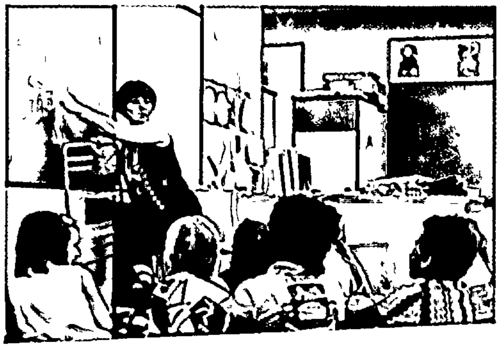
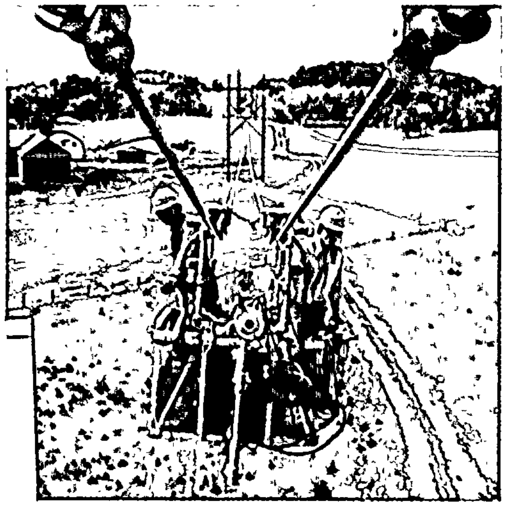
Niagara Mohawk Power Corporation

Annual Report 1977

TOMORROW IS ON OUR MIND . . .





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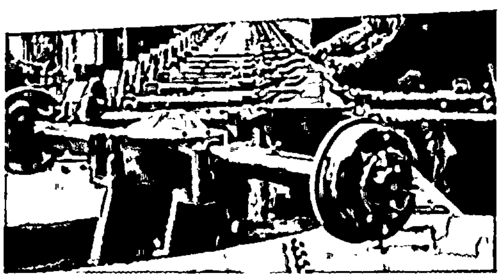
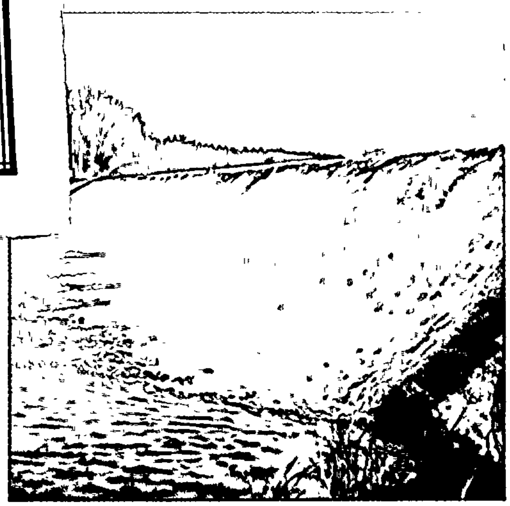
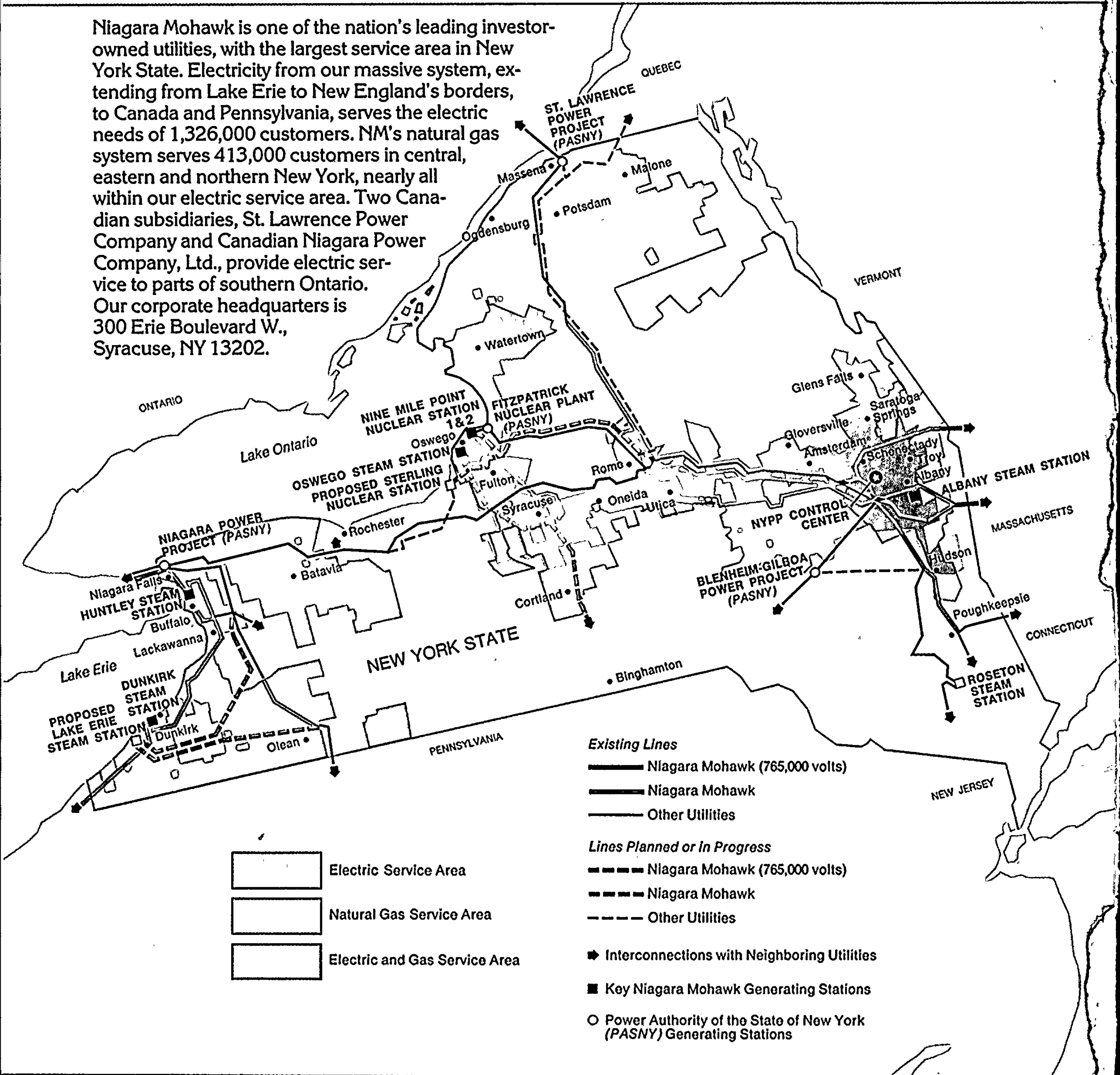




Our Service Area

Niagara Mohawk is one of the nation's leading investor-owned utilities, with the largest service area in New York State. Electricity from our massive system, extending from Lake Erie to New England's borders, to Canada and Pennsylvania, serves the electric needs of 1,326,000 customers. NM's natural gas system serves 413,000 customers in central, eastern and northern New York, nearly all within our electric service area. Two Canadian subsidiaries, St. Lawrence Power Company and Canadian Niagara Power Company, Ltd., provide electric service to parts of southern Ontario. Our corporate headquarters is 300 Erie Boulevard W., Syracuse, NY 13202.



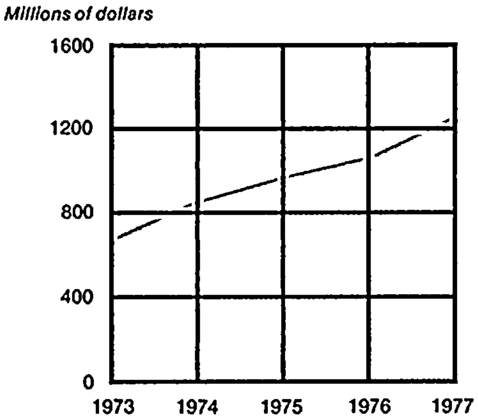
Upstate New York consumers. Niagara Mohawk people.
We're charged with the never-ending responsibility of providing ample, affordable, reliable energy to more than 3 ½ million residents.
Not just today, but through the critical decades ahead.

Highlights of 1977

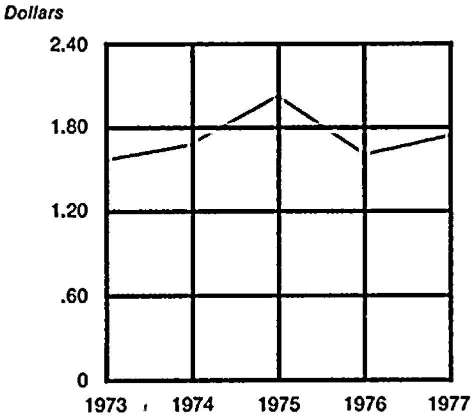
	1977	1976	% Change
Total operating revenues	$1,225,832,000	$1,077,230,000	14
Income available for common stockholders	$ 98,127,000	$ 84,903,000	16
Earnings per common share	$1.74	$1.61	8
Dividends per common share	$1.31½	$1.24	6
Common shares outstanding *(average)*	56,278,556	52,731,329	7
Utility plant *(gross)*	$3,553,560,000	$3,304,072,000	8
Gross additions to utility plant	$ 289,931,000	$ 282,702,000	3
Kilowatt-hour sales to customers	31,367,000,000	31,802,000,000	(1)
Electric customers at end of year	1,326,000	1,317,000	1
Electric peak load *(kilowatts)*	6,935,000	6,327,000	10
Natural gas sales to customers *(cubic feet)*	90,827,000,000	100,115,000,000	(9)
Gas customers at end of year	413,000	416,000	(1)
Maximum day gas sendout *(cubic feet)*	660,974,000	743,979,000	(11)

Contents

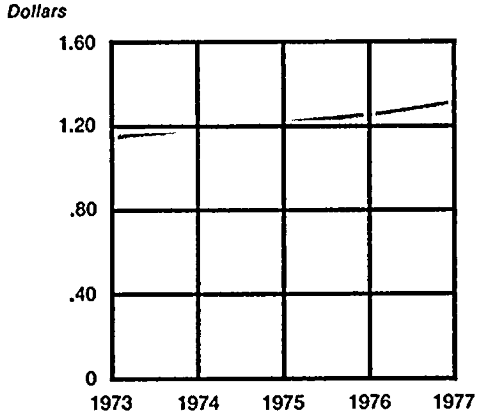
TOTAL OPERATING REVENUES



EARNINGS PER COMMON SHARE (RESTATED)



DIVIDENDS PER COMMON SHARE



To our stockholders

Our earnings for 1977 were $1.74 per share of common stock, compared with $1.61 in 1976 when fewer shares were outstanding. This improvement resulted primarily from electric and natural gas rate increases granted by the New York State Public Service Commission in late 1976.

Although earnings were improved by the revised rates, they still fell far short of budgeted expectations and an adequate return on stockholders' investment. Inflationary elements kept eroding earnings projections despite our continued assault on rising costs. To counter these pressures we are continuing to apply strict controls on manpower and are employing effective management techniques to produce the advances in productivity and creative innovation described in the following pages.

On August 5, we again filed with the Public Service Commission for higher rates. Estimated cost hikes and income projections through mid-1979 indicate rate relief is a must to maintain earnings quality. As in the past, we will continue to pursue rate revisions as may be necessary.

This year's report highlights the ultimate importance placed upon the future of our business and its role as upstate New York's principal energy supplier. We have always looked ahead to plan and supply our service area's electric and gas needs. However, in view of recent evidence, new trends in various social and economic conditions have required modification of both long and short-term sales growth projections. Overall electric sales decreased 1%, the mixed result of lethargic recovery from economic recession, impact of the energy conservation ethic and resistance to higher electric and gas charges as an increasing element in customer budgets. Presently, indicators point to very moderate growth in all market sectors. We are encouraged over a change to a more positive attitude toward business indicated in statements by government officials and we are hopeful the tempo of the economy will rise. But the conservation ethic, spurred by necessary increases in the cost of our services, is a restraining growth factor. Instead of a 4% growth projection, a 2.5% increase now appears more realistic.

