1987 ANNUAL REPORT

"Anticipating change in our marketplace is one of our greatest challenges. Responding to change requires our greatest vision, creativity, productivity and commitment."

Detroit Edison

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To Our Shareholders:

The list of accomplishments of Detroit Edison and its employes in 1987 is matched only by the list of challenges still facing the company. Yet, the accomplishments — coupled with years of extensive planning and preparation — now make the company better positioned for, and able to focus on, the critical financial, competitive and regulatory issues ahead.

Common stock earnings set a record in 1987, increasing 26 percent to $476.7 million from $378.3 million in 1986. Per-share earnings were a new high of $3.25, up 67 cents from $2.58 for 1986. During the past 10 years, earnings have increased 332 percent, with earnings per share rising 63 percent in the same period despite a 166-percent increase in the average number of shares outstanding. In spite of significantly higher kilowatthour sales, operating revenues declined 0.4 percent to $2.857 billion in 1987, compared with $2.869 billion in 1986. The decline was due primarily to substantially lower fuel and purchased power costs which were passed along to customers through a rate-adjustment procedure. Kilowatthour sales to a record 1,856,968 customers reached a new high of 39.5 billion, up 3.8 percent from 1986 sales of 38-billion kilowatthours.

However, this impressive earnings record will be interrupted in 1988. As announced in January 1988, the company expects to report a loss in the first quarter of 1988 and anticipates that financial performance for the remainder of the year will be under severe pressure. Contributing to the depressed financial outlook are several factors, including the end of capitalization of Fermi 2 construction and financing costs, the need for unusual write-offs required by new standards issued by the Financial Accounting Standards Board (FASB), and other financial uncertainties outlined more fully later in this report.

Common stock earnings were a record $476.7 million in 1987.

The company has been working hard in many areas to minimize the extent and duration of this earnings decline. The programs are many and comprehensive, but progress on three major corporate goals — bringing Fermi 2 into commercial operation, increasing sales and cutting costs — is particularly noteworthy.

The Fermi 2 power plant was placed in commercial operation January 23, 1988, and on January 24 the company began collecting the first of five annual phased-in rate increases authorized by the Michigan Public Service Commission (MPSC). These rate increases, however, represent only partial recovery of the company's investment in Fermi 2.

In accordance with the new FASB standard effective January 1, 1988, the company wrote off $420 million in January, reflecting disallowances by the MPSC of some Fermi 2 construction costs and removal from the rate base of the company's oil-fired Greenwood power plant.

Maintaining the dividend is an imperative objective.

Additional write-offs may be necessary and may occur in 1988. The size and timing of these write-offs will depend on the MPSC's response to the company's pending request for an additional $298-million rate increase related largely to Fermi 2 costs. The current rate request reflects $1.7 billion in Fermi 2 costs not considered in the last rate case.

Because of a generally healthy and increasingly diversified economy, unusual weather conditions and aggressive marketing, both sales and peak demand reached record levels in 1987. The July 20 record summer peak, which exceeded loads projected for the early 1990s, was 8.4-million kilowatts, while the record winter peak set on December 15 was 6.4-million kilowatts. Fermi 2 generated about 1.2-billion kilowatthours in 1987 to help meet that demand.

During the year, the price of electricity to customers fell an average of 3.9 percent due to lower fuel and purchased power costs and reduced federal income taxes. Holding the line on the price of electricity is a major company commitment. In fact, the new rate increase of about 2.5 percent — the first since 1985 — is still lower than the 1987 Southeastern Michigan rate of inflation and the rate forecast for 1988.

The company's continuing extensive cost-reduction program resulted in cost savings in 1987 which will continue into 1988 and beyond — and ultimately will further lower the price of electricity for customers. Budgets have been reduced, salary increases delayed, a selective hiring freeze instituted, and salary levels and pay increases restructured for some employe groups.

Maintaining the dividend remains an imperative objective toward which every one of our programs and plans and all of our employes' commitment and efforts are directed.

Our planning effort is broad and deep. A new Corporate Strategic Plan is in place and working — involving all employes. That plan led to a comprehensive 1987 study of the competitive forces at work in the company's marketplace. Responding to these forces will require broad corporate initiatives being developed in four key areas — improving effectiveness in cost-control, marketing, human resources and the company's organization.

The cover of our annual report notes that "Anticipating change in our marketplace is one of our greatest challenges. Responding to change requires our greatest vision, creativity, productivity and commitment." We believe we are developing the strategies and action plans to meet the challenges and help weather the short-term financial pressures ahead. With the support of our employes and shareholders, we know we will be successful.

February 22, 1988

Ernest L. Grove, Jr.
Vice Chairman of the Board and
Chief Financial Officer

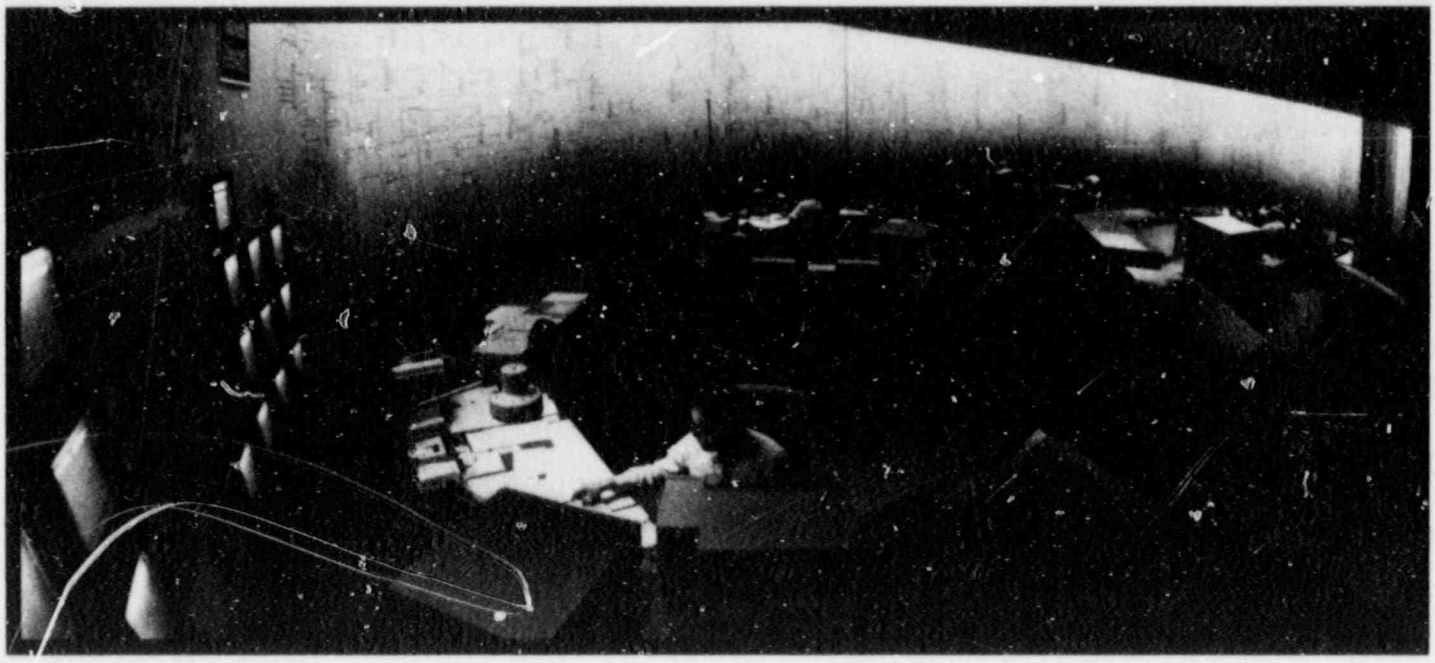
Charles M. Heidel
President and
Chief Operating Officer

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

Detroit Edison marked several milestones in 1987.

The company and its employes provided more electricity to more customers in 1987 than ever before in Detroit Edison's 85-year history. This was accomplished while lowering the cost of producing the electricity — in part by increasing power plant availability — and at the same time surpassing government standards for environmental protection. The company generated and distributed this energy through a modern bulk-power system that is basically complete for the foreseeable future, which means substantially reduced capital spending in the years ahead. Finally, the employes responsible for these accomplishments and other activities essential to operating the company's complex business were supportive, loyal and dedicated — challenging the company to be even better!

Detroit Edison will continue to need this spirit and determination, because the list of external challenges facing electric utilities is long. It includes accelerating competition from other increasingly aggressive energy suppliers, higher customer expectations, a possible economic slowdown, and current or prospective regulatory changes that could affect both the structure of the electric utility industry and the financial stability of many individual utility companies.



Customers generally are attempting to lower their energy costs by using energy more efficiently. While Detroit Edison views this as an effective use of resources — good for both individual customers and the nation's competitiveness — the company also recognizes it will hold down the growth of electricity sales.

At the same time, natural gas utilities — supported by the current oversupply which results in lower prices — are aggressively courting commercial and industrial

customers by promoting natural gas as an alternative to traditional uses of electricity for process heating, space conditioning, water heating and cooking. These competitors also are promoting use of natural gas to produce electricity through cogeneration projects.

Following on the heels of deregulation in the railroad, airline, telephone, oil and natural gas industries are increasing calls for deregulating the electric utility industry. Some regulatory agencies and a growing number of commercial and industrial customers are proposing changes that would impact the fundamental tenets of electric utilities — their obligation to serve, reliability and non-discriminatory customer practices.

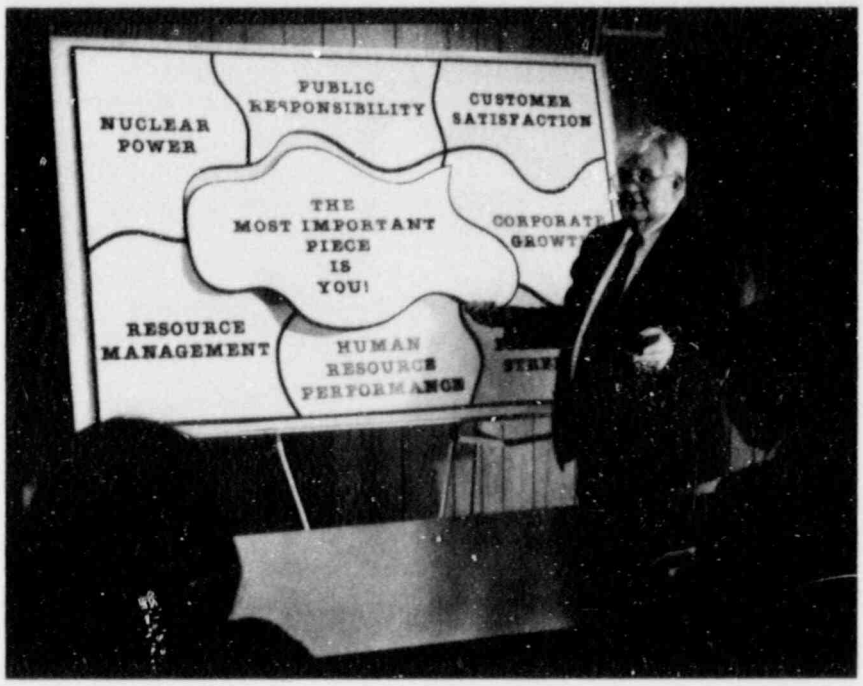
Proponents of deregulation would permit large customers to buy their energy from other utilities and then require the local utility to use its own lines to deliver that energy in a process called wheeling. They would also permit cogenerators to require utilities to wheel power to other facilities owned by the cogenerator or to other customers of the utility company. Because these proposals could have an adverse impact on the company and its smaller customers, Detroit Edison is actively involved in trying to help shape the regulatory format in order to protect the interests of the company and *all* of its customers.

Difficult challenges face the company in the years ahead.

The prospect of slower national economic growth during the next few years, according to some economists, will apply further pressures on sales gains by electric utilities. Thus, with increases in electricity sales resulting less from traditional external factors — population and economic growth, along with lifestyle changes — and with some traditional markets reduced by competitive forces and governmental initiatives, growth will have to come more from the company's own marketing efforts.

(Left) *The company's expanded System Operations Center, using state-of-the-art computer technology, helped meet record electricity demands by a record number of customers.* ***(Above)*** *Customer office representative Alonzita Henderson points out the many benefits of home security lighting.*

At the same time, demands on electric companies continue to come from many directions. Shareholders properly look to their companies for increasing value and a fair return on their investments. Customers expect more reliable electric service — at the lowest reasonable price — and faster restoration of service after storms and other emergencies. Communities expect utilities to respond positively to local social and economic conditions, as well as to the energy needs of their residents.



And, of course, utilities responsible for completing and operating nuclear power plants face an additional set of operating, regulatory, financial and public relations challenges. All of these challenges demand the intensive attention that Detroit Edison management has devoted to them — and the thoughtful decisions which have been made and will continue to be made to meet them successfully. At the same time, the company is highly sensitive to these challenges and their potentially adverse impact on its business.

At Detroit Edison, existing programs to meet the company's many challenges were strengthened and extended during 1987, and new programs were initiated. Significantly, the company put its new Corporate Strategic Plan to work in 1987. Guided by the company's mission statement — to prosper as a financially sound business by meeting the energy and related service needs of our customers — employes set out to achieve several key objectives. These included strengthening the company's financial position, achieving corporate growth, increasing sales and customer satisfaction, improving human resource performance, better managing physical resources, operating Fermi 2 safely and efficiently, and meeting the company's public responsibilities.

To enhance employe understanding and support of — and involvement in — the Corporate Strategic Plan, a teleconference was held with employe groups at various company locations. This was followed by meetings in which every work group mapped out its own objectives and action plans to support company goals.

Another direct result of the new plan was a comprehensive study of all the competitive forces at work in the company's energy marketplace. This work better defined and quantified these forces, as well as the threats and opportunities they present. With this information in hand, senior management undertook initiatives to identify and prioritize the steps needed for aggressive response. The four initiatives — to improve cost-control, marketing, human resources and organizational effectiveness — involve every member of senior management, as well as employes throughout the company. On schedule for mid-1988 completion, this work is intended to help shape and position the company to cope with its changing environment and marketplace over the next 5 to 10 years.

New rates became effective when Fermi 2 reached commercial operation.

At the same time it was positioning itself for the future, Detroit Edison also was tending to the present-day needs of the most customers it has ever served — totaling 1,856,968 individuals, families, businesses, hospitals, schools and other institutions. Meeting their needs required supplying a record summer peak load of 8.4-million kilowatts — a 4.7-percent increase over the previous record set in 1986 — as well as a record winter peak load of 6.4-million kilowatts. Those increases resulted not only from unusual weather conditions and from aggressive marketing, but also from a generally improved economy in Southeastern Michigan — the fifth successive year of expansion of the area's economy. This helped boost sales 23 percent during the same five years.

Important in meeting these growing customer needs was Fermi 2, which generated about 1.2-billion kilowatthours in its 1987 testing program. Commercial operation was achieved January 23, 1988.

With this success at Fermi 2, however, came the onset of severe financial strains on the company — the end of the large non-cash accounting credit which helped support earnings during the plant's construction and testing, the need for unusual write-offs — because of a new accounting standard — of power plant costs

(Left) Construction superintendent John P. Kilcline pieces together the new Corporate Strategic Plan with employes as part of a companywide communication program. (Above) Technician Patricia Brunson records data from hand-held electronic meter reading devices which help ensure fast, accurate billing for customers.

disallowed for ratemaking purposes by the Michigan Public Service Commission (MPSC), and the need to phase in over five years the rate increases currently authorized for Fermi 2 to help recover the company's investment in the plant.

