Consumers

Power

Company

**Annual Report**

**1977**

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# Contents



**Consumers Power Company**
**Annual Report 1977**
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# 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, transmission, distribution and sale of electricity, and in the purchase, production, manufacture, storage, transmission, 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 by the Company is estimated to exceed 5,200,000. The Company's utility operating revenues in 1977 were derived approximately 56% from electric service and 44% from gas service.

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, agriculture, food products and a diversified list of other businesses.

The Company has four wholly-owned subsidiaries. Northern Michigan Exploration Company is engaged in exploration and development, purchase and sale of oil and natural gas, primarily operating in the contiguous 48 states. Michigan Gas Storage Company is engaged in the purchase, transmission and storage of gas and in the sale to the Company of gas from interstate pipeline suppliers. Michigan Utility Collection Service Co. Inc. is engaged in a special collection service for past-due utility service bills. Plateau Resources Limited is engaged in acquisition, exploration, and development of properties for the mining and milling of uranium, and the purchase and sale of uranium.

*A. H. Aymond* *J. D. Selby*

# To Our Fellow Shareholders:

Beginning with President Carter's characterization of the energy crisis as "the moral equivalent of war" and ending in the continuing, painfully slow debate on how to mobilize for that new and unique war, 1977 was a year of both exhilaration and frustration for the energy industry. Certainly energy was never before so prominent in so many Americans' minds, but certainly too the year's events demonstrated just how far and how rough a road we have to travel in converting that concern to action.

Consumers Power Company was not immune to those events on the national energy scene. Indeed, the past year for your Company in many ways reflected a mixture of concern about energy, on the one hand, versus indecision and delay on the part of government, on the other.

**Progress Made on Key Fronts**

Your Company recorded substantial progress in many areas during 1977, notably in construction, record service to our customers, and the continuing search for new supplies of oil, gas and uranium. But there were disappointments as well, foremost among them a decline in earnings per share from those reported for 1976. That decline was not unexpected, and indeed, we could not realistically have hoped to overcome the problems which brought it about in the space of one year. What is important about 1977 is that we continued to make solid, steady progress in that direction.

At last year's shareholder meetings we noted that while the bitter cold and the energy shortages of the winter of 1976-77 were already fading from many people's minds, Consumers Power Company had no intention of changing its stance: The nation continued to face serious energy problems and during 1977 your management continued to act to meet Michigan's energy needs.

The Company has major facilities under construction to meet increased demand for electric energy in the 1980s. Those facilities are needed on their present schedules. Only if those schedules are adhered to can the projects be kept within present budgeted costs. Our customers will be hurt not only by inadequate service but also by unnecessarily higher costs if the projects are delayed. And of course they will not be a source of revenues for our stockholders until they are completed.

**The Company's Authorized Rates Are Too Low**

Yet the Company's earnings continue to fall short of what is necessary to attract capital for the construction program on reasonable terms. This is demonstrated by market evaluation of the Company's securities. The common stock continues to sell below book value and senior securities continue to have inferior ratings requiring unnecessarily high yields to attract new capital. Indeed, the coverages necessary in order to sell new bonds and preferred stock are barely sufficient at this time and threaten to deteriorate further. The urgent need for rate relief is clear.

How did this situation come about? 1976 was a pretty good year. Why couldn't we keep up the pace in 1977? We worked hard to control costs and improve efficiency. The problem is twofold. First, inflation has continued at a rapid pace in 1976 and 1977 and the prices the Company charged in 1977, other than for fuel, purchased gas and purchased power, were based mainly on 1975 costs. Second, the Company's earnings in 1976 reflected an inadequate common equity base. As additional shares were issued in 1977 to bring common equity closer to an appropriate percentage of total capital, the earnings per share declined.

Earnings per share stood at a record high of $3.91 per average share outstanding for the 12 months ended March 31, 1977. However, during the last three quarters earnings per share declined and ended at $3.18 for the year, as compared with $3.63 for 1976. Revenues and net income increased during the year, but the gain was not sufficient to offset the combined impact of increased operating costs and a larger number of common shares outstanding.

**Gas Rate Increase Inadequate**

In January 1978 the Michigan Public Service Commission issued a final order granting an additional $11 million in gas rate relief in a case originally filed in November 1974. In March 1977 the Commission had granted a second interim gas rate increase of $4.9 million annually, which was in addition to $29.2 million in interim relief allowed in June 1975. The final increase was primarily based on 1975 costs and consequently a new gas rate increase request, designed to bring revenues in line with current cost levels and to improve the Company's authorized rate of return, will be filed early in 1978.

In October 1977 hearings were concluded on a request filed by the Company in January for $164 million annually in electric rate relief. A final order in that proceeding is expected in the spring.

**Needed Construction Continues**

Even as we sought the rate levels necessary to finance needed construction on reasonable terms, that construction continued. The Company invested almost $20 million a month during 1977 in construction of the twin-unit Midland nuclear plant, and by year-end the project was 41 percent complete. During the coming year plans call for an investment of an additional $350 million in the project and maintenance of a work force at the site of more than 2,800. Also in connection with Midland, we were heartened by the decision of a Nuclear Regulatory Commission Atomic Safety and Licensing Board which permitted construction of the plant to continue pending further proceedings. Challenges to the project also continue, but we are confident of its ultimate successful completion.

In addition to continuing work on Midland and a new 770-megawatt coal-fired unit at the J. H. Campbell plant, in September we brought on line a major oil-fired electric generating unit, Karn 4. That unit and its companion unit, Karn 3, have a total generating capability of 1,120 megawatts.

**Oil, Gas and Uranium Exploration Aggressive**

Tied closely to the importance of building new facilities is the need to secure adequate fuel supplies to meet both electric and gas demand in the years ahead. During 1977 your Company continued an aggressive resource exploration and development program spearheaded by our wholly-owned subsidiaries Northern Michigan Exploration Company and Plateau Resources Limited. After lengthy regulatory proceedings, federal authorities last year authorized the transportation to Michigan and sale to Consumers Power of gas produced by Northern Michigan Exploration Company in the offshore Louisiana area of the Gulf of Mexico. Deliveries are expected to begin during 1978 and will increase the Company's annual gas supply by three to four billion cubic feet.

Though only a year old, Plateau Resources Limited is already deeply involved in uranium exploration and development activities. Its mission is to help ensure adequate fuel supplies for the Company's nuclear plants in the 1980s and thereafter.

**Company Now Serves More Than 1,250,000 Electric Customers and 1,000,000 Gas Customers**

We added our 1,000,000th gas customer in October 1977, becoming one of only 11 natural gas operating companies in the nation to serve that number. Interestingly, we had added our 1,000,000th electric customer just 10 years earlier, in 1967.

In addition, due to successful gas exploration programs and planned conservation efforts, plus the good performance of the Marysville gas reforming plant and decreased pipeline curtailments, in 1977 we were able to accept new small industrial and commercial gas customers for the first time since April 1975.

And demand from our customers was strong. On the electric side, we set new records during the year both in terms of one-hour demand and 24-hour sendout; on the gas side, customers also established a new record for 24-hour usage, which in turn was surpassed in January 1978.

During regional meetings of shareholders last spring, we also noted that the introduction of the President's energy bill marked the nation's long overdue first step toward a critical goal — a national energy policy. We said then that it would be a difficult undertaking, and events since make one wonder if it is not insurmountable. Proposals, counterproposals, confusion, political bickering and delays have failed to produce even the semblance of a realistic plan which acknowledges the importance of energy to our nation.

**Leadership Is the Key to Continued Progress**

Leadership is the key. At the national level it must meld the best interests of all the diverse segments of our society into a blueprint that fairly allocates the financial burden of energy growth, but also recognizes the essentiality of energy supplies which are adequate to meet the needs and aspirations of us all.

At the state level, in Michigan, a first step toward such leadership emerged late in 1977 with the announcement of the formation of the Michigan Committee for Jobs and Energy, an organization dedicated to the premise that an economy that is short on energy is also short on jobs. The Committee's Policy Council includes leaders from virtually every sector of Michigan life including labor, business, industry, agriculture, education, energy producers and distributors, consumers, and other groups and individuals concerned about Michigan's energy future. Consumers Power Company endorsed the formation of the Committee, and we believe it is a good beginning in the quest for realistic solutions to the energy problems facing the state.

**Shareholder, Employee Support Vital**

But whatever developments take place on the national and state scenes in the year ahead, your management realizes that a large share of the challenge of continued progress for the Company rests with us. We can hope that leadership on the national scene will emerge; we can be heartened by its emergence in Michigan; but we can assure you of this much: That in 1978 we will continue to act to move your Company forward, and that with the continued support of shareholders and the demonstrated skills of our employees, our actions will continue to produce positive results.

Sincerely,

J. D. Selby, President

A. H. Aymond, Chairman of the Board

February 10, 1978

# Energy and people

**More than 10,650 employees served 1,250,000 electric customers and 1,000,000 gas customers through distribution systems geared to reliability, efficiency and the wise use of energy**

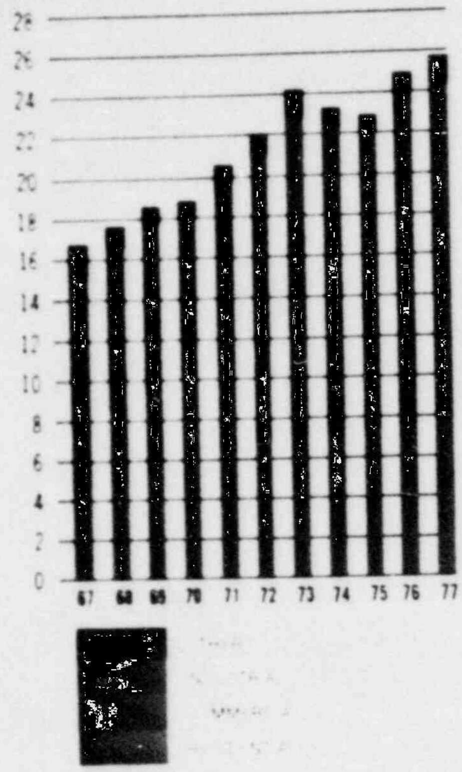
As the era of rapid expansion in energy demand — an era made possible by low cost, abundant energy sources — has changed to a period of rising energy prices and somewhat slower growth, the Company has moved aggressively to maximize the efficiency of its distribution system and stress the need for conservation and wise energy use. In 1976 the Company reorganized its field operations, consolidating 15 operating divisions into eight operating regions, and during the past year further steps were taken to increase the efficiency of the new system in meeting increasing, although changing, energy needs.

**Energy Conservation Encouraged**

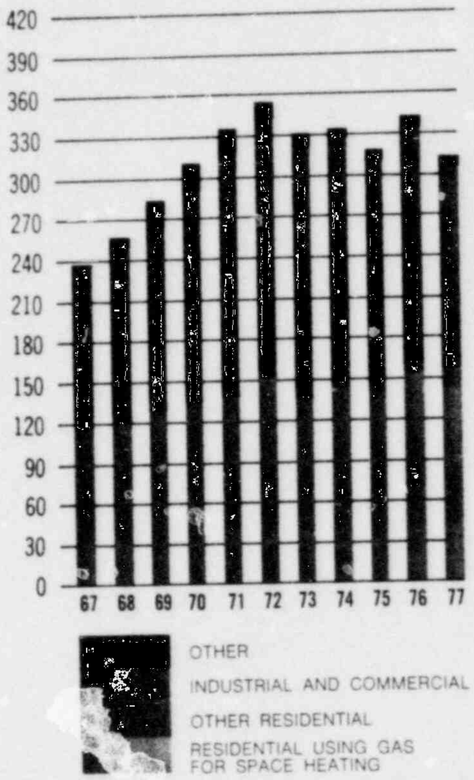
In a major conservation effort, the Company in July submitted to the Michigan Public Service Commission a home insulation and furnace retrofit program which it believes can result in significant natural gas savings without adverse effects on customers' life-styles. Although approval of the expanded insulation program has been delayed because of Congressional consideration of related national programs, the Company remains committed to the program's objectives. The three-phase effort includes: a combination sidewall and ceiling insulation program, with customers who participate repaying installation costs over a ten-year period; a two-year furnace retrofit testing program to increase heating system efficiency, which is already under way in conjunction with a national program coordinated by the American Gas Association; and actual installation of those retrofit devices which prove cost effective during the test period. Following Commission approval, a subsidiary company would be formed to finance and operate the program, and its costs, including administrative and interest expense, would be covered through a surcharge added to the bills of customers benefiting from the program, including new gas customers. The Company estimates savings of 5 billion cubic feet of gas annually after the first year of the insulation program, 25 billion cubic feet annually after the sixth year if all homes are insulated to recommended levels.

While awaiting approval of the expanded program, the Company continues to encourage the wise use of both electricity and natural gas through radio, television and newspaper advertising, brochures made available to customers and displays at customer service locations. The Company is also continuing its existing home insulation program and in 1977 this effort resulted in the insulation of 36,153 homes, which will save an estimated 830 million cubic feet of gas annually. Since this program's inception in 1973 nearly 120,700 homes have been insulated at an estimated total saving of 2,700 million cubic feet of gas.

**Electric Sales**



**Gas Sales**
BILLIONS OF CUBIC FEET

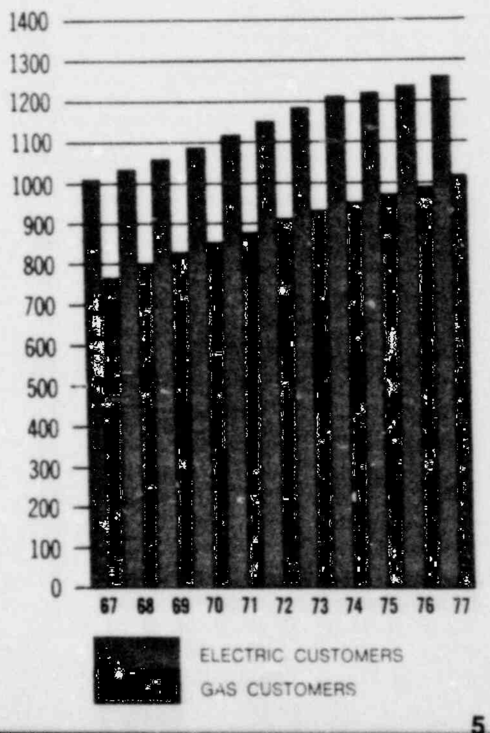



## Electric Sales Increase, Gas Sales Decline

At year-end 1977 the Company was serving 1,258,380 electric customers, 22,423 more than one year earlier, in a service area encompassing 27,800 square miles in 61 lower Michigan counties. Industrial electric customers totaled 7,830, commercial, 122,577 and residential 1,127,103. The population of the service area is approximately 3.3 million. Its industry features the manufacture of automobiles and their equipment, agriculture and tourism, and includes primary metals, chemicals, metal products, pharmaceuticals, machinery, oil refining, paper and paper products, food products and diverse other businesses. During 1977 the state's economy, reflecting gains in the national economy, continued its recovery from the 1974-75 recession. Of particular significance was a 7 percent increase in domestic new car sales. Total employment in the state increased by an estimated 150,000 jobs during the year, while the average annual unemployment rate fell from 9.4 percent in 1976 to 7.0 percent in 1977. Partly in response to those gains, during 1977 the Company sold a total of 25.7 billion kilowatthours of electricity, a 3.1 percent increase over 1976.