Thus, in light of 1977's electric load forecast revisions, we have rescheduled construction of our Nine Mile Point Nuclear Unit No. 2 for completion in 1983. Meanwhile, we are progressing with a 14-year plan to expand our existing hydroelectric capacity by more than 30%. High electric generation fuel costs make development of once-uneconomic hydro sites competitive with steam-electric units for the first time in decades. In addition, our Research and Development Department is seeking alternate energy sources, besides enhancing performance and environmental compatibility of those in service.

With our mind on the future, we have followed with interest and concern Congressional deliberations toward enactment of a National Energy Act. The Act's complicated mix of taxes, rebates and regulatory reform, when unclothed, appears to be essentially a massive tax bill. We are especially concerned over its potential impact on the cost of fuel for our generating stations.

In our view, the nation would be better served by an effective energy policy to reduce its dependence on imported oil and assure steady, reliable energy supplies to sustain economic growth. This can only be accomplished through greater domestic production of oil, coal, natural gas and uranium, the discovery of new energy sources and easing of environmental restrictions on the mining and use of coal.

Eyeing more secure future supplies of nuclear fuel, our investment in NM Uranium, Inc., now totals some $73 million. This subsidiary owns half of a southeast Texas mining operation that will produce 500,000 pounds of uranium per year for our Nine Mile Point nuclear units.

A report on a year-long audit of our management and operations by Arthur Young and Company, as directed by the Public Service Commission and released in October, was especially gratifying in its recognition that: "The environment at Niagara Mohawk is excellent . . . The Company has a nucleus of trained, capable managers who im-

pressed us with their attitude and dedication." Wherever practical, we are implementing the study's recommendations to further upgrade our performance.

A first for us in 1977 was formation of an independent Consumer Advisory Council on Energy Affairs. Consisting of volunteers from the communities we serve, the Council was conceived to foster better understanding between NM and the public, benefiting both in this era of consumerism. Members' various suggestions are being incorporated in our practices and procedures.

Our natural gas supply outlook is considerably brighter than in recent years. We were permitted in 1977 by the Public Service Commission to add 5,000 residential gas space heating customers and to increase some commercial and industrial sales, as well as to add some such customers with high priority uses. This is the first action to renew markets and to recover portions of sales denied us since 1975, when concern about prospective shortages forced a complete halt on all new sales.

While the price of natural gas is certain to rise, as a result of the impact of pending congressional action, we anticipate that gas—a clean fuel—can continue to be competitive with other fuels in upcoming years. Again, increasing prices will bring noticeable evidence of reduction in average customer use through conservation. The lifting of restrictions will not affect our ability to meet emergency supply situations such as occurred in winter 1976-77.

NM's financial posture showed improvement this year when we regained an A rating for our bonds from one of the three major rating agencies. This results from our better earnings-to-debt coverage and lowered financing requirements, thereby reducing the cost of money to us. All three agencies currently give our bonds an A rating.

In financing, we sold $75 million of 8.35%, 30-year first mortgage bonds in August 1977. In December, $50 million of similar bonds were issued through private placement at 8⅝%, and early in 1978 we sold at private placement $40 million of 8⅜% series preferred stock. Only somewhat limited new public financing will be necessary for 1978, including probable issuance of some $40 million in common stock.

We were pleased to raise our quarterly dividend to 33½ cents a share during the second quarter, our third dividend increase in five years. The indicated annual dividend is now $1.34, up from $1.14 in 1973. Whenever possible, we will adjust dividends to fairly compensate investors.

The northern New York Town of Massena is maintaining its bid, commenced May 1974, to create a municipal electric system by expropriating NM facilities. Recently, the Town secured a court adjudication, now under appeal, permitting it to proceed with condemnation efforts. We will protect the interests of stockholders to the fullest extent by continuing to exert absolute opposition to this effort—or any similar takeover threat.

Today more than ever, a motivating influence on each of us in management is the consistent loyalty of Niagara Mohawk stockholders and employees. For this support, we thank you.

John G. Haehl, Jr.

John G. Haehl, Jr.
President and Chief Executive Officer

February 1, 1978

Time for action and resolve

Our management and operations received high overall ratings in the first phase of an intensive, Public Service Commission-mandated study of the Company in 1977. Still under way, the evaluation is yielding numerous recommendations that already are contributing to increased productivity and efficiency.

Legislation has been enacted for audit review of all New York State utilities every five years. The audits are currently in various stages of planning and examination under the direction of the Commission. A management consulting firm, Arthur Young & Company, has been conducting the NM study since 1976.

In their Phase I report, the Young consultants termed the working environment at Niagara Mohawk excellent, adding that our Company has a record of meeting customer needs for energy, achieving operating objectives and minimizing electric interruptions—"despite winter operating conditions that are among the most difficult in the nation."

The report also noted that many areas of our operations had been improved following the management restructuring of 1976. Primary recommendations concerned budgeting, major capital projects, emergency and fuel shortage planning, electric and gas losses and power plant operations.

In Phase II, scheduled through mid-1978, the consultants will provide technical assistance in developing and implementing programs and portions of selected projects related to Phase I recommendations.

Everywhere in our business, constant emphasis and attention to controlling expenses prevailed through the year. We are taking all avenues to strengthen our financial stability and combat rising costs, including measures such as a freeze on work force expansion and strict requirements for filling vacant positions. Overtime work has been drastically reduced.

In 1977, NM's consolidated income available for holders of common stock was $1.74 per share, up 13¢ over $1.61 in 1976 when fewer shares were outstanding. Overall revenues climbed $148,602,000 in 1977, 14% higher than for 1976, essentially resulting from rate revisions and higher purchased gas and fuel adjustment revenues. These increases were partially offset by a reduction in revenues from sales to other electric systems. The tables on page 5 show major changes in electric and gas revenues and sales.

In 1977 our electric revenues increased $124,700,000 compared with $67,100,000 in 1976.

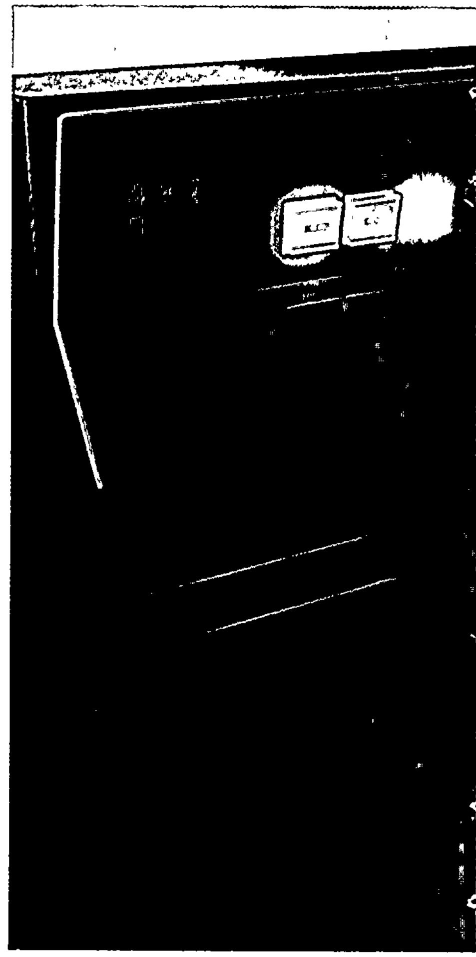
The upturn in electric revenues attributable to modified base rates stems from permanent rate increases of $52,400,000 annually, effective on December 1, 1976 and $9,900,000 on June 1, 1977. The June revision was authorized by the PSC to reflect 1977 wage increases.

Electric sales to ultimate consumers increased 2.8% compared with a 4.5% rise in 1976.

During 1977, 9,000 customers were added to our electric lines, raising the total to 1,326,000 at year end. Average price per kilowatt-hour paid by residential consumers rose from 3.40 cents to 3.85 cents, about the same unit cost as in 1937.

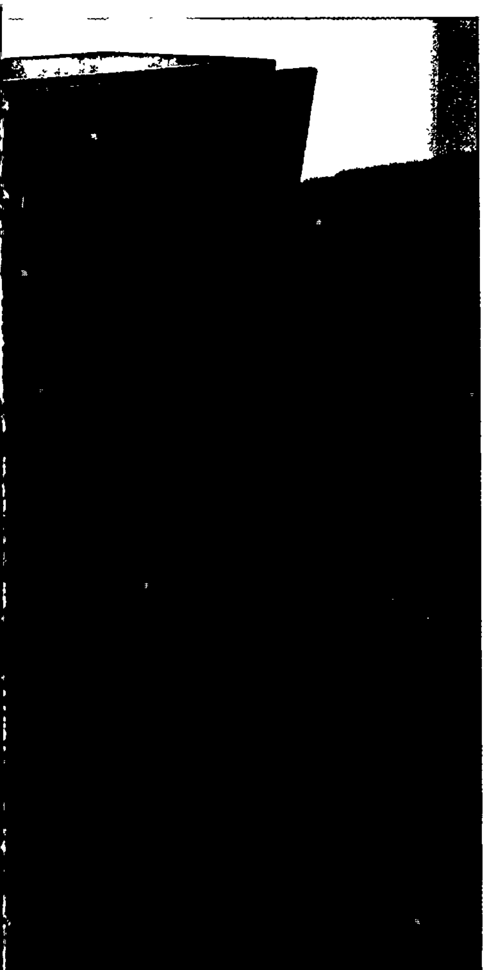
Natural gas revenues climbed $23,900,000 in 1977 and $37,900,000 in 1976. Gas sales decreased 9.2% in 1977 because of emergency curtailments required in January, warmer weather and conservation efforts by all customer categories. Sales were 10.8% higher in 1976 than in 1975 due to colder weather in November and December.

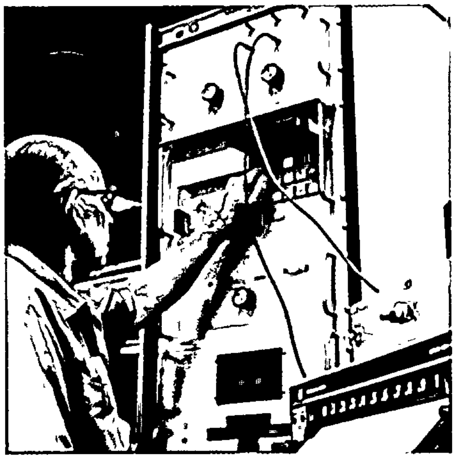
The average cost per thousand cubic feet of gas for residential customers was $.53 more in 1977 than in 1976, due primarily to cost increases allowed by the Federal Energy Regulatory Commission to our wholesale supplier, Consolidated Gas Supply Corporation and the 5.8% rate increase granted NM, effective December 1, 1976. The new rates were designed to provide $10,800,000 in additional annual revenue.

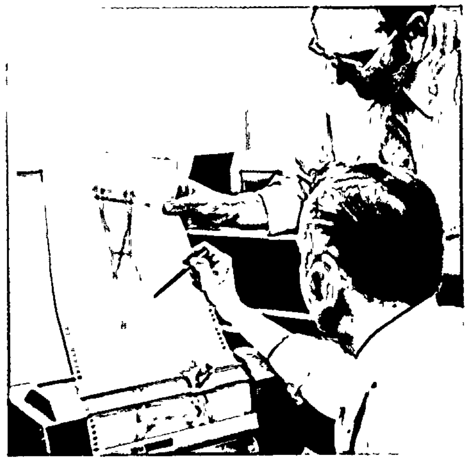


During 1977, the number of gas customers decreased from 416,000 to 413,000. The decline in residential and commercial customers was related to PSC restrictions on the addition of new customers.

A new electric net system peak of 5,405,000 kilowatts was recorded on December 12, 1977, some 20,000 kw over 1976's peak.







Advances in productivity, with unprecedented specialization and precision, are continuing assets of computer technology at NM. Computer applications are constantly broadening and include, from left, stockholder records and information, meter testing, transmission tower design and system power control operations. NM saved $3.4 million in 1977 by in-house time-sharing of computer systems.

