# Selected Unaudited Proportionate Data

| Years Ended December 31 | 1998 | 1997 | In Millions 1996 |
|---|---|---|---|
| Operating revenue | **$6,358** | $5,672 | $4,809 |
| Operating expenses | **5,238** | 4,746 | 4,005 |
| Pretax operating income | **1,120** | 926 | 804 |
| Fixed charges [(a)] | **638** | 538 | 427 |
| Other income (expenses), net | **(24)** | (7) | 1 |
| Income before income taxes | **458** | 381 | 378 |
| Income taxes | **173** | 137 | 154 |
| Net income | **$ 285** | $ 244 | $ 224 |
| Operating cash flow [(b)] | **$1,724** | $1,505 | $1,319 |

*(a) Fixed charges include interest on long-term debt,preferred dividends, and Trust Preferred Securities' distributions less capitalized interest.*
*(b) Pretax operating income plus depreciation and amortization.*

Because significant 50 percent or less owned investments of CMS Energy are not consolidated, CMS Energy believes that the discussion below of certain proportionate data enhances an understanding and assessment of its results of operations. The table above sets forth the major components of CMS Energy's net income for each of the last three years on a proportionate accounting basis. Proportionate accounting reflects CMS Energy's pro rata ownership interest in its energy projects and investments. Except for certain industries, proportionate accounting is not in accordance with generally accepted accounting principles.

Of the $686 million increase in 1998 operating revenue, $169 million (25 percent) is attributable to operating revenue from 1998 investments by the international energy distribution segment, and an increase of $161 million (23 percent) in revenue associated with investments made in 1997 (CMS Generation's Loy Yang and Jorf Lasfar projects, and CMS MST's Texon acquisition). The $492 million increase in operating expenses includes $123 million (25 percent) related to 1998 international energy investments and $100 million (20 percent) associated with increases in cost related to the 1997 investments previously described. The $100 million increase in fixed charges includes $33 million (33 percent) of interest charges associated with new international energy investments and an increase of $45 million (45 percent) in interest charges relating to Loy Yang and Jorf Lasfar.

Of the $863 million increase in 1997 operating revenue, $350 million (40 percent) is attributable to operating revenue from investments in 1997 (Loy Yang, Jorf Lasfar and Texon). The $741 million increase in operating expenses includes a $271 million (36 percent) increase in expenses for these same three 1997 investments. The $111 million increase in fixed charges includes $60 million (54 percent) of interest charges associated with Loy Yang and Jorf Lasfar.

For further information, refer to the Management's Discussion and Analysis.

# Management's Discussion and Analysis

CMS Energy Corporation (CMS Energy) is the parent holding company of Consumers Energy Company (Consumers) and CMS Enterprises Company (Enterprises). Consumers is a combination electric and gas utility company serving the Lower Peninsula of Michigan and is the principal subsidiary of CMS Energy. Enterprises is engaged in several domestic and international energy-related businesses including: acquisition, development and operation of independent power production facilities; oil and gas exploration and production; transmission, storage and processing of natural gas; energy marketing, services and trading; and international energy distribution.

This Annual Report contains forward-looking statements, as defined by the Private Securities Litigation Reform Act of 1995. Where any such forward-looking statements include a statement of the assumptions underlying forward-looking statements, CMS Energy cautions that, while such assumptions are believed to be reasonable and are made in good faith, assumed results almost always vary from actual results and differences between assumed and actual results can be material. The type of assumptions that could materially affect the actual results are discussed in the Forward-Looking Statements section in this Management's Discussion and Analysis. More specific risk factors are contained in various public filings made by CMS Energy with the Securities and Exchange Commission (SEC). This Annual Report also describes material contingencies in the Notes to Consolidated Financial Statements and the readers are encouraged to read such Notes.

## Results of Operations

### CMS ENERGY CONSOLIDATED EARNINGS

*In Millions, Except Per Share Amounts*

| Years Ended December 31 | **1998**[(a)] | 1997 | Change |
|---|---|---|---|
| Consolidated Net Income | **$ 285** | $ 244 | $ 41 |
| Net Income Attributable to Common Stocks: | | | |
| CMS Energy | **272** | 229 | 43 |
| Class G | **13** | 15 | (2) |
| Earnings Per Average Common Share: | | | |
| CMS Energy | | | |
| Basic | **2.65** | 2.39 | .26 |
| Diluted | **2.62** | 2.37 | .25 |
| Class G | | | |
| Basic and Diluted | **1.56** | 1.84 | (.28) |

*(a) Includes the cumulative effect of an accounting change for property taxes which increased net income by $43 million or $.40 per share—basic and diluted—for one of two classes of common stock of CMS Energy, par value $.01 per share (CMS Energy Common Stock) and $12 million or $.36 per share—basic and diluted—for one of two classes of common stock of CMS Energy, no par value (Class G Common Stock).*

The increase in consolidated net income for 1998 over 1997 resulted from increased earnings from the electric utility; independent power production; natural gas transmission, storage and processing; and marketing, services and trading businesses. Partially offsetting these increases were lower earnings from the gas utility, exploration and production and international energy distribution businesses, the recognition of a $37 million loss ($24 million after-tax) for the underrecovery of power costs under the power purchase agreement between Consumers and the Midland Cogeneration Venture Limited Partnership (MCV Partnership), and higher interest expense.

The increase in consolidated net income for 1997 over 1996 resulted from increased income from the electric utility; independent power production; and natural gas transmission, storage and processing businesses. Partially offsetting these increases were lower incomes from the gas utility and exploration and production businesses, coupled with higher interest expense.

For further information, see the individual results of operations for each CMS Energy business segment in this Management's Discussion and Analysis.

### CONSUMERS' ELECTRIC UTILITY RESULTS OF OPERATIONS

*Electric Pretax Operating Income:*

*In Millions*

| Change Compared to Prior Year | **1998 vs 1997** | 1997 vs 1996 |
|---|---|---|
| Deliveries (including special contract discounts) | **$40** | $ 5 |
| Lower power supply cost per kWh | **20** | — |
| Rate increases and other non-commodity revenue | **(4)** | 11 |
| Operation and maintenance | **(3)** | 24 |
| General taxes, depreciation and other | **(10)** | (19) |
| Total increase (decrease) in pretax operating income | **$43** | $21 |

*Electric Deliveries:* Total electric deliveries in 1998 were 40 billion kilowatt-hours (kWh), an increase of 6 percent over 1997. The increase is primarily attributable to an increase in sales between utility systems and a 3 percent increase in deliveries to ultimate customers. Total electric deliveries in 1997 were 38 billion kWh, an increase of 2 percent over 1996 deliveries. The increase in 1997 was the result of continued economic growth in Michigan and a 1 percent increase in deliveries to ultimate customers, primarily within the industrial class.

*Power Supply Costs:* Cost increases in both 1998 and 1997 over the prior periods reflect increased power purchases from outside sources to meet increased sales demand. In addition, the 1998 cost increase reflects higher internal kWh generation to meet the increased demand for electricity. The following table quantifies the changes in electric power costs:

| Years Ended December 31 | 1998 | 1997 | Change | 1997 | 1996 | Change |
|---|---|---|---|---|---|---|
| | | | | | | *In Millions* |
| | **$1,175** | $1,139 | $36 | $1,139 | $1,087 | $52 |

Consumers purchased $5 million of energy options to ensure a reliable source of capacity during the summer months of 1998. As a result of weather conditions and fluctuations in the price of electricity, some options were sold totaling $11 million during June, July, and August 1998. All of the remaining options have expired. The costs relating to the expired options and income received from the sale of options were reflected as purchased power costs.

*Uncertainties:* CMS Energy's financial position may be affected by a number of trends or uncertainties that have, or CMS Energy reasonably expects could have, a material impact on net sales, revenues, or income from continuing electric operations. Such uncertainties are: (i) environmental liabilities arising from compliance with various federal, state and local environmental laws and regulations, including potential liability or expenses relating to the Michigan Natural Resources and Environmental Protection Act and Comprehensive Environmental Response, Compensation and Liability Act; (ii) capital expenditures for compliance with the federal Clean Air Act, as amended (Clean Air Act); (iii) suits by two independent power producers alleging antitrust violations and economic losses due to special electric contracts signed by Consumers; (iv) cost recovery relating to the natural gas-fueled, combined-cycle cogeneration facility (MCV Facility) and nuclear plant investments and an experimental direct-access program; (v) electric industry restructuring; (vi) implementation of a frozen power supply cost recovery and initiatives to be undertaken to reduce exposure to high energy prices; (vii) after-tax cash underrecoveries associated with power purchases from the MCV Partnership; and (viii) Big Rock Point nuclear power plant decommissioning issues and ongoing issues relating to the storage of spent fuel and the operating life of Palisades nuclear power plant (Palisades). For detailed information about these trends or uncertainties see Note 3, "Uncertainties," incorporated by reference herein.

## CONSUMERS GAS GROUP RESULTS OF OPERATIONS

*Gas Pretax Operating Income:*

| Change Compared to Prior Year | 1998 vs 1997 | 1997 vs 1996 |
|---|---|---|
| | | *In Millions* |
| Sales | **$(36)** | $(13) |
| Reduced gas cost per thousand cubic feet | **19** | — |
| Gas wholesale and retail services activities | **1** | (9) |
| Operation and maintenance | **(1)** | 24 |
| General taxes, depreciation and other | **(10)** | (7) |
| Total increase (decrease) in pretax operating income | **$(27)** | $ (5) |

*Gas Deliveries:* System deliveries in 1998, including miscellaneous transportation, totaled 360 billion cubic feet (bcf), a decrease of 60 bcf or 14 percent compared to 1997. The decreased deliveries for 1998 compared to 1997 reflect warmer temperatures in 1998. System deliveries in 1997, including miscellaneous transportation, totaled 420 bcf, a decrease of 28 bcf or 6 percent compared to 1996. The decreased deliveries for 1997 compared to 1996 reflect warmer temperatures in 1997 and the loss of an extra day for the 1996 leap year.

*Cost of Gas Sold:* The cost decrease for 1998 was the result of decreased sales and decreased gas prices. The cost decrease for 1997 also was the result of decreased sales and lower gas prices.

| Years Ended December 31 | 1998 | 1997 | Change | 1997 | 1996 | Change |
|---|---|---|---|---|---|---|
| | | | | | | *In Millions* |
| | **$564** | $694 | $(130) | $694 | $750 | $(56) |

*Uncertainties:* CMS Energy's financial position may be affected by a number of trends or uncertainties that have, or CMS Energy reasonably expects could have, a material impact on net sales or revenues or income from continuing gas operations. Such uncertainties are: (i) potential environmental costs at a number of sites, including sites formerly housing manufactured gas plant facilities; (ii) a statewide experimental gas transportation program; and (iii) implementation of a frozen gas cost recovery and initiatives undertaken to protect against gas price increases. For detailed information about these uncertainties see Note 3, "Uncertainties," incorporated by reference herein.

#### INDEPENDENT POWER PRODUCTION RESULTS OF OPERATIONS

*Pretax Operating Income:* Pretax operating income for 1998 increased $48 million (50 percent) from the comparable period in 1997. This increase primarily reflects increased operating income from international plant earnings and fees, a $26 million gain on the sale of two biomass project power purchase agreements, and a $9 million gain on the sale of two biomass plants, partially offset by higher net operating expenses and a scheduled reduction in the industry expertise service fee income earned in connection with the 2,000 megawatt (MW) brown coal-fueled Loy Yang A power plant and an associated coal mine in Victoria, Australia (Loy Yang). Pretax operating income for 1997 increased $28 million (41 percent) from 1996, primarily reflecting increased international earnings, higher electricity sales by the MCV Facility, and the industry expertise service fee income earned in connection with Loy Yang in 1997. These increases were partially offset by the absence of certain 1996 nonrecurring gains, including the gain on the sale of a power purchase agreement.

#### OIL AND GAS EXPLORATION AND PRODUCTION RESULTS OF OPERATIONS

*Pretax Operating Income:* Pretax operating income for 1998 decreased $20 million (77 percent) from the comparable period in 1997. This decrease is the result of lower oil prices and a gain in the prior period from the sale of CMS Oil and Gas Company's (CMS Oil and Gas) (formerly CMS NOMECO Oil & Gas Co.) entire interest in oil and gas properties in Yemen, partially offset by increased oil production, decreased exploration expenses, and decreased depreciation, depletion and amortization expenses. Pretax operating income for 1997 decreased $7 million (21 percent) from 1996 as a result of lower oil and gas prices, decreased gas production and higher operating expenses. The decrease is partially offset by a gain on the sale of the entire interest in oil and gas properties in Yemen and 33 percent higher oil production.

CMS Oil and Gas changed its method of accounting, effective January 1, 1998, for oil and gas operations from the full cost method to the successful efforts method. CMS Oil and Gas believes that the successful efforts method will minimize asset write-offs caused by periodic price swings, which may not be representative of overall or long-term markets, and will allow its results of operations to be more easily compared to other oil and gas companies. Nitrotec Corporation (Nitrotec), in which CMS Gas Transmission and Storage Company (CMS Gas Transmission) has an equity investment, also elected to convert, effective January 1, 1998,from the full cost method of accounting to the successful efforts method of accounting. All prior period financial statements presented have been restated to conform with successful efforts accounting. The effect, after tax, of the change in accounting method as of December 31, 1997, was a reduction to retained earnings of $175 million for CMS Oil and Gas and $15 million for CMS Gas Transmission,primarily attributable to a decrease in CMS Oil and Gas' net plant and property and deferred tax liability of $270 million and $95 million, respectively, and a $15 million decrease in CMS Gas Transmission's equity investment in Nitrotec.

#### NATURAL GAS TRANSMISSION, STORAGE AND PROCESSING RESULTS OF OPERATIONS

*Pretax Operating Income:* Pretax operating income for 1998 increased $6 million (22 percent) from the comparable period in 1997. The increase primarily reflects a gain on the sale of Petal Gas Storage Company, a gain on the sale of Australian gas reserves, and lower operating expenses, partially offset by a decrease in earnings from international operations. Pretax operating income for 1997 increased $10 million (59 percent) from 1996. The increase primarily reflects income attributable to an Australian pipeline acquired in 1997, higher income from domestic and international operations, a larger restated loss from Nitrotec in 1996 subsequent to converting to the successful efforts method of accounting, and a gain on the sale of a portion of the Crescent and Ames gas gathering systems and processing plant in Oklahoma. These increases were partially offset by the 1996 gain resulting from the dissolution of the Moss Bluff Gas Storage Systems and Grand Lacs Limited Partnerships.

#### MARKETING, SERVICES AND TRADING RESULTS OF OPERATIONS

*Pretax Operating Income:* Pretax operating income for 1998 increased $9 million from the comparable period in 1997. This increase is the result of improved margins on electricity and gas sales combined with increased electric and gas sales volumes, partially offset by additional operating costs relating to growth objectives. Pretax operating income for 1997 decreased $7 million from the 1996 period. The decrease is a result of substantially higher than expected natural gas prices that severely restricted CMS Marketing, Services and Trading Company's ability to achieve positive margins on fixed price sales, and higher than expected start-up costs. Electric marketing volumes reached 6.9 million MW for the year ended December 31, 1998 compared to 900,000 MW for the comparable period in 1997. Gas managed and marketed for end users totaled 366 bcf, 243 bcf and 108 bcf for the years ended December 31, 1998, 1997 and 1996, respectively.

#### MARKET RISK INFORMATION

CMS Energy is exposed to market risk including, but not limited to, changes in interest rates, currency exchange rates, and certain commodity and equity prices. Derivative instruments including, but not limited to, futures contracts, swaps, options and forward contracts may be used to manage these exposures. Derivatives are principally used to hedge market risks.

Management uses commodity futures contracts, options and swaps (which require a net cash payment for the difference between a fixed and variable price) and oil swaps to manage commodity price risk. They also use forward exchange contracts to hedge certain receivables, payables and long-term debt relating to foreign investments. Management also uses equity investments in which CMS Energy or its subsidiaries hold less than a 20 percent interest. These commodity, financial and equity instruments do not expose CMS Energy to material market risk.

During 1998, derivative trading activities were immaterial. Management believes that any losses incurred on derivative instruments used as a hedge would be offset by the opposite movement of the underlying hedged item.

*Interest Rate Risk:* Management uses a combination of fixed-rate and variable-rate debt to reduce interest rate exposure. Interest rate swaps and rate locks may be used to adjust exposure when deemed appropriate, based upon market conditions. These strategies attempt to provide and maintain the lowest cost of capital. The carrying amount of long-term debt was $4.7 billion at December 31, 1998 with a fair value of $4.7 billion. The fair value of CMS Energy's financial derivative instruments at December 31, 1998, with a notional amount of $579 million, was $15 million, representing the amount that CMS Energy would have paid to terminate these agreements on December 31, 1998.

*Sensitivity Analysis:* In accordance with SEC disclosure requirements, CMS Energy performed a sensitivity analysis. The analysis assesses the potential loss in fair value, cash flows and earnings based upon hypothetical increases and decreases in market interest rates. A hypothetical 10 percent adverse shift in market rates in the near term would not have a material impact on CMS Energy's consolidated financial position, results of operations or cash flows as of December 31, 1998. Management does not believe that a sensitivity analysis alone provides an accurate or reliable method for monitoring and controlling risk. Therefore, CMS Energy and its subsidiaries rely on the experience and judgment of senior management and traders to revise strategies and adjust positions as they deem necessary. Losses in excess of the amounts determined in the sensitivity analysis could occur if market rates or prices exceed the 10 percent shift used for the analysis. The analysis assumes that the maximum exposure associated with purchased options is limited to premiums paid. The analysis assumes that the CMS Energy Trust Preferred Securities are not converted into CMS Energy Common Stock. If the conversion occurred, the $173 million of CMS Energy Trust Preferred Securities would be discharged through the issuance of 4.2 million shares of CMS Energy Common Stock. The analysis also does not quantify short-term exposure to hypothetically adverse price fluctuations in inventories.

For a discussion of accounting policies related to derivative transactions, see Note 8.

## Capital Resources and Liquidity

### CASH POSITION, INVESTING AND FINANCING

CMS Energy's primary ongoing source of operating cash is dividends and distributions from subsidiaries. In 1998, Consumers paid $241 million in common dividends. In December 1998, CMS Energy contributed $100 million of paid-in capital to Consumers. During 1998, Enterprises paid common dividends and other distributions of $122 million to CMS Energy. CMS Energy's consolidated operating cash requirements are met by its operating and financing activities.

*Operating Activities:* CMS Energy's consolidated net cash provided by operating activities is derived mainly from the processing, storage, transportation and sale of natural gas; the generation, transmission and sale of electricity; and the sale of oil. Consolidated cash from operations totaled $516 million and $624 million for 1998 and 1997, respectively. The $108 million decrease resulted from cash outflows related to increases in accounts receivable from and advances to affiliates, partially offset by an increase in consolidated net income. CMS Energy uses its operating cash primarily to expand its international businesses, to maintain and expand electric and gas systems of Consumers, to pay interest on and retire portions of its long-term debt, and to pay dividends.

*Investing Activities:* CMS Energy's consolidated net cash used in investing activities totaled $1.634 billion and $1.551 billion for 1998 and 1997, respectively. The increase of $83 million primarily reflects increased capital expenditures for acquisitions, partially offset by decreased investments in partnerships and unconsolidated subsidiaries (1997 included an approximately $500 million investment in Loy Yang). CMS Energy's 1998 expenditures for its utility and international businesses were $429 million and $1.271 billion, respectively, compared to $371 million and $1.148 billion, respectively, during 1997.