At year-end the Company was serving 1,014,585 gas customers, an in-

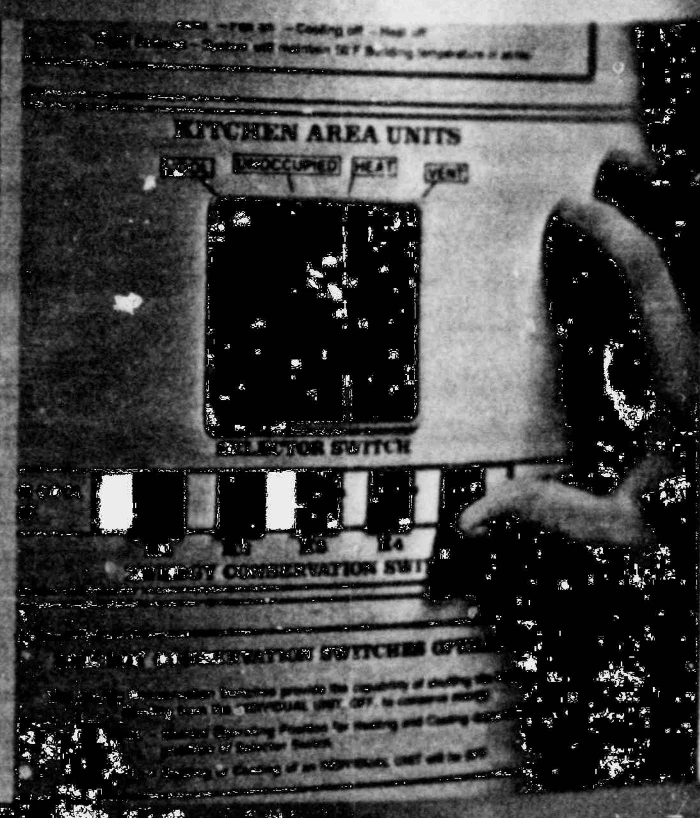
**Gas and Electric Customers**
THOUSANDS



## Conservation Is Catching

### Wise Use of Energy Is the Order of the Day

Perhaps the single unifying thread in the current patchwork of proposed solutions to the nation's energy dilemma is the need for wise energy use, for the elimination of waste wherever possible in our energy-dependent society. During 1977 Consumers Power Company continued to communicate that need to its customers through its advertising and public information programs while at the same time assuming an active role in helping customers to identify and take advantage of opportunities for energy savings. Some examples: As part of a major gas conservation program the Company began installing and testing various energy-saving furnace devices in the homes of volunteer residential customers. In the City of Jackson a series of infrared aerial photographs assembled as a mosaic map allowed residents to locate their homes and, according to the tint revealed by the photos, judge the effectiveness of their ceiling and roof insulation. The Company also worked closely with its commercial and industrial customers in seeking to minimize nonessential energy use in stores, factories and industrial processes.



crease of 24,066 during the year. The Company serves 6,483 industrial, 58,906 commercial, and 949,196 residential gas customers (of whom 882,470 use natural gas for home heating) in 40 lower Michigan counties. The 12,900-square-mile gas service area has 3.8 million residents and includes much of the populous suburban area north and west of Detroit. Warmer weather and energy conservation measures by customers in 1977 resulted in a decline in gas sales to 312 billion cubic feet, a decrease of 8.7 percent from 1976.

**Priority II Gas Service Reopened**

In September the Company began accepting for the first time since April 1975 new small industrial and commercial gas customers, classified as Priority II customers under a plan approved by the Michigan Public Service Commission. The Company had continued to add new residential customers (Priority I) throughout that period. The reopening of Priority II was in anticipation of increased natural gas supplies resulting from conservation efforts, the continued availability of the Marysville gas reforming plant, and successful gas exploration efforts by the Company's exploration subsidiary and interstate pipeline gas suppliers.

**New Labor Agreement Reached**

Operating, maintenance and construction employees represented by the Michigan State Utility Workers Council (AFL-CIO) approved a new three-year contract effective September 1, 1977. The agreement covers approximately 4,500 employees and calls for general wage increases averaging 31.3 cents per hour in each of the three years. An increase in the cost-of-living allowance of eight cents an hour became effective September 5, 1977. Additional cost-of-living allowances of up to 25 cents per hour each year are possible. The new contract provides for improved benefits during the term of the agreement, as well as for certain changes in work rules to improve efficiency.

**"Miss Dig" Extended to Overhead Lines**

"Miss Dig," the utility communications system which has reduced damage to underground utility lines in Michigan by an estimated 50 percent, was expanded in July to provide assistance to those working in proximity to overhead lines as well. At present an overhead pilot program is operable in four lower Michigan counties. Since 1970, when Consumers Power Company initiated it, the underground program has grown to encompass other utilities across the entire state, including the Upper Peninsula. The new overhead program employs the same procedure used for underground facilities. Contractors or others planning work in the vicinity of overhead lines call a toll-free number at least 48 hours before beginning work. Participating utilities with overhead lines in the area are then contacted and their representatives inspect the work site and provide information on voltages and the proper procedures to be followed in working near overhead lines.

# Keeping up with demand

**Our job: Maintain adequate energy supplies for the 5,200,000 people who live in our service area**

Consumers Power Company is a fully integrated energy company operating one of the larger electric systems and one of the larger natural gas systems in the United States. The Company's 25 electric generating plants have a total net demonstrated capability of 6,406,300 kilowatts. The gas system, assuming availability of supply, has a peak day transmission and distribution capacity of more than 2.8 billion cubic feet.

**New Peak Records Set**

New records for energy supply to both electric and gas customers were set in 1977. On January 17 a new 24-hour gas sendout record was established when customer usage reached 2.346 billion cubic feet. The previous peak 24-hour sendout was 2.314 billion cubic feet, set on December 6, 1976. The 1977 record was in turn broken on January 10, 1978, when customers required 2.38 billion cubic feet. On the electric system the records for 24-hour sendout and one-hour demand were both broken three times in July, with the current sendout and demand records being set on the 20th at 93,298,900 kilowatthours and 4,542,340 kilowatts. Prior to 1977 the peak records were 88,503,590 kilowatthours and 4,394,295 kilowatts, both set in August 1973. Another record was established during the week ended December 10, 1977, when the electric system met customers' demands for 594,800,500 kilowatthours, which surpassed the 584,508,200 kilowatthours sent to customers during the week ended January 15, 1977.

**Nuclear Reliability Demonstrated By Big Rock, Palisades**

The Company's Palisades and Big Rock Point nuclear plants both performed well, supplying nearly 20 percent of customers' electric energy requirements during 1977, up from 11 percent in 1976. Big Rock Point, which went into service in 1962 as the nation's fifth commercial nuclear plant, set a new world record for continuous production of electricity by nuclear generation. The plant operated a total of 343 continuous days from August 13, 1976 until July 23, 1977, when it was shut down until October for refueling and scheduled maintenance. Also during 1977 the 730,000-kilowatt Palisades plant had a unit availability factor of approximately 91 percent, versus an average availability factor of approximately 75 percent for the nuclear industry as a whole. After generating more than five billion kilowatthours of electricity in 1977, more than ever before, Palisades was taken out of service in January 1978 for refueling, scheduled maintenance and testing.

The two plants also continued to demonstrate that nuclear power is economical. In 1977 they generated power at a cost of .209¢ per kilowatthour in fuel costs, compared to a system average of 1.208¢ and an average of 1.541¢ for fossil-fueled generation alone.

**Fuel, Gas Costs Up**

Fuel for the Company's fossil-fueled electric generating plants continued to increase in cost. In 1977 coal-fired plants burned 5.6 million tons at an average cost of $25.36 per ton as compared to $23.37 in 1976. Consumption of oil, which fuels about one-fourth of the Company's generating capacity, amounted to 6.2 million barrels during the year at an average cost of $14.89 per barrel as compared to $13.60 in 1976.

The cost of gas purchased and produced by the Company also rose, from $1.37 per Mcf in 1976 to $1.63 in 1977, an increase of 19 percent.

## Marysville Ran Smoothly

The Marysville gas reforming plant, which converts liquid hydrocarbon feedstocks into pipeline-quality gas, produced 40 billion cubic feet of gas during the year, which represented 12 percent of the Company's total gas supply. During the extremely cold weather of January 1977 Marysville not only played a vital role in maintaining uninterrupted gas service to the Company's customers in Michigan, but also came to the aid of an Ohio gas utility which was experiencing serious supply shortages and a partial shutdown of its own reforming plant. For approximately two months, through a procedure known as "displacement," up to 35 million cubic feet of gas per day enroute via interstate pipeline to Consumers Power were diverted to the Ohio utility. In turn, feedstock liquids originally intended for the Ohio utility's reforming plant were sent to Marysville, where they were converted into pipeline-quality gas for the Company's customers. The Ohio utility, in addition to supplying the feedstock, also paid the cost of reforming it.

Total gas production at Marysville since the plant went into operation in 1973 is in excess of 229 billion cubic feet.

## Plateau Has Its First Birthday

The Company's wholly-owned subsidiary, Plateau Resources Limited, completed its first year in June and throughout 1977 continued its search for uranium, principally to help meet the Company's long-term need for fuel for its nuclear plants. Plateau owns mining claims covering 122,000 acres in Utah, Colorado and Wyoming and has options to purchase claims on an additional 3,000 acres. It also has rights to purchase mined ores from some 17,000 acres in Utah and Colorado. With an office in Grand Junction, Colorado, Plateau increased its staff to 96 as operational activity increased during the year, and also completed an ore-buying station in Utah. Based on exploration work through 1977, it is estimated that there are reserves of approximately 6.2 million pounds of uranium contained in 2.6 million tons of economically mineable ore on Plateau properties.

## Gas Supply Improved

About 73 percent of the Company's gas supply in 1977 came from interstate pipeline suppliers, up 5 percent from 1976. Another 15 percent came from Michigan production and 12 percent was produced by the Marysville gas reforming plant. Curtailments from pipeline suppliers remained in effect but eased somewhat, from some 123 billion cubic feet in 1976 to some 100 billion cubic feet in 1977, largely due to new gas production in the Gulf of Mexico. The Company has all or part of working interests in 71 producing oil or gas wells in several fields in southern lower Michigan, from which it receives some 8 million cubic feet of gas per day.

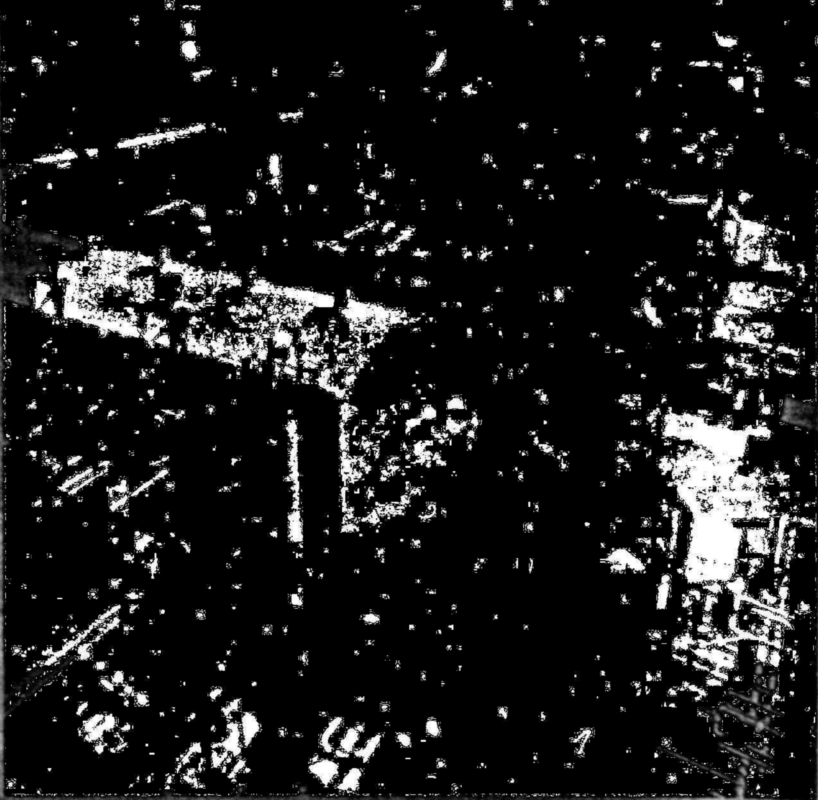
## NOMECO's Success Story Continued

Northern Michigan Exploration Company, the Company's wholly-owned oil and gas exploration and development subsidiary, completed its 10th full year of operations in November. NOMECO operates primarily in the lower 48 states but also has interests in petroleum concessions in the Kingdom of Tonga 1,100 miles northeast of New Zealand and the country of Belize in Central America. NOMECO has interests in oil and gas leases on approximately 471,000 acres in northern lower Michigan, from which it supplies the Company with some 35 million cubic feet of gas per day (an additional 75 million cubic feet per day is supplied by other producers in northern lower Michigan).

NOMECO is also involved in the search for gas and oil in seven tracts located on 32,500 acres offshore Louisiana, and has interests in four production platforms as well as an interest in a fifth platform under construction. NOMECO also has interests in 455,000 acres onshore Louisiana and in Texas, Colorado, Wyoming, Montana, South Dakota and California.

In all, NOMECO has interests in leases on 4,361,000 acres and has interests in 152 oil and gas wells, as compared to 135 at year-end 1976. In 1977 NOMECO was involved in the drilling of 56 wells, and found oil or gas in 18. The subsidiary's net production for 1977 was 1,276,000 barrels of oil and 15 billion cubic feet of gas, and its proved reserves as of January 1, 1978 were 8,620,000 barrels of oil and 79 billion cubic feet of gas.

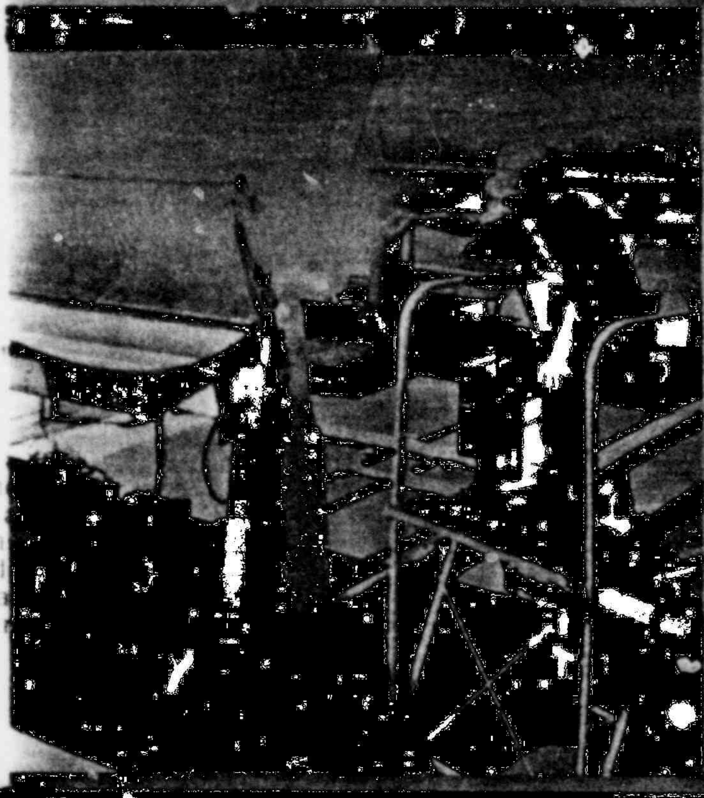
For 1977 NOMECO, with total assets of $79.5 million, had gross revenues of $43.5 million and net income of $12.8 million.



# Developing Our Energy Resources

## From the Routine to the Exotic

Some people insist that there must be an easy answer to the energy dilemma, a new "[illegible]" technology that can be put in place almost overnight. Energy experts know, however, that the only answer to dwindling conventional energy sources is painstaking exploration, research and development, all of which mean time and money. Consumers Power Company is actively engaged in such efforts. The success of its wholly-owned subsidiary, Northern Michigan Exploration Company, in seeking new sources of oil and gas has been well documented, and during the past year a new subsidiary, Plateau Resources Limited, has begun making its own name in the field of uranium exploration and discovery. The Company was also among the first to employ the synthetic natural gas process for making high Btu gas, and the importance of its Marysville gas reforming plant was demonstrated dramatically in the energy crisis in early 1977. Looking to the future, the Company is contributing to research in solar, geothermal, wind, the breeder reactor, nuclear fusion, and other new energy sources through its support of organizations such as the Electric Power Research Institute.



# Lead time is the name of the game

**Tomorrow's energy can only come from facilities being developed today**

In the energy business, as perhaps in no other, long-range planning and extended lead times are essential in providing adequate facilities to meet — in Consumers Power Company's case — the needs of millions of people decades into the future. The lead time required in building a major coal-fired electric generating plant is now more than eight years, while building a nuclear plant takes more than 11 years. Exploring for oil and gas, developing discoveries and building gathering and transmission systems offer similar challenges — the development of the gas producing area in northern lower Michigan, for example, took two and one-half years after the first commercial discovery was made until the first natural gas was delivered to a customer.

