

AUG 22 1974

DOCKET NOS.: 50-329 AND 50-330

THIS DOCUMENT CONTAINS  
POOR QUALITY PAGES

APPLICANT : CONSUMERS POWER COMPANY

FACILITY : MIDLAND UNITS 1 AND 2

**SUMMARY OF MEETING FOR DISCUSSION OF THE CURRENT FINANCIAL STATUS OF CONSUMERS POWER COMPANY (CPC)**

A meeting was held on July 25, 1974 in Bethesda, Maryland to discuss the applicant's present financial position and the details of financial data previously submitted. An attendance list is attached as Enclosure 1.

REGULATORY STAFF CONCERNS:

The staff summarized recent indicators of CPC's financial performance and the effect of such performance on the company's financial ability to continue the construction of Midland Units 1 and 2. The company's bond ratings were revised downward from Aa (high grade bonds) to A (upper medium grade bonds) by Moody's Investors Service, Inc., on July 9, 1974. Earnings declined as a result of higher fuel prices; increased high cost purchased power requirements due to the August 1973 shutdown of the Palisades Unit; rising material and interest costs; and the declining demand for electric energy because of energy conservation measures. Earnings per average common share declined from \$2.77 for the year ended June 30, 1973 to \$1.79 for the year ended June 30, 1974, 21¢ below the applicant's annual dividend requirement of \$2 per share. In its announcement of the cancellation of the proposed Quanicassee Plant, Units 1 and 2, the applicant cited currently prevailing market conditions for utility securities and present inadequate earnings as reasons for not being assured of raising sufficient new capital over the lengthy construction period of the project to finance the project in addition to the hundreds of millions of dollars which must be raised for other projects to meet customer demands over the next ten years. The staff expressed much concern as to whether or not the applicant, in view of these developments, has a reasonable probability of obtaining the funds necessary to construct the Midland Units 1 and 2.

In reply to the staff's request for up-to-date financial information, the applicant referred to its responses dated June 13, 1974 pursuant to the staff's request of May 29, 1974. Described below are the applicant's addenda to certain of its responses dated June 13, 1974.

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SOURCES OF CONSTRUCTION FUNDS

The \$50 million loan from First National City Bank was executed on June 20, 1974 with interest at 115% of the prime rate for the first two years, 117% for the next two years, and 120% for the remaining three years of the seven-year term of the loan. The loan application did not require a projection of earnings according to the applicant. \$50 million of straight preference stock will be issued in November 1974. The \$35 million nuclear fuel lease is subject to negotiation. A major New York bank has made a commitment based on a five year term with interest charges computed at 116% of the prime rate for the first two years, 117% for the next two years, and 120% for the fifth and last year. \$30 million in lieu of the proposed \$50 million of convertible preference stock will be issued in July 1974 (NOTE: 600,000 convertible preference shares, a hybrid security seldom used by utilities, were actually issued on July 25, 1974 at \$50 per share with a 6% dividend rate resulting in a 12% yield according to The Wall Street Journal of July 26, 1974). The \$100 million of first mortgage bonds scheduled for sale in the late summer of 1974 will be changed to a two-part financing arrangement: \$60 million to be sold by negotiation in August 1974 with a twenty year term and a coupon rate of 11-3/8%; \$50-55 million to be sold later by negotiation with a term of 8-9 years. The \$286 million to be raised through external sources during the twelve months beginning June 1, 1974, as described in the company's response of June 13, 1974, have been revised as detailed above to amount to \$291 million. Adding the estimated internally generated funds of \$97 million, based on the assumption that the Palisades Unit does not operate during the subject twelve months period, to the \$291 million results in sources of construction funds aggregating \$388 million compared with estimated construction requirements of \$364 million.

LINES OF BANK CREDIT

The applicant stated that it now has available \$132 million as a firm line of credit with four large banks versus the \$122 million line of credit noted in its response of June 13, 1974. The increase in the line of credit was necessary to compensate for the cancellation in June 1974 of a common stock offering.

RATE CASES

The applicant stated that its April 23, 1974 filing for a \$72.2 million rate increase is still in the hearing stage which is 50% complete. The requested rate increase of \$614,500 for public pumping service was withdrawn but will be resubmitted to request an increase of \$1 million.

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The requested rate increase of \$1.5 million for wholesale rates was settled with the Federal Power Commission at \$1.03 million. The requested rate increase of \$192,500 for steam service was approved. The applicant indicated that it has filed a request with the Michigan Public Service Commission for changes in its fuel adjustment clause which would recover from ratepayers increases in purchased power costs and provide for recovery on a current basis of increases in the cost of fuel used for generating electric energy and thereby eliminate the present two months lag between cost incurrence and recovery from ratepayers. The applicant pointed out that the attitude of the Michigan Commission will be revealed by its treatment of the requested rate increases. If favorable action occurs, the applicant believes that bond rating agencies and investment analysts will be less pessimistic regarding its financial prospects.

CANCELLATION OF QUANICASSEE PLANT, UNITS 1 AND 2

The staff asked the applicant to explain the various factors influencing its decision to cancel plans to construct the Quanicassee Plant. The applicant commented as follows: (1) reference was made to the statements on page 4 of its prospectus dated July 17, 1974 for \$60 million of first mortgage bonds (Enclosure No. 2), e.g., "... the Company could not be assured of raising sufficient new capital over the lengthy construction period of the project to finance the project in addition to the hundreds of millions of dollars which must be raised for other projects to meet customer demands over the next ten years"; (2) construction budgets are evaluated by financial and technical experts and finally approved by the applicant's board of directors. If the probability of obtaining adequate funds from outside financing and internal sources is not favorable, the construction program is curtailed. Among many financial constraints is the necessity of maintaining a viable capital structure which the applicant considers as 55% long-term debt with the remaining 45% including common equity and preferred stock; (3) coal-fired generating units are superior to nuclear units with regard to planning flexibility, the shorter construction period, and the regulatory constraints; (4) other construction projects in addition to Quanicassee were eliminated or curtailed; and (5) energy conservation practices began to be discernible in December 1973. A 5% decline in residential demand occurred during the winter months and was followed by a 2% drop in the spring. Lighting service declined 25% and commercial service dropped 6%-8%. The applicant revised its forecast of load growth which indicated that a deferral of Quanicassee would be reasonable. It was later decided to cancel the plant largely because of financial constraints.

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QUALITY CONTROL ACTIVITIES

The staff emphasized the fact that its financial qualifications review is related to the safety aspects of nuclear reactor construction and operation, and indicated concern over any cutbacks in quality control and quality assurance activities associated with the Midland Plant, Units 1 and 2. The applicant stated that safety was paramount and that doubts about its financial ability to construct or operate a nuclear facility according to existing safety standards would result in cancellation of the project.

CONSUMERS POWER COMPANY CURRENT ECONOMIES

The staff noted that the applicant's earnings per common share of \$1.79 for the year ended June 30, 1974 were 21¢ per share below the present annual dividend requirement of \$2 per share (Enclosure No. 3). The applicant submitted a statement dated June 27, 1974 (Enclosure No. 4) which explained that despite disappointing earnings of \$1.79 per share of common stock for the 12 months ended May 31, 1974, the applicant's board of directors on June 25, 1974 declared the regular quarterly dividend of 50¢ a share. The statement included these comments: "The company has undertaken stringent economies in order to cut costs. These include a cut of approximately \$60 million in the 1974 construction budget, the elimination of more than 500 jobs, a total suspension of all motor vehicle purchases, and discontinuance of service building construction."

ESTIMATES OF SOURCES OF CONSTRUCTION EXPENDITURES

In response to the staff's request for estimates of sources of system-wide construction expenditures during the construction period for Midland the applicant stated that such estimates would involve projections of earnings and would violate certain SEC regulations regarding disclosure of information to one party without disclosure to the investing public. The staff pointed out that a number of utilities have submitted such projections as amendments to their applications for construction permits. The staff offered to make available to the applicant copies of projections filed by several utilities during the past several months.

The meeting closed after the applicant agreed to file as an amendment to its CP application the financial data including handouts provided the staff during the meeting.

Original Signed by

Original Signed by

Bruce M. Hurt  
Office of Antitrust & Indemnity  
Directorate of Licensing

Leon B. Engle, Project Manager  
Light Water Reactors Branch 2-3  
Directorate of Licensing

OFFICE

SURNAM

DATE

Enclosures:  
See next page

Enclosures:

1. List of Attandees
2. CPC's Prospectus, dtd 7/17/74
3. CPC's Statement of Income,  
dtd 7/25/74
4. CPC's Statement, dtd 6/27/74

DISTRIBUTION:

Docket Files (2)  
AEC PDR  
LPDR  
LWR 2-3 Reading  
AGiambusso  
RSBoyd  
VAMoore  
FSchroeder  
AKenneke  
DEisenhut  
RKlecker  
SVarga  
RP ADs  
RP BCs  
TR ADs  
TR BCs  
LEngle  
BHurt  
EGoulbourne  
OGC  
RO (3)  
RS (3)  
ACRS (16)

OFFICE	x7886/LWR 2-3	<i>[Signature]</i>			
SURNAME	LEngle:cjb	BHurt			
DATE	8/22/74	8/22/74			

ENCLOSURE 1

MEETING HELD WITH CONSUMERS POWER COMPANY  
ON MIDLAND UNITS 1 AND 2  
DOCKET NOS. 50-329/330

LIST OF ATTENDEES

Atomic Energy Commission

A. Giambusso  
V. Moore  
J. Stolz  
D. Vassallo  
I. Peltier  
L. Engle  
B. Hurt

Consumers Power Company

S. Howell  
J. Bacon  
J. Bahn  
B. Fisher  
W. Boris  
J. McDivitt

## PROSPECTUS

\$60,000,000

**Consumers Power Company****FIRST MORTGAGE BONDS, 11<sup>3</sup>/<sub>8</sub>% SERIES DUE 1994***Interest payable February 1 and August 1*

Redeemable on 30 days' notice (a) at any time, at the option of the Company, as a whole or in part, at 111.23% to and including July 31, 1975, and at decreasing prices thereafter to and including July 31, 1993 and thereafter at 100% and (b) commencing August 1, 1979 at 100% through operation of the sinking fund, together in each case with accrued interest; provided, however, that no optional redemption may be effected prior to August 1, 1984 from or in anticipation of moneys borrowed at an interest cost to the Company of less than 11.275% per annum.

Annual sinking fund payments on each August 1, of \$3,000,000 commencing on August 1, 1979, together with a payment at maturity of \$15,000,000 on August 1, 1994, are calculated to retire 100% of the issue. The Company has the option to deliver New Bonds in lieu of cash and has the non-cumulative option to increase any sinking fund payment by an amount not exceeding such sinking fund payment.

Application will be made to list the New Bonds on the New York Stock Exchange.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

**PRICE 100% AND ACCRUED INTEREST**

	Price to Public(1)	Underwriting Discounts and Commissions(2)	Proceeds to Company(1)(3)
Per Bond.....	100%	1½%	98½%
Total.....	\$60,000,000	\$900,000	\$59,100,000

(1) Plus accrued interest, if any, from August 1, 1974.

(2) The Company has agreed to indemnify the Underwriters against certain liabilities, including liability under the Securities Act of 1933.

(3) Before deduction of estimated expenses of \$100,000 payable by the Company.

The New Bonds are offered by the several Underwriters named herein, subject to prior sale, when, as and if accepted by the Underwriters, and subject to approval of certain legal matters by Simpson Thacher & Bartlett, counsel for the Underwriters. It is expected that delivery of the New Bonds will be made on or about August 1, 1974, at the office of Morgan Stanley & Co. Incorporated, 140 Broadway, New York, N. Y., against payment therefor in New York funds.

**MORGAN STANLEY & CO.**  
Incorporated

July 17, 1974

Consumers Power Company (the "Company") is subject to the informational requirements of the Securities Exchange Act of 1934 and, in accordance therewith, files reports and other information with the Securities and Exchange Commission. Information, as of particular dates, concerning directors and officers, their remuneration, the principal holders of securities of the Company and any material interest of such persons in transactions with the Company, as of particular dates, is disclosed in proxy statements distributed to shareholders of the Company and filed with the Commission. Such reports, proxy statements and other information can be inspected at the office of the Commission at Room 6101, 1100 L Street, N. W., Washington, D. C., where copies can be obtained from the Commission at prescribed rates. In addition, reports, proxy statements and other information concerning the Company can be inspected at the offices of the New York Stock Exchange, the Detroit Stock Exchange and the Midwest Stock Exchange. The Company's executive offices are located at 212 West Michigan Avenue, Jackson, Michigan 49201 (telephone number: 517-788-1030).

No person is authorized to give any information or to make any representations other than those contained in this Prospectus in connection with the offer contained in this Prospectus and, if given or made, any such information or representation must not be relied upon as having been authorized by the Company or any Underwriter. Neither the delivery of this Prospectus nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Company since the date hereof. The First Mortgage Bonds offered hereby are herein sometimes referred to as the "New Bonds".

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IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE NEW BONDS AND ANY OTHER BONDS OF THE COMPANY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH TRANSACTIONS MAY BE EFFECTED ON THE NEW YORK STOCK EXCHANGE OR IN THE OVER-THE-COUNTER MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.



## THE COMPANY

Consumers Power Company was incorporated in Michigan in 1968 and is the successor to a corporation of the same name which was organized in Maine in 1910 and which did business in Michigan from 1915 to 1968.

The Company is a public utility engaged in the generation, purchase, distribution and sale of electricity, and in the purchase, production, manufacture, storage, distribution and sale of gas, in the Lower Peninsula of the State of Michigan. The Company also supplies steam service in one community. The population of the territory served is estimated to exceed 5,200,000. The Company's utility operating revenues were derived about 58% from electric service and 42% from gas service for the twelve months ended May 31, 1974.

The industries in the territory served by the Company include automobile and automobile equipment, primary metals, chemicals, fabricated metal products, pharmaceuticals, machinery, oil refining, paper and paper products, food products and a diversified list of other industries.

## USE OF PROCEEDS

The net proceeds from this sale of New Bonds will be used to finance in part the Company's construction program and to repay short-term borrowings made and to be made in connection with interim financing of the construction program. It is estimated that just prior to this sale of New Bonds and the New Preference Stock referred to below short-term borrowings will aggregate approximately \$120,000,000.

The Company estimates that its construction program for the years 1974 through 1978 will require expenditures of approximately \$2.2 billion. In order to finance this program and to meet First Mortgage Bond maturities of \$170,334,000 during this period, it will be necessary for the Company to sell substantial additional securities, the amounts and types of which have not yet been determined. The sale of certain securities may be restricted as set forth under "Statement of Income". The Company presently proposes to issue 800,000 shares of Preference Stock (the "New Preference Stock"), the New Bonds and approximately \$45,000,000 of additional First Mortgage Bonds in the summer of 1974, and it may issue additional equity securities later in 1974. The sales of the New Bonds, the additional First Mortgage Bonds and the New Preference Stock are not dependent upon one another. References herein to \$105,000,000 of First Mortgage Bonds include the New Bonds and such additional First Mortgage Bonds.

## CONSTRUCTION EXPENDITURES

As of June 5, 1974 the Company had made or proposed to make capital expenditures for property additions in 1974 in an estimated amount of \$360,318,250, which estimate gives effect to a decision by the Company in June 1974 to effect a retrenchment program involving the elimination of approximately \$60,000,000 from its construction budget for 1974. The 1974 program as projected includes \$197,552,000 of expenditures towards the construction of three major projects as follows:

Project and Location	Features	Estimated Year of Operation	Estimated Total Cost to Company (a)
Palisades Plant (Van Buren County, Michigan)	Nuclear fueled with initial full capacity of about 700,000 kilowatts and ultimate capacity of about 773,000 kilowatts	(b)	\$ 100,000,000
Midland Plant (Near Eastland, Michigan)	Two nuclear fueled units with aggregate capacity of about 1,000,000 kilowatts and 4,000,000 pounds per hour of process steam (b)(c)	First unit in 1978, second unit in 1980	\$ 240,000,000
D. E. Karn Plant, Units 3 and 4 (Near Essexville, Michigan)	Two oil fired units at existing plant to add approximately 1,307,000 kilowatts of capacity (d)	Unit 3 in 1974, Unit 4 in 1975	\$ 234,000,000

(a) Expenditures have been made or are scheduled to be made as follows:

	<u>Prior to 1974</u>	<u>1974</u>	<u>After 1974</u>
Pedisades Plant.....	\$180,048,000	\$ 8,552,000	\$ —
Midland Plant.....	\$104,073,000	\$101,000,000	\$ 734,927,000
D. E. Karn Plant.....	\$ 92,578,000	\$ 88,000,000	\$ 53,422,000

(b) Reference is made to "Atomic Energy Commission" under "Regulation" and to Note (b) to the Statement of Income herein.

(c) The steam will be furnished to The Dow Chemical Company for industrial processes.

(d) In connection with the construction of the two oil fired units and the conversion of other units to burn oil, the Company has a purchase agreement with a Canadian supplier to import oil from Canada. See "Business—Electric Fuel Supply".

The 1974 construction program includes \$162,766,250 for other facilities, including other electric production facilities, power supply projects, electric transmission and distribution facilities, gas supply lines, gas production, transmission and distribution facilities, steam additions and general and miscellaneous additions. Of this amount, it is estimated \$112,934,650 will be expended for electric additions, \$41,906,000 for gas additions and \$7,925,600 for general, miscellaneous and steam additions.

The Company has cancelled plans to construct a two-unit, 2,300 megawatt nuclear power plant near Quanicassee, Michigan for initial use in 1984 and 1986. The decision to cancel the \$1.4 billion project was made for the reason that in view of currently prevailing market conditions for utility securities and the Company's presently inadequate earnings, the Company could not be assured of raising sufficient new capital over the lengthy construction period of the project to finance the project in addition to the hundreds of millions of dollars which must be raised for other projects to meet customer demands over the next ten years. Total costs (not including land costs) incurred to date for the plant are approximately \$13,500,000 which consist of engineering, license application, environmental impact studies, and other preliminary work. The Company will explore the possibility of obtaining authorization from the AEC to locate a nuclear plant on this site at some time in the future and therefore some of the costs may be salvageable, but it may be necessary to make a charge against current operations in 1974 for all or a part of the costs incurred.

