after the outage) for one year and $1,175,000 per week for the second year, or 80% of those amounts per unit if both units are down for the same reason. The Company would be subject to a retrospective premium of up to $8,138,000 (five times annual premium) if NEIL's losses exceeded its accumulated funds.

An incident at the Cook Plant could have a substantial adverse effect upon the Company.

Disposal of Spent Nuclear Fuel and Nuclear Decommissioning

The Nuclear Waste Policy Act establishes Federal responsibility for the permanent disposal of spent nuclear fuel. Disposal costs are paid by fees assessed against owners of nuclear plants and deposited into the Nuclear Waste Fund created by the Act. For the disposal of nuclear fuel consumed after April 6, 1983 by the Cook Plant, the Company must pay to the fund a fee of one mill per kilowatthour, which the Company is currently recovering from its customers. In June 1983, the Company entered into a contract with DOE for the disposal of spent nuclear fuel. Under terms of the contract the Company must pay over a period of 10 years to the U.S. Treasury a fee estimated at approximately $71,964,000, exclusive of interest, for the disposal of nuclear fuel consumed prior to April 7, 1983. The Company has deferred this amount plus accrued interest on its balance sheet and has received regulatory approval for the recovery of this amount and has begun to amortize the amount deferred as it is being recovered.

An independent consulting firm employed by the Company has estimated that the cost of decommissioning the Cook Plant could range from $284,000,000 to $321,000,000 in 1986 dollars. The Company has received regulatory approval in each of its jurisdictions for the recovery of nuclear decommissioning costs associated with the Cook Plant. The Company intends to reevaluate periodically amounts collected for such costs and to seek regulatory approval to revise such amounts as necessary.

Funds recovered through the rate-making process for disposal of spent nuclear fuel consumed prior to April 7, 1983 and for nuclear decommissioning have been deposited in external funds for the future payment of such costs.

10. Leases:

The companies, as part of their operations, lease property, plant and equipment under leases with terms up to 35 years. Most of the leases require the companies to pay related property taxes, maintenance costs and other costs of operation. The companies expect that, in the normal course of business, leases generally will be renewed or replaced by other leases. The majority of the various rentals have purchase options or renewal options for substantially all of the economic lives of the properties.

In accordance with the provisions of SFAS 71, the companies recorded retroactively in January 1987 the assets and related liabilities for all capital leases entered into prior to January 1, 1983. This increased total assets and total liabilities by $179,341,000 at December 31, 1986. This standard also requires the companies to record rental expense in a manner consistent with rate-making treatment; therefore, there was no effect on the Consolidated Statements of Income.

The following is an analysis of properties under capital leases and related obligations:

	December 31,	
	1987	1986
	(in thousands)	
Electric Utility Plant:		
Production	$ 8,406	$ 5,823
Distribution	14,603	18,620
General and Miscellaneous	34,051	37,059
	57,060	61,502
Less Accumulated Provision for Amortization	21,848	21,721
	35,212	39,781
Nuclear Fuel Under Capital Leases (net of amortization)	133,321	145,629
Net Electric Utility Plant	168,533	185,410
Other Property	19,362	9,346
Less Accumulated Provision for Amortization	17,065	6,911
Other Property Less Provision	2,297	2,435
Net Properties under Capital Leases	$170,830	$187,845
Obligations under Capital Leases (a)	$170,830	$187,845

(a) Including an estimated $43,856,000 and $61,630,000 at December 31, 1987 and 1986, respectively, due within one year.

Payments made under capital leases include $55,557,000, $61,409,000 and $45,073,000 of amortization expense for the years ended December 31, 1987, 1986 and 1985, respectively.

Future minimum lease payments, by year and in the aggregate, of the companies' capital leases and noncancelable operating leases consisted of the following at December 31, 1987:

	Capital Leases (a)	Operating Leases
	(in thousands)	
1988	$ 9,000	$ 20,000
1989	7,000	20,000
1990	5,000	20,000
1991	4,000	19,000
1992	4,000	15,000
Later Years	42,000	184,000
Total Future Minimum Lease Payments	71,000	$278,000
Less Estimated Interest Element Included Therein	33,000	
Estimated Present Value of Future Minimum Lease Payments	$38,000	

(a) Minimum payments do not include leases of nuclear fuel. Nuclear fuel rentals comprise the unamortized balance of the lessor's cost (approximately $133,000,000) less salvage value, if any, to be paid in proportion to heat produced and carrying charges on the lessor's unrecovered costs. It is contemplated that portions of the presently leased material will be replenished by additional leased material.

