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A N N U A L  
R E P O R T

*Power for Progress in Southeastern Michigan*

**Detroit  
Edison**

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# Southeastern Michigan . . . the shape of progress

Southeastern Michigan is a state of progress. It is a state of opportunity. It is a state of growth. It is a state of innovation. It is a state of leadership. It is a state of excellence. It is a state of achievement. It is a state of success. It is a state of progress.

Only one advantage, the fact that it is a state of progress, has made it so successful. It is a state of progress. It is a state of opportunity. It is a state of growth. It is a state of innovation. It is a state of leadership. It is a state of excellence. It is a state of achievement. It is a state of success. It is a state of progress.

Another is the fact that it is a state of progress. It is a state of opportunity. It is a state of growth. It is a state of innovation. It is a state of leadership. It is a state of excellence. It is a state of achievement. It is a state of success. It is a state of progress.

The fact that it is a state of progress is what has made it so successful. It is a state of opportunity. It is a state of growth. It is a state of innovation. It is a state of leadership. It is a state of excellence. It is a state of achievement. It is a state of success. It is a state of progress.

It is a state of progress. It is a state of opportunity. It is a state of growth. It is a state of innovation. It is a state of leadership. It is a state of excellence. It is a state of achievement. It is a state of success. It is a state of progress.

The report, titled "Power in Progress," shows that Southeastern Michigan has already made a considerable amount of progress. It is a state of progress. It is a state of opportunity. It is a state of growth. It is a state of innovation. It is a state of leadership. It is a state of excellence. It is a state of achievement. It is a state of success. It is a state of progress.



The Company's six geographic divisions (with headquarters highlighted above) serve more than half the state's population in our 7,600-square-mile service area.

Detroit Edison and others have helped thousands of businesses - many headquartered in other states or countries - locate or expand in Southeastern Michigan. Following is a short cross-section of the hundreds of developments - large and small - announced in 1985 and their impact on jobs:

- Ogihara of Japan, auto supply facility in Howell, 280 jobs.
- Lionel, model-train plant in Chesterfield Township, 300 jobs.
- Electronic Data Systems of Texas, major operation in Auburn Hills, 8,600 jobs.
- Gratiot Center Associates, shopping center in Roseville, 350 jobs.
- GMF Robotics, headquarters in Troy, 600 jobs now, 2,000 by 1990.
- Mazda of Japan, auto assembly plant in Flat Rock, 3,500 jobs.
- Gilreath Manufacturing, expanded injection-molding plant in Detroit, 120 jobs.
- Advanced Friction Material, auto parts plant in Sterling Heights, 150 jobs.
- Republic Airlines, regional ticket center in Livonia, 500 jobs.
- Irvine Industries, industrial park near Rochester, 150 jobs.
- Kaumagraph Flint of Delaware, specialty printing plant in Millington, 75 jobs.
- Port Huron Molded Products, injection-molding plant, 50 jobs.
- Chemseco of Kansas, molded plastics facility in Pinckney, 30 jobs.
- Techni-Moules of France, high-tech center in Detroit, 17 jobs.

## FINANCIAL HIGHLIGHTS

	1985	1984	Percent Increase (Decrease)
Operating Revenues	\$2,788,157,000	\$2,498,205,000	11.6
Earnings for Common Stock	\$334,251,000	\$297,778,000	12.2
Earnings per Common Share	\$2.33	\$2.20	5.9
Common Shares Outstanding (Average)	143,183,133	135,230,827	5.9
Dividends Paid per Share	\$1.68	\$1.68	—
Gross Utility Plant	\$10,466,039,000	\$9,752,346,000	7.3
Capitalization	\$7,238,385,000	\$7,119,438,000	1.7
Sales of Electricity (kWh-Thousands)	36,695,000	35,887,000	2.3
System Capability at Time of Peak (kW)	9,367,000	9,271,000	1.0
System Peak Demand (kW)	7,172,000	7,350,000	(2.4)
Electric Customers at Year End	1,792,000	1,776,000	0.9

## TABLE OF CONTENTS

Page 1 . . . <b>Financial Highlights</b>	Page 16 . . . <b>Detroit Edison Is a Key Player</b> – The Company is playing a major role in helping build a stronger service area.
Page 2 . . . <b>Letter to Shareholders</b>	Page 20 . . . <b>Financial Review</b> – Higher sales, reduced capital spending, tighter cost controls aid Company earnings.
Page 4 . . . <b>People, Power, Progress</b> – The keys to Southeastern Michigan's future.	Page 23 . . . <b>Financial Statements</b>
Page 7 . . . <b>It's a Team Effort</b> – Many hands help turn the wheels of progress.	Page 48 . . . <b>Miscellaneous Corporate Data</b>
Page 12 . . . <b>Brick, Mortar, Mind and Muscle</b> – Many resources contribute to revitaliz- ing the area.	Page 49 . . . <b>Directors and Officers</b>

# To our fellow shareholders:

February 24, 1986

The year 1985 was one of both trial and triumph for your Company as major milestones, culminating years of patience and hard work, were achieved, and as your management prepared for some of the challenging uncertainties that lie ahead in the next few years.

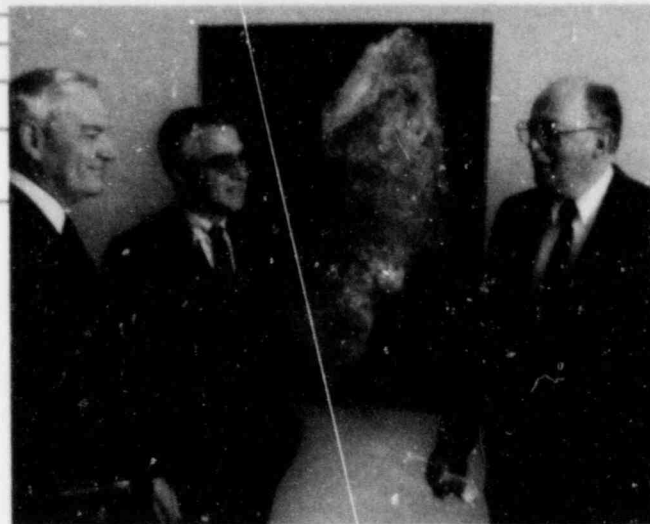
Earnings for common stock gained for the ninth straight year, totaling a record \$334.3 million, and per-share earnings of \$2.33 also were the highest on record. Your management is proud of the long record of year-to-year financial gains shown in Comparative Results of Operations and the statistical tables on pages 44 to 47 of this report. They demonstrate that from 1975, the earliest year on the tables, common-stock earnings have increased 464 percent — from \$59.3 million in 1975 to the \$334.3 million in 1985. Per-share earnings are up 89 percent, from \$1.23 in 1975 to the \$2.33 for 1985.

**Your Company further strengthened its electric generating system** by placing the second unit of its Belle River Power Plant in commercial operation and by obtaining a full-power license for its Fermi 2 Power Plant. These milestones virtually closed an \$11-billion, post-World War II construction and modernization program that will give our service area more than 10 million kilowatts of power to generate further revitalization of the area's economy.

Record Company revenues of \$2.8 billion and the highest kilowatthour sales since 1979 reflected continuing resurgence of the service-area economy and suggested the theme for this report — "Power for Progress in Southeastern Michigan." But this is more than a theme of a report; it is the embodiment of our commitment to the area and its people. We have played a significant role in the progress to date, and will continue to do even more to ensure the area's growth. Detroit Edison will do its part with restructured marketing and customer relations programs designed to sell more electricity and to improve customer services.

**The achievements of the past year have been satisfying** and reflect the will and spirit of Detroit Edison men and women. That same resolve will be needed in the coming years.

Our concern now is the extent to which recent earnings levels can be maintained in the years immediately ahead because of the delay in getting the Fermi 2 Power Plant into commercial operation, the costs associated with that delay and the need for increased rates to cover the plant invest-



Flanking a satellite photograph of Detroit Edison's service area are, left to right, Charles M. Heidel, president and chief operating officer; Ernest L. Grove, Jr., vice chairman of the board and chief financial officer; and Walter J. McCarthy, Jr., chairman of the board and chief executive officer.

ment. We also must seriously consider the potential adverse impact of a proposed new accounting standard pertaining to our industry.

During our long years of building new power plants and other facilities, earnings have been supported significantly by a non-cash accounting credit to the income statement called AFUDC, or Allowance for Funds Used During Construction. AFUDC, an accounting principle unique to the utility industry, is discussed in Note 1 in the Notes to Consolidated Financial Statements on page 31. In recent years, AFUDC has ranged from a high of 133.4 percent of common-stock earnings in 1982 to a six-year low of 73.7 percent in 1985.

**Detroit Edison is in a process of transition**, from a company with a large construction program to one which is almost totally an operating company. Once Fermi 2, the last of our major postwar projects, is in commercial operation, AFUDC will virtually cease as a credit to income. Maintenance of earnings thus will depend not only on maintaining and increasing sales, but also on our ability to control expenses and to receive rate adjustments sufficient to reflect the cost of building and operating the new facilities.

The outlook for adequate rate increases is not good. We have had to initiate court action for what we believe should be more equitable treatment of our Belle River plant, and an administrative law judge for the Michigan Public Service Commission (MPSC) has recommended that some of what we requested for Fermi 2 be disallowed. Additionally, our request for rate increases for Fermi 2 does not include recovery of the plant costs in excess of those included in the case filed with the MPSC in July 1983. It appears that it will be necessary to go to the Commission with a request for additional rate adjustments for Fermi 2. We also have taken issue with a recommendation of the administrative

law judge that the revenue increase for Fermi 2 be phased in over a longer period than we think is necessary. (See details on page 22.)

**Until Fermi 2 is considered in commercial operation by the MPSC**, of course, we can receive no rate adjustment for the plant. The transition from constructing a nuclear plant to operating one can be difficult and frustrating, as many companies have found. The regulatory and public scrutiny can be intense as testing at various power levels is performed. In extended testing preparatory to commercial operation, Fermi 2 encountered a series of equipment and procedural problems which, while not unusual in the industry and with such complex mechanisms, nevertheless frustrated hopes to begin commercial operation of the plant first in late 1985 and then in early 1986. We cannot determine with certainty a commercial operation date for Fermi 2 until the Company and the Nuclear Regulatory Commission (NRC) reach agreement on resuming operations at the plant.

We have been working diligently on our own and with the NRC to resolve problems at the plant, and on January 29 sent the Commission a detailed description of actions being taken to ensure the plant's safe and efficient operation, which is the top priority of your management and Company.

As one step, we have formed an Independent Overview Committee to review Fermi 2 operations, critique plant management and advise us on a program to raise Fermi 2 to the level of power needed to achieve commercial operation (the MPSC may determine what that level must be). The overview committee is made up of six recognized outside consultants on nuclear energy, and already has made initial recommendations for improvements at the plant. The committee will continue to consult with your management for an indefinite period.

**Another development which concerns your management**, in addition to Fermi 2 and the earnings outlook, is a recommendation by the Financial Accounting Standards Board (FASB) for an amended standard governing phased-in rate increases, abandonments of facilities and disallowances of certain plant costs. The proposed standard is discussed in detail in Note 3 on pages 33 and 34. Adoption of the new standard could seriously impact your Company's retained earnings and ability to pay dividends and borrow

money. We strongly disagree with the proposal and are working with the industry to document our objections. The new standard, which would apply to regulated enterprises including electric utilities, would not take effect until 1987, but we must view it as a possible contingency in our planning.

One result of the foregoing and other concerns is the strongest marketing program your Company can mount to meet the growing challenge of an increasingly competitive energy market.

Another result is one of the most extensive cost-reduction programs in your Company's history. To keep Detroit Edison competitive, we must make it more "lean and trim" than ever. To that end, we have instituted cuts of one kind or another in virtually every phase of our operations. Every reasonable economy is being effected, short of hampering the Company's ability to operate its facilities safely and efficiently and to provide needed customer services.

As one example, Detroit Edison in late January offered a voluntary separation program to certain management employees who will be 58 years of age or older by the end of 1986 and were willing to leave the Company by the end of March 1986. The program, expected to involve several hundred persons, was designed in part to reduce the number of supervisory levels and personnel without jeopardizing management efficiency.

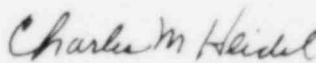
**Virtual completion of our successful \$1.1-billion facilities expansion and modernization program** marks the end of one era for Detroit Edison and the beginning of another. During the long postwar construction period, earnings were supported by AFUDC and other factors. With that protection about to be removed, we must have adequate rates to cover the large investments made to ensure a sufficient supply of electricity for our customers and to firmly establish Detroit Edison as a customer-oriented, market-driven company providing good products and good services at fair prices.

We have spent billions of dollars on brick and mortar to ensure adequate supplies of power for a growing and heavily industrialized economy. Now our resources must be directed more than ever to satisfying our customers, selling our products and earning a fair return for our investors.

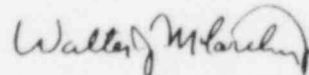
We are determined that they will be.



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

# People, Power, Progress

**T**wo developments have dominated the past year for Detroit Edison and Southeastern Michigan: virtual completion of the Company's massive post-World War II program to modernize and expand its generating system, and continued business resurgence resulting from an improved economy generally, but more specifically from aggressive economic development efforts by the Company and many other organizations, both public and private, throughout the area.

It is these developments – and the prospects for additional “quality-of-life” gains – that are reflected in the theme “Power for Progress in Southeastern Michigan.” And, People, Power and Progress are the three basic elements of that theme which apply

*(continued on page 6)*







**In the Belle River Power Plant's ultra-modern control room, supervising operator Robert Johnson helps keep the plant running at peak efficiency.**

both to this report and to the region.

In Detroit Edison's view, the well-being of the five million people it serves will depend on how people power and electric power are harnessed to bring about progress in the months and years ahead.

People -- Detroit Edison's customers, employees and shareholders -- are the lifeblood of the area. They contribute to progress -- in business and industry, on the farm, and in homes, schools, churches, workshops, laboratories and government offices.

**The electric power the Company provides is essential** to every facet of life in the area -- in offices and homes, sports arenas and hospitals, factories and schools. It's needed to run farms and dentists' drills, illuminate playgrounds and shopping centers, and power life-support systems and stereo music systems.

As later sections of this report will document, important progress has been made but much more is needed. However, advances can be sustained only with continuing teamwork between the public and private sectors, and among the many disciplines that comprise our redeveloping economy and contribute to our quality of life.

Detroit Edison takes seriously its obligation to provide elec-

tricity -- literally the "power for progress by people" -- in the coming years.

That's why we have spent nearly \$11 billion in the postwar years to build a modern electric generating system using a balanced variety of fuels, and a state-of-the-art transmission and control system to deliver electricity, minimize breakdowns, and ensure reserve power when needed. Adequate generation, transmission and distribution facilities are critical to meeting the power needs of the area, as well as producing the revenues required for a fair return on shareholder investment.

Both the area and our Company still have hurdles to surmount. Despite a steady gain in jobs, Southeastern Michigan's unemployment rate continues to be above the national average. Moreover, much work remains to be done to improve the business climate.

**But good things are happening**, and will continue to happen. Many minds have been set to solving the remaining problems, and we are confident that answers will be found through a constructive combination of People, Power and Progress.



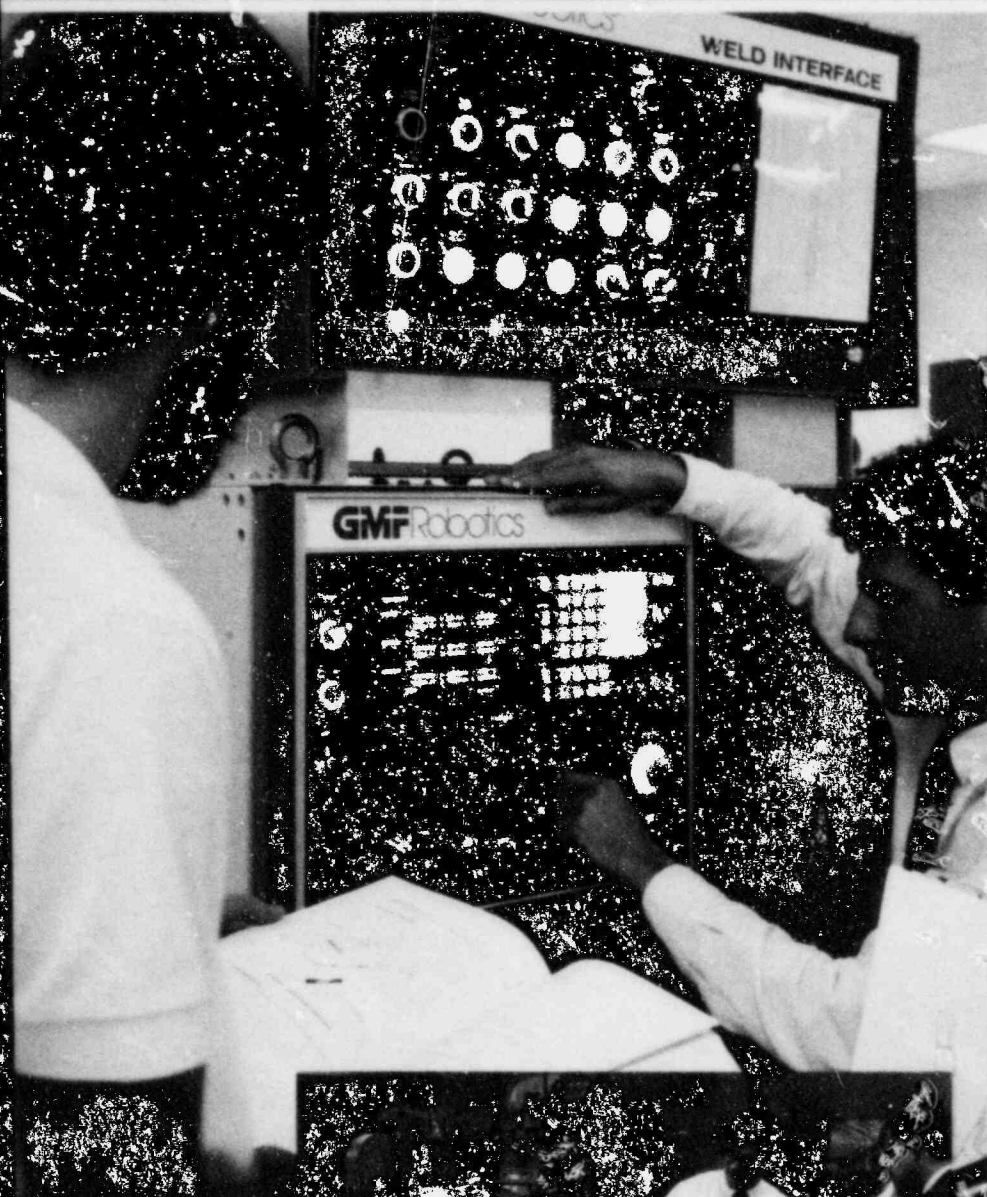
## It's a team effort

In 1982, the United States and particularly Michigan had been buffeted for almost four years by a major recession. The end of that year saw unemployment at 10.5 percent nationally, but at 17.3 percent in Michigan and nearly 18 percent in the south-eastern part of the state served by Detroit Edison.

An earlier recession, in 1974-75, had resulted largely from the quadrupling of OPEC oil prices, the removal of wage and price controls and increasing world competition for scarce commodities. Recovery was accompanied by severe inflation, leading to a government-orchestrated reaction - tighter money and much higher interest rates. The result, in 1979, was the start of another deep recession, which once again was felt most severely in the industrial heartland, particularly Michigan.

The 1979-82 downturn, in fact, was devastating for Michigan. A nose dive in auto production led to steep declines in steel, construction and virtually all other business activity. Michigan was so strapped financially it had to arrange loan guarantees from Japanese banks to pay its bills. Local governments also were in dire straits.

For Detroit Edison, the demand for electricity slipped to its lowest level since 1971. Three major generating units already had been cancelled, and some observers questioned the need



High-tech and traditional manufacturing provide a new industrial/economic mix for Michigan. In top photo, a GMF Robotics unit is being programmed. In bottom photo, Thumb Division

economic development consultant Robert Sheehy (far right) and industrial marketing engineer Joseph Bauerschmidt (second from right) visit personnel supervisor Donald Voyles at U.S. Manufacturing's new plant in Bad Axe.



**Key support services for the robotics industry include instruction in robotics theory at Macomb County Community College (above) and research, development and testing at the Industrial Technology Institute in Ann Arbor (below).**

for three others on which construction was well under way.

Clearly, changes were needed in Michigan — not just short-term cyclical improvements, but basic structural changes in the state's economic and social fabric.

**Unprecedented teamwork was called for.** Groups representing area business, labor, government, education and agriculture got together, rolled up their sleeves and made some hard decisions.

They knew the state and area had to diversify their economies — mainly to get away from such heavy reliance on the auto industry. They had to craft and pursue vigorous economic development programs to achieve the diversification. They had to improve the business climate, both to attract new enterprises and to retain existing ones threatening to flee to climates perceived to be more hospitable — weather-wise, economically and politically. The changes had to be far-reaching, and many would have to share the responsibility for carrying them out.

Every major sector participated. Close and effective cooperation took place at the

**Marketing service representative William Rounne inspects roses grown at the Blue Water Greenhouse in Mount Clemens with the assistance of "daylight-producing" high-pressure sodium lamps. Use of the lamps could give local growers a competitive edge over foreign sources.**

state, regional and local levels to bring about needed changes and help reverse Michigan's "rust-belt/frost-belt" image.

These changes would be important to the continued economic well-being of Detroit Edison and its shareholders. That's why the Company participated so extensively in state and regional "comeback" efforts.

**The results have been impressive,** and all have contributed to a major economic rebound and, many believe, needed long-term structural and business-climate improvements.

