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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**Form 10-Q**

(Mark one)

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

For the Quarterly Period Ended March 31, 2003

or

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

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

Commission file number 000-24890

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**EDISON MISSION ENERGY**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**95-4031807**

(I.R.S. Employer Identification No.)

**18101 Von Karman Avenue**

**Irvine, California**

(Address of principal executive offices)

**92612**

(Zip Code)

Registrant's telephone number, including area code: **(949) 752-5588**

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). YES  NO

Number of shares outstanding of the registrant's Common Stock as of May 14, 2003: 100 shares (all shares held by an affiliate of the registrant).

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**PART I—FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**EDISON MISSION ENERGY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands)

	<b>Three Months Ended March 31,</b>	
	<b>2003</b>	<b>2002</b>
	<b>(Unaudited)</b>	
<b>Operating Revenues</b>		
Electric revenues . . . . .	\$680,933	\$505,817
Net gains (losses) from price risk management and energy trading . . . . .	(6,830)	21,366
Operation and maintenance services . . . . .	9,357	9,534
Total operating revenues . . . . .	<u>683,460</u>	<u>536,717</u>
<b>Operating Expenses</b>		
Fuel . . . . .	276,887	204,572
Plant operations and transmission costs . . . . .	202,826	183,152
Plant operating leases . . . . .	51,468	52,029
Operation and maintenance services . . . . .	6,379	7,102
Depreciation and amortization . . . . .	71,831	57,439
Administrative and general . . . . .	38,047	45,072
Total operating expenses . . . . .	<u>647,438</u>	<u>549,366</u>
Operating income (loss) . . . . .	<u>36,022</u>	<u>(12,649)</u>
<b>Other Income (Expense)</b>		
Equity in income from unconsolidated affiliates . . . . .	63,837	52,574
Interest and other income . . . . .	6,778	10,260
Interest expense . . . . .	(116,823)	(113,130)
Dividends on preferred securities . . . . .	(5,594)	(5,136)
Total other income (expense) . . . . .	<u>(51,802)</u>	<u>(55,432)</u>
Loss from continuing operations before income taxes and minority interest . . .	(15,780)	(68,081)
Benefit for income taxes . . . . .	(11,360)	(32,279)
Minority interest . . . . .	(4,061)	(5,366)
<b>Loss From Continuing Operations</b> . . . . .	<u>(8,481)</u>	<u>(41,168)</u>
Income from operations of discontinued foreign subsidiaries, net of tax (Note 6) . . . . .	228	5,329
<b>Loss Before Accounting Change</b> . . . . .	<u>(8,253)</u>	<u>(35,839)</u>
Cumulative effect of change in accounting, net of tax (Notes 3 and 12) . . . . .	(8,571)	(13,986)
<b>Net Loss</b> . . . . .	<u><u>\$ (16,824)</u></u>	<u><u>\$ (49,825)</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

**EDISON MISSION ENERGY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
(In thousands)

	Three Months Ended March 31,	
	2003	2002
	(Unaudited)	
<b>Net Loss</b> .....	\$(16,824)	\$(49,825)
Other comprehensive income, net of tax:		
Foreign currency translation adjustments:		
Foreign currency translation adjustments, net of income tax expense of \$965 and \$867 for the three months ended March 31, 2003 and 2002, respectively .....	21,288	15,859
Minimum pension liability adjustment .....	201	—
Unrealized gains (losses) on derivatives qualified as cash flow hedges:		
Other unrealized holding gains (losses) arising during period, net of income tax expense (benefit) of \$(17,596) and \$11,457 for the three months ended March 31, 2003 and 2002, respectively .....	(3,147)	38,085
Reclassification adjustments included in net loss, net of income tax expense (benefit) of \$(3,932) and \$428 for the three months ended March 31, 2003 and 2002, respectively .....	(1,269)	706
Other comprehensive income .....	17,073	54,650
<b>Comprehensive Income</b> .....	\$ 249	\$ 4,825

The accompanying notes are an integral part of these consolidated financial statements.

**EDISON MISSION ENERGY AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands)

	<u>March 31, 2003</u>	<u>December 31, 2002</u>
	<u>(Unaudited)</u>	
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents . . . . .	\$ 653,651	\$ 647,164
Accounts receivable—trade, net of allowance of \$12,316 and \$13,113 in 2003 and 2002, respectively . . . . .	379,677	296,193
Accounts receivable—affiliates . . . . .	32,103	39,456
Assets under price risk management and energy trading . . . . .	48,126	33,742
Inventory . . . . .	159,443	176,437
Prepaid expenses and other . . . . .	149,680	169,262
Total current assets . . . . .	<u>1,422,680</u>	<u>1,362,254</u>
<b>Investments in Unconsolidated Affiliates</b> . . . . .	<u>1,681,093</u>	<u>1,645,253</u>
<b>Property, Plant and Equipment</b> . . . . .	8,077,943	7,649,791
Less accumulated depreciation and amortization . . . . .	979,015	888,060
Net property, plant and equipment . . . . .	<u>7,098,928</u>	<u>6,761,731</u>
<b>Other Assets</b>		
Goodwill . . . . .	734,676	659,837
Deferred financing costs . . . . .	52,081	55,553
Long-term assets under price risk management and energy trading . . . . .	121,615	112,571
Restricted cash and other . . . . .	506,237	484,850
Total other assets . . . . .	<u>1,414,609</u>	<u>1,312,811</u>
<b>Assets of Discontinued Operations</b> . . . . .	<u>5,795</u>	<u>10,273</u>
<b>Total Assets</b> . . . . .	<u>\$11,623,105</u>	<u>\$11,092,322</u>

The accompanying notes are an integral part of these consolidated financial statements.

**EDISON MISSION ENERGY AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands)

	<u>March 31, 2003</u>	<u>December 31, 2002</u>
	<u>(Unaudited)</u>	
<b>Liabilities and Shareholder's Equity</b>		
<b>Current Liabilities</b>		
Accounts payable—affiliates . . . . .	\$ 21,653	\$ 12,244
Accounts payable and accrued liabilities . . . . .	465,708	456,518
Liabilities under price risk management and energy trading . . . . .	134,135	44,538
Interest payable . . . . .	89,891	91,789
Short-term obligations . . . . .	126,916	77,551
Current maturities of long-term obligations . . . . .	1,204,988	1,089,918
Total current liabilities . . . . .	<u>2,043,291</u>	<u>1,772,558</u>
<b>Long-Term Obligations Net of Current Maturities . . . . .</b>	<u>5,104,912</u>	<u>4,872,012</u>
<b>Long-Term Deferred Liabilities</b>		
Deferred taxes and tax credits . . . . .	1,200,775	1,180,523
Deferred revenue . . . . .	479,978	454,438
Long-term incentive compensation . . . . .	29,036	29,486
Long-term liabilities under price risk management and energy trading . . . . .	136,855	162,484
Other . . . . .	206,117	219,703
Total long-term deferred liabilities . . . . .	<u>2,052,761</u>	<u>2,046,634</u>
<b>Liabilities of Discontinued Operations . . . . .</b>	<u>2,723</u>	<u>3,024</u>
<b>Total Liabilities . . . . .</b>	<u>9,203,687</u>	<u>8,694,228</u>
<b>Minority Interest . . . . .</b>	<u>437,722</u>	<u>423,844</u>
<b>Preferred Securities of Subsidiaries</b>		
Company-obligated mandatorily redeemable security of partnership holding solely parent debentures . . . . .	150,000	150,000
Subject to mandatory redemption . . . . .	138,425	131,225
Total preferred securities of subsidiaries . . . . .	<u>288,425</u>	<u>281,225</u>
<b>Commitments and Contingencies (Note 7)</b>		
<b>Shareholder's Equity</b>		
Common stock, par value \$0.01 per share; 10,000 shares authorized; 100 shares issued and outstanding . . . . .	64,130	64,130
Additional paid-in capital . . . . .	2,632,917	2,632,886
Retained deficit . . . . .	(808,628)	(791,770)
Accumulated other comprehensive loss . . . . .	(195,148)	(212,221)
<b>Total Shareholder's Equity . . . . .</b>	<u>1,693,271</u>	<u>1,693,025</u>
<b>Total Liabilities and Shareholder's Equity . . . . .</b>	<u>\$11,623,105</u>	<u>\$11,092,322</u>

The accompanying notes are an integral part of these consolidated financial statements.

**EDISON MISSION ENERGY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2003</b>	<b>2002</b>
	<b>(Unaudited)</b>	
<b>Cash Flows From Operating Activities</b>		
Loss from continuing operations, after accounting change, net . . . . .	\$ (17,052)	\$ (55,154)
Adjustments to reconcile income to net cash provided by (used in) operating activities:		
Equity in income from unconsolidated affiliates . . . . .	(63,837)	(52,574)
Distributions from unconsolidated affiliates . . . . .	29,946	139,953
Depreciation and amortization . . . . .	71,831	57,439
Deferred taxes and tax credits . . . . .	(18,011)	(38,043)
Cumulative effect of change in accounting, net of tax . . . . .	8,571	13,986
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable . . . . .	(57,473)	35,199
Decrease (increase) in inventory . . . . .	18,247	(12,635)
Decrease in prepaid expenses and other . . . . .	33,602	21,042
Increase (decrease) in accounts payable and accrued liabilities . . . . .	12,265	(69,281)
Decrease in interest payable . . . . .	(3,246)	(813)
Increase in long-term incentive compensation . . . . .	818	822
Decrease (increase) in net assets under risk management . . . . .	5,384	(22,114)
Other operating, net . . . . .	(23,006)	(6,818)
	<u>(1,961)</u>	<u>11,009</u>
Operating cash flow from discontinued operations . . . . .	20	257
Net cash provided by (used in) operating activities . . . . .	<u>(1,941)</u>	<u>11,266</u>
<b>Cash Flows From Financing Activities</b>		
Borrowings on long-term debt and lease swap agreements . . . . .	226,797	88,706
Payments on long-term debt agreements . . . . .	(36,104)	(33,984)
Short-term financing and lease swap agreements, net . . . . .	133,624	(81,292)
Financing costs . . . . .	(1,098)	—
	<u>323,219</u>	<u>(26,570)</u>
Financing cash flow from discontinued operations . . . . .	—	(3,971)
Net cash provided by (used in) financing activities . . . . .	<u>323,219</u>	<u>(30,541)</u>
<b>Cash Flows From Investing Activities</b>		
Investments in and loans to energy projects . . . . .	(22,321)	1,224
Purchase of common stock of acquired companies . . . . .	(274,813)	—
Purchase of power sales agreement . . . . .	—	(80,084)
Capital expenditures . . . . .	(56,484)	(133,096)
Proceeds from return of capital and loan repayments . . . . .	11,903	83,606
Proceeds from sale of interest in projects . . . . .	—	43,986
Decrease in restricted cash . . . . .	3,200	87,682
Investments in other assets . . . . .	10,071	573
Other, net . . . . .	—	(6,037)
	<u>(328,444)</u>	<u>(2,146)</u>
Investing cash flow from discontinued operations . . . . .	4,434	999
Net cash used in investing activities . . . . .	<u>(324,010)</u>	<u>(1,147)</u>
Effect of exchange rate changes on cash . . . . .	9,268	2,885
Net increase (decrease) in cash and cash equivalents . . . . .	6,536	(17,537)
Cash and cash equivalents at beginning of period . . . . .	647,240	434,249
Cash and cash equivalents at end of period . . . . .	653,776	416,712
Cash and cash equivalents classified as part of discontinued operations . . . . .	(125)	(69,603)
Cash and cash equivalents of continuing operations . . . . .	<u>\$ 653,651</u>	<u>\$ 347,109</u>

The accompanying notes are an integral part of these consolidated financial statements.

**EDISON MISSION ENERGY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2003**  
**(Dollars in millions)**

**Note 1. General**

In the opinion of management, all adjustments, including recurring accruals, have been made that are necessary to present fairly the consolidated financial position and results of operations for the periods covered by this report. The results of operations for the three months ended March 31, 2003 are not necessarily indicative of the operating results for the full year.

Edison Mission Energy's (EME's) significant accounting policies are described in Note 2 to its Consolidated Financial Statements as of December 31, 2002 and 2001, included in EME's annual report on Form 10-K for the year ended December 31, 2002. EME follows the same accounting policies for interim reporting purposes. This quarterly report should be read in connection with such financial statements.

Terms used but not defined in this report are defined in EME's annual report on Form 10-K for the year ended December 31, 2002. Certain prior period amounts have been reclassified to conform to the current period financial statement presentation. These reclassifications had no effect on net income or shareholder's equity.

*Current Developments*

A number of significant developments during late 2001 and 2002 adversely affected independent power producers and subsidiaries of major integrated energy companies that sell a sizable portion of their generation into the wholesale energy market (sometimes referred to as merchant generators), including several of EME's subsidiaries. These developments included lower market prices in wholesale energy markets both in the United States and United Kingdom, significant declines in the credit ratings of most major market participants, decreased availability of debt financing or refinancing, and a resulting decline of liquidity in the energy markets due to growing concern about the ability of counterparties to perform their obligations. Since the beginning of 2003, several merchant generators reached agreements to extend existing bank credit facilities.

EME's largest subsidiary, Edison Mission Midwest Holdings, has \$911 million of debt maturing in December 2003 which will need to be repaid, extended or refinanced. Edison Mission Midwest Holdings is not expected to have sufficient cash to repay the \$911 million debt due in December 2003, and there is no assurance that Edison Mission Midwest Holdings will be able to extend or refinance its debt obligation on similar terms and rates as the existing debt, on commercially reasonable terms, on the terms permitted under the financing documents entered into by EME's parent company, Mission Energy Holding Company, in July 2001, or at all. EME's independent accountants' audit opinion for the year ended December 31, 2002 contains an explanatory paragraph that indicates the consolidated financial statements have been prepared on the basis that EME will continue as a going concern and that the uncertainty about Edison Mission Midwest Holdings' ability to repay, extend or refinance this obligation raises substantial doubt about EME's ability to continue as a going concern. Accordingly, the consolidated financial statements do not include any adjustments that might result from the resolution of this uncertainty.

During the first quarter of 2003, wholesale energy prices in the Pennsylvania-New Jersey-Maryland Power Pool, or PJM, increased primarily due to colder-than-normal weather and increases in the prices for natural gas. However, the recent changes in wholesale energy prices may or may not continue

throughout 2003. See “Item 2. Management’s Discussion and Analysis of Results of Operations and Financial Condition—Market Risk Exposures” for more information regarding forward market prices.

## **Note 2. Acquisitions and Dispositions**

### *Acquisitions*

On March 3, 2003, Contact Energy, EME’s 51% owned subsidiary, completed a transaction with NGC Holdings Ltd. to acquire the Taranaki Combined Cycle power station and related interests. The Taranaki station is a 357 MW combined cycle, natural gas-fired plant located near Stratford, New Zealand. Consideration for the Taranaki station consisted of a cash payment of approximately \$275 million, which was financed with bridge loan facilities. The bridge loan facilities were subsequently repaid with proceeds from the issuance of long-term U.S. dollar denominated notes.

### *Dispositions*

During the first quarter of 2002, EME completed the sales of its 50% interests in the Commonwealth Atlantic and James River projects and its 30% interest in the Harbor project. Proceeds received from the sales were \$44 million. During 2001, EME recorded asset impairment charges of \$32 million related to these projects based on the expected sales proceeds. No gain or loss was recorded from the sale of EME’s interests in these projects during the first quarter of 2002.

## **Note 3. Goodwill and Intangible Assets**

Effective January 1, 2002, EME adopted Statement of Financial Accounting Standards No. 142, “Goodwill and Other Intangible Assets.” SFAS No. 142 establishes accounting and reporting standards requiring goodwill not to be amortized but rather tested for impairment at least annually at the reporting unit level. EME will perform its annual evaluation of goodwill on October 1, 2003 or sooner if indicators of impairment exist. During the third quarter of 2002, EME concluded that fair value of the goodwill related to the Citizens Power LLC acquisition was impaired by \$14 million, net of \$9 million of income tax benefit and, accordingly, reported this amount as a cumulative change in accounting. In accordance with SFAS No. 3, “Reporting Accounting Changes in Interim Financial Statements,” EME’s financial statements for the first quarter of 2002 were restated to reflect the accounting change as of January 1, 2002.

Included in “Restricted cash and other assets” on EME’s consolidated balance sheet are customer contracts with a gross carrying amount of \$87 million and accumulated amortization of \$6 million at March 31, 2003. The contracts have a weighted average amortization period of 20 years. For the three months ended March 31, 2003, the amortization expense was \$1 million. Based on the current amount of intangible assets subject to amortization, the estimated amortization expense for fiscal years 2004 through 2008 is \$5 million each year. Intangible assets classified in “Restricted cash and other assets” of \$1 million at March 31, 2003 consists of an additional minimum pension liability at Midwest Generation.

Changes in the carrying amount of goodwill, by geographical segment, for the three months ended March 31, 2003 are as follows:

	<u>Americas</u>	<u>Asia Pacific</u>	<u>Europe</u>	<u>Total</u>
Carrying amount at December 31, 2002 . . . . .	\$ 2	\$384	\$274	\$660
Goodwill resulting from an acquisition(1) . . . . .	—	43	—	43
Translation adjustments and other . . . . .	—	37	(5)	32
Carrying amount at March 31, 2003 (unaudited) . . . . .	<u>\$ 2</u>	<u>\$464</u>	<u>\$269</u>	<u>\$735</u>

(1) Represents goodwill resulting from Contact Energy's acquisition of the Taranaki station in March 2003.

**Note 4. Inventory**

Inventory is stated at the lower of weighted average cost or market. Inventory at March 31, 2003 and December 31, 2002 consisted of the following:

	<u>March 31, 2003</u>	<u>December 31, 2002</u>
	(Unaudited)	
Coal and fuel oil . . . . .	\$ 92	\$111
Spare parts, materials and supplies . . . . .	67	65
Total . . . . .	<u>\$159</u>	<u>\$176</u>

**Note 5. Accumulated Other Comprehensive Income (Loss)**

Accumulated other comprehensive income (loss) consisted of the following:

	<u>Currency Translation Adjustments</u>	<u>Unrealized Gains (Losses) on Cash Flow Hedges</u>	<u>Minimum Pension Liability Adjustment</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>
Balance at December 31, 2002 . . . . .	\$ (8)	\$(193)	\$ (11)	\$(212)
Current period change . . . . .	21	(4)	—	17
Balance at March 31, 2003 (unaudited) . . . . .	<u>\$ 13</u>	<u>\$(197)</u>	<u>\$ (11)</u>	<u>\$(195)</u>

Unrealized gains (losses) on cash flow hedges included those related to the hedge agreement with the State Electricity Commission of Victoria for electricity prices from the Loy Yang B project in Australia. This contract does not qualify under the normal sales and purchases exception because financial settlement of the contract occurs without physical delivery. These losses arise because current forecasts of future electricity prices in these markets are greater than contract prices. In addition to this contract, unrealized gains (losses) on cash flow hedges included those related to EME's share of interest rate swaps of its unconsolidated affiliates and the Loy Yang B project.

