

INCREASING SHAREHOLDER VALUE

BY PROVIDING SUPERIOR CUSTOMER VALUE

Detroit
Edison

1989 ANNUAL REPORT



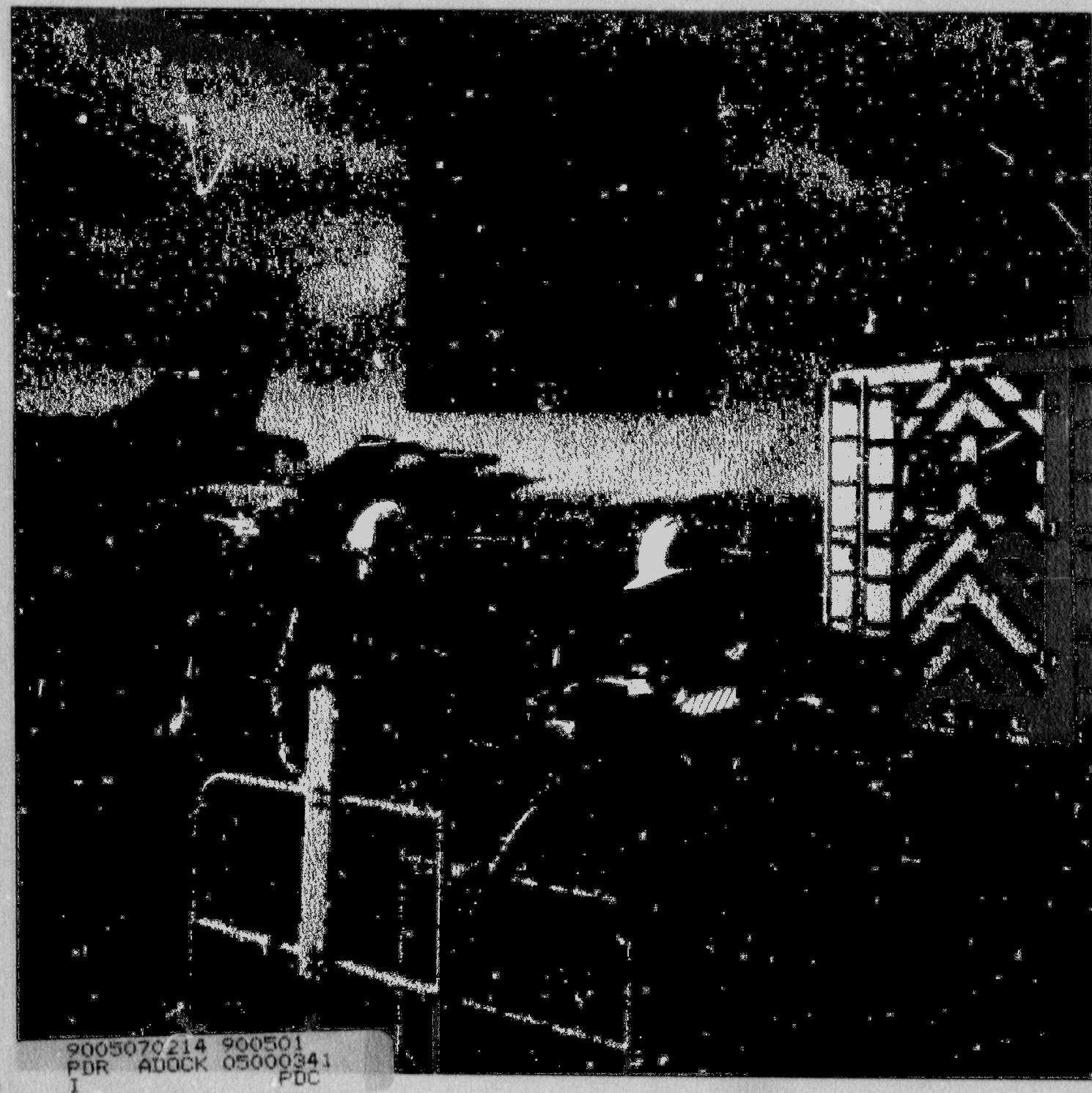
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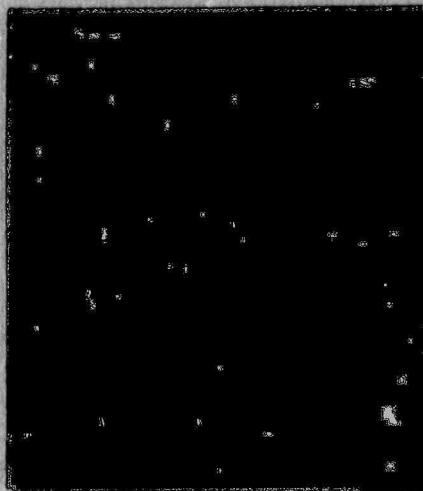
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ON THE COVER

Detroit Edison employees were involved in hundreds of efforts in 1989 that increased shareholder value by providing superior customer value.

Here, employees Edward Zabczynski, left, and Willie Worthem install a new underground cable to improve service to Detroit Metropolitan Airport. See "Keep 'Em Flying," page 7.



FINANCIAL HIGHLIGHTS

	1989	1988	% Increase (Decrease)
Operating Revenues	\$3,203,031,000	\$3,102,172,000	3.3
Income (Loss) Before Cumulative Effect of Accounting Changes	\$425,951,000	\$(235,334,000)	—
Cumulative Effect for Years Prior to 1988 of Accounting Changes (Net of Income Taxes)	—	\$(143,492,000)	—
Earnings (Loss) for Common Stock	\$388,933,000	\$(428,583,000)	—
Earnings (Loss) per Common Share	\$2.65	\$(2.92)	—
Common Shares Outstanding (Average)	146,816,363	146,761,458	—
Dividends Paid per Share	\$1.68	\$1.68	—
Gross Utility Plant	\$11,024,368,000	\$10,766,755,000	2.4
Capitalization	\$7,330,253,000	\$6,881,697,000	6.5
Sales of Electricity (kWh-Thousands)	40,585,000	40,958,000	(0.9)
System Capability at Time of Peak (kW)	9,942,000	10,038,000	(1.0)
System Peak Demand (kW)	8,704,000	9,133,000	(4.7)
Electric Customers at Year-End	1,905,000	1,882,000	1.2

TO OUR SHAREHOLDERS

Detroit Edison was among the nation's top-performing utilities in 1989.

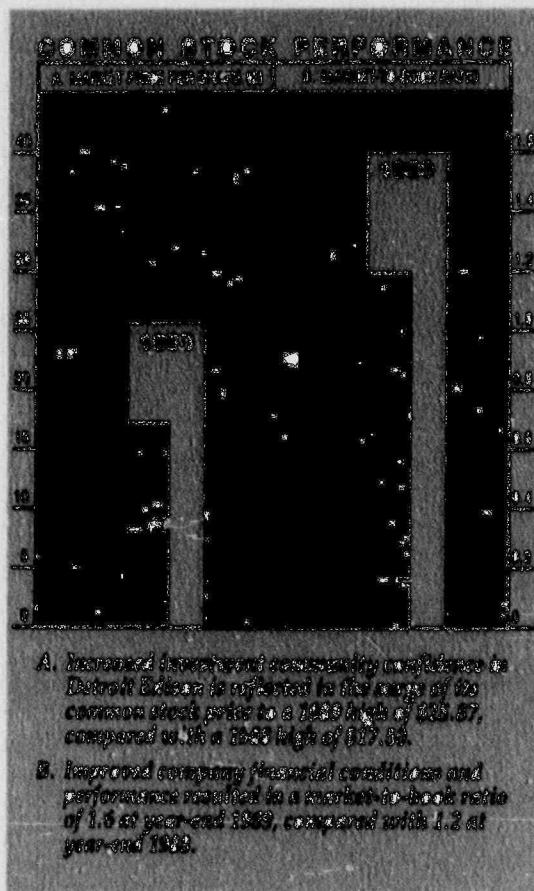
Total return on common stock, including dividends, rose 56 percent in the year—the second-largest increase among electric utilities in the Dow Jones Utilities Average. The stock closed at \$25.38 at year-end—within 50 cents of the December 12 peak of \$25.87 which represented a 19-year high. By comparison, the highest 1988 price was \$17.50.

The record \$1.2-billion increase in market value and the increased confidence in Detroit Edison by the financial community resulted from improved performance in key areas and from the resolution of major uncertainties that had faced the company for many years. Key ratemaking issues have now been resolved, the Fermi 2 power plant's operation and performance have improved markedly,

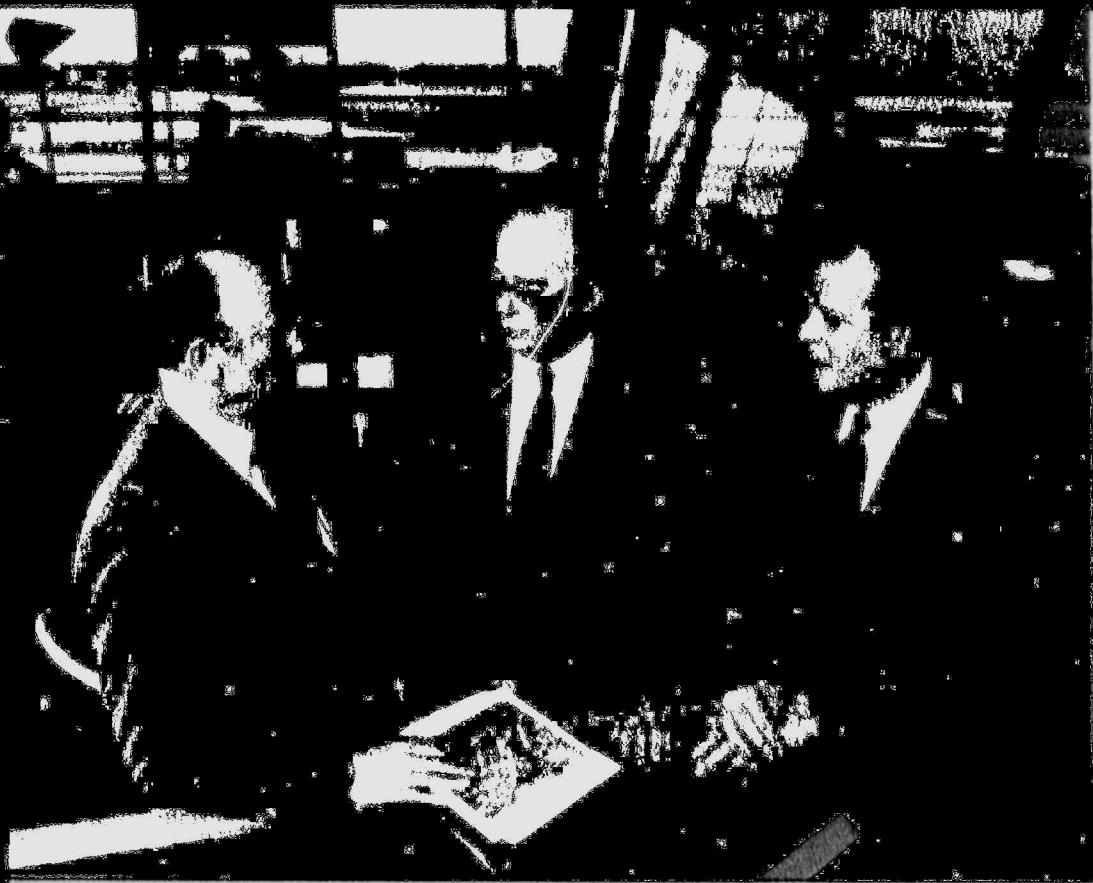
sales were strong, costs continue to be under tight control, and improved management systems resulting from a series of strategic initiatives have taken root.

Your management deeply appreciates the patience and support shown by shareholders during the difficult years of Fermi 2's construction, testing and ratemaking challenges, which were exacerbated by energy crises and by economic recessions felt especially hard in Michigan. Tough financial stewardship enabled us to maintain the common stock dividend then, and improved performance and prospects for a brighter future permit us now to increase the dividend by an annual rate of 10 cents per share.

All of our efforts are focused on continuing to increase shareholder value. That has become a fashionable term to some in the business world these days—so much so that one recent business survey raised the question whether building shareholder value has become reality or just corporate rhetoric.



Chairman and Chief Executive Officer
Walter J. McCarthy, Jr., retires May 1
after more than 26 years with the
company. McCarthy will be succeeded
by John E. Lobbis, president and chief
operating officer.



In the Northwest Airlines control tower at Detroit Metropolitan Airport, Walter J. McCarthy, Jr., center, chairman and chief executive officer, and John E. Lobbia, right, president and chief operating officer, join Wayne County Executive Edward H. McNamara in reviewing electric supply improvements made by Detroit Edison at the airport. (See page 7.)

All of our efforts are focused on continuing to increase shareholder value.

Perhaps the most visible symbol of the company's 1989 turnaround was the improved performance and operation of Fermi 2.

At Detroit Edison, as the theme and substance of this annual report suggest, the reality of our commitment to increasing shareholder value is demonstrated day in and day out by 9,950 employes working together to provide the essential element of shareholder value—superior customer value—through service, teamwork, caring and performance.

This improved value can be seen in our financial performance last year, when earnings for common stock rebounded sharply to \$388.9

million, or \$2.65 per share. That compared with a 1988 loss of \$428.6 million, or \$2.92 per share, resulting from after-tax write-offs of \$968 million due to the Fermi 2 rate-case settlement in December 1988 and to Michigan Public Service Commission disallowances in an earlier Fermi 2 rate case.

But improved 1989 earnings also resulted from strong sales and lower costs. A total of 40.6-billion kilowatthours (kWh) were sold to a record 1.9-million customers. Sales were less than 1 percent below 1988's record level of 41-billion kWh, which was aided by that year's blistering summer heat wave. Revenues from 1989 sales reached an all-time high of \$3.2 billion, up 3.3 percent from the \$3.1 billion in 1988.

Although the weather was more normal in 1989, continuing economic expansion in Southeastern Michigan, combined with increasingly aggressive marketing and sales efforts by Detroit Edison, contributed to new monthly sales records in six of the year's 12 months, record monthly peak demands in nine of the months and a record winter peak.

The most intensive cost-control program in the company's history continued with close scrutiny of operation and maintenance expenses, capital expenditures and staff levels, which currently are at their lowest point in 12 years.

MEMORIAL STATEMENT

The most visible symbol of the 1989 turnaround was the improved performance and operation of Fermi 2.

The plant produced more than five-billion kWh of electricity, most of it during an uninterrupted 168-day run; was removed from the Nuclear Regulatory Commission's (NRC's) list of plants requiring special attention; received its best-ever performance

rating from the NRC; successfully completed its first scheduled refueling outage; and set a plant record for employee safety. Our challenge in the years ahead is not only to continue this record of achievement, but to improve on it.

Although 1989 will be a tough act to follow, programs are in place designed to continue the improvement in the value of shareholder investment in the company. While some utilities have opted for growth through broad and rapid diversification outside the energy field, our intention is to stick to the basics of providing energy products and services of superior value. In these times of increasing energy choices for our commercial and industrial customers, we believe we will serve our shareholders best if our customers continue to view us as their supplier of choice.

To that end, a series of strategic corporate initiatives, called Detroit Edison 1994, is focusing on aggressive cost-reduction, seeking revenue increases in targeted markets, responding rapidly to customer needs, and managing change in our own structure and culture to help us respond better by 1994.

Recent retirements include those of Vice Chairman and Chief Financial Officer Ernest L. Grove, Jr., and Senior Vice President Burkhard H. Schneider. Their contributions and dedication have been instrumental to our achievements and are deeply appreciated.

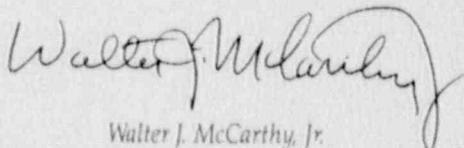
Their successors—and other members of the new management team still evolving—are faced with a broad array of regulatory and legislative issues, including competition, possible industry restructuring and potentially costly environmental legislation.

The members of this team—along with all the other men and women of Detroit Edison—are committed to dealing with these issues in ways which will continue to make Detroit Edison a rewarding investment.

February 26, 1990



John E. Lobbia
President and
Chief Operating Officer



Walter J. McCarthy, Jr.
Chairman and
Chief Executive Officer

Walter J. McCarthy, Jr., may never have more than 20 years of devoted service to the company, including nearly a decade as chairman and chief executive officer. But during his tenure he guided the company through the unprecedented economic, legislative and regulatory challenges of the 1980s.

McCarthy's legacy of leadership has spurred investments throughout the company, the utility industry and the Michigan community at large.

Leading the helm of Detroit Edison in 1981, during the nation's most severe economic recession since the 1930s, McCarthy led the company to financial recovery while completing a decade-long, multi-billion-dollar program of plant construction, expansion and modernization program that included successful building and operation of the company's first nuclear generating facility.

His stewardship also was marked by effective program and initiatives that positioned the company well for the future, and set the stage for continued enhancement of shareholder value. Detroit Edison now is much better equipped to address such key issues as accelerated demand for electricity, growing competition from other energy providers, and the use of alternative and independent sources of electrical power.

A tireless worker who is known throughout the company, the community and the industry as "Mac," McCarthy set an example for his peers and for the next generation of leadership by devoting his time, talents and name to scores of civic, cultural and human services programs that have improved the quality of life at all levels.

The fulfillment of Mac's legacy will be measured not only by the long-term results of the work he started, but also by the new standards for service he set.

AN EMPLOYEE COMMITMENT

When it comes to electricity, customer value means different things to different people.

To the multi-billion-dollar global manufacturer, it means reliable service with no assembly-line power interruptions and rates that keep its products competitive. To the fast-food chain, it means a quick service hookup. To the homeowner, it means respect for his or her property and environmental cleanliness in nearby power plants.

To all of them, it means an electric company simply caring about and responding to their needs—through a friendly voice at the other end of the phone line; long hours worked to restore storm-affected service; new rates, processes or technologies which better meet business needs; or maybe just the thoughtfulness of closing a backyard gate after the meter is read.

For Detroit Edison, improving the value of the service customers receive for their energy dollars means all of these and more. The "more" includes teamwork inside the company and among the company, its customers and others who can help. And it includes performance—by 9,950 employees dedicated to delivering all of the diverse ingredients that spell superior customer value.

Why the stress on customer value? Because in an increasingly competitive and tough business environment, we know that if our customers receive superior value in their service, our shareholders will receive superior value from their investments.

Following are just a few of the hundreds of examples of how Detroit Edison employs combined service, teamwork, caring and performance to deliver customer value in 1989.

S E R V I C E



ICING ON THE CAKE

The Company and Awrey Bakeries Cook Up Unique Energy-Conservation Project

Thanks to Detroit Edison, Awrey Bakeries Inc. of Livonia is in a lot of hot water—but isn't complaining. That's because its hot water is being put to good use as part of a unique energy-conservation project being tested in cooperation with Detroit Edison.

While Awrey is a well-known local retail supplier of baked goods, its nationwide institutional food service is the bakery's mainstay. According to Betty Jean Awrey, director, Public Relations, frozen Danish rolls are the hottest—or coldest—items.

"We supply frozen baked goods to institutional customers in all 50 states, under any of several brand names," she said. "In all of our frozen products, we believe in—and insist on—quality."

