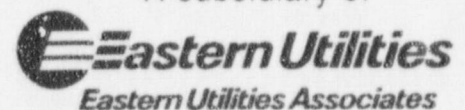


# Eastern Edison Company 1997 Annual Report

1997's continuing changes  
to the very underpinning of  
the electric utility industry  
**challenged us**  
as never before...

A subsidiary of



## **Company Profile**

Eastern Edison Company (Eastern Edison or the Company) is a retail electric utility company. Eastern Edison supplies retail electric service to approximately 184,000 customers in 22 cities and towns in southeastern Massachusetts. The largest communities served are the cities of Brockton and Fall River, Massachusetts. Eastern Edison is a wholly owned subsidiary of Eastern Utilities Associates (EUA). EUA owns directly all of the shares of common stock of Eastern Edison, Blackstone Valley Electric Company (Blackstone) and Newport Electric Corporation (Newport). These EUA subsidiaries are collectively referred to as the Retail Subsidiaries. Blackstone and Newport are retail electric utility companies operating in northern Rhode Island and south coastal Rhode Island, respectively. Eastern Edison owns all of the permanent securities of Montaup Electric Company (Montaup), a generation and transmission company, which supplies electricity to Eastern Edison, to Blackstone, to Newport and to two unaffiliated utilities for resale. EUA also owns directly all of the shares of common stock of EUA Service Corporation (EUA Service), EUA Cogenex Corporation (EUA Cogenex), EUA Energy Investment Corporation (EUA Energy), EUA Ocean State Corporation (EUA Ocean State), EUA Energy Services Corporation (EUA Energy Services), and EUA Telecommunications Corporation (EUA Telecommunications). EUA Service provides various accounting, financial, engineering, planning, data processing and other services to all EUA System companies. EUA Cogenex is an energy services company. EUA Energy was organized to invest in energy related projects. EUA Ocean State owns a 29.9% interest in Ocean State Power's two gas-fired generating units in northern Rhode Island. EUA Energy Services owns an interest in a limited liability company which markets energy and energy services. EUA Telecommunications provides telecommunications and information services. The holding company system of EUA, the Retail Subsidiaries, Montaup, EUA Service, EUA Cogenex, EUA Energy, EUA Ocean State, EUA Energy Services, and EUA Telecommunications is referred to as the EUA System. The Core Electric Business consists of the Retail Subsidiaries and Montaup. (See Electric Utility Industry Restructuring for a discussion of changes taking place in the utility industry in the territories served by EUA's Core Electric Business.)

## **Form 10-K**

A copy of EUA's, Eastern Edison's and Blackstone's Co-Registrant 1997 Annual Report on Form 10-K, which is filed with the Securities and Exchange Commission, is available without charge by contacting us at:

EUA Service Corporation  
Post Office Box 2333  
Boston, MA 02107  
(617) 357-9590

## **Internet Address**

## MARKET FOR EASTERN EDISON'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

All of Eastern Edison's common stock is owned beneficially and of record by Eastern Utilities Associates (EUA).

The dividends paid on Eastern Edison's common stock during the past two years are as follows:

<u>1997</u>	Dividends Paid <u>Per Share</u>	<u>1996</u>	Dividends Paid <u>Per Share</u>
First Quarter	\$2.70	First Quarter	\$2.87
Second Quarter	2.70	Second Quarter	3.00
Third Quarter	2.70	Third Quarter	3.00
Fourth Quarter	2.70	Fourth Quarter	3.00

In January of 1997, a special common stock dividend was declared and paid in the amount of \$17 million.

No dividend may be paid on Eastern Edison's common stock unless full dividends on Eastern Edison's outstanding Preferred Stock for all past and the current quarterly dividend periods have been paid or declared and set apart for payment, nor may any dividends be paid on Eastern Edison's common stock if Eastern Edison is in default on any sinking fund obligation provided for its Preferred Stock. See also Notes C, D and E of Notes to Consolidated Financial Statements.

### SELECTED CONSOLIDATED FINANCIAL DATA

(In Thousands)	For the Years Ended December 31,				
	1997	1996	1995	1994	1993
Operating Revenues	\$435,014	\$404,808	\$420,069	\$418,424	\$417,021
Net Earnings	27,059	30,983	31,455	31,395	28,145
Total Assets	777,124	775,082	739,198	756,045	742,273
Capitalization:					
Long-Term Debt-Net Redeemable Preferred Stock-Net	162,491	222,402	222,313	229,224	264,134
Common Equity	<u>218,468</u>	<u>240,213</u>	<u>244,368</u>	<u>225,064</u>	<u>223,005</u>
Total Capitalization	<u>\$408,571</u>	<u>\$489,650</u>	<u>\$492,899</u>	<u>\$479,545</u>	<u>\$511,963</u>



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND REVIEW OF OPERATIONS

### Overview

Consolidated Net Earnings were approximately \$27.1 million in 1997, a decrease of \$3.9 million or 12.7% as compared to 1996 Consolidated Net Earnings of approximately \$31.0 million. The 1997 results include the impacts of increased jointly owned units expenses, primarily related to the extended Millstone 3 outage, and increased expenses due to a June 1997 voluntary retirement incentive offer (VRI) discussed below.

1996 Consolidated Net Earnings of approximately \$31.0 million decreased \$0.5 million, or 1.5% compared to those of 1995 which included a one-time charge of approximately \$1.5 million, on an after tax basis, related to the 1995 VRI. The 1996 results were impacted by increased expenses related to an unusual number of severe storms which struck Eastern Edison's service territory during 1996 and increased legal expenses, partially offset by a decrease in interest expense from debt issues that matured in 1995.

### Comparison of Financial Results

#### Operating Revenues

Operating Revenues of approximately \$435.0 million increased approximately \$30.2 million or 7.5% as compared to 1996. This change was primarily due to increased recoveries of purchased power, fuel and conservation and load management (C&LM) expenses aggregating approximately \$23.2 million. Also impacting revenues was increased base rate recoveries and increased short-term contract demand sales.

Operating Revenues for 1996 decreased by approximately \$15.3 million, as compared to 1995. The change was primarily due to recoveries of decreased C&LM and purchased power expenses aggregating approximately \$14.0 million and decreased contract demand sales of \$1.6 million.

#### Voluntary Retirement Incentives

In June of 1997, an early retirement offer was accepted by a group of employees who were eligible for, but not offered a VRI completed in 1995, resulting in a charge of approximately \$700,000 (approximately \$500,000 after-tax) to second quarter 1997 earnings.

#### Expenses

The Company's most significant expense items continue to be fuel and purchased power expenses which together comprised about 59% of total operating expenses for 1997.



Fuel expense increased by approximately \$18.6 million or 20.1% as compared to 1996. Outages of nuclear units in 1997 contributed to a greater dependence on higher cost fossil fuels for energy requirements, resulting in an increase in average fuel costs of 16.3% in 1997. Also impacting fuel expense was an increase in total energy generated and purchased of 4.6% in 1997 due mainly to increased sales to NEPOOL and increased short-term unit contract energy sales. Fuel expense increased by \$1.3 million or 1.4% in 1996 as compared to 1995 due to primarily to a 2.0% increase in total energy generated and purchased.

Purchased Power demand expense increased approximately \$600,000 or less than 1% in 1997. This change is primarily due to increased billings from the Pilgrim and the Maine Yankee Nuclear Units and the Potter #2 Fossil Unit aggregating approximately \$6.5 million. These increases were offset by decreased billings from Connecticut Yankee and the Ocean State Power Project (OSP) of approximately \$3.0 million and approximately \$2.8 million, respectively. Purchased Power demand expense decreased \$6.8 million or 5.4% in 1996. The decrease was due primarily to the impact of lower billings from the Pilgrim nuclear unit of approximately \$4.2 million which included a prior period refund of approximately \$2.0 million, and decreased billings from OSP and Maine Yankee aggregating \$2.5 million.

Other Operation and Maintenance expenses (O&M) are comprised of two components, Direct Controllable and Indirect. Direct Controllable expenses include expense items such as salaries, fringe benefits, insurance, maintenance, etc. Indirect expenses include items over which the Company has limited short-term control and include such expense items as Montaup's joint ownership interests in generating facilities such as Seabrook I and Millstone 3, power contracts where transmission rental fees are fixed, conservation and load management expenses that are fully recovered in revenues and expenses related to accounting standards such as Statement of Financial Accounting Standard No. 106, "Employers' Accounting for Post Retirement Benefits Other Than Pensions" (FAS106).

Other O&M expenses, including affiliated company transactions, increased approximately \$14.1 million or 15.3% in 1997. This change was primarily due to increased jointly owned unit expense of approximately \$9.0 million, of which \$5.0 million is related to the Millstone 3 outages and the remainder is due to increased expenses related to the scheduled maintenance outages at the Canal and Seabrook units. Also impacting the change was increased C&LM expenses of approximately \$1.8 million, increased legal expenses of approximately \$1.3 million and \$1.2 million of transmission expenses related to new transmission tariffs implemented by FERC in 1997 to accommodate utility industry restructuring. Other O&M expenses, including affiliated company transactions, decreased by \$4.8 million or 5% in 1996. The change was primarily due to decreased C&LM expenses of \$7.7 million, lower power contract and transmission expenses of Montaup and effective cost control efforts aggregating \$1.1 million. Offsetting these decreases somewhat were increases in storm related, legal and jointly owned unit expenses aggregating \$4.5 million.