*Financing Activities:* CMS Energy's net cash provided by financing activities totaled $1.150 billion and $938 million for 1998 and 1997, respectively. The increase of $212 million in net cash provided by financing activities resulted from an increase of $848 million in the issuance of new securities, partially offset by increases in the retirement of bonds and other long-term debt ($140 million) and the repayment of bank loans ($545 million). The following is a listing of new securities issued during 1998.

| | Month Issued | Maturity | Distribution/ Interest Rate | *In Millions* Principal Amount | Use of Proceeds |
|---|---|---|---|---|---|
| **CMS Energy** | | | | | |
| GTNs | | | | | |
| Series D | *(1)* | *(1)* | 6.8%*(1)* | $ 122 | General corporate purposes |
| Series E | *(1)* | *(1)* | 6.9%*(1)* | 34 | General corporate purposes |
| Extendible Tenor Rate Adjusted Securities*(2)* | January | 2005 | 7.0% | 180 | Pay down borrowings |
| Common Stock | November | N/A | 4.5 shares | 208 | General corporate purposes |
| | | | | 544 | |
| **Consumers** | | | | | |
| Senior Notes*(3)* | February | 2008 | 6.375% | 250 | Pay down First Mortgage Bonds and general corporate purposes |
| Senior Notes*(3)* | March | 2018 | 6.875% | 225 | Pay down First Mortgage Bonds and borrowings under credit facilities |
| Senior Notes*(3)* | May | 2008 | 6.2%*(4)* | 250 | Pay down First Mortgage Bonds, long-term bank debt and general corporate purposes |
| Senior Notes*(3)* | June | 2018 | 6.5%*(5)* | 200 | Pay down First Mortgage Bonds and general corporate purposes |
| Long-Term Bank Debt | May | 2001 – 2003 | 6.05%*(6)* | 225 | Pay down long-term bank debt |
| Senior Notes*(3)* | October | 2028 | 6.5% | 150 | Pay down long-term bank debt and general corporate purposes |
| **Total** | | | | $1,844 | |

*(1) CMS Energy General Term Notes® (GTNs) are issued from time to time with varying maturity dates. The rate shown herein is a weighted average interest rate.*
*(2) May be extended for an additional seven years.*
*(3) The Senior Notes are secured by Consumers' First Mortgage Bonds issued contemporaneously in a similar amount.*
*(4) The interest rate may be reset in May 2003.*
*(5) The interest rate will be reset in June 2005.*
*(6) The interest rate is variable; weighted average interest rate upon original issuance was 6.05 percent.*

In 1998, CMS Energy paid $129 million in cash dividends to holders of CMS Energy Common Stock and $11 million in cash dividends to holders of Class G Common Stock. In January 1999, the Board of Directors of CMS Energy declared a quarterly dividend of $.33 per share on CMS Energy Common Stock and $.325 per share on Class G Common Stock, payable in February 1999.

In August 1998, CMS Energy filed a shelf registration statement for the issuance of $400 million of GTNs Series E.

In December 1998, CMS Energy filed two shelf registration statements for the issuance of $1.5 billion of CMS Energy Common Stock and $400 million of senior and subordinated debt securities.

In January 1999, CMS Energy received net proceeds of approximately $473 million from the sale of $480 million of senior notes. In February 1999, CMS Energy received net proceeds of approximately $296 million from the sale of $300 million of senior notes. Proceeds from these offerings were used to repay debt and for general corporate purposes.

*Other Investing and Financing Matters:* At December 31, 1998, the book value per share of CMS Energy Common Stock and Class G Common Stock was $19.61 and $11.46, respectively.

In January 1998, a Delaware statutory business trust established by CMS Energy sold $180 million of certificates due January 15, 2005 in a public offering. In exchange for those proceeds, CMS Energy sold to the trust $180 million aggregate principal amount of 7 percent Extendible Tenor Rate Adjusted Securities due January 15, 2005, which may be extended for an additional seven years. Net proceeds to CMS Energy from the sale totaled $176 million.

As of December 31, 1998, CMS Energy had an aggregate $2.3 billion in securities registered for future issuance, including securities to be issued to permanently finance the acquisition, as described below, of Panhandle Eastern Pipe Line Company, Trunkline Gas Company, Pan Gas Storage Company, Panhandle Storage Company and Trunkline LNG Company (Panhandle Companies). CMS Energy also has $725 million senior credit facilities (Senior Credit Facilities), unsecured lines of credit and letters of credit as sources of funds needed to fulfill, in whole or in part, material commitments for capital expenditures. For detailed information, see "Short-Term Financings" and "Capitalization" in Notes 4 and 6, respectively, incorporated by reference herein.

CMS Energy's Senior Credit Facilities consist of a $600 million three-year revolving credit facility and a five-year $125 million term loan facility. Additionally, CMS Energy has unsecured lines of credit and letters of credit in an aggregate amount of $216 million. These credit facilities are available to finance working capital requirements and to pay for capital expenditures between long-term financings. At December 31, 1998, the total amount utilized under the Senior Credit Facilities was $725 million, including $57 million of contingent obligations, and under the unsecured lines of credit and letters of credit was $147 million.

Consumers has Federal Energy Regulatory Commission (FERC) authorization to issue securities and guarantees. Consumers has a credit facility, lines of credit and a trade receivable sale program in place as anticipated sources of funds needed to fulfill, in whole or in part, material commitments for capital expenditures as of December 31, 1998. For detailed information, see "Short-Term Financings" and "Capitalization" in Notes 4 and 6, respectively, incorporated by reference herein.

CMS Energy and its subsidiaries must redeem or retire $762 million of long-term debt over the three-year period ending December 2001. In addition, at December 31, 1998, Consumers had a recorded liability to the U.S. Department of Energy (DOE) of $117 million, which Consumers must pay upon the first delivery of spent nuclear fuel to the DOE. Current federal law originally scheduled delivery of the fuel to occur in 1998; for additional information, see "Nuclear Fuel Cost" in Note 2.

On November 2, 1998, CMS Energy announced an agreement to acquire the Panhandle Companies from Duke Energy Corporation for a cash payment of $1.9 billion and existing Panhandle Companies debt of $300 million. The transaction was completed in March 1999, and will be accounted for under the purchase method of accounting.

The acquisition of the Panhandle Companies initially was financed in part with bridge loan facilities negotiated with domestic banks and in part with approximately $800 million of debt securities issued by the Panhandle Companies. CMS Energy expects to permanently finance the acquisition with existing arrangements as well as the sale of approximately $600 million of CMS Energy Common Stock and other CMS Energy securities.

### CAPITAL EXPENDITURES

CMS Energy estimates that capital expenditures, including new lease commitments and investments in partnerships and unconsolidated subsidiaries, will total $6.8 billion over the next three years. These estimates are prepared for planning purposes and are subject to revision. This total includes approximately $2.2 billion for the acquisition of the Panhandle Companies as described above. A substantial portion of the remaining capital expenditures is expected to be satisfied by cash from operations. Nevertheless, CMS Energy will continue to evaluate capital markets in 1999 as a potential source of financing its subsidiaries' investing activities.

CMS Energy estimates capital expenditures by business segment over the next three years as follows:

| | | | *In Millions* |
|---|---|---|---|
| Years Ended December 31 | 1999 | 2000 | 2001 |
| Consumers electric operations[(a)(b)] | $ 380 | $ 385 | $ 385 |
| Consumers gas operations[(a)] | 123 | 125 | 120 |
| Independent power production | 724 | 435 | 224 |
| Oil and gas exploration and production | 135 | 165 | 165 |
| Natural gas transmission and storage | 2,412[(c)] | 225 | 143 |
| International energy distribution | 359 | 100 | 126 |
| Marketing, services and trading | 5 | 15 | 12 |
| Other | 10 | — | — |
| | $4,148 | $1,450 | $1,175 |

*(a) These amounts include an attributed portion of Consumers' anticipated capital expenditures for plant and equipment common to both the electric and gas utility businesses.*
*(b) These amounts do not include preliminary estimates for capital expenditures possibly required to comply with recently revised national air quality standards under the Clean Air Act. For further information, see Note 3.*
*(c) Includes approximately $2.2 billion for the acquisition of the Panhandle Companies.*

CMS Energy currently plans investments from 1999 to 2001: (i) for oil and gas exploration and production operations, primarily in North and South America, offshore West Africa and North Africa; (ii) for independent power production operations to pursue acquisitions and development of electric generating plants in the United States, Latin America, Asia, Australia, the Pacific Rim region, North Africa and the Middle East; (iii) to continue development of nonutility natural gas storage, gathering and pipeline operations of CMS Gas Transmission, both domestic and international; (iv) to acquire, develop and expand international energy distribution businesses; and (v) to provide gas, electric, oil and coal marketing, risk management and energy management services throughout the United States and eventually worldwide.

## Outlook

As the deregulation and privatization of the energy industry takes place in the United States and internationally, CMS Energy has positioned itself to be a leading international diversified energy company acquiring, developing and operating energy facilities and providing energy services in major world growth markets. CMS Energy provides a complete range of international energy expertise from energy production to consumption.

### INTERNATIONAL OPERATIONS OUTLOOK

CMS Energy will continue to grow internationally by investing in multiple projects in several countries as well as by developing synergistic projects across its lines of business. CMS Energy believes these integrated projects will create more opportunities and greater value than individual investments. Also, CMS Energy will achieve this growth through strategic partnering where appropriate.

CMS Energy seeks to minimize operational and financial risks when operating internationally by working with local partners, utilizing multilateral financing institutions, procuring political risk insurance and hedging foreign currency exposure where appropriate.

### CONSUMERS' ELECTRIC UTILITY OUTLOOK

*Growth:* Consumers expects average annual growth of 2.4 percent per year in electric system deliveries over the next five years, absent the impact of restructuring on the industry and its regulation in Michigan. Abnormal weather, changing economic conditions, or the developing competitive market for electricity may affect actual electric sales in future periods.

*Restructuring:* Consumers' retail electric business is affected by competition. To meet its challenges, Consumers entered into multi-year contracts with some of its largest industrial customers to serve certain facilities. The Michigan Public Service Commission (MPSC) has approved these contracts as part of its phased introduction to competition. Certain customers have the option of terminating their contracts early.

FERC final rules issued on April 24, 1996 (Orders 888 and 889), as amended, require utilities to provide direct access to the interstate transmission grid for wholesale transactions. Consumers and The Detroit Edison Company (Detroit Edison) disagree on the effect of the orders on the Michigan Electric Power Coordination Center pool. Consumers proposes to maintain the benefits of the pool through at least December 2000, while Detroit Edison contends that the pool agreement should be terminated immediately. Among Consumers' alternatives in the event of the pool being terminated would be joining an independent system operator. FERC has indicated this preference for structuring the operations of the electric transmission grid.

For material changes relating to the restructuring of the electric utility industry, see "Consumers' Electric Utility Rate Matters—Electric Restructuring" in Note 3, incorporated by reference herein.

*Electric Application of SFAS 71:* Consumers applies utility accounting standard, Statement of Financial Accounting Standards (SFAS) 71. At December 31, 1998, Consumers believed that the generation segment of its business was still subject to cost-based rate regulation due to legislative and regulatory uncertainty about the status of Consumers' continuing obligation to provide generation service to customers. Subsequent to year-end, Consumers received MPSC electric restructuring orders which among other things identified the terms and timing for implementing electric restructuring in Michigan. Consumers anticipates that it will discontinue application of SFAS 71 for the generation segment of its business in the first quarter of 1999 as Consumers is now preparing to implement electric customer direct access. According to current accounting standards, Consumers can continue to carry its generation-related regulatory assets or liabilities for the part of the business being deregulated if deregulatory legislation or an MPSC rate order allows the collection of cash flows from its regulated transmission and distribution customers to recover these specific costs or settle obligations. A February 1998 MPSC order allows Consumers to fully recover its costs incurred by utilities in order to serve their customers in a regulated monopoly environment (Transition Costs). At December 31, 1998, Consumers had $259 million of generation-related net regulatory assets recorded on its balance sheet, and a net investment in generation facilities of $1.3 billion included in electric plant and property.

### CONSUMERS GAS GROUP OUTLOOK

*Growth:* Consumers currently anticipates gas deliveries, including gas customer choice deliveries (excluding transportation to the MCV Facility and off-system deliveries), to grow at an average annual rate of between one and two percent over the next five years based primarily on a steadily growing customer base. Actual gas deliveries in future periods may be affected by abnormal weather, alternative energy prices, changes in competitive conditions, and the level of natural gas consumption. Consumers also offers a variety of energy-related services to its customers focused upon appliance maintenance, home safety, commodity choice and assistance to customers purchasing heating, ventilation and air conditioning equipment.

*Restructuring:* In December 1997, the MPSC approved Consumers' application to implement a statewide three-year experimental gas transportation program, eventually allowing 300,000 residential, commercial and industrial retail gas sales customers to choose their gas supplier. For further information regarding restructuring of the gas distribution, storage and transportation businesses currently conducted by Consumers and Michigan Gas Storage Company (Consumers Gas Group), see "Uncertainties—Consumers Gas Group Matters—Gas Restructuring" in Note 3, incorporated by reference herein.

*Other:* Effective January 1, 1999, Consumers was allowed to solicit Michigan Consolidated Gas Company (MichCon) and SEMCO Energy Gas Company customers due to a three-year experimental program ordered by the MPSC allowing customers a choice of gas suppliers. As of February 8, 1999, Consumers has signed up 650 of MichCon's customers and 300 of SEMCO Energy Gas Company's customers.

## Other Matters

### NEW ACCOUNTING RULES

In 1998, the American Institute of Certified Public Accountants issued Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,* and Statement of Position 98-5, *Reporting on the Costs of Start-Up Activities*. These statements will be effective in 1999. CMS Energy does not expect the application of these standards to materially affect its financial position, liquidity or results of operations. Also in 1998, the Financial Accounting Standards Board issued SFAS 133, *Accounting for Derivative Instruments and Hedging Activities,* which will be effective in 2000, and the Emerging Issues Task Force published Issue 98-10, *Accounting for Energy Trading and Risk Management Activities,* which will be effective in 1999. CMS Energy is currently studying these new standards and has not yet quantified the impacts of adopting SFAS 133 or Issue 98-10 on its financial statements and has not determined the timing of or method of adoption. However, SFAS 133 and Issue 98-10 will increase volatility in earnings and other comprehensive income.

### YEAR 2000 COMPUTER MODIFICATIONS

CMS Energy uses software and related technologies throughout its domestic and international businesses that the year 2000 date change could affect and, if uncorrected, could cause CMS Energy to, among other things, delay issuance of bills or reports, issue inaccurate bills, report inaccurate data, incur generating plant outages, or create energy delivery uncertainties. In 1995, CMS Energy established a Year 2000 Program to ensure the continued operation of its businesses at the turn of the century. CMS Energy's efforts included dividing the programs requiring modification between critical and noncritical programs. A formal methodology was established to identify critical business functions and risk scenarios, to correct problems identified, to develop test plans and expected results, and to test the corrections made. CMS Energy's Year 2000 Program involves an aggressive, comprehensive four-phase approach, including impact analysis, remediation, compliance review, and monitoring/contingency planning.

The impact analysis phase includes the analysis, inventory, prioritization and remediation plan development for all technology essential to core business processes. The remediation phase involves testing and implementation of remediated technology. A mainframe test environment was established in 1997 and a test environment for network servers and stand-alone personal computers was established in mid-1998. All essential corporate business systems have been, or will be, tested in these test environments. The compliance review phase includes the assembling of compliance documentation for each technology component as remediation efforts are completed, and additional verification testing of essential technology where necessary. The monitoring/contingency planning phase includes compliance monitoring to ensure that year 2000 problems are not reintroduced into remediated technology, as well as the development of contingency plans to address reasonably likely risk scenarios.

*State of Readiness:* CMS Energy is managing traditional information technology (IT), which consists of essential business systems such as payroll, billing and purchasing; and infrastructure, including mainframe, wide area network, local area networks, personal computers, radios and telephone systems. CMS Energy is also managing process control computers and embedded systems contained in buildings, equipment and energy supply and delivery systems.

Essential goods and services for CMS Energy are electric fuel supply, gas fuel supply, independent electric power supplies, facilities, electronic commerce, telecommunications network carriers, financial institutions, purchasing vendors, and software and hardware technology vendors. CMS Energy is addressing the preparedness of these businesses and their risk through readiness assessment questionnaires.

The status of CMS Energy's Year 2000 Program by phase, with target dates for completion and current percentage complete based upon software and hardware inventory counts as of December 31, 1998, is as follows:

| | Impact Analysis | | Remediation | | Compliance Review | | Monitoring/ Contingency Planning | |
|---|---|---|---|---|---|---|---|---|
| | *(a)* | *(b)* | *(a)* | *(b)* | *(a)* | *(b)* | *(a)* | *(b)* |
| Electric utility | 3/98 | 100% | 6/99 | 78% | 6/99 | 66% | 6/99 | 50% |
| Gas utility | 3/98 | 100% | 6/99 | 73% | 6/99 | 38% | 6/99 | 10% |
| Independent power production | 1/99 | 66% | 9/99 | 44% | 9/99 | 30% | 9/99 | 10% |
| Oil and gas | 1/99 | 97% | 9/99 | 80% | 9/99 | 20% | 9/99 | 20% |
| Natural gas transmission | 1/99 | 50% | 9/99 | 75% | 9/99 | 25% | 9/99 | 5% |
| Marketing, services and trading | 1/99 | 77% | 9/99 | 50% | 9/99 | 50% | 9/99 | 10% |
| Essential goods and services | 6/99 | 56% | N/A | | N/A | | (c) | |

*(a) Target date for completion.*
*(b) Current percentage complete.*
*(c) Contingency planning for essential goods and services is incorporated into contingency planning for each segment presented.*

*Cost of Remediation:* CMS Energy expenses spending for software modifications as incurred, and capitalizes and amortizes the cost for new software and equipment over its useful life. The total estimated cost of the Year 2000 Program is approximately $30 million. Costs incurred through December 31, 1998 were approximately $16 million. CMS Energy's annual Year 2000 Program costs have represented approximately 2 percent to 10 percent of CMS Energy's annual IT budget through 1998 and are expected to represent approximately 25 percent of CMS Energy's annual IT budget in 1999. Year 2000 compliance work is being funded primarily from operations. To date, the commitment of CMS Energy resources to the year 2000 issue has not deferred any material IT projects which could have a material adverse affect on CMS Energy's financial position, liquidity or results of operations.

*Risk Assessment:* CMS Energy considers the most reasonably likely worst-case scenarios to be: (i) a lack of communications to dispatch crews to electric or gas emergencies; (ii) a lack of communications to generating units to balance electrical load; (iii) power shortages due to the lack of stability of the electric grid; and (iv) a failure of fuel suppliers to deliver fuel to generating facilities. These scenarios could result in CMS Energy not being able to generate or distribute enough energy to meet customer demand for a period of time, which could result in lost sales and profits, as well as legal liability. Year 2000 remediation and testing efforts are concentrating on these risk areas and will continue through the end of 1999. Contingency plans will be revised and executed to further mitigate the risks associated with these scenarios.

*Contingency Plans:* Contingency planning efforts are currently underway for all business systems and providers of essential goods and services. Extensive contingency plans are already in place in many locations and are currently being revised for reasonably likely worst-case scenarios related to year 2000 issues. In many cases, Consumers already has arrangements with multiple vendors of similar goods and services so that in the event that one cannot meet its commitments, others may be able to. Current contingency plans provide for manual dispatching of crews and manual coordination of electrical load balancing and are being revised to provide for radio or satellite communications. Coordinated contingency planning efforts are in progress with third parties to minimize risk to electric generation, transmission and distribution systems.

*Expectations:* CMS Energy does not expect that the cost of these modifications will materially affect its financial position, liquidity or results of operations. There can be no guarantee, however, that these costs, plans or time estimates will be achieved, and actual results could differ materially.

Because of the integrated nature of CMS Energy's business with other energy companies, utilities, jointly owned facilities operated by other entities, and business conducted with suppliers and large customers, CMS Energy may be indirectly affected by year 2000 compliance complications. At this time, CMS Energy is unable to anticipate the magnitude of the operational or financial impact of year 2000 issues on CMS Energy.

