SCHWARTZ MICHAEL D
Form 4
February 25, 2005

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL

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Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
SCHWARTZ MICHAEL D

(Last) (First) (Middle)

PO BOX 46700

(Street)

MT. CLEMENS, MI 48046

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
COMMUNITY CENTRAL BANK CORP [ccbd]

3. Date of Earliest Transaction (Month/Day/Year)
02/24/2005

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	02/24/2005		S		100	D	$ 17.3	27,211	D	
Common Stock	02/25/2005		S		500	D	$ 17	26,711	D	
Common Stock								1,068	I	Wife with their children

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form

SEC 1474 (9-02)

displays a currently valid OMB control number.

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
								Date Exercisable	Expiration Date	Title	Amount or Number of Shares		
				Code	V	(A)	(D)						

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
SCHWARTZ MICHAEL D PO BOX 46700 MT. CLEMENS, MI 48046	X			

Signatures

s/ Michael D. Schwartz	02/25/2005
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. I) CMS Pipeline Assets... CMS Enterprises pipeline assets in Michigan and Australia CMS Viron... CMS Viron Energy Services, formerly a wholly owned subsidiary of CMS MST. The sale of this subsidiary closed in June 2003. Common Stock.. All classes of Common Stock of CMS Energy and each of its subsidiaries, or any of them individually, at the time of an award or grant under the Performance Incentive Stock Plan Consumers.. Consumers Energy Company, a subsidiary of CMS Energy Consumers Funding.. Consumers Funding LLC, a wholly-owned special purpose subsidiary of Consumers for the issuance of securitization bonds dated November 8, 2001 Consumers Receivables Funding II.................................. Consumers Receivables Funding II LLC, a wholly-owned subsidiary of Consumers Court of Appeals.. Michigan Court of Appeals

CPEE.. Companhia Paulista de Energia Eletrica, a subsidiary of Enterprises
Customer Choice Act... Customer Choice and Electricity Reliability Act, a Michigan statute enacted in June 2000 that allows all retail customers choice of alternative electric suppliers as of January 1, 2002, provides for full recovery of net stranded costs and implementation costs, establishes a five percent reduction in residential rates, establishes rate freeze and rate cap, and allows for Securitization Detroit
Edison.. The Detroit Edison Company, a non-affiliated company
DIG... Dearborn Industrial Generation, LLC, a wholly owned subsidiary of CMS Generation DOE... U.S. Department of Energy
DOJ... U.S. Department of Justice
Dow... The Dow Chemical Company, a non-affiliated company
EBITDA.. Earnings before income taxes, depreciation, and amortization
EISP... Executive Incentive Separation Plan
EITF... Emerging Issues Task Force EITF Issue No.
02-03.. Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities EITF Issue No.
97-04.. Deregulation of the Pricing of Electricity-- Issues Related to the Application of FASB Statements No. 71 and 101 El Chocon... The 1,200 MW hydro power plant located in Argentina, in which CMS Generation holds a 17.23 percent ownership Interest
Enterprises... CMS Enterprises Company, a subsidiary of CMS Energy
EPA.. U.S. Environmental Protection Agency
EPS... Earnings per share ERISA.. Employee Retirement Income Security Act Ernst & Young... Ernst & Young LLP
Exchange Act.. Securities Exchange Act of 1934, as amended
FASB... Financial Accounting Standards Board FASB Staff Position, No. SFAS
106-1................................ Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (January 12, 2004) FASB Staff Position, No. SFAS
106-2................................ Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (May 19, 2004) FERC... Federal Energy Regulatory Commission 147 FMB... First Mortgage Bonds
FMLP.. First Midland Limited Partnership, a partnership that holds a lessor interest in the MCV facility Ford... Ford Motor Company
GasAtacama.. An integrated natural gas pipeline and electric generation project located in Argentina and Chile which includes 702 miles of natural gas pipeline and a 720 MW gross capacity power plant GCR... Gas cost recovery GEII... General Electric International Inc. Goldfields... A pipeline business located in Australia, in which CMS Energy holds a 39.7 percent ownership interest
Guardian... Guardian Pipeline, LLC, in which CMS Gas Transmission owned a one-third interest Health Care Plan... The medical, dental, and prescription drug programs offered to eligible employees of Consumers and CMS Energy HL
Power.. H.L. Power Company, a California Limited Partnership, owner of the Honey Lake generation project in Wendel, California Integrum... Integrum Energy Ventures, LLC IPP... Independent Power Production
ITC... Investment tax credit JOATT... Joint Open Access Transmission Tariff Jorf Lasfar... The 1,356 MW coal-fueled power plant in Morocco, jointly owned by CMS Generation and ABB Energy Ventures, Inc.
Karn... D.E. Karn/J.C. Weadock Generating Complex, which is owned by Consumers kWh... Kilowatt-hour
LIBOR... London Inter-Bank Offered Rate Loy
Yang.. The 2,000 MW brown coal fueled Loy Yang A power plant and an associated coal mine in Victoria, Australia, in which CMS Generation holds a 50 percent ownership interest
LNG... Liquefied natural gas Ludington...

Ludington pumped storage plant, jointly owned by Consumers and Detroit Edison MAPL... Marathon Ashland Petroleum, LLC, partner in Centennial Marysville.. CMS Marysville Gas Liquids Company, a Michigan corporation and a subsidiary of CMS Gas Transmission that held a 100 percent interest in Marysville Fractionation Partnership and a 51 percent interest in St. Clair Underground Storage Partnership mcf... Thousand cubic feet MCV Expansion, LLC.. An agreement entered into with General Electric Company to expand the MCV Facility MCV Facility... A natural gas-fueled, combined-cycle cogeneration facility operated by the MCV Partnership MCV Partnership.. Midland Cogeneration Venture Limited Partnership in which Consumers has a 49 percent interest through CMS Midland MD&A... Management's Discussion and Analysis METC... Michigan Electric Transmission Company, formerly a subsidiary of Consumers Energy and now an indirect subsidiary of Trans-Elect Michigan Power.. CMS Generation Michigan Power, LLC, owner of the Kalamazoo River Generating Station and the Livingston Generating Station MISO... Midwest Independent System Operator Moody's... Moody's Investors Service, Inc. MPSC... Michigan Public Service Commission 148 MSBT... Michigan Single Business Tax MTH... Michigan Transco Holdings, Limited Partnership MW... Megawatts NEIL.. Nuclear Electric Insurance Limited, an industry mutual insurance company owned by member utility companies NMC.. Nuclear Management Company, LLC, formed in 1999 by Northern States Power Company (now Xcel Energy Inc.), Alliant Energy, Wisconsin Electric Power Company, and Wisconsin Public Service Company to operate and manage nuclear generating facilities owned by the four Utilities NERC.. North American Electric Reliability Council NRC... Nuclear Regulatory Commission NYMEX... New York Mercantile Exchange OATT.. Open Access Transmission Tariff OPEB.. Postretirement benefit plans other than pensions for retired Employees Palisades....................................... Palisades nuclear power plant, which is owned by Consumers Panhandle Eastern Pipe Line or Panhandle.......... Panhandle Eastern Pipe Line Company, including its subsidiaries Trunkline, Pan Gas Storage, Panhandle Storage, and Panhandle Holdings. Panhandle was a wholly owned subsidiary of CMS Gas Transmission. The sale of this subsidiary closed in June 2003. Parmelia.. A business located in Australia comprised of a pipeline, processing facilities, and a gas storage facility, a subsidiary of CMS Gas Transmission PCB.. Polychlorinated biphenyl Pension Plan.................................... The trusteed, non-contributory, defined benefit pension plan of Panhandle, Consumers and CMS Energy PJM RTO... Pennsylvania-Jersey-Maryland Regional Transmission Organization Powder River.................................... CMS Oil & Gas previously owned a significant interest in coalbed methane fields or projects developed within the Powder River Basin Which spans the border between Wyoming and Montana. The Powder River properties have been sold. PPA.. The Power Purchase Agreement between Consumers and the MCV Partnership with a 35-year term commencing in March 1990 Price Anderson Act.............................. Price Anderson Act, enacted in 1957 as an amendment to the Atomic Energy Act of 1954, as revised and extended over the years. This act stipulates between nuclear licensees and the U.S. government the insurance, financial responsibility, and legal liability for nuclear accidents. PSCR.. Power supply cost recovery PUHCA... Public Utility Holding Company Act of 1935 PURPA.. Public Utility Regulatory Policies Act of 1978 RCP... Resource Conservation Plan ROA.. Retail Open Access RTO.. Regional Transmission Organization Rouge.. Rouge Steel Industries SCP.. Southern Cross Pipeline in Australia, in which CMS Gas Transmission holds a 45 percent ownership interest SEC.. U.S. Securities and Exchange Commission Securitization.................................. A financing method authorized by statute and approved by the MPSC which allows a utility to sell its right to receive a portion of the rate payments received from its customers for the repayment of Securitization bonds issued by a special purpose entity affiliated with such utility SENECA... Sistema Electrico del Estado Nueva Esparta, C.A., a subsidiary of Enterprises

SERP.. Supplemental Executive Retirement Plan SFAS.. Statement of Financial Accounting Standards 149 SFAS No. 5...................................... SFAS No. 5, "Accounting for Contingencies" SFAS No. 52..................................... SFAS No. 52, "Foreign Currency Translation" SFAS No. 71...................................... SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" SFAS No. 87...................................... SFAS No. 87, "Employers' Accounting for Pensions" SFAS No. 88...................................... SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" SFAS No. 98..................................... SFAS No. 98, "Accounting for Leases" SFAS No. 106.................................... SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" SFAS No. 107.................................... Disclosures about Fair Value of Financial Instruments SFAS No. 109.................................... SFAS No. 109, "Accounting for Income Taxes" SFAS No. 115.................................... SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" SFAS No. 123.................................... SFAS No. 123, "Accounting for Stock-Based Compensation" SFAS No. 128.................................... SFAS No. 128, "Earnings per Share" SFAS No. 133.................................... SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities, as amended and interpreted" SFAS No. 143.................................... SFAS No. 143, "Accounting for Asset Retirement Obligations" SFAS No. 144.................................... SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" SFAS No. 148.................................... SFAS No. 148, "Accounting for Stock-Based Compensation-- Transition and Disclosure" SFAS No. 149.................................... SFAS No. 149, "Amendment of Statement No. 133 on Derivative Instruments and Hedging Activities" SFAS No. 150.................................... SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" Southern Union.................................. Southern Union Company, a non-affiliated company Special Committee................................ A special committee of independent directors, established by CMS Energy's Board of Directors, to investigate matters surrounding Round-trip trading Stranded Costs.................................. Costs incurred by utilities in order to serve their customers in a regulated monopoly environment, which may not be recoverable in a competitive environment because of customers leaving their systems and ceasing to pay for their costs. These costs could include owned and purchased generation and regulatory assets. Superfund....................................... Comprehensive Environmental Response, Compensation and Liability Act Taweelah.. Al Taweelah A2, a power and desalination plant of Emirates CMS Power Company, in which CMS Generation holds a forty percent interest TEPPCO.. Texas Eastern Products Pipeline Company, LLC Toledo Power.................................... Toledo Power Company, the 135 MW coal and fuel oil power plant located on Cebu Island, Phillipines, in which CMS Generation held a 47.5 percent interest. Transition Costs................................ Stranded Costs, as defined, plus the costs incurred in the transition to competition Trunkline...................................... Trunkline Gas Company, LLC, formerly a subsidiary of CMS Panhandle Holdings, LLC Trunkline LNG.................................. Trunkline LNG Company, LLC, formerly a subsidiary of LNG Holdings, LLC Trust Preferred Securities....................... Securities representing an undivided beneficial interest in the Assets of statutory business trusts, the interests of which have a preference with respect to certain trust distributions over the interests of either CMS Energy or Consumers, as applicable, as owner of the common beneficial interests of the trusts Union.. Utility Workers of America, AFL-CIO VEBA Trusts..................................... VEBA (voluntary employees' beneficiary association) Trusts accounts established to specifically set aside employer contributed assets to pay for future expenses of the OPEB plan 150

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

 Pursuant to Regulation S-X, Rule 3-09, the financial statements for the fiscal years ended June 30, 2002, 2003 and 2004 for SCP Investments (1) PTY. LTD. which is a foreign business will be filed by CMS Energy by December 31, 2004. F-1 CMS ENERGY CORPORATION CONSOLIDATED STATEMENTS OF INCOME (LOSS) (UNAUDITED) THREE MONTHS ENDED SIX MONTHS ENDED RESTATED RESTATED JUNE 30 2004 2003 2004 2003 ------- ------- ------- ------- ------- In Millions, Except Per Share Amounts OPERATING REVENUE $ 1,093 $ 1,126 $ 2,847 $ 3,094 EARNINGS FROM EQUITY METHOD INVESTEES 41 50 60 97 OPERATING EXPENSES Fuel for electric generation 184 98 356 206 Purchased and interchange power 80 102 157 341 Purchased power - related parties - 124 - 260 Cost of gas sold 263 298 1,024 1,135 Other operating expenses 224 217 442 415 Maintenance 65 61 122 119 Depreciation, depletion and amortization 108 90 252 218 General taxes 62 7 136 76 Assets impairment charges - 3 125 9 ------- ------- ------- ------- 986 1,000 2,614 2,779 ------- ------- ------- ------- OPERATING INCOME 148 176 293 412 OTHER INCOME (DEDUCTIONS) Accretion expense (6) (9) (12) (16) Gain (loss) on asset sales, net 1 (3) 3 (8) Interest and dividends 7 7 14 11 Foreign currency gains (losses), net (3) 5 (6) 11 Other income 15 3 27 6 Other expense (2) (1) (4) (3) ------- ------- ------- ------- 12 2 22 1 ------- ------- ------- ------- FIXED CHARGES Interest on long-term debt 126 128 256 225 Interest on long-term debt - related parties 14 - 29 - Other interest 7 11 12 18 Capitalized interest (1) (3) (3) (5) Preferred dividends of subsidiaries 1 1 2 1 Preferred securities distributions - 18 - 36 ------- ------- ------- ------- 147 155 296 275 ------- ------- ------- ------- INCOME BEFORE INCOME TAXES AND MINORITY INTERESTS 13 23 19 138 INCOME TAX EXPENSE (BENEFIT) (7) 34 (10) 73 MINORITY INTERESTS 1 1 12 2 ------- ------- ------- ------- INCOME (LOSS) FROM CONTINUING OPERATIONS 19 (12) 17 63 LOSS FROM DISCONTINUED OPERATIONS, NET OF $- AND $1 TAX BENEFIT IN 2004 AND $3 AND $21 TAX EXPENSE IN 2003 - (53) (2) (22) ------- ------- ------- ------- INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING 19 (65) 15 41 CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING, NET OF $13 TAX BENEFIT IN 2003: DERIVATIVES (NOTE 6) - - - (23) ASSET RETIREMENT OBLIGATIONS, SFAS NO. 143 (NOTE 10) - - - (1) ------- ------- ------- ------- - - - (24) ------- ------- ------- ------- NET INCOME (LOSS) 19 (65) 15 17 PREFERRED DIVIDENDS 3 - 6 - ------- ------- ------- ------- NET INCOME (LOSS) AVAILABLE TO COMMON STOCK $ 16 $ (65) $ 9 $ 17 ======= ======= ======= ======= THE ACCOMPANYING CONDENSED NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS. F-2 THREE MONTHS ENDED SIX MONTHS ENDED RESTATED RESTATED JUNE 30 2004 2003 2004 2003 ------- ------- ------- ------- ------- In Millions, Except Per Share Amounts CMS ENERGY NET INCOME (LOSS) Net Income (Loss) Available to Common Stock $ 16 $ (65) $ 9 $ 17 ======= ======= ======= ======= BASIC EARNINGS (LOSS) PER AVERAGE

COMMON SHARE Income (Loss) from Continuing Operations $ 0.10 $ (0.08) $ 0.07 $ 0.43 Income (Loss) from Discontinued Operations - (0.37) (0.01) (0.15) Loss from Changes in Accounting - - - (0.16) ------- ------- ------- ------- Net Income (Loss) Attributable to Common Stock $ 0.10 $ (0.45) $ 0.06 $ 0.12 ======= ======= ======= ======= DILUTED EARNINGS (LOSS) PER AVERAGE COMMON SHARE Income (Loss) from Continuing Operations $ 0.10 $ (0.08) $ 0.07 $ 0.43 Income (Loss) from Discontinued Operations - (0.37) (0.01) (0.14) Loss from Changes in Accounting - - - (0.15) ------- ------- ------- ------- Net Income (Loss) Attributable to Common Stock $ 0.10 $ (0.45) $ 0.06 $ 0.14 ======= ======= ======= ======= DIVIDENDS DECLARED PER COMMON SHARE $ - $ - $ - $ - ------- ------- ------- ------- THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS. F-3 CMS ENERGY CORPORATION CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) SIX MONTHS ENDED RESTATED JUNE 30 2004 2003 ------- ------- ------- In Millions CASH FLOWS FROM OPERATING ACTIVITIES Net income $ 15 $ 17 Adjustments to reconcile net income to net cash provided by operating activities Depreciation, depletion and amortization (includes nuclear decommissioning of $3 and $3, respectively) 252 218 Loss on disposal of discontinued operations 1 49 Asset impairments (Note 2) 125 9 Capital lease and debt discount amortization 14 12 Accretion expense 12 16 Bad debt expense 5 8 Undistributed earnings from related parties (44) (69) Loss (gain) on the sale of assets (3) 8 Cumulative effect of accounting changes - 24 Changes in other assets and liabilities: Increase in accounts receivable and accrued revenues (112) (69) Decrease (increase) in inventories 81 (2) Increase (decrease) in accounts payable and accrued expenses 66 (298) Deferred income taxes and investment tax credit 44 169 Decrease in other assets 16 91 Increase (decrease) in other liabilities 9 (36) ------- ------- Net cash provided by operating activities $ 481 $ 147 ------- ------- CASH FLOWS FROM INVESTING ACTIVITIES Capital expenditures (excludes assets placed under capital lease) $ (237) $ (261) Cost to retire property (37) (35) Restricted cash (12) (167) Investment in Electric Restructuring Implementation Plan (3) (4) Investments in nuclear decommissioning trust funds (3) (3) Proceeds from nuclear decommissioning trust funds 23 18 Maturity of MCV restricted investment securities held-to-maturity 300 - Purchase of MCV restricted investment securities held-to-maturity (300) - Proceeds from sale of assets 66 726 Other investing (11) 18 ------- ------- Net cash provided by (used in) investing activities $ (214) $ 292 ------- ------- CASH FLOWS FROM FINANCING ACTIVITIES Proceeds from notes, bonds, and other long-term debt $ 9 $ 1,449 Retirement of bonds and other long-term debt (274) (830) Payment of preferred stock dividends (6) - Decrease in notes payable - (487) Payment of capital lease obligations (5) (7) ------- ------- Net cash provided by (used in) financing activities $ (276) $ 125 ------- ------- EFFECT OF EXCHANGE RATES ON CASH (1) 2 ------- ------- NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS $ (10) $ 566 CASH AND CASH EQUIVALENTS FROM EFFECT OF REVISED FASB INTERPRETATION NO. 46 CONSOLIDATION 174 - CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD 532 351 ------- ------- CASH AND CASH EQUIVALENTS, END OF PERIOD $ 696 $ 917 ======= ======= OTHER CASH FLOW ACTIVITIES AND NON-CASH INVESTING AND FINANCING ACTIVITIES WERE: CASH TRANSACTIONS Interest paid (net of amounts capitalized) $ 246 $ 233 Income taxes paid (net of refunds) - (33) OPEB cash contribution 33 40 NON-CASH TRANSACTIONS Other assets placed under capital leases $ 1 $ 10 ======= ======= THE ACCOMPANYING CONDENSED NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS. F-4 CMS ENERGY CORPORATION CONSOLIDATED BALANCE SHEETS ASSETS JUNE 30 JUNE 30 2003 2004 DECEMBER 31 RESTATED (UNAUDITED) 2003 (UNAUDITED) ----------- ----------- ----------- In Millions PLANT AND PROPERTY (AT COST) Electric utility $ 7,776 $ 7,600 $ 7,465 Gas utility 2,898 2,875 2,805 Enterprises 3,392 895 706 Other 28 32 37 ----------- ----------- ----------- 14,094 11,402 11,013 Less accumulated depreciation, depletion and amortization 5,958 4,846 4,777 ----------- ----------- ----------- 8,136 6,556 6,236 Construction work-in-progress 392 388 438 ----------- ----------- ----------- 8,528 6,944 6,674 ----------- ----------- ----------- INVESTMENTS Enterprises 754 724 740 Midland Cogeneration Venture Limited Partnership - 419 422 First Midland Limited Partnership - 224 263 Other 24 23 2 ----------- ----------- ----------- 778 1,390 1,427 ----------- ----------- ----------- CURRENT ASSETS Cash and cash equivalents at cost, which approximates market 696 532 917 Restricted cash 213 201 205 Accounts receivable, notes receivable and accrued revenue, less allowances of $28, $29 and $17, respectively 531 367 473 Accounts receivable - Energy Resource Management, less allowances of $10, $11and $9, respectively 36 36 145 Accounts receivable and notes receivable - related parties 60 73 182 Inventories at average cost: Gas in underground storage 665 741 460 Materials and supplies 107 110 102 Generating plant fuel stock 60 41 42 Assets held for sale 14 24 79 Price risk management assets 99 102 101 Regulatory assets 19 19 19 Derivative instruments 114 2 2 Prepayments and other 238 246 308 ----------- -----------

----------- 2,852 2,494 3,035 ----------- ----------- ----------- NON-CURRENT ASSETS Regulatory Assets Securitized costs 627 648 669 Postretirement benefits 151 162 174 Abandoned Midland Project 10 10 11 Other 318 266 255 Assets held for sale - 2 213 Price risk management assets 192 177 213 Nuclear decommissioning trust funds 559 575 553 Prepaid pension costs 378 388 - Goodwill 23 25 36 Notes receivable - related parties 231 242 147 Notes receivable 125 125 126 Other 535 390 406 ----------- ----------- ----------- 3,149 3,010 2,803 ----------- ----------- ----------- TOTAL ASSETS $ 15,307 $ 13,838 $ 13,939 =========== =========== =========== F-5 STOCKHOLDERS' INVESTMENT AND LIABILITIES JUNE 30 JUNE 30 2003 2004 DECEMBER 31 RESTATED (UNAUDITED) 2003 (UNAUDITED) ----------- ----------- ----------- In Millions CAPITALIZATION Common stockholders' equity Common stock, authorized 350.0 shares; outstanding 161.3 shares, 161.1 shares and 144.1 shares, respectively $ 2 $ 2 $ 1 Other paid-in-capital 3,848 3,846 3,608 Accumulated other comprehensive loss (313) (419) (690) Retained deficit (1,835) (1,844) (1,783) ----------- ----------- ----------- 1,702 1,585 1,136 Preferred stock of subsidiary 44 44 44 Preferred stock 261 261 - Company-obligated convertible Trust Preferred Securities of subsidiaries - - 393 Company-obligated mandatorily redeemable Trust Preferred Securities of Consumers' subsidiaries - - 490 Long-term debt 5,816 6,020 6,062 Long-term debt - related parties 684 684 - Non-current portion of capital and finance lease obligations 338 58 119 ----------- ----------- ----------- 8,845 8,652 8,244 ----------- ----------- ----------- MINORITY INTERESTS 740 73 43 ----------- ----------- ----------- CURRENT LIABILITIES Current portion of long-term debt, capital and finance leases 903 519 544 Accounts payable 358 296 334 Accounts payable - Energy Resource Management 21 21 52 Accounts payable - related parties 2 40 47 Accrued interest 170 130 126 Accrued taxes 239 285 180 Liabilities held for sale 2 2 66 Price risk management liabilities 93 89 93 Current portion of purchase power contracts 13 27 26 Current portion of gas supply contract obligations 30 29 28 Deferred income taxes 29 27 32 Other 301 185 185 ----------- ----------- ----------- 2,161 1,650 1,713 ----------- ----------- ----------- NON-CURRENT LIABILITIES Regulatory Liabilities Cost of removal 1,016 983 950 Income taxes, net 321 312 313 Other 165 172 155 Postretirement benefits 252 265 791 Deferred income taxes 651 615 487 Deferred investment tax credit 82 85 87 Asset retirement obligation 407 359 364 Liabilities held for sale - - 45 Price risk management liabilities 188 175 206 Gas supply contract obligations 190 208 221 Power purchase agreement - MCV Partnership - - 14 Other 289 289 306 ----------- ----------- ----------- 3,561 3,463 3,939 ----------- ----------- ----------- COMMITMENTS AND CONTINGENCIES (Notes 1, 3 and 4) TOTAL STOCKHOLDERS' INVESTMENT AND LIABILITIES $ 15,307 $ 13,838 $ 13,939 =========== =========== =========== THE ACCOMPANYING CONDENSED NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS. F-6 CMS ENERGY CORPORATION CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDERS' EQUITY (UNAUDITED) THREE MONTHS ENDED SIX MONTHS ENDED RESTATED RESTATED JUNE 30 2004 2003 2004 2003 ------- ------- ------- ------- ------- In Millions COMMON STOCK At beginning and end of period $ 2 $ 1 $ 2 $ 1 ------- ------- ------- ------- OTHER PAID-IN CAPITAL At beginning of period 3,846 3,605 3,846 3,605 Common stock reacquired (1) (1) (1) (1) Common stock issued 3 4 3 4 ------- ------- ------- ------- At end of period 3,848 3,608 3,848 3,608 ------- ------- ------- ------- ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) Minimum Pension Liability At beginning of period - (241) - (241) Minimum pension liability adjustments (a) - (20) - (20) ------- ------- ------- ------- At end of period - (261) - (261) ------- ------- ------- ------- Investments At beginning of period 9 2 8 2 Unrealized gain (loss) on investments (a) (1) 3 - 3 ------- ------- ------- ------- At end of period 8 5 8 5 ------- ------- ------- ------- Derivative Instruments At beginning of period (13) (29) (8) (31) Unrealized gain (loss) on derivative instruments (a) 22 (14) 19 (7) Reclassification adjustments included in consolidated net income (loss) (a) (3) 21 (5) 16 ------- ------- ------- ------- At end of period 6 (22) 6 (22) ------- ------- ------- ------- Foreign Currency Translation At beginning of period (313) (445) (419) (458) Change in foreign currency translation (a) (14) 33 92 46 ------- ------- ------- ------- At end of period (327) (412) (327) (412) ------- ------- ------- ------- At end of period (313) (690) (313) (690) ------- ------- ------- ------- RETAINED DEFICIT At beginning of period (1,851) (1,718) (1,844) (1,800) Net income (loss) (a) 19 (65) 15 17 Preferred stock dividends declared (3) - (6) - Common stock dividends declared - - - - ------- ------- ------- ------- At end of period (1,835) (1,783) (1,835) (1,783) ------- ------- ------- ------- TOTAL COMMON STOCKHOLDERS' EQUITY $ 1,702 $ 1,136 $ 1,702 $ 1,136 ======= ======= ======= ======= (a) DISCLOSURE OF OTHER COMPREHENSIVE INCOME (LOSS): Minimum Pension Liability Minimum pension liability adjustments, net of tax benefit of $-, $(10), $- and $(10), respectively $ - $ (20) $ - $ (20) Investments Unrealized gain (loss) on investments, net of tax of $-, $1, $- and $1, respectively (1) 3 - 3 Derivative Instruments Unrealized loss on derivative instruments, net of tax (tax benefit) of $2, $(3), $7 and $2, respectively 22 (14) 19 (7)

Reclassification adjustments included in net income (loss), net of tax (tax benefit) of $(2), $14, $(3) and $11, respectively (3) 21 (5) 16 Foreign currency translation, net (14) 33 92 46 Net income (loss) 19 (65) 15 17 ------- ------- ------- ------- Total Other Comprehensive Income (Loss) $ 23 $ (42) $ 121 $ 55 ======= ======= ======= ======= THE ACCOMPANYING CONDENSED NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS. F-7 CMS ENERGY CORPORATION CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) These interim Consolidated Financial Statements have been prepared by CMS Energy in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. As such, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. Certain prior year amounts have been reclassified to conform to the presentation in the current year. In management's opinion, the unaudited information contained in this report reflects all adjustments of a normal recurring nature necessary to assure the fair presentation of financial position, results of operations and cash flows for the periods presented. The Condensed Notes to Consolidated Financial Statements and the related Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements contained in CMS Energy's Form 10-K/A for the year ended December 31, 2003. Due to the seasonal nature of CMS Energy's operations, the results as presented for this interim period are not necessarily indicative of results to be achieved for the fiscal year. RESTATEMENT OF 2003 FINANCIAL STATEMENTS Our financial statements as of and for the three and six months ended June 30, 2003, as presented in this Form 10-Q, have been restated for the following matters that were disclosed previously in Note 19, Quarterly Financial and Common Stock Information (Unaudited), in our 2003 Form 10-K/A: - International Energy Distribution, which includes SENECA and CPEE, is no longer considered "discontinued operations," due to a change in our expectations as to the timing of the sales, - certain derivative accounting corrections at our equity affiliates, and - the net loss recorded in the second quarter of 2003 relating to the sale of Panhandle, reflected as Discontinued Operations, was understated by approximately $14 million, net of tax. 1: CORPORATE STRUCTURE AND ACCOUNTING POLICIES CORPORATE STRUCTURE: CMS Energy is an integrated energy company with a business strategy focused primarily in Michigan. We are the parent holding company of Consumers and Enterprises. Consumers is a combination electric and gas utility company serving Michigan's Lower Peninsula. Enterprises, through various subsidiaries and equity investments, is engaged in domestic and international diversified energy businesses including: independent power production and natural gas transmission, storage and processing. We manage our businesses by the nature of services each provides and operate principally in three business segments: electric utility, gas utility, and enterprises. PRINCIPLES OF CONSOLIDATION: The consolidated financial statements include the accounts of CMS Energy, Consumers, Enterprises, and all other entities in which we have a controlling financial interest or are the primary beneficiary, in accordance with Revised FASB Interpretation No. 46. The primary beneficiary of a variable interest entity is the party that absorbs or receives a majority of the entity's expected losses or expected residual returns or both as a result of holding variable interests, which are ownership, contractual, or other economic interests. In 2004, we consolidated the MCV Partnership and the FMLP in accordance with Revised FASB Interpretation No. 46. For additional details, see Note 11, Implementation of New Accounting Standards. We use the equity method of accounting for investments in companies and partnerships that are not consolidated, where we have significant influence over operations and financial policies, but are not the primary beneficiary. Intercompany transactions and balances have been eliminated. USE OF ESTIMATES: We prepare our financial statements in conformity with accounting principles generally accepted in the United States. We are required to make estimates using assumptions that may affect the reported amounts and disclosures. Actual results could differ from those estimates. F-8 We are required to record estimated liabilities in the financial statements when it is probable that a loss will be incurred in the future as a result of a current event, and when an amount can be reasonably estimated. We have used this accounting principle to record estimated liabilities as discussed in Note 3, Uncertainties. REVENUE RECOGNITION POLICY: We recognize revenues from deliveries of electricity and natural gas, and the transportation, processing, and storage of natural gas when services are provided. Sales taxes are recorded as liabilities and are not included in revenues. Revenues on sales of marketed electricity, natural gas, and other energy products are recognized at delivery. Mark-to-market changes in the fair values of energy trading contracts that qualify as derivatives are recognized as revenues in the periods in which the changes occur. CAPITALIZED INTEREST: We are required to capitalize interest on certain qualifying assets that are undergoing activities to prepare them for their intended use. Capitalization of interest for the period is limited to the actual interest cost that is incurred, and our non-regulated businesses are prohibited from imputing interest costs on any equity funds. Our regulated businesses are permitted to capitalize an allowance for funds used during construction on regulated construction projects and to include such amounts in plant in service. CASH EQUIVALENTS AND RESTRICTED CASH: All highly liquid investments with an original maturity of three months or less are considered cash equivalents. At June 30, 2004, our restricted cash on hand was $213 million. Restricted cash primarily includes cash collateral for letters of credit to satisfy certain debt agreements and cash dedicated for repayment of Securitization bonds. It is classified as a current asset as the related letters of credit mature within one year and the payments on the related Securitization bonds occur within one year. EARNINGS PER SHARE: Basic and diluted earnings per share are based on the weighted average number of shares of common stock and dilutive potential common stock outstanding during the period. Potential common stock, for purposes of determining diluted earnings per share, includes the effects of dilutive stock options, warrants and convertible securities. The effect on number of shares of such potential common stock is computed using the treasury stock method or the if-converted method, as applicable. For earnings per share computation, see Note 5, Earnings Per Share and Dividends. FINANCIAL INSTRUMENTS: We account for investments in debt and equity securities using SFAS No. 115. Debt and equity securities can be classified into one of three categories: held-to-maturity, trading, or available-for-sale. Our debt securities are classified as held-to-maturity securities and are reported at cost. Our investments in equity securities are classified as available-for-sale securities. They are reported at fair value, with any unrealized gains or losses resulting from changes in fair value reported in equity as part of accumulated other comprehensive income and are excluded from earnings unless such changes in fair value are determined to be other than temporary. Unrealized gains or losses resulting from changes in the fair value of our nuclear decommissioning investments are reflected in Regulatory Liabilities. The fair value of our equity securities is determined from quoted market prices. For additional details regarding financial instruments, see Note 6, Financial and Derivative Instruments. FOREIGN CURRENCY TRANSLATION: Our subsidiaries and affiliates whose functional currency is not the U.S. dollar translate their assets and liabilities into U.S. dollars at the exchange rates in effect at the end of the fiscal period. We translate revenue and expense accounts of such subsidiaries and affiliates into U.S. dollars at the average exchange rates that prevailed during the period. The gains or losses that result from this process, and gains and losses on intercompany foreign currency transactions that are long-term in nature that we do not intend to settle in the foreseeable future, are shown in the stockholders' equity section in the Consolidated Balance Sheets. For subsidiaries operating in highly inflationary economies, the U.S. dollar is considered to be the functional currency, and transaction gains and losses are included in determining net income. Gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency, except those that are hedged, are included in determining net income. IMPAIRMENT OF INVESTMENTS AND LONG-LIVED ASSETS: We evaluate potential impairments of our investments in long-lived assets other than goodwill based on various analyses, including the projection of undiscounted cash flows, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If the carrying amount of the asset exceeds its estimated undiscounted future cash flows, an impairment loss is recognized and the asset is written down to its estimated fair value. F-9 NUCLEAR FUEL COST: We amortize nuclear fuel cost to fuel expense based on the quantity of heat produced for electric generation. For nuclear fuel used after April 6, 1983, we charge disposal costs to nuclear fuel expense, recover these costs through electric rates, and remit them to the DOE quarterly. We elected to defer payment for disposal of spent nuclear fuel burned before April 7, 1983. As of June 30, 2004, we have recorded a liability to the DOE for $140 million, including interest, which is payable upon the first delivery of spent nuclear fuel to the DOE. The amount of this liability, excluding a portion of interest, was recovered through electric rates. For additional details on disposal of spent nuclear fuel, see Note 3, Uncertainties, "Other Consumers' Electric Utility Uncertainties - Nuclear Matters." OTHER INCOME AND OTHER EXPENSE: The following tables show the components of Other income and Other expense: IN MILLIONS ------------------------------------- THREE MONTHS ENDED SIX MONTHS ENDED ----------------- ---------------- JUNE 30 2004 2003 2004 2003 ------- ------ ------ ------ ------ Other income Interest and dividends - related parties $ 1 $ 1 $ 2 $ 2 PA141 Return on capital expenditures 9 - 18 - Electric restructuring return 1 2 3 3 Investment sale gain 1 - 1 - All other 3 - 3 1 ------ ------ ------ ------ Total other income $ 15 $ 3 $ 27 $ 6 ====== ====== ====== ====== IN MILLIONS ------------------------------------- THREE MONTHS ENDED SIX MONTHS ENDED ------------------ --------------- JUNE 30 2004 2003 2004 2003 ------- ------ ------ ------ ------ Other expense Loss on SERP investment $

(1) $ - $ (1) $ (1) Civic and political expenditures - - (1) (1) All other (1) (1) (2) (1) ------ ------ ------ ------ Total other expense $ (2) $ (1) $ (4) $ (3) ====== ====== ====== ====== PROPERTY, PLANT, AND EQUIPMENT: We record property, plant, and equipment at original cost when placed into service. When regulated assets are retired, or otherwise disposed of in the ordinary course of business, the original cost is charged to accumulated depreciation and cost of removal, less salvage is recorded as a regulatory liability. For additional details, see Note 10, Asset Retirement Obligations. An allowance for funds used during construction is capitalized on regulated construction projects. With respect to the retirement or disposal of non-regulated assets, the resulting gains or losses are recognized in income. RECLASSIFICATIONS: Certain prior year amounts have been reclassified for comparative purposes. These reclassifications did not affect consolidated net income for the years presented. UTILITY REGULATION: We account for the effects of regulation based on the regulated utility accounting standard SFAS No. 71. As a result, the actions of regulators affect when we recognize revenues, expenses, assets, and liabilities. SFAS No. 144 imposes strict criteria for retention of regulatory-created assets by requiring that such assets be probable of future recovery at each balance sheet date. Management believes these assets are probable of future recovery. 2: DISCONTINUED OPERATIONS, OTHER ASSET SALES, IMPAIRMENTS, AND RESTRUCTURING Our continued focus on financial improvement has led to discontinuing operations, completing many asset sales, impairing some assets, and incurring costs to restructure our business. Gross cash proceeds received from the sale F-10 of assets totaled $66 million for the six months ended June 30, 2004 and $726 million for the six months ended June 30, 2003. DISCONTINUED OPERATIONS We have discontinued the following operations: IN MILLIONS --- PRETAX AFTER-TAX BUSINESS/PROJECT DISCONTINUED GAIN(LOSS) GAIN(LOSS) STATUS ----------------- ------------ ---------- ---------- ------------------ CMS Viron June 2002 $ (14) $ (9) Sold June 2003 Panhandle December 2002 (39) (44) Sold June 2003 CMS Field Services December 2002 (5) (1) Sold July 2003 Marysville June 2003 2 1 Sold November 2003 Parmelia (a) December 2003 - - Held for sale ================== ============ ========== ========== ================== (a) We expect the sale of Parmelia to occur in 2004. In December 2003, we reduced the carrying amount of our Parmelia business by $26 million to reflect fair value. This after-tax loss was reported in discontinued operations in December 2003. At June 30, 2004, "Assets held for sale" includes Parmelia. At December 31, 2003, "Assets held for sale" includes Parmelia, Bluewater Pipeline, and our investment in the American Gas Index Fund. At June 30, 2003, "Assets held for sale" includes CMS Field Services, Marysville, and Parmelia. The major classes of assets and liabilities held for sale on our Consolidated Balance Sheet are as follows: IN MILLIONS -- RESTATED JUNE 30, 2004 DECEMBER 31, 2003 JUNE 30, 2003 ------------- ---------------- ------------- Assets Cash $ 8 $ 7 $ 2 Accounts receivable 3 2 71 Property, plant and equipment - net - 2 197 Other 3 15 22 --- --- ----- Total assets held for sale $14 $26 $ 292 === === ===== Liabilities Accounts payable $ 1 $ 2 $ 61 Minority interest - - 44 Other 1 - 6 --- --- ----- Total liabilities held for sale $ 2 $ 2 $ 111 === === ===== F-11 The following amounts are reflected in the Consolidated Statements of Income, in the Loss From Discontinued Operations line: IN MILLIONS -- RESTATED THREE MONTHS ENDED JUNE 30 2004 2003 --- ------ -------- Revenues $ 5 $ 250 ====== ======== Discontinued operations: Pretax income from discontinued operations $ - $ 6 Income tax expense - 4 ------ -------- Income from discontinued operations - 2 Pretax loss on disposal of discontinued operations - (56) Income tax benefit - (1) ------ -------- Loss on disposal of discontinued operations - (55) ------ -------- Loss from discontinued operations $ - $ (53) ====== ======== IN MILLIONS -- RESTATED SIX MONTHS ENDED JUNE 30 2004 2003 --- ------ -------- Revenues $ 10 $ 496 ====== ======== Discontinued operations: Pretax income (loss) from discontinued operations $ (1) $ 46 Income tax expense - 19 ------ -------- Income (loss) from discontinued operations (1) 27 Pretax loss on disposal of discontinued operations (2) (47) Income tax expense (benefit) (1) 2 ------ -------- Loss on disposal of discontinued operations (1) (49) ------ -------- Loss from discontinued operations $ (2) $ (22) ====== ======== The loss from discontinued operations includes a reduction in asset values, a provision for anticipated closing costs, and a portion of CMS Energy's interest expense. Interest expense of less than $1 million for the six months ended June 30, 2004 and $21 million for the six months ended June 30, 2003 has been allocated based on a ratio of the expected proceeds for the asset to be sold divided by CMS Energy's total capitalization of each discontinued operation times CMS Energy's interest expense. OTHER ASSET SALES Our other asset sales include the following non-strategic and

under-performing assets. The impacts of these sales are included in "Gain (loss) on asset sales, net" in the Consolidated Statements of Income (Loss). F-12 For the six months ended June 30, 2004, we sold the following assets that did not meet the definition of, and therefore were not reported as, discontinued operations: IN MILLIONS --- PRETAX AFTER-TAX DATE SOLD BUSINESS/PROJECT GAIN GAIN --- February Bluewater Pipeline (a) $ 1 $ 1 April Loy Yang (b) - - May American Gas Index fund (c) 1 1 Various Other 1 - --- Total gain on asset sales $ 3 $ 2 === (a) Bluewater Pipeline is a 24.9 mile pipeline that extends from Marysville, Michigan to Armada, Michigan. (b) In April 2004, we and our partners sold the 2,000 MW Loy Yang power plant and adjacent coal mine in Victoria, Australia for about A$3.5 billion ($2.6 billion in U.S. dollars), including A$145 million for the project equity. Our share of the proceeds, net of transaction costs and closing adjustments, was $44 million. In anticipation of the sale, we recorded an impairment in the first quarter as discussed in "Asset Impairments" within this Note. (c) In May 2004, we sold our interest in the American Gas Index fund for $7 million. For the six months ended June 30, 2003, we sold the following assets that did not meet the definition of, and therefore were not reported as, discontinued operations: IN MILLIONS --- PRETAX AFTER-TAX DATE SOLD BUSINESS/PROJECT GAIN(LOSS) GAIN(LOSS) --- January CMS MST Wholesale Gas $ (6) $ (4) March CMS MST Wholesale Power 2 1 June Guardian Pipeline (4) (3) --- Total loss on asset sales $ (8) $ (6) === SUBSEQUENT EVENT: In July 2004, we entered into a definitive agreement to sell our interests in Parmelia and Goldfields to APT for approximately $208 million Australian (approximately $145 million in U.S. dollars). The sale is subject to customary closing conditions. We expect the sale to close in the third quarter of 2004. ASSET IMPAIRMENTS We record an asset impairment when we determine that the expected future cash flows from an asset would be insufficient to provide for recovery of the asset's carrying value. An asset held-in-use is evaluated for impairment by calculating the undiscounted future cash flows expected to result from the use of the asset and its eventual disposition. If the undiscounted future cash flows are less than the carrying amount, we recognize an impairment loss. The impairment loss recognized is the amount by which the carrying amount exceeds the fair value. We estimate the fair market value of the asset utilizing the best information available. This information includes quoted market prices, market prices of similar assets, and discounted future cash flow analyses. The assets written down include both domestic and foreign electric power plants, gas processing facilities, and certain equity method and other investments. In addition, we have written off the carrying value of projects under development that will no longer be pursued. F-13 The table below summarizes our asset impairments: IN MILLIONS -- SIX MONTHS ENDED JUNE 30 PRETAX 2004 AFTER-TAX 2004 PRETAX 2003 AFTER-TAX 2003 ----------------------------------- ----------- ------------- ----------- ------------- Asset impairments: Enterprises (a) $ - $ - $ 7 $ 4 International Energy Distribution - - 2 1 Loy Yang (b) 125 81 - - ----- ---- --- --- Total asset impairments $ 125 $ 81 $ 9 $ 5 ===== ==== === === (a) Primarily represents an impairment recorded to reflect the fair value of two generators. (b) In the first quarter of 2004, an impairment charge was recorded to recognize the reduction in fair value as a result of the sale of Loy Yang, completed in April 2004, which included a cumulative net foreign currency translation loss of approximately $110 million. RESTRUCTURING AND OTHER COSTS In June 2002, we announced a series of initiatives to reduce our annual operating costs by an estimated $50 million. As such, we: - relocated CMS Energy's corporate headquarters from Dearborn, Michigan to a new combined CMS Energy and Consumers headquarters in Jackson, Michigan in July 2003, - implemented changes to our 401(k) savings program, - implemented changes to our health care plan, and - completed the termination of numerous employees, including five officers. The following tables shows the amount charged to expense for restructuring costs, the payments made, and the unpaid balance of accrued costs for the six months ended June 30, 2004 and June 30, 2003. IN MILLIONS -- INVOLUNTARY LEASE TERMINATION TERMINATION TOTAL ----------- ----------- ------- Beginning accrual balance, January 1, 2004 $ 3 $ 6 $ 9 Expense - - - Payments (1) (2) (3) ----------- ----------- ------- Ending accrual balance at June 30, 2004 $ 2 $ 4 $ 6 =========== =========== ======= IN MILLIONS --

INVOLUNTARY LEASE TERMINATION TERMINATION TOTAL ----------- ----------- ------- Beginning accrual balance, January 1, 2003 $ 12 $ 8 $ 20 Expense 3 - 3 Payments (8) - (8) ----------- ----------- ------- Ending accrual balance at June 30, 2003 $ 7 $ 8 $ 15 =========== =========== ======= 3: UNCERTAINTIES Several business trends or uncertainties may affect our financial results and condition. These trends or uncertainties have, or we reasonably expect could have, a material impact on net sales, revenues, or income from continuing operations. Such trends and uncertainties are discussed in detail below. F-14 SEC AND OTHER INVESTIGATIONS: As a result of round-trip trading transactions by CMS MST, CMS Energy's Board of Directors established a Special Committee to investigate matters surrounding the transactions and retained outside counsel to assist in the investigation. The Special Committee completed its investigation and reported its findings to the Board of Directors in October 2002. The Special Committee concluded, based on an extensive investigation, that the round-trip trades were undertaken to raise CMS MST's profile as an energy marketer with the goal of enhancing its ability to promote its services to new customers. The Special Committee found no effort to manipulate the price of CMS Energy Common Stock or affect energy prices. The Special Committee also made recommendations designed to prevent any recurrence of this practice. Previously, CMS Energy terminated its speculative trading business and revised its risk management policy. The Board of Directors adopted, and CMS Energy has implemented the recommendations of the Special Committee. CMS Energy is cooperating with an investigation by the DOJ concerning round-trip trading. CMS Energy is unable to predict the outcome of this matter and what effect, if any, this investigation will have on its business. In March 2004, the SEC approved a cease-and-desist order settling an administrative action against CMS Energy related to round-trip trading. The order did not assess a fine and CMS Energy neither admitted to nor denied the order's findings. The settlement resolved the SEC investigation involving CMS Energy and CMS MST. SECURITIES CLASS ACTION LAWSUITS: Beginning on May 17, 2002, a number of securities class action complaints were filed against CMS Energy, Consumers, and certain officers and directors of CMS Energy and its affiliates. The complaints were filed as purported class actions in the United States District Court for the Eastern District of Michigan, by shareholders who allege that they purchased CMS Energy's securities during a purported class period. The cases were consolidated into a single lawsuit and an amended and consolidated class action complaint was filed on May 1, 2003. The consolidated complaint contains a purported class period beginning on May 1, 2000 and running through March 31, 2003. It generally seeks unspecified damages based on allegations that the defendants violated United States securities laws and regulations by making allegedly false and misleading statements about CMS Energy's business and financial condition, particularly with respect to revenues and expenses recorded in connection with round-trip trading by CMS MST. The judge issued an opinion and order dated March 31, 2004 in connection with various pending motions, including plaintiffs' motion to amend the complaint and the motions to dismiss the complaint filed by CMS Energy, Consumers and other defendants. The judge directed plaintiffs to file an amended complaint under seal and ordered an expedited hearing on the motion to amend, which was held on May 12, 2004. At the hearing, the judge ordered plaintiffs to file a Second Amended Consolidated Class Action complaint deleting Counts III and IV relating to purchasers of CMS PEPS, which the judge ordered dismissed with prejudice. Plaintiffs filed this complaint on May 26, 2004. CMS Energy, Consumers, and the individual defendants filed new motions to dismiss on June 21, 2004. A hearing on those motions occurred on August 2, 2004 and the judge has taken the matter under advisement. CMS Energy, Consumers and the individual defendants will defend themselves vigorously but cannot predict the outcome of this litigation. DEMAND FOR ACTIONS AGAINST OFFICERS AND DIRECTORS: In May 2002, the Board of Directors of CMS Energy received a demand, on behalf of a shareholder of CMS Energy Common Stock, that it commence civil actions (i) to remedy alleged breaches of fiduciary duties by certain CMS Energy officers and directors in connection with round-trip trading by CMS MST, and (ii) to recover damages sustained by CMS Energy as a result of alleged insider trades alleged to have been made by certain current and former officers of CMS Energy and its subsidiaries. In December 2002, two new directors were appointed to the Board. The Board formed a special litigation committee in January 2003 to determine whether it is in CMS Energy's best interest to bring the action demanded by the shareholder. The disinterested members of the Board appointed the two new directors to serve on the special litigation committee. In December 2003, during the continuing review by the special litigation committee, CMS Energy was served with a derivative complaint filed on behalf of the shareholder in the Circuit Court of Jackson County, Michigan in furtherance of his demands. The date for CMS Energy and other defendants to answer or otherwise respond to the complaint has been extended to September 1, 2004, subject to such further extensions as may be mutually agreed upon by the parties and authorized by the Court. CMS Energy cannot predict the outcome of this matter. ERISA LAWSUITS: CMS Energy is a named defendant, along with Consumers, CMS MST, and certain named and unnamed officers and directors, in two lawsuits brought as purported class actions on behalf of participants and beneficiaries of the CMS Employees' Savings and Incentive Plan (the Plan). The two cases, filed in July 2002 in United States District Court for the Eastern District of Michigan, were consolidated by the trial judge and an F-15 amended consolidated complaint was filed. Plaintiffs allege breaches of fiduciary duties under ERISA and seek restitution on behalf of the Plan with respect to a decline in value of the shares of CMS Energy Common Stock held in the Plan. Plaintiffs also seek other equitable relief and legal fees. The judge issued an opinion and order dated March 31, 2004 in connection with the motions to dismiss filed by CMS Energy, Consumers and the individuals. The judge dismissed certain of the amended counts in the plaintiffs' complaint and denied CMS Energy's motion to dismiss the other claims in the complaint. CMS Energy, Consumers and the individual defendants filed answers to the amended complaint on May 14, 2004. A trial date has not been set, but is expected to be no earlier than late in 2005. CMS Energy and Consumers will defend themselves vigorously but cannot predict the outcome of this litigation. GAS INDEX PRICE REPORTING INVESTIGATION: CMS Energy has notified appropriate regulatory and governmental agencies that some employees at CMS MST and CMS Field Services appeared to have provided inaccurate information regarding natural gas trades to various energy industry publications which compile and report index prices. CMS Energy is cooperating with an ongoing investigation by the DOJ regarding this matter. CMS Energy is unable to predict the outcome of the DOJ investigation and what effect, if any, this investigation will have on its business. GAS INDEX PRICE REPORTING LITIGATION: In August 2003, Cornerstone Propane Partners, L.P. (Cornerstone) filed a putative class action complaint in the United States District Court for the Southern District of New York against CMS Energy and dozens of other energy companies. The court ordered the Cornerstone complaint to be consolidated with similar complaints filed by Dominick Viola and Roberto Calle Gracey. The plaintiffs filed a consolidated complaint on January 20, 2004. The consolidated complaint alleges that false natural gas price reporting by the defendants manipulated the prices of NYMEX natural gas futures and options. The complaint contains two counts under the Commodity Exchange Act, one for manipulation and one for aiding and abetting violations. CMS Energy is no longer a defendant, however, CMS MST and CMS Field Services are named as defendants. (CMS Energy sold CMS Field Services to Cantera Natural Gas, Inc. but is required to indemnify Cantera Natural Gas, Inc. with respect to this action). In a similar but unrelated matter, Texas-Ohio Energy, Inc. filed a putative class action lawsuit in the United States District Court for the Eastern District of California against a number of energy companies engaged in the sale of natural gas in the United States. CMS Energy is named as a defendant. The complaint alleges defendants entered into a price-fixing conspiracy by engaging in activities to manipulate the price of natural gas in California. The complaint contains counts alleging violations of the Sherman Act, Cartwright Act (a California statute), and the California Business and Profession Code relating to unlawful, unfair and deceptive business practices. There is currently pending in the Nevada federal district court a multi-district court litigation (MDL) matter involving seven complaints originally filed in various state courts in California. These complaints make allegations similar to those in the Texas-Ohio case regarding price reporting, although none contain a Sherman Act claim and some of the defendants in the MDL matter are also defendants in the Texas-Ohio case. Those defendants successfully argued to have the Texas-Ohio case transferred to the MDL proceeding. The plaintiff in the Texas-Ohio case agreed to extend the time for all defendants to answer or otherwise respond until May 28, 2004 and on that date a number of defendants filed motions to dismiss. In order to negotiate possible dismissal and/or substitution of defendants, CMS Energy and two other parent holding company defendants were given further extensions to answer or otherwise respond to the complaint until August 16, 2004. Benscheidt v. AEP Energy Services, Inc., et al., a new class action complaint containing allegations similar to those made in the Texas-Ohio case, albeit limited to California state law claims, was filed in California state court in February 2004. CMS Energy and CMS MST are named as defendants. Defendants filed a notice to remove this action to California federal district court, which was granted, and had it transferred to the MDL proceeding in Nevada. However, the plaintiff is seeking to have the case remanded back to California and until the issue is resolved, no further action will be taken. Three new, virtually identical actions were filed in San Diego Superior Court in July 2004, one by the County of Santa Clara (Santa Clara), one by the County of San Diego (San Diego), and one by the City of and County of San Francisco and the San Francisco City Attorney (collectively San Francisco). Defendants, consisting of a number of energy companies including CMS Energy, CMS MS&T, Cantera Natural Gas and Cantera Gas Company, are alleged to have engaged in false reporting of natural gas price and volume information and sham sales to artificially F-16 inflate natural gas retail prices in California. All three complaints allege claims for unjust enrichment and violations of the Cartwright Act, and the San Francisco action also alleges a claim for violation of the California Business and Profession Code relating to unlawful, unfair and deceptive business practices. CMS Energy and the other CMS defendants will defend themselves vigorously, but cannot predict the outcome of these matters. CONSUMERS' UNCERTAINTIES Several business trends or uncertainties may affect our financial results and condition. These trends or uncertainties have, or we reasonably expect could have, a material impact on revenues or income from continuing electric and gas operations. Such trends and uncertainties include: Environmental - increased capital expenditures and operating expenses for Clean Air Act compliance, and - potential environmental liabilities arising from various environmental laws and regulations, including potential liability or expense relating to the Michigan Natural Resources and Environmental Protection Acts, Superfund, and at former manufactured gas plant facilities. Restructuring - response of the MPSC and Michigan legislature to electric industry restructuring issues, - ability to meet peak electric demand requirements at a reasonable cost, without market disruption, - ability to recover any of our net Stranded Costs under the regulatory policies being followed by the MPSC, - effects of lost electric supply load to alternative electric suppliers, and - status as an electric transmission customer, instead of an electric transmission owner. Regulatory - recovery of nuclear decommissioning costs, - responses from regulators regarding the storage and ultimate disposal of spent nuclear fuel, - inadequate regulatory response to applications for requested rate increases, and - response to increases in gas costs, including adverse regulatory response and reduced gas use by customers. Other - pending litigation regarding PURPA qualifying facilities, and - other pending litigation. CONSUMERS' ELECTRIC UTILITY CONTINGENCIES ELECTRIC ENVIRONMENTAL MATTERS: Our operations are subject to environmental laws and regulations. Costs to operate our facilities in compliance with these laws and regulations generally have been recovered in customer rates. Clean Air: The EPA and the state regulations require us to make significant capital expenditures estimated to be $771 million. As of June 30, 2004, we have incurred $489 million in capital expenditures to comply with the EPA regulations and anticipate that the remaining $282 million of capital expenditures will be made between 2004 and 2009. These expenditures include installing catalytic reduction technology at some of our coal-fired electric plants. Based on the Customer Choice Act, beginning January 2004, an annual return of and on these types of capital F-17 expenditures, to the extent they are above depreciation levels, is expected to be recoverable from customers, subject to the MPSC prudency hearing. The EPA has alleged that some utilities have incorrectly classified plant modifications as "routine maintenance" rather than seek modification permits from the EPA. We have received and responded to information requests from the EPA on this subject. We believe that we have properly interpreted the requirements of "routine maintenance." If our interpretation is found to be incorrect, we may be required to install additional pollution controls at some or all of our coal-fired electric plants and potentially pay fines. Additionally, the viability of certain plants remaining in operation could be called into question. In addition to modifying the coal-fired electric plants, we expect to purchase nitrogen oxide emissions credits for years 2004 through 2008. The cost of these credits is estimated to average $8 million per year and is accounted for as inventory. The credit inventory is expensed as the coal-fired electric plants generate electricity. The price for nitrogen oxide emissions credits is volatile and could change substantially. The EPA has proposed a Clean Air Interstate Rule that would require additional coal-fired electric plant emission controls for nitrogen oxides and sulfur dioxide. If implemented, this rule would potentially require expenditures equivalent to those efforts in progress required to reduce nitrogen oxide emissions under the Title I provisions of the Clean Air Act. The rule proposes a two-phase program to reduce emissions of sulfur dioxide by 70 percent and nitrogen oxides by 65 percent by 2015. Additionally, the EPA also proposed two alternative sets of rules to reduce emissions of mercury and nickel from coal-fired and oil-fired electric plants. Until the proposed environmental rules are finalized, an accurate cost of compliance cannot be determined. Several bills have been introduced in the United States Congress that would require reductions in emissions of greenhouse gases. We cannot predict whether any federal mandatory greenhouse gas emission reduction rules ultimately will be enacted, or the specific requirements of any such rules if they were to become law. To the extent that greenhouse gas emission reduction rules come into effect, such mandatory emissions reduction requirements could have far-reaching and significant implications for the energy sectors. We cannot estimate the potential effect of United States federal or state level greenhouse gas policy on future consolidated results of operations, cash flows or financial position due to the speculative nature of the policy. We stay abreast of and engage in the greenhouse gas policy developments, and will continue to assess and respond to their potential implications on our business operations. Water: In March 2004, the EPA changed the rules that govern generating plant cooling water intake systems. The new rules require significant reduction in fish killed by operating equipment. Some of our facilities will be required to comply by 2006. We are studying the rules to determine the most cost-effective solutions for compliance. Cleanup and Solid Waste: Under the Michigan Natural Resources and Environmental Protection Act, we expect that we will ultimately incur investigation and remedial action costs at a number of sites. We believe that these costs will be recoverable in rates under current ratemaking policies. We are a potentially responsible party at several contaminated sites administered under Superfund. Superfund liability is joint and several, meaning that many other creditworthy parties with substantial assets are potentially responsible with respect to the individual sites. Based on past experience, we estimate that our share of the total liability for the known Superfund sites will be between $1 million and $9 million. As of June 30, 2004, we have recorded a liability for the minimum amount of our estimated Superfund liability. In October 1998, during routine maintenance activities, we identified PCB as a component in certain paint, grout, and sealant materials at the Ludington Pumped Storage facility. We removed and replaced part of the PCB material. We have proposed a plan to deal with the remaining materials and are awaiting a response from the EPA. LITIGATION: In October 2003, a group of eight PURPA qualifying facilities selling power to us filed a lawsuit in Ingham County Circuit Court. The lawsuit alleges that we incorrectly calculated the energy charge payments made F-18 pursuant to power purchase agreements with qualifying facilities. More specifically, the lawsuit alleges that we should be basing the energy charge calculation on the cost of more expensive eastern coal, rather than on the cost of the coal actually burned by us for use in our coal-fired generating plants. We believe we have been performing the calculation in the manner prescribed by the power purchase agreements, and have filed a request with the MPSC (as a supplement to the PSCR plan) that asks the MPSC to review this issue and to confirm that our method of performing the calculation is correct. We filed a motion to dismiss the lawsuit in the Ingham County Circuit Court due to the pending request at the MPSC concerning the PSCR plan case. In February 2004, the judge ruled on the motion and deferred to the primary jurisdiction of the MPSC. This ruling resulted in a dismissal of the circuit court case without prejudice. Although only eight qualifying facilities have raised the issue, the same energy charge methodology is used in the PPA with the MCV Partnership and in approximately 20 additional power purchase agreements with us, representing a total of 1,670 MW of electric capacity. The eight plaintiff qualifying facilities have appealed the dismissal of the circuit court case to the Michigan Court of Appeals. We cannot predict the outcome of this matter. CONSUMERS' ELECTRIC UTILITY RESTRUCTURING MATTERS ELECTRIC RESTRUCTURING LEGISLATION: The Michigan legislature passed electric utility restructuring legislation known as the Customer Choice Act. This Act: - allows all customers to choose their electric generation supplier effective January 1, 2002, - provides a one-time five percent residential electric rate reduction, - froze all electric rates through December 31, 2003, and established a rate cap for residential customers through at least December 31, 2005, and a rate cap for small commercial and industrial customers through at least December 31, 2004, - allows deferred recovery of an annual return of and on capital expenditures in excess of depreciation levels incurred during and before the rate freeze-cap period, - allows for the use of Securitization bonds to refinance qualified costs, - allows recovery of net Stranded Costs and implementation costs incurred as a result of the passage of the act, - requires Michigan utilities to join a FERC-approved RTO or sell their interest in transmission facilities to an independent transmission owner, - requires Consumers, Detroit Edison, and AEP to jointly expand their available transmission capability by at least 2,000 MW, and - establishes a market power supply test that, if not met, may require transferring control of generation resources in excess of that required to serve retail sales requirements. The following summarizes our status under the last three provisions of the Customer Choice Act. First, we chose to sell our interest in our transmission facilities to an independent transmission owner to comply with the Customer Choice Act; for additional details regarding the sale of the transmission facility, see "Transmission Sale" within this section. Second, in July 2002, the MPSC issued an order approving our plan to achieve the increased transmission capacity required under the Customer Choice Act. We have completed the transmission capacity projects identified in the plan and have submitted verification of this fact to the MPSC. We believe we are in full compliance. Lastly, in September 2003, the MPSC issued an order finding that we are in compliance with the market power supply test set forth in the Customer Choice Act. ELECTRIC ROA: The MPSC approved revised tariffs that establish the rates, terms, and conditions under which retail customers are permitted to choose an electric supplier. These revised tariffs allow ROA customers, upon as little as 30 days notice to us, to return to our generation service at current tariff rates. If any class of customers' F-19 (residential, commercial, or industrial) ROA load reaches ten percent of our total load for that class of customers, then returning ROA customers for that class must give 60 days notice to return to our generation service at current tariff rates. However, we may not have capacity available to serve returning ROA customers that is sufficient or reasonably priced. As a result, we may be forced to purchase electricity on the spot market at higher prices than we can recover from our customers during the rate cap periods. We cannot predict the total amount of electric supply load that may be lost to alternative electric suppliers. As of July 2004, alternative electric suppliers are providing 858 MW of load. This amount represents 11 percent of the total distribution load and an increase of 49 percent compared to July 2003. ELECTRIC RESTRUCTURING PROCEEDINGS: Below is a discussion of our electric restructuring proceedings. They are: - Securitization, - Stranded Costs, - implementation costs, - security costs, and - transmission rates. The following chart summarizes the filings with the MPSC. For additional details related to these proceedings, see related sections within this Note. PROCEEDING YEARS FILED YEARS COVERED REQUESTED AMOUNTS STATUS -------------- ----------- ------------- ----------------- -- Securitization 2003 N/A $1.083 billion Received order from the MPSC authorizing the issuance of Securitization bonds in the amount of $554 million. Pending MPSC order resolving outstanding issues. Stranded Costs 2002-2004 2000-2003 $137 million (a) MPSC ruled that we experienced zero Stranded Costs for 2000 through 2001, which we are appealing. Filings for 2002 and 2003 in the amount of $116 million are still pending MPSC approval. Implementation 1999-2004 1997-2003 $91 million (b) MPSC allowed $68 million for the years 1997-2001, plus Costs $20 million for the cost of money through 2003. Implementation cost filings for 2002 and 2003 in the amount of $8 million, which includes the cost of money through 2003, are still pending MPSC approval. Security Costs 2004 2001-2005 $25 million Pending MPSC approval. As of June 30, 2004, we have recorded $7 million of costs incurred as a regulatory asset. (a) Amount includes the cost of money through the year in which we expected to receive recovery from the MPSC and assumes the issuance of Securitization bonds in an amount that includes Clean Air Act investments. If Clean Air Act investments were not included in the issuance of Securitization bonds, Stranded Costs requested would total $304 million. (b) Amounts include the cost of money through year incurred. F-20 Securitization: The Customer Choice Act allows for the use of Securitization bonds to refinance certain qualified costs. Since Securitization involves issuing bonds secured by a revenue stream from rates collected directly from customers to service the bonds, Securitization bonds typically have a higher credit rating than conventional utility corporate financing. In 2000 and 2001, the MPSC issued orders authorizing us to issue Securitization bonds. We issued our first Securitization bonds in late 2001. Securitization resulted in: - lower interest costs, and - longer amortization periods for the securitized assets. We will recover the repayment of principal, interest, and other expenses relating to the bond issuance through a Securitization charge and a tax charge that began in December 2001. These charges are subject to an annual true up until one year before the last scheduled bond maturity date, and no more than quarterly thereafter. The December 2003 true up modified the total Securitization and related tax charges from 1.746 mills per kWh to 1.718 mills per kWh. There will be no impact on customer bills from Securitization for most of our electric customers until the Customer Choice Act cap period expires, and an electric rate case is processed. Securitization charge collections, $25 million for the six months ended June 30, 2004, and $25 million for the six months ended June 30, 2003, are remitted to a trustee. Securitization charge collections are restricted to the repayment of the principal and interest on the Securitization bonds and payment of the ongoing expenses of Consumers Funding. Consumers Funding is legally separate from Consumers. The assets and income of Consumers Funding, including the securitized property, are not available to creditors of Consumers or CMS Energy. In March 2003, we filed an application with the MPSC seeking approval to issue additional Securitization bonds. In June 2003, the MPSC issued a financing order authorizing the issuance of Securitization bonds in the amount of $554 million. This amount relates to Clean Air Act expenditures and associated return on those expenditures through December 31, 2002, ROA implementation costs and previously authorized return on those expenditures through December 31, 2000, and other up front qualified costs related to issuance of the Securitization bonds. In July 2003, we filed for rehearing and clarification on a number of features in the financing order. In December 2003, the MPSC ordered remanded hearings in response to our request for rehearing and clarification. In March 2004, the MPSC conducted the remanded hearings and the matter is presently before the MPSC awaiting a decision. In May 2004, we withdrew our request for approved implementation costs incurred for the years 1998 through 2000 from the Securitization case, as we chose recovery of the approved implementation costs through the use of a surcharge, as described in "Implementation Costs" within this section. However, qualified Clean Air Act costs, after taking out implementation costs, still exceed the $554 million MPSC limit on the amount of securitized bonds. As a result, we did not request a decrease to allowable securitized costs. If and when the MPSC issues an order with favorable terms, then the order will become effective upon our acceptance. Stranded Costs: The Customer Choice Act allows electric utilities to recover their net Stranded Costs, without defining the term. The Act directs the MPSC to establish a method of calculating net Stranded Costs and of conducting related true-up adjustments. In December 2001, the MPSC Staff recommended a methodology, which calculated net Stranded Costs as the shortfall between: - the revenue required to cover the costs associated with fixed generation assets and capacity payments associated with purchase power agreements, and - the revenues received from customers under existing rates available to cover the revenue requirement. The MPSC authorizes us to use deferred accounting to recognize the future recovery of costs determined to be stranded. According to the MPSC, net Stranded Costs are to be recovered from ROA customers through a Stranded Cost transition charge. However, the MPSC has not yet allowed such a transition charge. The MPSC has declined to resolve numerous issues regarding the net Stranded Cost methodology in a way that would allow a reliable F-21 prediction of the level of Stranded Costs. As a result, we have not recorded regulatory assets to recognize the future recovery of such costs. The following table outlines the applications filed by us with the MPSC and the status of recovery for these costs: IN MILLIONS --- REQUESTED, WITHOUT THE REQUESTED, WITH THE ISSUANCE ISSUANCE OF SECURITIZATION OF SECURITIZATION BONDS THAT BONDS THAT INCLUDE CLEAN AIR YEAR YEAR INCLUDE CLEAN AIR ACT ACT INVESTMENT AND COST OF RECOVERABLE FILED INCURRED INVESTMENT AND COST OF MONEY MONEY AMOUNT ----- -------- --------------------------- --------------------------- ----------- 2002 2000 $12 $ 26 $ - 2002 2001 9 46 - 2003 2002 47 104 Pending 2004 2003 69 128 Pending ===== ==== === ===== ======= We are currently in the process of appealing the MPSC orders regarding Stranded Costs for 2000 and 2001 with the Michigan Court of Appeals and the Michigan Supreme Court. In June 2004, the MPSC conducted hearings for our 2002 Stranded Cost application. Once a final financing order on Securitization is reached, we will know the amount of our request for net Stranded Cost recovery for 2002. In July 2004, the ALJ issued a proposal for decision in our 2002 net Stranded Cost case, which recommended that the MPSC find that we incurred net Stranded Costs of $12 million. This recommendation includes the cost of money through July 2004 and excludes Clean Air Act investments. The MPSC has scheduled hearings for our 2003 Stranded Cost application for August 2004. In July 2004, the MPSC Staff issued a position on our 2003 net Stranded Cost application, which resulted in a Stranded Cost calculation of $52 million. The amount includes the cost of money, but excludes Clean Air Act investments. We cannot predict how the MPSC will rule on our requests for recoverability of 2002 and 2003 Stranded Costs or whether the MPSC will adopt a Stranded Cost recovery method that will offset fully any associated margin loss from ROA. Implementation Costs: The Customer Choice Act allows electric utilities to recover their implementation costs. The following table outlines the applications filed by us with the MPSC and the status of recovery for these costs: IN MILLIONS --- (b) RECOVERABLE, INCLUDING COST YEAR FILED YEAR INCURRED REQUESTED DISALLOWED ALLOWED OF MONEY THROUGH 2003 --------------- ------------ --------- --------- ------- -------------------------- 1999 1997 & 1998 $ 20 $ 5 $ 15 $ 22 2000 1999 30 5 25 33 2001 2000 25 5 20 24 2002 2001 8 - 8 9 2003 & 2004 (a) 2002 7 Pending Pending Pending 2004 2003 1 Pending Pending Pending ==== ==== ========= ========= ======= ======= (a) On March 31, 2004, we requested additional 2002 implementation cost recovery of $5 million related to our former participation in the development of the Alliance RTO. This cost has been expensed; therefore, the amount is not included as a regulatory asset. (b) Amounts include the cost of money through year incurred. F-22 In addition to seeking MPSC approval for these costs, we are pursuing authorization at the FERC for the MISO to reimburse us for approximately $8 million, for implementation costs related to our former participation in the development of the Alliance RTO which includes the $5 million pending approval by the MPSC as part of 2002 implementation costs recovery. These costs have generally either been expensed or approved as recoverable implementation costs by the MPSC. The FERC has denied our request for reimbursement and we are appealing the FERC ruling at the United States Court of Appeals for the District of Columbia. We cannot predict the outcome of the appeal process or the ultimate amount, if any, we will collect for Alliance RTO development costs. The MPSC disallowed certain costs, determining that these amounts did not represent costs incremental to costs already reflected in electric rates. As of June 30, 2004, we incurred and deferred as a regulatory asset $94 million of implementation costs, which includes $25 million associated with the cost of money. We believe the implementation costs and associated cost of money are fully recoverable in accordance with the Customer Choice Act. In June 2004, following an appeal and remand of initial MPSC orders relating to 1999 implementation costs, the MPSC authorized the recovery of all previously approved implementation costs for the years 1997 through 2001 totaling $88 million. This total includes carrying costs through 2003. Additional carrying costs will be added until collection occurs. The implementation costs will be recovered through surcharges over 36-month collection periods and phased in as applicable rate caps expire. We cannot predict the amounts the MPSC will approve as recoverable costs for 2002 and 2003. Security Costs: The Customer Choice Act, as amended, allows for recovery of new and enhanced security costs, as a result of federal and state regulatory security requirements incurred before January 1, 2006. All retail customers, except customers of alternative electric suppliers, would pay these charges. In April 2004, we filed a security cost recovery case with the MPSC for costs for which recovery has not yet been granted through other means. The requested amount includes reasonable and prudent security enhancements through December 31, 2005. The costs are for enhanced security and insurance because of federal and state regulatory security requirements imposed after the September 11, 2001 terrorist attacks. In July 2004, a settlement was reached with the parties to the case, which would provide for full recovery of the requested security costs over a five-year period beginning in 2004. We are presently awaiting approval from the MPSC. We cannot predict how the MPSC will rule on our request for the recoverability of security costs. The following table outlines the applications filed by us with the MPSC and the status of recovery for these costs: IN MILLIONS -- REGULATORY ASSET AS OF JUNE YEAR FILED YEARS INCURRED REQUESTED 30, 2004 DISALLOWED ALLOWED ---------- ------------- --------- ------------------------- ---------- ------- 2004 2001-2005 $25 $7 Pending Pending ==== ======== === == ======= ======= Transmission Rates: Our application of JOATT transmission rates to customers during past periods is under FERC review. The rates included in these tariffs were applied to certain transmission transactions affecting both Detroit Edison's and our transmission systems between 1997 and 2002. We believe our reserve is sufficient to satisfy our refund obligation to any of our former transmission customers under our former JOATT. TRANSMISSION SALE: In May 2002, we sold our electric transmission system to MTH, a non-affiliated limited partnership whose general partner is a subsidiary of Trans-Elect, Inc. We are currently in arbitration with MTH regarding property tax items used in establishing the selling price of our electric transmission system. An unfavorable outcome could result in a reduction of sale proceeds previously recognized of approximately $2 million to $3 million. Under an agreement with MTH, our transmission rates are fixed by contract at current levels through December 31, 2005, and are subject to the FERC ratemaking thereafter. However, we are subject to certain additional MISO surcharges, which we estimate to be $10 million in 2004. CONSUMERS' ELECTRIC UTILITY RATE MATTERS PERFORMANCE STANDARDS: Electric distribution performance standards developed by the MPSC became effective in February 2004. The standards relate to restoration after outages, safety, and customer services. The F-23 MPSC order calls for financial penalties in the form of customer credits if the standards for the duration and frequency of outages are not met. We met or exceeded all approved standards for year-end results for both 2002 and 2003. As of June 2004, we are in compliance with the acceptable level of performance. We are a member of an industry coalition that has appealed the customer credit portion of the performance standards to the Michigan Court of Appeals. We cannot predict the likely effects of the financial penalties, if any, nor can we predict the outcome of the appeal. Likewise, we cannot predict our ability to meet the standards in the future or the cost of future compliance. POWER SUPPLY COSTS: We were required to provide backup service to ROA customers on a best efforts basis. In October 2003, we provided notice to the MPSC that we would terminate the provision of backup service in accordance with the Customer Choice Act, effective January 1, 2004. To reduce the risk of high electric prices during peak demand periods and to achieve our reserve margin target, we employ a strategy of purchasing electric call options and capacity and energy contracts for the physical delivery of electricity primarily in the summer months and to a lesser degree in the winter months. As of June 30, 2004, we purchased capacity and energy contracts partially covering the estimated reserve margin requirements for 2004 through 2007. As a result, we have recognized an asset of $18 million for unexpired capacity and energy contracts. In March 2004, we filed a summer assessment for meeting 2004 peak load demand as required by the MPSC, stating that our summer 2004 reserve margin target is 11 percent or supply resources equal to 111 percent of projected summer peak load. Presently, we have a reserve margin of 14 percent, or supply resources equal to 114 percent of projected summer peak load for summer 2004. Of the 114 percent, approximately 102 percent is from owned electric generating plants and long-term contracts, and approximately 12 percent is from short-term contracts. This reserve margin met our summer 2004 reserve margin target. The total premium costs of electricity call options and capacity and energy contracts for 2004 is expected to be approximately $12 million, as of July 2004. PSCR: As a result of meeting the transmission capability expansion requirements and the market power test, as discussed within this Note, we have met the requirements under the Customer Choice Act to return to the PSCR process. The PSCR process provides for the reconciliation of actual power supply costs with power supply revenues. This process assures recovery of all reasonable and prudent power supply costs actually incurred by us. In September 2003, we submitted a PSCR filing to the MPSC that reinstates the PSCR process for customers whose rates are no longer frozen or capped as of January 1, 2004. The proposed PSCR charge allows us to recover a portion of our increased power supply costs from large commercial and industrial customers, and subject to the overall rate caps, from other customers. We estimate the recovery of increased power supply costs from large commercial and industrial customers to be approximately $30 million in 2004. As allowed under current regulation, we self-implemented the proposed PSCR charge on January 1, 2004. The revenues received from the PSCR charge are also subject to subsequent reconciliation at the end of the year after actual costs have been reviewed for reasonableness and prudence. We cannot predict the outcome of this reconciliation proceeding. OTHER CONSUMERS' ELECTRIC UTILITY UNCERTAINTIES THE MIDLAND COGENERATION VENTURE: The MCV Partnership, which leases and operates the MCV Facility, contracted to sell electricity to Consumers for a 35-year period beginning in 1990 and to supply electricity and steam to Dow. We hold, through two wholly owned subsidiaries, the following assets related to the MCV Partnership and the MCV Facility: - CMS Midland owns a 49 percent general partnership interest in the MCV Partnership, and - CMS Holdings holds, through the FMLP, a 35 percent lessor interest in the MCV Facility. In 2004, we consolidated the MCV Partnership and the FMLP into our consolidated financial statements in accordance with Revised FASB Interpretation No. 46. For additional details, see Note 11, Implementation of New Accounting Standards. Our consolidated retained earnings include undistributed earnings from the MCV Partnership, which at June 30, 2004 are $246 million and at June 30, 2003 are $243 million. F-24 Power Supply Purchases from the MCV Partnership: Our annual obligation to purchase capacity from the MCV Partnership is 1,240 MW through the term of the PPA ending in 2025. The PPA requires us to pay, based on the MCV Facility's availability, a levelized average capacity charge of 3.77 cents per kWh and a fixed energy charge. We also pay a variable energy charge based on our average cost of coal consumed for all kWh delivered. Effective January 1999, we reached a settlement agreement with the MCV Partnership that capped capacity payments made on the basis of availability that may be billed by the MCV Partnership at a maximum 98.5 percent availability level. Since January 1993, the MPSC has permitted us to recover capacity charges averaging 3.62 cents per kWh for 915 MW, plus fixed and variable energy charges. Since January 1996, the MPSC has also permitted us to recover capacity charges for the remaining 325 MW of contract capacity with an initial average charge of 2.86 cents per kWh increasing periodically to an eventual 3.62 cents per kWh by 2004 and thereafter. However, due to the frozen retail rates required by the Customer Choice Act, the capacity charge for the 325 MW was frozen at 3.17 cents per kWh until December 31, 2003. Recovery of both the 915 MW and 325 MW portions of the PPA are subject to certain limitations discussed below. In 1992, we recognized a loss and established a liability for the present value of the estimated future underrecoveries of power supply costs under the PPA based on the MPSC cost-recovery orders. The remaining liability associated with the loss totaled $13 million at June 30, 2004 and $40 million at June 30, 2003. We expect the PPA liability to be depleted in late 2004. We estimate that 51 percent of the actual cash underrecoveries for 2004 will be charged to the PPA liability, with the remaining portion charged to operating expense as a result of our 49 percent ownership in the MCV Partnership. We will expense all cash underrecoveries directly to income once the PPA liability is depleted. If the MCV Facility's generating availability remains at the maximum 98.5 percent level, our cash underrecoveries associated with the PPA could be as follows: IN MILLIONS -- 2004 2005 2006 2007 ------ ------ ------ ------ Estimated cash underrecoveries at 98.5% $ 56 $ 56 $ 55 $ 39 Amount to be charged to operating expense 29 56 55 39 Amount to be charged to PPA liability 27 - - - ====== ====== ====== ====== Beginning January 1, 2004, the rate freeze for large industrial customers was no longer in effect and we returned to the PSCR process. Under the PSCR process, we will recover from our customers the approved capacity and fixed energy charges based on availability, up to an availability cap of 88.7 percent as established in previous MPSC orders. Effects on Our Ownership Interest in the MCV Partnership and the MCV Facility: As a result of returning to the PSCR process on January 1, 2004, we returned to dispatching the MCV Facility on a fixed load basis, as permitted by the MPSC, in order to maximize recovery from electric customers of our capacity and fixed energy payments. This fixed load dispatch increases the MCV Facility's output and electricity production costs, such as natural gas. As the spread between the MCV Facility's variable electricity production costs and its energy payment revenue widens, the MCV's Partnership's financial performance and our investment in the MCV Partnership is and will be affected adversely. Under the PPA, variable energy payments to the MCV Partnership are based on the cost of coal burned at our coal plants and our operation and maintenance expenses. However, the MCV Partnership's costs of producing electricity are tied to the cost of natural gas. Because natural gas prices have increased substantially in recent years and the price the MCV Partnership can charge us for energy has not, the MCV Partnership's financial performance has been impacted negatively. Until September 2007, the PPA and settlement agreement require us to pay capacity and fixed energy charges F-25 based on the MCV Facility's actual availability up to the 98.5 percent cap. After September 2007, we expect to claim relief under the regulatory out provision in the PPA, limiting our capacity and fixed energy payments to the MCV Partnership to the amount collected from our customers. The MPSC's future actions on the capacity and fixed energy payments recoverable from customers subsequent to September 2007 may affect negatively the earnings of the MCV Partnership and the value of our investment in the MCV Partnership. Resource Conservation Plan: In February 2004, we filed the RCP with the MPSC that is intended to help conserve natural gas and thereby improve our investment in the MCV Partnership. This plan seeks approval to: - dispatch the MCV Facility based on natural gas market prices without increased costs to electric customers, - give Consumers a priority right to buy excess natural gas as a result of the reduced dispatch of the MCV Facility, and - fund $5 million annually for renewable energy sources such as wind power projects. The RCP will reduce the MCV Facility's annual production of electricity and, as a result, reduce the MCV Facility's consumption of natural gas by an estimated 30 to 40 bcf. This decrease in the quantity of high-priced natural gas consumed by the MCV Facility will benefit Consumers' ownership interest in the MCV Partnership. The amount of PPA capacity and fixed energy payments recovered from retail electric customers would remain capped at 88.7 percent. Therefore, customers will not be charged for any increased power supply costs, if they occur. Consumers and the MCV Partnership have reached an agreement that the MCV Partnership will reimburse Consumers for any incremental power costs incurred to replace the reduction in power dispatched from the MCV Facility. Presently, we are in settlement discussions with the parties to the RCP filing. However, in July 2004, several qualifying facilities filed for a stay on the RCP proceeding in the Ingham County Circuit Court after their previous attempt to intervene on the proceeding was denied by the MPSC. Hearings on the stay are scheduled for August 11, 2004. We cannot predict if or when the MPSC will approve the RCP or the outcome of the Ingham County Circuit Court hearings. The two most significant variables in the analysis of the MCV Partnership's future financial performance are the forward price of natural gas for the next 20 years and the MPSC's decision in 2007 or beyond related to limiting our recovery of capacity and fixed energy payments. Natural gas prices have been volatile historically. Presently, there is no consensus in the marketplace on the price or range of future prices of natural gas. Even with an approved RCP, if gas prices continue at present levels or increase, the economics of operating the MCV Facility may be adverse enough to require us to recognize an impairment of our investment in the MCV Partnership. We presently cannot predict the impact of these issues on our future earnings, cash flows, or on the value of our investment in the MCV Partnership. MCV PARTNERSHIP PROPERTY TAXES: In January 2004, the Michigan Tax Tribunal issued its decision in the MCV Partnership's tax appeal against the City of Midland for tax years 1997 through 2000. The MCV Partnership estimates that the decision will result in a refund to the MCV Partnership of approximately $35 million in taxes plus $9 million of interest. The Michigan Tax Tribunal decision has been appealed to the Michigan Court of Appeals by the City of Midland and the MCV Partnership has filed a cross-appeal at the Michigan Court of Appeals. The MCV Partnership also has a pending case with the Michigan Tax Tribunal for tax years 2001 through 2004. The MCV Partnership cannot predict the outcome of these proceedings; therefore, the above refund (net of approximately $15 million of deferred expenses) has not been recognized in year-to-date 2004 earnings. NUCLEAR PLANT DECOMMISSIONING: Our site-specific decommissioning cost estimates for Big Rock and Palisades assume that each plant site will eventually be restored to conform to the adjacent landscape and all contaminated equipment will be disassembled and disposed of in a licensed burial facility. Decommissioning funding practices approved by the MPSC require us to file a report on the adequacy of funds for decommissioning at three-year intervals. We prepared and filed updated cost estimates for each plant on March 31, 2004. Excluding additional costs for spent nuclear fuel storage, due to the DOE's failure to accept this spent nuclear fuel on schedule, these reports show a decommissioning cost of $361 million for Big Rock and $868 million for Palisades. Since Big F-26 Rock is currently in the process of being decommissioned, the estimated cost includes historical expenditures in nominal dollars and future costs in 2003 dollars, with all Palisades costs given in 2003 dollars. In 1999, the MPSC orders for Big Rock and Palisades provided for fully funding the decommissioning trust funds for both sites. In December 2000, funding of the Big Rock trust fund stopped because the MPSC-authorized decommissioning surcharge collection period expired. The MPSC order set the annual decommissioning surcharge for Palisades at $6 million through 2007. Amounts collected from electric retail customers and deposited in trusts, including trust earnings, are credited to a regulatory liability. However, based on current projections, the current levels of funds provided by the trusts are not adequate to fully fund the decommissioning of Big Rock or Palisades. This is due in part to the DOE's failure to accept the spent nuclear fuel and lower returns on the trust funds. We are attempting to recover our additional costs for storing spent nuclear fuel through litigation, as discussed in "Nuclear Matters". We will also seek additional relief from the MPSC. In the case of Big Rock, excluding the additional nuclear fuel storage costs due to the DOE's failure to accept this spent fuel on schedule, we are currently projecting that the level of funds provided by the trust will fall short of the amount needed to complete the decommissioning by $25 million. At this point in time, we plan to provide the additional amounts needed from our corporate funds and, subsequent to the completion of radiological decommissioning work, seek recovery of such expenditures at the MPSC. We cannot predict how the MPSC will rule on our request. In the case of Palisades, again excluding additional nuclear fuel storage costs due to the DOE's failure to accept this spent fuel on schedule, we have concluded that the existing surcharge needs to be increased to $25 million annually, beginning January 1, 2006, and continue through 2011, our current license expiration date. In June 2004, we filed an application with the MPSC seeking approval to increase the surcharge for recovery of decommissioning costs related to Palisades beginning in 2006. We cannot predict how the MPSC will rule on our request. NUCLEAR MATTERS: Big Rock: With the removal and safe disposal of the reactor vessel, steam drum, and radioactive waste processing systems in 2003, dismantlement of plant systems is nearly complete and demolition of the remaining plant structures is set to begin. The restoration project is on schedule to return approximately 530 acres of the site, including the area formerly occupied by the nuclear plant, to a natural setting for unrestricted use in mid-2006. An additional 30 acres, the area where seven transportable dry casks loaded with spent nuclear fuel and an eighth cask loaded with high-level radioactive waste material are stored, will be returned to a natural state by the end of 2012 if the DOE begins removing the spent nuclear fuel by 2010. The NRC and the Michigan Department of Environmental Quality continue to find all decommissioning activities at Big Rock are being performed in accordance with applicable regulations including license requirements. Palisades: In March 2004, the NRC completed its end-of-cycle plant performance assessment of Palisades. The assessment for Palisades covered the period from January 1, 2003 through December 31, 2003. The NRC determined that Palisades was operated in a manner that preserved public health and safety and fully met all cornerstone objectives. As of June 2004, all inspection findings were classified as having very low safety significance and all performance indicators indicated performance at a level requiring no additional oversight. Based on the plant's performance, only regularly scheduled inspections are planned through September 2005. The amount of spent nuclear fuel exceeds Palisades' temporary onsite storage pool capacity. We are using dry casks for temporary onsite storage. As of June 30, 2004, we have loaded 18 dry casks with spent nuclear fuel and are scheduled to load additional dry casks this summer in order to continue operation. DOE Litigation: In 1997, a U.S. Court of Appeals decision confirmed that the DOE was to begin accepting deliveries of spent nuclear fuel for disposal by January 1998. Subsequent U.S. Court of Appeals litigation, in which we and other utilities participated, has not been successful in producing more specific relief for the DOE's failure to accept the spent nuclear fuel. F-27 There are two court decisions that support the right of utilities to pursue damage claims in the United States Court of Claims against the DOE for failure to take delivery of spent nuclear fuel. Over 60 utilities have initiated litigation in the United States Court of Claims; we filed our complaint in December 2002. In July 2004, the DOE filed an amended answer and motion to dismiss the complaint. If our litigation against the DOE is successful, we anticipate future recoveries from the DOE. The recoveries will be used to pay the cost of spent nuclear fuel storage until the DOE takes possession as required by law. We can make no assurance that the litigation against the DOE will be successful. In July 2002, Congress approved and the President signed a bill designating the site at Yucca Mountain, Nevada, for the development of a repository for the disposal of high-level radioactive waste and spent nuclear fuel. We expect that the DOE will submit, by December 2004, an application to the NRC for a license to begin construction of the repository. The application and review process is estimated to take several years. Spent nuclear fuel complaint: In March 2003, the Michigan Environmental Council, the Public Interest Research Group in Michigan, and the Michigan Consumer Federation filed a complaint with the MPSC, which was served on us by the MPSC in April 2003. The complaint asks the MPSC to initiate a generic investigation and contested case to review all facts and issues concerning costs associated with spent nuclear fuel storage and disposal. The complaint seeks a variety of relief with respect to

