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CONSUMERS ENERGY CO  
Form 10-Q/A  
May 15, 2003

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q/A  
AMENDMENT NO. 1

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2003

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission  
File Number

Registrant; State of Incorporation;  
Address; and Telephone Number

IRS Employer  
Identification No.

1-5611

CONSUMERS ENERGY COMPANY  
(A Michigan Corporation)  
One Energy Plaza, Jackson, Michigan 49201  
(517) 788-0550

38-0442310

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

Number of shares outstanding of each of the issuer's classes of common stock at May 1, 2003:

CONSUMERS ENERGY COMPANY, \$10 par value, privately held by CMS Energy 84,108,789

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CONSUMERS ENERGY COMPANY

QUARTERLY REPORT ON FORM 10-Q/A TO THE UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2003

EXPLANATORY NOTE

This Form 10-Q/A amends Consumers' quarterly report on Form 10-Q for the quarterly period ended March 31, 2003, which was filed with the SEC on May 14, 2003. As discussed below, Consumers' Consolidated Balance Sheets and Consolidated Statements of Common Stockholder's Equity for the quarterly period ending March 31, 2003 have been restated to reflect a March 2003 common dividend declaration.

In March 2003, Consumers Board of Directors declared a \$31 million common dividend to CMS Energy, payable in May 2003. Consumers' Consolidated Balance Sheets and Consolidated Statements of Common Stockholder's Equity filed in the Form 10-Q for the quarterly period ended March 31, 2003 did not reflect this dividend declaration. Therefore, Consumers has restated its March 31, 2003 Consolidated Balance Sheets and Consolidated Statements of Common Stockholder's Equity to reflect this dividend declaration.

There is no impact on the CMS Energy Corporation or Panhandle Eastern Pipeline Company Form 10-Q for the quarterly period ended March 31, 2003 regarding this issue and they are not being amended.

No attempt has been made in this Form 10-Q/A to modify or update other disclosures as presented in the March 31, 2003 Form 10-Q except as required to reflect the effects of the restatement.

CONSUMERS ENERGY COMPANY

QUARTERLY REPORT ON FORM 10-Q/A TO THE  
UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
FOR THE QUARTER ENDED MARCH 31, 2003

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### GLOSSARY

Certain terms used in the text and financial statements are defined below.

ALJ.....	Administrative Law Judge
APB.....	Accounting Principles Board
APB Opinion No. 18.....	APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock"
APB Opinion No. 20.....	APB Opinion No. 20, "Accounting Changes"
APB Opinion No. 30.....	APB Opinion No. 30, "Reporting Results of Operations Reporting the Effects of Disposal of a Segment of a Business"
Accumulated Benefit Obligation.....	The liabilities of a pension plan based on service and date. This differs from the Projected Benefit Obligation is typically disclosed in that it does not reflect expected future salary increases
Alliance.....	Alliance Regional Transmission Organization
ARO.....	Asset Retirement Obligation
bcf.....	Billion cubic feet
BG LNG Services.....	BG LNG Services, Inc., a subsidiary of BG Group of the Kingdom
Big Rock.....	Big Rock Point nuclear power plant, owned by Consumers Energy
Board of Directors.....	Board of Directors of CMS Energy
Centennial.....	Centennial Pipeline, LLC, in which Panhandle owns a interest
CEO.....	Chief Executive Officer

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CFO.....	Chief Financial Officer
Clean Air Act.....	Federal Clean Air Act, as amended
CMS Capital.....	CMS Capital Corp., a subsidiary of Enterprises
CMS Electric and Gas.....	CMS Electric and Gas Company, a subsidiary of Enterprises
CMS Energy.....	CMS Energy Corporation, the parent of Consumers and Enterprises
CMS Energy Common Stock.....	Common stock of CMS Energy, par value \$.01 per share
CMS Gas Transmission.....	CMS Gas Transmission Company, a subsidiary of Enterprises
CMS Generation.....	CMS Generation Co., a subsidiary of Enterprises
CMS Holdings.....	CMS Midland Holdings Company, a subsidiary of Consumers
CMS Midland.....	CMS Midland Inc., a subsidiary of Consumers
CMS MST.....	CMS Marketing, Services and Trading Company, a subsidiary of Enterprises
CMS Oil and Gas .....	CMS Oil and Gas Company, a subsidiary of Enterprises
CMS Viron.....	CMS Viron Energy Services, a wholly owned subsidiary of MST
Consumers.....	Consumers Energy Company, a subsidiary of CMS Energy
Court of Appeals.....	Michigan Court of Appeals
Customer Choice Act.....	Customer Choice and Electricity Reliability Act, a Michigan statute enacted in June 2000 that allows all retail customers the choice of alternative electric suppliers as of January 1, 2002, provides for full recovery of net stranded costs and implementation costs, establishes a five percent reduction in residential rates, establishes rate freeze and rate of return and allows for Securitization
Detroit Edison.....	The Detroit Edison Company, a non-affiliated company
DIG.....	Dearborn Industrial Generation, L.L.C., a wholly owned subsidiary of CMS Generation

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DOE.....	U.S. Department of Energy
Dow.....	The Dow Chemical Company, a non-affiliated company
Duke Energy.....	Duke Energy Corporation, a non-affiliated company
EITF.....	Emerging Issues Task Force
Enterprises.....	CMS Enterprises Company, a subsidiary of CMS Energy
EPA.....	U.S. Environmental Protection Agency
EPS.....	Earnings per share
ERISA.....	Employee Retirement Income Security Act
Ernst & Young.....	Ernst & Young LLP
FASB.....	Financial Accounting Standards Board
FERC.....	Federal Energy Regulatory Commission
FMB.....	First Mortgage Bonds
FMLP.....	First Midland Limited Partnership, a partnership that holds a lessor interest in the MCV facility
FTC.....	Federal Trade Commission
GCR.....	Gas cost recovery
GTNs.....	CMS Energy General Term Notes(R), \$200 million Series E, \$200 million Series F and \$300 million Series G
Guardian .....	Guardian Pipeline, LLC, in which Panhandle owns a one-third interest
Health Care Plan.....	The medical, dental, and prescription drug programs of CMS Energy

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to eligible employees of Panhandle, Consumers and CMS

INGAA .....	Interstate Natural Gas Association of America
IPP.....	Independent Power Producer
Jorf Lasfar.....	The 1,356 MW coal-fueled power plant in Morocco, jointly owned by CMS Generation and ABB Energy Venture, Inc.
kWh.....	Kilowatt-hour
LIBOR.....	London Inter-Bank Offered Rate
Loy Yang.....	The 2,000 MW brown coal fueled Loy Yang A power plant associated coal mine in Victoria, Australia, in which Generation holds a 50 percent ownership interest
LNG.....	Liquefied natural gas
LNG Holdings.....	CMS Trunkline LNG Holdings, LLC, jointly owned by CMS Panhandle Holdings, LLC and Dekatherm Investor Trust
Ludington.....	Ludington pumped storage plant, jointly owned by Consumers Energy and Detroit Edison
MACT.....	Maximum Achievable Control Technology
MAPL.....	Marathon Ashland Petroleum, LLC, partner in Centennial
mcf.....	Thousand cubic feet
MCV Facility.....	A natural gas-fueled, combined-cycle cogeneration facility operated by the MCV Partnership
MCV Partnership.....	Midland Cogeneration Venture Limited Partnership in which Consumers has a 49 percent interest through CMS Midland
MD&A.....	Management's Discussion and Analysis

METC.....	Michigan Electric Transmission Company, formally a subsidiary of Consumers Energy and now an indirect subsidiary of Trans-Elect
Michigan Gas Storage.....	Michigan Gas Storage Company, a subsidiary of Consumers Energy
MISO.....	Midwest Independent System Operator
Moody's .....	Moody's Investors Service, Inc.
MPSC.....	Michigan Public Service Commission
MTH.....	Michigan Transco Holdings, Limited Partnership
MW.....	Megawatts
NEIL.....	Nuclear Electric Insurance Limited, an industry mutual insurance company owned by member utility companies
NMC.....	Nuclear Management Company, LLC, formed in 1999 by Northern States Power Company (now Xcel Energy Inc.), Alliant Energy, Wisconsin Electric Power Company, and Wisconsin Public Service Company to operate and manage nuclear generation facilities owned by the four utilities
NOPR.....	Notice of Proposed Rulemaking
NRC.....	Nuclear Regulatory Commission
OATT.....	Open Access Transmission Tariff
OPEB.....	Postretirement benefit plans other than pensions for non-union employees
Palisades.....	Palisades nuclear power plant, which is owned by Consumers Energy
Panhandle.....	Panhandle Eastern Pipe Line Company, including its subsidiaries Trunkline, Pan Gas Storage, Panhandle Storage

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	and Panhandle Holdings. Panhandle is a wholly owned subsidiary of CMS Gas Transmission
Panhandle Eastern Pipe Line.....	Panhandle Eastern Pipe Line Company, a wholly owned subsidiary of CMS Gas Transmission
PCB.....	Polychlorinated biphenyl
Pension Plan.....	The trustee, non-contributory, defined benefit pension plan of Panhandle, Consumers and CMS Energy
Powder River.....	CMS Oil & Gas previously owned a significant interest in coalbed methane fields or projects developed within the Powder River Basin which spans the border between Wyoming and Montana. The Powder River properties have been sold and reported as a discontinued operation for the three months ended March 31, 2002
PPA.....	The Power Purchase Agreement between Consumers and the Partnership with a 35-year term commencing in March 1997
Price Anderson Act.....	Price Anderson Act, enacted in 1957 as an amendment to the Atomic Energy Act of 1954, as revised and extended over the years. This act stipulates between nuclear licensees and the U.S. government the insurance, financial responsibility and legal liability for nuclear accidents
PSCR.....	Power supply cost recovery
PURPA.....	Public Utility Regulatory Policies Act of 1978
RTO.....	Regional Transmission Organization
SEC.....	U.S. Securities and Exchange Commission

Securitization.....	A financing method authorized by statute and approved by the SEC which allows a utility to set aside and pledge a portion of the rate payments received by its customers for the repayment of Securitization bonds issued by a special purpose entity with such utility
SERP.....	Supplemental Executive Retirement Plan
SFAS.....	Statement of Financial Accounting Standards
SFAS No. 5.....	SFAS No. 5, "Accounting for Contingencies"
SFAS No. 34.....	SFAS No. 34, "Capitalization of Interest Cost"
SFAS No. 52.....	SFAS No. 52, "Foreign Currency Translation"
SFAS No. 71.....	SFAS No. 71, "Accounting for the Effects of Certain Ty Regulation"
SFAS No. 87.....	SFAS No. 87, "Employers' Accounting for Pensions"
SFAS No. 106.....	SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions"
SFAS No. 115.....	SFAS No. 115, "Accounting for Certain Investments in D Equity Securities"
SFAS No. 123.....	SFAS No. 123, "Accounting for Stock-Based Compensation"
SFAS No. 133.....	SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities, as amended and interpreted"
SFAS No. 142.....	SFAS No. 142, "Goodwill and Other Intangible Assets"
SFAS No. 143.....	SFAS No. 143, "Accounting for Asset Retirement Obligations"
SFAS No. 144.....	SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets"
SFAS No. 145.....	SFAS No. 145, "Rescission of FASB Statements No. 4, 44, 64, Amendment of FASB Statement No. 13, and Technical Corrections"
SFAS No. 146.....	SFAS No. 146, "Accounting for Costs Associated with Exit and Disposal Activities"

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SFAS No. 148.....	SFAS No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure"
SIPS.....	State Implementation Plans
Southern Union.....	Southern Union Company, a non-affiliated company
Special Committee.....	A special committee of independent directors, established by CMS Energy's Board of Directors, to investigate matters surrounding round-trip trading
Stranded Costs.....	Costs incurred by utilities in order to serve their customers in a regulated monopoly environment, which may not be recoverable in a competitive environment because of customers leaving their systems and ceasing to pay for their costs. These costs could include owned and purchased generating regulatory assets
Superfund.....	Comprehensive Environmental Response, Compensation and Liability Act
TEPPCO.....	TE Products Pipeline Company, Limited Partnership, part of the Centennial
Trunkline .....	Trunkline Gas Company, LLC, a subsidiary of CMS Panhandle Holdings, LLC
Trunkline LNG .....	Trunkline LNG Company, LLC, a subsidiary of LNG Holdings
Trust Preferred Securities.....	Securities representing an undivided beneficial interest in the assets of statutory business trusts, the interests of which have a preference with respect to certain trust distributions over the interests of either CMS Energy or Consumers, as applicable, as owner of the common beneficial interests of the trusts

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VEBA Trusts.....	VEBA (voluntary employees' beneficiary association) Trusts are tax-exempt accounts established to specifically secure employer contributed assets to pay for future expenses under an OPEB plan
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Consumers Energy Company

CONSUMERS ENERGY COMPANY  
MANAGEMENT'S DISCUSSION AND ANALYSIS

Consumers, a subsidiary of CMS Energy, a holding company, is an electric and gas utility company that provides service to customers in Michigan's Lower Peninsula. Consumers' customer base includes a mix of residential, commercial and diversified industrial customers, the largest segment of which is the automotive industry.

FORWARD-LOOKING STATEMENTS AND RISK FACTORS

This MD&A refers to, and in some sections specifically incorporates by reference, Consumers' Notes to Consolidated Financial Statements and should be read in conjunction with such Consolidated Financial Statements and Notes. This Form 10-Q and other written and oral statements that Consumers may make contain

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forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Consumers' intentions with the use of the words, "anticipates," "believes," "estimates," "expects," "intends," and "plans," and variations of such words and similar expressions, are solely to identify forward-looking statements that involve risk and uncertainty. These forward-looking statements are subject to various factors that could cause Consumers' actual results to differ materially from the results anticipated in such statements. Consumers has no obligation to update or revise forward-looking statements regardless of whether new information, future events or any other factors affect the information contained in such statements. Consumers does, however, discuss certain risk factors, uncertainties and assumptions in this MD&A and in Item 1 of the 2002 Form 10-K in the section entitled "Forward-Looking Statements Cautionary Factors" and in various public filings it periodically makes with the SEC. Consumers designed this discussion of potential risks and uncertainties, which is by no means comprehensive, to highlight important factors that may impact Consumers' business and financial outlook. This Form 10-Q also describes material contingencies in Consumers' Condensed Notes to Consolidated Financial Statements, and Consumers encourages its readers to review these Notes. All note references within this MD&A refer to Consumers' Notes to Consolidated Financial Statements.

### CRITICAL ACCOUNTING POLICIES

Presenting financial statements in accordance with accounting principles generally accepted in the United States requires using estimates, assumptions, and accounting methods that are often subject to judgment. Presented below, are the accounting policies and assumptions that Consumers believes are most critical to both the presentation and understanding of its financial statements. Applying these accounting policies to financial statements can involve very complex judgments. Accordingly, applying different judgments, estimates or assumptions could result in a different financial presentation.

### USE OF ESTIMATES IN ACCOUNTING FOR CONTINGENCIES

The principles in SFAS No. 5 guide the recording of estimated liabilities for contingencies within the financial statements. SFAS No. 5 requires a company to record estimated liabilities in the financial statements when a current event has caused a probable future loss payment of an amount that can be reasonably estimated. Consumers has used this accounting principle to record estimated liabilities for the following significant events.

**ELECTRIC ENVIRONMENTAL ESTIMATES:** Consumers is subject to costly and increasingly stringent environmental regulations. Consumers expects to incur significant costs for future environmental compliance, especially compliance with clean air laws.

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Consumers Energy Company

The EPA has issued regulations regarding nitrogen oxide emissions from certain generators, including some of Consumers' electric generating facilities. These regulations require Consumers to make significant capital expenditures estimated to be \$770 million. As of March 31, 2003, Consumers has incurred \$420 million in capital expenditures to comply with these regulations and anticipates that the remaining capital expenditures will be incurred between 2003 and 2009. Additionally, Consumers expects to supplement its compliance plan with the purchase of nitrogen oxide emissions credits in the years 2005 through 2008. The cost of these credits based on the current market is estimated to average \$6 million per year; however, the market for nitrogen oxide emissions credits and



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their cost can change significantly. At some point, if new environmental standards become effective, Consumers may need additional capital expenditures to comply with the standards. For further information see Note 2, Uncertainties, "Electric Contingencies - Electric Environmental Matters."

**GAS ENVIRONMENTAL ESTIMATES:** Under the Michigan Natural Resources and Environmental Protection Act, Consumers expects that it will incur investigation and remedial action costs at a number of sites. Consumers estimates the costs for 23 former manufactured gas plant sites will be between \$82 million and \$113 million, using the Gas Research Institute-Manufactured Gas Plant Probabilistic Cost Model. These estimates are based on discounted 2001 costs and follow EPA recommended use of discount rates between three and seven percent. Consumers expects to recover a significant portion of these costs through MPSC-approved rates charged to its customers. Any significant change in assumptions, such as remediation techniques, nature and extent of contamination, and legal and regulatory requirements, could change the remedial action costs for the sites. For further information see Note 2, Uncertainties, "Gas Contingencies - Gas Environmental Matters."

**MCV UNDERRECOVERIES:** The MCV Partnership, which leases and operates the MCV Facility, contracted to sell electricity to Consumers for a 35-year period beginning in 1990 and to supply electricity and steam to Dow. Consumers, through two wholly owned subsidiaries, holds a 49 percent partnership interest in the MCV Partnership, and a 35 percent lessor interest in the MCV Facility.

Consumers' annual obligation to purchase capacity from the MCV Partnership is 1,240 MW through the term of the PPA ending in 2025. The PPA requires Consumers to pay, based on the MCV Facility's availability, a levelized average capacity charge of 3.77 cents per kWh and a fixed energy charge, and also to pay a variable energy charge based primarily on Consumers' average cost of coal consumed for all kWh delivered. Consumers has not been allowed full recovery of the capacity and fixed energy charges in rates. After September 2007, the PPA's regulatory out terms obligate Consumers to pay the MCV Partnership only those capacity and energy charges that the MPSC has authorized for recovery from electric customers.

In 1992, Consumers recognized a loss and established a PPA liability for the present value of the estimated future underrecoveries of power supply costs under the PPA based on MPSC cost recovery orders. Primarily as a result of the MCV Facility's actual availability being greater than management's original estimates, the PPA liability has been reduced at a faster rate than originally anticipated. At March 31, 2003 and 2002, the remaining after-tax present value of the estimated future PPA liability associated with the loss totaled \$30 million and \$46 million, respectively. The PPA liability is expected to be depleted in late 2004.

In March 1999, Consumers and the MCV Partnership reached a settlement agreement effective January 1, 1999, that addressed, among other things, the ability of the MCV Partnership to count modifications increasing the capacity of the existing MCV Facility for purposes of computing the availability of contract capacity under the PPA for billing purposes. That settlement agreement capped payments made on the basis of availability that may be billed by the MCV Partnership at a maximum 98.5 percent availability level.

When Consumers returns, as expected, to unfrozen rates beginning in 2004, Consumers will recover from customers capacity and fixed energy charges on the basis of availability, to the extent that availability does

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not exceed 88.7 percent availability established in previous MPSC orders. For capacity and energy payments billed by the MCV Partnership after September 15, 2007, and not recovered from customers, Consumers would expect to claim a regulatory out under the PPA. The regulatory out provision relieves Consumers of the obligation to pay more for capacity and energy payments than the MPSC allows Consumers to collect from its customers. Consumers estimates that 51 percent of the actual cash underrecoveries for the years 2003 and 2004 will be charged to the PPA liability, with the remaining portion charged to operating expense as a result of Consumers' 49 percent ownership in the MCV Partnership. All cash underrecoveries will be expensed directly to income once the PPA liability is depleted. If the MCV Facility's generating availability remains at the maximum 98.5 percent level during the next five years, Consumers' after-tax cash underrecoveries associated with the PPA could be as follows:

	2003	2004	2005	2006
Estimated cash underrecoveries at 98.5%, net of tax	\$37	\$36	\$36	\$36
Amount to be charged to operating expense, net of tax	\$18	\$18	36	\$36
Amount to be charged to PPA liability, net of tax	\$19	\$18	\$--	\$--

In February 1998, the MCV Partnership appealed the January 1998 and February 1998 MPSC orders related to electric utility restructuring. At the same time, MCV Partnership filed suit in the United States District Court in Grand Rapids seeking a declaration that the MPSC's failure to provide Consumers and MCV Partnership a certain source of recovery of capacity payments after 2007 deprived MCV Partnership of its rights under the Public Utilities Regulatory Policies Act of 1978. In July 1999, the District Court granted MCV Partnership's motion for summary judgment. The Court permanently prohibited enforcement of the restructuring orders in any manner that denies any utility the ability to recover amounts paid to qualifying facilities such as the MCV Facility or that precludes the MCV Partnership from recovering the avoided cost rate. The MPSC appealed the Court's order to the 6th Circuit Court of Appeals in Cincinnati. In June 2001, the 6th Circuit overturned the lower court's order and dismissed the case against the MPSC. The appellate court determined that the case was premature and concluded that the qualifying facilities needed to wait until 2008 for an actual factual record to develop before bringing claims against the MPSC in federal court.