The energy-conservation project is icing on the cake in the close working relationship between Awrey and Detroit Edison. But it also holds great promise for other Detroit Edison customers.

KEY INGREDIENTS

"We began looking at how we could reduce costs," says Robert Awrey, chairman of the board of Awrey's Famous Bakery. "Detroit Edison had a heat-recovery system installed at our plant, which was designed to save us money. We took a group of us, including myself, to Detroit Edison to see what they do." Awrey says Detroit Edison's "shareholder value" approach to doing business is what impressed him. "Detroit Edison is growing another important role," he said. "It's not just electricity. It's helping keep the bakery competitive."



"The application of heat-recovery technology can apply to almost every commercial and industrial customer we have," said Willard R. Holland, senior vice president, Energy Marketing and Distribution. "With thousands of such customers, our company could realize great marketing potential from the project while at the same time helping our customers conserve energy."

"Projects like the one with Awrey are great examples of how shareholder value can be increased by providing superior customer value in all its forms."

The pilot project with Awrey represents part of an important "save" for Detroit Edison. As late as December 1988, the bakery was seriously considering producing its own electricity through cogeneration.

According to Robert Awrey, chairman of the board, his firm had been looking for ways to control operating costs to remain competitive, "and energy is a substantial portion of those costs."

"Our overriding goal is to stay independent, and that must be done from a position of competitive strength," he said.

While various cogeneration firms were tempting Awrey with cost-saving estimates for changing to gas,

Detroit Edison was doing a little math of its own. When the final tally was in, Ralph Paschke, account executive, Wayne-Monroe Division, and several associates could report things differently.

"Cogenerators were telling Awrey that having its own electric energy supply would save it \$450,000 over five years," Paschke said. "However, our figures indicated that cogeneration would cost Awrey \$650,000 more in total operating costs over the same period. That's a differential of more than a million dollars."

The availability of Detroit Edison's interruptible primary supply rate made cogeneration uneconomical. The new rate saves Awrey 16.5 percent on its electric bill.

"The Detroit Edison people gave us good information and ideas that made our decision rather obvious," Robert Awrey said.

Not only was a valuable account saved, but in the process the heat-recovery test project originally proposed in May 1987 was re-evaluated, creating a challenging marketing opportunity for Detroit Edison and a new, economical and efficient hot water system for Awrey.

In pursuing the project, the utility found a way for Awrey to make productive, cost-effective use of wasted energy.

"When looking at the energy-conservation alternatives available to a customer," said Robert Luke, a supervisor in Detroit Edison's Customer Options unit, "one of the first opportunities evaluated in the study is the potential for recovering heat from equipment used at the facility."

The specific focus of attention was the four air compressors used to drive the bakery's production processes and control its internal environment.

The compressors must be cooled during operation. In the past, tap water had been drawn in continually for once-through cooling and disposal. Consequently, a lot of potentially useful heat and water had literally gone down the drain.

Under the conservation project being tested, an industrial electric heat pump works to cool water that's used over and over in a closed-loop system. In the process, the heat extracted from the water is intensified by the heat pump and used to heat water for various uses. Having this water available means less work for the plant's gas-fired boiler.

"The heat pump heat-recovery system also helps Awrey offset some gas, water and sewage charges while improving its overall efficiency," said Julian

Ninichuk, senior engineer, Detroit Edison's Marketing Technical Services.

The energy-conservation test will last for at least three years. If successful, it could save Awrey about \$40,000 per year in total production costs.

KEEP THE LINE MOVING

Improved Power Quality Helps GM's Computers, Robots

Production of today's sophisticated automobile engines has shifted focus from the foundries of yesterday to the complexities of computerized manufacturing. Involved are the micro-tolerances and macro-efficiencies of space-age automotive designs—keys to helping American automakers meet both foreign and domestic competition.

But when electrical quality and supply problems confuse or shut down the computers and robots that control production equipment, production slows, fewer engines come off the assembly line and Detroit Edison's phones start ringing.

"Recovery from a power outage or power-related problem is costly in a system as complicated as ours," said Jon R. Smith, senior electrical engineer in General Motors' (GM) Livonia Engine Plant. "The total manufacturing rhythm is broken."

SAVINGS BY DESIGN

Wiegand's Nursery in Richmond wanted to save money and increase yield. With Detroit Edison's help, it did. Using the company's special greenhouse ray, Mark Wiegand, left, of Wiegand's and Detroit Edison's Jared Goetz set up one of the area's first high-intensity discharge lighting systems. Later, the nursery replaced gas-fired boilers with electric water-source heat pumps to heat plants more, halve growing time and cut heating costs up to 60 percent.

As a result of this installation, Detroit Edison gained new — off-peak load.



GM's 950,000-square-foot Livonia facility employs 1,200 people and is the automaker's sole production facility for 4.5-liter V-8 engines for Cadillac's DeVille, Seville, Eldorado and Allante models.

Power supply reliability will become even more crucial as GM upgrades certain products for the 1991 model year.

GM Livonia had experienced 21 electric-service disruptions since 1985—from both known and unknown causes. Its concerns about the problem were brought to light when Ernest L. Grove, Jr., Detroit Edison's vice chairman and chief financial officer, now retired, met with Livonia Engine Plant Manager Thomas Stephens as part of the utility's Executive Contact Program. The goal of the program is to share plans and concerns for the benefit of both the customer and the company.

Detroit Edison, through GM industrial account contacts Lawrence Orlow and Steven Sheppard, coordinated an expert team led by principal engineer

Thomas W. Diliberti. They analyzed sensitive production equipment and the utility's own equipment in the area over a five-month period in an effort to isolate the cause of electrical failures.

Van E. Wagner, a senior engineer in Detroit Edison's Technical and Engineering Services area, monitored the delicately controlled equipment to establish electrical supply standards and tolerances.

According to Cheryl A. Murphy, the plant's manufacturing engineer, the expertise brought to bear on the plant's power-supply problems was reassuring.

"It was good to know that people in these specialized fields were available at Detroit Edison, rather than our having to assemble resources from the outside and manage the study ourselves," she said.

The study eventually determined that most of the plant's power-supply problems had resulted from automatic switching of equipment to compensate for unavoidable power outages, and to automatic switching of Detroit Edison's capacitor equipment to maintain adequate voltage levels. Those problems have since been significantly reduced.

Among other measures now being considered is a proposal to upgrade the plant's electric supply from 40,000 volts to 120,000 volts, which would help improve power quality throughout the plant. When 1991 model year equipment is installed, the additional production is expected to increase electrical use at the facility by 64 percent and Detroit Edison revenues from sales to the facility by 42 percent.

KEEP 'EM FLYING

Detroit Edison Crews Went High and Low to serve Detroit Metro Airport

For busy international terminals like Detroit Metropolitan Airport, on-time performance and split-second timing are crucial. As the nation's 14th largest airport in terms of passengers and 13th busiest for



Detroit Edison associate engineer Joseph E. Staniak, left, monitors a General Motors cam-shaft production line with GM engineers Jon R. Smith and Cheryl A. Murphy.

TEAMWORK

aircraft operations, Metro handles more than a thousand aircraft landings and takeoffs each day. Annual passenger traffic has doubled in the last five years to 20 million and is expected to double again by the year 2005.

Like nearly every other institution in today's complex economy, Metro's performance and timing depend heavily on electricity. Without it, the airport cannot function and the region could virtually grind to a halt.

Detroit Edison lines crews and a team of six company departments learned those lessons firsthand last summer, when they had to find ways to install the equipment for additional crucially needed electricity. They not only met the airport's operational and financial needs, but also helped retain about \$2.5 million of annual revenue for Detroit Edison—helping maintain shareholder value—and provided the area with a significant economic boost.

The latter was attested to by Wayne County Executive Edward H. McNamara, who said that by helping the airport, Detroit Edison aided the economy of all of Southeastern Michigan.

The story actually goes back to the fall of 1988, when officials of Wayne County—which owns and operates the airport—considered installing 6,000 kilowatts (kW) of cogeneration at the airport. They needed to increase capacity and to reduce operating expenses.

Detroit Edison specialists analyzed the airport's needs, what the projected cogeneration system would do to meet those needs as well as to help the airport's budget, and what the loss in revenue would mean to Detroit Edison and its shareholders.

Their solution was for the company to add a large, new transformer at the airport substation to supplement the two existing transformers.

The installation of the new transformer was completed in August 1989, allowing the airport to boost its

LETTERS

Dear Sirs:
I am writing to you to express my appreciation for the excellent service provided by your company. I have been a customer of yours for many years and have always found your staff to be friendly, helpful and knowledgeable. Your prices are competitive and your delivery times are reliable. I would like to thank you for your continued support and I look forward to doing business with you in the future.

use of electricity to 10,000 kW—an increase of about 70 percent.

Lloyd Clapper, senior governmental account executive, Major Accounts, said the transformer and related transmission facilities will result in a gain of \$1 million per year in revenues from 4,000 kW of new load, and the retention of \$2.5 million annually in revenues that would have been lost to 6,000 kW of cogeneration.

"Also, by completing the job as quickly as we did," Clapper said, "we probably gained an additional \$350,000 in revenues from load that was being kept off-line by the county until the third transformer was installed. Finally, we created a lot of good will with the county."

Harold F. Weiss, general supervisor in Operations, Wayne-Monroe Lines, knows all too well the difficulties involved in connecting the 9,000 feet of underground cable through 21 manholes at the airport.

Weiss handled the scheduling and coordination of the 40 employees from the Trombly, Plymouth, Newport and Ecorse service centers who worked on the job. The rebuilding of Metro substation and installation of the new transformer were accomplished in record time by System Maintenance and Modification.

"Gaining access to the manholes—many of which were beneath runways and taxiways—was difficult

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because airport officials naturally had to give first priority to the airlines," Weiss said. "We had to work around their schedules, which meant most of our work had to be done in the middle of the night and on weekends.

"Even though we couldn't always get the time we wanted, we completed the job in about five weeks, instead of the eight weeks originally projected."

Airport officials also recognized the significance of the accomplishment. They wrote to Walter J. McCarthy, Jr., chairman and chief executive officer, praising Detroit Edison for a job well done.

Each crew member and employee involved in the project sports a T-shirt that describes the job: "We really flew at Metro."

And they did.

AGRI-SAFETY

Helping Cows, Farmers and Electricity Work Together

Farmers in Detroit Edison's service area have competitive pressures too, just like the company's big manufacturing customers. That means they have to do things as economically as possible.

Technological innovations in a variety of motors and farm equipment—all powered by electricity—play a major role in helping them do just that.

Sometimes there's a catch, however. Mike VanGordon, Detroit Edison's agribusiness account executive, says that "while the increased use of electricity by farmers is good news for Detroit Edison, the installation and maintenance of electrical farm equipment can sometimes lead to a problem for the farmer."

For example, Christopher Sullivan of Dexter was having trouble with his cows at milking time. They were hesitant to enter the milking parlor and became agitated when they contacted electrical cleaning and milking equipment. Less milk means lower productivity for Sullivan, which puts him at a competitive disadvantage.

Following a routine inspection of the Sullivan farm, Duayne Crouch, a representative of the Michigan Milk Producers Association, suspected the problem was neutral-to-earth voltage (NEV), also known as stray voltage.

NEV results from low-level electrical current flowing into the earth from a grounded conductor. It may pass through people and animals when they come in contact with metal objects connected to the grounded conductors.

NEV isn't harmful to or even detectable by humans. But animals—particularly dairy cows—appear to be sensitive to it. They may experience it when they come in contact with such objects as stanchions, feeders, milking equipment or drinking-water containers.

At Crouch's suggestion, Sullivan called Ron Mason, general supervisor of customer service in the company's Ann Arbor Division.

"Our new company guidelines give NEV calls top priority from trained personnel," Mason said. "So within two hours we had customer field servicemen James Kessler, Kenneth Huff and Robert Armstrong at Sullivan's farm."

According to Kessler, the most important thing the servicemen do is listen. "We always try to remember that these farmers know their cows as well as you and I know our own children," he said.

The three-man team, using the company's step-by-step NEV inspection process, determined that the NEV problem was caused by a change in the electrical service that had been installed in Sullivan's milking parlor.

"Once we identified the source, the problem was quickly corrected," Kessler said.

Since it was his wiring problem, Sullivan hadn't expected Detroit Edison to look at anything beyond its

own equipment. "Instead," he said, "Detroit Edison spent the next four hours checking things out. They were great. Three guys. A cold day. They didn't have to do it."

To prevent such potentially costly problems is one reason Detroit Edison expanded its agricultural outreach program in 1989. Working with Michigan State



University (MSU), the company launched the Teaching Electrification in Agribusiness Classes in High Schools program in two service-area high schools. Truman C. Surbrook, MSU professor of Agricultural Engineering and a nationally recognized expert on NEV, worked with Detroit Edison's VanGordon to develop and implement the program.

To date, company farm-safety training programs have reached more than 700 dairy and crop farmers, electricians and electrical contractors, inspectors, equipment dealers and agribusiness students, with another 4,000 having received the company's literature on farm safety.

Said Surbrook: "I don't know of another power supplier in the United States that has done more than Detroit Edison to look out for the farmers' best interests in this issue."

Sandusky High School teacher Robert Miller, second from left, teaches electrification to students in an agribusiness classroom program developed by Detroit Edison and Michigan State University.

TREE-MENDOUS EFFORTS

Protecting the Environment While Ensuring Reliable Electric Service

On October 19, 1989, nearly three inches of snow dropped on Southeastern Michigan. With most leaves still on the trees, this wet, early autumn snowfall weighed down branches, entangling them with power lines.

The resulting power outages affected nearly 90,000 Detroit Edison customers. None, however, was in the southeast section of Oakland County's Rochester Hills.

SAFETY FIRST

"Safety first" has been the motto of the company since its inception. The company's commitment to safety is reflected in a long-standing program sponsored by Detroit Edison and other utility companies, known as "Service Partners." Through volunteer efforts, grants, and in-kind services as part of its public responsibility, the company and its members have contributed more than \$2.2 million to promote the economic, social, educational and cultural well-being of service-area communities.



Why? Months earlier, Detroit Edison had piloted an innovative tree removal and replacement program in that area that balanced the need for safe, reliable electric service with a commitment to protect the environment and people's needs for aesthetically pleasing neighborhoods.

Under the program, the company removed all fast-growing, so-called "weed" trees growing near power lines. For each such tree removed, the company provided the customer with a free replacement tree that would never grow high enough to reach power lines.

"Residents here are tree-sensitive," said Rochester Hills Mayor Billie M. Ireland. Like other Oakland County communities, the city has responded to the wishes of its citizens by enacting a tree-preservation ordinance.

However, safety and reliability of electricity can be endangered by tree branches that come in contact with power lines as a result of normal tree growth, high winds or storms.

"Removing trees, even for safety and reliability reasons, is not something the company takes lightly," said Maurice L. Vermeulen, manager, Oakland Division. The company spends about \$21 million annually on a line-clearance program which emphasizes prevention by trimming to provide a minimum of four years of safe clearance or, when necessary, removing trees near power lines. This program not only helps improve customer safety and electric service reliability; it is also cost-effective by avoiding the potentially higher costs of storm restoration.

John F. Donahue, Jr., general foreman of line clearance in the company's Oakland Division, had felt for years that a comprehensive tree-replacement program would be beneficial. Rochester Hills provided an ideal

opportunity to test his theory.

In July 1989, after gaining the support of Mayor Ireland and her staff, Detroit Edison began removing various species of trees growing near power lines in the heavily wooded southeast section of Rochester Hills. None of these targeted trees came under the city's tree-preservation ordinance. For each "weed" tree removed, Detroit Edison provided a free redbud or flowering crab tree.

"In the past," Mayor Ireland said, "the only time the city would get involved is when a line-clearance crew was in a resident's yard and the resident was upset. We were braced for a storm of protest, but resident calls numbered only about 60 and most merely wanted more information about the program."

Mayor Ireland said a large part of the program's success could be traced to joint city-company communication efforts that kept residents informed about the program and to Therese E. Jacob, an Oakland Division line-clearance investigator.

Jacob served as the division's liaison with Rochester Hills for the four-month effort. She was available to respond to questions at all hours either from the desk assigned to her at City Hall or from a mobile telephone when she was in the field monitoring the work crews.

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"She handled the few complaints we received with understanding and came up with solutions that were satisfactory to the residents involved," Mayor Ireland said.

Besides the customer good will and environmental benefits achieved, the program already has paid for itself—another plus for shareholder value.

"The tree-replacement program cost about \$4,000 more than it would have cost for trimming alone," said James F. Connelly, director of lines in the Oakland Division. "The difference is about what it costs when we have a power outage, and we made that up when we didn't have any power outages in the test area following the October snowstorm."

Perhaps the best endorsement of the program came from a Rochester Hills resident who sent a letter to Detroit Edison in November 1989. "Thank you," it read, "for cutting down our tree." It was signed in crayon, "Love, Anthony, age 5."

GENERATING VALUE

Efficient Plant Operation Means Economy, Safety and Reliability

Providing superior customer value is more than offering outstanding service through teamwork in a caring manner. It also means performing efficiently at all levels of the company so that major operational savings can be passed on to shareholders in the form of higher earnings and to customers in the form of fair rates.

For the 3,300 employees at the company's seven fossil-fueled plants and one nuclear plant, performance means giving customers what they want when they want it—safe, reliable and fairly priced electricity.

In 1989, these employees did just that, setting numerous performance records in the process.

"You don't have to have face-to-face contact with customers to give them superior value," said Frank E. Agosti, senior vice president, Power Supply. "Everything we do affects the price and quality of the product."

Added B. Ralph Sylvia, senior vice president, Nuclear Generation: "That applies to nuclear as well—whether through fuel purchases, operations or maintenance. Everything affects the customer."

Record monthly electricity demands occurred in all but three months of 1989—and all were met successfully by the company. Those demands included an all-time record winter peak of 6,675 megawatts on December 20.

Other 1989 milestones:

- System availability—the amount of time the plants were available to produce electricity—averaged 86.36 percent. Also, the overall heat rate for the company's seven fossil-fueled plants—another measure of efficiency—set a 26-year record.
- The Monroe Power Plant was the second-largest producer of electricity among all U.S. coal-fired plants in 1988, the last year for which national data are available.
- Fermi 2 also was a top performer during its first full year of commercial operation in 1989, producing more than five-billion kilowatthours of electricity.
- Fermi 2 was removed from the list of plants considered by the Nuclear Regulatory Commission (NRC) to require special attention.
- The NRC's annual review of Fermi 2 in March was the best since the plant received its operating license in 1985.
- Injury-free work performance reduced health-care costs and improved productivity. The company reduced its lost-workday-incidence rate by 60 percent. Fermi 2 employees worked more than five-million hours since March 1987 without a lost-workday injury. Employees at the company's fossil-fueled plants completed three-million hours without a lost-workday injury, earning the company an Edison Electric Institute award.
- Stringent environmental protection controls on air, water, noise and toxic and hazardous waste quality

LITTLE COMFORTS COUNT

Employee Provides Special Measure of Caring

On a cool fall evening in September, Laurice Azoury of Grosse Pointe Woods needed help. Electric power in half her home had gone out; yet her bed-ridden grandmother, Elizabeth Housey, depended for comfort on an electric hospital bed and electric air-flow mattress.