As EME's hedged positions are realized, approximately \$10 million, after tax, of the net unrealized losses on cash flow hedges at March 31, 2003 are expected to be reclassified into earnings during the next 12 months. Management expects that when the hedged items are recognized in earnings, the net unrealized losses associated with them will be offset. The maximum period over which EME has designated a cash flow hedge, excluding those forecasted transactions related to the payment of variable interest on existing financial instruments, is 14 years. Actual amounts ultimately reclassified into earnings over the next 12 months could vary materially from this estimated amount as a result of changes in market conditions.

Under SFAS No. 133, the portion of a cash flow hedge that does not offset the change in value of the transaction being hedged, which is commonly referred to as the ineffective portion, is immediately recognized in earnings. EME recorded a net loss of approximately \$8 million and \$1 million during the first quarters of 2003 and 2002, respectively, representing the amount of cash flow hedges' ineffectiveness, reflected in net gains (losses) from price risk management and energy trading in EME's consolidated income statement.

**Note 6. Discontinued Operations**

**Lakeland Project**

EME's Lakeland project operated a 220 MW combined cycle, natural gas-fired power plant located in the United Kingdom. The assets of the project are owned by EME's indirect subsidiary, Lakeland Power Ltd., which sold power generated from the plant pursuant to a power sales agreement with Norweb Energi Ltd., a subsidiary of TXU (UK) Holdings Limited (TXU UK) and an indirect subsidiary of TXU Europe Group plc (TXU Europe).

On December 19, 2002, the lenders to the Lakeland project accelerated the debt owing under the bank agreement that governs the project's indebtedness, and on December 20, 2002, the Lakeland project lenders appointed an administrative receiver over the assets of Lakeland Power Ltd. The administrative receiver was appointed to take control of the affairs of Lakeland Power Ltd. and has a wide range of powers (specified in the Insolvency Act), including authorizing the sale of the power plant. The appointment of the administrative receiver requires the treatment of Lakeland power plant as an asset held for sale under Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144). Due to EME's loss of control arising from the appointment of the administrative receiver, EME no longer consolidates the activities of Lakeland Power Ltd. The consolidated financial statements have been restated to conform to discontinued operations treatment for all historical periods presented.

On April 22, 2003, a third party announced that it had entered an agreement with the administrative receiver to purchase the Lakeland power plant for £24 million. Subject to satisfaction of closing conditions, completion of the sale is expected during the second quarter of 2003.

*Ferrybridge and Fiddler's Ferry Plants*

On December 21, 2001, EME completed the sale of the Ferrybridge and Fiddler's Ferry coal-fired power plants located in the United Kingdom to two wholly owned subsidiaries of American Electric Power. In addition, as part of the transactions, the purchasers acquired other assets and assumed specified liabilities associated with the plants. The sale was the result of a competitive bidding process. EME acquired the plants in 1999 from PowerGen UK plc for £1.3 billion. In accordance with SFAS No. 144, the results of Ferrybridge and Fiddler's Ferry have been reflected as discontinued operations in EME's consolidated financial statements. The consolidated financial statements have been restated to conform to discontinued operations treatment for all historical periods presented.

Summarized results of discontinued operations are as follows:

	Three Months Ended March 31,	
	2003	2002
	(Unaudited)	
Total operating revenues . . . . .	\$ —	\$21
Income before income taxes . . . . .	—	5
Income from operations of discontinued foreign subsidiaries . .	—	5



the above table assumes the partners will contribute equity for the entire construction cost. For more information on the Sunrise project financing, see “Item 2. Management’s Discussion and Analysis of Results of Operations and Financial Condition—Liquidity and Capital Resources—Subsidiary Financing Plans—Sunrise Project Financing.”

Firm commitments to contribute project equity to the CBK project could be accelerated due to events of default as defined in the non-recourse project financing facilities.

### *Contingencies*

#### *Legal Developments Affecting Sunrise Power Company*

Sunrise Power Company, in which EME’s wholly owned subsidiary owns a 50% interest, sells all its output to the California Department of Water Resources under an eleven-year power purchase agreement entered into on June 25, 2001 and restructured on December 31, 2002. In January 2003, the California Public Utilities Commission and the California Electricity Oversight Board dismissed the complaints they had filed with the Federal Energy Regulatory Commission against Sunrise Power Company, alleging that the contract was “unjust and unreasonable.”

On May 2, 2002, the United States Justice Foundation announced that it had filed a complaint in the Superior Court of the State of California, Los Angeles County, against the California Department of Water Resources, all sellers of power under long-term energy contracts entered into in 2001, including Sunrise Power Company, and Vikram Budhraj, one of the consultants involved in the negotiation of energy contracts on behalf of the California Department of Water Resources. The lawsuit asks the Superior Court to void all the contracts entered into in 2001, as well as all the contracts renegotiated in 2002, as a result of a purported conflict of interest by Mr. Budhraj. Sunrise Power Company has not yet been served with the complaint.

On May 15, 2002, Sunrise Power Company was served with a complaint filed in the Superior Court of the State of California, City and County of San Francisco, by James M. Millar, “individually, and on behalf of the general public and as a representative taxpayer suit” against sellers of long-term power to the California Department of Water Resources, including Sunrise Power Company. The lawsuit alleges that the defendants, including Sunrise Power Company, engaged in unfair and fraudulent business practices by knowingly taking advantage of a manipulated power market to obtain unfair contract terms. The lawsuit seeks to enjoin enforcement of the “unfair and oppressive terms and conditions” in the contracts, as well as restitution by the defendants of excessive monies obtained by the defendants. Plaintiffs in several other class action lawsuits pending in Northern California have filed petitions seeking to have the Millar lawsuit consolidated with those lawsuits. The defendants in the Millar lawsuit and other class action suits removed all the lawsuits to the U.S. District Court, Northern District of California, and filed a motion to stay all proceedings pending final resolution of the jurisdictional issue. Various plaintiffs have filed pleadings opposing the removal and requesting that the matters be remanded to state court. The motions are still pending. EME believes that the outcome of this litigation will not have a material adverse effect on its consolidated financial position or results of operations.

#### *Regulatory Developments Affecting Doga Project*

On August 4, 2002, a new Electricity Market License Regulation was implemented in Turkey. The regulation contains, among other things, a requirement for each generator to obtain a generation license. Historically, Doga’s Implementation Contract has been its sole license. The new regulation contemplates an initial fixed license fee and a yearly license fee based on the amount of energy generated, which will increase the project’s costs of operation by an undetermined amount. In addition, the regulation allows the insertion of provisions in the license which are different from those in the Implementation Contract.

The effect of the new regulation is still undetermined, as the new license provisions have not been specified. The new regulation requires Doga to apply for a generation license by June 2, 2003. If actions or inactions undertaken pursuant to the new regulation directly or indirectly impede, hinder, prevent or delay the operation of the Doga facility or increase Doga's cost of performing its obligations under its project documents, this may constitute a risk event under Doga's Implementation Contract. A risk event may permit Doga to request an increase in its tariff or, under certain circumstances, request a buyout of the project by the Ministry of Energy and Natural Resources.

On October 3, 2002, Doga and several other independent power producers filed a lawsuit in the Danistay, Turkey's high administrative court, against the Energy Market Regulatory Authority seeking invalidation of certain provisions of the new regulation, arguing the unconstitutionality of the imposition of new license requirements that do not take into account the vested rights of companies presently performing electricity generation pursuant to previously agreed conditions. No decision has been rendered, and discussions with the Turkish authorities continue.

#### *Federal Income Taxes*

EME is, and may in the future be, under examination by tax authorities in varying tax jurisdictions with respect to positions it takes in connection with the filing of its tax returns. Matters raised upon audit may involve substantial amounts, which, if resolved unfavorably, an event not currently anticipated, could possibly be material. However, in EME's opinion, it is unlikely that the resolution of any such matters will have a material adverse effect upon EME's financial condition or results of operations.

#### *Litigation*

EME experiences other routine litigation in the normal course of its business. None of such pending routine litigation is expected to have a material adverse effect on EME's consolidated financial position or results of operations.

#### *Guarantees and Indemnities*

##### *Tax Indemnity Agreements*

In connection with the sale-leaseback transactions that EME has entered into related to the Collins Station, Powerton and Joliet plants in Illinois and the Homer City facilities in Pennsylvania, EME or one of its subsidiaries has entered into tax indemnity agreements. Under these tax indemnity agreements, EME has agreed to indemnify the lessors in the sale-leaseback transactions for specified adverse tax consequences that could result in certain situations set forth in each tax indemnity agreement, including specified defaults under the respective leases. The potential indemnity obligations under these tax indemnity agreements could be significant. Due to the nature of these obligations under these tax indemnity agreements, EME cannot determine a maximum potential liability. The indemnities would be triggered by a valid claim from the lessors. EME has not recorded a liability related to these indemnities.

##### *Indemnities Provided as Part of the Acquisition of the Illinois Plants*

In connection with the acquisition of the Illinois Plants, EME agreed to indemnify Commonwealth Edison against damages, claims, fines, liabilities and expenses and losses arising from, among other things, environmental liabilities before and after the date of sale as specified in the Asset Sale Agreement dated March 22, 1999. The indemnification claims are reduced by any insurance proceeds and tax benefits related to such claims and are subject to a requirement by Commonwealth Edison to take all reasonable steps to mitigate losses related to any such indemnification claim. Due to the nature of the obligation under this indemnity, a maximum potential liability cannot be determined. The indemnification for the environmental liabilities referred to above is not limited in term and would be

triggered by a valid claim from Commonwealth Edison. Except as discussed below, EME has not recorded a liability related to this indemnity.

Midwest Generation entered into a supplemental agreement on February 20, 2003 to resolve a dispute regarding interpretation of its reimbursement obligation for asbestos claims under the environmental indemnities set forth in the Asset Sale Agreement. Under this supplemental agreement, Midwest Generation agreed to reimburse Commonwealth Edison 50% of specific existing asbestos claims less recovery of insurance costs, and agreed to a sharing arrangement for liabilities associated with future asbestos related claims as specified in the agreement. The obligations under this agreement are not subject to a maximum liability. The supplemental agreement has a five-year term with an automatic renewal provision (subject to the right to terminate). Payments are made under this indemnity by a valid claim provided from Commonwealth Edison. At March 31, 2003, Midwest Generation recorded a \$5 million liability related to known claims provided by Commonwealth Edison.

#### *Indemnity Provided as Part of the Acquisition of the Homer City Facilities*

In connection with the acquisition of the Homer City facilities, EME Homer City Generation L.P. is obligated to indemnify the sellers against damages, claims and losses arising from environmental liabilities before and after the date of sale as specified in the Asset Purchase Agreement dated August 1, 1998. EME guaranteed the obligations of EME Homer City. Due to the nature of the obligation under this indemnity provision, it is not subject to a maximum potential liability nor has an expiration date. Payments would be triggered under this indemnity by a claim from the sellers. EME has not recorded a liability related to this indemnity.

#### *Indemnities Provided Under Asset Sale Agreements*

In connection with the sale of assets, EME has provided indemnities to the purchasers for taxes imposed with respect to operations of the asset prior to the sale, and EME or its subsidiaries have received similar indemnities from purchasers related to taxes arising from operations after the sale. EME has also provided indemnities to purchasers for items specified in each agreement (for example, specific pre-existing litigation matters and/or environmental conditions). Due to the nature of the obligations under these indemnity agreements, a maximum potential liability cannot be determined. Not all indemnities under the asset sale agreements have specific expiration dates. Payments would be triggered under these indemnities by valid claims from the sellers or purchasers, as the case may be. EME has not recorded a liability related to these indemnities.

#### *Guarantee of Brooklyn Navy Yard Contractor Settlement Payments*

Brooklyn Navy Yard is a 286 MW gas-fired cogeneration power plant in Brooklyn, New York. EME's wholly owned subsidiary owns 50% of the project. In February 1997, the construction contractor asserted general monetary claims under the turnkey agreement against Brooklyn Navy Yard Cogeneration Partners, L.P. A settlement agreement was executed on January 17, 2003, and all litigation has been dismissed. EME has indemnified Brooklyn Navy Yard Cogeneration Partners, L.P. for any payments due under this settlement agreement which are scheduled through 2006. At March 31, 2003, EME recorded a liability of \$12 million related to this indemnity.

#### *Guarantee of 50% of TM Star Fuel Supply Obligations*

TM Star was formed for the limited purpose of selling natural gas to March Point Cogeneration Company, an affiliate through common ownership, under a fuel supply agreement that extends through December 31, 2011. TM Star has entered into fuel purchase contracts with unrelated third parties to meet a portion of the obligations under the fuel supply agreement. EME has guaranteed 50% of TM Star's obligation under the fuel supply agreement to March Point Cogeneration Company. Due to the nature of the obligation under this guarantee, a maximum potential liability cannot be determined. TM

Star has met its obligations to March Point Cogeneration Company, and, accordingly, no claims against this guarantee have been made.

#### *Capacity Indemnification Agreements*

EME has guaranteed, jointly and severally with Texaco Inc., the obligations of March Point Cogeneration Company under its project power sales agreements to repay capacity payments to the project's power purchaser in the event that the power sales agreements terminate, March Point Cogeneration Company abandons the project, or the project fails to return to normal operations within a reasonable time after a complete or partial shutdown, during the term of the power contracts. In addition, subsidiaries of EME have guaranteed the obligations of Kern River Cogeneration Company and Sycamore Cogeneration Company under their project power sales agreements to repay capacity payments to the projects' power purchaser in the event that the projects unilaterally terminate their performance or reduce their electric power producing capability during the term of the power contracts. The obligations under the indemnification agreements as of March 31, 2003, if payment were required, would be \$200 million. EME has no reason to believe that any of these projects will either cease operations or reduce its electric power producing capability during the term of its power contract.

#### *Bank Indemnity Under a Letter of Credit Supporting ISAB Energy's Debt Service Reserve Account*

EME has indemnified its lenders under its credit facilities from amounts drawn on a \$35 million letter of credit issued for the benefit of the lenders to ISAB Energy, a 49% unconsolidated affiliate, in lieu of ISAB Energy funding a debt service reserve account using additional equity contributions. Accordingly, a default under ISAB Energy's project debt could result in a draw under the letter of credit which, in turn, would result in a borrowing under EME's credit facilities. The letter of credit is renewed each six-month period or until ISAB Energy funds the debt service account. The indemnification is subject to the maximum amount drawn under the letter of credit. EME has not recorded a liability related to this indemnity.

#### *Subsidiary Indemnity to Central Maine Power Company for Value of Points of Delivery*

A subsidiary of EME has indemnified Central Maine Power Company against decreases in the value of power deliveries by CL Power Sales Eight, L.L.C., an unconsolidated affiliate, to Central Maine Power as a result of the implementation of a location-based pricing system in the New England Power Pool. The indemnity has the same term as a power supply agreement between Central Maine Power and CL Eight, which runs through December 2016. It is not possible to determine potential differences in values between the various points of delivery in New England Power Pool at this time. Due to the nature of this indemnity, a maximum potential liability cannot be determined. To the extent EME's subsidiary would be required to make a payment under this indemnity, it and EME are indemnified by Peabody Energy Corporation pursuant to the 2000 Purchase and Sale Agreement for the acquisition of Citizens Power LLC. EME's subsidiary has not recorded a liability related to this indemnity.

#### *Subsidiary Guarantees for Performance of Unconsolidated Affiliates*

A subsidiary of EME has guaranteed the obligations of two unconsolidated affiliates to make payments to third parties for power delivered under fixed-price power sales agreements. These agreements run through 2008. EME believes there is sufficient cash flow to pay the power suppliers assuming timely payment by the power purchasers. Due to the nature of this indemnity, a maximum potential liability cannot be determined. To the extent EME's subsidiary would be required to make payments under the guarantee, EME's subsidiary and EME are indemnified by Peabody Energy Corporation pursuant to the 2000 Purchase and Sale Agreement for Citizens Power LLC. EME's subsidiary has not recorded a liability related to this indemnity.

### ***Environmental Matters and Regulations***

EME is subject to environmental regulation by federal, state and local authorities in the United States and foreign regulatory authorities with jurisdiction over projects located outside the United States. EME believes that it is in substantial compliance with environmental regulatory requirements and that maintaining compliance with current requirements will not materially affect its financial position or results of operation. However, possible future developments, such as the promulgation of more stringent environmental laws and regulations, and future proceedings that may be initiated by environmental authorities, could affect the costs and the manner in which EME conducts its business and could cause it to make substantial additional capital expenditures. There is no assurance that EME would be able to recover these increased costs from its customers or that EME's financial position and results of operations would not be materially adversely affected.

Typically, environmental laws require a lengthy and complex process for obtaining licenses, permits and approvals prior to construction and operation of a project. Meeting all the necessary requirements can delay or sometimes prevent the completion of a proposed project as well as require extensive modifications to existing projects, which may involve significant capital expenditures. If EME fails to comply with applicable environmental laws, it may be subject to penalties and fines imposed against EME by regulatory authorities.

### **Note 8. Business Segments**

EME operates predominantly in one line of business, electric power generation, with reportable segments organized by geographic region: Americas, Asia Pacific and Europe. EME's plants are located in different geographic areas, which mitigate the effects of regional markets, economic downturns or unusual weather conditions.

<u>Three Months Ended</u>	<u>Americas</u>	<u>Asia Pacific</u>	<u>Europe</u>	<u>Corporate/ Other</u>	<u>Total</u>
	(Unaudited)				
<b>March 31, 2003</b>					
Operating revenues from consolidated subsidiaries . . .	\$367	\$193	\$132	\$ (2)	\$690
Net gains (losses) from price risk management and energy trading . . . . .	4	(6)	(5)	—	(7)
Total operating revenues . . . . .	<u>\$371</u>	<u>\$187</u>	<u>\$127</u>	<u>\$ (2)</u>	<u>\$683</u>
Income (loss) from continuing operations before income taxes and minority interest . . . . .	<u>\$ 39</u>	<u>\$ 16</u>	<u>\$ 24</u>	<u>\$ (95)</u>	<u>\$(16)</u>
<b>March 31, 2002</b>					
Operating revenues from consolidated subsidiaries . . .	\$259	\$141	\$115	\$ 1	\$516
Net gains (losses) from price risk management and energy trading . . . . .	18	(1)	4	—	21
Total operating revenues . . . . .	<u>\$277</u>	<u>\$140</u>	<u>\$119</u>	<u>\$ 1</u>	<u>\$537</u>
Income (loss) from continuing operations before income taxes and minority interest . . . . .	<u>\$(13)</u>	<u>\$ 27</u>	<u>\$ 25</u>	<u>\$(107)</u>	<u>\$(68)</u>

### **Note 9. Investments**

The following table presents summarized financial information of the significant subsidiary investments in unconsolidated affiliates accounted for by the equity method. The significant subsidiary investments include the California Power Group, Watson Cogeneration Company, Four Star Oil & Gas Company, PT Paiton Energy and ISAB Energy S.r.l. The California Power Group (not a legal entity)

consists of Kern River Cogeneration Company, Sycamore Cogeneration Company, Coalinga Cogeneration Company, Mid-Set Cogeneration Company, Salinas River Cogeneration Company, Sargent Canyon Cogeneration Company, and Sunrise Power Company, LLC.