### FOREIGN CURRENCY TRANSLATION

CMS Energy adjusts common stockholders' equity to reflect foreign currency translation adjustments for the operation of long-term investments in foreign countries. The adjustment is primarily due to the exchange rate fluctuations between the U.S. dollar and each of the Australian dollar and Brazilian real. From January 1, 1998 through December 31, 1998, the change in the foreign currency translation adjustment totaled $40 million, net of after-tax hedging proceeds. Although management currently believes that the currency exchange rate fluctuations over the long term will not materially adversely affect CMS Energy's financial position, liquidity or results of operations, CMS Energy has hedged its exposure to the Australian dollar and the Brazilian real. CMS Energy uses forward exchange contracts and collared options to hedge certain receivables, payables, long-term debt and equity value relating to foreign investments. The notional amount of the outstanding foreign exchange contracts was $736 million at December 31, 1998, which includes $450 million and $250 million for Australian and Brazilian foreign exchange contracts, respectively. Subsequent to December 31, 1998, the fair value of the Brazilian foreign exchange contracts increased significantly, as the Brazilian real weakened against the U.S. dollar.

## Forward-Looking Statements

This Annual Report contains forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. The words "anticipates," "believes," "estimates," "expects," "intends," and "plans," as well as variations of such words and similar expressions, are intended to identify forward-looking statements that involve risk and uncertainty. These statements are necessarily based upon various assumptions involving judgments with respect to the future including, among others, the ability to achieve operating synergies and revenue enhancements; international, national, regional and local economic, competitive and regulatory conditions and developments;capital and financial market conditions, including currency exchange controls and interest rates; weather conditions; adverse regulatory or legal decisions, including environmental laws and regulations; the pace of deregulation of the natural gas and electric industries; energy markets, including the timing and extent of changes in commodity prices for oil, coal, natural gas, natural gas liquids, electricity and certain related products; the timing and success of business development efforts; potential disruption, expropriation or interruption of facilities or operations due to accidents or political events; nuclear power and other technological developments; and other uncertainties, all of which are difficult to predict and many of which are beyond the control of CMS Energy. Accordingly, while CMS Energy believes that the assumed results are reasonable, there can be no assurance that they will approximate actual results. CMS Energy disclaims any obligation to update or revise forward-looking statements, whether as a result of new information,future events or otherwise. Certain risk factors are detailed from time to time in various public filings made by CMS Energy with the SEC.

# Consolidated Statements of Income

| Years Ended December 31 | | *In Millions, Except Per Share Amounts* 1998 | 1997 | 1996 |
|---|---|---|---|---|
| **Operating Revenue** | Electric utility | **$2,606** | $2,515 | $2,446 |
| | Gas utility | **1,051** | 1,204 | 1,282 |
| | Independent power production[(a)] | **277** | 168 | 140 |
| | Natural gas transmission, storage and processing[(a)] | **160** | 96 | 53 |
| | Oil and gas exploration and production | **63** | 93 | 130 |
| | Marketing, services and trading[(a)] | **939** | 692 | 258 |
| | Other[(a)] | **45** | 13 | 15 |
| | | **5,141** | 4,781 | 4,324 |
| **Operating Expenses** | Operation | | | |
| | Fuel for electric generation | **359** | 319 | 312 |
| | Purchased power—related parties | **573** | 599 | 589 |
| | Purchased and interchange power | **584** | 265 | 202 |
| | Cost of gas sold | **1,212** | 1,311 | 997 |
| | Other | **763** | 719 | 742 |
| | | **3,491** | 3,213 | 2,842 |
| | Maintenance | **176** | 174 | 178 |
| | Depreciation, depletion and amortization | **484** | 467 | 427 |
| | General taxes | **215** | 211 | 201 |
| | | **4,366** | 4,065 | 3,648 |
| **Pretax Operating Income (Loss)** | Electric utility | **475** | 432 | 411 |
| | Gas utility | **126** | 153 | 158 |
| | Independent power production | **144** | 96 | 68 |
| | Natural gas transmission, storage and processing | **33** | 27 | 17 |
| | Oil and gas exploration and production | **6** | 26 | 33 |
| | Marketing, services and trading | **4** | (5) | 2 |
| | Other | **(13)** | (13) | (13) |
| | | **775** | 716 | 676 |
| **Other Income (Deductions)** | Loss on MCV power purchases | **(37)** | — | — |
| | Accretion income | **6** | 8 | 10 |
| | Accretion expense | **(16)** | (17) | (22) |
| | Other, net | **1** | (3) | 1 |
| | | **(46)** | (12) | (11) |
| **Fixed Charges** | Interest on long-term debt | **318** | 273 | 230 |
| | Other interest | **47** | 49 | 43 |
| | Capitalized interest | **(29)** | (13) | (5) |
| | Preferred dividends | **19** | 25 | 28 |
| | Trust Preferred Securities distributions | **32** | 18 | 8 |
| | | **387** | 352 | 304 |
| **Income Before Income Taxes** | | **342** | 352 | 361 |
| **Income Taxes** | | **100** | 108 | 137 |
| **Consolidated Net Income before Cumulative Effect of Change in Accounting Principle** | | **242** | 244 | 224 |
| **Cumulative Effect of Change in Accounting for Property Taxes, Net of $23 Tax** | | **43** | — | — |
| **Consolidated Net Income** | | **$ 285** | $ 244 | $ 224 |
| **Net Income Attributable to Common Stocks** | CMS Energy | **$ 272** | $ 229 | $ 210 |
| | Class G | **$ 13** | $ 15 | $ 14 |
| **Basic Earnings Per Average Common Share** | CMS Energy | **$ 2.65** | $ 2.39 | $ 2.27 |
| | Class G | **$ 1.56** | $ 1.84 | $ 1.82 |
| **Diluted Earnings Per Average Common Share** | CMS Energy | **$ 2.62** | $ 2.37 | $ 2.26 |
| | Class G | **$ 1.56** | $ 1.84 | $ 1.82 |
| **Dividends Declared Per Common Share** | CMS Energy | **$ 1.26** | $ 1.14 | $ 1.02 |
| | Class G | **$ 1.27** | $ 1.21 | $ 1.15 |

*(a) Does not include revenue associated with CMS' interests in unconsolidated partnerships. For 1998, 1997 and 1996, that revenue totaled $761 million, $621 million and $493 million, respectively, for independent power production; and $67 million, $51 million and $42 million, respectively, for natural gas transmission, storage and processing; and $198 million, $39 million and $22 million, respectively, for international energy distribution, which is reported in Other. For 1998 and 1997, that revenue totaled $291 million and $202 million, respectively, for marketing, services and trading.*

*The accompanying notes are an integral part of these statements.*

# Consolidated Balance Sheets

| December 31 | | 1998 | *In Millions* 1997 |
|---|---|---|---|
| ASSETS | | | |
| **Plant and Property (at cost)** | Electric | $ 6,720 | $ 6,491 |
| | Gas | 2,701 | 2,528 |
| | Oil and gas properties (successful efforts method) | 670 | 545 |
| | Independent power production | 518 | 122 |
| | Other | 373 | 46 |
| | | 10,982 | 9,732 |
| | Less accumulated depreciation, depletion and amortization | 5,213 | 4,849 |
| | | 5,769 | 4,883 |
| | Construction work-in-progress | 271 | 261 |
| | | 6,040 | 5,144 |
| **Investments** | Independent power production | 888 | 792 |
| | Natural gas transmission, storage and processing | 494 | 241 |
| | International energy distribution | 209 | 255 |
| | First Midland Limited Partnership | 240 | 242 |
| | Midland Cogeneration Venture Limited Partnership | 209 | 171 |
| | Other | 33 | 45 |
| | | 2,073 | 1,746 |
| **Current Assets** | Cash and temporary cash investments at cost, which approximates market | 101 | 69 |
| | Accounts receivable and accrued revenue, less allowances of $13 in 1998 and $7 in 1997 | 720 | 495 |
| | Inventories at average cost | | |
| | Gas in underground storage | 219 | 197 |
| | Materials and supplies | 99 | 87 |
| | Generating plant fuel stock | 43 | 35 |
| | Deferred income taxes | — | 38 |
| | Prepayments and other | 225 | 235 |
| | | 1,407 | 1,156 |
| **Non-current Assets** | Nuclear decommissioning trust funds | 557 | 486 |
| | Postretirement benefits | 373 | 404 |
| | Abandoned Midland project | 71 | 93 |
| | Other | 789 | 479 |
| | | 1,790 | 1,462 |
| **Total Assets** | | $ 11,310 | $ 9,508 |

*The accompanying notes are an integral part of these statements.*

| December 31 | | 1998 | *In Millions* 1997 |
|---|---|---|---|
| STOCKHOLDERS' INVESTMENT AND LIABILITIES | | | |
| **Capitalization** | Common stockholders' equity | $ 2,216 | $ 1,787 |
| | Preferred stock of subsidiary | 238 | 238 |
| | Company-obligated mandatorily redeemable Trust Preferred Securities of: | | |
| | Consumers Power Company Financing I [a] | 100 | 100 |
| | Consumers Energy Company Financing II [a] | 120 | 120 |
| | Company-obligated convertible Trust Preferred Securities of CMS Energy Trust I [b] | 173 | 173 |
| | Long-term debt | 4,726 | 3,272 |
| | Non-current portion of capital leases | 105 | 75 |
| | | 7,678 | 5,765 |
| **Current Liabilities** | Current portion of long-term debt and capital leases | 293 | 643 |
| | Notes payable | 328 | 382 |
| | Accounts payable | 501 | 398 |
| | Accrued taxes | 272 | 272 |
| | Accounts payable—related parties | 79 | 80 |
| | Accrued interest | 65 | 51 |
| | Power purchases | 47 | 47 |
| | Accrued refunds | 11 | 12 |
| | Other | 214 | 190 |
| | | 1,810 | 2,075 |
| **Non-current Liabilities** | Deferred income taxes | 649 | 648 |
| | Postretirement benefits | 489 | 514 |
| | Deferred investment tax credit | 135 | 151 |
| | Power purchases | 121 | 133 |
| | Regulatory liabilities for income taxes, net | 87 | 54 |
| | Other | 341 | 168 |
| | | 1,822 | 1,668 |
| | Commitments and Contingencies (Notes 2, 3 and 13) | | |
| **Total Stockholders' Investment and Liabilities** | | $11,310 | $ 9,508 |

*(a) The primary asset of Consumers Power Company Financing I is $103 million principal amount of 8.36 percent subordinated deferrable interest notes due 2015 from Consumers. The primary asset of Consumers Energy Company Financing II is $124 million principal amount of 8.20 percent subordinated deferrable interest notes due 2027 from Consumers. For further discussion, see Note 6 to the Consolidated Financial Statements.*
*(b) As described in Note 6, the primary asset of CMS Energy Trust I is $178 million principal amount of 7.75 percent convertible subordinated debentures due 2027 from CMS Energy.*

# Consolidated Statements of Cash Flows

*In Millions*

| Years Ended December 31 | | 1998 | 1997 | 1996 |
|---|---|---|---|---|
| **Cash Flows From Operating Activities** | Consolidated net income | **$ 285** | $ 244 | $ 224 |
| | Adjustments to reconcile net income to net cash provided by operating activities | | | |
| | Depreciation, depletion and amortization (includes nuclear decommissioning of $51, $50 and $49, respectively) | **484** | 467 | 427 |
| | Deferred income taxes and investment tax credit | **54** | 24 | 45 |
| | Capital lease and debt discount amortization | **51** | 44 | 41 |
| | Loss on MCV power purchases | **37** | — | — |
| | Accretion expense | **16** | 17 | 22 |
| | Accretion income—abandoned Midland project | **(6)** | (8) | (10) |
| | Undistributed earnings of related parties | **(95)** | (58) | (55) |
| | Cumulative effect of accounting change for property taxes | **(66)** | — | — |
| | MCV power purchases | **(64)** | (62) | (63) |
| | Other | **6** | (9) | 27 |
| | Changes in other assets and liabilities | **(186)** | (35) | (11) |
| | Net cash provided by operating activities | **516** | 624 | 647 |
| **Cash Flows From Investing Activities** | Capital expenditures (excludes capital lease additions of $60, $11 and $31, respectively and DSM) | **(1,295)** | (678) | (643) |
| | Investments in partnerships and unconsolidated subsidiaries | **(345)** | (830) | (163) |
| | Cost to retire property, net | **(83)** | (46) | (31) |
| | Other | **32** | (46) | (47) |
| | Acquisition of companies, net of cash acquired | **—** | — | (20) |
| | Proceeds from sale of property | **57** | 49 | 79 |
| | Net cash used in investing activities | **(1,634)** | (1,551) | (825) |
| **Cash Flows From Financing Activities** | Proceeds from bank loans, notes and bonds | **2,348** | 1,214 | 433 |
| | Issuance of Common Stock | **269** | 224 | 95 |
| | Proceeds from Trust Preferred Securities | **—** | 286 | 97 |
| | Retirement of bonds and other long-term debt | **(661)** | (521) | (37) |
| | Repayment of bank loans | **(574)** | (29) | (256) |
| | Payment of Common Stock dividends | **(140)** | (119) | (103) |
| | Increase (decrease) in notes payable, net | **(53)** | 49 | (8) |
| | Payment of capital lease obligations | **(36)** | (44) | (40) |
| | Retirement of Common Stock | **(3)** | (2) | (1) |
| | Retirement of preferred stock | **—** | (120) | — |
| | Net cash provided by financing activities | **1,150** | 938 | 180 |
| **Net Increase in Cash and Temporary Cash Investments** | | **32** | 11 | 2 |
| | Cash and temporary cash investments | | | |
| | Beginning of year | **69** | 58 | 56 |
| | End of year | **$ 101** | $ 69 | $ 58 |

*The accompanying notes are an integral part of these statements.*

# Consolidated Statements of Preferred Stock

| December 31 | Series | Optional Redemption Price | Number of Shares 1998 | 1997 | In Millions 1998 | 1997 |
|---|---|---|---|---|---|---|
| **Consumers' Preferred Stock** | | | | | | |
| Cumulative, $100 par value, authorized 7,500,000 shares, with no mandatory redemption | $4.16 | $103.25 | **68,451** | 68,451 | **$ 7** | $ 7 |
| | 4.50 | 110.00 | **373,148** | 373,148 | **37** | 37 |
| **Consumers' Class A Preferred Stock** | | | | | | |
| Cumulative, no par value, authorized 16,000,000 shares, with no mandatory redemption | 2.08 | 25.00 (a) | **8,000,000** | 8,000,000 | **194** | 194 |
| **Total Preferred Stock** | | | | | **$238** | $238 |

*(a) Redeemable beginning April 1, 1999.*

*The accompanying notes are an integral part of these statements.*

# Consolidated Statements of Common Stockholders' Equity

| Years Ended December 31 | Number of Shares, In Thousands 1998 | 1997 | 1996 | In Millions 1998 | 1997 | 1996 |
|---|---|---|---|---|---|---|
| **Common Stock** | | | | | | |
| At beginning and end of period | | | | **$ 1** | $ 1 | $ 1 |
| **Other Paid-in Capital—CMS Energy** | | | | | | |
| At beginning of period | **100,792** | 94,813 | 91,594 | **2,131** | 1,916 | 1,827 |
| Common stock reacquired | **(72)** | (54) | (32) | **(3)** | (2) | (1) |
| Common stock issued | **7,383** | 6,031 | 3,248 | **324** | 217 | 90 |
| Common stock reissued | **1** | 2 | 3 | **—** | — | — |
| At end of period | **108,104** | 100,792 | 94,813 | **2,452** | 2,131 | 1,916 |
| **Other Paid-in Capital—Class G** | | | | | | |
| At beginning of period | **8,219** | 7,877 | 7,619 | **136** | 129 | 124 |
| Common stock reacquired | **(1)** | (1) | — | **—** | — | — |
| Common stock issued | **235** | 343 | 258 | **6** | 7 | 5 |
| At end of period | **8,453** | 8,219 | 7,877 | **142** | 136 | 129 |
| **Revaluation Capital** | | | | | | |
| At beginning of period | | | | **(6)** | (6) | (8) |
| Change in unrealized investment— gain (loss) (a) | | | | **(3)** | — | 2 |
| At end of period | | | | **(9)** | (6) | (6) |
| **Foreign Currency Translation** | | | | | | |
| At beginning of period | | | | **(96)** | — | — |
| Change in foreign currency translation (a) | | | | **(40)** | (96) | — |
| At end of period | | | | **(136)** | (96) | — |
| **Retained Earnings (Deficit)** | | | | | | |
| At beginning of period | | | | **(379)** | (504) | (625) |
| Consolidated net income (a) | | | | **285** | 244 | 224 |
| Common stock dividends declared: | | | | | | |
| CMS Energy | | | | **(129)** | (109) | (94) |
| Class G | | | | **(11)** | (10) | (9) |
| At end of period | | | | **(234)** | (379) | (504) |
| **Total Common Stockholders' Equity** | | | | **$ 2,216** | $ 1,787 | $ 1,536 |

| (a) Disclosure of Comprehensive Income: | 1998 | 1997 | 1996 |
|---|---|---|---|
| Revaluation capital | | | |
| unrealized investment—gain (loss), net of tax of $2,$0 and $0, respectively | $ (3) | $ — | $ 2 |
| Foreign currency translation | (40) | (96) | — |
| Consolidated net income | 285 | 244 | 224 |
| Total Consolidated Comprehensive Income | $ 242 | $ 148 | $ 226 |

*The accompanying notes are an integral part of these statements.*

### 1: CORPORATE STRUCTURE

CMS Energy Corporation (CMS Energy) is the parent holding company of Consumers Energy Company (Consumers) and CMS Enterprises Company (Enterprises). Consumers, a combination electric and gas utility company serving the Lower Peninsula of Michigan, is the principal subsidiary of CMS Energy. Enterprises is engaged in several domestic and international energy-related businesses including: acquisition, development and operation of independent power production facilities; oil and gas exploration and production; transmission, storage, and processing of natural gas; energy marketing, services and trading; and international energy distribution.

### 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS

*Basis of Presentation:* The consolidated financial statements include CMS Energy, Consumers and Enterprises and their majority owned subsidiaries. The financial statements are prepared in conformity with generally accepted accounting principles and use management's estimates where appropriate. Affiliated companies (more than 20 percent but less than a majority ownership interest) are accounted for by the equity method.

*Change in Method of Accounting for Investments in Oil and Gas Properties:* CMS Oil and Gas Company (CMS Oil and Gas) (formerly CMS NOMECO Oil & Gas Co.) elected to convert, effective January 1, 1998, from the full cost method to the successful efforts method of accounting for its investments in oil and gas properties. CMS Oil and Gas believes this accounting change will more accurately present the results of its exploration and development activities and minimize asset write-offs caused by periodic price swings, which may not be representative of overall or long-term markets. In addition, the Financial Accounting Standards Board has stated a preference for the use of successful efforts accounting. Nitrotec Corporation (Nitrotec), in which CMS Gas Transmission and Storage Company (CMS Gas Transmission) has an equity investment, also elected to convert, effective January 1, 1998, from the full cost method of accounting to the successful efforts method of accounting. Accordingly, all prior period financial statements presented have been restated to conform with successful efforts accounting. The effect, after tax, of the change in accounting method as of December 31, 1997, was a reduction to retained earnings of $175 million for CMS Oil and Gas and $15 million for CMS Gas Transmission, primarily attributable to a decrease in CMS Oil and Gas'net plant and property and deferred tax liability of $270 million and $95 million, respectively, and a $15 million decrease in CMS Gas Transmission's equity investment in Nitrotec.

*Change in Method of Accounting for Property Taxes:* During the first quarter of 1998, Consumers implemented a change in the method of accounting for property taxes so that such taxes are recognized during the fiscal period of the taxing authority for which the taxes are levied. This change better matches property tax expense with the services provided by the taxing authorities, and is considered the most acceptable basis of recording property taxes. Prior to 1998, Consumers recorded property taxes monthly during the year following the assessment date (December 31). The cumulative effect of this one-time change in accounting increased other income by $66 million, and earnings, net of tax, by $43 million or $.40 per share. The pro forma effect on prior years' consolidated net income of retroactively recording property taxes as if the new method of accounting had been in effect for all periods presented is not material.