Azoury called Detroit Edison, and learned that it was a particularly busy evening for customer service employees. They told her it might involve a two-hour wait.

Azoury described what followed in a letter to Detroit Edison.

"I explained the situation concerning my grandmother," she wrote, "and was told you would do your best to get here quickly. Imagine my surprise and delight when a service man arrived in only 10 minutes! Even though it was time for him to go off-duty, he spent a good hour looking for the problem."

Customer serviceman Roger Wood traced the problem to the house's wiring system. An electrician solved the problem the next day. In the interim, heavy-duty extension cords were hooked up to other parts of the house to keep electrical equipment operating and Azoury's grandmother comfortable.

Helping customers who have special needs is an important part of Detroit Edison's service. For example, during storms the company gives restoration priority to its nearly 180 customers who depend on life-support equipment, and next priority to nearly 1,000 emergency facilities such as hospitals and fire departments.

There's more to the Housey story. Azoury especially wanted to make sure her ailing grandmother was comfortable because it was her 89th birthday.

continued, with the company's investment totaling \$2 billion since 1971. One result: a 63-percent reduction in sulfur-dioxide emissions from power plants since 1974. Another result: an innovative chemical waste treatment approach at the Monroe Power Plant, which reduced sludge by 75 percent, saves the company more than \$350,000 annually, and earned an environmental excellence award from the Michigan Department of Natural Resources.

Whether setting electricity production records, working safely or protecting the environment, Detroit Edison power plant employees have set even higher goals in the 1990s to become "best in class" in key performance measures and further enhance shareholder value.

FINANCIAL REVIEW

Total Common Stock Return Increases 56% in 1989

Improved customer value, resolution of ratemaking and other regulatory uncertainties, tight cost controls and successfully targeted marketing efforts all contributed to a 56-percent increase in the total return on common stock in 1989.

The \$1.2-billion increase in market value far outperformed the industry as a whole. The company's performance and prospects did not go unnoticed by the financial community as several major brokerage firms began to recommend the company's stock even as the price achieved a 19-year high of more than \$25 per share.

The company's rapid return to financial stability, following the first loss in its history in 1988, was supported by strong sales, which yielded record revenues; new control and accountability systems, which led to greater productivity and lower operation expenses; and reduced requirements for preferred and preference stock dividends and debt service.

Earnings for common stock totaled \$388.9 million, or \$2.65 per share, compared with the 1988 loss of \$428.6 million, or \$2.92 per share. The loss had resulted from an accounting change and large write-offs due to disallowances of certain Fermi 2 and Greenwood Unit 1 costs.

Sales of 40.6-billion kilowatthours (kWh) in 1989 came within 1 percent of 1988's record performance of 41-billion kWh, which was aided by extremely hot summer weather.

This strong performance was led by sales in the commercial sector, which increased by 2.9 percent to 8.6-billion kWh, reflecting the continued boom in office building and shopping center construction. Industrial sales of 18.8-billion kWh were down 1.7 percent from 1988 as automobile and steel production dipped toward year-end. Residential sales of 11.5-billion kWh experienced the same 1.7-percent decline, with an increase in the number of customers offset by lower average use per customer, due largely to the significantly cooler summer.

Despite the slight drop in kilowatthour sales, revenues in 1989 rose 3.3 percent to a record \$3.2 billion as previously approved rate increases, related to completion of the Fermi 2 power plant, added \$109 million in revenues.

Modest future increases scheduled under these Fermi 2 rate orders, combined with the company's agreement not to seek additional base rate increases through 1993, assure Detroit Edison customers of relatively stable rates during the coming years. This should help large electricity users plan their production schedules as well as help the state retain and attract industry to the area.

1989 FINANCING

Type of Security & Month Sold	Gross Amount (Millions)	Cost to Company (After Expenses)
Mortgage Bonds June	\$310.0	10.12%
Pollution Control Bonds July	130.0	7.72
December	95.7	7.90
Pollution Control Refunding Bonds April and August	10.0	7.94
Unsecured Term Notes February	50.0	9.69
Total	\$564.7	

On the expense side, continuing cost controls and accountability systems are holding down operation and maintenance (O&M) expenses, including fuel and purchased power, while completion of a major power plant construction and modernization program, which had proceeded virtually uninterrupted since the end of World War II, has reduced capital spending requirements to levels now being covered entirely by internal cash generation, making costly new financing unnecessary.

O&M expenses of just under \$1.8 billion, including fuel purchases, were virtually unchanged from 1988, while capital expenditures increased only 3.3 percent during 1989 to \$243 million.

Among specific cost-reduction measures in 1989 was the Contract Portfolio Reformation Program, which resulted in \$24 million in coal purchase savings. Contributing to these savings were the renegotiation of coal and transportation agreements, aggressive and efficient plant performance from using more lower-cost Western low-sulfur coal, and sale of some coal inventories and their replacement with lower-cost purchases.

Among other cost-saving activities during 1989:

- Bank borrowings were reduced, based on favorable projections for internal cash generation and the company's generally improved financial condition. Lines of credit were reduced from \$325 million to \$200 million, and \$525 million of bank revolving credit was refunded. The company continued to reduce its level of short-term indebtedness through the sale of \$200 million of its accounts receivable. The sale was made at a variable cost comparable to the company's other short-term borrowings and in lieu of selling mortgage bonds. In addition, lower bank fees were negotiated

and lower-cost commercial paper was substituted for some bank loans, saving \$1.5 million annually.

■ Insurance and other liability costs were reduced by \$2.5 million without a reduction in coverage, due to rebidding and renegotiation of contracts.

■ At year-end, employees numbered 9,950, the lowest level in 12 years and down 844, or nearly 8 percent, in just the past three years. The Corporate Redeployment Program continued in 1989 as 103 employees accepted voluntary separations that will result in annual payroll savings of nearly \$5 million. Since the program began in 1988, 383 employees have accepted voluntary separation with annual savings in salary to the company of more than \$17.5 million against a one-time expense of \$23.5 million.

Also contributing significantly to the company's financial progress is the internal drive to become a more cost-effective producer of electricity. A key element in what amounts to the beginning of a major cultural change in the company is *Detroit Edison 1994*, which is a dynamic amalgamation of 14 initiatives focused on aggressively reducing costs, targeting marketplace efforts and changing the way employees approach their jobs.

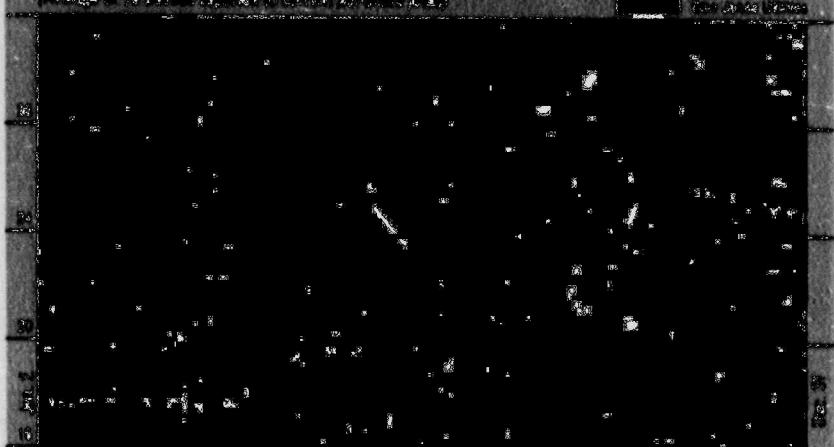
An early product of *Detroit Edison 1994* is the Shareholder Value Improvement Program, implemented in 1989 to make employees more accountable for their decisions and actions and reward them for achieving organizational and corporate goals. Among the objectives of this "pay-for-performance" program are higher per-share earnings, improved customer service and greater operating efficiencies and productivity. Begun with some 400 management employees in 1989, the program was extended in 1990 to cover all 6,000 non-represented employees.

■ Additionally, a Management Control System concept, incorporating the latest technologies and

1989 MARKET PRICE FOR COMMERICAL CHARGE (Dollars)

Detroit Edison vs. Dow Jones 10 Index

Average of 10 stocks in the Dow Jones Industrial Average



managerial and organizational techniques, was implemented in 1988 in the Power Supply organization. The system contributed to cash-flow improvements totaling \$60 million in 1989 and is now being adapted to other major company components.

■ In February 1990 the company completed the \$540-million purchase of the remaining interest in Fermi 2 held by the Wolverine Power Supply Cooperative, Inc., making Detroit Edison the sole owner of the plant. The purchase was financed through issuance of general and refunding mortgage bonds.

Together, the broad array of improvements being implemented by Detroit Edison will lead to a company more streamlined and flexible in its operations, more responsive to its customers and the marketplace in general, less vulnerable to changing external forces, and with a more productive work force. The result should be enhanced value for shareholders, customers and the employee team.

Detroit Edison common stock, which reached a high of \$25.87 in 1989, consistently outperformed the Dow Jones Utilities Average throughout the year.

UNITED BY LIGHT

Two lighting billboards operated by Gannett Outdoor of Michigan light up the Detroit area skyline at night. But Gannett's 2 square billboards were generating about 1,000 individual electric bills each month from Detroit Edison, causing processing problems for the customer. Detroit Edison created a new billing system that provides only 22 billing categories for Gannett and also saves Detroit Edison \$100,000 annually.

MY NEW FAV

GANNETT OUTDOOR

EDISON

**Statement of Management's Responsibility
for Financial Statements**

The consolidated financial statements of The Detroit Edison Company and subsidiary companies have been prepared by management in conformity with generally accepted accounting principles, based upon currently available facts and circumstances and management's best evaluations and judgments of known conditions. It is the responsibility of management to assure the integrity and objectivity of such financial statements and to assure that these statements fairly report the Company's financial position and the results of its operations.

To meet this responsibility, management maintains a high standard of record keeping and an effective system of internal controls, including an extensive program of internal audits, written administrative policies and procedures, and programs to ensure the selection and training of qualified personnel.

These financial statements have been audited by the Company's independent accountants, Price Waterhouse, whose report appears on this page. Their audit was conducted in accordance with generally accepted auditing standards. Such standards include the evaluation of internal accounting controls to establish a basis for developing the scope of the audit, as well as such other procedures they deem necessary for expressing an opinion as to whether the financial statements are presented fairly.

The Board of Directors, through its Audit Committee consisting solely of outside directors, meets with Price Waterhouse, representatives of management and the internal auditors to review the activities of each and to discuss accounting, auditing and financial matters and the carrying out of responsibilities and duties of each group. Price Waterhouse has full and free access to meet with the Audit Committee to discuss its audit results and opinions, without management representatives present, to allow for complete independence.

Ronald W. Gossom

Ronald W. Gossom
Vice President and
Controller

Walter J. McCloskey

Walter J. McCloskey, Jr.
Chairman of the Board and
Chief Executive Officer

Report of Independent Accountants

To the Board of Directors and Shareholders of
The Detroit Edison Company

In our opinion, the consolidated financial statements appearing on pages 15 through 31 of this report present fairly, in all material respects, the financial position of The Detroit Edison Company and its subsidiary companies at December 31, 1989 and 1988, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1989, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and

significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

As discussed in Notes 4 and 5 to the consolidated financial statements, the Company changed its methods of accounting for disallowed plant costs and abandonments, unbilled revenues and property taxes in 1988.

Price Waterhouse

Price Waterhouse

200 RENAISSANCE CENTER
DETROIT, MICHIGAN 48226
February 9, 1990

**Consolidated Statement
of Income**

	Year Ended December 31 (Thousands)		
	1989	1988	1987
Operating Revenues			
Electric	\$ 3,171,456	\$ 3,070,724	\$ 2,825,910
Steam	31,575	31,448	30,821
Total Operating Revenues	\$ 3,203,031	\$ 3,102,172	\$ 2,856,731
Operating Expenses			
Operation			
Fuel	\$ 820,765	\$ 846,678	\$ 813,376
Other power supply	142,240	146,773	47,814
Other operation	514,017	521,152	441,046
Maintenance	291,365	275,610	245,736
Depreciation and amortization	364,554	325,423	237,325
Deferred Fermi 2 depreciation	(35,234)	(44,143)	—
Taxes other than income	225,763	212,656	179,308
Income taxes	129,626	89,944	159,488
Total Operating Expenses	\$ 2,453,096	\$ 2,374,093	\$ 2,124,093
Operating Income	\$ 749,935	\$ 728,079	\$ 732,638
Other Income and Deductions			
Allowance for other funds used during construction	\$ —	\$ 1,663	\$ 136,452
Deferred Fermi 2 return	107,169	134,264	—
Other income and deductions	675	(789)	(3,435)
Income taxes	843	(759)	663
Disallowled plant costs	—	(875,372)	—
Accretion income	50,188	25,866	—
Income taxes — disallowed plant costs and accretion income	(17,047)	225,171	—
Net Other Income and Deductions	\$ 141,828	\$ (489,966)	\$ 133,680
Income Before Interest Charges	\$ 891,763	\$ 238,113	\$ 866,318
Interest Charges			
Long-term debt	\$ 444,204	\$ 451,415	\$ 417,474
Amortization of debt discount, premium and expense	4,368	4,593	3,626
Other	20,980	20,663	23,459
Allowance for borrowed funds used during construction (credit)	(3,740)	(3,224)	(133,215)
Net Interest Charges	\$ 465,812	\$ 473,447	\$ 311,344
Income (Loss) Before Cumulative Effect of Accounting Changes	\$ 425,951	\$ (235,334)	\$ 554,974
Cumulative Effect for Years Prior to 1988 of Accounting Changes for (Notes 4 and 5):			
Disallowled plant costs and abandonments (net of income taxes of \$111,257,000)	—	(344,147)	—
Unbilled revenues (net of income taxes of \$40,912,000)	—	61,367	—
Property taxes (net of income taxes of \$101,306,000)	—	139,288	—
Net Income (Loss)	\$ 425,951	\$ (378,826)	\$ 554,974
Preferred and Preference Stock Dividend Requirements	37,018	49,757	78,240
Earnings (Loss) for Common Stock (Note 5)	\$ 388,933	\$ (428,583)	\$ 476,734
Common Shares Outstanding — Average	146,816,363	146,761,458	146,729,292
Earnings (Loss) Per Share			
Before cumulative effect of accounting changes	\$2.65	\$ (1.95)	\$ 3.25
Cumulative effect for years prior to 1988 of accounting changes for: Disallowled plant costs and ab Unbilled revenues Property taxes	— — —	(2.34) 0.42 0.95	— — —
Earnings (Loss) Per Share (Note 5)	\$2.65	\$ (2.92)	\$ 3.25

(See accompanying Notes to Consolidated Financial Statements.)

Consolidated
Balance Sheet

December 31 (Thousands)

1989

1988

ASSETS**Utility Properties**

Plant in service	\$ 10,893,234	\$ 10,611,077
Electric	59,456	58,999
Steam		
Less: Accumulated depreciation and amortization	\$ 10,952,690	\$ 10,670,076
	(2,787,815)	(2,463,111)
Construction work in progress	\$ 8,164,875	\$ 8,206,965
63,046		89,547
Nuclear fuel	8,632	7,132
Net utility properties	\$ 8,236,553	\$ 8,303,644
Property under capital leases	\$ 271,058	\$ 265,615
Nuclear fuel under capital lease	404,807	373,791
	\$ 675,865	\$ 639,406
Less: Accumulated amortization	(234,337)	(172,916)
Net property under capital leases	\$ 441,528	\$ 466,490
Total owned and leased properties	\$ 8,678,081	\$ 8,770,134

Other Property and Investments

Non-utility property	\$ 9,739	\$ 9,557
Investments and special funds	41,092	31,165
Nuclear decommissioning trust funds	5,825	2,667
	\$ 56,656	\$ 43,389

Current Assets

Cash	\$ 6,664	\$ 3,647
Temporary cash investments (at cost, approximating market value)	9,000	—
Customer accounts receivable and unbilled revenues (less allowance for uncollectible accounts of \$19,000,000 and \$16,000,000, respectively)	197,139	366,682
Other accounts receivable	58,629	31,526
Inventories (at average cost)		
Fuel	176,201	234,499
Materials and supplies	147,553	149,567
Prepayments and other	7,279	6,925
	\$ 602,465	\$ 792,846

Deferred Debits

Unamortized debt expense	\$ 50,913	\$ 43,988
Accumulated deferred income taxes	196,399	192,860
Unrecovered plant costs	20,183	25,332
Fermi 2 phase-in plan	320,810	178,407
Other	24,092	13,337
	\$ 612,397	\$ 453,924
Total	\$ 9,949,599	\$ 10,060,293

(See accompanying Notes to Consolidated Financial Statements.)

**Consolidated
Balance Sheet**

December 31 (Thousands)

1989

1988

LIABILITIES**Capitalization**

Common stock—\$10 par value, 160,000,000 shares authorized; 146,859,569 and 146,783,212 shares outstanding, respectively (522,524 and 598,926 shares, respectively, reserved for conversion of preferred stock)	\$ 1,468,596	\$ 1,467,832
Premium on common stock	552,501	551,907
Common stock expense	(47,742)	(47,712)
Retained earnings used in the business	396,705	254,922
Total common shareholders' equity	\$ 2,370,060	\$ 2,226,949
Cumulative preferred stock—\$100 par value, 9,000,000 shares authorized; 3,379,537 and 3,455,629 shares outstanding, respectively (3,539,827 shares unissued)		
Non-redeemable preferred stock	239,495	240,824
Redeemable preferred stock	86,484	92,667
Cumulative preference stock—\$1 par value, 30,000,000 shares authorized; 3,380,180 and 3,780,180 shares outstanding, respectively (26,619,820 and 26,219,820 shares unissued, respectively)		
Non-redeemable preference stock	47,891	47,891
Redeemable preference stock	25,318	34,830
Long-term debt	4,561,005	4,238,536
Total Capitalization	\$ 7,330,253	\$ 6,881,697

Other Non-Current Liabilities

Obligations under capital leases	\$ 131,358	\$ 139,153
Accumulated rate refunds, with interest	2,627	—
	\$ 133,985	\$ 139,153

Current Liabilities

Short-term borrowings		
Bank loans	\$ —	\$ 17,000
Commercial paper	—	212,325
Amounts due within one year		
Long-term debt	168,789	595,815
Preferred and preference stock	13,750	13,750
Obligations under capital leases	310,170	327,337
Accounts payable	229,604	192,799
Property and general taxes	41,512	39,872
Income taxes	8,328	9,421
Interest	105,975	102,378
Dividends payable	70,782	71,193
Payrolls	59,332	60,925
MPSC-ordered refunds, with interest	—	10,239
Other	40,183	43,315
	\$ 1,048,425	\$ 1,696,369

Deferred Credits

Accumulated deferred income taxes	\$ 1,065,329	\$ 989,729
Accumulated deferred investment tax credits	333,003	318,674
Other	38,604	34,671
	\$ 1,436,936	\$ 1,343,074

Commitments and Contingencies (Notes 2, 6, 13 and 14)

Total	\$ 9,949,599	\$ 10,060,293
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(See accompanying Notes to Consolidated Financial Statements.)