	Three Months Ended March 31,	
	2003	2002
	(Unaudited)	
Operating revenues . . . . .	\$560	\$401
Operating income . . . . .	143	113
Net income . . . . .	104	92

**Note 10. Supplemental Statements of Cash Flows Information**

	Three Months Ended March 31,	
	2003	2002
	(Unaudited)	
Cash paid		
Interest (net of amount capitalized) . . . . .	\$111	\$100
Income taxes (receipts) . . . . .	\$ (2)	\$ (9)
Cash payments under plant operating leases . . . . .	\$ 58	\$ 55
Details of assets acquired		
Fair value of assets acquired . . . . .	\$333	\$ —
Liabilities assumed . . . . .	58	—
Net cash paid for acquisitions . . . . .	<u>\$275</u>	<u>\$ —</u>

**Note 11. Stock-based Compensation**

Edison International has three stock-based employee compensation plans, which are described more fully in Note 15—Stock Compensation Plans included in EME’s annual report on Form 10-K for the year ended December 31, 2002. EME accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, “Accounting for Stock Issued to Employees,” and related interpretations. Upon grant, no stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income (loss) if EME had used the fair value accounting method.

	Three Months Ended March 31,	
	2003	2002
	(Unaudited)	
Net loss, as reported . . . . .	\$(17)	\$(50)
Add: stock-based compensation expense included in reported net loss, net of related tax effects . . . . .	1	—
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects . . . . .	<u>(1)</u>	<u>—</u>
Pro forma net loss . . . . .	<u>\$(17)</u>	<u>\$(50)</u>

**Note 12. Changes in Accounting**

*Statement of Financial Accounting Standards No. 143*

Effective January 1, 2003, EME adopted Statement of Financial Accounting Standards No. 143, “Accounting for Asset Retirement Obligations.” SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is increased to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. As of January 1, 2003, EME recorded a \$9 million, after tax, decrease to net income as the cumulative effect of adoption of SFAS No. 143.

EME recorded a liability representing expected future costs associated with site reclamations, facilities dismantlement and removal of environmental hazards as follows:

Initial asset retirement obligation as of January 1, 2003 . . . . .	\$17
Translation adjustments . . . . .	<u>1</u>
Balance of asset retirement obligation as of March 31, 2003 (unaudited) . . . . .	<u>\$18</u>

For the three months ended March 31, 2003, EME recognized accretion expense related to its asset retirement obligation of approximately \$400,000. Had SFAS No. 143 been applied retroactively in the three months ended March 31, 2002, it would not have had a material effect upon EME’s results of operations.

*Statement of Financial Accounting Standards Interpretation No. 45*

In November 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards Interpretation No. 45, “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.” This interpretation establishes reporting requirements to be made by a guarantor about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of this standard had no impact on EME’s financial statements. See disclosure regarding guarantees and indemnities in Note 7—Commitments and Contingencies.

*Statement of Financial Accounting Standards Interpretation No. 46*

In January 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards Interpretation No. 46, “Consolidation of Variable Interest Entities” (FIN 46). This interpretation of Accounting Research Bulletin No. 51, “Consolidated Financial Statements,” addresses consolidation by business enterprises of variable interest entities. The primary objective of the Interpretation is to provide guidance on the identification of, and financial reporting for, entities over which control is achieved through means other than voting rights; such entities are known as variable-interest entities. This interpretation applies to variable interest entities created after January 31, 2003, and applies to variable interest entities in which EME holds a variable interest that it acquired before February 1, 2003, beginning July 1, 2003.

Under FIN 46, an enterprise that will (1) absorb a majority of a variable interest entity’s expected losses (if they occur), (2) receive a majority of a variable interest entity’s expected residual returns (if they occur), or (3) both of the above, must consolidate the variable interest entity. The enterprise that

consolidates the variable interest entity is called the primary beneficiary. EME believes it is reasonably possible that one or more of its investments in unconsolidated affiliates will be a variable interest entity. Accordingly, EME is in the process of making this determination, and for investments in unconsolidated affiliates which are variable interest entities, a further determination will be made if EME is the primary beneficiary.

EME has concluded that it is the primary beneficiary of Brooklyn Navy Yard Cogeneration Partners L.P. since it is at risk with respect to a majority of its losses and is entitled to receive a majority of its residual returns. Accordingly, EME will consolidate Brooklyn Navy Yard Cogeneration Partners L.P. effective July 1, 2003. In accordance with the transition provisions of FIN 46, the consolidation of Brooklyn Navy Yard Cogeneration Partners L.P. will be based on the historical cost of the assets, liabilities and non-controlling interest which would have been carried by EME effective when EME became the primary beneficiary. This means that EME will consolidate the assets and liabilities of Brooklyn Navy Yard Cogeneration Partners L.P. using the June 30, 2003 balance sheet and eliminate intercompany balances. EME expects the consolidation of this entity to increase total assets by approximately \$364 million and total liabilities by approximately \$435 million. Furthermore, EME expects to record a loss of approximately \$71 million as a cumulative change of accounting as a result of consolidating this variable interest entity. This loss is primarily due to cumulative losses allocated to the other 50% partner in excess of equity contributions recorded.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION**

*The following discussion contains forward-looking statements. These statements are based on Edison Mission Energy's (EME's) knowledge of present facts, current expectations about future events and assumptions about future developments. Forward-looking statements are not guarantees of performance; they are subject to risks, uncertainties and assumptions that could cause actual future activities and results of operations to be materially different from those set forth in this discussion. Important factors that could cause differences in EME's results of operations are set forth under "—Market Risk Exposures" below, and under "—Risk Factors" in the Management's Discussion and Analysis of Results of Operations and Financial Condition included in Item 7 of EME's annual report on Form 10-K for the year ended December 31, 2002.*

*The Management's Discussion and Analysis of Results of Operations and Financial Condition of this Form 10-Q discusses material changes in the results of operations, financial condition and other developments of EME since December 31, 2002, and as compared to the three months ended March 31, 2002. This discussion presumes that the reader has read or has access to Management's Discussion and Analysis of Results of Operations and Financial Condition included in Item 7 of EME's annual report on Form 10-K for the year ended December 31, 2002.*

### **General**

EME is an independent power producer engaged in the business of owning or leasing and operating electric power generation facilities worldwide. EME also conducts price risk management and energy trading activities in power markets open to competition. EME is a wholly owned subsidiary of Mission Energy Holding Company. Edison International is EME's ultimate parent company. Edison International also owns Southern California Edison Company, one of the largest electric utilities in the United States.

As of March 31, 2003, EME owned or leased interests in 27 domestic and 54 international operating power plants with an aggregate generating capacity of 23,868 megawatts (MW), of which EME's share was 18,823 MW. At that date, one domestic and two international power plants, totaling 615 MW of generating capacity, of which EME's anticipated share will be approximately 308 MW, were under construction.

### **Current Developments**

A number of significant developments during late 2001 and 2002 adversely affected independent power producers and subsidiaries of major integrated energy companies that sell a sizable portion of their generation into the wholesale energy market (sometimes referred to as merchant generators), including several of EME's subsidiaries. These developments included lower market prices in wholesale energy markets both in the United States and United Kingdom, significant declines in the credit ratings of most major market participants, decreased availability of debt financing or refinancing, and a resulting decline of liquidity in the energy markets due to growing concern about the ability of counterparties to perform their obligations. Since the beginning of 2003, several merchant generators reached agreements to extend existing bank credit facilities.

EME's largest subsidiary, Edison Mission Midwest Holdings, has \$911 million of debt maturing in December 2003 which will need to be repaid, extended or refinanced. Edison Mission Midwest Holdings is not expected to have sufficient cash to repay the \$911 million debt due in December 2003, and there is no assurance that Edison Mission Midwest Holdings will be able to extend or refinance its debt obligation on similar terms and rates as the existing debt, on commercially reasonable terms, on the terms permitted under the financing documents entered into by Mission Energy Holding Company in July 2001, or at all. EME's independent accountants' audit opinion for the year ended December 31,

2002 contains an explanatory paragraph that indicates the consolidated financial statements have been prepared on the basis that EME will continue as a going concern and that the uncertainty about Edison Mission Midwest Holdings' ability to repay, extend or refinance this obligation raises substantial doubt about EME's ability to continue as a going concern. Accordingly, the consolidated financial statements do not include any adjustments that might result from the resolution of this uncertainty.

During the first quarter of 2003, wholesale energy prices in the Pennsylvania-New Jersey-Maryland Power Pool, or PJM, increased primarily due to colder-than-normal weather and increases in the prices for natural gas. However, the recent changes in wholesale energy prices may or may not continue throughout 2003. See "—Market Risk Exposures" for more information regarding forward market prices.

### **Acquisitions and Dispositions of Investments in Energy Plants**

#### *Acquisitions*

On March 3, 2003, Contact Energy, EME's 51% owned subsidiary, completed a transaction with NGC Holdings Ltd. to acquire the Taranaki Combined Cycle power station and related interests. The Taranaki station is a 357 MW combined cycle, natural gas-fired plant located near Stratford, New Zealand. Consideration for the Taranaki station consisted of a cash payment of approximately \$275 million, which was financed with bridge loan facilities. The bridge loan facilities were subsequently repaid with proceeds from the issuance of long-term U.S. dollar denominated notes.

#### *Dispositions*

During the first quarter of 2002, EME completed the sales of its 50% interests in the Commonwealth Atlantic and James River projects and its 30% interest in the Harbor project. Proceeds received from the sales were \$44 million. During 2001, EME recorded asset impairment charges of \$32 million related to these projects based on the expected sales proceeds. No gain or loss was recorded from the sale of EME's interests in these projects during the first quarter of 2002.

## RESULTS OF OPERATIONS

### CONSOLIDATED OPERATING RESULTS

#### Net Income (Loss) Summary

Net loss is comprised of the following components:

	Three Months Ended March 31,	
	2003	2002
	(Unaudited) (in millions)	
Loss from continuing operations . . . . .	\$ (8)	\$(41)
Income from discontinued operations . . . . .	—	5
Cumulative changes in accounting . . . . .	(9)	(14)
Net Loss . . . . .	\$(17)	\$(50)

EME's loss from continuing operations for the first quarter of 2003 was \$8 million compared to \$41 million for the first quarter of 2002. The 2003 reduction in loss from continuing operations from 2002 was primarily due to higher PJM power prices and higher generation by EME's Homer City facilities, higher west coast energy prices and higher earnings from oil and gas activities.

#### Operating Revenues

Operating revenues increased 27% for the first quarter of 2003, compared to the first quarter of 2002. The 2003 increase was primarily due to increased electric revenues from the Illinois Plants, Homer City facilities and Contact Energy.

Net gains (losses) from price risk management and energy trading activities is comprised of:

	Three Months Ended March 31,	
	2003	2002
	(Unaudited) (in millions)	
Price risk management . . . . .	\$(22)	\$ 4
Energy trading . . . . .	15	17
Net Gains (Losses) . . . . .	\$ (7)	\$ 21

Net gains and (losses) from price risk management activities result from recording derivatives at fair value under Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133). Included in net gains (losses) from price risk management were:

- \$(8) million for the first quarter of 2003, related to the ineffective portion of Homer City forward electricity contracts, which are derivatives that qualify as cash flow hedges under SFAS No. 133, effective April 1, 2002.
- \$(6) million for the first quarter of 2003, related to the change in market value of electricity and financial contracts entered into by Contact Energy.
- \$(5) million for the first quarter of 2003 and \$4 million for the first quarter of 2002, related to realized losses and the change in market value of long-term commodity contracts entered into by the First Hydro plant for the purchase and sale of electricity that is recorded at fair value under SFAS No. 133, with changes in fair value recorded through the income statement.

Under SFAS No. 133, the portion of a cash flow hedge that does not offset the change in value of the transaction being hedged, which is commonly referred to as the ineffective portion, is immediately recognized in earnings. EME recorded a net loss of approximately \$8 million and \$1 million during the first quarters of 2003 and 2002, respectively, representing the amount of cash flow hedges' ineffectiveness. The net losses during the first quarter of 2003 are attributable to increases in the difference between energy prices at PJM West Hub (where EME's subsidiary enters into forward contracts) and the energy prices at the delivery point where power generated by the Homer City facilities is delivered into the transmission system (referred to as the Homer City busbar). See "—Market Risk Exposures—Americas" for more information regarding forward market prices.

The 2003 net gains from energy trading activities were primarily the result of net gains from transmission congestion contracts and other power contracts in markets where EME has power plants. The 2002 net gains from energy trading activities primarily represent the completion of the restructuring of a power sales agreement with an unaffiliated electric utility. As part of the transaction, an EME subsidiary purchased the power sales agreement held by a third party, modified its terms and conditions, and entered into a long-term power supply agreement with another party. Although the sale and purchase of power arising from these contracts will occur over their term, net gains of \$17 million were recorded during the first quarter of 2002 attributable to the fair value of the contracts (generally referred to as mark-to-market accounting).

EME's third quarter electric revenues are materially higher than revenues related to other quarters of the year because warmer weather during the summer months results in higher electric revenues being generated from the Homer City facilities and the Illinois Plants. By contrast, the First Hydro plants have higher electric revenues during their winter months.

### **Operating Expenses**

Fuel costs increased \$72 million for the first quarter of 2003, compared to the first quarter of 2002. Fuel costs in 2003 increased primarily due to increased generation from the Illinois Plants and the Homer City facilities.

Plant operations and transmission costs increased \$20 million for the first quarter of 2003, compared to the first quarter of 2002. Transmission costs were \$55 million and \$36 million for the first quarters of 2003 and 2002, respectively. The 2003 increase in transmission costs was primarily due to higher retail sales generated by Contact Energy.

Depreciation and amortization expense increased \$14 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 increase is primarily due to higher amortization expense resulting from the adoption of SFAS No. 142 at Contact Energy. In addition, depreciation expense increased in the first quarter of 2003 from the first quarter of 2002, resulting from the termination of the Midwest Generation equipment lease in August 2002.

Administrative and general expenses decreased \$7 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 decrease was primarily due to cost reductions implemented in 2002. During the first quarter of 2002, EME severance and other related costs were \$4 million.

### **Other Income (Expense)**

Equity in income from unconsolidated affiliates increased 21% for the first quarter of 2003, compared to the first quarter of 2002. The 2003 increase was primarily due to an increase in EME's share of income from the Big 4 projects and Four Star Oil & Gas. EME's third quarter equity in income from its domestic energy projects is materially higher than equity in income related to other quarters of the year due to warmer weather during the summer months and because a number of

EME's domestic energy projects, located on the west coast, have power sales contracts that provide for higher payments during the summer months.

Interest and other income decreased \$3 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 decrease was primarily due to lower interest income.

Interest expense increased \$4 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 increase was due to higher interest costs at the Illinois Plants due to a downgrade of the credit rating of Edison Mission Midwest Holdings and higher levels of borrowings at Contact Energy. See “—Liquidity and Capital Resources—Credit Ratings.”

### **Income Taxes**

EME's annual effective tax rate (excluding state tax reallocation benefits) was 41% in the first quarter of 2003 compared to 47% in the first quarter of 2002. During the first quarter of 2003, EME recorded \$5 million of additional state tax benefits net of federal income taxes, as a result from participation in a tax-allocation agreement with Edison International.

### **Minority Interest**

Minority interest expense decreased \$1 million for the first quarter of 2003, compared to the first quarter of 2002. Minority interest primarily relates to 49% ownership of Contact Energy by the public in New Zealand.

### **Discontinued Operations**

#### *Lakeland Project*

EME's Lakeland project operated a 220 MW combined cycle, natural gas-fired power plant located in the United Kingdom. The assets of the project are owned by EME's indirect subsidiary, Lakeland Power Ltd., which sold power generated from the plant pursuant to a power sales agreement with Norweb Energi Ltd., a subsidiary of TXU (UK) Holdings Limited (TXU UK) and an indirect subsidiary of TXU Europe Group plc (TXU Europe).

On December 19, 2002, the lenders to the Lakeland project accelerated the debt owing under the bank agreement that governs the project's indebtedness, and on December 20, 2002, the Lakeland project lenders appointed an administrative receiver over the assets of Lakeland Power Ltd. The administrative receiver was appointed to take control of the affairs of Lakeland Power Ltd. and has a wide range of powers (specified in the Insolvency Act), including authorizing the sale of the power plant. The appointment of the administrative receiver requires the treatment of Lakeland power plant as an asset held for sale under Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144). Due to EME's loss of control arising from the appointment of the administrative receiver, EME no longer consolidates the activities of Lakeland Power Ltd. The consolidated financial statements have been restated to conform to discontinued operations treatment for all historical periods presented.

On April 22, 2003, a third party announced that it had entered an agreement with the administrative receiver to purchase the Lakeland power plant for £24 million. Subject to satisfaction of closing conditions, completion of the sale is expected during the second quarter of 2003.

During the first quarter of 2002, EME recorded income of \$5 million from discontinued operations primarily related to operating income from the Lakeland power plant.

## **Cumulative Effect of Change in Accounting Principle**

### *Statement of Financial Accounting Standards No. 142*

Effective January 1, 2002, EME adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 establishes accounting and reporting standards requiring goodwill not to be amortized but rather tested for impairment at least annually at the reporting unit level. EME will perform its annual evaluation of goodwill on October 1, 2003 or sooner if indicators of impairment exist. During the third quarter of 2002, EME concluded that fair value of the goodwill related to the Citizens Power LLC acquisition was impaired by \$14 million, net of \$9 million of income tax benefit and, accordingly, reported this amount as a cumulative change in accounting. In accordance with SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements," EME's financial statements for the first quarter of 2002 were restated to reflect the accounting change as of January 1, 2002.

### *Statement of Financial Accounting Standards No. 143*

Effective January 1, 2003, EME adopted Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is increased to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. As of January 1, 2003, EME recorded a \$9 million, after tax, decrease to net income as the cumulative effect of the adoption of SFAS No. 143.

## **REGIONAL OPERATING RESULTS**

EME operates predominantly in one line of business, electric power generation, organized by three geographic regions: Americas, Asia Pacific, and Europe. Operating revenues are derived from EME's majority-owned domestic and international entities. Intercompany interest expense and income between EME and its consolidated subsidiaries have been eliminated in the following project results, except as described below with respect to loans provided to EME from a wholly owned subsidiary, Midwest Generation. Equity in income from unconsolidated affiliates relates to energy projects where EME's ownership interest is 50% or less in the projects. The equity method of accounting is generally used to account for the operating results of entities over which EME has a significant influence but in which it does not have a controlling interest. With respect to entities accounted for under the equity method, EME recognizes its proportional share of the income or loss of such entities.