*Accretion Income and Expense:* In 1991, the Michigan Public Service Commission (MPSC) allowed Consumers to recover a portion of its abandoned Midland investment over a 10-year period, but did not allow Consumers to earn a return on that amount. Consumers reduced the recoverable investment to the present value of the future recoveries. During the recovery period, Consumers adjusts the unrecovered asset to its present value. It reflects this adjustment as accretion income. Conversely, Consumers recorded a loss in 1992 for the present value of its estimated future underrecoveries of power costs resulting from purchases from the Midland Cogeneration Venture Limited Partnership (MCV Partnership) (see Note 3). It now recognizes accretion expense annually to reflect the time value of money on the recorded loss.

*Gas Inventory:* Consumers uses the weighted average cost method for valuing working gas inventory. It records cushion gas, which is gas stored to maintain reservoir pressure for recovery of working gas, in the appropriate gas utility plant account. Consumers stores gas inventory in its underground storage facilities.

*Maintenance, Depreciation and Depletion:* Consumers charges property repairs and minor property replacements to maintenance expense. Depreciable property retired or sold, plus cost of removal (net of salvage credits), is charged to accumulated depreciation. Consumers bases depreciation provisions for utility plant on straight-line and units-of-production rates approved by the MPSC. The composite depreciation rate for electric utility property was 3.5 percent for 1998, 3.6 percent for 1997 and 3.5 percent for 1996. The composite rate for gas utility plant was 4.2 percent for 1998, 4.1 percent for 1997 and 4.2 percent for 1996. The composite rate for other plant and property was 7.4 percent for 1998, 8.2 percent for 1997 and 5.5 percent for 1996.

CMS Oil and Gas follows the successful efforts method of accounting for its investments in oil and gas properties. CMS Oil and Gas capitalizes the costs of property acquisitions, successful exploratory wells, all development costs, and support equipment and facilities when incurred. It expenses unsuccessful exploratory wells when they are determined to be non-productive. CMS Oil and Gas also charges to expense production costs, overhead, and all exploration costs other than exploratory drilling as incurred. Depreciation, depletion and amortization of proved oil and gas properties is determined on a field-by-field basis using the units-of-production method over the life of the remaining proved reserves.

Other nonutility depreciable property is amortized over its estimated useful life; gains and losses are recognized at the time of sale.

*Nuclear Fuel Cost:* Consumers amortizes nuclear fuel cost to fuel expense based on the quantity of heat produced for electric generation. Interest on leased nuclear fuel is expensed as incurred. Under current federal law, as confirmed by court decision, the U.S. Department of Energy (DOE) was to begin accepting deliveries of spent nuclear fuel by January 31, 1998 for disposal. For fuel used after April 6, 1983, Consumers charges disposal costs to nuclear fuel expense, recovers them through electric rates and remits to the DOE quarterly. Consumers elected to defer payment for disposal of spent nuclear fuel burned before April 7, 1983. At December 31, 1998, Consumers had a recorded liability to the DOE of $117 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. In January 1997, in response to the DOE's declaration that it would not begin to accept spent nuclear fuel deliveries in 1998, Consumers and other utilities filed suit in federal court. A decision was issued by the court in late 1997 affirming the DOE's duty to take delivery of spent fuel, but was not specific as to the relief available for failure of the DOE to comply. Further litigation brought by Consumers and others in 1998 is intended to produce specific monetary relief for the DOE's failure to comply. In January 1999, federal legislation was reintroduced in the House of Representatives to clarify the timing of the DOE's obligation to accept spent nuclear fuel and to direct the DOE to establish an integrated spent fuel management system that includes designing and constructing an interim storage facility in Nevada. Similar legislation is expected to be reintroduced in the Senate.

*Nuclear Plant Decommissioning:* Consumers collected $51 million in 1998 from its electric customers for decommissioning of its two nuclear plants. Amounts collected from electric retail customers and deposited in trusts (including trust earnings) are credited to accumulated depreciation. In 1996, Consumers received a decommissioning order fromthe MPSC that estimated decommissioning costs for Big Rock Point nuclear power plant (Big Rock) and Palisades nuclear power plant (Palisades) to be $344 million and $599 million (in 1998 dollars), respectively. Consumers filed with the MPSC in March 1998 site-specific decommissioning cost estimates for Big Rock and Palisades, assuming that each plant site will eventually be restored to conform with the adjacent landscape, and that all contaminated equipment will be disassembled and disposed of in a licensed burial facility. The revised estimated decommissioning costs for Big Rock and Palisades are $304 million and $541 million (in 1998 dollars), respectively. The decreases in cost from previous estimates are principally due to the Big Rock immediate dismantlement and reductions in decommissioning costs. Consumers has determined that the current decommissioning surcharge will be sufficient to provide for decommissioning of its nuclear plants and anticipates a new MPSC order in early 1999. After retirement of Palisades, Consumers plans to maintain the facility in protective storage if radioactive waste disposal facilities are not available. Consumers will incur most of the Palisades decommissioning costs after the plant's Nuclear Regulatory Commission (NRC) operating license expires. When the Palisades'NRC license expires in 2007, the trust funds are currently estimated to have accumulated $719 million. Consumers estimates that at the time Palisades is fully decommissioned in the year 2046, the trust funds will have provided $1.9 billion, including trust earnings, over this decommissioning period. At December 31, 1998, Consumers had an investment in nuclear decommissioning trust fundsof $376million for Palisadesand $181million forBig Rock.

Big Rock was closed permanently in 1997 because management determined that it would be uneconomical to operate in an increasingly competitive environment. The plant was originally scheduled to close on May 31, 2000, at the end of the plant's operating license. The MPSC has allowed Consumers to continue collecting decommissioning surcharges through December 31, 2000. Plant decommissioning began in 1997 and may take five to ten years to return the site to its original condition. Consumers has spent $75 million for the decommissioning and withdrew $68 million from the Big Rock nuclear decommissioning trust fund.

*Reclassifications:* CMS Energy has reclassified certain prior year amounts for comparative purposes. These reclassifications did not affect consolidated net income for the years presented.

*Related-Party Transactions:* In 1998, 1997 and 1996, Consumers purchased $51 million, $51 million and $50 million, respectively, of electric generating capacity and energy from affiliates of Enterprises. Affiliates of CMS Energy sold, stored and transported natural gas and provided other services to the MCV Partnership totaling $21 million, $21 million and $17 million for 1998, 1997 and 1996. For additional discussion of related-party transactions with the MCV Partnership and the First Midland Limited Partnership (FMLP), see Notes 3 and 18. Other related-party transactions are immaterial.

*Utility Regulation:* Consumers accounts for the effects of regulation based on a regulated utility accounting standard Statement of Financial Accounting Standards (SFAS) 71. As a result, the actions of regulators affect when revenues, expenses, assets and liabilities are recognized. SFAS 121 imposes stricter 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 will be recovered.

The following regulatory assets (liabilities), which include both current and non-current amounts, are reflected in the Consolidated Balance Sheets. These costs are being recovered through rates over periods of up to 14 years.

| | | *In Millions* |
|---|---|---|
| December 31 | **1998** | 1997 |
| Postretirement benefits (Note 12) | **$ 397** | $ 429 |
| Income taxes (Note 9) | **148** | 172 |
| Abandoned Midland project | **71** | 93 |
| Manufactured gas plant sites (Note 3) | **48** | 47 |
| DSM—deferred costs | **32** | 46 |
| Uranium enrichment facility | **20** | 22 |
| Other | **38** | 28 |
| Total regulatory assets | **$ 754** | $ 837 |
| Income taxes (Note 9) | **$(235)** | $(226) |
| DSM—deferred revenue | **(24)** | (24) |
| Total regulatory liabilities | **$(259)** | $(250) |

Consumers anticipates that it will discontinue application of SFAS 71 for the generation segment of its business in the first quarter of 1999 as Consumers is now preparing to implement electric customer direct access.

*Implementation of New Accounting Standards:* In 1998 CMS Energy implemented SFAS 130, *Reporting Comprehensive Income,* SFAS 131, *Disclosures about Segments of an Enterprise and Related Information,* and SFAS 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits.* SFAS 130 establishes standards for reporting and display of comprehensive income and its components. Equity adjustments related to unrealized investment gains and losses (net of tax) and foreign currency translation, along with consolidated net income, comprise comprehensive income. SFAS 131 and 132 require expanded disclosure concerning segments of an enterprise and pension and other postretirement benefits.

*Foreign Currency Translation:* Foreign currency translation adjustments relating to the operation of CMS Energy's long-term investments in foreign countries are included in common stockholders' equity. For the year ended December 31, 1998, the change in the foreign currency translation adjustment totaled $40 million, net of after-tax hedging proceeds.

*Other:* For significant accounting policies regarding cash equivalents, see Note 16; for income taxes, see Note 9; for executive incentive compensation, see Note 11; and for pensions and other postretirement benefits, see Note 12.

## 3: UNCERTAINTIES

**Consumers' Electric Utility Contingencies**

*Electric Environmental Matters:* The federal Clean Air Act, as amended (Clean Air Act), limits emissions of sulfur dioxide and nitrogen oxides and requires emissions and air quality monitoring. Consumers currently operates within these limits and meets current emission requirements. The Clean Air Act requires the Environmental Protection Agency (EPA) to periodically review the effectiveness of the national air quality standards in preventing adverse health effects, and in 1997 the EPA revised these standards. It is probable that the 1997 standards will result in further limitations on small particulate-related emissions.

In September 1998, based upon the 1997 standards, the EPA Administrator signed final regulations requiring the State of Michigan to further limit nitrogen oxide emissions. Fossil-fueled emitters, such as Consumers' generating units, can anticipate a reduction in nitrogen oxide emissions by 2003 to only 32 percent of levels allowed for the year 2000. The State of Michigan has one year to submit an implementation plan. The State of Michigan has filed a lawsuit objecting to the extent of the required emission reductions. It is unlikely that the State of Michigan will establish Consumers' nitrogen oxide emissions reduction target until mid-to-late 1999. Until this target is established, the estimated cost of compliance discussed below is subject to revision. If a court were to order the EPA to adopt the State of Michigan's position, compliance costs could be less than the preliminary estimated amounts.

The preliminary estimate of capital expenditures to reduce nitrogen oxide-related emissions for Consumers' fossil-fueled generating units is approximately $290 million, plus $10 million per year for operation and maintenance costs. Consumers anticipates that these capital expenditures will be incurred between 1999 and 2003. Consumers may need an equivalent amount of capital expenditures and operation and maintenance costs to comply with the new small particulate standards.

Consumers' coal-fueled electric generating units burn low-sulfur coal and are currently operating at or near the sulfur dioxide emission limits that will be effective in the year 2000. During the past few years, in order to comply with the Clean Air Act, Consumers incurred capital expenditures totaling $55 million to install equipment at certain generating units. Consumers estimates an additional $16 million of capital expenditures for ongoing and proposed modifications at the remaining coal-fueled units to meet year 2000 requirements. Management believes that these expenditures will not materially affect Consumers' annual operating costs.

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. Nevertheless, it believes that these costs are properly recoverable in rates under current ratemaking policies.

Consumers is a so-called potentially responsible party at several contaminated sites administered under the Comprehensive Environmental Response, Compensation and Liability Act (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 negotiations, Consumers estimates that its share of the total liability for the known Superfund sites will be between $3 million and $9 million. At December 31, 1998, Consumers has accrued the minimum amount of the range for its estimated Superfund liability.

While decommissioning Big Rock, Consumers found that some areas of the plant have coatings that contain both metals and polychlorinated biphenyls. Consumers does not believe that any facility in the United States currently accepts the radioactive portion of that waste. The cost of removal and disposal is currently unknown. These costs will constitute part of the cost to decommission the plant, and will be paid from the decommissioning fund. Consumers is studying the extent of the contamination and reviewing options.

*Antitrust:* In October 1997, two independent power producers sued Consumers in a federal court. The suit alleges antitrust violations relating to contracts which Consumers entered into with some of its customers and claims relating to power facilities. The plaintiffs claim damages of $100 million (which a court can treble in antitrust cases as provided by law). Consumers has filed a motion to dismiss and is awaiting a court ruling on this motion. Consumers believes the lawsuit is without merit and will vigorously defend against it, but cannot predict the outcome of this matter.

**Consumers' Electric Utility Rate Matters**

*Electric Proceedings:* In 1996, the MPSC issued a final order that authorized Consumers to recover costs associated with the purchase of the additional 325 megawatts (MW) of the natural gas-fueled, combined-cycle cogeneration facility (MCV Facility) capacity (see "Power Purchases from the MCV Partnership" in this Note) and to recover its nuclear plant investment by increasing prospective annual nuclear plant depreciation expense by $18 million, with a corresponding decrease in fossil-fueled generating plant depreciation expense. It also established an experimental direct-access program. Customers having a maximum demand of 2 MW or greater are eligible to purchase generation services directly from any eligible third-party power supplier and Consumers will transmit the power for a fee. The direct-access program is limited to 134 MW of load. In accordance with the MPSC order, Consumers held a lottery in April 1997 to select the customers to participate in the direct-access program. Subsequently, direct access for a portion of this 134 MW began in late 1997. The program was substantially filled by mid-January 1999 and Consumers expects the remaining amount to begin by the end of the first quarter of 1999.

In January 1998, the Michigan Court of Appeals (Court of Appeals) affirmed an MPSC conclusion that the MPSC has statutory authority to authorize an experimental electric retail wheeling program. No retail wheeling has yet occurred pursuant to that program. In October 1998, the Michigan Supreme Court issued an order granting Consumers' application for leave to appeal. A decision by the Michigan Supreme Court in this matter may be issued in mid-1999.

*Electric Restructuring:* As part of ongoing proceedings relating to the restructuring of the electric utility industry in Michigan, the MPSC in June 1997 issued an order proposing that beginning January 1, 1998 Consumers transmit and distribute energy on behalf of competing power suppliers to retail customers. Further restructuring orders issued in late 1997 and early 1998 provide for: (i) recovery of costs incurred by utilities in order to serve their customers in a regulated monopoly environment of $1.755 billion through a charge to all customers purchasing their power from other sources until the end of the transition period in 2007, subject to an adjustment through a true-up mechanism; (ii) commencement of the phase-in of direct access in 1998; (iii) suspension of the power supply cost recovery (PSCR) clause as discussed below; and (iv) all customers to choose their power suppliers on January 1, 2002. The recovery of costs of implementing a direct-access program, preliminarily estimated at an additional $200 million, would be reviewed for prudence and recovered via a charge approved by the MPSC. Nuclear decommissioning costs will also continue to be collected through a separate surcharge to all customers.

In June 1998, Consumers submitted its plan for implementing direct access to the MPSC. The primary issues addressed in the plan are: (i) the implementation schedule; (ii) the direct-access service options available to customers and suppliers; (iii) the process and requirements for customers and others to obtain direct-access service; and (iv) the roles and responsibilities for Consumers, customers and suppliers. In the plan, Consumers proposed to phase in 750 MW of retail customer load to customers purchasing their power from other sources over the 1998–2001 period. Subsequent to year-end, Consumers received MPSC electric restructuring orders which generally supported Consumers'implementation plan. Accordingly, Consumers is now preparing to implement electric customer direct access.

There are numerous appeals pending at the Court of Appeals relating to the MPSC's restructuring orders, including appeals by Consumers. Consumers believes that the MPSC lacks statutory authority to mandate industry restructuring, and its appeal is limited to this jurisdictional issue. CMS Energy cannot predict the outcome of electric restructuring on CMS Energy's financial position, liquidity or results of operations.

In October 1998, Consumers initiated a process for the solicitation of bids to acquire Consumers' rights to 1,240 MW of contract capacity and associated energy being purchased from the MCV Partnership. Subsequent to year-end, Consumers signed a tentative long-term power sales agreement with PECO Energy Company. This transaction is subject to obtaining satisfactory rate-making and accounting treatment and regulatory rulings. In an order issued in 1998, the MPSC delayed its consideration of the bidding process until a definitive agreement was signed (subject to review by the MPSC), but stated that Consumers' approach offers a legitimate way to utilize independent market forces to determine the above-market or stranded portion of Consumers'obligations under the Power Purchase Agreement (PPA) with the MCV Partnership. Consumers anticipates that its regulatory filing will be made with the MPSC for consideration by the end of the first quarter of 1999.

As a result of a 1998 MPSC order in connection with the electric restructuring program, Consumers' ability to recover certain costs pursuant to the PSCR process was suspended. Under this program, customers buying electricity from Consumers as traditional customers will not have their rates adjusted to reflect the actual costs of fuel and purchased and interchanged power during the 1998–2001 period. In prior years, any change in power supply costs was passed through to Consumers' customers. In order to reduce the risk of high energy prices during peak demand periods, Consumers is purchasing energy options and contracting to buy electricity during the months of June through September 1999. Consumers is planning to have sufficient generation and purchased capacity for a 16 percent to 21 percent reserve margin in order to provide reliable service to its electric service customers and to protect itself against unscheduled plant outages. Under certain circumstances, the cost of purchasing capacity and energy on the spot market could be substantial.

**Other Consumers' Electric Utility 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 The Dow Chemical Company. Consumers, through two wholly owned subsidiaries, holds the following assets related to the MCV Partnership and MCV Facility: (i)CMS Midland Inc., a subsidiary of Consumers, owns a 49percent generalpartnership interest in the MCV Partnership; and (ii) CMS Midland Holdings Company, a subsidiary of Consumers, holds, through FMLP, a 35 percent lessor interest in the MCV Facility.

*Summarized Statements of Income for CMS Midland and CMS Holdings (unaudited):*

| *In Millions* | | | |
|---|---|---|---|
| December 31 | **1998** | 1997 | 1996 |
| Pretax operating income | **$49** | $46 | $40 |
| Income taxes and other | **15** | 14 | 11 |
| Net income | **$34** | $32 | $29 |

*Power Purchases from the MCV Partnership:* Consumers' annual obligation to purchase capacity from the MCV Partnership is 1,240 MW through the termination of the PPA in 2025. The PPA provides that Consumers is to pay a levelized average capacity charge, based on the MCV Facility's availability, of 3.77 cents per kilowatt-hour (kWh), a fixed energy charge, and a variable energy charge based primarily on Consumers' average cost of coal consumed. Since January 1, 1993, Consumers has been permitted by the MPSC 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, Consumers also has been permitted 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. Because the MPSC has already approved recovery of this capacity, Consumers expects to recover these increases through an adjustment to the currently frozen PSCR level. This adjustment is currently under consideration by the MPSC. After September 2007, under the terms of the PPA, Consumers will only be required to pay the MCV Partnership capacity and energy charges that the MPSC has authorized for recovery from electric customers.

Consumers recognized a loss in 1992 for the present value of the estimated future underrecoveries of power costs under the PPA based on MPSC recovery orders. At December 31, 1998 and December 31, 1997, the remaining after-tax present value of the estimated future PPA liability associated with the 1992 loss totaled $110 million and $117 million, respectively. At December 31, 1998, the undiscounted after-tax amount associated with this liability totaled $164 million. These after-tax cash underrecoveries are based on the assumption that the MCV Facility would be available to generate electricity 91.5 percent of the time over its expected life. Historically the MCV Facility has operated above the 91.5 percent level. Accordingly, in 1998, Consumers increased its PPA liability by $37 million. Because the MCV Facility was available 99.4 percent of the time in 1998, Consumers has an accumulated unrecovered after-tax shortfall of $10 million as of December 31, 1998. If the MCV Facility was to be available to generate electricity at the expected 91.5 percent level during the next five years, Consumers' after-tax cash underrecoveries associated with the PPA would be as follows:

*In Millions*

| | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|
| Estimated cash under-recoveries, net of tax | $22 | $21 | $20 | $19 | $18 |

If the MCV Facility operates at availability levels above management's estimate over the remainder of the PPA, Consumers will need to recognize additional losses for future underrecoveries. For further discussion on the impact of the frozen PSCR, see "Electric Restructuring" in this Note. Management will continue to evaluate the adequacy of the contract loss liability considering actual MCV Facility operations and the potential sale of the PPA.