Consumers, Detroit Edison, Indiana & Michigan Electric Company, Wisconsin Electric Power Company, and Wisconsin Public Service Corporation. The complaint states that amounts collected from customers for spent nuclear fuel storage and disposal should be placed in an independent trust. The complaint also asks the MPSC to take additional actions. In May 2003, Consumers and other named utilities each filed motions to dismiss the complaint. We are unable to predict the outcome of this matter. Insurance: We maintain nuclear insurance coverage on our nuclear plants. At Palisades, we maintain nuclear property insurance from NEIL totaling $2.750 billion and insurance that would partially cover the cost of replacement power during certain prolonged accidental outages. Because NEIL is a mutual insurance company, we could be subject to assessments of up to $27 million in any policy year if insured losses in excess of NEIL's maximum policyholders surplus occur at our, or any other member's, nuclear facility. NEIL's policies include coverage for acts of terrorism. At Palisades, we maintain nuclear liability insurance for third-party bodily injury and off-site property damage resulting from a nuclear hazard for up to approximately $10.761 billion, the maximum insurance liability limits established by the Price-Anderson Act. The United States Congress enacted the Price-Anderson Act to provide financial liability protection for those parties who may be liable for a nuclear accident or incident. Part of the Price-Anderson Act's financial protection is a mandatory industry-wide program where owners of nuclear generating facilities could be assessed if a nuclear incident occurs at any nuclear generating facility. The maximum assessment against us could be $101 million per occurrence, limited to maximum annual installment payments of $10 million. We also maintain insurance under a program that covers tort claims for bodily injury to nuclear workers caused by nuclear hazards. The policy contains a $300 million nuclear industry aggregate limit. Under a previous insurance program providing coverage for claims brought by nuclear workers, we remain responsible for a maximum assessment of up to $6 million. Big Rock remains insured for nuclear liability by a combination of insurance and a NRC indemnity totaling $544 million and a nuclear property insurance policy from NEIL. Insurance policy terms, limits, and conditions are subject to change during the year as we renew our policies. COMMITMENTS FOR FUTURE PURCHASES: We enter into a number of unconditional purchase obligations that represent normal business operating contracts. These contracts are used to assure an adequate supply of goods and services necessary for the operation of our business and to minimize exposure to market price fluctuations. We believe that these future costs are prudent and reasonably assured of recovery in future rates. Coal Supply and Transportation: We have entered into coal supply contracts with various suppliers and associated rail transportation contracts for our coal-fired generating stations. Under the terms of these agreements, F-28 we are obligated to take physical delivery of the coal and make payment based upon the contract terms. Our coal supply contracts expire through 2005, and total an estimated $147 million. Our coal transportation contracts expire through 2007, and total an estimated $108 million. Long-term coal supply contracts have accounted for approximately 60 to 90 percent of our annual coal requirements over the last 10 years. Although future contract coverage is not finalized at this time, we believe that it will be within the historic 60 to 90 percent range. Power Supply, Capacity, and Transmission: As of June 30, 2004, we had future unrecognized commitments to purchase power transmission services under fixed price forward contracts for 2004 and 2005 totaling $8 million. We also had commitments to purchase capacity and energy under long-term power purchase agreements with various generating plants. These contracts require monthly capacity payments based on the plants' availability or deliverability. These payments for 2004 through 2030 total an estimated $3.033 billion, undiscounted. This amount may vary depending upon plant availability and fuel costs. If a plant was not available to deliver electricity to us, then we would not be obligated to make the capacity payment until the plant could deliver. CONSUMERS' GAS UTILITY CONTINGENCIES GAS ENVIRONMENTAL MATTERS: We expect to incur investigation and remedial costs at a number of sites under the Michigan Natural Resources and Environmental Protection Act, a Michigan statute that covers environmental activities including remediation. These sites include 23 former manufactured gas plant facilities. We operated the facilities on these sites for some part of their operating lives. For some of these sites, we have no current ownership or may own only a portion of the original site. We have completed initial investigations at the 23 sites. We will continue to implement remediation plans for sites where we have received MDEQ remediation plan approval. We will also work toward resolving environmental issues at sites as studies are completed. We have estimated our costs for investigation and remedial action at all 23 sites using the Gas Research Institute-Manufactured Gas Plant Probabilistic Cost Model. We expect our remaining costs to be between $37 million and $90 million. The range reflects multiple alternatives with various assumptions for resolving the environmental issues at each site. The estimates are based on discounted 2003 costs using a discount rate of three percent. The discount rate represents a ten-year average of U.S. Treasury bond rates reduced for increases in the consumer price index. We expect to fund most of these costs through insurance proceeds and through the MPSC approved rates charged to our customers. As of June 30, 2004, we have recorded a regulatory liability of $42 million, net of $41 million of expenditures incurred to date, and a regulatory asset of $66 million. Any significant change in assumptions, such as an increase in the number of sites, different remediation techniques, nature and extent of contamination, and legal and regulatory requirements, could affect our estimate of remedial action costs. In its November 2002 gas distribution rate order, the MPSC authorized us to continue to recover approximately $1 million of manufactured gas plant facilities environmental clean-up costs annually. This amount will continue to be offset by $2 million to reflect amounts recovered from all other sources. We defer and amortize, over a period of 10 years, manufactured gas plant facilities environmental clean-up costs above the amount currently included in rates. Additional amortization of the expense in our rates cannot begin until after a prudency review in a gas rate case. CONSUMERS' GAS UTILITY RATE MATTERS GAS COST RECOVERY: The MPSC is required by law to allow us to charge customers for our actual cost of purchased natural gas. The GCR process is designed to allow us to recover all of our gas costs; however, the MPSC reviews these costs for prudency in an annual reconciliation proceeding. GCR YEAR 2002-2003: In June 2003, we filed a reconciliation of GCR costs and revenues for the 12-months ended March 2003. We proposed to recover from our customers approximately $6 million of underrecovered gas costs using a roll-in methodology. The roll-in methodology incorporates the GCR underrecovery in the next GCR plan year. The approach was approved by the MPSC in a November 2002 order. In January 2004, intervenors filed their positions in our 2002-2003 GCR case. Their positions were that not all of our gas purchasing decisions were prudent during April 2002 through March 2003 and they proposed F-29 disallowances. In 2003, we reserved $11 million for a settlement agreement associated with the 2002-2003 GCR disallowance. Interest on the disallowed amount from April 1, 2003 through February 2004, at Consumers' authorized rate of return, increased the cost of the settlement by $1 million. The interest was recorded as an expense in 2003. In February 2004, the parties in the case reached a settlement agreement that resulted in a GCR disallowance of $11 million for the GCR period. The settlement agreement was approved by the MPSC in March 2004. The disallowance is included in our 2003-2004 GCR reconciliation filed in June 2004. GCR YEAR 2003-2004: In June 2004, we filed a reconciliation of GCR for the 12-months ended March 2004. We proposed to refund to our customers $28 million of overrecovered gas cost, plus interest. The refund will be included in the 2004-2005 GCR plan year. The overrecovery includes the $11 million refund settlement for the 2002-2003 GCR year, as well as refunds received by us from our suppliers and required by the MPSC to be refunded to our customers. GCR PLAN FOR YEAR 2004-2005: In December 2003, we filed an application with the MPSC seeking approval of a GCR plan for the 12-month period of April 2004 through March 2005. The second quarter GCR adjustment resulted in a GCR ceiling price of $6.57. In June 2004, the MPSC issued a final Order in our GCR plan approving a settlement, which included a quarterly mechanism for setting a GCR ceiling price. The mechanism did not change the current ceiling price of $6.57. Actual gas costs and revenues will be subject to an annual reconciliation proceeding. Our GCR factor for the billing month of August is $6.39 per mcf. 2003 GAS RATE CASE: In March 2003, we filed an application with the MPSC for a $156 million annual increase in our gas delivery and transportation rates that included a 13.5 percent return on equity. In September 2003, we filed an update to our gas rate case that lowered the requested revenue increase from $156 million to $139 million and reduced the return on common equity from 13.5 percent to 12.75 percent. The MPSC authorized an interim gas rate increase of $19 million annually. The interim increase is under bond and subject to refund if the final rate relief is a lesser amount. The interim increase order includes a $34 million reduction in book depreciation expense and related income taxes effective only during the period of interim relief. The MPSC order allowed us to increase our rates beginning December 19, 2003. As part of the interim order, Consumers agreed to restrict dividend payments to its parent company, CMS Energy, to a maximum of $190 million annually during the period of interim relief. On March 5, 2004, the ALJ issued a Proposal for Decision recommending that the MPSC not rely upon the projected test year data included in our filing, which was supported by the MPSC Staff and the ALJ further recommended that the application be dismissed. In response to the Proposal for Decision, the parties have filed exceptions and replies to exceptions. The MPSC is not bound by the ALJ's recommendation and will review the exceptions and replies to exceptions prior to issuing an order on final rate relief. 2001 GAS DEPRECIATION CASE: In December 2003, we filed an update to our gas utility plant depreciation case originally filed in June 2001. This case is not affected by the 2003 gas rate case interim increase order that reduced book depreciation expense and related income taxes only for the period that we receive the interim relief. The June 2001 depreciation case filing was based on December 2000 plant balances and historical data. The December 2003 filing updates the gas depreciation case to include December 2002 plant balances. The proposed depreciation rates, if approved, would result in an annual increase of $12 million in depreciation expense based on December 2002 plant balances. In June 2004, the ALJ issued a Proposal for Decision recommending adoption of the Michigan Attorney General's proposal to reduce our annual depreciation expense by $52 million. In response to the Proposal for Decision, the parties filed exceptions and are expected to file replies to exceptions. In our exceptions, we proposed alternative depreciation rates that would result in an annual decrease of $7 million in depreciation expense. The MPSC is not bound by the ALJ's recommendation and will review the exceptions and replies to exceptions prior to issuing an order on final depreciation rates. In September 2002, the FERC issued an order rejecting our filing to assess certain rates for non-physical gas title tracking services we provide. In December 2003, the FERC ruled that no refunds were at issue and we reversed $4 million related to this matter. In January 2004, three companies filed with the FERC for clarification or rehearing of the FERC's December 2003 order. In April 2004, the FERC issued its Order Granting Clarification. In that Order, the FERC indicated that its December 2003 order was in error. It directed us to file within 30 days a fair and equitable title-tracking fee and to make refunds, with interest, to customers based on the difference between the F-30 accepted fee and the fee paid. In response to the FERC's April 2004 order, we filed a Request for Rehearing in May 2004. The FERC issued an Order Granting Rehearing for Further Consideration in June 2004. We expect the FERC to issue an order on the merits of this proceeding in the third quarter of 2004. We believe that with respect to the FERC jurisdictional transportation, we have not charged any customers title transfer fees, so no refunds are due. At this time, we cannot predict the outcome of this proceeding. OTHER UNCERTAINTIES INTEGRUM LAWSUIT: Integrum filed a complaint in Wayne County, Michigan Circuit Court in July 2003 against CMS Energy, Enterprises and APT. Integrum alleges several causes of action against APT, CMS Energy, and Enterprises in connection with an offer by Integrum to purchase the CMS Pipeline Assets. In addition to seeking unspecified money damages, Integrum is seeking an order enjoining CMS Energy and Enterprises from selling, and APT from purchasing, the CMS Pipeline Assets and an order of specific performance mandating that CMS Energy, Enterprises, and APT complete the sale of the CMS Pipeline Assets to APT and Integrum. A certain officer and director of Integrum is a former officer and director of CMS Energy, Consumers, and their subsidiaries. The individual was not employed by CMS Energy, Consumers, or their subsidiaries when Integrum made the offer to purchase the CMS Pipeline Assets. CMS Energy and Enterprises filed a motion to change venue from Wayne County to Jackson County, which was granted. The parties are now awaiting transfer of the file from Wayne County to Jackson County. CMS Energy and Enterprises believe that Integrum's claims are without merit. CMS Energy and Enterprises intend to defend vigorously against this action but they cannot predict the outcome of this litigation. CMS GENERATION-OXFORD TIRE RECYCLING: In an administrative order, the California Regional Water Control Board of the state of California named CMS Generation as a potentially responsible party for the clean up of the waste from the fire that occurred in September 1999 at the Filbin Tire Pile, which the state claims was owned by Oxford Tire Recycling of North Carolina, Inc. CMS Generation reached a settlement with the state, which the court approved, pursuant to which CMS Generation paid the state $5.5 million, $1.6 million of which it had paid the state prior to the settlement. CMS Generation continues to negotiate to have the insurance company pay a portion of the settlement amount, as well as a portion of its attorney fees. At the request of the DOJ in San Francisco, CMS Energy and other parties contacted by the DOJ in San Francisco entered into separate Tolling Agreements with the DOJ in San Francisco in September 2002. The Tolling Agreement stops the running of any statute of limitations during the ninety-day period between September 13, 2002 and (through several extensions of the tolling period) March 30, 2004, to facilitate settlement discussions between all the parties in connection with federal claims arising from the fire at the Filbin Tire Pile. On September 23, 2002, CMS Energy received a written demand from the U.S. Coast Guard for reimbursement of approximately $3.5 million in costs incurred by the U.S. Coast Guard in fighting the fire. It is CMS Energy's understanding that these costs, together with any accrued interest, are the sole basis of any federal claims. CMS Energy has entered into a consent judgment with the U.S. Coast Guard to settle this matter for $475,000 that is awaiting final court approval. DEARBORN INDUSTRIAL GENERATION: In October 2001, Duke/Fluor Daniel (DFD) presented DIG with a change order to their construction contract and filed an action in Michigan state court claiming damages in the amount of $110 million, plus interest and costs, which DFD states represents the cumulative amount owed by DIG for delays DFD believes DIG caused and for prior change orders that DIG previously rejected. DFD also filed a construction lien for the $110 million. DIG, in addition to drawing down on three letters of credit totaling $30 million that it obtained from DFD, has filed an arbitration claim against DFD asserting in excess of an additional $75 million in claims against DFD. The judge in the Michigan state court case entered an order staying DFD's prosecution of its claims in the court case and permitting the arbitration to proceed. DFD has appealed the decision by the judge in the Michigan state court case to stay the litigation. DIG will continue to defend itself vigorously and pursue its claims. DIG cannot predict the outcome of this matter. DIG NOISE ABATEMENT LAWSUIT: In February 2003, DIG was served with a three-count first amended complaint filed in Wayne County Circuit Court in the matter of Ahmed, et al v. Dearborn Industrial Generation, LLC. The complaint sought damages "in excess of $25,000" and injunctive relief based upon allegations of excessive noise F-31 and vibration created by operation of the power plant. The first amended complaint was filed on behalf of six named plaintiffs, all alleged to be adjacent or nearby residents or property owners. The damages alleged were injury to persons and property of the landowners. Certification of a class of "potentially thousands" who have been similarly affected was requested. The parties entered into a settlement agreement on June 25, 2004, whereby DIG will remediate the sound emitted from various pieces of plant equipment to a level below the ambient noise level and pay a substantial portion of plaintiffs' attorney fees and costs. A class will be certified for settlement purposes only and remediation will take approximately 280 days. DIG is seeking proposals for remediation and testing but DIG cannot predict the cost associated with the settlement of this matter. MCV EXPANSION, LLC: Under an agreement entered into with General Electric Company (GE) in October 2002, MCV Expansion, LLC has a remaining contingent obligation to GE in the amount of $2.2 million that may become payable in the fourth quarter of 2004. The agreement provides that this contingent obligation is subject to a pro rata reduction under a formula based upon certain purchase orders being entered into with GE by June 30, 2003. MCV Expansion, LLC anticipates but cannot assure that purchase orders will be executed with GE sufficient to eliminate contingent obligations of $2.2 million. FORMER CMS OIL AND GAS OPERATIONS: A Michigan trial judge granted Star Energy, Inc. and White Pine Enterprises, LLC a declaratory judgment in an action filed in 1999 that claimed Terra Energy Ltd., a former CMS Oil and Gas subsidiary, violated an oil and gas lease and other arrangements by failing to drill wells it had committed to drill. A jury then awarded the plaintiffs a $7.6 million award. Terra appealed this matter to the Michigan Court of Appeals. The Michigan Court of Appeals reversed the trial court judgment with respect to the appropriate measure of damages and remanded the case for a new trial on damages. The trial judge reinstated the judgment against Terra and awarded Terra title to the minerals. Terra has appealed this judgment. Enterprises has an indemnity obligation with regard to losses to Terra that might result from this litigation. GASATACAMA: On March 24, 2004, the Argentine Government authorized the restriction of exports of natural gas to Chile giving priority to domestic demand in Argentina. This restriction could have a detrimental effect on GasAtacama's earnings since GasAtacama's gas-fired power plant is located in Chile and uses Argentine gas for fuel. On April 21, 2004, Argentina and Bolivia signed an agreement in which Bolivian gas producers agreed to supply natural gas to Argentina for six months. Bolivian gas began flowing to Argentina in mid-June and will continue to flow through October 2004. The government of Argentina has also approved an agreement with Argentine producers that should help solve Argentina's long-term gas shortage problems. Additionally, on May 11, 2004, the Argentine Government announced the creation of a state-owned and operated energy company, which intends to make investments in domestic natural gas and electricity infrastructure projects. Currently, management of GasAtacama is working with government officials of Chile and Argentina, as well as meeting with its electricity customers and gas producers, to attempt to mitigate the impact of this situation. At this point, it is not possible to predict the outcome of these events and their effect on the earnings of GasAtacama. ARGENTINA ECONOMIC SITUATION: In January 2002, the Republic of Argentina enacted the Public Emergency and Foreign Exchange System Reform Act. This law repealed the fixed exchange rate of one U.S. dollar to one Argentine peso, converted all dollar-denominated utility tariffs and energy contract obligations into pesos at the same one-to-one exchange rate, and directed the President of Argentina to renegotiate such tariffs. Effective April 30, 2002, we adopted the Argentine peso as the functional currency for our Argentine investments. We had used previously the U.S. dollar as the functional currency. As a result, we translated the assets and liabilities of our Argentine entities into U.S. dollars using an exchange rate of 3.45 pesos per U.S. dollar, and recorded an initial charge to the Foreign Currency Translation component of stockholders' equity of $400 million. While we cannot predict future peso-to-U.S. dollar exchange rates, we do expect that these non-cash charges reduce substantially the risk of further material balance sheet impacts when combined with anticipated proceeds from international arbitration currently in progress, political risk insurance, and the eventual sale of these assets. At June 30, 2004, the net foreign currency loss due to the unfavorable exchange rate of the Argentine peso recorded in the Foreign Currency Translation component of stockholders' equity using an exchange rate of 2.97

pesos per U.S. dollar was $263 million. This amount also reflects the effect of recording, at December 31, 2002, U.S. income taxes F-32 on temporary differences between the book and tax bases of foreign investments, including the foreign currency translation associated with our Argentine investments. LEONARD FIELD DISPUTE: Pursuant to a Consent Judgment entered in Oakland County, Michigan Circuit Court in September 2001, CMS Gas Transmission had 18 months to extract approximately one bcf of pipeline quality natural gas held in the Leonard Field in Addison Township. The Consent Judgment provided for an extension of that period upon certain circumstances. CMS Gas Transmission has complied with the requirements of the Consent Judgment. Addison Township filed a lawsuit in Oakland County Circuit Court against CMS Gas Transmission in February 2004 alleging the Leonard Field was discharging odors in violation of the Consent Judgment. Pursuant to a Stipulated Order entered April 1, 2004, CMS Gas Transmission agreed to certain undertakings to address the odor complaints and further agreed to temporarily cease operations at the Leonard Field during the month of April 2004, the last month provided for in the Consent Judgment. Also, Addison Township was required to grant CMS Gas Transmission an extension to withdraw its natural gas if certain conditions were met. Addison Township denied CMS Gas Transmission's request for an extension on April 5, 2004. CMS Gas Transmission is pursuing its legal remedies and filed a complaint against Addison Township in June 2004. CMS Gas Transmission cannot predict the outcome of this matter, and unless an extension is provided, it will be unable to extract approximately 500,000 mcf of gas remaining in the Leonard Field. CMS ENSENADA CUSTOMER DISPUTE: Pursuant to a long-term power purchase agreement, CMS Ensenada sells power and steam to YPF Repsol at the YPF refinery in La Plata, Argentina. As a result of the so-called "Emergency Laws," payments by YPF Repsol under the power purchase agreement have been converted to pesos at the exchange rate of one U.S. dollar to one Argentine peso. Such payments are currently insufficient to cover CMS Ensenada's operating costs, including quarterly debt service payments to the Overseas Private Investment Corporation (OPIC). Enterprises is party to a Sponsor Support Agreement pursuant to which Enterprises has guaranteed CMS Ensenada's debt service payments to the OPIC up to an amount which is in dispute, but which Enterprises estimated to be approximately $9 million at June 30, 2004. Following a payment made to the OPIC in July 2004, Enterprises now believes this amount to be approximately $7 million. An interim arrangement, which provided CMS Ensenada with payments under the power purchase agreement that covered most, but not all, of CMS Ensenada's operating costs, was agreed to with YPF Repsol in 2002 but expired on December 31, 2003. Efforts to negotiate a new agreement with YPF Repsol have been unsuccessful. As a result, CMS Ensenada initiated two legal actions: (1) an ex parte action in the Argentine commercial courts, requesting injunctive relief in the form of a temporary increase in the payments by YPF Repsol under the power purchase agreement that would allow CMS Ensenada to continue to operate while seeking a final and permanent resolution; and (2) an arbitration administered by the International Chamber of Commerce seeking a ruling that the application of the Emergency Laws to the power purchase agreement is unconstitutional, or, alternatively, that the arbitral panel reestablish the economic equilibrium of the power purchase agreement, as required by the Emergency Laws taking into account that a significant portion of CMS Ensenada's operating costs are payable in U.S. dollars. In April 2004, the injunctive relief was granted on appeal, but in an amount lower than requested by CMS Ensenada. The injunctive relief expired at the end of May, but the court recently extended the term of relief until the end of the arbitration. OTHER: Certain CMS Gas Transmission and CMS Generation affiliates in Argentina received notice from various Argentine provinces claiming stamp taxes and associated penalties and interest arising from various gas transportation transactions. Although these claims total approximately $24 million, we believe the claims are without merit and will continue to contest them vigorously. CMS Generation does not currently expect to incur significant capital costs at its power facilities for compliance with current U.S. environmental regulatory standards. In addition to the matters disclosed within this Note, Consumers and certain other subsidiaries of CMS Energy are parties to certain lawsuits and administrative proceedings before various courts and governmental agencies arising from the ordinary course of business. These lawsuits and proceedings may involve personal injury, property damage, contractual matters, environmental issues, federal and state taxes, rates, licensing, and other matters. F-33 We have accrued estimated losses for certain contingencies discussed within this Note. Resolution of these contingencies is not expected to have a material adverse impact on our financial position, liquidity, or results of operations. 4: FINANCINGS AND CAPITALIZATION Long-term debt is summarized as follows: IN MILLIONS --------------------------------------- JUNE 30, 2004 DECEMBER 31, 2003 ------------- ----------------- CMS ENERGY CORPORATION Senior notes $ 2,063 $ 2,063 General term notes 236 496 Extendible tenor rate adjusted securities and other 186 187 ------- ------- Total - CMS Energy Corporation 2,485 2,746 ------- ------- CONSUMERS ENERGY

COMPANY First mortgage bonds 1,483 1,483 Senior notes 1,254 1,254 Bank debt and other 468 469 Securitization bonds 412 426 FMLP debt 411 - ------- ------- Total - Consumers Energy Company 4,028 3,632 ------- ------- OTHER SUBSIDIARIES 200 191 ------- ------- Principal amounts outstanding 6,713 6,569 Current amounts (860) (509) Net unamortized discount (37) (40) ------- ------- Total consolidated long-term debt $ 5,816 $ 6,020 ======= ======= FMLP DEBT: We consolidate the FMLP in accordance with Revised FASB Interpretation No. 46. At June 30, 2004, long-term debt of the FMLP consists of: IN MILLIONS ---------------------------- MATURITY 2004 -------- ----------- 11.75% subordinated secured notes 2005 $ 185 13.25% subordinated secured notes 2006 75 6.875% tax-exempt subordinated secured notes 2009 137 6.75% tax-exempt subordinated secured notes 2009 14 ---- ----- Total amount outstanding $ 411 ==== ===== The FMLP debt is essentially project debt secured by certain assets of the MCV Partnership and the FMLP. The debt is non-recourse to other assets of CMS Energy and Consumers. DEBT MATURITIES: At June 30, 2004, the aggregate annual maturities for long-term debt for the six months ending December 31, 2004 and the next four years are: IN MILLIONS -- PAYMENTS DUE -- 2004 2005 2006 2007 2008 ----- ----- ----- ----- ------- Long-term debt $ 342 $ 789 $ 549 $ 550 $ 1,053 ===== ===== ===== ===== ======= F-34 REGULATORY AUTHORIZATION FOR FINANCINGS: Effective July 1, 2004, Consumers received new FERC authorization to issue or guarantee up to $1.1 billion of short-term securities and up to $1.1 billion of short-term first mortgage bonds as collateral for such short-term securities. Effective July 1, 2004, Consumers received new FERC authorization to issue up to $1 billion of long-term securities for refinancing or refunding purposes, $1.5 billion of long-term securities for general corporate purposes, and $2.5 billion of long-term first mortgage bonds to be issued solely as collateral for other long-term securities. SHORT-TERM FINANCINGS: At June 30, 2004, CMS Energy had a $190 million secured revolving credit facility with banks and a $185 million cash-collateralized letter of credit facility with banks. At June 30, 2004, all of the $190 million is available for general corporate purposes and $17 million is available for letters of credit. At June 30, 2004, Consumers had a $400 million secured revolving credit facility with banks. At June 30, 2004, $24 million of letters of credit are issued and outstanding under this facility and $376 million is available for general corporate purposes, working capital, and letters of credit. The MCV Partnership had a $50 million working capital facility available. As of August 3, 2004, CMS Energy obtained an amended and restated $300 million secured revolving credit facility to replace both the $190 million and the $185 million facilities. As of August 3, 2004, Consumers obtained an amended and restated $500 million secured revolving credit facility to replace their $400 million facility. The amended facilities carry three-year terms and provide for lower interest rates. FIRST MORTGAGE BONDS: Consumers secures its first mortgage bonds by a mortgage and lien on substantially all of its property. Its ability to issue and sell securities is restricted by certain provisions in the first mortgage bond indenture, its articles of incorporation, and the need for regulatory approvals under federal law. CAPITAL AND FINANCE LEASE OBLIGATIONS: Our capital leases are comprised mainly of leased service vehicles and office furniture. As of June 30, 2004, capital lease obligations totaled $64 million. In order to obtain permanent financing for the MCV Facility, the MCV Partnership entered into a sale and lease back agreement with a lessor group, which includes the FMLP, for substantially all of the MCV Partnership's fixed assets. In accordance with SFAS No. 98, the MCV Partnership accounted for the transaction as a financing arrangement. As of June 30, 2004, finance lease obligations totaled $317 million, which represents the third-party portion of the MCV Partnership's finance lease obligation. SALE OF ACCOUNTS RECEIVABLE: Under a revolving accounts receivable sales program, we currently sell certain accounts receivable to a wholly owned, consolidated, bankruptcy remote special purpose entity. In turn, the special purpose entity may sell an undivided interest in up to $325 million of the receivables. We sold no receivables at June 30, 2004 and we sold $50 million at June 30, 2003. The Consolidated Balance Sheets exclude these sold amounts from accounts receivable. We continue to service the receivables sold. The purchaser of the receivables has no recourse against our other assets for failure of a debtor to pay when due and the purchaser has no right to any receivables not sold. No gain or loss has been recorded on the receivables sold and we retain no interest in the receivables sold. Certain cash flows received from and paid to us under our accounts receivable sales program are shown below: IN MILLIONS ----------------------- SIX MONTHS ENDED JUNE 30 2004 2003 --- -------- -------- Proceeds from sales (remittance of collections) under the program $ (297) $ (275) Collections reinvested under the program $ 2,645 $ 2,459 ======= ======= DIVIDEND RESTRICTIONS: Under the provisions of its articles of incorporation, at June 30, 2004, Consumers had $396 million of unrestricted retained earnings available to pay common stock dividends. However, covenants in

Consumers' debt facilities cap common stock dividend payments at $300 million in a calendar year. Consumers is also under an annual dividend cap of $190 million imposed by the MPSC during the current interim gas rate relief period. For the six months ended June 30, 2004, CMS Energy received $105 million of common stock dividends from Consumers. F-35 Our amended and restated $300 million secured revolving credit facility restricts payments of dividends on our common stock during a 12-month period to $75 million, dependent on the aggregate amounts of unrestricted cash and unused commitments under the facility. For additional details on the cap on common stock dividends payable during the current interim gas rate relief period, see Note 3, Uncertainties, "Consumers' Gas Utility Rate Matters - 2003 Gas Rate Case." FASB INTERPRETATION NO. 45, GUARANTOR'S ACCOUNTING AND DISCLOSURE REQUIREMENTS FOR GUARANTEES, INCLUDING INDIRECT GUARANTEES OF INDEBTEDNESS OF OTHERS: This Interpretation became effective January 2003. It describes the disclosure to be made by a guarantor about its obligations under certain guarantees that it has issued. At the beginning of a guarantee, it requires a guarantor to recognize a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provision of this Interpretation does not apply to some guarantee contracts, such as warranties, derivatives, or guarantees between either parent and subsidiaries or corporations under common control, although disclosure of these guarantees is required. For contracts that are within the recognition and measurement provision of this Interpretation, the provisions were to be applied to guarantees issued or modified after December 31, 2002. The following table describes our guarantees at June 30, 2004: IN MILLIONS --- ISSUE EXPIRATION MAXIMUM CARRYING RECOURSE GUARANTEE DESCRIPTION DATE DATE OBLIGATION AMOUNT(b) PROVISION(c) -------------------------------------- ------- ---------- ---------- --------- ------------ Indemnifications from asset sales and other agreements(a) Various Various $1,147 $ 4 $ - Letters of credit Various Various 235 - - Surety bonds and other indemnifications Various Various 28 - - Other guarantees Various Various 199 - - Nuclear insurance retrospective premiums Various Various 134 - - ======= ======= ====== === === (a) The majority of this amount arises from routine provisions in stock and asset sales agreements under which we indemnify the purchaser for losses resulting from events such as failure of title to the assets or stock sold by us to the purchaser. We believe the likelihood of a loss for any remaining indemnifications to be remote. (b) The carrying amount represents the fair market value of guarantees and indemnities recorded on our balance sheet that are entered into subsequent to January 1, 2003. (c) Recourse provision indicates the approximate recovery from third parties including assets held as collateral. The following table provides additional information regarding our guarantees: GUARANTEE DESCRIPTION HOW GUARANTEE AROSE EVENTS THAT WOULD REQUIRE PERFORMANCE -- ---------------------------------- ------------------------------------ Indemnifications from asset sales and Stock and asset sales agreements Findings of misrepresentation, other agreements breach of warranties, and other specific events or circumstances Standby letters of credit Normal operations of coal power Noncompliance with environmental plants regulations Self-insurance requirement Nonperformance Surety bonds Normal operating activity, permits Nonperformance and license Other guarantees Normal operating activity Nonperformance or non-payment by a subsidiary under a related contract Nuclear insurance retrospective premiums Normal operations of nuclear plants Call by NEIL and Price-Anderson Act for nuclear incident We have entered into typical tax indemnity agreements in connection with a variety of transactions including transactions for the sale of subsidiaries and assets, equipment leasing, and financing agreements. These indemnity F-36 agreements generally are not limited in amount and, while a maximum amount of exposure cannot be identified, the probability of liability is considered remote. We have guaranteed payment of obligations through letters of credit, indemnities, surety bonds, and other guarantees of unconsolidated affiliates and related parties of $462 million as of June 30, 2004. We monitor and approve these obligations and believe it is unlikely that we would be required to perform or otherwise incur any material losses associated with the above obligations. The off-balance sheet commitments expire as follows: COMMERCIAL COMMITMENTS IN MILLIONS -- COMMITMENT EXPIRATION --- 2009 AND TOTAL 2004 2005 2006 2007 2008 BEYOND ----- ---- ---- ---- ---- ---- -------- Off-balance sheet: Guarantees $ 199 $ 6 $ 36 $ 5 $ - $ - $ 152 Surety bonds and other 28 1 - - - - 27 indemnifications (a) Letters of Credit (b) 235 23 184 5 5 5 13 ----- ---- ----- ---- --- --- ----- Total $ 462 $ 30 $ 220 $ 10 $ 5 $ 5 $ 192 ===== ==== ===== ==== === === ===== (a) The surety bonds are continuous in nature. The need for the bonds is determined on an annual basis. (b) At June 30, 2004, we had $169 million of cash held as collateral for letters of credit. The cash that collateralizes the letters of credit is included in

Restricted cash on the Consolidated Balance Sheets. CONTINGENTLY CONVERTIBLE SECURITIES: At June 30, 2004, we have contingently convertible debt and equity securities outstanding. The significant terms of these securities are as follows: Convertible Senior Notes: Our $150 million 3.375 percent convertible senior notes are putable to CMS Energy by the note holders at par on July 15, 2008, July 15, 2013 and July 15, 2018. The notes are convertible to Common Stock at the option of the holder if the price of our Common Stock remains at or above $12.81 per share for 20 of 30 consecutive trading days ending on the last trading day of a quarter. The $12.81 price per share may be adjusted if there is a payment or distribution to our Common Stockholders. If conversion were to occur, the notes would be converted into 14.1 million shares of Common Stock based on the initial conversion rate. Convertible Preferred Stock: Our $250 million 4.50 percent cumulative convertible perpetual preferred stock has a liquidation value of $50.00 per share. The security is convertible to Common Stock at the option of the holder if the price of our Common Stock remains at or above $11.87 per share for 20 of 30 consecutive trading days ending on the last trading day of a quarter. On or after December 5, 2008, we may cause the Preferred Stock to convert into Common Stock if the closing price of our Common Stock remains at or above $12.86 for 20 of any 30 consecutive trading days. The $11.87 and $12.86 prices per share may be adjusted if there is a payment or distribution to our Common Stockholders. If conversion were to occur, the securities would be converted into 25.3 million shares of Common Stock based on the initial conversion rate. F-37 5: EARNINGS PER SHARE AND DIVIDENDS The following table presents the basic and diluted earnings per share computations. IN MILLIONS, EXCEPT PER SHARE AMOUNTS ------------------------------------ RESTATED ------------- -------------- THREE MONTHS ENDED JUNE 30 2004 2003 -- ------------- -------------- EARNINGS ATTRIBUTABLE TO COMMON STOCK: Income (Loss) from Continuing Operations $ 19 $ (12) Less Preferred Dividends (3) - ------ ------- Income (Loss) from Continuing Operations attributable to Common Stock - Basic $ 16 $ (12) Add conversion of Trust Preferred Securities (net of tax) - (a) - (a) ------ ------- Income (Loss) from Continuing Operations attributable to Common Stock - Diluted $ 16 $ (12) ====== ======= AVERAGE COMMON SHARES OUTSTANDING APPLICABLE TO BASIC AND DILUTED EPS CMS Energy: Average Shares - Basic 161.2 144.1 Add conversion of Trust Preferred Securities - (a) - (a) Add dilutive Stock Options and Warrants 0.5 (b) - (b) ------ ------- Average Shares - Diluted 161.7 144.1 ====== ======= EARNINGS (LOSS) PER AVERAGE COMMON SHARE ATTRIBUTABLE TO COMMON STOCK Basic $ 0.10 $ (0.08) Diluted $ 0.10 $ (0.08) ====== ======= IN MILLIONS, EXCEPT PER SHARE AMOUNTS ------------------------------------ RESTATED ------------- SIX MONTHS ENDED JUNE 30 2004 2003 -- ----------- ------------- EARNINGS ATTRIBUTABLE TO COMMON STOCK: Income from Continuing Operations $ 17 $ 63 Less Preferred Dividends (6) - ------ ------- Income from Continuing Operations attributable to Common Stock - Basic $ 11 $ 63 Add conversion of Trust Preferred Securities (net of tax) - (a) 5 (a) ------ ------- Income from Continuing Operations attributable to Common Stock - Diluted $ 11 $ 68 ====== ======= AVERAGE COMMON SHARES OUTSTANDING APPLICABLE TO BASIC AND DILUTED EPS CMS Energy: Average Shares - Basic 161.2 144.1 Add conversion of Trust Preferred Securities - (a) 16.6 (a) Add dilutive Stock Options and Warrants 0.5 (b) - (b) ------ ------- Average Shares - Diluted 161.7 160.7 ====== ======= EARNINGS PER AVERAGE COMMON SHARE ATTRIBUTABLE TO COMMON STOCK Basic $ 0.07 $ 0.43 Diluted $ 0.07 $ 0.43 ====== ======= F-38 (a) Due to antidilution, the computation of diluted earnings per share excluded the conversion of Trust Preferred Securities into 4.2 million shares of Common Stock and a $2.2 million reduction of interest expense, net of tax, for the three months ended June 30, 2004 and the three months ended June 30, 2003 and a $4.3 million reduction of interest expense, net of tax, for the six months ended June 30, 2004 and the six months ended June 30, 2003. Effective July 2001, we can revoke the conversion rights if certain conditions are met. (b) Since the exercise price was greater than the average market price of the Common Stock, options and warrants to purchase 5.4 million and 5.1 million shares of Common Stock were excluded from the computation of diluted EPS for the three and six months ended June 30, 2004 and the three and six months ended June 30, 2003, respectively. Computation of diluted earnings per share for the three months and the six months ended June 30, 2004 excluded conversion of our $150 million 3.375 percent convertible senior notes and our 5 million shares of 4.50 percent cumulative convertible preferred stock. Both are "contingently convertible" securities and, as of June 30, 2004, none of the stated contingencies have been met. For additional details on these securities, see Note 4, Financings and Capitalization. In January 2003, the Board of Directors suspended the payment of common stock dividends. 6: FINANCIAL AND DERIVATIVE INSTRUMENTS FINANCIAL INSTRUMENTS: The carrying amounts of cash, short-term investments, and current liabilities approximate their fair values because of their short-term nature. We estimate the fair values of long-term financial instruments based on quoted market prices or, in the absence of specific market prices, on quoted market prices of similar instruments or other valuation techniques. The carrying amount of all long-term financial instruments, except as shown below, approximates fair value. Our held-to-maturity investments consist of debt securities held by the MCV Partnership totaling $140 million as of June 30, 2004. These securities represent funds restricted primarily for future lease payments and are classified as Other Assets on the Consolidated Balance Sheets. These investments have original maturity dates of approximately one year or less and, because of their short maturities, their carrying amounts approximate their fair values. For additional details, see Note 1, Corporate Structure and Accounting Policies. IN MILLIONS --- JUNE 30 2004 2003 -------------------------- ------------------------------- ------------------------------- FAIR UNREALIZED FAIR UNREALIZED COST VALUE GAIN(LOSS) COST VALUE GAIN ------ -------- ---------- ------- ------- ---------- Long-term debt (a) $ 6,676 $ 6,834 $ (158) $ 6,594 $ 6,813 $ (219) Long-term debt - related parties (b) 684 644 40 - - - Trust Preferred Securities (b) - - - 883 769 114 Available-for-sale securities: Nuclear decommissioning (c) 434 559 125 453 553 100 SERP 54 66 12 55 61 6 ======= ======= ======== ======= ======= ====== (a) Includes a principal amount of $860 million at June 30, 2004 and $532 million at June 30, 2003 relating to current maturities. Settlement of long-term debt is generally not expected until maturity. (b) We determined that we are not the primary beneficiary of our trust preferred security structures. Accordingly, those entities have been deconsolidated as of December 31, 2003. Company Obligated Trust Preferred Securities totaling $663 million that were previously included in mezzanine equity, have been eliminated due to deconsolidation and are reflected in Long-term debt - related parties on the Consolidated Balance Sheets. For additional details, see Note 11, Implementation of New Accounting Standards. In addition, company obligated Trust Preferred Securities totaling $220 million have been converted to Common Stock as of August 2003. (c) On January 1, 2003, we adopted SFAS No. 143 and began classifying our unrealized gains and losses on nuclear decommissioning investments as regulatory liabilities. We previously included the unrealized gains and losses on these investments in accumulated depreciation. F-39 DERIVATIVE INSTRUMENTS: We are exposed to market risks including, but not limited to, changes in interest rates, commodity prices, currency exchange rates, and equity security prices. We manage these risks using established policies and procedures, under the direction of both an executive oversight committee consisting of senior management representatives and a risk committee consisting of business-unit managers. We may use various contracts to manage these risks including swaps, options, futures and forward contracts. We intend that any gains or losses on these contracts will be offset by an opposite movement in the value of the item at risk. Risk management contracts are classified as either trading or other than trading. These contracts contain credit risk if the counterparties, including financial institutions and energy marketers, fail to perform under the agreements. We minimize such risk by performing financial credit reviews using, among other things, publicly available credit ratings of such counterparties. Contracts used to manage interest rate, foreign currency, and commodity price risk may be considered derivative instruments that are subject to derivative and hedge accounting pursuant to SFAS No. 133. If a contract is accounted for as a derivative instrument, it is recorded in the financial statements as an asset or a liability, at the fair value of the contract. The recorded fair value of the contract is then adjusted quarterly to reflect any change in the market value of the contract, a practice known as marking the contract to market. Changes in the fair value of a derivative (that is, gains or losses) are reported either in earnings or accumulated other comprehensive income depending on whether the derivative qualifies for special hedge accounting treatment. For derivative instruments to qualify for hedge accounting under SFAS No. 133, the hedging relationship must be formally documented at inception and be highly effective in achieving offsetting cash flows or offsetting changes in fair value attributable to the risk being hedged. If hedging a forecasted transaction, the forecasted transaction must be probable. If a derivative instrument, used as a cash flow hedge, is terminated early because it is probable that a forecasted transaction will not occur, any gain or loss as of such date is immediately recognized in earnings. If a derivative instrument, used as a cash flow hedge, is terminated early for other economic reasons, any gain or loss as of the termination date is deferred and recorded when the forecasted transaction affects earnings. We use a combination of quoted market prices and mathematical valuation models to determine fair value of those contracts requiring derivative accounting. The ineffective portion, if any, of all hedges is recognized in earnings. The majority of our contracts are not subject to derivative accounting because they qualify for the normal purchases and sales exception of SFAS No. 133, or are not derivatives because there is not an active market for the commodity. Certain of our electric capacity and energy contracts are not accounted for as derivatives due to the lack of an active energy market in the state of Michigan, as defined by SFAS No. 133, and the significant transportation costs that would be incurred to deliver the power under the contracts to the closest active energy market at the Cinergy hub in Ohio. If an active market develops in the future, we may be required to account for these contracts as derivatives. The mark-to-market impact on earnings related to these contracts could be material to the financial statements. F-40 Derivative accounting is required for certain contracts used to limit our exposure to commodity price risk and interest rate risk. The following table reflects the fair value of all contracts requiring derivative accounting: IN MILLIONS --- JUNE 30 2004 2003 -- -------------------------- ------------------------- FAIR UNREALIZED FAIR UNREALIZED DERIVATIVE INSTRUMENTS COST VALUE GAIN (LOSS) COST VALUE GAIN (LOSS) --- ---- ----- ---------- ---- ----- ---------- Other than trading Electric - related contracts $ - $ - $ - $ 8 $ - $ (8) Gas contracts 3 6 3 2 1 (1) Interest rate risk contracts - (2) (2) - - - Derivative contracts associated with Consumers' investment in the MCV Partnership: Prior to consolidation - - - - 20 20 After consolidation: Gas fuel contracts - 80 80 - - - Gas fuel futures, options, and swaps - 54 54 - - - Trading Electric / gas contracts (5) 10 15 - 15 15 Derivative contracts associated with equity investments in: Shuweihat - (19) (19) - (39) (39) Taweelah (35) (19) 16 - (36) (36) Jorf Lasfar - (10) (10) - (14) (14) Other - (1) (1) - (4) (4) ==== ==== === ==== ===== ====== The fair value of our other than trading derivative contracts is included in Derivative Instruments, Other Assets, or Other Liabilities on the Consolidated Balance Sheets. The fair value of our trading derivative contracts is included in either Price Risk Management Assets or Price Risk Management Liabilities on the Consolidated Balance Sheets. The fair value of derivative contracts associated with our equity investments is included in Enterprises Investments on the Consolidated Balance Sheets. The fair value of derivative contracts associated with our investment in the MCV Partnership for 2003 is included in Investments - Midland Cogeneration Venture Limited Partnership on the Consolidated Balance Sheets. ELECTRIC CONTRACTS: Our electric utility business uses purchased electric call option contracts to meet, in part, our regulatory obligation to serve. This obligation requires us to provide a physical supply of electricity to customers, to manage electric costs, and to ensure a reliable source of capacity during peak demand periods. GAS CONTRACTS: Our gas utility business uses fixed price and index-based gas supply contracts, fixed price weather-based gas supply call options, fixed price gas supply call and put options, and other types of contracts, to meet our regulatory obligation to provide gas to our customers at a reasonable and prudent cost. Unrealized gains and losses associated with these options are reported directly in earnings as part of other income, and then directly offset in earnings and recorded on the balance sheet as a regulatory asset or liability as part of the GCR process. INTEREST RATE RISK CONTRACTS: We use interest rate swaps to hedge the risk associated with forecasted interest payments on variable-rate debt and to reduce the impact of interest rate fluctuations. Most of our interest rate swaps are designated as cash flow hedges. As such, we record changes in the fair value of these contracts in accumulated other comprehensive income unless the swaps are sold. For interest rate swaps that did not qualify for hedge accounting treatment, we record changes in the fair value of these contracts in Other income. F-41 The following table reflects the outstanding floating-to-fixed interest rates swaps: IN MILLIONS ------------------------------------ FLOATING TO FIXED NOTIONAL MATURITY FAIR INTEREST RATE SWAPS AMOUNT DATE VALUE --------------------- -------- --------- ----- June 30, 2004 $ 26 2005-2006 $ (2) ==== ========= ==== June 30, 2003 3 2006 - ==== ========= ==== Notional amounts reflect the volume of transactions but do not represent the amount exchanged by the parties to the financial instruments. Accordingly, notional amounts do not necessarily reflect our exposure to credit or market risks. The weighted average interest rate associated with outstanding swaps was approximately 7.3 percent at June 30, 2004 and 9.0 percent at June 30, 2003. There was no ineffectiveness associated with any of the interest rate swaps that qualified for hedge accounting treatment. As of June 30, 2004, we have recorded an unrealized loss of $1 million, net of tax, in accumulated other comprehensive income related to interest rate risk contracts accounted for as cash flow hedges. We expect to reclassify $1 million of this amount as a decrease to earnings during the next 12 months primarily to offset the variable-rate interest expense on hedged debt. Certain equity method investees have issued interest rate swaps to hedge the risk associated with variable-rate debt, as listed in the table under "Derivative Instruments" within this Note. These instruments are not included in this analysis, but can have an impact on financial results. The accounting for these instruments depends on whether they qualify for cash flow hedge accounting treatment. The interest rate swap held by Taweelah and certain interest rate swaps held by Shuweihat do not qualify as cash flow hedges, and therefore, we record our proportionate share of the change in the fair value of these contracts in Earnings from Equity Method Investees. The remainder of these instruments do qualify as cash flow hedges, and we record our proportionate share of the change in the fair value of these contracts in accumulated other comprehensive income. DERIVATIVE CONTRACTS ASSOCIATED WITH CONSUMERS' INVESTMENT IN THE MCV PARTNERSHIP: Gas Fuel Contracts: The MCV Partnership uses natural gas fuel contracts to buy gas as fuel for generation, and to manage gas fuel costs. The MCV Partnership believes that its long-term natural gas contracts, which do not contain volume optionality, qualify under SFAS No. 133 for the normal purchases and normal sales exception. Therefore, these contracts are currently not recognized at fair value on the balance sheet. Should significant changes in the level of the MCV Facility operational dispatch or purchases of long-term gas occur, the MCV Partnership would be required to re-evaluate its accounting treatment for these long-term gas contracts. This re-evaluation may result in recording mark-to-market activity on some contracts, which could add to earnings volatility. At June 30, 2004, the MCV Partnership had six long-term gas contracts that contained both an option and forward component. Because of the option component, these contracts do not qualify for the normal purchases and sales exception and are accounted for as derivatives, with changes in fair value recorded in earnings each quarter. The MCV Partnership expects future earnings volatility on these six contracts, since gains or losses will be recorded on a quarterly basis during the remaining life of approximately four years for these gas contracts. For the six months ended June 30, 2004, the MCV Partnership recorded in Fuel for electric generation a $6 million net gain in earnings associated with these contracts. Gas Fuel Futures, Options, and Swaps: To manage market risks associated with the volatility of natural gas prices, the MCV Partnership maintains a gas hedging program. The MCV Partnership enters into natural gas futures contracts, option contracts, and over-the-counter swap transactions in order to hedge against unfavorable changes in the market price of natural gas in future months when gas is expected to be needed. These financial instruments are being used principally to secure anticipated natural gas requirements necessary for projected electric and steam sales, and to lock in sales prices of natural gas previously obtained in order to optimize the MCV Partnership's existing gas supply, storage, and transportation arrangements. These financial instruments are accounted for as derivatives under SFAS No. 133. The contracts that are used to secure anticipated natural gas requirements necessary for projected electric and steam sales qualify as cash flow hedges under SFAS No. 133. The MCV Partnership also engages in cost mitigation activities to offset the fixed F-42 charges the MCV Partnership incurs in operating the MCV Facility. These cost mitigation activities include the use of futures and options contracts to purchase and/or sell natural gas to maximize the use of the transportation and storage contracts when it is determined that they will not be needed for the MCV Facility operation. Although these cost mitigation activities do serve to offset the fixed monthly charges, these cost mitigation activities are not considered a normal course of business for the MCV Partnership and do not qualify as hedges under SFAS No. 133. Therefore, the mark-to-market gains and losses from these cost mitigation activities are recorded in earnings each quarter. For the six months ended June 30, 2004, the MCV Partnership has recorded an unrealized gain of $24 million in other comprehensive income on those futures contracts that qualify as cash flow hedges, which resulted in a cumulative net gain of $55 million in other comprehensive income as of June 30, 2004. This balance represents natural gas futures, options, and swaps with maturities ranging from July 2004 to December 2009, of which $34 million of this gain is expected to be reclassified as an increase to earnings within the next 12 months. As of June 30, 2004, Consumers' pretax proportionate share of the MCV Partnership's $55 million net gain recorded in other comprehensive income is $27 million, of which $17 million is expected to be reclassified as an increase to earnings within the next 12 months. In addition, for the six months ended June 30, 2004, the MCV Partnership has recorded a net gain of $16 million in earnings from hedging activities related to natural gas requirements for the MCV Facility operations and a net gain of $1 million in earnings from cost mitigation activities. TRADING ACTIVITIES: Through December 31, 2002, our wholesale power and gas trading activities were accounted for under the mark-to-market method of accounting in accordance with EITF Issue No. 98-10. Effective January 1, 2003, EITF Issue No. 98-10 was rescinded and replaced by EITF Issue No. 02-03. As a result, only energy contracts that meet the definition of a derivative under SFAS No. 133 are to be carried at fair value. The impact of this change was recognized as a cumulative effect of a change in accounting principle loss of $23 million, net of tax, for the three month period ended March 31, 2003. During 2003, we sold a majority of our wholesale natural gas and power-trading portfolio, and exited the energy services and retail customer choice business. As a result, our trading activities have been significantly reduced. Our current activities center around entering into energy contracts that are related to the activities considered to be an integral part of our ongoing operations. The intent of holding these energy contracts is to optimize the financial performance of our owned generating assets and to fulfill contractual obligations. These contracts are classified as trading activities in accordance with EITF No. 02-03 and are accounted for using the criteria defined in SFAS No. 133. Energy trading contracts that meet the definition of a derivative are recorded as assets or liabilities in the financial statements at the fair value of the contracts. Gains or losses arising from changes in fair value of these contracts are recognized in earnings as a component of operating revenues in the period in which the changes occur. Energy trading contracts that do not meet the definition of a derivative are accounted for as executory contracts (i.e., on an accrual basis). The market prices we use to value our energy trading contracts reflect our consideration of, among other things, closing exchange and over-the-counter quotations. In certain contracts, long-term commitments may extend beyond the period in which market quotations for such contracts are available. Mathematical models are developed to determine various inputs into the fair value calculation including price and other variables that may be required to calculate fair value. Realized cash returns on these commitments may vary, either positively or negatively, from the results estimated through application of the mathematical model. Market prices are adjusted to reflect the impact of liquidating our position in an orderly manner over a reasonable period of time under present market conditions. In connection with the market valuation of our energy trading contracts, we maintain reserves for credit risks based on the financial condition of counterparties. We also maintain credit policies that management believes will minimize its overall credit risk with regard to our counterparties. Determination of our counterparties' credit quality is based upon a number of factors, including credit ratings, disclosed financial condition, and collateral requirements. Where contractual terms permit, we employ standard agreements that allow for netting of positive and negative exposures associated with a single counterparty. Based on these policies, our current exposures, and our credit reserves, we do not anticipate a material adverse effect on our financial position or results of operations as a result of counterparty nonperformance. F-43 FOREIGN EXCHANGE DERIVATIVES: We may use forward exchange and option contracts to hedge certain receivables, payables, long-term debt, and equity value relating to foreign investments. The purpose of our foreign currency hedging activities is to protect the company from the risk associated with adverse changes in currency exchange rates that could affect cash flow materially. These contracts would not subject us to risk from exchange rate movements because gains and losses on such contracts offset losses and gains, respectively, on assets and liabilities being hedged. At June 30, 2004 and June 30, 2003, we had no outstanding foreign exchange contracts. As of June 30, 2004, Taweelah, one of our equity method investees, held a foreign exchange contract that hedged the foreign currency risk associated with payments to be made under an operating and maintenance service agreement. This contract did not qualify as a cash flow hedge; and therefore, we record our proportionate share of the change in the fair value of the contract in Earnings from Equity Method Investees. 7: RETIREMENT BENEFITS We provide retirement benefits to our employees under a number of different plans, including: - non-contributory, defined benefit Pension Plan, - a cash balance pension plan for certain employees hired after June 30, 2003, - benefits to certain management employees under SERP, - health care and life insurance benefits under OPEB, - benefits to a select group of management under EISP, and - a defined contribution 401(k) plan. Pension Plan: The Pension Plan includes funds for our employees and our non-utility affiliates, including former Panhandle employees. The Pension Plan's assets are not distinguishable by company. As of June 30, 2004, we have recorded a prepaid pension asset of $398 million, $20 million of which is in Other current assets on our Consolidated Balance Sheet. OPEB: We adopted SFAS No. 106, effective as of the beginning of 1992. Consumers recorded a liability of $466 million for the accumulated transition obligation and a corresponding regulatory asset for anticipated recovery in utility rates. For additional details, see Note 1, Corporate Structure and Accounting Policies, "Utility Regulation." In 1994, the MPSC authorized recovery of the electric utility portion of these costs over 18 years and in 1996, the MPSC authorized recovery of the gas utility portion of these costs over 16 years. We have made contributions of $33 million to our 401(h) and VEBA trust funds in 2004. We plan to make additional contributions of $30 million in 2004. F-44 Costs: The following table recaps the costs incurred in our retirement benefits plans: IN MILLIONS -- PENSION -- THREE MONTHS ENDED SIX MONTHS ENDED ------------------ ----------------- JUNE 30 2004 2003 2004 2003 ----- ----- ---- ---- Service cost $ 9 $ 9 $ 19 $ 19 Interest expense 18 18 36 37 Expected return on plan assets (27) (21) (54) (41) Amortization of: Net loss 4 3 7 5 Prior service cost 2 2 3 4 ---- ---- ---- ---- Net periodic pension cost $ 6 $ 11 $ 11 $ 24 Service cost $ 5 $ 6 $ 10 $ 11 Interest expense 14 16 29 33 Expected return on plan assets (12) (10) (24) (21) Amortization of: Net loss 3 5 5 10 Prior service cost (2) (2) (5) (4) ---- ---- ---- ---- Net periodic postretirement benefit cost $ 8 $ 15 $ 15 $ 29 ==== ==== ==== ==== The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Act) was signed into law in December 2003. The Act establishes a prescription drug benefit under Medicare (Medicare Part D) and a federal subsidy, which is exempt from federal taxation, to sponsors of retiree health care benefit plans that provide a benefit that is actuarially equivalent to Medicare Part D. We believe our plan is actuarially equivalent to Medicare Part D and have incorporated retroactively the effects of the subsidy into our financial statements as of June 30, 2004 in accordance with FASB Staff Position, No. SFAS 106-2. We remeasured our obligation as of December 31, 2003 to incorporate the impact of the Act, which resulted in a reduction to the accumulated postretirement benefit obligation of $158 million. The remeasurement resulted in a reduction of OPEB cost of $6 million for the three months ended June 30, 2004, $12 million for the six months ended June 30, 2004, and an expected total reduction of $24 million for 2004. The reduction of $24 million includes $7 million in capitalized OPEB costs. For additional details, see Note 11, Implementation of New Accounting Standards. 8: EQUITY METHOD INVESTMENTS Where ownership is more than 20 percent but less than a majority, we account for certain investments in other companies, partnerships and joint ventures by the equity method of accounting in accordance with APB Opinion No. 18. Net income from these investments included undistributed earnings of $38 million for the three months ended June 30, 2004 and $36 million for the three months ended June 30, 2003 and $44 million for the six months ended June 30, 2004 and $69 million for the six months ended June 30, 2003. The most significant of these investments is our 50 percent interest in Jorf Lasfar, our 45 percent interest in SCP, and our 40 percent interest in Taweelah. Summarized income statement information for our most significant equity method investments is as follows: INCOME STATEMENT DATA IN MILLIONS -- JORF THREE MONTHS ENDED JUNE 30, 2004 LASFAR SCP TAWEELAH TOTAL -------------------------------- ------ ----- -------- ------ Operating revenue $ 102 $ 18 $ 26 $ 146 Operating expenses (56) (5) (12) (73) ----- ---- ----- ----- Operating income 46 13 14 73 Other income (expense), net (14) (5) 33 14 ----- ---- ----- ----- Net income $ 32 $ 8 $ 47 $ 87 ===== ==== ===== ===== F-45 \ IN MILLIONS -- JORF THREE MONTHS ENDED JUNE 30, 2003 LASFAR SCP TAWEELAH TOTAL ------------------------------- ------- -------- -------- -------- Operating revenue $ 91 $ 13 $ 25 $ 129 Operating expenses (43) (4) (9) (56) -------- -------- -------- -------- Operating income 48 9 16 73 Other expense, net (5) (5) (24) (34) -------- -------- -------- -------- Net income (loss) $ 43 $ 4 $ (8) $ 39 ======== ======== ======== ======== INCOME STATEMENT DATA IN MILLIONS -- JORF SIX MONTHS ENDED JUNE 30, 2004 LASFAR SCP TAWEELAH TOTAL ----------------------------- -------- -------- -------- -------- Operating revenue $ 212 $ 37 $ 48 $ 297 Operating expenses (121) (10) (22) (153) -------- -------- -------- -------- Operating income 91 27 26 144 Other income (expense), net (29) (12) 8 (33) -------- -------- -------- -------- Net income $ 62 $ 15 $ 34 $ 111 ======== ======== ======== ======== IN MILLIONS -- JORF SIX MONTHS ENDED JUNE 30, 2003 LASFAR SCP TAWEELAH TOTAL ----------------------------- -------- -------- -------- -------- Operating revenue $ 181 $ 25 $ 48 $ 254 Operating expenses (86) (8) (18) (112) -------- -------- -------- -------- Operating income 95 17 30 142 Other expense, net (24) (9) (26) (59) -------- -------- -------- -------- Net income $ 71 $ 8 $ 4 $ 83 ======== ======== ======== ======== 9: REPORTABLE SEGMENTS Our reportable segments consist of business units organized and managed by their products and services. We evaluate performance based upon the net income of each segment. We operate principally in three reportable segments: electric utility, gas utility, and enterprises. The electric utility segment consists of the generation and distribution of electricity in the state of Michigan through our subsidiary, Consumers. The gas utility segment consists of regulated activities associated with the transportation, storage, and distribution of natural gas in the state of Michigan through our subsidiary, Consumers. The enterprises segment consists of: - investing in, acquiring, developing, constructing, managing, and operating non-utility power generation plants and natural gas facilities in the United States and abroad, and - providing gas, oil, and electric marketing services to energy users. The following tables show our financial information by reportable segment. The "Other" net income segment includes corporate interest and other, discontinued operations, and the cumulative effect of accounting changes. REVENUES IN MILLIONS --------------------- RESTATED THREE MONTHS ENDED JUNE 30 2004 2003 ------------------------- -------- -------- Electric utility $ 611 $ 602 Gas utility 300 299 Enterprises 182 225 -------- -------- $ 1,093 $ 1,126 ======== ======== F-46 NET INCOME (LOSS) AVAILABLE TO COMMON STOCK IN MILLIONS --------------------- RESTATED THREE MONTHS ENDED JUNE 30 2004 2003 ------------------------- -------- -------- Electric utility $ 27 $ 35 Gas utility 1 5 Enterprises 38 8 Other (50) (113) -------- -------- $ 16 $ (65) ======== ======== REVENUES IN MILLIONS --------------------- RESTATED SIX MONTHS ENDED JUNE 30 2004 2003 ----------------------- -------- -------- Electric utility $ 1,241 $ 1,252 Gas utility 1,205 1,088 Enterprises 401 754 -------- -------- $ 2,847 $ 3,094 ======== ======== NET INCOME (LOSS)