## **Financial Condition and Liquidity**

Eastern Edison's and Montaup's need for permanent capital is primarily related to the construction of facilities required to meet the needs of existing and future customers. For 1997, 1996 and 1995, Eastern Edison's and Montaup's combined cash construction expenditures were \$15.7 million, \$26.0 million, and \$23.4 million, respectively. Internally generated funds provided approximately 123%, 118% and 236% of these combined cash construction requirements in 1997, 1996 and 1995, respectively.

Cash construction expenditures are expected to be approximately \$22.7 million in 1998, \$16.1 million in 1999, and \$14.5 million in 2000, and are expected to be financed with internally generated funds.

In the utility industry, cash construction requirements not met with internally generated funds are obtained through short-term borrowings which are ultimately funded with permanent capital. In July 1997, several EUA System companies, including Eastern Edison and Montaup, entered into a three-year revolving credit agreement allowing for borrowings in aggregate of up to \$120 million. As of December 31, 1997, various financial institutions have committed up to \$75 million under the revolving credit facility. At December 31, 1997, under the revolving credit agreement the EUA System had short-term borrowings available of approximately \$13.5 million. At December 31, 1997, Eastern Edison had \$4.7 million of outstanding short-term debt and Montaup had no outstanding short-term debt.

In addition to construction expenditures, projected requirements for maturing long-term debt securities through 2002 are \$60 million in 1998 and \$35 million in 2002. The Company has no sinking fund requirements through the year 2002.

## **Electric Utility Industry Restructuring Initiatives**

### Unbundled Services:

The electric utility industry in both Massachusetts and Rhode Island, the states in which EUA provides electric services, is transitioning from a traditional rate regulated environment to a competitive marketplace. Traditional electric utility services - generation, transmission and distribution - have been unbundled into separate and distinct services. The generation, or supply, function is now competitive with customers able to choose their own electricity supplier at market prices. The transmission and distribution functions remain regulated services. The local distribution company is responsible for providing distribution services to the ultimate electricity consumer within its franchised service territory and the transmission company is required to provide open access, non-discriminatory transmission services to generation or supply companies.

## Stranded Costs:

*Stranded costs* represent prudently incurred costs of generation which are now above their current economic value. In both Massachusetts and Rhode Island (see discussions below) stranded costs have been defined to include items such as above market net investments in generation assets, generation related regulatory assets, nuclear decommissioning and above market commitments under current power purchase contracts. A December 19, 1997 order from FERC provides Montaup, with full recovery of its stranded costs. Stranded costs are recovered, via a Contract Termination Charge (CTC) under a contract termination agreement which replaced the all-requirements contracts formerly in force between Montaup and its retail affiliates. In its order, FERC approved settlement agreements between Montaup, its retail affiliates and consumer representatives in Massachusetts and Rhode Island. Both states' regulatory bodies have approved retail settlements in accordance with enabling state legislation. At December 31, 1997 Montaup estimated its stranded costs, including unmitigated investment in owned generation, generation-related regulatory assets, above-market purchase power commitments, nuclear decommissioning and transition expenses to be approximately \$1 billion on a present value basis. This estimate is subject to significant uncertainties including the future market price of electricity. (See "Divestiture" below for a discussion of stranded cost mitigation.)

## Rhode Island - Retail:

On August 7, 1996, the Governor of Rhode Island signed into law the Utility Restructuring Act of 1996 (URA). The URA provides for customer choice of electricity supplier in several phases commencing July 1, 1997 for certain customers and culminating with choice for all customers by July 1, 1998, or sooner. Under the URA, the local distribution company retains the responsibility of providing distribution services to the ultimate electricity consumer within its franchised service territory. For customers who do not choose an alternative supplier, the local distribution company must arrange for standard offer service. Distribution companies are providers of last resort service for customers who are unable to obtain their own supply.

The URA provides for full recovery of stranded costs, through a non-bypassable transition charge initially set at 2.8 cents per kWh through December 31, 2000. The costs of net, above-market generation assets and regulatory assets will be recovered, with a return, through a fixed component of the transition charge from January 1, 1998, through December 31, 2009. A variable component of the transition charge will recover, on a reconciling basis, among other things, nuclear decommissioning and above market purchased power commitments from January 1, 1998, through the life of the respective unit or contract. The URA also provides for commitments to demand side management initiatives and renewables, low-income customer protections, divestiture of at least 15% of owned non-nuclear generating units as a valuation basis for mitigation of stranded cost recovery, and performance-based ratemaking (PBR) standards for electric distribution companies to be in effect until the end of 1998.

In February 1997, Blackstone, Newport and Montaup reached a settlement in principle with the Rhode Island Division of Public Utilities and Carriers (RIDIV) and the state's Attorney General and filed a Memorandum of Understanding (MOU) with the Rhode Island Public Utilities Commission (RIPUC),



outlining the terms of the settlement. The settlement was submitted to the RIPUC in two separate filings which were approved on April 21, 1997 and December 17, 1997, respectively. In addition to complying with the URA, the settlement, similar in many respects to the settlement negotiated in Massachusetts, described below, provided for, among other things, amendments to Blackstone and Newport power contracts with Montaup to replace all-requirements provisions with a CTC commensurate with retail access and the filing of a plan to divest all of Montaup's generating assets. The net proceeds of the divestiture will be used to mitigate the amount of Montaup's stranded costs to be recovered through the CTC. (See "Divestiture" below for a discussion of Montaup's divestiture process.)

On December 17, 1997, the RIPUC approved a retail settlement which included a distribution rate freeze through December 31, 2000, except for any temporary credit or surcharge resulting from PBR implementation or the standard offer reconciliation, and retail access for all customers commencing January 1, 1998. In addition to the approval of wholesale power contract amendments by FERC, received on December 19, 1997 (See "FERC -Wholesale" below), any disposition of generation assets resulting from the agreements or the URA would also require the approval of the Securities and Exchange Commission (SEC) under the Public Utility Holding Company Act of 1935.

#### Massachusetts - Retail:

On December 23, 1996, Eastern Edison and Montaup reached an agreement in principle with the Attorney General of Massachusetts and the Massachusetts Department of Energy Resources (MADOER) and filed a MOU with the Massachusetts Department of Telecommunications and Energy (DTE) (formerly the Department of Public Utilities) outlining the terms of a plan, similar in many aspects to the URA, which would allow retail customers to choose their supplier of electricity in 1998 and provide Eastern Edison and Montaup full recovery of stranded costs. On May 16, 1997 an Offer of Settlement was filed with the DTE.

The Offer of Settlement provided all of Eastern Edison's customers the ability to choose an alternative supplier of electricity beginning as soon as January 1, 1998. Until a customer chooses an alternative supplier, that customer would receive standard offer service which would be priced to guarantee at least a 10% reduction in electricity rates. Eastern Edison would be required to arrange for standard offer service through December 31, 2004 and would purchase power for standard offer service from suppliers through a competitive bidding process. Montaup has guaranteed standard offer supply at a fixed price schedule for the duration of the standard offer period. For competitive suppliers to be eligible to provide supplies for standard offer service, their prices must be competitive with the fixed prices guaranteed by Montaup. In the event that some, or all, of the standard offer requirement is not awarded to competitive suppliers, Montaup has an obligation to provide such requirement at the indicated fixed price schedule, so called *backstop service*. This backstop service will be assigned proportionately to purchasers of Montaup's generating capacity. The agreement is also designed to achieve full divestiture of Montaup's generating assets via implementation of a plan, that would require (1) functional separation by Montaup of its generating and transmission businesses, and (2) full market valuation and sale of all non-nuclear assets through an auction or equivalent process.

On March 1, 1998, commensurate with retail choice in Massachusetts Montaup's FERC-approved, all-requirements wholesale contract with Eastern Edison was terminated. In its place, Montaup is billing Eastern Edison a CTC designed to recover, among other things, Montaup's stranded costs. Eastern Edison recovers the CTC through a non-bypassable transition access charge to all of its distribution customers. The transition access charge will be reduced by the fair market value of Montaup's generating assets as determined by selling, spinning off, or otherwise disposing of such generating facilities. (See "Divestiture" below.)

Embedded costs associated with generating plants and regulatory assets are recovered, with a return, over a period of twelve years ending December 31, 2009. Purchased power contracts and nuclear decommissioning costs are recovered as incurred over the life of those obligations, a period expected to extend beyond twelve years. The initial transition access charge is set at 3.04 cents per kWh through December 31, 2000, and is expected to decline thereafter.

The agreement also establishes a performance component for Eastern Edison, incorporating a floor and cap on allowed return on equity. Under the agreement, Eastern Edison's distribution rates are frozen until December 31, 2000. Subsequent to the commencement of retail choice, Eastern Edison's annual return on equity is subject to a floor of 6% and a ceiling of 11.75%.

On November 25, 1997, the Governor of Massachusetts signed the Electric Industry Restructuring Act (the Act) into law. The Act directed the DTE to require electric companies to accommodate retail access to generation services and choice of supplier by March 1, 1998 and to require electric companies to file restructuring plans to do so. The Act also provides for a 10% reduction in electric rates commencing March 1, 1998 and an additional 5% reduction, adjusted for inflation, commencing September 1, 1999. The additional 5% reduction may be accomplished with benefits from asset divestiture and/or securitization.

On December 23, 1997 the DTE approved the Settlement as being in substantial compliance with the Act. Retail access commenced on March 1, 1998 for Eastern Edison's retail customers.