Continuation of the Company's construction program depends upon continuing availability of substantial amounts of outside capital from frequent sales of debt and equity securities over the foreseeable future. The balance of funds needed is expected to be provided from internal sources. The Company will need significant and timely rate increases if revenues and income are to be maintained at levels which will result in sufficient internally generated funds and which will permit external financing of its construction program and its operational requirements at reasonable cost. If adequate funds cannot be obtained from outside financing and internal sources, the Company, of necessity, will further curtail its construction program to the extent feasible. The Company is currently studying its revised construction schedules and budgets with a view to additional future cutbacks should the unavailability of funds make this necessary. Any expenditure reductions which might result from the deferral of construction could be significantly offset by cost escalations and by general inflationary price trends.

## CAPITALIZATION

The following table sets forth the capitalization of the Company as of May 31, 1974 (excluding current portions of long-term debt) and as adjusted to reflect the balance of the \$34,700,000 principal amount of Installment Sales Contracts with the City of Marysville and the Charter Township of Hampton, Michigan, executed in February 1974, the balance of the \$39,000,000 principal amount of Installment Sales Contracts with Covert Township and the City of Luna Pier, Michigan executed in August 1973, the execution of a \$50,000,000 term bank loan in June 1974, the sale of \$105,000,000 principal amount of First Mortgage Bonds in the summer of 1974 and the sale of the New Preference Stock.

<u>Title of Class</u>	<u>Outstanding May 31, 1974</u>	<u>As Adjusted</u>	<u>% of Capitalization As Adjusted</u>
	<u>Thousands of Dollars</u>		
<b>Long-term debt(1)</b>			
First mortgage bonds.....	\$1,151,153	\$1,256,153	
Installment sales contracts payable.....	59,631	73,700	
4% Sinking fund debentures due 1994.....	37,000	37,000	
Term bank loan (2) .....	—	50,000	
Other long-term debt.....	123	123	
Unamortized net debt premium.....	2,061	2,061	
Total long-term debt .....	<u>\$1,249,968</u>	<u>\$1,419,037</u>	56.0%
<b>Preferred stock, cumulative, \$100 par value, authorized 5,000,000 shares, outstanding 3,471,338 shares (1).....</b>			
	\$ 347,134	\$ 347,134	
<b>Preference stock, cumulative, \$1 par value, authorized 5,000,000 shares, none outstanding at May 31, 1974 and 800,000 shares as adjusted (1) .....</b>			
	—	800	
Capital in excess of par value of preference stock.....	—	39,200	
Total preferred and preference stock .....	<u>\$ 347,134</u>	<u>\$ 387,134</u>	15.3%
<b>Common stockholders' equity</b>			
Common stock, \$10 par value, authorized 32,500,000 shares, outstanding 26,233,838 shares (3) .....	\$ 262,338	\$ 262,338	
Capital in excess of par value .....	247,231	247,231	
Retained earnings(1) .....	227,852	227,852	
Less—Capital stock expense .....	(7,005)	(9,540)(4)	
Total common stockholders' equity.....	<u>\$ 730,416</u>	<u>\$ 727,881</u>	28.7%
Total capitalization(5) .....	<u>\$2,327,518</u>	<u>\$2,534,052</u>	100.0%

(1) Reference is made to Financial Statements and notes related thereto.

(2) On June 20, 1974 the Company borrowed \$50,000,000 from a bank under a promissory note maturing in 1981 and bearing interest at a fluctuating rate (13.225% at June 27, 1974) related to the bank's prime lending rate. The proceeds were used to repay short term borrowings which amounted to \$73,650,000 as of June 27, 1974.

(3) The number of shares issuable upon conversion at the initial conversion price will be reserved for issuance upon conversion of the New Preference Stock.

(4) This amount gives effect to estimated expenses payable by the Company.

(5) The Company has been authorized by the Federal Power Commission to incur short-term borrowings of up to \$300,000,000. The Company has agreements with banks providing for short-term borrowings of up to \$132,000,000. As of May 31, 1974 short-term borrowings amounted to \$104,510,000 and the current sinking fund requirements on long-term debt amounted to \$13,288,000. See "Use of Proceeds."

**CONSUMERS POWER COMPANY**  
**STATEMENT OF INCOME**

The following Statement of Income of Consumers Power Company for the five years ended December 31, 1973 has been examined by Arthur Andersen & Co., independent public accountants, as set forth in their report elsewhere in this Prospectus. The Statement of Income for the twelve months ended May 31, 1974 (including the notes related thereto), which has not been examined by independent public accountants, reflects, in the opinion of the Company, all adjustments (which consist only of normal recurring adjustments) necessary to present fairly the results of operations for such period. This statement should be read in conjunction with the Financial Statements and related notes appearing elsewhere in this Prospectus.

	Year Ended December 31					Twelve Months Ended May 31, 1974
	1969	1970	1971	1972	1973	(Unaudited)
Thousands of Dollars						
<b>Operating Revenue: (a)</b>						
Electric .....	\$308,000	\$334,904	\$364,230	\$416,994	\$495,723	\$522,574
Gas .....	240,536	273,874	236,091	332,085	337,906	386,161
Steam .....	1,239	1,212	1,296	1,374	1,325	1,390
<b>Total operating revenue .....</b>	<b>\$549,775</b>	<b>\$609,990</b>	<b>\$651,617</b>	<b>\$750,453</b>	<b>\$834,954</b>	<b>\$910,125</b>
<b>Operating Expenses and Taxes:</b>						
Operation (b)(c)(d) .....	\$280,384	\$324,789	\$378,987	\$444,489	\$493,755	\$581,625
Maintenance .....	26,121	32,818	31,512	41,187	44,263	46,529
Depreciation and amortization .....	51,881	55,608	58,210	62,937	73,428	77,895
General taxes .....	37,058	9,062	43,873	48,204	54,160	57,260
Income taxes (e) .....	59,472	54,281	37,585	39,519	44,633	29,491
<b>Total operating expenses and taxes .....</b>	<b>\$454,916</b>	<b>\$506,558</b>	<b>\$550,167</b>	<b>\$636,336</b>	<b>\$710,239</b>	<b>\$792,800</b>
<b>Net operating income .....</b>	<b>\$ 94,859</b>	<b>\$103,432</b>	<b>\$101,450</b>	<b>\$114,117</b>	<b>\$124,715</b>	<b>\$117,325</b>
<b>Other Income:</b>						
Allowance for funds used during construction (f) .....	\$ 8,421	\$ 14,108	\$ 21,862	\$ 25,455	\$ 23,223	\$ 21,942
Income of Subsidiaries .....	1,350	1,650	1,897	1,920	3,341	4,701
Gain on reacquisition of long-term debt .....	769	1,074	1,260	1,418	1,609	1,613
Other, net .....	282	530	889	526	1,990	2,132
<b>Net other income .....</b>	<b>\$ 10,822</b>	<b>\$ 17,362</b>	<b>\$ 25,908</b>	<b>\$ 29,319</b>	<b>\$ 30,163</b>	<b>\$ 30,388</b>
<b>Interest Charges:</b>						
Interest on long-term debt .....	\$ 35,867	\$ 44,774	\$ 53,829	\$ 63,754	\$ 71,322	\$ 74,669
Other interest charges .....	2,854	3,188	1,749	1,504	2,663	4,092
<b>Total interest charges .....</b>	<b>\$ 38,721</b>	<b>\$ 47,962</b>	<b>\$ 55,578</b>	<b>\$ 65,258</b>	<b>\$ 73,985</b>	<b>\$ 78,761</b>
<b>Net Income</b> .....	<b>\$ 66,960</b>	<b>\$ 72,832</b>	<b>\$ 71,780</b>	<b>\$ 78,178</b>	<b>\$ 80,893</b>	<b>\$ 68,952</b>
<b>Dividends on Preferred Stock</b> .....	<b>3,534</b>	<b>3,517</b>	<b>7,108</b>	<b>11,251</b>	<b>17,746</b>	<b>21,902</b>
<b>Net Income After Dividends on Preferred Stock</b> .....	<b>\$ 63,426</b>	<b>\$ 69,315</b>	<b>\$ 64,672</b>	<b>\$ 66,927</b>	<b>\$ 63,147</b>	<b>\$ 47,050</b>
<b>Earnings per Share of Common Stock (g)</b> .....	<b>\$ 2.79</b>	<b>\$ 2.95</b>	<b>\$ 2.69</b>	<b>\$ 2.72</b>	<b>\$ 2.41</b>	<b>\$ 1.79</b>
<b>Cash Dividends Declared Per Share of Common Stock (h)</b> .....	<b>\$ 1.425</b>	<b>\$ 2.00</b>	<b>\$ 2.00</b>	<b>\$ 2.00</b>	<b>\$ 2.00</b>	<b>\$ 2.00</b>
<b>Ratio of Earnings to Fixed Charges (i)</b> .....	<b>4.28</b>	<b>3.67</b>	<b>2.98</b>	<b>2.81</b>	<b>2.69</b>	<b>2.23</b>
<b>Ratio of Earnings to Fixed Charges Plus Preferred Dividend Requirements (Pre-Income Tax Basis) (i)</b> .....	<b>3.65</b>	<b>3.25</b>	<b>2.49</b>	<b>2.23</b>	<b>1.96</b>	<b>1.59</b>

See Notes to Statement of Income

## NOTES TO STATEMENT OF INCOME

(Including Notes Related to Unaudited Statement of Income)

(a) On January 18, 1974, the Michigan Public Service Commission ("MPSC") authorized increases in the Company's electric and gas rates of \$31,000,000 and \$46,600,000, respectively, on an annual basis. The rate increases included interim increases aggregating \$50,000,000 divided equally between electric and gas rates which were placed in effect November 10, 1973. Of the authorized gas rate increase, approximately \$14,571,000 became effective on April 20, 1974 after the second unit of the Marysville Gas Reforming Plant became fully and commercially operable. In response to requests by the Michigan Attorney General and others for a rehearing on the authorized rate increases, the MPSC on March 27, 1974, reaffirmed the rate increases granted on January 18, 1974. In addition, the MPSC noted that the authorized rate schedules were based on capital expenditures relating to the Marysville Gas Reforming Plant in the amount of \$119,700,000, which amount represented estimated costs at the time of the Company's rate application, and that consideration for rate purposes of subsequent additional costs estimated to aggregate \$35,300,000 is to be delayed pending completion of a performance audit with respect to the Marysville Gas Reforming Plant conducted under the auspices of the Commission's Staff.

In April 1974 the Company submitted an application to the MPSC to increase its electric rates by not less than \$72,159,000 annually and at the same time requested partial and interim relief in the amount of \$54,659,000 annually. It is not expected that the MPSC will act upon the application or the request for partial and interim relief until later in 1974 following hearings and other investigation of the requests.

Litigation is pending in the Ingham County Circuit Court with respect to electric and gas rate increases which became effective in 1969 and which are subject to refund relating to the reduction and elimination of the Federal income tax surcharge. In 1970, the Court issued a temporary injunction permitting the Company to collect the rates without adjustment for the subsequent reduction and elimination of the income tax surcharge, subject to possible refund, with interest, of a portion of the amounts collected. As a result of further authorizations by the MPSC in December 1971 to increase electric and gas rates effective December 14 and December 23, 1971, respectively, the Company believes that there are no refund obligations with respect to service rendered subsequent to these dates. In March and April 1974, the Court ruled in favor of the MPSC with respect to the income tax surcharge issue and ordered the Company to refund \$24,542,632 to its electric and gas customers. The Company has established a reserve stated net of related income taxes in the amount of \$11,867,818, and believes that the amount of such reserve is adequate to cover the refund obligation, exclusive of interest charges which are presently not capable of determination. The Company is undertaking to seek judicial review of the Court orders of March and April 1974, including a request for a stay of the refund pending further judicial action. The litigation also involves a claim with respect to the legality of the electric rate increase, which became effective in 1969, on the grounds that the increased rates became effective by Court order in October 1969, that the MPSC did not issue an order approving said rates until April 1970 and that as a result, the electric rates charged during the period are subject to refund in an amount of approximately \$7,763,000, plus interest charges which are presently not capable of determination, for which no reserve has been provided.

(b) Throughout 1972 operations of the Palisades Nuclear Plant were significantly restricted by the Atomic Energy Commission ("AEC") and, accordingly, the Company capitalized an allowance for funds used during construction (\$5,600,000) and other costs normally charged to operations (\$2,000,000) on a pro rata basis reflecting actual output of the plant during the year. In December 1972, the cost of the plant including fuel (\$176,294,000) was transferred to plant in service.

The Palisades Nuclear Plant has been shut down since August 1973 for repairs to certain reactor vessel internal components and the steam generators of the plant. It was thought that repairs had been completed and the plant would be returned to service during May 1974. However, during pre-operational tests being conducted in preparation for start up of the plant, two tubes in one of the plant's two steam generators failed to withstand the pressure buildup. This will require further testing and repair which will further delay the start up. In addition, public hearings may be required by the AEC before the plant is returned to commercial operation. During the period of shutdown the Company also installed cooling

towers which were originally scheduled to be tied into the plant during a 12-week outage in the first six months of 1974. The net cost of replacement power, net of related income taxes, amounting to \$7,221,000 (\$.27 per share of common stock) for the year ended December 31, 1973 and \$16,687,000 (\$.64 per share of common stock) for the twelve months ended May 31, 1974, has been charged to income.

(c) The Company receives a portion of its gas supply from its wholly-owned subsidiaries and, accordingly, operation expense includes approximately, \$37,170,000 in 1969, \$39,465,000 in 1970, \$40,770,000 in 1971, \$47,953,000 in 1972, \$49,213,000 in 1973 and \$51,817,000 for the twelve months ended May 31, 1974, relating to the cost of gas purchased from these subsidiaries.

(d) Reference is made to Note 7 to Financial Statements for information relating to the Company's pension plan.

(e) Reference is made to Notes 15 and 16 to Financial Statements for information relating to income taxes.

(f) The allowance for funds used during construction, included in other income, is defined in the applicable regulatory systems of accounts as the net cost, during the period of construction, of borrowed funds used for construction and a reasonable rate on other funds when so used. Under established regulatory practices, the Company is permitted to earn a return on the capitalized cost of such funds and to recover the same in the rates charged for utility services.

The composite rate used by the Company to capitalize the cost of funds devoted to construction was 6.8%, 7.6%, 8.0%, 7.5%, 7.5% and 7.6% in the years 1969 through 1973 and the twelve months ended May 31, 1974, respectively. The current rate being used is 7.75%. The amount capitalized has increased since 1969 principally as a result of substantial increases in construction work in progress and in the costs of capital.

Based on the Company's source of funds for gross property additions, and assuming that the cost of financing other than common equity financing was equivalent to the current cost of long-term and short-term debt (before income tax effect), preferred stock and other sources available in each of the periods, the estimated common equity component of the allowance for funds used during construction amounted to 5.3%, 7.9%, 10.9%, 12.0%, 9.6% and 13.3% of net income available for common stock for the years 1969 through 1973 and the twelve months ended May 31, 1974, respectively.

(g) Earnings per share of common stock are computed based on the average number of shares outstanding during the periods shown as follows: 22,768,900 shares in 1969, 23,506,780 shares in 1970, 24,033,838 shares in 1971, 24,583,838 shares in 1972, 26,233,838 shares in 1973 and 26,233,838 shares for the twelve months ended May 31, 1974.

(h) The quarterly dividend on common stock formerly declared in December was declared in January starting in 1970. Therefore, the dividends declared in 1969 only include three quarterly dividend declarations. Dividend payments have continued to be made in the months of February, May, August and November.

(i) For the purpose of computing the ratio of earnings to fixed charges, earnings represent the Company's net income (including allowance for funds used during construction), before deducting income taxes and fixed charges. Fixed charges represent the Company's interest expense and amortization of debt discount, premium and expense. In addition, for the purpose of computing the ratio of earnings to fixed charges plus preferred dividend requirements (pre-income tax basis), preferred dividend requirements represent an amount equal to earnings which, on a pre-tax basis, would be required to meet the preferred stock dividends.

(j) Reference is made to "Construction Expenditures" for information relating to cancellation of the Quanicassee Nuclear Plant project.

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The annual interest requirements on the New Bonds will be \$6,825,000.

The pro forma ratio of earnings to fixed charges for the 12 months ended May 31, 1974, is approximately 1.82, based on long-term debt outstanding at that date (excluding current maturities and including the balance of Installment Sales Contracts executed in August 1973 and February 1974) after giving effect to the issuance of the New Bonds, the proposed issuance of \$45,000,000 principal amount of First Mortgage Bonds at an assumed interest rate, the retirement of all short-term borrowings, and the execution of the \$50,000,000 term bank loan in June 1974.

The pro forma ratio of earnings to fixed charges plus preferred and preference dividend requirements (pre-income tax basis) for the twelve months ended May 31, 1974 is approximately 1.30, based on the adjustments in the foregoing paragraph and a full year's dividend requirements on preferred stock outstanding at that date, after giving effect to the proposed issuance of the New Preference Stock at an assumed dividend rate.

The earnings coverage provisions of the Indenture covering the Company's First Mortgage Bonds require for the issuance of additional mortgage bonds, except for certain refunding purposes, minimum earnings coverage, before income taxes, of at least two times pro forma annual interest charges on bonds. The Company's Charter requires for the issuance of additional shares of Preferred Stock specified earnings coverages, including minimum earnings coverage, after income taxes, of at least one and one-half times the pro forma annual interest charges on all indebtedness and preferred dividend requirements. On the basis of these formulae, the pro forma coverages (assuming the issuance of \$105,000,000 of First Mortgage Bonds) for the twelve months ended May 31, 1974 (computed including allowance for funds used during construction) would be, respectively, not less than 2.01 times as compared with the requirement of at least two times and (including the \$50,000,000 term bank loan) not less than 1.22 times as compared with the requirement of at least one and one-half times. The amounts of additional First Mortgage Bonds and Preferred Stock which can be issued in future years will be contingent upon increases in earnings through rate increases or otherwise.

At May 31, 1974, after giving effect to the execution of the \$50,000,000 term bank loan in June 1974, the balance of Installment Sales Contracts executed in August 1973 and February 1974, the proposed issuance of \$105,000,000 principal amount of First Mortgage Bonds and the proposed issuance of 800,000 shares of the New Preference Stock, retained earnings in the amount of \$106,306,247 would not be available for the payment of cash dividends on common stock under provisions of the Company's Articles of Incorporation which, except under certain circumstances, prohibit the payment of common stock dividends in cash which would reduce the percentage of common stock equity to total capitalization below 25%. There are also other restrictions as to the payment of dividends on common stock which, however, would be less restrictive than the limitation mentioned above.