AVAILABLE TO COMMON STOCK IN MILLIONS --------------------- RESTATED SIX MONTHS ENDED JUNE 30 2004 2003 ----------------------- -------- -------- Electric utility $ 75 $ 86 Gas utility 57 59 Enterprises (23) 29 Other (100) (157) -------- -------- $ 9 $ 17 ======== ======== TOTAL ASSETS IN MILLIONS --------------------- RESTATED JUNE 30 2004 2003 ------- -------- -------- Electric utility $ 6,935 $ 6,603 Gas utility 2,886 2,586 Enterprises 5,030 4,277 Other 456 473 -------- -------- $ 15,307 $ 13,939 ======== ======== 10: ASSET RETIREMENT OBLIGATIONS SFAS NO. 143: This standard became effective January 2003. It requires companies to record the fair value of the cost to remove assets at the end of their useful life, if there is a legal obligation to do so. We have legal obligations to remove some of our assets, including our nuclear plants, at the end of their useful lives. Before adopting this standard, we classified the removal cost of assets included in the scope of SFAS No. 143 as part of the reserve for accumulated depreciation. For these assets, the removal cost of $448 million that was classified as part of the reserve at December 31, 2002, was reclassified in January 2003, in part, as a: - $364 million ARO liability, - $134 million regulatory liability, - $42 million regulatory asset, and - $7 million net increase to property, plant, and equipment as prescribed by SFAS No. 143. We are reflecting a regulatory asset and liability as required by SFAS No. 71 for regulated entities instead of a cumulative effect of a change in accounting principle. F-47 The fair value of ARO liabilities has been calculated using an expected present value technique. This technique reflects assumptions, such as costs, inflation, and profit margin that third parties would consider to assume the settlement of the obligation. Fair value, to the extent possible, should include a market risk premium for unforeseeable circumstances. No market risk premium was included in our ARO fair value estimate since a reasonable estimate could not be made. If a five percent market risk premium were assumed, our ARO liability would increase by $22 million. If a reasonable estimate of fair value cannot be made in the period the ARO is incurred, such as for assets with indeterminate lives, the liability is to be recognized when a reasonable estimate of fair value can be made. Generally, transmission and distribution assets have indeterminate lives. Retirement cash flows cannot be determined and there is a low probability of a retirement date. Therefore, no liability has been recorded for these assets. Also, no liability has been recorded for assets that have insignificant cumulative disposal costs, such as substation batteries. The measurement of the ARO liabilities for Palisades and Big Rock are based on decommissioning studies that largely utilize third-party cost estimates. In addition, in 2003, we recorded an ARO liability for certain pipelines and non-utility generating plants and a $1 million, net of tax, cumulative effect of change in accounting for accretion and depreciation expense for ARO liabilities incurred prior to 2003. The following tables describe our assets that have legal obligations to be removed at the end of their useful life: JUNE 30, 2004 IN MILLIONS -- IN SERVICE TRUST ARO DESCRIPTION DATE LONG LIVED ASSETS FUND --------------------------------------- --- Palisades-decommission plant site 1972 Palisades nuclear plant $ 495 Big Rock-decommission plant site 1962 Big Rock nuclear plant 64 JHCampbell intake/discharge water line 1980 Plant intake/discharge water line - Closure of coal ash disposal areas Various Generating plants coal ash areas - Closure of wells at gas storage fields Various Gas storage fields - Indoor gas services equipment relocations Various Gas meters located inside structures - Closure of gas pipelines Various Gas transmission pipelines - Dismantle natural gas-fired power plant 1997 Gas fueled power plant - JUNE 30, 2004 IN MILLIONS -- ARO LIABILITY ARO ----------------- CASH FLOW LIABILITY ARO DESCRIPTION 1/1/03 12/31/03 INCURRED SETTLED ACCRETION REVISIONS 6/30/04 ----------------------------- ------ -------- -------- ------- --------- --------- --------- Palisades-decommission $ 249 $ 268 $ - $ - $ 10 $ 31 $ 309 Big Rock-decommission 61 35 - (24) 6 22 39 JHCampbell intake line - - - - - - - Coal ash disposal areas 51 52 - (1) 3 - 54 Wells at gas storage fields 2 2 - - - - 2 Indoor gas services relocations 1 1 - - - - 1 Closure of gas pipelines (a) 8 - - - - - - Natural gas-fired power plant 1 1 - - 1 - 2 ------ ------ --- ----- ------ ------- ------ Total $ 373 $ 359 $ - $ (25) $ 20 $ 53 $ 407 ====== ====== === ===== ====== ======= ====== (a) ARO Liability was settled in 2003 as a result of the sales of Panhandle and CMS Field Services. The Palisades and Big Rock cash flow revisions resulted from new decommissioning reports filed with the MPSC in March 2004. For additional details, see Note 3, Uncertainties, "Other Consumers' Electric Utility Uncertainties - Nuclear Plant Decommissioning." Reclassification of certain types of Cost of Removal: Beginning in December 2003, the SEC requires the quantification and reclassification of the estimated cost of removal obligations arising from other than legal F-48 obligations. These cost of removal obligations have been accrued through depreciation charges. We estimate that we had $1.016 billion at June 30, 2004 and $950 million at June 30, 2003 of previously accrued asset removal costs related to our regulated obligations arising from other than legal operations.

These obligations, which were previously classified as a component of accumulated depreciation, are now classified as regulatory liabilities in the accompanying Consolidated Balance Sheets. 11: IMPLEMENTATION OF NEW ACCOUNTING STANDARDS FASB INTERPRETATION NO. 46, CONSOLIDATION OF VARIABLE INTEREST ENTITIES: The FASB issued this Interpretation in January 2003. The objective of the Interpretation is to assist in determining when one party controls another entity in circumstances where a controlling financial interest cannot be properly identified based on voting interests. Entities with this characteristic are considered variable interest entities. The Interpretation requires the party with the controlling financial interest, known as the primary beneficiary, in a variable interest entity to consolidate the entity. On December 24, 2003, the FASB issued Revised FASB Interpretation No. 46. For entities that have not previously adopted FASB Interpretation No. 46, Revised FASB Interpretation No. 46 provided an implementation deferral until the first quarter of 2004. As of and for the quarter ended March 31, 2004, we adopted Revised FASB Interpretation No. 46 for all entities. We determined that we are the primary beneficiary of both the MCV Partnership and the FMLP. We have a 49 percent partnership interest in the MCV Partnership and a 46.4 percent partnership interest in the FMLP. Consumers is the primary purchaser of power from the MCV Partnership through a long-term power purchase agreement. In addition, the FMLP holds a 75.5 percent lessor interest in the MCV Facility, which results in Consumers holding a 35 percent lessor interest in the MCV Facility. Collectively, these interests make us the primary beneficiary of these entities. As such, we consolidated their assets, liabilities, and activities into our financial statements for the first time as of and for the quarter ended March 31, 2004. These partnerships have third-party obligations totaling $728 million at June 30, 2004. Property, plant, and equipment serving as collateral for these obligations has a carrying value of $1.453 billion at June 30, 2004. The creditors of these partnerships do not have recourse to the general credit of CMS Energy. At December 31, 2003, we determined that we are the primary beneficiary of three other entities that are determined to be variable interest entities. We have 50 percent partnership interest in the T.E.S. Filer City Station Limited Partnership, the Grayling Generating Station Limited Partnership, and the Genesee Power Station Limited Partnership. Additionally, we have operating and management contracts and are the primary purchaser of power from each partnership through long-term power purchase agreements. Collectively, these interests make us the primary beneficiary as defined by the Interpretation. Therefore, we consolidated these partnerships into our consolidated financial statements for the first time as of December 31, 2003. These partnerships have third-party obligations totaling $118 million at June 30, 2004. Property, plant, and equipment serving as collateral for these obligations has a carrying value of $169 million as of June 30, 2004. Other than outstanding letters of credit and guarantees of $5 million, the creditors of these partnerships do not have recourse to the general credit of CMS Energy. We also determined that we are not the primary beneficiary of our trust preferred security structures. Accordingly, those entities have been deconsolidated as of December 31, 2003. Company Obligated Trust Preferred Securities totaling $663 million, that were previously included in mezzanine equity, have been eliminated due to deconsolidation. As a result of the deconsolidation, we reflected $684 million of long-term debt - related parties and reflected an investment in related parties of $21 million. We are not required to restate prior periods for the impact of this accounting change. Additionally, we have variable interest entities in which we are not the primary beneficiary. FASB Interpretation No. 46 requires us to disclose certain information about these entities. The chart below details our involvement in these entities at June 30, 2004: F-49 INVESTMENT OPERATING TOTAL NAME (OWNERSHIP NATURE OF THE INVOLVEMENT BALANCE AGREEMENT WITH GENERATING INTEREST) ENTITY COUNTRY DATE (IN MILLIONS) CMS ENERGY CAPACITY --------------- ------------- ---------- ----------- ------------- ------------- ---------- Taweelah (40%) Generator United Arab 1999 $ 93 Yes 777 MW Emirates Jubail (25%) Generator - Saudi Arabia 2001 $ - Yes 250 MW Under Construction Shuweihat (20%) Generator - United Arab 2001 $ (16)(a) Yes 1,500 MW Under Emirates Construction --------------- ------------ ------------ ---- ----- --- -------- Total $ 77 2,527 MW =============== ============ ============ ==== ===== === ======== (a) At June 30, 2004, we carried a negative investment in Shuweihat. The balance is comprised of our investment of $3 million reduced by our proportionate share of the negative fair value of derivative instruments of $19 million. We are required to record the negative investment due to our future commitment to make an equity investment in Shuweihat. Our maximum exposure to loss through our interests in these variable interest entities is limited to our investment balance of $77 million, and letters of credit, guarantees, and indemnities relating to Taweelah and Shuweihat totaling $129 million. Included in that total is a letter of credit relating to our required initial investment in Shuweihat of $70 million. We plan to contribute our initial investment when the project becomes commercially operational in 2004. FASB STAFF POSITION, NO. SFAS 106-2,

ACCOUNTING AND DISCLOSURE REQUIREMENTS RELATED TO THE MEDICARE PRESCRIPTION DRUG, IMPROVEMENT, AND MODERNIZATION ACT OF 2003: The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Act) was signed into law in December 2003. The Act establishes a prescription drug benefit under Medicare (Medicare Part D) and a federal subsidy, which is exempt from federal taxation, to sponsors of retiree health care benefit plans that provide a benefit that is actuarially equivalent to Medicare Part D. At December 31, 2003, we elected a one-time deferral of the accounting for the Act, as permitted by FASB Staff Position, No. SFAS 106-1. The final FASB Staff Position, No. SFAS 106-2 supersedes FASB Staff Position, No. SFAS 106-1 and provides further accounting guidance. FASB Staff Position, No. SFAS 106-2 states that for plans that are actuarially equivalent to Medicare Part D, employers' measures of accumulated postretirement benefit obligations and postretirement benefit costs should reflect the effects of the Act. We believe our plan is actuarially equivalent to Medicare Part D and have incorporated retroactively the effects of the subsidy into our financial statements as of June 30, 2004, in accordance with FASB Staff Position, No. SFAS 106-2. We remeasured our obligation as of December 31, 2003 to incorporate the impact of the Act, which resulted in a reduction to the accumulated postretirement benefit obligation of $158 million. The remeasurement resulted in a reduction of OPEB cost of $6 million for the three months ended June 30, 2004, $12 million for the six months ended June 30, 2004, and an expected total reduction of $24 million for 2004. Consumers capitalizes a portion of OPEB cost in accordance with regulatory accounting. As such, the remeasurement resulted in a net reduction of OPEB expense of $4 million, or $0.03 per share, for the three months ended June 30, 2004, $9 million, or $0.05 per share, for the six months ended June 30, 2004, and an expected total net expense reduction of $17 million for 2004. EITF NO. 03-6, PARTICIPATING SECURITIES AND THE TWO-CLASS METHOD UNDER SFAS NO. 128: EITF No. 03-6, effective June 30, 2004, addresses the treatment of participating securities in earnings per share calculations. This EITF defines participating securities and describes their treatment using a two-class method of calculating earnings per share. Since we have not issued any participating securities, as defined by EITF No. 03-6 and SFAS No. 128, there was no impact on earnings per share upon adoption. F-50 CMS ENERGY CORPORATION SELECTED FINANCIAL INFORMATION CMS ENERGY CORPORATION -- RESTATED RESTATED RESTATED 2003 2002(E) 2001(E) 2000(E) 1999 ---- -------- -------- -------- ---- Operating revenue (in millions).................................... ($) 5,513 8,673 8,006 6,623 5,114 Earnings from equity method investees (in millions)................. ($) 164 92 172 213 136 Income (loss) from continuing operations (in millions).............. ($) (43) (394) (327) (85) 191 Cumulative effect of change in accounting (in millions)............. ($) (24) 18 (4) -- -- Consolidated net income (loss) (in millions)........................ ($) (44) (650) (459) 5 277 Average common shares outstanding (in thousands).................... 150,434 139,047 130,758 113,128 110,140 Income (loss) from continuing operations per average common share CMS Energy -- Basic... ($) (0.30) (2.84) (2.50) (0.76) 1.66(a) -- Diluted... .... ($) (0.30) (2.84) (2.50) (0.76) 1.66(a) Class G -- Basic and Diluted.................................... ($) -- -- -- -- 4.21(a) Cumulative effect of change in accounting per average common share CMS Energy -- Basic.. ($) (0.16) 0.13 (0.03) -- --(a) -- Diluted.. ($) (0.16) 0.13 (0.03) -- --(a) Net income (loss) per average common share CMS Energy -- Basic.. ($) (0.30) (4.68) (3.51) 0.04 2.18(a) -- Diluted... .... ($) (0.30) (4.68) (3.51) 0.04 2.17(a) Class G -- Basic and Diluted..................................... ($) -- -- -- -- 4.21(a) Cash from (used in) operations (in millions)........................ ($) (251) 614 372 600 917 Capital expenditures, excluding acquisitions, capital lease additions and DSM (in millions).................................. ($) 535 747 1,239 1,032 1,124 Total assets (in millions)(f)...................................... ($) 13,838 14,781 17,633 17,801 16,336 Long-term debt, excluding current maturities (in millions)........... ($) 6,020 5,357 5,842 6,052 6,428 Long-term debt, related parties (in millions)(b).................... ($) 684 -- -- -- -- Non-current portion of capital leases (in millions)................. ($) 58 116 71 49 88 Total preferred stock (in millions)................................ ($) 305 44 44 44 44 Total Trust Preferred Securities (in millions)...................... ($) --(b) 883 1,214 1,088 1,119 Cash dividends declared per common share CMS Energy... ($) -- 1.09 1.46 1.46 1.39 Class G.. ($) -- -- -- -- 0.99 Market price of common stock at year-end CMS Energy... ($) 8.52 9.44 24.03 31.69 31.19 Class G... ($) -- -- -- -- 24.56(c) Book value per common share at year-end CMS Energy... ($) 9.84 7.48 14.98 19.62 21.17 Number of employees at year-end (full-time equivalents)............ . 8,411 10,477 11,510 11,652 11,462 ELECTRIC UTILITY STATISTICS Sales (billions of kWh)... 39 39 40 41 41 Customers (in thousands)... 1,754 1,734 1,712 1,691 1,665 Average sales rate per kWh.. (C) 6.91 6.88 6.65 6.56 6.54 GAS UTILITY STATISTICS Sales and transportation deliveries (bcf).......................... 380 376 367 410 389 Customers (in thousands)(d)....................................... 1,671 1,652 1,630 1,611 1,584 Average sales rate per mcf.. ($) 6.72 5.67 5.34 4.39 4.52 (a) 1999 earnings per average common share includes allocation of the premium on redemption of Class G Common Stock of $(0.26) per CMS Energy basic share, $(0.25) per CMS Energy diluted share and $3.31 per Class G basic and diluted share. F-51 (b) Effective December 31, 2003, Trust Preferred Securities are classified on the balance sheet as Long term debt -- related parties. (c) Reflects closing price at the October 25, 1999 exchange date. (d) Excludes off-system transportation customers. (e) For additional details, see Note 18, Restatement and Reclassification. (f) For additional details on the reclassification of non-legal cost-of-removal, see Note 16, Asset Retirement Obligations, "Reclassification of Non-Legal Cost of Removal." Following is the amount of cost of removal reclassified from accumulated depreciation to a regulatory liability by year: $983 million in 2003; $907 million in 2002; $870 million in 2001; $896 million in 2000; and $874 million in 1999. F-52 CMS ENERGY CORPORATION CONSOLIDATED STATEMENTS OF INCOME (LOSS) YEARS ENDED DECEMBER 31 RESTATED RESTATED 2003 2002 2001 --------- --------- --------- In Millions OPERATING REVENUE .... $ 5,513 $ 8,673 $ 8,006 164 92 172 EARNINGS FROM EQUITY METHOD INVESTEES OPERATING EXPENSES Fuel for electric generation..................................... 256 341 297 Purchased and interchange power .... 689 2,677 1,834 Purchased power -- related parties .... 455 564 555 Cost of gas sold .... 1,791 2,745 3,233 Other operating expenses .... 951 915 932 Maintenance .... 226 212 225 Depreciation, depletion and amortization .... 428 412 408 General taxes .... 191 222 220 Asset impairment charges .... 95 602 323 --------- --------- --------- 5,082 8,690 8,027 --------- --------- --------- OPERATING INCOME (LOSS) .... 595 75 151 OTHER INCOME (DEDUCTIONS) Accretion expense .... (29) (31) (37) Gain (loss) on asset sales, net .... (3) 37 (2) Interest and dividends .... 28 15 23 Foreign currency gains (losses), net .... 15 (7) (3) Other income .... 24 16 11 Other expense .... (21) (30) (5) 14 -- (13) --------- --------- --------- FIXED CHARGES Interest on long-term debt .... 473 404 420 Interest on long-term debt -- related parties .... 58 -- -- Other interest .... 59 32 83 Capitalized interest .... (9) (16) (35) Preferred dividends .... 3 2 2 Preferred securities distributions .... 10 86 96 --------- --------- --------- 594 508 566 --------- --------- --------- INCOME (LOSS) BEFORE INCOME TAXES AND MINORITY INTERESTS .... 15 (433) (428) INCOME TAX EXPENSE (BENEFIT) .... 58 (41) (94) MINORITY INTERESTS .... -- 2 (7) --------- --------- --------- LOSS FROM CONTINUING OPERATIONS .... (43) (394) (327) INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF $50 TAX EXPENSE IN 2003, $118 TAX BENEFIT IN 2002 AND $92 TAX EXPENSE IN 2001 .... 23 (274) (128) --------- --------- --------- LOSS BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE .... (20) (668) (455) CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING, NET OF $13 TAX BENEFIT IN 2003, $10 TAX EXPENSE IN 2002 AND $ -- IN 2001 DERIVATIVES (NOTE 7 AND NOTE 15) .... (23) 18 (4) ASSET RETIREMENT OBLIGATION, SFAS NO. 143 (NOTE 16) .... (1) -- -- --------- --------- --------- (24) 18 (4) NET LOSS .... $ (44) $ (650) $ (459) ========= ========= ========= F-53 YEARS ENDED DECEMBER 31 -------------------------------------- RESTATED RESTATED 2003 2002 2001 --------- --------- --------- In Millions EXCEPT PER SHARE AMOUNTS CMS ENERGY NET LOSS Net Loss Available to Common Stock .... $ (44) $ (650) $ (459) ========= ========= ========= BASIC LOSS PER AVERAGE COMMON SHARE Loss from Continuing Operations .... $ (0.30) $ (2.84) $ (2.50) Income (Loss) from Discontinued Operations .... 0.16 (1.97) (0.98) Income (Loss) from Changes in Accounting .... (0.16) 0.13 (0.03) --------- --------- --------- Net Loss Attributable to Common Stock .... $ (0.30) $ (4.68) $ (3.51) ========= ========= ========= DILUTED LOSS PER AVERAGE COMMON SHARE Loss from Continuing Operations .... $ (0.30) $ (2.84) $ (2.50) Income (Loss) from Discontinued Operations .... 0.16 (1.97) (0.98) Income (Loss) from Changes in Accounting .... (0.16) 0.13 (0.03) --------- --------- --------- Net Loss Attributable to Common Stock .... $

(0.30) $ (4.68) $ (3.51) ========= ========= ========= DIVIDENDS DECLARED PER COMMON SHARE .... $ -- $ 1.09 $ 1.46 --------- --------- --------- The accompanying notes are an integral part of these statements. F-54 CMS ENERGY CORPORATION CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31 ------------------------------------- RESTATED RESTATED 2003 2002 2001 --------- --------- --------- IN MILLIONS CASH FLOWS FROM OPERATING ACTIVITIES Net loss .... $ (44) $ (650) $ (459) Adjustments to reconcile net loss to net cash provided by operating activities Depreciation, depletion and amortization (includes nuclear decommissioning of $6, $6, and $6, respectively) .... 428 412 408 Depreciation and amortization of discontinued operations .... 34 73 186 Loss (gain) on disposal of discontinued operations (Note 2) .... 46 237 (8) Asset writedowns (Note 2) .... 95 602 323 Capital lease and debt discount amortization .... 25 18 11 Accretion expense .... 29 31 37 Bad debt expense .... 28 22 22 Distributions from related parties in excess of (less than) earnings .... (41) (39) 68 Loss (gain) on sale of assets .... 3 (37) 2 Cumulative effect of accounting changes .... 24 (18) 4 Pension contribution .... (560) (64) (65) Changes in assets and liabilities: Decrease in accounts receivable and accrued revenue .... 200 99 337 Decrease (increase) in inventories .... (288) 140 (339) Decrease in accounts payable and accrued expenses .... (280) (48) (388) Deferred income taxes and investment tax credit .... 242 (398) 228 Changes in other assets .... 50 (198) 687 Changes in other liabilities .... (242) 432 (682) --------- --------- --------- Net cash provided by (used in) operating activities .... (251) 614 372 --------- --------- --------- CASH FLOWS FROM INVESTING ACTIVITIES Capital expenditures (excludes assets placed under capital lease)........ (535) (747) (1,239) Investments in partnerships and unconsolidated subsidiaries .... -- (55) (111) Cost to retire property .... (72) (66) (118) Restricted cash .... (163) (34) (4) Investments in Electric Restructuring Implementation Plan .... (8) (8) (13) Investments in nuclear decommissioning trust funds .... (6) (6) (6) Proceeds from nuclear decommissioning trust funds .... 34 30 29 Proceeds from sale of assets .... 939 1,659 134 Other investing .... 14 56 (21) --------- --------- --------- Net cash provided by (used in) investing activities .... 203 829 (1,349) --------- --------- --------- F-55 YEARS ENDED DECEMBER 31 ------------------------------------- RESTATED RESTATED 2003 2002 2001 --------- --------- --------- IN MILLIONS CASH FLOWS FROM FINANCING ACTIVITIES Proceeds from notes, bonds and other long-term debt .... 2,080 725 2,021 Proceeds from trust preferred securities .... -- -- 125 Issuance of common stock .... -- -- 326 Issuance of preferred stock .... 272 -- -- Retirement of bonds and other long-term debt .... (1,656) (1,834) (1,343) Common stock repurchased .... -- (8) (5) Payment of common stock dividends .... -- (149) (190) Payment of capital lease obligations .... (13) (15) (20) Increase (decrease) in notes payable .... (470) 75 21 Other financing .... 17 (17) 32 --------- --------- --------- Net cash provided by (used in) financing activities .... 230 (1,223) 967 --------- --------- --------- EFFECT OF EXCHANGE RATES ON CASH .... (1) 8 (10) NET INCREASE (DECREASE) IN CASH AND TEMPORARY CASH INVESTMENTS .... 181 228 (20) CASH AND TEMPORARY CASH INVESTMENTS, BEGINNING OF PERIOD .... 351 123 143 --------- --------- --------- CASH AND TEMPORARY CASH INVESTMENTS, END OF PERIOD .... $ 532 $ 351 $ 123 ========= ========= ========= OTHER CASH FLOW ACTIVITIES AND NON-CASH INVESTING AND FINANCING ACTIVITIES WERE: CASH TRANSACTIONS Interest paid (net of amounts capitalized) .... $ 564 $ 409 $ 447 Income taxes paid (net of refunds) .... (33) (217) (60) OPEB cash contribution .... 76 84 57 NON-CASH TRANSACTIONS Nuclear fuel placed under capital leases .... $ -- $ -- $ 13 Other assets placed under capital lease .... 19 62 37 ========= ========= ========= The accompanying notes are an integral part of these statements. F-56 CMS ENERGY CORPORATION CONSOLIDATED BALANCE SHEETS DECEMBER 31 ----------------------- RESTATED 2003 2002 --------- --------- IN MILLIONS ASSETS PLANT AND PROPERTY (AT COST) Electric utility .... $ 7,600 $ 7,523 Gas utility .... 2,875 2,719 Enterprises .... 895 644 Other .... 32 45 --------- --------- 11,402 10,931 Less accumulated depreciation, depletion and amortization (Note 16) 4,846 5,385

--------- --------- 6,556 5,546 Construction work-in-progress .... 388 557 --------- --------- 6,944 6,103 --------- --------- INVESTMENTS Enterprises Investments .... 724 724 Midland Cogeneration Venture Limited Partnership .... 419 388 First Midland Limited Partnership .... 224 255 Other .... 23 2 --------- --------- 1,390 1,369 --------- --------- CURRENT ASSETS Cash and temporary cash investments at cost, which approximates market .. 532 351 Restricted cash .... 201 38 Accounts receivable, notes receivable and accrued revenue, less allowances of $29 in 2003 and $15 in 2002 .... 367 349 Accounts receivable -- Marketing, services and trading, less allowances of $11 in 2003 and $8 in 2002 .... 36 248 Accounts receivable and notes receivable -- related parties .... 73 186 Inventories at average cost Gas in underground storage .... 741 491 Materials and supplies .... 110 96 Generating plant fuel stock .... 41 37 Assets held for sale .... 24 595 Price risk management assets .... 102 115 Prepayments and other .... 267 233 --------- --------- 2,494 2,739 --------- --------- NON-CURRENT ASSETS Regulatory Assets Securitized costs .... 648 689 Postretirement benefits .... 162 185 Abandoned Midland project .... 10 11 Other .... 266 168 Assets held for sale .... 2 2,084 Price risk management assets .... 177 135 Nuclear decommissioning trust funds .... 575 536 Prepaid pension costs .... 388 -- Goodwill .... 25 31 Notes receivable -- related parties .... 242 160 Notes receivable .... 125 126 Other .... 390 445 --------- --------- 3,010 4,570 --------- --------- TOTAL ASSETS .... $ 13,838 $ 14,781 ========= ========= The accompanying notes are an integral part of these statements. F-57 CMS ENERGY CORPORATION DECEMBER 31 ---------------------- RESTATED 2003 2002 --------- --------- IN MILLIONS STOCKHOLDERS' INVESTMENT AND LIABILITIES CAPITALIZATION Common stockholders' equity Common stock, authorized 250.0 shares; outstanding 161.1 shares in 2003 and 144.1 shares in 2002 .... $ 2 $ 1 Other paid-in capital .... 3,846 3,605 Accumulated other comprehensive loss .... (419) (728) Retained deficit .... (1,844) (1,800) --------- --------- 1,585 1,078 Preferred stock of subsidiary (Note 5) .... 44 44 Preferred stock .... 261 -- Company-obligated convertible Trust Preferred Securities of subsidiaries (Note 5) .... -- 393 Company-obligated mandatorily redeemable Trust Preferred Securities of Consumers' subsidiaries (Note 5) .... -- 490 Long-term debt .... 6,020 5,357 Long-term debt -- related parties (Note 5) .... 684 -- Non-current portion of capital leases .... 58 116 --------- --------- 8,652 7,478 --------- --------- MINORITY INTERESTS .... 73 38 --------- --------- CURRENT LIABILITIES Current portion of long-term debt and capital leases .... 519 646 Notes payable .... -- 458 Accounts payable .... 296 377 Accounts payable -- Marketing, services and trading .... 21 119 Accounts payable -- related parties .... 40 53 Accrued interest .... 130 131 Accrued taxes .... 285 291 Liabilities held for sale .... 2 427 Price risk management liabilities .... 89 96 Current portion of purchase power contracts .... 27 26 Current portion of gas supply contract obligations .... 29 25 Deferred income taxes .... 27 15 Other .... 185 225 --------- --------- 1,650 2,889 --------- --------- NON-CURRENT LIABILITIES Postretirement benefits .... 265 725 Deferred income taxes .... 615 438 Deferred investment tax credit .... 85 91 Regulatory liabilities for income taxes, net .... 312 297 Regulatory liabilities for cost of removal (Note 16) .... 983 907 Other regulatory liabilities .... 172 4 Asset retirement obligation .... 359 -- Liabilities held for sale .... -- 1,218 Price risk management liabilities .... 175 135 Gas supply contract obligations .... 208 241 Power purchase agreement -- MCV Partnership .... -- 27 Other .... 289 293 --------- --------- 3,463 4,376 --------- --------- Commitments and Contingencies (Notes 2, 4, 5, 8, 10, 11) TOTAL STOCKHOLDERS' INVESTMENT AND LIABILITIES .... $ 13,838 $ 14,781 ========= ========= F-58 CMS ENERGY CORPORATION

CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDERS' EQUITY YEARS ENDED DECEMBER 31 -- RESTATED RESTATED 2003 2002 2001 2003 2002 2001 ------- ------- ------- -------- -------- -------- NUMBER OF SHARES IN THOUSANDS IN MILLIONS COMMON STOCK At beginning and end of period.............. $ 2 $ 1 $ 1 OTHER PAID-IN CAPITAL At beginning of period...................... 144,088 132,989 121,201 3,605 3,257 2,936 Common stock repurchased..................... (14) (39) (232) -- (8) (5) Common stock reacquired..................... (217) (220) (11) (5) (1) (1) Common stock issued......................... 17,273 11,358 11,681 234 357 320 Common stock reissued....................... -- -- 350 1 -- 7 Issuance cost of preferred stock............ -- -- -- (8) -- -- Deferred gain (Note 5)...................... -- -- -- 19 -- -- ------- ------- ------- -------- -------- ------- At end of period....................... 161,130 144,088 132,989 3,846 3,605 3,257 ------- ------- ------- -------- -------- -------- ACCUMULATED OTHER COMPREHENSIVE LOSS Minimum Pension Liability At beginning of period................... (241) -- -- Minimum pension liability adjustments(a)......................... 241 (241) -- -------- -------- ------- At end of period....................... -- (241) -- -------- -------- ------- Investments At beginning of period................... 2 (5) (2) Unrealized gain (loss) on investments(a)......................... 6 -- (3) Realized gain on investments(a)........... -- 7 -- -------- -------- ------- At end of period....................... 8 2 (5) -------- -------- -------- Derivative Instruments At beginning of period(b)................ (31) (28) 10 Unrealized gain (loss) on derivative instruments(a)............... 4 (7) (31) Reclassification adjustments included in consolidated net income (loss)(a)....................... 19 4 (7) -------- -------- -------- At end of period....................... (8) (31) (28) -------- -------- -------- FOREIGN CURRENCY TRANSLATION At beginning of period...................... (458) (233) (206) Change in foreign currency translation(a)........................... 39 (225) (27) -------- -------- -------- At end of period....................... (419) (458) (233) -------- -------- -------- At end of period.................... (419) (728) (266) -------- -------- -------- RETAINED DEFICIT (1,800) (1,001) (352) At beginning of period(c)................... Consolidated net loss(a).................... (44) (650) (459) Common stock dividends declared............. -- (149) (190) -------- -------- -------- At end of period....................... (1,844) (1,800) (1,001) -------- -------- -------- TOTAL COMMON STOCKHOLDERS' EQUITY.............. $ 1,585 $ 1,078 $ 1,991 ======== ======== ======== F-59 YEARS ENDED DECEMBER 31 ------------------------------- RESTATED RESTATED 2003 2002 2001 --------- ----------- -------- IN MILLIONS (a) DISCLOSURE OF OTHER COMPREHENSIVE INCOME (LOSS): Minimum pension liability Minimum pension liability adjustments, net of tax (tax benefit) of $132, $(132), and $ -- , respectively................ $ 241 $ (241) $ -- Investments Unrealized gain (loss) on investments, net of tax (tax benefit) of $3, $ -- , and $(2), respectively................... 6 -- (3) Realized gain on investments, net of tax of $ -- , $ -- , and $ -- , respectively.. -- 7 -- Derivative Instruments Unrealized gain (loss) on derivative instruments, net of tax (tax benefit) of $ -- , $(4), and $(13), respectively.... 4 (7) (31) Reclassification adjustments included in net loss, net of tax (tax benefit) of $11, $2, and $(3), respectively........ 19 4 (7) Foreign currency translation, net.. 39 (225) (27) Consolidated net loss... (44) (650) (459) ------- --------- -------- Total Other Comprehensive Income (Loss)................................. $ 265 $ (1,112) $ (527) ======= ========= ======== (b) YEAR ENDED DECEMBER 31, 2001 REFLECTS THE CUMULATIVE CHANGE IN ACCOUNTING PRINCIPLE, NET OF $7 TAX (NOTE 7.) (c) BEGINNING BALANCE FOR YEAR ENDED DECEMBER 31, 2001 WAS DECREASED BY $38 MILLION DUE TO AN ADJUSTMENT TO DEFERRED TAXES RELATED TO LOY YANG (NOTE 8.) The accompanying notes are an integral part of these statements. F-60 CMS ENERGY CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS We have determined the need to make certain adjustments to our consolidated financial statements for the fiscal years ended December 31, 2002, December 31, 2001, and December 31, 2000. Therefore, the consolidated financial statements for 2002 and 2001 have been restated from amounts previously reported. See Note 18, Restatement and Reclassification. 1: CORPORATE STRUCTURE AND ACCOUNTING POLICIES CORPORATE STRUCTURE: CMS Energy is the parent holding company of Consumers and Enterprises. Consumers is a combination electric and gas utility company serving Michigan's Lower Peninsula. Enterprises, through subsidiaries, is engaged in domestic and international diversified energy businesses including independent power production, natural gas transmission, storage and processing, and energy services. PRINCIPLES OF CONSOLIDATION: The consolidated financial statements include the accounts of CMS Energy, Consumers and Enterprises and all other entities in which we have a controlling financial interest, in accordance with Revised FASB Interpretation No. 46. Intercompany transactions and balances have been eliminated. We use the equity method of accounting for investments in companies and partnerships that are not consolidated where we have significant influence over operations and financial policies, but not a controlling financial interest. USE OF ESTIMATES: We prepare our financial statements in conformity with accounting principles generally accepted in the United States. Management is required to make estimates using assumptions that affect the reported amounts and disclosures. Actual results could differ from those estimates. We are required to record estimated liabilities in the financial statements when it is probable that a loss will be incurred in the future as a result of a current event, and when an amount can be reasonably estimated. We have used this accounting principle to record estimated liabilities as discussed in Note 4, Uncertainties. REVENUE RECOGNITION POLICY: We recognize revenues from deliveries of electricity and natural gas, and the transportation, processing, and storage of natural gas when services are provided. Sales taxes are recorded as liabilities and are not included in revenues. Revenues on sales of marketed electricity, natural gas, and other energy products are recognized at delivery. Mark-to-market changes in the fair values of energy trading contracts that qualify as derivatives are recognized as revenues in the periods in which the changes occur. CAPITALIZED INTEREST: We are required to capitalize interest on certain qualifying assets that are undergoing activities to prepare them for their intended use. Capitalization of interest for the period is limited to the actual interest cost that is incurred, and our non-regulated businesses are prohibited from imputing interest costs on any equity funds. Our regulated businesses are permitted to capitalize an allowance for funds used during construction on regulated construction projects and to include such amounts in plant in service. CASH EQUIVALENTS AND RESTRICTED CASH: All highly liquid investments with an original maturity of three months or less are considered cash equivalents. At December 31, 2003, our restricted cash on hand was $201 million. Restricted cash primarily includes cash collateral for letters of credit to satisfy certain debt agreements and cash dedicated for repayment of securitization bonds. It is classified as a current asset as the related letters of credit mature within one year and the payments on the related securitization bonds occur within one year. COAL INVENTORY: We use the weighted average cost method for valuing coal inventory. EARNINGS PER SHARE: Basic and diluted earnings per share are based on the weighted average number of shares of common stock and potential common stock outstanding during the period. Potential common stock, for purposes of determining diluted earnings per share, includes the effects of dilutive stock options and convertible securities. The effect on number of shares of such potential common stock is computed using the treasury stock method or the if-converted method, as applicable. For earnings per share computation, see Note 6, Earnings Per Share and Dividends. F-61 FINANCIAL INSTRUMENTS: We account for investments in debt and equity securities in accordance with SFAS No. 115. These debt and equity securities are classified into three categories: held-to-maturity, trading, or available-for-sale. Our investments in equity securities are classified as available-for-sale. They are reported at fair value, with any unrealized gains or losses resulting from changes in fair value reported in equity as part of accumulated other comprehensive income, and are excluded from earnings unless such changes in fair value are determined to be other than temporary. Unrealized gains or losses from changes in the fair value of our nuclear decommissioning investments are reported as regulatory liabilities. The fair value of these investments is determined from quoted market prices. For additional details regarding financial instruments, see Note 7, Financial and Derivative Instruments. FOREIGN CURRENCY TRANSLATION: Our subsidiaries and affiliates whose functional currency is not the U.S. dollar translate their assets and liabilities into U.S. dollars at the exchange rates in effect at the end of the fiscal period. We translate revenue and expense accounts of such subsidiaries and affiliates into U.S. dollars at the average exchange rates that prevailed during the period. The gains or losses that result from this process, and gains and losses on intercompany foreign currency transactions that are long-term in nature that we do not intend to settle in the foreseeable future, are shown in the stockholders' equity section of the balance sheet. For subsidiaries operating in highly inflationary economies, the U.S. dollar is considered to be the functional currency, and transaction gains and losses are included in determining net income. Gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency, except those that are hedged, are included in determining net income. The change in the foreign currency translation adjustment increased equity by $39 million for the year ended December 31, 2003. The change in the foreign currency translation adjustment decreased equity by $225 million for the year ended December 31, 2002. GAS INVENTORY: Consumers uses the weighted average cost method for valuing working gas and recoverable cushion gas in underground storage facilities. GOODWILL: Goodwill represents the excess of the purchase price over the fair value of the net assets of acquired companies. Goodwill is not amortized, but is tested annually for impairment. For additional information, see Note 3, Goodwill. IMPAIRMENT OF INVESTMENTS AND LONG-LIVED ASSETS: We evaluate potential impairments of our investments in long-lived assets other than goodwill based on various analyses, including the projection of undiscounted cash flows, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If the carrying amount of the asset exceeds its estimated undiscounted future cash flows, an impairment loss is recognized and the asset is written down to its estimated fair value. MAINTENANCE AND DEPRECIATION: We charge property repairs and minor property replacements to maintenance expense. We also charge planned major maintenance activities to operating expense unless the cost represents the acquisition of additional components or the replacement of an existing component. We capitalize the cost of plant additions and replacements. We depreciate utility property on straight-line and units-of-production rates approved by the MPSC. The composite depreciation rates for our properties are: YEARS ENDED DECEMBER 31 -------------------- 2003 2002 2001 ------ ------ ------ Electric utility property... 3.1% 3.1% 3.1% Gas utility property........ 4.6% 4.5% 4.4% Other property............. 8.1% 7.2% 11.2% NUCLEAR FUEL COST: We amortize nuclear fuel cost to fuel expense based on the quantity of heat produced for electric generation. For nuclear fuel used after April 6, 1983, we charge disposal costs to nuclear fuel expense, recover these costs through electric rates, and remit them to the DOE quarterly. We elected to defer payment for disposal of spent nuclear fuel burned before April 7, 1983. As of December 31, 2003, we have recorded a liability to the DOE for $139 million, including interest, which is payable upon the first delivery of spent nuclear fuel to the DOE. The amount of this liability, excluding a portion of interest, was recovered through electric rates. For F-62 additional details on disposal of spent nuclear fuel, see Note 4, Uncertainties, "Other Consumers' Electric Utility Uncertainties -- Nuclear Matters." NUCLEAR PLANT DECOMMISSIONING: Our site-specific decommissioning cost estimates for Big Rock and Palisades assume that each plant site will eventually be restored to conform to the adjacent landscape and all contaminated equipment will be disassembled and disposed of in a licensed burial facility. Trust Funds: MPSC orders, received in March 1999 for Big Rock and December 1999 for Palisades, provided for fully funding the decommissioning trust funds for both sites. The December 1999 order set the annual decommissioning surcharge for Palisades at $6 million. In 2003, we collected $6 million from our electric customers for the decommissioning of our Palisades nuclear plant. Amounts collected from electric retail customers and deposited in trusts, including trust earnings, are credited to a regulatory liability. In December 2000, we stopped depositing funds in the Big Rock trust fund based on its funding status at that time. However, the current level of funds provided by the trust may not be adequate to fully fund the decommissioning of Big Rock. This is due in part to the DOE's failure to accept spent nuclear fuel and lower returns on the trust fund. We are attempting to recover our additional costs for storing spent nuclear fuel through litigation, as discussed in Note 4, Uncertainties, "Other Consumers' Electric Utility Uncertainties -- Nuclear Matters." To the extent the funds are not sufficient, we would seek additional relief from the MPSC. We can make no assurance that the MPSC would grant this request. In March 2001, we filed with the MPSC a "Report on the Adequacy of the Existing Provision for Nuclear Plant Decommissioning" for each plant reflecting decommissioning cost estimates of $349 million for Big Rock, excluding spent nuclear fuel storage costs, and $739 million for Palisades, in 2000 dollars. We are required to file the next such reports with the MPSC by March 31, 2004 for Big Rock and Palisades and we are in the process of preparing updated cost estimates. Big Rock: In 1997, Big Rock closed permanently and plant decommissioning began. We estimate that the Big Rock site will be returned to a natural state by the end of 2012 if the DOE begins removing the spent nuclear fuel by 2010. The following table shows our Big Rock decommissioning activities: YEAR-TO-DATE ACCUMULATIVE DECEMBER 31, 2003 TOTAL-TO-DATE ----------------- ------------ IN MILLIONS Decommissioning expenditures..... $ 45 $ 263 Withdrawals from trust funds..... 34 243 These activities had no material impact on net income. At December 31, 2003, we have an investment in nuclear decommissioning trust funds of $88 million for Big Rock. In addition, at December 31, 2003, we have charged $7 million to our FERC jurisdictional depreciation reserve for the decommissioning of Big Rock. Palisades: In December 2000, the NRC extended the Palisades operating license to March 2011 and the impact of this extension was included as part of our March 2001 filing with the MPSC. At December 31, 2003, we have an investment in the MPSC nuclear decommissioning trust funds of $477 million for Palisades. In addition, at December 31, 2003, we have a FERC decommissioning trust fund with a balance of $10 million. For additional details on decommissioning costs accounted for as asset retirement obligations, see Note 16, Asset Retirement Obligations. F-63 OTHER INCOME AND EXPENSE: The following tables show the components of Other income and Other expense: YEARS ENDED DECEMBER 31 -- RESTATED RESTATED 2003 2002 2001 ------------ ------------ ------------ IN MILLIONS Other income Interest and dividends - related parties.. $ 6 $ 3 $ 5 Electric restructuring return............ 8 5 3 Gain on sale of investment............... 4 -- -- All other................................ 6 8 3

------- ------- ------- Total other income........................ $ 24 $ 16 $ 11 ======= ======= ======= YEARS ENDED DECEMBER 31 --- RESTATED RESTATED 2003 2002 2001 ------------ ------------ -------- IN MILLIONS Other expense Loss on SERP investment................. $ (1) $ (10) $ -- Donations............................... (1) (9) (1) CMS MST remediation costs................ (6) (1) -- Civic and political expenditures......... (2) (3) (2) All other............................... (11) (7) (2) ------- ------- ------- Total other expense.................... $ (21) $ (30) $ (5) ======= ======= ======= PROPERTY, PLANT, AND EQUIPMENT: We record property, plant and equipment at original cost when placed into service. When regulated assets are retired, or otherwise disposed of in the ordinary course of business, the original cost is charged to accumulated depreciation and cost of removal, less salvage is recorded as a regulatory liability. For additional details, see Note 16, Asset Retirement Obligations. An allowance for funds used during construction is capitalized on regulated construction projects. With respect to the retirement or disposal of non-regulated assets, the resulting gains or losses are recognized in income. Property, plant, and equipment at December 31, 2003 and 2002, was as follows: ESTIMATED DEPRECIABLE YEARS ENDED DECEMBER 31 LIFE IN YEARS(E) 2003 2002 --- ----------------- --------- -------- IN MILLIONS Electric: Generation.................................. 13-75 $ 3,332 $ 3,489 Distribution................................ 12-85 3,799 3,619 Other....................................... 5-50 388 300 Capital leases(a)............................ 81 115 Gas: Underground storage facilities(b)............ 30-75 232 217 Transmission................................ 15-75 342 310 Distribution................................ 35-75 1,976 1,899 Other....................................... 5-48 300 237 Capital leases(a)............................ 25 56 Enterprises: IPP... 3-40 511 250 CMS Gas Transmission......................... 5-40 119 120 CMS Electric and Gas......................... 2-30 241 227 Other....................................... 4-25 24 47 Other:....................................... 7-71 32 45 Construction work-in-progress(c)............... 388 557 Less accumulated depreciation, depletion, and amortization(d)............................. 4,846 5,385 --------- -------- Net property, plant, and equipment(e).......... $ 6,944 $ 6,103 ========= ======== F-64 (a) Capital leases presented in this table are gross amounts. Amortization of capital leases was $38 million in 2003 and $96 million in 2002. (b) Includes unrecoverable base natural gas in underground storage of $23 million at December 31, 2003 and $23 million at December 31, 2002, which is not subject to depreciation. (c) Included in construction costs at December 31, 2002 was $54 million, relating to the capital lease of our main headquarters. We purchased the main headquarters in November 2003. (d) Accumulated depreciation, depletion, and amortization is comprised of $4.416 billion from our public utility plant assets as of December 31, 2003 and $4.989 billion from public utility plant assets as of December 31, 2002 and $430 million from other plant assets as of December 31, 2003 and $396 million from other plant assets as of December 31, 2002. (e) Included in net property, plant and equipment are intangible assets primarily related to software development costs, consents, leasehold improvements, and rights of way. The estimated amortization life for software development costs is seven years, leasehold improvements is over the life of the lease and other intangible amortization lives range from 50 to 75 years. Intangible assets at December 31, 2003 and 2002 were as follows: YEARS ENDED DECEMBER 31 ------------------------- 2003 2002 ---------- ---------- IN MILLIONS Intangible assets at cost Software development .... $ 178 $ 149 Rights of way.. 89 84 Leasehold improvements.. 32 35 Franchises and consents.. 19 19 Other intangibles... 101 192 ---------- ---------- Intangible assets at cost.. $ 419 $ 479 ========== ========== YEARS ENDED DECEMBER 31 ------------------------- 2003 2002 ---------- ---------- IN MILLIONS Intangible assets accumulated amortization................................. Software development.. $ 107 $ 92 Rights of way.. 25 26 Leasehold improvements.. 30 28 Franchises and consents.. 8 8 Other intangibles... 41 82 ---------- ---------- Intangible assets accumulated amortization................................. $ 211 $ 236 ========== ========== YEARS ENDED DECEMBER 31 ------------------------- 2003 2002 ---------- ---------- IN MILLIONS Intangible assets, net.. Software development .... $ 71 $ 57 Rights of way.. 64 58 Leasehold improvements.. 2 7 Franchises and consents.. 11 11 Other intangibles... 60 110 ---------- ---------- Intangible assets, net .... $ 208 $ 243 ========== ========== F-65 Pretax amortization expense related to these intangible assets for the year ended December 31, 2003 was $21 million and for the year ended December 31, 2002 was $20 million. Intangible assets amortization is forecasted to range from $18 million to $26 million per year over the next five years. (f) The following table illustrates the depreciable life for electric and gas structures and improvements. ESTIMATED ESTIMATED DEPRECIABLE DEPRECIABLE ELECTRIC LIFE IN YEARS GAS LIFE IN YEARS ---------------- --------------- ---------------------------- ------------- Generation: Underground storage facilities 45 Coal 39-43 Transmission 60 Nuclear 25 Distribution 60 Hydroelectric 55-71 Other 42-48 Other 32 Distribution 50-60 Other 40-42 RECLASSIFICATIONS: Certain prior year amounts have been reclassified for comparative purposes. These reclassifications did not affect consolidated net income for the years presented. RELATED-PARTY TRANSACTIONS: Consumers paid $64 million in 2003, $67 million in 2002, and $71 million in 2001 for electric generating capacity and energy from affiliates of Enterprises. CMS Energy recorded interest charges on long-term debt to related parties of $58 million in 2003. Affiliates of CMS Energy sold, stored and transported natural gas and provided other services to the MCV Partnership totaling $17 million in 2003, $41 million in 2002, and $35 million in 2001. We expensed purchases of capacity and energy from the MCV Partnership totaling $455 million in 2003, $497 million in 2002, and $488 million in 2001. As a result of our deconsolidation of our affiliated Trust Preferred Securities as of December 31, 2003, we recorded $2 million of dividend income from related parties in 2003. For additional discussion of related-party transactions with the MCV Partnership and the FMLP, see Note 4, Uncertainties and Note 15, Summarized Financial Information of Significant Related Energy Supplier. For additional discussion of related-party transactions with our affiliated Trust Preferred Securities see Note 6, Financing and Capitalization. Other related-party transactions are immaterial. TRADE RECEIVABLES: We record our accounts receivable at fair value. Accounts deemed uncollectable are charged to operating expense. UNAMORTIZED DEBT PREMIUM, DISCOUNT AND EXPENSE: We amortize premiums, discounts and expenses incurred in connection with the issuance of outstanding long-term debt over the terms of the issues. For the regulated portions of our businesses, if debt is refinanced, we amortize any unamortized premiums, discounts and expenses over the term of the new debt. UTILITY REGULATION: We account for the effects of regulation based on the regulated utility accounting standard SFAS No. 71. As a result, the actions of regulators affect when we recognize revenues, expenses, assets, and liabilities. In 1999, we received MPSC electric restructuring orders, which, among other things, identified the terms and timing for implementing electric restructuring in Michigan. Consistent with these orders and EITF No. 97-4, we discontinued the application of SFAS No. 71 for the energy supply portion of our business because we expected to implement ROA at competitive market based rates for our electric customers. Since 1999, there have been significant legislative and regulatory changes in Michigan that has resulted in: - electric supply customers of utilities remaining on cost-based rates, and - utilities being provided the opportunity to recover Stranded Costs associated with electric restructuring, from customers who choose an alternative electric supplier. F-66 During 2002, we re-evaluated the criteria used to determine if an entity or a segment of an entity meets the requirements to apply regulated utility accounting, and determined that the energy supply portion of our business could meet the criteria if certain regulatory events occurred. In December 2002, we received a MPSC Stranded Cost order that allowed us to re-apply regulatory accounting standard SFAS No. 71 to the energy supply portion of our business. Re-application of SFAS No. 71 had no effect on the prior discontinuation accounting, but allowed us to apply regulatory accounting treatment to the energy supply portion of our business beginning in the fourth quarter of 2002, including regulatory accounting treatment of costs required to be recognized in accordance with SFAS No. 143. For additional details, see Note 12, Asset Retirement Obligations. SFAS No. 144 imposes strict criteria for retention of regulatory-created assets by requiring that such assets be probable of future recovery at each balance sheet date. Management believes these assets are probable of future recovery. The following regulatory assets and liabilities, which include both current and non-current amounts, are reflected in the Consolidated Balance Sheets. We expect to recover these costs through rates over periods of up to 14 years. We recognized an OPEB transition obligation in accordance with SFAS No. 106 and established a regulatory asset for this amount that we expect to recover in rates over the next nine years. DECEMBER 31 ----------------- 2003 2002 -------- --------- IN MILLIONS Securitized costs (Note 4)............................ $ 648 $ 689 Postretirement benefits (Note 10)..................... 181 204 Electric Restructuring Implementation Plan (Note 4).... 91 83 Manufactured gas plant sites (Note 4)................. 67 69 Abandoned Midland project............................ 10 11 Unamortized debt..................................... 51 14 Asset retirement obligation (Note 16)................. 49 -- Other.. 8 2 -------- --------- Total regulatory assets............................... $ 1,105 $ 1,072 ======== ========= Cost of removal (Note 16)............................ $ 983 $ 907 Income taxes (Note

8)................................. 312 297 Asset retirement obligation (Note 16)................. 168 -- Other.. 4 4 -------- --------- Total regulatory liabilities.......................... $ 1,467 $ 1,208 ======== ========= In October 2000, we received an MPSC order authorizing us to securitize certain regulatory assets up to $469 million, net of tax, see Note 4, Uncertainties, "Consumers' Electric Utility Restructuring Matters -- Securitization." Accordingly, in December 2000, we established a regulatory asset for securitized costs of $709 million, before tax, that had previously been recorded in other regulatory asset accounts. To prepare for the financing of the securitized assets and the subsequent retirement of debt with Securitization proceeds, issuance fees were capitalized as a part of Securitization costs. These issuance costs are amortized each month for up to fourteen years. The components of the unamortized securitized costs are illustrated below. DECEMBER 31 -------------- 2003 2002 ------ ------ IN MILLIONS Unamortized nuclear costs......................... $ 405 $ 405 Postretirement benefits........................... 84 84 Income taxes..................................... 203 203 Uranium enrichment facility....................... 16 16 Other.. 12 12 Accumulated Securitization cost amortization....... (72) (31) ------ ------ Total unamortized securitized costs............... $ 648 $ 689 ====== ====== F-67 2: DISCONTINUED OPERATIONS, OTHER ASSET SALES, IMPAIRMENTS, AND RESTRUCTURING Our continued focus on financial improvement has led to discontinuing operations, completing many asset sales, impairing some assets, and incurring costs to restructure our business. Gross cash proceeds received from the sale of assets totaled $939 million in 2003 and $1.659 billion in 2002. DISCONTINUED OPERATIONS We have discontinued the following operations: PRETAX AFTER-TAX BUSINESS/PROJECT DISCONTINUED GAIN(LOSS) GAIN(LOSS) STATUS --------------------- -------------- ---------- ---------- ------------------- IN MILLIONS Equatorial Guinea(a).. December 2001 $ 497 $ 310 Sold January 2002 Powder River.......... March 2002 17 11 Sold May 2002 Zirconium Recovery.... June 2002 (47) (31) Abandoned CMS Viron............ June 2002 (14) (9) Sold June 2003 Oil and Gas(b)........ September 2002 (126) (82) Sold September 2002 Panhandle(c).......... December 2002 (39) (44) Sold June 2003 Field Services........ December 2002 (5) (1) Sold July 2003 Marysville........... June 2003 2 1 Sold November 2003 Parmelia(d)........... December 2003 -- -- Held for sale (a) In the first quarter of 2003, we settled a liability with the purchaser of Equatorial Guinea and reversed the remaining excess reserve. This settlement resulted in a gain of $6 million after-tax, which is included in discontinued operations. (b) As a result of the sale of CMS Oil and Gas, we recorded liabilities for certain sale indemnification obligations and other matters. In September 2003, we re-evaluated our exposure to the obligations and reduced the carrying value of these liabilities by $8 million after-tax. This adjustment is reported in discontinued operations. (c) The Pension Plan retained pension payment obligations for Panhandle employees who were vested under the Pension Plan. Panhandle employees are no longer eligible to accrue additional benefits. Because of the significant change in the makeup of the plan, a remeasurement of the obligation at the date of sale was required. The remeasurement resulted in a $4 million increase in our 2003 OPEB expense, as well as an additional charge to accumulated other comprehensive income of approximately $34 million ($22 million after-tax) as a result of the increase in the additional minimum pension liability. Additionally, a significant number of Panhandle employees elected to retire as of July 1, 2003 under the CMS Energy Employee Pension Plan. As a result, we have recorded a $25 million ($16 million after-tax) settlement loss, and a $10 million ($7 million after-tax) curtailment gain, pursuant to the provisions of SFAS No. 88, which is reflected in discontinued operations. (d) In December 2003, we began reporting the operations of our Parmelia business in discontinued operations and reduced the carrying amount of our Parmelia business to reflect fair value. The $26 million after-tax adjustment is reported in discontinued operations. We expect the sale of Parmelia to occur in 2004. Due to lack of progress on the sale, we reclassified our international energy distribution business, which includes CPEE and SENECA, from discontinued operations to continuing operations for the years 2003, 2002, and 2001. When we initially reported the international energy distribution business as a discontinued operation in 2001, we applied APB Opinion No. 30, which allowed us to record a provision for anticipated operating losses. We currently apply FASB No. 144, which does not allow us to record a provision for future operating losses. Therefore, in the process of reclassifying the international energy distribution business to continuing operations and reversing such provisions, we increased our net loss by $3 million in 2002 and decreased our net loss by $3 million in 2001. In 2003, there was an increase to net income of $75 million as a result of reversing the previously recognized impairment loss in discontinued operations. At December 31, 2003, "Assets held for sale" includes Parmelia, Bluewater Pipeline, and our investment in the American Gas Index fund. Although Bluewater Pipeline and the American Gas Index fund are considered held for F-68 sale, they did not meet the criteria for discontinued operations. At December 31, 2002, "Assets held for sale" includes Panhandle, CMS Viron, CMS Field Services, Marysville, and Parmelia. The major classes of assets and liabilities held for sale are as follows: AS OF DECEMBER 31 ------------------ RESTATED 2003 2002 ----- -------- IN MILLIONS Assets Cash................................. $ 7 $ 82 Accounts receivable................... 2 133 Property, plant and equipment -- net... 2 2,003 Goodwill............................. -- 117 Other................................ 15 344 ----- -------- Total assets held for sale.............. $ 26 $ 2,679 ===== ======== Liabilities Accounts payable...................... $ 2 $ 74 Long-term debt........................ -- 1,150 Minority interest..................... -- 45 Other................................ -- 376 ----- -------- Total liabilities held for sale......... $ 2 $ 1,645 ===== ======== The following amounts are reflected in the Consolidated Statements of Income (Loss) for discontinued operations: YEARS ENDED DECEMBER 31 --------------------------------- RESTATED RESTATED 2003 2002 2001 ------- -------- -------- IN MILLIONS Revenues.. $ 504 $ 891 $ 1,453 ======= ======= ======== Discontinued operations: Pretax gain (loss) from discontinued operations...... $ 115 $ (38) $ (53) Income tax expense (benefit)........................ 46 (1) 83 ------- ------- -------- Income (loss) from discontinued operations.......... 69 (37) (136) ======= ======= ======== Pretax gain (loss) on disposal of discontinued operations....................................... (42) (354) 17 Income tax expense (benefit)........................ 4 (117) 9 ------- ------- -------- Gain (loss) on disposal of discontinued operations... (46) (237) 8 ------- ------- -------- Income (loss) from discontinued operations............ $ 23 $ (274) $ (128) ======= ======= ======== The income (loss) from discontinued operations includes a reduction in asset values, a provision for anticipated closing costs, and a portion of the Parent Company's interest expense. Interest expense of $22 million for 2003, $71 million for 2002 and $86 million for 2001 has been allocated based on a ratio of the expected proceeds for the asset to be sold divided by the Parent Company's total capitalization of each discontinued operation times the Parent Company's interest expense. OTHER ASSET SALES Our other asset sales include the following non-strategic and under-performing assets. The impacts of these sales are included in "Gain (loss) on asset sales, net" in the Consolidated Statements of Income (Loss). F-69 In 2003, we sold the following assets that did not meet the definition of, and therefore were not reported as, discontinued operations: PRETAX AFTER-TAX DATE SOLD BUSINESS/PROJECT GAIN (LOSS) GAIN (LOSS) ------------ ------------------------ ----------- ----------- IN MILLIONS January CMS MST Wholesale Gas $ (6) $ (4) March CMS MST Wholesale Power 2 1 June Guardian Pipeline (4) (3) December CMS Land -- Arcadia 3 2 Various Other 2 1 ----- ----- Total loss on asset sales $ (3) $ (3) ===== ===== In June 2003, we received three million shares of Southern Union common stock worth $49 million from the sale of Panhandle, a discontinued operation. In July 2003, Southern Union declared a five percent common stock dividend payable July 31, 2003, to shareholders of record as of July 17, 2003. As a result of the stock dividend, on September 30, 2003, we held 3.15 million shares of Southern Union common stock worth $54 million based on the closing price of $17.00 per share. The $2 million increase in value was recorded in dividend income. In October 2003, we sold our 3.15 million shares of Southern Union common stock to a private investor for $17.77 per share. The additional $5 million gain was recorded in other income in 2003. In 2002, we sold the following assets that did not meet the definition of, and therefore were not reported as, discontinued operations: PRETAX AFTER-TAX DATE SOLD BUSINESS/PROJECT GAIN (LOSS) GAIN (LOSS) ------------ ------------------------ ----------- ----------- IN MILLIONS January Equatorial Guinea -- methanol plant $ 19 $ 12 April Toledo Power (11) (5) May Electric Transmission System 38 31 August National Power Supply 15 30 October Vasavi Power Plant (25) (24) Various Other 1 -- ------ ------ Total gain on asset sales $ 37 $ 44 ====== ====== In 2001, we sold miscellaneous assets for a pretax loss of $2 million. In February 2004, we sold Bluewater Pipeline, a 24.9 mile pipeline that extends from Marysville, Michigan to Armada, Michigan to Bluewater Gas Storage, LLC, a subsidiary of Sempra Energy Trading Corporation. We do not expect the gain or loss on the sale to be significant. ASSET IMPAIRMENTS We record an asset impairment when we determine that the expected future cash flows from an asset would be insufficient to provide for recovery of the asset's carrying value. An asset held-in-use is evaluated for impairment by calculating the undiscounted future cash flows expected to result from the use of the asset and its eventual disposition. If the undiscounted future cash flows are less than the carrying amount, we recognize an impairment loss. The impairment loss recognized is the amount by which the carrying amount exceeds the fair value. We estimate the fair market value of the asset utilizing the best information available. This information includes quoted market prices, market prices of similar assets, and discounted future cash flow analyses. The assets written down include both domestic and foreign electric power plants, gas processing facilities, and certain equity method and other investments. In addition, we have written off the carrying value of projects under development that will no longer be pursued. F-70 The table below summarizes our asset impairments: YEARS ENDED DECEMBER 31