*EME uses the words "earnings" or "losses" in this section to describe income or loss from continuing operations before income taxes and minority interest.*

Americas

	Three Months Ended March 31,	
	2003	2002
	(Unaudited) (in millions)	
<b>Operating Revenues from Consolidated Subsidiaries</b>		
Illinois Plants . . . . .	\$212	\$166
Homer City . . . . .	149	86
Other . . . . .	6	7
	<u>\$367</u>	<u>\$259</u>
<b>Income (Loss) before Taxes and Minority Interest (Earnings/ Losses)</b>		
<i>Consolidated operations</i>		
Illinois Plants . . . . .	(42)	(44)
Homer City . . . . .	46	2
Other . . . . .	13	21
<i>Unconsolidated affiliates</i>		
Big 4 projects . . . . .	17	1
Four Star Oil & Gas . . . . .	15	7
Sunrise . . . . .	(1)	(1)
March Point . . . . .	3	3
Other . . . . .	(2)	9
<i>Regional overhead</i> . . . . .	(10)	(11)
	<u>\$ 39</u>	<u>\$ (13)</u>

Illinois Plants

	Three Months Ended March 31,	
	2003	2002
<b>Statistics—Coal-Fired Generation</b>		
Generation (in GWhr):		
Power purchase agreement . . . . .	3,600	5,998
Merchant . . . . .	3,204	236
Total coal-fired generation . . . . .	<u>6,804</u>	<u>6,234</u>
Availability(1) . . . . .	75.3%	81.1%
Forced outage rate(2) . . . . .	6.7%	4.0%
Average realized energy price/MWh:		
Power purchase agreement . . . . .	\$18.02	\$16.70
Merchant . . . . .	\$25.48	\$19.49
Total coal-fired generation . . . . .	<u>\$21.53</u>	<u>\$16.81</u>
Capacity revenues (in millions) . . . . .	\$ 32	\$ 52

- (1) The availability factor is determined by the number of megawatt-hours the coal plants are available to generate electricity divided by the product of the capacity of the coal plants (in megawatts) and the number of megawatt-hours in the period. The coal plants are not available during periods of planned and unplanned maintenance.
- (2) The forced outage rate is generally referred to as unplanned maintenance.

In accordance with the power purchase agreements, Exelon Generation released 4,548 MW of generating capacity during 2002 from the power purchase agreements at the Illinois Plants. Of the generating capacity released by Exelon Generation, EME's subsidiary suspended operations for 1,370 MW and decommissioned 45 MW. As a result, beginning in 2003, the Illinois Plants have 3,133 MW available for sale as merchant generation. Operating revenues from the Illinois Plants increased \$46 million for the first quarter of 2003, compared to the first quarter of 2002, primarily due to increased merchant generation at the coal plants released by Exelon Generation. Operating revenues were also higher due to average realized energy prices from merchant generation due to colder-than-normal weather, partially offset by lower capacity revenue from the reduction in megawatts contracted under the power purchase agreements. The average realized prices from merchant generation during the first quarter of 2003 were less than the actual spot market prices during that period due to forward contracts entered into during 2002 (prior to the increase in spot market prices that took place during the first quarter of 2003) for approximately 52% of the Illinois Plants' actual merchant generation. See "—Market Risk Exposures—Illinois Plants."

Exelon Generation is obligated under the power purchase agreements to make capacity payments for the plants under contract (4,739 MW during 2003) and energy payments for electricity produced by these plants. As a result of the decline in contracted generating capacity under the power purchase agreements, revenues from Exelon Generation as a percentage of EME's consolidated operating revenues decreased from 30% for the first quarter of 2002 to 19% for the first quarter of 2003. Revenues from Exelon Generation were \$131 million and \$161 million for the first quarters of 2003 and 2002, respectively. For more information on the power purchase agreements and wholesale energy markets, see "—Market Risk Exposures—Illinois Plants."

Losses from the Illinois Plants decreased \$2 million for the first quarter of 2003, compared to the first quarter of 2002, due to the following factors:

- higher revenues as described above, partially offset by additional fuel costs related to higher generation and higher fuel prices at the Collins Station.
- lower plant operations costs primarily due to lower labor costs resulting from cost reductions implemented in the fourth quarter of 2002 and lower employee benefit costs.

The losses of the Illinois Plants included interest income of \$28 million and \$31 million for the first quarters of 2003 and 2002, respectively, related to loans to EME. In August 2000, Midwest Generation, which owns or leases the Illinois Plants, entered into a sale-leaseback transaction of the Powerton-Joliet facilities. The proceeds from the sale of these facilities were loaned to EME, which also provided a guarantee of the related lease obligations of Midwest Generation. The Powerton-Joliet sale-leaseback is recorded as an operating lease for accounting purposes.

*Homer City*

Statistics	Three Months Ended March 31,	
	2003	2002
Generation (in GWhr) . . . . .	3,620	2,695
Availability(1) . . . . .	88.9%	67.2%
Forced outage rate(2) . . . . .	6.7%	28.7%
Average realized energy price/MWh . . . . .	\$39.82	\$26.65
Capacity revenues (in millions) . . . . .	\$ 3	\$ 13

(1) The availability factor is determined by the number of megawatt-hours the coal plants are available to generate electricity divided by the product of the capacity of the coal plants (in megawatts) and

the number of megawatt-hours in the period. The coal plants are not available during periods of planned and unplanned maintenance.

(2) The forced outage rate is generally referred to as unplanned maintenance.

Operating revenues from Homer City increased \$63 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 increase primarily resulted from higher electric revenues from the Homer City facilities due to increased generation and higher energy prices. On February 10, 2002, Homer City experienced a major unplanned outage due to a collapse of the SCR ductwork of one of the units, known as Unit 3. The unit was restored to operation on April 4, 2002 and is operating with the SCR bypassed.

Earnings from Homer City increased \$44 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 increase in earnings is due to increased generation and higher energy prices. See “—Market Risk Exposures—Homer City Facilities.”

Losses from price risk management activities were \$8 million for the first quarter of 2003. The losses primarily represent the ineffective portion of forward contracts which are derivatives that qualify as cash flow hedges under SFAS No. 133. No comparable amount was recorded the first quarter of 2002. See “—Consolidated Operating Results—Operating Revenues” for further discussion.

#### *Big 4 Projects*

EME owns partnership investments (50% ownership or less) in Kern River Cogeneration Company, Midway-Sunset Cogeneration Company, Sycamore Cogeneration Company and Watson Cogeneration Company. These projects have similar economic characteristics and have been used, collectively, to secure bond financing by Edison Mission Energy Funding Corp., a special purpose entity that EME includes in its consolidated financial statements. Due to similar economic characteristics and the bond financing related to EME's equity investments in these projects, EME evaluates them collectively and refers to them as the Big 4 projects.

Earnings from the Big 4 projects increased \$16 million for the first quarter of 2003, compared to the first quarter of 2002. The change in earnings was largely due to higher energy prices in 2003. The earnings from the Big 4 projects included interest expense from Edison Mission Energy Funding of \$4 million and \$5 million for the first quarters of 2003 and 2002, respectively.

#### *Four Star Oil & Gas*

EME owns a 37.2% direct and indirect interest, with 36.05% voting stock, in Four Star Oil & Gas Company, with majority control held by affiliates of ChevronTexaco Corporation. Four Star Oil & Gas owns oil and gas reserves in the San Juan Basin, the Hugoton Basin, the Permian Basin and offshore Gulf Coast and Alabama. EME's share of earnings from Four Star Oil & Gas Company was \$15 million and \$7 million for the first quarters of 2003 and 2002, respectively. The 2003 increase in earnings was primarily due to higher natural gas prices.

#### *Other*

Earnings from other projects in the Americas region (consolidated subsidiaries and unconsolidated affiliates) included net gains from energy trading activities of \$15 million and \$17 million for the first quarters of 2003 and 2002, respectively. See “—Consolidated Operating Results—Operating Revenues” for further discussion.

Asia Pacific

	Three Months Ended March 31,	
	2003	2002
	(Unaudited) (in millions)	
<b>Operating Revenues from Consolidated Subsidiaries</b>		
Contact Energy . . . . .	\$143	\$ 95
Loy Yang B . . . . .	36	37
Other . . . . .	14	9
	<u>\$193</u>	<u>\$141</u>
<b>Income (Loss) before Taxes and Minority Interest (Earnings/ Losses)</b>		
<i>Consolidated operations</i>		
Contact Energy(1) . . . . .	5	7
Loy Yang B . . . . .	3	9
Other . . . . .	3	3
<i>Unconsolidated affiliates</i>		
Paiton . . . . .	9	12
Other . . . . .	(2)	(1)
<i>Regional overhead</i> . . . . .	(2)	(3)
	<u>\$ 16</u>	<u>\$ 27</u>

(1) Income before taxes of Contact Energy represents both EME's 51% ownership and the ownership of minority interest holders on a calendar year basis. The interests of minority shareholders in the after-tax earnings of Contact Energy are reflected in a separate line item in the consolidated statements of income. See "—Consolidated Operating Results—Minority Interest." Contact Energy is a public company in New Zealand and provides shareholders' financial results in accordance with New Zealand accounting standards for its fiscal year ended September 30.

*Contact Energy*

Operating revenues increased \$48 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 increase was primarily due to higher wholesale electricity prices and higher generation. In addition, there was a 29% increase in the average exchange rate of the New Zealand dollar compared to the U.S. dollar during the first quarter of 2003, compared to the first quarter of 2002.

Earnings from Contact Energy, included in the consolidated statements of income of EME as described above, decreased \$2 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 decrease is primarily due to a \$6 million loss from price risk management activities for the first quarter of 2003 related to a change in market value of electricity and financial contracts that were not designated as cash flow hedges for hedge accounting under SFAS No. 133. No comparable amount was recorded for the first quarter of 2002.

*Loy Yang B*

Operating revenues decreased \$1 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 decrease in operating revenues is primarily due to lower generation resulting from a planned outage in March 2003 and lower pool prices for the power sold into the wholesale energy market. The 2003 decrease was partially offset by a 14% increase in the average exchange rate

of the Australian dollar compared to the U.S. dollar during the first quarter of 2003, compared to the first quarter of 2002.

Earnings from Loy Yang B decreased \$6 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 decrease in earnings is due to lower electric revenues discussed above and higher plant maintenance costs related to the planned outage in March 2003.

*Paiton Energy*

Earnings from Paiton Energy decreased \$3 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 decrease in earnings is primarily due to an unplanned outage during the first quarter of 2003.

*Other*

Operating revenues from other consolidated subsidiaries increased \$5 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 increase in operating revenues is primarily due to higher electric revenues from the Valley Power Peaker project in Australia. Commercial operation of the Valley Power Peaker project commenced during the second quarter of 2002.

*Regional G&A*

Asia Pacific's Regional G&A decreased \$1 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 decrease in Regional G&A was primarily due to cost reductions implemented in 2002.

**Europe(1)**

	<b>Three Months Ended March 31,</b>	
	<b>2003</b>	<b>2002</b>
	<b>(Unaudited) (in millions)</b>	
<b>Operating Revenues from Consolidated Subsidiaries</b>		
First Hydro . . . . .	\$ 91	\$ 79
Doga(2) . . . . .	33	30
Other . . . . .	8	6
	<u>\$132</u>	<u>\$115</u>
<b>Income (Loss) before Taxes and Minority Interest (Earnings/ Losses)</b>		
<b><i>Consolidated operations</i></b>		
First Hydro . . . . .	5	12
Doga . . . . .	4	6
Other . . . . .	4	3
<b><i>Unconsolidated affiliates</i></b>		
ISAB . . . . .	11	9
Other . . . . .	4	1
<b><i>Regional overhead</i></b> . . . . .	<u>(4)</u>	<u>(6)</u>
	<u>\$ 24</u>	<u>\$ 25</u>

(1) The results of Lakeland and Ferrybridge and Fiddler's Ferry are not included in this table since the operations are classified as discontinued operations for all historical periods presented. For

more information on Lakeland and Ferrybridge and Fiddler's Ferry, see “—Consolidated Operating Results—Discontinued Operations.”

- (2) Income before taxes of Doga represents both EME's 80% ownership and the ownership of minority interest holders on a calendar year basis. The interests of minority shareholders in the after-tax earnings of Doga are reflected in a separate line item in the consolidated statements of income. See “—Consolidated Operating Results—Minority Interest.”

#### *First Hydro*

Operating revenues increased \$12 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 increase resulted primarily from higher electric revenues from the First Hydro plant due to increased volumes of power sales and a 12% increase in the average exchange rate of the British pound compared to the U.S. dollar during the first quarter of 2003, compared to the first quarter of 2002. These increases were partially offset by lower ancillary services revenues during the first quarter of 2003 from the first quarter of 2002. The First Hydro plant is expected to provide for higher electric revenues during its winter months.

Earnings from First Hydro decreased \$7 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 decrease in earnings is primarily due to a \$5 million loss from price risk management activities for the first quarter of 2003, compared to a \$4 million gain from price risk management activities for the first quarter of 2002. First Hydro's gains (losses) from price risk management relate to realized losses and the change in market value of commodity contracts that are recorded at fair value under SFAS No. 133, with changes in fair value recorded through the income statement.

#### *Doga*

Revenues from Doga increased \$3 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 increase is due to an increase in electricity generation, higher steam sales and higher natural gas prices. Earnings from Doga decreased \$2 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 decrease in earnings is primarily due to higher fuel costs and plant costs, partially offset by higher electric revenues discussed above.

#### *ISAB*

Earnings from ISAB increased \$2 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 increase was primarily due to higher generation in the first quarter of 2003, compared to the first quarter of 2002.

#### *Other*

Earnings from other projects in the Europe region (consolidated subsidiaries and unconsolidated affiliates) increased \$4 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 increase in earnings is primarily due to increased operating revenues from EME's Spanish Hydro project largely due to higher generation caused by more rainfall in the first quarter of 2003, compared to the first quarter of 2002.

#### *Regional G&A*

Europe's Regional G&A decreased \$2 million for the first quarter of 2003, compared to the first quarter of 2002. The 2003 decrease in Regional G&A is primarily due to lower development costs.

## LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2003, EME and its subsidiaries had cash and cash equivalents of \$654 million and EME had available a total of \$274 million of borrowing capacity under its \$487 million corporate credit facility. EME's consolidated debt at March 31, 2003 was \$6.4 billion, including \$911 million of debt maturing in December 2003 which is owed by EME's largest subsidiary, Edison Mission Midwest Holdings. In addition, EME's subsidiaries have \$7 billion of long-term lease obligations that are due over a period ranging up to 32 years.

The \$911 million of debt of Edison Mission Midwest Holdings maturing in December 2003 will need to be repaid, extended or refinanced. Edison Mission Midwest Holdings is not expected to have sufficient cash to repay the \$911 million debt due in December 2003, and there is no assurance that it will be able to extend or refinance its debt obligation on similar terms and rates as the existing debt, on commercially reasonable terms, on the terms permitted under the financing documents entered into by Mission Energy Holding Company in July 2001, or at all. EME's independent accountants' audit opinion for the year ended December 31, 2002 contains an explanatory paragraph that indicates the consolidated financial statements have been prepared on the basis that EME will continue as a going concern and that the uncertainty about Edison Mission Midwest Holdings' ability to repay, extend or refinance this obligation raises substantial doubt about EME's ability to continue as a going concern. Accordingly, the consolidated financial statements do not include any adjustments that might result from the resolution of this uncertainty.

### Credit Ratings

Credit ratings for EME and its subsidiaries, Edison Mission Midwest Holdings and Edison Mission Marketing & Trading, are as follows:

	<u>Moody's Rating</u>	<u>S&amp;P Rating</u>
Edison Mission Energy (senior unsecured) . . . . .	Ba3	BB-
Edison Mission Midwest Holdings (bank facility) . . . . .	Ba2	BB-
Edison Mission Marketing & Trading (senior unsecured) .	Not Rated	BB-

Standard & Poor's has assigned a negative rating outlook for each of these entities. Moody's has Edison Mission Energy's and Edison Mission Midwest Holdings' ratings under review for further downgrade.

The credit ratings of EME are below investment grade and, accordingly, EME has agreed to provide collateral in the form of cash and letters of credit for the benefit of counterparties for its price risk management and domestic trading activities related to accounts payable and unrealized losses (\$65 million as of May 9, 2003). EME has also provided collateral for a portion of its United Kingdom trading activities. To this end, EME's subsidiary, Edison Mission Operation and Maintenance Limited, has obtained a cash collateralized credit facility, under which letters of credit totaling £17 million have been issued as of April 30, 2003.

EME anticipates that sales of power from its Illinois Plants, Homer City facilities and First Hydro plants in the United Kingdom may require additional credit support, depending upon market conditions and the strategies adopted for the sale of this power. Changes in forward market prices and margining requirements could further increase the need for credit support for the price risk management and trading activities related to these projects. EME currently projects the potential working capital to support its price risk management and trading activity to be between \$100 million and \$200 million from time to time during 2003.

EME cannot provide assurance that its current credit ratings or the credit ratings of its subsidiaries will remain in effect for any given period of time or that one or more of these ratings will not be

lowered again. EME notes that these credit ratings are not recommendations to buy, sell or hold its securities and may be revised or withdrawn at any time by a rating agency.

*Credit Rating of Edison Mission Midwest Holdings*

As a result of the downgrade of Edison Mission Midwest Holdings below investment grade in October 2002, provisions in the agreements binding on Edison Mission Midwest Holdings and Midwest Generation restrict the ability of Edison Mission Midwest Holdings to make distributions to its parent company, thereby eliminating distributions to EME.

The following table summarizes the provisions restricting cash distributions (sometimes referred to as cash traps) and the related changes in the cost of borrowing by Edison Mission Midwest Holdings under the applicable financing agreements. The currently applicable provisions are those set forth in the same row as the Standard & Poor’s rating “BB-.”

<u>S&amp;P Rating</u>	<u>Moody’s Rating</u>	<u>Cost of Borrowing Margin</u> (based on LIBOR)	<u>Cash Trap</u>
BBB- or higher	Baa3 or higher	150	No cash trap
BB+	Ba1	225	50% of excess cash flow trapped until six month debt service reserve is funded
BB	Ba2	275	100% of excess cash flow trapped
BB-	Ba3	325	100% of excess cash flow trapped
B+	B1	325	100% of excess cash flow trapped and used to repay debt

Based on its current credit rating, provisions in the agreements binding on Edison Mission Midwest Holdings require it to deposit, on a quarterly basis, 100% of its excess cash flow as defined in the agreements into a cash flow recapture account held and maintained by the collateral agent. In accordance with these provisions, Edison Mission Midwest Holdings deposited \$50 million into the cash flow recapture account on October 31, 2002, and another \$28 million on January 27, 2003. The funds in the cash flow recapture account may be used only to meet debt service obligations of Edison Mission Midwest Holdings if funds are not otherwise available from working capital. There is no assurance that Edison Mission Midwest Holdings’ current credit rating will not be lowered again, in which case Edison Mission Midwest Holdings would be required to use its defined excess cash flow, as well as cash in the cash flow recapture account, to repay indebtedness.