**Consolidated Statement
of Cash Flows**

Year Ended December 31 (Thousands)

1989 1988 1987

Operating Activities

Net Income (Loss)	\$ 425,951	\$ (378,826)	\$ 554,974
Adjustments to reconcile net income (loss) to net cash from operating activities:			
Cumulative effect for years prior to 1988 of accounting changes for:			
Disalloweed plant costs and abandonments — net	—	344,147	—
Unbilled revenues and property taxes — net	—	(200,655)	—
Disalloweed plant costs	—	875,372	—
Accretion income	(50,188)	(25,866)	—
Depreciation and amortization	364,554	325,423	237,325
Deferred Fermi 2 depreciation and return	(142,403)	(178,407)	—
Deferred income taxes and investment tax credit — net	86,516	(137,522)	99,050
Amortization of property losses and unrecovered plant costs	7,128	7,128	9,708
Allowance for other funds used during construction	—	(1,663)	(136,452)
Sale of accounts receivable and unbilled revenues	200,000	—	—
Other	(713)	(26,789)	24,189
Changes in current assets and liabilities:*			
Customer accounts receivable and unbilled revenues	(30,457)	(60,687)	16,577
Other accounts receivable	(27,103)	11,054	(13,283)
Inventories	59,003	386	2,892
MPSC-ordered refunds, with interest	(10,239)	(23,080)	22,688
Accounts payable	34,829	3,659	(12,028)
Taxes payable	489	(251)	13,209
Interest payable	3,597	2,469	14,292
Other	(4,829)	12,091	6,746
Net cash from operating activities	\$ 916,135	\$ 547,983	\$ 839,887

Investing Activities

Plant and equipment expenditures	\$ (242,973)	\$ (235,127)	\$ (709,084)
Purchase from Cooperative — Fermi 2	—	(4,121)	(116,173)
Allowance for other funds used during construction	—	1,663	136,452
Changes in current assets and liabilities*	3,093	(8,890)	(521)
Other	(18,836)	(16,539)	(14,955)
Net cash used for investing activities	\$ (258,716)	\$ (263,014)	\$ (704,281)

Financing Activities

Issuance of unsecured promissory notes	\$ 50,046	\$ 201,924	\$ 525,000
Sale of general and refunding mortgage bonds	296,460	—	1,292,812
Funds received from Trustees: Installment sales contracts and loan agreements	228,265	7,300	7,740
Increase (decrease) in short-term borrowings	(229,325)	229,325	(104,656)
Repayment of long-term debt	(679,965)	(247,975)	(1,256,427)
Redemption of preferred and preference stock	(16,250)	(283,250)	(114,148)
Dividends on common, preferred and preference stock	(284,024)	(304,106)	(328,351)
Other	(10,609)	(24,001)	(20,884)
Net cash (used for) from financing activities	\$ (645,402)	\$ (420,783)	\$ 1,086

Net Increase (Decrease) in Cash and Temporary Cash Investments

Cash and Temporary Cash Investments at Beginning of the Period

Cash and Temporary Cash Investments at End of the Period

Supplementary Cash Flow Information

Interest paid (excluding interest capitalized)	\$ 453,739	\$ 466,721	\$ 282,451
Income taxes paid	59,541	10,813	59,757
New capital lease obligations	36,459	57,638	49,672

For purposes of the consolidated financial statements, the Company considers investments purchased with a maturity of three months or less to be temporary cash investments.

*Excludes cumulative effect for years prior to 1988 of accounting changes.

(See accompanying Notes to Consolidated Financial Statements.)

*Consolidated Statement of
Common Shareholders' Equity*

	Common Stock Shares	\$10 Par Value	Premium on Common Stock	Common Stock Expense	Retained Earnings Used in the Business
(Dollars in Thousands)					
Balance at December 31, 1986	146,699,431	\$1,466,994	\$551,254	(\$47,680)	\$745,835
Issuance of common stock on conversion of convertible cumulative preferred stock, 5½% series	52,434	525	408	(20)	
Premium and expense associated with preferred and preference stock redeemed					(28,270)
Net income					554,974
Cash dividends declared					
Common stock — \$1.68 per share					(246,518)
Cumulative preferred and preference stock*					(77,517)
Balance at December 31, 1987	146,751,865	\$1,467,519	\$551,662	(\$47,700)	\$948,504
Issuance of common stock on conversion of convertible cumulative preferred stock, 5½% series	31,347	313	245	(12)	
Premium and expense associated with preferred and preference stock redeemed					(19,905)
Net loss					(378,826)
Cash dividends declared					
Common stock — \$1.68 per share					(246,564)
Cumulative preferred and preference stock*					(48,287)
Balance at December 31, 1988	146,783,212	\$1,467,832	\$551,907	(\$47,712)	\$254,922
Issuance of common stock on conversion of convertible cumulative preferred stock, 5½% series	76,357	764	594	(30)	
Expense associated with preferred and preference stock redeemed					(556)
Net income					425,951
Cash dividends declared					
Common stock — \$1.68 per share					(246,667)
Cumulative preferred and preference stock*					(36,945)
Balance at December 31, 1989	146,859,569	\$1,468,596	\$552,501	(\$47,742)	\$396,705

*At established rate for each series.

(See accompanying Notes to Consolidated Financial Statements.)

**Notes to Consolidated
Financial Statements**

NOTE 1

Significant Accounting Policies

Industry Segment—The Detroit Edison Company ("Company") is a regulated public utility engaged in the generation, purchase, transmission, distribution and sale of electric energy.

Regulation—The Company is subject to regulation by the Michigan Public Service Commission ("MPSC") and the Federal Energy Regulatory Commission ("FERC") with respect to accounting matters and maintains its accounts in accordance with Uniform Systems of Accounts prescribed by these agencies. As a regulated entity, the Company meets the criteria of Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation." This accounting standard recognizes the ratemaking process which results in differences in the application of generally accepted accounting principles between regulated and non-regulated businesses. Such differences concern mainly the time at which various items enter into the determination of net income in order to follow the principle of matching costs and revenues.

Principles Applied in Consolidation—The Consolidated Financial Statements include the accounts of all subsidiary companies, all of which are wholly-owned.

Revenues—The Company recorded revenues for 1987 as customers were billed on a monthly cycle basis. Effective January 1, 1988, the Company changed its method of accounting to record unbilled revenues for electric and steam heating services provided after cycle billings through month-end in order to better match revenues with expenses. See Note 5. Revenues for 1988 and 1987 also included the recovery of fuel and purchased power costs, subject to annual Power Supply Cost Recovery ("PSCR") reconciliation hearings conducted by the MPSC. Any over or under recovery of these costs was recorded in the Consolidated Balance Sheet pending the results of such hearings. The MPSC's order of December 27, 1988 temporarily suspended the PSCR Clause effective January 1, 1989 through December 31, 1992. See Note 3.

Property Taxes—Effective January 1, 1988, the Company changed its method of accounting for property taxes so that such taxes are accrued monthly during the fiscal period of the applicable taxing authority. This is considered the most acceptable basis of providing for property taxes. Prior to January 1, 1988, the Company accrued property taxes monthly during the calendar year ending on the assessment date (December 31). See Note 5.

Property, Depreciation, Retirement and Maintenance—Utility properties are recorded at original cost. The annual provision for depreciation is calculated on the straight-line remaining life method by applying annual rates approved by the MPSC to the average of year-beginning and year-ending balances of depreciable property by primary plant accounts. For major generating units, the first year's depreciation expense is calculated on a monthly basis commencing with the month in which the unit is placed into commercial operation. Provision for depreciation of Fermi 2 was 2.63% of average depreciable property for 1989 and 1988, except for \$300 million being amortized over 10 years commencing in 1989. See Note 3. Provision for depreciation of all other utility plant, as a percent of average depreciable property, was

3.3% for 1989, 1988 and 1987. In general, the cost of properties retired in the normal course of business is charged to accumulated depreciation. Expenditures for maintenance and repairs are charged to expense, and the cost of new property installed, which replaces property retired, is charged to property accounts.

Deferred Fermi 2 Depreciation and Return—An MPSC-authorized phase-in plan for Fermi 2, which was effective on January 24, 1988, provides for gradual rate increases in the early years of plant operation rather than a one-time substantial rate increase which would be provided by conventional ratemaking. SFAS No. 92, "Regulated Enterprises - Accounting for Phase-in Plans," permits the capitalization of costs deferred for future recovery under a phase-in plan. In December 1988, the MPSC amended the Fermi 2 phase-in plan to bring the plan in compliance with SFAS No. 92 and the Company then adopted SFAS No. 92. In accordance with the Fermi 2 rate phase-in plan, the Company recorded non-cash income items of deferred depreciation (\$35.2 million in 1989 and \$44.1 million in 1988) and deferred return (\$107.2 million in 1989 and \$134.3 million in 1988). Deferred depreciation is that portion of depreciation expense not covered in current rates. Deferred return is the accrual of carrying charges on Fermi 2 costs not covered in current rates. See Note 3.

Income Taxes—Deferred income taxes are provided for timing differences between book and taxable income to the extent authorized by the MPSC. For federal income tax purposes, the Company computes depreciation using accelerated methods and shorter depreciable lives. Investment tax credits utilized are deferred and amortized over the estimated composite service life of the related property. See Note 8.

Allowance for Funds Used During Construction ("AFUDC")—AFUDC, a non-operating non-cash item, is defined in the FERC Uniform System of Accounts to include "the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used." AFUDC involves an accounting procedure whereby the approximate interest expense and the cost of other (common, preferred and preference shareholders' equity) funds applicable to the cost of construction are transferred from the income statement to construction work in progress in the balance sheet. The cash recovery of AFUDC, as well as other costs of construction, occurs only when completed projects are placed in service and related depreciation is authorized to be recovered through customer rates. See Note 3.

The Company capitalized AFUDC at 9.65% in 1989, 10.18% in 1988 and 10.3% in 1987. In accordance with MPSC requirements, the composite AFUDC rate is equal to the overall rate of return authorized in electric rate orders. In accordance with FERC accounting requirements, the Consolidated Statement of Cash Flows is not adjusted to remove the borrowed funds component of AFUDC of \$3.7 million, \$3.2 million and \$133.2 million for 1989, 1988 and 1987, respectively. Total AFUDC for both borrowed and other funds amounted to \$3.7 million, \$4.9 million and \$269.7 million for 1989, 1988 and 1987, respectively.

Accretion Income—In accordance with SFAS No. 90, "Regulated Enterprises - Accounting for Abandonments and Disallowances of Plant Costs," the Company records a non-cash return (accretion income) on certain plant costs which have been discounted to recognize an MPSC disallowance of a return on the investment. The Company recorded \$33.1 million and \$16.8 million of net after-tax accretion income in 1989 and 1988, respectively. See Note 4.

Capitalization—Discount, Premium and Expense—The discount, premium and expense related to the issuance of long-term debt are amortized over the life of each issue. Capital stock premium and expense relate to redeemed preferred and preference stock is written off first against the accumulated net gain on reacquired capital stock included in premium on common stock and subsequently against retained earnings used in the business.

Unrecovered Plant Costs—Amortization of unrecovered plant costs commences when recovery of such costs is authorized by accounting and ratemaking orders of the MPSC. No return on investment is provided for unrecovered plant costs. See Note 4. The Company is amortizing costs of \$71.3 million associated with the abandoned Greenwood Unit Nos. 2 and 3 over the period 1983-1993. The unamortized balances at December 31, 1989 and 1988 were \$20.2 million and \$25.3 million, respectively.

Leases—See Note 13.

Employees' Retirement Plan and Other Postretirement Benefits—See Note 15.

NOTE 2

Fermi 2

General—Fermi 2, a nuclear generating unit having a capability rating of 1,093 MW, began commercial operation on January 23, 1988. This unit represents approximately 31% of the Company's total assets, 11% of total operation and maintenance expenses and 10% of the Company's summer net rated capability.

At December 31, 1989, Wolverine Power Supply Cooperative, Inc. ("Cooperative") held an 11.198% interest in the facility. The Company has agreed to purchase the Cooperative's Fermi 2 ownership interest in February 1990 for approximately \$540 million (\$513 million for plant, \$25 million for nuclear fuel and \$2 million for materials and supplies). The Company will issue its General and Refunding Mortgage Bonds as payment of the purchase price, and such Mortgage Bonds will be held by the United States of America, Rural Electrification Administration, guarantor of the Cooperative's Fermi 2-related debt. The Mortgage Bonds will bear interest at the rate carried by the Cooperative's Fermi 2-related debt, which is approximately 8%. The MPSC has authorized the issuance of the Mortgage Bonds associated with the 1990 Fermi 2 purchase.

See Notes 3 and 4 for a discussion of the MPSC's treatment of Fermi 2 project costs of \$4.858 billion (including the purchase of the Cooperative's interest in 1990).

Licensing and Operation—The Nuclear Regulatory Commission ("NRC") maintains jurisdiction over the licensing and operation of Fermi 2.

From time to time the NRC considers taking enforcement or other action against the Company as a result of alleged technical and procedural violations at the plant. Enforcement action has resulted in fines against the Company of \$250,000 for 1988 and \$175,000 for 1987.

During 1989 and the period from commercial operation through December 31, 1988, Fermi 2 has been available for system power generation 63.7% and 57.2% of the time, respectively. The plant's capacity factor (measured by the amount of power produced as compared to full power capability) was 54.6% and 45.2%, respectively, during these same periods. Fermi 2 plant availability and capacity factors were affected in 1989 and 1988 by both scheduled (15 and 7 weeks, respectively) and forced (4 and 14 weeks, respectively) shutdowns and power level restrictions necessitated by mechanical difficulties.

The first refueling outage for Fermi 2 commenced September 5, 1989 and the plant was returned to service December 16, 1989. During the outage, approximately one-third of the fuel in the reactor was replaced, plant modifications installed, and preventive and corrective maintenance performed on plant equipment.

Decommissioning—The NRC regulates nuclear plant decommissioning. The MPSC has jurisdiction over the recovery of costs of decommissioning nuclear power plants. In January 1987, the MPSC issued an order authorizing the establishment of a \$100 million External Trust Fund (in 1987 dollars) to finance the decommissioning of Fermi 2. The order approves surcharges on customer bills commencing with the commercial operation of Fermi 2 and extending over the life of the plant. The Company is currently collecting estimated Fermi 2 decommissioning costs through a rate surcharge under which approximately \$3 million is collected annually. Effective in July 1990, an NRC rule will require decommissioning funding based upon a site-specific estimate or a predetermined NRC formula. The currently authorized surcharge will not provide adequate funding under the new NRC rule, but the Company believes increases in decommissioning costs will be substantially recovered in rates charged to customers.

Nuclear Fuel Disposal Costs—The Company has a contract with the United States Department of Energy ("DOE") for the future storage and disposal of spent nuclear fuel from Fermi 2. Under the terms of the contract, the Company makes quarterly payments to the DOE based upon a current fee of 1 mill per kilowatthour applied to the Fermi 2 net generation. The spent nuclear fuel disposal cost is included as a component of the Company's nuclear fuel expense.

Contingencies—Ownership of an operating nuclear generating unit subjects the Company to significant additional risks. Nuclear plants are highly regulated by a number of governmental agencies concerned with public health and safety as well as the environment, and consequently, are subject to greater risks and scrutiny than conventional fossil-fueled plants.

The Company is insured as to its interest in Fermi 2 under property damage insurance provided by Nuclear Mutual Limited ("NML"), Nuclear Electric Insurance Limited ("NEIL") and American Nuclear Insurers ("ANI"). The NML and NEIL insurance policies provide \$500 million of composite primary coverage and \$975 million of excess coverage, respectively, for decontamination

costs, debris removal and repair and/or replacement of property. Under the NML and NEIL policies, the Company could be liable for maximum retrospective assessments of up to approximately \$35 million per loss, if any one loss should exceed the accumulated funds available to NML or NEIL. An additional \$560 million of excess coverage is provided by ANI for which the Company pays an annual premium and is not liable for retrospective assessments. Accordingly, the combined limits provide total property damage insurance of \$2.035 billion. The Company is also insured by NEIL for replacement power costs associated with accidental plant outages.

As required by federal law, the Company maintains \$200 million of public liability insurance for a nuclear incident. Further, under the Price-Anderson Amendments Act of 1988, deferred premium charges of \$63 million may be levied against each licensed nuclear facility, but not more than \$10 million per year per facility. On December 31, 1989 there were 114 licensed nuclear facilities in the United States. Thus, deferred premium charges in the aggregate amount of approximately \$7.2 billion could be levied against all owners of licensed nuclear facilities in the event of a nuclear incident. Accordingly, public liability for a single nuclear incident is currently limited to approximately \$7.4 billion.

To the extent that insurable claims for replacement power, property damage, decontamination, repair and replacement and other costs and expenses arising from a nuclear incident at Fermi 2 exceed the policy limits of insurance, or to the extent such insurance becomes unavailable in the future, the Company will retain the risk of loss. Although the Company has no reason to anticipate a serious nuclear incident at Fermi 2, if such an incident did happen it could have a material but presently undeterminable adverse impact on the Company's financial position.

NOTE 3

Rate Matters

General—The Company is subject to the general regulatory jurisdiction of the MPSC, which, from time to time, issues its orders pertaining to the Company's conditions of service, rates and recovery of certain costs including the costs of generating facilities.

1986 Rate Order—In April 1986, an MPSC order disallowed \$397 million of Fermi 2 project costs (\$327 million applicable to the Company's portion of the plant) based on a 1983 cost estimate of \$3.075 billion which subsequently increased. This order established a five-year \$404.2 million rate phase-in plan for Fermi 2 which became effective on January 24, 1988 following attainment of commercial operation and which was subsequently amended and extended to seven years. See "1988 Rate Order" below. In addition, the April 1986 order required the removal of the Company's 795 MW oil-fueled Greenwood Unit No. 1 from rate base, upon the commercial operation of Fermi 2, until the conclusion of subsequent proceedings before the MPSC to determine the need for this unit for reliability or economic reasons.

1988 Rate Order—In 1987, the Company requested increased rates from the MPSC in the annual amount of \$298 million to reflect a \$1.7 billion increase in Fermi 2 project costs. The proceeding also included a request that the MPSC authorized phase-in plan for

Fermi 2 be modified to comply with SFAS No. 92. On December 27, 1988, the MPSC issued an order approving a settlement agreement among the Company, MPSC staff, Michigan Attorney General ("AG") and other intervenors.

The 1988 order increased the Company's base rates by \$29.5 million annually, effective January 1, 1989. The order indicated that an overall rate of return of 9.65%, which reflects a return on common equity of 13% (as compared to the prior 14%) and a common equity capital structure ratio of 34%, is just and reasonable. In addition the order (1) amended the MPSC's authorized phase-in plan for Fermi 2 in order to comply with the provisions of SFAS No. 92, (2) transferred the collection of \$159 million of revenue (\$151.7 million MPSC jurisdictional) from the PSCR Clause to base rates, effective January 1, 1989, for capacity buybacks from the Company's jointly-owned Fermi 2 and Belle River power plants, (3) transferred a court-ordered \$12.1 million annual surcharge to base rates effective January 1, 1989 and (4) suspended the PSCR Clause for the four-year period January 1, 1989 through December 31, 1992.

The order provides for a five-year moratorium on base rate changes, through December 31, 1993, with exceptions for previously authorized rate increases (the Fermi 2 phase-in plan) and for federal income tax law or regulation changes, new acid rain legislation and new cogeneration legislation that would increase or decrease costs by \$5 million (1983 dollars adjusted by the Consumer Price Index, "CPI") or more annually.