-- RESTATED RESTATED -------------------- -------------------- PRETAX AFTER-TAX PRETAX AFTER-TAX PRETAX AFTER-TAX 2003 2003 2002 2002 2001 2001 ------ --------- ------ --------- ------ --------- IN MILLIONS Asset impairments: Consumers......................... $ -- $ -- $ -- $ -- $ 3 $ 2 Enterprises: International Energy 72 53 4 3 95 62 Distribution(a)..................... CMS Generation DIG(b)....................... -- -- 460 299 -- -- Michigan Power.............. -- -- 62 40 -- -- Craven....................... -- -- 23 15 -- -- National Power Supply........ -- -- -- -- 89 88 El Chocon................... -- -- -- -- 45 42 HL Power.................... -- -- -- -- 30 18 Other(c)..................... 16 11 20 13 16 11 Natural Gas Transmission....... -- -- -- -- 31 20 Marketing, Services and Trading -- -- 18 11 -- -- Other(d)....................... 7 4 15 10 14 9 ----- ----- ------ ----- ------ ----- Total asset impairments............ $ 95 $ 68 $ 602 $ 391 $ 323 $ 252 ===== ===== ====== ===== ====== ===== (a) In September 2003, we wrote down our investment in CMS Electric and Gas' Venezuelan electric distribution utility and an associated equipment lease to reflect fair value. The impairment was based on estimates of the utility's future cash flows, incorporating certain assumptions about Venezuela's regulatory, political, and economic environment. (b) DIG's reduced valuation was primarily a reflection of the unfavorable terms of its power purchase agreement. (c) At CMS Generation, we determined that the fair value of our equity investments was lower than its carrying amount, and that this decline in value was other than temporary. Therefore, in accordance with APB No. 18, we recognized an impairment charge of $16 million ($11 million, net of tax). (d) Includes development projects of $7 million ($4 million, net of tax) in 2003 that would no longer be pursued. RESTRUCTURING AND OTHER COSTS In June 2002, we announced a series of initiatives to reduce our annual operating costs by an estimated $50 million. As such, we: - relocated CMS Energy's corporate headquarters from Dearborn, Michigan to a new combined CMS Energy and Consumers headquarters in Jackson, Michigan in July 2003, - implemented changes to our 401(k) savings program, - implemented changes to our health care plan, and - terminated 64 employees, including five officers. Prior to December 31, 2002, 123 employees elected severance arrangements. Of these 187 officers and employees, 65 had been terminated as of December 31, 2002. All remaining terminations were completed in 2003. F-71 The following table shows the amount charged to expense for restructuring costs, the payments made, and the unpaid balance of accrued costs at December 31, 2002 and December 31, 2003. INVOLUNTARY LEASE TERMINATION TERMINATION TOTAL ----------- ----------- ----- IN MILLIONS Beginning accrual balance, January 1, 2002....... $ -- $ -- $ -- Expense... 22 11 33 Payments.. (10) (3) (13) ------ ------ ------ Ending accrual balance at December 31, 2002...... $ 12 $ 8 $ 20 ------ ------ ------ Expense.. 3 -- 3 Payments....................................... (12) (2) (14) ------ ------ ------ Ending accrual balance at December 31, 2003...... $ 3 $ 6 $ 9 ====== ====== ====== Restructuring costs for the year ended December 31, 2003, which are included in operating expenses, include $3 million of involuntary employee termination benefits. 3: GOODWILL Our goodwill balance was $25 million at December 31, 2003 and $31 million at December 31, 2002. Our entire goodwill balance is recorded at the Enterprises segment. The following table presents changes in the carrying amount of goodwill: IN MILLIONS Beginning balance, January 1, 2002... $ 811 Panhandle goodwill impairment.. (601) CMS Viron goodwill impairment.. (15) Goodwill transferred to assets held for sale.................................... (117) Other goodwill write-downs included in asset impairment charges.................. (47) ---------- Ending balance at December 31, 2002.. $ 31 ========== CPEE goodwill impairment and other.. (6) ---------- Ending balance at December 31, 2003.. $ 25 ========== CMS GAS TRANSMISSION: We recorded goodwill as an asset when we purchased Panhandle and began, over time, to expense a portion of goodwill. Effective January 1, 2002, a new accounting standard went into effect that required us to stop expensing goodwill and to test for impairment. We tested the value of the goodwill related to Panhandle for impairment by comparing the fair value of goodwill, as determined by independent appraisers, to the value on our books. The test results showed that the goodwill was impaired. We recorded a loss of $601 million ($369 million, after-tax), that was the amount by which the value on our books exceeded the fair value. In 2002, we also discontinued the operations of Panhandle; therefore, the $369 million after-tax goodwill impairment is reflected in discontinued operations. In 2003, we sold Panhandle. CMS MST: During the third quarter of 1999, we purchased a 100 percent interest in CMS Viron and recorded goodwill. In 2002, we performed an impairment test, which determined our goodwill related to CMS Viron was impaired. In the first quarter of 2002, we recorded a loss of $15 million ($10 million, after-tax) for goodwill impairment. In 2002, we also discontinued the operations of CMS Viron; therefore, the $10 million after-tax goodwill impairment is reflected in discontinued operations. In 2003, we sold CMS Viron. Additionally, the following table represents net loss for the year 2001 without goodwill amortization expense. RESTATED 2001 -------- IN MILLIONS Reported net loss.......................... $ (459) Add: goodwill amortization expense(a)....... 13 -------- Adjusted net loss.......................... $ (446) Adjusted basic and diluted loss per share... $ (3.41) ======== (a) Net of tax of $7 million. F-72 4: UNCERTAINTIES Several business trends or uncertainties may affect our financial results. These trends or uncertainties have, or we reasonably expect could have, a material impact on net sales, revenues, or income from continuing operations. Such trends and uncertainties are discussed in detail below. SEC AND OTHER INVESTIGATIONS: As a result of round-trip trading transactions by CMS MST, CMS Energy's Board of Directors established a Special Committee to investigate matters surrounding the transactions and retained outside counsel to assist in the investigation. The Special Committee completed its investigation and reported its findings to the Board of Directors in October 2002. The Special Committee concluded, based on an extensive investigation, that the round-trip trades were undertaken to raise CMS MST's profile as an energy marketer with the goal of enhancing its ability to promote its services to new customers. The Special Committee found no effort to manipulate the price of CMS Energy Common Stock or affect energy prices. The Special Committee also made recommendations designed to prevent any reoccurrence of this practice. Previously, CMS Energy terminated its speculative trading business and revised its risk management policy. The Board of Directors adopted, and CMS Energy has implemented the recommendations of the Special Committee. CMS Energy is cooperating with other investigations concerning round-trip trading, including an investigation by the SEC regarding round-trip trades and CMS Energy's financial statements, accounting policies and controls, and an investigation by the DOJ. CMS Energy is unable to predict the outcome of these matters, and what effect, if any, these investigations will have on its business. SECURITIES CLASS ACTION LAWSUITS: Beginning on May 17, 2002, a number of securities class action complaints were filed against CMS Energy, Consumers, and certain officers and directors of CMS Energy and its affiliates. The complaints were filed as purported class actions in the United States District Court for the Eastern District of Michigan, by shareholders who allege that they purchased CMS Energy's securities during a purported class period. The cases were consolidated into a single lawsuit and an amended and consolidated class action complaint was filed on May 1, 2003. The consolidated complaint contains a purported class period beginning on May 1, 2000 and running through March 31, 2003. It generally seeks unspecified damages based on allegations that the defendants violated United States securities laws and regulations by making allegedly false and misleading statements about CMS Energy's business and financial condition, particularly with respect to revenues and expenses recorded in connection with round-trip trading by CMS MST. CMS Energy, Consumers, and their affiliates will defend themselves vigorously but cannot predict the outcome of this litigation. DEMAND FOR ACTIONS AGAINST OFFICERS AND DIRECTORS: In May 2002, the Board of Directors of CMS Energy received a demand, on behalf of a shareholder of CMS Energy Common Stock, that it commence civil actions (i) to remedy alleged breaches of fiduciary duties by certain CMS Energy officers and directors in connection with round-trip trading by CMS MST, and (ii) to recover damages sustained by CMS Energy as a result of alleged insider trades alleged to have been made by certain current and former officers of CMS Energy and its subsidiaries. In December 2002, two new directors were appointed to the Board. The Board formed a special litigation committee in January 2003 to determine whether it is in the best interest of CMS Energy to bring the action demanded by the shareholder. The disinterested members of the Board appointed the two new directors to serve on the special litigation committee. In December 2003, during the continuing review by the special litigation committee, CMS Energy was served with a derivative complaint filed on behalf of the shareholder in the Circuit Court of Jackson County, Michigan in furtherance of his demands. The date for CMS Energy and other defendants to answer or otherwise respond to the complaint was extended to June 1, 2004, subject to such further extensions as may be mutually agreed upon by the parties and authorized by the Court. CMS Energy cannot predict the outcome of this matter. ERISA LAWSUITS: CMS Energy is a named defendant, along with Consumers, CMS MST, and certain named and unnamed officers and directors, in two lawsuits brought as purported class actions on behalf of participants and beneficiaries of the CMS Employees' Savings and Incentive Plan (the "PLAN"). The two cases, filed in July 2002 in United States District Court for the Eastern District of Michigan, were consolidated by the trial judge and an amended consolidated complaint was filed. Plaintiffs allege breaches of fiduciary duties under ERISA and seek F-73 restitution on behalf of the Plan with respect to a decline in value of the shares of CMS Energy Common Stock held in the Plan. Plaintiffs also seek other equitable relief and legal fees. CMS Energy and Consumers will defend themselves vigorously but cannot predict the outcome of this litigation. GAS INDEX PRICE REPORTING INVESTIGATION: CMS Energy has notified appropriate regulatory and governmental agencies that some employees at CMS MST and CMS Field Services appeared to have provided inaccurate information regarding natural gas trades to various energy industry publications which compile and report index prices. CMS Energy is cooperating with an investigation by the DOJ regarding this matter. In November 2003, CMS MST and CMS Field Services (now Cantera Gas Company) entered into a settlement with the CFTC pursuant to which they paid a $16 million civil monetary penalty in connection with the inaccurate reporting of natural gas trading data to publications that compile and publish price indices. The settlement resolves all matters investigated by the CFTC involving CMS Energy, including round-trip trading. CMS Energy neither admits nor denies the CFTC's findings in the settlement order. CMS Energy is unable to predict the outcome of the DOJ investigation and what effect, if any, this investigation will have on its business. GAS INDEX PRICE REPORTING LITIGATION: In August 2003, Cornerstone Propane Partners, L.P. ("CORNERSTONE") filed a putative class action complaint in the United States District Court for the Southern District of New York against CMS Energy and dozens of other energy companies. The court ordered the Cornerstone complaint to be consolidated with similar complaints filed by Dominick Viola and Roberto Calle Gracey. The plaintiffs filed a consolidated complaint on January 20, 2004. The consolidated complaint alleges that false natural gas price reporting by the defendants manipulated the prices of NYMEX natural gas futures and options. The complaint contains two counts under the Commodity Exchange Act, one for manipulation and one for aiding and abetting violations. CMS Energy is no longer a defendant, however, CMS MST and CMS Field Services are named as defendants. (CMS Energy sold CMS Field Services to Cantera Natural Gas, Inc. but is required to indemnify Cantera Natural Gas, Inc. with respect to this action.) In a similar but unrelated matter, Texas-Ohio Energy, Inc. filed a putative class action lawsuit in the United States District Court for the Eastern District of California against a number of energy companies engaged in the sale of natural gas in the United States. CMS Energy is named as a defendant. The complaint alleges defendants entered into a price-fixing conspiracy by engaging in activities to manipulate the price of natural gas in California. The complaint contains counts alleging violations of the Sherman Act, Cartwright Act (a California Statute), and the California Business and Profession Code relating to unlawful, unfair and deceptive business practices. The plaintiff in the Texas-Ohio case has agreed to extend the time for all defendants to answer or otherwise respond until after the multi district court litigation ("MDL") panel decides whether to take the case. There is currently pending in the Nevada federal district court a MDL matter involving seven complaints originally filed in various state courts in California. These complaints make allegations similar to those in the Texas-Ohio case regarding price reporting, although none contain a Sherman Act claim. Some of the defendants in the MDL matter who are also defendants in the Texas-Ohio case are trying to have the Texas-Ohio case transferred to the MDL proceeding. Benscheidt v. AEP Energy Services, Inc., et al., a new class action complaint containing allegations similar to those made in the Texas-Ohio case, albeit limited to California state law claims, was filed in California state court in February 2004. CMS Energy and CMS MST are named as defendants. Defendants are likely to seek to remove this action from the California federal district court and have it transferred to the MDL proceeding in Nevada. CMS Energy and the other CMS defendants will defend themselves vigorously, but cannot predict the outcome of these matters. CONSUMERS' UNCERTAINTIES Several business trends or uncertainties may affect Consumers' financial results and condition. These trends or uncertainties have, or we expect could have, a material impact on revenues or income from continuing electric and gas operations. Such trends and uncertainties include: Environmental - increased capital expenditures and operating expenses for Clean Air Act compliance, and F-74 - potential environmental liabilities arising from various environmental laws and regulations, including potential liability or expenses relating to the Michigan Natural Resources and Environmental Protection Acts, Superfund, and at former manufactured gas plant facilities. Restructuring - response of the MPSC and Michigan legislature to electric industry restructuring issues, - ability to meet peak electric demand requirements at a reasonable cost, without market disruption, - ability to recover any of our net Stranded Costs under the regulatory policies being followed by the MPSC, - recovery of electric restructuring implementation costs, - effects of lost electric supply load to alternative electric suppliers, and - status as an electric transmission customer, instead of an electric transmission owner-operator. Regulatory - effects of conclusions about the causes of the August 14, 2003 blackout, including exposure to liability, increased regulatory requirements, and new legislation, - effects of potential performance standards payments, - successful implementation of initiatives to reduce exposure to purchased power price increases, - responses from regulators regarding the storage and ultimate disposal of spent nuclear fuel, - potential adverse appliance service plan ruling or related legislation, - inadequate regulatory response to applications for requested rate increases, and - response to increases in gas costs, including adverse regulatory response and reduced gas use by customers. Other - pending litigation regarding PURPA qualifying facilities, and - pending litigation and government investigations. CONSUMERS' ELECTRIC UTILITY CONTINGENCIES ELECTRIC ENVIRONMENTAL MATTERS: Our operations are subject to environmental laws and regulations. Costs to operate our facilities in compliance with these laws and regulations generally have been recovered in customer rates. Clean Air: In 1998, the EPA issued regulations requiring the state of Michigan to further limit nitrogen oxide emissions at our coal-fired electric plants. The Michigan Department of Environmental Quality finalized its rules to comply with the EPA regulations in December 2002. It submitted these rules to the EPA for approval in the first quarter of 2003. The EPA has yet to approve the Michigan rules. If the EPA does not approve the Michigan rules, similar federal regulations will take effect. The EPA and the state regulations require us to make significant capital expenditures estimated to be $771 million. As of December 31, 2003, we have incurred $446 million in capital expenditures to comply with the EPA regulations and anticipate that the remaining $325 million of capital expenditures will be incurred between 2004 and F-75 2009. These expenditures include installing catalytic reduction technology on some of our coal-fired electric plants. Based on the Customer Choice Act, beginning January 2004, an annual return of and on these types of capital expenditures, to the extent they are above depreciation levels, is expected to be recoverable from customers, subject to a MPSC prudency hearing. The EPA has alleged that some utilities have incorrectly classified plant modifications as "routine maintenance" rather than seek modification permits from the EPA. We have received and responded to information requests from the EPA on this subject. We believe that we have properly interpreted the requirements of "routine maintenance." If our interpretation is found to be incorrect, we may be required to install additional pollution controls at some or all of our coal-fired electric plants. In addition to modifying the coal-fired electric plants, we expect to purchase nitrogen oxide emissions credits for years 2004 through 2008. The cost of these credits is estimated to average $8 million per year and is accounted for as inventory. The credit inventory is expensed as the coal-fired electric plants generate electricity. The price for nitrogen oxide emissions credits is volatile and could change substantially. Future clean air regulations requiring emission controls for sulfur dioxide, nitrogen oxides, mercury, and nickel may require additional capital expenditures. Total expenditures will depend upon the final makeup of the new regulations. Water: The EPA has proposed changes to the rules that govern generating plant cooling water intake systems. The proposed rules will require significant reduction in fish killed by operating equipment. The proposed rules are scheduled to become final in the first quarter of 2004 and some of our facilities would be required to comply by 2006. We are studying the proposed rules to determine the most cost-effective solutions for compliance. Cleanup and Solid Waste: Under the Michigan Natural Resources and Environmental Protection Act, we expect that we will ultimately incur investigation and remedial action costs at a number of sites. We believe that these costs will be recoverable in rates under current ratemaking policies. We are a potentially responsible party at several contaminated sites administered under Superfund. Superfund liability is joint and several, meaning that many other creditworthy parties with substantial assets are potentially responsible with respect to the individual sites. Based on past experience, we estimate that our share of the total liability for the known Superfund sites will be between $1 million and $9 million. As of December 31, 2003, we have recorded a liability for the minimum amount of our estimated Superfund liability. In October 1998, during routine maintenance activities, we identified PCB as a component in certain paint, grout, and sealant materials at the Ludington Pumped Storage facility. We removed and replaced part of the PCB material. We have proposed a plan to deal with the remaining materials and are awaiting a response from the EPA. LITIGATION: In October 2003, a group of eight PURPA qualifying facilities selling power to us filed a lawsuit in Ingham County Circuit Court. The lawsuit alleges that we incorrectly calculated the energy charge payments made pursuant to power purchase agreements with qualifying facilities. More specifically, the lawsuit alleges that we should be basing the energy charge calculation on the cost of more expensive eastern coal, rather than on the cost of the coal actually burned by us for use in our coal-fired generating plants. We believe we have been performing the calculation in the manner prescribed by the power purchase agreements, and have filed a request with the MPSC (as a supplement to the PSCR plan) that asks the MPSC to review this issue and to confirm that our method of performing the calculation is correct. We filed a motion to dismiss the lawsuit in the Ingham County Circuit Court due to the pending request at the MPSC in regard to the PSCR plan case. In February 2004, the judge ruled on the motion and deferred to the primary jurisdiction of the MPSC. This ruling effectively suspends the lawsuit until the MPSC rules. Although only eight qualifying facilities have raised the issue, the same energy charge methodology is used in the PPA with the MCV Partnership and in approximately 20 additional power purchase agreements with us, representing a total of 1,670 MW of electric capacity. We cannot predict the outcome of this matter. F-76 CONSUMERS' ELECTRIC UTILITY RESTRUCTURING MATTERS ELECTRIC RESTRUCTURING LEGISLATION: In June 2000, the Michigan legislature passed electric utility restructuring legislation known as the Customer Choice Act. This act: - allows all customers to choose their electric generation supplier effective January 1, 2002, - provides a one-time five percent residential electric rate reduction, - froze all electric rates through December 31, 2003, and established a rate cap for residential customers through at least December 31, 2005, and a rate cap for small commercial and industrial customers through at least December 31, 2004, - allows deferred recovery of an annual return of and on capital expenditures in excess of depreciation levels incurred during and before the rate freeze-cap period, - allows for the use of Securitization bonds to refinance qualified costs, - allows recovery of net Stranded Costs and implementation costs incurred as a result of the passage of the act, - requires Michigan utilities to join a FERC-approved RTO or sell their interest in transmission facilities to an independent transmission owner, - requires Consumers, Detroit Edison, and AEP to jointly expand their available transmission capability by at least 2,000 MW, and - establishes a market power supply test that, if not met, may require transferring control of generation resources in excess of that required to serve retail sales requirements. The following summarizes our status under the last three provisions of the Customer Choice Act. First, we chose to sell our interest in our transmission facilities to an independent transmission owner in order to comply with the Customer Choice Act; for additional details regarding the sale of the transmission facility, see "Transmission Sale" within this section. Second, in July 2002, the MPSC issued an order approving our plan to achieve the increased transmission capacity required under the Customer Choice Act. The MPSC found that once the planned projects were completed and verification was submitted, a utility was in technical compliance. We have completed the transmission capacity projects identified in the plan and have submitted verification of this fact to the MPSC. We believe we are in full compliance. Lastly, in September 2003, the MPSC issued an order finding that we are in compliance with the market power supply test set forth in the Customer Choice Act. ELECTRIC ROA PLAN: In 1998, we submitted a plan for electric ROA to the MPSC. In March 1999, the MPSC issued orders generally supporting the plan. The Customer Choice Act states that the MPSC orders issued before June 2000 are in compliance with this act and enforceable by the MPSC. Those MPSC orders: - allow electric customers to choose their supplier, - authorize recovery of net Stranded Costs from ROA customers and implementation costs from all customer classes, and - confirm any voluntary commitments of electric utilities. The MPSC approved revised tariffs that establish the rates, terms, and conditions under which retail customers are permitted to choose an electric supplier. These revised tariffs allow ROA customers, upon as little as 30 days notice to us, to return to our generation service at current tariff rates. If any class of customers' (residential, commercial, or industrial) ROA load reaches ten percent of our total load for that class of customers, then returning ROA customers for that class must give 60 days notice to return to our generation service at current tariff rates. However, we may not have capacity available to serve returning ROA customers that is sufficient or reasonably F-77 priced. As a result, we may be forced to purchase electricity on the spot market at higher prices than we can recover from our customers during the rate cap periods. We cannot predict the total amount of electric supply load that may be lost to competitor suppliers. As of March 2004, alternative electric suppliers are providing 735 MW of load. This amount represents nine percent of the total distribution load and an increase of 42 percent compared to March 2003. We cannot predict whether the Stranded Cost recovery method adopted by the MPSC will be applied in a manner that will fully offset any associated margin loss from ROA. In February 2004, the MPSC issued an order on Detroit Edison's request for rate relief for costs associated with customers leaving under electric customer choice. The MPSC order allows Detroit Edison to charge a transition surcharge of approximately 0.4 cent per kWh to ROA customers and eliminates securitization offsets of 0.7 cents per kWh for primary service customers and 0.9 cents per kWh for secondary service customers. We are seeking similar recovery of Stranded Costs due to ROA customers leaving our system and are encouraged by this ruling. ELECTRIC RESTRUCTURING PROCEEDINGS: Below is a discussion of our electric restructuring proceedings. They are: - Securitization, - Stranded Costs, - implementation costs, and - transmission. Securitization: The Customer Choice Act allows for the use of Securitization bonds to refinance certain qualified costs. Since Securitization involves issuing bonds secured by a revenue stream from rates collected directly from customers to service the bonds, Securitization bonds typically have a higher credit rating than conventional utility corporate financing. In 2000 and 2001, the MPSC issued orders authorizing us to issue Securitization bonds. We issued our first Securitization bonds in late 2001. Securitization resulted in: - lower interest costs, and - longer amortization periods for the securitized assets. We will recover the repayment of principal, interest, and other expenses relating to the bond issuance through a Securitization charge and a tax charge that began in December 2001. These charges are subject to an annual true up until one year prior to the last scheduled bond maturity date, and no more than quarterly thereafter. The December 2003 true up modified the total Securitization and related tax charges from 1.746 mills per kWh to 1.718 mills per kWh. There will be no impact on customer bills from Securitization for most of our electric customers until the Customer Choice Act cap period expires, and an electric rate case is processed. Securitization charge collections, $50 million for the twelve months ended December 31, 2003, and $52 million for the twelve months ended December 31, 2002, are remitted to a trustee. Securitization charge collections are restricted to the repayment of the principal and interest on the Securitization bonds and payment of the ongoing expenses of Consumers Funding. Consumers Funding is legally separate from Consumers. The assets and income of Consumers Funding, including the securitized property, are not available to creditors of Consumers or CMS Energy. In March 2003, we filed an application with the MPSC seeking approval to issue additional Securitization bonds. In June 2003, the MPSC issued a financing order authorizing the issuance of Securitization bonds in the amount of $554 million. This amount relates to Clean Air Act expenditures and associated return on those expenditures through December 31, 2002; ROA implementation costs, and previously authorized return on those expenditures through December 31, 2000; and other up front qualified costs related to issuance of the Securitization bonds. The MPSC rejected the portion of the application related to pension costs. The MPSC based its decision on the reasoning that a rebounding economy and stock market could potentially reverse recent Pension Plan losses. Also, the MPSC rejected Palisades expenditures previously not securitized as eligible securitized costs; therefore, these costs will be F-78 included in a future electric rate case proceeding with the MPSC and as a component of the 2002 net Stranded Cost calculation. In July 2003, we filed for rehearing and clarification on a number of features in the financing order. In December 2003, the MPSC issued its order on rehearing, which rejected our requests for clarification and modification to the dividend payment restriction, failed to rule directly on the accounting clarifications requested, and remanded the proceeding to the ALJ for additional proceedings to address rate design. We filed testimony regarding the remanded proceeding in February 2004. The financing order will become effective after acceptance by us and resolution of any appeals. Stranded Costs: The Customer Choice Act allows electric utilities to recover their net Stranded Costs, without defining the term. The Act directs the MPSC to establish a method of calculating net Stranded Costs and of conducting related true-up adjustments. In December 2001, the MPSC Staff recommended a methodology, which calculated net Stranded Costs as the shortfall between: - the revenue required to cover the costs associated with fixed generation assets and capacity payments associated with purchase power agreements, and - the revenues received from customers under existing rates available to cover the revenue requirement. We are authorized by the MPSC to use deferred accounting to recognize the future recovery of costs determined to be stranded. According to the MPSC, net Stranded Costs are to be recovered from ROA customers through a Stranded Cost transition charge. However, the MPSC has not yet allowed such a transition charge and we have not recorded regulatory assets to recognize the future recovery of such costs. In 2002 and 2001, the MPSC issued orders finding that we experienced zero net Stranded Costs from 1999 to 2001. The MPSC also declined to resolve numerous issues regarding the net Stranded Cost methodology in a way that would allow a reliable prediction of the level of Stranded Costs for future years. We are currently in the process of appealing these orders with the Michigan Court of Appeals and the Michigan Supreme Court. In March 2003, we filed an application with the MPSC seeking approval of net Stranded Costs incurred in 2002, and for approval of a net Stranded Cost recovery charge. Our net Stranded Costs incurred in 2002 are estimated to be $38 million with the issuance of Securitization bonds that include Clean Air Act investments, or $85 million without the issuance of Securitization bonds that include Clean Air Act investments. The MPSC scheduled hearings for our 2002 Stranded Cost application to take place during the second quarter of 2004. Once a final financing order on Securitization is reached, we will know the amount of our request for net Stranded Cost recovery for 2002. We cannot predict how the MPSC will rule on our request for the recoverability of Stranded Costs. Implementation Costs: Since 1997, we have incurred significant electric utility restructuring implementation costs. The Customer Choice Act allows electric utilities to recover their implementation costs. The following table outlines the applications filed by us with the MPSC and the status of recovery for these costs. YEAR FILED YEAR INCURRED REQUESTED PENDING ALLOWED DISALLOWED ------------- ------------ ---------------- ------- ---------- IN MILLIONS 1999.......... 1997 & 1998 $ 20 $ -- $ 15 $ 5 2000.......... 1999 30 -- 25 5 2001.......... 2000 25 -- 20 5 2002.......... 2001 8 -- 8 -- 2003.......... 2002 2 2 Pending Pending The MPSC disallowed certain costs, determining that these amounts did not represent costs incremental to costs already reflected in electric rates. In the order received for the year 2001, the MPSC also reserved the right to reevaluate the implementation costs depending upon the progress and success of the ROA program, and ruled that due to the rate freeze imposed by the Customer Choice Act, it was premature to establish a cost recovery method for the allowable implementation costs. In addition to the amounts shown above, we incurred and deferred as a F-79 regulatory asset, as of December 31, 2003, $2 million of additional implementation costs and $19 million for the cost of money associated with total implementation costs. We believe the implementation costs and associated cost of money are fully recoverable in accordance with the Customer Choice Act. Cash recovery from customers is expected to begin after the rate cap period expires. The rate cap expired for large commercial and industrial customers on December 31, 2003. We have asked to include implementation costs through December 31, 2000 in the pending Securitization case. If approved, the sale of Securitization bonds will allow for the recovery of a significant portion of these costs. We cannot predict the amount the MPSC will approve as allowable costs. Also, we are pursuing authorization at the FERC for MISO to reimburse us for $8 million in certain electric utility restructuring implementation costs related to our former participation in the development of the Alliance RTO, a portion of which has been expensed. In May 2003, the FERC issued an order denying MISO's request for authorization to reimburse us. In June 2003, we filed a joint petition with MISO for rehearing with the FERC, which the FERC denied in September 2003. We appealed the FERC ruling at the United States Court of Appeals for the District of Columbia and are pursuing other potential means of recovery at the FERC. In conjunction with our appeal of the September order denying recovery, MISO agreed to file a request with the FERC seeking authority to reimburse METC. As part of the contract for the sale of our former transmission system, should the FERC approve the new MISO filing, METC is contractually obligated to flow-through to us the full amount of any Alliance RTO start-up costs that it is authorized to recover by FERC. We cannot predict the outcome of the appeal process, the MISO request, or the ultimate amount, if any, FERC will allow us to collect for implementation costs. Transmission Rates: Our application of JOATT transmission rates to customers during past periods is under FERC review. The rates included in these tariffs were applied to certain transmission transactions affecting both Detroit Edison's and our transmission systems between 1997 and 2002. We believe our reserve is sufficient to satisfy our refund obligation to any of our former transmission customers under our former JOATT. TRANSMISSION SALE: In May 2002, we sold our electric transmission system for $290 million to MTH, a non-affiliated limited partnership whose general partner is a subsidiary of Trans-Elect, Inc. The pretax gain was $31 million ($26 million, net of tax). We are currently in arbitration with MTH regarding property tax items used in establishing the selling price of our electric transmission system. We cannot predict whether the remaining open items will impact materially the recorded gain on the sale. As a result of the sale, after-tax earnings have decreased due to a loss of revenue from wholesale and ROA customers who will buy services directly from MTH. METC has completed the capital program to expand the transmission system's capability to import electricity into Michigan, as required by the Customer Choice Act. We will continue to maintain the system until May 1, 2007 under a contract with METC. Under an agreement with MTH, transmission rates charged to us are fixed by contract at current levels through December 31, 2005, and are subject to FERC ratemaking thereafter. However, we are subject to certain additional MISO surcharges, which are estimated to be $15 million in 2004. CONSUMERS' ELECTRIC UTILITY RATE MATTERS AUGUST 14, 2003 BLACKOUT: On August 14, 2003, the electric transmission grid serving parts of the Midwest and the Northeast experienced a significant disturbance that impacted electric service to millions of homes and businesses. Approximately 100,000 of our 1.7 million electric customers were without power for approximately 24 hours as a result of the disturbance. We incurred $1 million of immediate expense as a result of the blackout. We continue to cooperate with investigations of the blackout by several federal and state agencies. We cannot predict the outcome of these investigations. In November 2003, the MPSC released its report on the blackout. The MPSC report found no evidence to suggest that the events in Michigan or actions taken by the Michigan utilities or transmission operators were factors contributing to the cause of the blackout. Also in November 2003, the United States and Canadian power system outage task force preliminarily reported that the primary cause of the blackout was due to transmission line contact with trees in areas outside of Consumers' operating territory. In December 2003, the MPSC issued an order F-80 requiring Michigan investor-owned utilities to file reports by April 1, 2004, on the status of the transmission and distribution lines used to serve their customers, including details on vegetation trimming practices in calendar year 2003. Consumers intends to comply with the MPSC's request. In February 2004, the Board of Trustees of NERC approved recommendations to improve electric transmission reliability. The key recommendations are as follows: - strengthen the NERC compliance enforcement program, - evaluate vegetation management procedures, and - improve technology to prevent or mitigate future blackouts. These recommendations require transmission operators, which Consumers is not, to submit annual reports on vegetation management beginning March 2005 and improve technology over various milestones throughout 2004. These recommendations could result in increased transmission costs payable by transmission customers in the future. The financial impacts of these recommendations are not currently quantifiable. PERFORMANCE STANDARDS: Electric distribution performance standards developed by the MPSC were in proposal status during 2002 and 2003. The performance standards were placed into Michigan law in January 2004 and became effective on February 9, 2004. They relate to restoration after an outage, safety, and customer relations. During 2002 and 2003, Consumers monitored and reported to the MPSC its performance relative to the performance standards. Year-end results for both 2002 and 2003 resulted in compliance with the acceptable level of performance as established by the approved standards. Financial incentives and penalties are contained within the performance standards. An incentive is possible if all of the established performance standards have been exceeded for a calendar year. However, the value of such incentive cannot be determined at this point as the performance standards do not contain an approved incentive mechanism. Financial penalties in the form of customer credits are also possible. These customer credits are based on duration and repetition of outages. We cannot predict the likely effects of the financial incentive or penalties, if any, on us. POWER SUPPLY COSTS: We were required to provide backup service to ROA customers on a best efforts basis. In October 2003, we provided notice to the MPSC that we would terminate the provision of backup service in accordance with the Customer Choice Act, effective January 1, 2004. To reduce the risk of high electric prices during peak demand periods and to achieve our reserve margin target, we employ a strategy of purchasing electric call option and capacity and energy contracts for the physical delivery of electricity primarily in the summer months and to a lesser degree in the winter months. As of December 31, 2003, we purchased capacity and energy contracts partially covering the estimated reserve margin requirements for 2004 through 2007. As a result, we have recognized an asset of $20 million for unexpired capacity and energy contracts. Currently, we have a reserve margin of 5 percent, or supply resources equal to 105 percent of projected summer peak load for summer 2004. We are in the process of securing the additional capacity needed to meet our summer 2004 reserve margin target of 11 percent (111 percent of projected summer peak load). The total premium costs of electricity call option and capacity and energy contracts for 2003 were approximately $10 million. As a result of meeting the transmission capability expansion requirements and the market power test, as discussed in this note, we have met the requirements under the Customer Choice Act to return to the PSCR process. The PSCR process provides for the reconciliation of actual power supply costs with power supply revenues. This process assures recovery of all reasonable and prudent power supply costs actually incurred by us. In September 2003, we submitted a PSCR filing to the MPSC that reinstates the PSCR process for customers whose rates are no longer frozen or capped as of January 1, 2004. The proposed PSCR charge allows us to recover a portion of our increased power supply costs from large commercial and industrial customers, and subject to the overall rate cap, from other customers. We estimate the recovery of increased power supply costs from large commercial and industrial customers to be approximately $30 million in 2004. As allowed under current regulation, we self-implemented the proposed PSCR charge on January 1, 2004. The revenues received from the PSCR charge are also F-81 subject to subsequent reconciliation at the end of the year after actual costs have been reviewed for reasonableness and prudence. We cannot predict the outcome of this filing. OTHER CONSUMERS' ELECTRIC UTILITY UNCERTAINTIES THE MIDLAND COGENERATION VENTURE: The MCV Partnership, which leases and operates the MCV Facility, contracted to sell electricity to Consumers for a 35-year period beginning in 1990 and to supply electricity and steam to Dow. We hold, through two wholly owned subsidiaries, the following assets related to the MCV Partnership and MCV Facility: - CMS Midland owns a 49 percent general partnership interest in the MCV Partnership, and - CMS Holdings holds, through FMLP, a 35 percent lessor interest in the MCV Facility. Our consolidated retained earnings include undistributed earnings from the MCV Partnership, which at December 31, 2003 are $245 million and at December 31, 2002 are $226 million. SUMMARIZED STATEMENTS OF INCOME FOR CMS MIDLAND AND CMS HOLDINGS YEARS ENDED DECEMBER 31 ----------------- 2003 2002 2001 ----- ------ ----- IN MILLIONS Earnings from equity method investees............................ $ 42 $ 52 $ 38 Operating expenses, taxes and other.............................. 22 18 13 ----- ------ ----- Income before cumulative effect of accounting change............. $ 20 $ 34 $ 25 Cumulative effect of change in method of accounting for derivatives, net of $10 million tax expense in 2002 (Note 15)... -- 18 -- ----- ------ ----- Net income.. $ 20 $ 52 $ 25 ===== ====== ===== Power Supply Purchases from the MCV Partnership: Our annual obligation to purchase capacity from the MCV Partnership is 1,240 MW through the term of the PPA ending in 2025. The PPA requires us to pay, based on the

MCV Facility's availability, a levelized average capacity charge of 3.77 cents per kWh and a fixed energy charge. We also pay a variable energy charge based on our average cost of coal consumed for all kWh delivered. Effective January 1999, we reached a settlement agreement with the MCV Partnership that capped payments made on the basis of availability that may be billed by the MCV Partnership at a maximum 98.5 percent availability level. Since January 1993, the MPSC has permitted us to recover capacity charges averaging 3.62 cents per kWh for 915 MW, plus fixed and variable energy charges. Since January 1996, the MPSC has also permitted us to recover capacity charges for the remaining 325 MW of contract capacity with an initial average charge of 2.86 cents per kWh increasing periodically to an eventual 3.62 cents per kWh by 2004 and thereafter. However, due to the frozen retail rates required by the Customer Choice Act, the capacity charge for the 325 MW was frozen at 3.17 cents per kWh until December 31, 2003. Recovery of both the 915 MW and 325 MW portions of the PPA are subject to certain limitations discussed below. In 1992, we recognized a loss and established a liability for the present value of the estimated future underrecoveries of power supply costs under the PPA based on MPSC cost-recovery orders. The remaining liability associated with the loss totaled $27 million at December 31, 2003, $53 million at December 31, 2002, and $77 million at December 31, 2001. We expect the PPA liability to be depleted in late 2004. We estimate that 51 percent of the actual cash underrecoveries for 2004 will be charged to the PPA liability, with the remaining portion charged to operating expense as a result of our 49 percent ownership in the MCV Partnership. We will expense all cash underrecoveries directly to income once the PPA liability is depleted. If the MCV Facility's generating availability remains at the maximum 98.5 percent level, our cash underrecoveries associated with the PPA could be as follows: F-82 2004 2005 2006 2007 ---- ---- ---- ---- IN MILLIONS Estimated cash underrecoveries at 98.5%....... $ 56 $ 56 $ 55 $ 39 Amount to be charged to operating expense..... 29 56 55 39 Amount to be charged to PPA liability......... 27 -- -- -- Beginning January 1, 2004, the rate freeze for large industrial customers was no longer in effect and we returned to the PSCR process. Under the PSCR process, we will recover from our customers the capacity and fixed energy charges based on availability, up to an availability cap of 88.7 percent as established in previous MPSC orders. Effects on Our Ownership Interest in the MCV Partnership and MCV Facility: As a result of returning to the PSCR process, we returned to dispatching the MCV Facility on a fixed load basis, as permitted by the MPSC, in order to maximize recovery of our capacity payments. This fixed load dispatch increases the MCV Facility's output and electricity production costs, such as natural gas. As the spread between the MCV Facility's variable electricity production costs and its energy payment revenue widens, the MCV's Partnership's financial performance and our equity interest in the MCV Partnership may be affected negatively. Under the PPA, variable energy payments to the MCV Partnership are based on the cost of coal burned at our coal plants and operation and maintenance expenses. However, the MCV Partnership's costs of producing electricity are tied to the cost of natural gas. Because natural gas prices have increased substantially in recent years, while the price the MCV Partnership can charge us for energy has not, the MCV Partnership's financial performance has been impacted negatively. Until September 2007, the PPA and settlement require us to pay capacity and fixed energy charges based on the MCV Facility's actual availability up to the 98.5 percent cap. After September 2007, we expect to exercise the regulatory out provision in the PPA, limiting our capacity and fixed energy payments to the MCV Partnership to the amount collected from our customers. The MPSC's future actions on the capacity and fixed energy payments recoverable from customers subsequent to September 2007 may affect negatively the earnings of the MCV Partnership and the value of our equity interest in the MCV Partnership. In February 2004, we filed a resource conservation plan with the MPSC that is intended to help conserve natural gas and thereby improve our equity investment in the MCV Partnership. This plan seeks approval to: - dispatch the MCV Facility on an economic basis depending on natural gas market prices without increased costs to electric customers, - give Consumers a priority right to buy excess natural gas as a result of the reduced dispatch of the MCV Facility, and - fund $5 million annually for renewable energy sources such as wind power projects. The resource conservation plan will reduce the MCV Facility's annual natural gas consumption by an estimated 30 to 40 billion cubic feet. This decrease in the quantity of high-priced natural gas consumed by the MCV Facility will benefit Consumers' ownership interest in the MCV Partnership. The amount of PPA capacity and fixed energy payments recovered from retail electric customers would remain capped at 88.7 percent. Therefore, customers will not be charged for any increased power supply costs, if they occur. Consumers and the MCV Partnership have reached an agreement that the MCV Partnership will reimburse Consumers for any incremental power costs incurred to replace the reduction in power dispatched from the MCV Facility. We requested that the MPSC provide interim approval while it conducts a full review of the plan. The MPSC has scheduled a prehearing conference with respect to the MCV resource conservation plan for April 2004. We cannot predict if or when the MPSC will approve our request. The two most significant variables in the analysis of the MCV Partnership's future financial performance are the forward price of natural gas for the next 22 years and the MPSC's decision in 2007 or beyond on our recovery of capacity payments. Natural gas prices have been historically volatile. Presently, there is no consensus in the F-83 marketplace on the price or range of prices of natural gas in the short term or beyond the next five years. Therefore, we cannot predict the impact of these issues on our future earnings, cash flows, or on the value of our equity interest in the MCV Partnership. NUCLEAR MATTERS: Big Rock: Significant progress continues to be made in the decommissioning of Big Rock. We submitted the License Termination Plan to the NRC staff for review in April 2003. System dismantlement and building demolition are on schedule to return the 560-acre site to a natural setting for unrestricted use in early 2006. The NRC and Michigan Department of Environmental Quality continue to find that all decommissioning activities at Big Rock are being performed in accordance with applicable regulatory and license requirements. Seven transportable dry casks have been loaded with spent nuclear fuel and an eighth cask has been loaded with high-level radioactive waste material. These dry casks will remain onsite until the DOE moves the material to a national spent nuclear fuel repository. Palisades: In July 2003, the NRC completed its mid-cycle plant performance assessment of Palisades. The mid-cycle assessment for Palisades covered the period from January 1, 2003 through the end of July 2003. The NRC determined that Palisades was operated in a manner that preserved public health and safety and fully met all cornerstone objectives. Based on the plant's performance, only regularly scheduled inspections are planned through September 2004. The amount of spent nuclear fuel exceeds Palisades' temporary onsite storage pool capacity. We are using dry casks for temporary onsite storage. As of December 31, 2003, we have loaded 18 dry casks with spent nuclear fuel and we will need to load additional dry casks by the fall of 2004 in order to continue operation. Palisades currently has three empty dry casks onsite, with storage pad capacity for up to seven additional loaded dry casks. We anticipate that transportable dry casks, along with more storage pad capacity, will be available by fall 2004. DOE Litigation: In 1997, a U.S. Court of Appeals decision confirmed that the DOE was to begin accepting deliveries of spent nuclear fuel for disposal by January 1998. Subsequent U.S. Court of Appeals litigation, in which we and other utilities participated, has not been successful in producing more specific relief for the DOE's failure to accept the spent nuclear fuel. There are two court decisions that support the right of utilities to pursue damage claims in the United States Court of Claims against the DOE for failure to take delivery of spent nuclear fuel. A number of utilities have initiated litigation in the United States Court of Claims; we filed our complaint in December 2002. If our litigation against the DOE is successful, we anticipate future recoveries from the DOE. The recoveries will be used to pay the cost of spent nuclear fuel storage until the DOE takes possession as required by law. We can make no assurance that the litigation against the DOE will be successful. In July 2002, Congress approved and the President signed a bill designating the site at Yucca Mountain, Nevada, for the development of a repository for the disposal of high-level radioactive waste and spent nuclear fuel. The next step will be for the DOE to submit an application to the NRC for a license to begin construction of the repository. The application and review process is estimated to take several years. Spent nuclear fuel complaint: In March 2003, the Michigan Environmental Council, the Public Interest Research Group in Michigan, and the Michigan Consumer Federation filed a complaint with the MPSC, which was served on us by the MPSC in April 2003. The complaint asks the MPSC to initiate a generic investigation and contested case to review all facts and issues concerning costs associated with spent nuclear fuel storage and disposal. The complaint seeks a variety of relief with respect to Consumers, Detroit Edison, Indiana & Michigan Electric Company, Wisconsin Electric Power Company, and Wisconsin Public Service Corporation. The complaint states that amounts collected from customers for spent nuclear storage and disposal should be placed in an independent trust. The complaint also asks the MPSC to take additional actions. In May 2003, Consumers and other named utilities each filed motions to dismiss the complaint. We are unable to predict the outcome of this matter. Insurance: We maintain nuclear insurance coverage on our nuclear plants. At Palisades, we maintain nuclear property insurance from NEIL, totaling $2.750 billion and insurance that would partially cover the cost of replacement power during certain prolonged accidental outages. Because NEIL is a mutual insurance company, we F-84 could be subject to assessments of up to $26 million in any policy year if insured losses in excess of NEIL's maximum policyholders surplus occur at our, or any other member's, nuclear facility. NEIL's policies include coverage for acts of terrorism. At Palisades, we maintain nuclear liability insurance for third-party bodily injury and off-site property damage resulting from a nuclear hazard for up to approximately $10.862 billion, the maximum insurance liability limits established by the Price-Anderson Act. The United States Congress enacted the Price-Anderson Act to provide financial liability protection for those parties who may be liable for a nuclear accident or incident. Part of the Price-Anderson Act's financial protection is a mandatory industry-wide program where owners of nuclear generating facilities could be assessed if a nuclear incident occurs at any nuclear generating facility. The maximum assessment against us could be $101 million per occurrence, limited to maximum annual installment payments of $10 million. We also maintain insurance under a program that covers tort claims for bodily injury to nuclear workers caused by nuclear hazards. The policy contains a $300 million nuclear industry aggregate limit. Under a previous insurance program providing coverage for claims brought by nuclear workers, we remain responsible for a maximum assessment of up to $6 million. Big Rock remains insured for nuclear liability by a combination of insurance and a NRC indemnity totaling $544 million and a nuclear property insurance policy from NEIL. Insurance policy terms, limits, and conditions are subject to change during the year as we renew our policies. COMMITMENTS FOR FUTURE PURCHASES: We enter into a number of unconditional purchase obligations that represent normal business operating contracts. These contracts are used to assure an adequate supply of goods and services necessary for the operation of our business and to minimize exposure to market price fluctuations. We believe that these future costs are prudent and reasonably assured of recovery in future rates. Coal Supply and Transportation: We have entered into coal supply contracts with various suppliers for our coal-fired generating stations. Under the terms of these agreements, we are obligated to take physical delivery of the coal and make payment based upon the contract terms. Our coal supply contracts expire from 2004 to 2005, and total an estimated $177 million. Our coal transportation contracts expire from 2004 to 2007, and total an estimated $139 million. Long-term coal supply contracts account for approximately 60 to 90 percent of our annual coal requirements. In 2003, coal purchases totaled $265 million of which $207 million (78 percent of the tonnage requirement) was under long-term contract. We supplement our long-term contracts with spot-market purchases. Power Supply, Capacity, and Transmission: As of December 31, 2003, we had future unrecognized commitments to purchase power transmission services under fixed price forward contracts for 2004 and 2005 totaling $8 million. We also had commitments to purchase capacity and energy under long-term power purchase agreements with various generating plants including the MCV Facility. These contracts require monthly capacity payments based on the plants' availability or deliverability. These payments for 2004 through 2030 total an estimated $14.483 billion, undiscounted, which includes $11.381 billion related to the MCV Facility. These payments exclude the obligations that Consumers has with the Genesee, Grayling, and Filer City generating plants because these entities are consolidated for CMS Energy under FASB Interpretation No. 46. This amount may vary depending upon plant availability and fuel costs. If a plant was not available to deliver electricity to us, then we would not be obligated to make the capacity payment until the plant could deliver. CONSUMERS' GAS UTILITY CONTINGENCIES GAS ENVIRONMENTAL MATTERS: We expect to have investigation and remedial costs at a number of sites under the Michigan Natural Resources and Environmental Protection Act, a Michigan statute that covers environmental activities including remediation. These sites include 23 former manufactured gas plant facilities. We operated the facilities on these sites for some part of their operating lives. For some of these sites, we have no current ownership or may own only a portion of the original site. We have completed initial investigations at the 23 sites. We will continue to implement remediation plans for sites where we have received MDEQ remediation plan approval. We will also work toward resolving environmental issues at sites as studies are completed. F-85 We have estimated our costs for investigation and remedial action at all 23 sites using the Gas Research Institute-Manufactured Gas Plant Probabilistic Cost Model. We expect our remaining costs to be between $37 million and $90 million. The range reflects multiple alternatives with various assumptions for resolving the environmental issues at each site. The estimates are based on discounted 2003 costs using a discount rate of three percent. The discount rate represents a ten-year average of U.S. Treasury bond rates reduced for increases in the consumer price index. We expect to fund most of these costs through insurance proceeds and through MPSC approved rates charged to our customers. As of December 31, 2003, we have recorded a liability of $44 million, net of $38 million of expenditures incurred to date, and a regulatory asset of $67 million. Any significant change in assumptions, such as an increase in the number of sites, different remediation techniques, nature and extent of contamination, and legal and regulatory requirements, could affect our estimate of remedial action costs. In its November 2002 gas distribution rate order, the MPSC authorized us to continue to recover approximately $1 million of manufactured gas plant facilities environmental clean-up costs annually. This amount will continue to be offset by $2 million to reflect amounts recovered from all other sources. We defer and amortize, over a period of 10 years, manufactured gas plant facilities environmental clean-up costs above the amount currently included in rates. Additional amortization of the expense in our rates cannot begin until after a prudency review in a gas rate case. CONSUMERS' GAS UTILITY RATE MATTERS GAS COST RECOVERY: The MPSC is required by law to allow us to charge customers for our actual cost of purchased natural gas. The GCR process is designed to allow us to recover all of our gas costs; however, the MPSC reviews these costs for prudency in an annual reconciliation proceeding. In June 2003, we filed a reconciliation of GCR costs and revenues for the 12-months ended March 2003. We proposed to recover from our customers approximately $6 million of under-recovered gas costs using a roll-in methodology. The roll-in methodology incorporates the GCR under-recovery in the next GCR plan year. The approach was approved by the MPSC in a November 2002 order. In January 2004, intervenors filed their positions in our 2003 GCR case. Their positions were that not all of our gas purchasing decisions were prudent during April 2002 through March 2003 and they proposed disallowances. In February 2004, the parties in the case reached a tentative settlement agreement that would result in a GCR disallowance of $11 million for the GCR period. Interest on the disallowed amount from April 1, 2003 through February 2004, at the Consumers' authorized rate of return, adds $1 million to the cost of the settlement. We believe this settlement agreement will be executed by the parties in the case in the near future and approved by the MPSC. A reserve was recorded in December 2003. In July 2003, the MPSC approved a settlement agreement authorizing us to increase our gas cost recovery for the remainder of the current GCR plan year (August 2003 through March 2004) and to apply a quarterly ceiling price adjustment, based on a formula that tracks changes in NYMEX natural gas prices. The terms of the settlement allow a GCR ceiling price of $6.11 per mcf. Our GCR is $5.36 per mcf for March 2004 bills. 2003 GAS RATE CASE: In March 2003, we filed an application with the MPSC for a $156 million annual increase in our gas delivery and transportation rates that included a 13.5 percent return on equity. In September 2003, we filed an update to our gas rate case that lowered the requested revenue increase from $156 million to $139 million and reduced the return on common equity from 13.5 percent to 12.75 percent. The MPSC authorized an interim gas rate increase of $19 million annually. The interim increase is under bond and subject to refund if the final rate relief is a lesser amount. The interim increase order includes a $34 million reduction in book depreciation expense and related income taxes effective only during the period that we receive the interim relief. The MPSC order allowed us to increase our rates beginning December 19, 2003. As part of the interim order, Consumers agreed to restrict its dividend payments to CMS Energy, to a maximum of $190 million annually during the period that Consumers receives the interim relief. On March 5, 2004, the ALJ issued a Proposal for Decision recommending that the MPSC not rely upon the projected test year data included in our filing and supported by the MPSC Staff and further recommended that the application be dismissed. The MPSC is not bound by these recommendations and will consider the issues anew after receipt of exceptions and replies to the exception filed by the parties in response to the Proposal for Decision. F-86 2001 GAS DEPRECIATION CASE: In December 2003, we filed an update to our gas utility plant depreciation case originally filed in June 2001. This case is independent of the 2003 gas rate case. The original filing was based on December 2000 plant balances and historical data. The December 2003 filing updates the gas depreciation case to include December 2002 plant balances. The proposed depreciation rates, if approved, will result in an annual increase of $12 million in depreciation expense. OTHER CONSUMERS' GAS UTILITY UNCERTAINTIES COMMITMENTS FOR GAS SUPPLIES: We enter into contracts to purchase gas and gas transportation from various suppliers for our natural gas business. These contracts have expiration dates that range from 2004 to 2007. Our 2003 gas purchases totaled 248 bcf at a cost of $1.379 billion. At the end of 2003, we estimate our gas purchases for 2004 to be 235 bcf, of which 22 percent is covered by existing fixed price contracts and 37 percent is covered by indexed price contracts that are subject to price variations. The remaining 2004 gas purchases will be made at market prices at the time of purchase. OTHER CONSUMERS' UNCERTAINTIES In addition to the matters disclosed in this note, we are parties to certain lawsuits and administrative proceedings before various courts and governmental agencies arising from the ordinary course of business. These lawsuits and proceedings may involve personal injury, property damage, contractual matters, environmental issues, federal and state taxes, rates, licensing, and other matters. We have accrued estimated losses for certain contingencies discussed in this note. Resolution of these contingencies is not expected to have a material adverse impact on our financial position, liquidity, or results of operations. OTHER UNCERTAINTIES INTEGRUM LAWSUIT: Integrum filed a complaint in Wayne County, Michigan Circuit Court in July 2003 against CMS Energy, Enterprises and APT. Integrum alleges several causes of action against APT, CMS Energy, and Enterprises in connection with an offer by Integrum to purchase the CMS Pipeline Assets. In addition to seeking unspecified money damages, Integrum is seeking an order enjoining CMS Energy and Enterprises from selling and APT from purchasing the CMS Pipeline Assets and an order of specific performance mandating that CMS Energy, Enterprises, and APT complete the sale of the CMS Pipeline Assets to APT and Integrum. A certain officer and director of Integrum is a former officer and director of CMS Energy, Consumers, and their subsidiaries. The individual was not employed by CMS Energy, Consumers or their subsidiaries when Integrum made the offer to purchase the CMS Pipeline Assets. CMS Energy believes that Integrum's claims are without merit. CMS Energy will defend itself vigorously but cannot predict the outcome of this lawsuit. CMS GENERATION-OXFORD TIRE RECYCLING: In an administrative order, the California Regional Water Control Board of the state of California named CMS Generation as a potentially responsible party for the clean up of the waste from the fire that occurred in September 1999 at the Filbin Tire Pile, which the State claims was owned by Oxford Tire Recycling of North Carolina, Inc. CMS Generation reached a settlement with the state, which the court approved, pursuant to which CMS Generation paid the state $5.5 million, $1.6 million of which it had paid the state prior to the settlement. CMS Generation continues to negotiate to have the insurance company pay a portion of the settlement amount, as well as a portion of its attorney fees. At the request of the DOJ in San Francisco, CMS Energy and other parties contacted by the DOJ in San Francisco entered into separate Tolling Agreements with the DOJ in San Francisco in September 2002. The Tolling Agreement stops the running of any statute of limitations during the ninety-day period between September 13, 2002 and (through several extensions of the tolling period) March 30, 2004, to facilitate settlement discussions between all the parties in connection with federal claims arising from the fire at the Filbin Tire Pile. On September 23, 2002, CMS Energy received a written demand from the U.S. Coast Guard for reimbursement of approximately $3.5 million in costs incurred by the U.S. Coast Guard in fighting the fire. It is CMS Energy's understanding that these costs, together with any accrued interest, are the sole basis of any federal claims. CMS Energy has reached an agreement in principle with the U.S. Coast Guard to settle this matter for $475,000. F-87 DEARBORN INDUSTRIAL GENERATION: In October 2001, Duke/Fluor Daniel (DFD) presented DIG with a change order to their construction contract and filed an action in Michigan state court claiming damages in the amount of $110 million, plus interest and costs, which DFD states represents the cumulative amount owed by DIG for delays DFD believes DIG caused and for prior change orders that DIG previously rejected. DFD also filed a construction lien for the $110 million. DIG, in addition to drawing down on three letters of credit totaling $30 million that it obtained from DFD, has filed an arbitration claim against DFD asserting in excess of an additional $75 million in claims against DFD. The judge in the Michigan state court case entered an order staying DFD's prosecution of its claims in the court case and permitting the arbitration to proceed. DFD has appealed the decision by the judge in the Michigan state court case to stay the litigation. DIG will continue to defend itself vigorously and pursue its claims. DIG cannot predict the outcome of this matter. DIG CUSTOMER DISPUTES: As a result of the continued delays in the DIG project becoming fully operational, DIG's customers, Ford Motor Company, and Rouge Industries, asserted claims that the continued delays relieve them of certain contractual obligations, totaling $43 million. In addition, Ford and/or Rouge asserted several other commercial claims against DIG relating to operation of the DIG plant. In February 2003, Rouge filed an Arbitration Demand against DIG and CMS MST Michigan L.L.C. with the American Arbitration Association. Rouge was seeking a total of approximately $27 million, plus additional accrued damages at the time of any award, plus interest. More specifically, Rouge was seeking at least $20 million under a Blast Furnace Gas Delivery Agreement in connection with DIG's purported failure to declare a Blast Furnace Gas Delivery Date within a reasonable time period, plus approximately $7 million for assorted damage claims under several legal theories. As part of this arbitration, DIG filed claims against Rouge and Ford, and Ford filed claims for unspecified amounts against DIG. In October 2003, Rouge filed bankruptcy under Chapter 11 of the United States Bankruptcy Code and as a result, the arbitration was subject to the automatic stay imposed by the Bankruptcy Code. OAO Severstal, which has acquired substantially all of Rouge's assets, has indicated it will continue operations at the Rouge site and will honor the contractual obligations to pay for the steam and electricity DIG and CMS MST Michigan L.L.C. provide. In January 2004, DIG and CMS MST Michigan L.L.C. entered into a settlement agreement with Ford and Rouge to resolve all outstanding claims between the parties, including the arbitration claims and DIG and CMS MST Michigan L.L.C.'s claims in the Rouge bankruptcy. The settlement was approved by the bankruptcy court. Under the settlement, Ford paid DIG $12 million cash and Rouge and Ford paid DIG and CMS MST Michigan L.L.C. a total of $3.8 million owed by Rouge for steam and electricity supplied to Rouge prior to the filing of the bankruptcy petition. DIG NOISE ABATEMENT LAWSUIT: In February 2003, DIG was served with a three-count first amended complaint filed in Wayne County Circuit Court in the matter of Ahmed, et al v. Dearborn Industrial Generation, LLC. The complaint seeks damages "in excess of $25,000" and injunctive relief based upon allegations of excessive noise and vibration created by operation of the power plant. The first amended complaint was filed on behalf of six named plaintiffs, all alleged to be adjacent or nearby resident or property owners. The damages alleged are injury to persons and property of the landowners. Certification of a class of "potentially thousands" who have been similarly affected is requested. DIG intends to defend this action aggressively but cannot predict the outcome of this matter. MCV EXPANSION, LLC: Under an agreement entered into with General Electric Company ("GE") in October 2002, MCV Expansion, LLC has a remaining contingent obligation to GE in the amount of $2.2 million that may become payable in the fourth quarter of 2004. The agreement provides that this contingent obligation is subject to a pro rata reduction under a formula based upon certain purchase orders being entered into with GE by June 30, 2003. MCV Expansion, LLC anticipates but cannot assure that purchase orders will be executed with GE sufficient to eliminate contingent obligations of $2.2 million. FORMER CMS OIL AND GAS OPERATIONS: A Michigan trial judge granted Star Energy, Inc. and White Pine Enterprises, LLC a declaratory judgment in an action filed in 1999 that claimed Terra Energy Ltd., a former CMS Oil and Gas subsidiary, violated an oil and gas lease and other arrangements by failing to drill wells it had committed to drill. A jury then awarded the plaintiffs a $7.6 million award. Terra appealed this matter to the Michigan Court of Appeals. The Michigan Court of Appeals reversed the trial court judgment with respect to the appropriate measure of damages and remanded the case for a new trial on damages. The trial judge reinstated the judgment against Terra and awarded Terra title to the minerals. CMS Energy will appeal this judgment. F-88 ARGENTINA ECONOMIC SITUATION: In January 2002, the Republic of Argentina enacted the Public Emergency and Foreign Exchange System Reform Act. This law repealed the fixed exchange rate of one U.S. dollar to one Argentine peso, converted all dollar-denominated utility tariffs and energy contract obligations into pesos at the same one-to-one exchange rate, and directed the President of Argentina to renegotiate such tariffs. Effective April 30, 2002, we adopted the Argentine peso as the functional currency for our Argentine investments. We had previously used the U.S. dollar as the functional currency for these investments. As a result, on April 30, 2002, we translated the assets and liabilities of our Argentine entities into U.S. dollars, in accordance with SFAS No. 52, using an exchange rate of 3.45 pesos per U.S. dollar, and recorded an initial charge to the Foreign Currency Translation component of Common Stockholders' Equity of approximately $400 million. While we cannot predict future peso-to-U.S. dollar exchange rates, we do expect that these non-cash charges reduce substantially the risk of further material balance sheet impacts when combined with anticipated proceeds from international arbitration currently in progress, political risk insurance, and the eventual sale of these assets. At December 31, 2003, the net foreign currency loss due to the unfavorable exchange rate of the Argentine peso recorded in the Foreign Currency Translation component of Common Stockholders' Equity using an exchange rate of 2.94 pesos per U.S. dollar was $264 million. This amount also reflects the effect of recording U.S. income taxes with respect to temporary differences between the book and tax basis of foreign investments, including the foreign currency translation associated with our Argentine investments, that were determined to no longer be essentially permanent in duration. OTHER: Certain CMS Gas Transmission and CMS Generation affiliates in Argentina received notice from various Argentine provinces claiming stamp taxes and associated penalties and interest arising from various gas transportation transactions. Although these claims total approximately $24 million, we believe the claims are without merit and will continue to contest them vigorously. CMS Generation does not currently expect to incur significant capital costs at its power facilities for compliance with current U.S. environmental regulatory standards. In addition to the matters disclosed in this Note, Consumers and certain other subsidiaries of CMS Energy are parties to certain lawsuits and administrative proceedings before various courts and governmental agencies arising from the ordinary course of business. These lawsuits and proceedings may involve personal injury, property damage, contractual matters, environmental issues, federal and state taxes, rates, licensing, and other matters. We have accrued estimated losses for certain contingencies discussed in this Note. Resolution of these contingencies is not expected to have a material adverse impact on our financial position, liquidity, or results of operations. F-89 5: FINANCINGS AND CAPITALIZATION CMS Energy's Long-term debt as of December 31 follows: INTEREST RATE (%) MATURITY 2003 2002 ---------------- -------- ---- ---- IN MILLIONS CMS ENERGY CORPORATION Senior notes............................... 6.750 2004 $ -- $ 287 7.625 2004 176 176 9.875 2007 468 468 8.900 2008 260 260 7.500 2009 409 409 7.750 2010 300 -- 8.500 2011 300 300 8.375 2013 -- 150 3.375(a) 2023 150 -- --------- --------- 2,063 2,050 --------- --------- General term notes: Series D................................. 6.938(b)(c) 2004-2008 65 94 Series E................................. 7.788(b)(c) 2004-2009 139 227 Series F................................ 7.487(b)(c) 2004-2016 292 298 --------- --------- 496 619 --------- --------- Extendible tenor rate adjusted securities... 7.000 2005 180 180 Revolving credit facilities and other....... 7 320 --------- ---------

Total -- CMS Energy Corporation........ 2,746 3,169 --------- --------- CONSUMERS ENERGY COMPANY First mortgage bonds........................ 4.250 2008 250 -- 4.800 2009 200 -- 4.000 2010 250 -- 5.375 2013 375 -- 6.000 2014 200 -- 7.375 2023 208 208 --------- --------- 1,483 208 --------- --------- Senior notes............................... 6.000 2005 300 300 6.250 2006 332 332 6.375 2008 159 159 6.200 2008 -- 250 6.875 2018 180 180 6.500(d) 2018 141 141 6.500(e) 2028 142 142 --------- --------- 1,254 1,504 --------- --------- Securitization bonds........................ 5.097(c) 2005-2015 426 453 Long-term bank debt........................ Variable 2006-2009 200 328 Nuclear fuel disposal liability............ (f) 139 138 Pollution control revenue bonds............ Various 2010-2018 126 126 Other...................................... 4 8 --------- --------- Total -- Consumers Energy Company...... 3,632 2,765 --------- --------- OTHER SUBSIDIARIES 191 84 --------- --------- Total principal amount outstanding............ 6,569 6,018 Current amounts............................ (509) (633) Net unamortized discount................... (40) (28) --------- --------- Total consolidated long-term debt............. $ 6,020 $ 5,357 ========= ========= (a) These notes are putable to CMS Energy by the note holders at par on July 15, 2008, July 15, 2013 and July 15, 2018, and are convertible at the holder's option into CMS Energy Common Stock at $10.671 per share under certain circumstances, none of which currently are probable to occur. CMS Energy intends to file a registration F-90 statement with the SEC by October 16, 2004, relating to the resale of the notes and the convertibility into common stock. (b) $29 million Series D, $112 million Series E, and $104 million Series F have been called and redeemed through February 15, 2004. (c) Represents the weighted average interest rate at December 31, 2003. (d) 2018 maturity is subject to successful remarketing by Consumers after June 15, 2005. (e) Callable at par. (f) Maturity date uncertain. LONG-TERM DEBT-RELATED PARTIES: Long-term debt-related parties as of December 31, 2003 follows: DEBENTURE AND RELATED PARTY INTEREST RATE MATURITY 2003 -- ----------------- ------------ ------ IN MILLIONS Convertible subordinated debentures, CMS Energy Trust I................. 7.75% 2027 $ 178 Subordinated deferrable interest notes, Consumers Power Company Financing I.. 8.36% 2015 73 Subordinated deferrable interest notes, Consumers Energy Company Financing II.. 8.20% 2027 124 Subordinated debentures, Consumers Energy Company Financing III.......... 9.25% 2029 180 Subordinated debentures, Consumers Energy Company Financing IV........... 9.00% 2031 129 ------ Total amount outstanding.. $ 684 ====== DEBT ISSUANCES: The following is a summary of long-term debt issuances during 2003: PRINCIPAL USE OF FACILITY TYPE (IN MILLIONS) ISSUE RATE ISSUE DATE MATURITY DATE PROCEEDS COLLATERAL ----------------------- ------------ ---------- ---------- ------------ -------- ---------- CMS ENERGY Senior notes(a)....... $ 150 3.375% July 2003 July 2023 (c) Unsecured Senior notes(b)....... 300 7.750% July 2003 August 2010 (c) Unsecured CONSUMERS ENERGY Term loan............. 140 LIBOR + March 2003 March 2009 GCP FMB(h) 475 bps Term loan............. 150 LIBOR + March 2003 March 2006 GCP FMB(h) 450 bps (paid off)(f) FMB(i)................ 375 5.375% April 2003 April 2013 (d) -- FMB(i)................ 250 4.250% April 2003 April 2008 (d) -- FMB(i)................ 250 4.000% May 2003 May 2010 (e) -- FMB(i)................ 200 4.800% August 2003 February 2009 (f) -- FMB(i)................ 200 6.000% August 2003 February 2014 (f) -- Term loan............. 60 LIBOR + November 2003 November 2006 (g) FMB(h) 135 bps ------- Total.......... $ 2,075 ======= (bps -- basis points), (GCP -- General corporate purposes) (a) These notes are putable to CMS Energy by the note holders at par on July 15, 2008, July 15, 2013 and July 15, 2018, and are convertible at the holder's option into CMS Energy Common Stock at $10.671 per share under certain circumstances, none of which currently are probable to occur. CMS Energy intends to file a registration statement with the SEC by October 16, 2004, relating to the resale of the notes and the convertibility into common stock. F-91 (b) CMS Energy intends to file a registration statement with the SEC by March 14, 2004, to permit note holders to exchange their securities for ones that will be registered under the Securities Act of 1933. (c) CMS Energy used the net proceeds to retire revolving debt and redeem a portion of a 6.75 percent Senior note due January 2004. (d) Consumers used the net proceeds to fund the maturity of a $250 million bond, to fund a $32 million option call payment, and for general corporate purposes. (e) Consumers used the net proceeds to prepay a portion of a term loan that was due to mature in July 2004. (f) Consumers used the net proceeds to pay off a $150 million term loan, to pay off $50 million balance on a term loan that was due to mature in July 2004, and for general corporate purposes. (g) Consumers used the net proceeds to purchase its headquarters building and pay off the capital lease. (h) Refer to "Regulatory Authorization for Financings" below for details about Consumers' FERC debt authorization. (i) Consumers filed a registration statement with the SEC in December 2003 to permit holders of these FMBs to exchange their bonds for FMBs that are registered under the Securities Act of 1933. The exchange offer was completed on February 13, 2004. DEBT