The decrease in net income for the 12 months ended May 31, 1974 from the 12 months ended December 31, 1973 is principally the result of continuing inadequate levels of electric and gas rates in relation to increases in operating costs (principally purchased power, fuel and gas, including the continued cost of replacement power during the Palisades Nuclear Plant shutdown), higher interest costs, continuing inflation and a flattening demand for electricity and gas. The decrease in earnings per share of Common Stock in 1973 and for the 12 months ended May 31, 1974 is the result of all the factors affecting net income, increased dividends due to the issuance of additional Preferred Stock and to a larger average number of shares of Common Stock outstanding. The Company believes that the most significant factors accounting for the flattening demand in electric energy sales were energy conservation measures and reduced business activity, particularly in the automobile and automobile equipment industries. With respect to gas sales, the Company believes that the flattening demand was due in large part to warmer than normal weather and the curtailment of sales to seasonal customers as well as conservation measures and reduced business activity.

The foregoing adverse factors are continuing and if not offset by proportionate increases in operating revenues, including periodic rate relief, or otherwise, will continue to adversely affect earnings.

## BUSINESS

### Electric Service

The Company renders electric service in an area of approximately 27,800 square miles, having a population of approximately 3,300,000. Principal cities served are Battle Creek, Bay City, Flint, Grand Rapids, Jackson, Kalamazoo, Muskegon, Pontiac and Saginaw.

The Company owns and operates electric generating plants with aggregate capacity of 5,363,100(a) kilowatts and, as shown under "Construction Expenditures" above, is constructing additional plants which will add 2,607,000 kilowatts to the Company's generating capacity as follows:

	Kilowatts	
	Present Plants	Plants Under Construction
Fossil fuel steam-electric plants (6 at present, 2 units under construction)		
Coal .....	2,400,000	—
Oil .....	542,000	1,307,000
Nuclear steam-electric plants (2 at present, 1 under construction) .....	771,000(a)	1,300,000
Pumped storage plant(1) .....	994,500(b)	—
Hydroelectric plants(13) .....	133,600	—
Gas turbine plants(7) .....	522,000	—
Total.....	5,363,100(a)	2,607,000

(a) This includes 700,000 kilowatts for the Palisades Nuclear Plant. See "Atomic Energy Commission" under "Regulation" and Note (b) to the Statement of Income herein.

(b) This represents the Company's share of the capacity of the Ludington Pumped Storage Plant. The Company and The Detroit Edison Company have 51% and 49% undivided ownership, respectively, in the plant and the capacity of the plant is shared accordingly. Agreements are in effect providing for the purchase by Commonwealth Edison Company of one-third of the capacity from the plant until early August 1983 and one-sixth of the capacity from the plant thereafter until early August 1988.

The Company's electric generating plants are interconnected by a transmission system operating at from 138,000 to 345,000 volts.

The Company has an electric coordination agreement with The Detroit Edison Company providing for coordination of planning, design, construction and operation of the electric systems of the parties, the rendering of mutual assistance during emergencies and the effecting of the maximum practical economy in providing the electric power requirements of each system. There are four 138,000 volt and four 345,000 volt interconnections between the systems. These interconnections permit a sharing of the reserve capacity of the two systems and a substantial reduction in investment in plant facilities for each company. The Company and The Detroit Edison Company have filed a joint petition with the MPSC for approval of certain emergency procedures to be invoked, if necessary, in the event of anticipated or predictable energy shortages in the electric service areas of the two companies. In January 1974 the MPSC authorized on an interim basis emergency electrical procedures to be followed by the two companies and a proceeding is currently pending before the MPSC to determine whether the procedures should be permanently adopted.

The Company has an agreement with The Detroit Edison Company and Ontario Hydro for interconnections linking the power systems of the Company and Detroit Edison with the power system of Ontario Hydro and also providing for mutual assistance during emergencies, improved reliability of bulk



power supply and the effecting of economies by coordinated development and exchange of power. Two 230,000 volt and one 345,000 volt interconnections have been established under the agreement.

The Company has agreements with several other major electric utilities operating in Michigan, Ohio, Indiana and Illinois providing for interconnection services and other transactions. The Company also maintains interconnections with the Michigan Municipals and Cooperatives Power Pool, the Cities of Lansing and Holland and interchanges power with the Edison Sault Electric Company.

The maximum net demonstrated capability for the summer of 1974 of the Company's interconnected system including supplemental purchases is 5,525,000 kilowatts (including the Palisades Nuclear Plant) to serve a projected maximum demand of 4,330,000 kilowatts. The net maximum demand on the interconnected system through May 31, 1974 was 4,394,295 kilowatts on August 27, 1973.

#### **Electric Fuel Supply**

In addition to substantial and continuing increases in fuel costs, the Company is also experiencing limitations and restrictions on the availability of fuel.

For the twelve months ended May 31, 1974, approximately 55% of the Company's kilowatt-hour requirements were obtained from coal-fired generation, 6% from nuclear, 7% from oil, 3% from peaking units (oil and gas), —1% from hydro (including net pumped storage generation) and 30% from purchased and interchanged power.

Approximately 55% of the Company's owned generating capability (excluding pumped storage) is dependent upon coal as a source of fuel and requires approximately 6.5 million tons of coal annually. The Company has long-term coal contracts which provide for the delivery of approximately 90% of its coal requirements in 1974. These long-term contracts provide for deliveries through 1977 and in some instances through 1982. The sulfur content of the contract coal ranges from 0.6% to 4.0% by weight, the majority of which falls between 2.0% and 3.0% sulfur. Approximately 900,000 tons of low-sulfur coal per year is under long-term contract from mines located in eastern Kentucky, and 3.7 million tons of high-sulfur coal per year is under long-term contract from mines located in Ohio. The remaining long-term contract coal supplies are from mines in northern West Virginia, Indiana and western Kentucky. Due to shortages of railroad cars, enforcement of the Federal Coal Mine Health and Safety Act of 1969 in mines serving the Company, equipment breakdowns at mines and breakdowns of coal-handling facilities at the Company's plants, as much as 10% of the long-term contract coal may not be available in 1974. The balance of the Company's coal requirements not under long-term contract and that quantity of coal under long-term contracts which cannot be delivered must be supplied through short-term agreements or spot purchases at prices substantially higher than coal obtained under long-term contracts. At present the price for such spot purchases of coal with less than 1% sulfur ranges from \$25 to \$37 per ton as compared to long-term contract prices of from \$13 to \$20 per ton.

As of June 1, 1974 the Company's coal inventory amounted to approximately 79 days' supply. The Company is undertaking a program to maintain or improve coal inventories to a level equal to or above normal seasonal levels because of the expiration in November 1974 of the labor agreement between the United Mine Workers and the mine owners. Future changes in governmental requirements pertaining to the coal industry could adversely affect cost and availability of coal supplies. See "Regulation—Compliance with Environmental Requirements" for matters pertaining to meeting EPA regulations on coal-fired generating units.

The Company is negotiating for supplies of low-sulfur coal from two or more new mines which are to become operational from 1976 to 1978. These new sources are intended to supply low-sulfur coal to complement existing long-term contracts and to possibly replace the existing fuel supplies at one or more existing generating units. Although there is no assurance that the Company will complete such negotiations, the Company believes that any successful completion of current negotiations for new coal supplies will require the Company's participation in partial or total ownership of the coal mines.

In connection with generating units which burn crude oil and the construction of new oil-burning generating units, the Company expects to import from Canada approximately 2,700,000 barrels in 1974, increasing to an annual rate of approximately 11,000,000 barrels beginning in November 1975. As a result of taxes and other increases in cost, imported low-sulfur crude oil from Canada increased to \$12.46 per

barrel as of June 1, 1974 as compared to \$4.12 per barrel a year earlier. The Company expects to recover substantially all of such additional expense through the operation of fuel adjustment clauses included in its rate schedules for electric service. For additional information see "Gas Service" below.

The Federal Energy Office ("FEO") adopted mandatory fuel allocation regulations, under which volumes of middle distillates, residual and crude oils are to be allocated. Such regulations are now administered by the Federal Energy Administration ("FEA"). The Company is to be allocated 100% of its 1972 volume of middle distillate oil (as reduced by application of an allocation factor), or as otherwise determined by the FEA, but not less than 100% of current requirements for nuclear plants, start-up, testing, and flame stability of coal-fired plants (except for peaking uses). Crude and residual oils used as fuel for electric generation are to be allocated among utilities using such fuel on the basis of the amount available and the recommendations of the Federal Power Commission ("FPC") so that, if necessary, each utility "within appropriate groupings" will absorb an equal percentage cutback of power generation to the maximum extent possible. While the Company is not assured of receiving its required allocations, and the failure to receive the same could have an adverse effect upon its supplies of oil and the Company's generation, to date such supplies have been adequate to meet the Company's requirements.

The Company's overall average cost of fuel burned has increased substantially, as shown below, and further increases are expected for the foreseeable future.

	Cents per Million Btu Fuel Consumed					Percentage of Total Fuel Consumed				
	1973	1972	1971	1970	1969	1973	1972	1971	1970	1969
	¢	¢	¢	¢	¢	%	%	%	%	%
Coal.....	48.9	44.0	42.9	36.6	31.2	70.1	75.5	85.0	86.2	92.9
Oil.....	85.4	77.8	79.9	84.1	82.7	9.7	5.0	2.7	.3	.2
Gas.....	66.4	54.8	45.4	43.0	41.1	5.3	7.7	10.1	11.3	4.4
Nuclear.....	24.1	24.3	27.8	36.0	33.9	14.9	11.8	2.2	2.2	2.5
All Fuels.....	49.6	44.2	43.8	37.4	31.8	100.0	100.0	100.0	100.0	100.0

For the five months ended May 31, 1974, the Company's overall average cost of fuel consumed increased to 69.1¢ per million Btu as a result of higher fuel costs and a lower percentage of nuclear fuel consumed. For this period, the percentage of total fuel consumed and cost per million Btu of fuel consumed for the four fuel classes are, respectively, coal: 81.5% and 59.0¢, oil: 9.2% and 157.6¢, gas: 7.4% and 83.2¢ and nuclear: 1.9% and 20.1¢.

The Company's present nuclear fuel requirements are for the Big Rock Point Plant and the Palisades Nuclear Plant. The Company has contracts for each of these plants providing for the supply of all segments of the nuclear fuel supply chain, including uranium ore concentrates and the conversion to uranium hexafluoride; enrichment of the uranium hexafluoride; fabrication of nuclear fuel assemblies; and transportation, reprocessing and reconversion of the "spent" nuclear fuel assemblies. The contracts cover requirements for a minimum of the next five years. These agreements are with major private industrial suppliers of nuclear fuel and related services and with the United States government.

The Company also has contracts for several but not all segments of the nuclear fuel cycle for the Midland Plant. These include contracts for the supply of uranium ore concentrates, conversion to uranium hexafluoride, and fabrication of nuclear fuel assemblies for the initial cores for the Midland Plant. In late June 1974, the Company applied to the AEC for enrichment service for initial cores for the Midland Plant but the AEC declined at that time to execute contracts for such services. If the AEC continues to decline to furnish such enrichment services for a substantial period of time and if alternative enrichment services are not available, initial operation of the plant could thereby be delayed.

#### Gas Service

The Company renders gas service in an area of approximately 12,900 square miles having a population of approximately 3,800,000. Principal cities served are Bay City, Flint, Jackson, Kalamazoo, Lansing, Pontiac, Royal Oak, Saginaw, Warren and a number of suburban communities near Detroit.

The Company owns gas transmission and distribution mains and other gas lines, compressor stations and facilities, and storage rights, wells and gathering facilities in several fields in Michigan. The Company and Michigan Gas Storage Company ("Storage Company"), a wholly-owned subsidiary of the Company, store a portion of its gas supply in the warmer months of the year for use in the colder months of the year.

For the twelve months ended May 31, 1974, approximately 52% of the Company's gas supply was obtained from Trunkline Gas Company ("Trunkline"), 25% from Storage Company, 8% from Michigan fields, 9% from Marysville Gas Reforming Plant and 6% from miscellaneous spot purchases.

Gas is furnished by Trunkline to the Company pursuant to a contract providing for the delivery of approximately 255 billion cubic feet of natural gas per year. Storage Company presently has a contract with Panhandle Eastern Pipe Line Company ("Panhandle") providing for the delivery of 92 billion cubic feet of gas per year. Since 1971 the Company has experienced curtailments from its pipeline suppliers and is currently experiencing additional curtailments which are expected to continue for an indefinite period. These curtailments aggregated approximately 64 billion cubic feet of gas in 1973 and are expected to be 90 billion cubic feet in 1974 and could increase to a higher level in the future. The curtailments imposed by the pipeline companies are the subject of pending proceedings before the FPC, and orders issued in such proceedings will determine the curtailment procedures ultimately to be placed into effect by the pipeline companies.

The maximum daily sendout of natural gas for the Company through June 30, 1974 was 2,283 million cubic feet on January 15, 1972. Of this total, 691 million cubic feet were purchased from Storage Company, 897 million cubic feet were delivered from the Company's storage fields, 649 million cubic feet were purchased from Trunkline and 46 million cubic feet were obtained from producing Michigan fields. The peak-day system capacity is in excess of 2,800 million cubic feet.

In May 1973, Panhandle applied to the FPC for increases in its wholesale gas rates which would, if approved, result in an increase in the cost of gas purchased by Storage Company from Panhandle of approximately \$4,700,000 annually. Any increase in such wholesale rates to Storage Company would be passed on to the Company under Storage Company's cost-of-service rates approved by the FPC. Panhandle's proposed rates were suspended by the FPC until December 1, 1973 and settlement discussions have been held among Panhandle, its customers and the FPC staff. A proposal of settlement has been tentatively reached which would result in an increase in Storage Company's rates by approximately \$3,400,000 per year. In May 1974, Trunkline applied to the FPC for increases in its wholesale gas rates which would, if approved, result in an increase in the cost of gas purchased by the Company from Trunkline of approximately \$28,600,000 per year. The FPC suspended the proposed tariffs until December 1, 1974. The Company expects to recover substantially all of any such additional expense incurred by reason of such proceedings through the operation of cost-of-gas-sold clauses contained in its retail rate schedules for gas service.

As a consequence of the national gas shortage and in order to protect service to its existing customers and to limit new customer requirements to the gas supply available, between May 1973 and May 1974 the Company issued permits only to new residential and home heating customers. In late May 1974 the MPSC authorized the Company to attach a limited number of new small commercial and industrial customers in addition to new residential and home heating customers. The Company is unable to predict whether it will be required in 1974 and later years to cease adding customers or to curtail gas service to any of its customers other than seasonal customers or whether it will be able to continue attaching additional load. Such actions are dependent upon the extent of future curtailments on the part of the Company's pipeline suppliers referred to above and the receipt of additional gas supplies from the sources of supply hereinafter described. The Company has filed a petition, which is pending, with the MPSC for approval of a curtailment program for firm gas customers, to be invoked if it becomes necessary.

The Company has initiated several programs to provide it with additional supplies of gas. Northern Michigan Exploration Company ("Northern"), a wholly-owned subsidiary of the Company, has carried on a gas exploration program in the northern part of the Lower Peninsula of Michigan for the past several years, and has varying interests in oil and gas leases on lands covering approximately 500,000 acres in that area. Such leases authorize exploration for oil and gas with the right to retain a portion of any oil or gas produced thereunder. Northern owns part of the working interest in 43 oil or gas wells in several fields in

northern Michigan. Further drilling and development will be required to determine the size of the field in which these wells are located, and additional geophysical surveys and exploratory wells are planned in northern Michigan.

Northern is also participating with others in the exploration and development of 97,600 acres in offshore Louisiana in 21 tracts and Northern's net ownership therein is 10,900 acres. Four production platforms have been set on three of these tracts; development drilling is in progress on three of the platforms and has been completed on one platform. In June 1974 Northern applied to the FPC for authorization to sell and arrange for the transportation of up to 40 million cubic feet of gas per day to the Company from these three tracts. Delivery to the Company of Northern's share in gas from this development is not expected before the end of 1974 and will be subject to the receipt of regulatory approvals, which is not assured.

The Company's geologists and petroleum engineers estimate that Northern presently holds working interests which amount to approximately 12 million barrels of proven oil reserves and approximately 2 million barrels of probable oil reserves as well as approximately 135 billion cubic feet of proven gas reserves and approximately 40 billion cubic feet of probable gas reserves. Reference is made to Note 5 to the Financial Statements for further information relating to Northern.

The Company has gas purchase contracts with several producers in the northern Michigan area and has placed in service pipelines to transport gas purchased in this area to its integrated gas transmission system. By the end of 1973 the Company was receiving approximately 35 million cubic feet of natural gas per day from this northern Michigan area and deliveries are expected to increase to 60 million cubic feet by the latter part of 1974. The Company also is engaged in a gas exploration program in the southern part of the Lower Peninsula of Michigan.

The Company has been receiving gas from producers near Mason, Michigan. Purchases from this source amounted to approximately 15 million cubic feet of gas per day at the end of 1973. During 1973 the Company also made spot purchases of gas aggregating approximately 22 billion cubic feet and plans to make further purchases in 1974.

The Company in April 1974 completed the construction of a gas reforming plant at Marysville, Michigan for converting natural gas liquids into gas. Such liquids are imported from Canada under a purchase agreement expiring in 1988, which provides for delivery to the Company of up to 50,000 barrels per day. The plant began production at an average rate of approximately 100 million cubic feet of gas per day in September 1973, and production up to 200 million cubic feet of gas per day commenced in April 1974. The cost to the Company of such gas, including overheads, fixed charges, import fees and export taxes, is and will be substantially in excess of the present cost of other gas now received by the Company from interstate pipelines and other sources and has resulted and will result in a substantial increase in the cost of service to the Company's gas customers. In connection with the natural gas liquids to be converted into gas by the reforming plant, as a result of Canadian export taxes and other increased costs, the feedstock costs about \$12.00 per barrel as of June 1974 as compared to less than \$4.00 per barrel a year earlier. The Company expects to recover substantially all of such additional expense through the operation of cost of gas sold clauses contained in its rate schedules for gas service. The impact of the Canadian tax in future years is unknown because it is based upon the difference between the price of foreign crude oil (other than Canadian) in eastern Canada and Canadian crude oil, with the aim being to have the export price of Canadian crude oil at least equal to the price of foreign crude oil in eastern Canada. Future policies of the Canadian government regarding the levy of such a tax are uncertain. Canadian export licenses and United States import licenses for the natural gas liquids are required to be renewed from time to time. The receipt of such licenses is not necessarily assured.