A new expense stabilization procedure, applicable to approximately \$750 million of Company operation and maintenance expenses, permits rates to be adjusted for the effects of inflation. Under this procedure, a surcharge or credit will be implemented on January 1 of each of the years 1990 through 1992 to offset annual increases or decreases in operation and maintenance expenses. This surcharge or credit will be adjusted each January 1 based on the annual change in the CPI for the preceding 12-month period October 1 through September 30, as follows:

CPI Change	Adjustment to Base
0% - 2%	None
2% - 8%	80% of change in excess of 2%
More than 8%	100% of change in excess of 8% plus 4.8%

Pursuant to a December 1989 MPSC order, an expense stabilization procedure surcharge was approved for implementation on January 1, 1990. Such surcharge will increase annual revenues by approximately \$27 million.

Set forth below is a summary of the Company's scheduled rate increases and other rate changes for the period 1988-1994, excluding surcharges. This summary includes the increases authorized as part of the Fermi 2 phase-in plan.

Year	Authorized Base Rate Increases(a)	Other Rate Changes(b)	Total (Millions)	Cumulative Amounts
	Annual Amounts			
1988	\$ 68.4	\$ —	\$ 68.4	\$ 68.4
1989	104.2	0.5	104.7	173.1
1990	76.8	13.4	90.2	263.3
1991	81.9	7.7	89.6	352.9
1992	102.5	7.6	110.1	463.0
1993	—	39.1	39.1	502.1
1994	(c)	6.7	(c)	(c)

(a) The \$68.4 million increase became effective on January 24, 1988 with other increases scheduled to become effective on January 1 of each applicable year as authorized by the MPSC's December 27, 1988 order.

(b) Principally jurisdictional portion of utilization of Fermi 2 and Belle River capacity buybacks. These are known future expense reductions which by themselves would have reduced customer rates under the PSCR Clause.

(c) \$70.8 million required under the amended Fermi 2 phase-in plan will, under the MPSC's December 27, 1988 order, be included as a cost of service component in the determination of the rate adjustment in 1994 and beyond, so that all amounts deferred are recovered during the period ending no later than December 31, 1998.

The amended MPSC Fermi 2 phase-in plan granted \$527.1 million of rate increases and other rate changes for Fermi 2 to be phased in over a seven-year period. During the phase-in period, the Company is recording related non-cash items of income consisting of deferred depreciation and deferred return totaling \$506.5 million (annual deferrals for the first five years of commercial operation of Fermi 2 as follows: \$178.4 million in 1988, \$142.4 million in 1989, \$104.2 million in 1990, \$63.2 million in 1991 and \$18.3 million in 1992), with these deferred amounts amortized to operating expense as the cash recovery of the deferred amounts is realized through revenues during the period ending December 31, 1998.

In accordance with the December 27, 1988 order, \$700 million of Fermi 2 costs is included in rate base for ratemaking purposes, \$700 million was written off by the Company, and \$300 million is being amortized ratably over 10 years with no return on the investment. See Note 4.

The Company's investment in its 795 MW Greenwood oil-fired unit is excluded from rate base through December 31, 1993. See Note 4.

The February 1990 purchase by the Company of the Cooperative's ownership interest in Fermi 2, estimated at \$513 million, is to be treated as a regulatory asset with a 19-year principal amortization and associated interest at 8%. The debt incurred in connection with this purchase and the associated interest are to be excluded from the calculation of the Company's overall return on investment.

During the period January 1, 1989 through December 31, 2003, the order established a cap on Fermi 2 capital additions of \$25 million per year, cumulative, adjusted by the CPI, a cap on Fermi 2 non-fuel operation and maintenance expenses at the level presented by the Company in its economic study provided in the rate case, adjusted by the CPI, and a capacity factor performance standard based on a three-year rolling average commencing in 1991. For a major capital investment of \$200 million or more, the Company shall apply to the MPSC for prior approval. If approved, and

if found to be reasonable and prudent, the major investment will be included in rate base. Under the performance standard, effective January 1, 1993, a disallowance of net incremental replacement power cost will be imposed for the amount by which the Fermi 2 three-year rolling average capacity factor is less than the greater of either the average of the top 50% of U.S. boiling water reactors or 50%.

While the order restricts the Company's ability to have certain future costs reflected in rates, the Company believes it will be able to continue to operate effectively within the constraints of the order without any significant adverse effects on the Company.

The order also provides that if nuclear operations at Fermi 2 permanently cease, the remaining net rate base investment amount shall be removed from rate base and amortized in rates, without return, over ten years with such amortization not to exceed \$290 million per year. In this event, unamortized amounts of deferred depreciation and deferred return, recorded in the balance sheet under the phase-in plan prior to the removal of Fermi 2 from rate base, will continue to be amortized, with a full return on such unamortized balances, so that all amounts deferred are recovered during the period ending no later than December 31, 1998. Also, amortization in rates of the \$300 million and \$513 million investments in Fermi 2, as described in the preceding paragraphs, would continue.

A summary of the ratemaking treatment of the Company's Fermi 2 project costs (including the purchase of the Cooperative's interest in 1990) is as follows:

Fermi 2 Project Costs	
	(Millions)
In rate base, with recovery and return	\$3,018
Amortized over 10 years with no return	300
Amortized over 19 years, with associated interest	513
Written-off by the Company (\$327 million disallowed in MPSC order of April 1986 and \$700 million disallowed in MPSC order of December 1988)	1,027
Total	\$4,858

See Note 4 for a summary of the manner in which the Company accounted for the disallowances shown above.

NOTE 4 Accounting for Disallowances of Plant Costs

In December 1986, the Financial Accounting Standards Board ("FASB") issued SFAS No. 90 which, among other things, requires any disallowed costs of a recently completed plant to be recognized as a loss when such a disallowance becomes probable and a reasonable estimate of the disallowance can be made. If part of the cost is disallowed indirectly (such as a disallowance of return on investment on a portion of the plant), an equivalent amount of cost shall be deducted from the reported cost of the plant and recognized as a loss.

In 1988, the Company adopted SFAS No. 90 and recorded net after-tax losses totaling \$968 million, or \$6.60 per share (\$344 million, or \$2.34 per share, cumulative effect at January 1, 1988 for years prior to 1988 and a \$624 million, or \$4.26 per share, charge to

income in 1988 which is net of accretion income of \$17 million, or \$0.11 per share). These losses reflect the MPSC's ratemaking treatment for costs incurred in the construction of the Fermi 2 and Belle River Power Plants and the removal of Greenwood Unit No. 1 from rate base, as shown below.

	Disallowment Costs (Millions)	Income Taxes (Millions)	Net Loss (Millions)
Fermi 2—No recovery or return, per April 1986 (\$327 million) and December 1988 (\$700 million) MPSC orders	\$1,027	\$242	(\$785)
Fermi 2—Recovery (\$300 million) over 10 years beginning January 1, 1989 with no return, per December 1988 MPSC order	(141)	48	(93)
Greenwood Unit No. 1—Removed from rate base (\$280 million) from January 1988 through December 31, 1993 with no return, per April 1986 and December 1988 MPSC orders	(153)	52	(101)
Other—Belle River Power Plant costs disallowed in 1985, the abandonment of Greenwood Unit Nos. 2 and 3 in 1980 (see Note 1), and other—net	(9)	3	(6)
Total	\$1,330	\$345	\$985
Less: Accretion income resulting from losses due to discounting	26	(9)	17
Net Total	\$1,304	\$336	\$968
Allocated to:			
Income in 1988			
Disallowment plant costs	\$ (875)	\$234	\$ (641)
Accretion income	26	(9)	17
Cumulative effect for years prior to 1988	\$ (849)	\$225	\$ (624)
Net Total	\$ (1,304)	\$336	\$ (968)

The losses for Greenwood Unit No. 1, for the abandoned Greenwood Unit Nos. 2 and 3, and for a portion of Fermi 2 are recorded as a discount (reduction) of the Company's investment in these units. Thus, net after-tax losses, due to discounting, total \$198 million and such amount will be restored to net income over the period 1988-1998 as the Company records a non-cash return (accretion income) on its investments in these units.

NOTE 6

Accounting Changes in 1988

SFAS No. 90—See Note 4.

SFAS No. 92—See Notes 1 and 3.

Unbilled Revenues—As discussed in Note 1, effective January 1, 1988, the Company changed its method of accounting for revenues to record an estimate of revenues for electric and steam heating service rendered and unbilled at the end of each month.

The effect of the change in accounting was to increase earnings for common stock by \$82.4 million (\$0.56 per share) of which an increase of \$61.4 million (\$0.42 per share) represents the cumulative effect of the change at January 1, 1988, and an increase of \$21.0 million (\$0.14 per share) represents an increase in earnings for the year 1988.

Property Taxes—As discussed in Note 1, effective January 1, 1988, the Company changed its method of accounting for property taxes so that such taxes are accrued monthly during the fiscal period of the applicable taxing authority. The effect of the change in accounting was to increase earnings for common stock by \$165.6 million (\$1.13 per share) of which an increase of \$139.3 million (\$0.95 per share) represents the cumulative effect of the change at January 1, 1988, and an increase of \$26.3 million (\$0.18 per share) represents an increase in earnings for the year 1988.

Pro Forma Amounts—The following table shows pro forma amounts assuming that the Company applied accounting changes for SFAS No. 90, unbilled revenues and property taxes retroactively:

	1988	1987
As Reported:		
Net Income (Loss)	\$ (378,826)	\$554,974
Earnings (Loss) For Common Stock	\$ (428,583)	\$476,734
Earnings (Loss) Per Share	\$ (2.92)	\$ 3.25
Pro Forma Amounts:		
Net Income (Loss)	\$ (235,334)	\$529,414
Earnings (Loss) For Common Stock	\$ (285,091)	\$451,174
Earnings (Loss) Per Share	\$ (1.95)	\$ 3.07

NOTE 6

Jointly-Owned Utility Plant

The Company's portion of jointly-owned utility plant is as follows:

	Fermi 2	Belle River	Ludington Pumped Storage
In-service date	1988	1984-1985	1973
Undivided ownership interest	88.802%	*	49%
Investment (millions)	\$3,233.5	\$1,021.7	\$168.4
Accumulated depreciation and amortization (millions)	\$ 189.9	\$ 165.1	\$ 54.3

*The Company's undivided ownership interest is 62.78% in Unit No. 1, 81.39% of the portion of the facilities applicable to Belle River used jointly by the Belle River and St. Clair Power Plants, 49.59% in certain transmission lines and at least 70% in facilities used in common with Unit No. 2.

Fermi 2—From January 24, 1988, the effective date of the rate increase associated with Fermi 2, through 1989, the Company purchased 100% of the Cooperative's Fermi 2 capacity and energy entitlement. The cost for the buyback of power is based on the Cooperative's total debt service (interest and amortization of principal) and certain other costs such as fuel and operation and maintenance expenses. Buyback payments to the Cooperative

were \$88.8 million and \$102.4 million in 1988 and 1989, respectively. In addition, the Cooperative has agreed to purchase capacity and energy from the Company, 12.5 MW for 1989 increasing annually to 135 MW by the year 2010 and continuing at that level through the year 2025. See Note 2 for a discussion of the Company's planned purchase of the Cooperative's ownership interest in February 1990.

Belle River—The Michigan Public Power Agency ("MPPA") has an undivided ownership interest in Belle River Unit No. 1 and facilities used in common by Belle River Unit No. 1 and Belle River Unit No. 2, and certain other related facilities. MPPA is entitled to 18.61% of the capacity and energy of the entire plant and is responsible for the same percentage of the plant's operation and maintenance expenses and capital improvements. The Company is obligated to provide MPPA with backup power when either unit is out of service.

In 1984, following commercial operation of Belle River Unit No. 1, the Company began contractual purchases of MPPA's capacity and energy entitlement. Such purchases are to continue for up to eleven years, at 100% through 1990, with declining amounts thereafter through 1994. The cost for the buyback of power is based on MPPA's plant-related investment, interest costs incurred by MPPA on their original project financing plus 2.5%, and certain other costs such as depreciation and operation and maintenance expenses. Buyback payments to MPPA were \$73.5 million, \$72.6 million and \$71.3 million for 1987, 1988 and 1989 respectively, and are currently estimated at \$71.0 million, \$63.1 million, \$55.3 million, \$13.7 million and \$6.7 million for 1990, 1991, 1992, 1993 and 1994, respectively.

Ludington Pumped Storage—Operation, maintenance and other expenses of the Ludington Pumped Storage Plant are shared by the Company and Consumers Power Company ("Consumers") in proportion to their respective interests in the plant. See Note 14.

NOTE 7

Sale of Accounts Receivable and Unbilled Revenues

On February 28, 1989, the Company entered into a five year program for the sale of \$200 million of the Company's accounts receivable and unbilled revenues. The sale was accomplished by an assignment of an undivided ownership interest in the Company's customer accounts receivable and unbilled revenues. At December 31, 1989, customer accounts receivable and unbilled revenues on the Consolidated Balance Sheet have been reduced by \$200 million reflecting the sale. All costs associated with the program are being charged to other operation expense in the Consolidated Statement of Income.

NOTE 8

Income Taxes

Total income tax expense as a percent of income (loss) before tax was less than the statutory federal income tax rate for the following reasons:

	Percent of Income (Loss) Before Tax		
	1989	1988	1987
Statutory income tax rate	34.0%	(34.0)%	40.0%
Disallowable plant costs and abandonments	—	24.2	—
Deferred Fermi 2 depreciation and return	(6.8)	(10.1)	—
AFUDC	(4.2)	(5.1)	(18.1)
Indirect construction costs	(0.5)	(0.6)	(2.3)
Investment tax credit—amortized	(1.8)	(2.0)	(1.3)
Depreciation	5.9	5.6	2.6
Other—net	(1.1)	0.5	1.4
Effective income tax rate	25.5%	(21.5)%	22.3%

Components of income taxes were applicable to the following:

	1989		
	(Thousands)		
Operating expenses			
Current	\$ 61,811	\$ 39,199	\$ 62,267
Deferred—net			
Borrowed funds component of			
AFUDC	(24,181)	(23,868)	(21,656)
Depreciation	92,920	116,898	128,185
Property taxes	3,851	(14,686)	—
Unbilled revenues	(10,922)	(12,269)	(6,799)
Alternative minimum tax	10,832	567	(69,356)
Fermi 2 capitalized labor and expenses	(1,943)	2,575	48,956
Indirect construction costs	(1,977)	1,333	(2,253)
Uncollectible accounts	(3,422)	3,679	(4,741)
Contributions in aid of construction	(4,115)	(3,392)	(3,328)
Amortization of property losses and unrecovered plant costs	(2,464)	(2,464)	(3,671)
Other	(5,093)	(857)	4,408
	53,486	67,516	69,745
Investment tax credit—net			
Utilized	24,892	(7,140)	36,479
Amortized	(10,563)	(9,631)	(9,003)
	14,329	(16,771)	27,476
Total	129,626	89,944	159,488
Other income and deductions			
Current	(460)	1,081	(2,492)
Deferred—net	(383)	(312)	1,829
Total	(843)	769	(663)
Disallowable plant costs and accretion income			
Current	(2,036)	(37,216)	—
Deferred—net			
Disallowable plant costs	23,971	(182,717)	—
Accretion income	17,064	9,086	—
Alternative minimum tax	(21,952)	—	—
Investment tax credit—amortized	—	(14,324)	—
Total	17,047	(225,171)	—
Cumulative effect of accounting changes			
Deferred—net			
Disallowable plant costs and abandonments	—	(111,257)	—
Unbilled revenues	—	40,912	—
Property taxes	—	101,306	—
Total	—	30,961	—
Total income taxes	\$145,830	\$(103,497)	\$158,825

In accordance with MPSC requirements, deferred income tax accounting was not followed for the borrowed funds component of AFUDC and indirect construction costs relating to Fermi 2, nor is it followed for interest on nuclear fuel financing (see Note 13) and certain other current income tax deductions.

In 1985, the MPSC ordered that, for accounting and ratemaking purposes, the accumulated deferred income taxes related to indirect construction costs and the borrowed funds component of AFUDC for Belle River Unit No. 1 and common plant be amortized to income over a five-year period rather than over the life of the plant. Such credits to income amounted to \$24 million for each of the years 1989, 1988 and 1987.

The amended Fermi 2 phase-in plan requires the Company to record additional deferred income tax expense related to deferred depreciation totaling \$33.5 million (\$11.3 million in 1988, \$9.4 million in 1989, \$6.9 million in 1990, \$4.2 million in 1991 and \$1.2 million in 1992), with these amounts amortized to income over the period ending December 31, 1998.

The cumulative net amounts of income tax timing differences for which deferred taxes have not been provided at December 31, 1989 and 1988 are \$2.3 billion and \$2.2 billion, respectively. The tax effect of these amounts not provided for currently will be recorded when such taxes become payable and are recovered from customers.

Investment tax credit carryforwards of approximately \$101 million are available to offset future years' tax liabilities as permitted by law. Such credits, if unused, expire over the period 1998 through 2004.

As authorized by the MPSC, deferred income taxes are recorded for tax credits generated under the Alternative Minimum Tax ("AMT") system created by the federal Tax Reform Act of 1986 ("TRA"). The AMT system requires the Company to perform a separate tax calculation, in addition to the regular tax calculation, using a 20% tax rate applied to an AMT base. The Company is required to pay the greater of either the regular tax or the tax calculated under the AMT system. The amount by which the AMT exceeds the regular tax represents a tax credit that can be carried forward indefinitely. After all investment tax credit carryforwards are used, the AMT credits can be used to reduce regular tax liabilities whenever such liabilities exceed AMT liabilities. The Company's current income tax liability for 1987 and 1989 was determined under the AMT method resulting in an AMT credit carryforward of approximately \$79 million at December 31, 1989.

In December 1987, the FASB issued SFAS No. 96, "Accounting for Income Taxes." The Company anticipates adopting the provisions of SFAS No. 96 on a prospective basis in 1992. SFAS No. 96 establishes financial accounting and reporting standards for the effects of income taxes that result from an enterprise's activities during the current and preceding years. It requires an asset and liability approach for financial accounting and reporting for income taxes. When SFAS No. 96 is adopted, the Company will be

required to recompute its tax liability at the then current tax rate and adjust the Accumulated Deferred Income Tax asset and liability amounts in the Consolidated Balance Sheet. In addition, SFAS No. 96 requires that the Company record additional deferred income taxes for temporary differences not previously recognized. Temporary differences include the timing differences discussed above (\$2.3 billion and \$2.2 billion at December 31, 1989 and 1988, respectively) and all other existing differences that will result in taxable or deductible amounts in future years. SFAS No. 96 requires the recognition of an asset to the extent that such additional deferred income taxes are associated with probable future revenue from customers. The Company expects that when SFAS No. 96 is adopted, it will not have a material effect on net income.

NOTE 6

Short-Term Credit Arrangements and Borrowings

As described below, at December 31, 1989, the Company had total short-term credit arrangements of \$303.4 million under which no borrowings were outstanding.

The Company had bank lines of credit of \$200 million all of which had commitment fees in lieu of compensating balances. Commitment fees incurred in 1989 for bank lines of credit were \$0.7 million. The Company uses bank lines of credit to support the issuance of commercial paper, eurocommercial paper, bankers' acceptances and bank loans. All borrowings are at prevailing money market rates which are below the banks' prime lending rates.