ELECTRIC REVENUES	Increase (decrease) from prior period *In millions of dollars* 1977	1976
Increase in base rates	$ 54.2	$10.1
Fuel and purchased power cost increases	78.9	10.7
Sales to other electric systems	(24.0)	14.5
Sales to ultimate consumers	13.8	29.1
Miscellaneous operating revenues ..	1.8	2.7
	$124.7	$67.1

GAS REVENUES	Increase (decrease) from prior period *In millions of dollars* 1977	1976
Increase in base rates	$ 8.2	$ 5.0
Purchased gas cost increases .	21.7	21.9
Gas sales	(6.0)	11.0
	$23.9	$37.9

CLASS OF SERVICE	% of total electric revenues	% increase over 1976 Electric revenues	Kilowatt-hours
Residential	31	15	2
Commercial	33	20	4
Industrial	26	24	3
Municipal service	2	17	1
Total to ultimate consumers	92	19	3
Other electric systems	6	(29)	(33)
Miscellaneous	2	8	—
	100%	14	(1)

CLASS OF SERVICE	% of total gas revenues	% increase from 1976 Gas revenues	Cubic feet
Residential	63	13	(8)
Commercial	22	5	(14)
Industrial	12	16	(7)
Total to ultimate consumers ...	97	11	(9)
Other gas systems	2	4	(11)
Miscellaneous	1	(11)	—
	100%	11	(9)

In mid-1977, the troubled gas supply outlook improved considerably, enabling NM to file with the Public Service Commission for a partial lifting of restrictions on attaching new customers. Permission was granted in November. Among positive developments to allow the easing were new offshore gas fields in the Gulf of Mexico, additional volumes in storage, anticipated deliveries of liquefied gas from Algeria and a variety of conservation efforts by customers. In November, the Commission approved a program by NM to provide additional gas service, and the Company began issuing permits to qualified customers in all service categories. The move has already helped improve the economic climate and building construction in our service area.

Regarding NM's application on August 5, 1977 to the PSC for approval to increase electric and natural gas rates, public hearings on the request concluded January 20, 1978. The Company seeks revised rate schedules to raise annual electric revenues by approximately $81,964,000, an increase of about 8.3% and additional annual gas revenues of some $21,258,000, an increase of 8.5%. Both the electric and gas rate proposals are based on projected sales for the 12 months ending June 30, 1979. We anticipate a recommendation by the Commission's administrative law judge in the case in early April 1978. A final decision by the PSC is anticipated about mid-year.

Combined costs of fuel, purchased power and gas also continued to climb in 1977, due to higher rates charged by the Company's suppliers and higher output from fossil fuel generation while our nuclear plant was shut down for refueling and maintenance. The higher fuel costs associated with sales to ultimate consumers produced an increase in revenues through NM's fuel adjustment and purchased gas adjustment clauses applied to customer bills. Higher costs for sales to other utility systems are recovered immediately in the price charged.

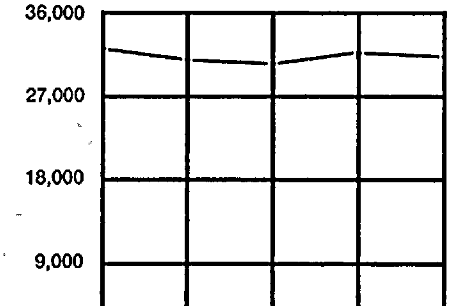
Other operation and maintenance expenses rose $31,900,000 in 1977, compared with a rise of $23,700,000 in 1976, due primarily to higher labor costs and increased levels of maintenance work required at our steam generating stations and on our electric distribution system. Federal and Canadian income taxes climbed $4,200,000 in 1977 and $3,300,000 in 1976. The higher income taxes for 1977 were attributable to increased earnings, while those of 1976 were linked to a decrease in flow-through tax adjustments. Real estate, revenue and other taxes increased $17,200,000 in 1977 and $17,800,000 in 1976, due principally to higher property taxes resulting from property additions, increased tax rates and improved revenues.

A $13,400,000 increase in allowance for funds used during construction in 1977 resulted from additional construction work in progress and nuclear fuel in process. A decrease in such allowance occurred in 1976 when our new Unit No. 5 at Oswego Steam Station was placed in service.

Other income for 1976 includes $8,986,000 representing a portion of the income tax refunds for the years 1966 through 1968, as a result of the retroactive adoption of "guideline" lives in computing tax depreciation, as discussed in Note 12 of Notes to Consolidated Financial Statements, page 18.

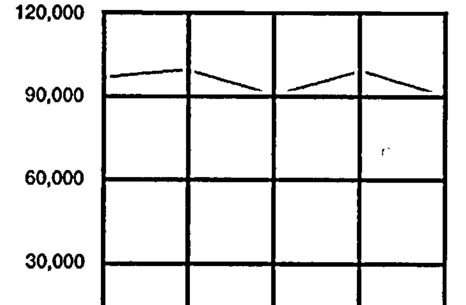
ELECTRIC SALES

Millions of Kw-hrs.



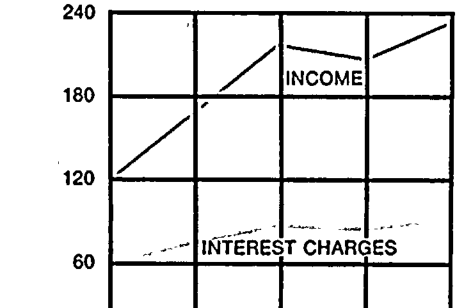
GAS SALES

Millions of cubic feet



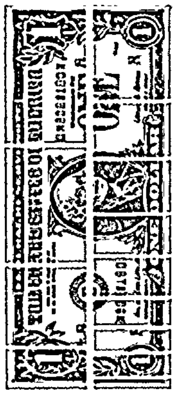
INCOME (BEFORE INTEREST AND INCOME TAXES) AND INTEREST CHARGES

Millions of dollars



THE 1977 REVENUE DOLLAR AND WHERE IT WENT

In thousands of dollars	Change from 1976		
$454,739	15%	37¢	Residential customers
377,497	17	31¢	Commercial customers
283,026	23	23¢	Industrial customers
110,570	(15)	9¢	All others



		In thousands of dollars	Change from 1976
Fuel for production of electricity	25¢	$311,185	29%
Income and other taxes	14¢	166,923	16
Wages, salaries, employee benefits	14¢	166,735	12
Interest and other costs—net	12¢	144,954	8
Gas purchased	12¢	142,071	14
Dividends to stockholders	8¢	99,738	12
Electricity purchased	7¢	93,019	(6)
Depreciation	6¢	77,113	(1)
Retained in business	2¢	24,094	25

Dividend requirements on preferred stock, the average number of shares of common stock outstanding and interest charges rose in 1977 and 1976, the result of higher capital costs and additional securities issued to finance construction requirements. During late 1976, declining interest rates and reduced short-term borrowings resulted in a decrease in other interest charges for 1976.

In August 1977, the Company sold $75,000,000 of 8.35% 30-year first mortgage bonds. Further financing in December involved the private placement of $50,000,000 of 8⅝% 30-year first mortgage bonds. Net proceeds from these sales were applied to reduce outstanding borrowings issued to meet construction costs, including planned generating units on Lakes Ontario and Erie and related energy projects.

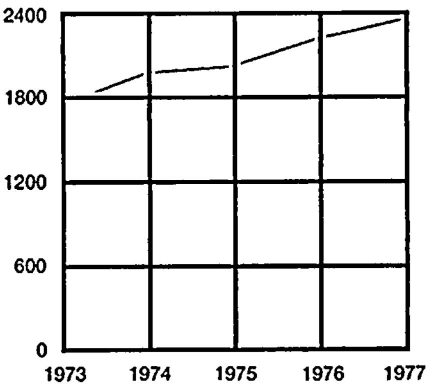
Also used to finance construction were net proceeds of $21,500,000 from the sale of 1,371,000 shares of common stock sold through our Dividend Reinvestment and Stock Purchase Plan and Employee Savings Fund Plan.

Dividends per share of our common stock and quoted prices were:

1976	Dividends paid per share	Price range High	Low
1st quarter ...	$ .31	$14¼	$12½
2nd quarter ..	$ .31	$14	$12½
3rd quarter ..	$ .31	$14¼	$12⅝
4th quarter ...	$ .31	$15	$13⅛
	$1.24		
1977			
1st quarter ...	$ .31	$15¾	$14
2nd quarter ..	$ .33½	$16⅝	$14¾
3rd quarter ..	$ .33½	$17¼	$15
4th quarter ...	$ .33½	$16⅜	$15
	$1.31½		

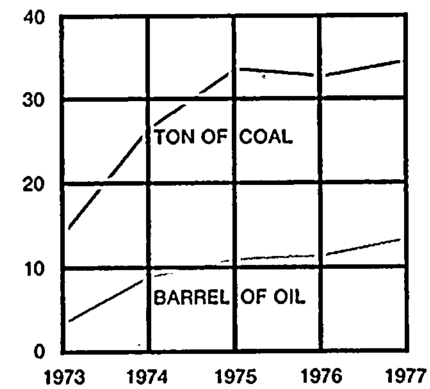
AVERAGE GROSS ELECTRIC UTILITY PLANT PER ELECTRIC CUSTOMER

Dollars



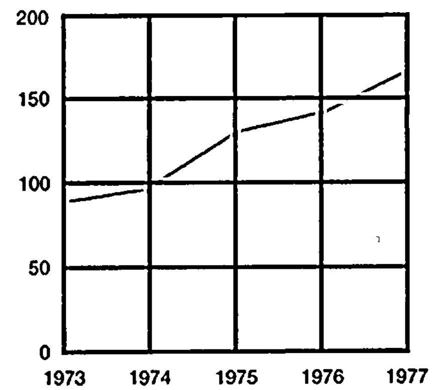
AVERAGE COST OF FUEL BURNED

Dollars



TOTAL TAXES, INCLUDING INCOME TAXES

Millions of dollars



Unending responsibility

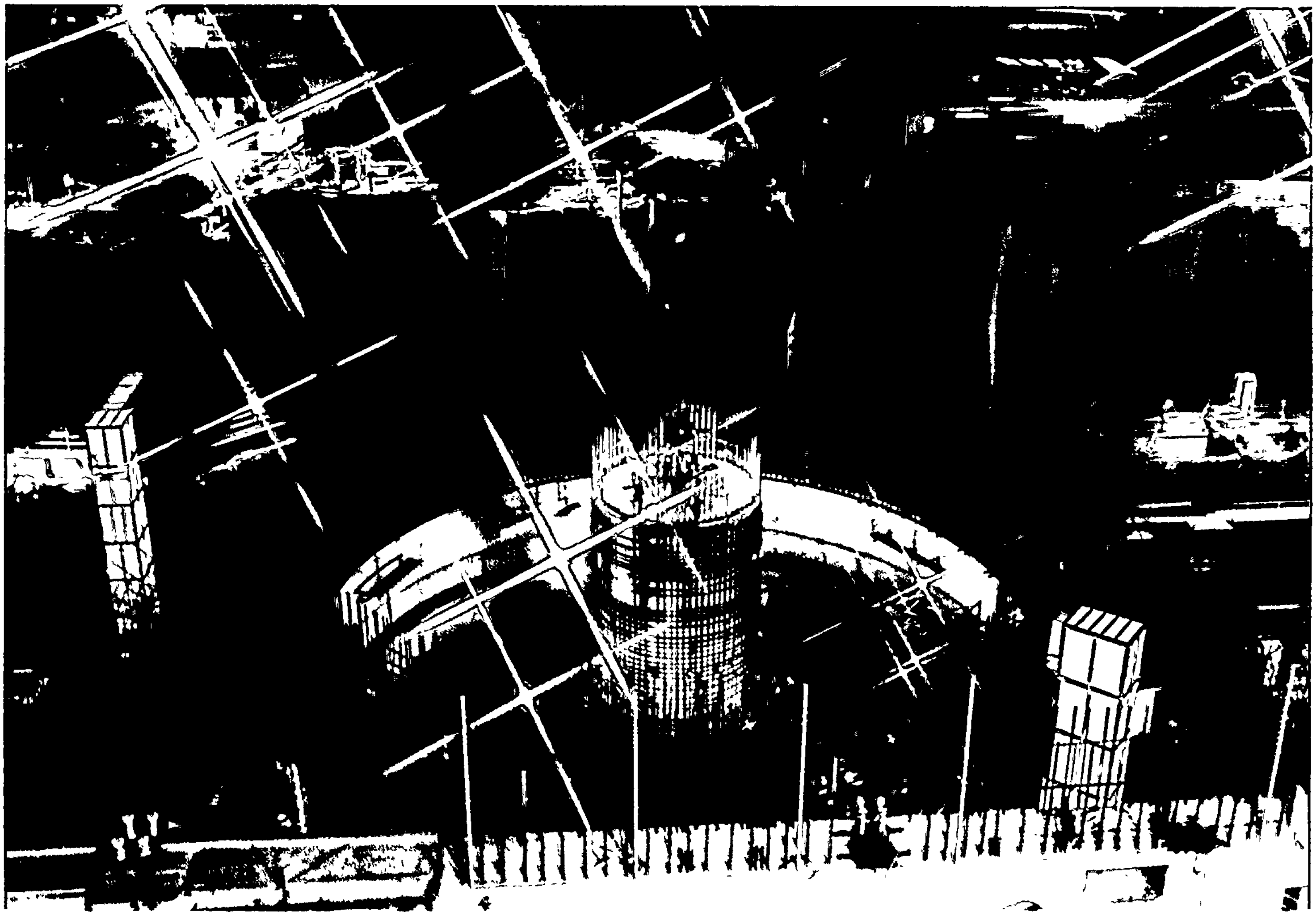
Construction by Niagara Mohawk of major new power plants to keep pace with long-term future electric needs is enmeshed with the economic activity of the entire upstate New York community. Building these massive generating projects, along with related transmission and other necessary energy installations, entails billions of dollars for payroll, taxes, materials and equipment. All give a needed assist to employment conditions by creating thousands of construction and supplier jobs in our service area.