- Michigan, once \$1.7 billion in debt, has balanced its budget and, in fact, achieved a healthy surplus for the first time since 1975. An important factor in this recovery was a program recommended to the governor-elect in late 1982 by the Michigan Financial Crisis Council headed by Walter J. McCarthy, Jr., chairman and chief executive officer of Detroit Edison.

- The state's credit rating, once the worst among the 50 states, is now among the best.





Lionel model trains are back on track in Michigan after a brief production stay in Mexico. Macomb Division economic development consultant Russell Clark (top left) is trackside with Lionel marketing director John Brady.

- Michigan income taxes, raised in 1983 to help ease the financial crunch, have been cut back once and are expected to be cut again. The state also has reduced the Single Business Tax for small low- and no-profit businesses and has committed to look for ways to provide general property-tax relief.

- Some of the money earned through the temporary income tax boost has been used to provide record increases in support of higher education – clearly a critical resource for the advanced research, training and knowledge needed to propel the state and area to new technological and economic heights.

- Largely through the efforts of the Economic Alliance for Michigan, a coalition of business and labor leaders which Detroit Edison helped found in 1982, and prompt action by the Michigan Legislature, projected costs for state unemployment compensation have been reduced significantly. Efforts also are continuing to improve the state workers' compensation system.

- Since the end of 1982, unemployment rates have dropped more sharply for the state and Southeastern Michigan than for

the country as a whole. In December 1985, Michigan's unemployment rate was 7.6 percent – its lowest level since 1979 – compared with a national figure of 6.7 percent. However, the improvement for Michigan since December 1982 is 9.7 percentage points, compared with only 3.8 percentage points for the country as a whole. The numbers of people working in December 1985 were at record levels for both Michigan and the United States.

- The state has eliminated 29 percent of all regulations imposed on business by the Departments of Commerce, Labor and Natural Resources, and adopted measures aimed at halting, and even lowering, the rapidly rising cost of health care for businesses by stimulating competition among insurance providers. It also has deregulated state security laws and updated and streamlined franchise laws to make Michigan more competitive.

The driving force in bringing about these much-needed changes was the recognition by business and labor – and action by a receptive state government – that “business as usual”

was a pattern of the past and that dramatic steps were needed if the state were ever to regain its place as a leader in commerce and quality of life.

Among literally hundreds of pieces of evidence that industry still can thrive in Michigan are the facts that the state in 1984 led the nation in manufacturing plant construction, added more new manufacturing jobs than all but three other states, and shared with California the U. S. lead in new industrial investment and industrial research and development expenditures.

**One particularly strong force in the area's economic rejuvenation** has been the Greater Detroit/Southeast Michigan Business Attraction and Expansion Council (BAEC), which Detroit Edison helped found in 1981 and helps lead today. Ernest L. Grove, Jr., vice chairman and chief financial officer of Detroit Edison, is chairman of the Greater Detroit Chamber of Commerce, another BAEC charter member, and was instrumental in the Council's development of a broad strategy for economic improvement and the implementation now in progress. By late 1985, the Council

Electricity helps keep Michigan a winter wonderland even at night.



**The "Focus: HOPE" Machinists Training Program, supervised by Father William T. Cunningham, is helping provide disadvantaged Michigan workers with new job skills.**



was able to point to this area's gains outstripping the national averages for car and truck production and for construction, both residential and nonresidential – definitive signs of turnaround and recovery.

**Also reflecting the state's improved hospitality to business,** a record 12,000 new companies are estimated to have been formed in Southeastern Michigan in 1985 for a three-year total of 34,050. As a result of a new, streamlined Michigan franchise law adopted 18 months ago, the number of new franchises has nearly doubled, including a record 272 registrations in 1985.

The fundamental structural changes needed in the area's economic makeup are taking place. Although Southeastern Michigan remains one of the world's leading manufacturing centers, local industry is shifting away from cranking products with routine, standardized processes that are ripe for raiding by states and countries offering lower wages. The sophisticated products of today and tomorrow are more dependent than ever on the area's highly skilled labor force and the technologies developed with the help of its many outstanding universities.

Southeastern Michigan is the catalyst for the accelerating transition from standard

manufacturing to high technology. In fact, this area, which just a short time ago was pronounced dead because of its perceived reliance on less-skilled labor, is now recognized as the robotics center of the world. For example, Ann Arbor's Industrial Technology Institute, founded in 1982, works as part of an innovative coalition of industry, education, government and labor representatives dedicated exclusively to advancing computer-integrated manufacturing and transforming the Ann Arbor area into the nation's "Automation Alley."

Other developmental organizations – in all of which Detroit Edison is active – include the Detroit Metropolitan Center for High Technology, the Governor's Commission on Jobs and Economic Development, the Detroit Economic Growth Corporation chaired by Walter J. McCarthy, Jr., the Michigan High Technology Task Force and the Governor's Executive Corps.

Still other steps have been taken to stimulate research and business progress. A new Michigan Research Excellence and Economic Development Fund underwrites projects at Michigan universities, and the Michigan Technology Deployment Service lends technical assistance to small- and medium-

**First-class hotel accommodations support the state's third-largest industry--tourism.**



sized manufacturers seeking to modernize their facilities.

**Key to keeping Michigan in the forefront** of emerging technology is a new partnership of labor and management in which today's workers not only operate mechanical systems, but also team up with management to introduce new techniques and solve problems. Traditional labor-management confrontations are being replaced increasingly by a system fostered by shared responsibility and trust.

Michigan's labor force is developing new skills, both through state funding and through cooperative training programs involving business, labor, agriculture and academia. The federal Job Training Partnership Act provides funds for private-sector job training and placement; Michigan's Business and Industrial Training Program offers free training assistance to new or expanding businesses;

and the state's Quickstart program helps make programs at vocational schools and community colleges more affordable to business.

The state also is making more seed money available to business. The Michigan Strategic Fund will provide nearly \$80 million in venture capital to support entrepreneur start-ups and to help small- to medium-sized businesses expand and conduct research and development. Additionally, Michigan is one of the few states to invest part of its pension fund -- nearly \$150 million -- in new businesses.

Agriculture, the state's second-largest industry -- the first is automobile manufacturing -- maintains its strong position in the economy. Food processing and forest products are among the "target" industries identified for special redevelopment efforts by the Governor's Commission on Jobs and Economic Development.

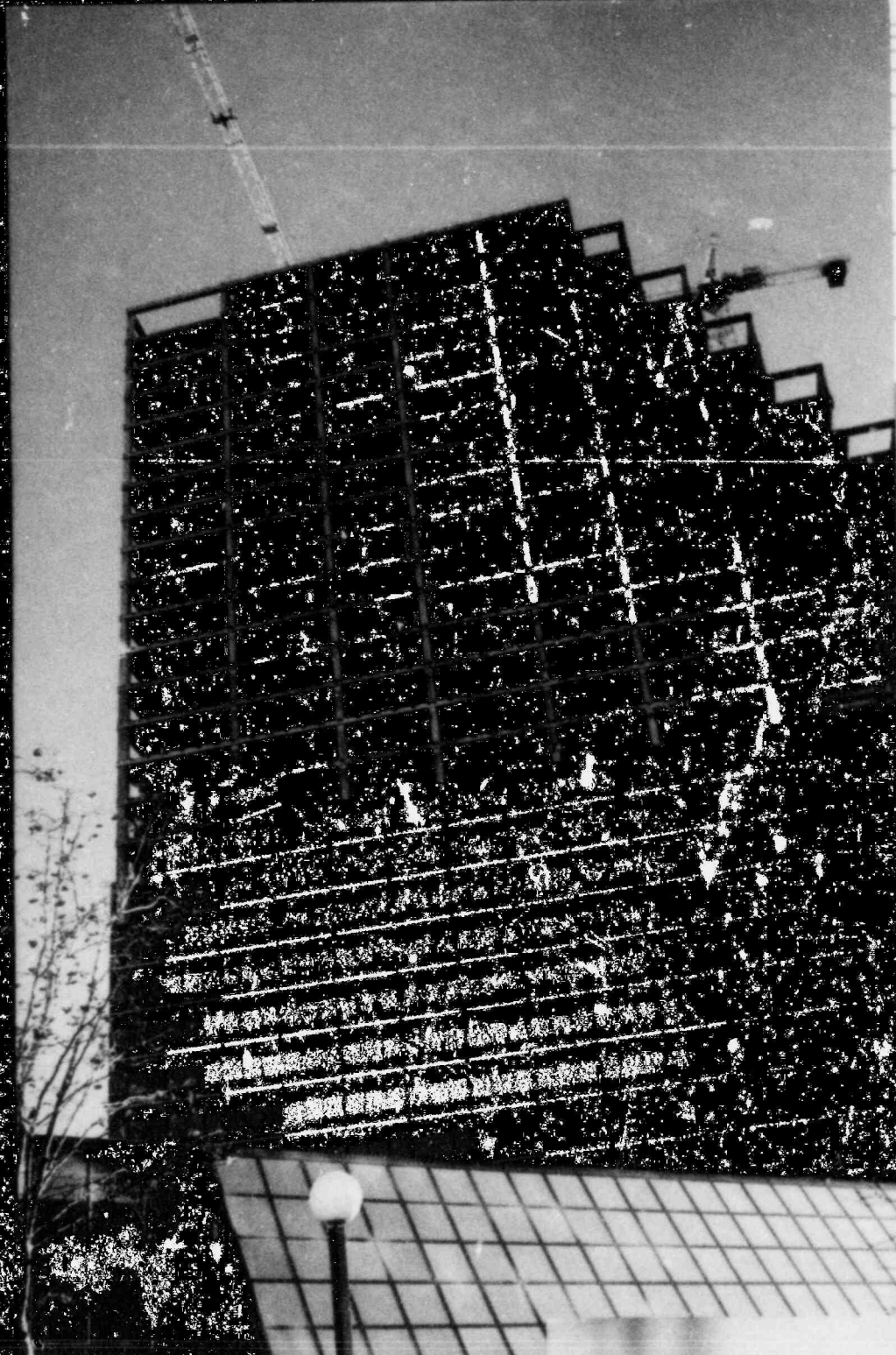
The state's third-largest industry -- tourism -- also continues to grow significantly. In 1984, visitors spent 28 percent more money in Southeastern Michigan than in 1980. Attendance at metropolitan Detroit conventions grew by more than 36 percent in the same period.

**Efforts to strengthen area business** are an important part of the job assigned to Detroit Edison's extensive economic development program -- the largest such private effort in Michigan. For example, companies aided by Detroit Edison in 1985 included a computer manufacturer in Oakland County, auto parts suppliers in Detroit and Howell, induction metal-melting facilities in Troy and Trenton, a plastics firm in Port Huron, a specialty printer in Millington, and a producer of famous toy trains which returned to Chesterfield Township, near Mount Clemens, after a few years in Mexico.

Primary goals of Detroit Edison and other organizations are to attract and retain business. That's not an easy task. It takes hard work and teamwork. But progress is being made and we are convinced it will continue.



**Agriculture is the state's second-largest business activity, with food processing a "targeted" growth industry.**



## **B**rick, mortar, mind and muscle

**T**he Michigan "comeback" perceived by futurist John Naisbitt has been dependent largely on a sound infrastructure including a reliable and fairly priced supply of electricity provided by Detroit Edison.

This infrastructure — mainly facilities for energy, water, transportation, communications and waste disposal — has supported two major developments in our service area: a rebound by basic industries, and increased diversification which is transforming the area into one of the nation's most advanced high-technology centers.

**Diversification also is helping** the area claim an increasing share of the service industry, a growing mainstay of the U. S. economy. The U. S. Bureau of Labor Statistics says the Detroit metropolitan area gained more than 50,000 manufacturing jobs in 1984, and a University of Michigan study shows there are 54,000 more service and trade jobs here now than in 1979.

**Big numbers are behind Michigan's "comeback" . . . 11.5 million square feet of new office space represented here by one of Southfield's many new buildings, and a record 15 million passengers at Detroit Metropolitan Airport.**



**Housing permits increased  
64 percent in 1985 over 1984.**



Contributing importantly to the upturn in Southeastern Michigan's economy have been major gains in construction, air transportation and retailing. In addition, combined car and truck sales hit a record level in 1985.

**Detroit Edison's 7,600-square-mile service area is building** at levels not seen for decades. With interest rates lower, property values more attractive and office space in greater demand, non-residential building experienced a 267-percent increase in activity from the fourth quarter of 1982 to the second quarter of 1985. An estimated 11.5 million square feet of space have recently been completed or are being built.

Residential construction has recorded equally impressive gains. According to the U.S. Department of Commerce, 64 percent more housing permits were issued in this area in 1985 than in 1984, triple the amount in 1982. Condominiums are rising faster in the Detroit area than anywhere else in the country.

If you add in all the "renew" activities — the expansion of or new adaptations for existing buildings — the picture is even more impressive. For example, a \$200-million expansion of Detroit's Cobo Hall will enable the city to offer the highly competitive convention world 650,000 square feet of unbroken floor space — the most in the

country. By 1993, larger conventions and trade shows will attract an estimated 250,000 more delegates a year, create another 20,000 jobs and enrich the area by an additional \$150 million annually in convention-related revenues.

The new hotels being built in Detroit and throughout the metropolitan area will benefit from the influx of people and dollars along with local restaurants, entertainment facilities and other support services. One such enterprise — a festival-style entertainment, food and shopping complex called Trappers Alley in Detroit's Greektown area — is already drawing visitors and area residents alike in unprecedented numbers.

**Air transportation is undergoing significant growth.** During the past year, Detroit Metropolitan Airport handled a record 15 million passengers — nearly four million more than the previous year. Much of the substantial increase in traffic that has made Detroit Metro one of the fastest-growing airports in the country is due to Republic Airlines' decision to use Detroit as the hub for flights

throughout its nationwide system.

Retailing is making strong gains, too. The Michigan Employment Security Commission reports 14,100 new retail jobs in the last year in the Detroit metropolitan area alone, and *The Detroit News* says "Detroit has become very attractive to developers all over the country as other urban markets have become overstored and overdeveloped." In late December, the Minnesota-based Dayton Hudson Corporation announced plans to build 30 Mervyn's Department stores employing 6,750 people in Michigan, with about half of them in Detroit suburbs. The Ohio-based Federated Department Stores organization has also disclosed plans for eight new MainStreet outlets in metropolitan Detroit.

Millions of square feet of added space are home to new enterprises, including the research and development efforts of high-tech companies. These also help make the region's basic industries — such as automotive and steel — more efficient and competitive. A recent *New York Times* study placed Ann Arbor and Southeastern



**Computer capabilities provide new levels of flexibility and quality control for automotive production.**

**In 1985, more than 14,000 new retail jobs were created in metropolitan Detroit. Downtown Detroit's new Trappers Alley was one of several new retail shopping centers opened in 1985.**



Michigan at the "center of a (Midwestern) manufacturing revolution that could be as dramatic as the one that began with Henry Ford's moving assembly line."

The robotics industry is a case in point. Virtually every robot manufacturer in the world today has quarters in Southeastern Michigan. And supporting that industry are many small but strong local research groups working to make robotics more flexible in today's and tomorrow's workplaces.

A key to this flexibility is advanced computerization. As an example, 1,500 employees of General Motors' Electronic Data Systems — most of them transferred from EDS' Texas operations — are developing a nationwide telecommunications network which, among other things, will enable the company to control, from its suburban Auburn Hills computer base, GM manufacturing operations throughout the country. Another 1,200 persons at GM locations in Troy and Madison Heights will provide manage-

ment, research and computer controls for GM's highly advanced Saturn new-car project.

Southeastern Michigan will have the best of two worlds through a joint Ford-Mazda venture in Flat Rock, southwest of Detroit. Once a former Ford casting plant is enlarged and reshaped for vehicle assembly, it will employ 3,500 people making 240,000 "Japanese cars" a year for sale through Ford's domestic network. Among factors that persuaded Mazda to locate here was Detroit Edison's assurance of a reliable supply of electricity at the special economic redevelopment rates also available to other eligible businesses.

**Diversification in Southeastern Michigan** is taking many forms in the service industry, including growth of two relatively young companies into two of the largest fast-food chains in the country. Domino's Pizza, Inc., which started in 1960 with a \$500 investment and last year realized \$1 billion in sales, is building an ultra-modern headquarters in Ann Arbor Township





**Oakland Division economic development consultant Jane Bashara (right, standing) stops by the RELO Center, a new Southfield enterprise which provides assistance to individuals and corporations relocating in the area. With Bashara are the center's co-founders, Barbara Hoffmeyer and Larry Goldsmith.**



which, when completed, will cover a million square feet of space. Little Caesars Enterprises, Inc., which has almost 100 outlets in Southeastern Michigan and nearly 1,000 nationally, is planning a new headquarters complex in Detroit's Farmington Hills suburb.

Diversification has been nurtured in part through foreign investments — from a Canadian grain terminal in Brown City in Michigan's "Thumb" area to a growing number of Japanese and European automotive parts suppliers locating operations in Southeastern Michigan.

Obviously, diversification and growth are heavily dependent on electricity. The new growth

in this area for 1986 alone is expected to increase demand by hundreds of millions of kilowatt-hours. And not all of the added demand is for traditional uses. For example, the new Omni International Hotel, in the recently completed Millender Center in downtown Detroit, as well as 30 of the 15 hotels now being built in Oakland County, just north of Detroit, are all-electric — including heating — as are many of the area's new office buildings.


**Although much has been achieved in the last three years,** the "comeback" is far from complete. Many observers still believe Michigan is deficient in terms of perceived business

climate and that additional improvements are required. To complete the recovery, most agree, the drive to ensure the area's leadership in high technology must continue unabated. The state's educational system is strong but needs further encouragement from both the public and private sectors. The gains made in labor-management cooperation must continue and increase.

But steps are under way to bring about the needed improvements. Once these and other goals are realized, the "comeback" already in progress in Southeastern Michigan will be a reality and the area's quality of life will be even better.

**Two of the many new all-electric hotels in Southeastern Michigan — the Omni International Hotel in Detroit and the suburban Residence Inn.**





# Detroit Edison is a key player

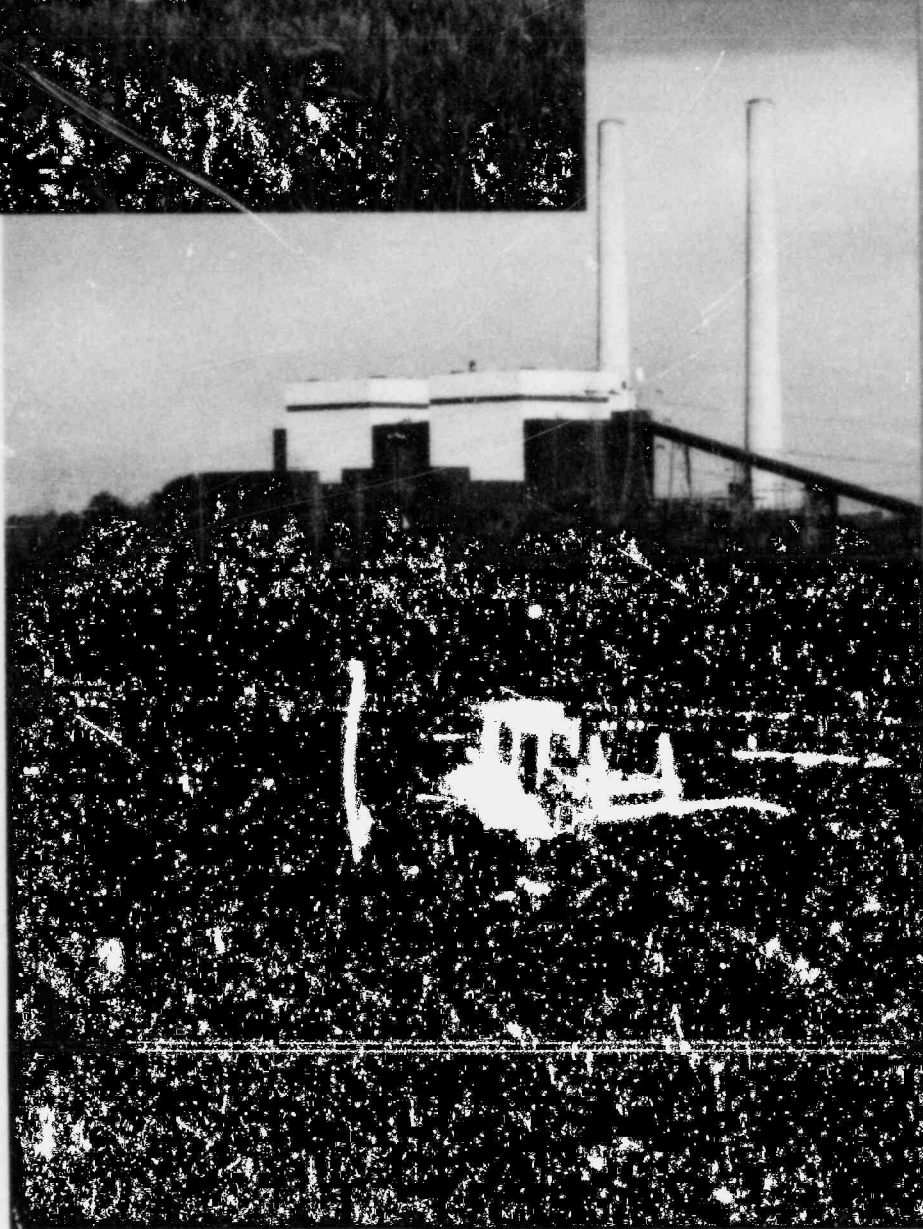
**D**etroit Edison is a key player in virtually all efforts to revitalize Southeastern Michigan.

The Company's most important role, of course, is to provide enough electric power, at reasonable prices, to operate and attract the growing business enterprises needed for a growing economy, and to help sustain and improve the quality of life in non-business areas — homemaking, recreation and a broad range of educational, cultural, spiritual and human services.