The Company has a nuclear fuel financing arrangement under which Renaissance Energy Company ("Renaissance"), an unaffiliated company, raises funds to purchase nuclear fuel and to lend to the Company for general corporate purposes. Renaissance may issue commercial paper or borrow from participating banks on the basis of promissory notes. To the extent the maximum amount of funds available to Renaissance (currently \$400 million) is not needed by Renaissance from time to time to purchase nuclear fuel, such funds may be loaned to the Company pursuant to a separate Loan Agreement. At December 31, 1989, \$103.4 million was available to the Company under such Loan Agreement. See Note 13.

NOTE 10**Common Stock and Non-Redeemable Cumulative Preferred and Preference Stock**

Non-redeemable Cumulative Preferred and Preference Stock outstanding at December 31 was:

	Date of Issuance	1989 (Thousands)	1988 (Thousands)
Non-Redeemable Preferred Stock			
5 1/2% convertible series, 92,957 and 106,549 shares, respectively	October 1967	\$ 9,296	\$ 10,655
9.32% series, 499,080 shares	October 1970	49,908	49,908
7.68% series, 500,000 shares	March 1971	50,000	50,000
7.45% series, 600,000 shares	November 1971	60,000	60,000
7.36% series, 750,000 shares	December 1972	75,000	75,000
Non-redeemable preferred stock expense		(4,709)	(4,739)
Total Non-Redeemable Preferred Stock		<u>\$239,495</u>	<u>\$240,824</u>
Non-Redeemable Preference Stock			
\$2.28 series, 2,000,000 shares	December 1977	\$ 2,000	\$ 2,000
Premium on non-redeemable preference stock		48,000	48,000
Non-redeemable preference stock expense		(2,109)	(2,109)
Total Non-Redeemable Preference Stock		<u>\$ 47,891</u>	<u>\$ 47,891</u>

The Convertible Cumulative Preferred Stock, 5 1/2% Series, is convertible into Common Stock. The conversion price was \$17.79 per share at December 31, 1989. The number of shares converted during 1989, 1988 and 1987 were 13,592, 5,581 and 9,334, respectively. The number of shares of Common Stock reserved for issuance upon conversion and the conversion price are subject to further adjustment in certain events. The Convertible Cumulative Preferred Stock, 5 1/2% Series, may be redeemed at any time in whole or in part at the option of the Company at \$100 per share, plus accrued dividends.

The Company's 9.32% Series, 7.68% Series, 7.45% Series and 7.36% Series Preferred Stock are redeemable solely at the option of the Company at a per share redemption price of \$101, plus accrued dividends.

On January 15, 1988, the Company redeemed all of the outstanding shares of certain series of its \$1 par value Preference Stock, as follows: 3,000,000 shares of \$3.42 Series at \$27.35 per share, 2,250,000 shares of \$3.40 Series at \$27.35 per share and 750,000 shares of \$3.12 Series at \$27.00 per share.

On October 15, 1988, the Company redeemed 2,600,000 shares of \$3.13 Series and 1,400,000 shares of \$3.24 Series, \$1 par value Preference Stock, constituting all of the outstanding shares of both issues, at a price of \$27.17 and \$27.25 per share, respectively.

The Company's \$2.28 Series Preference Stock is redeemable solely at the option of the Company at the stated per share redemption price of \$25.75, plus accrued dividends, prior to January 15, 1993 and \$25.25 per share, plus accrued dividends, on and after January 15, 1993.

Apart from MPSC approval and the requirement that Common, Preferred and Preference Stock be sold for at least par value, there are no legal restrictions on the issuance of additional authorized shares of such stock.

NOTE 11**Redeemable Cumulative Preferred and Preference Stock**

Redeemable Cumulative Preferred and Preference Stock outstanding at December 31 was:

	Date of Issuance	1989 (Thousands)	1988 (Thousands)
Redeemable Preferred Stock			
9.72% series, 375,000 and 400,000 shares, respectively	December 1978	\$37,500	\$40,000
9.72% series, 75,000 and 80,000 shares, respectively	January 1979	7,500	8,000
9.60% series, 266,250 and 284,000 shares, respectively	October 1979	26,625	28,400
9.60% series, 221,250 and 236,000 shares, respectively	January 1980	22,125	23,600
Redeemable preferred stock due within one year		(6,250)	(6,250)
Redeemable preferred stock expense		(1,016)	(1,083)
Total Redeemable Preferred Stock		<u>\$86,484</u>	<u>\$92,667</u>
Redeemable Preference Stock			
\$2.75 series, 580,180 and 780,180 shares, respectively	July 1975	\$ 580	\$ 780
\$2.75 series B, 800,000 and 1,000,000 shares, respectively	December 1975	800	1,000
Premium on redeemable preference stock		33,124	42,724
Redeemable preference stock due within one year		(7,500)	(7,500)
Redeemable preference stock expense		(1,686)	(2,174)
Total Redeemable Preference Stock		<u>\$25,318</u>	<u>\$34,830</u>

The following redeemable series of Preferred and Preference Stock are entitled to the benefit of sinking funds (provided that no dividend arrearages exist) providing for the annual redemption of shares at stated per share prices, plus accrued dividends:

Redeemable Series	Annual Number of Shares	Price Per Share	Non-Cumulative Option to Redeem Additional Shares in Any Year
Preferred Stock			
9.72%	30,000	\$100	30,000
9.60%	32,500	100	32,500*
Preference Stock			
\$2.75	100,000	25	100,000
\$2.75 Series B	100,000	25	100,000

*Not to exceed 220,000 cumulative additional shares.

The following numbers of shares were purchased for application to sinking fund requirements:

	1989	1988	1987
Preferred Stock, 9.72% Series	30,000	—	58,980
Preferred Stock, 9.60% Series	32,500	32,500	32,500
Preferred Stock, 13.50% Series	—	—	50,000
Preference Stock, \$4.12 Series	—	—	250,000
Preference Stock, \$2.75 Series	200,000	200,000	200,000
Preference Stock, \$2.75 Series B	200,000	200,000	200,000

In the event that a payment due under requirements of a sinking fund for any series of redeemable Preferred or Preference Stock is not made, no dividend shall be paid (other than a dividend paid in junior stock) or declared or other distribution made upon any junior stock (Common and Preference Stock in the case of Preferred Stock, and Common Stock in the case of Preference Stock) until such payment is made.

The following series of Preferred and Preference Stock, which are redeemable pursuant to sinking fund requirements, may also be redeemed at the option of the Company at stated per share redemption prices, plus accrued dividends:

Redeemable Series	Decreasing From	Prior To	To	On and After
Preferred Stock:				
9.72%	\$102.90	1-15-94	\$101	1-15-94
9.60%	104.00	10-15-94	101	10-15-94
Preference Stock				
\$2.75	26.10	7-15-90	25.25	7-15-90
\$2.75 Series B	26.10	1-15-91	25.25	1-15-91

The following series of Preferred and Preference Stock were redeemed at the option of the Company:

Redeemable Series	Date	Price Per Share	Number of Shares
Preferred Stock, 13.50% Series	1-15-88	\$104.05	200,000
Preference Stock, \$4.00 Series	4-15-87	27.41	1,600,000
Preference Stock, \$4.12 Series	1-15-87	27.85	1,750,000

The combined aggregate annual amounts of redemption requirements at December 31, 1989 for all series of redeemable Preferred and Preference Stock are \$14 million for 1990 and \$11 million for each of the years 1991 through 1994.

NOTE 12

Long-Term Debt

Long-term debt outstanding at December 31 was:

	Interest Rate	1989	1988
(Thousands)			
General and Refunding Mortgage Bonds			
Series Q, due 6/1/89	4 1/8%	\$ —	\$ 37,695
Series R, due 12/1/96	6	100,000	100,000
Series S, due 10/1/98	6.4	150,000	150,000
Series T, due 12/1/99	9	75,000	75,000
Series U, due 7/1/00	9.15	75,000	75,000
Series V, due 12/15/00	8.15	100,000	100,000
Series X, due 6/15/01	8 1/8	100,000	100,000
Series Y, due 11/15/01	7 3/8	60,000	60,000
Series Z, due 1/15/03	7 1/2	100,000	100,000
Series AA, due 5/1/04	9 1/8	100,000	100,000
Series EE, due 12/15/97	11 1/8	20,000	25,000
Series HH, due 7/15/06	10 1/8	50,000	50,000
Series PP, due 6/15/08	9 1/8	70,000	70,000
Series RR, due 10/15/08	9.8	70,000	70,000
Series SS, due 3/15/99	10 1/8	100,000	110,000
Series UU, due 9/15/09	10 1/8	100,000	100,000
1980 Series B, due 4/1/97	12 1/4	46,800	60,100
1985 Series A, due 5/1/92	11.9	35,000	35,000
1985 Series B, due 6/1/92	11.25	50,000	50,000
1986 Series A, due 4/15/16	9 1/8	200,000	200,000
1986 Series B, due 8/15/16	9 1/4	100,000	100,000
1986 Series C, due 12/15/16	9 1/2	200,000	200,000
1987 Series A, due 2/15/17	9	300,000	300,000
1987 Series B, due 4/15/97	8 3/4	175,000	175,000
1987 Series C, due 4/15/14	9 1/4	225,000	225,000
1987 Series D, due 8/15/92	9 1/8	250,000	250,000
1987 Series E, due 8/15/96	10 1/8	150,000	150,000
1987 Series F, due 6/15/93	9 1/8	200,000	200,000
1989 Series A, due 7/1/99	9 1/8	300,000	—
Less: Unamortized net discount		(14,418)	(11,491)
Amount due within one year		(19,150)	(56,845)
		\$3,468,232	\$3,199,459

	Interest Rate*	1989	1988			
	(Thousands)					
Tax Exempt Revenue Bond Obligations						
Installment Sales Contracts (Secured by corresponding amounts of General and Refunding Mortgage Bonds)						
City of Detroit, due 3/1/90 - 6/1/94	7.18%	\$ 8,130	\$ 13,335			
City of Harbor Beach, due 3/1/90 - 3/1/05	6.99	3,190	3,265			
City of River Rouge, due 2/15/90 - 10/1/02	6.95	45,090	46,560			
City of Superior, due 2/1/90 - 2/1/01	8.10	39,800	40,500			
City of Trenton, due 3/1/90 - 3/1/05	7.04	5,810	5,945			
County of Monroe, due 3/1/90 - 12/1/19	8.12	162,780	57,750			
County of St. Clair, due 6/15/90 - 5/1/22	10.27	203,920	207,035			
Less: Unamortized net discount		(425)	(460)			
Funds on deposit with Trustee		(4,353)	(112)			
Amount due within one year		(10,530)	(11,980)			
		\$ 453,412	\$ 361,838			
Installment Sales Contracts						
County of Monroe, due 5/1/90 - 12/1/19	9.90	\$ 430,600	\$ 314,230			
Less: Funds on deposit with Trustee		(2,124)	—			
Amount due within one year		(2,140)	(1,990)			
		\$ 426,336	\$ 312,240			
Loan Agreements						
Pollution Bond Refunding Projects, due 2/15/94 - 8/15/09	8.64	\$ 53,025	\$ 43,075			
		\$ 932,773	\$ 717,153			
Unsecured Promissory Notes						
Variable interest rates, due 3/31/90 - 4/15/91	9.08%	\$ 171,969	\$ 676,924			
Fixed interest rates, due 6/28/90 - 1/13/93	10.12	125,000	170,000			
Less: Amount due within one year		(136,969)	(525,000)			
Total Long-Term Debt		\$ 160,000	\$ 321,924			
		\$ 4,561,005	\$ 4,238,536			

*Weighted average interest rate at December 31, 1989 for Tax Exempt Revenue Bond Obligations and Unsecured Promissory Notes.

The Company's 1924 Mortgage and Deed of Trust ("Mortgage"), the lien of which covers substantially all of the Company's properties, provides for the issuance of additional bonds (1) based upon property additions, combined with an earnings test provision, or (2) based upon retirements of previously issued bonds. At December 31, 1989, approximately \$2.4 billion principal amount of additional Mortgage Bonds could have been issued on the basis of (1) above, assuming an interest rate of 10% on any such additional Mortgage Bonds. At December 31, 1989, approximately \$144 million of additional bonds could have been issued on the basis of bond retirements.

Tax-Exempt Revenue Bond Obligations—Agreements have been signed with certain municipalities, municipal agencies and state authorities under which tax-exempt bonds were issued to finance certain Company projects or to refund maturing issues. The Company is obligated to make payments sufficient to meet the principal and interest due on the bonds. To secure the Company's obligations under certain of these agreements, the Company has issued Mortgage Bonds with principal amounts, interest rates and maturity dates corresponding to those of the tax-exempt bonds. Payments made on the tax-exempt revenue bond obligations secured by Mortgage Bonds automatically discharge corresponding Mortgage Bond obligations.

The Company has obtained insurance for certain of its tax-exempt obligations. Such insurance arrangements provide for the funding of escrow accounts in the amount of \$80 million in the event that a prescribed debt ratio is exceeded.

Long-Term Debt Maturities—In 1990, 1991, 1992, 1993 and 1994, long-term debt maturities consist of \$172 million, \$93 million, \$404 million, \$310 million and \$45 million, respectively.

NOTE 13

Leases

Future minimum lease payments under long-term noncancelable leases, consisting of nuclear fuel (\$428 million computed on a projected units of production basis), lake vessels (\$78 million), locomotives and coal cars (\$76 million), office space (\$45 million) and computers, vehicles and other equipment (\$62 million) at December 31, 1989 are as follows:

	(Millions)	(Millions)	
1990	\$106	1993	\$ 81
1991	87	1994	73
1992	79	Remaining years	263
		Total	\$689

The Company has a heat purchase contract with Renaissance which provides for the purchase by Renaissance for the Company of up to \$400 million of nuclear fuel, subject to the continued availability of funds to Renaissance to purchase such fuel. Title to the nuclear fuel is held by Renaissance. The Company makes quarterly payments under the heat purchase contract based on the consumption of nuclear fuel for the generation of electricity. Renaissance's investment in nuclear fuel was \$292 million and \$309 million at December 31, 1989 and 1988, respectively. The decrease in 1989 from 1988 of \$17 million includes additions of \$31 million (purchases of \$10 million and capitalized interest of \$21 million) less \$48 million for the amortization of nuclear fuel consumed in 1989.

Under SFAS No. 71, amortization of leased assets is modified so that the total of interest on the obligation and amortization of the leased asset is equal to the rental expense allowed for ratemaking purposes. For ratemaking purposes, the MPSC has treated all leases as operating leases. Net income is not affected by capitalization of leases.

Rental expenses were \$106 million (including \$58 million for nuclear fuel), \$103 million (including \$57 million for nuclear fuel) and \$45 million for 1989, 1988 and 1987, respectively.

NOTE 14

Commitments and Contingencies

Commitments—The Company has entered into purchase commitments of approximately \$342 million at December 31, 1989. The Company has also entered into substantial long-term fuel supply commitments.

Combustion Engineering, Inc. ("Combustion") has constructed the Detroit Resource Recovery Facility in the City of Detroit. The facility, which began commercial operation in 1989, is fueled by municipal solid waste, and is producing steam and electricity. The Company has entered into a 20-year Energy Purchase Agreement with Combustion for the purchase of steam and electricity. The Company is seeking to negotiate an addendum to the Energy Purchase Agreement to reduce the rate to be paid for steam.

See Notes 2 and 6.

Contingencies—In September 1986, the AG, asserting a claim as a "trustee" on behalf of the people of the State of Michigan and the Michigan Natural Resources Commission, filed a lawsuit against the Company and Consumers, as co-owners of the Ludington Pumped Storage Plant ("Ludington"). The Company is a 49% co-owner of Ludington. The suit alleged violations of the Michigan Environmental Protection Act and the common law for claimed aquatic losses. The lawsuit claims past damages (including interest) of approximately \$148 million and future damages (from the time of the filing of the lawsuit) in the amount of approximately \$89,500 per day (of which 49% would be applicable to the Company). An answer was filed denying liability. On November 10, 1987, the AG filed an additional lawsuit in this matter seeking to declare void or voidable the lease to certain state-owned land on which portions of the plant are constructed. Both matters remain pending before the Ingham County Circuit Court.

In 1986, two environmental organizations requested FERC to withdraw the Ludington license or provide some mitigation for fish mortality. On September 30, 1988, FERC ordered Consumers and the Company to install a temporary barrier net, designed by the Michigan Department of Natural Resources ("MDNR"), around the plant to protect fish on an interim basis until permanent measures could be developed. The companies installed a temporary barrier net in April 1989 (at a cost to the Company of \$544,000) and then began a monitoring program. The companies are now evaluating the barrier net as a proposed permanent measure. However, a study released by Consumers on September 8, 1988 estimated the costs of alternative permanent fish protection measures to be between \$38 million and \$200 million. At this time, the Company is unable to determine what the total costs will be to maintain the temporary barrier net and develop permanent measures.

The Company believes that the outcome of the litigation discussed above will not have a material effect on its financial position or results of operations. In addition to the matters reported herein,

the Company is involved in litigation dealing with the numerous aspects of its business operations and such litigation is not expected to have a material effect on the Company's financial position or results of operations.

See Note 2 for a discussion of contingencies related to Fermi 2.

NOTE 15

Employees' Retirement Plan and Other Postretirement Benefits

Employees' Retirement Plan—The Company has a trustee and noncontributory defined benefit retirement plan ("Plan") covering all eligible employees who have completed six months of service. The Plan provides retirement benefits based on the employee's years of benefit service, average final compensation and age at retirement. The Company's policy is to fund pension cost calculated under the projected unit credit actuarial cost method, provided that this amount is at least equal to the minimum funding requirement of the Employee Retirement Income Security Act of 1974, as amended, and is not greater than the maximum amount deductible for federal income tax purposes. The Company is operating under the IRS full funding limitation and, therefore, did not make a contribution to the Plan in 1987, 1988 and 1989 and does not expect to make a contribution to the Plan in 1990.

Net pension cost included the following components:

	1989	1988	1987
	(Thousands)		
Service cost - benefits earned during the period	\$ 15,142	\$ 16,032	\$ 16,564
Interest cost on projected benefit obligation	59,561	57,254	54,514
Actual return on Plan assets	(150,708)	(52,264)	(89,651)
Net deferral and amortization:			
Deferral of net gain (loss) during current period	81,387	(14,597)	28,896
Amortization of unrecognized prior service cost	174	65	—
Amortization of unrecognized net asset resulting from initial application	(4,507)	(4,507)	(4,507)
Net pension cost	<u>\$ 1,049</u>	<u>\$ 1,983</u>	<u>\$ 5,816</u>

Assumptions used in determining net pension cost are as follows:

	1989	1988	1987
Discount rate	9.5%	9.5%	9.0%
Increase in future compensation levels	5.5	6.0	6.0
Expected long-term rate of return on Plan assets	9.5	9.5	9.0

The following table reconciles the funded status of the Plan to the liability recorded in the Company's Consolidated Balance Sheet:

	December 31	
	1989	1988
Plan assets at fair value, primarily equity securities	\$867,176	\$759,476
(Thousands)		
Less actuarial present value of benefit obligations:		
Accumulated benefit obligation, including vested benefits of \$616,800,000 and \$526,243,000	643,566	551,433
Increase in future compensation levels	102,568	94,172
Projected benefit obligation	746,134	645,605
Plan assets in excess of projected benefit obligation	121,042	113,871
Unrecognized net asset resulting from initial application	(55,823)	(60,330)
Unrecognized net gain	(81,167)	(62,185)
Unrecognized prior service cost	7,100	845
Liability recorded as Other Deferred Credits in the Consolidated Balance Sheet	<u>\$ (8,848)</u>	<u>\$ (7,799)</u>

Assumptions used in determining projected benefit obligations are as follows:

	December 31	
	1989	1988
Discount rate	8.5%	9.5%
Increase in future compensation levels	5.0	5.5

The unrecognized net asset at date of initial application is being amortized over approximately 15.4 years, which is the average remaining service period of employees at January 1, 1987.