In January 1998, several parties filed motions for reconsideration of Eastern Edison's approved settlement agreement and motions to extend the judicial appeal period with the DTE. The motions for reconsideration claim that provisions of the approved plan involving consumer rates, cost recovery, energy efficiency and reliability do not meet standards set forth in the Act. The DTE denied one party's motions and that party has appealed the DTE's ruling to the Massachusetts Supreme Judicial Court. Management cannot predict the ultimate outcome of the pending motions for reconsideration or judicial appeal.

The Office of the Attorney General has certified a referendum petition to repeal the Act as a matter appropriate for a referendum initiative. A petition was filed with the Election Division of the Office of the Secretary of State in February 1998. A question on repealing the Act will be presented to voters on the November 1998 ballot. EUA and the electric industry in Massachusetts will actively oppose repeal. Management cannot predict the outcome of the November ballot question.

#### FERC - Wholesale:

On May 1, 1997, Montaup and the R.I. Distribution Companies jointly filed amendments to their FERC-approved all-requirements power contracts. The filing included a calculation for a CTC to recover stranded costs and a provision for standard offer service for resale to retail customers who do not choose an alternate generation supplier as discussed under "Massachusetts-Retail" above. These provisions replaced the services offered by the all-requirements contracts upon full retail access pursuant to the URA. The filing also included *hold harmless* provisions for Montaup's other wholesale customers and for retail customers of the R.I. Distribution Companies and lost revenue provisions, which allow for recovery of any of Montaup's lost revenues for the period from the initial phases of retail access in Rhode Island through completion of Montaup's divestiture process. This filing allowed the R.I. Distribution Companies to implement on July 1, 1997, the phase-in provisions of the URA and prevented any cross-subsidies by their retail customers who were excluded from the groups of customers given retail choice prior to January 1, 1998 and by Montaup's other customers.

On May 30, 1997, elements of the Massachusetts Settlement Agreement, including the CTC calculation, which fall under the jurisdiction of FERC were filed with FERC.

The May 1st and May 30th filings were consolidated by FERC and on October 29, 1997, settlement agreements among Montaup, its affiliated and non-affiliated customers, the Massachusetts Attorney General, the MADOER, the RIDIV and RIPUC were submitted for FERC approval. These settlements represent a comprehensive resolution of federal/wholesale issues of electric utility industry restructuring based on the settlement agreements in Massachusetts and Rhode Island. FERC approved the settlements on December 19, 1997, accommodating retail choice for EUA's retail customers in Massachusetts and Rhode Island.

#### Divestiture:

Montaup began marketing its portfolio of generation assets in July 1997, and subsequently received bids from a number of potential purchasers. On January 23, 1998, based on a review of the offers and discussions with potential purchasers, Montaup announced that it was reopening the sales process on the majority of its generating assets. The process is expected to require four to six months to execute a purchase and sale agreement. The net proceeds of the sale, as defined in the settlement agreements, will be used to mitigate Montaup's CTC to its retail affiliates via a Residual Value Credit (RVC). The RVC will reduce the fixed component of the CTC for the net proceeds, with a return, in equal annual amounts over the period commencing on the date the RVC is implemented through December 31, 2009. Subject to regulatory approvals, Montaup anticipates the sale will be completed in early 1999.

#### Accounting Issues:

Historically, electric rates have been designed to recover a utility's full cost of providing electric service including recovery of investment in plant assets. Also, in a regulated environment, electric



utilities are subject to certain accounting rules that are not applicable to other industries. These accounting rules allow regulated companies, in appropriate circumstances, to establish regulatory assets and liabilities, which defer the current financial impact of certain costs that are expected to be recovered in future rates. The SEC has raised issues concerning the continued applicability of these standards with certain other electric utilities in other states facing restructuring.

In July 1997, the Financial Accounting Standards Board's (FASB) Emerging Issues Task Force (EITF) reached a consensus regarding certain issues raised related to the application of Statement of Financial Accounting Standards No. 71 (FAS71), "Accounting for the Effects of Certain Types of Regulation." The EITF determined that when sufficient detail is available for an enterprise to reasonably determine, from legislation and enabling rate orders, how the transition plan will affect the separable portion of its business being deregulated, the enterprise should discontinue the application of FAS71 to that deregulated portion of its business. The EITF also concluded that utilities can continue to carry previously recorded regulatory assets on their balance sheet if regulators have guaranteed a regulated cash flow stream to recover the cost of those assets.

In light of approved restructuring settlement agreements and restructuring legislation in both Massachusetts and Rhode Island, EUA has determined that Montaup no longer will apply the provisions for FAS71 to the generation portion of its business. Due to the recoverability of regulatory assets granted in the approved restructuring plans, EUA believes that the discontinuation of FAS71 for the generation portion of Montaup's business will not have a material impact on EUA's results of operation or financial condition. EUA believes its transmission and retail distribution businesses continue to meet the criteria for continued application of FAS71.

In addition, if legislative or regulatory changes and/or competition result in electric rates which do not fully recover a company's costs, a write-down of plant assets could be required pursuant to Financial Accounting Standard No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." EUA does not anticipate any write-down of plant assets as a result of approved restructuring plans or enacted legislation at this time.

### **Environmental Matters**

Eastern Edison, Montaup and other companies owning generating units from which power is obtained are subject, like other electric utilities, to environmental and land use regulations at the federal, state and local levels. The federal Environmental Protection Agency (EPA), and certain state and local authorities, have jurisdiction over releases of pollutants, contaminants and hazardous substances into the environment and have broad authority to set rules and regulations in connection therewith, such as the Clean Air Act Amendments of 1990, which could require installation of pollution control devices and remedial actions. In 1994, EUA instituted an environmental audit program designed to ensure compliance with environmental laws and regulations and to identify and reduce liability with respect to those requirements.

Because of the nature of Eastern Edison's and Montaup's business, various by-products and substances are produced or handled which are classified as hazardous under the rules and regulations promulgated by such authorities. Eastern Edison and Montaup typically provide for the disposal of such substances through licensed contractors, but statutory provisions generally impose potential joint and several responsibility on the generators of the wastes for cleanup costs. In the past, Eastern Edison and Montaup had been notified with respect to a number of sites where they were allegedly responsible for such costs, including sites where they allegedly had joint and several liability with other responsible parties. Eastern Edison and Montaup are currently not involved in any environmental site investigations. It is the policy of the EUA System companies to notify liability insurers and to initiate claims related to such costs.

A number of scientific studies in the past several years have examined the possibility of health effects from electric and magnetic fields (EMF) that are found wherever there is electricity. While some of the studies have indicated some association between exposure to EMF and health effects, many others have indicated no direct association. On October 31, 1996, the National Academy of Sciences issued a literature review of all research to date, "Possible Health Effects of Exposure to Residential Electric and Magnetic Fields." Its most widely reported conclusion stated, "No clear, convincing evidence exists to show that residential exposures to EMF are a threat to human health." Additional studies, which are intended to provide a better understanding of EMF, are continuing. Management cannot predict the ultimate outcome of the EMF issue.

### **Nuclear Power Issues**

Montaup has a 4.01% ownership interest in Millstone 3, an 1154-mw nuclear unit that is jointly owned by a number of New England utilities, including subsidiaries of Northeast Utilities (Northeast). Subsidiaries of Northeast are the lead participants in Millstone 3. On March 30, 1996, it was necessary to shut down the unit following an engineering evaluation which determined that four safety-related valves would not be able to perform their design function during certain postulated events.

The Nuclear Regulatory Commission (NRC) has raised numerous issues with respect to the unit and certain of the other nuclear units operated by Northeast. The NRC informed Northeast that it was establishing a Special Projects Office to oversee inspection and licensing activities at Millstone and directed Northeast to submit a plan for disposition of safety issues raised by employees and retain an independent third-party to oversee implementation of this plan.

In March of 1997, Northeast announced that Millstone 3 had been designated as the lead unit in the recovery process of the three Millstone nuclear units that are currently out of service. Millstone 3 is the largest of the three units currently out of service, and its return to service will most benefit the energy needs of the New England region.

On January 8, 1998, Northeast announced that Millstone 3 was "physically ready for restart" indicating that virtually all of the restart-required physical work had been completed. Northeast indicated that a small amount of systems work needs to be completed prior to restart. Various NRC and

independent inspections are required prior to restart. EUA cannot predict when the plant will be restarted. While Millstone 3 is out of service, Montaup will continue to incur incremental replacement power costs estimated at up to \$1 million per month.

Montaup has been paying its share of Millstone 3's O&M expenses on a reservation of right basis. The fact that Montaup makes payment for these expenses is not an admission of financial responsibility for expenses incurred or to be incurred due to the outage.

In August 1997, nine non-operating owners, including Montaup, who together own approximately 19.5% of Millstone 3, filed a demand for arbitration against Connecticut Light and Power (CL&P) and Western Massachusetts Electric Company (WMECO) as well as lawsuits against Northeast and its Trustees. CL&P and WMECO, owners of approximately 65% of Millstone 3, are Northeast subsidiaries which agreed to be responsible for the proper operation of the unit.

The non-operating owners of Millstone 3 claim that Northeast and its subsidiaries failed to comply with NRC regulations, failed to operate the facility in accordance with good utility operating practice and attempted to conceal their activities from the non-operating owners and the NRC. The arbitration and lawsuits seek to recover costs associated with replacement power and O&M costs resulting from the shutdown of Millstone 3. The non-operating owners conservatively estimate that their losses will exceed \$200 million.