So the planning function and the construction and exploration programs are where tomorrow's adequate energy supplies have to begin.

In its construction activities in 1977 the Company spent $521 million, advancing three major electric projects and strengthening its gas supply facilities in the north-central Lower Peninsula.

**Midland Construction Progresses Substantially**

Perhaps the most dramatic construction event of the year in Michigan occurred on July 16 when the 185-ton dome for Unit 1 of the Midland nuclear plant was lifted — by two 300-ton-capacity ground-based ringer cranes — into position 200 feet above the base of the reactor building. Only a week before Unit 1's 170-ton-capacity polar crane had likewise been lifted into place.

Construction continued on schedule throughout 1977 with an average of some 2,500 workers at the plant site. By year-end more than $655 million had been spent on the project, about $230 million of it in 1977; and the plant was 41 percent complete.

When in operation, Midland's two units will have a total generating capability of approximately 1,300 megawatts as well as the ability to supply up to 4,000,000 pounds of steam per hour to The Dow Chemical Company for use in industrial processes. Unit 2 is scheduled to go into service in 1981, and Unit 1 — which will produce the process steam for Dow — in 1982. The project, estimated to cost $1.67 billion, has been noted nationally as a foremost example of cogeneration.

Quarterly press briefings were held during the year at the plant to keep news media informed on construction progress, and public interest remained high as more than 3,200 people in groups of varying sizes visited the site and were updated on the project by Company personnel.

The construction permits for the Midland plant are the subject of litigation which is discussed on Page 17 of this Annual Report. That litigation did not delay construction during 1977.

**Karn 4 Completed, Placed in Service**

The Company's 620-megawatt Unit 4 of the Dan E. Karn plants at Essexville, Michigan, went into commercial operation in September. Unit 3 originally went into operation in 1975. Together, oil-fired Karn 3 and 4 cost $250 million. With coal-fired Units 1 and 2, the Karn plants have a total capacity of 1,670 megawatts.

**Campbell 3 Work Proceeds**

Construction of Unit 3 of the James H. Campbell plants at Port Sheldon, Michigan, continued as planned during the year, with an average of nearly 450 workers on the project. The 770-megawatt nameplate rating unit is expected to cost $510 million and is scheduled for commercial service in 1980. At that time the three coal-fired units at the Campbell plants will have a total capacity of 1,430 megawatts.

# Adequate Environmental Protection Is Essential ...and Expensive

### Costs and Benefits Must Be Weighed

Protecting the environment, for our own health and safety as well as that of future generations, is everyone's business, including Consumers Power Company's. At the same time, however, the Company believes that the benefits to be derived from environmental protection projects must always be weighed against their ever-increasing cost, a cost which ultimately must be borne by the consumer. The projects shown here — a new meteorological tower at the Palisades nuclear plant, water chemistry facilities at the Morrow plant, precipitators at the Campbell plant — represent just a small fraction of the Company's overall investment in environmental protection. But the Campbell Unit 2 precipitator, in particular, demonstrates the often dubious relationship between environmental benefits and the cost of achieving them: Constructed to assure compliance with Michigan Air Pollution Control Commission emission limits, a modification to the precipitator will increase the fly ash removal efficiency of the plant's previously existing facilities by only 4 percent — at a cost of approximately $25 million.

### More Gas From the Northern Niagaran Trend

The Company's largest gas construction job of 1977 was completed in January 1978, when a new 26-mile pipeline linked the Muskegon River Compressor Station near Marion, Michigan, with existing facilities to the north in Missaukee County. The line will increase by about 25 million cubic feet daily, or more than 20 percent, the capacity of the Company's pipeline system for transporting gas from the northern Niagaran trend, an oil and gas producing area extending northeast across the northern Lower Peninsula. The cost of the project was approximately $4.5 million.

### Construction Costs Include Major Environmental Expenses

The Company expects approximately $2.9 billion to be spent on construction during the five-year period 1978-1982. Of that total, anticipated construction expenditures for environmental protection are estimated at $519 million. In addition, $230 million in costs will be incurred for operation and maintenance of pollution control equipment and for the premium required for low-sulfur fuel over the five-year period.

Meeting environmental requirements adds significantly to the cost of supplying electric and gas service and ultimately, to the bills paid by customers for those services. In 1977 alone the Company spent a total of $112 million to meet environmental standards involving air, water, nuclear radiation control, solid waste disposal, noise abatement, aesthetics and land use. About $89 million went for capital investments in facilities and the remainder was incurred as added costs for operation and maintenance of environmental facilities, including incremental costs for low-sulfur fuel and energy costs for operation of environmental equipment.

### Environmental Quality Protected

The Company has been committed to a sound policy of environmental quality for many decades, and its activities have borne out that commitment. However, particularly in these days of severe inflation, the Company feels strongly that the cost-benefit ratio of every environmental activity should be studied carefully to determine just what projects are necessary. Those projects which will bring little or no measurable improvements but involve substantial expense should be rejected.

As one example of this problem, in December 1977 the Company presented evidence to the Michigan Air Pollution Control Commission (MAPCC) to support its prior request to modify a January 1, 1980 requirement for reduction of sulfur dioxide emissions at three of its electric plants. The Company pointed out that if it was required to convert to low-sulfur coal at those plants by 1980, its customers would pay $595 million for the substitution during the period 1980-1985, based on the cost of adding precipitators to two plants and using the more expensive low-sulfur coal at all three. However, a more gradual phasing in of the environmental requirement, as recommended by the Company and the Michigan Public Service Commission staff, allowing two of the plants until 1983 and one until 1985 to comply, would cost $95 million over the period, thus saving customers $500 million. And while the delay would be much more economical, it would not compromise air quality in the areas adjacent to the plants. The Company received favorable response to part of its proposal when in January 1978 the MAPCC granted a compliance date extension for the J. H. Campbell plant until 1985, saving the Company's customers an estimated $310 million between 1980 and 1985 provided that subsequent approval is also obtained from the Federal Environmental Protection Agency. The decision allows an orderly and economical changeover while still assuring continuing protection of air quality. Commission decisions on the request for extensions at the two other locations, the Cobb and Weadock plants, are pending.

Consumers Power Company will continue to present such proposals to the appropriate authorities whenever the Company feels it can save its customers money without endangering Michigan's environment.

# Corporate Review—1977

**1977 was a year of record financing to maintain needed construction**

**1977 Financing**

The year was highlighted by the pressing demands of financing, both to provide the funds necessary for construction and to retire maturing debt which was incurred at interest rates far below those now in effect. To accomplish those aims during 1977 the Company completed new financing in the total amount of approximately $509.5 million, which included three issues of First Mortgage Bonds, an issue of Pollution Control Revenue Bonds, one issue of Preferred Stock, one issue of Preference Stock, and two issues of Common Stock, as follows:

**First Mortgage Bonds**
**March**
$40 million, 8¾% Series due 1997

Effective interest cost to the Company: 8.80%

**June**
$85 million, 8⅞% Series due 2007

Effective interest cost to the Company: 9.01%

**October**
$100 million, 8⅝% Series due October 15, 2007

Effective interest cost to the Company: 8.74%

**Pollution Control Revenue Bonds**
**August**
$23 million due August 1, 1982-August 1, 2007

Effective interest cost to the Company: 4.50% to 6.40% depending on respective maturity dates

**Preferred Stock**
**July**
$32 million gross proceeds from private placement of 320,000 shares, cumulative, $100 par value, at $100 per share, annual dividend rate: $9.25

Cost after underwriting commissions: 9.31%

**Preference Stock**
**October**
$50 million gross proceeds from sale of 2,000,000 shares, cumulative, $1 par value, at $25 per share, annual dividend rate: $2.23

Cost after underwriting commissions: 9.27%

**Common Stock**
**May**
3,500,000 shares, $23⅛ per share

Net proceeds after underwriting discounts and commissions: $78.5 million

**November**
2,500,000 shares, $24⅛ per share

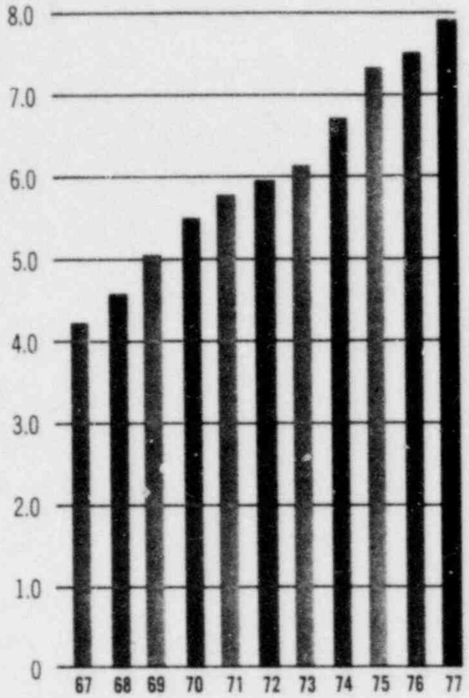
Net proceeds after underwriting discounts and commissions: $58.5 million

Also during the year the Company negotiated an increase in a bank term loan, from $50 million to $75 million, and increased the credit available under a lease arrangement for a portion of its nuclear fuel from $32.5 million to $50 million.

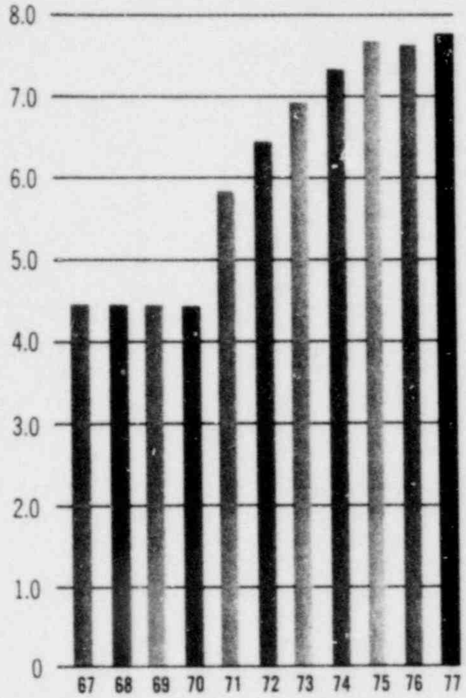
**1978 Financing**

The need to maintain an expanded construction program and to finance that construction will not lessen in the year ahead. The Company estimates construction expenditures of approximately $563 million for 1978, net of $203 million of anticipated participation by third parties. To finance that program it is expected that the Company will carry out financing in the approximate amount of $450 million during the year.

**Average Cost of Long-term Debt**
PERCENT




**Average Cost of Preferred and Preference Stock**
PERCENT



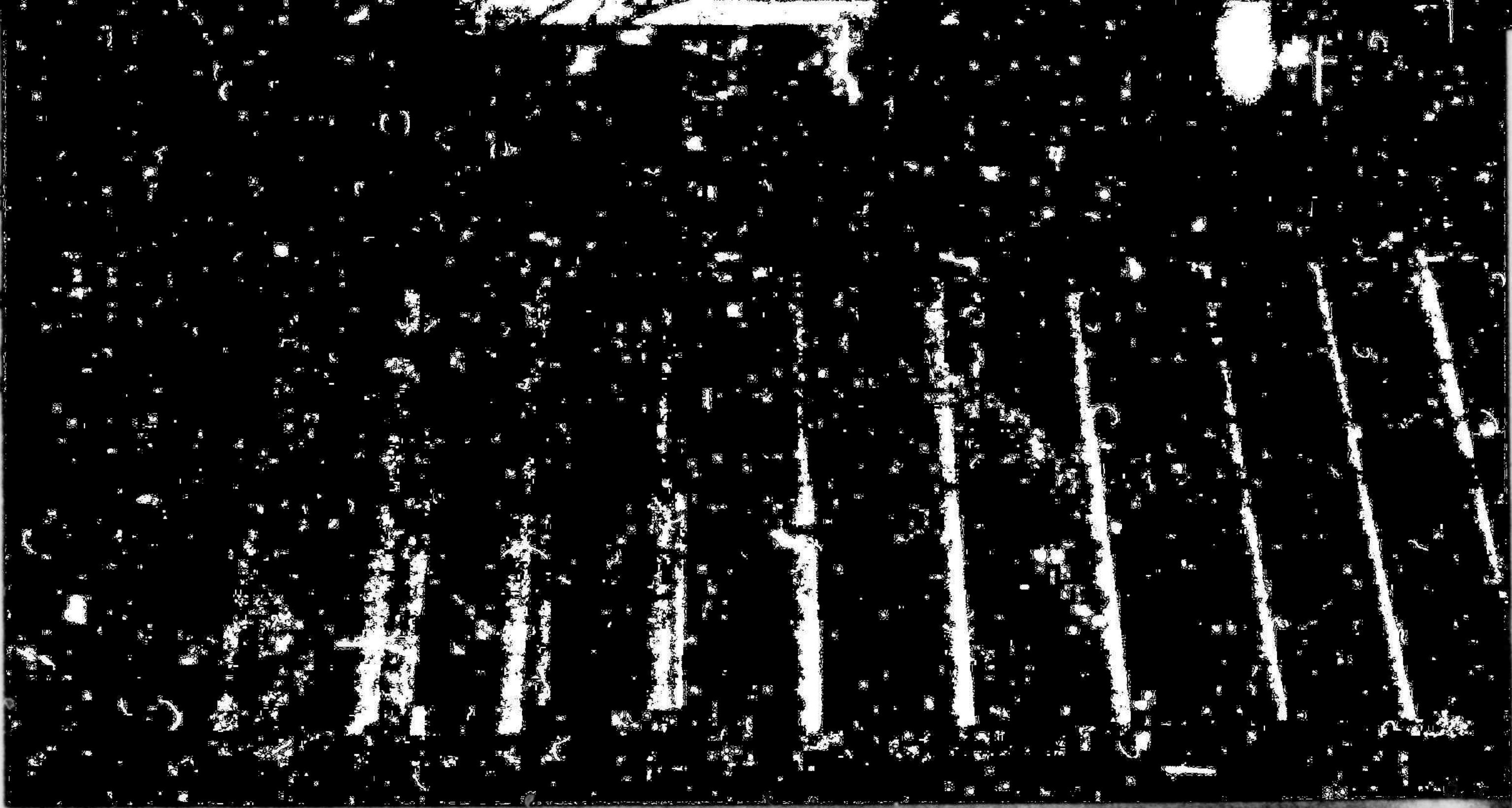

**Dividend Reinvestment and Common Stock Purchase Plan**

The 19,431 shareholders who are enrolled in the Company's dividend reinvestment and common stock purchase plan had dividends of $5,414,067 reinvested in common stock in 1977, along with optional cash payments of $1,832,502. At year-end, 383,021 shares of stock had been issued to plan participants at an average price of $23.15 per share. Proceeds from the issue of stock through the dividend reinvestment program were used to help finance the construction program. Under the plan, dividends of shareholders who have elected to participate are automatically reinvested in new shares of common stock. Participants in the plan may also invest optional cash payments along with their reinvested dividends. Common stock shareholders who are interested in obtaining more information concerning the dividend reinvestment plan should write to: The Stock Transfer Department, Consumers Power Company, 212 W. Michigan Avenue, Jackson, MI 49201. Any offering of securities by the Company will be made only by means of a prospectus.

**Electric and Gas Rate Cases**

One facet of the Company's corporate picture entering 1978 is clear: If necessary financing is to be obtained at an acceptable cost, then timely and adequate rate relief — relief which will bring the Company's revenues, earnings and rates of return into a realistic balance with the cost of doing business — is essential. In 1977 two such requests for rate relief were pending before the Michigan Public Service Commission. In March 1977 the MPSC authorized $4.9 million annually in interim gas rate relief in a proceeding originally filed by the Company in November 1974. That rate relief was in addition to $29.2 million in interim relief granted in June 1975. In January 1978 the Company received a final order granting an additional $11 million relief in this case.