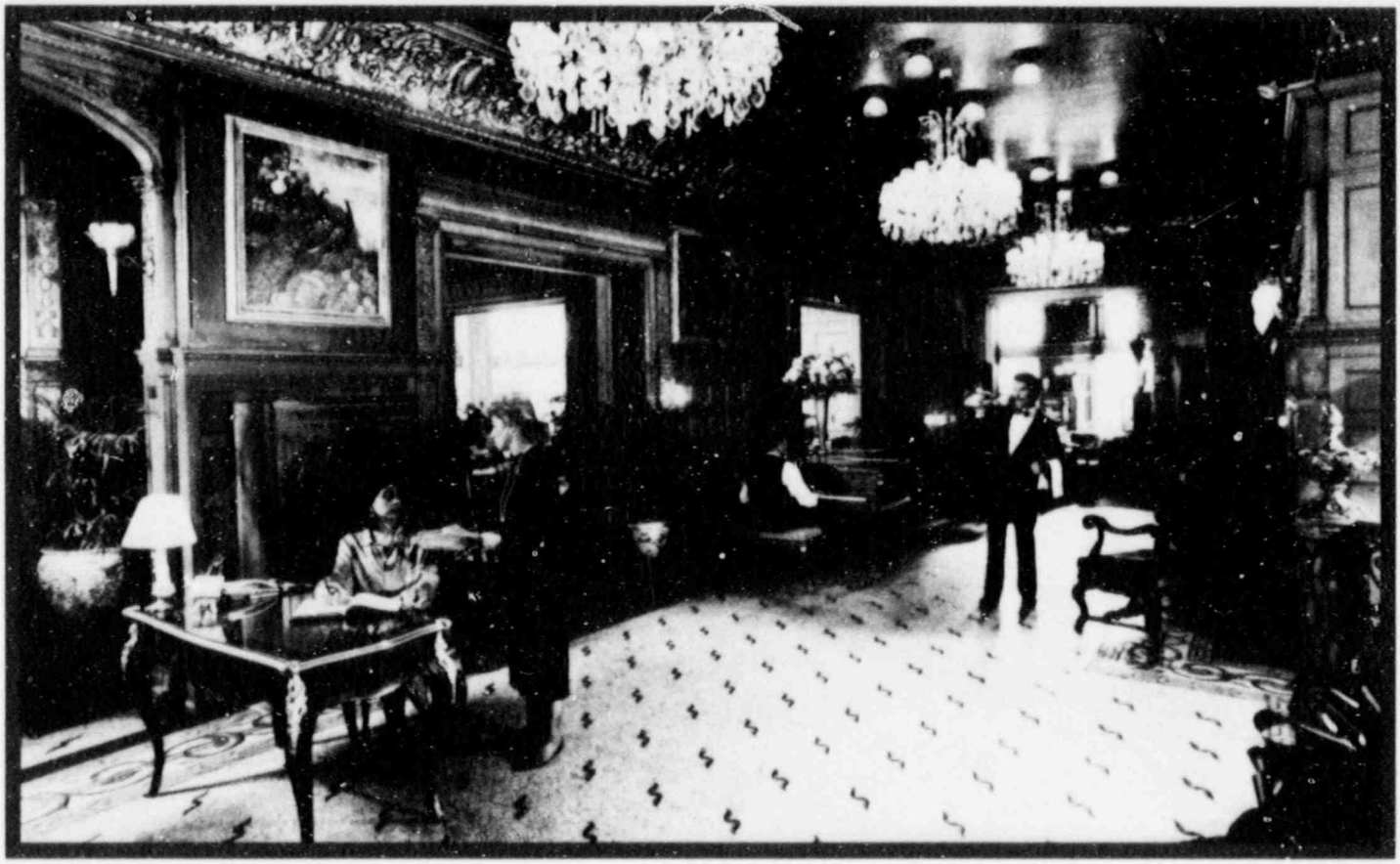
However, with Fermi 2 in commercial operation, Detroit Edison now has one of the most modern generating and transmission systems in the country — a system that includes, among others, its huge Monroe and state-of-the-art Belle River coal-fired power plants. With this modern generating system in place and using a diversified fuel mix of uranium and low-sulfur eastern and western coal, the company does not expect additional capacity to be needed until the mid-1990s. As that time approaches, the company will consider a wide variety of options to meet future energy needs, including cogeneration, long-term contracts with other utilities or other power suppliers, conservation, and customer-based demand-control options, as well as traditional central-station generating plants.

Additional generating capacity won't be needed before mid-1990s.

The transmission system will be enhanced by a final major link — a 22-mile, 345,000-volt line to improve service reliability from the Belle River plant. This major power line will be completed in 1990. Extensive modernization was completed during the year on the company's System Operations Center in Detroit and at the energy management system and power pool control facility in Ann Arbor, the latter operated jointly with Consumers Power Company. These improvements will result in better reliability of electric service at lower cost to a growing number of customers who are using increasing amounts of electricity. Also in 1987, the company neared the $2-billion mark in capital expenditures over the past 17 years to help protect the environment.

The average price of a kilowatthour of electricity sold was reduced from 7.36 cents in 1986 to 7.07 cents in 1987, a 3.9-percent savings for customers. Total fuel and other power supply costs actually were lower than in 1986, even though the company delivered more electricity in 1987. The company's cost reduction was achieved by timely and economical fuel purchases, economical power purchases from other utilities, and passing along to customers savings resulting from changes in federal income tax laws.

Completion of the Fermi 2 and Belle River power plants, coupled with modernization of other facilities, now permits the company to close some older plants. Most have served well beyond their originally projected useful lives of about 40 years, primarily as a result of expensive renovations and extensive maintenance in



recent years. The Delray plant, one of the company's oldest, was closed in January 1988. Two other plants more than 65 years old — Conners Creek and Marysville — will be placed in reserve in 1988.

Responding to current financial pressures caused by the delays and cost increases at Fermi 2, the company is in the midst of the most extensive cost-reduction program in its history — an intensification of efforts started several years ago. Operation and maintenance budgets will be severely restricted for at least the next two years. Late in 1987, the company initiated a selective hiring freeze which, combined with retirements and other voluntary separations, will reduce the number of full-time employes by 300 in 1988. These and other actions will result in substantial additional savings in 1988 and beyond.

(Left) Meter tester Daniel Sorel is one of more than 2,000 employe "Gatekeepers" trained to be alert to the special needs of senior citizens. ***(Above)*** *Modern electric heat pump systems for heating and cooling are making their mark — even in turn-of-the-century buildings such as Detroit's elegant Whitney restaurant.*

In addition to cutting costs and bringing Fermi 2 into commercial operation, the company significantly expanded its marketing activities in 1987 and undertook the largest financing program in its history. These strategic measures are designed to improve the company's financial position and increase shareholder value.

Despite the competitive forces discussed previously, sales of electricity in 1987 increased to all categories of Detroit Edison customers — residential, commercial and industrial — with total consumption up 3.8 percent. New residential customers added in 1987 totaled 33,100, compared with increases of 21,245 in 1986 and 13,313 in 1985. Part of the 1987 increase in customers resulted from the company's purchase from

Consumers Power Company during the year of its electric business and properties serving the Pontiac area. This area previously had been an island within the company's service area served through a Detroit Edison bulk-power sale to Consumers Power.

The increased use of electricity by all customer groups was due in part to successful targeted marketing efforts. One of the goals of these intensified marketing efforts has been increased industrial use of process energy — heat-treating of metals, metal-melting, surface drying of paints and films, and other applications — with particular emphasis on conversions from natural gas to electricity. One interesting program — called "Test Drive a Furnace" — has allowed customers to test small electric induction melting furnaces at no cost in order to compare them with use of

existing natural gas energy for productivity, cost-effectiveness and quality.

Other marketing efforts were directed toward increasing use of electricity in new office buildings, hotels, department stores, restaurants and other commercial structures. Closed-loop water-source electric heat pumps were installed successfully and have proved their efficiency in buildings with a variety of energy needs. This will result in additional sales of 12.3-million kilowatthours per year for heating alone. Residential lighting, also a marketing target, has increased as the result of continued promotion of security lighting.

The company has moved aggressively to counteract possible loss of business to prospective cogenerators. For example, The Detroit Medical Center — a large and long-time user of Detroit Edison steam — was considering its own cogeneration facility. The company developed a proposal in conjunction with the City of Detroit public lighting department, which supplies the center's electricity. When final negotiations are completed between the city and medical center, this first-of-its-kind long-term contract will ensure continued and reliable business from an important customer for at least the next 21 years.

A continuing and important marketing program is devoted to attracting new companies to Southeastern Michigan, as well as keeping existing companies in the area and helping them expand and diversify. This means more business and jobs for the service area and, therefore, more sales for Detroit Edison. In 1987, the company's economic development team helped 193 companies locate, relocate, expand, modernize or diversify in Southeastern Michigan, up substantially from 125 companies in 1986.

The cost of electricity to customers fell 3.9 percent in 1987.

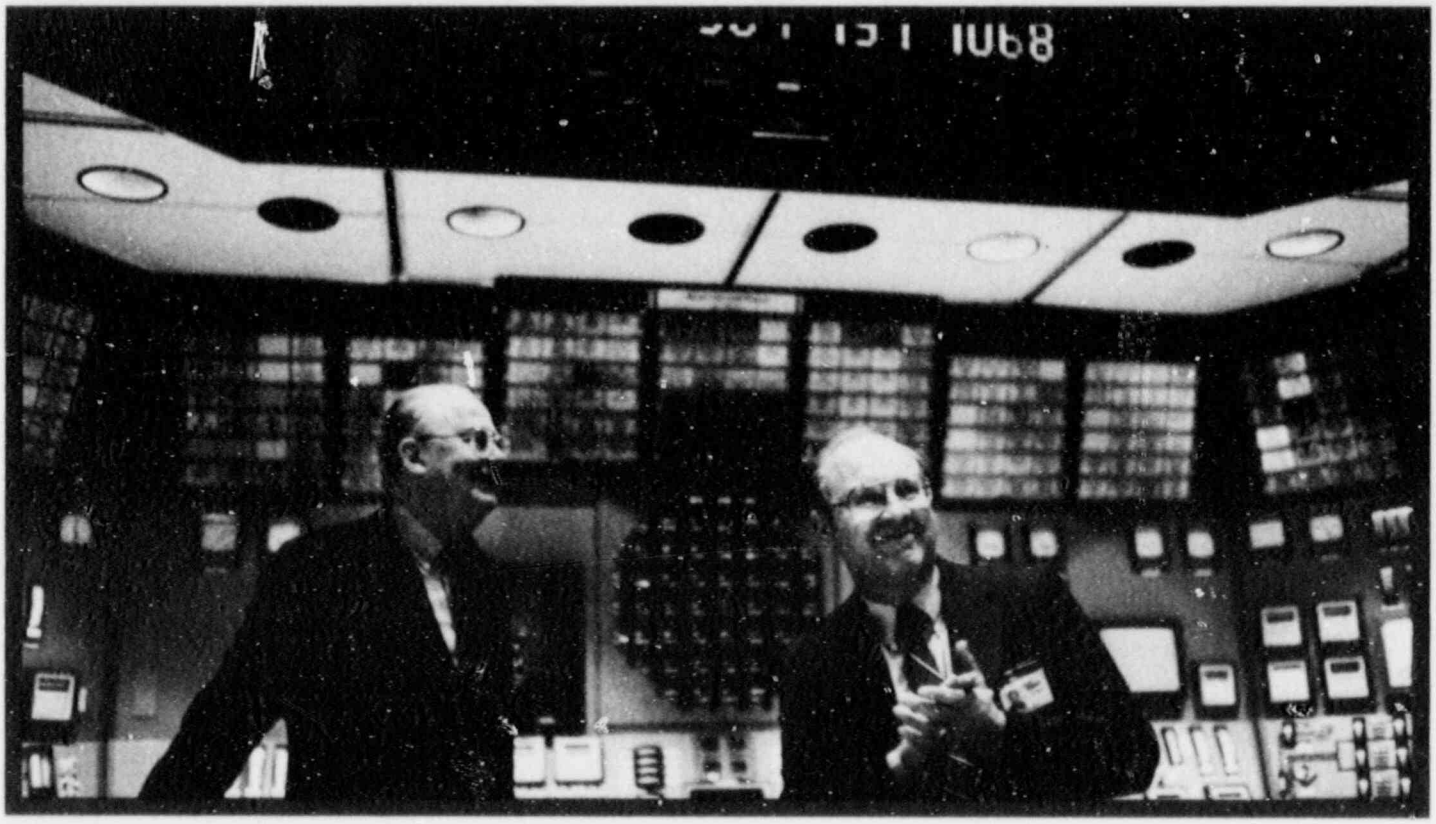
(Left) Detroit division manager Ronald L. Klinect and division director Helen E. Zdeba play key roles, with a strong supporting staff, in managing restoration of electric service to customers after storms. (Above) Meeting a customer's growing needs means final touches on a new substation by electricians Anthony Hoffman, left, and Theodore Kohler.

The ever-increasing link between good service and increased sales has been clearly identified through customer surveys which provide continuing insights into customer needs. Currently being explored to help meet some of these needs are pilot electric equipment leasing programs for manufacturers, economic development and other special rates, and additional bill-paying help for low-income customers. In addition to Detroit Edison's sales of electricity, the company's SYNDECO subsidiary is marketing a number of energy-related services to businesses in Michigan and elsewhere throughout the United States.

New strategic plans are in place to meet competitive challenges.

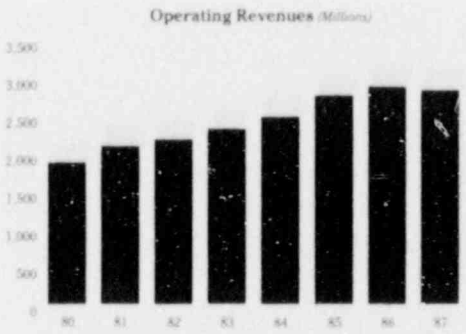
Despite 1987 records, 1988 will be a challenging year.

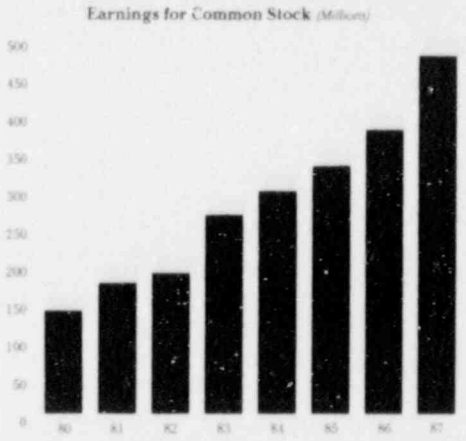
While record earnings were reported in 1987, they were supported substantially by a non-cash accounting credit. As reported previously, the company expects to report a loss in the first quarter of 1988 and anticipates that financial performance for the remainder of the year will be under severe pressure because of the end of capitalization of Fermi 2 construction and financing costs, the need for unusual write-offs, and continuation of other financial uncertainties.



Chairman Walter J. McCarthy, Jr. and Group Vice President B. Ralph Sylvia, in the Fermi 2 power plant control room, celebrate the moment of commercial operation which the plant achieved on January 23, 1988.

Total 1987 earnings for common stock were a record $476.7 million, up 26 percent from $378.3 million in 1986. Earnings per share of common stock also set a record at $3.25, compared with $2.58 for 1986. Return on common equity also reached a new high of 16.69 percent, up from 14.09 percent in 1986. Total revenues of $2.857 billion declined 0.4 percent from 1986's $2.869 billion, primarily because of lower fuel and purchased power costs which were passed along to customers. Sales increased 3.8 percent from 38-billion kilowatthours of electricity in 1986 to 39.5 billion in 1987.

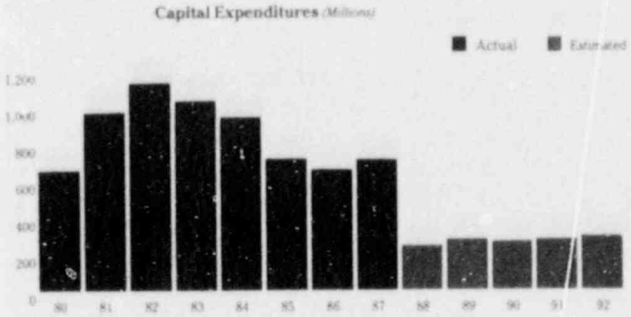




Effective January 1, 1988, the accounting credit resulting from capitalization of Fermi 2 financing costs no longer could be taken. In 1987, this accounted for about 57 percent of earnings. In addition, a new ruling by the Financial Accounting Standards Board requires the company to write off as a loss power plant construction costs for which rate relief was requested but denied, even though the company is appealing the disallowance in the Michigan courts. Accordingly, the company announced a $420-million write-off in January for Fermi 2 and for other power plant disallowances required by an April 1986 order by the MPSC. More write-offs may be necessary and may occur in 1988 because of possible disallowances of additional Fermi 2 costs included in a rate case pending before the MPSC.

Taking advantage of lower interest rates in 1987, the company completed more than $1.8 billion of debt financing, the highest level in its history. Included were $1.3 billion of mortgage bonds, $7.7 million of pollution control refunding bonds, and $525 million of bank borrowing. This financing — when combined with internally generated funds — covered capital expenditures of $709.1 million and permitted total prepayment of the balance of the $1.2-billion project financing for the Belle River power plant, which went into commercial operation in 1985, and the repayment of maturing debt. In addition, strategic timing of financing enabled the company to redeem high-cost preferred and preference stock, resulting in substantial savings.

Financing in 1988 is expected to be substantially lower. Capital spending also will continue to be modest for a number of years.



The company currently has a request for increased annual rates of $298 million pending before the MPSC. This covers higher operation and maintenance expenses, as well as additional capital costs for Fermi 2. In January 1988, as noted earlier, the company began collecting the first phase of increased rates when Fermi 2 went into commercial operation. This covers a portion of the plant's capital costs, along with some operation and maintenance expenses.

Another major accomplishment in 1987 was completion of the agreement to purchase from Wolverine Power Supply Cooperative, Inc. its remaining ownership interest in Fermi 2. The $550-million transaction — to be completed in January 1990 — and the accompanying long-term power supply agreement will benefit both Detroit Edison and Wolverine.

Problems and challenges notwithstanding, Detroit Edison's management is confident it has done the right planning, made the right decisions and initiated effective sales, operating and cost-containment programs to keep the company on the right track for the future. Fermi 2 is operating successfully. Other generating and transmission facilities are modern and adequate for years to come. The Detroit Edison work force is talented and is dedicated to achieving the goals the company has set for itself in every area of activity. And despite compelling financial problems, the company expects to remain profitable — except for the interruption in 1988 caused by the power plant write-offs — while making every effort to maintain dividends for shareholders and quality service for customers.