At the site of Unit No. 2 at Nine Mile Point Nuclear Station on Lake Ontario, nearly 2,000 construction workers, representing dozens of trades, kept the 1,080,000-kilowatt installation moving towards its targeted 1983 completion. Over its nine-year construction period, the unit will produce a total payroll exceeding $300,000,000. Total cost is some $1 billion, excluding financing costs. NM's share is $418,000,000.

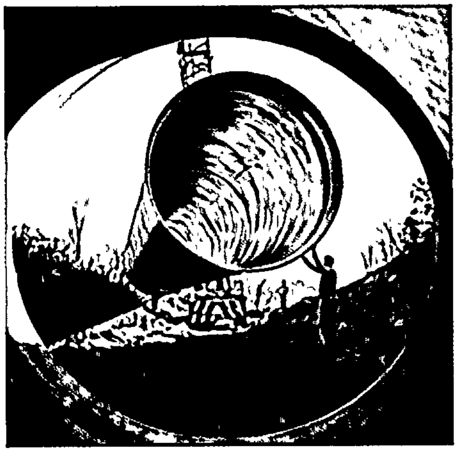
Just six miles west of Nine Mile Point, progress also continued on the new 850,000-kilowatt Unit No. 6 at Oswego Steam Station, more than 62% completed at the end of 1977. Some 650 construction workers were employed at the oil-fired facility's site. The addition, requiring seven years to build, will boost station capacity to a total 2,075,000 kilowatts, some five times its original output. Scheduled for startup in late 1979, the unit will cost an estimated $253,000,000, excluding financing. NM's share is $188,000,000. It will include a total construction payroll of some $100,000,000.

Near Lake Erie, south of Dunkirk, we are planning a 1,700,000-kilowatt coal-fired generating station that will employ 2,500 during peak construction. So far, NM has spent some $11 million for environmental hearings concerning the project. The data was submitted to the New York State Board on Electric Generation Siting and the Environment and we anticipate a decision in late 1978. During this major power plant's six-year construction period, workers will be paid an estimated $570,000,000.

In 1977, the Company announced plans for a hydroelectric expansion program to add 205,000 kilowatts to our power system. Included are three altogether new site developments and enlargement of 12 existing hydro stations, with more than 70% of the new capacity planned for the upper Hudson River Basin, the remainder from seven other rivers



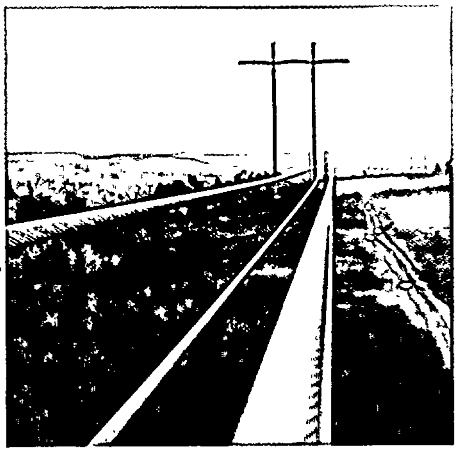
and streams in northern and central New York. In early 1978, the first application will be filed with the Federal Energy Regulatory Commission and other state and federal agencies. This work, to continue through 1990 at a total cost of more than $200,000,000, will require a construction payroll estimated at $40,000,000, a welcome addition to the economies of northern communities in Niagara Mohawk's service territory.

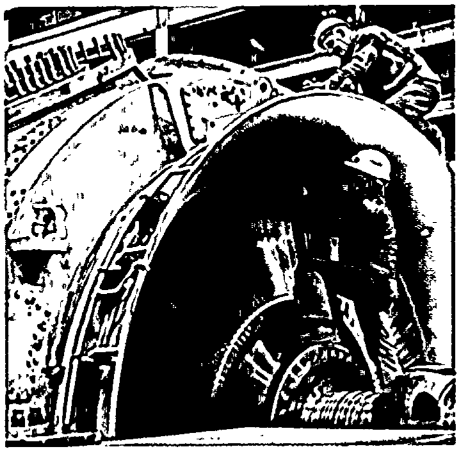


The year 1977 saw further action toward a proposal by NM, together with five other key New York utilities, to share ownership of large upstate power generating stations. Involved are Oswego Unit No. 6, Nine Mile Point Unit No. 2 and a 1,150,000-kilowatt nuclear station planned at Sterling on Lake Ontario by Rochester Gas & Electric Corp. Late in 1977 Sterling was certified by the New York State Board on Electric Generation Siting and the Environment. This ownership sharing is intended to help pave the way for Empire State Power Resources, Inc. (ESPRI) a statewide utility to be responsible for future construction and operation of base-load generating stations needed to supply the load growth of all investor-owned utilities in New York State. ESPRI, pending approval by regulatory agencies, features many financial and operating advantages and will reduce the financing requirements for its sponsoring utilities.

All of these generation plans will require expansion of transmission systems, with lines now on the drawing board or being installed to comply with scheduling of new units. During the year, three key NM transmission links, among more than 20 planned in our system for future years, were completed at an expenditure of more than $50,000,000.

The year also saw formation of a new System Project Management Department, directly responsible for timely execution of all key construction activities.





Building to meet future energy requirements—with night scene of construction at Nine Mile Point Unit No. 2, left, views of penstock pipe being installed at NM hydroelectric plant, transmission line with "gull wing" supports near Utica and work on turbine at Oswego Steam Station Unit No. 6. Our construction budget for 1978 is $215.9 million.

Quest—creative technology

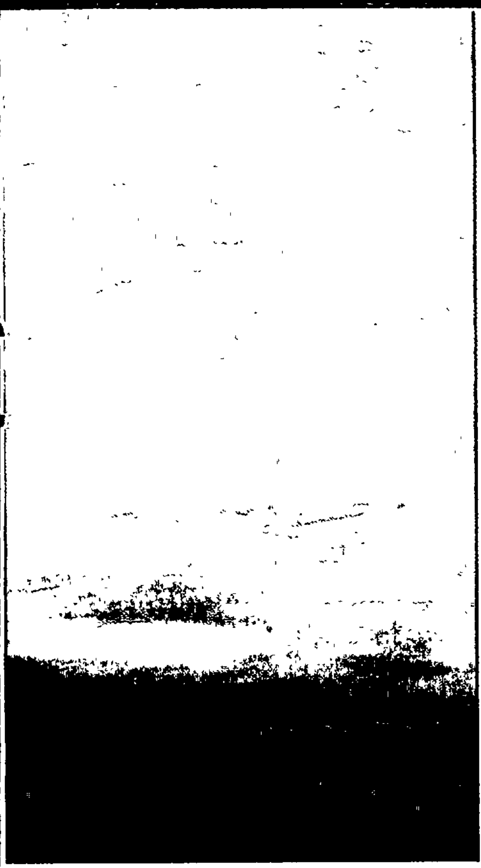
Our Company looks more and more toward research to help us clear today's critical energy hurdles. Alternate energy sources, new methods of stabilizing basic fuel supplies and development of better ways to improve the environment are primary aims.

We introduced formal research into NM's corporate structure more than six years ago in the firm belief that it will help chart a course to self-sufficiency. For us, and the entire utility industry, elimination of vulnerability to any fuel supply problems that could impede production of electric energy is paramount. Our research work focuses on near-term projects designed to meet these goals.

NM's Research Department has developed into a mature organization with a professional staff experienced in research and energy-related areas. Our research budget has grown from $456,000 in 1971 to almost $9,000,000 in 1977, with $76,000,000 the estimated total for the next five years.

In 1977, a breakthrough in our hunt for alternate energy possibilities was achieved when tests of a 1,000-kilowatt fuel cell proved highly successful. Since 1973—in a contract with United Technologies Corp. and eight other leading utilities—NM has been striving to develop a commercially viable 26,000-kilowatt fuel cell power unit. This effort, an extension of fuel cell technology originally applied in U.S. space missions, concentrates on development of modified cells to use coal-derived fuels. Studies indicate that large-scale introduction of the battery-like devices throughout our electric system could ultimately bring marked improvement in total utilization of the complete power system and significant reduction in the consumption of critical fuels used to generate power. Moreover, the quiet, pollution-free units have low maintenance requirements. By early 1980, two 4,800-kilowatt prototypes will be constructed and field-tested by utilities. A 9,600-kilowatt unit is targeted for our system by 1981. The 1977 tests confirm the fuel cell as the most significant advance in electric generation technology since the introduction of nuclear energy.

Another important NM research project, aimed at enabling power plants to burn lower cost Eastern coal while producing much less waste compared with other methods, is also being watched nationwide. This involves installation of a pilot "scrubber" on the stack at our Huntley Steam Station near Buffalo to demonstrate the ability to control sulfur dioxide (SO_2) emissions. The regional research organization, Empire State Electric Energy Research Corp. (ESEERCO) is sponsoring the project. ESEERCO is making design studies with Atomics International of Los Angeles and the U.S. Environ-



mental Protection Agency. The target, a commercial system for SO_2 removal that will save mineral resources, also entails simplified waste disposal facilities which will recover marketable sulfur. The Huntley demonstrator is scheduled to go on line in 1980.

To foster conservation of natural resources, NM is pursuing many other advanced technologies which hold varying promise. Several wind power projects (including a pioneering turbine at a customer's farm and plans for windmills at a hydroelectric site) were launched in 1977. For five years we have been directly involved with leading manufacturers in heat pump research efforts costing over $2,000,000, with an eye toward making advanced high-performance heat pumps available for northern climates by 1980.

Solar energy for residential and commercial heating is under intensive study by NM and other research parties at an alumni house and conference center at the State University of New York in Albany. There, we will obtain valuable data on the feasibility of combining energy from

the sun with basic power from our utility system.

Other research work by the Company in 1977 focused on management of electric load, transmission losses, customer energy conservation, as well as improved air, land and water preservation. Participation in these and additional research efforts involves the leadership and teamwork of Niagara Mohawk's scientists, engineers and technologists, along with colleagues in government and industry.

Our determination to find more effective methods of producing energy and preserving the environment takes us from the vastness of a Northern New York sunset to the microrealm of a slide specimen. At far left, tri-bladed propeller of 15-kilowatt wind research prototype turns quietly above farmer cutting hay. Rooftop collectors reflect particular purpose in NM-aided solar research program at Albany, while algae sample is readied for microscope analysis in laboratory near Lake Ontario. Vineyard study is devoted to quality of grape industry near NM-proposed power plant site on Lake Erie. Over next five years, we will spend more than $76 million on energy research, most of it interlocked with air, water and land concerns.