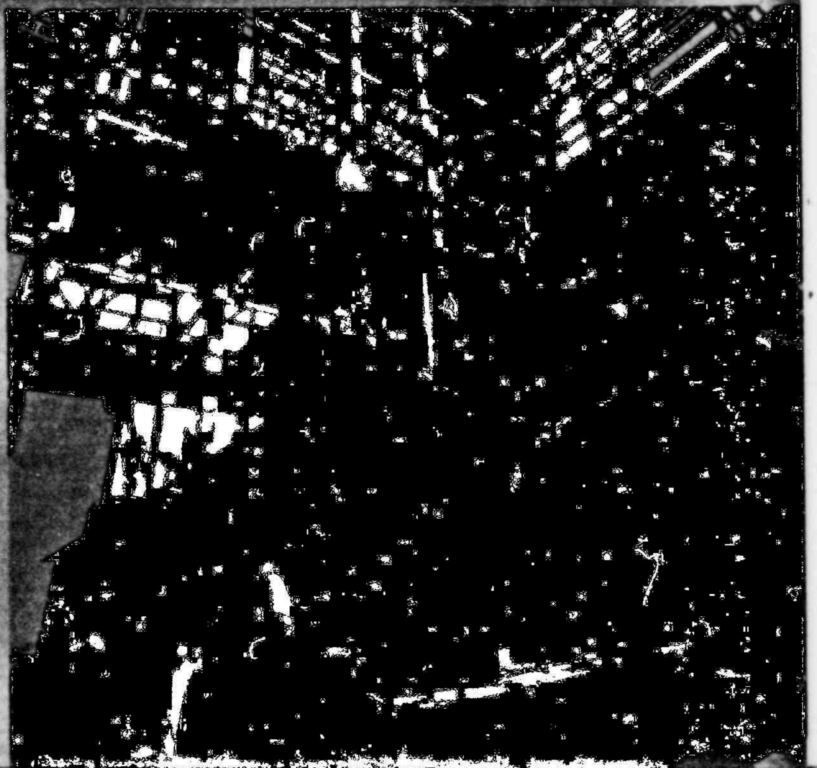
Also before the Commission is an application filed in January 1977 for $164.2 million in electric rate relief, including $43.7 million in interim relief. Hearings have been completed in the proceeding and a final order on this request is expected in the spring. Of the total amount requested, some $79.4 million reflects proposed accounting changes needed to improve the quality of earnings and would not increase net income. The balance is needed to recover and meet increased operating costs and to increase the authorized rate of return on common equity in the electric business from the present 12.75 percent to 15 percent.



## Construction Today for Energy Tomorrow

**Though at a Somewhat Slower Rate Than in the '60s and Early '70s, Demand Will Continue to Grow**

Public discussion of energy matters tends to ebb and flow, with headlines one month, silence the next. But Consumers Power Company cannot afford the luxury of part-time concern; if the future needs of customers are to be met, then action now is a must — and that means pressing ahead with construction of major facilities to provide power in the 1980s and beyond. During 1977 one such project, the oil-fired Karn Unit 4, was completed. (At the same time two new 60-car TankTrains entered service. Each train makes a complete, 300-mile round trip between Sarnia, Ontario, and the Karn plants at Essexville every 48 hours, including loading and unloading 1,389,000 gallons of oil.) In addition to the completion of Karn 4, work continued on the coal-fired Campbell Unit 3, scheduled for completion in late 1980, and on the twin-unit Midland nuclear plant, a cogeneration project which in 1981 and 1982 is scheduled to begin providing needed power to our electric customers as well as process steam to The Dow Chemical Company.



**Midland Litigation Continuing**

In September a Nuclear Regulatory Commission Atomic Safety and Licensing Board issued a decision allowing construction of the Company's Midland nuclear generating plant to continue pending the outcome of hearings on issues which a U.S. Court of Appeals in July 1976 remanded to the NRC for review. That decision was affirmed by an Atomic Safety and Licensing Appeal Board in February 1978.

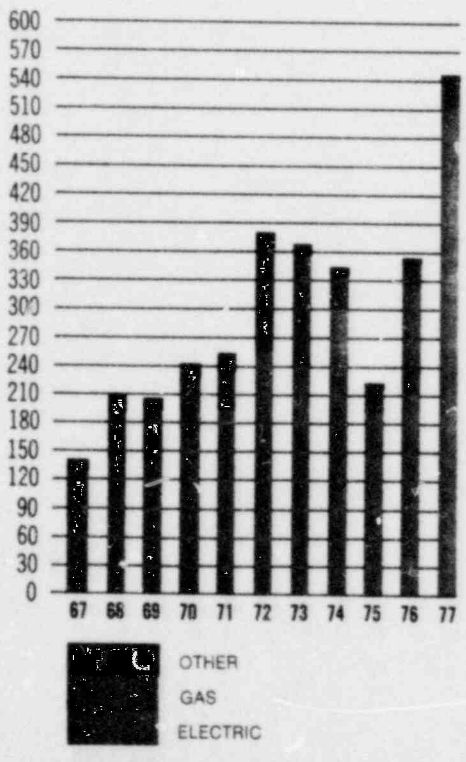
Hearings on the merits of the issues remanded by the Court of Appeals to the NRC are to be conducted in 1978. Those issues are the impact of energy conservation and nuclear fuel cycle matters on the cost-benefit analysis performed for the plant, any changed circumstances regarding The Dow Chemical Company's need for process steam from the plant as well as Dow's intentions concerning continued operation of its fossil-fueled facilities, and clarification of the report on the plant issued by the former Atomic Energy Commission's Advisory Committee on Reactor Safeguards.

At the Company's request, the U.S. Supreme Court is reviewing the July 1976 Court of Appeals decision. The Court heard arguments in the case in December 1977, and a decision is expected early in 1978.

In August the Company applied to the NRC for a 40-year operating license for the Midland plant. Included in the application was the Final Safety Analysis Report, a description and safety analysis of the facility and its design and operational capabilities. The Midland plant environmental report, another major element of the license application, is scheduled to be submitted to the NRC by March 1, 1978.

In December an NRC Atomic Safety and Licensing Appeal Board issued a 432-page decision which remanded proceedings for the taking of further evidence in light of recent events and to determine what conditions should be attached to the Midland construction permits in order to protect smaller utilities in the Company's service area against practices which the Appeal Board found to be inconsistent with the antitrust laws. The Appeal Board action reversed the finding of an Atomic Safety and Licensing Board which in 1975 ruled that operation of the Midland plant without license conditions would not be inconsistent with the antitrust laws. Since the 1975 decision the Company has offered to sell a total of approximately 12 percent of the electric portion of the Midland plant to Northern Michigan Electric Cooperative, Inc. and Wolverine Electric Cooperative, Inc. and has offered to sell to the cities of Holland and Lansing a total of approximately 9 percent of the electric portion of the facility. Northern Michigan Electric Cooperative, Inc., Wolverine Electric Cooperative, Inc. and the City of Holland are intervenors in the proceeding. Although the Company expects ultimately to resolve this matter through agreement with the cooperatives and municipalities, the Company does not agree with the findings of the NRC Appeal Board and plans to seek review of its decision.

**Plant Additions and Improvements**
MILLIONS OF DOLLARS



## Palisades Suit Settled

During 1977 the Company reached settlements with the three remaining defendants in its lawsuit stemming from work done at the Palisades nuclear plant. Under an agreement reached in May 1977 with Bechtel Corporation and Bechtel Company, the Company accepted approximately $14 million in cash and future services, and under an agreement reached in December with Combustion Engineering, Inc., the Company accepted approximately $40.5 million in cash and future services, which could rise to $60.5 million depending on the future value of certain uranium fuel assemblies. The Company in 1976 had reached settlements totaling $13.5 million with the suit's other two defendants, Ingersoll-Rand Company and the Wolverine Tube Division of UOP, Inc. The total amount of the settlements reached with the five defendants in 1976 and 1977 was approximately $68 million in cash and future services. The Company originally filed the suit in August 1974 in Federal District Court in Grand Rapids.

## Dividends and Annual Meeting

At its April 1977 meeting the Company's Board of Directors raised the quarterly dividend on common stock by 6 percent, to 53 cents per share. During the year the Company paid $77,866,000, or $2.09 per share, in dividends to its common shareholders and $33,372,000 in dividends to holders of preferred and preference stock. Preference shareholders converted 680,326 shares of the $5.50 preference stock issued in 1975 and 452,256 shares of the $6.00 preference stock issued in 1974 into 4,002,652 shares of common stock by year-end.

As of December 31, 1977, there were 154,550 common shareholders and 40,051 preferred and preference shareholders. The Company's shareholders include residents of all 50 states, the District of Columbia and 28 foreign countries, with average holdings of 259 shares. Approximately 56 percent of all shareholders are Michigan residents.

The Company's 1977 Annual Meeting of Shareholders was held April 12, 1977, in the Company's Parnall Office Building. A total of 26,778,071 shares or 69.7 percent of all shares of stock outstanding, was represented at the meeting either in person or by proxy. Following the Annual Meeting almost 5,000 shareholders attended eight regional shareholder meetings held during April in the Company's region headquarters cities.

The 1978 Annual Meeting of Shareholders will take place Tuesday, April 11, at 2:00 P.M. Jackson time in the Parnall Office Building, 1945 West Parnall Road, Jackson, Michigan. Four regional meetings of shareholders also will be held in 1978 as follows: Grand Rapids, April 12; Lansing, April 18; Saginaw, April 19; and Pontiac, April 20. Further information will be made available to shareholders prior to the dates of the regional meetings.

## Dr. Upjohn Retires, R. B. White Elected to Board

At the 1977 Annual Meeting, the shareholders elected Robert B. White, executive vice president of Citibank, N.A., New York, a director. Mr. White succeeded Dr. E. Gifford Upjohn, director of The Upjohn Company, who retired in accordance with the Board's retirement policy. Dr. Upjohn made many valuable contributions during the 12 years he served as a director.

## In Memoriam

The Company was saddened at the loss on May 2 of Edward N. Cole, a member of the Board of Directors, who died in the crash of a private plane. Mr. Cole was chairman of the board of International Husky, Inc. and Checker Motors Corporation, and was retired president of General Motors Corporation. He had been a valued member of the Company's Board of Directors since October 1974.

## Company Directors

A. H. AYMOND
Chairman of the Board of the Company
Jackson, Michigan

WALTER R. BORIS
Executive Vice President of the Company
Jackson, Michigan

E. NEWTON CUTLER, JR.
Retired
New Vernon, New Jersey

RICHARD M. GILLETT
Chairman of the Board and Chief Executive Officer of Old Kent Financial Corporation, Grand Rapids, Michigan, a bank holding company

MARTHA W. GRIFFITHS
Attorney, Griffiths and Griffiths
Romeo, Michigan

JOHN W. HANNON, JR.
President of Bankers Trust Company and Bankers Trust New York Corporation
New York, New York

DON T. McKONE
President and Chief Operating Officer of Libbey-Owens[illegible] Company, Toledo, Ohio, a diversified corporation

C. S. HARDING MOTT
Chairman and Trustee of the Charles Stewart Mott Foundation, Flint, Michigan, a philanthropic foundation

L. C. ROLL
Vice Chairman of the Board of Kellogg Company, Battle Creek, Michigan, cereal manufacturer

JOHN D. SELBY
President of the Company
Jackson, Michigan

JOHN B. SIMPSON
Executive Vice President of the Company
Jackson, Michigan

JOHN C. SUERTH
Chairman of the Board and Chief Executive Officer of Gerber Products Company, Fremont, Michigan, leading manufacturer of foods, special products, and services for babies

ROBERT B. WHITE
Executive Vice President of Citibank, N.A.,
New York, New York

RUSSELL C. YOUNGDAHL
Executive Vice President of the Company
Jackson, Michigan

## Company Officers

A. H. AYMOND
Chairman of the Board, Chief Executive Officer

JOHN D. SELBY
President, Chief Operating Officer

JOHN B. SIMPSON
Executive Vice President, Energy Distribution, Customer Services, General Services, and Oil and Gas Exploration

RUSSELL C. YOUNGDAHL
Executive Vice President, Energy Supply

WALTER R. BORIS
Executive Vice President, Finance and Corporate Affairs

JOHN W. KLUBERG
Senior Vice President, Accounting and Corporate Information Systems

JAMES B. FALAHEE
Senior Vice President, Legal, Regulation and Public Affairs

STEPHEN H. HOWELL
Vice President, Projects Engineering and Construction

LOWELL L. SHEPARD
Vice President, Region Operations

RAYNARD C. LINCOLN, JR.
Vice President, General Services

JACK W. REYNOLDS
Vice President, Personnel

CHARLES R. BILBY
Vice President, Electric Production and Transmission

ROBERT J. FITZPATRICK
Vice President, Public Affairs

LAWRENCE B. LINDEMER
Vice President and General Counsel

JAMES W. COOK
Vice President, Energy Planning

PAUL A. PERRY
Secretary

RICHARD M. GRISWOLD
Treasurer

SAMUEL N. SPRING
Controller

## Regions and General Managers

(Headquarters cities in parentheses)

Central Region (Saginaw) CHARLES F. BROWN
Eastern Region (Flint) STANLEY M. JURRENS
Metro Region (Royal Oak) EUGENE A. WAGGENER
Northern Region (Traverse City) JOHN G. GOENSE
South Central Region (Lansing) WILLIAM A. HOLTGREIVE
Southeastern Region (Pontiac) RALPH HAHN
Southwestern Region (Kalamazoo) K. EUGENE McGRAW
Western Region (Grand Rapids) J. LAURENCE GILLIE

# Statement of Income

CONSUMERS POWER COMPANY

| | YEAR ENDED DECEMBER 31 | |
|---|---|---|
| | 1977 | 1976 |
| | Thousands of Dollars | |
| OPERATING REVENUE (Note 1): | | |
| Electric | $ 908,963 | $ 878,468 |
| Gas | 724,821 | 700,236 |
| Steam | 2,826 | 2,548 |
| Total operating revenue | $1,636,610 | $1,581,252 |
| OPERATING EXPENSES AND TAXES: | | |
| Operation— | | |
| Fuel consumed in electric generation | $ 262,723 | $ 266,447 |
| Purchased and interchange power | 130,005 | 127,464 |
| Cost of gas sold (Note 1) | 496,567 | 460,458 |
| Other | 215,107 | 194,555 |
| Total operation | $1,104,402 | $1,048,924 |
| Maintenance (Note 14) | 80,576 | 68,724 |
| Depreciation and amortization (Note 14) | 102,448 | 96,954 |
| General taxes | 74,397 | 77,365 |
| Income taxes (Note 8) | 62,845 | 77,315 |
| Total operating expenses and taxes | $1,424,668 | $1,369,282 |
| NET OPERATING INCOME: | | |
| Electric | $ 162,873 | $ 151,952 |
| Gas | 48,952 | 59,864 |
| Steam | 117 | 154 |
| Total net operating income | $ 211,942 | $ 211,970 |
| OTHER INCOME: | | |
| Allowance for funds used during construction prior to 1/1/77 (Notes 1 and 9) | $ — | $ 33,848 |
| Allowance for other funds used during construction after 1/1/77 (Notes 1 and 9) | 30,444 | — |
| Income of subsidiaries (Notes 1 and 10) | 13,450 | 10,779 |
| Gain on reacquisition of long-term debt | 2,389 | 2,539 |
| Other, net | 5,508 | 1,469 |
| Net other income | $ 51,791 | $ 48,635 |
| INTEREST CHARGES: | | |
| Interest on long-term debt | $ 131,931 | $ 113,695 |
| Other interest charges | 562 | 2,365 |
| Allowance for borrowed funds used during construction after 1/1/77 (Notes 1 and 9) | (23,767) | — |
| Total interest charges | $ 108,726 | $ 116,060 |
| Net income | $ 155,007 | $ 144,545 |
| DIVIDENDS ON PREFERRED STOCK | 25,437 | 24,071 |
| DIVIDENDS ON NONCONVERTIBLE PREFERENCE STOCK | 5,764 | 1,701 |
| DIVIDENDS ON CONVERTIBLE PREFERENCE STOCK | 3,386 | 5,177 |
| Net income after dividends on preferred and preference stock | $ 120,420 | $ 113,596 |
| AVERAGE NUMBER OF SHARES OUTSTANDING: | | |
| ASSUMING NO DILUTION | 37,866,497 | 31,300,333 |
| ASSUMING FULL DILUTION | 39,942,354 | 34,487,013 |
| EARNINGS PER SHARE OF COMMON STOCK: | | |
| ASSUMING NO DILUTION | $3.18 | $3.63 |
| ASSUMING FULL DILUTION | $3.10 | $3.44 |

The accompanying notes are an integral part of this statement.