MATURITIES: The aggregate annual maturities for long-term debt for the next five years are: PAYMENTS DUE DECEMBER 31 ----------------------------------- 2004 2005 2006 2007 2008 ------- ------- ------- ------- ------ IN MILLIONS Long-term debt...... $ 509 $ 696 $ 490 $ 516 $ 987 DEBT COVENANT RESTRICTIONS: The indenture pursuant to our GTNs contains certain provisions that can trigger a limitation on our consolidated indebtedness. The limitation can be activated when our consolidated leverage ratio, as defined in the indenture (essentially the ratio of consolidated debt to consolidated capital), exceeds 0.75 to 1.0. At June 30 and September 30, 2003, our consolidated leverage ratio was 0.76 to 1.0. As a result, we were subject to certain debt limitations. At December 31, 2003, the ratio was 0.72 to 1, and we were no longer subject to the debt limitations. The indenture under which Senior notes are issued and certain other debt agreements contain provisions requiring us to maintain interest coverage ratios, and debt to earnings ratios. We were in compliance with these ratios, as defined, at December 31, 2003. CMS ENERGY CREDIT FACILITY: CMS Energy has a $185 million revolving credit facility with banks. This facility matures on May 21, 2005. This facility provides letter of credit support for Enterprises' subsidiary activities, principally credit support for project debt. Enterprises provides funds to cash collateralize the letters of credit issued through this facility. As of December 31, 2003, approximately $165 million of letters of credit were issued under this facility and the cash used to collateralize the letters of credit is included on the Consolidated Balance Sheet as Restricted cash. REGULATORY AUTHORIZATION FOR FINANCINGS: At December 31, 2003, Consumers had remaining FERC authorization to issue or guarantee up to $500 million of short-term securities and up to $700 million of short-term first mortgage bonds as collateral for such short-term securities. At December 31, 2003, Consumers had remaining FERC authorization to issue up to $740 million of long-term securities for refinancing or refunding purposes, $560 million of long-term securities for general corporate purposes, and $2 billion of long-term first mortgage bonds to be issued solely as collateral for other long-term securities. F-92 With the granting of authorization, FERC waived its competitive bid/negotiated placement requirements applicable to the long-term securities authorization. The authorizations expire on June 30, 2004. SHORT-TERM FINANCINGS: CMS Energy has a $190 million revolving credit facility with banks. The facility is secured by our investment in Enterprises and Consumers. The interest rate of the facility is LIBOR plus 325 basis points. This facility expires in November 2004. At December 31, 2003, all of the $190 million is available. Consumers has a $400 million revolving credit facility with banks. The facility is secured with first mortgage bonds. The interest rate of the facility is LIBOR plus 175 basis points. This facility expires in March 2004 with two annual extensions at Consumers' option, which would extend the maturity to March 2006. At December 31, 2003, $10 million of letters of credit are issued and outstanding under this facility and $390 million is available for general corporate purposes, working capital, and letters of credit. At December 31, 2002, Consumers had $457 million of bank notes outstanding at a weighted average interest rate of 4.50 percent. FIRST MORTGAGE BONDS: Consumers secures its first mortgage bonds by a mortgage and lien on substantially all of its property. Its ability to issue and sell securities is restricted by certain provisions in the first mortgage bond indenture, its articles of incorporation, and the need for regulatory approvals under federal law. POLLUTION CONTROL REVENUE BONDS: In January 2004, Consumers amended the PCRB indentures to add an auction rate interest mode and switched to that mode for the two floating rate bonds. Under the auction rate mode, the bonds' interest rate will be reset every 35 days. While in the auction rate mode, no letter of credit liquidity facility is required and investors do not have a put right. PREFERRED STOCK ISSUANCE: In December 2003, CMS Energy issued 5 million shares of 4.50 percent cumulative convertible preferred stock. Each share has a liquidation value of $50.00 and is convertible into CMS Energy common stock at the option of the holder under certain circumstances. The initial conversion price is $9.893 per share, which translates into 5.0541 shares of common stock for each share of preferred stock converted. The annual dividend of $2.25 per share is payable quarterly, in cash, in arrears commencing March 1, 2004. We used the net proceeds of $242 million to retire other long-term debt in January 2004 and February 2004. We have agreed to file a shelf registration with the SEC by November 5, 2004, covering resales of the preferred stock and of common stock issuable upon conversion of the preferred stock. SALE OF SUBSIDIARY INTEREST: In December 2003, we sold, in a private placement, a non-voting preferred interest in an indirect subsidiary of CMS Enterprises that owns certain gas pipeline and power generation assets. CMS Energy received $30 million for the preferred interest, of which $19 million has been recorded as an addition to other paid-in capital (deferred gain) and $11 million has been recorded as a preferred stock issuance. WARRANTS: We granted warrants to purchase 204,000 shares of our common stock to a third party and expensed $1 million in 2003. The warrants which are fully vested are exercisable for seven years at an exercise price of $8.25 per share. CAPITALIZATION: The authorized capital stock of CMS

Energy consists of 250 million shares of CMS Energy Common Stock and 10 million shares of CMS Energy Preferred Stock, $.01 par value. PREFERRED STOCK OF SUBSIDIARY: The follow table describes Consumers' Preferred Stock outstanding: OPTIONAL NUMBER OF SHARES REDEMPTION --------------- DECEMBER 31 SERIES PRICE 2003 2002 2003 2002 ---------------------------------- ------ ---------- ---- ---- ---- ---- IN MILLIONS PREFERRED STOCK Cumulative, $100 par value, authorized 7,500,000 shares, with no mandatory redemption...... $ 4.16 $ 103.25 68,451 68,451 $ 7 $ 7 4.50 110.00 373,148 373,148 37 37 ---- ---- TOTAL PREFERRED STOCK................ $ 44 $ 44 ==== ==== F-93 COMPANY-OBLIGATED MANDATORILY REDEEMABLE PREFERRED SECURITIES OF SUBSIDIARIES: CMS Energy and Consumers each formed various statutory wholly owned business trusts for the sole purpose of issuing preferred securities and lending the gross proceeds to the parent companies. The sole assets of the trusts are debentures of the parent company with terms similar to those of the preferred security. Summarized information for company-obligated mandatorily redeemable preferred securities is as follows: AMOUNT OUTSTANDING EARLIEST TRUST AND SECURITIES ---------------------- OPTIONAL DECEMBER 31 RATE 2003 2002 MATURITY REDEMPTION(B) --- ------ ---------- ----------- ------------ -------------- IN MILLIONS CMS Energy Trust I(c)........................ 7.75% $ -- (a) $ 173 2027 2001 CMS Energy Trust III......................... 7.25% -- (d) 220 2004 2003 Consumers Power Company Financing I, Trust Originated Preferred Securities............ 8.36% -- (a) 70 2015 2000 Consumers Energy Company Financing II, Trust Originated Preferred Securities............ 8.20% -- (a) 120 2027 2002 Consumers Energy Company Financing III, Trust Originated Preferred Securities............ 9.25% -- (a) 175 2029 2004 Consumers Energy Company Financing IV, Trust Preferred Securities....................... 9.00% -- (a) 125 2031 2006 ---- ------ Total amount outstanding..................... $ -- $ 883 ==== ====== -------- (a) We determined that we do not hold the controlling financial interest in our trust preferred security structures. Accordingly, those entities have been deconsolidated as of December 31, 2003. Company obligated Trust Preferred Securities totaling $663 million that were previously included in mezzanine equity, have been eliminated due to deconsolidation and are reflected in Long-term debt -- related parties. For additional details, see "Long-Term Debt -- Related Parties" within this Note and Note 17, Implementation of New Accounting Standards. (b) The trusts must redeem the securities at a liquidation value of $25 per share ($50 per share for QUIPS (c)), which is equivalent to the carrying cost, plus accrued but unpaid distributions when the securities are paid at maturity or upon any earlier redemption. Prior to an early redemption date, the securities could be redeemed at market value. (c) Represents 3,450,000 shares of Quarterly Income Preferred Securities (QUIPS) that are convertible into 1.2255 shares of CMS Energy Common Stock (equivalent to a conversion price of $40.80). Conversion is unlikely as of December 31, 2003, based on the market price of CMS Energy's Common Stock of $8.52. If conversion were to occur in the future, the securities would be converted into 4,227,975 shares of CMS Energy Common Stock. Effective July 2001, we can revoke the conversion rights if certain conditions are met. (d) In August 2003, 8,800,000 units of outstanding 7.25 percent Premium Equity Participating Security Units (CMS Energy Trust III) were converted to 16,643,440 newly issued shares of CMS Energy Common Stock. Each trust receives payments on the debenture it holds. Those receipts are used to make cash distributions on the preferred securities the trust has issued. The securities allow CMS Energy and Consumers the right to defer interest payment on the debentures, and, as a consequence, the trusts would defer dividend payments on the preferred securities. Should the parent companies exercise this right, they cannot declare or pay dividends on, or redeem, purchase or acquire, any of their capital stock during the deferral period until all deferred dividends are paid in full. In the event of default, holders of the preferred securities would be entitled to exercise and enforce the trusts' creditor rights against CMS Energy and Consumers, which may include acceleration of the principal amount due on the debentures. The parent companies have issued certain guarantees with respect to payments on the preferred securities. These guarantees, when taken together with each parent company's obligations under the debentures, F-94 related indenture and trust documents, provide full and unconditional guarantees for the trust's obligations under the preferred securities. SALE OF ACCOUNTS RECEIVABLE: Under a revolving accounts receivable sales program, we currently sell certain accounts receivable to a wholly owned, consolidated, bankruptcy remote special purpose entity. In turn, the special purpose entity may sell an undivided interest in up to $325 million of the receivables. The amounts sold were $297 million at December 31, 2003 and $325 million at December 31, 2002. The Consolidated Balance Sheets exclude these amounts from accounts receivable. We continue to service the receivables sold. The purchaser of the receivables has no recourse against our other assets for failure of a debtor to pay when due and the purchaser has no right to any receivables not sold. No gain or loss has been recorded on the receivables sold and we retain no interest in the receivables sold. Certain cash flows received from and paid to us under our accounts receivable sales program are shown below: YEARS ENDED DECEMBER 31 -------------------- 2003 2002 --------- --------- IN MILLIONS Proceeds from sales (remittance of collections) under the program.. $ (28) $ (9) Collections reinvested under the program................... 4,361 4,080 DIVIDEND RESTRICTIONS: Under the provisions of its articles of incorporation, at December 31, 2003, Consumers had $373 million of unrestricted retained earnings available to pay common dividends. However, covenants in Consumers' debt facilities cap common stock dividend payments at $300 million in a calendar year. Through December 31, 2003, we received the following common stock dividend payments from Consumers: IN MILLIONS January... $ 78 May.. 31 June... 53 November.. 56 ------ Total common stock dividends paid to CMS Energy........ $ 218 ====== As of December 18, 2003, Consumers is also under an annual dividend cap of $190 million imposed by the MPSC during the current interim gas rate relief period. Because all of the $218 million of common stock dividends to CMS Energy were paid prior to December 18, 2003, Consumers was not out of compliance with this new restriction for 2003. In February 2004, Consumers paid a $78 million common stock dividend. For additional details on the potential cap on common dividends payable included in the MPSC Securitization order, see Note 4, Uncertainties, "Consumers' Electric Utility Rate Matters -- Securitization." Also, for additional details on the cap on common dividends payable during the current interim gas rate relief period, see Note 4, Uncertainties, "Consumers' Gas Utility Rate Matters -- 2003 Gas Rate Case." FASB INTERPRETATION NO. 45, GUARANTOR'S ACCOUNTING AND DISCLOSURE REQUIREMENTS FOR GUARANTEES, INCLUDING INDIRECT GUARANTEES OF INDEBTEDNESS OF OTHERS: This interpretation became effective January 2003. It describes the disclosure to be made by a guarantor about its obligations under certain guarantees that it has issued. At the beginning of a guarantee, it requires a guarantor to recognize a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provision of this interpretation does not apply to some guarantee contracts, such as warranties, derivatives, or guarantees between either parent and subsidiaries or corporations under common control, although disclosure of these guarantees is required. For contracts that are within the recognition and measurement provision of this interpretation, the provisions were to be applied to guarantees issued or modified after December 31, 2002. F-95 The following table describe our guarantees at December 31, 2003: ISSUE EXPIRATION MAXIMUM CARRYING RECOURSE GUARANTEE DESCRIPTION DATE DATE OBLIGATION AMOUNT(b) PROVISION(c) -- ------- ---------- ---------- --------- ------------ IN MILLIONS Indemnifications from asset sales and other agreements(a)............................ Various Various $ 1,955 $ 3 $ -- Letters of credit.......................... Various Various 254 -- -- Surety bonds and other indemnifications..... Various Various 28 -- -- Other guarantees........................... Various Various 239 -- -- Nuclear insurance retrospective premiums.... Various Various 133 -- -- ------------ (a) The majority of this amount arises from routine provisions in stock and asset sales agreements under which we indemnify the purchaser for losses resulting from events such as failure of title to the assets or stock sold by us to the purchaser. Included in this amount is a $739 million indemnification obligation related to the sale of CMS Oil and Gas facilities in Equatorial Guinea which expired January 3, 2004, and for which no loss occurred. We believe the likelihood of a loss for any remaining indemnifications to be remote. (b) The carrying amount represents the fair market value of guarantees and indemnities on our balance sheet that are entered into subsequent to January 1, 2003. In addition, $25 million has been recorded prior to 2003 in accordance with SFAS No. 5. (c) Recourse provision indicates the approximate recovery from third parties including assets held as collateral. The following table provides additional information regarding our guarantees at December 31, 2003: EVENTS THAT WOULD GUARANTEE DESCRIPTION HOW GUARANTEE AROSE REQUIRE PERFORMANCE ------------------------------ ------------------------------ ----------------------------- Indemnifications from asset Stock and asset sales Findings of misrepresentation, sales and other agreements agreements breach of warranties, and other specific events or circumstances Standby letters of credit Normal operations of coal Noncompliance with power plants environmental regulations Self-insurance requirement Nonperformance Surety bonds Normal operating activity, Nonperformance permits and license Other guarantees Normal operating activity Nonperformance or non- payment by a subsidiary under the related contract Nuclear insurance Normal operations of nuclear Call by NEIL and Price retrospective premiums plants Anderson Act for nuclear incident We have entered into typical tax indemnity agreements in connection with a variety of transactions including transactions for the sale of subsidiaries and assets, equipment leasing, and financing agreements. These indemnity agreements generally are not limited in amount and, while a maximum amount of exposure cannot be identified, the amount and probability of liability is considered remote. F-96 We have guaranteed payment of obligations through letters of credit, indemnities, surety bonds, and other guarantees of unconsolidated affiliates and related parties of $521 million as of December 31, 2003. We monitor and approve these obligations and believe it is unlikely that we would be required to perform or otherwise incur any material losses associated with the above obligations. The off-balance sheet commitments expire as follows: COMMITMENT EXPIRATION -- DECEMBER 31 TOTAL 2004 2005 2006 2007 2008 BEYOND ----------------------------- -------- ------ ------ ------ ------ ------ -------- IN MILLIONS COMMERCIAL COMMITMENTS Off-balance sheet: Guarantees.......................... $ 239 $ 20 $ 36 $ 4 $ -- $ -- $ 179 Indemnities......................... 28 8 -- -- -- -- 20 Letters of Credit(a)................ 254 215 10 5 5 5 14 ------ ------ ----- ---- ---- ---- ------ Total.......................... $ 521 $ 243 $ 46 $ 9 $ 5 $ 5 $ 213 ====== ====== ===== ==== ==== ==== ====== (a) At December 31, 2003, we had $175 million of cash collateralized letters of credit and the cash used to collateralize the letters of credit is included in Restricted cash on the Consolidated Balance Sheets. 6: EARNINGS PER SHARE AND DIVIDENDS The following table presents the basic and diluted earnings per share computations. YEARS ENDED DECEMBER 31 ` ---------------------------------- RESTATED RESTATED 2003 2002 2001 -------- -------- -------- IN MILLIONS, EXCEPT PER SHARE AMOUNTS LOSS ATTRIBUTABLE TO COMMON STOCK: Loss from Continuing Operations - Basic....................... $ (43) $ (394) $ (327) Add conversion of Trust Preferred Securities (net of tax)............................... -- (a) -- (a) -- (a) -------- -------- -------- Loss from Continuing Operations - Diluted..................... $ (43) $ (394) $ (327) ======== ======== ======== AVERAGE COMMON SHARES OUTSTANDING APPLICABLE TO BASIC AND DILUTED EPS CMS Energy: Average Shares - Basic...................................... 150.4 139.0 130.7 Add conversion of Trust Preferred Securities................ -- (a) -- (a) -- (a) Stock Options and Warrants................................. -- (b) -- -- (b) -------- -------- -------- Average Shares - Diluted.................................... 150.4 139.0 130.7 ======== ======== ======== LOSS PER AVERAGE COMMON SHARE Basic $ (0.30) $ (2.84) $ (2.50) Diluted $ (0.30) $ (2.84) $ (2.50) (a) Due to antidilution, the computation of diluted earnings per share excluded the conversion of Trust Preferred Securities. (b) Due to antidilution, the computation of diluted earnings per share excluded shares of outstanding stock options and warrants of 0.3 million for the year ended 2003 and 0.2 million for the year ended 2001. F-97 In January 2003, the Board of Directors suspended the payment of common stock dividends. However, in 2002, we paid the following dividends per share: CMS ENERGY COMMON STOCK DIVIDENDS PER SHARE PAYOUT ------------------------- February.... $ 0.365 April....... $ 0.365 August...... $ 0.180 November.... $ 0.180 7: FINANCIAL AND DERIVATIVE INSTRUMENTS FINANCIAL INSTRUMENTS: The carrying amounts of cash, short-term investments, and current liabilities approximate their fair values because of their short-term nature. We estimate the fair values of long-term investments based on quoted market prices or, in the absence of specific market prices, on quoted market prices of similar investments or other valuation techniques. The carrying amount of all long-term financial instruments, except as shown below, approximate fair value. For additional details, see Note 1, Corporate Structure and Accounting Policies. DECEMBER 31 --- 2003 2002 ------------------------------ -------------------------------- FAIR UNREALIZED FAIR UNREALIZED COST VALUE GAIN (LOSS) COST VALUE GAIN -------- ------- ---------- -------- -------- ---------- IN MILLIONS Long-term debt(a)....................... $ 6,020 $ 6,225 $ (205) $ 5,357 $ 5,027 $ 330 Long-term debt-related parties(b)........ 684 648 36 -- -- -- Trust Preferred Securities(b)........... -- -- -- 883 704 179 Available for sale securities: Nuclear decommissioning(c).............. 442 575 133 458 536 78 SERP.................................... 54 66 12 54 57 3 (a) Settlement of long-term debt is generally not expected until maturity. (b) We determined that we do not hold the controlling financial interest in our trust preferred security structures. Accordingly, those entities have been deconsolidated as of December 31, 2003. Company obligated Trust Preferred Securities totaling $663 million that were previously included in mezzanine equity, have been eliminated due to deconsolidation and are reflected in Long-term debt -- related parties on the Consolidated Balance Sheets. For additional details, refer to Note 5, Financings and Capitalization, "Long-Term Debt -- Related Parties" and Note 17, Implementation of New Accounting Standards. In addition, company obligated Trust Preferred Securities totaling $220 million have been converted to Common Stock as of August 2003. (c) On January 1, 2003, we adopted SFAS No. 143 and began classifying our unrealized gains and losses on nuclear decommissioning investments as regulatory liabilities. We previously classified the unrealized gains and losses on these investments in accumulated depreciation. DERIVATIVE INSTRUMENTS: We are exposed to market risks including, but not limited to, changes in interest rates, commodity prices, currency exchange rates, and equity security prices. We manage these risks using established policies and procedures, under the direction of both an executive oversight committee consisting of senior management representatives and a risk committee consisting of business-unit managers. We may use various contracts to manage these risks including swaps, options, and forward contracts. We intend that any gains or losses on these contracts will be offset by an opposite movement in the value of the item at risk. We enter into all risk management contracts for purposes other than trading. These contracts contain credit risk if the counterparties, including financial institutions and energy marketers, fail to perform under the agreements. We minimize such risk by performing financial credit reviews using, among other things, publicly available credit ratings of such counterparties. F-98 Contracts used to manage interest rate, foreign currency, and commodity price risk may be considered derivative instruments that are subject to derivative and hedge accounting pursuant to SFAS No. 133. If a contract is accounted for as a derivative instrument, it is recorded in the financial statements as an asset or a liability, at the fair value of the contract. The recorded fair value of the contract is then adjusted quarterly to reflect any change in the market value of the contract, a practice known as marking the contract to market. The accounting for changes in the fair value of a derivative (that is, gains or losses) is reported either in earnings or accumulated other comprehensive income depending on whether the derivative qualifies for special hedge accounting treatment. For derivative instruments to qualify for hedge accounting under SFAS No. 133, the hedging relationship must be formally documented at inception and be highly effective in achieving offsetting cash flows or offsetting changes in fair value attributable to the risk being hedged. If hedging a forecasted transaction, the forecasted transaction must be probable. If a derivative instrument, used as a cash flow hedge, is terminated early because it is probable that a forecasted transaction will not occur, any gain or loss as of such date is immediately recognized in earnings. If a derivative instrument, used as a cash flow hedge, is terminated early for other economic reasons, any gain or loss as of the termination date is deferred and recorded when the forecasted transaction affects earnings. We use a combination of quoted market prices and mathematical valuation models to determine fair value of those contracts requiring derivative accounting. The ineffective portion, if any, of all hedges is recognized in earnings. The majority of our contracts are not subject to derivative accounting because they qualify for the normal purchases and sales exception of SFAS No. 133 or are not derivatives because there is not an active market for the commodity. Derivative accounting is required for certain contracts used to limit our exposure to electricity and gas commodity price risk and interest rate risk. The following table reflects the fair value of all contracts requiring derivative accounting: DECEMBER 31 -- 2003 2002 ------------------------------ ----------------------------- FAIR UNREALIZED FAIR UNREALIZED DERIVATIVE INSTRUMENTS COST VALUE GAIN (LOSS) COST VALUE GAIN (LOSS) -- ------ -------- ------------- ------ -------- ------------ IN MILLIONS Other than trading Electric-related contracts................ $ -- $ -- $ -- $ 8 $ 1 $ (7) Gas contracts............................ 3 2 (1) -- 1 1 Interest rate risk contracts.............. -- (3) (3) -- (28) (28) Derivative contracts associated with equity investments in: Shuweihat................................ -- (27) (27) -- (30) (30) Taweelah................................. -- (26) (26) -- (33) (33) MCV Partnership........................... -- 15 15 -- 13 13 Jorf Lasfar............................... -- (11) (11) -- (11) (11) Other.................................... -- 1 1 -- (2) (2) Trading Electric-related contracts................ (2) -- 2 -- 43 43 Gas contracts............................ -- 15 15 -- 38 38 The fair value of other than trading derivative contracts is included in either Other Assets or Other Liabilities on the Consolidated Balance Sheets. The fair value of trading derivative contracts is included in either Price Risk Management Assets or Price Risk Management Liabilities on the Consolidated Balance Sheets. The fair value of derivative contracts associated with our equity investment in the MCV Partnership is included in Investments -- Midland Cogeneration Venture Limited Partnership on the Consolidated Balance Sheets. Effective April 1, 2002, the MCV Partnership changed its accounting for derivatives. For additional details see Note 15, Summarized Financial Information of Significant Related Energy Supplier. The fair value of derivative contracts associated with other equity investments is included in Enterprises Investments on the Consolidated Balance Sheets. Cumulative Effect of Change in Accounting Principle: On January 1, 2001, upon initial adoption of the derivatives standard, we recorded a $10 million, net of tax, cumulative effect adjustment as an increase in accumulated other comprehensive income. This adjustment relates to the difference between the fair value and F-99 recorded book value of contracts related to gas call options, gas fuel for generation swap contracts, and interest rate swap contracts that qualified for hedge accounting prior to the initial adoption of SFAS No. 133 and our proportionate share of the effects of adopting SFAS No. 133 related to our equity investments in the MCV Partnership and Taweelah. Based on the initial transition adjustment of $21 million, net of tax, recorded in accumulated other comprehensive income at January 1, 2001, Consumers reclassified to earnings $12 million as a reduction to the cost of gas, $1 million as a reduction to the cost of power supply, $2 million as an increase in interest expense, and $8 million as an increase in other revenues for the twelve months ended December 31, 2001. CMS Energy recorded $12 million as an increase in interest expense during 2001, which includes the $2 million of additional interest expense at Consumers. The difference between the initial transition adjustment and the amounts reclassified to earnings represents an unrealized loss in the fair value of the derivative instruments since January 1, 2001, resulting in a decrease of accumulated other comprehensive income. We also recorded a $7 million, net of tax, cumulative effect adjustment as an increase to earnings. This adjustment relates to our proportionate share of the difference between the fair value and the recorded book value of interest rate swaps at Taweelah, and financial gas and supply contracts that were required to be accounted for as derivatives as of January 1, 2001. In June and December 2001, the FASB issued guidance that resolved the accounting for certain utility industry contracts. As a result, we recorded a $3 million, net of tax, cumulative effect adjustment as an unrealized loss, decreasing accumulated other comprehensive income, and on December 31, 2001, recorded an $11 million, net of tax, cumulative effect adjustment as a decrease to earnings. These adjustments relate to the difference between the fair value and the recorded book value of certain electric call option contracts. Effective, January 1, 2003, EITF Issue No. 98-10 was rescinded by EITF Issue No. 02-03 and as a result, only energy contracts that meet the definition of a derivative in SFAS No. 133 can be carried at fair value. The impact of this change was recognized as a cumulative effect of a change in accounting principle loss of $23 million, net of tax. For additional details regarding this loss see Note 17, Implementation of New Accounting Standards. ELECTRIC CONTRACTS: Our electric utility business uses purchased electric call option contracts to meet, in part, our regulatory obligation to serve. This obligation requires us to provide a physical supply of electricity to customers, to manage electric costs and to ensure a reliable source of capacity during peak demand periods. Certain of our electric capacity and energy contracts are not accounted for as derivatives due to the lack of an active energy market in the state of Michigan, as defined by SFAS No. 133, and the transportation costs that would be incurred to deliver the power under the contracts to the closest active energy market at the Cinergy hub in Ohio. If a market develops in the future, we may be required to account for these contracts as derivatives. The mark-to-market impact on earnings related to these contracts, particularly related to the PPA, could be material to the financial statements. Our electric business also uses gas option and swap contracts to protect against price risk due to the fluctuations in the market price of gas used as fuel for generation of electricity. These contracts are financial contracts that are used to offset increases in the price of potential gas purchases. These contracts do not qualify for hedge accounting. Therefore, we record any change in the fair value of these contracts directly in earnings as part of power supply costs. For the year ended December 31, 2003, the unrealized gain in accumulated other comprehensive income related to our proportionate share of the effects of derivative accounting related to our equity investment in the MCV Partnership is $10 million, net of tax. We expect to reclassify this gain, if this value remains, as an increase to earnings from equity method investees during the next 12 months. GAS CONTRACTS: Our gas utility business uses fixed price gas supply contracts, fixed price weather-based gas supply call options, fixed price gas supply call and put options, and other types of contracts, to meet our regulatory obligation to provide gas to our customers at a reasonable and prudent cost. Unrealized gains and losses associated with these options are reported directly in earnings as part of other income, and then directly offset in earnings and recorded on the balance sheet as a regulatory asset or liability. ENERGY TRADING ACTIVITIES: Through December 31, 2002, CMS MST's wholesale power and gas trading activities were accounted for under the mark-to-market method of accounting. Under mark-to-market accounting, F-100 energy-trading contracts are reflected at fair market value, net of reserves, with unrealized gains and losses recorded as an asset or liability in the Consolidated Balance Sheets. These assets and liabilities are affected by the timing of settlements related to these contracts, current-period changes from newly originated transactions and the impact of price movements. Changes in fair value are recognized as revenues in the Consolidated Statements of Income in the period in which the changes occur. The market prices we use to value our energy trading contracts reflect our consideration of, among other things, closing exchange and over-the-counter quotations. In certain contracts, long-term commitments may extend beyond the period in which market quotations for such contracts are available. Mathematical models are developed to determine various inputs into the fair value calculation including price and other variables that may be required to calculate fair value. Realized cash returns on these commitments may vary, either positively or negatively, from the results estimated through application of the mathematical model. We believe that our mathematical models use state-of-the-art technology, pertinent industry data, and prudent discounting in order to forecast certain elongated pricing curves. Market prices are adjusted to reflect the impact of liquidating our position in an orderly manner over a reasonable period of time under present market conditions. In connection with the market valuation of our energy trading contracts, we maintain reserves for credit risks based on the financial condition of counterparties. We also maintain credit policies that management believes minimize overall credit risk with regard to our counterparties. Determination of our counterparties' credit quality is based upon a number of factors, including credit ratings, disclosed financial condition, and collateral requirements. Where contractual terms permit, we employ standard agreements that allow for netting of positive and negative exposures associated with a single counterparty. Based on these policies, our current exposures, and our credit reserves, we do not anticipate a material adverse effect on our financial position or results of operations as a result of counterparty nonperformance. INTEREST RATE RISK CONTRACTS: We use interest rate swaps to hedge the risk associated with forecasted interest payments on variable-rate debt. Most of our interest rate swaps are designated as cash flow hedges. As such, we record any change in the fair value of these contracts in accumulated other comprehensive income unless the swaps are sold. For interest rate swaps that did not qualify for hedge accounting treatment, we record any change in the fair value of these contracts in earnings. As of December 31, 2003, we have recorded an unrealized loss of $1 million, net of tax, in accumulated other comprehensive income related to interest rate risk contracts accounted for as cash flow hedges. We expect to reclassify $1 million of this amount as a decrease to earnings during the next 12 months primarily to offset the variable-rate interest expense on hedged debt. We have entered into floating-to-fixed interest rate swap agreements to reduce the impact of interest rate fluctuations. The difference between the amounts paid and received under the swaps is accrued and recorded as an adjustment to interest expense over the term of the agreement. We were able to apply the shortcut method to all interest rate swaps that qualified for hedge accounting treatment; therefore, there was no ineffectiveness associated with these hedges. The following table reflects the outstanding floating-to-fixed interest rates swaps at year end: FLOATING TO FIXED NOTIONAL MATURITY FAIR INTEREST RATE SWAPS AMOUNT DATE VALUE -------------------------- -------- -------- ----- IN MILLIONS December 31, 2003.......... $ 28 2005-2006 $ (3) December 31, 2002.......... 493 2003-2007 (28) Notional amounts reflect the volume of transactions but do not represent the amount exchanged by the parties to the financial instruments. Accordingly, notional amounts do not necessarily reflect our exposure to credit or market risks. The weighted average interest rate associated with outstanding swaps was approximately 7.4 percent at December 31, 2003 and 4.0 percent at December 31, 2002. Certain equity method investees have issued interest rate swaps and similar instruments to hedge the risk associated with variable-rate debt. These instruments are not included in this analysis, but can have an impact on financial results. The accounting for these instruments depends on whether they qualify for cash flow hedge F-101 accounting treatment. The interest rate derivatives held by Taweelah and certain interest rate swaps held by Shuweihat do not qualify as cash flow hedges, and therefore, we record our proportionate share of the change in the fair value of these contracts in Earnings from Equity Method Investees. The remainder of these instruments do qualify as cash flow hedges, and we record our proportionate share of the change in the fair value of these contracts in accumulated other comprehensive income. See discussion of these instruments in Note 18, Restatement and Reclassification. FOREIGN EXCHANGE DERIVATIVES: We may use forward exchange and option contracts to hedge certain receivables, payables, long-term debt, and equity value relating to foreign investments. The purpose of our foreign currency hedging activities is to protect the company from the risk associated with adverse changes in currency exchange rates that could affect cash flow materially. These contracts would not subject us to risk from exchange rate movements because gains and losses on such contracts offset losses and gains, respectively, on assets and liabilities being hedged. There were no outstanding foreign exchange contracts at December 31, 2003. The notional amount of the outstanding foreign exchange contracts at December 31, 2002 was $1 million Canadian. The estimated fair value of the foreign exchange and option contracts at December 31, 2002 was zero. As of December 31, 2003, Taweelah, one of our equity method investees, held a foreign exchange contract that hedged the foreign currency risk associated with payments to be made under an operating and maintenance service agreement. This contract did not qualify as a cash flow hedge, and therefore, we record our proportionate share of the change in the fair value of the contract in Earnings from Equity Method Investees. 8: INCOME TAXES CMS Energy and its subsidiaries file a consolidated federal income tax return. Income taxes generally are allocated based on each company's separate taxable income. We practice deferred tax accounting for temporary differences in accordance with SFAS No. 109, Accounting for Income Taxes. U.S. income taxes are not recorded on the undistributed earnings of foreign subsidiaries that have been or are intended to be reinvested indefinitely. Upon distribution, those earnings may be subject to both U.S. income taxes (adjusted for foreign tax credits or deductions) and withholding taxes payable to various foreign countries. We annually determine the amount of undistributed foreign earnings that we expect will remain invested indefinitely in foreign subsidiaries. Cumulative undistributed earnings of foreign subsidiaries for which income taxes have not been provided totaled approximately $106 million at December 31, 2003. It is impractical to estimate the amount of unrecognized deferred income taxes or withholding taxes on these undistributed earnings. Also, at December 31, 2003 and 2002, we recorded U.S. income taxes with respect to temporary differences between the book and tax bases of foreign investments that were determined to be no longer essentially permanent in duration. The Job Creation and Worker Assistance Act of 2002 provided corporate taxpayers a 5-year carryback of tax losses incurred in 2001 and 2002. As a result of this legislation, we carried back consolidated 2001 and 2002 tax losses to tax years 1996 through 1999 to obtain refunds totaling $250 million. The tax loss carryback, however, resulted in a reduction in AMT credit carryforwards that previously had been recorded as deferred tax assets in the amount of $47 million. This non-cash reduction in AMT credit carryforwards was reflected in our tax provision in 2002. We use ITC to reduce current income taxes payable, and amortize ITC over the life of the related property. AMT paid generally becomes a tax credit that we can carry forward indefinitely to reduce regular tax liabilities in future periods when regular taxes paid exceed the tax calculated for AMT. At December 31, 2003, we had AMT credit carryforwards in the amount of $214 million that do not expire, tax loss carryforwards in the amount of $1.151 billion that expire from 2021 through 2023. In addition, we had capital loss carryforwards in the amount of $29 million that expire in 2007, and general business credit carryforwards in the amount of $42 million that primarily expire in 2005, for which valuation allowances have been provided. During the fourth quarter of 2000, we wrote down the value of our investment in Loy Yang by $329 million ($268 million after-tax). We have now concluded the tax benefit associated with the write-down should have been F-102 reduced by $38 million. Accordingly, retained earnings as of January 1, 2001 have been reduced by this amount. For additional details, see Note 18, Restatement and Reclassification. The significant components of income tax expense (benefit) on continuing operations consisted of: YEARS ENDED DECEMBER 31 ---------------------------------- RESTATED RESTATED 2003 2002 2001 ------ ------- -------- IN MILLIONS Current income taxes: Federal.................... $ (17) $ (171) $ (209) State and local........... 1 (8) 6 Foreign................... 17 28 8 ------ ------- -------- $ 1 $ (151) $ (195) Deferred income taxes Federal................... $ 54 $ 107 $ 97 State..................... 4 7 3 Foreign................... 5 2 8 ------ ------- -------- $ 63 $ 116 $ 108 Deferred ITC, net........... (6) (6) (7) ------ ------- -------- Tax expense (benefit)........ $ 58 $ (41) $ (94) ====== ======= ======== The principal components of deferred tax assets (liabilities) recognized in the consolidated balance sheet are as follows: DECEMBER 31 ----------------------- RESTATED 2003 2002 ---------- ---------- IN MILLIONS Property... $ (842) $ (814) Securitization costs............................. (186) (192) Prepaid pension.................................. (136) -- Unconsolidated investments....................... (254) 55 Postretirement benefits.......................... (70) (72) Gas inventories.................................. (100) (74) Employee benefit obligations..................... 130 265 Tax credit carryforwards......................... 255 247 Tax loss carryforwards........................... 413 190 Valuation allowances............................. (54) (4) Regulatory liabilities........................... 120 115 Other, net....................................... 82 (169) ---------- ---------- Net deferred tax liabilities................... $ (642) $ (453) ========== ========== Deferred tax liabilities......................... $ (1,581) $ (1,339) Deferred tax assets, net of valuation reserves.... 939 886 ---------- ---------- Net deferred tax liabilities................... $ (642) $ (453) ========== ========== F-103 The actual income tax expense (benefit) on continuing operations differs from the amount computed by applying the statutory federal tax rate of 35 percent to income before income taxes as follows: YEARS ENDED DECEMBER 31 -------------------------------- RESTATED RESTATED 2003 2002 2001 ------- ------- ------- IN MILLIONS Income (loss) from continuing operations before income taxes and minority interests Domestic.. $ (73) $ (527) $ (320) Foreign... 88 94 (108) ------- ------- ------- Total... 15 (433) (428) Statutory federal income tax rate................................ x 35% x 35% x 35% ------- ------- ------- Expected income tax expense (benefit)............................ 5 (152) (150) Increase (decrease) in taxes from: Property differences.. 18 18 23 Income tax effect of foreign investments....................... (18) 47 52 Tax credits... (6) 51 (8) State and local income taxes, net of federal benefit........... -- (7) 3 Tax return accrual adjustments................................. (1) (7) (4) Minority interests... -- (5) (9) Valuation allowance provision (reversal)....................... 50 -- (1) Other, net... 10 14 -- ------- ------- ------- Recorded income tax expense (benefit)(a)......................... $ 58 $ (41) $ (94) ------- -------

------- Effective tax rate(b)... (b) 9.5% 22.0% ======= ======= ======= (a) The increased income tax expense for 2003 is primarily attributable to the valuation reserve provisions for the possible loss of general business credit, capital loss, and charitable contributions carryforwards. (b) Because of the small size of the net income in 2003, the effective tax rate is not meaningful. Changes in the effective tax rate in 2002 from 2001 resulted principally from the reduction in AMT credit carryforwards and the recording of U.S. taxes on undistributed earnings and basis differences of foreign subsidiaries. 9: EXECUTIVE INCENTIVE COMPENSATION We provide a Performance Incentive Stock Plan to key management employees based on their contributions to the successful management of the Company. The Plan includes the following type of awards for common stock: - restricted shares of common stock, - stock options, and - stock appreciation rights. Restricted shares of common stock are outstanding shares with full voting and dividend rights. These awards vest over five years at the rate of 25 percent per year after two years. Some restricted shares are subject to achievement of specified levels of total shareholder return and are subject to forfeiture if employment terminates before vesting. Restricted shares vest fully if control of CMS Energy changes, as defined by the plan. Stock options give the holder the right to purchase common stock at a given price over an extended period of time. Stock appreciation rights give the holder the right to receive common stock appreciation, which is defined as the excess of the market price of the stock at the date of exercise over the grant date price. Our stock options and stock appreciation rights are valued at market price when granted. All options and rights may be exercised upon grant and they expire up to ten years and one month from the date of grant. F-104 Our Performance Incentive Stock Plan was amended in January 1999. It uses the following formula to grant awards: - Up to five percent of our common stock outstanding at January 1 each year less: - the number of shares of restricted common stock awarded, and - common stock subject to options granted under the plan during the immediately preceding four calendar years. - the number of shares of restricted common stock awarded under this plan cannot exceed 20 percent of the aggregate number of shares reserved for awards, and - forfeiture of shares previously awarded will increase the number of shares available to be awarded under the plan. Awards of up to 2,240,247 shares of CMS Energy Common Stock may be issued as of December 31, 2003. The following table summarizes the restricted stock and stock options granted to our key employees under the Performance Incentive Stock Plan: RESTRICTED STOCK OPTIONS ---------- -------------------------------- NUMBER OF NUMBER OF WEIGHTED AVERAGE SHARES SHARES EXERCISE PRICE ---------- ---------- ---------------- CMS ENERGY COMMON STOCK Outstanding at January 1, 2001........... 786,427 3,058,186 $ 31.47 Granted............................... 266,500 1,036,000 $ 30.21 Exercised or Issued................... (82,765) (150,174) $ 19.11 Forfeited or Expired.................. (182,177) (31,832) $ 35.10 ---------- ---------- -------- Outstanding at December 31, 2001......... 787,985 3,912,180 $ 31.58 Granted............................... 512,726 1,492,200 $ 15.64 Exercised or Issued................... (116,562) (39,600) $ 17.07 Forfeited or Expired.................. (225,823) (243,160) $ 28.91 ---------- ---------- -------- Outstanding at December 31, 2002......... 958,326 5,121,620 $ 27.18 Granted............................... 600,000 1,593,000 $ 6.35 Exercised or Issued................... (80,425) (8,000) $ 8.12 Forfeited or Expired.................. (213,873) (885,044) $ 28.66 ---------- ---------- -------- Outstanding at December 31, 2003......... 1,264,028 5,821,576 $ 21.27 ========== ========== ======== At December 31, 2003, 186,522 of the 1,264,028 shares of restricted common stock outstanding are subject to performance objectives. Compensation expense included in income for restricted stock was $2 million for 2003, less than $1 million in 2002, and $1 million in 2001. The following table summarizes our stock options outstanding at December 31, 2003: NUMBER OF SHARES WEIGHTED AVERAGE WEIGHTED AVERAGE OUTSTANDING REMAINING LIFE EXERCISE PRICE ----------- ------------- ------------- RANGE OF EXERCISE PRICES CMS ENERGY COMMON STOCK: $6.35 -- $8.12......................... 2,144,500 9.45 years $ 6.81 $17.00 -- $22.20...................... 1,268,450 6.83 years $ 20.13 $22.69 -- $31.04...................... 1,150,122 5.78 years $ 29.74 $34.80 -- $44.06...................... 1,258,504 4.92 years $ 39.32 --------- --------- -------- $6.35 -- $44.06....................... 5,821,576 7.17 years $ 21.27 The number of stock options exercisable was 5,795,145 at December 31, 2003, 5,007,329 at December 31, 2002 and 3,760,883 at December 31, 2001. In December 2002, we adopted the fair value based method of accounting for stock-based employee compensation, under SFAS No. 123, as amended by SFAS No. 148. We elected to adopt the prospective method F-105 recognition provisions of this Statement, which applies the recognition provisions to all awards granted, modified, or settled after the beginning of the fiscal year that the recognition provisions are first applied. The following table summarizes the weighted average fair value of stock options granted: OPTIONS GRANT DATE 2003 2002(A) 2001 ------------------------- ------------------- ------ Fair value at grant date..... $ 2.96 $3.84, $1.44 $ 6.43 (a) For 2002, there were two stock option grants. The stock options fair value is estimated using the Black-Scholes model, a mathematical formula used to value options traded on securities exchanges. The following assumptions were used in the Black-Scholes model: YEARS ENDED DECEMBER 31 2003 2002(A) 2001 --- -------- ---------------------------------- CMS ENERGY COMMON STOCK OPTIONS Risk-free interest rate.......................... 3.02% 3.95%, 3.16% 4.77% Expected stock price volatility.................. 55.46% 32.44%, 40.81% 30.59% Expected dividend rate........................... -- $ 0.365, $ 0.1825 $ 0.365 Expected option life (years)..................... 4.2 4.2 4.2 4.2 (a) For 2002, there were two stock option grants. We recorded $5 million as stock-based employee compensation cost for 2003 and $4 million for 2002. All stock options vest at date of grant. If stock-based compensation costs had been determined under SFAS No. 123 for the year ended December 31, 2001, consolidated net loss and pro forma net loss would have been as follows: YEARS ENDED DECEMBER 31 ------------------------------- RESTATED 2001 ------------------------------- NET LOSS BASIC DILUTED -------- -------- ------- IN MILLIONS, EXCEPT PER SHARE AMOUNTS Net loss, as reported... $ (459) $ (3.51) $ (3.51) Add: Stock-based employee compensation expense included in reported net loss, net of related taxes......................... -- -- -- Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related taxes (4) (0.03) (0.03) ------- -------- -------- Pro forma net loss.. $ (463) $ (3.54) $ (3.54) ======= ======== ======== 10: RETIREMENT BENEFITS We provide retirement benefits to our employees under a number of different plans, including: - non-contributory, defined benefit Pension Plan, - a cash balance pension plan for certain employees hired after June 30, 2003, - benefits to certain management employees under SERP, - health care and life insurance benefits under OPEB, - benefits to a select group of management under EISP, and - a defined contribution 401(k) plan. Pension Plan: The Pension Plan includes funds for all of our employees, and the employees of our subsidiaries, including Panhandle. The Pension Plan's assets are not distinguishable by company. F-106 In June 2003, we sold Panhandle to Southern Union Panhandle Corp. No portion of the Pension Plan assets were transferred with the sale and Panhandle employees are no longer eligible to accrue additional benefits. The Pension Plan retained pension payment obligations for Panhandle employees that were vested under the Pension Plan. The sale of Panhandle resulted in a significant change in the makeup of the Pension Plan. A remeasurement of the obligation was required at the date of sale. The remeasurement further resulted in the following: - an increase in OPEB expense of $4 million for 2003, and - an additional charge to accumulated other comprehensive income of $34 million ($22 million after-tax) as a result of the increase in the additional minimum pension liability. Due to large contributions, the additional minimum pension liability was eliminated as of December 31, 2003. Additionally, a significant number of Panhandle employees elected to retire as of July 1, 2003 under the CMS Energy Employee Pension Plan. As a result, we have recorded a $25 million ($16 million after-tax) settlement loss, and a $10 million ($7 million after-tax) curtailment gain, pursuant to the provisions of SFAS No. 88, which is reflected in discontinued operations. In 2003, a substantial number of non-Panhandle retiring employees also elected a lump sum payment instead of receiving pension benefits as an annuity over time. Lump sum payments constitute a settlement under SFAS No. 88. A settlement loss must be recognized when the cost of all settlements paid during the year exceeds the sum of the service and interest costs for that year. We recorded settlement loss of $59 million ($39 million after-tax) in December 2003. SERP: SERP benefits are paid from a trust established in 1988. SERP is not a qualified plan under the Internal Revenue Code; SERP trust earnings are taxable and trust assets are included in consolidated assets. Trust assets were $66 million at December 31, 2003, and $57 million at December 31, 2002. The assets are classified as other non-current assets. The Accumulated Benefit Obligation for SERP was $62 million at December 31, 2003 and $54 million at December 31, 2002. OPEB: Retiree health care costs at December 31, 2003 are based on the assumption that costs would increase 8.5 percent in 2003. The rate of increase is expected to be 7.5 percent for 2004. The rate of increase is expected to slow to an estimated 5.5 percent by 2010 and thereafter. The health care cost trend rate assumption significantly affects the estimated costs recorded. A one-percentage point change in the assumed health care cost trend assumption would have the following effects: ONE PERCENTAGE ONE PERCENTAGE POINT INCREASE POINT DECREASE ------------- ------------- IN MILLIONS Effect on total service and interest cost component... $ 15 $ (12) Effect on postretirement benefit obligation........... $ 149 $ (129) We adopted SFAS No. 106, effective as of the beginning of 1992. Consumers recorded a liability of $466 million for the accumulated transition obligation and a corresponding regulatory asset for anticipated recovery in utility rates (see Note 1, Corporate Structure and Accounting Policies, "Utility Regulation.") The MPSC authorized recovery of the electric utility portion of these costs in 1994 over 18 years and the gas utility portion in 1996 over 16 years. EISP: We implemented an EISP in 2002 to provide flexibility in separation of employment by officers, a select group of management, or other highly compensated employees. Terms of the plan may include payment of a lump sum, payment of monthly benefits for life, payment of premium for continuation of health care, or any other legally permissible term deemed to be in our best interest to offer. EISP expense was $1 million in 2003 and $2 million in 2002. As of December 31, 2003, the Accumulated Benefit Obligation of the EISP was $3 million. The measurement date for all plans is December 31. F-107 Assumptions: The following table recaps the weighted-average assumptions used in our retirement benefits plans to determine benefit obligations and net periodic benefit cost: YEARS ENDED DECEMBER 31 -- PENSION & SERP OPEB ------------------------ ----------------------- 2003 2002 2001 2003 2002 2001 -------- ------- -------- -------- -------- ------ Discount rate........................... 6.25% 6.75% 7.25% 6.25% 6.75% 7.25% Expected long-term rate of return on plan assets(a)............................. 8.75% 8.75% 9.75% Union................................ 8.75% 8.75% 9.75% Non-Union............................. 6.00% 6.00% 6.00% Rate of compensation increase: Pension............................... 3.25% 3.50% 5.25% SERP.................................. 5.50% 5.50% 5.50% (a) We determine our long-term rate of return by considering historical market returns, the current and future economic environment, the capital market principles of risk and return, and the expertise of individuals and firms with financial market knowledge. We use the asset allocation of the portfolio to forecast the future expected total return of the portfolio. The goal is to determine a long-term rate of return that can be incorporated into the planning of future cash flow requirements in conjunction with the change in the liability. The use of forecasted returns for various classes of assets used to construct an expected return model is reviewed periodically for reasonability and appropriateness. Costs: The following table recaps the costs incurred in our retirement benefits plans: YEARS ENDED DECEMBER 31 -- PENSION & SERP OPEB ------------------------ ----------------------- 2003 2002 2001 2003 2002 2001 ------- ------- ------- ------- ------- ------ IN MILLIONS Service cost...................................... $ 40 $ 44 $ 39 $ 21 $ 20 $ 16 Interest expense.................................. 79 89 88 66 69 62 Expected return on plan assets..................... (81) (103) (98) (42) (43) (41) Plan amendments................................... -- 4 -- -- -- -- Curtailment credit................................ (2) -- -- (8) -- -- Settlement charge................................. 84 -- -- -- -- -- Amortization of: Net transition (asset).......................... -- -- (5) -- -- -- Prior service cost............................... 7 8 8 (7) (1) (1) Other... 9 (1) (1) 19 10 1 ------ ------- ----- ----- ----- ----- Net periodic pension and postretirement benefit cost $ 136 $ 41 $ 31 $ 49 $ 55 $ 37 ====== ======= ===== ===== ===== ===== Plan Assets: The following table recaps the categories of plan assets in our retirement benefits plans: YEARS ENDED DECEMBER 31 ------------------------------- PENSION OPEB --------------- -------------- 2003 2002 2003 2002 -------- ------- -------- ------ Asset Category: Fixed Income.......................... 52% 32%(b) 51% 55% Equity Securities..................... 44% 60% 48% 44% CMS Energy Common Stock(a).......... 4% 8% 1% 1% (a) At December 31, 2003, there were 4,970,000 shares of CMS Energy Common Stock in the Pension Plan assets with a fair value of $42 million, and 414,000 shares in the OPEB plan assets with a fair value of $4 million. At December 31, 2002, there were 5,099,000 shares of CMS Energy Common Stock in the Pension Plan assets with a fair value of $48 million, and 284,000 shares in the OPEB plan assets with a fair value of $3 million. F-108 (b) At February 29, 2004, the Pension Plan assets were 66 percent equity, 34 percent fixed income. We plan to contribute $72 million to our OPEB plan in 2004. We estimate a contribution of $26 million to our Pension Plan in 2004. We have established a target asset allocation for our Pension Plan assets of 65 percent equity and 35 percent fixed income investments to maximize the long-term return on plan assets, while maintaining a prudent level of risk. The level of acceptable risk is a function of the liabilities of the plan. Equity investments are diversified mostly across the Standard & Poor's 500 Index, with a lesser allocation to the Standard & Poor's Mid Cap and Small Cap Indexes and a Foreign Equity Index Fund. Fixed income investments are diversified across investment grade instruments of both government and corporate issuers. Annual liability measurements, quarterly portfolio reviews, and periodic asset/liability studies are used to evaluate the need for adjustments to the portfolio allocation. We have established union and non-union VEBA trusts to fund our future retiree health and life insurance benefits. These trusts are funded through the rate making process for Consumers, and through direct contributions from the non-utility subsidiaries. The equity portions of the union and non-union health care VEBA trusts are invested in an Standard & Poor's 500 Index fund. The fixed income portion of the union health care VEBA trust is invested in domestic investment grade taxable instruments. The fixed income portion of the non-union health care VEBA trust is invested in a diversified mix of domestic tax-exempt securities. The investment selections of each VEBA are influenced by the tax consequences, as well as the objective of generating asset returns that will meet the medical and life insurance costs of retirees. Reconciliations: The following table reconciles the funding of our retirement benefit plans with our retirement benefit plans' liability: YEARS ENDED DECEMBER 31 -- PENSION PLAN SERP OPEB ------------------ ---------------- ---------------- 2003 2002 2003 2002 2003 2002 -------- -------- -------- -------- -------- ------ IN MILLIONS Benefit obligation January 1...................... $ 1,256 $ 1,195 $ 81 $ 73 $ 982 $ 956 Service cost.................................... 38 40 2 4 21 20 Interest cost................................... 74 84 5 5 66 69 Plan amendment.................................. (19) 3 -- -- (47) (64) Actuarial loss (gain)............................ 55 72 (10) 1 91 41 Business combinations............................ -- -- -- -- (42) -- Benefits paid.................................... (215) (138) (2) (2) (42) (40) -------- -------- ------ ------ -------- ------ Benefit obligation December 31(a)................ 1,189 1,256 76 81 1,029 982 -------- -------- ------ ------ -------- ------ Plan assets at fair value at January 1........... 607 845 -- -- 508 508 Actual return on plan assets..................... 115 (164) -- -- 75 (43) Company contribution............................ 560 64 2 2 76 83 Actual benefits paid............................ (215) (138) (2) (2) (41) (40) -------- -------- ------ ------ -------- ------ Plan assets at fair value at December 31.......... 1,067 607 -- -- 618 508 -------- -------- ------ ------ -------- ------ Benefit obligation in excess of plan assets....... (122) (649) (76) (81) (411) (474) Unrecognized net loss from experience different than assumed.................................. 501 573 3 13 313 313 Unrecognized prior service cost (benefit)......... 29 60 1 1 (112) (77) Panhandle adjustment........................... -- (7) -- -- -- -- -------- -------- ------ ------ -------- ------ Net Balance Sheet Asset (Liability)............. 408 (23) (72) (67) (210) (238) Additional minimum liability adjustment(b)...... -- (426) -- -- -- -- -------- -------- ------ ------ -------- ------ Total Net Balance Sheet Asset (Liability)..... $ 408 $ (449) $ (72) $ (67) $ (210) $ (238) ======== ======== ====== ====== ======== ====== F-109 (a) The Medicare Prescription Drug, Improvement and Modernization Act of 2003 was signed into law in December 2003. This Act establishes a prescription drug benefit under Medicare (Medicare Part D), and a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is actuarially equivalent to Medicare Part D. Accounting guidance for the subsidy is not yet available, therefore, we have decided to defer recognizing the effects of the Act in our 2003 financial statements, as permitted by FASB Staff Position No. 106-1. When accounting guidance is issued, our retiree health benefit obligation may be adjusted. (b) The Pension Plan's Accumulated Benefit Obligation of $1.055 billion exceeded the value of the Pension Plan assets and net balance sheet liability at December 31, 2002. As a result, we recorded an additional minimum liability, including an intangible asset of $53 million, and $373 million of accumulated other comprehensive income. In August 2003, we made our planned contribution of $210 million to the Pension Plan. In December 2003, we made an additional contribution of $350 million to the Pension Plan that eliminated the additional minimum liability. The Accumulated Benefit Obligation for the pension plan was $1.019 billion at December 31, 2003. Defined Contribution 401(k) Plan: Our matching contributions to the 401(k) plan are invested in CMS Energy Common Stock. Amounts charged to expense for this plan were $12 million in 2002, and $26 million in 2001. Effective September 1, 2002, our match for the 401(k) plan was suspended. 11: LEASES We lease various assets including vehicles, railcars, construction equipment, an airplane, computer equipment, and buildings. We have both full-service and net leases. A net lease requires us to pay for taxes, maintenance, operating costs, and insurance. Most of our leases contain options at the end of the initial lease term to: - purchase the asset at the then fair value of the asset, or - renew the lease at the then fair rental value. Minimum annual rental commitments under our non-cancelable leases at December 31, 2003 were: CAPITAL LEASES OPERATING LEASES ----------------------------- IN MILLIONS 2004... $ 13 $ 12 2005... 12 10 2006... 12 10 2007... 11 9 2008... 9 7 2009 and thereafter............................. 21 30 ----- ----- Total minimum lease payments..................... 78 $ 78 ===== Less imputed interest........................... 10 ----- Present value of net minimum lease payments...... 68 Less current portion............................ 10 ----- Non-current portion............................ $ 58 ===== Consumers is authorized by the MPSC to record both capital and operating lease payments as operating expense and recover the total cost from our customers. Operating lease charges were $14 million in 2003, $13 million in 2002, and $15 million in 2001. Capital lease expenses were $17 million in 2003, $20 million, in 2002 and $26 million in 2001. Included in the $26 million for 2001 is $7 million of nuclear fuel lease expense. In November 2001, our nuclear fuel capital leasing arrangement expired. At termination of the lease, we paid the lessor $48 million, which was the lessor's remaining investment at that time. F-110 In April 2001, we entered into a lease agreement for the construction of an office building to be used as the main headquarters for CMS Energy and Consumers in Jackson, Michigan. In November 2003, we exercised our purchase option under the lease agreement and bought the office building with proceeds from a $60 million term loan.

12: JOINTLY OWNED REGULATED UTILITY FACILITIES We are required to provide only our share of financing for the jointly owned utility facilities. The direct expenses of the jointly owned plants are included in operating expenses. Operation, maintenance, and other expenses of these jointly owned utility facilities are shared in proportion to each participant's undivided ownership interest. The following table indicates the extent of our investment in jointly owned regulated utility facilities: DECEMBER 31 -- NET ACCUMULATED CONSTRUCTION INVESTMENT DEPRECIATION WORK IN PROGRESS ----------- ------------ --------------- 2003 2002 2003 2002 2003 2002 ---- ---- ---- ---- ---- ---- IN MILLIONS Campbell Unit 3 -- 93.3 percent....... $ 299 $ 298 $ 328 $ 313 $ 113 $ 111 Ludington -- 51 percent.............. 84 83 87 85 (1) 2 Distribution -- various.............. 74 77 32 31 5 4 13: EQUITY METHOD INVESTMENTS Where ownership is more than 20 percent but less than a majority, we account for certain investments in other companies, partnerships and joint ventures by the equity method of accounting in accordance with APB Opinion No. 18. The most significant of these investments is our 50 percent interest in Jorf Lasfar, and our 49 percent interest in the MCV Partnership (Note 15). Our investment in Jorf Lasfar is $256 million at December 31, 2003 and $240 million at December 31, 2002. Net income from these investments included undistributed earnings of $41 million in 2003 and $39 million in 2002 and distributions in excess of earnings of $68 million in 2001. Summarized financial information of the MCV Partnership is disclosed separately in Note 15, Summarized Financial Information of Significant Related Energy Supplier. Listed below is the summarized income and balance sheet information for these investments. INCOME STATEMENT DATA YEAR ENDED DECEMBER 31, --- 2003 -- JORF SCP ALL LASFAR FMLP TAWEELAH INVESTMENTS OTHERS TOTAL ------ ---- -------- ---------- ------ ----- IN MILLIONS Operating revenue............ $ 369 $ 79 $ 99 $ 74 $ 1,135 $ 1,756 Operating expenses........... 191 4 38 18 1,006 1,257 ----- ----- ----- ---- ------- ------- Operating income............. 178 75 61 56 129 499 Other expense, net........... 58 43 18 25 35 179 ----- ----- ----- ---- ------- ------- Net income (loss)............ $ 120 $ 32 $ 43 $ 31 $ 94 $ 320 ===== ===== ===== ==== ======= ======= YEAR ENDED DECEMBER 31, --- 2002 -- JORF SCP ALL LASFAR FMLP TAWEELAH INVESTMENTS OTHERS TOTAL ------ ---- -------- ---------- ------ ----- IN MILLIONS Operating revenue........... $ 364 $ 91 $ 101 $ 43 $ 3,376 $ 3,975 Operating expenses.......... 176 4 33 13 3,209 3,435 ----- ----- ----- ---- ------- ------- Operating income............ 188 87 68 30 167 540 Other expense, net.......... 56 49 86 16 206 413 ----- ----- ----- ---- ------- ------- Net income (loss)........... $ 132 $ 38 $ (18) $ 14 $ (39) $ 127 ===== ===== ===== ==== ======= ======= F-111 YEAR ENDED DECEMBER 31, --- 2001 -- JORF SCP ALL LASFAR FMLP TAWEELAH INVESTMENTS OTHERS TOTAL ------ ---- -------- ---------- ------ ----- IN MILLIONS Operating revenue........... $ 357 $ 99 $ 44 $ 39 $ 3,814 $ 4,353 Operating expenses.......... 151 6 17 12 3,459 3,645 ----- ----- ----- ---- ------- ------- Operating income............ 206 93 27 27 355 708 Other expense, net.......... 45 63 42 16 237 403 ----- ----- ----- ---- ------- ------- Net income.................. $ 161 $ 30 $ (15) $ 11 $ 118 $ 305 ===== ===== ===== ==== ======= ======= BALANCE SHEET DATA YEAR ENDED DECEMBER 31, --- 2003 -- JORF SCP ALL LASFAR FMLP TAWEELAH INVESTMENTS OTHERS TOTAL ------ ---- -------- ---------- ------ ----- IN MILLIONS Assets Current assets.......................... $ 277 $ -- $ 93 $ 60 $ 434 $ 864 Property, plant and equipment, net....... 10 -- 638 383 2,475 3,506 Other assets............................ 1,152 893 10 -- 1,159 3,214 ------- ------ ----- ------ ------- ------- $ 1,439 $ 893 $ 741 $ 443 $ 4,068 $ 7,584 ======= ====== ===== ====== ======= ======= Liabilities Current liabilities...................... $ 314 $ 21 $ 81 $ 19 $ 425 $ 860 Long-term debt and other non-current liabilities.......................... 612 411 509 225 3,121 4,878 Equity.................................... 513 461 151 199 522 1,846 ------- ------ ----- ------ ------- ------- $ 1,439 $ 893 $ 741 $ 443 $ 4,068 $ 7,584 ======= ====== ===== ====== ======= ======= YEAR ENDED DECEMBER 31, --- 2002 -- JORF SCP ALL LASFAR FMLP TAWEELAH INVESTMENTS OTHERS TOTAL ------ ---- -------- ---------- ------ ----- Assets Current assets.......................... $ 225 $ -- $ 91 $ 36 $ 676 $ 1,028 Property, plant and equipment, net....... 7 -- 656 291 2,695 3,649 Other assets............................ 1,118 998 10 -- 1,076 3,202 ------- ------ ----- ------ ------- ------- $ 1,350 $ 998 $ 757 $ 327 $ 4,447 $ 7,879 ======= ====== ===== ====== ======= ======= Liabilities Current liabilities..................... $

249 $ 22 $ 95 $ 18 $ 692 $ 1,076 Long-term debt and other non-current liabilities.......................... 622 428 530 172 2,896 4,648 Equity.................................... 479 548 132 137 859 2,155 ------- ------ ----- ------ ------- ------- $ 1,350 $ 998 $ 757 $ 327 $ 4,447 $ 7,879 ======= ====== ===== ====== ======= ======= 14: REPORTABLE SEGMENTS Our reportable segments consist of business units organized and managed by their products and services. We evaluate performance based upon the net income of each segment. We operate principally in three reportable segments: electric utility, gas utility, and enterprises. The electric utility segment consists of the generation and distribution of electricity in the state of Michigan through its subsidiary, Consumers. The gas utility segment consists of regulated activities like transportation, storage, and distribution of natural gas in the state of Michigan through its subsidiary, Consumers. The enterprises segment consists of: F-112 - investing in, acquiring, developing, constructing, managing, and operating non-utility power generation plants and natural gas facilities in the United States and abroad, and - providing gas, oil, and electric marketing services to energy users. The tables below show financial information by reportable segment. The "Other" net income segment includes corporate interest and other, discontinued operations, and the cumulative effect of accounting changes. We restated 2002 and 2001 information due to the management reorganization and the change in our business strategy in 2003 from five to three operating segments. REPORTABLE SEGMENTS YEARS ENDED DECEMBER 31 --------------------------------- RESTATED RESTATED 2003 2002 2001 --------- -------- -------- IN MILLIONS Revenues Electric utility.............................. $ 2,583 $ 2,644 $ 2,630 Gas utility.................................. 1,845 1,519 1,338 Enterprises.................................. 1,085 4,508 4,034 Other....................................... -- 2 4 --------- -------- -------- $ 5,513 $ 8,673 $ 8,006 ========= ======== ======== Earnings from Equity Method Investees Enterprises.................................. $ 164 $ 92 $ 172 --------- -------- -------- $ 164 $ 92 $ 172 ========= ======== ======== Depreciation, Depletion, and Amortization Electric utility.............................. $ 247 $ 228 $ 219 Gas utility.................................. 128 118 118 Enterprises.................................. 52 64 70 Other....................................... 1 2 1 --------- -------- -------- $ 428 $ 412 $ 408 ========= ======== ======== Income Taxes Electric utility.............................. $ 90 $ 138 $ 69 Gas utility.................................. 35 33 25 Enterprises.................................. 14 (155) (83) Other....................................... (81) (57) (105) --------- -------- -------- $ 58 $ (41) $ (94) ========= ======== ======== Net Income (Loss) Electric utility.............................. $ 167 $ 264 $ 120 Gas utility.................................. 38 46 21 Enterprises.................................. 8 (419) (272) Other....................................... (257) (541) (328) --------- -------- -------- $ (44) $ (650) $ (459) ========= ======== ======== Investments in Equity Method Investees Enterprises.................................. $ 1,366 $ 1,367 $ 1,912 Other....................................... 24 2 36 --------- -------- -------- $ 1,390 $ 1,369 $ 1,948 ========= ======== ======== F-113 YEARS ENDED DECEMBER 31 ---------------------------------- RESTATED RESTATED 2003 2002 2001 --------- ---------- ---------- IN MILLIONS Identifiable Assets Electric utility(a)........... $ 6,831 $ 6,058 $ 5,784 Gas utility(a)............... 2,983 2,586 2,734 Enterprises.................. 3,670 5,724 8,891 Other........................ 354 413 224 --------- ---------- ---------- $ 13,838 $ 14,781 $ 17,633 ========= ========= ========= Capital Expenditures(b) Electric utility............. $ 310 $ 437 $ 623 Gas utility.................. 135 181 145 Enterprises.................. 49 235 427 Other........................ -- 8 263 --------- ---------- ---------- $ 494 $ 861 $ 1,458 ========= ========= ========= GEOGRAPHIC AREAS(C) RESTATED RESTATED 2003 2002 2001 ---------- ---------- ---------- IN MILLIONS United States Operating Revenue............. $ 5,222 $ 8,361 $ 7,639 Operating Income (Loss)........ 511 (36) 189 Identifiable Assets............ 12,372 13,355 14,770 International Operating Revenue............. $ 291 $ 312 $ 367 Operating Income (Loss)........ 84 111 (38) Identifiable Assets............ 1,466 1,426 2,863 (a) Amounts includes a portion of Consumers' assets for both the Electric and Gas utility units. (b) Amounts include electric restructuring implementation plan, capital leases for nuclear fuel, purchase of nuclear fuel and other assets and electric DSM costs. Amounts also include a portion of Consumers' capital expenditures for plant and equipment that both the electric and gas utility units use. (c) Revenues are based on the country location of customers. 15: SUMMARIZED FINANCIAL INFORMATION OF SIGNIFICANT RELATED ENERGY SUPPLIER Under the PPA with the MCV Partnership discussed in Note 4, Uncertainties, our 2003 obligation to purchase electric capacity from the MCV Partnership provided 15 percent of our owned and contracted electric generating capacity. Summarized financial information of the MCV Partnership follows: STATEMENTS OF INCOME YEARS ENDED DECEMBER 31 ----------------------- 2003 2002 2001 ------- ------- ------- IN MILLIONS Operating revenue(a)....................................... $ 584 $ 597 $ 611 Operating expenses.. 416 409 453 ------- ------- ------- Operating income.. 168 188 158 Other expense, net.. 108 114 110 ------- ------- ------- Income before cumulative

effect of accounting change......... 60 74 48 Cumulative effect of change in method of accounting for derivative options contracts(b)........................... -- 58 -- ------- ------- ------- Net Income... $ 60 $ 132 $ 48 ======= ======= ======= F-114 BALANCE SHEETS DECEMBER 31 ------------------- 2003 2002 -------- --------- IN MILLIONS ASSETS Current assets(c)............ $ 389 $ 358 Plant, net................... 1,494 1,550 Other assets................. 187 190 --------- --------- $ 2,070 $ 2,098 ========= ========= LIABILITIES AND EQUITY Current liabilities........... $ 250 $ 209 Non-current liabilities(d)............. 1,021 1,155 Partners' equity(e)........... 799 734 --------- --------- $ 2,070 $ 2,098 ========= ========= ------------ (a) Revenue from Consumers totaled $514 million in 2003, $557 million in 2002, and $550 million in 2001. (b) On April 1, 2002, the MCV Partnership implemented a new accounting standard for derivatives. As a result, the MCV Partnership began accounting for several natural gas contracts containing an option component at fair value. The MCV Partnership recorded a $58 million cumulative effect adjustment for the change in accounting principle as an increase to earnings. CMS Midland's 49 percent ownership share was $28 million ($18 million after-tax), which is reflected as a change in accounting principle on our Consolidated Statements of Income (Loss). (c) Receivables from Consumers totaled $40 million for December 31, 2003 and $44 million for December 31, 2002. (d) FMLP is the sole beneficiary of a trust that is the lessor in a long-term direct finance lease with the MCV Partnership. CMS Holdings holds a 46.4 percent ownership interest in FMLP. The MCV Partnership's lease obligations, assets, and operating revenues secure FMLP's debt. The following table summarizes obligation and payment information regarding the direct finance lease. DECEMBER 31 -------------- 2003 2002 ---- ---- IN MILLIONS Balance Sheet: MCV Partnership: Lease obligation $ 894 $ 975 FMLP: Non-recourse debt 431 449 Lease payment to service non-recourse debt (including interest) 158 370 CMS Holdings: Share of interest portion of lease payment 37 34 Share of principle portion of lease payment 36 65 YEARS ENDED DECEMBER 31 ----------------- 2003 2002 2001 ---- ---- ---- IN MILLIONS Income Statement: FMLP: Earnings $ 32 $ 38 $ 30 (e) CMS Midland's recorded investment in the MCV Partnership includes capitalized interest, which we are expensing over the life of our investment in the MCV Partnership. The financing agreements prohibit the MCV Partnership from distributing any cash to its owners until it meets certain financial test requirements. We do not anticipate receiving a cash distribution in the near future. 16: ASSET RETIREMENT OBLIGATIONS SFAS NO. 143, ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS: This standard became effective January 2003. It requires companies to record the fair value of the cost to remove assets at the end of their useful life, if there is a legal obligation to do so. We have legal obligations to remove some of our assets, including our nuclear plants, at the end of their useful lives. F-115 Before adopting this standard, we classified the removal cost of assets included in the scope of SFAS No. 143 as part of the reserve for accumulated depreciation. For these assets, the removal cost of $448 million that was classified as part of the reserve at December 31, 2002, was reclassified in January 2003, in part, as: - $364 million ARO liability, - $134 million regulatory liability, - $42 million regulatory asset, and - $7 million net increase to property, plant, and equipment as prescribed by SFAS No. 143. We are reflecting a regulatory asset and liability as required by SFAS No. 71 for regulated entities instead of a cumulative effect of a change in accounting principle. Accretion of $1 million related to the Big Rock and Palisades' profit component included in the estimated cost of removal was expensed for 2003. The fair value of ARO liabilities has been calculated using an expected present value technique. This technique reflects assumptions, such as costs, inflation, and profit margin that third parties would consider to assume the settlement of the obligation. Fair value, to the extent possible, should include a market risk premium for unforeseeable circumstances. No market risk premium was included in our ARO fair value estimate since a reasonable estimate could not be made. If a five percent market risk premium were assumed, our ARO liability would be $381 million. If a reasonable estimate of fair value cannot be made in the period the asset retirement obligation is incurred, such as assets with indeterminate lives, the liability is to be recognized when a reasonable estimate of fair value can be made. Generally, transmission and distribution assets have indeterminate lives. Retirement cash flows cannot be determined. There is a low probability of a retirement date, so no liability has been recorded for these assets. No liability has been recorded for assets that have insignificant cumulative disposal costs, such as substation batteries. The measurement of the ARO liabilities for Palisades and Big Rock are based on decommissioning studies that are based largely on third-party cost estimates. In addition, in 2003, we recorded an ARO liability for certain pipelines and non-utility generating plants and a $1 million, net of tax, cumulative effect of change in accounting for accretion and depreciation expense for ARO liabilities incurred prior to 2003. The pro forma effect on results of operations would not have been material for the year ended December 31, 2002. The following tables describe our assets that have legal obligations to be removed at the end of their useful life.