Rentals for all operating leases are classified approximately as follows:

	Year Ended December 31,		
	1987	1986	1985
	(in thousands)		
Gross Rentals	$18,000	$20,000	$20,000
Less Rental Recoveries (including sublease rentals) (a)	2,000	3,000	3,000
Net Rentals (b)	$16,000	$17,000	$17,000
(a) Includes amounts paid for or reimbursed by associated companies.			
(b) Classified approximately as:			
Operating Expenses	$11,000	$10,000	$10,000
Clearing and Miscellaneous Accounts (portions of which are charged to income)	5,000	7,000	7,000
Total	$16,000	$17,000	$17,000

Included in the above analysis of future minimum lease payments and of properties under capital leases and related obligations are certain leases as to which portions of the related rentals are paid for or reimbursed by associated companies in the AEP System based on their usage of the leased property. The companies cannot predict the extent to which or proportion in which the associated companies will utilize the properties under such leases in the future.

11. Unaudited Quarterly Financial Information:

The following consolidated quarterly financial information is unaudited but, in the opinion of the Company, includes all adjustments (consisting of only normal recurring accruals) necessary for a fair presentation of the amounts shown:

Quarterly Periods Ended	Operating Revenues	Operating Income	Net Income*	Quarterly Periods Ended	Operating Revenues	Operating Income	Net Income*
		(in thousands)				(in thousands)	
1987				1986			
March 31	$253,638	$59,738	$47,390	March 31	$279,398	$54,720	$37,921
June 30	241,653	48,999	37,989	June 30	266,990	36,674	27,665
September 30	283,944	52,881	38,914	September 30	273,549	47,534	41,485
December 31	238,033	61,428	42,073	December 31	271,358	52,216	45,410

*Before preferred stock dividend requirements.

Auditors' Opinion

Deloitte Haskins+Sells

155 East Broad Street
Columbus, Ohio 43215-3650
(614) 221-1000
ITT Telex: 4995627

To the Shareowners and the Board of
Directors of Indiana Michigan
Power Company:

We have examined the consolidated balance sheets of Indiana Michigan Power Company (formerly Indiana & Michigan Electric Company) and its subsidiaries as of December 31, 1987 and 1986 and the related consolidated statements of income, retained earnings and sources and applications of funds for each of the three years in the period ended December 31, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such consolidated financial statements present fairly the financial position of the Company and its subsidiaries at December 31, 1987 and 1986 and the results of their operations and their sources and applications of funds for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

Deloitte Haskins & Sells

February 23, 1988

Operating Statistics

	1987	1986	1985	1984	1983
Electric Operating Revenues (in thousands):					
From Kilowatt-hour Sales:					
Retail:					
Residential:					
Without Electric Heating	$ 186,418	$ 174,550	$ 175,534	$150,334	$144,370
With Electric Heating	90,261	90,881	90,949	82,739	70,851
Total Residential	276,679	265,431	266,483	233,073	215,221
Commercial	191,352	184,276	181,240	150,733	137,616
Industrial	235,470	219,344	213,161	173,986	154,751
Miscellaneous	11,533	11,171	11,234	9,666	8,696
Total Retail	715,034	680,222	672,118	567,458	516,284
Wholesale (sales for resale) (a)	293,379	400,779	396,980	414,390	370,551
Total from Kilowatt-hour Sales	1,008,413	1,081,001	1,069,098	981,848	886,835
Provision for Revenue Refunds	—	541	(105)	(12,494)	—
Total Net of Provision for Revenue Refunds	1,008,413	1,081,542	1,068,993	969,354	886,835
Other Operating Revenues	8,855	9,753	9,800	10,197	9,269
Total Electric Operating Revenues	$1,017,268	$1,091,295	$1,078,793	$979,551	$896,104

	1987	1986	1985	1984	1983
Sources and Sales of Energy (in millions of kilowatt-hours):					
Sources:					
Net Generated — Steam:					
Fossil Fuel	6,662	8,187	7,933	7,071	5,684
Nuclear Fuel	10,060	10,986	7,800	12,913	12,301
Net Generated — Hydroelectric	62	79	74	68	55
Subtotal	16,784	19,252	15,807	20,052	18,040
Purchased (a)	2,558	4,941	3,248	4,913	4,891
Net Interchange (a)	1,947	542	4,948	1,353	1,847
Total Sources	21,289	24,735	24,003	26,318	24,778
Less: Losses, Company Use, Etc.	1,456	1,645	1,542	1,508	1,441
Net Sources	19,833	23,090	22,461	24,810	23,337
Sales:					
Retail:					
Residential:					
Without Electric Heating	2,719	2,536	2,557	2,534	2,596
With Electric Heating	1,445	1,442	1,481	1,561	1,458
Total Residential	4,164	3,978	4,038	4,095	4,054
Commercial	3,142	3,007	2,968	2,870	2,807
Industrial	4,834	4,371	4,282	4,201	3,941
Miscellaneous	221	212	216	209	204
Total Retail	12,361	11,568	11,504	11,375	11,006
Wholesale (sales for resale) (a)	7,472	11,522	10,957	13,435	12,331
Total Sales	19,833	23,090	22,461	24,810	23,337

(a) Prior-period amounts have been restated to conform to 1987 presentation.

