

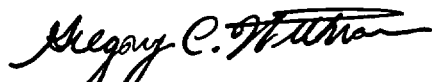
May 5, 2002

U.S. Nuclear Regulatory Commission
Document Control Desk
Washington, DC 20555-0001

**DOCKETS 50-155 AND 72-043 – LICENSE DPR-6 – BIG ROCK POINT PLANT –
2002 CONSUMERS ENERGY COMPANY ANNUAL REPORT**

In accordance with the requirements of 10 CFR 50.71(b) and 72.80(b), attached is the 2002 Consumers Energy Company's annual financial report, including certified financial statement.

If you have any questions, please contact Greg Withrow, Engineering, Operations, and Licensing Manager at 231-547-8176.



Gregory C. Withrow
Engineering, Operations, and Licensing Manager

cc: Administrator, Region III, USNRC
NRC NMSS Project Manager
NRC RIII Decommissioning Inspector

ATTACHMENT

NMSS01

ATTACHMENT 1

**Big Rock Point
Dockets 50-155 and 72-043**

May 5, 2003

**CMS Energy
2002 Annual Report**

CMS ENERGY

2002
ANNUAL
REPORT

ABOUT OUR BUSINESS

CMS Energy is an integrated energy company whose business strategy is focused in the Midwestern United States. CMS Energy's two principal subsidiaries are Consumers Energy and CMS Enterprises. Consumers Energy provides natural gas and

electricity to more than 6 million of Michigan's 10 million residents in all 68 Lower Peninsula counties. CMS Enterprises, through its subsidiaries, is engaged primarily in the independent power, natural gas transmission and wholesale energy service businesses.

KEY FIGURES

Millions of dollars, except as noted

| December 31 | 2002 | 2001 |
|--|-----------|-----------|
| REVENUE | | |
| Electric utility | \$ 2,644 | \$ 2,630 |
| Gas utility | 1,519 | 1,338 |
| Independent power production | 372 | 388 |
| Natural gas transmission | 50 | 59 |
| Marketing, services and trading | 4,076 | 3,674 |
| Other | 26 | (26) |
| Consolidated revenue | \$ 8,687 | \$ 8,063 |
| Consolidated net income (loss) | \$ (620) | \$ (448) |
| Ongoing net income ^(a) | \$ 213 | \$ 9 |
| Per common share | | |
| Diluted earnings per average common share: | | |
| Earnings (loss) per share | \$ (4.46) | \$ (3.42) |
| Ongoing earnings per share ^(a) | \$ 1.53 | \$ 0.08 |
| Dividends declared | \$ 1.09 | \$ 1.46 |
| Book value | \$ 7.86 | \$ 15.33 |
| Market value (year-end) | \$ 9.44 | \$ 24.03 |

^(a)Ongoing net income differs from net income prepared in accordance with Generally Accepted Accounting Principles (GAAP) in that it excludes the effects of the following reconciling items:

| | Millions of dollars, except per share amounts | | | |
|--|---|-----------|----------------------|-----------|
| | Net income (loss) | Per share | Net income (loss) | Per share |
| Reported net income — GAAP Basis | \$ (620) | \$ (4.46) | \$ (448) | \$ (3.42) |
| Asset impairments | 455 | 3.27 | 206 | 1.57 |
| Discontinued operations | 222 | 1.60 | 210 | 1.61 |
| Addback of Panhandle and Field Services, net | 64 | .46 | 39 | .30 |
| Tax strategy changes | 111 | .80 | - | - |
| Net asset sales and other | (19) | (.14) | 2 | .02 |
| Ongoing net income — non-GAAP Basis | \$ 213 | \$ 1.53 | \$ 9 | \$.08 |

Management believes that ongoing earnings provide a key measure of the company's current operating financial performance, unaffected by losses or gains caused by net asset write-downs, impairments, sales and other items detailed above.

TO OUR SHAREHOLDERS: ACROSS THE COUNTRY,
SHAREHOLDERS ARE RECEIVING ANNUAL REPORTS THAT
ACCOUNT FOR THEIR INVESTMENTS DURING THE PAST
YEAR. SOME COMPANIES WILL DELIVER GOOD NEWS,
THOUGH LESS FREQUENTLY THAN IN MOST YEARS

REBUILDING
CONFIDENCE
WITH FINANCIAL
IMPROVEMENT

BECAUSE OF THE ECONOMY AND
FINANCIAL MARKETS. MANY
OTHERS WILL TRY TO PUT
A GOOD "SPIN" ON A YEAR THAT
DIDN'T GO QUITE RIGHT. I

CERTAINLY CAN'T MAKE A PRETENSE OF DOING THE
FIRST, AND I DON'T BELIEVE IN THE SECOND. INSTEAD,
I'LL DISCUSS WHAT WE HAVE BEEN DOING TO TURN THIS
COMPANY AROUND SINCE I BECAME CHAIRMAN AND CEO
IN LATE MAY.

First, I hope you'll allow me to spend a moment thanking our hard-working employees who, incidentally, own about 12 percent of our stock and who feel the company's financial difficulties as directly as anyone. These men and women demonstrated once again why they are among the best in the industry. A full report on their superb operating performance, which includes an important award recognizing customer satisfaction, begins on page 8. The competitive superiority of our service to customers will continue to be our best asset.

The energy industry had a fairly lousy 2002, and you could use the same adjective to describe our company's overall results. We had a net loss of \$620 million, or \$4.46 per share – due largely to write-downs or losses on assets – on a Generally Accepted Accounting Principles (GAAP) basis. That compares to a net loss of \$448 million, or \$3.42 per share in 2001. Ongoing net income (non-GAAP; see page 1 for explanation) was a lot better because of our strong operating performance. It totaled \$213 million, or \$1.53 per share, compared to \$9 million, or \$.08 per share in 2001. While perhaps a small consolation, I'm pleased that we have met or beaten our ongoing earnings forecasts since the new management team took over in May. We have put a high priority on delivering on our commitments.

And even though profits are important, at the moment our most important short-term priority is liquidity – plain old cash. Our debt is too high for the size of this company and we have to pay some of it down, so we can use more of our cash flow to run the business and pay a dividend to shareholders.

Because the energy industry is out of favor with most investors, we have to control our own destiny as much as possible. We implemented a tough cost management program in 2002 that reduces annual operating

costs by more than \$50 million, and we are making additional reductions this year. In addition, we have reduced capital expenditures by \$540 million in 2002 and another \$350 million in 2003.

Last January, the Board of Directors suspended the common stock dividend. This is painful for our owners, but it will improve liquidity by more than \$100 million annually. Our company needs to be the kind of company that pays dividends, however, and the board intends to restore a dividend as soon as it is financially prudent to do so.

Our liquidity actions have given us a good base for continued improvement.

While the closing of the Panhandle sale has been delayed somewhat from our original plan, we have arranged financing to satisfy all of our parent company and Consumers Energy debt obligations well into 2004. We reduced debt by about \$800 million in 2002. With the closing of the Panhandle sale and other planned asset sales, we will continue to make substantial debt reductions.

Next, I'll cover the sad chapter on so-called round-trip trading. As most people now know, round-trip trades are simultaneous purchases and sales of electricity and natural gas with the same parties at the same price. They may not be illegal, but they were dumb and they didn't come close to meeting our ethical

standards. Last May, I formed a special committee of outside Directors to make sure we had all the facts on the table. No significant new information was discovered, and there was no indication of motives other than to pump up the marketing credentials of the Marketing, Services and Trading business by showing higher sales volumes. We have shared the results with the Securities and Exchange Commission and other agencies and have taken the appropriate personnel disciplinary actions.

The company has restated its 2000 and 2001 consolidated financial statements to eliminate the effects of round-trip trading, a project that was expanded to include a full re-audit of those years. With the filing of the Form 10-K for 2002 that accompanies this annual report, our re-audit is complete. We expect to complete a review of 2001 quarterly results by mid-summer.

Finally, the company is working to resolve a number of Michigan regulatory issues that affect the earnings of Consumers Energy. These include:

- Recovery of stranded costs resulting from Michigan's electric customer choice program, as permitted by state law. We have asked the Michigan Public Service Commission (MPSC) to reconsider its order regarding 2000 and 2001 stranded costs, and have filed a request for recovery of 2002 stranded costs.

The absence of a recovery plan for the costs accelerates the loss of customers – primarily industrial – to alternate suppliers, and potentially increases future electric bills for small commercial and residential customers.

- Consumers Energy has asked the MPSC to approve securitization of up to \$1.1 billion of costs, about half of which are related to capital expenditures the company has made to comply with new Clean Air Act requirements.

Securitization of these costs will save customers more than \$100 million annually on future bills.

- This month we asked the MPSC to approve a \$156 million natural gas rate increase. Although we received a \$56 million increase in November – the first since 1984 – it was not adequate to fully serve natural gas customers, meet new regulatory requirements and provide an acceptable return to shareholders.

* * * * *

We have made a good start in 2002, but as you can tell by the priorities I have listed, a lot of work remains. I think it's important that investors understand that our financial recovery is a multiyear journey.

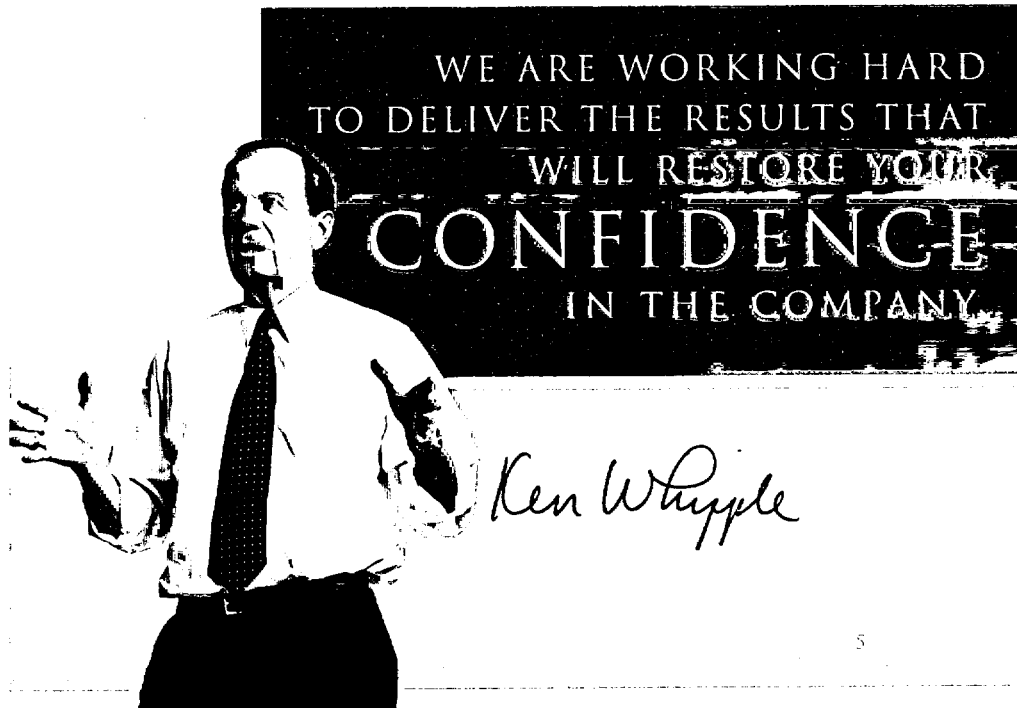
For 2003, we expect reported earnings per share will be roughly break even. That's a huge improvement over 2002, but a long way from where this

company can and needs to be. We expect ongoing net income (non-GAAP) to be in the range of 80 cents to 90 cents per share. This decrease from 2002 is the result of several factors. First, we are selling assets that were contributing earnings, the largest being our Panhandle pipeline system. Second, Consumers Energy's earnings will decrease because of investments at our generating plants to comply with the Clean Air Act; the shift of customers to electric customer choice in the absence of stranded cost recovery; and higher borrowing costs.

There is one more item that is very important to all of us at this company – rebuilding the confidence of investors in our financial and business integrity. On pages 6-7 of this report we have outlined some of the measures that are in place to ensure sound and credible corporate governance, and to comply with new laws and regulations. But these measures are not just about compliance. We are dead serious about seeing that they are fully embraced in *spirit*, as well as the letter of the law, by all our employees.

Our new management team is a good one, and we are working hard to deliver the results that will restore your confidence in the company.

Sincerely, Ken Whipple
Chairman and Chief Executive Officer
March 31, 2003



THE SARBANES - OXLEY ACT WAS PASSED LAST YEAR by Congress to increase corporate responsibility and help ensure ethical business practices throughout corporate America.

We know that CMS Energy's shareholders will be paying close attention to how the company addresses this law, as well as new rules from securities regulators and other governance groups.

And a commitment to compliance – simply following the letter of the law – is not enough. Our standards for corporate governance must also embrace the spirit of the law – doing business in an ethical and compliant manner because it is the right thing to do.

REBUILDING
CONFIDENCE
WITH BUSINESS
INTEGRITY

Here are some of the measures we have taken to help fulfill our commitments:

- Adopting governance principles that ensure the Board of Directors' independence from management. As a result: a majority of the Board must be independent members, and no more than three officers can be members; at each regularly scheduled Board meeting, non-management Directors will have an opportunity to conduct a session without management; and

all Board committees, with the exception of the Executive Committee that is chaired by the chief executive officer, will be comprised entirely of independent Directors.



- Expanding the Board of Directors' financial and operational expertise with the addition of two new Board members. Joe Paquette brings excellent utility experience; he is the retired Chairman and Chief Executive Officer of PECO Energy Company, and was an executive of our company from 1986-88. The Board will benefit from the extensive financial expertise of Mike Monahan, previously Chairman of Munder Capital Management and President and Director of Comerica, Inc.

- Appointing Michael D. VanHemert to the new position of chief compliance officer. He will oversee the company's compliance with corporate governance standards, and will report directly to the Board of Directors. He also will manage the company's compliance training, and will provide advice to employees with questions or concerns about ethical behavior or potential conflicts of interest.

- Creating a confidential hotline, administered by a third party, which employees can use to report corporate compliance concerns.


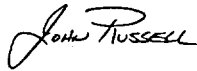


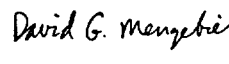
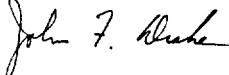


- Rewriting the company's Code of Conduct handbook, which explains corporate policies and procedures relating to proper business conduct, and ensuring understanding throughout the work force. The handbook establishes a clear understanding of proper and improper behavior, and now includes sections regarding insider trading and whistleblower protection.

- Expanding the duties of the company's chief risk officer to encompass procedures for assessing legal and business risks, in addition to financial risks.

This overview doesn't cover all of our governance activities, of course. Later this year the company will provide more detailed information on its Web site, www.cmsenergy.com.

Finally, the most important measure is to give you our personal commitment to operate this business in a manner that lives up to your expectations. As your senior management team, that is our promise to you.



 S. Kinnie Smith, Jr. 
 Ken Whipple  Carl English  David G. Mengebier
 John F. Drake  Tom Elward  Tom Webb

left to right: Dave Joos, President and COO;
 Kinnie Smith, Vice Chairman and General Counsel
 John Russell, President and CEO - Electric, Consumers Energy
 Ken Whipple, Chairman and CEO
 Carl English, President and CEO - Gas, Consumers Energy
 Dave Mengebier, Senior Vice President, Governmental and Public Affairs
 John Drake, Senior Vice President, Human Resources
 Tom Elward, President and COO, CMS Enterprises
 Tom Webb, Executive Vice President and CFO

C M S E N E R G Y H A S E M B A R K E D O N A
B A C K - T O - B A S I C S B U S I N E S S S T R A T E G Y T H A T W I L L
F U N D A M E N T A L L Y C H A N G E T H E C O M P A N Y . F I R S T , W E
W I L L B E C O M E A M U C H S I M P L E R C O M P A N Y T O U N D E R S T A N D -
A S T R E A M L I N E D " U T I L I T Y - P L U S " S E T O F B U S I N E S S E S

OPERATING
EXCELLENCE
REMAINS THE HEART
OF THE COMPANY

C E N T E R E D A R O U N D O U R P R I N C I P A L
S U B S I D I A R Y , C O N S U M E R S E N E R G Y .
S E C O N D , O U R P R I M A R Y B U S I N E S S
F O C U S - A N D C E R T A I N L Y O U R F U T U R E
G R O W T H - W I L L B E C O N C E N T R A T E D

I N N O R T H A M E R I C A , A M A R K E T W E U N D E R S T A N D A N D W H E R E W E
H A V E A T R A C K R E C O R D O F S U C C E S S .

Through aggressive asset sales, we have streamlined our businesses considerably. Sales completed or pending include:

- Our entire oil and gas exploration and production business.
- The electric and natural gas books of our Houston-based energy trading business; we are closing the Houston office.
- Our interests in seven generating plants, including plants in Thailand, India, the Philippines and the United States.
- Our interstate pipeline and liquefied natural gas business, CMS Panhandle. We expect the sale to be completed in the second quarter of this year.

The core businesses that will become the heart of our strategy had a strong operating performance in 2002.

Consumers Energy, which serves more than 6 million Michigan residents,

produced a record 28 billion kilowatt-hours of electricity as its generating plants had one of their best years ever. In July, the company posted the highest monthly sendout for any month in the company's 117-year history, one of six sendout or hourly peak records set during the warmer-than-usual summer and fall.

The company's coal-fired plants achieved a forced outage rate of 5.4 percent, second-lowest in their history. The 789-megawatt Palisades nuclear plant, which supplied about 23 percent of the electricity generated by Consumers Energy in 2002, set a new annual production mark and recorded the second-longest continuous run in its history.

Consumers Energy's substantial investment at its coal-fired generating plants has helped make Michigan the largest industrial state in full compliance with all major federal air quality standards. Beginning in 1999, Consumers Energy started investing more than \$700 million to comply with new nitrogen oxide standards set by the U.S. Environmental Protection Agency. When completed, ozone season nitrogen oxide emissions from the company's coal plants will be 85 percent lower than 1990 levels.

The company's efforts include increasing the use of western U.S. coal,

which produces less nitrogen oxides, sulfur dioxide and other compounds when burned; installing special burners in boilers to reduce nitrogen oxides; installing advanced computer systems to fine-tune the combustion process; and adding technology at four generating units to remove nitrogen oxides from the exhaust.

Consumers Energy completed the fifth year of a seven-year program to decommission the Big Rock Point nuclear plant and restore the 580-acre site to a natural green state. All spent nuclear fuel has been loaded into dry fuel storage casks. Workers are preparing to remove the plant's reactor vessel for shipment to a licensed waste disposal site.

In May, Consumers Energy sold its high-voltage electric transmission system to TransElect, an independent transmission company. We also completed improvements that expanded the system's capability to import electricity into Michigan. We continue to operate and maintain the system under a five-year contract.

The sale was part of our preparation for Michigan's electric customer choice program, which allows all Michigan electric customers to choose their electricity supplier. During the past two years, customers have shifted a total of about 500 megawatts of load to alternate suppliers, and we anticipate

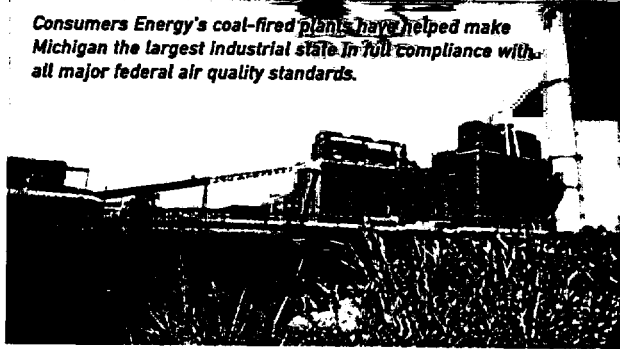
an additional shift this year. We continue to deliver the electricity through our distribution system, which added 22,113 new customers last year.

The company once again demonstrated its tradition of outstanding customer service, continuing its four-year climb to the top quartile in a nationwide survey of large-volume electricity customers.

Our natural gas business also turned in an outstanding performance, placing first in the Midwest in the J.D. Powers survey of residential customer satisfaction.

Consumers Energy increased natural gas deliveries by 2.6 percent to 376 billion

Consumers Energy's coal-fired plants have helped make Michigan the largest industrial state in full compliance with all major federal air quality standards.



cubic feet, and added 22,657 new customers. Our natural gas distribution cost continues to rank among the lowest 10 percent in the United States.

Meanwhile, a multiyear program to protect our 14,000-mile pipeline system from natural corrosion neared the 90 percent completion mark. Our aggressive program to protect our sys-

tem from construction work and other digging also paid off, as third-party damage declined about 13 percent.

The company also began a pipeline integrity program, which uses a "smart pig" device to internally inspect its 2,300 miles of high-pressure gas transmission lines. The program gives the company a head start on inspection requirements contained in federal pipeline safety legislation enacted late last year.

The nonutility businesses that will be a key part of our new business strategy also performed very well, led by several key generating plants in Michigan. These include:

- The 1,500-megawatt Midland Cogeneration Venture is the largest, and one of the most reliable, independent power plants in the United States. The gas-fueled plant is capable of supplying enough electricity for a city of more than 1 million people. Last year, the plant posted 95.3 percent availability, and sold a total of 8,275 million megawatt-hours of electricity and 5.4 million pounds of process steam.
- The 35-megawatt Genesee plant, which burns waste-wood, turned in one of its best years, in part due to changes in its fuel inventory management system that

helped the plant avoid supplementing its fuel with higher-cost natural gas. The Michigan and U.S. Departments of Agriculture have selected the plant for a pilot program that disposes of ash trees infested by destructive emerald ash borers. The effort will provide the plant up to 20,000 tons of ash wood for fuel.

- The waste-wood-fueled Grayling Generating Station achieved a plant availability of 97.5 percent, and has averaged over 98 percent availability in the past two years.

Several key international assets also had very good years. They include:

- The 1,356-megawatt Jorf Lasfar plant in Morocco – Africa's largest independent generating plant – reached availability of 93 percent and a capacity factor of 85 percent in 2002. Its availability ranks it as a leader among large coal-fueled plants worldwide.

- Also in Africa, the Takoradi 2 plant completed its best year ever for electricity production. In 2002, the 220-megawatt plant generated 1.4 million megawatt-hours of electricity for the people and businesses of Ghana.

- Al Taweelah A2, the first independent combined-cycle power and water desalination plant in the United Arab Emirates, completed its first full year of operation in October. The facility has set a benchmark for

combined power and water projects throughout the Middle East, achieving electricity availability of 98.1 percent and 97.9 percent for desalination.

- Two major contracts gave a significant boost to GasAtacama, an integrated natural gas pipeline and generating plant. The 600-mile pipeline transports natural gas from Argentina to fuel the NOPEL generating plant on Chile's coast. Under a 10-year contract, the plant last year began supplying about 200 megawatts of electricity to EMEL, the electric distribution company serving northern Chile. Demand is estimated to grow to about 300 megawatts by 2010. In December, the plant began providing about 150 megawatts to Escondida, the world's largest copper mine.

SENIOR MANAGEMENT

KEN WHIPPLE
Chairman and Chief Executive Officer,
CMS Energy and Consumers Energy

DAVID W. JOOS
President and Chief Operating Officer,
CMS Energy and Consumers Energy

S. KINNIE SMITH JR.
Vice Chairman, CMS Energy and Consumers
Energy; General Counsel, CMS Energy

THOMAS J. WEBB
Executive Vice President and Chief Financial
Officer, CMS Energy and Consumers Energy

ADDITIONAL OFFICERS

WILLIAM J. HAENER
Executive Vice President-Natural Gas,
CMS Energy

DAVID A. MIKELONIS
Senior Vice President and
General Counsel, Consumers Energy

ROBERT A. FENECH
Senior Vice President,
Nuclear, Fossil and Hydro Operations,
Consumers Energy

PAUL N. PREKETES
Senior Vice President,
Gas Operations, Consumers Energy

PRESTON D. HOPPER
Senior Vice President, Information
Technology and Administrative Services,
CMS Energy and Consumers Energy

GLENN P. BARBA
Vice President, Controller and
Chief Accounting Officer, CMS Energy and
Consumers Energy

FRANK JOHNSON
Senior Vice President
Electric Transmission and Distribution,
Consumers Energy

BELINDA M. FOXWORTH
Vice President and Deputy General Counsel
CMS Energy

WILLIAM E. GARRITY
Vice President, Electric and Gas Supply,
Consumers Energy

CAROL A. ISLES
Vice President and Controller,
CMS Enterprises

THOMAS W. ELWARD
President and Chief Operating Officer,
CMS Enterprises

CARL L. ENGLISH
President and Chief Executive Officer-Gas,
Consumers Energy

JOHN G. RUSSELL
President and Chief Executive Officer-
Electric, Consumers Energy

JOHN D. KOBASA
Vice President, Engineering, Operations and
Construction, CMS Gas Transmission

M. CLIFFORD LAWRENSON
Vice President, Financial Advisory Services
and Strategic Planning, CMS Enterprises

SHARON A. McILNAY
Vice President and General Counsel,
CMS Gas Transmission

THOMAS L. MILLER
Vice President, Business Analysis,
CMS Gas Transmission

LAURA L. MOUNTCASTLE
Vice President, Investor Relations and
Treasurer, CMS Energy;
Vice President, Consumers Energy

MICHAEL J. SHORE
Vice President and Chief Risk Officer,
CMS Energy and Consumers Energy

JOHN F. DRAKE
Senior Vice President, Human Resources,
CMS Energy and Consumers Energy

DAVID G. MENGBIER
Senior Vice President,
Governmental and Public Affairs,
CMS Energy and Consumers Energy

PAUL A. STADNIKIA
Treasurer, Consumers Energy

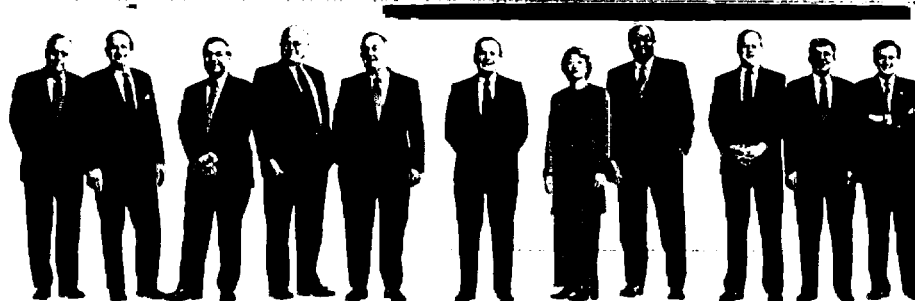
WILLIAM H. STEPHENS III
Vice President, CMS Enterprises

SUSAN C. SWAN
Vice President, Customer Operations,
Consumers Energy

JOSEPH P. TOMASIK
Vice President and Chief Development
Officer, CMS Enterprises

MICHAEL D. VANHEMERT
Vice President, Corporate Secretary and
Chief Compliance Officer, CMS Energy and
Consumers Energy; Deputy General Counsel,
CMS Energy

THEODORE J. VOGEL
Vice President, Taxes and Tax Counsel,
CMS Energy and Consumers Energy



KEN WHIPPLE

Chairman of the Board and Chief Executive Officer of CMS Energy and Consumers Energy. Previously Executive Vice President of Ford Motor Company, President of the Ford Financial Services Group, Chairman and Chief Executive Officer of Ford Motor Credit Company and Chairman and Chief Executive Officer of Ford of Europe, Inc. Director of AB Volvo and Trustee of J. P. Morgan Mutual Funds. Director since 1993.

S. KINNIE SMITH JR.

Vice Chairman and General Counsel of CMS Energy and Vice Chairman of Consumers Energy. Most recently was Senior Counsel for the law firm of Skadden, Arps, State, Meagher & Flom. Previously Vice Chairman and President of CMS Energy and Consumers Energy and General Counsel of CMS Energy. Director 1987-1996 and since 2002.

JOHN M. DEUTCH

Institute Professor, Massachusetts Institute of Technology. Formerly Director of the Central Intelligence Agency and U.S. Deputy Secretary of Defense. Director of Citigroup Inc., Schlumberger Ltd., ARIAD Pharmaceuticals Inc., Raytheon Company and Cummins Engine Company Inc. Director 1986-1993 and since 1997.

JAMES J. DUDERSTADT

President Emeritus and University Professor of Science and Engineering, The University of Michigan, Ann Arbor, Mich. Director of Unisys Corporation, Chair of the Nuclear Energy Research Advisory Committee of the Department of Energy and numerous studies for the National Academy of Sciences. Director since 1993.

KATHLEEN R. FLAHERTY

Former President and Chief Operating Officer, WinStar International. Formerly President and Chief Operating Officer of WinStar Communications, Europe. Senior Vice President, Product Architecture for MCI Communications Corp., and National Business Marketing Director for British Telecom. Director since 1995.

EARL D. HOLTON

Vice Chairman, Meijer Inc., a Grand Rapids, Mich.-based operator of food and general merchandise centers and Chairman, Steelcase Inc. Director of Meijer Inc. and Steelcase Inc. Director since 1989.

DAVID W. JOOS

President and Chief Operating Officer, CMS Energy and Consumers Energy. Previously Executive Vice President and Chief Operating Officer-Electric for Consumers Energy. Director of Steelcase Inc., Nuclear Management Co., the Michigan Colleges Foundation, Michigan Economic Development Corporation, and Director and Vice Chairman of the Michigan Manufacturers Association. Director since 2001.



LEFT TO RIGHT:

*S. Kinnie Smith Jr., John M. Deutch, Kenneth L. Way, William U. Parfet,
Michael T. Monahan, Ken Whipple, Kathleen R. Flaherty, Percy A. Pierre,
James J. Duderstadt, Joseph F. Paquette Jr., John B. Yasinsky,
David W. Joos, Earl D. Holton.*

MICHAEL T. MONAHAN

President, Monahan Enterprises, LLC., Bloomfield Hills, Mich., a consulting firm. Previously Chairman of Munder Capital Management and President and Director of Comerica, Inc. Director of The Munder Funds Inc. and Director and Chairman of Guilford Mills Inc. Trustee of Henry Ford Health Systems, Inc. and the Community Foundation for Southeastern Michigan. Director since December 2002.

JOSEPH F. PAQUETTE JR.

Retired Chairman and Chief Executive Officer of PECO Energy Company, formerly the Philadelphia Electric Company, a major supplier of electric energy. Previously Executive Vice President and Chief Financial Officer of Consumers Energy. Director of USEC Inc., AAA Mid-Atlantic Inc., Mid-Atlantic Insurance Company and Mercy Health Systems. Director 1987-1988 and since December 2002.

WILLIAM U. PARFET

Chairman and Chief Executive Officer, MPI Research Inc., Mattawan, Mich., a contract research laboratory conducting risk assessment toxicology studies. Previously co-chairman of MPI Research. Director of Pharmacia Corporation, Stryker Corporation, PAREXEL International Corp. and Monsanto Company and a Michigan Department of Natural Resources Commissioner. Director since 1991.

PERCY A. PIERRE

Professor of Electrical Engineering, Michigan State University, East Lansing, Mich. Formerly Assistant Secretary of the Army for Research, Development and Acquisition, President of Prairie View A&M University and Vice President for Research and Graduate Studies at Michigan State University. Director of Fifth Third Bank and the Whitman Education Group and Trustee for the University of Notre Dame and Hampshire College. Director since 1990.

KENNETH L. WAY

Retired Chairman of the Board, Lear Corporation, a Southfield, Mich.-based supplier of automotive interior systems to the automotive industry, and formerly Chief Executive Officer, Lear Corporation. Director of Comerica Inc. and WESCO International Inc., and Trustee for Kettering University and Henry Ford Health Systems, Inc. Director since 1998.

JOHN B. YASINSKY

Retired Chairman and Chief Executive Officer, OMNOVA Solutions Inc., Fairlawn, Ohio, a developer, manufacturer and marketer of emulsion polymers, specialty chemicals and building products. Previously Chairman, Chief Executive Officer and President of GenCorp. Director of A. Schulman Inc. Director since 1994.

BOARD COMMITTEE MEMBERSHIP

AUDIT COMMITTEE

Members: William U. Parfet (Chair),
John M. Deutch, James J. Duderstadt,
Michael T. Monahan, Joseph F. Paquette Jr.,
Kenneth L. Way and John B. Yasinsky

GOVERNANCE AND NOMINATING COMMITTEE

Members: John M. Deutch (Chair),
James J. Duderstadt, Kathleen R. Flaherty,
Earl D. Holton, Joseph F. Paquette Jr. and
Percy A. Pierre

ORGANIZATION AND COMPENSATION COMMITTEE

Members: John B. Yasinsky (Chair),
John M. Deutch, Earl D. Holton,
Joseph F. Paquette Jr., William U. Parfet and
Kenneth L. Way

ENVIRONMENTAL AND CORPORATE RESPONSIBILITY COMMITTEE

Members: Percy A. Pierre (Chair),
James J. Duderstadt, Kathleen R. Flaherty,
Earl D. Holton, Michael T. Monahan and
John B. Yasinsky

EXECUTIVE COMMITTEE

Members: Ken Whipple (Chair),
John M. Deutch, William U. Parfet,
Percy A. Pierre, Kenneth L. Way and
John B. Yasinsky

FINANCE AND PENSION COMMITTEE

Members: Kenneth L. Way (Chair),
James J. Duderstadt, Kathleen R. Flaherty,
Michael T. Monahan, William U. Parfet and
Percy A. Pierre

SHAREHOLDER INFORMATION

As a CMS Energy shareholder, you can choose either direct or indirect stock ownership. With direct stock ownership, shares are registered in your name; you can purchase additional shares directly from the company with no commission or service charge; you can enjoy the benefits of direct communication with CMS Energy; and you can participate in the CMS Energy stock purchase plan. With indirect stock ownership, your shares are held in "street name" by a broker, and communications from the company come through a broker, rather than directly from CMS Energy. For more information on direct and indirect ownership, please contact Investor Services for a copy of the brochure, "Stock Ownership: What Every Investor Should Know."

With direct stock ownership, you can:

- Purchase common stock directly from CMS Energy with no brokerage commission or service charge.
- Use automatic monthly deduction from your bank account to grow your CMS investment with no brokerage charge.
- Reinvest dividends to purchase additional shares of common stock (with no commission).
- Have dividends deposited directly into your checking or savings account, putting your money to work immediately and saving you a trip to the bank.

Interested? If so:

- Click on "Invest in CMS" at our Web site, www.cmsenergy.com
- Call Investor Services at (517) 788-1868

2003 Annual Meeting:

CMS Energy's 2003 annual meeting is scheduled for 10:30 a.m. on May 23 at the Potter Center, Jackson Community College, Jackson, Michigan. Proxy material will be mailed in April.

Registered Shareholders:

As of December 31, 2002, the number of registered shareholders totaled 62,739 for CMS Energy Common Stock.

Shareholder Contacts:

Inquiries about stock ownership, stock purchase, change of address, dividend payments, dividend reinvestment or the stock purchase plan may be directed to: Investor Services Department
One Energy Plaza
Jackson, MI 49201-2276
(517) 788-1868 or send an e-mail to: invest@cmsenergy.com

Financial and Operating Information:

Investor Relations Department
One Energy Plaza
Jackson, MI 49201-2276
(517) 788-2590

Stock Exchange Listing:

CMS Energy Common Stock is listed on the New York Stock Exchange under the symbol CMS.

Transfer Agent, Registrar and Paying Agent:

Investor Services Department
One Energy Plaza
Jackson, MI 49201-2276



CMS Energy Corporation
One Energy Plaza
Jackson, MI 49201-2276

**2002 CMS ENERGY
FORM 10-K**

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2002

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

| <u>Commission File Number</u> | <u>Registrant; State of Incorporation Address; and Telephone Number</u> | <u>IRS Employer Identification No.</u> |
|-----------------------------------|--|--|
| 1-9513 | CMS ENERGY CORPORATION (A Michigan Corporation) Fairlane Plaza South, Suite 1100 330 Town Center Drive, Dearborn, Michigan 48126 (313) 436-9200 | 38-2726431 |

Securities registered pursuant to Section 12(b) of the Act:

| <u>Registrant</u> | <u>Title of Class</u> | <u>Name of Each Exchange on Which Registered</u> |
|------------------------|---|--|
| CMS Energy Corporation | Common Stock, \$.01 par value | New York Stock Exchange |
| CMS Energy Trust I | 7.75% Quarterly Income Preferred Securities | New York Stock Exchange |
| CMS Energy Trust III | 7.25% Premium Equity Participating Security Units | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the Registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrants' knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

The aggregate market value of CMS Energy voting and non-voting common equity held by non-affiliates was \$1.305 billion for the 135,104,392 CMS Energy Common Stock shares outstanding on June 28, 2002 based on the closing sale price of \$10.92 for CMS Energy Common Stock, as reported by the New York Stock Exchange on such date. There were 144,078,509 Shares of CMS Energy Common Stock outstanding as of March 15, 2003.

Documents incorporated by reference: CMS Energy's proxy statement and Consumers, information statement relating to the 2003 annual meeting of shareholders to be held May 23, 2003, are incorporated by reference in Part III, except for the organization and compensation committee report, performance graph and audit committee report contained therein.

CMS ENERGY CORPORATION

EXPLANATORY NOTE

The certifications of the principal executive officer and principal financial officer of CMS Energy will not be provided because CMS Energy is in the process of restating 2001 for each quarter and intends to amend this form 10-K and provide the required certifications at that time.

CMS Energy Corporation
Annual Report on Form 10-K to the Securities and Exchange Commission
for the Year Ended December 31, 2002

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GLOSSARY

Certain terms used in the text and financial statements are defined below.

| | |
|---|---|
| <p>ABATE</p> <p>Accumulated Benefit Obligation</p> <p>AEP</p> <p>ALJ</p> <p>Alliance</p> <p>AMT</p> <p>APB</p> <p>APB Opinion No. 18.</p> <p>APB Opinion No. 25.</p> <p>APB Opinion No. 30.</p> <p>Arthur Andersen</p> <p>Attorney General</p> <p>bcf</p> <p>Big Rock</p> <p>Board of Directors</p> <p>Bookouts</p> <p>Btu</p> <p>CEO</p> <p>CFO</p> <p>Clean Air Act</p> <p>CMS Electric and Gas</p> <p>CMS Energy</p> <p>CMS Energy Common Stock</p> <p>CMS Gas Transmission</p> <p>CMS Generation</p> <p>CMS Holdings</p> <p>CMS Midland</p> <p>CMS MST</p> <p>CMS Oil and Gas</p> <p>CMS Panhandle</p> <p>Common Stock</p> <p>Consumers</p> <p>Consumers Campus Holdings</p> <p>Consumers Receivables Funding</p> | <p>Association of Businesses Advocating Tariff Equity</p> <p>The liabilities of a pension plan based on service and pay to date. This differs from the Projected Benefit Obligation that is typically disclosed in that it does not reflect expected future salary increases</p> <p>American Electric Power Co.</p> <p>Administrative Law Judge</p> <p>Alliance Regional Transmission Organization</p> <p>Alternative minimum tax</p> <p>Accounting Principles Board</p> <p>APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock"</p> <p>APB Opinion No. 25, "Accounting for Stock Issued to Employees"</p> <p>APB Opinion No. 30, "Reporting Results of Operations — Reporting the Effects of Disposal of a Segment of a Business"</p> <p>Arthur Andersen, LLP</p> <p>Michigan Attorney General</p> <p>Billion cubic feet</p> <p>Big Rock Point nuclear power plant, owned by Consumers</p> <p>Board of Directors of CMS Energy</p> <p>Unplanned netting of transactions from multiple contracts</p> <p>British thermal unit</p> <p>Chief Executive Officer</p> <p>Chief Financial Officer</p> <p>Federal Clean Air Act, as amended</p> <p>CMS Electric and Gas Company, a subsidiary of Enterprises</p> <p>CMS Energy Corporation, the parent of Consumers and Enterprises</p> <p>Common stock of CMS Energy, par value \$.01 per share</p> <p>CMS Gas Transmission Company, a subsidiary of Enterprises</p> <p>CMS Generation Co., a subsidiary of Enterprises</p> <p>CMS Midland Holdings Company, a subsidiary of Consumers</p> <p>CMS Midland Inc., a subsidiary of Consumers</p> <p>CMS Marketing, Services and Trading Company, a subsidiary of Enterprises</p> <p>CMS Oil and Gas Company, a subsidiary of Enterprises</p> <p>Panhandle Eastern Pipeline Company, including its subsidiaries Trunkline, Pan Storage, Panhandle Storage, and Trunkline LNG. Panhandle is a wholly owned subsidiary of CMS Gas Transmission</p> <p>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</p> <p>Consumers Energy Company, a subsidiary of CMS Energy</p> <p>Consumers Campus Holdings, L.L.C., a wholly owned subsidiary of Consumers</p> <p>Consumers Receivables Funding L.L.C., a wholly-owned subsidiary of Consumers</p> |
|---|---|

| | |
|---------------------------|---|
| Court of Appeals | Michigan Court of Appeals |
| 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 no later than 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, L.L.C., a wholly owned subsidiary of CMS Generation |
| DOE | U.S. Department of Energy |
| Dow | The Dow Chemical Company, a non-affiliated company |
| DSM | Demand-side management |
| Duke Energy | Duke Energy Corporation, a non-affiliated company |
| EISP | Executive Incentive Separation Plan |
| EITF | Emerging Issues Task Force |
| El Chocon | Hidroelectrica El Chocon S.A. |
| 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 |
| FASB | Financial Accounting Standards Board |
| FERC | Federal Energy Regulatory Commission |
| FMLP | First Midland Limited Partnership, a partnership which holds a lessor interest in the MCV facility |
| FTC | Federal Trade Commission |
| GCR | Gas cost recovery |
| GTNs | CMS Energy General Term Notes®, \$200 million Series D, \$400 million Series E and \$300 million Series F |
| GWh | Gigawatt-hour |
| Health Care Plan | The medical, dental, and prescription drug programs offered to eligible employees of Panhandle, Consumers and CMS Energy |
| IPP | Independent Power Producer |
| ISO | Independent System Operator |
| ITC | Investment tax credit |
| Jorf Lasfar | The 1,356 MW coal-fueled power plant in Morocco, jointly owned by CMS Generation and ABB Energy Venture, Inc. |
| 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 |
| LNG Holdings | CMS Trunkline LNG Holdings, LLC, jointly owned by CMS Panhandle Holdings, LLC and Dekatherm Investor Trust |
| Ludington | Ludington pumped storage plant, jointly owned by Consumers and Detroit Edison |
| mcf | Thousand cubic feet |
| 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, a subsidiary of Consumers Energy |
| Michigan Gas Storage | Michigan Gas Storage Company, a subsidiary of Consumers |
| MISO | Midwest Independent System Operator |
| Mbbls | Thousand barrels |
| MMbbls | Million barrels |
| MMBtu | Million British thermal unit |
| MMcf | Million cubic feet |
| MPSC | Michigan Public Service Commission |
| MTH | Michigan Transco Holdings, Limited Partnership |
| MW | Megawatts |
| NEIL | Nuclear Electric Insurance Limited, an industry mutual insurance company owned by member utility companies |
| Nitrotec | Nitrotec Corporation, a propriety gas technology company in which CMS Gas Transmission owns an equity interest |
| NMC | Nuclear Management Company, a Wisconsin company, 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 |
| NOx | Nitrogen Oxide |
| 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, owned by Consumers |
| Pan Gas Storage | Pan Gas Storage Company, a subsidiary of Panhandle Eastern Pipe Line Company |
| Panhandle | Panhandle Eastern Pipe Line Company, including its subsidiaries Trunkline, Pan Gas Storage, Panhandle Storage, and Trunkline LNG. Panhandle is a wholly owned subsidiary of CMS Gas Transmission |
| Panhandle Eastern Pipe Line | Panhandle Eastern Pipe Line Company, a wholly owned subsidiary of CMS Gas Transmission |
| Panhandle Storage | CMS Panhandle Storage Company, a subsidiary of Panhandle Eastern Pipe Line Company |
| PCB | Polychlorinated biphenyl |
| Pension Plan | The trustee, non-contributory, defined benefit pension plan of Panhandle, Consumers and CMS Energy |
| PJM | Pennsylvania-Jersey-Maryland |
| Powder River | CMS Oil & Gas owns a significant interest in 13 coal bed methane fields or projects developed within the Powder River Basin which spans the border between Wyoming and Montana. |
| PPA | The Power Purchase Agreement between Consumers and the MCV Partnership with a 35-year term commencing in March 1990 |
| ppm | Parts per million |

| | |
|--------------------------|--|
| 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 |
| RTO | Regional Transmission Organization |
| SAB | Staff Accounting Bulletin |
| SAB No. 101 | SEC SAB No. 101, "Revenue Recognition" |
| Sea Robin | Sea Robin Pipeline Company |
| SEC | U.S. Securities and Exchange Commission |
| Securitization | A financing authorized by statute in which a MPSC approved flow of revenues from a portion of the rates charged by a utility to its customers is set aside and pledged as security for the repayment of Securitization bonds issued by a special purpose entity affiliated with such utility |
| SERP | Supplemental Executive Retirement Plan |
| SFAS | Statement of Financial Accounting Standards |
| SFAS No. 5 | SFAS No. 5, "Accounting for Contingencies" |
| SFAS No. 13 | SFAS No. 13 "Accounting for Leases" |
| SFAS No. 34 | SFAS No. 34, "Capitalization of Interest Cost" |
| 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. 106 | SFAS No. 106, "Employers' Accounting for Postretirement Benefits" |
| SFAS No. 115 | SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" |
| SFAS No. 121 | SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" |
| SFAS No. 123 | SFAS No. 123, "Accounting for Stock-Based Compensation" |
| SFAS No. 133 | SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities, as amended and interpreted" |
| SFAS No. 142 | SFAS No. 142, "Goodwill and Other Intangible Assets" |
| 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. 145 | SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections" |
| SFAS No. 146 | SFAS No. 146, "Accounting for Costs Associated With Exit or Disposal Activities with Exit or Disposal Activities" |
| 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, but 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 |
| TBtu | Trillion british thermal unit |
| Transition Costs | Stranded Costs, as defined, plus the costs incurred in the transition to competition. |
| Trunkline | Trunkline Gas Company, a subsidiary of Panhandle Eastern Pipe Line Company |
| Trunkline LNG | Trunkline LNG Company, a subsidiary of Panhandle Eastern Pipe Line Company |
| Trust Preferred Securities | Securities representing an undivided beneficial interest in the assets of statutory business trusts, which interests 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 are tax-exempt accounts established to specifically set aside employer contributed assets to pay for future expenses of the OPEB plan. |

PART I
ITEM 1. BUSINESS

GENERAL

CMS Energy

CMS Energy, formed in Michigan in 1987, is an energy holding company operating through subsidiaries in the United States and in selected markets around the world. Its two principal subsidiaries are Consumers and Enterprises. Consumers is a public utility that provides natural gas and/or electricity to almost 6 million of Michigan's 10 million residents and serves customers in all 68 of the state's Lower Peninsula counties. Enterprises, through subsidiaries, is engaged in several energy businesses in the United States and in selected international markets.

In 2002, CMS Energy's consolidated operating revenue was approximately \$8.7 billion. See BUSINESS SEGMENTS later in this Item 1 for further discussion of each segment.

Consumers

Consumers, formed in Michigan in 1968, is the successor to a corporation organized in Maine in 1910 that conducted business in Michigan from 1915 to 1968. In 1997, Consumers, formerly named Consumers Power Company, changed its name to Consumers Energy Company to better reflect its integrated electricity and gas businesses.

Consumers' service areas include automotive, metal, chemical, food and wood products and a diversified group of other industries. Consumers' consolidated operations account for a majority of CMS Energy's total assets and income, as well as a substantial portion of its operating revenue. At year-end 2002, Consumers' customer base and operating revenues were as follows:

| | Customers Served (millions) | Operating Revenue (millions) | 2002 vs. 2001 Operating Revenue % Increase/(Decrease) |
|---------------------------------|--------------------------------|---------------------------------|---|
| Electric Utility Business | 1.73 | \$2,648 | .057% |
| Gas Utility Business | 1.65 | 1,519 | 13.53 |
| Other | — | 55(a) | 27.91 |
| Total | 3.38 | \$4,222 | 5.18% |

(a) Primarily represents earnings attributable to Consumers' interest in the MCV Partnership and MCV Facility, the earnings of which are reported within CMS Energy's independent power production business segment.

Consumers' rates and certain other aspects of its business are subject to the jurisdiction of the MPSC and FERC, as described in CMS ENERGY, CONSUMERS AND PANHANDLE REGULATION later in this Item 1.

Consumers Properties — General: The principal properties of Consumers and its subsidiaries are owned in fee, except that most electric lines and gas mains are located, pursuant to easements and other rights, in public roads or on land owned by others. Substantially all of Consumers' properties are subject to the lien of its First Mortgage Bond Indenture. For additional information on Consumers' properties see BUSINESS SEGMENTS — Consumers Electric Utility Operations — Electric Utility Properties, and — Consumers Gas Utility Operations — Gas Utility Properties, below.

BUSINESS SEGMENTS

CMS Energy Financial Information

For information with respect to operating revenue, net operating income, identifiable assets and liabilities attributable to all of CMS Energy's business segments and international and domestic operations, see ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — SELECTED FINANCIAL INFORMATION AND CMS ENERGY'S CONSOLIDATED FINANCIAL STATEMENTS AND NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

Consumers' Electric Utility Operations

Based on the average number of customers, Consumers' electric utility operations, if independent, would be the thirteenth largest electric utility company in the United States. Consumers' electric utility operations include the generation, purchase, distribution and sale of electricity. At year-end 2002, it served customers in 61 of the 68 counties of Michigan's lower peninsula. Principal cities served include Battle Creek, Flint, Grand Rapids, Jackson, Kalamazoo, Midland, Muskegon and Saginaw. Consumers' electric utility customer base includes a mix of residential, commercial and diversified industrial customers, the largest segment of which is the automotive industry. Consumers' electric utility operations are not dependent upon a single customer, or even a few customers, and the loss of any one or even a few of such customers is not reasonably likely to have a material adverse effect on its financial condition.

Consumers' electric utility operations are seasonal. The summer months usually increase demand for electric energy, principally due to the use of air conditioners and other cooling equipment, thereby affecting revenues. In 2002 and 2001, total electric deliveries were 39 billion kWh and 40 billion kWh, respectively. In 2002, electric sales totaled 37 billion kWh and retail open access deliveries totaled 2 billion kWh. In 2001, electric sales totaled 39 billion kWh and retail open access deliveries totaled 1 billion kWh.

Excluding retail open access loads, Consumers experienced a 2002 summer peak demand of 7,697 MW. In 2002, the winter peak demand was 5,573 MW for the winter 2001-02 period and 5,862 MW for the winter 2002-03 period. In 2002, based on the actual summer peak, Consumers' power reserve, also called a reserve margin, was 20.6 percent compared to 11.1 percent in 2001. Based on its summer 2002 forecast, Consumers carried a 15.0 percent reserve margin. In recent years, Consumers has planned for a reserve margin of approximately 15 percent from a combination of its owned electric generating plants and electricity purchase contracts or options, as well as other arrangements. However, in light of various factors, including the addition of new generating capacity in Michigan and throughout the Midwest region and additional transmission import capability, Consumers is continuing to evaluate the appropriate reserve margin for 2003 and beyond. Currently, Consumers has a reserve margin of approximately 11 percent for summer 2003. The ultimate use of the reserve margin needed will depend primarily on summer weather conditions, the level of retail open access requirements being served by others during the summer, and any unscheduled plant outages.

Including retail open access loads, Consumers experienced a 2002 summer peak demand of 7,984 MW. Winter peak demand for 2002, including retail open access loads, was 5,694 MW for the winter 2001-02 period and 6,140 MW for the winter 2002-03 period.

Electric Utility Properties: At December 31, 2002, Consumers' electric generating system consists of the following:

| <u>Name and Location (Michigan)</u> | <u>Size and Year Entering Service</u> | <u>2002 Summer Net Demonstrated Capability (KW's)</u> | <u>2002 Net Generation (Thousands of kWh's)</u> |
|---|---------------------------------------|---|---|
| Coal Generation | | | |
| J H Campbell 1 & 2 — West Olive | 2 Units, 1962-1967 | 615,000 | 4,406,940 |
| J H Campbell 3 — West Olive | 1 Unit, 1980 | 765,140(a) | 4,511,713 |
| D E Karn — Essexville | 2 Units, 1959-1961 | 515,000 | 3,824,249 |
| B C Cobb — Muskegon | 2 Units, 1956-1957 | 312,000 | 2,150,510 |
| J R Whiting — Erie | 3 Units, 1952-1953 | 326,000 | 2,262,509 |
| J C Weadock — Essexville | 2 Units, 1955-1958 | 310,000 | 2,205,575 |
| Total coal generation | | <u>2,843,140</u> | <u>19,361,496</u> |
| Oil/Gas Generation | | | |
| B C Cobb — Muskegon | 3 Units, 1999-2000 | 183,000 | 38,035 |
| D E Karn — Essexville | 2 Units, 1975-1977 | 1,276,000 | 650,008 |
| Total oil/gas generation | | <u>1,459,000</u> | <u>688,043</u> |
| Hydroelectric | | | |
| Conventional Hydro Generation | 13 Plants, 1906-1949 | 73,540 | 386,691 |
| Ludington Pumped Storage | 6 Units, 1973 | 954,700(b) | (486,322)(c) |
| Total Hydroelectric | | <u>1,028,240</u> | <u>(99,631)</u> |
| Nuclear Generation | | | |
| Palisades — South Haven | 1 Unit, 1971 | 767,000 | 6,357,962 |
| Gas/Oil Combustion Turbine | | | |
| Generation | 7 Plants, 1966-1971 | 346,800(d) | 12,743 |
| Total owned generation | | 6,444,180 | 26,320,613 |
| Purchased and Interchange Power Capacity | | <u>1,766,180(e)</u> | |
| Total | | <u>8,210,360</u> | |

(a) Represents Consumers' share of the capacity of the J H Campbell 3, net of 6.69 percent (ownership interests of the Michigan Public Power Agency and Wolverine Power Supply Cooperative, Inc.).

(b) Represents Consumers' share of the capacity of Ludington. Consumers and Detroit Edison have 51 percent and 49 percent undivided ownership, respectively, in the plant.

(c) Represents Consumers' share of net pumped storage generation. This facility electrically pumps water during off-peak hours for storage to later generate electricity during peak-demand hours.

(d) Includes 1.8 MW of distributed diesel generation.

(e) Includes 1,240 MW of purchased contract capacity from the MCV Facility.

In 2002, Consumers purchased, through long-term purchase contracts, options, spot market and other seasonal purchases, up to 2,683 MW of net capacity from other power producers, which amounted to 34.9 percent of Consumers' total system requirements, the largest of which was the MCV Partnership.

A high voltage transmission system interconnects Consumers' electric generating plants at many locations with transmission facilities of unaffiliated systems including those of other utilities in Michigan and Indiana. The interconnections permit a sharing of the reserve capacity of the connected systems. This allows mutual assistance during emergencies and substantially reduces investment in utility plant facilities. Consumers owns: a) 338 miles of high voltage distribution radial lines operating at 120 kilovolts and above; b) 4,159 miles of high voltage distribution overhead lines operating at 23 kilovolts and 46 kilovolts; c) 16 subsurface miles of high voltage

distribution underground lines operating at 23 kilovolts and 46 kilovolts; d) 54,681 miles of electric distribution overhead lines; e) 8,201 subsurface miles of underground distribution lines and f) substations having an aggregate transformer capacity of 20,596,240 kilovoltamperes.

On April 1, 2001, Consumers transferred its investment in electric transmission lines and substations to a wholly owned subsidiary, Michigan Electric Transmission Company (METC). On May 1, 2002, Consumers transferred its interest in METC to a third party, Michigan Transco Holdings, LLC (MTH), and Consumers no longer owns or controls transmission facilities either directly or indirectly. MTH owns the former Consumers transmission assets through a new transmission company called Michigan Electric Transmission Company, LLC. For additional information on the sale of the transmission assets, see ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTE 2 OF CONSUMERS' NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — ELECTRIC RATE MATTERS — TRANSMISSION.

Fuel Supply: Consumers has four generating plant sites that use coal as a fuel source and that constitute 73.6 percent of its baseload supply, the capacity used to serve a constant level of customer demand. In 2002, these plants produced a combined total of 19,361 million kWhs of electricity and required 9.7 million tons of coal. On December 31, 2002, Consumers' coal inventory amounted to approximately 30 days' supply. For additional information on future sources of coal, see ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTE 2 OF CONSUMERS' NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — OTHER ELECTRIC UNCERTAINTIES — COAL SUPPLY.

Consumers owns two nuclear power plants, Big Rock, located near Charlevoix, Michigan and Palisades, located near South Haven, Michigan. In 1997, Consumers ceased operating Big Rock. In May 2001, with the approval of the NRC, Consumers transferred its authority to operate Palisades to the Nuclear Management Company (NMC). The Palisades nuclear fuel supply responsibilities are under the control of NMC acting as agent for Consumers. During 2002, Palisades' net generation was 6,358 million kWhs, constituting 24.2 percent of Consumers' baseload supply. New fuel contracts are being written as NMC Agreements. Consumers/NMC currently have sufficient contracts for uranium concentrates to provide up to 100 percent of its fuel supply requirements for the 2003 and 2004 period. Consumers/NMC also have contracts for conversion services and enrichment services with quantity flexibility ranging up to 100 percent. If spot market prices are below the contract price, NMC will purchase only the minimum amount of nuclear fuel required by the contracts. Conversely, if spot market prices are above the contract prices, Consumers will purchase the maximum amount of nuclear fuel allowed by the contracts to meet its requirements.

For the spring 2003 refueling outage, Consumers has purchased all of its fuel supply requirements. NMC also has contracts for nuclear fuel services and for fabrication of nuclear fuel assemblies. The fabrication contract for Palisades remains in effect for the next two reloads with options to extend the contract for an additional two reloads. The fuel contracts are with major private industrial suppliers of nuclear fuel and related services and with uranium producers, converters and enrichers who participate in the world nuclear fuel marketplace.

As shown below, Consumers generates electricity principally from coal and nuclear fuel.

| Power Generated | Millions of kWhs | | | | |
|----------------------------|------------------|---------------|---------------|---------------|---------------|
| | 2002 | 2001 | 2000 | 1999 | 1998 |
| Coal | 19,361 | 19,203 | 17,926 | 19,085 | 17,959 |
| Nuclear | 6,358 | 2,326(a) | 5,724 | 5,105 | 5,364 |
| Oil | 347 | 331 | 645 | 809 | 520 |
| Gas | 354 | 670 | 400 | 441 | 302 |
| Hydro | 387 | 423 | 351 | 365 | 395 |
| Net pumped storage | (486) | (553) | (541) | (476) | (480) |
| Total net generation | <u>26,321</u> | <u>22,400</u> | <u>24,505</u> | <u>25,329</u> | <u>24,060</u> |

(a) On June 20, 2001, the Palisades reactor was shut down so technicians could inspect a small steam leak on a control rod drive assembly. The defective components were replaced and the plant returned to service on January 21, 2002.

The cost of all fuels consumed, shown below, fluctuates with the mix of fuel burned.

| <u>Fuel Consumed</u> | <u>Cost per Million Btu</u> | | | | |
|----------------------|-----------------------------|-------------|-------------|-------------|-------------|
| | <u>2002</u> | <u>2001</u> | <u>2000</u> | <u>1999</u> | <u>1998</u> |
| Coal | \$1.34 | \$1.38 | \$1.34 | \$1.38 | \$1.45 |
| Oil | 3.49 | 4.02 | 3.30 | 2.69 | 2.73 |
| Gas | 3.98 | 4.05 | 4.80 | 2.74 | 2.66 |
| Nuclear | 0.35 | 0.39 | 0.45 | 0.52 | 0.50 |
| All Fuels(a) | 1.19 | 1.44 | 1.27 | 1.28 | 1.28 |

(a) Weighted average fuel costs.

Pursuant to the Nuclear Waste Policy Act of 1982, the federal government became responsible for the permanent disposal of spent nuclear fuel and high-level radioactive waste by 1998. To date, the DOE has been unable to arrange for storage facilities to meet this obligation and it does not expect that in 2003 it will be able to receive spent nuclear fuel for storage. For additional information on disposal of nuclear fuel see ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTE 2 OF CMS ENERGY'S NOTES TO CONSOLIDATED FINANCIAL STATEMENTS. The amount of spent nuclear fuel discharged from the reactor to date exceeds Palisades' temporary on-site storage pool capacity, and Consumers is currently storing spent nuclear fuel in NRC-approved steel and concrete vaults, known as "dry casks". Currently, three dry casks are available for future storage. For a discussion relating to the NRC approval of dry casks and Consumers' use of the dry casks, see ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTE 5 OF CMS ENERGY'S NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — UNCERTAINTIES — OTHER CONSUMERS ELECTRIC UTILITY UNCERTAINTIES.

Consumers' Gas Utility Operations

Based on the average number of customers, Consumers' gas utility operations, if independent, would be the 6th largest gas utility company in the United States. Consumers' gas utility operations purchase, transport, store, distribute and sell natural gas. As of December 31, 2002, it was authorized to provide service in 54 of the 68 counties in Michigan's lower peninsula. Principal cities served include Bay City, Flint, Jackson, Kalamazoo, Lansing, Pontiac and Saginaw, as well as the suburban Detroit area, where nearly 900,000 of the gas customers are located. Consumers' gas utility operations are not dependent upon a single customer, or even a few customers, and the loss of any one or even a few of such customers is not reasonably likely to have a material adverse effect on its financial condition.

Consumers' gas utility operations are seasonal. Consumers injects natural gas into storage during the summer months of the year for use during the winter months when the demand for natural gas is higher. Peak demand usually occurs in the winter due to colder temperatures and the resulting increased demand for heating fuels. In 2002, total deliveries of natural gas sold by Consumers and by other sellers who deliver natural gas through Consumers' pipeline and distribution network to ultimate customers, including the MCV Partnership, totaled 376.4 bcf.

Due to prolonged colder than normal weather during the winter months of 2002-2003, Consumers' gas storage fields were drawn down to unexpected and unusually low levels. This caused withdrawal of the entire amount of working storage gas from some fields. As a result, some salt water has entered Consumers' pipelines and distribution lines that may increase future maintenance problems and costs resulting from pipe corrosion.