IN SERVICE TRUST ARO DESCRIPTION DATE LONG LIVED ASSETS FUND -- ----------------------------------- ----------- IN MILLIONS December 31, 2003 Palisades-decommission plant site... 1972 Palisades nuclear plant $ 487 Big Rock-decommission plant site.... 1962 Big Rock nuclear plant 88 JHCampbell intake/discharge water line............................ 1980 Plant intake/discharge water line -- Closure of coal ash disposal areas.. Various Generating plants coal ash areas -- Closure of wells at gas storage fields.......................... Various Gas storage fields -- Indoor gas services equipment relocations..................... Various Gas meters located inside structures -- Closure of gas pipelines............ Various Gas transmission pipelines -- Dismantle natural gas-fired power plant........................... 1997 Gas fueled power plant -- F-116 PRO FORMA ARO LIABILITY CASH ARO ARO LIABILITY ---------------------------- FLOW LIABILITY ARO DESCRIPTION 1/1/02 1/1/03 INCURRED SETTLED ACCRETION REVISIONS 12/31/03 ---------------------------- ------------ ------ -------- ---------- ------------------ --------- IN MILLIONS December 31, 2003 Palisades-decommission..... $ 232 $ 249 $ -- $ -- $ 19 $ -- $ 268 Big Rock-decommission...... 94 61 -- (39) 13 -- 35 JHCampbell intake line..... -- -- -- -- -- -- -- Coal ash disposal areas.... 46 51 -- (4) 5 -- 52 Wells at gas storage fields................. 2 2 -- -- -- -- 2 Indoor gas services relocations............ 1 1 -- -- -- -- 1 Closure of gas pipelines(a)............ 7 8 -- (8) -- -- -- Dismantle natural gas-fired power plant... 1 1 -- -- -- -- 1 ----- ----- ---- ----- ----- ---- ----- Total................ $ 383 $ 373 $ -- $ (51) $ 37 $ -- $ 359 ===== ===== ==== ===== ===== ==== ===== ------------ (a) ARO Liability was settled in 2003 as a result of the sales of Panhandle and CMS Field Services. Reclassification of Non-Legal Cost of Removal: Beginning in December 2003, the SEC requires the quantification and reclassification of the estimated cost of removal obligations arising from other than legal obligations. These obligations have been accrued through depreciation charges. We estimate that we had $983 million in 2003 and $907 million in 2002 of previously accrued asset removal costs related to our regulated operations, for other than legal obligations. These obligations, which were previously classified as a component of accumulated depreciation, were reclassified as regulatory liabilities in the accompanying consolidated balance sheets. 17: IMPLEMENTATION OF NEW ACCOUNTING STANDARDS SFAS NO. 149, AMENDMENT OF STATEMENT 133 ON DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES: Amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. This statement is effective for contracts entered into or modified after June 30, 2003. Implementation of this statement has not impacted our Consolidated Financial Statements. SFAS NO. 150, ACCOUNTING FOR CERTAIN FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF BOTH LIABILITIES AND EQUITY: Establishes standards for how we classify and measure certain financial instruments with characteristics of both liabilities and equity. The statement requires us to classify financial instruments within its scope as liabilities rather than mezzanine equity, the area between liabilities and equity. SFAS No. 150 became effective July 1, 2003. We have five Trust Preferred Securities outstanding as of December 31, 2003 that are issued by our affiliated trusts. Each trust holds a subordinated debenture from the parent company. The terms of the debentures are identical to those of the trust-preferred securities, except that the debenture has an explicit maturity date. The trust documents, in turn, require that the trust be liquidated upon the repayment of the debenture. The preferred securities are redeemable upon the liquidation of the subsidiary; therefore, are considered equity in the financial statements of the subsidiary. At their October 29, 2003 Board meeting, the FASB deferred the implementation of the portion of SFAS No. 150 relating to mandatorily redeemable noncontrolling interests in subsidiaries when the noncontrolling interests are classified as equity in the financial statements of the subsidiary. Our Trust Preferred Securities are included in the deferral action. Upon adoption of FASB Interpretation No. 46, we determined that our trusts that issue Trust Preferred Securities should be deconsolidated and reported as long-term debt -- related parties. Refer to further discussion under FASB Interpretation No. 46, Consolidation of Variable Interest Entities. F-117 EITF ISSUE NO. 02-03, RECOGNITION AND REPORTING OF GAINS AND LOSSES ON ENERGY TRADING CONTRACTS UNDER EITF ISSUES NO. 98-10 AND 00-17: At the October 25, 2002 meeting, the EITF reached a consensus to rescind EITF Issue No. 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities. As a result, only energy contracts that meet the definition of a derivative in SFAS No. 133 will be carried at fair value. Energy trading contracts that do not meet the definition of a derivative must be accounted for as executory contracts. We recognized a cumulative effect of change in accounting principle loss of $23 million, net of tax, for the year ended December 31, 2003. EITF ISSUE NO. 01-08, DETERMINING WHETHER AN ARRANGEMENT CONTAINS A LEASE: In May 2003, the EITF reached consensus in EITF Issue No. 01-08 requiring both parties to a transaction, such as power purchase agreements, to determine whether a service contract or similar arrangement is or includes a lease within the scope of SFAS No. 13, Accounting for Leases. The consensus is to be applied prospectively to arrangements agreed to, modified, or acquired in business combinations in fiscal periods beginning July 1, 2003. Prospective accounting under EITF Issue No. 01-08, could affect the timing and classification of revenue and expense recognition. Certain product sales and service revenue and expenses may be required to be reported as rental or leasing income and/or expenses. Transactions deemed to be capital lease arrangements would be included on our balance sheet. The adoption of EITF Issue No. 01-08 has not impacted our results of operations, cash flows, or financial position. EITF ISSUE NO. 03-04, ACCOUNTING FOR CASH BALANCE PENSION PLANS: In May 2003, the EITF reached consensus in EITF Issue No. 03-04 to specifically address the accounting for certain cash balance pension plans. EITF Issue No. 03-04 concluded that certain cash balance plans be accounted for as defined benefit plans under SFAS No. 87, Employers' Accounting for Pensions. The EITF requirements must be applied as of our next plan measurement date after issuance, which is December 31, 2003. In 2003, we started a cash balance pension plan that covers employees hired after June 30, 2003. We do account for this plan as a defined benefit plan under SFAS No. 87 and comply with EITF Issue No. 03-04. For further information, see Note 10, Retirement Benefits. ACCOUNTING STANDARDS NOT YET EFFECTIVE FASB INTERPRETATION NO. 46, CONSOLIDATION OF VARIABLE INTEREST ENTITIES: FASB issued this interpretation in January 2003. The objective of the Interpretation is to assist in determining when one party controls another entity in circumstances where a controlling financial interest cannot be properly identified based on voting interests. Entities with this characteristic are considered variable interest entities. The Interpretation requires the party with the controlling financial interest to consolidate the entity. On December 24, 2003, the FASB issued Revised FASB Interpretation No. 46. For entities that have not previously adopted FASB Interpretation No. 46, Revised FASB Interpretation No. 46 provides an implementation deferral, until the first quarter of 2004. Revised FASB Interpretation No. 46 is effective for the first quarter of 2004 for all entities other than special purpose entities. Special-purpose entities must apply either FASB Interpretation No. 46 or Revised FASB Interpretation No. 46 for the first reporting period that ends after December 15, 2003. As of December 31, 2003, we have completed our analysis for and have adopted Revised FASB Interpretation No. 46 for all entities other than the MCV Partnership and FMLP. We continue to evaluate and gather information regarding those entities. We will adopt the provisions of Revised FASB Interpretation No. 46 for the MCV Partnership and FMLP in the first quarter of 2004. If our completed analysis shows we have the controlling financial interest in the MCV Partnership and FMLP, we would consolidate their assets, liabilities, and activities, including $700 million of non-recourse debt, into our financial statements. Financial covenants under our financing agreements could be impacted negatively after such a consolidation. As a result, it may become necessary to seek amendments to the relevant financing agreements to modify the terms of certain of these covenants to remove the effect of this consolidation, or to refinance the relevant debt. As of December 31, 2003, our investment in the MCV Partnership was $419 million and our investment in the FMLP was $224 million. F-118 We determined that we have the controlling financial interest in three entities that are determined to be variable interest entities. We have 50-percent partnership interest in T.E.S Filer City Station Limited Partnership, Grayling Generating Station Limited Partnership, and Genesee Power Station Limited Partnership. Additionally, we have operating and management contracts and are the primary purchaser of power from each partnership through long-term power purchase agreements. Collectively, these interests provide us with the controlling financial interest as defined by the Interpretation. Therefore, we have consolidated these partnerships into our consolidated financial statements for the first time as of December 31, 2003. At December 31, 2003, total assets consolidated for these entities are $227 million and total liabilities are $164 million, including $128 million of non-recourse debt. At December 31, 2003, CMS Energy has outstanding letters of credit and guarantees of $5 million relating to these entities. At December 31, 2003, minority interest recorded for these entities totaled $36 million. We also determined that we do not hold the controlling financial interest in our trust preferred security structures. Accordingly, those entities have been deconsolidated as of December 31, 2003. Company obligated Trust Preferred Securities totaling $663 million that were previously included in mezzanine equity, have been eliminated due to deconsolidation. As a result of the deconsolidation, we have reflected $684 million of long-term debt -- related parties and have reflected an investment in related parties of $21 million. We are not required to, and have not, restated prior periods for the impact of this accounting change. Additionally, we have non-controlling interests in four other variable interest entities. FASB Interpretation No. 46 requires us to disclose certain information about these entities. The chart below details our involvement in these entities at December 31, 2003: INVESTMENT OPERATING NAME

INVOLVEMENT BALANCE AGREEMENT WITH (OWNERSHIP INTEREST) NATURE OF THE ENTITY COUNTRY DATE (IN MILLIONS) CMS ENERGY ------------------- ------------------- ------------------- ----------- ------------- -------------- Loy Yang Power (49%) Power Generator Australia 1997 $ -- Yes Taweelah (40%) Power Generator United Arab Emirates 1999 $ 83 Yes Jubail (25%) Generator-- Saudi Arabia 2001 $ -- Yes Under Construction Shuweihat (20%) Generator-- United Arab Emirates 2001 $ (24)(a) Yes Under Construction ----- Total $ 59 ===== TOTAL NAME GENERATING (OWNERSHIP INTEREST) CAPACITY ------------------- ---------- Loy Yang Power (49%) 2,000 MW Taweelah (40%) 777 MW Jubail (25%) 250 MW Shuweihat (20%) 1,500 MW ----- Total 4,527 MW ===== (a) At December 31, 2003, we recorded a negative investment in Shuweihat. The balance is comprised of our investment of $3 million reduced by our proportionate share of the negative fair value of derivative instruments of $27 million. We are required to record the negative investment due to our future commitment to make an equity investment in Shuweihat. Our maximum exposure to loss through our interests in these variable interest entities is limited to our investment balance of $59 million, Loy Yang currency translation losses of $110 million, net of tax, and letters of credit, guarantees, and indemnities relating to Taweelah and Shuweihat totaling $146 million. Included in the $146 million is a letter of credit relating to our required initial investment in Shuweihat of $70 million. We plan to contribute our initial investment when the project becomes commercially operational in 2004. STATEMENT OF POSITION, ACCOUNTING FOR CERTAIN COSTS AND ACTIVITIES RELATED TO PROPERTY, PLANT, AND EQUIPMENT: At its September 9, 2003 meeting, the Accounting Standards Executive Committee, of the American Institute of Certified Public Accountants voted to approve the Statement of Position, Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment. The Statement of Position is expected to be presented for FASB clearance in 2004 and F-119 would be applicable for fiscal years beginning after December 15, 2004. An asset classified as property, plant, and equipment asset often comprises multiple parts and costs. A component accounting policy determines the level at which those parts are recorded. Capitalization of certain costs related to property, plant, and equipment are included in the total cost. The Statement of Position could impact our component and capitalization accounting for property, plant, and equipment. We continue to evaluate the impact, if any, this Statement of Position will have upon adoption. 18: RESTATEMENT AND RECLASSIFICATION We have determined the need to make certain adjustments to our consolidated financial statements for the fiscal years ended December 31, 2002, December 31, 2001, and December 31, 2000. Therefore, the consolidated financial statements for 2002 and 2001 have been restated from amounts previously reported. The table below summarizes the significant adjustments and the effects on our consolidated net loss. NET LOSS (INCREASE) DECREASE 2002 2001 TOTAL --- ------ ------ ------ IN MILLIONS Interest allocation reclassification for International Energy Distribution.................................. $ (3) $ 3 $ -- Derivatives related to the equity method investments.... (27) (14) (41) ------ ------ ------ Total.. $ (30) $ (11) $ (41) ====== ====== ====== INTEREST ALLOCATION RECLASSIFICATION FOR INTERNATIONAL ENERGY DISTRIBUTION: Due to lack of progress on the sale, we reclassified our international energy distribution business, which includes CPEE and SENECA, from discontinued operations to continuing operations for the years 2003, 2002, and 2001. When we initially reported the international energy distribution business as a discontinued operation in 2001, we applied APB Opinion No. 30, which allowed us to record a provision for anticipated operating losses. We currently apply FASB No. 144 which does not allow us to record a provision for future operating losses. Therefore, in the process of reclassifying the international energy distribution business to continuing operations and reversing such provisions, we increased our net loss by $3 million in 2002 and decreased our net loss by $3 million in 2001. DERIVATIVES RELATED TO THE EQUITY METHOD INVESTMENTS: Some of our equity affiliates hold derivative instruments, including interest rate swaps and other similar instruments. Some of these instruments have been accounted for as cash flow hedges, with changes in the fair value of the hedges reported in accumulated other comprehensive income in 2003, 2002 and 2001. However, in late 2003 it was determined that certain of our equity affiliates did not formally designate their instruments as hedges, or did not do so in a timely manner, in accordance with SFAS No. 133. Therefore, the changes in the fair value of the hedges should have been reported in earnings in 2003, 2002, and 2001. As a result, the effects of the changes in the fair value of the hedges require restatement. Our proportionate share of the adjustments increased our net loss by $27 million in 2002 and increased our net loss by $14 million in 2001. BALANCE SHEET IMPACTS: The most significant effects on our consolidated balance sheets include the reclassification of International Energy Distribution from "held for sale" to continuing operations and the change in our investments due to the correction of the derivatives discussed above. During the fourth quarter of 2000, we wrote down the value of our investment in Loy Yang by $329 million ($268 million after-tax). We have now concluded that the tax benefit associated with the write-down should have been reduced by $38 million. Accordingly, our retained deficit as of January 1, 2001 increased by this amount. The following tables present the effects of the adjustments we made to our consolidated financial statements for the fiscal years ended December 31, 2002 and December 31, 2001, as well as effects of reclassifying Marysville and Parmelia into discontinued operations. F-120 CONSOLIDATED STATEMENTS OF INCOME 2002 2001 ----------------------- ----------------------- AS REPORTED AS RESTATED AS REPORTED AS RESTATED ---------- ---------- ---------- ----------- IN MILLIONS Operating Revenue............................. $ 8,561 $ 8,673 $ 7,878 $ 8,006 Earnings from Equity Method Investees.......... 126 92 185 172 Operating expenses Operation.................................. 7,177 7,242 6,762 6,851 Maintenance................................ 211 212 224 225 Depreciation, depletion and amortization..... 403 412 398 408 General taxes............................... 199 222 196 220 Asset impairment charges..................... 598 602 240 323 -------- -------- -------- -------- Total Operating Expenses..................... 8,588 8,690 7,820 8,027 -------- -------- -------- -------- Operating Income.............................. 99 75 243 151 -------- -------- -------- -------- Other Income (Deductions): Accretion expense........................... (31) (31) (37) (37) Gain (loss) on asset sales, net............. 37 37 - (2) Other, net.................................. (4) (6) 25 26 -------- -------- -------- -------- Total Other Income (Deductions).............. 2 -- (12) (13) -------- -------- -------- -------- Fixed Charges................................. 504 508 562 566 Loss From Continuing Operations Before Income Taxes and Minority Interests................ (403) (433) (331) (428) -------- -------- -------- -------- Income Tax Expense (Benefit).................. 13 (41) (98) (94) Minority Interests............................ -- 2 3 (7) -------- -------- -------- -------- Loss From Continuing Operations................ (416) (394) (236) (327) -------- -------- -------- -------- Loss From Discontinued Operations............. (222) (274) (210) (128) -------- -------- -------- -------- Loss Before Cumulative Effect of Change in Accounting Principle........................ (638) (668) (446) (455) -------- -------- -------- -------- Cumulative Effect of Change in Accounting...... 18 18 (2) (4) -------- -------- -------- -------- Consolidated Net Loss......................... $ (620) $ (650) $ (448) $ (459) ======== ======== ======== ======== Basic and Diluted Loss Per Share.............. $ (4.46) $ (4.68) $ (3.42) $ (3.51) ======== ======== ======== ======== CONSOLIDATED STATEMENTS OF CASH FLOWS 2002 2001 ----------------------- ----------------------- AS REPORTED AS RESTATED AS REPORTED AS RESTATED ---------- ---------- ---------- ----------- IN MILLIONS Consolidated net loss......................... $ (620) $ (650) $ (448) $ (459) Net cash provided by operating activities...... 624 614 366 372 Net cash provided by (used in) investing activities................................. 863 829 (1,348) (1,349) Net cash provided by (used in) financing activities................................. (1,237) (1,223) 968 967 Effect of Exchange Rate on Cash............... -- 8 -- (10) Net Increase (Decrease) in Cash and Temporary Cash Investments............................ 250 228 (14) (20) --------- --------- --------- --------- Cash and Cash Investments, End of Period....... $ 377 $ 351 $ 127 $ 123 ========= ========= ========= ========= F-121 CONSOLIDATED BALANCE SHEETS 2002 2001 ----------------------- ----------------------- AS REPORTED AS RESTATED AS REPORTED AS RESTATED ---------- ---------- ---------- ----------- IN MILLIONS ASSETS Plant and Property (at cost).................. $ 5,234 $ 6,103 $ 5,848 $ 6,703 ---------- --------- --------- --------- Investments................................... 1,398 1,369 1,961 1,960 ---------- --------- --------- --------- Current Assets: Cash and temporary cash investments.......... 377 351 127 123 Restricted cash............................ -- 38 -- 4 Accounts receivable, notes receivable, and accrued revenue......................... 757 783 704 743 Assets held for sale......................... 644 595 471 412 Price risk management assets................ 115 115 327 327 Prepayments, inventories, and other.......... 855 857 931 951 ---------- --------- --------- --------- Total Current Assets.......................... 2,748 2,739 2,560 2,560 ---------- --------- --------- --------- Non-current Assets: Regulatory assets........................... 1,053 1,053 1,105 1,105 Assets held for sale........................ 2,081 2,084 3,480 3,438 Price risk management assets................ 135 135 368 368 Other...................................... 1,266 1,298 1,453 1,499 ---------- --------- --------- --------- Total Non-current Assets...................... 4,535 4,570 6,406 6,410 ---------- --------- --------- --------- Total Assets.................................. $ 13,915 $ 14,781 $ 16,775 $ 17,633 ========== ========= ========== ========= 2002 2001 ----------------------- ----------------------- AS REPORTED AS RESTATED AS REPORTED AS RESTATED ---------- ---------- ---------- ---------- IN MILLIONS STOCKHOLDERS' INVESTMENT AND LIABILITIES Capitalization: Common stockholders' equity..................... $ 1,133 $ 1,078 $ 2,038 $ 1,991 Long-term debt................................. 5,356 5,357 5,840 5,842 Non-current portion of capital leases............ 116 116 71 71 Other.. 927 927 1,258 1,258 ---------- --------- --------- --------- Total Capitalization........................... 7,532 7,478 9,207 9,162 ---------- --------- --------- --------- Minority

Interests.............................. 21 38 24 43 ---------- --------- ---------- --------- Current Liabilities: Current portion of long-term debt and capital leases..................................... 640 646 1,016 1,016 Notes payable................................. 458 458 416 416 Accounts payable.............................. 482 496 595 614 Accrued taxes................................. 291 291 111 111 Liabilities held for sale...................... 465 427 639 605 Price risk management liabilities............. 96 96 367 367 Deferred income taxes......................... 15 15 49 49 Other... 451 460 478 494 ---------- --------- ---------- --------- Total Current Liabilities....................... 2,898 2,889 3,671 3,672 ---------- --------- ---------- --------- Non-current Liabilities: Deferred income taxes......................... 414 438 824 864 Regulatory liabilities for cost of removal..... -- 907 -- 870 Liabilities held for sale...................... 1,243 1,218 1,376 1,354 Price risk management liabilities............. 135 135 287 287 Other... 1,672 1,678 1,386 1,381 ---------- --------- ---------- --------- Total Non-current Liabilities................... 3,464 4,376 3,873 4,756 ---------- --------- ---------- --------- Total Stockholders' Investment and Liabilities................................... $ 13,915 $ 14,781 $ 16,775 $ 17,633 ========== ========= ========== ========= F-122 CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDERS' EQUITY 2002 2001 ----------------------- ----------------------- AS REPORTED AS RESTATED AS REPORTED AS RESTATED ----------- ----------- ----------- ----------- IN MILLIONS Retained Deficit At beginning of period............. $ (951) $ (1,001) $ (313) $ (352) Consolidated net loss.............. (620) (650) (448) (459) Common stock dividends declared..... (149) (149) (190) (190) --------- --------- -------- --------- At end of period................ (1,720) (1,800) (951) (1,001) --------- --------- -------- --------- Accumulated Other Comprehensive Loss At beginning of period............. (269) (266) (201) (198) Minimum pension liability........... (241) (241) -- -- Investments........................ 7 7 (3) (3) Derivative instruments............. (25) (3) (38) (38) Foreign currency translation........ (225) (225) (27) (27) --------- --------- -------- --------- At end of period................ (753) (728) (269) (266) --------- --------- -------- --------- Common stock......................... 1 1 1 1 Other paid-in capital................ 3,605 3,605 3,257 3,257 --------- --------- -------- --------- Total Common Stockholders' Equity..... $ 1,133 $ 1,078 $ 2,038 $ 1,991 ========= ========= ======== ========= Total Other Comprehensive Loss........ $ (1,104) $ (1,112) $ (516) $ (527) ========= ========= ======== ========= 19: QUARTERLY FINANCIAL AND COMMON STOCK INFORMATION (UNAUDITED) We have determined the need to make certain adjustments to our consolidated financial statements for the quarterly periods of 2003 and 2002. Therefore, the consolidated financial statements for the quarterly periods of 2003 and 2002 have been restated from amounts previously reported. 2003 (RESTATED) --- QUARTERS ENDED MARCH 31 JUNE 30 SEPT. 30 DEC. 31 -- -------- -------- --------- --------- IN MILLIONS, EXCEPT PER SHARE AMOUNTS Operating revenue... $ 1,968 $ 1,126 $ 1,047 $ 1,372 Operating income... 236 176 78 105 Income (loss) from continuing operations.................... 75 (12) (71) (35) Discontinued operations(a)................................. 31 (53) 2 43 Cumulative effect of change in accounting principles(a)...... (24) -- -- -- Consolidated net income (loss)............................. 82 (65) (69) 8 Income (loss) from continuing operations per average common share-- basic.. 0.52 (0.08) (0.47) (0.22) Income (loss) from continuing operations per average common share-- diluted... 0.47 (0.08) (0.47) (0.22) Basic earnings (loss) per average common share(b)............ 0.57 (0.45) (0.46) 0.05 Diluted earnings (loss) per average common share(b).......... 0.52 (0.45) (0.46) 0.05 Dividends declared per common share......................... -- -- -- -- Common stock prices(c) High.. 10.59 8.50 7.99 8.63 ======== ======== ======== ======== Low... 3.49 4.58 6.11 7.44 ======== ======== ======== ======== F-123 2002 (RESTATED) --- QUARTERS ENDED MARCH 31 JUNE 30 SEPT. 30 DEC. 31 -- -------- -------- --------- --------- IN MILLIONS, EXCEPT PER SHARE AMOUNTS Operating revenue... $ 2,248 $ 2,123 $ 2,566 $ 1,736 Operating income (loss)..................................... 283 136 178 (522) Income (loss) from continuing operations.................... 103 17 (1) (513) Discontinued operations(a)................................. (52) (128) 26 (120) Cumulative effect of change in accounting principles(a)...... -- 17 1 -- Consolidated net income (loss).............................. 51 (94) 26 (633) Income (loss) from continuing operations per average common share-- basic... 0.77 0.14 -- (3.57) Income (loss) from continuing operations per average common share-- diluted... 0.77 0.14 -- (3.57) Basic earnings (loss) per average common share(b)............ 0.38 (0.69) 0.18 (4.40) Diluted earnings (loss) per average common share(b).......... 0.38 (0.69) 0.18 (4.40) Dividends declared per common share......................... 0.365 0.365 0.18 0.18 Common stock prices(c) High.. 24.62 22.24 11.28 10.48 Low... 21.27 10.46

7.49 5.79 ======== ======== ======== ======== (a) Net of tax (b) Sum of the quarters may not equal the annual earnings per share due to changes in shares outstanding (c) Based on New York Stock Exchange -- Composite transactions The following tables present the effects of the adjustments we made to our consolidated financial statements for the quarterly periods of 2003 and 2002, as well as the effects of reclassifying Marysville and Parmelia into discontinued operations. 2003 ------------------------------------ QUARTERS ENDED -- REPORTED VS. RESTATED MARCH 31 JUNE 30 SEPT. 30 --- ---------- ---------- ---------- IN MILLIONS, EXCEPT PER SHARE AMOUNTS Operating revenue as reported .... $ 1,992 $ 1,154 $ 1,016 Operating revenue as restated .... 1,968 1,126 1,047 Operating income as reported .... 239 183 129 Operating income as restated .... 236 176 78 Income (loss) from continuing operations as reported .. 76 (5) (34) Income (loss) from continuing operations as restated .. 75 (12) (71) Discontinued operations as reported .... 27 (40) (43) Discontinued operations as restated .... 31 (53) 2 Consolidated net income (loss) as reported .... 79 (45) (77) Consolidated net income (loss) as restated .... 82 (65) (69) Basic earnings (loss) per average common share as reported .... 0.55 (0.31) (0.51) Basic earnings (loss) per average common share as restated .... 0.57 (0.45) (0.46) Diluted earnings (loss) per average common share as reported .... 0.51 (0.31) (0.51) Diluted earnings (loss) per average common share as restated .... 0.52 (0.45) (0.46) F-124 2002 --- QUARTERS ENDED -- REPORTED VS. RESTATED MARCH 31 JUNE 30 SEPT. 30 DEC. 31 --- -------- -------- --------- --------- IN MILLIONS, EXCEPT PER SHARE AMOUNTS Operating revenue as reported......................... $ 2,263 $ 2,135 $ 2,534 $ 1,708 Operating revenue as restated......................... 2,248 2,123 2,566 1,736 Operating income (loss) as reported.................. 275 152 190 (520) Operating income (loss) as restated.................. 283 136 178 (522) Income (loss) from continuing operations as reported.. 93 36 11 (557) Income (loss) from continuing operations as restated.. 103 17 (1) (513) Discontinued operations as reported.................. (51) (127) 25 (68) Discontinued operations as restated.................. (52) (128) 26 (120) Consolidated net income (loss) as reported............ 42 (74) 37 (625) Consolidated net income (loss) as restated............ 51 (94) 26 (633) Basic earnings (loss) per average common share as reported... 0.32 (0.55) 0.26 (4.34) Basic earnings (loss) per average common share as restated... 0.38 (0.69) 0.18 (4.40) Diluted earnings (loss) per average common share as reported... 0.32 (0.55) 0.26 (4.34) Diluted earnings (loss) per average common share as restated... 0.38 (0.69) 0.18 (4.40) The table below summarizes the significant adjustments and the effect on consolidated net income (loss) by quarter. 2003 2002 -------------------------- ---------------------------------- QUARTERS ENDED MAR. 31 JUNE 30 SEPT. 30 MAR. 31 JUNE 30 SEPT. 30 DEC. 31 ---------------------------------- ------- ------- -------- ------- ------- -------- ------- IN MILLIONS Consolidated net income (loss) as reported.......................... $ 79 $ (45) $ (77) $ 42 $ (74) $ 37 $ (625) Discontinued operations reclass(a).. -- -- -- (1) (1) (1) -- Derivative accounting changes(b).... 3 (6) 8 10 (19) (10) (8) Panhandle sale adjustment(c)........ -- (14) -- -- -- -- -- ----- ----- ----- ----- ----- ----- ------ Consolidated net income (loss) as restated.......................... $ 82 $ (65) $ (69) $ 51 $ (94) $ 26 $ (633) ===== ===== ===== ===== ===== ===== ====== (a) We continue to pursue the sale of International Energy Distribution, which includes CPEE and SENECA, but due to the slow progress on the sale, we have reclassified this entity from discontinued operations to continuing operations for the years 2003, 2002, and 2001. When we initially reported the international energy distribution business as a discontinued operation in 2001, we applied APB Opinion No. 30, which allowed us to record a provision for anticipated closing costs and operating losses. We currently apply FASB No. 144 which does not allow us to record a provision for future operating losses. Therefore, in the process of reclassifying the international energy distribution business to continuing operations and reversing such provisions, we increased our net loss by $3 million in 2002 and decreased our net loss by $3 million in 2001. In 2003, there was an increase to net income of $75 million as a result of reversing the previously recognized impairment loss in discontinued operations. (b) We determined that certain equity method investees inappropriately accounted for interest rate swaps as hedges. For additional details, see Note 18, Restatement and Reclassification. (c) We determined the net loss recorded in the second quarter of 2003 relating to the sale of Panhandle, reflected as Discontinued Operations, was understated by approximately $14 million, net of tax. The understatement occurred because we did not recognize through our second quarter 2003 earnings an unrealized loss related to certain Panhandle interest rate hedging derivative instruments. Pursuant to SFAS No. 133, the unrealized loss was accounted for in Other Comprehensive Income, but needed to be recognized through earnings upon the sale of Panhandle. F-125 (This page intentionally left blank) F-126 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM The Board of Directors and Stockholders CMS Energy Corporation We have audited the accompanying consolidated balance sheets of CMS Energy Corporation (a Michigan corporation) and subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of income (loss), common stockholders' equity and cash flows for each of three years in the period ended December 31, 2003. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits. The financial statements of Midland Cogeneration Venture Limited Partnership and Jorf Lasfar Energy Company S.C.A., which represent investments accounted for under the equity method of accounting, have been audited by other auditors (the other auditors for 2001 for Midland Cogeneration Venture Limited Partnership have ceased operations) whose reports have been furnished to us; insofar as our opinion on the consolidated financial statements relates to the amounts included for Midland Cogeneration Venture Limited Partnership and Jorf Lasfar Energy Company S.C.A., respectively, it is based solely on their reports. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) generally accepted in the United States. 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 and the reports of other auditors provide a reasonable basis for our opinion. In our opinion, based on our audits and the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of CMS Energy Corporation and subsidiaries at December 31, 2003 and 2002, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein. As discussed in Notes 16 and 17 to the consolidated financial statements, in 2003, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 143, "Accounting for Asset Retirement Obligations", EITF Issue No. 02-03, "Recognition and Reporting of Gains and Losses on Energy Trading Contracts" and of Financial Accounting Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities". As discussed in Notes 3, 9 and 15 to the consolidated financial statements, in 2002, the Company adopted the provisions of SFAS No. 142, "Goodwill and Other Intangibles", SFAS No. 148, "Accounting for Stock-Based Compensation" and Midland Cogeneration Venture Limited Partnership adopted the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended and interpreted. As discussed in Note 18 to the consolidated financial statements, the Company restated its 2002 and 2001 financial statements. /s/ERNST & YOUNG LLP Detroit, Michigan February 27, 2004 F-127 REPORT OF INDEPENDENT AUDITORS We have audited the accompanying balance sheets of Jorf Lasfar Energy Company S.C.A (the "COMPANY") as of December 31, 2003, 2002 and 2001, and the related statements of income, of stockholders' equity and of cash flows for the years then ended. 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 auditing standards generally accepted in the United States of America. 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 statements 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 Jorf Lasfar Energy Company S.C.A at December 31, 2003, 2002 and 2001, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. /s/Price Waterhouse Casablanca, Morocco, February 10, 2004 F-128 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM To the Partners and the Management Committee of Midland Cogeneration Venture Limited Partnership: In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, partners' equity and cash flows present fairly, in all material respects, the financial position of the Midland Cogeneration Limited Partnership (a Michigan limited partnership) and its subsidiaries (MCV) at December 31, 2003 and 2002, and the results of their operations and their cash flows for the each of the two years ended December 31, 2003 and 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of MCV's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. The financial statements of MCV for the year ended December 31, 2001, were audited by other independent accountants who have ceased operations. Those independent accountants expressed an unqualified opinion on those financial statements in their report dated January 18, 2002. As explained in Note 2 to the financial statements, effective April 1, 2002, Midland Cogeneration Venture Limited Partnership changed its method of accounting for derivative and hedging activities in accordance with Derivative Implementation Group ("DIG") Issue C-16. /S/ PricewaterhouseCoopers LLP Detroit, Michigan February 18, 2004 F-129 THIS REPORT IS A COPY OF THE PREVIOUSLY ISSUED ARTHUR ANDERSEN REPORT AND THIS REPORT HAS NOT BEEN REISSUED BY ARTHUR ANDERSEN LLP REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS To the Partners and the Management Committee of the Midland Cogeneration Venture Limited Partnership: We have audited the accompanying consolidated balance sheets of the MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP (a Michigan limited partnership) and subsidiaries (MCV) as of December 31, 2001 and 2000, and the related consolidated statements of operations, partners' equity and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of MCV's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. 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 consolidated financial position of the Midland Cogeneration Venture Limited Partnership and subsidiaries as of December 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States. As explained in Note 2 to the financial statements, effective January 1, 2001, Midland Cogeneration Venture Limited Partnership changed its method of accounting related to derivatives and hedging activities. /s/Arthur Andersen LLP Detroit, Michigan, January 18, 2002 F-130 Jorf Lasfar Energy Company S.C.A JLEC CENTRALE THERMIQUE DE JORF LASFAR B P 99 SIDI BOUZID EL JADIDA MOROCCO Tel : 212 23 34 53 71 Fax : 212 23 34 54 05 US GAAP FINANCIAL STATEMENTS AS OF DECEMBER 31, 2003, 2002 AND 2001 AUDITED R.C. n(degree)86655 - Patente n(degree)35511273 - Identification Fiscale (I.S TVA) n(degree)1021595 F-131 JORF LASFAR ENERGY COMPANY INDEX TO FINANCIAL STATEMENTS PAGE(S) Balance Sheet As of December 31, 2003, 2002, and 2001............ Statement of Income For year ending December 31, 2003, 2002, and 2001.. Statement of Stockholders' Equity For year ending December 31, 2003, 2002, and 2001.. Statement of Cash Flows For year ending December 31, 2003, 2002, and 2001.. Notes to US GAAP Financial Statements......................... F-132 REPORT OF INDEPENDENT AUDITORS We have audited the accompanying balance sheets of Jorf Lasfar Energy Company S.C.A (the "COMPANY") as of December 31, 2003, 2002 and 2001, and the related statements of income, of stockholders' equity and of cash flows for the years then ended. 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 auditing standards generally accepted in the United States of America. 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 statements 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 Jorf Lasfar Energy Company S.C.A at December 31, 2003, 2002 and 2001, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Price Waterhouse Casablanca, Morocco, February 10, 2004 F-133 JORF LASFAR ENERGY COMPANY BALANCE SHEET NOTE DECEMBER 31, 2003 DECEMBER 31, 2002 DECEMBER 31, 2001 ---------- ------------------ ------------------ ------------------ (000) U.S. DOLLARS (000) U.S. DOLLARS (000) U.S. DOLLARS ASSETS Current Assets Cash... 3.1 65,611 46,683 67,106 Inventories.................................... 2.c & 4 38,548 40,615 31,759 Account Receivable............................. 5 85,486 76,175 86,515 Prepayments.................................... 6 8,138 10,431 4,477 Net investment from $ DFL model................ 2.b & 17.3 38,461 20,206 56,061 Net investment from Euro DFL model............. 2.b & 17.3 40,942 31,298 21,301 Other... 0 0 0 --------- --------- --------- Total current assets..................... 277,186 225,408 267,219 Long Term Assets, net Restricted Cash................................ 3.2 83,049 53,778 17,140 Fixed Assets.................................. 7 9,603 6,554 6,284 Net investment from $ DFL model................ 2.b & 17.3 638,004 678,549 686,660 Net investment from Euro DFL model............. 2.b & 17.3 411,100 374,509 339,492 $ Capacity Charges less than $ DFL model........ 13.1 713 0 9,907 Euro Capacity Charges less than Euro DFL model.. 13.2 0 0 4,225 Other Long Term Assets.......................... 9 19,058 10,968 9,445 --------- --------- --------- Total Long Term Assets.................. 1,161,527 1,124,357 1,073,153 --------- --------- --------- Total assets............................ 1,438,713 1,349,765 1,340,372 LIABILITIES AND STOCKHOLDERS' EQUITY Current Liabilities Accounts payable to third parties.............. 10 47,851 25,498 34,764 Accounts payable to related parties............ 11 176,693 145,065 74,704 VAT Liability................................. 8 3,972 2,871 3,078 Taxes payable.................................. 12 7,527 4,866 873 Current part of Long-term loans in US Dollars... 15 25,749 25,749 24,873 Current part of Long-term loans in Euro......... 15 44,491 36,855 31,167 Other current liabilities...................... 14 7,739 7,955 18,607 --------- --------- --------- Total current liabilities............... 314,023 248,859 188,066 Non-Current Liabilities Long-term loans in US Dollars.................. 15 212,426 238,174 251,667 Long-term loans in Euro........................ 15 367,052 340,912 319,457 $ Capacity Charges greater than $ DFL model..... 13.1 0 2,441 0 Euro Capacity Charges greater than Euro DFL model....................................... 13.2 422 236 0 Deferred Tax Liability......................... 2.f 0 13,005 6,097 Derivative Instrument Liability................ 20 22,050 21,410 10,665 Unfunded Pension Obligations................... 19.1 9,878 5,693 0 --------- --------- --------- Total non-current liabilities............ 611,828 621,872 587,886 Commitment and Contingencies....................... 22 Stockholders' Equity Common Stock.................................. 16.1 58 58 58 Convertible Stockholders' Securities........... 16.2 201,425 201,425 201,425 Preferred Stock............................... 16.3 185,930 185,930 185,930 Retained Earnings............................. 16.4 147,499 113,031 187,672 Other Comprehensive Income or (Loss)........... 20 (22,050) (21,410) (10,665) --------- --------- --------- Total stockholders' equity.............. 512,862 479,033 564,420 --------- --------- --------- Total liabilities and stockholders' equity................................ 1,438,713 1,349,765 1,340,372 The accompanying Notes 1 to 23 are an integral part of these financial statements. F-134 JORF LASFAR ENERGY COMPANY STATEMENT OF INCOME JANUARY 1, 2003 JANUARY 1, 2002 JANUARY 1, 2001 TO TO TO NOTE DECEMBER 31, 2003 DECEMBER 31, 2002 DECEMBER 31, 2001 --------- ----------------- ----------------- ----------------- (000) U.S. DOLLARS (000) U.S. DOLLARS (000) U.S. DOLLARS REVENUE Lease Revenue from $ DFL model............ 2.b 17.2 81,793 88,464 100,679 Lease Revenue from Euro DFL model......... 2.b 17.2 104,635 95,078 94,545 Energy Payments.......................... 128,981 130,446 116,709 O&M Revenue.............................. 45,066 42,930 38,809 Supplemental Capacity Charges............ 3,949 4,017 3,887 Sale of Fly Ash.......................... 214 247 303 License Tax Reimbursement................ 4,102 0 0 Others.................................. 138 3,090 2,364 ------- ------- ------- TOTAL REVENUE 368,878 364,272 357,296 OPERATING EXPENSES Coal Cost............................... 129,935 126,957 115,066 Fuel Oil Cost........................... 1,280 910 754 O&M Costs............................... 33,554 25,057 20,329 Operator's Incentive..................... 2,784 3,721 2,099 Generator Costs.......................... 11,994 11,397 12,547 License Tax Costs........................ 4,102 0 0 Amortization of Major Maintenance......... 9.1 1,935 1,128 261 Depreciation of Other Assets.............. 2,093 1,624 470 Provision For Future Pension Obligations.. 2,902 5,427 0 ------- ------- ------- TOTAL OPERATING EXPENSES 190,580 176,222 151,525 OPERATING INCOME.............................. 178,299 188,050 205,771 FINANCIAL ITEMS Financial Income.........................

2,025 1,764 4,735 Exchange Gain (+) or Loss (-)............. 2.d (8,605) (1,558) 8,197 Financial Expenses....................... 18 (49,425) (44,834) (50,617) ------- ------- ------- TOTAL FINANCIAL ITEMS (56,005) (44,628) (37,685) INCOME BEFORE TAXES 122,293 143,422 168,086 Income Taxes Current........................... 2.e 15,448 4,226 603 Deferred.......................... 2.f (13,005) 6,908 6,097 ------- ------- ------- NET INCOME 16.4 & 21 119,850 132,288 161,386 The accompanying Notes 1 to 23 are an integral part of these financial statements. F-135 JORF LASFAR ENERGY COMPANY STATEMENT OF STOCKHOLDERS' EQUITY JANUARY 1, 2003 JANUARY 1, 2002 JANUARY 1, 2001 TO TO TO NOTE DECEMBER 31, 2003 DECEMBER 31, 2002 DECEMBER 31, 2001 ---- ----------------- ----------------- ----------------- (000) U.S. Dollars --- COMMON STOCK At beginning and end of period in number of shares 16.1 5,500 5,500 5,500 At beginning and end of period in thousands of USD 16.1 58 58 58 CONVERTIBLE STOCKHOLDERS' SECURITIES At beginning of period 201,425 201,425 387,355 Conversion of Convertible Stockholders' Securities to Preferred Stock 0 0 (185,930) Conversion of Convertible Stockholders' Securities to Common Stock 0 0 0 ------- -------- -------- At end of period 16.2 201,425 201,425 201,425 PREFERRED STOCK At beginning of period 185,930 185,930 0 Conversion of Convertible Stockholders' Securities to Preferred Stock 0 0 185,930 Conversion of Preferred Stock to Common Stock 0 0 0 ------- -------- -------- At end of period 16.3 185,930 185,930 185,930 RETAINED EARNINGS (DEFICIT) At beginning of period 113,031 187,672 296,409 Net income 119,850 132,288 161,386 Common stock dividend (64,973) (184,891) (270,123) Preferred stock dividend (9,796) (9,942) 0 Convertible stockholders' securities (10,613) (12,096) 0 ------- -------- -------- At end of period 16.4 147,499 113,031 187,672 OTHER COMPREHENSIVE INCOME (LOSS) (A) Derivative Instruments At beginning of period (21,410) (10,665) 0 Reclassification of gains (losses) included in net income 6,871 5,811 699 Unrealized gain (loss) on derivative instruments (7,511) (16,556) (11,364) ------- -------- -------- At end of period 20 (22,050) (21,410) (10,665) ------- -------- -------- 512,862 479,034 564,420 ======= ======== ======== (a) Disclosure of Comprehensive Income (Loss) Net income 119,850 132,288 161,386 Derivative instruments Reclassification of gains (losses) in net income 6,871 5,811 699 Unrealized gain (loss) on derivative instruments (7,511) (16,556) (11,364) ------- -------- -------- Total Comprehensive Income 119,211 121,543 150,721 ======= ======== ======== The accompanying Notes 1 to 23 are an integral part of these financial statements. F-136 JORF LASFAR ENERGY COMPANY STATEMENT OF CASH FLOWS JANUARY 1, 2003 JANUARY 1, 2002 JANUARY 1, 2001 TO TO TO DECEMBER 31, 2003 DECEMBER 31, 2002 DECEMBER 31, 2001 ------------------ ------------------ ------------------ NOTE (000) U.S. DOLLARS (000) U.S. DOLLARS (000) U.S. DOLLARS ----- ------------------ ------------------ ------------------ CASH FLOWS FROM OPERATING ACTIVITIES Payments received from ONE........................ $ 426,250 $ 471,044 $ 411,872 Interest received................................ 1,870 1,748 4,543 Insurance Payments............................... (5,699) (5,665) (7,104) Payments of Operating Costs...................... (233,068) (249,255) (228,771) Cash Effect of Value Added Tax................... 2,463 (321) 4,430 ------------ ------------ ------------ Net cash provided by operating activities.. 21 191,816 217,551 184,970 CASH FLOWS USED FOR INVESTING ACTIVITIES Net (increase) in restricted cash................ (25,942) (36,638) (17,140) Acquisition of fixed assets...................... (2,300) (3,957) (5,501) Payment of Major Maintenance costs................ (6,261) (93) (21,504) ------------ ------------ ------------ Net cash used in investing activities...... (34,503) (40,688) (44,145) CASH FLOWS FROM FINANCING ACTIVITIES Proceeds from loans.............................. 0 0 92,589 Proceeds of share capital payments................ 0 0 0 Repayment of loans............................... (65,639) (57,964) (41,961) Payment of Convertible Securities interest........ (11,417) (12,386) 0 Payment of Preferred Stock dividend.............. (10,539) (10,181) 0 Payment of Common Stock dividend................. (54,877) (121,933) (189,600) Repayment of Stockholders loans.................. 0 0 0 Purchase of Preferred Stock shares................ 0 0 0 Purchase of Common Stock shares.................. 0 0 0 ------------ ------------ ------------ Net cash provided by financing activities.. (142,472) (202,464) (138,972) Effect of exchange rate changes on cash........... 4,087 5,178 (1,950) CASH AT BEGINNING OF PERIOD............................. 46,683 67,106 67,203 NET INCREASE (DECREASE) IN CASH DURING PERIOD........... 18,928 (20,422) (97) ------------ ------------ ------------ CASH AT END OF PERIOD................................... 3.1 $ 65,611 $ 46,683 $ 67,106 ============ ============ ============ SUPPLEMENTAL CASH FLOWS INFORMATION Cash paid during the year-Interest 49,136 56,054 45,486 Income taxes 12,826 5,150 6,173 The accompanying Notes 1 to 23 are an integral part of these financial statements. F-137 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 1. GENERAL A. BACKGROUND The power station at Jorf Lasfar is located on the Atlantic coast of Morocco, adjacent to the Port of Jorf Lasfar, in the Province of El Jadida. This location is approximately 127 km south--west of Casablanca. Units 1 and 2 of the power station were constructed by GEC Alstom for the Moroccan Electricity Company, Office National de l'Electricite ("ONE"), and are now in commercial operation. Each of these existing Units is 330 MW, fired by coal. In October of 1994, the ONE issued a public tender for international companies to expand the power station at Jorf Lasfar. In February of 1995, the ONE selected the "Consortium" of ABB Energy Ventures and CMS Generation as the preferred bidder and exclusive partner for negotiation. In April of 1996, the Consortium and the ONE reached agreement in principle, and initialed the necessary Project Agreements. B. ESTABLISHMENT In order to officially conclude and implement these Project Agreements, the Consortium established the Jorf Lasfar Energy Company (the "COMPANY" or "JLEC") on January 20, 1997. The Company was established as a limited partnership ("societe en commandite par actions") in accordance with the Laws of the Kingdom of Morocco, with Commercial Registration Number 86655, Fiscal Identification Number 1021595, and Patente Number 35511274. In accordance with its charter documents, the Company's objective and purpose is to construct, operate, manage and maintain the power station at Jorf Lasfar, including the development, financing, engineering, design, construction, commissioning, testing, operation and maintenance of two (2) new coal-fired Units, which are very similar in size and technology to the existing Units. In order to secure its fuel supply the Company also operates and maintains the coal-unloading pier in the Port of Jorf Lasfar. For these activities, the Company received a "right of possession" ("droit de jouissance") for the Site, the existing Units, the new Units and coal unloading pier. This "right of possession" will continue for the duration of the Project Agreements, which is anticipated to be in the range from 15 to 30 years. C. COMPANY LOAN, TRANSFER OF POSSESSION, PROJECT FINANCING AND INITIAL DISBURSEMENT On September 12, 1997, all Project Agreements were signed, the Company Loan Agreement was executed and the first disbursement of the Company Loan was used to pay the TPA fee to ONE. As a consequence, JLEC received possession of the power station at Jorf Lasfar on September 13, 1997, and began to sell its available capacity and net generation to ONE. All remaining requirements for project financing were completed in November, and initial disbursement of the Project Loans occurred on November 25, 1997. D. CONSTRUCTION, COMMERCIAL OPERATION, PURCHASE OF COMPANY LOAN AND REPAYMENT OF PROJECT LOANS After a period of construction lasting 33 months and 41 months, Unit 3 and 4 began normal commercial operation on June 9, 2000, and February 2, 2001, respectively. Consequently, the JLEC stockholders purchased 100% of the Company Loan Notes on December 11, 2000, and JLEC began the repayment of all Project Loans on May 15, 2001. After JLEC completes the repayment of all Project Loans (which is scheduled for February 15, 2013), ONE has the option to pay JLEC the Termination Amount, and then terminate all Project Agreements and retake possession of the Site and power station at Jorf Lasfar. 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES A. BASIS OF PREPARATION OF FINANCIAL STATEMENTS The Company's financial statements are prepared using the historical cost convention. The accounting and reporting policies of the Company are in accordance with the generally accepted accounting principles of Morocco, which are called "Code General de Normalisation Comptable" or "CGNC". Financial statements are prepared in accordance with these CGNC standards, and expressed in Dirhams. In addition to and separately from Moroccan (CGNC) financial statements in Dirhams, the Company uses the U.S Dollar as functional currency, and has prepared these financial statements in accordance with generally accepted accounting principles of the United States. F-138 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 B. REVENUE RECOGNITION On September 12, 1997, the Company and the Office National de L'Electricite executed a set of contracts related to the power station at Jorf Lasfar. In accordance with Statement of Financial Accounting Standard (SFAS) No. 13, these contracts are accounted for as a direct financing lease. Accordingly, JLEC (the "LESSOR") will receive a stream of payments from ONE (the "LESSEE") over the term of the lease. The term of the lease is determined in accordance with SFAS No. 13 Section (5)(f) which has been superseded by SFAS No. 98 Section 22(a). The following policies are used to calculate the minimum lease payments and the unearned income from the lease. MINIMUM LEASE PAYMENTS are determined in accordance with SFAS No. 13 Section 5(j), and are based on the capacity payments that ONE will take to JLEC. These minimum lease payments do not include reimbursable or executory costs such as the reimbursement of coal costs. The sum of these capacity payments equal the gross investment under the lease. This gross investment minus the net investment in the plants is defined to be the UNEARNED INTEREST INCOME. This unearned interest income will be accreted and recognized into earnings as LEASE REVENUE over the lease term using the effective interest method so as to produce a constant periodic rate of return on the net investment. The NET INVESTMENT represents the cost of acquiring and constructing the leased assets. These ACQUISITION AND CONSTRUCTION

COSTS include the following items which are capitalized and allocated to Units 1 and 2 and Units 3 and 4 based upon appropriate allocation methodologies: TRANSFER OF POSSESSION AGREEMENT (TPA): The TPA payment is included in the cost basis of the leased assets. DIRECT CONSTRUCTION COSTS: All direct costs related to construction are included in the cost basis of the leased assets. CAPITALIZED COSTS: Interest and financing costs incurred during construction are capitalized and included in the cost of the constructed units. PROJECT DEVELOPMENT COSTS AND FEES: These costs and fees are also capitalized and included in the cost basis of the leased assets. FINANCING COSTS: Interest expense is recognized on the effective interest method over the life of the debt. Other financing costs such as commitment fees, guarantee fees, etc. are considered a component of the interest expense of the related debt or financing. As such, they are amortized into expense using the effective interest method over the life of the related debt or financing. C. INVENTORIES The Company accounts for inventories by consistently applying the FIFO or average cost method to each item, and uses the conservatism principle (lesser of market value or cost) in its procedures for valuing inventories. D. FOREIGN CURRENCY TRANSACTIONS The books and records of the Company for U.S. GAAP are maintained in U.S. Dollars, which is both the reporting and functional currency. Transactions in other currencies are translated to U.S. Dollars at the spot rate for current period expenses and at the settlement rate for non-period transactions. Monetary assets and monetary liabilities outstanding in other foreign currencies on balance sheet dates are translated into U.S. Dollars at rates prevailing on such balance sheet dates. Exchange gains and losses on those foreign currency operations are included in determining net income for the period in which exchange rates change. F-139 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 E. CORPORATE TAX Current Income tax is determined under Moroccan Income tax rules. In 1997, JLEC signed a "tax incentive" convention with the Moroccan tax authorities. The main principles of this convention are summarized below: - Income is subject to corporate tax and "Produit de Solidarite National" tax (PSN) - PSN tax rate is 8.75% and is not subject of any tax holiday - Income tax holiday period is ten years - Income tax holiday period starts on the "commercial operation date" for each unit - Income tax holiday is 100% during the first five-year period then at 50% of the income tax rate during the second five-year period - Income not related to the sale of electricity is subject to a tax rate of 35% The "commercial operation date" for Units 1 and 2, Unit 3 and Unit 4 were September 1997, June 2000 and February 2001, respectively. On September 13, 2002, income related to Units 1 and 2 became taxable at 17.5%. Unit 3 and Unit 4 are still in the 100% tax holiday period. The PSN tax was eliminated on January 1, 2001. F. DEFERRED INCOME TAX Starting September 13, 2002, JLEC tax rate on Units 1&2 is 17.5%. JLEC determines and books the current income tax (US$ 15,448,426 for 2003) as required by the tax laws and regulations of Morocco. Temporary differences between the US GAAP and the CGNC balance sheets are creating the need to record deferred income taxes. The main temporary differences result from the use of the Direct Financing Lease method under US GAAP. In particular, the treatment of Net Investment and revenue recognition (as disclosed in note 2.b above) under US GAAP are quite different from the treatment of these items under Moroccan GAAP . The total of all the deferred tax liabilities is $ 0 ($13,005,298 as of December 31, 2002 minus $13,005,298 for 2003). G. OFF BALANCE SHEET COMMITMENTS The Company discloses all off-balance sheet commitments, if any, on balance sheet dates. H. USE OF ESTIMATES The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Actual result could differ from these estimates and assumptions. 3. CASH 3.1 CASH The Company's cash as of December 31, 2003, includes the initial capital deposits of the Company's stockholders, as explained further in Note 16.1 . Such cash is held in Moroccan Dirhams in accounts at CITIBANK MAGHREB, which is located at Zenith Millenium Immeuble 1, Lotissement Attaoufik, Sidi Maarouf, Casablanca Morocco. The remainder of the company's cash is held by the Offshore Collateral Agent, Deutsche Bank Trust Company Americas in US$ and Euro, and by the Onshore Collateral Agent, BMCI - Banque Marocaine pour le Commerce et l'Industrie in Morocain Dirhams and US$. F-140 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 The cash balances includes the following categories: 12/31/03 12/31/02 12/31/01 US$ US$ US$ ---------- ---------- ---------- Off-shore Revenue in US$ 24,426,875 22,666,875 36,223,422 Off-shore Revenue in Euro 6,590,224 5,331,124 5,000,414 ----------- ----------- ---------- Total Off-Shore Revenue 31,017,099 27,997,998 41,223,836 On-shore O&M Account - Generator 6,946,245 793,293 2,899,102 On-shore O&M Account - Operator 4,279,000 3,258,836 2,298,642 Off-shore O&M Accounts 4,546 10,607 8,464 ----------- ----------- ---------- Total

O&M Accounts 11,229,792 4,062,735 5,206,208 Fuel & Spare Part Accounts 12,929,694 5,289,381 12,080,028 On-shore Construction Accounts 0 0 1,100,363 Off-shore Debt Service Accrual Accounts in US$ 3,734,278 3,843,187 3,540,479 Off-shore Debt Service Accrual Accounts in Euro 6,637,737 5,433,301 3,898,143 ----------- ----------- ---------- Total Debt Service Accrual Accounts 10,372,015 9,276,488 7,438,623 Stockholder capital deposits 62,863 56,624 56,624 ----------- ----------- ---------- Total 65,611,462 46,683,227 67,105,682 =========== =========== ========== 3.2 Restricted Cash The Reserve Accounts are as follow: Major Maintenance Reserve Account in US$ 3.4 a 2,500,000 2,500,000 5,000,000 Fixed O&M Reserve Account in US$ 3.4 b 4,800,000 4,800,000 9,600,000 Debt Service Reserve Account in US$ 3.4 c 11,200,000 11,730,000 730,000 Super Reserve Account in US$ 3.4 d 45,600,000 18,100,000 0 Distribution Account in US$ 0 0 0 ----------- ----------- ---------- Off-shore Reserve Accounts in US$ 64,100,000 37,130,000 15,330,000 Fixed O&M Reserve Account in Euro 243,656 197,262 161,372 Debt Service Reserve Account in Euro 3.4 e 18,705,220 16,450,805 1,649,031 ----------- ----------- ---------- Off-shore Reserve Accounts in Euro 18,948,876 16,648,067 1,810,404 ----------- ----------- ---------- Total Reserve Accounts 83,048,876 53,778,067 17,140,404 =========== ========== ========== 3.3 Total Cash Cash 3.1 65,611,462 46,683,227 67,105,682 Restricted Cash in Reserve Accounts 3.2 83,048,876 53,778,067 17,140,404 ----------- ---------- ---------- 148,660,339 100,461,294 84,246,086 =========== ========== ========== 3.4 LETTERS OF CREDIT Additional liquidity is available, if needed for debt service, from Sponsor (CMS and ABB) Letters of Credit in the following accounts: 12/31/03 12/31/02 12/31/01 ---------- ---------- ---------- a. Major Maintenance Reserve Account US$ 2,500,000 2,500,000 0 b. Fixed O&M Reserve Account US$ 4,800,000 4,800,000 0 c. Debt Service Reserve Account US$ 11,300,000 11,300,000 22,600,000 d. Super Reserve Account US$ 39,086,700 47,900,000 36,800,000 e. Debt Service Reserve Account Euro 15,000,000 15,000,000 30,000,000 4. INVENTORIES The inventories are detailed as follows for the year ending: 12/31/03 12/31/02 12/31/01 US$ US$ US$ ---------- ---------- ---------- Stock of Coal 4.1 24,763,321 22,499,748 23,305,684 Stock of Fuel-oil 4.2 1,638,256 2,078,600 2,988,752 Stock of Spare Parts 4.3 10,940,862 15,081,606 4,952,377 Other Stocks (Chemicals, Oils, ...) 1,205,566 954,692 512,445 ---------- ---------- ---------- 38,548,005 40,614,646 31,759,259 ========== ========== ========== F-141 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 4.1 The stock of coal represents the value of 397,745 tones existing in the coal storage area plus 184,318 tones in transit to Jorf Lasfar, for a total inventory of 582,063 tones as of December 31, 2003 (606,115 tones total as of December 31, 2002 and 643,042 tones total as of December 31, 2001). 4.2 The stock of fuel oil represents 9,471 m3 existing in the fuel tanks as of December 31, 2003 (12,300 m3 as of December 31, 2002). 4.3 The stock of Spare Parts represents the value of spare parts as of December 31, 2003, that were purchased after the close-out of the Net Investment on December 31, 2000. ($ 15,081,606 as of December 31, 2002). 5. RECEIVABLES The "Accounts Receivables" as of December 31, 2003 are detailed as follows: 12/31/03 12/31/02 12/31/01 US$ US$ US$ ---------- ---------- ---------- Account Receivable - ONE 5.1 85,214,510 76,098,673 85,811,099 Account Receivable - Others 5.2 271,345 76,097 704,024 ---------- ---------- ---------- 85,485,855 76,174,769 86,515,123 ========== ========== ========== 5.1 The account receivable - ONE includes November 2003 and December 2003 invoices The account receivable balance as of December 31, 2002 was US$ 76,098,673 (Nov. and Dec. Invoices). 5.2 The other receivables include a) invoices to Valcen Gie (association of Moroccan cement companies) for purchases of fly ash during 4Q 2003 (US$ 71,101), b) accrued interest earned by investment of JLEC's cash balances ($ 67,425), and c) other receivable (US$ 132,819). 6. PREPAYMENTS The "Prepayments" as of December 31, 2003 are detailed as follows: 12/31/03 12/31/02 12/31/01 US$ US$ US$ --------- ---------- --------- Prepaid Insurance 3,599,349 3,582,404 3,822,746 Prepayments for Income Tax 3,929,580 5,194,869 0 Other Prepayments 609,277 1,653,537 653,896 --------- ---------- --------- 8,138,206 10,430,810 4,476,641 ========= ========= ========= 7. FIXED ASSETS The "Fixed Assets" are detailed as follows for year ending: 12/31/03 12/31/02 12/31/01 US$ US$ US$ ---------- ---------- --------- Fixed Asset - Gross 11,694,954 7,455,511 5,314,528 Depreciation -2,516,437 -1,884,137 -260,099 Construction in Progress 424,902 982,455 1,229,571 ---------- ---------- --------- 9,603,420 6,553,829 6,284,000 ========== ========== ========= 8. V.A.T LIABILITY The "V.A.T Liability" account represents the net amount of Value Added Tax as shown below: 12/31/03 12/31/02 12/31/01 US$ US$ US$ ---------- ---------- ---------- Value Added Tax received from ONE to be declared 5,179,969 4,805,614 8,415,330 Value Added Tax to be paid & declared -1,207,918 -1,934,168 -5,337,662 ---------- ---------- ---------- 3,972,052 2,871,446 3,077,668 ========== ========== ========== F-142 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 9. OTHER

LONG TERM ASSETS The Other Long Term Assets are as follows: 12/31/03 12/31/02 12/31/01 US$ US$ US$ ---------- ---------- --------- Long Term Receivables Loan 3,372,930 2,754,540 2,016,161 Long Term Ash Disposal Site 1,389,307 1,913,308 0 Major Maintenance capitalized during 2001 Unit 1 turbine overhaul outage 7,898,850 7,898,850 7,898,850 Less: Amortization of Unit 1 Major Maintenance in 2001 and 2002 -1,598,577 -470,170 -470,170 9.1 Less: Amortization of Unit 1 Major Maintenance in 2003 -1,036,582 -1,128,407 0 Less: Adjustments due to changes in methodes -599,070 0 0 Major Maintenance capitalized during 2003 - Unit 2 turbine overhaul outage 10,529,148 0 0 9.1 Less: Amortization of Unit 2 Major Maintenance in 2003 -898,320 0 0 ---------- ---------- --------- 19,057,685 10,968,120 9,444,841 ========== ========== ========= 9.1 Capitalized major maintenance costs are amortized over the estimated useful life of the investment, which for the turbine overhauls is 7 years (84 months). 10. ACCOUNTS PAYABLE TO THIRD PARTIES The "Account Payable to Third Parties" includes the main suppliers of JLEC as of December 31, 2003 and are detailed as follows: 12/31/03 12/31/02 12/31/01 US$ US$ US$ ---------- ---------- ---------- Billiton (coal supplier) 2,800,790 4,119,817 16,060,510 Anglo (coal supplier) 6,320,391 2,245,218 5,281,412 RAG Trading (coal supplier) 0 4,499,958 0 Glencore (coal supplier) 20,030,571 2,187,744 0 BULK (coal supplier) 4,470,349 0 0 Total (coal supplier) 0 0 2,267,178 Alstom Power 1,507,931 2,845,357 2,607,834 ONE - Rebate 4,139,908 2,767,010 3,547,774 Other suppliers 8,581,419 6,832,615 4,999,250 ---------- ---------- ---------- Total 47,851,359 25,497,718 34,763,957 ========== ========== ========== 11. RELATED PARTY TRANSACTIONS During the year 2003, JLEC has booked a number of related parties transactions as follows: ABB ABB CMS CMS CMS TOTAL EV MAROC MOPCO MOPCO RD & GEN US$ MAD MAD MAD US$ US$ CURRENCIES Acc. Payable 12/31/02 105,764 125,880 -1,452,394 46,253,345 82,686 2003: Management Fees 32,938,795 Incentive Accrual 29,320,319 Other 214,644 237,916 3,582,315 Total Payments 2003 230,400 363,796 30,311,126 46,253,688 82,686 Acc. Payable 90,007 0 4,757,590 29,319,976 0 Acc. Pay. in US$ 90,007 0 542,101 3,340,851 0 3,972,960 F-143 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 11. RELATED PARTY TRANSACTIONS (CONTINUED) JORF LASFAR JORF LASFAR TRE KRONOR ENERGIAKTIE- POWER ENERGY JORF LASFAR INVESTMENT BOLAG AB HANDELSBOLAG AB AB CYTHERE 61 AB CYTHERE 63 TOTAL COMMON STOCK MAD MAD MAD MAD MAD MAD MAD CURRENCIES Acc. Payable 12/31/02 220,166,565 202,553,239 17,613,325 39,682,115 2,164,464 950,199,532 1,432,379,240 Dividend Payable 10/30/03 151,250,000 139,150,000 12,100,000 12,100,000 660,000 289,740,000 605,000,000 Total Payments 2003 156,487,853 143,968,825 12,519,028 8,343,124 455,079 199,779,902 521,553,812 Acc. Payable 214,928,711 197,734,415 17,194,297 43,438,991 2,369,384 1,040,159,631 1,515,825,428 B/S FX Rate MAD/USD 8.776 8.776 8.776 8.776 8.776 8.776 8.776 Acc. Pay. in US$ 24,489,951 22,530,755 1,959,196 4,949,635 269,978 118,520,502 172,720,019 JORF LASFAR JORF LASFAR TRE KRONOR PREFERRED STOCK & CONVERTIBLE ENERGIAKTIE- POWER ENERGY JORF LASFAR INVESTMENT AB AB SECURITIES BOLAG AB HANDELSBOLAG AB CYTHERE 61 CYTHERE 63 TOTAL MAD MAD MAD MAD MAD MAD MAD CURRENCIES Preferred Stock Dividend payable 0 0 0 0 226,840 99,666,957 99,893,797 Convertible Securities Interest payable 52,028,019 47,865,778 4,162,242 4,162,242 0 0 108,218,281 Total Payments 2003 52,028,019 47,865,778 4,162,242 4,162,242 226,840 99,666,957 208,112,078 Acc. Payable 0 0 0 0 0 0 0 B/S FX Rate MAD/USD 8.776 8.776 8.776 8.776 8.776 8.776 8.776 Acc. Pay. in US$ 0 0 0 0 0 0 0 ----------- Total Accounts Payable to Related Parties 176,692,979 During 2002, related party transactions consisted of the following: ABB ABB CMS CMS CMS EV MAROC MOPCO MOPCO RD & GEN TOTAL US$ MAD MAD MAD US$ US$ CURRENCIES Acc. Payable 12/31/01 137,581 78,576 7,726,314 44,598,493 76,753 Management Fees 35,654,033 Incentive Accrual 46,253,517 Other 207,059 778,086 6,139,521 114,510 Total Payments 2002 238,876 730,782 38,693,220 44,598,665 108,577 Acc. Payable 12/31/02 105,764 125,880 1,452,394 46,253,345 82,686 Acc. Pay. in US$ 12/31/02 105,764 12,345 142,433 4,535,976 82,686 4,594,337 JORF LASFAR JORF LASFAR TRE KRONOR ENERGIAKTIE- POWER ENERGY JORF LASFAR INVESTMENT BOLAG AB HANDELSBOLAG AB AB CYTHERE 61 AB CYTHERE 63 TOTAL COMMON STOCK MAD MAD MAD MAD MAD MAD MAD CURRENCIES Acc. Payable 12/31/01 202,826,993 186,600,834 16,226,160 16,226,160 885,063 388,542,764 811,307,973 Dividend Payable Oct 29, 2002 495,000,000 455,400,000 39,600,000 39,600,000 2,160,000 948,240,000 1,980,000,000 Total Payments 2002 477,660,429 439,447,594 38,212,834 16,144,045 880,600 386,583,232 1,358,928,734 Acc. Payable 12/31/02 220,166,565 202,553,239 17,613,325 39,682,115 2,164,464 950,199,532 1,432,379,240 B/S FX Rate MAD/USD 10.197 10.197 10.197 10.197 10.197 10.197 10.197 Acc. Pay. in US$ 12/31/02 21,591,308 19,864,003 1,727,305 3,891,548 212,265 93,184,224 140,470,652 JORF LASFAR JORF