In addition to the Plan, the Company has several supplemental non-qualified, non-contributory, unfunded retirement benefit plans for certain management employees.

Other Postretirement Benefits—The Company provides certain postretirement health care and life insurance benefits for retired employees. Substantially all of the Company's employees will become eligible for such benefits if they reach retirement age while still working for the Company. These benefits, as well as similar benefits for active employees, are provided principally through insurance companies and other organizations whose premiums are based on the benefits paid during the year. The Company recognizes the cost of providing these benefits as the premiums are paid.

	1989	1988	1987
(Thousands)			
Cost to the Company of providing health care and life insurance benefits to employees			
Active employees	\$41,323	\$38,891	\$38,952
Retired employees	15,694	13,090	13,483
Total	<u>\$57,017</u>	<u>\$51,981</u>	<u>\$52,435</u>

NOTE 16

Supplementary Quarterly Financial Information (Unaudited)

	1989 Quarter Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
(Thousands, except per share amounts)				
Operating Revenues	\$ 790,121	\$ 758,445	\$ 861,752	\$ 792,713
Operating Income	187,531	178,679	218,330	165,395
Net Income	102,748	96,133	139,494	87,576
Earnings for Common Stock	93,379	86,806	130,286	78,462
Earnings Per Share	0.64	0.59	0.89	0.53
	1988 Quarter Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
(Thousands, except per share amounts)				
Operating Revenues	\$ 751,704	\$ 721,853	\$ 867,917	\$ 760,698
Operating Income	166,076	151,880	225,442	184,681
Income (Loss) Before Cumulative Effect of Accounting Changes	7,669	73,445	145,948	(462,396)
Cumulative Effect for Years Prior to 1988 of Accounting Changes (Net of Income Taxes)	(143,492)	—	—	—
Net Income (Loss)	(135,823)	73,445	145,948	(462,396)
Earnings (Loss) for Common Stock	(149,739)	60,510	133,129	(472,483)
Earnings (Loss) Per Share Before Cumulative Effect of Accounting Changes	(0.04)	0.41	0.91	(3.22)
Cumulative Effect for Years Prior to 1988 of Accounting Changes	(0.98)	—	—	—
Earnings (Loss) Per Share	(1.02)	0.41	0.91	(3.22)

The 1988 fourth quarter loss reflects the write-off of Fermi 2 and Greenwood Unit No. 1 plant costs of \$561 million, partially offset by a decrease in book depreciation expense of \$24 million, pursuant to the December 27, 1988 MPSC order and in accordance with SFAS No. 90. See Notes 3 and 4.

Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion and analysis should be read in conjunction with the Consolidated Financial Statements and accompanying Notes thereto, contained herein.

Earnings (Loss) for Common Stock and Earnings (Loss) Per Share

Total and per share Earnings for Common Stock increased for the year 1989, as compared with a loss for 1988. The loss for 1988 resulted from an accounting change and the write-off of certain plant costs disallowed by the Michigan Public Service Commission ("MPSC"). Also contributing to higher earnings for 1989 were increased rates implemented in January 1989 as part of the Fermi 2 phase-in plan, higher accretion income resulting from the discounting of certain losses recorded in 1988, lower operation expenses, lower interest charges and lower preferred and preference stock dividend requirements.

In 1988, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 90, "Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs," and recorded net after-tax losses totaling \$968 million, or \$6.60 per share (\$344 million, or \$2.34 per share, cumulative effect at January 1, 1988 for years prior to 1988 and a \$624 million, or \$4.26 per share, charge to income in 1988 which is net of accretion income of \$17 million, or \$0.11 per share). These losses reflect the MPSC's ratemaking treatment for costs incurred in the construction of the Fermi 2 and Belle River Power Plants and the removal of Greenwood Unit No. 1 from rate base. In addition, the Company adopted, through recognition of the cumulative effect at January 1, 1988, changes in accounting for unbilled revenues and property taxes which increased total and per share earnings for common stock by \$201 million and \$1.37, respectively, and partially offset the losses recorded.

Earnings in 1987 were supported significantly by the Allowance for Funds Used During Construction ("AFUDC") for Fermi 2 while the unit was under construction. Higher kilowatthour ("kWh") sales, lower other operation and maintenance expenses and lower preferred and preference stock dividend requirements also contributed to higher earnings in 1987.

As a result of the above factors, return on average total common shareholders' equity was 16.8% in 1989, (15.9)% in 1988 and 16.7% in 1987. The 1989 return was higher than the return of 13% provided for in a December 1988 MPSC rate order primarily because total common shareholders' equity was reduced significantly by the write-offs of plant costs recorded in 1988.

Consolidated Statement of Income

Operating Revenues—Total operating revenues changed in each year due to the following factors:

	Increase (Decrease) From Prior Year		
	1989	1988	1987
	(Millions)		
Base Rate Changes			
Fermi 2 commercial operation	\$109	\$ 69	\$ —
Tax Reform Act of 1986 ("TRA")	—	(53)	(20)
	109	16	(20)
Power Supply Cost Recovery Clause (fuel and net purchased power cost)	9	120	(68)
kWh sales	(1)	74	83
Unbilled revenue	(23)	29	—
Other - net	7	6	(8)
Total	\$101	\$245	\$139

A December 1988 MPSC rate order amended the Fermi 2 phase-in plan and granted \$527.1 million of rate increases and other rate changes for Fermi 2 to be phased in over the seven-year period 1988-1994. The order also provided for a moratorium on other base rate changes for the five-year period 1989-1993, an expense stabilization procedure which permits rates to be adjusted annually for the years 1990-1992 for the effects of inflation and a suspension of the Power Supply Cost Recovery ("PSCR") Clause for the four-year period 1989-1992. The Company expects the PSCR Clause to be reinstated beginning January 1, 1993.

Changes in kWh sales were as follows:

	Increase (Decrease) From Prior Year		
	1989	1988	1987
Residential	(1.7)%	5.3%	6.1%
Commercial	2.9	5.6	5.0
Industrial	(1.7)	4.7	5.7
Total	(0.9)	3.7	3.8

Favorable business and economic conditions existed throughout the Company's service area during the three-year period; however, business expansion slowed in the fourth quarter of 1989 as automobile and steel production declined toward year-end, reflecting plant shutdowns and weak automotive sales. For the fourth quarter of 1989, industrial sales were down five percent from the same period a year ago. The increases in industrial sales in 1987 and 1988 were due to increased sales to automotive, automotive-related and steel customers. The decrease in industrial sales in 1989 was due primarily to lower sales to automotive, automotive-related and steel customers, partially offset by higher sales to other industrial customers. The increases in commercial sales were due to continued growth in the number of customers. The increases in residential sales in 1987 and 1988 were due to increases in the number of customers and warmer summer weather, with record-breaking 1988 summer temperatures, resulting in higher kilowatthour use per customer. The decrease in residential sales in 1989 was due primarily to cooler summer

weather. Total sales for 1990 are anticipated to remain at approximately the same level as experienced in 1989. Higher residential and commercial sales are expected to offset the decline in industrial sales which began in 1989 and is expected to continue into 1990.

The Company is forecasting average long-term sales growth between 1 and 1.4 percent per year. The Company expects to meet near-term demand for energy by the return to service, subject to environmental regulations, of plants currently in extended cold standby and economy reserve units when energy demand and consumption requirements provide economic justification. However, the Company faces continuing, and possibly increasing competition from cogenerators and independent power producers. Current laws require the Company to purchase the electrical output of certain non-utility companies at a price approved by the MPSC. Current and proposed Federal Energy Regulatory Commission ("FERC") and legislative activities would further encourage the development of generating facilities by independent power producers. Electric energy eventually produced by these other sources could result in displacement or loss of sales made by the Company; however, it could also become a means of providing needed future capacity.

Operating Expenses—Operating expenses decreased in 1987, but increased in 1988 and 1989.

Fuel and other power supply expense changed in each year due to the following factors:

	Increase (Decrease) From Prior Year		
	1989	1988	1987
	(Millions)		
Net system output	\$(12)	\$ 36	\$ 33
Average unit cost	(21)	99	(99)
Other	3	(3)	(5)
Total	\$(30)	\$132	\$(71)

Net system output and average unit costs for the three-year period were as follows:

	1989	1988	1987
	(Thousands of Megawatthours)		
Power plant generation			
Fossil	41,181	41,925	44,139
Nuclear	4,612	3,756	1,193
Purchased and net interchange power	(2,089)	(1,430)	(2,971)
Net system output	43,704	44,251	42,361
Average Unit Cost (\$/Megawatthour)	\$20.72	\$21.19	\$18.95

Average unit costs for 1987 and 1989 reflect declining fuel prices, while the increase for 1988 reflects the buyback of Fermi 2 generation from the Wolverine Power Supply Cooperative, Inc. ("Cooperative"). See Note 6. The 1989 decrease also reflects greater use of lower cost Western low-sulfur coal and improved operating performance of the Company's generating units. Because market conditions have changed and the Company is able to purchase coal at prices lower than some existing long-term contracts, the Company is buying out fuel supply contracts whenever it is prudent and economic.

Other operation expense decreased in 1987 due primarily to lower labor, pension and uncollectible expenses, partially offset by higher employee and public liability insurance expenses and the write-off of power plant site studies. Other operation expense increased in 1988 due primarily to the cost of operating Fermi 2 which commenced commercial operation in January 1988 and expenses related to a voluntary separation plan which provides for the early retirement of certain employees. Other operation expense decreased in 1989 due primarily to lower expenses related to the voluntary separation plan and the lower cost of operating Fermi 2. These decreases were partially offset in 1989 by service fees and expenses associated with the sale of accounts receivable and unbilled revenues.

Maintenance expense decreased in 1987 due to the improved availability of generating equipment, partially offset by higher storm expense. Maintenance expense increased in 1988 due primarily to expense associated with the commercial operation of Fermi 2, partially offset by lower fossil fuel production maintenance. Maintenance expense also increased in 1989 due primarily to higher fossil fuel production maintenance (primarily at Monroe Power Plant) and nuclear production maintenance due to the first scheduled refueling and maintenance outage at Fermi 2.

Depreciation and amortization expense increased due to increases in plant in service, including the addition of Fermi 2 in 1988.

Taxes other than income taxes increased due to higher Michigan Single Business Tax, higher property taxes in 1988 and 1989 resulting from the commercial operation of Fermi 2 and higher payroll taxes in 1988 and 1989.

Income taxes increased in 1987 due primarily to higher pretax income and filed return and audit adjustments, partially offset by the effects of a lower federal income tax rate under the TRA. Income taxes decreased in 1988 due primarily to lower pretax income and the effects of a lower federal income tax rate under the TRA. Income taxes increased in 1989 due primarily to higher pretax income. The effective income tax rate has increased from 22.3% in 1987 to 25.5% in 1989. See Notes 1 and 8.

AFUDC, a non-operating non-cash item, consists of the net cost of borrowed funds used for construction purposes and a reasonable rate on other funds when so used. AFUDC increased in 1987 due to additional capital expenditures for Fermi 2. AFUDC decreased in 1988 and 1989 when AFUDC for the Fermi 2 investment was discontinued effective January 1, 1988. AFUDC amounted to 57% of Earnings for Common Stock in 1987. Future annual amounts of AFUDC are expected to approximate the 1989 level. See Note 1.

Deferred Fermi 2 depreciation and return, non-cash items of income, were recorded beginning with the implementation of the Fermi 2 phase-in plan on January 24, 1988. The annual amounts deferred will decrease in each year through 1992. See Notes 1 and 3.

Accretion income, a non-cash item of income, was recorded beginning in January 1988 in order to restore to income, over the period 1988-1998, losses recorded due to discounting indirect disallowances of plant costs. The level of accretion income recorded increased in 1989, as a result of additional Fermi 2 losses recorded in December 1988.

Other income and deductions include a contribution of \$5 million in 1987 to a charitable foundation.

Interest expense on long-term debt increased in 1987 and 1988 due to the issuance of new securities, partially offset by refunding of maturing securities and early repayment of Belle River project financing obligations in 1987. Interest expense on long-term debt decreased in 1989 due to the early repayment of certain securities and the refunding of maturing securities, partially offset by the issuance of new securities.

Other interest expense decreased in 1987 and 1988 primarily as a result of lower interest on refunds to customers, partially offset by increased interest due to higher levels of short-term borrowings. The average interest rate for short-term borrowings was 7.1% for 1987, 7.9% for 1988 and 9.5% for 1989.

Preferred and preference stock dividend requirements decreased due to optional and mandatory redemptions of outstanding shares.

Consolidated Balance Sheet

Customer accounts receivable and unbilled revenues decreased due to the sale of \$200 million of the Company's accounts receivable and unbilled revenues under a five year program entered into in February 1989.

Fuel inventories decreased due to lower fuel prices and lower quantity levels.

The Fermi 2 phase-in plan, recorded as deferred debits, increased due to the recording of non-cash income items of deferred depreciation and deferred return in accordance with the MPSC-authorized phase-in plan for Fermi 2. These deferred amounts will be amortized to operating expense as the cash recovery of the deferred amounts is realized through revenues during the period ending December 31, 1998.

Other deferred debits increased due to the recording in 1989 of \$14.3 million of buyout costs for fuel supply contracts. These deferred amounts will be amortized to fuel expense to match costs with savings realized under the replacement fuel supply contracts.

Liquidity and Capital Resources

The Company's liquidity has improved since the commercial operation of Fermi 2 as a result of rate increases and lower levels of capital expenditures. A rate phase-in plan for this unit became effective on January 24, 1988. Also, a rate case settlement

approved by the MPSC in December 1988 resulted in additional revenues related to Fermi 2, commencing January 1, 1989, as described in Note 3. The commercial operation of Fermi 2 completed the Company's power plant construction program. The Company has no current plans for additional generating plants.

The Company generates substantial cash flows from operating activities as shown in the Consolidated Statement of Cash Flows. Net cash from operating activities is the Company's primary source of liquidity and was \$840 million in 1987, \$548 million in 1988 and \$916 million in 1989. Net cash from operating activities has changed due primarily to changes in net income and, in 1989, to the sale of accounts receivable and unbilled revenues.

Net cash used for investing activities was \$704 million in 1987, \$263 million in 1988 and \$259 million in 1989. Net cash used for investing activities was higher in 1987 due to higher plant and equipment expenditures and purchases from the Cooperative of a portion of its ownership interest in Fermi 2. Net cash used for investing activities was lower in 1988 and 1989 due to a lower level of plant and equipment expenditures resulting from the completion of the Company's power plant construction program.

Net cash from financing activities of \$1 million in 1987 was due to more than \$1.8 billion of debt financing which, when combined with internally generated funds, covered capital expenditures of \$709 million and permitted early repayment of the balance of \$825 million of the project financing for the Belle River Power Plant, and the repayment of maturing debt and redemption of higher cost preferred and preference stock. Net cash used for financing activities was \$421 million in 1988 and \$645 million in 1989. With the completion of the Company's power plant construction program, debt financing in 1988 and 1989 was used for optional and mandatory redemption of higher cost long-term debt and preferred and preference stock. Dividends on preferred and preference stock decreased during the three year period due to the redemption of preferred and preference stock.

Funds generated internally after payment of dividends on common, preferred and preference stock were 70%, 128% and 169% of capital expenditures (excluding total AFUDC) in 1987, 1988 and 1989, respectively. The higher levels of internal generation of funds result primarily from increases in net income in 1987 and 1989 and lower capital expenditures beginning in 1988.

Cash requirements for capital expenditures from 1990 to 1994 are estimated to be approximately \$1.4 billion (excluding approximately \$27 million of AFUDC). In 1990, cash requirements for capital expenditures are estimated at \$245 million (excluding \$4 million of AFUDC). The Company expects to meet the cash requirements for capital expenditures from internal cash generation. These projections do not include any expenditures for new generating plant, for the Company's 1990 planned purchase of the Cooperative's remaining undivided ownership interest in Fermi 2 or for expenditures required as a result of changes to existing environmental regulations.

The Company has agreed to purchase the Cooperative's remaining ownership interest in Fermi 2 in February 1990 for approximately \$540 million (\$513 million for plant, \$25 million for nuclear fuel and \$2 million for materials and supplies). The Company will issue its General and Refunding Mortgage Bonds, which

will bear interest at the rate carried by the Cooperative's Fermi 2-related debt of approximately 8%, as payment of the purchase price. See Note 2.

In 1989, President George Bush proposed comprehensive amendments to the Clean Air Act of 1970. Subsequent bills in the House of Representatives and Senate focused attention on acid rain, urban ozone and hazardous air pollutants. The acid rain provisions would require significant reductions in sulfur dioxide and nitrogen oxides emissions. No clean air legislation was enacted by Congress in 1989; however, if the present proposals are enacted into law, additional annual expenditures of from \$135 million to \$380 million would be necessary, beginning in the late 1990's, to meet the proposed requirements. At this point, the Company is unable to predict the likelihood of any clean air legislation being enacted, or what provisions such legislation may contain.

The Company's internal cash generation is expected to be sufficient to meet scheduled long-term debt maturities and preferred and preference stock redemption requirements which are approximately \$186 million, \$104 million, \$415 million, \$321 million, and \$56 million for 1990, 1991, 1992, 1993 and 1994, respectively. These cash requirements do not include annual principal payments of \$19 million beginning in 1990 for mortgage bonds to be issued to purchase the Cooperative's remaining undivided ownership interest in Fermi 2.

The Company had short-term credit arrangements of approximately \$303.4 million at December 31, 1989 under which no borrowings were outstanding (the Company had \$9 million in temporary cash investments at December 31, 1989). The Company has substantially reduced its short-term credit arrangements because of reduced financing needs resulting from the completion of its power plant construction program.

The Company's objective is to achieve a capital structure of approximately 40% common shareholders' equity, 5-10% preferred and preference stock and 50-55% long-term debt. The Company's capital structure ratios (excluding amounts of long-term debt and preferred and preference stock due within one year) were as follows:

	December 31		
	1989	1988	1987
Common Shareholders' Equity	32.3%	32.4%	35.9%
Preferred and Preference Stock	5.5	6.0	6.4
Long-Term Debt	62.2	61.6	57.7
	100.0%	100.0%	100.0%

As a percent of total capitalization, common shareholders' equity decreased and long-term debt increased due to a significant increase in long-term debt financings in 1987 and the write-offs of disallowed plant costs in 1988. The ratio of preferred and preference stock to total capitalization has decreased due to optional and

mandatory redemptions of outstanding shares. The Company expects to attain its capital structure objectives with future earnings and the redemption of certain debt securities prior to scheduled maturity when economic.