Gas Utility Properties: Consumers' gas distribution and transmission system consists of 25,218 miles of distribution mains and 1,624 miles of transmission lines throughout Michigan's lower peninsula. It owns and operates seven compressor stations with a total of 162,000 installed horsepower. Consumers has 14 gas storage fields located across Michigan with an aggregate storage capacity of 330.8 bcf.

In February 2002, the FERC approved Michigan Gas Storage's application for a declaration of exemption from provisions of the National Gas Act. This allowed Consumers to file with the MPSC for approval to merge with Michigan Gas Storage. The merger was approved and completed in November 2002.

Gas Supply: Total 2002 purchases included 58 percent from United States producers outside Michigan, 22 percent from Canadian producers and 6 percent from Michigan producers. Authorized suppliers in the permanent gas customer choice pilot program, which started in April 2001, supplied the remaining 14 percent of gas delivered by Consumers.

Consumers' firm transportation agreements are with ANR Pipeline Company, Great Lakes Gas Transmission, L.P., Trunkline and Panhandle Eastern Pipe Line. Consumers uses these agreements to deliver gas to Michigan for ultimate deliveries to market. In total, Consumers' firm transportation and city gate arrangements are capable of delivering over 95 percent of Consumers' total gas supply requirements. As of December 31, 2002, Consumers' portfolio of firm transportation from pipelines to Michigan is as follows:

| | Volume (dekatherms/day) | Expiration |
|--|----------------------------|---------------|
| ANR Pipeline Company | 84,113 | October 2003 |
| Great Lakes Gas Transmission, L.P..... | 85,092 | April 2004 |
| Trunkline | 336,375 | October 2005 |
| Panhandle Eastern Pipe Line (starting April 1, 2003) | 60,000 | October 2003 |
| ANR Pipeline Company | 10,000 | December 2002 |

Consumers purchases the balance of its required gas supply under firm city gate contracts and as needed, interruptible contracts. The amount of interruptible transportation service and its use varies primarily with the price for such service and the availability and price of the spot supplies being purchased and transported. Consumers' use of interruptible transportation is generally in off-peak summer months and after Consumers has fully utilized the services under the firm transportation agreements.

Natural Gas Transmission

CMS Gas Transmission, formed in 1988, owns, develops and manages domestic and international natural gas facilities. In 2002, CMS Gas Transmission's operating revenue was \$50 million. In 1999, CMS Energy acquired Panhandle.

Panhandle: On December 21, 2002, CMS Energy reached a definitive agreement to sell the Panhandle companies to Southern Union Panhandle Corp. The agreement calls for Southern Union Panhandle Corp., a newly formed entity owned by Southern Union Company and AIG Highstar Capital, L.P. to pay \$662 million in cash and assume \$1.166 billion in debt. Under terms of the agreement, CMS Energy will retain Panhandle's ownership in the Centennial and Guardian pipeline projects, as well as certain of Panhandle's net deferred tax assets, all tax liabilities, and pension assets and liabilities. Panhandle has since sold its interest in Centennial and the Guardian interest and the related cash collateral has been transferred to Panhandle's direct parent, CMS Gas Transmission. The sale of Panhandle has been approved by the board of directors of each company and is subject to customary closing conditions and action by the Federal Trade Commission under the Hart-Scott-Rodino Act.

On February 10, 2003, Panhandle sold its one-third equity interest in Centennial Pipeline, LLC for \$40 million to Centennial's two other partners, Marathon Ashland Petroleum, LLC (MAPL) and TE Products Pipeline Company, Limited Partnership, through its general partner, Texas Eastern Products Pipeline Company, LLC (TEPPCO). Panhandle has been released by MAPL, TEPPCO and the lenders for any liabilities, including credit fees, related to Panhandle's \$50 million parent guaranty of the project debt. In December 2002, Panhandle recorded a \$26 million pre-tax (\$16 million after-tax) writedown of its investment in Centennial to \$40 million.

On March 10, 2003, Panhandle's ownership interest in Guardian and \$63 million of cash collateral was transferred to CMS Gas Transmission. Panhandle was also released from its guarantee obligations associated with the Guardian non-recourse guaranty as of March 10, 2003, by the partners, Prudential and the other noteholders.

Panhandle Eastern Pipe Line, formed in Delaware in 1929, is a wholly owned subsidiary of CMS Gas Transmission. In March 1999, CMS Energy acquired Panhandle Eastern Pipe Line and its principal subsidiaries, Trunkline and Pan Gas Storage, as well as Panhandle Eastern Pipe Line's affiliates, Trunkline LNG and Panhandle Storage, from subsidiaries of Duke Energy. Immediately following the acquisition, Trunkline LNG

and Panhandle Storage became wholly owned subsidiaries of Panhandle Eastern Pipe Line. In December 2001, Panhandle monetized the value of its Trunkline LNG business and the value created by long-term contracts for capacity at the Trunkline LNG Lake Charles terminal. The transaction included the formation of CMS Trunkline LNG Holdings LLC which now owns 100 percent of Trunkline LNG. At December 31, 2001, LNG Holdings was jointly owned by a subsidiary of Panhandle Eastern Pipe Line and Dekatherm Investor Trust, an unaffiliated entity. In November 2002, Panhandle acquired Dekatherm Investor Trust's interest for approximately \$41 million and now owns 100% of LNG Holdings, which has \$282 million of non-recourse secured debt at December 31, 2002.

Panhandle is primarily engaged in the interstate transmission and storage of natural gas and also provides LNG terminalling and regasification services. Panhandle operates a large natural gas pipeline network, which provides customers in the Midwest and Southwest with a comprehensive array of transportation services. Panhandle's major customers include 25 utilities located primarily in the United States Midwest market area, which encompasses large portions of Illinois, Indiana, Michigan, Missouri, Ohio and Tennessee.

In 2002, Panhandle's consolidated operating revenue was \$484 million. Of Panhandle's operating revenue, 77 percent was generated from transportation services, 12 percent from LNG terminalling services, 9 percent from storage services and 3 percent from other services. During 2002, sales to Proliance Energy, LLC, a nonaffiliated gas marketer, accounted for 16 percent of Panhandle's consolidated revenues. Also during 2002, sales to BG LNG Services, a nonaffiliated gas marketer, accounted for 13 percent of Panhandle's consolidated revenue. Sales to subsidiaries of CMS Energy, primarily Consumers, accounted for 12 percent of Panhandle's consolidated revenues during 2002; 15 percent during 2001; and 12 percent during 2000. No other customer accounted for 10 percent or more of Panhandle's consolidated revenues during 2002, 2001 or 2000. Aggregate sales to Panhandle's top ten customers accounted for 67%, 60% and 53% during 2002, 2001 and 2000, respectively.

For the years 1998 to 2002, Panhandle's combined throughput was 1,141 TBtu, 1,139 TBtu, 1,374 TBtu, 1,335 TBtu and 1,259 TBtu, respectively. Beginning in March 2000, the combined throughput includes Sea Robin's throughput. A majority of Panhandle's revenue comes from long-term service agreements with local distribution company customers. Panhandle also provides firm transportation services under contract to gas marketers, producers, other pipelines, electric power generators and a variety of end-users. In addition, the pipelines offer both firm and interruptible transportation to customers on a short-term or seasonal basis. Demand for gas transmission on Panhandle's pipeline systems is seasonal, with the highest throughput and a higher portion of revenues occurring during the colder period in the first and fourth quarters.

Natural Gas Transmission Properties: Domestic — CMS Gas Transmission has a total of 15,460 miles of pipeline in the United States, with a daily capacity of approximately 8 bcf. Panhandle Eastern Pipe Line's portion of CMS Gas Transmission's natural gas transmission system consists of four large diameter pipelines extending approximately 1,300 miles from producing areas in the Anadarko Basin of Texas, Oklahoma and Kansas through the states of Missouri, Illinois, Indiana, Ohio and into Michigan. Trunkline's transmission system now includes 2 large diameter pipelines which extend approximately 1,400 miles from the Gulf Coast areas of Texas and Louisiana through the states of Arkansas, Mississippi, Tennessee, Kentucky, Illinois and Indiana to a point on the Indiana-Michigan border.

At December 31, 2002, CMS Gas Transmission had processing capabilities of approximately 700 MMcf per day of natural gas at eight locations in Michigan, Oklahoma and Texas. In addition, CMS Gas Transmission has a hydrocarbon fractionation plant in Michigan with a capacity of 30,000 barrels per day. Through Panhandle, CMS Gas Transmission owns and operates 47 compressor stations. It also has five gas storage fields located in Illinois, Kansas, Louisiana, Michigan and Oklahoma with an aggregate storage capacity of 70 bcf. CMS Gas Transmission has a 51 percent ownership interest in underground storage caverns capable of storing 7 million barrels of natural gas liquids.

At December 31, 2002, CMS Gas Transmission operated 3,826 miles of gas gathering systems with total capacity of approximately 1 bcf per day in Michigan, Oklahoma, Texas and Wyoming.

During 2002, CMS Gas Transmission, through Panhandle, had a one-third interest in Guardian Pipeline LLC, which constructed a 141 mile, 36 inch pipeline from Illinois to southeastern Wisconsin for the transportation of natural gas. The Guardian Pipeline was placed into service on December 7, 2002. On March 10, 2003, Panhandle's ownership interest in Guardian was transferred to CMS Gas Transmission, Panhandle's direct parent company. Panhandle was also released from its guarantee obligations associated with the Guardian non-recourse guaranty as of March 10, 2003 by the partners, Prudential and the other note holders.

International — At December 31, 2002, CMS Gas Transmission has ownership interests in the following pipelines:

| <u>Location</u> | <u>Ownership Interest (%)</u> | <u>Miles of Pipelines</u> |
|-------------------------------------|-------------------------------|---------------------------|
| Argentina | 29.42 | 3,362 |
| Argentina to Brazil | 20.00 | 262 |
| Argentina to Chile | 50.00 | 707 |
| Australia (Western Australia) | 40.00(a) | 927 |
| Australia (Western Australia) | 100.00 | 259 |

(a) CMS Gas Transmission has a 45 percent interest in a consortium that acquired an 88 percent interest in the pipeline.

In January 2002, CMS Gas Transmission completed the previously announced sale of all of its ownership interest in the Atlantic Methanol Production Company located in Equatorial Guinea.

Properties of certain CMS Gas Transmission subsidiaries are subject to liens of creditors of the respective subsidiaries.

Independent Power Production

CMS Generation, formed in 1986, invests in, acquires, develops, constructs and operates non-utility power generation plants in the United States and abroad. In 2002, the independent power production business segment's operating revenue, which includes revenues from CMS Generation, CMS Operating, S.A., the MCV Facility and the MCV Partnership, was \$382.5 million. For additional information, see ITEM 7. CMS ENERGY'S MANAGEMENT'S DISCUSSION AND ANALYSIS — INDEPENDENT POWER PRODUCTION RESULTS OF OPERATIONS.

Independent Power Production Properties: As of December 31, 2002, CMS Generation had ownership interests in operating power plants totaling 8,745 gross MW (4,140 net MW) throughout the United States and abroad. At December 31, 2002, additional plants totaling approximately 1,789 gross MW (421 net MW) were under construction or advanced development. In 2003, CMS Generation plans to complete the restructuring of its operations by narrowing the scope of its existing operations and commitments from four to two regions: the U.S. and the Middle East/North Africa. In addition, it plans to sell designated assets and investments that are under-performing, non-region focused and non-synergistic with other CMS Energy business units. For additional information on CMS Generation's restructuring see ITEM 7. CMS ENERGY'S MANAGEMENT'S DISCUSSION AND ANALYSIS — OUTLOOK — DIVERSIFIED ENERGY OUTLOOK — INDEPENDENT POWER PRODUCTION OUTLOOK.

The following table details CMS Generation's interest in independent power plants in the United States as well as abroad as of year-end 2002 (excluding the plants owned by CMS Operating S.A. and CMS Electric and Gas and the MCV facility, discussed further below):

| <u>Location</u> | <u>Fuel Type</u> | <u>Ownership Interest (%)</u> | <u>Gross Capacity (MW)</u> |
|--|------------------|-------------------------------|----------------------------|
| California | Wood | 37.8% | 36 |
| Connecticut | Scrap tire | 100.0% | 31 |
| Michigan | Coal | 50.0% | 62 |
| Michigan | Natural gas | 100.0% | 710 |
| Michigan | Natural gas | 100.0% | 224 |
| Michigan | Wood | 50.0% | 35 |
| Michigan | Wood | 50.0% | 39 |
| New York | Hydro | 0.3% | 14 |
| North Carolina | Wood | 50.0% | 45 |
| Oklahoma | Natural gas | 8.8% | 124 |
| Domestic | | | 1,320 |
| Argentina | Hydro | 17.2% | 1,320 |
| Australia | Coal | 49.6% | 2,000 |
| Chile | Natural gas | 50.0% | 720 |
| Ghana | Light fuel oil | 90.0% | 224 |
| India | Coal | 50.0% | 250 |
| India | Natural gas | 33.2% | 235 |
| Jamaica | Diesel | 41.2% | 63 |
| Latin America | Various | Various | 480 |
| Morocco | Coal | 50.0% | 1,356 |
| United Arab Emirates | Natural gas | 40.0% | 777 |
| International | | | 7,425 |
| Total | | | 8,745 |
| Projects Under Construction/Adv.Dev | | | 1,789 |

CMS Enterprises, CMS Gas Transmission and CMS Generation, through a CMS International Ventures subsidiary, CMS Operating, SRL, have 100 percent ownership interest in a 128 MW natural gas power plant and a 92.6 percent ownership interest in a 540 MW natural gas power plant, each in Argentina.

CMS Enterprises, through CMS Electric and Gas, have a 70 percent ownership interest in a 150 MW diesel plant in Venezuela.

CMS Midland owns 49 percent interest in the MCV Partnership, which was formed to construct and operate the MCV Facility. The MCV Facility was sold to five owner trusts and leased back to the MCV Partnership. CMS Holdings is a limited partner in the FMLP, which is a beneficiary of one of these trusts. CMS Holdings' indirect beneficial interest in the MCV Facility is 49 percent. The MCV Facility has a net electrical generating capacity of approximately 1,500 MW.

CMS Generation has ownership interests in certain facilities such as Loy Yang, Jorf Lasfar and El Chocon. The Loy Yang assets are owned in fee, but are subject to the security interests of its lenders. CMS Energy is actively working to sell its interest in the Loy Yang facility. The Jorf Lasfar facility is held pursuant to a right of possession agreement with the Moroccan state-owned Office National de l'Electricite. The El Chocon facility is held pursuant to a 30-year possession agreement.

For information on capital expenditures, see ITEM 7. CMS ENERGY'S MANAGEMENT'S DISCUSSION AND ANALYSIS — CAPITAL RESOURCES AND LIQUIDITY AND ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTE 5 OF CMS ENERGY'S NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

Oil and Gas Exploration and Production

CMS Oil and Gas, formed in 1967, conducted oil and gas exploration and development operations in the United States, primarily the Permian Basin in Texas and the Powder River Basin in Wyoming, and in the countries of Cameroon, Congo, Colombia, Eritrea, Tunisia and Venezuela. In January 2002, CMS Energy completed the sale of its ownership interests in Equatorial Guinea to Marathon Oil Company for approximately \$993 million. Proceeds from this transaction were used primarily to retire existing debt. Included in the sale were all of CMS Oil and Gas' oil and gas reserves in Equatorial Guinea. In September 2002, CMS Energy closed on the sale of the stock of CMS Oil and Gas and the stock of a subsidiary of CMS Oil and Gas that holds property in Venezuela. In October 2002, CMS Energy completed its exit from the oil and gas exploration and production business.

Marketing, Services and Trading

CMS MST, provides or has provided gas, oil, and electric marketing, risk management and energy management services to industrial, commercial, utility and municipal energy users throughout the United States and abroad. CMS Energy has decided to phase out CMS MST's wholesale energy trading business. On January 16, 2003, CMS MST closed the sale on a major portion of its wholesale natural gas trading book to Sempra Energy Trading. The sale price was approximately \$18 million. On February 13, 2003, CMS MST signed a definitive agreement with Constellation Power Source, Inc. to sell its wholesale electric power business. The sale has been approved by the FERC and closing is expected within the second quarter of 2003. On February 20, 2003, CMS MST signed a definitive agreement with Chevron Energy Solutions Company, a division of Chevron U.S.A., to sell the non-federal business of CMS Viron, its energy management services provider subsidiary. On February 26, 2003 CMS MST signed a definitive agreement with Pepco Energy Services, Inc. to sell CMS Viron's federal energy management services business. The sale is subject to federal government novation which the parties are not permitted to seek until closing has occurred. CMS MST will continue to focus its business on the retail sector, specifically in the state of Michigan. CMS MST has announced plans to move its headquarters from Houston, Texas to Jackson, Michigan. In 2002, CMS MST marketed approximately 601 bcf of natural gas, 62,004 GWh of electricity, 34 million barrels of crude oil and 10 million barrels of natural gas liquids. From 1997 through 2002, CMS MST also performed over 300 energy management services projects. At December 31, 2002, CMS MST had more than 1,200 wholesale and retail customers, transported gas on more than 40 gas pipelines and was active in 50 states and Canada. In 2002, CMS MST's operating revenue was \$4.2 billion. For additional information, see ITEM 7. CMS ENERGY'S MANAGEMENT'S DISCUSSION AND ANALYSIS — MARKETING, SERVICES AND TRADING RESULTS OF OPERATIONS.

International Energy Distribution

In October 2001, CMS discontinued the operations of its international energy distribution business. CMS also discontinued all new development outside North America, which includes closing all non-US development offices. However, CMS will continue to honor prior commitments in the Middle East. For additional information, see ITEM 7 — CMS ENERGY'S MANAGEMENT'S DISCUSSION AND ANALYSIS — OUTLOOK.

CMS ENERGY REGULATION

CMS Energy is a public utility holding company that is exempt from registration under PUHCA. CMS Energy, Consumers, Panhandle and their subsidiaries are subject to regulation by various federal, state, local and foreign governmental agencies, including those specifically described below.

Michigan Public Service Commission

Consumers is subject to the MPSC's jurisdiction, which regulates public utilities in Michigan with respect to retail utility rates, accounting, utility services, certain facilities and various other matters. The MPSC also has, or will have, rate jurisdiction over several limited partnerships in which CMS Gas Transmission has ownership interests. These partnerships own, or will own, and operate intrastate gas transmission pipelines.

The Attorney General, ABATE, and the MPSC staff typically intervene in MPSC electric and gas related proceedings concerning Consumers. For many years, almost every significant MPSC order affecting Consumers has been appealed. Certain appeals from the MPSC orders are pending in the Court of Appeals.

Rate Proceedings: In 1996, the MPSC issued an order that established the electric authorized rate of return on common equity at 12.25 percent. In 2002, the MPSC issued an order that established the gas authorized rate of return on common equity at 11.4 percent.

MPSC Regulatory and Michigan Legislative Changes: State regulation of the retail electric and gas utility businesses is in the process of undergoing significant changes. In 2000, the Michigan Legislature enacted the Customer Choice Act. Pursuant to the Customer Choice Act, as of January 2002, all electric customers have their choice of buying generation service from an alternative electric supplier. The Customer Choice Act also imposes rate reductions, rate freezes and rate caps. For a description and additional information regarding the Customer Choice Act, see ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTE 5 OF CMS ENERGY'S NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

As a result of regulatory changes in the natural gas industry, Consumers transports the natural gas commodity that is sold to some customers by competitors like gas producers, marketers and others. From April 1, 1998, to March 31, 2001, Consumers implemented a statewide experimental gas customer choice pilot program that allowed up to 300,000 residential, commercial and industrial retail gas sales customers to choose their gas supplier and froze the rates Consumers was permitted to charge for the service of distributing gas to its customers:

Beginning April 1, 2001, Consumers established a permanent gas customer choice program that allows up to 600,000 of Consumers' gas customers to select an alternative gas commodity supplier. By April 2003, all of Consumers' gas customers will be eligible to select an alternative gas commodity supplier. As of December 31, 2002, 178,000 of Consumers' gas customers had elected an alternate gas commodity supplier. Also on April 1, 2001, pursuant to the permanent gas customer choice program, Consumers returned to a GCR mechanism that allows it to recover from its customers all prudently incurred costs to purchase the natural gas commodity and transport it to Consumers' facilities. For additional information on gas customer choice programs see ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTE 5 OF CMS ENERGY'S NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

Federal Energy Regulatory Commission

FERC has exercised limited jurisdiction over several independent power plants in which CMS Generation has ownership interests, as well as over CMS MST. FERC also has more comprehensive jurisdiction over Panhandle Eastern Pipe Line, Pan Gas Storage, Trunkline, Trunkline LNG and Sea Robin as natural gas companies within the meaning of the Natural Gas Act. FERC jurisdiction relates, among other things, to the acquisition, operation and disposal of assets and facilities and to the service provided and rates charged. Some of Consumers' gas business is also subject to regulation by FERC, including a blanket transportation tariff pursuant to which Consumers can transport gas in interstate commerce.

FERC has authority to regulate rates and charges for transportation or storage of natural gas in interstate commerce, as well as those for gas, sold by a natural gas company in interstate commerce for resale. FERC also has authority over the construction and operation of pipeline and related facilities utilized in the transportation and sale of natural gas in interstate commerce, including the extension, enlargement or abandonment of service using such facilities. Panhandle Eastern Pipe Line, Trunkline Gas Company, Sea Robin, Trunkline LNG, and Pan Gas Storage hold certificates of public convenience and necessity issued by the FERC, authorizing them to construct and operate the pipelines, facilities and properties now in operation for which such certificates are required, and to transport and store natural gas in interstate commerce.

FERC also regulates certain aspects of Consumers' electric operations including: compliance with FERC accounting rules; wholesale rates; transfers of certain facilities; and corporate mergers and issuance of securities. FERC is currently soliciting comments on whether it should exercise jurisdiction over power marketers like CMS

MST and require them to follow FERC's uniform system of accounts and seek authorization for issuance of securities and assumption of liabilities. These issues are pending before the agency.

For a discussion of the effect of certain FERC orders on Consumers, see ITEM 7. CMS ENERGY'S MANAGEMENT'S DISCUSSION AND ANALYSIS — OUTLOOK — CONSUMERS' ELECTRIC BUSINESS OUTLOOK.

Nuclear Regulatory Commission

Under the Atomic Energy Act of 1954, as amended, and the Energy Reorganization Act of 1974, Consumers is subject to the jurisdiction of the NRC with respect to the design, construction, operation and decommissioning of its nuclear power plants. Consumers is also subject to NRC jurisdiction with respect to certain other uses of nuclear material. These and other matters concerning Consumers' nuclear plants are more fully discussed in ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTES 2 AND 5 OF CMS ENERGY'S CONSOLIDATED FINANCIAL STATEMENTS.

Other Regulation

The Secretary of Energy regulates the importation and exportation of natural gas and has delegated various aspects of this jurisdiction to FERC and the DOE's Office of Fossil Fuels.

Pipelines owned by system companies are also subject to the Natural Gas Pipeline Safety Act of 1968 and the Pipeline Safety Improvement Act of 2002, which regulates the safety of gas pipelines. Consumers and Panhandle are also subject to the Hazardous Liquid Pipeline Safety Act of 1979, which regulates oil and petroleum pipelines.

CMS ENERGY ENVIRONMENTAL COMPLIANCE

CMS Energy, Consumers and Panhandle and their subsidiaries are subject to various federal, state and local regulations for environmental quality, including air and water quality, waste management, zoning and other matters. For additional information concerning environmental matters, see ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTE 5 OF CMS ENERGY'S NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — UNCERTAINTIES — CONSUMERS' ELECTRIC UTILITY CONTINGENCIES.

Consumers has installed and is currently installing modern emission controls at its electric generating plants and has converted and is converting electric generating units to burn cleaner fuels. Consumers expects that the cost of future environmental compliance, especially compliance with clean air laws, will be significant because of EPA regulations regarding nitrogen oxide and particulate-related emissions. These regulations will require Consumers to make significant capital expenditures. For the preliminary estimates of these capital expenditures to reduce nitrogen oxide-related emissions see ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTE 5 OF CMS ENERGY'S NOTES TO CONSOLIDATED FINANCIAL STATEMENTS UNCERTAINTIES — CONSUMERS ELECTRIC UTILITY CONTINGENCIES.

Consumers is in the process of closing older ash disposal areas at two plants. Construction, operation, and closure of a modern solid waste disposal area for ash can be expensive, because of strict federal and state requirements. In order to significantly reduce ash field closure costs, Consumers has worked with others to use bottom ash and fly ash as part of temporary and final cover for ash disposal areas instead of native materials in cases where such use of bottom ash and fly ash is compatible with environmental standards. To reduce disposal volumes, Consumers sells coal ash for use as a filler for asphalt, for incorporation into concrete products and for other environmentally compatible uses. The EPA has announced its intention to develop new nationwide standards for ash disposal areas. Consumers intends to work through industry groups to help ensure that any such regulations require only the minimum cost necessary to adhere to standards that are consistent with protection of the environment.

Consumers has PCB in some of its electrical equipment, as do most electric utilities. During routine maintenance activities, Consumers identified PCB as a component in certain paint, grout and sealant materials at

the Ludington Pumped Storage facility. Consumers removed and replaced part of the PCB material. Consumers has proposed a plan to the EPA to deal with the remaining materials and is waiting on a response from the EPA.

Certain environmental regulations affecting CMS Energy, Consumers and Panhandle include, but are not limited to, the Clean Air Act Amendments of 1990 and Superfund. Superfund can require any individual or entity that may have owned or operated a disposal site, as well as transporters or generators of hazardous substances that were sent to such site, to share in remediation costs for the site.

Consumers', CMS Energy's and Panhandle's current insurance coverages do not extend to certain environmental clean-up costs, such as claims for air pollution, some past PCB contamination and for some long-term storage or disposal of pollutants.

Panhandle does not anticipate that compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise protecting the environment will have a material adverse effect on the competitive position, consolidated results of operations or financial position of Panhandle.

CMS ENERGY COMPETITION

Electric Competition

Consumers' electric utility business experiences competition, actual and potential, from many sources, both in the wholesale and retail markets, and in electric generation, electric delivery, and retail services.

In the wholesale electricity markets, Consumers competes with other wholesale suppliers, marketers and brokers. Electric competition in the wholesale markets increased significantly since 1996 due to FERC Order 888. Whereas Consumers is still active in wholesale electricity markets, wholesale for retail transactions by Consumers generated an immaterial amount of Consumers' 2002 revenues from electric utility operations. Consumers does not believe future loss of wholesale for retail sales to be significant.

A significant increase in retail electric competition is now possible with the passage of the Customer Choice Act and the availability of retail open access. The Customer Choice Act of June 2000 required Consumers to open progressive tiers of its electric customer power supply requirement such that a total of 750 MW was open to competition in 2001. As of January 1, 2002, the Consumer Choice Act also gave all electric customers the right to buy generation service from an alternative electric supplier. The Michigan Public Service Commission has adopted a mechanism pursuant to the Customer Choice Act to provide for recovery of stranded costs. The company cannot predict the total amount of electric supply load that may be lost to competitor suppliers, nor whether the stranded cost recovery method adopted by the MPSC will be applied in a manner that will fully offset any associated margin loss.

In addition to retail electric customer choice, Consumers also has competition or potential competition from: 1) the threat of customers relocating outside Consumers' service territory; 2) the possibility of municipalities owning or operating competing electric delivery systems; 3) customer self-generation; and 4) adjacent municipal utilities that extend lines to customers near service territory boundaries. Consumers addresses this competition primarily through offering rate discounts, providing additional services and insistence upon compliance with MPSC and FERC rules.

Consumers offers non-commodity retail services to electric customers in an effort to offset costs. Consumers faces competition from many sources, including energy management services companies, other utilities, contractors, and retail merchandisers.

CMS MST, which is a non-utility electric subsidiary, faced competition from marketers, brokers, financial management firms, energy management firms and other utilities. CMS Energy's independent power production business segment, another non-utility electric subsidiary, faces competition from generators, marketers and brokers, as well as lower power prices on the wholesale market.

For additional information concerning electric competition, see ITEM 7. CMS ENERGY'S MANAGEMENT'S DISCUSSION AND ANALYSIS — OUTLOOK — CONSUMERS' ELECTRIC UTILITY BUSINESS OUTLOOK.

Gas Competition

Competition has existed for the past decade, and is likely to increase, in various aspects of Consumers' gas utility business. Competition traditionally comes from alternate fuels and energy sources, such as propane, oil, and electricity. Competition has also been introduced through the gas customer choice program which allows residential, commercial and industrial retail gas sales customers to choose an alternative gas commodity supplier in direct competition with Consumers. Consumers would continue to transport and distribute gas to these customers.

CMS Energy's non-utility gas subsidiaries face significant competition from other gas pipeline companies, gas producers, gas storage companies, brokers and marketers and competition from other fuels such as oil and coal.

For additional information concerning gas competition, see Panhandle Competition below, ITEM 7. CMS ENERGY'S MANAGEMENT DISCUSSION AND ANALYSIS — OUTLOOK.

Panhandle Competition

Panhandle's interstate pipelines compete with other interstate and intrastate pipeline companies in the transportation and storage of natural gas. The principal elements of competition among pipelines are rates, terms of service and flexibility and reliability of service. Panhandle competes directly with Alliance Pipeline LP, ANR Pipeline Company, Natural Gas Pipeline Company of America, Northern Border Pipeline Company, Texas Gas Transmission Corporation, Northern Natural Gas Company and Vector Pipeline in the Midwest market area.

Natural gas competes with other forms of energy available to Panhandle's customers and end-users, including electricity, coal and fuel oils. The primary competitive factor is price. Changes in the availability or price of natural gas and other forms of energy, the level of business activity, conservation, legislation and governmental regulations, the capability to convert to alternative fuels, and other factors, including weather and natural gas storage levels, affect the demand for natural gas in the areas served by Panhandle.

INSURANCE

CMS Energy and its subsidiaries, including Consumers and Panhandle, maintain insurance coverage similar to other comparable companies in the same lines of business. The insurance policies are subject to term, conditions, limitations and exclusions that might not fully compensate CMS for all losses. Furthermore, as CMS renews its policies it is possible that full insurance coverage may not be obtainable on commercially reasonable terms due to the recent increasingly restrictive insurance markets.

For additional information regarding Insurance, see CMS ENERGY FORWARD LOOKING STATEMENTS CAUTIONARY FACTORS AND UNCERTAINTIES — International Operations, NOTE 5 — Nuclear Matters of CMS ENERGY'S NOTE'S TO CONSOLIDATED FINANCIAL STATEMENTS.

EMPLOYEES

CMS Energy

As of December 31, 2002, CMS Energy and its subsidiaries, including Consumers and Panhandle, had 10,477 full-time equivalent employees of whom 10,398 are full-time employees and 79 full-time equivalent employees associated with the part-time work force. Included in the total are 3,902 employees who are covered by union contracts.

Consumers

As of December 31, 2002, Consumers and its subsidiaries had 8,311 full-time equivalent employees of whom 8,238 are full-time employees and 73 full-time equivalent employees associated with the part-time work force. Included in the total are 3,630 full-time operating, maintenance and construction employees of Consumers who are represented by the Utility Workers Union of America. Consumers and the Union negotiated a collective bargaining agreement that became effective as of June 1, 2000 and will continue in full force and effect until

June 1, 2005. Consumers is currently negotiating with the Union for a collective bargaining agreement for its Call Center employees.

Panhandle

At December 31, 2002, Panhandle and its subsidiaries had 1,155 full-time equivalent employees. Included in the total are 247 full-time, compressor, pipeline, gas measurement, and field clerical employees of Panhandle Eastern Pipe Line Company who are represented by the Paper, Allied — Industrial Chemical and Energy Workers International Union. Panhandle and the Union negotiated a collective bargaining agreement that became effective as of May 28, 1999 and will continue in full force and effect until May 27, 2003.

CMS ENERGY FORWARD-LOOKING STATEMENTS, CAUTIONARY FACTORS AND UNCERTAINTIES.

International Operations

CMS Energy, through certain of its Enterprises subsidiaries, has made substantial international investments in approximately 10 countries. These international investments in electric generating facilities, natural gas pipelines and electric distribution systems face a number of risks inherent in acquiring, developing and owning these types of facilities. CMS Energy believes that its subsidiaries maintain appropriate levels of traditional insurance, similar to comparable companies in the same line of business, for the various risk exposures incidental to CMS Energy's businesses. Notably, all insurance is subject to terms and conditions that might not fully compensate a loss. Further, due to increasingly restrictive insurance markets, partly as a result of terrorist attacks of September 11, 2001, it is anticipated that insurance, particularly terrorism and sabotage coverages, will be difficult or impossible to maintain on all investments.

Although CMS Energy maintains insurance in certain high-risk countries for certain specific political risks, CMS Energy is exposed to some risks that include local political and economic factors over which it has no control and that may not be covered by insurance. CMS Energy, through its Enterprises subsidiaries, may incur risk exposures such as changes in foreign governmental and regulatory policies (including changes in industrial regulation and control and changes in taxation), changing political conditions and international monetary fluctuations. Particularly, international investments are subject to the risk that they may be expropriated or that the required agreements, licenses, permits and other approvals may be changed or terminated in violation of their terms. Also, the local foreign currency may be devalued or the conversion of the currency may be restricted or prohibited or other actions, such as increases in taxes, royalties or import duties, may be taken which adversely affect the value and the recovery of the investment. In some cases, the investment may have to be abandoned or disposed of at a loss. These factors could significantly adversely affect the financial results of the affected subsidiary and CMS Energy's financial position and results of operations.

Uncertainties

Specific uncertainties are described in ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTE 5 OF CMS ENERGY'S NOTES TO CONSOLIDATED FINANCIAL STATEMENTS. Certain risks are described in ITEM 7. CMS ENERGY'S MANAGEMENT'S DISCUSSION AND ANALYSIS — MARKET RISK INFORMATION and ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTE 10 OF CMS ENERGY'S NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements to encourage such disclosures without the threat of litigation, if those statements are identified as forward-looking and are accompanied by meaningful, cautionary statements identifying important factors that could cause the actual results to differ materially from those projected in the statements. Forward-looking statements give our expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. Forward-looking statements have been and will be made in this Form 10-K and in our other written documents (such as press releases, visual presentations, and securities disclosure documents) and oral presentations (such as analyst conference calls). Such statements are based on management's beliefs as well as assumptions made by, and information currently available to, management. When used in our documents or oral presentations, we intend the words "anticipate", "believe", "estimate",

“expect”, “forecast”, “intend”, “objective”, “plan”, “possible”, “potential”, “project” “projection” and variations of such words and similar expressions to target forward-looking statements that involve risk and uncertainty.

Any or all of our forward-looking statements in oral or written statements or in other publications may turn out to be wrong. They can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Many such factors will be important in determining our actual future results. Consequently, we cannot guarantee any forward-looking statement.

In addition to any assumptions and other factors referred to specifically in connection with such forward-looking statements, there are numerous factors that could cause our actual results to differ materially from those contemplated in any forward-looking statements. Such factors include our inability to predict and/or control:

- The efficient sale of non-strategic and under-performing domestic and international assets and discontinuation of certain operations;
- Achievement of capital expenditure reductions and cost savings;
- Capital and financial market conditions, including current price of CMS Energy Common Stock and the effect on the Pension Plan, interest rates and availability of financing to CMS Energy, Consumers, Panhandle or any of their affiliates and the energy industry;
- Market perception of the energy industry, CMS Energy, Consumers, Panhandle or any of their affiliates;
- CMS Energy’s, Consumers’, Panhandle’s or any of their affiliates’ securities ratings;
- Currency fluctuations, transfer restrictions and exchange controls;
- Factors affecting utility and diversified energy operations such as unusual weather conditions, catastrophic weather-related damage, unscheduled generation outages, maintenance or repairs, unanticipated changes to fossil fuel, nuclear fuel or gas supply costs or availability due to higher demand, shortages, transportation problems or other developments, environmental incidents, or electric transmission or gas pipeline system constraints;
- Ability to successfully access the capital markets;
- Electric transmission or gas pipeline system constraints;
- International, national, regional and local economic, competitive and regulatory conditions and developments;
- Adverse regulatory or legal decisions, including environmental laws and regulations;
- Federal regulation of electric sales and transmission of electricity including re-examination by Federal regulators of the market-based sales authorizations by which our subsidiaries participate in wholesale power markets without price restrictions and proposals by FERC to change the way it currently lets our subsidiaries and other public utilities and natural gas companies interact with each other;
- Energy markets, including the timing and extent of unanticipated changes in commodity prices for oil, coal, natural gas, natural gas liquids, electricity and certain related products due to lower or higher demand, shortages, transportation problems or other developments;
- The increased competition in natural gas transportation which could reduce volumes of gas transported by our natural gas transmission businesses or cause them to lower rates in order to meet competition;
- Potential disruption, expropriation or interruption of facilities or operations due to accidents, war and terrorism or political events and the ability to obtain or maintain insurance coverage for such events;
- Nuclear power plant performance, decommissioning, policies, procedures, incidents, and regulation, including the availability of spent nuclear fuel storage;
- Technological developments in energy production, delivery and usage;

- Changes in financial or regulatory accounting principles or policies;
- Outcome, cost, and other effects of legal and administrative proceedings, settlements, investigations and claims including particularly claims, damages, and fines resulting from those involving round-trip trading and inaccurate commodity price reporting;
- Limitations on our ability to control the development or operation of projects in which our subsidiaries have a minority interest;
- Disruptions in the normal commercial insurance and surety bond markets that may increase costs or reduce traditional insurance coverage, particularly terrorism and sabotage insurance and performance bonds;
- Other business or investment considerations that may be disclosed from time to time in CMS Energy's, Consumers' or Panhandle's SEC filings or in other publicly disseminated written documents; and
- Other uncertainties, which are difficult to predict and many of which are beyond our control.

CMS Energy and its affiliates undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The foregoing review of factors pursuant to the Private Securities Litigation Reform Act should not be construed as exhaustive or as any admission regarding the adequacy of our disclosures. Certain risk factors are detailed from time to time in our various public filings. You are advised, however to consult any further disclosures we make on related subjects in our reports to the SEC. In particular, you should read the discussion in the section entitled "Forward-Looking Statements and Risk Factors" in our most recent reports to the SEC on Form 10-Q or Form 8-K filed subsequent to this Form 10-K.

EXECUTIVE OFFICERS

| <u>Name</u> | <u>Age</u> | <u>Position</u> | <u>Period</u> | | |
|---|--------------|--|-------------------|--|--------------|
| Kenneth Whipple | 68 | Chairman of the Board, Chief Executive Officer of CMS Energy | 2002-Present | | |
| | | Chairman of the Board, Chief Executive Officer of Consumers | 2002-Present | | |
| | | Chairman of the Board of Enterprises | 2002-Present | | |
| | | Director of CMS Energy | 1993-Present | | |
| | | Director of Consumers | 1993-Present | | |
| | | Chairman and Chief Executive Officer of Ford Credit Company | 1997-1999 | | |
| | | Executive Vice President and President of Ford Financial Services Group | 1989-1999 | | |
| S. Kinnie Smith, Jr. | 72 | Vice Chairman of the Board of CMS Enterprises | 2003-Present | | |
| | | Vice Chairman of the Board and General Counsel of CMS Energy | 2002-Present | | |
| | | Vice Chairman of the Board of Consumers | 2002-Present | | |
| | | Executive Vice President of Enterprises | 2002-2003 | | |
| | | Director of CMS Energy | 2002-Present | | |
| | | Director of Consumers | 2002-Present | | |
| | | Vice Chairman of Trans-Elect, Inc Senior Counsel at Skadden, Arps, Slate, Meagher, & Flom LLP | 2002 1995-2002 | | |
| David W. Joos | 49 | Chairman of the Board and Chief Executive Officer of CMS Enterprises | 2003-Present | | |
| | | President and Chief Operating Officer of CMS Energy | 2001-Present | | |
| | | President and Chief Operating Officer of Consumers | 2001-Present | | |
| | | President and Chief Operating Officer of CMS Enterprises | 2001-2003 | | |
| | | Director of CMS Energy | 2001-Present | | |
| | | Director of Consumers | 2001-Present | | |
| | | Executive Vice President and Chief Operating Officer — Electric of CMS Energy | 2000-2001 | | |
| | | Executive Vice President and Chief Operating Officer — Electric of Enterprises | 2000-2001 | | |
| | | Executive Vice President and President and Chief Executive Officer — Electric of Consumers | 1997-2001 | | |
| | | Thomas J. Webb | 50 | Executive Vice President and Chief Financial Officer of CMS Energy | 2002-Present |
| | | | | Executive Vice President and Chief Financial Officer of Consumers | 2002-Present |
| Executive Vice President and Chief Financial Officer of Enterprises | 2002-Present | | | | |
| Executive Vice President and Chief Financial Officer of Panhandle Eastern Pipe Line | 2002-Present | | | | |
| Executive Vice President and Chief Financial Officer of Kellogg Company | 1999-2002 | | | | |
| Vice President and Chief Financial Officer of Visteon, a division of Ford Motor Company | 1996-1999 | | | | |

| <u>Name</u> | <u>Age</u> | <u>Position</u> | <u>Period</u> |
|---------------------------|------------|--|---------------|
| Thomas W. Elward | 54 | President and Chief Operating Officer of CMS Enterprises | 2003-Present |
| | | President and Chief Executive Officer of CMS Generation Co. | 2002-Present |
| | | Senior Vice President of CMS Enterprises | 2002-2003 |
| | | Senior Vice President of CMS Generation Co. | 1998-2001 |
| | | Vice President of CMS Generation Co | 1990-1998 |
| Carl L. English | 56 | Executive Vice President and President and Chief Executive Officer — Gas of Consumers | 1999-Present |
| | | Vice President of Consumers | 1990-1999 |
| David G. Mengebier* | 45 | Senior Vice President of CMS Enterprises | 2003-Present |
| | | Senior Vice President of CMS Energy | 2001-Present |
| | | Senior Vice President of Consumers | 2001-Present |
| | | Vice President of CMS Energy | 1999-2001 |
| | | Vice President of Consumers | 1999-2001 |
| John G. Russell** | 45 | Executive Vice President and President and Chief Executive Officer — Electric of Consumers | 2001-Present |
| | | Senior Vice President of Consumers | 2000-2001 |
| | | Vice President of Consumers | 1999-2000 |
| John F. Drake | 54 | Senior Vice President of CMS Enterprises | 2003-Present |
| | | Senior Vice President of CMS Energy | 2002-Present |
| | | Senior Vice President of Consumers | 2002-Present |
| | | Vice President of CMS Energy | 1997-2002 |
| | | Vice President of Consumers | 1998-2002 |
| Glenn P. Barba | 37 | Vice President and Chief Accounting Officer of CMS Enterprises | 2003-Present |
| | | Vice President, Controller and Chief Accounting Officer of CMS Energy | 2003-Present |
| | | Vice President, Controller and Chief Accounting Officer of Consumers | 2003-Present |
| | | Vice President and Controller of Consumers | 2001-2003 |
| | | Controller of CMS Generation | 1997-2001 |

* Mr. Mengebier has served as Senior Vice President of CMS Energy and Consumers since 2001, after receiving a promotion from his position in both companies as Vice President, which he had held since 1999. From 1997 to 1999, Mr. Mengebier served as Executive Director of Federal Governmental Affairs for CMS Enterprises.

** Mr. Russell has served as Executive Vice President and President and Chief Executive Officer — Electric of Consumers since October 2001. From December 2000 until October 2001, Mr. Russell served as Senior Vice President of Consumers. From October 1999 until December 2000, Mr. Russell served as Vice President of Consumers. From July 1997 until October 1999, Mr. Russell served as Manager — Electric Customer Operations of Consumers.

The present term of office of each of the executive officers extends to the first meeting of the Board of Directors after the next annual election of Directors of CMS Energy (scheduled to be held on May 23, 2003).

There are no family relationships among executive officers and directors of CMS Energy.

AVAILABLE INFORMATION

CMS Energy's internet address is <http://www.cmsenergy.com>. You can access free of charge on our website all of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act. Such reports are available as soon as practical after they are electronically filed with the SEC.

ITEM 2. PROPERTIES.

A description of CMS Energy properties is contained in ITEM 1. BUSINESS — Consumers — Consumers Properties — General; BUSINESS — BUSINESS SEGMENTS — Consumers Electric Utility Operations — Electric Utility Properties; Consumers Gas Utility — Gas Utility Properties; Natural Gas Transmission — Natural Gas Transmission Properties; Independent Power Production — Independent Power Production Properties; Oil and Gas Exploration and Production — Oil and Gas Exploration and Production Properties; International Energy Distribution — International Energy Distribution Properties, all of which are incorporated by reference herein.

ITEM 3. LEGAL PROCEEDINGS

CMS Energy and some of its subsidiaries and affiliates are parties to certain routine lawsuits and administrative proceedings incidental to their businesses involving, for example, claims for personal injury and property damage, contractual matters, various taxes, and rates and licensing. Reference is made to the ITEM 1. BUSINESS — CMS ENERGY REGULATION, as well as CMS Energy's ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS and CMS Energy's ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTES TO CONSOLIDATED FINANCIAL STATEMENTS included herein for additional information regarding various pending administrative and judicial proceedings involving regulatory, operating and environmental matters.

CMS ENERGY

DEMAND FOR ACTIONS AGAINST OFFICERS AND DIRECTORS

The Board of Directors of CMS Energy received a demand, on behalf of a shareholder of Common Stock, that it commence civil actions (i) to remedy alleged breaches of fiduciary duties by CMS Energy officers and directors in connection with round-trip trading at CMS MS&T, 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. If the Board elects not to commence such actions, the shareholder has stated that he will initiate a derivative suit, bringing such claims on behalf of CMS Energy. CMS Energy has elected two new members to its Board of Directors to serve as an independent litigation committee to determine whether it is in the best interest of the company to bring the action demanded by the shareholder. Counsel for the shareholder has agreed to extend the time for CMS Energy to respond to the demand. CMS Energy cannot predict the outcome of this litigation.

EMPLOYMENT RETIREMENT INCOME SECURITY ACT CLASS ACTION 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 Employee's Savings and Incentive Plan (the "Plan"). The two cases, filed in July 2002 in the U.S. District Court, were consolidated by the trial judge and an 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 Common Stock held in the Plan. Plaintiffs also seek other equitable relief and legal fees. These cases will be vigorously defended. CMS Energy and Consumers cannot predict the outcome of this litigation.

SECURITIES CLASS ACTION LAWSUITS

Beginning on May 17, 2002, a number of securities class action complaints have been filed against CMS Energy, Consumers and certain officers and directors of CMS Energy and its affiliates. The complaints have been filed in the United States District Court for the Eastern District of Michigan as purported class actions by individuals who allege that they purchased CMS Energy's securities during a purported class period. At least two of the complaints contain purported class periods beginning on August 3, 2000 and running through May 10, 2002 or May 14, 2002. These complaints generally seek unspecified damages based on allegations that the

defendants violated United States securities laws and regulations by making allegedly false and misleading statements about the company's business and financial condition. The cases have been consolidated into a single lawsuit, and an amended and consolidated complaint is due to be filed by May 1, 2003. CMS Energy and Consumers intend to vigorously defend against this action. CMS Energy and Consumers cannot predict the outcome of this litigation.

Environmental Matters: CMS Energy and its subsidiaries and affiliates are subject to various federal, state and local laws and regulations relating to the environment. Several of these companies have been named parties to various actions involving environmental issues. Based on its present knowledge and subject to future legal and factual developments, CMS Energy, believe that it is unlikely that these actions, individually or in total, will have a material adverse effect on its financial condition. See CMS Energy's, Consumers' and Panhandle's ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS; and CMS Energy's ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

During the fourth quarter of 2002, CMS Energy did not submit any matters to vote of security holders.

PART II

ITEM 5. MARKET FOR CMS ENERGY'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

Market prices for CMS Energy's Common Stock and related security holder matters are contained in ITEM 7. CMS ENERGY'S MANAGEMENT'S DISCUSSION AND ANALYSIS and ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — CMS ENERGY'S QUARTERLY FINANCIAL AND COMMON STOCK INFORMATION, which is incorporated by reference herein. At February 28, 2003, the number of registered shareholders totaled 62,687.

ITEM 6. SELECTED FINANCIAL DATA.

Selected financial information is contained in ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — CMS ENERGY'S SELECTED FINANCIAL INFORMATION, which is incorporated by reference herein.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Management's discussion and analysis of financial condition and results of operations is contained in ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — CMS ENERGY'S MANAGEMENT'S DISCUSSION AND ANALYSIS, which is incorporated by reference herein.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Quantitative and Qualitative Disclosures About Market Risk is contained in ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA — CMS ENERGY'S MANAGEMENT'S DISCUSSION AND ANALYSIS — CRITICAL ACCOUNTING POLICIES — MARKET RISK INFORMATION, which is incorporated by reference herein.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

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CMS ENERGY CORPORATION
SELECTED FINANCIAL INFORMATION

| | | 2002 | Restated 2001(a) | Restated 2000(a) | 1999 | 1998 |
|--|------|---------|---------------------|---------------------|----------|---------|
| Operating revenue (in millions)(e) | (\$) | 8,687 | 8,063 | 6,697 | 5,094 | 4,963 |
| Income (loss) from continuing operations(e) | (\$) | (416) | (236) | (40) | 207 | 250 |
| Consolidated net income (loss) (in millions)(e) | (\$) | (620) | (448) | (43) | (277) | 285 |
| Average common shares outstanding | | | | | | |
| (in thousands) | | | | | | |
| CMS Energy | | 139,047 | 130,758 | 113,128 | 110,140 | 102,446 |
| Class G | | — | — | — | — | 8,333 |
| Income (loss) from continuing operations per | | | | | | |
| average common share | | | | | | |
| CMS Energy — Basic | | (2.99) | (1.79) | (0.35) | 1.81 | 2.31 |
| — Diluted | | (2.99) | (1.79) | (0.35) | 1.81 | 2.29 |
| Class G — Basic and Diluted | | — | — | — | 4.21 | 1.57 |
| Net income (loss) per average common share | | | | | | |
| CMS Energy — Basic | (\$) | (4.46) | (3.42) | 0.38 | 2.18(b) | 2.65 |
| — Diluted | (\$) | (4.46) | (3.42) | 0.38 | 2.17(b) | 2.62 |
| Class G — Basic and Diluted | (\$) | — | — | — | 4.21(b) | 1.56 |
| Cash from operations (in millions) | (\$) | 403 | 366 | 586 | 917 | 516 |
| Capital expenditures, excluding acquisitions, capital lease additions and DSM | | | | | | |
| (in millions) | (\$) | 747 | 1,239 | 1,032 | 1,124 | 1,295 |
| Total assets (in millions) | (\$) | 13,915 | 16,775 | 16,903 | 15,462 | 11,310 |
| Long-term debt, excluding current maturities | | | | | | |
| (in millions) | (\$) | 5,356 | 5,840 | 6,048 | 6,428 | 4,726 |
| Non-current portion of capital leases | | | | | | |
| (in millions) | (\$) | 116 | 71 | 49 | 88 | 105 |
| Total preferred stock (in millions) | (\$) | 44 | 44 | 44 | 44 | 238 |
| Total Trust Preferred Securities | | | | | | |
| (in millions) | (\$) | 883 | 1,214 | 1,089 | 1,119 | 393 |
| Cash dividends declared per common share | | | | | | |
| CMS Energy | (\$) | 1.09 | 1.46 | 1.46 | 1.39 | 1.26 |
| Class G | (\$) | — | — | — | 0.99 | 1.27 |
| Market price of common stock at year-end | | | | | | |
| CMS Energy | (\$) | 9.44 | 24.03 | 31.69 | 31.19 | 48.44 |
| Class G | (\$) | — | — | — | 24.56(c) | 25.25 |
| Book value per common share at year-end | | | | | | |
| CMS Energy | (\$) | 7.86 | 15.33 | 19.93 | 21.17 | 19.61 |
| Class G | (\$) | — | — | — | — | 11.46 |
| Return on average common equity | (%) | (39.1) | (20.1) | 1.8 | 11.8 | 14.2 |
| Return on assets | (%) | (1.6) | (0.2) | 2.7 | 5.3 | 5.5 |
| Number of employees at year-end | | | | | | |
| (full-time equivalents) | | 10,477 | 11,510 | 11,652 | 11,462 | 9,710 |
| Electric Utility Statistics | | | | | | |
| Sales (billions of kWh) | | 39.3 | 39.6 | 41.0 | 41.0 | 40.0 |
| Customers (in thousands) | | 1,734 | 1,712 | 1,691 | 1,665 | 1,640 |
| Average sales rate per kWh | (¢) | 6.88 | 6.65 | 6.56 | 6.54 | 6.50 |

| | <u>2002</u> | <u>Restated 2001</u> | <u>Restated 2000</u> | <u>1999</u> | <u>1998</u> |
|--|-------------|--------------------------|--------------------------|-------------|-------------|
| Gas Utility Statistics | | | | | |
| Sales and transportation deliveries (bcf) | 376 | 367 | 410 | 389 | 360 |
| Customers (in thousands)(d)..... | 1,652 | 1,630 | 1,611 | 1,584 | 1,558 |
| Average sales rate per mcf | (\$) 5.67 | 5.34 | 4.39 | 4.52 | 4.56 |
| Diversified Energy Statistics | | | | | |
| CMS Energy's share of unconsolidated revenue (in millions): | | | | | |
| Independent power production | (\$) 704 | 742 | 837 | 802 | 761 |
| Natural gas transmission..... | (\$) 150 | 239 | 171 | 130 | 67 |
| Marketing, services and trading | (\$) 1,003 | 1,138 | 1,238 | 524 | 291 |
| Independent power production sales (millions of kWh) | 19,776 | 19,212 | 21,379 | 20,478 | 19,017 |
| Gas pipeline throughput (bcf) | 1,534 | 1,555 | 1,586 | 1,141 | 253 |
| Gas managed and marketed for end users (bcf) | 601 | 750 | 615 | 470 | 366 |
| Electric power marketed (millions of kWh) | 62,004 | 51,790 | 37,781 | 3,709 | 6,973 |

- (a) CMS Energy's Consolidated Financial Statements for the years 2001 and 2000 have been restated, pursuant to adjustments resulting from the re-audit of CMS Energy. See Note 2 in the Notes to the Consolidated Financial Statements.
- (b) 1999 earnings per average common share includes allocation of the premium on redemption of Class G Common Stock of \$(.26) per CMS Energy basic share, \$(.25) per CMS Energy diluted share and \$3.31 per Class G basic and diluted share.
- (c) Reflects closing price at the October 25, 1999 exchange date.
- (d) Excludes off-system transportation customers.
- (e) See Notes 3, 4 and 5 to the Consolidated Financial Statements.

CMS ENERGY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS

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, including Panhandle and its subsidiaries, is engaged in several domestic and international diversified energy businesses including: natural gas transmission, storage and processing; independent power production; and energy marketing, services and trading. CMS Energy's consolidated financial statements for the years 2001 and 2000 have been restated as a result of accounting adjustments identified in connection with the re-audit and preparation of the restated 2001 and 2000 consolidated financial statements of CMS Energy. CMS Energy is currently in the process of completing its restatement of the consolidated financial statements for the quarters of 2001, and upon completion, Ernst & Young will perform a review of the 2001 quarterly financial data in accordance with standards established by the American Institute of Certified Public Accountants. As a result, the 2001 quarterly information has not yet been restated. Upon completion, CMS Energy will file restated financial statements for those interim periods, and for the interim periods of 2002, in an amended Form 10-Q for September 30, 2002. That filing will include details of the quarterly impacts of the restatement adjustments for 2001 and the first three quarters of 2002. The 2002 interim financial data contained in Note 20, Quarterly Financial and Common Stock Information, to the consolidated financial statements has been restated to reflect the impacts of restatement adjustments.

FORWARD-LOOKING STATEMENTS AND RISK FACTORS

This MD&A refers to, and in some sections specifically incorporates by reference, CMS Energy's Notes to Consolidated Financial Statements and should be read in conjunction with such Consolidated Financial Statements and Notes. This Annual Report and other written and oral statements that CMS Energy may make contain forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. CMS Energy's intentions with the use of the words "anticipates," "believes," "estimates," "expects," "intends," and "plans," and variations of such words and similar expressions, are solely to identify forward-looking statements that involve risk and uncertainty. These forward-looking statements are subject to various factors that could cause CMS Energy's actual results to differ materially from the results anticipated in such statements. CMS Energy has no obligation to update or revise forward-looking statements regardless of whether new information, future events or any other factors affect the information contained in such statements. CMS Energy does, however, discuss certain risk factors, uncertainties and assumptions in this MD&A and in Item 1 of this Form 10-K in the section entitled "Forward-Looking Statements Cautionary Factors and Uncertainties" and in various public filings it periodically makes with the SEC. CMS Energy designed this discussion of potential risks and uncertainties, which is by no means comprehensive, to highlight important factors that may impact CMS Energy's business and financial outlook. This Annual Report also describes material contingencies in CMS Energy's Notes to Consolidated Financial Statements, and CMS Energy encourages its readers to review these Notes.

In addition to any assumptions and other factors referred to specifically in connection with such forward-looking statements, there are several factors that could affect CMS Energy's liquidity, including but not limited to:

- Generation of sufficient cash flows from operations;
- Near term cash requirements;
- Timely closing of asset sales, including the sale of Panhandle;
- Access to capital markets or other financing sources; and
- Numerous other significant risks and difficulties including, but not limited to, SEC and other investigations, securities class action lawsuits, and ERISA cases.

CAPITAL RESOURCES AND LIQUIDITY

CMS Energy's liquidity and capital requirements generally are a function of its results of operations, capital expenditures, contractual obligations, working capital needs and collateral requirements. CMS Energy historically has met its consolidated cash needs through its operating and investing activities and, as needed, through access to bank financing and the capital markets.

During 2003, CMS Energy has contractual obligations and planned capital expenditures that would require substantial amounts of cash. As of March 14, 2003, CMS Energy at the parent level had approximately \$615 million, Consumers Energy and its subsidiaries had approximately \$727 million, and Panhandle and its subsidiaries had approximately \$52 million of publicly issued and credit facility debt maturing in 2003. CMS Energy and Consumers Energy have taken significant steps to address their 2003 maturities, as described below. In addition, CMS Energy also could become subject to liquidity demands pursuant to commercial commitments under guarantees, indemnities and letters of credit. Management is pursuing actively plans to refinance debt and to sell assets, including the sale of Panhandle. In December 2002, CMS Energy signed a definitive agreement to sell Panhandle for a total of \$1.828 billion, which is expected to result in \$662 million of cash and \$1.166 billion of debt assumption. However, closing of the sale is pending action by the FTC under the Hart-Scott-Rodino Act. All other regulatory approvals have been granted.

CMS ENERGY PARENT LEVEL LIQUIDITY

CMS Energy at the parent level is addressing its near-to-mid-term liquidity and capital requirements through a financial improvement plan that involves the sale of non-strategic and under-performing assets of approximately \$912 million, receipt of dividends from its subsidiaries of approximately \$280 million, and reduction of approximately \$598 million of outstanding debt along with reduced capital expenditures, cost reductions and other measures.

As noted elsewhere in this MDA, CMS Energy has reduced debt of approximately \$2.7 billion through asset sales with cash proceeds and associated debt assumption from such sales over the past two years. Through the first quarter of 2003, CMS Energy has accomplished \$60 million of additional asset sales. In January 2003, CMS MST closed on the sale of a substantial portion of its natural gas trading contracts for \$17 million of cash proceeds, and in February 2003 signed a definitive agreement to sell its wholesale power contract. In addition, the sale of the Centennial Pipeline, resulting in proceeds to CMS Energy of \$40 million, closed in February 2003.

CMS Energy believes that further targeted asset sales, together with its planned reductions in operating expenses, capital expenditures, and the suspension of the common dividend also will contribute to improved liquidity. CMS Energy believes that, assuming the successful implementation of its financial improvement plan, its present level of cash and borrowing capacity along with anticipated cash flows from operating and investing activities will be sufficient to meet its liquidity needs through 2003. There can be no assurances that the financial improvement plan will be successful and failure to achieve its goals could have a material adverse effect on CMS Energy's liquidity and operations. In such event, CMS Energy would be required to consider the full range of strategic measures available to companies in similar circumstances.

CMS Energy continues to explore financing opportunities to supplement its financial improvement plan. These potential opportunities include refinancing its bank credit facilities; entering into leasing arrangements and/or vendor financing; refinancing and issuing new capital markets debt, preferred and/or common equity; and negotiating private placement debt, preferred and/or common equity. Specifically, as of March 31, 2003, CMS Energy has taken the following action to supplement its financial improvement plan in 2003:

- On March 30, 2003 CMS Energy entered into an amendment and restatement of its existing \$300 million and \$295.8 million revolving credit facilities under which \$409 was then outstanding. The Second Amended and Restated Senior Credit Agreement includes a \$234 million tranche with a maturity date of April 30, 2004 and a \$175 million tranche with a maturity date of September 30, 2004. The facility is being underwritten by several banks at a total annual cost to CMS Energy of approximately ten percent, which includes the initial commitment fee. Any proceeds of equity issuances by CMS Energy and its subsidiaries or any asset sales and debt issuances by CMS Energy or its subsidiaries, other than

Consumers Energy, are required to be used to prepay this facility. This facility is collateralized primarily by the common stock of Consumers Energy, CMS Enterprises and certain CMS Enterprises subsidiaries.

- On March 30, 2003 CMS Enterprises entered into a revolving credit facility in an aggregate amount of \$441 million. The maturity date of this facility is April 30, 2004. The facility is being underwritten by several banks at a total annual cost to CMS Energy of approximately ten percent, which includes the initial commitment fee. Proceeds from this loan will be used for general corporate purposes, to retire debt, and to collateralize approximately \$160 million of letters of credit. Any proceeds of equity issuances by CMS Energy and its subsidiaries or any asset sales and debt issuances by CMS Energy or its subsidiaries, other than Consumers Energy, are required to be used to prepay this facility. It is expected that proceeds from the Panhandle sale will be used to pay off this facility in full. This facility is guaranteed by CMS Energy, whose guaranty is secured by the common stock of Consumers Energy and CMS Enterprises.

In addition, if necessary, CMS Energy also would postpone the \$52 million pension contribution expected to be made in September 2003. Also, CMS Energy may pursue other avenues of private debt or equity investment.