1987 Financing

Type of Security & Month Sold	Gross Amount (Millions)	Cost to Company (After Expenses)
Mortgage Bonds		
February	$ 300	9.27%
April	400	9.49
August	400	9.82
December	200	10.04
Pollution Control Refunding Bonds		
May and September	7.7	9.12
Unsecured Term Notes		
October and December	525	8.19
Total	$1,832.7	

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 estimates 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 assure the selection and training of qualified personnel.

These financial statements have been examined by the Company's independent accountants, Price Waterhouse, whose report appears on this page. Their examination 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 examination, 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 examination results and opinions, without management representatives present, to allow for complete independence.

Ernest L. Grove, Jr.
Vice Chairman of the Board and
Chief Financial Officer

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

Report of Independent Accountants

Price Waterhouse

200 RENAISSANCE CENTER
DETROIT, MICHIGAN 48243
February 12, 1988

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

We have examined the consolidated financial statements of The Detroit Edison Company and its subsidiary companies appearing on pages 16 through 35 of this report. Our examinations were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note 4, the Financial Accounting Standards Board in December 1986 issued Statement of Financial Accounting Standards No. 90 which amends an earlier statement and, among other things, requires losses to be recognized as a result of utility plant cost disallowances and abandonments. The Company plans to adopt this Statement in the first quarter of 1988, effective January 1, 1988.

As described more fully in Note 3, there are continuing uncertainties regarding the recovery of the Company's investment in Fermi 2. The extent of recovery of the Company's investment will not be determinable until all appropriate proceedings (including court reviews) have occurred, including the pending appeal of the April 1986 rate order and the final resolution of the Company's 1987 rate case. The Company is unable to determine the effects, if any, that the resolution of these uncertainties may have on its 1987 and 1986 consolidated financial statements.

In our opinion, subject to the effects on the 1987 and 1986 consolidated financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainties referred to in the preceding paragraph been known, the consolidated financial statements examined by us present fairly the financial position of The Detroit Edison Company and its subsidiary companies at December 31, 1987 and 1986, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles consistently applied.

Price Waterhouse

Consolidated Statement of Income

	Year Ended December 31 (Thousands)		
	1987	1986	1985
Operating Revenues			
Electric (Note 1)	$2,825,910	$2,832,945	$2,738,356
Steam	30,821	36,339	49,801
Total Operating Revenues	$2,856,731	$2,869,284	$2,788,157
Operating Expenses			
Operation			
Fuel	$ 813,376	$ 741,206	$ 785,110
Other power supply	47,814	191,126	196,918
Other operation	441,046	459,534	422,133
Maintenance	245,736	258,655	250,798
Depreciation (Note 1)	237,325	232,240	218,502
Taxes other than income	179,308	177,381	175,556
Income taxes (Notes 1 and 6)	159,488	126,596	124,939
Total Operating Expenses	$2,124,093	$2,186,738	$2,173,956
Operating Income	$ 732,638	$ 682,546	$ 614,201
Other Income and Deductions			
Allowance for other funds used during construction (Note 1)	$ 136,452	$ 117,069	$ 113,225
Other income and deductions	(3,435)	(16,869)	(5,240)
Income taxes (Note 6)	663	8,827	1,642
Net Other Income and Deductions	$ 133,680	$ 109,027	$ 109,627
Income Before Interest Charges	$ 866,318	$ 791,573	$ 723,828
Interest Charges			
Long-term debt	$ 417,474	$ 399,429	$ 401,272
Amortization of debt discount, premium and expense (Note 1)	3,626	2,721	2,502
Other	23,459	41,410	15,642
Allowance for borrowed funds used during construction (credit) (Note 1)	(133,215)	(129,082)	(133,103)
Net Interest Charges	$ 311,344	$ 314,478	$ 286,313
Net Income	$ 554,974	$ 477,095	$ 437,515
Preferred and Preference Stock Dividend Requirements	78,240	98,803	103,264
Earnings for Common Stock	$ 476,734	$ 378,292	$ 334,251
Common Shares Outstanding – Average	146,729,292	146,643,377	143,183,133
Earnings Per Share	$ 3.25	$ 2.58	$ 2.33

(See accompanying Notes to Consolidated Financial Statements.)

Consolidated Statement of Changes in Financial Position

	Year Ended December 31 (Thousands)		
	1987	1986*	1985*
Financial Resources Provided			
Operations			
Net Income	$ 554,974	$ 477,095	$ 437,515
Items not affecting working capital			
Depreciation	237,325	232,240	218,502
Deferred income taxes and investment tax credit – net	99,050	104,430	110,778
Amortization of extraordinary property losses and unrecovered plant costs (Note 8)	9,708	12,231	12,231
Allowance for other funds used during construction (Note 1)	(136,452)	(117,069)	(113,225)
Other	(762)	(1,999)	2,385
Financial resources provided by operations	$ 763,843	$ 706,928	$ 668,186
External Financing			
Sale of common stock	$ —	$ —	$ 113,683
Issuance of common stock on conversion of convertible cumulative preferred stock, 5½% series	912	2,139	1,538
Sale of general and refunding mortgage bonds	1,282,005	491,696	84,728
Funds received from Trustees: Installment sales contracts and loan agreements	7,374	16,591	187,091
Issuance of unsecured promissory notes	524,172	99,988	309,870
Increase (decrease) in short-term borrowings	(104,656)	104,656	(2,000)
	$1,709,807	$ 715,070	$ 694,910
Other Sources			
Change in obligations under capital leases (Note 12)	$ 14,708	$ 15,329	$ 113,344
Increase (decrease) in accumulated rate refunds, with interest	(15,939)	12,345	(43,975)
Other – net	26,054	10,223	(4,224)
Total	$2,498,473	$1,459,895	$1,428,241
Financial Resources Used			
Plant and equipment expenditures	$ 709,084	$ 645,196	$ 710,699
Purchase from Cooperative - Fermi 2 (Note 2)	78,514	83,512	40,479
Allowance for other funds used during construction (Note 1)	(136,452)	(117,069)	(113,225)
	$ 651,146	$ 611,639	$ 637,953
Change in net property under capital leases (Note 12)	14,708	15,329	113,344
Dividends on common, preferred and preference stock	324,035	344,767	344,621
Conversion of convertible cumulative preferred stock, 5½% series	913	2,140	1,540
Repayment of long-term debt	1,256,590	485,975	376,185
Redemption of redeemable preferred and preference stock (Note 10)	122,986	79,613	10,015
Increase (decrease) in working capital**	128,095	(79,568)	(55,417)
Total	$2,498,473	$1,459,895	$1,428,241
Changes in Working Capital			
Cash and temporary cash investments	$136,692	$(11,980)	$ 3,030
Accounts receivable	(3,294)	(12,297)	10,069
Inventories	1,535	20,520	(75,179)
Accounts payable	12,578	(14,861)	37,572
Property, general and income taxes	(15,888)	(19,595)	(34,220)
Interest	(14,292)	3,027	5,134
Other	10,764	(44,382)	(1,823)
Increase (decrease) in working capital**	$128,095	$(79,568)	$(55,417)

*Changes in obligations and net property under capital leases restated for 1986 and 1985 (see Note 12).

**Excluding short-term borrowings, current maturities of long-term debt, current obligations under capital leases and preferred and preference stock due within one year.

(See accompanying Notes to Consolidated Financial Statements.)

Consolidated Balance Sheet

	December 31 (Thousands)	
	1987	1986*
Assets		
Utility Properties (Notes 1, 2, 4, 5 and 12)		
Plant in service		
Electric	$ 7,406,432	$ 7,230,676
Steam	59,249	58,816
	$ 7,465,681	$ 7,289,492
Less: Accumulated depreciation	(2,210,543)	(2,027,733)
	$ 5,255,138	$ 5,261,759
Construction work in progress (primarily Fermi 2)	4,420,920	3,772,957
Nuclear fuel	6,817	—
Net utility properties	$ 9,682,875	$ 9,034,716
Property under capital leases	$ 256,994	$ 245,699
Nuclear fuel under capital leases	324,774	286,397
	$ 581,768	$ 532,096
Less: Accumulated amortization	(108,485)	(73,521)
Net property under capital leases	$ 473,283	$ 458,575
Total owned and leased properties	$10,156,158	$ 9,493,291
Other Property and Investments		
Non-utility property	$ 8,845	$ 12,098
Investments and special funds (less allowance for decline in value of investments of $4,400,000)	26,781	24,543
	$ 35,626	$ 36,641
Current Assets		
Cash	$ 4,829	$ 2,769
Temporary cash investments (at cost, approximating market value)	134,632	—
Customer accounts receivable (less allowance for uncollectible accounts of $36,000,000 and $32,000,000, respectively)	203,716	220,293
Other accounts receivable	42,580	29,297
Inventories (at average cost)		
Fuel	238,678	246,474
Materials and supplies	141,591	132,260
Prepayments	7,869	9,957
Other	2,548	—
	$ 776,443	$ 641,050
Deferred Debits		
Unamortized debt expense (Note 1)	$ 47,318	$ 38,408
Accumulated deferred income taxes (Note 1)	100,603	20,850
Extraordinary property losses and unrecovered plant costs (Note 8)	37,423	47,131
Other (Note 2)	4,643	99,754
	$ 189,987	$ 206,143
Total	$11,158,214	$10,377,125

*Net property under capital leases restated for 1986 (see Note 12).

(See accompanying Notes to Consolidated Financial Statements.)

Consolidated Balance Sheet

	December 31 (Thousands)	
	1987	1986*
Liabilities		
Capitalization		
Common stock – $10 par value, 160,000,000 shares authorized; 146,751,865 and 146,699,431 shares outstanding, respectively (630,298 and 682,766 shares, respectively, reserved for conversion of preferred stock) (Note 9)	$ 1,467,519	$ 1,466,994
Premium on common stock	551,662	551,254
Common stock expense	(47,700)	(47,680)
Retained earnings used in the business	948,504	745,835
Total common shareholders' equity	$ 2,919,985	$ 2,716,403
Non-redeemable preferred stock (Note 9)	241,370	242,284
Redeemable preferred stock (Note 10)	98,777	124,885
Non-redeemable preference stock (Note 9)	137,406	287,406
Redeemable preference stock (Note 10)	44,341	87,698
Long-term debt (Note 11)	4,693,687	3,656,569
Total Capitalization	$ 8,135,566	$ 7,115,245
Other Non-Current Liabilities		
Obligations under capital leases (Note 12)	$ 153,623	$ 155,823
Accumulated rate refunds, with interest	10,839	26,778
	$ 164,462	$ 182,601
Current Liabilities		
Short-term borrowings (Note 7)		
Bank loans	$ —	$ 19,000
Bankers acceptances	—	18,905
Commercial paper	—	56,751
Trust demand notes	—	10,000
Amounts due within one year		
Long-term debt (Note 11)	178,825	646,440
Preferred and preference stock, including redemption premium of $14,647,500 in 1987 (Notes 9 and 10)	195,398	70,648
Obligations under capital leases (Note 12)	319,660	302,752
Accounts payable	184,670	197,248
Property and general taxes	288,770	273,624
Income taxes	11,455	10,713
Interest	99,909	85,617
Dividends payable	80,448	84,764
Payrolls	55,406	50,504
MPSC ordered refunds, with interest	33,319	10,631
Other	39,324	72,902
	$ 1,487,184	$ 1,910,499
Deferred Credits		
Accumulated deferred income taxes (Note 1)	$ 972,551	$ 821,224
Accumulated deferred investment tax credits (Note 1)	349,769	322,293
Other	48,682	25,263
	$ 1,371,002	$ 1,168,780
Commitments and Contingencies (Notes 2, 3, 4, 5, 12 and 13)		
Total	$11,158,214	$10,377,125

*Obligations under capital leases restated for 1986 (see Note 12).

(See accompanying Notes to Consolidated Financial Statements.)

Consolidated Statement of Common Shareholders' Equity

	Common Stock		Premium on Common Stock	Common Stock Expense	Retained Earnings Used in the Business
	Shares	$10 Par Value			
			(Dollars in Thousands)		
Balance at December 31, 1984	139,081,562	$1,390,816	$512,401	$(47,370)	$524,151
Issuance of common stock					
Dividend Reinvestment and Common Share Purchase Plan	6,307,762	$ 63,077	$ 33,409	$ (227)	$
Employes' Savings Plans	1,098,764	10,988	6,436		
Conversion of convertible cumulative preferred stock, 5½% series	88,408	884	689	(35)	
Expense associated with preferred and preference stock redeemed (Notes 1 and 10)			(88)		
Net income					437,515
Cash dividends declared					
Common stock—$1.68 per share					(241,397)
Cumulative preferred and preference stock*					(103,224)
Balance at December 31, 1985	146,576,496	$1,465,765	$552,847	$(47,632)	$617,045
Issuance of common stock on conversion of convertible cumulative preferred stock, 5½% series	122,935	$ 1,229	$ 538	$ (48)	$
Premium and expense associated with preferred and preference stock redeemed (Notes 1 and 10)			(2,551)		(3,538)
Net income					477,095
Cash dividends declared					
Common stock—$1.68 per share					(246,389)
Cumulative preferred and preference stock*					(98,378)
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 (Notes 1 and 10)					(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

*At established rate for each series.

(See accompanying Notes to Consolidated Financial Statements.)

Consolidated Statement of Cumulative Preferred and Preference Stock

	Date of Issuance	December 31 (Thousands) 1987	1986
Cumulative Preferred Stock – $100 Par Value			
Authorized – 9,000,000 shares; Outstanding – 3,693,710 and 3,844,524 shares, respectively (3,539,827 shares unissued)			
Non-Redeemable Preferred Stock (Note 9)			
5½% convertible series, 112,130 and 121,464 shares, respectively	October 1967	$ 11,213	$ 12,146
9.32% series, 499,080 shares	October 1970	49,968	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		(4,751)	(4,770)
Total Non-Redeemable Preferred Stock		$241,370	$242,284
Redeemable Preferred Stock (Note 10)			
9.72% series, 400,000 and 449,150 shares, respectively	December 1978	$ 40,000	$ 44,915
9.72% series, 80,000 and 89,830 shares, respectively	January 1979	8,000	8,983
9.60% series, 301,750 and 319,500 shares, respectively	October 1979	30,175	31,950
9.60% series, 250,750 and 265,500 shares, respectively	January 1980	25,075	26,550
13.50% series, 200,000 and 250,000 shares, respectively	December 1980	20,000	25,000
Redeemable preferred stock due within one year		(23,250)	(11,148)
Redeemable preferred stock expense		(1,223)	(1,365)
Total Redeemable Preferred Stock		$ 98,777	$124,885
Cumulative Preference Stock – $1 Par Value			
Authorized – 30,000,000 shares; Outstanding – 14,180,180 and 18,180,180 shares, respectively (15,819,820 shares unissued)			
Non-Redeemable Preference Stock (Note 9)			
$2.28 series, 2,000,000 shares	December 1977	$ 2,000	$ 2,000
$3.42 series, 3,000,000 shares	October 1982	3,000	3,000
$3.40 series, 2,250,000 shares	December 1982	2,250	2,250
$3.12 series, 750,000 shares	February 1983	750	750
$3.13 series, 2,600,000 shares	May 1983	2,600	2,600
$3.24 series, 1,400,000 shares	September 1983	1,400	1,400
Premium on non-redeemable preference stock		288,000	288,000
Non-redeemable preference stock due within one year		(150,000)	—
Non-redeemable preference stock expense		(12,594)	(12,594)
Total Non-Redeemable Preference Stock		$137,406	$287,406
Redeemable Preference Stock (Note 10)			
$2.75 series, 980,180 and 1,180,180 shares, respectively	July 1975	$ 980	$ 1,180
$2.75 series B, 1,200,000 and 1,400,000 shares, respectively	December 1975	1,200	1,400
$4.12 series, 2,000,000 shares (redeemed January 1987)	January 1982	—	2,000
$4.00 series, 1,600,000 shares (redeemed April 1987)	April 1982	—	1,600
Premium on redeemable preference stock		52,324	148,324
Redeemable preference stock due within one year		(7,500)	(59,500)
Redeemable preference stock expense		(2,663)	(7,306)
Total Redeemable Preference Stock		$ 44,341	$ 87,698

(See accompanying Notes to Consolidated Financial Statements.)