For further information see Note 2, Uncertainties, "Other Electric Uncertainties - The Midland Cogeneration Venture."

ACCOUNTING FOR DERIVATIVE AND FINANCIAL INSTRUMENTS AND MARKET RISK INFORMATION

DERIVATIVE INSTRUMENTS: Consumers uses the criteria in SFAS No. 133, as amended and interpreted, to determine if certain contracts must be accounted for as derivative instruments. The rules for determining whether a contract meets the criteria for derivative accounting are numerous and complex. As a result, significant judgment is required to determine whether a contract requires derivative accounting, and similar contracts can sometimes be accounted for differently.

Consumers currently accounts for the following contracts as derivative

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instruments: interest rate swaps, certain electric call options, fixed priced weather-based gas supply call options and fixed price gas supply put options. Consumers does not account for the following contracts as derivative instruments: electric capacity and energy contracts, gas supply contracts without embedded options, coal and nuclear fuel supply contracts, and purchase orders for numerous supply items.

Consumers believes that certain of its electric capacity and energy contracts are not derivatives due to the lack of an active energy market in the state of Michigan, as defined by SFAS No. 133, and the transportation cost

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Consumers Energy Company

to deliver the power under the contracts to the closest active energy market at the Cinergy hub in Ohio. If a market develops in the future, Consumers may be required to account for these contracts as derivatives. The mark-to-market impact on earnings related to these contracts, particularly related to the PPA, could be material to the financial statements.

If a contract is accounted for as a derivative instrument, it is recorded in the financial statements as an asset or a liability, at the fair value of the contract. Any difference between the recorded book value and the fair value is reported either in earnings or other comprehensive income, depending on certain qualifying criteria. The recorded fair value of the contract is then adjusted quarterly to reflect any change in the market value of the contract.

In order to determine the fair value of contracts that are accounted for as derivative instruments, Consumers uses a combination of quoted market prices and mathematical models. Option models require various inputs, including forward prices, volatilities, interest rates and exercise periods. Changes in forward prices or volatilities could significantly change the calculated fair value of the call option contracts. At March 31, 2003, Consumers assumed a market-based interest rate of 4.5 percent and a volatility rate of 107.5 percent in calculating the fair value of its electric call options.

In order for derivative instruments to qualify for hedge accounting under SFAS No. 133, the hedging relationship must be formally documented at inception and be highly effective in achieving offsetting cash flows or offsetting changes in fair value, attributable to the risk being hedged. If hedging a forecasted transaction, the forecasted transaction must be probable. If a derivative instrument, used as a cash flow hedge, is terminated early because it is probable that a forecasted transaction will not occur, any gain or loss as of such date is immediately recognized in earnings. If a derivative instrument, used as a cash flow hedge, is terminated early for other economic reasons, any gain or loss as of the termination date is deferred and recorded when the forecasted transaction affects earnings.

**FINANCIAL INSTRUMENTS:** Consumers accounts for its debt and equity investment securities in accordance with SFAS No. 115. As such, debt and equity securities can be classified into one of three categories: held-to-maturity, trading, or available-for-sale securities. Consumers' investments in equity securities, including its investment in CMS Energy Common Stock, are classified as available-for-sale securities. They are reported at fair value, with any unrealized gains or losses from changes in fair value reported in equity as part of other comprehensive income and excluded from earnings unless such changes in fair value are other than temporary. In 2002, Consumers determined that the decline in value related to its investment in CMS Energy Common Stock was other than temporary as the fair value was below the cost basis for a period greater

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than six months. As a result, Consumers recognized a loss on its investment in CMS Energy Common Stock through earnings of \$12 million in the fourth quarter of 2002, and an additional \$12 million in the first quarter of 2003. As of March 31, 2003, Consumers held 2.4 million shares of CMS Energy Common Stock with a fair value of \$10 million. Unrealized gains or losses from changes in the fair value of Consumers' nuclear decommissioning investments are reported as regulatory liabilities. The fair value of these investments is determined from quoted market prices.

**MARKET RISK INFORMATION:** Consumers is exposed to market risks including, but not limited to, changes in interest rates, commodity prices, and equity security prices. Consumers' market risk, and activities designed to minimize this risk, are subject to the direction of an executive oversight committee consisting of designated members of senior management and a risk committee, consisting of certain business unit managers. The role of the risk committee is to review the corporate commodity position and ensure that net corporate exposures are within the economic risk tolerance levels established by Consumers' Board of Directors. Established policies and procedures are used to manage the risks associated with market fluctuations.

Consumers uses various contracts, including swaps, options, and forward contracts to manage its risks

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Consumers Energy Company

associated with the variability in expected future cash flows attributable to fluctuations in interest rates and commodity prices. When management uses these instruments, it intends that an opposite movement in the value of the at-risk item would offset any losses incurred on the contracts. Contracts used to manage interest rate and commodity price risk may be considered derivative instruments that are subject to derivative and hedge accounting pursuant to SFAS No. 133. Consumers enters into all risk management contracts for purposes other than trading.

These instruments contain credit risk if the counterparties, including financial institutions and energy marketers, fail to perform under the agreements. Consumers minimizes such risk by performing financial credit reviews using, among other things, publicly available credit ratings of such counterparties.

In accordance with SEC disclosure requirements, Consumers performs sensitivity analyses to assess the potential loss in fair value, cash flows and earnings based upon a hypothetical 10 percent adverse change in market rates or prices. Management does not believe that sensitivity analyses alone provide an accurate or reliable method for monitoring and controlling risks. Therefore, Consumers relies on the experience and judgment of its senior management to revise strategies and adjust positions, as it deems necessary. Losses in excess of the amounts determined in sensitivity analyses could occur if market rates or prices exceed the 10 percent shift used for the analyses.

**INTEREST RATE RISK:** Consumers is exposed to interest rate risk resulting from the issuance of fixed-rate financing and variable-rate financing, and from interest rate swap agreements. Consumers uses a combination of these instruments to manage and mitigate interest rate risk exposure when it deems it appropriate, based upon market conditions. These strategies attempt to provide and maintain the lowest cost of capital. As of March 31, 2003 and 2002, Consumers had outstanding \$1.324 billion and \$1.329 billion of variable-rate financing, respectively, including variable-rate swaps and fixed-rate swaps. At March 31, 2003 and 2002, assuming a hypothetical 10 percent adverse change in market

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interest rates, Consumers' before tax earnings exposure on its variable-rate financing would be \$2 million and \$3 million, respectively. As of March 31, 2003 and 2002, Consumers had entered into a floating-to-fixed interest rate swap agreement for a notional amount of \$75 million, and as of March 31, 2002 a variable-to-fixed interest rate swap agreement for a notional of \$300 million. These swaps exchange variable-rate interest payment obligations for fixed-rate interest payment obligations, or fixed-rate interest payment obligations for variable-rate interest payment obligations in order to minimize the impact of potential adverse interest rate changes. As of March 31, 2003 and 2002, Consumers had outstanding fixed-rate financing, including fixed and variable-rate swaps, of \$2.756 billion and \$2.477 billion, respectively, with a fair value of \$2.690 billion and \$2.769 billion, respectively. As of March 31, 2003 and 2002, assuming a hypothetical 10 percent adverse change in market rates, Consumers would have an exposure of \$131 million and \$144 million, respectively, to the fair value of these instruments if it had to refinance all of its fixed-rate financing. As discussed below in Electric Business Outlook - Securitization, Consumers has filed an application with the MPSC to securitize certain costs. If approved, Consumers will use the proceeds from the securitization for refinancing or retirement of debt, which could include a portion of its current fixed-rate debt. Consumers does not believe that any adverse change in debt price and interest rates would have a material adverse effect on either its consolidated financial position, results of operation or cash flows.

COMMODITY MARKET RISK: For purposes other than trading, Consumers enters into electric call options, fixed price gas supply contracts containing embedded put options, fixed priced weather-based gas supply call options and fixed priced gas supply put options. The electric call options are used to protect against risk due to fluctuations in the market price of electricity and to ensure a reliable source of capacity to meet customers' electric needs. The gas supply contracts containing embedded put options, the weather-based gas supply call options, and the gas supply put options are used to purchase reasonably priced gas supply.

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As of March 31, 2003 and 2002, the fair value based on quoted future market prices of electricity-related call option and swap contracts was \$10 million and \$19 million, respectively. At March 31, 2003 and 2002, assuming a hypothetical 10 percent adverse change in market prices, the potential reduction in fair value associated with these contracts would be \$2 million and \$4 million respectively. As of March 31, 2003 and 2002, Consumers had an asset of \$28 million and \$48 million, respectively, related to premiums incurred for electric call option contracts. Consumers' maximum exposure associated with the call option contracts is limited to the premiums incurred. As of March 31, 2003, Consumers did not have any gas supply-related call or put option contracts. As of March 31, 2002, the fair value based on quoted future market prices of gas supply contracts containing embedded put options was \$4 million. At March 31, 2002, a hypothetical 10 percent adverse change in market prices was immaterial.

EQUITY SECURITY PRICE RISK: Consumers owns less than 20 percent of the outstanding shares of CMS Energy Common Stock. Consumers recognized a loss on this investment through earnings of \$12 million in the fourth quarter of 2002 and an additional \$12 million loss in the first quarter of 2003, because the loss was other than temporary as the fair value was below the cost basis for a period greater than six months. As of March 31, 2003, Consumers held 2.4 million shares of CMS Energy Common stock at a fair value of \$10 million. Consumers believes that any further adverse change in the market price of this investment would not have a material effect on its consolidated financial position, results

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of operation or cash flows.

For further information on market risk and derivative activities, see Note 4, Financial and Derivative Instruments.

### ACCOUNTING FOR THE EFFECTS OF INDUSTRY REGULATION

Because Consumers is involved in a regulated industry, regulatory decisions affect the timing and recognition of revenues and expenses. Consumers uses SFAS No. 71 to account for the effects of these regulatory decisions. As a result, Consumers may defer or recognize revenues and expenses differently than a non-regulated entity.

For example, items that a non-regulated entity would normally expense, Consumers may capitalize as regulatory assets if the actions of the regulator indicate such expenses will be recovered in future rates. Conversely, items that non-regulated entities may normally recognize as revenues, Consumers may record as regulatory liabilities if the actions of the regulator indicate they will require such revenues to be refunded to customers. Judgment is required to discern the recoverability of items recorded as regulatory assets and liabilities. As of March 31, 2003, Consumers had \$1.121 billion recorded as regulatory assets and \$463 million recorded as regulatory liabilities.

In March 1999, Consumers received MPSC electric restructuring orders, which, among other things, identified the terms and timing for implementing electric restructuring in Michigan. Consistent with these orders and EITF No. 97-4, Consumers discontinued the application of SFAS No. 71 for the energy supply portion of its business because Consumers expected to implement retail open access at competitive market-based rates for its electric customers. Since 1999, there has been a significant legislative and regulatory change in Michigan that has resulted in: 1) electric supply customers of utilities remaining on cost-based rates and 2) utilities being given the ability to recover Stranded Costs associated with electric restructuring, from customers who choose an alternative electric supplier. During 2002, Consumers re-evaluated the criteria used to determine if an entity or a segment of an entity meets the requirements to apply regulated utility accounting, and determined that the energy supply portion of its business could meet the criteria if certain regulatory events occurred. In December 2002, Consumers received a MPSC Stranded Cost order that allowed Consumers to re-apply regulatory accounting standard SFAS No. 71 to the energy supply portion of its business. Re-application of SFAS No. 71 had no effect on the prior discontinuation accounting, but will allow Consumers to apply regulatory accounting treatment to the energy supply portion of its business

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beginning in the fourth quarter of 2002, including regulatory accounting treatment of costs required to be recognized in accordance with SFAS No. 143.

### ACCOUNTING FOR PENSION AND OPEB

Consumers provides postretirement benefits under its Pension Plan, and postretirement health and life benefits under its OPEB plans to substantially all its retired employees. Consumers uses SFAS No. 87 to account for pension costs and uses SFAS No. 106 to account for other postretirement benefit costs. These statements require liabilities to be recorded on the balance sheet at the present value of these future obligations to employees net of any plan assets. The calculation of these liabilities and associated expenses require the expertise of actuaries and are subject to many assumptions including life

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expectancies, present value discount rates, expected long-term rate of return on plan assets, rate of compensation increase and anticipated health care costs. Any change in these assumptions can significantly change the liability and associated expenses recognized in any given year. The Pension Plan includes amounts for employees of CMS Energy and non-utility affiliates, including Panhandle, which were not distinguishable from the Pension Plan's total assets. On December 21, 2002, a definitive agreement was executed to sell Panhandle. The sale is expected to close in 2003. No portion of the Pension Plan will be transferred with the sale of Panhandle. At the closing of the sale, none of the employees of Panhandle will be eligible to accrue additional benefits. The Pension Plan will retain pension payment obligations for Panhandle employees that are vested under the Pension Plan. Consumers does not expect the impact to be material.

Consumers estimates pension expense will approximate \$36 million, \$42 million and \$48 million in fiscal 2003, fiscal 2004 and fiscal 2005, respectively. Future actual pension expense will depend on future investment performance, changes in future discount rates and various other factors related to the populations participating in the Pension Plan.

Consumers has announced changes to the Pension Plan. Employees hired on or after July 1, 2003 will be covered by the cash balance plan section of the current plan. Under the cash balance section, an employee's retirement account is credited annually with a percentage of their salary and any amounts that are vested are portable when an employee leaves the company. In addition, the method used to convert an employee's benefit to a lump sum payment is being changed. Employees who elect the lump sum payment option will not earn an additional early retirement subsidy. As a result, employees who choose the lump sum payment option, and retire before age 65, will receive lower lump sum payments.

In order to keep health care benefits and costs competitive, Consumers has announced several changes to the Health Care Plan. These changes were effective January 1, 2003. The most significant change is that Consumers' future increases in health care costs will be shared with salaried employees. The salaried retirees health care plan has also been amended. Pre-Medicare retirees now elect coverage from four different levels of coverage, with the two best coverage options requiring premium contributions. These plans also coordinate benefits under a maintenance of benefits provision to reduce claim costs for Consumers. Mail-order prescription copays have also been increased for all salaried retirees.

### ACCOUNTING FOR NUCLEAR DECOMMISSIONING COSTS

Consumers' decommissioning cost estimates for the Big Rock and Palisades plants assume that each plant site will eventually be restored to conform to the adjacent landscape with all contaminated equipment and material removed and disposed of in a licensed burial facility and the site released for unrestricted use. A March 1999 MPSC order provided for fully funding the decommissioning trust funds for both sites. The order set the annual decommissioning surcharge for the Palisades decommissioning at \$6 million a year. Consumers estimates that at the time of the decommissioning of Palisades, its decommissioning trust fund will be fully funded. Earnings assumptions are that the trust funds are invested in equities and fixed income investments,

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equities will be converted to fixed income investments during decommissioning and fixed income investments are converted to cash as needed. Decommissioning

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costs have been developed, in part, by independent contractors with expertise in decommissioning. These costs estimates use various inflation rates for labor, non-labor, and contaminated equipment disposal costs.

On December 31, 2000, the Big Rock trust fund was considered fully funded. A portion of its current decommissioning cost is due to the failure of the DOE to remove fuel from the site. These costs, and similar costs incurred at Palisades, would not be necessary but for the failure of the DOE to take possession of the spent fuel as required by the Nuclear Waste Policy Act of 1982. A number of utilities have commenced litigation in the Court of Claims, including Consumers, which filed its complaint in December 2002. The Chief Judge of the Court of Claims identified six lead cases to be used as vehicles for resolving dispositive motions. Consumers' case is not a lead case. It is unclear what impact this decision by the Chief Judge will have on the outcome of Consumers' litigation. If the litigation that was commenced in the fourth quarter of 2002, against the DOE is successful, Consumers anticipates future recoveries from the DOE to defray the significant costs it will incur for the storage of spent fuel until the DOE takes possession as required by law.

On March 26, 2003, the Michigan Environmental Council, the Public Interest Research Group in Michigan, and the Michigan Consumer Federation submitted a complaint to the MPSC, which was served on Consumers by the MPSC on April 18, 2003. The complaint asks the MPSC to commence a generic investigation and contested case to review all facts and issues concerning costs associated with spent nuclear fuel storage and disposal. The complaint seeks a variety of relief with respect to Consumers Energy, The Detroit Edison Company, Indiana & Michigan Electric Company, Wisconsin Electric Power Company and Wisconsin Public Service Corporation including establishing external trusts to which amounts collected in electric rates for spent nuclear fuel storage and disposal should be transferred, and the adoption of additional measures related to the storage and disposal of spent nuclear fuel. Consumers is reviewing the complaint. Consumers is unable to predict the outcome of this matter.

The funds provided by the trusts and additional funds from DOE litigation are expected to fully fund the decommissioning costs. Variance from trust earnings, a lesser recovery of costs from the DOE, changes in decommissioning technology, regulations, estimates or assumptions could affect the cost of decommissioning these sites and the adequacy of the decommissioning trust funds.

### RELATED PARTY TRANSACTIONS

Consumers enters into a number of significant transactions with related parties. These transactions include the purchase of capacity and energy from the MCV Partnership and from affiliates of Enterprises, the purchase of electricity and gas supply from CMS MST, the sale of electricity to CMS MST, the purchase of gas transportation from CMS Bay Area Pipeline, L.L.C., the purchase of gas transportation from Trunkline, a subsidiary of Panhandle, the payment of parent company overhead costs to CMS Energy, the sale, storage and transportation of natural gas and other services to the MCV Partnership, and an investment in CMS Energy Common Stock.

Transactions involving CMS Energy and its affiliates and the sale, storage and transportation of natural gas and other services to the MCV Partnership are generally based on regulated prices, market prices or competitive bidding. Transactions involving the power supply purchases from the MCV Partnership, and certain affiliates of Enterprises, are based upon avoided costs under PURPA and competitive bidding; and the payment of parent company overhead costs to CMS Energy are based upon use or accepted industry allocation methodologies.

In 2002, Consumers also sold its transmission facilities to MTH, a non-affiliated limited partnership whose general partner is a subsidiary of Trans-Elect, Inc., an independent company, whose management includes former



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executive employees of Consumers. The transaction was based on competitive bidding. Additionally, Consumers continues to use the transmission facilities now owned by MTH, and a director of Consumers is currently a stockholder of Trans-Elect, Inc.

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For detailed information about related party transactions see Note 2, Uncertainties, "Electric Rate Matters - Transmission", and "Other Electric Uncertainties - The Midland Cogeneration Venture".

RESULTS OF OPERATIONS

CONSUMERS CONSOLIDATED EARNINGS

March 31	2003	2002
Three months ended	\$99	\$71

2003 COMPARED TO 2002: For the three months ended March 31, 2003, Consumers' net income available to the common stockholder totaled \$99 million, an increase of \$18 million from the previous year. This increase in earnings reflects an after-tax benefit of \$30 million due to increased electric and gas deliveries. Also contributing to the earnings increase is the after-tax benefit of \$12 million due to the final gas rate order issued in 2002 authorizing Consumers to increase its gas tariff rates. This increase in earnings also reflects an \$8 million after-tax benefit primarily from increased intersystem revenues along with a \$5 million benefit from increased electric miscellaneous service revenues. Offsetting these increases is a \$12 million charge to non-utility expense in order to recognize a decline in market value of CMS Energy Stock held by Consumers and increased electric and gas operating expenses that reduced earnings by \$24 million after-tax.

For further information, see the Electric and Gas Utility Results of Operations sections and Note 2, Uncertainties.

ELECTRIC UTILITY RESULTS OF OPERATIONS

March 31	2003	2002
Three months ended	\$51	\$36

Reasons for the change:

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Electric deliveries  
 Power supply costs and related revenue  
 Other operating expenses and non-commodity revenue  
 Fixed charges

Total change

=====

ELECTRIC DELIVERIES: For the three months ended March 31, 2003, electric delivery revenues increased by \$13 million from the previous year. Electric deliveries, including transactions with other wholesale market participants and other electric utilities, were 9.7 billion kWh, an increase of 0.5 billion kWh or 5.6 percent from 2002. This increase is primarily the result of increased deliveries to the higher margin residential and commercial sectors, along with the growth in retail deliveries.