As part of the sale-leaseback of the Powerton and Joliet power stations, Midwest Generation loaned the proceeds (\$1.4 billion) to EME in exchange for promissory notes in the same aggregate amount. Debt service payments by EME on the promissory notes may be used by Midwest Generation to meet its payment obligations under these leases in whole or part. Furthermore, EME has guaranteed the lease obligations of Midwest Generation under these leases. EME’s obligations under the promissory notes payable to Midwest Generation are general corporate obligations of EME and are not contingent upon receiving distributions from Edison Mission Midwest Holdings. See “—Restricted Assets of EME’s Subsidiaries—Edison Mission Midwest Holdings (Illinois Plants)” for a discussion of implications for the Powerton and Joliet leases.

*Credit Rating of Edison Mission Marketing & Trading*

Pursuant to the Homer City sale-leaseback documents, a below investment grade credit rating of Edison Mission Marketing & Trading restricts the ability of EME Homer City Generation L.P. (EME Homer City) to enter into permitted trading activities, as defined in the documents, with Edison Mission Marketing & Trading to sell forward the output of the Homer City facilities. These documents include a requirement that the counterparty to such transactions, and EME Homer City, if acting as

seller to an unaffiliated third party, be investment grade. EME currently sells all of the output from the Homer City facilities through Edison Mission Marketing & Trading, which has a below investment grade credit rating, and EME Homer City is not rated. Therefore, in order for EME to continue to sell forward the output of the Homer City facilities, either: (1) EME must obtain consent from the sale-leaseback owner participant to permit EME Homer City to sell directly into the market or through Edison Mission Marketing & Trading; or (2) Edison Mission Marketing & Trading must provide assurances of performance consistent with the requirements of the sale-leaseback documents. EME has obtained a consent from the sale-leaseback owner participant that will allow EME Homer City to enter into such sales, under specified conditions, through December 31, 2004. EME is permitted to sell the output of the Homer City facilities into the PJM at any time on a spot-market basis. See “—Market Risk Exposures—Homer City Facilities.”

### **Corporate Liquidity**

EME has a \$487 million corporate credit facility which includes a \$275 million component, Tranche A, that expires on September 16, 2003 and a \$212 million component, Tranche B, that expires on September 17, 2004. At March 31, 2003, EME had borrowing capacity under this facility of \$274 million and corporate cash and cash equivalents of \$31 million.

Cash distributions from EME’s subsidiaries and partnership investments, tax-allocation payments from Edison International and unused capacity under its corporate credit facilities represent EME’s major sources of liquidity to meet its cash requirements. In addition, EME expects to complete the Sunrise project financing during the summer of 2003 which, upon completion, will result in the receipt by EME of approximately \$140 million to \$150 million of capital previously invested in this project. See “Subsidiary Financing Plans.” EME expects its 2003 cash requirements to be primarily comprised of:

- interest payments on its indebtedness, including interest payments to Midwest Generation related to intercompany loans,
- collateral requirements in the form of letters of credit or cash margining in support of forward contracts for the sale of power from its merchant energy operations,
- general administrative expenses, and
- equity contribution obligations.

The timing and amount of distributions from EME’s subsidiaries may be affected by many factors beyond its control. See “—Historical Distributions Received by Edison Mission Energy—Restricted Assets of EME’s Subsidiaries.” Also see “—Risk Factors” in the Management’s Discussion and Analysis of Results of Operations and Financial Condition included in Item 7 of EME’s annual report on Form 10-K for the year ended December 31, 2002. In addition, the right of EME to receive tax-allocation payments, and the timing and amount of tax-allocation payments received by EME are subject to factors beyond EME’s control. See “—Intercompany Tax-Allocation Payments.” If Tranche A of the corporate facility is not extended and the Sunrise project financing is not completed as scheduled, EME’s ability to provide credit support for bilateral contracts for power and fuel of its merchant energy operations will be severely limited. If EME is unable to provide such credit support, this will reduce the number of counterparties willing to enter into bilateral contracts with EME’s subsidiaries, thus requiring EME’s subsidiaries to rely on short-term markets instead of bilateral contracts. Furthermore, if this situation occurs, EME may not be able to meet margining requirements if forward prices for power increase significantly. Failure to meet a margining requirement would permit the counterparty to terminate the related bilateral contract early and demand immediate payment for the replacement value of the contract.

EME’s corporate credit facility provides credit available in the form of cash advances or letters of credit. At March 31, 2003, Tranche A consisted of borrowings of \$80 million, and \$132 million of letters

of credit were outstanding under Tranche B. In addition to the interest payments, EME pays a facility fee determined by its long-term credit ratings (0.875% and 1.00% at March 31, 2003 for Tranche A and Tranche B, respectively) on the entire credit facility independent of the level of borrowings.

Under the credit agreement governing its credit facility, EME has agreed to maintain an interest coverage ratio that is based on cash received by EME, including tax-allocation payments, cash disbursements and interest paid. At March 31, 2003, EME met this interest coverage ratio. The interest coverage ratio in the ring-fencing provisions of EME's certificate of incorporation and bylaws remains relevant for determining EME's ability to make distributions. See "—Interest Coverage Ratio."

## Discussion of Historical Cash Flow

### *Cash Flows From Operating Activities*

Net cash provided by (used in) operating activities:

	Three Months Ended March 31,	
	2003	2002
	(Unaudited) (in millions)	
Continuing operations . . . . .	\$(2)	\$11
Discontinued operations . . . . .	—	—
	<u>\$(2)</u>	<u>\$11</u>

The lower operating cash flow from continuing operations in the first quarter of 2003, compared to the first quarter of 2002, reflects lower distributions from unconsolidated affiliates. Distributions from unconsolidated affiliates during the first quarter of 2002 were higher than the first quarter of 2003 primarily due to the collection of past due accounts receivable from California utilities, arising from the California energy crisis, by EME's investments in California qualifying facilities which amounts were then distributed to their partners. EME received \$13 million in tax-allocation payments from Edison International during the first three months of 2003, partially offsetting the cash used in operating activities. For further discussion on the tax-allocation payments, see "—Intercompany Tax-Allocation Payments." The change in operating cash flow from continuing operations in the first quarter of 2003 was also due to the timing of cash receipts and disbursements related to working capital items.

### *Cash Flows From Financing Activities*

Net cash provided by (used in) financing activities:

	Three Months Ended March 31,	
	2003	2002
	(Unaudited) (in millions)	
Continuing operations . . . . .	\$323	\$(27)
Discontinued operations . . . . .	—	(4)
	<u>\$323</u>	<u>\$(31)</u>

Cash provided by financing activities from continuing operations during the first quarter of 2003 consisted of net borrowings of \$80 million on EME's \$487 million corporate credit facility and \$320 million in borrowings by Contact Energy, EME's 51% owned subsidiary, of which \$275 million was used to finance the acquisition of the Taranaki power station. Debt service payments of \$23 million related to one of EME's subsidiaries were made in March 2003.

Cash used in financing activities from continuing operations during the first quarter of 2002 consisted of net payments of \$80 million on EME's corporate credit facility and \$22 million related to debt service payments of one of EME's subsidiaries. In addition, a wholly owned subsidiary borrowed \$84 million under a note purchase agreement in January 2002.

*Cash Flows From Investing Activities*

Net cash used in investing activities:

	Three Months Ended March 31,	
	2003	2002
	(Unaudited) (in millions)	
Continuing operations . . . . .	\$(328)	\$ (2)
Discontinued operations . . . . .	4	1
	<u>\$(324)</u>	<u>\$ (1)</u>

Cash used in investing activities from continuing operations during the first quarter of 2003 included \$275 million paid by Contact Energy for the acquisition of the Taranaki power station during the first quarter of 2003 and \$23 million in equity contributions to the Sunrise and CBK projects. EME invested \$56 million in the first quarter of 2003 in new plant and equipment principally related to the Illinois Plants and the Homer City facilities.

Cash used in investing activities from continuing operations during the first quarter of 2002 included \$80 million paid for the purchase of a power sales agreement held by a third party. EME invested \$72 million in the first quarter of 2002 in new plant and equipment principally related to the Valley Power Peaker project in Australia, the Illinois Plants and the Homer City facilities. Also, included in capital expenditures during the first quarter of 2002 were payments for three turbines purchased under EME's Master Turbine Lease with funds from restricted cash of \$61 million. Included in first quarter 2002 investing activities was \$86 million of restricted cash used to purchase the three turbines and satisfy EME's obligation related to the termination of EME's Master Turbine Lease, thereby reducing EME's restricted cash account. EME received proceeds of \$44 million from the sales of its 50% interests in the Commonwealth Atlantic and James River projects and its 30% interest in the Harbor project during the first quarter of 2002. In addition, EME received \$78.5 million as a return of capital from the Kern River and Sycamore projects subsequent to their receipt of payments of past due accounts receivable from Southern California Edison during the first quarter of 2002.

**Historical Distributions Received By Edison Mission Energy**

The following table is presented as an aid in understanding the cash flow of EME and its various subsidiary holding companies which depend on distributions from subsidiaries and affiliates to fund general and administrative costs and interest costs of recourse debt. Distributions for the first three

months of each year are not necessarily indicative of annual distributions due to the seasonal fluctuations in EME's business.

	March 31, 2003	March 31, 2002
	(Unaudited) (in millions)	
<b>Distributions from Consolidated Operating Projects:</b>		
EME Homer City Generation L.P. (Homer City facilities) . . .	\$ 21	\$ —
Holding companies of other consolidated operating projects .	36	4
<b>Distributions from Non-Consolidated Operating Projects:</b>		
Edison Mission Energy Funding Corp. (Big 4 Projects)(1) . . .	20	82
Four Star Oil & Gas Company . . . . .	—	4
Holding companies of other non-consolidated operating projects . . . . .	23	24
<b>Total Distributions . . . . .</b>	<u>\$100</u>	<u>\$114</u>

(1) Distributions do not include either capital contributions made during the California energy crisis or the subsequent return of such capital. Distributions reflect the amount received by EME after debt service payments by Edison Mission Energy Funding Corp.

Total distributions to EME decreased due to:

- lower distributions from the Big 4 projects (in March 2002, Southern California Edison paid the Big 4 projects their past due accounts receivable that accrued during the California energy crisis);

Partially offset by:

- distribution from Homer City (the project did not make a distribution in the first quarter of 2002 because it distributed its excess cash in December 2001 upon closing the Homer City sale-leaseback transaction);
- increased shareholder dividends from Contact Energy; and
- distribution from the Loy Yang B project following completion of the refinancing of the Valley Power Peaker project construction loan.

*Restricted Assets of EME's Subsidiaries*

Each of EME's direct or indirect subsidiaries is organized as a legal entity separate and apart from EME and its other subsidiaries. Assets of EME's subsidiaries are not available to satisfy EME's obligations or the obligations of any of its other subsidiaries. However, unrestricted cash or other assets that are available for distribution may, subject to applicable law and the terms of financing arrangements of the parties, be advanced, loaned, paid as dividends or otherwise distributed or contributed to EME or to its subsidiary holding companies. Set forth below is a description of covenants binding EME's principal subsidiaries that may restrict the ability of those entities to make distributions to EME directly or indirectly through the other holding companies owned by EME.

*Edison Mission Midwest Holdings Co. (Illinois Plants)*

Edison Mission Midwest Holdings Co. is the borrower under a \$1.9 billion credit facility with a group of commercial banks. The funds borrowed under this facility were used to fund the acquisition of the Illinois Plants and provide working capital to such operations. Midwest Generation, a wholly owned subsidiary of Edison Mission Midwest Holdings, owns or leases and operates the Illinois Plants. Midwest Generation entered into sale-leaseback transactions for the Collins Station as part of the original acquisition and for the Powerton Station and the Joliet Station in August 2000. In order for Edison Mission Midwest Holdings to make a distribution, Edison Mission Midwest Holdings and Midwest Generation must be in compliance with the covenants specified in these agreements, including maintaining a minimum credit rating. Because Edison Mission Midwest Holdings' credit rating is below investment grade, no distributions can currently be made by Edison Mission Midwest Holdings to its parent company and ultimately, to EME at this time. See "—Credit Ratings."

Edison Mission Midwest Holdings must also maintain a debt service coverage ratio for the prior twelve-month period of at least 1.50 to 1 as long as the power purchase agreements with Exelon Generation represent 50% or more of Edison Mission Midwest Holdings' and its subsidiaries' revenues. If the power purchase agreements with Exelon Generation represent less than 50% of Edison Mission Midwest Holdings' and its subsidiaries' revenues, it must maintain a debt service coverage ratio of at least 1.75 to 1. EME expects that revenues for 2003 from Exelon Generation will represent 50% or more of Edison Mission Midwest Holdings' and its subsidiaries' revenues. In addition, Edison Mission Midwest Holdings must maintain a debt-to-capital ratio no greater than 0.60 to 1. Failure to meet the historical debt service coverage ratio and the debt-to-capital ratio are events of default under the credit agreement and Collins lease agreements, which, upon a vote by a majority of the lenders, could cause an acceleration of the due date of the obligations of Edison Mission Midwest Holdings and those associated with the Collins lease. Such an acceleration would result in an event of default under the Powerton and Joliet leases. During the 12 months ended March 31, 2003, the historical debt service coverage ratio was 3.77 to 1 and the debt-to-capital ratio was 0.52 to 1.

There are no restrictions on the ability of Midwest Generation to make payments on the outstanding intercompany loans from its affiliate Edison Mission Overseas Co. (which is also a subsidiary of Edison Mission Midwest Holdings) or to make distributions directly to Edison Mission Midwest Holdings.

*EME Homer City Generation L.P. (Homer City facilities)*

EME Homer City Generation L.P. completed a sale-leaseback of the Homer City facilities in December 2001. In order to make a distribution, EME Homer City must be in compliance with the covenants specified in the lease agreements, including the following financial performance requirement measured on the date of distribution:

- At the end of each quarter, the senior rent service coverage ratio for the prior twelve-month period (taken as a whole) must be greater than 1.7 to 1. The senior rent service coverage ratio is defined as all income and receipts of EME Homer City less amounts paid for operating expenses, required capital expenditures, taxes and financing fees divided by the aggregate amount of the debt portion of the rent, plus fees, expenses and indemnities due and payable with respect to the lessor's debt service reserve letter of credit.

At the end of each quarter, the equity and debt portions of rent then due and payable must have been paid. The senior rent service coverage ratio (discussed in the bullet point above) projected for each of the prospective two twelve-month periods must be greater than 1.7 to 1. No more than two rent default events may have occurred, whether or not cured. A rent default event is defined as the failure to pay the equity portion of the rent within five business days of when it is due.

During the 12 months ended March 31, 2003, the senior rent service coverage ratio was 4.2 to 1.

*First Hydro Holdings*

A subsidiary of First Hydro Holdings, First Hydro Finance plc, is the borrower of £400 million of Guaranteed Secured Bonds due in 2021. In order to make a distribution, First Hydro Finance must be in compliance with the covenants specified in its bond indenture, including an interest coverage ratio. When measured for the twelve-month period ended December 31, 2002, First Hydro Holdings met the interest coverage ratio and made a distribution of \$18 million on May 7, 2003.

On March 14, 2003, First Hydro Finance plc received a letter from the trustee for the First Hydro bonds, requesting that First Hydro Finance engage in a process to determine whether an early redemption option in favor of the bondholders has been triggered under the terms of the First Hydro bonds. This letter states that, given requests made of the trustee by a group of First Hydro bondholders, the trustee needs to satisfy itself whether the termination of the pool system in the United Kingdom (replaced with the new electricity trading arrangements, referred to as NETA), was materially prejudicial to the interests of the bondholders. If this were the case, it could provide the First Hydro bondholders with an early redemption option. In this regard, on August 29, 2000, First Hydro Finance notified the trustee that the enactment of the Utilities Act of 2000, which laid the foundation for NETA, would result, after its implementation, in a so called restructuring event under the terms of the First Hydro bonds. However, First Hydro Finance did not believe then, nor does it believe now, that this event was materially prejudicial to the First Hydro bondholders. Since NETA implementation, First Hydro Finance has continued to meet all of its debt service obligations and financial covenants under the bond documentation, including the required interest coverage ratio. Until its receipt of the trustee's March 14, 2003 letter, First Hydro Finance had not received a response from the trustee to its August 29, 2000 notice. First Hydro Finance will dispute any attempt to have the early redemption option deemed applicable due to NETA implementation.

Neither the August 2000 notice provided to the trustee, nor the March 14, 2003 letter from the trustee constitutes an event of default under the terms of the First Hydro bonds; and there is no recourse to EME for the obligations of First Hydro Finance in respect of the First Hydro bonds. However, if the bondholders were entitled to an early redemption option, First Hydro Finance would be obligated to purchase all First Hydro bonds put to it by bondholders at par plus an early redemption premium. If all bondholders opted for the early redemption option, it is unlikely that First Hydro Finance would have sufficient financial resources to so purchase the bonds. There is no assurance that First Hydro Finance would be able to obtain additional financing to fund the purchase of the First Hydro bonds. Therefore, an exercise of the early redemption option by the bondholders could lead to administration proceedings as to First Hydro Finance in the United Kingdom, which is similar to Chapter 11 bankruptcy proceedings in the United States. If these events were to occur, it would have a material adverse effect upon First Hydro Finance and could have a material adverse effect upon EME.

*Edison Mission Energy Funding Corp. (Big 4 Projects)*

EME's subsidiaries, which EME refers to, in this context, as the guarantors, that hold EME's interests in the Big 4 projects completed a \$450 million secured financing in December 1996. Edison Mission Energy Funding Corp., a special purpose Delaware corporation, issued notes (\$260 million) and bonds (\$190 million), the net proceeds of which were lent to the guarantors in exchange for a note. The guarantors have pledged their cash proceeds from the Big 4 projects to Edison Mission Energy Funding as collateral for the note. All distributions receivable by the guarantors from the Big 4 projects are deposited into a trust account from which debt service payments are made on the obligations of Edison Mission Energy Funding and from which distributions may be made to EME if Edison Mission

Energy Funding is in compliance with the terms of the covenants in its financing documents, including the following requirements measured on the date of distribution:

- The debt service coverage ratio for the preceding four fiscal quarters is at least 1.25 to 1.
- The debt service coverage ratio projected for the succeeding four fiscal quarters is at least 1.25 to 1.

The debt service coverage ratio is determined by the amount of distributions received by the guarantors from the Big 4 projects during the relevant quarter divided by the debt service (principal and interest) on Edison Mission Energy Funding's notes and bonds paid or due in the relevant quarter. During the 12 months ended March 31, 2003, the debt service coverage ratio was 2.16 to 1. Although the credit ratings of Edison Mission Energy Funding's notes and bonds are below investment grade, this has no effect on the ability of the guarantors to make distributions to EME.

### *CBK Project*

EME holds a 50% interest in CBK Power Co Ltd. CBK Power operates under a 25-year build-rehabilitate-operate-transfer agreement with National Power Corporation for the 755 MW Caliraya-Botocan-Kalayaan hydro electric complex, located in the Republic of the Philippines, which EME refers to as the CBK project. On April 23, 2003, the President of the Republic of the Philippines signed into law the 2003 General Appropriations Bill which includes a provision that prohibits payments by agencies of the Philippine government to CBK Power with respect to two of its units until National Power Corporation submits a report based upon a review of "overpayments" to the CBK project, if any, and until the project documentation has been amended to provide for recovery by National Power Corporation of any "overpayments." The assertion regarding "overpayment" stems from a supplemental agreement entered into during 1999 which modified the original build-rehabilitate-operate-transfer agreement by adjusting the schedule for completion of two units of the CBK complex.