In connection with the natural gas liquids to be converted into gas by the reforming plant, the FEO granted the Company an interim determination in February 1974 exempting such liquids from certain propane allocation regulations pending further analysis of the circumstances by the FEO. Subsequently the FEO published revised Mandatory Petroleum Allocations effective June 1, 1974. Such allocation regulations are now administered by the FEA. As a result of the revisions, the Company was required to petition for an adjustment of its base period volume of feedstock. The February 1974 order of the FEO

will remain in effect until the FEA rules on the Company's petition. Receipt of a favorable ruling on the petition is not assured and failure to receive a favorable ruling could have a substantial adverse impact on the Company's ability to produce gas at the Marysville Gas Reforming Plant, the cost of producing reformed gas, and the Company's ability to serve its gas customers.

### Employees

The Company has approximately 11,300 employees, of whom about 5,200 operating, maintenance and construction employees are represented by the Utility Workers Union of America, AFL-CIO. The current working agreement between the Company and the Union was reached on August 31, 1971 and expires August 31, 1974. Pursuant to the agreement increases in wages were made on June 18, 1973, in addition to cost of living increases. The wage increases, together with wage increases placed in effect for office and technical employees, resulted in additional costs (before income taxes) in 1973 of approximately \$3,661,000 of which approximately \$2,770,000 was charged to operations.

## REGULATION

### Compliance With Environmental Requirements

The Company and its subsidiaries, Northe. and Storage Company, are subject to regulation with regard to environmental quality, including air and water quality (including thermal discharges) and other matters, by various Federal, State and local authorities and are also subject to zoning and other regulation by local authorities. The Company and its subsidiaries are attempting to insure that their facilities meet applicable environmental regulations and standards. However, it is not presently possible to forecast the ultimate effect of environmental quality regulations upon the existing and proposed facilities and operations of the Company and its subsidiaries. Moreover, developments in these and other areas may require the Company or its subsidiaries to modify, supplement, replace or cease operating equipment and facilities, and may delay or impede construction and operation of new facilities, at costs which could be substantial.

For many years the Company has followed an environmental protection program which included reforestation along Michigan rivers and the siting of electric generating plants and transmission lines with consideration for the impact of such facilities upon the environment. In more recent years the program has included installation of electrostatic precipitators to remove particulates from smoke emission at electric generating plants and conversion of electric generating units to burn cleaner fuels. The program through 1978 includes, among other things, installation of new precipitators and adding new controls and modifying previously installed precipitators at existing plants; utilization of coal with a lower sulfur content; construction of new smoke stacks at generating plants designed to reduce ground level concentrations of sulfur dioxide due to "downwash" conditions; and construction of ponds or towers to cool water at new generating plants before it is returned to its source. The Company made capital expenditures of \$45,000,000 in 1973 and estimates that it will make capital expenditures of more than \$330,000,000 during the five years 1974-1978 for environmental protection.

Regulations promulgated by the United States Environmental Protection Agency ("EPA") in August 1973 will require, unless other measures are approved by EPA, that various steps be taken by the Company to reduce emissions of sulfur dioxide at the J. H. Campbell Plant, Units 1 and 2; the D. E. Karn Plant, Units 1 and 2; the B. C. Cobb Plant and the J. C. Weadock Plant, Units 7 and 8. Such generating facilities have an aggregate generating capability of over 2,000 megawatts. Specifically the new regulations required that the Company should have notified EPA no later than October 1, 1973 of its intention to either (i) utilize fuel with a sulfur content of not more than 1½ percent or (ii) install stack gas desulfurization equipment to reduce emissions to an equivalent amount, not later than July 1, 1975. The new regulations further required that the Company notify EPA not later than January 31, 1974 of its intention to either (i) utilize fuel with a sulfur content of not more than 1 percent or (ii) install stack gas desulfurization equipment to reduce emissions to an equivalent amount, not later than July 1, 1978. Dates are also specified in the regulations for various increments of progress to be met in achieving the lowered

sulfur dioxide emissions by July 1, 1975 and July 1, 1978. The Company believes that adequate amounts of low sulfur fuel may not be available to permit conversion of such plants to low sulfur fuel. Moreover, the Company believes that stack gas desulfurization technology is not adequately developed to assure that any such equipment would allow satisfactory operation of its plants. In September 1973, the Company instituted suit in the U. S. Court of Appeals for the Sixth Circuit against EPA for review of the regulations which would require the Company to take immediate steps toward the reduction of sulfur dioxide emissions at the generating plants mentioned above. A stay of the regulations was issued by the Court. The matter is pending before the Court. The Company has entered into performance contracts ("compliance schedules") with the Michigan Air Pollution Control Commission regarding the four plants, under which compliance schedules the Company would be required to submit to the Commission by January 1, 1977 sulfur dioxide control strategies and time schedules for the implementation of the same not later than January 1, 1980. The compliance schedules also require the Company to monitor air quality in the vicinity of the four plants and to periodically report the results thereof to the Commission. Should the data secured by such monitoring at any time fail to substantiate that emissions from such plants are not causing or contributing to ambient levels of sulfur dioxide in excess of applicable air quality standards, the compliance schedules provide that the Company must then submit to the Commission sulfur dioxide control strategies and time schedules for the implementation thereof as expeditiously as practicable. The Company has submitted the compliance schedules to EPA for approval. Should EPA's approval be secured, the requirements of the new EPA regulations will be replaced by said compliance schedules. In a proposed rulemaking published in February 1974, EPA solicited public comment as to whether the compliance schedules should be approved.

EPA gave public notice in July 1973 that it intends to issue regulations setting up a mechanism for preventing "significant deterioration" of air quality in areas where air pollution levels are below the national ambient air quality standards. In announcing that it proposed to consider four alternative proposals for defining and preventing "significant deterioration", EPA stated that any policy adopted will have a substantial impact on the nature, extent and location of future industrial, commercial and residential development throughout the United States and could affect a number of economically and socially important matters, including the cost of producing and transporting electricity. The Company is unable to forecast the ultimate regulations that will be adopted by EPA in this matter, but it is likely that any such regulations will materially affect the Company's operating expenses and power resources.

Applications for water discharge permits for various of the Company's existing and proposed plants and facilities are currently pending under the Federal Water Pollution Control Act Amendments of 1972 (the "1972 Amendments"). In October 1973, the EPA delegated to an agency of the State of Michigan responsibility for processing the applications under the 1972 Amendments and applicable standards. With respect to existing facilities and plants, the 1972 Amendments require achievement of effluent limitations that necessitate the application of the "best practicable control technology currently available" by July 1, 1977 and the "best available technology economically achievable" by July 1, 1983. They also require that the standards for cooling water intake structures must reflect the "best technology available for minimizing adverse environmental impact." With respect to future steam electric power plants, standards of performance required to be established by the 1972 Amendments will require achievement of effluent limitations that necessitate the application of the "best available demonstrated control technology," including, where practicable, a standard permitting no discharge of pollutants. Proposed guidelines for effluent limitations have been issued by EPA for public comment. The Company is not presently able to evaluate the effect of any standard or guideline ultimately to be adopted, although such effect may be substantially adverse to the Company's operations.

The FEO issued regulations in May 1974 establishing priorities for use of certain low sulfur petroleum products. Such regulations are now administered by the FEA. The intent of the regulations is to prevent the use of low-sulfur fuel oil in new power generators, coal-to-oil fuel conversions and to delay shifts to lower sulfur content fuel oils than were in use in November 1973, except where such actions are required to achieve primary ambient air quality standards under the Federal Clean Air Act or to comply with EPA new source performance standards. The Company has arranged to purchase oil to fuel the D. E. Karn Units 3 and 4, two generating units scheduled to commence operation in 1974 and 1975, respectively. The Company is in the process of applying to the Michigan Air Pollution Control Commission for a

certification that the use of such oil is essential to meet the primary ambient air quality standards of the air quality region in which the plant is located. Under the regulations, the FEA is required to grant an exception to the regulations upon receipt of such a certification. Because the oil may be of lower sulfur content than required by primary ambient air quality standards, the Company may be required to apply for an exception from the regulations on other grounds. Receipt of such an exception is not assured, and the failure to receive the same could adversely affect the Company's cost of generating electricity with the units and/or the Company's ability to obtain an adequate supply of fuel to operate the units.

#### Michigan Public Service Commission

The Company is subject to the jurisdiction of the MPSC, which has general power of supervision and regulation of public utilities in Michigan with respect to rates, accounting, services, certain facilities, ascertainment of values, the issuance of securities, and various other matters.

Adjustment clauses authorized by the MPSC in 1973, provide for reflecting in the Company's residential gas and electric rates certain changes in fuel cost and cost of gas sold. Similar clauses had theretofore been in effect covering industrial and commercial rates. Together they permit recovery of substantially all of such fossil fuel cost increases after billing lags up to 60 days in the case of electric service and increases in cost of gas sold after billing lags up to 30 days in the case of gas service. In July 1974 the Company applied to the MPSC for authority to amend the adjustment clauses in its electric rates so as to eliminate the delay that presently occurs before increased fuel costs are collected and to include the cost of purchased and net interchange power in the adjustment. The Company is also requesting the MPSC to eliminate the billing delay with respect to gas service in connection with the partial rehearing ordered by the MPSC on its own motion on March 27, 1974 and referred to below.

In March 1973 the Company submitted applications to the MPSC to increase its electric rates by approximately \$59,000,000 annually and its gas rates by approximately \$83,000,000 annually. At the same time the Company requested interim gas rate relief of approximately \$55,600,000 annually pending the outcome of that rate case. In April 1973 the MPSC dismissed the applications without hearing (and without prejudice to the filing of new applications) principally on the grounds that the rate relief requested was excessive and contrary to criteria for public utility rate increases established in January 1973 by the Federal Cost of Living Council pursuant to the Federal Economic Stabilization Act of 1970, as amended, and contrary to similar criteria established under rules of the MPSC adopted in May 1972 pursuant to the aforesaid Federal Act. In May 1973, the Company petitioned the MPSC to reconsider such dismissal order, which petition is pending. In addition, in April 1973 the Company submitted new applications to the MPSC for authorization to increase its electric rates by approximately \$36,100,000 annually and its gas rates by approximately \$50,400,000 annually. In filing the new applications, the Company acted without prejudice to and with specific reservation of its legal rights to further challenge the MPSC's dismissal order of April 1973. In November 1973 the MPSC authorized interim rate increases, effective November 10, 1973, aggregating \$50,000,000, divided equally between the pending electric and gas rate proceedings, subject to refund, pending the final determination of the Commission and directed its Staff to cause an investigation to be made as to the planning and construction of the Marysville Gas Reforming Plant to determine whether the feasibility of the plant and its cost of construction were justified. In December 1973 the Attorney General of the State of Michigan instituted judicial review of the interim rate orders, including a request for a temporary injunction staying their effectiveness, which request has not been acted upon by the Court. On January 18, 1974, the MPSC authorized increases in the Company's electric and gas rates of \$31,000,000 and \$46,600,000, respectively, on an annual basis. The rate increases included the interim increases aggregating \$50,000,000 which were placed in effect November 10, 1973. Of the authorized gas rate increase, approximately \$14,571,000 became effective on April 20, 1974 after the second unit of the Marysville Gas Reforming Plant became fully and commercially operable. In response to requests for a rehearing on the authorized rate increases, including such a request by the Attorney General of Michigan, on March 27, 1974 the MPSC reaffirmed the electric rate increase granted on January 18, 1974, and on its own motion ordered a partial rehearing with respect to the gas rate increase.

Such rehearing, which has been partially completed, is limited to a review of the portion of the gas decision which allocates among residential, commercial and industrial customers the amount of revenues previously authorized and a consideration of the manner in which the cost of gas sold adjustment clauses of the rate operate to pass through increases in the cost of gas to the Company's various classes of customers. The MPSC also announced its decision to delay recognition of costs of the Marysville Gas Reforming Plant in excess of \$119,700,000 (which costs are estimated to presently aggregate \$155,000,000) pending completion of a performance audit conducted under the auspices of the MPSC Staff to be completed in 1974. Further, the MPSC also strongly urged the Company not to file any new gas rate application during the pendency of the limited rehearing which it directed to be completed by September 1, 1974.

In April 1974 the Company submitted an application to the MPSC to increase its electric rates by not less than \$72,159,000 annually and at the same time requested partial and interim relief in the amount of \$54,659,000 annually. It is not expected that the MPSC will act upon the application or the request for partial and interim relief until later in 1974 following hearings and other investigation of the requests.

In September 1969 the MPSC authorized increases in the Company's electric and gas rates of \$16,514,000 and \$21,308,000, respectively, on an annual basis. Litigation is pending in a State Court with respect to such increases, which became effective in 1969 and which are subject to refund relating to the reduction and elimination of the Federal income tax surcharge then in effect. The MPSC order authorizing the increases required that the rates be reduced to reflect any subsequent reduction in or expiration of the Federal income tax surcharge. However, in February 1970, the Court granted a temporary injunction permitting the Company to continue to collect the rates without adjustment for the later reduction and elimination of the income tax surcharge, subject to possible refund, with interest, of the amounts collected if the MPSC order with respect to the income tax surcharge had not been stayed by the Court. As a result of further authorizations by the MPSC in 1971 to increase electric and gas rates effective December 14 and December 23, 1971, respectively, the Company believes that there are no refund obligations with respect to service rendered subsequent to these dates. In March and April 1974, the Court ruled in favor of the MPSC with respect to the issue of the income tax surcharge and ordered the Company to refund \$24,542,632 to its electric and gas customers. In connection with this litigation, the Company has established a reserve stated net of related income taxes in the amount of \$11,867,818. The Company believes that the amount of such reserve is adequate to cover the refund obligation, exclusive of interest charges which are presently not capable of determination but which may be substantial in amount. The Company is undertaking to seek judicial review of the Court orders of March and April 1974, including a request for a stay of the refund pending further judicial action. The pending litigation, which also involves appeals taken by the Company as well as by parties opposing the rate increases, includes, among other things, a claim for refunds to customers amounting to approximately \$7,763,000, plus interest charges which are presently not capable of determination, for which no reserve has been provided. This claim is based upon the circumstance that the electric rates were placed in effect by the Court's order on October 22, 1969, but the MPSC did not issue an order approving such rates until April 20, 1970.

In 1974, the MPSC issued proposed rules covering customer standards and billing practices for residential electric and gas service. Among other things, the rules would require utilities to extend the time for payment of service bills, eliminate late payment charges and, in most instances, security deposits, establish procedures to provide customers with opportunity for hearing with respect to contested service bills prior to service termination, and other similar provisions. If the rules become effective they are likely to add substantially to the Company's cost of rendering service and could lead to substantial increases in delinquent payments for utility services rendered.

In the opinion of the General Counsel for the Company, Storage Company and Northern are not public utilities under the laws of Michigan.

#### **Federal Power Commission**

The FPC has jurisdiction over Storage Company as a natural gas company within the meaning of the Natural Gas Act, which jurisdiction relates, among other things, to the acquisition and operation of assets and facilities and to rates charged by Storage Company. If the Company obtains from Northern deliveries of gas produced in offshore Louisiana, as described under "Business—Gas Service", Northern will be



subject to FPC's jurisdiction as a natural gas company within the meaning of the Natural Gas Act. In instances of shortage of supply, the FPC has entered orders curtailing deliveries of natural gas transmitted by interstate pipelines to various users to amounts less than provided in their gas sales contracts. Under certain circumstances, the FPC also has the power under the Natural Gas Act to modify gas sales contracts of interstate pipeline companies. The FPC has adopted an end-use priority system for pipeline curtailments and is now considering adoption of a proposed rule which would make the end-use priority system also applicable to certificate proceedings for transmission of additional gas supplies. The end-use priority system places residential and small commercial service in the highest priority and interruptible service in the lowest priority. As natural gas companies under the Natural Gas Act, Panhandle, Trunkline and Storage Company, which provide the major portion of the Company's gas supply, are subject to the FPC's regulations. The effect of FPC regulations, present or future, upon the Company's gas supply and operations cannot be determined although such effect may be materially adverse.

The Company has accepted licenses under Part I of the Federal Power Act for a number of its constructed hydroelectric projects. The Company and The Detroit Edison Company have accepted a license extending to the year 2019 from the FPC to construct, operate and maintain the Ludington Pumped Storage Plant. As a licensee, certain of the Company's operations are subject to regulation by the FPC, including compliance with the FPC's rules and regulations respecting accounting applicable to licensees. The Act provides that if a new license for a hydroelectric project is not issued to the original licensee upon expiration of the original license, a new license may be issued to a new licensee, or the United States may take over the project, upon paying severance damages, if any, and the amount of the original licensee's "net investment" in the project but not in excess of the fair value thereof.

By reason of the interconnections linking the electric system of the Company with the systems of companies in other states, the Company is a "public utility" under Part II of the Federal Power Act and certain of the Company's operations are subject to regulation by the FPC, including compliance with the FPC's rules and regulations respecting accounting applicable to "public utilities", the transmission of electric energy in interstate commerce and the rates and charges for the sale of such energy at wholesale, as provided by the Federal Power Act. The Company is also subject to the general supervision and regulation of the MPSC as described above, including the fixing of almost all retail rates and charges for the sale of electricity and gas.

In November 1972, the Company tendered for filing with the FPC proposed increases in its wholesale electric rates so as to increase the Company's wholesale electric revenues approximately \$1,500,000 on an annual basis. The increased rates became effective in June 1973, subject to refund, pending FPC determination as to their reasonableness. A number of municipal electric systems and rural electric cooperatives intervened in the proceeding and opposed the proposed increases. Hearings upon the Company's application and related issues have been held in abeyance pending settlement discussions involving the Company, the intervenors and the FPC staff. A proposal of settlement satisfactory to all of the parties was submitted to the FPC for approval in late June 1974. Under such proposal, the Company's wholesale electric rates would be increased so as to increase the Company's electric revenues by approximately \$1,030,000 annually as of June 7, 1973 and appropriate refunds of a portion of sums collected under the rates which became effective in June 1973, together with interest thereon, would be required to be made by the Company.