LASFAR TRE KRONOR ENERGIAKTIE- POWER ENERGY JORF LASFAR INVESTMENT PREFERRED STOCK & BOLAG AB HANDELSBOLAG AB AB CYTHERE 61 AB CYTHERE 63 TOTAL CONVERTIBLE SECURITIES MAD MAD MAD MAD MAD MAD MAD CURRENCIES Preferred Stock Dividend payable 0 0 0 0 261,774 115,016,078 115,277,852 Convertible Securities Interest payable 63,882,171 58,771,597 5,110,574 5,110,574 16,749 7,359,167 140,250,832 Total Payments 2002 63,882,171 58,771,597 5,110,574 5,110,574 278,523 122,375,245 255,528,684 Acc. Payable 12/31/02 0 0 0 0 0 0 0 B/S FX Rate MAD/USD 10.197 10.197 10.197 10.197 10.197 10.197 10.197 Acc. Pay. in US$ 12/31/02 0 0 0 0 0 0 0 Total Accounts Payable to Related Parties 145,064,990 F-144 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 11. RELATED PARTY TRANSACTIONS (CONTINUED) During 2001, related party transactions consisted of the following: ABB ABB ABB ABB CMS CMS CMS EV SECHERON SECHERON MAROC MOPCO MOPCO RD & GEN TOTAL US$ DEM CHF MAD MAD MAD US$ US$ CURRENCIES Acc. Payable 12/31/00 43,545 - - - 16,747,904 96,757,074 200,667 Management Fees 35,287,098 Incentive Accrual 44,314,093 Other 331,716 375,000 25,200 469,461 5,873,718 471,870 Total Payments 2001 237,679 375,000 25,200 390,885 38,434,970 96,472,673 595,784 Acc. Payable 12/31/01 137,581 - - 78,576 7,726,314 44,598,493 76,753 Acc. Pay. in US$ 12/31/01 137,581 - - 6,777 666,349 3,846,356 76,753 4,733,816 JORF LASFAR JORF LASFAR TRE KRONOR JORF LASFAR AB ENERGIAKTIE- POWER ENERGY INVESTMENT HANDELS- CYTHERE AB CYTHERE 63 BOLAG AB AB BOLAG 61 TOTAL MAD MAD MAD MAD MAD MAD MAD CURRENCIES Dividend Payable Apr 24, 2001 790,200,000 412,500,000 379,500,000 33,000,000 33,000,000 1,800,000 1,650,000,000 Dividend Payable Oct 29, 2001 650,598,000 339,625,000 312,455,000 27,170,000 27,170,000 1,482,000 1,358,500,000 Total Payments 2001 1,052,255,236 549,298,007 505,354,166 43,943,841 43,943,841 2,396,937 2,197,192,027 Acc. Payable 12/31/01 388,542,764 202,826,993 186,600,834 16,226,160 16,226,160 885,063 811,307,973 B/S FX Rate MAD/USD 11.60 11.60 11.60 11.60 11.60 11.60 11.60 Acc. Pay. in US$ 12/31/01 33,509,510 17,492,626 16,093,216 1,399,410 1,399,410 76,331 69,970,502 Total Accounts Payable to Related Parties 74,704,318 12. TAXES PAYABLE: The "taxes payable" includes the following items as of December 31, 2003: 12/31/03 12/31/02 12/31/01 US$ US$ US$ --------- --------- ------- Value Added Tax on behalf of foreign suppliers 309,190 299,199 312,044 Income Tax 2001 0 0 186,202 Income Tax 2002 0 4,226,098 0 Income Tax 2003 5,393,931 0 0 Withholding Tax 260,841 155,281 192,380 Payroll Tax 237,358 185,575 182,715 Licence Tax 1,325,971 0 0 --------- --------- ------- Total 7,527,291 4,866,153 873,340 ========= ========= ======= 13. CAPACITY CHARGES 13.1 $ CAPACITY CHARGES GREATER THAN $ DFL MODEL ACTUAL DFL MODEL $ CAPACITY MIN LEASE CHARGES PAYMENTS DIFFERENCE CGNC US GAAP US GAAP USD USD USD ----------- ----------- -------- $ Capacity Charges 103,690,956 104,516,335 -825,379 $ O.N.E Rebate -2,761,910 -2,874,199 112,289 ----------- ----------- -------- 2003 in USD 100,929,046 101,642,136 -713,090 $ Capacity Charges greater than $ DFL Model -713,090 -------- 13.2 EURO CAPACITY CHARGES GREATER THAN EURO DFL MODEL ACTUAL DFL MODEL EURO CAPACITY MIN LEASE CHARGES PAYMENTS DIFFERENCE CGNC US GAAP US GAAP EURO EURO EURO/USD ----------- ----------- ---------- Euro Capacity Charges 125,149,979 124,917,610 232,369 Euro O.N.E Rebate -3,333,492 -3,435,234 101,742 ----------- ----------- ---------- 2003 in Euro 121,816,487 121,482,376 334,111 B/S FX Rate X 1.263417 ---------- Euro Capacity Charges greater than Euro DFL Model in USD 422,122 F-145 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 13. CAPACITY CHARGES (CONTINUED) 13.1 $ CAPACITY CHARGES GREATER THAN $ DFL MODEL ACTUAL DFL MODEL $ CAPACITY MIN LEASE CHARGES PAYMENTS DIFFERENCE CGNC US GAAP US GAAP USD USD USD ----------- ----------- ---------- $ Capacity Charges 152,243,461 148,653,918 3,589,543 $ O.N.E Rebate -7,466,514 -6,317,791 -1,148,723 ----------- ----------- ---------- 2002 in USD 144,776,947 142,336,127 2,440,820 $ Capacity Charges greater than $ DFL Model 2,440,820 ---------- 13.2 EURO CAPACITY CHARGES GREATER THAN EURO DFL MODEL ACTUAL DFL MODEL EURO CAPACITY MIN LEASE CHARGES PAYMENTS DIFFERENCE CGNC US GAAP US GAAP EURO EURO EURO/USD ------------ ----------- ---------- Euro Capacity Charges 131,283,947 130,150,792 1,133,155 Euro O.N.E Rebate -6,438,591 -5,531,409 -907,183 ------------ ----------- ---------- 2002 in Euro 124,845,355 124,619,384 225,971 B/S FX Rate X 1.046582 ---------- Euro Capacity Charges greater than Euro DFL Model in USD 236,497 13.1 $ CAPACITY CHARGES GREATER THAN $ DFL MODEL ACTUAL DFL MODEL $ CAPACITY MIN LEASE CHARGES PAYMENTS DIFFERENCE CGNC US GAAP US GAAP USD USD USD ----------- ----------- ---------- $ Capacity Charges 167,725,226 174,863,943 -7,138,718 $ O.N.E Rebate -4,643,978 -1,876,144 -2,767,834

----------- ----------- ---------- 2001 in USD 163,081,248 172,987,799 -9,906,551 $ Capacity Charges greater than $ DFL Model -9,906,551 ---------- 13.2 EURO CAPACITY CHARGES GREATER THAN EURO DFL MODEL ACTUAL DFL MODEL EURO CAPACITY MIN LEASE CHARGES PAYMENTS DIFFERENCE CGNC US GAAP US GAAP EURO EURO EURO/USD ----------- ----------- ---------- Euro Capacity Charges 114,874,856 117,731,467 -2,856,611 Euro O.N.E Rebate -3,180,600 -1,263,161 -1,917,440 ----------- ----------- ---------- 2001 in Euro 111,694,256 116,468,307 -4,774,051 B/S FX Rate X 0.88504 --------- Euro Capacity Charges greater than Euro DFL Model in USD -4,225,210 14. OTHER CURRENT LIABILITIES The "Other Current Liabilities" as of December 31, 2003 are detailed as follows: 12/31/03 12/31/02 12/31/01 US$ US$ US$ ----------- --------- ---------- Accrued Expenses: interest, swaps and fees 14.1 5,904,937 6,072,924 17,293,488 Accrued salaries expense 1,198,164 1,390,179 986,669 Liability for Compensated Absences 298,523 307,449 108,027 Other Liabilities 337,780 184,470 218,670 ----------- --------- ---------- 7,739,404 7,955,022 18,606,854 =========== ========= ========== F-146 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 14. OTHER CURRENT LIABILITIES (CONTINUED) 14.1 The accrued interests and fee expenses are detailed by loans as follows: 12/31/03 12/31/02 12/31/01 US$ US$ US$ --------- ---------- ---------- OPIC 728,141 807,914 907,733 SACE 1,586,760 1,522,740 1,413,325 WB 1,712,739 1,629,541 1,146,864 US EXIM - Exposure Fees 0 0 12,255,922 US EXIM 1,574,138 1,823,435 1,370,400 ERG 303,158 289,295 199,245 --------- ---------- ---------- 5,904,937 6,072,924 17,293,488 ========= ========== ========== 15. LONG TERM LOANS Long term loans are detailed as follows as of December 31, 2003: INTEREST REIMBURSEMENT BORROWING PRINCIPAL ---------------------- INTERES -------------------------- LOAN DATE CURRENCY AMOUNT TYPE RATE PAYMENT MATURITY PERIODICITY ------------ ----------- --------- ----------- -------- --------- --------- ------------- ----------- US EXIM 9/12/02 US$ 181,363,762 Fixed 7.2000% Quarterly Feb. 15, 2013 Quarterly OPIC Note A 11/25/97 US$ 46,635,417 Fixed 10.2300% Quarterly Feb. 15, 2013 Quarterly OPIC Note B 02/11/98 US$ 10,175,000 Fixed 9.9200% Quarterly Feb. 15, 2013 Quarterly ----------- 56,810,417 ----------- Total L.T loan in US$ 238,174,179 ----------- Current part in USD 25,748,560 ----------- Non-Current part in USD 212,425,619 ----------- INTEREST REIMBURSEMENT BORROWING PRINCIPAL ---------------------- INTERES -------------------------- LOAN DATE CURRENCY AMOUNT TYPE RATE PAYMENT MATURITY PERIODICITY ------------ ------------ --------- ------------ -------- --------- --------- ------------ ----------- SACE 11/17/03 Euro 179,332,929 Fixed 5.7300% Quarterly Feb. 15, 2013 Quarterly ERG 11/17/03 Euro 23,045,939 Variable 4.16888% Quarterly Feb. 15, 2013 Quarterly World Bank 11/17/03 Euro 123,359,818 Variable 3.9189% Quarterly Feb. 15, 2013 Quarterly ----------- Total L.T loan in Euro 325,738,687 ----------- B/S FX Rate Euro/USD 1.26342 ----------- Total L.T loan in USD 411,543,784 ----------- Current part in USD 44,491,219 ----------- Non-Current part in USD 367,052,565 ----------- Total principal repayments for the next five years are detailed below. Forecasts of interest payments, interest-rate swap payments and guarantee fees are also shown below. For further information regarding swaps, see Note 20. REMAINING REMAINING REMAINING PRINCIPAL PRINCIPAL PRINCIPAL PRINCIPAL PRINCIPAL INTEREST SWAP GUARANTEE REPAYMENT IN REPAYMENT IN REPAYMENT IN REPAYMENT IN REPAYMENT IN PAYMENTS PAYMENTS FEES 2004 2005 2006 2007 2008 2004-2013 2004-2013 2004-2013 In USD US EXIM 19,606,893 19,606,893 19,606,893 19,606,893 19,606,893 62,017,946 0 0 OPIC A 5,041,667 5,041,666 5,041,666 5,041,666 5,041,666 22,657,888 0 0 OPIC B 1,100,000 1,100,000 1,100,000 1,100,000 1,100,000 4,793,735 0 0 Total in USD 25,748,560 25,748,559 25,748,559 25,748,559 25,748,559 89,469,569 0 0 In Euro SACE 19,387,344 19,387,344 19,387,344 19,387,344 19,387,344 49,481,105 0 0 ERG 2,491,452 2,491,452 2,491,452 2,491,452 2,491,452 4,730,553 4,774,063 0 WB 13,336,197 13,336,197 13,336,197 13,336,197 13,336,197 22,600,374 25,202,063 5,472,842 Total in Euro 35,214,993 35,214,993 35,214,993 35,214,993 35,214,993 76,812,032 29,976,126 5,472,842 B/S FX Rate Euro/USD 1.26342 1.26342 1.26342 1.26342 1.26342 1.26342 1.26342 1.26342 Total in USD 44,491,219 44,491,219 44,491,219 44,491,219 44,491,219 97,045,624 37,872,347 6,914,481 F-147 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 15. LONG TERM LOANS (CONTINUED) Long term loans are detailed as follows as of December 31, 2002: INTEREST REIMBURSEMENT BORROWING PRINCIPAL ---------------- INTEREST -------------------------- LOAN DATE CURRENCY AMOUNT TYPE RATE PAYMENT MATURITY PERIODICITY US EXIM 9/12/02 US$ 200,971,655 Fixed 7.2% Quarterly Feb. 15, 2013 Quarterly OPIC Note A 11/25/97 US$ 51,677,083 Fixed 10.23% Quarterly Feb. 15, 2013 Quarterly OPIC Note B 02/11/98 US$ 11,275,000 Fixed 9.92% Quarterly Feb. 15, 2013 Quarterly ----------- 62,952,083 ----------- Total L.T loan in US$ 263,923,738 ----------- Current part in USD 25,748,560 ----------- Non-Current part in USD 238,175,178 ----------- INTEREST REIMBURSEMENT BORROWING PRINCIPAL ---------------- INTEREST -------------------------- LOAN DATE CURRENCY AMOUNT TYPE RATE PAYMENT MATURITY PERIODICITY SACE 11/15/02 Euro 198,720,273 Fixed 5.73% Quarterly Feb. 15, 2013 Quarterly ERG 11/15/02 Euro 25,537,392 Variable 5.14% Quarterly Feb. 15, 2013 Quarterly World Bank 11/15/02 Euro 136,696,015 Variable 4.89% Quarterly Feb. 15, 2013 Quarterly ------------ Total L.T loan in Euro 360,953,680 ------------ B/S FX Rate Euro/USD 1.04658 ------------ Total L.T loan in USD 377,767,743 ------------ Current part in USD 36,855,389 ------------ Non-Current part in USD 340,912,354 ------------ Total principal repayments for the next five years are detailed below. Forecasts of interest payments, interest-rate swap payments and guarantee fees are also shown below. For further information regarding swaps, see Note 20. REMAINING REMAINING REMAINING PRINCIPAL PRINCIPAL PRINCIPAL PRINCIPAL PRINCIPAL INTEREST SWAP GUARANTEE REPAYMENT IN REPAYMENT IN REPAYMENT IN REPAYMENT IN REPAYMENT IN PAYMENTS PAYMENTS FEES 2003 2004 2005 2006 2007 2003-2013 2003-2013 2003-2013 In USD US EXIM 19,606,893 19,606,893 19,606,893 19,606,893 19,606,893 76,033,383 0 0 OPIC A 5,041,667 5,041,666 5,041,666 5,041,666 5,041,666 27,754,052 0 0 OPIC B 1,100,000 1,100,000 1,100,000 1,100,000 1,100,000 5,871,955 0 0 Total in USD 25,748,560 25,748,559 25,748,559 25,748,559 25,748,559 109,659,390 0 0 In Euro SACE 19,387,344 19,387,344 19,387,344 19,387,344 19,387,344 60,663,342 0 0 ERG 2,491,452 2,491,452 2,491,452 2,491,452 2,491,452 7,093,552 4,535,473 0 WB 13,336,197 13,336,197 13,336,197 13,336,197 13,336,197 36,148,188 23,844,995 6,757,469 Total in Euro 35,214,993 35,214,993 35,214,993 35,214,993 35,214,993 103,905,082 28,380,468 6,757,469 B/S FX Rate Euro/USD 1.04658 1.04658 1.04658 1.04658 1.04658 1.04658 1.04658 1.04658 Total in USD 36,855,389 36,855,389 36,855,389 36,855,389 36,855,389 108,745,223 29,702,496 7,072,248 Long term loans are detailed as follows as of December 31, 2002: DRAWDOWN DRAWDOWN INTEREST INTEREST REIMBURSEMENT LOAN DATE CURRENCY AMOUNT TYPE RATE PAYMENT MATURITY PERIODICITY US EXIM 11/15/2001 US$ 207,446,204 Variable 4.14% Quarterly Feb. 15, 2013 Quarterly OPIC Note A 11/25/97 US$ 56,718,750 Fixed 10.48% Quarterly Feb. 15, 2013 Quarterly OPIC Note B 02/11/98 US$ 12,375,000 Fixed 10.17% Quarterly Feb. 15, 2013 Quarterly 69,093,750 Total L.T loan in US$ 276,539,954 Current part in USD 24,873,137 Non-Current part in USD 251,666,817 DRAWDOWN DRAWDOWN INTEREST INTEREST REIMBURSEMENT LOAN DATE CURRENCY AMOUNT TYPE RATE PAYMENT MATURITY PERIODICITY SACE 11/15/2001 Euro 218,107,617 Fixed 5.73% Quarterly Feb. 15, 2013 Quarterly ERG 11/15/2001 Euro 28,028,845 Variable 5.34% Quarterly Feb. 15, 2013 Quarterly World Bank 11/15/2001 Euro 150,032,211 Variable 5.09% Quarterly Feb. 15, 2013 Quarterly Total L.T loan in Euro 396,168,673 B/S FX Rate Euro/USD 0.885 Total L.T loan in USD 350,623,797 Current part in USD 31,166,559 Non-Current part in USD 319,457,237 F-148 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 15. LONG TERM LOANS (CONTINUED) Total principal repayments for the next five years are detailed below. Forecast interest payments, interest-rate swap payments and guarantee fees are also shown below. For further information regarding swaps, see Note 20. REMAINING REMAINING REMAINING PRINCIPAL PRINCIPAL PRINCIPAL PRINCIPAL PRINCIPAL INTEREST SWAP GUARANTEE REPAYMENT IN REPAYMENT IN REPAYMENT IN REPAYMENT IN REPAYMENT IN PAYMENTS PAYMENTS FEES 2002 2003 2004 2005 2006 2002-2013 2002-2013 2002-2013 In USD US EXIM 18,731,470 19,606,893 19,606,893 19,606,893 19,606,893 87,235,810 0 1,176,315 OPIC A 5,041,667 5,041,666 5,041,666 5,041,666 5,041,666 33,499,497 0 0 OPIC B 1,100,000 1,100,000 1,100,000 1,100,000 1,100,000 7,088,426 0 0 Total in USD 24,873,137 25,748,559 25,748,559 25,748,559 25,748,559 127,823,733 0 1,176,315 In Euro SACE 19,387,344 19,387,344 19,387,344 19,387,344 19,387,344 72,907,871 0 0 ERG 2,491,452 2,491,452 2,491,452 2,491,452 2,491,452 8,830,924 4,982,063 0 WB 13,336,197 13,336,197 13,336,197 13,336,197 13,336,197 45,081,853 25,824,728 8,173,329 Total in Euro 35,214,993 35,214,993 35,214,993 35,214,993 35,214,993 126,820,648 30,806,791 8,173,329 B/S FX Rate USD/Euro 0.88504 0.88504 0.88504 0.88504 0.88504 0.88504 0.88504 0.88504 Total in USD 31,166,559 31,166,559 31,166,559 31,166,559 31,166,559 112,240,922 27,265,139 7,233,696 PLEADGE OF STOCK AND OTHER ASSETS As security for the repayment of the loans, and the payment of all related interest, fees and swap obligations, JLEC and its stockholders have entered into various pledge agreements with Deutsche Bank Trust Company Americas, as Offshore Collateral Agent, and with Banque Marocaine pour le Commerce et l'Industrie, as Onshore Collateral Agent, for the benefit of such lenders and other secured parties. Such security shall continue in effect until the repayment in full of all outstanding principal amounts and the payment in full of all related interest, fee and swap obligations, which is scheduled to occur in February of 2013. The principle pledge agreements are: 1. The Stockholder Pledge and Security Agreements, in which each of JLEC's stockholders pledges all of its shares, claims, rights and interests in JLEC to the Offshore Collateral Agent. 2. The Security and Assignment Agreement, in which JLEC assigns to the Offshore Collateral Agent a security interest in all of JLEC's rights, title and interest in the following collateral, among others: a. all of JLEC's contractual rights, b. all rents, profits, income and revenues derived by JLEC from its ownership of the Project, c. all cash deposits and other assets in any of JLEC's accounts with financial institutions, d. all permits, licenses and other governmental authorizations obtained by JLEC in connection with its ownership of the Project, e. all of JLEC's insurance policies and related claims and proceeds, and f. all personal property and inventories of JLEC. 3. The Agreement for Pledge of Shares, in which each of JLEC's stockholders pledges all of its shares, claims, rights and interests in JLEC to the Onshore Collateral Agent, and assigns to the Onshore Collateral Agent the direct payment by JLEC of all dividends and other stockholder distributions if and whenever a Default has occurred and is continuing. 4. The General Delegation of Contract Claims, in which JLEC assigns to the Onshore Collateral Agent the direct payment of any and all contract claims due to JLEC if and whenever a Default has occurred and is continuing. 5. The Pledge over General Operating Accounts, in which JLEC pledges to the Onshore Collateral Agent any and all monies in JLEC's accounts with the Onshore Collateral Agent. 6. The Master Agreement for Assignment of Accounts Receivable as Security, in which JLEC assigns to the Onshore Collateral Agent a security interest in all of the accounts receivable payable by ONE to JLEC under the Power Purchase Agreement. F-149 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 COVENANTS The covenants on the loans also place restrictions on JLEC's payment of dividends and other distributions to JLEC's stockholders. Specifically, JLEC may not: 1. Pay any dividends to its stockholders, or 2. Make any distribution, payment or delivery of property or cash to its stockholders, or 3. Redeem, retire, purchase or otherwise acquire any shares of its capital stock, or 4. Purchase or redeem any subordinated debt except, on quarterly repayment dates and only then after first satisfying all debt service obligations and satisfying all of the following conditions, among others: a. No default shall have occurred, b. The cash balance in all JLEC reserve and accrual accounts shall equal or exceed required levels, c. JLEC's actual debt service coverage ratios for the current quarter and preceding four quarters have all been greater than 1.3, and d. JLEC's forecasted debt service coverage ratios for the next succeeding two quarters are greater than 1.3 JLEC has complied with these covenants since May 2001, when the loans began to be repaid. 16. STOCKHOLDERS' EQUITY The composition of Stockholders' Equity as of December 31, 2003 was: 16.1 COMMON STOCK COMMON STOCK -------------------------------- NUMBER PAR VALUE PAR VALUE STOCKHOLDERS OF SHARES DIRHAM US DOLLAR --- ------------------ ----------- AB Cythere 63, Sweden.................... 2,634 263,400 27,668 Jorf Lasfar Energiaktiebolag, Sweden...... 1,375 137,500 14,443 Jorf Lasfar Power Energy AB, Sweden....... 1,265 126,500 13,288 Tre Kronor Investment AB, Sweden.......... 110 11,000 1,155 Jorf Lasfar Handelsbolag, Sweden.......... 110 11,000 1,155 AB Cythere 61, Sweden.................... 6 600 63 ----- -------- ------ Total 5,500 550,000 57,773 16.2 CONVERTIBLE STOCKHOLDERS' SECURITIES On December 11, 2000, the JLEC stockholders purchased 100% of all Company Loan Notes for $387,355,000, and amended the Company Loan Agreement to make such stockholder securities convertible into Preferred Stock or Common Stock. On January 1, 2001, the convertible securities (Company Loan Principal) held by AB Cythere 61 and AB Cythere 63 were converted into Preferred Stock as shown below on Note 16.3. Such conversions shall be made into a fixed number of JLEC shares as listed below: NUMBER PAR VALUE PAR VALUE STOCKHOLDERS OF SHARES DIRHAM US DOLLAR --- ---------------------- ----------- AB Cythere 63, Sweden................... 0 0 0 Jorf Lasfar Energiaktiebolag, Sweden..... 10,537,024 1,053,702,400 96,838,750 Jorf Lasfar Power Energy AB, Sweden...... 9,694,062 969,406,200 89,091,650 Tre Kronor Investment AB, Sweden......... 842,962 84,296,200 7,747,100 Jorf Lasfar Handelsbolag, Sweden......... 842,962 84,296,200 7,747,100 AB Cythere 61, Sweden................... 0 0 0 ---------- ------------ ----------- Total 21,917,010 2,191,701,000 201,424,600 F-150 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 Under the terms of the amended Company Loan Agreement summarized below, these convertible securities constitute an hybrid instrument which are delt with in accordance with the substance of the transaction, i.e. as a Preferred Stock equivalent: (a) Expression of the Loan in MAD The outstanding USD 201,424,600 principal amount is expressed as MAD 2,191,701,000 for the purpose of computing interest and principal payments due under this Agreement. However, interest and principal payments will be paid to the stockholders in USD, provided that the Company is not responsible for any losses realized by the stockholders resulting from the depreciation of the value of the MAD relative to the USD. (b) Repayment or conversion into Stock Under the terms of the amended Agreement: - the Security may only be repaid, in whole or in part, at the Company's option; - the part of the Security principal held by other Company Lenders listed above may be converted into Common Stock at any time, using the same conversion ratio used for the conversion of the parts of AB Cythere 61 and AB Cythere 63; - the shares of Preferred Stock issued to AB Cythere 61 and AB Cythere 63 may be converted into Common Stock. In this case, all outstanding Security principal held by other Company Lenders will be mandatorily converted into Common Stock at the same conversion ratio. (c) Interest payment and accruals as Retained Earning In accordance with Amendment N(degree).2, the Company will pay interest on the unpaid principal amount once per year, at the interest rate per annum equal to the greater of (1) the Moroccan maximum deductible rate, and (2) 4.00%. The applicable interest rate for 2003 is 4.00%. Accruals for such interest payments are reported as part of the Retained Earning allocation in Note 16.4, and are not expensed. 16.3 PREFERRED STOCK In accordance with Section 3.01 par.(b) of the amended Company Loan Agreement (see note 16.2 above), the Company as converted on January 1, 2001, all outstanding Company Loan principal held by AB Cythere 61 and AB Cythere 63, at the conversion ratio of one (1) share of Preferred Stock for each one hundred (100) MAD of such Company Loan principal converted into Preferred Stock, as follows: PREFERRED STOCK --------------------------------------- NUMBER PAR VALUE PAR VALUE STOCKHOLDERS OF SHARES DIRHAM US DOLLAR --------------------------------------- ---------- ------------ ----------- AB Cythere 63, Sweden..................... 20,185,145 2,018,514,500 185,508,183 Jorf Lasfar Energiaktiebolag, Sweden...... 0 0 0 Jorf Lasfar Power Energy AB, Sweden....... 0 0 0 Tre Kronor Investment AB, Sweden.......... 0 0 0 Jorf Lasfar Handelsbolag, Sweden.......... 0 0 0 AB Cythere 61, Sweden..................... 45,941 4,594,100 422,217 ---------- ------------ ----------- Total 20,231,086 2,023,108,600 185,930,400 Such shares are non-participating voting shares of convertible Preferred Stock of the Company, and: - are convertible at any moment into shares of Common Stock; - give right to the collection of a minimum priority dividend, at least equal to 4% of the aggregate par value of the preferred shares, F-151 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 - do not participate in the distribution of the remaining balance of Retained Earning, which is divided among the shares of Common Stock as shown in Note 16.4. 16.4 RECONCILIATION AND ALLOCATION OF RETAINED EARNINGS 2003 US$ -- ----------- Retained Earnings as of December 31, 2002 113,030,506 Retained Earnings increase during 2003 119,850,319 Retained Earnings decrease during 2003 Convertible Securities interest payable as of January 1, 2003 -10,612,757 108,218,281 Dirhams 10.1970 Dirhams per US Dollar Preferred Stock Dividend payable as of January 1, 2003 -9,796,391 99,893,797 Dirhams 10.1970 Dirhams per US Dollar Common Stock Dividend payable as of October 30, 2003 -64,972,722 5,500 Common Stock Shares 110,000 Dirhams per share 605,000,000 Dirhams 9.3116 Dirhams per US Dollar on October 30, 2003 ----------- Total Retained Earnings 147,498,955 The Retained Earnings are allocated among the stockholders as follows: COMMON CONVERTIBLE SECURITIES PREFERRED STOCK STOCK TOTAL ----------------------- ---------------------- ------------------------- STOCKHOLDERS DIRHAMS US DOLLARS DIRHAMS US DOLLARS US DOLLARS US DOLLARS -- --------- --------- --------- --------- ----------- ------------ AB Cythere 63, Sweden........................ 0 0 81,861,977 9,327,725 61,310,884 70,638,608 Jorf Lasfar Energiaktiebolag, Sweden.......... 42,733,486 4,869,247 0 0 32,005,492 36,874,739 Jorf Lasfar Power Energy AB, Sweden........... 39,314,807 4,479,707 0 0 29,445,052 33,924,760 Tre Kronor Investment AB, Sweden............. 3,418,679 389,540 0 0 2,560,439 2,949,979 Jorf Lasfar Handelsbolag, Sweden.............. 3,418,679 389,540 0 0 2,560,439 2,949,979 AB Cythere 61, Sweden........................ 0 0 186,316 21,230 139,660 160,890 ---------- ---------- ---------- --------- ---------- ----------- Total 88,885,652 10,128,034 82,048,293 9,348,954 128,021,967 147,498,955 The allocations for Convertible Securities (88,885,652 Dirhams) and Preferred Stock (82,048,293 Dirhams) are payable as of January 1, 2004, and are scheduled for payment on May 17, 2004. 2002 US$ -- ---------- Retained Earnings as of December 31, 2001 187,671,644 Retained Earnings increase during 2002 132,287,908 Retained Earnings decrease during 2002: Convertible Securities interest payable as of January 1, 2002 -12,095,803 140,250,832 Dirhams 11.5950 Dirhams per US Dollar Preferred Stock Dividend payable as of January 1, 2002 -9,942,031 115,277,852 Dirhams 11.5950 Dirhams per US Dollar Common Stock Dividend payable as of October 29, 2002 -184,891,213 5,500 Common Stock Shares 360,000 Dirhams per share 1,980,000,000 Dirhams 10.7090 Dirhams per US Dollar on October 29, 2002 -----------

Total Retained Earnings 113,030,506 F-152 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 The Retained Earnings are allocated among the shareholders as follows: COMMON CONVERTIBLE SECURITIES PREFERRED STOCK STOCK TOTAL ------------------------ ----------------------- -------------------------- SHAREHOLDERS DIRHAMS US DOLLARS DIRHAMS US DOLLARS US DOLLARS US DOLLARS --------------------------------------- ---------- ------------ ---------- ---------- ----------- ------------ AB Cythere 63, Sweden................. 0 0 99,666,957 9,774,145 44,357,210 54,131,355 Jorf Lasfar Energiaktiebolag, Sweden... 52,028,019 5,102,287 0 0 23,155,340 28,257,626 Jorf Lasfar Power Energy AB, Sweden.... 47,865,778 4,694,104 0 0 21,302,912 25,997,016 Tre Kronor Investment AB, Sweden....... 4,162,242 408,183 0 0 1,852,427 2,260,610 Jorf Lasfar Handelsbolag, Sweden....... 4,162,242 408,183 0 0 1,852,427 2,260,610 AB Cythere 61, Sweden 0 0 226,840 22,246 101,041 123,287 ----------- ----------- ---------- --------- ----------- ------------ Total 108,218,281 10,612,757 99,893,797 9,796,391 92,621,358 113,030,506 2001 USD -- ----------- Retained Earnings as of December 31, 2000 296,408,600 Retained Earnings increase during 2001 161,385,686 Retained Earnings decrease during 2001 Common Stock dividend declared payable on April 24, 2001 -151,362,260 5,500 Common Stock Shares 300,000 Dirhams per share 1,650,000,000 Dirhams 10.9010 Dirhams per US Dollar on April 24, 2001 Common Stock dividend declared payable on October 29, 2001 -118,760,381 5,500 Common Stock Shares 247,000 Dirhams per share 1,358,500,000 Dirhams 11.4390 Dirhams per US Dollar on October 29, 2001 ----------- Total Retained Earnings 187,671,644 The Retained Earnings are allocated among the shareholders as follows: COMMON CONVERTIBLE SECURITIES PREFERRED STOCK STOCK TOTAL SHAREHOLDERS DIRHAMS US DOLLARS DIRHAMS US DOLLARS US DOLLARS US DOLLARS -------------------------------------- ------------ ----------- ----------- ---------- ----------- ----------- AB Cythere 63, Sweden................. 7,359,167 634,685 115,016,078 9,919,455 79,323,538 89,877,677 Jorf Lasfar Energiaktiebolag, Sweden... 63,882,171 5,509,458 0 0 41,408,453 46,917,911 Jorf Lasfar Power Energy AB, Sweden.... 58,771,597 5,068,702 0 0 38,095,776 43,164,478 Tre Kronor Investment AB, Sweden....... 5,110,574 440,757 0 0 3,312,676 3,753,433 Jorf Lasfar Handelsbolag, Sweden....... 5,110,574 440,757 0 0 3,312,676 3,753,433 AB Cythere 61, Sweden................. 16,749 1,445 261,774 22,576 180,691 204,712 ----------- ----------- ----------- --------- ----------- ----------- Total 140,250,833 12,095,803 115,277,852 9,942,031 165,633,810 187,671,644 17. DIRECT FINANCING LEASE - (D.F.L) As explained in Note 2b, JLEC is using the Direct Financing Lease methodology. Specific accounts were created to reflect this method. These accounts are detailed below. DIRECT FINANCING LEASE - (D.F.L) AS OF DECEMBER 31, 2003 17.1 LONG TERM RECEIVABLES AS OF DECEMBER 31, 2003 US$ EURO UNITS 1 TO 4 UNITS 1 TO 4 ------------- ------------ Total Minimum Lease Payments 1,283,596,155 956,285,785 Minimum Lease Payments for 2003 -101,642,136 -121,482,375 ------------- ------------- Total of Future Minimum Lease Payments 1,181,954,019 834,803,410 X 1.263417 ------------- ------------- Total of Future Minimum Lease Payments in US$ 17.3 1,181,954,019 1,054,704,794 ============= ============ F-153 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 The minimum lease payments under the US GAAP model for the next five years are as follows: US$ EURO ------------ ------------ YEAR UNITS 1 TO 4 UNITS 1 TO 4 ---- ------------ ----------- 2004 116,664,592 116,635,941 2005 116,371,118 107,167,144 2006 108,749,430 92,362,540 2007 96,617,923 85,060,254 2008 104,467,842 84,500,888 17.2 UNEARNED INCOME AS OF DECEMBER 31, 2003 US$ EURO ------------ ------------ UNITS 1 TO 4 UNITS 1 TO 4 ------------ ------------ Total Unearned Income 587,282,368 568,767,180 Lease Revenue 2003 -81,792,828 -91,756,966 X 1.14035 104,635,053 ----------- ----------- --------- ------------ 505,489,540 477,010,214 X 1.263417 ----------- ----------- Total Remaining Unearned Income in US$ 17.3 505,489,540 602,662,799 =========== =========== The minimum lease payments under the US GAAP model for the next five years are as follows: US$ EURO ------------ ------------ YEAR UNITS 1 TO 4 UNITS 1 TO 4 ---- ------------ ------------ 2004 78,203,985 84,230,456 2005 73,392,008 76,117,547 2006 68,172,214 69,587,224 2007 64,172,868 64,534,124 2008 59,591,568 58,711,491 17.3 NET INVESTMENT IN DIRECT FINANCING LEASES AS OF DECEMBER 31, 2003 US$ EURO ------------ ------------ UNITS 1 TO 4 UNITS 1 TO 4 ------------ ------------ Total of Future Minimum Lease Payments in US$ 17.1 1,181,954,019 1,054,704,794 Total Remaining Unearned Income in US$ 17.2 -505,489,540 -602,662,799 ------------- ------------- Net investment in direct financing leases in US$ 676,464,479 452,041,995 ============ ============ Current part in US$ 38,460,607 40,941,639 Non-Current part in US$ 638,003,872 411,100,356 DIRECT FINANCING LEASE - (D.F.L) AS OF DECEMBER 31, 2002 17.1 LONG TERM RECEIVABLES AS OF DECEMBER 31, 2002 US$ EURO -----------

------------ UNITS 1 TO 4 UNITS 1 TO 4 ------------ ------------ Total Minimum Lease Payments 1,426,008,468 1,081,037,348 Minimum Lease Payments for 2002 -142,336,127 -124,619,384 ------------ ------------- Total of Future Minimum Lease Payments 1,283,672,341 956,417,964 ------------ ------------- X 1.046582 Total of Future Minimum Lease Payments in US$ 17.3 1,283,672,341 1,000,970,139 ============= ============= F-154 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 The minimum lease payments under the US GAAP model for the next five years are as follows: US$ EURO ------------ ------------ YEAR UNITS 1 TO 4 UNITS 1 TO 4 ------------- ------------ ------------ 2003 101,642,136 121,482,376 2004 116,664,592 116,635,941 2005 116,371,118 107,167,144 2006 106,872,046 90,768,049 2007 96,617,923 85,060,254 17.2 UNEARNED INCOME AS OF DECEMBER 31, 2002 US$ EURO ------------ ------------ UNITS 1 TO 4 UNITS 1 TO 4 ------------ ------------ Total Unearned Income 673,381,447 668,603,895 Lease Revenue 2002 -88,463,713 -99,930,507 X 0.95144 95,077,872 ----------- ------------ --------- ---------- 584,917,734 568,673,388 ------------ ------------ X 1.046582 ------------ ------------ Total Remaining Unearned Income in US$ 17.3 584,917,734 595,163,517 =========== =========== The Lease Revenue under the US GAAP model for the next five years are as follows: US$ EURO ------------ ------------ YEAR UNITS 1 TO 4 UNITS 1 TO 4 ----------- ------------ ------------ 2003 81,436,213 91,576,926 2004 77,831,811 84,020,822 2005 73,012,360 75,871,769 2006 67,896,425 69,487,000 2007 64,019,517 64,661,480 17.3 NET INVESTMENT IN DIRECT FINANCING LEASES AS OF DECEMBER 31, 2002 US$ EURO ------------ ------------ UNITS 1 TO 4 UNITS 1 TO 4 ------------ ------------ Total of Future Minimum Lease Payments in US$ 17.1 1,283,672,341 1,000,970,139 Total Remaining Unearned Income in US$ 17.2 -584,917,734 -595,163,517 ------------- ------------- Net investment in direct financing leases in US$ 698,754,607 405,806,622 ============= ============= Current part in US$ 20,205,960 31,298,090 Non-Current part in US$ 678,548,647 374,508,532 17.1 LONG TERM RECEIVABLES AS OF DECEMBER 31, 2001 US$ EURO ------------ ------------ UNITS 1 TO 4 UNITS 1 TO 4 ------------ ------------ Total Minimum Lease Payments 1,638,683,000 1,210,483,496 Minimum Lease Payments for 2001 -172,987,799 -116,468,307 ------------- ------------- Total of Future Minimum Lease Payments 1,465,695,201 1,094,015,189 ------------- ------------- X 0.88504 ------------- ------------- Total of Future Minimum Lease Payments in US$ 17.3 1,465,695,201 968,243,542 ============= ============ The minimum lease payments under the US GAAP model for the next five years are as follows: US$ EURO ------------ ------------ YEAR UNITS 1 TO 4 UNITS 1 TO 4 ----------- ------------ ------------ 2002 147,453,739 125,654,878 2003 108,352,169 125,448,188 2004 121,415,209 118,233,920 2005 120,444,202 108,413,086 2006 109,842,978 91,398,693 F-155 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 17.2 UNEARNED INCOME AS OF DECEMBER 31, 2001 US$ EURO ------------ ------------ UNITS 1 TO 4 UNITS 1 TO 4 ------------ ------------ Total Unearned Income 823,653,897 792,223,192 Lease Revenue 2001 -100,679,205 -105,867,406 X 0.89305 94,544,727 ----------- ----------- --------- ---------- 722,974,692 686,355,786 ----------- ----------- 91,398,693 ----------- ----------- Total Remaining Unearned Income in US$ 17.3 722,974,692 607,450,028 =========== =========== The Lease Revenue under the US GAAP model for the next five years are as follows: US$ EURO ------------- ------------ YEAR UNITS 1 TO 4 UNITS 1 TO 4 -------------- ------------- ------------ 2002 91,392,805 101,298,144 2003 87,462,185 94,047,617 2004 83,519,951 86,014,881 2005 78,375,499 77,627,453 2006 73,017,083 71,189,178 17.3 NET INVESTMENT IN DIRECT FINANCING LEASES AS OF DECEMBER 31, 2001 US$ EURO ------------ ------------ UNITS 1 TO 4 UNITS 1 TO 4 ------------ ------------ Total of Future Minimum Lease Payments in US$ 17.1 1,465,695,201 968,243,542 Total Remaining Unearned Income in US$ 17.2 -722,974,692 -607,450,028 ------------- ------------ Net investment in direct financing leases in US$ 742,720,509 360,793,514 ============= ============ Current part in US$ 56,060,930 21,301,261 Non-Current part in US$ 686,659,570 339,492,340 18. FINANCIAL EXPENSES The Financial Expenses are detailed as follows, for the year ending: 12/31/03 12/31/02 12/31/01 US$ US$ US$ ----------- ----------- ----------- Interest, Fees and Swaps incurred from inception to December 31, 2003 Up-Front Fees 25,609,073 25,609,073 25,609,073 Interest Costs 287,290,576 246,526,514 210,187,205 Premiums 23,808,481 23,808,481 23,808,481 Commitment Fees 19,312,672 19,312,672 18,136,357 Arrangement Fees 2,396,273 2,396,273 2,396,273 Other Fees (acceptance fees, Agent fees...etc) 9,754,617 9,297,751 8,875,953 Guarantee Fees 20,598,822 19,101,732 5,496,128 Swaps 37,238,114 30,362,978 25,851,201 ----------- ----------- ----------- 426,008,628 376,415,474 320,360,671 Accrued Interest, Fees, Swaps (see Note 14.1) 5,904,937 6,072,924 17,293,488 ----------- ----------- ----------- Total Interest, Fees and Swaps 431,913,565 382,488,398 337,654,159 Interest, fees and swaps capitalized as part of the project construction for Units 3&4 -210,949,363 -210,949,363 -210,949,363 -----------

----------- ----------- Interest and swaps expensed - Total 220,964,202 171,539,035 126,704,796 Interest and swaps expensed from 1997 through 2002 -171,539,035 -126,704,796 -76,088,286 ----------- ----------- ----------- Interest and swaps expensed 49,425,167 44,834,239 50,616,510 =========== =========== =========== F-156 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 19. PENSION PLANS JLEC contributes to the following pension plans: 19.1 COMMON FUND FOR RETIREMENT (CAISSE COMMUNE DES RETRAITES OR CCR) As required by PPA Section 23.2.4, most of JLEC's employees (259 employees of 313, or 84%) plus 1 recent retiree are participants in the CCR defined benefit pension plan. This plan is funded by employee payroll deductions equal to 9% of the employee's gross pay, plus JLEC contributions equal to 18% of the participating employee's gross pay. In 2003, 2002 and 2001, JLEC contributed to the CCR US$ 350,071, US$ 291,036 and US$ 266,972, respectively. Benefits provided under this plan include pension and retiree health insurance. As of December 31, 2003, the benefit obligation totalled US$ 14,584,092 (MAD 127,992,907/8.7762). The fair value of assets contributed to the CCR was US$ 4,705,965 (MAD 41,300,493/8.7762) as of December 31, 2003. The net unfunded benefit obligation as of December 31, 2003 reflected in the accompanying balance sheet was US$ 9,878,126 (MAD 86,692,413/8.7762). The following assumptions were used to perform the actuarial valuations: 2003 2002 2001 ------ ----- ----- Discount rate 6.00% 7.58% 7.58% Rate of compensation increase 6.50% 6.50% 6.50% 19.2 MOROCCAN RETIREMENT FUND FOR PROFESSIONALS (CAISSE INTERPROFESSIONNELLE MAROCAINE DE RETRAITES OR CIMR) Employees of JLEC not covered by CCR participate in a fund to which the employer contributes an amount equal to 12 percent of the employee's gross pay. This fund is carried in the employee's name, and the pension benefits an employee will receive depend only on the amount contributed to this account and the returns earned on investments of those contributions. In 2003, JLEC's contribution to that fund amounted to USD 145,677 (USD 109,147 in 2002, and USD 105,912 in 2001) 20. DERIVATIVE INSTRUMENT LIABILITY / OTHER COMPREHENSIVE INCOME JLEC adopted SFAS N(degree). 133 on January 1, 2001. This standard requires JLEC to recognize at fair value on the balance sheet, as assets or liabilities, all contracts that meet the definition of a derivative instrument. Details of all JLEC derivative instruments (interest rate swaps) are provided in the following table as of December 31, 2003, and all such swaps qualify with 100% effectiveness as cash flow hedge for JLEC's variable interest rate loans. Therefore, in accordance with SFAS N(degree). 133, the changes in fair value of these interest rate swaps are reflected directly in Stockholders' Equity under "Other Comprehensive Income or (Loss)". JLEC determines fair value based upon market price estimations provided by the swap providers. 2003 FIXED RATE CURRENT CURRENT SETTLEMENT FORECAST OF VALUATION CREDIT SWAP PAID BY LIBOR PAID NOTIONAL AND TERMINATION REMAINING IN FACILITY PROVIDERS CURRENCY JLEC TO JLEC AMOUNT AMORTIZATION DATE PAYMENTS EURO ---------- ---------- -------- -------- ---------- ----------- ------------ ----------- ------------ ----- World Bank BNP Euro 6.4115% 2.16888% 41,119,939 Quarterly 2/15/2013 8,400,358 4,942,789 ABN Euro 6.4175% 2.16888% 41,119,939 Quarterly 2/15/2013 8,412,238 4,940,969 CSFB Euro 6.4060% 2.16888% 41,119,939 Quarterly 2/15/2013 8,389,468 4,733,058 ----------- ---------- ---------- 123,359,818 25,202,063 14,616,816 ----------- ---------- ---------- ERG BNP Euro 6.4700% 2.16888% 7,681,980 Quarterly 2/15/2013 1,590,984 942,887 ABN Euro 6.4750% 2.16888% 7,681,980 Quarterly 2/15/2013 1,592,834 942,179 CSFB Euro 6.4680% 2.16888% 7,681,980 Quarterly 2/15/2013 1,590,245 950,471 ----------- ---------- ---------- 23,045,940 4,774,063 2,835,537 ----------- ---------- ---------- Total in Euro 17,452,353 ---------- B/S FX rate X 1.26342 Total in USD 22,049,599 ========== F-157 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 2002 FIXED RATE CURRENT CURRENT SETTLEMENT FORECAST OF VALUATION CREDIT SWAP PAID BY LIBOR PAID NOTIONAL AND TERMINATION REMAINING IN FACILITY PROVIDERS CURRENCY JLEC TO JLEC AMOUNT AMORTIZATION DATE PAYMENTS EURO -------- --------- -------- ---- ------- ------ ------------ ---- -------- ---- World Bank BNP Euro 6.4115% 3.13725% 45,565,338 Quarterly 2/15/2013 7,947,927 5,729,083 ABN Euro 6.4175% 3.13725% 45,565,338 Quarterly 2/15/2013 7,962,491 5,739,581 CSFB Euro 6.4060% 3.13725% 45,565,338 Quarterly 2/15/2013 7,934,576 5,719,459 ----------- ---------- ---------- 136,696,014 23,844,995 17,188,122 ----------- ---------- ---------- ERG BNP Euro 6.4700% 3.13725% 8,512,464 Quarterly 2/15/2013 1,511,371 1,089,437 ABN Euro 6.4750% 3.13725% 8,512,464 Quarterly 2/15/2013 1,513,638 1,091,072 CSFB Euro 6.4680% 3.13725% 8,512,464 Quarterly 2/15/2013 1,510,464 1,088,783 ----------- ----------- ----------- 25,537,392 4,535,473 3,269,292 ----------- ----------- ----------- Total in Euro 20,457,415 ---------- B/S FX rate X 1.04658 Total in USD 21,410,369 ========== 2001 FIXED RATE CURRENT CURRENT

SETTLEMENT FORECAST OF VALUATION CREDIT SWAP PAID BY LIBOR PAID NOTIONAL AND TERMINATION REMAINING IN FACILITY PROVIDERS CURRENCY JLEC TO JLEC AMOUNT AMORTIZATION DATE PAYMENTS EURO -------- --------- -------- ---- ------- ------ ------------ ---- -------- ---- World Bank BNP Euro 6.4300% 3.34000% 48,899,387 Quarterly 12/17/2012 8,614,748 3,369,696 ABN Euro 6.4300% 3.34000% 48,899,387 Quarterly 12/17/2012 8,614,748 3,369,696 CSFB Euro 6.4230% 3.34000% 48,899,387 Quarterly 12/17/2012 8,595,232 3,362,062 ----------- ---------- ---------- 146,698,162 25,824,728 10,101,454 ----------- ---------- ---------- ERG BNP Euro 6.3600% 3.34000% 9,654,551 Quarterly 12/17/2012 1,662,339 650,231 ABN Euro 6.3600% 3.34000% 9,654,551 Quarterly 12/17/2012 1,662,339 650,231 CSFB Euro 6.3510% 3.34000% 9,654,551 Quarterly 12/17/2012 1,657,385 648,293 ----------- ---------- ---------- 28,963,653 4,982,063 1,948,755 ----------- ---------- ---------- Total in Euro 12,050,209 ---------- B/S FX rate X 0.88504 Total is USD 10,664,877 21. CASH FLOWS FOR 2003 Reconciliation of net income to net cash from operating activities under the Direct Method is as follows : 2003 2002 2001 US$ US$ US$ --- --- --- Net Income... 119,850,319 132,287,908 161,385,686 Adjustment to reconcile Net Income to cash provided from operating activities : Depreciation and amortization................................. 4,028,115 2,752,641 731,003 Deferred taxes.. (13,005,297) 6,908,298 6,097,093 Lease Revenue.. (186,427,881) (183,541,585) (195,223,932) Finance tariff cash revenue.................................. 246,405,730 263,559,812 262,829,803 Changes in operating assets and liabilities: Inventories... 2,066,641 (8,855,387) (9,242,424) Accounts receivable.. (9,311,086) 10,340,353 (22,975,149) Prepayments.. 2,292,604 (5,954,169) 979,429 Accounts payable... 22,353,640 (9,266,000) (20,701,000) Unfunded pension obligation.................................. 4,185,183 5,692,943 -- Other liabilities.. (2,445,519) (608,934) 3,093,490 Effect of exchange rate changes............................... 1,824,028 4,235,487 (2,003,877) -------------- ------------- ----------- Net cash provided by operating activities.............................. 191,816,478 217,551,367 184,970,122 22. UNCERTAINTIES AS OF DECEMBER 31, 2003 22.1 JLEC's corporate tax return, payroll tax and VAT returns for the years 2000 to 2003 are open to audit by the Moroccan Tax Authorities. JLEC is periodically involved in other legal, tax and other proceedings regarding matters arising in the ordinary course of business. JLEC believes that the outcome of these matters will not materially affect its results of operations or liquidity. 22.2 Discussions are currently underway between JLEC and ONE, which may result in amendments of the Power Purchase Agreement (PPA) and the Transfer of Possession Agreement (TPA). As currently drafted, such amendments would eliminate ONE's right of termination for convenience (which right ONE could otherwise exercise starting on September 13, 2012) and reduce ONE's right of termination due to adverse economic F-158 JORF LASFAR ENERGY COMPANY NOTES TO US GAAP FINANCIAL STATEMENTS DATED DECEMBER 31, 2003 circumstances (which right ONE might otherwise be entitled to exercise after all of the principal amount of JLEC's indebtedness to the project lenders has been repaid); and thereby, the proposed amendments would increase the likelihood that the PPA and TPA continue in effect until their scheduled expiration on September 13, 2027. In exchange, it is proposed that the PPA's gross capacity charges be reduced by means of a new rebate (to be paid by JLEC to ONE on a quarterly basis, and calculated starting from September 13, 2003) and future tariff reductions (starting from September 13, 2014). These possible PPA and TPA amendments are still under negotiation, and such negotiations may or may not converge on agreements acceptable to both JLEC and ONE. Furthermore, any potential PPA and TPA amendments agreed between JLEC and ONE would still be subject to change by and the approval of ONE's Board of Directors, JLEC's shareholders and JLEC's lenders before coming into effect. This process of negotiation, review and approval will require several months at least, and may possibly never result in any amendments. This uncertainty exists as of the date of these financial statements. 23. NEW ACCOUNTING STANDARDS In June 2002, FASB issued SFAS No 146, "Accounting for Costs Associated with Exit or Disposal Activities.". This statement addresses the recognition, measurement and reporting of costs that are associated with exit and disposal activities and nullifies EITF 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to exit an Activity (Including Certain costs incurred in a Restructuring)". Under SFAS 146, the cost associated with an exit or disposal activity is recognized in the periods in which it is incurred rather than at the date the company committed to the exit plan. This statement became effective for exit or disposal activities initiated after December 31, 2002. The adoption of SFAS No 146 did not have a material impact on JLEC's results of operations or its financial position. In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." The Standard specifies that instruments within its scope embody obligations of the issuer and that, therefore, the issuer must classify them as liabilities. The Standard is effective for interim or fiscal periods ending after June 15, 2003. JLEC is currently assessing the new standard and has not yet determined the impact on its financial statements. F-159 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM To the Partners and the Management Committee of Midland Cogeneration Venture Limited Partnership: In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, partners' equity and cash flows present fairly, in all material respects, the financial position of the Midland Cogeneration Limited Partnership (a Michigan limited partnership) and its subsidiaries (MCV) at December 31, 2003 and 2002, and the results of their operations and their cash flows for the each of the two years ended December 31, 2003 and 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of MCV's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. The financial statements of MCV for the year ended December 31, 2001, were audited by other independent accountants who have ceased operations. Those independent accountants expressed an unqualified opinion on those financial statements in their report dated January 18, 2002. As explained in Note 2 to the financial statements, effective April 1, 2002, Midland Cogeneration Venture Limited Partnership changed its method of accounting for derivative and hedging activities in accordance with Derivative Implementation Group ("DIG") Issue C-16. /s/ PricewaterhouseCoopers LLP ------------------------------ Detroit, Michigan February 18, 2004 F-160 THE FOLLOWING REPORT IS A COPY OF A PREVIOUSLY ISSUED REPORT BY ARTHUR ANDERSEN LLP (ANDERSEN). THIS REPORT HAS NOT BEEN REISSUED BY ANDERSEN, AND ANDERSEN DID NOT CONSENT TO THE INCLUSION OF THIS REPORT INTO THIS FORM 10-K. THE FOOTNOTE SHOWN BELOW WAS NOT PART OF ANDERSEN'S REPORT. ARTHUR ANDERSEN LLP REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS To the Partners and the Management Committee of the Midland Cogeneration Venture Limited Partnership: We have audited the accompanying consolidated balance sheets of the MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP (a Michigan limited partnership) and subsidiaries (MCV) as of December 31, 2001 and 2000*, and the related consolidated statements of operations, partners' equity and cash flows for each of the three years in the period ended December 31, 2001*. These financial statements are the responsibility of MCV's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. 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 consolidated financial position of the Midland Cogeneration Venture Limited Partnership and subsidiaries as of December 31, 2001 and 2000*, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2001*, in conformity with accounting principles generally accepted in the United States. As explained in Note 2 to the financial statements, effective January 1, 2001, Midland Cogeneration Venture Limited Partnership changed its method of accounting related to derivatives and hedging activities. ARTHUR ANDERSEN LLP Detroit, Michigan January 18, 2002 *The MCV's consolidated balance sheets as of December 31, 2001 and 2000 and the consolidated statements of operations, partners' equity and cash flows for the years ended December 31, 1999 and 2000 are not included in this Annual Report on Form 10-K. F-161 MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, (IN THOUSANDS) 2003 2002 ----------- ----------- ASSETS CURRENT ASSETS: Cash and cash equivalents $ 173,651 $ 160,425 Accounts and notes receivable - related parties 43,805 48,448 Accounts receivable 38,333 32,479 Gas inventory 20,298 19,566 Unamortized property taxes 17,672 18,355 Derivative assets 86,825 73,819 Broker margin accounts and prepaid expenses 8,101 5,165 ----------- ----------- Total current assets 388,685 358,257 ----------- ----------- PROPERTY, PLANT AND EQUIPMENT Property, plant and equipment 2,463,931 2,449,148 Pipeline 21,432 21,432 ----------- ----------- Total property, plant and equipment 2,485,363 2,470,580 Accumulated depreciation (991,556) (920,614) ----------- ----------- Net property, plant and equipment 1,493,807 1,549,966 ----------- ----------- OTHER ASSETS: Restricted investment securities held-to-maturity 139,755 138,701 Derivative assets non-current 18,100 31,037 Deferred financing costs, net of accumulated amortization of $17,285 and $15,930, respectively 7,680 9,035 Prepaid gas costs, materials and supplies 21,623 11,077 ----------- ----------- Total other assets 187,158 189,850 ----------- ----------- TOTAL ASSETS $ 2,069,650 $ 2,098,073 =========== =========== LIABILITIES AND PARTNERS' EQUITY CURRENT LIABILITIES: Accounts payable and accrued liabilities $ 57,368 $ 58,080 Gas supplier funds on deposit 4,517 -- Interest payable 53,009 56,386 Current portion of long-term debt 134,576 93,928 ----------- ----------- Total current liabilities 249,470 208,394 ----------- ----------- NON-CURRENT LIABILITIES: Long-term debt 1,018,645 1,153,221 Other 2,459 2,148 ----------- ----------- Total non-current liabilities 1,021,104 1,155,369 ----------- ----------- COMMITMENTS AND CONTINGENCIES TOTAL LIABILITIES 1,270,574 1,363,763 ----------- ----------- PARTNERS' EQUITY 799,076 734,310 ----------- ----------- TOTAL LIABILITIES AND PARTNERS' EQUITY $ 2,069,650 $ 2,098,073 =========== =========== The accompanying notes are an integral part of these statements. F-162 MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, (IN THOUSANDS) 2003 2002 2001 ------------ ------------ ------------ OPERATING REVENUES: Capacity $ 404,681 $ 404,713 $ 409,633 Electric 162,093 177,569 184,707 Steam 17,638 14,537 16,473 ------------ ------------ ------------ Total operating revenues 584,412 596,819 610,813 ------------ ------------ ------------ OPERATING EXPENSES: Fuel costs 254,988 255,142 288,167 Depreciation 89,437 88,963 92,176 Operations 16,943 16,642 16,082 Maintenance 15,107 12,666 13,739 Property and single business taxes 30,040 27,087 26,410 Administrative, selling and general 9,959 8,195 16,404 ------------ ------------ ------------ Total operating expenses 416,474 408,695 452,978 ------------ ------------ ------------ OPERATING INCOME 167,938 188,124 157,835 ------------ ------------ ------------ OTHER INCOME (EXPENSE): Interest and other income 5,100 5,555 16,725 Interest expense (113,247) (119,783) (126,296) ------------ ------------ ------------ Total other income (expense), net (108,147) (114,228) (109,571) ------------ ------------ ------------ NET INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE 59,791 73,896 48,264 Cumulative effect of change in method of accounting for derivative option contracts (to April 1, 2002) (Note 2) -- 58,131 -- ------------ ------------ ------------ NET INCOME $ 59,791 $ 132,027 $ 48,264 ============ ============ ============ The accompanying notes are an integral part of these statements. F-163 MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP CONSOLIDATED STATEMENTS OF PARTNERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, (IN THOUSANDS) GENERAL LIMITED PARTNERS PARTNERS TOTAL ----------- ----------- ----------- BALANCE, DECEMBER 31, 2000 $ 448,100 $ 79,638 $ 527,738 Comprehensive Income Net Income 42,020 6,244 48,264 Other Comprehensive Income Cumulative effect of accounting change 13,688 2,034 15,722 Unrealized loss on hedging activities (42,444) (6,307) (48,751) Reclassification adjustments recognized in net income above 7,608 1,131 8,739 ----------- ----------- ----------- Total other comprehensive income (21,148) (3,142) (24,290) ----------- ----------- ----------- Total Comprehensive Income 20,872 3,102 23,974 ----------- ----------- ----------- BALANCE, DECEMBER 31, 2001 $ 468,972 $ 82,740 $ 551,712 Comprehensive Income Net Income 114,947 17,080 132,027 Other Comprehensive Income Unrealized gain on hedging activities since beginning of period 33,311 4,950 38,261 Reclassification adjustments recognized in net income above 10,717 1,593 12,310 ----------- ----------- ----------- Total other comprehensive income 44,028 6,543 50,571 ----------- ----------- ----------- Total Comprehensive Income 158,975 23,623 182,598 ----------- ----------- ----------- BALANCE, DECEMBER 31, 2002 $ 627,947 $ 106,363 $ 734,310 Comprehensive Income Net Income 52,056 7,735 59,791 Other Comprehensive Income Unrealized gain on hedging activities since beginning of period 34,484 5,125 39,609 Reclassification adjustments recognized in net income above (30,153) (4,481) (34,634) ----------- ----------- ----------- Total other comprehensive income 4,331 644 4,975 ----------- ----------- ----------- Total Comprehensive Income 56,387 8,379 64,766 ----------- ----------- ----------- BALANCE, DECEMBER 31, 2003 $ 684,334 $ 114,742 $ 799,076 =========== =========== =========== The accompanying notes are an integral part of these statements. F-164 MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, (IN THOUSANDS) 2003 2002 2001 ------------ ------------ ------------ CASH FLOWS FROM OPERATING ACTIVITIES: Net income $ 59,791 $ 132,027 $ 48,264 Adjustments to reconcile net income to net cash provided by operating activities Depreciation and amortization 90,792 90,430 93,835 Cumulative effect of change in accounting principle -- (58,131) -- (Increase) decrease in accounts receivable (1,211) 48,343 55,127 (Increase) decrease in gas inventory (732) 133 (5,225) (Increase) decrease in unamortized property taxes 683 (1,730) (415) (Increase) decrease in broker margin accounts and prepaid expenses (4,778) 31,049 (26,587) (Increase) decrease in derivative assets 4,906 (20,444) -- (Increase) decrease in prepaid gas costs, materials and supplies (8,704) 1,376 8,414 Increase (decrease) in accounts payable and accrued liabilities (712) 8,774 (43,704) Increase in gas supplier funds on deposit 4,517 -- -- Decrease in interest payable (3,377) (3,948) (7,082) Increase (decrease) in other non-current liabilities 311 (24) 245 ------------ ------------ ------------ Net cash provided by operating activities 141,486 227,855 122,872 ------------ ------------ ------------ CASH FLOWS FROM INVESTING ACTIVITIES: Plant modifications and purchases of plant equipment (33,278) (29,529) (30,530) Maturity of restricted investment securities held-to-maturity 601,225 377,192 538,327 Purchase of restricted investment securities held-to-maturity (602,279) (374,426) (539,918) ------------ ------------ ------------ Net cash used in investing activities (34,332) (26,763) (32,121) ------------ ------------ ------------ CASH FLOWS FROM FINANCING ACTIVITIES: Repayment of financing obligation (93,928) (182,084) (155,632) ------------ ------------ ------------ Net cash used in financing activities (93,928) (182,084) (155,632) ------------ ------------ ------------ NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS 13,226 19,008 (64,881) CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD 160,425 141,417 206,298 ------------ ------------ ------------ CASH AND EQUIVALENTS AT END OF PERIOD $ 173,651 $ 160,425 $ 141,417 =========== =========== =========== The accompanying notes are an integral part of these statements. F-165 MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (1) THE PARTNERSHIP AND ASSOCIATED RISKS MCV was organized to construct, own and operate a combined-cycle, gas-fired cogeneration facility (the "FACILITY") located in Midland, Michigan. MCV was formed on January 27, 1987, and the Facility began commercial operation in 1990. In 1992, MCV acquired the outstanding common stock of PVCO Corp., a previously inactive company. MCV and PVCO Corp. entered into a partnership agreement to form MCV Gas Acquisition General Partnership ("MCV GAGP") for the purpose of buying and selling natural gas on the spot market and other transactions involving natural gas activities. Currently, MCV GAGP is not actively engaged in any business activity. The Facility has a net electrical generating capacity of approximately 1500 MW and approximately 1.5 million pounds of process steam capacity per hour. MCV has entered into three principal energy sales agreements. MCV has contracted to (i) supply up to 1240 MW of electric capacity ("CONTRACT CAPACITY") to Consumers Energy Company ("CONSUMERS") under the Power Purchase Agreement ("PPA"), for resale to its customers through 2025, (ii) supply electricity and steam to The Dow Chemical Company ("DOW") under the Steam and Electric Power Agreement ("SEPA") through 2015 and (iii) supply steam to Dow Corning Corporation ("DCC") under the Steam Purchase Agreement ("SPA") through 2011. From time to time, MCV enters into other sales agreements for the sale of excess capacity and/or energy available above MCV's internal use and obligations under the PPA, SEPA and SPA. Results of operations are primarily dependent on successfully operating the Facility at or near contractual capacity levels and on Consumers' ability to perform its obligations under the PPA. Sales pursuant to the PPA have historically accounted for over 90% of MCV's revenues. The PPA permits Consumers, under certain conditions, to reduce the capacity and energy charges payable to MCV and/or to receive refunds of capacity and energy charges paid to MCV if the Michigan Public Service Commission ("MPSC") does not permit Consumers to recover from its customers the capacity and energy charges specified in the PPA (the "REGULATORY-OUT" PROVISION). Until September 15, 2007, however, the capacity charge may not be reduced below an average capacity rate of 3.77 cents per kilowatt-hour for the available Contract Capacity notwithstanding the "regulatory-out" provision. Consumers and MCV are required to support and defend the terms of the PPA. The Facility is a qualifying cogeneration facility ("QF") originally certified by the Federal Energy Regulatory Commission ("FERC") under the Public Utility Regulatory Policies Act of 1978, as amended ("PURPA"). In order to maintain QF status, certain operating and efficiency standards must be maintained on a calendar-year basis and certain ownership limitations must be met. In the case of a topping-cycle generating plant such as the Facility, the applicable operating standard requires that the portion of total energy output that is put to some useful purpose other than facilitating the production of power (the "THERMAL PERCENTAGE") be at least 5%. In addition, the Facility must achieve a