POWER SUPPLY COSTS AND RELATED REVENUE: For the three months ended March 31, 2003, power supply costs and related revenues increased electric net income by \$13 million from 2002. This increase is primarily the result of increased intersystem revenues.

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Consumers Energy Company

OTHER OPERATING EXPENSES AND NON-COMMODITY REVENUE: For the three months ended March 31, 2003, operating expenses increased compared to 2002. This increase can be attributed to a scheduled refueling outage at Palisades that began in March and higher transmission costs due to the loss of a financial return on the sold Consumers transmission system asset in May 2002. Slightly offsetting these increased operating expenses are increased non-commodity revenues associated with miscellaneous service revenues.

INCOME TAXES: For the three months ended March 31, 2003, income tax expense remained relatively flat compared to 2002.

GAS UTILITY RESULTS OF OPERATIONS

March 31	2003	2002
Three months ended	\$54	\$

Reasons for the change:

Gas deliveries  
 Gas rate increase  
 Gas wholesales and retail services

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Operation and maintenance  
General taxes, depreciation, and other income  
Fixed charges  
Income taxes

Total change  
=====

**GAS DELIVERIES:** For the three months ended March 31, 2003, gas delivery revenues increased by \$33 million from the previous year. System deliveries, including miscellaneous transportation, totaled 174 bcf, an increase of 25 bcf or 16.4 percent compared with 2002. This increase is primarily due to colder weather that resulted in increased deliveries to the residential and commercial sectors in 2003.

**GAS RATE INCREASE:** In November 2002, the MPSC issued a final gas rate order authorizing a \$56 million annual increase in Consumers gas tariff rates. As a result of this order, Consumers recognized increased gas revenues of \$19 million.

**OPERATION AND MAINTENANCE:** For the three months ended March 31, 2003, operation and maintenance expenses increased \$10 million compared to 2002. This increase reflects the recognition of additional expenditures on safety, reliability and customer service due to the colder temperatures for the quarter, compared to the same period in 2002

**INCOME TAXES:** For the three months ended March 31, 2003, income tax expense increased primarily due to improved earnings of the gas utility.

### CAPITAL RESOURCES AND LIQUIDITY

#### CASH POSITION, INVESTING AND FINANCING

**OPERATING ACTIVITIES:** Consumers' principal source of liquidity is from cash derived from operating activities involving the sale and transportation of natural gas and the generation, delivery and sale of electricity. Cash

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Consumers Energy Company

from operations totaled \$387 million and \$270 million for the first three months of 2003 and 2002, respectively. The \$117 million increase resulted from an increase in electric and gas deliveries, a gas rate increase and changes in working capital items due to the timing of cash receipts and payments. Consumers primarily uses cash derived from operating activities to operate, maintain, expand and construct its electric and gas systems, to retire portions of long-term debt, and to pay dividends. A decrease in cash from operations could reduce the availability of funds and result in additional short-term financings, see Note 3, Financings and Capitalization for additional details about this source of funds.

**INVESTING ACTIVITIES:** Cash used for investing activities totaled \$117 million and \$154 million for the first three months of 2003 and 2002, respectively. The change of \$37 million is primarily due to a \$16 million decrease from the 2002 level of capital expenditures to comply with the Clean Air Act and a \$12 million decrease in gas supply system additions and improvements.

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FINANCING ACTIVITIES: Cash used for financing activities totaled \$51 million and \$105 million for the first three months of 2003 and 2002, respectively. The change of \$54 million is primarily due to a decrease of \$309 million retirements of bonds and other long-term debt, partially offset by \$96 million additional payments of notes payable and the absence of \$150 million cash infusion from CMS Energy.

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS: The following schedule of material contractual obligations and commercial commitments is provided to aggregate information in a single location so that a picture of liquidity and capital resources is readily available. For further information see Note 2, Uncertainties, and Note 3, Financings and Capitalization.

### Contractual Obligations

March 31	Total	Payments Due				
		2003	2004	2005	2006	2007
On-balance sheet:						
Long-term debt	\$ 2,724	\$ -	\$228	\$470	\$512	\$ 31
Current portion of long-term debt	277	277	-	-	-	-
Notes payable	252	252	-	-	-	-
Capital lease obligations	153	14	19	18	17	16
Off-balance sheet:						
Operating leases	79	10	12	8	8	6
Non-recourse debt of FMLP	208	8	54	41	26	13
Sale of accounts receivable	325	325	-	-	-	-
Unconditional purchase obligations	18,888	1,843	1,386	1,119	874	742

REGULATORY AUTHORIZATION FOR FINANCINGS: At March 31, 2003, Consumers had FERC authorization to issue or guarantee through June 2004, up to \$1.1 billion of short-term securities outstanding at any one time. Consumers also had remaining FERC authorization to issue through June 2004 up to \$500 million of long-term securities for refinancing or refunding purposes, \$381 million for general corporate purposes, and \$610 million of first mortgage bonds to be issued solely as collateral for the long-term securities. On April 30, 2003, Consumers sold \$625 million principal amount of first mortgage bonds, described below. Its remaining FERC authorization after this issue is (1) \$250 million of long-term securities for refinancing or refunding purposes, (2) \$6 million for general corporate purposes, and (3) \$610 million remaining first mortgage bonds available to be issued solely as collateral for the long-term securities. Consumers anticipates applying in the second quarter of 2003 for an increase in FERC authorization to issue new long-term securities for

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refinancing or refunding and for general corporate purposes. On October 10, 2002, FERC granted a waiver of its competitive bid/negotiated placement requirements applicable to the remaining long-term securities authorization

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indicated above.

**LONG TERM DEBT:** In March 2003, Consumers entered into a \$140 million term loan secured by first mortgage bonds with a private investor bank. This loan has a term of six years at a cost of LIBOR plus 475 basis points. Proceeds from this loan were used for general corporate purposes.

In March 2003, Consumers entered into a \$150 million term loan secured by first mortgage bonds. This term loan has a three-year maturity expiring in March 2006; the loan has a cost of LIBOR plus 450 basis points. Proceeds from this loan were used for general corporate purposes.

In April 2003, Consumers sold \$625 million principal amount of first mortgage bonds in a private offering to institutional investors ; \$250 million were issued at 4.25 percent, maturing on April 15, 2008, and net proceeds were approximately \$248 million, \$375 million were issued at 5.38 percent, maturing on April 15, 2013, and net proceeds were approximately \$371 million. Consumers used the net proceeds to replace a \$250 million senior reset put bond that matured in May 2003, to pay an associated \$32 million option call payment, and for general corporate purposes that may include paying down additional debt. Consumers has agreed to file a registration statement with the SEC to permit holders of these first mortgage bonds to exchange the bonds for new bonds that will be registered under the Securities Act of 1933. Consumers has agreed to file this registration statement by December 31, 2003.

Consumers' current portion of long-term debt maturing in 2003 is \$277 million. Refer to Outlook, "Liquidity and Capital Resources" below for information about Consumers strategic measures addressing its future liquidity and capital requirements.

**SHORT TERM FINANCINGS:** In March 2003, Consumers obtained a replacement revolving credit facility in the amount of \$250 million secured by first mortgage bonds. The cost of the facility is LIBOR plus 350 basis points. The new credit facility matures in March 2004 with two annual extensions at Consumers' option, which would extend the maturity to March 2006. The prior facility was due to expire in July 2003.

Pursuant to restrictive covenants in debt facilities, Consumers is limited to common stock dividend payments that will not exceed \$300 million in any calendar year. Consumers paid common stock dividends of \$231 million in 2002 and \$190 million in 2001 to CMS Energy. In January 2003, Consumers declared and paid a \$78 million common dividend. In March 2003, Consumers declared a \$31 million common dividend payable in May 2003.

**LEASES:** Consumers' capital leases are predominately for leased service vehicles and the new headquarters building. Operating leases are predominately for railroad coal cars.

**OFF-BALANCE SHEET ARRANGEMENTS:** Consumers' use of long-term contracts for the purchase of commodities and services, the sale of its accounts receivable, and operating leases are considered to be off-balance sheet arrangements. Consumers has responsibility for the collectability of the accounts receivable sold, and the full obligation of its leases become due in case of lease payment default. Consumers uses these off-balance sheet arrangements in its normal business operations.

**SALE OF ACCOUNTS RECEIVABLE:** At March 31, 2003, Consumers had, through its wholly owned subsidiary Consumers Receivables Funding, a \$325 million trade receivable sale program in place as an anticipated source of funds for general corporate purposes. At March 31, 2003 and 2002, the receivables sold totaled \$325 million for each year; the average annual discount rate was 1.57 percent and 2.15 percent, respectively. Accounts receivable and accrued revenue in the

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Consolidated Balance Sheets have been reduced to reflect receivables sold. On April 30, 2003, Consumers ended its trade receivable sale program with its then existing purchaser and anticipates that a new trade receivable program will be in place with a new purchaser in May 2003.

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Consumers Energy Company

**UNCONDITIONAL PURCHASE OBLIGATIONS:** Unconditional purchase obligations include natural gas, electricity, and coal purchase contracts and their associated cost of transportation. These obligations represent normal business operating contracts used to assure adequate supply and to minimize exposure to market price fluctuations.

Included in unconditional purchase obligations are long-term power purchase agreements with various generating plants including the MCV Facility. These contracts require monthly capacity payments based on the plants' availability or deliverability. These payments are approximately \$47 million per month for the remaining nine months of 2003, including \$34 million related to the MCV Facility. For the period that a plant is not available to deliver electricity to Consumers, Consumers is not obligated to make the capacity payments to the plant. See Electric Utility Results of Operations above and Note 2, Uncertainties, "Electric Rate Matters - Power Supply Costs" and "Other Electric Uncertainties - The Midland Cogeneration Venture" for further information concerning power supply costs.

### Commercial Commitments

March 31	Total	Commitment Expiration				
		2003	2004	2005	2006	2007
Off-balance sheet:						
Indemnities	\$8	\$-	-	-	-	-
Letters of credit	7	7	-	-	-	-

Indemnities are agreements by Consumers to reimburse other companies, such as an insurance company, if those companies have to complete Consumers' performance involving a third party contract. Letters of credit are issued by a bank on behalf of Consumers, guaranteeing payment to a third party. Letters of credit substitute the bank's credit for Consumers' and reduce credit risk for the third party beneficiary. The amount and time period for drawing on a letter of credit is limited.

### OUTLOOK

#### LIQUIDITY AND CAPITAL RESOURCES

Consumers' liquidity and capital requirements generally are a function of its results of operations, capital expenditures, contractual obligations, debt maturities, working capital needs and collateral requirements. During the summer months, Consumers purchases natural gas and stores it for resale primarily during the winter heating season. Recently, the market price for natural gas has

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increased. If continued, this price increase could impose liquidity needs beyond what is anticipated for 2003. Although Consumers' natural gas purchases are recoverable from its customers, the amount paid for natural gas stored as inventory could require additional liquidity due to the timing of the cost recoveries. In addition, certain commodity suppliers to Consumers have requested advance payments or other forms of assurances in connection with maintenance of ongoing deliveries of gas and electricity.

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Consumers Energy Company

Consumers has historically met its consolidated cash needs through its operating and financing activities and access to bank financing and the capital markets. In 2003, Consumers has contractual obligations and planned capital expenditures that would require substantial amounts of cash. Consumers may also become subject to liquidity demands pursuant to commercial commitments under guarantees, indemnities and letters of credit as indicated above. Consumers plans to meet its liquidity and capital requirements in 2003 through a combination of approximately \$290 million from operations, \$1.290 billion from borrowings, including \$563 million of new debt and \$727 million from refinancing of existing debt, reduced capital expenditures, cost reductions and other measures. The following table is a summary of Consumers' debt financing plan and actual borrowings for 2003:

### Debt Financing in 2003

Financing	Financing Plan	Actual Borrowing	Type	Retired or Issued Date	Maturity
<b>Anticipated Maturities:</b>					
Revolving credit facility	\$ 250	\$ 250	Refinanced	March 2003	March 2004
Senior note	250	250	Refunded (b)	April 2003	April 2008
Gas Inventory facility	227	-	Retired (c)	March 2003	-
	-----	-----			
Subtotal	\$ 727	\$ 500			
	-----	-----			
<b>New Financings:</b>					
Bank loan	140	140	New issue	March 2003	March 2009
Term loan	150	150	New issue	March 2003	March 2006
First mortgage bonds	250	375	New issue	April 2003	April 2013
Additional gas Inventory facility	23	-	(d)-	-	-
	-----	-----			
Subtotal	\$ 563	\$ 665			
	-----	-----			
Total	\$1,290	\$1,165			

(a) This facility has two annual extensions at Consumers' option, which would extend the maturity to March 2006.

(b) Refunded and replaced with FMB.

(c) Includes a gas inventory facility of \$207 million retired in March 2003 and

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anticipated new gas inventory facility pay down of \$20 million expected to occur in December 2003. See footnote (d).

(d) Consumers will seek to arrange a \$125 million gas inventory loan in the third quarter 2003 and thus complete the \$1.290 billion financing plan.

(e) Refer to Capital Resources and Liquidity, "Regulatory Authorization for Financings" above for information about Consumers' remaining FERC debt authorization.

Consumers believes that its current level of cash and borrowing capacity, along with anticipated cash flows from operating and investing activities, will be sufficient to meet its liquidity needs through 2003, including debt maturities in 2003. In addition to executing the debt financing plan for 2003 as discussed above, the following activities also have been initiated by Consumers to enhance further its liquidity beyond 2003:

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- o Consumers filed a general rate case for its gas utility business on March 14, 2003. Consumers requested rate relief in the amount of approximately \$156 million. In its filing, Consumers requested immediate interim relief. If interim relief of \$156 million were granted, Consumers expects that it will be in place by the fourth quarter of 2003.
- o Consumers filed an application in March 2003, with the MPSC seeking authorization to issue \$1.084 billion of Securitization bonds. These bonds would provide liquidity to Consumers at interest rates reflective of high quality credit. Consumers would utilize these proceeds to retire higher cost debt and in turn would realize significant interest expense savings over the life of the bonds. If the MPSC approves a financing in the amount requested, and there are no rehearing or court appeals and no other delays in the offering process, Consumers anticipates that bonds could be issued by year-end 2003.

There is no assurance that the pending Securitization bond issuance transaction noted above will be completed, nor is there assurance that the MPSC will grant either interim or final gas utility rate relief.

### SEC AND OTHER INVESTIGATIONS

As a result of round-trip trading transactions at CMS MST, CMS Energy's Board of Directors established a Special Committee of independent directors to investigate matters surrounding the transactions and retained outside counsel to assist in the investigation. The Special Committee completed its investigation and reported its findings to the Board of Directors in October 2002. The Special Committee concluded, based on an extensive investigation, that the round-trip trades were undertaken to raise CMS MST's profile as an energy marketer with the goal of enhancing its ability to promote its services to new customers. The Special Committee found no apparent effort to manipulate the price of CMS Energy Common Stock or affect energy prices. The Special Committee also made recommendations designed to prevent any reoccurrence of this practice, most of which have already been implemented. Previously, CMS Energy terminated its speculative trading business and revised its risk management policy. The Board of Directors adopted, and CMS Energy has begun implementing, the remaining recommendations of the Special Committee.

CMS Energy is cooperating with other investigations concerning round-trip



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trading, including an investigation by the SEC regarding round-trip trades and CMS Energy's financial statements, accounting policies and controls, and investigations by the United States Department of Justice, the Commodity Futures Trading Commission and the FERC. The FERC issued an order on April 30, 2003 directing eight companies, including CMS MST, to submit written demonstrations within forty-five days that they have taken certain specified remedial measures with respect to the reporting of natural gas trading data to publications that compile and publish price indices. CMS MST intends to make a written submission within the specified time period demonstrating compliance with the FERC's directives. Other than the FERC investigation, CMS Energy is unable to predict the outcome of these matters, and Consumers is unable to predict what effect, if any, these investigations will have on its business.

**SECURITIES CLASS ACTION LAWSUITS:** Beginning on May 17, 2002, a number of securities class action complaints were filed against CMS Energy, Consumers, and certain officers and directors of CMS Energy and its affiliates. The complaints were filed as purported class actions in the United States District Court for the Eastern District of Michigan. The cases were consolidated into a single lawsuit and an amended and consolidated class action complaint was filed on May 1, 2003. The defendants named in the amended and consolidated class action complaint consist of CMS Energy, Consumers, and certain officers and directors of CMS Energy and its affiliates, and certain underwriters of CMS Energy securities. The purported class period is from May 1, 2000 through and including March 31, 2003. The amended and consolidated class action complaint seeks unspecified damages based on allegations that the defendants violated United States securities laws and regulations by making allegedly false and misleading statements about CMS Energy's business and financial condition. CMS Energy and Consumers intend to vigorously defend against this action, but cannot predict the outcome of this litigation.

**ERISA CASES:** Consumers is a named defendant, along with CMS Energy, CMS MST and certain named

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and unnamed officers and directors, in two lawsuits brought as purported class actions on behalf of participants and beneficiaries of the 401(k) plan. The two cases, filed in July 2002 in the United States District Court for the Eastern District of Michigan, were consolidated by the trial judge and an amended and consolidated complaint has been filed. Plaintiffs allege breaches of fiduciary duties under ERISA and seek restitution on behalf of the plan with respect to a decline in value of the shares of CMS Energy Common Stock held in the plan. Plaintiffs also seek other equitable relief and legal fees. These cases will be vigorously defended. Consumers cannot predict the outcome of this litigation.

### ELECTRIC BUSINESS OUTLOOK

**GROWTH:** Over the next five years, Consumers expects electric deliveries (including both full service sales and delivery service to customers who choose to buy generation service from an alternative electric supplier, but excluding transactions with other wholesale market participants including other electric utilities) to grow at an average rate of approximately two percent per year based primarily on a steadily growing customer base. This growth rate reflects a long-range expected trend of growth. Growth from year to year may vary from this trend due to customer response to abnormal weather conditions and changes in economic conditions including, utilization and expansion of manufacturing facilities. Consumers has experienced much stronger than expected growth in 2002 as a result of warmer than normal summer weather. Assuming that normal weather

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conditions will occur in the remaining three quarters of 2003, electric deliveries are expected to grow less than one percent over the strong 2002 electric deliveries.

**COMPETITION AND REGULATORY RESTRUCTURING:** The enactment in 2000 of Michigan's Customer Choice Act and other developments will continue to result in increased competition in the electric business. Generally, increased competition can reduce profitability and threatens Consumers' market share for generation services. The Customer Choice Act allowed all of the company's electric customers to buy electric generation service from Consumers or from an alternative electric supplier as of January 1, 2002. As a result, alternative electric suppliers for generation services have entered Consumers' market. As of early May 2003, alternative electric suppliers are providing 571 MW of generation supply to customers. To the extent Consumers experiences "net" Stranded Costs as determined by the MPSC, the Customer Choice Act allows for the company to recover such "net" Stranded Costs by collecting a transition surcharge from those customers who switch to an alternative electric supplier. Consumers cannot predict the total amount of electric supply load that may be lost to competitor suppliers, nor whether the stranded cost recovery method adopted by the MPSC will be applied in a manner that will fully offset any associated margin loss.

**Stranded and Implementation Costs:** The Customer Choice Act allows electric utilities to recover the act's implementation costs and "net" Stranded Costs (without defining the term). The act directs the MPSC to establish a method of calculating "net" Stranded Costs and of conducting related true-up adjustments. In December 2001, the MPSC adopted a methodology which calculated "net" Stranded Costs as the shortfall between: (a) the revenue required to cover the costs associated with fixed generation assets, generation-related regulatory assets, and capacity payments associated with purchase power agreements, and (b) the revenues received from customers under existing rates available to cover the revenue requirement. The MPSC authorized Consumers to use deferred accounting to recognize the future recovery of costs determined to be stranded. Consumers has initiated an appeal at the Michigan Court of Appeals related to the MPSC's December 2001 "net" Stranded Cost order.

According to the MPSC, "net" Stranded Costs were to be recovered from retail open access customers through a Stranded Cost transition charge. In April 2002, Consumers made "net" Stranded Cost filings with the MPSC for \$22 million for 2000 and \$43 million for 2001. In the same filing, Consumers estimated that it would experience "net" Stranded Costs of \$126 million for 2002. Consumers, in its hearing brief, filed in August 2002, revised its request for "net" Stranded Costs to \$7 million and \$4 million for 2000 and 2001, respectively, and an estimated \$73 million for 2002. The single largest reason for the difference was the

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exclusion, as ordered by the MPSC, of all costs associated with expenditures required by the Clean Air Act.