The first need in fulfilling this obligation is adequate electric generating facilities. In 1985, the Company virtually completed a \$11-billion postwar facilities construction and modernization program designed to satisfy the power needs of Southeastern Michigan through the end of the 20th century.

**Two 1985 milestones in this program** were the placing in commercial operation of the second unit of the Belle River Power Plant near Port Huron, and completion and licensing of the Company's first commercial nuclear power plant — Fermi 2 — near Monroe.

These were two tremendously important steps in the strengthening of Detroit Edison's generating system to meet present and future needs. Belle River, which burns environmentally clean low-sulfur coal, was completed on time and under budget, and is operating efficiently. Fermi 2 received its full-



**1985 Detroit Edison milestones included licensing of the Fermi 2 Power Plant (top) and full commercial operation of the Belle River Power Plant (bottom). Both occurred at mid-year.**



Calling on plant manager Robert E. Garlo (far right) at Chrysler's Trenton Engine Plant—a major industrial customer—are, from left, Lawrence Orlow, industrial account engineer; Maurice Vermeulen, manager-Wayne-Morroe Division, and James H. Tuttle, assistant vice president and manager-Marketing.

power license in July 1985 and since has been conducting a long series of tests and exercises to ensure the plant's safety, reliability and operational readiness. (See details in Letter to Shareholders.)

With Belle River on line and capable of producing 1.3 million kilowatts of electricity, and with Fermi 2 expected to add 1.1 million kilowatts, the Company will have a total capability of more than 10 million kilowatts. This positions Southeastern Michigan well into the future as a key center for further revitalization — not only its own but also that of the state and indeed the entire Great Lakes region.

**In addition to providing modern generating facilities** such as Belle River and Fermi 2, Detroit Edison looks constantly to the adequacy of its transmission, distribution and control systems. Two major improvements are under way.

One, a new Detroit Edison System Operations Center (SOC) in downtown Detroit, is scheduled for completion in the fall of 1986, while the present SOC will be remodeled by mid-1987 principally as a storm command center. Both SOC locations will house advanced computers and other sophisticated equipment designed to improve the control and monitoring of the Company's entire electric power transmission network — both during normal times and in

storm emergencies involving power interruptions.

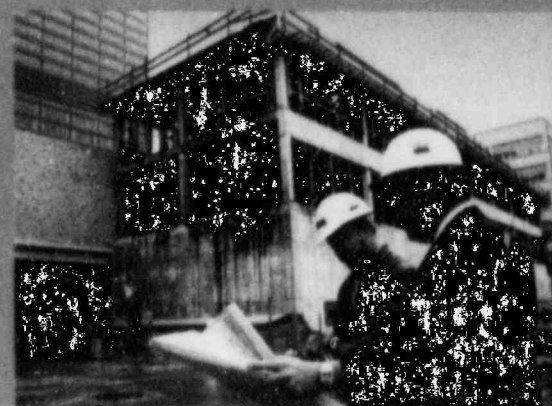
Second, a new computerized control system is being installed at the Michigan Electric Power Coordination Center near Ann Arbor, with work to be finished by mid-summer of 1987. That center, operated jointly by Detroit Edison and Consumers Power Company, monitors the generating systems of both companies to determine which power plants are most cost-efficient to operate at any given time. It also sells power to — and buys from — other utilities when such transactions serve the best interests of the customers of the two companies.

Future needs for the generation and transmission of power are the subject of an active strategic planning process now under way at all levels of Detroit

Edison. This planning embraces not only the brick-and-mortar needs of the future, but also the personnel, financial and other elements needed to maintain cost-efficiency and adequate returns to our 238,000 shareholders while preserving excellence in the service provided to our 1.8 million customers.

**As Southeastern Michigan is diversifying its business operations** to protect itself from severe cyclical swings, so too is Detroit Edison exploring diversified activities. The Company is using its new wholly owned subsidiary, SYNDECO, as a "laboratory" to explore the potential and feasibility of diversification. In the process it is offering for sale — to other utilities and other businesses as well — a broad range of

**Construction continues as the Company's System Operations Center in downtown Detroit expands to accommodate advanced computers and other sophisticated equipment. Overseeing construction are two North Division construction representatives, Richard H. Baker, general foreman (right), and Edward R. Welch, senior job supervisor.**





Plasma arc technologies are at the cutting edge of new marketing opportunities. A plasma torch creates an intense flame through the interaction of gases with electricity. It is employed in cutting and welding operations with many new uses on the horizon.

managerial, consultive and technological services in which Detroit Edison has a deep reservoir of experience and talent. In 1985, its second full year of operation, SYNDECO — formerly called Utility Technical Services — quadrupled its annual sales level to nearly \$8 million. At the time the subsidiary's name was changed in 1985, SYNDECO created its own subsidiary to perform certain engineering functions and named it Utility Technical Services.

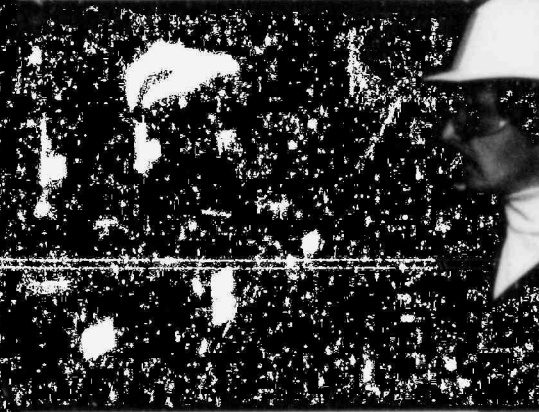
Yet not all such activities are long-range in view. As Detroit Edison's ability to meet demands in the '90s is satisfied with power plants completed in the '80s, meeting financial goals will require increasing sales. Thus, a major strengthening and redirecting of the Company's strategic marketing plans was completed in 1985 with a goal of selling an additional 7.7 billion kilowatthours of electricity from 1986 through 1990.

**The new marketing program**, and a complementary customer relations program, are designed to make Detroit Edison a more market-driven, customer-oriented company. Specific goals are to increase sales by learning more about — and satisfying — customer needs. But a corollary benefit will be to bring the entire Detroit Edison "family" closer

together. Employees will be provided with tools to help them become personal "salespeople" for Detroit Edison while also enhancing the Company's one-on-one relations with its customers.

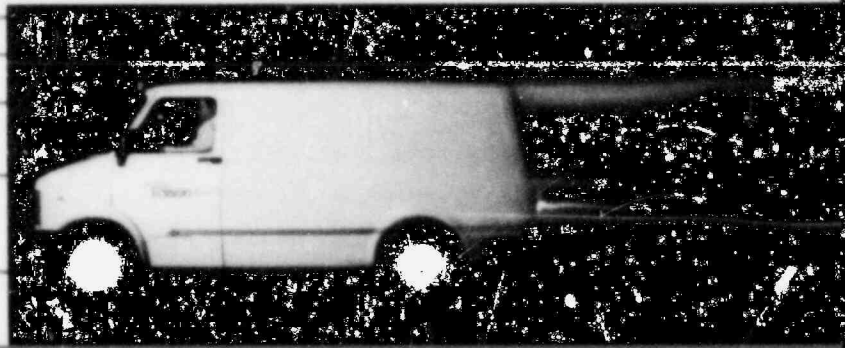
Innovative rates are an important economic development and marketing tool for Detroit Edison. Since 1983, for example, the Company's special metal-melting rate has been used by three area steel companies that might otherwise have reduced operations in Southeastern Michigan or halted them altogether. A special economic redevelopment rate has been available since 1984 to new businesses and existing companies expanding and modernizing their local operations. New rates and customer equipment-financing incentives are being explored.

**Coupled with efforts to increase revenues** by selling more electricity have been numerous streamlining and cost-cutting actions. For instance, the Company saved its customers many millions of dollars last year when it prevailed in a legal proceeding that it instituted over prices in a long-term contract for purchase of low-sulfur coal from Montana. It realized other multi-million-dollar savings by signing five new 10-year contracts at highly attractive prices for low-sulfur coal from Appalachia, with an option to extend for five years, and by assembling the



Technical supervisor Rick Chernick tests a battery as part of a new procedure developed and marketed by PowerScan, a service of Detroit Edison's SYNDECO subsidiary.

One of the six electric vans in use by the Company in a jointly funded program with the U.S. Department of Energy to evaluate the feasibility of using the vans for commercial purposes in the United States.



largest all-aluminum-bodied rail-car fleet in the country to haul coal from the western states. Use of aluminum cars instead of heavier steel cars will represent a continuing economy for Detroit Edison customers.

**The Company's concern for its customers and the public** extends beyond supplying electricity and related services as efficiently as possible. In the last year it has focused on three additional elements critical to the public welfare: electrical safety, substance abuse and the environment.

For example, electrical safety is an area in which surveys show customers have extreme confidence in the Company. One reason for this is an educational program, now in its third year,

featuring Isiah Thomas, star player for the Detroit Pistons basketball team. In advertisements and personal appearances for Detroit Edison, Thomas urges young people and their parents to treat electrical equipment with proper caution and to stay away from downed power lines during or after storms.

Thomas, because of his high degree of credibility, also has represented Detroit Edison in a well-received series of TV and radio messages urging youths to "Say NO to Drugs." A related brochure developed by the Company was sent to all customers and delivered free in bulk to hundreds of churches, clubs and other organizations for use in their own substance-abuse efforts.

On the environment, Detroit Edison continues to monitor very carefully the quality of the air and water discharged from its power plants and other facilities, and to ensure compliance with all requirements - including Michigan regulations which are among the most stringent in the country.

**Environmental concerns extend beyond the facilities,** however. For example, Detroit

Edison has a key role in a new \$500-million "resource-recovery" plant scheduled to be built starting this year in Detroit. When completed in early 1989, it will be the largest of its kind in the country and will convert 4,000 tons of refuse daily into electricity and steam which Detroit Edison will buy for delivery to its customers. The project would not have been possible without the Company's participation. Again, the public benefits are significant because the refuse no longer will have to be placed in scarce and environmentally undesirable landfill areas.

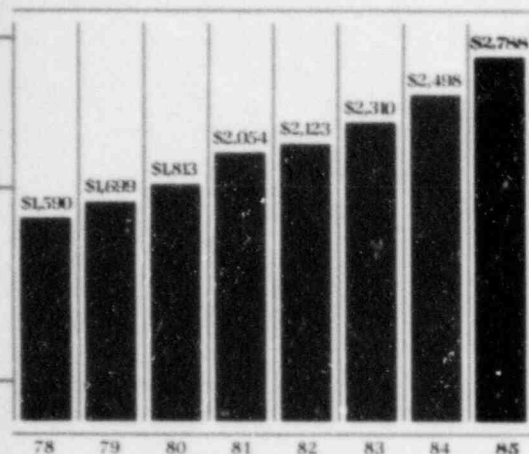
In summary, Detroit Edison recognizes its key obligations:

- To constantly upgrade the efficiency of its operations, the quality of its customer service and the scope of its marketing activities, thus helping generate economic development for the area and additional income for the Company and its shareholders.
- To provide the electric and steam power and other services which enable people to realize the progress needed to make Southeastern Michigan a better place in which to live and do business.

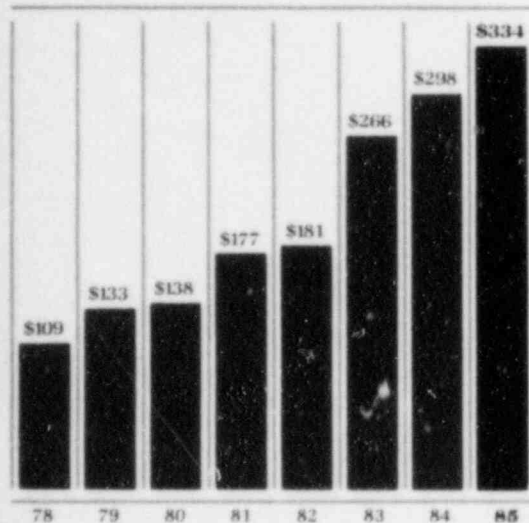
Safety education continues as a major corporate priority. Safety programs are presented at public events throughout the Company's service area.



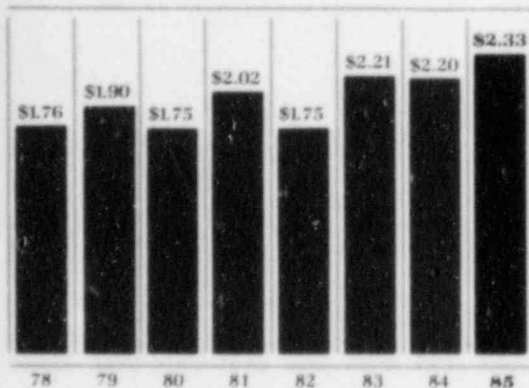
### Operating Revenues (millions)



### Earnings for Common Stock (millions)



### Earnings Per Share



Higher sales, reduced capital spending and tighter cost controls helped Detroit Edison record important financial gains in 1985.

Earnings on common stock and operating revenues reached peak levels, and kilowatt-hour sales were the best since the pre-recession year of 1979. With major construction all but completed, capital spending continued to decline, although outside financing increased.

**Total earnings of \$334.3 million** and per-share earnings of \$2.33 were all-time highs for the Company. Total earnings were up 12.2 percent from \$298 million in 1984, and earnings per share exceeded by 5.9 percent the 1984 figure of \$2.20.

Earnings continued to be supported in large part by AFUDC (Allowance for Funds Used During Construction), a non-cash accounting credit made to the income statement primarily reflecting the cost of financing Fermi 2 construction until the plant is placed in service. In 1985, AFUDC accounted for 73.7 percent of reported earnings, compared with 98.6 percent in 1984. Once Fermi 2 is placed in commercial operation, AFUDC will be reduced; thus, maintenance of earnings at recent levels will depend on adequate rate increases granted by the Michigan Public Service Commission (MPSC) to reflect the added investment in the new generating plant. Among steps being taken to help maintain earnings and reduce the need for rate

increases are a major increase in the Company's marketing program and one of the most extensive cost-reduction programs in the Company's history – a further extension of the ever-tightening control of manpower and expenses during the past decade.

Record 1985 revenues of \$2.8 billion surpassed the 1984 total of \$2.5 billion by 11.6 percent, reflecting sales of 36.7 billion kilowatt-hours of electricity and rate increases granted by the MPSC. Sales in 1985 trailed only the previous peaks of 37.1 billion kWh set in 1978 and 36.9 billion kWh recorded in 1979, and sales in the fourth quarter of 1985 were the highest for any fourth quarter in three years. Sales in 1984 totaled 35.9 billion kWh.

**Near-record electricity sales** were accompanied by a high peak demand as well. On December 18, 1985, a peak wintertime load of 6.3 million kilowatts was recorded, erasing the old cold-weather mark of 6.2 million kW set in January 1979. The summertime peak remains at 7.4 million kW set in July 1977.

The 1985 average return on common equity was 13.3 percent, compared with 12.9 percent the previous year, but still was below the 14.5 percent authorized by the MPSC. The Commission cut the authorized maximum from 15 percent when the second unit of the Belle River Power Plant went into commercial operation in July 1985, and said it would make a further reduction when it authorizes

rate adjustments for Fermi 2, reflecting lower interest rates and the Company's reduced need for outside financing.

**Capital spending continued to drop**, totaling \$710.7 million in 1985. That was down from \$938 million in 1984 and more than \$1 billion a year in 1982 and 1983. Facilities spending should decline still more in the next few years with completion of the Company's postwar modernization and expansion program.

External financing increased in 1985, to \$709.2 million from \$505.4 million in 1984. Financing in 1985 included a \$192-million bond offering to cover pollution-control expenditures at Fermi 2 earlier than originally planned in anticipation of unfavorable tax-law changes in 1986. Funds from this offering enabled the Company to prepay 1986 debt maturities with a significant interest savings.

With interest rates down,

total interest expense in 1985 was \$419.4 million, compared with \$432.2 million the previous year. Outside financing in 1985 benefited from improved securities ratings by Moody's Investors Service, Inc.

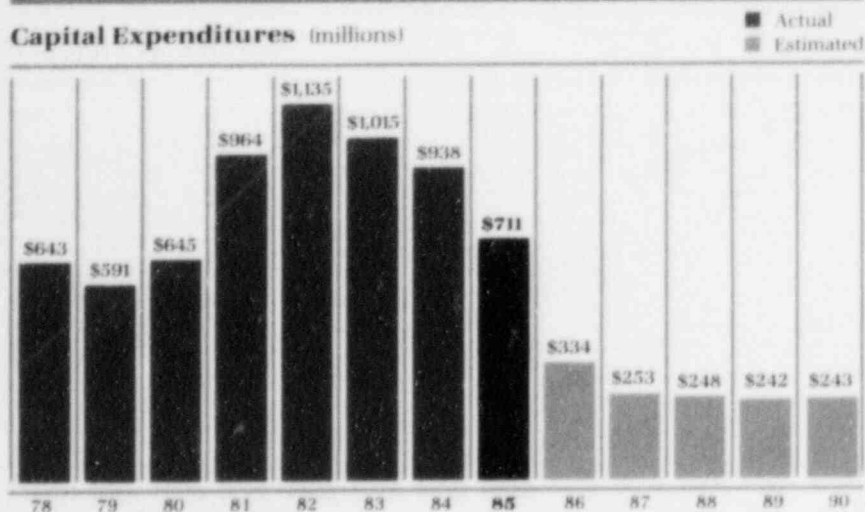
At the end of 1985, 82,674 shareholders were participating in the Detroit Edison Dividend Reinvestment Plan. That figure represented 31.6 percent of those eligible to participate. New investments under the plan in 1985 totaled \$95.9 million, including \$83.9 million in reinvested dividends and \$12 million in cash investments. Under amendments to the plan effective November 1, 1985, cash investments no longer are accepted and the plan has been converted from the use of newly issued shares of common stock to the purchase of outstanding shares in the open market. The plan was changed because the Company has no need for additional common equity capital in the foreseeable future.

### 1985 Financing

Type of Security & Month Sold	Gross Amount (millions)	Cost to Company (after expenses)
Mortgage Bonds		
May	\$ 35	11.95%
May	50	11.32
Pollution Control Refunding Bonds		
February and June	8.3	10.05
Pollution Control Bonds		
October	192	10.55
Unsecured Term Notes		
May	50	10.56
June	10	11.40
July	250	10.06
Common Stock		
Dividend Reinvestment and Employees' Savings Plans (7,406,526 shares)	113.9	
Total	\$709.2	

**The Company continues to be disappointed with MPSC action** on rates. On July 16, 1985, the Commission approved only \$99.3 million in rate adjustments for the Belle River Power Plant and all other issues except Fermi 2, in addition to an interim award of \$182.9 million in June 1984 for the first Belle River unit. Because the second adjustment of \$99.3 million associated with the second Belle River unit is considerably less than the \$134 million recommended by the administrative law judge who presided over the rate proceeding, Detroit Edison has filed a circuit court suit seeking judicial review of the Commission's action. Among other things, the Company questions the MPSC's disallowance of \$96.9 million of the Belle River investment, including \$60.9 million which the Commission

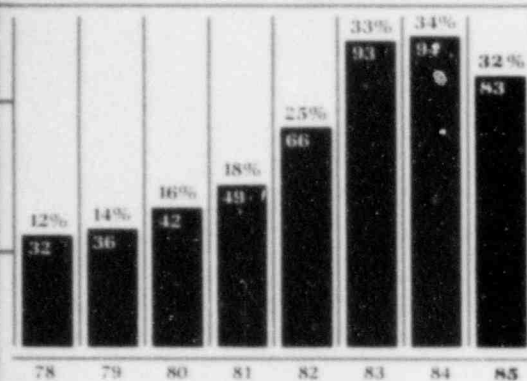
**Capital Expenditures** (millions)



## Shareholders In Dividend Reinvestment

(thousands)

100% Percent of Shareholders  
 00 Number of Shareholders



attributed to an "imprudent" one-year delay in the Belle River project. Detroit Edison notes that an MPSC staff witness testified that there should be no disallowance because the delay occurred early in the construction schedule before large outlays of money were involved.

In this legal action, the Ingham County Circuit Court in September 1985 granted the Company's request for a temporary injunction against the MPSC, thus allowing Detroit Edison to bill its customers an additional \$12.1 million over that approved by the MPSC for Belle River. The action was attributable to the arbitrary disallowance of \$60.9 million of the Belle River investment referred to earlier.

At the time this report was published, the Company still had not been granted rate relief for the Fermi 2 Power Plant. In a case filed with the MPSC in July 1983, Detroit Edison requested a \$556-million rate increase to coincide with commercial operation of Fermi 2. Last July, the Company filed exceptions to an administrative law judge's Proposal for Decision which included a recommendation for disallowance of nearly \$300 million in plant construction costs and a suggestion that the eventual rate increase be phased in over a period of five years, with

an additional 10 years—beginning with the seventh year following commercial operation—to recover in customer rates revenues not recoverable during the five-year phase-in period. In its exceptions, the Company noted that a shorter overall phase-in period would reduce investor risk and at the same time lower the ultimate cost to customers. The status of Fermi 2, as well as proposed changes in the accounting for phase-in plans, abandonment losses and disallowances of plant costs, is discussed in detail in Notes 2 and 3 of the Notes to the Consolidated Financial Statements.

**One positive action by the MPSC during 1985** was restructuring of residential rates to eliminate the so-called Lifeline system under which rates were sharply inverted to penalize higher-than-average usage. For Detroit Edison the new structure went into effect coincident with the rate increase for Belle River Unit 2 in July 1985.

In an effort to increase electricity sales and stimulate business growth in Southeastern Michigan, the Company has

asked the MPSC to approve three new industrial incentive-rate proposals. Two would extend the present electric metal-melting and economic redevelopment rates for 4-1/2 and 10-1/2 years, respectively, beyond their scheduled expiration date of May 1, 1986. The third would establish a new electric process-heat rate. Approval of the new rate applications could produce more than 200,000 kilowatts of additional load for Detroit Edison and about 5,000 new jobs for area workers.