In February 1998, the MCV Partnership filed a claim of appeal from the January 1998 and February 1998 MPSC orders in the electric utility industry restructuring. At the same time, the MCV Partnership filed suit in the U.S. District Court seeking a declaration that the MPSC's failure to provide Consumers and the MCV Partnership a certain source of recovery of capacity payments after 2007 deprived the MCV Partnership of its rights under the Public Utilities Regulatory Policies Act of 1978. The MCV Partnership is seeking to prohibit the MPSC from implementing portions of the order.

*Nuclear Matters:* In January 1997, the NRC issued its Systematic Assessment of Licensee Performance report for Palisades. The report rated all areas as good. The NRC suspended the assessment process for all licensees in 1998.

Palisades' temporary on-site storage pool for spent nuclear fuel is at capacity. Consequently, Consumers is using NRC-approved steel and concrete vaults, commonly known as "dry casks," for temporary on-site storage. As of December 31, 1998 Consumers had loaded 13 dry storage casks with spent nuclear fuel at Palisades and plans to load five additional casks in 1999 pending approval by the NRC. In June 1997, the NRC approved Consumers' process for unloading spent fuel from a cask previously discovered to have minor weld flaws. Consumers intends to transfer the spent fuel to a new transportable cask when one is available.

Consumers maintains insurance coverage against property damage, debris removal, personal injury liability and other risks that are present at its nuclear generating facilities. Consumers also maintains coverage for replacement power costs during prolonged accidental outages at Palisades. Insurance would not cover such costs during the first 17 weeks of any outage, but would cover most of such costs during the next 58 weeks of the outage, followed by reduced coverage to 80 percent for two additional years. If certain covered losses occur at its own or other nuclear plants similarly insured, Consumers could be required to pay maximum assessments of $15 million in any one year to Nuclear Electric Insurance Limited; $88 million per occurrence, limited to a maximum installment payment of $10 million per occurrence in any year; and $6 million if nuclear workers claim bodily injury from radiation exposure. Consumers considers the possibility of these assessments to be remote.

The NRC requires Consumers to make certain calculations and report on the continuing ability of the Palisades reactor vessel to withstand postulated pressurized thermal shock events during its remaining license life, considering the embrittlement of reactor materials. In December 1996, Consumers received an interim Safety Evaluation Report from the NRC indicating that the reactor vessel can be safely operated through 2003 before reaching the NRC's screening criteria for reactor embrittlement. Consumers believes that with fuel management designed to minimize embrittlement, it can operate Palisades to the end of its license life in the year 2007 without annealing the reactor vessel. Nevertheless, Consumers will continue to monitor the matter.

*Commitments for Coal Supplies:* Consumers has entered into coal supply contracts with various suppliers for its coal-fired generating stations. Under the terms of these agreements, Consumers is obligated to take physical delivery of the coal and make payment based upon the contract terms. Consumers' current contracts have expiration dates that range from 1999 to 2004. Consumers enters into long-term contracts for approximately 50–75 percent of its annual coal requirements. In 1998 coal purchases totaled $246 million of which $161 million (60 percent of the tonnage requirement) was under long-term contract. Consumers supplements its long-term contracts with spot-market purchases.

**Consumers Gas Group 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, including some 23 sites that formerly housed manufactured gas plant facilities, even those in which it has a partial or no current ownership interest. On 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 estimates its costs related to investigation and remedial action for all 23 sites between $48 million and $98 million, of which Consumers accrued a liability for $48 million. These estimates are undiscounted 1998 costs. As of December 31, 1998, Consumers has an accrued liability of $48 million and a regulatory asset for approximately the same amount. Any significant change in assumptions, such as remediation techniques, nature and extent of contamination, and legal and regulatory requirements, could affect the estimate of remedial action costs for the sites. Consumers defers and amortizes over a period of ten years, environmental clean-up costs above the amount currently being recovered in rates. Rate recognition of amortization expense will not begin until after a prudence review in a general rate case. Consumers is allowed current recovery of $1 million annually. Consumers has initiated lawsuits against certain insurance companies regarding coverage for some or all of the costs that it may incur for these sites.

**Consumers Gas Group Matters**

*Gas Restructuring:* In December 1997, the MPSC approved Consumers' application to implement an experimental gas transportation program, which will extend over a three-year period, eventually allowing 300,000 residential, commercial and industrial retail gas sales customers to choose their gas supplier in direct competition with Consumers. The program is voluntary and participating natural gas customers are selected on a first-come, first-served basis, up to a limit of 100,000 per year. As of December 31, 1998, more than 102,000 customers chose alternative gas suppliers, representing approximately 24.1 billion cubic feet (bcf) of gas load. Customers choosing to remain as sales customers of Consumers will not see a rate change in their natural gas rates. This three-year program: (i) suspends Consumers' gas cost recovery clause, effective April 1, 1998, establishing a gas commodity cost at a fixed rate of $2.84 per thousand cubic feet (mcf); (ii) establishes an earnings sharing mechanism with customers if Consumers' earnings exceed certain pre-determined levels; and (iii) establishes a gas transportation code of conduct that addresses the relationship between Consumers and marketers, including its affiliated marketers. In January 1998, the Michigan Attorney General, Association of Businesses Advocating Tariff Equity and other parties filed claims of appeal regarding the program with the Court of Appeals.

Consumers uses gas purchase contracts to limit its risk associated with gas price increases. It is management's intent to take physical delivery of the commodity and failure could result in a significant penalty for nonperformance. At December 31, 1998, Consumers had an exposure to gas price increases if the ultimate cost of gas was to exceed $2.84 per mcf for the following volumes: 15 percent of its 1999 requirements; 45 percent of its 2000 requirements; and 45 percent of its first quarter 2001 requirements. Additional contract coverage is currently under review. The gas purchase contracts currently in place were consummated at prices less than $2.84 per mcf. The gas purchase contracts are being used to protect against gas price increases in a three-year experimental gas program where Consumers is recovering from its customers $2.84 per mcf for gas.

*Commitments for Gas Supplies:* Consumers entered into gas supply contracts and transportation contracts with various suppliers for its natural gas business. These contracts have expiration dates that range from 1999 to 2003. Consumers'1998 gas requirements totaled 210 bcf at a cost of $565 million, 70 percent of which was under long-term contracts for one year or more. As of the end of 1998, Consumers had 85 percent of its 1999 gas requirements under such long-term contracts, and will supplement them with additional long-term contracts and spot-market purchases.

**Other Uncertainties**

*CMS Generation Environmental Matters:* CMS Generation Co. (CMS Generation) does not currently expect to incur significant capital costs, if any, at its power facilities to comply with current environmental regulatory standards.

*Capital Expenditures:* CMS Energy estimates capital expenditures, including investments in unconsolidated subsidiaries and new lease commitments, of $4.148 billion for 1999, which includes approximately $2.2 billion for the acquisition of the Panhandle Eastern Pipe Line Company, Trunkline Gas Company, Pan Gas Storage Company, Panhandle Storage Company and Trunkline LNG Company (Panhandle Companies), $1.450 billion for 2000, and $1.175 billion for 2001. For further information, see Capital Resources and Liquidity—Capital Expenditures in the Management's Discussion and Analysis.

*Other:* As of December 31, 1998, CMS Energy and Enterprises have guaranteed up to $433 million in contingent obligations of unconsolidated affiliates and related parties.

In addition to the matters disclosed in this note, Consumers and certain other subsidiaries of CMS Energy 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.

CMS Energy has accrued estimated losses for certain contingencies discussed in this Note. Resolution of these contingencies is not expected to have a material adverse impact on CMS Energy's financial position, liquidity or results of operations.

### 4: SHORT-TERM FINANCINGS

At December 31, 1998, CMS Energy and a subsidiary had bridge loan facilities negotiated with domestic banks in an aggregate amount of $1.9 billion. These facilities were specifically available to finance CMS Energy's acquisition of the Panhandle Companies, and had a term of six months from the date of acquisition. These facilities had aggregate average commitment and usage fees of approximately 53 basis points on amounts committed and/or used.

At February 1, 1999, Consumers had Federal Energy Regulatory Commission (FERC) authorization to issue or guarantee through June 2000, up to $900 million of short-term securities outstanding at any one time and to guarantee, through 1999, up to $25 million in loans made by others to residents of Michigan for making energy-related home improvements. Consumers also had remaining FERC authorization to issue through June 2000, up to $475 million and $425 million of long-term securities with maturities up to 30 years for refinancing purposes and for general corporate purposes respectively.

Consumers has an unsecured $425 million credit facility and unsecured lines of credit aggregating $130 million. These facilities are available to finance seasonal working capital requirements and to pay for capital expenditures between long-term financings. At December 31, 1998, a total of $215 million was outstanding at a weighted average interest rate of 5.8 percent, compared with $377 million outstanding at December 31, 1997, at a weighted average interest rate of 6.5 percent. In January 1999, Consumers renegotiated a variable-to-fixed interest rate swap totaling $175 million in order to reduce the impact of interest rate fluctuations.

Consumers also has in place a $500 million trade receivables sale program. At December 31, 1998 and 1997, receivables sold under the program totaled $306 million and $335 million, respectively. Accounts receivable and accrued revenue in the ConsolidatedBalance Sheets have been reduced to reflect receivables sold.

## 5: LONG-TERM DEBT

Long-term debt consists of the following:

| December 31 | Maturing/Expiring | Interest Rate | 1998 | *In Millions* 1997 |
|---|---|---|---|---|
| First Mortgage Bonds | 1998 to 2023 | 6.4% to 8.9% | **$ 628** | $1,255 |
| Long-Term Bank Debt | 2003 | 5.8% (a) | **175** | 400 |
| Senior Notes: | | | | |
| CMS Energy | 2000 to 2004 | 7.8% (a) | **830** | 830 |
| Consumers | 2008 to 2028 | 6.5% (a) | **1,075** | — |
| Extendible Tenor Rate | | | | |
| Adjusted Securities | 2005 (b) | 7.0% (a) | **180** | — |
| Senior Credit Facilities | 2002 | 6.6% (a) | **669** | 305 |
| General Term Notes® | | | | |
| Series A to E | 1999 to 2008 | 7.5% (a) | **625** | 509 |
| Pollution Control Revenue Bonds | 2000 to 2018 | 5.2% (a) | **131** | 131 |
| Term Loan Agreement—CMS Generation | 1998 | 7.4% (a) | **—** | 91 |
| Revolving Line of Credit | 2003 | 5.9% (a) | **168** | 124 |
| Nuclear Fuel Disposal | (c) | 5.1% (a) | **117** | 111 |
| Bank Loans and Other | 1999 to 2014 | 7.7% (a) | **410** | 134 |
| Principal Amount Outstanding | | | **5,008** | 3,890 |
| Current Amounts | | | **(258)** | (609) |
| Net Unamortized Discount | | | **(24)** | (9) |
| Total Long-Term Debt | | | **$4,726** | $3,272 |

*(a) Represents the weighted average interest rate at December 31,1998.*
*(b) May be extended for an additional seven years.*
*(c) Maturity date uncertain (see Note 2).*

The scheduled maturities of long-term debt and improvement fund obligations are as follows: $258 million in 1999, $408 million in 2000, $96 million in 2001, $1.306 billion in 2002 and $592 million in 2003.

**CMS Energy**

CMS Energy has $725 million of senior credit facilities consisting of a $600 million three-year revolving credit facility and a five-year $125 million term loan facility (Senior Credit Facilities). Additionally, CMS Energy has unsecured lines of credit and letters of credit in an aggregate amount of $216 million. At December 31, 1998, the total amount utilized under the Senior Credit Facilities was $725 million, including $57 million of contingent obligations, and under the unsecured lines of credit and letters of credit was $147 million.

In January 1998, a Delaware statutory business trust established by CMS Energy sold $180 million of certificates due January 15, 2005 in a public offering. In exchange for those proceeds, CMS Energy sold to the trust $180 million aggregate principal amount of 7 percent Extendible Tenor Rate Adjusted Securities due January 15, 2005, which may be extended for an additional seven years. Net proceeds to CMS Energy from the sale totaled $176 million.

In August 1998, CMS Energy filed a shelf registration statement for the issuance of $400 million of General Term Notes® Series E.

In January 1999, CMS Energy received net proceeds of approximately $473 million from the sale of $480 million of senior notes. In February 1999, CMS Energy received net proceeds of approximately $296 million from the sale of $300 million of senior notes. Proceeds from these offerings were used to repay debt and for general corporate purposes.

**Consumers**

Consumers issued a total of $1.075 billion of senior notes throughout 1998 at varying interest rates between 6.2 percent and 6.875 percent, principal amounts between $150 million and $250 million, and maturities from 2008 to 2028. The senior notes are secured by Consumers First Mortgage Bonds issued contemporaneously in similar amounts and one series of senior notes also is secured by an insurance policy. Consumers also issued long-term bank debt of $225 million in May 1998, maturing in 2001 to 2003, at an initial interest rate of 6.05 percent. Proceeds from these issuances were used primarily to pay down $627 million of First Mortgage Bonds and $450 million of long-term bank debt, as well as for general corporate purposes.

Consumers secures its First Mortgage Bonds by a mortgage and lien on 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.

Consumers' long-term pollution control revenue bonds are secured by irrevocable letters of credit or First Mortgage Bonds, and an insurance policy.

**CMS Oil and Gas**

CMS Oil and Gas has a $225 million revolving credit facility that converts to term loans maturing from March 1999 through March 2003.

### 6: CAPITALIZATION

**CMS Energy**

The authorized capital stock of CMS Energy consists of 250 million shares of CMS Energy Common Stock, one of two classes of par value $.01 per share (CMS Energy Common Stock), 60 million shares of Class G Common Stock, one of two classes of no par value (Class G Common Stock), and 10 million shares of CMS Energy Preferred Stock, $.01 par value.

In November 1998, CMS Energy sold 4.5 million new shares of CMS Energy Common Stock in a block trade. The net proceeds of approximately $208 million were used for general corporate purposes.

In December 1998, CMS Energy filed a shelf registration statement for the issuance of $1.5 billion of CMS Energy Common Stock, trust preferred securities and other securities which could be converted into CMS Energy Common Stock.

CMS Energy, through CMS Energy Trust I, a wholly owned business trust, sold 3.45 million units of 7.75 percent tax deductible Trust Preferred Securities. The primary asset of CMS Energy Trust I is $178 million principal amount of 7.75 percent subordinated debentures issued by CMS Energy, which mature in 2027. These tax deductible Trust Preferred Securities are convertible into 4.2 million shares of CMS Energy Common Stock at a rate equivalent to a conversion price of $40.80 per share of CMS Energy Common Stock.

*Other:* Under its most restrictive borrowing arrangement at December 31, 1998, none of CMS Energy's consolidated net income was restricted for payment of common dividends. CMS Energy could pay $800 million in common dividends under its most restrictive debt covenant.

**Consumers**

Consumers has 4 million shares of 8.36 percent Trust Preferred Securities which were sold through Consumers Power Company Financing I, a wholly owned business trust consolidated with Consumers. Net proceeds from the sale totaled $97 million. Consumers has 4.8 million shares of 8.2 percent Trust Preferred Securities which were sold through Consumers Energy Company Financing II, a wholly owned business trust consolidated with Consumers. Net proceeds from the sale totaled $116 million. Consumers formed both trusts for the sole purpose of issuing the Trust Preferred Securities. Consumers' obligations with respect to the Trust Preferred Securities under the related tax-deductible notes, under the indenture through which Consumers issued the notes, under Consumers' guarantee of the Trust Preferred Securities, and under the declaration by the trusts, taken together, constitute a full and unconditional guarantee by Consumers of the trusts' obligations under the Trust Preferred Securities.

Under the provisions of its Articles of Incorporation, Consumers had $300 million of unrestricted retained earnings available to pay common dividends at December 31, 1998. In January 1999, Consumers declared and paid a $97 million common dividend.

### 7: EARNINGS PER SHARE AND DIVIDENDS

CMS Energy currently has two classes of common stock: CMS Energy Common Stock and Class G Common Stock (Common Stock). Earnings per share attributable to Common Stock for the years ended December 31, 1998, 1997 and 1996 include earnings of the gas distribution, storage and transportation businesses currently conducted by Consumers and Michigan Gas Storage Company (Consumers Gas Group). The allocation of earnings attributable to each class of common stock and the related amounts per share are computed by considering the weighted average number of shares outstanding.

Earnings attributable to the outstanding shares of Class G Common Stock (Outstanding Shares) are equal to Consumers Gas Group net income multiplied by a fraction; the numerator is the weighted average number of Outstanding Shares during the period and the denominator is the weighted average number of Outstanding Shares and authorized but unissued shares of Class G Common Stock not held by holders of the Outstanding Shares during the period. The earnings attributable to Class G Common Stock on a per share basis for 1998, 1997 and 1996 are based on 25.5 percent, 24.5 percent, and 23.8 percent, respectively, of the income of Consumers Gas Group.

*Computation of Earnings Per Share:*

| *In Millions, Except Per Share Amounts* | 1998 | 1997 | 1996 |
|---|---|---|---|
| **Net Income Applicable to Basic and Diluted Earnings Per Share** | | | |
| Consolidated Net Income | $ 285 | $ 244 | $ 224 |
| Net Income Attributable to Common Stocks: | | | |
| CMS Energy—Basic Income | $ 272 | $ 229 | $ 210 |
| Add conversion of 7.75% Trust Preferred Securities (net of tax) | 9 | 5 | — |
| CMS Energy—Diluted Income | $ 281 | $ 234 | $ 210 |
| Class G: | | | |
| Basic and Diluted Income | $ 13 | $ 15 | $ 14 |
| **Average Common Shares Outstanding Applicable to Basic and Diluted Earnings Per Share** | | | |
| CMS Energy: | | | |
| Average Shares—Basic | 102.4 | 96.1 | 92.5 |
| Add conversion of 7.75% Trust Preferred Securities | 4.3 | 2.3 | — |
| Options—Treasury Shares | 0.5 | 0.3 | 0.2 |
| Average Shares—Diluted | 107.2 | 98.7 | 92.7 |
| Class G: | | | |
| Average Shares Basic and Diluted | 8.3 | 8.0 | 7.7 |
| **Earnings Per Average Common Share** | | | |
| CMS Energy: | | | |
| Basic | $ 2.65 | $2.39 | $2.27 |
| Diluted | 2.62 | 2.37 | 2.26 |
| Class G: | | | |
| Basic and Diluted | 1.56 | 1.84 | 1.82 |

Holders of Class G Common Stock have no direct rights in the equity or assets of Consumers Gas Group, but rather have rights in the equity and assets of CMS Energy as a whole. In the sole discretion of the CMS Energy Board of Directors (Board of Directors), CMS Energy may pay dividends exclusively to the holders of Class G Common Stock, exclusively to the holders of CMS Energy Common Stock, or to the holders of both classes in equal or unequal amounts. The Board of Directors has stated its intention to declare and pay dividends on the CMS Energy Common Stock based primarily on the earnings and financial condition of CMS Energy. Dividends on Class G Common Stock are paid at the discretion of the Board of Directors based primarily upon the earnings and financial condition of Consumers Gas Group, and to a lesser extent, CMS Energy as a whole.

In February and May 1998, CMS Energy paid dividends of $.30 per share on CMS Energy Common Stock and $.31 per share on Class G Common Stock. In August and November 1998, CMS Energy paid dividends of $.33 per share on CMS Energy Common Stock and $.325 per share on Class G Common Stock. In January 1999, the Board of Directors declared a quarterly dividend of $.33 per share on CMS Energy Common Stock and $.325 per share on Class G Common Stock, which were paid in February 1999.