In December 2002, the MPSC issued an order finding that Consumers experienced zero "net" Stranded Costs in 2000 and 2001, but declined to establish a defined methodology that would allow a reliable prediction of the level of Stranded Costs for 2002 and future years. In January 2003, Consumers filed a petition for rehearing of the December 2002 Stranded Cost order in which it asked the MPSC to grant rehearing and revise certain features of the order. Several other parties also filed rehearing petitions with the MPSC. As discussed below, Consumers has

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filed a request with the MPSC for authority to issue securitization bonds that would allow recovery of the Clean Air Act expenditures that were excluded from the Stranded Cost calculation and post-2000 Palisades expenditures.

On March 4, 2003, Consumers filed an application with the MPSC seeking approval of "net" Stranded Costs incurred in 2002, and for approval of a "net" Stranded Cost recovery charge. In the application, Consumers indicated that if Consumers' proposal to securitize Clean Air Act expenditures and post-2000 Palisades expenditures were approved as proposed in its securitization case as discussed below, then Consumers' "net" Stranded Costs incurred in 2002 are approximately \$35 million. If the proposal to securitize those costs is not approved, then Consumers indicated that the costs would be properly included in the 2002 "net" Stranded Cost calculation, which would increase Consumers' 2002 "net" Stranded Costs to approximately \$103 million. Consumers cannot predict the recoverability of Stranded Costs, and therefore has not recorded any regulatory assets to recognize the future recovery of such costs.

The MPSC staff has scheduled a collaborative process to discuss Stranded Costs and related issues and to identify and make recommendations to the MPSC. Consumers is participating in this collaborative process.

Since 1997, Consumers has incurred significant electric utility restructuring implementation costs. The following table outlines the applications filed by Consumers with the MPSC and the status of recovery for these costs.

Year Filed	Year Incurred	Requested	Pending	Allowed
1999	1997 & 1998	\$20	\$ -	\$15
2000	1999	30	-	25
2001	2000	25	-	20
2002	2001	8	8	Pending
2003	2002	2	2	Pending

The MPSC disallowed certain costs based upon a conclusion that these amounts did not represent costs incremental to costs already reflected in electric rates. In the orders received for the years 1997 through 2000, the MPSC also reserved the right to review again the total implementation costs depending upon the progress and success of the retail open access program, and ruled that due to the rate freeze imposed by the Customer Choice Act, it was premature to establish a cost recovery method for the allowable implementation costs. In addition to the amounts shown above, as of March 31, 2003, Consumers incurred and deferred as a regulatory asset, \$2 million of additional implementation costs and has also recorded as a regulatory asset \$14 million for the cost of money associated with total implementation costs. Consumers believes the implementation costs and the associated cost of money are fully recoverable in accordance with the Customer Choice Act. Cash recovery from customers will probably begin after the rate freeze or rate cap period has expired. As discussed below, Consumers has asked to include implementation costs through December 31, 2003 in the pending securitization case. If approved, the sale of Securitization bonds will allow for the recovery of these costs. Consumers cannot predict the amounts the MPSC will approve as allowable costs.

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Consumers is also pursuing authorization at the FERC for MISO to reimburse Consumers for approximately \$8 million in certain electric utility restructuring implementation costs related to its former participation in the development of the Alliance RTO, a portion of which has been expensed. However, Consumers cannot predict the amount the FERC will ultimately order to be reimbursed by the MISO.

**Securitization:** In March 2003, Consumers filed an application with the MPSC seeking approval to issue Securitization bonds in the amount of approximately \$1.084 billion. If approved, this would allow the recovery of costs and reduce interest rates associated with financing Clean Air Act expenditures, post-2000 Palisades expenditures, and retail open access implementation costs through December 31, 2003, and certain pension fund expenses, and expenses associated with the issuance of the bonds.

**Rate Caps:** The Customer Choice Act imposes certain limitations on electric rates that could result in Consumers being unable to collect from electric customers its full cost of conducting business. Some of these costs are beyond Consumers' control. In particular, if Consumers needs to purchase power supply from wholesale suppliers while retail rates are frozen or capped, the rate restrictions may make it impossible for Consumers to fully recover purchased power and associated transmission costs from its customers. As a result, Consumers may be unable to maintain its profit margins in its electric utility business during the rate freeze or rate cap periods. The rate freeze is in effect through December 31, 2003. The rate caps are in effect through at least December 31, 2004 for small commercial and industrial customers, and at least through December 31, 2005 for residential customers.

**Industrial Contracts:** In response to industry restructuring efforts, in 1995 and 1996, Consumers entered into multi-year electric supply contracts with certain large industrial customers to provide electricity at specially negotiated prices, usually at a discount from tariff prices. The MPSC approved these special contracts as part of its phased introduction to competition. Unless terminated or restructured, the majority of these contracts are in effect through 2005. As of March 31, 2003, outstanding contracts involve approximately 513 MW. Consumers cannot predict the ultimate financial impact of changes related to these power supply contracts, or whether additional contracts will be necessary or advisable. However, of the original special contracts that have terminated, contracts for 52MW have gone to an alternative electric supplier and contracts for 129MW have returned to bundled tariff rates.

**Code of Conduct:** In December 2000, as a result of the passage of the Customer Choice Act, the MPSC issued a new code of conduct that applies to electric utilities and alternative electric suppliers. The code of conduct seeks to prevent cross-subsidization, information sharing, and preferential treatment between a utility's regulated and unregulated services. The new code of conduct is broadly written, and as a result, could affect Consumers' retail gas business, the marketing of unregulated services and equipment to Michigan customers, and internal transfer pricing between Consumers' departments and affiliates. In October 2001, the new code of conduct was reaffirmed by the MPSC without substantial modification. Consumers appealed the MPSC orders related to the code of conduct and sought a stay of the orders until the appeal was complete; however, the request for a stay was denied. Consumers filed a compliance plan in accordance with the code of conduct. It also sought waivers to the code of conduct in order to continue utility activities that provide approximately \$50 million in annual electric and gas revenues. In October 2002, the MPSC denied waivers for three programs that provided approximately \$32 million in gas revenues in 2001, of which \$30 million relates to the appliance service plan. The waivers denied included all waivers associated with the

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appliance service plan program that has been offered by Consumers for many years. Consumers filed a renewed motion for a stay of the effectiveness of the code of conduct and an appeal of the waiver denials with the Michigan Court of Appeals. On November 8, 2002, the Michigan Court of Appeals denied Consumers' request for a stay. Consumers filed an application for leave to appeal with the Michigan Supreme Court with respect to the Michigan Court of Appeals' November ruling denying the stay. In February 2003, the Michigan Supreme Court denied the application. In December 2002, Consumers filed a renewed request with the MPSC for a temporary waiver until April 2004 for the appliance service plan, which generated \$33 million in gas revenues in 2002. In February 2003, the MPSC granted an extension of the temporary waiver until December 31, 2003. The full impact of the new code of conduct on Consumers' business will remain uncertain until the

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appellate courts issue definitive rulings. Recently, in an appeal involving affiliate pricing guidelines, the Michigan Court of Appeals struck the guidelines down because of a procedurally defective manner of enactment by the MPSC. A similar procedure was used by the MPSC in enacting the new code of conduct. Consumers is also exploring seeking legislative clarification of the scope of the code of conduct.

**Energy Policy:** Uncertainty exists regarding the enactment of a national comprehensive energy policy, specifically federal electric industry restructuring legislation. A variety of bills introduced in the United States Congress in recent years aimed to change existing federal regulation of the industry. If the federal government enacts a comprehensive energy policy or electric restructuring legislation, then that legislation could potentially affect company operations and financial requirements.

**Transmission:** In 2002, Consumers sold its electric transmission system to MTH, a non-affiliated limited partnership whose general partner is a subsidiary of Trans-Elect, Inc.

As a result of the sale, Consumers anticipates its after-tax earnings will be decreased by \$15 million in 2003, and decrease by approximately \$14 million annually for the next three years due to a loss of revenue from wholesale and retail open access customers who will buy services directly from MTH and the loss of a return on the sold electric transmission system.

Under an agreement with MTH, and subject to certain additional RTO surcharges, transmission rates charged to Consumers are fixed by contract at current levels through December 31, 2005, and subject to FERC ratemaking thereafter. MTH has completed the capital program to expand the transmission system's capability to import electricity into Michigan, as required by the Customer Choice Act, and Consumers will continue to maintain the system under a five-year contract with MTH.

Consumers is a customer of AEP, holding 300 MW of long-term transmission service reservations through the AEP transmission system. Effective June 1, 2003, Consumers will have an additional 100 MW of long-term transmission, resulting in a total of 400 MW of long-term transmission for summer 2003, reserved through the AEP transmission system. AEP has indicated its intent, and has received preliminary FERC approval, to turn control of its transmission system over to the PJM RTO. This will require current AEP wholesale transmission customers to become members of, and resubmit reservation requests to, PJM. Due to legislation recently enacted in Virginia, which precludes Virginia utilities (including AEP)

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from joining an RTO until at least July 2004, as well as uncertainty associated with state approvals AEP is seeking from various state regulatory bodies, the timing of AEP's membership in PJM is currently in some doubt. Upon completion of the steps necessary for the integration of AEP into PJM, Consumers will complete the application process to join PJM as a transmission customer.

There are multiple proceedings and a proposed rulemaking pending before the FERC regarding transmission pricing mechanisms and standard market design for electric bulk power markets and transmission. The results of these proceedings and proposed rulemaking could significantly affect the trend of transmission costs and increase the delivered power costs to Consumers and the retail electric customers it serves. The specific financial impact on Consumers of such proceedings, rulemaking and trends are not currently quantifiable.

In addition, Consumers is evaluating whether or not there may be impacts on electric reliability associated with the outcomes of these various transmission related proceedings. Consumers cannot assure that all risks to reliability can be avoided.

Consumers cannot predict the impact of these electric industry-restructuring issues on its financial position, liquidity, or results of operations.

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**PERFORMANCE STANDARDS:** In July 2001, the MPSC proposed electric distribution performance standards for Consumers and other Michigan electric distribution utilities. The proposal would establish standards related to restoration after an outage, safety, and customer relations. Failure to meet the standards would result in customer bill credits. Consumers submitted comments to the MPSC. In December 2001, the MPSC issued an order stating its intent to initiate a formal rulemaking proceeding to develop and adopt performance standards. In November 2002, the MPSC issued an order initiating the formal rulemaking proceeding. Consumers has filed comments on the proposed rules and will continue to participate in this process. Consumers cannot predict the nature of the proposed standards or the likely effect, if any, on Consumers.

For further information and material changes relating to the rate matters and restructuring of the electric utility industry, see Note 1, Corporate Structure and Summary of Significant Accounting Policies, and Note 2, Uncertainties, "Electric Rate Matters - Electric Restructuring" and "Electric Rate Matters - Electric Proceedings."

**UNCERTAINTIES:** Several electric business trends or uncertainties may affect Consumers' financial results and condition. These trends or uncertainties have, or Consumers reasonably expects could have, a material impact on net sales, revenues, or income from continuing electric operations. Such trends and uncertainties include: 1) pending litigation and government investigations; 2) the need to make additional capital expenditures and increase operating expenses for Clean Air Act compliance; 3) environmental liabilities arising from various federal, state and local environmental laws and regulations, including potential liability or expenses relating to the Michigan Natural Resources and Environmental Protection Acts and Superfund; 4) uncertainties relating to the storage and ultimate disposal of spent nuclear fuel; 5) electric industry restructuring issues, including those described above; 6) Consumers' ability to meet peak electric demand requirements at a reasonable cost, without market disruption, and successfully implement initiatives to reduce exposure to purchased power price increases; 7) the recovery of electric restructuring implementation costs; 8) Consumers new status as an electric transmission

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customer and not as an electric transmission owner/operator; 9) sufficient reserves for OATT rate refunds; 10) the effects of derivative accounting and potential earnings volatility; 11) increased costs for safety and homeland security initiatives that are not recoverable on a timely basis from customers; and 12) potentially rising pension costs due to market losses (as discussed above in Accounting for Pension and OPEB). For further information about these trends or uncertainties, see Note 2, Uncertainties.

### GAS BUSINESS OUTLOOK

**GROWTH:** Over the next five years, Consumers expects gas deliveries, including gas full service and customer choice deliveries (excluding transportation to the MCV Facility and off-system deliveries), to grow at an average rate of less than one percent per year based primarily on a steadily growing customer base. Actual gas deliveries in future periods may be affected by abnormal weather, use of gas by independent power producers, changes in competitive and economic conditions, and the level of natural gas consumption per customer.

**2001 GAS RATE CASE:** In June 2001, Consumers filed an application with the MPSC seeking a distribution service rate increase. On November 7, 2002, the MPSC issued a final order approving a \$56 million annual distribution service rate increase, which includes the \$15 million interim increase, with an 11.4 percent authorized return on equity, for service effective November 8, 2002. As part of this order, the MPSC approved Consumers' proposal to absorb the assets and liabilities of Michigan Gas Storage Company into Consumers' rate base and rates. This has occurred through a statutory merger of Michigan Gas Storage Company into Consumers and this is not expected to have an impact on Consumers' consolidated financial statements.

**2003 GAS RATE CASE:** On March 14, 2003, Consumers filed an application with the MPSC seeking a \$156 million increase in its gas delivery and transportation rates, which includes a 13.5 percent authorized return on

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equity, based on a 2004 test year. If approved, the request would add about \$6.40 per month, or about 9 percent, to the typical residential customer's average monthly bill. Contemporaneously with this filing, Consumers has requested interim rate relief in the same amount.

In September 2002, the FERC issued an order rejecting a filing by Consumers to assess certain rates for non-physical gas title tracking services offered by Consumers. Despite Consumers' arguments to the contrary, the FERC asserted jurisdiction over such activities and allowed Consumers to refile and justify a title transfer fee not based on volumes as Consumers proposed. Because the order was issued six years after Consumers made its original filing initiating the proceeding, over \$3 million in non-title transfer tracking fees had been collected. No refunds have been ordered, and Consumers sought rehearing of the September order. If refunds were ordered they may include interest which would increase the refund liability to more than the \$3 million collected. In December 2002, Consumers established a \$3.6 million reserve related to this matter. Consumers is unable to say with certainty what the final outcome of this proceeding might be.

**ENERGY-RELATED SERVICES:** Consumers offers a variety of energy-related services to retail customers that focus on appliance maintenance, home safety, commodity choice, and assistance to customers purchasing heating, ventilation and air conditioning equipment. Consumers continues to look for additional growth

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opportunities in providing energy-related services to its customers. The ability to offer all or some of these services and other utility related revenue-generating services, which provide approximately \$36 million in annual gas revenues, may be restricted by the new code of conduct issued by the MPSC, as discussed above in Electric Business Outlook, "Competition and Regulatory Restructuring - Code of Conduct."

UNCERTAINTIES: Several gas business trends or uncertainties may affect Consumers' financial results and conditions. These trends or uncertainties have, or Consumers reasonably expects could have, a material impact on net sales, revenues, or income from continuing gas operations. Such trends and uncertainties include: 1) pending litigation and government investigations; 2) potential environmental costs at a number of sites, including sites formerly housing manufactured gas plant facilities; 3) future gas industry restructuring initiatives; 4) any initiatives undertaken to protect customers against gas price increases; 5) an inadequate regulatory response to applications for requested rate increases; 6) market and regulatory responses to increases in gas costs, including a reduced average use per residential customer; 7) increased costs for pipeline integrity and safety and homeland security initiatives that are not recoverable on a timely basis from customers; and 8) potentially rising pension costs due to market losses (as discussed above in Accounting for Pension and OPEB). For further information about these uncertainties, see Note 2, Uncertainties.

### OTHER OUTLOOK

See Outlook, "Liquidity and Capital Resources," "SEC and Other Investigations," "Securities Class Action Lawsuits," and "ERISA Cases" above.

SECURITY COSTS: Since the September 11, 2001 terrorist attacks in the United States, Consumers has increased security at all critical facilities and over its critical infrastructure, and will continue to evaluate security on an ongoing basis. Consumers may be required to comply with federal and state regulatory security measures promulgated in the future. Through December 31, 2002, Consumers has incurred approximately \$4 million in incremental security costs, including operating, capital, and decommissioning and removal costs. Consumers estimates it may incur additional incremental security costs in 2003 of approximately \$6 million. Consumers will attempt to seek recovery of these costs from its customers. In December 2002, the Michigan legislature passed, and the governor signed, a bill that would allow Consumers to seek recovery of additional nuclear electric division security costs incurred during the rate freeze and cap periods imposed by the Customer Choice Act. Of the \$4 million in incremental security costs incurred through December 31, 2002, approximately \$3 million related to nuclear security costs. Of the estimated \$6 million for incremental

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security costs expected to be incurred in 2003, \$4 million relates to nuclear security costs. On February 5, 2003, the MPSC adopted filing requirements for the recovery of enhanced security costs.

### OTHER MATTERS

### DISCLOSURE AND INTERNAL CONTROLS

Consumers' CEO and CFO are responsible for establishing and maintaining Consumers' disclosure controls and procedures. Management, under the direction



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of Consumers' principal executive and financial officers, has evaluated the effectiveness of Consumers' disclosure controls and procedures as of a date within 90 days prior to this filing. Based on this evaluation, Consumers' CEO and CFO have concluded that Consumers' disclosure controls and procedures are effective to ensure that material information was presented to them. There have been no significant changes in Consumers' internal controls or in other factors that could significantly affect internal controls subsequent to such evaluation.

NEW ACCOUNTING STANDARDS

FASB INTERPRETATION NO. 46, CONSOLIDATION OF VARIABLE INTEREST ENTITIES: Issued by the FASB in January 2003, the interpretation expands upon and strengthens existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. The consolidation requirements of the interpretation apply immediately to variable interest entities created after January 31, 2003. For Consumers, the consolidation requirements apply to pre-existing entities beginning July 1, 2003. Certain of the disclosure requirements apply to all financial statements initially issued after January 31, 2003. Consumers will be required to consolidate any entities that meet the requirements of the interpretation. Upon adoption of the standard on January 31, 2003, there was no impact on Consumers' consolidated financial statements, and Consumers does not anticipate any additional impact to its consolidated financial statements upon adoption of additional standard requirements on July 1, 2003.

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CONSUMERS ENERGY COMPANY  
 CONSOLIDATED STATEMENTS OF INCOME  
 (UNAUDITED)

MARCH 31	THR 20
-----	
OPERATING REVENUE	
Electric	\$ 6
Gas	7
Other	
	----- 1,4
-----	
OPERATING EXPENSES	
Operation	
Fuel for electric generation	
Purchased power - related parties	1
Purchased and interchange power	
Cost of gas sold	5
Cost of gas sold - related parties	

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Other	1
	-----
	9
Maintenance	
Depreciation, depletion and amortization	1
General taxes	
	-----
	1,2
-----	
OPERATING INCOME	
Electric	1
Gas	1
Other	
	-----
	2
-----	
OTHER INCOME (DEDUCTIONS)	
Dividends and interest from affiliates	
Accretion expense	
Other, net	
	-----
	(
-----	
INTEREST CHARGES	
Interest on long-term debt	
Other interest	
Capitalized interest	
	-----
-----	
INCOME BEFORE INCOME TAXES	1
INCOME TAXES	
	-----
NET INCOME	1
PREFERRED SECURITIES DISTRIBUTIONS	
	-----
NET INCOME AVAILABLE TO COMMON STOCKHOLDER	\$
=====	

THE ACCOMPANYING CONDENSED NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS.