**In late 1985, the Company began refunding about \$28 million to customers** who were billed a surcharge in November and December of 1976. The MPSC ordered the refund following a series of court decisions in which the surcharge was first approved and later disapproved. Current customers received the refunds as credits on their October bills. Former customers receive cash payments as they are identified. The refund averages \$5.60 for residential customers using 500 kilowatthours of electricity per month.

### Distribution of Ownership of Detroit Edison Common Stock

(December 31, 1985)

Type of Owner:			State and Country:		
	Owners	Shares		Owners	Shares
Individuals	116,398	29,811,523	Michigan	113,969	51,357,388
Joint Accounts	110,989	35,729,955	Florida	19,003	7,113,499
Trust Accounts	7,986	4,082,216	California	14,012	5,330,611
Nominees	248	56,703,314	New York	12,999	55,535,698
Institutions and Foundations	277	161,903	Illinois	10,810	7,403,799
Brokers and Security Dealers	39	1,978,491	Ohio	8,034	2,105,967
Others	2,183	18,109,094	44 Other States	58,464	17,474,412
Total	238,120	146,576,496	Foreign Countries	829	255,122
			Total	238,120	146,576,496



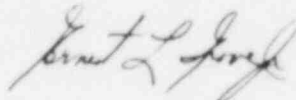
**RESPONSIBILITY FOR  
FINANCIAL STATEMENTS**

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.

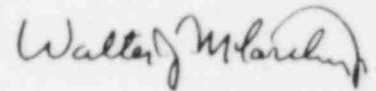
To meet this responsibility, management maintains a high standard of record keeping and an effective system of internal controls, including an extensive program of internal audits, written administrative policies and procedures, and programs to assure the selection and training of qualified personnel.

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 which include a review of internal controls, as well as such other procedures they deem necessary to provide reasonable assurance as to the fairness of the Company's financial statements and to enable them to express an opinion thereon.

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 14, 1986

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

In our opinion, the statements appearing on pages 24 through 40 of this report present fairly the financial position of The Detroit Edison Company and its subsidiary companies at December 31, 1985 and 1984, 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, 1985 in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements 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.

*Price Waterhouse*

**CONSOLIDATED STATEMENT OF INCOME**

Year Ended December 31

	<b>1985</b>	1984	1983
	<i>(thousands)</i>		
<b>Operating Revenues</b>			
Electric (Note 1)	<b>\$2,738,356</b>	\$2,439,835	\$2,260,021
Steam	<b>49,801</b>	58,370	49,637
Total Operating Revenues	<b>\$2,788,157</b>	\$2,498,205	\$2,309,658
<b>Operating Expenses</b>			
Operation			
Fuel	<b>\$ 785,110</b>	\$ 700,789	\$ 676,409
Other power supply	<b>196,918</b>	184,740	128,921
Other operation	<b>422,133</b>	403,616	374,164
Maintenance	<b>250,798</b>	203,945	187,769
Depreciation (Note 1)	<b>218,502</b>	190,420	171,940
Taxes other than income	<b>175,556</b>	144,471	142,743
Income taxes (Notes 1 and 5)	<b>124,939</b>	131,459	145,559
Total Operating Expenses	<b>\$2,173,956</b>	\$1,959,440	\$ 1,827,505
<b>Operating Income</b>	<b>\$ 614,201</b>	\$ 538,765	\$ 482,153
<b>Other Income and Deductions</b>			
Allowance for other funds used during construction (Note 1)	<b>\$ 113,225</b>	\$ 130,350	\$ 92,750
Other income and deductions	<b>(5,240)</b>	1,829	7,877
Income taxes (Note 5)	<b>1,642</b>	(112)	(5,487)
Total Other Income and Deductions	<b>\$ 109,627</b>	\$ 132,067	\$ 95,140
<b>Income Before Interest Charges</b>	<b>\$ 723,828</b>	\$ 670,832	\$ 577,293
<b>Interest Charges</b>			
Long-term debt	<b>\$ 401,272</b>	\$ 399,448	\$ 351,854
Amortization of debt discount, premium and expense (Note 1)	<b>2,502</b>	2,191	2,131
Other	<b>15,642</b>	30,592	53,088
Allowance for borrowed funds used during construction (credit) (Note 1)	<b>(133,103)</b>	(163,336)	(194,402)
Net Interest Charges	<b>\$ 286,313</b>	\$ 268,895	\$ 212,671
<b>Net Income</b>	<b>\$ 437,515</b>	\$ 401,937	\$ 364,622
<b>Preferred and Preference Stock Dividend Requirements</b>	<b>103,264</b>	104,159	98,614
<b>Earnings for Common Stock</b>	<b>\$ 334,251</b>	\$ 297,778	\$ 266,008
<b>Common Shares Outstanding - Average</b>	<b>143,183,133</b>	135,230,827	120,274,269
<b>Earnings Per Share</b>	<b>\$ 2.33</b>	\$ 2.20	\$ 2.21

## CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Year Ended December 31

	1985	1984	1983
	<i>(thousands)</i>		
<b>Financial Resources Provided</b>			
<b>Operations</b>			
Net Income	\$ 437,515	\$ 401,937	\$ 364,622
Items not affecting working capital			
Depreciation	218,502	190,420	171,940
Deferred income taxes and investment tax credit - net	110,778	127,436	135,603
Amortization of extraordinary property losses and unrecovered plant costs (Note 7)	12,231	12,231	10,449
Allowance for other funds used during construction (Note 1)	(113,225)	(130,350)	(92,750)
Other	2,385	(5,286)	744
Financial resources provided by operations	<u>\$ 668,186</u>	<u>\$ 596,388</u>	<u>\$ 590,608</u>
<b>External Financing</b>			
Sale of common stock	\$ 113,683	\$ 112,040	\$ 261,179
Issuance of common stock on conversion of convertible cumulative preferred stock, 5½% series	1,538	2,286	3,624
Sale of preference stock	—	—	113,537
Belle River Project Financing (Note 10)	—	331,686	266,899
Sale of general and refunding mortgage bonds	84,728	—	—
Funds received from Trustees: Installment sales contracts and loan agreements	187,091	40,170	36,181
Issuance of unsecured promissory notes	309,870	344,754	159,949
Increase (decrease) in short-term borrowings	(2,000)	2,000	(233,933)
Financial resources provided by operations	<u>\$ 694,910</u>	<u>\$ 832,936</u>	<u>\$ 607,436</u>
<b>Other Sources</b>			
Change in obligations under capital leases (Note 11)	\$ 48,490	\$ 14,010	\$ 9,292
Sale to MPPA of an ownership interest in the Belle River Project (Note 4)	—	—	337,053
Increase (decrease) in accumulated rate refunds, with interest	(43,975)	32,215	(24,855)
Other - net	(4,224)	(18,832)	(3,734)
Total	<u>\$1,363,387</u>	<u>\$1,456,717</u>	<u>\$1,515,800</u>
<b>Financial Resources Used</b>			
Plant and equipment expenditures	\$ 710,699	\$ 938,004	\$1,014,568
Purchase from Cooperative of ownership interest in Fermi 2 (Note 4)	40,479	—	—
Allowance for other funds used during construction (Note 1)	(113,225)	(130,350)	(92,750)
Financial resources used	<u>\$ 637,953</u>	<u>\$ 807,654</u>	<u>\$ 921,818</u>
Change in net property under capital leases (Note 11)	48,490	14,010	9,292
Dividends on common, preferred and preference stock	344,621	332,344	306,073
Conversion of convertible cumulative preferred stock, 5½% series	1,540	2,291	3,626
Repayment of long-term debt	376,185	370,070	256,925
Redemption of redeemable preferred and preference stock	10,015	6,221	5,363
Increase (decrease) in working capital*	(55,417)	(75,873)	12,703
Total	<u>\$1,363,387</u>	<u>\$1,456,717</u>	<u>\$1,515,800</u>
<b>Changes in Working Capital</b>			
Cash and temporary cash investments	\$ 3,030	\$40,331	\$ 42,693
Accounts receivable	10,069	10,116	26,297
Inventories	(75,179)	42,414	(21,826)
Accounts payable	37,572	(35,881)	4,028
Property, general and income taxes	(34,220)	(5,086)	(25,153)
Interest	5,134	(39,752)	3,645
Other	(1,823)	(7,553)	(16,981)
Increase (decrease) in working capital*	<u>\$65,417</u>	<u>\$75,873</u>	<u>\$ 12,703</u>

\*Excluding short-term borrowings, current maturities of long-term debt, current obligations under capital leases and preferred and preference stock sinking fund requirements.

(See accompanying Notes to Consolidated Financial Statements.)

**CONSOLIDATED BALANCE SHEET**

	December 31	
	1985	1984
	<i>(thousands)</i>	
<b>Assets</b>		
<b>Utility Properties</b> (Notes 1, 2, 4 and 11)		
Plant in service and held for future use		
Electric	<b>\$7,107,569</b>	\$6,299,292
Steam	<b>58,569</b>	58,112
	<b>\$7,166,138</b>	\$6,357,404
Less: Accumulated depreciation	<b>(1,853,149)</b>	(1,676,178)
	<b>\$5,312,989</b>	\$4,681,226
Construction work in progress	<b>3,299,901</b>	3,394,942
Net utility properties	<b>\$8,612,890</b>	\$8,076,168
Property under capital leases	<b>\$ 79,947</b>	\$ 26,517
Less: Accumulated amortization	<b>(8,155)</b>	(3,215)
Net property under capital leases	<b>\$ 71,792</b>	\$ 23,302
Total owned and leased properties	<b>\$8,684,682</b>	\$8,099,470
<b>Other Property and Investments</b>		
Non-utility property and other	<b>\$ 37,944</b>	\$ 33,518
Investment in coal supply	<b>—</b>	2,800
	<b>\$ 37,944</b>	\$ 36,318
<b>Current Assets</b>		
Cash (Note 6)	<b>\$ 1,741</b>	\$ 3,719
Temporary cash investments (at cost, approximating market value)	<b>13,008</b>	8,000
Customer accounts receivable (less allowance for uncollectible accounts of \$16,000,000)	<b>227,753</b>	201,882
Other accounts receivable	<b>34,134</b>	49,936
Inventories (at average cost)		
Fuel	<b>236,626</b>	313,884
Materials and supplies	<b>121,588</b>	119,509
Prepayments	<b>6,980</b>	2,427
	<b>\$ 641,830</b>	\$ 699,357
<b>Deferred Debits</b>		
Unamortized debt expense (Note 1)	<b>\$ 35,301</b>	\$ 29,329
Accumulated deferred income taxes (Note 1)	<b>15,488</b>	16,047
Extraordinary property losses and unrecovered plant costs (Note 7)	<b>59,362</b>	71,593
Other	<b>17,753</b>	17,900
	<b>\$ 127,904</b>	\$ 134,869
<b>Total</b>	<b>\$9,492,360</b>	\$8,970,014

**CONSOLIDATED BALANCE SHEET**

December 31

**1985****1984***(thousands)***Liabilities****Capitalization**

Common stock—\$10 par value, 160,000,000 shares authorized: 146,576,496 and 139,081,562 shares outstanding, respectively (805,756 and 894,227 shares, respectively, reserved for conversion of preferred stock) (Note 8)	<b>\$1,465,765</b>	\$1,390,816
Premium on common stock	<b>552,847</b>	512,401
Common stock expense	<b>(47,632)</b>	(47,370)
Retained earnings used in the business	<b>617,045</b>	524,151
Total common shareholders' equity	<b>\$2,588,025</b>	\$2,379,998
Non-redeemable preferred stock (Note 8)	<b>244,424</b>	245,963
Redeemable preferred stock (Note 9)	<b>197,805</b>	206,088
Non-redeemable preference stock (Note 8)	<b>287,406</b>	287,432
Redeemable preference stock (Note 9)	<b>149,862</b>	154,685
Long-term debt (Note 10)	<b>3,770,863</b>	3,845,272
Total Capitalization	<b>\$7,238,385</b>	\$7,119,438

**Other Noncurrent Liabilities**

Obligations under capital leases (Note 11)	<b>\$ 64,882</b>	\$ 20,025
Accumulated rate refunds, with interest	<b>14,433</b>	58,408
	<b>\$ 79,315</b>	\$ 78,433

**Current Liabilities**

Bank loans (Note 6)	<b>\$ —</b>	\$ 2,000
Long-term debt due within one year (Note 10)	<b>404,325</b>	116,185
Preferred and preference stock sinking fund requirements due within one year (Note 9)	<b>9,087</b>	5,750
Obligations under capital leases due within one year (Note 11)	<b>6,910</b>	3,277
Accounts payable	<b>182,387</b>	219,959
Property and general taxes	<b>251,131</b>	220,159
Income taxes	<b>13,611</b>	10,363
Interest	<b>88,644</b>	93,778
Dividends payable	<b>87,267</b>	84,396
Payrolls	<b>54,948</b>	53,674
Other	<b>29,227</b>	26,996
	<b>\$1,127,537</b>	\$ 836,537

**Deferred Credits**

Accumulated deferred income taxes (Note 1)	<b>\$ 774,715</b>	\$ 713,295
Accumulated deferred investment tax credits (Note 1)	<b>259,010</b>	210,211
Other	<b>13,398</b>	12,100
	<b>\$1,047,123</b>	\$ 935,606

**Commitments and Contingencies** (Notes 2, 3, 4, 11, 12 and 13)**Total**

<b>\$9,492,360</b>	<b>\$8,970,014</b>
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**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			
<i>(dollars in thousands)</i>					
<b>Balance at December 31, 1982</b>	111,391,399	\$1,113,914	\$402,686	\$(40,428)	\$396,009
Issuance of Common Stock					
Public offerings (6 million shares in March 1983 and 5.95 million shares in December 1983)	11,950,000	\$ 119,500	\$ 53,794	\$ (5,748)	\$
Dividend Reinvestment and Common Share Purchase Plan	6,427,824	64,278	24,292	(489)	
Employes' Savings Plans	364,624	3,646	1,731		
Conversion of convertible cumulative preferred stock, 5½% series	201,097	2,011	1,694	(81)	
Gain on preference stock purchased and retired			178		
Expense of increase in authorized number of common shares				(175)	
Net income					364,622
Cash dividends declared					
Common stock—\$1.68 per share					(206,817)
Cumulative preferred and preference stock*					(99,256)
<b>Balance at December 31, 1983</b>	130,334,944	\$1,303,349	\$484,375	\$(46,921)	\$454,558
Issuance of Common Stock					
Dividend Reinvestment and Common Share Purchase Plan	7,577,594	\$ 75,776	\$ 22,612	\$ (398)	\$
Employes' Savings Plans	1,037,720	10,378	3,672		
Conversion of convertible cumulative preferred stock, 5½% series	131,304	1,313	1,024	(51)	
Gain on preferred and preference stock purchased and retired			718		
Net income					401,937
Cash dividends declared					
Common stock—\$1.68 per share					(228,218)
Cumulative preferred and preference stock*					(104,126)
<b>Balance at December 31, 1984</b>	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)	
Loss on preferred and preference stock purchased and retired			(88)		
Net income					437,515
Cash dividends declared					
Common stock—\$1.68 per share					(241,397)
Cumulative preferred and preference stock*					(103,224)
<b>Balance at December 31, 1985</b>	146,576,496	\$1,465,765	\$552,847	\$(47,632)	\$617,045

\*At established rate for each series.

## CONSOLIDATED STATEMENT OF CUMULATIVE PREFERRED AND PREFERENCE STOCK

	Date of Issuance	December 31	
		1985	1984
<i>(thousands)</i>			
<b>Cumulative Preferred Stock - \$100 Par Value</b>			
Authorized - 9,000,000 shares; Outstanding - 4,548,904 and 4,628,163 shares, respectively (3,539,827 shares unissued)			
<b>Non-Redeemable Preferred Stock</b> (Note 8)			
5½% convertible series, 143,344 and 159,083 shares, respectively	October 1967	\$ 14,334	\$ 15,908
9.32% series, 499,080 shares	October 1970	49,908	49,908
7.68% series, 500,000 shares	March 1971	50,000	50,000
7.45% series, 600,000 shares	November 1971	60,000	60,000
7.36% series, 750,000 shares	December 1972	75,000	75,000
Non-redeemable preferred stock expense		(4,818)	(4,853)
Total Non-Redeemable Preferred Stock		<u>\$244,424</u>	<u>\$245,963</u>
<b>Redeemable Preferred Stock</b> (Note 9)			
9.72% series, 449,150 shares and 475,000 shares, respectively	December 1978	\$ 44,915	\$ 47,500
9.72% series, 89,830 shares and 95,000 shares, respectively	January 1979	8,983	9,500
9.60% series, 337,250 shares and 355,000 shares, respectively	October 1979	33,725	35,500
9.60% series, 280,250 shares and 295,000 shares, respectively	January 1980	28,025	29,500
12.80% series, 400,000 shares	May 1980	40,000	40,000
13.50% series, 250,000 shares	December 1980	25,000	25,000
15.68% series, 250,000 shares	June 1981	25,000	25,000
Redeemable preferred stock sinking fund requirement due within one year		(5,250)	(3,250)
Redeemable preferred stock expense		(2,593)	(2,662)
Total Redeemable Preferred Stock		<u>\$197,805</u>	<u>\$206,088</u>
<b>Cumulative Preference Stock - \$1 Par Value</b>			
Authorized - 30,000,000 shares; Outstanding - 18,453,480 and 18,599,980 shares, respectively (11,546,520 shares unissued)			
<b>Non-Redeemable Preference Stock</b> (Note 8)			
\$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 expense		(12,594)	(12,568)
Total Non-Redeemable Preference Stock		<u>\$287,406</u>	<u>\$287,432</u>
<b>Redeemable Preference Stock</b> (Note 9)			
\$2.75 series, 1,380,180 and 1,499,980 shares, respectively	July 1975	\$ 1,380	\$ 1,500
\$2.75 series B, 1,473,300 and 1,500,000 shares, respectively	December 1975	1,473	1,500
\$4.12 series, 2,000,000 shares	January 1982	2,000	2,000
\$4.00 series, 1,600,000 shares	April 1982	1,600	1,600
Premium on redeemable preference stock		154,884	158,399
Redeemable preference stock sinking fund requirement due within one year		(3,837)	(2,500)
Redeemable preference stock expense		(7,638)	(7,814)
Total Redeemable Preference Stock		<u>\$149,862</u>	<u>\$154,685</u>

## CONSOLIDATED STATEMENT OF LONG-TERM DEBT

	Interest Rate*	December 31	
		1985	1984
(thousands)			
<b>General and Refunding Mortgage Bonds</b>			
Series J, due 3/1/85	2 3/4%	\$ —	\$ 35,000
Series P, due 8/15/87	4 3/8	66,325	66,325
Series Q, due 6/1/89	4 3/8	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	8 3/8	100,000	100,000
Series Y, due 11/15/01	7 3/8	60,000	60,000
Series Z, due 1/15/03	7 1/2	100,000	100,000
Series AA, due 5/1/04	9 3/8	100,000	100,000
Series EE, due 12/15/00	11 3/8	37,500	40,000
Series HH, due 7/15/06	10 3/8	50,000	50,000
Series PP, due 6/15/08	9 3/8	70,000	70,000
Series RR, due 10/15/08	9.8	70,000	70,000
Series SS, due 3/15/99	10 3/8	140,000	150,000
Series UU, due 9/15/09	10 3/8	100,000	100,000
1980 Series A, due 1/1/87 (Refunded 6/3/85)	12 3/4	—	50,000
1980 Series B, due 4/1/00	12 3/4	100,000	100,000
1985 Series A, due 5/1/92	11.9	35,000	—
1985 Series B, due 6/1/92	11.25	50,000	—
Less: Unamortized net discount		(2,096)	(2,220)
Amount due within one year		(19,150)	(47,500)
		<b>\$ 1,595,274</b>	<b>\$ 1,579,300</b>
<b>Tax Exempt Revenue Bond Obligations</b>			
Installment Sales Contracts (Secured by corresponding amounts of General and Refunding Mortgage Bonds)			
City of Detroit, due 3/1/86 - 6/1/94	6.87%	\$ 19,105	\$ 20,615
City of Harbor Beach, due 3/1/86 - 3/1/05	6.94	3,490	3,565
City of River Rouge, due 7/1/86 - 10/1/02	6.87	50,970	52,440
City of Superior, due 2/1/86 - 2/1/01	8.06	42,500	43,100
City of Trenton, due 3/1/86 - 3/1/05	7.00	6,350	6,485
County of Monroe, due 3/1/86 - 10/1/14	9.29	61,590	42,870
County of St. Clair, due 6/15/86 - 5/1/22	10.15	216,380	218,495
Less: Unamortized net discount		(571)	(449)
Funds on deposit with Trustee		(839)	(2,549)
Amount due within one year		(8,235)	(7,185)
		<b>\$ 390,740</b>	<b>\$ 377,387</b>
Installment Sales Contracts			
County of Monroe, due 5/1/86 - 12/1/16	10.62	\$ 320,050	\$ 149,550
Less: Funds on deposit with Trustee		(7,076)	—
Amount due within one year		(1,940)	(1,500)
		<b>\$ 311,034</b>	<b>\$ 148,050</b>
Loan Agreements			
Pollution Bond Refunding Projects, due 2/15/94 - 6/15/07	9.87	\$ 18,815	\$ 10,535
		<b>\$ 720,589</b>	<b>\$ 535,972</b>
<b>Unsecured Promissory Notes</b>			
Belle River Project Financing, due 7/1/86 - 10/1/89	9.55%	\$ 1,050,000	\$ 1,200,000
Variable interest rates, due 5/2/86 - 1/15/90	9.05	150,000	210,000
Fixed interest rate, due 10/1/86	14.20	200,000	200,000
Fixed interest rate, due 7/9/87	10.05	250,000	—
Fixed interest rates, due 5/1/87 - 4/25/91	13.69	180,000	180,000
Less: Amount due within one year		(375,000)	(60,000)
		<b>\$ 1,455,000</b>	<b>\$ 1,730,000</b>
Total Long-Term Debt (Note 10)		<b>\$ 3,770,863</b>	<b>\$ 3,845,272</b>

\*Weighted average interest rate at December 31, 1985 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 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.