Under the supplemental agreement, rehabilitation of existing Kalayaan Units 1 and 2 was brought forward because of National Power Corporation's concern about the possibility of transformer failure and other risks affecting the reliability of these units. Under the original schedule, Kalayaan Units 1 and 2 were to be operated by CBK Power for operation and maintenance fees only during the lengthy construction of new Kalayaan Units 3 and 4, and upon completion of these units, Kalayaan Units 1 and 2 were to be taken out of service for rehabilitation. Under the build-rehabilitate-operate-transfer agreement, National Power Corporation is obligated to pay capacity recovery fees to CBK Power upon completion of the construction or rehabilitation of each unit, as the case may be. EME understands the term "overpayment" as used in the Special Provision of the General Appropriations Act to refer to the payments of capital recovery fees for the Kalayaan Units 1 and 2 arising from the earlier than initially scheduled rehabilitation of these units. At the time EME made its investment in CBK Power, the decision to accelerate the work on Kalayaan Units 1 and 2 had been made and incorporated in the supplemental agreement, and all appropriate Philippine government approvals of the supplemental and other project agreements with National Power Corporation had been obtained. Subsequently, some parties in the Philippines have contended that payments made to CBK Power as a result of the earlier than initially scheduled rehabilitation of Kalayaan Units 1 and 2 were unreasonable in comparison to the amount of additional work required to rehabilitate the units.

CBK Power is currently considering legal options available to it to respond to the enactment of the Special Provision. Failure by National Power Corporation to pay and/or a failure by the Philippine government to honor its commitments under the Government Undertaking signed in connection with the project to cause National Power Corporation to pay will constitute defaults under the build-rehabilitate-operate-transfer agreement and the Government Undertaking, respectively. On April 28, 2003, CBK sent a notice of claim to the President of the Republic of the Philippines, pursuant to the terms of the Government Undertaking. A default under the Government Undertaking will permit CBK

Power to require the Philippine government to purchase the power plants subject to the build-rehabilitate-operate-transfer agreement for a price which will at least recover EME's investment in the project. Prior to asserting these rights, however, CBK Power is required to engage in good faith negotiations with National Power Corporation in an attempt to resolve the situation. These discussions have commenced but thus far have not resulted in a mutually acceptable resolution.

CBK Power has advised its lenders of these developments and is discussing with them the ramifications under its credit agreements. Further, CBK Power has advised its lenders that National Power Corporation is presently overdue in the payment of invoices totaling \$11 million, a substantial portion of which is related to Kalayaan Units 1 and 2. Some of these events, if not cured, are or may with the passage of time become events of default under CBK Power's credit agreements, which would permit the lenders to demand payment in full of the project loans and to foreclose upon the assets of CBK Power. CBK Power intends to seek a waiver from the lenders of any existing defaults and any related defaults as may occur while it considers its response to these developments and enters into negotiations with National Power Corporation. There is no assurance, however, that such a waiver will be obtained or that, if not obtained, the lenders will not exercise their rights under the credit agreement.

As of March 31, 2003, EME has invested \$49 million in the CBK project and as of such date is committed to invest up to an additional \$30 million. EME believes that either on a negotiated basis or through the exercise of legal remedies it shall recover its entire investment. The indebtedness incurred by CBK Power is non-recourse to EME and, except for EME's commitment to contribute up to an additional \$30 million as equity, EME has no obligation with respect to CBK Power's indebtedness. Further, these events do not constitute a default under any indebtedness incurred by EME or to which EME or any of its affiliates is subject.

#### **Interest Coverage Ratio**

During 2001, EME amended its organizational documents to include so-called "ring-fencing" provisions. These provisions require the unanimous approval of EME's board of directors, including at least one independent director, before EME can do any of the following:

- declare or pay dividends or distributions unless either of the following are true: EME then has an investment grade credit rating and receives rating agency confirmation that the dividend or distribution will not result in a downgrade; or the dividends do not exceed \$32.5 million in any fiscal quarter and EME meets an interest coverage ratio of not less than 2.2 to 1 for the immediately preceding four fiscal quarters.
- institute or consent to bankruptcy, insolvency or similar proceedings or actions; or consolidate or merge with any entity or transfer substantially all EME's assets to any entity, except to an entity that is subject to similar restrictions.

The following details of EME's interest coverage ratio are provided as an aid to understanding the components of the computations that are set forth in EME's organizational documents. This information is not intended to measure the financial performance of EME and, accordingly, should not be used in lieu of the financial information set forth in EME's consolidated financial statements. The terms Funds Flow from Operations, Operating Cash Flow and Interest Expense are as defined in EME's organizational documents and are not the same as would be determined in accordance with generally accepted accounting principles.

The following table sets forth the major components of the interest coverage ratio for the twelve months ended March 31, 2003 and the year ended December 31, 2002:

	March 31, 2003	December 31, 2002
	(Unaudited) (in millions)	
<b>Funds Flow from Operations:</b>		
Operating Cash Flow(1) from Consolidated Operating Projects(2):		
Illinois Plants(3) . . . . .	\$ 304	\$ 294
Homer City . . . . .	95	51
First Hydro . . . . .	35	45
Other consolidated operating projects . . . . .	146	160
Price risk management and trading . . . . .	10	16
Distributions from non-consolidated Big 4 projects . . . . .	75	137
Distributions from other non-consolidated operating projects . . . . .	115	120
Interest income . . . . .	6	8
Operating expenses . . . . .	(134)	(139)
Total funds flow from operations . . . . .	<u>\$ 652</u>	<u>\$ 692</u>
<b>Interest Expense:</b>		
From obligations to unrelated third parties . . . . .	\$ 167	\$ 178
From notes payable to Midwest Generation . . . . .	114	115
Total interest expense . . . . .	<u>\$ 281</u>	<u>\$ 293</u>
<b>Interest Coverage Ratio . . . . .</b>	<u>2.32</u>	<u>2.36</u>

- (1) Operating cash flow is defined as revenues less operating expenses, foreign taxes paid and project debt service. Operating cash flow does not include capital expenditures or the difference between cash payments under EME's long-term leases and lease expenses recorded in EME's income statement. EME expects its cash payments under its long-term power plant leases to be higher than its lease expense through 2014.
- (2) Consolidated operating projects are entities of which EME owns more than a 50% interest and, thus, include the operating results and cash flows in its consolidated financial statements. Non-consolidated operating projects are entities of which EME owns 50% or less and which EME accounts for on the equity method.
- (3) Distribution to EME of funds flow from operations of the Illinois Plants is currently restricted. See "—Credit Ratings—Credit Rating of Edison Mission Midwest Holdings."

The major factors affecting funds flow from operations during the twelve months ended March 31, 2003, compared to the year ended December 31, 2002, were:

- lower distributions from the Big 4 projects (in March 2002, Southern California Edison paid the Big 4 projects their past due accounts receivable that accrued during the California energy crisis); and
- higher revenues at Homer City due to increased generation and higher energy prices.

Interest expense decreased by \$12 million for the twelve months ended March 31, 2003, compared to the year ended December 31, 2002 due to a lower average debt balance.

EME's interest coverage ratio for the twelve months ended March 31, 2003 was 2.32 to 1. Accordingly, EME is currently permitted to pay dividends of up to \$32.5 million in the second quarter of 2003 under the "ring-fencing" provisions of EME's certificate of incorporation and bylaws.

The above interest coverage ratio is not determined in accordance with generally accepted accounting principles as reflected in EME's Consolidated Statements of Cash Flows. Accordingly, this ratio should not be considered in isolation or as a substitute for cash flows from operating activities or cash flow statement data set forth in EME's Consolidated Statement of Cash Flows. This ratio does not measure the liquidity or ability of EME's subsidiaries to meet their debt service obligations. Furthermore, this ratio is not necessarily comparable to other similarly titled captions of other companies due to differences in methods of calculations.

### Edison Mission Energy Recourse Debt to Recourse Capital Ratio

Under the credit agreement governing its credit facility, EME has agreed to maintain a recourse debt to recourse capital ratio as shown in the table below.

Financial Ratio	Covenant	Actual at March 31, 2003	Description
Recourse Debt to Recourse Capital Ratio	Less than or equal to 67.5%	62.8%	Ratio of (a) senior recourse debt to (b) sum of (i) shareholder's equity per EME's balance sheet adjusted by comprehensive income after December 31, 1999, plus (ii) senior recourse debt

#### Discussion of Recourse Debt to Recourse Capital Ratio

The recourse debt to recourse capital ratio of EME at March 31, 2003 and December 31, 2002 was calculated as follows:

	March 31, 2003	December 31, 2002
	(Unaudited) (in millions)	
<b>Recourse Debt(1)</b>		
Corporate Credit Facilities . . . . .	\$ 220	\$ 140
Senior Notes . . . . .	1,600	1,600
Guarantee of termination value of Powerton/Joliet operating leases . . . . .	1,433	1,452
Coal and Capex Facility . . . . .	178	182
Other . . . . .	31	30
Total Recourse Debt to EME . . . . .	<u>\$3,462</u>	<u>\$3,404</u>
<b>Adjusted Shareholder's Equity(2)</b> . . . . .	<u>\$2,049</u>	<u>\$2,066</u>
<b>Recourse Capital(3)</b> . . . . .	<u>\$5,511</u>	<u>\$5,470</u>
<b>Recourse Debt to Recourse Capital Ratio</b> . . . . .	<u>62.8%</u>	<u>62.2%</u>

- (1) Recourse debt means senior direct obligations of EME or obligations related to indebtedness or rental expenses of one of its subsidiaries for which EME has provided a guarantee.
- (2) Adjusted shareholder's equity is defined as the sum of total shareholder's equity and equity preferred securities, less changes in accumulated other comprehensive gain or loss after December 31, 1999.
- (3) Recourse capital is defined as the sum of adjusted shareholder's equity and recourse debt.

During the three months ended March 31, 2003, the recourse debt to recourse capital ratio was slightly higher due to:

- \$80 million drawdown on corporate line of credit to cover seasonal working capital needs as well as cash collateral for hedging; and
- reduction in adjusted shareholder's equity as a result of \$17 million net loss for the three months ended March 31, 2003.

### **Subsidiary Financing Plans**

The estimated capital and construction expenditures of EME's subsidiaries for the final three quarters of 2003 total \$56 million. These expenditures are planned to be financed by existing subsidiary credit agreements and cash generated from their operations, except with respect to the Homer City project. Under the Homer City sale-leaseback agreements, EME has committed to provide funds for capital expenditures needed to complete the Homer City environmental improvement project. EME expects to contribute \$17 million in 2003 to fund the completion of this project, of which \$7 million was contributed during the first quarter of 2003.

#### *Edison Mission Midwest Holdings*

EME's wholly owned subsidiary, Edison Mission Midwest Holdings, had long-term debt with the following maturities at March 31, 2003:

<u>Amount</u> (in millions)	<u>Due Date</u>
\$ 911	December 2003
808	December 2004
<u>\$1,719</u>	

In addition, Edison Mission Midwest Holdings has a \$150 million working capital facility (unused at March 31, 2003) which is scheduled to expire in December 2004. At March 31, 2003, Edison Mission Midwest Holdings had cash and cash equivalents of \$260 million, as well as \$78 million deposited into a restricted cash account. Edison Mission Midwest Holdings is not expected to have sufficient cash to repay the \$911 million debt due in December 2003. Edison Mission Midwest Holdings plans to extend or refinance the \$911 million debt obligation prior to its expiration in December 2003. Completion of this extension or refinancing is subject to a number of uncertainties, including the ability of the Illinois Plants to generate funds during the remainder of 2003 and the availability of new credit from financial institutions on acceptable terms in light of industry conditions. Accordingly, there is no assurance that Edison Mission Midwest Holdings will be able to extend or refinance this debt when it becomes due or that the terms will not be substantially different from those under the current credit facility.

#### *Sunrise Project Financing*

EME owns a 50% interest in Sunrise Power Company, which owns a natural gas-fired facility currently under construction in Kern County, California, which EME refers to as the Sunrise project. The Sunrise project consists of two phases. Phase 1, a simple-cycle gas-fired facility (320 MW), was completed on June 27, 2001. Phase 2, conversion to a combined-cycle gas-fired facility (bringing the capacity to a total of 560 MW), is currently scheduled to be completed in July 2003. Sunrise Power Company entered into a long-term power purchase agreement with the California Department of Water Resources on June 25, 2001. The agreement was amended on December 31, 2002 as part of the settlement of several matters between Sunrise Power Company and the State of California. The construction of the Sunrise project has been funded with equity contributions by its partners, including

EME. Sunrise Power Company has engaged a financial advisor to assist with obtaining project financing. Completion of project financing is subject to a number of uncertainties, including market uncertainties and obtaining final environmental permits. EME believes that project financing will be obtained in 2003, although no assurance can be provided in this regard. If project financing is completed by mid-2003, EME estimates a distribution of approximately \$140 million to \$150 million from the proceeds of such financing.

### **Intercompany Tax-Allocation Payments**

EME is included in the consolidated federal and combined state income tax returns of Edison International and is eligible to participate in tax-allocation payments with other subsidiaries of Edison International. These arrangements depend on Edison International continuing to own, directly or indirectly, at least 80% of the voting power of the stock of EME and at least 80% of the value of such stock. The arrangements are subject to the terms of tax allocation and payment agreements among Edison International, Mission Energy Holding Company, EME and other Edison International subsidiaries. The agreements to which EME is a party may be terminated by the immediate parent company at any time, by notice given before the first day of the first year with respect to which the termination is to be effective. However, termination does not relieve any party of any obligations with respect to any tax year beginning prior to the notice. EME has historically received tax-allocation payments related to domestic net operating losses incurred by EME. The right of EME to receive and the amount and timing of tax-allocation payments are dependent on the inclusion of EME in the consolidated income tax returns of Edison International and its subsidiaries and other factors, including the consolidated taxable income of Edison International and its subsidiaries, the amount of net operating losses and other tax items of EME, its subsidiaries, and other subsidiaries of Edison International and specific procedures regarding allocation of state taxes. EME receives tax-allocation payments for tax losses when and to the extent that the consolidated Edison International group generates sufficient taxable income in order to be able to utilize EME's tax losses in the consolidated income tax returns for Edison International and its subsidiaries. During the first quarter of 2003, EME received \$13 million in tax-allocation payments from Edison International. In the future, based on the application of the factors cited above, EME may be obligated during periods it generates taxable income to make payments under the tax-allocation agreements.

### **Contractual Obligations**

#### *Chicago In-City Obligation*

In April 2003, Midwest Generation and Commonwealth Edison amended their February 2003 settlement agreement which terminated Midwest Generation's obligation to build additional gas-fired generation in the Chicago area. In accordance with the amendment, Midwest Generation paid Commonwealth Edison \$9.8 million in exchange for the termination of nine annual installment payments of \$1.5 million beginning in 2004 and for the termination of the security interest of Commonwealth Edison in 125,000 barrels of oil at the Collins Station.

### **MARKET RISK EXPOSURES**

EME's primary market risk exposures are associated with the sale of electricity from and the procurement of fuel for its uncontracted generating plants. These risks arise from fluctuations in electricity and fuel prices, emission and transmission rights, interest rates and foreign currency exchange rates. EME manages these risks in part by using derivative financial instruments in accordance with established policies and procedures. See "—General—Current Developments" and "—Liquidity and Capital Resources—Credit Ratings" for a discussion of market developments and their impact on EME's credit and the credit of its counterparties.

### *Commodity Price Risk*

EME's merchant power plants and energy trading activities expose EME to commodity price risks. Commodity price risks are actively monitored to ensure compliance with EME's risk management policies. Policies are in place which define risk tolerances for each EME regional business unit. Procedures exist which allow for monitoring of all commitments and positions with regular reviews by a risk management committee. EME performs a "value at risk" analysis in its daily business to measure, monitor and control its overall market risk exposure. The use of value at risk allows management to aggregate overall commodity risk, compare risk on a consistent basis and identify the drivers of the risk. Value at risk measures the possible loss over a given time interval, under normal market conditions, at a given confidence level. Given the inherent limitations of value at risk and relying on a single risk measurement tool, EME supplements this approach with the use of stress testing and worst-case scenario analysis, as well as stop loss limits and counterparty credit exposure limits. Despite this, there can be no assurance that all risks have been accurately identified, measured and/or mitigated.

Electric power generated at EME's domestic merchant plants is generally sold under bilateral arrangements with utilities and power marketers under short-term transactions with terms of two years or less or, in the case of the Homer City facilities, to the PJM and/or the New York Independent System Operator (NYISO) as well as utilities and power marketers. As discussed further below, beginning in 2003, EME is selling a significant portion of the power generated from its Illinois Plants into wholesale energy markets. In order to provide more predictable earnings and cash flow, EME may hedge a portion of the electric output of its merchant plants, the output of which is not committed to be sold under long-term contracts. When appropriate, EME manages the spread between electric prices and fuel prices, and uses forward contracts, swaps, futures, or options contracts to achieve those objectives. There is no assurance that contracts to hedge changes in market prices will be effective.

EME's revenues and results of operations during the estimated useful lives of its merchant power plants will depend upon prevailing market prices for capacity, energy, ancillary services, fuel oil, coal and natural gas and associated transportation costs and emission credits in the market areas where EME's merchant plants are located. Among the factors that influence the price of power in these markets are:

- prevailing market prices for fuel oil, coal and natural gas and associated transportation costs;
- the extent of additional supplies of capacity, energy and ancillary services from current competitors or new market entrants, including the development of new generation facilities;
- transmission congestion in and to each market area;
- the market structure rules to be established for each market area;
- the cost of emission credits or allowances;
- the availability, reliability and operation of nuclear generating plants, where applicable, and the extended operation of nuclear generating plants beyond their presently expected dates of decommissioning;
- weather conditions prevailing in surrounding areas from time to time; and
- the rate of electricity usage as a result of factors such as regional economic conditions and the implementation of conservation programs.

A discussion of each market area is set forth below by region.

## *Americas*

### *Illinois Plants*

Electric power generated at the Illinois Plants is sold under three power purchase agreements between EME's wholly owned subsidiary, Midwest Generation, and Exelon Generation Company, under which Exelon Generation purchases capacity and has the right to purchase energy generated by the Illinois Plants. The agreements, which began on December 15, 1999 and expire in December 2004, provide for capacity and energy payments. Exelon Generation is obligated to make a capacity payment for the plants under contract and an energy payment for the electricity produced by these plants and taken by Exelon Generation. The capacity payments provide the revenue for fixed charges, and the energy payments compensate the Illinois Plants for variable costs of production.

Under each of the power purchase agreements, Exelon Generation, upon notice by a specified date, has the option to terminate each agreement with respect to all or a portion of the units subject to it, as described below. As a result of notices given in 2002, Exelon Generation released 4,548 MW of Midwest Generation's generating capacity from the power purchase agreements, thus increasing Midwest Generation's reliance on sales into the wholesale markets. As a result, 4,739 MW remain subject to power purchase agreements with Exelon Generation in 2003.