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CONSUMERS ENERGY COMPANY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

MARCH 31

THR  
2003

CASH FLOWS FROM OPERATING ACTIVITIES

Net income	\$110
Adjustments to reconcile net income to net cash	

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provided by operating activities	
Depreciation, depletion and amortization (includes nuclear decommissioning of \$2 and \$2, respectively)	116
Deferred income taxes and investment tax credit	28
Loss on CMS Energy stock	12
Capital lease and other amortization	4
Undistributed earnings of related parties	(16)
Changes in assets and liabilities	
Decrease in inventories	238
Decrease in accounts payable	(5)
Increase in accounts receivable and accrued revenue	(50)
Changes in other assets and liabilities	(50)
	-----
Net cash provided by operating activities	387
	-----
CASH FLOWS FROM INVESTING ACTIVITIES	
Capital expenditures (excludes assets placed under capital lease)	(114)
Cost to retire property, net	(18)
Investment in Electric Restructuring Implementation Plan	(2)
Investments in nuclear decommissioning trust funds	(2)
Proceeds from nuclear decommissioning trust funds	6
Cash receipts from asset sales	13
	-----
Net cash used in investing activities	(117)
	-----
CASH FLOWS FROM FINANCING ACTIVITIES	
Decrease in notes payable, net	(205)
Payment of common stock dividends	(78)
Retirement of bonds and other long-term debt	(35)
Preferred securities distributions	(11)
Payment of capital lease obligations	(3)
Redemption of preferred securities	-
Payment of preferred stock dividends	-
Stockholder's contribution	-
Proceeds from senior notes and bank loans	281
	-----
Net cash used in financing activities	(51)
	-----
NET INCREASE IN CASH AND TEMPORARY CASH INVESTMENTS	219
CASH AND TEMPORARY CASH INVESTMENTS, BEGINNING OF PERIOD	271
	-----
CASH AND TEMPORARY CASH INVESTMENTS, END OF PERIOD	\$ 490
	=====
OTHER CASH FLOW ACTIVITIES AND NON-CASH INVESTING AND FINANCING ACTIVITIES WERE:	
CASH TRANSACTIONS	
Interest paid (net of amounts capitalized)	\$ 61
Income tax paid	5
Pension and OPEB cash contribution	18
NON-CASH TRANSACTIONS	
Other assets placed under capital leases	\$ 8
	=====

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All highly liquid investments with an original maturity of three months or less are considered cash equivalents.

THE ACCOMPANYING CONDENSED NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS.

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### CONSUMERS ENERGY COMPANY CONSOLIDATED BALANCE SHEETS

ASSETS	MARCH 31 2003 (UNAUDITED)	DECEMBER 31 2002
	-----	
	(As Restated) (See Note 6)	
PLANT (AT ORIGINAL COST)		
Electric	\$7,356	\$7,523
Gas	2,787	2,719
Other	21	23
	-----	
	10,164	10,265
Less accumulated depreciation, depletion and amortization	5,267	5,900
	-----	
Construction work-in-progress	4,897	4,365
	487	548
	-----	
	5,384	4,913
-----		
INVESTMENTS		
Stock of affiliates	10	22
First Midland Limited Partnership	259	255
Midland Cogeneration Venture Limited Partnership	405	388
Consumers Nuclear Services, LLC	2	2
	-----	
	676	667
-----		
CURRENT ASSETS		
Cash and temporary cash investments at cost, which approximates market	490	271
Accounts receivable and accrued revenue, less allowances of \$5, \$4 and \$3, respectively	279	236
Accounts receivable - related parties	15	13
Inventories at average cost		
Gas in underground storage	256	486
Materials and supplies	74	71
Generating plant fuel stock	26	37
Deferred property taxes	117	142
Regulatory assets	19	19
Other	53	38
	-----	
	1,329	1,313
-----		
NON-CURRENT ASSETS		
Regulatory assets		
Securitized costs	678	689

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Postretirement benefits	180	185
Abandoned Midland Project	11	11
Other	233	168
Nuclear decommissioning trust funds	529	536
Other	199	218
	-----	-----
	1,830	1,807
-----		
TOTAL ASSETS	\$9,219	\$8,700
=====		

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STOCKHOLDERS' INVESTMENT AND LIABILITIES	MARCH 31 2003 (UNAUDITED)	DECEMBER 31 2002
	(As Restated)	
	(See Note 6)	
-----		
CAPITALIZATION		
Common stockholder's equity		
Common stock	\$ 841	\$ 841
Paid-in capital	682	682
Other Comprehensive Income	(175)	(179)
Retained earnings since December 31, 1992	535	545
	-----	-----
	1,883	1,889
Preferred stock	44	44
Company-obligated mandatorily redeemable preferred securities of subsidiaries (a)	490	490
Long-term debt	2,724	2,442
Non-current portion of capital leases	121	116
	-----	-----
	5,262	4,981
-----		
CURRENT LIABILITIES		
Current portion of long-term debt and capital leases	290	318
Notes payable	252	457
Notes payable- CMS Energy	-	-
Accounts payable	252	261
Accrued taxes	161	214
Accounts payable - related parties	88	84
Deferred income taxes	29	25
Current portion of purchased power contracts	26	26
Other	198	200
	-----	-----
	1,296	1,585
-----		
NON-CURRENT LIABILITIES		
Deferred income taxes	961	949

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Postretirement benefits	566	563
Regulatory liabilities for income taxes, net	311	297
Other Regulatory liabilities	152	4
Asset Retirement Obligation	364	-
Power purchase agreement - MCV Partnership	21	27
Deferred investment tax credit	89	91
Other	197	203
	2,661	2,134

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 COMMITMENTS AND CONTINGENCIES (Notes 1 and 2)

TOTAL STOCKHOLDERS' INVESTMENT AND LIABILITIES	\$9,219	\$8,700
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(a) See Note 3, Financings and Capitalization

THE ACCOMPANYING CONDENSED NOTES ARE AN INTEGRAL PART OF THESE BALANCE SHEETS.

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CONSUMERS ENERGY COMPANY  
 CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY  
 (UNAUDITED)

MARCH 31	THRU 20
	(As Res (See N
-----	
COMMON STOCK	
At beginning and end of period (a)	\$ 8
-----	
OTHER PAID-IN CAPITAL	
At beginning of period	6
Stockholder's contribution	
At end of period	6
-----	
OTHER COMPREHENSIVE INCOME	
Minimum Pension Liability	
At beginning of period	(1
Minimum liability pension adjustments	
At end of period	(1
-----	
Investments	
At beginning of period	
Unrealized loss on investments (b)	
At end of period	
-----	

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Derivative Instruments (c)	
At beginning of period	
Unrealized gain on derivative instruments (b)	
Reclassification adjustments included in net income (b)	
At end of period	---
-----	
RETAINED EARNINGS	
At beginning of period	5
Net income (b)	1
Cash dividends declared- Common Stock	(1)
Preferred securities distributions	(
At end of period	5
-----	
TOTAL COMMON STOCKHOLDER'S EQUITY	\$1,8
=====	

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(a) Number of shares of common stock outstanding was 84,108,789 for all periods presented

(b) Disclosure of Comprehensive Income:

Other Comprehensive Income	
Investments	
Unrealized loss on investments, net of tax of \$- and \$2, respectively	\$
Derivative Instruments (d)	
Unrealized gain on derivative instruments, net of tax of \$4 and \$3, respectively	
Reclassification adjustments included in net income, net of tax of (\$2) and \$1, respectively	
Net income	11
	-----
Total Comprehensive Income	\$ 11
	=====

(c) Included in these amounts is Consumers' proportionate share of the effects of derivative accounting related to its equity investment in the MCV Partnership as follows:

At the beginning of the period	\$
Unrealized gain on derivative instruments	
Reclassification adjustments included in net income	(
At the end of period	\$ 1
	-----
	=====

The accompanying notes are an integral part of these statements

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Consumers Energy Company

CONSUMERS ENERGY COMPANY  
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

Consumer's Consolidated Balance Sheets and Consolidated Statements of Common Stockholder's Equity for the quarterly period ended March 31, 2003 have been restated, as discussed in Note 6, Restatement, to reflect a March 2003 common dividend declaration.

Except for the addition of Note 6, the following notes to the consolidated financial statements have not been modified.

These interim Consolidated Financial Statements have been prepared by Consumers in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. As such, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. Certain prior year amounts have been reclassified to conform to the presentation in the current year. In management's opinion, the unaudited information contained in this report reflects all adjustments necessary to assure the fair presentation of financial position, results of operations and cash flows for the periods presented. The Condensed Notes to Consolidated Financial Statements and the related Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements contained in the Consumers Form 10-K for the year ended December 31, 2002, which includes the Reports of Independent Auditors. Due to the seasonal nature of Consumers operations, the results as presented for this interim period are not necessarily indicative of results to be achieved for the fiscal year.

1: CORPORATE STRUCTURE AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES



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CORPORATE STRUCTURE: Consumers, a subsidiary of CMS Energy, a holding company, is an electric and gas utility company that provides service to customers in Michigan's Lower Peninsula. Consumers' customer base includes a mix of residential, commercial and diversified industrial customers, the largest segment of which is the automotive industry.

COLLECTIVE BARGAINING AGREEMENT: As of December 31, 2002, 44 percent of Consumers' workforce was represented by the Utility Workers Union of America. Consumers and the Union negotiated a collective bargaining agreement that became effective as of June 1, 2000, and will continue in full force and effect until June 1, 2005. On March 26, 2003, Consumers reached a tentative agreement with the Union for a collective bargaining agreement for its Call Center employees. The agreement was effective April 1, 2003, and covers approximately 300 employees. The agreement will continue in full force and effect until August 1, 2005.

BASIS OF PRESENTATION: The consolidated financial statements include Consumers and its wholly owned subsidiaries. Consumers uses the equity method of accounting for investments in companies and partnerships where it has more than a twenty percent but less than a majority ownership interest and includes these results in operating income. Consumers prepared the financial statements in conformity with accounting principles generally accepted in the United States that include the use of management's estimates.

REPORTABLE SEGMENTS: Consumers has two reportable segments: electric and gas. The electric segment consists of activities associated with the generation and distribution of electricity. The gas segment consists of activities associated with the transportation, storage and distribution of natural gas. Consumers' reportable segments are domestic business units organized and managed by the nature of the product and service each provides. The accounting policies of the segments are the same as those described in Consumers' 2002 Form 10-K. Consumers' management has changed its evaluation of the performance of the electric and gas segments from operating income to net income available to common stockholder. The Consolidated Statements of Income show operating revenue and operating income by reportable segment. Intersegment sales and transfers are accounted for at current market prices and are eliminated in consolidated net income available to common stockholder by segment. Consumers' classifies its equity investments as a part of the other business unit. The other business unit also includes Consumers' consolidated statutory business trusts, which were created to issue preferred securities and Consumers' consolidated special purpose entity for the sale of trade receivables.

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Consumers Energy Company

The net income available to common stockholder by reportable segment is as follows:

-----  
March 31  
-----

T  
20

Net income available to common stockholder

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Electric  
Gas  
Other

\$

-----  
Total Consolidated

\$  
=====

FINANCIAL INSTRUMENTS: Consumers accounts for its debt and equity investment securities in accordance with SFAS No. 115. As such, debt and equity securities can be classified into one of three categories: held-to-maturity, trading, or available-for-sale securities. Consumers' investments in equity securities, including its investment in CMS Energy Common Stock, are classified as available-for-sale securities. They are reported at fair value, with any unrealized gains or losses from changes in fair value reported in equity as part of other comprehensive income and excluded from earnings, unless such changes in fair value are other than temporary. In 2002, Consumers determined that the decline in value related to its investment in CMS Energy Common Stock was other than temporary as the fair value was below the cost basis for a period greater than six months. As a result, Consumers recognized a loss on its investment in CMS Energy Common Stock through earnings of \$12 million in the fourth quarter of 2002 and an additional \$12 million loss in the first quarter of 2003. As of March 31, 2003, Consumers held 2.4 million shares of CMS Energy Common Stock with a fair value of \$10 million. Unrealized gains or losses from changes in the fair value of Consumers' nuclear decommissioning investments are reported as regulatory liabilities. The fair value of these investments is determined from quoted market prices.

UTILITY REGULATION: Consumers accounts for the effects of regulation based on the regulated utility accounting standard SFAS No. 71. As a result, the actions of regulators affect when Consumers recognizes revenues, expenses, assets and liabilities.

In March 1999, Consumers received MPSC electric restructuring orders, which, among other things, identified the terms and timing for implementing electric restructuring in Michigan. Consistent with these orders and EITF No. 97-4, Consumers discontinued the application of SFAS No. 71 for the energy supply portion of its business because Consumers expected to implement retail open access at competitive market based rates for its electric customers. Discontinuation of SFAS No. 71 for the energy supply portion of Consumers' business resulted in Consumers reducing the carrying value of its Palisades plant-related assets, in 1999, by approximately \$535 million and establishing a regulatory asset for a corresponding amount. As of March 31, 2003, Consumers had a net investment in energy supply facilities of \$1.554 billion included in electric plant and property.

Since 1999, there has been a significant legislative and regulatory change in Michigan that has resulted in: 1) electric supply customers of utilities remaining on cost-based rates and 2) utilities being given the ability to recover Stranded Costs associated with electric restructuring, from customers who choose an alternative electric supplier. During 2002, Consumers re-evaluated the criteria used to determine if an entity or a segment of an entity meets the requirements to apply regulated utility accounting, and determined that the energy supply portion of its business could meet the criteria if certain regulatory events occurred. In December 2002, Consumers received a MPSC Stranded Cost order that allowed Consumers to re-apply regulatory accounting standard SFAS No. 71 to the energy supply portion of its business. Re-application of

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Consumers Energy Company

SFAS No. 71 had no effect on the prior discontinuation accounting, but will allow Consumers to apply regulatory accounting treatment to the energy supply portion of its business beginning in the fourth quarter of 2002, including regulatory accounting treatment of costs required to be recognized in accordance with SFAS No. 143. See Note 2, Uncertainties, "Electric Rate Matters - Electric Restructuring."

SFAS No. 144 imposes strict criteria for retention of regulatory-created assets by requiring that such assets be probable of future recovery at each balance sheet date. Management believes these assets are probable of future recovery.

SFAS NO. 148, ACCOUNTING FOR STOCK-BASED COMPENSATION - TRANSITION AND DISCLOSURE: Issued by the FASB in December 2002, this standard provides for alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, the statement amends the disclosure requirements of SFAS No. 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The transition guidance and annual disclosure provisions of the statement were effective as of December 31, 2002 and interim disclosure provisions are effective for interim financial reports starting in 2003. Consumers decided to voluntarily adopt the fair value based method of accounting for stock-based employee compensation effective December 31, 2002, applying the prospective method of adoption which requires recognition of all employee awards granted, modified, or settled after the beginning of the year in which the recognition provisions are first applied. The following table shows the amounts that would have been included in net income had the fair value method been applied to all awards granted in the first quarter of 2002:

-----  
Three Months Ended March 31  
-----

Net income, as reported  
Add: Stock-based employee compensation expense included in reported net income, net of related taxes  
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related taxes

Pro forma net income  
=====

2: UNCERTAINTIES

Several business trends or uncertainties may affect Consumers' financial results and condition. These trends or uncertainties have, or Consumers reasonably expects could have, a material impact on net sales, revenues, or income from continuing electric operations. Such trends and uncertainties are discussed in detail below and include: 1) pending litigation and government investigations; 2) the need to make additional capital expenditures and increase operating expenses for Clean Air Act compliance; 3) environmental liabilities arising from various federal, state and local environmental laws and regulations, including potential liability or expenses relating to the Michigan Natural Resources and Environmental Protection Acts and Superfund; 4) electric industry restructuring

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issues; 5) Consumers' ability to meet peak electric demand requirements at a reasonable cost, without market disruption, and successfully implement initiatives to reduce exposure to purchased power price increases; 6) the recovery of electric restructuring implementation costs; 7) Consumers' new status as an electric transmission customer and not as an electric transmission owner/operator; 8) sufficient reserves for OATT rate refunds; 9) uncertainties relating to the storage and ultimate disposal of spent nuclear fuel; 10) the effects of derivative accounting and potential earnings volatility; 11) potential environmental costs at a number of sites, including sites formerly housing manufactured gas plant facilities; 12) future gas industry restructuring initiatives; 13) any initiatives undertaken to protect customers against gas price increases; 14) an inadequate regulatory response to applications for requested rate increases; 15) market and regulatory responses to increases in gas costs, including a reduced average use per residential customer; and 16) increased costs for pipeline integrity and safety and homeland security initiatives that are not recoverable on a timely basis from customers.

SEC AND OTHER INVESTIGATIONS: As a result of the round-trip trading transactions at CMS MST, CMS Energy's Board of Directors established a Special Committee of independent directors to investigate matters surrounding the transactions and retained outside counsel to assist in the investigation. The Special Committee completed its investigation and reported its findings to the Board of Directors in October 2002. The Special Committee concluded, based on an extensive investigation, that the round-trip trades were undertaken to raise CMS MST's profile as an energy marketer with the goal of enhancing its ability to promote its services to new customers. The Special Committee found no apparent effort to manipulate the price of CMS Energy Common Stock or affect energy prices. The Special Committee also made recommendations designed to prevent any reoccurrence of this practice, most of which have already been implemented. Previously, CMS Energy terminated its speculative trading business and revised its risk management policy. The Board of Directors adopted, and CMS Energy has begun implementing, the remaining recommendations of the Special Committee.

CMS Energy is cooperating with other investigations concerning round-trip trading, including an investigation by the SEC regarding round-trip trades and CMS Energy's financial statements, accounting policies and controls, and investigations by the United States Department of Justice, the Commodity Futures Trading Commission and the FERC. The FERC issued an order on April 30, 2003 directing eight companies, including CMS MST, to submit written demonstrations within forty-five days that they have taken certain specified remedial measures with respect to the reporting of natural gas trading data to publications that compile and publish price indices. CMS MST intends to make a written submission within the specified time period demonstrating compliance with the FERC's directives. Other than the FERC investigation, CMS Energy is unable to predict the outcome of these matters, and Consumers is unable to predict what effect, if any, these investigations will have on its business.

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Consumers Energy Company

SECURITIES CLASS ACTION LAWSUITS: Beginning on May 17, 2002, a number of securities class action complaints were filed against CMS Energy, Consumers, and certain officers and directors of CMS Energy and its affiliates. The complaints were filed as purported class actions in the United States District Court for the Eastern District of Michigan. The cases were consolidated into a single lawsuit and an amended and consolidated class action complaint was filed on May 1, 2003. The defendants named in the amended and consolidated class action complaint consist of CMS Energy, Consumers, certain officers and directors of CMS Energy and its affiliates, and certain underwriters of CMS Energy securities. The purported class period is from May 1, 2000 through and including

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March 31, 2003. The amended and consolidated class action complaint seeks unspecified damages based on allegations that the defendants violated United States securities laws and regulations by making allegedly false and misleading statements about CMS Energy's business and financial condition. CMS Energy and Consumers intend to vigorously defend against this action, but cannot predict the outcome of this litigation.

ERISA CASES: Consumers is a named defendant, along with CMS Energy, CMS MST and certain named and unnamed officers and directors in two lawsuits brought as purported class actions on behalf of participants and beneficiaries of the 401(k) plan. The two cases, filed in July 2002 in the United States District Court for the Eastern District of Michigan, were consolidated by the trial judge and an amended and consolidated complaint has been filed. Plaintiffs allege breaches of fiduciary duties under ERISA and seek restitution on behalf of the plan with respect to a decline in value of the shares of CMS Energy Common Stock held in the plan. Plaintiffs also seek other equitable relief and legal fees. These cases will be vigorously defended. Consumers cannot predict the outcome of this litigation.

### ELECTRIC CONTINGENCIES

ELECTRIC ENVIRONMENTAL MATTERS: Consumers is subject to costly and increasingly stringent environmental regulations. Consumers expects that the cost of future environmental compliance, especially compliance with clean air laws, will be significant.

Clean Air - In 1998, the EPA issued regulations requiring the state of Michigan to further limit nitrogen oxide emissions. The Michigan Department of Environmental Quality finalized rules to comply with the EPA regulations in December 2002 and submitted these rules for approval to the EPA in the first quarter of 2003. In addition, the EPA has also issued additional regulations regarding nitrogen oxide emissions that require certain generators, including some of Consumers' electric generating facilities, to achieve the same emissions rate as that required by the 1998 regulations. The EPA and the state regulations require Consumers to make significant capital expenditures estimated to be \$770 million. As of March 31, 2003, Consumers has incurred \$420 million in capital expenditures to comply with the EPA regulations and anticipates that the remaining capital expenditures will be incurred between 2003 and 2009. Additionally, Consumers currently expects to supplement its compliance plan with the purchase of nitrogen oxide emissions credits for years 2005 through 2008. The cost of these credits based on the current market is estimated to average \$6 million per year; however, the market for nitrogen oxide emissions credits and their price could change significantly. Based on the Customer Choice Act, beginning January 2004, an annual return of and on these types of capital expenditures, to the extent they are above depreciation levels, is expected to be recoverable from customers, subject to an MPSC prudency hearing.

Cleanup and Solid Waste - Under the Michigan Natural Resources and Environmental Protection Act, Consumers expects that it will ultimately incur investigation and remedial action costs at a number of sites. Consumers believes that these costs will be recoverable in rates under current ratemaking policies.

Consumers is a potentially responsible party at several contaminated sites administered under Superfund. Superfund liability is joint and several. Along with Consumers, many other creditworthy, potentially responsible parties with substantial assets cooperate with respect to the individual sites. Based upon past

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Consumers Energy Company

negotiations, Consumers estimates that its share of the total liability for the known Superfund sites will be between \$1 million and \$9 million. As of March 31, 2003, Consumers had accrued the minimum amount of the range for its estimated Superfund liability.