#### **Atomic Energy Commission**

In 1967 the AEC granted the Company a permit to construct the Palisades Nuclear Plant, described under "Construction Expenditures" above. In March 1970, the AEC gave public notice of its proposed issuance of a provisional operating license for the plant. Thereafter, a number of organizations and individuals intervened in the proceedings before the AEC and opposed the licensing of the plant. In view of the crucial importance of getting the plant in operation at the earliest possible date, and faced with indefinite delays in completion of the AEC hearing, the Company reached an agreement with the intervenors in March 1971 whereby the Company would install cooling towers to substantially eliminate thermal discharges into Lake Michigan and other equipment to eliminate release of virtually all radioactive materials in liquid discharges and, subject to certain conditions, the intervenors agreed to withdraw their opposition to a full-power operating license. The additional facilities, which cost an

estimated \$30,000,000 to construct, are expected to result in additional annual costs in excess of \$5,000,000 attributable to reduced thermal efficiency of the plant, some curtailment of generating capability and increased operating and maintenance expenses, as well as fixed charges on the invested capital.

The Palisades Nuclear Plant has been out of service for the reasons described in Note 17 to the Statement of Income herein. In addition, public hearings may be required by the AEC before the plant is returned to commercial operation. The operating license issued by the AEC for the plant is provisional in nature and was scheduled to expire in March 1974, but was automatically extended pending AEC action on the Company's application for a full-term, 40-year operating license. The application will be subject to the right of any person whose interest may be affected by the proceeding to intervene and request a public hearing on the application.

In 1971, the AEC announced that it was reviewing the adequacy of emergency core cooling systems in light-water power reactors, and thereafter held a public rule-making hearing with respect to new regulations covering the design of such emergency core cooling systems. In December 1973, the AEC announced its new regulations which provide that licensees, including the Company, must submit to the AEC by early August 1974, except as extensions are granted, a plan detailing how compliance with the new rules will be achieved for each of the nuclear plants affected. The effect of the new rules upon the Company's plants has not yet been determined, but it may be necessary to modify the designs of the Big Rock Point Plant, the Palisades Nuclear Plant and the Midland Plant (referred to below) and it may be necessary to derate the Big Rock Point Plant and/or the Palisades Nuclear Plant. The cost of such potential modifications and deratings cannot be estimated at this time but could be substantial. Intervenor in the AEC rule-making proceeding have taken an appeal to the U. S. Court of Appeals for the District of Columbia Circuit (Docket No. RM50-1) from the AEC regulations issued in December 1973.

In May 1973 a suit was commenced against the AEC for a declaratory judgment and injunctive relief. The suit sought to compel the revocation of operating licenses heretofore issued by the AEC for 20 nuclear generating units, including the Palisades Nuclear Plant. The basis for the suit was that operation of these units in accordance with certain AEC interim criteria for emergency core cooling systems allegedly constitutes a threat to the public health and safety. The court dismissed the suit. In July 1973 the plaintiffs in such suit petitioned the AEC to revoke immediately the operating licenses of the 20 nuclear generating units on the same grounds alleged in the lawsuit. The petition was denied and an appeal from the denial is now pending before the U. S. Court of Appeals for the District of Columbia Circuit (Docket No. 73-1872).

In 1969 the Company applied to the AEC for permits to construct the Midland Plant, described under "Construction Expenditures" above. Various organizations and individuals intervened in the proceeding and objected to the granting of such permits. After extended hearings the AEC issued construction permits for the Midland Plant in December 1972. Thereafter the intervenors appealed the granting of the permits and in May 1973 an Atomic Safety and Licensing Appeal Board of the AEC affirmed the issuance of the construction permits, subject to conditions imposing several new reporting requirements with respect to quality assurance matters. Construction on the site, which was halted in November 1970, was resumed in June 1973. In the summer of 1973, the intervenors instituted appeals to the U. S. Court of Appeals for the District of Columbia Circuit (Docket Nos. 73-1776 and 73-1867) from the action of the AEC in granting the construction permits and such appeals are pending. In May 1972 some of the intervenors began suit in a Federal Court to prevent construction of the Midland Plant, contending that the AEC had not complied with the National Environmental Policy Act of 1969 in the proceedings for issuance of the construction permits for the plant. The Company and the AEC have moved to dismiss the suit. In March 1973 another intervenor began suit in a State Court in Jackson County, Michigan, seeking damages and a declaratory judgment that the plant violates a Michigan environmental protection act and constitutes a nuisance. The case was transferred to Midland County, Michigan, where it was decided in the Company's favor in June 1974 on motions based on legal grounds. An appeal from such decision is expected. Following AEC inspections of the implementation of the quality assurance program at the Midland construction site, the AEC's Director of Regulation issued an order in December 1973 for the Company to show cause why all activities under the construction permits for the Midland Plant should not be suspended pending a showing that the Company is in compliance with the AEC's quality assurance regulations and that there is reasonable assurance that such compliance will continue throughout the construction process. The

Company responded to the order to show cause by a motion to dismiss and an answer noting that the most recent AEC inspection had found the Company to be in compliance with AEC quality assurance regulations. Certain of the intervenors in the construction permit proceeding requested a hearing on the order to show cause. Also, in December 1973, the same intervenors petitioned the AEC to revoke the construction permits for the Midland Plant. The AEC, in January 1974, denied the petition to revoke the construction permits, denied the Company's motion to dismiss the order to show cause, and granted the intervenors' requests for a public hearing. A hearing on the show cause order commenced in July 1974. If the Atomic Safety and Licensing Board appointed to conduct the hearing decides that the Company is not implementing its quality assurance program in compliance with AEC regulations, or that there is not reasonable assurance that such implementation will continue throughout the construction process, it will determine whether the construction permits for the Midland Plant shall be modified, suspended or revoked, or whether other action is warranted by the record. The Company is unable to predict the outcome of these proceedings before the AEC, as well as the outcome of the litigation described in this paragraph and the immediately preceding paragraph. However, if the Company is not successful in the AEC proceedings or the litigation, the effect upon the Company's operating expenses and its power resources could be materially adverse.

In January and February 1974, certain individuals reported to the AEC and publicly charged that the Company and certain of its employees had, in 1972 and early 1973, willfully and wrongfully withheld information from the AEC, and falsified information submitted to the AEC, about malfunctioning of the waste gas decay system and other occurrences at the Company's Palisades Nuclear Plant. AEC representatives have investigated the charges and have cited the Company for several license violations in connection with the charges. The Company could be subject to monetary or other civil penalties in connection with such violations. The U. S. Attorney General has been requested to investigate the matter, and an organization has petitioned the AEC to issue a show cause order or to hold a hearing on whether the operating license of the Palisades Nuclear Plant should be revoked, suspended or modified or other penalties imposed in connection with the charges. The AEC investigators have found that there is no basis to conclude that the Company or its employees deliberately withheld any clearly reportable information. The matter is still pending before the Attorney General.

Under amendments to the Atomic Energy Act which became effective in December 1970, applications to construct commercial nuclear reactors are subject to review to determine whether the activities under the license would create or maintain a situation inconsistent with the Federal antitrust laws and the AEC is required to refer such applications to the Attorney General of the United States for his advice. In June 1971, the Attorney General advised the AEC that the granting of authorization to construct the Midland Plant "may maintain a situation inconsistent with the antitrust laws" and recommended that the AEC conduct a hearing to determine whether there is any factual basis to so find. A number of municipal electric systems and generating and transmission cooperatives have intervened in the proceeding. The AEC is authorized to issue or refuse to issue any license applied for or to issue a license with such conditions as it deems appropriate, and if it finds there are adverse antitrust aspects involved in any license applications, it is also to consider, in determining whether a license shall be issued, such other factors as in its judgment it deems necessary to protect the public interest including the need for power in the affected area. The Attorney General has indicated an intention to seek conditions in any license for the Midland Plant which would, among other things, require the Company to interconnect and share reserves with any utility engaged or proposing to engage in the generation of electric power, require the Company to engage in coordinated operations, development and electric plant construction with any such other electric utility, and to wheel power across the Company's transmission system. An AEC hearing with respect to the antitrust issues began in late 1973 and concluded in June 1974. An initial decision is expected later in 1974.

In December 1972 the AEC amended the Big Rock Point Plant operating license to authorize the use of a full core loading of nuclear fuel containing plutonium as well as uranium. The transition to the use of such fuel will extend over a period of several years, with a few fuel assemblies having been installed in 1973 and with greater use of such fuel to occur in 1974 and later years. The use at the Big Rock Point Plant of developmental fuel assemblies and fuel rods containing plutonium had been authorized and

carried out since 1969. In March 1973 an organization began suit in the U. S. District Court for Western Michigan (File No. G58-73CA) to prevent the use of such plutonium fuel at the Big Rock Point Plant. A temporary injunction against the 1973 fuel loading was refused by the Court. The lawsuit is pending and is opposed by the Company as well as by the AEC. In April 1973 the AEC offered an opportunity for public hearing on the December 1972 license amendment and the organization opposing the use of plutonium fuel at the plant has been granted the right to intervene and to have a public hearing. The matter is pending (AEC Docket No. 50-155). In June 1974, the Court ordered the lawsuit held in abeyance pending completion of the AEC proceeding.

Under the Price-Anderson amendments to the Atomic Energy Act, the Company maintains public liability insurance and agreements of indemnity with the AEC to cover public liability for the consequences of nuclear incidents which might occur at the Company's nuclear power plants. Such nuclear insurance and indemnity coverage does not include coverage of the plant facilities themselves. To cover possible damage to these facilities, the Company maintains property damage insurance from Nuclear Mutual Limited, a Bermuda mutual insurance company of which the Company is a member, in the maximum amount available from such insurer, which is presently \$100,000,000, or the insurable value of the facility, whichever is less. Except for the Company's Big Rock Point Plant, such insurance does not equal in amount the sums invested or to be invested in the Company's nuclear plants. The Company is therefore a self-insurer for any loss to its nuclear plant facilities to the extent its investment in them exceeds \$100,000,000 at any location. The Company regards this risk to be acceptable because of the very low probabilities of occurrence believed to be associated with incidents which could give rise to losses in excess of the insurance. The Company's practice in this regard is consistent with that of other utilities similarly situated. It is expected that the amount of available insurance coverage will soon be increased by Nuclear Mutual Limited to \$130,000,000.

In May and June 1974, following a request by an organization that the AEC review the Company's continuing financial qualifications to construct the Midland Plant and operate the Palisades Plant, in view of the Company's declining earnings and other events, the AEC requested the Company to furnish to it certain information as to the Company's financial condition and financing plans. The Company furnished the requested information in June 1974 and the matter is pending.

#### **Equal Employment Opportunity Commission**

In January 1972 the U. S. Equal Employment Opportunity Commission ("EEOC") charged the Company and the Utility Workers of America with violation of Title VII of the 1964 Civil Rights Act, alleging discrimination against Negroes and females in matters of hiring, promotion, training, compensation, membership, referral representation and other terms and conditions of employment. An investigation was conducted and an *ex parte* decision was rendered by the EEOC finding reasonable cause to believe that the Company discriminated against females and that the Union failed to equally represent females. EEOC has proposed a conciliation agreement be negotiated with the Company as a means of correcting the alleged discrimination, but no such agreement has yet been entered into.

## OPERATING STATISTICS

	Year Ended December 31					Twelve Months Ended May 31, 1974
	1969	1970	1971	1972	1973	
<b>Electric Energy Generated, Purchased and Sold</b> (Thousands of Kwh):						
Generated—after station loss and use:						
Fossil Fuel.....	17,517,548	17,701,285	17,465,481	17,379,239	17,360,718	16,584,835
Nuclear .....	401,049	362,430	368,988	2,125,281	2,834,049	1,510,330
Hydro .....	495,638	438,625	438,635	410,287	1,422,871	1,314,554
Purchased (including interchange).....	1,848,148	2,268,680	4,118,538	4,404,300	6,112,898	7,911,176
Less energy for pumping.....	—	—	—	(11,622)	(1,380,519)	(1,917,670)
<b>Total Electric Energy Generated and Purchased .....</b>	<b>20,262,383</b>	<b>20,771,020</b>	<b>22,391,642</b>	<b>24,307,485</b>	<b>26,350,017</b>	<b>25,903,225</b>
Lost, unaccounted for and used by Company.....	(1,783,020)	(1,964,343)	(1,895,889)	(2,229,011)	(2,248,017)	(2,246,517)
<b>Total Energy Sold .....</b>	<b>18,479,363</b>	<b>18,806,677</b>	<b>20,495,753</b>	<b>22,078,474</b>	<b>24,102,000</b>	<b>23,656,708</b>
<b>Electric Sales (Thousands of Kwh):</b>						
Residential.....	5,546,263	5,931,840	6,328,749	6,841,221	7,090,854	7,131,275
Commercial .....	3,673,709	4,027,215	4,349,075	4,699,559	5,160,245	5,143,314
Industrial .....	8,578,389	8,073,913	8,972,723	9,575,919	10,773,530	10,239,761
Interdepartmental and Other.....	191,951	208,526	223,849	235,871	239,152	231,401
<b>Total Sales to Ultimate Consumers.....</b>	<b>17,990,312</b>	<b>18,241,494</b>	<b>19,874,396</b>	<b>21,352,570</b>	<b>23,263,781</b>	<b>22,745,751</b>
Power Pool .....	—	—	—	—	—	—
Other Resale.....	489,051	565,183	621,357	725,904	838,219	910,957
<b>Total Electric Sales .....</b>	<b>18,479,363</b>	<b>18,806,677</b>	<b>20,495,753</b>	<b>22,078,474</b>	<b>24,102,000</b>	<b>23,656,708</b>
<b>Gas Produced, Purchased and Sold (1,000 cubic feet):</b>						
Gas Produced and Purchased:						
Marysville Reforming Plant.....	—	—	—	—	8,285,680	30,076,281
Michigan Fields .....	16,600,080	17,196,639	13,194,067	18,905,307	26,266,614	29,745,620
Trunkline Gas Company.....	197,825,691	226,111,937	247,445,052	231,889,872	193,031,460	183,262,040
Michigan Gas Storage Company.....	87,821,500	90,697,573	88,327,683	95,612,848	88,973,946	87,968,580
Other purchases .....	—	—	—	—	21,989,179	21,599,978
<b>Total Gas Produced and Purchased.....</b>	<b>302,247,271</b>	<b>334,006,149</b>	<b>348,966,802</b>	<b>346,408,027</b>	<b>338,546,879</b>	<b>352,652,499</b>
Net (to) from Storage .....	(10,937,194)	(13,896,516)	(9,882,117)	15,550,365	1,633,498	(18,001,437)
Compressor Station and Other Use .....	(2,724,061)	(3,604,715)	(2,871,811)	(2,455,853)	(2,835,560)	(2,355,813)
Lost, unaccounted for and used by Company.....	(6,824,203)	(6,160,960)	(2,339,363)	(6,239,695)	(7,585,417)	(5,785,988)
<b>Total Gas Sold .....</b>	<b>281,761,813</b>	<b>310,343,958</b>	<b>333,873,511</b>	<b>353,262,844</b>	<b>329,759,400</b>	<b>326,509,261</b>
<b>Gas Sales (1,000 cubic feet):</b>						
Residential—Home Heating.....	120,060,276	134,425,759	138,223,552	150,602,418	136,323,024	139,790,436
Other Residential .....	3,997,083	3,733,980	3,225,088	3,313,156	3,016,273	2,865,187
Industrial and Commercial.....	139,497,140	152,704,824	176,350,317	187,916,368	183,124,071	176,517,956
Interdepartmental .....	7,214,920	18,507,064	15,262,159	11,430,902	7,296,077	7,335,687
<b>Total Sales to Ultimate Consumers.....</b>	<b>279,769,419</b>	<b>309,381,627</b>	<b>333,061,117</b>	<b>353,262,844</b>	<b>329,759,400</b>	<b>326,509,261</b>
Resale .....	1,992,394	962,331	812,394	—	—	—
<b>Total Gas Sales .....</b>	<b>281,761,813</b>	<b>310,343,958</b>	<b>333,873,511</b>	<b>353,262,844</b>	<b>329,759,400</b>	<b>326,509,261</b>
Sales of Steam (1,000 pounds) .....	847,854	814,225	742,650	682,412	655,895	671,938

## DESCRIPTION OF NEW BONDS

### General

The New Bonds are to be issued under an Indenture dated as of September 1, 1945, between the Company and First National City Bank, as Trustee, as supplemented by various supplemental indentures (the "Mortgage"), copies of which are filed as exhibits to the registration statement. In connection with the change of the State of incorporation from Maine to Michigan in 1968, the Company succeeded to and was substituted for the Maine corporation under the Mortgage. The statements herein concerning the New Bonds and the Mortgage are an outline and do not purport to be complete. They make use of defined terms and are qualified in their entirety by express reference to the cited sections and articles of the Mortgage.

The New Bonds will mature August 1, 1994 and will bear interest at the rate shown in their title, payable semi-annually on February 1 and August 1 in each year. Interest will, subject to certain exceptions, be paid to holders registered at the close of business on the January 15 or July 15, as the case may be, next preceding the interest payment date. The New Bonds will be issued only as registered Bonds without coupons in denominations of \$1,000 and any multiple thereof. The New Bonds are exchangeable, in each case for a like aggregate principal amount of New Bonds of other authorized denominations, and are transferable, at the corporate trust office of the Trustee in New York City, without payment of any charge other than for any tax or other governmental charge required to be paid by the Company. (Twenty-seventh Supplemental Indenture, Section 1.)

The Company will make application for the listing of the New Bonds on the New York Stock Exchange.

### Priority and Security

The New Bonds will rank pari passu as to security with bonds of other series now outstanding or hereafter issued under the Mortgage, which, in the opinion of the Company's General Counsel, is a direct first lien on substantially all the Company's fixed property and franchises, subject only to excepted encumbrances as defined in the Mortgage. The Mortgage permits, with certain limitations specified in Section 7.05, the acquisition of property subject to prior liens and, under certain conditions specified in Section 7.14, permits the issuance of additional indebtedness under such prior liens to the extent of 60% of net property additions made by the Company to the property subject to such prior liens.

### Sinking (Improvement) Fund Requirement

The Mortgage (Section 2.12) provides for annual sinking fund payments, which began in 1956, in an amount equal to 1% of the aggregate principal amount of bonds authenticated (exclusive of bonds authenticated to refund other bonds) prior to January 1 of the year in which the deposit is made less certain bonds retired. Payments may be made in cash or in principal amount of bonds authenticated under the Mortgage, whether or not such bonds have previously been disposed of by the Company. Deposited cash is to be used to retire bonds of such series (one or more) as the Company may designate or may be withdrawn by the Company against the deposit of bonds. After the bonds of all series created prior to December 31, 1959 have been retired, the sinking fund will be replaced by an improvement fund and the improvement fund requirement (which will then be 1% of the principal amount of bonds of any other series having such an improvement fund requirement less certain bonds retired) may also be satisfied and cash withdrawn to the extent of 60% of unfunded net property additions.