CONSUMERS ENERGY LIQUIDITY

Consumers plans to meet its liquidity and capital requirements in 2003 through a combination of approximately \$513 million from operations and approximately \$295 million of new debt along with reduced capital expenditures, cost reductions and other measures. As of March 14, 2003, Consumers planned to refinance \$727 million of debt in 2003. To that end, Consumers has initiated several transactions with various financial institutions, regulators, banks, lenders, and others that are designed to provide liquidity:

- On March 26, 2003, Consumers entered into a \$140 million term loan secured by first mortgage bonds with a private investor bank. This loan has a term of six years at a cost of LIBOR plus 475 basis points. Proceeds from this loan will be used to retire debt and for general corporate purposes.
- On March 27, 2003, Consumers obtained a replacement revolving credit facility in the amount of \$250 million, secured by first mortgage bonds. The cost of the facility is LIBOR plus 350 basis points. The new credit facility matures in March 2004 with two annual extensions at Consumers' option, which would extend the maturity to March 2006. The prior facility was due to expire in July 2003.
- On March 28, 2003, Consumers syndicated a \$150 million term loan secured by first mortgage bonds. This term loan has a three-year maturity and will bear interest at LIBOR plus 450 basis points. Proceeds from this loan will be used to retire debt and for general corporate purposes.
- Consumers filed a general rate case for its gas utility business on March 14, 2003. Consumers requested rate relief in the amount of approximately \$156 million. In its filing, Consumers requested immediate interim relief. If interim relief of \$156 million were granted, Consumers expects that the rate relief could be in place by the fourth quarter of 2003.
- Consumers has filed an application with the MPSC seeking authorization to issue \$1.084 billion of securitization bonds. These bonds would provide liquidity to Consumers at interest rates reflective of high quality credit. Consumers would utilize these proceeds to retire higher cost debt and in turn would realize significant interest expense savings over the life of the bonds. If the MPSC approves a financing in the amount requested, and there are no delays in the offering process, Consumers anticipates that bonds would be issued by year end, 2003.

If necessary, Consumers would also postpone the planned \$158 million pension contribution expected to be made in September 2003.

In the event Consumers is unable to access bank financing or the capital markets to incur or refinance indebtedness, there could be a material adverse effect on Consumers' liquidity and operations. There is no assurance that the pending securitization bond issuance transaction noted above will be completed. Further, there is no assurance that the MPSC will grant either interim or final gas utility rate relief.

ROUND-TRIP TRADES

During the period of May 2000 through January 2002, CMS MST engaged in simultaneous, prearranged commodity trading transactions in which energy commodities were sold and repurchased at the same price. These transactions, which had no impact on previously reported consolidated net income, earnings per share or cash flows, had the effect of increasing operating revenues, operating expenses, accounts receivable, accounts payable and reported trading volumes. After internally concluding that cessation of these trades was in CMS Energy's best interest, these so called round-trip trades were halted in January 2002.

CMS Energy accounted for these trades in gross revenue and expense through the third quarter of 2001, but subsequently concluded that these round-trip trades should have been reflected on a net basis. In the fourth quarter of 2001, CMS Energy ceased recording these trades in either revenues or expenses. CMS Energy's 2001 Form 10-K, issued in March 2002, restated revenue and expense for the first three quarters of 2001 to eliminate \$4.2 billion of previously reported revenue and expense. The 2001 Form 10-K did include \$5 million of revenue and expense for 2001 from such trades, which remained uncorrected. At the time of the initial restatement, CMS Energy inadvertently failed to restate 2000 for round-trip trades.

CMS Energy is cooperating with an SEC investigation regarding round-trip trading and the Company's financial statements, accounting practices and controls. CMS Energy is also cooperating with inquiries by the Commodity Futures Trading Commission, the FERC, and the United States Department of Justice regarding these transactions. CMS Energy has also received subpoenas from U.S. Attorneys Offices regarding investigations of these trades. In addition, CMS Energy's Board of Directors established the Special Committee of independent directors to investigate matters surrounding round-trip trading and the Special Committee retained outside counsel to assist in the investigation.

On October 31, 2002, the Special Committee reported the results of its investigation to the Board of Directors. The Special Committee discovered no new information inconsistent with the information previously reported by CMS Energy and as reported above. The investigation also concluded that the round-trip trades were undertaken to raise CMS MST's profile as an energy marketer, with the goal of enhancing CMS MST's ability to promote its services to new customers. The Special Committee found no apparent effort to manipulate the price of CMS Energy Common Stock or to affect energy prices.

The Special Committee also made recommendations designed to prevent any reoccurrence of this practice, most of which have already been implemented. Previously, CMS Energy terminated its speculative trading business and revised its risk management policy. The Board of Directors adopted, and CMS Energy has begun implementing, the remaining recommendations of the Special Committee.

CHANGE IN AUDITORS AND RESTATEMENTS

In April 2002, the Board of Directors, upon the recommendation of the Audit Committee of the Board, voted to discontinue using Arthur Andersen to audit CMS Energy's financial statements for the year ending December 31, 2002. CMS Energy previously had retained Arthur Andersen to review its financial statements for the quarter ended March 31, 2002. In May 2002, the Board of Directors engaged Ernst & Young to audit CMS Energy's financial statements for the year ending December 31, 2002. Also in May 2002, CMS Energy stated its intention to restate its consolidated financial statements for 2000 and 2001 to eliminate the effects of round-trip trading.

Following CMS Energy's announcement that it would restate its financial statements for 2000 and 2001 to eliminate the effects of round-trip energy trades and form the Special Committee to investigate these trades, CMS Energy received formal notification from Arthur Andersen that it had terminated its relationship with CMS Energy and affiliates. Arthur Andersen notified CMS Energy that due to the investigation, Arthur Andersen's historical opinions on CMS Energy's financial statements for the periods being restated could not be relied upon. Arthur Andersen also notified CMS Energy that it would be unable to give an opinion on CMS Energy's restated financial statements when they are completed. Arthur Andersen's reports on CMS Energy's, Consumers', and Panhandle's consolidated financial statements for each of the fiscal years ended December 31, 2001 and

December 31, 2000 contained no adverse or disclaimer of opinion, nor were the reports qualified or modified regarding uncertainty, audit scope or accounting principles.

There were no disagreements between CMS Energy and Arthur Andersen on any matter of accounting principle or practice, financial statement disclosure, or auditing scope or procedure during the years 2000 and 2001 and through the date of their opinion for the quarter ended March 31, 2002.

As a result of the restatement required with respect to the round-trip trading transactions, Ernst & Young was engaged to re-audit CMS Energy's consolidated financial statements for each of the fiscal years ended December 31, 2001 and December 31, 2000, which included audit work at Consumers and Panhandle for these years. None of CMS Energy's former auditors, some of whom are now employed by Ernst & Young, were involved in the re-audit of CMS Energy's consolidated financial statements. During CMS Energy's two most recent fiscal years ended December 31, 2000 and December 31, 2001 and the subsequent interim period through June 10, 2002, CMS Energy did not consult with Ernst & Young regarding any matter or event identified by SEC laws and regulations.

In connection with Ernst & Young's re-audit of the fiscal years ended December 31, 2001 and December 31, 2000, CMS Energy has determined to make certain adjustments (in addition to the round-trip trades) to its consolidated financial statements for the fiscal years ended December 31, 2001 and December 31, 2000. Therefore, the consolidated financial statements for 2001 and 2000 have been restated from amounts previously reported. At the time it adopted the accounting treatment for these items, CMS Energy believed such accounting was appropriate under accounting principles generally accepted in the United States.

The tables below summarize the adjustments and the effects on CMS Energy's consolidated financial statements.

| <u>Net Income Increase (Decrease)</u> | <u>2001</u> | <u>2000</u> | <u>Total</u> |
|--|---------------------|--------------------|---------------------|
| | (In Millions) | | |
| MCV PPA Adjustments | \$ 90 | \$(20) | \$ 70 |
| DIG Loss Contract Accounting | 126 | — | 126 |
| Mark-to-Market Gains and Losses on Inter-book Transactions and other related adjustments | (43) | 18 | (25) |
| Mark-to-Market Gains and Losses on Intercompany Transactions | (30) | 18 | (12) |
| CMS MST Account Reconciliations | (5) | (13) | (18) |
| Income Tax Adjustments | (30) | — | (30) |
| Panhandle System Gas | (7) | — | (7) |
| Amortization of Debt Costs | (2) | 7 | 5 |
| Other | (2) | (3) | (5) |
| Total | <u>\$ 97</u> | <u>\$ 7</u> | <u>\$104</u> |
| <u>Balance Sheet: Increase in Consolidated Debt</u> | | <u>2001</u> | <u>2000</u> |
| | | (In Millions) | |
| Reconsolidation of LNG Facility | | \$215 | \$ — |
| Structured Financing of Methanol Plant | | 125 | 125 |
| Consumers' Headquarters Capital Lease | | 16 | — |

For detailed information about the restatement of CMS Energy's consolidated financial statements reflecting these audit adjustments, see Note 2, Restatement.

CRITICAL ACCOUNTING POLICIES

CMS Energy's consolidated financial statements are based on the application of accounting principles generally accepted in the United States. The application of these principles often requires management to make certain judgments, assumptions and estimates that may result in different financial presentations. CMS Energy

believes that certain accounting principles are critical in terms of understanding its consolidated financial statements. These principles include the use of estimates in accounting for contingencies and long-lived assets, equity method investments and long-term obligations, accounting for derivatives and financial instruments, mark-to-market accounting, and international operations and foreign currency, pension and postretirement benefits and Regulatory accounting.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities, 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. Certain accounting principles require subjective and complex judgments used in the preparation of financial statements. Accordingly, a different financial presentation could result depending on the judgment, estimates or assumptions that are used. Such estimates and assumptions include, but are not specifically limited to; depreciation, amortization, interest rates, discount rates, currency exchange rates, future commodity prices, mark-to-market valuations, investment returns, impact of new accounting standards, international economic policy, future costs associated with long-term contractual obligations, future compliance costs associated with environmental regulations and continuing creditworthiness of counterparties. Actual results could materially differ from those estimates.

Periodically, in accordance with SFAS No. 144 and APB Opinion No. 18, long-lived assets and equity method investments of CMS Energy and its subsidiaries are evaluated to determine whether conditions, other than those of a temporary nature, indicate that the carrying value of an asset may not be recoverable. Management bases its evaluation on impairment indicators such as the nature of the assets, future economic benefits, domestic and foreign state and federal regulatory and political environments, historical or future profitability measurements, as well as other external market conditions or factors that may be present. If such indicators are present or other factors exist that indicate that the carrying value of the asset may not be recoverable, CMS Energy determines whether impairment has occurred through the use of an undiscounted cash flow analysis of assets at the lowest level for which identifiable cash flows exist. If impairment, other than a temporary nature, has occurred, CMS Energy recognizes a loss for the difference between the carrying value and the estimated fair value of the asset. The fair value of the asset is measured using discounted cash flow analysis or other valuation techniques. The analysis of each long-lived asset is unique and requires management to use certain estimates and assumptions that are deemed prudent and reasonable for a particular set of circumstances. Of CMS Energy's total assets, valued at \$14 billion at December 31, 2002, approximately 40 to 45 percent represent the carrying value of long-lived assets and equity method investments that are subject to this type of analysis. If future market, political or regulatory conditions warrant, CMS Energy and its subsidiaries may be subject to write-downs in future periods. Conversely, if market, political or regulatory conditions improve, accounting standards prohibit the reversal of previous write-downs.

CMS Energy recently recorded write-downs of non-strategic or under-performing long-lived assets as a result of implementing a new strategic direction. CMS Energy is pursuing the sale of all of these non-strategic and under-performing assets, including some assets that were not determined to be impaired. Upon the sale of these assets, the proceeds realized may be materially different from the remaining carrying value of these assets. Even though these assets have been identified for sale, management cannot predict when, nor make any assurances that, these asset sales will occur, or the amount of cash or the value of consideration to be received.

Similarly, the recording of estimated liabilities for contingent losses, including estimated losses on long-term obligations, within the financial statements is guided by the principles in SFAS No. 5 that require a company 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 the amount can be reasonably estimated. Management uses cash flow valuation techniques similar to those described above to estimate contingent losses on long-term contracts.

Electric Environmental Estimates: Consumers is subject to costly and increasingly stringent environmental regulations. Consumers expects to incur significant costs for future environmental compliance, especially compliance with clean air laws.

The EPA has issued final regulations regarding nitrogen oxide emissions from certain generators, including some of Consumers' electric generating facilities. These regulations will require Consumers to make significant capital expenditures estimated to be \$770 million. As of December 31, 2002, Consumers has incurred \$405 million in capital expenditures to comply with these regulations and anticipates that the remaining capital expenditures will be incurred between 2003 and 2009. Additionally, Consumers expects to supplement its compliance plan with the purchase of nitrogen oxide emissions credits in the years 2005 through 2008. The cost of these credits based on the current market is estimated to average \$6 million per year; however, the market for nitrogen oxide emissions credits is volatile and the price could change significantly. At some point, if new environmental standards become effective, Consumers may need additional capital expenditures to comply with the standards. These and other required environmental expenditures, if not recovered in Consumers' rates, may have a material adverse effect upon Consumers' financial condition and results of operations. For further information see Note 6, Uncertainties, "Electric Contingencies — Electric Environmental Matters."

Gas Environmental Estimates: Under the Michigan Natural Resources and Environmental Protection Act, Consumers expects that it will incur investigation and remedial action costs at a number of sites. Consumers estimates the costs for 23 former manufactured gas plant sites will be between \$82 million and \$113 million, using the Gas Research Institute — Manufactured Gas Plant Probabilistic Cost Model. These estimates are based on discounted 2001 costs and follow EPA recommended use of discount rates between three and seven percent. Consumers expects to recover a significant portion of these costs through MPSC-approved rates charged to its customers. Any significant change in assumptions, such as remediation techniques, nature and extent of contamination, and legal and regulatory requirements, could change the remedial action costs for the sites. For further information see Note 6, Uncertainties, "Gas Contingencies — Gas Environmental Matters."

MCV Underrecoveries: 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. Consumers, through two wholly owned subsidiaries, holds a 49 percent partnership interest in the MCV Partnership, and a 35 percent lessor interest in the MCV Facility.

Consumers' annual obligation to purchase capacity from the MCV Partnership is 1,240 MW through 2025. The PPA requires Consumers to pay, based on the MCV Facility's availability, a levelized average capacity charge of 3.77 cents per kWh, a fixed energy charge, and a variable energy charge based primarily on Consumers' average cost of coal consumed for all kWh delivered. Consumers has not been allowed full recovery of the capacity charges in rates. After September 2007, the PPA's terms obligate Consumers to pay the MCV Partnership only those capacity and energy charges that the MPSC has authorized for recovery from electric customers.

In 1992, Consumers recognized a loss and established a PPA liability for the present value of the estimated future underrecoveries of power supply costs under the PPA based on MPSC cost recovery orders. Primarily as a result of the MCV Facility's actual availability being greater than management's original estimates, the PPA liability has been reduced at a faster rate than originally anticipated. At December 31, 2002, 2001 and 2000, the remaining after-tax present value of the estimated future PPA liability associated with the loss totaled \$34 million, \$50 million and \$64 million respectively. The PPA liability is expected to be depleted in late 2004.

In March 1999, Consumers and the MCV Partnership reached a settlement agreement effective January 1, 1999, that addressed, among other things, the ability of the MCV Partnership to count modifications increasing the capacity of the existing MCV Facility for purposes of computing the availability of contract capacity under the PPA for billing purposes. That settlement agreement capped availability payments that may be billed by the MCV Partnership at a 98.5 percent level.

When Consumers returns, as expected, to unfrozen rates beginning in 2004, Consumers will recover from customers, on-peak and off-peak capacity, so long as availability does not exceed an average 88.7 percent established in previous MPSC orders. For availability payments billed by the MCV Partnership after September 15, 2007, and not recovered from customers, Consumers would expect to claim a regulatory out under

the PPA. If the MCV Facility's generating availability remains at the maximum 98.5 percent level during the next five years, Consumers' after-tax cash underrecoveries associated with the PPA could be as follows:

| | <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> |
|---|-------------|-------------|-------------|-------------|-------------|
| | In Millions | | | | |
| Estimated cash underrecoveries at 98.5%, net of tax | \$37 | \$36 | \$36 | \$36 | \$25 |

It is currently estimated that 51 percent of the actual cash underrecoveries for the years 2003 and 2004 will be charged to the PPA liability, with the remaining portion charged to operating expense as a result of Consumers' 49 percent ownership in the MCV Partnership. All cash underrecoveries will be expensed directly to income once the PPA liability is depleted.

For further information see Note 6, Uncertainties, "Other Electric Uncertainties — The Midland Cogeneration Venture."

UTILITY REGULATION

Consumers accounts for the effects of regulation based on the regulated utility accounting standard SFAS No. 71. As a result, the actions of regulators affect when Consumers recognizes revenues, expenses, assets and liabilities.

In March 1999, Consumers 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, Consumers discontinued the application of SFAS No. 71 for the energy supply portion of its business because Consumers expected to implement retail open access at competitive market based rates for its electric customers. Discontinuation of SFAS No. 71 for the energy supply portion of Consumers' business resulted in Consumers reducing the carrying value of its Palisades plant-related assets, in 1999, by approximately \$535 million and establishing a regulatory asset for a corresponding amount. As of December 31, 2002, Consumers had a net investment in energy supply facilities of \$1.475 billion included in electric plant and property.

Since 1999, there has been a significant legislative and regulatory change in Michigan that has resulted in: 1) electric supply customers of utilities remaining on cost-based rates and 2) utilities being given the ability to recover Stranded Costs associated with electric restructuring, from customers who choose an alternative electric supplier. During 2002, Consumers 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 its business could meet the criteria if certain regulatory events occurred. In December 2002, Consumers received a MPSC Stranded Cost order that allowed Consumers to re-apply regulatory accounting standard SFAS No. 71 to the energy supply portion of its business. Re-application of SFAS No. 71 had no effect on the prior discontinuation accounting, but will allow Consumers to apply regulatory accounting treatment to the energy supply portion of its business on a prospective basis, including regulatory accounting treatment of costs required to be recognized in accordance with SFAS No. 143. See Note 6, Uncertainties, "Electric Rate Matters — Electric Restructuring."

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 (liabilities), which include both current and non-current amounts, are reflected in the Consolidated Balance Sheets. These costs are expected to be recovered through rates over periods

of up to 14 years. Consumers recognized an OPEB transition obligation in accordance with SFAS No. 106 and established a regulatory asset for this amount, which it expects to recover in rates over the next ten years.

| <u>December 31</u> | <u>2002</u> | <u>2001</u> |
|--|------------------------|------------------------|
| | In Millions | |
| Securitized costs | \$ 689 | \$ 717 |
| Postretirement benefits | 204 | 228 |
| Electric Restructuring Implementation Plan | 83 | 82 |
| Manufactured gas plant sites | 69 | 70 |
| Abandoned Midland project | 11 | 12 |
| Income taxes | — | 6 |
| Other | 16 | 15 |
| Total regulatory assets | <u>\$1,072</u> | <u>\$1,130</u> |
| Income taxes | \$ (297) | \$ (282) |
| GCR over recovery | (11) | (9) |
| Other | (5) | — |
| Total regulatory liabilities | <u>\$ (313)</u> | <u>\$ (291)</u> |

In October 2000, Consumers received an MPSC order authorizing Consumers to securitize certain regulatory assets up to \$469 million, net of tax, see Note 6, Uncertainties, "Electric Rate Matters — Electric Restructuring". Accordingly, in December 2000, Consumers established a regulatory asset for securitized costs of \$709 million, before tax, that had previously been recorded in other regulatory asset accounts. In order to prepare for the financing of the securitized assets and the subsequent retirement of debt with Securitization proceeds, issuance fees of \$1 million, \$10 million and \$1 million were incurred in 2002, 2001 and 2000, respectively, and capitalized as a part of Securitization costs. These issuance costs are amortized each month for up to fourteen years. Amortization of the Securitized assets approximated \$29 million and \$2 million in 2002 and 2001, respectively, for accumulated securitized cost amortization of \$31 million. The components of the unamortized securitized costs are illustrated below.

| <u>December 31</u> | <u>2002</u> | <u>2001</u> |
|--|---------------------|---------------------|
| | In Millions | |
| Unamortized nuclear costs | \$405 | \$405 |
| Postretirement benefits | 84 | 84 |
| Income taxes | 203 | 203 |
| Uranium enrichment facility | 16 | 16 |
| Accumulated Securitization-cost amortization | (31) | (2) |
| Other | 12 | 11 |
| Total unamortized securitized costs | <u>\$689</u> | <u>\$717</u> |

ACCOUNTING FOR DERIVATIVE AND FINANCIAL INSTRUMENTS AND MARKET RISK INFORMATION

Derivative Instruments: CMS Energy uses the criteria in SFAS No. 133, as amended and interpreted, to determine if certain contracts must be accounted for as derivative instruments. The rules for determining whether a contract meets the criteria for derivative accounting are numerous and complex. As a result, significant judgment is required to determine whether a contract requires derivative accounting, and similar contracts can sometimes be accounted for differently.

The types of contracts CMS Energy currently accounts for as derivative instruments include interest rate swaps, foreign currency exchange contracts, certain electric call options, fixed priced weather-based gas supply call options and fixed price gas supply put options. CMS Energy does not account for electric capacity and certain energy contracts, gas supply contracts, coal and nuclear fuel supply contracts, or purchase orders for numerous supply items as derivatives.

Consumers believes that certain of its electric capacity and energy contracts are not derivatives due to the lack of an active energy market in the state of Michigan, as defined by SFAS No. 133, and the transportation cost 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, Consumers 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.

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. Any difference between the recorded book value and the fair value is reported either in earnings or other comprehensive income, depending on certain qualifying criteria. The recorded fair value of the contract is then adjusted quarterly to reflect any change in the market value of the contract.

In order to value the contracts that are accounted for as derivative instruments, CMS Energy uses a combination of market quoted prices and mathematical models. Option models require various inputs, including forward prices, volatilities, interest rates and exercise periods. Changes in forward prices or volatilities could significantly change the calculated fair value of the call option contracts. The models used by CMS Energy have been tested against market quotes to ensure consistency between model outputs and market quotes. At December 31, 2002, CMS Energy assumed a market-based interest rate of 4.5 percent and a volatility rate of 70 percent in calculating the fair value of its electric call options.

In order 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.

Financial Instruments: CMS Energy accounts for its investments in debt and equity securities in accordance with SFAS No. 115. As such, debt and equity securities can be classified into one of three categories: held-to-maturity, trading, or available-for-sale securities. CMS Energy's 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 other comprehensive income and excluded from earnings unless such changes in fair value are other than temporary. Unrealized gains or losses resulting from changes in the fair value of Consumers' nuclear decommissioning investments are reported in accumulated depreciation. The fair value of these investments is determined from quoted market prices.

Market Risk Information: CMS Energy is exposed to market risks including, but not limited to, changes in interest rates, commodity prices, currency exchange rates, and equity security prices. CMS Energy's market risk, and activities designed to minimize this risk, are subject to the direction of an executive oversight committee consisting of designated members of senior management and a risk committee, consisting of certain business unit managers. The role of the risk committee is to review the corporate commodity position and ensure that net corporate exposures are within the economic risk tolerance levels established by CMS Energy's Board of Directors. Established policies and procedures are used to manage the risks associated with market fluctuations.

In accordance with SEC disclosure requirements, CMS Energy performs sensitivity analyses to assess the potential loss in fair value, cash flows and earnings based upon hypothetical 10 percent increases and decreases in market rates or prices. Management does not believe that sensitivity analyses alone provide an accurate or reliable method for monitoring and controlling risks. Therefore, CMS Energy and its subsidiaries, rely on the experience and judgment of senior management and traders to revise strategies and adjust positions as they deem necessary. Losses in excess of the amounts determined in the sensitivity analyses could occur if market rates or prices exceed the 10 percent shift used for the analyses.

Interest Rate Risk: CMS Energy is exposed to interest rate risk resulting from the issuance of fixed-rate and variable-rate financing, including interest rate risk associated with trust preferred securities, and from interest rate swap agreements. CMS Energy uses a combination of these instruments to manage and mitigate interest rate risk exposure when deemed appropriate, based upon market conditions. These strategies attempt to provide and maintain a balance between risk and the lowest cost of capital. At December 31, 2002, the carrying amounts of long-term debt and trust preferred securities were \$5.4 billion and \$927 million, respectively, with corresponding fair values of \$5.0 billion and \$729 million, respectively. Based on a sensitivity analysis at December 31, 2002, CMS Energy estimates that if market interest rates average 10 percent higher or lower, earnings before income taxes for the subsequent 12 months would decrease or increase, respectively, by approximately \$37 million. In addition, based on a 10 percent adverse shift in market interest rates, CMS Energy would have an exposure of approximately \$332 million to the fair value of its long-term debt and trust preferred securities if it had to refinance all of its long-term fixed-rate debt and trust preferred securities. CMS Energy does not intend to refinance any of its outstanding fixed-rate debt and trust preferred securities in the near term and believes that any adverse change in interest rates would not have a material effect on CMS Energy's consolidated financial position as of December 31, 2002.

At December 31, 2002, the fair value of CMS Energy's floating to fixed interest rate swaps with a notional amount of \$294 million was negative \$7 million, which represents the amount CMS Energy would pay to settle. The swaps mature at various times through 2006 and are designated as cash flow hedges for accounting purposes.

Commodity Price Risk: CMS Energy is exposed to market fluctuations in the price of natural gas, oil, electricity, coal, natural gas liquids and other commodities. CMS Energy employs established policies and procedures to manage these risks using various commodity derivatives, including futures contracts, options and swaps (which require a net cash payment for the difference between a fixed and variable price), for non-trading purposes. The prices of these energy commodities can fluctuate because of, among other things, changes in the supply of and demand for those commodities. To minimize adverse price changes, CMS Energy also hedges certain inventory and purchases and sales contracts. Based on a sensitivity analysis, CMS Energy estimates that if energy commodity prices change by an average 10 percent, pretax operating income for the subsequent twelve months would change by \$1.7 million. These hypothetical 10 percent shifts in quoted commodity prices would not have had a material impact on CMS Energy's consolidated financial position or cash flows as of December 31, 2002. The analysis does not quantify short-term exposure to hypothetically adverse price fluctuations in inventories or for commodity positions related to trading activities, or the commodity price risks of certain operating activities.

Consumers enters into electric call options, fixed price gas supply contracts containing embedded put options, fixed priced weather-based gas supply call options and fixed priced gas supply put options. The electric call options are used to protect against risk due to fluctuations in the market price of electricity and to ensure a reliable source of capacity to meet customers' electric needs. The gas supply contracts containing embedded put options, the weather-based gas supply call options, and the gas supply put options are used to purchase reasonably priced gas supply.

As of December 31, 2002, the fair value based on quoted future market prices of electricity-related call option contracts was \$9 million. At December 31, 2002, assuming a hypothetical 10 percent adverse change in market prices, the potential reduction in fair value associated with these contracts would be \$2 million. As of December 31, 2002, Consumers had an asset of \$37 million, related to premiums incurred for electric call option contracts. Consumers' maximum exposure associated with the call option contracts is limited to the premiums incurred. As of December 31, 2002, the fair value based on quoted future market prices of gas supply-related call and put option contracts was \$1 million. At December 31, 2002, a hypothetical 10 percent adverse change in market prices would be immaterial.

Currency Exchange Risk: CMS Energy is exposed to currency exchange risk arising from investments in foreign operations as well as various international projects in which CMS Energy has an equity interest and which have debt denominated in U.S. dollars. CMS Energy typically uses forward exchange contracts and other risk mitigating instruments to hedge currency exchange rates. The impact of the hedges on the investments in foreign operations is reflected in other comprehensive income as a component of foreign currency translation adjustment.

For the year ended December 31, 2002, there was no mark-to-market adjustment included in the total net foreign currency translation adjustment of \$225 million. Based on a sensitivity analysis at December 31, 2002, a 10 percent adverse shift in currency exchange rates would not have a material effect on CMS Energy's consolidated financial position or results of operations. At December 31, 2002, the estimated fair value of the foreign exchange hedges was immaterial.

Equity Security Price Risk: CMS Energy and certain of its subsidiaries have equity investments in companies in which they hold less than a 20 percent interest. As of December 31, 2002, a hypothetical 10 percent adverse shift in equity securities prices would not have a material effect on CMS Energy's consolidated financial position, results of operations or cash flows.

For a discussion of accounting policies related to derivative transactions, see Note 10, Risk Management Activities and Financial Instruments, incorporated by reference herein.

MARK-TO-MARKET ACCOUNTING

CMS MST's wholesale power and gas trading activities are accounted for under mark-to-market method of accounting consistent with guidance provided in EITF Issue No. 98-10. EITF Issue No. 98-10 has been rescinded by EITF Issue No. 02-03. The consensus rescinding EITF Issue No. 98-10 must be applied to all contracts that existed as of October 25, 2002 and must be recognized as a cumulative effect of a change in accounting principle in accordance with APB Opinion No. 20, Accounting Changes, effective the first day of the first interim or annual period beginning after December 15, 2002. The consensus also must be applied immediately to all new contracts entered into after October 25, 2002. See discussion on EITF Issue No. 02-03 under New Accounting Standards. Under mark-to-market accounting, 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. Market prices used to value outstanding energy trading contracts reflect management's 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 and volumetric obligations may not be defined. Mathematical models are developed to determine various inputs into the fair value calculation including price, anticipated volumetric obligations and other inputs that may be required to adequately address the determination of fair value of the contracts. Realized cash returns on these commitments may vary, either positively or negatively, from the results estimated through application of the mathematical model. CMS Energy believes that its mathematical models utilize 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 the company's position in an orderly manner over a reasonable period of time under present market conditions.

In connection with the market valuation of its energy commodity contracts, CMS Energy maintains reserves for credit risks based on the financial condition of counterparties. The creditworthiness of these counterparties will impact overall exposure to credit risk; however, CMS Energy maintains credit policies that management believes minimize overall credit risk with regard to its counterparties. Determination of its counterparties' credit quality is based upon a number of factors, including credit ratings, financial condition, and collateral requirements. When trading terms permit, CMS Energy employs standard agreements that allow for netting of positive and negative exposures associated with a single counterparty. Based on these policies, its current exposures and its credit reserves, CMS Energy does not anticipate a material adverse effect on its financial position or results of operations as a result of counterparty nonperformance.

The following tables provide a summary of the fair value of CMS Energy's energy commodity contracts as of December 31, 2002.

| | In Millions |
|---|--------------|
| Fair value of contracts outstanding as of January 1, 2002 | \$ 41 |
| Fair value of new contracts when entered into during the period | 22 |
| Changes in fair value attributable to changes in valuation techniques and assumptions (a) | (48) |
| Contracts realized or otherwise settled during the period (b) | 40 |
| Other changes in fair value (c) | <u>26</u> |
| Fair value of contracts outstanding as of December 31, 2002 (d) | <u>\$ 81</u> |

- (a) Reflects change in fair value based on market indicators confirmed by the anticipated sale of gas and power contracts.
- (b) Reflects current net liability position as of 12/31/01.
- (c) Reflects changes in price and net increase/(decrease) in position size of forward positions as well as changes to MTM and credit reserves.
- (d) Includes \$62 million of net assets and liabilities classified as "held for sale".

| Source of Fair Value | Total Fair Value | Fair Value of Contracts at December 31, 2002 | | | |
|--|---------------------|--|-------------|-------------|----------------|
| | | Less than 1 | 1 to 3 | 4 to 5 | Greater than 5 |
| In Millions | | | | | |
| Maturity (in years) | | | | | |
| Prices actively quoted | \$ 6 | \$ 6 | \$— | \$— | \$— |
| Prices provided by other external sources | 57 | 7 | 29 | 13 | 8 |
| Prices based on models and other valuation methods ... | <u>17</u> | <u>(15)</u> | <u>19</u> | <u>5</u> | <u>8</u> |
| Total | <u>\$80</u> | <u>\$ (2)</u> | <u>\$48</u> | <u>\$18</u> | <u>\$16</u> |

INTERNATIONAL OPERATIONS AND FOREIGN CURRENCY

CMS Energy, through its subsidiaries and affiliates, has acquired investments in energy-related projects in a number of world markets. As a result of a change in business strategy, CMS Energy has begun divesting its non-strategic or under-performing foreign investments.

Balance Sheet: CMS Energy's subsidiaries and affiliates whose functional currency is other than 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. The revenue and expense accounts of such subsidiaries and affiliates are translated into U.S. dollars at the average exchange rate 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 CMS Energy does not intend to settle in the foreseeable future, are reflected as a component of stockholders' equity in the consolidated balance sheets as "Foreign Currency Translation" in accordance with the accounting guidance provided in SFAS No. 52. In 2002, the cumulative Foreign Currency Translation decreased stockholders' equity by \$225 million.

Income Statement: For subsidiaries operating in highly inflationary economies or that meet the U.S. functional currency criteria outlined in SFAS No. 52, the U.S. dollar is deemed to be the functional currency. Gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the U.S. dollar, except those that are hedged, are included in determining net income.

Argentina: 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 Argentina 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.

In February 2002, the Republic of Argentina enacted additional measures that required all monetary obligations (including current debt and future contract payment obligations) denominated in foreign currencies to be converted into pesos. These February measures also authorize the Argentine judiciary essentially to rewrite private contracts denominated in dollars or other foreign currencies if the parties cannot agree on how to share equitably the impact of the conversion of their contract payment obligations into pesos. In April 2002, based on a consideration of these environmental factors, CMS Energy evaluated its Argentine investments for impairment as required under SFAS No. 144 and APB Opinion No. 18. These impairment models contain certain assumptions regarding anticipated future exchange rates and operating performance of the investments. Exchange rates used in the models assume that the rate will decrease from current levels to approximately 3.00 pesos per U.S. dollar over the remaining life of these investments. Based on the results of these models, CMS Energy determined that these investments were not impaired.

Effective April 30, 2002, CMS Energy adopted the Argentine peso as the functional currency for most of its Argentine investments. CMS had previously used the U.S. dollar as the functional currency for its Argentine investments. As a result, on April 30, 2002, CMS Energy translated the assets and liabilities of its 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.

For the year ended December 31, 2002, CMS Energy recorded losses of \$31 million reflecting the negative impact of the actions of the Argentine government. These losses represent changes in the value of peso-denominated monetary assets (such as receivables) and liabilities of Argentina-based subsidiaries and lower net project earnings resulting from the conversion to pesos of utility tariffs and energy contract obligations that were previously calculated in dollars.

While CMS Energy's management cannot predict the most likely future, or average peso to U.S. dollar exchange rates, it does expect that these non-cash charges substantially reduce 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, 2002, the net foreign currency loss due to the unfavorable exchange rate of the Argentine peso recorded in the Foreign Currency Translation component of Common Stockholder's Equity using an exchange rate of 3.3647 pesos per U.S. dollar was \$266 million. This amount also reflected the effect of recording, at December 31, 2002, U.S. income taxes with respect to temporary differences between the book and tax bases of foreign investments, including the foreign currency translation associated with CMS Energy's Argentine investments, that were determined to be no longer essentially permanent in duration (see Note 11).

Australia: In 2000, an impairment loss of \$329 million (\$268 million after-tax) was realized on the carrying amount of the investment in Loy Yang. This loss did not include \$168 million cumulative net foreign currency translation losses due to unfavorable changes in the exchange rates, which, in accordance with SFAS No. 52, will not be realized until there has been a sale, full liquidation, or other disposition of CMS Energy's investment in Loy Yang, all of which are currently being pursued. In connection with the restatement of CMS Energy's December 31, 2000 consolidated financial statements, a deferred U.S. income tax asset of \$48 million was recorded with respect to the cumulative net foreign currency translation losses associated with CMS Energy's Loy Yang investment. At December 31, 2002, the net foreign currency loss due to the unfavorable exchange rate of the Australian dollar recorded in the Foreign Currency Translation component of Common Stockholders' Equity using an exchange rate of 1.7817 Australian dollars per U.S. dollar was \$120 million.

Hedging Strategy: CMS Energy uses forward exchange and option contracts to hedge certain receivables, payables, long-term debt and equity value relating to foreign investments. The purpose of CMS Energy's foreign currency hedging activities is to protect the company from risk that U.S. dollar net cash flows resulting from sales to foreign customers and purchases from foreign suppliers and the repayment of non-U.S. dollar borrowings, as well as the equity reported on the company's balance sheet, may be adversely affected by changes in exchange rates. These contracts do not subject CMS Energy to risk from exchange rate movements because gains and losses on such contracts are inversely correlated with the losses and gains, respectively, on the assets and liabilities being hedged. Foreign currency adjustments for other CMS Energy international investments were immaterial.

ACCOUNTING FOR PENSION AND OPEB

CMS Energy provides postretirement benefits under its Pension Plan, and postretirement health and life insurance benefits under its OPEB plans to substantially all its retired employees. CMS Energy uses SFAS No. 87 to account for pension costs and uses SFAS No. 106 to account for other postretirement benefit costs. These statements require liabilities to be recorded on the balance sheet at the present value of these future obligations to employees net of any plan assets. The calculation of these liabilities and associated expenses require the expertise of actuaries and are subject to many assumptions including life expectancies, present value discount rates, expected long-term rate of return on plan assets, rate of compensation increase and anticipated health care costs. Any change in these assumptions can significantly change the liability and associated expenses recognized in any given year. The Pension Plan includes amounts for employees of Panhandle, which were not distinguishable from the Pension Plan's total assets. On December 21, 2002, a definitive agreement was executed to sell Panhandle. The sale is expected to close in 2003. No portion of the Pension Plan will be transferred with the sale of Panhandle. At the closing of the sale, all employees of Panhandle will no longer be eligible to accrue additional benefits. The Pension Plan will retain pension payment obligations for Panhandle employees that are vested under the Pension Plan. CMS Energy does not expect the curtailment from both the Pension Plan and OPEB plans to be material.

Pension and OPEB plan assets, net of contributions, have reduced in value from the previous year due to the downturn in the equities market, and a decrease in the price of CMS Energy Common Stock. As a result, CMS Energy expects to see an increase in pension and OPEB expense levels over the next several years unless market performance of plan assets improves. CMS Energy anticipates its pension expense to rise in 2003 by approximately \$13 million over 2002 expenses. OPEB expenses in 2003 are anticipated to stay the same as 2002 expenses. For pension expense, this increase is due to a downturn in value of pension assets during the past two years, forecasted increases in pay and added service, and a decline in the interest rate used to value the liability of the plan. Estimated 2003 OPEB expenses are expected to remain the same as 2002 due to additional required contributions from retirees and increases in mail-order prescription copays. Under the OPEB plans' assumptions, health care costs increase at a slower rate from current levels through 2010; however, CMS Energy cannot predict the impact that future health care costs and interest rates or market returns will have on pension and OPEB expense in the future. As of January 2002, OPEB plan claims are paid from the VEBA Trusts.

The recent significant downturn in the equities markets has affected the value of the Pension Plan assets. The Pension Plan's Accumulated Benefit Obligation exceeded the value of these assets at December 31, 2002, and as a result, CMS Energy was required to recognize an additional minimum liability for this excess in accordance with SFAS No. 87. The fair value of the Pension Plan assets at December 31, 2002 was \$607 million, including CMS Energy Common Stock which had a market value of \$49 million based on a market price of \$9.44. As of March 14, 2003, the market value of CMS Energy Common Stock in the Pension Plan was \$18 million based on a share price of \$3.52. As of December 31, 2002, the Accumulated Benefit Obligation was estimated at \$1.055 billion and the additional minimum liability was \$426 million, of which \$53 million was recorded as an intangible asset, and \$373 million was charged to other comprehensive income (\$241 million after-tax).

At December 31, 2002, the balance of the OPEB plans' assets was \$509 million. This amount consists primarily of stocks and bonds, including CMS Energy Common Stock of \$1.3 million, based on a share price of \$9.44. As of March 14, 2003, the market value of CMS Energy Common Stock in the OPEB plans' assets was \$0.5 million, based on a share price of \$3.52.

During 2002, CMS Energy made contributions to the plans' trust accounts of \$147 million. This amount represents \$64 million of pension related benefits and \$83 million of postretirement health care and life insurance benefits. CMS Energy expects similar contributions for postretirement health care and life insurance benefits will be made in 2003, 2004, and 2005. The investment performance returns and declining discount rates have worsened the underfunded status of the Pension Plan, net of benefit obligations, from \$350 million at December 31, 2001 to \$650 million at December 31, 2002. Because of the recent rise in the underfunded status of the Pension Plan, based on actuarial assumptions, CMS Energy expects to make cash contributions to the Pension Plan which approximate \$210 million, \$292 million, and \$29 million in 2003, 2004, and 2005, respectively. However, if necessary to increase liquidity, CMS Energy would postpone the 2003 contribution.

CMS Energy's expense for the pension plan approximated \$33 million and \$23 million for the years ended December 31, 2002 and December 31, 2001, respectively, and is calculated based upon a number of actuarial assumptions, including an expected long-term rate of return on the Plan assets of 8.75 percent in 2002 and 9.75 percent in 2001.

Lowering the expected long-term rate of return on the Plan assets by 0.25 percent (from 8.75 percent to 8.5 percent) would have increased pension expense for fiscal 2002 by approximately \$3 million. Lowering the discount rate by 0.25 percent would have increased pension expense for fiscal 2002 by approximately \$2 million.

CMS Energy estimates pension expense will approximate \$46 million, \$51 million and \$58 million in 2003, 2004 and 2005, respectively. Future actual pension expense will depend on future investment performance, changes in future discount rates and various other factors related to the populations participating in the pension plan.

CMS Energy bases the determination of pension expense on a market-related valuation of assets which reduces year-to-year volatility. This market-related valuation recognizes investment gains or losses over a 5-year period from the year in which they occur. Investment gains or losses for this purpose are the difference between the expected return calculated using the market-related value of assets and the actual return based on the market-related value of assets. Since the market-related value of assets recognizes gains or losses over a 5-year period, the future value of assets will be impacted as previously deferred gains or losses are recorded.

Due to the unfavorable performance of the equity markets, as of December 31, 2002, CMS Energy had cumulative losses of approximately \$205 million which remain to be recognized in the calculation of the market-related value of assets. These unrecognized net actuarial losses result in increases in future pension expense depending on several factors, including whether such losses at each measurement date exceed the corridor in accordance with SFAS No. 87.

CMS Energy has announced changes to the Pension Plan. Employees hired on or after July 1, 2003 will be covered by the cash balance plan section of the plan currently being used. Under the cash balance plan, an employee's retirement account is credited annually with a percentage of their salary and any amounts that are vested are portable when an employee leaves the company. In addition, the method used to convert an employee's benefit to a lump sum payment is being changed. Employees who elect the lump sum payment option will no longer receive an early retirement subsidy. As a result, employees who choose the lump sum payment option, and retire before age 65, will receive lower lump sum payments.

CMS Energy also provides retirement benefits under a defined contribution 401(k) plan. CMS Energy previously offered an employer's contribution match of 50 percent of the employee's contribution up to six percent (three percent maximum), as well as an incentive match in years when CMS Energy's financial performance exceeded targeted levels. Amount charged to expense for the employer's match for 2002 was \$12 million, \$26 million in 2001, and \$24 million in 2000. Effective September 1, 2002, the employer's match was suspended until January 1, 2005, and the incentive match was permanently eliminated.

In order to keep health care benefits and costs competitive, CMS Energy has announced several changes to the Health Care Plan. These changes are effective January 1, 2003. The most significant change is that CMS Energy's future increases in health care costs will be shared with salaried employees. The salaried retirees health care plan has also been amended. Pre-Medicare retirees now elect coverage from four different levels of coverage, with the two best coverage options requiring premium contributions. These plans also coordinate benefits under a maintenance of benefits provision to reduce claims cost for CMS Energy. Mail-order prescription copays have also been increased for all salaried retirees.

RESULTS OF OPERATIONS

CMS ENERGY CONSOLIDATED EARNINGS (LOSS)

CMS Energy Consolidated earnings reflect the continued implementation of the financial improvement plan and on-going asset sales program first announced in 2001. The financial improvement plan focuses on strengthening CMS Energy's balance sheet and improving financial liquidity through debt reduction and

aggressive cost management. The on-going asset sales program's objective is to reduce business risk and to provide for more predictable on-going earnings. This encompasses the sale of non-strategic and under-performing assets, the proceeds of which are being used to reduce debt. In 2002, CMS Energy has recorded charges to earnings in connection with the execution of its "back-to-basics" strategy.

| <u>Years Ended December 31</u> | <u>2002</u> | <u>Restated 2001</u> | <u>Restated 2000</u> |
|--|-------------|--------------------------|--------------------------|
| | In Millions | | |
| CMS Energy Consolidated Net Income (Loss) | \$ (620) | \$ (448) | \$ 43 |
| CMS Energy Basic Earnings (Loss) Per Share | \$(4.46) | \$(3.43) | \$0.38 |
| CMS Energy Diluted Earnings (Loss) Per Share | \$(4.46) | \$(3.43) | \$0.38 |

CMS Energy Consolidated Net Income (Loss)

| <u>Years Ended December 31</u> | <u>2002</u> | <u>Restated 2001</u> | <u>Change</u> | <u>Restated 2001</u> | <u>Restated 2000</u> | <u>Change</u> |
|---------------------------------------|----------------|--------------------------|----------------|--------------------------|--------------------------|----------------|
| | In Millions | | | | | |
| | <u>\$(620)</u> | <u>\$(448)</u> | <u>\$(172)</u> | <u>\$(448)</u> | <u>\$ 43</u> | <u>\$(491)</u> |
| Electric Utility | \$ 264 | \$ 109 | \$ 155 | \$ 109 | \$173 | \$ (64) |
| Gas Utility | 46 | 21 | 25 | 21 | 18 | 3 |
| Independent Power Production | (336) | (63) | (273) | (63) | (92) | 29 |
| Natural Gas Transmission | (30) | (53) | 23 | (53) | 11 | (64) |
| Marketing, Services and Trading | (42) | (6) | (36) | (6) | 13 | (19) |
| Corporate Interest and Other | (300) | (246) | (54) | (246) | (163) | (83) |
| Discontinued Operations | (222) | (210) | (12) | (210) | 83 | (293) |
| Net Income | <u>\$(620)</u> | <u>\$(448)</u> | <u>\$(172)</u> | <u>\$(448)</u> | <u>\$ 43</u> | <u>\$(491)</u> |

During 2002, CMS Energy recorded \$388 million of after-tax charges in recognition of planned and completed divestitures and reduced asset valuations. These included a \$299 million after-tax impairment loss on the carrying value of DIG and \$89 million of after-tax charges related to other investments and development projects in recognition of the reduced net recoverable value or sale of these investments. The \$388 million after-tax charge is comprised of: \$367 million for independent power production; \$11 million for marketing, services and trading; and \$10 million for Enterprises and other businesses.

2002 also reflects a \$222 million after-tax loss related to the discontinuation of several businesses. These include Panhandle, the sale of which is pending regulatory approval and is currently expected to close in 2003, CMS Oil and Gas, which sale was completed in September 2002, and CMS Field Services and CMS Viron; which sales are expected to close in 2003. Included in the discontinued operations are after-tax goodwill impairments at Panhandle (\$369 million) and CMS Viron (\$10 million). 2002 also reflects \$37 million of after-tax gains on asset sales and \$21 million of after-tax restructuring charges.

CMS Energy's 2001 results reflect \$408 million of after-tax charges in recognition of completed and planned divestitures and reduced asset valuations. These charges include a \$210 million after-tax charge related to the discontinuation of certain CMS Energy businesses and a \$198 million after-tax charge related to energy development projects and international investments in recognition of the reduced net recoverable value of these investments. Results of operations also includes a \$2 million after-tax charge related to the cumulative effect of a change in accounting for derivatives.

In 2000, an impairment loss was recorded on the carrying amount of the equity investment in Loy Yang of \$268 million after-tax. This loss does not include \$168 million cumulative net foreign currency translation losses due to unfavorable changes in exchange rates, which, in accordance with SFAS No. 52 will not be realized until there has been a sale, full liquidation or other disposition of CMS Energy's investment in Loy Yang, all of which are currently being pursued but may not occur in 2003. In connection with the restatement of CMS Energy's December 31, 2000 consolidated financial statements, a deferred U.S. income tax asset of \$48 million was recorded with respect to the cumulative net foreign currency translation losses associated with CMS Energy's Loy Yang investment (see Note 11, Income Taxes).

CONSUMERS' ELECTRIC UTILITY RESULTS OF OPERATIONS

| <u>Years Ended December 31</u> | <u>2002</u> | <u>2001</u> | <u>Change</u> | <u>2001</u> | <u>2000</u> | <u>Change</u> |
|--|--------------|--------------|---------------|--------------|--------------|---------------|
| | | | In Millions | | | |
| Net income available to common stockholder | <u>\$264</u> | <u>\$109</u> | <u>\$155</u> | <u>\$109</u> | <u>\$199</u> | <u>\$(90)</u> |
| Reasons for the change: | | | | | | |
| Electric deliveries | | | \$ 41 | | | \$ 19 |
| Power supply costs and related revenue | | | 120 | | | (109) |
| Rate decrease | | | — | | | (35) |
| Other operating expenses and non-commodity revenue | | | 5 | | | 17 |
| Implementation of accounting standard (SFAS 133) | | | 17 | | | (17) |
| Gain on asset sales | | | 38 | | | — |
| Fixed charges | | | 9 | | | (6) |
| Income taxes | | | (75) | | | 41 |
| Total change | | | <u>\$155</u> | | | <u>\$(90)</u> |

Electric Deliveries: For the year 2002, electric delivery revenues increased by \$41 million from the previous year. Electric deliveries, including transactions with other wholesale market participants and other electric utilities, were 39.3 billion kWh, a decrease of 0.3 billion kWh or 0.7 percent from 2001. This reduction in electric deliveries is primarily due to reduced transactions with other utilities and the expiration of wholesale power sales contracts with certain Michigan municipal utilities. Although total deliveries were below the 2001 level, increased deliveries to the higher margin residential and commercial sectors, along with the growth in retail deliveries, more than offset the impact of reduced deliveries to lower margin customers. For the year, Consumers set an all-time monthly sendout record during the month of July, and new monthly hourly peak demand records were set on April 16, 2002, June 25, 2002, September 9, 2002, and October 1, 2002. For the year 2001, electric delivery revenues increased by \$19 million from the previous year. Electric deliveries, including transactions with other wholesale market participants and other electric utilities, were 39.6 billion kWh, a decrease of 1.4 billion kWh or 3.5 percent from 2000.

Power Supply Costs and Related Revenue: For the year 2002, power supply costs and related revenues provided a net increase of \$120 million from 2001. This net increase was primarily due to reduced purchased power costs resulting from the Palisades plant being returned to service in 2002. In 2001, Consumers purchased higher cost replacement power during the refueling outage that began in March and ended in May and the unscheduled forced outage at Palisades that began in June and ended in January 2002. Also contributing to this decrease in power costs is lower priced power options and dispatchable capacity contracts that were purchased for 2002. For the year 2001, power supply costs and related revenues resulted in a net decrease of \$109 million from 2000. This net decrease was primarily due to the need to purchase greater quantities of higher-priced electricity to offset the loss of generation resulting from the Palisades outages mentioned above.

For the years 2002 and 2001 respectively, Consumers purchased and expensed \$23 million and \$65 million of electric call options to ensure a reliable source of power supply during the summer months. As a result of periodic excess daily capacity, certain call options were sold and the remaining call options were either exercised or expired. Consumers accounted for the costs relating to the expired call options and the income received from the sale of call options, as purchased power supply costs.

Other Operating Expenses and Non-Commodity Revenue: For the year 2002, non-commodity revenues increased primarily resulting from increased miscellaneous service revenues. Partially offsetting this increase in revenues, are increased other operating expenses compared to 2001. This increase can be attributed to higher depreciation expense resulting from higher plant in service along with increased operating costs resulting from higher health care expenses, storm restoration expenses, and increased contracted maintenance expenses. For the year 2001, other operating expenses and non-commodity revenues provided a net benefit when compared to 2000. This benefit is primarily due to reduced amortization expense, as permitted by MPSC orders resulting from the Customer Choice Act. Consumers temporarily suspended amortization of the securitized assets pending the issuance of Securitization bonds in November 2001.

Implementation of Accounting Standard (SFAS No. 133): In 2001, Consumers implemented SFAS No. 133 which provides for derivative and hedge accounting for certain utility industry contracts, particularly electric call option contracts and option-like contracts. After receiving guidance from the FASB, Consumers re-evaluated its electric call option and option-like contracts and determined that these contracts require derivative accounting, and therefore recorded a \$17 million pre-tax cumulative effect adjustment as a decrease to earnings. This adjustment relates to the difference between the fair value and the recorded book value of these electric call option contracts.

Gain on Asset Sales: For the year 2002, asset sales resulted in a \$31 million pretax gain associated with the sale of Consumers' electric transmission system and a \$7 million pretax gain on the sale of nuclear equipment from the cancelled Midland project.

Income Taxes: For the year 2002, income tax expense increased primarily due to an increase in earnings by the electric utility. Income taxes associated with the transmission system sale reflect a \$5 million benefit due to the recognition of the remaining unutilized investment tax credit related to the assets sold.

CONSUMERS' GAS UTILITY RESULTS OF OPERATIONS

| <u>Years Ended December 31</u> | <u>2002</u> | <u>2001</u> | <u>Change</u> | <u>2001</u> | <u>2000</u> | <u>Change</u> |
|--|-------------|-------------|--------------------|-------------|-------------|---------------|
| | | | <u>In Millions</u> | | | |
| Net income available to common stockholder | <u>\$46</u> | <u>\$21</u> | <u>\$ 25</u> | <u>\$21</u> | <u>\$18</u> | <u>\$ 3</u> |
| Gas deliveries | | | 21 | | | (21) |
| Gas commodity and related revenue | | | — | | | 44 |
| Gas rate increase | | | 25 | | | — |
| Gas wholesales and retail services | | | 1 | | | 8 |
| Operation and maintenance | | | (14) | | | (30) |
| General taxes and depreciation | | | (3) | | | — |
| Fixed charges | | | 3 | | | 1 |
| Income taxes | | | (8) | | | 1 |
| Total change | | | <u>\$ 25</u> | | | <u>\$ 3</u> |

Gas Deliveries: For the year 2002, gas delivery revenues increased by \$21 million from the previous year. System deliveries, including miscellaneous transportation, totaled 376.4 bcf, an increase of 9.4 bcf or 2.6 percent compared with 2001. This increase is primarily due to colder weather that resulted in increased deliveries to the residential and commercial sectors in 2002. For the year 2001, gas delivery revenues decreased by \$21 million from the previous year. System deliveries, including miscellaneous transportation, totaled 367 bcf, a decrease of 43 bcf or 10 percent compared with 2000. This decrease is primarily due to warmer temperatures compared to the 2000 heating season and a reduction due to the economic slowdown in 2001.

Gas Rate Increase: In 2001, the MPSC issued an interim order in Consumers' gas rate filing. In November 2002, the MPSC issued a final gas rate order authorizing a \$56 million annual increase in Consumers gas tariff rates. As a result of these orders, Consumers recognized increased gas revenues of \$25 million.

Operation and Maintenance: For the year 2002, operation and maintenance expenses increased \$14 million compared to 2001. This increase reflects the recognition of gas storage inventory losses, and additional expenditures on customer reliability and service.

Income Taxes: For the year 2002, income tax expense increased, primarily due to improved earnings of the gas utility.

INDEPENDENT POWER PRODUCTION RESULTS OF OPERATIONS

Net Income: For the year ended December 31, 2002, independent power production's reported net loss was \$336 million, a degradation of \$273 million from its restated reported net loss in 2001. The variation reflects the effects of the investment write-downs, net of an improved operating performance at DIG due to lower steam

generation costs compared to 2001, when DIG was experiencing construction delays. Other operation performance improvements were offset by expropriation and devaluation losses related to the Argentine facilities.

For the year ended December 31, 2001, independent power production's restated reported net loss was \$63 million, an improvement of \$29 million from restated reported net loss in 2000. This change reflects the sale of power plants in 2000, construction delays at the DIG plant that led to increased costs for steam generation, and a gain recorded in 2000 on the restructuring of a power supply contract. These changes were partially offset by the earnings benefits from the expansion of the Jorf Lasfar facility coupled with the facility's improved operating performance, the operation of additional units at a new African facility and the absence of operating losses in 2001 from the investment in Loy Yang, which was written off in the fourth quarter of 2000.

NATURAL GAS TRANSMISSION RESULTS OF OPERATIONS

In December 2002, CMS Energy reached a definitive agreement to sell the Panhandle companies to Southern Union Panhandle Corp. The agreement calls for Southern Union Panhandle Corp, a newly formed entity owned by Southern Union Company and AIG Highstar Capital, L.P. to pay \$662 million in cash and assume \$1.166 billion in debt. Under the terms of the agreement, CMS Energy was to retain Panhandle's ownership interests in the Centennial and Guardian pipeline projects, as well as certain of Panhandle's net deferred tax assets, all tax liabilities, and pension assets and liabilities. Panhandle has since sold its interest in Centennial and the Guardian interest and related cash collateral has been transferred to Panhandle's direct parent, CMS Gas Transmission. The transaction has been approved by the board of directors of each company and is subject to customary closing conditions and action by the FTC under the Hart-Scott-Rodino Act. The sale is expected to close in 2003. Panhandle's results have been reclassified to discontinued operations in the consolidated statements of income. For more information, see Note 4, Discontinued Operations.

Net Income: For the year ended December 31, 2002, the natural gas transmission segment's reported net loss was \$30 million, an improvement of \$23 million from the restated reported net loss in 2001. This increase was due primarily to project write-downs recorded in 2001 partly offset by additional Argentine expropriation and devaluation losses in 2002.

For the year ended December 31, 2001, the segment's restated reported net loss was \$53 million, a degradation of \$64 million from the restated reported net loss in 2000.

MARKETING, SERVICES AND TRADING RESULTS OF OPERATIONS

During the second quarter of 2002, CMS MST announced its intention to sell its ownership interest in CMS Viron, resulting in a reclassification of CMS Viron's assets and liabilities to be classified as held for sale and its results of operations to discontinued operations in the consolidated statements of income. For more information, see Note 4, Discontinued Operations. CMS Energy closed on the sale of a majority of CMS MST's wholesale natural gas contracts and inventory to Sempra Energy Trading in January 2003 and signed a definitive agreement in February 2003 to sell its wholesale power trading portfolio to a unit of Constellation Energy Group, Inc. These actions resulted in classifying \$77 million of net price risk management assets and liabilities and natural gas inventory expected to be sold into Assets and Liabilities Held For Sale in the consolidated balance sheets. In addition, CMS MST sold its 50 percent joint venture ownership in Enline in September 2002, reached agreement to sell its 50 percent interest in Premstar in early 2003, and sold its Tulsa retail trading contracts in January 2003 and is in the process of negotiating an agreement to sell its 50 percent interest in Texon.

Net Income: For the year ended December 31, 2002, CMS MST's reported net loss was \$42 million excluding a loss from discontinued operations of \$21 million, a decrease of \$36 million from its restated reported net loss in 2001. Credit constraints severely reduced the overall liquidity of the energy trading markets, limiting CMS MST's ability to actively manage and optimize its open positions and to execute new transactions. Contributing to the net loss was the recognition of a \$31 million (net of tax) reduction in fair value of the wholesale natural gas and power portfolios based on valuation reductions resulting from fair value evidence derived from the negotiated sales prices for its wholesale natural gas and power contracts. Restructuring costs related to the reorganization of the business unit of \$11 million and impairment of investment of \$11 million.

For the year ended December 31, 2001, CMS MST's restated reported net loss was \$6 million, including a cumulative effort of a change in accounting for derivative instruments of \$9 million and excluding income from discontinued operations of \$1 million a decrease of \$19 million from restated reported net income in 2000. This decrease was primarily a result of the change in fair value of financial derivatives entered into as economic hedges for the retail sales contracts that are accounted for on an accrual basis. Partially offsetting these losses was an increase in the value of the wholesale power portfolio due to power contracts executed during 2001, and \$9 million increase to net income representing the cumulative effect of a change in accounting resulting from the implementation of SFAS No. 133.

Sales Volumes: For the year ended December 31, 2002, power sales volumes were 63,128 GWh, an increase of 31,929 GWh over 2001, for which volumes have been restated to exclude the effect of any round-trip trades. The increase in power volumes reflect the addition of long-term power contracts that were executed during the latter part of 2001 and early 2002. Natural gas sales volumes were 550 bcf, a decrease of 200 bcf from 2001, for which volumes have been restated to exclude the effect of any round-trip trades.

For the year ended December 31, 2001, power sales volumes were 31,199 GWh, an increase of 23,044 GWh over 2000, for which volumes have been restated to exclude the effect of any round-trip trades. Natural gas sales volumes were 750 bcf, an increase of 144 bcf over 2000, for which volumes have been restated to exclude the effect of any round-trip trades.

OIL AND GAS EXPLORATION AND PRODUCTION RESULTS OF OPERATIONS

In January 2002, CMS Energy completed the sale of its ownership interests in Equatorial Guinea to Marathon Oil Company for approximately \$993 million. Included in the sale were all of CMS Oil and Gas' oil and gas reserves in Equatorial Guinea and CMS Gas Transmission's ownership interest in the related methanol plant. The gain on the CMS Oil and Gas Equatorial Guinea properties of \$497 million (\$310 million, net of tax) is included in discontinued operations.

In September 2002, CMS Energy closed on the sale of the stock of CMS Oil and Gas and the stock of a subsidiary of CMS Oil and Gas that holds property in Venezuela. In October 2002, CMS Energy closed on the sale of CMS Oil and Gas's properties in Colombia. As a result of these closings, CMS Energy has completed its exit from the oil and gas exploration and production business. The proceeds from the combined sales total approximately \$210 million and have been used to retire the remaining balance on a \$150 million Enterprises term loan due in December 2002 and a portion of a \$295.8 million CMS Energy loan which had at that time a due date of the March 31, 2003. The combined sales resulted in an after-tax loss of approximately \$82 million. For more information, see Note 4, Discontinued Operations, incorporated by reference herein.

INTERNATIONAL ENERGY DISTRIBUTION RESULTS OF OPERATIONS

In the third quarter of 2001, CMS Energy discontinued the operations of the international energy distribution segment of its business. For more information, see Note 4, Discontinued Operations, incorporated by reference herein.

OTHER RESULTS OF OPERATIONS

Tax Loss Allocations: The Job Creation and Worker Assistance Act of 2002 provided to corporate taxpayers a 5-year carryback of tax losses incurred in 2001 and 2002. As a result of this legislation, CMS Energy was able to carry back consolidated 2001 and 2002 tax losses to tax years 1996 through 1999 to obtain refunds of prior years tax payments totaling \$250 million. The tax loss carryback, however, resulted in a reduction of AMT credit carryforwards that previously had been recorded by CMS Energy as deferred tax assets in the amount of \$47 million. This non-cash reduction in AMT credit carryforwards has been reflected in the tax provision of CMS Energy.