OPERATING STATISTICS (Concluded)

	1987	1986	1985	1984	1983
Average Cost of Fuel Consumed (in cents):					
Per Million Btu:					
Coal	190	185	194	189	184
Nuclear	75	74	80	65	54
Overall	117	118	136	103	92
Per Kilowatt-hour Generated:					
Coal	1.87	1.82	1.97	1.83	1.76
Nuclear	.84	.83	.86	.70	.59
Overall	1.25	1.25	1.42	1.08	.96
Residential Service — Averages:					
Annual Kwh Use per Customer:					
Total	10,146	9,813	10,050	10,249	10,187
With Electric Heating	17,341	17,716	18,486	19,771	18,780
Annual Electric Bill:					
Total	$674.13	$654.88	$663.18	$583.35	$540.74
With Electric Heating	$1,083.10	$1,116.86	$1,135.42	$1,048.27	$912.31
Price per Kwh (in cents):					
Total	6.64	6.67	6.60	5.69	5.31
With Electric Heating	6.25	6.30	6.14	5.30	4.86
Number of Electric Customers:					
Year-End:					
Retail:					
Residential:					
Without Electric Heating	328,937	325,623	322,922	321,286	320,655
With Electric Heating	84,442	82,324	80,734	79,823	78,311
Total Residential	413,379	407,947	403,656	401,109	398,966
Commercial	44,207	43,689	43,017	42,912	42,552
Industrial	4,345	3,882	3,701	3,415	3,253
Miscellaneous	1,946	1,846	1,852	1,584	1,571
Total Retail	463,877	457,364	452,226	449,020	446,342
Wholesale (sales for resale)	105	106	104	105	106
Total Electric Customers	463,982	457,470	452,330	449,125	446,448

Dividends and Price Ranges of Cumulative Preferred Stock

By Quarters (1987 and 1986)

	1987 — Quarters				1986 — Quarters			
	1st	2nd	3rd	4th	1st	2nd	3rd	4th
Cumulative Preferred Stock								
($100 Par Value)								
4⅛% Series								
Dividends Paid Per Share	$1.03125	$1.03125	$1.03125	$1.03125	$1.03125	$1.03125	$1.03125	$1.03125
Market Price — $ Per Share								
(MSE) — High	43⅞	43	—	—	36½	—	36½	44
— Low	41⅞	41½	—	—	34⅝	—	35	35⅛
4.56% Series								
Dividends Paid Per Share	$1.14	$1.14	$1.14	$1.14	$1.14	$1.14	$1.14	$1.14
Market Price — $ Per Share								
(OTC)								
Ask (high/low)	—	—	—	—	—	—	—	—
Bid (high/low)	—	—	—	—	—	—	—	—
4.12% Series								
Dividends Paid Per Share	$1.03	$1.03	$1.03	$1.03	$1.03	$1.03	$1.03	$1.03
Market Price — $ Per Share								
(OTC)								
Ask (high/low)	—	—	—	—	—	—	—	—
Bid (high/low)	—	—	—	—	—	—	—	—
7.08% Series								
Dividends Paid Per Share	$1.77	$1.77	$1.77	$1.77	$1.77	$1.77	$1.77	$1.77
Market Price — $ Per Share								
(NYSE) — High	88	84¼	75¾	71	76	80⅜	80½	88½
— Low	79	70⅞	67⅜	61⅝	65	67¾	70	77
7.76% Series								
Dividends Paid Per Share	$1.94	$1.94	$1.94	$1.94	$1.94	$1.94	$1.94	$1.94
Market Price — $ Per Share								
(NYSE) — High	96½	93½	82½	76	84	89	87¼	94½
— Low	85⅛	80	72¾	65	69¼	75	76	83⅛
8.68% Series								
Dividends Paid Per Share	$2.17	$2.17	$2.17	$2.17	$2.17	$2.17	$2.17	$2.17
Market Price — $ Per Share								
(NYSE) — High	104⅝	102	90⅝	85½	93½	98¾	98½	102½
— Low	99¼	90½	87	79⅝	78½	85¼	88¼	92½
12% Series								
Dividends Paid Per Share	$3.00	$3.00	$3.00	$3.00	$3.00	$3.00	$3.00	$3.00
Market Price — $ Per Share								
(NYSE) — High	105½	108	107½	107⅜	106½	107	106	106
— Low	103	104	103	101¼	101¼	99½	100½	102
($25 Par Value)								
$2.15 Series								
Dividends Paid Per Share	$0.5375	$0.5375	$0.5375	$0.5375	$0.5375	$0.5375	$0.5375	$0.5375
Market Price — $ Per Share								
(NYSE) — High	26⅛	25¾	23¼	22⅝	24¼	25	24¾	25½
— Low	24	21½	19⅞	18½	19⅜	21	22¼	23⅝
$2.25 Series								
Dividends Paid Per Share	$0.5625	$0.5625	$0.5625	$0.5625	$0.5625	$0.5625	$0.5625	$0.5625
Market Price — $ Per Share								
(NYSE) — High	27	26⅞	26	24	24½	25½	25¼	26⅝
— Low	24¾	23½	20½	20	20⅜	21⅝	23⅛	24⅜
$2.75 Series								
Dividends Paid Per Share	$0.6875	$0.6875	$0.6875	$0.6875	$0.6875	$0.6875	$0.6875	$0.6875
Market Price — $ Per Share								
(NYSE) — High	27¼	26¼	26½	27	29	27½	28	27⅜
— Low	26¾	26	25⅝	25	26	25	27	27⅜
$3.63 Series (a)								
Dividends Paid Per Share	$0.9075				$0.9075	$0.9075	$0.9075	$0.9075
Market Price — $ Per Share								
(NYSE) — High	31				31½	30¼	31⅝	30½
— Low	27¼				28¾	28⅝	28⅛	27