Section 2 of the Twenty-seventh Supplemental Indenture provides that, so long as any New Bonds are outstanding, the Company shall, as a sinking fund for the retirement of New Bonds, deliver to the Trustee \$3,000,000 in cash or in principal amount of New Bonds on August 1 of each year, beginning with 1979 and to and including 1993. The Company has the non-cumulative option to increase any such sinking fund payment by an amount not exceeding such sinking fund payment and can take credit against any such payment for the principal amount of New Bonds retired on or before any such August 1 by operation of the provisions of Section 2.12 of the Mortgage. Not more than \$6,000,000 aggregate principal amount of New Bonds may be redeemed on any such August 1 by operation of the provisions of Section 2.12 of the Mortgage and of Section 2 of the Twenty-seventh Supplemental Indenture, and none of the New Bonds may be redeemed prior to August 1, 1979 by operation of the provisions of said Section 2.12.

### **Maintenance and Replacement Requirement**

The Mortgage (Section 7.07) requires the Company as of the end of each calendar year to have applied for maintenance, renewals and replacements of the mortgaged and pledged property, with certain exceptions, the greater of the following amounts: (i) 15% of gross operating revenues derived by the Company subsequent to December 31, 1945 and up to the end of such calendar year from such mortgaged and pledged property after deducting the cost of electricity, gas and steam purchased for resale or (ii) the sum of the amounts equal to 4% of the principal amount of bonds outstanding at the end of each calendar year, or to the extent of any deficiency to certify to the Trustee unfunded net property additions or deposit with the Trustee cash or bonds (taken at their principal amount). A credit balance established in any year may be carried forward and used to meet requirements during a later period or in effect a withdrawal of deposited cash or bonds or to restore as unfunded property any property previously certified.

### **Issuance of Additional Bonds**

Additional bonds may be issued under the Mortgage to the extent of 60% of unfunded net property additions or against the deposit of an equal amount of cash, if, for any period of twelve consecutive months within the fifteen preceding calendar months, the net earnings of the Company (before income or excess profits taxes) shall have been at least twice the interest requirements for one year on all bonds outstanding and to be issued and on indebtedness of prior or equal rank. Additional bonds may also be issued to refund bonds theretofore outstanding under the Mortgage. Deposited cash may be applied to the retirement of bonds or be withdrawn to the extent of 60% of unfunded net property additions. (Articles I, IV, V and VI.)

The New Bonds are to be issued against unfunded net property additions which, at May 31, 1974, amounted to approximately \$695,000,000.

### **Release and Substitution of Property**

The Mortgage provides that, subject to various limitations, property may be released from the lien thereof when sold or exchanged, upon the basis of cash deposited with the Trustee, bonds or purchase money obligations delivered to the Trustee, prior lien bonds delivered to the Trustee or reduced or assumed by the purchaser, property additions acquired in exchange for the property released, or upon a showing that unfunded net property additions exist. The Mortgage also permits the withdrawal of cash upon a showing that unfunded net property additions exist or against the deposit of bonds or the application thereof to the retirement of bonds. (Articles VI, VII and X.)

### **Limitations on Dividends**

The Mortgage (Section 7.15) in effect prohibits the payment of cash dividends on Common Stock except out of retained earnings accumulated after September 30, 1945 and unless after such payment there remains of such retained earnings an amount equivalent to the amount by which the charges to income or retained earnings since December 31, 1945 for repairs, maintenance and depreciation shall have been less than the maintenance and replacement requirement computed in accordance with Section 7.07 of the Mortgage. Other restrictions on dividends are imposed by the Articles of Incorporation of the Company. Reference is made to Note 10 to Financial Statements.

### **Modification of Mortgage**

The Mortgage, the rights and obligations of the Company and the rights of the bondholders may be modified by the Company only with the consent of the holders of 75% in principal amount of the bonds and of not less than 60% of the principal amount of each series affected. However, no modification of the terms of payment of principal or interest and no modification affecting the lien or reducing the percentage required for modification is effective against any bondholder without his consent. (Article XVII.)

### **Redemption Provisions**

The New Bonds will be redeemable at the option of the Company in whole or in part at any time on thirty days' notice at the principal amount and accrued interest, (a) without premium if redeemed for the

sinking fund or (b) plus the regular redemption premiums set forth below for all other redemptions; provided, however, that none of the New Bonds shall be redeemed prior to August 1, 1984 at the regular redemption premiums if such redemption is for the purpose or in anticipation of refunding such New Bond through the use, directly or indirectly, of funds borrowed by the Company at an effective interest cost to the Company (computed in accordance with generally accepted financial practice) of less than 11.375% per annum. (Twenty-seventh Supplemental Indenture, Section 1.)

If redeemed during 12 months period ending the last day of July	Regular Redemption Premium %	If redeemed during 12 months period ending the last day of July	Regular Redemption Premium %
1975 .....	11.38	1985 .....	5.39
1976 .....	10.78	1986 .....	4.79
1977 .....	10.18	1987 .....	4.19
1978 .....	9.58	1988 .....	3.59
1979 .....	8.98	1989 .....	2.99
1980 .....	8.38	1990 .....	2.39
1981 .....	7.78	1991 .....	1.80
1982 .....	7.18	1992 .....	1.20
1983 .....	6.59	1993 .....	.60
1984 .....	5.99		

and without premium if redeemed after July 31, 1993.

#### Concerning the Trustee

In the regular course of business, the Company and its subsidiaries borrow short-term funds from several banks for the companies' purposes. During 1973, the Company made short-term bank borrowings from time to time, each at the prime interest rate then in effect, from First National City Bank in the maximum amount of \$27,000,000 at any one time outstanding. On June 20, 1974 the Company borrowed \$50,000,000 from such bank as described under "Capitalization". First National City Bank is Trustee of the Employees' Savings Plan of the companies and Mr. E. Newton Cutler, Jr., Senior Vice President of First National City Bank, is a director of the Company.

The Trustee or the holders of 20% in aggregate principal amount of the bonds may declare the principal due on default, but the holders of a majority in aggregate principal amount may annul such declaration and waive the default if the default has been cured. (Section 11.05.) The holders of a majority in aggregate principal amount may direct the time, method and place of conducting any proceeding for the enforcement of the Mortgage. (Sections 11.01 and 11.12.) No bondholder has the right to institute any proceedings for the enforcement of the Mortgage unless such holder shall have given the Trustee written notice of a default, the holders of 20% shall have tendered to the Trustee indemnity against costs, expenses and liabilities and requested the Trustee to take action, the Trustee shall have declined to take action or failed so to do within sixty days and no inconsistent directions shall have been given by the holders of a majority. (Section 11.14.) The Trustee is not required to advance or risk its own funds or otherwise incur personal financial liability in the performance of any of its duties if there is reasonable ground for believing that repayment is not reasonably assured to it. (Section 16.03.)

#### Defaults

By Section 11.01 of the Mortgage, the following are defined as "defaults":

Failure to pay principal when due; failure to pay interest for sixty days; failure to pay any installment of any sinking or other purchase fund for ninety days; certain events in bankruptcy, insolvency or reorganization; and failure to perform any other covenant for ninety days following written demand by the Trustee for the Company to cure such failure. By Section 9.03, a failure to provide money for the redemption of bonds called for redemption also constitutes a default. The Mortgage does not require any periodic evidence to be furnished as to the absence of default or as to compliance with the terms thereof.



## EXPERTS

The Financial Statements including the Statement of Income for the five years ended December 31, 1973 set forth in this Prospectus have been examined by Arthur Andersen & Co., independent public accountants, as indicated in their report with respect thereto, and are included herein in reliance upon the authority of said firm as experts in auditing and accounting in giving such report.

Statements under "Regulation" and "Description of New Bonds", as to matters of law and legal conclusions, have been reviewed by Harold P. Graves, Esq., General Counsel for the Company, and all such statements are made on his authority as an expert.

## LEGAL OPINIONS

The legality of the securities offered hereby will be passed upon for the Company by Harold P. Graves, Esq., or James B. Falahee, Esq., Jackson, Michigan, General Counsel and General Attorney, respectively, for the Company, and by Messrs. Winthrop, Stimson, Putnam & Roberts, New York, N. Y., and for the Underwriters by Messrs. Simpson Thacher & Bartlett, New York, N. Y.

As of May 31, 1974, 830 shares of common stock of the Company were credited to Harold P. Graves' account in the Employees' Savings Plan. He and his wife own as joint tenants 189 shares of common stock of the Company. Mr. Graves is an officer of the Company and a director and/or an officer of each of its subsidiaries.

As of May 31, 1974, 297 shares of common stock of the Company were credited to James B. Falahee's account in the Employees' Savings Plan. He and his wife own as joint tenants 75 shares of common stock of the Company. Mr. Falahee is employed by the Company as General Attorney.

## UNDERWRITERS

Under the terms of and subject to the conditions contained in an Underwriting Agreement dated July 17, 1974, the Underwriters named below have severally agreed to purchase, and the Company has agreed to sell to each Underwriter, severally, the respective principal amounts of New Bonds set forth below.

<u>Name</u>	<u>Principal Amount</u>	<u>Name</u>	<u>Principal Amount</u>
Morgan Stanley & Co. Incorporated	\$ 9,150,000	Josephthal & Co.	\$ 150,000
Adams & Peck	250,000	Kidder, Peabody & Co. Incorporated	900,000
Advest Co.	300,000	Kormendi, Byrd Brothers, Inc.	250,000
American Securities Corporation	400,000	Kuhn, Loeb & Co.	900,000
A. E. Ames & Co. Incorporated	250,000	Ladenburg, Thalmann & Co. Inc.	400,000
Arnhold and S. Bleichroeder, Inc.	400,000	Lazard Freres & Co.	900,000
Bacon, Whipple & Co.	400,000	Legg Mason/Wood Walker Div. of First Regional Securities, Inc.	300,000
Robert W. Baird & Co. Incorporated	400,000	Lehman Brothers Incorporated	900,000
Brexeman Eichler, Hill Richards, Incorporated	400,000	Lepercq, de Neufville & Co. Incorporated	250,000
Bear, Stearns & Co.	700,000	Loeb, Rhoades & Co.	900,000
William Blair & Company	400,000	Loewi & Co. Incorporated	300,000
Blunt Ellis & Simmons Incorporated	400,000	Manley, Bennett, McDonald & Co.	300,000
Blyth Eastman Dillon & Co. Incorporated	900,000	McDonald & Company	400,000
Boettcher & Company	300,000	McLeod, Young, Weir, Incorporated	150,000
Bosworth, Sullivan & Company, Inc.	150,000	McMaster Hutchinson & Co.	250,000
J. C. Bradford & Co.	400,000	Merrill Lynch, Pierce, Fenner & Smith Incorporated	1,200,000
Alex. Brown & Sons	500,000	The Milwaukee Company	250,000
Butcher & Singer	300,000	Moore, Leonard & Lynch, Incorporated	250,000
The Chicago Corporation	250,000	Moseley, Hallgarten & Estabrook Inc.	500,000
City Securities Corporation	150,000	Newhard, Cook & Co. Incorporated	150,000
Crowell, Weedon & Co.	300,000	The Ohio Company	400,000
Dain, Kalman & Quail, Incorporated	400,000	Paine, Webber, Jackson & Curtis Incorporated	900,000
Dillon, Read & Co. Inc.	900,000	Parker/Hunter Incorporated	150,000
Drexel Burnham & Co. Incorporated	900,000	Piper, Jaffray & Hopwood Incorporated	400,000
A. G. Edwards & Sons, Inc.	300,000	Wm. E. Pollock & Co., Inc.	400,000
Edwards & Hanly	400,000	Prescott, Ball & Turben	400,000
Elkins, Morris, Stroud & Co.	300,000	R. W. Pressprich & Co. Incorporated	500,000
Fahnestock & Co.	300,000	Paffensperger, Hughes & Co., Inc.	150,000
The First Boston Corporation	1,200,000	Rand & Co., Inc.	150,000
First Equity Corporation of Florida	150,000	Rauscher Pierce Securities Corporation	400,000
First of Michigan Corporation	500,000	Reinholdt & Gardner	400,000
First Southwest Company	150,000	Reynolds Securities Inc.	900,000
Folger Nolan Fleming Douglas Incorporated	400,000	The Robinson-Humphrey Company, Inc.	400,000
Fulton, Reid & Staples, Inc.	250,000	Wm. C. Roney & Co.	300,000
Goldman, Sachs & Co.	900,000	Rotan Mosie Inc.	300,000
Greenshields & Co Inc	250,000	L. F. Rothschild & Co.	700,000
Halsey, Stuart & Co. Inc.	300,000	Salomon Brothers	1,200,000
Harris, Upham & Co. Incorporated	500,000	Shields Securities Corporation	700,000
Hayden Stearns Inc.	500,000	Shuman, Agnew & Co., Inc.	400,000
Herzfeld & Stern	250,000	Smith, Barney & Co. Incorporated	900,000
J. J. B. Hilliard, W. L. Lyons, Inc.	250,000	SoGen Swiss International Corporation	500,000
Hoppin, Watson Inc.	250,000	Stern Brothers & Co.	250,000
Hornblower & Weeks-Hemphill, Noyes Incorporated	900,000	Stern, Frank, Meyer & Fox, Incorporated	150,000
Howard, Weil, Lanoose, Langlois Incorporated	300,000	Stifel, Nicolaus & Company Incorporated	150,000
E. F. Hutton & Company Inc.	900,000	Stone & Webster Securities Corporation	900,000
The Illinois Company Incorporated	150,000	Stone & Youngberg	250,000
Interstate Securities Corporation	150,000	Stuart Brothers	300,000
Janney Montgomery Scott Inc.	300,000		
Johnston, Lemon & Co. Incorporated	300,000		

<u>Name</u>	<u>Principal Amount</u>
Sutro & Co. Incorporated	\$ 300,000
Thomson & McKinnon Auchincloss Kohlmeyer Inc.	500,000
Spencer Trask & Co. Incorporated	500,000
Tucker, Anthony & R. L. Day	500,000
UBS-DB Corporation	500,000
G. H. Walker, Laird Incorporated	500,000
Warburg-Paribas, Inc.	500,000

<u>Name</u>	<u>Principal Amount</u>
Watling, Lerchen & Co. Incorporated	\$ 400,000
Weeden & Co. Incorporated	700,000
Wertheim & Co., Inc.	900,000
Wheat, First Securities, Inc.	400,000
White, Weld & Co. Incorporated	900,000
Dean Witter & Co. Incorporated	900,000
Wood, Struthers & Winthrop Inc.	700,000
	<u>\$60,000,000</u>

The Underwriting Agreement provides that the several obligations of the Underwriters are subject to the approval of certain legal matters by counsel and to the conditions that no stop order suspending the effectiveness of the Registration Statement is in effect and no proceedings for such purpose are pending before or threatened by the Securities and Exchange Commission, that an appropriate order of the MPSC is in effect and that there has been no material adverse change (not in the ordinary course of business) in the condition of the Company from that set forth in or contemplated by the Registration Statement. The nature of the Underwriters' obligation is such that they are committed to take and pay for all of the New Bonds if any are taken.

The Underwriters propose to offer part of the New Bonds directly to the public at the public offering price set forth on the cover page hereof and part to dealers at a price which represents a concession of 1.0% of the principal amount under the public offering price and any Underwriter may offer New Bonds to certain dealers who are either a parent or a subsidiary of such Underwriter at not less than such price to dealers. The Underwriters may allow and such dealers may reallow a concession, not in excess of .5%, to certain other dealers.

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Consumers Power Company:

We have examined the balance sheet of CONSUMERS POWER COMPANY ( a Michigan corporation ) as of December 31, 1973, and the related statements of income, retained earnings, capital in excess of par value and source of funds for gross property additions for the five years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Consumers Power Company as of December 31, 1973, and the results of its operations and the source of funds for gross property additions for the periods stated, in conformity with generally accepted accounting principles applied on a consistent basis during the periods.

ARTHUR ANDERSEN & Co.

Detroit, Michigan.  
April 25, 1974.

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

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We have examined the balance sheet of CONSUMERS POWER COMPANY (a Michigan corporation) as of December 31, 1973, and the related statements of income, retained earnings, capital in excess of par value and source of funds for gross property additions for the five years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

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ARTHUR ANDERSEN & Co.

Detroit, Michigan.  
April 25, 1974.

# CONSUMERS POWER COMPANY

## BALANCE SHEET

### ASSETS

	<u>December 31,</u> <u>1973</u>	<u>May 31,</u> <u>1974</u>  (Unaudited)
	<u>Thousands of Dollars</u>	
Utility Plant, at original cost (Note 2):		
Plant in service and held for future use—		
Electric.....	\$1,895,704	\$1,893,213
Gas.....	889,129	888,438
Steam.....	3,280	3,280
Common to all departments.....	71,481	71,564
	<u>\$2,859,594</u>	<u>\$2,856,495</u>
Less—Provision for accrued depreciation.....	653,537	686,722
	<u>\$2,206,057</u>	<u>\$2,169,773</u>
Construction work in progress (Note 4) .....	359,548	483,533
	<u>\$2,565,605</u>	<u>\$2,653,306</u>
 Other Physical Property:		
At cost or less .....	\$ 2,764	\$ 2,774
Less—Provision for accrued depreciation .....	37	37
	<u>\$ 2,727</u>	<u>\$ 2,737</u>
 Investments:		
Wholly-owned subsidiaries—		
Michigan Gas Storage Company (Note 1) .....	\$ 20,111	\$ 20,358
Northern Michigan Exploration Company (Notes 1 and 5) .....	16,631	22,560
Other, at cost or less.....	922	842
	<u>\$ 37,664</u>	<u>\$ 43,760</u>
 Current Assets:		
Cash (Note 14) .....	\$ 12,243	\$ 13,652
Accounts receivable, less reserves of \$674,000 and \$704,000 respectively (includes \$85,000 and \$121,000 respectively due from subsidiaries).....	67,295	63,454
Materials and supplies, at average cost.....	52,483	65,676
Gas in underground storage, at average cost.....	31,931	21,827
Property taxes—future period, net .....	27,903	15,877
Prepayments and other.....	1,076	5,564
	<u>\$ 192,931</u>	<u>\$ 186,050</u>
Deferred Debits.....	\$ 6,926	\$ 9,967
	<u>\$2,805,853</u>	<u>\$2,895,820</u>

The Notes to Financial Statements are an integral part of this statement.