Montaup cannot predict the ultimate outcome of the NRC inquiries or legal proceedings brought against CL&P, WMECO and Northeast or the impact which they may have on Montaup and the EUA system.

On August 6, 1997, as the result of an economic evaluation, the Maine Yankee Board of Directors voted to permanently close that nuclear plant. Montaup has a 4.0% equity ownership in Maine Yankee with a book value of approximately \$3.2 million at December 31, 1997. Montaup's share of the total estimated costs for the permanent shutdown, decommissioning, and recovery of the remaining investment in Maine Yankee, is approximately \$35.4 million and is included with Other Liabilities on the Consolidated Balance Sheet for the period ended December 31, 1997. Also, due to anticipated recoverability, a regulatory asset has been recorded for the same amount and is included with Other Assets. The recovery of this estimated amount is subject to approval of FERC. Montaup cannot predict the ultimate outcome of FERC's review.

Also, as a result of the shutdown, Montaup and the other equity owners of Maine Yankee have been notified by the Secondary Purchasers that they will no longer make payments for purchased power to Maine Yankee. The Secondary Purchase Contracts are between the equity owners as a group and 30 municipalities throughout New England. The equity owners are currently making payments to Maine Yankee to cover the payments that would be made by the municipals.

On November 28, 1997, the Secondary Purchasers sent a Notice of Initiation of Arbitration to the equity owners of Maine Yankee. On December 15, 1997, the equity owners as a group filed at FERC



a Complaint and Petition for Investigation, Contract Modification, and Declaratory Order. The equity owners are seeking an order from FERC declaring that the Secondary Purchasers remain responsible for payments due under the Purchase Contracts and directing the Secondary Purchasers to make such payments. The equity owners also seek a modification of the Purchase Contracts to extend the termination date or otherwise to ensure that the equity owners may fully recover from the Secondary Purchasers a share of the costs of shutting down and decommissioning the Maine Yankee plant that is proportional to the Secondary Purchasers' entitlements to energy from the plant. Management does not believe that this contract issue will have a material effect on EUA's future operating results or financial position and cannot predict its ultimate outcome at this time.

Recent actions by the NRC, some of which are cited above, indicate that the NRC has become more critical and active in its oversight of nuclear power plants. EUA is unable to predict at this time, what, if any, ramifications these NRC actions will have on any of the other nuclear power plants in which Montaup has an ownership interest or power contract.

Montaup is recovering through rates its share of estimated decommissioning costs for the Millstone 3 and Seabrook I nuclear generating units. Montaup's share of the currently allowed estimated total costs to decommission Millstone 3 is approximately \$21.9 million in 1997 dollars and Seabrook I is approximately \$13.7 million in 1997 dollars. These figures are based on studies performed for the lead owners of the units. Montaup also pays into decommissioning reserves, pursuant to contractual arrangements, at other nuclear generating facilities in which it has an equity ownership interest or life-of-unit entitlement. Such expenses are currently recovered through rates.

In early 1998, Yankee Atomic, Maine Yankee and Connecticut Yankee, individually, as well as a number of other utilities, filed suit in federal appeals court seeking a court order to require the Department of Energy (DOE) to immediately establish a program for the disposal of spent nuclear fuel. Yankee Atomic and Connecticut Yankee are also seeking damages of approximately \$70 million and \$90 million, respectively. Under the Federal Energy Policy Act of 1992 and Nuclear Waste Policy Act, the DOE was to provide for the disposal of radioactive wastes and spent nuclear fuel starting in 1998 and has collected funds from owners of nuclear facilities to do so. Management cannot predict the ultimate outcome of this issue.

### **Year 2000 Issue**

The Company has conducted a comprehensive review of its computer systems to identify the systems that could be affected by the Year 2000 Issue and is developing an implementation plan to resolve the issue. The Year 2000 Issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any programs that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a major system failure or miscalculations. The Company believes that, with modifications to existing software and conversions to new software, the Year 2000 problem will not pose significant operational problems for its computer systems as so modified and converted. It is anticipated that all reprogramming efforts will be complete by the spring of 1999, allowing adequate time for testing. In addition, notices have

been sent to the Company's primary processing vendors seeking assurance that plans are being developed to address processing of transactions in the year 2000. Management does not believe the year 2000 compliance expense will be material to the Company's future operating results or future financial condition.

### **New Accounting Standards**

In June 1997 the FASB issued Statement No. 130, "Reporting Comprehensive Income," which establishes standards for reporting comprehensive income and its components (revenues, expenses, gains, and losses) in a set of general-purpose financial statements. This Statement requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. This Statement is effective for fiscal years beginning after December 15, 1997, and the Company will adopt Statement 130 in the first quarter of 1998.

### **Other**

The Company occasionally makes forward-looking projections of expected future performance or statements of our plans and objectives. These forward-looking statements may be contained in filings with the SEC, press releases and oral statements. Actual results could differ materially from these statements. Therefore, no assurances can be given that such forward-looking statements and estimates will be achieved.

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*Management's Discussion and Analysis of Financial Condition and Review of Operations provides a summary of information regarding the Company's financial condition and results of operation and should be read in conjunction with the "Consolidated Financial Statements" and "Notes to Consolidated Financial Statements" in arriving at a more complete understanding of such matters.*

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**Eastern Edison Company and Subsidiary**  
**Consolidated Statements of Income**  
Years Ended December 31,  
(In Thousands)

	<u>1997</u>	<u>1996</u>	<u>1995</u>
Operating Revenues:			
From Affiliated Companies	\$ 127,882	\$ 127,981	\$ 133,388
Other	<u>307,132</u>	<u>276,827</u>	<u>286,681</u>
Total Operating Revenues	435,014	404,808	420,069
Operating Expenses:			
Fuel	110,717	92,159	90,881
Purchased Power - Demand	119,434	118,843	125,594
Other Operation and Maintenance	78,232	66,311	73,638
Affiliated Company Transactions	28,119	25,908	23,386
Voluntary Retirement Incentive	737		2,413
Depreciation and Amortization	27,489	26,810	26,039
Taxes - Other than Income	10,844	10,705	10,233
- Income	<u>14,247</u>	<u>16,058</u>	<u>15,653</u>
Total Operating Expenses	<u>389,819</u>	<u>356,794</u>	<u>367,837</u>
Operating Income	45,195	48,014	52,232
Equity in Earnings of Jointly Owned Companies	1,599	1,587	1,646
Allowance for Other Funds Used During			
Construction	162	365	473
Other Income (Deductions) - Net	<u>666</u>	<u>1,583</u>	<u>407</u>
Income Before Interest Charges	<u>47,622</u>	<u>51,549</u>	<u>54,758</u>
Interest Charges:			
Interest on Long-Term Debt	15,006	15,233	18,277
Other Interest Expense	3,792	3,653	3,541
Allowance for Borrowed Funds Used During			
Construction (Credit)	<u>(223)</u>	<u>(308)</u>	<u>(503)</u>
Net Interest Charges	<u>18,575</u>	<u>18,578</u>	<u>21,315</u>
Net Income	29,047	32,971	33,443
Preferred Dividend Requirements	1,988	1,988	1,988
Consolidated Net Earnings Applicable to Common Stock	<u>\$ 27,059</u>	<u>\$ 30,983</u>	<u>\$ 31,455</u>

**Consolidated Statements of Retained Earnings**  
Years Ended December 31,  
(In Thousands)

	<u>1997</u>	<u>1996</u>	<u>1995</u>
Retained Earnings - Beginning of Year	\$ 120,724	\$ 124,878	\$ 105,574
Net Income	29,047	32,971	33,443
Amortization of Preferred Stock Redemption Premium	<u>(577)</u>	<u>(817)</u>	<u>(961)</u>
Total	149,194	157,032	138,056
Dividends Paid:			
Preferred	1,988	1,988	1,988
Common	<u>48,227</u>	<u>34,320</u>	<u>11,190</u>
Retained Earnings - End of Year	<u>\$ 98,979</u>	<u>\$ 120,724</u>	<u>\$ 124,878</u>

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

**Eastern Edison Company and Subsidiary**  
**Consolidated Statements of Cash Flows**  
Years Ended December 31,  
(In Thousands)