Under the power purchase agreement related to Midwest Generation's coal-fired generation units, Exelon Generation continues to have a similar option, exercisable not later than 180 days prior to January 1, 2004, to retain or release for 2004 all or a portion of the 1,265 MW of option coal units retained for 2003. Exelon Generation remains committed to purchase the capacity of committed units having 1,696 MW of capacity for both 2003 and 2004.

Under the power purchase agreements related to Midwest Generation's Collins Station and peaking units, Exelon Generation continues to have a similar option to terminate, exercisable not later than 90 days prior to January 1, 2004, the power purchase agreements for 2004 with respect to all or a portion of the 1,084 MW from the Collins Station, and 694 MW from the peaking units, that were retained for 2003.

The energy and capacity from any units which are not subject to one of the power purchase agreements with Exelon Generation will be sold under terms, including price and quantity, to be negotiated with customers through a combination of bilateral agreements, forward energy sales and spot market sales. These arrangements generally have a term of two years or less. Thus, EME will be subject to market risks related to the price of energy and capacity described above. EME expects that capacity prices for merchant energy sales will, in the near term, be negligible in comparison to those Midwest Generation currently receives under its existing agreements with Exelon Generation (with the possibility of minimal revenues due to the current oversupply conditions in this marketplace). EME further expects that the lower revenues resulting from this difference will be offset in part by energy prices, which EME believes will, in the near term, be higher for merchant energy sales than those Midwest Generation currently receives under its existing agreements, as indicated below in the table of forward-looking prices. EME intends to manage this price risk, in part, by accessing both the wholesale customer and over-the-counter markets described below as well as using derivative financial instruments in accordance with established policies and procedures.

During 2003, the primary markets available to Midwest Generation for wholesale sales of electricity from the Illinois Plants are expected to be "wholesale customer" and "over-the-counter." The most liquid over-the-counter markets in the Midwest region are sales into the control area of Cinergy, referred to as "Into Cinergy," and, to a lesser extent, sales into the control area of Commonwealth Edison, referred to as "Into ComEd" (due to geographic proximity, "Into ComEd" has been the primary market for Midwest Generation). "Into Cinergy" and "Into ComEd" are bilateral markets for the sale or purchase of electrical energy for future delivery. Performance of transactions in these markets is subject to contracts that generally provide for liquidated damages supported by a variety of credit requirements, which may include independent credit assessment, parental guarantees, letters of credit and cash margining arrangements.

The following table depicts the historical average market prices for energy per megawatt-hour “Into ComEd” and “Into Cinergy” for the first three months of 2003:

<u>Historical Energy Prices</u>	<u>Into ComEd*</u>			<u>Into Cinergy*</u>		
	<u>On-Peak(1)</u>	<u>Off-Peak(1)</u>	<u>24-Hr</u>	<u>On-Peak(1)</u>	<u>Off-Peak(1)</u>	<u>24-Hr</u>
January .....	\$37.06	\$19.36	\$30.97	\$38.59	\$29.91	\$32.18
February .....	51.71	27.53	43.33	55.18	38.59	45.96
March .....	47.96	24.57	39.68	51.68	42.48	42.64
Quarterly Average .....	<u>\$45.58</u>	<u>\$23.82</u>	<u>\$37.99</u>	<u>\$48.48</u>	<u>\$36.99</u>	<u>\$40.26</u>

(1) On-peak refers to the hours of the day between 7:00 a.m. and 11:00 p.m. Monday through Friday, excluding North American Electric Reliability Council (NERC) holidays. All other hours of the week are referred to as off-peak.

\* Source: Energy prices were determined by obtaining broker quotes and other public price sources, for both “Into ComEd” and “Into Cinergy” delivery points.

The following table sets forth forward market prices for energy per megawatt-hour as quoted for sales “Into ComEd” and “Into Cinergy” at March 31, 2003. These forward prices will continue to fluctuate as a result of a number of factors, including gas prices, electricity demand, which is also affected by economic growth, and the amount of existing and planned power plant capacity. The actual spot prices for electricity delivered into these markets may vary materially from the forward market prices.

<u>Forward Energy Prices</u>	<u>Into ComEd*</u>			<u>Into Cinergy*</u>		
	<u>On-Peak(1)</u>	<u>Off-Peak(1)</u>	<u>24-Hr</u>	<u>On-Peak(1)</u>	<u>Off-Peak(1)</u>	<u>24-Hr</u>
<b>2003</b>						
April .....	\$36.00	\$18.00	\$30.00	\$40.25	\$20.00	\$33.50
May .....	33.81	18.75	25.55	38.21	21.25	28.91
June .....	35.50	19.25	26.83	40.38	21.50	30.31
July .....	45.18	20.25	32.04	50.50	23.25	36.14
August .....	44.18	20.25	31.06	49.50	23.25	35.10
September .....	31.43	17.00	23.73	35.75	19.25	26.95
October .....	28.50	16.25	22.31	34.00	18.25	26.04
November .....	29.50	17.25	22.42	35.00	19.25	25.90
December .....	30.50	18.25	24.05	36.00	20.25	27.70
<b>2004 Calendar “strip”(2)</b> .....	34.43	18.71	26.06	36.99	20.50	28.21

(1) On-peak refers to the hours of the day between 7:00 a.m. and 11:00 p.m. Monday through Friday, excluding NERC holidays. All other hours of the week are referred to as off-peak.

(2) Market price for energy purchases for the entire calendar year, as quoted for sales “Into ComEd” and “Into Cinergy.”

\* Source: Energy prices were determined by obtaining broker quotes and other public price sources, for both “Into ComEd” and “Into Cinergy” delivery points.

Midwest Generation intends to hedge a portion of its merchant portfolio risk through its marketing affiliate. To the extent it does not do so, the unhedged portion will be subject to the risks and benefits of spot market price movements. The extent to which Midwest Generation will hedge its market price risk through forward over-the-counter sales depends on several factors. First, Midwest Generation will evaluate over-the-counter market prices to determine whether sales at forward market

prices are sufficiently attractive compared to assuming the risk associated with spot market sales. Second, Midwest Generation's ability to enter into hedging transactions will depend upon its and its marketing affiliate's credit capacity and upon the over-the-counter forward sales markets' having sufficient liquidity to enable Midwest Generation to identify counterparties who are able and willing to enter into hedging transactions with it. Due to factors beyond Midwest Generation's control, market liquidity decreased significantly during 2002 and a number of formerly significant trading parties have completely withdrawn from the market or substantially reduced their trading activities. See "—Credit Risk," below.

In addition to the prevailing market prices, Midwest Generation's ability to derive profits from the sale of electricity from the released units will be affected by the cost of production, including costs incurred to comply with environmental regulations. The costs of production of the released units vary and, accordingly, depending on market conditions, the amount of generation that will be sold from the released units is expected to vary from unit to unit. In this regard, Midwest Generation suspended operations of Will County Units 1 and 2 and Collins Station Units 4 and 5 at the end of 2002 pending improvement in market conditions. If market conditions were to be depressed for an extended period of time, Midwest Generation would need to consider decommissioning these units, which would result in a charge against income.

In addition to the price risks described previously, there are risks with respect to the availability and cost of transmission required to market the power produced by the units not under contract with Exelon Generation. Currently, transmission must be obtained from Commonwealth Edison under its open-access tariff filed with the Federal Energy Regulatory Commission. Recently, however, Commonwealth Edison and PJM issued a joint press release announcing the integration of Commonwealth Edison into PJM, beginning June 1, 2003, with a goal of being "fully integrated" by October 2003. In response to this announcement, EME and a number of other affected parties have filed with the Commission contesting the integration of Commonwealth Edison into PJM on a so-called "islanded" basis. See "—Regulatory Matters." EME is unable to predict the manner in which the Commission will react or, if such integration is permitted, the effect of any final integration configuration on the markets into which Midwest Generation sells its power.

Midwest Generation's ability to transmit energy to counterparty delivery points to consummate spot sales and hedging transactions may also be affected by transmission service limitations and constraints and new standard market design proposals proposed by and currently pending before the Federal Energy Regulatory Commission. Although the Federal Energy Regulatory Commission and the relevant industry participants are working to minimize such issues, Midwest Generation cannot determine how quickly or how effectively such issues will be resolved.

#### *Homer City Facilities*

Electric power generated at the Homer City facilities is sold under bilateral arrangements with domestic utilities and power marketers pursuant to transactions with terms of two years or less, or to the PJM or the NYISO. These pools have short-term markets, which establish an hourly clearing price. The Homer City facilities are situated in the PJM control area and are physically connected to high-voltage transmission lines serving both the PJM and NYISO markets. The Homer City facilities can also transmit power to the Midwestern United States.

The following table depicts the average market prices per megawatt-hour in PJM during the first quarters of 2003 and 2002:

	24-Hour PJM Historical Energy Prices*	
	2003	2002
January . . . . .	\$36.56	\$20.52
February . . . . .	46.13	20.62
March . . . . .	46.85	24.27
Quarterly Average . . . . .	<u>\$43.18</u>	<u>\$21.80</u>

\* Energy prices were calculated at the Homer City busbar (delivery point) using historical hourly prices provided on the PJM-ISO web-site.

As shown on the above table, the average historical market prices at the Homer City busbar (delivery point) during the first three months of 2003 were significantly higher than the average historical market prices during the first three months of 2002. Forward market prices in PJM fluctuate as a result of a number of factors, including natural gas prices, transmission congestion, changes in market rules, electricity demand which is affected by weather and economic growth, and the amount of existing and planned power plant capacity. The actual spot prices for electricity delivered into these markets may vary materially from the forward market prices.

Sales made in the real-time or day-ahead market receive the actual spot prices at the Homer City busbar. In order to mitigate price risk from changes in spot prices at the Homer City busbar, EME may enter into forward contracts with counterparties for forecasted generation in future periods. Currently, there is not a liquid market for entering into forward contracts at the Homer City busbar. A liquid market does exist for delivery to a collection of delivery points known as PJM West Hub, which EME's price risk management activities use to enter into forward contracts. EME's revenues with respect to such forward contracts include:

- sales of actual generation in the amounts covered by such forward contracts with reference to PJM spot prices at the Homer City busbar, plus or minus,
- sales to third parties under such forward contracts at designated delivery points (generally the PJM West Hub) less the cost of purchasing power at spot prices at the same designated delivery points to fulfill obligations under such forward contracts.

Under the PJM market design, locational marginal pricing (sometimes referred to as LMP) has the effect of reducing prices at those delivery points affected by transmission congestion and raising prices at points which are free of the congestion. During the past 12 months, an increase in transmission congestion between the Homer City facilities and delivery points east has resulted in prices at the Homer City facilities being lower than those at PJM West Hub, which is east of the Homer City facilities. Thus, while forward prices at PJM West Hub have historically been higher than the prices at the Homer City busbar by less than 5%, increased congestion during the last 12 months between the Homer City facilities and points east has resulted in prices at PJM West Hub being on average 11% higher than those at the Homer City busbar.

By entering into forward contracts using the PJM West Hub as the delivery point, EME is exposed to "basis risk", which occurs when forward contracts are executed on a different basis (in this case PJM West Hub) than the actual point of delivery (Homer City busbar). In order to mitigate basis risk resulting from forward contracts using PJM West Hub as the delivery point, EME has participated in purchasing firm transmission rights in PJM, and may continue to do so in the future. A firm transmission right provides the holder with a financial instrument to receive actual spot prices at one point of delivery and pay spot prices at another point of delivery. Accordingly, EME's price risk

management activities include using firm transmission rights alone or in combination with forward contracts to manage changes in prices within the PJM market.

The following table sets forth the forward market prices for energy per megawatt-hour as quoted for sales into the PJM West Hub at March 31, 2003:

	<u>24-Hour PJM West Forward Energy Prices*</u>
<b>2003</b>	
April . . . . .	\$42.67
May . . . . .	41.43
June . . . . .	44.10
July . . . . .	53.24
August . . . . .	49.55
September . . . . .	39.43
October . . . . .	36.28
November . . . . .	34.86
December . . . . .	36.60
<b>2004 Calendar “strip”(1)</b> . . . . .	<b>34.97</b>

(1) Market price for energy purchases for the entire calendar year, as quoted for sales into the PJM West Hub.

\* Energy prices were determined by obtaining broker quotes and other public sources for the PJM West Hub delivery point. Forward prices at PJM West are generally higher than the prices at the Homer City busbar.

The ability of EME’s subsidiary, EME Homer City, to make payments under the long-term lease entered into as part of the sale-leaseback transaction discussed under “—Off-Balance Sheet Transactions—Sale-Leaseback Transactions,” included in Item 7 of EME’s annual report on Form 10-K for the year ended December 31, 2002, depends on revenues generated by the Homer City facilities, which depend in part on the market conditions for the sale of capacity and energy. These market conditions are beyond EME’s control.

*Europe*

*United Kingdom*

The First Hydro plant sells electrical energy and capacity through bilateral contracts of varying terms in the England and Wales wholesale electricity market.

The electricity trading arrangements introduced in March 2001 provide, among other things, for the establishment of a range of voluntary short-term power exchanges and brokered markets operating from a year or more in advance to 1 hour prior to the delivery or receipt of power. In the final hour after the notification of all contracts, the system operator can accept bids and offers in the Balancing Mechanism to balance generation and demand and resolve any transmission constraints. There is a mandatory settlement process for recovering imbalances between contracted and metered volumes with strong incentives for being in balance, and a Balancing and Settlement Code Panel to oversee governance of the Balancing Mechanism. The system operator can also purchase system reserve and response services to maintain the quality of the electrical supply directly from generators (generally referred to as “ancillary services”). Ancillary services contracts typically run for up to a year and can consist of both fixed amounts and variable amounts represented by prices for services that are only paid for when actually called upon by the grid operator. A key feature of the trading arrangements is the requirement for firm physical delivery, which means that a generator must deliver, and a consumer

must take delivery of, its net contracted positions or pay for any energy imbalance at the imbalance prices calculated by the system operator based on the prices of bids and offers accepted in the Balancing Mechanism. This provides an incentive for parties to contract in advance and for the development of forwards and futures markets. Under these arrangements, there has been an increased demand for credit support, including parent company guarantees or letters of credit.

The wholesale price of electricity has decreased significantly in recent years. The reduction has been driven principally by surplus generating capacity and increased competition. In addition, First Hydro was adversely affected in the second half of 2001 by a fall in the differential of the peak day time energy price compared to the cost of purchasing power at night time to pump water back to the top reservoir. This too was a reflection both of excess generating capacity on the system as a whole. During 2002 and the first quarter of 2003, there was further downward pressure on wholesale prices but some recovery in the peak/off peak differentials during the winter period.

Despite the difficult market conditions, First Hydro has continued to meet the interest coverage ratios specified in its bond financing documents, and to meet its half yearly interest payments without recourse to the project's debt service reserve. EME believes that if market and trading conditions experienced in 2002 are sustained, First Hydro will continue to be compliant with the requirements of its bond financing documents. This compliance is, however, subject to market conditions for electric energy and ancillary services, which are beyond EME's control.

#### *Asia Pacific*

##### *Australia*

The Loy Yang B plant and the Valley Power Peaker project sell electrical energy through a centralized electricity pool, which provides for a system of generator bidding, central dispatch and a settlements system based on a clearing market for each half-hour of every day. The National Electricity Market Management Company, operator and administrator of the pool, determines a system marginal price each half-hour. To mitigate exposure to price volatility of the electricity traded into the pool, the Loy Yang B plant and the Valley Power Peaker project have entered into a number of financial hedges. The State Hedge agreement with the State Electricity Commission of Victoria is a long-term contractual arrangement based upon a fixed price commencing May 8, 1997 and terminating October 31, 2016. The State Government of Victoria, Australia guarantees the State Electricity Commission of Victoria's obligations under the State Hedge. From January 2003 to July 2014, approximately 77% of the Loy Yang B plant output sold is hedged under the State Hedge. From August 2014 to October 2016, approximately 56% of the Loy Yang B plant output sold is hedged under the State Hedge. Additionally, the Loy Yang B plant and the Valley Power Peaker project have entered into a number of derivative contracts to mitigate further against price volatility inherent in the electricity pool. These contracts consist of fixed forward electricity contracts and/or cap contracts that expire on various dates through December 31, 2006.

##### *New Zealand*

Contact Energy generates about a quarter of New Zealand's electricity and is the largest retailer of natural gas and electricity in New Zealand. A substantial portion of Contact Energy's generation output is matched with the demand of its retail electricity customers or sold through forward contracts with other wholesale electricity counterparties. The forward contracts and/or option contracts have varying terms that expire on various dates through June 30, 2010, although the majority of the forward contracts are short term (less than two years).

The New Zealand Government released a Government Policy Statement in December 2001, which called for the industry to rationalize the three existing industry codes, form a single governance structure and address transmission investment and pricing issues.

During 2001, an amendment to the Electricity Act of 1992 was passed that laid out the form that regulation would take if the industry does not heed the government's call. A draft single governance code was presented to the New Zealand Commerce Commission for approval early in 2002. In October 2002, the Commerce Commission approved the new arrangements in the form of a rulebook for the self-governance of the electricity sector, with some conditions attached. The market participants are currently voting to determine whether the rulebook will be adopted. It is currently anticipated that the vote will not succeed and that a government-imposed body will be formed. The New Zealand Government is therefore currently progressing with plans for a Crown Electricity Governance Board, which is likely to be substantially based on the single rulebook created following the earlier Government Policy Statement. Under this model, the Governance Board will be responsible for acting on government policy and will implement measures approved by regulation.

While these arrangements have been progressing, several events in the months leading to the winter of 2003 in New Zealand have raised concerns about the security of supply in the country. Wholesale electricity prices have risen in response to dry hydro conditions, higher-than-expected demand, and anticipated restrictions on the availability of thermal fuel. Further, there are concerns that new investment in generation has not been forthcoming with the risk that similar shortages may arise in subsequent years. In March 2003, the Government responded to these conditions by suggesting that significant changes may be required to the electricity market to avoid the risk of insufficient supply in the future. In early May 2003, the Government issued a statement suggesting that the market would be retained, but that a mechanism would be introduced to operate alongside the market to ensure that there is sufficient standby generation to meet potential shortages in the future. Fuller details of this mechanism are expected to be announced towards the end of May 2003 or in June 2003.

#### *Credit Risks*

In conducting EME's price risk management and trading activities, EME contracts with a number of utilities, energy companies and financial institutions. Due to factors beyond EME's control, market liquidity has decreased significantly since the beginning of 2002, and a number of formerly significant trading parties have completely withdrawn from the market or substantially reduced their trading activities. The reduction in the credit quality of traditional trading parties increases EME's credit risk. In addition, the decrease in market liquidity may require EME to rely more heavily on wholesale electricity sales to wholesale customer markets, which may also increase EME's credit risk. While various industry groups and regulatory agencies have taken steps to address market liquidity, transparency and credit issues, there is no assurance as to when, or how effectively, such efforts will restore market confidence. In the event a counterparty were to default on its trade obligation, EME would be exposed to the risk of possible loss associated with reselling the contracted product at a lower price if the non-performing counterparty were unable to pay the resulting liquidated damages owed to EME. Further, EME would be exposed to the risk of non-payment of accounts receivable accrued for products delivered prior to the time such counterparty defaulted.