**Employees' Retirement Plan and Other Postretirement Benefits**—See Note 14.

**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 3.28%, 3.31% and 3.38% for 1985, 1984 and 1983, respectively. 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 2 and 13 for pending rate matters.)

The Company capitalized AFUDC at 9.94% from January 1, 1983 through March 31, 1983, 10.73% from April 1, 1983 through July 16, 1985 and 10.3% thereafter, except for AFUDC related to the Belle River Project Financing for which the actual interest and commitment fees were capitalized. (See Note 10.) In accordance with MPSC requirements, these composite AFUDC rates are equal to the overall rate of return authorized in electric rate orders. Also, pursuant to an MPSC order, AFUDC is not recorded on construction work in progress relating to pollution control facilities for fossil-fueled power plants, except for such expenditures financed under the Belle River Project Financing Agreement.

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 \$133.1 million, \$163.3 million and \$194.4 million for 1985, 1984 and 1983, respectively. Total AFUDC for both borrowed and other funds amounted to \$246.3 million, \$293.7 million and \$287.2 million for 1985, 1984 and 1983, respectively. AFUDC amounted to 74%, 99% and 108% of Earnings for Common Stock for 1985, 1984 and 1983, 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 as authorized by the MPSC. Investment tax credits utilized are deferred and amortized over the estimated composite service life of the related property. (See Note 5.)

**Capitalization - Discount, Premium and Expense**—The discount, premium and expense related to the issuance of long-term debt is amortized over the lives of the issues. Capital stock expense related to that portion of preferred and preference stock redeemed is written off against the accumulated net gain on reacquired capital stock included in premium on common stock.

**Extraordinary Property Losses and Unrecovered Plant Costs**—See Note 7.

### Note 2 - Fermi 2

**Project Costs**—In 1985, the project estimate for Fermi 2, a nuclear generating unit having a nominal capability rating of 1,100 MW, was increased from \$3.375 billion (including \$867 million of AFUDC) to \$3.765 billion (including \$1.036 billion of AFUDC) assuming March 1986 commercial operation at a 75% power level, which is no longer attainable; see discussion below. These estimates include the undivided ownership interest of Wolverine Power Supply Cooperative, Inc. ("Cooperative") other than interest on construction loans capitalized by the Cooperative relating to its ownership interest from the date of sale in 1977. This increase will be funded solely by the Company because the Cooperative's obligations have been limited by agreement. The revised project estimate does not include the quarterly purchases of portions of the Cooperative's interest in Fermi 2, which are estimated to total \$59 million (excluding \$2 million of AFUDC recorded by the Company) for the period July 1985 through March 1986. (See Note 4.) Through December 31, 1985, actual expenditures were \$3.634 billion (including \$979 million of AFUDC). The Company's portion of the latest project estimate for Fermi 2 is \$3.338 billion (including \$1.017 billion of AFUDC); and, through December 31, 1985, the Company has expended \$3.207 billion (including \$960 million of AFUDC) on its undivided ownership interest in this unit.

The Company is subject to the regulatory jurisdiction of the Nuclear Regulatory Commission ("NRC") with respect to construction, licensing and operation of Fermi 2. As discussed herein, the NRC is continuing to review Fermi 2 management, equipment and procedural difficulties. Also, the MPSC may determine that commercial operation of Fermi 2 requires a power level in excess of 75% as well as compliance with other criteria. As a result, the Company is unable to determine with certainty when Fermi 2 will commence commercial operation. The Company previously announced a commercial operation date for Fermi 2 of March 1986, assuming a 75% power level, which is no longer attainable. For each month of delay beyond March 1986, Fermi 2 project costs (which will be funded solely by the Company) will increase by approximately \$30-40 million per month, a substantial portion of which will be AFUDC. Under current generally accepted accounting principles, the Company will continue to capitalize all costs, including AFUDC, associated with the unit until commercial operation.

**Testing and Licensing**—In July 1985, the Company received a full power operating license for Fermi 2 from the NRC which permitted power ascension at levels above 5% power. During testing of the plant, a number of management, procedural and technical difficulties have been experienced. In light of these difficulties the Company has agreed that it will not ascend to power levels in excess of 5% until such time as the NRC and the Company are satisfied that all appropriate corrections and modifications are in place or are progressing satisfactorily. The Fermi 2 reactor is presently in a cold shut-down status initiated by the Company for the completion of certain plant modifications.

Although the integrity of the plant's safety systems (both technical and security) has not been compromised, the NRC is reviewing the possibility of taking enforcement action against the Company as a result of a number of technical and procedural violations at the plant. In addition, the Company is continuing to work to correct bearing problems encountered on back-up diesel generators. Any enforcement action may result in fines levied against the Company. At this time, the Company is awaiting further notification from the NRC as to these violations.

By letter dated December 24, 1985, the NRC requested the Company to prepare a program for Company actions that would improve Fermi 2 management and technical performance during testing and subsequent power ascension. Key management changes are being made and changes in reporting relationships will be effected. On January 29, 1986, the Company submitted its program to the NRC. The Company believes its program, which includes such management changes, provides for enhanced personnel training, restructures the Fermi 2 organization and provides greater support for Fermi 2 personnel, is responsive to the NRC's concerns and should make adverse action unnecessary with respect to the plant's operating license.

The Company has also established an Independent Overview Committee, comprised of recognized nuclear industry consultants, to review the operations at Fermi 2 and to make recommendations for improvement. The Company proposes to utilize the expertise of the Committee during power ascension. The Committee will review plant operations and advise as to power ascension at six increasing power levels up to and including full power.

Until such time as the Company and the NRC reach agreement on a power ascension program, the Company is unable to determine with certainty the commercial operation date for Fermi 2.

**Rate Matters**—Pursuant to the Company's request for rate relief of \$556 million coincident with the commercial operation of Fermi 2 (See Note 13), the MPSC Staff's case, filed in 1984, proposes a disallowance of a return on \$365.5 million (\$301.3 million of which is applicable to the Company's rate base) of project costs for Fermi 2 resulting from the Staff's prudence review of construction expenditures and is based upon a previous cost estimate of \$3.075 billion (including \$755 million of AFUDC), compared to the Company's latest project estimate of \$3.765 billion which assumed March 1986 commercial operation, which is no longer attainable. The Staff's case would allow the recovery through depreciation of the disallowed project costs, although return on such costs would be denied. A Staff report on Fermi 2 stated that the Company must be held accountable for costs related to fuel load delays after December 1983 and that a further disallowance may be considered since fuel load did not occur by June 1984.

The Staff's case also presented a proposed revenue deferral plan which would phase in the cash recovery of a portion of the net income associated with Fermi 2. Under this alternative proposal, there would be an annual deferral (in declining

amounts) for the first four years of the project's commercial operation, based on the Staff's characterization of certain capacity as "unrequired," with the deferred amounts, including return thereon at the Company's overall rate of return, being recovered through revenues over the subsequent twelve years. (See Note 3.)

On June 5, 1985, an Administrative Law Judge ("ALJ") issued a Proposal for Decision ("PFD") with respect to Fermi 2. The ALJ, acknowledging that the final cost of the project will exceed the \$3.075 billion estimate presented in the record, concluded that consideration of additional costs must necessarily be addressed in a subsequent proceeding. The Company will seek recovery of all Fermi 2 costs not yet presented to the MPSC for review (estimated at \$751 million at March 31, 1986) in future proceedings.

While the Staff had recommended Fermi 2 disallowances aggregating \$365.5 million (\$301.3 million of which is applicable to the Company's rate base), the ALJ found \$294.3 million (\$242.6 million of which is applicable to the Company's rate base) more appropriate. Recovery through depreciation of the disallowed project costs was recommended, although the return on such costs would be denied.

As discussed in Note 4, the Company is obligated to purchase the capacity and energy entitlements of the Cooperative for up to fifteen years. The Cooperative's portion of the Fermi 2 disallowance is reflected in the capacity buyback costs and, therefore, the Company expects that the MPSC will disallow the recovery of a corresponding portion of such capacity buyback costs in Power Supply Cost Recovery proceedings.

The ALJ recommended that an annual revenue increase of \$454 million for Fermi 2 not be fully effective commencing with commercial operation, but be implemented generally in accordance with the Staff's phase-in plan. Under this phase-in proposal, \$227, \$272, \$318, \$363 and \$409 million of the revenues associated with Fermi 2 would be recoverable in the first five years, respectively, with \$454 million recoverable each year thereafter. In addition, the revenues not recoverable during the five year phase-in period (aggregating \$681 million) would be deferred on an after-tax basis, together with a 10.3% return on the accumulated after-tax amounts, to be recovered in customer rates in the amount of \$162 million of revenues annually over a 10 year period, beginning with the seventh year following commercial operation.

The ALJ addressed the significant matter of determining when Fermi 2 is to be accorded rate relief associated with commercial operation by suggesting a number of criteria, the most stringent of which is a 90% power 100 hour run, which is not expected until four to six months after achieving a 75% power level. The Company believes that a 75% power level should be the threshold for placing the unit in commercial operation. However, the MPSC may determine that commercial operation of Fermi 2 requires a power level in excess of 75% as well as compliance with other criteria, which could result in a further delay in commercial operation. As discussed above, delays in the commercial operation of Fermi 2 beyond March 1986 will increase the project costs by approximately \$30.40 million per month.

The ALJ also recommended that at the time Fermi 2 is declared to be in commercial operation, the 795 MW oil-fueled Greenwood Unit No. 1 be temporarily mothballed and removed from rate base (a rate base reduction of \$283 million). No adjustment was proposed to operation and maintenance expenses or depreciation expense to reflect the removal of Greenwood Unit No. 1 from rate base as these expenses were considered appropriate. The ALJ recommended that the unit be returned to rate base in 1990 when needed to meet system requirements. However, no current or deferred return would be allowed on this investment until it is returned to rate base, thus reducing operating revenues by approximately \$44 million per

year for this period of time.

This PFD is the recommendation of the ALJ and as such is not binding upon the MPSC, which may adopt an order containing provisions which are substantially different from the recommendations included in the PFD. The Company, in its exceptions to the PFD filed July 8, 1985, vigorously opposed the ALJ's recommendations regarding disallowances from rate base, the duration of the proposed phase-in plan, the criteria for determining the operational status of Fermi 2 and the temporary removal of Greenwood Unit No. 1 from rate base.

Because the recommendations of the ALJ discussed above do not provide for the full recovery (from either current customer rates or phase-in revenues) of the project costs and operating expenses (operation, maintenance, depreciation, property and other taxes) for Fermi 2, these recommendations would, if adopted by the MPSC in its order, adversely affect future earnings per share when this unit commences commercial operation. (See Note 3.)

The Company believes that no portion of the new generating capacity is "unrequired", and all project costs incurred were reasonable and prudent. Accordingly, any proposed disallowances will be vigorously opposed. Under current generally accepted accounting principles, if it is ultimately determined that a portion and/or the return on a portion of project costs is disallowed, total and per share Earnings for Common Stock will be reduced over the period of time the plant remains in service. A write-off would be required under current generally accepted accounting principles only if, and to the extent that, anticipated future revenues associated with the 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. Since the Company believes commercial operation of Fermi 2 will commence before the point in time when the total plant costs and expenses would equal anticipated future revenues associated with the plant, it believes that such a write-off will not be required.

On the basis of current generally accepted accounting principles and without giving effect to the matters discussed in Note 3, the Company believes that, although no absolute assurance can be given, the ultimate resolution of these rate matters (including those matters discussed under "MPSC Electric Rate Case" in Note 13), after all appropriate proceedings (including court reviews), will not have a material adverse effect on its financial position and results of operations. However, see Note 3 for a discussion of proposed changes in accounting for phase-in plans, abandonments and disallowances of plant costs.

**Decommissioning Costs**—The NRC has authority to regulate the method by which Fermi 2 will be decommissioned. Decommissioning, which could cost in excess of \$100 million depending upon the method adopted (mothballing, dismantling or entombment), would occur 35 to 40 years after the plant commences commercial operation. The MPSC has jurisdiction over the manner in which the Company will fund and recover these costs from its customers.

In 1979, the MPSC ordered that generic hearings be conducted to receive comments and proposals on the establishment and financing of funds for the purpose of decommissioning nuclear power plants. In 1981, a PFD was issued which recommended that an external fund to cover future decommissioning expenditures be established. In August 1985, the MPSC reopened the record in this proceeding to allow for further testimony because of a provision in the Tax Reform Act of 1984 which permits a tax deduction for contributions made to an external "Nuclear Decommissioning Reserve Fund". Such an external fund is an alternative to an internal fund that would be maintained by the Company as the owner of a

nuclear plant. Proceedings are continuing before the MPSC. The Company believes that an internal fund has a cost advantage over an external fund. However, the MPSC Staff has taken the position that an external fund is preferable because of the security it will provide to ratepayers.

The Company is awaiting final MPSC action before establishing a funding mechanism for decommissioning costs. At this time, the Company has not requested recovery through rates of such undetermined costs.

### **Note 3 – Proposed Changes in Accounting Standards**

In December 1985, the Financial Accounting Standards Board ("FASB") published for comment an Exposure Draft which would, if adopted, amend Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation" for three types of events – accounting for phase-in plans, abandonments and disallowances of plant costs. An Exposure Draft is a proposed Statement of Financial Accounting Standards which sets forth the FASB's tentative conclusions on an issue, which are circulated for public comment and subject to public hearings. The Company is unable to predict which provisions, if any, in the Exposure Draft may be adopted.

The Exposure Draft, which includes significant changes in current generally accepted accounting principles, if issued as a Standard, would have to be applied by the Company for the first time in 1987. The Exposure Draft would permit retroactive application of the amended Standard to years prior to 1987 through restatement or, alternatively, would call for reflection of the cumulative effect of a change in accounting principles in 1987. Although the following discussion provides a description of the accounting that would be required had the Exposure Draft been applicable as a Standard effective for the year ended December 31, 1985, the estimated adverse effects set forth below would result in reductions in Earnings for Common Stock in various years depending on the alternative selected. This analysis is based upon the Company's interpretation of the Exposure Draft provisions and assumes that the MPSC had issued a rate order consistent with the Fermi 2 PFD. (See Note 2.) The amounts set forth below for the estimated adverse effects of applying these proposed changes in accounting standards have been reduced by interperiod income tax calculations, where applicable.

**Phase-in Plans**—The Exposure Draft would require that phase-in plans meet certain criteria before any amounts deferred for future recovery pursuant to such plans are capitalized for financial reporting purposes. Phase-in plans must be formal arrangements, agreed to by the regulator, which specify the timing of recovery of all amounts deferred. In addition, all amounts deferred under phase-in plans must be recovered within 10 years of the date when deferrals began. As discussed in Note 2, the phase-in plan recommended by the ALJ covers a period of 16 years commencing with commercial operation of Fermi 2. If this phase-in plan is adopted by the MPSC, the 10-year recoverability provision of the Exposure Draft would prohibit the Company from recording deferred net income of approximately \$368 million during the five-year phase-in period together with a 10.3% return thereon and, accordingly, earnings would be adversely affected in each of those years. However, during the subsequent recovery period, earnings would be enhanced as revenues are actually recovered in customer rates.

**Abandonments**—The Exposure Draft would require that when an operating asset or an asset under construction is abandoned, the present value of the probable future revenues expected to be provided to recover the annual amortization of the cost of that asset, if any, shall be reported as a separate asset (a deferred

charge). Any excess of the carrying amount of the asset over that present value shall be recognized as a loss. At December 31, 1985, the Company has \$52.4 million of Fermi 3 and Greenwood Unit Nos. 2 and 3 unrecovered plant costs and \$18.2 million of related accumulated deferred income taxes. (See Note 7.) The discount to present value of abandoned plant costs approximates \$10 million at December 31, 1985.

**Disallowances of Plant Costs**—The Exposure Draft would require that when part of the cost of a newly completed plant is disallowed for ratemaking purposes or when such a disallowance becomes probable, that part of the cost shall be deducted from the reported cost of the plant and charged to expense immediately (recorded as a loss). 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 charged to expense. In the PFD, the ALJ recommended that \$242.6 million of the Company's portion of Fermi 2 costs be disallowed from rate base. (See Note 2.) Additional AFUDC on these disallowed costs which was not considered in the PFD approximates \$35 million. Recovery through depreciation of the disallowed project costs was recommended, although a return on such costs would be denied. Under the provisions of the Exposure Draft, the discount to present value of such disallowed costs would be recorded as a loss and would reduce Earnings for Common Stock when such a disallowance becomes probable or when an order containing such a disallowance is received in a rate proceeding. The discount to present value of plant costs recommended for disallowance by the ALJ approximates \$115 million at December 31, 1985.

In the PFD, the ALJ also recommended that at the time Fermi 2 is declared to be in commercial operation, Greenwood Unit No. 1 should be temporarily removed from rate base and returned in 1990 when needed to meet system requirements. Operating expenses, including depreciation, would be recovered through rates but no return on investment would be allowed during the time the plant is removed from rate base. The discount to present value of the cost of plant temporarily removed from rate base for the four year period approximates \$50 million at December 31, 1985.

As discussed in Note 13, on July 16, 1985, the MPSC issued a partial final opinion and order which provided a total disallowance from rate base of approximately \$96.9 million for Belle River. Of this amount \$32.8 million was ordered to be recovered through depreciation with no return allowed; \$64.1 million was accorded neither return nor recovery. If the Company's portion of disallowed Belle River costs of \$90.2 million were accounted for at December 31, 1985 pursuant to the provisions of the Exposure Draft, Earnings for Common Stock for the year ended December 31, 1985 would be reduced by approximately \$75 million. The Company has appealed the Belle River rate order to the Ingham County Circuit Court and is presently collecting surcharge revenues of \$12.1 million annually granted by the Court, subject to refund. The Exposure Draft would require the Company to make an immediate write-off based on the adverse MPSC order in spite of the favorable court order; subsequently, after all court proceedings, if the Company is ultimately successful in its appeal, it would record a gain.

**Summary**—If the amendments proposed by the Exposure Draft had been issued as a final FASB Statement, effective for the year ended December 31, 1985, and assuming that the MPSC had issued a rate order consistent with the Fermi 2 PFD, the Company would have been prohibited from recording deferred net income associated with the phase-in plan and would have been required to recognize losses

of approximately \$250 million. This amount, which has been reduced by interperiod income taxes where applicable, is the sum of the amounts set forth above under "Abandonments" and "Disallowances of Plant Costs", the calculation of which are approximations based upon the Company's interpretation of the relevant Exposure Draft provisions and certain assumptions regarding rate relief. Accordingly, the amount of the eventual losses, if any, could be greater or less than the amount set forth. Such losses would be significant in relation to both retained earnings (\$617 million at December 31, 1985) and total common shareholders' equity (\$2.588 billion at December 31, 1985).

In addition to the above, as discussed in Note 2, the PFD concluded that consideration of additional Fermi 2 costs in excess of the \$3.075 billion presented in the record must necessarily be addressed in a subsequent proceeding. The Company has not included in its current main electric rate case before the MPSC approximately \$751 million of Fermi 2 project costs. (See Notes 2 and 4.) Under the provisions of the Exposure Draft, any project costs for which rate recovery is not considered probable shall be charged to expense at the time such determination is made. Although the Company believes that all project costs at Fermi 2 have been prudently incurred and intends to seek recovery of all Fermi 2 costs not yet presented to the MPSC for review, the provisions of the Exposure Draft may require recognition of all or part of these additional costs as a loss at the time it is deemed probable that favorable rate action will not result.

The Exposure Draft, if issued as a Standard, would require adjustments to the Company's accounts in 1987 (to be effected either through restatement of previously issued financial statements or through reflection of a cumulative effect) which, depending on the ratemaking treatment accorded Fermi 2 costs, could have a material adverse effect on the Company's financial position and results of operations.

A required write-off of abandoned plant costs, proposed disallowances and possible additional disallowances from rate base for Fermi 2 could significantly reduce or eliminate retained earnings, and accordingly would result in a substantial reduction in the aggregate amount of retained earnings and capital surplus legally available for the payment of dividends. Because of the resultant reduction in the equity component of the Company's capitalization, the Company may be requested to fund certain escrow accounts in an amount that may approach \$163 million. The earnings test provision of the Mortgage and Deed of Trust could preclude the issuance of Mortgage Bonds on the basis of property additions for at least nine months. However, Mortgage Bonds could be issued on the basis of retirements. (See Note 10.) Under the terms of the Company's nuclear fuel financing arrangement, the renewal in January 1987 of the Heat Purchase Contract would be prevented and correspondingly require the repurchase of approximately \$264 million of nuclear fuel being financed by Renaissance Energy Company (See Notes 6 and 11.) In addition, due to the customary conditions associated with extensions of new or renewals of existing credit, certain credit facilities such as commercial paper, revocable lines of credit and revolving credit arrangements may be available to the Company, if at all, on the basis of less favorable terms. Fixed income quality ratings of the Company's securities might be adversely affected and hence, the Company's ability to obtain long term funds from the financial markets on favorable terms may be adversely affected.

#### **Note 4 – Jointly-Owned Utility Plant**

The Company's portion of jointly-owned utility plant at December 31, 1985 is as follows:

	Fermi 2	Belle River(2)	Ludington Pumped Storage
In-service date	—	(3)	1973
Undivided ownership interest	(1)	(4)	49%
Investment (millions)	\$3,208.9	\$1,052.1	\$168.3
Accumulated depreciation (millions)	\$ —	\$ 58.8	\$ 41.1

(1) See discussion below.