# CONSUMERS POWER COMPANY

## BALANCE SHEET

### STOCKHOLDERS' INVESTMENT AND LIABILITIES

	December 31, 1973	May 31, 1974
	(Unaudited)	
	Thousands of Dollars	
Capitalization:		
Common stockholders' equity—		
Common stock, \$10 par value, authorized 32,500,000 shares, outstanding 26,233,838 shares.....	\$ 262,338	\$ 262,338
Capital in excess of par value .....	247,070	247,231
Retained earnings (Note 10) .....	228,397	227,852
	\$ 737,805	\$ 737,421
Less—Capital stock expense .....	6,975	7,005
Total common stockholders' equity.....	\$ 730,830	\$ 730,416
Preferred stock, cumulative, \$100 par value, authorized 5,000,000 shares (Note 11).....	347,534	347,134
Total stockholders' investment .....	\$1,078,364	\$1,077,550
Long-term debt (Note 12).....	1,222,340	1,249,968
Total capitalization.....	\$2,300,704	\$2,327,518
Notes Payable, due within one year (Notes 3 and 14):		
To banks (average interest rate of 9.80% and 11.46% respectively)...	\$ 43,000	\$ 63,700
Commercial paper (average interest rate of 9.62% and 10.84% respectively).....	1,800	40,810
	\$ 44,800	\$ 104,510
Current Liabilities (excluding notes payable due within one year):		
Current maturities and sinking fund on long-term debt (Note 12) ....	\$ 17,309	\$ 14,019
Accounts payable (includes \$6,981,000 and \$3,755,000 respectively due to subsidiaries).....	100,311	58,064
Accrued taxes.....	57,831	72,404
Accrued interest.....	20,787	24,116
Other .....	22,893	35,987
	\$ 219,131	\$ 204,590
Deferred Credits and Reserves:		
Deferred income taxes (Note 16).....	\$ 173,616	\$ 188,815
Investment tax credit (Note 15) .....	47,938	50,332
Other .....	19,664	20,055
	\$ 241,218	\$ 259,202
Construction Commitments (Note 9)	\$2,805,853	\$2,895,820

The Notes to Financial Statements are an integral part of this statement.

## CONSUMERS POWER COMPANY

### STATEMENT OF RETAINED EARNINGS

	Year Ended December 31					Twelve Months Ended May 31, 1974
	1969	1970	1971	1972	1973	(Unaudited)
Thousands of Dollars						
Balance Beginning of Period .....	\$125,503	\$156,483	\$178,995	\$195,599	\$213,358	\$233,270
Add:						
Net income .....	66,960	72,832	71,780	78,178	80,893	68,952
Equity in undistributed earnings of subsidiaries at December 31, 1972 (Note 1) .....	—	—	—	—	4,359	—
	<u>\$192,463</u>	<u>\$229,315</u>	<u>\$250,775</u>	<u>\$273,777</u>	<u>\$298,610</u>	<u>\$302,222</u>
Deduct:						
Cash dividends on preferred stock .....	\$ 3,534	\$ 3,517	\$ 7,108	\$ 11,251	\$ 17,746	\$ 21,902
Cash dividends on common stock declared in the amounts of \$1.425 per share in 1969 and \$2.00 per share in 1970, 1971, 1972, 1973 and the twelve months ended May 31, 1974 .....	32,446*	46,803	48,068	49,168	52,467	52,468
	<u>\$ 35,980</u>	<u>\$ 50,320</u>	<u>\$ 55,176</u>	<u>\$ 60,419</u>	<u>\$ 70,213</u>	<u>\$ 74,370</u>
Balance End of Period (Note 10) .....	<u>\$156,483</u>	<u>\$178,995</u>	<u>\$195,599</u>	<u>\$213,358</u>	<u>\$228,397</u>	<u>\$227,852</u>

\* The quarterly dividend on common stock formerly declared in December was declared in January starting in 1970. Therefore, the dividends declared in 1969 only include three quarterly dividend declarations. Dividend payments have continued to be made in the months of February, May, August and November.

### STATEMENT OF CAPITAL IN EXCESS OF PAR VALUE

	Year Ended December 31					Twelve Months Ended May 31, 1974
	1969	1970	1971	1972	1973	(Unaudited)
Thousands of Dollars						
Balance Beginning of Period .....	\$187,654	\$187,756	\$208,905	\$209,038	\$246,788	\$246,914
Add:						
Excess over par value of common stock sold .....	—	21,012	—	37,620	—	—
Excess over par value of preferred stock sold .....	—	—	—	—	156	156
Net gain on reacquisition of preferred stock .....	102	137	133	130	126	161
Balance End of Period .....	<u>\$187,756</u>	<u>\$208,905</u>	<u>\$209,038</u>	<u>\$246,788</u>	<u>\$247,070</u>	<u>\$247,231</u>

The Notes to Financial Statements are an integral part of these statements.



# CONSUMERS POWER COMPANY

## STATEMENT OF SOURCE OF FUNDS FOR GROSS PROPERTY ADDITIONS

	Year Ended December 31					Twelve Months Ended May 31, 1974
	1969	1970	1971	1972	1973	(Unaudited)
	Thousands of Dollars					
Source of Funds for Gross Property Additions:						
Funds generated from operations:						
Net income after dividends on preferred stock	\$ 63,426	\$ 69,315	\$ 64,672	\$ 66,927	\$ 63,147	\$ 47,050
Principal noncash items—						
Depreciation and amortization (Notes 8 and 17)—						
Per statement of income	51,881	55,608	58,210	62,937	73,428	77,895
Charged to other accounts	5,200	6,162	6,403	11,472	13,616	9,394
Deferred income taxes, net	10,962	10,222	14,300	18,972	25,072	29,130
Investment tax credit, net	3,416	448	5,751	5,960	14,057	8,237
Allowance for funds used during construction	(8,421)	(14,108)	(21,862)	(25,455)	(23,223)	(21,942)
Undistributed earnings of subsidiaries (Note 1)	—	—	—	—	(1,541)	(2,946)
	\$126,464	\$127,647	\$127,474	\$140,813	\$164,556	\$146,818
Less—						
Dividends declared on common stock	32,446*	46,803	48,068	49,168	52,467	52,468
Retirement of long-term debt and preferred stock	7,788	9,438	10,538	11,738	12,938	12,938
	\$ 86,230	\$ 71,406	\$ 68,868	\$ 79,907	\$ 99,151	\$ 81,412
Funds obtained from new financing:						
Issuance of common stock	\$ —	\$ 33,661	\$ —	\$ 59,620	\$ —	\$ —
Issuance of preferred stock	—	—	70,000	70,000	130,000	130,000
Issuance of first mortgage bonds	105,000	110,000	120,000	120,000	75,000	75,000
Net proceeds from installment sales contracts payable	—	—	—	—	31,744	59,631
Increase (decrease) in other long-term debt	—	12,730	(4,239)	(4,418)	(3,915)	(2,102)
Increase (decrease) in notes payable	6,900	12,600	(36,500)	6,500	19,300	34,510
	\$111,900	\$168,991	\$149,261	\$251,702	\$252,129	\$297,039
Funds obtained from other sources:						
Allowance for funds used during construction	\$ 8,421	\$ 14,108	\$ 21,862	\$ 25,455	\$ 23,223	\$ 21,942
Increase in reserve for possible rate refunds (Note 6)	—	4,406	7,278	184	—	—
Change in net current assets and current liabilities**	(2,171)	(15,140)	7,018	9,020	(1,696)	(25,502)
(Increase) decrease in investment in Northern Michigan Exploration Company (Note 5)	(2,000)	(4,000)	(4,000)	4,000	(8,600)	(5,700)
Other, net	193	33	62	2,850	(3,332)	(7,630)
	\$ 4,443	\$ (593)	\$ 32,220	\$ 41,509	\$ 9,595	\$ (16,890)
Gross Property Additions (Note 2)	\$202,573	\$239,804	\$250,349	\$373,118	\$360,875	\$361,561

\* See Note to "Statement of Retained Earnings".

\*\* The changes in the individual accounts classified as current assets and current liabilities are not material in relation to gross property additions.

The Notes to Financial Statements are an integral part of this statement.

# CONSUMERS POWER COMPANY

## NOTES TO FINANCIAL STATEMENTS

(Including Notes Related to Unaudited Financial Statements)

### 1. SIGNIFICANT ACCOUNTING POLICIES

The Company's wholly-owned subsidiaries, Michigan Gas Storage Company and Northern Michigan Exploration Company, have not been consolidated as they are not significant. Effective January 1, 1973, the Company, pursuant to Federal Power Commission Order No. 469, adopted the equity method of accounting for the investment in subsidiaries. Under this method of accounting the Company's interest in the earnings of the subsidiaries is reflected currently in earnings and in the carrying value of the investments. Prior years, which include dividends paid by one of the subsidiaries, have not been restated for this change in accounting since the effect was not material; however, retained earnings have been credited with the undistributed earnings of the subsidiaries at December 31, 1972 in the amount of \$4,359,272.

The Company provides depreciation on the basis of straight-line rates approved by the Michigan Public Service Commission (See Note 8).

Operating revenue is recognized at the time of monthly billings on a cycle basis for electric and gas service.

The Company makes annual contributions to the pension plan sufficient to cover current service costs, interest on unfunded prior service costs and amortization of prior service costs (See Note 7).

Reference is made to Notes 15 and 16 for information regarding income taxes.

Reference is made to Note (f) to the Statement of Income for information regarding the allowance for funds used during construction.

### 2. CONTRIBUTIONS IN AID OF CONSTRUCTION

Effective January 1, 1974 the Company, pursuant to Federal Power Commission Order No. 490, reclassified contributions in aid of construction as an offset to Utility Plant at original cost. The financial statements for periods prior to 1974 have been restated to a comparable basis.

### 3. FINANCING

Reference is made to "Use of Proceeds" for information regarding financing.

### 4. NUCLEAR GENERATING PLANTS

Construction work in progress includes \$103,932,000 at December 31, 1973 and \$131,735,000 at May 31, 1974 related to the Midland Plant. The issuance of construction permits by the Atomic Energy Commission (AEC) in December 1972 was upheld by an Appeal Board of the AEC in May 1973 but has been appealed to the U. S. Court of Appeals for the District of Columbia Circuit. Construction, delayed since 1970, was resumed in June 1973. In December 1973 the AEC issued an order for the Company to show cause why all construction activity should not be suspended pending a showing that the Company is in compliance with the AEC's quality assurance regulations and that there is reasonable assurance that such compliance will continue throughout the construction process. An AEC hearing on the show cause order is scheduled to commence in July 1974.

Reference is made to "Construction Expenditures" for information relating to the cancellation of the Company's Quanicassee Nuclear Plant.

Reference is made to Note (b) to the Statement of Income for information relating to the Palisades Nuclear Plant.

### 5. NORTHERN MICHIGAN EXPLORATION COMPANY

Northern Michigan Exploration Company (Northern), a wholly-owned subsidiary of the Company, is engaged in gas exploration programs in northern Michigan and the southern United States. The Company's investment in Northern, excluding equity in the undistributed net earnings of Northern, consisted of \$14,600,000 in common stock at December 31, 1973 and \$14,600,000 in common stock and

## CONSUMERS POWER COMPANY

### NOTES TO FINANCIAL STATEMENTS—(Continued) (Including Notes Related to Unaudited Financial Statements)

\$4,000,000 in Notes at May 31, 1974. The Company's Board of Directors has authorized loans to Northern up to a maximum of \$20,000,000 and has authorized a total common stock investment of \$20,000,000.

#### 6. RATE MATTERS

Reference is made to Note (a) to the Statement of Income for information relating to electric and gas rate matters.

#### 7. PENSION PLAN

The Company has a trustee noncontributory pension plan under which full-time regular employees within specified age limits and periods of service are qualified to participate. The contributions to the plan were \$7,386,000 in 1969, \$9,195,000 in 1970, \$10,575,000 in 1971, \$13,066,000 in 1972, \$14,607,000 in 1973 and \$15,507,000 for the twelve months ended May 31, 1974. Of these amounts, \$5,722,000 in 1969, \$6,945,000 in 1970, \$8,127,000 in 1971, \$9,817,000 in 1972, \$10,968,000 in 1973 and \$11,961,000 for the twelve months ended May 31, 1974 were charged directly to expense accounts with the remainder being charged to various construction, clearing and other accounts.

On April 11, 1972 the Company's shareholders approved certain revisions in the pension plan which substantially increased the Company's contributions. Concurrent with the revisions to the pension plan, the Company changed two of its actuarial assumptions and increased the period of amortization of unfunded prior service costs from approximately 13 years to 25 years. The assumed rate of return was increased from 3¼% to 4½% and the method of reflecting unrealized appreciation was changed from the "appreciation account" method to the "assumed growth rate" method. The change in the actuarial assumptions and increase in the period of amortization of prior service costs had the effect of reducing the impact of the revisions to the plan on net income and earnings per share of common stock for the year 1972 by approximately \$1,140,000 and \$.05, respectively.

The unfunded prior service cost at January 1, 1974, the date of the most recent actuary's report, amounted to approximately \$21,569,000.

#### 8. DEPRECIATION

Composite depreciation rates were approximately 2.85% for electric plant and 3.20% for gas plant for the year ended December 31, 1969; 2.95% for electric plant and 3.00% for gas plant for the two years ended December 31, 1971; 2.95% for electric plant and 3.01% for gas plant for the year ended December 31, 1972; 2.92% for electric plant and 3.01% for gas plant for the year ended December 31, 1973; and 2.83% for electric plant and 3.40% for gas plant for the twelve months ended May 31, 1974. In the opinion of management, the balance in the provision for accrued depreciation at December 31, 1973 and May 31, 1974 is reasonably adequate to cover the requirements for depreciation accrued on the original cost of the depreciable utility plant. At the time properties are retired or otherwise disposed of in the normal course of business, charges are made to the provision for accrued depreciation in the amounts of such retirements, less net salvage credits, and no other adjustments of the provision for accrued depreciation are normally made. Depletion rates, established for each producing field based on the total cost of leaseholds divided by the estimated recoverable reserves, are applied to withdrawals from each field to determine the provision for depletion.

#### 9. CONSTRUCTION COMMITMENTS AND FINANCING RESTRICTIONS

As of June 5, 1974 capital expenditures for property additions in 1974 were estimated to total approximately \$360,318,000. Total construction expenditures over the five years ending December 31, 1978, are presently estimated to approximate \$2,200,000,000. Substantial commitments have been made with respect to capital expenditures in future years.

# CONSUMERS POWER COMPANY

## NOTES TO FINANCIAL STATEMENTS— (Continued)

(Including Notes Related to Unaudited Financial Statements)

In order to finance this construction program and to meet first mortgage bond maturities of \$170,334,000 during the five years ending December 31, 1978, it will be necessary for the Company to sell substantial additional securities, the amounts, timing and nature of which have not yet been determined.

✓ The sale of certain securities may be restricted as set forth under "Statement of Income".

Reference is made to "Construction Expenditures" for additional information regarding the Company's construction program.

### 10. LIMITATION ON DIVIDENDS

At May 31, 1974, after giving effect to the execution of a \$50 million term bank loan in June 1974, retained earnings in the amount of \$50,748,364 are not available for the payment of cash dividends on common stock under provisions of the Articles of Incorporation of the Company which, except under certain circumstances, prohibit the payment of common stock dividends in cash which would reduce the percentage of common stock equity to total capitalization below 25%. There are also other restrictions as to the payment of dividends on common stock which, however, are presently less restrictive than the limitation mentioned above. The limitation on the payment of cash dividends may increase as set forth under "Statement of Income."

### 11. PREFERRED STOCK AND PREFERENCE STOCK

Preferred stock is represented by:

	Redemption Price Per Share	December 31, 1973	May 31, 1974  (Unaudited)
		Thousands of Dollars	
\$4.50—547,788 Shares Outstanding .....	\$110.00	\$ 54,779	\$ 54,779
\$4.52—127,550 Shares Outstanding (less 4,000 shares purchased for re- tirement in 1974) .....	104.725	12,755	12,355
\$4.16—100,000 Shares Outstanding .....	103.25	10,000	10,000
\$7.45—700,000 Shares Outstanding .....	108.00	70,000	70,000
\$7.72—700,000 Shares Outstanding .....	108.00	70,000	70,000
\$7.76—750,000 Shares Outstanding .....	109.19	75,000	75,000
\$7.68—550,000 Shares Outstanding .....	108.00	55,000	55,000
Total preferred stock .....		<u>\$347,534</u>	<u>\$347,134</u>

The preferred stock of the Company is redeemable as a whole or in part, at the option of the Company, at the above redemption prices plus accrued dividends to the date of redemption, except that prior to April 1, 1978, July 1, 1977, June 1, 1978 and November 1, 1978, the \$7.45, \$7.72, \$7.76 and \$7.68 preferred stock, respectively, may not be redeemed through certain refunding operations.

The Company is required to endeavor to purchase and retire annually 4,000 shares of the \$4.52 preferred stock at a price per share not to exceed \$102.725 plus accrued dividends.

On April 9, 1974 the Company's shareholders approved an increase of 1,500,000 shares in the authorized preferred stock from 3,500,000 shares to 5,000,000 shares.

On April 9, 1974 the Company's shareholders approved a revision in the Company's Articles of Incorporation to authorize 5,000,000 shares of cumulative \$1 par value Preference Stock. There are no shares of this new class of stock outstanding.