	1997	1996	1995
<b>CASH FLOW FROM OPERATING ACTIVITIES:</b>			
Net Income	\$ 29,047	\$ 32,971	\$ 33,443
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Depreciation and Amortization	28,592	28,607	29,852
Amortization of Nuclear Fuel	1,067	1,676	3,647
Deferred Taxes	(4,872)	5,217	2,694
Investment Tax Credit, Net	(935)	(939)	(942)
Allowance for Funds Used During Construction	(162)	(365)	(473)
Other - Net	(4,215)	(2,333)	1,219
Changes to Operating Assets and Liabilities:			
Accounts Receivable	10,038	(1,862)	(7,055)
Fuel, Materials and Supplies	2,666	673	(1,678)
Accounts Payable	3,088	186	827
Accrued Taxes	(653)	(241)	1,807
Other - Net	(2,282)	9,266	(6,630)
Net Cash Provided from Operating Activities	<u>61,379</u>	<u>72,856</u>	<u>56,711</u>
<b>CASH FLOW FROM INVESTING ACTIVITIES:</b>			
Construction Expenditures	(15,662)	(26,006)	(23,423)
Decrease in Other Investments	219	148	
Net Cash (Used in) Investing Activities	<u>(15,443)</u>	<u>(25,858)</u>	<u>(23,423)</u>
<b>CASH FLOW FROM FINANCING ACTIVITIES:</b>			
Redemptions:			
Long-Term Debt		(7,000)	(35,000)
Common Stock Dividends Paid	(48,227)	(34,320)	(11,190)
Preferred Dividends Paid	(1,988)	(1,988)	(1,988)
Net Increase (Decrease) in Short Term Debt	2,635	(2,118)	4,158
Net Cash (Used in) Financing Activities	<u>(47,580)</u>	<u>(45,426)</u>	<u>(44,020)</u>
Net (Decrease) Increase in Cash and Temporary Cash Investments	<u>(1,644)</u>	<u>1,572</u>	<u>(10,732)</u>
Cash and Temporary Cash Investments at Beginning of Year	<u>2,105</u>	<u>533</u>	<u>11,265</u>
Cash and Temporary Cash Investments at End of Year	<u>\$ 461</u>	<u>\$ 2,105</u>	<u>\$ 533</u>
Cash paid during the year for:			
Interest (Net of Amounts Capitalized)	\$ 13,993	\$ 15,241	\$ 18,343
Income Taxes	\$ 21,291	\$ 13,267	\$ 9,044

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



**Eastern Edison Company and Subsidiary**  
**Consolidated Balance Sheets**

December 31,  
(In Thousands)

**ASSETS**

	<u>1997</u>	<u>1996</u>
Utility Plant and Other Investments:		
Utility Plant	\$ 825,238	\$ 817,992
Less Accumulated Provision for Depreciation	279,711	261,464
Net Utility Plant	545,527	556,528
Non-Utility Property - Net	2,705	2,705
Investment in Jointly Owned Companies	13,524	13,210
Other Investments (at cost)	55	95
Total Utility Plant and Other Investments	<u>561,811</u>	<u>572,538</u>
Current Assets:		
Cash and Temporary Cash Investments	461	2,105
Accounts Receivable:		
Customers	27,801	27,633
Others	4,486	3,464
Accrued Unbilled Revenue	8,490	8,376
Associated Companies	14,143	25,486
Fuel (at average cost)	4,248	6,844
Plant Materials and Operating Supplies (at average cost)	3,734	3,805
Prepayments and Other Current Assets	3,688	3,598
Total Current Assets	<u>67,051</u>	<u>81,311</u>
Other Assets (Note A)	148,262	121,233
Total Assets	<u>\$ 777,124</u>	<u>\$ 775,082</u>

**LIABILITIES AND CAPITALIZATION**

Capitalization:		
Common Equity	\$ 218,468	\$ 240,213
Redeemable Preferred Stock - Net	29,665	29,665
Preferred Stock Redemption Cost	(2,053)	(2,630)
Long-term Debt - Net	162,491	222,402
Total Capitalization	<u>408,571</u>	<u>489,650</u>
Current Liabilities:		
Long-term Debt Due Within One Year	60,000	
Notes Payable	4,675	2,040
Accounts Payable:		
Public	27,113	27,391
Associated Companies	7,317	3,950
Customer Deposits	1,258	1,153
Taxes Accrued	2,325	2,977
Interest Accrued	4,923	4,895
Other Current Liabilities	13,753	16,081
Total Current Liabilities	<u>121,364</u>	<u>58,487</u>
Other Liabilities	68,345	41,914
Deferred Credits:		
Unamortized Investment Credit	15,967	16,903
Other Deferred Credits	23,402	25,689
Total Deferred Credits	<u>39,369</u>	<u>42,592</u>
Accumulated Deferred Taxes	139,475	142,439
Commitments and Contingencies (Note J)		
Total Liabilities and Capitalization	<u>\$ 777,124</u>	<u>\$ 775,082</u>

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



**Eastern Edison Company and Subsidiary**  
**Consolidated Statements of Capitalization**

December 31,  
(In Thousands)

	<b>1997</b>	<b>1996</b>
Common Stock:		
\$25 par value, authorized and outstanding		
2,891,357 shares	\$ 72,284	\$ 72,284
Other Paid-In Capital	47,249	47,249
Common Stock Expense	(44)	(44)
Retained Earnings	98,979	120,724
Total Common Equity	<u>218,468</u>	<u>240,213</u>
Redeemable Preferred Stock:		
6 5/8%, \$100 par value, 300,000 shares (1)	30,000	30,000
Expense, Net of Premium	(335)	(335)
Preferred Stock Redemption Cost	(2,053)	(2,630)
Total Redeemable Preferred Stock	<u>27,612</u>	<u>27,035</u>
Long-Term Debt:		
First Mortgage and Collateral Trust Bonds:		
5 7/8% due 1998	20,000	20,000
6 7/8% due 2003	40,000	40,000
8% due 2023	40,000	40,000
5 3/4% due 1998	40,000	40,000
6.35% due 2003	8,000	8,000
7.78% Secured Medium-Term Notes due 2002	35,000	35,000
Pollution Control Revenue Bond:		
5 7/8% due 2008	40,000	40,000
Unamortized (Discount) - Net	(509)	(598)
	<u>222,491</u>	<u>222,402</u>
Less Portion Due Within One Year	60,000	
Total Long-Term Debt	<u>162,491</u>	<u>222,402</u>
Total Capitalization	<u>\$ 408,571</u>	<u>\$ 489,650</u>

(i) Authorized and Outstanding.

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

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**EASTERN EDISON COMPANY AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 1997, 1996, and 1995**

**(A) Nature of Operations and Summary of Significant Accounting Policies:**

**General:** Eastern Edison Company (Eastern Edison or the Company) and its wholly owned subsidiary, Montaup Electric Company (Montaup) are principally engaged in the generation, transmission, distribution and sale of electric energy.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The accounting policies and practices of Eastern Edison and of Montaup are subject to regulation by the Federal Energy Regulatory Commission (FERC) and the Massachusetts Department of Telecommunications and Energy (formerly Massachusetts Department of Public Utilities) with respect to their rates and accounting. Eastern Edison and Montaup conform with generally accepted accounting principles, as applied in the case of regulated public utilities, and conform with the accounting requirements and ratemaking practices of the regulatory authority having jurisdiction.

**Principles of Consolidation:** The consolidated financial statements include the accounts of Eastern Edison and its subsidiary, Montaup. All material intercompany balances and transactions have been eliminated in consolidation.

**Jointly Owned Companies:** Montaup Electric Company (Montaup) follows the equity method of accounting for its stock ownership investments in jointly owned companies including four regional nuclear generating companies. Montaup's investments in these nuclear generating companies range from 2.5% to 4.5%. Three of the four facilities have been permanently shut down and are in the process of decommissioning. Montaup is entitled to electricity produced from the remaining facility based on its ownership interest and is billed for its entitlement pursuant to a contractual agreement which is approved by FERC.

In December 1996, the Board of Directors of Connecticut Yankee voted to retire the generating station. Connecticut Yankee certified to the Nuclear Regulatory Commission (NRC) that it had permanently closed power generation operations and removed fuel from the reactor. Montaup has a 4.5% equity ownership in Connecticut Yankee. Montaup's share of the total estimated costs for the permanent shutdown, decommissioning, and recovery of the investment in Connecticut Yankee is approximately \$27.4 million and is included with Other Liabilities on the Consolidated



**(A) Nature of Operations and Summary of Significant Accounting Policies: (continued)**

Balance Sheet as of December 31, 1997. Also, due to recoverability, a regulatory asset has been recorded for the same amount and is included with Other Assets. The recovery of this estimated amount, elements of which have been disputed by certain intervening parties, is subject to approval of FERC. Montaup cannot predict the ultimate outcome of FERC's review.

In August 1997, as the result of an economic evaluation, the Maine Yankee Board of Directors voted to permanently close that nuclear plant. Montaup has a 4.0% equity ownership in Maine Yankee. Montaup's share of the total estimated costs for the permanent shutdown, decommissioning, and recovery of the remaining investment in Maine Yankee is approximately \$35.4 million and is included with Other Liabilities on the Consolidated Balance Sheet as of December 31, 1997. Also, due to recoverability, a regulatory asset has been recorded for the same amount and is included with Other Assets. The recovery of this estimated amount, elements of which have been disputed by certain intervening parties, is subject to approval of FERC. Montaup cannot predict the ultimate outcome of FERC's review.

Montaup also has a stock ownership investment of 3.27% in each of the two companies which own and operate certain interconnection facilities used to transmit hydroelectric power between the Hydro-Quebec Electric System and New England.

**Transactions with Affiliates:** Eastern Edison is a wholly owned subsidiary of Eastern Utilities Associates (EUA). In addition to its investment in Eastern Edison, EUA has interests in two other retail companies, a service corporation, and five other non-utility companies.

Transactions between Montaup and other affiliated companies include the following: sales of electricity by Montaup to Blackstone Valley Electric Company (Blackstone) and Newport Electric Corporation (Newport) aggregating approximately \$127,882,000 in 1997, \$127,536,000 in 1996, and \$133,841,000 in 1995; accounting, engineering and other services rendered by EUA Service Corporation to Eastern Edison and Montaup of approximately \$32,190,000, \$30,886,000, and \$29,264,000, in 1997, 1996 and 1995, respectively; and operating expense from the rental of transmission and generation facilities by Blackstone and Newport to Montaup aggregating approximately \$4,197,000 in 1997, \$3,960,000 in 1996, and \$4,351,000 in 1995. Transactions with affiliated companies are subject to review by applicable regulatory commissions.