Mission to serve

In a unique step to gain a candid flow of information and attitudes from the customer's side of our business, NM formed a Consumer Advisory Council in 1977.

Representing all walks of life in our 13 operating areas, the Council's 26 volunteers meet with NM executives monthly for discussions of Company policies and procedures. Their frankness, advice and suggestions have already proved helpful in our efforts to further refine service and improve communications with our customers. The group, one of the few formed to advise a principal U.S. utility, consists of housewives, retirees, social workers, clergy, business executives, consumer advocates and minorities. Members, all community leaders in their occupations or fields of interest, participate in the Council on their own time. None are stockholders or related to NM employees. In less than a year since its formation, the Council has become recognized as our consumer "sounding board," enabling NM to know more about what consumers are thinking of us and to better understand their needs.

At year's end, NM employees numbered 9,200, an increase of 300 over year end 1976. In June 1977, the second year of a two-year contract between NM and the International Brotherhood of Electrical Workers (AFL-CIO) began and included an 8.3% general wage increase for represented employees.

The Company contributed about $2,662,000 to our Employee Savings Fund Plan in 1977. Some 6,200 or 73% of all eligible employees are subscribers, allocating from 2% to 6% of their wages (matched 50% by the Company) toward purchase of NM common stock or U.S. Government securities. Of those participating, 98% invest in stock. The plan holds 4,524,000 shares or 8% of the outstanding common shares. Employees may also voluntarily make additional, unmatched contributions of up to 4% of their wages.

NM stockholders now number about 210,000, with 196,000 holding common shares and 14,000 owning preferred. Stockholders live in all 50 states and 40 foreign countries, with 71,000 residing in New York and holding 51% of the total shares. Most shares are held for long-term investment. A large number of common stockholders (61,000) hold less than 100 shares.

Size of holding (Shares)	Total stockholders	Total shares held
1 to 99	61,000	2,090,439
100 to 999 ...	129,000	28,763,713
1,000 or more	6,000	26,268,489
	196,000	57,122,641

Our Dividend Reinvestment and Stock Purchase Plan continues to grow in popularity each year. It allows purchase of newly issued stock directly from the Company and optional payments for purchase of additional common shares without brokerage commissions or service charges. This helps to provide NM with funds to meet required financing. In 1977, about 22,000 participating stockholders invested $8,192,000 for purchase of additional common shares. Representing 11% of all common stockholders, they reinvested $5,006,000 of dividends, adding $3,186,000 in optional payments.

NM's Stockholder Records Department in Syracuse or Morgan Guaranty Trust Company of New York, Dividend Reinvestment Plan (P.O. Box 3506, Church Street Station, New York, NY 10008) will be glad to provide application forms and literature describing the reinvestment program upon request.

We note with regret the death on October 16, 1977 of Dean P. Taylor, who served on our Board of Directors since January 1961. Former Congressman Taylor retired from the U.S. House of Representatives in 1960 after nine terms of distinguished service.

Consolidated Statement of Income and Retained Earnings

NIAGARA MOHAWK POWER CORPORATION AND SUBSIDIARIES

For the year ended December 31,	1977	1976	1975	1974	1973
	In thousands of dollars				
Operating revenues:					
Electric	$ 987,760	$ 863,012	$795,917	$671,246	$534,559
Gas	238,072	214,218	176,289	159,564	136,798
	1,225,832	1,077,230	972,206	830,810	671,357
Operating expenses:					
Operation:					
Fuel for electric generation	311,185	241,040	223,095	136,983	82,523
Electricity purchased	93,019	99,297	86,533	122,476	93,650
Gas purchased	142,071	124,811	94,960	86,900	70,770
Other operation expenses	166,297	152,759	136,470	127,100	115,223
Maintenance	84,536	66,171	58,724	59,753	54,885
Depreciation *(Note 2)*	77,113	77,629	69,228	63,055	59,181
Federal and Canadian income taxes *(Note 12)*	22,124	17,896	14,630	(4,050)	(2,571)
Other taxes	148,989	131,817	113,997	102,248	92,556
	1,045,334	911,420	797,637	694,465	566,217
Operating income	180,498	165,810	174,569	136,345	105,140
Other income and deductions:					
Allowance for funds used during construction *(Note 1)*	—	20,711	29,376	27,373	18,836
Allowance for other funds used during construction *(Note 1)*	21,660	—	—	—	—
Income tax refunds *(Note 12)*	—	8,986	—	—	—
Other (net)	3,645	1,251	2,153	528	(133)
	25,305	30,948	31,529	27,901	18,703
Income before interest charges	205,803	196,758	206,098	164,246	123,843
Interest charges:					
Interest on long-term debt	91,563	87,270	84,018	66,080	54,761
Other interest	2,892	1,039	7,285	11,659	5,979
Allowance for borrowed funds used during construction *(Note 1)*	(12,484)	—	—	—	—
	81,971	88,309	91,303	77,739	60,740
Income before cumulative effect of accounting change	123,832	108,449	114,795	86,507	63,103
Cumulative effect of accounting change *(Note 3)*	—	—	—	9,406	—
Net income *(Note 3)*	123,832	108,449	114,795	95,913	63,103
Dividends on preferred stock	25,705	23,546	19,430	15,082	12,872
Balance available for common stock	98,127	84,903	95,365	80,831	50,231
Dividends on common stock	74,033	65,642	56,590	49,444	41,409
Retained earnings for the year	24,094	19,261	38,775	31,387	8,822
Retained earnings at beginning of year	313,740	294,479	255,704	224,317	215,495
Retained earnings at end of year	$ 337,834	$ 313,740	$294,479	$255,704	$224,317
Average number of shares of common stock outstanding	56,278,556	52,731,329	47,089,331	42,032,244	36,170,326
Per average share of common stock:					
Balance available for common stock before cumulative effect of accounting change	$ 1.74	$ 1.61	$ 2.03	$ 1.70	$ 1.39
Cumulative effect of accounting change *(Note 3)*	—	—	—	$ .22	—
Balance available for common stock *(Note 3)*	$ 1.74	$ 1.61	$ 2.03	$ 1.92	$ 1.39
Dividends paid	$ 1.31½	$ 1.24	$ 1.21	$ 1.18	$ 1.15
Pro forma amounts reflecting the consistent application of the change to energy deferral accounting *(Note 3):*					
Balance available for common stock	—	—	—	$71,425	$56,787
Per average share of common stock	—	—	—	$ 1.70	$ 1.57

( ) Denotes deduction.

Consolidated Balance Sheet

NIAGARA MOHAWK POWER CORPORATION AND SUBSIDIARIES

At December 31,	In thousands of dollars 1977	1976
ASSETS		
Utility plant, at original cost *(Notes 4 and 5 and Page 20)*	$3,553,560	$3,304,072
Less accumulated depreciation *(Note 2)*	841,498	780,799
	2,712,062	2,523,273
Other property and investments	15,584	17,858
Current assets:		
Cash *(Note 6)*	6,579	7,054
Accounts receivable (less allowance for doubtful accounts of $1,500,000 and $1,300,000, respectively)	121,855	116,605
Income tax refund claims *(Note 12)*	8,391	7,038
Materials and supplies, at average cost:		
Coal and oil for production of electricity	79,942	66,925
Other	26,367	24,877
Prepayments	5,152	4,448
	248,286	226,947
Deferred debits:		
Unamortized debt expense	14,375	13,803
Deferred recoverable energy costs *(Note 3)*	24,951	29,605
Other	3,796	4,814
	43,122	48,222
	$3,019,054	$2,816,300

	1977	1976
LIABILITIES		
Capitalization:		
Common stockholders' equity:		
Common stock—$1 par value; authorized 65,000,000 shares; issued 57,122,641 shares and 55,751,330 shares, respectively *(Note 8)*	$ 57,123	$ 55,751
Premium on capital stock *(Note 8)*	581,473	561,323
Capital stock expense *(Note 8)*	(8,194)	(8,079)
Retained earnings *(Page 13)*	337,834	313,740
	968,236	922,735
Cumulative preferred stock *(Note 8 and Page 21)*	366,400	368,200
Cumulative preference stock—$25 par value; authorized 4,000,000 shares; issued—none *(Note 8)*	—	—
Long-term debt *(Page 20)*	1,394,387	1,268,269
Total capitalization	2,729,023	2,559,204
Current liabilities:		
Notes payable and commercial paper *(Note 6)*	39,200	40,750
Long-term debt due within one year *(Page 20)*	10,250	—
Sinking fund requirements on preferred stock *(Page 21)*	1,800	1,800
Accounts payable	79,031	78,030
Customers' deposits	4,734	4,147
Accrued taxes	18,680	13,853
Accrued interest	27,760	23,270
Accrued vacation pay	11,757	10,110
Other	6,320	6,116
	199,532	178,076
Deferred credits:		
Income tax refunds *(Note 12)*	19,721	19,421
Other	9,106	11,260
	28,827	30,681
Accumulated deferred federal income taxes *(Note 12)*	61,672	48,339
Commitments *(Note 10)*	—	—
	$3,019,054	$2,816,300

( ) Denotes deduction.

Consolidated Statement of Changes in Financial Position

NIAGARA MOHAWK POWER CORPORATION AND SUBSIDIARIES

			In thousands of dollars			
For the year ended December 31,	1977	1976	1975	1974	1973	Total
Financial resources were provided by:						
Operations:						
Income before cumulative effect of accounting change	$123,832	$108,449	$ 114,795	$ 86,507	$ 63,103	$ 496,686
Charges (credits) to income not requiring (not providing) working capital—						
Depreciation	77,113	77,629	69,228	63,055	59,181	346,206
Allowance for funds used during construction	(34,144)	(20,711)	(29,376)	(27,373)	(18,836)	(130,440)
Amortization of nuclear fuel	21,458	22,555	11,481	10,665	10,788	76,947
Provision for deferred Federal income taxes (net)	13,333	14,628	11,800	(280)	3,359	42,840
	201,592	202,550	177,928	132,574	117,595	832,239
Cumulative effect of accounting change	—	—	—	9,406	—	9,406
Outside financing:						
Sale of common stock	21,522	70,105	72,557	29,964	88,005	282,153
Sale of preferred stock	—	30,000	70,000	—	60,000	160,000
Sale of mortgage bonds	125,000	—	100,000	125,000	80,000	430,000
Sale of promissory note (net)	2,338	5,671	10,839	27,752	—	46,600
Issuance of long-term notes payable	15,000	18,000	—	—	—	33,000
Increase (decrease) in notes payable	(1,550)	(8,114)	(117,786)	129,300	(9,850)	(8,000)
	162,310	115,662	135,610	312,016	218,155	943,753
Other sources:						
Deferred recoverable energy costs	4,654	8,785	(591)	(37,799)	—	(24,951)
Income tax refunds	300	(8,686)	1,241	26,866	—	19,721
(Increase) decrease in working capital other than notes payable	1,667	30,465	(122,388)	(12,727)	28,359	(74,624)
Miscellaneous (net)	52	4,203	7,592	6,031	5,649	23,527
	6,673	34,767	(114,146)	(17,629)	34,008	(56,327)
Total resources provided	$370,575	$352,979	$ 199,392	$436,367	$369,758	$1,729,071
Financial resources were used for:						
Construction additions	$264,913	$195,676	$ 194,155	$283,844	$278,941	$1,217,529
Nuclear fuel	25,018	87,026	11,959	11,503	7,372	142,878
Allowance for funds used during construction	(34,144)	(20,711)	(29,376)	(27,373)	(18,836)	(130,440)
Construction costs relating to sharing of generating plants *(Note 7)*	—	—	(53,366)	—	—	(53,366)
Net additions	255,787	261,991	123,372	267,974	267,477	1,176,601
Long-term debt due within one year	10,250	—	—	103,867	48,000	162,117
Mortgage bonds retired	3,000	—	—	—	—	3,000
Sinking fund requirements on preferred stock	1,800	1,800	—	—	—	3,600
Dividends	99,738	89,188	76,020	64,526	54,281	383,753
Total resources used	$370,575	$352,979	$ 199,392	$436,367	$369,758	$1,729,071
(Increase) decrease in working capital other than notes payable:						
Cash	$ 475	$ 13,620	$ (3,067)	$ (4,431)	$ (1,856)	$ 4,741
Accounts receivable	(5,250)	(11,041)	(16,310)	(19,505)	(12,936)	(65,042)
Receivable from plant sharing	—	12,402	(12,402)	—	—	—
Income tax refund claims	(1,353)	(300)	15,639	(16,977)	(5,400)	(8,391)
Coal and oil for production of electricity	(13,017)	(15,433)	(626)	(33,483)	(2,954)	(65,513)
Other materials and supplies	(1,490)	1,193	1,213	(10,124)	(2,420)	(11,628)
Long-term debt due within one year	10,250	—	(103,867)	55,867	48,000	10,250
Sinking fund requirements on preferred stock	—	1,800	—	—	—	1,800
Accounts payable	1,001	18,982	(855)	9,644	615	29,387
Accrued taxes and interest	9,317	6,205	2,435	4,609	638	23,204
Other (net)	1,734	3,037	(4,548)	1,673	4,672	6,568
	$ 1,667	$ 30,465	$(122,388)	$ (12,727)	$ 28,359	$ (74,624)

Notes to Consolidated Financial Statements

NOTE 1. Summary of Significant Accounting Policies

The Company is subject to regulation by the New York State Public Service Commission (PSC) and the Federal Energy Regulatory Commission (FERC) with respect to its rates for service and the maintenance of its accounting records. The Company's accounting policies conform to generally accepted accounting principles as applied in the case of regulated New York public utilities to give effect to the ratemaking and accounting practices and policies of the PSC.