Consolidated Statement of Long-Term Debt

	Interest Rate*	December 31 (Thousands) 1987	1986
General and Refunding Mortgage Bonds			
Series P, due 8/15/87	4⅞%	$ —	$ 66,325
Series Q, due 6/1/89	4⅝	37,695	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	8⅛	100,000	100,000
Series Y, due 11/15/01	7⅜	60,000	60,000
Series Z, due 1/15/03	7½	100,000	100,000
Series AA, due 5/1/04	9⅞	100,000	100,000
Series EE, due 12/15/99	11⅞	30,000	35,000
Series HH, due 7/15/06	10⅝	50,000	50,000
Series PP, due 6/15/08	9⅞	70,000	70,000
Series RR, due 10/15/08	9.8	70,000	70,000
Series SS, due 3/15/99	10⅜	120,000	130,000
Series UU, due 9/15/09	10⅞	100,000	100,000
1980 Series B, due 4/1/99	12¾	73,400	86,700
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	9⅜	200,000	200,000
1986 Series B, due 8/15/16	9¾	100,000	100,000
1986 Series C, due 12/15/16	9½	200,000	200,000
1987 Series A, due 2/15/17	9	300,000	—
1987 Series B, due 4/15/97	8¾	175,000	—
1987 Series C, due 4/15/14	9¾	225,000	—
1987 Series D, due 8/15/92	9⅜	250,000	—
1987 Series E, due 8/15/96	10⅛	150,000	—
1987 Series F, due 6/15/93	9⅞	200,000	—
Less: Unamortized net discount		(12,050)	(5,372)
Amount due within one year		(19,150)	(85,475)
		$3,264,895	$1,999,873
Tax Exempt Revenue Bond Obligations			
Installment Sales Contracts (Secured by corresponding amounts of General and Refunding Mortgage Bonds)			
City of Detroit, due 3/1/88 – 6/1/94	6.95%	$ 15,295	$ 17,545
City of Harbor Beach, due 3/1/88 – 3/1/05	6.98	3,340	3,415
City of River Rouge, due 2/15/88 – 10/1/02	6.93	48,030	49,500
City of Superior, due 2/1/88 – 2/1/01	8.09	41,200	41,900
City of Trenton, due 3/1/88 – 3/1/05	7.04	6,080	6,215
County of Monroe, due 3/1/88 – 10/1/14	9.36	59,030	60,310
County of St. Clair, due 6/15/88 – 5/1/22	10.22	210,150	213,265
Less: Unamortized net discount		(498)	(537)
Funds on deposit with Trustee		(105)	(97)
Amount due within one year		(8,735)	(9,025)
		$ 373,787	$ 382,491
Installment Sales Contracts			
County of Monroe, due 5/1/88 – 12/1/16	10.68	$ 315,170	$ 318,110
Less: Amount due within one year		(940)	(1,940)
		$ 314,230	$ 316,170
Loan Agreements			
Pollution Bond Refunding Projects, due 2/15/94 – 9/15/07	9.05	$ 35,775	$ 28,035
		$ 723,792	$ 726,696
Unsecured Promissory Notes			
Belle River Project Financing (retired during 1987)	—%	$ —	$ 825,000
Variable interest rates, due 3/18/88 – 1/15/90	8.34	625,000	125,000
Fixed interest rate, due 7/9/87	10.05	—	250,000
Fixed interest rates, due 3/14/88 – 4/25/91	12.05	230,000	280,000
Less: Amount due within one year		(150,000)	(550,000)
		$ 705,000	$ 930,000
Total Long-Term Debt (Note 11)		$4,693,687	$3,656,569

*Weighted average interest rate at December 31, 1987 for Tax Exempt Revenue Bond Obligations and Unsecured Promissory Notes.

(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 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.

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

Revenues – Revenues are recorded when customers are billed on a monthly cycle basis. Revenues include 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 is recorded in the Consolidated Balance Sheet pending the results of such hearings.

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. Annual depreciation provisions expressed as a percent of average depreciable property were approximately 3.3% for 1987, 1986 and 1985. 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.

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. This accounting procedure is intended to remove the effect of the cost of financing construction activity from the income statement. Under current ratemaking practice, 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 Notes 3 and 4 for information regarding pending rate matters, MPSC-ordered disallowances, and new accounting standards.)

The Company capitalized AFUDC at 10.73% through July 16, 1985 and 10.3% thereafter. In accordance with MPSC requirements, these composite AFUDC rates are equal to the overall rate of return authorized in electric rate orders.

In accordance with FERC accounting requirements, the Consolidated Statement of Changes in Financial Position is not adjusted to remove the borrowed funds component of AFUDC of $133.2 million, $129.1 million and $133.1 million for 1987, 1986 and 1985, respectively. Total AFUDC for both borrowed and other funds amounted to $269.7 million, $246.2 million and $246.3 million for 1987, 1986 and 1985, respectively. AFUDC amounted to 57%, 65% and 74% of Earnings for Common Stock for 1987, 1986 and 1985, respectively.

Income Taxes – For federal income tax purposes, the Company computes depreciation using accelerated methods and shorter depreciable lives. Deferred income taxes are provided for timing differences between book and taxable income to the extent authorized by the MPSC. Investment tax credits utilized are deferred and amortized over the estimated composite service life of the related property. (See Note 6.)

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 expense related 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.

Extraordinary Property Losses and Unrecovered Plant Costs – See Note 8.

Leases – See Note 12.

Employes' Retirement Plan and Other Postretirement Benefits – See Note 14.

Notes to Consolidated Financial Statements

Note 2

Fermi 2

Project Costs – Fermi 2, a nuclear generating unit having a nominal capability rating of 1,100 MW, was placed into commercial operation on January 23, 1988. In 1977, the Company sold a 20% undivided ownership interest in Fermi 2 to Wolverine Power Supply Cooperative, Inc. ("Cooperative"). Under the terms of a Participation Agreement providing for the Cooperative's purchase, 20% of all costs associated with the construction and operation of Fermi 2 were to be paid by the Cooperative. The Participation Agreement was later amended to limit the Cooperative's Fermi 2 investment to $426.9 million for plant (excluding other costs capitalized by the Cooperative), $24.3 million for nuclear fuel and $3.0 million for materials and supplies. In 1984, the investment limitation was reached and the Company began funding all subsequent Fermi 2 project costs and the Cooperative's Fermi 2 ownership interest began to decline.

In 1985 and 1986, the Participation Agreement was again amended to provide for quarterly purchases of portions of the Cooperative's Fermi 2 ownership interest. Such quarterly purchases continued for the period commencing July 1985 through the commercial operation of Fermi 2. These quarterly purchases, as well as the Company's planned January 1990 purchase of the Cooperative's remaining Fermi 2 ownership interest, are discussed below.

Project costs at December 31, 1987 of both the Company and Cooperative are shown below:

Fermi 2 Project Costs
(Millions)

	Total Project Cost(1)	Less Cooperative's Portion	Company Project Cost	Add Purchases from Cooperative(2)	Total Company Cost
Base	$3,088.5	$408.4	$2,680.1	$192.2	$2,872.3
AFUDC	1,477.0	18.5	1,458.5	10.3	1,468.8
Total	$4,565.5	$426.9	$4,138.6	$202.5	$4,341.1

Cooperative's Ownership Interest

Portion of Project Cost	Other Costs	Total Cooperative's Cost
$426.9	$306.8	$733.7

(1) See Note 4 for information on Statement of Financial Accounting Standards ("SFAS") No. 90, "Regulated Enterprises – Accounting for Abandonments and Disallowances of Plant Costs."

(2) Quarterly purchases by the Company from the Cooperative from July 1985 through December 1987. (See "Purchase of Cooperative's Ownership Interest," herein.)

In an April 1, 1986 order, the MPSC imposed the requirement that Fermi 2 could be declared to be in commercial operation only when a 90% power level for 100 continuous hours ("100 hour run") had been achieved. The 100 hour run was completed on January 23, 1988 and, as authorized, on January 24, 1988 the Company began collecting rates for a portion of the Fermi 2 investment.

Testing and Licensing – The Company is subject to the jurisdiction of the Nuclear Regulatory Commission ("NRC") with respect to construction, licensing and operation of Fermi 2. From time to time the NRC may consider taking enforcement or other action against the Company as a result of alleged technical and procedural violations at the plant. Any enforcement action may result in fines levied against the Company.

In July 1985, the NRC granted the Company a full power operating license for Fermi 2, which the NRC subsequently made subject to administrative restrictions requiring NRC approval of test completion and power ascension at increasing levels. On January 15, 1988 the Company received NRC approval to increase power to 100% and on January 23, 1988 the unit was declared to be in commercial operation.

Purchase of Cooperative's Ownership Interest – In 1985, the Company commenced quarterly purchase payments equal to the Cooperative's quarterly interest payments on indebtedness related to its investment. A dispute arose between the Company and the Cooperative relating to whether payments made after December 31, 1985 would reduce the Cooperative's ownership interest. Accordingly, title documentation for payments for the quarters ended March 31, 1986 and June 30, 1986 were placed in escrow pending resolution of the dispute. In March 1986, the Company and the Cooperative further agreed that the Company would make quarterly purchases of an additional portion of the Cooperative's ownership interest in Fermi 2, equal to the Cooperative's quarterly principal payments on indebtedness related to its investment. In September 1986, because of the dispute, quarterly purchase payments were deferred upon agreement of the parties.

On December 14, 1987, the Company and the Cooperative executed an amendment to the Participation Agreement which provides for the terms of a January 1990 purchase (estimated at $550 million: $513 million for plant, $35 million for nuclear fuel and $2 million for materials and supplies) by the Company of the Cooperative's remaining undivided ownership interest in Fermi 2. This amendment resolves the dispute as to quarterly payments and provides that title documentation for the quarterly purchase payments made after December 31, 1985, equal to the Cooperative's interest on indebtedness related to its investment in Fermi 2, will remain in escrow until the completion of the scheduled January 1990 purchase.

Payment of deferred and current quarterly purchases of $117.3 million to the Cooperative was made in December 1987. Quarterly purchases from the Cooperative totaled $213.3 million ($202.5 million for plant, $10 million for nuclear fuel and $0.8 million for materials and supplies) through December 31, 1987. Of this amount, $147.1 million represents purchases for which title documentation was placed in escrow and will not be released until the scheduled final purchase in January 1990.

As of December 31, 1986, $79.3 million of quarterly purchases of the Cooperative's ownership interest in Fermi 2 were recorded as Other Deferred Debits in the Consolidated Balance Sheet because of the dispute noted above. At December 31, 1987, due to the resolution of the dispute, quarterly purchase payments are recorded as Utility Properties in the Consolidated Balance Sheet.

At December 31, 1987, the Cooperative's adjusted participation interest in Fermi 2 was 11.282%.

In January 1990, the Company expects to issue approximately $550 million in General and Refunding Mortgage Bonds ("Mortgage Bonds") as payment for the Cooperative's remaining ownership interest. Such Mortgage Bonds will bear the same interest rates as the Cooperative's Fermi 2 related indebtedness and will be assigned by the Cooperative to the Rural Electrification Administration, guarantor of the Cooperative's Fermi 2 related indebtedness. In March 1987, the Company received authorization from the MPSC for the issuance of such Mortgage Bonds.

From January 24, 1988, the effective date of rate relief associated with Fermi 2, through the January 1990 planned purchase date, the Company will purchase 100% of the Cooperative's Fermi 2 capacity and energy entitlements. The cost for the buyback of power will be 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 are currently estimated at $87.9 million and $97.2 million for 1988 and 1989, respectively. In addition, the Cooperative will continue to purchase capacity and energy from the Company and such current purchases of 7.5 MW will increase annually to 135 MW by the year 2010 and continue at that level through the year 2025.

Decommissioning – The NRC has authority to regulate the method by which Fermi 2 will be decommissioned. The MPSC has jurisdiction over the matters pertaining to 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 of both the Company and the Cooperative commencing with the commercial operation of Fermi 2 and extending over the life of the plant. Beginning in 1990 and every three years thereafter, there will be a review of the adequacy of the estimated decommissioning costs and related surcharge.

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. Orders of the MPSC are generally appealed and as such are often subject to judicial review over protracted periods of time and such matters are often remanded to the MPSC for additional proceedings.

Tax Reform Act of 1986 – On September 1, 1987, the MPSC ordered the Company to reduce its electric rates based on a 1986 test period by $66 million annually to reflect the effects of the federal Tax Reform Act of 1986 ("TRA"). This order reduced rates effective September 2, 1987 by approximately 2.45% for all classes of customers.

Prior MPSC Electric Rate Case Orders – In 1983, the Company filed an electric rate case with the MPSC requesting an annual revenue increase of approximately $969 million for general cost increases for the 1984 test year and for revenues coincident with the commercial operation of Belle River Unit Nos. 1 and 2 and Fermi 2. On August 1, 1984, Belle River Unit No. 1 commenced commercial operation and the Company began collecting rates designed to produce annual revenues in the amount of $182.9 million. On July 9, 1985, Belle River Unit No. 2 commenced commercial operation. On July 16, 1985, the MPSC issued an order designed to produce annual revenues in the amount of $99.3 million for the commercial operation of Belle River Unit No. 2. On April 1, 1986, the MPSC issued an order for the Company's Fermi 2 rate request (discussed below).

In its July 16, 1985 order, the MPSC allowed rate base treatment of the Belle River Project but based on its "reasonable and prudent" standard concluded there was an unreasonable delay in the construction of this project. The MPSC disallowed approximately $96.9 million ($90.2 million of which is applicable to the Company's rate base) including $36.0 million for coal handling facilities and boiler plant equipment and $60.9 million due to what the MPSC termed an imprudent delay of twelve months. The Company appealed and on September 17, 1985, the Ingham County Circuit Court issued an injunction which allowed the Company to collect, subject to refund, rates in an amount designed to produce an additional $12.1 million in annual revenues to compensate for the $60.9 million of the Belle River disallowance. On December 16, 1985, the Court ruled that the MPSC had not met the substantial evidence standard for the $60.9 million Belle River costs disallowed due to imprudent delay and remanded the case to the MPSC for further proceedings consistent with the Court's decision.

The April 1, 1986 order provided for a rate increase to be phased in over a five-year period commencing with the commercial operation of Fermi 2. On December 22, 1987, the April 1, 1986 phase-in rate increases were restated by the

MPSC for the effects of a recent Internal Revenue Service ("IRS") ruling and the TRA and totaled $404.2 million (including interest) apportioned by year as follows: $68.4 million increase in the first year, followed by increases of $74.7 million, $76.7 million, $81.9 million and $102.5 million. Based on current generally accepted accounting principles, the phase-in plan, as amended, would be accounted for by recording non-cash items of income consisting of deferred depreciation and deferred return (at the overall rate of return of 10.18%) totaling approximately $475.8 million (annual deferrals for the first four years of Fermi 2's commercial operation of $190.3 million, $142.7 million, $95.2 million and $47.6 million, respectively), with these deferred amounts amortized to operating expense as the cash recovery of such deferred amounts is realized through revenues over the life of the plant. However, the MPSC order, as amended, does not provide for the recovery through revenues of deferred depreciation or a portion of deferred return, nor a full return on such deferred amounts, and this provision of the order, among others, is the subject of pending appeals. The MPSC authorized phase-in plan does not meet the requirements of SFAS No. 92 as discussed in Note 4.

The order, which disallows $397 million of Fermi 2 project costs, is based upon a 1983 total project cost estimate of $3.075 billion of which $2.648 billion ($2.552 billion MPSC jurisdictional and $0.096 billion FERC jurisdictional) relates to the Company's portion of the plant. The order grants recovery of $2.237 billion in MPSC jurisdictional project costs for Fermi 2. Based upon alleged imprudence of certain expenditures, no return on or recovery of $313 million of the Company's MPSC jurisdictional project costs were allowed. The order allows recovery through depreciation of $2 million of disallowed project costs, but a return on such costs is not allowed.

The MPSC also ordered that, upon Fermi 2 commercial operation, the Company was to remove its 795 MW oil-fueled Greenwood Unit No. 1 from rate base until it is determined in future proceedings to be necessary for reliability or economic reasons. On January 24, 1988, Greenwood Unit No. 1 was removed from rate base. However, the Company is permitted to recover through rates operating expenses with respect to Greenwood Unit No. 1, including depreciation, but may not earn a further return on the $283 million net investment.

The Company has appealed the Fermi 2 project cost disallowances and the MPSC-ordered removal of the Greenwood unit from rate base as well as other provisions of the order to the Ingham County Circuit Court. The Michigan Attorney General ("AG") has also appealed portions of the MPSC's order, including placing the MPSC authorized portion of Fermi 2 in rate base and allowing a return on the amounts deferred under the phase-in plan. The matter has been remanded by the Court to the MPSC where further proceedings are pending.

In July 1985, the MPSC reduced the Company's authorized return on common equity to 14.5% and authorized overall rate of return to 10.3%. The Fermi 2 order, as amended, further reduced the Company's authorized rate of return on common equity to 14.0% and its authorized overall rate of return to 10.18%, to be effective when Fermi 2 commenced commercial operation. However, such returns are not assured, but rather are dependent upon levels of sales, revenues and expenses.

In its order establishing the 1987 PSCR billing factor, the MPSC left unresolved the issues concerning the amounts that are recoverable for reasonable and prudent expenditures for nuclear fuel and the buyback from the Cooperative of capacity and energy associated with Fermi 2. The Company expects that the MPSC may disallow the recovery of a portion of nuclear fuel and buyback costs in PSCR proceedings. (See Note 2.)