**Utility Plant and Depreciation:** Utility plant is stated at original cost. The cost of additions to utility plant includes contracted work, direct labor and material, allocable overhead, allowance for funds used during construction and indirect charges for engineering and supervision. For financial statement purposes, depreciation is computed on the straight-line method based on estimated useful lives of the various classes of property. Provisions for depreciation, on a consolidated basis, were equivalent to a composite rate of approximately 3.2% in 1997, 1996 and 1995 based on the average depreciable property balances at the beginning and end of each year. Beginning in 1998, coincident

**(A) Nature of Operations and Summary of Significant Accounting Policies: (continued)**

with billing a contract termination charge (CTC) to its retail affiliates, Montaup will commence depreciating its investment in generation related assets recoverable through the CTC over a twelve-year period.

**Other Assets:** The components of Other Assets at December 31, 1997 and 1996 are detailed as follows:

(In Thousands)	<u>1997</u>	<u>1996</u>
Regulatory Assets:		
Unamortized losses on reacquired debt	\$ 11,588	\$ 13,277
Unrecovered plant and decommissioning cost	68,345	41,914
Deferred SFAS 109 costs (Note B)	46,806	47,326
Deferred SFAS 106 costs (Note J)	1,726	2,153
Other regulatory assets	<u>5,875</u>	<u>4,886</u>
Total regulatory assets	134,340	109,556
Other deferred charges and assets:		
Unamortized debt expenses	2,092	2,456
Other	<u>11,830</u>	<u>9,221</u>
Total Other Assets	<u>\$148,262</u>	<u>\$121,233</u>

**Regulatory Accounting:** Eastern Edison and Montaup are subject to certain accounting rules that are not applicable to other industries. These accounting rules allow regulated companies, in appropriate circumstances, to establish regulatory assets and liabilities which defer the current financial impact of certain costs that are expected to be recovered in future rates. In light of approved restructuring settlement agreements and restructuring legislation in both Massachusetts and Rhode Island, the Company has determined that Montaup no longer will apply the provisions of Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards No. 71 (FAS71), "Accounting for the Effects of Certain Types of Regulation" to the generation portion of its business. Due to the recoverability of regulatory assets granted in the approved restructuring plans, the company believes that the discontinuation of FAS71 for the generation portion of Montaup's business will not have a material impact on the Company's results of operation or financial condition. The Company believes its transmission and retail distribution businesses continue to meet the criteria for continued application of FAS71.

**(A) Nature of Operations and Summary of Significant Accounting Policies: (continued)**

**Allowance for Funds Used During Construction (AFUDC):** AFUDC represents the estimated cost of borrowed and equity funds used to finance Eastern Edison's and Montaup's construction program. In accordance with regulatory accounting, AFUDC is capitalized, as a cost of utility plant, in the same manner as certain general and administrative costs. AFUDC is not an item of current cash income, but is recovered over the service life of utility plant in the form of increased revenues collected as a result of higher depreciation expense. The combined rate used in calculating AFUDC was 8.2% in 1997; 8.9% in 1996, and 9.4% in 1995.

**Operating Revenues:** Revenues are based on billing rates authorized by applicable federal and state regulatory commissions. Eastern Edison accrues the estimated amount of unbilled revenues at the end of each month to match costs and revenues more closely. Montaup recognizes revenues when billed. In 1998, Eastern Edison and Montaup also began accruing revenues consistent with provisions of approved settlement agreements and the Massachusetts Electric Industry Restructuring Act.

**Income Taxes:** The general policy of Eastern Edison and Montaup with respect to accounting for federal and state income taxes is to reflect in income the estimated amount of taxes currently payable, as determined from the EUA consolidated tax return on an allocated basis, and to provide for deferred taxes on certain items subject to temporary differences to the extent permitted by the various regulatory commissions. As permitted by the regulatory commissions, it is the policy of Eastern Edison and Montaup to defer recognition of the annual investment tax credits and to amortize these credits over the productive lives of the related assets. Beginning in 1998, Montaup will amortize previously deferred ITC related to generation investments recoverable through the CTC over a twelve-year period.

**Cash and Temporary Cash Investments:** Eastern Edison and Montaup consider all highly liquid investments and temporary cash investments with a maturity of three months or less, when acquired, to be cash equivalents.



**(B) Income Taxes:**

Components of income tax expense for the years 1997, 1996, and 1995 are as follows:

(In Thousands)	<u>1997</u>	<u>1996</u>	<u>1995</u>
Federal:			
Current	\$16,427	\$ 9,111	\$11,387
Deferred	(4,031)	5,152	3,679
Investment Tax Credit, Net	<u>(935)</u>	<u>(939)</u>	<u>(942)</u>
	<u>\$11,461</u>	<u>\$13,324</u>	<u>\$14,124</u>
State:			
Current	3,505	2,612	2,447
Deferred	<u>(719)</u>	<u>122</u>	<u>(918)</u>
	<u>2,786</u>	<u>2,734</u>	<u>1,529</u>
Charged to Operations	<u>14,247</u>	<u>16,058</u>	<u>15,653</u>
Charged to Other Income:			
Current	1,175	1,233	522
Deferred	<u>(219)</u>	<u>(67)</u>	<u>(67)</u>
Total	<u>\$15,203</u>	<u>\$17,224</u>	<u>\$16,108</u>

Total income tax expense was different than the amounts computed by applying federal income tax statutory rates to book income subject to tax for the following reasons:

(In Thousands)	<u>1997</u>	<u>1996</u>	<u>1995</u>
Federal Income Tax Computed at Statutory Rates	\$15,487	\$17,568	\$17,343
(Decreases) Increases in Tax from:			
Equity Component of AFUDC	(56)	(128)	(165)
Consolidated Tax Savings		(156)	(108)
Depreciation Differences	(348)	(452)	(264)
Amortization and Utilization of ITC	(935)	(939)	(942)
State Taxes, Net of Federal Income Tax Benefit	1,919	1,897	(2,625)
Cost of Removal			58
Other	<u>(864)</u>	<u>(566)</u>	<u>2,811</u>
Total Income Tax Expense	<u>\$15,203</u>	<u>\$17,224</u>	<u>\$16,108</u>

**(B) Income Taxes** (continued)

Eastern Edison and Montaup adopted Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes" (FAS109) which required recognition of deferred income taxes for temporary differences that are reported in different years for financial reporting and tax purposes using the liability method. Under the liability method, deferred tax liabilities or assets are computed using the tax rates that will be in effect when temporary differences reverse. Generally, for regulated companies, the change in tax rates may not be immediately recognized in operating results because of rate making treatment and provisions in the Tax Reform Act of 1986. The total deferred tax assets and liabilities at December 31, 1997 and 1996 are comprised as follows (In Thousands):

	Deferred Tax			Deferred Tax	
	Assets			Liabilities	
	<u>1997</u>	<u>1996</u>		<u>1997</u>	<u>1996</u>
Plant Related			Plant Related		
Differences	\$11,997	\$13,490	Differences	\$154,025	\$153,471
Alternative			Refinancing		
Minimum Tax		412	Costs	1,264	1,471
Pensions	1,837	1,299	Pensions	987	877
Other	<u>5,974</u>	<u>1,040</u>	Other	<u>3,007</u>	<u>2,507</u>
Total	<u>\$19,808</u>	<u>\$16,241</u>	Total	<u>\$159,283</u>	<u>\$158,326</u>

As of December 31, 1997 and 1996, the Company had recorded on its Consolidated Balance Sheet a regulatory liability to ratepayers of approximately \$15.2 million and \$18.0 million, respectively. This amount primarily represents excess deferred income taxes resulting from the reduction in the federal income tax rate and also includes deferred taxes provided on investment tax credits. Also at December 31, 1997 and 1996, a regulatory asset of approximately \$46.8 million and \$47.3 million, respectively, has been recorded, representing the cumulative amount of federal income taxes on temporary depreciation differences which were previously flowed through to ratepayers.

**(C) Capital Stock:**

There were no changes in the number of shares of common or preferred stock during the years ended December 31, 1997, 1996 and 1995.

Under the terms and provisions of the issues of preferred stock of Eastern Edison, certain restrictions are placed upon the payment of dividends on common stock by Eastern Edison. At December 31, 1997, 1996 and 1995, the respective capitalization ratios were in excess of the minimum requirements which would make these restrictions effective.



**(D) Redeemable Preferred Stock:**

Eastern Edison's 6-5/8% Preferred Stock issue is entitled to an annual mandatory sinking fund sufficient to redeem 15,000 shares commencing September 1, 2003. The redemption price is \$100 per share plus accrued dividends. All outstanding shares of the 6 5/8% issue will be subject to mandatory redemption on September 1, 2008 at a price of \$100 per share plus accrued dividends.

In the event of liquidation, the holders of Eastern Edison's 6 5/8% Preferred Stock are entitled to \$100 per share plus accrued dividends.

**(E) Retained Earnings:**

Under the provisions of Eastern Edison's Indenture securing the First Mortgage and Collateral Trust Bonds, retained earnings in the amount of \$96,218,056 as of December 31, 1997 were unrestricted as to the payment of cash dividends on its Common Stock.

**(F) Long-Term Debt:**

The various mortgage bond issues of Eastern Edison are collateralized by substantially all of their utility plant. In addition, Eastern Edison's bonds are collateralized by securities of Montaup, which are wholly-owned by Eastern Edison, in the principal amount of approximately \$236 million.