# Statement of Source of Funds for Gross Property Additions



| | | YEAR ENDED DECEMBER 31 1977 | 1976 |
|---|---|---|---|
| | | Thousands of Dollars | |
| **SOURCE OF FUNDS FOR GROSS PROPERTY ADDITIONS:** | | | |
| Funds generated from operations: | Net income | $ 155,007 | $ 144,545 |
| | Principal noncash items— | | |
| | Depreciation and amortization | | |
| | Per statement of income | 102,448 | 96,954 |
| | Charged to other accounts | 5,798 | 8,849 |
| | Deferred income taxes, net | 25,328 | 26,603 |
| | Investment tax credit, net | 46,728 | 14,643 |
| | Allowance for funds used during construction | (54,211) | (33,848) |
| | Undistributed earnings of subsidiaries (Note 1) | (11,189) | (8,400) |
| | | $ 269,909 | $ 249,346 |
| | Less— | | |
| | Dividends on preferred stock | 25,437 | 24,071 |
| | Dividends on preference stock | 9,150 | 6,878 |
| | Dividends declared on common stock | 77,866 | 61,038 |
| | Retirement of long-term debt and preferred stock | 17,035 | 15,848 |
| | | $ 140,421 | $ 141,511 |
| Funds obtained from new financing: | Issuance of common stock | $ 146,221 | $ 114,508 |
| | Issuance of preferred stock | 32,000 | — |
| | Issuance of preference stock | 50,000 | 50,000 |
| | Sale of first mortgage bonds | 225,000 | 190,000 |
| | Net proceeds from installment sales contracts payable | 17,304 | 18,643 |
| | Increase in term bank loan | 25,000 | — |
| | Increase in other long-term debt | 131 | 60 |
| | Decrease in notes payable | — | (38,500) |
| | Less refunded first mortgage bonds | (24,010) | (60,000) |
| | | $ 471,646 | $ 274,711 |
| Other sources (uses) of funds: | Changes in net current assets and current liabilities (excluding obligations expected to be refinanced)— | | |
| | Temporary cash investments | $(103,274) | $ (36,450) |
| | Accounts receivable | 22,321 | (54,489) |
| | Accrued revenues | 13,484 | (28,060) |
| | Generating plant fuel stock | 1,142 | (8,377) |
| | Gas in underground storage | (55,198) | 8,253 |
| | Accounts payable | (2,601) | 15,238 |
| | Accrued taxes | 4,278 | 67,776 |
| | Other, net | (14,567) | (38,336) |
| | | $(134,415) | $ (74,445) |
| | Property sold under leaseback arrangements (Note 5) | 25,025 | 10,689 |
| | Increase in investment in Plateau Resources Limited | (15,000) | (5,000) |
| | Other, net | 2,890 | (28,155) |
| | | $(121,500) | $ (96,911) |
| Total funds for construction from above sources | | $ 490,567 | $ 319,311 |
| Allowance for funds used during construction | | 54,211 | 33,848 |
| Gross property additions | | $ 544,778 | $ 353,159 |
| Gross property additions by reportable segments: | | | |
| Electric | | $ 510,792 | $ 326,489 |
| Gas | | 29,879 | 24,953 |
| Other | | 4,107 | 1,717 |
| | | $ 544,778 | $ 353,159 |

( ) Denotes deduction.

The accompanying notes are an integral part of this statement.

# Balance Sheet

## Assets

| | | DECEMBER 31 1977 | DECEMBER 31 1976 |
|---|---|---|---|
| | | Thousands of Dollars | |
| UTILITY PLANT: | At original cost— | | |
| | Plant in service and held for future use— | | |
| | Electric | $2,447,839 | $2,276,100 |
| | Gas | 1,037,052 | 1,015,562 |
| | Steam | 3,306 | 3,306 |
| | Common to all departments | 48,548 | 43,616 |
| | | $3,536,745 | $3,338,584 |
| | Less—Provision for accrued depreciation | 968,114 | 864,945 |
| | | $2,568,631 | $2,473,639 |
| | Construction work in progress (Notes 2 and 3) | 930,778 | 627,886 |
| | | $3,499,409 | $3,101,525 |
| OTHER PHYSICAL PROPERTY: | At cost or less—less provision for accrued depreciation of $359,000 in 1977 and $363,000 in 1976 | $ 3,185 | $ 3,045 |
| INVESTMENTS: | Wholly-owned subsidiaries (Note 1)— | | |
| | Michigan Gas Storage Company | $ 20,455 | $ 20,427 |
| | Northern Michigan Exploration Company (Note 10) | 52,714 | 39,914 |
| | Plateau Resources Limited | 18,361 | 5,000 |
| | Other, at cost or less | 988 | 971 |
| | | $ 92,518 | $ 66,312 |
| CURRENT ASSETS: | Cash | $ 20,272 | $ 20,804 |
| | Temporary cash investments, at cost | 139,724 | 36,450 |
| | Accounts receivable, less reserves of $2,557,000 in 1977 and $2,341,000 in 1976 | 124,577 | 146,898 |
| | Accrued revenues (Note 1) | 98,685 | 112,169 |
| | Notes receivable from subsidiary | 7,700 | — |
| | Gas in underground storage, at average cost | 142,813 | 87,615 |
| | Generating plant fuel stock, at average cost | 61,961 | 63,103 |
| | Materials and supplies, at average cost | 67,218 | 51,570 |
| | Prepayments and other | 79,030 | 69,936 |
| | Total current assets | $ 741,980 | $ 588,545 |
| OTHER: | Deferred debits (Note 7) | $ 47,958 | $ 55,185 |
| | | $4,385,050 | $3,814,612 |

The accompanying notes are an integral part of this statement.

# Stockholders' Investment and Liabilities

| | | DECEMBER 31 1977 | DECEMBER 31 1976 |
|---|---|---|---|
| | | Thousands of Dollars | |
| CAPITALIZATION: | (See Statement of Capitalization) | | |
| | Common stockholders' equity | **$1,159,570** | $ 959,662 |
| | Preferred stock | **377,934** | 346,334 |
| | Preference stock | **123,371** | 87,189 |
| | Long-term debt | **1,815,671** | 1,569,881 |
| | Total capitalization | **$3,476,546** | $2,963,066 |
| CURRENT LIABILITIES: | Current obligation expected to be refinanced— First Mortgage Bonds, 2⅞% Series due 1977 | **$ —** | $ 24,010 |
| | Other current liabilities— | | |
| | Current maturities and sinking fund on long-term debt (Note 4) | **$ 19,345** | $ 16,635 |
| | Accounts payable | **135,017** | 137,835 |
| | Accounts payable to subsidiaries | **13,511** | 13,294 |
| | Accrued taxes | **177,238** | 172,960 |
| | Accrued interest | **40,762** | 38,109 |
| | Other | **77,293** | 65,313 |
| | | **$ 463,166** | $ 444,146 |
| | Total current liabilities | **$ 463,166** | $ 468,156 |
| DEFERRED CREDITS AND RESERVES: | Deferred income taxes (Note 8) | **$ 296,503** | $ 270,708 |
| | Investment tax credit (Note 8) | **122,200** | 79,750 |
| | Other | **26,635** | 32,932 |
| | | **$ 445,338** | $ 383,390 |
| | Construction Commitments and Contingent Liabilities (Notes 3 and 11) | | |
| | | **$4,385,050** | $3,814,612 |

**The accompanying notes are an integral part of this statement.**

# Statement of Capitalization

CONSUMERS POWER COMPANY

| | DECEMBER 31 1977 | 1976 |
|---|---|---|
| | Thousands of Dollars | |
| **Common Stockholders' Equity (Note 4):** | | |
| Common stock, $10 par value, authorized 60,000,000 shares; outstanding 42,199,870 and 34,846,409 shares, respectively | $ 421,999 | $ 348,464 |
| Capital in excess of par value | 405,502 | 318,837 |
| Retained earnings | 349,138 | 306,584 |
| Less—capital stock expense | 17,069 | 14,223 |
| Total common stockholders' equity | $1,159,570 | $ 959,662 |
| **Preferred Stock—cumulative, $100 par value, authorized 5,000,000 shares (Note 4):** | | |
| $4.50—547,788 Shares Outstanding $110.00 Current Redemption Price | $ 54,779 | $ 54,779 |
| $4.52—111,550 Shares Outstanding 104.725 Current Redemption Price | 11,155 | 11,555 |
| $4.16—100,000 Shares Outstanding 103.25 Current Redemption Price | 10,000 | 10,000 |
| $7.45—700,000 Shares Outstanding 108.00 Current Redemption Price | 70,000 | 70,000 |
| $7.72—700,000 Shares Outstanding 106.00 Current Redemption Price | 70,000 | 70,000 |
| $7.76—750,000 Shares Outstanding 109.19 Current Redemption Price | 75,000 | 75,000 |
| $7.68—550,000 Shares Outstanding 108.00 Current Redemption Price | 55,000 | 55,000 |
| $9.25—320,000 Shares Outstanding 110.00 Current Redemption Price | 32,000 | — |
| Total preferred stock | $ 377,934 | $ 346,334 |

**Preference Stock—cumulative, $1 par value, authorized 5,000,000 shares (Note 4):**

| | Shares Outstanding 1977 | Shares Outstanding 1976 | Conversion Price | Converted 1977 | Converted 1976 | Common Issued 1977 | Common Issued 1976 | 1977 | 1976 |
|---|---|---|---|---|---|---|---|---|---|
| Convertible $6.00, $50 Stated Value | 147,744 | 236,909 | $12.50 | 89,165 | 150,617 | 356,660 | 602,468 | $ 7,387 | $ 11,846 |
| Convertible $5.50, $50 Stated Value | 319,674 | 506,867 | $15.50 | 187,193 | 345,003 | 603,411 | 1,112,477 | 15,984 | 25,343 |
| Nonconvertible $2.43, $1 Par Value | 2,000,000 | 2,000,000 | | | | | | 2,000 | 2,000 |
| Nonconvertible $2.23, $1 Par Value | 2,000,000 | — | | | | | | 2,000 | — |
| Capital in excess of par value of nonconvertible preference stock | | | | | | | | 96,000 | 48,000 |
| Total preference stock | | | | | | | | $ 123,371 | $ 87,189 |

| | 1977 | 1976 |
|---|---|---|
| **Long-Term Debt (Note 4):** | | |
| First Mortgage Bonds, secured by a mortgage and lien on substantially all property— | | |
| 2⅞%, Series due 1977 | $ — | $ 24,010 |
| 9¾%, Series due 1980 | 75,000 | 75,000 |
| 3⅛%, Series due 1981 | 38,992 | 38,992 |
| 11¼%, Series due 1982 | 50,000 | 50,000 |
| 3%-4¾%, Series due 1984-1991 | 195,068 | 206,420 |
| 11⅜%, Series due 1994 | 60,000 | 60,000 |
| 5⅞%-9⅞%, Series due 1996-2000 | 497,088 | 461,771 |
| 11½%, Series due 2000 | 75,000 | 75,000 |
| 7½%-9¾%, Series due 2001-2007 | 620,000 | 435,000 |
| Total First Mortgage Bonds | $1,611,148 | $1,426,193 |
| Installment Sales Contracts Payable, average interest rate 6.48% in 1977 and 6.57% in 1976 (net of $9,471,000 and $3,775,000, respectively, held in trust pending certification of construction expenditures) | 118,229 | 100,925 |
| Sinking Fund Debentures, 4⅝%, due 1994 | 35,200 | 35,800 |
| Bank Term Loan, at 114% of Bank's prime rate due 1980 through 1985 | 75,000 | 50,000 |
| Other | 190 | 59 |
| Unamortized net debt premium and discount—not material by individual issue | (4,751) | (2,451) |
| | $1,835,016 | $1,610,526 |
| Deduct—Current maturities and sinking fund— | | |
| First Mortgage Bonds | 18,045 | 16,035 |
| Sinking Fund Debentures | 600 | 600 |
| First Mortgage Bonds, 2⅞% Series due 1977 | — | 24,010 |
| Installment Sales Contracts Payable | 700 | — |
| Total long-term debt | $1,815,671 | $1,569,881 |
| Total capitalization | $3,476,546 | $2,963,066 |

The accompanying notes are an integral part of this statement.

## Statement of Retained Earnings



| | YEAR ENDED DECEMBER 31 | |
|---|---|---|
| | 1977 | 1976 |
| | Thousands of Dollars | |
| BALANCE—Beginning of year | **$306,584** | $254,026 |
| ADD—Net income after dividends on preferred and preference stock | **120,420** | 113,596 |
| | **$427,004** | $367,622 |
| DEDUCT—Cash dividends on common stock declared in the amount of $2.09 per share in 1977 and $2.00 per share in 1976 (quarterly dividend increased from $.50 to $.53 per share beginning in April 1977) | **77,866** | 61,038 |
| BALANCE—End of year (Note 4) | **$349,138** | $306,584 |

## Statement of Capital in Excess of Par Value

| | YEAR ENDED DECEMBER 31 | | | |
|---|---|---|---|---|
| | 1977 | 1976 | 1977 | 1976 |
| | Number of Shares | | Thousands of Dollars | |
| COMMON STOCK | | | | |
| BALANCE—Beginning of year | **34,846,409** | 27,561,474 | **$318,837** | $252,203 |
| Issuance of common stock through: | | | | |
| Sales through underwriters | **6,000,000** | 5,500,000 | **77,035** | 58,022 |
| Dividend reinvestment plan | **313,031** | 69,990 | **4,116** | 786 |
| Employee stock ownership plan | **80,359** | — | **1,136** | — |
| Conversions of preference stock | **960,071** | 1,714,945 | **4,211** | 7,625 |
| Net gain on reacquisition of preferred stock | **—** | — | **167** | 201 |
| BALANCE—End of year | **42,199,870** | 34,846,409 | **$405,502** | $318,837 |
| NONCONVERTIBLE PREFERENCE STOCK | | | | |
| BALANCE—Beginning of year | **2,000,000** | — | **$ 48,000** | $ — |
| Issuance of nonconvertible preference stock | **2,000,000** | 2,000,000 | **48,000** | 48,000 |
| BALANCE—End of year | **4,000,000** | 2,000,000 | **$ 96,000** | $ 48,000 |

The accompanying notes are an integral part of these statements.

# Notes to the Financial Statements

## 1 SIGNIFICANT ACCOUNTING POLICIES

The Company follows the equity method of accounting for the investment in its wholly-owned 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. At December 31, 1977, the undistributed earnings of subsidiaries were $40,725,000. Operation expense includes approximately $94,390,000 in 1977 and $74,174,000 in 1976 relating to gas purchased from two of these subsidiaries.

The Company provides depreciation on the basis of straight-line rates approved by the Michigan Public Service Commission (MPSC). (See Note 14)

The Company accrues revenues for service rendered to utility customers but not billed at month end.

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 over a 25-year period. (See Note 7)

The Company capitalizes as a component of the cost of utility plant and includes in other income and as a deduction to interest charges allowance for funds used during construction (AFUDC), a noncash item. AFUDC is the cost of funds applicable to utility plant in process of construction. (See Note 9)

Reference is made to Note 8 for information regarding income taxes.

## 2 NUCLEAR GENERATING PLANTS

Construction work in progress includes $655,587,000 at December 31, 1977 and $425,707,000 at December 31, 1976, related to the Midland Nuclear Plant which is expected to be completed in 1981-1982 at a presently estimated total cost of $1.67 billion. Construction permits issued by the Atomic Energy Commission (AEC), now Nuclear Regulatory Commission (NRC) in 1972 and upheld by an AEC Appeal Board in 1973, were remanded to the NRC for further proceedings in July 1976, by the U.S. Court of Appeals for the District of Columbia Circuit. At the Company's request, the U.S. Supreme Court is reviewing the Court of Appeals decision. Arguments were heard in December 1977 and a decision from the Supreme Court is expected in early 1978.