Under generally accepted accounting principles in effect in 1987, a write-off would be required only if, and to the extent that, anticipated future revenues associated with a plant, including return, are insufficient to recover current operating expenses and depreciation of all of the plant investment, including the amount disallowed, plus associated ongoing interest costs. The Company believes that anticipated future revenues associated with Belle River and [illegible] as a result of the MPSC's April 1, 1986 order, as amended, the 1987 MPSC Electric Rate Case Filing and judicial [illegible] will be sufficient to recover total plant costs and expenses. Accordingly, a write-off in 1987 of MPSC-disallowed plant costs is not required under generally accepted accounting principles in effect through December 31, 1987. However, until all appropriate proceedings (including court reviews) with respect to the Company's appeal of the MPSC April 1, 1986 rate order, as amended, and with respect to the 1987 MPSC Electric Rate Case Filing have been completed, an uncertainty exists as to the amount of future revenues associated with Fermi 2 and as to their sufficiency to recover total plant costs and expenses.

1987 MPSC Electric Rate Case Filing – On June 10, 1987, the Company filed an application with the MPSC requesting increased electric rates, which request was amended on October 1, 1987. The Company has requested increased rates of $298 million and proposed modifications to the Fermi 2 phase-in plan which are necessary to bring such plan into compliance with the requirements of SFAS No. 92, "Regulated Enterprises – Accounting for Phase-In Plans," (discussed in Note 4). This rate request addresses additional operation and maintenance expenses and return on and recovery of additional Fermi 2 project costs of approximately $1.5 billion over the Fermi 2 investment considered in rates in the MPSC's April 1, 1986 order, as amended. The filing also includes an

estimated $201 million of expenditures by the Company through December 31, 1987 for quarterly purchases from the Cooperative. The filing does not include the Company's scheduled 1990 purchase for approximately $550 million of the Cooperative's remaining undivided ownership interest in Fermi 2.

The Company's proposed amended phase-in plan for annual rate increases, as compared with the phase-in plan set forth in the December 22, 1987 MPSC order is as follows:

Year	October 1, 1987 Company Requested Phase-In Rates	December 22, 1987 MPSC Amended April 1, 1986 Phase-In Rates
	(Thousands)	
1	$ 70,872	$ 68,379
2	$112,965	$ 74,695
3	$ 92,112	$ 76,756
4	$ 94,480	$ 81,904
5	$ 97,261	$102,496
6	$ 35,812	—

The Company is required to file proposed rate schedules on an annual basis with rates effective upon approval of the rate schedules by the MPSC. The first year rates of $68.4 million became effective on January 24, 1988.

The MPSC authorized phase-in plan does not meet the requirements under SFAS No. 92. The Company's requested phase-in rates shown above contain adjustments in the second year which, if adopted by the MPSC, would bring the phase-in plan into compliance with SFAS No. 92. (See Note 4.)

The Company intends to seek a rate adjustment from the MPSC to reflect (1) the anticipated January 1990 $550 million purchase of the Cooperative's remaining ownership interest in Fermi 2 through the issuance of an equivalent amount of Mortgage Bonds and (2) the partial offsets to such rate adjustment by reduced billings through the Power Supply Cost Recovery Clause upon termination of the 100% buyback of the Cooperative's Fermi 2 capacity and energy entitlements on January 1, 1990, and the effect of additional purchases of capacity and energy by the Cooperative from the Company. (See Note 2.)

Note 4

Statements of Financial Accounting Standards Nos. 90, 92 and 95

SFAS No. 90 – In December 1986, the Financial Accounting Standards Board ("FASB") issued SFAS No. 90, "Regulated Enterprises-Accounting for Abandonments and Disallowances of Plant Costs," which is required to be adopted in 1988.

SFAS No. 90 requires the future revenue that is expected to result from the regulator's inclusion of the cost of an abandoned plant in allowable costs for ratemaking purposes to be reported at its present value when the abandonment becomes probable. If the carrying amount of the abandoned plant exceeds that present value, a loss would be recognized.

SFAS No. 90 also 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.

SFAS No. 90 specifies that AFUDC should be capitalized only if its subsequent inclusion in allowable costs for ratemaking purposes is probable.

The Company plans to adopt SFAS No. 90 in January 1988 and will record certain net after tax losses totaling $420 million ($344 million cumulative effect at January 1, 1988 and $76 million charge to income in 1988) as discussed below.

The cumulative effect for years prior to January 1, 1988 is as follows:

	Disallowed Costs	Deferred Income Taxes*	Net Loss
		(Millions)	
1. MPSC disallowances of Fermi 2 project costs as set forth in the order dated April 1, 1986, as amended, plus AFUDC thereon through December 31, 1987 (See Note 3)	$446	$(107)	$339
2. Other – Disallowance of Belle River project costs in 1985 and the abandonment of Greenwood Nuclear Unit Nos. 2 and 3 in 1980 (See Notes 3 and 8)	9	(4)	5
Total cumulative effect for years prior to January 1, 1988	$455	$(111)	$344

*As discussed in Note 6, the Company anticipates adopting SFAS No. 96 "Accounting for Income Taxes" by 1989. Upon adoption of SFAS No. 96, the Company is required to adjust deferred income tax balances in accordance with prevailing tax rates. The Company estimates the required adjustment to the deferred taxes shown in the table above will reduce Earnings for Common Stock in the period of adoption by approximately $29 million based upon an assumed 34% federal income tax rate.

Notes to Consolidated Financial Statements

The following table shows pro forma amounts assuming that the Company had applied SFAS No. 90 retroactively in 1988 by restatement of financial statements for prior years:

	Year Ended December 31		
	1987	1986	1985
	(Millions, except per share amounts)		
Net Income	$527	$169	$438
Earnings for Common Stock	$449	$ 70	$335
Earnings Per Share	$3.06	$0.48	$2.34

The removal of Greenwood Unit No. 1 from rate base will be recognized as a loss in accordance with SFAS No. 90 at the time Fermi 2 achieves commercial operation (January 23, 1988) and it will be accounted for as a charge to income in 1988 as follows:

	Estimated Loss	Deferred Income Taxes	Estimated Net Loss in 1988
		(Millions)	
MPSC removal of the oil-fueled Greenwood Unit No. 1 from rate base on January 23, 1988, the commercial operation date of Fermi 2 (See Note 3)	$115	$(39)	$76

In order to recover and earn a return on all Fermi 2 costs in excess of $3.075 billion (the project estimate considered by the MPSC in its April 1, 1986 order), the Company must receive additional rate relief from the MPSC. The Company's pending application for a rate increase seeks to recover approximately $1.5 billion in Fermi 2 costs plus quarterly purchases of ownership interests from the Cooperative of an estimated $201 million. Under the provisions of SFAS No. 90, any project costs which are considered probable of disallowance must be recognized as a loss at the time such determination is made. If all additional costs for which recovery has been requested from the MPSC were disallowed, the Company would be required to recognize an additional net after tax loss of up to approximately $1.3 billion in the period in which the determination was made.

In accordance with SFAS No. 90, the Company ceased capitalizing AFUDC on Fermi 2 effective January 1, 1988.

Additional disallowances from rate base for Fermi 2 could have a material adverse effect on the Company's financial position and results of operations. Such disallowances could significantly reduce or eliminate retained earnings ($949 million at December 31, 1987) and reduce total common shareholders' equity ($2.920 billion at December 31, 1987), and accordingly could result in a substantial reduction in the aggregate amount of funds legally available for the payment of dividends. See Note 11 for a discussion of the impact of the Fermi 2 disallowance on long-term debt.

SFAS No. 92 – In August 1987, the FASB issued SFAS No. 92, "Regulated Enterprises-Accounting for Phase-In Plans," which permits the capitalization of costs deferred for future recovery under a phase-in plan if four requirements are met. These requirements are: (1) the plan has been agreed to by the regulator (in this case the MPSC), (2) the plan specifies when recovery will occur, (3) all allowable costs deferred under the plan are scheduled for recovery within ten years of the date when deferrals begin, and (4) the percentage increase in rates scheduled for each future year under the plan is not greater than the percentage increase in rates scheduled for each immediately preceding year. The Fermi 2 phase-in plan adopted in the April 1, 1986 MPSC order, as amended, is not in compliance with the requirements of SFAS No. 92. In its October 1, 1987 filing with the MPSC, the Company proposed modifications to the Fermi 2 phase-in plan that it believes will bring the plan into compliance with SFAS No. 92. See Note 3 for a discussion of the Company's proposed modifications to the phase-in plan. Although SFAS No. 92 becomes applicable to the Company at the time Fermi 2 achieves commercial operation, the Company will delay adoption, as permitted, because it is reasonably possible that the MPSC will modify the phase-in plan beginning in the second year of the plan to comply with the requirements of SFAS No. 92.

The April 1, 1986 order, as amended, provides for non-cash income items of deferred depreciation and deferred return. However, the order did not provide for the recovery of deferred depreciation or a portion of deferred return nor a full return on such deferred amounts. The Company's October 1, 1987 filing has made provision for these omissions.

In the event the phase-in plan is not modified so that it complies with SFAS No. 92, the Company would be unable to record deferred depreciation and deferred return and may be required to record a net after tax loss of approximately $102 million to recognize an indirect disallowance of Fermi 2 project costs. If this were to occur, earnings would be adversely affected. In addition, the Company would be required to reverse the non-cash income items recorded during the period of delayed adoption of SFAS No. 92.

SFAS No. 95 – In November 1987, the FASB issued SFAS No. 95, "Statement of Cash Flows". The statement, effective for annual financial statements for fiscal years ending after July 15, 1988, establishes new standards for cash flow reporting and requires a statement of cash flows in place of the current presentation of the Consolidated Statement of Changes in Financial Position. The Company plans to adopt the standard in 1988 and intends to restate prior years for comparative purposes.

Note 5

Jointly-Owned Utility Plant

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

	Fermi 2	Belle River(1)	Ludington Pumped Storage
In-service date	1988	(1)	1973
Undivided ownership interest	(2)	(1)	49%
Investment (Millions)	(2)	$1,030.3	$168.4
Accumulated depreciation (Millions)	(2)	$ 111.0	$ 47.7

(1) Includes Belle River Unit No. 1, facilities used in common with Unit No. 2, facilities used jointly by the Belle River and St. Clair Power Plants and certain transmission lines. Unit No. 1 and facilities used in common with Unit No. 2 were placed in service on August 1, 1984. Unit No. 2 was placed in service on July 9, 1985. Certain coal handling facilities used jointly by the Belle River and St. Clair Power Plants were placed in service in 1976 and 1977. The transmission lines were placed in service in various years between 1960 and 1981. 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.

(2) See Note 2.

Belle River – In 1983, the Company sold to Michigan Public Power Agency ("MPPA") 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. At December 31, 1987, MPPA's investment consisted of $344.9 million for Unit No. 1 and common facilities, $28 million for certain coal handling and transmission facilities and $17.4 million for coal inventories and other non-capitalized costs.

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.

The Company began contractual purchases of MPPA's capacity and energy entitlements at the commercial operation date of Unit No. 1 and will continue to do so for up to eleven years, initially 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 in the Belle River project, 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 $75.3 million, $72.9 million and $73.5 million for 1985, 1986 and 1987, respectively, and are currently estimated at $71.0 million, $71.5 million, $70.7 million, $62.9 million and $55.2 million for 1988, 1989, 1990, 1991 and 1992, 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 13.)

Note 6

Income Taxes

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

	Percent of Income Before Tax		
	1987	1986	1985
Statutory income tax rate	40.0%	46.0%	46.0%
AFUDC	(18.1)	(22.5)	(21.3)
Indirect construction costs	(2.3)	(3.1)	(2.7)
Interest on nuclear fuel financing	(1.4)	(1.7)	(1.7)
Depreciation	2.6	3.4	3.6
Other—net	1.5	(2.3)	(1.9)
Effective income tax rate	22.3%	19.8%	22.0%

Components of income taxes were applicable to the following:

	1987	1986	1985
		(Thousands)	
Operating expenses			
Current	$ 62,267	$ 18,304	$ 13,549
Deferred—net			
Borrowed funds component of AFUDC	(21,656)	(20,609)	(6,399)
Depreciation	128,185	64,423	62,764
Alternative minimum tax	(69,356)	—	—
Fermi 2 capitalized labor and expenses	42,685	—	—
Indirect construction costs	(2,253)	5,819	6,926
Amortized extraordinary property losses and unrecovered plant costs	(3,671)	(4,823)	(4,823)
Other	(4,189)	199	4,122
	69,745	45,009	62,590
Investment tax credit—net			
Utilized	36,479	71,790	55,409
Amortized	(9,003)	(8,507)	(6,609)
	27,476	63,283	48,800
Total	159,488	126,596	124,939
Other income and deductions			
Current	(2,492)	(4,965)	(1,030)
Deferred—net	1,829	(3,862)	(612)
Total	(663)	(8,827)	(1,642)
Total income taxes	$158,825	$117,769	$123,297

Notes to Consolidated Financial Statements

In accordance with MPSC requirements, deferred income tax accounting is not followed for the borrowed funds component of AFUDC and indirect construction costs relating to Fermi 2, interest on nuclear fuel financing (see Note 12) and certain other current income tax deductions.

In July 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 both 1987 and 1986 and $12 million for 1985.

The cumulative net amounts of income tax timing differences for which deferred taxes have not been provided at December 31, 1987 and 1986 are $2.8 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 $138 million are available to offset future years' tax liabilities as permitted by law. This aggregate amount of credits has been reduced by 35% in accordance with the provisions of the TRA. Such credits, if unused, expire over the period 1998 through 2002.

In December 1987, the FASB issued SFAS No. 96, "Accounting for Income Taxes." The Company is currently reviewing the statement and, as permitted, anticipates adopting the provisions of SFAS No. 96 by 1989. 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 ($2.8 billion and $2.2 billion at December 31, 1987 and 1986, respectively) and all other existing differences that will result in taxable or deductible amounts in future years. To the extent that such additional deferred income taxes are associated with probable future revenue from customers, SFAS No. 96 requires the recognition of an asset to the extent of such future revenue.

Note 7

Short-Term Credit Arrangements and Borrowings

As described below, at December 31, 1987, the Company had total short-term credit arrangements of $430.6 million under which no borrowings were outstanding.

The Company had bank lines of credit of $300.1 million, substantially all of which had commitment fees in lieu of compensating balances. Commitment fees paid in lieu of compensating bank balances for 1987 were $1.3 million. Substantially all borrowings are at rates 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, subject to the satisfaction of certain conditions, to purchase nuclear fuel and to lend to the Company, pursuant to a separate Loan Agreement, for general corporate purposes for periods not to exceed 270 days. Renaissance may issue letter of credit-backed commercial paper (currently limited to 180 days' maturity) or borrow from participating banks on the basis of promissory notes limited to 270 days' maturity. To the extent the maximum amount of funds available to Renaissance (currently $409 million) is not needed by Renaissance from time to time to purchase nuclear fuel, such funds may be loaned to the Company pursuant to the Loan Agreement. At December 31, 1987, $105.5 million was available to the Company under such Loan Agreement. (See Note 12.)

The Company has a $25 million credit arrangement restricted to bankers acceptances.

Note 8

Extraordinary Property Losses and Unrecovered Plant Costs

Amortization of extraordinary property losses and unrecovered plant costs commences when recovery of such costs is authorized by accounting and ratemaking orders of the MPSC. While a return on investment was provided for the unamortized extraordinary property losses, no return on investment is provided for unrecovered plant costs. (See Note 4.) Information relating to these items is as follows:

	Amortization Period	Total	Unamortized Balance December 31 1987	1986
			(Thousands)	
Extraordinary Property Losses				
April 1979 Storm	1982-1987	$12,783	$ —	$ 1,492
July 1980 Storm	1982-1987	9,326	—	1,088
Unrecovered Plant Costs				
Greenwood Unit Nos. 2 and 3	1983-1993	71,282	37,423	44,551
		$93,391	$37,423	$47,131

Note 9

Common Stock and Non-Redeemable Cumulative Preferred and Preference Stock

The Convertible Cumulative Preferred Stock, 5½% Series, is convertible into Common Stock. The conversion price was $17.79 per share at December 31, 1987. The numbers of shares converted during 1987, 1986 and 1985 were 9,334, 21,880 and 15,739, 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, 5½% 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 following series of Preferred and Preference Stock, which are not redeemable pursuant to sinking fund requirements, are redeemable solely at the option of the Company at stated per share redemption prices, plus accrued dividends:

Non-Redeemable Series	Decreasing From	Prior To	To	On and After
Preferred Stock				
9.32%	$ —	—	$101	10-15-86
7.68%	—	—	101	4-15-86
7.45%	—	—	101	11-15-86
7.36%	—	—	101	12- 1-87
Preference Stock				
$2.28	26.50	1-15-88	25.25	1-15-93
$3.42 (redeemed 1-15-88)	28.42	1-15-88	25.25	1-15-98
$3.40 (redeemed 1-15-88)	28.40	1-15-88	25.25	1-15-98
$3.12 (redeemed 1-15-88)	28.00	1-15-88	25.00	1-15-98
$3.13	28.13	7-15-88	25.25	7-15-98
$3.24	28.24	10-15-88	25.25	10-15-98

None of the shares of the $3.13 Series and $3.24 Series Preference Stock may be redeemed through certain refunding operations prior to July 15, 1988 and October 15, 1988, respectively, at an effective cost less than that indicated by the original dividend rate.

On January 15, 1988, the Company redeemed all of the oustanding 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. A total of $163.8 million has been recorded in the Company's 1987 Consolidated Balance Sheet as amounts due within one year.