**CONSUMERS POWER COMPANY**

NOTES TO FINANCIAL STATEMENTS—(Continued)

(Including Notes Related to Unaudited Financial Statements)

12. LONG-TERM DEBT

Long-term debt is represented by:

	December 31, 1973	May 31, 1974
	(Unaudited)	
	Thousands of Dollars	
First Mortgage Bonds secured by a mortgage and lien on substantially all property—		
2 $\frac{7}{8}$ % Series due 1975 .....	\$ 86,324	\$ 86,324
8 $\frac{3}{4}$ % Series due 1976 .....	60,000	60,000
2 $\frac{7}{8}$ % Series due 1977 .....	24,010	24,010
3 $\frac{1}{4}$ % Series due 1981 .....	39,000	39,000
3% Series due 1984 .....	24,075	24,075
4% Series due 1986 .....	33,255	33,255
3 $\frac{1}{4}$ % Series due 1987 .....	25,000	25,000
4 $\frac{1}{4}$ % Series due 1987 .....	210	210
4 $\frac{1}{2}$ % Series due 1988 .....	34,326	34,326
4 $\frac{1}{2}$ % Series due 1989 .....	28,630	28,630
3 $\frac{1}{4}$ % Series due 1990 .....	30,000	30,000
4 $\frac{1}{2}$ % Series due 1990 .....	29,572	29,572
4 $\frac{1}{2}$ % Series due 1991 .....	31,889	31,889
5 $\frac{1}{8}$ % Series due 1996 .....	59,000	59,000
6% Series due 1997 .....	78,550	78,550
6 $\frac{1}{8}$ % Series due 1998 .....	55,000	55,000
6 $\frac{1}{8}$ % Series due 1998 .....	55,000	55,000
7 $\frac{1}{8}$ % Series due 1999 .....	50,000	50,000
8 $\frac{1}{4}$ % Series due 1999 .....	55,000	55,000
8 $\frac{1}{8}$ % Series due 2000 .....	50,000	50,000
8 $\frac{1}{8}$ % Series due 2001 .....	60,000	60,000
7 $\frac{1}{2}$ % Series due 2001 .....	60,000	60,000
7 $\frac{1}{2}$ % Series due 2002 .....	70,000	70,000
7 $\frac{1}{2}$ % Series due 2002 .....	50,000	50,000
8 $\frac{1}{8}$ % Series due 2003 .....	75,000	75,000
Total First Mortgage Bonds .....	\$1,163,841	\$1,163,841
Installment Sales Contracts Payable (Net of \$7,256,000 and \$14,069,000 respectively held in trust pending completion of construction) .....	31,744	59,631
Sinking Fund Debentures, 4 $\frac{1}{2}$ %, due 1994 .....	37,600	37,600
Other .....	4,310	2,333
Unamortized Net Debt Premium (not material by individual issue) .....	2,154	2,061
	\$1,239,649	\$1,265,466
Deduct—		
Current Maturities and Sinking Fund In- cluded in Current Liabilities—		
First Mortgage Bonds .....	\$ 12,688	\$ 11,809
Sinking Fund Debentures .....	600	—
Other .....	4,021	2,210
	\$ 17,309	\$ 14,019
Securities Recquired for Sinking Fund Re- quirements (not yet retired) .....	—	1,479
	\$ 17,309	\$ 15,498
Total Long-Term Debt .....	\$1,222,340	\$1,249,968

# CONSUMERS POWER COMPANY

## NOTES TO FINANCIAL STATEMENTS—(Continued) (Including Notes Related to Unaudited Financial Statements)

Under the terms of the Indenture securing the First Mortgage Bonds, the Company is required, on or before October 1 of each year, to deposit with the Trustee, cash and/or bonds in an amount equal to 1% of the aggregate principal amount of bonds of all series, other than refunding series, authenticated prior to January 1 of the year of deposit. With respect to all series which have been issued through December 31, 1973, the annual sinking fund requirement is \$12,688,000. In addition, an annual \$600,000 sinking fund deposit is due on the 4% Sinking Fund Debentures on or before September 1 of each year.

In addition on June 20, 1974, the Company borrowed \$50,000,000 from a bank under a promissory note maturing in 1981 and bearing interest at a fluctuating rate related to the bank's prime lending rate.

### 13. MAINTENANCE

It is the practice of the Company to charge to maintenance the cost of repairs of property and replacements and renewals of items determined to be less than units of property, except for such costs as are charged to transportation expenses, stores expenses or other clearing accounts and redistributed from these accounts, together with other charges, to various operating, construction and other accounts. The latter amounts so charged are not considered significant and are not readily determinable. Costs of replacements and renewals of items considered to be units of property are charged to the utility plant accounts and charges for the units of property replaced are made to the provision for accrued depreciation and removed from utility plant accounts. Property additions are charged to the utility plant accounts.

### 14. COMPENSATING BALANCES AND NOTES PAYABLE

The Company has agreements with banks providing for short-term borrowings of up to \$132,000,000. In connection with these agreements the Company is required to maintain average compensating balances with the banks, over an unspecified period of time, equal to 10% of the total line of credit plus 10% of the average borrowings outstanding, as determined from the bank's records after adjustment for uncollected funds. There are no legal restrictions on the withdrawal of these funds. In addition, the Company issued commercial paper from time to time on a short-term basis, generally for periods of less than one month.

During 1973 and the twelve months ended May 31, 1974, average short-term borrowings outstanding amounted to \$31,809,000 and \$40,189,000, respectively, the maximum amount outstanding at any one time was \$82,000,000 and \$104,510,000, respectively, and the weighted average interest rate was 7.85% and 9.43%, respectively, excluding the effect of compensating balances.

### 15. INCOME TAX EXPENSE

Income tax expense is made up of the following components:

	Year Ended December 31					Twelve Months Ended May 31, 1974
	1969	1970	1971	1972	1973	(Unaudited)
	Thousands of Dollars					
Charged to utility operations—						
Federal income taxes.....	\$41,023	\$38,824	\$14,469	\$11,371	\$ 2,718	\$(7,778)
State income taxes.....	4,071	4,787	3,065	3,216	2,786	(98)
Deferred federal income taxes, net.....	9,753	8,936	12,337	15,929	21,133	24,598
Deferred state income taxes, net.....	1,209	1,286	1,963	3,043	3,939	4,532
Charge equivalent to investment tax credit, net.....	416	448	5,751	5,960	14,057	8,237
Total—see Statement of Income.....	<u>\$59,472</u>	<u>\$54,281</u>	<u>\$37,585</u>	<u>\$39,519</u>	<u>\$44,633</u>	<u>79,491</u>
Charged to nonutility operations.....	677	767	536	253	1,091	196
Total income tax expense.....	<u>\$60,149</u>	<u>\$55,048</u>	<u>\$38,121</u>	<u>\$39,772</u>	<u>\$45,724</u>	<u>80,687</u>

The Company utilizes liberalized depreciation and the "class life asset depreciation range system" for income tax purposes. Income tax deferred due to the use of these methods is charged to income currently and credited to a reserve for deferred income taxes. As income taxes previously deferred become payable, the related deferrals are credited to income. (See Note 16)

# CONSUMERS POWER COMPANY

## NOTES TO FINANCIAL STATEMENTS—(Continued) (Including Notes Related to Unaudited Financial Statements)

Certain costs, principally interest, capitalized in accordance with the provisions of the Uniform System of Accounts, are expensed for income tax purposes and the tax reduction resulting therefrom is reflected in the income statement currently as ordered by the Michigan Public Service Commission.

The investment tax credit and job development investment credit utilized as a reduction of the current year's income tax is deferred and amortized to operating expense over the life of the related property.

The following schedule reconciles the statutory Federal income tax rate to the effective income tax rates for the five years ended December 31, 1973 and the twelve months ended May 31, 1974.

	Year Ended December 31					Twelve Months Ended May 31, 1974
	1969	1970	1971	1972	1973	(Unaudited)
Federal income tax statutory rate .....	52.8%	49.2%	48.0%	48.0%	48.0%	48.0%
Increase (reduction) in income tax rate resulting from:						
Certain capitalized construction costs, principally interest, deducted currently for income tax purposes for which no deferred taxes are provided in accordance with the requirements of the MPSC.....	(5.4)	(7.8)	(12.8)	(14.0)	(12.3)	(14.8)
State income taxes, net of Federal income tax benefit .....	2.0	2.4	2.4	2.8	2.8	2.3
Amortization of deferred investment tax credit .....	(.5)	(.6)	(.7)	(.8)	(1.0)	(1.5)
Other miscellaneous items .....	(1.6)	(.2)	(2.2)	(2.3)	(1.4)	(3.2)
Effective income tax rate .....	<u>47.3%</u>	<u>43.0%</u>	<u>34.7%</u>	<u>33.7%</u>	<u>36.1%</u>	<u>30.8%</u>

### 16. DEFERRED INCOME TAXES

The Company has elected to compute depreciation allowances for income tax purposes on the basis of the accelerated methods permitted by Sections 167 and 168 of the Internal Revenue Code of 1954. The Michigan Public Service Commission has prescribed that, during the period when the annual allowances for tax depreciation are more than the normal tax depreciation, the income tax deferred is to be charged to income with a concurrent credit to a reserve for deferred income taxes. During the period when the annual allowances for tax depreciation are less than the normal tax depreciation, amounts previously deferred are charged to the reserve and credited to income. The provisions for deferred income taxes subsequent to 1970 reflect the effect of shortened depreciation lives under a "class life depreciation system" in accordance with liberalized depreciation guide lines under the Revenue Act of 1971. Following is a summary of the provision for deferred income taxes:

	Year Ended December 31					Twelve Months Ended May 31, 1974
	1969	1970	1971	1972	1973	(Unaudited)
	Thousands of Dollars					
Accelerated depreciation—						
Amount deferred during year .....	\$11,938	\$11,599	\$15,595	\$20,467	\$26,656	\$30,821
Less— Taxes deferred in prior years credited to income .....	(302)	(540)	(458)	(658)	(747)	(854)
	<u>\$11,636</u>	<u>\$11,059</u>	<u>\$15,137</u>	<u>\$19,809</u>	<u>\$25,909</u>	<u>\$29,967</u>
Accelerated amortization of emergency facilities—						
Taxes deferred in prior years credited to income .....	(674)	(837)	(837)	(837)	(837)	(837)
Total .....	<u>\$10,962</u>	<u>\$10,222</u>	<u>\$14,300</u>	<u>\$18,972</u>	<u>\$25,072</u>	<u>\$29,130</u>

## CONSUMERS POWER COMPANY

### NOTES TO FINANCIAL STATEMENTS— (Concluded) (Including Notes Related to Unaudited Financial Statements)

#### 17. SUPPLEMENTARY INCOME INFORMATION

##### Maintenance:

The amounts of maintenance, other than those set forth in the Statement of Income, that have been charged to clearing accounts and redistributed are not significant.

##### Depreciation, depletion and amortization:

In addition to the amounts set forth in the Statement of Income, depreciation of transportation and other equipment was charged to clearing accounts in the following amounts: \$2,241,000 in 1969, \$2,851,000 in 1970, \$2,715,000 in 1971, \$3,278,000 in 1972, \$3,375,000 in 1973 and \$3,422,000 for the twelve months ended May 31, 1974. Also, depreciation, depletion and amortization was charged to accounts, other than depreciation and amortization, in the Statement of Income in the following amounts: \$2,959,000 in 1969, \$3,311,000 in 1970, \$3,688,000 in 1971, \$8,194,000 in 1972, \$10,241,000 in 1973 and \$5,972,000 for the twelve months ended May 31, 1974.

Taxes, other than income taxes, charged to operating expenses, follow:

	Year Ended December 31,					Twelve Months Ended May 31, 1974
	1969	1970	1971	1972	1973	(Unaudited)
	Thousands of Dollars					
Real and personal property taxes.....	\$30,670	\$33,295	\$36,607	\$40,027	\$44,092	\$46,436
Payroll taxes.....	2,908	3,075	3,650	4,211	5,395	5,869
Michigan State franchise fee.....	3,212	2,403	3,444	3,854	4,593	4,897
Other taxes.....	268	289	172	112	75	58
General taxes—see Statement of Income.....	<u>\$37,058</u>	<u>\$39,062</u>	<u>\$43,873</u>	<u>\$48,204</u>	<u>\$54,160</u>	<u>\$57,260</u>



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Consumers  
Power  
Company

CONSUMERS POWER COMPANY  
Statement of Income

Month of June	1974	1973
Gross Operating Revenue	\$ 75,251,533	\$ 54,591,082
Operating Expenses	\$ 19,612,053	\$ 35,175,076
Provision for Depreciation and Amortization	5,624,470	5,263,920
Provision for Taxes - Federal Income	850,418	2,616,805
- State Income	152,808	287,734
- Deferred Income Tax	2,133,863	1,758,963
- General	4,334,667	4,060,352
Net Operating Income	\$ 11,554,254	\$ 9,428,232
Allowance for Funds Used During Construction	1,639,608	1,277,460
Other Income (Net)	745,281	511,529
Interest Charges	7,477,937	6,045,681
Net Income	\$ 6,461,206	\$ 5,891,540
Dividends on Preferred Stock	2,008,522	1,352,204
Balance for Common Stock	\$ 4,452,684	\$ 4,539,336
<u>12 Months Ended June 30</u>	<u>1974</u>	<u>1973</u>
Gross Operating Revenue - Electric	\$531,330,260	\$492,141,303
- Gas	393,986,228	340,366,549
- Steam	1,401,066	1,260,033
Total Gross Operating Revenue	\$926,717,554	\$793,767,885
Operating Expenses	\$642,556,847	\$500,254,751
Provision for Depreciation and Amortization	78,325,373	67,852,474
Provision for Taxes - Federal Income	(1,267,304)	25,434,337
- State Income	(224,284)	4,298,294
- Deferred Income Tax	29,859,916	21,737,906
- General	58,054,467	49,467,303
Net Operating Income	\$119,450,539	\$124,722,620
Allowance for Funds Used During Construction	21,583,732	25,854,343
Other Income (Net)	8,680,007	4,298,813
Interest Charges	80,192,824	69,205,816
Net Income	\$ 69,321,454	\$ 85,370,140
Dividends on Preferred Stock	22,558,293	14,122,843
Balance for Common Stock	\$ 46,763,161	\$ 71,247,297

Earnings per Share of Common Stock Based on Average Shares Outstanding  
(26,233,838 Shares of 1974 and 25,683,838 Shares in 1973)      \$1.79      \$2.77

Notes: (1) This statement is on the basis of interim figures and is subject to audit and adjustment.  
(2) Because of seasonal and other factors, the earnings for the month should not be taken as an indication of earnings for all or any part of the balance of the current year.

(3) On January 18, 1974, the Michigan Public Service Commission (MPSC) authorized increases in the Company's electric and gas rates of \$31,000,000 and \$46,600,000, respectively, on an annual basis. The rate increases included interim increases aggregating \$50,000,000 divided equally between electric and gas rates which were placed in effect November 10, 1973. The authorized rate increases became effective on January 19, 1974 except for approximately \$14,571,000 of the gas rate increase which became effective on April 20, 1974 after the Company had submitted proof to the MPSC that the second unit of the Marysville Gas Reforming Plant was fully and commercially operable.

(4) Litigation is pending with respect to electric and gas rate increases which became effective in 1969 and which are subject to refund relating to the reduction and elimination of the Federal income tax surcharge. In March and April 1974, the Court ruled in favor of the MPSC with respect to the income tax surcharge issue and ordered the Company to refund \$24,542,632 to its electric and gas customers. The Company has established a reserve stated net of related income taxes in the amount of \$11,867,818, and believes that the amount of such reserve is adequate to cover the refund obligation, exclusive of interest charges which are presently not capable of determination. The Company is undertaking to seek judicial review of the Court Orders of March and April 1974, including a request for a stay of the refund pending further judicial action. The litigation also involves a claim with respect to the legality of the electric rate increase, which became effective in 1969, on the grounds that the increased rates became effective by Court Order in October 1969, that the MPSC did not issue an order approving said rates until April 1970 and that as a result, the electric rates charged during the period are subject to refund in an amount of approximately \$7,703,000, plus interest which is presently not capable of determination, for which no reserve has been provided.

(5) In April 1974 the Company submitted an application to the MPSC to increase its electric rates by not less than \$72,159,000 annually and at the same time requested partial and interim relief in the amount of \$54,659,000 annually. It is not expected that the MPSC will act upon the application or the request for partial and interim relief until later in 1974 following hearings and other investigation of the requests.

(6) The Palisades Plant has been shut down since August 1973 for repairs to certain reactor vessel internal components and the steam generators of the plant. It was thought that repairs had been completed and the plant would be returned to service during May 1974. However, during pre-operational tests being conducted in preparation for start-up of the plant, there were tube failures in one of the plant's two steam generators. This will require further testing and repair which will further delay the start-up. In addition, public hearings may be required by the MPSC before the plant is returned to commercial operation. During the period of shutdown the Company has also installed cooling towers which were originally scheduled to be tied into the plant during a 12-week outage in the first six months of 1974. The net cost of replacement power, through June 30, 1974, amounting to

## IMMEDIATELY

JACKSON, Michigan, June 27 -- Consumers Power Company today reported earnings of \$1.79 per share of common stock outstanding for the 12 months ended May 31, 1974. This compared to \$2.77 for the same period ended May 31, 1973, and represented a decline of nine cents a share from earnings reported as of the end of April.

Total gross operating revenues for the year ended May 31 were \$910,125,103, and net operating income was \$117,324,517. This compared to \$784,553,027 in gross revenues and net income of \$122,905,624 a year earlier. Balance for common stock was \$47,049,812 for the 12 months ended May 31, 1974, compared to \$70,649,578 for the same period in 1973.

Despite disappointing earnings, the company's board of directors on June 25 declared the regular quarterly dividend of 50 cents a share on common stock payable August 20, 1974, to shareholders of record July 19, 1974. The board also declared the usual dividends on preferred stock, all payable October 1, 1974, to shareholders of record August 30.

The company has undertaken stringent economies in order to cut costs. These include a cut of approximately \$60 million in the 1974 construction budget, the elimination of more than 500 jobs, a total suspension of all motor vehicle purchases, and discontinuance of service building construction. It has pending before the Michigan Public Service Commission an application for permission to raise its electric rates by \$72 million annually, with \$54 million being asked in partial and immediate rate relief.

Mr. A. H. Aymond, chairman of the board and president of the company said additional capital must be attracted in order to continue construction of additional facilities needed to meet customer demands and that the continuation of the common stock dividend is important in obtaining such capital. He said that the board also was mindful of the fact that holders of Consumers Power common stock are, for the most part, relatively small holders, including many retired persons who depend on a continuation of dividend payments for essential income.

More than 74,800 Michigan residents are numbered among the company's holders of common stock, with the average holding being about 163 shares. Total shareholders of common stock, including those residing elsewhere, number 112,400, with average ownership of 233 shares.

Of the total 112,400 holders of common stock, 109,000 are individuals, as distinct from institutions, stockbrokers, nominees, and others. At the end of 1973, approximately 98 percent of all holders of the company's common stock owned less than 1,000 shares.

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June 27, 1974