Hearings on the merits of the issues remanded to the NRC, including reconsideration of waste disposal and other fuel cycle issues, energy conservation alternatives and other issues affecting the environmental cost-benefit analysis performed for the Plant and clarification of the report on the Plant issued by the AEC's Advisory Committee on Reactor Safeguards, have not been scheduled.

In September 1977, an NRC Atomic Safety and Licensing Board (ASLB) issued a decision allowing construction of the Plant to continue pending the outcome of the hearings on the issues remanded to the NRC. Intervenors are seeking to have the order overturned.

In July 1975, an ASLB decided that the Plant construction permit should continue without the imposition of any antitrust restrictions. That decision was reversed by an NRC Atomic Safety and Licensing Appeal Board in December 1977 and remanded to the ASLB for further proceedings and decision as to specific antitrust remedies to protect smaller utilities in the Company's service area against practices which the Appeal Board found to be inconsistent with the antitrust laws.

If the Company is not ultimately successful in the Midland proceedings, the effect on the Company's future power resources and financial position could be materially adverse. The Company is unable at this time, pending further developments in the proceedings, to evaluate the ultimate effect of the remands on the investment in and commitments with respect to the Midland Nuclear Plant. (See Note 11)

In 1974, the Company filed suit in a U.S. District Court seeking damages, together with equitable relief, from five suppliers of components and design work for the Palisades Nuclear Plant, which was shut down for essentially all of a period commencing in August 1973 and extending to early April 1975 to make repairs to certain of the Plant's reactor vessel internal components, steam generators, main condenser and other equipment. During 1976 and 1977 the Company reached settlements with the five suppliers totaling approximately $68 million in cash and future services, the majority of which has been or will be used to reduce the investment in the Palisades Plant. The amount of the settlement could reach $88 million depending on the future value of certain uranium fuel assemblies. In January 1978, the Palisades Plant was taken out of service for a scheduled 14-week outage for refueling, maintenance and testing.

The Company's applications for full-term, forty-year operating licenses for the Palisades and Midland Nuclear Plants are pending before the NRC.

## 3 CONSTRUCTION PROGRAM AND SHORT-TERM BORROWING ARRANGEMENTS

Capital expenditures in 1978 are currently estimated to total approximately $563 million and total construction expenditures through 1982 are presently estimated to approximate $2.5 billion, net of anticipated participation by third parties in certain generating units estimated at $203 million and $380 million, respectively, during such periods. Substantial commitments have been made with respect to the construction program in future years. In order to finance this construction program and to meet debt maturities of $211.8 million through 1982 it will be necessary for the Company to issue substantial additional securities, the amounts, timing and nature of which have not yet been determined.

The Company presently has arrangements with banks providing for short-term borrowings of up to $208.4 million (including acceptance draft commitments up to $5.0 million) which are subject to periodic review. In connection with these arrangements, the Company is generally 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 banks' records after adjustment for uncollected funds. There are no legal restrictions on the withdrawal of these funds. The banker's acceptance drafts, when issued, are secured by a lien on certain of the Company's fuel inventories.

During 1977 the Company had no outstanding short-term borrowings. In 1976 average short-term borrowings outstanding amounted to $9,782,000, and the weighted average interest rate (calculated daily) was 7.13% per annum, excluding the effect of compensating balances. The maximum amount outstanding at any one time during 1976 was $59,500,000.

## 4 CAPITALIZATION

At December 31, 1977, after giving effect to the issuance of 500,000 shares of $9.00 Preferred Stock, retained earnings in the amount of $42,456,000, out of total retained earnings of $349,138,000, cannot be distributed as cash dividends on Common Stock under provisions of The Articles of Incorporation of the Company. There are also other restrictions as to payment of dividends on Common Stock which are presently less restrictive. At December 31, 1977, 116,979 shares of Common Stock are reserved for issuance in connection with a Common Stock Dividend Reinvestment Plan, 590,976 shares of Common Stock are reserved for issuance upon conversion of the $6.00 Preference Stock and 1,031,206 shares of Common Stock are reserved for issuance upon conversion of the $5.50 Preference Stock.

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. The Company is required to purchase or redeem annually 16,000 shares of the $9.25 Preferred Stock at a price of $100 per share plus accrued dividends commencing in 1982. The Preferred Stock of the Company is redeemable as a whole or in part, at the option of the Company, except that prior to April 1, 1978, June 1, 1978, November 1, 1978, and April 1, 1987 the $7.45, $7.76, $7.68, and $9.25 Preferred Stock, respectively, may not be redeemed through certain refunding operations.

In February 1978, the Company issued 500,000 shares of $9.00 Preferred Stock. The current optional redemption price is $110 per share plus accrued dividends. The Company is required to redeem at a price of $100 per share plus accrued dividends, 25,000 shares annually commencing in 1983.

Beginning in 1979, the Company is required to purchase or redeem annually 37,500 shares of the $6.00 Preference Stock at a price per share of $50 plus accrued dividends. Beginning in 1980, the Company is required to purchase or redeem annually 50,000 shares of the $5.50 Preference Stock at a price per share of $50 plus accrued dividends. The Company has the option to receive credit for shares of the $5.50 Preference Stock converted.

The $6.00 and $5.50 Preference Stock of the Company are redeemable in whole or in part, at the option of the Company, after July 31, 1979 and June 30, 1980, respectively, at a price per share of $52.50 plus accrued dividends and at decreasing prices after July 31, 1984 and June 30, 1985, respectively.

The $2.43 Preference Stock and the $2.23 Preference Stock are not convertible. The $2.43 Preference Stock is redeemable at any time, in whole or in part, at the option of the Company at a price per share of $27.43 plus accrued dividends if redeemed prior to September 1, 1981, and at decreasing prices thereafter, except that prior to September 1, 1981 it may not be redeemed through certain refunding operations. The $2.23 Preference Stock is redeemable at any time, in whole or in part, at the option of the Company at a price per share of $27.25 plus accrued dividends if redeemed prior to November 1, 1982, and at decreasing prices thereafter, except that prior to November 1, 1982 it may not be redeemed through certain refunding operations.

The Company has executed $31,000,000 principal amount of Installment Sales Contracts, for which the Company has pledged a like amount of First Mortgage Bonds as security for its obligations under such contracts.

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. In addition, a $600,000 sinking fund deposit is due on the 4⅝% Sinking Fund Debentures on or before September 1 of each year.

Maturities and annual sinking fund requirements of long-term debt for the five years subsequent to 1977 are shown below:

| | Debt Maturities | Annual Sinking Fund Requirements |
|---|---|---|
| | Thousands of Dollars | |
| 1978 | $ 700 | $18,645 |
| 1979 | 1,550 | 18,645 |
| 1980 | 85,050 | 18,645 |
| 1981 | 56,542 | 18,645 |
| 1982 | 67,950 | 18,645 |

## 5 LEASE OBLIGATIONS AND RENTALS

The Company leases a portion of the nuclear fuel utilized or to be utilized at the Palisades and the Midland Plants. The Lessor's remaining investment in the nuclear fuel at December 31, 1977 was approximately $49,000,000. The initial term of the fuel lease runs to November 1981, with provision for one-year extensions from time to time to November 2029, subject to earlier termination in certain events. The quarterly lease charges consist of a fuel factor computed on the basis of heat production plus interest costs and administrative fees and expenses incurred by the Lessor. In the event of termination of the fuel lease, the Lessor would be entitled to an amount equal to the Lessor's remaining investment. The Company is also responsible for payment of taxes, maintenance, operating costs, risks of loss and insurance.

The Company has entered into sale-and-leaseback transactions aggregating $26,000,000 with respect to two of the Company's general office buildings. The leases have an initial term of 28 years beginning in 1975 with two five-year renewal options subject to escalation clauses and a third five-year renewal option at the then fair market rental value with the option to purchase at the expiration of the basic term or any renewal term at the then fair market sales value. Annual rentals under the leases are subject to quadrennial escalation and currently approximate $2,816,000. Taxes, insurance and other operating costs relating to the buildings are required to be paid by the Company.

Rentals, including amounts charged to clearing and other accounts, amounted to approximately $21,756,000 in 1977 and $25,893,000 in 1976. Rentals contingent upon usage were approximately $7,663,000 in 1977 and $10,510,000 in 1976.

The minimum rental commitments for leases presently in effect will amount to approximately $17,739,000 in 1978, $12,474,000 in 1979 and 1980, $12,078,000 in 1981, $7,214,000 in 1982, $19,343,000 for the period 1983-1987, $15,638,000 for the period 1988-1992, $14,079,000 for the period 1993-1997 and $15,487,000 for remaining years.

The Company's lease obligations are accounted for as operating leases in the rate-making process. Accordingly, obligations related to financing leases have been charged to expense as incurred. Had these leases been capitalized the aggregate amounts of assets and liabilities that would have been recorded are $93,665,000 related to utility plant, net of accumulated depreciation and/or amortization and $94,449,000 related to obligations under capital leases. If all financing leases were capitalized, the effect on expense would not be material.

## 6 RATE MATTERS

In January 1978 the MPSC issued an order in a gas rate proceeding authorizing the Company to increase its gas rates in the annual amount of $10,995,000. Interim increases in the annual amount of approximately $34,122,000 ($29,194,000 in June 1975 and $4,928,000 in March 1977) collected under bond and subject to refund, had previously been authorized by the MPSC in the proceeding. Hearings and briefing in an electric rate increase proceeding have been completed. Appeals are pending with respect to several electric and gas rate orders, including litigation involving alleged over-collections under the fuel cost adjustment clause, the legality of the purchased and interchange power clause (PPAC) applicable to the Company's electric rates and the legality of the December 1977 PPAC revenue collected under protection of court order. The Company is vigorously pursuing these matters before regulatory bodies and the courts and, in the opinion of management and its counsel, their ultimate resolution should not materially affect the financial position of the Company or the results of operations for the periods involved.

## 7 PENSION PLAN

The Company has a trusteed 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 $18,502,000 in 1977 and $17,454,000 in 1976. Of these amounts $14,732,000 in 1977 and $14,028,000 in 1976 were charged directly to expense accounts with the remainder being charged to various construction, clearing and other accounts.

As of January 1, 1977, the date of the most recent actuary's report, the actuarially computed value of vested benefits was $226,000,000. The market value of the assets of the plan was $211,460,000 at January 1, 1977 and $211,785,000 at December 31, 1977. If the market value of the assets of the plan should remain below the vested benefits, the actuarial method used in determining the annual contribution will fund this amount over a period of years.

The unfunded prior service cost at January 1, 1977, amounted to approximately $19,910,000. The Company has proposed changes in the pension plan effective September 1, 1977 covering all employees. In addition, the Company has proposed, for salaried employees, changes in the pension plan in which hourly employees as a bargaining unit may elect to participate. These proposed changes to be effective January 1, 1978 and which are subject to Internal Revenue Service approval, would increase the Company's contributions to the Plan and its liability for unfunded prior service costs.

In July 1976, the Company adopted an Early Retirement Incentive Program, in connection with the reorganization of its work force, at a cost of approximately $14,000,000. The cost, which is recorded in a deferred debit account, is being amortized over a five year period for accounting purposes in accordance with an MPSC order and will be reflected in rates to the extent the savings and value of the program to the overall reorganization justify such costs. In the opinion of management, the savings and value of the program justify such costs.

## 8 INCOME TAX EXPENSE

Income tax expense is made up of the following components:

| | YEAR ENDED DECEMBER 31 | |
|---|---|---|
| | **1977** | 1976 |
| | Thousands of Dollars | |
| Federal income taxes | **$ (5,051)** | $40,518 |
| State income taxes | **—** | (2,920) |
| Deferred Federal income taxes, net | **28,215** | 28,370 |
| Deferred State income taxes, net | **(2,887)** | (1,767) |
| Charge equivalent to investment tax credit, net | **46,728** | 14,643 |
| Total | **$67,005** | $78,844 |
| Charged to utility operations (See Statement of Income) | **$62,845** | $77,315 |
| Charged to nonutility operations | **4,160** | 1,529 |
| Total | **$67,005** | $78,844 |

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 these timing differences reverse, the related deferrals are credited to income. Following is a summary of the provision for deferred income taxes:

| | YEAR ENDED DECEMBER 31 | |
|---|---|---|
| | **1977** | 1976 |
| | Thousands of Dollars | |
| Accelerated depreciation— | | |
| Amount deferred during year | **$31,137** | $31,340 |
| Less—Taxes deferred in prior years credited to income | **(3,803)** | (3,900) |
| | **$27,334** | $27,440 |
| Accelerated amortization of emergency facilities— | | |
| Taxes deferred in prior years credited to income | **(837)** | (837) |
| Other, net | **(1,169)** | — |
| Total | **$25,328** | $26,603 |

Certain costs, principally interest, which are capitalized for financial reporting purposes in accordance with the provisions of the Uniform System of Accounts, are expensed for income tax purposes and the resulting tax reduction is reflected currently in the income statement as ordered by the MPSC.

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

The total income tax expense as set forth above produces an effective income tax rate of 30.1% in 1977, and 35.3% in 1976. The following schedule reconciles the statutory Federal income tax rate of 48% to such effective income tax rates.

| | YEAR ENDED DECEMBER 31 | | | |
|---|---|---|---|---|
| | 1977 | | 1976 | |
| | AMOUNT | RATE | AMOUNT | RATE |
| | Thousands of Dollars | | Thousands of Dollars | |
| Income tax expense at Federal statutory tax rate | **$106,566** | **48.0%** | $107,227 | 48.0% |
| Increase (reduction) in taxes resulting from: | | | | |
| Certain capitalized construction costs, principally interest, deducted currently for income tax purposes for which no deferred taxes are provided in accordance with the requirements of the MPSC | **(31,461)** | **(14.2)** | (21,251) | (9.5) |
| State income taxes | **(2,887)** | **(1.3)** | (3,285) | (1.5) |
| Amortization of deferred investment tax credit | **(2,847)** | **(1.3)** | (2,281) | (1.0) |
| Equity in earnings of subsidiaries | **(6,456)** | **(2.9)** | (5,174) | (2.3) |
| Other miscellaneous items | **4,090** | **1.8** | 3,608 | 1.6 |
| Total income tax expense | **$ 67,005** | **30.1%** | $ 78,844 | 35.3% |

## 9 ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION

The Company capitalized AFUDC at a rate of 8.5% in 1977 and 8% in 1976. Substantially all of the AFUDC related to electric plant construction. 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.

Prior to 1977, AFUDC was defined by 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. In February 1977 the Federal Power Commission (FPC), since superseded by the Federal Energy Regulatory Commission (FERC), issued an order, retroactive to January 1, 1977, revising its uniform system of accounts. The February 1977 order provides for a credit to amounts recorded as interest charges for that portion of the allowance allocable to borrowed funds and limits the amount recorded as other income to the portion of the allowance allocable to other funds used during construction.

The allowance for 1976 was based on the Company's source of funds for gross property additions and accordingly has not been reclassified since such amounts would not be comparable to the components of allowance for funds used during construction determined using the FPC formula. 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 then current cost of long-term and short-term debt (before income tax effect), preferred stock and other available sources, the estimated common equity component of the allowance for funds used during construction amounted to 5.2% of net income available for Common Stock for 1976.

## 10 NORTHERN MICHIGAN EXPLORATION COMPANY

Northern Michigan Exploration Company (Northern), a wholly-owned subsidiary of the Company, is engaged in gas and oil exploration and development programs.

Northern follows full cost accounting for financial reporting purposes, including a policy of capitalizing interest costs related to properties in process of development. Summarized financial information is shown below.

| | 1977 | 1976 |
|---|---|---|
| Operating revenues | $43,452,000 | $34,490,000 |
| Net income | 12,800,000 | 9,239,000 |
| Gas and oil properties | 69,705,000 | 63,188,000 |
| Total assets | 79,454,000 | 81,809,000 |
| Stockholder's investment | 52,714,000 | 39,914,000 |
| Production payment | 4,000,000 | 15,000,000 |

In December 1977, the Financial Accounting Standards Board issued a Statement prescribing successful efforts accounting for oil and gas producing companies. The Statement which is effective for fiscal years beginning after December 15, 1978 will be applied retroactively by restating prior periods' financial statements. It is presently estimated that the restatement will reduce net income for 1977 and 1976 by $3,100,000 and $1,000,000, respectively, and retained earnings at December 31, 1977 by $15,600,000.