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 10

Redeemable Cumulative Preferred and Preference Stock

On August 15, 1986, the Company redeemed 360,000 shares of 12.80% Series and 250,000 shares of 15.68% Series, $100 par value Preferred Stock, constituting all of the outstanding shares of both issues, at a price of $108.50 and $105.88 per share, respectively.

On January 15, 1987, the Company redeemed 2,000,000 shares of $4.12 Series, $1 par value Preference Stock, constituting all of the outstanding shares, at a price of $25 per share for the redemption of 250,000 shares and $27.85 per share for the early redemption of 1,750,000 shares.

On April 15, 1987, the Company redeemed 1,600,000 shares of $4.00 Series, $1 par value Preference Stock, constituting all of the outstanding shares, at a composite price of $27.41 per share.

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, commencing on dates indicated:

Redeemable Series	Commencing On	Annual Number of Shares	Price Per Share	Non-Cumulative Option to Redeem Additional Shares in Any Year
Preferred Stock				
9.72%	1-15-85	30,000	$100	30,000
9.60%	10-15-85	32,500	100	32,500*
13.50% (redeemed 1-15-88)	1-15-87	50,000	100	—
Preference Stock				
$2.75	7-15-80	100,000	25	100,000
$2.75 Series B	1-15-81	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:

	1987	1986	1985
Preferred stock, 9.72% Series	58,980	—	31,020
Preferred stock, 9.60% Series	32,500	32,500	32,500
Preferred stock, 12.80% Series	—	40,000	—
Preferred stock, 13.50% Series	50,000	—	—
Preference stock, $2.75 Series	200,000	200,000	119,800
Preference stock, $2.75 Series B	200,000	73,300	26,700

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%	$105.80	1-15-89	$101	1-15-94
9.60%	107.00	10-15-89	101	10-15-94
13.50% (redeemed 1-15-88)	108.10	1-15-88	100	1-15-90
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

None of the shares of the Cumulative Preferred Stock, 9.60% Series may be redeemed through certain refunding operations prior to October 15, 1989 at an effective cost less than that indicated by the original dividend rate.

On January 15, 1988, the Company redeemed 200,000 shares of 13.50% Series, $100 par value Preferred Stock, constituting all of the outstanding shares, at a composite price of $104.05 per share. A total of $20.8 million has been recorded in the Company's 1987 Consolidated Balance Sheet as amounts due within one year.

After giving effect to the redemptions on January 15, 1988, the combined aggregate annual amounts of redemption requirements at December 31, 1987 for all series of redeemable Preferred and Preference Stock are $10.8 million for 1988 and $11.3 million for each of the years 1989 through 1992.

Note 11

Long-Term Debt

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 based upon property additions, combined with an earnings test provision, and based upon retirements of previously issued bonds. The MPSC-ordered Fermi 2 disallowances of project costs (see Note 3), as well as possible future disallowances, and corresponding write-offs required under SFAS No. 90 (see Note 4) will reduce bondable property under the Mortgage. In addition, such write-offs may limit the amount, if any, of additional bonds that could be issued under the earnings test provision. The Company does not anticipate that additional Fermi 2 project cost disallowances would preclude the issuance of additional bonds on the basis of the earnings test provision. At December 31, 1987, after giving effect to the Fermi 2 disallowance of $446 million (see Note 4), approximately $2.4 billion principal amount of additional Mortgage Bonds could have been issued on the basis of property additions or the earnings test provision of the Mortgage, assuming an interest rate of 11.25% on any such additional Mortgage Bonds. Of this amount, $2.1 billion would be supported by property additions related to Fermi 2. At December 31, 1987, approximately $436 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 event certain debt ratios are not maintained. Fermi 2 disallowed project costs (see Note 3) and associated write-offs (see Note 4) may require the Company to fund these insurance-related escrow accounts in an amount of up to $127 million.

Long-Term Debt Maturities – In 1988, 1989, 1990, 1991 and 1992, long-term debt maturities consist of $178.8 million, $654.6 million, $92.1 million, $94.0 million and $373.6 million, respectively.

Note 12

Leases

Future minimum lease payments under long-term noncancellable leases, consisting of nuclear fuel ($431.2 million computed on a projected units of production basis), lake vessels ($90.6 million), locomotives and coal cars ($88.5 million), office space ($49.1 million) and computers, vehicles and other equipment ($75.5 million) at December 31, 1987 are as follows:

	(Millions)		(Millions)
1988	$115.5	1991	$ 89.9
1989	90.0	1992	72.8
1990	88.0	Remaining years	278.7
		Total	$734.9

The Company has a heat purchase contract with Renaissance which provides for the purchase by Renaissance for the Company of up to $409 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 $304 million and $285 million at December 31, 1987 and 1986, respectively. The increase in 1987 over 1986 of $19 million includes additions of $38 million (purchases of $24 million, capitalized interest of $10 million and other capitalized costs of $4 million) less $19 million for the amortization of nuclear fuel consumed in 1987. (See Note 7.)

At December 31, 1986, the Company had recorded assets and liabilities for those capital leases for which the inception date was subsequent to December 31, 1982 as was permitted by SFAS No. 71. Effective January 1, 1987, the Company has recorded the remaining capital leases and, accordingly, has restated lease assets and obligations for periods prior to 1987 on the Consolidated Balance Sheet and the Consolidated Statement of Changes in Financial Position.

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 $44.6 million, $41.1 million and $39.1 million for 1987, 1986 and 1985, respectively.

Note 13

Commitments and Contingencies

Commitments – The Company has entered into purchase commitments of approximately $320 million at December 31, 1987. The Company has also entered into substantial long-range fuel supply commitments.

See Notes 2 and 5 for the Company's obligation to purchase capacity and energy entitlements of the Cooperative and the MPPA, respectively.

Combustion Engineering, Inc. ("Combustion") is constructing the Detroit Resource Recovery Facility in the City of Detroit with an expected commercial operation date in early 1989. The facility, which will be fueled by municipal solid waste, will produce steam and electricity. As a result of statutory and regulatory provisions requiring public utilities, such as the Company, to offer to purchase electric energy from qualifying cogenerators, the Company entered into a 20-year Energy Purchase Agreement with Combustion for the purchase of steam and electricity. Payments for the first three years of operation are estimated to aggregate $104 million. The Company is seeking to negotiate an addendum to the Energy Purchase Agreement to reduce the rate to be paid for steam.

Contingencies – On March 19, 1986, the Company initiated litigation in the U.S. District Court for the Eastern District of Michigan against Decker Coal Company ("Decker") seeking recovery of approximately $39 million of overpayments of Montana state coal taxes the Company claims were improperly calculated since 1973. On May 9, 1986, Decker filed a counterclaim for breach of contract and demand for trial by jury. On February 5, 1988, the Company and Decker reached an agreement for the settlement of this matter which will result in lower future fuel costs to the Company's customers.

The State of Montana has filed assessments claiming that additional Montana severance and related taxes, plus interest, are due for 1980 through 1984 as a result of costs incurred by the Company resulting from the renegotiation of a contract with Decker. These assessments have been filed against Decker as the producer, and they have been formally protested. The 1980 through 1984 assessments could amount to as much as $13 million plus interest. If Decker is unsuccessful in its protest and appeal, the Company may be required to reimburse Decker for all or a portion of the assessments.

On September 4, 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. 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). On September 25, 1986, 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 November 1985, the National Wildlife Federation filed suit in the United States District Court for the Western District of Michigan against Consumers contending that the Ludington plant had been illegally discharging pollutants without a National Pollutant Discharge Elimination System ("NPDES") permit. (The Company is a 49% co-owner of Ludington.) In an opinion issued on March 31, 1987, Consumers was ordered to apply for a NPDES permit concerning turbine generation water at the plant. In addition, a five-year statute of limitations (from the date of filing of the lawsuit) was found to be applicable in the event civil penalties (claimed at up to $10,000 per day, of which 49% would be applicable to the Company, if levied) were found to be appropriate. Consumers appealed and oral argument on the appeal was held by the United States Court of Appeals for the Sixth Circuit on December 18, 1987. On June 29, 1987, Consumers filed a NPDES permit application which remains pending. Held in abeyance pending the Sixth Circuit appeal is the issue of civil penalties.

In addition to the litigation discussed above, the Company is involved, from time to time, in litigation dealing with the numerous aspects of its business operations. The Company believes that the outcome of all such litigation will not have a material effect on its financial position or results of operations.

Ownership of an operating nuclear generating unit subjects a company to additional risks. The Company is insured as to its interest in Fermi 2 under property damage insurance provided by American Nuclear Insurers ("ANI") and Nuclear Electric Insurance Limited ("NEIL"). Under the ANI insurance policies, $500 million of composite primary coverage and $250 million of excess coverage is provided for decontamination costs, debris removal and repair and/or replacement of property. The Company pays annual premiums for this coverage and is not liable for retrospective assessments. Under the NEIL insurance policy, $775 million of excess property damage insurance is provided. The combined limits provide total property damage insurance of $1.525 billion ($500 million of composite primary coverage, $250 million of excess coverage and $775 million of additional excess coverage). In addition, the Company will obtain coverage for replacement power costs associated with accidental plant outages through NEIL. Under the NEIL coverages, the Company could be liable for maximum retrospective assessments of up to approximately $16 million per year if losses were to exceed accumulated funds available to NEIL.

As required by federal law, the Company maintains public liability insurance for a nuclear incident. The current limit of liability is $160 million of private insurance plus deferred premium charges of $5 million which may be levied against each nuclear unit licensed to operate (but not more than $10 million per year per nuclear unit). On December 31, 1987, there were 111 licensed nuclear units in the United States. Thus, deferred premium charges in the aggregate amount of $555 million could be levied against all owners of licensed nuclear units in the event of a nuclear incident. Accordingly, public liability for a single nuclear incident is currently limited to $715 million ($160 million of private insurance and $555 million of deferred premium charges).

The Company's total liability under federal law is expected to increase as a result of revisions which are scheduled for 1988. The exact amount of liability has not been determined as of December 31, 1987.

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.

See Notes 3 and 4 for a discussion of contingencies related to Fermi 2 and other rate matters.

Note 14

Employes' Retirement Plan and Other Postretirement Benefits

Employes' Retirement Plan – The Company has a trusteed and noncontributory defined benefit retirement plan ("Plan") covering all eligible employes who have completed six months of service. The Plan provides retirement benefits based on the employe'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 and does not expect to make a contribution to the Plan in 1988.

Effective January 1, 1987, the Company implemented the provisions of SFAS No. 87, "Employers' Accounting for Pensions." The effect of this change in accounting was to reduce net pension cost for 1987 by $18.7 million and increase total and per share Earnings for Common Stock by $8.2 million and $0.06, respectively.

Net pension cost included the following components:

	1987
	(Thousands)
Service cost – benefits earned during the period	$ 16,564
Interest cost on projected benefit obligation	54,514
Actual return on Plan assets	(89,651)
Net deferral and amortization:	
Deferral of net gain during current period	28,896
Amortization of unrecognized net asset at date of initial application	(4,507)
Net pension cost	$ 5,816

Assumptions used in determining net pension cost for 1987 include a discount rate of 9%, a rate of increase in future compensation levels of 6% and an expected long-term rate of return on Plan assets of 9%.

Cost to the Company to fund the Plan was $27.0 million and $37.9 million for 1986 and 1985, respectively. Effective January 1, 1986, the discount rate used in determining net pension cost was changed from 7% to 9%, and the rate of increase in future compensation levels was changed from 5% to 7%. Cost to the Company to fund the Plan was reduced by approximately $10.6 million in 1986 as a result of these changes.

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

	December 31, 1987
	(Thousands)
Plan assets at fair value, primarily equity securities	$ 746,383
Less actuarial present value of benefit obligations:	
Accumulated benefit obligation, including vested benefits of $495,378,000	517,920
Increase in future compensation levels	103,433
Projected benefit obligation	621,353
Plan assets in excess of projected benefit obligation	125,030
Unrecognized net asset at date of initial application	(64,837)
Unrecognized net gain	(66,009)
Liability recorded as Other Deferred Credits in the Consolidated Balance Sheet	$ (5,816)

Assumptions used in determining the projected benefit obligation at December 31, 1987 include a discount rate of 9.5% and a rate of increase in future compensation levels of 6%. 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 employes at January 1, 1987.

The actuarial present value of accumulated Plan benefits at December 31, 1986, based upon a 9% discount rate, was $514,181,000, including vested benefits of $491,802,000. Net assets available for Plan benefits at December 31, 1986 were $693,384,000.

Other Postretirement Benefits – The Company provides certain postretirement health care and life insurance benefits for retired employes. Substantially all of the Company's employes 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 employes, 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.

	1987	1986	1985
		(Thousands)	
Cost to the Company of providing health care and life insurance benefits to employes			
Active employes	$38,952	$37,678	$31,227
Retired employes	13,483	10,268	6,308
Total	$52,435	$47,946	$37,535

Note 15

Supplementary Quarterly Financial Information (Unaudited)

	1987 Quarter Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
	(Thousands, except per share amounts)			
Operating Revenues	$708,496	$688,215	$787,157	$672,863
Operating Income	192,365	167,411	217,034	155,828
Net Income	152,558	122,644	172,968	106,804
Earnings for Common Stock	131,443	103,273	154,040	87,978
Earnings Per Share	0.90	0.70	1.05	0.60

	1986 Quarter Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
	(Thousands, except per share amounts)			
Operating Revenues	$748,862	$691,371	$738,061	$690,990
Operating Income	182,250	153,618	176,975	169,703
Net Income	130,097	108,593	127,099	111,306
Earnings for Common Stock	104,443	82,954	102,753	88,142
Earnings Per Share	0.71	0.57	0.70	0.60

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.

General – Improved business and economic conditions existed throughout the Company's service area during the three-year period resulting in higher kilowatthour ("kWh") sales and an increase in total and per share Earnings for Common Stock in each year. Earnings in each year were supported significantly by AFUDC for Fermi 2.

In January 1988, Fermi 2 completed 100 hours of sustained operation at power levels of 90% or above and was declared in commercial operation on January 23, 1988. On January 24, 1988, the Company implemented the first year rate increase under a five-year Fermi 2 rate phase-in plan.

The April 1, 1986 MPSC phase-in rate order, as amended, for Fermi 2 does not provide for the return on and the recovery of all Fermi 2 project costs and operating expenses. (See Note 3.) Therefore, 1988 total and per share Earnings for Common Stock are expected to decline significantly from 1987 levels. Further, the Company expects that a loss will be reported for the first quarter of 1988 as a result of recording the write-offs of disallowed plant costs required by SFAS No. 90, which became applicable to the Company on January 1, 1988. (See Note 4.) The Company has pending before the MPSC a request for increased annual rates in the amount of $298 million for the return on and recovery of $1.7 billion of additional investment in Fermi 2 and for increases in operation and maintenance expenses. While the Company believes that all Fermi 2 costs before the MPSC should be recovered through rates, the Company may be required by SFAS No. 90 to recognize additional net after tax losses of up to $1.3 billion in 1988.

In testimony filed to support the Company's request for increased rates for Fermi 2, the Company advised the MPSC that its financial condition, as measured by earnings coverage of fixed charges, return on common equity, earnings per share, percent of earnings represented by AFUDC, relation of common stock market value to book value, and quality ratings on its senior securities, is still relatively poor. In its filing, the Company noted that it will experience a sharp and continuing decline in earnings, commencing with Fermi 2 commercial operation, until a new rate increase can become effective. The Company filing also states that in view of the severe impact on earnings of Fermi 2 going into service and the write-offs required in 1988 under SFAS No. 90, the Company is facing a serious adverse change in its financial condition which will threaten its ability to finance and its ability to maintain its current common stock dividend.

Consolidated Statement of Income

Operating Revenues – Approximately 98% of the Company's 1987 operating revenues were subject to the jurisdiction of the MPSC, with the remaining 2% subject to the jurisdiction of the FERC.

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

	Estimated Increase (Decrease) From Prior Year		
	1987	1986	1985
	(Millions)		
Rate changes	$(13)	$75	$147
Fuel and net purchased power cost adjustment clause	(68)	(26)	105
Kilowatthour sales	83	64	32
Other-net	(9)	(32)	6
Total	$(13)	$81	$290

Operating revenues include an MPSC authorized annual rate increase of $182.9 million effective with the commercial operation of Belle River Unit No. 1 in August 1984 and an additional $99.3 million annual rate increase effective with the commercial operation of Belle River Unit No. 2 in July 1985. Operating revenues also include an electric rate surcharge ordered by the Ingham County Circuit Court effective in September 1985 in the annual amount of $12.1 million, collected subject to refund.

In 1986 and 1987, operating revenues include lower unit fuel costs and lower net purchased power costs. In addition, the MPSC's September 1, 1987 order reduced the Company's rates by $66 million annually due to the effects of the TRA.

Operating revenues realized from rate changes are dependent upon actual levels of kWh sales and billing demands (requirements for electrical power measured in kilowatts).