(2) 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.

(3) 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.

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

**Fermi 2**—In 1977, the Company sold an undivided ownership interest in Fermi 2 to the Cooperative. The Company is obligated to complete construction promptly and retains control over construction and operation of the facility. Under certain circumstances, should the Company delay construction of the unit, it may be obligated to supply the Cooperative with its entitlement of electricity, otherwise expected to have been generated after the anticipated completion date and may have to indemnify the Cooperative for additional construction costs resulting from the delay.

The Cooperative made an initial payment to the Company at the time of sale equal to 20% of construction expenditures, including AFUDC, and became obligated to make monthly progress payments for construction expenditures, excluding AFUDC. The Cooperative's investment in Fermi 2 has been limited by a 1983 amendment to the Participation Agreement to \$426.9 million for plant, \$24.3 million for nuclear fuel and \$3.0 million for materials and supplies, which limitations were reached in 1984. Expenditures to complete plant construction in progress at the time the plant investment limitation was reached in 1984 have been made solely by the Company with the Cooperative's participation interest decreasing through December 31, 1985. An August 1985 amendment to the Participation Agreement requires the Company to make quarterly purchases of a portion of the Cooperative's ownership and participation interests in Fermi 2 (in amounts equivalent to the Cooperative's quarterly interest during construction on its investment), stops the decrease in the Cooperative's participation interest at December 31, 1985 except for such quarterly purchases, and modifies the capacity and energy buyback schedule. Expenditures after December 31, 1985 for plant construction in progress and for any plant improvement projects commenced within a period of up to two years after the plant commences commercial operation will be completed solely with funds provided by the Company. The Cooperative's ownership interest will decrease due to these expenditures and the quarterly purchases, as the proportion of its investment to the total investment declines. The participation interest remains fixed at 15.229% at December 31, 1985 subject only to decreases resulting from the quarterly purchases. Through December 31, 1985, the Company has made such quarterly purchases amounting to \$39.8 million for plant (excluding \$0.7 million for AFUDC recorded by the Company), \$2.1 million for nuclear fuel and \$0.1 million for materials and supplies, which reduced the Cooperative's adjusted participation

interest to 14.412%. The Company's remaining purchase obligations will average approximately \$7 million per month and will continue until commercial operation.

The parties will share electricity generated and plant operation and maintenance expenses in proportion to their adjusted participation interests in plant at the commercial operation date. The Company will have certain obligations to provide replacement power to the Cooperative when the unit is out of service.

The Company is obligated to purchase the Cooperative's capacity and energy entitlements for up to fifteen years following the commercial operation of Fermi 2, initially at 100% through the second full calendar year of commercial operation and declining each year thereafter. The costs for the buyback of power will be based on the Cooperative's plant-related investment in the project, interest costs incurred by the Cooperative (plus 0.55% for the 100% buyback years and plus 1% thereafter) and certain other costs such as fuel, depreciation and operation and maintenance expenses. Buyback payments to the Cooperative are currently estimated at \$108.5 million, \$141.6 million, \$118.4 million, \$112.2 million and \$99.7 million for 1986, 1987, 1988, 1989 and 1990, respectively.

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, 1985, MPPA's investment consisted of \$344.2 million for Unit No. 1 and common facilities, \$27.9 million for certain coal handling and transmission facilities and \$16.8 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. The Company is obligated to provide MPPA with backup power when either unit is out of service.

The Company began obligatory 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. 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 (plus 2.5%) and certain other costs such as fuel, depreciation and operation and maintenance expenses. Buyback payments to MPPA were \$32.1 million and \$76.6 million for 1984 and 1985, respectively, and are currently estimated at \$74.7 million, \$73.2 million, \$69.2 million, \$68.3 million and \$67.4 million for 1986, 1987, 1988, 1989 and 1990, respectively.

**Ludington Pumped Storage**—Operation, maintenance and other expenses of the Ludington Pumped Storage Plant are shared by the Company and Consumers Power Company in proportion to their respective interests in the plant.

## Note 5 - 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		
	1985	1984	1983
Statutory income tax rate	46.0%	46.0%	46.0%
AFUDC	(21.3)	(18.4)	(14.6)
Indirect construction costs	(2.7)	(2.4)	(2.1)
Interest on nuclear fuel financing	(1.7)	(1.7)	(1.3)
Depreciation	3.6	3.1	2.3
Other—net	(1.9)	(1.9)	(1.0)
Effective income tax rate	22.0%	24.7%	29.3%

Components of income taxes were applicable to the following:

	1985	1984	1983
	<i>(thousands)</i>		
Operating expenses			
Current	\$ 13,549	\$ 3,411	\$ 14,685
Deferred—net			
Borrowed funds component of AFUDC	(6,399)	36,724	56,783
Depreciation	62,764	49,136	35,175
Indirect construction costs	6,926	8,684	11,612
Deferred fuel refund	—	—	11,288
Sale to MPPA of an ownership interest in the Belle River Project	—	—	(31,496)
Amortization of extraordinary property losses and unrecovered plant costs	(4,823)	(4,817)	(4,208)
Other	4,122	(51)	(2,565)
	<u>62,590</u>	<u>89,676</u>	<u>76,589</u>
Investment tax credit—net			
Utilized	55,409	43,667	58,829
Amortized	(6,609)	(5,295)	(4,544)
	<u>48,800</u>	<u>38,372</u>	<u>54,285</u>
Total	<u>124,939</u>	<u>131,459</u>	<u>145,559</u>
Other income and deductions			
Current	(1,030)	725	758
Deferred—net	(612)	(613)	4,729
Total	<u>(1,642)</u>	<u>112</u>	<u>5,487</u>
Total income taxes	<u>\$ 123,297</u>	<u>\$ 131,571</u>	<u>\$ 151,046</u>

The Company defers income taxes for the borrowed funds component of AFUDC and indirect construction costs which are deducted currently for federal income tax purposes. In accordance with MPSC requirements, deferred income tax accounting is not followed for such construction costs relating to Fermi 2, interest on nuclear fuel financing (See Note 11) and certain other current income tax deductions.

In July 1985, the MPSC ordered that, for accounting and ratemaking purposes, the accumulated deferred income tax credits 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 \$12 million for 1985.

The cumulative net amount of income tax timing differences for which deferred taxes have not been provided at December 31, 1985 and 1984 are \$2.0 billion and \$1.7 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 \$291 million at December 31, 1985 are available to offset future years' tax liabilities as permitted by law. Such credits, if unused, expire over the period 1996 through 2000.

#### Note 6 – Compensating Balances and Short-Term Borrowings

As described below, at December 31, 1985, the Company had total short-term credit arrangements of \$369.7 million under which no borrowings were outstanding.

The Company had bank lines of credit of \$300.1 million, of which \$5.1 million required compensating balances, \$293.5 million had commitment fees in lieu of compensating balances and \$1.5 million did not require compensating balances or commitment fees. In support of lines of credit requiring compensating balances, the Company maintained bank balances which during 1985 averaged \$2.2 million. None of these balances is subject to usage or withdrawal restrictions. Commitment fees paid in lieu of compensating bank balances for 1985 were \$1.7 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 \$309 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, 1985, \$44.6 million was available to the Company under such Loan Agreement. (See Note 11.)

The Company has a \$25.0 million credit arrangement restricted to bankers acceptances.

#### Note 7 – 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. A return on investment is provided only for the unamortized extraordinary property losses. (See Note 3.) Information relating to these items is as follows:

Amortization Period	Total	Unamortized Balance December 31	
		1985	1984
<i>(thousands)</i>			
Extraordinary Property Losses			
April 1979 Storm	1982-1987	\$ 4,048	\$ 6,605
July 1980 Storm	1982-1987	2,953	4,818
Unrecovered Plant Costs			
Enrico Fermi Unit No. 3	1977-1986	681	1,362
Greenwood Unit Nos. 2 and 3	1983-1993	51,680	58,808
		<u>\$ 59,362</u>	<u>\$ 71,593</u>

#### Note 8 – Common Stock and Non-Redeemable Cumulative Preferred and Preference Stock

In the fourth quarter of 1985, the Company discontinued the issuance of new shares of its Common Stock through the Dividend Reinvestment Plan and the Employees' Savings Plans.

The Convertible Cumulative Preferred Stock, 5 1/2% Series, is convertible into Common Stock. The conversion price was \$17.79 per share at December 31, 1985. The numbers of shares converted during 1985, 1984 and 1983 were 15,739, 23,417 and 37,072, respectively. The number of shares of Common Stock reserved for issuance upon conversion and the conversion price are subject to further

adjustment in certain events. The Convertible Cumulative Preferred Stock, 5 1/2% Series, may be redeemed at any time in whole or in part at the option of the Company at \$100 per share, plus accrued dividends.

The 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
<b>Preferred Stock</b>				
9.32%	\$104	10-15-86	\$101	10-15-86
7.68%	103	4-15-86	101	4-15-86
7.45%	103	11-15-86	101	11-15-86
7.36%	102.50	12-1-87	101	12-1-87
<b>Preference Stock</b>				
\$2.28	26.50	1-15-88	25.25	1-15-93
\$3.42	28.42	1-15-88	25.25	1-15-98
\$3.40	28.40	1-15-88	25.25	1-15-98
\$3.12	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 \$3.42 Series, \$3.40 Series, \$3.12 Series, \$3.13 Series or \$3.24 Series Preference Stock may be redeemed through certain refunding operations prior to January 15, 1988, January 15, 1988, January 15, 1988, July 15, 1988 and October 15, 1988, respectively, at an effective cost less than that indicated by the original dividend rate.

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 9 - Redeemable Cumulative Preferred and Preference Stock

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
<b>Preferred Stock</b>				
9.72%	1-15-85	30,000	\$100	30,000
9.60%	10-15-85	32,500	100	32,500*
12.80%	7-15-86	20,000	100	20,000
13.50%	1-15-87	50,000	100	—
15.68%	7-15-87	50,000	100	—
<b>Preference Stock</b>				
\$2.75	7-15-80	100,000	25	100,000
\$2.75 Series B	1-15-81	100,000	25	100,000
\$4.12	1-15-87	100,000	25	150,000
\$4.00	4-15-87	80,000	25	120,000

\*Not to exceed 220,000 cumulative additional shares.

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

	1985	1984	1983
Preferred stock, 9.72% Series	31,020	30,000	—
Preferred stock, 9.60% Series	32,500	—	—
Preference stock, \$2.75 Series	119,800	28,900	114,500
Preference stock, \$2.75 Series B	26,700	99,920	100,000

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

The combined aggregate annual amounts of redemption requirements at December 31, 1985 for all series of redeemable Preferred and Preference Stock are \$9.1 million, \$27.6 million, \$27.8 million, \$27.8 million and \$27.8 million for 1986, 1987, 1988, 1989 and 1990, respectively.

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
<b>Preferred Stock</b>				
9.72%	\$105.80	1-15-89	\$101	1-15-94
9.60%	107.00	10-15-89	101	10-15-94
12.80%	108.50	7-15-90	100	7-15-95
13.50%	113.50	1-15-86	100	1-15-90
15.68%	107.84	7-15-86	100	7-15-89
<b>Preference Stock</b>				
\$2.75	26.10	7-15-90	25.25	7-15-90
\$2.75 Series B	26.95	1-15-86	25.25	1-15-91
\$4.12	29.15	1-15-87	25.25	1-15-97
\$4.00	29.00	4-15-87	25.25	4-15-97

None of the shares of the Cumulative Preferred Stock, 9.60% Series, 13.50% Series or 15.68% Series may be redeemed through certain refunding operations prior to October 15, 1989, January 15, 1986 and July 15, 1986, respectively, at an effective cost less than that indicated by the original dividend rate. None of the shares of the Cumulative Preference Stock, \$4.12 Series or \$4.00 Series may be redeemed through certain refunding operations prior to January 15, 1987 and April 15, 1987, respectively, at an effective cost less than that indicated by the original dividend rate.

### Note 10 - Long-Term Debt

**General and Refunding Mortgage Bonds**—The Company's 1924 Mortgage and Deed of Trust, as amended, ("Mortgage"), the lien of which covers substantially all of the Company's properties, limits the amount of additional General and Refunding Mortgage Bonds ("Mortgage Bonds") which may be issued on the basis of property additions, an earnings test provision and Mortgage Bond retirements. At December 31, 1985, approximately \$3.8 billion principal amount of additional Mortgage Bonds could have been issued on the basis of property additions, after taking into account the effect of the earnings test provision of the Mortgage and assuming an interest rate of 11.25% on any such additional Mortgage Bonds. In addition, at December 31, 1985, approximately \$298 million principal amount of Mortgage Bonds could have been issued on the basis of Mortgage Bond retirements. See Note 3 for possible changes which could limit the Company's ability to issue Mortgage Bonds.

**Tax Exempt Revenue Bond Obligations**—Agreements have been signed with certain municipalities and municipal agencies, under which the municipalities and agencies issued tax exempt bonds to finance certain Company projects and 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 most 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.

**Belle River Project Financing**—The Company has an agreement with a group of commercial banks for a \$1.2 billion project financing relating to Belle River Unit No. 1 and facilities used in common with Belle River Unit No. 2. In March 1984, the maximum of \$1.2 billion of borrowings under this agreement was reached. In 1985, the Company prepaid \$150 million representing quarterly repayments due January 1 and April 1, 1986. Quarterly repayments are due beginning July 1, 1986 and continuing thereafter through October 1, 1989 with provision for prepayment at any time without penalty. The agreement contains a number of covenants, including an agreement by the Company not to pledge or sell any of its assets except in the ordinary course of business and except for the sale or conveyance to one or more utilities of undivided interests in generating plants; and not to create certain liens on its assets. For 1985, 1984 and 1983, interest and commitment fees of \$119.5 million, \$152.7 million and \$120.3 million, respectively, are included in interest charges, offset by \$1.3 million, \$64.2 million and \$110.3 million, respectively, included in the borrowed funds component of AFUDC.

**Long-Term Debt Maturities**—In 1986, 1987, 1988, 1989 and 1990, long-term debt maturities consist of \$404.3 million, \$721.4 million, \$379.8 million, \$429.6 million and \$92.1 million, respectively.

#### Note 11 — Leases

Rental expenses were \$39.1 million, \$38.0 million and \$36.1 million for 1985, 1984 and 1983, respectively.

Future minimum lease payments under long-term noncancellable leases, consisting of nuclear fuel (\$386.3 million computed on a projected units of production basis, plus current interest), lake vessels (\$103.6 million), locomotives and coal cars (\$107.8 million), office space (\$59.3 million) and computers, vehicles and other equipment (\$66.7 million) at December 31, 1985 are as follows:

	(millions)		(millions)
1986	\$76.2	1989	\$ 93.0
1987	97.6	1990	72.0
1988	75.8	Remaining years	309.1
		Total	\$723.7

The Company has a heat purchase contract with Renaissance which provides for the purchase by Renaissance for the Company of up to \$309 million of nuclear fuel. Title to the nuclear fuel is held by Renaissance. Subject to the continued availability of funds to Renaissance to purchase such fuel, the Company's obligation to make quarterly payments under the heat purchase contract will not commence until the consumption of nuclear fuel for the generation of electricity begins. Renaissance's investment in nuclear fuel was \$264.4 million and \$189.9 million at December 31, 1985 and 1984, respectively. (See Notes 3 and 6.)

In accordance with SFAS No. 71, the Company records capital leases for which the inception date is after December 31, 1982. Accordingly, balance sheet assets

and liabilities at December 31, 1985 and 1984 include certain property and related obligations under capital leases.

By 1987, as permitted by SFAS No. 71, the Company will record capital leases for which the inception date is on or before December 31, 1982. Had all such eligible leases been accounted for as capital leases, assets at December 31, 1985 and 1984 would have included additional property under capital leases (including nuclear fuel), less accumulated amortization, of \$371.4 million and \$306.6 million, respectively. Also, liabilities at December 31, 1985 and 1984 would have included additional noncurrent liabilities under capital leases of \$98.1 million and \$105.4 million, respectively, and additional current liabilities (including nuclear fuel obligations) under capital leases of \$273.3 million and \$201.2 million, respectively.

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. Net income is not affected by capitalization of leases.

For ratemaking purposes, the MPSC has treated all leases as operating leases.

#### Note 12 — Commitments and Contingencies

**Commitments**—The Company has entered into purchase commitments of approximately \$491 million at December 31, 1985. The Company has also entered into substantial long-range fuel supply commitments.

**Contingencies**—The Company has experienced and in the future may experience some of the problems confronting the electric utility industry in general, such as difficulty in obtaining sufficient return on invested capital through timely and adequate rate increases resulting in part from phase-in plans and disallowances of plant costs; low levels of funds generated internally for construction; the effects of significant cash commitments and extended construction periods for generating units; additional expenditures and delays due to efforts to comply with changing environmental laws and regulations; increased operation and maintenance expenses; unanticipated reduction in load growth; inability or unwillingness of joint-owners of generating units to honor commitments; dilution of common shareholders' equity due to the issuance of substantial numbers of common shares at prices below book value; and increased political activities by consumer interest groups.

See Notes 2, 3 and 13 for a discussion of contingencies related to Fermi 2 and other rate matters.

Ownership of an operating nuclear generating unit subjects a company to additional risks. The Company is insured as to its interests 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 \$85 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, \$525 million of excess property damage insurance is provided. The combined limits provide total property damage insurance of \$1.11 billion (\$500 million of composite primary coverage, \$85 million of excess coverage and \$525 million of additional excess coverage). In addition, the Company will obtain coverage for fuel costs associated with plant outages through NEIL. Under the NEIL coverages, the Company could be liable for maximum retrospective assessments of up to approximately \$17 million per year if losses were to exceed accumulated funds available to NEIL.

As required under the Price Anderson Act (which expires in 1987), 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, 1985, there were 98 licensed nuclear units in the United States. Thus, deferred premium charges in the aggregate amount of \$490 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 \$650 million (\$160 million of private insurance and \$490 million of deferred premium charges).

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 as a self insurer. Although the Company has no reason to anticipate a serious nuclear incident at Fermi 2, if such an incident did happen it could have a material but presently undeterminable adverse impact on the Company's financial position.

### Note 13 - Rate Matters

**MPSC Electric Rate Case**—In 1983, the Company filed an electric rate case with the MPSC requesting an annual revenue increase of approximately \$969 million which included (1) \$71 million for general cost increases related to a 1984 test year, (2) \$213 million coincident with the commercial operation of Belle River Unit No. 1, (3) \$129 million coincident with the commercial operation of Belle River Unit No. 2 and (4) \$556 million coincident with the commercial operation of 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 pursuant to an interim order of the MPSC. At the time the Belle River interim order was issued, the Company's request for \$71 million to cover general cost increases was denied. On July 9, 1985, Belle River Unit No. 2 commenced commercial operation and the Company ceased to accrue AFUDC on the unit and began to record expenditures associated with plant operations and depreciation as current operating expenses. On July 16, 1985, the MPSC issued a partial final opinion and order which represents disposition of all issues relevant to this case (including the \$71 million requested for general cost increases) with the exception of those pertaining to the Fermi 2 plant which will be addressed at a later date. The MPSC authorized an additional electric rate increase in the annual amount of \$99.3 million effective July 16, 1985, bringing the total rate increase for Belle River and all issues excluding Fermi 2 to \$282.2 million in response to the \$413 million requested by the Company for the revenue requirements associated with the commercial operation of Belle River Unit Nos. 1 and 2 and for general cost increases. The Company awaits the final decision and order of the MPSC dealing with its Fermi 2 rate request (\$556 million coincident with the commercial operation of Fermi 2) and related issues, including proposed disallowances, a proposed rate moderation plan and alleged unrequired capacity. (See Note 2.)

In its July 16, 1985 order, the MPSC stated that while rate base treatment of the Belle River Project is justified, it must also determine the appropriate level of costs included in rate base for the facilities based on a "reasonable and prudent" standard. The MPSC concluded that there was an unreasonable delay in the construction of this project. The MPSC provided a total disallowance of approximately \$96.9 million (\$90.2 million of which is applicable to the Company's rate base) for Belle River. This amount included the disallowance of \$33.9 million for certain coal handling facilities and \$2.1 million for certain other boiler plant equipment plus a disallowance of \$60.9 million due to what the MPSC termed an imprudent delay of twelve months. With respect to the \$60.9 million disallowance related to the delay in construction and the \$2.1 million disallowance for certain

other boiler plant equipment, the MPSC determined that a return on and a recovery of the expenditures through depreciation are not appropriate. Approximately \$32.8 million of the \$33.9 million disallowance relating to certain coal handling facilities will be recovered through depreciation, but a return on this investment is not allowed; pursuant to the order, the Company is not entitled to a return on and a recovery of the remaining \$1.1 million through depreciation. The Company appealed to the Ingham County Circuit Court the July 16, 1985 order of the MPSC which denied the Company rate base treatment of approximately \$96.9 million of costs associated with Belle River. On September 17, 1985 the Court issued an injunction which allows the Company to collect, subject to refund, rates in an amount designed to produce an additional \$12.1 million in annual revenues. This additional amount of authorized revenues is to compensate for the \$60.9 million of the Belle River disallowance.

The Company's analysis of the rate order indicates that the revenues allowed for the Belle River Plant are sufficient to recover current operating expenses and depreciation of all of the plant investment, including the amount disallowed, plus associated ongoing interest costs. Therefore, the Company believes that, under current generally accepted accounting principles, a current period write-off of the amounts disallowed is not required. However, total and per share Earnings for Common Stock will be adversely affected over the period of time the plant is in service. See Note 3 for a discussion of proposed amendments to SFAS No. 71 concerning the disallowances of plant costs.