## 11 CONTINGENT LIABILITIES

The Company is involved in certain legal and administrative proceedings before various courts and governmental agencies and in contractual matters with others concerning rates, environmental issues, property taxes, licensing, fuel supplies and costs, and other matters, the outcome of which might result in a decrease in the Company's revenues and/or increases in construction expenditures and/or operating expenses.

In testimony before an NRC Atomic Safety and Licensing Board in the remanded proceeding relating to the Midland Nuclear Plant (See Note 2), The Dow Chemical Company (Dow) officials have indicated that Dow is considering the possibility of making a breach of contract claim against the Company for damages alleged to be in excess of $100,000,000 and to be attributable to the delay in completion of the Plant beyond 1980. The Company believes it is not in default of its contractual obligations to Dow. The amount invested by the Company in equipment at the Midland Plant allocable to the service of process steam to Dow, which may not be salvageable in the event Dow is entitled to terminate the contract is estimated at approximately $105,000,000 as of December 31, 1977.

## 12 SEGMENTS OF BUSINESS

Depreciation and amortization expense and income tax expense for 1977 and total assets as of December 31, 1977 by department are shown below.

| | 1977 | | |
|---|---|---|---|
| | Depreciation and Amortization | Income Tax Expense | Assets |
| | Thousands of Dollars | | |
| Electric | $ 67,312 | $47,115 | $2,832,412 |
| Gas | 35,032 | 15,714 | 912,759 |
| Steam | 104 | 16 | 2,135 |
| Unallocated | — | — | 637,744 |
| | $102,448 | $62,845 | $4,385,050 |

Income taxes and corporate expenses are allocated to departments in accordance with the regulatory accounting requirements of both the MPSC and the FERC. Allocated assets include construction work in progress.

Revenue derived from sales to General Motors Corporation amounted to 11.1% of total revenue for the year 1977.

## 13 QUARTERLY FINANCIAL INFORMATION

Quarterly financial information for 1977 and 1976 is as follows:

| | QUARTER ENDED | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | March 1977 | June 1977 | Sept. 1977 | Dec. 1977 | March 1976 | June 1976 | Sept. 1976 | Dec. 1976 |
| | Thousands of Dollars | | | | | | | |
| Total operating revenue | $544,101 | $316,688 | $326,400 | $449,421 | $465,299 | $333,214 | $298,213 | $484,526 |
| Net operating income | 75,810 | 41,477 | 46,533 | 48,122 | 63,141 | 45,614 | 43,472 | 59,743 |
| Net income | 59,506 | 27,529 | 34,814 | 33,158 | 44,674 | 28,514 | 28,587 | 42,770 |
| Net income after dividends on Preferred and Preference Stock | 51,259 | 19,388 | 26,174 | 23,599 | 37,130 | 21,172 | 20,868 | 34,426 |
| Earnings per share: | | | | | | | | |
| Assuming no dilution | $1.47 | $ .53 | $ .67 | $ .58 | $1.25 | $ .68 | $ .67 | $1.04 |
| Assuming full dilution | 1.40 | .52 | .66 | .57 | 1.16 | .66 | .64 | .99 |

## 14 MAINTENANCE AND DEPRECIATION AND NUCLEAR FUEL AMORTIZATION

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.

Property additions, replacements and renewals of items considered to be units of property are charged to the utility plant accounts and units of property retired or otherwise disposed of in the normal course of business are charged to the provision for accrued depreciation in the amount of such retirements, less net salvage credits. No other adjustments of the provision for accrued depreciation are normally made. Composite depreciation rates were approximately 2.94% for electric plant and 3.66% for gas plant in 1977 and 2.86% for electric plant and 3.64% for gas plant in 1976. The composite electric rate which is based upon rates which have been effective since 1975 includes an estimate for the decommissioning costs of the Company's nuclear plants. The method of decommissioning nuclear plants has not been redetermined in light of recent developments and, therefore, retirement costs are currently uncertain. The Company plans to seek approval of revised electric depreciation rates to be effective within the next two years, which in all probability will incorporate higher decommissioning costs. In the opinion of management, the balance in the provision for accrued depreciation at year end 1977 is reasonably adequate to cover the requirements for depreciation accrued on the original cost of the depreciable utility plant.

The cost of nuclear fuel is amortized to fuel expense based on the quantity of heat produced for the generation of electric energy. The Company's policy is to review periodically the outlook for spent fuel disposal cost or storage cost and to revise as appropriate on a prospective basis after regulatory approval, its estimate of providing for all such costs over the active life of the fuel. The nuclear fuel amortization rate utilized to date for accounting and rate purposes is based upon the assumptions that spent nuclear fuel has a residual salvage value and will be chemically processed. In its current electric rate proceeding the Company is seeking to change nuclear fuel expense for accounting and rate purposes for the majority of its fuel to reflect the assumptions of zero residual value for spent nuclear fuel and the need for perpetual storage.

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.

## 15 REPLACEMENT COST INFORMATION (UNAUDITED)

Estimates of replacement cost information for certain of the Company's assets and related depreciation is presented to comply with the reporting requirements of the Securities and Exchange Commission. The Company advises readers of the imprecise nature of this data and of the many subjective judgments required in estimating the replacement cost of productive capacity. This information does not purport to represent the projected current value of the assets, the amounts which could be realized if the assets were to be sold, the reproduction costs of assets currently owned, or the historical costs of such assets adjusted for inflation. Further, as this data is limited to selected categories of assets and related depreciation, there are inherent limitations in using this information to compute the effect of inflation on the Company. Moreover, for regulated utilities such as the Company, whose rates and charges are based upon the historical costs of their assets, an evaluation of replacement costs may be of limited worth.

The estimated replacement cost of the Company's productive capacity and the estimated accumulated depreciation and depreciation expense restated for the replacement cost is as follows:

| | DECEMBER 31 | |
|---|---|---|
| | **1977** | 1976 |
| | Thousands of Dollars | |
| Utility Plant in Service | **$8,200,000** | $7,400,000 |
| Less Provision for Accumulated Depreciation | **2,600,000** | 2,400,000 |
| | **$5,600,000** | $5,000,000 |
| Depreciation Expense | **$ 250,000** | $ 200,000 |

The original cost of land, landrights, nuclear fuel, mineral resource assets and intangible plant, amounting to $175 million and $167 million at December 31, 1977 and 1976 respectively, is excluded from this replacement cost information. Noncapitalized leases are not significant.

The replacement cost of the electric generation facilities was determined by applying the estimated construction cost per kilowatt of units recently installed or currently planned for construction, trended to year-end by an equivalent construction cost escalation rate, to each type of generating capacity in the existing system. The original cost of the synthetic natural gas plant was trended to year-end using a composite process and petrochemical plant construction cost index. The Handy-Whitman Index of Public Utility Construction Costs for the North Central Division was applied to the original cost of electric transmission and distribution facilities and gas storage, transmission and distribution facilities. The original cost of substantially all remaining utility plant was trended to year-end using the Bureau of Labor Statistics Wholesale Price Index or the Engineering News Record Construction Cost Index.

Depreciation expense for the replacement cost of productive capacity was developed by applying the actual functional class depreciation rates in use to the average replacement cost balance of each functional class. The accumulated depreciation reserve based on the replacement cost was developed by multiplying the weighted average age of the historical assets to the annual replacement cost depreciation expense.

Replacement cost data relating to inventories and cost of goods sold have not been included in this analysis since these amounts are not material. Where practicable, the calculation of replacement cost incorporates the latest technology and provision for pollution control equipment required under environmental regulations as of December 31, 1977 and 1976. Such replacement would result in changes in fuel, operation and maintenance costs. In the above figures no consideration was given to any additional operating costs or to any savings from operating efficiencies of technically improved replacement facilities. Also, the Company is subject to governmental regulation in the determination of a fair rate of return on its investment. Under such regulation, costs incurred in the replacement of productive capacity would ultimately expand the base on which such allowable return is determined. No recognition was given to the added revenues that would normally be realized from the recovery of increased costs through the regulatory ratemaking process.

ARTHUR ANDERSEN & CO.

DETROIT, MICHIGAN

To the Board of Directors,
Consumers Power Company:

We have examined the balance sheet and statement of capitalization of CONSUMERS POWER COMPANY (a Michigan corporation) as of December 31, 1977, and December 31, 1976, and the related statements of income, retained earnings, capital in excess of par value and source of funds for gross property additions for the 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.

As discussed in Note 2, the construction permits for the Midland Nuclear Plant have been remanded to the Nuclear Regulatory Commission for further proceedings. The Company is unable at this time, pending further developments in the proceedings, to evaluate the ultimate effect of the remands on the investment in and commitments with respect to the Midland Nuclear Plant.

In our opinion, subject to the effect, if any, on the financial statements of the resolution of the matters discussed above, the financial statements referred to above present fairly the financial position of Consumers Power Company as of December 31, 1977 and December 31, 1976, and the results of its operations and the source of funds for gross property additions for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

Detroit, Michigan,
February 9, 1978.

Arthur Andersen & Co.

# Consumers Power Company
# Dividends and Stock Prices

| Security | Dividends Paid Per Share | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Calendar Quarter—1976 | | | | Calendar Quarter—1977 | | | |
| | 1 | 2 | 3 | 4 | 1 | 2 | 3 | 4 |
| Common Stock | $0.50 | $0.50 | $0.50 | $0.50 | $0.50 | $0.53 | $0.53 | $0.53 |
| Preferred Stock: | | | | | | | | |
| $4.16 | 1.04 | 1.04 | 1.04 | 1.04 | 1.04 | 1.04 | 1.04 | 1.04 |
| 4.50 | 1.125 | 1.125 | 1.125 | 1.125 | 1.125 | 1.125 | 1.125 | 1.125 |
| 4.52 | 1.13 | 1.13 | 1.13 | 1.13 | 1.13 | 1.13 | 1.13 | 1.13 |
| 7.45 | 1.8625 | 1.8625 | 1.8625 | 1.8625 | 1.8625 | 1.8625 | 1.8625 | 1.8625 |
| 7.68 | 1.92 | 1.92 | 1.92 | 1.92 | 1.92 | 1.92 | 1.92 | 1.92 |
| 7.72 | 1.93 | 1.93 | 1.93 | 1.93 | 1.93 | 1.93 | 1.93 | 1.93 |
| 7.76 | 1.94 | 1.94 | 1.94 | 1.94 | 1.94 | 1.94 | 1.94 | 1.94 |
| 9.25 | — | — | — | — | — | — | — | 2.00 |
| Preference Stock: | | | | | | | | |
| $6.00 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 |
| 5.50 | 1.375 | 1.375 | 1.375 | 1.375 | 1.375 | 1.375 | 1.375 | 1.375 |
| 2.43 | — | — | — | 0.243 | 0.6075 | 0.6075 | 0.6075 | 0.6075 |
| 2.50 | — | — | — | — | — | — | — | — |

| Security | High and Low Sales Prices Based on NYSE Composite Transactions | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Calendar Quarter—1976 | | | | | | | | Calendar Quarter—1977 | | | | | | | |
| | 1 | | 2 | | 3 | | 4 | | 1 | | 2 | | 3 | | 4 | |
| | High | Low | High | Low | High | Low | High | Low | High | Low | High | Low | High | Low | High | Low |
| Common Stock | [illegible] | 19 | 22 | 19¾ | 22½ | 20 | 22⅝ | 21 | 23½ | 20⅝ | 24⅞ | 21¼ | 25⅞ | 23¾ | 25⅛ | 22¾ |
| Preferred Stock: | | | | | | | | | | | | | | | | |
| $4.16 | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 47 | 43½ | 46¼ | 44 | 48 | 45 | 46 | 44 |
| 4.50 | [illegible] | [illegible] | 46½ | [illegible] | [illegible] | [illegible] | 50¼ | 46¾ | 52 | 48 | 51½ | 47½ | 53 | 49¾ | 51½ | 48 |
| 4.52 | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 50¼ | [illegible] | 53 | 50¾ | 57⅝ | 52⅞ | 54 | 52⅝ | 57 | 52 |
| 7.45 | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 79 | 75 | 82 | 77½ | 84 | 78½ | 88 | 82⅛ | 85 | 79 |
| 7.68 | [illegible] | [illegible] | 76 | 72 | 80 | [illegible] | 82 | 77 | 84¾ | 80 | 86¼ | 81¼ | 89¼ | 85 | 86⅞ | 82½ |
| 7.72 | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 78 | [illegible] | 79¾ | 88 | 81½ | 90⅞ | 85⅞ | 87 | 82 |
| 7.76 | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 80½ | 87¼ | 81½ | 90¾ | 85¼ | 88½ | 83½ |
| [illegible] | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| Preference Stock: | | | | | | | | | | | | | | | | |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 93½ | 87½ | 102¾ | 94 | 100 | 91⅞ |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 74¾ | 67¼ | 79 | 69¾ | 82¾ | 76 | 80¼ | 73¾ |
| [illegible] | — | — | — | — | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 25¼ | 27 | 25⅝ | 27⅞ | 26 | 27⅝ | 25⅝ |
| [illegible] | — | — | — | — | — | — | — | — | — | — | — | — | — | — | 25⅛ | 23⅝ |

[illegible]

**Exchanges on Which the Company's Equity Securities Are Listed for Trading:**

Common Stock is listed on the New York and Midwest stock exchanges.

[illegible] and Preference Stock are listed on the New York Stock Exchange.