## 8: RISK MANAGEMENT ACTIVITIES AND DERIVATIVES TRANSACTIONS

CMS Energy and its subsidiaries use a variety of derivative instruments (derivatives), including futures contracts, swaps, options and forward contracts, to manage exposure to fluctuations in commodity prices, interest rates and foreign exchange rates. To qualify for hedge accounting, derivatives must meet the following criteria: (i) the item to be hedged exposes the enterprise to price, interest or exchange rate risk; and (ii) the derivative reduces that exposure and is designated as a hedge.

Derivative instruments contain credit risk if the counter parties, including financial institutions and energy marketers, fail to perform under the agreements. CMS Energy minimizes such risk by performing financial credit reviews using, among other things, publicly available credit ratings of such counter parties. Nonperformance by counter parties is not expected to have a material adverse impact on CMS Energy's financial position, liquidity or results of operations.

*Commodity Price Hedges:* CMS Energy accounts for its commodity price derivatives as hedges, as defined above, and as such, defers any changes in market value and gains and losses resulting from settlements until the hedged transaction is complete. If there was a loss of correlation between the changes in (i) the market value of the commodity price contracts and (ii) the market price ultimately received for the hedged item, and the impact was material, the open commodity price contracts would be marked to market and gains and losses would be recognized in the income statement currently.

Consumers has entered into and will enter into electric option contracts to ensure a reliable source of capacity to meet its customers' electric requirements and to limit its risk associated with electricity price increases. It is management's intent to take physical delivery of the commodity. Consumers continuously evaluates its daily capacity needs and sells the option contracts, if marketable, when it has excess daily capacity. Consumers' maximum exposure associated with these options is limited to premiums paid.

CMS Oil and Gas has one arrangement which is used to fix the prices that CMS Oil and Gas will pay for gas supplied to the MCV Facility for the years 2001 through 2006 by purchasing the economic equivalent of 10,000 million British thermal units (MMBtu) per day at a fixed price, escalating at 8 percent per year thereafter, starting at $2.82 per MMBtu in 2001. The settlement periods are each a one-year period ending December 31, 2001 through 2006 on 3.65 million MMBtu. If the floating price, essentially the then-current Gulf Coast spot price, for a period is higher than the fixed price, the seller pays CMS Oil and Gas the difference, and vice versa. If a party's exposure at any time exceeds $5 million, that party is required to obtain a letter of credit in favor of the other party for the excess over $5 million and up to $10 million. At December 31, 1998, no letter of credit was posted by either party to the agreement. As of December 31, 1998, the fair value of this contract reflected payment due from CMS Oil and Gas of $14.5 million.

A subsidiary of CMS Gas Transmission uses natural gas future contracts and CMS Marketing, Services and Trading Company uses natural gas and oil futures contracts, options and swaps (which require a net cash payment for the difference between a fixed and variable price).

*Interest Rate Hedges:* CMS Energy and some of its subsidiaries enter into interest rate swap agreements to exchange variable rate interest payment obligations to fixed rate obligations without exchanging the underlying notional amounts. These agreements convert variable rate debt to fixed rate debt to reduce the impact of interest rate fluctuations. The notional amounts parallel the underlying debt levels and are used to measure interest to be paid or received and do not represent the exposure to credit loss. The notional amount of CMS Energy's and its subsidiaries' interest rate swaps was $579 million at December 31, 1998. The difference between the amounts paid and received under the swaps is accrued and recorded as an adjustment to interest expense over the life of the hedged agreement.

*Foreign Exchange Hedges:* CMS Energy uses forward exchange contracts and collared options to hedge certain receivables, payables, long-term debt and equity value relating to foreign investments. The purpose of CMS Energy's foreign currency hedging activities is to protect the company from the risk that U.S. dollar net cash flows resulting from sales to foreign customers and purchases from foreign suppliers and the repayment of non-U.S. dollar borrowings as well as equity reported on the company's balance sheet, may be adversely affected by changes in exchange rates. These contracts do not subject CMS Energy to risk from exchange rate movements because gains and losses on such contracts offset losses and gains, respectively, on assets and liabilities being hedged. The notional amount of the outstanding foreign exchange contracts was $736 million at December 31, 1998, which includes $450 million and $250 million for Australian and Brazilian foreign exchange contracts, respectively. Subsequent to December 31, 1998, the fair value of the Brazilian foreign exchange contracts increased significantly, as the Brazilian real weakened against the U.S. dollar.

## 9: INCOME TAXES

CMS Energy and its subsidiaries file a consolidated federal income tax return. Income taxes are generally allocated based on each company's separate taxable income. CMS Energy and Consumers practice full deferred tax accounting for temporary differences, but federal income taxes have not been recorded on the undistributed earnings of international subsidiaries where CMS Energy intends to permanently reinvest those earnings. Upon distribution, those earnings may be subject to both U.S. income taxes (adjusted for foreign tax credits or deductions) and withholding taxes payable to various foreign countries. It is not practical to estimate the amount of unrecognized deferred income taxes or withholding taxes on undistributed earnings.

CMS Energy used investment tax credit (ITC) to reduce current income taxes payable, and amortizes ITC over the life of the related property. Any alternative minimum tax (AMT) paid generally becomes a tax credit that CMS Energy can carry forward indefinitely to reduce regular tax liabilities in future periods when regular taxes paid exceed the tax calculated for AMT. The significant components of income tax expense (benefit) consisted of:

| | | | *In Millions* |
|---|---|---|---|
| Years Ended December 31 | **1998** | 1997 | 1996 |
| Current income taxes | | | |
| Federal and other | **$ 61** | $ 76 | $ 86 |
| State and local | **5** | 3 | 4 |
| Foreign | **3** | 5 | 3 |
| | **69** | 84 | 93 |
| Deferred income taxes | | | |
| Federal | **77**(a) | 41 | 54 |
| Foreign | **(7)** | (7) | — |
| | **70** | 34 | 54 |
| Deferred ITC, net | **(16)** | (10) | (10) |
| | **$123** | $108 | $137 |

*(a) Includes $23 million for 1998 change in property tax accounting.*

The principal components of CMS Energy's deferred tax assets (liabilities) recognized in the balance sheet are as follows:

| *In Millions* | | |
|---|---|---|
| December 31 | **1998** | 1997 |
| Property | **$ (574)** | $ (558) |
| Unconsolidated investments | **(285)** | (263) |
| Postretirement benefits | **(139)** | (150) |
| Abandoned Midland project | **(25)** | (33) |
| Employee benefit obligations (includes postretirement benefits of $141 and $155) | **182** | 195 |
| AMT carryforward | **134** | 147 |
| Power purchases | **59** | 66 |
| Other | **(1)** | (14) |
| | **$ (649)** | $ (610) |
| Gross deferred tax liabilities | **$(1,786)** | $(1,758) |
| Gross deferred tax assets | **1,137** | 1,148 |
| | **$ (649)** | $ (610) |

The actual income tax expense differs from the amount computed by applying the statutory federal tax rate of 35% to income before income taxes as follows:

| *In Millions* | | | |
|---|---|---|---|
| Years Ended December 31 | **1998** | 1997 | 1996 |
| Consolidated net income before preferred dividends | | | |
| Domestic | **$247** | $222 | $230 |
| Foreign | **57** | 47 | 22 |
| | **304** | 269 | 252 |
| Income tax expense | **123**[(a)] | 108 | 137 |
| | **427** | 377 | 389 |
| Statutory federal income tax rate | **x 35%** | x 35% | x 35% |
| Expected income tax expense | **149** | 132 | 136 |
| Increase (decrease) in taxes from: | | | |
| Capitalized overheads previously flowed through | **5** | 5 | 5 |
| Differences in book and tax depreciation not previously deferred | **14** | 14 | 13 |
| Impact of foreign taxes, tax rates and credits | **(5)** | 1 | 8 |
| Undistributed earnings of international subsidiaries | **(13)** | (10) | (2) |
| ITC amortization/adjustments | **(16)** | (10) | (10) |
| Section 29 Fuel Tax Credits | **(13)** | (13) | (13) |
| Other, net | **2** | (11) | — |
| | **$123** | $108 | $137 |
| Effective tax rate | **28.8%** | 28.6% | 35.4% |

*(a) Includes $23 million for 1998 change in property tax accounting.*

## 10: FINANCIAL INSTRUMENTS

The carrying amounts of cash, short-term investments and current liabilities approximate their fair values due to their short-term nature. The estimated fair values of long-term investments are 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 carryingamounts of all long-term investments in financial instruments approximate fair value.

The carrying amount and fair values of long-term debt were $4.7 billion at December 31, 1998 and $3.3 billion at December 31, 1997. Although the current fair value of the long-term debt may differ from the current carrying amount, settlement of the reported debt is generally not expected until maturity. The carrying amount of preferred stock and Trust Preferred Securities was $631 million at December 31, 1998 and $631 million at December 31, 1997, and the fair value was $631 million and $632 million, respectively.

The fair values of CMS Energy's off balance-sheet financial instruments are based on the amounts estimated to terminate or settle the instruments. At December 31, 1998, the fair value of CMS Energy's interest rate swap agreements, with a notional amount of $579 million, was $15 million, representing the amount that CMS Energy would have to pay to terminate the agreements. The settlement of theinterest rate swap agreements in 1998 did not materially affect interest expense. At December 31, 1997, CMS Energy would have paid $13 million to terminate the agreements. Also refer to Note 8 for a discussion of CMS Oil and Gas'price hedging arrangements and their fair values. Guarantees were $433 million and $543 million at December 31, 1998 and 1997, respectively.

The amortized cost of Consumers' nuclear decommissioning investments, which are considered available-for-sale securities in accordance with SFAS 115, *Accounting For Certain Investments in Debt and Equity Securities,* was $425 million and $405 million as of December 31, 1998 and 1997, respectively. The unrealized gain, which is classified in accumulated depreciation, was $132 million and $81 million as of December 31, 1998 and 1997, respectively.

## 11: EXECUTIVE INCENTIVE COMPENSATION

Under CMS Energy's Performance Incentive Stock Plan, restricted shares of Common Stock as well as stock options and stock appreciation rights relating to Common Stock may be granted to key employees based on their contributions to the successful management of CMS Energy and its subsidiaries. Awards under the plan may consist of any class of Common Stock. Certain plan awards are subject to performance-based business criteria. The plan reserves for award not more than three percent of Common Stock outstanding on January 1 each year, less (i) the number of shares of restricted Common Stock awarded and (ii) Common Stock subject to options granted under the plan during the immediately preceding four calendar years. Any forfeitures of shares previously awarded will increase the number of shares available to be awarded under the plan. At December 31, 1998, awards of up to 681,603 shares of CMS Energy Common Stock and 138,780 shares of Class G Common Stock may be issued.

Restricted shares of Common Stock are outstanding shares with full voting and dividend rights. These awards vest over five years at the rate of 25 percent per year after two years. The restricted shares are subject to achievement of specified levels of total shareholder return and are subject to forfeiture if employment terminates before vesting. If performance objectives are exceeded, the plan provides additional awards. Restricted shares vest fully if control of CMS Energy changes, as defined by the plan. At December 31, 1998, 658,494 of the 861,744 shares of restricted CMS Energy Common Stock outstanding are subject to performance objectives. At December 31, 1998 all of the 30,490 restricted shares of Class G Common Stock outstanding are subject to performance objectives.

Under the plan, stock options and stock appreciation rights relating to Common Stock are granted with an exercise price equal to the closing market price on each grant date. Options are exercisable upon grant and expire up to ten years and one month from date of grant.

The weighted average fair value of options granted for CMS Energy Common Stock was $6.43 in 1998, $6.38 in 1997, and $6.94 in 1996. The weighted average fair value of options granted for Class G Common Stock was $3.03 in 1998, $1.87 in 1997 and $1.59 in 1996. Fair value is estimated using the Black-Scholes model, a mathematical formula used to value options traded on securities exchanges, with the following assumptions:

| Years Ended December 31 | 1998 | 1997 | 1996 |
|---|---|---|---|
| **CMS Energy Common Stock Options** | | | |
| Risk-free interest rate | 5.45% | 6.06% | 6.63% |
| Expected stock-price volatility | 15.93% | 17.43% | 24.08% |
| Expected dividend rate | $ .33 | $ .30 | $ .27 |
| Expected option life (years) | 4 | 5 | 5 |
| **Class G Common Stock Options** | | | |
| Risk-free interest rate | 5.44% | 6.06% | 6.63% |
| Expected stock-price volatility | 20.02% | 18.05% | 16.19% |
| Expected dividend rate | $.325 | $ .31 | $ .295 |
| Expected option life (years) | 5 | 5 | 5 |

CMS Energy applies Accounting Principles Board Opinion 25 and related interpretations in accounting for the Performance Incentive Stock Plan. Since stock options are granted at market price, no compensation cost has been recognized for stock options granted under the plan. The compensation cost charged against income for restricted stock was $9 million in 1998, $6 million in 1997, and $2 million in 1996. If compensation cost for stock options had been determined in accordance with SFAS 123, *Accounting for Stock-Based Compensation,* CMS Energy's consolidated net income and earnings per share would have been as follows:

*In Millions, Except Per Share Amounts*

| | Pro Forma | | As Reported | |
|---|---|---|---|---|
| Years Ended December 31 | 1998 | 1997 | 1998 | 1997 |
| Consolidated Net Income | $283 | $242 | $285 | $244 |
| Net Income Attributable to Common Stocks | | | | |
| CMS Energy | 270 | 228 | 272 | 229 |
| Class G | 13 | 14 | 13 | 15 |
| Earnings Per Average Common Share | | | | |
| CMS Energy | | | | |
| Basic | 2.64 | 2.37 | 2.65 | 2.39 |
| Diluted | 2.61 | 2.35 | 2.62 | 2.37 |
| Class G | | | | |
| Basic and Diluted | 1.54 | 1.81 | 1.56 | 1.84 |

The status of the restricted stock granted to CMS Energy's key employees under the Performance Incentive Stock Plan and options granted under the plan follows.

| | Restricted Stock Number of Shares | Options Number of Shares | Options Weighted-Average Exercise Price |
|---|---|---|---|
| **CMS Energy Common Stock:** | | | |
| Outstanding at January 1, 1996 | 517,447 | 1,592,000 | $24.50 |
| Granted | 222,000 | 368,176 | $30.55 |
| Exercised or Issued | (92,533) | (231,550) | $20.79 |
| Forfeited | (46,076) | — | — |
| Expired | — | (12,000) | $32.88 |
| Outstanding at December 31, 1996 | 600,838 | 1,716,626 | $26.24 |
| Granted | 366,360 | 431,500 | $35.91 |
| Exercised or Issued | (159,405) | (479,422) | $26.54 |
| Forfeited | (59,582) | — | — |
| Expired | — | (2,987) | $30.13 |
| Outstanding at December 31, 1997 | 748,211 | 1,665,717 | $28.65 |
| Granted | **304,750** | **376,000** | **$43.38** |
| Exercised or Issued | **(185,217)** | **(331,925)** | **$27.69** |
| Forfeited | **(6,000)** | **—** | **—** |
| Outstanding at December 31, 1998 | **861,744** | **1,709,792** | **$32.07** |
| **Class G Common Stock:** | | | |
| Outstanding at January 1, 1996 | 6,924 | 10,000 | $17.88 |
| Granted | 9,423 | 11,000 | $17.88 |
| Outstanding at December 31, 1996 | 16,347 | 21,000 | $17.88 |
| Granted | 8,784 | 12,000 | $20.24 |
| Exercised or Issued | (1,385) | (5,000) | $17.88 |
| Forfeited | (3,955) | — | — |
| Outstanding at December 31, 1997 | 19,791 | 28,000 | $18.89 |
| Granted | **14,720** | **45,900** | **$24.50** |
| Exercised or Issued | **(4,021)** | **—** | **—** |
| Outstanding at December 31, 1998 | **30,490** | **73,900** | **$22.37** |

The following table summarizes information about stock options outstanding at December 31, 1998:

| Range of Exercise Prices | Number of Shares Outstanding | Weighted-Average Remaining Life | Weighted-Average Exercise Price |
|---|---|---|---|
| **CMS Energy Common Stock:** | | | |
| $17.13–$26.25 | 576,000 | 4.45 years | $22.92 |
| $27.25–$35.94 | 755,292 | 6.11 years | $33.40 |
| $38.00–$44.06 | 378,500 | 9.64 years | $43.34 |
| $17.13–$44.06 | 1,709,792 | 6.33 years | $32.07 |
| **Class G Common Stock:** | | | |
| $17.88–$19.44 | 25,500 | 7.62 years | $18.46 |
| $23.31–$24.50 | 48,400 | 9.60 years | $24.44 |
| $17.88–$24.50 | 73,900 | 8.92 years | $22.37 |

## 12: RETIREMENT BENEFITS

CMS Energy and its subsidiaries provide retirement benefits under a number of different plans, including certain health care and life insurance benefits under its postretirement benefit plans other than pensions for retired employees (OPEB), benefits to certain management employees under its Supplemental Executive Retirement Plan (SERP), and benefits to substantially all its employees under a trusteed, non-contributory, defined benefit pension plan of Consumers and CMS Energy (Pension Plan), and a defined contribution 401(k) plan.

Amounts presented below for the Pension Plan include amounts for employees of CMS Energy and nonutility affiliates which were not distinguishable from the plan's total assets.

*Weighted-Average Assumptions:*

| | Pension & SERP | | | OPEB | | |
|---|---|---|---|---|---|---|
| Years Ended December 31 | **1998** | 1997 | 1996 | **1998** | 1997 | 1996 |
| Discount rate | **7.00%** | 7.50% | 7.75% | **7.00%** | 7.50% | 7.75% |
| Expected long-term rate of return on plan assets | **9.25%** | 9.25% | 9.25% | **7.00%** | 7.00% | 7.00% |
| Rate of compensation increase: | | | | | | |
| Pension—to age 45 | **5.25%** | 5.25% | 5.50% | | | |
| —age 45 to assumed retirement | **3.75%** | 3.75% | 4.00% | | | |
| SERP | **5.50%** | 5.50% | 5.50% | | | |

Retiree health care costs at December 31, 1998 are based on the assumption that costs would increase 6.5 percent in 1999, then decrease gradually to 5.5 percent in 2005 and thereafter.