Other: Corporate and other net expenses were \$300 million in 2002, an increase of \$54 million from \$246 million in 2001. In 2002, tax credit write-offs, which are all recorded at CMS Energy, the Parent, amounted to \$58 million. Interest expense after tax amounted to \$187 million in 2002 as compared to \$197 million in 2001.

Corporate and other net expenses include \$56 million related to investment write-downs, and restructuring and other costs of \$24 million in 2002. These expenses were partly offset by the consolidating eliminations of intercompany losses and gains recorded by CMS MST that result from mark-to-market transactions with affiliates. These eliminations increased net income by \$46 million in 2002 and decreased net income by \$30 million in 2001.

Corporate and other net expenses were \$246 million in 2001, an increase of \$80 million from \$166 million in 2000. Interest expense after taxes amounted to \$197 million in 2001 as compared to \$173 million in 2000. These expenses also include the consolidating eliminations of intercompany losses and gains recorded by CMS MST that result from mark-to-market transactions with affiliates. These eliminations decreased net income by \$30 million in 2001 and increased net income by \$18 million in 2000.

Discontinued Operations include, in addition to Panhandle, CMS Viron, CMS Oil and Gas, and International Energy Distribution discussed above, a \$31 million after-tax loss as a result of abandoning the Zirconium Recovery Project. For more information, see Note 4, Discontinued Operations.

RESTRUCTURING AND OTHER COSTS

CMS Energy announced in 2002 a series of new initiatives intended to sharpen its business focus and help restore its financial health by reducing operating costs. The initiatives announced included the following:

- Relocating CMS Energy's corporate headquarters from Dearborn, Michigan to a new headquarters building then under construction in Jackson, Michigan. The Jackson headquarters building opened in March 2003 and will house an estimated 1,450 CMS Energy and Consumers Energy employees. In the longer term, the relocation will reduce corporate operating expenses.
- Implementing changes to CMS Energy's 401(K) savings program which will provide savings for CMS Energy and enhanced investment options for employee participants.
- Implementing changes to CMS Energy's health care plan in order to keep benefits and costs competitive.
- Terminating five officers, 18 CMS Field Services employees and 41 CMS MST trading group employees. Prior to December 31, 2002, 31 Dearborn-based employees and 92 Houston employees have elected severance arrangements. Of these 187 officers and employees, 65 had been terminated as of December 31, 2002. The remaining terminations will be completed in 2003.

Restructuring costs for the year ended December 31, 2002, which are reported in operating expenses, include:

- Involuntary termination benefits of \$22 million for officers and employees.
- The present value of future non-cancelable lease obligations of \$11 million related to relocating the corporate headquarters to Jackson, Michigan.

In addition, in the first half of 2003, restructuring costs related to relocating employees and other headquarters expenses are expected to be \$2 million. The relocation will occur between March and June 2003, and such costs will be expensed as incurred.

The following table shows the amount charged to expense during 2002 for restructuring costs, the payments made, and the unpaid balance of accrued costs at December 31, 2002, which is expected to be paid in 2003.

| | Year Ended | | Unpaid Balance |
|----------------------------------|-------------------|-------------|-------------------|
| | December 31, 2002 | | |
| | Expense | Payments | December 31, 2002 |
| In Millions | | | |
| Involuntary termination | \$22 | \$10 | \$12 |
| Non-cancelable lease obligations | 11 | 3 | 8 |
| Total | <u>\$33</u> | <u>\$13</u> | <u>\$20</u> |

CAPITAL RESOURCES AND LIQUIDITY

CMS Energy's liquidity and capital requirements generally are a function of its results of operations, capital expenditures, contractual obligations, working capital needs and collateral requirements. CMS Energy historically has met its consolidated cash needs through its operating and investing activities and, as needed, through access to bank financing and the capital markets.

CASH POSITION, INVESTING AND FINANCING

CMS Energy's primary ongoing source of cash is dividends and other distributions from subsidiaries, including proceeds from asset sales. In 2002, Consumers paid \$333 million in common dividends and other distributions and Enterprises paid \$1,053 million in common dividends and other distributions to CMS Energy. In January 2003, Consumers paid a \$78 million common dividend to CMS Energy. In February 2003, Enterprises paid \$18 million in dividends and other distributions to CMS Energy. CMS Energy's consolidated cash requirements are met by its operating and financing activities. At December 31, 2002, CMS Energy had \$377 million cash on hand.

Operating Activities: CMS Energy's consolidated net cash provided by operating activities is derived mainly from the processing, storage, transportation and sale of natural gas; and the generation, distribution and sale of electricity. For 2002 and 2001, consolidated cash from operations after interest charges totaled \$403 million and \$366 million, respectively. The \$37 million increase in cash from operations resulted primarily from a decrease in inventories and other temporary changes in working capital items due to timing of cash receipts and payments. These sources of cash were partially offset by a decrease in deferred income taxes and investment tax credit. CMS Energy uses cash derived from its operating activities primarily to maintain its diversified energy businesses, to maintain and expand electric and gas systems of Consumers and, to pay interest on and retire portions of long-term debt.

Investing Activities: For 2002 and 2001, CMS Energy's consolidated net cash provided by (used in) investing activities totaled \$1,084 million and (\$1,348) million, respectively. The \$2,432 million increase in cash provided as compared to 2001, primarily reflects an increase in proceeds received from the sale of assets (\$1,525 million), a reduction in the amount of capital expenditures (\$492 million), and a reduction in investments in partnerships and unconsolidated subsidiaries (\$56 million). CMS Energy's expenditures during 2002 for its utility and diversified energy businesses were \$618 million and \$188 million, respectively, compared to \$768 million and \$445 million, respectively, during 2001.

Financing Activities: For 2002 and 2001, CMS Energy's net cash provided by (used in) financing activities totaled (\$1,237 million) and \$968 million, respectively. The \$2,205 million increased use of cash resulted primarily from a reduction of proceeds from notes, bonds, and other long-term debt (\$1,296 million), combined with an increase in retirement of long-term debt (\$505 million), an increase in the retirement of trust preferred securities (\$331 million), and a reduction in the proceeds from trust preferred securities (\$125 million). These

changes were partially offset by a reduction in the amount of common stock dividends paid (\$41 million) and an increase in notes payable. The following table summarizes securities issued during 2002:

| | <u>Month Issued</u> | <u>Maturity</u> | <u>Distribution/ Interest Rate</u> | <u>Amount</u> (In Millions) | <u>Use of Proceeds</u> |
|-------------------------|---------------------|-----------------|--|--------------------------------|--|
| CMS Energy | | | | | |
| GTNs Series F | January | (1) | 7.33% | \$ 12 | General corporate purposes |
| Common Stock | (2) | n/a | 11 million shares | 350 | Repay debt and general corporate purposes |
| | | | | <u>362</u> | |
| Consumers | | | | | |
| Senior Notes | March | 2005 | 6.00% | <u>300</u> | Repay debt |
| Total | | | | <u>\$662</u> | |

(1) GTNs are issued with varying maturity dates. The interest rate shown herein is a weighted average interest rate.

(2) In July 2002, approximately 8.8 million shares of Common Stock were issued in conjunction with the conversion of the Adjustable Convertible Trust Securities (CMS Energy Trust II). Through May 10, 2002, 1.3 million shares were issued in conjunction with CMS Energy's Continuous Stock Offering Program, activated in February 2002, for which 2 million shares are registered. No shares have been issued under this program since that date. Finally, approximately 1 million shares were issued from time to time in conjunction with the stock purchase plan and various employee savings and stock incentive plans.

In 2002, CMS Energy paid \$149 million in cash dividends to holders of CMS Energy Common Stock. In January 2003, the Board of Directors suspended the payment of dividends. CMS Energy expects the dividend suspension will improve its liquidity by more than \$100 million in 2003.

Other Investing and Financing Matters:

In May 2002, CMS Energy registered \$300 million Series G GTNs. The notes will be issued from time to time with the proceeds being used for general corporate purposes. As of December 31, 2002, no Series G GTNs had been issued.

On July 1, 2002, the 7,250,000 units of 8.75 percent Adjustable Convertible Trust Securities (CMS Energy Trust II) were converted to 8,787,725 newly issued shares of CMS Energy Common Stock.

Credit Facilities: On July 12, 2002, CMS Energy and its subsidiaries reached agreement with its lenders on five credit facilities (facilities) totaling approximately \$1.3 billion of credit for CMS Energy, Enterprises and Consumers. The agreements were executed by various combinations of up to 21 lenders and by CMS Energy, Consumers and Enterprises and included: a \$295.8 million revolving credit facility for CMS Energy originally set to mature on March 31, 2003; a \$300 million revolving credit facility for CMS Energy, maturing December 15, 2003; a \$150 million short-term loan for Enterprises, originally set to mature on December 13, 2002; a \$250 million revolving credit facility for Consumers, maturing July 11, 2003; and a \$300 million term loan for Consumers, maturing July 11, 2003. In March 2003, the CMS Energy \$295.8 million revolving credit facility and \$300 million revolving credit facility under which a combined \$409 million was then outstanding were amended and restated. The Second Amended and Restated Senior Credit Agreement includes a \$234 million tranche with a maturity date of April 30, 2004 and a \$175 million tranche with a maturity date of September 30, 2004. Also in March 2003, Consumers obtained a replacement revolving credit facility in the amount of \$250 million. The new credit facility matures in March 2004 with two annual extensions at Consumers' option, which would extend the maturity to March 2006. In September 2002, the term loan maturity was extended by one year at Consumers' option and now has a maturity date of July 11, 2004. Also in September 2002, CMS Energy retired the \$150 million short-term loan to Enterprises using proceeds from the sale of CMS Oil and Gas and other assets. At December 31, 2002, a total of \$841 million was outstanding under these facilities, of which Consumers'

\$250 million revolving credit facility is included in notes payable, in the accompanying consolidated balance sheet.

In March 2003, CMS Enterprises entered into a revolving credit facility in an aggregate amount of \$441 million. The maturity date of this facility is April 30, 2004.

The facilities are secured with mandatory prepayment of borrowings under certain of the facilities with proceeds from asset sales and capital market issuances. The CMS Energy facilities grant the applicable bank groups first liens on the capital stock of Consumers and Enterprises and its major direct and indirect domestic subsidiaries, including Panhandle Eastern Pipe Line (but excluding subsidiaries of Panhandle Eastern Pipe Line). The Consumers facilities grant the applicable bank groups security through first mortgage bonds.

The July 12, 2002 facilities essentially replaced or restructured previously existing credit facilities or lines at CMS Energy or Consumers, without substantially changing credit commitments. The two CMS Energy facilities and the terminated Enterprises facility aggregating \$745.8 million represented a restructuring of a prior CMS Energy \$300 million three-year revolving credit facility maturing in June 2004 and a prior CMS Energy \$450 million revolving credit facility originally maturing June 2002, but previously extended through July 12, 2002. The two Consumers facilities aggregating \$550 million replace a \$300 million revolving credit facility that matured July 14, 2002, as well as various credit lines aggregating \$200 million. The prior credit facilities and lines were unsecured.

Consumers' Regulatory Authorization for Financings: At December 31, 2002, Consumers had FERC authorization to issue or guarantee through June 2004, up to \$1.1 billion of short-term securities outstanding at any one time. Consumers also had remaining FERC authorization to issue through June 2004 up to \$500 million of long-term securities for refinancing or refunding purposes, \$677 million for general corporate purposes, and \$900 million of first mortgage bonds to be issued solely as security for the long-term securities. On October 10, 2002, FERC granted a waiver of its competitive bid/negotiated placement requirements applicable to the remaining long-term securities authorization indicated above.

Notes Payable: In October 2002, Consumers simultaneously entered into a new term loan agreement collateralized by first mortgage bonds and a new gas inventory term loan agreement collateralized by Consumers' natural gas in storage. These agreements contain complementary collateral packages that provide Consumers, as additional first mortgage bonds become available, borrowing capacity of up to \$225 million, of which \$207 million was outstanding at December 31, 2002 with an effective interest rate of 6.3 percent. The bank and legal fees associated with the agreements were \$2 million. The first amortization payment under these agreements occurred in December 2002 with monthly amortization payments scheduled until full repayment is completed in mid-April of 2003. The loan amortization also reduces the bank's loan commitment to the amount of loan outstanding, which was \$207 million as of December 31, 2002.

Restricted Payments: CMS Energy's Board of Directors reduced the CMS Energy Common Stock dividend by approximately 50 percent, to an annual rate of 72 cents per share during the third quarter of 2002. In January 2003, the Board of Directors suspended the common stock dividend.

Pursuant to restrictive covenants in its facilities, Consumers is limited to common stock dividend payments that will not exceed \$300 million in any calendar year. Consumers paid \$233 million and \$190 million in common stock dividends to CMS Energy in 2002 and 2001, respectively. In January 2003, Consumers declared and paid a \$78 million common dividend.

Required Ratios: The facilities also have contractual restrictions that require CMS Energy and Consumers to maintain, as of the last day of each fiscal quarter, the following:

| <u>Required Ratio</u> | <u>Limitation</u> | <u>Ratio at December 31, 2002</u> |
|---|----------------------------|-----------------------------------|
| CMS Energy: | | |
| Consolidated Leverage Ratio(a)(b) | not more than 5.75 to 1.00 | 5.59 to 1.00 |
| Cash Dividend Coverage Ratio(a) | not less than 1.25 to 1.00 | 1.57 to 1.00 |
| Consumers: | | |
| Debt to Capital Ratio(a)(b) | not more than 0.65 to 1.00 | 0.55 to 1.00 |
| Interest Coverage Ratio(a)(b) | not less than 2.00 to 1.00 | 4.01 to 1.00 |

- (a) Violation of this ratio would constitute an event of default under the facility which provides the lender, among other remedies, the right to declare the principal and interest immediately due and payable.
- (b) For purposes of these ratios, the terms of the credit facilities provide for the exclusion of securitization bonds in the calculation of these ratios.

In 1994, CMS Energy executed an indenture with J.P.Morgan Chase Bank pursuant to CMS Energy's general term notes program. The indenture, through supplements, contains certain provisions that can trigger a limitation on CMS Energy's consolidated indebtedness. The limitation can be activated when CMS Energy's consolidated leverage ratio, as defined in the indenture (essentially the ratio of consolidated debt to consolidated capital), exceeds 0.75 to 1.0. At December 31, 2002, CMS Energy's consolidated leverage ratio was 0.79 to 1.0. As a result, CMS Energy will not, and will not permit certain material subsidiaries, excluding Consumers and its subsidiaries, to become liable for new indebtedness. However, the indenture contains certain express exceptions to this limitation, and pursuant to one such exception, CMS Energy and the material subsidiaries may incur revolving indebtedness to banks of up to \$1 billion in the aggregate and refinance existing debt outstanding of CMS Energy and of its material subsidiaries.

Credit Ratings: In July 2002, the credit ratings of the publicly traded securities of each of CMS Energy, Consumers and Panhandle (but not Consumers Funding LLC) were downgraded by the major rating agencies. The ratings downgrade for all three companies' securities was largely a function of the uncertainties associated with CMS Energy's financial condition and liquidity, restatement and re-audit of 2000 and 2001 financial statements, and lawsuits. These downgrades directly affect and limit CMS Energy's access to the capital markets.

As a result of certain of these downgrades, rights were triggered in several contractual arrangements between CMS Energy subsidiaries and third parties. A few commodity suppliers to Consumers have requested advanced payments or other forms of assurances in connection with maintenance of ongoing deliveries of gas and electricity. Consumers has addressed these issues.

In addition, the construction lenders for each of the Guardian and Centennial pipeline projects, each partially owned by Panhandle, requested acceptable credit support for Panhandle's guarantee of its pro rata portion of those construction loans, which aggregate \$110 million including anticipated future draws. On September 27, 2002 Panhandle's Centennial partners provided credit support of \$25 million each in the form of guarantees to the lender to cover Panhandle's obligation of \$50 million of loan guarantees. The partners were paid credit fees by Panhandle on the outstanding balance of the guarantees for any periods for which they were in effect. On February 10, 2003, Panhandle sold its one-third interest in Centennial for \$40 million to Centennial's two other partners. Panhandle has been relieved and indemnified by the purchasers and the lenders for any liabilities, including credit fees related to Panhandle's \$50 million parent guaranty of the project debt.

In October 2002, Panhandle provided a letter of credit to the lenders which constitutes acceptable credit support under the Guardian financing agreement. This letter of credit was cash collateralized by Panhandle with approximately \$63 million. Effective March 1, 2003, Panhandle's ownership interest in Guardian was transferred to CMS Gas Transmission along with the \$63 million of cash collateral plus accrued interest. Panhandle was released from its guarantee obligations associated with the Guardian non-recourse guaranty as of March 10, 2003 by Prudential and the other noteholders.

In December 2002 and January 2003, Panhandle secured short-term bank loans in the amounts of \$30 million and \$10 million, respectively. The loans are due the earlier of December 2003 or upon the sale of Panhandle. The stock of most of Panhandle's subsidiaries were pledged as collateral for the loans, which were utilized to improve overall liquidity which had been reduced by various cash requirements. Panhandle is required to provide certified September 30, 2002 financial statements to the banks by April 30, 2003. Panhandle intends to provide these statements to the banks prior to April 30, 2003. Should it be unable to deliver the certified financial statements or obtain a waiver by that date, Panhandle could be declared to be in default and the debt could be accelerated and become immediately due and payable.

Additionally, Panhandle was unable to deliver certified September 30, 2002 financial statements to the LNG Holdings lenders as required under that credit facility. Panhandle has received a waiver of this requirement until April 30, 2003 and a waiver of a requirement to provide certain documentation until June 30, 2003. Should Panhandle be unable to deliver the certified financial statements or execute the required documents by the timing indicated, LNG Holdings could be declared to be in default under its credit facility and the debt there under could be accelerated and become immediately due and payable.

Further, one of the issuers of a joint and several surety bond in the approximate amount of \$187 million supporting a CMS MST gas supply contract has demanded acceptable collateral for the full amount of such bond. The second issuer of the \$187 million surety bond has similar rights in connection with surety bonds supporting two other CMS MST gas supply contracts, aggregating approximately \$112 million. CMS Energy has reached a settlement that provides the issuers with acceptable collateral.

CMS Energy plans to continue to pursue the sale of targeted assets throughout 2003. Even though assets have been identified for sale, management cannot predict when, nor make assurances regarding the value of the consideration to be received or whether these sales will occur.

OBLIGATIONS AND COMMITMENTS

The following information on CMS Energy's contractual obligations, off-balance sheet arrangements and commercial commitments is provided to collect information in a single location so that a picture of liquidity and capital resources is readily available.

Contractual Obligations: CMS Energy has contractual obligations including long-term debt, notes payable, and capital lease obligations. Notes payable include the two term loans at Consumers and their revolving credit agreement. Capital leases include leased service vehicles and the new headquarters building.

Off-Balance Sheet Arrangements: CMS Energy's use of long-term contracts for the purchase of commodities and services, the sale of Consumers' accounts receivables, and operating leases are considered to be off-balance sheet arrangements. Consumers has responsibility for the collectability of the accounts receivables sold, and the full obligation of its leases become due in case of lease payment default. Operating leases are predominately railroad coal car leases, aircraft, vehicles and miscellaneous office equipment. Unconditional purchase obligations include natural gas, electricity, and coal purchase contracts and their associated cost of transportation. These obligations represent normal business operating contracts used to assure adequate supply and to minimize exposure to market price fluctuations. Consumers has 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 are approximately \$45 million per month for year 2003, which includes \$33 million related to the MCV Facility. If a plant is not available to deliver electricity to Consumers, then Consumers would not be obligated to make the capacity payment while the plant is unable to deliver. CMS Energy uses these off-balance sheet arrangements in its normal business operations.

In addition, CMS Energy, through its subsidiary companies, has equity investments in partnerships and joint ventures in which they have a minority ownership interest. As of December 31, 2002, CMS Energy's proportionate share of unconsolidated debt associated with these investments was \$2.6 billion. This

unconsolidated debt is non-recourse to CMS Energy and is not included in the amount of long-term debt that appears on CMS Energy's Consolidated Balance Sheets.

Contractual Obligations

| December 31 | Total | Payments Due | | | | | Beyond |
|--|-----------------|----------------|----------------|----------------|----------------|--------------|-----------------|
| | | 2003 | 2004 | 2005 | 2006 | 2007 | |
| In Millions | | | | | | | |
| On-balance sheet: | | | | | | | |
| Long-term debt | \$ 5,983 | \$ 627 | \$ 964 | \$ 742 | \$ 514 | \$538 | \$ 2,598 |
| Notes payable | 458 | 458 | — | — | — | — | — |
| Capital lease obligations(a) | 163 | 21 | 20 | 18 | 17 | 16 | 71 |
| Total on-balance sheet | <u>\$ 6,604</u> | <u>\$1,106</u> | <u>\$ 984</u> | <u>\$ 760</u> | <u>\$ 531</u> | <u>\$554</u> | <u>\$ 2,669</u> |
| Off-balance sheet: | | | | | | | |
| Non-recourse debt | 2,601 | 253 | 188 | 123 | 346 | 96 | 1,595 |
| Headquarters building lease(b) | 6 | — | — | — | — | — | 6 |
| Operating leases(c) | 93 | 16 | 12 | 10 | 9 | 8 | 38 |
| Sale of accounts receivable | 325 | 325 | — | — | — | — | — |
| Unconditional purchase Obligations | 17,344 | 1,368 | 975 | 877 | 727 | 727 | 12,670 |
| Total off-balance sheet | <u>\$20,369</u> | <u>\$1,962</u> | <u>\$1,175</u> | <u>\$1,010</u> | <u>\$1,082</u> | <u>\$831</u> | <u>\$14,309</u> |

- (a) Capital lease obligation shown includes imputed interest of \$28 million.
- (b) The headquarters building capital lease is estimated to be \$60 million, of which a \$54 million construction obligation has been incurred and recorded on CMS Energy's balance sheet as of December 31, 2002.
- (c) Operating lease obligation shown excludes \$53 million for Panhandle due to the discontinuation of Panhandle during 2002.

Commercial Commitments: As of December 31, 2002, CMS Energy, Enterprises, and their subsidiaries have guaranteed payment of obligations through guarantees, indemnities and letters of credit, of unconsolidated affiliates and related parties approximating \$1.1 billion. Included in this amount, Enterprises, in the ordinary course of its business, has guaranteed contracts of CMS MST that contain certain schedule and performance requirements. As of December 31, 2002, the actual amount of financial exposure covered by these guarantees and indemnities was \$219 million. Management monitors and approves these obligations and believes it is unlikely that CMS Energy would be required to perform or otherwise incur any material losses associated with these guarantees. Indemnities are three-party agreements used to assure performance of contracts by CMS Energy. Letters of credit are issued by banks guaranteeing CMS Energy's payments of its drafts. Drafts are for a stated amount and for a specified period; they substitute the bank's credit for CMS Energy's and eliminate the credit risk for the other party.

Commercial Commitments

| December 31 | Total | Commitment Expiration | | | | | Beyond |
|-------------------------|----------------|-----------------------|-------------|-------------|-------------|-------------|--------------|
| | | 2003 | 2004 | 2005 | 2006 | 2007 | |
| In Millions | | | | | | | |
| Off-balance sheet: | | | | | | | |
| Guarantees | \$ 524 | \$ — | \$ — | \$ — | \$ 4 | \$ — | \$520 |
| Indemnities | \$ 230 | 5 | — | 36 | — | — | 189 |
| Letters of Credit | 296 | 275 | 18 | — | — | — | 3 |
| Total | <u>\$1,046</u> | <u>\$280</u> | <u>\$18</u> | <u>\$36</u> | <u>\$ 4</u> | <u>\$ —</u> | <u>\$712</u> |

For further information, see Note 7, Short-Term and Long-Term Financings and Note 8, Capitalization, incorporated by reference herein.

CAPITAL EXPENDITURES

CMS Energy estimates that capital expenditures, including new lease commitments and investments in new business developments through partnerships and unconsolidated subsidiaries, will total \$1.8 billion during 2003 through 2005. These estimates are prepared for planning purposes and are subject to revision. CMS Energy expects to satisfy a substantial portion of the capital expenditures with cash from operations.

CMS Energy estimates capital expenditures by business segment over the next three years as follows:

| <u>Years Ending December 31</u> | <u>2003</u> | <u>2004</u> | <u>2005</u> |
|---|--------------|--------------|--------------|
| | In Millions | | |
| Consumers electric operations(a)(b) | \$341 | \$408 | \$385 |
| Consumers gas operations(a) | 144 | 167 | 225 |
| Natural gas transmission | 23 | 1 | 1 |
| Independent power production | 9 | 79 | 4 |
| Marketing, services and trading | 1 | — | — |
| Other | 27 | — | — |
| | <u>\$545</u> | <u>\$655</u> | <u>\$615</u> |

- (a) These amounts include an attributed portion of Consumers' anticipated capital expenditures for plant and equipment common to both the electric and gas utility businesses.
- (b) These amounts include estimates for capital expenditures that may be required by recent revisions to the Clean Air Act's national air quality standards. For further information see Note 6, Uncertainties — Electric Environmental Matters.

OUTLOOK

CORPORATE OUTLOOK

During 2002, CMS Energy continued to implement its financial improvement plan and on-going asset sales program first announced in 2001. The financial improvement plan focuses on strengthening CMS Energy's balance sheet and improving financial liquidity through debt reduction and aggressive cost management. The on-going asset sales program's objective is to reduce business risk and to provide for more predictable on-going earnings. This encompasses the sale of non-strategic and under-performing assets, the proceeds of which are being used to reduce debt.

Consistent with this "back-to-basics" strategy, CMS Energy is actively pursuing the sale of non-strategic and under-performing assets in order to improve cash flow and the balance sheet and has received approximately \$2.7 billion of cash and associated debt assumption from asset sales. Upon the sale of additional non-strategic and under-performing assets, the proceeds realized may be materially different than the book value of those assets. Even though these assets have been identified for sale, management cannot predict when, nor make any assurances that, these asset sales will occur. CMS Energy anticipates, however, that the sales, if any, will result in additional cash proceeds that will be used to retire existing debt of CMS Energy or Consumers.

In December 2002, CMS Energy reached a definitive agreement to sell the Panhandle companies to Southern Union Panhandle Corp. The agreement calls for Southern Union Panhandle Corp, a newly formed entity owned by Southern Union Company and AIG Highstar Capital, L.P. to pay \$662 million in cash and assume \$1.166 billion in debt. Under the terms of the agreement, CMS Energy was to retain Panhandle's ownership interests in the Centennial and Guardian pipeline projects, as well as certain of Panhandle's net deferred tax assets, all tax liabilities, and pension assets and liabilities. Panhandle has since sold its interest in Centennial (described below) and the Guardian interest has been transferred to Panhandle's direct parent, CMS Gas Transmission. The transaction has been approved by the board of directors of each company and is subject to customary closing conditions and action by the FTC under the Hart-Scott-Rodino Act. The sale is expected to close in 2003. Panhandle's results have been reclassified to discontinued operations in the consolidated

statements of income. For more information, see Note 4, Discontinued Operations to consolidated financial statements.

In January 2003, CMS Energy closed on the sale of a substantial portion of CMS MST's wholesale natural gas trading contracts to Semptra Energy Trading, the wholesale commodity trading unit of Semptra Energy and received \$17 million of cash proceeds. In February 2003, CMS Energy entered into a definitive agreement with Constellation Power Source, Inc. to sell CMS MST's wholesale power contracts. The sale has been approved by FERC and is expected to close as early as March 31 of 2003.

In February 2003, Panhandle sold its one third interest in Centennial Pipeline, LLC for \$40 million to Centennial's two other partners, Marathon Ashland Petroleum, LLC and TE Products Pipeline Company, Limited Partner, through its general partner, Texas Eastern Products Pipeline Company.

CONSUMERS' ELECTRIC UTILITY BUSINESS OUTLOOK

Growth: Over the next five years, Consumers expects electric deliveries (including both full service sales and delivery service to customers who choose to buy generation service from an alternative electric supplier, but excluding transactions with other wholesale market participants including other electric utilities) to grow at an average rate of approximately two percent per year based primarily on a steadily growing customer base. This growth rate reflects a long-range expected trend of growth. Growth from year to year may vary from this trend due to customer response to abnormal weather conditions and changes in economic conditions including, utilization and expansion of manufacturing facilities. Consumers has experienced much stronger than expected growth in 2002 as a result of warmer than normal summer weather. Assuming that normal weather conditions will occur in 2003, electric deliveries are expected to grow less than one percent over the strong 2002 electric deliveries.

Competition and Regulatory Restructuring: The enactment in 2000 of Michigan's Customer Choice Act and other developments will continue to result in increased competition in the electric business. Generally, increased competition can reduce profitability and threatens Consumers' market share for generation services. The Customer Choice Act allowed all of the company's electric customers to buy electric generation service from Consumers or from an alternative electric supplier as of January 1, 2002. As a result, alternative electric suppliers for generation services have entered Consumers' market. As of mid-March 2003, alternative electric suppliers are providing 516 MW of generation supply to customers. To the extent Consumers experiences "net" Stranded Costs as determined by the MPSC, the Customer Choice Act allows for the company to recover such "net" Stranded Costs by collecting a transition surcharge from those customers who switch to an alternative electric supplier. Consumers cannot predict the total amount of electric supply load that may be lost to competitor suppliers, nor whether the stranded cost recovery method adopted by the MPSC will be applied in a manner that will fully offset any associated margin loss.

Stranded and Implementation Costs: The Customer Choice Act allows electric utilities to recover the act's implementation costs and "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 adopted a methodology which calculated "net" Stranded Costs as the shortfall between: (a) the revenue required to cover the costs associated with fixed generation assets, generation-related regulatory assets, and capacity payments associated with purchase power agreements, and (b) the revenues received from customers under existing rates available to cover the revenue requirement. The MPSC authorized Consumers to use deferred accounting to recognize the future recovery of costs determined to be stranded. Consumers has initiated an appeal at the Michigan Court of Appeals related to the MPSC's December 2001 "net" Stranded Cost order.

According to the MPSC, "net" Stranded Costs were to be recovered from retail open access customers through a Stranded Cost transition charge. In April 2002, Consumers made "net" Stranded Cost filings with the MPSC for \$22 million and \$43 million for 2000 and 2001, respectively. In the same filing, Consumers estimated that it would experience "net" Stranded Costs of \$126 million for 2002. Consumers, in its hearing brief, filed in August 2002, revised its request for "net" Stranded Costs to \$7 million and \$4 million for 2000 and 2001,

respectively, and an estimated \$73 million for 2002. The single largest reason for the difference was the exclusion, as ordered by the MPSC, of all costs associated with expenditures required by the Clean Air Act.

In December 2002, the MPSC issued an order finding that Consumers experienced zero “net” Stranded Costs in 2000 and 2001, but declined to establish a defined methodology that would allow a reliable prediction of the level of Stranded Costs for 2002 and future years. In January 2003, Consumers filed a petition for rehearing of the December 2002 Stranded Cost order in which it asked the MPSC to grant rehearing and revise certain features of the order. Several other parties also filed rehearing petitions with the MPSC. As discussed below, Consumers has filed a request with the MPSC for authority to issue securitization bonds that would allow recovery of the Clean Air Act expenditures and post-2000 Palisades expenditures that were excluded from the Stranded Cost calculation.

On March 4, 2003, Consumers 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. In the application, Consumers indicated that if Consumers’ proposal to securitize Clean Air Act expenditures and post-2000 Palisades expenditures were approved as proposed in its securitization case as discussed below, then Consumers’ “net” Stranded Costs incurred in 2002 are approximately \$35 million. If the proposal to securitize those costs is not approved, then Consumers indicated that the costs would be properly included in the 2002 “net” Stranded Cost calculation, which would increase Consumers’ 2002 “net” Stranded Costs to approximately \$103 million. Consumers cannot predict the recoverability of Stranded Costs, and therefore has not recorded any regulatory assets to recognize the future recovery of such costs.

The MPSC staff has scheduled a collaborative process to discuss Stranded Costs and related issues and to identify and make recommendations to the MPSC. Consumers intends to participate in this collaborative process.

Since 1997, Consumers has incurred significant electric utility restructuring implementation costs. The following table outlines the applications filed by Consumers with the MPSC and the status of recovery for these costs.

| <u>Year Filed</u> | <u>Year Incurred</u> | <u>Requested</u> | <u>Pending</u> | <u>Allowed</u> | <u>Disallowed</u> |
|-------------------|----------------------|------------------|----------------|--------------------|-------------------|
| | | | | <u>In Millions</u> | |
| 1999 | 1997 & 1998 | \$20 | \$— | \$15 | \$ 5 |
| 2000 | 1999 | 30 | — | 25 | 5 |
| 2001 | 2000 | 25 | — | 20 | 5 |
| 2002 | 2001 | 8 | 8 | — | — |
| 2003 | 2002 | 2 | 2 | — | — |

The MPSC disallowed certain costs based upon a conclusion that these amounts did not represent costs incremental to costs already reflected in electric rates. In the orders received for the years 1997 through 2000, the MPSC also reserved the right to review again the total implementation costs depending upon the progress and success of the retail open access 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, as of December 2002, Consumers incurred and deferred as a regulatory asset, \$1 million of additional implementation costs and has also recorded as a regulatory asset \$13 million for the cost of money associated with total implementation costs. Consumers believes the implementation costs and the associated cost of money are fully recoverable in accordance with the Customer Choice Act. Cash recovery from customers will probably begin after the rate freeze or rate cap period has expired. Consumers cannot predict the amounts the MPSC will approve as allowable costs.

Consumers is also pursuing authorization at the FERC for MISO to reimburse Consumers for approximately \$8 million in certain electric utility restructuring implementation costs related to its former participation in the development of the Alliance RTO, a portion of which has been expensed. However, Consumers cannot predict the amount the FERC will ultimately order to be reimbursed by the MISO.

Securitization: On March 4, 2003, Consumers filed an application with the MPSC seeking approval to issue Securitization bonds in the amount of approximately \$1.084 billion. If approved, this would allow the recovery of

costs associated with Clean Air Act expenditures, post-2000 Palisades expenditures, and retail open access implementation costs through December 31, 2003, and certain pension fund expenses and expenses associated with the issuance of the bonds.

Rate Caps: The Customer Choice Act imposes certain limitations on electric rates that could result in Consumers being unable to collect from electric customers its full cost of conducting business. Some of these costs are beyond Consumers' control. In particular, if Consumers needs to purchase power supply from wholesale suppliers while retail rates are frozen or capped, the rate restrictions may make it impossible for Consumers to fully recover purchased power and associated transmission costs from its customers. As a result, Consumers may be unable to maintain its profit margins in its electric utility business during the rate freeze or rate cap periods. The rate freeze is in effect through December 31, 2003. The rate caps are in effect through at least December 31, 2004 for small commercial and industrial customers, and at least through December 31, 2005 for residential customers.

Industrial Contracts: In response to industry restructuring efforts, in 1995 and 1996, Consumers entered into multi-year electric supply contracts with certain large industrial customers to provide electricity at specially negotiated prices, usually at a discount from tariff prices. The MPSC approved these special contracts as part of its phased introduction to competition. Unless terminated or restructured, the majority of these contracts are in effect through 2005. As of December 2002, some contracts have expired, but outstanding contracts involve approximately 500 MW. Consumers cannot predict the ultimate financial impact of changes related to these power supply contracts, or whether additional contracts will be necessary or advisable.

Code of Conduct: In December 2000, as a result of the passage of the Customer Choice Act, the MPSC issued a new code of conduct that applies to electric utilities and alternative electric suppliers. The code of conduct seeks to prevent cross-subsidization, information sharing, and preferential treatment between a utility's regulated and unregulated services. The new code of conduct is broadly written, and as a result, could affect Consumers' retail gas business, the marketing of unregulated services and equipment to Michigan customers, and internal transfer pricing between Consumers' departments and affiliates. In October 2001, the new code of conduct was reaffirmed by the MPSC without substantial modification. Consumers appealed the MPSC orders related to the code of conduct and sought a stay of the orders until the appeal was complete; however, the request for a stay was denied. Consumers filed a compliance plan in accordance with the code of conduct. It also sought waivers to the code of conduct in order to continue utility activities that provide approximately \$50 million in annual revenues. In October 2002, the MPSC denied waivers for three programs that provide approximately \$32 million in revenues in 2001, of which \$30 million relates to the appliance service plan. The waivers denied included all waivers associated with the appliance service plan program that has been offered by Consumers for many years. Consumers filed a renewed motion for a stay of the effectiveness of the code of conduct and an appeal of the waiver denials with the Michigan Court of Appeals. On November 8, 2002, the Michigan Court of Appeals denied Consumers' request for a stay. Consumers has filed an application for leave to appeal with the Michigan Supreme Court with respect to the Michigan Court of Appeals' November ruling denying the stay. In February 2003, the Michigan Supreme Court denied the application. In December 2002, Consumers filed a renewed request with the MPSC for a temporary waiver until April 2004 for the appliance service plan, which generated \$33 million in revenues in 2002. In February 2003, the MPSC granted an extension of the temporary waiver until December 31, 2003. The full impact of the new code of conduct on Consumers' business will remain uncertain until the appellate courts issue definitive rulings. Recently, in an appeal involving affiliate pricing guidelines, the Michigan Court of Appeals struck the guidelines down because of a procedurally defective manner of enactment by the MPSC. A similar procedure was used by the MPSC in enacting the new code of conduct. Consumers is also exploring seeking legislative clarification of the scope of the code of conduct.

Energy Policy: Uncertainty exists regarding the enactment of a national comprehensive energy policy, specifically federal electric industry restructuring legislation. A variety of bills introduced in the United States Congress in recent years aimed to change existing federal regulation of the industry. If the federal government enacts a comprehensive energy policy or electric restructuring legislation, then that legislation could potentially affect company operations and financial requirements.

Transmission: In 1999, the FERC issued Order No. 2000, strongly encouraging electric utilities to transfer operating control of their electric transmission system to an RTO, or sell the facilities to an independent company. In addition, in June 2000, the Michigan legislature passed Michigan's Customer Choice Act, which also requires utilities to divest or transfer the operating authority of transmission facilities to an independent company. Consumers chose to offer its electric transmission system (METC) for sale rather than own and invest in an asset it could not control. In May 2002, Consumers sold its electric transmission system for approximately \$290 million in cash to MTH, a non-affiliated limited partnership whose general partner is a subsidiary of Trans-Elect, Inc.

Trans-Elect, Inc. submitted the winning bid through a competitive bidding process, and various federal agencies approved the transaction. Consumers did not provide any financial or credit support to Trans-Elect, Inc. Certain of Trans-Elect's officers and directors are former officers and directors of CMS Energy, Consumers and their subsidiaries. None of them were employed by CMS Energy, Consumers, or their affiliates when the transaction was discussed internally and negotiated with purchasers. As a result of the sale, Consumers experienced an after-tax earnings increase of approximately \$17 million in 2002, due to the recognition of a \$26 million gain on the sale of the electric transmission system. This gain from the sale is offset by a loss of revenue from wholesale and retail open access customers who will buy services directly from MTH, including the loss of a return on the sold electric transmission system. Consumers anticipates that the future impact of the loss of revenue from wholesale and retail open access customers who will buy services directly from MTH and the loss of a return on the sold electric transmission system on its after-tax earnings will be a decrease of \$15 million in 2003, and a decrease of approximately \$14 million annually for the next three years.

Under the agreement with MTH, and subject to certain additional RTO surcharges, transmission rates charged to Consumers are fixed by contract at current levels through December 31, 2005, and subject to FERC ratemaking thereafter. MTH has completed the capital program to expand the transmission system's capability to import electricity into Michigan, as required by the Customer Choice Act, and Consumers will continue to maintain the system under a five-year contract with MTH. Effective April 30, 2002, Consumers and METC withdrew from the Alliance RTO, and MTH (METC) has joined the MISO RTO. For further information, see Note 6, Uncertainties, "Electric Rate Matters — Transmission."

Consumers is a customer of AEP, holding 500 MW of long-term transmission service reservations through the AEP transmission system. AEP recently indicated its intent to turn control of its transmission system over to the PJM RTO and become part of the PJM market sometime after May 1, 2003, which requires approval by FERC. This will require current AEP customers to become members of, and resubmit reservation requests to, PJM. Consumers filed an intervention requesting clarification in January 2003. Upon FERC's approval of this transfer, Consumers will complete the application process to join PJM. Of the 500 MW of long-term transmission service reservations held, 200 MW will expire on April 1, 2003. Effective June 1, 2003, Consumers will have an additional 100 MW of long-term transmission, resulting in a total of 400 MW of long-term transmission for summer 2003.

In July 2002, the FERC issued a 600-page notice of proposed rulemaking on standard market design for electric bulk power markets and transmission. Its stated purpose is to remedy undue discrimination in the use of the interstate transmission system and give the nation the benefits of a competitive bulk power system. The proposed rulemaking is primarily designed to correct perceived problems in the electric transmission industry. Consumers sold its electric transmission system in 2002, but is a transmission customer. The financial impact to Consumers is uncertain, but the final standard market design rules could significantly increase delivered power costs to Consumers and the retail electric customers it serves. Consumers has filed comments with the FERC in general opposition to the proposal.

There are multiple proceedings pending before the FERC regarding transitional transmission pricing mechanisms intended to mitigate the revenue impact on transmission owners resulting from the elimination of "Rate Pancaking". "Rate Pancaking" represents the application of the transmission rate of each individual transmission owner whose system is utilized on the scheduled path of an energy delivery and its elimination has been alleged to result in "lost revenues" for transmission owners. It is unknown what mechanism(s) may result from the proceedings currently pending before the FERC, and as such, it is not possible at this time to identify the

specific effect on Consumers. It should be noted, however, that Consumers believes the results of these proceedings could also significantly increase the delivered power costs to Consumers and the retail electric customers it serves.

Similarly, other proceedings before the FERC involving rates of transmission providers of Consumers could increase Consumers' cost of transmitting power to its customers in Michigan. As RTOs develop and mature in Consumers' area of electrical operation, and those RTOs respond to FERC initiatives concerning the services they must provide and the systems they maintain, Consumers believes that there is likely to be an upward cost trend in transmission used by Consumers, ultimately increasing the delivered cost of power to Consumers and the retail electric customers it serves. The specific financial impact on Consumers of such proceedings and trends is not currently quantifiable.

In addition to the potential cost impacts identified above, Consumers is evaluating whether or not there may be impacts on electric reliability associated with the outcomes of these various transmission related proceedings. Consumers cannot assure that all risks to reliability can be avoided.

Consumers cannot predict the impact of these electric industry-restructuring issues on its financial position, liquidity, or results of operations.

Performance Standards: In July 2001, the MPSC proposed electric distribution performance standards for Consumers and other Michigan electric distribution utilities. The proposal would establish standards related to restoration after an outage, safety, and customer relations. Failure to meet the standards would result in customer bill credits. Consumers submitted comments to the MPSC. In December 2001, the MPSC issued an order stating its intent to initiate a formal rulemaking proceeding to develop and adopt performance standards. In November 2002, the MPSC issued an order initiating the formal rulemaking proceeding. Consumers has filed comments on the proposed rules and will continue to participate in this process. Consumers cannot predict the nature of the proposed standards or the likely effect, if any, on Consumers.

For further information and material changes relating to the rate matters and restructuring of the electric utility industry, see Note 1, Corporate Structure and Summary of Significant Accounting Policies, and Note 6, Uncertainties, "Electric Rate Matters — Electric Restructuring" and "Electric Rate Matters — Electric Proceedings."

Uncertainties: Several electric business trends or uncertainties may affect Consumers', financial results and condition. These trends or uncertainties have, or Consumers reasonably expects could have, a material impact on net sales, revenues, or income from continuing electric operations. Such trends and uncertainties include: 1) pending litigation and government investigations; 2) the need to make additional capital expenditures and increase operating expenses for Clean Air Act compliance; 3) environmental liabilities arising from various federal, state and local environmental laws and regulations, including potential liability or expenses relating to the Michigan Natural Resources and Environmental Protection Acts and Superfund; 4) uncertainties relating to the storage and ultimate disposal of spent nuclear fuel and the successful operation of Palisades by NMC; 5) electric industry restructuring issues, including those described above; 6) Consumers' ability to meet peak electric demand requirements at a reasonable cost, without market disruption, and successfully implement initiatives to reduce exposure to purchased power price increases; 7) the recovery of electric restructuring implementation costs; 8) Consumers' new status as an electric transmission customer and not as an electric transmission owner/operator; 9) sufficient reserves for OATT rate refunds; 10) the effects of derivative accounting and potential earnings volatility; 11) increased costs for safety and homeland security initiatives that are not recoverable on a timely basis from customers; 12) Consumers' continuing ability to raise funds at reasonable rates in order to meet the cash requirements of its electric business and to pay maturing debt in the short-term, and 13) potentially rising pension costs due to market losses. For further information about these trends or uncertainties, see Note 6, Uncertainties.

CONSUMERS' GAS UTILITY BUSINESS OUTLOOK

Growth: Over the next five years, Consumers expects gas deliveries, including gas full service and customer choice deliveries (excluding transportation to the MCV Facility and off-system deliveries), to grow at an

average rate of less than one percent per year based primarily on a steadily growing customer base. Actual gas deliveries in future periods may be affected by abnormal weather, use of gas by independent power producers, changes in competitive and economic conditions, and the level of natural gas consumption per customer.

2001 Gas Rate Case: In June 2001, Consumers filed an application with the MPSC seeking a distribution service rate increase. On November 7, 2002, the MPSC issued a final order approving a \$56 million annual distribution service rate increase, which includes the \$15 million interim increase, with an 11.4 percent authorized return on equity, for service effective November 8, 2002. As part of this order, the MPSC approved Consumers' proposal to absorb the assets and liabilities of Michigan Gas Storage Company into Consumers' rate base and rates. This has occurred through a statutory merger of Michigan Gas Storage Company into Consumers and this is not expected to have an impact on Consumers' consolidated financial statements. See Note 6, Uncertainties, Gas Rate Matters — 2001 Gas Rate Case for further information.

2003 Gas Rate Case: On March 14, 2003, Consumers filed an application with the MPSC seeking a \$156 million increase in its gas delivery and transportation rates, which includes a 13.5 percent authorized return on equity, based on a 2004 test year. If approved, the request would add about \$6.40 per month, or about 9 percent, to the typical residential customer's average monthly distribution bill. Contemporaneously with this filing, Consumers has requested interim rate relief in the same amount.

Unbundling Study: In July 2001, the MPSC directed gas utilities under its jurisdiction to prepare and file an unbundled cost of service study. The purpose of the study is to allow parties to advocate or oppose the unbundling of the following services: metering, billing information, transmission, balancing, storage, backup and peaking, and customer turn-on and turn-off services. Unbundled services could be separately priced in the future and made subject to competition by other providers. The MPSC addressed Consumers' study in the November 2002 gas distribution rate case order and indicated that it makes little sense to set rates for unbundled services before the details of those services are known. Unbundled services may continue to be an issue in future proceedings.

In September 2002, the FERC issued an order rejecting a filing by Consumers to assess certain rates for non-physical gas title tracking services offered by Consumers. Despite Consumers' arguments to the contrary, the FERC asserted jurisdiction over such activities and allowed Consumers to refile and justify a title transfer fee not based on volumes as Consumers proposed. Because the order was issued six years after Consumers made its original filing initiating the proceeding, over \$3 million in non-title transfer tracking fees had been collected. No refunds have been ordered, and Consumers sought rehearing of the September order. If refunds were ordered they may include interest which would increase the refund liability to more than the \$3 million collected. In December 2002, Consumers established a \$3.6 million reserve related to this matter. Consumers is unable to say with certainty what the final outcome of this proceeding might be.

Uncertainties: Several gas business trends or uncertainties may affect Consumers' financial results and conditions. These trends or uncertainties have, or Consumers reasonably expects could have, a material impact on net sales, revenues, or income from continuing gas operations. Such trends and uncertainties include: 1) pending litigation and government investigations; 2) potential environmental costs at a number of sites, including sites formerly housing manufactured gas plant facilities; 3) future gas industry restructuring initiatives; 4) any initiatives undertaken to protect customers against gas price increases; 5) an inadequate regulatory response to applications for requested rate increases; 6) market and regulatory responses to increases in gas costs, including a reduced average use per residential customer; 7) increased costs for pipeline integrity and safety and homeland security initiatives that are not recoverable on a timely basis from customers; 8) Consumers' continuing ability to raise funds at reasonable rates in order to meet the cash requirements of its gas business; and 9) potentially rising pension costs due to market losses. For further information about these uncertainties, see Note 6, Uncertainties.

CONSUMERS' OTHER OUTLOOK

Terrorist Attacks: Since the September 11, 2001 terrorist attacks in the United States, Consumers has increased security at all critical facilities and over its critical infrastructure, and will continue to evaluate security on an ongoing basis. Consumers may be required to comply with federal and state regulatory security measures promulgated in the future. Through December 31, 2002, Consumers has incurred approximately \$4 million in

incremental security costs, including operating, capital, and decommissioning and removal costs. Consumers estimates it may incur additional incremental security costs in 2003 of approximately \$6 million. Consumers will attempt to seek recovery of these costs from its customers. In December 2002, the Michigan legislature passed, and the governor signed, a bill that would allow Consumers to seek recovery of additional electric division security costs incurred during the rate freeze and cap periods imposed by the Customer Choice Act. On February 5, 2003, the MPSC adopted filing requirements for the recovery of enhanced security costs.

Energy-Related Services: Consumers offers a variety of energy-related services to retail customers that focus on appliance maintenance, home safety, commodity choice, and assistance to customers purchasing heating, ventilation and air conditioning equipment. Consumers continues to look for additional growth opportunities in providing energy-related services to its customers. The ability to offer all or some of these services and other utility related revenue-generating services, which provide approximately \$50 million in annual revenues, may be restricted by the new code of conduct issued by the MPSC, as discussed above in Electric Business Outlook, "Competition and Regulatory Restructuring — Code of Conduct."

ENTERPRISES OUTLOOK

CMS Energy's independent power production (IPP) subsidiary plans to complete the restructuring of its operations by narrowing the scope of its existing operations and commitments to two regions: North America and the Middle East/North Africa. In addition, its plans include selling designated assets and investments that are under-performing, non-region focused and non-synergistic with other CMS Energy business units. The independent power production business unit will continue to optimize the operations and management of its remaining portfolio of assets in order to contribute to CMS Energy's earnings and to maintain its reputation for solid performance in the construction and operation of power plants.

Dynamic changes in the energy trading markets over the past year have resulted in a deterioration of credit quality, loss of market liquidity and a heightened sensitivity to earnings volatility. Management cannot predict what effect these events may have on the liquidity of the trading markets in the short-term, but credit constraints continue to severely limit CMS MST's ability to actively manage and optimize its open positions. These changes have forced a significant change in CMS MST's business strategy. CMS MST will continue to streamline its portfolio to reduce outstanding credit guarantees as well as its non-core businesses. In January 2003, CMS MST closed on the sale of a significant portion of its natural gas trading contracts for \$17 million of cash proceeds, and in February 2003 signed a definitive agreement to sell its wholesale power contracts. The sale of the company's non-core retail offices and its energy conservation unit, CMS Viron, are expected to be complete by the second quarter of 2003, however, management cannot make any assurances as to when these asset sales will actually occur.

The future CMS MST activities will be centered around marketing the merchant power from DIG, Michigan Power, LLC and other IPPs as their current power purchase agreements expire. CMS MST will continue to focus its business on the retail sector, specifically in the state of Michigan. CMS Gas Transmission plans to also narrow its scope of existing operations and commitments. In doing so, CMS Energy is actively pursuing the sale, liquidation, or other disposition of several of its designated assets and investments, but management cannot predict when, nor make any assurances that, these asset and investment sales will occur.

Uncertainties: The results of operations and financial position of CMS Energy's diversified energy businesses may be affected by a number of trends or uncertainties that have, or CMS Energy reasonably expects could have, a material impact on income from continuing operations, cash flows and balance sheet and credit improvement. Such trends and uncertainties include: 1) the ability to sell or optimize assets or businesses in accordance with its financial plan; 2) the international monetary fluctuations, particularly in Argentina, as well as Brazil and Australia; 3) the changes in foreign laws, governmental and regulatory policies that could significantly reduce the tariffs charged and revenues recognized by certain foreign investments; 4) the imposition of stamp taxes on certain South American contracts that could significantly increase project expenses; 5) the impact of any future rate cases or FERC actions or orders on regulated businesses and the effects of changing regulatory and accounting related matters resulting from current events; 6) unhedged commodity price exposures; and 7) the impact of ratings downgrades on CMS Energy's liquidity, costs of operating, current limited access to capital markets, and cost of capital.

OTHER OUTLOOK

SEC and Other Investigations: As a result of round-trip trading transactions at CMS MST, CMS Energy's Board of Directors established a Special Committee of independent directors 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, most of which have already been implemented. Previously, CMS Energy terminated its speculative trading business and revised its risk management policy. The Board of Directors adopted, and CMS Energy has begun implementing, the remaining 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 investigations by the United States Department of Justice, the Commodity Futures Trading Commission and the FERC. CMS Energy has also received subpoenas from U.S. Attorneys Offices regarding investigations of those trades. 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 have been filed against CMS Energy, Consumers, and certain officers and directors of CMS Energy and its affiliates. The complaints have been filed in the United States District Court for the Eastern District of Michigan as purported class actions by individuals who allege that they purchased CMS Energy's securities during a purported class period. At least two of the complaints contain purported class periods beginning on August 3, 2000 and running through May 10, 2002 or May 14, 2002. These complaints generally seek unspecified damages based on allegations that the defendants violated United States securities laws and regulations by making allegedly false and misleading statements about the company's business and financial condition. The cases have been consolidated into a single lawsuit, and an amended and consolidated complaint is due to be filed by May 1, 2003. CMS Energy intends to vigorously defend against these actions. CMS Energy cannot predict the outcome of this litigation.

Demand for Actions Against Officers and Directors: The Board of Directors 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 CMS Energy officers and directors in connection with round-trip trading at CMS Energy, 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. If the Board elects not to commence such actions, the shareholder has stated that he will initiate a derivative suit, bringing such claims on behalf of CMS Energy. CMS Energy has elected two new members to its Board of Directors to serve as an independent litigation committee to determine whether it is in the best interest of CMS Energy to bring the action demanded by the shareholder. Counsel for the shareholder has agreed to extend the time for CMS Energy to respond to the demand. CMS Energy cannot predict the outcome of this litigation.

ERISA Claims: 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 401(k) plan. The two cases, filed in July 2002 in the United States District Court for the Eastern District of Michigan, were consolidated by the trial judge and an amended and consolidated complaint has been 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. These cases will be vigorously defended. CMS Energy cannot predict the outcome of this litigation.

Gas Index Pricing Reporting: 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 investigations by the Commodity Futures Trading Commission, Department of Justice and FERC regarding this matter. CMS Energy is unable to predict the outcome of these matters and what effect, if any, these investigations will have on its business.

OTHER MATTERS

CHANGE IN EXECUTIVE OFFICERS

In 2002, certain changes occurred in CMS Energy's executive officers. In May 2002, the Board of Directors elected Kenneth Whipple as Chairman of the Board and Chief Executive Officer; on June 27, 2002, S. Kinnie Smith, Jr. was elected Vice Chairman of the Board and General Counsel; on July 22, 2002, Thomas J. Webb was elected Executive Vice President and Chief Financial Officer; on August 2, 2002, John F. Drake was elected Senior Vice President; and on December 6, 2002, Michael T. Monahan and Joseph F. Paquette, Jr. joined the Board of Directors.

COMPLIANCE WITH THE SARBANES-OXLEY ACT OF 2002

In July 2002, the Sarbanes-Oxley Act of 2002 was enacted and requires companies to: 1) make certain certifications related to its financial statements, disclosure controls and procedures, and internal controls; and 2) make certain disclosures about its disclosure controls and procedures, and internal controls as follows:

CEO AND CFO CERTIFICATIONS

The Sarbanes-Oxley Act of 2002 requires the CEOs and CFOs of public companies to make certain certifications relating to the financial statements included in SEC filings. CMS Energy has not filed the certifications required by the Sarbanes-Oxley Act of 2002 relating to the financial statements included in this Form 10-K because CMS Energy is in the process of restating 2001 for each quarter, and intends to amend this Form 10-K and provide the required certifications at that time.

DISCLOSURE AND INTERNAL CONTROLS

CMS Energy's CEO and CFO are responsible for establishing and maintaining CMS Energy's disclosure controls and procedures. Management, under the direction of CMS Energy's principal executive and financial officers, has evaluated the effectiveness of CMS Energy's disclosure controls and procedures within the past ninety days of this filing. Based on this evaluation, CMS Energy's CEO and CFO have concluded that disclosure controls and procedures are effective to ensure that material information was presented to them and properly disclosed. There have been no significant changes in CMS Energy's internal controls or in factors, other than as discussed below, that could significantly affect internal controls subsequent to such evaluation.

CONTROL WEAKNESSES AT CMS MST

In late 2001 and during 2002, the Company identified a number of deficiencies in MST's systems of internal accounting controls. The internal control deficiencies related to, among other things, a lack of account reconciliations, unidentified differences between subsidiary ledgers and the general ledger, and procedures and processes surrounding the Company's accounting for energy trading contracts, including mark-to-market accounting.

Senior management, the Audit Committee of the Board of Directors, and the independent auditors were notified of these deficiencies as they were discovered, and the Company commenced a plan of remediation that included the replacement of certain key personnel and the deployment of additional internal and external accounting personnel to CMS MST. Significant aspects of the remediation plan, which includes the implementation of improvements and changes to CMS MST's internal accounting controls, were postponed to enable the Company to prepare restated financial statements for 2000 and 2001. While a number of these control improvements and changes were implemented in late 2002, the most important ones occurred in the first quarter of 2003.

The implementation of certain elements of its remediation plan enabled the Company to prepare reliable restated financial statements for CMS MST for December 31, 2000 and 2001, as well as for the quarterly periods and full year of 2002. Management has not yet prepared restated quarterly financial statements for 2001, although it expects to do so as soon as practicable.

Management believes that the improvements to its system of internal accounting controls implemented in late 2002 and the first quarter of 2003 are appropriate and responsive to the internal control deficiencies that were identified. Management will continue to monitor the operation of the improved internal controls to assess their sustained effectiveness through 2003.

NEW ACCOUNTING STANDARDS NOT YET ADOPTED

SFAS No. 143, *Accounting for Asset Retirement Obligations*: Beginning January 1, 2003, companies must comply with SFAS No. 143. The standard requires companies to record the fair value of the legal obligations related to an asset retirement in the period in which it is incurred. CMS Energy has determined that it has legal asset retirement obligations, particularly in regard to Consumers' nuclear plants, but it has not yet finalized its assessment of the obligation. However, upon initial adoption of the standard, CMS Energy, as it relates to Consumers, expects to record a regulatory liability, as well as an asset retirement obligation, as required by SFAS No. 71. The regulatory liability recognizes the difference between the cost of removal included in the reserve for accumulated depreciation for assets within the scope of SFAS No. 143 and the accretion expense of the asset retirement obligation and the depreciation expense of the asset retirement obligation asset from when the obligation was initially incurred through December 2002. When the asset retirement obligation liability is initially recorded, the company would capitalize an offsetting amount by increasing the carrying amount of the related long-lived asset. Over time, the initial liability would be accreted to its present value each period and the capitalized cost would be depreciated over the related asset's useful life. CMS Energy, as it relates to Enterprises, is currently inventorying assets, including its international investments, that may have a retirement obligation and consulting with counsel to determine if a legal retirement obligation exists. While CMS Energy has not finalized its assessment of the legal retirement obligation, the removal cost estimate will be determined based on fair value cost estimates as required by the new standard. The present value of the legal retirement obligations will be used to quantify the future effects of adoption of this standard.

SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*: Issued by the FASB in July 2002, this standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. This standard is effective for exit or disposal activities initiated after December 31, 2002. CMS Energy believes there will be no impact on its financial statements upon adoption of the standard.

FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirement for Guarantees, Including Indirect Guarantees of Indebtedness of Others*: Effective January 1, 2003, CMS Energy adopted this interpretation which elaborates on the disclosure to be made by a guarantor about its obligations under certain guarantees that it has issued. It requires that a guarantor recognize, at the inception of a guarantee, 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 certain guarantee contracts, such as warranties, derivatives, or guarantees between either parent and subsidiaries or corporations under common control, although disclosure of such guarantees is required. For contracts that are within the initial recognition and measurement provision of this Interpretation, the provisions are to be applied to guarantees issued or modified after December 31, 2002; no cumulative effect adjustments will be required.

FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*: Issued by the FASB in January 2003, the interpretation expands upon and strengthens existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. The consolidation requirements of the interpretation apply immediately to variable interest entities created after January 31, 2003. For CMS Energy, the consolidation requirements apply to pre-existing entities beginning July 1, 2003. Certain of the disclosure requirements apply to all financial statements initially issued after January 31, 2003. CMS Energy will be required to consolidate any entities that meet the requirements of the

interpretation. CMS Energy is in the process of studying the interpretation, and has yet to determine the effects, if any, on its consolidated financial statements.

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 final 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 an executory contract (i.e., on an accrual basis). The consensus rescinding EITF Issue No. 98-10 must be applied to all contracts that existed as of October 25, 2002 and must be recognized as a cumulative effect of a change in accounting principle in accordance with APB Opinion No. 20, *Accounting Changes*, effective the first day of the first interim or annual period beginning after December 15, 2002. The consensus also must be applied immediately to all new contracts entered into after October 25, 2002. As a result of these recent changes, CMS Energy is currently evaluating its existing energy contracts to determine the impact of this change which will be effective January 1, 2003.