During routine maintenance activities, Consumers identified PCB as a component in certain paint, grout and sealant materials at the Ludington Pumped Storage facility. Consumers removed and replaced part of the PCB material. Consumers has proposed a plan to deal with the remaining materials and is awaiting a response from the EPA.

### ELECTRIC RATE MATTERS

**ELECTRIC RESTRUCTURING:** In June 2000, the Michigan legislature passed electric utility restructuring legislation known as the Customer Choice Act. This act: 1) permits all customers to choose their electric generation supplier beginning January 1, 2002; 2) cut residential electric rates by five percent; 3) freezes all electric rates through December 31, 2003, and establishes a rate cap for residential customers through at least December 31, 2005, and a rate cap for small commercial and industrial customers through at least December 31, 2004; 4) allows for the use of low-cost Securitization bonds to refinance qualified costs, as defined by the act; 5) establishes a market power supply test that may require transferring control of generation resources in excess of that required to serve firm retail sales requirements (On March 31, 2003, Consumers filed an application with the MPSC that seeks confirmation that Consumers is in compliance with the market power test set forth in the Customer Choice Act); 6) requires Michigan utilities to join a FERC-approved RTO or divest their interest in transmission facilities to an independent transmission owner (Consumers has sold its interest in its transmission facilities to an independent transmission owner, see "Transmission" below); 7) requires Consumers, Detroit Edison and American Electric Power to jointly expand their available transmission capability by at least 2,000 MW; 8) allows deferred recovery of an annual return of and on capital expenditures in excess of depreciation levels incurred during and before the rate freeze/cap period; and 9) allows recovery of "net" Stranded Costs and implementation costs incurred as a result of the passage of the act. In July 2002, the MPSC issued an order approving the plan to achieve the increased transmission capacity. Consumers has completed the transmission capacity projects identified in the plan and has submitted verification of this fact to the MPSC. Consumers believes it is in full compliance with item 7 above.

In 1998, Consumers submitted a plan for electric retail open access to the MPSC. In March 1999, the MPSC issued orders generally supporting the plan. The Customer Choice Act states that the MPSC orders issued before June 2000 are in compliance with this act and enforceable by the MPSC. Those MPSC orders: 1) allow electric customers to choose their supplier; 2) authorize recovery of "net" Stranded Costs and implementation costs; and 3) confirm any voluntary commitments of electric utilities. In September 2000, as required by the MPSC, Consumers once again filed tariffs governing its retail open access program and made revisions to comply with the Customer Choice Act. In December 2001, the MPSC approved revised retail open access tariffs. The revised tariffs establish the rates, terms, and conditions under which retail customers will be permitted to choose an alternative electric supplier. The tariffs, effective January 1, 2002, did not require significant modifications in the existing retail open access program. The tariff terms allow retail open access customers, upon as little as 30 days notice to Consumers, to return to Consumers' generation service at current tariff rates. If any class of customers' (residential, commercial, or industrial) retail open access load reaches 10 percent of Consumers' total load for that class of customers, then returning retail open access customers for that class must give 60 days notice to return to Consumers'

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generation service at current tariff rates. However, Consumers may not have sufficient, reasonably priced, capacity to meet the additional demand of returning retail open access customers, and may be forced to purchase electricity on the spot market at higher prices than it could recover from its customers. Consumers cannot predict the total amount of electric supply load that may be lost to competitor suppliers, nor whether the stranded cost recovery method adopted by the MPSC will be applied in a manner that will fully offset any associated margin loss.

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Consumers Energy Company

**SECURITIZATION:** The Customer Choice Act allows for the use of low-cost Securitization bonds to refinance certain qualified costs, as defined by the act. Securitization typically involves issuing asset-backed bonds with a higher credit rating than conventional utility corporate financing. In 2000 and 2001, the MPSC issued orders authorizing Consumers to issue Securitization bonds. Consumers issued its first Securitization bonds in 2001. Securitization resulted in lower interest costs and a longer amortization period for the securitized assets, and offset the majority of the impact of the required residential rate reduction. The Securitization orders directed Consumers to apply any cost savings in excess of the five percent residential rate reduction to rate reductions for non-residential customers and reductions in Stranded Costs for retail open access customers after the bonds are sold. Excess savings are approximately \$12 million annually.

Consumers and Consumers Funding will recover the repayment of principal, interest and other expenses relating to the bond issuance through a securitization charge and a tax charge that began in December 2001. These charges are subject to an annual true-up until one year prior to the last expected bond maturity date, and no more than quarterly thereafter. The first true-up occurred in November 2002, and prospectively modified the total securitization and related tax charges from 1.677 mills per kWh to 1.746 mills per kWh. Current electric rate design covers these charges, and there will be no rate impact for most Consumers electric customers until the Customer Choice Act rate freeze expires. Securitization charge collections, \$13 million for the three months ended March 31, 2003, and \$12 million for the three months ended March 31, 2002, are remitted to a trustee for the Securitization bonds. Securitization charge collections are dedicated for the repayment of the principal and interest on the Securitization bonds and payment of the ongoing expenses of Consumers Funding and can only be used for those purposes. Consumers Funding is legally separate from Consumers. The assets and income of Consumers Funding, including without limitation, the securitized property, are not available to creditors of Consumers or CMS Energy.

In March 2003, Consumers filed an application with the MPSC seeking approval to issue Securitization bonds in the amount of approximately \$1.084 billion. If approved, this would allow the recovery of costs and reduce interest rates associated with financing Clean Air Act expenditures, post-2000 Palisades expenditures, and retail open access implementation costs through December 31, 2003, and certain pension fund expenses, and expenses associated with the issuance of the bonds.

**TRANSMISSION:** In 2002, Consumers sold its electric transmission system (METC) to MTH, a non-affiliated limited partnership whose general partner is a subsidiary of Trans-Elect Inc.

As a result of the sale, Consumers anticipates its after-tax earnings will be decreased by \$15 million in 2003, and decrease by approximately \$14 million annually for the next three years due to a loss of revenue from wholesale and

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retail open access customers who will buy services directly from MTH and the loss of a return on the sold electric transmission system.

Under an agreement with MTH, and subject to certain additional RTO surcharges, transmission rates charged to Consumers are fixed by contract at current levels through December 31, 2005, and subject to FERC ratemaking thereafter. MTH has completed the capital program to expand the transmission system's capability to import electricity into Michigan, as required by the Customer Choice Act, and Consumers will continue to maintain the system under a five-year contract with MTH.

When IPPs connect to transmission systems, they pay transmission companies the capital costs incurred to connect the IPP to the transmission system and make system upgrades needed for the interconnection. It is the FERC's policy that the system upgrade portion of these IPP payments be credited against transmission service charges over time as transmission service is taken. METC recorded a \$35 million liability for IPP credits. Subsequently, MTH assumed this liability as part of its purchase of the electric transmission system. Several months after METC started operation, the FERC changed its policy to provide for interest on IPP

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Consumers Energy Company

payments that are to be credited. The \$35 million liability for IPP credits did not include interest since the associated interconnection agreements did not at that time provide for interest. MTH had asserted that Consumers might be liable for interest on the IPP payments to be credited if interest provisions were added to these agreements. However, in January 2003, the FERC changed and clarified its approach to contracts that were entered into before the FERC started allowing the crediting of interest, and as a result, Consumers believes that there is no longer any such potential liability under the current FERC policy.

**POWER SUPPLY COSTS:** During periods when electric demand is high, the cost of purchasing electricity on the spot market can be substantial. To reduce Consumers' exposure to the fluctuating cost of electricity, and to ensure adequate supply to meet demand, Consumers intends to maintain sufficient generation and to purchase electricity from others to create a power supply reserve, also called a reserve margin. The reserve margin provides additional power supply capability above Consumers' anticipated peak power supply demands. It also allows Consumers to provide reliable service to its electric service customers and to protect itself against unscheduled plant outages and unanticipated demand. In recent years, Consumers has planned for a reserve margin of approximately 15 percent from a combination of its owned electric generating plants and electricity purchase contracts or options, as well as other arrangements. However, in light of various factors, including the addition of new generating capacity in Michigan and throughout the Midwest region and additional transmission import capability, Consumers is continuing to evaluate the appropriate reserve margin for 2003 and beyond. Currently, Consumers has an estimated reserve margin of approximately 11 percent for summer 2003 or supply resources equal to 111 percent of projected summer peak load. Of the 111 percent, approximately 101 percent is met from owned electric generating plants and long-term power purchase contracts and 10 percent from short-term contracts and options for physical deliveries and other agreements. The ultimate use of the reserve margin will depend primarily on summer weather conditions, the level of retail open access requirements being served by others during the summer, and any unscheduled plant outages. As of early May 2003, alternative electric suppliers are providing 571 MW of generation supply to ROA customers. Consumers'



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reserve margin does not include generation being supplied by other alternative electric suppliers under the ROA program.

To reduce the risk of high electric prices during peak demand periods and to achieve its reserve margin target, Consumers employs a strategy of purchasing electric call option and capacity and energy contracts for the physical delivery of electricity primarily in the summer months and to a lesser degree in the winter months. As of March 31, 2003, Consumers had purchased or had commitments to purchase electric call option and capacity and energy contracts partially covering the estimated reserve margin requirements for 2003 through 2007. As a result, Consumers has a recognized asset of \$28 million for unexpired call options and capacity and energy contracts. The total cost of electricity call option and capacity and energy contracts for 2003 is expected to be approximately \$9 million.

Prior to 1998, the PSCR process provided for the reconciliation of actual power supply costs with power supply revenues. This process assured recovery of all reasonable and prudent power supply costs actually incurred by Consumers, including the actual cost for fuel, and purchased and interchange power. In 1998, as part of the electric restructuring efforts, the MPSC suspended the PSCR process, and would not grant adjustment of customer rates through 2001. As a result of the rate freeze imposed by the Customer Choice Act, the current rates will remain in effect until at least December 31, 2003 and, therefore, the PSCR process remains suspended. Therefore, changes in power supply costs as a result of fluctuating electricity prices will not be reflected in rates charged to Consumers' customers during the rate freeze period.

**ELECTRIC PROCEEDINGS:** The Customer Choice Act allows electric utilities to recover the act's implementation costs and "net" Stranded Costs (without defining the term). The act directs the MPSC to establish a method of calculating "net" Stranded Costs and of conducting related true-up adjustments. In December 2001, the MPSC adopted a methodology which calculated "net" Stranded Costs as the shortfall between: (a) the revenue required to cover the costs associated with fixed generation assets, generation-related regulatory assets, and

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Consumers Energy Company

capacity payments associated with purchase power agreements, and (b) the revenues received from customers under existing rates available to cover the revenue requirement. The MPSC authorized Consumers to use deferred accounting to recognize the future recovery of costs determined to be stranded. Consumers has initiated an appeal at the Michigan Court of Appeals related to the MPSC's December 2001 "net" Stranded Cost order.

According to the MPSC, "net" Stranded Costs were to be recovered from retail open access customers through a Stranded Cost transition charge. In April 2002, Consumers made "net" Stranded Cost filings with the MPSC for \$22 million for 2000 and \$43 million for 2001. In the same filing, Consumers estimated that it would experience "net" Stranded Costs of \$126 million for 2002. Consumers in its hearing brief, filed in August 2002, revised its request for Stranded Costs to \$7 million and \$4 million for 2000 and 2001, respectively, and an estimated \$73 million for 2002. The single largest reason for the difference in the filing was the exclusion, as ordered by the MPSC, of all costs associated with expenditures required by the Clean Air Act.

In December 2002, the MPSC issued an order finding that Consumers experienced zero "net" Stranded Costs in 2000 and 2001, but declined to establish a defined

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methodology that would allow a reliable prediction of the level of Stranded Costs for 2002 and future years. In January 2003, Consumers filed a petition for rehearing of the December 2002 Stranded Cost order in which it asked the MPSC to grant a rehearing and revise certain features of the order. Several other parties also filed rehearing petitions with the MPSC. As noted above, Consumers has filed a request with the MPSC for authority to issue securitization bonds that would allow recovery of the Clean Air Act expenditures that were excluded from the Stranded Cost calculation and post-2000 Palisades expenditures.

On March 4, 2003, Consumers filed an application with the MPSC seeking approval of "net" Stranded Costs incurred in 2002, and for approval of a "net" Stranded Cost recovery charge. In the application, Consumers indicated that if Consumers' proposal to securitize Clean Air Act expenditures and post-2000 Palisades' expenditures were approved as proposed in its securitization case as discussed above, then Consumers' "net" Stranded Costs incurred in 2002 are approximately \$35 million. If the proposal to securitize those costs is not approved, then Consumers indicated that the costs would be properly included in the 2002 "net" Stranded Cost calculation, which would increase Consumers' 2002 "net" Stranded Costs to approximately \$103 million. Consumers cannot predict the recoverability of Stranded Costs, and therefore has not recorded any regulatory assets to recognize the future recovery of such costs.

The MPSC staff has scheduled a collaborative process to discuss Stranded Costs and related issues and to identify and make recommendations to the MPSC. Consumers is participating in this collaborative process.

Since 1997, Consumers has incurred significant electric utility restructuring implementation costs. The following table outlines the applications filed by Consumers with the MPSC and the status of recovery for these costs.

Year Filed	Year Incurred	Requested	Pending	Allowed
1999	1997 & 1998	\$ 20	\$ -	\$ 15
2000	1999	30	-	25
2001	2000	25	-	20
2002	2001	8	8	Pending
2003	2002	2	2	Pending

The MPSC disallowed certain costs based upon a conclusion that these amounts did not represent costs

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incremental to costs already reflected in electric rates. In the orders received for the years 1997 through 2000, the MPSC also reserved the right to review again the total implementation costs depending upon the progress and success of the retail open access program, and ruled that due to the rate freeze imposed by the Customer Choice Act, it was premature to establish a cost recovery method for the allowable implementation costs. In addition to the amounts shown above, as of March 31, 2003, Consumers incurred and deferred as a regulatory asset, \$2 million of additional implementation costs and has also recorded as a regulatory

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asset \$14 million for the cost of money associated with total implementation costs. Consumers believes the implementation costs and the associated cost of money are fully recoverable in accordance with the Customer Choice Act. Cash recovery from customers will probably begin after the rate freeze or rate cap period has expired. As discussed above, Consumers has asked to include implementation costs through December 31, 2003 in the pending securitization case. If approved, the sale of Securitization bonds will allow for the recovery of these costs. Consumers cannot predict the amounts the MPSC will approve as allowable costs.

Consumers is also pursuing authorization at the FERC for MISO to reimburse Consumers for approximately \$8 million in certain electric utility restructuring implementation costs related to its former participation in the development of the Alliance RTO, a portion of which has been expensed. However, Consumers cannot predict the amount the FERC will ultimately order to be reimbursed by the MISO.

In 1996, Consumers filed new OATT transmission rates with the FERC for approval. Interveners contested these rates, and hearings were held before an ALJ in 1998. In 1999, the ALJ made an initial decision that was largely upheld by the FERC in March 2002, which requires Consumers to refund, with interest, over-collections for past services as measured by the FERC's finally approved OATT rates. Since the initial decision, Consumers has been reserving a portion of revenues billed to customers under the filed 1996 OATT rates. Consumers submitted revised rates to comply with the FERC final order in June 2002. Those revised rates were accepted by the FERC in August 2002 and Consumers is in the process of computing refund amounts for individual customers. Consumers believes its reserve is sufficient to satisfy its refund obligation. As of April 2003, Consumers had paid \$19 million in refunds.

In November 2002, the MPSC, upon its own motion, commenced a contested proceeding requiring each utility to give reason as to why its rates should not be reduced to reflect new personal property multiplier tables, and why it should not refund any amounts that it receives as refunds from local governments as they implement the new multiplier tables. Consumers responded to the MPSC that it believes that refunds would be inconsistent with the electric rate freeze that is currently in effect, and may otherwise be unlawful. Consumers is unable to predict the outcome of this matter.

### OTHER ELECTRIC UNCERTAINTIES

**THE MIDLAND COGENERATION VENTURE:** The MCV Partnership, which leases and operates the MCV Facility, contracted to sell electricity to Consumers for a 35-year period beginning in 1990 and to supply electricity and steam to Dow. Consumers, through two wholly owned subsidiaries, holds the following assets related to the MCV Partnership and MCV Facility: 1) CMS Midland owns a 49 percent general partnership interest in the MCV Partnership; and 2) CMS Holdings holds, through FMLP, a 35 percent lessor interest in the MCV Facility.

Consumers' consolidated retained earnings includes undistributed earnings from the MCV Partnership, which at March 31, 2003 and 2002 are \$233 million and \$187 million, respectively.

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Summarized Statements of Income for CMS Midland and CMS Holdings

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March 31	2003
Operating income	\$16
Income taxes and other	5
Net income	\$11

Power Supply Purchases from the MCV Partnership - Consumers' annual obligation to purchase capacity from the MCV Partnership is 1,240 MW through the term of the PPA ending in 2025. The PPA requires Consumers to pay, based on the MCV Facility's availability, a levelized average capacity charge of 3.77 cents per kWh and a fixed energy charge, and also to pay a variable energy charge based primarily on Consumers' average cost of coal consumed for all kWh delivered. Since January 1, 1993, the MPSC has permitted Consumers to recover capacity charges averaging 3.62 cents per kWh for 915 MW, plus a substantial portion of the fixed and variable energy charges. Since January 1, 1996, the MPSC has also permitted Consumers to recover capacity charges for the remaining 325 MW of contract capacity with an initial average charge of 2.86 cents per kWh increasing periodically to an eventual 3.62 cents per kWh by 2004 and thereafter. However, due to the current freeze of Consumers' retail rates that the Customer Choice Act requires, the capacity charge for the 325 MW is now frozen at 3.17 cents per kWh. Recovery of both the 915 MW and 325 MW portions of the PPA are subject to certain limitations discussed below. After September 2007, the PPA's regulatory out terms obligate Consumers to pay the MCV Partnership only those capacity and energy charges that the MPSC has authorized for recovery from electric customers.

In 1992, Consumers recognized a loss and established a PPA liability for the present value of the estimated future underrecoveries of power supply costs under the PPA based on MPSC cost recovery orders. Primarily as a result of the MCV Facility's actual availability being greater than management's original estimates, the PPA liability has been reduced at a faster rate than originally anticipated. At March 31, 2003 and 2002, the remaining after-tax present value of the estimated future PPA liability associated with the loss totaled \$30 million and \$46 million, respectively. The PPA liability is expected to be depleted in late 2004. For further discussion on the impact of the frozen PSCR, see "Electric Rate Matters" in this Note.

In March 1999, Consumers and the MCV Partnership reached a settlement agreement effective January 1, 1999, that addressed, among other things, the ability of the MCV Partnership to count modifications increasing the capacity of the existing MCV Facility for purposes of computing the availability of contract capacity under the PPA for billing purposes. That settlement agreement capped payments made on the basis of availability that may be billed by the MCV Partnership at a maximum 98.5 percent availability level.

When Consumers returns, as expected, to unfrozen rates beginning in 2004, Consumers will recover from customers capacity and fixed energy charges on the basis of availability, to the extent that availability does not exceed 88.7 percent availability established in previous MPSC orders. For capacity and energy payments billed by the MCV Partnership after September 15, 2007, and not recovered from customers, Consumers would expect to claim a regulatory out under the PPA. The regulatory out provision relieves Consumers of the obligation to pay more for capacity and energy payments than the MPSC allows Consumers to collect from its customers. Consumers estimates that 51 percent of the actual cash underrecoveries for the years 2003 and 2004 will be charged to the PPA

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liability, with the remaining portion charged to operating expense as a result of Consumers' 49 percent ownership in the MCV Partnership. All cash underrecoveries will be expensed directly to income once the PPA liability is depleted. If the MCV Facility's generating availability remains at the maximum 98.5 percent level during the next five years, Consumers' after-tax cash

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underrecoveries associated with the PPA could be as follows:

	2003	2004	2005
Estimated cash underrecoveries at 98.5%, net of tax	\$37	\$36	\$36
Amount to be charged to operating expense, net of tax	\$18	\$18	\$36
Amount to be charged to PPA liability, net of tax	\$19	\$18	\$ -

In February 1998, the MCV Partnership appealed the January 1998 and February 1998 MPSC orders related to electric utility restructuring. At the same time, MCV Partnership filed suit in the United States District Court in Grand Rapids seeking a declaration that the MPSC's failure to provide Consumers and MCV Partnership a certain source of recovery of capacity payments after 2007 deprived MCV Partnership of its rights under the Public Utilities Regulatory Policies Act of 1978. In July 1999, the District Court granted MCV Partnership's motion for summary judgment. The Court permanently prohibited enforcement of the restructuring orders in any manner that denies any utility the ability to recover amounts paid to qualifying facilities such as the MCV Facility or that precludes the MCV Partnership from recovering the avoided cost rate. The MPSC appealed the Court's order to the 6th Circuit Court of Appeals in Cincinnati. In June 2001, the 6th Circuit overturned the lower court's order and dismissed the case against the MPSC. The appellate court determined that the case was premature and concluded that the qualifying facilities needed to wait until 2008 for an actual factual record to develop before bringing claims against the MPSC in federal court.