Prior to the issuance of the MPSC's July 16, 1985 order, the Company's approved rate of return on common equity was 15% and its authorized overall rate of return was 10.73%. The July 16, 1985 order expressed the MPSC's view that the completion of the Belle River Project has eliminated a continuing risk to investors; and for this reason, the MPSC's order has reduced the Company's return on common equity to 14.5% and its overall rate of return to 10.3%. The MPSC also advised that, when a decision is rendered with respect to Fermi 2, it intends to reduce the Company's return on common equity to a maximum of 14.25% and the overall rate of return will be reduced at least to 10.23%. However, such returns are not assured and the Company has not been able to achieve previously allowed rates of return.

**Deferred Fuel Cost Refund**—In 1983, the Michigan Supreme Court denied the Company's motion for a re-hearing of the deferred fuel cost matter, thereby requiring a refund of \$23.5 million of revenues collected to recover 1975 deferred fuel costs and a restatement of earnings for 1975, with corresponding reductions in retained earnings used in the business at December 31, 1975 and subsequent periods. Interest, preliminarily determined, of \$23.2 million reduced total and per share Earnings for Common Stock for 1983 by \$12.5 million and \$0.10, respectively. Subsequently, the MPSC issued an order directing the Company to refund the \$23.5 million of revenues previously collected, with interest preliminarily determined of \$23.2 million. Accordingly, the Company refunded portions of the \$23.5 million with interest and deposited funds with a trustee sufficient to refund the remaining balance. In 1984, the MPSC issued a final order directing the Company to refund \$19.1 million of interest. Since the preliminary interest of \$23.2 million refunded by the Company exceeded that required by the order, the Company believes that it has no further refund obligation. Because the preliminary interest was stipulated to by the Company, the excess amount refunded cannot be recovered from customers. In January 1985, the Michigan Attorney General and Association of Businesses Advocating Tariff Equity filed an appeal with the Ingham County Circuit Court which challenged the MPSC's method of determining interest. In September 1985, the Court remanded the case to the MPSC for consideration of additional evidence presented to the Court and a decision with respect thereto.

**Rate Refund**—In 1976, pursuant to a temporary order of the Ingham County Circuit Court, the Company collected revenues of \$13.7 million, subject to refund, which increased total and per share Earnings for Common Stock by approximately \$7.1 million and \$0.14, respectively. In 1981, the Ingham County Circuit Court issued a final opinion and order concluding that there was insufficient evidence to support the collection of the additional \$13.7 million of revenues. In 1984, after a series of appeals, the final opinion and order of the Ingham County Circuit Court was affirmed, thereby requiring a refund, with interest, of \$13.7 million of revenues collected in 1976. In February 1985, the Ingham County Circuit Court ruled that the statutory interest rate should be used for the refund and remanded the case to the MPSC to determine the method of refund. In March 1985, the Michigan Attorney General and other intervenors filed an appeal with the Michigan Court of Appeals which argues that the statutory interest rate is unreasonably low. In August 1985, the MPSC ordered the Company to refund the \$13.7 million of revenues with interest preliminarily determined. Accordingly, the Company refunded portions of the \$13.7 million with interest and deposited funds with a trustee sufficient to refund the remaining balance. Final interest charges will be determined by the MPSC after appropriate proceedings. The accrual of this refund with interest reduced total and per share Earnings for Common Stock for 1984 by \$15.8 million and \$0.12, respectively.

**Fuel Cost Recovery**—In 1979, the Michigan Attorney General requested orders from the Ingham County Circuit Court and the MPSC prohibiting the Company from charging, over the period 1980 through the first quarter of 1985, approximately \$30 million under the fuel cost adjustment clause. These charges related to certain costs resulting from the renegotiation of a contract with Decker Coal Company. In 1980, the Circuit Court denied the requested relief and remanded the case to the MPSC. In 1983, the MPSC issued a final order which dismissed the Michigan Attorney General's complaint. The Michigan Attorney General appealed the order to the Ingham County Circuit Court which denied the appeal in September 1985. In September 1985 the Michigan Attorney General appealed this case to the Michigan Court of Appeals.

**Steam Heating Rate Case Appeal**—In 1984, the Michigan Supreme Court decided to hear an appeal challenging a 1970 MPSC order granting an increase in steam heating rates. If it is ultimately determined that the Company must refund all or a portion of the approximately \$8.1 million collected plus interest of an estimated \$14.8 million at December 31, 1985, such amounts refunded would reduce Earnings for Common Stock in the period of such determination (approximately \$12.4 million at December 31, 1985).

#### Note 14 - Employees' Retirement Plan and Other Postretirement Benefits

**Employees' Retirement Plan**—The Company has a trustee and noncontributory defined benefit retirement plan covering all eligible employees who have completed six months of service. The Company's policy is to fund pension cost annually as it accrues based on the actuarial cost of the Plan. Unfunded prior service cost is amortized over forty years and thirty years (for costs relating to amendments to the Plan after April 1, 1976), as appropriate, and net experience gains and losses are amortized over fifteen years. Cost to the Company to fund the plan was \$37.9 million, \$35.7 million and \$41.3 million for 1985, 1984 and 1983, respectively. Effective January 1, 1984, the Company changed the actuarial funding method used in determining pension cost from the entry age normal cost method to the projected unit credit method. In addition, the Company changed the interest rate used in determining pension cost from 6% in 1983 to 7% in 1984 and 1985.

A comparison of the actuarial present value of accumulated Plan benefits, determined using an interest rate of 10%, and net assets available for benefits at

December 31, 1984 and 1983, the latest dates for which actuarial information is available, is as follows:

	December 31	
	1984	1983
	(thousands)	
Actuarial present value of accumulated Plan benefits		
Vested	\$366,914	\$322,875
Nonvested	17,177	21,167
Total	\$384,091	\$344,042
Net assets available for Plan benefits	\$483,891	\$454,258

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

	1985	1984	1983
Cost to the Company of providing health care and life insurance benefits to active and retired employees (thousands)	\$37,535	\$38,795	\$41,612
Average number of active employees	11,042	10,965	11,144
Average number of retired employees	3,314	3,288	3,259

#### Note 15 - Supplementary Quarterly Financial Information (Unaudited)

	1985 Quarter Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
	(thousands, except per share amounts)			
Operating Revenues	\$713,032	\$651,273	\$722,297	\$701,555
Operating Income	149,512	131,101	170,904	162,684
Net Income	108,421	94,608	121,042	113,444
Earnings for Common Stock	82,535	68,749	95,242	87,725
Earnings Per Share	0.59	0.48	0.66	0.60

	1984 Quarter Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
	(thousands, except per share amounts)			
Operating Revenues	\$620,021	\$549,669	\$682,750	\$645,765
Operating Income	124,478	100,209	164,012	150,066
Net Income	100,975	74,265	123,143	103,554
Earnings for Common Stock	74,846	48,226	97,071	77,635
Earnings Per Share	0.57	0.36	0.71	0.56

#### Note 16 - Supplementary Information Concerning the Effects of Changing Prices (Unaudited)

The following supplementary information is supplied in accordance with the requirements of SFAS No. 33, "Financial Reporting and Changing Prices," as

amended. SFAS No. 33 addresses aspects of an inflationary environment i.e., the effects of changes in the specific prices of certain assets used by the Company (the "current cost" method). It is an attempt to display the approximate economic effects of inflation and should be considered an estimate of those effects rather than a precise measure.

Consolidated Statement of Income Adjusted for Changes in Specific Prices (Current Cost)	Year Ended December 31, 1985
	(millions of average 1985 dollars)
Earnings for Common Stock, as reported in the historical cost statement of income	\$334
Additional depreciation	(306)
Earnings for Common Stock adjusted for changes in specific prices	\$ 28
Increase in specific prices of net utility plant*	302
Effect of increase in the general price level	(499)
Adjustment of net utility plant to net recoverable amount	195
Reduction of purchasing power loss through debt financing	217
Net change in Common Shareholders' Equity	\$243

\*At December 31, 1985, the current cost of utility plant, net of accumulated depreciation, was \$14.5 billion, while historical cost or net amount recoverable through depreciation was \$8.6 billion.

**General**—The current cost data reflect changes in the specific prices of utility plant from the date such plant was acquired to the present, as measured by the Handy-Whitman Index of Public Utility Construction Costs ("Index").

**Earnings for Common Stock Adjusted for Changes in Specific Prices**—Adjustment of the historical cost statement of income to arrive at Earnings for Common Stock adjusted for changes in specific prices was limited to depreciation expense, in accordance with procedures specified in SFAS No. 33.

Estimated utility plant was determined under this method by applying the Index to the historical cost of utility plant by vintage year. Depreciation expense was then determined for the adjusted amounts of utility plant by applying the same composite depreciation rate used to compute the historical amount of depreciation expense.

Since the higher depreciation expense under the current cost method is not tax deductible, income taxes were not adjusted from the amount shown in the Company's historical cost statement of income.

Fuel inventories and the cost of fuel used in the generation of electricity were not restated from their historical costs. Regulation provides for the current recovery of fuel expense. Materials and supplies inventories were not restated since they are not a cost of generating electricity and the amounts involved are insignificant.

**Adjustment of Net Utility Plant to Net Recoverable Amount**—Under current ratemaking policies prescribed by the MPSC and the FERC, only the historical cost of utility plant is recoverable through depreciation charges as part of the cost of service billed to customers. Therefore, the excess of the cost of utility plant adjusted for changes in specific prices is not presently recoverable in rates as depreciation. In accordance with the requirements of SFAS No. 33, the amount of this excess that accrued as a result of changing prices during 1985 is reflected as an adjustment to net recoverable amount.

**Reduction of Purchasing Power Loss through Debt Financing**—Since the Company owed net monetary liabilities during a period in which the general purchasing power of the dollar declined, the Company experienced an economic gain in purchasing power. All assets and liabilities other than utility plant, as well as amounts applicable to preferred and preference stock, were treated as monetary items. Preferred and preference stock were treated in the same manner as long-term debt. The gain in purchasing power which results from the Company's use of debt financing is strictly an economic concept. The Company cautions readers that such gains will never be realized and therefore will not contribute to cash flow.

**Summary**—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, thus further exposing the Company to the effects of inflation in the form of increased financing costs. The Company, therefore incurs a significant purchasing power loss which is experienced by the common shareholder and can be overcome only as a result of adequate rate relief in the regulatory process.

#### Five-Year Comparison of Selected Supplementary Financial Data\*

	1985	1984	1983	1982	1981
	(millions)				
<b>Earnings for Common Stock</b>					
As reported	\$ 334	\$ 298	\$ 266	\$ 181	\$ 177
Adjusted for changes in specific prices	28	(11)	(35)	(122)	(97)
<b>Earnings Per Common Share</b>					
As reported	\$ 2.33	\$ 2.20	\$ 2.21	\$ 1.75	\$ 2.02
Adjusted for changes in specific prices	0.20	(0.01)	(0.29)	(1.18)	(1.11)
<b>Increase in Specific Prices of Net Utility Plant over (under) the Increase in the General Price Level</b>	\$ (197)	\$ (242)	\$ 67	\$ (85)	\$ (175)
<b>Reduction of Purchasing Power Loss through Debt Financing</b>	\$ 217	\$ 215	\$ 203	\$ 186	\$ 383
<b>Net Assets (Common Shareholders' Equity) at Year-End</b>					
As reported	\$ 2,588	\$ 2,380	\$ 2,195	\$ 1,872	\$ 1,675
Adjusted for changes in specific prices after adjustment to recoverable amount	2,547	2,431	2,330	2,063	1,917

\*All data adjusted for changing prices are stated in average 1985 dollars.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

### Consolidated Statement of Income

*General*—Improved business and economic conditions existed throughout the Company's service area during the three-year period resulting in higher kilowatt-hour ("kWh") sales, particularly in the commercial and industrial sectors. The Company also experienced increased operating expenses and increased costs of capital associated with financing capital expenditures.

Although rate increases were received during this period, they were not adequate to permit the Company a reasonable opportunity to earn the rates of return on common equity authorized by the MPSC.

*Operating Revenues*—Approximately 97% of the Company's operating revenues are subject to the jurisdiction of the MPSC, with the remaining 3% subject to the jurisdiction of the FERC.

Revenues increased in each year due to the following factors:

	Estimated Increase (Decrease) From Prior Year		
	1985	1984	1983
	<i>(millions)</i>		
Rate increases and the recovery of fuel and net purchased power costs	\$229	\$ 66	\$ 53
Kilowatt-hour sales	54	105	144
Other-net	7	18	(11)
Total	\$290	\$189	\$186

Operating revenues include the following MPSC authorized electric rate increases:

Annual Revenues - Millions	
Interim	Final Including Interim
\$145.2 (July 1982)	\$203.4 (Mar. 1983)
182.9 (June 1984)	282.2 (July 1985)

The June 1984 and the July 1985 rate increases became effective with the commercial operation of Belle River Unit Nos. 1 and 2 in August 1984 and July 1985, respectively.

For 1985, revenues include an electric rate surcharge ordered by the Ingham County Circuit Court effective in September in the annual amount of \$12.1 million. For 1984, revenues decreased by \$13.7 million due to a court ordered refund of revenues collected in 1976. (See Note 13.)

Operating revenues realized from rate increases 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		
	1985	1984	1983
Residential	0.71%	11.01%	3.2%
Commercial	4.1	5.7	3.6
Industrial	1.8	7.7	10.3
Total	2.3%	4.6%	7.2%

The increases in commercial and industrial sales were due primarily to improved business and economic conditions with major increases in sales to automotive and automotive-related customers. Sales to steel customers were higher in 1983 and 1984, but declined in 1985. The decreases in residential sales in 1984 and 1985 were due primarily to cooler summer weather.

*Operating Expenses*—Operating expenses increased in each year. Fuel expense decreased in 1983 due primarily to decreased generation, coal freight rate tariff refunds and increased consumption of coal, the Company's lowest cost fuel. Fuel expense increased in 1984 and 1985 due primarily to increased generation reflecting higher kWh sales to customers and, in 1985, to higher costs of coal. The increase in 1985 was partially offset by a reduction in expense for a reclamation settlement with Decker Coal Company. The average cost per ton of coal consumed for 1983, 1984 and 1985 was \$42.09, \$41.96 and \$44.34, respectively. Coal as a percent of total fuel consumed in 1983, 1984 and 1985 was 97.4%, 97.8% and 98.0%, respectively. Other power supply expense increased in 1983 due to increased purchases of energy at lower unit prices reflecting decreased generation and higher sales to customers. Other power supply expense increased in 1984 and 1985 due primarily to the purchase of MPPA's capacity and energy entitlements beginning in August 1984 (See Note 4) and lower sales of energy to General Public Utilities Corporation. The increase in 1985 was partially offset by lower purchases of energy from other electric utilities. Other operation expense increased due primarily to higher labor and general inflationary increases, despite management's continuing stringent control of expenses. The 1983 increase included the write-off of fuel oil conversion projects at two peaker sites and the amortization of unrecovered plant costs relating to Greenwood Unit Nos. 2 and 3, partially offset by a decrease in uncollectible expense. The 1984 and 1985 increases included the cost to operate Belle River Unit Nos. 1 and 2 which commenced commercial operation in August 1984 and July 1985, respectively, and a renewed participation in the Electric Power Research Institute. The 1985 increase also included higher public liability insurance premiums and legal expenses. Maintenance expense increased due primarily to higher labor and material costs, continuing efforts to maintain or improve the availability and efficiency of all generating equipment, and a severe ice storm in January 1985. The 1984 and 1985 increases also reflect expenses associated with the commercial operation of Belle River Unit Nos. 1 and 2. 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. (See Note 1.) Taxes other than income taxes increased due to higher property and payroll taxes and in 1983 and 1985 to an increase in Michigan Single Business Tax. Higher property taxes in 1984 and 1985 reflect the commercial operation of Belle River Unit Nos. 1 and 2, respectively. Income taxes increased in 1983 due primarily to higher pretax income. Income taxes decreased in 1984 and 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. (See Notes 1 and 5.)

*Costs of Capital*—Interest on long term debt and dividends on common shares outstanding increased for all periods and preferred and preference stock dividend requirements increased in 1983 and 1984 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. The increase in

interest on long-term debt was partially offset by lower interest rates in 1983 and 1985. Other interest expense decreased in 1983 due to lower levels of short-term borrowings and lower interest rates, partially offset by interest on the deferred fuel cost refund. (See Note 13.) Other interest expense decreased in 1984 due to lower levels of short-term borrowings and the accrual in 1983 of interest on the deferred fuel cost refund, partially offset by higher interest rates and interest on the court ordered refund of revenues collected in 1976. (See Note 12.) 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. The average interest rate for short-term borrowings increased from 10.4% in 1983 to 11.7% in 1984 and decreased to 8.8% in 1985.

**Earnings for Common Stock and Earnings Per Share**—Earnings for Common Stock increased in each year due to rate increases and to higher kWh sales, partially offset by increased operating expenses in spite of management's continuing stringent control of expenses. Despite the increases in Earnings for Common Stock, earnings per share declined in 1984 and were reduced in 1983 and 1985 as a result of increases in the average number of common shares outstanding.

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 increased in 1983 and 1984 due to additional capital expenditures and an increase in the AFUDC rate in April 1983 (in recognition of increasing costs of capital). In 1983, additional capital expenditures on the Belle River project were substantially offset by the sale to MPPA and lower interest rates. In 1984, the increase in AFUDC was substantially offset by the commercial operation of Belle River Unit No. 1. AFUDC decreased in 1985 due to the commercial operation of the Belle River Power Plant, partially offset by additional capital expenditures for Fermi 2. AFUDC amounted to 108%, 99% and 74% of Earnings for Common Stock for the years 1983, 1984 and 1985, respectively. Accordingly, earnings available for dividends on Common Stock are dependent in part upon sources other than current operating income. (See Note 1.)

Return on average common equity was 13.0%, 12.9% and 13.3% for 1983, 1984 and 1985, respectively, as compared with the 14.0% return authorized by the MPSC through March 1983, 15.0% from April 1983 to July 1985 and 14.5% thereafter.

### **Consolidated Balance Sheet**

Plant in service increased and construction work in progress decreased primarily as a result of the commencement of commercial operation of Belle River Unit No. 2 in July 1985. The decrease in construction work in progress was partially offset by additional capital expenditures for Fermi 2.

### **Liquidity and Capital Resources**

External financing provided 88%, 84% and 60% of capital expenditures (excluding total AFUDC) in 1983, 1984 and 1985, respectively. Low levels of internal cash generation are expected to continue until Fermi 2 commences commercial operation and rates are authorized by the MPSC allowing the Company capital recovery and return on the investment in this unit. See Note 2 for a description of a plan recommended by the ALJ which would phase in the cash recovery of a portion of the net income requirement associated with Fermi 2. This plan does not provide for the full recovery (from either current

customer rates or phase-in revenues) of the project costs and operating expenses (operation, maintenance, depreciation, property and other taxes) for Fermi 2.

Cash requirements for capital expenditures from 1986 to 1990 are estimated to be approximately \$1.2 billion (excluding approximately \$79 million of AFUDC). In 1986, cash requirements for capital expenditures are estimated at \$273 million (excluding \$61 million of AFUDC). These estimates assume the commercial operation of Fermi 2 in March 1986, which is no longer attainable. (See Note 2 for a discussion of additional Fermi 2 project costs.)

Cash requirements for the Company's remaining purchase obligation for portions of the Cooperative's ownership interest in Fermi 2 are approximately \$7 million per month and will continue until commercial operation. (See Note 4.)

Cash requirements for long-term debt maturities and cumulative preferred and preference stock sinking fund requirements are \$413.4 million (after prepayment in 1985 of \$150 million under the Belle River Project Financing), \$749.1 million, \$407.6 million, \$457.4 million, and \$119.8 million for 1986, 1987, 1988, 1989 and 1990, respectively.

Short-term borrowings are incurred to finance the Company's capital expenditure program, to refund maturing long-term debt and to meet other interim cash requirements, pending the receipt of proceeds from unsecured long-term bank borrowings and the sale of debt and equity securities. The Company had temporary cash investments of \$13.0 million at December 31, 1985. The Company had short-term credit arrangements of approximately \$369.7 million at December 31, 1985 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 debt or equity financing would increase reliance on short-term borrowings and, depending on the circumstances, could adversely affect the Company's financial condition.

The Company's objective is to achieve a capital structure 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 due within one year) increased from 33.4% at December 31, 1984 to 35.8% at December 31, 1985 due primarily to the issuance of 7,494,934 additional common shares and the increase in net income in 1985. The ratio of preferred and preference stock to total capitalization decreased from 12.6% at December 31, 1984 to 12.1% at December 31, 1985 due primarily to redemptions of preferred and preference stock and the increase in common shareholders' equity. The ratio of long-term debt to total capitalization decreased from 54.0% at December 31, 1984 to 52.1% at December 31, 1985 due primarily to increases in amounts due within one year.

See Note 3 for a discussion of the possible adverse effects on the Company if the FASB Exposure Draft is issued as a final Statement and the MPSC issues a rate order consistent with the Fermi 2 PFD.

See Notes 4, 6, 11, 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. (See Note 16.)