PURPA efficiency standard (the sum of the useful power output plus one-half of the useful thermal energy output, divided by the energy input (the "EFFICIENCY PERCENTAGE")) of at least 45%. If the Facility maintains a Thermal Percentage of 15% or higher, the required Efficiency Percentage is reduced to 42.5%. Since 1990, the Facility has achieved the applicable Thermal and Efficiency Percentages. For the twelve months ended December 31, 2003, the Facility achieved a Thermal Percentage of 21.0% and an Efficiency Percentage of 47.4%. The loss of QF status could, among other things, cause the Facility to lose its rights under PURPA to sell power to Consumers at Consumers' "avoided cost" and subject the Facility to additional federal and state regulatory requirements. MCV believes that the Facility will meet the required Thermal Percentage and the corresponding Efficiency Percentage in 2003 and beyond, as well as the PURPA ownership limitations. The Facility is wholly dependent upon natural gas for its fuel supply and a substantial portion of the Facility's operating expenses consist of the costs of natural gas. MCV recognizes that its existing gas contracts are not sufficient to satisfy the anticipated gas needs over the term of the PPA and, as such, no assurance can be given as to the availability or price of natural gas after the expiration of the existing gas contracts. In addition, to the extent that the costs associated with production of electricity rise faster than the energy charge payments, MCV's financial performance will be negatively affected. The extent of such impact will depend upon the amount of the average F-166 energy charge payable under the PPA, which is based upon costs incurred at Consumers' coal-fired plants and upon the amount of energy scheduled by Consumers for delivery under the PPA. However, given the unpredictability of these factors, the overall economic impact upon MCV of changes in energy charges payable under the PPA and in future fuel costs under new or existing contracts cannot accurately be predicted. At both the state and federal level, efforts continue to restructure the electric industry. A significant issue to MCV is the potential for future regulatory denial of recovery by Consumers from its customers of above market PPA costs Consumers pays MCV. At the state level, the MPSC entered a series of orders from June 1997 through February 1998 (collectively the "RESTRUCTURING ORDERS"), mandating that utilities "wheel" third-party power to the utilities' customers, thus permitting customers to choose their power provider. MCV, as well as others, filed an appeal in the Michigan Court of Appeals to protect against denial of recovery by Consumers of PPA charges. The Michigan Court of Appeals found that the Restructuring Orders do not unequivocally disallow such recovery by Consumers and, therefore, MCV's issues were not ripe for appellate review and no actual controversy regarding recovery of costs could occur until 2008, at the earliest. In June 2000, the State of Michigan enacted legislation which, among other things, states that the Restructuring Orders (being voluntarily implemented by Consumers) are in compliance with the legislation and enforceable by the MPSC. The legislation provides that the rights of parties to existing contracts between utilities (like Consumers) and QFs (like MCV), including the rights to have the PPA charges recovered from customers of the utilities, are not abrogated or diminished, and permits utilities to securitize certain stranded costs, including PPA charges. In 1999, the U.S. District Court granted summary judgment to MCV declaring that the Restructuring Orders are preempted by federal law to the extent they prohibit Consumers from recovering from its customers any charge for avoided costs (or "STRANDED COSTS") to be paid to MCV under PURPA pursuant to the PPA. In 2001, the United States Court of Appeals ("APPELLATE COURT") vacated the U.S. District Court's 1999 summary judgment and ordered the case dismissed based upon a finding that no actual case or controversy existed for adjudication between the parties. The Appellate Court determined that the parties' dispute is hypothetical at this time and the QFs' (including MCV) claims are premised on speculation about how an order might be interpreted by the MPSC, in the future. MCV continues to monitor and participate in these industry restructuring matters as appropriate, and to evaluate potential impacts on both cash flows and recoverability of the carrying value of property, plant and equipment. MCV management cannot, at this time, predict the impact or outcome of these matters. (2) SIGNIFICANT ACCOUNTING POLICIES The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Following is a discussion of MCV's significant accounting policies. PRINCIPLES OF CONSOLIDATION The consolidated financial statements include the accounts of MCV and its wholly owned subsidiaries. All material transactions and balances among entities, which comprise MCV, have been eliminated in the consolidated financial statements. REVENUE RECOGNITION MCV recognizes revenue for the sale of variable energy and fixed energy when delivered. Capacity and other installment revenues are recognized based on plant availability or other contractual arrangements. FUEL COSTS MCV's fuel costs are those costs associated with securing natural gas, transportation and storage services necessary to generate electricity and steam from the Facility. These costs are recognized in the income statement F-167 based upon actual volumes burned to produce the delivered energy. In addition, MCV engages in certain cost mitigation activities to offset the fixed charges MCV incurs for these activities. The gains or losses resulting from these activities have resulted in net gains of approximately $7.7 million, $3.9 million and $5.5 million for the years ended 2003, 2002 and 2001, respectively. These net gains are reflected as a component of fuel costs. In July 2000, in response to rapidly escalating natural gas prices and since Consumers electric rates were frozen, MCV entered into transactions with Consumers whereby Consumers agreed to reduce MCV's dispatch level and MCV agreed to share with Consumers the savings realized by not having to generate electricity ("DISPATCH MITIGATION"). For the years ended 2003, 2002 and 2001, MCV estimates that Dispatch Mitigation resulted in net savings of approximately $13.0 million, $2.5 million and $7.6 million, respectively, a portion of which will be realized in reduced maintenance expenditures in future years. Subsequently, on January 1, 2004, Dispatch Mitigation ceased and Consumers began dispatching MCV pursuant to the 915 MW Settlement and the 325 MW Settlement "availability caps" provision (i.e., minimum dispatch of 1100 MW on- and off-peak ("FORCED DISPATCH")). On February 12, 2004, MCV and Consumers entered into a Resource Conservation Agreement ("RCA") which, among other things, provides that Consumers will economically dispatch MCV, if certain conditions are met. Such dispatch is expected to reduce electric production from what would have occurred under the Forced Dispatch, as well as decrease gas consumption by MCV. The RCA provides that Consumers has a right of first refusal to purchase, at market prices, the gas conserved under the RCA. The RCA further provides for the parties to enter into another agreement implementing the terms of the RCA including the sharing of savings realized by not having to generate electricity. The RCA is subject to MPSC approval and MCV and Consumers must accept the terms of the MPSC order as a condition precedent to the RCA becoming effective. The MPSC has not yet acted upon Consumers' application for approval of the RCA. MCV cannot predict the outcome of the MPSC proceedings necessary to effectuate the RCA. INVENTORY MCV's inventory of natural gas is stated at the lower of cost or market, and valued using the last-in, first-out ("LIFO") method. Inventory includes the costs of purchased gas, variable transportation and storage. The amount of reserve to reduce inventories from first-in, first-out ("FIFO") basis to the LIFO basis at December 31, 2003 and 2002, was $8.4 million and $7.4 million, respectively. Inventory cost, determined on a FIFO basis, approximates current replacement cost. MATERIALS AND SUPPLIES Materials and supplies are stated at the lower of cost or market using the weighted average cost method. The majority of MCV's materials and supplies are considered replacement parts for MCV's Facility. DEPRECIATION Original plant, equipment and pipeline were valued at cost for the constructed assets and at the asset transfer price for purchased and contributed assets, and are depreciated using the straight-line method over an estimated useful life of 35 years, which is the term of the PPA, except for the hot gas path components of the GTGs which are primarily being depreciated over a 25-year life. Plant construction and additions, since commercial operations in 1990, are depreciated using the straight-line method over the remaining life of the plant which currently is 22 years. Major renewals and replacements, which extend the useful life of plant and equipment are capitalized, while maintenance and repairs are expensed when incurred. Major equipment overhauls are capitalized and amortized to the next equipment overhaul. Personal property is depreciated using the straight-line method over an estimated useful life of 5 to 15 years. The cost of assets and related accumulated depreciation are removed from the accounts when sold or retired, and any resulting gain or loss reflected in operating income. FEDERAL INCOME TAX MCV is not subject to Federal or State income taxes. Partnership earnings are taxed directly to each individual partner. F-168 STATEMENT OF CASH FLOWS All liquid investments purchased with a maturity of three months or less at time of purchase are considered to be current cash equivalents. FAIR VALUE OF FINANCIAL INSTRUMENTS The carrying amounts of cash and cash equivalents and short-term investments approximate fair value because of the short maturity of these instruments. MCV's short-term investments, which are made up of investment securities held-to-maturity, as of December 31, 2003 and December 31, 2002 have original maturity dates of approximately one year or less. The unique nature of the negotiated financing obligation discussed in Note 6 makes it unnecessary to estimate the fair value of the Owner Participants' underlying debt and equity instruments supporting such financing obligation, since SFAS No. 107 "Disclosures about Fair Value of Financial Instruments" does not require fair value accounting for the lease obligation. ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES Effective January 1, 2001, MCV adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" which was issued in June 1998 and then amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging

Activities - Deferral of the Effective Date of SFAS No. 133," SFAS No. 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities - An amendment of FASB Statement No. 133" and SFAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activity (collectively referred to as "SFAS NO. 133"). SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument be recorded on the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 requires that changes in a derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges in some cases allows a derivative's gains and losses to offset related results on the hedged item in the income statement or permits recognition of the hedge results in other comprehensive income, and requires that a company formally document, designate and assess the effectiveness of transactions that receive hedge accounting. ELECTRIC SALES AGREEMENTS MCV believes that its electric sales agreements currently do not qualify as derivatives under SFAS No. 133, due to the lack of an active energy market (as defined by SFAS No. 133) in the State of Michigan and the transportation cost to deliver the power under the contracts to the closest active energy market at the Cinergy hub in Ohio and as such does not record the fair value of these contracts on its balance sheet. If an active energy market emerges, MCV intends to apply the normal purchase, normal sales exception under SFAS No. 133 to its electric sales agreements, to the extent such exception is applicable. FORWARD FOREIGN EXCHANGE CONTRACTS An amended service agreement was entered into between MCV and Alstom Power Company ("ALSTOM") (the "AMENDED SERVICE AGREEMENT"), under which Alstom will provide hot gas path parts for MCV's twelve gas turbines. The payments due to Alstom under the Amended Service Agreement are adjusted annually based on the U.S. dollar to Swiss franc currency exchange rate. To manage this currency exchange rate risk and hedge against adverse currency fluctuations impacting the payments under the Amended Service Agreement, MCV maintained a foreign currency hedging program whereby MCV periodically entered into forward purchase contracts for Swiss francs. Under SFAS No. 133, the forward foreign currency exchange contracts qualified as fair value hedges, since they hedged the identifiable foreign currency commitment of the Amended Service Agreement. As of December 31, 2003, MCV did not have any such transactions outstanding and does not anticipate any future transactions since the Alstom Agreement is expected to be terminated in the near future. As of December 31, 2002, MCV had a forward purchase contract involving Swiss francs in the notional amount of $5.0 million. This hedge was considered highly effective, therefore, there was no material gain or loss recognized in earnings during the twelve months ended December 31, 2002. F-169 NATURAL GAS SUPPLY CONTRACTS MCV management believes that its long-term natural gas contracts which do not contain volume optionality qualify under SFAS No. 133 for the normal purchases and normal sales exception. Therefore, these contracts are currently not recognized at fair value on the balance sheet. The FASB issued DIG Issue C-16, which became effective April 1, 2002, regarding natural gas commodity contracts that combine an option component and a forward component. This guidance requires either that the entire contract be accounted for as a derivative or the components of the contract be separated into two discrete contracts. Under the first alternative, the entire contract considered together would not qualify for the normal purchases and sales exception under the revised guidance. Under the second alternative, the newly established forward contract could qualify for the normal purchases and sales exception, while the option contract would be treated as a derivative under SFAS No. 133 with changes in fair value recorded through earnings. At April 1, 2002, MCV had nine long-term gas contracts that contained both an option and forward component. As such, they were no longer accounted for under the normal purchases and sales exception and MCV began mark-to-market accounting of these nine contracts through earnings. Based on the natural gas prices, at the beginning of April 2002, MCV recorded a $58.1 million gain for the cumulative effect of this accounting change. During the fourth quarter of 2002, MCV removed the option component from three of the nine long-term gas contracts, which should reduce some of the earnings volatility. Since April 2002, MCV has recorded an additional mark-to-market gain of $16.9 million for these gas contracts for a cumulative mark-to-market gain through December 31, 2003 of $75.0 million, which will reverse over the remaining life of these gas contracts, ranging from 2004 to 2007. For the twelve months ended December 31, 2003, MCV recorded in "Fuel costs" a $5.0 million net mark-to-market loss in earnings associated with these contracts. In addition, as of December 31, 2003 and December 31, 2002, MCV recorded "Derivative assets" in Current Assets in the amount of $56.9 million and $48.9 million, respectively, and for the same periods recorded "Derivative assets" in Other Assets in the amount of $18.1 million and $31.0 million, respectively, representing the mark-to-market gain on these long-term natural gas contracts. NATURAL GAS SUPPLY FUTURES AND OPTIONS To manage market risks associated with the volatility of natural gas prices, MCV maintains a gas hedging program. MCV enters into natural gas futures and option contracts in order to hedge against unfavorable changes in the market price of natural gas in future months when gas is expected to be needed. These financial instruments are being utilized principally to secure anticipated natural gas requirements necessary for projected electric and steam sales, and to lock in sales prices of natural gas previously obtained in order to optimize MCV's existing gas supply, storage and transportation arrangements. These financial instruments are derivatives under SFAS No. 133 and the contracts that are utilized to secure the anticipated natural gas requirements necessary for projected electric and steam sales qualify as cash flow hedges under SFAS No. 133, since they hedge the price risk associated with the cost of natural gas. MCV also engages in cost mitigation activities to offset the fixed charges MCV incurs in operating the Facility. These cost mitigation activities include the use of futures and options contracts to purchase and/or sell natural gas to maximize the use of the transportation and storage contracts when it is determined that they will not be needed for Facility operation. Although these cost mitigation activities do serve to offset the fixed monthly charges, these cost mitigation activities are not considered a normal course of business for MCV and do not qualify as hedges under SFAS No. 133. Therefore, the resulting mark-to-market gains and losses from cost mitigation activities are flowed through MCV's earnings. Cash is deposited with the broker in a margin account at the time futures or options contracts are initiated. The change in market value of these contracts requires adjustment of the margin account balances. The margin account balance as of December 31, 2003 and December 31, 2002 was recorded as a current asset in "Broker margin accounts and prepaid expenses," in the amount of $4.1 million and $.8 million, respectively. For the twelve months ended December 31, 2003, MCV has recognized in other comprehensive income, an unrealized $5.0 million increase on the futures contracts, which are hedges of forecasted purchases for plant use of market priced gas. This resulted in a net $31.3 million gain in other comprehensive income as of December 31, 2003. F-170 This balance represents natural gas futures and options with maturities ranging from January 2004 to December 2007, of which $21.8 million of this gain is expected to be reclassified into earnings within the next twelve months. MCV also has recorded, as of December 31, 2003, a $29.9 million current derivative asset in "Derivative assets," representing the mark-to-market gain on natural gas futures for anticipated projected electric and steam sales accounted for as hedges. In addition, for the twelve months ended December 31, 2003, MCV has recorded a net $35.0 million gain in earnings included in fuel costs from hedging activities related to MCV natural gas requirements for Facility operations and a net $1.0 million gain in earnings from cost mitigation activities. For the twelve months ended December 31, 2002, MCV recognized an unrealized $50.6 million increase in other comprehensive income on the futures contracts, which are hedges of forecasted purchases for plant use of market priced gas, resulting in a $26.3 million gain balance in other comprehensive income as of December 31, 2002. As of December 31, 2002, MCV had recorded a $24.9 million current derivative asset in "Derivative assets." For the twelve months ended December 31, 2002, MCV had recorded a net $12.2 million loss in earnings from hedging activities related to MCV natural gas requirements for Facility operations and a net $.4 million gain in earnings from cost mitigation activities. INTEREST RATE SWAPS To manage the effects of interest rate volatility on interest income while maximizing return on permitted investments, MCV established an interest rate hedging program. The notional amounts of the hedges are tied directly to MCV's anticipated cash investments, without physically exchanging the underlying notional amounts. Cash is deposited with the broker in a margin account at the time the interest rate swap transactions are initiated. The change in market value of these contracts may require further adjustment of the margin account balance. The margin account balance at December 31, 2002, of approximately $25,000, which was recorded as a current asset in "Broker margin accounts and prepaid expenses," was returned to MCV during the month of January 2003 since MCV currently does not have any outstanding interest rate swap transactions. As of December 31, 2002, MCV had one interest rate swap, with a notional amount of $20.0 million with a period of performance that extended to December 1, 2002, which did not qualify as a hedge under SFAS No. 133. The gains and losses on this swap were recorded currently in earnings. For the twelve months ended December 31, 2002, MCV recorded an immaterial loss in earnings. RECLASSIFICATION Certain prior period amounts have been reclassified to conform to the current year financial statement presentation. NEW ACCOUNTING STANDARDS In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." This SFAS amends SFAS No. 133 for decisions made (1) as part of the Derivative Implementations Group process that effectively required amendments to SFAS No. 133, (2) for other Financial Accounting Standards Board projects dealing with financial instruments and (3) for implementation issues raised in relation to the application of this definition of a derivative. The changes in this SFAS No. 149 improve financial reporting by requiring that contracts with comparable characteristics be accounted for similarly, which will result in more consistent reporting of contracts as either derivatives or hybrid instruments. This standard is effective for contracts entered into or modified after June 30, 2003, with some exceptions. MCV has adopted this standard and does not expect the application to materially affect its financial position or results of operations. (3) RESTRICTED INVESTMENT SECURITIES HELD-TO-MATURITY Non-current restricted investment securities held-to-maturity have carrying amounts that approximate fair value because of the short maturity of these instruments and consist of the following at December 31 (in thousands): 2003 2002 ----------- ----------- Funds restricted for rental payments pursuant to the Overall Lease Transaction $ 137,296 $ 136,554 Funds restricted for management non-qualified plans 2,459 2,147 ----------- ----------- Total $ 139,755 $ 138,701 =========== =========== F-171 (4) ACCOUNTS PAYABLE AND ACCRUED LIABILITIES Accounts payable and accrued liabilities consist of the following at December 31 (in thousands): 2003 2002 ---------- ---------- Accounts payable Related parties $ 7,386 $ 12,224 Trade creditors 34,786 27,935 Property and single business taxes 12,548 14,842 Other 2,648 3,079 ---------- ---------- Total $ 57,368 $ 58,080 ========== ========== (5) GAS SUPPLIER FUNDS ON DEPOSIT Pursuant to individual gas contract terms with counterparties, deposit amounts may be required by one party to the other based upon the net amount of exposure. The net amount of exposure will vary with changes in market prices, credit provisions and various other factors. Collateral paid or received will be posted by one party to the other based upon the net amount of exposure. The net amount of exposure will vary with changes in market prices, credit provisions and various other factors. Collateral paid or received will be posted by one party to the other based on the net amount of the exposure. Interest is earned on funds on deposit. As of December 31, 2003 MCV was not supplying any credit support in the form of cash or letters of credit. As of December 31, 2003 MCV was holding $4.5 million of cash on deposit and letters of credit totaling $116.6 million from two gas suppliers as collateral support. (6) LONG-TERM DEBT Long-term debt consists of the following at December 31 (in thousands): 2003 2002 ------------- ------------- Financing obligation, maturing through 2015, payable in semi- annual installments of principal and interest, collateralized by property, plant and equipment $ 1,153,221 $ 1,247,149 Less current portion (134,576) (93,928) ------------- ------------- Total long-term debt $ 1,018,645 $ 1,153,221 ============= ============= FINANCING OBLIGATION In June 1990, MCV obtained permanent financing for the Facility by entering into sale and leaseback agreements ("OVERALL LEASE TRANSACTION") with a lessor group, related to substantially all of MCV's fixed assets. Proceeds of the financing were used to retire borrowings outstanding under existing loan commitments, make a capital distribution to the Partners and retire a portion of notes issued by MCV to MEC Development Corporation ("MDC") in connection with the transfer of certain assets by MDC to MCV. In accordance with SFAS No. 98, "Accounting For Leases," the sale and leaseback transaction has been accounted for as a financing arrangement. The financing obligation utilizes the effective interest rate method, which is based on the minimum lease payments required through the end of the basic lease term of 2015 and management's estimate of additional anticipated obligations after the end of the basic lease term. The effective interest rate during the remainder of the basic lease term is approximately 9.4%. Under the terms of the Overall Lease Transaction, MCV sold undivided interests in all of the fixed assets of the Facility for approximately $2.3 billion, to five separate owner trusts ("OWNER TRUSTS") established for the benefit of certain institutional investors ("OWNER PARTICIPANTS"). U.S. Bank National Association (formerly known as State Street Bank and Trust Company) serves as owner trustee ("OWNER TRUSTEE") under each of the Owner Trusts, and leases undivided interests in the Facility on behalf of the Owner Trusts to MCV for an initial term of 25 years. CMS F-172 Midland Holdings Company ("CMS HOLDINGS"), currently a wholly owned subsidiary of Consumers, acquired a 35% indirect equity interest in the Facility through its purchase of an interest in one of the Owner Trusts. The Overall Lease Transaction requires MCV to achieve certain rent coverage ratios and other financial tests prior to a distribution to the Partners. Generally, these financial tests become more restrictive with the passage of time. Further, MCV is restricted to making permitted investments and incurring permitted indebtedness as specified in the Overall Lease Transaction. The Overall Lease Transaction also requires filing of certain periodic operating and financial reports, notification to the lessors of events constituting a material adverse change, significant litigation or governmental investigation, and change in status as a qualifying facility under FERC proceedings or court decisions, among others. Notification and approval is required for plant modification, new business activities, and other significant changes, as defined. In addition, MCV has agreed to indemnify various parties to the sale and leaseback transaction against any expenses or environmental claims asserted, or certain federal and state taxes imposed on the Facility, as defined in the Overall Lease Transaction. Under the terms of the Overall Lease Transaction and refinancing of the tax-exempt bonds, approximately $25.0 million of transaction costs were a liability of MCV and have been recorded as a deferred cost. Financing costs incurred with the issuance of debt are deferred and amortized using the interest method over the remaining portion of the 25-year lease term. Deferred financing costs of approximately $1.4 million, $1.5 million and $1.7 million were amortized in the years 2003, 2002 and 2001, respectively. Interest and fees incurred related to long-term debt arrangements during 2003, 2002 and 2001 were $111.9 million, $118.3 million and $124.6 million, respectively. Interest and fees paid during 2003, 2002 and 2001 were $115.4 million, $122.1 million and $131.7 million, respectively. Minimum payments due under these long-term debt arrangements over the next five years are (in thousands): PRINCIPAL INTEREST TOTAL ----------- ---------- ----------- 2004 $ 134,576 $ 108,233 $ 242,809 2005 76,547 97,836 174,383 2006 63,459 92,515 155,974 2007 62,916 87,988 150,904 2008 67,753 83,163 150,916 ----------- ---------- ----------- $ 405,251 $ 469,735 $ 874,986 =========== ========= =========== REVOLVING CREDIT AGREEMENT MCV has also entered into a working capital line ("WORKING CAPITAL FACILITY"), which expires August 29, 2004. Under the terms of the existing agreement, MCV can borrow up to the $50 million commitment, in the form of short-term borrowings or letters of credit collateralized by MCV's natural gas inventory and earned receivables. At any given time, borrowings and letters of credit are limited by the amount of the borrowing base, defined as 90% of earned receivables and 50% of natural gas inventory, capped at $15 million. During 2003, MCV did not utilize the Working Capital Facility. At December 31, 2003, MCV had no outstanding borrowings or letters of credit. INTERCREDITOR AGREEMENT MCV has also entered into an Intercreditor Agreement with the Owner Trustee, Working Capital Lender, U.S. Bank National Association as Collateral Agent ("COLLATERAL AGENT") and the Senior and Subordinated Indenture Trustees. Under the terms of this agreement, MCV is required to deposit all revenues derived from the operation of the Facility with the Collateral Agent for purposes of paying operating expenses and rent. In addition, these funds are required to pay construction modification costs and to secure future rent payments. As of December 31, 2003, MCV has deposited $137.3 million into the reserve account. The reserve account is to be maintained at not less than $40 million nor more than $137 million (or debt portion of next succeeding basic rent payment, whichever is greater). Excess funds in the reserve account are periodically transferred to MCV. This agreement also contains provisions governing the distribution of revenues and rents due under the Overall Lease Transaction, and establishes F-173 the priority of payment among the Owner Trusts, creditors of the Owner Trusts, creditors of MCV and the Partnership. (7) COMMITMENTS AND OTHER AGREEMENTS MCV has entered into numerous commitments and other agreements related to the Facility. Principal agreements are summarized as follows: Power Purchase Agreement MCV and Consumers have executed the PPA for the sale to Consumers of a minimum amount of electricity, subject to the capacity requirements of Dow and any other permissible electricity purchasers. Consumers has the right to terminate and/or withhold payment under the PPA if the Facility fails to achieve certain operating levels or if MCV fails to provide adequate fuel assurances. In the event of early termination of the PPA, MCV would have a maximum liability of approximately $270 million if the PPA were terminated in the 12th through 24th years. The term of this agreement is 35 years from the commercial operation date and year-to-year thereafter. STEAM AND ELECTRIC POWER AGREEMENT MCV and Dow executed the SEPA for the sale to Dow of certain minimum amounts of steam and electricity for Dow's facilities. If the SEPA is terminated, and Consumers does not fulfill MCV's commitments as provided in the Backup Steam and Electric Power Agreement, MCV will be required to pay Dow a termination fee, calculated at that time, ranging from a minimum of $60 million to a maximum of $85 million. This agreement provides for the sale to Dow of steam and electricity produced by the Facility for terms of 25 years and 15 years, respectively, commencing on the commercial operation date and year-to-year thereafter. STEAM PURCHASE AGREEMENT MCV and DCC executed the SPA for the sale to DCC of certain minimum amounts of steam for use at the DCC Midland site. Steam sales under the SPA commenced in July 1996. Termination of this agreement, prior to expiration, requires the terminating party to pay to the other party a percentage of future revenues, which would have been realized had the initial term of 15 years been fulfilled. The percentage of future revenues payable is 50% if termination occurs prior to the fifth anniversary of the commercial operation date and 33-1/3% if termination occurs after the fifth anniversary of this agreement. The term of this agreement is 15 years from the commercial operation date of steam deliveries under the contract and year-to-year thereafter. GAS SUPPLY AGREEMENTS MCV has entered into gas purchase agreements with various producers for the supply of natural gas. The current contracted volume totals 227,561 MMBtu per day annual average for 2004. As of January 1, 2004, gas contracts with U.S. suppliers provide for the purchase of 149,423 MMBtu per day while gas contracts with Canadian suppliers provide for the purchase of 78,138 MMBtu per day. Some of these contracts require MCV to pay for a minimum amount of natural gas per year, whether or not taken. The estimated minimum commitments under these contracts based on current long term prices for gas for the years 2004 through 2008 are $267.3 million, $338.6 million, $344.1 million, $340.4 million and $283.9 million, respectively. A portion of these payments may be utilized in future years to offset the cost of quantities of natural gas taken above the minimum amounts. GAS TRANSPORTATION AGREEMENTS MCV has entered into firm natural gas transportation agreements with various pipeline companies. These agreements require MCV to pay certain reservation charges in order to reserve the transportation capacity. MCV incurred reservation charges in 2003, 2002 and 2001, of $34.8 million, $35.1 million and $36.2 million, respectively. The estimated minimum reservation charges required under these agreements for each of the years 2004 through 2008 are $34.9 million, $33.8 million, $30.0 million, $21.6 million and $21.6 million, respectively. These projections are based on current commitments. F-174 GAS TURBINE SERVICE AGREEMENT MCV entered into a Service Agreement, as amended, with Alstom, which commenced on January 1, 1990 and was set to expire upon the earlier of the completion of the sixth series of major GTG inspections or December 31, 2009. Under the terms of this agreement, Alstom sold MCV an initial inventory of spare parts for the GTGs and provides qualified service personnel and supporting staff to assist MCV, to perform scheduled inspections on the GTGs, and to repair the GTGs at MCV's request. Upon termination of the Service Agreement (except for nonperformance by Alstom), MCV must pay a cancellation payment. MCV and Alstom amended the Service Agreement, effective December 31, 1993, to include the supply of hot gas path parts. Under the amended Service Agreement, Alstom provides hot gas path parts for MCV's twelve gas turbines through the fourth series of major GTG inspections, which were completed in 2002. In January 1998, MCV and Alstom amended the length of the amended Service Agreement to extend through the sixth series of major GTG inspections, which are expected to be completed by year end 2008, for a lump sum fixed price covering the entire term of the amended Service Agreement of $266.5 million (in 1993 dollars, which is adjusted based on exchange rates and Swiss inflation indices), payable on the basis of operating hours as they occur over the same period. MCV has made payments totaling approximately $200.7 million under this amended Service Agreement through December 31, 2003. MCV signed a new maintenance service and parts agreement with General Electric International, Inc. ("GEII"), effective December 31, 2002 ("GEII Agreement"). GEII will provide maintenance services and hot gas path parts for MCV's twelve GTG's. Under terms and conditions similar to the MCV/Alstom Service Agreement, as described above the GEII Agreement will cover four rounds of major GTG inspections, which are expected to be completed by the year 2015, at a savings to MCV as compared to the Service Agreement with Alstom. The GEII Agreement is expected to replace the current Alstom Service Agreement commencing July 1, 2004. The GEII Agreement can be terminated by either party for cause or convenience. Should termination for convenience occur, a buy out amount will be paid by the terminating party with payments ranging from approximately $19.0 million to $.9 million, based upon the number of operating hours utilized since commencement of the GEII Agreement. MCV terminated the Alstom Service Agreement in February 2004, for cause and therefore does not owe the approximately $5.8 million termination payment to Alstom. MCV has a claim against Alstom for approximately $3.0 million for adjustments due to reduced equivalent operating hours experienced under the Service Agreement, that was paid by MCV and a claim against Alstom for one set of hot gas path spare parts (valued within a range of $3.0 million to $7.0 million). These matters may be disputed by Alstom and other disputes may arise. MCV will seek final resolution of all claims that may arise between the parties. At this time, MCV has not recognized any liability to or receivable from Alstom in connection with these claims or termination. STEAM TURBINE SERVICE AGREEMENT MCV entered into a nine year Steam Turbine Maintenance Agreement with General Electric Company effective January 1, 1995, which is designed to improve unit reliability, increase availability and minimize unanticipated maintenance costs. In addition, this contract includes performance incentives and penalties, which are based on the length of each scheduled outage and the number of forced outages during a calendar year. Effective February 1, 2004, MCV and GE amended this contract to extend its term through August 31, 2007. MCV will continue making monthly payments over the life of the contract, which will total $22.3 million (subject to escalation based on defined indices). The parties have certain termination rights without incurring penalties or damages for such termination. Upon termination, MCV is only liable for payment of services rendered or parts provided prior to termination. SITE LEASE In December 1987, MCV leased the land on which the Facility is located from Consumers ("SITE LEASE"). MCV and Consumers amended and restated the Site Lease to reflect the creation of five separate undivided interests in the Site Lease as of June 1, 1990. Pursuant to the Overall Lease Transaction, MCV assigned these undivided interests in the Site Lease to the Owner Trustees, which in turn subleased the undivided interests back to MCV under five separate site subleases. F-175 The Site Lease is for a term which commenced on December 29, 1987, and ends on December 31, 2035, including two renewal options of five years each. The rental under the Site Lease is $.6 million per annum, including the two five-year renewal terms. GAS TURBINE GENERATOR COMPRESSOR BLADE AGREEMENT MCV entered into an agreement with MTS Machinery Tools & Services AG ("MTS"), in January 2002. Under this agreement MTS redesigned and will manufacture and install new design compressor blades for MCV's twelve GTG's, which is expected to increase the overall electrical capacity and efficiency of each GTG. MCV has purchased three sets of such blades and has the option to purchase an additional nine sets. The first set of compressor blades was installed in the second quarter of 2003 for approximately $4.2 million. At this time, an additional two sets have been ordered at a cost of $4.1 million. (8) PROPERTY TAXES In 1997, MCV filed a property tax appeal against the City of Midland at the Michigan Tax Tribunal contesting MCV's 1997 property taxes. Subsequently, MCV filed appeals contesting its property taxes for tax years 1998 through 2003 at the Michigan Tax Tribunal. A trial was held for tax years 1997 - 2000. The appeals for tax years 2001-2003 are being held in abeyance. On January 23, 2004, the Michigan Tax Tribunal issued its decision in MCV's tax appeal against the City of Midland for tax years 1997 through 2000. MCV management has estimated that the decision will result in a refund to MCV for the tax years 1997 through 2000 of approximately $29 million in taxes plus $7 million of interest. The decision is subject to reconsideration at the Tribunal and may be appealed to the Michigan Appellate Court and Michigan Supreme Court. The City of Midland has filed a motion for reconsideration at the Michigan Tax Tribunal, asking the Tribunal to make certain technical corrections, as well as substantive changes to the decision. MCV has opposed this motion. MCV management cannot predict the outcome of these further legal proceedings. MCV has not recognized any of the above stated refunds (net of approximately $15.5 million of deferred expenses) in earnings at this time. (9) RETIREMENT BENEFITS POSTRETIREMENT HEALTH CARE PLANS In 1992, MCV established defined cost postretirement health care plans ("PLANS") that cover all full-time employees, excluding key management. The Plans provide health care credits, which can be utilized to purchase medical plan coverage and pay qualified health care expenses. Participants become eligible for the benefits if they retire on or after the attainment of age 65 or upon a qualified disability retirement, or if they have 10 or more years of service and retire at age 55 or older. The Plans granted retroactive benefits for all employees hired prior to January 1, 1992. This prior service cost has been amortized to expense over a five year period. MCV annually funds the current year service and interest cost as well as amortization of prior service cost to both qualified and non-qualified trusts. The MCV accounts for retiree medical benefits in accordance with SFAS 106, "Employers Accounting for Postretirement Benefits Other Than Pensions." This standard required the full accrual of such costs during the years that the employee renders service to the MCV until the date of full eligibility. The accumulated benefit obligation of the Plans were $3.3 million at December 31, 2003 and $2.7 million at December 31, 2002. The measurement date of these Plans was December 31, 2003. On December 8, 2003, President Bush signed into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "ACT"). The Act expanded Medicare to include, for the first time, coverage for prescription drugs. At this time, because of various uncertainties related to this legislation and the appropriate accounting methodology, MCV has elected to defer financial recognition of this legislation until the FASB issues final accounting guidance. When issued, that final guidance could require MCV to change previously reported information. This deferral election is permitted under SFAS 106-1. F-176 The following table reconciles the change in the Plans' benefit obligation and change in Plan assets as reflected on the balance sheet as of December 31 (in thousands): 2003 2002 ----------- ----------- Change in benefit obligation: Benefit obligation at beginning of year $ 2,741.9 $ 2,405.1 Service cost 212.5 197.3 Interest cost 178.2 188.7 Actuarial gain (loss) 147.4 (44.6) Benefits paid during year (4.0) (4.6) ----------- ----------- Benefit obligation at end of year 3,276.0 2,741.9 ----------- ----------- Change in Plan assets: Fair value of Plan assets at beginning of year 2,045.8 2,088.0 Actual return on Plan assets 527.5 (270.9) Employer contribution 257.5 233.3 Benefits paid during year (4.0) (4.6) ----------- ----------- Fair value of Plan assets at end of year 2,826.8 2,045.8 ----------- ----------- Unfunded (funded) status 449.2 696.1 Unrecognized prior service cost (170.3) (184.6) Unrecognized net gain (loss) (278.9) (511.5) ----------- ----------- Accrued benefit cost $ -- $ -- =========== =========== Net periodic postretirement health care cost for years ending December 31, included the following components (in thousands): 2003 2002 2001 ---------- ---------- ---------- Components of net periodic benefit cost: Service cost $ 212.5 $ 197.3 $ 173.5 Interest cost 178.2 188.7 142.9 Expected return on Plan assets (163.7) (167.0) (171.3) Amortization of unrecognized net (gain) or loss 30.5 14.3 (12.6) ---------- ---------- ---------- Net periodic benefit cost $ 257.5 $ 233.3 $ 132.5 ========== ==========

========== Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects (in thousands): 1-PERCENTAGE-POINT 1-PERCENTAGE-POINT INCREASE DECREASE ------------------ ------------------ Effect on total of service and interest cost components $ 48.6 $ 41.8 Effect on postretirement benefit obligation $ 358.1 $ 310.9 Assumptions used in accounting for the Post-Retirement Health Care Plan were as follows: 2003 2002 2001 ---- ---- ---- Discount rate 6.00% 6.75% 7.25% Long-term rate of return on Plan assets 8.00% 8.00% 8.00% Inflation benefit amount 1998 through 2004 0.00% 0.00% 0.00% 2005 and later years 4.00% 4.00% 4.00% The long-term rate of return on Plan assets is established based on MCV's expectations of asset returns for the investment mix in its Plan (with some reliance on historical asset returns for the Plans). The expected returns for various asset categories are blended to derive one long-term assumption. F-177 PLAN ASSETS. Citizens Bank has been appointed as trustee ("TRUSTEE") of the Plan. The Trustee serves as investment consultant, with the responsibility of providing financial information and general guidance to the MCV Benefits Committee. The Trustee shall invest the assets of the Plan in the separate investment options in accordance with instructions communicated to the Trustee from time to time by the MCV Benefit Committee. The MCV Benefits Committee has the fiduciary and investment selection responsibility for the Plan. The MCV Benefits Committee consists of MCV Officers (excluding the President and Chief Executive Officer). The MCV has a target allocation of 80% equities and 20% debt instruments. These investments emphasis total growth return, with a moderate risk level. The MCV Benefits Committee reviews the performance of the Plan investments quarterly, based on a long-term investment horizon and applicable benchmarks, with rebalancing of the investment portfolio, at the discretion of the MCV Benefits Committee. MCV's Plan's weighted-average asset allocations, by asset category are as follows as of December 31: 2003 2002 ---- ---- Asset Category: Cash and cash equivalents 11% 1% Fixed income 17% 23% Equity securities 72% 76% ---- ---- Total 100% 100% ---- ---- CONTRIBUTIONS. MCV expects to contribute approximately $.2 million to the Plan in 2004. RETIREMENT AND SAVINGS PLANS MCV sponsors a defined contribution retirement plan covering all employees. Under the terms of the plan, MCV makes contributions to the plan of either five or ten percent of an employee's eligible annual compensation dependent upon the employee's age. MCV also sponsors a 401(k) savings plan for employees. Contributions and costs for this plan are based on matching an employee's savings up to a maximum level. In 2003, 2002 and 2001, MCV contributed $1.3 million, $1.2 million and $1.1 million, respectively under these plans. SUPPLEMENTAL RETIREMENT BENEFITS MCV provides supplemental retirement, postretirement health care and excess benefit plans for key management. These plans are not qualified plans under the Internal Revenue Code; therefore, earnings of the trusts maintained by MCV to fund these plans are taxable to the Partners and trust assets are included in the assets of MCV. F-178 MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (10) PARTNERS' EQUITY AND RELATED PARTY TRANSACTIONS The following table summarizes the nature and amount of each of MCV's Partner's equity interest, interest in profits and losses of MCV at December 31, 2003, and the nature and amount of related party transactions or agreements that existed with the Partners or affiliates as of December 31, 2003, 2002 and 2001, and for each of the twelve month periods ended December 31 (in thousands). BENEFICIAL OWNER, EQUITY PARTNER, RELATED PARTY TYPE OF PARTNER AND NATURE EQUITY TRANSACTIONS AND OF RELATED PARTY INTEREST INTEREST AGREEMENTS 2003 2002 2001 ---------------------------------- ---------- -------- -------------------- --------- --------- ---------- CMS ENERGY COMPANY Power purchase CMS Midland, Inc. agreements $ 513,774 $ 557,149 $ 550,477 General Partner; wholly-owned Purchases under gas subsidiary of Consumers Energy transportation Company agreements 14,294 23,552 24,059 Purchases under spot gas agreements 663 3,631 3,756 Purchases under gas supply agreements 2,330 11,306 10,725 Gas storage agreement 2,563 2,563 2,563 Land lease/easement agreements 600 600 600 Accounts receivable 40,373 44,289 48,843 Accounts payable 1,025 3,502 4,772 Sales under spot $ 391,546 49.0% gas agreements 3,260 1,084 7,107 ========== ====== El Paso Corporation Source Midland Limited Partnership ("SMLP") General Partner; owned by subsidiaries of El Paso Corporation(1) Purchase under gas transportation agreements 13,023 12,463 13,653 Purchases under spot gas agreement 610 15,655 45,130 Purchases under gas supply agreement 54,308 47,136 5,912 Gas agency agreement 238 365 1,989 Deferred reservation charges under gas purchase agreement 4,728 -- 7,880 Accounts receivable -- 523 -- Accounts payable 5,751 7,706 5,198 Sales under spot gas agreements 3,474 14,007 28,451 Partner cash withdrawal (including accrued $ 139,421 18.1% interest)(2) -- -- 56,714 El Paso Midland, Inc. ("EL PASO See related party MIDLAND") General Partner; activity listed wholly-owned subsidiary of El under SMLP. Paso Corporation(1) 83,653 10.9 See related party activity listed MEI Limited Partnership ("MEI") under SMLP. A General and Limited Partner; 50% interest owned by El Paso Midland, Inc. and 50% interest owned by SMLP(1) General Partnership Interest 69,714 9.1 Limited Partnership Interest 6,969 .9 See related party activity listed Micogen Limited Partnership 34,854 4.5 under SMLP. F-179 ("MLP") Limited Partner, owned subsidiaries of El Paso Corporation(1) Total El Paso ---------- ------ Corporation $ 334,611 43.5% ========== ====== The Dow Chemical Company Steam and electric The Dow Chemical Company power agreement 36,207 29,385 33,727 Steam purchase agreement - Dow Corning Corp Limited Partner (affiliate) 4,017 3,746 3,781 Purchases under demineralized water supply agreement 6,396 6,605 6,913 Accounts receivable 3,431 3,635 3,191 Accounts payable 610 1,016 948 Standby and backup fees 731 734 696 Sales of gas under $ 72,918 7.5% tolling agreement -- 6,442 -- ========== ====== Alanna Corporation Alanna Corporation Note receivable 1 1 1 Limited Partner; wholly-owned subsidiary of Alanna Holdings Corporation $ 1(3) .00001% ========== ====== FOOTNOTES TO PARTNERS' EQUITY AND RELATED PARTY TRANSACTIONS (1) On January 29, 2001, El Paso Corporation ("EL PASO") announced that it had completed its merger with The Coastal Corporation ("COASTAL"). Coastal was the previous parent company of El Paso Midland (formerly known as Coastal Midland, Inc.), SMLP, MLP and, through SMLP, MEI. After the merger, Coastal became a wholly-owned subsidiary of El Paso and has changed its name to El Paso CGP Company. (2) A letter of credit has been issued and recorded as a note receivable from El Paso Midland, this amount includes their share of cash available, as well as, cash available to MEI, MLP and SMLP. (3) Alanna's capital stock is pledged to secure MCV's obligation under the lease and other overall lease transaction documents. SUPPLEMENTAL INFORMATION Supplemental information is to be furnished with reports filed pursuant to Section 15 (d) of the Act by registrants, which have not registered securities pursuant to Section 12 of the Act. No such annual report or proxy statement has been sent to security holders. SIGNATURES Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized. MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP Date: March 1, 2004 By /s/ James M. Kevra -------------------- James M. Kevra President and Chief Executive Officer F-180 Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated. SIGNATURE TITLE DATE --------------------- -------------------------------------- ------------- /s/ James M. Kevra President and Chief Executive Officer March 1, 2004 ------------------ _____________________ (Principal Executive Officer) James M. Kevra /s/ James M. Rajewski Chief Financial Officer, Vice President March 1, 2004 --------------------- _____________________ and Controller (Principal Accounting James M. Rajewski Officer) /s/ John J. O'Rourke Chairman, Management Committee March 1, 2004 -------------------- John J. O'Rourke /s/ David W. Joos Member, Management Committee March 1, 2004 ----------------- David W. Joos F-181 EMIRATES CMS POWER COMPANY PJSC FINANCIAL STATEMENTS F-182 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTNG FIRM TO THE BOARD OF DIRECTORS OF EMIRATES CMS POWER COMPANY PJSC We have audited the accompanying balance sheet of Emirates CMS Power Company Private Joint Stock Company ("the Company") as of 31 December 2003 and the related statements of income, cash flows and stockholders' equity for the year then ended. 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 audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 audit provides 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 31 December 2003, and the results of its operations and its cash flows for the year then ended in conformity with US generally accepted accounting principles. /S/ Ernst & Young Abu Dhabi, United Arab Emirates 27 June 2004 F-183 EMIRATES CMS POWER COMPANY PJSC BALANCE SHEETS 31 December 2003 and 2002 UNAUDITED NOTES 2003 2002 AED `000 AED `000 ASSETS Current assets Cash and cash equivalents 120,300 124,278 Prepayments and other current assets 4 25,074 10,933 Amounts due from related party 5 38,799 37,986 Advance to Al Taweelah Shared Facilities Company LLC 6 1,747 1,800 Inventories 7 166,734 160,247

---------- --------- 352,654 335,244 ---------- --------- NON-CURRENT ASSETS Advance to Al Taweelah Shared Facilities Company LLC 6 34,058 35,674 Other long term asset 5,173 - Investment 9 178 178 Property, plant and equipment, net 8 2,242,212 2,291,152 Intangible asset, net 10 106,720 109,683 ---------- --------- 2,388,341 2,436,687 ---------- --------- TOTAL ASSETS 2,740,995 2,771,931 ========== ========= LIABILITIES AND STOCKHOLDERS' EQUITY CURRENT LIABILITIES Trade accounts payable 2,847 962 Amounts due to related parties 11 3,477 2,424 Accruals and other liabilities 12 346,690 388,346 Current portion of long term debt 13 58,631 81,676 Current portion of loan from shareholders 14 129,000 - ---------- --------- 540,645 473,408 ---------- --------- NON-CURRENT LIABILITIES Asset retirement obligation 15,403 - Loan from shareholders 14 131,000 272,000 Long term debt 13 1,769,539 1,828,171 ---------- --------- 1,915,942 2,100,171 ---------- --------- TOTAL LIABILITIES 2,456,587 2,573,579 ---------- --------- STOCKHOLDERS' EQUITY Share capital (ordinary shares, AED 10 par value, authorised, issued and outstanding 41,324,000 shares) 15 413,240 413,240 Accumulated losses 15 (147,665) (237,512) Accumulated other comprehensive income 18 18,833 22,624 ---------- --------- TOTAL STOCKHOLDERS' EQUITY 284,408 198,352 ---------- --------- TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY 2,740,995 2,771,931 ========== ========= The attached notes 1 to 21 form part of these financial statements. F-184 EMIRATES CMS POWER COMPANY PJSC INCOME STATEMENTS Years ended 31 December 2003, 2002 and 2001 UNAUDITED UNAUDITED 2003 2002 2001 NOTES AED `000 AED `000 AED `000 Revenue 363,564 370,686 196,091 -------- --------- --------- Cost of sales Contractors' staff costs (14,149) (14,297) (13,982) Repairs, maintenance and consumables used (47,095) (36,262) (42,046) Depreciation (63,591) (63,402) (35,370) Amortisation of intangible asset 10 (2,963) (2,940) - -------- --------- --------- (127,798) (116,901) (91,398) -------- --------- --------- GROSS PROFIT 235,766 253,785 104,693 Administrative and other operating expenses 20 (8,087) (7,925) (4,821) -------- --------- --------- INCOME FROM OPERATIONS 227,679 245,860 99,872 Financing cost (119,730) (124,163) (57,835) Accretion expense (872) - - Interest income 784 1,848 783 Changes in fair value of derivative instruments 18 55,867 (199,093) (108,536) Other income (expense) 1,084 704 (33) -------- --------- --------- NET INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLES 164,812 (74,844) (65,749) Cumulative effect of change in accounting for derivatives 18 - - (21,477) Cumulative effect of change in accounting for asset retirement obligation (1,165) - - -------- --------- --------- NET INCOME (LOSS) 163,647 (74,844) (87,226) ======== ========= ========= The attached notes 1 to 21 form part of these financial statements. F-185 EMIRATES CMS POWER COMPANY PJSC STATEMENTS OF CASH FLOWS Years ended 31 December 2003, 2002 and 2001 UNAUDITED UNAUDITED 2003 2002 2001 NOTES AED `000 AED `000 AED `000 OPERATING ACTIVITIES Net income (loss) 163,647 (74,844) (87,226) Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: Depreciation and amortisation of intangible asset 66,554 66,342 35,370 Accretion expense 872 - - Changes in fair value of derivative instruments (55,867) 199,093 108,536 Reclassification from accumulated other comprehensive income to earnings of cash flow hedges (3,791) (3,955) (4,098) Cumulative effect of change in accounting principles 1,165 - 21,477 Loss on disposal of property, plant and equipment 14 173 - Changes in assets and liabilities: Increase in inventories (6,487) (63,623) (53,137) (Increase) decrease in amounts due from related parties (813) 21,064 (39,852) Increase in prepayments and other current assets (5,644) 17,742 (6,313) (Increase) decrease in accounts payable and accruals and due to related parties 8,652 (30,980) (186,208) -------- -------- -------- Net cash provided by (used in) operating activities 168,302 131,012 (211,451) -------- -------- -------- INVESTING ACTIVITIES Purchase of property, plant and equipment (1,299) (2,090) (400,832) Liquidated damages received (paid) - 10,846 (6,556) Recovery of advance to Al Taweelah Shared Facilities Company LLC 1,669 1,669 1,799 -------- -------- -------- Net cash from (used in) investing activities 370 10,425 (405,589) -------- -------- -------- FINANCING ACTIVITIES Dividends paid (73,800) (79,400) - Long term debt refinancing fees paid (5,173) - - Repayment of loan from shareholders (12,000) - - (Repayment) receipt of term loan (81,677) (71,467) 734,041 -------- -------- -------- Cash (used in) from financing activities (172,650) (150,867) 734,041 -------- -------- -------- (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS (3,978) (9,430) 117,001 Cash and cash equivalents at the beginning of the year 124,278 133,708 16,707 -------- -------- -------- CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR 120,300 124,278 133,708 ======== ======== ======== SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: Cash paid during the year for interest 117,034 92,694 68,374 Cash received during the year for interest 784 1,848 783 SUPPLEMENTAL DISCLOSURES OF SIGNIFICANT NON-CASH TRANSACTIONS: Disposal of property, plant and equipment 8 - 1,961 - Transfer of property, plant and equipment to related party 8 &

10 - 112,623 - The attached notes 1 to 21 form part of these financial statements. F-186 EMIRATES CMS POWER COMPANY PJSC STATEMENTS OF STOCKHOLDERS' EQUITY Years ended 31 December 2003, 2002 and 2001 RETAINED ACCUMULATED EARNINGS OTHER SHARE (ACCUMULATED COMPREHENSIVE CAPITAL LOSSES) INCOME TOTAL AED `000 AED `000 AED `000 AED `000 Balance at 1 January 2001 - unaudited 413,240 3,958 - 417,198 Transition adjustment from adoption of SFAS 133 (note 18) - - 30,677 30,677 Net loss for the year - (87,226) - (87,226) Reclassification to earnings of cash flow hedges (note 18) - - (4,098) (4,098) -------- -------- -------- --------- Balance at 31 December 2001 - unaudited 413,240 (83,268) 26,579 356,551 Net loss for the year - (74,844) - (74,844) Dividends paid (note 15) - (79,400) - (79,400) Reclassification to earnings of cash flow hedges (note 18) - - (3,955) (3,955) -------- -------- -------- --------- Balance at 31 December 2002 - unaudited 413,240 (237,512) 22,624 198,352 Net income for the year - 163,647 - 163,647 Dividends paid (note 15) - (73,800) - (73,800) Reclassification to earnings of cash flow hedges (note 18) - - (3,791) (3,791) -------- -------- -------- --------- Balance at 31 December 2003 413,240 (147,665) 18,833 284,408 ======== ======== ======== ========= The attached notes 1 to 21 form part of these financial statements. F-187 EMIRATES CMS POWER COMPANY PJSC NOTES TO THE FINANCIAL STATEMENTS 31 December 2003 and 2002 1 ACTIVITIES Emirates CMS Power Company PJSC is a private joint stock company registered and incorporated in the United Arab Emirates and is engaged in the generation of electricity and the production of desalinated water for supply into the Abu Dhabi grid. The Company is 60% owned by Emirates Power Company PJSC a wholly owned subsidiary of Abu Dhabi Water & Electricity Authority (ADWEA), and 40% owned by CMS Generation Taweelah Limited. The Company has a management operation and maintenance agreement with Taweelah A2 Operating Company, a related party, whereby the latter has undertaken to manage the day-to-day operations and maintain the Company's plant. The Company has entered into a power and water purchase agreement with Abu Dhabi Water and Electricity Company (ADWEC), a related party, (a wholly-owned subsidiary of ADWEA). Under the agreement, the Company undertakes to make available, and ADWEC undertakes to purchase, the entire net capacity and output of the plant until October 2021 in accordance with various agreed terms and conditions. The output payments cover variable operation and maintenance costs and fuel efficiency bonuses or penalty for actual output. Natural gas fuel is supplied by ADWEC at no cost. The Company's registered head office is P O Box 47688, Abu Dhabi, United Arab Emirates. At 31 December 2003 and 2002 there were no staff employed by the Company. 2 BASIS OF PRESENTATION Although at 31 December 2003, the Company's current liabilities exceeded its current assets by AED 187,991,000 (2002: AED 138,164,000) the financial statements have been prepared on a going concern basis in view of the credit facilities available from the bankers and the refinancing of the term loan explained in note 13. Further, the negative fair value of derivatives amounting to AED 242.6 million (2002: AED 298.4 million) included within current liabilities (note 12) will not significantly affect the Company's cash flow in the foreseeable future. 3 SIGNIFICANT ACCOUNTING POLICIES BASIS OF PREPARATION The financial statements are prepared on the basis of U.S. generally accepted accounting principles and applicable requirements of United Arab Emirates Law and are presented in United Arab Emirates Dirhams (AED). ESTIMATES AND ASSUMPTIONS The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates. REVENUE RECOGNITION Revenue represents the sale of water desalination and electricity generation services comprised of the available capacity and variable output to Abu Dhabi Water and Electricity Company (a wholly owned subsidiary of ADWEA) during the year. Revenues are recognised when services are provided. Unbilled revenues are based on estimated quantities of potable water and kilowatts of electricity delivered during the period but not yet billed. These estimates are generally based on contract data and preliminary throughput and allocation measurements. F-188 PROPERTY, PLANT AND EQUIPMENT Property, plant and equipment is stated at historical cost less accumulated depreciation and any impairment in value. The Company capitalises all construction-related direct labour and material costs as well as indirect construction costs. Indirect construction costs include engineering and the cost of funds during the construction phase. The cost of renewals and betterments that extend the useful life of the property, plant and equipment are capitalised. The cost of repairs, spare parts and major maintenance that do not extend the useful life or increase the expected output of property, plant and equipment, is expensed as incurred. The cost of spare parts held as essential for the continuity of operations and which are designated as strategic spares are depreciated on a straight-line basis over the estimated remaining operating life of the plant and equipment to which they relate Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets as follows: Buildings 30 to 40 years

Plant and equipment (including plant spares) 3 to 40 years LONG-LIVED ASSETS Long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144) when events or changes in circumstances indicate that the related carrying amount may not be recoverable. Impairment is assessed by comparing an asset's net undiscounted cash flows expected to be generated over its remaining useful life to the asset's net carrying value. If impairment is indicated, the carrying amount of the asset is reduced to its estimated fair value. INTANGIBLE ASSETS Intangible assets, which represent acquisition of connection rights, are capitalised at cost. The carrying values of intangible assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. The connection rights cost is amortised on a straight line basis over the 38 year period, being the expected period of benefit, commencing 1 January 2002. INVENTORIES Inventories are valued at the lower of cost, determined on the basis of weighted average costs and net realisable value. Costs are those expenses incurred in bringing each item to its present location and condition. ACCOUNTS RECEIVABLE Accounts receivable are stated net of provisions for amounts estimated to be non-collectible. An estimate for doubtful accounts is made when collection of the full amount is no longer probable. Bad debts are written-off as incurred. ACCOUNTS PAYABLE Liabilities are recognised for amounts to be paid in the future for goods or services received, whether billed by the supplier or not. CASH AND CASH EQUIVALENTS All highly liquid investments with an original maturity of three months or less are considered cash equivalents. F-189 TERM LOAN The term loan is carried on the balance sheet at its principal amount. Instalments due within one year are shown as a current liability. Interest is charged as an expense as it accrues, with unpaid amounts included in "accruals". TRANSLATION OF FOREIGN CURRENCIES AND FOREIGN EXCHANGE TRANSACTIONS Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date. All differences are taken to the income statement. CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLES The Company adopted SFAS 133 "Accounting for Derivative Instruments and Hedging Activities," as amended on 1 January 2001. SFAS 133 establishes new accounting and disclosure requirements for most derivative instruments and hedging transactions involving derivatives. SFAS 133 also requires formal documentation procedures for hedging relationships and effectiveness testing when hedge accounting is to be applied. In accordance with the transition provisions of SFAS 133, in the year ended 31 December 2001, the Company recorded a cumulative loss adjustment of AED 21.5 million in its income statement as a transition adjustment to reflect a liability for the fair value of all derivatives that did not previously meet the requirement for hedge accounting treatment prior to the adoption of SFAS 133. In addition, the Company recorded a transition gain of AED 30.7 million to accumulated other comprehensive income to recognise an asset for the fair value of all derivatives accounted for as cash flow hedges prior to the adoption of SFAS 133. DERIVATIVES The Company obtained long-term USD debt to fund the development and construction of the plant. Interest payments associated with the debt are based on LIBOR plus a spread. The Company uses derivative financial instruments to manage the interest rate exposures associated with the debt. The Company's objective is to offset gains and losses resulting from these exposures with losses and gains on the derivative financial instruments thereby reducing volatility in earnings and cash flows. In addition, the Company uses forward foreign exchange contracts to hedge its risk associated with foreign currency fluctuations relating to scheduled maintenance cost payments to an overseas supplier. The Company does not utilize derivative financial instruments with a level of complexity or with a risk greater than the exposures to be managed nor does it enter into or hold derivatives for trading purposes. The use of the derivative financial instruments associated with the interest rate risk is mandated by the debt agreement. All derivatives entered into by the Company are subject to internal policies that provide guidelines for control, counterparty risk and ongoing monitoring and reporting of such activities. The fair value of all derivatives are reported on the balance sheet based on prevailing market rates. Derivatives with positive market values (unrealised gains) are included in other current assets and derivatives with negative market values (unrealised losses) are included in other current liabilities in the balance sheet. Changes in fair value of derivatives qualifying as cash flow hedges are recorded in accumulated other comprehensive income and recognised in the income statement in the corresponding period to which the cash flows associated with the underlying hedged item transpire. Changes in fair values of contracts excluded from the assessment of hedge effectiveness together and those contracts that have not been formally designated as hedges are recorded as a separate line in the income statement in the period they arise. ASSET RETIREMENT OBLIGATIONS (ARO) SFAS No. 143, Accounting for Asset Retirement Obligations became effective January 2003. It requires companies to record the fair value of the cost to remove assets at the end of their useful life, if there is a legal obligation to do so. The Company has legal obligations to remove assets at the end of their useful lives and restore the land. F-190 The fair value of ARO liabilities has been calculated using an expected present value technique. This technique reflects assumptions, such as costs, inflation and profit margin that third parties would consider to assume the settlement of the obligation. Fair value, to the extent possible, should include a market risk premium for unforeseeable circumstances. No market risk premium was included in our ARO fair value estimate since a reasonable estimate could not be made. If a five percent market risk premium were assumed, our ARO liability would be AED 16.2 million. In 2003, the Company recorded an ARO liability for the restoration of land and an AED 1.2 million, cumulative effect of change in accounting for accretion and depreciation expense for ARO liabilities incurred prior to 2003. As the plant began operation in August 2001, the pro forma effect on results of operations would not have been material for the year ended 31 December 2002. The following table presents the reconciliation of the beginning and ending carrying value of the ARO: AED `000 Proforma ARO liability - At 1 January 2002 13,710 ====== ARO liability - At 1 January 2003 14,531 Liabilities incurred - Liabilities settled - Accretion expense 872 Revisions in estimated cash flow - ------ ARO liability - At 31 December 2003 15,403 ====== 4 PREPAYMENTS AND OTHER CURRENT ASSETS UNAUDITED 2003 2002 AED `000 AED `000 Positive fair value of derivatives (note 18) 15,234 6,737 Other receivables 313 252 Prepaid expenses 9,527 3,944 ------ ------ 25,074 10,933 ====== ====== 5 AMOUNTS DUE FROM RELATED PARTY UNAUDITED 2003 2002 AED `000 AED `000 Abu Dhabi Water and Electricity Company 38,799 37,986 ====== ====== 6 ADVANCE TO AL TAWEELAH SHARED FACILITIES COMPANY LLC (TSFC) This represents an advance made to TSFC by the Company in proportion to its 18% (2002: 18%) shareholding in TSFC against future use of their facilities. Amount receivable within one year has been included under current assets. F-191 7 INVENTORIES UNAUDITED 2003 2002 AED `000 AED `000 Fuel 26,975 26,975 Spare parts and consumables 139,759 133,272 ------- ------- 166,734 160,247 ======= ======= 8 PROPERTY, PLANT AND EQUIPMENT, NET The components of property, plant and equipment are as follows: UNAUDITED 2003 2002 AED `000 AED `000 Buildings 205,114 204,823 Plant and equipment 2,193,309 2,178,384 Plant spares 6,656 6,656 --------- --------- 2,405,079 2,389,863 Less: accumulated depreciation (162,867) (98,711) --------- --------- 2,242,212 2,291,152 ========= ========= The activities of the Company are carried out from premises and equipment constructed on land leased from ADWEA. The initial term of the lease is 25 years and a nominal rental is payable by the Company. Leasehold land is carried in the books at nil value. During 2002, plant and equipment of net book value AED 112,623,000 was transferred to a related party for the right to connection to the transmission system (see note 10). During 2002, property, plant and equipment amounting to AED 1,961,000 in respect of an open discharge channel was transferred to TSFC in accordance with an agreement dated May 2002. Under the agreement, the Company has received additional shares in TSFC, amounting to AED 8,000 (see note 9) and a promissory note from TSFC for the balance of the transfer value of the open discharge channel, amounting to AED 1,953,000 to be treated as an additional advance to TSFC (note 6). 9 INVESTMENT UNAUDITED 2003 2002 AED `000 AED `000 Unquoted investment Cost: At 1 January 178 170 Additions - 8 --- --- At 31 December 178 178 === === F-192 The investment represents the 18% (2002: 18%) equity interest acquired by the Company in TSFC. TSFC is a closely held private company which maintains shared utility facilities for the supply and discharge of sea water and provides other related services to the Company and other operators at the Taweelah complex. The fair value of the investment is not materially different from its carrying amount. 10 INTANGIBLE ASSET UNAUDITED 2003 2002 AED `000 AED `000 Cost: At 1 January 112,623 - Additions - 112,623 ------- ------- At 31 December 112,623 112,623 ------- ------- Amortisation: At 1 January 2,940 - Charge for the year 2,963 2,940 ------- ------- At 31 December 5,903 2,940 ------- ------- Net book amount 106,720 109,683 ======= ======= The intangible asset arose from the transfer during the year ended 31 December 2002 of plant and equipment to a related party in accordance with an agreement dated August 2000 and represents the acquisition cost of the Company's right of connection to the transmission system at the connection site for a period of 38 years (note 8). Accordingly, the connection rights cost is being amortised on a straight-line basis over the 38 year period, being the expected period of benefit, commencing 1 January 2002. 11 AMOUNT DUE TO RELATED PARTIES UNAUDITED 2003 2002 AED `000 AED `000 Al Taweelah Shared Facilities Company 225 282 Taweelah A2 Operating Company 1,923 2,142 CMS Resource Development Company 1,329 - ----- ----- 3,477 2,424 ===== ===== 12 ACCRUALS AND OTHER LIABILITIES UNAUDITED 2003 2002 AED `000 AED `000 Accrual for spare parts 34,659 37,217 Accrued interest expense 42,439 35,952 Negative fair value of derivatives (note 18) 257,796 305,166 Other payables 11,796 10,011 ------- ------- 346,690 388,346 =======

======= F-193 13 LONG TERM DEBT During 1999 the Company obtained a loan facility from a syndicate of banks led by Barclays Capital Bank amounting to US $596,000,000 (AED 2,188,810,000) out of which US $556,000,000 (AED 2,041,910,000) was fully drawn by 31 December 2001 to finance the construction of the Plant. The loan carries interest at a variable rate of LIBOR plus a premium of between 0.8% and 1.5% per annum for the remainder period of the term loan. The loan also carried a commitment fee of 0.35% per annum of the undrawn amount. During the year ended 31 December 2003, the fourth and fifth instalments amounting to AED 81.7 million (2002: AED 71.5 million) were paid, with the remaining balance repayable in half yearly instalments until December 2013 in accordance with an agreed upon instalment schedule. The term loan is secured by a number of security documents including a commercial mortgage over all tangible and intangible assets of the Company, a pledge of the shares in the Company by both shareholders and a pledge of the equity interest in TSFC. The term loan is also subject to various covenants as stipulated in the loan facility agreement. Under the terms of its loan facility agreement, the Company is required to enter into interest rate swap agreements to hedge its interest cost exposure against fluctuations in interest rates (note 18). On 15 March 2004, the Company obtained a US $391 million (AED 1,436 million) conventional loan facility and US $150 million (AED 551 million) Islamic loan facility (the "new facilities") from a syndicate of international and UAE based banks to refinance the term loan and repay up to US $35 million (AED 129 million) of the loans from shareholders (note 14). As the existing term loan is to be refinanced by the new facilities, the amounts due in less than one year have been calculated in accordance with the repayment schedules of the new facilities. Under the new facilities 2.951% (US $15,965 thousand (AED 58,631 thousand)) is repayable in 2004 and this amount has been disclosed as being due in less than one year (current liability), with the remaining balance repayable in half yearly instalments until December 2020. Amounts repayable over the next five years are as follows: US $'000 2004 15,965 2005 22,285 2006 21,191 2007 21,250 2008 21,835 14 LOAN FROM SHAREHOLDERS UNAUDITED 2003 2002 AED `000 AED `000 Emirates Power Company PJSC 156,000 163,200 CMS Generation Taweelah Limited 104,000 108,800 ------- ------- 260,000 272,000 ======= ======= Non-current liabilities 131,000 272,000 Current liabilities 129,000 - ------- ------- 260,000 272,000 ======= ======= The above loans are free of interest and are unsecured. Though the terms of repayment have not been specified for these loans, they are subject to terms of repayment as resolved by the Board of Directors. F-194 The Board of Directors anticipates that the Company will make a shareholder loan repayment of approximately AED 129 million in 2004. Accordingly, this amount has been included under current liabilities. 15 SHARE CAPITAL AND STOCKHOLDERS' EQUITY AUTHORISED, ISSUED AND FULLY PAID UNAUDITED 2003 2002 AED `000 AED `000 Ordinary Shares of AED 10 each 413,240 413,240 ======= ======= The Company maintain its statutory accounting records in accordance with International Financial Reporting Standards (IFRS). U.A.E. Commercial Companies Law of 1984 (as amended) and the Company's Articles of Association require 10% of the net profit for the year, based on net income derived from the statutory financial statements prepared in accordance with IFRS, to be transferred to a statutory reserve. The reserve is not available for distribution. Included in (accumulated losses) retained earnings is an amount of AED 27,029,000 (2002: AED 16,603,000) in respect of the required statutory reserve, which is not available for distribution. The Board of Directors recommendation for the distribution of dividends and the ratification and approval of the Shareholders of the dividends were based on the statutory financial statements. Included in the dividends paid during the year ended 31 December 2003, are interim dividends of AED 0.56 (2002: AED 1.07) per share of AED 23,000,000 (2002: AED 44,400,000) which were declared and approved by the Board of Directors and paid during the year. The shareholders have subsequently ratified and approved the interim dividends paid at the Annual General Meeting. 16 RELATED PARTY TRANSACTIONS These represent transactions with related parties, ie. other subsidiaries of Abu Dhabi Power Corporation and Abu Dhabi Water and Electricity Authority and other subsidiaries of CMS Energy Corporation, shareholders and senior management of the Company, and companies of which they are principal owners. Pricing policies and terms of these transactions are approved by the Company's senior management. Significant transactions with related parties included in the income statement are as follows: UNAUDITED UNAUDITED 2003 2002 2001 AED `000 AED `000 AED `000 Revenue from available capacity and supply of water and electricity to Abu Dhabi Water & Electricity Company 363,564 370,686 196,091 Al Taweelah Shared Facilities Company LLC (TSFC) service charge 1,586 2,067 2,767 Other charges from TSFC 1,668 1,670 1,799 Charges by Taweelah A2 Operating Company analysed as follows: Management fee 4,261 4,319 1,755 Manpower support services 10,852 9,673 8,991 Reimbursement of other third party costs paid on behalf of the Company 614 1,429 722 Charges by CMS Generation analysed as follows: Manpower support service 1,979 3,193 2,677 Amounts due from and to related parties are disclosed in notes 5, 6, 11 and 14 to the financial statements. F-195 17 FAIR VALUE OF FINANCIAL INSTRUMENTS With the exception of the loan from shareholders the fair value of the Company's financial instruments approximates their carrying amounts. It is not practicable to determine the fair value of the loan from shareholders with sufficient accuracy. Information on the principal characteristics of the loan is presented in note 14 to the financial statements. 18 DERIVATIVES In order to reduce its exposure to interest rates fluctuations on the term loan, the Company has entered into an interest rate arrangement with a counter-party bank for a notional amount that matches the outstanding term loan. The notional amount outstanding at 31 December 2003 was AED 1,828 million (2002: AED 1,910 million). In addition, the Company uses forward foreign exchange contracts to hedge its risk associated with foreign currency fluctuations relating to scheduled maintenance cost payments to an overseas supplier. The outstanding forward foreign exchange commitment at the year end amounted to approximately AED 42 million (2002: AED 62 million). The derivative instruments had a negative fair value of AED 258 million (2002: negative fair value of AED 305 million) which is included within other current liabilities (note 12) and a positive fair value of AED 15 million (2002: positive fair value of AED 7 million) which is included within other current assets (note 4). As a result of the debt refinancing arrangements concluded by the Company in March 2004 as explained in note 13, the existing derivatives have extinguished and new interest rate swap contracts have been entered into as part of the debt refinancing arrangements. Consequently, the Company expects to reclassify the remaining transition amount recorded in accumulated other comprehensive income into earnings in the year 2004. 19 RISK MANAGEMENT INTEREST RATE RISK The Company is exposed to interest rate risk on its interest bearing liabilities (term loan). Whilst current interest are low, management has sought to limit the exposure of the Company to any adverse future movements in interest rates by entering into interest rate arrangements (derivative instruments see note 19). Management is therefore of the opinion that the Company's exposure to interest rate risk is limited. CONCENTRATION OF CREDIT RISK The Company sells its products to one related party. It seeks to limits its credit risk with respect to this customer by monitoring outstanding receivables. LIQUIDITY RISK The Company limits its liquidity by monitoring its current financial position in conjunction with its cash flow forecasts on a regular basis to ensure funds are available to meet its commitments for liabilities as they fall due. The Company's terms of sale require amounts to be paid within 30 days of the date of sale. Trade payables are normally settled within 30 days of the date of purchase. CURRENCY RISK The Company uses forward currency contracts to eliminate currency exposures on its fixed Euro plant maintenance payments. The majority of other transactions are in UAE Dirhams, which are pegged to the US Dollar. Management is therefore of the opinion that the Company's exposure to currency risk is limited. F-196 20 ADMINISTRATIVE AND OTHER OPERATING EXPENSES UNAUDITED UNAUDITED 2003 2002 2001 AED `000 AED `000 AED `000 Management fees 4,261 4,319 1,755 Other 3,826 3,606 3,066 ----- ----- ----- 8,087 7,925 4,821 ===== ===== ===== 21 INCOME TAX The Company is not subject to income or other similar taxes in the United Arab Emirates and, accordingly, no income tax has been reflected in these financial statements. F-197 NO DEALER, SALESPERSON OR ANY OTHER PERSON HAS BEEN AUTHORIZED TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATIONS OTHER THAN THOSE CONTAINED IN THIS PROSPECTUS IN CONNECTION WITH THE OFFERING MADE HEREBY, AND, IF GIVEN OR MADE, SUCH INFORMATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY CMS ENERGY, THE INITIAL PURCHASERS OR ANY OTHER PERSON. THIS PROSPECTUS DOES NOT CONSTITUTE AN OFFER TO SELL OR A SOLICITATION OF ANY OFFER TO BUY THE NEW NOTES BY ANYONE IN ANY JURISDICTION IN WHICH SUCH OFFER OR SOLICITATION IS NOT AUTHORIZED, OR IN WHICH THE PERSON MAKING THE OFFER OR SOLICITATION IS NOT QUALIFIED TO DO SO, OR TO ANY PERSON TO WHOM IT IS UNLAWFUL TO MAKE SUCH OFFER OR SOLICITATION. NEITHER THE DELIVERY OF THIS PROSPECTUS NOR ANY SALE MADE HEREUNDER SHALL CREATE ANY IMPLICATION THAT THE INFORMATION CONTAINED HEREIN IS CORRECT AS OF ANY TIME SUBSEQUENT TO THE DATE HEREOF. TABLE OF CONTENTS PAGE

 OFFER TO EXCHANGE 7.75% SENIOR NOTES DUE 2010 WHICH HAVE BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED FOR ANY AND ALL OF THE OUTSTANDING 7.75% SENIOR NOTES DUE 2010 [CMS ENERGY LOGO]