The ratio of earnings to fixed charges for 1989, 1988 and 1987 was 2.14, 0.05 and 2.54, respectively. The ratio of earnings to fixed charges and preferred and preference stock dividend requirements for 1989, 1988 and 1987 was 1.95, 0.04 and 2.09, respectively. These ratios increased in 1987 and 1989 due to an increase in earnings before taxes based on income, but decreased in 1988 due to the write-offs of disallowed plant costs.

Although the TRA resulted in a reduction in the federal income tax rate, the cash requirements for the Company's income tax liabilities have increased significantly in 1989 and are expected to remain at an increased level over the next few years principally because of the alternative minimum tax and a reduction in the amount of available investment tax credits that the Company can utilize. See Note 8.

The Company has obtained insurance for certain of its tax-exempt obligations. Such insurance arrangements provide for the funding of escrow accounts in the amount of \$80 million in the event that a prescribed debt ratio is exceeded.

Inflation

The Company has been and will continue to be impacted by an inflationary economy. Although the current inflation rate is relatively low, its compound effect through time is significant, primarily in its effect on the Company's ability to replace its investment in utility plant.

The regulatory process limits the amount of depreciation expense recoverable through revenues to the historical cost of the Company's investment in utility plant. Such amount produces cash flows which are inadequate to replace such property in future years or to preserve the purchasing power of common equity capital invested.

The cost of fuel used in the generation of electricity, the Company's single largest expense, is subject to increase due to price escalation provisions in long-term coal contracts. The MPSC's December 1988 order suspends, for the four-year period January 1, 1989 through December 31, 1992, the PSCR Clause which provided for the current recovery of fuel and purchased and net interchange power expense. However, it is expected that such expenses will be relatively stable during the four-year period.

Pursuant to the MPSC's December 1988 order, a new expense stabilization procedure applicable to approximately \$750 million of Company operation and maintenance expenses, permits rates to be adjusted for the effects of inflation. Under this procedure, a surcharge or credit will be implemented on January 1 of each of the years 1990 through 1992 to offset annual increases or decreases in operation and maintenance expenses. Pursuant to a December 1989 MPSC order, a surcharge estimated to increase annual revenues by \$27 million was approved for implementation on January 1, 1990. See Note 3.

**Comparative Results of
Operations**

	1989	1988	1987	1986
Operating Revenues				
Electric	\$ 3,171,456	\$ 3,070,724	\$ 2,825,910	\$ 2,832,945
Steam	31,575	31,448	30,821	36,339
Total Operating Revenues	\$3,203,031	\$3,102,172	\$2,856,731	\$2,869,284
Operating Expenses				
Operation				
Fuel	\$ 820,765	\$ 846,678	\$ 813,376	\$ 741,206
Other power supply	142,240	146,773	47,814	191,126
Other operation	514,017	521,152	441,046	459,534
Maintenance	291,365	275,610	245,736	258,655
Depreciation and amortization	364,554	325,423	237,325	232,240
Deferred Fermi 2 depreciation	(35,234)	(44,143)	—	—
Taxes other than income	225,763	212,656	179,308	177,381
Income taxes	129,626	89,944	159,488	126,596
Total Operating Expenses	\$2,453,096	\$2,374,093	\$2,124,093	\$2,186,738
Operating Income	\$ 749,935	\$ 728,079	\$ 732,638	\$ 682,546
Other Income and Deductions				
Allowance for other funds used during construction	\$ —	\$ 1,663	\$ 136,452	\$ 117,069
Deferred Fermi 2 return	107,169	134,264	—	—
Other income and deductions	675	(789)	(3,435)	(16,869)
Income taxes	843	(769)	663	8,827
Disallowled plant costs	—	(875,372)	—	—
Accretion income	50,188	25,866	—	—
Income taxes – disallowed plant costs and accretion income	(17,047)	225,171	—	—
Net Other Income and Deductions	\$ 141,828	\$ (489,966)	\$ 133,680	\$ 109,027
Income Before Interest Charges	\$ 891,763	\$ 238,113	\$ 866,318	\$ 791,573
Interest Charges				
Long-term debt	\$ 444,204	\$ 451,415	\$ 417,474	\$ 399,429
Amortization of debt discount, premium and expense	4,368	4,593	3,626	2,721
Other	20,980	20,663	23,459	41,410
Allowance for borrowed funds used during construction (credit)	(3,740)	(3,224)	(133,215)	(129,082)
Net Interest Charges	\$ 465,812	\$ 473,447	\$ 311,344	\$ 314,478
Income (Loss) Before Cumulative Effect of Accounting Changes	\$ 425,951	\$ (235,334)	\$ 554,974	\$ 477,095
Cumulative Effect for Years Prior to 1988 of Accounting Changes for:				
Disallowled plant costs and abandonments (net of income taxes of \$111,257,000)	—	(344,147)	—	—
Unbilled revenues (net of income taxes of \$40,912,000)	—	61,367	—	—
Property taxes (net of income taxes of \$101,306,000)	—	139,288	—	—
Net Income (Loss)	\$ 425,951	\$ (378,826)	\$ 554,974	\$ 477,095
Preferred and Preference Stock Dividend Requirements	37,018	49,757	78,240	98,803
Earnings (Loss) for Common Stock	\$ 388,933	\$ (428,583)	\$ 476,734	\$ 378,292
Common Shares Outstanding—Average	146,816,363	146,761,458	146,729,292	146,643,377
Earnings (Loss) Per Share				
Before cumulative effect of accounting changes	\$ 2.65	\$ (1.95)	\$ 3.25	\$ 2.58
Cumulative effect for years prior to 1988 of accounting changes for:				
Disallowled plant costs and abandonments	\$ —	\$ (2.34)	\$ —	\$ —
Unbilled revenues	\$ —	\$ 0.42	\$ —	\$ —
Property taxes	\$ —	\$ 0.95	\$ —	\$ —
Earnings (Loss) Per Share	\$ 2.65	\$ (2.92)	\$ 3.25	\$ 2.53
Dividends Declared Per Share of Common Stock	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
Ratio of Earnings to Fixed Charges (SEC Basis)	2.14	0.05	2.54	2.29
Ratio of Earnings to Fixed Charges and Preferred and Preference Stock Dividend Requirements (SEC Basis)	1.95	0.04	2.09	1.81

	1985	1984	1983	1982	1981	1980	1979
<i>(Thousands)</i>							
\$2,738,356	\$2,439,835	\$2,260,021	\$2,078,965	\$2,011,217	\$1,776,364	\$1,667,679	
49,801	58,370	49,637	44,289	42,840	36,150	30,832	
\$2,788,157	\$2,498,205	\$2,309,658	\$2,123,254	\$2,054,057	\$1,812,514	\$1,698,511	
 \$ 785,110	\$ 700,789	\$ 676,409	\$ 718,431	\$ 689,165	\$ 670,116	\$ 647,620	
196,918	184,740	128,921	74,654	139,981	107,767	96,502	
422,133	403,616	374,164	372,767	333,440	290,566	266,410	
250,798	203,945	187,769	170,974	164,978	133,270	128,600	
218,502	190,420	171,940	161,430	150,240	141,948	129,644	
—	—	—	—	—	—	—	
175,556	144,471	142,743	118,537	117,224	115,520	99,552	
124,939	131,459	145,559	96,912	64,388	37,012	54,706	
\$2,173,956	\$1,959,440	\$1,827,505	\$1,713,705	\$1,659,416	\$1,496,199	\$1,423,034	
 \$ 614,201	\$ 538,765	\$ 482,153	\$ 409,549	\$ 394,641	\$ 316,315	\$ 275,477	
 \$ 113,225	\$ 130,350	\$ 92,750	\$ 47,995	\$ 39,398	\$ 38,815	\$ 38,323	
—	—	—	—	—	—	—	
(5,240)	1,829	7,877	(4,820)	(9,501)	692	3,664	
1,642	(112)	(5,487)	1,155	4,771	(669)	(1,554)	
—	—	—	—	—	—	—	
—	—	—	—	—	—	—	
—	—	—	—	—	—	—	
\$ 109,627	\$ 132,067	\$ 95,140	\$ 44,330	\$ 34,668	\$ 38,838	\$ 40,433	
 \$ 723,828	\$ 670,832	\$ 577,293	\$ 453,879	\$ 429,309	\$ 355,153	\$ 315,910	
 \$ 401,272	\$ 399,448	\$ 351,854	\$ 331,469	\$ 290,045	\$ 211,857	\$ 167,585	
2,502	2,191	2,131	2,006	1,853	1,776	1,644	
15,642	30,592	53,088	59,779	37,025	19,662	13,823	
(133,103)	(163,336)	(194,402)	(194,076)	(133,967)	(66,708)	(43,171)	
 \$ 286,313	\$ 268,895	\$ 212,671	\$ 199,178	\$ 194,956	\$ 166,587	\$ 139,881	
 \$ 437,515	\$ 401,937	\$ 364,622	\$ 254,701	\$ 234,353	\$ 188,566	\$ 176,029	
103,264	104,159	98,614	73,245	57,566	51,037	43,457	
\$ 334,251	\$ 297,778	\$ 266,008	\$ 181,456	\$ 176,787	\$ 137,529	\$ 132,572	
 143,183,133	135,230,827	120,274,269	103,585,915	87,473,581	78,780,863	69,848,484	
 \$ 2.33	\$ 2.20	\$ 2.21	\$ 1.75	\$ 2.02	\$ 1.75	\$ 1.90	
\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
\$ 2.33	2.20	2.21	1.75	2.02	1.75	1.90	
\$ 1.68	1.68	1.68	1.68	1.64	1.60	1.60	
2.28	2.19	2.22	1.85	1.84	1.90	2.17	
1.75	1.67	1.67	1.49	1.53	1.53	1.69	

Statistical Review

	1989	1988	1987	1986
Operating Revenues (Thousands)				
Residential — Electric	\$ 1,013,677	\$ 984,689	\$ 905,208	\$ 880,205
Commercial — Electric	828,106	760,040	701,275	693,071
Industrial — Electric	1,171,389	1,139,778	1,056,906	1,063,551
Other	189,859	217,665	193,342	232,457
Total	\$ 3,203,031	\$ 3,102,172	\$ 2,856,731	\$ 2,869,284
Sales (Millions of kWh)				
Residential	11,524	11,723	11,134	10,492
Commercial	8,552	8,310	7,873	7,501
Industrial	18,762	19,080	18,225	17,240
Other	1,747	1,845	2,260	2,807
Total	40,585	40,958	39,492	38,040
Electric Customers (Year End)				
Residential	1,738,494	1,718,835	1,697,326	1,664,226
Commercial	162,255	158,850	155,216	148,987
Industrial	2,671	2,592	2,507	2,384
Other	1,925	1,917	1,919	1,896
Total	1,905,345	1,882,194	1,856,968	1,817,493
Average Annual Use Per Residential Customer (kWh)				
Average Annual Bill Per Residential Customer	6,668	6,866	6,635	6,350
	\$586.50	\$576.70	\$539.44	\$532.74
Average Revenue Per kWh				
Residential	8.80¢	8.40¢	8.13¢	8.39¢
Commercial	9.68	9.15	8.91	9.24
Industrial	6.24	5.97	5.80	6.17
Capitalization (Thousands)				
Long-Term Debt	\$ 4,561,005	\$ 4,238,536	\$ 4,693,687	\$ 3,656,569
Preferred/Preference Stock	399,188	416,212	521,894	742,273
Common Shareholders' Equity	2,370,060	2,226,949	2,919,985	2,716,403
Total	\$ 7,330,253	\$ 6,881,697	\$ 8,135,566	\$ 7,115,245
Capitalization (Percent)				
Long-Term Debt	62.2	61.6	57.7	51.4
Preferred/Preference Stock	5.5	6.0	6.4	10.4
Common Shareholders' Equity	32.3	32.4	35.9	38.2
Total	100.0	100.0	100.0	100.0
Common Stock Data				
Earnings (Loss) Per Share	\$2.65	\$2.92	\$3.25	\$2.58
Dividend Paid Per Share	\$1.68	\$1.68	\$1.68	\$1.68
Payout	63%	—%	52%	65%
Shares Outstanding — Average	146,816,363	146,761,458	146,729,292	146,643,377
Return on Average Common Equity	16.75%	(15.91)%	16.69%	14.09%
Book Value Per Share	\$16.07	\$15.10	\$19.75	\$18.34
Market Price				
High	\$25½	\$17½	\$19	\$19½
Low	\$17½	\$12	\$12½	\$15½
Miscellaneous Financial Data				
Average Interest Rate on Long-Term Debt	9.5%	9.6%	9.5%	9.2%
Average Dividend Rate on Preferred/Preference Stock	8.8%	8.9%	10.7%	11.5%
Long-Term Debt Obligations and Redeemable Preferred and Preference Stock Outstanding (Thousands)	\$ 5,028,961	\$ 5,148,498	\$ 5,232,662	\$ 4,774,495
Total Assets (Thousands)	\$ 9,949,599	\$10,060,293	\$11,158,214	\$10,377,125
Gross Utility Plant (Thousands)	\$11,024,368	\$10,766,755	\$11,893,418	\$11,062,449
Net Utility Plant (Thousands)	\$ 8,236,553	\$ 8,303,644	\$ 9,682,875	\$ 9,034,716
Capital Expenditures (Thousands)	\$ 242,973	\$ 235,127	\$ 709,084	\$ 645,196
Miscellaneous Operating Data				
System Capability at Year End — MW	10,081	10,004	9,164	9,070
System Capability at Time of Peak — MW	9,942	10,038	9,020	9,199
System Peak Demand — MW	8,704	9,133	8,427	8,050
Reserve Margin at Time of Peak	14.2%	9.9%	7.0%	14.3%
System Load Factor	57.3%	55.2%	57.4%	57.9%
Heat Rate — Btu Per kWh	9,940	9,990	10,060	10,090
Fuel Cost — ¢ Per Million Btu	169.2¢	173.8¢	172.9¢	189.2¢
Number of Employees at Year End	10,254	10,614	11,221	10,967

1985	1984	1983	1982	1981	1980	1979
\$ 827,210	\$ 758,124	\$ 741,399	\$ 676,370	\$ 642,301	\$ 583,701	\$ 524,613
651,559	570,082	513,292	473,498	436,868	382,018	345,576
1,034,374	919,490	818,660	754,238	763,167	658,051	647,438
275,014	250,509	236,307	219,148	211,721	188,744	180,884
\$ 2,788,157	\$ 2,498,205	\$ 2,309,658	\$ 2,123,254	\$ 2,054,057	\$ 1,812,514	\$ 1,698,511
10,077	10,150	10,256	9,940	10,134	10,394	10,274
7,130	6,850	6,479	6,252	6,310	6,265	6,251
16,613	16,324	15,162	13,751	15,471	15,472	17,960
2,875	2,563	2,402	2,052	2,107	2,104	2,406
36,695	35,887	34,299	31,995	34,022	34,235	36,891
1,642,981	1,629,668	1,621,172	1,619,369	1,624,161	1,623,162	1,622,768
144,942	142,395	140,403	139,376	138,830	136,983	135,788
2,314	2,246	2,253	2,239	2,305	2,293	2,264
1,883	1,885	1,878	1,827	1,821	1,750	1,713
1,792,120	1,776,194	1,765,706	1,762,811	1,767,117	1,764,188	1,762,533
6,165	6,253	6,332	6,133	6,243	6,408	6,402
\$ 506,06	\$ 467,03	\$ 457,74	\$ 417,33	\$ 395,66	\$ 359,86	\$ 326,92
8.21¢	7.47¢	7.23¢	6.80¢	6.34¢	5.62¢	5.11¢
9.14	8.32	7.92	7.57	6.92	6.10	5.53
6.23	5.63	5.40	5.49	4.93	4.25	3.60
\$ 3,770,863	\$ 3,845,272	\$ 3,542,438	\$ 3,218,649	\$ 2,753,978	\$ 2,450,457	\$ 2,069,518
879,497	894,168	907,505	802,423	603,161	591,346	510,748
2,588,025	2,379,998	2,195,361	1,872,181	1,675,385	1,514,169	1,387,768
\$ 7,238,385	\$ 7,119,438	\$ 6,645,304	\$ 5,893,253	\$ 5,032,524	\$ 4,555,972	\$ 3,968,034
52.1	54.0	53.3	54.6	54.7	53.8	52.1
12.1	12.6	13.7	13.6	12.0	13.0	12.9
35.8	33.4	33.0	31.8	33.3	33.2	35.0
100.0	100.0	100.0	100.0	100.0	100.0	100.0
\$2.33	\$2.20	\$2.21	\$1.75	\$2.02	\$1.75	\$1.90
\$1.68	\$1.68	\$1.68	\$1.68	\$1.62	\$1.60	\$1.58
72%	76%	76%	96%	80%	91%	83%
143,183,133	135,230,827	120,274,269	103,585,915	87,473,581	78,780,863	69,848,484
13.31%	12.87%	13.03%	10.14%	11.12%	9.47%	10.01%
\$ 17.47	\$16.91	\$16.63	\$16.60	\$17.47	\$17.85	\$18.46
\$17½	\$16½	\$16	\$13¾	\$12¾	\$13½	\$15½
\$14	\$11½	\$13	\$11	\$10½	\$10	\$12¼
9.9%	9.9%	9.5%	9.5%	9.4%	9.0%	8.5%
11.6%	11.6%	11.6%	11.3%	9.8%	9.5%	9.0%
\$ 4,731,589	\$ 4,460,381	\$ 4,155,329	\$ 3,792,982	\$ 3,182,033	\$ 2,809,976	\$ 2,332,200
\$ 9,863,760	\$ 9,276,614	\$ 8,477,218	\$ 7,645,856	\$ 6,617,903	\$ 5,751,801	\$ 5,156,138
\$ 10,466,039	\$ 9,752,346	\$ 8,845,779	\$ 8,252,570	\$ 7,139,790	\$ 6,215,495	\$ 5,660,023
\$ 8,612,890	\$ 8,076,168	\$ 7,320,570	\$ 6,824,058	\$ 5,842,997	\$ 5,026,245	\$ 4,590,829
\$ 710,699	\$ 938,004	\$ 1,014,568	\$ 1,135,045	\$ 964,261	\$ 644,540	\$ 591,389
9.296	8.898	8.162	7,762	8,221	8,234	8,964
9,367	9,271	7,810	8,569	8,458	8,531	8,877
7,172	7,350	7,063	6,394	7,171	6,703	6,829
30.6%	26.1%	10.6%	34.0%	17.9%	27.2%	30.0%
63.3%	60.2%	60.2%	61.7%	58.4%	63.1%	66.2%
9,990	9,990	10,040	10,060	10,060	10,140	10,280
202.0¢	190.6¢	190.2¢	193.8¢	190.5¢	178.3¢	163.4¢
11,086	11,136	11,152	11,208	11,024	10,789	10,908

**Directors and
Officers**

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Louis H. Roddis, Jr.	Consulting Engineer (not standing for re-election)
Alan E. Schwartz	Senior Partner, Honigman Miller Schwartz and Cohn (attorneys at law)
Otis M. Smith	Of Counsel to Lewis, White and Clay (attorneys at law) and retired Vice President, General Motors Corporation

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