CMS ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

| | Years Ended December 31 | | |
|--|-------------------------|---------------------|---------------------|
| | 2002 | As Restated 2001 | As Restated 2000 |
| | In Millions | | |
| Operating Revenue | | | |
| Electric utility | \$2,644 | \$2,630 | \$2,676 |
| Gas utility | 1,519 | 1,338 | 1,196 |
| Independent power production | 372 | 388 | 503 |
| Natural gas transmission | 50 | 59 | 88 |
| Marketing, services and trading | 4,076 | 3,674 | 2,178 |
| Other | 26 | (26) | 56 |
| | <u>8,687</u> | <u>8,063</u> | <u>6,697</u> |
| Operating Expenses | | | |
| Operation | | | |
| Fuel for electric generation | 341 | 297 | 407 |
| Purchased and interchange power — | | | |
| Marketing, services and trading | 2,193 | 1,189 | 349 |
| Purchased and interchange power | 455 | 599 | 429 |
| Purchased power — related parties | 546 | 539 | 555 |
| Cost of gas sold — Marketing, services and trading | 1,710 | 2,311 | 1,699 |
| Cost of gas sold | 1,037 | 923 | 707 |
| Other operating expenses | 895 | 904 | 867 |
| | <u>7,177</u> | <u>6,762</u> | <u>5,013</u> |
| Maintenance | 211 | 224 | 189 |
| Depreciation, depletion and amortization | 403 | 398 | 489 |
| General taxes | 199 | 196 | 209 |
| Reduced asset valuations | 598 | 240 | 329 |
| | <u>8,588</u> | <u>7,820</u> | <u>6,229</u> |
| Operating Income (Loss) | | | |
| Electric utility | 512 | 349 | 454 |
| Gas utility | 127 | 97 | 96 |
| Independent power production | (444) | (76) | (136) |
| Natural gas transmission | (15) | (50) | 22 |
| Marketing, services and trading | (60) | (22) | 23 |
| Other | (21) | (55) | 9 |
| | <u>99</u> | <u>243</u> | <u>468</u> |
| Other Income (Deductions) | | | |
| Accretion expense | (31) | (37) | (35) |
| Gain on asset sales, net of foreign currency translation losses of \$25 in 2000 | 37 | — | 54 |
| Other, net | (4) | 25 | 12 |
| | <u>2</u> | <u>(12)</u> | <u>31</u> |
| Income Before Fixed Charges and Taxes | <u>101</u> | <u>231</u> | <u>499</u> |

| | Years Ended December 31 | | |
|---|-------------------------|---------------------|---------------------|
| | 2002 | As Restated 2001 | As Restated 2000 |
| | In Millions | | |
| Fixed Charges | | | |
| Interest on long-term debt | 401 | 416 | 420 |
| Other interest | 31 | 83 | 34 |
| Capitalized interest | (16) | (35) | (47) |
| Preferred dividends | 2 | 2 | 2 |
| Preferred securities distributions | 86 | 96 | 93 |
| | <u>504</u> | <u>562</u> | <u>502</u> |
| Loss From Continuing Operations Before Income Taxes and Minority Interests | (403) | (331) | (3) |
| Income Tax Expense (Benefit) | 13 | (98) | 34 |
| Minority Interests | — | 3 | 3 |
| | <u>(416)</u> | <u>(236)</u> | <u>(40)</u> |
| Loss From Continuing Operations | | | |
| Discontinued Operations, Net of \$167 Tax Benefit in 2002, \$93 Tax Expense in 2001 and \$33 Tax Expense in 2000 | (222) | (210) | 83 |
| | <u>(638)</u> | <u>(446)</u> | <u>43</u> |
| Income (Loss) Before Cumulative Effect of Change in Accounting Principle | | | |
| Cumulative Effect of Change in Accounting for Derivative Instruments, Net of \$10 Tax in 2002 and \$— in 2001 | 18 | (2) | — |
| | <u>18</u> | <u>(2)</u> | <u>—</u> |
| Consolidated Net Income (Loss) | <u>\$ (620)</u> | <u>\$ (448)</u> | <u>\$ 43</u> |

| | Years Ended December 31 | | |
|---|--|---------------------|---------------------|
| | 2002 | As Restated 2001 | As Restated 2000 |
| | In Millions, Except Per Share Amounts | | |
| CMS Energy | | | |
| Net Income (Loss) | | | |
| Net Income (Loss) Available to Common Stock | <u>\$ (620)</u> | <u>\$ (448)</u> | <u>\$ 43</u> |
| Basic Income (Loss) Per Average Common Share | | | |
| Loss from Continuing Operations | \$(2.99) | \$(1.79) | \$(0.35) |
| Income (Loss) from Discontinued Operations | (1.60) | (1.61) | 0.73 |
| Loss from Change in Accounting Principle | 0.13 | (0.02) | — |
| Net Income (Loss) Attributable to Common Stock | <u>\$(4.46)</u> | <u>\$(3.42)</u> | <u>\$ 0.38</u> |
| Diluted Income (Loss) Per Average Common Share | | | |
| Loss from Continuing Operations | \$(2.99) | \$(1.79) | \$(0.35) |
| Income (Loss) from Discontinued Operations | (1.60) | (1.61) | 0.73 |
| Loss from Change in Accounting Principle | 0.13 | (0.02) | — |
| Net Income (Loss) Attributable to Common Stock | <u>\$(4.46)</u> | <u>\$(3.42)</u> | <u>\$ 0.38</u> |
| Dividends Declared Per Common Share | <u>\$ 1.09</u> | <u>\$ 1.46</u> | <u>\$ 1.46</u> |

The accompanying notes are an integral part of these statements.

CMS ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Years Ended December 31 | | |
|---|-------------------------|---------------------|---------------------|
| | 2002 | As Restated 2001 | As Restated 2000 |
| | In Millions | | |
| Cash Flows from Operating Activities | | | |
| Consolidated net income (loss) | \$ (620) | \$ (448) | \$ 43 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities | | | |
| Depreciation, depletion and amortization (includes nuclear decommissioning of \$6, \$6, and \$39, respectively) | 403 | 398 | 489 |
| Depreciation and amortization of discontinued operations | 94 | 186 | — |
| Reduced asset valuations (Note 3) | 598 | 240 | 329 |
| Loss on disposal of discontinued operations (Note 4) | 186 | 193 | — |
| Capital lease and debt discount amortization | 18 | 11 | 34 |
| Accretion expense | 31 | 37 | 35 |
| Distributions from related parties in excess of (less than) earnings | (39) | 68 | (171) |
| Cumulative effect of accounting change | (18) | 2 | — |
| Gain on sale of assets | (37) | — | (54) |
| Changes in assets and liabilities: | | | |
| Decrease (increase) in accounts receivable and accrued revenues .. | 100 | 330 | (310) |
| Decrease (increase) in inventories | 140 | (346) | (73) |
| Increase (decrease) in accounts payable and accrued expenses .. | (13) | (363) | 101 |
| Increase (decrease) in deferred income taxes and investment tax credit | (374) | 227 | 2 |
| Changes in other assets and liabilities | (66) | (169) | 161 |
| Net cash provided by operating activities | <u>403</u> | <u>366</u> | <u>586</u> |
| Cash Flows from Investing Activities | | | |
| Capital expenditures (excludes assets placed under capital lease) | (747) | (1,239) | (1,032) |
| Investments in partnerships and unconsolidated subsidiaries | (55) | (111) | (466) |
| Cost to retire property, net | (66) | (118) | (125) |
| Investments in Electric Restructuring Implementation Plan | (8) | (13) | (29) |
| Investments in nuclear decommissioning trust funds | (6) | (6) | (39) |
| Proceeds from nuclear decommissioning trust funds | 30 | 29 | 37 |
| Acquisition of companies, net of cash acquired | — | — | (74) |
| Proceeds from sale of property | 1,659 | 134 | 629 |
| Other | 277 | (24) | (107) |
| Net cash provided by (used in) investing activities | <u>1,084</u> | <u>(1,348)</u> | <u>(1,206)</u> |

| | Years Ended December 31 | | |
|---|-------------------------|----------------------|----------------------|
| | 2002 | As Restated 2001 | As Restated 2000 |
| | In Millions | | |
| Cash Flows from Financing Activities | | | |
| Proceeds from notes, bonds and other long-term debt | 725 | 2,021 | 1,189 |
| Proceeds from trust preferred securities | — | 125 | 220 |
| Issuance of common stock | 357 | 327 | 332 |
| Retirement of bonds and other long-term debt | (1,848) | (1,343) | (692) |
| Retirement of trust preferred securities | (331) | — | (250) |
| Common stock reacquired | (1) | (1) | (16) |
| Repurchase of common stock | (8) | (5) | (129) |
| Payment of common stock dividends | (149) | (190) | (167) |
| Payment of capital lease obligations | (15) | (20) | (32) |
| Increase (decrease) in notes payable, net | 75 | 21 | 174 |
| Other | (42) | 33 | — |
| Net cash provided by (used in) financing activities | <u>(1,237)</u> | <u>968</u> | <u>629</u> |
| Net Increase (Decrease) in Cash and Temporary Cash Investments ... | 250 | (14) | 9 |
| Cash and Temporary Cash Investments, Beginning of Period | 127 | 141 | 132 |
| Cash and Temporary Cash Investments, End of Period | <u>\$ 377</u> | <u>\$ 127</u> | <u>\$ 141</u> |
| Other cash flow activities and non-cash investing and financing activities were: | | | |
| Cash transactions | | | |
| Interest paid (net of amounts capitalized) | \$ 408 | \$ 442 | \$ 413 |
| Income taxes paid (net of refunds) | (217) | (60) | — |
| Pension and OPEB cash contribution | 147 | 122 | — |
| Non-cash transactions | | | |
| Nuclear fuel placed under capital leases | \$ — | \$ 13 | \$ 4 |
| Other assets placed under capital lease | 62 | 37 | 15 |

All highly liquid investments with an original maturity of three months or less are considered cash equivalents.

The accompanying notes are an integral part of these statements.

CMS ENERGY CORPORATION
CONSOLIDATED BALANCE SHEETS

| | December 31 | |
|--|-----------------|---------------------|
| | 2002 | As Restated 2001 |
| | In Millions | |
| ASSETS | | |
| Plant and Property (at cost) | | |
| Electric utility | \$ 7,523 | \$ 7,661 |
| Gas utility | 2,719 | 2,593 |
| Natural gas transmission | 210 | 205 |
| Independent power production | 251 | 916 |
| Other | 92 | 110 |
| | 10,795 | 11,485 |
| Less accumulated depreciation, depletion and amortization | 6,110 | 6,158 |
| | 4,685 | 5,327 |
| Construction work-in-progress | 549 | 521 |
| | 5,234 | 5,848 |
| Investments | | |
| Independent power production | 565 | 714 |
| Natural gas transmission | 178 | 577 |
| Midland Cogeneration Venture Limited Partnership | 388 | 300 |
| First Midland Limited Partnership | 255 | 253 |
| Other | 12 | 117 |
| | 1,398 | 1,961 |
| Current Assets | | |
| Cash and temporary cash investments at cost, which approximates market | 377 | 127 |
| Accounts receivable, notes receivable and accrued revenue, less allowances of \$8 in 2002 and \$5 in 2001 | 322 | 219 |
| Accounts receivable — Marketing, services and trading, less allowances of \$8 in 2002 and \$9 in 2001 | 248 | 295 |
| Accounts receivable and notes receivable — related parties | 187 | 190 |
| Inventories at average cost | | |
| Gas in underground storage | 491 | 590 |
| Materials and supplies | 89 | 89 |
| Generating plant fuel stock | 37 | 52 |
| Assets held for sale | 644 | 471 |
| Price risk management assets | 115 | 327 |
| Prepayments and other | 238 | 200 |
| | 2,748 | 2,560 |
| Non-current Assets | | |
| Regulatory Assets | | |
| Securitized costs | 689 | 717 |
| Postretirement benefits | 185 | 209 |
| Abandoned Midland project | 11 | 12 |
| Other | 168 | 167 |
| Assets held for sale | 2,081 | 3,480 |
| Price risk management assets | 135 | 368 |
| Nuclear decommissioning trust funds | 536 | 581 |
| Notes receivable — related parties | 160 | 177 |
| Notes receivable | 126 | 130 |
| Other | 444 | 565 |
| | 4,535 | 6,406 |
| Total Assets | \$13,915 | \$16,775 |

The accompanying notes are an integral part of these statements.

CMS ENERGY CORPORATION
STOCKHOLDERS' INVESTMENT AND LIABILITIES

| | December 31 | |
|--|-----------------|---------------------|
| | 2002 | As Restated 2001 |
| | In Millions | |
| Capitalization | | |
| Common stockholders' equity | | |
| Common stock, authorized 250.0 shares; outstanding 144.1 shares in 2002 and 133.0 shares in 2001 | \$ 1 | \$ 1 |
| Other paid-in capital | 3,605 | 3,257 |
| Other comprehensive income (loss) | (753) | (269) |
| Retained earnings (deficit) | (1,720) | (951) |
| | 1,133 | 2,038 |
| Preferred stock of subsidiary | 44 | 44 |
| Company-obligated convertible Trust Preferred Securities of subsidiaries(a) | 393 | 694 |
| Company-obligated mandatorily redeemable preferred securities of Consumer's subsidiaries(a) | 490 | 520 |
| Long-term debt | 5,356 | 5,840 |
| Non-current portion of capital leases | 116 | 71 |
| | 7,532 | 9,207 |
| Minority Interests | 21 | 24 |
| Current Liabilities | | |
| Current portion of long-term debt and capital leases | 640 | 1,016 |
| Notes payable | 458 | 416 |
| Accounts payable | 363 | 359 |
| Accounts payable — Marketing, services and trading | 119 | 236 |
| Accrued interest | 131 | 135 |
| Accrued taxes | 291 | 111 |
| Accounts payable — related parties | 53 | 54 |
| Liabilities held for sale | 465 | 639 |
| Price risk management liabilities | 96 | 367 |
| Current portion of purchase power contracts | 26 | 24 |
| Current portion of gas supply contract obligations | 25 | 22 |
| Deferred income taxes | 15 | 49 |
| Other | 216 | 243 |
| | 2,898 | 3,671 |
| Non-current Liabilities | | |
| Postretirement benefits | 725 | 356 |
| Deferred income taxes | 414 | 824 |
| Deferred investment tax credit | 91 | 102 |
| Regulatory liabilities for income taxes, net | 297 | 276 |
| Liabilities held for sale | 1,243 | 1,376 |
| Price risk management liabilities | 135 | 287 |
| Gas supply contract obligations | 241 | 266 |
| Power purchase agreement — MCV Partnership | 27 | 52 |
| Other | 291 | 334 |
| | 3,464 | 3,873 |
| Commitments and Contingencies (Notes 1, 2, 3, 4, 5, 6, 14 and 18) | | |
| Total Stockholders' Investment and Liabilities | \$13,915 | \$16,775 |

(a) For further discussion, see Note 8 to the Consolidated Financial Statements.

CMS ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF PREFERRED STOCK

| <u>December 31</u> | <u>Series</u> | <u>Optional Redemption Price</u> | <u>2002</u> | <u>2001</u> | <u>2002</u> | <u>2001</u> |
|---|---------------|--|-------------------------|-------------|--------------------|-------------|
| | | | <u>Number of Shares</u> | | <u>In Millions</u> | |
| Consumers' Preferred Stock | | | | | | |
| Cumulative, \$100 par value, authorized | | | | | | |
| 7,500,000 shares, | \$4.16 | \$103.25 | 68,451 | 68,451 | \$ 7 | \$ 7 |
| with no mandatory redemption..... | 4.50 | 110.00 | 373,148 | 373,148 | <u>37</u> | <u>37</u> |
| Total Preferred Stock | | | | | <u>\$44</u> | <u>\$44</u> |

The accompanying notes are an integral part of these statements.

CMS ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDERS' EQUITY

| <u>Years Ended December 31</u> | <u>2002</u> | <u>2001</u> | <u>2000</u> | <u>2002</u> | <u>As Restated 2001</u> | <u>As Restated 2000</u> |
|--|-------------------------------|----------------|----------------|-----------------|-----------------------------|-----------------------------|
| | Number of Shares in Thousands | | | In Millions | | |
| Common Stock | | | | | | |
| At beginning and end of period | | | | \$ 1 | \$ 1 | \$ 1 |
| Other Paid-in Capital | | | | | | |
| At beginning of period | 132,989 | 121,201 | 116,038 | 3,257 | 2,936 | 2,749 |
| Common stock repurchased | (39) | (232) | (6,600) | (8) | (5) | (129) |
| Common stock reacquired | (220) | (11) | (259) | (1) | (1) | (16) |
| Common stock issued | 11,358 | 11,681 | 11,538 | 357 | 320 | 321 |
| Common stock reissued | — | 350 | 484 | — | 7 | 11 |
| At end of period | <u>144,088</u> | <u>132,989</u> | <u>121,201</u> | <u>3,605</u> | <u>3,257</u> | <u>2,936</u> |
| Other Comprehensive Income (Loss) | | | | | | |
| Minimum Pension Liability | | | | | | |
| At beginning of period | | | | — | — | — |
| Minimum pension liability adjustments(a) | | | | (241) | — | — |
| At end of period | | | | <u>(241)</u> | <u>—</u> | <u>—</u> |
| Investments | | | | | | |
| At beginning of period | | | | (5) | (2) | 3 |
| Unrealized gain (loss) on investments(a) | | | | — | (3) | (5) |
| Realized gain (loss) on investments(a) | | | | 7 | — | — |
| At end of period | | | | <u>2</u> | <u>(5)</u> | <u>(2)</u> |
| Derivative Instruments(c) | | | | | | |
| At beginning of period(b) | | | | (31) | 7 | — |
| Unrealized gain (loss) on derivative instruments(a) | | | | (29) | (31) | — |
| Reclassification adjustments included in consolidated net income (loss)(a) | | | | 4 | (7) | — |
| At end of period | | | | <u>(56)</u> | <u>(31)</u> | <u>—</u> |
| Foreign Currency Translation | | | | | | |
| At beginning of period | | | | (233) | (206) | (108) |
| Change in foreign currency translation realized from asset sale(a) | | | | — | — | 25 |
| Change in foreign currency translation(a) | | | | (225) | (27) | (123) |
| At end of period | | | | <u>(458)</u> | <u>(233)</u> | <u>(206)</u> |
| Retained Earnings (Deficit) | | | | | | |
| At beginning of period | | | | (951) | (313) | (189) |
| Consolidated net income (loss)(a) | | | | (620) | (448) | 43 |
| Common stock dividends declared: Common stock dividends declared | | | | (149) | (190) | (167) |
| At end of period | | | | <u>(1,720)</u> | <u>(951)</u> | <u>(313)</u> |
| Total Common Stockholders' Equity | | | | <u>\$ 1,133</u> | <u>\$2,038</u> | <u>\$2,416</u> |

| <u>Years Ended December 31</u> | <u>2002</u> | <u>2001</u> | <u>2000</u> | <u>2002</u> | <u>As Restated 2001</u> | <u>As Restated 2000</u> |
|---|-------------------------------|-----------------|----------------|-------------|-----------------------------|-----------------------------|
| | Number of Shares in Thousands | | | In Millions | | |
| (a) Disclosure of Comprehensive Income (Loss): | | | | | | |
| Other Comprehensive Income | | | | | | |
| Minimum pension liability | | | | | | |
| Minimum pension liability adjustments, net of tax of \$132, \$—, and \$—, respectively | \$ (241) | \$ — | \$ — | | | |
| Investments | | | | | | |
| Unrealized gain (loss) on investments, net of tax of \$—, \$2, and \$3, respectively | — | (3) | (5) | | | |
| Realized gain (loss) on investments, net of tax of \$—, \$—, and \$—, respectively | | | | | | |
| Derivative Instruments | 7 | — | — | | | |
| Unrealized gain (loss) on derivative instruments, net of tax of \$—, \$13, and \$—, respectively | (29) | (31) | — | | | |
| Reclassification adjustments included in consolidated net income, net of tax of \$(2), \$3, and \$—, respectively | 4 | (7) | — | | | |
| Foreign currency translation | (225) | (27) | (98) | | | |
| Consolidated net income (loss) | <u>(620)</u> | <u>(448)</u> | <u>43</u> | | | |
| Total Consolidated Comprehensive Loss | <u>\$ (1,104)</u> | <u>\$ (516)</u> | <u>\$ (60)</u> | | | |

(b) Year ended December 31, 2001 reflects the cumulative change in accounting principle, net of \$(7) tax (Note 10).

(c) Included in these amounts is CMS Energy's proportionate share of the effects of derivative accounting related to its equity investment in the MCV Partnership and Taweelah as follows:

| | | | |
|---|----------------|---------------|------------|
| MCV Partnership: | | | |
| At the beginning of the period | \$ (8) | \$ 5 | \$— |
| Unrealized gain (loss) on derivative instruments | 12 | (15) | — |
| Reclassification adjustments included in net income | 4 | 2 | — |
| At the end of period | <u>\$ 8</u> | <u>\$ (8)</u> | <u>\$—</u> |
| Taweelah: | | | |
| At the beginning of the period | \$ — | \$ — | \$— |
| Unrealized gain (loss) on derivative instruments | (32) | — | — |
| At the end of period | <u>\$ (32)</u> | <u>\$ —</u> | <u>\$—</u> |

The accompanying notes are an integral part of these statements.

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1: CORPORATE STRUCTURE AND SUMMARY OF SIGNIFICANT 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: natural gas transmission, storage and processing; independent power production; and energy marketing, services and trading.

Restatement: CMS Energy's consolidated financial statements for the years 2001 and 2000 have been restated, as discussed in Note 2, Restatement, pursuant to adjustments resulting from the re-audit of the consolidated financial statements of CMS Energy for the years 2001 and 2000.

Principles of Consolidation: The consolidated financial statements include the accounts of CMS Energy, Consumers and Enterprises and their majority-owned subsidiaries. Investments in affiliated companies where CMS Energy has the ability to exercise significant influence, but not control are accounted for using the equity method. Intercompany transactions and balances have been eliminated.

Use of Estimates: 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.

The principles in SFAS No. 5 guide the recording of estimated liabilities for contingencies within the financial statements. SFAS No. 5 requires a company to record estimated liabilities in the financial statements when it is probable that a loss will be paid in the future as a result of a current event, and that an amount can be reasonably estimated. CMS Energy has used this accounting principle to record estimated liabilities discussed in Note 6, Uncertainties.

Revenue Recognition Policy: Revenues from deliveries of electricity and the transportation and storage of natural gas are recognized as services are provided. Revenues on sales of marketed electricity, natural gas, and other energy products, as well as natural gas and LNGs, are recognized at delivery. Revenues on sales of oil and natural gas produced are recognized when production occurs, a sale is completed, and the risk of loss transfers to a third-party purchaser. Mark-to-market changes in the fair value of energy trading contracts are recognized as revenues in the periods in which the changes occur.

Accretion Income and Expense: In 1991, the MPSC allowed Consumers to recover a portion of its abandoned Midland investment over a 10-year period, but did not allow Consumers to earn a return on that amount. Consumers reduced the recoverable investment to the present value of the future recoveries. During the recovery period, Consumers adjusts the unrecovered asset to its present value. It reflects this adjustment as accretion income. In 1992, Consumers recorded a loss for the present value of its estimated future underrecoveries of power supply costs resulting from purchases from the MCV Partnership (see Note 6). It now recognizes accretion expense annually to reflect the time value of money on the recorded loss. CMS MST has entered into prepaid sales arrangements to provide natural gas to various entities over periods of up to 12 years at predetermined price levels. CMS MST has established a liability for these outstanding obligations equal to the discounted present value of the contracts, and has hedged its exposures under these arrangements. At December 31, 2002 and 2001, the amounts recorded as liabilities on the Consolidated Balance Sheets totaled \$266 million and \$288 million, respectively, and are guaranteed by Enterprises. As CMS MST fulfills its obligations under the contracts, it recognizes revenues upon the delivery of natural gas, and records a reduction to the outstanding obligation, and recognizes accretion expense.

Capitalized Interest: SFAS No. 34 requires capitalization of interest on certain qualifying assets that are undergoing activities to prepare them for their intended use. SFAS No. 34 limits the capitalization of interest for the period to the actual interest cost that is incurred and prohibits imputing interest costs on any equity funds. The nonregulated businesses of CMS Energy are subject to these rules. The regulated businesses of CMS Energy are

CMS ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

permitted to capitalize an allowance for funds used during construction on regulated construction projects and to include such amounts in plant in service.

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 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 9.

Financial Instruments: CMS Energy accounts for its debt and equity investment securities in accordance with SFAS No. 115. As such, debt and equity securities can be classified into one of three categories: held-to-maturity, trading, or available-for-sale securities. CMS Energy's investments in equity securities are classified as available-for-sale securities. They are reported at fair value, with any unrealized gains or losses from changes in fair value usually reported in equity as part of other comprehensive income and excluded from earnings unless such changes in fair value are other than temporary. Unrealized gains or losses from changes in the fair value of Consumers' nuclear decommissioning investments are reported in accumulated depreciation. The fair value of these investments is determined from quoted market prices.

Foreign Currency Translation: CMS Energy's subsidiaries and affiliates whose functional currency is other than the U.S. dollar translate their assets and liabilities into U.S. dollars at the current exchange rates in effect at the end of the fiscal period. The revenue and expense accounts of such subsidiaries and affiliates are translated 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, and which CMS Energy does 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. For the years ended 2002 and 2001, the change in the foreign currency translation adjustment decreased equity by \$225 million and \$27 million, respectively, net of after-tax hedging proceeds.

Goodwill: Goodwill represents the excess of the purchase price over the fair value of the net assets of acquired companies. Effective January 1, 2002, CMS Energy adopted SFAS No. 142, which disallowed, upon adoption and on an annual basis, the continued amortization of goodwill and required the testing of goodwill for potential impairment. Effective January 1, 2002, CMS MST recorded a loss of \$10 million, net of tax for goodwill impairment. In addition, Panhandle recorded a write-off of goodwill in the amount of \$369 million, net of tax. For additional information, see Note 5, Goodwill.

Impairment of Investments and Long-Lived Assets: In accordance with APB Opinion No. 18 and SFAS No. 144, CMS Energy evaluates the potential impairment of its investments in projects and other 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 investment or asset exceeds the amount of the expected future undiscounted cash flows, an impairment loss is recognized and the investment or asset is written down to its estimated fair value.

Inventories: Consumers uses the weighted average cost method for valuing working gas inventory. Beginning October 2000, gas inventory also includes recoverable cushion gas. Consumers records non-recoverable cushion gas in the appropriate gas utility plant account. Consumers stores gas inventory in its underground storage facilities.

In 2000, CMS Energy adopted the provisions of the SAB No. 101 summarizing the SEC staff's views on revenue recognition policies based upon existing generally accepted accounting principles. As a result, the oil and

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

gas exploration and production industry's long-standing practice of recording inventories at their net realizable amount at the time of production was viewed as inappropriate. Rather, inventories should be presented at the lower of cost or market. Consequently, in conforming to the interpretations of SAB No. 101, CMS Energy implemented a change in the recording of these oil and gas exploration and production inventories as of January 1, 2000. The cumulative effect of this one-time non-cash accounting change decreased 2000 income by \$7 million, or \$5 million, net of tax.

Nuclear Fuel Cost: Consumers amortizes nuclear fuel cost to fuel expense based on the quantity of heat produced for electric generation. Through November 2001, Consumers expensed the interest on leased nuclear fuel as it was incurred. Effective December 2001, Consumers no longer leases its nuclear fuel.

For nuclear fuel used after April 6, 1983, Consumers charges disposal costs to nuclear fuel expense, recovers these costs through electric rates, and then emits them to the DOE quarterly. Consumers elected to defer payment for disposal of spent nuclear fuel burned before April 7, 1983. As of December 31, 2002, Consumers has a recorded liability to the DOE of \$138 million, including interest, which is payable upon the first delivery of spent nuclear fuel to the DOE. Consumers recovered through electric rates the amount of this liability, excluding a portion of interest.

Nuclear Plant Decommissioning: In 2002, Consumers collected \$6 million from its electric customers for the decommissioning of its Palisades nuclear plant. Amounts collected from electric retail customers and deposited in trusts (including trust earnings) are credited to accumulated depreciation. In March 2001, Consumers filed updated decommissioning cost estimates for Big Rock and Palisades that were \$349 million and \$739 million in 2000 dollars, respectively. Using the inflation factors presented in the filing to the MPSC, the Palisades estimated decommissioning cost in 2002 dollars is \$809 million. The Big Rock decommissioning cost in 2002 dollars is \$327 million. Consumers' 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. On December 31, 2000, Big Rock trusts were fully funded per the March 22, 1999 MPSC order and Consumers discontinued depositing funds in the trust. In December 2000, the NRC extended the Palisades operating license to March 2011 and the impact of this extension was included as part of Consumers' March 2001 filing with the MPSC. Consumers is required to file the next "Report on the Adequacy of the Existing Annual Provision for Nuclear Plant Decommissioning" (Report) with the MPSC by March 31, 2004.

In 1997, Big Rock closed permanently and plant decommissioning began. Consumers estimates 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. In 2002, Consumers incurred costs of \$28 million that were charged to the accumulated depreciation reserve for decommissioning and withdrew \$30 million from the Big Rock nuclear decommissioning trust fund. In total, Consumers has incurred costs of \$218 million that have been charged to the accumulated depreciation reserve for decommissioning and withdrew \$209 million from the Big Rock nuclear decommissioning trust fund. These activities had no material impact on net income. At December 31, 2002, Consumers is the beneficiary of the investment in nuclear decommissioning trust funds of \$110 million for Big Rock.

After retirement of Palisades, Consumers plans to maintain the facility in protective storage if radioactive waste disposal facilities are not available. Consumers will incur most of the Palisades decommissioning costs after the plant's NRC operating license expires. Palisades' current NRC license will expire in 2011 and the trust funds were estimated to have accumulated \$921 million by that time, assuming currently approved MPSC surcharge levels. Consumers estimates that at the time Palisades is fully decommissioned in the year 2049, the trust funds will have provided \$2.5 billion, including trust earnings, to pay for the anticipated expenditures over the entire decommissioning period. At December 31, 2002, Consumers is the beneficiary of the investment in the MPSC nuclear decommissioning trust funds of \$416 million for Palisades. In addition, at December 31, 2002, Consumers has a FERC decommissioning trust fund with a balance of approximately \$9 million.

CMS ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Plant and Property: Plant and Property, including improvements, is stated at cost. Construction-related labor and material costs, as well as indirect construction costs such as engineering and interest costs, are capitalized. Property repairs, minor property replacements and maintenance are charged to maintenance expense as incurred. When depreciable plant and property maintained by CMS Energy's regulated operations are retired or sold, the original cost plus cost of removal (net of salvage credits), is charged to accumulated depreciation.

Depreciation expense for plant and property was \$343 million, \$312 million, and \$345 million in 2002, 2001 and 2000, respectively. Consumers bases depreciation provisions for utility property on straight-line and units-of-production rates approved by the MPSC. For 2002, 2001 and 2000, the composite depreciation rate for electric utility property was 3.1 percent annually. For 2002, 2001 and 2000, the composite rate for gas utility property was 4.5 percent, 4.4 percent and 4.4 percent, respectively. For 2002, 2001 and 2000, the composite rate for other property was 7.2 percent, 11.2 percent and 10.7 percent, respectively. Other nonutility depreciable property is amortized over its estimated useful life; gains and losses on asset sales are recognized at the time of sale.

Related-Party Transactions: In 2002, 2001 and 2000, Consumers paid \$49 million, \$55 million, and \$51 million, respectively, for electric generating capacity and energy from affiliates of Enterprises. Affiliates of CMS Energy sold, stored and transported natural gas and provided other services to the MCV Partnership totaling \$43 million, \$49 million, and \$54 million for 2002, 2001 and 2000. For additional discussion of related-party transactions with the MCV Partnership and the FMLP, see Note 6, Uncertainties and Note 18, Summarized Financial Information of Significant Related Energy Supplier. Other related-party transactions are immaterial.

Unamortized Debt Premium, Discount and Expense: CMS Energy amortizes premiums, discounts and expenses incurred in connection with the issuance of presently outstanding long-term debt over the terms of the respective issues. For the regulated portions of CMS Energy's businesses, if debt is refinanced, CMS Energy amortizes any unamortized premiums, discounts and expenses over the term of the new debt, as allowed under regulated utility accounting.

Utility Regulation: Consumers accounts for the effects of regulation based on the regulated utility accounting standard SFAS No. 71. As a result, the actions of regulators affect when Consumers recognizes revenues, expenses, assets and liabilities.

In March 1999, Consumers 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, Consumers discontinued the application of SFAS No. 71 for the energy supply portion of its business because Consumers expected to implement retail open access at competitive market based rates for its electric customers. Discontinuation of SFAS No. 71 for the energy supply portion of Consumers' business resulted in Consumers reducing the carrying value of its Palisades plant-related assets, in 1999, by approximately \$535 million and establishing a regulatory asset for a corresponding amount. As of December 31, 2002, Consumers had a net investment in energy supply facilities of \$1.475 billion included in electric plant and property.

Since 1999, there has been a significant legislative and regulatory change in Michigan that has resulted in: 1) electric supply customers of utilities remaining on cost-based rates and 2) utilities being given the ability to recover Stranded Costs associated with electric restructuring, from customers who choose an alternative electric supplier. During 2002, Consumers 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 its business could meet the criteria if certain regulatory events occurred. In December 2002, Consumers received a MPSC Stranded Cost order that allowed Consumers to re-apply regulatory accounting standard SFAS No. 71 to the energy supply portion of its business. Re-application of SFAS No. 71 had no effect on the prior discontinuation accounting, but will allow Consumers to apply regulatory accounting treatment to the energy supply portion of its business on a prospective basis, including regulatory accounting treatment of costs required

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

to be recognized in accordance with SFAS No. 143. See Note 6, Uncertainties, "Electric Rate Matters — Electric Restructuring."

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 (liabilities), which include both current and non-current amounts, are reflected in the Consolidated Balance Sheets. These costs are expected to be recovered through rates over periods of up to 14 years. Consumers recognized an OPEB transition obligation in accordance with SFAS No. 106 and established a regulatory asset for this amount, which it expects to recover in rates over the next ten years.

| | <u>December 31</u> | |
|--|--------------------|-----------------|
| | <u>2002</u> | <u>2001</u> |
| | In Millions | |
| Securitized costs | \$ 689 | \$ 717 |
| Postretirement benefits | 204 | 228 |
| Electric Restructuring Implementation Plan | 83 | 82 |
| Manufactured gas plant sites | 69 | 70 |
| Abandoned Midland project | 11 | 12 |
| Income taxes | — | 6 |
| Other | <u>16</u> | <u>15</u> |
| Total regulatory assets | <u>\$1,072</u> | <u>\$1,130</u> |
| Income taxes | \$ (297) | \$ (282) |
| GCR over recovery | (11) | (9) |
| Other | <u>(5)</u> | <u>—</u> |
| Total regulatory liabilities | <u>\$ (313)</u> | <u>\$ (291)</u> |

In October 2000, Consumers received an MPSC order authorizing Consumers to securitize certain regulatory assets up to \$469 million, net of tax; see Note 6, Uncertainties, "Electric Rate Matters — Electric Restructuring". Accordingly, in December 2000, Consumers established a regulatory asset for securitized costs of \$709 million, before tax, that had previously been recorded in other regulatory asset accounts. In order to prepare for the financing of the securitized assets and the subsequent retirement of debt with Securitization proceeds, issuance fees of \$1 million, \$10 million and \$1 million were incurred in 2002, 2001 and 2000, respectively, and capitalized as a part of Securitization costs. These issuance costs are amortized each month for up to fourteen years. Amortization of the securitized assets approximated \$29 million and \$2 million in 2002 and 2001; respectively for accumulated securitized cost amortization of \$31 million. The components of the unamortized securitized costs are illustrated below.

| | <u>December 31</u> | |
|--|--------------------|--------------|
| | <u>2002</u> | <u>2001</u> |
| | In Millions | |
| Unamortized nuclear costs | \$405 | \$405 |
| Postretirement benefits | 84 | 84 |
| Income taxes | 203 | 203 |
| Uranium enrichment facility | 16 | 16 |
| Accumulated Securitization cost amortization | (31) | (2) |
| Other | <u>12</u> | <u>11</u> |
| Total unamortized securitized costs | <u>\$689</u> | <u>\$717</u> |

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Implementation of New Accounting Standards

SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*: This new standard was issued by the FASB in October 2001, and supersedes SFAS No. 121, and APB Opinion No. 30. SFAS No. 144 requires long-lived assets to be measured at the lower of either the carrying amount or of the fair value less the cost to sell, whether reported in continuing operations or in discontinued operations. Therefore, discontinued operations will no longer be measured at net realizable value or include amounts for operating losses that have not yet occurred. SFAS No. 144 also broadens the reporting of discontinued operations to include all components of an entity with operations that can be distinguished from the rest of the entity and that will be eliminated from the ongoing operations of the entity in a disposal transaction. The adoption of SFAS No. 144, effective January 1, 2002, results in CMS Energy accounting for any impairment or disposal of long-lived assets under the provisions of SFAS No. 144 subsequent to January 1, 2002, but will not change the accounting used for previous asset impairments or disposals. See Note 4, Discontinued Operations.

SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*: Issued by the FASB in April 2002, this standard rescinds SFAS No. 4, *Reporting Gains and Losses from Extinguishment of Debt*, and SFAS No. 64, *Extinguishment of Debt Made to Satisfy Sinking-Fund Requirements*. As a result, any gain or loss on extinguishment of debt should be classified as an extraordinary item only if it meets the criteria set forth in APB Opinion No. 30. The provisions of this section are applicable to fiscal years beginning 2003, however CMS Energy has adopted this provision effective in 2002 and reclassified extraordinary losses of \$7 million and \$18 million in 2002 and 2001, respectively, to the accompanying Consolidated Statements of Income. The 2002 reclassification increased interest expense \$12 million (\$8 million after-tax) and increased income from discontinued operations \$1 million. The 2001 reclassification increased interest expense \$25 million (\$16 million after-tax) and decreased income from discontinued operations \$2 million. SFAS No. 145 amends SFAS No. 13, *Accounting for Leases*, to require sale-leaseback accounting for certain lease modifications that have similar economic impacts to sale-leaseback transactions. This provision is effective for transactions occurring after May 15, 2002. Finally, SFAS No. 145 amends other existing authoritative pronouncements to make various technical corrections and rescinds SFAS No. 44, *Accounting for Intangible Assets of Motor Carriers*. These provisions are effective for financial statements issued on or after May 15, 2002.

SFAS No. 148, *Accounting for Stock-Based Compensation — Transition and Disclosure*: Issued by the FASB in December 2002, this standard provides for alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, the statement amends the disclosure requirements of SFAS No. 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The transition guidance and annual disclosure provisions of the statement are effective as of December 31, 2002 and interim disclosure provisions are effective for interim financial reports starting in 2003. CMS Energy adopted the fair value based method of accounting for stock-based employee compensation effective December 31, 2002, applying the prospective method of adoption which requires recognition of all employee awards granted, modified, or settled after the beginning of the year in which the recognition provisions are first applied. Therefore, CMS Energy recorded expense for the fair value of stock options issued in 2002. The implementation had an immaterial effect on CMS Energy's financial statements upon adoption of the method. Accordingly, CMS Energy recognized the \$4 million fair value of stock based awards granted, modified or settled in 2002 in operating expenses. See Note 12, Executive Incentive Compensation.

New Accounting Standards Not Yet Adopted: Beginning January 1, 2003, companies must comply with SFAS No. 143, *Accounting for Asset Retirement Obligations*. The standard requires companies to record the fair value of the legal obligations related to an asset retirement in the period in which it is incurred. Consumers has determined that it has legal asset retirement obligations, particularly in regard to its nuclear plants, but it has not yet finalized its assessment of the obligation. However, upon initial adoption of the standard, CMS Energy, as it

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

relates to Consumers, expects to record a regulatory liability, as well as an asset retirement obligation, as required by SFAS No. 71. The regulatory liability recognizes the difference between the cost of removal included in the reserve for accumulated depreciation for assets within the scope of SFAS No. 143 and the accretion expense of the asset retirement obligation and the depreciation expense of the asset retirement obligation asset from when the obligation was initially incurred through December 2002. When the asset retirement obligation liability is initially recorded, the company would capitalize an offsetting amount by increasing the carrying amount of the related long-lived asset. Over time, the initial liability would be accreted to its present value each period and the capitalized cost would be depreciated over the related asset's useful life. CMS Energy, as it relates to Enterprises, is currently inventorying assets, including its international investments, that may have a retirement obligation and is consulting with counsel to determine if a legal retirement obligation exists. While CMS Energy has not finalized its assessment of the legal retirement obligation, the removal cost estimate will be determined based on fair value cost estimates as required by the new standard. The present value of the legal retirement obligations will be used to quantify the future effects of adoption of this standard.

SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*: Issued by the FASB in July 2002, this standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. This standard is effective for exit or disposal activities initiated after December 31, 2002. CMS Energy believes there will be no impact on its financial statements upon adoption of the standard.

FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirement for Guarantees, Including Indirect Guarantees of Indebtedness of Others*: Effective January 1, 2003, CMS Energy adopted this interpretation which elaborates on the disclosure to be made by a guarantor about its obligations under certain guarantees that it has issued. It requires that a guarantor recognize, at the inception of a guarantee, 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 certain guarantee contracts, such as warranties, derivatives, or guarantees between either parent and subsidiaries or corporations under common control, although disclosure of such guarantees is required. For contracts that are within the initial recognition and measurement provision of this Interpretation, the provisions are to be applied to guarantees issued or modified after December 31, 2002; no cumulative effect adjustments will be required.

FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*: Issued by the FASB in January 2003, the interpretation expands upon and strengthens existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. The consolidation requirements of the interpretation apply immediately to variable interest entities created after January 31, 2003. For CMS Energy, the consolidation requirements apply to pre-existing entities beginning July 1, 2003. Certain of the disclosure requirements apply to all financial statements initially issued after January 31, 2003. CMS Energy will be required to consolidate any entities that meet the requirements of the interpretation. CMS Energy is in the process of studying the interpretation, and has yet to determine the effects, if any, on its consolidated financial statements.

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 final 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 an executory contract (i.e., on an accrual basis). The consensus rescinding EITF Issue No. 98-10 must be applied to all contracts that existed as of October 25, 2002 and must be recognized as a cumulative effect of a change in accounting principle in accordance with APB Opinion No. 20, *Accounting Changes*, effective the first day of the first interim or annual period beginning after December 15, 2002. The consensus also must be applied immediately to all new contracts entered into after October 25, 2002. As a result of these recent changes,

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

CMS Energy is currently evaluating its existing energy contracts to determine the impact of this change which will be effective January 1, 2003.

Other: For significant accounting policies regarding risk management activities and financial instruments, see Note 10; income taxes, see Note 11; executive incentive compensation, see Note 12; and retirement benefits, see Note 13.

2. RESTATEMENT

Round-Trip Trades: During the period of May 2000 through January 2002, CMS MST engaged in simultaneous, prearranged commodity trading transactions in which energy commodities were sold and repurchased at the same price. These transactions, which had no impact on previously reported consolidated net income, earnings per share or cash flows, had the effect of increasing operating revenues, operating expenses, accounts receivable, accounts payable and reported trading volumes. After internally concluding that cessation of these trades was in CMS Energy's best interest, these so called round-trip trades were halted in January 2002.

CMS Energy accounted for these trades in gross revenue and expense through the third quarter of 2001, but subsequently concluded that these round-trip trades should have been reflected on a net basis. In the fourth quarter of 2001, CMS Energy ceased recording these trades in either revenues or expenses. CMS Energy's 2001 Form 10-K, issued in March 2002, restated revenue and expense for the first three quarters of 2001 to eliminate \$4.2 billion of previously reported revenue and expense. The 2001 Form 10-K did include \$5 million of revenue and expense for 2001 from such trades, which remained uncorrected. CMS Energy inadvertently failed to restate 2000 for round trip trades in the 2001 10-K. Financial statements have now been restated to eliminate \$1 billion in 2000 and \$5 million in 2001 of previously reported revenue and expenses.

CMS Energy is cooperating with an SEC investigation regarding round-trip trading and the Company's financial statements, accounting practices and controls. CMS Energy is also cooperating with inquiries by the Commodity Futures Trading Commission, the FERC, and the United States Department of Justice regarding these transactions. CMS Energy has also received subpoenas from U.S. Attorney Offices regarding investigations of those trades. In addition, CMS Energy's Board of Directors established the Special Committee of independent directors to investigate matters surrounding round-trip trading and the Special Committee retained outside counsel to assist in the investigation.

On October 31, 2002, the Special Committee reported the results of its investigation to the Board of Directors. The Special Committee discovered no new information inconsistent with the information previously reported by CMS Energy and as reported above. The investigation also concluded that the round-trip trades were undertaken to raise CMS MST's profile as an energy marketer, with the goal of enhancing CMS MST's ability to promote its services to new customers. The Special Committee found no apparent effort to manipulate the price of CMS Energy Common Stock or to affect energy prices.

The Special Committee also made recommendations designed to prevent any reoccurrence of this practice, most of which have already been implemented. Previously, CMS Energy terminated its speculative trading business and revised its risk management policy. The Board of Directors adopted, and CMS Energy has begun implementing, the remaining recommendations of the Special Committee.

Restatement: In connection with the re-audit of the financial statements for the fiscal years ended December 31, 2001 and December 31, 2000, CMS Energy determined to make certain adjustments (in addition to the round-trip trades) to its consolidated financial statements for the fiscal years ended December 31, 2001 and December 31, 2000. Therefore, the consolidated financial statements for 2001 and 2000 have been restated from amounts previously reported. At the time it adopted the accounting treatment for these items, CMS Energy believed such accounting was appropriate under accounting principles generally accepted in the United States.

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The tables below summarize the significant adjustments and the effects on CMS Energy's consolidated financial statements.

| <u>Net Income Increase (Decrease)</u> | <u>2001</u> | <u>2000</u> | <u>Total</u> |
|--|---------------|-------------|--------------|
| | (In Millions) | | |
| MCV PPA Adjustments | \$ 90 | \$(20) | \$ 70 |
| DIG Loss Contract Accounting | 126 | — | 126 |
| Mark-to-Market Gains and Losses on Inter-book Transactions and other related adjustments | (43) | 18 | (25) |
| Mark-to-Market Gains and Losses on Intercompany Transactions | (30) | 18 | (12) |
| CMS MST Account Reconciliations | (5) | (13) | (18) |
| Income Tax Adjustments | (30) | — | (30) |
| Panhandle System Gas | (7) | — | (7) |
| Amortization of Debt Costs | (2) | 7 | 5 |
| Other | (2) | (3) | (5) |
| Total | <u>\$ 97</u> | <u>\$ 7</u> | <u>\$104</u> |

| <u>Balance Sheet: Increase in Consolidated Debt</u> | <u>2001</u> | <u>2000</u> |
|---|---------------|-------------|
| | (In Millions) | |
| Reconsolidation of LNG Facility | \$215 | \$ — |
| Structured Financing of Methanol Plant | 125 | 125 |
| Consumers' Headquarters Capital Lease | 16 | — |

MCV PPA Adjustments: In 1992, Consumers originally accounted for losses associated with the PPA by establishing a reserve for the difference between the amount that Consumers was paying for power in accordance with the terms of the PPA, and the amount that Consumers was ultimately allowed by the MPSC to recover from electric customers. At that time, the reserve did not take into account earnings Consumers would receive from its 49 percent interest in the MCV Partnership due to uncertainties with the level of performance of the facility.

In 2000, Consumers reviewed its estimate of the economic losses it would experience with respect to the PPA and re-evaluated all of the then current facts and circumstances used to calculate the disallowance reserve, including earnings from its 49 percent interest in the MCV Partnership. Consumers concluded that no adjustment to the reserve was required in 2000. However, as conditions surrounding MCV Partnership operations evolved in 2001, Consumers concluded that it needed to increase the reserve by \$126 million (pre-tax) in the third quarter of 2001, and did so.

In connection with the re-audit of CMS Energy's consolidated financial statements for the fiscal years 2000 and 2001, Consumers reviewed its 2000 and 2001 PPA accounting and related assumptions, and determined that the reserve balance as of January 1, 2000 did appropriately reflect Consumers' probable losses as of that date. However, as a result of reconsideration of all subsidiary accounting effects, the re-evaluation of the PPA accounting did result in a net reduction of operating expenses associated with the PPA of \$12 million in 2001, an increase to operating expenses associated with the PPA of \$29 million in 2000, the reversal of the \$126 million increase to the reserve originally recorded in 2001, and immaterial adjustments to accretion expense for both years.

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table reflects the audit adjustments associated with the MCV PPA accounting and the related net income statement effects:

| | <u>2001</u> | <u>2000</u> |
|--|---------------------|---------------|
| | Increase/(Decrease) | |
| | In Millions | |
| Reverse the original operating charge associated with continuing losses on the MCV PPA . . . | \$ 39 | \$ — |
| Charge 49 percent of annual capacity losses associated with the MCV PPA to operating expense instead of to the reserve | <u>(27)</u> | <u>(29)</u> |
| Net operating expense decrease/(increase) | 12 | (29) |
| Reverse the 2001 increase to the MCV PPA reserve | 126 | — |
| Accretion Expense | <u>—</u> | <u>(2)</u> |
| Pre-tax effect of adjustments | 138 | (31) |
| Income tax effect | <u>(48)</u> | <u>11</u> |
| Net income impact of MCV PPA adjustments | <u>\$ 90</u> | <u>\$(20)</u> |

DIG Loss Contract Accounting: The Dearborn Industrial Generation complex, a 710 MW combined-cycle facility, was constructed during 1998 through 2001 to fulfill contractual requirements and to sell excess power in the wholesale power market. DIG entered into electric sales agreements (ESA) with Ford Motor Company, Rouge Industries and Double Eagle Steel Coating Company, later assigned by DIG to CMS MST Michigan, LLC, that require CMS MST Michigan to provide up to 300 MW of electricity at pre-determined prices for a fifteen-year term beginning in June 2000. DIG also entered into steam sales agreements (SSA) with Ford and Rouge, whereby DIG is to supply process and heating steam at a fixed price commencing no later than June 1, 2000.

During the third quarter of 2001, CMS Energy recognized a pretax charge to earnings of \$200 million for the calculated loss on portions of the power capacity under the ESAs. At that time CMS Energy assessed whether the DIG facility was impaired under SFAS No. 121 and concluded that the DIG facility was not impaired.

CMS Energy has now determined that existing accounting literature precludes the recognition of anticipated losses on executory contracts such as those involved with the ESAs at DIG. Accordingly, CMS Energy reversed the \$200 million pretax loss (\$126 million after-tax) in 2001 on the ESA contracts and subsequent related transactions.

Elimination of Mark-to-Market Gains and Losses on Inter-book Transactions and Other Related Adjustments: CMS MST's business activities include marketing to end users of energy commodities such as commercial and small industrial purchasers of natural gas (CMS MST's retail business) and trading activities with such entities as other energy trading companies (CMS MST's wholesale business). During 2000 and 2001, CMS MST used two different methods to account for these distinct activities: it applied the mark-to-market method of accounting to its wholesale trading business operations, and it accounted for its retail business operations using the accrual method. Some other energy trading companies have taken a similar approach when their business activities have included retail operations.

EITF Issue No. 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, applies to certain parts of CMS MST's operations. EITF Issue No. 98-10 requires that energy-trading contracts be marked to market; that is, measured at fair value determined as of the balance sheet date, with the gains and losses included in earnings. According to EITF Issue No. 98-10, the determination of whether an entity is involved in energy trading activities is a matter of judgment that depends on the relevant facts and circumstances. CMS MST had used the mark-to-market method of accounting for its wholesale operations because these had been considered trading activities under EITF Issue No. 98-10. Because CMS MST's retail operations had not been considered trading activities, mark-to-market accounting under EITF Issue No. 98-10 was not applied to any retail contracts.

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

During 2000 and 2001, CMS MST's wholesale business entered into certain transactions with CMS MST's retail business (inter-book transactions) in order to economically hedge retail sales. The wholesale business marked-to-market these inter-book transactions while the retail business did not; however, the transactions were not properly documented as hedges under SFAS No. 133 or other previously applicable accounting standard. Accordingly, CMS Energy has determined that the mark-to-market gains and losses that were recognized by the wholesale business on these inter-book transactions should have been eliminated in consolidation. CMS Energy therefore has recognized a \$75 million after-tax charge to earnings in 2001 and \$34 million of after-tax income in 2000 to eliminate the effects of mark-to-market accounting in consolidation on inter-book transactions.

A number of other adjustments have been recorded at CMS MST relating to front-office activities and mark-to-market accounting. The adjustments, which mainly affect price risk management assets and liabilities and inventory, increased after-tax income by \$32 million in 2001 and reduced after-tax income by \$16 million in 2000.

Elimination of Mark-to-Market Gains and Losses on Intercompany Transactions: As explained above, during 2000 and 2001 CMS MST applied the mark-to-market method of accounting to the energy-trading contracts of its wholesale operations. In doing so, CMS MST did not distinguish between counterparties that were unrelated third parties, and those that were consolidated or equity-method affiliates. Energy-trading contracts with affiliated companies were therefore measured at their fair values as of the balance sheet date, with the gains and losses included in earnings. The affiliated counterparties, however, accounted for these contracts on the accrual basis, because these companies were not engaged in energy trading activities and therefore their activities were not within the scope of EITF Issue No. 98-10. In addition, their contracts with CMS MST were not required to be marked to market in 2001 under SFAS No. 133. The mark-to-market profits and losses that CMS MST recognized on the contracts with affiliated companies were included in the CMS Energy consolidated financial statements. CMS Energy has now concluded that these amounts should have been eliminated in consolidation.

CMS Energy's restated consolidated financial statements have eliminated \$30 million of after-tax mark-to-market gains in 2001 and \$18 million of after-tax mark-to-market losses in 2000 on intercompany transactions.

CMS MST Account Reconciliations: CMS MST's business experienced rapid growth during 2000 and 2001. Late in 2001, CMS Energy became aware of certain control weaknesses at CMS MST and immediately began an internal investigation. The investigation revealed that the size and expertise of the back-office accounting staff had not kept pace with the rapid growth and, as a result, bookkeeping errors had occurred and account reconciliations were not prepared. Additionally, computer interfaces of sub-ledgers to the general ledger were ineffective or lacking. As a result, sub-ledger balances did not agree to the general ledger and the differences were not adjusted. In early 2002, CMS MST commenced an account recalculation and reconciliation project that focused initially on accounts receivable and payable, intercompany and cash accounts, but was later expanded to include other accounts. The recalculation and reconstruction work for 2000, 2001 and 2002 has been completed and the consolidated financial statements reflect the required adjustments, which decreased net income by \$5 million in 2001 and \$13 million in 2000.

Income Tax Adjustment: During the third quarter of 2001, CMS Energy wrote down the value of certain of its foreign investments (see Note 3, Asset Sales, Write-downs and Restructuring). The write-down was net of deferred U.S. income tax benefits in the amount of \$30 million expected to be realized upon the ultimate disposition of these investments in transactions subject to U.S. income tax. CMS Energy has now concluded that since these foreign investments were considered by CMS Energy at the time to be essentially permanent in duration, no deferred U.S. income tax benefits should have been recorded in 2001 on the write-down (see Note 11, Income Taxes).

Panhandle System Gas: Panhandle maintains system-balancing gas for use in operations. During 2001, Panhandle applied lower of cost or market pricing only to the portion of system balancing gas that it expected to consume in its operations over the next twelve months. The remaining gas was reflected as non-current and was

CMS ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

recorded at cost. Upon further review, Panhandle has determined that it should have applied lower of cost or market pricing to all system balancing gas. The application of the lower of cost or market pricing to the non-current system balancing gas results in an additional \$7 million after-tax write-down.

Consolidation of LNG Holdings: In late 2001, Panhandle entered into a structured transaction to monetize a portion of the value of a long-term terminalling contract of its LNG subsidiary. The LNG assets were contributed to LNG Holdings, which then received an equity investment from an unaffiliated third party, Dekatherm Investor Trust, and obtained new loans secured by the assets. After paying expenses, net proceeds of \$235 million were distributed to Panhandle and the venture also loaned \$75 million to Panhandle. While the proceeds received by Panhandle were in excess of its book basis, a gain on the transaction was not recorded. This excess was originally recorded as a deferred commitment, reflecting the fact that Panhandle was expecting to reinvest proceeds into LNG Holdings for a planned expansion. Panhandle is the manager and operator of the venture, and has the primary economic interest in it. Initially, Panhandle believed that off-balance sheet treatment for the venture was appropriate under generally accepted accounting principles. Upon further analysis of these facts, CMS Energy and Panhandle have now concluded that it did not meet the conditions precedent to account for the contribution of the LNG entity as a disposition given Panhandle's continuing involvement and the lack of sufficient participating rights by the third-party equity holder in the venture. As a result, CMS Energy has restated its financial statements to reflect consolidation of LNG Holdings at December 31, 2001. The new accounting treatment resulted in a net increase of \$215 million of debt, the elimination of \$183 million of deferred commitment, minority interest of \$30 million and other net assets of \$62 million. Due to the pending sale of Panhandle, all of these adjustments are included in discontinued operations on CMS Energy's consolidated balance sheet at December 31, 2001. With the exception of certain immaterial reclassifications, there was no impact to 2001 net income resulting from this accounting treatment.

Structured Financing of Methanol Plant: In 1999, CMS Gas Transmission and an unrelated entity financed \$250 million of the costs of construction of a jointly owned methanol plant with an off-balance-sheet special purpose entity (SPE) that entered into two separate non-recourse note borrowings containing cross-collateral provisions only with respect to a joint collection account into which the proceeds from shared collateral were to be deposited. Plant construction was completed in the spring of 2001. In December 2001, CMS Gas Transmission issued an irrevocable call for \$125 million of these notes (i.e., the A1 Notes) and they were paid off in January 2002. As part of the 1999 financing, CMS Energy guaranteed the interest payments on the A1 Notes, subject to a \$75 million limit. CMS Energy did not guarantee repayment of the A1 Notes; however, CMS Energy issued mandatorily convertible preferred stock to a trust as security for the A1 Notes. If an amount to repay the A1 Notes was not deposited within 120 days of the maturity date (or earlier date caused by, for example, a downgrade of the credit rating of CMS Energy) the holders of 25 percent of the A1 Notes could cause the mandatorily convertible preferred shares to be sold. The mandatorily convertible preferred stock of CMS Energy was convertible into the number of shares of CMS Energy Common Stock needed to make the note holder whole without limit. Additional security for the A1 Notes was 60 percent of the capital stock of CMS Methanol, an entity that held a 45 percent ownership interest in the methanol plant. The SPE's assets comprised investments in CMS Methanol and in another subsidiary that also owned a 45 percent interest in the methanol plant. Because the use of non-recourse debt having cross-collateral provisions only with respect to the joint collection account effectively segregated the cash flows and assets, in substance this financing created two separate SPEs. CMS Energy has now concluded that it should have consolidated the virtual SPE created by the non-recourse borrowing. Therefore, CMS Energy has restated its 2000 and 2001 financial statements to increase its equity ownership interest in the methanol plant and increase debt, each by \$125 million.

The following tables reflect the effects of the adjustments CMS Energy made to its consolidated financial statements for the fiscal years ended December 31, 2001 and December 31, 2000, as well as the effects of discontinued operations.

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

CONSOLIDATED STATEMENT OF INCOME(A)

| | 2001 | | 2000 | |
|---|------------------|------------------|----------------|----------------|
| | As Reported | As Restated | As Reported | As Restated |
| | In Millions | | | |
| Operating Revenue | <u>\$9,597</u> | <u>\$8,063</u> | <u>\$8,739</u> | <u>\$6,697</u> |
| Operating expenses | 7,644 | 6,762 | 6,567 | 5,013 |
| Maintenance | 263 | 224 | 295 | 189 |
| Depreciation, depletion and amortization | 530 | 398 | 605 | 489 |
| General taxes | 231 | 196 | 240 | 209 |
| Reduced asset valuations | 628 | 240 | 329 | 329 |
| Total Operating Expenses | <u>9,296</u> | <u>7,820</u> | <u>8,036</u> | <u>6,229</u> |
| Operating Income: | | | | |
| Electric utility | 339 | 349 | 481 | 454 |
| Gas utility | 99 | 97 | 98 | 96 |
| Natural gas transmission | 207 | (50) | 227 | 22 |
| Independent power production | 121 | (76) | 192 | (136) |
| Oil and gas exploration and production | 74 | — | 31 | — |
| Marketing, services and trading | 71 | (22) | 14 | 23 |
| Other | 18 | (55) | (11) | 9 |
| Less contracts and reduced asset valuation(b) | <u>(628)</u> | <u>—</u> | <u>(329)</u> | <u>—</u> |
| Total Operating Income | <u>301</u> | <u>243</u> | <u>703</u> | <u>468</u> |
| Other Income (Deductions): | | | | |
| Accretion expense | (37) | (37) | (33) | (35) |
| Gains on asset sales, net | 11 | — | 84 | 54 |
| Other, net | 15 | 25 | 12 | 12 |
| Total Other Income (Deductions) | <u>(11)</u> | <u>(12)</u> | <u>63</u> | <u>31</u> |
| Fixed Charges | <u>691</u> | <u>562</u> | <u>676</u> | <u>502</u> |
| Income (Loss) From Continuing Operations Before | | | | |
| Income Taxes and Minority Interests: | <u>(401)</u> | <u>(331)</u> | <u>90</u> | <u>(3)</u> |
| Income Tax Provision (Benefit) | (73) | (98) | 50 | 34 |
| Minority Interest | 3 | 3 | 2 | 3 |
| Income (Loss) From Continuing Operations | <u>(331)</u> | <u>(236)</u> | <u>38</u> | <u>(40)</u> |
| Discontinued Operations | <u>(185)</u> | <u>(210)</u> | <u>3</u> | <u>83</u> |
| Income (Loss) Before Cumulative Effect of Change in | | | | |
| Accounting Principle and Extraordinary Item | <u>(516)</u> | <u>(446)</u> | <u>41</u> | <u>43</u> |
| Cumulative Effect of Change in Accounting for | | | | |
| Derivative Instruments | (11) | (2) | (5) | — |
| Extraordinary Item | (18) | — | — | — |
| Consolidated Net Income (Loss) | <u>(545)</u> | <u>(448)</u> | <u>36</u> | <u>43</u> |
| Basic and diluted earnings (loss) per share | <u>\$ (4.17)</u> | <u>\$ (3.42)</u> | <u>\$ 0.32</u> | <u>\$ 0.38</u> |

(a) 2001 and 2000 also includes the effects of discontinued operations.

(b) 2001 and 2002 as reported did not reflect an allocation of reduced asset valuations to the associated business segments. 2001 and 2000 as restated reflect such an allocation. See Note 3 for a breakdown of reduced asset valuation by business segment for 2001 and 2000 as restated.