Utility Plant: The cost of additions to utility plant and of replacements of retirement units of property is capitalized. Cost includes direct material, labor and similar items and charges for such indirect costs as engineering, supervision, payroll taxes, pension benefits, etc. The Company capitalizes an allowance for funds used during construction (AFC) equivalent to the cost of funds devoted to plant under construction (8% for the period January 1, 1973 through June 30, 1976 and 9% effective July 1, 1976). As a result of a rate proceeding, effective December 1, 1976, the Company began computing AFC on its Oswego Steam Station Unit #6 and Nine Mile Point Nuclear Station Unit #2 at a rate which is reduced to reflect the income tax effect of the interest portion of AFC.

Effective January 1, 1977, the FERC issued an order revising its accounting procedures for determination of the rate for computing AFC and requiring segregation of AFC into its two component parts, borrowed funds and other funds. The revision did not have any effect on income in 1977. The Company, since January 1, 1977, has reflected the borrowed funds component in the Interest Charges section of the income statement. The Company has not reclassified AFC into its borrowed and other funds components for periods prior to January 1, 1977 since, prior to 1977, rates were not required to be separately determined for the cost of borrowed funds and the cost of other funds. Therefore, the Company believes that such reclassification would be inappropriate since the allocation between the borrowed and other components for prior periods would not be comparable to the components of AFC determined subsequent to December 31, 1976, by using the FERC formula.

The cost of current repairs and maintenance is charged to expense. Whenever utility plant is retired, the original cost of such utility plant, together with the cost of removal, less salvage, is charged to accumulated depreciation.

Depreciation: For general accounting purposes, depreciation of utility plant is computed on the straight-line basis using the estimated useful lives by classes of depreciable property. For Federal income tax purposes, the Company computes depreciation using accelerated methods and shorter allowable depreciable lives.

Amortization of Nuclear Fuel and Nuclear Generating Plant Decommissioning Costs: The cost of nuclear fuel plus estimated reprocessing and storage costs is charged to operating expenses on the basis of the quantity of heat produced for the generation of electric energy. These costs, which are net of an estimated residual value of uranium to be recovered at the time of reprocessing, are charged to customers through base rates or through the fuel adjustment clause. Events during 1977 and recently proposed federal action could result in the abandonment of reprocessing plans since there is no reprocessing facility presently in operation and it has been proposed that reprocessing be deferred indefinitely. The Company believes that under either its reprocessing assumption or an alternative storage assumption similar to that recently proposed by the Department of Energy, costs would be approximately equal. The Company believes that nuclear fuel reprocessing or storage costs, which may be higher than presently estimated, will continue to be allowed to be recovered in the rate process, although no such assurance can be given.

Estimated decommissioning costs (costs to take the plant out of service in the future) of the Company's Nine Mile Point Unit #1 nuclear generating plant are presently not charged to current operations and, therefore, not recognized in rates charged to customers. As part of a pending rate filing, the Company has before the PSC a request for a cost allowance designed to recognize such decommissioning costs. Because of many uncertainties, there is no assurance that such additional revenues, if any, as might be provided by this allowance would aggregate a sufficient amount to decommission the plant. The Company believes that nuclear generating plant decommissioning costs, which may be higher than now estimated, will ultimately be allowed to be recovered in the rate process, although no such assurance can be given.

Revenues: Revenues are based on cycle billings rendered to certain customers monthly and others bi-monthly. The Company does not accrue revenues at the end of any fiscal period in respect of energy sold but not billed at such date as a result of this cycle billing method. The Company's tariffs include electric and gas adjustment clauses under which energy and purchased gas costs, respectively, above or below the levels allowed in approved rate schedules are billed or credited to customers. Effective January 1, 1974, the Company adopted the policy of charging operations for energy cost increases in the period of recovery (see Note 3). Effective September 1, 1975, the Company began deferring similar purchased gas costs as directed by the PSC, which change did not have a material effect on income.

Federal Income Taxes: The general policy, in accordance with PSC requirements, is to flow-through the effect of accounting-tax differences; that is, record only income taxes currently payable. However, deferred taxes are provided on the additional depreciation charges, resulting from using shorter depreciable tax lives, the interest portion of AFC on certain plants (as discussed above) and certain other items as approved by the PSC. Effective as of January 1, 1975, the benefits resulting from a temporary increase in the investment tax credit from 4% to 10% and from the temporary change in the limitation on the amount of credit which may be claimed in any year have been deferred. Other than for these increased benefits, investment tax credits are applied currently as a reduction of taxes. No deferred taxes are provided for other depreciation differences, except under necessity certificates in prior years, or for other expenditures (principally other AFC, taxes, pensions and certain other employee benefits) which are deducted currently for tax purposes but are capitalized for accounting purposes.

Pension Plans: The cost of pension plans is based upon current costs, amortization of unfunded past service benefits over periods ranging from 25 to 40 years and amortization over 15 years of unfunded past service benefits arising from plan amendments since inception.

NOTE 2. Depreciation

The percentage relationship between the total provision for depreciation and average depreciable property was 2.70% in 1977, 2.84% in 1976, 2.84% in 1975, 2.83% in 1974 and 2.83% in 1973. The Company makes depreciation studies on a continuing basis and adjusts the rates of its various classes of depreciable property, subject to PSC approval, when considered appropriate. Effective December 1, 1976, consistent with a PSC rate decision in November 1976, electric depreciation provisions were modified resulting in a reduction in depreciation expense of $4,300,000 for the year 1977.

NOTE 3. Accounting Change

Effective January 1, 1974, as permitted by a PSC policy statement, the Company changed its accounting for the increased energy costs above or below the levels allowed in approved rate schedules to defer those costs until the time they are billed to customers, thus achieving a better matching of revenue and expense. This accounting change, net of deferred income taxes of $3,170,000, resulted in an increase in net income for 1974 of $34,629,000 ($.82 per share), of which $25,223,000 ($.60 per share) was credited to income before cumulative effect of accounting change and $9,406,000 ($.22 per share), net of deferred income taxes of $400,000, represented the cumulative effect to January 1, 1974 of the accounting change. Effective March 1975, the PSC required the Company to make changes in its electric adjustment clause. As a result, approximately $31,000,000 of then unrecovered deferred energy costs are being recovered through the electric adjustment clause over a period of 36 months.

NOTE 4. N M Uranium, Inc.

During 1976, through a newly created wholly-owned subsidiary, N M Uranium, Inc., the Company purchased a 50 percent undivided interest in uranium deposits and associated mining equipment for approximately $52,500,000 consisting of $34,500,000 cash and $18,000,000 in 7¾% notes payable guaranteed by the Company (see page 20). The acquisition of this interest was made to provide a more assured future supply of nuclear fuel for the Nine Mile Point Nuclear Stations. The net assets, including costs incurred since acquisition of the subsidiary, have been included in Utility Plant in the consolidated financial statements.

NOTE 5. Replacement Cost (Unaudited)

Because of inflation, the cost of replacing the Company's plant in service today would exceed the amounts actually spent for such facilities and reported in the Company's financial statements. The Company believes that any higher replacement costs it may experience will be recovered through the normal regulatory process. The Company has computed the replacement cost data in accordance with Securities and Exchange Commission requirements and such data are reported in its Form 10-K.

NOTE 6. Lines of Credit and Compensating Balances

At December 31, 1977, the Company had available bank lines of credit aggregating $124,500,000 which are renewable on an annual basis. The banks have the option of terminating $69,500,000 of the lines at any time. In addition, the Company has a $50,000,000 Acceptance Facility Agreement expiring May 31, 1978, which may be used to finance the seasonal build-up of fuel oil inventory at one of its major generating locations. Substantially all short-term borrowings are made at the prevailing prime interest rate for each respective lender.

With respect to most of its lines of credit, the Company maintains compensating balances which are averaged over time. At December 31, 1977, approximately $1,000,000 of cash represented compensating balances.

NOTE 7. Sharing of Generating Plants

During 1975, the Company sold a 24% interest in the ownership of Unit #6 under construction at its Oswego Steam Station and a 59% interest in the ownership of Unit #2 under construction at its Nine Mile Point Nuclear Station for approximately $53,366,000. The Company also acquired a 22% interest in the ownership of Rochester Gas and Electric Corporation's proposed Sterling Nuclear Station for an initial investment of approximately $4,337,000.

NOTE 8. Capital Stock

On May 7, 1976, by an amendment to the Certificate of Incorporation, each authorized but unissued share of preferred stock and preference stock was changed into four shares with a par value of $25 each. Premium on capital stock increased $20,150,000 in 1977 and $64,738,000 in 1976 from the sale of 1,371,311 and 5,367,766 shares of common stock, respectively. As a result of the foregoing and the issuance of 1,200,000 shares of preferred stock in 1976, capital stock expense increased $115,000 and $390,000 in 1977 and 1976, respectively.

In January 1978, the Company, through a private placement, will sell 1,600,000 shares of preferred stock, 8⅜% series for $40,000,000.

NOTE 9. Pension Plans

The Company and its subsidiaries have non-contributory pension plans covering substantially all their employees. The total pension cost was $22,489,000 for 1977, $20,762,000 for 1976, $18,825,000 for 1975, $15,589,000 for 1974 and $13,947,000 for 1973 (of which $4,668,000 for 1977, $3,878,000 for 1976, $3,344,000 for 1975, $3,755,000 for 1974 and $3,565,000 for 1973, are included in construction costs).

The Company's policy is to fund pension costs accrued. Preliminary studies indicate that the estimated amount of vested benefits at December 31, 1977 exceeded the net assets of the funds by approximately $83,000,000.

Amendments to the Company's pension plan resulting from the Employee Retirement Income Security Act of 1974 and periodic collective bargaining agreements did not have a significant effect on the Company's annual contribution to the fund or on unfunded vested benefits.

NOTE 10. Commitments

The Company presently estimates that the construction program for the years 1978 through 1980 will require over $716,000,000, excluding AFC and certain overheads capitalized. At December 31, 1977 substantial construction commitments exist, including those for the Company's share of Unit #2 at Nine Mile Point Nuclear Station, Unit #6 at Oswego Steam Station and the Sterling Nuclear Station.

NOTE 11. Information Regarding the Electric and Gas Businesses

The Company is engaged in the electric and gas utility businesses. Certain information regarding these segments for the year ended December 31, 1977 is set forth below. General corporate expenses, property common to both segments and depreciation of such common property have been allocated to the segments in accordance with practices established for regulatory purposes. Corporate assets consist of other property and investments, cash, accounts receivable, income tax refund claims, prepayments, unamortized debt expense and other deferred debits.