**COMPARATIVE RESULTS OF OPERATIONS**

	1985	1984	1983	1982
<b>Operating Revenues</b>				
Electric	\$2,738,356	\$2,439,835	\$2,260,021	\$2,078,965
Steam	49,801	58,370	49,637	44,289
Total Operating Revenues	\$2,788,157	\$2,498,205	\$2,309,658	\$2,123,254
<b>Operating Expenses</b>				
Operation				
Fuel	\$ 785,110	\$ 700,789	\$ 676,409	\$ 718,431
Other power supply	196,918	184,740	128,921	74,654
Other operation	422,133	403,616	374,164	372,767
Maintenance	250,798	203,945	187,769	170,974
Depreciation	218,502	190,420	171,940	161,430
Taxes other than income	175,556	144,471	142,743	118,537
Income taxes	124,939	131,459	145,559	96,912
Total Operating Expenses	\$2,173,956	\$1,959,440	\$1,827,505	\$1,713,705
<b>Operating Income</b>	\$ 614,201	\$ 538,765	\$ 482,153	\$ 409,549
<b>Other Income and Deductions</b>				
Allowance for funds used during construction	\$ —	\$ —	\$ —	\$ —
Allowance for other funds used during construction	113,225	130,350	92,750	47,995
Other income and deductions	(5,240)	1,829	7,877	(4,820)
Income taxes	1,642	(1,121)	(5,487)	1,155
Total Other Income and Deductions	\$ 109,627	\$ 132,067	\$ 95,140	\$ 44,330
<b>Income Before Interest Charges</b>	\$ 723,828	\$ 670,832	\$ 577,293	\$ 453,879
<b>Interest Charges</b>				
Long-term debt	\$ 401,272	\$ 399,448	\$ 351,854	\$ 331,469
Amortization of debt discount, premium and expense	2,502	2,191	2,131	2,006
Other	15,642	30,592	53,088	59,779
Allowance for borrowed funds used during construction (credit)	(133,103)	(163,336)	(194,402)	(194,076)
Net Interest Charges	\$ 286,313	\$ 268,895	\$ 212,671	\$ 199,178
<b>Net Income</b>	\$ 437,515	\$ 401,937	\$ 364,622	\$ 254,701
<b>Preferred and Preference Stock Dividend Requirements</b>	103,264	104,159	98,614	73,245
<b>Earnings for Common Stock</b>	\$ 334,251	\$ 297,778	\$ 266,008	\$ 181,456
<b>Common Shares Outstanding—Average</b>	143,183,133	135,230,827	120,274,269	103,585,915
<b>Earnings Per Share</b>	\$ 2.33	\$ 2.20	\$ 2.21	\$ 1.75
<b>Dividends Declared Per Share of Common Stock</b>	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
<b>Ratio of Earnings to Fixed Charges (SEC Basis)</b>	2.28	2.19	2.22	1.85
<b>Ratio of Earnings to Fixed Charges and Preferred and Preference Stock Dividend Requirements (SEC Basis)</b>	1.75	1.67	1.67	1.49

1981	1980 <i>(thousands)</i>	1979	1978	1977	1976	1975
\$2,011,217	\$1,776,364	\$1,667,679	\$1,561,296	\$1,423,909	\$1,241,883	\$1,052,061
42,840	36,150	30,832	28,546	27,012	24,284	18,719
<u>\$2,054,057</u>	<u>\$1,812,514</u>	<u>\$1,698,511</u>	<u>\$1,589,842</u>	<u>\$1,450,921</u>	<u>\$1,266,167</u>	<u>\$1,070,780</u>
\$ 689,165	\$ 670,116	\$ 647,620	\$ 580,869	\$ 538,325	\$ 477,231	\$ 471,873
139,981	107,767	96,502	158,098	108,648	88,350	(9,464)
333,440	290,566	266,410	235,720	203,300	179,867	160,224
164,978	133,270	128,600	124,804	110,736	100,577	91,253
150,240	141,948	129,644	115,325	102,304	93,875	89,240
117,224	115,520	99,552	91,488	96,597	94,234	76,365
64,388	37,012	54,706	56,686	66,717	35,940	24,398
<u>\$1,659,416</u>	<u>\$1,496,199</u>	<u>\$1,423,034</u>	<u>\$1,362,990</u>	<u>\$1,226,627</u>	<u>\$1,070,074</u>	<u>\$ 903,889</u>
\$ 394,641	\$ 316,315	\$ 275,477	\$ 226,852	\$ 224,294	\$ 196,093	\$ 166,891
\$ —	\$ —	\$ —	\$ —	\$ —	\$ 49,833	\$ 43,463
39,398	38,815	38,323	32,273	23,750	—	—
(9,501)	692	3,664	2,371	4,821	1,728	2,412
4,771	(669)	(1,554)	(1,228)	(1,700)	451	(1,353)
<u>\$ 34,668</u>	<u>\$ 38,838</u>	<u>\$ 40,433</u>	<u>\$ 33,416</u>	<u>\$ 26,871</u>	<u>\$ 52,012</u>	<u>\$ 44,522</u>
\$ 429,309	\$ 355,153	\$ 315,910	\$ 260,268	\$ 251,165	\$ 248,105	\$ 211,413
\$ 290,045	\$ 211,857	\$ 167,585	\$ 140,288	\$ 129,078	\$ 124,992	\$ 116,267
1,853	1,776	1,644	1,403	1,339	1,084	945
37,025	19,662	13,823	5,298	1,959	2,404	8,420
(133,967)	(66,708)	(43,171)	(33,590)	(25,726)	—	—
<u>\$ 194,956</u>	<u>\$ 166,587</u>	<u>\$ 139,881</u>	<u>\$ 113,399</u>	<u>\$ 106,650</u>	<u>\$ 128,480</u>	<u>\$ 125,632</u>
\$ 234,353	\$ 188,566	\$ 176,029	\$ 146,869	\$ 144,515	\$ 119,625	\$ 85,781
57,566	51,037	43,457	38,056	34,635	34,589	26,463
<u>\$ 176,787</u>	<u>\$ 137,529</u>	<u>\$ 132,572</u>	<u>\$ 108,813</u>	<u>\$ 110,420</u>	<u>\$ 85,036</u>	<u>\$ 59,318</u>
87,473,581	78,780,863	69,848,484	61,898,763	55,202,974	51,277,789	48,120,898
\$ 2.02	\$ 1.75	\$ 1.90	\$ 1.76	\$ 2.00	\$ 1.66	\$ 1.23
\$ 1.64	\$ 1.60	\$ 1.60	\$ 1.52	\$ 1.4675	\$ 1.45	\$ 1.45
1.84	1.90	2.17	2.28	2.48	2.13	1.85
1.53	1.53	1.69	1.71	1.85	1.61	1.45

## STATISTICAL REVIEW

	1985	1984	1983	1982
<b>Operating Revenues</b> (thousands)				
Residential—Electric	\$ 827,210	\$ 758,124	\$ 741,399	\$ 676,370
Commercial—Electric	651,559	570,082	513,292	473,498
Industrial—Electric	1,034,374	919,490	818,660	754,238
Other	275,014	250,509	236,307	219,148
Total	\$ 2,788,157	\$2,498,205	\$2,309,658	\$2,123,254
<b>Sales</b> (millions of kWh)				
Residential	10,077	10,150	10,256	9,940
Commercial	7,130	6,850	6,479	6,252
Industrial	16,613	16,324	15,162	13,751
Other	2,875	2,563	2,402	2,052
Total	36,695	35,887	34,299	31,995
<b>Electric Customers</b> (year end)				
Residential	1,642,981	1,629,668	1,621,172	1,619,369
Commercial	144,942	142,395	140,403	139,376
Industrial	2,314	2,246	2,253	2,239
Other	1,883	1,885	1,878	1,827
Total	1,792,120	1,776,194	1,765,706	1,762,811
<b>Average Annual Use Per Residential Customer</b> (kWh)				
	6,165	6,253	6,332	6,133
<b>Average Annual Bill Per Residential Customer</b>				
	\$506.06	\$467.03	\$457.74	\$417.33
<b>Average Revenue Per kWh</b>				
Residential	8.21 <sup>c</sup>	7.47 <sup>c</sup>	7.23 <sup>c</sup>	6.80 <sup>c</sup>
Commercial	9.14	8.32	7.92	7.57
Industrial	6.23	5.63	5.40	5.49
<b>Capitalization</b> (thousands)				
Long-Term Debt	\$ 3,770,863	\$3,845,272	\$3,542,438	\$3,218,649
Preferred/Preference Stock	879,497	894,166	907,505	802,423
Common Shareholders' Equity	2,588,025	2,379,998	2,195,361	1,872,181
Total	\$ 7,238,385	\$7,119,438	\$6,645,304	\$5,893,253
<b>Capitalization</b> (percent)				
Long-Term Debt	52.1	54.0	53.3	54.6
Preferred/Preference Stock	12.1	12.6	13.7	13.6
Common Shareholders' Equity	35.8	33.4	33.0	31.8
Total	100.0	100.0	100.0	100.0
<b>Common Stock Data</b>				
Earnings Per Share	\$2.33	\$2.20	\$2.21	\$1.75
Dividend Paid Per Share	\$1.68	\$1.68	\$1.68	\$1.68
Payout	72%	76%	76%	96%
Shares Outstanding—Average	143,183,133	135,230,827	120,274,269	103,585,915
Return on Average Common Equity	13.31%	12.87%	13.03%	10.14%
Book Value Per Share	\$17.47	\$16.91	\$16.63	\$16.60
Market Price				
High	\$17 <sup>3</sup> / <sub>8</sub>	\$16 <sup>1</sup> / <sub>2</sub>	\$16	\$13 <sup>3</sup> / <sub>4</sub>
Low	\$14	\$11 <sup>1</sup> / <sub>2</sub>	\$13	\$11
<b>Miscellaneous Financial Data</b>				
Average Interest Rate on Long-Term Debt	9.9%	9.9%	9.5%	9.5%
Average Dividend Rate on Preferred/Preference Stock	11.6%	11.6%	11.6%	11.3%
Long-Term Debt Obligations and Redeemable Preferred and Preference Stock Outstanding (Thousands)	\$ 4,552,755	\$4,343,674	\$4,027,029	\$3,792,982
Total Assets (Thousands)	\$ 9,492,360	\$8,970,014	\$8,201,418	\$7,645,856
Gross Utility Plant (Thousands)	\$10,466,039	\$9,752,346	\$8,845,779	\$8,252,570
Net Utility Plant (Thousands)	\$ 8,612,890	\$8,076,168	\$7,320,570	\$6,824,058
Capital Expenditures (Thousands)	\$ 710,699	\$ 938,004	\$1,014,568	\$1,135,045
<b>Miscellaneous Operating Data</b>				
System Capability at Year End—MW	9,296	8,898	8,162	7,762
System Capability at Time of Peak—MW	9,367	9,271	7,810	8,569
System Peak Demand—MW	7,172	7,350	7,063	6,394
Reserve Margin at Time of Peak	30.6%	26.1%	10.6%	34.0%
System Load Factor	63.3%	60.2%	60.2%	61.7%
Heat Rate—Btu Per kWh	9,990	9,990	10,040	10,060
Fuel Cost—¢ Per Million Btu	202.0 <sup>c</sup>	190.6 <sup>c</sup>	190.2 <sup>c</sup>	193.8 <sup>c</sup>
Number of Employees at Year End	11,086	11,136	11,152	11,208



1981	\$ 642,301	\$ 583,701	\$ 524,613	\$ 497,988	\$ 464,906	\$ 408,828	\$ 366,381	\$ 218,424	363,732	122,193	\$1,070,780	10.134	6.310	15.471	34.022	1,624,161	1,38,830	2,305	1,821	1,767,117	6,243	8,995.66	6,345	5,625	4,795	4,485	4,055	3,675	3,389	2,42	\$1,573,077	418,312	926,920	\$2,918,309	53.9	14.3	31.8	100.0	\$1.23	\$1.45	118%	48,120,898	6,33%	\$18.66	\$14%	\$ 8%	7.5%	8.3%	\$1,720,340	\$1,828,669	\$3,623,504	\$3,934,752	\$3,221,932	\$ 241,186	8,780	8,556	8,467	32.3%	61.8%	10,190	110.15	9,567
1980	\$ 583,701	\$ 524,613	\$ 497,988	\$ 464,906	\$ 408,828	\$ 366,381	\$ 218,424	363,732	122,193	\$1,070,780	10.134	6.310	15.471	34.022	1,624,161	1,38,830	2,305	1,821	1,767,117	6,243	8,995.66	6,345	5,625	4,795	4,485	4,055	3,675	3,389	2,42	\$1,573,077	418,312	926,920	\$2,918,309	53.9	14.3	31.8	100.0	\$1.23	\$1.45	118%	48,120,898	6,33%	\$18.66	\$14%	\$ 8%	7.5%	8.3%	\$1,720,340	\$1,828,669	\$3,623,504	\$3,934,752	\$3,221,932	\$ 241,186	8,780	8,556	8,467	32.3%	61.8%	10,190	110.15	9,567	
1979	\$ 497,988	\$ 464,906	\$ 408,828	\$ 366,381	\$ 218,424	363,732	122,193	\$1,070,780	10.134	6.310	15.471	34.022	1,624,161	1,38,830	2,305	1,821	1,767,117	6,243	8,995.66	6,345	5,625	4,795	4,485	4,055	3,675	3,389	2,42	\$1,573,077	418,312	926,920	\$2,918,309	53.9	14.3	31.8	100.0	\$1.23	\$1.45	118%	48,120,898	6,33%	\$18.66	\$14%	\$ 8%	7.5%	8.3%	\$1,720,340	\$1,828,669	\$3,623,504	\$3,934,752	\$3,221,932	\$ 241,186	8,780	8,556	8,467	32.3%	61.8%	10,190	110.15	9,567			
1978	\$ 408,828	\$ 366,381	\$ 218,424	363,732	122,193	\$1,070,780	10.134	6.310	15.471	34.022	1,624,161	1,38,830	2,305	1,821	1,767,117	6,243	8,995.66	6,345	5,625	4,795	4,485	4,055	3,675	3,389	2,42	\$1,573,077	418,312	926,920	\$2,918,309	53.9	14.3	31.8	100.0	\$1.23	\$1.45	118%	48,120,898	6,33%	\$18.66	\$14%	\$ 8%	7.5%	8.3%	\$1,720,340	\$1,828,669	\$3,623,504	\$3,934,752	\$3,221,932	\$ 241,186	8,780	8,556	8,467	32.3%	61.8%	10,190	110.15	9,567					
1977	\$ 366,381	\$ 218,424	363,732	122,193	\$1,070,780	10.134	6.310	15.471	34.022	1,624,161	1,38,830	2,305	1,821	1,767,117	6,243	8,995.66	6,345	5,625	4,795	4,485	4,055	3,675	3,389	2,42	\$1,573,077	418,312	926,920	\$2,918,309	53.9	14.3	31.8	100.0	\$1.23	\$1.45	118%	48,120,898	6,33%	\$18.66	\$14%	\$ 8%	7.5%	8.3%	\$1,720,340	\$1,828,669	\$3,623,504	\$3,934,752	\$3,221,932	\$ 241,186	8,780	8,556	8,467	32.3%	61.8%	10,190	110.15	9,567						
1976	\$ 218,424	363,732	122,193	\$1,070,780	10.134	6.310	15.471	34.022	1,624,161	1,38,830	2,305	1,821	1,767,117	6,243	8,995.66	6,345	5,625	4,795	4,485	4,055	3,675	3,389	2,42	\$1,573,077	418,312	926,920	\$2,918,309	53.9	14.3	31.8	100.0	\$1.23	\$1.45	118%	48,120,898	6,33%	\$18.66	\$14%	\$ 8%	7.5%	8.3%	\$1,720,340	\$1,828,669	\$3,623,504	\$3,934,752	\$3,221,932	\$ 241,186	8,780	8,556	8,467	32.3%	61.8%	10,190	110.15	9,567							
1975	\$ 122,193	\$1,070,780	10.134	6.310	15.471	34.022	1,624,161	1,38,830	2,305	1,821	1,767,117	6,243	8,995.66	6,345	5,625	4,795	4,485	4,055	3,675	3,389	2,42	\$1,573,077	418,312	926,920	\$2,918,309	53.9	14.3	31.8	100.0	\$1.23	\$1.45	118%	48,120,898	6,33%	\$18.66	\$14%	\$ 8%	7.5%	8.3%	\$1,720,340	\$1,828,669	\$3,623,504	\$3,934,752	\$3,221,932	\$ 241,186	8,780	8,556	8,467	32.3%	61.8%	10,190	110.15	9,567									

## MARKET FOR THE COMPANY'S COMMON EQUITY AND RELATED STOCKHOLDER 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		Dividends
	High	Low	Paid Per Share
1985 First	\$16 1/2	\$15	\$0.42
Second	17 3/4	16	0.42
Third	17 3/4	14	0.42
Fourth	16 3/4	14 1/4	0.42
1984 First	14 3/4	12 3/4	0.42
Second	13 1/2	11 1/2	0.42
Third	14 1/2	12 3/4	0.42
Fourth	16 3/4	13 3/4	0.42

At December 31, 1985, 146,576,496 shares of the Company's Common Stock were outstanding. These shares were held by a total of 238,120 shareholders.

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

## MISCELLANEOUS CORPORATE DATA

### Annual Meeting Scheduled for April 28

The 1986 Annual Meeting of Shareholders will be held at 10 a.m. EST Monday, April 28, at the Henry and Edsel Ford Auditorium in Detroit. Shareholders will be asked to elect members of the Board of Directors and ratify reappointment of Price Waterhouse as independent accountants for the Company.

At the 1985 meeting, on April 22, 15 members were re-elected to the Board of Directors for one-year terms. They included David Bing, president of Bing Steel Inc., a new Director who first joined the Board on February 25, 1985.

### Company Mourns Messrs. Hamann, Kigar, Kirkby

Two retired officers of the Company and one corporate vice president died in 1985.

John R. Hamann, former president and chief operating officer, who was vice chairman of the Board at the time of his retirement, died September 4 at the age of 70. He had been retired since 1980, and served 45 years with Detroit Edison.

Donald E. Kigar, former president, died July 17 at the age of 80. He served the Company for 41 years before his retirement in 1967.

Robert C. Kirkby, vice president, Engineering and Construction, died December 27 at the age of 61. He originally joined Detroit Edison in 1947.

### Corporate Address

The Detroit Edison Company  
General Offices  
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

Fidata Trust Company  
New York  
67 Broad Street  
New York, New York 10004  
Charles A. Babcock  
Ronald J. Gdowski  
Elaine M. Godfrey  
Sophia J. Koziatek  
Kathryn L. Westman  
2000 Second Avenue  
Detroit, Michigan 48226

### Registrars of Stock

Fidata 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

Unlisted trading on the Boston, Cincinnati, Midwest, and Philadelphia Stock Exchanges

## DIRECTORS AND OFFICERS

### Board of Directors

<b>Wendell W. Anderson, Jr.</b>	Chairman of the Board and Chief Executive Officer, Bundy Corporation (Manufacturer of steel tubing, flexible hose and engineered plastic products)
<b>David Bing</b>	President, Bing Steel Inc., (A steel service center)
<b>Malcolm Carron, S.J.</b>	President, University of Detroit High School
<b>Charles T. Fisher III</b>	Chairman and President, National Bank of Detroit
<b>David M. Gates</b>	Professor of Botany and Director of Biological Station, University of Michigan
<b>Edward J. Giblin</b>	Retired Chairman and Chief Executive Officer, Ex-Cell-O Corporation (Manufacturer of diversified industrial products)
<b>Ernest L. Grove, Jr.</b>	Vice Chairman of the Board and Chief Financial Officer, The Detroit Edison Company
<b>Charles M. Heidel</b>	President and Chief Operating Officer, The Detroit Edison Company
<b>Patricia Shontz Longe</b>	Economist; Professor of Business Administration, University of Michigan
<b>Walter J. McCarthy, Jr.</b>	Chairman of the Board and Chief Executive Officer, The Detroit Edison Company
<b>Frank Merriman</b>	Dairy Farmer
<b>Dean E. Richardson</b>	Chairman of the Board and Chief Executive Officer, Manufacturers National Bank of Detroit
<b>Louis H. Roddis, Jr.</b>	Consulting Engineer
<b>Alan E. Schwartz</b>	Senior Partner, Honigman Miller Schwartz and Cohn (Attorneys at law)
<b>Otis M. Smith</b>	Retired Vice President, General Motors Corporation

### Committees of the Board of Directors

#### Audit

Edward J. Giblin \*  
Patricia Shontz Longe\*\*  
David Bing  
Malcolm Carron, S.J.  
Dean E. Richardson  
Otis M. Smith

#### Executive

Walter J. McCarthy, Jr.\*  
Malcolm Carron, S.J.  
Ernest L. Grove, Jr.  
Charles M. Heidel  
Frank Merriman  
Dean E. Richardson  
Alan E. Schwartz

#### Nominating

Alan E. Schwartz\*  
Charles T. Fisher III\*\*  
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\*\*  
Charles T. Fisher III  
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\*  
Malcolm Carron, S.J.  
Charles T. Fisher III  
Edward J. Giblin  
Ernest L. Grove, Jr.  
Patricia Shontz Longe  
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

<b>Walter J. McCarthy, Jr.</b>	Chairman of the Board and Chief Executive Officer	<b>J. Philip Lenihan</b>	Vice President - Marketing and Customer Relations
<b>Charles M. Heidel</b>	President and Chief Operating Officer	<b>John E. Lobbia</b>	Vice President - Financial Services
<b>Ernest L. Grove, Jr.</b>	Vice Chairman of the Board and Chief Financial Officer	<b>Claybourne Mitchell, Jr.</b>	Vice President - Planning and Research
<b>Leon S. Cohan</b>	Senior Vice President and General Counsel	<b>James B. Oliver</b>	Vice President - Employee Relations
<b>Burkhard H. Schneider</b>	Group Vice President	<b>William K. Pence</b>	Vice President - Operations
<b>Harry Tauber</b>	Group Vice President	<b>Donald J. Pizzimenti</b>	Vice President - Community and Governmental Affairs
<b>Willard R. Holland</b>	Vice President	<b>Saul J. Waldman</b>	Vice President - Public Affairs
<b>Wayne H. Jens</b>	Vice President - Nuclear Operations	<b>Kathryn L. Westman</b>	Secretary
<b>John W. Johnson, Jr.</b>	Vice President - Finance	<b>Leslie L. Loomans</b>	Treasurer
<b>M. Jane Kay</b>	Vice President - Administration	<b>Ronald W. Gresens</b>	Controller
<b>Robert C. Kirkby</b> (deceased 12/27/85)	Vice President - Engineering and Construction	<b>Arnold J. Benes</b>	General Auditor

Detroit  
Edison

2000 Second Avenue  
Detroit, Michigan 48226