Net Pension Plan, SERP and OPEB costs consist of:

*In Millions*

| | Pension & SERP | | | OPEB | | |
|---|---|---|---|---|---|---|
| Years Ended December 31 | **1998** | 1997 | 1996 | **1998** | 1997 | 1996 |
| Service cost | **$ 27** | $ 26 | $ 26 | **$ 11** | $ 10 | $ 13 |
| Interest expense | **64** | 61 | 58 | **43** | 41 | 42 |
| Expected return on plan assets | **(73)** | (70) | (69) | **(18)** | (13) | (6) |
| Amortization of unrecognized transition (asset) | **(5)** | (5) | (5) | **—** | — | — |
| Amortization of prior service cost | **4** | 4 | 5 | **—** | — | — |
| Net periodic pension and postretirement benefit cost | **$ 17** | $ 16 | $ 15 | **$ 36** | $ 38 | $ 49 |

The health care cost trend rate assumption significantly affects the amounts reported. A one percentage point change in the assumed health care cost trend assumption would have the following effects:

*In Millions*

| | One Percentage Point Increase | One Percentage Point Decrease |
|---|---|---|
| Effect on total service and interest cost components | $ 9 | $ (8) |
| Effect on postretirement benefit obligation | $92 | $(76) |

The funded status of CMS Energy's Pension Plan, SERP and OPEB plans is reconciled with the liability recorded at December 31 as follows:

*In Millions*

| | Pension Plan | | SERP | | OPEB | |
|---|---|---|---|---|---|---|
| | **1998** | 1997 | **1998** | 1997 | **1998** | 1997 |
| Benefit obligation, January 1 | **$792** | $734 | **$ 41** | $ 37 | **$ 582** | $ 585 |
| Service cost | **25** | 24 | **2** | 2 | **11** | 10 |
| Interest cost | **60** | 59 | **3** | 3 | **43** | 41 |
| Plan amendments | **—** | — | **—** | — | **—** | (7) |
| Actuarial loss (gain) | **76** | 36 | **5** | — | **47** | (21) |
| Benefits paid | **(79)** | (61) | **(1)** | (1) | **(28)** | (26) |
| Benefit obligation, December 31 | **874** | 792 | **50** | 41 | **655** | 582 |
| Plan assets at fair value, January 1 | **882** | 779 | **—** | — | **224** | 138 |
| Actual return on plan assets | **167** | 164 | **—** | — | **54** | 37 |
| Company contribution | — | — | **1** | 1 | **49** | 49 |
| Actual benefits paid | **(79)** | (61) | **(1)** | (1) | **—** | — |
| Plan assets at fair value, December 31 | **970**(a) | 882(a) | **—** | — | **327** | 224 |
| Benefit obligation less than (in excess of) plan assets | **96** | 90 | **(50)** | (41) | **(328)** | (358) |
| Unrecognized net (gain) loss from experience different than assumed | **(176)** | (157) | **10** | 5 | **(72)** | (83) |
| Unrecognized prior service cost | **31** | 35 | **1** | 2 | **—** | — |
| Unrecognized net transition (asset) obligation | **(16)** | (22) | **—** | — | **—** | — |
| Recorded liability | **$ (65)** | $ (54) | **$ (39)** | $ (34) | **$(400)** | $(441) |

*(a) Primarily stocks and bonds, including $168 million in 1998 and $153 million in 1997 of CMS Energy Common Stock.*

SERP benefits are paidfrom a trust established in 1988. SERP is not a qualified plan under the Internal Revenue Code, and as such, earnings of the trust are taxable and trust assets are included in consolidated assets. At December 31, 1998 and 1997, trust assets were $53 million and $44 million, respectively, and were classified as other noncurrent assets. The accumulated benefit obligation forSERP was $31 million in 1998 and$25 million in 1997.

Contributions to the 40l(k) plan are invested in CMS Energy Common Stock. Amounts charged to expense for this plan were $18 million in 1998, $20 million in 1997, and $18 million in 1996.

Beginning January 1, 1986, the amortization period for the Pension Plan's unrecognized net transition asset is 16 years and 11 years for the SERP's unrecognized net transition obligation. Prior service costs are amortized on a straight-line basis over the average remaining service period of active employees.

CMS Energy and its subsidiaries adopted SFAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* effective as of the beginning of 1992 and Consumers recorded a liabilityof $466million for theaccumulatedtransition obligation and a corresponding regulatory asset for anticipated recovery in utility rates (see Note 2, Utility Regulation). The MPSC authorized recovery of the electric utility portion of these costs in 1994 over 18 years and the gas utility portion in 1996 over 16 years. At December 31, 1998, Consumers had a recorded FERC regulatory asset and liability of $6 million. The FERC has authorized recovery of these costs.

## 13: LEASES

CMS Energy, Consumers, and Enterprises lease various assets, including vehicles, rail cars, aircraft, construction equipment, computer equipment, nuclear fuel and buildings. Consumers' nuclear fuel capital leasing arrangement expires in November 2000, yet provides for additional one-year extensions upon mutual agreement by the parties. Upon termination of the lease, the lessor would be entitled to a cash payment equal to its remaining investment, which was $72 million as of December 31, 1998. Consumers is responsible for payment of taxes, maintenance, operating costs, and insurance.

Minimum rental commitments under CMS Energy's non-cancelable leases at December 31, 1998 were:

| | | *In Millions* |
|---|---|---|
| | Capital Leases | Operating Leases |
| 1999 | $ 46 | $ 20 |
| 2000 | 71 | 19 |
| 2001 | 18 | 16 |
| 2002 | 17 | 15 |
| 2003 | 12 | 12 |
| 2004 and thereafter | 9 | 89 |
| Total minimum lease payments | 173 | $171 |
| Less imputed interest | 33 | |
| Present value of net minimum lease payments | 140 | |
| Less current portion | 35 | |
| Noncurrent portion | $105 | |

Consumers recovers lease charges from customers and accordingly charges payments for its capital and operating leases to operating expense. Operating lease charges, including charges to clearing and other accounts for the years ended December 31, 1998, 1997 and 1996, were $19 million, $10 million and $8 million, respectively.

Capital lease expenses for the years ended December 31, 1998, 1997 and 1996 were $42 million, $43 million and $46 million, respectively. Included in these amounts for the years ended 1998, 1997 and 1996 are nuclear fuel lease expenses of $23 million, $31 million and $25 million, respectively.

## 14: JOINTLY OWNED UTILITY FACILITIES

Consumers is responsible for providing its share of financing for the jointly owned utility facilities. The direct expenses of the joint plants are included in Consumers' operating expenses. The following table indicates the extent of Consumers' investment in jointly owned utility facilities:

| | | | | *In Millions* |
|---|---|---|---|---|
| | Net Investment | | Accumulated Depreciation | |
| December 31 | **1998** | 1997 | **1998** | 1997 |
| Campbell Unit 3—93.3 percent | **$299** | $314 | **$279** | $265 |
| Ludington pumped storage plant—51 percent | **106** | 112 | **94** | 88 |
| Transmission lines—various | **33** | 34 | **15** | 14 |

## 15: REPORTABLE SEGMENTS

CMS Energy operates principally in the following six reportable segments: electric utility; gas utility; independent power production; oil and gas exploration and production; natural gas transmission, storage and processing; and energy marketing, services and trading.

The electric utility segment consists of regulated activities associated with the generation, transmission and distribution of electricity in the State of Michigan. The gas utility segment consists of regulated activities associated with the production, transportation, storage and distribution of natural gas in the State of Michigan. The other reportable segments consist of the development and management of electric, gas and other energy-related projects in the United States and internationally, including energy trading and marketing. CMS Energy's reportable segments are strategic business units organized and managed by the nature of the products and services each provides. The accounting policies of each reportable segment are the same as thosedescribedin the summary of significant accountingpolicies. CMS Energy's management evaluates performance based on pretax operating income. Intersegment sales and transfers are accounted for at current market prices and are eliminated in consolidated pretax operating income by segment.

The Consolidated Statements of Income show operating revenue and pretax operating income by reportable segment. Revenues from an international energy distribution business and a land development business fall below the quantitative thresholds for reporting. Neither of these segments has ever met any of the quantitative thresholds for determining reportable segments. Other financial data for reportable segments and geographic area are as follows:

**Reportable Segments**

| | | | *In Millions* |
|---|---|---|---|
| Years Ended December 31 | **1998** | 1997 | 1996 |
| **Depreciation, Depletion and Amortization** | | | |
| Electric utility | **$ 304** | $ 296 | $ 282 |
| Gas utility | **97** | 93 | 87 |
| Independent power production | **22** | 13 | 8 |
| Oil and gas exploration and production | **38** | 48 | 42 |
| Natural gas transmission, storage and processing | **14** | 14 | 7 |
| Marketing, services and trading | **2** | 1 | — |
| Other | **7** | 2 | 1 |
| | **$ 484** | $ 467 | $ 427 |
| **Identifiable Assets** | | | |
| Electric utility [(a)] | **$ 4,640** | $4,472 | $4,505 |
| Gas utility [(a)] | **1,726** | 1,644 | 1,709 |
| Independent power production | **2,252** | 1,710 | 1,053 |
| Oil and gas exploration and production | **547** | 456 | 476 |
| Natural gas transmission,storage and processing | **971** | 508 | 388 |
| Marketing, services and trading | **152** | 191 | 52 |
| Other | **1,022** | 527 | 180 |
| | **$11,310** | $9,508 | $8,363 |
| **Capital Expenditures** [(b)] | | | |
| Electric utility | **$ 331** | $ 255 | $ 310 |
| Gas utility | **114** | 116 | 137 |
| Independent power production | **462** | 704 | 142 |
| Oil and gas exploration and production | **143** | 99 | 72 |
| Natural gas transmission,storage and processing | **573** | 115 | 136 |
| Marketing, services and trading | **1** | 28 | — |
| Other | **76** | 202 | 66 |
| | **$ 1,700** | $1,519 | $ 863 |

| Years Ended December 31 | 1998 | 1997 | 1996 |
|---|---|---|---|
| | | | *In Millions* |
| **Investments in Equity Method Investees** | | | |
| Independent power production | $ 1,337 | $1,205 | $ 683 |
| Natural gas transmission, storage and processing | 494 | 241 | 225 |
| Marketing, services and trading | 25 | 26 | — |
| Other | 217 | 274 | 85 |
| | $ 2,073 | $1,746 | $ 993 |
| **Earnings from Equity Method Investees** (c) | | | |
| Independent power production | $ 158 | $ 89 | $ 91 |
| Natural gas transmission,storage and processing | 9 | 4 | 3 |
| Marketing, services and trading | 2 | 2 | — |
| Other | 2 | 8 | 8 |
| | $ 171 | $ 103 | $ 102 |

**Geographic Areas** (d)

| | Operating Revenue | Pretax Operating Income | Identifiable Assets |
|---|---|---|---|
| **1998** | | | |
| United States | $4,867 | $ 702 | $8,842 |
| International | 274 | 73 | 2,468 |
| 1997 | | | |
| United States | $4,576 | $ 665 | $7,872 |
| International | 205 | 51 | 1,636 |
| 1996 | | | |
| United States | $4,211 | $ 651 | $7,668 |
| International | 113 | 25 | 695 |

*(a) Amounts include an attributed portion of Consumers' other common assets to both the electric and gas utility businesses.*
*(b) Includes electric restructuring implementation plan, capital leases for nuclear fuel and other assets and electric demand-side management costs (DSM) (see Consolidated Statements of Cash Flows). Amounts also include an attributed portion of Consumers' capital expenditures forplant andequipment commonto boththeelectric and gas utility businesses.*
*(c) These amounts are included in operating revenue in the Consolidated Statements of Income.*
*(d) Revenues are attributed to countries based on location of customers.*

## 16: SUPPLEMENTAL CASH FLOW INFORMATION

For purposes of the Consolidated Statements of Cash Flows, all highly liquid investments with an original maturity of three months or less are considered cash equivalents. Other cash flow activities and noncash investing and financing activities were:

| Years Ended December 31 | 1998 | 1997 | 1996 |
|---|---|---|---|
| | | | *In Millions* |
| **Cash Transactions** | | | |
| Interest paid (net of amounts capitalized) | $313 | $293 | $240 |
| Income taxes paid (net of refunds) | 64 | 67 | 82 |
| **Noncash Transactions** | | | |
| Nuclear fuel placed under capital leases | $ 46 | $ 4 | $ 28 |
| Other assets placed under capital leases | 14 | 7 | 3 |
| Common stock issued to acquire companies | 61 | — | — |
| Assumption of debt | 88 | — | — |

Changes in other assets and liabilities as shown on the Consolidated Statements of Cash Flows are described below:

| Years Ended December 31 | 1998 | 1997 | 1996 |
|---|---|---|---|
| | | | *In Millions* |
| Sale of receivables, net | $ (29) | $ 17 | $ 23 |
| Accounts receivable | (183) | (160) | (28) |
| Accrued revenue | (5) | 64 | (82) |
| Inventories | (42) | (15) | — |
| Accounts payable | 104 | 67 | 55 |
| Accrued refunds | (1) | 4 | (14) |
| Other current assets and liabilities, net | 126 | (6) | 25 |
| Noncurrent deferred amounts, net | (156) | (6) | 10 |
| | $(186) | $(35) | $(11) |

## 17: EQUITY METHOD INVESTMENTS

Certain of CMS Energy's investments in companies, partnerships and joint ventures, where CMS Energy's ownership in its affiliates is more than 20 percent but less than a majority, are accounted for by the equity method. Consolidated net income includes undistributed equity earnings of $95 million in 1998, $58 million in 1997, and $55 million in 1996 from these investments. The more significant of these investments are CMS Energy's 50 percent interest in Loy Yang, a 2,000 MW brown coal-fueled power plant and coal mine in Australia, and CMS Energy's 50 percent interest in Jorf Lasfar, a 1,356 MW coal-fueled power plant in Africa. Summarized combined financial information of CMS Energy's equity method investees follows, except for the MCV Partnership, which is disclosed separately in Note 18.

**Income Statement Data (unaudited)**

| Years Ended December 31 | 1998 | 1997 | 1996 |
|---|---|---|---|
| | | | *In Millions* |
| Operating revenue | $2,255 | $1,603 | $ 769 |
| Operating expenses | 1,503 | 1,154 | 532 |
| Operating income | 752 | 449 | 237 |
| Other expense, net | 409 | 271 | 91 |
| Net income | $ 343 | $ 178 | $ 146 |

**Balance Sheet Data (unaudited)**

| December 31 | 1998 | 1997 |
|---|---|---|
| | | *In Millions* |
| **Assets** | | |
| Current assets | $ 646 | $ 642 |
| Property, plant and equipment, net | 6,783 | 6,304 |
| Other assets | 2,694 | 2,052 |
| | $10,123 | $8,998 |
| **Liabilities and Equity** | | |
| Current liabilities | $ 804 | $ 688 |
| Long-term debt and other noncurrent liabilities | 6,341 | 5,678 |
| Equity | 2,978 | 2,632 |
| | $10,123 | $8,998 |

## 18: SUMMARIZED FINANCIAL INFORMATION OF SIGNIFICANT RELATED ENERGY SUPPLIER

Under the PPA with the MCV Partnership discussed in Note 3, Consumers' 1998 obligation to purchase electric capacity from the MCV Partnership was 15.5 percent of Consumers' owned and contracted capacity. Summarized financial information of the MCV Partnership follows:

**Statements of Income (unaudited)**

| | | | *In Millions* |
|---|---|---|---|
| Years Ended December 31 | **1998** | 1997 | 1996 |
| Operating revenue [(a)] | **$627** | $652 | $645 |
| Operating expenses | **405** | 435 | 417 |
| Operating income | **222** | 217 | 228 |
| Other expense, net | **142** | 154 | 162 |
| Net income before cumulative effect of accounting change | **80** | 63 | 66 |
| Cumulative effect of change in method of accounting for property tax | **—** | 15 | — |
| Net income | **$ 80** | $ 78 | $ 66 |

**Balance Sheets (unaudited)**

| | | *In Millions* |
|---|---|---|
| December 31 | **1998** | 1997 |
| **Assets** | | |
| Current assets [(b)] | **$ 341** | $ 362 |
| Plant, net | **1,773** | 1,820 |
| Other assets | **173** | 169 |
| | **$2,287** | $2,351 |
| **Liabilities and Equity** | | |
| Current liabilities | **$ 204** | $ 285 |
| Noncurrent liabilities [(c)] | **1,725** | 1,789 |
| Partners' equity [(d)] | **358** | 277 |
| | **$2,287** | $2,351 |

*(a) Revenue from Consumers totaled $584 million,$609 million and $598 million for 1998, 1997 and 1996, respectively.*
*(b) Receivables from Consumers totaled $49 million and $54 million, at December 31, 1998 and 1997, respectively.*
*(c) FMLP is the sole beneficiary of an owner-trust that is the lessor in a long-term direct finance lease with the lessee, MCV Partnership. CMS Holdings holds a 46.4 percent ownership interest in FMLP. At December 31,1998 and 1997, lease obligations of $1.41 billion and $1.52 billion, respectively, were owed to the owner trust. CMS Holdings' share of the interest and principal portion for the 1998 lease payments was $59 million and $49 million, respectively, and for the 1997 lease payments was $62 million and $28 million, respectively. The lease payments service $907 million and $1,016 million in nonrecourse debt outstanding as of December 31, 1998 and 1997, respectively, of the owner-trust. FMLP's debt is secured by the MCV Partnership's lease obligations, assets, and operating revenues. For 1998 and 1997, the owner-trust made debt payments (including interest) of $233 million and $192 million, respectively. FMLP's earnings for 1998,1997 and 1996 were $23 million,$20 million and $17 million, respectively.*
*(d) CMS Midland's recorded investment in the MCV Partnership includes capitalized interest, which is being amortized to expense over the life of its investment in the MCV Partnership. Covenants contained in financing agreements prohibit the MCV Partnership from paying distributions until certain financial test requirements are met. Consumers does not anticipate receiving a cash distribution in the near future.*

## 19: SUBSEQUENT EVENT

In 1999, CMS Energy completed the acquisition of the Panhandle Companies from Duke Energy Corporation for a cash payment of $1.9 billion and existing Panhandle Companies debt of $300 million. The Panhandle Companies are primarily engaged in the interstate transportation and storage of natural gas. The transaction will be accounted for under the purchase method of accounting.

The acquisition of the Panhandle Companies initially was financed in part with bridge loan facilities negotiated with domestic banks and in part with approximately $800 million of debt securities issued by the Panhandle Companies. CMS Energy expects to permanently finance the acquisition with existing arrangements as well as the sale of approximately $600 million of CMS Energy Common Stock and other CMS Energy securities.

The following unaudited pro forma combined selected financial information assumes: (i) various restructuring, realignment and elimination of activities between the Panhandle Companies and Duke Energy Corporation prior to closing; (ii) adjustments resulting from the acquisition; and (iii) Panhandle Companies and CMS Energy financing transactions (except bridge financing fees) completed to facilitate the acquisition, as if the acquisition had occurred on January 1, 1998. Unaudited pro forma amounts for operating revenue, consolidated net income, basic earnings per share and total assets were $5.6 billion, $319 million, $2.66 and $13.8 billion, respectively.

# Report of Independent Public Accountants

**TO CMS ENERGY CORPORATION:**

We have audited the accompanying consolidated balance sheets and consolidated statements of preferred stock of CMS Energy Corporation (a Michigan corporation) and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, common stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based upon our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CMS Energy Corporation and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998 in conformity with generally accepted accounting principles.

As discussed in Note 2 to the financial statements, effective January 1, 1998, Consumers Energy Company, a wholly owned subsidiary of CMS Energy Corporation, changed its method of accounting for property taxes.

ARTHUR ANDERSEN LLP

Detroit, Michigan,
January 26, 1999 (except with respect to the matters disclosed in Note 3, "Consumers' Electric Utility Rate Matters," and Note 19, as to which the date is March 29, 1999).