NUCLEAR MATTERS: Throughout 2002, Big Rock, currently in decommissioning, progressed on plan with building and equipment dismantlement to return the site to a natural setting free for any future use. Periodic NRC inspection reports continued to reflect positively on Big Rock project performance. The NRC found all decommissioning activities were performed in accordance with applicable regulatory and license conditions.

In February 2003, the NRC completed its end-of-cycle plant performance assessment of Palisades. The end-of-cycle review for Palisades covered the 2002 calendar year. The NRC determined that Palisades was operated in a manner that preserved public health and safety and fully met all cornerstone objectives. Based on the plant's performance, only regularly scheduled inspections are planned through March 2004. The NRC noted that they are planning inspections of the new independent spent fuel storage facility as needed during construction activities along with routine inspections for the new security requirements.

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Spent Nuclear Fuel Storage: During the fourth quarter of 2002, equipment fabrication, assembly and testing was completed at Big Rock on NRC approved transportable steel and concrete canisters or vaults, commonly known as "dry-casks", for temporary onsite storage of spent fuel and movement of fuel from the fuel pool to dry casks began. As of March 31, 2003, all of the seven dry casks had been loaded with spent fuel. These transportable dry casks will remain onsite until the DOE moves the material to a permanent national fuel repository.

At Palisades, the amount of spent nuclear fuel discharged from the reactor to date exceeds Palisades' temporary on-site storage pool capacity. Consequently, Consumers is using NRC-approved steel and concrete vaults, "dry casks," for temporary on-site storage. As of March 31, 2003, Consumers had loaded 18 dry casks with spent nuclear fuel at Palisades. Palisades will need to load additional dry casks by the fall of 2004 in order to continue operation. Palisades currently has three empty storage-only dry casks on-site, with storage pad capacity for up to seven additional loaded dry casks. Consumers anticipates that licensed transportable dry casks for additional storage, along with more storage pad capacity, will be available prior to 2004.

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In 1997, a U.S. Court of Appeals decision confirmed that the DOE was to begin accepting deliveries of spent nuclear fuel for disposal by January 31, 1998. Subsequent U.S. Court of Appeals litigation in which Consumers and certain other utilities participated has not been successful in producing more specific relief for the DOE's failure to comply.

In July 2000, the DOE reached a settlement agreement with one utility to address the DOE's delay in accepting spent fuel. The DOE may use that settlement agreement as a framework that it could apply to other nuclear power plants. However, certain other utilities challenged the validity of the mechanism for funding the settlement in an appeal, and the reviewing court sustained their challenge. Additionally, there are two court decisions that support the right of utilities to pursue damage claims in the United States Court of Claims against the DOE for failure to take delivery of spent fuel. A number of utilities have commenced litigation in the Court of Claims, including Consumers, which filed its complaint in December 2002. The Chief Judge of the Court of Claims identified six lead cases to be used as vehicles for resolving dispositive motions. Consumers' case is not a lead case. It is unclear what impact this decision by the Chief Judge will have on the outcome of Consumers' litigation. If the litigation that was commenced in the fourth quarter of 2002, against the DOE is successful, Consumers anticipates future recoveries from the DOE to defray the significant costs it will incur for the storage of spent fuel until the DOE takes possession as required by law.

As of March 31, 2003, Consumers has a recorded liability to the DOE of \$138 million, including interest, which is payable upon the first delivery of spent nuclear fuel to the DOE. Consumers recovered through electric rates the amount of this liability, excluding a portion of interest.

On March 26, 2003, the Michigan Environmental Council, the Public Interest Research Group in Michigan, and the Michigan Consumer Federation submitted a complaint to the MPSC, which was served on Consumers by the MPSC on April 18, 2003. The complaint asks the MPSC to commence a generic investigation and contested case to review all facts and issues concerning costs associated with spent nuclear fuel storage and disposal. The complaint seeks a variety of relief with respect to Consumers Energy, The Detroit Edison Company, Indiana & Michigan

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Electric Company, Wisconsin Electric Power Company and Wisconsin Public Service Corporation, including establishing external trusts to which amounts collected in electric rates for spent nuclear fuel storage and disposal should be transferred, and the adoption of additional measures related to the storage and disposal of spent nuclear fuel. Consumers is reviewing the complaint and, at this time, is unable to predict the outcome of this matter.

In July 2002, Congress approved and the President signed a bill designating the site at Yucca Mountain, Nevada, for the development of a repository for the disposal of high-level radioactive waste and spent nuclear fuel. The next step will be for the DOE to submit an application to the NRC for a license to begin construction of the repository. The application and review process is estimated to take several years.

Palisades Plant Operations: In March 2002, corrosion problems were discovered in the reactor head at an unaffiliated nuclear power plant in Ohio. As a result, the NRC requested that all United States nuclear plants utilizing pressurized water reactors to provide reports detailing their reactor head inspection histories, design capabilities and future inspection plans. In response to the issues identified at this and other nuclear plants worldwide, a bare metal visual inspection was completed on the Palisades reactor vessel head during the spring 2003 refueling outage. No indication of leakage was detected on any of the 54 penetrations.

Insurance: Consumers maintains primary and excess nuclear property insurance from NEIL, totaling \$2.7 billion in recoverable limits for the Palisades nuclear plant. Consumers also procures coverage from NEIL that would partially cover the cost of replacement power during certain prolonged accidental outages at Palisades. NEIL's policies include coverage for acts of terrorism.

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Consumers retains the risk of loss to the extent of the insurance deductibles and to the extent that its loss exceeds its policy limits. Because NEIL is a mutual insurance company, Consumers could be subject to assessments from NEIL up to \$25.8 million in any policy year if insured losses in excess of NEIL's maximum policyholders surplus occur at its, or any other member's nuclear facility.

Consumers maintains nuclear liability insurance for injuries and off-site property damage resulting from the nuclear hazard at Palisades for up to approximately \$9.5 billion, the maximum insurance liability limits established by the Price-Anderson Act. Congress enacted the Price-Anderson Act to provide financial protection for persons who may be liable for a nuclear accident or incident and persons who may be injured by a nuclear incident. The Price-Anderson Act was recently extended to December 31, 2003. Part of the Price-Anderson Act's financial protection consists of a mandatory industry-wide program under which owners of nuclear generating facilities could be assessed if a nuclear incident occurs at any of such facilities. The maximum assessment against Consumers could be \$88 million per occurrence, limited to maximum annual installment payments of \$10 million. Consumers also maintains insurance under a master worker program that covers tort claims for bodily injury to workers caused by nuclear hazards. The policy contains a \$300 million nuclear industry aggregate limit. Under a previous insurance program providing coverage for claims brought by nuclear workers, Consumers remains responsible for a maximum assessment of up to \$6.3 million. The Big Rock plant remains insured for nuclear liability by a combination of insurance and United States government indemnity totaling \$544 million.

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Insurance policy terms, limits and conditions are subject to change during the year as Consumers renews its policies.

### GAS CONTINGENCIES

**GAS ENVIRONMENTAL MATTERS:** Under the Michigan Natural Resources and Environmental Protection Act, Consumers expects that it will ultimately incur investigation and remedial action costs at a number of sites. These include 23 former manufactured gas plant facilities, which were operated by Consumers for some part of their operating lives, including sites in which it has a partial or no current ownership interest. Consumers has completed initial investigations at the 23 sites. For sites where Consumers has received site-wide study plan approvals, it will continue to implement these plans. It will also work toward closure of environmental issues at sites as studies are completed. Consumers has estimated its costs related to investigation and remedial action for all 23 sites using the Gas Research Institute-Manufactured Gas Plant Probabilistic Cost Model. The estimated total costs are between \$82 million and \$113 million; these estimates are based on discounted 2001 costs and follow EPA recommended use of discount rates between three and seven percent for this type of activity. Consumers expects to fund a significant portion of these costs through insurance proceeds and through MPSC approved rates charged to its customers. As of March 31, 2003, Consumers has an accrued liability of \$49 million, net of \$33 million of expenditures incurred to date, and a regulatory asset of \$69 million. Any significant change in assumptions, such as an increase in the number of sites, different remediation techniques, nature and extent of contamination, and legal and regulatory requirements, could affect Consumers' estimate of remedial action costs.

The MPSC, in its November 7, 2002, gas distribution rate order, authorized Consumers to continue to recover approximately \$1 million of manufactured gas plant facilities environmental clean-up costs annually. Consumers defers and amortizes, over a period of 10 years, manufactured gas plant facilities environmental clean-up costs above the amount currently being recovered in rates. Additional rate recognition of amortization expense cannot begin until after a prudency review in a gas rate case. The annual amount that the MPSC authorized Consumers to recover in rates will continue to be offset by \$2 million to reflect amounts recovered from all other sources.

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### GAS RATE MATTERS

**GAS COST RECOVERY:** As part of the on-going GCR process, which includes an annual reconciliation process with the MPSC, Consumers expects to collect all of its incurred gas costs. Under an order issued by the MPSC on March 12, 2003, Consumers increased its maximum GCR factor in May 2003, based on a formula that tracks increases in NYMEX prices.

**2003 GAS RATE CASE:** On March 14, 2003, Consumers filed an application with the MPSC seeking a \$156 million increase in its gas delivery and transportation rates, which include a 13.5 percent authorized return on equity, based on a 2004 test year. If approved, the request would add about \$6.40 per month, or about 9 percent, to the typical residential customer's average monthly bill. Contemporaneously with this filing, Consumers has requested interim rate relief in the same amount.

In September 2002, the FERC issued an order rejecting a filing by Consumers to assess certain rates for non-physical gas title tracking services offered by Consumers. Despite Consumers' arguments to the contrary, the FERC asserted



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jurisdiction over such activities and allowed Consumers to refile and justify a title transfer fee not based on volumes as Consumers proposed. Because the order was issued six years after Consumers made its original filing initiating the proceeding, over \$3 million in non-title transfer tracking fees had been collected. No refunds have been ordered, and Consumers sought rehearing of the September order. If refunds were ordered they may include interest which would increase the refund liability to more than the \$3 million collected. In December 2002, Consumers established a \$3.6 million reserve related to this matter. Consumers is unable to say with certainty what the final outcome of this proceeding might be.

In November 2002, the MPSC upon its own motion commenced a contested proceeding requiring each utility to give reason as to why its rates should not be reduced to reflect new personal property multiplier tables, and why it should not refund any amounts that it receives as refunds from local governments as they implement the new multiplier tables. Consumers responded to the MPSC that it believes that refunds would be inconsistent with the November 7, 2002 gas rate order in case U-13000, with the Customer Choice Act, and may otherwise be unlawful. Consumers is unable to predict the outcome of this matter.

### OTHER UNCERTAINTIES

**SECURITY COSTS:** Since the September 11, 2001 terrorist attacks in the United States, Consumers has increased security at all critical facilities and over its critical infrastructure, and will continue to evaluate security on an ongoing basis. Consumers may be required to comply with federal and state regulatory security measures promulgated in the future. Through December 31, 2002, Consumers has incurred approximately \$4 million in incremental security costs, including operating, capital, and decommissioning and removal costs. Consumers estimates it may incur additional incremental security costs in 2003 of approximately \$6 million. Consumers will attempt to seek recovery of these costs from its customers. In December 2002, the Michigan legislature passed, and the governor signed, a bill that would allow Consumers to seek recovery of additional nuclear electric division security costs incurred during the rate freeze and cap periods imposed by the Customer Choice Act. Of the \$4 million in incremental security costs incurred through December 31, 2002, approximately \$3 million related to nuclear security costs. Of the estimated \$6 million for incremental security costs expected to be incurred in 2003, \$4 million relates to nuclear security costs. On February 5, 2003, the MPSC adopted filing requirements for the recovery of enhanced security costs.

**DERIVATIVE ACTIVITIES:** Consumers uses a variety of contracts to protect against commodity price and interest rate risk. Some of these contracts may be subject to derivative accounting, which requires that the value of the contracts to be adjusted fair value through earnings or equity depending upon certain criteria. Such adjustments to fair value could cause earnings volatility. For further information about derivative activities, see Note 4, Financial and Derivative Instruments.

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In addition to the matters disclosed in this note, Consumers and certain of its subsidiaries are parties to certain lawsuits and administrative proceedings before various courts and governmental agencies arising from the ordinary course of business. These lawsuits and proceedings may involve personal injury, property damage, contractual matters, environmental issues, federal and state taxes, rates, licensing and other matters.

Consumers has accrued estimated losses for certain contingencies discussed in

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this note. Resolution of these contingencies is not expected to have a material adverse impact on Consumers' financial position, liquidity, or results of operations.

### 3: FINANCINGS AND CAPITALIZATION

REGULATORY AUTHORIZATION FOR FINANCINGS: At March 31, 2003, Consumers had FERC authorization to issue or guarantee through June 2004, up to \$1.1 billion of short-term securities outstanding at any one time. Consumers also had remaining FERC authorization to issue through June 2004 up to \$500 million of long-term securities for refinancing or refunding purposes, \$381 million for general corporate purposes, and \$610 million of first mortgage bonds to be issued solely as collateral for the long-term securities. On April 30, 2003, Consumers sold \$625 million principal amount of first mortgage bonds, described below. Its remaining FERC authorization after this issue is (1) \$250 million of long-term securities for refinancing or refunding purposes, (2) \$6 million for general corporate purposes, and (3) \$610 million remaining first mortgage bonds available to be issued solely as collateral for the long-term securities. On October 10, 2002, FERC granted a waiver of its competitive bid/negotiated placement requirements applicable to the remaining long-term securities authorization indicated above.

SHORT-TERM FINANCINGS: In March 2003, Consumers obtained a replacement revolving credit facility in the amount of \$250 million secured by first mortgage bonds. The cost of the facility is LIBOR plus 350 basis points. The new credit facility matures in March 2004 with two annual extensions at Consumers' option, which would extend the maturity to March 2006. The prior facility was due to expire in July 2003. At March 31, 2003, a total of \$252 million was outstanding on all short-term financing at a weighted average interest rate of 6.22 percent, compared with \$150 million outstanding at March 31, 2002 at a weighted average interest rate of 2.6 percent.

LONG-TERM FINANCINGS: In March 2003, Consumers entered into a \$140 million term loan secured by first mortgage bonds with a private investor bank. This loan has a term of six years at a cost of LIBOR plus 475 basis points. Proceeds from this loan were used for general corporate purposes.

In March 2003, Consumers entered into a \$150 million term loan secured by first mortgage bonds. This term loan has a three-year maturity expiring in March 2006; the loan has a cost of LIBOR plus 450 basis points. Proceeds from this loan were used for general corporate purposes.

FIRST MORTGAGE BONDS: In April 2003, Consumers sold \$625 million principal amount of first mortgage bonds in a private offering to institutional investors; \$250 million were issued at 4.25 percent, maturing on April 15, 2008, and net proceeds were approximately \$248 million, \$375 million were issued at 5.38 percent, maturing on April 15, 2013, and net proceeds were approximately \$371 million. Consumers used the net proceeds to replace a \$250 million senior reset put bond that matured in May 2003, to pay an associated \$32 million option call payment, and for general corporate purposes that may include paying down additional debt. Consumers has agreed to file a registration statement with the SEC to permit holders of these first mortgage bonds to exchange the bonds for new bonds that will be registered under the Securities Act of 1933. Consumers has agreed to file this registration statement by December 31, 2003.

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Consumers secures its first mortgage bonds by a mortgage and lien on

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substantially all of its property. Consumers' ability to issue and sell securities is restricted by certain provisions in its first mortgage bond Indenture, its articles of incorporation and the need for regulatory approvals to meet appropriate federal law.

**MANDATORILY REDEEMABLE PREFERRED SECURITIES:** Consumers has wholly owned statutory business trusts that are consolidated within its financial statements. Consumers created these trusts for the sole purpose of issuing Trust Preferred Securities. The primary asset of the trusts is a note or debenture of Consumers. The terms of the Trust Preferred Security parallel the terms of the related Consumers' note or debenture. The term, rights and obligations of the Trust Preferred Security and related note or debenture are also defined in the related indenture through which the note or debenture was issued, Consumers' guarantee of the related Trust Preferred Security and the declaration of trust for the particular trust. All of these documents together with their related note or debenture and Trust Preferred Security constitute a full and unconditional guarantee by Consumers of the trust's obligations under the Trust Preferred Security. In addition to the similar provisions previously discussed, specific terms of the securities follow.

Trust and Securities	Rate	Amount Outstanding			Maturity
March 31		2003	2002	2001	
Consumers Power Company Financing I, Trust Originated Preferred Securities	8.36%	\$ 70	\$ 70	\$100	201
Consumers Energy Company Financing II, Trust Originated Preferred Securities	8.20%	120	120	120	202
Consumers Energy Company Financing III, Trust Originated Preferred Securities	9.25%	175	175	175	202
Consumers Energy Company Financing IV, Trust Preferred Securities	9.00%	125	125	-	203
<b>Total</b>		<b>\$490</b>	<b>\$490</b>	<b>\$395</b>	

**OTHER:** At March 31, 2003, Consumers had, through its wholly owned subsidiary Consumers Receivables Funding, a \$325 million trade receivable sale program in place as an anticipated source of funds for general corporate purposes. At March 31, 2003 and 2002, the receivables sold under the program were \$325 million for each year; the average annual discount rate was 1.57 percent and 2.15 percent, respectively. Accounts receivable and accrued revenue in the Consolidated Balance Sheets have been reduced to reflect receivables sold. On April 30, 2003, Consumers ended its trade receivable sale program with its then existing purchaser and anticipates that a new trade receivable program will be in place with a new purchaser in May 2003.

Under the program discussed above, Consumers sold accounts receivable but retained servicing responsibility. Consumers is responsible for the collectability of the accounts receivable sold, however, the purchaser of sale of accounts receivable have no recourse to Consumers' other assets for failure of debtors to pay when due and there are no restrictions on accounts receivables not sold. No gain or loss has been recorded on the sale of accounts receivable and Consumers retains no interest in the receivables sold.

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DIVIDEND RESTRICTIONS: Under the provisions of its articles of incorporation, Consumers had \$423 million of unrestricted retained earnings available to pay common dividends at March 31, 2003. However, pursuant to restrictive covenants in its debt facilities, Consumers is limited to common stock dividend payments that will not exceed \$300 million in any calendar year. In January 2003, Consumers declared and paid a \$78 million common dividend. In March 2003, Consumers declared a \$31 million common dividend payable in May 2003.

FASB INTERPRETATION NO. 45, GUARANTOR'S ACCOUNTING AND DISCLOSURE REQUIREMENT FOR GUARANTEES, INCLUDING INDIRECT GUARANTEES OF INDEBTEDNESS OF OTHERS: Effective January 2003, this interpretation elaborates on the disclosure to be made by a guarantor about its obligations under certain guarantees that it has issued. It also requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provision of this interpretation does not apply to certain guarantee contracts, such as warranties, derivatives, or guarantees between either parent and subsidiaries or corporations under common control, although

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disclosure of such guarantees is required. For contracts that are within the initial recognition and measurement provision of this interpretation, the provisions are to be applied to guarantees issued or modified after December 31, 2002; no cumulative effect adjustments are required.

Following is a general description of Consumers' guarantees as required by this Interpretation:

March 31, 2003

Guarantee Description	Issue Date	Expiration Date	Maximum Obligation	Carrying Amount
Standby letters of credit	Various	Various	\$ 7	\$ -
Surety bonds	Various	Various	8	-
Nuclear insurance retrospective premiums	Various	Various	120	-

- (a) Recourse provision indicates the approximate recovery from third parties including assets held as collateral.

Following is additional information regarding Consumers' guarantees:

March 31, 2003

Guarantee Description	How Guarantee Arose
Standby letters of credit	Normal operations of

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Surety bonds	coal power plants	environ
	Self insurance requirement	
Nuclear insurance retrospective premiums	Normal operating activity,	
	permits and license	
	Normal operations of	
	nuclear plants	

4: FINANCIAL AND DERIVATIVE INSTRUMENTS

FINANCIAL INSTRUMENTS: The carrying amounts of cash, short-term investments and current liabilities approximate their fair values due to their short-term nature. Consumers estimates the fair values of long-term investments based on quoted market prices or, in the absence of specific market prices, on quoted market prices of similar investments or other valuation techniques. The carrying amounts of all long-term investments, except as shown below, approximate fair value.