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

CONSOLIDATED STATEMENT OF CASH FLOWS(A)

| | 2001 | | 2000 | |
|--|--------------------|--------------------|--------------------|--------------------|
| | <u>As Reported</u> | <u>As Restated</u> | <u>As Reported</u> | <u>As Restated</u> |
| | In Millions | | | |
| Cash Flows from Operating Activities | | | | |
| Net Income (Loss) | \$(545) | \$(448) | \$ 36 | \$ 43 |
| Reduced asset valuations | 628 | 240 | 329 | 329 |
| Increase (decrease) deferred income taxes and investment tax credit | 135 | 227 | 8 | 2 |
| Decrease (increase) in accounts receivable and accrued revenue | 68 | 330 | (398) | (310) |
| Decrease (increase) in inventories | (353) | (346) | (54) | (73) |
| Increase (decrease) in accounts payable | (94) | (363) | 181 | 101 |
| Changes in other assets and liabilities | 225 | (169) | 297 | 161 |
| Net cash provided by operating activities | 417 | 366 | 453 | 586 |
| Net increase (decrease) in Cash and Temporary Cash Investments | <u>7</u> | <u>(14)</u> | <u>50</u> | <u>9</u> |
| Cash and Cash Investments, End of Period | <u>\$ 189</u> | <u>\$ 127</u> | <u>\$ 182</u> | <u>\$ 141</u> |

(a) 2001 and 2000 also includes the effects of discontinued operations.

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

CONSOLIDATED BALANCE SHEET

| | 2001 | | 2000 | |
|---|-----------------|-----------------|-----------------|-----------------|
| | As Reported | As Restated | As Reported | As Restated |
| | In Millions | | | |
| ASSETS | | | | |
| Plant and Property | 8,362 | 5,848 | 7,831 | 5,227 |
| Investments | 1,895 | 1,961 | 2,016 | 2,091 |
| Current Assets: | | | | |
| Cash and temporary cash investments | 189 | 127 | 182 | 141 |
| Accounts receivable, notes receivable, accrued revenue | 681 | 219 | 914 | 589 |
| Accounts receivable, Marketing, services and trading | 683 | 295 | 526 | 336 |
| Price risk management assets | 461 | 327 | 1,097 | 871 |
| Assets held for sale | — | 471 | — | 545 |
| Deferred income taxes | — | — | 39 | 30 |
| Prepayments, inventories, and other | 1,019 | 1,121 | 745 | 641 |
| Total Current Assets | 3,033 | 2,560 | 3,503 | 3,153 |
| Non-current Assets: | | | | |
| Assets held for sale | — | 3,480 | — | 3,508 |
| Price risk management assets | 424 | 368 | 350 | 212 |
| Goodwill, net | 811 | 71 | 891 | 87 |
| Regulatory assets | 1,105 | 1,105 | 1,131 | 968 |
| Other | 1,472 | 1,382 | 1,529 | 1,659 |
| Total Non-current Assets | 3,812 | 6,406 | 3,901 | 6,434 |
| Total Assets | <u>\$17,102</u> | <u>\$16,775</u> | <u>\$17,251</u> | <u>\$16,905</u> |
| STOCKHOLDERS' INVESTMENT AND LIABILITIES | | | | |
| Capitalization: | | | | |
| Total common stockholders' equity | \$ 1,890 | \$ 2,038 | \$ 2,361 | \$ 2,416 |
| Long-term debt | 6,923 | 5,840 | 6,770 | 6,048 |
| Non-current portion of capital leases | 60 | 71 | 54 | 49 |
| Other | 1,258 | 1,258 | 1,133 | 1,133 |
| Total Capitalization | 10,131 | 9,207 | 10,318 | 9,646 |
| Minority Interest | 86 | 24 | 88 | 23 |
| Current Liabilities: | | | | |
| Current maturities of long-term debt and capital leases | 981 | 1,016 | 707 | 272 |
| Notes payable | 416 | 416 | 403 | 403 |
| Accounts payable | 547 | 359 | 614 | 325 |
| Accounts payable — Marketing, services and trading | 574 | 236 | 410 | 274 |
| Liabilities held for sale | — | 639 | — | 604 |
| Accrued taxes | 125 | 111 | 309 | 300 |
| Deferred income taxes | 51 | 49 | — | — |
| Price risk management liabilities | 381 | 367 | 1,068 | 831 |
| Other | 735 | 478 | 750 | 489 |
| Total Current Liabilities | 3,810 | 3,671 | 4,261 | 3,498 |
| Non-current Liabilities: | | | | |
| Deferred income taxes | 773 | 824 | 749 | 697 |
| Price risk management liabilities | 352 | 287 | 341 | 208 |
| Liabilities held for sale | — | 1,376 | — | 1,418 |
| Other | 1,950 | 1,386 | 1,494 | 1,415 |
| Total Non-current Liabilities | 3,075 | 3,873 | 2,584 | 3,738 |
| Total Stockholders' Investment and Liabilities | <u>\$17,102</u> | <u>\$16,775</u> | <u>\$17,251</u> | <u>\$16,905</u> |

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDERS' EQUITY

| | 2001 | | 2000 | |
|--|--------------------|--------------------|--------------------|--------------------|
| | <u>As Reported</u> | <u>As Restated</u> | <u>As Reported</u> | <u>As Restated</u> |
| | In Millions | | | |
| Retained Earnings | | | | |
| At beginning of period | \$ (320) | \$ (313) | \$ (189) | \$ (189) |
| Consolidated net income (loss) | (545) | (448) | 36 | 43 |
| Common stock dividends declared | <u>(190)</u> | <u>(190)</u> | <u>(167)</u> | <u>(167)</u> |
| At end of period | <u>(1,055)</u> | <u>(951)</u> | <u>(320)</u> | <u>(313)</u> |
| Other Comprehensive Income (Loss) | | | | |
| At beginning of period | 5 | 5 | 3 | 3 |
| Investments | (2) | (3) | (5) | (5) |
| Derivative instruments | <u>(33)</u> | <u>(38)</u> | <u>—</u> | <u>—</u> |
| At end of period | <u>(30)</u> | <u>(36)</u> | <u>(2)</u> | <u>(2)</u> |
| Total Common Stockholders' Equity | <u>\$ 1,890</u> | <u>\$2,038</u> | <u>\$2,361</u> | <u>\$2,416</u> |
| Total Consolidated Comprehensive Income (Loss) | <u>\$ (621)</u> | <u>\$ (516)</u> | <u>\$ (115)</u> | <u>\$ (60)</u> |

3. ASSET SALES, WRITE-DOWNS AND RESTRUCTURING

During 2001 and 2002, CMS Energy completed numerous asset sales, recorded significant write-downs and incurred restructuring costs.

ASSET SALES

During 2002, CMS Energy continued to implement its financial improvement plan and on-going asset sales program that was initiated in late 2001. The asset sales program encompasses the sale of all non-strategic and under-performing assets. The impacts of these sales are included in "Gain (losses) on asset sales" in the Consolidated Statements of Income.

In January 2002, CMS Energy completed the sale of its ownership interests in Equatorial Guinea to Marathon Oil Company for approximately \$993 million. Proceeds from this transaction were used primarily to retire existing debt. Included in the sale were all of CMS Oil and Gas' oil and gas reserves in Equatorial Guinea and CMS Gas Transmission's ownership interest in the related methanol plant. The gain on the methanol plant of \$19 million (\$12 million, net of tax) is included in "Gain (loss) on asset sales" in the accompanying consolidated statements of income. The gain on the sale of CMS Oil & Gas' Equatorial Guinea properties of \$497 million (\$310 million, net of tax) is included in discontinued operations in 2002.

In April 2002, CMS Energy sold its equity ownership interest in Toledo Power Company electric generating facility in the Philippines for \$10 million. Proceeds from the sale were used to repay debt. The pretax loss of \$11 million (\$5 million, net of tax) is included in "Gain (loss) on asset sales" in the accompanying consolidated statements of income in 2002.

In May 2002, Consumers Energy closed on the sale of its electric transmission system to a limited partnership whose general partner is Washington D.C.-based Trans-Elect. Also, in May 2002, Consumers sold its reactor top equipment. Both sales totaled approximately \$295 million. The pretax gains on these sales, which totaled \$39 million (\$31 million, net of tax), are included in "Gain (loss) on asset sales" in the accompanying consolidated statements of income.

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

In August 2002, CMS Energy sold its equity ownership interest in The National Power Supply Company electric generating facility in Thailand for \$48 million. The pretax gain of \$15 million (\$30 million, net of tax benefit) is included in "Gain (loss) on asset sales" in the accompanying consolidated statements of income.

In October 2002, CMS Generation completed the sale of its ownership interest in the 200 MW Vasavi Power Plant, located in Tamil Nada, India for \$34 million. CMS Generation's investment in the Vasavi Power Plant at September 30, 2002 was \$59 million.

| | Pre-tax 2002 | After-tax 2002 | Pre-tax 2001 | After-tax 2001 | Pre-tax 2000 | After-tax 2000 |
|---|-----------------|-------------------|-----------------|-------------------|-----------------|-------------------|
| | In Millions | | | | | |
| Asset Sales — Gain (Loss): | | | | | | |
| Energy | — | — | (1) | — | 12 | 8 |
| Enterprises | — | — | — | — | — | — |
| Generation | (21) | 1 | (1) | — | 42 | 25 |
| Natural Gas Transmission | 19 | 12 | — | — | — | — |
| Consumers Energy | 39 | 31 | 1 | — | — | — |
| Energy Distribution | — | — | — | — | (8) | (2) |
| Total Gain (Loss) on Asset Sales | <u>37</u> | <u>44</u> | <u>(1)</u> | <u>—</u> | <u>46</u> | <u>31</u> |

In January 2003, CMS Energy closed on the sale of a substantial portion of CMS MST's wholesale natural gas trading contracts to Sempra Energy Trading, the wholesale commodity trading unit of Sempra Energy and received \$17 million of cash proceeds. In February 2003, CMS Energy entered into a definitive agreement with Constellation Power Source, Inc. to sell CMS MST's wholesale power contracts. The sale has been approved by FERC and is expected to close as early as March 31, 2003.

In February 2003, Panhandle sold its one third interest in Centennial Pipeline, LLC for \$40 million to Centennial's two other partners, Marathon Ashland Petroleum, LLC and TE Products Pipeline Company, Limited Partner, through its general partner, Texas Eastern Products Pipeline Company.

ASSET WRITE-DOWNS

In 2002 and 2001, implementation of a new strategic direction and financial improvement plan for CMS Energy has resulted in assets and development projects that have been identified by the business units as non-strategic or under-performing. These assets include both domestic and foreign electric power plants, gas processing facilities, and certain equity method and other investments. In addition, CMS Energy has written off the carrying value of development projects that will no longer be pursued. Management has evaluated operating assets for impairment in accordance with the provisions of SFAS No. 144 in 2002 (SFAS No. 121 in 2001 or prior), and has evaluated equity investments for impairment in accordance with the provisions of APB Opinion No. 18.

The reduced asset valuations were primarily a result of management's determination that the anticipated future cash flows from these projects would be insufficient to provide for recovery of their carrying value. The charges are reflected in the accompanying consolidated statements of income under the caption "Reduced asset valuations". CMS Generation has evaluated the fair values of its investments using discounted cash flow analyses and the values of contract prices. The fair values of other CMS Energy investments have been determined using market prices and evaluations of expected future cash flows. Based on these evaluations, certain assets were determined to be impaired.

Reductions in asset valuations recognized in 2002 were \$598 million (\$388 million, net of tax). Included in this amount were reductions in CMS Generation's valuation of DIG \$460 million (\$299 million, net of tax); Michigan Power, which owns natural gas-fueled peaking units in Michigan, \$62 million (\$40 million, net of tax);

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

and Craven, a 45-Mwh wood-fueled plant in North Carolina, \$23 million (\$15 million, net of tax). DIG's reduced valuation is primarily a reflection of the unfavorable terms of its power purchase agreement (PPA). Michigan Power's reduced valuation is primarily a result of a depressed merchant power market and the lack of a long-term PPA. Craven's reduced valuation is primarily a result of the anticipated expiration of its current PPA at the end of 2005 and a depressed merchant power market.

In 2001, asset valuations were reduced by \$240 million (\$198 million, net of tax) to reflect the excess of the carrying value of these assets over their fair value. Included in the 2001 charge were reduced asset valuations at CMS Generation for National Power Supply, a 300-Mwh coal-fueled plant in Thailand, \$89 million (\$88 million, net of tax); El Chocon, a 1,200-Mwh hydro-electric plant in Argentina, \$45 million (\$42 million net of tax); and HL Power, a 36-Mwh wood-fueled plant in California, \$30 million (\$18 million net of tax). Also included in the 2001 charge were reduced asset valuations at CMS Gas Transmission for several development projects of \$16 million (\$10 million, net of tax) that would no longer be pursued, and for goodwill associated with a gas fractionation facility in southeastern Michigan.

In the first quarter of 2000, CMS Energy announced its intention to sell its 50 percent ownership interest in Loy Yang, retained the services of investment bankers to assist in the sales process, and solicited bids from potential buyers for CMS Energy's interest in Loy Yang. As a result of being unable to attract a reasonable offer for Loy Yang by the end of November 2000, and after re-evaluating the expected future cash flows from this investment, including the continuing unfavorable electric market prices in Victoria, Australia, management determined in the fourth quarter of 2000 that the carrying amount of the equity investment in Loy Yang was not recoverable. Consequently, in accordance with the provisions of APB Opinion No. 18, CMS Energy determined that there has been a loss in value of the investment and an impairment loss on the carrying amount of the investment has been realized.

This impairment loss is reflected under the caption "Reduced asset valuations" in the accompanying consolidated statements of income in 2000 as a pretax charge of \$329 million (\$268 million after-tax). This loss does not include cumulative net foreign currency translation losses of \$168 million due to unfavorable changes in exchange rates, which, in accordance with SFAS No. 52, will not be realized until there has been a sale, full liquidation or other disposition of CMS Energy's investment in Loy Yang. In connection with the restatement of CMS Energy's December 31, 2000 consolidated financial statements, a deferred U.S. income tax asset of \$48 million was recorded with respect to the cumulative net foreign currency translation losses associated with CMS Energy's Loy Yang investment (see Note 11, Income Taxes).

CMS Energy is continuing to review its business alternatives for its investment in Loy Yang, including future financing and operating alternatives, the nature and extent of CMS Energy's future involvement and the potential for an ultimate sale of its interest in the future. CMS Energy has not established a deadline for any of these alternatives.

| | Pre-tax 2002 | After-tax 2002 | Pre-tax 2001 | After-tax 2001 | Pre-tax 2000 | After-tax 2000 |
|---------------------------------|-----------------|-------------------|-----------------|-------------------|-----------------|-------------------|
| | In Millions | | | | | |
| Asset Write-Downs: | | | | | | |
| Energy | \$ — | \$ — | \$ (14) | \$ (9) | \$ — | \$ — |
| Enterprises | (15) | (10) | — | — | — | — |
| Generation | (565) | (367) | (180) | (159) | (329) | (268) |
| Natural Gas Transmission | — | — | (43) | (28) | — | — |
| Consumers Energy | — | — | (3) | (2) | — | — |
| Marketing, Services and Trading | (18) | (11) | — | — | — | — |
| Total Asset Write-Downs | <u>\$(598)</u> | <u>\$(388)</u> | <u>\$(240)</u> | <u>\$(198)</u> | <u>\$(329)</u> | <u>\$(268)</u> |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

RESTRUCTURING AND OTHER COSTS

CMS Energy announced in 2002 a series of new initiatives intended to sharpen its business focus and help restore its financial health by reducing operating costs. The initiatives announced included the following:

- Relocating CMS Energy's corporate headquarters from Dearborn, Michigan to a new headquarters building then under construction in Jackson, Michigan. The Jackson headquarters building opened in March 2003 and will house an estimated 1,450 CMS Energy and Consumers Energy employees. In the longer term, the relocation will reduce corporate operating expenses.
- Implementing changes to CMS Energy's 401(K) savings program which will provide savings for CMS Energy and enhanced investment options for employee participants.
- Implementing changes to CMS Energy's health care plan in order to keep benefits and costs competitive.
- Terminating five officers, 18 CMS Field Services employees and 41 CMS MST trading group employees. Prior to December 31, 2002, 31 Dearborn-based employees and 92 Houston employees have elected severance arrangements. Of these 187 officers and employees, 65 had been terminated as of December 31, 2002. The remaining terminations will be completed in 2003.

Restructuring costs for the year ended December 31, 2002, which are reported in operating expenses, include:

- Involuntary termination benefits of \$22 million for officers and employees.
- The present value of future non-cancelable lease obligations of \$11 million related to relocating the corporate headquarters to Jackson, Michigan.

In addition, in the first half of 2003, restructuring costs related to relocating employees and other headquarters expenses are expected to be \$2 million. The relocation will occur between March and June 2003, and such costs will be expensed as incurred.

The following table shows the amount charged to expense during 2002 for restructuring costs, the payments made, and the unpaid balance of accrued costs at December 31, 2002, which is expected to be paid in 2003.

| | Year Ended | | Unpaid Balance |
|--|-------------------|-------------|-------------------|
| | December 31, 2002 | | |
| | Expense | Payments | December 31, 2002 |
| | In Millions | | |
| Involuntary termination | \$22 | \$10 | \$12 |
| Non-cancelable lease obligations | 11 | 3 | 8 |
| Total | <u>\$33</u> | <u>\$13</u> | <u>\$20</u> |

4: DISCONTINUED OPERATIONS

In accordance with SFAS No. 144, discontinued operations include components of entities or entire entities that, through disposal transactions, will be eliminated from the ongoing operations of CMS Energy. The assets and liabilities of these entities were measured at the lower of the carrying value or the fair value less cost to sell as required by SFAS No. 144. A description of the entities included in discontinued operations is as follows:

In September 2001, CMS Energy discontinued the operations of the International Energy Distribution segment. CMS Energy is actively seeking a buyer for the assets of CMS Electric and Gas, and although the timing of this sale is difficult to predict, nor can it be assured, management expects the sale to occur in 2003.

CMS ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

In January 2002, CMS Energy completed the sale of its ownership interests in Equatorial Guinea to Marathon Oil Company for approximately \$993 million. Included in the sale were all of CMS Oil and Gas' oil and gas reserves in Equatorial Guinea and CMS Gas Transmission's ownership interest in the related methanol plant. The gain on the CMS Oil & Gas Equatorial Guinea properties of \$497 million (\$310 million, net of tax) is included in discontinued operations.

In May 2002, CMS closed on the sale of CMS Oil and Gas' coal-bed methane holdings in the Powder River Basin to XTO Energy. The Powder River properties were included in discontinued operations for the first four months of 2002, including a gain on the sale of \$20 million (\$11 million net of tax).

In June 2002, CMS Energy abandoned the Zirconium Recovery Project, which was initiated in January 2000. The purpose of the project was to extract and sell uranium and zirconium from a pile of caldesite ore held by the Defense Logistic Agency of the U.S. Department of Defense. After evaluating future cost and risk, CMS Energy decided to abandon this project and recorded a \$47 million after-tax loss in discontinued operations.

In June 2002, CMS Energy announced its plan to sell CMS MST's energy performance contracting subsidiary, CMS Viron. CMS Viron enabled building owners to improve their facilities with equipment upgrades and retrofits and finance the work with guaranteed energy and operational savings. After evaluating all of the relevant facts and circumstances, \$6 million, net of tax, has been reflected as a loss on discontinued operations in order to appropriately reflect the fair value less selling costs of CMS Viron. CMS Energy is actively seeking a buyer for the assets of CMS Viron and although the timing of this sale is difficult to predict, nor can it be assured, management expects the sale to occur in 2003.

In September 2002, CMS Energy closed on the sale of the stock of CMS Oil and Gas and the stock of a subsidiary of CMS Oil and Gas that holds property in Venezuela. In October 2002, CMS Energy closed on the sale of CMS Oil and Gas's properties in Colombia. As a result of these closings, CMS Energy has completed its exit from the oil and gas exploration and production business. The proceeds from the combined sales total approximately \$232 million and have been used to retire the remaining balance on a \$150 million Enterprises term loan due in December 2002 and a portion of a \$295.8 million CMS Energy loan originally due March 2003. The combined sales resulted in a loss of approximately \$126 million (\$82 million, net of tax), which is included in discontinued operations.

In December 2002, CMS Energy reached a definitive agreement to sell the Panhandle companies to Southern Union Panhandle Corp. The agreement calls for Southern Union Panhandle Corp, a newly formed entity owned by Southern Union Company and AIG Highstar Capital, L.P. to pay \$662 million in cash and assume \$1.166 billion in debt. Under the terms of the agreement, CMS Energy was to retain Panhandle's ownership interests in the Centennial and Guardian pipeline projects, as well as certain of Panhandle's net deferred tax assets, all tax liabilities, and pension assets and liabilities. Panhandle has since sold its interest in Centennial and the Guardian interest has been transferred to Panhandle's direct parent, CMS Gas Transmission. The transaction has been approved by the board of directors of each company and is subject to customary closing conditions and action by the FTC under the Hart-Scott-Rodino Act. The sale is expected to close in 2003. Panhandle's results of operations have been reclassified to discontinued operations in the consolidated statements of income.

In December 2002, CMS Energy discontinued the operations of Field Services, a subsidiary of CMS Gas Transmission. CMS Energy is actively seeking a buyer for the assets of Field Services, and although the timing of this sale is difficult to predict, nor can it be assured, management expects the sale to occur in 2003.

The summary of balance sheet information below represents those entities that are still in the disposal process, including Panhandle, CMS Viron, Field Services, International Energy Distribution, and the Zirconium Recovery Project. The assets and liabilities of the discontinued operations and other assets and liabilities held for

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

sale, including price risk management assets and liabilities and equity method investments are shown as separate components in the consolidated balance sheets of CMS Energy.

| | December 31 | |
|--|-----------------------|-----------------------|
| | 2002 | 2001 (Restated) |
| | In Millions | |
| Assets | | |
| Cash | \$ 83 | \$ 47 |
| Accounts receivable, net | 179 | 313 |
| Materials and supplies | 53 | 92 |
| Other | 329 | 19 |
| Total current assets held for sale | <u>\$ 644</u> | <u>\$ 471</u> |
| Property, plant and equipment, net | \$1,970 | \$2,562 |
| Unconsolidated investments | (80) | 88 |
| Goodwill | 139 | 754 |
| Other | 52 | 76 |
| Total non current assets held for sale | <u>\$2,081</u> | <u>\$3,480</u> |
| Liabilities | | |
| Accounts payable | \$ 105 | \$ 212 |
| Current portion of long-term debt | 6 | 112 |
| Accrued taxes | 22 | — |
| Other current liabilities | 332 | 315 |
| Total current liabilities held for sale | <u>\$ 465</u> | <u>\$ 639</u> |
| Long-term debt | \$1,151 | \$1,290 |
| Minority interest | 63 | 91 |
| Other non current liabilities | 83 | 7 |
| Total non current liabilities held for sale | <u>\$1,297</u> | <u>\$1,388</u> |

Revenues from such operations were \$1,158 million, \$1,453 million and \$1,008 million in 2002, 2001 and 2000, respectively. In accordance with SFAS No. 144, the net income (loss) of the operations is included in the consolidated statements of income under "discontinued operations". The pretax gain (loss) related to discontinued operations recorded for the years ended December 31, 2002, 2001 and 2000 was \$389 million, \$117 million and \$115 million, respectively, which included charges resulting from reductions in asset values and a portion of CMS Energy's interest expense. Interest expense of \$69 million, \$94 million and \$83 million for

CMS ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2002, 2001 and 2000, respectively, was allocated to each discontinued operation based on its ratio of total capital to that of CMS Energy. See the table below for income statement components of the discontinued operations.

| | Years ended December 31 | | |
|--|-------------------------|--------------------|--------------------|
| | 2002 | 2001 (Restated) | 2000 (Restated) |
| | In Millions | | |
| Discontinued operations: | | | |
| Income (loss) from discontinued operations, net of tax benefit of \$2, tax of \$93, and tax of \$32..... | \$ (36) | \$ (17) | \$ 83 |
| Loss on disposal of discontinued operations, net of tax benefit of \$165, tax of \$0, and tax of \$0 | (186) | (193) | — |
| Total | <u>\$(222)</u> | <u>\$(210)</u> | <u>\$ 83</u> |

5. GOODWILL

CMS Gas Transmission: Effective January 1, 2002, SFAS No. 142 disallowed the continued amortization of goodwill and required the testing of goodwill for potential impairment. In accordance with SFAS No. 142, Panhandle completed the first step of the goodwill impairment testing which indicated a significant impairment of Panhandle's goodwill existed as of January 1, 2002. The actual amount of impairment was determined in a second step by comparing the fair value of goodwill, as determined by independent appraisers, to book value, using a combination of the income approach based on discounted cash flows and the market approach using public guideline companies and market transactions. As a result of this second step appraisal, Panhandle recorded a write-off of goodwill in the amount of \$601 million (\$369 million, net of tax).

CMS MST: During the third quarter of 1999, CMS MST purchased a 100 percent interest in Viron Energy Services. CMS MST consolidated the activity of CMS Viron and recorded goodwill as a result of the purchase price allocation. Based on the quantitative and qualitative analysis, CMS MST recorded a loss of \$15 million (\$10 million, net of tax) for goodwill impairment effective January 1, 2002.

In 2002, CMS Energy discontinued the operations of Panhandle. As a result, the goodwill impairment of \$369 million after tax is reflected in discontinued operations. Also in 2002, CMS Energy discontinued the operations of CMS Viron. As a result, the goodwill impairment of \$10 million after tax is reflected in discontinued operations.

Accumulated amortization of goodwill at December 31, 2002 and 2001 was \$63 million and \$67 million, respectively.

Additionally, the following table represents pro forma net income for the years 2002, 2001 and 2000, exclusive of amortization expense.

| | 2002 | Restated 2001 | Restated 2000 |
|---|-----------------|------------------|------------------|
| | In Millions | | |
| | | | |
| Reported Net Income (Loss) | \$ (620) | \$ (448) | \$ 43 |
| Add: goodwill amortization expense, net of tax of \$—, \$7, and \$8, respectively ... | — | 13 | 14 |
| Adjusted Net Income | <u>\$ (620)</u> | <u>\$ (435)</u> | <u>\$ 57</u> |
| Adjusted Net Income (Loss) Per Share | <u>\$(4.46)</u> | <u>\$(3.33)</u> | <u>\$0.50</u> |

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6: UNCERTAINTIES

SEC and Other Investigations: As a result of round-trip trading transactions at CMS MST, CMS Energy's Board of Directors established a Special Committee of independent directors 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, most of which have already been implemented. Previously, CMS Energy terminated its speculative trading business and revised its risk management policy. The Board of Directors adopted, and CMS Energy has begun implementing, the remaining 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 investigations by the United States Department of Justice, the Commodity Futures Trading Commission and the FERC. CMS Energy has also received subpoenas from U.S. Attorneys Offices regarding investigations of those trades. 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 have been filed against CMS Energy, Consumers, and certain officers and directors of CMS Energy and its affiliates. The complaints have been filed in the United States District Court for the Eastern District of Michigan as purported class actions by individuals who allege that they purchased CMS Energy's securities during a purported class period. At least two of the complaints contain purported class periods beginning on August 3, 2000 and running through May 10, 2002 or May 14, 2002. These complaints generally seek unspecified damages based on allegations that the defendants violated United States securities laws and regulations by making allegedly false and misleading statements about the company's business and financial condition. The cases have been consolidated into a single lawsuit, and an amended and consolidated complaint is due to be filed by May 1, 2003. CMS Energy intends to vigorously defend against these actions. CMS Energy cannot predict the outcome of this litigation.

Demand for Actions Against Officers and Directors: The Board of Directors 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 CMS Energy officers and directors in connection with round-trip trading at 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. If the Board elects not to commence such actions, the shareholder has stated that he will initiate a derivative suit, bringing such claims on behalf of CMS Energy. CMS Energy has elected two new members to its Board of Directors to serve as an independent litigation committee to determine whether it is in the best interest of CMS Energy to bring the action demanded by the shareholder. Counsel for the shareholder has agreed to extend the time for CMS Energy to respond to the demand. CMS Energy cannot predict the outcome of this litigation.

ERISA Claims: 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 401(k) plan. The two cases, filed in July 2002 in the United States District Court for the Eastern District of Michigan, were consolidated by the trial judge and an amended and consolidated complaint has been 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. These cases will be vigorously defended. CMS Energy cannot predict the outcome of this litigation.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Gas Index Pricing Reporting: 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 investigations by the Commodity Futures Trading Commission, Department of Justice and FERC regarding this matter. CMS Energy is unable to predict the outcome of these matters and what effect, if any, these investigations will have on its business.

Fees and Expenses: CMS Energy has accrued \$15 million for attorney's fees and costs associated with responding to and/or defending against investigations and lawsuits related to round-trip trading and the reporting of gas prices to trade publications. These expenses could total as much as \$37 million. CMS Energy expects to recover a significant portion of these expenses from insurers.

CONSUMERS' ELECTRIC UTILITY CONTINGENCIES

Electric Environmental Matters: Consumers is subject to costly and increasingly stringent environmental regulations. Consumers expects that the cost of future environmental compliance, especially compliance with clean air laws, will be significant.

Clean Air — In 1998, the EPA issued final regulations requiring the state of Michigan to further limit nitrogen oxide emissions. The Michigan Department of Environmental Quality finalized rules to comply with the EPA final regulations in December 2002 and submitted these rules for approval to the EPA in the first quarter of 2003. In addition, the EPA has also issued additional final regulations regarding nitrogen oxide emissions that require certain generators, including some of Consumers' electric generating facilities, to achieve the same emissions rate as that required by the 1998 regulations. The EPA and the state final regulations will require Consumers to make significant capital expenditures estimated to be \$770 million. As of December 31, 2002, Consumers has incurred \$405 million in capital expenditures to comply with the EPA final regulations and anticipates that the remaining capital expenditures will be incurred between 2003 and 2009. Additionally, Consumers currently expects to supplement its compliance plan with the purchase of nitrogen oxide emissions credits for years 2005 through 2008. The cost of these credits based on the current market is estimated to average \$6 million per year, however, the market for nitrogen oxide emissions credits is volatile and the price could change significantly. At some point, if new environmental standards become effective, Consumers may need additional capital expenditures to comply with the future standards. 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 an MPSC prudency hearing.

These and other required environmental expenditures, if not recovered from customers in Consumers' rates, may have a material adverse effect upon Consumers' financial condition and results of operations.

Cleanup and Solid Waste — Under the Michigan Natural Resources and Environmental Protection Act, Consumers expects that it will ultimately incur investigation and remedial action costs at a number of sites. Consumers believes that these costs will be recoverable in rates under current ratemaking policies.

Consumers is a potentially responsible party at several contaminated sites administered under Superfund. Superfund liability is joint and several. Along with Consumers, many other creditworthy, potentially responsible parties with substantial assets cooperate with respect to the individual sites. Based upon past negotiations, Consumers estimates that its share of the total liability for the known Superfund sites will be between \$1 million and \$9 million. As of December 31, 2002, Consumers had accrued the minimum amount of the range for its estimated Superfund liability.

During routine maintenance activities, Consumers identified PCB as a component in certain paint, grout and sealant materials at the Ludington Pumped Storage facility. Consumers removed and replaced part of the PCB material. Consumers has proposed a plan to deal with the remaining materials and is awaiting a response from the EPA.

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

CONSUMERS' ELECTRIC UTILITY RATE MATTERS

Electric Restructuring: In June 2000, the Michigan legislature passed electric utility restructuring legislation known as the Customer Choice Act. This act: 1) permits all customers to choose their electric generation supplier beginning January 1, 2002; 2) cut residential electric rates by five percent; 3) freezes all electric rates through December 31, 2003, and establishes 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; 4) allows for the use of low-cost Securitization bonds to refinance qualified costs, as defined by the act; 5) establishes a market power supply test that may require transferring control of generation resources in excess of that required to serve firm retail sales requirements (a requirement Consumers believes itself to be in compliance with at this time); 6) requires Michigan utilities to join a FERC-approved RTO or divest their interest in transmission facilities to an independent transmission owner; (Consumers has sold its interest in its transmission facilities to an independent transmission owner, see "Transmission" below); 7) requires Consumers, Detroit Edison and American Electric Power to jointly expand their available transmission capability by at least 2,000 MW; 8) 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; and 9) allows recovery of "net" Stranded Costs and implementation costs incurred as a result of the passage of the act. In July 2002, the MPSC issued an order approving the plan to achieve the increased transmission capacity. Consumers has completed the transmission capacity projects identified in the plan and has submitted verification of this fact to the MPSC. Consumers believes it is in full compliance with item 7 above. Consumers is also highly confident that it will meet the conditions contained in item 5 above, prior to the earliest rate cap termination dates specified in the act. Failure to do so, however, could result in an extension of the rate caps to as late as December 31, 2013.

In 1998, Consumers submitted a plan for electric retail open access 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: 1) allow electric customers to choose their supplier; 2) authorize recovery of "net" Stranded Costs and implementation costs; and 3) confirm any voluntary commitments of electric utilities. In September 2000, as required by the MPSC, Consumers once again filed tariffs governing its retail open access program and made revisions to comply with the Customer Choice Act. In December 2001, the MPSC approved revised retail open access tariffs. The revised tariffs establish the rates, terms, and conditions under which retail customers will be permitted to choose an alternative electric supplier. The tariffs, effective January 1, 2002, did not require significant modifications in the existing retail open access program. The tariff terms allow retail open access customers, upon as little as 30 days notice to Consumers, to return to Consumers' generation service at current tariff rates. If any class of customers' (residential, commercial, or industrial) retail open access load reaches 10 percent of Consumers' total load for that class of customers, then returning retail open access customers for that class must give 60 days notice to return to Consumers' generation service at current tariff rates. However, Consumers may not have sufficient, reasonably priced, capacity to meet the additional demand of returning retail open access customers, and may be forced to purchase electricity on the spot market at higher prices than it could recover from its customers. Consumers cannot predict the total amount of electric supply load that may be lost to competitor suppliers, nor whether the stranded cost recovery method adopted by the MPSC will be applied in a manner that will fully offset any associated margin loss.

Securitization: In October 2000 and January 2001, the MPSC issued orders authorizing Consumers to issue Securitization bonds. Securitization typically involves issuing asset-backed bonds with a higher credit rating than conventional utility corporate financing. The orders authorized Consumers to securitize approximately \$469 million in qualified costs, which were primarily regulatory assets plus recovery of the Securitization expenses. Securitization resulted in lower interest costs and a longer amortization period for the securitized assets, and offset the majority of the impact of the required residential rate reduction (approximately \$22 million in 2000 and \$49 million annually thereafter). The orders directed Consumers to apply any cost savings in excess of the five percent residential rate reduction to rate reductions for non-residential customers and reductions in

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Stranded Costs for retail open access customers after the bonds are sold. Excess savings are approximately \$12 million annually.

In November 2001, Consumers Funding issued \$469 million of Securitization bonds, Series 2001-1. The Securitization bonds mature at different times over a period of up to 14 years, with an average interest rate of 5.3 percent. The last expected maturity date is October 20, 2015. Net proceeds from the sale of the Securitization bonds, after issuance expenses, were approximately \$460 million. Consumers used the net proceeds to retire \$164 million of its common equity from its parent, CMS Energy. CMS Energy used the \$164 million from Consumers to pay down its own short-term debt. From December 2001 through March 2002, the remainder of these proceeds were used to pay down Consumers' long-term debt and Trust Preferred Securities. CMS Energy used the \$164 million from Consumers to pay down its own short-term debt.

Consumers and Consumers Funding 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 expected bond maturity date, and no more than quarterly thereafter. The first true-up occurred in November 2002, and prospectively modified the total securitization and related tax charges from 1.677 mills per kWh to 1.746 mills per kWh. Current electric rate design covers these charges, and there will be no rate impact for most Consumers electric customers until the Customer Choice Act rate freeze expires. Securitization charge collections, \$52 million in 2002, are remitted to a trustee for the Securitization bonds. Securitization charge collections are dedicated for the repayment of the principle and interest on the Securitization bonds and payment of the ongoing expenses of Consumers Funding and can be used only for those purposes. Consumers Funding is legally separate from Consumers. The assets and income of Consumers Funding, including without limitation, the securitized property, are not available to creditors of Consumers or CMS Energy.

Regulatory assets are normally amortized over their period of regulated recovery. Beginning January 1, 2001, the amortization was deferred for the approved regulatory assets being securitized, which effectively offset the loss in revenue in 2001 resulting from the five percent residential rate reduction. In December 2001, after the Securitization bonds were sold, the amortization was re-established, based on a schedule that is the same as the recovery of the principal amounts of the securitized qualified costs. In 2002, the accumulated amortization amount was approximately \$31 million and the securitized assets will be fully amortized by the end of 2015.

On March 4, 2003, Consumers filed an application with the MPSC seeking approval to issue Securitization bonds in the amount of approximately \$1.084 billion. If approved, this would allow the recovery of costs associated with Clean Air Act expenditures, post-2000 Palisades expenditures, and retail open access implementation costs through December 31, 2002, and certain pension fund expenses and expenses associated with the issuance of the bonds.

Transmission: In 1999, the FERC issued Order No. 2000, strongly encouraging electric utilities to transfer operating control of their electric transmission system to an RTO, or sell the facilities to an independent company. In addition, in June 2000, the Michigan legislature passed Michigan's Customer Choice Act, which also requires utilities to divest or transfer the operating authority of transmission facilities to an independent company. Consumers chose to offer its electric transmission system for sale rather than own and invest in an asset that it could not control. In May 2002, Consumers sold its electric transmission system (METC) for approximately \$290 million in cash to MTH, a non-affiliated limited partnership whose general partner is a subsidiary of Trans-Elect Inc.

Trans-Elect, Inc. submitted the winning bid through a competitive bidding process, and various federal agencies approved the transaction. Consumers did not provide any financial or credit support to Trans-Elect, Inc. Certain of Trans-Elect's officers and directors are former officers and directors of CMS Energy, Consumers and their subsidiaries. None of them were employed by CMS Energy, Consumers, or their affiliates when the transaction was discussed internally and negotiated with purchasers. As a result of the sale, Consumers

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experienced an after-tax earnings increase of approximately \$17 million in 2002, due to the recognition of a \$26 million gain on the sale of the electric transmission system. This gain from the sale is offset by a loss of revenue from wholesale and retail open access customers who will buy services directly from MTH, including the loss of a return on the sold electric transmission system. Consumers anticipates that the future impact of the loss of revenue from wholesale and retail open access customers who will buy services directly from MTH and the loss of a return on the sold electric transmission system on its after-tax earnings will be a decrease of \$15 million in 2003, and a decrease of approximately \$14 million annually for the next three years.

Under the agreement with MTH, and subject to certain additional RTO surcharges, transmission rates charged to Consumers are fixed by contract at current levels through December 31, 2005, and subject to FERC ratemaking thereafter. MTH has completed the capital program to expand the transmission system's capability to import electricity into Michigan, as required by the Customer Choice Act, and Consumers will continue to maintain the system under a five-year contract with MTH. Effective April 30, 2002, Consumers and METC withdrew from the Alliance RTO, and MTH has joined the MISO RTO.

When IPPs connect to transmission systems, they pay transmission companies the capital costs incurred to connect the IPP to the transmission system and make system upgrades needed for the interconnection. It is the FERC's policy that the system upgrade portion of these IPP payments be credited against transmission service charges over time as transmission service is taken. METC recorded a \$35 million liability for IPP credits. Subsequently, MTH assumed this liability as part of its purchase of the electric transmission system. Several months after METC started operation, the FERC changed its policy to provide for interest on IPP payments that are to be credited. The \$35 million liability for IPP credits does not include interest since the associated interconnection agreements do not at this time provide for interest. MTH has asserted that Consumers may be liable for interest on the IPP payments to be credited if interest provisions are added to these agreements. Consumers believes that any potential liability would not have a material adverse affect on its financial condition.

Power Supply Costs: During periods when electric demand is high, the cost of purchasing electricity on the spot market can be substantial. To reduce Consumers' exposure to the fluctuating cost of electricity, and to ensure adequate supply to meet demand, Consumers intends to maintain sufficient generation and to purchase electricity from others to create a power supply reserve, also called a reserve margin. The reserve margin provides additional power supply capability above Consumers' anticipated peak power supply demands. It also allows Consumers to provide reliable service to its electric service customers and to protect itself against unscheduled plant outages and unanticipated demand. In recent years, Consumers has planned for a reserve margin of approximately 15 percent from a combination of its owned electric generating plants and electricity purchase contracts or options, as well as other arrangements. However, in light of various factors, including the addition of new generating capacity in Michigan and throughout the Midwest region and additional transmission import capability, Consumers is continuing to evaluate the appropriate reserve margin for 2003 and beyond. Currently, Consumers has a reserve margin of approximately 11 percent for summer 2003, or 111 percent of projected summer peak load. Of the 111 percent, approximately 101 percent is met from owned electric generating plants and long-term power purchase contracts and 10 percent from short-term contracts and options for physical deliveries and other agreements. The ultimate use of the reserve margin needed will depend primarily on summer weather conditions, the level of retail open access requirements being served by others during the summer, and any unscheduled plant outages. As of mid-March 2003, alternative electric suppliers are providing 516 MW of generation supply to ROA customers. Consumers' reserve margin does not include generation being supplied by other alternative electric suppliers under the ROA program.

To reduce the risk of high electric prices during peak demand periods and to achieve its reserve margin target, Consumers employs a strategy of purchasing electric call option and capacity 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, 2002, Consumers had purchased or had commitments to purchase electric call option and capacity contracts partially covering the estimated reserve margin requirements for 2003 through 2007. As a result

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Consumers has a recognized asset of \$30 million for unexpired call options and capacity contracts. The total cost of electricity call option and capacity contracts for 2002 was \$13 million.

Prior to 1998, the PSCR process provided for the reconciliation of actual power supply costs with power supply revenues. This process assured recovery of all reasonable and prudent power supply costs actually incurred by Consumers, including the actual cost for fuel, and purchased and interchange power. In 1998, as part of the electric restructuring efforts, the MPSC suspended the PSCR process, and would not grant adjustment of customer rates through 2001. As a result of the rate freeze imposed by the Customer Choice Act, the current rates will remain in effect until at least December 31, 2003 and, therefore, the PSCR process remains suspended. Therefore, changes in power supply costs as a result of fluctuating electricity prices will not be reflected in rates charged to Consumers' customers during the rate freeze period.

Electric Proceedings: The Customer Choice Act allows electric utilities to recover the act's implementation costs and "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 adopted a methodology which calculated "net" Stranded Costs as the shortfall between: (a) the revenue required to cover the costs associated with fixed generation assets, generation-related regulatory assets, and capacity payments associated with purchase power agreements, and (b) the revenues received from customers under existing rates available to cover the revenue requirement. The MPSC authorized Consumers to use deferred accounting to recognize the future recovery of costs determined to be stranded. Consumers has initiated an appeal at the Michigan Court of Appeals related to the MPSC's December 2001 "net" Stranded Cost order.

According to the MPSC, "net" Stranded Costs were to be recovered from retail open access customers through a Stranded Cost transition charge. In April 2002, Consumers made "net" Stranded Cost filings with the MPSC for \$22 million and \$43 million for 2000 and 2001, respectively. In the same filing, Consumers estimated that it would experience "net" Stranded Costs of \$126 million for 2002. Consumers in its hearing brief, filed in August 2002, revised its request for Stranded Costs to \$7 million and \$4 million for 2000 and 2001, respectively, and an estimated \$73 million for 2002. The single largest reason for the difference in the filing was the exclusion, as ordered by the MPSC, of all costs associated with expenditures required by the Clean Air Act.

In December 2002, the MPSC issued an order finding that Consumers experienced zero "net" Stranded Costs in 2000 and 2001, but declined to establish a defined methodology that would allow a reliable prediction of the level of Stranded Costs for 2002 and future years. In January 2003, Consumers filed a petition for rehearing of the December 2002 Stranded Cost order in which it asked the MPSC to grant a rehearing and revise certain features of the order. Several other parties also filed rehearing petitions with the MPSC. As noted above, Consumers has filed a request with the MPSC for authority to issue securitization bonds that would allow recovery of the Clean Air Act expenditures and post-2000 Palisades expenditures that were excluded from the Stranded Cost calculation.

On March 4, 2003, Consumers 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. In the application, Consumers indicated that if Consumers' proposal to securitize Clean Air Act expenditures and post-2000 Palisades' expenditures were approved as proposed in its securitization case as discussed above, then Consumers' "net" Stranded Costs incurred in 2002 are approximately \$35 million. If the proposal to securitize those costs is not approved, then Consumers indicated that the costs would be properly included in the 2002 "net" Stranded Cost calculation, which would increase Consumers' 2002 "net" Stranded Costs to approximately \$103 million. Consumers cannot predict the recoverability of Stranded Costs, and therefore has not recorded any regulatory assets to recognize the future recovery of such costs.

The MPSC staff has scheduled a collaborative process to discuss Stranded Costs and related issues and to identify and make recommendations to the MPSC. Consumers intends to participate in this collaborative process.

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Since 1997, Consumers has incurred significant electric utility restructuring implementation costs. The following table outlines the applications filed by Consumers with the MPSC and the status of recovery for these costs.

| <u>Year Filed</u> | <u>Year Incurred</u> | <u>Requested</u> | <u>Pending</u> | <u>Allowed</u> | <u>Disallowed</u> |
|-------------------|----------------------|------------------|----------------|----------------|-------------------|
| | | | | 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 | — | — |

The MPSC disallowed certain costs based upon a conclusion that these amounts did not represent costs incremental to costs already reflected in electric rates. In the orders received for the years 1997 through 2000, the MPSC also reserved the right to review again the total implementation costs depending upon the progress and success of the retail open access 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, as of December 2002, Consumers incurred and deferred as a regulatory asset, \$1 million of additional implementation costs and has also recorded as a regulatory asset \$13 million for the cost of money associated with total implementation costs. Consumers believes the implementation costs and the associated cost of money are fully recoverable in accordance with the Customer Choice Act. Cash recovery from customers will probably begin after the rate freeze or rate cap period has expired. Consumers cannot predict the amounts the MPSC will approve as allowable costs.

Consumers is also pursuing authorization at the FERC for MISO to reimburse Consumers for approximately \$8 million in certain electric utility restructuring implementation costs related to its former participation in the development of the Alliance RTO, a portion of which has been expensed. However, Consumers cannot predict the amount the FERC will ultimately order to be reimbursed by the MISO.

In 1996, Consumers filed new OATT transmission rates with the FERC for approval. Interveners contested these rates, and hearings were held before an ALJ in 1998. In 1999, the ALJ made an initial decision that was largely upheld by the FERC in March 2002, which requires Consumers to refund, with interest, over-collections for past services as measured by the FERC's finally approved OATT rates. Since the initial decision, Consumers has been reserving a portion of revenues billed to customers under the filed 1996 OATT rates. Consumers submitted revised rates to comply with the FERC final order in June 2002. Those revised rates were accepted by the FERC in August 2002 and Consumers is in the process of computing refund amounts for individual customers. Consumers believes its reserve is sufficient to satisfy its estimated refund obligation. As of December 2002, Consumers had paid \$17 million in refunds.

In November 2002, the MPSC, upon its own motion, commenced a contested proceeding requiring each utility to give reason as to why its rates should not be reduced to reflect new personal property multiplier tables, and why it should not refund any amounts that it receives as refunds from local governments as they implement the new multiplier tables. Consumers responded to the MPSC that it believes that refunds would be inconsistent with the electric rate freeze that is currently in effect, and may otherwise be unlawful. Consumers is unable to predict the outcome of this matter.

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. Consumers, through two wholly owned subsidiaries, holds the following assets related to the

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MCV Partnership and MCV Facility: 1) CMS Midland owns a 49 percent general partnership interest in the MCV Partnership; and 2) CMS Holdings holds, through FMLP, a 35 percent lessor interest in the MCV Facility.

Consumers' consolidated retained earnings include undistributed earnings from the MCV Partnership for the years 2002, 2001 and 2000 of \$226 million, \$184 million, and \$168 million, respectively.

Summarized Statements of Income for CMS Midland and CMS Holdings

| <u>Years Ended December 31</u> | <u>2002</u> | <u>2001</u> | <u>2000</u> |
|--|--------------|--------------|--------------|
| | In Millions | | |
| Operating income | \$ 52 | \$ 36 | \$ 56 |
| Income taxes and other | (18) | (11) | (18) |
| Cumulative effect of a change in accounting for derivatives, net of \$10 million tax expense | 18 | — | — |
| Net income | <u>\$ 52</u> | <u>\$ 25</u> | <u>\$ 38</u> |

Power Supply Purchases from the MCV Partnership — Consumers' annual obligation to purchase capacity from the MCV Partnership is 1,240 MW through the termination of the PPA in 2025. The PPA requires Consumers to pay, based on the MCV Facility's availability, a levelized average capacity charge of 3.77 cents per kWh, a fixed energy charge, and a variable energy charge based primarily on Consumers' average cost of coal consumed for all kWh delivered. Since January 1, 1993, the MPSC has permitted Consumers to recover capacity charges averaging 3.62 cents per kWh for 915 MW, plus a substantial portion of the fixed and variable energy charges. Since January 1, 1996, the MPSC has also permitted Consumers 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 current freeze of Consumers' retail rates that the Customer Choice Act requires, the capacity charge for the 325 MW is now frozen at 3.17 cents per kWh. Recovery of both the 915 MW and 325 MW portions of the PPA are subject to certain limitations discussed below. After September 2007, the PPA's terms obligate Consumers to pay the MCV Partnership only those capacity and energy charges that the MPSC has authorized for recovery from electric customers.

In 1992, Consumers recognized a loss and established a PPA liability for the present value of the estimated future underrecoveries of power supply costs under the PPA based on MPSC cost recovery orders. Primarily as a result of the MCV Facility's actual availability being greater than management's original estimates, the PPA liability has been reduced at a faster rate than originally anticipated. At December 31, 2002, 2001 and 2000, the remaining after-tax present value of the estimated future PPA liability associated with the loss totaled \$34 million, \$50 million and \$64 respectively. The PPA liability is expected to be depleted in late 2004. For further discussion on the impact of the frozen PSCR, see "Electric Rate Matters" in this Note.

In March 1999, Consumers and the MCV Partnership reached a settlement agreement effective January 1, 1999, that addressed, among other things, the ability of the MCV Partnership to count modifications increasing the capacity of the existing MCV Facility for purposes of computing the availability of contract capacity under the PPA for billing purposes. That settlement agreement capped availability payments that may be billed by the MCV Partnership at a 98.5 percent level.

When Consumers returns, as expected, to unfrozen rates beginning in 2004, Consumers will recover from customers, on-peak and off-peak capacity, so long as availability does not exceed an average 88.7 percent established in previous MPSC orders. For availability payments billed by the MCV Partnership after September 15, 2007, and not recovered from customers, Consumers would expect to claim a regulatory out under

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the PPA. If the MCV Facility's generating availability remains at the maximum 98.5 percent level during the next five years, Consumers' after-tax cash underrecoveries associated with the PPA could be as follows:

| | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|-------------|------|------|------|------|
| | In Millions | | | | |
| Estimated cash underrecoveries at 98.5%, net of tax | \$37 | \$36 | \$36 | \$36 | \$25 |

It is currently estimated that 51 percent of the actual cash underrecoveries for the years 2003 and 2004 will be charged to the PPA liability, with the remaining portion charged to operating expense as a result of Consumers' 49 percent ownership in the MCV Partnership. All cash underrecoveries will be expensed directly to income once the PPA liability is depleted.

In February 1998, the MCV Partnership appealed the January 1998 and February 1998 MPSC orders related to electric utility restructuring. At the same time, MCV Partnership filed suit in the United States District Court in Grand Rapids seeking a declaration that the MPSC's failure to provide Consumers and MCV Partnership a certain source of recovery of capacity payments after 2007 deprived MCV Partnership of its rights under the Public Utilities Regulatory Policies Act of 1978. In July 1999, the District Court granted MCV Partnership's motion for summary judgment. The Court permanently prohibited enforcement of the restructuring orders in any manner that denies any utility the ability to recover amounts paid to qualifying facilities such as the MCV Facility or that precludes the MCV Partnership from recovering the avoided cost rate. The MPSC appealed the Court's order to the 6th Circuit Court of Appeals in Cincinnati. In June 2001, the 6th Circuit overturned the lower court's order and dismissed the case against the MPSC. The appellate court determined that the case was premature and concluded that the qualifying facilities needed to wait until 2008 for an actual factual record to develop before bringing claims against the MPSC in federal court.

Nuclear Matters: Throughout 2002, Big Rock, currently in decommissioning, progressed on plan with building and equipment dismantlement to return the site to a natural setting free for any future use. Periodic NRC inspection reports continued to reflect positively on Big Rock project performance. The NRC found all decommissioning activities were performed in accordance with applicable regulatory and license conditions.

In February 2003, the NRC completed its end-of-cycle plant performance assessment of Palisades. The end-of-cycle review for Palisades covered the 2002 calendar year. 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 March 2004. The NRC noted that they are planning inspections of the new independent spent fuel storage facility as needed during construction activities along with routine inspections for the new security requirements.

Spent Nuclear Fuel Storage: During the fourth quarter of 2002, equipment fabrication, assembly and testing was completed at Big Rock on NRC approved transportable steel and concrete canisters or vaults, commonly known as "dry-casks" for temporary onsite storage of spent fuel and movement of fuel from the fuel pool to dry casks began. As of March 2003, all of the seven dry casks had been loaded with spent fuel. These transportable dry casks will remain onsite until the DOE moves the material to a permanent national fuel repository.

At Palisades, the amount of spent nuclear fuel discharged from the reactor to date exceeds Palisades' temporary on-site storage pool capacity. Consequently, Consumers is using NRC-approved steel and concrete vaults, "dry casks", for temporary on-site storage. As of December 31, 2002, Consumers had loaded 18 dry casks with spent nuclear fuel at Palisades. Palisades will need to load additional dry casks by the fall of 2004 in order to continue operation. Palisades currently has three empty storage-only dry casks on-site, with storage pad capacity for up to seven additional loaded dry casks. Consumers anticipates that licensed transportable dry casks for additional storage, along with more storage pad capacity, will be available prior to 2004.

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In 1997, a federal court decision has confirmed that the DOE was to begin accepting deliveries of spent nuclear fuel for disposal by January 31, 1998. Subsequent litigation in which Consumers and certain other utilities participated has not been successful in producing more specific relief for the DOE's failure to comply.

In July 2000, the DOE reached a settlement agreement with one utility to address the DOE's delay in accepting spent fuel. The DOE may use that settlement agreement as a framework that it could apply to other nuclear power plants. However, certain other utilities challenged the validity of the mechanism for funding the settlement in an appeal, and recently the reviewing court sustained their challenge. Additionally, 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 fuel. A number of utilities have commenced litigation in the Court of Claims. If the litigation that was commenced in the fourth quarter of 2002 against the DOE is successful, Consumers anticipates future recoveries from the DOE to defray the significant costs it will incur for the storage of spent fuel until the DOE takes possession as required by law.

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 that asks the MPSC to commence a generic investigation and contested case to review all facts and issues concerning the recovery of costs associated with spent nuclear fuel storage and disposal. The complaint alleges that the rates of Consumers, The Detroit Edison Company, Indiana & Michigan Electric Company, Wisconsin Electric Power Company and Wisconsin Public Service Corporation are unjust and unreasonable with respect to the recovery of costs associated with spent nuclear fuel storage and disposal. The complaint seeks a variety of relief, including the establishing of external trusts to which amounts collected in electric rates for spent nuclear fuel storage and disposal should be transferred, and the adoption of additional measures to assure that adequate funds are available for the storage and disposal of spent nuclear fuel. Consumers has not had an opportunity to review the complaint in detail.

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.

Palisades Plant Operations: In December 2000, the NRC issued an amendment revising the operating license for Palisades to extend its expiration date to March 2011, with no restrictions related to reactor vessel embrittlement.

In 2000, Consumers made an equity investment and entered into an operating agreement with NMC. NMC was formed in 1999 by four utilities to operate and manage the nuclear generating plants owned by these utilities. Consumers benefits by consolidating expertise, cost control and resources among all of the nuclear plants being operated on behalf of the NMC member companies.

In November 2000, Consumers requested approval from the NRC to transfer operating authority for Palisades to NMC and the request was granted in April 2001. The formal transfer of authority from Consumers to NMC took place in May 2001. Consumers retains ownership of Palisades, its 789 MW output, the current and future spent fuel on-site, and ultimate responsibility for the safe operation, maintenance and decommissioning of the plant. Under the agreement that transferred operating authority of the plant to NMC, salaried Palisades' employees became NMC employees on July 1, 2001. Union employees work under the supervision of NMC pursuant to their existing labor contract as Consumers' employees. NMC currently has responsibility for operating eight units with 4,500 MW of generating capacity in Wisconsin, Minnesota, Iowa and Michigan.

Following a refueling outage in April 2001, the Palisades reactor was shut down on June 20, 2001 so technicians could inspect a small steam leak on a control rod drive assembly. There was no risk to the public or workers. In August 2001, Consumers completed an expanded inspection that included all similar control rod drive assemblies and elected to completely replace all the components. Installation of the new components was completed in December 2001. The plant was returned to service on January 21, 2002 and has been in continuous

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operation with the exception of three days in December 2002 when there was a transmission line related outage. Consumers' capital expenditures for the components and their installation was approximately \$31 million.

From the start of the June 20th outage through the end of 2001, the impact on net income of replacement power supply costs associated with the outage was approximately \$59 million. Subsequently, in January 2002, the impact on 2002 net income was \$5 million.

Insurance: Consumers maintains primary and excess nuclear property insurance from NEIL, totaling \$2.7 billion in recoverable limits for the Palisades nuclear plant. Consumers also procures coverage from NEIL that would partially cover the cost of replacement power during certain prolonged accidental outages at Palisades. NEIL's policies include coverage for acts of terrorism.

Consumers retains the risk of loss to the extent of the insurance deductibles and to the extent that its loss exceeds its policy limits. Because NEIL is a mutual insurance company, Consumers could be subject to assessments from NEIL up to \$25.8 million in any policy year if insured losses in excess of NEIL's maximum policyholders surplus occur at its, or any other member's nuclear facility.

Consumers maintains nuclear liability insurance for injuries and off-site property damage resulting from the nuclear hazard at Palisades for up to approximately \$9.5 billion, the maximum insurance liability limits established by the Price-Anderson Act. Congress enacted the Price-Anderson Act to provide financial protection for persons who may be liable for a nuclear accident or incident and persons who may be injured by a nuclear incident. The Price-Anderson Act was recently extended to December 31, 2003. Part of the Price-Anderson Act's financial protection consists of a mandatory industry-wide program under which owners of nuclear generating facilities could be assessed if a nuclear incident occurs at any of such facilities. The maximum assessment against Consumers could be \$88 million per occurrence, limited to maximum annual installment payments of \$10 million. Consumers also maintains insurance under a master worker program that covers tort claims for bodily injury to 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, Consumers remains responsible for a maximum assessment of up to \$6.3 million. The Big Rock plant remains insured for nuclear liability by a combination of insurance and United States government indemnity totaling \$544 million.

Insurance policy terms, limits and conditions are subject to change during the year as Consumers renews its policies.

Commitments for Future Purchases: Consumers enters 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 its business and to minimize exposure to market price fluctuations. Consumers believes that these future costs are prudent and reasonably assured of recovery in future rates.

Coal Supply: Consumers has entered into coal supply contracts with various suppliers for its coal-fired generating stations. Under the terms of these agreements, Consumers is obligated to take physical delivery of the coal and make payment based upon the contract terms. Consumers' current contracts have expiration dates that range from 2003 to 2005, and total an estimated \$276 million. Long-term coal supply contracts account for approximately 60 to 90 percent of Consumers' annual coal requirements. In 2002, coal purchases totaled \$247 million of which \$224 million (88 percent of the tonnage requirement) was under long-term contract. Consumers supplements its long-term contracts with spot-market purchases.

Power Supply, Capacity and Transmission: As of December 31, 2001, Consumers had future unrecognized commitments to purchase power supply and transmission services under fixed price forward contracts for the years 2003 and 2004 totaling \$15 million. Consumers also had commitments to purchase capacity and energy under long-term power purchase agreements with various generating plants including the MCV Facility. These

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contracts require monthly capacity payments based on the plants' availability or deliverability. These payments for the years 2003 through 2030 total an estimated \$16 billion, undiscounted, which includes \$12 billion related to the MCV Facility. This amount may vary depending upon plant availability and fuel costs. If a plant were not available to deliver electricity to Consumers, then Consumers would not be obligated to make the capacity payment until the plant could deliver. For further information, see Note 6, Uncertainties, "The Midland Cogeneration Venture" for information concerning power purchases from the MCV Facility.

CONSUMERS' GAS UTILITY CONTINGENCIES

Gas Environmental Matters: Under the Michigan Natural Resources and Environmental Protection Act, Consumers expects that it will ultimately incur investigation and remedial action costs at a number of sites. These include 23 former manufactured gas plant facilities, which were operated by Consumers for some part of their operating lives, including sites in which it has a partial or no current ownership interest. Consumers has completed initial investigations at the 23 sites. For sites where Consumers has received site-wide study plan approvals, it will continue to implement these plans. It will also work toward closure of environmental issues at sites as studies are completed. Consumers has estimated its costs related to further investigation and remedial action for all 23 sites using the Gas Research Institute-Manufactured Gas Plant Probabilistic Cost Model. The estimated total costs are between \$82 million and \$113 million; these estimates are based on discounted 2001 costs and follow EPA recommended use of discount rates between 3 and 7 percent for this type of activity. Consumers expects to recover a significant portion of these costs through insurance proceeds and through MPSC approved rates charged to its customers. As of December 31, 2002, Consumers has an accrued liability of \$51 million, net of \$31 million of expenditures incurred to date, and a regulatory asset of \$70 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 Consumers' estimate of remedial action costs.

The MPSC, in its November 7, 2002, gas distribution rate order, authorized Consumers to continue to recover approximately \$1 million of manufactured gas plant facilities environmental clean-up costs annually. Consumers defers and amortizes, over a period of 10 years, manufactured gas plant facilities environmental clean-up costs above the amount currently being recovered in rates. Additional rate recognition of amortization expense cannot begin until after a prudence review in a gas rate case. The annual amount that the MPSC authorized Consumers to recover in rates will continue to be offset by \$2 million to reflect amounts recovered from all other sources.