# Quarterly Financial and Common Stock Information

*In Millions, Except Per Share Amounts*

| | **1998 (Unaudited)** | | | | 1997 (Unaudited) | | | |
|---|---|---|---|---|---|---|---|---|
| Quarters Ended | **March 31** | **June 30** | **Sept. 30** | **Dec. 31** | March 31 | June 30 | Sept. 30 | Dec. 31 |
| Operating revenue [(a)] | **$1,374** | **$1,132** | **$1,286** | **$1,349** | $1,295 | $1,022 | $1,030 | $1,434 |
| Pretax operating income [(a)] | **$ 197** | **$ 188** | **$ 222** | **$ 168** | $ 204 | $ 158 | $ 178 | $ 176 |
| Consolidated net income [(a)] | **$ 88** | **$ 65** | **$ 81** | **$ 51** | $ 78 | $ 47 | $ 60 | $ 59 |
| Basic earnings (loss) per average common share: [(b)] | | | | | | | | |
| CMS Energy [(a)] | **$ .79** | **$ .63** | **$ .81** | **$ .44** | $ .73 | $ .48 | $ .64 | $ .54 |
| Class G | **$ 1.09** | **$ .12** | **$ (.16)** | **$ .52** | $ 1.18 | $ .16 | $ (.21) | $ .70 |
| Diluted earnings (loss) per average common share: [(b)] | | | | | | | | |
| CMS Energy [(a)] | **$ .77** | **$ .62** | **$ .80** | **$ .44** | $ .72 | $ .48 | $ .63 | $ .54 |
| Class G | **$ 1.09** | **$ .12** | **$ (.16)** | **$ .52** | $ 1.18 | $ .16 | $ (.21) | $ .70 |
| Dividends declared per common share: | | | | | | | | |
| CMS Energy | **$ .30** | **$ .30** | **$ .33** | **$ .33** | $ .27 | $ .27 | $ .30 | $ .30 |
| Class G | **$ .31** | **$ .31** | **$ .325** | **$ .325** | $ .295 | $ .295 | $ .31 | $ .31 |
| Common stock prices [(c)] | | | | | | | | |
| CMS Energy: | | | | | | | | |
| High | **$ 47 5/16** | **$ 47 3/16** | **$ 44 3/4** | **$ 50 1/8** | $ 34 1/2 | $ 35 5/8 | $ 38 1/16 | $ 44 1/16 |
| Low | **$ 41 7/8** | **$ 40 11/16** | **$ 38 3/4** | **$ 43 3/16** | $ 31 1/2 | $ 31 1/8 | $ 34 7/8 | $ 35 11/16 |
| Class G: | | | | | | | | |
| High | **$ 26 5/8** | **$ 26 7/8** | **$ 25 1/4** | **$ 26 1/2** | $ 19 7/8 | $ 19 7/8 | $ 22 | $ 27 1/8 |
| Low | **$ 22 1/4** | **$ 23 1/4** | **$ 21 3/8** | **$ 23 1/8** | $ 17 7/8 | $ 17 5/8 | $ 19 | $ 20 5/8 |

*(a) Amounts in the first quarter of 1998 and 1997 were restated for comparative purposes.*
*(b) The sum of the quarters may not equal the annual earnings per share due to changes in shares outstanding.*
*(c) Based on New York Stock Exchange—Composite transactions.*

# Selected Financial Information

| | | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|
| Operating revenue (in millions) | ($) | **5,141** | 4,781 | 4,324 | 3,890 | 3,614 |
| Consolidated net income (in millions) | ($) | **285** | 244 | 224 | 195 | 177 |
| Average common shares outstanding (in thousands) | | | | | | |
| CMS Energy | | **102,446** | 96,144 | 92,462 | 88,810 | 85,888 |
| Class G | | **8,333** | 8,015 | 7,727 | 7,511 | — |
| Earnings per average common share | | | | | | |
| CMS Energy—Basic | ($) | **2.65** | 2.39 | 2.27 | 2.16 | 2.07 |
| —Diluted | ($) | **2.62** | 2.37 | 2.26 | 2.16 | 2.06 |
| Class G —Basic and Diluted | ($) | **1.56** | 1.84 | 1.82 | .38 | — |
| Cash from operations (in millions) | ($) | **516** | 624 | 647 | 640 | 603 |
| Capital expenditures, excludes capital lease additions and DSM (in millions) | ($) | **1,295** | 678 | 643 | 508 | 575 |
| Total assets (in millions) | ($) | **11,310** | 9,508 | 8,363 | 7,909 | 7,159 |
| Long-term debt, excluding current maturities (in millions) | ($) | **4,726** | 3,272 | 2,842 | 2,906 | 2,709 |
| Noncurrent portion of capital leases (in millions) | ($) | **105** | 75 | 103 | 106 | 108 |
| Total preferred stock (in millions) | ($) | **238** | 238 | 356 | 356 | 356 |
| Total Trust Preferred Securities (in millions) | ($) | **393** | 393 | 100 | — | — |
| Cash dividends declared per common share | | | | | | |
| CMS Energy | ($) | **1.26** | 1.14 | 1.02 | .90 | .78 |
| Class G | ($) | **1.27** | 1.21 | 1.15 | .56 | — |
| Market price of common stock at year-end | | | | | | |
| CMS Energy | ($) | **48 7/16** | 44 1/16 | 33 5/8 | 29 7/8 | 22 7/8 |
| Class G | ($) | **25 1/4** | 27 1/8 | 18 3/8 | 18 7/8 | — |
| Book value per common share at year-end | | | | | | |
| CMS Energy | ($) | **19.61** | 16.84 | 15.24 | 13.51 | 11.16 |
| Class G | ($) | **11.46** | 10.91 | 11.38 | 10.60 | — |
| Return on average common equity | (%) | **14.2** | 14.7 | 15.7 | 17.1 | 19.8 |
| Return on assets | (%) | **5.5** | 5.6 | 5.4 | 5.2 | 5.0 |
| Number of employees at year-end (full-time equivalents) | | **9,710** | 9,682 | 9,712 | 10,105 | 9,972 |
| **Electric Utility Statistics** | | | | | | |
| Sales (billions of kWh) | | **40.0** | 37.9 | 37.1 | 35.5 | 34.5 |
| Customers (in thousands) | | **1,640** | 1,617 | 1,594 | 1,570 | 1,547 |
| Average sales rate per kWh | (¢) | **6.50** | 6.57 | 6.55 | 6.36 | 6.29 |
| **Gas Utility Statistics** | | | | | | |
| Sales and transportation deliveries (bcf) | | **360** | 420 | 448 | 404 | 409 |
| Customers (in thousands) [(a)] | | **1,558** | 1,533 | 1,504 | 1,476 | 1,448 |
| Average sales rate per mcf | ($) | **4.56** | 4.44 | 4.45 | 4.42 | 4.48 |
| **International Energy-Related Statistics** | | | | | | |
| CMS Energy's share of unconsolidated independent power production revenue (in millions) | ($) | **761** | 621 | 493 | 497 | 385 |
| Independent power production sales (millions of kWh) | | **19,017** | 13,126 | 7,823 | 7,422 | 6,216 |
| CMS Energy's share of unconsolidated natural gas transmission, storage and processing revenue (in millions) | ($) | **67** | 51 | 42 | 26 | 7 |
| CMS Energy's share of unconsolidated marketing, services and trading revenue | ($) | **291** | 202 | — | — | — |
| Gas managed and marketed for end users (bcf) | | **366** | 243 | 108 | 101 | 66 |
| **Exploration and Production Statistics** | | | | | | |
| Sales (millions of net equivalent barrels) | | **12.1** | 11.4 | 10.1 | 9.0 | 5.6 |
| Proved reserves (millions of net equivalent barrels) | | **182.6** | 152.0 | 133.5 | 124.5 | 108.0 |
| Proved reserves added (millions of net equivalent barrels) [(b)] | | **42.7** | 29.8 | 18.7 | 25.6 | 29.0 |
| Finding cost per net equivalent barrel [(b)] | ($) | **3.35** | 2.38 | 2.94 | 5.06 | 5.92 |

*(a) Excludes off-system transportation customers.*
*(b) Certain prior year amounts were restated for comparative purposes.*

# Shareholder Information

**1999 ANNUAL MEETING:**
CMS Energy's 1999 annual meeting is scheduled for 10:30 a.m. on May 28 at the Dearborn Inn, Dearborn, Michigan. Proxy material will be mailed in April.

**REGISTERED SHAREHOLDERS:**
As of February 19, 1999, the number of registered shareholders totaled 65,871 for CMS Energy Common Stock and 5,071 for Class G Common Stock.

**SHAREHOLDER CONTACTS:**
Inquiries about stock ownership, stock purchase, change of address, dividend payments, dividend reinvestment or the Stock Purchase Plan may be directed to:
Investor Services Department
212 W. Michigan Ave.
Jackson, MI 49201
(517) 788-1868 or send an E-mail to invest@cmsenergy.com

For financial and operating information, please contact:
Investor Relations Department
212 W. Michigan Ave.
Jackson, MI 49201
(517) 788-2590

**STOCK PURCHASE PLAN:**
Investors can buy shares of CMS Energy Common Stock and Class G Common Stock directly through the Corporation's Stock Purchase Plan, with no brokerage commission or service charge. Other plan features include dividend reinvestment, certificate safekeeping, direct deposit of dividends, automatic investment, sale of shares and gifting of shares. For more information and a plan prospectus, please contact the Investor Services Department or click on the "Invest in CMS Energy" icon at www.cmsenergy.com.

**STOCK OWNERSHIP:**
As a CMS Energy shareholder, you have the option of direct stock ownership or indirect stock ownership. Under direct stock ownership, the shares are registered in your name; you can purchase additional shares directly from the company with no commissions or service charge; you enjoy the benefits of direct communication to and from CMS Energy; and you can participate in the CMS Energy stock purchase plan. Under indirect stock ownership, your shares are held in "street name" by a broker, and your dividend payments come through a broker rather than directly from CMS Energy. (For more information on direct and indirect ownership, please contact the Investor Services Department for the brochure "Stock Ownership: What Every Investor Should Know.")

**DIRECT DEPOSIT AND AUTOMATIC INVESTMENT:**
CMS Energy can deposit your dividends directly into your bank account. We also offer automatic investment from your bank account to purchase CMS Common Stock and Class G Common Stock and keep your investment in CMS Energy growing. Please contact the Investor Services Department for more information.

**ELIMINATING DUPLICATE MAILINGS:**
To maintain more than one account, but eliminate duplicate mailings of annual and quarterly reports, send the labels from company mailings to the Investor Services Department, indicating the names you wish to keep on the mailing list. (Dividend checks and proxy materials will continue to be sent to each account.)

**CONSOLIDATING ACCOUNTS:**
To consolidate separate accounts into one account, contact the Investor Services Department.

**OBTAINING REPORTS:**
Shareholders may obtain without charge and exclusive of exhibits: CMS Energy's Form 10–K and an audiocassette recording of the annual report text. Please address all requests to the Investor Services Department.

**STOCK EXCHANGE LISTING:**
CMS Energy Common Stock is listed on the New York Stock Exchange under the symbol CMS. Class G Common Stock is listed under the symbol CPG.

**TRANSFER AGENT, REGISTRAR AND PAYING AGENT:**
Investor Services Department, 212 W. Michigan Ave., Jackson, Michigan 49201

Follow CMS Energy on the Internet:
http://www.cmsenergy.com

# Officers

## CMS ENERGY

**William T. McCormick Jr.**, 54
*Chairman of the Board and Chief Executive Officer*

**Victor J. Fryling**, 51
*President and Chief Operating Officer*

**Alan M. Wright**, 53
*Senior Vice President and Chief Financial Officer*

**Rodger A. Kershner**, 50
*Senior Vice President and General Counsel*

**John W. Clark**, 54
*Senior Vice President, Communications*

**James W. Cook**, 58
*Senior Vice President, Technology and Development*

**Preston D. Hopper**, 48
*Senior Vice President, Corporate Performance and Chief Accounting Officer*

**John F. Drake**, 50
*Vice President, Human Resources*

**Thomas A. McNish**, 61
*Vice President and Secretary*

**Laura L. Mountcastle**, 42
*Vice President, Planning and Investor Relations*

**Martin R. Walicki**, 48
*Vice President, Corporate Finance and Treasurer*

## CONSUMERS ENERGY

**William T. McCormick Jr.**, 54
*Chairman of the Board*

**Victor J. Fryling**, 51
*Vice Chairman of the Board*

**Paul A. Elbert**, 49
*Executive Vice President and President and Chief Executive Officer, Gas*

**David W. Joos**, 45
*Executive Vice President and President and Chief Executive Officer, Electric*

**Alan M. Wright**, 53
*Senior Vice President and Chief Financial Officer*

**John W. Clark**, 54
*Senior Vice President, Communications*

**David A. Mikelonis**, 50
*Senior Vice President and General Counsel*

**Robert A. Fenech**, 51
*Senior Vice President, Nuclear, Fossil and Hydro Operations*

**Helen Blohm**, 48
*Vice President, Retail Services*

**Dennis DaPra**, 56
*Vice President and Controller*

**Kenneth C. Emery**, 51
*Vice President, Information Technology and Operations Services*

**Carl L. English**, 52
*Vice President, Electric Transmission and Distribution*

**Thomas A. McNish**, 61
*Vice President and Secretary*

**Thomas J. Palmisano**, 48
*Site Vice President, Palisades*

**Paul N. Preketes**, 49
*Vice President, Gas Operations*

**Martin R. Walicki**, 48
*Vice President, Corporate Finance and Treasurer*

## CMS ENTERPRISES

**Doris F. Galvin**, 44
*Senior Vice President, Global Development*

**Belinda M. Foxworth**, 40
*Vice President and Deputy General Counsel*

**M. Clifford Lawrenson**, 38
*Vice President, Project Finance*

**Theodore J Vogel**, 46
*Vice President, Taxes and Tax Counsel*

**Martin R. Walicki**, 48
*Vice President, Corporate Finance and Treasurer*

## CMS OIL AND GAS

**Victor J. Fryling**, 51
*Chairman of the Board*

**Bradley W. Fischer**, 52
*President and Chief Executive Officer*

**William H. Stephens III**, 49
*Executive Vice President, General CounselandSecretary*

**Paul A. Doyle**, 47
*Vice President, Engineering*

**T. Rodney Dykes**, 42
*Vice President, Operations*

**Robert C. Olson**, 55
*Vice President, Exploration*

**Mark E. Stirl**, 44
*Vice President and Controller*

## CMS GENERATION

**Victor J. Fryling**, 51
*Chairman of the Board*

**Rodney E. Boulanger**, 58
*President and Chief Executive Officer*

**Thomas W. Elward**, 50
*Senior Vice President, Operations and Asset Management*

**Narendra K. Bhatia**, 63
*Vice President, Engineering and Construction*

## CMS GAS TRANSMISSION AND STORAGE

**Victor J. Fryling**, 51
*Chairman of the Board*

**William J. Haener**, 57
*President and Chief Executive Officer*

**Christopher A. Helms**, 45
*Executive Vice President and President of CMS Panhandle Pipe Line*

**John D. Kobasa**, 58
*Vice President, Engineering, Operations and Construction*

**Thomas L. Miller**, 43
*Vice President, Business Analysis*

## CMS MARKETING, SERVICES AND TRADING

**Victor J. Fryling**, 51
*Chairman of the Board*

**William W. Schivley**, 52
*Executive Vice President and Chief Operating Officer*

**David B. Geyer**, 35
*Vice President, Risk Management*

**Royal P. Lefere Jr.**, 51
*Vice President, Energy Management Services*

## CMS ELECTRIC AND GAS

**Victor J. Fryling**, 51
*Chairman of the Board*

**Prateep Ghose**, 58
*Vice President, International Electric and Gas Distribution*

**Frank Johnson**, 51
*Vice President, Distribution Operations*

## INTERNATIONAL OFFICES

### Singapore — Asia

**David W. Weaver**, 49
*Vice President, Development*

### Dearborn — The Americas — Northern Hemisphere

**William J. Haener**, 57
*Vice President, Development*

**Karl R. Wittbold**, 42
*Vice President*

### London — Africa/Middle East

**Joseph P. Tomasik**, 44
*Vice President, Development*

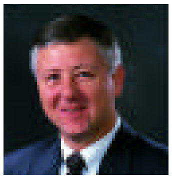
### Buenos Aires — The Americas — Southern Hemisphere

**Francisco A. Mezzadri**, 62
*Regional General Manager*

**John M. McLaughlin Jr.**, 48
*Vice President, Development*

# CMS Energy Board of Directors

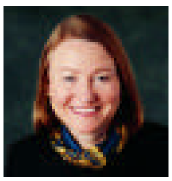
**William T. McCormick Jr.,** 54, Chairman of the Board and Chief Executive Officer of CMS Energy and Chairman of Consumers Energy. Director of Bank One Corporation, Rockwell International Corporation and Schlumberger Ltd. Director since 1985.



**Victor J. Fryling,** 51, President and Chief Operating Officer of CMS Energy and Vice Chairman of Consumers Energy. Director since 1990.

**John M. Deutch,** 60, Institute Professor, Massachusetts Institute of Technology. Director of Citigroup Inc., Schlumberger Ltd., ARIAD Pharmaceuticals Inc., Raytheon Company and Cummins Engine Company Inc. Director 1986–1993 and since 1997.

**James J. Duderstadt,** 56, President Emeritus and Professor of Science and Engineering, The University of Michigan, Ann Arbor, Mich. Director of Unisys Corporation. Director since 1993.

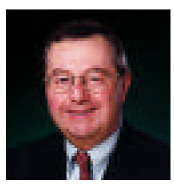


**Kathleen R. Flaherty,** 47, President and Chief Operating Officer, WinStar Communications, Europe. Director since 1995.

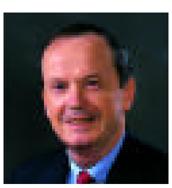
**Earl D. Holton,** 65, Vice Chairman, Meijer Inc., Grand Rapids, Mich. Director of Meijer Inc. and Steelcase Inc. Director since 1989.

**William U. Parfet,** 52, Co-chairman, MPI Research, Mattawan, Mich. Director of Pharmacia & Upjohn Inc., Stryker Corporation, ClinTrials Research Inc. and Sybron International Corporation. Director since 1991.

**Percy A. Pierre,** 60, Professor of Electrical Engineering, Michigan State University, East Lansing, Mich. Director of Old Kent Financial Corporation, the Whitman Education Group and Aerospace Corporation. Director since 1990.



**Kenneth L. Way,** 59, Chairman and Chief Executive Officer, Lear Corporation. Director of Lear Corporation, Comerica Inc. and WESCO International Inc. Director since 1998.



**Kenneth Whipple,** 64, Retired Executive Vice President, Ford Motor Company, Chairman of Ford Motor Credit and President, Ford Financial Services Group, Dearborn, Mich. Director of Associates First Capital Corp. and Galileo International, Inc. Director since 1993.

**John B. Yasinsky,** 59, Chairman, Chief Executive Officer and President, GenCorp, Fairlawn, Ohio. Director of GenCorp. Director since 1994.

# International Advisory Committee

**John M. Deutch,** Institute Professor and former Provost, Massachusetts Institute of Technology. Formerly Director of the Central Intelligence Agency; U.S. Deputy Secretary and Undersecretary of Defense; and Undersecretary of U.S. Department of Energy.

**Thomas E. Donilon,** Chairman of the Committee, partner with international law firm of O'Melveny & Myers L.L.P. Formerly Assistant Secretary of State for Public Affairs, and Chief of Staff to the Secretary of State.

**Arnold Kanter,** a principal in the Scowcroft Group, an international consulting firm, and a Senior Fellow at the RAND Corporation. Formerly Undersecretary of State for Political Affairs, U.S. Department of State; and Special Assistant to the President for National Security Affairs.

**Linda Yuen-Ching Lim,** Associate Professor of International Business and Director of the Southeast Asia Business Program at The University of Michigan. Founder and first Director of the University's Center for International Business Education. Founder and editor of *The Journal of Asian Business*.

**Moises Naim,** editor of *Foreign Policy*, teaches at Johns Hopkins and at IESA, a leading South American business school and policy research center. Formerly Senior Associate at the Carnegie Endowment for International Peace; Senior Adviser to the President of the World Bank; Dean of IESA; and Venezuela Minister of Trade and Industry.

**Peter Tarnoff,** President of the International Advisory Corporation. Formerly Undersecretary of State for Political Affairs, U.S. Department of State; President of the Council on Foreign Relations; and Executive Director of the World Affairs Council of Northern California.

**Frank G. Wisner,** Vice Chairman, External Affairs of American International Group, Inc. Formerly Undersecretary of State for International Security Affairs, U.S. Department of State; and U.S. Ambassador to Zambia, Egypt, the Philippines and India, retiring from the latter post in 1997 with the rank of Career Ambassador.

**World Headquarters**
Fairlane Plaza South
Suite 1100
330 Town Center Drive
Dearborn, MI 48126

**Principal Offices**
Abu Dhabi, United Arab Emirates
Ankara, Turkey
Buenos Aires, Argentina
Casablanca, Morocco
Chennai, India
Houston, Texas
Jackson, Michigan
London, England
Rio de Janeiro, Brazil
Santiago, Chile
Singapore
Tulsa, Oklahoma
Washington, DC

Bulk Rate
U.S. Postage
PAID
CMS Energy
Corporation