	In thousands of dollars		
	ELECTRIC	GAS	TOTAL
Operating revenues	$ 987,760	$238,072	$1,225,832
Operating expenses			
Depreciation	68,400	8,713	77,113
Other, excluding income taxes	742,541	203,556	946,097
Total	810,941	212,269	1,023,210
Operating income before income taxes ...	176,819	25,803	202,622
AFC	33,991	153	34,144
Pretax operating income, including AFC	$ 210,810	$ 25,956	236,766
Income taxes			22,124
Other income and deductions, net			3,645
Interest charges			94,455
Net income			$ 123,832
Construction expenditures (including nuclear fuel)	$ 277,828	$ 12,103	$ 289,931
Identifiable assets:			
Utility plant, net	$2,428,623	$283,439	$2,712,062
Material and supplies ..	104,653	1,656	106,309
Deferred recoverable energy costs	19,170	5,781	24,951
Corporate assets			175,732
Total assets			$3,019,054

The Company provides electric and gas service to approximately 15,000 federal, state and local governmental agency locations. During the year ended December 31, 1977, approximately $122,000,000 of revenue was received from these agencies.

Pretax operating income, including AFC, was $180,077,000 electric, $24,340,000 gas for 1976; $197,788,000 electric, $20,787,000 gas for 1975; $143,947,000 electric, $15,721,000 gas for 1974 and $108,938,000 electric, $12,467,000 gas for 1973.

NOTE 12. Federal and Canadian Income Taxes

Income Tax Refunds: Operations for the years 1974 and 1973 include credits of $4,700,000 and $5,400,000, respectively, attributable to the carryback benefits of net operating tax losses.

The Company received refunds in 1974 and 1975 totaling $21,400,000, including interest, as a result of the retroactive adoption of "guideline" lives in computing tax depreciation for the years 1966 through 1968. In connection with the Internal Revenue Service audit for the year 1969, the Company has requested a deduction for "guideline" depreciation yielding a tax benefit of approximately $7,300,000, including interest, which has been recorded as a receivable.

The tax depreciation benefits and accrued interest were recorded in Deferred Credits at December 31, 1975 pending resolution of the proper accounting and ratemaking treatment, as discussed below. During 1975 the PSC issued an order directing the Company to refund to its customers approximately $12,400,000, which represents the 1966 to 1968 tax refunds and interest, reduced by the tax assessments and interest previously paid for such years, and an allowance for a retention by the Company. The Company sought by court review a rescission of the order. By decision dated April 28, 1976, the New York Supreme Court ruled that the PSC lacked statutory authority for its action and that its order must be annulled. The PSC appealed from the judgment and order entered thereon to the Appellate Division which, although issuing an opinion dated November 10, 1976 unanimously affirming such judgment and order, stated the PSC may consider "this acquired money when a future rate adjustment is requested."

In an Opinion and Order on the Company's rate proceeding, dated November 16, 1976, the PSC directed that the $12,400,000 "be treated as customer contributed capital with a zero cost." The PSC, however, reserved the right to treat such amount differently in a future rate proceeding contingent on the then prevailing circumstances. On August 4, 1977, the Appellate Division, after an appeal by the Company, affirmed the PSC's treatment. The Company on September 1, 1977 filed a petition for a reargument of the decision or alternatively, leave to appeal to the Court of Appeals. The petition was denied by the Court's decision dated October 14, 1977. Subsequently, the Company filed a motion with the New York State Court of Appeals for leave to appeal; the motion was denied January 17, 1978. Presently, the Company is considering what legal recourse it may pursue, if any.

The portion of the refunds and accrued interest for the years 1966 through 1968, previously included in Deferred Credits totaling approximately $9,000,000 ($.17 per share), that was no longer subject to a future contingency was credited to Other Income in 1976. The remaining tax depreciation benefits and accrued interest through December 31, 1977 approximating $19,700,000 are recorded in Deferred Credits. The PSC indicated it would consider the accounting and ratemaking treatment of the 1969 refund when received.

Net Operating Tax Loss: During 1977, 1976 and 1975 the Company utilized $300,000, $20,100,000 and $22,600,000, respectively, of the available net operating tax loss carryforward. There is no net operating tax loss carryforward at December 31, 1977.

Investment Tax Credits: The Company has deferred the benefit of investment tax credits approximating $6,800,000 ($.12 per share), $5,300,000 ($.10 per share) and $12,500,000 ($.27 per share) for the years ended December 31, 1977, 1976 and 1975, respectively, in accordance with the general policy as stated in Note 1.

The Company has unused credits at December 31, 1977 of approximately $39,900,000 which may be utilized to reduce future tax expense, of which $7,900,000 expires in 1981, $13,700,000 in 1982, $7,600,000 in 1983 and $10,700,000 in 1984.

Income Tax Assessment: In October 1972, the Company paid a net assessment of $16,800,000 of additional Federal income tax for the years 1957 through 1962 relating to the deductions taken for the loss of the Company's water rights at Niagara Falls terminated in connection with the redevelopment of Niagara power by the Power Authority of the State of New York. The Company has instituted suit for recovery of this amount.

Summary Analysis:	1977	1976	1975	1974	1973
	In thousands of dollars				
Components of Federal and Canadian income taxes					
Current tax expense:					
Federal	$ 434	—	—	$ (5,500)	$ (7,700)
Canadian	3,314	$ 2,550	$ 2,830	1,730	1,770
	3,748	2,550	2,830	(3,770)	(5,930)
Deferred Federal income tax expense	18,376	15,346	11,800	(280)	3,359
Income taxes included in operating expenses	22,124	17,896	14,630	(4,050)	(2,571)
Income taxes included in other income and deductions	(5,043)	(718)	—	—	—
Total	$17,081	$17,178	$14,630	$ (4,050)	$ (2,571)
Timing differences resulting in deferred Federal income taxes *(see Note 1)*					
Depreciation	$ 7,146	$ 6,223	$ 1,313	$ 985	$ 2,767
Cost of removal of property	245	566	(899)	(750)	1,292
Investment tax credit	6,766	5,313	12,523	—	—
Necessity certificates	(700)	(700)	(700)	(700)	(700)
Recoverable energy and purchased gas costs	69	3,650	(477)	2,770	—
Pension costs under the age retirement allowance plan	—	—	—	(2,585)	—
Other	4,850	294	40	—	—
	$18,376	$15,346	$11,800	$ (280)	$ 3,359
Reconciliation between Federal and Canadian income taxes and the tax computed at prevailing U.S. statutory rates (48%) on income before income taxes and cumulative effect of accounting change					
Computed tax	$67,638	$60,301	$62,124	$39,579	$29,056
Reduction attributable to flow-through of certain tax adjustments:					
Depreciation	19,703	19,741	20,123	16,602	14,186
Allowance for funds used during construction	16,389	9,942	14,100	13,426	8,745
Taxes, pensions and employee benefits capitalized for accounting purposes	7,071	5,731	7,920	7,112	4,336
Real estate taxes on an assessment date basis	1,042	2,813	3,035	4,415	2,373
Release of accrued Federal income taxes no longer required	—	—	—	800	2,300
Income tax refunds	619	4,313	—	—	—
Other	5,733	583	2,316	1,274	(313)
	50,557	43,123	47,494	43,629	31,627
Federal and Canadian income taxes	$17,081	$17,178	$14,630	$ (4,050)	$ (2,571)

NOTE 13. Quarterly Financial Data (Unaudited)

Operating revenues, operating income, net income and earnings per common share by quarters for 1977 and 1976 are shown in the following table. The Company, in its opinion, has included all adjustments (consisting only of normal recurring accruals, except for that portion of the income tax refunds included in Other Income in the quarter ended December 31, 1976 as described in Note 12) necessary for a fair statement of the results of operation for the quarters. Due to the seasonal nature of the utility business, the annual amounts are not generated evenly by quarter during the year.

Quarters ended	Operating revenues	Operating income	Net income	Earnings per common share
	In thousands of dollars			
December 31				
1977	$309,348	$38,100	$24,001	$.31
1976	$273,280	$36,271	$29,333	$.41
September 30				
1977	$282,209	$35,488	$21,409	$.27
1976	$228,556	$30,050	$13,619	$.15
June 30				
1977	$281,762	$42,647	$28,902	$.40
1976	$255,590	$41,970	$24,370	$.37
March 31				
1977	$352,513	$64,263	$49,520	$.77
1976	$319,804	$57,519	$41,127	$.70

Summary of Electric and Gas Utility Plant

At December 31,	1977	%	1976
	In thousands of dollars		
Utility plant:			
Electric plant	$2,625,797	74	$2,542,786
Nuclear fuel *(Note 4)*	82,170	2	78,610
Gas plant	341,010	10	333,882
Common plant	57,584	2	56,494
Construction work in progress	446,999	12	292,300
Total utility plant	$3,553,560	100	$3,304,072

Long-Term Debt

At December 31,	1977	1976
	In thousands of dollars	
First Mortgage Bonds:		
2¾% Series due January 1, 1980	$ 40,000	$ 40,000
2⅞% Series due October 1, 1980	40,000	40,000
12.6% Series due October 1, 1981	125,000	125,000
3⅜% Series due December 1, 1981	15,000	15,000
3½% Series due February 1, 1983	25,000	25,000
3¼% Series due October 1, 1983	40,000	40,000
3⅛% Series due August 1, 1984	25,000	25,000
10⅝% Series due September 1, 1985	47,000	50,000
3⅝% Series due May 1, 1986	30,000	30,000
4⅞% Series due September 1, 1987	50,000	50,000
3⅞% Series due June 1, 1988	50,000	50,000
4¾% Series due April 1, 1990	50,000	50,000
4½% Series due November 1, 1991	40,000	40,000
4⅝% Series due December 1, 1994	40,000	40,000
5⅞% Series due November 1, 1996	45,000	45,000
6¼% Series due August 1, 1997	40,000	40,000
6½% Series due August 1, 1998	60,000	60,000
9⅛% Series due December 1, 1999	75,000	75,000
7⅜% Series due February 1, 2001	65,000	65,000
7⅝% Series due February 1, 2002	80,000	80,000
7¾% Series due August 1, 2002	80,000	80,000
8¼% Series due December 1, 2003	80,000	80,000
10.2% Series due March 1, 2005	50,000	50,000
8.35% Series due August 1, 2007	75,000	—
8⅝% Series due December 1, 2007	50,000	—
Paul Smith's Electric Light & Power & Railroad Company First Mortgage Bonds:		
4½% Series due July 1, 1979	450	450
5½% Series due May 1, 1985	450	450
Promissory Note, 8% Series A due June 1, 2004	46,600	46,600
Notes payable:		
7¾% due in equal installments, November 1, 1978, 1979 and 1980 *(Note 4)*	18,000	18,000
Prime rate plus ½% (not to exceed 7½%) due in 24 equal quarterly installments commencing July 1, 1978	15,000	—
Unamortized premium	7,137	7,769
Total long-term debt	1,404,637	1,268,269
Less long-term debt due within one year	10,250	—
	$1,394,387	$1,268,269

Preferred Stock

Cumulative preferred stock, authorized 3,400,000 shares, $100 par value and 9,600,000 shares, $25 par value—

At December 31,	In thousands of dollars 1977	1976	Redemption price per share (Before adding accumulated dividends) December 31, 1977	Eventual Minimum
$100 Par Value				
3.40% Series; 200,000 shares ...	$ 20,000	$ 20,000	$103.50	$103.50
3.60% Series; 350,000 shares ...	35,000	35,000	104.85	104.85
3.90% Series; 240,000 shares ...	24,000	24,000	106.00	106.00
4.10% Series; 210,000 shares ...	21,000	21,000	102.00	102.00
4.85% Series; 250,000 shares ...	25,000	25,000	102.00	102.00
5.25% Series; 200,000 shares ...	20,000	20,000	102.00	102.00
6.10% Series; 250,000 shares ...	25,000	25,000	103.00	101.00
7.45% Series; 600,000 shares ...	58,200	60,000	106.49	100.00
7.72% Series; 400,000 shares ...	40,000	40,000	107.37	102.36
10.60% Series; 400,000 shares ...	40,000	40,000	110.60	102.65
11.75% Series; 300,000 shares ...	30,000	30,000	111.75	102.75
$25 Par Value				
9.75% Series; 1,200,000 shares .	30,000	30,000	27.31	25.00
Total preferred stock	368,200	370,000		
Less sinking fund requirements ...	1,800	1,800		
	$366,400	$368,200		

Certain of the Company's preferred stock series provide for a mandatory sinking fund for the annual redemption, at par, as follows:

		Number of shares	Beginning
$100 Par Value	7.45% Series	18,000	June 30, 1977
	10.60% Series	20,000	March 31, 1980
	11.75% Series	15,000	September 30, 1980
$25 Par Value	9.75% Series	66,000	October 1, 1980

These series also have optional sinking funds through which the Company may at its option redeem, at par, a like amount of additional shares (limited to a total of 120,000 shares for the 7.45% Series and 300,000 shares for the 9.75% Series).