Changes in kWh sales were as follows:

	Increase (Decrease) From Prior Year		
	1987	1986	1985
Residential	6.1%	4.1%	(0.7)%
Commercial	5.0	5.2	4.1
Industrial	5.7	3.8	1.8
Total	3.8%	3.7%	2.3%

The increases in commercial and industrial sales were due primarily to improved business and economic conditions throughout the Company's service area, with increased sale to automotive and automotive-related customers. Sales to steel customers decreased in 1985 and 1986, but increased in 1987. The decrease in residential sales in 1985 was due primarily to cooler summer weather. The increases in residential sales in 1986 and 1987 were due to warmer summer weather and an increase in the number of customers. On October 2, 1987, the Company purchased Consumers' retail electric business within the City of Pontiac; therefore, after the purchase, sales to that business formerly included in sales for resale are now included in the residential, commercial and industrial classifications.

Operating Expenses – Operating expenses increased in 1985 and 1986, but decreased in 1987.

Fuel expense increased in 1985 due primarily to increased electric generation and higher costs of coal. The increase in 1985 was partially offset by a reduction in expense for a reclamation settlement with Decker Coal Company. Fuel expense decreased in 1986 due to lower unit fuel costs and lower quantities of steam sold to other companies, partially offset by higher electric generation and a reduction of expense in 1985 for the Decker reclamation settlement. Fuel expense increased in 1987 due primarily to higher electric generation, partially offset by lower unit fuel costs. The average cost per ton of coal consumed for 1985, 1986 and 1987 was $44.34, $41.67 and $38.75, respectively. Coal as a percent of total fuel consumed in 1985, 1986 and 1987 was 98.0%, 97.9% and 94.9%, respectively.

Other power supply expense increased in 1985 due primarily to the purchase of MPPA's capacity and energy entitlements (see Note 5) and lower sales of energy to General Public Utilities Corporation, partially offset by lower purchases of energy from other electric utilities. Other power supply expense decreased in 1986 due primarily to purchases of energy from other electric utilities and MPPA at lower unit costs, partially offset by higher quantities of energy purchased. Other power supply expense decreased in 1987 due primarily to lower purchases of energy from and higher sales of energy to other electric utilities, partially offset by lower unit prices of sales of energy to other electric utilities.

Other operation expense increased in 1985 and 1986 due primarily to higher labor and employe benefit expenses (which for 1986 included non-recurring labor expenses relating to a voluntary separation plan for certain management employes), higher public liability insurance expense and the cost of operating Belle River Unit Nos. 1 and 2, which commenced commercial operation in August 1984 and July 1985, respectively. The 1985 increase also included participation in the Electric Power Research Institute which was suspended effective January 1986, while the 1986 increase also included higher uncollectible expense. Other operation expense decreased in 1987 due primarily to lower labor, pension and uncollectible expenses, partially offset by higher health, life and public liability insurance expenses and the write-off of power plant site studies.

Maintenance expense increased in 1985 and 1986 due primarily to higher labor and material costs and continuing efforts to maintain or improve the availability and efficiency of all generating equipment. These increases also include expenses associated with the commercial operation of Belle River Unit Nos. 1 and 2, while the 1985 increase included the costs of a severe ice storm in January 1985 and the 1986 increase included increased production maintenance at Monroe Power Plant. Maintenance expense decreased in 1987 as a result of the improved availability of the generating equipment due to the additional maintenance expense in 1985 and 1986 (primarily at the Monroe Power Plant), partially offset by higher storm expense.

Depreciation expense increased due to increases in depreciable property including the addition of Belle River Unit Nos. 1 and 2 in 1984 and 1985, respectively.

Taxes other than income taxes increased due to higher Michigan Single Business Tax, higher property taxes in 1985 and higher payroll taxes in 1985 and 1986.

Income taxes decreased in 1985 due to lower deferred taxes on the borrowed funds component of AFUDC resulting from commercial operation of Belle River Unit No. 1, partially offset by an increase in pretax income. Income taxes increased in 1986 due primarily to higher pretax income, partially offset by the accelerated feedback of deferred taxes related to indirect construction costs and the borrowed funds component of AFUDC for Belle River Unit No. 1. 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. (See Notes 1 and 6.)

Other Income and Deductions – Other income and deductions, after income taxes, decreased in 1985 due primarily to a loss on the retirement of the Pennsalt Power Plant and additional expenses associated with a court ordered refund of revenues collected in 1976. Other income and deductions, after income taxes, decreased in 1986 due primarily to a contribution to establish a charitable foundation and the recording of a reserve for loss on an investment. Other income and deductions, after income taxes, increased in 1987 due primarily to higher interest income on temporary investments, a lower contribution in 1987 to the charitable foundation, and the recording in 1986 of a reserve for loss on an investment which was not required in 1987.

Costs of Capital – Dividends on common stock remained approximately the same because of only slight increases in the number of shares outstanding. Dividend requirements on preferred and preference stock decreased due to redemption of outstanding shares. Interest expense on long-term debt increased in 1985 due primarily to the issuance of securities to finance the Company's capital expenditure program and, to a lesser extent, to refund maturing security issues, partially offset by lower interest rates. Interest expense on long-term debt decreased in 1986 due to refunding of maturing securities, early repayment of Belle River Project Financing obligations and lower interest rates (principally the Belle River Project Financing), substantially offset by issuance of new securities. Interest expense on long-term debt increased in 1987 due to the issuance of new securities, partially offset by refunding of maturing securities and early repayment of Belle River Project Financing obligations. Other interest expense decreased in 1985 due primarily to the accrual in 1984 of interest on the court ordered refund of revenues collected in 1976. Other interest expense increased in 1986 due primarily to the accrual of additional interest on the deferred fuel cost refund and on the court ordered refund of revenues collected

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

in 1976. Other interest expense decreased in 1987 due primarily to the recording in 1986 of additional interest on the court ordered refund of revenues collected in 1976 and the deferred fuel cost refund, partially offset by higher short-term borrowings. The average interest rate for short-term borrowings decreased from 8.8% for 1985 to 6.7% for 1986, but increased to 7.1% for 1987.

Earnings for Common Stock and Earnings Per Share – Earnings for Common Stock and earnings per share increased in each year. The increases were due to rate increases authorized by the MPSC in 1984 and 1985, higher kWh sales and higher AFUDC for Fermi 2. Also, in 1987, earnings increased due to a reduction in other operation and maintenance expenses and lower preferred and preference stock dividend requirements.

Earnings for Common Stock include AFUDC, a non-operating non-cash item, consisting of the net cost of borrowed funds used for construction purposes and a reasonable rate on other funds when so used. AFUDC decreased in 1985 and 1986 due to the commercial operation of the Belle River Power Plant, partially offset by additional capital expenditures for Fermi 2. AFUDC increased in 1987 due to additional capital expenditures for Fermi 2. AFUDC amounted to 74%, 65% and 57% of Earnings for Common Stock in 1985, 1986 and 1987, respectively. Accordingly, earnings available for dividends on Common Stock were dependent in part upon sources other than current operating income. (See Note 1.)

Return on average total common shareholders' equity was 13.3%, 14.1% and 16.7% for 1985, 1986 and 1987, respectively, as compared with the 15.0% return authorized by the MPSC from April 1983 to July 1985 and 14.5% thereafter for the electric business (with a further reduction to 14.0%, effective January 24, 1988 following the commercial operation of Fermi 2).

Consolidated Balance Sheet

Other Deferred Debits and Other Current Liabilities decreased due primarily to the payment to the Cooperative of deferred Fermi 2 quarterly purchases upon execution of the December 14, 1987 amendment to the Participation Agreement. (See Note 2.)

Accumulated Deferred Income Taxes recorded as Deferred Debits increased due to the TRA, primarily the deferral of the higher amounts required to be paid as a result of the alternative minimum tax. (See Note 6.)

Liquidity and Capital Resources

Funds generated internally provided 40%, 59% and 70% of capital expenditures (excluding total AFUDC) in 1985, 1986 and 1987, respectively. The higher levels of internal generation of funds result primarily from increases in net income.

Cash requirements for capital expenditures from 1988 to 1992 are estimated to be approximately $1.3 billion (excluding approximately $24 million of AFUDC). In 1988, cash requirements for capital expenditures are estimated at $247 million (excluding $4 million of AFUDC).

Cash requirements for long-term debt maturities and preferred and preference stock redemption and sinking fund requirements are approximately $374 million, $666 million, $103 million, $105 million, and $385 million for 1988, 1989, 1990, 1991 and 1992, respectively.

See Note 2 for information regarding the Company's obligation to purchase in 1990, for approximately $550 million, the Cooperative's remaining ownership interest in Fermi 2.

Pending the receipt of proceeds from long-term debt securities, short-term borrowings are incurred to finance the Company's capital expenditure program, refund maturing long-term debt, redeem securities pursuant to sinking fund requirements, redeem outstanding securities when economic to do so and meet interim cash requirements. The Company had short-term credit arrangements of approximately $430.6 million at December 31, 1987 under which no borrowings were outstanding. Any material disruption in the securities markets or any other circumstance that might significantly delay or restrict the Company's access to long-term financing would increase reliance on short-term borrowings which, depending on the circumstances, may not be sufficient and hence, could adversely affect the Company's financial condition. (See Note 11.)

The Company's objective has been generally to achieve a capital structure with a minimum of approximately 35% common shareholders' equity, 10-15% preferred and preference stock and 50-55% long-term debt. The ratio of common shareholders' equity to total capitalization (excluding amounts of long-term debt and preferred and preference stock due within one year) decreased from 38.2% at December 31, 1986 to 35.9% at December 31, 1987 due primarily to a significant increase in long-term debt, partially offset by the increase in net income in 1987. The ratio of preferred and preference stock to total capitalization decreased from 10.4% at December 31, 1986 to 6.4% at December 31, 1987 due primarily to both early and scheduled redemptions of preferred and preference stock. The ratio of long-term debt to total capitalization increased from 51.4% at December 31, 1986 to 57.7% at December 31, 1987 due primarily to the issuance of additional amounts of long-term debt. The Company's capital structure will be adversely impacted in 1988 due to write-offs of disallowed plant costs required under SFAS No. 90. Fixed income quality ratings of the Company's securities might also be adversely affected, and the Company's ability to obtain long-term funds from the financial markets on favorable terms may be adversely affected. (See Note 4.)

Certain provisions of the TRA impact the public utility industry. Although there is a reduction in the federal income tax rate, the cash requirements for the Company's future income tax liabilities are expected to increase significantly over the next few years principally because of the new alternative minimum tax and a reduction in the amount of available investment tax credits that the Company can currently utilize. (See Notes 3 and 6.)

The MPSC's April 1, 1986 order, as amended, granted $404.2 million (including interest) of rate relief for Fermi 2, to be phased into the Company's rates over a five-year period commencing with commercial operation of the plant. (See Note 3.) Because the order does not provide for the return on and the recovery (from either current customer rates or phase-in revenues) of all the project costs and operating expenses (operation, maintenance, depreciation, property and other taxes) for Fermi 2, future total and per share Earnings for Common Stock will be adversely affected.

See Note 4 for a discussion of the effects on the Company of SFAS Nos. 90 and 92.

See Note 6 for a discussion of SFAS No. 96.

See Notes 5, 7, 12 and 13 for other matters that may affect the Company's liquidity and capital resources.

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. As a result, the Company must rely on the capital markets to provide necessary financial resources to replace utility plant, thus further exposing the Company to the effects of higher inflation in the form of increased financing costs. The Company, under the circumstances, incurs a significant purchasing power loss which is experienced by the common shareholder and can be overcome only through adequate rate relief in the regulatory process. 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. However, the impact on the Company is not expected to be significant, since regulation provides for the current recovery of fuel and purchased and net interchanged power expense through operation of the Power Supply Cost Recovery Clause. Recovery of increases in other operation and maintenance expense is dependent on timely and adequate rate relief in the regulatory process.

Comparative Results of Operations

	1987	1986	1985	1984
Operating Revenues				
Electric	$2,825,910	$2,832,945	$2,738,356	$2,439,835
Steam	30,821	36,339	49,801	58,370
Total Operating Revenues	$2,856,731	$2,869,284	$2,788,157	$2,498,205
Operating Expenses				
Operation				
Fuel	$ 813,376	$ 741,206	$ 785,110	$ 700,789
Other power supply	47,814	191,126	196,918	184,740
Other operation	441,046	459,534	422,133	403,616
Maintenance	245,736	258,655	250,798	203,945
Depreciation	237,325	232,240	218,502	190,420
Taxes other than income	179,308	177,381	175,556	144,471
Income taxes	159,488	126,596	124,939	131,459
Total Operating Expenses	$2,124,093	$2,186,738	$2,173,956	$1,959,446
Operating Income	$ 732,638	$ 682,546	$ 614,201	$ 538,765
Other Income and Deductions				
Allowance for other funds used during construction	$ 136,452	$ 117,069	$ 113,225	$ 130,350
Other income and deductions	(3,435)	(16,869)	(5,240)	1,829
Income taxes	663	8,827	1,642	(112)
Net Other Income and Deductions	$ 133,680	$ 109,027	$ 109,627	$ 132,067
Income Before Interest Charges	$ 866,318	$ 791,573	$ 723,828	$ 670,832
Interest Charges				
Long-term debt	$ 417,474	$ 399,429	$ 401,272	$ 399,448
Amortization of debt discount, premium and expense	3,626	2,721	2,502	2,191
Other	23,459	41,410	15,642	30,592
Allowance for borrowed funds used during construction (credit)	(133,215)	(129,082)	(133,103)	(163,336)
Net Interest Charges	$ 311,344	$ 314,478	$ 286,313	$ 268,895
Net Income	$ 554,974	$ 477,095	$ 437,515	$ 401,937
Preferred and Preference Stock Dividend Requirements	78,240	98,803	103,264	104,159
Earnings for Common Stock	$ 476,734	$ 378,292	$ 334,251	$ 297,778
Common Shares Outstanding—Average	146,729,292	146,643,377	143,183,133	135,230,827
Earnings Per Share	$ 3.25	$ 2.58	$ 2.33	$ 2.20
Dividends Declared Per Share of Common Stock	$ 1.68	$ 1.68	$ 1.68	$ 1.68
Ratio of Earnings to Fixed Charges (SEC Basis)	2.54	2.29	2.28	2.19
Ratio of Earnings to Fixed Charges and Preferred and Preference Stock Dividend Requirements (SEC Basis)	2.09	1.81	1.75	1.67

1983	1982	1981	1980	1979	1978	1977
	(Thousands)					
$2,260,021	$2,078,965	$2,011,217	$1,776,364	$1,667,679	$1,561,296	$1,423,909
49,637	44,289	42,840	36,150	30,832	28,546	27,012
$2,309,658	$2,123,254	$2,054,057	$1,812,514	$1,698,511	$1,589,842	$1,450,921
$ 676,409	$ 718,431	$ 689,165	$ 670,116	$ 647,620	$ 580,869	$ 538,325
128,921	74,654	139,981	107,767	96,502	158,098	108,648
374,164	372,767	333,440	290,566	266,410	235,720	203,300
187,769	170,974	164,978	133,270	128,600	124,804	110,736
171,940	161,430	150,240	141,948	129,644	115,325	102,304
142,743	118,537	117,224	115,520	99,552	91,488	96,597
145,559	96,912	64,388	37,012	54,706	56,686	66,717
$1,827,505	$1,713,705	$1,659,416	$1,496,199	$1,423,034	$1,362,990	$1,226,627
$ 482,153	$ 409,549	$ 394,641	$ 316,315	$ 275,477	$ 226,852	$ 224,294
$ 92,750	$ 47,995	$ 39,398	$ 38,815	$ 38,323	$ 32,273	$ 23,750
7,877	(4,820)	(9,501)	692	3,664	2,371	4,821
(5,487)	1,155	4,771	(669)	(1,554)	(1,228)	(1,700)
$ 95,140	$ 44,330	$ 34,668	$ 38,838	$ 40,433	$ 33,416	$ 26,871
$ 577,293	$ 453,879	$ 429,309	$ 355,153	$ 315,910	$ 260,268	$ 251,165
$ 351,854	$ 331,469	$ 290,045	$ 211,857	$ 167,585	$ 140,288	$ 129,078
2,131	2,006	1,853	1,776	1,644	1,403	1,339
53,088	59,779	37,025	19,662	13,823	5,298	1,959
(194,402)	(194,076)	(133,967)	(66,708)	(43,171)	(33,590)	(25,726)
$ 212,671	$ 199,178	$ 194,956	$ 166,587	$ 139,881	$ 113,399	$ 106,650
$ 364,622	$ 254,701	$ 234,353	$ 188,566	$ 176,029	$ 146,869	$ 144,515
98,614	73,245	57,566	51,037	43,457	38,056	34,095
$ 266,008	$ 181,456	$ 176,787	$ 137,529	$ 132,572	$ 108,813	$ 110,420
120,274,269	103,585,915	87,473,581	78,780,863	69,848,484	61,898,763	55,202,974
$ 2.21	$ 1.75	$ 2.02	$ 1.75	$ 1.90	$ 1.76	$ 2.00
$ 1.68	$ 1.68	$ 1.64	$ 1.60	$ 1.60	$ 1.52	$ 1.4675
2.22	1.85	1.84	1.90	2.17	2.28	2.48
1.67	1.49	1.53	1.53	1.69	1.71	1.85