# Summary of Statement of Income 1977-1973

| | 1977 | 1976 | 1975 | 1974 | 1973 |
|---|---|---|---|---|---|
| | | | Thousands of Dollars | | |
| **Operating Revenue** | | | | | |
| Electric | **$908,963** | $878,468 | $757,741 | $619,958 | $495,723 |
| Gas | **724,821** | 700,236 | 581,294 | 483,832 | 337,906 |
| Steam | **2,826** | 2,548 | 2,065 | 1,593 | 1,325 |
| **Operating Revenue Deductions, Except Income Taxes** | | | | | |
| Fuel Consumed in Electric Generation | **262,723** | 266,447 | 249,556 | 172,050 | 105,391 |
| Purchased and Interchange Power | **130,005** | 127,464 | 90,891 | 143,394 | 70,006 |
| Cost of Gas Sold | **496,567** | 460,458 | 375,495 | 293,190 | 175,185 |
| Other Operation and Maintenance | **295,683** | 263,279 | 236,636 | 208,759 | 187,436 |
| Depreciation and Amortization | **102,448** | 96,954 | 93,635 | 82,944 | 73,428 |
| General Taxes | **74,397** | 77,365 | 67,678 | 63,058 | 54,160 |
| **Net Operating Income Before Income Taxes** | | | | | |
| Electric | **209,988** | 202,926 | 161,468 | 78,614 | 121,196 |
| Gas | **64,666** | 86,159 | 65,461 | 63,192 | 48,083 |
| Steam | **133** | 200 | 280 | 182 | 69 |
| **Income Taxes** | | | | | |
| Federal Income Tax | **(9,211)** | 38,970 | (1,602) | (251) | 2,068 |
| State Income Tax | **—** | (2,901) | 3,417 | (764) | 2,754 |
| Deferred Income Tax (Net) | **25,328** | 26,603 | 31,318 | 26,191 | 25,072 |
| Investment Tax Credit (Net) | **46,728** | 14,643 | 24,431 | (5,118) | 14,057 |
| **Net Operating Income** | | | | | |
| Electric | **162,873** | 151,952 | 120,276 | 75,982 | 87,938 |
| Gas | **48,952** | 59,864 | 49,166 | 45,802 | 37,374 |
| Steam | **117** | 154 | 203 | 146 | 85 |
| Allowance for Funds Used During Construction (1) | **30,444** | 33,848 | 24,825 | 21,875 | 23,223 |
| Other Income | **21,347** | 14,787 | 15,828 | 11,066 | 6,940 |
| Interest Charges (1) | **108,726** | 116,060 | 110,362 | 94,783 | 75,370 |
| Income Before Cumulative Effect of Change in Method of Recording Revenue | | | | 60,088 | |
| Cumulative Effect on Years Prior to 1974 of Accruing Estimated Unbilled Revenue After Deduction for Related Income Taxes | | | | 24,864 | |
| Net Income | **155,007** | 144,545 | 99,936 | 84,952 | 80,190 |
| Cash Dividends on Preferred Stock | **25,437** | 24,071 | 24,093 | 24,089 | 17,746 |
| Cash Dividends on Nonconvertible Preference Stock | **5,764** | 1,701 | — | — | — |
| Cash Dividends on Convertible Preference Stock | **3,386** | 5,177 | 5,993 | 1,451 | — |
| Net Income After Dividends on Preferred and Preference Stock | **120,420** | 113,596 | 69,850 | 59,412 | 62,444 |
| Cash Dividends on Common Stock | **77,866** | 61,038 | 53,271 | 52,467 | 52,467 |
| Common Stock—Average Shares Outstanding—Assuming No Dilution (Thousands of Shares) | **37,866** | 31,300 | 26,677 | 26,234 | 26,234 |
| Earnings per Share of Common Stock Based on Average Shares Outstanding—Assuming No Dilution (2) | | | | | |
| Before Cumulative Effect of Change in Method of Recording Revenue | | | | $1.32 | |
| Cumulative Effect on Years Prior to 1974 of Accruing Estimated Unbilled Revenue After Deduction for Related Income Taxes | | | | .95 | |
| Total—Assuming No Dilution | **$3.18** | $3.63 | $2.62 | $2.27 | $2.38 |
| Common Stock—Average Shares Outstanding—Assuming Full Dilution (Thousands of Shares) | **39,942** | 34,487 | 30,437 | 27,157 | 26,234 |
| Earnings per Share of Common Stock Based on Average Shares Outstanding—Assuming Full Dilution (3) | | | | | |
| Before Cumulative Effect of Change in Method of Recording Revenue | | | | $1.33 | |
| Cumulative Effect on Years Prior to 1974 of Accruing Estimated Unbilled Revenue After Deduction for Related Income Taxes | | | | .92 | |
| Total—Assuming Full Dilution | **$3.10** | $3.44 | $2.49 | $2.25 | $2.38 |
| Pro Forma Amounts Assuming Change in Method of Recording Revenue Is Applied Retroactively | | | | | |
| Net Income | | | | $ 60,088 | $ 82,667 |
| Earnings per Share of Common Stock—Assuming No Dilution | | | | $1.32 | $2.47 |
| Earnings per Share of Common Stock—Assuming Full Dilution | | | | $1.33 | $2.47 |
| Cash Dividends Paid per Share | **$2.09** | $2.00 | $2.00 | $2.00 | $2.00 |

# Management's Discussion and Analysis of the Statement of Income

### OPERATING REVENUE

Electric revenue increased $30,495,000 in 1977 and $120,727,000 in 1976. The 1977 increase resulted from increased sales volume of 3.1% along with rate increases partially offset by decreased fuel cost adjustment clause revenue due in part to a Michigan Public Service Commission (MPSC) order disallowing recovery of certain nuclear fuel expenses. The 1976 increase was due to increased sales volume of 8.8% along with increased fuel and purchased power adjustment clause and rate revenues.

Gas revenue increased $24,585,000 in 1977 and $118,942,000 in 1976. The 1977 increase reflects increased cost of gas adjustment clause and rate revenues partially offset by an 8.7% decrease in sales volume due to warmer weather in 1977. The 1976 increase reflects increased cost of gas adjustment clause and rate revenues along with a 7.2% increase in sales volume from 1975 due to colder weather in 1976.

### OPERATING COSTS

Fuel for generation costs decreased $3,724,000 in 1977 and increased $16,891,000 in 1976. The decrease in 1977 reflects a 4.3% decrease in the average fossil and nuclear fuel cost per kWh generated, partially offset by a 7.0% increase in generation from Company-owned facilities. The decrease in the average cost per kWh was primarily due to decreased use of higher cost oil-fired units and the increased use of lower cost nuclear plants along with a decrease in nuclear fuel costs in 1977 to reflect an MPSC order relating to the recovery of certain nuclear fuel costs. The 1976 increase was due primarily to a 7.7% increase in the average fossil and nuclear fuel costs per kWh generated, reflecting a higher cost of oil and nuclear fuel than in 1975.

Purchased and interchange power costs increased $2,541,000 in 1977 and $36,573,000 in 1976. The increase for 1977 reflects an increase in the average price per kWh purchased from 1.85¢ to 2.01¢ or 8.8% partially offset by a 6.2% decrease in the purchased power requirement due to increased internal generation. The increase in 1976 reflects the Company's increased system requirements along with the reduced internal generation, partially offset by a 4.4% decrease in the average cost per kWh for purchased and interchange power.

Cost of gas sold increased $36,109,000 in 1977 and $84,963,000 in 1976. The 1977 increase reflects an 18.6% increase in the average cost per Mcf partially offset by reduced gas sendout associated with the 8.7% decrease in gas Mcf sales from 1976 due to warmer weather in 1977. The 1976 increase reflects a 13.9% increase in the average cost per Mcf and a 7.2% increase in gas Mcf sales due to colder weather in 1976. The increases in the average cost per Mcf reflect higher prices put into effect by pipeline suppliers and increased costs of liquid hydrocarbon feedstock for the production of synthetic natural gas at the Marysville Gas Reforming Plant. The increases in cost are almost totally offset by the cost of gas adjustment clause which permits pass-through to customers.

Other operation and maintenance expenses increased $32,404,000 in 1977 and $26,643,000 in 1976. Major increases reflected in these amounts were maintenance at the various generating plants and employee wages and benefits charged to operations.

### DEPRECIATION AND AMORTIZATION

Depreciation and amortization expenses increased $5,494,000 in 1977 and $3,319,000 in 1976, resulting from additions to depreciable property.

### GENERAL TAXES

General taxes decreased $2,968,000 in 1977 and increased $9,687,000 in 1976. The decrease in 1977 resulted primarily from the elimination of the Michigan Franchise Tax and a lower Michigan Single Business Tax, the latter reflecting a larger credit in 1977 for electric construction expenditures, partially offset by increased real and personal property taxes and payroll taxes. The increase in 1976 was due primarily to increased real and personal property taxes and the addition in 1976 of the Michigan Single Business Tax.

### NET OPERATING INCOME

In 1977, the net result of the increased revenues more than offset by higher costs was a $14,498,000 decrease in net operating income before income taxes. Income taxes decreased $14,470,000 reflecting the lower taxable income and a higher interest deduction, leaving a decrease in net operating income of $28,000. In 1976, the net result of the increased revenues partially offset by higher costs was a $62,076,000 growth in net operating income before income taxes. Income taxes increased $19,751,000. Income taxes in 1976 reflect the elimination of the State Income Tax and increased interest expense. The net result of the increased net operating income before income taxes, and the increased income taxes, was an increase in net operating income of $42,325,000.

### ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC)

Beginning in 1977, AFUDC reflects only the cost of other funds used during construction. The cost of borrowed funds used during construction is offset against interest charges. When the two amounts are added together for 1977 the total exceeds 1976 by $20,363,000. The 1976 amount was $9,023,000 over the 1975 amount. In both cases the increases resulted primarily from increased construction at the Midland Nuclear Plant.

### OTHER INCOME

Other income increased $6,560,000 in 1977 reflecting increased interest income from the Company's short-term investments along with increased earnings of subsidiaries. The decrease of $1,041,000 in 1976 was due to reduced Michigan Gas Storage Company earnings because of a Federal Power Commission-ordered reduction in a filed rate increase along with a decline in interest income.

### INTEREST CHARGES

Interest expense (exclusive of the allowance for borrowed funds used during construction) increased in each period, $16,433,000 in 1977 and $5,698,000 in 1976, as the result of additional sales of long-term debt partially offset in 1977 by no short-term borrowings and in 1976 by reduced short-term borrowings at lower interest rates.

### PREFERRED AND PREFERENCE STOCK DIVIDENDS

The increases in preferred dividends in 1977 and nonconvertible preference dividends in 1977 and 1976 reflect the issuance of additional securities during those periods. The decrease in convertible preference dividends in 1977 reflects conversions of previously issued convertible preference stock.

(1) Allowance for funds used during construction for 1977 reflects allowance for other funds used during construction. Interest charges for 1977 have been credited with allowance for borrowed funds used during construction. (See Note 9)

(2) After reduction for Cash Dividends on Preferred and Preference Stock.

(3) After reduction for Cash Dividends on Preferred Stock and Nonconvertible Preference Stock.

## Transfer Agents Common, Preference and Preferred Stock

Consumers Power Company
Jackson, Michigan 49201

Bradford Trust Company
New York, New York 10017

## Registrars Common Stock

The National Bank of Jackson
Jackson, Michigan 49201

Bradford Trust Company
New York, New York 10017

## Registrars Preference and Preferred Stock

City Bank and Trust Company, N.A.
Jackson, Michigan 49201

Bradford Trust Company
New York, New York 10017

## Notice of Annual Meeting

The Annual Meeting of Shareholders of Consumers Power Company will be held on Tuesday, April 11, 1978, at 2:00 PM Jackson time at the Company's Parnall Office Building, 1945 West Parnall Road, Jackson, Michigan. A notice of meeting, proxy statement and proxy will be mailed to shareholders in March 1978. Prompt signing and return of proxies will be appreciated by the management.

## Annual Report on Form 10-K*

A copy of Consumers Power Company's Annual Report, without exhibits, for the fiscal year ended December 31, 1977, on Form 10-K, required to be filed with the Securities and Exchange Commission pursuant to Rule 13a-1 under the Securities Exchange Act of 1934, will be furnished by the Company without charge to any shareholder who so requests. Such report will be available to shareholders after April 1, 1978.

Requests from beneficial owners of securities must indicate that, as of February 24, 1978, the record date for the Annual Meeting of Shareholders, the person making such request was a beneficial owner of securities entitled to vote at such meeting.

## Financial and Statistical Summary Available*

A *Financial and Statistical Supplement to the 1977 Annual Report* covering the years 1967-1977 is available to all interested shareholders at no charge.

## Shareholders Who Receive Duplicate Reports*

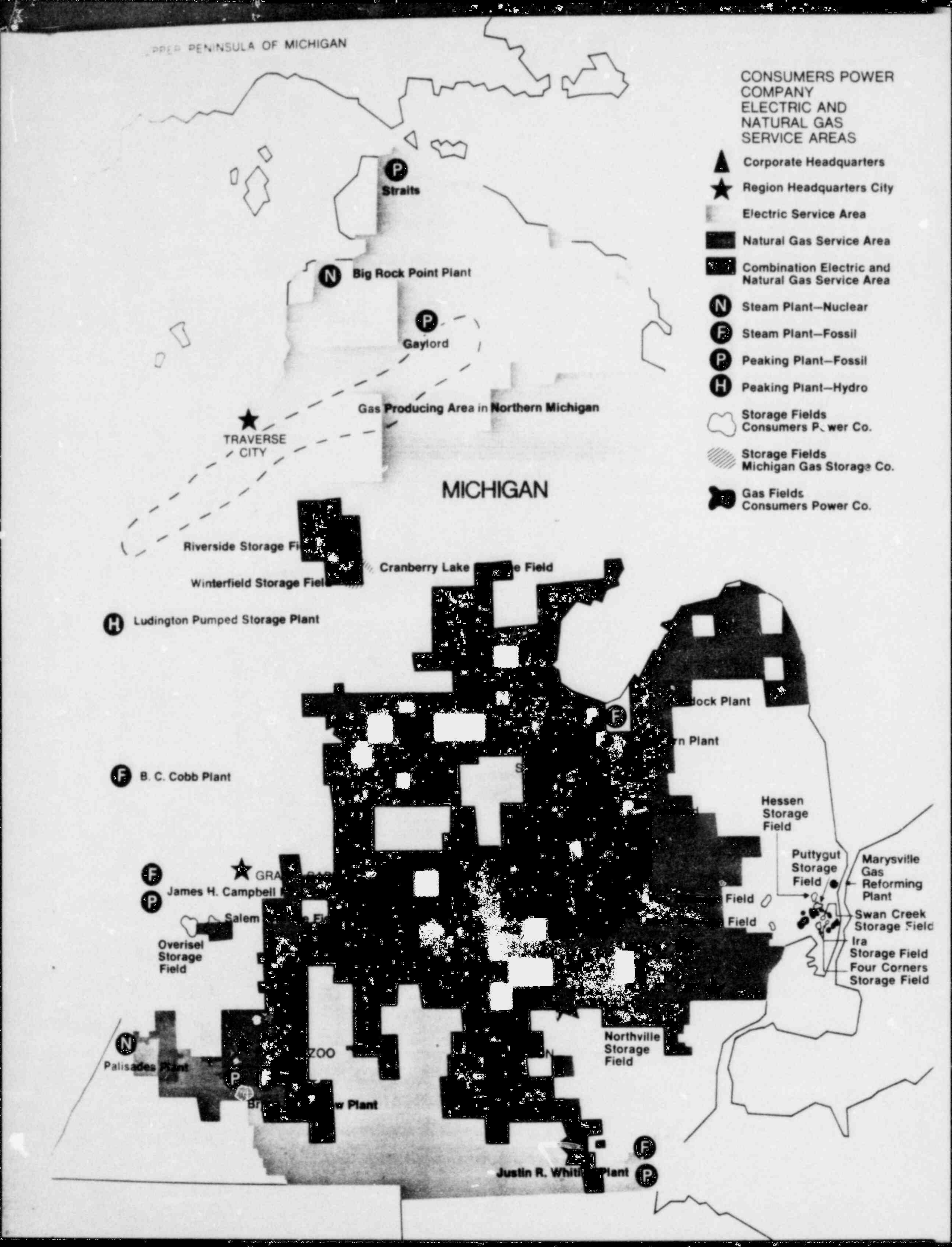
Shareholders who own shares of more than one class of Company stock may receive more than one copy of the Annual Report. Securities and Exchange Commission rules provide that the Company may omit sending an Annual Report to a shareholder if such shareholder authorizes the Company in writing to do so, provided that at least one report is sent to another shareholder at the same address.

If two or more copies of the Company's Annual Report to Shareholders are being sent to you and you wish to have the mailing of duplicate reports discontinued, please notify the Company in writing. Please include in your letter the classes of stock (common, preferred or preference) for which you want your name removed for Annual Report mailings, your name, address and signature.

This will not affect the mailing of your dividend checks, interim reports, proxies, and proxy statements, which each shareholder will continue to receive exactly as before.

You may request that your name be added to the list for Annual Reports at any time in the future.

*Please address all correspondence to Mr. P. A. Perry, Secretary, Consumers Power Company, 212 West Michigan Avenue, Jackson, Michigan 49201.


CONSUMERS POWER COMPANY ELECTRIC AND NATURAL GAS SERVICE AREAS
Corporate Headquarters
Region Headquarters City
Electric Service Area
Natural Gas Service Area
Combination Electric and Natural Gas Service Area
Steam Plant—Nuclear
Steam Plant—Fossil
Peaking Plant—Fossil
Peaking Plant—Hydro
Storage Fields Consumers Power Co.
Storage Fields Michigan Gas Storage Co.
Gas Fields Consumers Power Co.
PENINSULA OF MICHIGAN
Straits
Big Rock Point Plant
Gaylord
Gas Producing Area in Northern Michigan
TRAVERSE CITY
MICHIGAN
Cranberry Lake
Winterfield Storage Field
Ludington Pumped Storage Plant
B. C. Cobb Plant
James H. Campbell
Overisel Storage Field
Palisades Plant
Hessen Storage Field
Puttygut Storage Field
Marysville Gas Reforming Plant
Swan Creek Storage Field
Ira Storage Field
Four Corners Storage Field
Northville Storage Field
Justin R. Whiting Plant

Consumers Power Company, 212 West Michigan Avenue, Jackson, Michigan 49201