CONSUMERS' GAS UTILITY RATE MATTERS

Gas Restructuring: From April 1, 1998 to March 31, 2001, Consumers conducted an experimental gas customer choice pilot program that froze gas distribution and GCR rates through the period. On April 1, 2001, a permanent gas customer choice program commenced under which Consumers returned to a GCR mechanism that allows it to recover from its bundled sales customers all prudently incurred costs to purchase the natural gas commodity and transport it to Consumers for ultimate distribution to customers.

Gas Cost Recovery: As part of the on-going GCR process, which includes an annual reconciliation process with the MPSC, Consumers expects to collect all of its incurred gas costs. Under an order issued by the MPSC on March 12, 2003, Consumers is allowed to increase its maximum GCR factor in May 2003, based on a formula that tracks increases in NYMEX prices.

2001 Gas Rate Case: In June 2001, Consumers filed an application with the MPSC seeking a distribution service rate increase. On November 7, 2002, the MPSC issued a final order approving a \$56 million annual gas distribution service rate increase, which includes the \$15 million interim increase, with an 11.4 percent authorized return on equity, effective for service November 8, 2002. As part of this order, the MPSC approved Consumers' proposal to absorb the assets and liabilities of Michigan Gas Storage Company into Consumers' rate

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base and rates. This has occurred through a statutory merger of Michigan Gas Storage Company into Consumers and this is not expected to have an impact on Consumers' consolidated financial statements.

2003 Gas Rate Case: On March 14, 2003, Consumers filed an application with the MPSC seeking a \$156 million increase in its gas delivery and transportation rates, which includes a 13.5 percent authorized return on equity, based on a 2004 test year. If approved, the request would add about \$6.40 per month, or about 9 percent, to the typical residential customer's average monthly distribution bill. Contemporaneously with this filing, Consumers has requested interim rate relief in the same amount.

In September 2002, the FERC issued an order rejecting a filing by Consumers to assess certain rates for non-physical gas title tracking services offered by Consumers. Despite Consumers' arguments to the contrary, the FERC asserted jurisdiction over such activities and allowed Consumers to refile and justify a title transfer fee not based on volumes as Consumers proposed. Because the order was issued six years after Consumers made its original filing initiating the proceeding, over \$3 million in non-title transfer tracking fees had been collected. No refunds have been ordered, and Consumers sought rehearing of the September order. If refunds were ordered they may include interest which would increase the refund liability to more than the \$3 million collected. In December 2002, Consumers established a \$3.6 million reserve related to this matter. Consumers is unable to say with certainty what the final outcome of this proceeding might be.

In November 2002, the MPSC upon its own motion commenced a contested proceeding requiring each utility to give reason as to why its rates should not be reduced to reflect new personal property multiplier tables, and why it should not refund any amounts that it receives as refunds from local governments as they implement the new multiplier tables. Consumers responded to the MPSC that it believes that refunds would be inconsistent with the November 7, 2002 gas rate order in case U-13000, with the Customer Choice Act, and may otherwise be unlawful. Consumers is unable to predict the outcome of this matter.

OTHER GAS UNCERTAINTIES

Collective Bargaining Agreement: As of December 31, 2002, 44 percent of Consumers workforce was represented by the Utility Workers Union of America. Consumers and the Union negotiated a collective bargaining agreement that became effective as of June 1, 2000, and will continue in full force and effect until June 1, 2005. Consumers is currently negotiating with the Union for a collective bargaining agreement for its Call Center employees.

OTHER UNCERTAINTIES

CMS Generation-Oxford Tire Recycling: In 1999, the California Regional Water Control Board of the State of California named CMS Generation as a potentially responsible party for the cleanup of the waste from a fire that occurred in September 1999 at the Filbin tire pile. The tire pile was maintained as fuel for an adjacent power plant owned by Modesto Energy Limited Partnership. Oxford Tire Recycling of Northern California, Inc., a subsidiary of CMS Generation until 1995, owned the Filbin tire pile. CMS Generation has not owned an interest in Oxford Tire Recycling of Northern California, Inc. or Modesto Energy Limited Partnership since 1995. In 2000, the California Attorney General filed a complaint against the potentially responsible parties for cleanup of the site and assessed penalties for violation of the California Regional Water Control Board order. The parties have reached a settlement with the state, which the court approved, pursuant to which CMS Energy had to pay \$6 million. At the request of the U.S. Department of Justice in San Francisco (DOJ), CMS Energy and other parties contacted by the DOJ entered into separate tolling agreements with the DOJ in September 2002 that stopped the running of any statute of limitations until March 14, 2003 (later extended to June 30, 2003) to facilitate the 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.

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In connection with this fire, several class action lawsuits were filed claiming that the fire resulted in damage to the class and that management of the site caused the fire. CMS Generation has reached a settlement in principle with the plaintiffs in the amount of \$9 million. The primary insurance carrier will cover 100 percent of the settlement once the agreement is finalized.

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 arbitration. DIG will continue to vigorously defend itself and pursue its claims. CMS Energy cannot predict the outcome of this matter.

Dearborn Industrial Generation 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, have asserted claims that the continued delays relieve them of certain contractual obligations totaling \$43 million. In addition, Ford and/or Rouge have 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, LLC with the American Arbitration Association. Rouge is seeking a total of \$27 million plus additional accrued damages at the time of any award, plus interest. More specifically, Rouge is 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 \$7 million for assorted damage claims under several legal theories. DIG and CMS MST Michigan, LLC intend to vigorously defend themselves, and DIG has filed claims against Rouge and Ford as part of this arbitration. CMS Energy cannot predict the outcome of this matter.

Dearborn Industrial Generation Noise Abatement Lawsuit: In February 2003, DIG was served with a three-count first amended complaint in the matter of Ahmed, et al. v. Dearborn Industrial Generation, LLC, Wayne County Circuit Court Case No. 02-241296-CZ. 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 residents 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 aggressively defend this action. CMS Energy cannot predict the outcome of this matter.

Midland Cogeneration Venture Expansion, LLC: Under an agreement entered into with General Electric Company ("GE") in October 2002, as of December 31, 2002 Midland Cogeneration Venture Expansion, LLC ("MCV Expansion") has a remaining contingent obligation to GE in the amount of \$3.5 million that may become payable on July 1, 2003. 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 anticipates but cannot assure that purchase orders will be executed with GE by June 30, 2003 sufficient to eliminate the contingent obligation of \$3.5 million.

CMS Oil and Gas: In 1999, a former subsidiary of CMS Oil and Gas, Terra Energy Ltd., was sued by Star Energy, Inc. and White Pine Enterprises LLC in the 13th Judicial Circuit Court in Antrim County, Michigan, on grounds, among others, that Terra violated oil and gas lease and other agreements by failing to drill wells. Among the defenses asserted by Terra were that the wells were not required to be drilled and the claimant's sole remedy was termination of the oil and gas lease. During the trial, the judge declared the lease terminated in favor of White Pine. The jury then awarded Star Energy and White Pine \$7.6 million in damages. Terra appealed this matter to the Michigan Court of Appeals. The Court of Appeals reversed the trial court judgment with respect to

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

the appropriate measure of damages and remanded the case for a new trial on damages. Terra has taken an appeal to the Michigan Supreme Court. A reserve has been established for this matter.

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 Argentina 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.

In February 2002, the Republic of Argentina enacted additional measures that required all monetary obligations (including current debt and future contract payment obligations) denominated in foreign currencies to be converted into pesos. These February measures also authorize the Argentine judiciary essentially to rewrite private contracts denominated in dollars or other foreign currencies if the parties cannot agree on how to share equitably the impact of the conversion of their contract payment obligations into pesos. In April 2002, based on a consideration of these environmental factors, CMS Energy evaluated its Argentine investments for impairment as required under SFAS No. 144 and APB Opinion No. 18. These impairment models contain certain assumptions regarding anticipated future exchange rates and operating performance of the investments. Exchange rates used in the models assume that the rate will decrease from current levels to approximately 3.00 pesos per U.S. dollar over the remaining life of these investments. Based on the results of these models, CMS Energy determined that these investments were not impaired.

Effective April 30, 2002, CMS Energy adopted the Argentine peso as the functional currency for most of its Argentine investments. CMS had previously used the U.S. dollar as the functional currency for its Argentine investments. As a result, on April 30, 2002, CMS Energy translated the assets and liabilities of its 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.

For the year ended December 31, 2002, CMS Energy recorded losses of \$31 million, reflecting the negative impact of the actions of the Argentine government. These losses represent changes in the value of peso-denominated monetary assets (such as receivables) and liabilities of Argentina-based subsidiaries and lower net project earnings resulting from the conversion to pesos of utility tariffs and energy contract obligations that were previously calculated in dollars.

While CMS Energy's management cannot predict the most likely future, or average peso to U.S. dollar exchange rates, it does expect that these non-cash charges substantially reduce 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, 2002, the net foreign currency loss due to the unfavorable exchange rate of the Argentine peso recorded in the Foreign Currency Translation component of Common Stockholder's Equity using an exchange rate of 3.3647 pesos per U.S. dollar was \$266 million. This amount also reflected the effect of recording, at December 31, 2002, U.S. income taxes with respect to temporary differences between the book and tax bases of foreign investments, including the foreign currency translation associated with CMS Energy's Argentine investments, that were determined to no longer be essentially permanent in duration (see Note 11, Income Taxes.)

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 \$91 million, the affiliates and CMS Energy believe the claims are without merit and will continue to vigorously contest them.

CMS Generation does not currently expect to incur significant capital costs at its power facilities for compliance with current U.S. environmental regulatory standards.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

In addition to the matters disclosed in this Note, Consumers, Panhandle 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.

CMS Energy has accrued estimated losses for certain contingencies discussed in this Note. Resolution of these contingencies is not expected to have a material adverse impact on CMS Energy's financial position, liquidity, or results of operations.

7: SHORT-TERM AND LONG-TERM FINANCINGS

LONG-TERM DEBT SUMMARY

| | <u>Interest Rate(%)</u> | <u>Maturity</u> | <u>December 31</u> | |
|---|-------------------------|-----------------|-------------------------|-------------|
| | | | <u>2002</u> | <u>2001</u> |
| | | | In Millions Restated | |
| CMS Energy | | | | |
| Senior Notes | 8.125 | 2002 | \$ — | \$ 350 |
| | 7.625 | 2004 | 176 | 180 |
| | 6.750 | 2004 | 287 | 300 |
| | 9.875 | 2007 | 468 | 500 |
| | 8.900 | 2008 | 260 | 269 |
| | 7.500 | 2009 | 409 | 480 |
| | 8.500 | 2011 | 300 | 350 |
| | 8.375 | 2013 | 150 | 150 |
| | | | 2,050 | 2,579 |
| General Term Notes | | | | |
| Series A | | 2002–2010 | — | 31 |
| Series B | | 2002–2010 | — | 14 |
| Series C | | 2002–2010 | — | 58 |
| Series D | 6.90 (a) | 2003–2010 | 94 | 168 |
| Series E | 7.90 (a) | 2003–2010 | 227 | 391 |
| Series F | 7.60 (a) | 2003–2010 | 298 | 288 |
| | | | 619 | 950 |
| Extendible Tenor Rate Adjusted Securities | 7.000 | 2005 | 180 | 180 |
| Senior Credit Facilities | | 2003–2004 | 291 | 167 |
| Lines of Credit | | 2002 | — | 22 |
| Other | | | 29 | 10 |
| | | | 500 | 379 |

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

| | Interest Rate(%) | Maturity | December 31 | |
|---------------------------------------|------------------|-----------|-------------------------|-----------------|
| | | | 2002 | 2001 |
| | | | In Millions Restated | |
| Consumers Energy | | | | |
| First Mortgage Bonds | 6.375 | 2003 | — | 300 |
| | 7.375 | 2023 | 208 | 208 |
| | | | 208 | 508 |
| Senior Notes | Floating | 2002 | — | 100 |
| | 6.000 | 2005 | 300 | — |
| | 6.250 | 2006 | 332 | 332 |
| | 6.375 | 2008 | 159 | 159 |
| | 6.200(b) | 2008 | 250 | 250 |
| | 6.875 | 2018 | 180 | 180 |
| | 6.500(c) | 2018 | 141 | 141 |
| | 6.500 | 2028 | 142 | 143 |
| | | | 1,504 | 1,305 |
| Securitization Bonds | | 2005-2016 | 453 | 469 |
| Long-Term Bank Debt | | 2003 | 328 | 184 |
| Nuclear Fuel Disposal | | (d) | 138 | 135 |
| Pollution Control Revenue Bonds | 5.100 | 2010-2018 | 126 | 126 |
| Other | | | 8 | 8 |
| | | | 1,053 | 922 |
| Other Subsidiaries | | | 77 | 231 |
| Principal Amount Outstanding | | | 6,011 | 6,875 |
| Current Amounts | | | (627) | (1,003) |
| Net Unamortized Discount | | | (28) | (32) |
| Total Long-Term Debt | | | <u>\$5,356</u> | <u>\$ 5,840</u> |

- (a) Represents the weighted average interest rate at December 31, 2002.
- (b) These notes are subject to a Call Option by the Callholder or a Mandatory Put on May 1, 2003.
- (c) Includes \$141 million Senior Remarketed Notes subject to optional redemption by Consumers after June 15, 2005.
- (d) Maturity date uncertain (see Note 1).

The scheduled maturities of long-term debt and improvement fund obligations before consideration of refinancings completed subsequent to December 31, 2002 discussed in Note 19 are as follows: \$627 million in 2003, \$964 million in 2004, \$742 million in 2005, \$514 million in 2006, \$538 million in 2007 and \$2,626 million thereafter.

CREDIT FACILITIES

On July 12, 2002, CMS Energy and its subsidiaries reached agreement with its lenders on five credit facilities (facilities) totaling approximately \$1.3 billion of credit for CMS Energy, Enterprises and Consumers. The agreements were executed by various combinations of up to 21 lenders and by CMS Energy and included: a \$259.9 million revolving credit facility for CMS Energy originally set to mature on March 31, 2003; a \$300 million revolving credit facility for CMS Energy, maturing December 15, 2003; a \$150 million short-term loan for Enterprises, originally set to mature on December 13, 2002; a \$250 million revolving credit facility for Consumers, maturing July 11, 2003; and a \$300 million term loan for Consumers, maturing July 11, 2003. In

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

March 2003, the CMS Energy \$295.8 million revolving credit facility and \$300 million revolving credit facility under which \$409 million was then outstanding were amended and restated. The Second Amended and Restated Senior Credit Agreement includes a \$234 million tranche with a maturity date of April 30, 2004 and a \$175 million tranche with a maturity date of September 30, 2004. Also in March 2003, Consumers obtained a replacement revolving credit facility in the amount of \$250 million. The new credit facility matures in March 2004 with two annual extensions at Consumers' option which would extend the maturity to March 2006. In September 2002, CMS Energy retired the \$150 million short-term loan to Enterprises using proceeds from the sale of CMS Oil and Gas. Also in September 2002, Consumers' exercised its extension option on the \$300 million term loan to move the maturity date to July 11, 2004. At December 31, 2002, \$841 million remained outstanding under these facilities, of which Consumers' \$250 million revolving credit facility is included in notes payable in the accompanying consolidated balance sheet.

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Short-Term Financings: At December 31, 2002, CMS had \$291 million of borrowings outstanding under its credit facilities. CMS Energy's \$295.8 million credit facility had been reduced to \$187 million as a result of mandatory prepayments with proceeds of various asset sales and had \$187 million of borrowings at December 31, 2002. CMS Energy's \$300 million credit facility had \$104 million of borrowings and \$185 million of letter-of-credit usage outstanding at December 31, 2002.

General Term Notes: In May 2002, CMS Energy registered \$300 million of Series G GTNs. For the year ended December 31, 2002, no Series G GTNs had been issued. In 2002, CMS Energy called \$243 million of Series A through F GTNs at interest rates ranging from 7 percent to 9 percent using funds available from asset sales proceeds. At December 31, 2002, CMS Energy had issued and outstanding \$619 million GTNs, comprised of \$94 million Series D GTNs, \$227 million Series E GTNs and \$299 million of Series F GTNs with weighted average interest rates of 6.9 percent, 7.9 percent and 7.6 percent, respectively.

CONSUMERS

Authorization: At December 31, 2002, Consumers had FERC authorization to issue or guarantee through June 2004, up to \$1.1 billion of short-term securities outstanding at any one time. Consumers also had remaining FERC authorization to issue through June 2004 up to \$500 million of long-term securities for refinancing or refunding purposes, \$677 million for general corporate purposes, and \$900 million of first mortgage bonds to be issued solely as security for the long-term securities. On October 10, 2002, FERC granted a waiver of its competitive bid/negotiated placement requirements applicable to the remaining long-term securities authorization indicated above.

Short-Term Financings: At December 31, 2002 Consumers had a \$250 million credit facility secured by first mortgage bonds, a first mortgage bond term loan of \$155 million and a gas inventory loan of \$52 million. These facilities are available to finance seasonal working capital requirements and to pay for capital expenditures between long-term financings. At December 31, 2002, a total of \$457 million was outstanding at a weighted average interest rate of 4.5 percent, compared with \$416 million outstanding on a revolving credit facility and unsecured lines of credit at December 31, 2001, at a weighted average interest rate of 2.7 percent.

At December 31, 2002, Consumers' \$250 million credit facility had an effective interest rate of 5.9 percent. The rate may fluctuate depending on the rating of Consumers' first mortgage bonds or changes in the base LIBOR rate. On March 27, 2003, Consumers renewed its revolving credit facility which was set to expire in July 2003. The new \$250 million credit facility, secured by first mortgage bonds, matures in March 2004 with two annual extensions at Consumers' option, which would extend the maturity to March 2006. The cost of the facility is LIBOR plus 350 basis points.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The term loan, collateralized by first mortgage bonds, and the gas inventory loan, collateralized by Consumers' natural gas in storage, were simultaneously entered into in October 2002. These agreements contain complementary collateral packages that provide Consumers, as additional first mortgage bonds become available, borrowing capacity of up to \$225 million, of which \$207 million was outstanding at December 31, 2002 with an effective interest rate of 6.3 percent.

Long-Term Financings: In March 2002, Consumers sold \$300 million principal amount of six percent senior notes, maturing in March 2005. Net proceeds from the sale were \$299 million. Consumers used the net proceeds to replace a first mortgage bond that was to mature in 2003.

At December 31, 2002, Consumers' \$300 million credit facility, maturing in July 2004 and secured by first mortgage bonds had an effective interest rate of 8.9 percent. The rate may fluctuate depending on the rating of Consumers' first mortgage bonds or changes in the base LIBOR rate.

Consumers has a total of \$126 million of long-term pollution control revenue bonds outstanding, secured by first mortgage bonds and insurance policies. These bonds had a weighted average interest rate of 2.7 percent at December 31, 2002.

First Mortgage Bonds: Consumers secures its first mortgage bonds by a mortgage and lien on substantially all of its property. Consumers' ability to issue and sell securities is restricted by certain provisions in its first mortgage bond indenture, its articles of incorporation and the need for regulatory approvals to meet appropriate federal law.

Restricted Payments: Under the provisions of its articles of incorporation, Consumers had \$394 million of unrestricted retained earnings available to pay common dividends at December 31, 2002. In January 2003, Consumers declared and paid a \$78 million common dividend. However, due to Consumers' dividend restrictions included as part of an agreement with its lenders, Consumers' dividends are not to exceed \$300 million in any calendar year.

Other: On April 1, 2002, Consumers established a new subsidiary, Consumers Receivables Funding. This consolidated subsidiary was established as a special purpose entity to properly reflect the sale of trade receivables from Consumers to ASCC, an unrelated third party under a trade receivables sale agreement. Prior to the establishment of Consumers Receivables Funding, Consumers sold its accounts receivable directly to ASCC. At December 31, 2002 and 2001, the receivables sold under the program were \$325 million and \$334 million, respectively. Accounts receivable and accrued revenue in the Consolidated Balance Sheets have been reduced to reflect receivables sold.

Under the program discussed above, during 2002 and 2001, Consumers sold accounts receivable but retained servicing responsibility. Consumers is responsible for the collectability of the accounts receivable sold, however, the investors associated with the sale of accounts receivable have no recourse to Consumers' other assets for failure of debtors to pay when due and there are no restrictions on accounts receivables not sold. No gain or loss has been recorded on the sale of accounts receivable and Consumers retains no interest in the receivables sold. The average annual discount rate was 2.05 percent and 4.37 percent for 2002 and 2001, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

REQUIRED RATIOS

CMS Energy's and Consumers' credit facilities also have contractual restrictions that require CMS Energy and Consumers to maintain, as of the last day of each fiscal quarter, the following:

| <u>Required Ratio</u> | <u>Limitation</u> | <u>Ratio at December 31, 2002</u> |
|---|----------------------------|-----------------------------------|
| CMS Energy: | | |
| Consolidated Leverage Ratio(a)(b) | not more than 5.75 to 1.00 | 5.59 to 1.00 |
| Cash Dividend Coverage Ratio(a) | not less than 1.25 to 1.00 | 1.57 to 1.00 |
| Consumers: | | |
| Debt to Capital Ratio(a)(b) | not more than 0.65 to 1.00 | 0.55 to 1.00 |
| Interest Coverage Ratio(a)(b) | not less than 2.00 to 1.00 | 4.01 to 1.00 |

- (a) Violation of this ratio would constitute an event of default under the facility which provides the lender, among other remedies, the right to declare the principal and interest immediately due and payable.
- (b) For purposes of these ratios, the terms of the credit facilities provide for the exclusion of securitization bonds in the calculation of these ratios.

In 1994, CMS Energy executed an indenture with J.P.Morgan Chase Bank pursuant to CMS Energy's general term notes program. The indenture, through supplements, contains certain provisions that can trigger a limitation on CMS Energy's consolidated indebtedness. The limitation can be activated when CMS Energy's consolidated leverage ratio, as defined in the indenture (essentially the ratio of consolidated debt to consolidated capital), exceeds 0.75 to 1.0. At December 31, 2002, CMS Energy's consolidated leverage ratio was 0.79 to 1.0. As a result, CMS Energy will not and will not permit certain material subsidiaries, excluding Consumers and its subsidiaries, to become liable for new indebtedness. However, the indenture contains certain express exceptions to this limitation, and pursuant to one such exception, CMS Energy and the material subsidiaries may incur revolving indebtedness to banks of up to \$1 billion in the aggregate and refinance existing debt outstanding of CMS Energy and of its material subsidiaries.

Effective January 1, 2003, CMS Energy adopted the provisions of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. This interpretation requires additional disclosures by a guarantor about its obligations under certain guarantees that it has issued.

The off-balance sheet commitments at December 31, 2002 are as follows:

Commercial Commitments

| | <u>Commitment Expiration</u> | | | | | | |
|-------------------------|------------------------------|---------------------|--------------------|--------------------|-------------------|-------------------|---------------------|
| | <u>Total</u> | <u>December 31</u> | | | | | <u>Beyond</u> |
| | | <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | |
| <u>In Millions</u> | | | | | | | |
| Off-balance sheet: | | | | | | | |
| Guarantees | \$ 524 | \$ — | \$ — | \$ — | \$ 4 | \$ — | \$520 |
| Indemnities | 230 | 5 | — | 36 | — | — | 189 |
| Letters of Credit | 296 | 275 | 18 | — | — | — | 3 |
| Total | <u>\$1,050</u> | <u>\$280</u> | <u>\$18</u> | <u>\$36</u> | <u>\$4</u> | <u>\$—</u> | <u>\$712</u> |

CMS Energy and Enterprises, including subsidiaries, have guaranteed payment of obligations, through letters of credit and surety bonds, of unconsolidated affiliates and related parties approximating \$1.0 billion as of December 31, 2002. Included in this amount, Enterprises, in the ordinary course of business, has guarantees in

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place for contracts of CMS MST that contain certain schedule and performance requirements. As of December 31, 2002, the actual amount of financial exposure covered by these guarantees was \$219 million. This amount excludes the guarantees associated with CMS MST's natural gas sales arrangements totaling \$266 million, which are recorded as liabilities on the Consolidated Balance Sheet at December 31, 2002. Management monitors and approves these obligations and believes it is unlikely that CMS Energy or Enterprises would be required to perform or otherwise incur any material losses associated with the above obligations.

The following table is a summary of CMS Energy's guarantees as required by FASB Interpretation No. 45:

| <u>Guarantee Description</u> | <u>December 31, 2002</u> | | | | |
|---|--------------------------|------------------------|---------------------------|---------------------------|------------------------------|
| | <u>Issue Date</u> | <u>Expiration Date</u> | <u>Maximum Obligation</u> | <u>Carrying Amount(b)</u> | <u>Recourse Provision(c)</u> |
| | In Millions | | | | |
| Indemnifications from asset sales and other agreements(a) | Various | Various | \$1,672 | \$— | \$— |
| Letters of credit | Various | Various | 296 | — | — |
| Surety bonds and other indemnifications | Various | Various | 230 | — | — |
| Other guarantees | Various | Various | — | 524 | — |
| Nuclear insurance retrospective premiums | Various | Various | — | 120 | — |

- (a) The majority of this amount arises from routine provisions in stock and asset sales agreements under which the purchaser is indemnified by CMS Energy or a subsidiary for losses resulting from events such as failure of title to the assets or stock sold by CMS Energy or a subsidiary to the purchaser. CMS Energy believes the likelihood of a loss arising from such events to be remote.
- (b) The carrying amount represents the fair market value of guarantees and indemnities on CMS Energy's 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.

CMS Energy has 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.

See Note 19 for further discussion of CMS Energy's and Consumers Energy's new financing arrangements as of March 30, 2003.

8: 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.

Company-Obligated Preferred Securities: CMS Energy and Consumers each have wholly-owned statutory business trusts that are consolidated with the respective parent company. CMS Energy and Consumers created their respective trusts for the sole purpose of issuing trust preferred securities. In each case, the primary asset of the trust is a note or debenture of the parent company. The terms of the trust preferred security parallel the terms of the related parent company note or debenture. The terms, rights and obligations of the trust preferred security and related note or debenture are also defined in the related indenture through which the note or debenture was issued, the parent guarantee of the related trust preferred security and the declaration of trust for the particular trust. All of these documents together with their related note or debenture and trust preferred security constitute a full and unconditional guarantee by the parent company of the trust's obligations under the

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trust preferred security. In addition to the similar provisions previously discussed, specific terms of the securities follow:

| CMS Energy Trust and Securities December 31 | Rate(%) | Amount Outstanding | | Maturity | Earliest Redemption |
|---|---------|-----------------------|-------|----------|------------------------|
| | | 2002 | 2001 | | |
| | | In Millions | | | |
| CMS Energy Trust I(a)..... | 7.75 | \$173 | \$173 | 2027 | 2001 |
| CMS Energy Trust II(b)..... | 8.75 | — | 301 | 2004 | — |
| CMS Energy Trust III(c)..... | 7.25 | 220 | 220 | 2004 | — |
| Total Amount Outstanding..... | | \$393 | \$694 | | |

- (a) Represents Quarterly Income Preferred Securities that are convertible into 1.2255 shares of CMS Energy Common Stock (equivalent to a conversion price of \$40.80). Effective July 2001, CMS Energy can revoke the conversion rights if certain conditions are met.
- (b) On July 1, 2002, the 7,250,000 units of Adjustable Convertible Preferred Securities were converted to 8,787,725 newly issues shares of CMS Energy Common Stock.
- (c) Represents Premium Equity Participating Security Units in which holders are obligated to purchase a variable number of shares of CMS Energy Common Stock by the August 2003 conversion date.

| Consumers Energy Company Trust and Securities December 31 | Rate(%) | Amount Outstanding | | Maturity | Earliest Redemption |
|---|---------|-----------------------|-------|----------|------------------------|
| | | 2002 | 2001 | | |
| | | In Millions | | | |
| Consumers Power Company Financing I, Trust Originated Preferred Securities..... | 8.36 | \$ 70 | \$100 | 2015 | 2000 |
| Consumers Energy Company Financing II, Trust Originated Preferred Securities..... | 8.20 | 120 | 120 | 2027 | 2002 |
| Consumers Energy Company Financing III, Trust Originated Preferred Securities..... | 9.25 | 175 | 175 | 2029 | 2004 |
| Consumers Energy Company Financing IV, Trust Preferred Securities..... | 9.00 | 125 | 125 | 2031 | 2006 |
| Total Amount Outstanding..... | | \$490 | \$520 | | |

In March 2002, Consumers reduced its outstanding debt to Consumers Power Company Financing I, Trust Obligated Preferred Securities by \$30 million.

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9: EARNINGS PER SHARE AND DIVIDENDS

The following table presents a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations.

| | <u>Years Ended December 31</u> | | |
|--|---------------------------------------|--------------------------|--------------------------|
| | <u>2002</u> | <u>Restated 2001</u> | <u>Restated 2000</u> |
| | In Millions, Except Per Share Amounts | | |
| Net Income (Loss) Applicable to Basic and Diluted EPS | | | |
| Consolidated Net Income (Loss) | <u>\$ (620)</u> | <u>\$ (448)</u> | <u>\$ 43</u> |
| Net Income (Loss) Attributable to Common Stock: | | | |
| CMS Energy — Basic | \$ (620) | \$ (448) | \$ 43 |
| Add conversion of Trust Preferred Securities (net of tax) | <u>—(a)</u> | <u>—(a)</u> | <u>—(a)</u> |
| CMS Energy — Diluted | <u>\$ (620)</u> | <u>\$ (448)</u> | <u>\$ 43</u> |
| Average Common Shares Outstanding Applicable to Basic and Diluted EPS | | | |
| CMS Energy: | | | |
| Average Shares — Basic | 139.0 | 130.7 | 113.1 |
| Add conversion of Trust Preferred Securities | <u>—(a)</u> | <u>—(a)</u> | <u>—(a)</u> |
| Stock Options | <u>—</u> | <u>—(b)</u> | <u>—(b)</u> |
| Average Shares — Diluted | <u>139.0</u> | <u>130.7</u> | <u>113.1</u> |
| Net Income (Loss) Per Average Common Share | | | |
| Basic | \$(4.46) | \$(3.42) | \$ 0.38 |
| Diluted | <u>\$(4.46)</u> | <u>\$(3.42)</u> | <u>\$ 0.38</u> |

- (a) The effects of converting the trust preferred securities were not included in the computation of diluted earnings per share because to do so would have been antidilutive.
- (b) Shares of outstanding stock options of 0.2 million for both 2001 and 2000 were not included in the computation of diluted earnings per share because to do so would have been antidilutive.

In February, April, August and November 2002, CMS Energy paid dividends of \$0.365, \$0.365, \$0.18 and \$0.18 per share, respectively on CMS Energy Common Stock. In January 2003, the Board of Directors suspended the payment of common stock dividends.

10: RISK MANAGEMENT ACTIVITIES AND FINANCIAL INSTRUMENTS

The objective of the CMS Energy risk management policy is to analyze, manage and coordinate the identified risk exposures of the individual business segments and to exploit the presence of internal hedge opportunities that exist among its diversified business segments. CMS Energy, on behalf of its regulated and non-regulated subsidiaries, utilizes a variety of derivative instruments for both trading and non-trading purposes and executes these transactions with external parties through either CMS Enterprises or its marketing subsidiary, CMS MST. These derivative instruments include futures contracts, swaps, options and forward contracts to manage exposure to fluctuations in commodity prices, interest rates and foreign exchange rates. In order 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.

Derivative instruments contain credit risk if the counterparties, including financial institutions and energy marketers, fail to perform under the agreements. CMS Energy minimizes such risk by performing financial credit

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mitigation programs including, among other things, using publicly available credit ratings of such counterparties, internally developed statistical models for credit scoring and use of internal hedging programs to minimize exposure to external counterparties. No material nonperformance is expected.

Commodity Derivatives: Prior to January 1, 2001, CMS Energy accounted for its non-trading commodity contracts as hedges and deferred any changes in the market value and gains/losses resulting from settlements until the hedged transaction was completed. Since January 1, 2001, commodity contracts have been accounted for in accordance with the requirements of SFAS No. 133, as amended and interpreted, and may or may not qualify for hedge accounting treatment depending on the characteristics of each contract.

Derivative Instruments: CMS Energy adopted SFAS No. 133 on January 1, 2001. This standard requires CMS Energy to recognize at fair value on the balance sheet, as assets or liabilities, all contracts that meet the definition of a derivative instrument. The standard also requires CMS Energy to record all changes in fair value directly in earnings unless the derivative instrument meets certain qualifying cash flow hedge criteria, in which case the changes in fair value would be reflected in other comprehensive income. CMS Energy generally determines fair value based upon quoted market prices and mathematical models using current and historical pricing data. The ineffective portion, if any, of all hedges is recognized in earnings.

Excluding a substantial portion of CMS MST's operations, CMS Energy believes that the majority of its contracts, power purchase agreements and gas transportation contracts qualify for the normal purchases and sales exception of SFAS No. 133 and are not subject to the accounting rules for derivative instruments. CMS Energy uses derivative instruments that require derivative accounting, to limit its exposures to electricity and gas commodity price risk. The interest rate and foreign currency exchange contracts met the requirements for hedge accounting under SFAS No. 133 and CMS Energy recorded the changes in the fair value of these contracts in other comprehensive income.

On January 1, 2001, upon initial adoption of the standard including adjustments for subsequent guidance, CMS Energy recorded a \$7 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 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 Consumers' proportionate share of the effects of adopting SFAS No. 133 related to its equity investment in the MCV Partnership. Based on the pretax initial transition adjustment of \$21 million 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 other comprehensive income.

At adoption of the standard on January 1, 2001, derivative and hedge accounting for certain utility industry contracts, particularly electric call option contracts and option-like contracts, and contracts subject to Bookouts was uncertain. Consumers did not record these contracts on the balance sheet at fair value, but instead accounted for these types of contracts as derivatives that qualified for the normal purchase exception of SFAS No. 133. In June and December 2001, the FASB issued guidance that resolved the accounting for these contracts. As a result, on July 1, 2001, Consumers 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 electric call option contracts.

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Financial gas instruments and supply contracts that were assigned to CMS MST from another CMS subsidiary in 2000 and accounted for on an accrual basis were classified as derivatives under SFAS No. 133 on January 1, 2001. Upon adoption of the standard, CMS MST recorded a cumulative effect adjustment to record the fair value of these derivatives, which was a \$9 million increase to earnings, net of tax. Any changes after January 1, 2001 in the fair value of these derivatives is included in net income from continuing operations.

Electric Contracts: Consumers' electric business uses purchased electric call option contracts to meet, in part, its regulatory obligation to serve. This obligation requires Consumers 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. On July 1, 2001, upon initial adoption of the standard for these contracts, Consumers recorded a \$3 million, net of tax, cumulative effect adjustment as an unrealized loss, decreasing accumulated other comprehensive income. This adjustment relates to the difference between the fair value and the recorded book value of these electric call option contracts. The adjustment to accumulated other comprehensive income relates to electric call option contracts that qualified for cash flow hedge accounting prior to the initial adoption of SFAS No. 133. After July 1, 2001, these contracts did not qualify for hedge accounting under SFAS No. 133 and, therefore, Consumers records any change in fair value subsequent to July 1, 2001 directly in earnings, which can cause earnings volatility. The initial amount recorded in other comprehensive income was reclassified to earnings as the forecasted future transactions occurred or the call options expired. The majority of these contracts expired in the third quarter 2001 and the remaining contracts expired in the third quarter of 2002. As of December 31, 2001, Consumers reclassified from other comprehensive income to earnings, \$2 million, net of tax, as part of the cost of power supply, and the remainder, \$1 million, net of tax, was reclassified from other comprehensive income to earnings in the third quarter of 2002.

In December 2001, the FASB issued revised guidance regarding derivative accounting for electric call option contracts and option-like contracts. The revised guidance amended the criteria used to determine if derivative accounting is required. In light of the amended criteria, Consumers re-evaluated its electric call option and option-like contracts, and determined that additional contracts require derivative accounting. Therefore, as of December 31, 2001, upon initial adoption of the revised guidance for these contracts, Consumers recorded an \$11 million, net of tax, cumulative effect adjustment as a decrease to earnings. This adjustment relates to the difference between the fair value and the recorded book value of these electric call option contracts. Consumers records any change in fair value subsequent to December 31, 2001, directly in earnings, which could cause earnings volatility. During 2002, Consumers recorded, as part of power costs, a \$245,000 unrecognized gain on its unexpired electric call options contracts. As of December 30, 2002, Consumers recorded on the balance sheet all of its unexpired purchased electric call option contracts subject to derivative accounting at a fair value of \$1 million.

Consumers believes that certain of its electric capacity and energy contracts are not derivatives 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. If a market develops in the future, Consumers may be required to account for these contracts as derivatives. The mark-to-market impact in earnings related to these contracts, particularly related to the PPA could be material to the financial statements.

During 2002, Consumers' electric business also used gas 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 gas swaps were financial contracts that were used to offset increases in the price of probable forecasted gas purchases. These contracts did not qualify for hedge accounting. Therefore, Consumers recorded any change in the fair value of these contracts directly in earnings as part of power supply costs. These contracts expired in December 2002.

As of December 31, 2002, Consumers recorded a total of \$8 million, net of tax, as an unrealized gain in other comprehensive income related to its proportionate share of the effects of derivative accounting related to its equity investment in the MCV Partnership. Consumers expects to reclassify this gain, if this value remains, as an

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increase to other operating revenue during the next 12 months. On April 11, 2002, MCV Partnership changed its accounting for derivatives (Note 18). Consumer's ownership share of the cumulative effective adjustment to earnings is reflected as a change in accounting principle in 2002 in the accompanying statement of income.

Gas Contracts: Consumers' gas business uses fixed price gas supply contracts, and fixed price weather-based gas supply call options and fixed price gas supply put options, and other types of contracts, to meet its regulatory obligation to provide gas to its customers at a reasonable and prudent cost. During 2002, some of the fixed price gas supply contracts required derivative accounting because they contained embedded put options that disqualified the contracts from the normal purchase exception of SFAS No. 133. These contracts expired in October 2002.

As of December 31, 2002, weather-based gas call options and gas put options requiring derivative accounting had a net fair value of \$1 million, of which \$600,000, represents a fair value gain on the contracts since the date of inception. This gain was recorded directly in earnings as part of other income, and then directly offset and recorded on the balance sheet as a regulatory liability. Any subsequent changes in fair value will be recorded in a similar manner.

Interest Rate Risk Contracts: Consumers uses interest rate swaps to hedge the risk associated with forecasted interest payments on variable-rate debt. These interest rate swaps are designated as cash flow hedges. As such, Consumers will record any change in the fair value of these contracts in other comprehensive income unless the swap is sold. As of December 31, 2002, Consumers had entered into a swap to fix the interest rate on \$75 million of variable-rate debt. This swap will expire in June 2003. As of December 31, 2002, this interest rate swap had a negative fair value of \$1 million. This amount, if sustained, will be reclassified to earnings, increasing interest expense when the swaps are settled on a monthly basis. As of December 31, 2001, this interest rate swap had a negative fair value of \$3 million.

Consumers also uses interest rate swaps to hedge the risk associated with the fair value of its debt. These interest rate swaps are designated as fair value hedges. In March 2002, Consumers entered into a fair value hedge to hedge the risk associated with the fair value of \$300 million of fixed-rate debt, issued in March 2002. In June 2002, this swap was terminated and resulted in a \$7 million gain that is deferred and recorded as part of the debt. It is anticipated that this gain will be recognized over the remaining life of the debt.

In 2001, Consumers had entered into interest rate swaps to hedge the risk associated with the fair value of \$400 million of fixed-rate debt, which expire in May 2003 and December 2006. In November 2001, these swaps were terminated and resulted in a \$4 million gain that was deferred and recorded as part of the debt. This gain is being recognized over the remaining life of the debt.

In 2001, Consumers entered into fair value hedges to hedge the risk associated with the fair value of \$250 million of debt. These swaps terminated in the third quarter 2001, and resulted in a \$4 million gain that has been deferred and recorded as part of the debt. This gain is being recognized over the remaining life of the debt.

In September 2001, Consumers entered into a cash flow hedge to fix the interest rate on \$100 million of debt to be issued. In September 2001, the swap terminated and resulted in a \$2 million loss that was recorded in other comprehensive income and will be amortized to interest expense over the life of the debt using the effective interest method.

Energy Trading Activities: CMS Energy, through its subsidiary CMS MST, has engaged in trading activities. CMS MST manages any open positions within certain guidelines that limit its exposure to market risk and requires timely reporting to management of potential financial exposure. These guidelines include statistical risk tolerance limits using historical price movements to calculate daily value at risk measurements. CMS MST's wholesale power and gas trading activities are accounted for under mark-to-market method of accounting consistent with guidance provided in EITF Issue No. 98-10. EITF Issue No. 98-10 has been rescinded by EITF Issue No. 02-03. The consensus rescinding EITF Issue No. 98-10 must be applied to all contracts that existed as

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of October 25, 2002 and must be recognized as a cumulative effect of a change in accounting principle in accordance with APB Opinion No. 20, *Accounting Changes*, effective the first day of the first interim or annual period beginning after December 15, 2002. The consensus also must be applied immediately to all new contracts entered into after October 25, 2002. See discussion on EITF Issue No. 02-03 under New Accounting Standards. Under mark-to-market accounting, 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 values are recognized as revenues in the consolidated statements of income in the period in which the changes occur. Market prices used to value outstanding financial instruments reflect management's 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 and volumetric obligations may not be defined. Mathematical models are developed to determine various inputs into the fair value calculation including price, anticipated volumetric obligations and other inputs that may be required to adequately address the determination of fair value of the contracts. Realized cash returns on these commitments may vary, either positively or negatively, from the results estimated through application of the mathematical model. CMS Energy believes that its mathematical models utilize 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 potential impact of liquidating the company's position in an orderly manner over a reasonable period of time under present market conditions.

In connection with the market valuation of its energy commodity contracts, CMS Energy maintains reserves for credit risks based on the financial condition of counterparties. The creditworthiness of these counterparties will impact overall exposure to credit risk; however, with regard to its counterparties, CMS Energy maintains credit policies that management believes minimize overall credit risk. Determination of the credit quality of its counterparties is based upon a number of factors, including credit ratings, financial condition, and collateral requirements. When trading terms permit, CMS Energy employs standard agreements that allow for netting of positive and negative exposures associated with a single counterparty. Based on these policies, its current exposures and its credit reserves, CMS Energy does not anticipate a material adverse effect on its financial position or results of operations as a result of counterparty nonperformance.

At December 31, 2002, and 2001, CMS Energy has recorded a net price risk management asset of \$81 million and \$41 million respectively, net of reserves, related to the unrealized mark-to-market gains on existing wholesale power contracts, gas contracts, and economic hedges for retail activities that are marked as derivatives. For the year ended 2002, \$62 million of the \$80 million in net price risk management assets were reclassified to assets and liabilities held for sale to reflect the pending sales of CMS MST's wholesale gas and power contracts. In addition, the fair value of these portfolios were reduced by \$48 million as a result of fair value evidence derived from the negotiated sales prices for these contracts held for sale. See MD&A disclosure on mark-to-market accounting for further analysis of price risk management assets and liabilities.

| Source of Fair Value | Total Fair Value | Fair Value of Contracts at December 31, 2002 | | | |
|--|---------------------|--|-------------|-------------|----------------|
| | | Less than 1 | 1 to 3 | 4 to 5 | Greater than 5 |
| In Millions | | | | | |
| Maturity (in years) | | | | | |
| Prices actively quoted | \$ 6 | \$ 6 | \$— | \$— | \$— |
| Prices provided by other external sources | 57 | 7 | 29 | 13 | 8 |
| Prices based on models and other valuation methods ... | 17 | (15) | 19 | 5 | 8 |
| Total | \$80 | \$ (2) | \$48 | \$18 | \$16 |

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Floating to Fixed Interest Rate Swaps: CMS Energy and its subsidiaries enter into floating to fixed interest rate swap agreements to reduce the impact of interest rate fluctuations. These swaps are designated as cash flow hedges and 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. Changes in the fair value of these swaps are recorded in accumulated other comprehensive income until the swaps are terminated. As of December 31, 2002, these swaps had a negative fair value of \$7 million that if sustained, will be reclassified to earnings as the swaps are settled on a quarterly basis. No ineffectiveness was recognized during the fourth quarter of 2002 under the requirements of SFAS No. 133.

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 CMS Energy's exposure to credit or market risks. As of December 31, 2002 and 2001, the weighted average interest rate associated with outstanding swaps was approximately 5.2 percent and 5.9 percent, respectively.

| <u>Floating to Fixed Interest Rate Swaps</u> | <u>Notional Amount</u> | <u>Maturity Date</u> | <u>Fair Value</u> | <u>Unrealized Gain (Loss)</u> |
|--|----------------------------|--------------------------|-----------------------|-----------------------------------|
| | | | In Millions | |
| December 31, 2002..... | \$294 | 2003-2006 | \$ (7) | \$ 6 |
| December 31, 2001..... | \$318 | 2002-2006 | \$(11) | \$(2) |

Fixed to Floating Interest Rate Swaps: CMS Energy monitors its debt portfolio mix of fixed and variable rate instruments and from time to time enters into fixed to floating rate swaps to maintain the optimum mix of fixed and floating rate debt. These swaps are designated as fair value hedges and any realized gains or losses in the fair value are amortized to earnings after the termination of the hedge instrument over the remaining life of the hedged item. There were no outstanding fixed to floating interest rate swaps as of December 31, 2002.

| <u>Fixed to Floating Interest Rate Swaps</u> | <u>Notional Amount</u> | <u>Maturity Date</u> | <u>Fair Value</u> | <u>Unrealized Gain (Loss)</u> |
|--|----------------------------|--------------------------|-----------------------|-----------------------------------|
| | | | In Millions | |
| December 31, 2002..... | \$ — | — | \$— | \$ 1 |
| December 31, 2001..... | 200 | 2004-2005 | (1) | (1) |

Foreign Exchange Derivatives: CMS Energy uses forward exchange and option contracts to hedge certain receivables, payables, long-term debt and equity value relating to foreign investments. The purpose of CMS Energy's foreign currency hedging activities is to protect the company from the risk that U.S. dollar net cash flows resulting from sales to foreign customers and purchases from foreign suppliers and the repayment of non-U.S. dollar borrowings as well as equity reported on the company's balance sheet, may be adversely affected by changes in exchange rates. These contracts do not subject CMS Energy to risk from exchange rate movements because gains and losses on such contracts offset losses and gains, respectively, on assets and liabilities being hedged. The 2001 estimated 2002 fair value of the foreign exchange and option contracts at December 31, 2002 and 2001 was immaterial and \$(1) million, respectively; representing the amount CMS Energy would receive or (pay) upon settlement.

The notional amount of the outstanding foreign exchange contracts at December 31, 2002 was \$1 million Canadian contracts. Foreign exchange contracts outstanding as of December 31, 2001 had a total notional amount of \$50 million related to investments in Brazil. The Brazilian contracts matured during 2002 and had a weighted average transaction rate of 2.58 Brazilian Real to the U.S. dollar.

Financial Instruments: The carrying amounts of cash, short-term investments and current liabilities approximate their fair values due to their short-term nature. The estimated fair values of long-term investments are based on quoted market prices or, in the absence of specific market prices, on quoted market prices of similar investments or other valuation techniques. Judgment may also be required to interpret market data to develop certain estimates of fair value. Accordingly, the estimates determined as of December 31, 2002 and 2001 are not

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necessarily indicative of the amounts that may be realized in current market exchanges. The carrying amounts of all long-term investments in financial instruments, except for those as shown below, approximate fair value.

| | As of December 31 | | | | | |
|--|-------------------|---------------|--------------------------|------------------|---------------|--------------------------|
| | 2002 | | | 2001 | | |
| | Carrying Cost | Fair Value | Unrealized Gain(Loss) | Carrying Cost | Fair Value | Unrealized Gain(Loss) |
| | In Millions | | | | | |
| Long-Term Debt(a)..... | \$5,356 | \$5,027 | \$(329) | \$5,840 | \$5,731 | \$(109) |
| Preferred Stock and Trust Preferred Securities..... | 927 | 729 | (198) | 1,258 | 1,169 | (89) |
| <i>Available-for-Sale Securities:</i> | | | | | | |
| Nuclear Decommissioning(b)..... | \$ 458 | \$ 536 | \$ 78 | \$ 467 | \$ 581 | \$ 114 |
| SERP..... | 54 | 57 | 3 | 52 | 56 | 4 |
| Trading Securities: | | | | | | |
| Investments..... | \$ 5 | \$ 6 | \$ 1 | \$ 4 | \$ 7 | \$ 3 |

(a) Settlement of long-term debt is generally not expected until maturity.

(b) Unrealized gains and losses on nuclear decommissioning investments are classified in accumulated depreciation.

11: INCOME TAXES

CMS Energy and its subsidiaries file a consolidated federal income tax return. Income taxes are generally allocated based on each company's separate taxable income. CMS Energy utilizes 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. CMS Energy annually determines the amount of undistributed foreign earnings that it expects will remain invested indefinitely in foreign subsidiaries. Cumulative undistributed earnings of foreign subsidiaries for which income taxes have not been provided totaled approximately \$2 million at December 31, 2002. It is impractical to estimate the amount of unrecognized deferred income taxes or withholding taxes on these undistributed earnings. Also, at December 31, 2002, CMS Energy 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 to corporate taxpayers a 5-year carryback of tax losses incurred in 2001 and 2002. As a result of this legislation, CMS Energy was able to carry back consolidated 2001 and 2002 tax losses to tax years 1996 through 1999 to obtain refunds of prior years tax payments totaling \$250 million. The tax loss carryback, however, resulted in a reduction in AMT credit carryforwards that previously had been recorded by CMS Energy as deferred tax assets in the amount of \$47 million. This non-cash reduction in AMT credit carryforwards has been reflected in the tax provision of CMS Energy.

CMS Energy used ITC to reduce current income taxes payable, and amortizes ITC over the life of the related property. Alternative minimum tax AMT paid generally becomes a tax credit that CMS Energy 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, 2002, CMS Energy had AMT credit carryforwards in the amount of \$207 million that do not expire, tax loss carryforwards in the amount of \$327 million that expire in 2021 and 2022, capital loss

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carryforwards in the amount of \$215 million that expire in 2007, and general business credit carryforwards in the amount of \$39 million that expire in 2005.

The significant components of income tax expense (benefit) on continuing operations consisted of:

| | Years Ended December 31 | | |
|------------------------------------|-------------------------|------------------|------------------|
| | 2002 | Restated 2001 | Restated 2000 |
| | In Millions | | |
| Current income taxes | | | |
| Federal | \$(105) | \$(197) | \$ 74 |
| State and local | (8) | 7 | 4 |
| Foreign | 25 | (3) | 21 |
| | <u>\$ (88)</u> | <u>\$(193)</u> | <u>\$ 99</u> |
| Deferred income taxes | | | |
| Federal | 103 | 94 | (91) |
| State | 2 | 1 | 11 |
| Foreign | 2 | 8 | 24 |
| | <u>\$ 107</u> | <u>\$ 103</u> | <u>(56)</u> |
| Deferred ITC, net | <u>(6)</u> | <u>(8)</u> | <u>(9)</u> |
| Tax expense (benefit) | <u>\$ 13</u> | <u>\$ (98)</u> | <u>\$ 34</u> |

The principal components of CMS Energy's deferred tax assets (liabilities) recognized in the consolidated balance sheet are as follows:

| | December 31 | |
|--|-----------------|------------------|
| | 2002 | Restated 2001 |
| | In Millions | |
| Property | \$ (814) | \$ (826) |
| Securitization costs | (192) | (194) |
| Unconsolidated investments | 79 | (119) |
| Postretirement benefits | (72) | (76) |
| Gas inventories | (74) | (57) |
| Employee benefit obligations | 265 | 148 |
| Tax credit carryforward | 247 | 182 |
| Tax loss carryforward | 190 | — |
| Power purchases | 18 | 27 |
| Regulatory liabilities | 115 | 104 |
| Other, net | <u>(191)</u> | <u>(62)</u> |
| Net deferred tax assets (liabilities) | <u>\$ (429)</u> | <u>\$ (873)</u> |
| Deferred tax liabilities | \$(1,288) | \$(1,442) |
| Deferred tax assets | 859 | 569 |
| Net deferred tax assets (liabilities) | <u>\$ (429)</u> | <u>\$ (873)</u> |

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The actual income tax expense on continuing operations differs from the amount computed by applying the statutory federal tax rate of 35% to income before income taxes as follows:

| | 2002 | Restated 2001 | Restated 2000 |
|--|--------------|------------------|------------------|
| | In Millions | | |
| Loss from continuing operations before income taxes and minority interests | | | |
| Domestic | \$(505) | \$(349) | \$ 206 |
| Foreign | <u>102</u> | <u>18</u> | <u>(209)</u> |
| Total | (403) | (331) | (3) |
| Statutory federal income tax rate | <u>x 35%</u> | <u>x 35%</u> | <u>x 35%</u> |
| Expected income tax expense | (141) | (116) | (1) |
| Increase (decrease) in taxes from: | | | |
| Property differences | 18 | 23 | 27 |
| Income tax effect of foreign investments | 93 | 7 | 9 |
| Tax credits | 51 | (8) | (9) |
| State and local income taxes, net of federal benefit | (7) | 3 | 10 |
| Other, net | <u>(1)</u> | <u>(7)</u> | <u>(2)</u> |
| Recorded income tax expense | <u>\$ 13</u> | <u>\$ (98)</u> | <u>\$ 34</u> |
| Effective tax rate | <u>3.3%</u> | <u>29.7%</u> | <u>(a)</u> |

(a) Because of the small size of the net loss in 2000, 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 difference of foreign subsidiaries.

12: EXECUTIVE INCENTIVE COMPENSATION

Under CMS Energy's Performance Incentive Stock Plan, restricted shares of CMS Energy Common Stock as well as stock options and stock appreciation rights relating to common stock may be granted to key employees based on their contributions to the successful management of CMS Energy and its subsidiaries. Certain plan awards are subject to performance-based business criteria. The plan reserves for award not more than five percent of Common Stock outstanding on January 1 each year, less (i) the number of shares of restricted Common Stock awarded and (ii) 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 award. Any forfeitures of shares previously awarded will increase the number of shares available to be awarded under the plan. At December 31, 2002, awards of up to 1,716,856 shares of CMS Energy Common Stock may be issued.

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. If performance objectives are exceeded, the plan provides additional awards. Restricted shares vest fully if control of CMS Energy changes, as defined by the plan. At December 31, 2002, 375,039 of the 958,326 shares of restricted CMS Energy Common Stock outstanding are subject to performance objectives.

Under the plan, stock options and stock appreciation rights relating to Common Stock are granted with an exercise price equal to the closing market price on each grant date. Some options may be exercised upon grant; some vest over five years at the rate of 25 percent per year beginning at the end of the first year and others vest over three years at a rate of 33¹/₃ percent per year after one year. All options expire up to ten years and one month

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from date of grant. The status of the restricted stock granted to CMS Energy's key employees under the Performance Incentive Stock Plan and options granted under the plan follows.

| | Restricted Stock | Options | |
|--|---------------------|---------------------|------------------------------------|
| | Number of Shares | Number of Shares | Weighted-Average Exercise Price |
| CMS Energy Common Stock: | | | |
| Outstanding at January 1, 2000 | 884,129 | 2,530,040 | \$35.33 |
| Granted | 246,250 | 878,630 | \$17.96 |
| Exercised or Issued | (134,173) | (185,600) | \$17.36 |
| Forfeited | (209,779) | — | — |
| Expired | — | (164,884) | \$34.58 |
| Outstanding at December 31, 2000 | 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 | (182,177) | — | — |
| Expired | — | (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 | (225,823) | — | — |
| Expired | — | (243,160) | \$28.91 |
| Outstanding at December 31, 2002 | <u>958,326</u> | <u>5,121,620</u> | <u>\$27.18</u> |

The following table summarizes information about stock options outstanding at December 31, 2002:

| <u>Range of Exercise Prices</u> | <u>Number of Shares Outstanding</u> | <u>Weighted- Average Remaining Life</u> | <u>Weighted- Average Exercise Price</u> |
|---------------------------------|---|---|---|
| CMS Energy Common Stock: | | | |
| \$ 8.12 — \$17.00 | 1,198,300 | 8.64 years | \$11.85 |
| \$18.00 — \$24.75 | 1,096,286 | 7.60 years | \$22.40 |
| \$25.13 — \$31.04 | 1,221,576 | 6.85 years | \$30.33 |
| \$33.11 — \$39.06 | 1,042,552 | 6.07 years | \$37.80 |
| \$41.44 — \$44.06 | 562,906 | 5.92 years | \$42.58 |
| \$ 8.12 — \$44.06 | <u>5,121,620</u> | <u>7.17 years</u> | <u>\$27.18</u> |

At December 31, 2002, 2001 and 2000, the number of stock options exercisable were 5,007,329, 3,760,883, and 2,827,971, respectively.

The weighted average fair value of options granted for CMS Energy Common Stock in February 2002 was \$3.84, and in July 2002, \$1.44. In 2001 and 2000, the weighted average fair value of options granted for CMS Energy Common Stock were \$6.43 and \$2.04, respectively. Fair value is estimated using the Black-Scholes

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model, a mathematical formula used to value options traded on securities exchanges, with the following assumptions. For 2002, the assumptions listed are for the February grant, followed by the July grant:

| | Years Ended December 31 | | | |
|--|-------------------------|--------------|---------|---------|
| | February 2002 | July 2002 | 2001 | 2000 |
| CMS Energy Common Stock Options | | | | |
| Risk-free interest rate | 3.95% | 3.16% | 4.77% | 6.56% |
| Expected stock-price volatility | 32.44% | 40.81% | 30.59% | 27.25% |
| Expected dividend rate | 0.365 | \$0.1825 | \$0.365 | \$0.365 |
| Expected option life (years) | 4.2 | 4.2 | 4.2 | 4.1 |

In 2002 CMS Energy adopted the fair value method of accounting for stock based compensation under SFAS No. 123 as amended by SFAS No. 148 on a prospective method. Accordingly, CMS Energy recognized the \$4 million fair value of stock based awards granted, modified or settled in 2002 in operating expenses.

CMS Energy applied APB Opinion No. 25 and related interpretations in accounting for the Performance Incentive Stock Plan. Prior to 2002, stock options were granted at market price, no compensation cost was recognized for stock options granted under the plan. The net compensation cost charged against income for restricted stock was less than \$1 million in 2002, \$1 million in 2001, and \$2 million in 2000. If compensation cost for stock options had been determined in accordance with SFAS No. 123, in 2001, and 2000, CMS Energy's consolidated net income (loss), as reported and pro forma, and earnings per share would have been as follows:

| | Years Ended December 31 | | | | | | | | |
|---|---------------------------------------|-----------------|-----------------|------------------|-----------------|-----------------|------------------|----------------|----------------|
| | 2002 | Basic | Diluted | Restated 2001 | Basic | Diluted | Restated 2000 | Basic | Diluted |
| | In Millions, Except Per Share Amounts | | | | | | | | |
| Net income (loss), as reported..... | \$(620) | \$(4.46) | \$(4.46) | \$(448) | \$(3.42) | \$(3.42) | \$43 | \$ 0.38 | \$ 0.38 |
| Add: Stock-based employee compensation expense included in reported net income (loss), net of related taxes | 3 | 0.02 | 0.02 | — | — | — | — | — | — |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related taxes... | (3) | (0.02) | (0.02) | (4) | (0.03) | (0.03) | (1) | (0.01) | (0.01) |
| Pro forma net income (loss)..... | <u>\$(620)</u> | <u>\$(4.46)</u> | <u>\$(4.46)</u> | <u>\$(452)</u> | <u>\$(3.45)</u> | <u>\$(3.45)</u> | <u>\$42</u> | <u>\$ 0.37</u> | <u>\$ 0.37</u> |

13: RETIREMENT BENEFITS

CMS Energy and its subsidiaries provide retirement benefits under a number of different plans, including certain health care and life insurance benefits under OPEB, benefits to certain management employees under SERP and EISP, and benefits to substantially all its employees under a trustee, non-contributory, defined benefit pension plan of Consumers and CMS Energy, and a defined contribution 401(k) plan.

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Weighted-Average Assumptions:

| | Years Ended December 31 | | | | | |
|---|-------------------------|------------------|------------------|-------|------------------|------------------|
| | Pension & SERP | | | OPEB | | |
| | 2002 | Restated 2001 | Restated 2000 | 2002 | Restated 2001 | Restated 2000 |
| Discount rate | 6.75% | 7.25% | 7.75% | 6.75% | 7.25% | 7.75% |
| Expected long-term rate of return on plan assets: ... | 8.75% | 9.75% | 9.75% | | | |
| Union | | | | 8.75% | 9.75% | 9.75% |
| Non-Union | | | | 6.00% | 6.00% | 6.00% |
| Rate of compensation increase: | | | | | | |
| Pension — to age 45 | 3.50% | 5.25% | 5.25% | | | |
| — age 45 to assumed retirement | 3.50% | 3.75% | 3.75% | | | |
| SERP | 5.50% | 5.50% | 5.50% | | | |

Retiree health care costs at December 31, 2002 are based on the assumption that costs would increase 8.5 percent in 2002 with a gradual decrease to 5.5 percent in 2010 and thereafter.