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March 31		2003		2002	
Available-for-sale securities	Cost	Fair Value	Unrealized Gain	Cost	Fair Value
Common stock of CMS Energy (a)	\$ 10	\$ 10	\$ -	\$ 35	\$ 54
SERP	18	18	-	21	22
Nuclear decommissioning investments (b)	458	529	71	465	576

(a) Consumers recognized a \$12 million loss on this investment in 2002 and an additional \$12 million loss in the first quarter of 2003 because the loss was other than temporary, as the fair value was below the cost basis for a period greater than six months. As of March 31, 2003, Consumers held 2.4 million shares of CMS Energy Common Stock with a fair value of \$10 million.

(b) On January 1, 2003, Consumers adopted SFAS No. 143 and began classifying its unrealized gains and losses on nuclear decommissioning investments as regulatory liabilities. Consumers previously classified these investments in accumulated depreciation.

At March 31, 2003, the carrying amount of long-term debt was \$2.7 billion and at March 31, 2002, \$2.4 billion, and the fair values were \$2.7 billion and \$2.4 billion, respectively. For held-to-maturity securities and related-party financial instruments, see Note 1.

RISK MANAGEMENT ACTIVITIES AND DERIVATIVE TRANSACTIONS: Consumers is exposed to market risks including, but not limited to, changes in interest rates, commodity prices, and equity security prices. Consumers' market risk, and activities

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designed to minimize this risk, are subject to the direction of an executive oversight committee consisting of designated members of senior management and a risk committee, consisting of certain business unit managers. The role of the risk committee is to review the corporate commodity position and ensure that net corporate exposures are within the economic risk tolerance levels established by Consumers' Board of Directors. Established policies and procedures are used to manage the risks associated with market fluctuations.

Consumers uses various contracts, including swaps, options, and forward contracts to manage its risks associated with the variability in expected future cash flows attributable to fluctuations in interest rates and commodity prices. When management uses these instruments, it intends that an opposite movement in the value of the at-risk item would offset any losses incurred on the contracts. Consumers enters into all risk management contracts for purposes other than trading.

These instruments contain credit risk if the counterparties, including financial institutions and energy marketers, fail to perform under the agreements. Consumers minimizes such risk by performing financial credit reviews using, among other things, publicly available credit ratings of such counterparties.

Contracts used to manage interest rate and commodity price risk may be considered derivative instruments that are subject to derivative and hedge accounting pursuant to SFAS No. 133. SFAS No. 133 requires Consumers to recognize at fair value all contracts that meet the definition of a derivative instrument on the balance sheet as either assets or liabilities. The standard also requires Consumers to record all changes in fair value directly in earnings, or other comprehensive income if the derivative meets certain qualifying cash flow hedge criteria. In order for derivative instruments to qualify for hedge accounting under SFAS No. 133, the hedging relationship must be formally documented at inception and be highly effective in achieving offsetting cash flows or offsetting changes in fair value attributable to the risk being hedged. If hedging a forecasted transaction, the forecasted transaction must be probable. If a derivative instrument, used as a cash flow hedge, is terminated early because it is probable that a forecasted transaction will not occur, any gain or loss

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Consumers Energy Company

as of such date is immediately recognized in earnings. If a derivative instrument, used as a cash flow hedge, is terminated early for other economic reasons, any gain or loss as of the termination date is deferred and recorded when the forecasted transaction affects earnings.

Consumers determines fair value based upon quoted market prices and mathematical models using current and historical pricing data. Option models require various inputs, including forward prices, volatilities, interest rates and exercise periods. Changes in forward prices or volatilities could significantly change the calculated fair value of the call option contracts. At March 31, 2003, Consumers assumed a market-based interest rate of 4.5 percent and a volatility rate of 107.5 percent in calculating the fair value of its electric call options. The ineffective portion, if any, of all hedges is recognized in earnings.

The majority of Consumers' contracts are not subject to derivative accounting because they qualify for the normal purchases and sales exception of SFAS No. 133. Derivative accounting is required, however, for certain contracts used to limit Consumers' exposure to electricity and gas commodity price risk and

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interest rate risk.

The following table reflects the fair value of contracts requiring derivative accounting:

March 31		2003	
Derivative Instruments	Cost	Fair Value	Cost
Electric contracts	\$8	\$ 1	\$21
Gas contracts	-	-	-
Interest rate risk contracts	-	(1)	-
Derivative contracts associated with Consumers' equity investment in the MCV Partnership	-	17	-

The fair value of all derivative contracts, except the fair value of derivative contracts associated with Consumers' equity investment in the MCV Partnership, is included in either Other Assets or Other Liabilities on the Balance Sheet. The fair value of derivative contracts associated with Consumers' equity investment in the MCV Partnership is included in Investments - Midland Cogeneration Venture Limited Partnership on the Balance Sheet.

ELECTRIC CONTRACTS: Consumers' electric business uses purchased electric call option contracts to meet, in part, its regulatory obligation to serve. This obligation requires Consumers to provide a physical supply of electricity to customers, to manage electric costs and to ensure a reliable source of capacity during peak demand periods. As of March 31, 2003, Consumers recorded on the balance sheet all of its unexpired purchased electric call option contracts subject to derivative accounting at a fair value of \$1 million. These contracts will expire in the third quarter of 2003.

Consumers believes that certain of its electric capacity and energy contracts are not derivatives due to the lack of an active energy market in the state of Michigan, as defined by SFAS No. 133, and the transportation cost to deliver the power under the contracts to the closest active energy market at the Cinergy hub in Ohio. If a market develops in the future, Consumers may be required to account for these contracts as derivatives. The mark-to-market impact in earnings related to these contracts, particularly related to the PPA could be material to the financial statements.

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During 2002, Consumers' electric business also used gas swap contracts to protect against price risk due to the fluctuations in the market price of gas used as fuel for generation of electricity. These gas swaps were financial contracts that were used to offset increases in the price of probable forecasted gas purchases. These contracts did not qualify for hedge accounting. Therefore, Consumers recorded any change in the fair value of these contracts directly in earnings as part of power supply costs. As of March 31, 2002, these contracts

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had a fair value of \$1 million. These contracts expired in December 2002.

As of March 31, 2003, Consumers recorded a total of \$11 million, net of tax, as an unrealized gain in other comprehensive income related to its proportionate share of the effects of derivative accounting related to its equity investment in the MCV Partnership. Consumers expects to reclassify this gain, if this value remains, as an increase to other operating revenue during the next 12 months.

**GAS CONTRACTS:** Consumers' gas business uses fixed price gas supply contracts, and fixed price weather-based gas supply call options and fixed price gas supply put options, and other types of contracts, to meet its regulatory obligation to provide gas to its customers at a reasonable and prudent cost. During 2002, some of the fixed price gas supply contracts and the weather-based gas call options and gas put options required derivative accounting. The fixed price gas supply contracts expired in October 2002, and the weather-based gas call options and gas put options expired in February 2003. As of March 31, 2003, Consumers did not have any gas supply related contracts that required derivative accounting.

**INTEREST RATE RISK CONTRACTS:** Consumers uses interest rate swaps to hedge the risk associated with forecasted interest payments on variable-rate debt. These interest rate swaps are designated as cash flow hedges. As such, Consumers will record any change in the fair value of these contracts in other comprehensive income unless the swaps are sold. As of March 31, 2003 and March 31, 2002, Consumers had entered into a swap to fix the interest rate on \$75 million of variable-rate debt. This swap will expire in June 2003. As of March 31, 2003, this interest rate swap had a negative fair value of \$1 million. This amount, if sustained, will be reclassified to earnings, increasing interest expense when the swap is settled on a monthly basis. As of March 31, 2002, this interest rate swap had a negative fair value of \$2 million.

Consumers also uses interest rate swaps to hedge the risk associated with the fair value of its debt. These interest rate swaps are designated as fair value hedges. In March 2002, Consumers entered into a fair value hedge to hedge the risk associated with the fair value of \$300 million of fixed-rate debt, issued in March 2002. As of March 31, 2002, the swap had a negative fair value of less than \$1 million. In June 2002, this swap was terminated and resulted in a \$7 million gain that is deferred and recorded as part of the debt. It is anticipated that this gain will be recognized over the remaining life of the debt.

Consumers was able to apply the shortcut method to all interest rate hedges, therefore there was no ineffectiveness associated with these hedges.

### 5: IMPLEMENTATION OF NEW ACCOUNTING STANDARDS

**SFAS NO. 143, ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS:** Beginning January 1, 2003, companies must comply with SFAS No. 143. The standard requires companies to record the fair value of the legal obligations related to an asset retirement in the period in which it is incurred. Consumers has determined that it has legal asset retirement obligations, particularly in regard to its nuclear plants.

Prior to adoption of SFAS No. 143, Consumers classified the removal cost liability of assets included in the scope of SFAS No. 143 as part of the reserve for accumulated depreciation. For these assets, the removal cost of \$448 million which was classified as part of the reserve at December 31, 2002, was reclassified in January 2003, in part, as 1) a \$364 million ARO liability, 2) a \$136 million regulatory liability, 3) a \$45 million regulatory asset, and 4) a \$7 million net increase to property, plant, and equipment, as prescribed by SFAS



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No. 143. As required by SFAS No. 71 for regulated entities, Consumers is reflecting a regulatory asset and liability instead of a cumulative effect of a change in accounting principle.

The fair value of ARO liabilities has been calculated using an expected present value technique. This technique reflects assumptions, such as costs, inflation, and profit margin that third parties would consider in order to take on the settlement of the obligation. Fair value, to the extent possible, should include a market risk premium for unforeseeable circumstances. No market risk premium was included in Consumers' ARO fair value estimate since a reasonable estimate could not be made. If a five percent market risk premium was assumed, Consumers' ARO liability would be \$381 million.

If a reasonable estimate of fair value cannot be made in the period the asset retirement obligation is incurred, such as assets with an indeterminate life, the liability is to be recognized when a reasonable estimate of fair value can be made. Generally, transmission and distribution assets have an indeterminate life, retirement cash flows cannot be determined and there is a low probability of a retirement date, therefore no liability has been recorded for these assets. No liability has been recorded for assets that have an immaterial cumulative disposal cost, such as substation batteries. The initial measurement of the ARO liability for Consumers' Palisades Nuclear Plant and Big Rock Nuclear Plant is based on decommissioning studies, which are based largely on third party cost estimates.

The following table is a general description of the AROs and their associated long-lived assets.

March 31, 2003

ARO Description	In Service Date	Long Lived Assets
Palisades - decommission plant site	1972	Palisades nuclear plant
Big Rock - decommission plant site	1962	Big Rock nuclear plant
JHCampbell intake/discharge water line	1980	Plant intake/discharge water li
Closure of coal ash disposal areas	Various	Generating plants coal ash area
Closure of wells at gas storage fields	Various	Gas storage fields
Indoor gas services equipment relocations	Various	Gas meters located inside struc

The following table is a reconciliation of the carrying amount of the AROs.

March 31, 2003

ARO	Pro Forma ARO liability 1/1/02	ARO Liability		Accretion	Cash Rev
		1/1/03	Incurred	Settled	
Palisades - decommission	\$232	\$249	\$ -	\$ -	\$4
Big Rock - decommission	94	61	-	(7)	3

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JHCampbell intake line	-	-	-	-	-
Coal ash disposal areas	46	51	-	-	1
Wells at gas storage fields	2	2	-	-	-
Indoor gas services relocations	1	1	-	-	-
-----					
Total	\$375	\$364	\$ -	\$ (7)	\$8
=====					

SFAS NO. 146, ACCOUNTING FOR COSTS ASSOCIATED WITH EXIT OR DISPOSAL ACTIVITIES: Issued by the FASB in July 2002, this standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. This standard is effective for exit or disposal activities initiated after December 31, 2002. Upon adoption of the standard, there was no impact on Consumers' consolidated financial statements.

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FASB INTERPRETATION NO. 46, CONSOLIDATION OF VARIABLE INTEREST ENTITIES: Issued by the FASB in January 2003, the interpretation expands upon and strengthens existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. The consolidation requirements of the interpretation apply immediately to variable interest entities created after January 31, 2003. For Consumers, the consolidation requirements apply to pre-existing entities beginning July 1, 2003. Certain of the disclosure requirements apply to all financial statements initially issued after January 31, 2003. Consumers will be required to consolidate any entities that meet the requirements of the interpretation. Upon adoption of the standard on January 31, 2003, there was no impact on Consumers' consolidated financial statements, and Consumers does not anticipate any additional impact to its consolidated financial statements upon adoption of additional standard requirements on July 1, 2003.

6. RESTATEMENT

In March 2003, Consumers' Board of Directors declared a \$31 million common dividend to CMS Energy, payable in May 2003. Consumers' Consolidated Balance Sheets and Consolidated Statements of Common Stockholder's Equity filed in Form 10-Q for the quarterly period ended March 31, 2003 did not reflect this dividend declaration. Therefore, Consumers has restated its March 31, 2003 Consolidated Balance Sheets and Consolidated Statements of Common Stockholder's Equity to reflect this dividend declaration.

The financial statement items affected by the reflection of this dividend declaration are shown below:

CONSOLIDATED BALANCE SHEETS

In Millions	March 31, 2003 (Unaudited)		December 31, 2002		As Reported
	As Reported	As Restated	As Reported	As Restated	
-----					

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STOCKHOLDER'S INVESTMENT AND LIABILITIES CAPITALIZATION					
Common stockholder's equity					
Retained earnings since December 31, 1992	\$ 566	\$ 535	\$ 545	\$ 545	\$
Total common stockholder's equity	1,914	1,883	1,889	1,889	2
Total Capitalization	5,293	5,262	4,981	4,981	5
CURRENT LIABILITIES					
Other	167	198	200	200	
Total Current Liabilities	1,265	1,296	1,585	1,585	1

CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY (UNAUDITED)

March 31	Three Months Ended 2003		Three Months En	
	As Reported	As Restated	As Reported	As
RETAINED EARNINGS				
Cash dividends declared-Common Stock	\$ (78)	\$ (109)	\$ (55)	\$
At end of period	566	535	467	
Total Common Stockholder's Equity	\$1,914	\$1,883	\$2,099	\$2

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QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

CONSUMERS

Quantitative and Qualitative Disclosures about Market Risk is contained in PART I: CONSUMERS' ENERGY COMPANY'S MANAGEMENT'S DISCUSSION AND ANALYSIS, which is incorporated by reference herein.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The discussion below is limited to an update of developments that have occurred in various judicial and administrative proceedings, many of which are more fully described in Consumers' Form 10-K for the year ended December 31, 2002. Reference is also made to the Condensed Notes to the Consolidated Financial Statements, in particular Note 2, Uncertainties for Consumers, included herein for additional information regarding various pending administrative and judicial proceedings involving rate, operating, regulatory and environmental matters.

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### EMPLOYMENT RETIREMENT INCOME SECURITY ACT ("ERISA") CLASS ACTION LAWSUITS

CMS Energy is a named defendant, along with Consumers, CMS MS&T and certain named and unnamed officers and directors, in two lawsuits brought as purported class actions on behalf of participants and beneficiaries of the CMS Employee's Savings and Incentive Plan (the "Plan"). The two cases, filed in July 2002 in the U.S. District Court, were consolidated by the trial judge, and an amended consolidated complaint was filed. Plaintiffs allege breaches of fiduciary duties under ERISA and seek restitution on behalf of the Plan with respect to a decline in value of the shares of Common Stock held in the Plan. Plaintiffs also seek other equitable relief and legal fees. These cases will be vigorously defended. CMS Energy and Consumers cannot predict the outcome of this litigation.

### SECURITIES CLASS ACTION LAWSUITS

Beginning on May 17, 2002, a number of securities class action complaints were filed against CMS Energy, Consumers, and certain officers and directors of CMS Energy and its affiliates. The complaints were filed as purported class actions in the United States District Court for the Eastern District of Michigan. The cases were consolidated into a single lawsuit and an amended and consolidated class action complaint was filed on May 1, 2003. The defendants named in the amended and consolidated class action complaint consist of CMS Energy, Consumers, certain officers and directors of CMS Energy and its affiliates, and certain underwriters of CMS Energy securities. The purported class period is from May 1, 2000 through and including March 31, 2003. The amended and consolidated class action complaint seeks unspecified damages based on allegations that the defendants violated United States securities laws and regulations by making allegedly false and misleading statements about CMS Energy's business and financial condition. The companies intend to vigorously defend against this action but cannot predict the outcome of this litigation.

ENVIRONMENTAL MATTERS: Consumers, and its subsidiaries and affiliates are subject to various federal, state and local laws and regulations relating to the environment. Several of these companies have been named parties to various actions involving environmental issues. Based on its present knowledge and subject to future legal and factual developments, Consumers believes that it is unlikely that these actions, individually or in total, will have a material adverse effect on its financial condition. See Consumers' MANAGEMENT'S DISCUSSION AND ANALYSIS; and Consumers' CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

### ITEM 5. OTHER INFORMATION

A shareholder who wishes to submit a proposal for consideration at the CMS Energy 2004 Annual Meeting pursuant to the applicable rules of the SEC must send the proposal to reach CMS' Corporate Secretary on or before December 24, 2003. In any event if CMS has not

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received written notice of any matter to be proposed at that meeting by March 8, 2004, the holders of the proxies may use their discretionary voting authority on any such matter. The proposals should be addressed to: Mr. Michael D. VanHemert, Corporate Secretary, One Energy Plaza, Jackson, Michigan 49201.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (A) LIST OF EXHIBITS

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- (3) \* By-Laws of Consumers Energy Company
- (4) (a) \* 87th Supplemental Indenture, dated as of March 26, 2003, between Consumers Energy Company and JPMorgan Chase Bank as Trustee
- (4) (b) \* 88th Supplemental Indenture, dated as of March 27, 2003, between Consumers Energy Company and JPMorgan Chase Bank as Trustee
- (4) (c) \* 89th Supplemental Indenture, dated as of March 28, 2003, between Consumers Energy Company and JPMorgan Chase Bank as Trustee
- (4) (d) \* 90th Supplemental Indenture, dated as of April 30, 2003, between Consumers Energy Company and JPMorgan Chase Bank as Trustee
- (4) (e) \* \$140 million Term Loan Agreement dated March 26, 2003 between Consumers Energy Company and the Bank/Agent, as defined therein
- (4) (f) \* \$250 million Revolving Credit Facility dated March 27, 2003 among Consumers Energy Company, the Banks, the Agent, and the Co-Documentation Agents, all as defined therein
- (4) (g) \* \$150 million Term Loan Agreement dated March 28, 2003 among Consumers Energy Company, the Banks, and the Agent, all as defined therein
- (99) (a) Consumers Energy Company's certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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\* Filed as an Exhibit to Consumers Energy Company's Form 10-Q filed on May 14, 2003.

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(B) REPORTS ON FORM 8-K

During 1st Quarter 2003, Consumers filed reports of Form 8-K on January 24, 2003, February 21, 2003, March 5, 2003 and March 13, 2003 covering matters pursuant to ITEM 5. OTHER EVENTS.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, Consumers Energy Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

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CONSUMERS ENERGY COMPANY

Dated: May 15, 2003

By: /s/ Thomas J. Webb

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Thomas J. Webb  
Executive Vice President and  
Chief Financial Officer

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CERTIFICATION OF KENNETH WHIPPLE

I, Kenneth Whipple, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Consumers Energy Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operation and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) All significant deficiencies in the design or operation of

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internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

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6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: May 15, 2003

By: /s/ Kenneth Whipple

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Kenneth Whipple  
Chairman of the Board and  
Chief Executive Officer

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CERTIFICATION OF THOMAS J. WEBB

I, Thomas J. Webb, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Consumers Energy Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operation and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly

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report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

- 5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

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- 6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: May 15, 2003

By: /s/ Thomas J. Webb

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Thomas J. Webb  
Executive Vice President and  
Chief Financial Officer

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EXHIBITS

EXHIBIT NUMBER  
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DESCRIPTION  
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(3) \* By-Laws of Consumers Energy Company

(4) (a) \* 87th Supplemental Indenture, dated as of March 26, 2003



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- between Consumers Energy Company and JPMorgan Chase Bank as Trustee
- (4) (b) \* 88th Supplemental Indenture, dated as of March 27, 2003 between Consumers Energy Company and JPMorgan Chase Bank as Trustee
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