MSE — Midwest Stock Exchange
OTC — Over-the-Counter
NYSE — New York Stock Exchange

Note — The above bid and asked quotations represent prices between dealers and do not represent actual transactions.

Market quotations provided by National Quotation Bureau, Inc.

Dash indicates quotation not available.

(a) Redeemed April 1987.

The Company's Annual Report
(Form 10-K) to the Securities and
Exchange Commission will be available
on or about March 31, 1988 to shareowners
upon written request and at no cost.
Please address such requests to:

Mr. G. C. Dean
American Electric Power
Service Corporation
1 Riverside Plaza
Columbus, Ohio 43215

Transfer Agent and Registrar of Cumulative Preferred Stock

Morgan Shareholder Services Trust Company

30 West Broadway, New York, N.Y. 10007-2192

Indiana Michigan
Power Company
P.O. Box 16631
Columbus, OH 43216

AEP
INDIANA
MICHIGAN
POWER

AEP:NRC:0909D
10 CFR 50.71(b) & 140.21(e)

Donald C. Cook Nuclear Plant Unit Nos. 1 and 2
Docket Nos. 50-315 and 50-316
License Nos. DPR-58 and DPR-74
FINANCIAL INFORMATION FOR INDIANA MICHIGAN
POWER COMPANY

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

Attn: T. E. Murley

April 13, 1988

Dear Dr. Murley:

Enclosure 1 contains the Indiana Michigan Power Company's (I&M) annual report for 1987. Enclosure 2 contains a copy of I&M's projected cash flow for 1988. These reports are submitted pursuant to 10 CFR 50.71(b) and 10 CFR 140.21(e).

This document has been prepared following Corporate procedures which incorporate a reasonable set of controls to ensure its accuracy and completeness prior to signature by the undersigned.

Sincerely,

M. P. Alexich
Vice President

eh

Enclosures

cc: D. H. Williams (w/o enclosures)
W. G. Smith, Jr. - Bridgman (w/o enclosures)
R. C. Callen (w/o enclosures)
G. Charnoff (w/o enclosures)
G. Bruchmann (w/o enclosures)
NRC Resident Inspector - Bridgman
A. B. Davis - Region III

A004
1/1

Enclosure 2 to AEP:NRC:0909D

1988 Internal Cash Flow Projection for Donald C. Cook Nuclear Plant
($ Millions)

	Actual 1987	Projected 1988
Net income after taxes	166.4	129
Less dividends paid	134.2	133
Retained earnings	32.2	(4)
Adjustments:		
Depreciation and amortization	120.3	146
Deferred income taxes and investment tax credits	5.9	(8)
AFUDC	(49.4)	(62)
Total adjustments	76.8	76
Internal cash flow	109.0	72
Average quarterly cash flow	27.2	18
Average cash balances and short-term investments	38.0	20
Total	65.2	38

% Ownership in all operating nuclear units: Unit 1 and Unit 2 - 100%

Maximum Total Contingent Liability - $20.0 million (2 units)

Indiana Michigan Power Service Area and the American Electric Power System