Report of Independent Accountants

PRICE WATERHOUSE & CO.

Syracuse, New York
January 25, 1978

To the Stockholders and the Board of Directors
of Niagara Mohawk Power Corporation

We have examined the consolidated balance sheets of Niagara Mohawk Power Corporation and its subsidiaries as of December 31, 1977 and 1976 and the related consolidated statements of income and retained earnings and of changes in financial position for the five years ended December 31, 1977. Our examinations of these statements 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.

The Company, effective January 1, 1974, changed its accounting for increased energy costs to defer these costs until the time they are billed to customers as permitted by a New York State Public Service Commission policy statement as further discussed in Notes 1 and 3.

As discussed in Note 12, the Company has received or requested refunds of Federal income taxes for the years 1966 through 1969 as a result of the retroactive adoption of "guideline" lives in computing tax depreciation for such years. The accounting disposition of a part of the refunds for 1966 through 1968 and the refund to be received with respect to 1969 has been deferred pending possible court review of the New York State Public Service Commission treatment of the 1966 through 1968 refunds and receipt of the 1969 refund by the Company.

In our opinion, subject to the effect, if any, upon the financial statements of the matter referred to in the preceding paragraph, the consolidated financial statements examined by us present fairly the financial position of Niagara Mohawk Power Corporation and its subsidiaries at December 31, 1977 and 1976, and the results of their operations and the changes in their financial position for the five years ended December 31, 1977 in conformity with generally accepted accounting principles consistently applied during the period except for the change, with which we concur, referred to in the second paragraph of this report.

Price Waterhouse & Co.

Financial Statistics

Capitalization ratios:	1977	1976
Common stock equity	35.5%	36.0%
Preferred stock	13.4	14.4
Long-term debt	51.1	49.6
Ratio of earnings to fixed charges	2.49	2.35
Ratio of earnings to fixed charges and preferred stock dividends	1.90	1.82
Other ratios—% of operating revenues:		
Maintenance and depreciation	13.2	13.3
Taxes	14.0	13.9
Operating income	14.7	15.4
Balance available for common stock	8.0	7.9
Ratio of depreciation reserve to gross utility plant	23.7%	23.6%
Ratio of mortgage bonds to net utility plant	48.6%	47.4%

Electric Capability

		Thousands of kilowatts		
Thermal	At December 31,	1977	%	1976
Coal fuel				
Huntley, Niagara River		831	11	831
Dunkirk, Lake Erie		640	9	640
Total coal fuel		1,471	20	1,471
Residual oil fuel				
Albany, Hudson River		400	5	400
Oswego, Lake Ontario		1,225	17	1,025
Roseton, Hudson River		480	7	480
Middle distillate oil fuel				
20 Combustion turbine and diesel units		354	5	355
Total oil fuel		2,459	34	2,260
Nuclear fuel				
Nine Mile Point, Lake Ontario		610	8	610
Purchased—firm contract				
Power Authority—FitzPatrick, Lake Ontario		184	2	193
Total nuclear fuel		794	10	803
Total thermal sources		4,724	64	4,534
Hydro				
Owned and leased hydro stations (81 in 1977)		737	10	731
Purchased—firm contracts				
Power Authority—Niagara River		1,172	16	1,195
Power Authority—St. Lawrence River		115	2	115
Power Authority—Blenheim-Gilboa Pumped Storage Plant		550	7	550
Other		74	1	74
Total hydro sources		2,648	36	2,665
Total capability*		7,372	100	7,199
Electric peak load during year:*				
Total system demand		6,935		6,327
Net system demand		5,405		5,385

*Available capability can be increased during heavy load periods by purchases from neighboring interconnected systems. Hydro station capability is based on average December stream-flow conditions. Total system demand includes sales to other utilities; net system demand excludes such sales.

Electric and Gas Statistics

Electricity generated and purchased: *(Millions of kw-hrs.)*	1977	%	1976	%
Thermal:				
Generated				
Coal	7,579	22	7,262	20
Oil	8,293	24	6,262	18
Nuclear	2,946	8	4,113	12
Purchased—Nuclear from Power Authority	911	3	1,097	3
Total thermal	19,729	57	18,734	53
Hydro:				
Generated	3,782	11	4,213	12
Purchased from Power Authority	8,851	26	10,222	29
Total hydro	12,633	37	14,435	41
Other purchased power—various sources	1,926	6	2,069	6
Total generated and purchased	34,288	100	35,238	100

Electric sales: *(Millions of kw-hrs.)*	1977	1976
Residential	7,895	7,766
Commercial	8,770	8,407
Industrial	11,878	11,575
Municipal service	276	274
Other electric systems	2,548	3,780
	31,367	31,802
Electric revenues: *(Thousands of dollars)*		
Residential	$304,229	$263,663
Commercial	325,985	272,315
Industrial	253,690	204,018
Municipal service	20,905	17,851
Other electric systems	58,601	82,622
Miscellaneous	24,350	22,543
	$987,760	$863,012
Electric customers: *(Average)*		
Residential	1,187,318	1,178,314
Commercial	128,070	128,155
Industrial	2,876	2,932
Other	2,235	2,203
	1,320,499	1,311,604
Residential: *(Average)*		
Annual kw-hr. use per customer	6,649	6,591
Cost to customer per kw-hr.	3.85¢	3.40¢
Annual revenue per customer	$256.23	$223.76

Gas sales: *(Millions of cubic feet)*	1977	1976
Residential	52,684	57,166
Commercial	20,305	23,565
Industrial	14,528	15,673
Other gas systems	3,310	3,711
	90,827	100,115
Gas revenues: *(Thousands of dollars)*		
Residential	$150,510	$133,107
Commercial	51,512	49,098
Industrial	29,336	25,368
Other gas systems	5,595	5,388
Miscellaneous	1,119	1,257
	$238,072	$214,218
Gas customers: *(Average)*		
Residential	384,197	386,805
Commercial	28,632	29,183
Industrial	540	537
Other	2	2
	413,371	416,527
Residential: *(Average)*		
Annual use per customer *(Thousands of cubic feet)*	137.1	147.8
Cost to customer *(per thousand cubic feet)*	$2.86	$2.33
Annual revenue per customer	$391.75	$344.12
Maximum day gas sendout *(Thousands of cubic feet)*	660,974	743,979

Officers

Directors

Annual Meeting
The annual meeting of stockholders will be held on May 2, 1978 at the Company's principal office in Syracuse. A formal notice of meeting, proxy statement and proxy form will be sent to holders of common stock in early April.

Transfer Agents
Preferred Stock:
Marine Midland Bank—
New York
2 Broadway
New York, N.Y. 10004
Common Stock:
Morgan Guaranty Trust
Company of New York
30 West Broadway
New York, N.Y. 10015

Disbursing Agent
Preferred and Common Stocks:
Niagara Mohawk Power
Corporation
300 Erie Boulevard West
Syracuse, N.Y. 13202

Stock Exchanges
Common and Certain Preferred Series:
Listed on New York Stock Exchange
Common Stock:
Also traded on Amsterdam (Netherlands), Boston, Cincinnati, Detroit, Midwest, Pacific Coast and PBW stock exchanges.

Ticker Symbol: NMK

Form 10-K Report
A copy of the Company's Form 10-K report filed annually with the Securities and Exchange Commission is available after March 31, 1978 by writing the Vice President and Treasurer at 300 Erie Boulevard West, Syracuse, N.Y. 13202.

John G. Haehl, Jr.
President and Chief Executive Officer
James Bartlett
Executive Vice President
James J. Miller
Senior Vice President
Richard F. Torrey
Senior Vice President
William J. Donlon
Senior Vice President
John H. Terry
Senior Vice President, General Counsel and Secretary
Richard C. Clancy
Vice President—Research and Environmental Affairs
O. Mark DeMichele
Vice President—Public Relations
Donald P. Dise
Vice President—Engineering
(Elected October 6, 1977)
John J. Ehlinger
Vice President—Employee Relations
John M. Endries
Vice President and Controller
Richard A. Flynn, Jr.
Vice President—Consumer Relations
(Retired February 15, 1978)
William C. Franklin
Vice President—Purchasing
John M. Haynes
Vice President and Treasurer
Eugene J. Morel
Vice President—Employee Services and Risk Management
James F. Morrell
Vice President—Corporate Planning
Gerald K. Rhode
Vice President—System Project Management
(Elected October 6, 1977)
Rudolph R. Schneider
Vice President—Electric Production
Kenneth A. Tramutola
Vice President—Rates
Robert M. Cleary, Jr.
Vice President and General Manager—Western Division
Raymond Kolarz
Vice President and General Manager—Central Division
Richard H. Kukuk
Vice President and General Manager—Eastern Division
Edward P. Gueth, Jr.
Assistant General Counsel
Herman B. Noll
Assistant General Counsel
Anthony J. Baratta, Jr.
Assistant Controller
Adam F. Shaffer
Assistant Controller
Henry B. Wightman, Jr.
Assistant Controller
John W. Powers
Assistant Treasurer
Harold J. Bogan
Assistant Secretary
Joseph F. Cleary
Assistant Secretary—Eastern Division
Frederick C. McCall
Assistant Secretary—Western Division

James Bartlett
Executive Vice President, Syracuse
Thomas J. Brosnan
Consultant (formerly Vice President—Research and Development, Environmental Matters), Syracuse
Edmund M. Davis
Partner, Hiscock, Lee, Rogers, Henley & Barclay, attorneys-at-law, Syracuse
Edward W. Duffy
Chairman of the Board and Chief Executive Officer, Marine Midland Banks, Inc., a bank holding company, Buffalo
Edmund H. Fallon
Executive Consultant, Agway, Inc., purchasing and marketing organization, Syracuse
John G. Haehl, Jr.
President and Chief Executive Officer, Syracuse
Edwin F. Jaeckle
Senior Partner, Jaeckle, Fleischmann & Mugel, attorneys-at-law, Buffalo
Ralph F. Leach
Former Chairman of Executive Committee, Morgan Guaranty Trust Company of New York, commercial bank, New York
Lauman Martin
Consultant (formerly Senior Vice President and General Counsel), Syracuse
Baldwin Maull
Director of various corporations, New York
Martha Hancock Northrup
Housewife, former President, Crouse-Irving Memorial Hospital Board, Syracuse
Frank P. Piskor
President, St. Lawrence University, Canton
Lewis A. Swyer
President, L.A. Swyer Company, Inc., builders and construction managers, Albany
Dean P. Taylor
Senior Partner, Wager, Taylor, Howd, Brearton & Kessler, attorneys-at-law, Troy
(Deceased October 16, 1977)
John G. Wick
President and Chief Executive Officer, Merchants Insurance Group, Buffalo

BOARD COMMITTEES

Executive Committee
John G. Haehl, Jr., Chairman
Edmund H. Fallon
Edwin F. Jaeckle
Ralph F. Leach
Baldwin Maull
John H. Terry, Secretary

Pension Committee
Edmund H. Fallon, Chairman
Edmund M. Davis
Baldwin Maull

Salary Committee
Baldwin Maull, Chairman
Edwin F. Jaeckle
Ralph F. Leach

Audit Committee
Edward W. Duffy, Chairman
Lewis A. Swyer
Frank P. Piskor

Committee on Corporate Public Policy
Frank P. Piskor, Chairman
Martha H. Northrup
Edmund H. Fallon

Finance Committee
Ralph F. Leach, Chairman
John G. Wick
Edmund M. Davis

L.A. Swyer
T.J. Brosnan
J.G. Wick

L. Martin
R.F. Leach
F.P. Piskor

M.H. Northrup

E.H. Fallon
B. Maull
J. Bartlett

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