The Company's requirements for the maturities of long-term debt (excluding amounts that may be satisfied by available property additions) for each of the five years following 1997 are: \$60 million in 1998, and none in 1999, 2000, 2001 and \$35 million in 2002. The Company has no sinking fund requirements through the year 2002.

**(G) Lines of Credit:**

In July 1997, several EUA System companies, including Eastern Edison, entered into a three-year revolving credit agreement allowing for borrowings in aggregate of up to \$120 million. As of December 31, 1997, various financial institutions have committed up to \$75 million under the revolving credit facility. At December 31, 1997, under the revolving credit agreement the EUA System had short-term borrowings available of approximately \$13.5 million. Eastern Edison had \$4.7 million of outstanding short-term debt at December 31, 1997. In accordance with the revolving credit agreement commitment fees are required to maintain certain lines of credit. During 1997, the weighted average interest rate for short-term borrowings by the Company was 5.8%.



### (H) Jointly Owned Facilities:

At December 31, 1997, in addition to the stock ownership interests discussed in Note A, Summary of Significant Accounting Policies - Jointly Owned Companies, Montaup had direct ownership interests in the following electric generating facilities:

	Percent Owned	Utility Plant in Service	Accumulated Provision For Depreciation and Amortization	Net Utility Plant in Service	Construction Work in Progress
(\$ In Thousands):					
Montaup:					
Canal Unit 2	50.00%	\$ 85,750	\$ 44,498	\$ 41,252	\$ 227
Wyman Unit 4	1.96%	4,054	2,253	1,801	
Seabrook Unit I	2.90%	194,679	34,400	160,279	325
Millstone Unit 3	4.01%	178,918	54,844	124,074	285

The foregoing amounts represent Montaup's interest in each facility, including nuclear fuel where appropriate, and are included on the like-captioned lines on the Consolidated Balance Sheet. At December 31, 1997, Montaup's total net investment in nuclear fuel of the Seabrook and Millstone units amounted to \$2.2 million and \$1.8 million, respectively. Montaup's shares of related operating and maintenance expenses with respect to units reflected in the table above are included in the corresponding operating expenses on the Consolidated Statement of Income.

### (I) Fair Value of Financial Instruments:

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate:

**Cash and Temporary Cash Investments:** The carrying amount approximates fair value because of the short-term maturity of those instruments.

**Redeemable Preferred Stock and Long-Term Debt:** The fair value of the Company's redeemable preferred stock and long-term debt were based on quoted market prices for such securities.

The estimated fair values of the Company's financial instruments at December 31, 1997 and 1996 were as follows (In Thousands):

	Carrying Amount		Fair Value	
	1997	1996	1997	1996
Cash and Temporary Cash Investments	\$ 461	\$ 2,105	\$ 461	\$ 2,105
Redeemable Preferred Stock	30,000	30,000	31,613	30,300
Long-Term Debt	\$223,000	\$223,000	\$235,190	\$225,870

## (J) Commitments and Contingencies:

**Nuclear Fuel Disposal and Nuclear Decommissioning Costs:** The owners (or lead participants) of the nuclear units in which Montaup has an interest have made, or expect to make, various arrangements for the acquisition of uranium concentrate, the conversion, enrichment, fabrication and utilization of nuclear fuel and the disposition of that fuel after use. The owners (or lead participants) of United States nuclear units have entered into contracts with the Department of Energy (DOE) for disposal of spent nuclear fuel in accordance with the Nuclear Waste Policy Act of 1982 (NWPA). The NWPA requires (subject to various contingencies) that the federal government design, license, construct and operate a permanent repository for high level radioactive wastes and spent nuclear fuel and establish a prescribed fee for the disposal of such wastes and nuclear fuel. The NWPA specifies that the DOE provide for the disposal of such waste and spent nuclear fuel starting in 1998. Objections on environmental and other grounds have been asserted against proposals for storage as well as disposal of spent nuclear fuel. The DOE now estimates that a permanent disposal site for spent fuel will not be ready to accept fuel for storage or disposal until as late as the year 2010. In early 1998, a number of utilities filed suit in federal appeals court seeking, among other things, an order requiring the DOE to immediately establish a program for the disposal of spent nuclear fuel. Montaup owns a 4.01% interest in Millstone 3 and a 2.9% interest in Seabrook I. Northeast Utilities, the operator of the units, indicates that Millstone 3 has sufficient on-site storage facilities which, with rack additions, can accommodate its spent fuel for the projected life of the unit. At the Seabrook Project, there is on-site storage capacity which, with rack additions, will be sufficient to at least the year 2011.

The Energy Policy Act of 1992 requires that a fund be created for the decommissioning and decontamination of the DOE uranium enrichment facilities. The fund will be financed in part by special assessments on nuclear power plants in which Montaup has an interest. These assessments are calculated based on the utilities' prior use of the government facilities and have been levied by the DOE, starting in September 1993, and will continue over 15 years. This cost is passed on to the joint owners or power buyers as an additional fuel charge on a monthly basis and is currently being recovered by Montaup through rates.

Also, Montaup is recovering through rates its share of estimated decommissioning costs for Millstone 3 and Seabrook I. Montaup's share of the current estimate of total costs to decommission Millstone 3 is \$21.9 million in 1997 dollars, and Seabrook I is \$13.7 million in 1997 dollars. These figures are based on studies performed for the lead owners of the units. Montaup also pays into decommissioning reserves pursuant to contractual arrangements with other nuclear generating facilities in which it has an equity ownership interest or life of the unit entitlement. Such expenses are currently recoverable through rates.



(J) **Commitments and Contingencies** (continued)

**Pensions:** Eastern Edison and Montaup participate with the other EUA System companies in a non-contributory defined benefit pension plan covering substantially all of their employees (Retirement Plan). Retirement Plan benefits are based on years of service and average compensation over the four years prior to retirement. It is the EUA System's policy to fund the Retirement Plan on a current basis in amounts determined to meet the funding standards established by the Employee Retirement Income Security Act of 1974.

Total pension (income) expense for the Retirement Plan, including amounts related to the 1997 and 1995 voluntary retirement incentive offers, for 1997, 1996 and 1995 includes the following components (\$ In Thousands):

	<u>1997</u>	<u>1996</u>	<u>1995</u>
Service cost - benefits earned during the period	\$ 1,689	\$ 1,713	\$ 1,504
Interest cost on projected benefit obligation	6,021	5,767	5,575
Actual (return) on assets	(18,178)	(10,036)	(22,158)
Net amortization and deferrals	<u>9,891</u>	<u>2,407</u>	<u>14,855</u>
Net periodic pension (income) expense	\$ (577)	\$ (149)	\$ (224)
Voluntary retirement incentive			<u>857</u>
Total periodic pension (income) expense	<u>\$ (577)</u>	<u>\$ (149)</u>	<u>\$ 633</u>

Assumptions used to determine pension cost:

	<u>1997</u>	<u>1996</u>	<u>1995</u>
Discount Rate	7.50%	7.25%	8.25%
Compensation Increase Rate	4.25%	4.25%	4.75%
Long-Term Return on Assets	9.50%	9.50%	9.50%

The discount rate used to determine pension obligations was changed to 7.25% effective January 1, 1998. The funded status of the Retirement Plan cannot be presented separately for Eastern Edison and Montaup as they participate in the Retirement Plan with other subsidiaries of EUA.

The voluntary retirement incentives also resulted in non-qualified pension benefits of approximately \$752,000 and \$800,000 in 1997 and 1995, respectively. At December 31, 1997, approximately \$448,000 is included in other liabilities for these unfunded benefits.



**(J) Commitments and Contingencies** *(continued)*

EUA also maintains non-qualified supplemental retirement plans for certain officers and trustees of the EUA System (Supplemental Plans). Benefits provided under the Supplemental Plans are based primarily on compensation at retirement date. EUA maintains life insurance on the participants of the Supplemental Plans to fund in whole, or in part, its future liabilities under the Supplemental Plans. For the years ended December 31, 1997, 1996 and 1995 Eastern Edison's and Montaup's expenses related to the Supplemental Plan were approximately \$805,000, \$717,000 and \$825,000, respectively.

The Company also provides a defined contribution 401(k) savings plan for substantially all employees. The Company's matching percentage of employees' voluntary contributions to the plan, amounted to approximately \$321,000 in 1997, \$306,000 in 1996, and approximately \$369,000 in 1995.

**Post-Retirement Benefits:** Retired employees are entitled to participate in health care and life insurance benefit plans. Health care benefits are subject to deductibles and other limitations. Health care and life insurance benefits are partially funded by EUA System companies for all qualified employees.

Eastern Edison and Montaup adopted FAS106, "Employers' Accounting for Post-Retirement Benefits Other Than Pensions," as of January 1, 1993. This standard establishes accounting and reporting standards for such post-retirement benefits as health care and life insurance. Under FAS106 the present value of future benefits is recorded as a periodic expense over employee service periods through the date they become fully eligible for benefits. With respect to periods prior to adopting FAS106, EUA elected to recognize accrued costs (the Transition Obligation) over a period of 20 years, as permitted by FAS106. The resultant annual expense, including amortization of the Transition Obligation and net of amounts capitalized and deferred, was approximately \$3.9 million in 1997, \$3.6 million in 1996 and \$4.0 million in 1995.