To manage credit risk, EME looks at the risk of a potential default by its counterparties. Credit risk is measured by the loss EME would record if its counterparties failed to perform pursuant to the terms of their contractual obligations. EME has established controls to determine and monitor the creditworthiness of counterparties and uses master netting agreements whenever possible to mitigate its exposure to counterparty risk. EME may require counterparties to pledge collateral when deemed necessary. EME tries to manage the credit in its portfolio based on credit ratings using published ratings of counterparties and other publicly disclosed information, such as financial statements, regulatory filings, and press releases, to guide it in the process of setting credit levels, risk limits and contractual arrangements including master netting agreements. The credit quality of EME's counterparties is reviewed regularly by EME's risk management committee. In addition to continuously monitoring its credit exposure to its counterparties, EME also takes appropriate steps to limit or lower

credit exposure. Despite this, there can be no assurance that EME's actions to mitigate risk will be wholly successful or that collateral pledged will be adequate.

EME measures credit risk exposure from counterparties of its merchant energy activities by the sum of: (i) 60 days of accounts receivable, (ii) current fair value of open positions, and (iii) a credit value at risk. EME's subsidiaries enter into master agreements and other arrangements in conducting price risk management and trading activities which typically provide for a right of setoff in the event of bankruptcy or default by the counterparty. Accordingly, EME's credit risk exposure from counterparties is based on net exposure under these agreements. The credit ratings of EME's counterparties were as follows:

<u>S&amp;P Credit Rating</u>	<u>March 31, 2003</u> <u>(in millions)</u>
A or higher . . . . .	\$ 31
A- . . . . .	10
BBB+ . . . . .	67
BBB . . . . .	56
BBB- . . . . .	1
Total . . . . .	<u>\$165</u>

Exelon Generation accounted for 19% and 30% of EME's consolidated operating revenues for the first quarters of 2003 and 2002, respectively. The percentage is less in 2003 because a smaller number of plants are subject to contracts with Exelon Generation. See "Market Risk Exposures—Americas—Illinois Plants." Any failure of Exelon Generation to make payments to Midwest Generation under the power purchase agreements could result in a shortfall of cash available for Midwest Generation to meet its obligations. A default by Midwest Generation in meeting its obligations could in turn have a material adverse effect on EME.

EME's contracted power plants and the plants owned by unconsolidated affiliates in which EME owns an interest sell power under long-term power purchase agreements. Generally, each plant sells its output to one counterparty. Accordingly, a default by a counterparty under a long-term power purchase agreement, including a default as a result of a bankruptcy, would likely have a material adverse affect on the operations of such power plant.

*Interest Rate Risk*

Interest rate changes affect the cost of capital needed to operate EME's projects and the lease costs under the Collins Station lease. EME has mitigated the risk of interest rate fluctuations by arranging for fixed rate financing or variable rate financing with interest rate swaps, interest rate options or other hedging mechanisms for a number of its project financings. Interest expense included \$9 million and \$10 million of additional interest expense for the three months ended March 31, 2003 and 2002, respectively, as a result of interest rate hedging mechanisms. EME has entered into several interest rate swap agreements under which the maturity date of the swaps occurs prior to the final maturity of the underlying debt.

EME had short-term obligations of \$127 million at March 31, 2003, consisting of borrowings under EME's corporate credit facility and promissory notes related to Contact Energy. The fair values of these obligations approximated their carrying values at March 31, 2003, and would not have been materially affected by changes in market interest rates. The fair market values of long-term fixed interest rate obligations are subject to interest rate risk. The fair market value of EME's total long-term obligations (including current portion) was \$5.6 billion at March 31, 2003, compared to the carrying value of \$6.3 billion.

### *Foreign Exchange Rate Risk*

Fluctuations in foreign currency exchange rates can affect, on a U.S. dollar equivalent basis, the amount of EME's equity contributions to, and distributions from, its international projects. At times, EME has hedged a portion of its current exposure to fluctuations in foreign exchange rates through financial derivatives, offsetting obligations denominated in foreign currencies, and indexing underlying project agreements to U.S. dollars or other indices reasonably expected to correlate with foreign exchange movements. In addition, EME has used statistical forecasting techniques to help assess foreign exchange risk and the probabilities of various outcomes. EME cannot provide assurances, however, that fluctuations in exchange rates will be fully offset by hedges or that currency movements and the relationship between certain macroeconomic variables will behave in a manner that is consistent with historical or forecasted relationships.

The First Hydro plant in the U.K. and the plants in Australia have been financed in their local currencies, pounds sterling and Australian dollars, respectively, thus hedging the majority of their acquisition costs against foreign exchange fluctuations. Furthermore, EME has evaluated the return on the remaining equity portion of these investments with regard to the likelihood of various foreign exchange scenarios. These analyses use market-derived volatilities, statistical correlations between specified variables, and long-term forecasts to predict ranges of expected returns.

During the first three months of 2003, foreign currencies in Australia and New Zealand increased in value compared to the U.S. dollar by 7% and 5%, respectively (determined by the change in the exchange rates from December 31, 2002 to March 31, 2003). The increase in value of these currencies was the primary reason for the foreign currency translation gain of \$21 million during the first three months of 2003.

Contact Energy enters into foreign currency forward exchange contracts to hedge identifiable foreign currency commitments associated with transactions in the ordinary course of business. The contracts are primarily in Australian and U.S. dollars with varying maturities through April 2004. At March 31, 2003, the outstanding notional amount of the contracts totaled \$16 million and the fair value of the contracts totaled \$(120,000).

In addition, Contact Energy enters into cross currency interest rate swap contracts in the ordinary course of business. These cross currency swap contracts involve swapping fixed and floating-rate U.S. and Australian dollar loans into floating-rate New Zealand dollar loans with varying maturities through April 2018.

EME will continue to monitor its foreign exchange exposure and analyze the effectiveness and efficiency of hedging strategies in the future.

### *Non-Trading Derivative Financial Instruments*

The following table summarizes the fair values for outstanding derivative financial instruments used for purposes other than trading by risk category and instrument type (in millions):

	March 31, 2003 <u>(Unaudited)</u>	December 31, 2002 <u>                    </u>
Derivatives:		
Interest rate:		
Interest rate swap/cap agreements . . . . .	\$ (51)	\$ (48)
Interest rate options . . . . .	(2)	(2)
Commodity price:		
Electricity . . . . .	(129)	(100)
Cross currency interest rate swaps . . . . .	(15)	(2)

In assessing the fair value of EME's non-trading derivative financial instruments, EME uses a variety of methods and assumptions based on the market conditions and associated risks existing at each balance sheet date. The fair value of commodity price contracts takes into account quoted market prices, time value of money, volatility of the underlying commodities and other factors. The following table summarizes the maturities, the valuation method and the related fair value of EME's commodity price risk management assets and liabilities (as of March 31, 2003) (in millions):

	<u>Total Fair Value</u>	<u>Maturity &lt;1 year</u>	<u>Maturity 1 to 3 years</u>	<u>Maturity 4 to 5 years</u>	<u>Maturity &gt;5 years</u>
			(Unaudited)		
Prices actively quoted . . . . .	\$ (46)	\$ (46)	\$ —	\$ —	\$ —
Prices based on models and other valuation methods . . . . .	(83)	8	(2)	(12)	(77)
Total . . . . .	<u>\$(129)</u>	<u>\$ (38)</u>	<u>\$ (2)</u>	<u>\$ (12)</u>	<u>\$ (77)</u>

The fair value of the electricity rate swap agreements (included under commodity price-electricity) entered into by the Loy Yang B plant and the First Hydro plant has been estimated by discounting the future net cash flows resulting from the difference between the average aggregate contract price per MW and a forecasted market price per MW multiplied by the number of MW remaining to be sold under the contract.

*Energy Trading Derivative Financial Instruments*

EME's risk management and trading operations are conducted by its subsidiary, Edison Mission Marketing & Trading. As a result of a number of industry and credit related factors, Edison Mission Marketing & Trading has minimized its price risk management activities and its trading activities with third parties not related to EME's power plants or investments in energy projects. To the extent Edison Mission Marketing & Trading engages in trading activities, Edison Mission Marketing & Trading seeks to manage price risk and to create stability of future income by selling electricity in the forward markets and, to a lesser degree, to generate profit from price volatility of electricity and fuels by buying and selling these commodities in wholesale markets. EME generally balances forward sales and purchase contracts and manages its exposure through a value at risk analysis as described under "—Commodity Price Risk."

The fair value of the commodity financial instruments related to energy trading activities as of March 31, 2003 and December 31, 2002, are set forth below (in millions):

	<u>March 31, 2003</u>		<u>December 31, 2002</u>	
	<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>
	(Unaudited)			
Electricity . . . . .	\$143	\$ 45	\$109	\$ 15
Other . . . . .	(1)	1	—	2
Total . . . . .	<u>\$142</u>	<u>\$ 46</u>	<u>\$109</u>	<u>\$ 17</u>

The change in the fair value of trading contracts for the quarter ended March 31, 2003, was as follows (in millions):

Fair value of trading contracts at December 31, 2002 . . . . .	\$ 92
Net gains from energy trading activities . . . . .	15
Amount realized from energy trading activities . . . . .	<u>(11)</u>
Fair value of trading contracts at March 31, 2003 (unaudited) . . . . .	<u>\$ 96</u>

Quoted market prices are used to determine the fair value of the financial instruments related to energy trading activities, except for the power sales agreement with an unaffiliated electric utility that EME's subsidiary purchased and restructured and a long-term power supply agreement with another unaffiliated party. EME's subsidiary recorded these agreements at fair value based upon a discounting of future electricity prices derived from a proprietary model using a discount rate equal to the cost of borrowing the non-recourse debt incurred to finance the purchase of the power supply agreement. The following table summarizes the maturities, the valuation method and the related fair value of energy trading assets and liabilities (as of March 31, 2003) (in millions):

	Total Fair Value	Maturity <1 year	Maturity 1 to 3 years (Unaudited)	Maturity 4 to 5 years	Maturity >5 years
Prices actively quoted . . . . .	\$ 3	\$ 3	\$—	\$—	\$—
Prices based on models and other valuation methods . . . . .	93	(3)	4	3	89
Total . . . . .	<u>\$96</u>	<u>\$—</u>	<u>\$ 4</u>	<u>\$ 3</u>	<u>\$89</u>

### Regulatory Matters

For a discussion of EME's regulatory matters, refer to "Regulatory Matters" on page 20 of EME's annual report on Form 10-K for the year ended December 31, 2002 and the notes to the Consolidated Financial Statements set forth therein. There have been no significant developments with regard to regulatory matters that affect disclosures presented in the annual report, except as follows:

Currently, power produced by the Illinois Plants not under contract with Exelon Generation is sold using transmission which must be obtained from Commonwealth Edison under its open-access tariff filed with the Federal Energy Regulatory Commission. In 2002, Commonwealth Edison applied to the Commission for approval to join PJM in conjunction with American Electric Power, thereby creating an enlarged, contiguous regional transmission organization encompassing a broad regional market. Approval of this application was granted by the Commission on April 1, 2003. Concurrently, the ability of American Electric Power to join PJM has been brought into question by the enactment of legislation in Virginia requiring the approval of Virginia state authorities for any transfer of control from American Electric Power to PJM of American Electric Power transmission assets located in Virginia. On April 16, 2003, Commonwealth Edison and PJM issued a joint press release stating that the integration of Commonwealth Edison into PJM would proceed separately from that of American Electric Power, notwithstanding the absence of a direct transmission link owned by Commonwealth Edison between its service territory and the existing PJM. In response to this announcement, EME and other affected parties have filed with the Federal Energy Regulatory Commission for clarification or rehearing of its April 1, 2003 order, and essentially contesting the appropriateness of Commonwealth Edison joining PJM on an "islanded" basis. Given the stated intentions of Commonwealth Edison and PJM to proceed with integration beginning June 1, 2003, EME has requested expedited treatment of its request for clarification or rehearing. See also, "Market Risk Exposures—Commodity Price Risk—Americas—Illinois Plants."

### Off-Balance Sheet Transactions

For a discussion of EME's off-balance sheet transactions, refer to "Off-Balance Sheet Transactions" on page 80 of EME's annual report on Form 10-K for the year ended December 31, 2002.

## **Environmental Matters and Regulations**

For a discussion of EME's environmental matters, refer to "Environmental Matters and Regulations" on page 100 of EME's annual report on Form 10-K for the year ended December 31, 2002 and the notes to the Consolidated Financial Statements set forth therein. There have been no significant developments with regard to environmental matters that affect disclosures presented in the annual report.

## **Critical Accounting Policies and Estimates**

For a discussion of EME's critical accounting policies and estimates, refer to "Critical Accounting Policies and Estimates" on page 51 of EME's annual report on Form 10-K for the year ended December 31, 2002.

## **New Accounting Standards**

### *Statement of Financial Accounting Standards No. 143*

Effective January 1, 2003, EME adopted Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is increased to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. As of January 1, 2003, EME recorded \$9 million, after tax, decrease to net income as the cumulative effect of adoption of SFAS No. 143.

### *Statement of Financial Accounting Standards No. 146*

Effective January 1, 2003, EME adopted Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires that liabilities for costs associated with exit or disposal activities initiated after December 31, 2002 be recognized when incurred, rather than at the date of a commitment to an exit or disposal plan. The adoption of this standard had no impact on EME's consolidated financial statements.

### *Statement of Financial Accounting Standards Interpretation No. 45*

In November 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." This interpretation establishes reporting requirements to be made by a guarantor about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of this standard had no impact on EME's financial statements. See "—Commitments and Contingencies—Guarantees and Indemnities."

### *Statement of Financial Accounting Standards Interpretation No. 46*

In January 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). This interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements,"

addresses consolidation by business enterprises of variable interest entities. The primary objective of the Interpretation is to provide guidance on the identification of, and financial reporting for, entities over which control is achieved through means other than voting rights; such entities are known as variable-interest entities. This interpretation applies to variable interest entities created after January 31, 2003, and applies to variable interest entities in which EME holds a variable interest that it acquired before February 1, 2003, beginning July 1, 2003.

Under FIN 46, an enterprise that will (1) absorb a majority of a variable interest entity's expected losses (if they occur), (2) receive a majority of a variable interest entity's expected residual returns (if they occur), or (3) both of the above, must consolidate the variable interest entity. The enterprise that consolidates the variable interest entity is called the primary beneficiary. EME believes it is reasonably possible that one or more of its investments in unconsolidated affiliates will be a variable interest entity. Accordingly, EME is in the process of making this determination, and for investments in unconsolidated affiliates which are variable interest entities, a further determination will be made if EME is the primary beneficiary.

EME has concluded that it is the primary beneficiary of Brooklyn Navy Yard Cogeneration Partners L.P. since it is at risk with respect to a majority of its losses and is entitled to receive a majority of its residual returns. Accordingly, EME will consolidate Brooklyn Navy Yard Cogeneration Partners L.P. effective July 1, 2003. In accordance with the transition provisions of FIN 46, the consolidation of Brooklyn Navy Yard Cogeneration Partners L.P. will be based on the historical cost of the assets, liabilities and non-controlling interest which would have been carried by EME effective when EME became the primary beneficiary. This means that EME will consolidate the assets and liabilities of Brooklyn Navy Yard Cogeneration Partners L.P. using the June 30, 2003 balance sheet and eliminate intercompany balances. EME expects the consolidation of this entity to increase total assets by approximately \$364 million and total liabilities by approximately \$435 million. Furthermore, EME expects to record a loss of approximately \$71 million as a cumulative change of accounting as a result of consolidating this variable interest entity. This loss is primarily due to cumulative losses allocated to the other 50% partner in excess of equity contributions recorded.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For a discussion of market risk sensitive instruments, refer to "Market Risk Exposures" on page 83 of EME's annual report on Form 10-K for the year ended December 31, 2002. Refer to "Market Risk Exposures" in Item 2 for an update to that disclosure.

### **ITEM 4. CONTROLS AND PROCEDURES**

Under the Sarbanes-Oxley Act of 2002 and implementing rules and regulations adopted by the Securities and Exchange Commission (SEC), EME must maintain disclosure controls and procedures. The term "disclosure controls and procedures" is defined in the SEC's regulations to mean, as applied to EME, controls and other procedures that are designed to ensure that information required to be disclosed by EME in reports filed with the SEC is recorded, processed, summarized, and reported, within the time frames specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by EME in its SEC reports is accumulated and communicated to EME's management, including its Chief Executive Officer and its Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. The SEC's regulations also require EME to carry out evaluations, under the supervision and with the participation of EME's management, including its Chief Executive Officer and its Chief Financial Officer, of the effectiveness of the design and operation of EME's disclosure controls and procedures. These evaluations must be carried out within the 90-day period prior to the filing date of certain reports, including this quarterly report on Form 10-Q.

The Chief Executive Officer and the Chief Financial Officer of EME have evaluated the effectiveness of the design and operation of EME's disclosure controls and procedures as of May 8, 2003. They have concluded that those disclosure controls and procedures, as of the evaluation date, were effective in ensuring that information required to be disclosed by EME in its reports filed with the SEC was (1) accumulated and communicated to EME's management, as appropriate to allow timely decisions regarding disclosure, and (2) recorded, processed, summarized, and reported within the time frames specified in the SEC's rules and forms.

The Chief Executive Officer and the Chief Financial Officer of EME also have concluded that there were no significant changes in EME's internal controls or in other factors that could significantly affect those controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

**PART II—OTHER INFORMATION**

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

**(a) Exhibits**

<u>Exhibit No.</u>	<u>Description</u>
10.1	Terms of 2003 stock option and performance share awards under the Equity Compensation Plan or the 2000 Equity Plan, incorporated by reference to Exhibit 10.1 to Edison International's Form 10-Q for the quarter ended March 31, 2003 (File No. 1-9936).
99.1	Homer City Facilities Funds Flow From Operations for the twelve months ended March 31, 2003.
99.2	Illinois Plants Funds Flow From Operations for the twelve months ended March 31, 2003.
99.3	Statement Pursuant to 18 U.S.C. Section 1350.

**(b) Reports on Form 8-K**

The registrant filed the following reports on Form 8-K during the quarter ended March 31, 2003.

<u>Date of Report</u>	<u>Date Filed</u>	<u>Item Reported</u>
December 20, 2002	January 8, 2003	5
January 17, 2003	February 25, 2003	5



## CERTIFICATION

I, Thomas R. McDaniel, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Edison Mission Energy;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ Thomas R. McDaniel

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Thomas R. McDaniel  
*President and Chief Executive Officer*

## CERTIFICATION

I, Kevin M. Smith, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Edison Mission Energy;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ Kevin M. Smith

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Kevin M. Smith  
*Senior Vice President, Chief Financial  
Officer and Treasurer*