Statistical Review

	1987	1986	1985	1984
Operating Revenues (Thousands)				
Residential—Electric	$ 905,208	$ 880,205	$ 827,210	$ 758,124
Commercial—Electric	701,275	693,071	651,559	570,082
Industrial—Electric	1,056,906	1,063,551	1,034,374	919,490
Other	193,342	232,457	275,014	250,509
Total	$ 2,856,731	$ 2,869,284	$ 2,788,157	$2,498,205
Sales (Millions of kWh)				
Residential	11,134	10,497	10,077	10,150
Commercial	7,873	7,501	7,130	6,850
Industrial	18,225	17,240	16,613	16,324
Other	2,260	2,807	2,875	2,563
Total	39,492	38,040	36,695	35,887
Electric Customers (Year End)				
Residential	1,697,326	1,664,226	1,642,981	1,629,668
Commercial	155,216	148,987	144,942	142,395
Industrial	2,507	2,384	2,314	2,246
Other	1,919	1,896	1,883	1,885
Total	1,856,968	1,817,493	1,792,120	1,776,194
Average Annual Use Per Residential Customer (kWh)	6,635	6,356	6,165	6,253
Average Annual Bill Per Residential Customer	$539.44	$532.74	$506.06	$467.03
Average Revenue Per kWh				
Residential	8.13¢	8.39¢	8.21¢	7.47¢
Commercial	8.91	9.24	9.14	8.32
Industrial	5.80	6.17	6.23	5.63
Capitalization (Thousands)				
Long-Term Debt	$ 4,693,687	$ 3,656,569	$ 3,770,863	$3,845,272
Preferred/Preference Stock	521,894	747,273	879,497	894,168
Common Shareholders' Equity	2,919,985	2,711,403	2,588,025	2,379,998
Total	$ 8,135,566	$ 7,115,245	$ 7,238,385	$7,119,438
Capitalization (Percent)				
Long-Term Debt	57.7	51.4	52.1	54.0
Preferred/Preference Stock	6.4	10.4	12.1	12.6
Common Shareholders' Equity	35.9	38.2	35.8	33.4
Total	100.0	100.0	100.0	100.0
Common Stock Data				
Earnings Per Share	$3.25	$2.58	$2.33	$2.20
Dividend Paid Per Share	$1.68	$1.68	$1.68	$1.68
Payout	52%	65%	72%	76%
Shares Outstanding—Average	146,729,292	146,643,377	143,183,133	135,230,827
Return on Average Common Equity	16.69%	14.09%	13.31%	12.87%
Book Value Per Share	$19.75	$18.34	$17.47	$16.91
Market Price				
High	$19	$19¾	$17⅞	$16¼
Low	$12½	$15¼	$14	$11½
Miscellaneous Financial Data				
Average Interest Rate on Long-Term Debt	9.5%	9.2%	9.9%	9.9%
Average Dividend Rate on Preferred/Preference Stock	10.7%	11.5%	11.6%	11.6%
Long-Term Debt Obligations and Redeemable Preferred and Preference Stock Outstanding (Thousands)	$ 5,062,913	$ 4,600,917	$ 4,552,755	$4,343,674
Total Assets (Thousands)	$11,158,214	$10,377,125*	$ 9,863,760*	$9,276,614*
Gross Utility Plant (Thousands)	$11,893,418	$11,062,449	$10,466,039	$9,752,346
Net Utility Plant (Thousands)	$ 9,682,875	$ 9,034,716	$ 8,612,890	$8,076,168
Capital Expenditures (Thousands)	$ 709,084	$ 645,196	$ 710,699	$ 938,004
Miscellaneous Operating Data				
System Capability at Year End—MW	9,164	9,070	9,296	8,898
System Capability at Time of Peak—MW	9,020	9,199	9,367	9,271
System Peak Demand—MW	8,427	8,050	7,172	7,350
Reserve Margin at Time of Peak	7.0%	14.3%	30.6%	26.1%
System Load Factor	57.4%	57.9%	63.3%	60.2%
Heat Rate—Btu Per kWh	10,060	10,090	9,990	9,990
Fuel Cost—¢ Per Million Btu	172.9¢	189.2¢	202.0¢	190.6¢
Number of Employes at Year End	11,221	10,967	11,086	11,136

*Net property under capital leases restated (see Note 12).

1983	1982	1981	1980	1979	1978	1977
$ 741,399	$ 676,370	$ 642,301	$ 583,701	$ 524,613	$ 497,988	$ 464,906
513,292	473,498	436,868	382,018	345,576	313,673	291,220
818,660	754,238	763,167	658,051	647,438	611,404	539,469
236,307	219,148	211,721	188,744	180,884	166,777	155,326
$2,309,658	$2,123,254	$2,054,057	$1,812,514	$1,698,511	$1,589,842	$1,450,921
10,256	9,940	10,134	10,394	10,274	10,386	10,385
6,479	6,252	6,310	6,265	6,251	6,073	6,027
15,162	13,751	15,471	15,472	17,960	18,354	17,015
2,402	2,052	2,107	2,104	2,406	2,335	2,287
34,299	31,995	34,022	34,235	36,891	37,148	36,614
1,621,172	1,619,369	1,624,161	1,623,162	1,622,768	1,600,988	1,579,607
140,403	139,376	138,830	136,983	135,788	127,634	118,942
2,253	2,239	2,305	2,293	2,264	2,201	2,126
1,878	1,827	1,821	1,750	1,713	1,675	1,648
1,765,706	1,762,811	1,767,117	1,764,188	1,762,533	1,732,498	1,702,323
6,332	6,133	6,243	6,408	6,402	6,529	6,616
$457.74	$417.33	$395.66	$359.86	$326.92	$313.08	$296.20
7.23¢	6.80¢	6.34¢	5.62¢	5.11¢	4.79¢	4.48¢
7.92	7.57	6.92	6.10	5.53	5.16	4.83
5.40	5.49	4.93	4.25	3.60	3.33	3.01
$3,542,438	$3,218,649	$2,753,978	$2,450,457	$2,069,518	$1,843,036	$1,738,185
907,505	802,423	603,161	591,346	510,748	494,691	448,892
2,195,361	1,872,181	1,675,385	1,514,169	1,387,768	1,241,401	1,118,065
$6,645,304	$5,893,253	$5,032,524	$4,555,972	$3,968,034	$3,579,128	$3,305,142
53.3	54.6	54.7	53.8	52.1	51.5	52.6
13.7	13.6	12.0	13.0	12.9	13.8	13.6
33.0	31.8	33.3	33.2	35.0	34.7	33.8
100.0	100.0	100.0	100.0	100.0	100.0	100.0
$2.21	$1.75	$2.02	$1.75	$1.90	$1.76	$2.00
$1.68	$1.68	$1.62	$1.60	$1.58	$1.52	$1.45
76%	96%	80%	91%	83%	86%	73%
120,274,269	103,585,915	87,473,581	78,780,863	69,848,484	61,898,763	55,202,974
13.03%	10.14%	11.12%	9.47%	10.01%	9.26%	10.50%
$16.63	$16.60	$17.47	$17.85	$18.46	$18.62	$18.67
$16	$13¼	$12⅝	$13⅞	$15⅞	$16⅞	$18
$13	$11	$10⅞	$10	$12¼	$13⅛	$15¼
9.5%	9.5%	9.4%	9.0%	8.5%	7.7%	7.5%
11.6%	11.3%	9.8%	9.5%	9.0%	8.8%	8.6%
$4,027,029	$3,792,982	$3,182,033	$2,809,976	$2,332,200	$2,096,540	$1,888,740
$8,477,218*	$7,645,856	$6,617,903	$5,751,801	$5,156,138	$4,641,602	$4,141,713
$8,845,779	$8,252,570	$7,139,790	$6,213,495	$5,660,023	$5,102,843	$4,481,885
$7,320,570	$6,824,058	$5,842,997	$5,026,245	$4,590,829	$4,140,521	$3,608,509
$1,014,568	$1,135,045	$ 964,261	$ 644,540	$ 591,389	$ 642,676	$ 383,458
8,162	7,762	8,221	8,234	8,964	8,591	8,745
7,810	8,569	8,458	8,531	8,877	8,984	8,751
7,063	6,394	7,171	6,703	6,829	7,312	7,381
10.6%	34.0%	17.9%	27.3%	30.0%	22.9%	18.6%
60.2%	61.7%	58.1%	63.1%	66.2%	62.3%	60.7%
10,040	10,060	10,060	10,140	10,280	10,330	10,360
190.2¢	193.8¢	190.5¢	178.3¢	163.4¢	149.0¢	130.2¢
11,152	11,208	11,024	10,789	10,908	10,729	9,953

Miscellaneous Corporate Data

Market for the Company's Common Equity and Related Shareholder Matters

The Company's Common Stock is listed only on the New York Stock Exchange, which is the principal market for such stock. The following table indicates the reported high and low sales prices of the Company's Common Stock on the Composite Tape and dividends paid per share for each quarterly period during the past two years:

Calendar Quarter	Price Range High	Price Range Low	Dividends Paid Per Share
1987 First	$19	$16½	$0.42
Second	17⅞	15¾	0.42
Third	16⅞	14½	0.42
Fourth	14⅞	12½	0.42
1986 First	19⅜	15⅞	0.42
Second	19¼	15⅞	0.42
Third	18½	16⅞	0.42
Fourth	18½	16	0.42

At December 31, 1987, 146,751,865 shares of the Company's Common Stock were outstanding. These shares were held by a total of 212,833 shareholders.

The amount of future dividends will depend upon the Company's earnings (which in turn are dependent, among other things, upon levels of kilowatthour sales and timely and adequate rate relief), capital requirements, financial condition and other factors.

Distribution of Ownership of Detroit Edison Common Stock *(December 31, 1987)*

Type of Owner:

	Owners	Shares
Individuals	104,433	28,012,915
Joint Accounts	98,594	33,931,139
Trust Accounts	7,665	4,069,296
Nominees	208	66,169,267
Institutions and Foundations	255	151,574
Brokers and Security Dealers	36	510,846
Others	1,642	13,906,828
Total	212,833	146,751,865

State and Country:

	Owners	Shares
Michigan	98,411	43,421,081
Florida	15,788	6,285,124
California	12,899	4,341,115
New York	11,387	60,512,277
Illinois	9,961	10,462,310
Ohio	7,442	2,211,952
44 Other States	56,199	19,241,649
Foreign Countries	746	276,357
Total	212,833	146,751,865

Annual Meeting of Shareholders

The 1988 Annual Meeting of Shareholders will be held at 10 a.m. Detroit time Monday, April 25, at the Henry and Edsel Ford Auditorium, Detroit. Shareholders will be asked to elect members of the Board of Directors, to ratify the appointment of Price Waterhouse as independent accountants for the Company, and to amend the Company's Articles of Incorporation and By-Laws to limit certain liabilities of the Directors of the Company.

At the 1987 meeting, on April 27, 1987, 14 members were re-elected to the Board of Directors for one-year terms.

Director Changes

Charles T. Fisher III, a director since 1961, did not stand for re-election to the Board at the 1987 Annual Meeting. Terence E. Adderley, President and Chief Executive Officer, Kelly Services, Inc., was elected a director by the Board of Directors effective May 18, 1987.

Edward J. Giblin, a director since 1976, will not stand for re-election at the 1988 Annual Meeting because of the By-law age restriction.

Charles M. Heidel, President, and a director since 1980, has chosen not to stand for re-election at the 1988 Annual Meeting due to his forthcoming retirement from Detroit Edison on May 1, 1988, after more than 40 years of service.

Officer Changes

Lloyd W. Coombe, General Auditor, passed away on March 13, 1987. Robert H. Naftaly was elected Vice President and General Auditor effective July 1, 1987.

Claybourne Mitchell, Jr., Vice President-Planning, Research and Environmental Protection, retired on February 17, 1988. Harry Tauber, Group Vice President, will retire from the Company effective May 1, 1988.

Corporate Address

The Detroit Edison Company
2000 Second Avenue, Detroit, Michigan 48226
Telephone: (313) 237-8000

Independent Accountants

Price Waterhouse
200 Renaissance Center, Detroit, Michigan 48243

Form 10-K

Copies of Form 10-K, Securities and Exchange Commission Annual Report, are available.
Requests should be directed to:
Kathryn L. Westman
Secretary
The Detroit Edison Company
2000 Second Avenue, Detroit, Michigan 48226

Transfer Agents

Mellon Securities Trust Company, New York
67 Broad Street, New York, New York 10004

The Detroit Edison Company
2000 Second Avenue, Detroit, Michigan 48226
Charles A. Babcock
Ronald J. Gdowski
Elaine M. Godfrey
Sophia J. Koziatek
Kathryn L. Westman

Registrars of Stock

Mellon Securities Trust Company, New York
67 Broad Street, New York, New York 10004
(Preferred, Preference and Common)

Comerica Bank-Detroit
211 West Fort Street, Detroit, Michigan 48231
(Common)

National Bank of Detroit
611 Woodward Avenue, Detroit, Michigan 48232
(Preferred and Preference)

Common Stock

Listed on the New York Stock Exchange
Symbol – DTE

Directors and Officers

Board of Directors

Terence E. Adderley	President and Chief Executive Officer, Kelly Services, Inc. (A provider of temporary help, business services and home care services)
Wendell W. Anderson, Jr.	Chairman of the Board and Chief Executive Officer, Bundy Corporation (Manufacturer of steel tubing, flexible hose and engineered plastic products)
Lillian Bauder	President, Cranbrook Educational Community
David Bing	Chairman and Chief Executive Officer, Bing Steel, Inc. (A steel service center)
David M. Gates	Professor of Botany, University of Michigan
Edward J. Giblin	Retired Industrialist
Ernest L. Grove, Jr.	Vice Chairman of the Board and Chief Financial Officer, The Detroit Edison Company
Charles M. Heidel	President and Chief Operating Officer, The Detroit Edison Company
Patricia Shontz Longe	Economist; Senior Partner, Imeco-Longe Company (An economic and investment consulting firm)
Walter J. McCarthy, Jr.	Chairman of the Board and Chief Executive Officer, The Detroit Edison Company
Frank Merriman	Dairy Farmer
Dean E. Richardson	Chairman of the Board and President, Manufacturers National Bank of Detroit
Louis H. Roddis, Jr.	Consulting Engineer
Alan E. Schwartz	Senior Partner, Honigman Miller Schwartz and Cohn (Attorneys at law)
Otis M. Smith	Retired Vice President, General Motors Corporation

Committees of the Board of Directors

Audit
Edward J. Giblin*
Otis M. Smith**
Lillian Bauder
David Bing
Patricia Shontz Longe
Dean E. Richardson

Executive
Walter J. McCarthy, Jr.*
Lillian Bauder
Ernest L. Grove, Jr.
Charles M. Heidel
Frank Merriman
Dean E. Richardson
Alan E. Schwartz

Nominating
Alan E. Schwartz*
Wendell W. Anderson, Jr.
David M. Gates
Charles M. Heidel
Patricia Shontz Longe
Frank Merriman
Otis M. Smith

Organization and Compensation
Wendell W. Anderson, Jr.*
Edward J. Giblin**
Terence E. Adderley
Frank Merriman
Dean E. Richardson
Alan E. Schwartz

Energy Resources Planning
Frank Merriman*
Wendell W. Anderson, Jr.**
David Bing
David M. Gates
Charles M. Heidel
Louis H. Roddis, Jr.

Finance
Dean E. Richardson*
Patricia Shontz Longe**
Terence E. Adderley
Lillian Bauder
Edward J. Giblin
Ernest L. Grove, Jr.
Alan E. Schwartz

Nuclear Review
Louis H. Roddis, Jr.*
David M. Gates**
Patricia Shontz Longe
Frank Merriman

Retirement Fund Review
Patricia Shontz Longe*
Wendell W. Anderson, Jr.**
David M. Gates
Edward J. Giblin
Ernest L. Grove, Jr.
Otis M. Smith

*Chairman
**Vice Chairman

Officers

Walter J. McCarthy, Jr.	Chairman of the Board and Chief Executive Officer
Charles M. Heidel	President and Chief Operating Officer
Ernest L. Grove, Jr.	Vice Chairman of the Board and Chief Financial Officer
John E. Lobbia	Executive Vice President
Leon S. Cohan	Senior Vice President and General Counsel
Burkhard H. Schneider	Group Vice President
B. Ralph Sylvia	Group Vice President
Harry Tauber	Group Vice President
Frank E. Agosti	Vice President – Nuclear Engineering and Services
Malcolm G. Dade, Jr.	Vice President – Community and Governmental Affairs
Konald W. Gresens	Vice President and Controller
Willard R. Holland	Vice President – Operations
M. Jane Kay	Vice President – Administration
J. Philip Lenihan	Vice President – Marketing and Customer Relations
Claybourne Mitchell, Jr.	Vice President – Planning, Research and Environmental Protection
Robert H. Naftaly	Vice President and General Auditor
James B. Oliver	Vice President – Employe Relations
William S. Orser	Vice President – Nuclear Operations
Saul J. Waldman	Vice President – Public Affairs
Kathryn L. Westman	Secretary
Leslie L. Loomans	Treasurer

Detroit Edison
2000 Second Avenue
Detroit, Michigan 48226

A good part of your life.