**(J) Commitments and Contingencies** *(continued)*

The total cost of Post-Retirement Benefits other than Pensions, including amounts related to the 1997 and 1995 voluntary retirement incentive offers, for 1997, 1996 and 1995 includes the following components (In Thousands):

	<u>1997</u>	<u>1996</u>	<u>1995</u>
Service cost	\$587	\$637	\$565
Interest cost	2,701	2,688	2,926
Actual return on plan assets	(775)	(115)	(388)
Amortization of transition obligation	1,952	1,955	1,965
Net other amortization & deferrals	<u>(407)</u>	<u>(721)</u>	<u>(632)</u>
Net periodic post-retirement benefit costs	4,058	4,444	4,436
Voluntary retirement incentive	<u>102</u>	<u>—</u>	<u>470</u>
Total post-retirement benefit costs	<u>\$4,160</u>	<u>\$4,444</u>	<u>\$ 4,906</u>
Assumptions:			
Discount rate	7.50%	7.25%	8.25%
Health care cost trend rate - near-term	7.00%	9.00%	11.00%
- long-term	5.00%	5.00%	5.00%
Compensation increase rate	4.25%	4.25%	4.75%
Rate of return on plan assets - union	8.50%	8.50%	8.50%
- non-union	7.50%	7.50%	5.50%
Reconciliation of funded status:			
(In Thousands)	<u>1997</u>	<u>1996</u>	<u>1995</u>
Accumulated post-retirement benefit obligation (APBO):			
Retirees	\$(20,819)	\$(19,864)	\$(23,223)
Active employee fully eligible for benefits	(1,551)	(1,728)	(3,649)
Other active employees	<u>(6,101)</u>	<u>(6,031)</u>	<u>(7,711)</u>
Total	(28,471)	(27,623)	(34,583)
Fair Value of assets (primarily notes and bonds)	6,991	5,161	3,830
Unrecognized transition obligation	24,463	26,095	27,726
Unrecognized net gain	<u>(8,924)</u>	<u>(9,297)</u>	<u>(2,142)</u>
(Accrued) prepaid post-retirement benefit cost	\$(5,941)	\$5,664	\$(5,169)

(j) **Commitments and Contingencies** *(continued)*

The discount rate and compensation increase rates used to determine post-retirement benefit obligations was changed to 7.25% effective January 1, 1998, and was used to calculate the funded status of Post-Retirement Benefits at December 31, 1997.

Increasing the assumed health care cost trend rate by 1% each year would increase the total post-retirement benefit cost for 1997 by approximately \$299,000 and increase the total accumulated post-retirement benefit obligation by approximately \$2.9 million.

Eastern Edison and Montaup have also established an irrevocable external Voluntary Employees' Beneficiary Association (VEBA) Trust Fund. Contributions to the VEBA fund commenced in March 1993 and contributions were made totaling approximately \$2.9 million in 1997 and 1996, and \$3.2 million in 1995.

**Long-Term Purchased Power Contracts:** Montaup is committed under long-term purchased power contracts, expiring on various dates through September 2021, to pay demand charges whether or not energy is received. Under terms in effect at December 31, 1997, the aggregate annual minimum commitments for such contracts are approximately \$114 million in 1998, \$110 million in 1999, \$107 million in 2000, \$108 million in 2001, \$108 million in 2002, and will aggregate \$1.0 billion for the ensuing years. In addition, the EUA System is required to pay additional amounts depending on the actual amount of energy received under such contracts. The demand costs associated with these contracts are reflected as Purchased Power-Demand on the Consolidated Statement of Income. Such costs are currently recoverable through rates.

**Environmental Matters:** There is an extensive body of federal and state statutes governing environmental matters, which permit, among other things, federal and state authorities to initiate legal action providing for liability, compensation, cleanup, and emergency response to the release or threatened release of hazardous substances into the environment and for the cleanup of inactive hazardous waste disposal sites which constitute substantial hazards. Because of the nature of the Eastern Edison business, various by-products and substances are produced or handled which are classified as hazardous under the rules and regulations promulgated by the United States Environmental Protection Agency (EPA) as well as state and local authorities. The Company generally provides for the disposal of such substances through licensed contractors, but these statutory provisions generally impose potential joint and several responsibility on the generators of the wastes for cleanup costs. In the past, Eastern Edison and Montaup had been notified with respect to a number of sites where they were allegedly responsible for such costs, including sites where they allegedly had joint and several liability with other responsible parties. Eastern Edison and Montaup are currently not involved in any environmental site investigation. It is the policy of Eastern Edison and Montaup to notify liability insurers and to initiate claims. The costs incurred in connection with these sites have been financed primarily with internally generated cash.



**(J) Commitments and Contingencies** *(continued)*

As a general matter Eastern Edison and Montaup would seek to recover costs relating to environmental proceedings in their rates. Montaup is currently recovering certain of the incurred costs in its rates.

The Clean Air Act Amendments created new regulatory programs and generally updated and strengthened air pollution control laws. These amendments expanded the regulatory role of the EPA regarding emissions from electric generating facilities and a host of other sources. EUA System generating facilities were first affected in 1995, when EPA regulations took effect for facilities. Montaup's coal-fired Somerset Unit 6 is utilizing lower sulfur content coal to meet the 1995 air standards. EUA does not anticipate the impact from the Amendments to be material to the financial position of the EUA System.

In July, the EPA issued a new and more stringent rule covering ozone particulate matter which is to be followed by promulgation of more stringent ozone and particulate matter standards. The effect that such standards will have on the EUA System cannot be determined by management at this time.

Eastern Edison, Montaup, the Massachusetts Attorney General and Division of Energy Resources entered into a settlement regarding electric utility industry restructuring in Massachusetts. The settlement includes a plan for emissions reductions related to Montaup's Somerset Station Units 5 and 6, and to Montaup's 50% ownership share of Canal Electric's Unit 2. The basis for SO<sub>2</sub> and NO<sub>x</sub> emission reductions in the proposed settlement is an allowance cap calculation. Montaup may meet its allowance caps by any combination of control technologies, fuel switching, operational changes, and/or the use of purchased or surplus allowances. The settlement was approved by FERC on December 19, 1997.

In April 1992, the Northeast States for Coordinated Air Use Management (NESCAUM), an environmental advisory group for eight northeast states including Massachusetts and Rhode Island, issued recommendations for NO<sub>x</sub> controls for existing utility boilers required to meet the ozone non-attainment requirements of the Clean Air Act. The NESCAUM recommendations are more restrictive than the Clean Air Act requirements. The Massachusetts Department of Environmental Management has amended its regulations to require that Reasonably Available Control Technology (RACT) be implemented at all stationary sources potentially emitting 50 tons or more per year of NO<sub>x</sub>. Similar regulations have been issued in Rhode Island. Montaup has initiated compliance, through, among other things, selective noncatalytic reduction processes.

A number of scientific studies in the past several years have examined the possibility of health effects from EMF that are found wherever there is electricity. While some of the studies have indicated some association between exposure to EMF and health effects, many others have indicated

**(J) Commitments and Contingencies (continued)**

no direct association. On October 31, 1996, the National Academy of Sciences issued a literature review of all research to date, *Possible Health Effects of Exposure to Residential Electric and Magnetic Fields*. Its most widely reported conclusion stated, "No clear, convincing evidence exists to show that residential exposures to EMF are a threat to human health." Additional studies, which are intended to provide a better understanding of EMF, are continuing.

Some states have enacted regulations to limit the strength of magnetic fields at the edge of transmission line rights-of-way. Rhode Island has enacted a statute which authorizes and directs the Energy Facility Siting Board to establish rules and regulations governing construction of high voltage transmission lines of 69 kv or more. Management cannot predict the ultimate outcome of the EMF issue.

**Guarantee of Financial Obligations:** Montaup is a 3.27% equity participant in two companies which own and operate transmission facilities interconnecting New England and the Hydro Quebec system in Canada. Montaup has guaranteed approximately \$4.5 million of the outstanding debt of these two companies. In addition, Montaup has a minimum rental commitment which totals approximately \$12.0 million under a noncancellable transmission facilities support agreement for years subsequent to 1997.

**Other:** In early 1997, ten plaintiffs brought suit against numerous defendants, including EUA, for injuries and illness allegedly caused by exposure to asbestos over approximately a thirty-year period, at premises, including some owned by EUA companies. The total damages claimed in all of these complaints was \$25 million in compensatory and punitive damages, plus exemplary damages and interest and costs. Each names between fifteen and twenty-eight defendants, including EUA. These complaints have been referred to the applicable insurance companies. Counsel has been retained by the insurers and is actively defending all cases. Three cases have been dismissed as against EUA companies with prejudice. EUA cannot predict the ultimate outcome of this matter at this time.

The Office of the Attorney General has certified a referendum petition to repeal the Massachusetts Electric Industry Restructuring Act as a matter appropriate for a referendum initiative. A petition was filed with the Election Division of the Office of the Secretary of State in February 1998. A question on repealing the Act will be presented to voters on the November 1998 ballot. EUA and the electric industry in Massachusetts will actively oppose repeal. Management cannot predict the outcome of the November ballot question.

## Report of Independent Accountants

To the Directors and Shareholder of  
Eastern Edison Company and Subsidiary:

We have audited the accompanying consolidated balance sheets and consolidated statements of capitalization of Eastern Edison Company and its subsidiary (the Company) as of December 31, 1997 and 1996, and the related consolidated statements of income, retained earnings and cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 1997 and 1996, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P.

Boston, Massachusetts  
March 3, 1998