Net Pension Plan, SERP, EISP, and OPEB costs consist of:

| | Years Ended December 31 | | | | | |
|--------------------------------------|-------------------------|--------------|--------------|--------------|--------------|--------------|
| | Pension & SERP & EISP | | | OPEB | | |
| | 2002 | 2001 | 2000 | 2002 | 2001 | 2000 |
| | In Millions | | | | | |
| Service cost | \$ 46 | \$ 39 | \$ 33 | \$ 20 | \$ 16 | \$ 14 |
| Interest expense | 89 | 88 | 82 | 69 | 62 | 56 |
| Expected return on plan assets | (103) | (98) | (92) | (43) | (41) | (35) |
| Amortization of: | | | | | | |
| Prior service cost | 8 | 8 | 6 | (1) | (1) | — |
| Net transition (asset) | — | (5) | (5) | — | — | — |
| Other | (1) | (1) | (2) | 10 | 1 | (2) |
| Plan amendments | 4 | — | — | — | — | — |
| Net periodic benefit cost | <u>\$ 43</u> | <u>\$ 31</u> | <u>\$ 22</u> | <u>\$ 55</u> | <u>\$ 37</u> | <u>\$ 33</u> |

The health care cost trend rate assumption significantly affects the amounts reported. A one percentage point change in the assumed health care cost trend assumption would have the following effects:

| | One Percentage Point Increase | One Percentage Point Decrease |
|---|----------------------------------|----------------------------------|
| | In Millions | |
| Effect on total service and interest cost components | \$ 15 | \$ (12) |
| Effect on accumulated postretirement benefit obligation | 137 | (114) |

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The funded status of CMS Energy's Pension Plan, SERP and OPEB plans is reconciled with the liability recorded at December 31 as follows:

| | Pension Plan | | SERP | | OPEB | |
|--|------------------|------------------|---------------|---------------|----------------|----------------|
| | 2002 | 2001 | 2002 | 2001 | 2002 | 2001 |
| | In Millions | | | | | |
| Benefit obligation, January 1 | \$1,195 | \$1,081 | \$ 73 | \$ 58 | \$ 957 | \$ 815 |
| Service cost | 40 | 36 | 4 | 3 | 20 | 16 |
| Interest cost | 84 | 83 | 5 | 5 | 69 | 62 |
| Plan amendments | 4 | — | — | — | (64) | (18) |
| Actuarial loss (gain) | 72 | 96 | 1 | 8 | 41 | 116 |
| Benefits paid | <u>(138)</u> | <u>(101)</u> | <u>(2)</u> | <u>(1)</u> | <u>(40)</u> | <u>(35)</u> |
| Benefit obligation, December 31 | <u>\$1,257</u> | <u>\$1,195</u> | <u>\$ 81</u> | <u>\$ 73</u> | <u>\$ 983</u> | <u>\$ 957</u> |
| Plan assets at fair value, January 1 | \$ 845 | \$ 994 | \$ — | \$ — | \$ 509 | \$ 473 |
| Actual return on plan assets | (164) | (113) | — | — | (43) | (21) |
| Company contribution | 64 | 65 | 2 | 1 | 83 | 57 |
| Actual benefits paid | <u>(138)</u> | <u>(101)</u> | <u>(2)</u> | <u>(1)</u> | <u>(40)</u> | <u>(1)</u> |
| Plan assets at fair value, December 31 | <u>\$ 607(a)</u> | <u>\$ 845(a)</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 509</u> | <u>\$ 508</u> |
| Benefit obligation less than (in excess of) plan assets | \$ (650) | \$ (350) | \$(81) | \$(73) | \$(474) | \$(448) |
| Unrecognized: | | | | | | |
| Net (gain) loss from experience different than assumed | 574 | 235 | 13 | 12 | 313 | 197 |
| Prior service cost | 60 | 68 | 1 | 1 | (77) | (16) |
| Other | <u>(7)</u> | <u>(7)</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>—</u> |
| Recorded liability | <u>\$ (23)</u> | <u>\$ (54)</u> | <u>\$(67)</u> | <u>\$(60)</u> | <u>\$(238)</u> | <u>\$(267)</u> |
| Additional minimum pension liability(b) | <u>\$ (426)</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>—</u> |
| Total recorded liability | <u>\$ (449)</u> | <u>\$ (54)</u> | <u>\$(67)</u> | <u>\$(60)</u> | <u>\$(238)</u> | <u>\$(267)</u> |

(a) Primarily stocks and bonds, including 5,241,656 and 141,000 shares of CMS Energy Common Stock in Pension Plan assets and OPEB plan assets, respectively, with fair values of \$49 million and \$1 million, respectively, at December 31, 2002. Fair values at December 31, 2001 were \$126 million and \$3 million for the Pension Plan assets and OPEB plan assets, respectively.

(b) The recent significant downturn in the equities markets has affected the value of the Pension Plan assets. At December 31, 2002, the value of the Pension Plan assets was \$607 million and Accumulated Benefit Obligation was at \$1.055 billion. In accordance with SFAS No. 87, CMS Energy recognized an additional \$426 million pension liability, recorded a \$53 million intangible asset and charged \$373 million (\$242 after-tax) to accumulated other comprehensive income.

SERP benefits are paid from a trust established in 1988. SERP is not a qualified plan under the Internal Revenue Code, and as such, earnings of the trust are taxable and trust assets are included in consolidated assets. At December 31, 2002 and 2001, trust assets were \$57 million and \$56 million, respectively, and were classified as other noncurrent assets. The Accumulated Benefit Obligation for SERP was \$54 million in 2002 and \$48 million in 2001.

The Executive Incentive Separation Plan (EISP) was established 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

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continuation of health care, or any other legally permissible term deemed to be in the best interest of CMS Energy to offer. As of December 31, 2002, the Accumulated Benefit Obligation of the EISP was \$1.7 million.

The Pension Plan includes amounts for Panhandle employees which were not distinguishable from the Pension Plan's total assets. On December 21, 2002, a definitive agreement was executed to sell Panhandle. The sale is expected to close in 2003. No portion of the Pension Plan will be transferred with the sale of Panhandle. At the closing of the sale, all employees of Panhandle will no longer be eligible to accrue additional benefits. The Pension Plan will retain pension payment obligations under the Pension Plan for Panhandle employees that are vested under the Pension Plan. CMS Energy does not expect the curtailment from both the Pension and OPEB Plans to be material.

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, \$26 million in 2001, and \$24 million in 2000. Effective September 1, 2002, the employer's match for the 401(k) plan was suspended until January 1, 2005.

Beginning January 1, 1986, the amortization period for the Pension Plan's unrecognized net transition asset is 16 years. Prior service costs are amortized on a straight-line basis over the average remaining service period of active employees.

CMS Energy and its subsidiaries adopted SFAS No. 106, effective as of the beginning of 1992 and 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 Summary of Significant 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.

14: LEASES

CMS Energy, Consumers, and Enterprises lease various assets, including vehicles, rail cars, construction equipment, computer equipment, and buildings. In November 2001, Consumers' nuclear fuel capital leasing arrangement expired upon mutual agreement by the lessor and Consumers. At termination of the lease, Consumers paid the lessor \$48 million, which was the lessor's remaining investment at that time. Consumers has both full-service and net leases, the latter of which requires Consumers to pay for taxes, maintenance, operating costs, and insurance.

Minimum rental commitments under CMS Energy's non-cancelable leases at December 31, 2002 were:

| | <u>Capital Leases</u> | <u>Operating Leases</u> |
|--|---------------------------|-----------------------------|
| | In Millions | |
| 2003 | \$ 21 | \$16 |
| 2004 | 20 | 12 |
| 2005 | 18 | 10 |
| 2006 | 17 | 9 |
| 2007 | 16 | 8 |
| 2008 and thereafter | <u>71</u> | <u>38</u> |
| Total minimum lease payments | 163 | <u>\$93</u> |
| Less imputed interest | <u>(28)</u> | |
| Present value of net minimum lease payments | 135 | |
| Less current portion | (13) | |
| Less non-current portion of off-balance sheet lease payments | <u>(6)</u> | |
| Non-current portion | <u>\$116</u> | |

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The minimum lease rental commitments as shown do not include amounts for Panhandle and Field Services, as those business units have been discontinued. Collectively, Panhandle, Field Services and Viron have \$62 million on \$1 million in future commitments for operating and capital leases, respectively.

For the years ended December 31, 2002, 2001, and 2000, operating lease charges, including charges to clearing and other accounts, were \$13 million, \$15 million, and \$22 million, respectively. Consumers recovers lease charges from customers and accordingly charges payments for its capital and operating leases to operating expense.

For the years ended December 31, 2002, 2001 and 2000, capital lease expenses were \$20 million, \$25 million, and \$40 million, respectively. Included in these amounts for the years ended 2002, 2001 and 2000 are nuclear fuel lease expenses of \$— million, \$7 million, and \$22 million, respectively.

In April 2001, Consumers Campus Holdings entered into a lease agreement for the construction of an office building to be used as the main headquarters for Consumers in Jackson, Michigan. The new office-building lessor has committed to fund up to \$65 million for construction of the building and has appointed Consumers the construction agent for the project. Consumers' balance sheet as of December 31, 2002, reflects a capital lease asset and an offsetting non-current liability equivalent to the cost of construction at that date of \$54 million. The agreement is a seven-year lease term with payments commencing upon completion of construction, which occurred in March 2003. Consumers Campus Holdings has the right to acquire the property at any time during the life of the agreement. At the end of the lease term, Consumers Campus Holdings has the option to renew the lease, purchase the property, or return the property and assist the lessor in the sale of the building. The return option obligates Consumers Campus Holdings to pay the lessor an amount equal to the outstanding debt associated with the building. Estimated minimum lease commitments, assuming an investment of \$60 million and rates consistent with LIBOR at the inception of the lease, would be approximately \$4 million annually from April 2003 through April 2008 and a total of \$54 million for the remainder of the lease. Actual lease payments will depend upon final total construction costs and LIBOR rates.

15: JOINTLY OWNED UTILITY FACILITIES

Consumers is responsible for providing its share of financing for the jointly owned utility facilities. Consumers includes in operating expenses the direct expenses of the joint plants. The following table indicates the extent of Consumers' investment in jointly owned utility facilities:

| <u>December 31</u> | Net Investment | | Accumulated Depreciation | |
|---|----------------|-------|--------------------------|-------|
| | 2002 | 2001 | 2002 | 2001 |
| | In Millions | | | |
| Campbell Unit 3 — 93.3 percent | \$299 | \$279 | \$312 | \$312 |
| Ludington — 51 percent | 75 | 76 | 94 | 88 |
| Transmission facilities — various | — | 37 | — | 40 |
| Distribution lines — various | 13 | 10 | 1 | — |

16: REPORTABLE SEGMENTS

In 2002, CMS Energy operated principally in the following five reportable segments: electric utility; gas utility; independent power production; natural gas transmission; and marketing, services and trading. In 2003, operations will include three reportable segments: electric utility, gas utility, and enterprises.

CMS Energy's reportable segments are strategic business units organized and managed by the nature of the products and services each provides. Management evaluates performance based on the net income of each segment. The electric utility segment consists of regulated activities associated with the generation, transmission and distribution of electricity in the state of Michigan through its subsidiary, Consumers Energy. The gas utility

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segment consists of regulated activities associated with the transportation, storage and distribution of natural gas in the state of Michigan through its subsidiary, Consumers Energy. Independent power production invests in, acquires, develops, constructs and operates non-utility power generation plants in the United States and abroad. Natural gas transmission owns, develops, and manages natural gas facilities. The marketing, services and trading segment provides gas, oil, and electric marketing, risk management and energy management services to industrial, commercial, utility and municipal energy users.

The Consolidated Statements of Income show operating revenue and operating income by reportable segment. Intersegment sales and transfers are accounted for at current market prices and are eliminated in consolidated operating income by segment. Other financial data for reportable segments and geographic area are as follows:

Reportable Segments

| | Years Ended December 31 | | |
|---|-------------------------|------------------|------------------|
| | 2002 | Restated 2001 | Restated 2000 |
| | In Millions | | |
| Net Income | | | |
| Electric utility(e) | \$ 264 | \$ 120 | \$ 173 |
| Gas utility | 46 | 21 | 20 |
| Natural gas transmission | (30) | (53) | 11 |
| Independent power production | (336) | (63) | (92) |
| Marketing, services and trading(e) | (42) | (15) | 13 |
| Other | (522) | (458) | (82) |
| | <u>\$ (620)</u> | <u>\$ (448)</u> | <u>\$ 43</u> |
| Income Taxes | | | |
| Electric utility | \$ 138 | \$ 69 | \$ 123 |
| Gas utility | 33 | 25 | 24 |
| Natural gas transmission | 36 | (31) | 2 |
| Independent power production | (112) | (21) | (19) |
| Marketing, services and trading | (23) | (8) | 8 |
| Other | (59) | (132) | (104) |
| | <u>\$ 13</u> | <u>\$ (98)</u> | <u>\$ 34</u> |
| Depreciation, Depletion and Amortization | | | |
| Electric utility | \$ 228 | \$ 219 | \$ 311 |
| Gas utility | 118 | 118 | 113 |
| Natural gas transmission | 8 | 11 | 11 |
| Independent power production | 38 | 40 | 45 |
| Marketing, services and trading | 6 | 5 | 5 |
| Other | 5 | 5 | 4 |
| | <u>\$ 403</u> | <u>\$ 398</u> | <u>\$ 489</u> |

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

| | Years Ended December 31 | | |
|---|-------------------------|------------------|------------------|
| | 2002 | Restated 2001 | Restated 2000 |
| | In Millions | | |
| Identifiable Assets | | | |
| Electric utility(a) | \$ 5,744 | \$ 5,454 | \$ 5,230 |
| Gas utility(a) | 2,002 | 2,194 | 1,776 |
| Natural gas transmission | 2,828 | 3,953 | 4,025 |
| Independent power production | 1,816 | 2,630 | 2,699 |
| Marketing, services and trading | 794 | 1,139 | 1,600 |
| Other | 731 | 1,405 | 1,573 |
| | <u>\$13,915</u> | <u>\$16,775</u> | <u>\$16,903</u> |
| Capital Expenditures(b) | | | |
| Electric utility | \$ 437 | \$ 623 | \$ 430 |
| Gas utility | 181 | 145 | 120 |
| Natural gas transmission | 104 | 76 | 145 |
| Independent power production | 79 | 69 | 191 |
| Marketing, services and trading | 4 | 8 | 6 |
| Other | 1 | 292 | 192 |
| | <u>\$ 806</u> | <u>\$ 1,213</u> | <u>\$ 1,084</u> |
| Investments in Equity Method Investees | | | |
| Natural gas transmission | \$ 178 | \$ 577 | \$ 549 |
| Independent power production | 505 | 714 | 904 |
| Marketing, services and trading | 8 | 26 | 28 |
| Other | 4 | 79 | 61 |
| | <u>\$ 695</u> | <u>\$ 1,396</u> | <u>\$ 1,542</u> |
| Earnings from Equity Method Investees(c) | | | |
| Natural gas transmission | \$ 10 | \$ 13 | \$ 36 |
| Independent power production | 193 | 157 | 168 |
| Marketing, services and trading | 9 | 10 | 9 |
| Other | (58) | 5 | 1 |
| | <u>\$ 154</u> | <u>\$ 185</u> | <u>\$ 214</u> |

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Geographic Areas(d)

| | <u>Operating Revenue</u> | <u>Pretax Operating Income</u> | <u>Identifiable Assets</u> |
|---------------------|------------------------------|--|--------------------------------|
| 2002 | | | |
| United States | \$8,434 | \$ 15 | \$12,459 |
| International | 260 | 120 | 1,456 |
| 2001 — Restated | | | |
| United States | \$7,716 | \$ 213 | \$13,900 |
| International | 347 | 30 | 2,875 |
| 2000 — Restated | | | |
| United States | \$6,319 | \$ 629 | \$13,672 |
| International | 378 | (161) | 3,231 |

- (a) Amounts include an attributed portion of Consumers' other common assets to both the electric and gas utility businesses.
- (b) Includes electric restructuring implementation plan, capital leases for nuclear fuel, purchase of nuclear fuel and other assets and electric DSM costs. Amounts also include an attributed portion of Consumers' capital expenditures for plant and equipment common to both the electric and gas utility businesses.
- (c) These amounts are included in operating revenue in the Consolidated Statements of Income.
- (d) Revenues are attributed to countries based on location of customers.
- (e) Amounts exclude a \$11 million decrease and \$9 million increase related to cumulative effect of accounting change in 2001 related to electric utility and MS&T segments.

17. EQUITY METHOD INVESTMENTS

Certain of CMS Energy's investments in companies, partnerships and joint ventures, where ownership is more than 20 percent but less than a majority, are accounted for by the equity method of accounting in accordance with APB Opinion No. 18. In 2002, 2001 and 2000 consolidated net income included distributions in excess of (less than) earnings of \$(39) million, \$68 million, and \$(171) million, respectively, from these investments. The most significant of these investments is CMS Energy's 50 percent interest in Jorf Lasfar, as well as its 46 percent interest in First Midland and 40 percent interest in Taweelah. CMS Energy's investment in Loy Yang met the test of a significant subsidiary in prior years but was not reported separately in 2002 or 2001 as a result of the write-off of the investment in the fourth quarter of 2000 (Note 3). Summarized combined financial information of CMS Energy's equity method investments follows, with the exception of the MCV Partnership

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

that is disclosed separately in Note 18, Summarized Financial Information of Significant Related Energy Supplier.

Income Statement Data

| | Years Ended December 31, 2002 | | | | | |
|--------------------------|-------------------------------|-------------|--------------|--------------|----------------|---------------|
| | Jorf Lasfar | Loy Yang | First | | All Others | Total |
| | | | Midland | Taweelah | | |
| In Millions | | | | | | |
| Operating revenue | \$364 | \$ — | \$ 91 | \$101 | \$3,881 | \$4,437 |
| Operating expenses | 178 | — | 4 | 33 | 3,454 | 3,669 |
| Operating income | 186 | — | 87 | 68 | 427 | 768 |
| Other expense, net | 54 | — | 49 | 32 | 506 | 641 |
| Net income | <u>\$132</u> | <u>\$ —</u> | <u>\$ 38</u> | <u>\$ 36</u> | <u>\$ (79)</u> | <u>\$ 127</u> |

| | Years Ended December 31, 2001 | | | | | |
|--------------------------|-------------------------------|-------------|--------------|--------------|---------------|---------------|
| | Jorf Lasfar | Loy Yang | First | | All Others | Total |
| | | | Midland | Taweelah | | |
| In Millions | | | | | | |
| Operating revenue | \$357 | \$ — | \$ 99 | \$ 44 | \$4,219 | \$ 4,719 |
| Operating expenses | 143 | — | 6 | 17 | 3,653 | 3,819 |
| Operating income | 214 | — | 93 | 27 | 566 | 900 |
| Other expense, net | 53 | — | 63 | 8 | 425 | 549 |
| Net income | <u>\$161</u> | <u>\$ —</u> | <u>\$ 30</u> | <u>\$ 19</u> | <u>\$ 141</u> | <u>\$ 351</u> |

| | Years Ended December 31, 2000 | | | | | |
|--------------------------|-------------------------------|---------------|--------------|-------------|---------------|---------------|
| | Jorf Lasfar | Loy Yang | First | | All Others | Total |
| | | | Midland | Taweelah | | |
| In Millions | | | | | | |
| Operating revenue | \$246 | \$268 | \$109 | \$ 17 | \$3,735 | \$ 4,375 |
| Operating expenses | 99 | 123 | 2 | 9 | 3,336 | 3,569 |
| Operating income | 147 | 145 | 107 | 8 | 399 | 806 |
| Other expense, net | 29 | 169 | 80 | 6 | 166 | 450 |
| Net income | <u>\$118</u> | <u>\$(24)</u> | <u>\$ 27</u> | <u>\$ 2</u> | <u>\$ 233</u> | <u>\$ 356</u> |

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Balance Sheet Data

| | December 31, 2002 | | | | | |
|---|--------------------|-----------------|----------------|-----------------|-------------------|-----------------|
| | <u>Jorf Lasfar</u> | <u>Loy Yang</u> | First | | <u>All Others</u> | <u>Total</u> |
| | | | <u>Midland</u> | <u>Taweelah</u> | | |
| | In Millions | | | | | |
| <i>Assets</i> | | | | | | |
| Current assets | \$ 174 | \$— | \$ — | \$ 91 | \$ 938 | \$ 1,203 |
| Property, plant and equipment, net | 7 | — | — | 656 | 6,254 | 6,917 |
| Other assets | <u>2,349</u> | <u>—</u> | <u>998</u> | <u>10</u> | <u>1,073</u> | <u>4,430</u> |
| | <u>\$2,530</u> | <u>\$—</u> | <u>\$ 998</u> | <u>\$757</u> | <u>\$8,265</u> | <u>\$12,550</u> |
| <i>Liabilities and Equity</i> | | | | | | |
| Current liabilities | \$ 249 | \$— | \$ 22 | \$ 95 | \$1,617 | \$ 1,983 |
| Long-term debt and other non-current liabilities | 1,802 | — | 428 | 530 | 4,096 | 6,856 |
| Equity | <u>479</u> | <u>—</u> | <u>548</u> | <u>132</u> | <u>2,552</u> | <u>3,711</u> |
| | <u>\$2,530</u> | <u>\$—</u> | <u>\$ 998</u> | <u>\$757</u> | <u>\$8,265</u> | <u>\$12,550</u> |

Balance Sheet Data

| | December 31, 2001 | | | | | |
|---|--------------------|-----------------|----------------|-----------------|-------------------|-----------------|
| | <u>Jorf Lasfar</u> | <u>Loy Yang</u> | First | | <u>All Others</u> | <u>Total</u> |
| | | | <u>Midland</u> | <u>Taweelah</u> | | |
| | In Millions | | | | | |
| <i>Assets</i> | | | | | | |
| Current assets | \$ 190 | \$— | \$ — | \$127 | \$1,033 | \$ 1,350 |
| Property, plant and equipment, net | 6 | — | — | 676 | 6,929 | 7,611 |
| Other assets | <u>2,475</u> | <u>—</u> | <u>1,138</u> | <u>—</u> | <u>1,028</u> | <u>4,641</u> |
| | <u>\$2,671</u> | <u>\$—</u> | <u>\$1,138</u> | <u>\$803</u> | <u>\$8,990</u> | <u>\$13,602</u> |
| <i>Liabilities and Equity</i> | | | | | | |
| Current liabilities | \$ 188 | \$— | \$ 28 | \$ 38 | \$ 891 | \$ 1,145 |
| Long-term debt and other non-current liabilities | 1,918 | — | 569 | 630 | 5,164 | 8,281 |
| Equity | <u>565</u> | <u>—</u> | <u>541</u> | <u>135</u> | <u>2,935</u> | <u>4,176</u> |
| | <u>\$2,671</u> | <u>\$—</u> | <u>\$1,138</u> | <u>\$803</u> | <u>\$8,990</u> | <u>\$13,602</u> |

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

18: SUMMARIZED FINANCIAL INFORMATION OF SIGNIFICANT RELATED ENERGY SUPPLIER

Under the PPA with the MCV Partnership discussed in Note 6, Consumers' 2002 obligation to purchase electric capacity from the MCV Partnership provided 15.1 percent of Consumers' owned and contracted electric generating capacity. Summarized financial information of the MCV Partnership follows:

Statements of Income

| | Years Ended December 31 | | |
|--|----------------------------|--------------|--------------|
| | 2002 | 2001 | 2000 |
| | In Millions | | |
| Operating revenue(a) | \$597 | \$611 | \$604 |
| Operating expenses | 409 | 453 | 392 |
| Operating income | 188 | 158 | 212 |
| Other expense, net | 114 | 110 | 122 |
| Net income before cumulative effect of accounting change | 74 | 48 | 90 |
| Cumulative effect of change in method of accounting for derivative options contracts (April 1, 2002)(b) | 58 | — | — |
| Net income | <u>\$132</u> | <u>\$ 48</u> | <u>\$ 90</u> |

Balance Sheets

| | December 31 | | December 31 | |
|-------------------------|----------------|----------------|---------------------------------|-------------------------------|
| | 2002 | 2001 | 2002 | 2001 |
| | In Millions | | In Millions | |
| Assets | | | Liabilities and Equity | |
| Current assets(c) | \$ 356 | \$ 341 | Current liabilities | \$ 209 \$ 320 |
| Plant, net | 1,550 | 1,610 | Non-current liabilities(d) | 1,155 1,245 |
| Other assets | 192 | 166 | Partners' equity(e) | 734 552 |
| | <u>\$2,098</u> | <u>\$2,117</u> | | <u>\$2,098</u> <u>\$2,117</u> |

- (a) For 2002, 2001, and 2000, revenue from Consumers totaled \$557 million, \$550 million and \$569 million, respectively.
- (b) On April 1, 2002, the MCV Partnership implemented Derivative Implementation Group Issue C-16, an interpretation of SFAS No. 133. The MCV Partnership began accounting for several natural gas contracts containing an option component at fair value. As a result, a \$58 million cumulative effect adjustment for the change in accounting principle was recorded as an increase to earnings. CMS Midland's 49 percent ownership share was \$28 million, \$18 million after tax.
- (c) At December 31, 2002 and 2001, receivables from Consumers totaled \$44 and \$49 million, respectively.
- (d) FMLP is the sole beneficiary of an owner trust that is the lessor in a long-term direct finance lease with the lessee, MCV Partnership. CMS Holdings holds a 46.4 percent ownership interest in FMLP. At December 31, 2002 and 2001, the MCV Partnership owed lease obligations of \$975 million and \$1.11 billion, respectively, to the owner trust. CMS Holdings' share of the interest and principal portion for the 2002 lease payments was \$34 million and \$65 million, respectively, and for the 2001 lease payments was \$36 million and \$54 million, respectively. As of December 31, 2002 and 2001, the lease payments service \$449 million and \$597 million in non-recourse debt outstanding, respectively, of the owner trust. The MCV Partnership's lease obligations, assets, and operating revenues secures FMLP's debt. For 2002 and 2001, the owner trust made debt payments (including interest) of \$370 million and \$217 million, respectively. FMLP's earnings for 2002, 2001, and 2000 were \$38 million, \$30 million, and \$30 million, respectively.

CMS ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

- (e) CMS Midland's recorded investment in the MCV Partnership includes capitalized interest, which Consumers is amortizing to expense over the life of its investment in the MCV Partnership. Covenants contained in financing agreements prohibit the MCV Partnership from paying distributions until it meets certain financial test requirements. Consumers does not anticipate receiving a cash distribution in the near future.

19: FINANCIAL IMPROVEMENT PLAN

CAPITAL RESOURCES AND LIQUIDITY

CMS Energy's liquidity and capital requirements are generally a function of its results of operations, capital expenditures, contractual obligations, working capital needs and collateral requirements. CMS Energy historically has met its consolidated cash needs through its operating and investing activities and, as needed, through access to bank financing and the capital markets.

During 2003, CMS Energy has contractual obligations and planned capital expenditures that will require substantial amounts of cash. As of March 14, 2003, CMS Energy at the parent level had approximately \$615 million, Consumers Energy and its subsidiaries had approximately \$777 million, and Panhandle and its subsidiaries had approximately \$52 million of publicly issued and credit facility debt maturing in 2003. CMS Energy and Consumers Energy have taken significant steps to address their 2003 maturities, as described. In addition, CMS Energy also could become subject to liquidity demands pursuant to commercial commitments under guarantees, indemnities and letters of credit. Management is pursuing actively plans to refinance debt and to sell assets, including the sale of Panhandle. In December 2002, CMS Energy signed a definitive agreement to sell Panhandle for a total of \$1.828 billion, which is expected to result in \$662 million of cash and \$1.166 billion of debt assumption. However, closing of the sale is pending action by the Federal Trade Commission. All other regulatory approvals have been granted.

CMS ENERGY PARENT LEVEL LIQUIDITY

CMS Energy at the parent level is addressing its near-to-mid-term liquidity and capital requirements through a financial improvement plan that involves the sale of non-strategic and under-performing assets of approximately \$912 million, receipt of dividends from its subsidiaries of approximately \$280 million, and reduction of approximately \$598 million of outstanding debt along with reduced capital expenditures, cost reductions and other measures.

As noted elsewhere in these notes, CMS Energy has reduced debt of approximately \$2.7 billion through asset sales with cash proceeds and associated debt reduction from such sales over the past two years. Through the first quarter of 2003, CMS Energy has accomplished \$60 million of additional asset sales. In January 2003, CMS MST closed on the sale of a substantial portion of its natural gas trading contracts for \$17 million of cash proceeds, and in February 2003 signed a definitive agreement to sell its wholesale power contracts. In addition, the sale of the Centennial Pipeline, resulting in proceeds to CMS Energy of \$40 million, closed in February 2003.

CMS Energy believes that further targeted asset sales, together with its planned reductions in operating expenses, capital expenditures, and the suspension of the common dividend also will contribute to improved liquidity. CMS Energy believes that, assuming the successful implementation of its financial improvement plan, its present level of cash and borrowing capacity along with anticipated cash flows from operating and investing activities will be sufficient to meet its liquidity needs through 2003. There can be no assurances that the financial improvement plan will be successful and failure to achieve its goals could have a material adverse effect on CMS Energy's liquidity and operations. In such event, CMS Energy would be required to consider the full range of strategic measures available to companies in similar circumstances.

CMS Energy continues to explore financing opportunities to supplement its financial improvement plan. These potential opportunities include refinancing its bank credit facilities; entering into leasing arrangements

CMS ENERGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

and/or vendor financing; refinancing and issuing new capital markets debt, preferred and/or common equity; and negotiating private placement debt, preferred and/or common equity. Specifically, as of March 31, 2003, CMS Energy has taken the following action to supplement its financial improvement plan in 2003:

- On March 30, 2003 CMS Energy entered into an amendment and restatement of its existing \$300 million and \$295.8 million revolving credit facilities under which \$409 million was then outstanding. The Second Amended and Restated Senior Credit Agreement includes a \$234 million tranche with a maturity date of April 30, 2004 and a \$175 million tranche with a maturity date of September 30, 2004. The facility is being underwritten by several banks at a total annual cost to CMS Energy of approximately ten percent, which includes the initial commitment fee. Any proceeds of equity issuances by CMS Energy and its subsidiaries or any asset sales and debt issuances by CMS Energy or its subsidiaries, other than Consumers Energy, are required to be used to prepay this facility. This facility is collateralized primarily by the common stock of Consumers Energy, CMS Enterprises and certain CMS Enterprises subsidiaries.
- On March 30, 2003 CMS Enterprises entered into a revolving credit facility in an aggregate amount of \$441 million. The maturity date of this facility is April 30, 2004. The facility is being underwritten by several banks at a total annual cost to CMS Energy of approximately ten percent, which includes the initial commitment fee. Proceeds from this loan will be used for general corporate purposes, to retire debt, and to collateralize approximately \$160 million of letters of credit. Any proceeds of equity issuances by CMS Energy and its subsidiaries or any asset sales and debt issuances by CMS Energy or its subsidiaries, other than Consumers Energy, are required to be used to prepay this facility. It is expected that proceeds from the Panhandle sale will be used to pay off this facility in full. This facility is guaranteed by CMS Energy, whose guaranty is secured by the common stock of Consumers Energy and CMS Enterprises.

In addition, if necessary, CMS Energy would also postpone the \$52 million pension contribution expected to be made in September 2003. Also, CMS Energy may pursue other avenues of private debt or equity investment, albeit at a potentially significant cost.

CONSUMERS ENERGY LIQUIDITY

Consumers plans to meet its liquidity and capital requirements in 2003 through a combination of approximately \$229 million from operations and approximately \$513 million of new debt along with reduced capital expenditures, cost reductions and other measures. In addition, Consumers plans to refinance \$727 million of debt. Consumers has initiated several transactions with various financial institutions, regulators, banks, lenders, and others that are designed to provide liquidity:

- On March 26, 2003, Consumers entered into a \$140 million term loan secured by first mortgage bonds with a private investor bank. This loan has a term of six years at a cost of LIBOR plus 475 basis points. Proceeds from this loan will be used to retire debt, and for general corporate purposes.
- In March 2003, Consumers obtained a replacement revolving credit facility in the amount of \$250 million, secured by first mortgage bonds. The cost of the facility is LIBOR plus 350 basis points. The new credit facility matures in March 2004 with two annual extensions of consumers' option, which would extend the maturity to March 2006. The prior facility was due to expire in July 2003.
- On March 27, 2003, Consumers renewed its revolving credit facility which was set to expire in July 2003. Consumers negotiated a three year revolving credit facility in the amount of \$250 million secured by first mortgage bonds. The cost of the facility is LIBOR plus 350 basis points.
- On March 28, 2003, Consumers syndicated a \$150 million term loan secured by first mortgage bonds. This term loan has a tenor of three years at an anticipated cost of LIBOR plus 450 basis points. Proceeds from this loan will be used to retire debt and for general corporate purposes.

CMS ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

- Consumers filed a general rate case for its gas utility business on March 14, 2003. Consumers requested rate relief in the amount of approximately \$156 million. In its filing, Consumers requested immediate interim relief. If interim relief of \$156 million were granted, Consumers expects that the rate relief could be in place by the fourth quarter of 2003.
- Consumers has filed an application with the MPSC seeking authorization to issue \$1.084 billion of securitization bonds. These bonds would provide liquidity to Consumers at interest rates reflective of high quality credit. Consumers would utilize these proceeds to retire higher cost debt and in turn would realize significant interest expense savings over the life of the bonds. If the MPSC approves a financing in the amount requested, and there are no delays in the offering process, Consumers anticipates that bonds would be issued by year end, 2003.

If necessary, Consumers would also postpone the planned \$158 million pension contribution expected to be made in September 2003.

In the event Consumers is unable to access bank financing or the capital markets to incur or refinance indebtedness, there could be a material adverse effect on Consumers' liquidity and operations. There is no assurance that the pending securitization bond issuance transaction noted above will be completed. Further, there is no assurance that the MPSC will grant either interim or final gas utility rate relief.

20: QUARTERLY FINANCIAL AND COMMON STOCK INFORMATION (UNAUDITED)

| Quarters Ended | (a) 2002 (Restated) | | | | (b) 2001 (To be Restated) | | | |
|--|---------------------------------------|-----------|----------|-----------|------------------------------|---------|-----------|-----------|
| | March 31 | June 30 | Sept. 30 | Dec. 31 | March 31 | June 30 | Sept. 30 | Dec. 31 |
| | In Millions, Except Per Share Amounts | | | | | | | |
| Operating revenue | \$2,263 | \$2,137 | \$2,579 | \$1,708 | \$2,859 | \$2,237 | \$2,150 | \$2,351 |
| Pretax operating income (loss) | \$ 275 | \$ 152 | \$ 192 | \$ (520) | \$ 329 | \$ 254 | \$ (401) | \$ 119 |
| Income (loss) from continuing operations | \$ 93 | \$ 37 | \$ 11 | \$ (556) | \$ 109 | \$ 53 | \$ (384) | \$ (109) |
| Discontinued Operations(c) | \$ (51) | \$ (127) | \$ 24 | \$ (68) | \$ 0 | \$ 0 | \$ (185) | \$ 0 |
| Cumulative effect of change in accounting principles(c)(d) | \$ 0 | \$ 17 | \$ 1 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ (11) |
| Extraordinary item(c) | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ (18) |
| Consolidated net income (loss) | \$ 42 | \$ (73) | \$ 36 | \$ (625) | \$ 109 | \$ 53 | \$ (569) | \$ (138) |
| Basic earnings (loss) per average common share(d) | \$ 0.32 | \$ (0.55) | \$ 0.26 | \$ (4.25) | \$ 0.87 | \$ 0.40 | \$ (4.29) | \$ (1.03) |
| Diluted earnings (loss) per average common share(d) | \$ 0.32 | \$ (0.55) | \$ 0.26 | \$ (4.25) | \$ 0.85 | \$ 0.40 | \$ (4.29) | \$ (1.03) |
| Dividends declared per common share | \$0.365 | \$0.365 | \$ 0.18 | \$ 0.18 | \$0.365 | \$0.365 | \$0.365 | \$0.365 |
| Common stock prices(e) | | | | | | | | |
| High | \$24.62 | \$22.24 | \$11.28 | \$10.48 | \$31.44 | \$31.75 | \$28.37 | \$24.31 |
| Low | \$21.27 | \$10.46 | \$ 7.49 | \$ 5.79 | \$26.75 | \$27.68 | \$19.89 | \$20.00 |

- (a) CMS Energy is currently in the process of completing its restatement of the consolidated financial statements for the quarters of 2001, and upon completion, Ernst & Young will perform a review of the 2001 quarterly financial data in accordance with standards established by the American Institute of Certified Public Accountants. As a result, the 2001 quarterly information has not yet been restated. Upon completion, CMS Energy will file restated financial statements for those interim periods, and for the interim periods of 2002, in an amended Form 10-Q for September 30, 2002. That filing will include details of the quarterly impacts of the restatement adjustments for 2001 and the first three quarters of 2002. The 2002 interim financial data contained in Note 20, Quarterly Financial and Common Stock Information, to the consolidated

CMS ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

financial statements has been restated to reflect the impacts of restatement adjustments. The restatement adjustments for the interim periods of 2001 are expected to comprise adjustments that have already been identified and recorded in connection with the re-audit of 2001, as well as adjustments that will be identified through the quarterly reconstruction and reconciliation project now under way at CMS MST.

- (b) The 2002 quarterly financial data have been restated to reflect all adjustments by quarter from previously filed quarterly financial statements. The amended Form 10-Q for September 30, 2002, expected to be filed upon completion of the restatement of 2001 quarterly periods, will include details of the quarterly impacts of the adjustments made in 2002.
- (c) Net of tax.
- (d) The sum of the quarters may not equal the annual earnings per share due to changes in shares outstanding.
- (e) Based on New York Stock Exchange — Composite transactions.
- (f) See Note 3 to the consolidated financial statements.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
CMS Energy Corporation

We have audited the accompanying consolidated balance sheets and consolidated statements of preferred stock of CMS Energy Corporation (a Michigan corporation) and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of income, common stockholders' equity and cash flows for each of three years in the period ended December 31, 2002. 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, which represent investments accounted for under the equity method of accounting, have been audited by other auditors (the other auditors for 2001 and 2000 for Midland Cogeneration Ventures 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, respectively, it is based solely on their reports.

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 and the reports of other auditors provide a reasonable basis for our opinion.

The selected quarterly financial data related to 2001 included in Note 20, "Unaudited Summary of Quarterly Results of Operations," contain information that we did not audit, and accordingly, we do not express an opinion on that data. We attempted, but were unable, to review the quarterly financial data in accordance with standards established by the American Institute of Certified Public Accountants because we believe that the CMS Energy's system for preparing interim financial information did not provide an adequate basis to enable us to complete such a review.

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, 2002 and 2001, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States. 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 Note 10 to the consolidated financial statements, in 2001 CMS Energy Corporation changed its method of accounting related to derivatives and hedging. Also, in 2002 as discussed in Notes 5 and 12 to the consolidated financial statements, CMS Energy Corporation changed its method for accounting for goodwill and other intangibles and its method of accounting for stock-based compensation, respectively.

As more fully described in Note 2 to the consolidated financial statements, the Company restated its 2001 and 2000 financial statements.

Ernst & Young LLP

Detroit, Michigan
March 14, 2003, except for Notes 7 and 19, as to
which the date is March 31, 2003

REPORT OF INDEPENDENT ACCOUNTANTS

To the Management Committee
and Shareholders of Jorf Lasfar
Energy Company S.C.A. (JLEC)
B.P. 99 Sidi Bouzid
El Jadida

We have audited the accompanying balance sheet of JLEC and the related statements of income and retained earnings and of cash flows for the year ended December 31, 2002 as set out on pages 2 to 18. These statements are the responsibility of the Company's management. Our responsibility is to audit and express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements audited by us present fairly, in all material respects, the financial position of JLEC and the results of its operations and its cash flows for the year ended December 31, 2002; in conformity with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers


February 7, 2003

REPORT OF INDEPENDENT ACCOUNTANTS

To the Partners and the Management Committee of
Midland Cogeneration Venture Limited Partnership:

In our opinion, the accompanying consolidated balance sheet as of December 31, 2002 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 subsidiaries (MCV) at December 31, 2002 and the results of their operations and their cash flows for the year then ended 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 audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. The financial statements of MCV as of December 31, 2001 and for each of the two years in the period 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.



Detroit, Michigan
January 17, 2003

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

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS
ON ACCOUNTING AND FINANCIAL DISCLOSURE**

In April 2002, CMS Energy's Board of Directors, upon the recommendation of the Audit Committee of the Board, voted to discontinue using Arthur Andersen to audit the CMS Energy's financial statements for the year ending December 31, 2002. CMS Energy had previously retained Arthur Andersen to review its financial statements for the quarter ended March 31, 2002. In May 2002, CMS Energy's Board of Directors engaged Ernst & Young to audit its financial statements for the year ending December 31, 2002. Ernst & Young audited 2000, 2001, and 2002. As a result, CMS Energy restated its 2000 and 2001 financial statements contained herein.

PART III

ITEMS 10., 11., 12. and 13.

CMS Energy's definitive proxy statement, except for the Organization and Compensation Committee Report, the comparison of five-year cumulative total return performance graph contained therein, and the Audit Committee Report is incorporated by reference herein. See also ITEM 1. BUSINESS for information pursuant to ITEM 10.

ITEM 14. CONTROLS AND PROCEDURES

CMS Energy's CEO and CFO are responsible for establishing and maintaining CMS Energy's disclosure controls and procedures. Management, under the direction of CMS Energy's principal executive and financial officers, has evaluated the effectiveness of CMS Energy's disclosure controls and procedures as of a date within 90 days of the filing of this annual report on Form 10-K. Based on this evaluation, CMS Energy's CEO and CFO have concluded that CMS Energy's disclosure controls and procedures are effective to ensure that material information was presented to them. There have been no significant changes in CMS Energy's internal controls or in other factors that could significantly affect internal controls subsequent to such evaluation.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES
AND REPORTS ON FORM 8-K.

- (a)(1) Financial Statements and Reports of Independent Public Accountants are listed in ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA and are incorporated by reference herein.
- (a)(2) Financial Statement Schedules and Reports of Independent Public Accountants are listed after the Exhibits in the Index to Financial Statement Schedules, and are incorporated by reference herein.
- (a)(3) Exhibits for are listed after Item (c) below and are incorporated by reference herein.
- (b) Reports on Form 8-K.
During the fourth quarter of 2002, CMS Energy filed Current Reports on Form 8-K on December 23, 2002, covering matters reported pursuant to ITEM 5. OTHER EVENTS.
- (c) Exhibits, including those incorporated by reference (see also Exhibit volume).

CMS ENERGY EXHIBITS

| Exhibits | Previously Filed | | Description |
|----------|------------------|-------------------|--|
| | With File Number | As Exhibit Number | |
| (3)(a) | 333-51932 | (3)(a) | — Restated Articles of Incorporation of CMS Energy. (Form S-3 filed December 15, 2000) |
| (3)(b) | 333-45556 | (3)(b) | — By-Laws of CMS Energy. (Form S-3 filed September 11, 2000) |
| (3)(c) | 1-5611 | (3)(c) | — Restated Articles of Incorporation dated May 26, 2000, of Consumers (2000 Form 10-K) |
| (3)(d) | 1-5611 | (3)(d) | — By-Laws of Consumers. (1999 Form 10-K) |
| (3)(e) | 1-2921 | 3.01 | — Restated Certificate of Incorporation of Panhandle. (1999 Form 10-K) |
| (3)(f) | 1-2921 | (3)(f) | — By-Laws of Panhandle. (1999 Form 10-K) |
| (4)(a) | 2-65973 | (b)(1)-4 | — Indenture dated as of September 1, 1945, between Consumers and Chemical Bank (successor to Manufacturers Hanover Trust Company), as Trustee, including therein indentures supplemental thereto through the Forty-third Supplemental Indenture dated as of May 1, 1979. |
| | | | — Indentures Supplemental thereto: |
| | 33-41126 | (4)(c) | — 68th dated as of 06/15/93 |
| | 1-5611 | (4) | — 69th dated as of 09/15/93 (Form 8-K dated Sep. 21, 1993) |
| | 1-5611 | (4)(a) | — 70th dated as of 02/01/98 (1997 Form 10-K) |
| | 1-5611 | (4)(a) | — 71st dated as of 03/06/98 (1997 Form 10-K) |
| | 1-5611 | (4)(b) | — 72nd dated as of 05/01/98 (1st Qtr. 1998 Form 10-Q) |
| | 333-58943 | (4)(d) | — 73rd dated as of 06/15/98 (Form S-4 dated July 13, 1998) |
| | 1-5611 | (4)(b) | — 74th dated as of 10/29/98 (3rd Qtr. 1998 Form 10-Q) |
| | 1-5611 | (4)(b) | — 75th dated as of 10/1/99 (1999 Form 10-K) |
| | 1-5611 | (4)(d) | — 77th dated as of 10/1/99 (1999 Form 10-K) |
| | 1-5611 | 4(b) | — 79th dated as of 9/26/01 (3rd qtr 2001 10-Q) |
| | 1-5611 | 4(a)(i) | — 80th dated as of 3/22/02 (2001 Form 10-K) |
| | 1-5611 | 4.6 | — 81st dated as of 7/12/02 (Form 8-K dated July 30, 2002) |
| | 1-5611 | 4.7 | — 82nd dated as of 7/12/02 (Form 8-K dated July 30, 2002) |
| | 1-5611 | 4(a)(i) | — 83rd dated as of 9/26/02 (Consumers Energy 2002 Form 10-K) |
| | 1-5611 | 4(a)(ii) | — 84th dated as of 12/11/02 (Consumers Energy 2002 Form 10-K) |
| | 1-5611 | 4(a)(iii) | — 85th dated as of 10/17/02 (Consumers Energy 2002 Form 10-K) |
| | 1-5611 | 4(a)(iv) | — 86th dated as of 11/25/02 (Consumers Energy 2002 Form 10-K) |
| (4)(c) | 1-5611 | (4)(b) | — Indenture dated as of January 1, 1996 between Consumers and The Bank of New York, as Trustee. (1995 Form 10-K) |
| | | | — Indentures Supplemental thereto: |
| | 1-5611 | (4)(b) | — 1st dated as of 01/18/96 (1995 Form 10-K) |
| | 1-5611 | (4)(a) | — 2nd dated as of 09/04/97 (3rd qtr 1997 Form 10-Q) |
| | 1-9513 | (4)(a) | — 3rd 11/04/99 (3rd qtr 1999 Form 10-Q) |
| (4)(d) | 1-5611 | (4)(c) | — Indenture dated as of February 1, 1998 between Consumers and JPMorgan Chase (formerly "The Chase Manhattan Bank), as Trustee. (1997 Form 10-K) |
| | | | — Indentures Supplemental thereto: |
| | 1-5611 | (4)(a) | — 1st dated as of 05/01/98 (1st Qtr. 1998 Form 10-Q) |
| | 333-58943 | (4)(b) | — 2nd dated as of 06/15/98 |
| | 1-5611 | (4)(a) | — 3rd 10/29/98 (3rd Qtr. 1998 Form 10-Q) |
| (4)(e) | 33-47629 | (4)(a) | — Indenture dated as of September 15, 1992 between CMS Energy and NBD Bank, as Trustee. (Form S-3 filed May 1, 1992) |
| | | | — Indentures Supplemental thereto: |
| | 1-9513 | (4) | — 1st dated as of 10/01/92 (Form 8-K dated October 1, 1992) |
| | 1-9513 | (4)(a) | — 2nd dated as of 10/01/92 (Form 8-K dated October 1, 1992) |
| | 1-9513 | (4) | — 3rd dated as of 05/06/97 (1st qtr 1997 Form 10-Q) |

| Exhibits | Previously Filed | | Description |
|-----------|------------------|-------------------|--|
| | With File Number | As Exhibit Number | |
| (4)(f) | 333-37241 | (4)(a) | — 4th dated as of 09/26/97 (Form S-3 filed October 6, 1997) |
| | 1-9513 | (4)(b) | — 5th dated as of 11/04/97 (3rd qtr 1997 Form 10-Q) |
| | 1-9513 | (4)(d) | — 6th dated as of 01/13/98 (1997 Form 10-K) |
| | 1-9513 | (4)(d)(i) | — 7th dated as of 01/25/99 (1998 Form 10-K) |
| | 1-9513 | (4)(d)(ii) | — 8th dated as of 02/03/99 (1998 Form 10-K) |
| | 1-9513 | (4)(a) | — 9th dated as of 06/22/99 (2nd qtr 1999 Form 10-Q) |
| | 333-48276 | (4) | — 10th dated as of 10/12/00 (Form S-3MEF filed October 19, 2000) |
| | 333-58686 | (4) | — 11th dated as of 03/29/01 (Form S-8 filed April 11, 2001) |
| | 333-51932 | (4)(a) | — 12th dated as of 07/02/01 (Form POS AM filed August 8, 2001) |
| | 1-9513 | (4)(b) | — Indenture between CMS Energy and JPMorgan Chase (formerly "The Chase Manhattan Bank), as Trustee, dated as of January 15, 1994. (Form 8-K dated March 29, 1994) |
| | | | — Indentures Supplemental thereto: |
| | (4)(g) | 1-9513 | (4b) |
| 1-9513 | | (4) | — 2nd dated as of 03/19/96 (1st qtr 1996 Form 10-Q) |
| 1-9513 | | (4)(a)(iv) | — 3rd dated as of 03/17/97 (Form 8-K dated May 1, 1997) |
| 333-36115 | | (4)(d) | — 4th dated as of 09/17/97 (Form S-3 filed September 22, 1997) |
| 333-63229 | | (4)(c) | — 5th dated as of 08/26/98 (Form S-4 filed September 10, 1998) |
| 1-9513 | | (4) | — 6th dated as of 11/9/00 (3rd qtr 2000 Form 10-Q) |
| 333-74958 | | (4)(a)(viii) | — Form of Seventh Indenture (Form S-3 filed December 12, 2001) |
| 1-9513 | | (4a) | — Indenture dated as of June 1, 1997, between CMS Energy and The Bank of New York, as trustee. (Form 8-K filed July 1, 1997) |
| | | | — Indentures Supplemental thereto: |
| 1-9513 | | (4)(b) | — 1st dated as of 06/20/97 (Form 8-K filed July 1, 1997) |
| 333-45556 | | (4)(e) | — 4th dated as of 08/22/00 (Form S-3 filed September 11, 2000) |
| (4)(h) | | 1-2921 | (4)(a) |
| | 1-2921 | (4)(b) | — 1st Supplemental Indenture dated as of March 29, 1999, among CMS Panhandle Holding Company, Panhandle Eastern Pipe Line Company and NBD Bank, as Trustee, including a form of Guarantee by Panhandle Eastern Pipe Line Company of the obligations of CMS Panhandle Holding Company. (1st qtr 1999 Form 10-Q) |
| | 1-2921 | (4)(a) | — 2nd Supplemental Indenture dated as of March 27, 2000, among Panhandle, as Issuer and Bank One Trust Company, National Association, as Trustee, Pursuant to Item 6.01(b)(4)(iii) of Regulation S-K, in lieu of filing a copy of such agreement, Panhandle agrees to furnish a copy of such agreement to the Commission upon request. |
| | | | |
| (4)(i) | 33-58552 | (4) | — Indenture, dated as of February 1, 1993, between Panhandle and Morgan Guaranty Trust Company of New York. (Form S-3 filed February 19, 1993) |
| (4)(j) | 1-9513 | 4.1 | — \$295.8 million Revolving Credit Facility dated July 12, 2002 among CMS Energy, the Banks, the Administrative Agent, the Collateral Agent, the Co-Syndication Agents, the Documentation Agents, all as defined therein (Form 8-K filed July 30, 2002) |
| (4)(k) | 1-9513 | 4.2 | — \$300 million Revolving Credit Facility dated July 12, 2002 among CMS Energy, the Banks, the Administrative Agent, the Collateral Agent, the Co-Syndication Agents, the Documentation Agents, all as defined therein (Form 8-K filed July 30, 2002) |

| Exhibits | Previously Filed | | Description |
|----------|------------------|-------------------|---|
| | With File Number | As Exhibit Number | |
| (4)(l) | 1-5611 | 4.4 | — \$250 million Revolving Credit Facility dated July 12, 2002 among Consumers, the Banks, and the Agent, all as defined therein (Form 8-K filed July 30, 2002) |
| (4)(m) | 1-5611 | (4)(m) | — \$155 million Term Loan Agreement dated October 17, 2002 among Consumers Energy, the Banks, the Administrative Agent and the Syndication Agent, all as defined therein. (Consumers Energy 2002 Form 10-K) |
| (4)(n) | 1-5611 | (4)(n) | — \$300 million Amended and Restated Term Loan Agreement dated September 26, 2002 among Consumers, the Banks and the Agent, all as defined therein. (Consumers Energy 2002 Form 10-K) |
| (4)(o) | 1-9513 | 4.9 | — Pledge and Security Agreement dated as of July 12, 2002 among CMS Energy, Grantors and the Collateral Agent, all as defined therein (Form 8-K filed July 30, 2002) |
| (4)(p) | 1-9513 | 4.11 | — Pledge and Security Agreement dated as of July 12, 2002 among CMS Energy and the Collateral Agent, as defined therein (Form 8-K filed July 30, 2002) |
| (4)(q) | 1-9513 | 4.12 | — Guaranty dated as of July 12, 2002 by the Guarantor in favor of the Lenders, all as defined therein (Form 8-K filed July 30, 2002) |
| (10)(a) | 1-9513 | (10)(b) | — Form of Employment Agreement entered into by CMS Energy's and Consumers' executive officers. (1999 Form 10-K) |
| (10)(b) | 1-9513 | (10)(a) | — Acknowledgement of Resignation between Tamela W. Pallas and CMS Energy Corporation (3rd qtr 2002 Form 10-Q) |
| (10)(c) | 1-5611 | (10)(g) | — Consumers' Executive Stock Option and Stock Appreciation Rights Plan effective December 1, 1989. (1990 Form 10-K) |
| (10)(d) | 1-9513 | (10)(b) | — Employment, Separation and General Release Agreement between William T. McCormick and CMS Energy Corporation (3rd qtr 2002 Form 10-Q) |
| (10)(e) | 1-9513 | (10)(d) | — CMS Energy's Performance Incentive Stock Plan effective February 3, 1988, as amended December 3, 1999. (1999 Form 10-K) |
| (10)(f) | 1-9513 | (10)(c) | — Employment, Separation and General Release Agreement between Alan M. Wright and CMS Energy Corporation (3rd qtr 2002 Form 10-Q) |
| (10)(g) | 1-5611 | (10)(g) | — Employment Agreement dated as of June 1, 2002 between Kenneth Whipple and CMS Energy Corporation (Consumers Energy 2002 Form 10-K) |
| (10)(h) | 1-9513 | (10)(m) | — CMS Deferred Salary Savings Plan effective January 1, 1994. (1993 Form 10-K) |
| (10)(i) | 1-9513 | (10)(n) | — CMS Energy and Consumers Annual Executive Incentive Compensation Plan effective January 1, 1986, as amended January 1995. (1995 Form 10-K) |
| (10)(j) | 1-9513 | (10)(h) | — Supplemental Executive Retirement Plan for Employees of CMS Energy/Consumers Energy Company effective January 1, 1982, as amended December 3, 1999. (1999 Form 10-K) |
| (10)(k) | 33-37977 | 4.1 | — Senior Trust Indenture, Leasehold Mortgage and Security Agreement dated as of June 1, 1990 between The Connecticut National Bank and United States Trust Company of New York. (MCV Partnership) |
| | 33-37977 | 4.2 | — Supplement No. 1 dated as of June 1, 1990. (MCV Partnership) |

| <u>Exhibits</u> | <u>Previously Filed</u> | | <u>Description</u> |
|-----------------|---|--------------------------------------|---|
| | <u>With File Number</u> | <u>As Exhibit Number</u> | |
| (10)(l) | 1-9513 | (28)(b) | — Collateral Trust Indenture dated as of June 1, 1990 among Midland Funding Corporation I, MCV Partnership and United States Trust Company of New York, Trustee. (3rd qtr 1990 Form 10-Q) Indenture Supplemental thereto: |
| (10)(m) | 33-37977 1-9513 | 4.4 (10)(v) | — Supplement No. 1 dated as of June 1, 1990. (MCV Partnership) — Amended and Restated Investor Partner Tax Indemnification Agreement dated as of June 1, 1990 among Investor Partners, CMS Midland as Indemnitor and CMS Energy as Guarantor. (1990 Form 10-K) |
| (10)(n) | 1-9513 | (19)(d)** | — Environmental Agreement dated as of June 1, 1990 made by CMS Energy to The Connecticut National Bank and Others. (1990 Form 10-K) |
| (10)(o) | 1-9513 | (10)(z)** | — Indemnity Agreement dated as of June 1, 1990 made by CMS Energy to Midland Cogeneration Venture Limited Partnership. (1990 Form 10-K) |
| (10)(p) | 1-9513 | (10)(aa)** | — Environmental Agreement dated as of June 1, 1990 made by CMS Energy to United States Trust Company of New York, Meridian Trust Company, each Subordinated Collateral Trust Trustee and Holders from time to time of Senior Bonds and Subordinated Bonds and Participants from time to time in Senior Bonds and Subordinated Bonds. (1990 Form 10-K) |
| (10)(q) | 33-37977 | 10.4 | — Amended and Restated Participation Agreement dated as of June 1, 1990 among MCV Partnership, Owner Participant, The Connecticut National Bank, United States Trust Company, Meridian Trust Company, Midland Funding Corporation I, Midland Funding Corporation II, MEC Development Corporation and Institutional Senior Bond Purchasers. (MCV Partnership) |
| (10)(r) | 33-3797 33-37977 33-37977 33-37977 33-37977 | 10.4 10.5 10.6 10.7 10.8 | — Power Purchase Agreement dated as of July 17, 1986 between MCV Partnership and Consumers. (MCV Partnership) Amendments thereto: — Amendment No. 1 dated September 10, 1987. (MCV Partnership) — Amendment No. 2 dated March 18, 1988. (MCV Partnership) — Amendment No. 3 dated August 28, 1989. (MCV Partnership) — Amendment No. 4A dated May 25, 1989. (MCV Partnership) |
| (10)(s) | 1-5611 | (10)(y) | — Unwind Agreement dated as of December 10, 1991 by and among CMS Energy, Midland Group, Ltd., Consumers, CMS Midland, Inc., MEC Development Corp. and CMS Midland Holdings Company. (1991 Form 10-K) |
| (10)(t) | 1-5611 | (10)(z) | — Stipulated AGE Release Amount Payment Agreement dated as of June 1, 1990, among CMS Energy, Consumers and The Dow Chemical Company. (1991 Form 10-K) |
| (10)(u) | 1-5611 | (10)(aa)** | — Parent Guaranty dated as of June 14, 1990 from CMS Energy to MCV, each of the Owner Trustees, the Indenture Trustees, the Owner Participants and the Initial Purchasers of Senior Bonds in the MCV Sale Leaseback transaction, and MEC Development. (1991 Form 10-K) |
| (10)(v) | 1-8157 | 10.41 | — Contract for Firm Transportation of Natural Gas between Consumers Power Company and Trunkline Gas Company, dated November 1, 1989, and Amendment, dated November 1, 1989. (1989 Form 10-K of PanEnergy Corp.) |

| <u>Exhibits</u> | <u>Previously Filed</u> | | <u>Description</u> |
|-----------------|-------------------------|--------------------------|--|
| | <u>With File Number</u> | <u>As Exhibit Number</u> | |
| (10)(w) | 1-8157 | 10.41 | — Contract for Firm Transportation of Natural Gas between Consumers Power Company and Trunkline Gas Company, dated November 1, 1989. (1991 Form 10-K of PanEnergy Corp.) |
| (10)(x) | 1-2921 | 10.03 | — Contract for Firm Transportation of Natural Gas between Consumers Power Company and Trunkline Gas Company, dated September 1, 1993. (1993 Form 10-K) |
| (11) | | | — Statements regarding CMS Energy's Computation of earnings per share. |
| (12) | | | — Statements regarding computation of CMS Energy's Ratio of Earnings to Fixed Charges. |
| (16) | 1-9513 | 16.1 | — Letter from Arthur Anderson LLP to the Securities and Exchange Commission dated April 29, 2002 regarding change in certifying accountant (Form 8-K filed April 29, 2002) |
| (21) | | | — Subsidiaries of CMS Energy. (Form U-3A-2 filed February 25, 2003). |
| (23)(a) | | | — Consent of Ernst & Young LLP. |
| (23)(b) | | | — Consent of PricewaterhouseCoopers LLP. |
| (24) | | | — Power of Attorney for CMS Energy. |
| 99(a) | | | — Financial Statements for Midland Cogeneration Venture Limited Partnership for the year ended December 31, 2000, 2001, and 2002. |
| 99(b) | | | — Representation regarding Jorf Lasfar financial statements for the year ended December 31, 2000, 2001, and 2002. |

**** Obligations of only CMS Holdings and CMS Midland, second tier subsidiaries of Consumers, and of CMS Energy but not of Consumers.**

Exhibits listed above which have heretofore been filed with the Securities and Exchange Commission pursuant to various acts administered by the Commission, and which were designated as noted above, are hereby incorporated herein by reference and made a part hereof with the same effect as if filed herewith.

INDEX TO FINANCIAL STATEMENT SCHEDULES

| | <u>Page</u> |
|--|-------------|
| Schedule II Valuation and Qualifying Accounts and Reserves 2002, 2001 and 2000: CMS Energy Corporation | 165 |

Schedules other than those listed above are omitted because they are either not required, not applicable or the required information is shown in the financial statements or notes thereto.

Columns omitted from schedules filed have been omitted because the information is not applicable.

CMS ENERGY CORPORATION
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS AND RESERVES
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000

| <u>Description</u> | <u>Balance at Beginning of Period</u> | <u>Charged to Expense</u> | <u>Charged to other Accounts</u> | <u>Deductions</u> | <u>Balance at End of Period</u> |
|---|---|-----------------------------------|--|-------------------|---|
| | | | (In Millions) | | |
| Accumulated provision for uncollectible accounts: | | | | | |
| 2002..... | \$14 | \$18 | \$ 1 | \$17(a) | \$16 |
| 2001..... | \$ 8 | \$20 | \$— | \$14(a) | \$14 |
| 2000..... | \$12 | \$19 | \$(5) | \$18(a) | \$ 8 |

(a) Accounts receivable written off including net uncollectible amounts of \$15 in 2002, \$12 in 2001, and \$14 in 2000 charged directly to operating expense and credited to accounts receivable.

| <u>Signature</u> | <u>Title</u> |
|---|--------------|
| <u>JOSEPH F. PAQUETTE, JR.*</u> Joseph F. Paquette, Jr. | Director |
| <u>William U. Parfet</u> | Director |
| <u>PERCY A. PIERRE*</u> Percy A. Pierre | Director |
| <u>S. KINNIE SMITH, JR.*</u> S. Kinnie Smith, Jr. | Director |
| <u>KENNETH L. WAY*</u> Kenneth L. Way | Director |
| <u>KENNETH WHIPPLE*</u> Kenneth Whipple | Director |
| <u>JOHN B. YASINSKY*</u> John B. Yasinsky | Director |
| *By <u>/s/ S. KINNIE SMITH, JR.</u> S. Kinnie Smith, Jr., Attorney-in-Fact | |

CERTIFICATIONS

The certifications of the principal executive officer and principal financial officer of CMS Energy will not be provided because CMS Energy is in the process of restating 2001 for each quarter and intends to amend this Form 10-K and provide the required certifications at that time.